PPPs in Spain

Within the Operational Programme 2014-20

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PPPs may help governments overcome short-term budget constraints

Government infrastructure funding-capacity is limited by deficit/surplus and can only sustainably grow in line with economy and tax revenues

Governments financing-capacity through public-debt is limited because of credit-rating constraint

Privately financed PPPs may allow governments to meet immediate cash needs of infrastructure construction by changing the timing of required funding payments

Source of Public Funding
Taxation
User Charges
EU funds

Sources of Public Financing
Public Debt

Sources of Private Financing
Capital Debt Market
Capital Equity Market

and improve infrastructure service delivery through better project risks management

The ***key advantages*** of PPPs are:

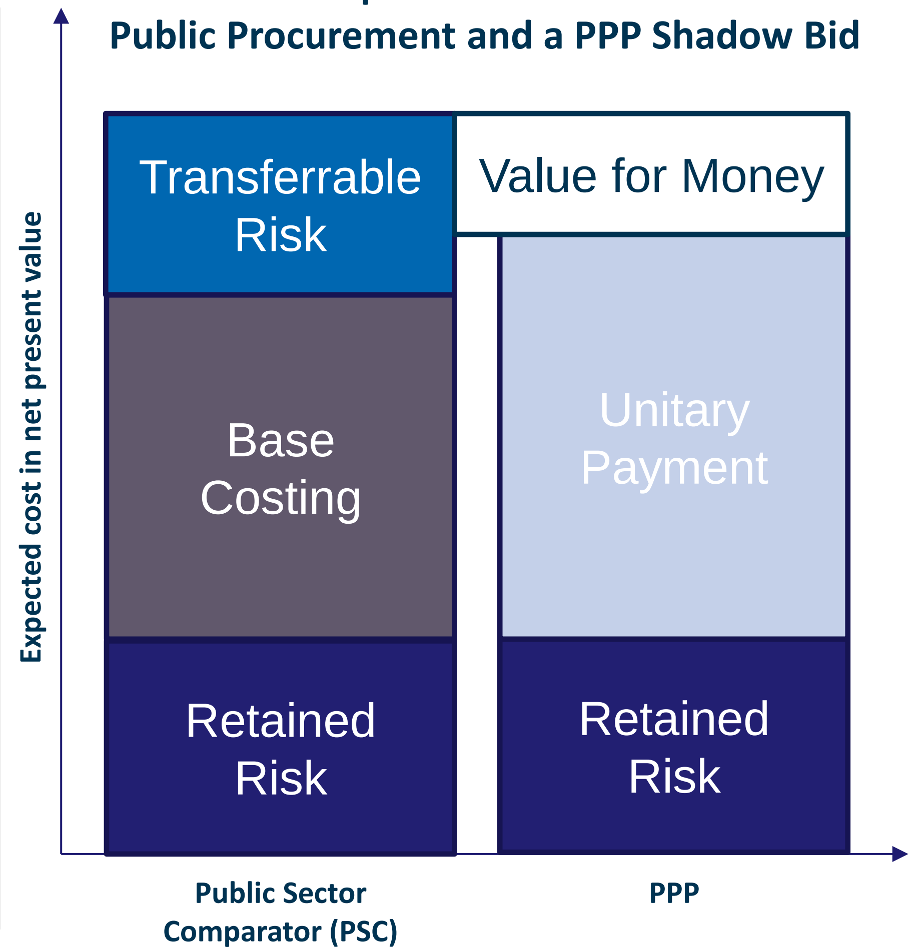
- bundling of certain tasks, typically design, build, operation, maintenance and/or financing
- contracted time and cost outcomes for Government
- clarity around project definition
- payments tied to service delivery, not asset provision
- whole-of-life cost management
- accelerated and enhanced delivery of projects

but to deliver value, the benefits of PPPs have to compensate for the increased cost factors

It is key to assess whether the greater efficiency of the PPP project is likely to outweigh:

- Increased financing costs
- Transaction, procurement and contract oversight costs

