International Aspects of Private Public Partnership (PPP) Finance

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Need for Sustainable Public Sector Finance

- There is a worldwide need for public-sector project finance, particularly in Asia: infrastructure, healthcare, water, sewage, energy, seaports, airports, railways and roads have to be financed. In order to maintain sustainable public debt levels internationally, tapping private finance sources is essential.
Principle of Private Public Partnership: Alternative to State Budget Funding

- Providing public sector assets or projects as collateral or underlying for private sector funding
- Using the income streams generated by such public sector assets or projects for payments to private sector fund providers
- Avoiding government borrowing and indebtedness by using private sector vehicle companies (SPVs) – „off-budget“ finance.
Private Public Partnership (PPP): A Multi-Billion Business in Europe

Toll Roads: Asfinag (Austria), France, Italy...
Private Public Partnership (PPP): A Multi-Billion Business in Europe

Paris Omnisports Complex
Private Public Partnership (PPP): A Multi-Billion Business in Europe

Paris, Parc du Millénaire
Private Public Partnership (PPP): A Multi-Billion Business in Europe

Hospitals: CHU de Nice

Central Hospital Versailles
Private Public Partnership (PPP): A Multi-Billion Business in Europe

University of Lille
Traditional State Budget Funding

- Direct investment in public-sector assets (real estate, utilities, hospitals, harbours etc.) by authorities / public entities.

  - Finance is provided directly to the respective public entity;
  - As the case may be, enhancement by mortgages / pledges over public-sector assets, or by a superior authority (depending on credit-worthiness and/or rating of the individual entity)
  - Finance may be provided bilaterally (loans) or by tapping the capital markets (bond issue)

Finance provider or investor in capital markets instruments issued by governments

Public Entity Asset owner
Private Public Partnership (PPP): Basic Principles and Structures

◆ Typical Eligible Public Sector Projects
  ➢ Hospitals, railway, roads, ports, airports, energy plants, sewage, water, schools, universities, stadiums and related equipment

◆ Two Alternative Structures
  ➢ **Lease Model:** Acquisition / construction / ownership of public sector assets by special purpose vehicles (SPVs) established under private law. Lease contract between the SPV and government authorities
  ➢ **Franchise Model:** Usufruct for the benefit of special purpose vehicles (SPVs) established under private law re. public sector assets owned by government authorities

◆ Income streams used for payment and repayment
  ➢ Rental income or assignment of government resources or revenues (royalties, franchise, special-purpose taxes, mandatory charges, e.g. healthcare contributions, concession revenues).
Private Public Partnership (PPP): Basic Principles and Structures / Lease Model

Alt. 1: Acquisition / construction / ownership of public sector assets (hospitals, real estate, utilities, railway, harbours etc.) by special purpose vehicles (SPVs) established under private law. Lease contract between the SPV and government authorities. Also possible: sale & lease back structures

- Asset finance enhanced with collateral by public sector entities to improve credit-worthiness and reduce finance costs. Finance can involve loans or issuance of capital market instruments (bonds)

- Assignment or purchase of lease / fee claims against a public-sector entity. Unconditional lease or fee payment would imply the same low risk as direct public-sector finance, enhanced by cash flow generated by public sector assets.

Finance provider or investor in capital market instruments issued by SPV

Private SPV asset owner

Authority

procuring finance

Purchase of lease / fee payment claims guarantee (optional)

Lease / fee
Alt. 2: Usufruct for the benefit of special purpose vehicles (SPVs) established under private law re. public sector assets owned by government authorities

- Franchise contract between SPV and authority
  - SPV operating asset (e.g. road) for public use
  - SPV collecting mandatory charges (e.g. tolls) assigned by authority and using related income streams for payment of funding. Financing can involve loans or issuance of capital market instruments (e.g. bonds)

Finance provider or investor in capital market instruments issued by SPV  \[
\text{finance} \quad \text{Private SPV usufruct beneficiary} \quad \text{Usufruct franchise} \quad \text{Authority asset owner}
\]

Collection of mandatory charges  \[
\text{Procurement of use \\& services}
\]

Public / Users

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Specific Legal Requirements to Ensure Safety and Soundness of Underlying Assets and Revenues

In the field of infrastructure and renewable energy projects, certain specific requirements regarding the validity and enforceability of rights can be identified:

- Clear regulation on ownership of and charges over plants and equipment such as:
  - Electrical power lines, distribution and transformer stations
  - Water and sewage pipes
  - Renewable energy plants such as wind and solar energy including construction on the continental shelf.
  - Introduction of specific public registers might be considered.

