FINANCING INFRASTRUCTURE IS ALL ABOUT BALANCING FOUR POINTS

(1) Social/ Economic/ Public Needs
- Measured by Net Economic Benefits such as NPV

(2) Customer Needs
- Measured by Cost of Service vs Willingness to pay

(3) Equity Needs
- Measured by Payback & ROE likelihood

(4) Lender Needs
- Measured by DSCR likelihood
WHAT AFFECTS THE LIKELIHOOD OF LENDERS & INVESTORS ACHIEVING THEIR NEEDS?

1. Commercial Risks – Normally covered by parties concerned
   - Contractor fails to complete project on time, to budget or specification
   - Operator fails to operate and maintain project well
   - Supplier fails to deliver

2. Natural Event Risks – Normally covered by insurance
   - Flooding
   - Seismic events
   - Storm

3. Public Sector Performance – Normally covered by an acceptable public entity
   - Change in policy or law
   - Failure of a governmental entity to supply
   - Non payment by a governmental entity

It is in the area of public sector performance where Guarantees Are focused.
THE KEY DIFFERENCE BETWEEN GUARANTEES & INSURANCE

1. Guarantees - A formal pledge to:
   ✓ Pay or perform…
   ✓ Another person's obligation…
   ✓ In the case of their default.

2. Insurance – Where a persons agrees:
   ✓ For consideration…
   ✓ To pay a certain amount…
   ✓ On the occurrence of a specified event.

Guarantors usually have a direct interest in the performance of the other person.

A Guarantor has a shared interest in minimizing the likelihood of their default.

An insurer focusses on understanding the likelihood of the specified event occurring, pricing the risk and charging an appropriate premium.
WHY GUARANTEES ARE NEEDED IN INFRASTRUCTURE

1. Uncertainty needs to be converted into risk
   - The outcome of a situation is completely unknown
   - Probability can’t be assigned to uncertainty
   - The market cannot price uncertainty

2. Risk can be priced and managed
   - Through risk identification
   - Allocation of risks to contractual parties
   - By structuring and designing risk management

3. Not all risks can be allocated or structured
   - Introduces a concept of “residual risk”
   - Residual risks require coverage with risk mitigation instruments
   - Most residual risks relate to government performance
   - Backstopping of government performance can help a project become bankable or achieve an acceptable cost of service
GUARANTORS NEED TO BE INVESTMENT GRADE OR HIGHER

S&P Credit Rating Scale

CCC (Weakest)

BBB (Investment Grade)

AAA (Strongest)

Scenario A
Municipality unlikely to need a Guarantor for Bankability. Guarantee Could reduce financing costs.

Scenario B
Municipality likely to need a Sovereign Guarantee for Bankability & Reducing financing costs. World Bank support could Reduce costs further.

Scenario C
Municipality likely to need a World Bank Guarantee for Bankability & Reducing financing costs.
SECTION 2:
GUARANTEE TYPES
WHAT TYPE OF GUARANTEES DOES THE WORLD BANK OFFER?

**Guarantee Program**

- **Project-Based Guarantees**
  - For private projects, SOEs and Municipalities

- **Policy-Based Guarantees**
  - For governments

**Bond/loan guarantees**
- Guarantees on loan related obligations for public or private projects

**Payment guarantees**
- Guarantees on non-loan related Government/SOE payment obligations for private projects

**Commercial bank**
- Bond/loan guarantees
  - Guarantee supports a WB Member Country’s program to promote growth and reduce poverty
Typical World Bank Coverage

Non-Loan related payment obligations *(PPA, GSA, etc.)*
3 – 12 months of payment obligation
*Examples:* Zambia Solar IPP (6 months), Azura IPP in Nigeria, Sankofa Gas in Ghana (12 months)

Letters of credit backstopping non-loan related payment obligations
100% of principal amount + 100% of accrued interest

Capital market transactions (bonds)
Amount equivalent to 40% of principal amount
*Examples:* Ghana 2030, $1,000m bond ($400 million first loss guarantee)

Commercial loans
Amount equivalent to 40-60% of principal amount
*Examples:* Pakistan $700m sovereign loan ($420m guarantee), KPLC $500m refinancing ($210 million guarantee)

Project loans
100% of principal amount + 100% of accrued interest on a partial amount of financing
Key takeaways

