MAKING PPP ATTRACTIVE FOR PRIVATE FINANCE IN INFRASTRUCTURE – THE INDIA STORY

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Overview

- Why is private sector investment needed and why PPP?;
- What is needed to attract private sector?;
- What is needed for individual projects?;
- Conclusion.

WHY IS PRIVATE FINANCE AND PPP NEEDED?

World Economic Forum's Positive Infrastructure report (2010):

-global infrastructure deficit of $2 Trillion p.a. For next 20 years

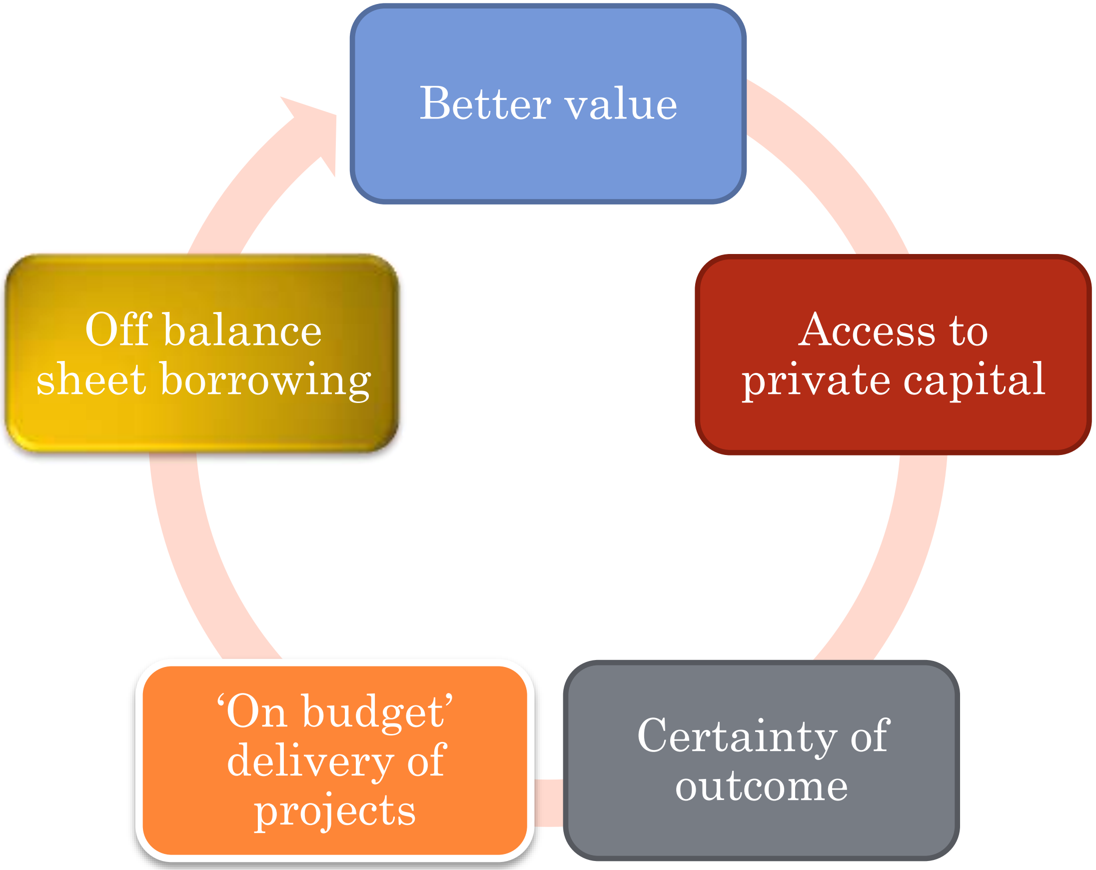
-most successful infrastructure projects where private sector involved through full life cycle

PPPs combine the best of both worlds:

Private sector resources, management skills and technology;

Public Sector regulatory actions and protection of the public interest.

Advantages of PPP?



