

***Infra*-News**



Global PPP/ Infrastructure Yearbook 2005

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Middle Age for the PPP Market?

Tony Poulter, Global Head of Government & Infrastructure, PricewaterhouseCoopers reviews the year...

2004 should be remembered in the UK as the year the local market reached a new level of maturity:

- The primary market continued to run at a total value of about £5 billion, but this was a function of several small and medium sized projects. There were no mega deals to distort the figures as there were in 2002 and 2003, the largest new transaction being Colchester Garrison at £700m. Instead we saw momentum in the LIFT and ISTC programmes (30 deals closed with a value of £744m); housing and waste promised to develop into sectors with strong deal flow, as lessons were learned from the early transactions; while hospitals continued, with a sensible number of specialist bidders. Old defence sector friends like Aquatrine, born in 1996 also contributed, challenging in the process the record for the most protracted completions; while the uncompleted saga of the year was FTSA (again). Despite all this activity there is an unmistakable sense of mild boredom in some quarters at the repetitiveness of implementing SOPC3; but perhaps that's only among legal and financial advisers, rather than the sponsors and funders.
- The debt refinancing market changed from having the odd deal to seeing a real volume of activity. Finance was put in place in the bank market with margins of around 80bps, covers below 1.20 and debt tails of around 12 months. In the bond market there were similar covers and debt tails, tighter spreads and lower fees - a consequence of fierce competition between underwriters and monoline insurers. Most parties have been applying the principles of the Treasury Code of Conduct; although it is rumoured that further clarifications to this may be issued in the New Year.
- The secondary market, debt refinancing's equity cousin, also had a good adolescence. Bidding was aggressive for both single project stakes and portfolios, in particular between the funds established specifically for such investment. SMIF, Infrastructure

Investors, Innisfree and Henderson all picked up assets through the year and Star Capital is also a force in the market.

- For the second year running there were some major failures. Jarvis as we know it has passed away but as the year ends appears to have sold both its holdings in smaller projects and the large Tubelines stake (itself the subject of an earlier refinancing). The National Physical Laboratory project was terminated, some time after the contractor effectively walked away from the construction subcontract as uncompletable. But both these events are actually signs of success. They show that the government achieved real risk transfer in its deals and that the market is deep enough to absorb problem projects. Even commentators appear to accept now that a healthy market needs some failures. The Economist, a previous PFI sceptic, acknowledged this with an article of unusual approbation at the end of the year.
- Government's overall agenda moved away from single or even bundled projects focused on a financing, onto broader models for delivery by the private sector of public services, the Independent Sector Treatment Centre programme being the clearest example. There is also growing interest in the role that private participation can play in urban regeneration. It remains to be seen what these developments mean for project finance bankers, but they certainly present new opportunities for sponsors and operators.

Financing competitions and the Treasury's Credit Guarantee Finance approach (the use of Government debt finance) have been the newer kids on the block. In Financing Competitions the Allenby-Connaught, Colchester Barracks and Derby hospital transactions showed the depth of appetite for big ticket deals among bond arrangers, and how pricing has fallen substantially since these deals originally gained funding support, with fees falling to a previously inconceivable 10bp and significant movement seen on monoline pricing as well.

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This has naturally increased the Government's appetite for ensuring that funding competitions become the norm. It remains to be seen whether this is the final stage of commoditisation in the market. Similarly, CGF is formally something to be tried in a minority of cases to test the market and was sneered at here last year; but could it be rolled out to fund big ticket deals, where the lower cost of underlying government finance is seen to give clear economic advantage?

Meanwhile what went out of fashion? Light Rail (too expensive) and large government office accommodation, because a number of departments have already implemented schemes, and the impact of the Gershon and Lyons reports may mean reduced central London accommodation for Departments. The biennial Crossrail announcement this time was that it would proceed - but not with private finance - and a Bill is targeted for the summer. The embargo on local government bond issues died, with Transport for London taking the lead in announcing an issuance programme under the Government's new 'prudential borrowing' regime. Sources are stating that the first issue will be for over £200m but less than £400m.

Finally, on the UK front the people market was quiet at senior levels after some years of activity. The transfer of the season was probably Spence to HSBC - although whether this is a play for the UK Government market remains to be seen -with Abadie bringing a younger and less familiar face to the Treasury (perhaps a Jose Mourinho figure?). Other veterans of the first generation of PFI transactions seemed content to stay where they had been for quite a time now.

Internationally our prediction last year that 2004 would see as much deafflow around the world as in the UK proved - like all predictions - not wrong, just premature. But there was an increase in momentum. Markets particularly worthy of mention are:

- France. 2004 has seen PPPs making their first headway on the French market, with the launching of the long-awaited DBFM prisons tender in November: a PPP-like scheme called AOT/LOA for a programme of 18 prisons, valued at over €1billion. The first tender, for a set of 4, is a real test of the concept and was launched alongside a more conventional design-build contract for 2 others. It will be conducted along the new "competitive dialogue" procedure with the first round of negotiations expected in February. The health sector has used the legislation promulgated in 2003 to facilitate an ambitious €5 billion, five-year plan called "Hopital 2007". Over 30 schemes are identified, at least, with around 10 at various stages of procurement and sizes vary between €10m and €250m. The final approval of the PPP Ordinance and plans for a Ministry of Finance task force may mean that 2005 sees growth and the emergence of new sectors such as public and educational buildings, sport facilities, road maintenance and defence. But the market continues to develop under the shadow a complex legal framework, fledgling political support and uncertainties over the new procurement models.

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- Anglo Saxon cynics have said that the French government is driving the EU's policy on PPPs because it knows it really needs this sort of approach to improve efficiency in its economy but doesn't want to do much itself. Hopefully however, the EU will restrict itself to facilitating cross border deals like Galileo (which eventually got going this year after the impasse on a Director was solved by appointing a

German) rather than making regulations on procurement that actually slow progress.

