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From Strategy to Action: Business Opportunities for Energy Market Transformation Project Finance and Guarantees



Financial Solutions Unit
Finance, Economics and Urban Development

Attracting Private Capital
for Sustainable Infrastructure Development

PSLO Mission
Washington DC
25 October 2011



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Project Finance and Guarantees

Project Finance



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Project Finance and Guarantees

Project Finance

- Long-term financing based on non-recourse or limited recourse
- **DEBT** and **EQUITY** paid from **project cash flows**
- Financing secured by project assets and revenue-producing contracts, not sponsor balance sheet
- Lenders receive lien on all the assets, and can assume control of project if project company has difficulties complying with loan terms
- Special purpose entity created for each project



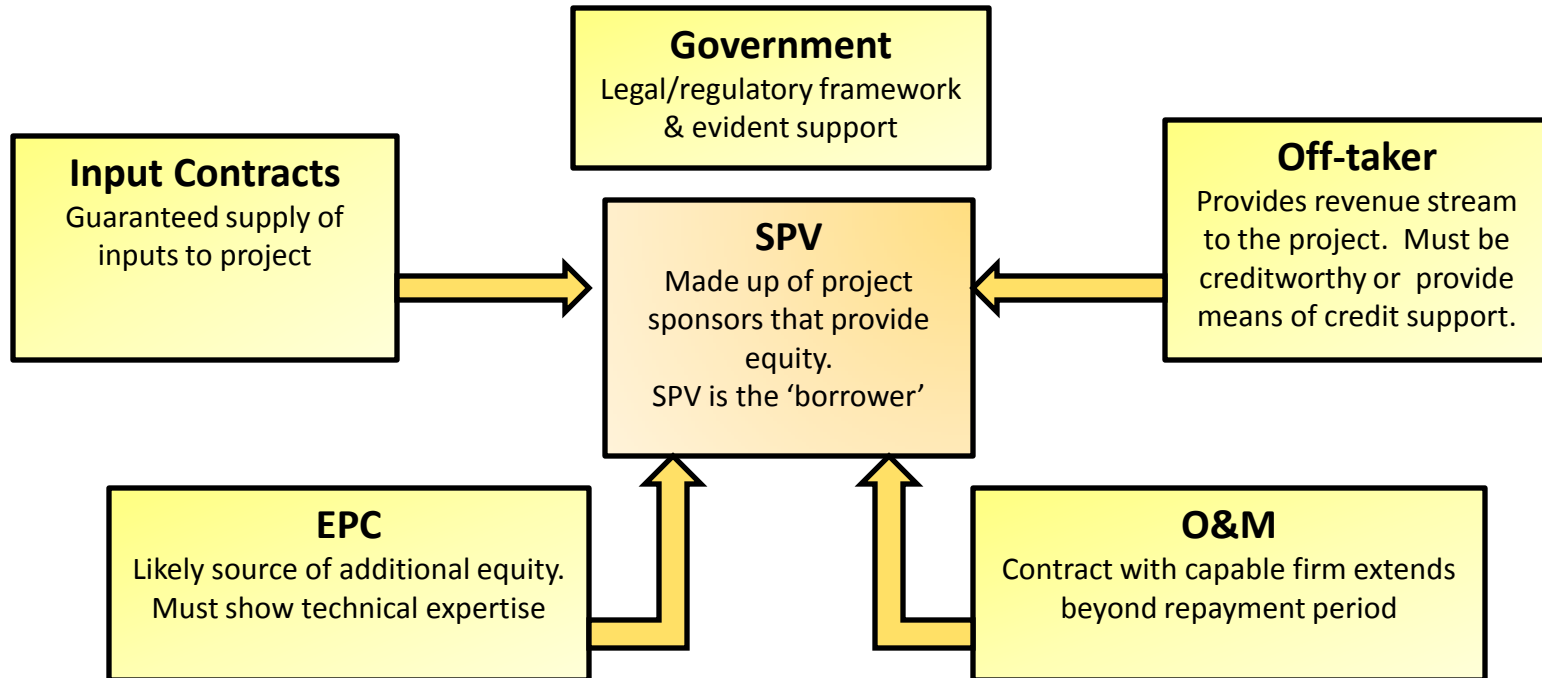
Project Finance and Guarantees

Project Finance

- **Projects evolve through two clearly differentiated stages:**
 - **construction and operation**
- **Financing “made to measure” – structuring tends to be costly, therefore, only justifiable for large-scale infrastructure projects**
- **Bulk of investment aimed at tangible assets**
- **Totality of project’s assets pledged to financial creditors**
- **High leverage usually employed (70:30 / 80:20)**
- **Investments usually long-term (20 + years)**
- **Only purpose of financing is to complete projects, thus it has a limited life-span**

Project Finance and Guarantees

Basic Project Finance Transaction Structure





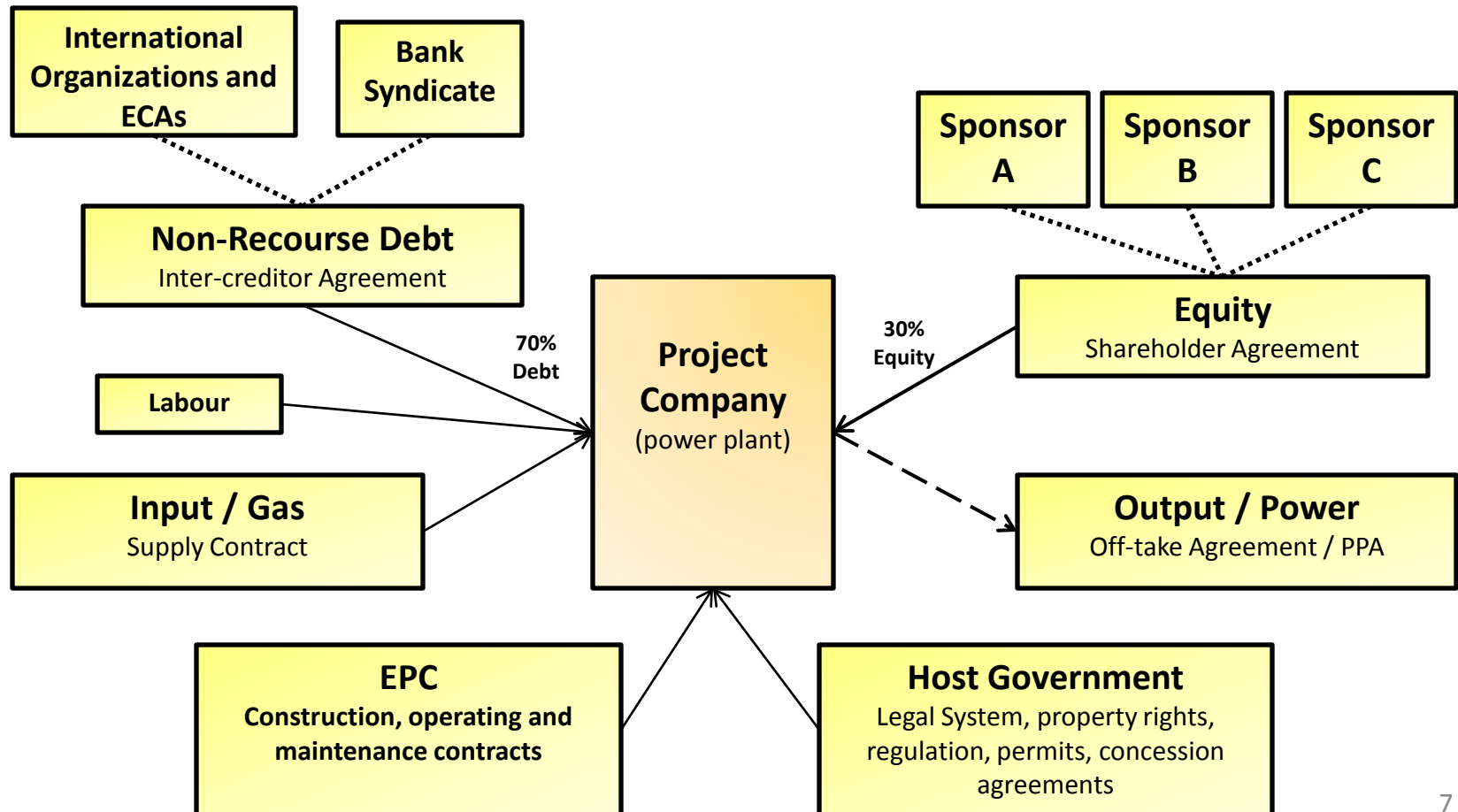
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Basic Project Finance Transaction Structure

