

# IMPACT OF THE FINANCIAL CRISIS ON PPPs



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# Main thesis

- Financial crisis has hit transport PPPs very hard;
- Most difficulties experienced by the transition economies;
- Signs of recovery but too early to say it will be ‘business as usual’ in the post-crisis;
- However, relative to the PPP capacity problem (lack of skills and knowledge within governments) the finance issue is not the critical issue in revitalizing transport infrastructure finance.

# Four Questions

1. Why PPP in transport?
2. What has been the impact of the crisis on PPP Transport projects?
3. With early signs of a recovery, will it be a return to business as usual?
4. To what extent is the revitalisation of transport infrastructure finance a financial issue per se?

# Why PPP in transport?

- Transport PPPs have been a significant spur to infrastructure revitalisation;
- Main pole of attraction within a country's PPP portfolio;
- Many successful PPPs in road, rail, ports (sea and air) light rail and urban transport);
- On time and to budget delivery;
- Improved maintenance and enhanced safety;
- OK some PPP transport failures e.g. London underground; but these were project specific, not intrinsic to the model.

# Example of a successful PPP in road maintenance

- Rajasthan Mega Highways Project;
- Challenge is that roads inadequate and dangerous;
- Upgrading of 1,053 km of key state roads to two lane carriageway with paved shoulders;
- Provides better connectivity between Delhi and Mumbai;
- Private sector undertakes maintenance and rehabilitation of roads for extended periods with payment based on asset performance rather than input/outputs.

# Quality improvements

Before



After



## Question 2: Impact of the financial crisis...

- Collapse of inter-bank lending has drastically reduced liquidity;
- Some banks have partially or totally withdrawn from the project finance market;
- Syndicated loan market has stalled and deals are closing as 'club' transactions;
- Senior bank debt tenors have significantly reduced preference for short term.

## Impact of the crisis contd...

- Crisis has rendered financing and refinancing more difficult and harder to secure through bank lending;
- The shrinking capital market, characterized by inactive bond markets, the collapse of the syndication market, and the decline in foreign investment, has further fuelled the problem;
- The financial crisis has also raised the risk awareness of investors and financial institutions. As such, investors have shown less interest in new projects and tended to apply more stringent lending terms.



## Impact of the Financial crisis contd...

Overall, with the lack of liquidity in the banking market the following trends are becoming apparent:

- Increasingly, banks are more selective in the projects they finance;
- Previously international players, the banks are now focusing on their domestic markets;
- The difficulties of securing funding increases with project size: now is not a good time to initiate large PPP projects e.g. transport!

## Impact on transition economies...

Generally the impact has been worse than in mature PPP markets but..

Many local banks better capitalised however:

- Retreat of overseas lenders
- Pressure on IFIs
- Stress on existing contracts: reduced demand, supplier liquidity problems
- Delay to development of long term sources of debt capital
- Reduction in project financing skills

## There is a 'flight to quality' ...

However in the EU countries the PPP market has not collapsed;

Deals are still being brought to the market and closing, albeit more slowly;

Banks really need to believe in the soundness of the project : forecast demand, due diligence, need for more assurance and robustness;

Transport projects are closing e.g. UK M25 but typically where there is considerable expertise already and conditions are stable and attractive to investors.

# Crisis is increasing the role of the state ...

- Several factors have pushed governments to reverse private borrowing to government borrowing for public service;
- The crisis has resulted in credit problems for private companies, but less for governments. Banks and investors continue to lend money to governments and the cost of that has actually been falling in some countries;<sup>[1]</sup>
- What is more important is that governments can borrow at an interest rate much lower than the private sector could obtain. The gap in the financing cost between the public sector and the private sector provides one argument for people advocating the withdrawal of the participation of the private sector in public service financing;
- General belief that private sector will endeavour to protect stakeholders' interests and manage risks much better than the public sector has been undermined by the financial crisis.

[1] David Hall, "Economic crisis and public services", December 2008

## Question 3: Post crisis will it be a return to ‘business as usual’?

- Possibly: banks may go back to long term lending;
- Some banks have re-opened their project finance departments e.g. RBS;
- But will we see deals of 20 or 30 years?
- Nonetheless, the PPP model is here to stay: emergence of Russian Federation, China, India and Brazil in PPP.