Comparison between a Public Procurement and a PPP Shadow Bid



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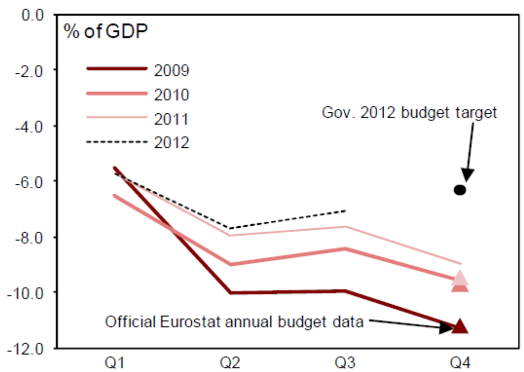
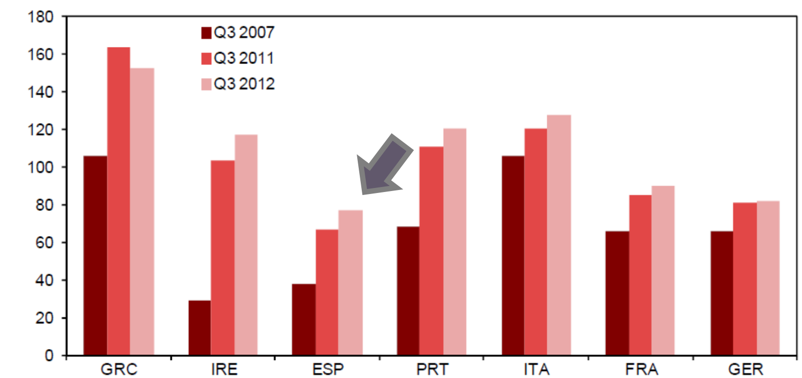
Against a macroeconomic context dominated by fiscal consolidation