- Typical project company financed with limited or non-recourse debt (70%) and sponsors' equity (30%)
- It buys labour, equipment and other inputs in order to produce a tangible output (energy, infrastructure)
- Government provides legal framework necessary for project to operate

Project Finance and Guarantees

Basic Project Finance Transaction Structure



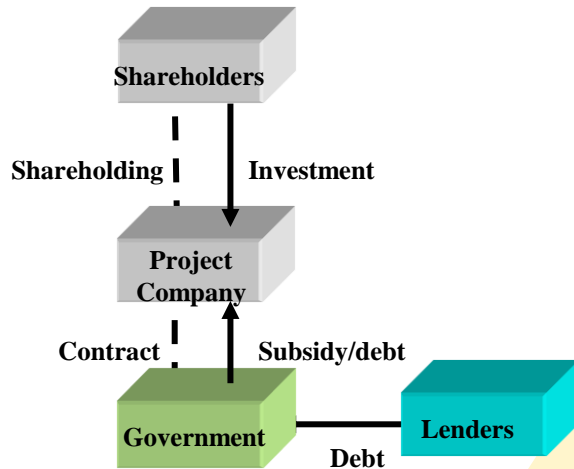
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Corporate Finance vs. Project Finance

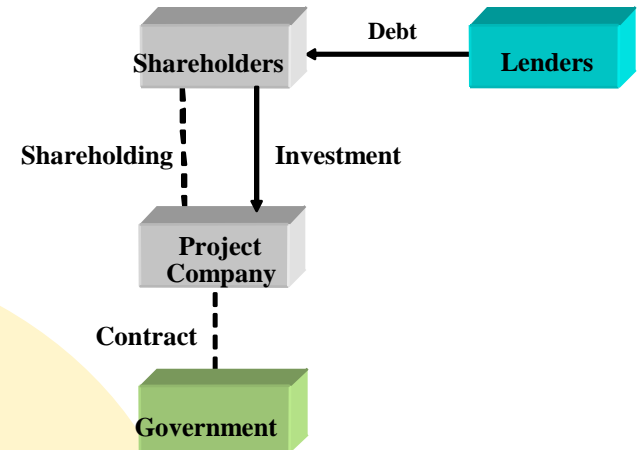
Item	Corporate Finance	Project Finance
Destination of financing	Multipurpose	Single purpose
Duration of financing	Variable	Long-term and limited by the lifetime of the project
Financial Structure	Debt-holders not related	Debt-holders tied by general agreement
Risk analysis	Highly dependent on financial statements and cash flow	Highly dependent on financial statements and cash flow In addition, technical considerations, contractual agreement and the debt structure are very important
Liquidity of financial instruments	Can be high if negotiated on capital markets	Generally low, as the financial agreement is private, made to measure and filled with contractual relationships
Financial costs	Relatively low	Relatively high, owing to both structuring costs and low liquidity of instruments
Room for management to make decisions	Plenty if company has open capital	Little, owing to the rigid contractual structure
Agency costs	High if company has open capital	Low, as the contractual structure leaves little margin for independent action by the partners

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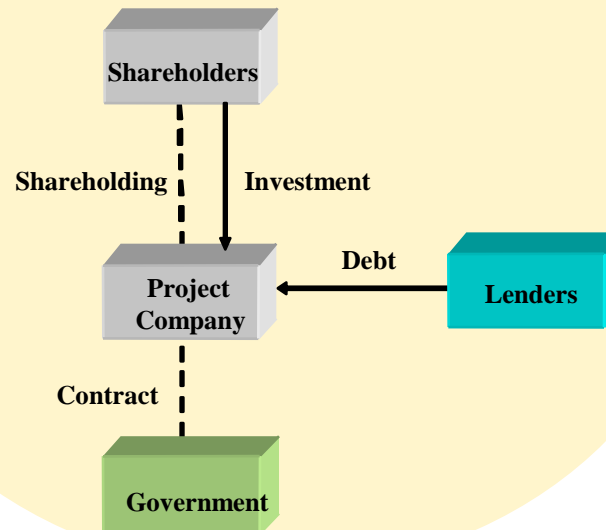
Government Finance



Corporate Finance



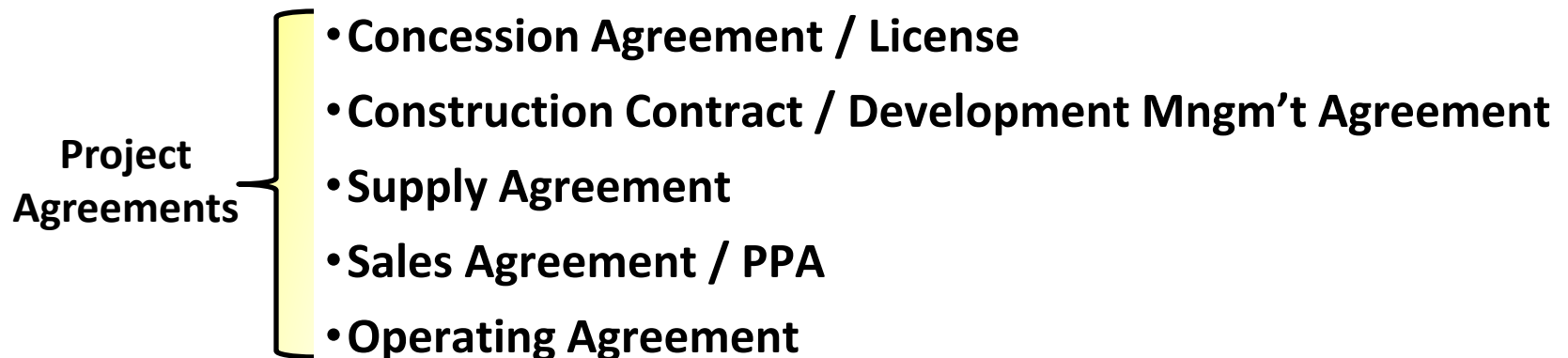
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Project Finance and Guarantees

The underlying contractual framework allocates risks between the various parties and determines the risk profile presented to the project lenders

- Pre-development Agreement
- Shareholder's Agreement



Beware the “Back-to-Back”



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Guarantees



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Key World Bank Guarantee Features

- Guarantees mitigate perceived risk to attract and encourage private sector investment
- Available to all countries eligible for IBRD / IDA borrowing
- Mobilize private sector participation and help catalyze debt with extended maturities and lower financing costs
- Guarantees **cover private/commercial debt** and back government obligations in private or public projects
- Requires counter-guarantee from Government (Finance Ministry)
- Guarantee is “Partial” - Bank only assumes specified risk
- Flexible: different currencies (local, FOREX), any sector, any tenor
- Structures vary to fit project and lenders needs
- Guarantees are integral part of Bank dialogue with client countries



Project Finance and Guarantees

Principles of Deployment

- **Guarantees can be used in the following situations:**
 - Sectors in early stages of reform
 - Larger size / riskier operations
 - Operations highly dependent on support/undertakings of gov'ts
- **Structure and coverage set at the lowest level to mobilize financing**