Infrastructure Status in India

- India's economic growth adversely impacted by inadequate infrastructure.
- This impacts foreign investment and constrains GDP growth
- Results in greater pressure on Government finances and
- Retards poverty alleviation and social programmes

EXPENDITURE ON INFRASTRUCTURE IN 5 YEAR PLANS IN USD AND % of GDP

- 10th Plan
  - 218 bill USD
- 11th Plan
  - 514 bill USD
- 12th Plan
  - 1025 bill USD

- 10th Plan
  - 5%
- 11th Plan
  - 7.55 %
- 12th Plan
  - 9.95 %

Increasing need for Private financing in Infrastructure

10th Plan

- 25 %

11th Plan

- 37 % Likely

12th Plan

- 50 % Expected making PPP an important route

Enablers for Private Investment

- *Political stability*
  - Government composition changes;
  - Changes in law and regulation
  - Expropriation
  - Etc.
- *Currency Stability and Forex risk*
  - Foreign capital, domestic income
  - Inflation
  - hedging

Enablers for Private Investment

- *PPP Policy: a government policy clearly setting out:*
  - reasons for using PPP;
  - Guidelines used for consistently assessing projects;
  - Who in government responsible for approvals through project selection, preparation and procurement;
  - The processes and costs involved in bidding.
- *Legal Framework: Private sector questions-*
  - Does it ensure the effectiveness of long term contract provisions?
  - Can the private sector deliver services?
  - Can the private sector charge fees?

Enablers for Private Investment

- *Legal Framework:*
  - Investors rights and will they be protected?
  - Can profits be repatriated?
  - What are lenders rights? Direct Agreements?
  - How will payments be taxed?
  - How are disputes resolved?: Local /International arbitration
- *Does the Government have an infrastructure investment plan?*
  - high level political commitment
  - understanding of the long term market (the "project pipeline")
  - projects are suitable for treatment as PPPs

Enablers for Private Investment

- *Institutional Framework:*
  - an effective PPP Unit within Government?
  - sufficient capacity within government to deliver projects?
  - Is there sufficient clarity of responsibilities between ministries/departments?
  - Has standard guidance, procuring documentation and contractual documentation been developed? E.g. UK, India, South Africa

Policy Framework

- *A Policy Framework is necessary to:*
  - Encourage PPP Investment
  - Inform widely within Government
  - Give Government officials the confidence to use PPP's
  - Inform widely Stakeholders including consumers/users
- *Benefits:*
  - Facilitates planning and implementation
  - Instils confidence and understanding by the private sector
  - Provides an enabling environment for PPP
  - Defines the role of the Government in the implementation of PPPs

Regulatory Framework

- *Regulation is important when:*
  - The service involved is a natural monopoly;
  - There is significant market power (e.g. highway with alternatives that are congested or in very poor conditions)
  - The rights and obligations in a PPP concession agreement rely on regulatory interpretation.

- *Typically, the functions of a regulator include:*
  - Establish standards for the terms and conditions for supply of services
  - Regulate rates (tariffs) and other service charges
  - Establish market rules for the sector (issue, review and cancel licenses)
  - Monitor performance of the regulated entities
  - Arbitrate and settle disputes within the sector

The Legal Framework

- *The Legal System:*
  - The Rule of Law!
  - Reliability (or otherwise!) of the Courts and the judiciary
  - Enforceability of International arbitration awards
- *The procurement process:*
  - Is it fair, open and transparent?
  - Are ministry responsibilities clear?
    - PPP Unit; Ministry of Finance; Line Ministries
  - Is there sufficient government support: financial and political?
  - Are the Guidance and documentation sufficient?
  - Is there sufficient monitoring capability within government?

INTERNATIONAL STANDARDS AND GUIDELINES

- Guidelines for Successful Public Private Partnerships (March 2003, EC)
- Law in Transition (April, 2007, EBRD)
- Guide to Promoting Good Governance in PPP (UNECE)
- UNCITRAL Model Law on International Commercial Arbitration
- Legislative Guide on Privately Financed Infrastructure Projects (UNCITRAL)
- OECD Basic Elements of a Law on Concessions Contracts 1999-2000
- EBRD Core Principles for a Modern Concessions Law 2006

INDIA - AREAS OF CHALLENGE

- No focal point for aggregation of PPP opportunities
- Capacity for PPP management inadequate – finance, evaluation, legal, process, construction oversight
- Inexperience in managing partnership over extended tenures

