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Infrastructure Partnerships Australia

Financing Infrastructure in the Global Financial Crisis

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Contact

Brendan Lyon
Executive Director
Infrastructure Partnerships Australia

P | 02 9240 2050
E | brendan.lyon@infrastructure.org.au

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1 – Key Findings & Recommendations

Key Findings

- Unprecedented changes in the global financial market have led to an environment where the capacity of Australian industry to secure the debt needed to deliver large infrastructure projects is severely constrained.
- If not acted upon soon, capacity constraints on existing infrastructure will significantly limit economic activity and restrict growth, adversely impacting our potential for economic recovery and productivity improvement.
- Lack of liquidity, departure of foreign banks from the domestic market and collapse of bond markets have made refinancing risk a significant concern for business broadly, including existing infrastructure projects.
- With the global economic downturn intensifying in 2009, the Commonwealth Government needs to take measures to bolster and reinforce financial market stability and to temporarily fill the gap in lending capacity for major infrastructure projects.
- Comparable nations including the United Kingdom, France and Canada have all responded to the issues facing their PPP/PFI sectors – it is responsible for Australia to also take decisive action to meet the challenge of financial turbulence; and only our national government can deliver the required policy changes.
- Australia's infrastructure sector does not want or need these changes to be permanent; the sector believes that the changes requested in this Paper must be transitionary and structured to revert to a 'pure' financing model as global financial markets recover their capacity over time.

Recommendations

The key options recommended in this Paper are one or more of the following:

1. **The Commonwealth Treasury to act as a co-lender to nationally significant PPP projects over the short term, meeting the gap created by the current incapacities of debt markets.**
2. **The Commonwealth to provide a debt guarantee to nationally significant PPP infrastructure projects to allow the private sector to raise sufficient debt to meet the financing gap.**
3. **The Commonwealth to provide direct Commonwealth grants to fill the financing gap on appropriate PPP projects.**
4. **The Commonwealth to take action to mitigate refinancing risks arising from the unavailability of long tenor debt.**
5. **The expansion of *Infrastructure Australia's* remit to ensure the rigorous appraisal and selection of appropriate social and economic infrastructure projects for support under a new, national financing partnership to meet short term challenges.**

The models examined in this Paper are laid out below, assessing their impacts across four criteria: an ability to deliver PPP viability, balance sheet impact, ease of exit and ease of implementation.

	Achieves viability of current PPPs	Commonwealth balance sheet liability	Ease of exit for the Commonwealth	Ease of implementation for the Commonwealth
Commonwealth co-lending on commercial terms to fill the funding gap	**Yes**	**Full liability.**	**3-5 years alongside private sector lenders.**	**Following the UK experience the Commonwealth would need to establish a dedicated unit to assess lending requests on a case-by-case basis.**
Commonwealth providing a guarantee to fill the funding gap	**Yes**	**Contingent liability that a counter party State defaults.**	**3-5 years alongside private sector lenders.**	**A specialist unit within the Commonwealth Treasury to advise on the provision of a guarantee to large, nationally significant infrastructure projects.**
Direct Commonwealth grant to fill the funding gap	**Yes**	**Full liability.**	**Generally, no exit – cash is spent.**	**Easy. However, in current circumstances the Commonwealth would need to borrow to provide the subsidy.**

2 – Introduction

2.1 – Infrastructure Partnerships Australia

IPA is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and, importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how it meets the needs of a changing economy and growing population; and how we service and sustain a cohesive and inclusive society.

IPA seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. IPA also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

2.2 – Opening Remarks

2.2.1 – About this Research Paper

The purpose of this Paper is to analyse the impact of the current global financial crisis on the financing of infrastructure projects and to consider how governments and the private sector can enter into a new partnership to meet and better the challenges presented by a much-changed global financial market.

The unprecedented domestic impact of the global credit shortage has meant that the environment for the financing and development of infrastructure has changed markedly from the conditions of recent years. Simply put, the future of some of Australia's most urgent and important economic and social infrastructure projects is at significant risk at the very time that national infrastructure needs are greater than ever.

These issues must be confronted and short and medium term solutions found to allow for the continued development of infrastructure – doing nothing is not an option if we are to ensure the national mobility, liveability and prosperity that will flow from infrastructure projects delivered this decade.

This Paper looks at the practical options available to Australia's policy makers to chart a clear path forward, and will focus on how governments can continue to successfully deliver PPP projects that are already in the market – and those that are planned over the short term.

The case to retain and sustain Australia's PPP infrastructure market is clear and compelling. The PPP model of procurement allows governments to deliver better value, better designed infrastructure, harnessing the innovation, expertise and investment of the private sector.

Research has shown time and again that PPPs deliver substantial savings in both time and cost, when compared to traditional methods of procurement. A comprehensive examination of PPPs by the UK Auditor General confirmed this, finding that 73 per cent of traditionally procured projects were over budget and 70 per cent were delivered late. By comparison, just 20 per cent of PPP projects were over budget and only 24 per cent were delivered late.

The Australian experience has been just as fruitful. In late 2007 a landmark Infrastructure Partnerships Australia study – prepared on commission by the Allen Consulting Group and Melbourne University - demonstrated the value of PPPs over traditionally procured projects. In our study, PPPs demonstrate superior cost efficiency over traditional projects ranging from 30.8 per cent from project inception to 11.4 per cent from contractual commitment to final outcome.

The IPA study found that in absolute terms, the PPP cost advantage was both economically and statistically significant. On a contracted $4.9 billion of PPP projects, the net cost over-run was $58 million; while on $4.5 billion of traditionally procured projects, the net cost over-run was $673 million. Time over-runs on a value-weighted basis showed that traditionally procured projects performed poorly - completed 23.5% behind time, while PPPs were completed 3.4% ahead of time, on average.

It is not in Australia's interests to return to a limited public works model with its inherent constraints or inefficiencies for infrastructure development. Over the next five years, Australia needs the large desalination plants, hospitals, transport facilities and social infrastructure that PPPs can most effectively deliver. But, unless we have significant policy reforms to deal with the current credit crisis, we risk the stalled development of these and other important infrastructure assets. We need to adapt the existing model of delivery to keep the PPP model of procurement available to Australia's governments. Without measures to address current credit shortages, the crisis will affect all large infrastructure projects.

This Paper examines the responses to credit rationing which have been employed in comparable overseas economies, such as the United Kingdom, the United States of America and France; and looks to potential solutions and policy options available to Australia's policy makers. A number of models will be analysed, looking at their respective risks and the size of capital outlay required by government.

This Paper – and Australia's infrastructure sector – takes the view that targeted Australian Government intervention will be vital given the global collapse in financial markets. Without clear minded and decisive government action Australia risks losing the innovation, expertise and full engagement of the private sector in the massive task ahead. Worse still, without government assistance in the short term, much of Australia's most important and productive infrastructure may not be developed, risking the productivity and prosperity of future generations.

