

Infrastructure Primer 1 – Characteristics and Structural Arrangements



What is Infrastructure?

Infrastructure investments are generally defined as investments in assets that provide essential services to society. Infrastructure investments fall into different sectors with different risks/returns associated with them and are broadly categorised between social and economic infrastructure (see below). In addition, the infrastructure asset class can be further segmented between primary (capital growth) and secondary (operational and yielding) assets. A subset of economic infrastructure is renewable energy infrastructure projects, wherein the revenue stream is a function of the electricity generated and the tariff/contractual payment regime. This subset is out of scope for the purposes of HICL's Acquisition Strategy.

(e.g. by teachers and pupils at a school, or by doctors, nurses and patients at a hospital). Assets in this subsector include education, health care, prisons, court houses, public sector buildings and public order training facilities. It can also include transportation assets where the revenue is paid by the procuring Client.

Economic infrastructure

Economic infrastructure supports economic development and commerce as well as the movement of goods and people. It includes transportation assets, transmission assets, and regulated utilities. Transportation assets include toll transport links (roads, bridges, tunnels), seaports, airports, heavy and light railways and bulk transport terminals. Regulated utilities include electricity generation, electricity/gas transmission, electricity/gas distribution, water and waste water utilities and water and waste water treatment. Usually a long term concession is let, but equally the asset can also be sold outright through privatisation. End-user payments finance the ongoing operations, maintenance and capital/acquisition costs of the assets. Transmission assets include electricity distribution cables and networks, and oil and gas pipelines and storage. Other broader examples of economic infrastructure include communications infrastructure (fixed line networks, mobile towers, satellite systems, broadcast facilities and cable networks), ferries, merchant power generation, energy trading, car parks, and motorway service stations.

Renewable energy projects

Substantial political, economic, social and environ-

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Social infrastructure

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mental drivers have emerged that underpin the commercial investment opportunity in renewable energy infrastructure. These include increasing concern about sources of energy supply and energy security, scarcity of key natural resources, and climate change, leading to a drive towards a lower carbon economy. Examples of renewable energy infrastructure projects include solar electricity generation, wind farms and hydro-electric power schemes. These projects tend to have revenues either based on agreed feed-in tariffs or other contractual mechanisms to ensure that, provided electricity is generated, the revenue earned is known. Properly structured renewable energy projects can produce long-term stable investment cash flows in a similar way to economic infrastructure assets.

Infrastructure Project Companies

In an infrastructure project, a private sector consortium (usually comprising a construction company, an operator and financial investor(s)) will form a new, and therefore 'clean', special purpose company ('Project Company') which bids for a concession contract from a procuring Client, typically in the public sector. If successful in its bid, the Project Company is appointed by the Client to be responsible for the financing and construction of an infrastructure asset such as a hospital, school or transport link, and that asset's long-term maintenance and operation in accordance with agreed service standards. The operational services for which the Project Company is responsible are typically low technology, such as cleaning, catering, maintenance, operation and security. Core 'delivery' services such as teaching or medical care are typically retained by the public sector Client,

rather than being provided by the private sector.

Although the Project Company is responsible for construction, it does not usually have full ownership rights over the asset (as some rights are retained by the procuring Client). The Project Company does, however, have various valuable rights under the long-term concession contract, including principally the right to receive the revenue represented by that contract, subject to performance of its obligations and/or proper provision of the required services.

At the outset of the project's life, during the initial process to win the Client's tender, the Project Company generally subcontracts the majority of its obligations to third parties, often for the duration of the concession. The Project Company seeks to pass on to those third parties the various risks associated with providing the construction and operational services, subject to appropriate liability and indemnity provisions in the subcontracts. In some instances, the Project Company may perform the operation and maintenance of the asset itself.

The Project Company funds the initial project costs, including the cost of the construction of the asset, through a mixture of: (i) long-term senior debt contributed by banks or through the issue of bonds; and (ii) 'Infrastructure Equity' (meaning the subordinated debt (or the entitlement to acquire subordinated debt) and equity of a Project Company) which is contributed by the financial investors and other consortium members participating in the Project Company. From time to time, the public sector Client may also provide some of the funding itself or contribute a subsidy to the capital cost.

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In the case of public sector concessions, the projects are able to support significant leverage. The long-term senior debt typically constitutes between 70-90 per cent. of the relevant Project Company’s initial funding, with the balance being provided by Infrastructure Equity.

This level of senior debt is generally available because the Project Company’s income stream is payable by public sector or equivalent bodies with low counterparty risk, and because the Project

Company has contractually allocated a number of key risks to subcontractors who have sufficient financial resources and experience to bear those risks. The senior debt is secured, inter alia, on the assets of the Project Company (including the concession contract, but generally excluding any land, structures or buildings).

A typical social infrastructure project structure, showing the various stakeholders to the project and the Project Company, is shown below.