- Clear regulation on contracts with public entities, including assignment of and charges over related income claims is essential, including:
  - Purchase commitment by public entities re. supply of energy, purified water and other environmentally relevant services
  - Mandatory connection of users to the public mains and mandatory usage on a fee basis.
Attracting Private Investors to Invest in Capital Market Instruments Based on Infrastructure Projects: Covered Bonds

Real estate and public-sector projects can be used as an issuance basis of capital market instruments instead of bilateral financing. There is a world-wide trend to establish covered bonds based on infrastructure projects and real estate (e.g. Australia, Canada, China, Europe, Singapore, USA).

Advantages:

- Economics of scope and scale: cheaper finance
- Broader investors’ base
- Added values:
  - Safe investment products for pension funds and insurance companies
  - Providing liquidity for the exchanges. So far, the Asian stock exchanges benefit from good index performance, but market capitalisation and turnover of developing markets may be relatively low
  - Sufficient critical mass to be used as collateral for transactions of private banks with domestic and international central banks.
Private Public Partnership (PPP) Finance: Shaping a Tailor-made Individual Project Structure is Essential

- Matched funding: funding instruments for PPP should at least to a large extent
  - Match the amortisation terms of the assets or projects to be financed
  - Be long-term and tailored to the investment period and income streams in order to avoid temporary liquidity bottlenecks
  - Accommodate premium costs and amortisation periods of environmentally responsible and resource-efficient structures and methods such as renewable energies.

- Bank loans as well as capital market instruments such as Covered Bonds may be used for this purpose.
Private Public Partnership (PPP) Finance: General Evaluation

◆ Advantages

➢ Outsourcing of public functions from government budgets
➢ Tapping private sector finance sources – domestic and international investors will be attracted by the quality and security of underlying assets and income streams
➢ Due to their safety and quality, assets and revenues are suitable collateral or underlyings for the issuance of capital market instruments, e.g. Covered bonds
➢ Authority may retain ownership (franchise model)

◆ Neutral

➢ PPP can be more, or less expensive than global state borrowing, depending on the situation of the individual state

◆ Disadvantage

➢ Due to structuring requirements, more complex than direct state borrowing.
Private Public Partnership (PPP) Finance: Added Value

Due to their coverage by the public sector or related assets and projects, capital market instruments based on PPP (Covered bonds) are safe assets which can fulfil important functions (as stated by the IMF Stability Reports):

- Eligible investment instruments for insurance companies and pension funds
- Sufficient critical mass to be used for liquidity management by banks
- Term note programs issued periodically can be used as indicative benchmarks, creating a benchmark yield-curve for a wide range of maturities.
Private Public Partnership (PPP) Finance: Managing International Indebtedness of States and Sub-Sovereign Entities

◆ PPP finance can reduce public indebtedness and enhance access to international capital markets
  ➢ Safety and soundness of underlying assets and revenues as an alternative to the fluctuating creditworthiness of state and public entities
  ➢ Matching debt service and revenues of specific public assets and services long-term, independently from fluctuating annual budgets

◆ PPP finance can help to improve budgetary discipline and to stabilise public budgets
  ➢ Decoupling specific services and revenues from politically driven global public budgets, social and deficit spending
Private Public Partnership (PPP) Finance: Managing International Indebtedness of States and Sub-Sovereign Entities (contd.)

- PPP finance can reduce excessive use of state guarantees
  - Project-specific collateral of assets and revenues
- PPP finance can help to calculate realistic prices for public services
- PPP finance can enhance credit assessment by finance providers
  - Specific project cash flow and collateral versus politically driven global public budgets
  - Improving adequate risk provisioning
Conclusion

Private Public Partnership Finance can help to manage public indebtedness and contribute significantly to stabilising the international finance markets.
Many thanks for your attention

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