- Identification, development of PPP projects to mature
- Contract enforcement systems to be positioned
- Absence of long-term debt instruments

Serious efforts are underway to overcome these shortcomings in India

Government of India initiatives in PPP

- The Ministry of Finance, Department of Economic Affairs (DEA), the designated nodal agency, has responsibility of promoting PPP in infrastructure through various measures:
  - provides viability gap funding (VGP) for specific projects
  - Assists in developing and financing private investment by establishing special institutions for this purpose
  - Funding of project preparation and also it's development
  - Coordinate enabling rules and laws to create an environment for PPP success

Government of India initiatives in PPP

- The Ministry of Finance, Department of Economic Affairs (DEA), the nodal agency, for promoting PPP in infrastructure also:

  - engages in capacity building capabilities of public officials in both the Central and State governments.

  - capacity building covers all aspects of PPP from conception to successful management of projects

- A National Capacity Building Programme (NCBP) has been initiated for Training Institutes for developing capacities needed.

Important steps by Govt. of India for PPP support

- National PPP Policy, 2011 – Draft on website for consultation
- PPP Rules, 2012 made – Draft on website for consultation
- India Development Fund initiated for long term debt and refinancing

Important steps by Govt. of India for PPP support (contd.)

- DEA engages in capacity building capabilities of public officials in both the Central and State governments.
- Capacity building covers all aspects of PPP from conception to successful management of projects
- PPP cells have been set up at Centre and States
- A National Capacity Building Programme (NCBP) has been initiated in Training Institutes for developing capacities needed.

India – National PPP Policy

Preamble :

- The Govt. aims to improve level & quality of economic and social infrastructure services
- PPP Appraisal Committee set up to streamline appraisal and approval of projects
- Provide fillip through project development funds, viability gap funding, user charge reforms, long tenor financing and refinancing
- Capacity building amongst individuals and institutions

PPP Rules, 2012 - India

Objectives

- Defining procedures for procuring PPP projects – guide in structuring PPP projects
- Ensuring economy & efficiency, effectiveness of terms of concession agreements; promotion of competition, fairness, transparency & equity in procurement process
- Encouraging private sector investment in public infrastructure and services

PPP Rules, 2012 – India

Objectives (contd.)

- Implementing governance over selection of PPP projects & a uniform framework and streamlined procedure
- Reducing cost of bidding, putting guidelines for evaluation of bids to ensure value for money
- Ensuring governance of PPPs that recognises and addresses evolving nature of PPPs

Financing PPPs - Challenges

- Lack of long term debt – IDFC, IIFCL (Last mile/ Take Out Financing) & Infrastructure Debt Funds

- Intermediation problems
  - Insurance companies, pension funds, infrastructure funds
  - Debt, equity and mezzanine finance

- External funding
- - Multi-lateral / Bi –lateral credit, ECBs, Bonds
- - Managing forex risk – since infra revenues are largely in rupees

The challenge is financeability – good projects find funding

Investor Incentives in India

- Fiscal Benefits - Tax holiday of 100% for 10 years in a block of 20 years
- Viability gap funding of up to 40% of the cost of the project – as a grant
- Foreign Direct Investment – 74 to 100% of the equity permitted
- Duty free import of high capacity & modern construction equipment
- Long Concession periods – up to 30 years

VIABILITY GAP FUNDING (VGF)

- To make infrastructure projects financially viable in order to attract private capital
- Revolving fund within Ministry of Finance
- Specified process for obtaining VGF
- Project gets the fund during implementation
- In the form of grant - up to a maximum of 40% of Total Project Cost – with Central Government grant not exceeding 20% and State Government component not exceeding a further 20%
- Utilization - monitored by Ministry of Finance

INDIA INFRASTRUCTURE PROJECT DEVELOPMENT FUND (IIPDF)

- Set up by Government of India (MoF)
- Initial corpus - Rs. 1 billion
- Objective to assist states & encourage PPPs
- Up to 75% of development costs
- IIPDF replenished by the successful bidder in case of successfully bid projects
- Topped up with budget support
- If bid unsuccessful – interest-free loan

India Infrastructure Finance Company Limited (IIFCL)

- Set up in 2006 to provide long-term debt for infrastructure projects.
- IIFCL can provide subordinated debt up to 10% of approved project cost in certain projects having compulsory buy-out. Debt moratorium of at least 12 years on repayment of principal.
- Within 20% exposure limit to project can give 10% in form of guarantees for long-term bonds.

