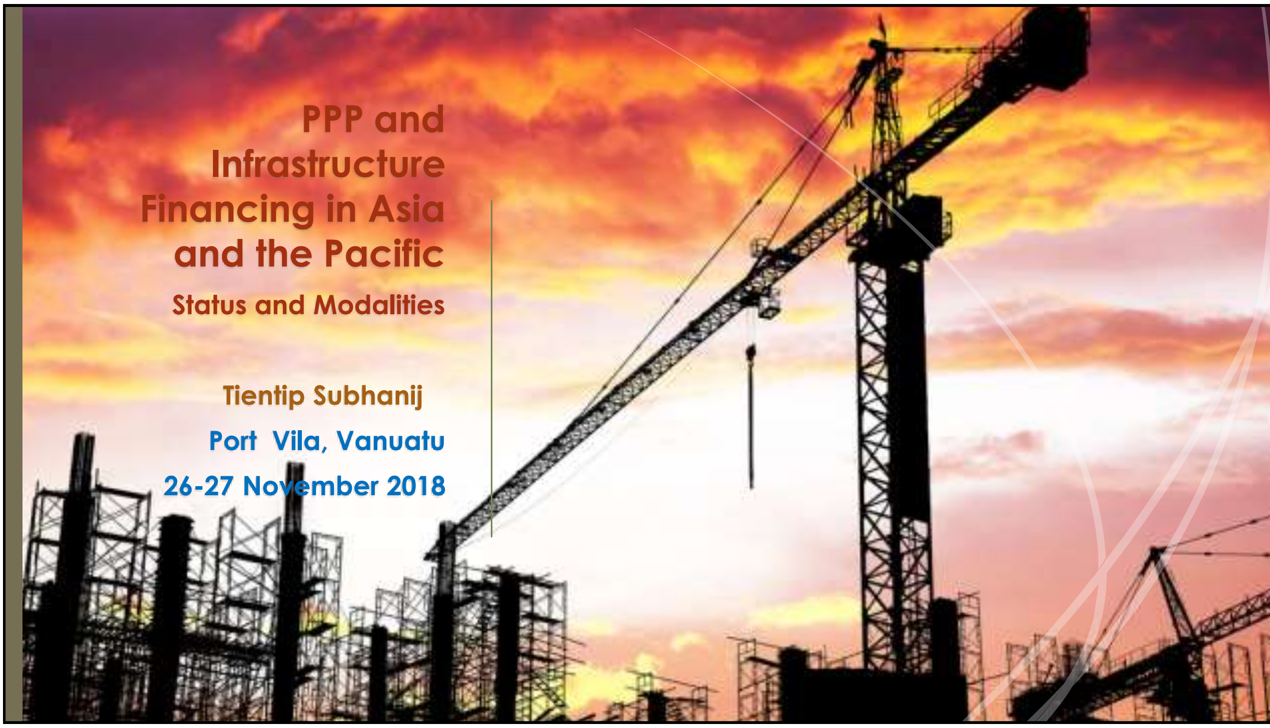
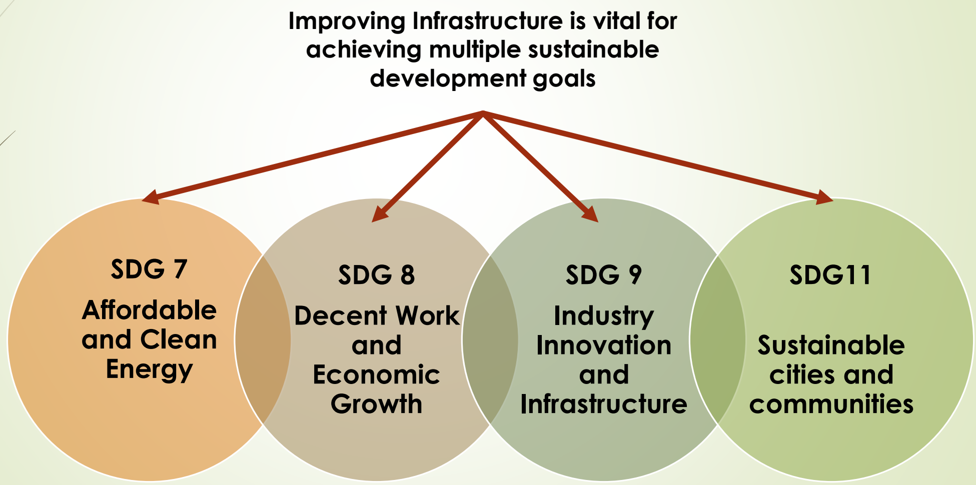
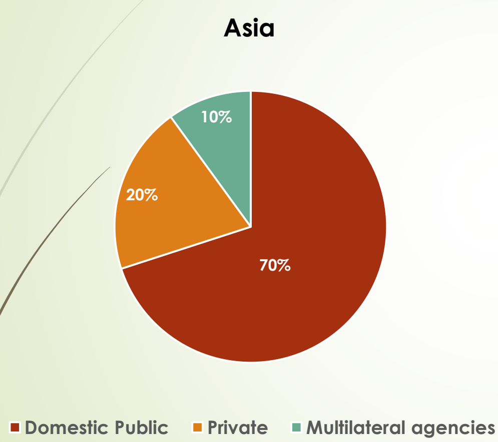

