Security Packages on PPPs: bonds and guarantees

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PPP: anything new under the sun?

- We are still living with the consequences of 2008 and on-going changes in the lending market.

- The PPP model continues to evolve:
  - Where are the projects? Where are the lenders?
  - Who are the lenders – have the pension fund investors arrived (yet)?
  - Balance shifting between equity and debt?
  - Return of bond finance market?
  - Development of credit enhancement products?
  - Government intervention?

“Is the deal bankable”?

- Despite changes, key question still remains as to whether the project is bankable:
  - Political support and sponsorship
  - “Economic reality” test
  - Appropriate risk allocation in the Project contracts.

- Key risk allocation issues for the EPC contractor:
  - What does the Project Agreement/PPP Contract say?
  - How have issues been flowed down – eg programme, supervening events, termination triggers, “equivalent project relief”?

Importance of security package

- The security package is at the heart of any analysis of project risk allocation, but needs to track back to the underlying contract[s] to which the EPC contractor is party.

- What risks are being guaranteed and bonded – a major consideration if the security package includes a form of adjudication bond?

- What discretion is there in respect of the forms of guarantee and/or security bond

Bond-financed projects: the old story

- Promised land of credit rating and role of rating agency

- Analysis of construction contract risks – supported by bond by way of security:
  - Performance (“on demand”) security bond
  - Adjudication security bonds
  - Value and term of security bonds
  - Additional security bonds:
    - Advanced Payments
    - Retention Payments

Typical bank debt financed projects

- "No one size fits all"

- Provision of parent company guarantee:
  - Form of guarantee (eg "primary obligor")
  - Covenant strength of guarantor
  - Duration of guarantee (and change to parties)

- Is the provision of security bond a substitute for or in addition to parent company guarantee?

Practical considerations

- Who is asking for the form of security?
  - Transition from bid bond to contract security
  - Requirements of legislation or procurement rules
  - Use of Performance Security Dealing Construction – and flow down to EPC contractor
  - Use of term-sheets to finalise arrangements with funders (and equity sponsors).

- Timing during tender process and contract finalisation.

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