



# Role of Banks and Investment Funds Development of PPP Projects in KSA



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Presented By:

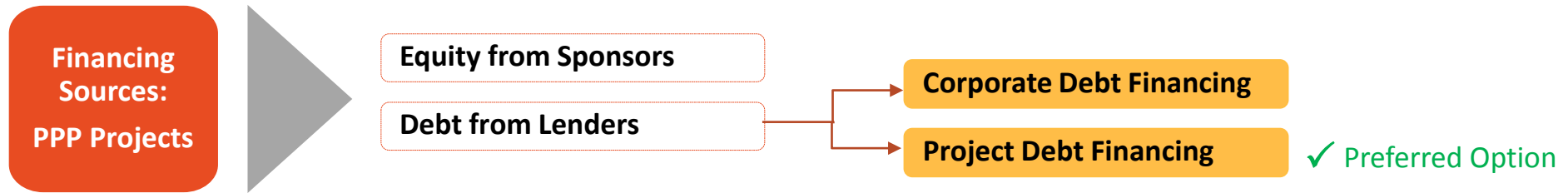
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## Role of Banks in PPPs

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# Financing Public Private Partnership Projects



## Project Financing: Preferred Option

- Financing structure in which lenders provide debt based on project parameters and project cash flows
- Limited to no recourse to the sponsors

### Benefits to Sponsors

- Relatively higher leverage (Debt/Equity Ratio of 70% to 90%)
- Longer tenor for debt financing
- Limited/ No guarantees from sponsors (non-recourse structure)
- Relatively lower cost of funding

### Benefits to Off-taker

- Appropriate risk allocation to the party most suitable to handle the risk
- Lower tariff (due to relatively lower cost of funding and longer tenors)
- Allows more private players to participate and increases competition

# Different Activities performed by Banks

### Financier

- Long term debt financing for projects
- Working capital financing for short term liquidity requirements
- Bridge loans for equity

### Lead Manager

- Syndication (debt provided by group of lenders and administered by one lead bank)
- Project due diligence and negotiations on key terms
- Liaising with legal, technical and insurance advisors

### Sector Development

- Risk management and mitigation
- Overall sector development by providing financing for critical infrastructure projects
- Positive feedback effect as reputed banks presence provide comfort to other market participants on projects