Industry does not want or need these changes to be permanent. The key to any proposed solution is to ensure that procurement of PPPs reverts to a pure financial model, once the global economy recovers and debt markets restore their capacities. But extraordinary economic circumstances demand new and rapid reforms if we are to lay the foundations of Australia's recovery and future growth.

It is also likely over time that further issues with the current PPP model will need to be addressed to ensure ongoing competition in the national infrastructure marketplace. In particular, given the wealth of superannuation savings in Australia, which has the fourth largest pool in the world – consideration should be given to models which will allow for additional superannuation funds to invest into infrastructure projects, either directly or via other mechanisms.

Any evolutions need to involve a re-examination of the PPP tender process, the allocation of risk and other considerations. This Paper restricts its inquiries and recommendations to the reforms which will be required for projects which are in the market or will need to be brought to market in the short term. Recommendations in this Paper will need to be considered in concert with evolutions to bid structuring and process.

Infrastructure Partnerships Australia will shortly release a paper on the options for the evolution of the Public Private Partnership model in Australia.

2.2.2 – Australia's Infrastructure Investment Task

In spite of Australia's sustained economic growth and development over the past decade and a half, the capacity and condition of Australia's existing infrastructure asset base has not kept pace with demand. Failure to restore, renew and enhance our productive capacity will significantly limit and restrict economic activity, hampering our potential for economic recovery and productivity improvements.

Recognising that Australia's historic infrastructure capacity constraints affect all sectors, governments across the nation have made significant commitments to boost infrastructure investment.

The Commonwealth Government has announced more than $82 billion in funding to support infrastructure development, including the $12.6 billion Building Australia Fund; funds for education ($6 billion), health and hospitals ($10 billion); a $26.4 billion investment in road and rail and the infrastructure elements within the various economic stimulus packages.

Across the forward estimates period, state government capital expenditure will top $195 billion. Not withstanding these record investments, the sufficient development of new and renewed infrastructure poses a significant challenge to all governments. Research released in June 2008 by Citigroup (prior to the global financial crisis) estimated the national infrastructure investment task to 2018 would exceed $770 billion – estimating the call on private sector capital at above $360 billion.

Similar research by ABN Amro (now the Royal Bank of Scotland) released in May 2008 forecast that up to $455 billion would need to be expended on infrastructure over the next decade. Of that figure, it was estimated that some $80 billion in private investment would be required, with around $14 billion worth of PPP projects expected to reach financial close before 2010.

In July 2007, Infrastructure Partnerships Australia released another major report, titled *Australia's Infrastructure Priorities: Securing Our Prosperity*. This Report identified more than 160 critical projects and key policy reforms to build Australia for the future. The projects identified in that Report were estimated by external parties to cost more than $700 billion.

These estimates of forward infrastructure requirements were based on a business as usual scenario. New infrastructure demands - like the investments which will be required to reduce carbon emissions and enhance sustainability across Australia's economy – did not form part of these figures.

In a preliminary report commissioned by Infrastructure Partnerships Australia and Bilfinger Berger Australia, consultants KPMG examined the impacts of the Carbon Pollution Reduction Scheme (CPRS) on the costs of meeting the currently identified infrastructure gap in the energy and transport sectors. This KPMG report (based on pre-financial crisis 2008 data) estimated that the cost of supplying the infrastructure necessary to close the infrastructure gap in those sectors could be more than $120 billion, once a CPRS system is imposed.

More immediately, governments plan to harness more than $13 billion in private sector investment in social infrastructure PPPs in 2009.

Whatever the exact forward capital investment task facing Australia, it is clear that the task is massive. And it is well beyond the capacity of the public sector alone. In spite of the current financial turmoil, significant engagement and investment by the private sector will be the key to any plan to address shortfalls and enhance national productivity in the years and decades ahead.

If left unchecked, a poor infrastructure legacy will put a brake on productivity in our economy. It is estimated by the Business Council of Australia that removing impediments to investment in important infrastructure areas will boost GDP by around 2 per cent (or $20 billion) a year.

Well-scoped infrastructure projects can impact on the overall productivity or efficiency of the economy, exerting a positive multiplier effect. A CEDA Report in 2005 found that investment in infrastructure has a positive, permanent effect on economic growth, with a 1 per cent increase in infrastructure expenditure increasing output by between 0.17 to 0.30 per cent, and generates higher returns than investment in other sectors.

Australia's policy makers need to look for smart frameworks and delicate policy solutions that will harness private sector innovation and aid short and medium term investment in a new, genuine partnership for the national future.

The positive policy reform options for the financing of public private partnerships should be given urgent but considered attention by government, recognising the critical role that infrastructure development will (or will not) play as Australia contemplates the ways to sustain and generate employment and liquidity in the short term – and enhance productivity and prosperity over the many decades ahead.

3 – Financial Challenges in the Current Market

The seismic disturbances in global financial markets now present an environment where the capacity of the private sector to finance infrastructure is severely constrained – at least in the short term. This section examines these financing constraints, discussing the changes and impacts that have lead to the current situation and the limits in debt financing available in the Australian markets for new and renewed infrastructure projects.

3.1 – Market Constraints

Simply put, the primary impediment to the development of privately financed infrastructure projects in the current market is a lack of available debt funding across the board, coupled with a much-reduced investment appetite by equity. This is underpinned by the overall lack of liquidity in the financial market.

Inevitably, this situation leads to increased refinancing risk for existing and planned infrastructure projects, and a severe lack of capital to finance new infrastructure projects.

In the relatively short period of two or three financial quarters, the PPP financing scenario has been totally transformed from an active market - where debt and equity capital competed to find projects for funding and investment - to the reverse situation where projects are struggling to find capital in a markedly slower market, with scarcity of available funds. We are now seeing rationing and reduced competition among both debt and equity providers.

It is becoming increasingly difficult for consortia competing for Public Private Partnership projects to raise the required limited recourse finance from banks and submit a fully underwritten bid. For the largest of the PPP projects, there is insufficient capacity in the debt market for even a single underwritten bid.

In the context of the global financial crisis, many reasons have emerged for the lack of available infrastructure funding. These include:

- Access by lenders to capital is severely constrained;
- Lending capacity for all commercial projects, including PPPs, has been substantially reduced;
- Banks are moving to a much more conservative approach to lending, with liquidity and capitalisation concerns in an uncertain and volatile market this is being exacerbated by APRA concerns over aggregation of risk;
- Where capital is available, banks are rationing it and its availability is often contingent upon more stringent conditions;
- Lenders have a reluctance to provide long-term financing reflecting their own funding constraints. Banks are now applying shorter tenors to loans, which increases refinancing risk for long-term concessions;
- Banks are tightening the covenants in loans, increasingly pushing risk to the borrower;
- Banks are pushing risk to equity and increasing price of debt;
- Where borrowers have refinancing obligations, they are facing certain lenders who wish to exit or reduce their exposure, tougher loan arrangements and higher costs;
- Many foreign banks are using their limited capital in their own domestic market and retracting their lending activity from Australia; and,
- Shorter underwriting periods, market disruption and market flex are becoming standard.

