



PROJECT FINANCE ADVISORY

 **ERNST & YOUNG**

Quality In Everything We Do

Private Sector Participation and Investment in Physical Infrastructure

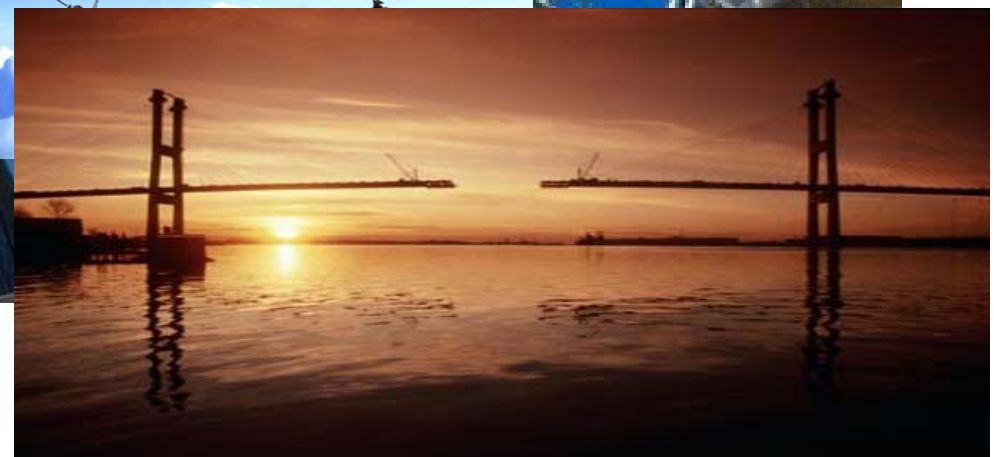
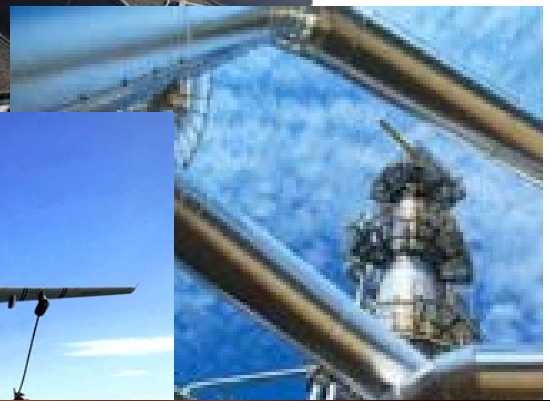
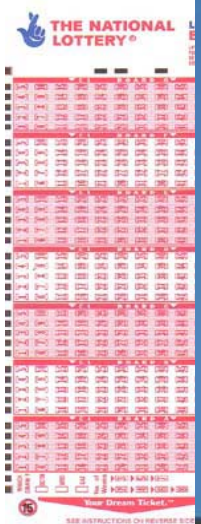
for CAREC, 5-7 March 2008, Tokyo

Bill Banks Ernst & Young

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What does Infrastructure cover?



What are Infrastructure Projects?