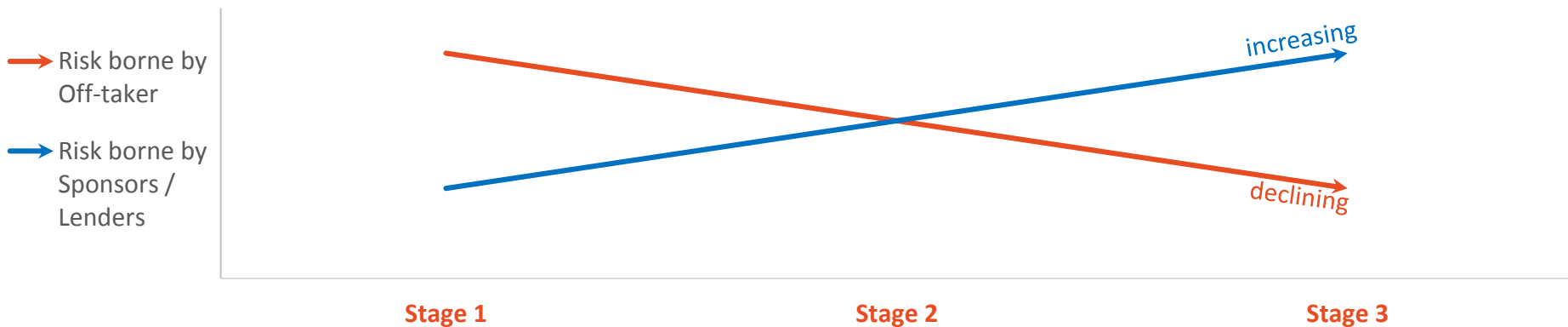
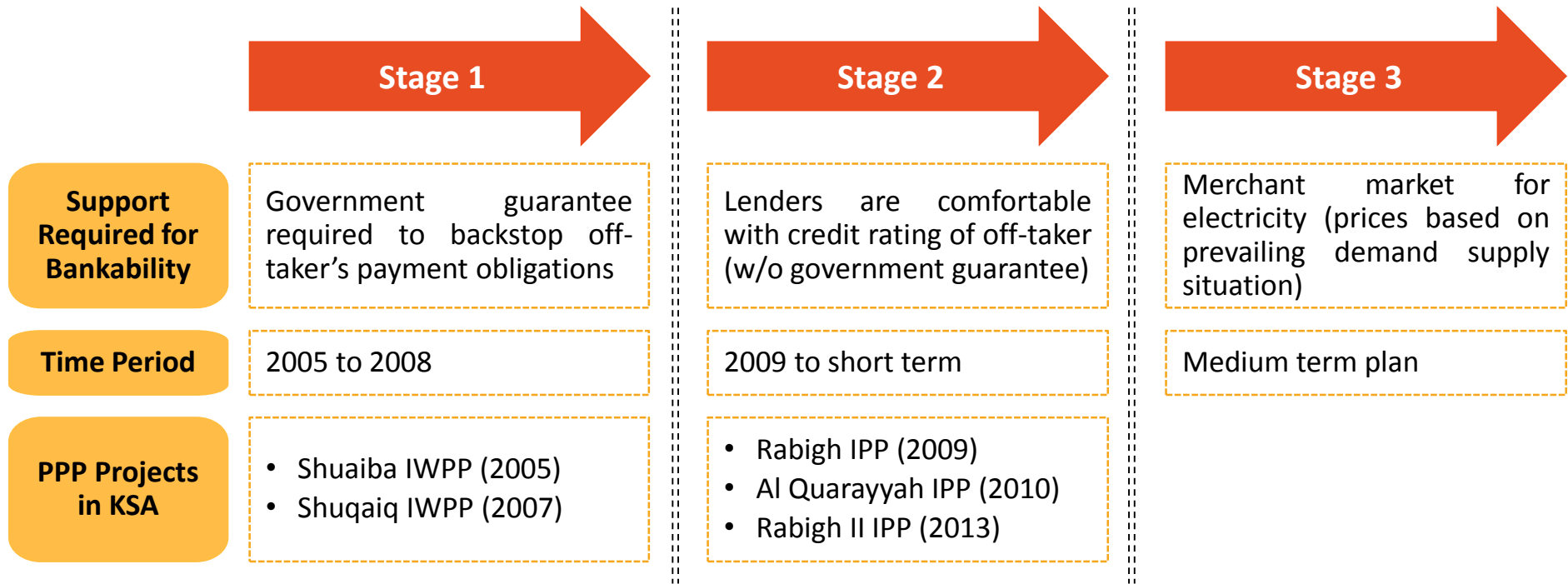
### Financial Advisor

- Feasibility study of the project and risk analysis
- Optimal financing structure of the project and sources of debt
- Optimizing economic, legal and tax structure

**By 2030, US\$ 60 to 70 trillion of funding is required for infrastructure projects globally**

**Banks/lenders are expected to play a major role in providing the required financing**

# Sector Development Case Study: Power Projects in KSA



## Banking Markets: Current Scenario

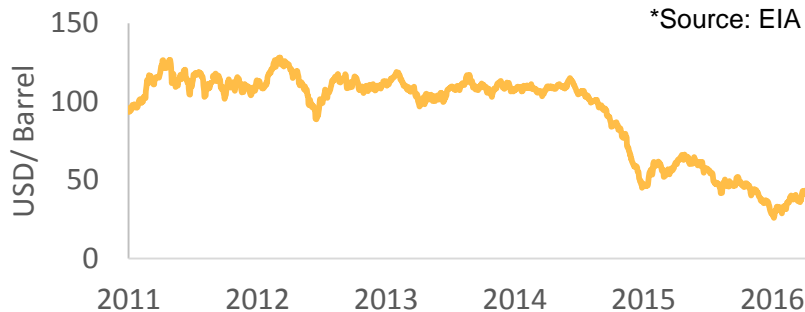
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# Banking Markets: Current Scenario

