Financial Viability Assessment

P3-VALUE Webinar

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Instructors

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P3-VALUE 2.0 Webinars

- **P3**: Public Private Partnership
- **P3-VALUE 2.0**: Analytical tool to help practitioners understand processes used to quantitatively evaluate P3 options
- This is one of a series of webinars on P3-VALUE
  - P3 Evaluation Overview (January 25, 2016)
  - Value for Money Analysis (February 8, 2016)
    - Value for Money Exercise (Feb. 16, 2016)
  - Project Delivery Benefit-Cost Analysis (Feb. 22)
    - Project Delivery BCA Exercise (Feb. 29, 2016)
  - Risk Assessment (March 7, 2016)
    - Risk Assessment Exercise (March 14)
  - Financial Viability Assessment (today)
Webinar Outline

Part 1  P3 Project Financing
Part 2  P3 Financial Structure
Part 3  Traffic & Revenue Forecasting
Part 4  Financial Viability Analysis
Part 5  Financial Models
Part 6  Using P3-VALUE for Financial Viability Assessment
Recap  Summary of Webinar
Webinar Objectives

After this webinar you should be able to:

- Explain how P3s are structured
- Describe the process for toll revenue forecasting
- Describe the key metrics used to evaluate the financial viability of a P3 project
- Describe the role of financial models and list key inputs and outputs
Part 1

What is P3 Project Financing
What is Financing?

Method by which an investment is paid for:

- A temporary provision of funds in exchange for a return paid to investors from future revenues
- Bridges mismatch in timing between ultimate funding source (e.g. tolls/availability payments) and required investments (e.g. capex)
What is Project Finance?

- Financing of (infrastructure) projects based on future project cash revenues (typically tolls or availability payments for roads)
- Non-recourse debt secured by project assets and repaid from project cash flows only
Special Purpose Vehicle

- Set up to finance the activities of a specific project
  - Created to ring fence project’s assets and cash flows from private sponsor’s other activities
  - No recourse to private sponsor’s balance sheet, limiting exposure of private sponsors in case of bankruptcy
- Financiers may ignore the private sponsor’s other activities that are not part of the project
Typical Toll Concession

**Public Sponsor**

- **Subsidy**
- **Revenue sharing**

**Lenders and loans**

- **Debt service**
- **Bonds**

**Concessionaire (SPV)**

- **Funds to build, maintain and operate**
- **Toll revenues**

**Equity Investors**

- **Equity investments**
- **Dividends**
Typical Availability Payment P3

- **Public Sponsor**
  - Availability payment

- **Concessionaire (SPV)**
  - Funds to build, maintain and operate
  - Debt service
  - Availability payment
  - Toll revenues

- **Lenders**
  - Bonds and loans

- **Equity Investors**
  - Equity investments
  - Dividends

- **Facility**
  - Debt service
  - Toll revenues

- **Equity investments**
  - Dividends
Test Your Knowledge

True or False

- An SPV’s debt providers have no recourse to the private sponsor’s balance sheet in case of bankruptcy of the SPV.
Questions?

Submit a question using the chat box
Part 2

P3 Financial Structure
Typical Cash Flow Waterfall

- Project Revenues
  - Revenue Fund
  - Operation & Maintenance Expenses
  - Operations & Maintenance Reserve Fund
  - Senior Debt Service Payments and Reserve Fund
  - Subordinate Debt Service Payments and Reserve Fund
  - Rehabilitation & Reconstruction Reserve Fund
  - Return on Equity
Sources of Project Revenues

Facility Revenues
- Tolls from users
- Ancillary revenue (e.g. fees from advertising)

Public Agency Payments
- Availability Payments
- Shadow tolls
- Subsidies
- Milestone payments
Sources of Project Financing: Equity

- Infrastructure development companies
- Private equity and infrastructure funds
- Pension funds, foundations, insurance companies, etc.
Sources of Project Financing: Debt