PPP and
Infrastructure
Financing in Asia
and the Pacific
Status and Modalities
Tientip Subhanij
Port Vila, Vanuatu
26-27 November 2018

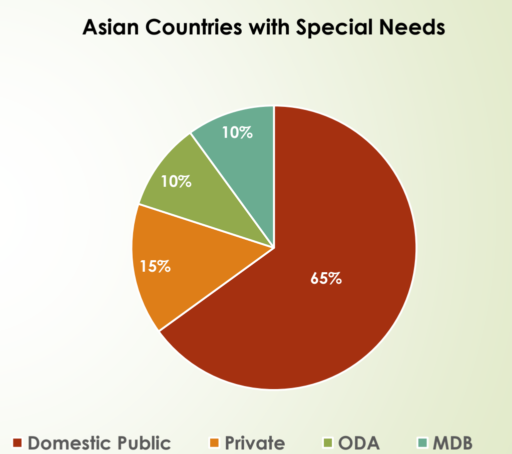

INFRASTRUCTURE
FINANCING:
A KEY AREA OF
RESOURCE
MOBILIZATION

The Importance of Infrastructure



Composition of Infrastructure Financing





Source: Deutsche Bank, Asia infrastructure financing 2016

Source: ESCAP – Asia-Pacific Countries with Special Needs Development Report 2017

A gap between public and private sector financing

Infrastructure investments have traditionally been financed with public funds, given the inherent public good nature of infrastructure

- Currently, the public sector funds 70% of infrastructure development in Asia
- The private sector accounts for 20% of Infrastructure financing
- The remaining 10% are provided by multilateral agencies

Public deficits and increased public debt to GDP ratios have led to reduction in the level of public funds for infrastructure

As countries develop, official development assistance has less impact

Private sector needs to step up
To address infrastructure gaps, it is estimated that private investments should increase from around $63 billion a year to as high as $250 billion over 2016-2020

Source: ADB Institute

Reasons for low private funding

Despite ample available capital...

Global institutional investors currently manage more than US$50 trillion

Investments in infrastructure assets, with theoretically stable cashflows over time, can still be unattractive even to investors with long-term liabilities

...Infrastructure investment is unattractive in both developed and developing countries

Infrastructure projects rarely rank as the most attractive option to deploy capital on a risk adjusted basis –
Too much risk and uncertainty over investment returns. Investors have global alternatives which present higher return in other asset classes for the same level of risk

55% to 65% of infrastructure projects in emerging markets are fundamentally not bankable without government or multilateral development bank support*

Private Sector: Banking Sector Dominance

Conventional Commercial Bank Loans

- The banking sector has traditionally played a major role in financing infrastructure projects in the region
- Banks take greater risks during the initial stage of construction, which only subside over time as projects become less risky.
- However, bank dominant system increase the risk of an overexposed banking system.

Syndicated Loans

- As infrastructure financing requirements are large, loans more often than not come under a **syndicate of banks***
- **Syndicated loans have grown steadily** since the global financial crisis.
- The US dollar is the predominant currency for syndicated loans, alongside local currencies

Banking Sector: Declining Involvement in Infrastructure Finance

Double mismatch

Banks are challenged by the inherent asset-liability mismatch infrastructure finance generates. Banks typically have substantial short-term liabilities, but infrastructure financing often involves long-term assets

Currency mismatch—the differences between project revenues generated in local currency for debt payments made in a foreign currency