- World Bank guarantees can protect lenders against the risk of an event of default
- World Bank guarantees are always partial ➔ no 100% cover
- Variety of structures can be contemplated ➔ highly flexible instrument
- Key benefits of using a World Bank guarantee:
  - Access to larger pool of investors/banks
  - Tenor extension
  - Larger volume
  - Lower interest rates/coupon payment

World Bank provides credit enhancement to public borrowers
MECHANICS OF PARTIAL BOND/LOAN GUARANTEE TO A SOVEREIGN OR SUB-SOVEREIGN

1. Event of default on a covered debt service payment
2. Notice sent to the World Bank
3. World Bank pays the lenders/bond investors
4. World Bank seeks repayment under the Indemnity Agreement with the National Government
5. World Bank exercises its subrogation rights* 

(*) to the extent it has not been reimbursed under the Indemnity Agreement
CONTRACTUAL STRUCTURE OF A LOAN GUARANTEE TO A PRIVATE PROJECT

Key takeaways

- Guarantee covers loan repayment by project company
- World Bank guarantee cover events of default triggered by the action or inaction of the Sovereign/Sub-Sovereign
- Ensures long term presence of the World Bank in the project
- Improved financing terms enable project company to offer more competitive tariffs

Loan guarantees to projects enable long term financing at competitive terms
MECHANICS OF A LOAN GUARANTEE TO A PRIVATE PROJECT

1. Event of default resulting from action or inaction of the Government/SOE

2. Notice sent to the World Bank

3. World Bank pays the commercial lender(s)

4. World Bank discusses repayment options under the Indemnity Agreement with the Government

5. World Bank exercises its subrogation rights*

(*) to the extent it has not been reimbursed under the Indemnity Agreement
PAYMENT GUARANTEES
WITH A LETTER OF CREDIT
CONTRACTUAL STRUCTURE OF PAYMENT GUARANTEE WITH A LETTER OF CREDIT

Key takeaways

- Guarantee covers Letter of Credit (L/C) providing liquidity support to mitigate the public offtaker payment risk.
- Each drawdown on the L/C is converted into a 12-month loan to the SOE/ Municipality.
- Upon drawdown on the L/C by SPV, SOE/ Municipality and/or government has an obligation to repay the L/C Bank.
- If the SOE/ Municipality and/or the government fail to repay the L/C Bank, the World Bank steps in and reimburses the L/C Bank.

The L/C Bank is ultimately only facing the World Bank counterparty risk.
MECHANICS OF A WORLD BANK PAYMENT GUARANTEE WITH A LETTER OF CREDIT

1. Obligor does not pay on time its bill to the project company.

2. Project company draws on a standby Letter of Credit (L/C).

3. L/C Drawdown converted into X-month loan to SOE/Municipality.

4a. SOE/Muni repays within X months? Yes ✔

4b. Government repays loan? (L/C replenished) ✔

4c. Commercial bank not repaid within X months ✔ Notice sent to World Bank for repayment.

5. World Bank pays the commercial bank (L/C not replenished).

6. World Bank seeks repayment under the Indemnity Agreement with the National Government.
CONTRACTUAL STRUCTURE OF A DIRECT PAYMENT GUARANTEE

Key takeaways

- Guarantee covers contractual payment obligations from the Government or Government entity to the contractor
- The Guarantee can be provided for the entire length of the contract on a rolling basis
- In the instance of a missed payment, the contractor will call on the World Bank Guarantee, which will trigger the Indemnity Agreement
MECHANICS OF A DIRECT WORLD BANK PAYMENT GUARANTEE

1. Government does not pay contractor on time
2. Project company draws on World Bank Payment Guarantee
3. World Bank pays the project company
4. World Bank discusses repayment options under the Indemnity Agreement with Government
SECTION 3: WRAP UP
GEOGRAPHIC SPREAD OF GUARANTEES

- 74 operations
- 43 countries
CALL TO ACTION: MANY SECTORS SUPPORTED BUT NOT CITIES (YET...)

World Bank guarantees can be applied to a variety of sectors and at the project, sub-sovereign or sovereign level.

- Power Sector
- Transport
- Extractives
- Water
- Sovereign & Sub-Sovereign financing
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