Impacts on the banking sector are discussed further in the next section.

3.2 – Changes in the Banking Sector

There are now fewer banks active in the Australian PPP market. With the rationing of capital, most foreign banks are retreating to their home markets. The credit wrapped bond market is effectively shut with investor appetite disappearing and seemingly with little prospect for downgraded monoline credit insurance providers to be upgraded to their previous AAA rating in the near future. In the unwrapped bond market, investor appetite PPP bonds issuance is non-existent, with little prospect of returning in material volumes in the short term.

Banks are mostly restricting the limited credit which is available to known and trusted clients, reducing their level of commitment or exposure to infrastructure and moving to shorter-term funding. Many banks are refocussing on core business or preparing for upcoming and significant refinancing transactions. Over the next two years alone, Australian companies need to refinance approximately $75 billion of foreign debt.

With banks focused on ‘core’ business, or on preparing for the upcoming wave of difficult refinancing deals, interest in funding new projects will be severely limited. This may especially be the case for special purpose vehicle consortium borrowers.

Concern about the forward availability, cost of finance and restricted available debt capital raising means that banks have reduced the tenor for loans to much shorter terms of 3-5 years, exposing borrowers to significantly increased refinancing risk.

Whereas banks previously organised themselves to form a financing group or bidding club to make limited recourse financing available to a bid for a PPP project and often competed for underwriting roles, the situation now sees banks and fund managers reluctant to make any long-term debt commitment. Further, there is not sufficient access to readily available funds to finance all the infrastructure projects which are planned and required over the short and medium term.

3.3 – Limits of Debt Financing

There is now a significant limitation on the amount of debt which can be raised in the Australian market for infrastructure investment. There are fewer banks active and prepared to lend – and those which are active in the market are only prepared to lend significantly smaller amounts.

For partnership projects requiring finance, the Australian financial market is limited to around eight banks. On the basis that bidders will form a syndicate to accumulate sufficient funding for a PPP project bid, banks will only currently lend smaller amounts of around $100 million to $150 million for the largest projects, with a preference to retain (or hold) between $50 million and $75 million. To submit a fully committed bid for a $500 million project, a bidder requires approximately 5 to 10 banks to commit to hold a position for their tender.

According to industry leaders, the current market allows potential bidders for PPP projects to raise a maximum of $500 million to $600 million in debt financing – once other bidders have been eliminated. Beyond that upper limit, there would be insubstantial appetite and no price tension - any higher than around $600 million and the borrower is captive to the last lender in, who is in the position to set the price and/or the terms and conditions.

Therefore, the actual amount able to be raised would depend on the composition of the bid consortium, on the quality and track record of bid team members individually, and in combination as a PPP sponsor. The key reason for banks to lend constrained capital for infrastructure projects is an ongoing business relationship with the sponsors. For example, if

there is a long-standing bank-client relationship, established parent company/subsidiary links or collateral business involved, this makes lending to the sponsor's bid consortium a priority for the bank.

It is also apparent that in the current, capital constrained environment, the sheer volume of infrastructure projects seeking capital will overwhelm the limited capacities of the banks still active in the market. In the near term, each successive project will face greater constraints on debt funding.

This will have a serious and significant impact on the types of projects which remain 'bankable'. Many mega projects – those with capital costs exceeding $1 billion – are now not able to procure the amount of debt financing required.

4 – The Australian Infrastructure Market

Australia's infrastructure sector has been experiencing amongst the most significant reforms undertaken since Federation more than a century ago.

The creation of *Infrastructure Australia* led by Sir Rod Eddington has brought all levels of government and the private sector together to streamline the assessment, prioritisation and procurement of infrastructure across the nation. This process will deliver the first rigorous national plan for key national infrastructure. This prioritisation complements *Infrastructure Australia's* harmonisation of both procurement and planning regimes, balancing the interests of government and industry toward the national interest.

Significantly, the reform of the infrastructure market being undertaken by *Infrastructure Australia* is supported by the creation of three 'Nation Building' funds which will be used to inject $28.6 billion into economic and social infrastructure assets.

The Commonwealth Government has also signalled an investment of many billions into so called 'shovel ready' infrastructure projects, components of the national response to the global financial crisis.

4.1 – Before the Global Financial Crisis

During 2008, Australia's infrastructure sector experienced a renaissance, with significant, targeted and meaningful industry reform. The appointment of Australia's first Federal Minister for Infrastructure, the creation of an independent infrastructure advisory body, *Infrastructure Australia,* and the move toward a harmonised way of identifying, financing and procuring infrastructure investment signalled long awaited moves toward a highly functional, national infrastructure marketplace.

Strong demand for Australian commodities, predominately coal and iron ore, coupled with a growing economy and population, had equally resulted in the identification of significant infrastructure capacity constraints resulting in many billions in squandered economic opportunities.

As discussed in section 2.2.2, estimates of the infrastructure investment gap over the coming decade ranges up to $755 billion. Government at all levels, recognising the size of the infrastructure challenge and limitations of stretched government balance sheets, increasingly engaged the private sector to assist in the financing and delivery of essential assets and services. The private sector, aided by access to comparatively low-cost debt finance, were able to commit heavily to the sector making a valuable contribution to the delivery of essential infrastructure.

Australia's planned investment programme – public and private – was to be underpinned by continuing record government sector surpluses and the ongoing availability of low-cost debt from foreign and domestic financiers. Indeed, the initial $20 billion endowment to the *Building Australia Fund* was in part to be funded by the expected 2009-10 Commonwealth Government's Budget surplus.

Through 2007 and 2008, policy and market reform and strong government budgetary positions saw a strong pipeline of multi-billion economic and social infrastructure being brought to market.

The Commonwealth Government's infrastructure sector reform programme included a significant commitment of federal funds and leadership toward new and renewed economic and social infrastructure.

The commitment to the development of a national pipeline of priority projects, seemingly with much greater certainty, lead to an increase in the underlying capacity of industry participants, in anticipation of a significant nation building agenda.

The growth in mega project opportunities resulted in an increased concentration of market participants, as potential project partners entered into alliances to pool financial and workforce capacity to deliver those significant projects.

As a result of the strong demand for projects and subsequent resourcing requirements, key limitations on the sector's ability to deliver the future planned projects became apparent, principally in terms of an appropriately skilled labour force. Skills and resource shortages resulted in a backlog of financed projects waiting for delivery. *Access Economics* estimated in August 2008 that $160 billion worth of construction activity was currently in market, with an additional $80 billion committed but not delivered.

4.2 – Infrastructure Investment Impacts of the Global Financial Crisis

As discussed in Section 3, the Global Financial Crisis has significantly impacted on the ability and capacity of the private sector to raise finance for planned infrastructure projects, including funding for PPP transactions. This has implications for the bid process, and may also affect the types of infrastructure which will attract funding.