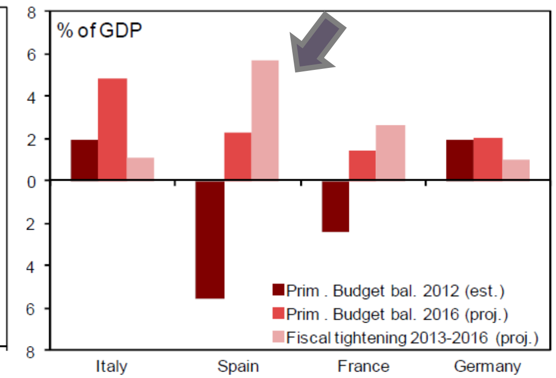
Spain: Deficit tracking



Public debt across the EMU



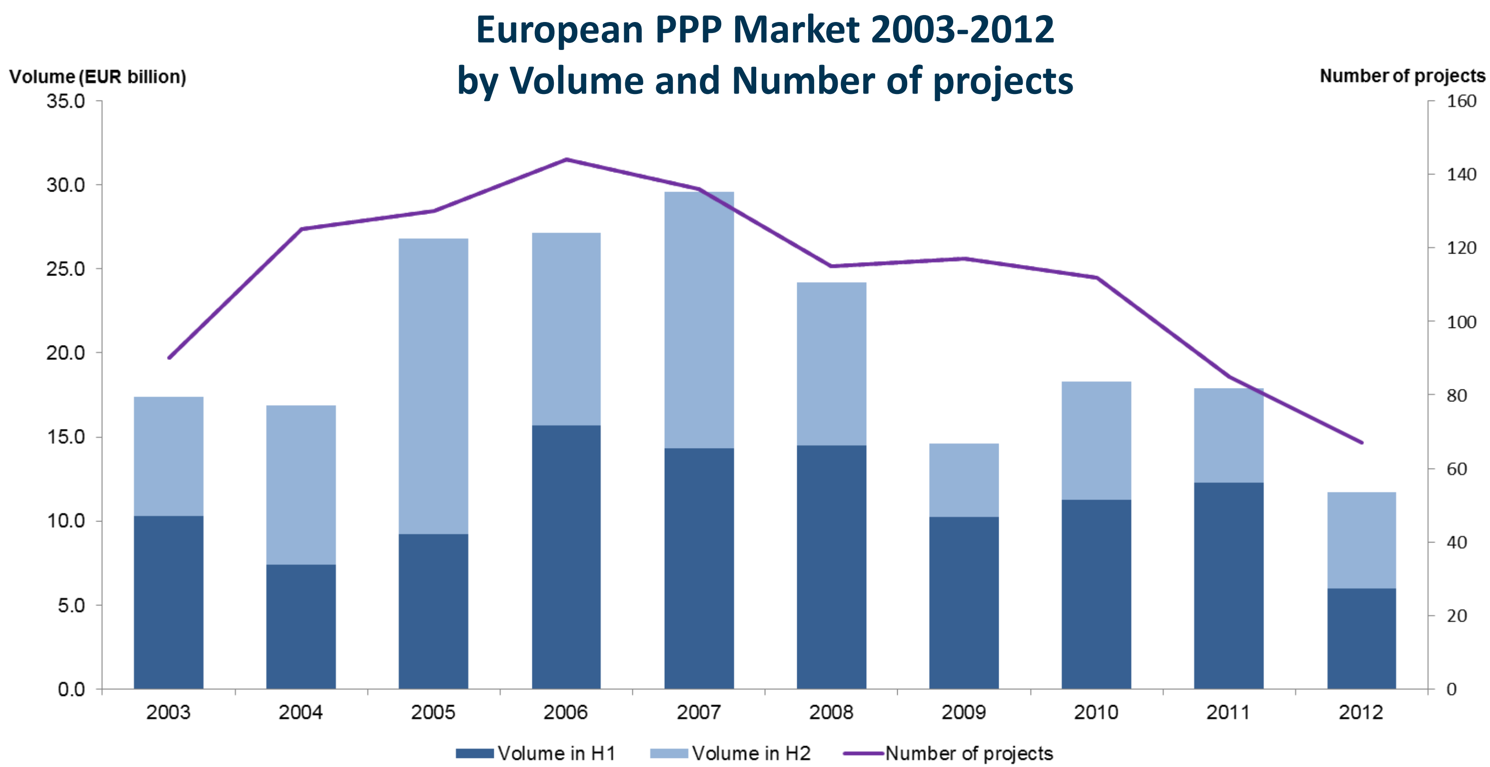
Austerity required to attain 2016 primary budget balance



Source: Eurostat, National sources, GS Global ECS Research

- Most EU governments are facing pressure to reduce public debt and deficits including cutting direct infrastructure investment but…
- …recognize the contribution of infrastructure development to economic growth
- Privately financed PPPs could be an option to deliver key infrastructure as they limit short-term pressure on both debt and deficit, yet…

