

# Marketing a concept abroad

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Deutsche Bank's announcement of April 13 that it has signed a co-operation agreement with Banco di Napoli to pursue public-private partnerships in Italy is part of a growing global trend. Spurred on by the success of the UK's Private Finance Initiative (PFI) a number of other governments are setting up similar schemes.

Official estimates indicate that £42 billion (\$67.5 billion) of infrastructure work will be required in southern Italy over the next 10 years. And in response to this the Italian government is setting up a private finance unit inside the Italian treasury which will mimic the UK's scheme. And while local governments prepare a list of their infrastructure requirements, it not just the Italian banks which hope to take advantage of the new flood of deals. Deutsche is clearly keen to grab a piece of the action. Says Geoffrey Spence, head of project finance for Europe, the Middle East and Africa at Deutsche in London: ? The Italian government recognizes that private finance is essential if the substantial programme of infrastructure projects is to be realized. We will be working closely with the government and our clients to help ensure that projects in the roads, bridges and water development sectors come to fruition.?

But while the UK government, the banks, lawyers and sponsors involved in projects have devoted most of their time to ventures in the UK, the concept is unquestionably arousing worldwide interest.

## Evolving and exporting the concept

PFI was launched in the UK in November 1992 by the then Conservative government. After a troubled beginning the initiative is bearing fruit.

The primary areas of difficulty have been the complexity and costs of bidding; the length of the procurement process; the lack of skills and commercial awareness of public sector officials; and the failure to prioritize projects for PFI suitability. The most significant development in PFI since the election of the Labour government was the Bates Review of the initiative. The recommendations from Malcolm Bates to streamline and improve delivery of projects were announced in June 1997 and subsequently adopted by the government.

According to Professor Velia Leone, the resident partner in law firm Berwin Leighton's Brussels office, it has to be established whether PFI has been successful in the UK before determining its suitability for export. Professor Leone notes that the UK has a highly sophisticated banking and insurance sector, the country has been in the forefront of developing contractual experience in project finance, and PFI has been developed within a substantially deregulated system. Obviously, not all these factors apply to other countries.

Leone agrees that many European countries face common problems such as budgetary constraints, a need for infrastructure improvement and the enhancement of services to the community. ?These developments have coincided with an intellectual appraisal of the form by which welfare services will be delivered,? says Leone. ?The concept of public private partnerships is now well spread throughout Europe, and most governments are considering similar ventures.? Leone believes that strong political support is crucial to the success of exporting PFI, to help overcome the obstacle of the

highly regulated legal systems in some European countries.

On the down side, Leone suspects that banks in Europe will not be so keen to lend for the same lengthy periods, sometimes 40 or 50 years, as has occurred in the UK. 'The majority of European governments feel PFI/PPP is exactly what they need, and will help alleviate many of their problems,' she says. 'But they are faced with the problem of encouraging their local capabilities - persuading local banks, advisers and promoters to come up with interesting projects. Otherwise, there is the danger that PFI will become solely an arena for the Anglo-American financial/project community.'

#### Portuguese progress

In western Europe, Spain, Portugal, Finland and Holland have the most advanced PFI-type arrangements. The Portuguese government is progressing with a roads programme, with two real toll and six shadow toll-roads under procurement. Financial closure has already been reached with the country's West Toll Road.

While the Portuguese government appears committed to the PFI route, some bankers in the UK have expressed doubts about whether the Portuguese domestic community will be able to finance a programme of such magnitude. Dominic Nathan, the executive director of the infrastructure finance team with CIBC world markets in London, sounds a note of caution. 'It's a very politically sensitive area,' he says. 'While the Portuguese PFI roads programme appears to offer good business opportunities, there may not be the same government commitment to the health sector, for example.'

#### Canada offers hope

But Nathan identifies Canada as promising for future PFI/PPP development. In Canada, the 407 highway is being privatized. Part of the road has already been completed and at the end of April it was announced that the Ontario government announced has reached a deal to sell Highway 407 to SNC-Lavalin Group, the Caisse de dépôt et placement du Québec and Spain's Grupo Ferrovial for \$3.1 billion. The final decision was based solely on the highest price according to an Ontario minister with responsibility for privatization, referring to a heated bidding war throughout the autumn that culminated in yesterday's announcement.

Water is the other sector in Canada which, after a slow start, is beginning to flow more rapidly. 'Again, this is politically sensitive,' comments Nathan, 'but there are considerable opportunities and the government is demonstrating a clear interest - a key element in all PFI/PPP transactions.'

But what makes PFI different from straight non-recourse financing?

