Public Private Partnerships

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The lack of PPP projects: myth or reality?

Over the last few years, many interesting, positive things have been happening simultaneously in the infrastructure and services Public-Private Partnerships (PPPs) sector. With such a strong tailwind one would expect a record high number of projects and investment volumes. But is this really happening?

Let us first point out a few of these potential “PPP catalyzers”:

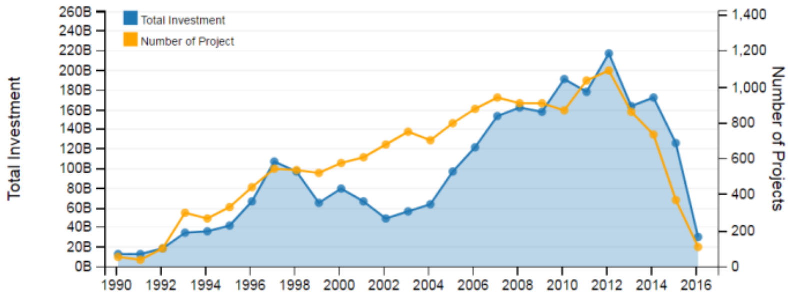
1) Lots of available liquidity along with restrictions to public debt increase: Many commercial and multilateral banks, funds of various natures, private equities, industrial companies, etc., are not meeting their infrastructure related investment goals and are ready to pursue PPP projects. According to the 2017 Preqin Global Infrastructure Report, by the end of 2016 infrastructure firms held $137bn of “*dry powder*” ready to be invested, and 73% of capital fund managers said that they were planning to deploy more or significantly more resources for infrastructure assets in 2017 than in 2016.
2) At the same time, national and local governments are subject to debt increase restrictions. One would expect that the combination of both circumstances would trigger PPPs.
3) The infrastructure financing gap is growing bigger. In general, in the short term there is no link between the infrastructure finance needs and the number of new PPPs. However, in the middle term, a positive correlation would be expected.
4) Even the private sector is requesting regulation (and a regulator) where one does not already exist. This seems to be counter-intuitive if we follow the traditional (mistaken) belief that the private sector craves unregulated sectors in order to maximize profit. Consequently, one would expect that more regulation would bring the public and the private sectors closer, and ultimately promote new PPPs.
5) There are flagship PPP projects all around the world and the body of knowledge is bigger than ever before.
6) Recent movements against PPPs seem to be struggling to become real alternatives or to deliver the promised results (decrease in tariffs, more and better jobs, bigger investment programs, more efficiency, etc.).
7) A wide consensus finally exists among multilateral banks, the United Nations, a significant number of NGOs, governments, development agencies and academia regarding the idea that PPPs are key to the achievement of goals set either by the Sustainable Development Goals or by national or local infrastructure and service plans.

8) Impact investment: Every year, the impact investment market grows. Although still a young market, according to the GIIN "2016 Annual Impact Investor Survey", $77bn of impact assets were held by the 156 respondents. Considering that infrastructure and services PPP projects are increasingly being considered as catalyzers for positive economic and social impact, more financial resources are expected to be available.

Despite the existence of these "catalyzers", they do not translate into bigger PPP pipelines. On the contrary, there is a continuous decrease in the number of PPP projects since 2012 while, at the same time, a lot of confusion is building up.
In **developed countries**, PPP markets are quite mature and stable. As such, no significant changes are expected (with some possible exceptions due to infrastructure renewal and investment in relatively new PPP sectors such as prisons, health or education).

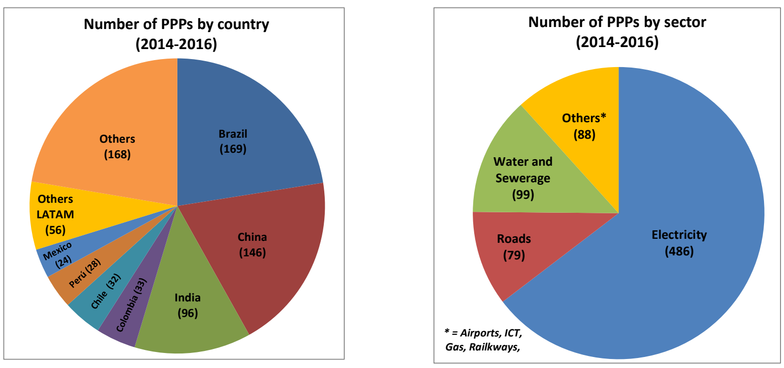
The World Bank´s "Private Participation in Infrastructure Database" presents historical data covering PPPs in 139 **low and middle income countries** which, considering that there are 193 United Nations member states, is a highly representative database. In these countries, one would expect a more dynamic PPP sector, due to a greater funding and knowledge gap.