# PPP backlash?

- Discontent, even outright hostility, among the general public against the capitalist system has gained ground during the crisis;
- Concern stoked by massive bank bail-outs, generous pay-offs awards to leading financial services executives, financial fraud, and rising unemployment;
- The 'system' is mistrusted, and confidence in capitalism and its future is low;
- The crisis appears to have had its roots in the era of deregulation and is replaced by the growing role of the state in managing financial capitalism and exercising accountability previously absent in the system;
- Risk is that PPPs are equated with the now discredited privatisation and financial liberalisation.

## There is a need to:

- Place more emphasis on good governance, accountability and transparency, and greater engagement and involvement with the end-users, citizens, workers and local communities;
- Broaden the objectives of the projects to include sustainable livelihoods as well as the needs of the socially and economically disadvantaged;
- More attention will be required for the training of PPP administrators to cope with these challenges;
- The great risk is that government will over-regulate PPPs and fail to allow them the flexibility from which benefits arise.

## **But PPPs will not be rendered irrelevant : the crisis brings opportunities**

- The global crisis may be an opportunity for the prosperity of PPPs in the medium run, if PPPs policy-makers and practitioners can adjust the PPPs models to the new social, political, and economic environments in the post-crisis era;
- Infrastructure investments, traditionally considered as an antidote for economic downturn, could increase employment, stimulate economic growth and alleviate inflationary pressures by removing supply-side constraints, and restore the general public's confidence in the private sector.



## The crisis brings opportunities contd...

The potential demand for social infrastructure such as public lighting, hospitals, and schools, is amplified in volatile times when financial and economic crisis negatively affect low-income people's life;

The social infrastructure can not only serve as a safety net but also generate economic flow-on effects with increased human resource investment;

The loss of investors' appetite for economic infrastructure typically financed by private users may be compensated by the increased demand and interests in social infrastructure investment generally paid by a public authority.

## The crisis brings opportunities contd...

- There are ongoing needs to restore and replace much of the existing physical infrastructures, to accommodate population growth and to deal with the threats of global warming in response to the call for sustainable development;
- In times of crisis, the speed-to-market investment in infrastructure is of utmost important, because governments are under pressure to take immediate action to address the crisis. PPPs projects, if properly managed, can be put into operation and bear fruit much quicker than traditional government funding projects;
- Reflationary policy, including higher government spending and tax cuts, has raised government deficits to an alarming level. PPPs could be a potential solution for public sector deficit, fulfilling the need for infrastructure investment and at the same time giving government flexible cash flows.

## Question 4 : How important is the financial issue in revitalising transport infrastructure ?

- Plenty of money has been promised to infrastructure from individual countries' stimulus packages;
- Perceived as a good means to stimulate the economies;
- However to date the effects have been disappointing;
- Biggest constraining factor –whether in the public or private sector – is NOT the lack of funding, but the lack of projects ready to be financed;
- Only once projects are made ready for financing ( i.e.. Planned , fully specified and contracts negotiated ) can they be financed , and only then can they be considered 'shovel –ready' i.e. construction can meaningfully commence.

# Real problem in revitalising transport infrastructure finance

- Is to overcome the capacity problem of governments to do PPPs;
- Government departments lack the projects finance skills;
- Problem very apparent at local and municipal levels;
- UNECE Team of Specialists on PPPs preparing training toolkit on how to do PPPs;
- But other things are needed...

# UNECE initiative to establish a PPP Centre for training

- Overall so much to do there is a need to scale up the response to the problem and tap the financial support of private sector;
- UN experts see the need to solve the capacity building problem by focusing on actual projects, ‘learning by doing’
- Concept paper has been written for the creation of centre and circulated widely;
- Meeting 14 September in London.

# Conclusions

In the short and medium term the future of the PPP model is being threatened:

- Withdraw of the banking sector from the PPP market;
- A growing role of the state in financial management that can threaten the freedom of public and private sectors to cooperate in PPP arrangements;
- A growing questioning of private sector methods in economic decision taking that may spill over to criticism of the PPP model itself.

## Recommendations

- Faced with the crisis it is important that more attention is given to capacity building in PPPs;
- Stimulus packages can help provided public sector capacity in PPP is developed;
- Transport Committee and the Committee on Economic Cooperation and Integration can cooperate on PPP capacity building.

**Thank You For Your Attention!**

<http://www.unece.org/ceci/ppp.html>

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