



Local situation of PPPs and opportunities for blending financial sources (EFSI, EISI, PPP, other public, private funds), examples and best praxis

Successful projects

Workshop on financing opportunities for the transport sector,
Ministry of Transport,
Riga, 21st of October, 2016

Agenda

Why PPP?

PPPs in Latvia

Successful projects

D4/R7 project

Lessons learnt

PPP

Why PPPs?

Pros and Cons of PPPs compared to traditional public sector schemes



PPPs and the infrastructure investment gap

PPPs enable the inclusion of private capital, which helps solving the infrastructure gap problem.



Budgetary constrains

PPPs may also be chosen as private finance may be the only option available due to public sector financing constraints (i.e. limitations on what it can borrow).



Optimal risk allocation

It is generally assumed that the private sector is better suited to managing commercial risk such as construction and operation efficiency / overrun and service performance.

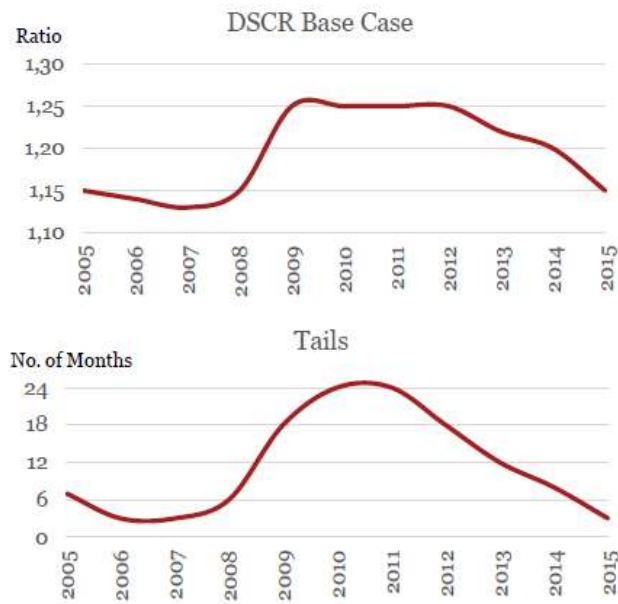


Higher cost and inflexibility

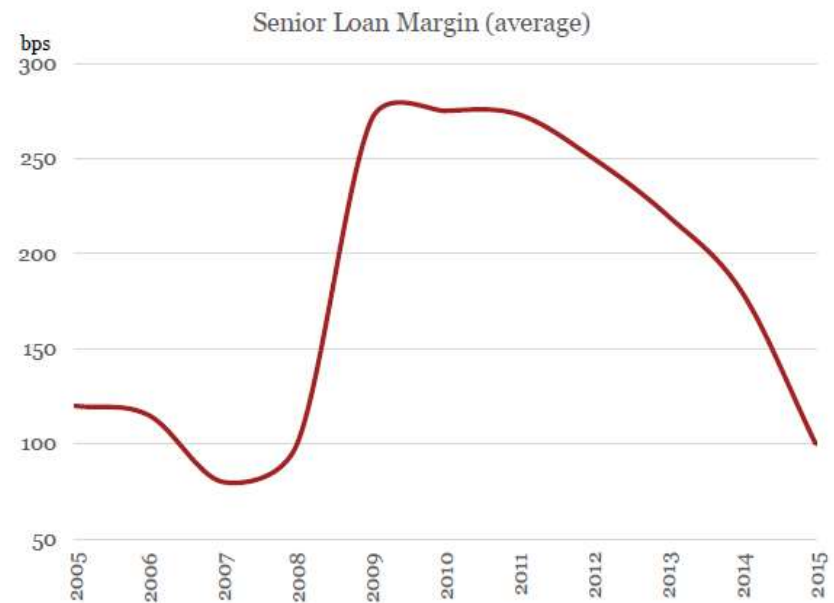
Private sector financing costs are higher than the government's cost of debt. To overcome uncertainties around the future outcomes, PPPs are often burdened by complex contractual arrangements and high transaction costs.