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Project Finance and Guarantees

Partial Risk Guarantees (PRGs)



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Project Finance and Guarantees

Key PRG Features

- Supports **private projects** in all member countries
- Supports foreign exchange earning projects in IDA countries
- Covers debt service default resulting from **governmental non-performance of contract obligations**
- Several structures available:
 - Guaranteed Debt, L/C Structure, Deferred Loan Option
- Some applications and innovations:
 - Letter of Credit structure for greenfield projects
 - Privatizations
 - Guarantee facilities
 - Local currency guarantee



Project Finance and Guarantees

Covered PRG Risks

- Changes in law / decrees / regulations
- Changes in licensing arrangements
- Political force majeure (war, revolution and expropriation)
- Transferability & convertibility of foreign exchange
- Frustration of arbitration
- Backstop of government subsidies (e.g. minimum revenue guarantees)



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PRG Structures

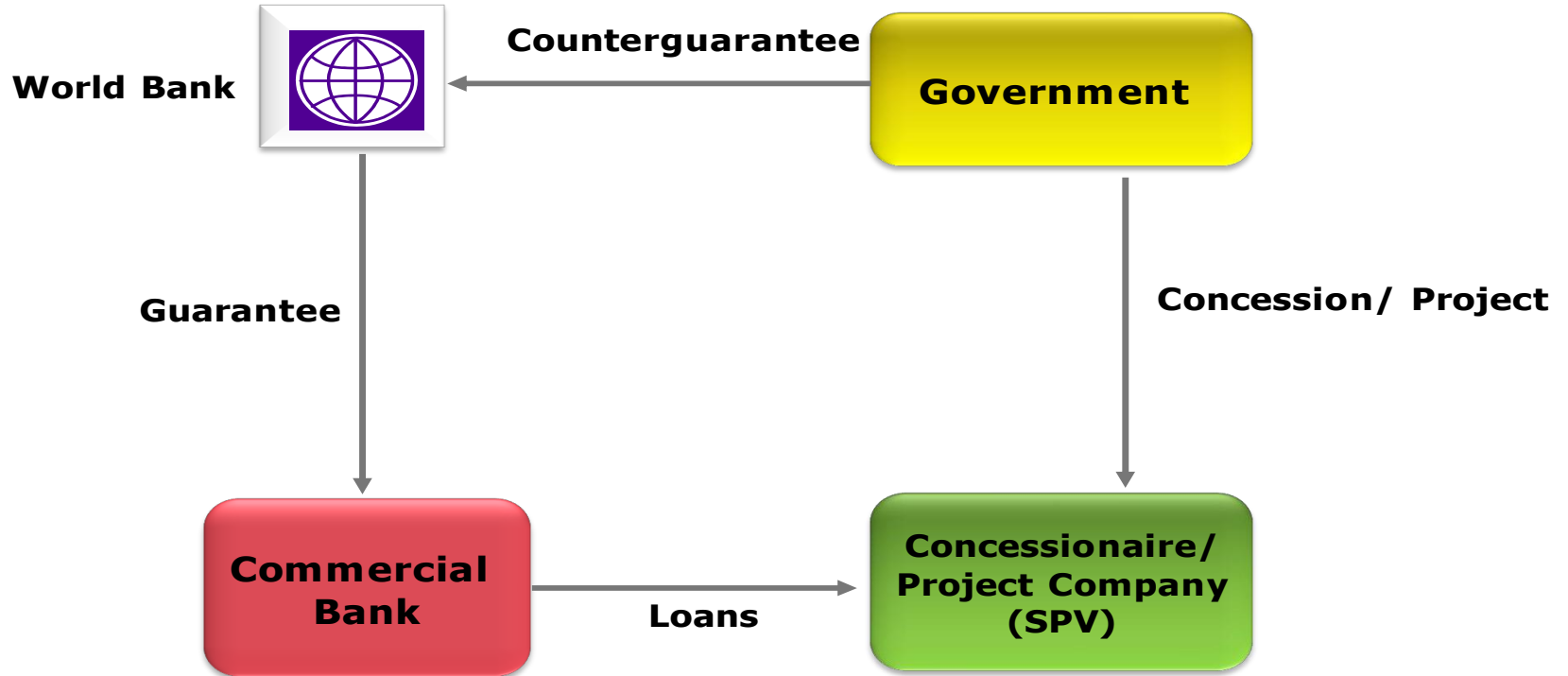


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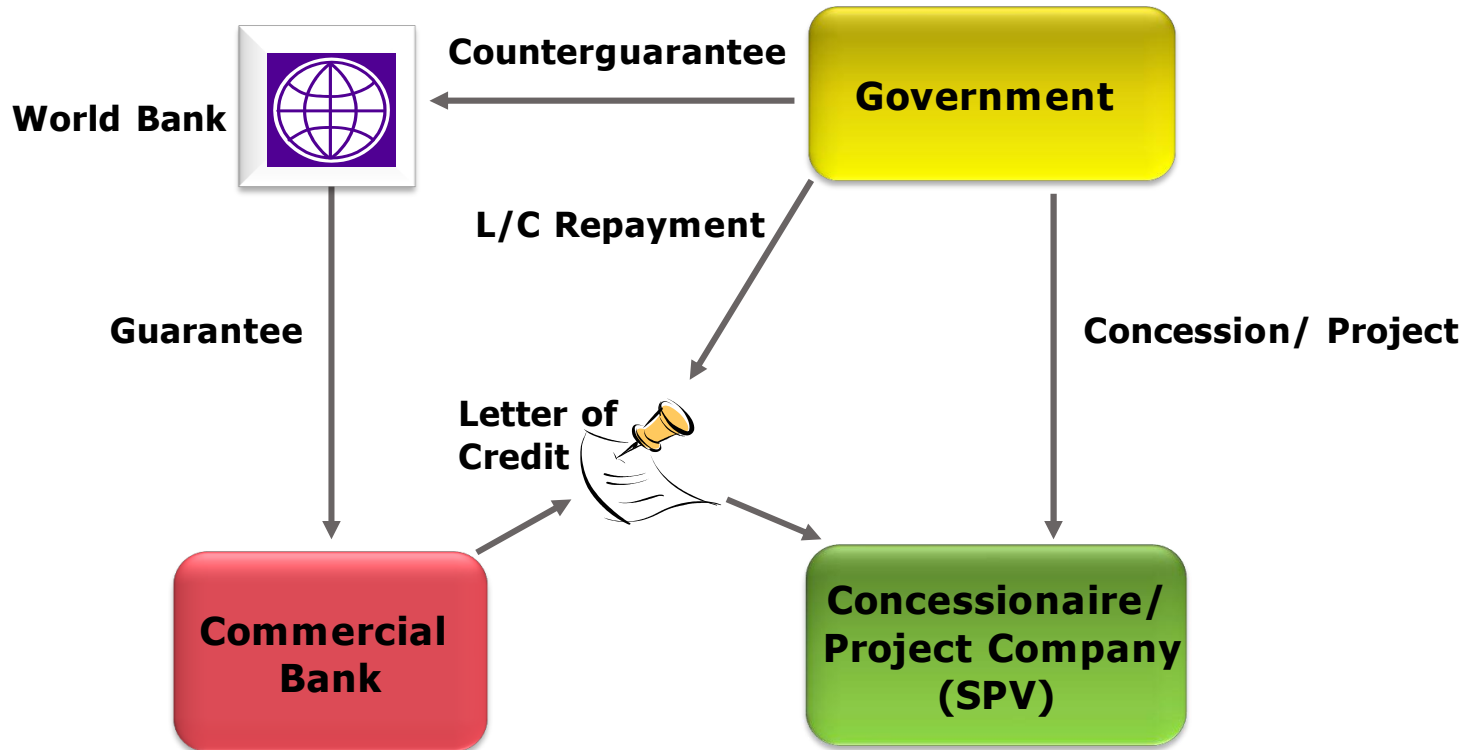
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1. Guaranteed Debt Structure



