TEN-T EA Workshop 27 November 2013

PPP Procurement for Transport Infrastructure: From Investment Programme to Project Implementation

Workshop Proceedings
Introduction

The TEN-T EA workshop — “PPP Procurement for Transport Infrastructure — From Investment Programme to Project Implementation” brought together over 150 participants to Brussels to discuss key issues related to the screening and preparation of TEN-T projects to be delivered as Public-Private Partnerships (PPPs) and equivalent models, including preparing ‘bond friendly’ PPPs.

Mr David Livingston, former Chief Executive Officer of Infrastructure Ontario and former Chief of Staff of the Premier of the Province of Ontario in Canada, was the keynote speaker of the morning session, outlining the Canadian example of delivering infrastructure projects through PPPs. Mr Olivier Onidi, Director for European Mobility Network at the Directorate-General for Mobility and Transport of the European Commission, stressed the importance of involving the private sector in the financing of future infrastructure projects in the European Union.

The workshop also featured three specific case studies of successfully implemented PPPs in the inland waterway, rail and airport sectors. Anna Panagopoulou, Head of Unit for Technical and Financial Engineering, GIS & Monitoring at the TEN-T EA concluded the workshop by thanking attendees and stressing the most important points to emerge from the day’s discussions.

This document provides a summary of these main points.
Welcome & Introduction to the event
Dirk Beckers, Executive Director, TEN-T Executive Agency

The TEN-T Executive Agency was established in 2006, with a mandate to implement the €8.013 billion TEN-T Programme, including the management of the project lifecycle for TEN-T projects, which has included support for the development of public-private partnership (PPP) procurement.

Apart from providing funding support through grants, the Agency promotes the use of financial instruments such as the Loan Guarantee for TEN-T projects (LGTT) and the Project Bond Instrument, implemented through the EIB. The Agency supports beneficiaries and project promoters in facilitating their understanding and ability to use these instruments, often by engaging in awareness-raising and capacity building related to PPP procurement issues.

The Connecting Europe Facility (CEF) will reinforce the development of alternative financing solutions for TEN-T projects and further encourage the use of PPP procurement. The Agency will continue its cooperation with the Commission and other EU institutions to provide appropriate financial engineering support for its beneficiaries and project promoters.

Opening Remarks: Overview of the Connecting Europe Facility–
Olivier Onidi, Director - European mobility network, European Commission -
DG for Mobility and Transport

One of a series of trainings and awareness-raising events organised by the TEN-T Executive Agency, this workshop is a good platform for sharing practical experience among people who are directly involved in organising complex infrastructure financing schemes using a PPP model. It also provides an opportunity for addressing questions about the use of EU financial instruments in order to accelerate the deployment of the necessary infrastructure projects to complete the TEN-T.

The importance of the discussion is motivated by the fact that despite the usefulness of PPP procurement the success rate of PPP projects is still below expectations. Such a situation can be explained to a large extent by the complexity of PPP models that in turn is determined not just by the difficulty of choosing the optimal mix of public funding and private financing, but also by the need to manage a broad range of unconventional financial instruments that are used in such models. Along with financial engineering issues the choice of project implementation schemes ranging from concessions to lease agreements adds to the complexity of cost benefit analyses and multiplies the options to be considered.

The discussion is especially timely given the need to develop working implementation plans for each of the nine geographical corridors and two functional corridors that form the core network of the TEN-T. The new Connecting Europe Facility offers a greatly simplified operational framework meant to promote policy execution through the explicit identification of financing sources and the use of financial instruments to implement the projects comprising these core corridors.
Why, What & How Province of Ontario established Infrastructure Ontario

David Livingston, ex-CEO Infrastructure Ontario, Senior Business Advisor, Borden Ladner Gervais

