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Dear colleague

Treasury lending to PFI projects and the Treasury's Infrastructure Finance Unit

This letter provides guidance on the implementation of the statement made on 3 March 2009 by the Chief Secretary to the Treasury that the Treasury will lend to Private Finance Initiative projects that cannot raise sufficient debt finance on acceptable terms. In particular it provides more information on the circumstances in which the Infrastructure Finance Unit that has now been established by the Treasury (TIFU) will consider lending to PFI projects, on how projects can access the Infrastructure Finance Unit and on the nature of loans to be made by the Treasury. It also sets out the Treasury's policy on direct and indirect loans by Departments and other procuring authorities to PFI projects.

Background

Recent difficulties in the financial markets have reduced the availability and increased the pricing of long-term debt finance accessible to PFI projects seeking to reach financial close. The current absence of capital market funding and the reduced number of active bank lenders to the PFI market mean that, in the Treasury's view, it is unlikely that private sector lending will be sufficient to deliver the scheduled pipeline of projects even taking account of increased lending activity by the EIB.

Objectives

As set out in the Chief Secretary's statement, the Government's primary objective in lending to PFI projects is to ensure that infrastructure projects go forward as planned despite financial market conditions and thereby support jobs and the economy.

The Treasury's intention is to supplement bank/capital market funding, where it is available on acceptable terms, not to replace it. The Treasury expects the private sector, together with the EIB, to provide the majority of debt finance for PFI transactions, but it is able to provide 100% of the senior debt finance required by a PFI project where necessary.



Treasury lending is intended to be temporary and reversible. It is therefore expected to cease when market lending capacity is adequate to meet PFI demand, and the Treasury's loans will be sold to the private sector in due course.

Treasury lending is also intended to provide a centralised, cross-departmental, approach to public sector credit provision to PFI projects, so that a consistent approach to the financial markets is achieved and the public sector collectively achieves acceptable co-financing terms.

The Infrastructure Finance Unit

The Treasury has established TIFU, headed by Andy Rose, to consider applications for Treasury loans to PFI projects, negotiate the terms of any such loans and monitor and manage loans once made. TIFU will operate at arm's length from procuring authorities and will be staffed by appropriate project finance professionals employed by Treasury. TIFU is establishing credit approval and loan monitoring processes comparable to those operated by commercial banks.

Eligibility

All PFI projects that have, by 3 March 2009, issued a notice in the Official Journal of the European Union (OJEU) or an equivalent procurement commencement document will be eligible for Treasury loans. PFI projects approved by the Project Review Group that issue an OJEU notice after 3 March 2009 will also be eligible.

Other PFI projects will be eligible provided they meet the usual value for money and affordability criteria and subject to obtaining Treasury approval before issuing their OJEU notice. Treasury approval for such projects should be therefore sought, from the Treasury's Corporate and Private Finance team, in advance of OJEU.

All eligible projects will be included in the Treasury's database of PFI projects, which will be published on the Treasury website in due course. Procuring authorities should reserve flexibility to access public funding when issuing future OJEU notices and other procurement documentation.

Circumstances in which Treasury lending to PFI projects will be considered

The Treasury will consider lending to PFI projects where insufficient private sector or EIB funding is available on acceptable terms to allow the project to reach financial close on a timely basis. In the current market this will generally only become apparent where a post-preferred bidder funding

competition (or equivalent process) has been held and the quantity of committed funding available from the market is not sufficient fully to finance the project.

It is also possible that a project attracts sufficient offers of funding but that some or all of the proposed funding is on terms, or is subject to conditions, that the procuring authority and the project's sponsors believe are not representative of the then current financing market for PFI projects. In those circumstances the procuring authority (and any relevant PFU) will be required to demonstrate to the Treasury's satisfaction that the relevant terms offered to the project are not representative of the terms generally available for PFI transactions in the sector concerned.

The fact that funding offered to a project is on terms which may create affordability difficulties will not, on its own, be grounds for Treasury to consider lending to that project. Authorities should note that the TIFU intends to lend on similar terms to commercial lenders in the market.