## Impact on PPP Projects

### Oil Prices Impact

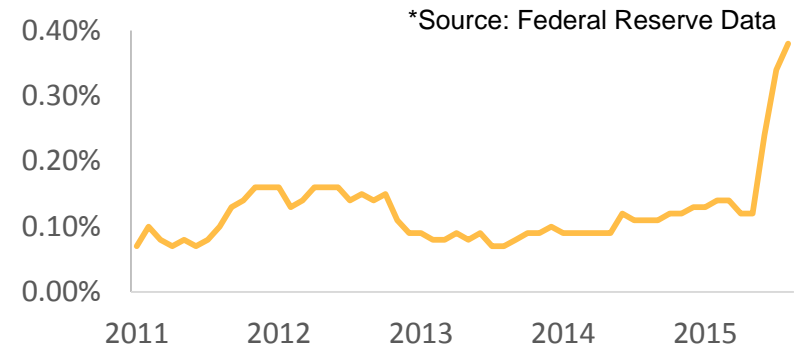
#### Brent Crude Oil Prices



- Asset quality and earnings deterioration for corporates
- Reduced deposit inflows from large government and government related entities

### Fed Policy Impact

#### Effective Federal Fund Rates



- US economy gradually recovering
- Fed reserve signaling increase in interest rates
- Sharp capital outflows from emerging markets

**Reduced liquidity and capital available with regional lenders in GCC**  
**Increased cost of capital for lenders**

#### Impact on Sponsors

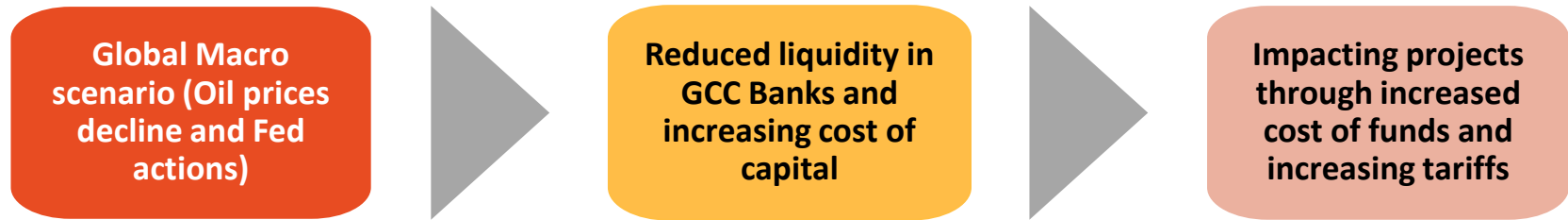
- Lower leverage (Debt to equity ratio)
- Increased cost of funding
- Considerably lower debt tenors

#### Impact on Off-takers

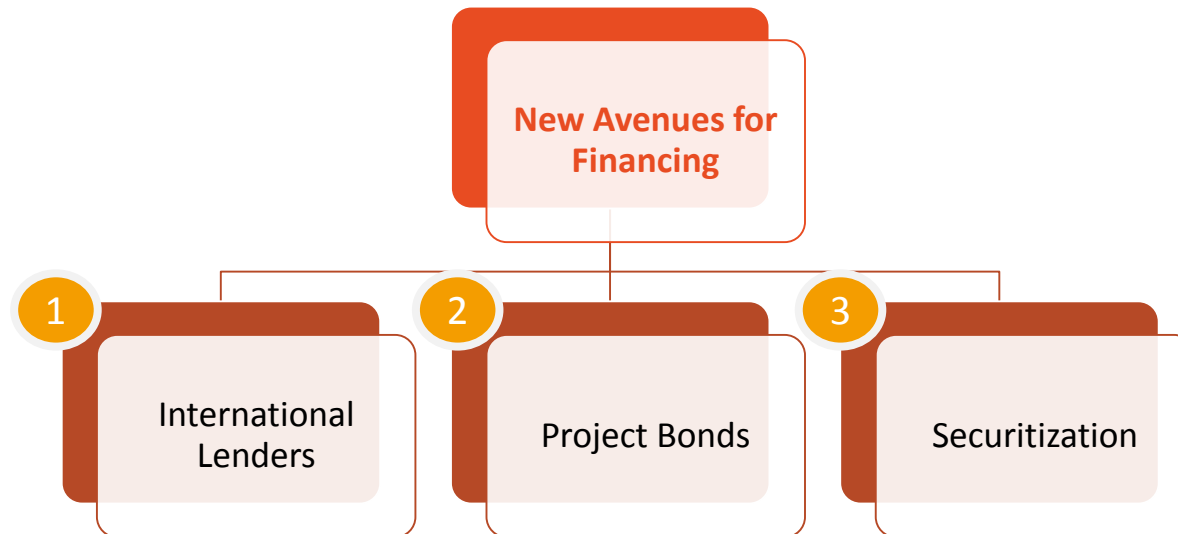
- Increased level of guarantees (as lenders become more risk averse)
- Increased tariff amounts