Current situation on financial markets

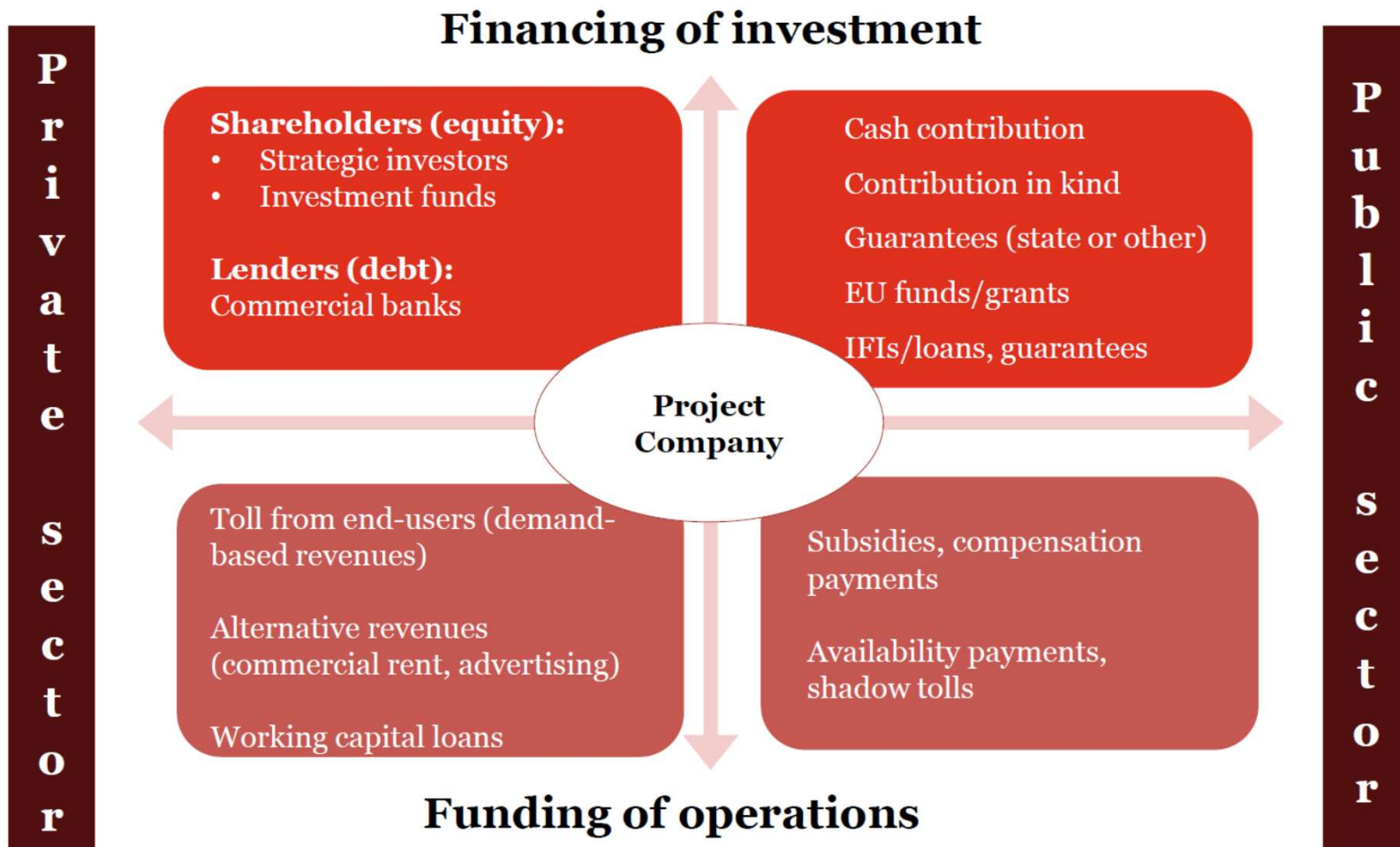
Back to pre-crisis period?