Without action, it is likely that financing difficulties may jeopardise PPP projects which are at advanced stages of planning - and those under procurement.

Already, Australia has seen priority projects like Brisbane's Northern Link toll road ($2 billion) delayed. There has also been media speculation around the viability of major PPP projects like the Melbourne Desalination Plant ($3 billion); the South Australian Prisons PPP ($1 billion), the new Royal Adelaide Hospital ($1.7 billion) and the Sunshine Coast Hospital ($1.2 billion). A number of large offshore PPPs are also facing delays as a result of the difficulty in arranging debt finance.

It is important to remember that the rationale driving the delivery of infrastructure by the PPP model continues to be relevant – the challenges facing the sector are not the fault of government policy, industry practice or the partnership model – but are rather the domestic impact of global financial market challenges. The financing challenge facing infrastructure is not unique to the sector, asset class or market – and this is clearly evidenced by the successful procurement of more than $1 billion in infrastructure PPPs since the global financial crisis.

4.3 – Economic Stimulus Programs & Infrastructure Investment

Governments in Australia and abroad have signalled a significant role for infrastructure development in the various economic stimulus programmes which are being used to mitigate the impact and lessen the length of a global recession.

Infrastructure investment will deliver short-term benefits through supporting employment and introducing liquidity into Australia's economy. Well targeted investment will also deliver substantial long-run returns through enhanced national productivity and efficiency. Stimulus programmes previously announced (and the ones which will likely follow) have identified a pipeline of projects; brought new projects to market and shortened the horizons for the delivery of others. The stimulus package has resulted in the engagement of substantial industry capacity to scope, plan and deliver these projects.

Meanwhile, Australia's state governments have also made substantial commitments to boost infrastructure investment to restore, renew and augment their asset base. Over the forward estimates period, state governments are expected to increase spending, in real terms.

The current economic climate is posing a significant challenge to state governments as well as industry. Dwindling revenues are creating budgetary pressures; with the potential for a downgrade of state government credit ratings providing a further limit to their capacity to fund additional PPP and other infrastructure projects.

There has been significant concern about the ability and capacity of the states to raise debt to meet forward capital commitments. Industry participants have indicated that this question has been exacerbated, given the $60 billion Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) and its impact on state issuance, in spite of the majority of states being rated as AAA. This inability has become real, with Western Australia now turning to the Commonwealth because the market for state bonds has 'disappeared'.

Both governments and the private sector have been significantly impacted by the global financial crisis. The underlying budgetary position of both parties has been compromised. The public sector has faced significant downgrading of tax receipts. The private sector has and will continue to face reduced revenue.

Government must find effective ways to share the costs and benefits of developing public infrastructure with the private sector.

Given the limitations on the private sector financing PPPs, recourse to a Commonwealth guarantee scheme or direct Commonwealth funding should be seriously examined as a possible funding alternative to supplement and top up the scarce funds available from the bank debt market.

As the credit market situation worsens and becomes entrenched for the short term, the case for Commonwealth intervention – supporting or providing funding for infrastructure projects - becomes more persuasive. Addressing the financing situation for PPPs and more broadly, infrastructure is a critical and immediate phenomenon.

5 – The International Marketplace

In an increasingly globalised world where capital is mobile and in constant flux, domestic infrastructure markets need to remain viable and competitive to maintain the right conditions to attract investment. If the current incapacities of the debt markets remain unaddressed, the nation will suffer primarily from a delayed pipeline of projects; with a real risk that the lack of available finance will be perpetuated even after future recovery, instead of moving to developed and robust infrastructure markets.

This section examines three case studies of offshore policy responses to shortfalls in infrastructure financing. In France, government guarantees are being extended to bank loans for partnership projects. In the United Kingdom, the Treasury is now acting to lend on commercial terms to projects which are unable to raise sufficient debt. While in the United States of America, transport projects of 'national significance' are given credit assistance by the Federal Government.

As the domestic effects of the global economic downturn intensifies through 2009 and beyond, it is imperative that Australia's policy makers take decisive action to mitigate the uncertainties in the financial markets; restoring Australia's capacity to resolve the significant challenges faced by the infrastructure market.

5.1 – France: The 'plan de relance' and €10 billion Guarantee for PPPs

In its '*plan de relance'* of economic measures to deal with the global financial crisis, the French Government committed to make nearly €18 billion available for infrastructure PPPs.

In late January 2009, the French Government introduced special amendments to its 2009-2012 budgetary law and PPP frameworks to address the impacts of challenging financial markets and facilitate the funding of PPPs by two forms of government intervention.

The French 'relaunch' plan lays out a two pronged approach to support the PPP market. The first measure aims to restore market liquidity through the provision of €8 billion to the State-backed Caisse des Dépôts (CDC), to help fund different projects via various commercial banks. The second component is the provision of a government guarantee for up to €10 billion in debt finance for PPP projects – delivering easier credit availability for major projects.

It provides for a government guarantee for all bank lending taken out for PPP projects for up to 80% of the private sector financing required for PPPs and concessions, either by senior debt or bonds, with a total maximum allocation of €10 billion.

For a large PPP project such as the proposed €7.2 billion Tours-Bordeaux high-speed rail line, where the private sector is required to contribute some €3 billion, the amended law will make it possible for the government to guarantee up to 80 per cent of the senior debt used to finance the loan at the lower, sovereign borrowing rate.

Government will also not require bidders to submit committed bank letters at the 'Best And Final Offer' stage during the 2009/10 fiscal year. Designed to enable PPP projects to proceed on the basis of government advances, while awaiting improved financial market capacities. This will allow PPPs to be executed on an adjustable financing basis, without finalising arrangements with the banks. While not wanting to encourage uncommitted bids, in recognition of the realities of current conditions, the French Government wants to maximise the opportunities for banks backing competing proposals to ultimately support the winning bid.

5.2 – United Kingdom: Financial Partnership – Government Co-Lending

The United Kingdom model was unveiled by the UK Government in early March 2009. This model has seen the UK Treasury establish its own lending unit to debt-fund Privately Financed Initiatives (PFIs) at the preferred bidder phase, allowing projects to achieve financial close.

In simple terms, this Unit will co-lend alongside commercial participants with the UK Government making available £1-£2billion across 2009/10 to support a pipeline of 110 projects worth £13 billion, together with other approved projects. The Unit will offer long-term, fixed rate loans on commercial terms, with similar fees and pricing as commercial lenders. The Unit will also consider equity bridge loans.

Designed to function much like a bank, the unit will have its own internal credit committee governance and due diligence procedures, with a mandate to lend on commercial terms where it is satisfied that private debt is not sufficiently available on appropriate terms. For example, the Unit may offer debt to a project where outlier private lenders are pushing up the overall costs of debt. The Unit can provide up to 100 per cent funding, but the clear policy preference is for the private sector to raise much of the debt required, with Treasury funding the gap.