India Infrastructure Debt Fund

- Concept to create Debt Funds for refinancing infrastructure projects past construction stage
- Proposed to channelise these funds to infra projects backed by ‘buy-out’ guarantee from government
- Credit enhancement through government guarantee to pay out 90% of project debt to concessionaire in case of default and government taking over – tantamount to sovereign guarantee
- 1^{st} Debt fund launched by consortium of 4 financial institutions – USD 2 billion – March 2012

Capacity Building - Shortcomings

- In Government – unprepared for these volumes of investment – both public and private
- Private Sector shortages
  - Contractors – experience in smaller projects to handling larger contracts
  - Contractors to developers – change in mindset
  - Consultants
  - Bankers and financial investors
- Key Resources shortages
  - Engineers (especially civil engineers)
  - Skilled work force
  - Material inputs – natural resources – coal, O&G, aggregate

Capacity Building in PPP

- Capacity building entails imparting of knowledge and skills for success of PPP projects amongst persons involved <u>both in public and private sectors</u>.
- Primarily it becomes an exercise in human resource development in a specialised area covering multiple disciplines related to that field.
- The target persons would be those whose performance would be crucial for success in dealing with PPP projects.

Public Officials

- PPP projects are primarily for public good
- Traditionally they would be done by Government
- Conceptualisation, selection of the project done is Government domain
- Development, assessment and due diligence also done by Government
- Success primarily depends on performance and skills of public officials
- In case of default by private partner onus to take over PPP infrastructure rests with Govt.

Private Sector

- Similar concerns as in government plus company financial status more susceptible
- Substantial risks taken over a long tenure
- Financing is difficult with lack of long-tenor loans
- Working in conjunction with Government a relatively new experience
- Conflict resolution process still in nascent stage

National PPP Capacity Building Programme (NCBP)

DEA / IDFC

- DEA invited IDFC, a leading integrated financial institution in infrastructure to assist in 2008

