

FINANCING LARGE INFRASTRUCTURE PROJECTS



The building of large infrastructure projects has been neglected over the last quarter of a century. Many of these needed projects have not been implemented because necessary capital funds have not been available to either the governmental or commercial entities that would benefit from these projects. The process of financing these projects appears to be complex to the uninitiated but the concepts involved are not near as complex as they appear. This article will attempt to explain the basics of the process and provide a few examples of projects which were financed which offer improved infrastructure and save money for the user of the project.

The major parties involved in financing the building of large infrastructure projects are the end user which will receive the benefits of the project, the contractor which will implement the project and Hannon Armstrong, the financing company, which will finance the project. Initially the end user and contractor must design and engineer a project that saves money and will provide benefits that the end user will be willing to make payments that will repay the costs of the project over time. The financing company provides the funds necessary to implement the project and will expect to be repaid over time once the project is completed. It is serious matter to emphasize the importance of the contractor and end-user in the design and engineering of a project. A poorly designed or engineered project will be difficult to finance.

The basics of financing any project is that there is an agreement between the end user and the contractor to implement the project and that there are agreements with the financing company to provide the long term financing for the project. The same agreement may provide the terms of payment by the end-user or there may be a separate agreement between the end-user and the contractor or the financing company regarding payment for the costs of the project.

The implementation of these projects can take up to 24 months from initial contract award to acceptance of the asset. During the implementation of the project, the financing company will require that the contractor be liable for the repayment of all amounts advanced, interest thereon and associated costs of the financing company. After acceptance of the project, the liability for

payment will shift to the end-user. Therefore, it will be important to the financing company that the contractor and the end-user be credit worthy. Since the cost of most projects is substantial, the financing company will require that the contractor and the end-user are investment grade credits. In most cases, the end-user and the financing company will require the contractor to post a construction bond during the implementation of the project assuring the timely completion of the project. The financing company often will require the contractor, during the implementation of the project, and the end-user, during the payment term for the project, to obtain insurance on the physical property delivered in connection with the project with respect to the loss or damage to such property during the implementation of the project and term. Certain entities which have substantial credit worthiness such as the federal government will be permitted to self insure, but in any event will be required to indemnify the financing company for any loss or damage to the property.

The financing company will be very concerned that the other parties have authority to enter into each contract or lease. The financing party may require certified board approvals, legal opinions and other documents to evidence the authority of each entity to enter into each agreement to which it is a party. In cases in which the end-user is a governmental entity, it is common that the end-user will not have the authority to enter into an agreement in which the term for implementation and payment for a long term will not be permitted by law. In those cases, the agreements with the end-user can be structured so that the agreement is for a permitted term with options to renew or for the entire term with rights of

cancellation or termination. In such cases the financing company will be concerned with the use for the project and will require evidence that the project is essential to the performance of vital governmental needs such that the governmental entity cannot effectively operate without the benefits of the project. It is advisable that the contractor and end-user have their attorneys, experienced in financing projects, involved in the development of the project to avoid misunderstanding late in the discussions.

The financing company will also be very concerned that the project be completed in a timely manner. The agreement between the contractor and the end-user will require the parties to cooperate to implement the project. The agreement between the contractor and the financing company will require the contractor to indemnify the financing company for late acceptance. Late acceptance may also result in a claim against the end-user for those costs incurred by the contractor as a result of failure by the end-user to perform its obligations which result in late acceptance.

The usual payment structure under any type of agreement will require the end-user to make payments at specified intervals (monthly, quarterly, or annually) over a fixed term. Often, there are provisions that require the end-user or give it the option to prepay future payments and cancel or terminate the agreement. The required prepayment or termination payment must compensate the financing company for its investment in the projects and associated costs. The financing company will require that the payments payable by the end-user be paid to the financing company whether by assignment under the agreement between

the contractor and end-user or under the contractor or under an agreement between the end-user and the financing company. The financing company will also want the payments to be further assignable to another financing institution. It is standard for financing companies to assign payments among themselves to change the risk structures of their respective portfolios. Any one who has entered into a home mortgage should be familiar with this concept.

The agreements among the parties will also have numerous other provisions. Examples are provisions regarding which party is responsible for taxes, permits and licenses required for implementation of the projects, whether the contractor, end-user or financing company has title to or a security interest in the physical property and when title transfers or the security interest terminates, whether the contractor or the end-user is responsible for the ongoing operation and maintenance of the physical property delivered in connection with the project, whether a reserve fund is established to assure payment of any future costs or whether the financing company may assume certain obligations and avoid termination of any agreement upon default of the contractor.

There will also be a number of general provisions that are common to agreements. There will be provisions that what law governs the transaction, whether the parties waives any rights to a jury trial, etc. These provisions will be familiar to each party's attorneys.

As stated earlier, this article will discuss certain examples of project financing. One project involved the financing of a Fiber Optic

System for the US Army base on Kwajalein Atoll (USAKA). USAKA is home to the Reagan Ballistic Missile Defense Test Site, which plays a critical role in the research, development, test and evaluation of the United States' missile defense and space programs. USAKA communications are satellite-based, which is costly and allows limited bandwidth. As a result, Space Missile Defense Command (SMDC) has to maintain a number of expensive contractors at USAKA that could otherwise perform their functions remotely from SMDC's Huntsville headquarters. The financing company, Hannon Armstrong, owns and financed the 2,900 km fiber optic system, connecting to Guam, for further connection to Huntsville. USAKA will be able to significantly lower costs in the Pacific by moving skilled jobs back to the US and accelerate information flows through the secure fiber optic system.

Another example is a project which involved the financing of a fiber optic system for the Norwegian Space Center through intergovernmental agreements that were with National Aeronautics and Space Administration ("NASA"), the National Oceanic and Atmospheric Administration ("NOAA") and the U.S. Air Force ("USAF") in the Arctic Circle. Critical environmental data is only available 24 hours a day from an observatory in Norway, in the Arctic Circle. NASA, NOAA and the USAF needed a fiber optic line to ensure fast and reliable transmission of the data, but had no funding. Hannon Armstrong provided the capital required to build the fiber system, taking payment out of reduced satellite transmission fees. The US Government will save over \$140 million in communications cost over the life of the system.

Both project described above were of substantial size and the implementation of the projects provided obstacles to their implementation, but each has provided substantial benefits to the end-user, substantial revenue to the contractors and were financed. Although the documents involved in financing a project of such scope may seem complex to the uninitiated, the basics of the transaction are not that complex. The end-user wants the benefits of the project, the contractor wants to be paid for its work during the implementation of the projects and does not want to be liable after acceptance of the project and the financing company wants to be repaid for financing the project.

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