# Banking Markets: Current Scenario

## Alternate Options for Financing Projects



### Potential Solution





## International Lenders

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# Key Requirements and Advantages

### Major Lenders

- European Banks: Standard Chartered, BNP Paribas, Credit Agricole and KfW
- Japanese Banks: Mizuho, Sumitomo Mitsui Trust Bank, Bank of Tokyo – Mitsubishi UFJ
- Chinese Banks: Bank of China, China Construction Bank, ICBC

### Key Requirements

- Government support and guarantee from MoF for off-taker's payment obligations
- Strong contractual framework with provisions for:
  - Standard tariff structure with take or pay tariff mechanism and inflation protection
  - Protection for Force Majeure events
  - Protection during termination (Debt to be covered under all events of termination)
  - Exchange rate risk mitigation as lending is done in US dollars

**International lenders can provide senior debt financing with competitive pricing and long tenors matching the concession term**



## Project Bonds

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# Project Bonds

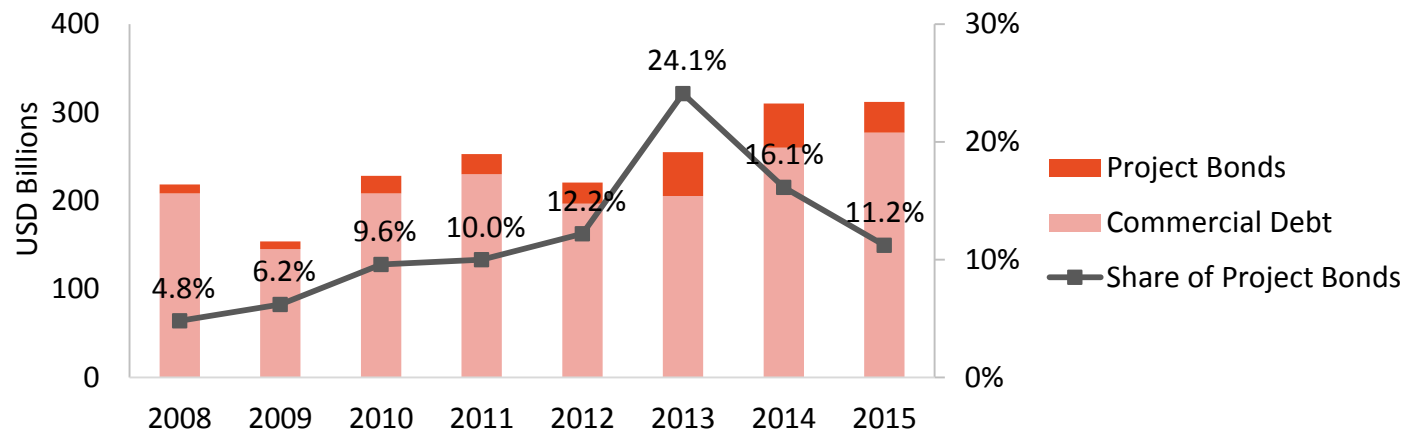
## Introduction

- Project Bonds provide an alternate source of financing infrastructure projects
- Allows institutional and retail investors to participate in infrastructure projects
- Listed and tradable securities that can offer superior risk-adjusted returns