INFRASTRUCTURE CATEGORIES

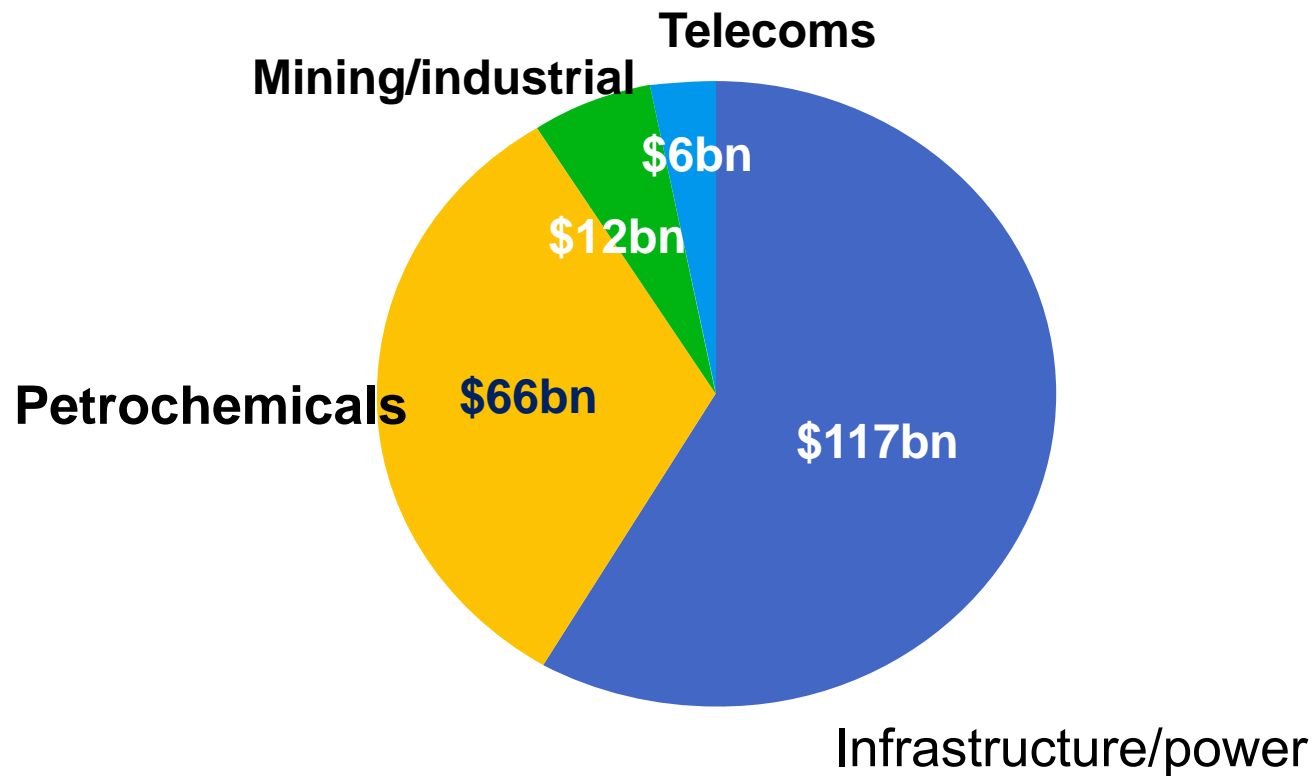
| Economic | | | Social |
|---------------------------|---------------------------------------|--------------------------------------|------------------------------|
| Transport | Energy & Utilities | Communications | |
| Roads | Gas Storage & Distribution | Cable Networks | Universities |
| Highways | Electricity Distribution & Generation | Cell Towers | Schools |
| Freeways | Water Supply & Wastewater Treatment | WiFi | Hospitals & Health Care |
| Toll Roads | Renewable Energy | Satellite, TV, Radio & Other Systems | Prisons |
| Bridges | | | Sports Stadiums & Facilities |
| Tunnels | | | Convention Centers |
| Airports | | | Public Housing |
| Rail Systems | | | Community Facilities |
| Seaports & Shipping | | | |
| Cargo & Logistics Centers | | | |
| Urban Mass Transit | | | |

Global Infrastructures Challenges

- Population growth
- Economic growth
- Increased global competition
- Insufficient or poorly planned public investment in Infrastructure
- Ageing and deteriorating infrastructure
- Increased infrastructure development costs

Global Infrastructure Investment by Sector

2005 – 2006



Investment Opportunity



- Estimate of the global private investment in infrastructure could **exceed a TRILLION dollars annually**
- Across the globe there is a **GROWING FUNDING GAP** between public spending on infrastructure and capital needed to build new infrastructure and modernize existing infrastructure
- Increasingly **governments are turning to private investors** and contractors to share the costs and risks of building, financing and operating infrastructure.
- Private investment in infrastructure is likely to experience the same explosive growth over next 10 years that investment in real estate has experienced over the previous decade.

Government is actively seeking to encourage Private Sector Investment

- Development of policy such as PPP's to facilitate private sector investment
- Use of Sovereign Wealth Funds
- Adaptation of REIT's
- Collaboration between countries to share infrastructure costs

Infrastructure Investors



Investment Banks

- Goldman
- Merrill
- Deutsche
- Morgan Stanley
- Barclays Capital
- HSBC
- ABN
- CBA

Specialist Funds

- Innisfree
- I2
- RREEF
- Galaxy/Ixis
- Benetton
- MENA Infrastructure Fund

Private Equity Funds

- 3i
- CVC
- Carlyle
- Colonial
- KKR
- Blackstone

Other

- Macquarie
- Babcock & Brown
- Qatar Investment Authority
- GIC

Pension Funds

- BT/Hermes
- Borealis
- Teachers

Insurance Companies

- Prudential
- Henderson

Corporates

- Laing
- Carillion
- Balfour Beatty
- Bilfinger & Berger
- Leighton Holdings

Why does the Private Sector Invest in Infrastructure?