Loans
- Private bank loans
- TIFIA loans

Bonds
- Private Activity Bonds (PABs)
- Project revenue bonds
Debt Repayment

Annuity type:
- Equal payment amount every period
- Multiple tranches may be used with differing maturities

Interest only:
- “Bullet” payment of principal at maturity

Sculpted repayment:
- Debt service payment is a mix of interest and principal that is “sculpted” to match the revenue stream profile
Annuity Debt Repayment

Example of annuity type debt service: Equal debt service payments in all years

Level Debt Service

- Principal Payments
- Interest Payments
- Revenue
Sculpted Debt Repayment

Example of sculpted debt service: Debt service follows net revenue profile, hence optimizing debt capacity

[Graph showing sculpted debt service with labels for Principal Payments, Interest Payments, and Revenue]
Leverage (or gearing or debt-to-equity ratio) indicates debt as a share of total required financing.

As debt service is paid before dividends, equity finance forms a buffer for debt, making debt less risky.

Lenders require less equity for projects with lower risks.
## Leverage vs. Required Revenues

<table>
<thead>
<tr>
<th></th>
<th>50/50 leverage</th>
<th>90/10 leverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project cost (millions)</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>(a) Debt</td>
<td>$500</td>
<td>$900</td>
</tr>
<tr>
<td>(b) Equity</td>
<td>$500</td>
<td>$100</td>
</tr>
<tr>
<td>(c) Required rate of return on equity</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>(d) Annual return on equity: (b) x (c)</td>
<td>$75</td>
<td>$15</td>
</tr>
<tr>
<td>(e) Annual interest rate on debt</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>(f) Interest payment: (a) x (e)</td>
<td>$25</td>
<td>$54</td>
</tr>
<tr>
<td><strong>Annual revenue required to pay for financing: (d) + (f)</strong></td>
<td><strong>$100</strong></td>
<td><strong>$69</strong></td>
</tr>
</tbody>
</table>

**Note:** This simplified example assumes “bullet” repayments of the principal on debt and the equity investment at the end of the concession term. It also does not consider minimum DSCR requirements (see later).
## Equity in US Transportation P3s

<table>
<thead>
<tr>
<th>Project</th>
<th>Concession Type</th>
<th>Equity (% of Financing)</th>
<th>Equity (% of Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I-95 HOT Lanes</td>
<td>Toll</td>
<td>35%</td>
<td>32%</td>
</tr>
<tr>
<td>LBJ-635 Corridor</td>
<td>Toll</td>
<td>31%</td>
<td>25%</td>
</tr>
<tr>
<td>North Tarrant Express</td>
<td>Toll</td>
<td>29%</td>
<td>21%</td>
</tr>
<tr>
<td>I-495 HOT Lanes</td>
<td>Toll</td>
<td>23%</td>
<td>18%</td>
</tr>
<tr>
<td>Midtown Tunnel</td>
<td>Toll</td>
<td>17%</td>
<td>11%</td>
</tr>
<tr>
<td>SH-130 Segment V-VI</td>
<td>Toll</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>I-595</td>
<td>AP</td>
<td>13%</td>
<td>11%</td>
</tr>
<tr>
<td>Presidio Parkway</td>
<td>AP</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Port of Miami Tunnel</td>
<td>AP</td>
<td>11%</td>
<td>7%</td>
</tr>
<tr>
<td><strong>East End Crossing</strong></td>
<td><strong>AP</strong></td>
<td><strong>10%</strong></td>
<td><strong>10%</strong></td>
</tr>
</tbody>
</table>

*Source: Official bond statements*
Credit Enhancements

External:

• Letters and lines of credit
• Bond insurance
• Construction risk guaranties
• Governmental guaranties

Internal

• Cash reserves
• Debt tranches (senior vs. junior)
• Cash flow optimization (apply excess cash to prepay ahead of scheduled amortization)
Test Your Knowledge

True or False

- A sculpted debt repayment schedule is able to optimize debt capacity.
Questions?