in 2012 the European PPP market recorded its lowest volume for 10 years



Source: EPEC

Limited availability of private finance, and limited confidence in the markets, affected by the sovereign debt-crisis are the main causes of this decline

Before the crisis, the Spanish PPP market delivered a large number of projects

Source :ASETA

Roads (toll/shadow toll/ availability)

- 15 billion Euros of investment
- 3,300 km

… but also

Hospitals

Urban projects

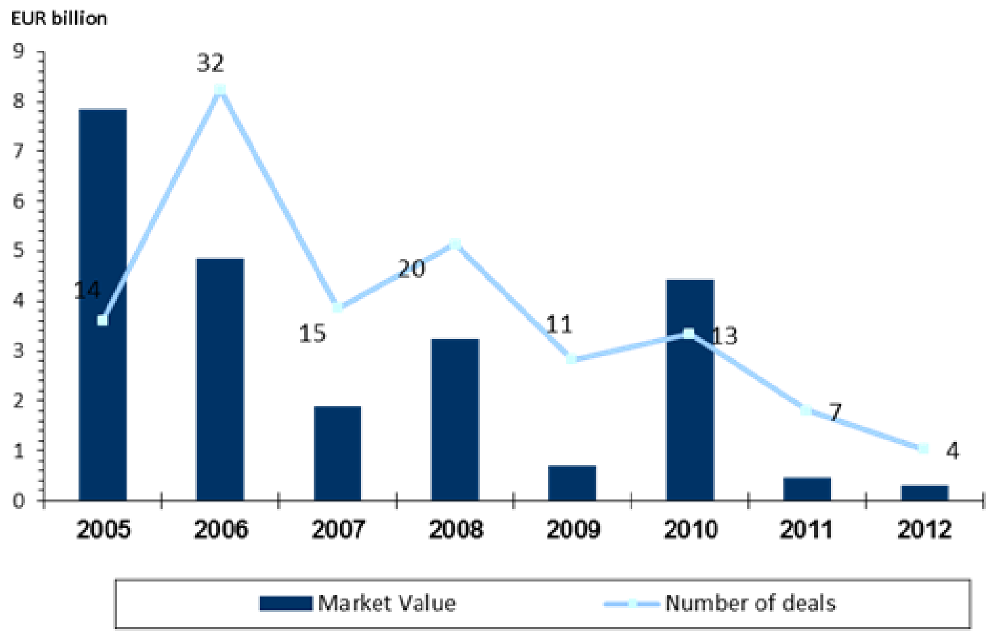
According to SEOPAN*, between 2003 and 2011 Spain generated over 500 PPP transactions worth approximately EUR 50 bn, primarily at regional level