- Investors are competing for new opportunities
 - ⊕ Emerging markets such as China, South East Asia, Brazil and India have exploding infrastructure needs.
 - ⊕ In mature markets, new sectors are opening to significant private investment.

- Infrastructure offers stable cash flows and returns
 - ⊕ These are important to pension fund investors, seeking to match income with their pension fund liabilities and providing for retirement for growing numbers of baby boomers.

- Infrastructure offers varying risk profiles
 - ⊕ Infrastructure investments offer opportunities all along the risk spectrum, from greenfield projects in developing nations to mature operating toll roads in developed countries.

A new Player - Sovereign Funds



- Emergence of so called Sovereign Wealth Funds
 - Funds may be a source of infrastructure capital
- | | |
|-------------------------|---------|
| ■ ADIA (UAE) | \$875bn |
| ■ GIC (Singapore) | \$330bn |
| ■ GPF (Norway) | \$324bn |
| ■ Saudi | \$300bn |
| ■ SFIC Hueijing (China) | \$200bn |
| ■ RFFG (Kuwait) | \$167bn |
| ■ Temasek (Singapore) | \$100bn |
| ■ QIA (Qatar) | \$ 40bn |

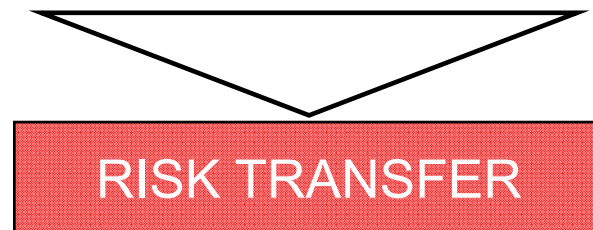
Why do they do it?



Private sector investors now view Infrastructure as an emerging Asset Class

What is PPP?

- Long-term output based contract between the government and borrower
 - for delivering a **specified** asset condition and **service**
 - with appropriate **incentives for performance** over the life of the contract capital costs paid over the **lifetime of the contract**
- Private sector involvement
 - in the design, build and operation of infrastructure projects ... and they take responsibility for **performance**
 - to **decide** what is the most effective **mechanism** for delivering the specified outputs



What is a PPP? (cont'd)



- Private sector financing (both equity and debt)
 - **increased scrutiny** of proposal and contractors ability to deliver
 - **certainty** of financing through **long-dated** funding structures
 - no payment until services delivered to the required standard
 - uses \$ payment structure to incentivise correct behaviour
- Assets revert to government at end of contract
- Contract can terminate for non performance

Key Features of PPP

- Government buys specified output or outcomes of a service – private sector provides necessary inputs required to deliver...
- Creates process that delivers the service required to the necessary standard throughout the lifetime of the project
- Aligns the interest of the user, the service provider and the funder. It is in funders' interest that service is supplied to the agreed standard
- Establishes a relationship between public and private sector based on partnership not confrontation
- Provides the appropriate training, motivation and reward for staff to ensure that quality services are provided on a consistent basis

When might PPPs be suitable



Key Benefits of PPP

- Deliver value for money, through synergies from combining design, construction and operation
- Takes spending out of political cycle; moves away from annual budget considerations
- Creates long-term approach to provision of public services
- Only used where it makes sense
- New facilities provided efficiently and effectively
- Innovation and spread of best practice
- Standards maintained over life of project
- Flexibility of approach to allow consideration for all types of infrastructure

Criticisms of PPP



| Criticism | But ... |
|--|--|
| Public finance is cheaper than private finance | Where is the risk priced? And besides, the gap is increasingly narrowing. |
| Transaction process is long and complex | Deals are now being done in under 18 months |
| Private sector makes super-profits | Bidding competition delivers competitive pricing. Sharing mechanisms provide Government with further upside share. |
| Service providers focus on cost-cutting | Negated by appropriate payment and performance regime |
| PPPs are not flexible | This comes down to partnership. Contracts are being varied and producing satisfactory outcomes. |
| PPP is privatisation by stealth | PPPs involve public sector providing “core” services and private sector providing “non-core” services |

What's in it for Government?