Submit a question using the chat box
Part 3

Traffic & Revenue Forecasting
Traffic & Revenue Forecasts

Level 1: Conceptual, based on available information
Level 2: Requires current and comprehensive survey data and full analysis
Level 3: “Investment-grade” forecast with toll plan, fully supported data and assumptions
Use of Traffic & Revenue Forecasts

Public Policy
- Are tolls a viable funding source?
- What is a feasible project size?
- How much funding from users? How much funding from subsidy?

Finance
- Credit analysis by lenders
- Return on equity for equity investors
Debt Rating

Credit agencies rate transaction (not forecast):

- Stress test the traffic & revenue (T&R) forecasts
- Assess security of the finance structure (DSCR, leverage)
- Borrowers typically structure a finance plan to the standards of a specific, desired “investment grade” rating
Regional Travel Forecasts

Source: MWCOG

Tolled vs. non-tolled road for work and non-work trips
Refine model to corridor/facility level

Evaluate assumptions

Perform scenario or risk analysis
Modeling Considerations

- Definition of “conservative”
- Truck and commercial traffic may not be specifically modeled
- Peak period vs. annual traffic
Major Variables

- Toll rates
- Values of time
- Demographics
- Land use patterns
- Environmental constraints
- Roadway network characteristics
- Modal splits
- Trip purpose mixes
Probabilistic Forecast

- Perform sensitivity analyses for each major variable (separately) to estimate its relative significance
- Develop probability distribution functions for revenues
Probabilistic Confidence Levels

- **P50**: 50% probability of revenue attainment
  “Most likely” case, may be used by equity investors

- **P90**: 90% probability of revenue attainment
  “Severe downside” case, may be used by debt providers
Test Your Knowledge

True or False

- Traffic forecasts obtained from regional travel models developed by MPOs are more than adequate for the purpose of rating debt.
Questions?

Submit a question using the chat box
Part 4

Financial Viability Analysis
Purpose

To determine affordability of the project

To structure an optimum P3 to ensure marketability

To determine likely concession fee or public subsidy
Key Metrics for Public Agency

- Concession fee – for “NPV positive” projects
- Public subsidy – for “NPV negative” projects
- Toll rates
- Concession term
Key Financial Metrics

1. Debt service coverage ratio (DSCR)
2. Gearing (or debt-to-equity ratio)
3. Equity internal rate of return (Equity IRR)
4. Weighted average cost of capital (WACC)
Debt Service Coverage Ratio (DSCR)

- Debt service coverage ratio (DSCR) = 
  
  \[ \frac{\text{Cash Flow Available for Debt Service (CFADS)}}{\text{Required Annual Debt Service}} \]

Higher minimum debt service coverage ratio requirement reduces debt capacity
2. Gearing

- Gearing (or debt-to-equity ratio) = 
  \[
  \frac{Debt \text{ Amount}}{Equity \text{ Amount}}
  \]

Higher gearing is the result of higher debt capacity and a lower equity requirement
3. Equity Internal Rate of Return

- Equity IRR is the discount rate at which the NPV of equity cash flows is zero.

- Solve for $r$ in the formula:

$$
\sum \frac{D_i - I_i}{1 + r} = 0
$$

Where $D_i = $ Equity distributions

$I_i = $ Equity investments
Weighted Average Cost of Capital

- WACC is calculated by combining both cost of debt and equity
- Text book formula (applicable only if gearing is constant):

\[
WACC = \frac{E}{D+E} \times r_e + \frac{D}{D+E} \times r_d \times (1-\tau)
\]

Where
- \(E\) = equity amount
- \(D\) = debt amount
- \(r_e\) = required equity return
- \(r_d\) = debt interest rate
- \((1-\tau)\) = tax shield
WACC Calculation: Textbook Example