Starting in 2000, the government of the Canadian Province of Ontario, facing similar challenges in the development of the infrastructure network as the European countries, made numerous efforts to address the problems of underinvestment and ineffectiveness of project management. Early attempts appeared to be costly learning exercises, in particular one concession project and this paved the way for a series of changes. In 2004, an investment programme was defined by the newly created Ministry of Infrastructure through a framework document, Building a Better Tomorrow that articulated the sectors in which the government would invest, how much funding was available and a reasonably specific identification of projects. In 2005, the government established a specialised, independent, publicly-owned agency – Infrastructure Ontario (IO) with a narrowly defined mandate separating political and project execution risks. IO was given the responsibility of planning, organising and undertaking public procurement, serving as an intermediary between the public and private sectors. The Agency’s approach to PPP procurement (re-branded ‘alternative financing and procurement’ to improve the public perception) involved shifting certain project risks to the private sector using pre-defined output specifications, encouraging the private sector to bring both innovation and discipline through flexible project design and independent project management. IO strictly followed the notion that effective risk transfer from the public to private sector is possible only if projects’ financing obligations are 100% placed set in the hands of the private sector.

The key components of the operational strategy of IO, with a successful track record of all 50 to 60 projects completed on-budget and most of them completed on time, include independent project assessment and budget validation as well as a quarterly update of the 3–5 year project pipeline. The communication to the private sector of the anticipated project pipeline was extremely important, because it created a credible baseline for financial projections and helped to manage expectations among market sector participants. One of the lessons learned from the earlier stages of infrastructure network development was not to give private sector the control over possible revenue streams from the projects, but rather rely on milestone payments and availability-based payment models. After the completion of the projects, when the volatility and growth rates of future revenue streams could have been estimated with greater reliability they could have been sold separately at more favourable terms.

The transparency of operations and consistently high quality of project delivery fostered the build-up of Infrastructure Ontario’s credibility among private market participants as well as in the public domain and eventually resulted in the expansion of its operations. A subsidiary of the IO is currently operating as a bank that issues bonds with provincial government guarantees and lends the proceeds to smaller public entities at preferred rates to finance infrastructure projects; however, the projects of these entities are not implemented under the oversight of the IO.

The new approach of the IO to public procurement had spillover effects on many stakeholders in the construction industry. Architects were encouraged to work with construction companies and take responsibility for possible problems during construction. Financing solutions became a combination of short-term bank financing and long-term bond financing provided by institutional investors. The landscape of the construction industry also changed, as foreign companies entered the market, drove up competition and forced domestic companies to improve their performance.

Overall, the experience of the IO shows that the effectiveness of public procurement can be achieved through the separation of policy design and project execution responsibilities. Certain project risks such as design, management and financing arrangements can be successfully transferred to private sector. A demanding but transparent and consistent attitude from the public sector regarding this risk transfer can result in a more disciplined private sector. However, there is little sense in concentrating on private financing and risk transfer optimisation without a solid pipeline and project preparation including standardised documentation.
Connecting Europe Facility: the complete EU toolkit for TEN-T PPPs

Stéphane Ouaki, Head of Unit B4, European Commission – DG for Mobility and Transport

The Connecting Europe Facility (CEF) is expected to enter into force from the 1st of January 2014. The CEF is a funding instrument encompassing three sectorial policy frameworks in transportation, energy and telecom that foresees the use of innovative financial instruments as a means to leverage public funds. The three sectors are brought together under a single funding framework for reasons of efficiency, cost-effectiveness, economies of scale and to concentrate on Trans-European Network projects with the highest EU value-added. A key objective of the CEF is to maximise synergies between the sectors. The use of a single Executive Agency and the shared use of financial instruments, managed in cooperation with the EIB, should contribute to this objective. The mandate of the TEN-T Executive Agency, with its unparalleled expertise in managing the TEN-T programme, will be broadened to include energy and telecom projects as well as to the Horizon 2020 research programme in energy and transport.

The CEF, with its budget of €33.2 billion is not meant to displace other EU facilities and instruments and will operate complementary to the Cohesion policy framework. Although the CEF budget is significantly larger than in previous programming periods, it is still insufficient for the funding needs for all core projects at the EU level, estimated at €250 billion to the end of 2020 in the transport sector alone. Therefore up to 10% of the budget will be reserved for financial instruments in order to leverage private financing.