- Pricing and timing certainty
 - **Only 24% of PPPs late** vs 73% for Public projects
 - **Only 22% of PPPs over budget** vs 73% of public projects
 - These risks borne largely by private sector

- Better Services

- Innovation

- Catalyst for Public Sector reform
 - Allows public sector to focus on key activities that are consistent with long term policy priorities.

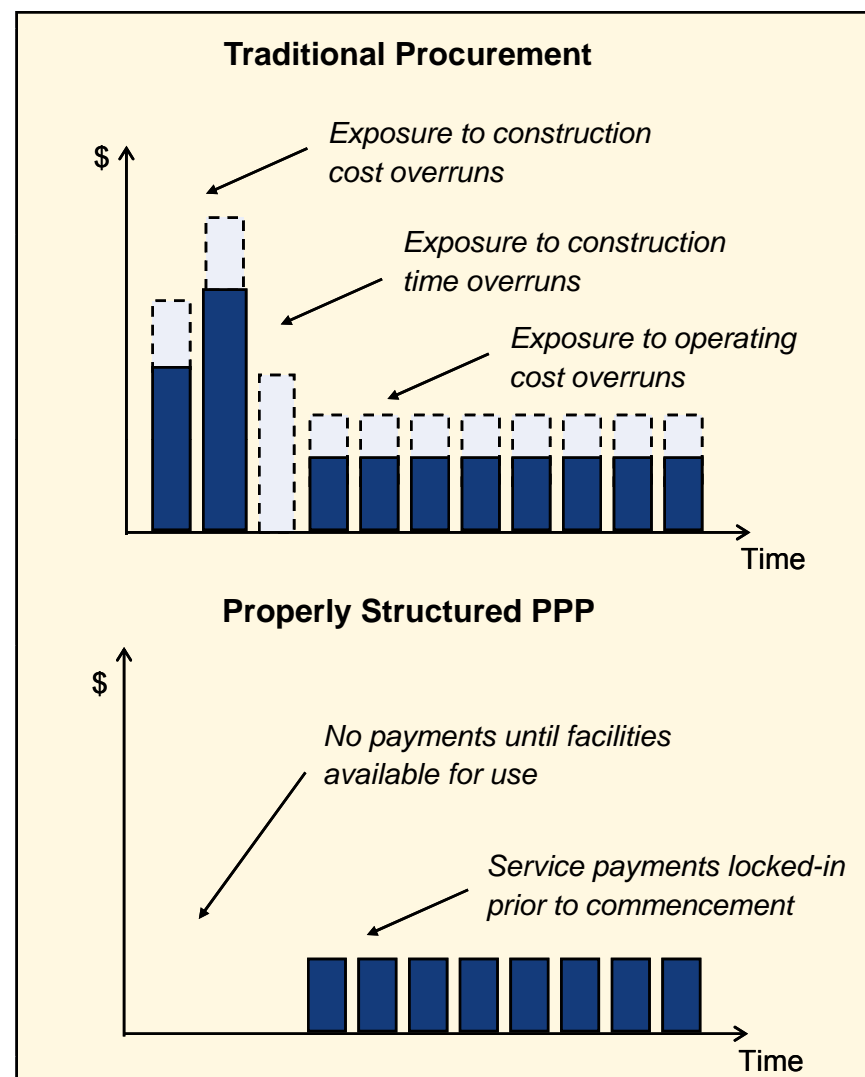
Why Are Governments Turning To PPP ?

Traditional procurement for projects:

- Focused on procurement of assets not services
- Spend depends on budget available
- Assuming risks that may be better handled by private sector

Properly structured, PPPs can:

- Certainty of delivery and budget
- Incentivise whole-life cost approach
- Result in optimal risk allocation
- Incentivise early completion
- Realisation of Government equity
- Discipline offered by private sector financing



