

MAKING MAJOR PROJECTS BANKABLE



Highlights from the Major Projects Association 2014 Annual Conference 17th-18th September 2014

Over recent years a comprehensive understanding of project finance and funding has become vital for major project sponsors, clients and programme directors. In *The Economist* article '[Investing in infrastructure, the trillion-dollar gap](#)', (March 2014), it was suggested that enhancing the 'professionalism' of project initiation and delivery was key to addressing the gap in investment.

The options for equity and debt financing sources, finance solutions and potential contractual structures have been evolving to meet the growing demand for major project finance at a time when the appetite of traditional financing sources has been curtailed. These issues were discussed at the Major Projects Association 2014 Annual Conference *Making Major Projects Bankable*.

'Attracting private sector funding from experienced infrastructure investors to [large infrastructure] schemes will be essential if we are to afford them. And maintaining confidence in our regulatory regime and the regulatory environment generally, both today and for the future will, therefore, be critically important to ensure healthy competition and attractive pricing particularly from international investors.'

Sir Neville Simms, Major Projects Association Prestige Lecture, July 2014

The conference was structured around two key points in a project life cycle at which an understanding of these topics is vital: rating an infrastructure investment and procuring finance from the market.

KEY POINT 1: RATING AN INFRASTRUCTURE INVESTMENT

What is a rating?

A rating is a tool for investors to enable them to make comparisons between investment opportunities. It is an independent assessment expressed as an alphanumeric (e.g. AAA) that gives investors a relative view of the risks associated with a project. It is an indicator of the issuer's ability to pay its obligation on time based on an assessed probability of contract default and debt recovery.

How is it done?

A rating is derived by a lead analyst gathering relevant information and undertaking an assessment based on an approved methodology that is relevant to the asset being procured. The lead analyst's recommendation is considered by a Rating Committee. The rating is determined by majority vote of the Committee.

THE TWO KEY QUESTIONS WHICH INVESTORS CONSIDER ARE:

- What is the likelihood of default?
- What would the size of the loss be?

The difference between project and corporate finance

With project finance a special company is set up that owns one or more assets; its only source of cash flow is from those assets. With corporate finance, for example power and water companies, there is an existing portfolio of assets that could provide a cash flow to repay debt. Hence, the rating approach is significantly different. With corporate finance the strength of the business's balance sheet and management behaviours are considered in giving a rating.

'It is not just engineering skills, but also the skills associated with properly preparing a project for market which are critical.'

Mark Moseley, Lead Lawyer, The World Bank

KEY POINT 2: PROCURING FINANCE FROM THE MARKET

CASE STUDY

The Mersey Gateway Toll Bridge scheme was used to illustrate the key considerations for the delivery of financial close. These included building capacity within the local authority client organisation to deliver a major capital investment deal. The need to assemble regional political support for the project and gaining acceptance to the business case for tolling the existing Mersey crossing were key to the success of the financing deal.

The client focused on the front end, including taking on the planning approval and toll road traffic demand risks. These decisions facilitated an early financial close and created a more affordable deal. The procurement model entailed identifying a consortium with the capacity to take on the interface risk for construction of the new bridge as well as operating the toll road schemes. The selected consortium had an integrated team with capacity to provide sponsor equity.

'Deliver within the funding envelope.'

Steve Nicholson, Project Director, Mersey Gateway

The changing demands on contractors in an increasingly competitive market were highlighted from the perspective of a supplier with extensive experience of complex PFI deals. There is a growing trend towards litigation, with less emphasis on collaboration. The UK PFI market is mature with a limited number of new deals. This has resulted in clients having a 'take it or leave it approach'. Major contractors are now looking at opportunities overseas. The secondary PFI market in the UK still remains favourable as contractors continue to divest and recycle their equity.

'Where there is limited capital available, then only the least risky projects will be financed, i.e. low and proven technology – not because the project doesn't have value but because other projects are perceived to be less risky.'

Rob Gray, Partner, CMS Cameron McKenna LLP

A global investor's perspective – The World Bank

The World Bank and other funding agencies are chronically overstretched and cannot meet the anticipated financial investment demand for global infrastructure without access to private finance. Following a period of growth in private infrastructure investment amongst middle-income countries there has been a decline in new investment in recent years, with significant decline occurring in Brazil and India from 2012 to 2013.

Some of the critical factors that have affected Public Private Partnerships (PPPs) in the developing world are:

- Poor project preparation
- An absence of project pipelines
- Negative public sentiment towards PPPs
- Availability of traditional project finance
- Misperceptions of risk

'In procuring finance from the market, it is important to recognise three things: put yourself in the position of the person from whom you are trying to raise the capital – be it debt or equity capital, the investor's interest comes first; never to forget the distinction between risk and exposure; understand that risks are always mitigated or priced.'

David Smith, Managing Director, Capital Dynamics Ltd

'Board meetings could have been a lot quicker if we had better understood one another's perspectives.'

Rob Brighthouse, Managing Director, Chiltern Railways

Rob also advised:

- Focus investment in areas where you will get the biggest return.
- Use a mix of finance arrangements.
- Start with the market – what do your customers want, who isn't using your service and why and what can you do about it – which will help to decide what infrastructure is needed.

more > The World Bank Public-Private Partnership in Infrastructure Resource Center for Contracts, Laws and Regulation

POINTS FOR FURTHER DISCUSSION:

1. What steps could be taken to avoid misunderstandings based on not sharing the same language?
2. Can a standard form of contract be developed for privately financed projects?
3. How can private money for public projects become 'business as usual'?
4. How can projects gain better access to finance from UK pension funds?

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