Challenges of project financing during a credit crunch

TEE Conference
Athens
June 3, 2013
Plan

- Infrastructure Concessions – a simplified model
- How did we get here?
- What were the parameters for investing in 2007/2008?
- What are the parameters today
- The plan
- Would we have been better off if they had been funded by the Public Investment Budget?
Infrastructure projects are investments:
- They mobilise resources immediately; and
- Provide future benefits to:
  - Directly to their users (time saving, safety, comfort, services etc.)
  - The wider community (network effects, reduced congestion, increased accessibility, environmental benefits etc.)

Resources are scarce and can be used for alternative projects/uses

Choices have to be made on the allocation of scarce resources

In the XIXth century, French civil engineer Jules Dupuit invented the concept of cost-benefit analysis, based on the idea that the value of a bridge to society is equivalent to how much toll people would be prepared to pay to use it (this deals only with direct benefits, not indirect to the wider community however)

TO INVEST IS TO GIVE UP SOMETHING IN ORDER TO GAIN AN UNCERTAIN FUTURE BENEFIT
Concessions allow the Public Sector

- to monetize a part of the value of the benefits to the users; and
- shift to the private sector the risk of estimating this benefit

The Public Sector maintains a balance between the maximization of the value of the users’ benefits and the benefits to the wider community through:

- Regulation of pricing levels (tolls, price of water, landing charges etc.);
- Regulation of the level of service; and
- Public subsidies if necessary
Infrastructure Concessions – additional benefits

- **Whole Life-Cycle optimization** of the Construction/Operation and Maintenance according to the cost of resources at the time of the investment
- **Performance based specifications** mobilizing the expertise of the private sector to optimize the design and construction
- **Off-balance sheet** treatment of the debt
- **Cross fertilization** of experience gained on various projects by the private sector
- **Client oriented** service provider
- **Flexibility** in the implementation of heavy maintenance program not dependent on availability of public funds
- **Technological** upgrades and improvements
- **Construction delays** and **cost overruns** more limited* 
- **Fairness** – users pay for the benefit they derive from the asset in the favour of taxpayers

*once project site is available
How did we get here?

- The five new generation Greek Motorway Concessions were bid in 2006 and closed in 2007/2008
- Money was abundant and cheap
- Greece was growing strongly
How did we get here?

- The combination of strong growth, cheap and available money and stability brought by Euro membership misled the investors in their estimation of future benefits.

- This was an assumption made across the board by all investors and banks – it was systemic, not linked to the (in)abilities of a particular investor.

- The bids therefore were structured with a high level of debt and very significant payments to the State by the Concessionaires over the 30 years.

- For example on Olympia Odos, in 2008 the estimates for the Net Present Value (NPV) at 7.5% of the Revenues was in the order of €4.7bn.

In 2008 the bubble burst in New York and the consequences spread over the world, reaching Greece at the end of 2009.
The Crisis

- The HR loses access to the capital markets
- MoU Program: tax hikes, reductions in pensions, public salaries, public investment programs
- Hair-cut on public debt
- Banking crisis -> collection of debts, no new loans, increase in margins
- Reduction in demand, increase in unemployment drop in traffic

Funding frozen at the end of 2010
Construction Suspended in June 2011
The resulting investment parameters

- **Resources are very scarce:**
  - Capital Markets are generally closed for Greece and if available (for quality signatures), margins are very high, maturities are short.
  - Reflects the credit glut of the past decade which needs to be processed – the investments in assets which did not find the expected demand will take longer to find it and until then will weigh on the balance sheets.
  - Public Investment Program is very low and mainly financed by the EU.

- **The expected benefits of the investments have gone down significantly (lower demand, lower growth) in the order of -66% over the life of the Concession.**

- **This requires re-thinking the investment decision:**
  - Minimize the resources requirements in the investment phase and adapt it to available resources.
  - Focus on the part of the investment which yields maximum benefit to the users.
The plan

- Focus available resources (Shareholders, Lenders, EU & State, EIB) on the priority projects (PATHE, Antirrio – Ioannina) in the short term.
- Existing investors (Shareholders, Lenders) are willing to support the effort in order to secure their existing exposure in the assets (On Olympia Odos represents in aggregate ~€700m).
- State accepts to support with the revenues from the tolls:
  - operations, maintenance of the assets,
  - repayment of debt; and
  - to incentivize the Shareholders to inject their equity and invest (human and technical) resources into the management of the asset.
- Mobilize EU funds for development of the country to compensate losses of toll revenue during construction.
- Mobilize additional public funds for the 2\textsuperscript{nd} phase (eg Patras – Pyrgos) to start as soon as possible.
- If the recovery is stronger than expected, leverage the additional funds to help finance the 2\textsuperscript{nd} phase.
- Move quickly to support the recovery of the Greek economy.
What if... the Projects had been fully publicly funded

- The total initial investment program for the 5 motorways was over €8bn with 25% from public funds
- Moreas has managed, largely due to its specific structure to nearly complete the investment – a success story in the circumstances
- The other projects were stopped at various stages of the investment (between 20% and 65%)
- The Crisis has reduced the ability of the State to fund investments severely - the projects would have stopped anyway
- Allocation of the (scarce) EU funds to the projects with the highest priority for the government
- No leveraging of additional EIB and private sector funds, especially from outside the country
- No securing of long-term operation and maintenance of the asset
- Potential cost overruns of continuous stop and go due to lack of available public funds