



Brien Desilets is an IP3 infrastructure finance and PPP specialist and trainer. He provides expert advice to governments on PPP finance, corporate governance, and risk assessment. He is currently working on PPP projects in Ukraine, Russia, and Jordan. He recently conducted an analysis of the UK's £2 billion Private Finance Initiative in Housing for lessons learned and best practices.

PPPs Projects and Financial Crisis: Short-Term Impacts and Medium-Term Trends

Brien Desilets

Abstract

In the current global economic environment, what PPP projects are reaching financial closure? Do they hold any lessons for other projects or for the overall PPP market? This article reviews three projects that have recently closed and tries to glean some indicative information from them that can help to understand the current market and predict future developments.

Introduction

There have been some very mixed signals about how the global financial crisis has affected PPPs during the past year. According to Reuters data, debt issuance for project finance rose 6.3 percent in 2008 to \$262.3 billion globally¹. However, some major players have been hit hard by the crisis. Royal Bank of Scotland (RBS) exited the project finance market in February 2009 as part of a major restructuring. The bank experienced an annual loss of £24.1 billion in 2008, the largest ever in UK corporate history². This was the same year the bank was ranked the lead Mandated Arranger for project finance lending globally. Macquarie Group Ltd, one of the major providers of debt and equity to PPP projects, share price and earnings are half what they were a year ago. Babcock and Brown Ltd. was placed into voluntary administration on March 13.

While global debt markets have been tightened, there still remains a large amount of private equity seeking infrastructure investments for a variety of different reasons. Globally, infrastructure funds raised \$24.7 billion in 2008, compared to \$34.3 billion in 2007 and \$17.9 billion in 2006. There are currently more than 75 infrastructure funds seeking to raise \$100 billion. Much of the funds already raised have had difficulty finding projects in which to invest. The problem for them is not lack of financing but lack of suitable projects. For example, Goldman Sachs raised over \$6 billion for an infrastructure fund in 2006 and has yet to find suitable projects to invest the full amount. Pension funds around the world are seeing positive returns from their infrastructure investments (and looking to invest more) as their investments in other asset classes have been reduced substantially.

In this environment, what projects are reaching financial close? Do they hold any lessons for other projects or for the overall PPP market? This write up briefly reviews three projects that have recently closed

¹ [Infrastructure Investor](#) February 27, 2009. "RBS to Exit Project Finance amid £24.1bn Annual Loss".

² [ibid.](#)

and tries to glean some indicative information from them that can help to understand the current market and predict future developments.

Florida I-595

The Florida I-595 PPP is a 35-year concession on a 10.5 mile portion of the highway in Broward County, north of Miami. The deal reached financial close on March 3, 2009. It is a \$1.8 billion project including: \$800 million in bank debt; \$600 million in TIFIA (Transportation Infrastructure Finance and Innovation Act) lending; \$232 million from the Florida Department of Transportation; \$200 million in equity; and \$10 million from revenue. The bank consortium includes BBVA, Caja Madrid, Calyon, Fortis, SG and Santander. ACS Dragados is the consortium leader and only equity investor.

This is the first PPP in the US to use an availability payment scheme. An availability payment scheme is where the private sector receives payment based on ensuring that the service or capacity in infrastructure is made available irrespective of actual traffic or use. Such a scheme encourages the private sector to manage the road maintenance program to avoid disruption to road users.³ Even though the road will be tolled, the bidders were not comfortable assuming market risk given the current economic climate. The consortium will receive annual payments of \$63.98 million for 30 years. This is a major development for the US market in which toll roads are common and usually provide the revenue for concessionaires on highway projects. Given the lower volumes of traffic as a result of the financial crisis, it is likely that availability payment schemes will become more popular not just in the US but globally.