* National association of construction companies

Today the Spanish PPP market has reached its lowest level since 2005

- Budget cuts by the Spanish governments have frozen the PPP projects pipeline
- The Spanish economic crisis and changes in financial markets have affected concessions **in operation**, **under construction** and **recently awarded**

Spanish PPP Market 2005-2012 by Volume and Number of projects



Source: EPEC

…with a drastic change in the financing conditions in Spain…

Before the crisis

Low risk perception

- Aggressive financing structures
- Long term financing (above 25yr)
- Low margins (below 100bps)
- High leverage ratios (up to 90/10)
- IRR (6-8%)
- Min DSCR 1.20x
- Demand risk accepted

Monoline Guarantees
Syndicated market
Competition amongst banks

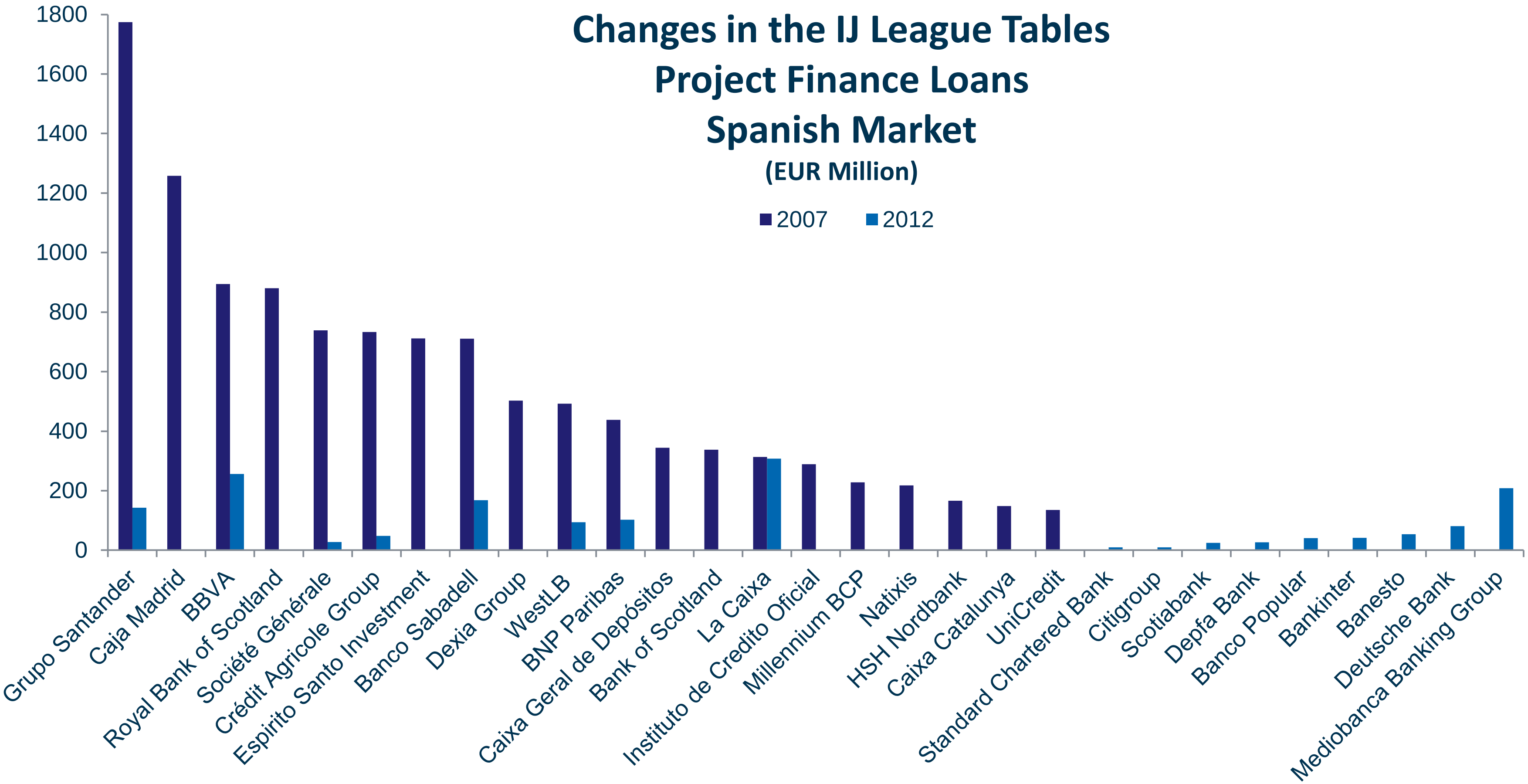
Today

Higher risk perception

- Hard to reach financial close
- Short term financing (5-7 yr)
- High margins (+500bps)
- Lower leverage ratios (below 80/20)
- IRR (+10%)
- Min DSCR 1.40x
- Demand risk no longer acceptable

Absence of monoline companies
Only club deals
Many projects without banks

…and a contraction of the project finance market



Source : Infrastructure Journal

Systemic factors are impacting banks' appetite for long-term PPP lending

- **Basel III increases the regulatory capital requirements, incentivizing the reduction of balance sheets of banks**
- **Basel III penalizes long-term lending particularly with the new liquidity ratios**

The consequence are:

- sale of existing project finance assets rather than making new loans by banks under liquidity and credit pressure
- increased long-term debt pricing
- shorter-term debt and refinancing requirements
- more corporate rather than project finance
- many banks exiting from the project finance market

which is further impacted by the contingent exposure to Spanish sovereign and banks’ crisis

- Spanish banks are under high liquidity and credit pressure, with limited or no willingness to provide long-term financing
- Foreign banks are not currently active in the Spanish PF market, given the increased perceived risk of the project
- Spanish and foreign banks involved in distress Spanish projects with approximately 3 bn EUR at risk
- Attracting long term financing without the support of EIB and/or credit enhancement provided by public entities (e.g. *prestamos participativos* by ICO) is very complicated...but EIB only finances up to 50% of senior debt