TIFU will not participate in funding competitions, act as part of the funding group in book-building exercises or engage in funding discussions with project sponsors before the preferred bidder stage of projects. Additional guidance on the evaluation of incomplete funding solutions prior to preferred bidder selection will be issued in the near future.

Access to TIFU

Where a procuring authority believes it faces circumstances of the sort described above it should first consider, with the relevant PFU/parent department and the project sponsor, whether there are reasonable and timely ways to restructure the project, or the financing arrangements for it, to allow it to attract sufficient private sector or EIB debt fully to fund the project whilst continuing to provide value for money. Options (if not already considered) might include amendments to project scope, the provision of additional equity or subordinated debt finance or accessing EIB lending where available. The Treasury's Corporate and Private Finance team should be made aware of projects in this position as soon as it appears that the project faces the circumstances described above.

If the project is still not able to attract sufficient finance on acceptable terms, the procuring authority and the relevant PFU should discuss with the Treasury's Corporate and Private Finance team the case for involving TIFU. The Treasury will require a short written business case setting out, inter-alia: the structuring and financing options considered by the project before approaching Treasury for a loan and responses to them where they were discussed with the market; the funding process the authority has pursued; where applicable the basis for its view that terms offered to the project are not

representative of the terms generally available for PFI transactions in the sector concerned, together with confirmation of that view from its financial adviser; the nature and causes of the funding gap; and the quantum of funding required.

If the Treasury's Corporate and Private Finance team considers there is a case for Treasury lending to the project concerned, it will invite TIFU to meet the procuring authority to discuss the project and the arrangements for TIFU involvement. This process will be expedited as required to allow transactions to proceed to financial close on a timely basis.

Lending by TIFU

Most Treasury loans will be provided alongside commercial banks, the EIB or capital market lenders on similar terms to those lenders (although Treasury may also provide 100% of the senior debt finance required by a PFI project).

The Treasury will provide long-term loans on either a fixed rate or a floating rate basis, in the latter case subject to hedging arrangements to be entered into either by co-funders or by other swap counterparties as agreed by TIFU and the project. The Treasury will also participate in or provide standard ancillary lending facilities for PFI projects.

Treasury loans will share in security and will rank pari-passu to commercial lenders both pre- and post-enforcement. They will have full, unencumbered, syndication and sale rights in common with other lenders and will be freely pre-payable alongside commercial bank loans as part of a refinancing of projects.

The Treasury expects to agree voting rights consistent with its position as a professional and commercial lender.

Treasury fixed-rate loans will be entitled to receive interest rate break costs on early pre-payment, which will rank alongside commercial swap counterparty break costs.

Refinancing

The syndication or sale of Treasury loans will be treated as any other transfer of PFI debt in the normal course of a bank's operations and therefore will not itself be a Qualifying Refinancing.

The refinancing of any Treasury loan by a Contractor will be treated as any other refinancing with the refinancing provisions of the project agreement applying to any gain.

Direct and indirect lending by Departments and other procuring authorities


Direct and indirect lending to PFI projects involves significant risk and can create conflicts of interest for procuring authorities. Management of these risks requires substantial expertise and resources. In addition, there are strong value for money and efficiency arguments for activities of this sort, in relation to PFI projects, to be carried out centrally through a specialist and appropriately resourced unit rather than at Departmental or procuring authority level.

Consequently, following the 3 March 2009 announcement and the creation of TIFU, the Treasury will consider direct and indirect lending by Departments and other procuring authorities to be novel and contentious and will not generally agree to arrangements under which authorities lend directly to PFI projects or enter into indirect arrangements that expose them to equivalent credit risk (such as through the provision of guarantees for third party lending).

The Treasury is currently considering its policy on authority capital contributions to PFI projects and will issue updated guidance on this shortly if necessary.

If you have any questions on this letter please contact me or your normal liaison point in the Treasury's Corporate and Private Finance team.

Yours sincerely



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