### Commercial Debt vs Project Bonds

Feature	Commercial Debt	Project Bonds
Typical Tenor	15-20 years	20-35 years
Stage of Finance	Construction Stage, New Financing	Operational Stage, Refinancing
Markets	Prevalent in Emerging Markets	Prevalent in Developed Markets
Drawdown	According to a pre-determined schedule	Whole amount at financial close
Prepayment	Pre-payable without a prepayment fee	May not be permitted or permitted only with the payment of a 'make-whole' amount

**Share of Project Bonds in financing PPP Projects globally**



\*Source: Project Finance International

# Project Bonds

## Key Features

### Key Entities

- **Underwriters:** Investment banks typically act as underwriters for issuing the bonds
- **Rating Agencies:** Ratings from a reputed agency is required before bond issuance
- **Credit Enhancement Agencies:** Credit enhancements and project specific mechanisms to support bond credit quality:
  - e.g. Europe 2020 project bond initiative by European Commission and EIB: credit enhancement through contingent credit line (drawn in case of bond service default)

### Key Requirements

- No construction risk (typically project bonds are used during operating phase of projects)
- Strong contractual framework with appropriate risk allocation and mitigation
- Availability of capital outside of the banking system
- A functional public bond market
- Credit Rating or a suitable Credit Enhancement mechanism

- **Project Bonds provide an attractive alternative to fund long term infrastructure projects**
- **Reduced margins and long tenors make these financial instruments extremely useful to sponsors and off-takers**

# Project Bonds

## Global Project Bond Market

### Project Bonds Market by Country

Country	Project Bonds Issued (USD Billion)		
	2013	2014	2015
USA	13.5	12.3	10.9
Canada	2.1	3.3	4.9
UK	4.2	4.9	3.2
Malaysia	0.5	1.7	2.4
Germany	3.5	0.6	2.3
France	0.4	4.3	2.0
Peru	1.1	1.2	1.6
Chile	0.8	2.7	1.2
Australia	1.9	3.1	1.1
Italy	0.9	3.6	0.9
Israel	-	2.0	-
GCC	2.0	-	-
Others	18.3	10.5	4.7
<b>Total</b>	<b>49.3</b>	<b>50.3</b>	<b>35.3</b>

\*Source: Project Finance International

### Project Bonds Market by Sector

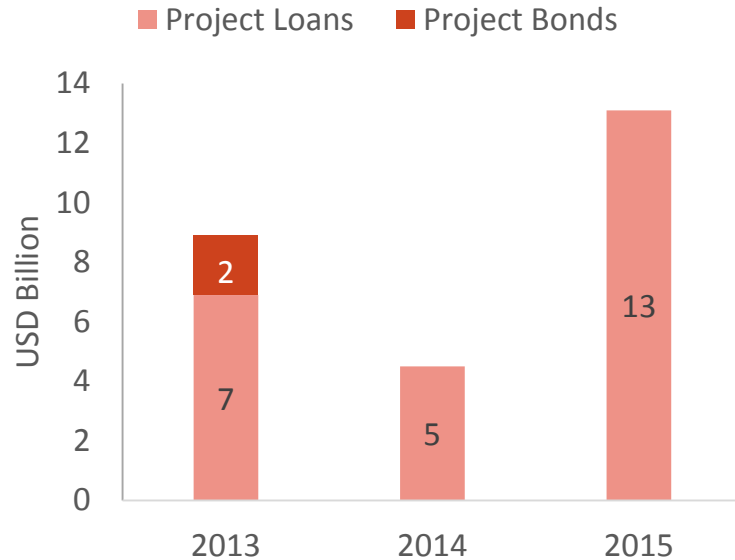
Sector	Project Bonds Issued (USD Million)		
	2013	2014	2015
Power	9.1	11.0	15.1
Infrastructure	18.9	18.1	14.5
Oil & Gas	15.3	18.2	3.0
Social Infrastructure	2.6	1.5	2.3
Petrochemicals	3.2	1.4	0.2
Telecom	0.1	0.2	0.3
<b>Total</b>	<b>49.3</b>	<b>50.3</b>	<b>35.3</b>