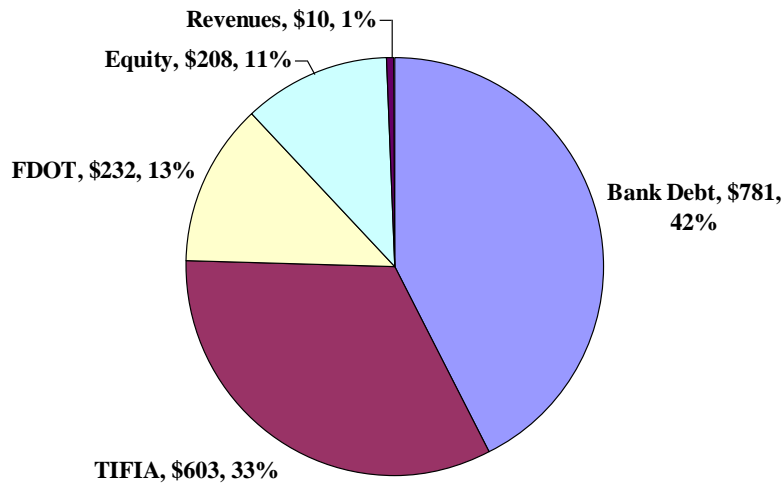
In addition to the federal TIFIA loan, the Florida State Department of Transportation contributed 13 percent of the financing for the project. That brings total public sector financing to 46 percent of the project costs. This is an indication of a true partnership where the public and private sectors are in fact co-financing the project. Private financing is used to leverage public financing, not to replace it. Private financial sources have become scarcer. The private financing that is available is risk averse and more comfortable investing in projects that have a medium to high level of public sector financing – in addition to risk sharing such as under availability payment schemes. It is likely that more projects will see a higher level of public sector financing. In fact, in the US we may see more of these types of partnerships given the availability of financing from the Stimulus program, the demand for infrastructure, and the interest in private investors in the asset profile that infrastructure investments offer.

Construction on the Florida project is expected to begin in June and be completed within five years⁴. See the graph on the following page for a breakout of the project's financing.

³ See <http://www.highways.gov.uk/roads/2746.aspx>

⁴ Project Finance March 2009. "Iridium Closes I-595 in Florida" and PFI February 25, 2009. "Club for I-595".

Figure 1 – I-595 Financing (US\$m) Total = US\$1.8b



The closing of the I-595 deal was a welcome positive sign for the PPP market especially in the middle of a financial and economic crisis⁵.

Poland A1 Phase II

The A1 motorway in Poland is a planned motorway which will run from the port city of Gdansk on the Baltic Sea to the Polish-Czech border. The highway will be a part of the European route E75. The total length of the motorway is planned to be 568 km.

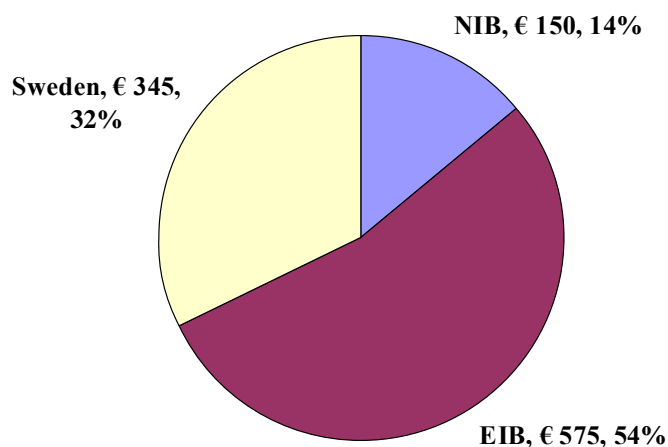
Phase I of the Poland A1 was launched in July 2005 and the road was opened to traffic in October 2008. It consists of a 90km section of road from Gdansk to Nowe Marzy. Gdansk Transport Company (GTC), the concessionaire for Phase I was also selected for Phase II of the Project. The members of GTC are: Skanska Infrastructure Development AB, one of the world's largest construction services companies; John Laing Infrastructure Ltd, a leading international investor and developer of PPPs; NDI Autostrada Sp. Z o.o, a subsidiary of NDI, a private Polish construction company; and Intertoll Infrastructure Developments BV, a subsidiary of Group Five, one of South Africa's largest construction groups.

In December 2008, financial close was reached on Phase II of the project, which will extend the southern section of the road 60 km to the City of Torun. Financing for Phase II came from European Investment Bank (€575), Nordic Investment Bank (€150) and Swedish Export Credit Corporation (€345) for a total of €1.07 billion of financing. The financing arrangements for Phase II are significant in that they do not include any private debt sources. The project was structured as PPP but with bilateral and multilateral financial agencies providing the key debt financing⁶. See the graph on the following page for a breakout of the project's financing.

⁵ For more information, please visit the project website: <http://www.i-595.com/default.aspx>.

