:

# Project Finance and Mega-Projects

Summary presentation By: Mohannad Qudah,

Minister of Transport, The Hashemite Kingdom of Jordan

May 2011

## Project Finance and Mega-Projects

- What is being done to secure financing for $30bn projects that are currently in the pipeline over the next 20 years or so?
- With 54% of economic activities carried out by the government, is there scope for private capital?
- What role do multilateral sources of finance play: catalytic or crucial?
- Can the securities markets be tapped to help fund mega-projects?
- Is the regulatory and legal framework in place?
- Are the institutions tested?
- If PPPs don’t work, how will the projects be financed?
- How can risk be classified and managed? Must the government always be the guarantor?

## Requirements for a BOT option

- **Assumption:**

  The BOT here means a project carried out and financed by a private operator, with no recourse on the state for financing.

- **Feasibility**

  The feasibility of such a scheme has several prerequisites, which are not only a question of cost, but most importantly a question of risks allocation.

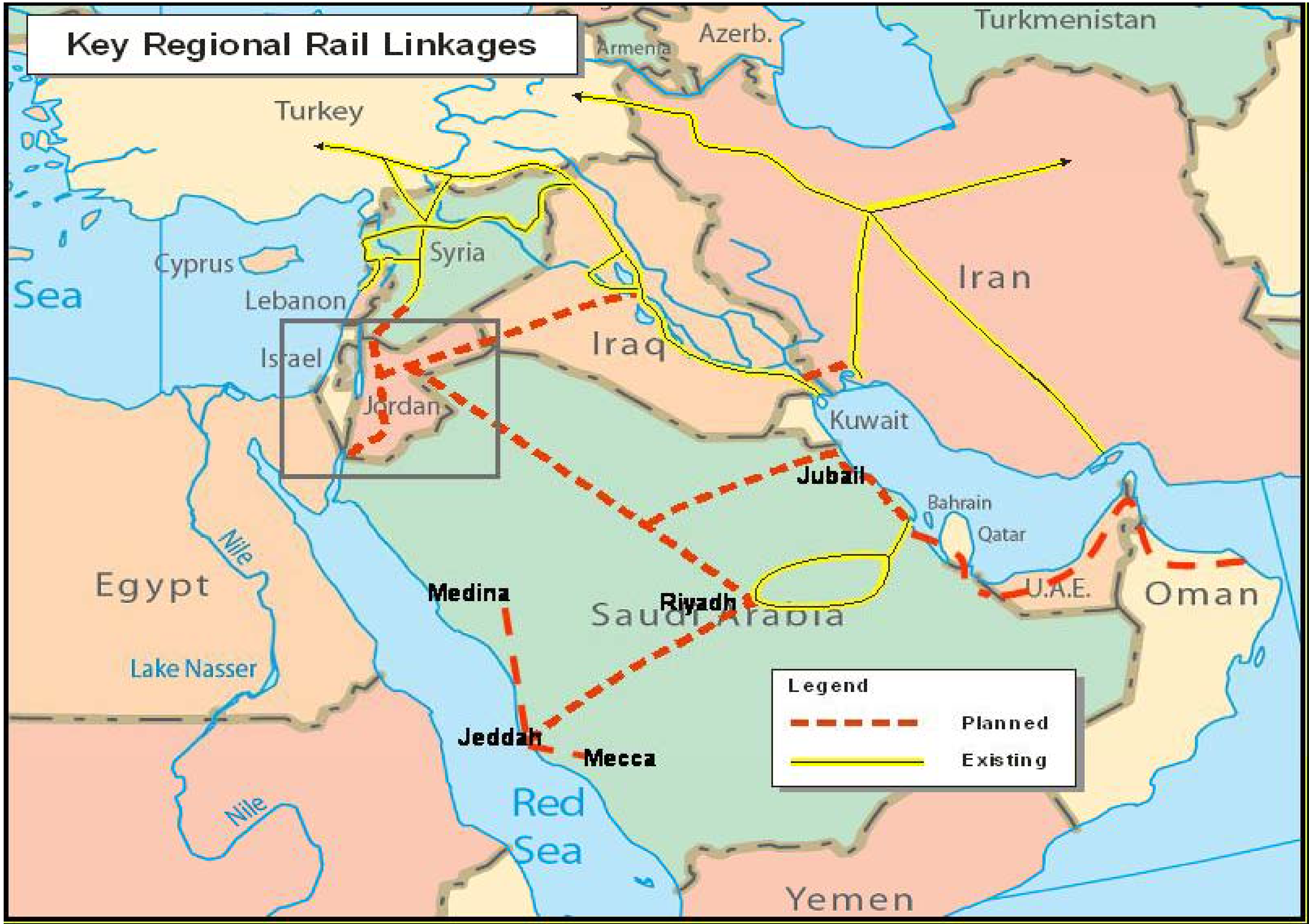
- **Infrastructure projects**

  - BOT projects usually work for infrastructures offering a virtually assured future cash flow. For instance,

  - BOT projects work well for utilities (such as Power & Water), in particular if there is a geographic monopoly.