Source: PwC

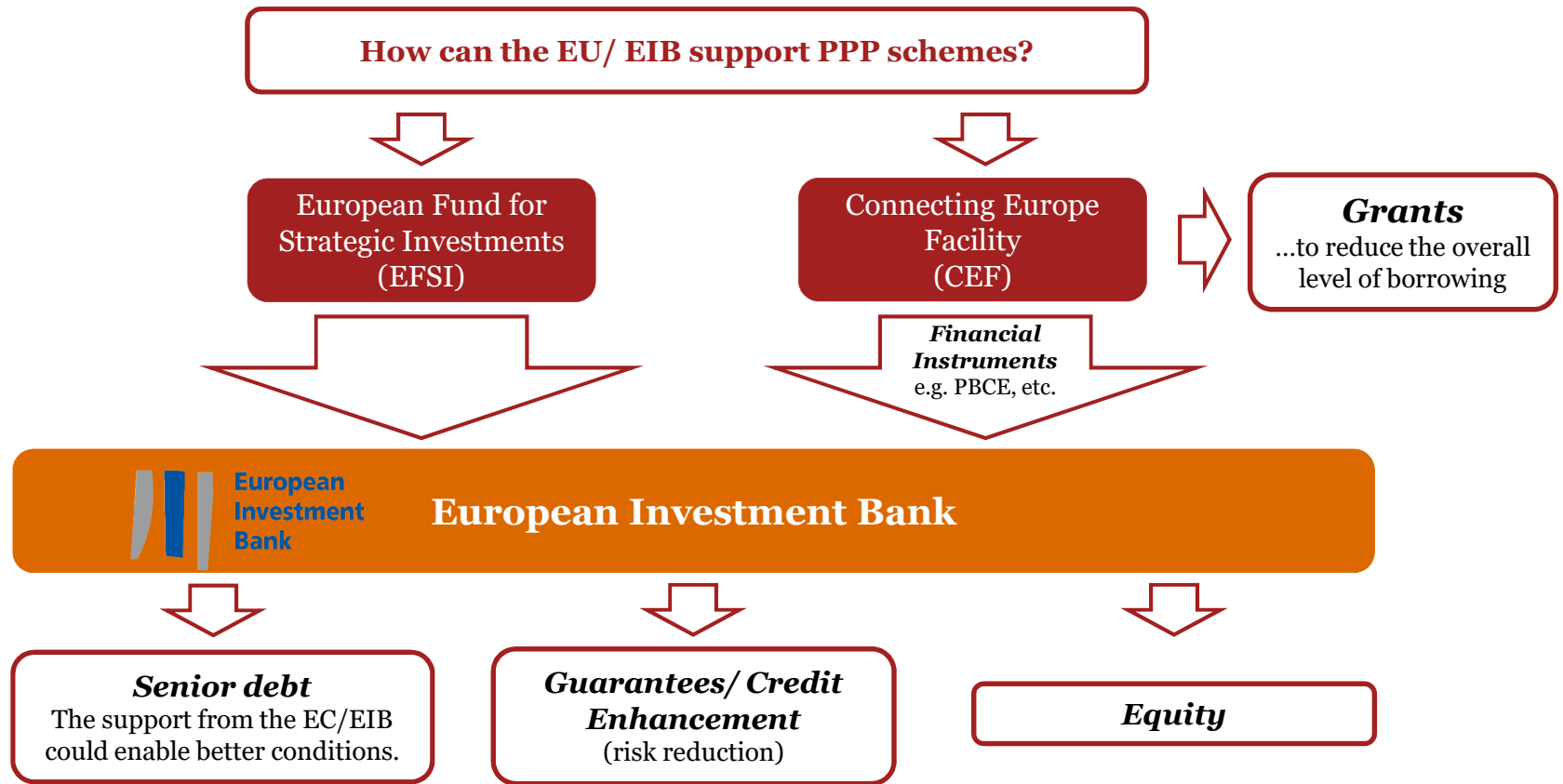


Financing sources for a public/private project



Source: PwC

Structuring PPPs



PPPs in Latvia

The history of the development of PPPs in Latvia

2009:
International Monetary Fund forbids increasing state debts. Commencing of new PPP projects was limited

2016: Cabinet of Ministers approves launch of procurement procedure for «E67/A7 Ķekavas apvedceļš». Success of this project is crucial to encourage future PPPs

2009: The Law on Public-Private Partnership entered into force

2012: PPP contracts are allowed again

2008: First infrastructure PPPs «Rīga Northern Transport Corridor» and «E77/A2 Rīga bypass - Sēnīte» launched