Obviously, public lending alongside the private sector raises some issues which will require clarity to both the public and private sectors. For example, intercreditor issues could be a concern and appropriate intercreditor arrangements would need to be made addressing matters such as voting rights and enforcement rights – also conflicts between the government parties to the transactions may arise.

Identifying the pre-qualifying lending criteria including what constitutes proof that the market is not able to provide sufficient debt funding for a particular project will be important. In addition the funding used to co-lend to PPP projects will be sourced from realising efficiencies in government departments. This may have an adverse impact as it gives this private financing initiative a public impact, costing the taxpayer more.

The methodology by which sponsors would be able to access public debt financing is not yet apparent – will each bidder negotiate pre-bid with the Treasury unit or will they bid for the project with whatever private debt they can arrange and effectively seek, as a bid item, public debt on certain terms?

Another matter needing clarification in the UK model is the term of public and private sector debt – it is highly likely that further government support on refinance will be required.

This PFI lending unit will be a special division of the Treasury and will operate at arms-length from the procuring authority and sponsor. It has been established as a temporary measure until 2010 – and it is the intention of policy makers that the loans will be sold to the private sector once the market stabilises.

5.3 – United States of America – TIFIA

The US Government's *Transportation Infrastructure Finance and Innovation Act* 1998 (**TIFIA**) established a Federal credit program for eligible transportation projects of national or regional significance. Its goal was to leverage limited Federal US Government financial resources to stimulate private capital investment in transportation infrastructure by providing credit assistance in the form of direct loans, loan guarantees, and standby lines of credit (rather than grants) to projects of national or regional significance.

Under the TIFIA scheme, the U.S. Department of Transportation (US DOT) offers three forms of credit assistance to transportation projects that have a dedicated revenue stream:

- *secured (direct) loans to project sponsors:* A debt obligation of the US DOT as the lender, and a non-Federal project sponsor as the borrower;
- *loan guarantees to institutional investors that make loans for projects:* Any guarantees or pledges by the US DOT to pay all or part of the principal and/or interest on a loan or other debt obligation of a project sponsor to a guaranteed lender; and
- *standby lines of credit:* This standby credit facility represents a secondary source of funding in the form of contingent direct loans that may be drawn upon to supplement project revenues, if needed, during the first 10 years of a project's operation.

Designed to fill in project gaps and leverage private investment with subordinate capital, the 10-year federal program offers low interest loans, pegged to Treasury rates, to transportation departments and private investors, and includes funding for multi-modal and cross-modal facilities.

To be considered for funding under the TIFIA scheme, project sponsors must submit proposals, including financial plans, to US DOT for consideration. In making an assessment of worthiness of the project for funding, projects are ranked based on a series of weighted selection criteria:

> Private Participation (20%); Environmental Impact (20%); National or Regional Significance (20%); Project Acceleration (12.5%); Credit Worthiness (12.5%); Use of New Technologies (5%); Reduced Federal Grant Assistance (5%); and Consumption of Budget Authority (5%).

In the decade since it was launched in 1998, the program has provided $8.05 billion of credit for highway, transit and intermodal projects, mostly backed by user charges.

The current financial constraints have led to a renewed focus on TIFIA, its budgets and terms of access on the basis that it may provide a useful existing vehicle for the US Government to support private investment in transport infrastructure.

In 2008, TIFIA funding was used by Australia's Transurban Group to obtain $US589 million subordinated debt at a low fixed interest rate of 4.45% for 40 years for the Washington D.C.'s $1.4bn Capital Beltway project. Transurban became the first company to combine TIFIA funding and tax-exempt private activity bonds within the one project structure.

A similar transport sector-specific program may warrant consideration for application in Australia.

6 – Solutions in the Australian Market

The problems in financing Australia's infrastructure assets are not caused by domestic policy failures, Australia's private sector or the PPP model. As discussed in previous sections of this paper - these challenges are far from unique in their impacts on the infrastructure sector – or the national economy.

But the result of fewer banks providing less debt for infrastructure projects has resulted in a significant funding gap for PPP projects. This gap continues to increase as projects increase in scale, number and cost. The following table shows, for a $2 billion social infrastructure project, the funding gap which has opened as a result of credit constraints:

Instrument	Amount	Percentage
Equity	$ 300 million	15%
Senior Debt – banks	$ 600 million	30%
Total Committed funding	$ 900 million	45%
Funding Gap	**$ 1,100 million**	**55%**

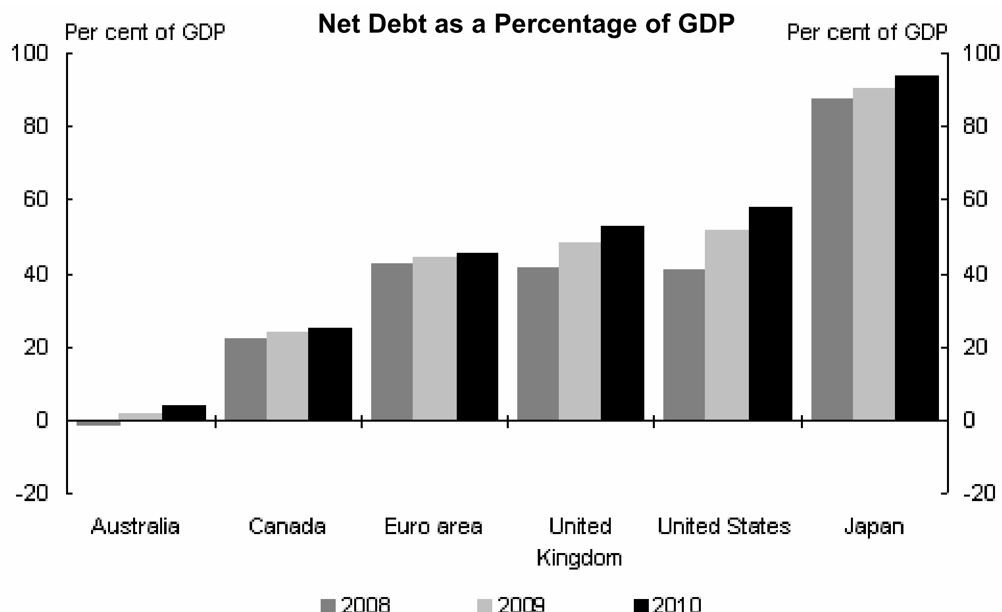
Source: Amalgam of RBS & CBA data March 2009

It is apparent that for PPP infrastructure projects to reach a successful conclusion in the current market, they will require an alternative source of funding. There are various models which are available to Australia's policy makers – which are outlined below.

What is clear is that any solution will require decisive and considered intervention by the Commonwealth. As discussed in section 4.3, the ability of state governments to raise capital on reasonable terms is low or non-existent. The only option available to ensure suitable ongoing investment is for Commonwealth intervention and investment.

Simply put, a PPP project which requires in excess of approximately $800 million now requires an upfront subsidy payment or alternative support from the Commonwealth Government to proceed.