ICAP

- IDFC set up India PPP Capacity Building Trust (ICAP) at government request

WB, KfW funding

- ICAP assisted DEA obtain funding through TA from World Bank and KfW

WB

- WB TA scope: Consultancy for content development and TOT

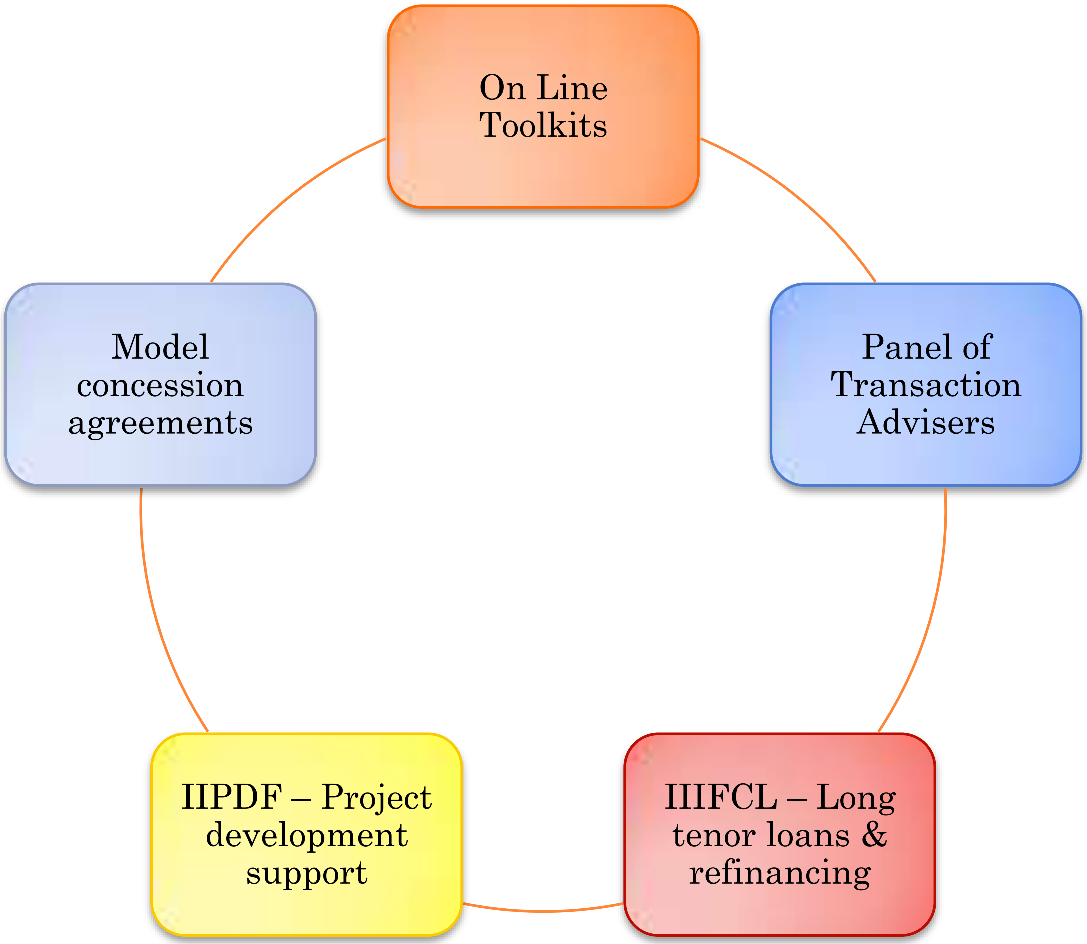
KfW

- KfW TA scope: Program Management including content development, TOT and roll out in partner Training Institutes

ICAP

- ICAP has run several training programs for government officers and has MOUs with several government training institutions

Other Measures by Govt. of India



Private Sector capacity building addressed

- NCBP launched with access also to private sector
- PPP Policy, Rules laid down
- Long-tenor debt initiated
- Model Concession Agreements made to ensure transparency and equity in contract management and resolution of conflict.
- On-line toolkits also available for private investors
- On-line guidance also available on some country websites:

- India www.pppininida.com
- Australia www.infrastructureaustralia.gov.au
- Republic of Korea www.pimac1.kdi.re.kr

Status of PPP Projects in India

- Master List PPP Projects in India as on January 31, 2011 lists 1051 projects
- No. of projects in main sectors of focus was 758 on 31.07.2011 of total value of approx – USD 2 billion
- Road projects account for 53.4% of the total projects and 46% of total value
- In terms types of PPP contracts, almost all contracts have been of the BOT/BOOT type (either toll or annuity payment models) or close variants

Individual Projects

- Are the projects feasible, realistic and are they needed?
- Will the procurement process be fair and transparent
- Are the projects bankable?:
  - Bankability of public sector obligations
  - Adequate regulatory regime
  - Step-in rights
  - Enforceability of the contract
  - Certainty of cash flows
- Are there willing funding institutions – local / international?
- Is the risks allocation based on whoever can manage each best?

Individual Projects

- Does the procuring authority have adequate capacity and iis using appropriate advisers (legal, technical and financial)?
- Is there sufficient Government support (guarantees, VGF, revenue support, tax allowances)?

- Is the output specification 'SMART'?
  - Specific;
  - Measurable;
  - Achievable;
  - Realistic;
  - Timely .

Individual Projects

- Is the payment and performance deduction mechanisms fair with realistic penalties and cure times that:
  - Incentivise the provider to meet the output specification;
  - But: do not penalise failure excessively to the extent of endangering the project viability.

- Are the mechanisms for compensation on termination adequate?

Conclusion

- Every country must realise they are in a buyers market;
- Projects and the environment within which they are to operate have therefore to be more attractive than projects and environments in which they are in competition:
- Therefore, full readiness assessments of the political, legal, regulatory, financial and macroeconomic environment should be conducted and an action plan implemented;
- adequate funding and preparation of early stage projects is vital to ensure that the market is prepared to ‘buy in’.

Thanks for inputs to

- Department of Economic Affairs, Government of India &
- IDFC

Thank you for the kind attention

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