Attractions to the Private Sector



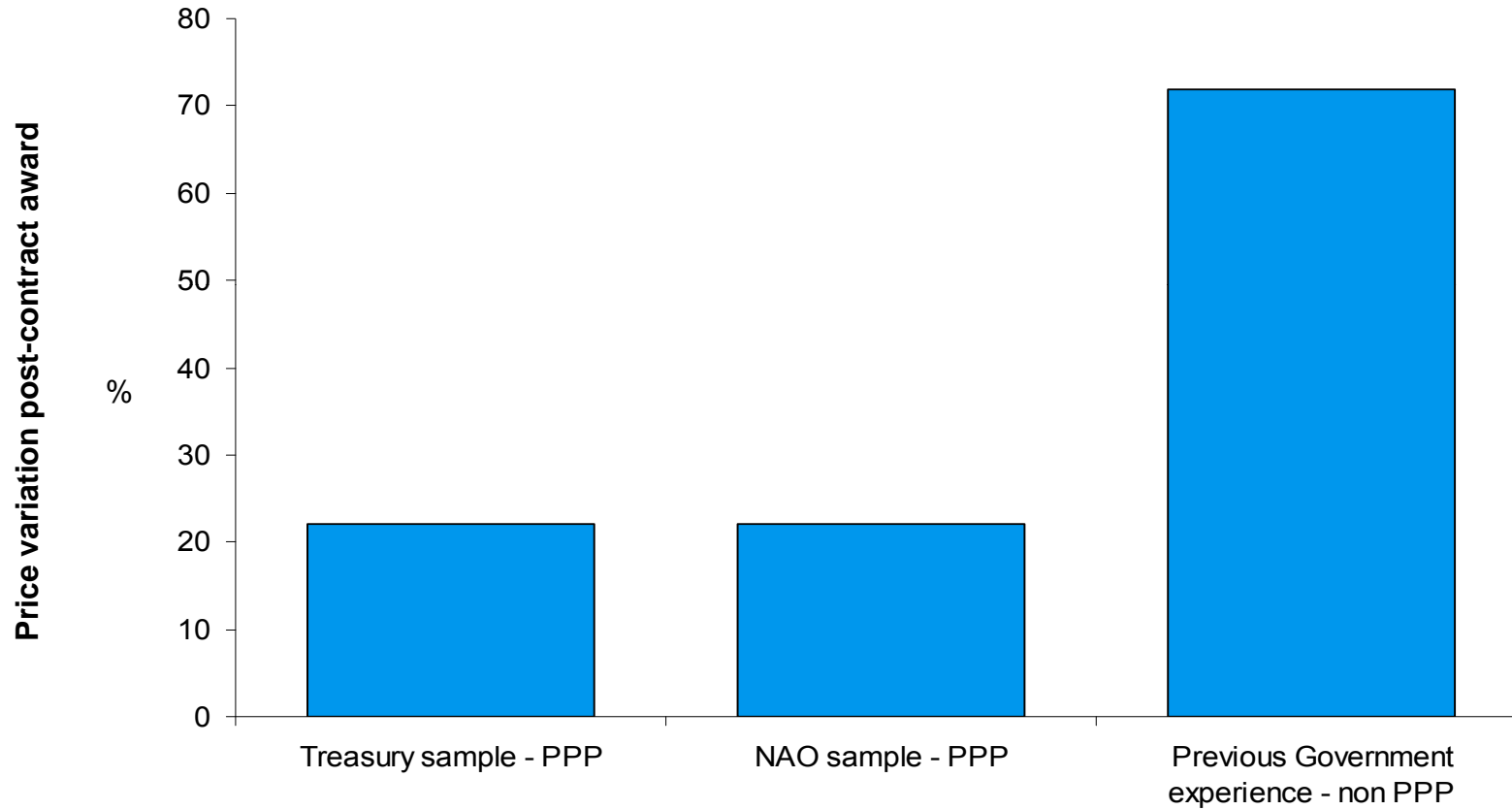
- Long term contracts
- Opportunity to build capability
- Derive value from more income streams
- Build relationship with Government
- Alignment with superannuation investment appetite

Is there the transaction pipeline
to justify an investment ?

How can Private Sector maximise benefits?