New regulations and Trends

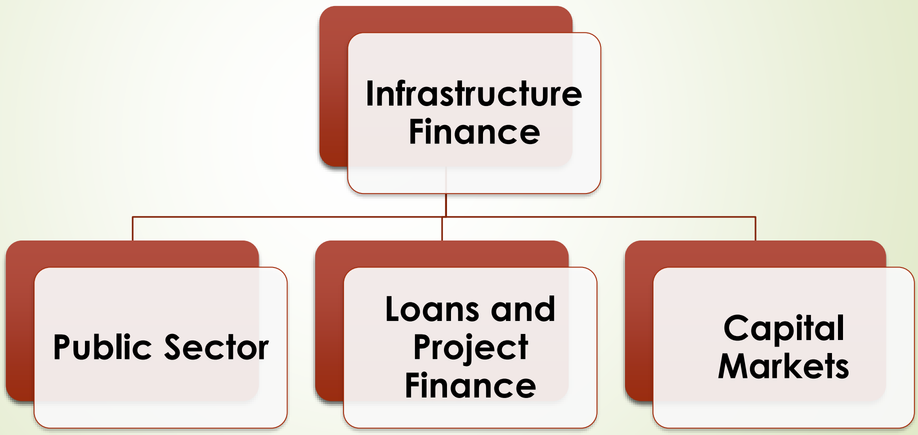
- Large international commercial banks, which had previously provided a significant portion of infrastructure financing, have been deleveraging since the global financial crisis.
- Provisions in Basel III are limiting the role of Banks in Infrastructure financing. Regulation of banking activities, such as capital requirements or liquidity coverage ratios, significantly affects banking industry's position on project finance

Capital Markets and Institutional Investors

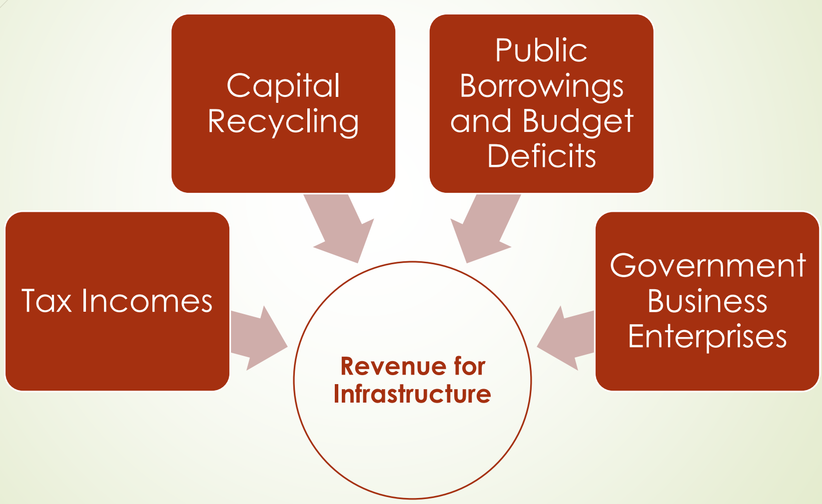
- **Capital markets would reduce the pressure on the banking system while also making available fresh equity to finance / refinance infrastructure projects.**
  - Asia is home to diverse financial systems that vary in depth and sophistication, ranging from developed countries with sophisticated financial markets to emerging markets and low-income economies where markets are still in their infancy.
- **Much attention is being focused on the institutional investor, given the long-term nature of the liabilities.**
  - The long-term nature of infrastructure projects matches the long-term liabilities of institutional investors.
  - Most institutional investors, even those with long-term liabilities such as pension funds, life insurance companies continue to invest in liquid assets, often with a short-term investment horizon.
- **There is a high correlation between the size of the institutional investor base and the size of capital markets.***
  - Underdeveloped equity and bond markets prevent institutional investors to finance infrastructure investment.

Infrastructure Financing Modalities and Current State

Financing Modalities: What is the ultimate source of financing?



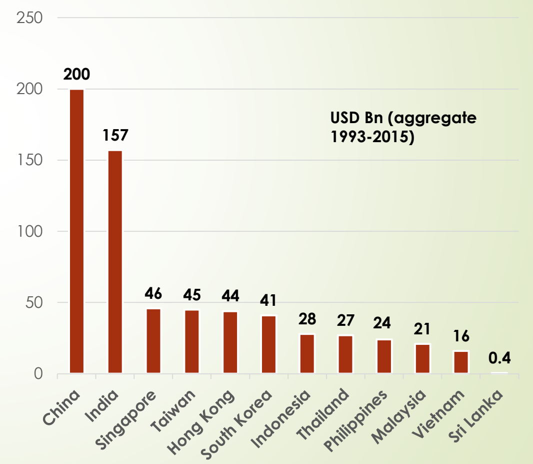
Government Provision



Loans and Project Finance

- Banks have provided most of the global finance since the 1960's and syndicated project finance remains the most common finance for financing private Infrastructure investment in the Asia Pacific region
- In 2014, Global project finance lending stood at **US$260 Bn** , highest level in 10 years. In the same year, Asian and The Pacific accounted for **US$72Bn (27.7%)** of the global Market, largest share.