⁶ For more information, please visit: www.autostradaa1.pl/en/index.html

Figure 2 – Poland A1 Phase II (€m) Total + €1.07b



Another highway project in Poland however (the A2 Highway, which runs East-West in Poland) failed to reach financial closure earlier this year. Since then, the AWSA consortium consisting of Strabag, Meridiam Infrastructure and Polish Electroenergy Group have obtained a guarantee from the Polish government for the project's debt. The project's financial advisors, Deutsche Bank and Calyon have now given lenders until the middle of June to come up with €600 million of financing. This is in addition to a €1 billion loan expected from the EIB.

In this case, we see both the increase of multi/bi lateral financing as well as an increased demand for public sector guarantees as important enablers for PPP projects to move forward.

Kenya Lake Turkana Wind Power (LTWP) Project

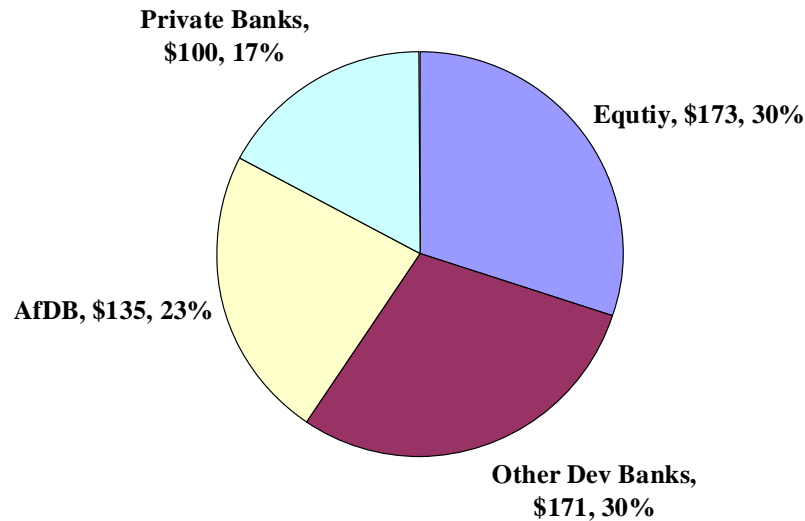
The Lake Turkana Wind Power (LTWP) project aims to add 300 MW of electricity to Kenya's national grid by June 2011, increasing electricity supply by approximately 30 percent. The LTWP consortium, including Anset Africa, a project development and management company, and KP&P, a Dutch wind developer, will build a wind farm of 353 turbines each with a capacity of 850 KW. The project will address the urgent need for additional electricity supply for Kenya, which is expected to face an electricity deficit in 2012 if no new capacity is added.

The African Development Bank (AfDB) originally committed to provide 30 percent of the financing for the project. In May, however, the bank agreed to act as Mandated Lead Arranger for the \$405 million of financing covering 70 percent of the project cost. AfDB will lend the project \$135 million directly and seek additional financing from other development institutions as well as private sector sources. The LTWP consortium will contribute 30 percent equity to the project.

Again, this shows the increased role of the development institutions and public sector in PPP projects. In this case, the AfDB has stepped up its role from one of the lenders to the Mandated Lead Arranger. The AfDB does plan to source some of the financing for this project from the private sector in the future. This project also features a high level of equity at 30 percent. While a few years ago, 90/10 was the standard debt/equity ratio for projects, we now see increasing

demands for equity in some projects. This is a more traditional approach to project finance that saw 70/30 or even 60/40 as the normal ratio in the 1980s.

Figure 3 – Kenya LTWP Likely Financing (US\$m) Total = \$579m



Conclusion

This brief review of these specific projects, US Florida I-595, Poland A1 Phase II and Kenya Lake Turkana Wind Power, demonstrate that the market is adjusting to the global financial crisis by requiring more public support, and more private equity, and concomitantly less leverage, without changing the basic risk/reward propositions that make PPP an attractive approach. The *public* part of the Public-Private Partnership is emerging more important than ever, especially as it relates to governance, while the *private* part of the partnership, is adjusting to market realities.

The Florida project is the first availability payments scheme in the US and the public sector financing is a high percentage of overall project costs at 46 percent. The Poland project is completely financed by development and public institutions and its corollary project, the A2 required a sovereign guarantee to move forward. In Kenya, the lead development institution has increased its role from lender to Lead Mandated Arranger.

Thus, the increased role of the public sector in PPP's is likely to continue and expand during the economic crisis, especially in the provision of some aspects of the debt side of the equation, and in the risk management arena as well. These three examples represent the current trend and the market should expect projects with similar characteristics in the coming months.

Please address questions about this article to the author at bdesilets@hotmail.com.

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