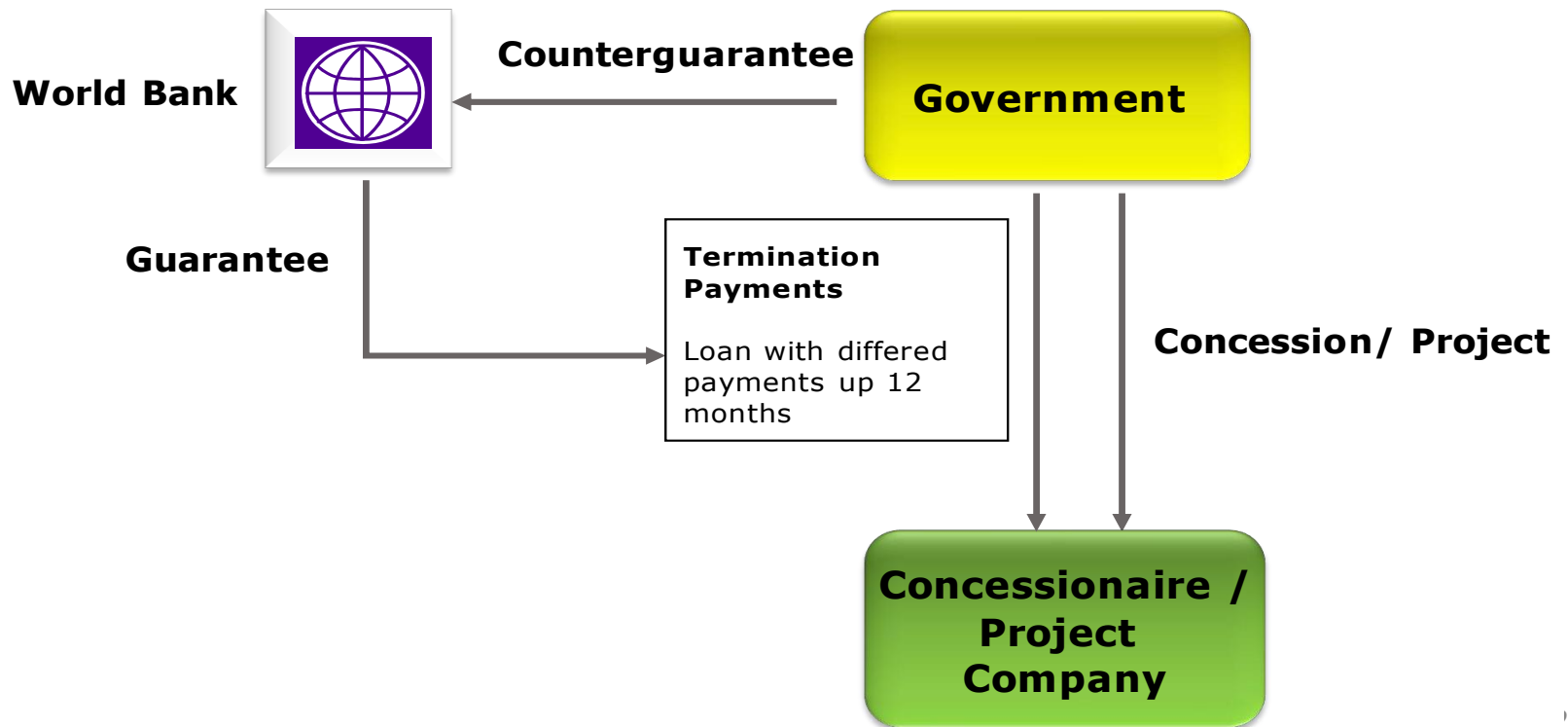
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2. Letter of Credit (L/C) Structure



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3. Guaranteed Deferred Loan





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Project Finance and Guarantees

Partial Credit Guarantees (PCGs)



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Key PCG Features

- Support for **public projects/** development policies
- Cover **bond/loan repayments** against **all risks** for **specific period of debt term** for public investment
- Designed to extend maturity and **improve market terms** of private debt beyond what's available in markets
- Flexible instrument, various structures to meet client needs:
 - Bullet guarantee
 - Letter maturities
 - Rolling non-reinstatable
 - Amortizing syndicated loan
- Available only for countries eligible for loans from IBRD
- Non accelerable



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PCG Structures



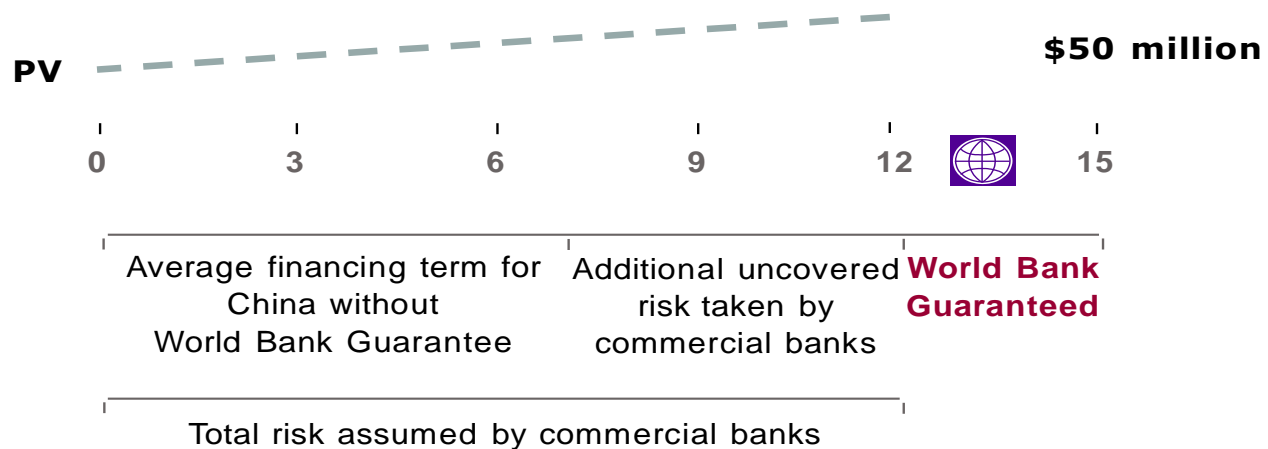
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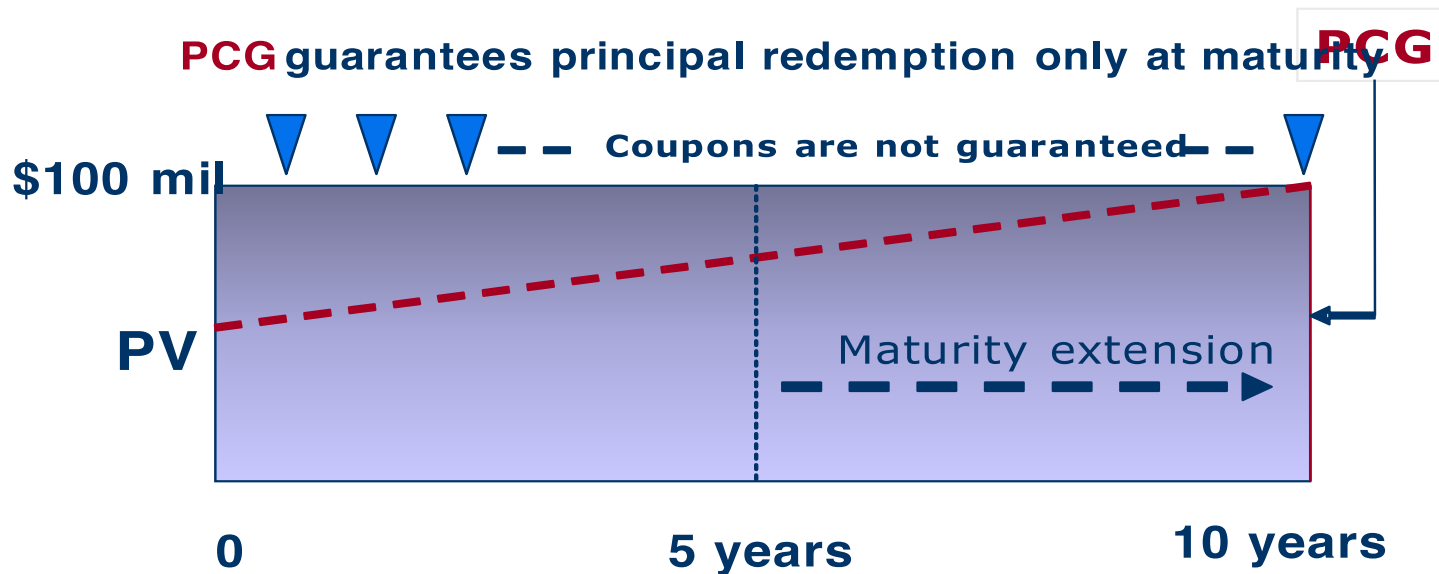
1. Amortizing Syndicated Loan with Cover for Later Maturities (Ej. China Ertan Power)