- Canada finally got to financial close on its first social infrastructure projects – with activity focussed in the health sector in British Columbia and Ontario, as you can read in the article from Aecon in this book, and a healthy mix of Canadian and international developers. In a jurisdiction where monolines are not yet able to operate, these have generally been based on construction finance and an expected bond takeout through private placement, with the equity bearing the risk of the take-out pricing. The RAV transaction in Vancouver (the rail link to the Airport and Richmond, also based on availability-type payments) is the first deal likely to break that mould, closing in the coming spring with long term European bank finance from financial close.
- Australia got more projects financed than in 2003 and promises to do the same in 2005, with New South Wales now running at the same pace as Victoria, and Queensland, Western Australia and the Federal Government all at different stages in their first deals. The dominant feature of the market, though, is the so called ABN-model, which has won the majority of the deals in 2004. Depending on which way you look at this it's either an innovative Principal Finance approach from a developer well tuned to the needs of Government, or a smoke and mirrors structure that promises a low price and leaves all the problems to be sorted out later by the public sector and the subcontractors.
- South East Asia has not yet got fully into gear but Singapore is perhaps predictably the front runner. The year saw the completion of the desalination deal and the launch of the Government's guidelines, along with the projects for waste treatment and a new sports stadium. It will be interesting to see whether these attract investment from international developers or are dominated by successful bids from Government-related groups; but this certainly looks like the market most tuned to the PFI-type model, with Hong Kong more focussed on outsourcings.
- Japan remains, as in most areas, a specialist and isolated market, significant in terms of deal flow in Government accommodation, a hospital and a prison, although with unrecognisably low equity returns and dominated by the local construction sector.

You can read more about many of these developments in this yearbook - which will continue, I'm sure, to be a beacon of illuminating hindsight and sometimes even prescience.

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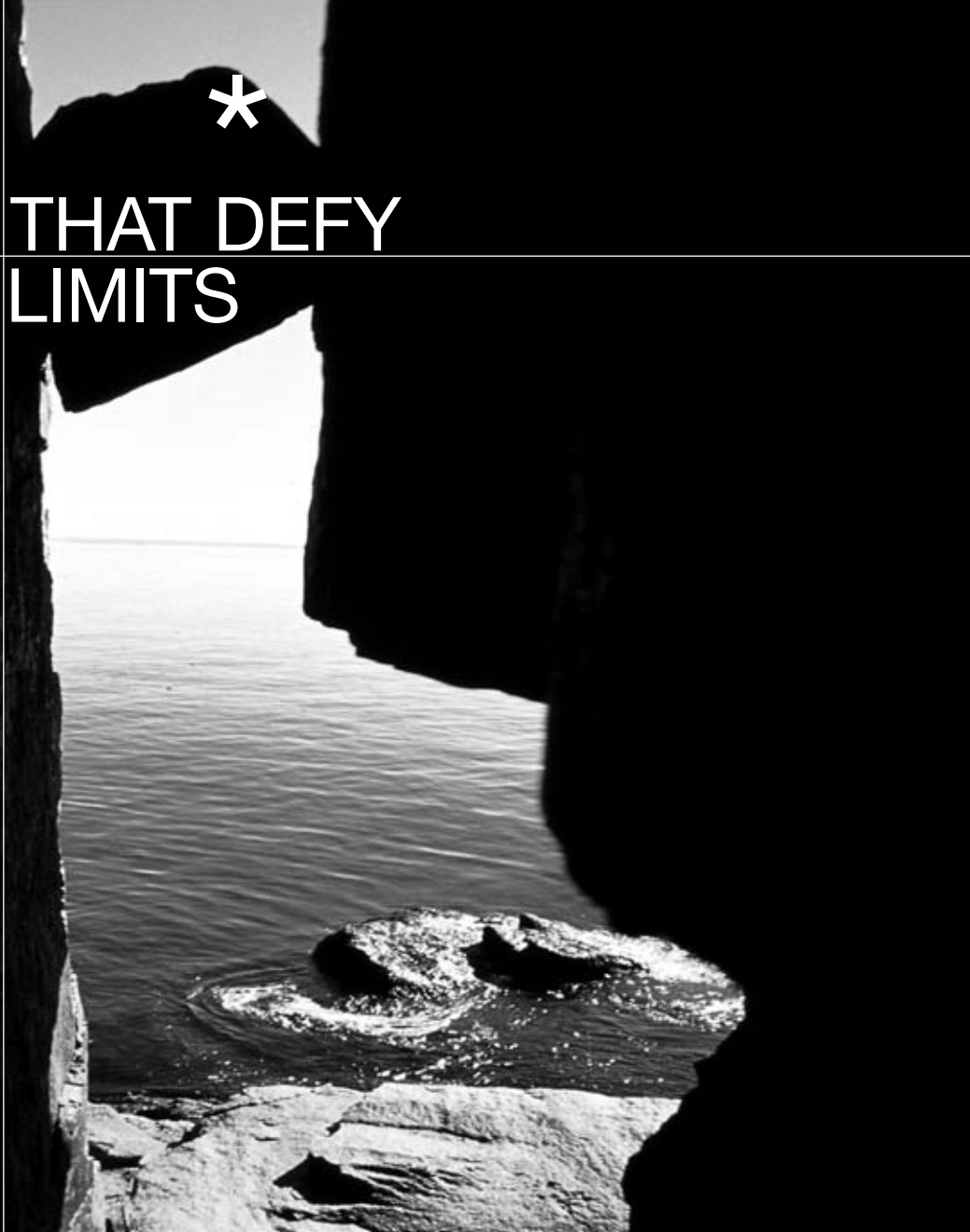
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