Multimodal corridors serve as the main guides for prioritising investments in the next financing period from the point of view of grant support and financial instruments with the ultimate aim of achieving transportation network realisation by 2020 and 2030. The eligibility of transportation projects for CEF financing will be determined by the TEN-T guidelines. Financial instruments will be available for TEN-T projects in all transport modes belonging to the core and comprehensive networks, as well as for ground and on-board equipment in traffic management systems.

Financial instruments under the CEF will target projects with identifiable revenue streams and long-term repayment prospects, allowing for project finance schemes such as motorways, airports, ports, alternative fuelling infrastructure, and traffic management systems on-board equipment. Financial instruments could be used alongside grant support in certain situations.

The main types of financial instruments include debt instruments such as the LGTT, the Project Bond Instrument, the Risk Sharing Finance Facility (RSFF) and equity instruments, such as the Marguerite Fund. An emphasis will be put on debt instruments since a shortage of equity finance could not be currently identified. On the contrary, the first results of the Project Bond Instrument (PBI) show that European institutional investors have become aware of the opportunities of investing in infrastructure. The PBI is especially important for the emergence of a liquid project bond market, for countering the bank lending crisis and for overcoming sovereign rating constraints. The main difficulty in the future is going to be the need of creating a visible pipeline of well-prepared projects to that can take the opportunities offered by EU financial instruments. Financial instruments will be implemented by the EIB while the Commission keeps responsibility for eligibility criteria. The cooperation scheme with the EIB also ensures that there will be no contingent liabilities for the EU budget.

Support for feasibility studies and PPP preparation will be intensified over the next planning period with direct involvement of TEN-T EA, as the main instrument for creating a visible pipeline of projects able to exploit EU financial instruments. Technical assistance on financial structuring of specific projects and administrative capacity development at national levels will be primarily performed by the EIB.
Session 1 - PPP Investment Programme and Capacity Building
Presenter: Rob de Jong, Senior Advisor - Project Controller, Rijkswaterstaat
Moderator: Shelley Forrester, Senior Financial Engineering Manager, TEN-T EA
EU Institutions response: Chris Blades, Head of the European PPP Expertise Centre (EPEC)

The case study on the Dutch lock programme is devoted to upstream preparatory work, the question of selecting projects for the PPPs and the benefits of having a programme approach to their development. The lock programme is a part a national multi-annual infrastructure investment programme (MIRT) that forms a visible national pipeline. The case study also discusses the role of the European PPP Expertise Centre, EPEC, which helps public sector entities build capacity to undertake PPPs.

The realisation of the €2.2 billion Lock programme, consisting of 5 separate projects, is foreseen for the period from 2012 to 2020. The size of the individual projects ranges from €60 million to almost €1 billion. The challenge of the programme is not only in the ambitious capital investment, but also in the short timeline of their implementation and the lack of necessary expertise in the public as well as the private sectors. Given that selected projects belong to inland waterways of the core TEN-T network and all of them have PPP potential there was a good reason to unite them in one programme. As a consequence, it will be possible to cultivate institutional knowledge within the public sector rather than among outsourced consultants. Internal capacity building includes training on the job, retention of employees, transfer of general and project specific experience from one project to another. A matrix approach to the organisation provides opportunity for putting the best people in the best place at the right time. The programme approach is also targeting the build-up of experience within private sector partners through the uniformity and predictability of the project pipeline. The TEN-T programme supports the programming through grants for studies on programme and project level as well as grants for works.

The main conclusion from the case study is that the pipeline formation through a programme approach creates a learning curve for the public and market sector participants. The support offered by the TEN-T programme accelerates project and capacity development that leads to faster and better PPP procurement, resulting in higher quality products for a better price. The studies of EPEC confirm that PPP programming is an efficient and effective way of using public sector resources as a result of standardisation, stronger procurement teams, capacity development and feedback loops. Other benefits include opportunities to lever public sector purchasing power on risk transfer negotiations, develop programme-wide quality assurance processes and feed expertise for conventionally procured projects. Overall, the programming approach improves management and coordination of the pipeline, matching supply to demand over programme period through clearer communication of policies and by building market confidence.
The case study on the rail link between the two terminals of the Malpensa airport looks at how TEN-T grant support can be used in the preparation of projects and feasibility studies. The uniqueness of the project is that it has obtained three different types of EU funding including grants for technical design, financial feasibility studies and works.

