PPP and Infrastructure Financing in Asia and the Pacific

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The Importance of Infrastructure

Improving Infrastructure is vital for achieving multiple sustainable development goals

SDG 7
Affordable and Clean Energy

SDG 8
Decent Work and Economic Growth

SDG 9
Industry, Innovation and Infrastructure

SDG 11
Sustainable cities and communities

Improving Infrastructure is vital for achieving multiple sustainable development goals.
Composition of Infrastructure Financing

Asia
- Domestic Public: 70%
- Private: 20%
- Multilateral agencies: 10%

Asian Countries with Special Needs
- Domestic Public: 65%
- Private: 15%
- ODA: 10%
- MDB: 10%

Source: Deutsche Bank, Asia infrastructure financing 2016
Source: ESCAP – Asia-Pacific Countries with Special Needs Development Report 2017
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*.
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.

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.
- Regulation of banking activities significantly affects banking industry’s position on project finance.
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.

*There is a high correlation between the size of the institutional investor base and the size of capital markets.*
Financing Modalities: What is the ultimate source of financing?

Infrastructure Finance

- Public Sector
- Loans and Project Finance
- Capital Markets
Government Provision

- Capital Recycling
- Public Borrowings and Budget Deficits
- Tax Incomes
- Government Business Enterprises

Revenue for Infrastructure
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.

Sources: ADB Institute, Deutsche Bank Research
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

Infrastructure company

- Power company that maintains electrical generation and transmission lines

- Energy company that runs a pipeline

- Firm that operates a portfolio of toll roads
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
ESCAP PPP Survey
2018
(Example Results)
Survey Themes

- Legal and Regulatory Framework
- Institutional Framework
- PPP Unit Functions
- Challenge in PPP Implementation
- Existing Mechanisms
- Sustainable Development Goals in PPPs
- Needs and Expectations
Legal Framework

Existing Legal Document

- PPP law: 58%
- PPP policy and/or Guidelines: 32%
- Other Law: 10%

Document under Development

- 9 cases are PPP law
- 2 cases are PPP Regulations
- 4 cases are No document
- 2 cases are Concession Law
- 8 cases are PPP policy and/or Guidelines

Source: ESCAP
Institutional Framework Staff Members

- Over 30 people: 31%
- 1-5 staff: 31%
- 6-10 staff: 13%
- 11-20 staff: 13%
- 21-30 staff: 19%

Source: ESCAP
PPP use by sector

In which sector are PPP used?

- Energy: 80%
- Transport: 70%
- Water: 40%
- Education: 30%
- Health: 50%
- Other: 20%

Source: ESCAP
Challenges in PPP implementation

1. Limited Experience
2. Weak Investment Climate
3. Lack of skills and technical capacity
4. Lack of legal framework
5. Lack of Bankable projects

Source: ESCAP
Existing Mechanisms Governmental Support

Guarantee of Support
- Yes: 53%
- Under development: 37%
- No: 10%

Financial Assistance Scheme
- Yes: 26%
- Usage: 5%
- No: 21%
- Under development: 48%

Source: ESCAP
PPP Funding Sources

1. Bank Loans
2. Equity
3. Foreign Direct Investment
4. Official Development Aid
5. Bonds

Source: ESCAP
SDG Concerns in PPP Projects

- **Environmental Concerns**: Yes 79%, No 21%
  - Under Development: 11%
  - No: 10%

- **SME Involvement**: No 74%, Yes 26%
  - Yes: 10%
  - Under Development: 16%

- **Gender Equality Concerns**: Yes 21%, No 42%
  - Under Development: 37%

*Source: ESCAP*
International Collaboration

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


- Experts contributing to the activities organized by the different partners.

- Joint research with the Korean Development Institute (KDI).
Experience sharing PPP and infrastructure financing Network

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

PPP Ministerial Conferences

Sub-regional and national workshops

Financing for Development,
(Yearly regional consultation since 2014)
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