  - BOT projects can also work in projects such as a railways associated to a mine, where the cost of the railway is an element of the mining cost, and where there is a long term off take agreement assuring future cash-flow.

## Regional railway network development




.

## Requirements for a BOT option

| Risk | Required for a BOT | Jordanian Railway Project |
|---|---|---|
| **Demand risk** | Virtually no demand risk : the demand is the object of a good historic track record or can be assessed confidently (for instance based on population or GDP) using international benchmarks. | Greenfield project:<br>No historical track record. Severe competition to be expected from oversupplied trucking sector<br>No benchmark available in the region. |
| **Construction risk** | Well under the control of contractors, and well covered by insurance | The advanced design performed is a strong base, but doesn't cover all potential risks |
| **Operations risks** | None, or well covered already | Key aspects remain to be dealt with fully<br>- customs arrangements with neighbours<br>- interoperability with neighbours<br>- possible reaction of trucking industry |
| **Cash flow visibility** | Good (no uncertainty with regards to collection of revenues, future costs, ..) | The long concession period required is too long to have full visibility |
| **Financial markets & Banks' appetite** | Appetite must be strong to insure long term lending is available at affordable rates (i.e. well below the project's IRR, to allow for equity return | Lending market is slowly recovering from a deep crisis. Little appetite for long term commitments. In practice a 15/20 year financing of the magnitude required would not be available to a private sector project company. |
| **IRR** | Compatible with investors requirement | Well below, even if some reduction in the project cost (10 to 15%) is achieved. |
| **Country risk** | None, or easily covered all over the concession period | Region is under historical stress.<br>Concession period too long for full coverage |

## Requirements for a BOT Option

**Project Subsidy:**

- No subsidy estimate will make the project doable under a BOT project, unless this subsidy amount means in fact the full coverage by the state of the above risks.

- Projects risks are in fact all undertaken by the state, which would mean that, under that scenario :
    - The state effectively guarantees the repayment of debts
    - while incurring the private sector cost of financing the project (rather than the sovereign cost of financing)
    - and, in practice assuring the investor its required equity return

The subsidy amount required for a BOT, could, in practice reach the full servicing of the infrastructure-related debt (interest + repayment), at a interest rate compatible with private sector financing.

# Jordanian National Railway Financial Structure

## Retained Transaction structure

### COMPANY STRUCTURE

**INFRASTRUCTURE ENTITY (PUBLIC ENTITY)**

- Owns and finances the railway infrastructure

**Debt :**
Sovereign / commercial financing

**Equity :**
State

**Lease**

**OPERATOR (PRIVATE COMPANY)**

- Operates the railway services
- Maintains the infrastructure

**Debt :**
Corporate / bank financing

**Equity :**
private investors, industrial partners

### IMPLIED BUSINESS PLANS

- Analysis is therefore based on 2 companies:
  1. A private company that will operate and maintain the railway on a concession basis (for an assumed period of 35 years), the **"Operating Co"**
  2. An infrastructure entity that will finance and own the railway, the **"Infra Co"**

# Public Debt Management -Application to JRC of EU and IMF principles

## I. Key features of the Jordanian Railway Corporation (JRC)

- A public corporation, owned fully by the Jordanian state. JRC will be under the control of the Jordanian Government, who will approve and follow up budgets, and debt contracts.

- JRC's debt could benefit from a guarantee from the Jordanian state which the lenders should be comfortable to analyse it as a first demand guarantee

- It is expected that JRC's revenue will consist of:
  - Lease fees received from the private operating company (approx 60 to 90% of revenues)
  - Ancillary revenues from real estate developments or other Subsidies

## II. Application of EU 95 and of the IMF Government Finance Statistics manual 2001 (GFSM2001)

Both manuals apply the same principles.

- Given the fact that a majority of JRC revenues are leases paid by the operating company, considered as "market" sales, JRC should not be considered as a General Government Unit, but rather as a Public Corporation.
- The debt of JRC should NOT be consolidated into Jordan's state debt, unless that debt (or a specific loan within it) gets called by the lenders as a result of a default on the part of JRC.
- Based on the IMF manual, there is a disclosure requirement of the debt of JRC, as a "Memorandum" item

## III. Jordanian Public Debt Law

- The Public Debt Law in its current form does not make any explicit distinction between guaranteed debt of General Government Unit and guaranteed debt of Public Corporation. the practice of MOF is to treat guaranteed debt of all public entities as part of the Public Debt.
- If international standards are strictly followed, then JRC debt should not be included in Jordan's government debt, as long as the Government guarantee on the debt is not called and as long as the activity is deemed commercial.