Following the TEN-T programme funding, Lombardy Region, the rail operator FERROVIENORD and the Malpensa airport concessionaire SEA commissioned a study to determine the feasibility of the infrastructure under a Public Private Partnership financing scheme. The scope of the PPP feasibility study included in-depth analyses of the demand and optimisation of the operation model with the goal of increasing revenues and economic benefits. The analysis of financing structure from the point of view of meeting bankability criteria had a goal of opening the possibility of private capital involvement and reducing the public funding contribution. The main challenges for the project were presented by regulatory, political and legal issues. Two models of funding the project were considered one based on market revenue and one on availability payments. Only the availability payment based model could prove to be bankable but the regional authority could not provide legal and financial guarantees over the lifetime of the PPP contract. As a result of numerous external factors no project finance structure was chosen and the finally agreed financing structure of the €115 million large project involved 40% of funds coming from the central government, 26% of funds provided by the regional government, 20% of co-financing from the TEN-T programme and the remaining coming from the project promoters, FERROVIENORD and SEA. The main lesson learned from the exercise is that although PPP schemes take time and are not necessarily suitable for all project sizes it is worthwhile to consider the PPP option during the planning stages.

Overall, the study enabled project stakeholders to carry out an extensive analysis of potential demand, helped to understand project risks and shaped overall commercial model meeting financial constraints. Apart from that, the study re-enforced the notion that the information asymmetry between private and public sectors can be reduced through well-documented legal framework and thoroughly developed financial model with contributions from all stakeholders. Based on the lessons learned from this case study the project promoters consider PPP procurement a realistic solution for financing the larger follow-up project, which aims at linking the airport to the international rail network.
Session 3 – Bank & Bond Financing of Transport Infrastructure
Case Study: Optimising public and private sector project finance in Canada

Presenter: Heather Douglas, Partner, Borden Ladner Gervais LLP - Legal Advisor to City of Ottawa
Moderator: Dominik Zunt, Policy Officer, European Commission - Directorate General for Economic and Financial Affairs
EU Institutions response: Ralph Eley, Senior Loan Officer, New Products Special Transactions, EIB

Governments in Canada and in Europe are committed to fight the deficit in infrastructure through sustaining, maintaining and expanding transportation networks. At the same time they are confronted with fiscal constraints.

The case study looks at the financing experience of a C$2.1 billion Light Rail Transit System project in Ottawa that represents one of the largest PPP transactions closed in the recent times in Canada. It is also the first municipal project to be procured by Infrastructure Ontario. The funding of the project in the total amount of C$1.8 billion was provided in equal proportions by the City of Ottawa, Province of Ontario and the federal government from the Build Canada Fund. The remaining C$300 million were provided by private sector, including C$75 million in equity and C$225 million in long-term debt from several insurance companies and an infrastructure debt fund. Additional short-term financing arrangements amounting to C$215 million were made with a consortium of 4 banks. The small share of private contribution was determined by the unwillingness of public authorities to involve more expensive sources of financing while they had an opportunity to borrow more cheaply on the capital markets. Furthermore the private debt is accounted in the public debt of the City of Ottawa, which is common practise in Canada.

The legal specifics of the project include the fact that it is a trans-provincial project that makes it subject to federal jurisdiction and federal rail regulatory requirements. However, in this particular case the right to develop rail regulatory requirements was delegated to private sector subject to approval from the City of Ottawa.