Even in the current circumstances, the capacity of the Commonwealth balance sheet is strong. As demonstrated in the graph below, even after the significant stimulus packages and debt announced by the Commonwealth, net debt as a percentage of Gross Domestic Product will be less than 5 per cent in 2011 – comparing to more than 90 per cent in Japan; and most compellingly, nearly 60 per cent in the USA and more than 20 per cent in Canada – two nations which have already announced significant support programmes to ease the delivery of infrastructure in those nations.



The net debt of all states is also relatively low but the abilities of state treasuries to raise debt through issuances and borrowings has been called into significant question – with industry participants citing the attraction of Commonwealth-guaranteed banks crowding out state governments.

A range of financing partnership opportunities exist which, singly or used in conjunction, may increase the appetite of private sector financiers to fund PPP projects via different funding mechanisms and structures including risk sharing, guarantees or underwriting and direct funding by government to the PPP project.

To address the current financing difficulties for obtaining private sector funding of PPPs in a capital-constrained market, this paper examines a number of options for private sector lenders to partner with government to finance projects and ensure that infrastructure assets are developed and value-for-money outcomes are still achieved**.**

1. **Government Co-Lending Model**
2. **Guarantee Model**
3. **Government Capital Contributions**

The impacts and ease of implementation of each model is described below;

	Achieves viability of current PPPs	Commonwealth balance sheet liability	Ease of exit for the Commonwealth	Ease of implementation for the Commonwealth
Commonwealth co-lending on commercial terms to fill the funding gap	**Yes**	**Full liability.**	**3-5 years alongside private sector lenders.**	**Following the UK experience the Commonwealth would need to establish a dedicated unit to assess lending requests on a case-by-case basis.**
Commonwealth providing a guarantee to fill the funding gap	**Yes**	**Contingent liability that a counterparty State defaults.**	**3-5 years alongside private sector lenders.**	**A specialist unit within the Commonwealth Treasury to advise on the provision of a guarantee to large, nationally significant infrastructure projects.**
Direct Commonwealth grant to fill the funding gap	**Yes**	**Full liability.**	**Generally, no exit – cash is spent.**	**Easy. However, in current circumstances the Commonwealth would need to borrow to provide the subsidy.**

One issue which is common to each model is whether the funding or support is provided at the Commonwealth level or directly or indirectly by the states. Clearly for efficiency and value purposes, the Commonwealth will be required to support or lend either to the states and territories or directly to prioritised projects. It seems preferable for several reasons that any financing partnership model is implemented at the Commonwealth Government level. As an added layer of risk management, it may be prudent to ensure projects are counter indemnified by the procuring state.

6.1.1 Government Co-Lending Model

The Australian application of this model would see the Federal Government provide gap funding of the project debt *pari passu* with the private sector, or under a subordinated arrangement, affording lower overall debt funding costs for infrastructure projects. In its broadest sense, this is a financing partnership with the Commonwealth intervening as a gap funder as required.

The ways in which the Commonwealth can participate include:

- gap funding or bridging finance variants where bidders are permitted to submit partially underwritten bids at bid close and government funds the shortfall not available in the market;
- partial funding, with a set refinancing period, where government funds the project alongside the winning consortium, with refinancing set for a future specified time when credit markets improve, or;
- a prioritised version of the Supported Debt Model – already used in Queensland for certain projects - where government partially funds the operational phase.

Where there is a limit or shortfall in committed funding from the market, the Commonwealth is called upon to finance the remaining portion of debt for which the private sector could not source full funding from commercial markets. This may involve governments no longer requiring fully underwritten bids, recognising current illiquid debt market conditions and then stepping in at financial close to provide the remaining unsyndicated portion of the debt that the successful bidder was not able to finance.

This should be a temporary lending situation, where government undertakes to provide the outstanding debt portion until full syndication is possible – reverting to a 'pure' model when financial markets begin to function.

In order to preserve the banks' credit commitments, the Commonwealth bridge funding tranche would need to accept very limited voting rights in intercreditor issues, noting the potential for perceived conflict between government (whether at state or Commonwealth level) as being both debtor and creditor. The Commonwealth should take strong comfort that banks will act in the best interests of all senior lenders. This also applies to Government's position under the Supported Debt Model.

6.1.2 Guarantee Model

The guarantee / underwriting model involves government underwriting financing risk and providing a government-backed credit guarantee to lift the bond ratings. The guarantees could apply at the project level for operating risk - or at the finance level to reduce finance risk.

6.1.3 Government Capital Contributions

This involves government contributing part of the capital cost to a project at financial close or providing a capital contribution that is progressively drawn alongside private debt and equity to reduce service payments. As it involves taking either an equity or quasi equity position, risk allocation and the appropriate exit strategy are important issues to consider.

These government contributions may be by way of equity contributed to the project vehicle appointed to undertake the infrastructure/PPP project or more likely, through a contribution to the project costs outside the project vehicle, thereby reducing the service payments and eliminating the need for agreement on issues such as ownership and termination arrangements.

This approach runs a greater risk than other options of compromising the risk allocation and presents a long-term impact on the Commonwealth balance sheet.

6.2 A New Financial Partnership – Policy Options for Australia

Option 1: Government Co-Lending – A New Financial Partnership

This option would see the Commonwealth co-lend to PPP projects, alongside commercial banks in the short to medium term – while having the right (and intention) to exit when the market recovers its capacity. To minimise risk to taxpayers, it is important to include an explicit requirement that more than one Australian bank be amongst the lending syndicate. This requirement would ensure suitable due diligence and risk management by the public and private sectors, providing added security for this Australian taxpayers' investment.

While this form of support is not likely to be required by smaller social infrastructure projects (by virtue of scale and risk of those projects), it would provide critical and immediate support for large social and economic infrastructure projects like major teaching hospitals, major prison PPPs and toll roads.

Comparable foreign governments have already introduced policies to allow them to take a role in provisioning of debt finance for at least the initial funding term (e.g. M25 in Britain) where it has been shown there is insufficient debt funding available for larger projects from the private sector. More information on those approaches can be found in the International Marketplace (sections 5.1 to 5.3).

The category of projects which would qualify for a co-lending arrangement would also need careful consideration. Not only should co-lending arrangements be structured to terminate when market conditions sufficiently stabilise – they should also be used only for key infrastructure projects deemed to hold national significance.

One option could be an expanded role for the *Infrastructure Australia Advisory Council* – in cooperation with the Council of Australian Governments - to designate appropriate projects as candidates for support under a Commonwealth co-lending arrangement. Projects considered for support and investment would (and should) extend beyond the current *Infrastructure Australia* priority list – and must include large social infrastructure projects – they should be objectively assessed to ensure clear economic, social and environmental benefits.

Another approach to the structure of government involvement is to adapt the UK Government co-lending unit approach which is discussed in more detail in the *International Marketplace* chapter at Section 5.2.