Ķekava bypass project is approved

Contracting Authority

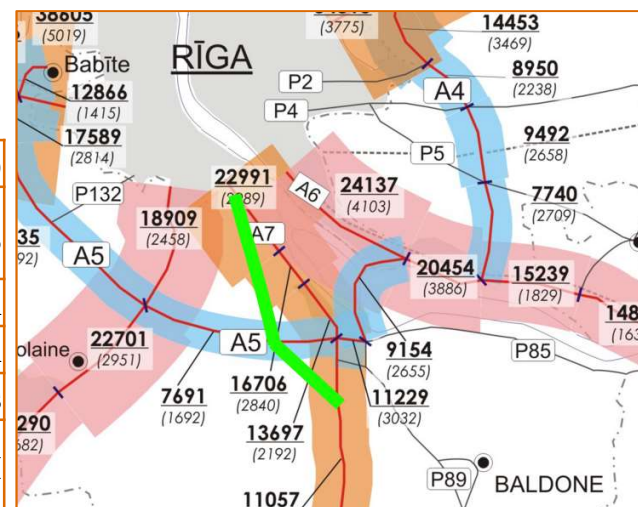
Latvijas Valsts ceļi (State owned company)

Project

Nominal contract value	EUR 160,606,139
Nominal contract value under Juncker's plan	EUR 140,155,033
Road length to be built	14,4 km
Road length to be reconstructed	3,1 km
Length of the contract	At least 20 years
Sources of financing	EFSI

Scope

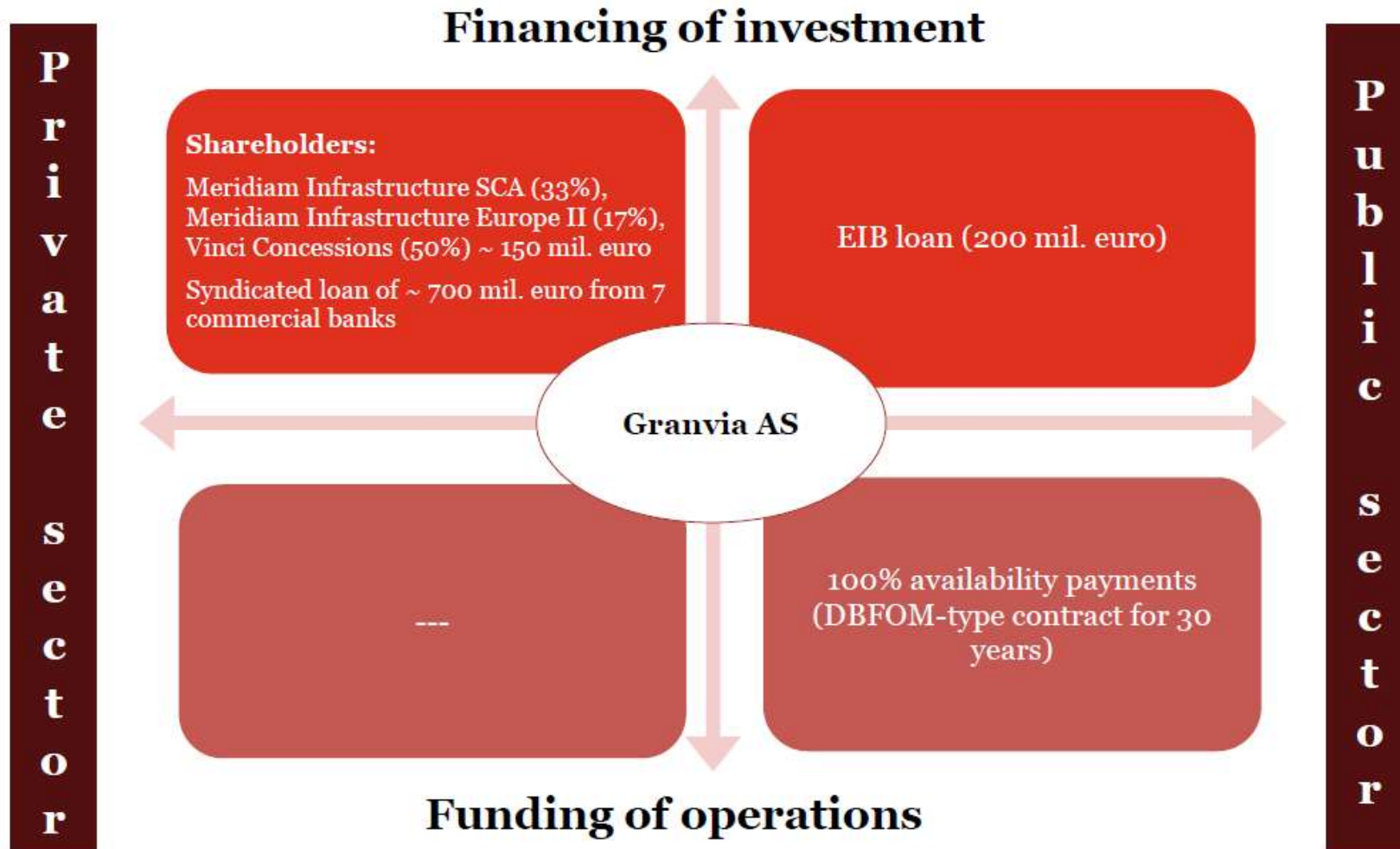
Design, construction, finance, operation and maintenance



