European Bank
for Reconstruction and Development

Annex 1.
Building a PPP financing model

This bundle has been designed as a practical tool to complement the Regional Study on Financing Models for Public-Private Partnerships in the EBRD's economies. By detailing the benefits and limitations of the financing structures and instruments available to create a PPP financing model and outlining the financing sources available, this guide allows a promoter to quickly build a tailored PPP model. The relevant pages will be linked to the corresponding sections in the chapter, where more details are provided.

A typical PPP financing structure involves the formation of a special purpose vehicle (SPV), with banks contributing roughly 75 per cent of financing (via debt) and shareholders/sponsors providing the remaining 25 per cent (via equity). The aim of this guide and its corresponding chapter is to improve the capacity of relevant public and private bodies to finance PPP infrastructure projects by drawing attention to alternative and innovative ways of financing and structuring PPP projects, beyond traditional bank lending.

Choosing a financing structure

To be considered:

- The size of the project
- The level of development of the local capital market
- The bank's appetite for project finance in the country
- The possibility to mix financing types as an alternative form of PPP financing structure
- Management

Finance structure	Benefits	Limitations
Non-recourse or limited recourse project finance and full recourse corporate finance (2.1.1-2)	Allows projects with substantial capital requirements and inherent risks to attract private financing while minimising the exposure of the sponsors or developers. Helpful for raising finance for large, highly leveraged investments.	High costs: development cost, interest rates (project finance debt generally more expensive), large insurance coverage by lenders. Commercial banks and development finance institutions do not tend to consider any project finance project below a certain threshold (US$ 10 million to US$ 20 million). Thus, for very small local projects, the sole necessity to create an SPV is itself an obstacle.
Forfaiting and receivables financing (2.1.3)	A type of financing through bank loans, guaranteed by the project proceeds, without supporting many project risks. Transfers significant risk from the bank to the public authority.	Concession PPP projects usually have complex contractual arrangements and financial structures that may not align with features of receivables financing. Receivables financing may not provide sufficient funds to cover the large capital requirements often associated with PPP projects.
Investment partnership (7.1)	A good alternative for rich countries where the technology or local capacity is not adequately developed.	
Financing as part of a PPP contractual package (stapled financing) (7.2)	Attractive to investors and good to secure the financing for a project in countries in desperate need of that infrastructure and where limited or no need for any negotiation is seen.	Pre-set agreements can be unbalanced in favour of the potential investors and lenders, risky for the off-taker and the state.
Flexible bid model (7.3)	Meets both governments' need for a competitive process and investors' risk-return appetite, ultimately providing certainty and value for money for governments, patrons and investors.	Flexible bid models can face opposition from pension funds, which may be unwilling to accept direct responsibility for projects.

Choosing a financing instrument

To be considered:

- Risk appetite and distribution (for example, liabilities, loan defaults, construction delays)
- Cost of loans and equity and the debt-equity ratio.
- Probability of returns and repayments
- Ownership (for example, dilution)

Instruments for financing PPP projects	Benefits	Limitations
Equity (4.1)	Risk is shared; equity investors have no legal right to the return of or a return on the capital they invest. Reduces the contingent fiscal liabilities (for instance, material construction risks).	Return is risky (in both directions), so equity financing is more expensive than debt. The risk profile affects both the cost of debt and the cost of equity. Increases the weighted average cost of capital.
Senior debt (4.2)	Lowest risk – thus, it is the least expensive way to finance a project (except for grants).	Requires a very high probability of repayment, providers of senior debt will normally not accept to finance the project fully unless almost all risk of loan default has been removed.
Subordinated debt (4.3)	More flexible terms than senior debt. Lower interest rates than pure equity financing. Interest payments made by the SPV to holders of subordinated debt are often tax deductible.	Typically has higher interest rates than senior debt.
Mezzanine financing (4.3)	Reduces exit risk. Can bridge gaps between equity and senior debt. Increases a project's debt-to-equity ratio, improving equity's rate of return. Frees up equity for other projects. Equity-type features allow investors to share gains realized by the SPV.	While less expensive than equity financing, it is still more costly than traditional debt financing.
Project bonds (4.4)	The long tenor is attractive to investors looking for stable, predictable returns and long-term investments that match their long-term liabilities. Offer higher yields than traditional bonds.	Generally, less flexible than bank loans. Unless the deal is exceptionally large, the transaction costs for project bonds are likely to be higher compared to bank loans.
Capital investment grants or subsidies (4.5)	Cost-free – a form of non-repayable financing.	

Choosing a financing source

To be considered:

- Bankability of the project – can it borrow the amount of debt required?
- Do both lenders and shareholders have incentives that reduce their risks and maximise their returns?
- How developed are capital markets?
- Is there a risk of excessive renumeration on the private side?

Sources of PPP Financing		
Commercial and investment/merchant banks (5.1)	**Development finance institutions (5.2)**	**Project sponsors (5.3)**
Capital market and bond issuance (5.4)	**Impact investors (5.5)**	**Mutual funds (5.6)**
Private equity funds (5.7)	**Strategic investment and infrastructure funds (5.8)**	**Sovereign wealth funds (5.9)**
State-owned non-bank finance companies (5.10)	**Export credit agencies (5.11)**	**Insurance companies (5.12)**
Pension funds (5.13)	**Investment platforms (crowdfunding) (5.14)**	**Philanthropic financing sources (5.15)**