There are various approaches and structures that government could apply to co-lending arrangements, but an issue common to each of them is how they would impact the settled PPP tender process. For example, government could inform the bidders upfront of the offer

to co-finance in the bid documentation or allow the bid process to proceed and make the offer to co-finance to the shortlisted bidders or single preferred bidder if (and only if) the shortlisted bidders are unable to obtain committed financing to submit a fully-committed bid or achieve financial close respectively.

The Commonwealth could conduct a blind underwrite through a Special Purpose Vehicle (SPV), which would be specially established within government for funding eligible PPP projects. Conducting a blind underwrite may be preferred by the Commonwealth for a range of reasons, including particular policy, inter-governmental, political or prudential concerns.

This Government SPV would be funded by Federal Government guaranteed debt, preferably bonds with common maturity dates so that the issues are fungible. To promote market liquidity and ensure commercial terms, this proposal could provide project funds, while delivering suitable motivation for bidders to seek external funding by a premium on the front end or establishment fee charged on the government component. Without appropriate checks and balances – and particularly when the government debt component is high, a potential disadvantage could be a perverse incentive for bidders to aggressively accept risk that private sector bidders would not usually assume.

The Government SPV would act as a facilitator and conduit to the market for lending for the project. It could be an externally managed SPV to service the Federal Government or possibly all levels of Government. It would be set up for a finite period only (say, for a period of 1-2 years) as a temporary contingency measure, available to PPP bidders and proponents, to overcome immediate capital-constrained conditions while waiting for the market recovery. Extension of the SPV mandate would be at the government's discretion, reflecting market conditions.

When it is deemed the lending market has improved or the time period has expired, government would act on its set exit strategy and sell the Government SPV, independent of syndicate participation terms or bond issue terms through debt defeasance.

As governments would not wish to remain in this business once efficiently operating debt markets return, their exit could be by sale of the SPV, rather than by sale of the individual loans. This would allow exit at a time independent of syndicate participation maturity terms or bond issue terms. Market purchasers could do their valuations based on pricing to maturity of the portfolio of loan assets and by a defeasance calculation of the Federal Government guaranteed funding benefit. It is contemplated that entry of the private sector into SPV or replacement of individual loans would trigger voting rights on the same terms as existing bank lenders.

While the SPV may end up with a small portion of unsuccessful loans, they will be in the same portion as the market and can be sold as part of the portfolio, rather than the government ending up with a residual book of only bad loans.

To the limited extent that management would be necessary, the government SPV could be externally managed by a syndicate of local and overseas banks, by the agency group/s of these banks on behalf of participants, or by suitably qualified, directly employed experts as within the UK Treasury Unit.

It is important that government participation in the Government SPV debt funding is on identical terms and conditions to the private sector funders including funding, completion risk, maturity term and termination rights as well as priorities and rights on default. However in this regard certain criteria and limitations may have to apply to government, due to the conflict of interest arising with government acting as both procurer and lender. For example, once government participates in co-funding a project, it would not be permitted to be involved in setting direction in the SPV or to invest or take equity in the project and it would not have voting rights. These restrictions should fall away on sale of the SPV or individual loans as mentioned above.

Such underwriting provisions offered by Government would be available to all bidders, but there would be some financial disincentive attached to using it (so it would not become oversubscribed). Once a bidder takes up the Government underwrite offer under the terms of engagement set by Government, a number of banks would be approached to commit to the funding.

Option 2: Government Guarantees:

This option proposes that government establish a credit guarantee scheme to provide the banks with a buffer to withstand the current challenging economic conditions and support the orderly issuance of debt guaranteed under the scheme.

A PPP Guarantee Scheme would be similar to the existing Guarantee Scheme for banks in that it would be a contingent liability for the Commonwealth and does not require upfront funding. The proposed PPP Guarantee Scheme responds to the same malaise that spurred the Australian Business Investment Partnership (AIBP): uncertainty and incapacity in the Australian syndicated loan market. However, unlike the ABIP, the proposed PPP Guarantee Scheme would be directed at particular critical infrastructure projects based on a known cashflow committed by state governments; not property asset values.

Unlike the Guarantee Scheme for Large Deposits and Wholesale Funding, the PPP Guarantee Scheme would be based around a list of PPP projects rather than a list of financial institutions. This is to ensure that the widest possible sources of debt are available for each PPP; not limited to authorised deposit-taking institutions (ADIs) or certain other financial institutions in Australia.

If the Commonwealth Government is to provide support to PPP projects, the least balance sheet intensive solution would be to underwrite the project by extending a guarantee to issuances for specific PPP projects (similar to the bank wholesale funding guarantee). Direct guarantees are a contingent liability for the Commonwealth and offer a relatively low-cost support mechanism for PPP projects. Guarantee debt can be issued against specific projects or pools of projects. It can be ranked so it has differentiated claim against the underlying asset in case of liquidation.

While the primary driver of this approach is to generate market capacity to absorb large infrastructure projects, it may be that the application of guarantees would lower capital costs for PPP projects for the duration of the guarantee. The Commonwealth Guarantee for PPPs proposal would require the Commonwealth Government to develop a structure for the issue of AAA-rated bonds aimed at institutional investors, which would provide a percentage of the debt requirement for each project – assuming the percentage may be much higher for larger projects which currently face the greatest debt shortfalls. The bonds could be guaranteed by government for an initial period of around 5 years, and then would be subject to refinancing.

A funding competition would then be run. The expressions of interest process would identify potential for funding assistance, and the bids received would identify the extent to which Commonwealth Government-guaranteed bonds would be used.

As with the Commonwealth co-lending model, appropriate safeguards, risk management and due diligence processes would need to be in place to safeguard the Commonwealth Government from unduly risky projects. However, the contingent liability to taxpayers is limited to the term of the guarantee, and the refinancing regime (including who bears upside/downside risk) would be set out at financial close.

Counterparty exposure for guarantee fees would effectively be with the state government. There would be potential for state governments to provide backstop guarantees, thereby ensuring state governments only negotiate bankable projects and limiting the exposure of the Federal Government to state government counterparty risk.

Inter-creditor regimes would essentially be the same as in a co-lending situation. If the state governments provide backstop guarantees, inter-creditor arrangements would be additional feature of PPP project documentation.

Option 3: Government Capital Contributions

Direct capital contributions by governments will always have a significant and important role in the delivery of infrastructure. A significant portion of infrastructure will never be suitable for PPP procurement and some projects will require Commonwealth or state government contributions to make the economic case for development under a partnership model compelling, as occurred with Sydney's Westlink M7.

But for projects which would, under ordinary financial circumstances suit a pure PPP model, this third option has the greatest balance sheet impact, effectively locking in a whole of life solution to funding problems which in all likelihood will exist over just a few years.

This model would see the government reduce the debt funding requirement for a given PPP project by contributing part of the capital cost, this contribution could be made through a direct, up-front grant to lower the overall cost of the project to bring it within the capacity of debt markets.