Traffic intensity map and Ķekavas bypass
Source: LVC

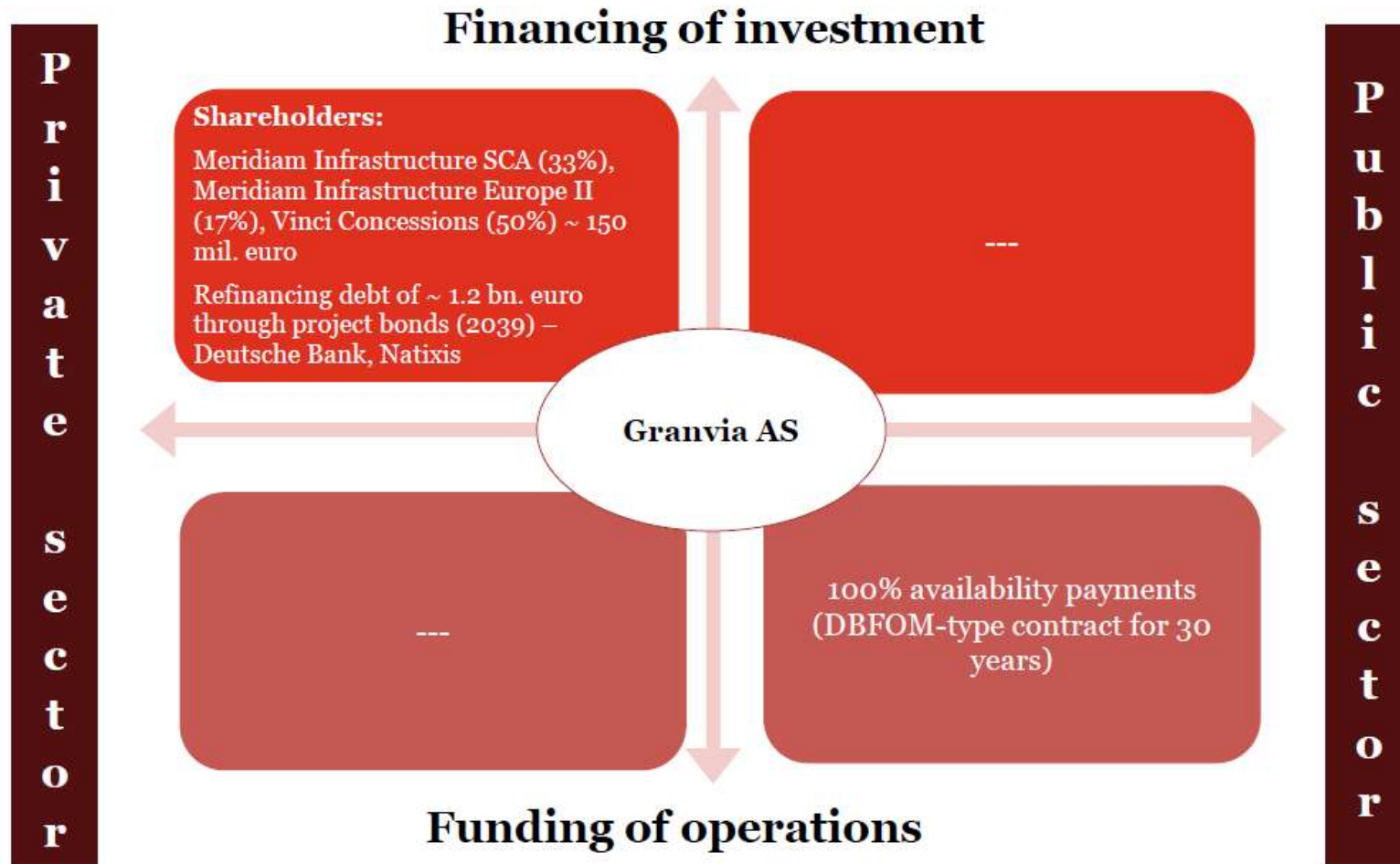
Successful projects

R1 Motorway, Slovakia (2009) ~ 1 bn. euro, 52 km



Source: <https://www.infra-deals.com/>

Refinancing R1 Motorway, Slovakia (2013) 1.2 bn euro (after commissioning in 2012)



Source: <https://www.infra-deals.com/>

D4/R7 project

Key highlights of the D4/R7 project

Contracting Authority

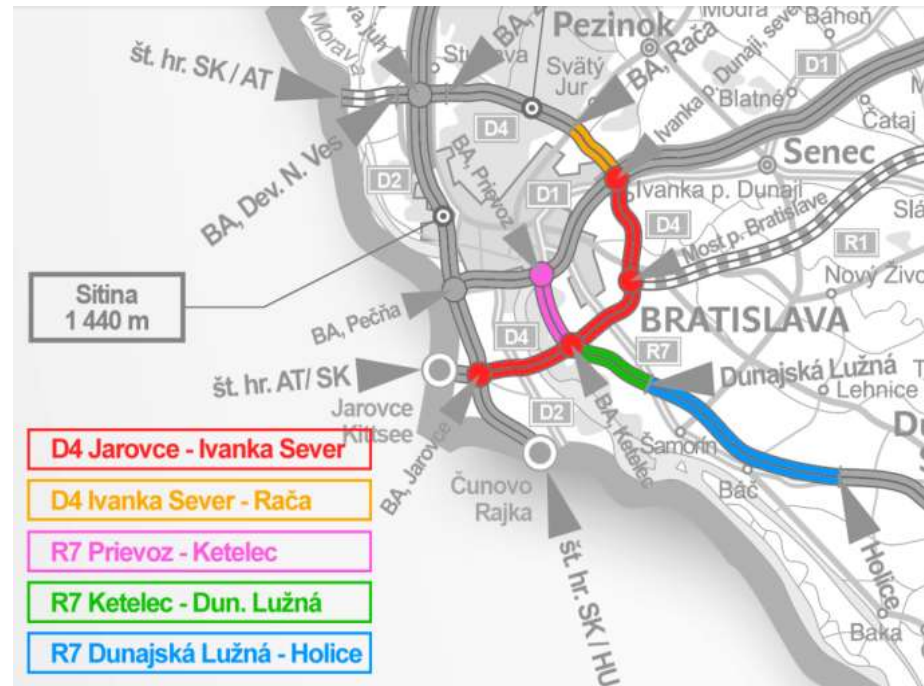
Ministry of Transport, Construction and Regional Development of the Slovak Republic

Project

Two sections of D4 highway representing 27 km of Bratislava bypass and three sections of two-lane R7 dual expressway at the length of 33 km

Scope

Design, construction, finance, operation and maintenance



Key highlights of the D4/R7 project

Payment mechanism

Payments subject to achievement of availability and performance criteria

Key risks allocation

- The private partner will bear construction and availability risk, demand risk will be borne by the public sector
- Project structured as off-balance sheet (Compliance with ESA 2010)

Contract period

Construction 4 years + 30 years of operation period

Procurement method

Competitive dialogue (with 4 shortlisted bidders)

Short listed consortiums

- 4 international consortia submitted final offers:
- ViaDunaj (Vinci, Meridiam)
 - BratislaVia (Hochtief, Iridium, DIF)
 - Obchvat Nula (Cintra, Porr, Macquarie)
 - ASTRELA (Strabag, John Laing, Reding)