\$150 million



Project Finance and Guarantees

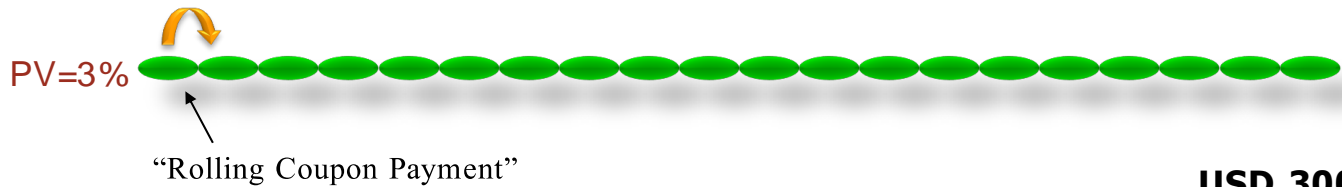
2. Principal cover for a bullet maturity (Example: National Power Corporation, Philippines)



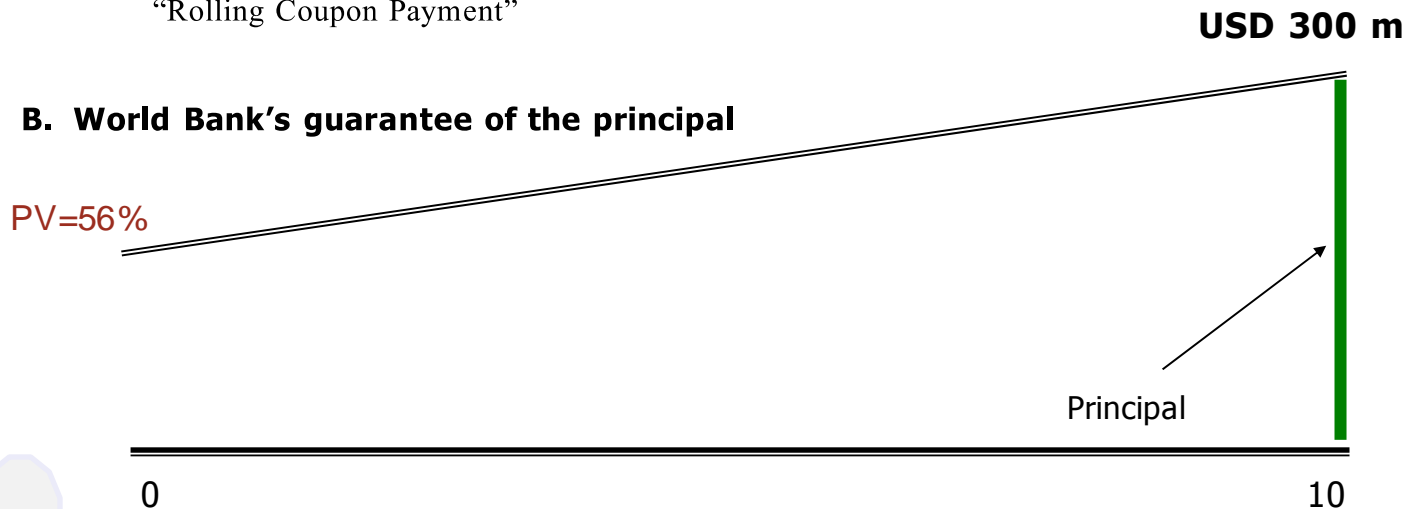
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3. Coverage of Bullet Maturity and "Rolling Coupon Payment" (Example: Thailand EGAT)

A. World Bank's guarantee of a single coupon payment on a rolling basis



B. World Bank's guarantee of the principal





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Benefits of Guarantees



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For the private sector:

- Mitigates critical perceived political risks and regulatory risks
- Facilitating direct access to financial markets – privatization
- Catalyzes long term “off balance sheet” debt financing; reducing risk profile of investment and overall capital costs

For the Government

- Access to debt markets on more favorable terms (PCGs)
- No additional contingent liability
- Can be additional to IMF external debt ceiling
- Additional to World Bank’s country lending program
- Creates market confidence through Bank leverage and track record
- Provides for risk sharing with private sector

For the World Bank

- Leverages Bank resources
- Saves Bank resource



Project Finance and Guarantees

Risk Analysis



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Projects attract sufficient finance to the extent uncertainties are reduced and risks are mitigated

- **Key risks affecting bankability along power sector value chain include:**
 - **Feedstock supply risk**
 - **Off-take risk**
 - **Regulatory risk**
 - **Legal risk, and**
 - **Operations and technology risk**

Project Finance and Guarantees

	Risks	Risk Mitigation
Government Support	Legal Framework	Comprehensive insurance coverage(MIGA) Partial Risk Guarantees
Market Economics	Transitional with limited experience	Legal opinions Implementation agreement Higher contingencies
Project Economics	Equipment supplier's reputation	Higher contingencies Product warranties
Contract Structure	Multiple EPC contractors Off-taker creditworthiness	Other similar arrangements Debt service levels
Security Package	Completion risk Product warranties	Sponsor support Contractor insurance
Sponsor Support	Inexperienced sponsor	Involve experienced co-sponsors with long-term commitment

