Alternative PFI-style

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Securitisation and PFI are not seen as types of deal that go together. While one could possibly envisage a PFI sponsor contemplating securitising a portfolio of PFI completed project assets in order to recoup some of its investment early, the ?true sale? element of a securitisation, whereby the originator's assets would have to be sold to a new SPV, might cause such a structure to be rejected by the Authority concerned. This would be quite apart from the question of whether the operating businesses comprised in a portfolio of PFI assets, once any construction had been completed, would provide the certainty of cashflow required for by the rating agencies for securitisation.

?Whole Business Securitisation? adopts a different structure in that it avoids a sale of the originator's assets and substitutes a secured loan type of structure. This involves an SPV bond issuer issuing bonds and lending the proceeds of the issue to the originator, which remains as the company which operates the businesses in question. The on-lending is secured by security granted by the originator and would require in England and Wales a fixed and floating charge; this security would allow the bond issuer, or in practice the security trustee, to appoint an administrative receiver over the secured assets. The idea of this type of securitisation is that upon a default by the originator the operating businesses would continue to be operated by an administrative receiver with a view to repaying the debt over its scheduled term.

This type of securitisation requires stable operating businesses and examples of these which have been securitised in this way include residential care homes. One could imagine therefore some PFI assets being capable of providing the same stability of cashflow. The covenant structure to be imposed on the originator would not be unlike that required for a normal PFI transaction and the structure also has the advantage of using familiar techniques such as a secured loan and keeping the more esoteric aspects like offshore bond issuers at one remove from the operating end of the transaction.

Doubts remain nonetheless in the author's mind as to how acceptable an Authority might find it to have the service provided by an administrative receiver, although one acknowledges that in practice such a function would have to be discharged by some sort of replacement operating company and that, in any case, the direct agreement with the Authority would set out the Authority's criteria in this regard.

Structured Corporates/ Hybrid Structures

The American power market has produced this type of financing structure recently in which an SPV is established by the sponsor to build or acquire assets and the financing is limited recourse; where the SPV is constructing an asset, the parent sponsor may provide a completion guarantee. While this technique has been used for single assets, more frequently it has been used to finance a portfolio of assets, so called ?Corporate GenCos?.

The interesting feature of the Corporate GenCos is that the financing is generally unsecured and permits changes to be made to the portfolio and may also allow the relaxation of the normally strict covenants for limited recourse project financing. While in the case of the Corporate GenCos flexibility has been required for merchant power assets, in domestic PFI negative covenants which restrict changes to services or the project facilities, change of control and distributions to sponsor-shareholders are all wont to cause sponsors difficulties from time to time and to the extent such difficulties can be avoided or mitigated the better.

The drawback of such ?structured corporate? transactions appears to be that lenders to them require a greater proportion of equity and this would be particularly significant for the domestic PFI market, where typical debt to equity ratios are relatively high. Nevertheless, such ratios do reflect the strength of the authority covenant and to that extent the ratio in a domestic structured corporate could should be lower than in the case of the American power market.

One of the features which is worthy of note is the general absence of security, which of course is normally taken, in the project finance context, as a means for the lenders to protect the project assets from other creditors of the project company. Even coupled with a negative pledge, it is difficult to imagine there being no project security, even with a portfolio of project assets, and one suspects therefore that there might be a floating charge over the portfolio and a share pledge over the shares in the SPV holder of the asset portfolio. These arrangements would allow the funders to take over the portfolio upon a default, but would not provide the same degree of protection against third party creditors that fixed security would confer. However, this would allow the sponsors to deal with the portfolio more flexibly.

It would be important with such a structure to fix financial ratios for the portfolio at a level which would give the funders adequate assurance as to the portfolio cashflows from the operating assets.

Apart from the flexibility which a ?structured corporate? facility might provide for sponsors, it could also help them fund groups of small projects more efficiently. Size can be a problem in domestic PFI projects, which do not always demand a service level sufficient to warrant the cost of the project and may, in some areas, prove to be an issue as PFI advances and project-finances all of the larger deals in a particular category.

Leasing

Although this structure is still used in project finance, for example, by the train-leasing companies, this aspect of the domestic project finance market has been dampened by, for instance, the restrictions which the 1996 Finance Act has imposed on leasing companies taking the benefit of capital allowances.

That said, leasing is a technique worth bearing in mind in particular circumstances. Apart from the circumstances where its use is relatively well known: to take the benefit of ?double-dipping?, itself currently a bone of contention with the Revenue, and to take advantage of lessees without taxable profits, it is possible to envisage leasing being used for projects which involve the supply and maintenance of equipment more than the provision of soft services. A particular feature of a lease is the manner in which payments are linked to the asset in question. In the context, perhaps, of a project without an SPV which consists of the supply and maintenance of several pieces of equipment by different suppliers, where provision of termination payments, for example, to each of the suppliers would not be practicable, leasing of the equipment might be an alternative.

Another example might be where, for some reason, perhaps because an existing project is already operating and an extension to the project is proposed, it was desired to arrange new finance without it impacting on the existing arrangements. In such a case, other things being equal, leasing might be an option. For this, though, the asset being supplied might have to have a significant re-sale value.

Outsourcing

Outsourcing, whereby non-core services are provided by a specialist service provider leaving the client to concentrate on its core business, is another structure already known to domestic project finance; indeed, in certain respects it can be compared to the FM element of a normal PFI structure. It has had a clear application to the provision of IT and other services which require a deal of highly-specialist input and a rapidly-evolving specification.

Outsourcing agreements provide for the transfer of risk to the service provider without the complexity of documentation that a normal PFI project finance transaction would require, although if the service provider wishes to finance the Agreement on a limited recourse basis there would need to be additional financing arrangements, perhaps by means of a lease, behind the outsourcing agreement itself.

Administratively, an outsourcing arrangement does necessitate regular involvement by the Authority letting the contract, which may not be desired by it to the extent that it wishes to concentrate on its core function, but on the other hand it does offer the possibility of greater flexibility in the provision of services than in the normal PFI project agreement.

Conclusion

Given the UK Government's commitment to PFI/PPP, it may be worth bearing in mind options, such as those presented above, as the market is bound to evolve and require, in the future, ways of packaging projects or accessing new sources of funding.

Further, certain of the above options involving structured financing and lighter security requirements may prove to be of assistance in the export of PFI/PPP to foreign jurisdictions where the cost or difficulty of granting comprehensive security can pose greater problems than in the UK.

For the moment, it is interesting to see how innovation is occurring within the existing parameters of PFI project finance, examples being outsourcing and the increased commitment by lenders of equity funds.