- Focus on the **SERVICES** to be provided
- **INNOVATE** – particularly in design and exploiting **SYNERGIES**
- Form **ALLIANCES** not just consortia
- Maintain **COMPETITION**, including the financing

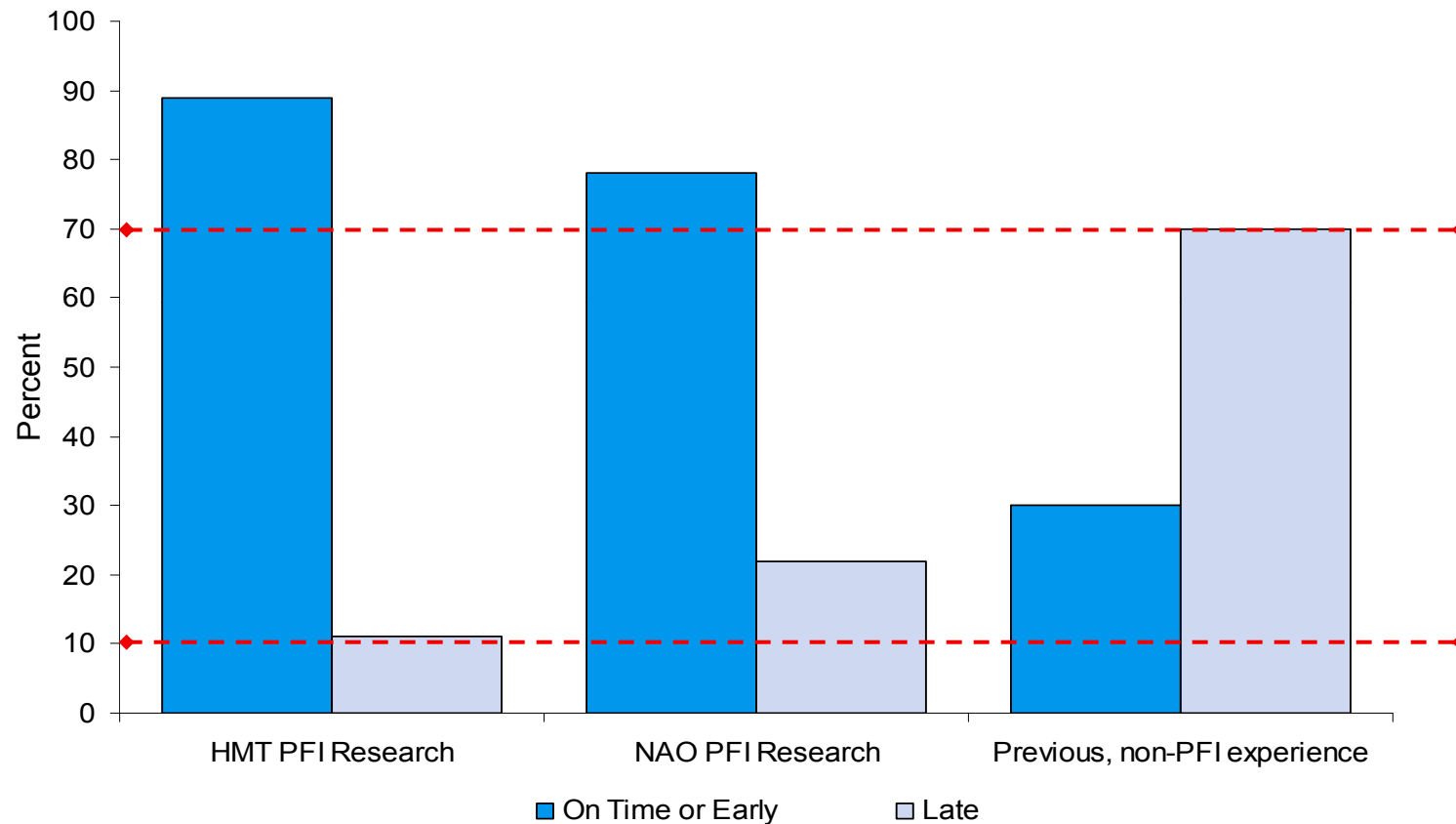
What they do – Delivering to Budget



What they do – Delivering on Time



Percentage of projects in the UK delivered on time or late

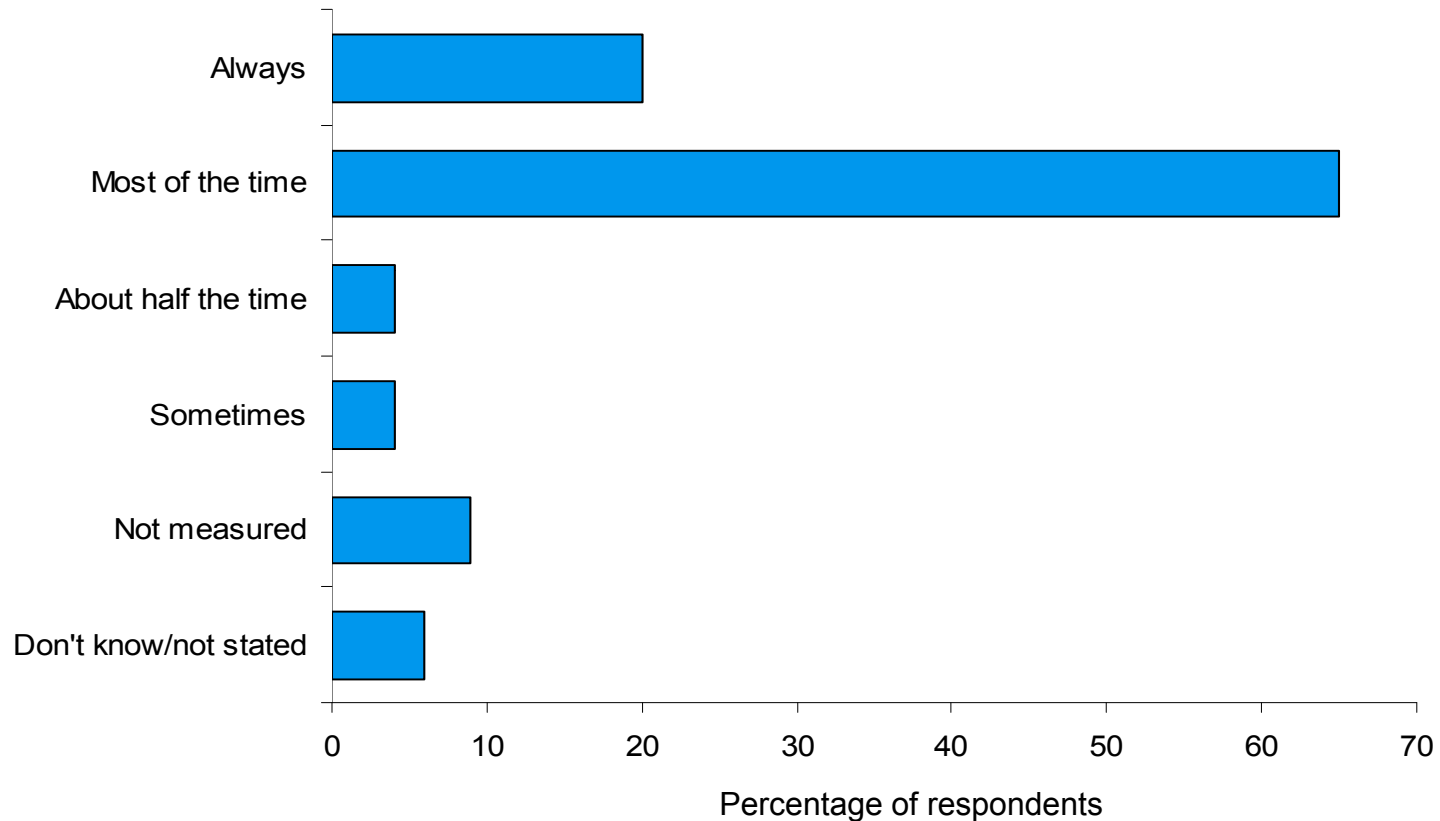


Source: HM Treasury; NAO: PFI Construction Performance 2002 HC 371, Session February 2002-03;
NAO: Modernising Construction, 2001, HC 87, Session 2000-01

What do they do – User Satisfaction



Do end-user satisfaction assessments find that services are being delivered to an acceptable standard?



Source: KPMG/BSA Effectiveness of operational contracts in PFI, 2005

Key Challenges facing PPP

- Does sufficient private sector expertise exist to warrant PPP approach?
- Does the public sector have sufficient capacity and skills to adopt the PPP approach?
- PPPs do not achieve absolute risk transfer....
- PPPs require management control through regulation by public sector
- PPP procurement can be lengthy and costly
- PPPs can be inflexible structures for contracted term

Conclusion



- A PPP can and should be “Win-Win”
- But there are pitfalls
- Governments need to be committed and have perspective
- Private sector need to be committed and selective



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