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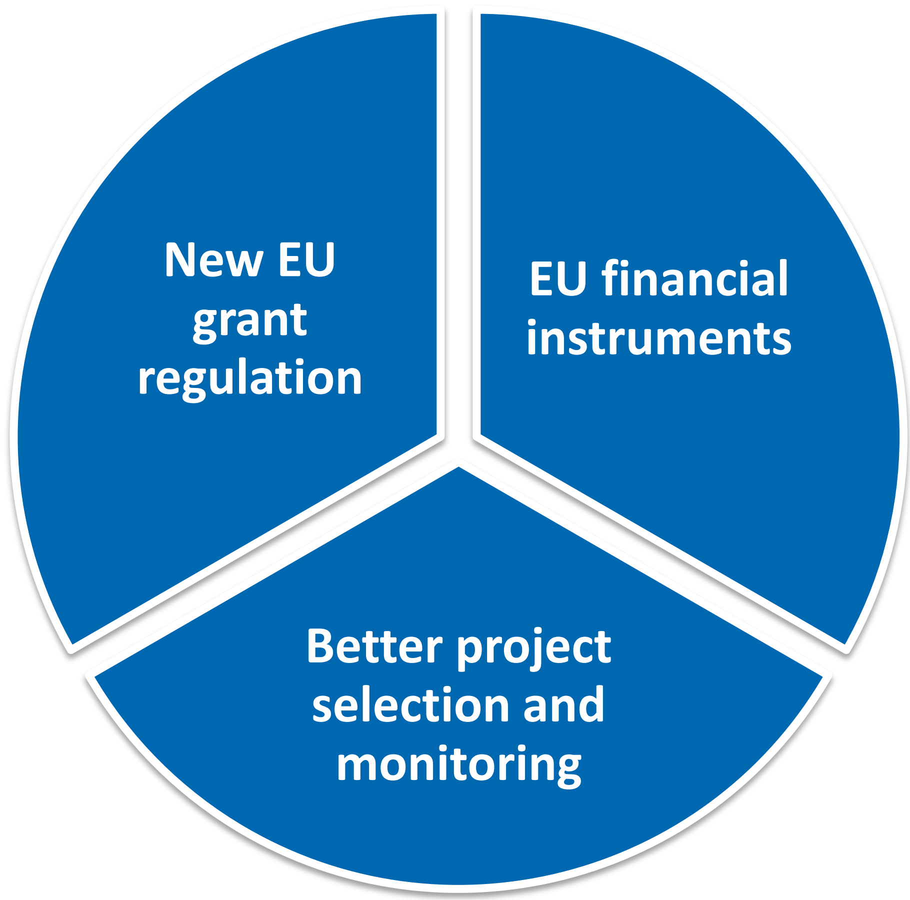
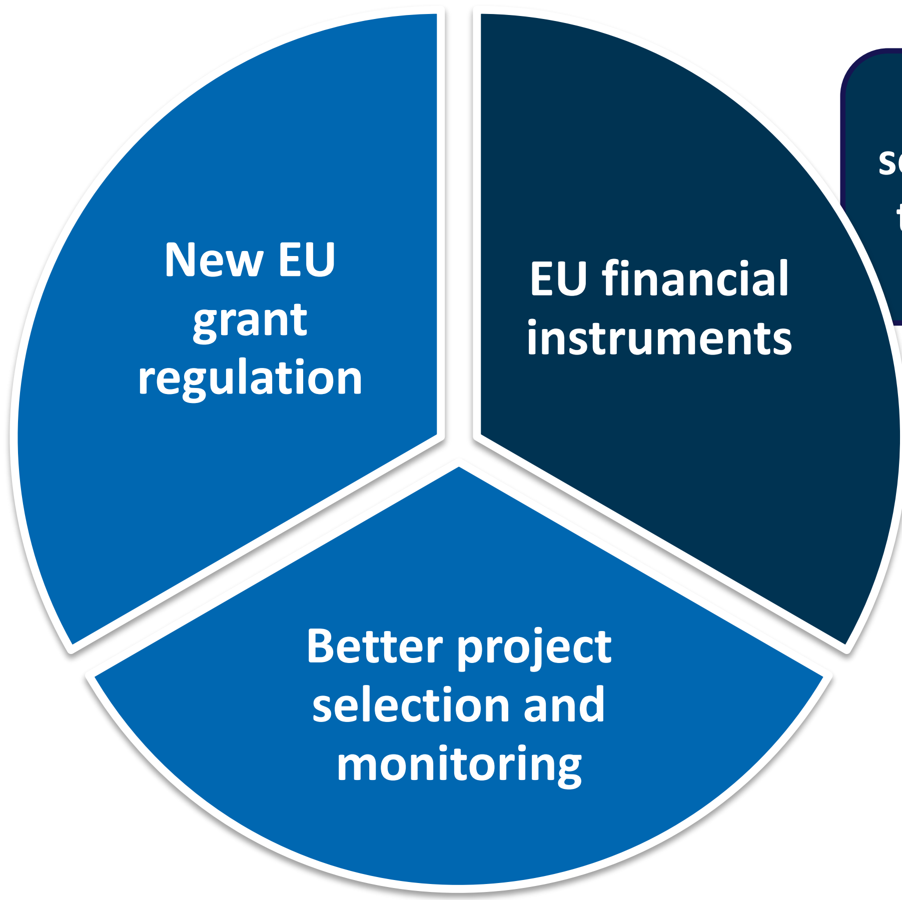
European PPP Expertise Centre