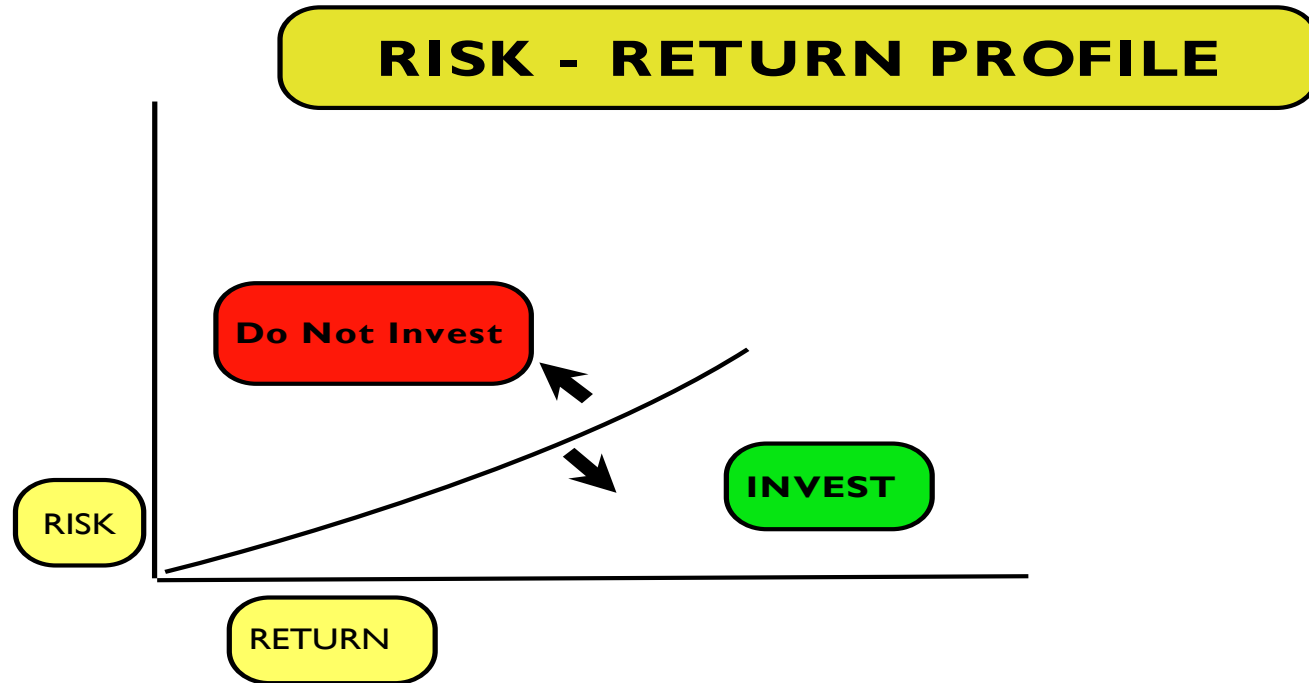
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Structure Prerequisites

Option	Political Commitment	Cost Recovery Tariffs	Regulatory Framework	Information Base	Government Capacity
Service Contracts	Low	Low	Low	Low	Moderate
Management Contracts	Moderate	Moderate	Moderate	Low	Moderate
Lease	Moderate	High	High	High	High
Concession	High	High	High	High	High
Build-Operate-Transfer and variations	High	Variable	High	High	High

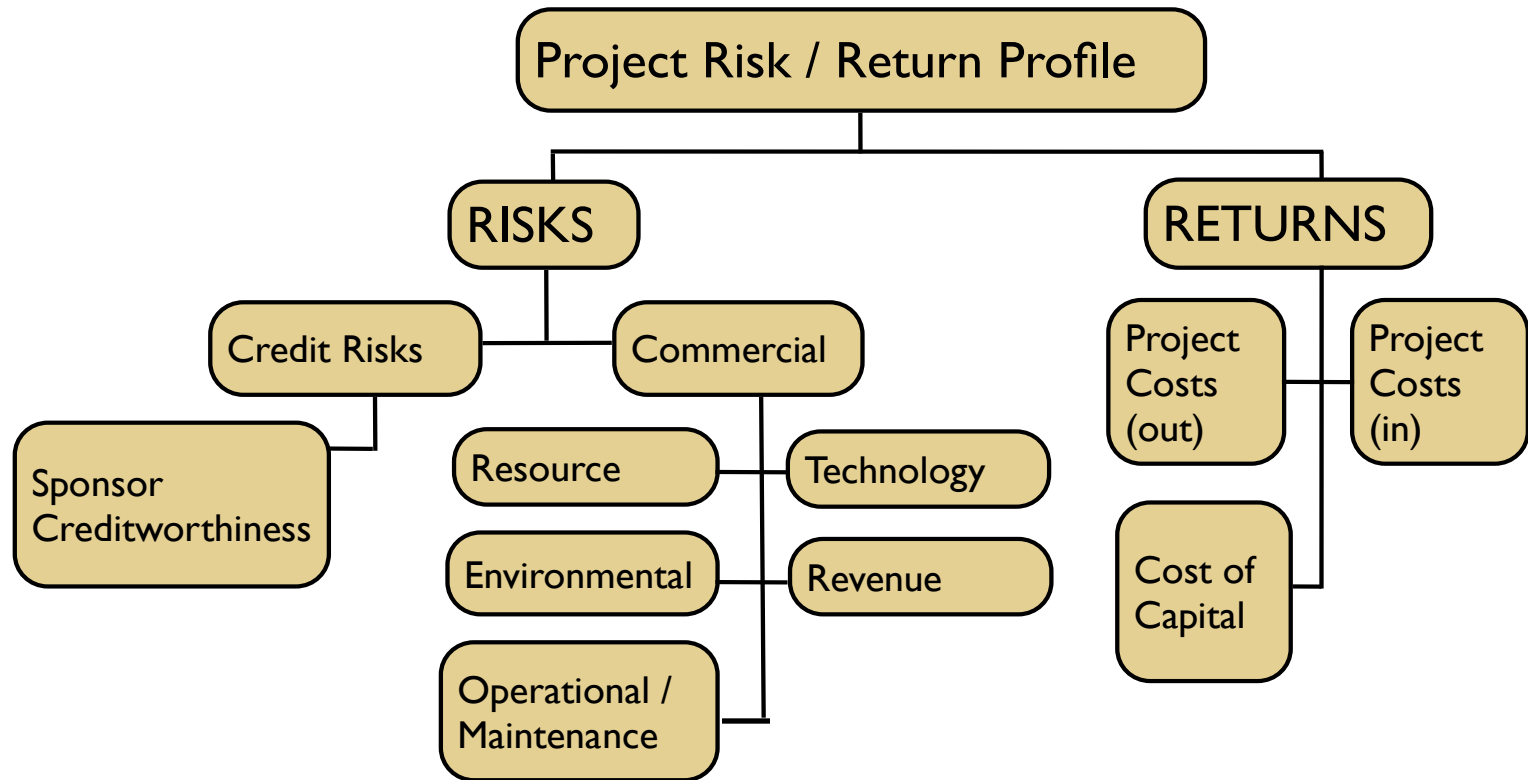
Structures that transfer greater risk to private sector require more sophisticated legal and regulatory structures, as well as availability of local skills to implement and monitor transactions

Project Finance and Guarantees



A basic principle in project finance is the relationship between **RISK** assumed in a given project and expected **RETURN** from such investment

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Variations

	OWN	DESIGN	BUILD	OPERATE & MAINTAIN	FINANCIAL RESPONSIBILITY
BOT	Public	Private By Fee Contract			Private
BRT	Public	Private By Fee Contract			Private
BO	Public	Private By Fee Contract			Public
DBFO	Public	Private By Fee Contract			Public or Private Public/Private
DOO	Private	Private By Fee Contract (Concession)			
ORT	Public	Public		Private By Fee Contract	Public