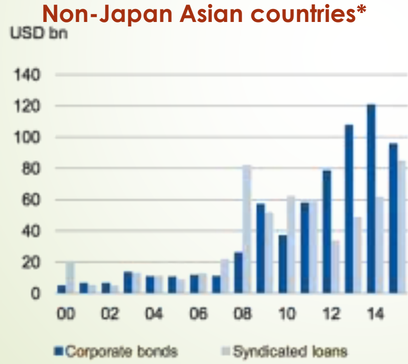
Syndicated loans to key infrastructure sectors in 12 Asian economies



Sources: ADB Institute, Deutsche Bank Research

Capital Markets: Bond Market

In recent years, bonds have outstripped syndicated loans as a source of infrastructure finance in Non-Japan Asian countries*



- The vast majority of infrastructure bonds have been issued in local currency (LCY).
- In some Non-Japan Asian countries where banking sectors are constrained by domestic factors such as deleveraging policies or legacy NPLs, such as China and India, many companies or state entities have increasingly turned to issuing bonds

Source: Deutsche Bank Research, Asia infrastructure financing

Infrastructure Companies

Private Company that operates infrastructure

Like all firms, infrastructure companies rely on equity and debt for financing. Infrastructure companies can be publicly listed.

Infrastructure companies are not SPVs : They make profit by operating the infrastructure they built or acquired

Energy company that runs a pipeline

Power company that maintains electrical generation and transmission lines

Firm that operates a portfolio of toll roads

Infrastructure company

Infrastructure Projects

SPV/SPE Listing

- Establish a dedicated project company known as a "Special Purpose Vehicle/ Entity (SPV/SPE) to acquire financing and implement project activities.
- This legally isolates the parent organization from direct exposure to the financial risks associated with a project.
- If the SPV is listed on the stock exchange, investors can invest directly in the project

Project Bond

- Project bonds are debt instruments used for financing stand-alone infrastructure projects.
- The creditworthiness of this bond depends on the cash flow performance of the underlying infrastructure project
- The volume of project bonds is $36 billion in world (2013). In Asia, the volume ranged between $1 billion and $ 3 billion
- Average maturity of the bonds is 8 years in Asia, compared to 15 years in advanced economies

Infrastructure Funds

- Another intermediary mechanism between investors and infrastructure projects
- Serve as a vehicle to pool resources, skills and experiences from different investors while achieving economies of scale
- Specialized skills are required for structuring and assessing infrastructure investments

Public Private Partnerships (PPP)

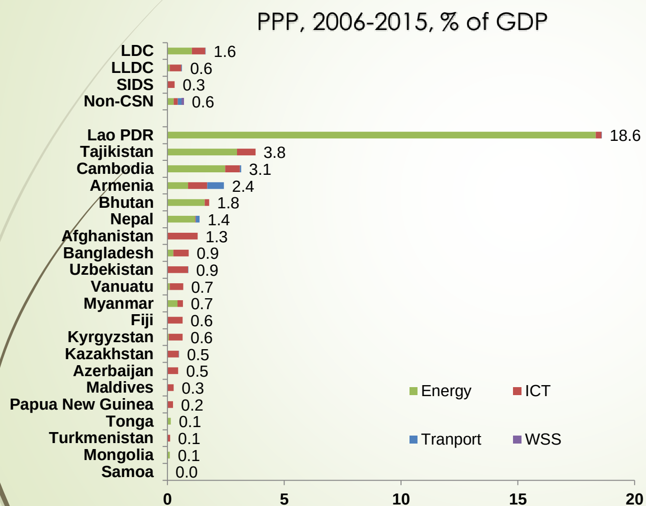
***"A long-term contract between a private party and a government agency, for providing public services and/or developing public infrastructure, in which the private party bears significant risk and management responsibility,** and remuneration is linked to performance"*

- Long term relationship beyond construction phase
- Contract Based
- Different from privatization

- Mobilize resources
- Achieving a long term solutions
- Transferring risks to the private sector