Possible solutions for Spanish PPP financing



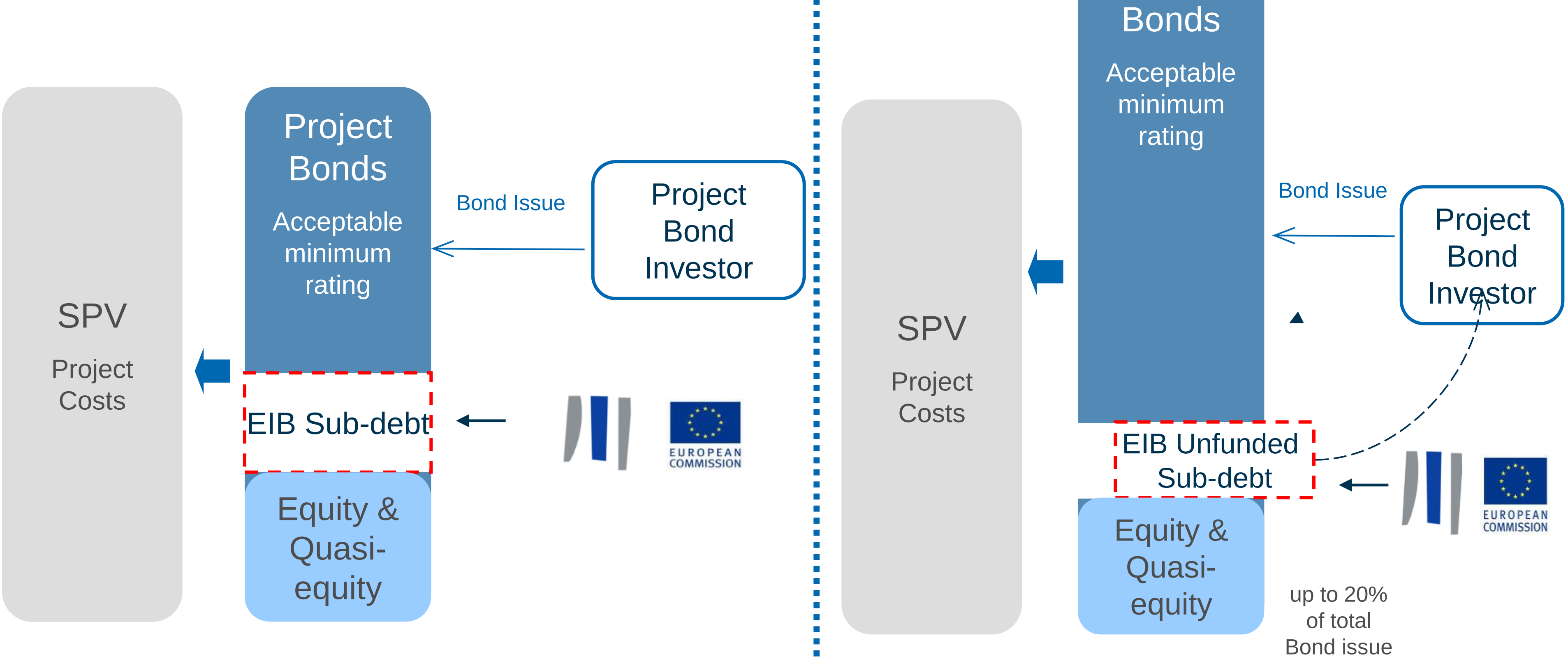
European Investment Bank

Possible solutions for Spanish PPP financing



to access new sources of capital and to complement bank lending

by supporting new financial instruments such as Project Bonds



EIB Subordinated debt or **partial guarantee** are expected to increase the rating of the bond to levels acceptable to Bond Investors (e.g. insurance/pension funds)

