

CASE STUDY

—PUBLIC-PRIVATE PARTNERSHIPS: THEORY, PRACTICE, AND CASES

DAY 3, OCTOBER 19, 2012    ADDENDUM

# **“Financing PPP Projects”**

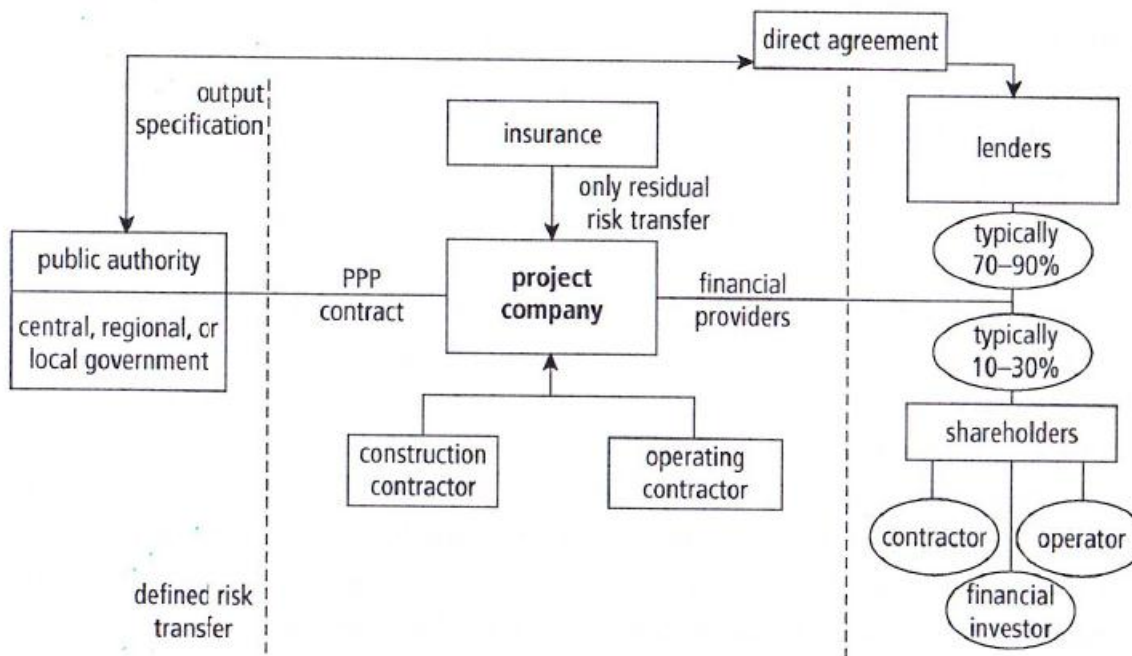
## **To Help Understand the Key Concepts**

# Private sources of finance for PPPs

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- Equity, to be provided by investors in the project, with a “*first in, last out*” nature
- Third-party debt, to be provided by banks or through financial instruments such as bonds

**Figure 5.1 Typical Contractual Structure of a Public-Private Partnership**



Source: Authors.

Source: page 59, World Bank/PPIAF (2011)

- Question: *What does the “first in, last out” nature of equity mean in financing PPP projects?*
- Question: *Which is more expensive, equity or debt, in financing PPP projects?*
- Question: *How could we lower the overall funding costs of a PPP project assuming you could change the debt-to-equity ratio (“gearing” or “leverage”)?*

### Benefit of leverage on investors' return

	Low leverage	High leverage
Project cost	1,000	1,000
(a) Debt	<b>500</b>	<b>900</b>
(b) Equity	<b>500</b>	<b>100</b>
(c) Revenue from project ( <i>p.a.</i> )	75	75
(d) Interest rate on debt ( <i>p.a.</i> )	5%	6%
(e) Interest payable [(a) x (d)]	25	54
(f) Profit [(c) - (e)]	50	21
Return on equity [(f) / (b)]	10%	21%

Source: page 120, Yescombe (2007)

- Question: *What would be the likely debt-to-equity ratio when a project is perceived as riskier than the other?*
- Question: *What would be the likely debt-to-equity ratio for a project when the domestic banking sector have limited capacity or experience to provide long-term debt required for PPP projects?*

- Limited-recourse finance, or “project finance”
- vs
- Corporate finance

- Question: *What are the major constraints that project sponsors (leading investors) will most likely face in using corporate finance for a large-scale infrastructure project?*
- Question: *In limited-recourse finance, what are the main assets that lenders can rely on as security?*



Instructor: Toshiro Nishizawa, Practitioner faculty member  
(Director General, Country Credit Department, JBIC)

TA: Ms. Ayaka Nishizawa (ayaka\_n@live.jp)

Contact info: t-nishizawa@jbic.go.jp; or toshironishizawa@gmail.com

*\* Please feel free to send me e-mails with any question about the course or if you want to make an appointment. To help me not to miss your incoming e-mails, **please start the subject line with “5140489” (Course No.)** when you send e-mails to Nishizawa’s.*