This database shows a continuous increase since the 90´s, with a peak of 1,096 PPP projects and $217bn invested in 2012. After that, the sector plummeted to 1992 levels in 2016 (108 projects and $31bn invested):



Source: PPI Project Database (World Bank) (2017)

Moreover, if we look at figures for the last three years (2014-2016) we can see the following PPP distributions:



Source: Author, based on PPI Project Database (World Bank) (2017)

In addition, only 117 projects (10%) and $2.63bn (less than 1%) have been deployed in low income countries. Finally, only 217 projects (19%) and $62,833bn (19%) were supported and invested through Multilateral Development Banks (MDBs) funding.

In short, we can conclude that **the PPP sector has experienced a dramatic decrease in the number of projects over the last three years while, at the same time, it is characterized by a significant concentration in specific middle income countries and sectors, with little financial support from MDBs**.

The underlying reasons explaining this situation are complex and involve several factors. Among various reasons, two factors can be highlighted:

1) <u>Politics</u>: Although enjoying the support from many stakeholders and players, national and local governments do not support PPPs as enthusiastically yet. Other possible reasons include social misperception, the cost and duration of the processes, political tacticism, more urgent problems, or endless discussions about accessory or ideological issues which hinder the creation of PPP projects and generate uncertainty around them.

   If governments do not take the lead and use PPPs as an effective tool to achieve infrastructure and services goals, there is not much that can be done.

   In order to facilitate this change of attitude, an effort should be made to help design shorter, accurate, transparent, balanced and less expensive processes, to measure and communicate the associated positive social and economic impact and the real added value of the PPPs. Additionally, it is essential to involve all the interested stakeholders throughout the process.

2) <u>Requirements of the investors and lenders</u>: Maybe it is time to reconsider whether some of the criteria followed by investors and lenders are still compatible with the current context and circumstances of the PPP sector (especially within certain geographies and sectors).

   In recent times, some of the biggest commercial banks have stated that it will be difficult for them to assume tenures of longer than 5-7 years (leaving the refinancing risk to their clients). In this context, they have asked MDBs to assume a larger share of the project risks (e.g. first losses) and the public sector to guarantee revenues in various different forms (e.g. pledges, trusts, sovereign guarantees, reserve accounts, take or pay clauses, etc.).

   At the same time, MDBs are not usually fast and require sovereign guarantees for their loans, have uniform demanding environmental policies, and do not seem to be able to assume any significant forex risk, expecting the private sector to absorb it. Additionally, some of them have unofficially pointed out that some of the recent PPPs might be over-guaranteed by the public sector. On the other hand, the new investment policy recently announced by the European Investment Bank, planning to increase the exposure to riskier projects and non-European countries, is significant.

Finally, the transformation of the uncertainties of some PPP projects into higher rates of return in some countries and sectors is sometimes difficult for the public administration to take on, as this would have a significant impact on tariffs or public budgets.

As a result, most of the tendered PPPs are concentrated in sectors (roads and electricity) and countries where national and/or local governments do not see a political risk, and all of the above requirements are met. Such PPPs are usually structured only around financial aspects and, as a consequence, are subject to a crude financial auction among highly liquid financial investors.

The ultimate consequence of the situation described above is that critical sectors and countries are left out of PPP schemes almost entirely. As a result, the PPP pipelines become smaller, and most of the added value that a PPP can transfer to the public sector does not materialize.

In summary, there are many positive “environmental” factors that should be expected to lead to rapidly growing PPP pipelines. However this does not seem to be the case. Two possible explanations can be highlighted: a lack of political will, and the requirements of investors and lenders.

To overcome such hurdles and increase PPP pipelines across countries and sectors, the following measures could be proposed: having better project designs, better identification and communication of the PPP’s associated economic and social benefits and its added value, having more consistent performance measurements, better and continuous communication, increasing the stakeholders´ involvement, and revision of the feasibility of the criteria followed by all interested investors and lenders.

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