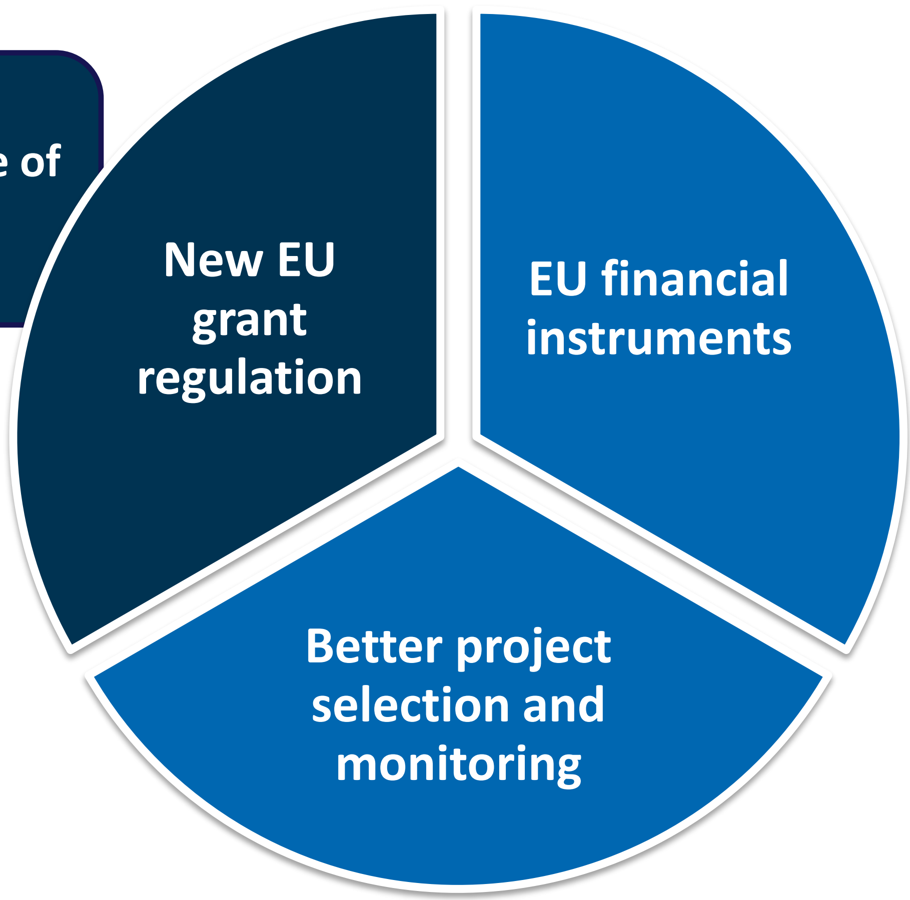
by enhancing tools to support bank financing

- **Mitigating the perception of risk** of banks in projects with guarantees or mezzanine/subordinated debt

- **Using revolving mechanisms**: resources available for future projects at maturity (Jessica-type holding funds)

Possible solutions for Spanish PPP financing

to increase the use of EU grant in PPPs



European PPP Expertise Centre

by leveraging EU grants in PPPs

- **Blending is possible** (see EPEC's Stocktake of blended projects)
- It is **expected to be recognised in the new regulation**
  - Council proposed a new Recital, Definition and chapter on PPP in draft regulations.
- **Private partner** to be identified may become **beneficiary** (and can be changed)
- **Eligibility of Expenditure** provisions better **adapted to PPPs**
- Revenue generating projects: introduction of **flat rates**
  - Partially neutralises the difficulty in calculating the funding gap
  - Should allow more certainty on the availability of the grant and its quantum

Possible solutions for Spanish PPP financing

- New EU grant regulation
- EU financial instruments
- Better project selection and monitoring

to deliver more resilient projects and ensure their affordability/sustainability

and by better selecting and monitoring projects

Value for money

- Comparison with PSC leading to a better risk assessment
- Better assessment and monitoring of project affordability (future liabilities)
- Better assessment of contracting entities' creditworthiness
- Formal process to evaluate procurement method (PPP vs. traditional public procurement)

Central PPP advisory body

- Repository of lessons learned and best practice
- Facilitator between public entities involved in PPP projects
- Provider of advisory for less experienced contracting authorities
- Independent view of Value for Money assessment

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