'Broadly speaking, the differences fall into two categories,' says Nathan. 'First of all, there's a general sector difference. Traditional non-recourse financing is a form of asset finance, with repayment being effected by the cash flow from the asset. Non-recourse financing invariably involves commodity-type products, electricity or oil revenue, for example, which have a market price. However, the financing of PFI/PPP can more accurately be defined as a financing of a service rather than an asset, such as the provision of a hospital or a road,' says Nathan.

Second, there are also significant structural differences in the financing, for example the compensation on termination component of PFI. If for any reason the contractor or project company defaults, the bank involved will require compensation so that there is no windfall gain to the government in the event of contract termination.

In general non-recourse financing, however, there is no concept of compensation because there's a marketable product that can be sold on to a third party,' he concludes.

#### Opportunities in the east

Takashi Nakamura is the director in the construction department of the Japan External Trade Organisation (Jetro). Jetro is a non-profit semi-governmental organization, established by the Japanese government in 1958, which supports trade between Japan and other countries by promoting imports into Japan and international exchange.

‘PFI is certainly arousing intense interest in Japan,’ says Nakamura. ‘A PFI Promotion Bill is nearing the end of its passage through the Japanese parliament, and is expected to be passed into the national diet by mid June. The concept has been under discussion in Japan for more than three years, with substantial research conducted on missions to the UK.’

In addition, some Japanese construction companies already have experience of build-operate-transfer schemes overseas, though no PFI projects are as yet operational in the country. The initiative is deemed suitable for a variety of sectors within the Japanese economy, including transport, health and waste disposal.

Says Nakamura: ‘The scope for PFI is probably wider in Japan than in the UK, as our public sector is significantly larger.’ Nakamura feels the creative dynamism between the government and private sector entity is the core strength of PFI, but that there is uncertainty in the future for both parties. The high cost of tendering is a further disadvantage. Yoshihiko Kato, chief representative liaison office of the Mitsubishi Research Institute in London, says: ‘There is a very high interest in PFI in Japan, with the emphasis more on transport, infrastructure, and regional development rather the health sector.’

#### African advance

Brian Molese is chief director of asset management in the department of finance, Pretoria, South Africa. ‘PFI, or rather PPP as we call it here, is very much a buzzword in South Africa today,’ he says. ‘Although we have not made much progress so far in terms of projects, our prisons sector in particular is an area where we see opportunity for PPP.’

Tony Phillips, managing director of project finance with SG, has a responsibility for Africa which he views as having good potential to develop PFI. ‘Southern Africa is particularly interesting,’ says Phillips. ‘Not merely is there the privatization of public entities, but there is increasing activity in the project finance field with a growing emphasis on PFI. The African states are now recognizing that this is probably the most effective way for them to go forward.’

Phillips sees the question of ownership as crucial. ‘This is something of a cultural issue. Africans naturally like to own things’ given the background of past exploitation that's a thoroughly logical position. The suggestion that the private sector can operate and deliver the same, or in some respects, a superior quality of service, is sometimes difficult to convey.’

How can that perception be overcome? Says Phillips: ‘Given time, I think it will. The key factor is the practical application through actual projects that are satisfactorily completed and clearly demonstrate in practical terms that PFI works.’

But on the other hand he argues that South Africa, in common with many African states, may not be suitable for the full range of PFI projects as experienced in the UK.

He identifies railways as having potential throughout southern Africa, as it is a comparatively cheap method of transport. Past infrastructural neglect and current financial constraints mean that PFI may be the sole method of project finance that can provide a decent transport system for the majority of African nations.

‘Many African countries have substantial natural resources, and not solely mineral deposits. Taking mining as an example, given a well structured mining code in nearly every case the government will take an equity stake. This should earn dividends and has the benefit of royalties which can be substantial. These incomes can then be used to kick-start

projects classified as PFI.?

Botswana is an excellent example of a country that, since gaining independence, has exploited its natural resources, and coupled with political stability can justifiably claim to be Africa's success story, he adds. ?While Botswana is an outstanding success, there are others, and steady progress generally has been made in recent years,? says Phillips. ? There's the added advantage that Africa has not experienced the ?boom and bust' that's occurred recently in the Far East, Asia and Latin America.?

Phillips sees political instability in the region as a possible impediment to PFI development, but the situation clearly varies enormously from one country to another.

Promoting the concept

SG's Phillip's believes that the UK government and banks, lawyers and sponsors involved in UK projects are not doing enough to promote the initiative abroad. But there is substantial evidence of many other countries in Europe, the Middle East and the Americas appraising the operation of PFI in the UK. ?PFI is yet another great British idea and the substantial expertise now available needs to be exported to other markets, where there is a great willingness to adopt the concept,? says Phillips. ?Exporting PFI is set to become a growth industry, but its true and full potential will only be realized if all interested parties, from the government down, work together to achieve that potential.?

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