European PPP Expertise Centre

PPP Perspectives in Lithuania

"PPP in the Financial Crisis"

Dr Goetz von Thadden, European PPP Expertise Centre (EPEC)
Vilnius, 10 December 2009

European PPP Expertise Centre

Credit crisis, the symptoms

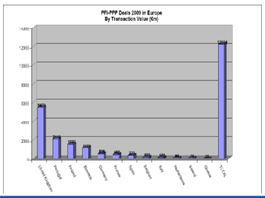
- Collapse of the inter-bank lending market, causing acute liquidity shortage
- Banks lending reduced dramatically
- Fly to safety: project finance loans have to compete with more attractive corporate opportunities
- Disappearance of the syndication market leads to less flexible Club transactions
- Banks reduced liquidity and limited refinancing prospects penalizes long tenors. « Mini-perms » become new standard in certain markets
- Sharp increase in margins and fees
- Many large banks phase down PPP activity. Some withdraw.
- Regional focus and relationship banking back in force
- No viable capital market solutions to replace the failed monoline model
- Longer term impact of the Basle II rules and other upcoming banking regulations

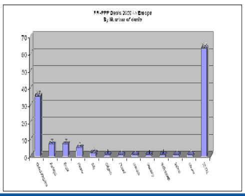
► Seller's market turns into buyer's market

European PPP Expertise Centre

Credit crisis, the consequences

- Project finance market strongly hit from last quarter 2008: PFI magazine reports 58% drop in activity in first half 2009. Up to 65% in EMEA region.
- PPP market weathers the blow better than global market: EPEC's analysis indicates 30% drop in PPP signatures across Europe, up from 70% in first quarter.





European PPP Expertise Centre

EPEC's first responses

- Early 2009, EPEC makes the credit crisis as a priority work stream.
- In March, EPEC undertakes a market survey of public and private stakeholders, PPP units, banks, investors, advisors and contractors.
- In April, EPEC holds a member's meeting to review outcome of its survey and exchange views and experiences.
- In May, EPEC publishes its first internal «credit crisis» paper
- In July, a member's meeting is organized to discuss the procurement issues linked to the credit crisis.
- In August, an updated version of the credit crisis paper is posted on EPEC's public website: «The financial crisis and the PPP market».
- The first draft of a «capital market» paper is also circulated to members.
- In September, EPEC initiates a review on PPP procurement across Europe. A final report is expected in the first quarter 2010.
- It is expected that a public version of the capital market paper will be available by the end of the year

European PPP Expertise Centre

Potential remedial actions

The report identifies 3 main streams for potential actions

- Remedial actions within the procurers' control

  → *Addresses mainly procurement issues*

- Remedial actions within States' or Public Authorities' control

  → *Addresses State financial support and guarantees*

- Remedial actions facilitating the entry of new investors into the PPP market

  → *Addresses capital market issues*

European PPP Expertise Centre

1. Remedial actions within the procurer's control

- Adjust procurement programmes
  → *Avoid 'XXL' projects*

- Adjust procurement process
  → *How best to cope with the competitive dialogue constraints in the current financial context, while respecting the 2004-18 Procurement Directive*

- Adjust contract durations or make the best of « mini-perms »
  → *When long term debt is not available, « mini-perms » can be advantageous to the procurers as long as the refinancing risk remains with the bidders, at a reasonable cost*

- Improve the risk-reward balance
  → *There is higher a price to pay for unusual/unreasonable risk transfer*

2. Remedial actions within States' or Public Authorities' control

- Up-front Government payments
  → *May add value for revenue based projects, but what upside for the Authority ?*
- Provide liquidity under private sector guarantees
  → *Most direst response to liquidity crisis. Low risk for the state, but almost impossible to refinance*
- Co-lending
  → *More complex to put in place. Short-term, reversible solution. Act as market moderator.*
- Direct guarantee facilities: *easier to implement, contingent only but no claw-back*
- Indirect guarantee facilities: *underpinning, sub-sovereign and refinancing guarantees*

European PPP Expertise Centre

3. Actions facilitating the entry of new investors into the PPP market

- Revive the monoline model
  → *A highly rated government or multilateral body to provide bond wraps*
- Develop infrastructure bonds
  → *Facilitate, through fiscal incentives or guarantees a focused infrastructure bond market (e.g. for TEN-T projects)*
- Stimulate the « un-wrapped » bond market
  → *Lift the senior debt rating, through structural changes (e.g. adding a layer of sub-debt on top of equity) in order to raise uncovered bonds or highly rated senior debt*
- Debt funds: *Raise long term debt from institutional investors*

European PPP Expertise Centre

Results achieved so far

- Multilateral lending sharply stepped-up.
- Co-lending being tested in the UK, through the Treasury Infrastructure Funding Unit (TIFU). Used only once (Manchester Waste), but appears to act as a good market moderator.
- State guarantees put in place in France and Portugal: first French project expected to close by year end (Tram-Train La Réunion). Many more to follow.
- Funding facilities in place in France and Germany: first French education projects (Paris VII, Sorbonne) closed in July.
- Underpinning already common practice in France (Cession de créances) and Germany (Forfeiting). Ad-hoc usage in other theatres (e.g. M25, Polish A2).

European PPP Expertise Centre

Results achieved so far (continued)

- Other indirect guarantees also used on specific projects, e.g.:
  - → sub-sovereign guarantee in La Réunion,
  - → LGTT: « Loan Guarantee for Ten-T projects » (EIB), covering traffic ramp-up Used in Portugal (IP4 and Baixo Alentejo) and Germany (A5),
  - → refinancing guarantee in Belgium (Brabo I Tramway, through April 2004 « de Lijn » decree)
- Several private sector initiatives in progress in order to bring capital markets back to PPP financing
- EIB considering a programme to facilitate TEN-T funding through various forms of credit enhancements.

European PPP Expertise Centre

Progress ?

- The UK PFI market has remained quite healthy, with 32 projects closed in the first 9 months of 2009, ranging from £4m to £1,300m, for a total value of close to £5billion, within 20% of last year.
- Margins in the UK stabilize around 250 bps. The TIFU appears to serve as an efficient market moderator.
- The rest of Europe appears to be down by over 40%, with 6 large road projects accounting for 2/3 of the total value.
- Government support was able to preserve large critical projects (often at high costs), rather than sustain mid market deal flow.
- Financing conditions seriously deteriorated, with margins often in the 250-400 bps range. A real challenge to the PPP financing model

► *Short term successes, although the jury is still out as to the best approach to deal with the financial crisis*

► *Serious long term challenges, (i) on the market, when stimulus measures are phased out and (ii) on the PPP model if the impact of increased financing costs cannot be mitigated.*

European PPP Expertise Centre

For more information…

http://www.eib.org/epec

Dr Goetz von Thadden

thadden@eib.org
Tel: +352 4379 87613
Fax: +352 4379 65499

European PPP Expertise Centre