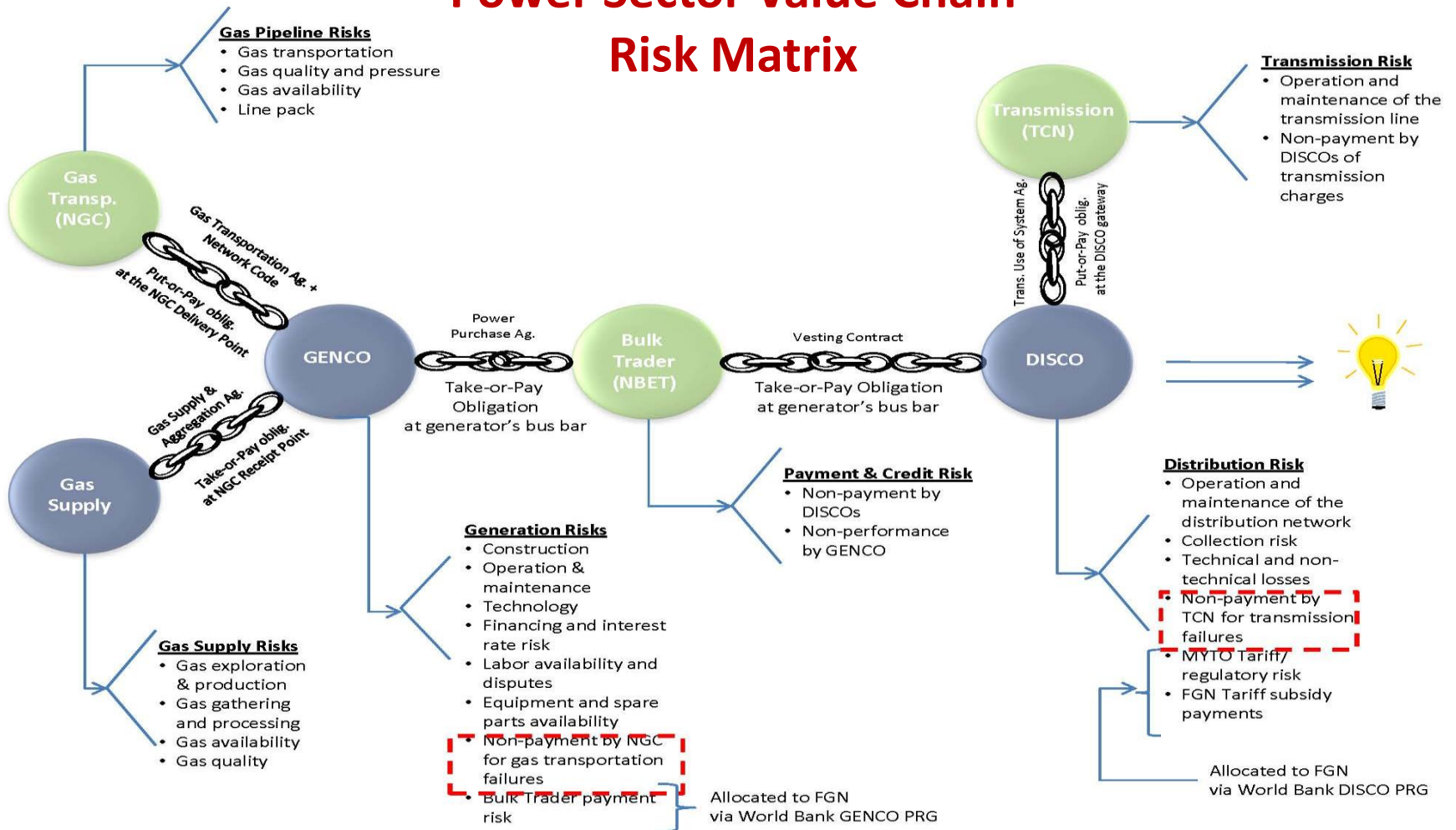
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TYPE OF RISK	PARTY CAPABLE OF MANAGING
Political / Background	Public Sector, International Institutions
Economic / Financial	Private Sector – Sponsor, Lenders
Technical / Construction	Private Sector – Contractor
Commercial	Private Sector – Project Sponsor
Environmental	Private Sector – Sponsor, Operator
Operational / Maintenance	Private Sector – Operator
Resource	Public Sector / Private Sector

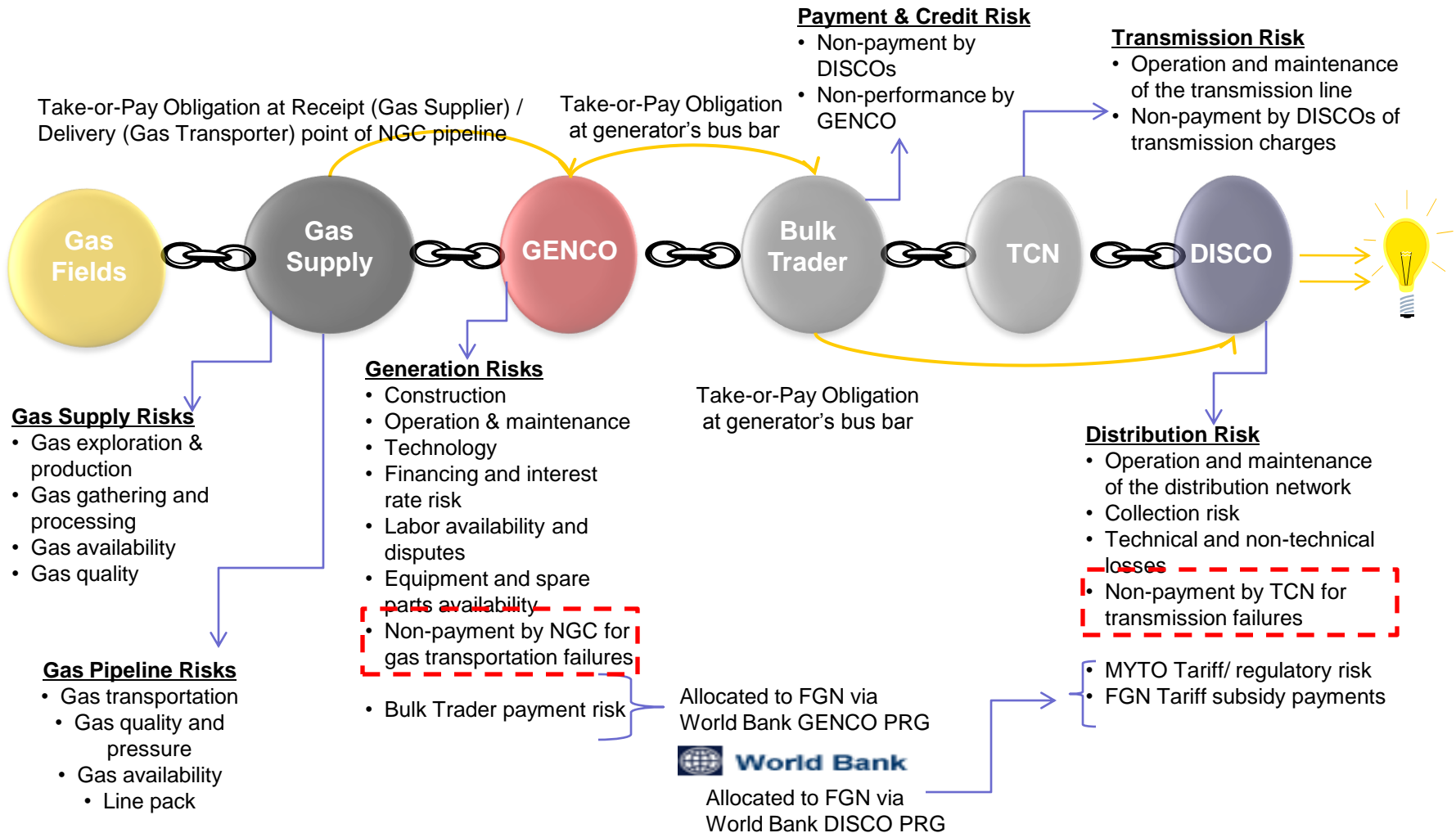
**Risk-sharing must be reasonable
with risk taking offset by profit**

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Power Sector Value Chain Risk Matrix