Risk allocation matrix

Risk category	Risk allocation		
	Public sector	Private sector	Shared
Land acquisition	✓		
Design & Construction		✓	
Demand (Traffic)	✓		
Operation & Maintenance		✓	
Financing		✓	
Changes in rate of inflation during construction		✓	
Tax changes – specific	✓		
Tax changes – general		✓	
Changes in legislation			✓
Force majeure			✓

Key outcomes of the Competitive dialogue

- Optimisation of the financial structure (involvement of multilaterals including EIB and New Juncker's)
- Technical optimisation of the Project (particularly design of junctions and bridges, road levels, highway technology)
- Reduction in CAPEX
- Development of bankable concession contract and project documentation (documented by 4 binding offers)
- Very competitive pricing in final offers compared to pre-tender estimates which were approx. **EUR 100m-135m:**



Parameter	AVP (EUR)
ViaDunaj (Vinci, Meridiam)	69 m
BratislaVia (Hochtief, Iridium, DIF)	77 m
Obchvat Nula (Cintra, Porr, Macquarie)	57 m
ASTRELA (Strabag, John Laing, Reding)	91 m

Value for Money



Why such aggressive offers?

- Project very attractive, with high priority due to following factors:
 - Macroeconomic and political stability + favourable country rating (A)
 - Attractive but still manageable size of the project
 - Use of innovative financial instruments, EIB funding increased due to Juncker Fund
 - Lack of well prepared similar PPP projects in Europe (ie good timing)
 - Risk allocation and paymech principles deemed appropriate (eg. No demand risk)

- Selected parameters indicated in market testing and their comparison with BAFO:

Parameter	Range in market testing	Typical answer in market testing	BAFO
Gearing	80:20 – 90:10	90:10	
IRR	8 – 15 %	Less than 11 %	Confidential
Margin	150 – 350 bps	Less than 200 bps	

Use of innovative financial instruments

European Fund for Strategic Investments (EFSI)

- ◇ EIB with support of EFSI could increase its lending capacity to a single project
- ◇ **D4/R7 PPP:** EIB offered senior financing up to EUR 500 mil. (EUR 350m of direct funding and EUR 150m guaranteed facility) at very competitive terms an investment vehicle to support long-term investment from European funds

Slovak Investment Holding (SIH)

- ◇ The Slovak Republic has set up SIH as
- ◇ Financial resources available to SIH include funds from European Structural and Investment Funds: minimum 3% of the allocations for each operational programme, approximately 450m EUR in total
- ◇ **D4/R7 PPP:** SIH providing mezzanine financing, up to EUR 50m at very competitive terms (4,5% interest rate)

Lessons learnt

Lessons learnt



Political support to the Project is fundamental



Experienced advisers



Attractive size of the project



Availability based payment mechanism



Risk matrix typical for road PPPs – don't be innovative!



Involvement of multilateral banks (time to perform eligibility assessment) in early stages of project development