- Project Bonds have been successfully utilized in Europe, USA and other developed markets to fund infrastructure projects
- Power and infrastructure sectors contributes to more than 60% of the Project Bond Market

**Limited penetration of project bonds in GCC region**

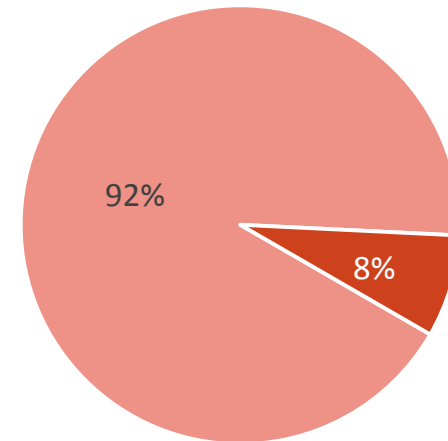
# Under Penetration in KSA : Significant Opportunity

### Project Loans and Project Bonds Issued in KSA



### Cumulative Debt and Bonds (2013 to 2105)

Project Loans Project Bonds



\*Source: Project Finance International

- Limited use of project bonds in the GCC region over last 3 years, with no issuances in 2014 and 2015
- Project Bonds form 8% of GCC's debt market which is way below global average of 18 %
- Huge scope for increasing project bond penetration in GCC and create an alternate source of project funding

# Key Projects funded by Project Bonds

Project	Deal Size (USD MN)	Coupon	Tenor (Years)	Year of Issue	Country
Sadara Integrated Chemical Project Sukuk	2,000	SAIBOR + 0.95%	16	2013	KSA
Satorp Refining and Petrochemical Project Sukuk	1,000	SAIBOR + 0.95%	14	2011	KSA
Shuweihat IWPP S2	825	6.00%	24	2013	Abu Dhabi
East End Crossing, Ohio River Bridge	677	4.56% to 4.96%	22 to 38	2013	United States
A11 Motorways Project	653	4.5%	31	2014	Belgium
Salford Pendleton Social Housing	120	5.41% to 8.35%	29	2013	United Kingdom