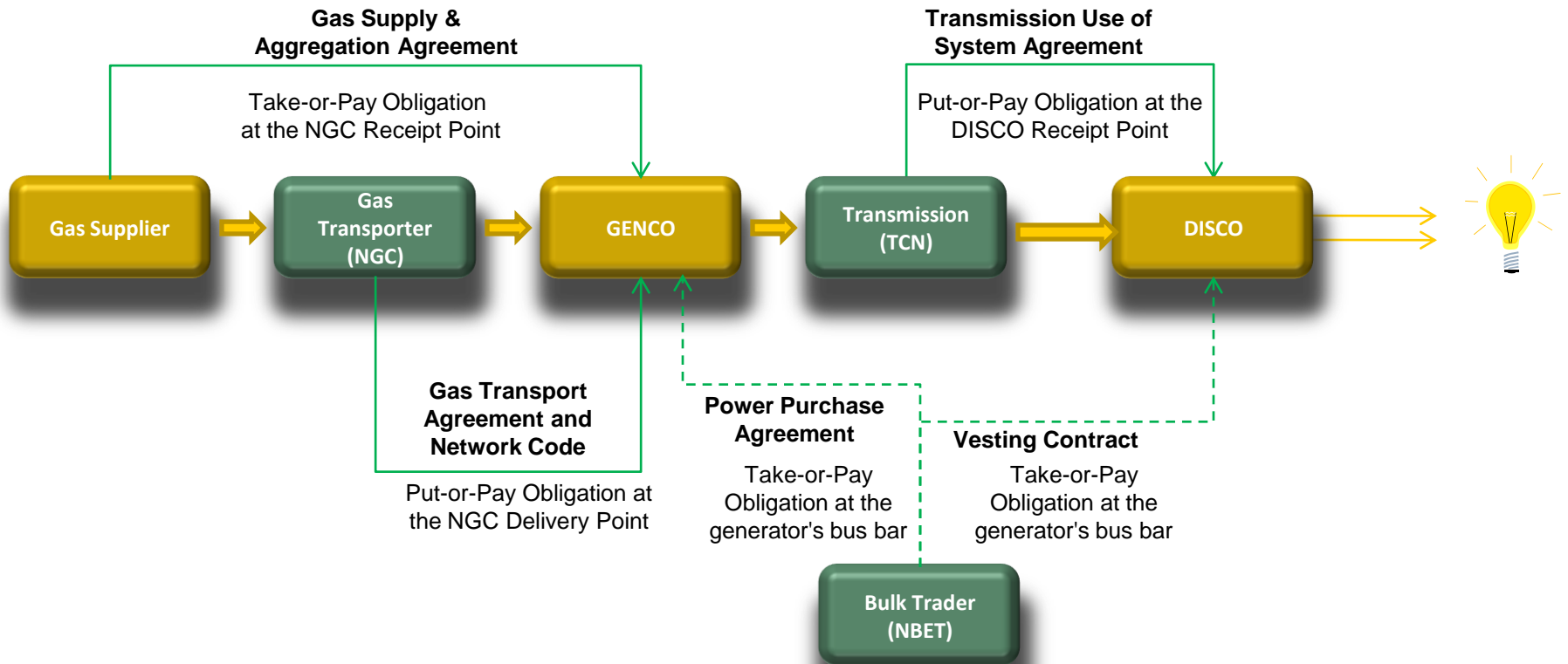


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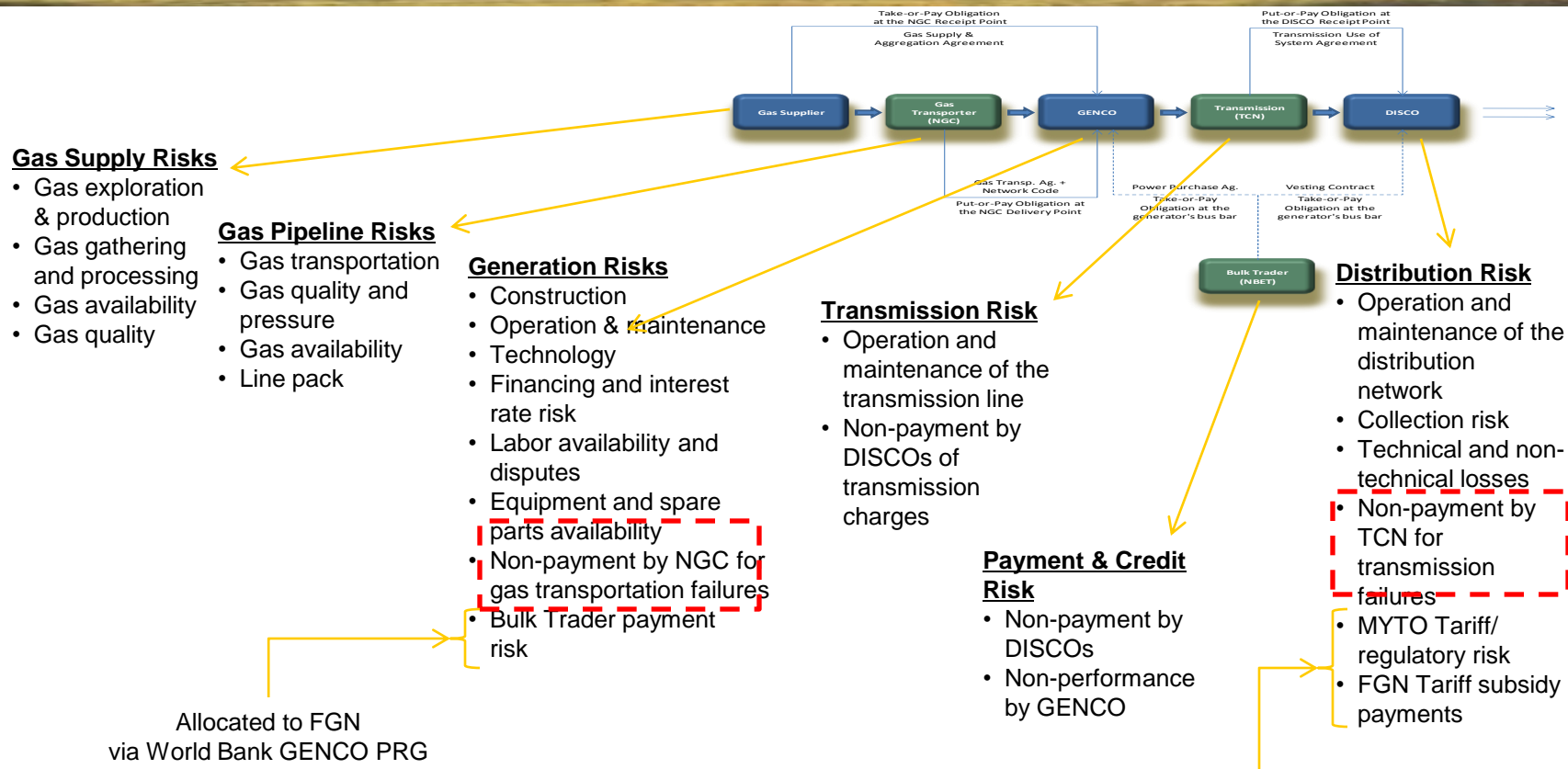


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Contractual Payment Obligations



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Allocated to FGN via World Bank GENCO PRG

Allocated to FGN via World Bank DISCO PRG



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Thank You



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Katharine Baragona - Ms. Baragona is a senior bank executive / US lawyer / UK solicitor with over 20 years of international project finance practice and experience. A member of The World Bank's Financial Solutions Group in the role of Senior Infrastructure Finance Specialist, Kate is currently leading the Bank's Partial Risk Guarantee (PRG) interventions in the power sectors of Nigeria, Ghana and Democratic Republic of the Congo. A graduate of the UOP-McGeorge School of Law's JD program in Sacramento, California, Kate also participated in McGeorge's LL.M studies and internship programs in Salzburg, Austria and London, England. As an undergraduate, Kate studied Economics & Finance at St. Edwards University in Austin, Texas, and Graphic Design at Louisiana State University in Baton Rouge, Louisiana. Prior to joining The World Bank, she held senior positions with Richards Butler (in London & Brussels), Hunton & Williams (in Brussels & New York) and Citibank (in New York & London).

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