Action to unlock value

PFI/PPP debt refinancing – a Value for Money essential…

DWPF is an independent financial advisor active in all aspects of PFI/PPP. The aggregate capital value of projects advised on to date is more than £2bn across over 50 projects. Other achievements include being voted Best Financial Advisor in the 2004 Public Private Finance Awards.

While we are very actively involved in bidding new transactions with our clients in the primary markets, we have also advised on both equity and debt transactions in the secondary markets and successfully promoted and undertaken approximately 20 debt refinancings over the past five years. Whilst the debt refinancing market has been quiet of late, probably influenced by recent adverse publicity, deals are now starting to happen. Huge opportunities exist for refinancing existing proven operational projects. We believe these opportunities are simply not getting the attention they deserve.

From a public sector perspective, leaving properly performing operational projects alone may seem like a PFI success story. But the truth is somewhat different when considered from a Value for Money standpoint. Even ignoring the possible benefits from re-engineering the financial structure of the project (which can be substantial), successful operational projects will have been financed on significantly worse funding terms or structures than those currently available in the market. This is a function of the intrinsic reduction in the project risk profile following completion of construction, evolving market products and also the substantive erosion in financing terms over the last two to three years. The value to the public sector of a refinancing is thus likely to be considerable.

The fact is that not actively promoting debt refinancing, where sufficient upside exists, is simply leaking cash from the project. Value for Money demands action.

Authorities and central government have had concerns about potential increases in liabilities on early termination of the contract. In our view, these concerns can be allayed by correct structuring and by Authorities obtaining quality due diligence and financial advice.

Apart from some early projects where senior debt was fully protected on contractor default termination, Authorities should be protected against contractor default by the existence (or introduction) of the re-tendering regime found in SOPC3. Exposure to senior debt liabilities may thereby be capped, enabling Authorities to ensure compliance with guidance.

Authority Default and Voluntary Termination will result in increased potential exposure under the senior debt heading where a project has been refinanced. However, where the contractor selected a Market Value basis for any equity element of compensation, this element may be reduced by the refinancing distribution, partly mitigating the increase in senior debt exposure. In any event, Authority Default and Voluntary Termination are broadly within an Authority's control and can be fully analysed and quantified. Involuntary exposure remains under Force Majeure scenarios, which, by definition, are expected to be remote possibilities.

In practice, experienced advisors can readily make a cogent VfM case for refinancing, but there remains an acute sensitivity where a refinancing involves a change to the commercial terms of the Contract (eg. a concession extension) that itself enhances the overall refinancing gain. We believe that Authorities need to treat such proposals very carefully, as any refinancing of this nature may in reality represent a re-negotiation of the commercial deal. The main purpose of a true refinancing is to unlock value inherent in the existing project structure to the benefit of both parties. Any commercial change to a Contract can be dealt with through specific sponsor proposals or the Change mechanism.

Refinancing transactions remain complex and time-consuming, something that is unlikely to change. Project finance transactions invariably require a substantial number of interlocking documents that will all need to be reviewed, and some amended. In addition, the calculation of the refinancing gain is never straightforward, and of course the cost of effecting a refinancing has to be carefully monitored. It is vital to use advisors with the required skills and proven experience.

DWPF has developed expert analytical and evaluation techniques in this field. A close current knowledge of such transactions combined with our track record of structuring and pushing deals through to close, allows us to forecast outcomes on new propositions with a greater degree of certainty.

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