Source: PPP Reference Guide 2.0

Public and private sectors



Domestic public finance

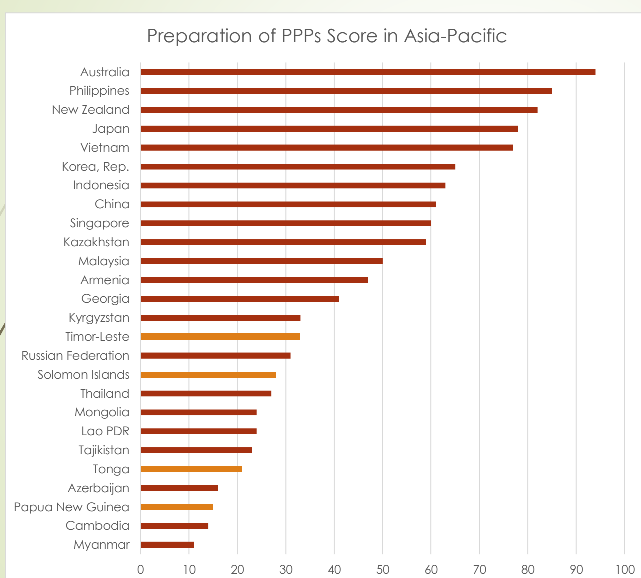
- Traditional sources of finance
- Expected to remain a significant source
- Should be used to *crowd in* private investment

Private sector participation

- Concentrated in a few mega energy projects and privatization of ICT infrastructure
- Has potential to play a bigger role but requires a stable "investor-friendly" climate

ESCAP – Asia-Pacific Countries with Special Needs Development Report 2017

PPP Preparation

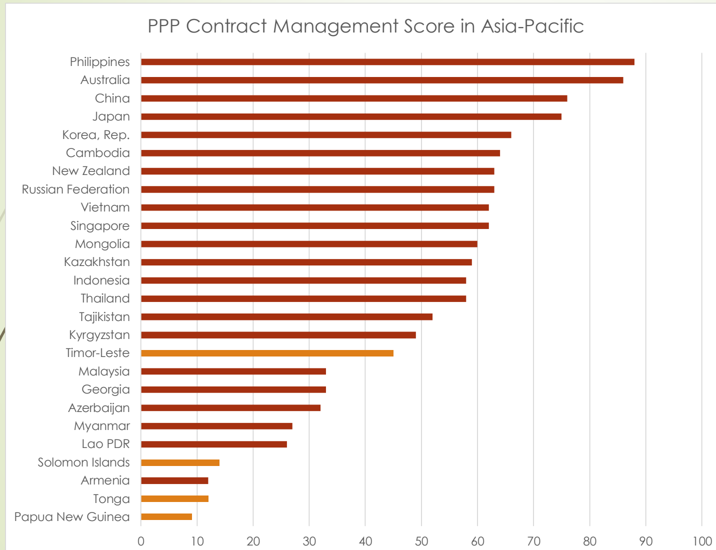


Good practices

- **Assessment of long-term financial implications (prior MoF approval)**
- **PPP project prioritized along other public investment (planning process)**
- **Project justified in terms of socioeconomic analysis, market assessment, procurement method, etc. (legal requirements + methodology)**
- **Standardized contracts / consistency**

World Bank – Procuring Infrastructure Public Private Partnerships, 2018

PPP Contract Management



Good practices

- **Establishment of a PPP project management team;**
- **Regulation of contracts modifications;**
- **Dispute resolution mechanisms in place;**
- **Ground for termination are well-specified and associated consequences defined**

World Bank – Procuring Infrastructure Public Private Partnerships, 2018

International Collaboration

- ESCAP is an active partner in the PPP Knowledge lab together with 11 international organizations

- ESCAP contributed to the 3rd edition of the Reference Guide published in 2017

- Experts contributing to the activities organized by the different partners
- Joint research with the Korean Development Institute (KDI)
- Book on Infrastructure Financing for Sustainable Development

Experience sharing
PPP and infrastructure financing Network

- Promote exchange of information / best practices among the countries of the region

Sub-regional and national workshops

PPP Ministerial Conferences
(Seoul 2007 – Jakarta 2010 – Tehran 2012)

Financing for Development,
(Yearly regional consultation since 2014)

First meeting of PPP and Infrastructure Financing
Guiyang, China

Way forward: Private sector engagement

- Private sector engagement has been severely hampered
  - Risk-return profile needs to be adjusted by Government support measures
- Governments can also
  - Enhance coordination across Government agencies to establish a bankable infrastructure project pipeline
  - Facilitate innovative PPP
  - Develop capital market
- Governments and SDGs
  - Ensure infrastructure development gains are shared in an equitable and sustainable manner
- ESCAP activity
  - PPP and infrastructure financing network in Asia-Pacific
  - Infrastructure financing capacity building workshops/field study events