Source: Project Finance International



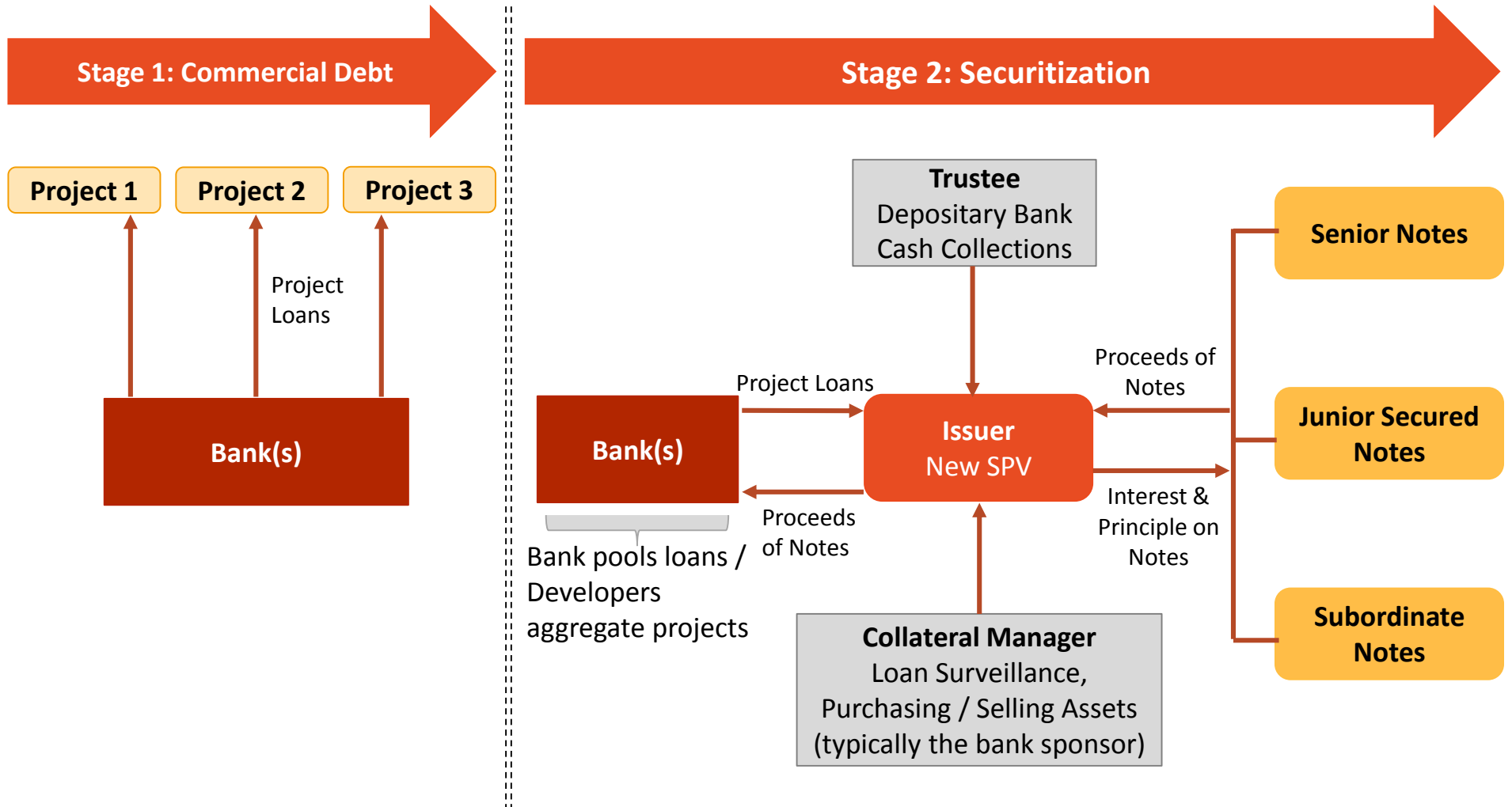


## Securitization

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# Securitization Introduction

- Securitization is the process of aggregating assets (Project Loans) in a pool
- Issuing new securities backed by the revenues expected to be generated by the pool



# Requirements and Advantages

### Key Requirements

- Portfolio of large and diversified projects / bank loans
- Required risk appetite in market to issue notes with varying degrees of risk and returns
- Large size of transaction and adequate returns to absorb costs involved in securitization

### Advantages: For Banks

- Reduced minimum capital requirements
- Receivables are moved "off balance sheet" and replaced by cash equivalent
- Potential to generate additional fee income

### Advantages: For Investors

- Highly customizable investments with wide range of yields: Investment grade to high yield
- Exposure to project loans across various assets resulting in natural diversification

**More capital and liquidity with banks to fund greenfield projects, thereby boosting overall economy**

# Securitization Examples

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## Project using Securitization

Project	Country	Size (USD MN)	Portfolio
<b>Project Funding Corp.I (PFC I) – 1998</b>	United States of America	617	40 loans made primarily to US projects
<b>Essential Public Infra. Capital (EPIC) – 2004</b>	United Kingdom	443	25 public infrastructure loans originated by Depfa Bank PLC
<b>WISE – 1, 2006</b>	United Kingdom	71	31 infrastructure bonds