- Equity amount = 50% of total financing
- Required equity return = 12%
- Debt amount = 50% of total financing
- Interest rate = 6%
- Tax rate = 35%, tax shield = 65%

\[
WACC = [50\% \times 12\%] + [50\% \times 6\% \times 65\%]\\
WACC = 7.95\%
\]
WACC Calculation in Project Finance

- In project finance, debt-to-equity ratio changes over time, so textbook WACC formula cannot be applied.
- WACC can be calculated by determining the internal rate of return (IRR) of all financing cash flows, i.e., the Project IRR:
  - Debt drawdown & debt service
  - Equity investment & dividend payments
  - Reserve movements
Project Internal Rate of Return

- Project IRR is the discount rate at which the NPV of financing cash flows is zero
- Solve for $r$ in the formula:

$$\sum \frac{R_i - I_i - C_i}{1 + r} = 0$$

Where

- $R_i = \text{Revenues}$
- $I_i = \text{Investments}$
- $C_i = \text{Operating costs}$
Test Your Knowledge

True or False

- A higher required minimum DSCR will allow a project to obtain a higher amount of debt
Questions?

Submit a question using the chat box
Part 5

Financial Models
Financial Calculations

**Funding/financing sources**
- Equity & debt
- Subsidies/Agency budget
- Toll revenues

**Uses of funds**
- Capital expenses
- Operating expenses
- Debt service
- Tax & dividends

P3-VALUE 2.0 Financial Model

- Capacity of project revenues to repay debt
- Capacity to attract equity
- Required public subsidy payments
Discounting of Cash Flows

- Converts future costs and revenues to “present value” terms
- Discount rate reflects risk and the time value of money

\[ PV = \sum_{0}^{n} \frac{CF_n}{(1+r)^n} \]

Where
- \( PV = \) Present Value
- \( CF_n = \) Cash Flow in year \( n \)
- \( r = \) discount rate
- \( n = \) year
Effects of Discounting

- Cash flows later in a concession period will have a relatively lower impact.
- In the example depicted below, the nominal and present value of the cost cash flows in year 2020 are:
  - Nominal value: $472M
  - Present value: $370M
Use of Financial Modeling

Project Development
• Determine financial viability
• Assess P3 Value for Money

Bid Preparation
• RFP designed to ensure project can be successfully tendered
• Bidders test potential financial structures
• Bid evaluation by public agency
Use of Financial Modeling

Commercial & Financial Close
- Due diligence by Lenders
- Term negotiations

Concession Period
- Monitoring project performance
- Calculate compensation payments
- Calculate any refinancing gains
- Revenue sharing
- Handback
Test Your Knowledge

True or False

- Using a high discount rate with a stream of future cash flows will result in a lower NPV
Questions?

Submit a question using the chat box
Part 6

Using P3-VALUE for Financial Viability Assessment
Training Modules

Value for Money Analysis

Risk Assessment

Project Delivery Benefit-Cost Analysis

Financial Viability Assessment
Training Navigator User Interface

Training Module selection

Input sheet selection

Output sheet selection
Demonstration of Financial Module

Please stand by as we open the Excel file
Tool and References

- P3-VALUE 2.0 Excel Spreadsheet
- User Guide
- P3 Project Financing Guidebook
Questions?

Submit a question using the chat box
Webinar Summary
## Webinar Recap

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Resources

FHWA’s Office of Innovative Program Delivery Website:
http://www.fhwa.dot.gov/ipd/

P3 Website:
Financial Assessment Exercise

- Exercise instructions may be downloaded from the web room

- Technical assistance options:
  - E-mail questions to: patrick.decorla-souza@dot.gov
  - Or call (202)-366-4076
  - Participate in “Exercise Review” webinar

- Exercise review webinar – March 28 at 12:30pm EST

To access the Exercise Review webinar, please use the following link and telephone number:

Link: https://connectdot.connectsolutions.com/p3
Telephone: 1-888-363-4749, Passcode: 6139168#
Contact Information

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