Early involvement of MinFin and Statistical Office into project preparation



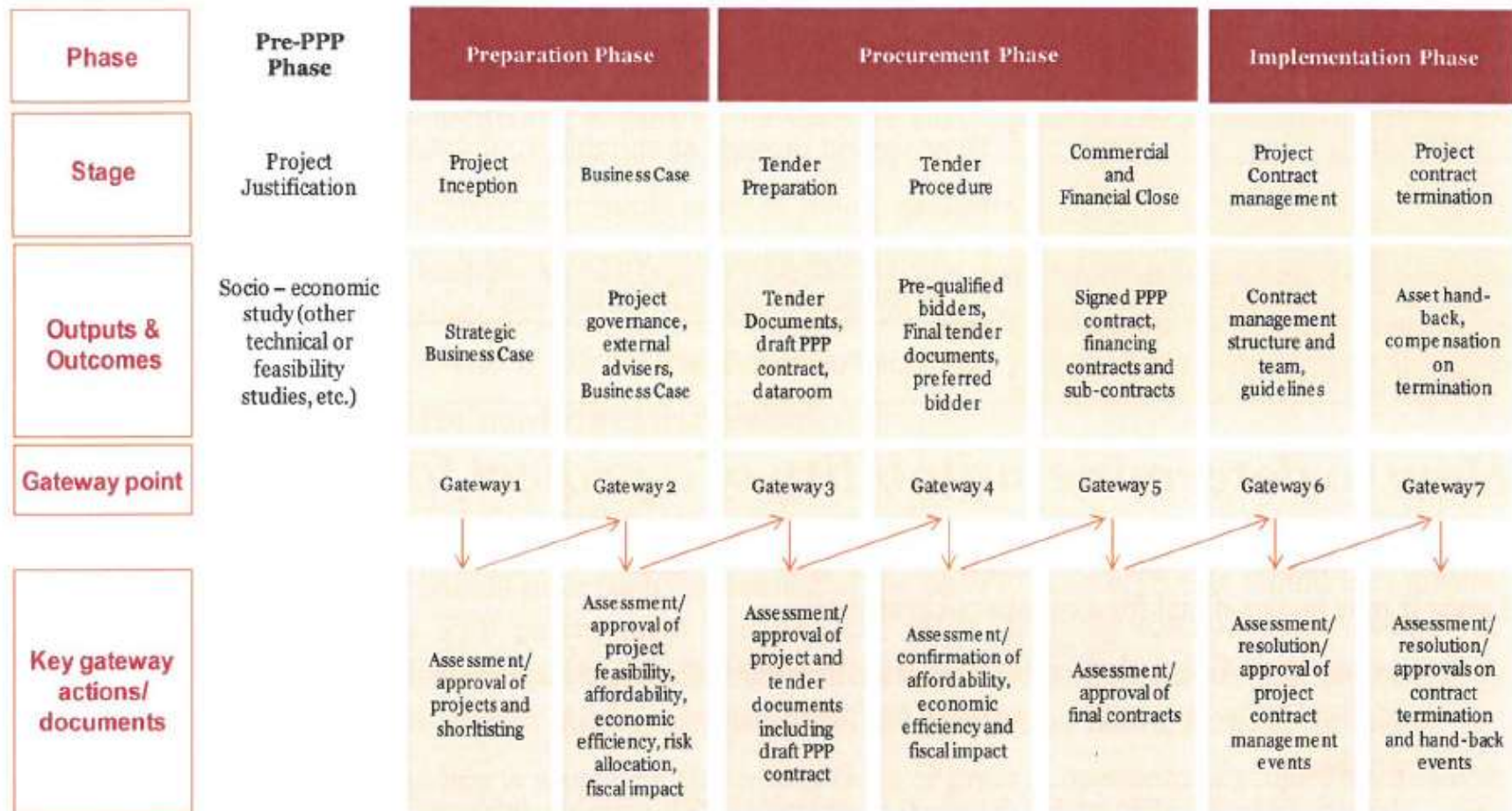
Ex ante consultations with EUROSTAT are crucial (if project is structured as off-balance sheet)



Well-prepared projects can happen relatively fast

Typical structure of PPP project

Figure 1: Phases of the PPP process



Source: PwC

Key risks to be considered



Design and planning

- **Design risk, planning and site permission, land acquisition, environmental impact;**
- **Permits and approvals;**
- **Lack of time/resources required for land acquisition;**
- **Lack of sufficient capacity and skills in public sector for managing PPP procurement process;**
- **Lack of various surveys (traffic, geotechnical, archaeological, utility network maps/ surveys, etc.);**
- **Lack of sufficiently developed Project documentation**



Construction risks

- **Geotechnical risks, Site risk, Construction cost over-run, Construction delay;**
- **Capacity of the construction sector in Baltics;**
- **Limited experience of local construction companies and investors with PPP model**



Operating risks

- **Lack of attractiveness of the Project and lack of sufficient competition;**
- **Performance**



Other risks

- **Financial risks (re-financing, interest rate risk, inflation, operating costs, demand, efficiency, Force Majeure);**
- **Affordability of the Project and accounting treatment of project assets in Government accounts;**
- **Political risk (Change of Law, change in standards);**
- **Counterparty risk, third party liability;**
- **Late involvement of IFIs in the process causing delays;**
- **Lack of sufficiently developed documentation alongside standards required by IFIs for their eligibility Project assessment. Over-optimistic traffic data and thus overstated socio-economic benefits;**
- **Lack of interest from IFIs**

“ There is no better sign of a brave mind than a hard hand. ”

— William Shakespeare

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