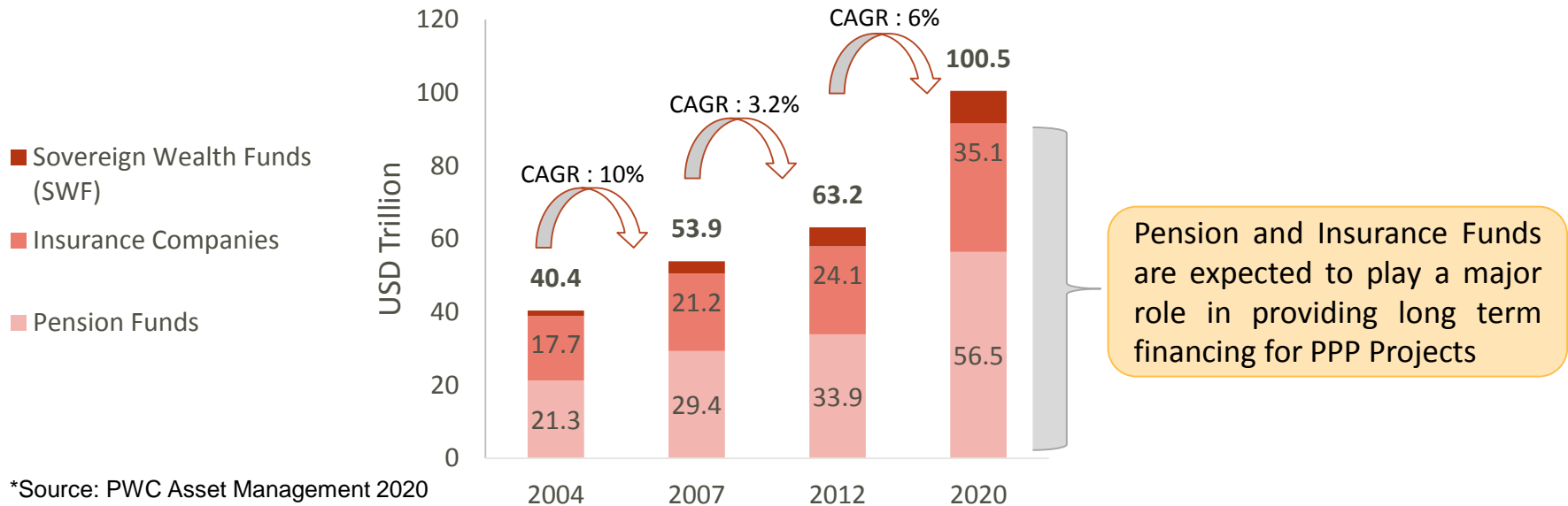


## Institutional Investors

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## Key Participants for Project Bonds and Securitization

### Growing Assets under Management for Pension and Insurance Funds



### Project Bonds and Securitization as Natural Match for Pension and Insurance Funds

- Bonds are more standardized capital market instruments and exhibit better liquidity than commercial debt
- Pension and insurance funds' long term financial obligations are met by long term cash flows from project
- Stability of cash flows and inflation indexation benefits
- Access to a new asset class providing diversification to the portfolio returns

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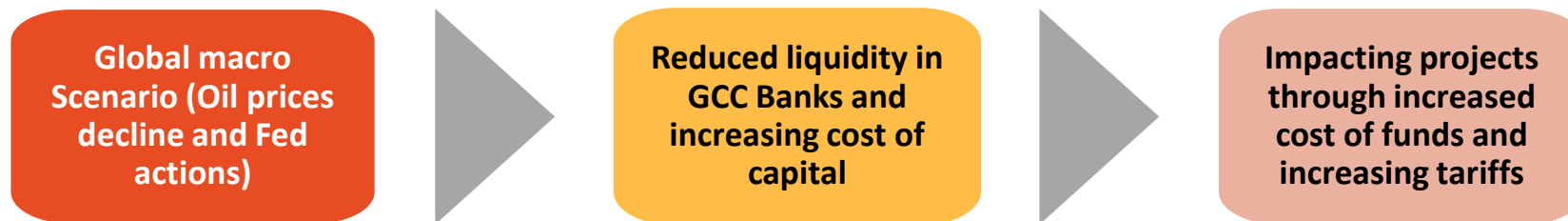
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## Conclusion

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# Conclusion



## New Avenues for Financing

	International Lenders	Project Bonds	Securitization
Key Requirements	<ul style="list-style-type: none"><li>• MoF guarantee for off-taker's payment obligations</li><li>• Strong contractual framework</li><li>• Force Majeure and Termination protection</li><li>• Take or pay Tariff structure</li></ul>	<ul style="list-style-type: none"><li>• Strong contractual framework</li><li>• Underwriters required for bond issuance</li><li>• Rating / Credit enhancements to support credit quality</li></ul>	<ul style="list-style-type: none"><li>• Portfolio of diversified projects / loans</li><li>• Required risk appetite in market to absorb notes with varying degrees of risk</li><li>• Returns adequate to compensate for securitization costs</li></ul>



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