The choice of a DBFM model for the project was motivated by several considerations – affordability, innovation and a willingness to preserve existing railway system operating structure. The “Federation Line” light rail is operated by and fully integrated in the city’s public transit system. Although the City of Ottawa has a very high credit rating (AAA) and was not inclined to shift financing responsibilities to private sector, the chosen PPP model included private sector financing because it helped to alleviate concerns about the project being delivered on time and on budget. The main objectives of private sector financing included leveraging of public sector resources, oversight and appropriate risk allocation. During the implementation of the construction phase of the DBFM contract, payments will be made upon the achievement of 12 milestones corresponding to substantial completion of key project components. During the maintenance period the city makes availability payments on a monthly basis subject to deductions. The city has also entered a lenders’ direct agreement with the providers of private financing that allows it to take over the debt obligations in the case of the contractor default.

Overall, the City of Ottawa was convinced that the utilisation of the DBFM model was the appropriate procurement scheme for the light rail project. The main benefit of the approach was in the possibility to align interests of private sector finance providers with those of public sector. The project was structured in such a way that private sector took construction, commissioning, vehicle procurement, tunnelling, and financing risks. The takeover of risks by private sector resulted in additional costs to the public sector, but at the same time any delays and cost overruns would inevitably materialise in reduced profits for the private partners. Thus, the additional oversight introduced confidence that the project will be delivered on time and on budget, while maintenance services will be performed according to city specifications within pre-specified budget.
Key messages from the case studies: analysis

Anna Panagopoulou, Head of Unit, TEN-T Executive Agency

Three case studies were presented covering the entire lifecycle of project preparation process starting from project origination through project assessment to project capital market financing arrangements and closure. Although the case studies were complementary, they still share several common messages. First of all, institutions and programmes, such as centralised support structures have an added value in the realisation of a series of complex projects. Also, there is a need to cultivate institutional knowledge and experience within institutions and sectors. Finally, it is important to anticipate challenges from the design, construction, operation and maintenance phase already at the outset of the project preparation. Given that PPP is a life-cycle based form of procurement, it provides the needed framework for taking into account all project risks that might materialise at the different stages of project lifecycle. Among other benefits, PPP approach usually results in faster implementation of projects, potential cost savings from private sector innovations and increased transparency through early involvement of private actors in the procurement process.

The Dutch case study showed that bringing together individual projects into one programme can create a framework that is attractive to both private and public partners. Moreover programming of project can provide benefits in many other project management issues, such as sharing costs on legal preparations, market research and risk assessment among several projects. Standardisation of contracts also reduces costs per projects for the private sector. Furthermore placing smaller, less complex projects at the start of the programme helps both public and private sectors to benefit from the learning process. Overall, long term planning gives certainty that initial investments in qualified staff and costs for participating in tenders will pay off, that leads to stronger private sector interest and more intensive competition.

The cases study of the Malpensa Rail Link in Italy presented the importance of analysing the feasibility of private financing and the development of different financing options. The case study made it apparent that the preparation of PPP projects requires considerable efforts at the outset in terms of modelling, negotiations, risk analysis and contingency planning compared to traditional procurement. However, the initial investments in the project preparation tend to pay back even if traditional procurement is at the end the preferred option, as clearer understanding and risks over the life-time of the project can help lowering costs and avoid overinvestment in projects. As the project was supported by the TEN-T programme all the way from initial design to actual construction works, it makes the rail link a good example of how PPP preparation studies can facilitate the realisation of complex projects without forcing any particular type of financing at the outset.

The presentation of Ottawa Light Rail Transit System in Canada shared international best practices in designing PPP procurement and offered a structured approach to combining bank and bond financing. The case study reiterated the importance of having bank and bond financing options readily available for financial engineering purposes. Another important aspect of the case study was the demonstration of the ability of the PPP model to ensure the alignment of interests in which the City of Ottawa was supported by the lenders to keep the construction schedule on-time. Overall, the Canadian way of debt financing has important lessons for Europe. Banks are able and willing to take higher risk over short periods and the capital market is able to provide long-term financing for lower risk project stages. Therefore the financing of the construction phase with bank loans and the operational phase with bonds presents a good combination.

The presentations and the lively discussion among PPP practitioners from different countries have brought forward two key messages. Solid upstream preparation of infrastructure investment is key in successful implementation of PPP projects and competition is an important factor in PPP procurement, therefore bank and capital market financing should be considered as complementary sources of financing.