For state sponsored projects, the Commonwealth could also take equity in the project's SPV or make a contribution outside the SPV, thereby reducing the service payments. Government capital funding and subsidies were successfully used to support recent Queensland and Victorian toll road projects.

This is a partial funding measure to assist the progress of a PPP, as distinct from full funding. It maintains the benefits provided by the private sector in PPP procurement such as the project discipline and competitive financing input from consortium bidders, which may be lost if the PPP procurement process is removed. It has the added benefit of avoiding complex intercreditor issues which will be exacerbated if the Commonwealth is also the procurer.

6.3 Other Support for PPP Models

Given the unsettled financial environment, other risks in Public Private Partnerships have emerged, in addition to the lack of liquidity in debt markets. These risks include refinancing risk and market disruption. Another risk which may have significant cost consequences (and which cannot be fully anticipated) is the situation where finance terms may be affected by adverse changes in the procuring state's credit rating.

These matters are discussed below – and equally, warrant action by government.

6.3.1 Government Refinancing Support

This lack of liquidity, departure of foreign banks from the domestic market and collapse of bond markets as source of funding have made refinancing risk a significant concern for business broadly. In response to the financial crisis, all banks have reduced debt funding terms (tenor) over the past several quarters. Although domestic banks have always been reluctant to lend for terms beyond a decade, there is now a marked resistance among the banks to offer long tenor debt for both new loans or on refinancing.

This is particularly risky for PPPs, whose concession periods typically extend to over 25 years or more. The private sector concessionaire will therefore be exposed to more regular requirements for refinancing over the economic life of a project, with the potential for

significant refinancing downside in future market likely to present far fewer positive options than in the past.

Refinancing assistance by government is required to overcome this increasing risk – and the problems of addressing less favourable refinancing terms, and the shorter debt terms applied to otherwise strong project credits for existing PPPs.

Banks are cautious of taking on a position where borrowers will need to rollover (or be in default) at the end of the facility term except in some cases where protections are in place such as where the base case assumes a significant margin step-up.

In the past, bidders have only been able to share upside with the public sector. Government has shared in refinancing benefits by building an upside assumption in at tender, but not taken a share of risk of increased costs at refinancing. If government were to fund a PPP project directly, it would face 100% of the refinancing cost or benefit ie. it would be entitled to the upside (gains) and the downside (losses) of refinancing. This is no different to the risk the government would take if it undertook a project on balance sheet and issued bonds in the market.

As a co-lender, Commonwealth debt will be an interim measure and government should have a right to initiate a refinance both as to price (that is a share of the benefit) and as to the amount to reduce or take out the Commonwealth co-financed component.

It is a question for government to ensure that in its evaluation, government makes a proper comparison in terms of the value to government of the sharing of the refinancing gains. There are a number of ways that the value of the refinancing potential gain could be made more explicit – whether through assumed refinancing which results in no sharing for government but a lower cost in terms of tolling or availability payments or whether it is through changes in thresholds or percentage sharing.

Of note, refinancing risk as an issue does not seem to be specifically addressed in establishing the UK Treasury's lending unit.

After appropriate market testing confirmed that a project could not economically be refinanced through the private sector, government could be required to intervene to refinance. This should reduce equity pricing excessive refinance risk into its required return and may assist to reduce debt margins to the extent that some addition is incorporated for end of term risks.

Government support for refinance of the private debt component may only be required for a period of 2 or 3 years post completion but refinancing support will still be reciprocal beyond that period to ensure defaults are not triggered if no private sector take-out is available. In addition, as assuming refinance risk means that government takes operator as well as finance risk, its exposure should be qualified where the price on refinance is increased because of performance of the asset (i.e. if the returns are at or above base case level, government would cover increased finance costs and if below, equity and debt would take the risk).

6.3.2 Market Disruption

Most banks currently insist on the right to recover increased costs based on reasonably settled definitions of market disruption. Equity may accept this risk although that still leaves the banks to accept any increased solvency risk consequent on the higher equity returns where, as is usual, the project is highly leveraged.

Depending on the type of project, recourse to uplifts in service payments and in the contract term may also be used to address this risk.

6.3.3 State Credit Ratings

Credit risk on the relevant procuring state as maker of service payments under the Project Agreement has not in the past been seen as a major issue and has not generally appeared in finance term sheets as a lending condition. Current circumstances bring it into play and that may involve increased debt pricing. Equity is likely to seek to pass this on through the service charge.

7 – The Way Forward

The extraordinary changes in the global economy have combined with contractions in the domestic banking sector, creating an environment where the financing of major infrastructure projects in the short term will require a thorough engagement by the Commonwealth Government in a new, genuine and highly functional financial partnership toward the Nation's future.

Exciting and necessary national reforms to Australia's infrastructure market have, unfortunately, taken place during the onset of what is widely described as the most significant reversal to global wealth since the Great Depression. It is estimated that over the past twelve months up to half the value of international capital markets has been lost.

This unprecedented funding challenge is overlaid by an equally unprecedented national requirement for renewed infrastructure investment. Restoring, renewing and enhancing the capacity of Australia's infrastructure asset base will be the key to national economic recovery and future prosperity.

The clear and unambiguous way forward for Australia will require significant engagement and support from the Commonwealth Government in the short term. This will require one or more financing solutions involving the Commonwealth Government, namely;

1. **The Commonwealth Treasury to act as a co-lender to nationally significant PPP projects over the short term, meeting the gap created by the current incapacities of debt markets.**
2. **The Commonwealth to provide a debt guarantee to nationally significant PPP infrastructure projects to allow the private sector to raise sufficient debt to meet the financing gap.**
3. **The Commonwealth to provide direct Commonwealth grants to fill the financing gap on appropriate PPP projects.**
4. **The Commonwealth to take action to mitigate refinancing risks arising from the unavailability of long tenor debt.**
5. **The expansion of *Infrastructure Australia's* remit to ensure the rigorous appraisal and selection of appropriate social and economic infrastructure projects for support under a new, national financing partnership to meet short term challenges.**

The policy reforms should be seen as transitory – neither the Commonwealth nor the infrastructure sector has an interest or appetite for Commonwealth intervention to become entrenched.

The policy options recommended in this paper, on balance, provide the most decisive and meaningful way forward. The findings of this Paper present the Commonwealth Government with positive pathways to ensure the continued delivery of infrastructure while protecting the national balance sheet; the recommendations provide a method for the public sector to exit, once the financial market disruption has reached resolution over the short to medium term.

The significant cost savings, efficiency gains and value for money delivered by the PPP procurement model must be supported through the current, short term market failure. This will ensure that Australia continues to harness the efficiency, capital and innovation of the private sector.

Infrastructure Partnerships Australia
8th Floor, 8-10 Loftus Street, Sydney NSW 2000
www.infrastructure.org.au

T 02 9240 2050
F 02 9240 2055
E contact@infrastructure.org.au