Dutch PPP Roundtable:Unlocking institutional enthusiasm

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Project lenders have started to turn their attention to the Netherlands, which enjoys a standardised procurement process, low sovereign counterparty risk and a wealth of first-class sponsors. Its pipeline for PPP projects is expected to accelerate over the forthcoming years. Given that the flow of big-ticket financings has started to slow down in France, and the UK government is still struggling to explain the intricacies of its PF2 model, this is welcome news.

But, nearly all projects so far have been procured at the national level, using tried-and-tested structures and long-term bank financing. Dutch sponsors and lenders will increasingly need to cope with decentralisation and the drive towards standardisation may be challenging in emerging sectors like water infrastructure. They will also need to find out which of the institutional debt structures on offer has the most realistic chance of success.

Project Finance gathered ten market participants in Amsterdam to discuss current issues in Dutch PPP. The ten participants were:

Nitesh Mistry, Bank of Tokyo-Mitsubishi-UFJ

Daphne Broerse, Norton Rose

Wouter Hertzberger, Norton Rose

Alistair Higgins, ING Bank

Jeroen Intveld, Rebel Group

Maarten van der Bent, BAM PPP

Gideon Tilburgs, John Laing Investments

Erik Naafs, VolkerInfra

Laurent Van Cutsem, Besix

Danny Zwerk, Rijkswaterstaat

Project Finance (PF): What do you think explains the increased level of activity in Dutch PPP recently, and will the recent delays to some projects have any effect on the upcoming pipeline?

Danny Zwerk, Rijkswaterstaat (DZ): The Dutch government is very much in favour of PPPs because they deliver value for money. The government uses a multi-annual infrastructure programme, where the budgets are fixed and appointed to projects, and they are also approved by Parliament. The multi-annual approach consists of 32 potential PPPs in the upcoming decade. I dont believe the cuts in central government expenditure will affect the first upcoming PPP tenders very much. We have a pipeline of at least Eu5 billion [$6.8 billion] for the upcoming years.

Nitesh Mistry, BTMU (NM): I think whats noticeable is that there was a period in the past where there were hardly any Dutch PPP deals, and that since 2008 there has been a steady increase in deal flow. Has the financial crisis triggered the need to do PPPs?

DZ: In my opinion its not budget driven in The Netherlands. As I said, we have a budget fixed for a project, and on a value for money basis we decide whether to go for a PPP or not, and when we start a tender we finish it. It took a while but now we are here to stay.

Alistair Higgins, ING (AH): Its also maybe worth saying that although there is an increase in terms of deal flow, its not a steep increase. Its more the relative background of the UK, French and German markets providing less deal flow. The focus of many banks, overseas banks in particular, is very much centred on Belgium and the Netherlands at the moment.

Erik Naafs, Volker Infra (EN): If you look at the actual number of deals getting closed within a year, its still a small number. Its still maybe three of four projects if you include social infrastructure, so for the time being its a small market.

PF: Which sectors are likely to experience the greatest increase in deal flow?

DZ: For transport projects there is a solid deal flow. We lowered the hurdle rate for the government to do a comparator to Eu60 million, but to be honest that has delivered us only one more project in the testing phase because our road projects are usually at least Eu60 million. In other sectors the deal flow will increase due to this lowering, for example the locks and inland waterways.

Jeroen Intveld, Rebel Group (JV): It has been around Eu25 million from the start for accommodation projects, so I would say its just getting to its normal speed now. I would expect infrastructure and accommodation projects to deliver around three to four deals per year for the next five to six years, and that the additional growth will come from other sectors.

DZ: Rijkswaterstaat is also supporting local governments, municipalities and provinces on PPPs. We have a special support unit, although it definitely needs some time to get going.

EN: It will probably require people willing and accepting that they cooperate with other government colleagues, because one local government will normally be too small for the project to qualify for a DBFM approach. In Belgium, for example, you saw one very tiny part, the German speaking region, group all its education needs into one project. In the Netherlands this type of approach could be trickier though because of all the various groups involved.

JV: There is another asset category where we might see developments in PPP, the rail sector. Prorail and the government are selecting projects to undertake a public private comparator so it will take some time, but I expect in two to three years time that they will be putting some projects out to the market as well. My expectation for growth will be in the lower levels of government and the rail sector.

DZ: A new asset class is the locks and inland waterways. We have six locks projects coming up. We start this year with the first two small ones and provided they are successful then we will bring the Afsluitdijk and the Amsterdam sea locks to the market, which are both approximately Eu1 billion. This asset class is very interesting because its very difficult to set a good performance regime when their main function is to keep the water out as opposed to the availability for road users, which we are familiar with.

PF: How do sponsors and lenders get comfortable with increased decentralisation in procurement and decision-making?

Gideon Tilburgs, Laing Infrastructure (GT): We saw last year something happening which clearly took away a lot of the appetite we as an organisation have in decentralised PPPs in the Netherlands when the Regional Tram project was cancelled after bids went in. In order to restore confidence two things need to happen. One is that sponsors and also lenders participating need comfort that a project is approved at all political levels. The second thing is that should political decision-makers during the tender process want to reconsider their choice there should be a level of compensation which is higher than what was available here.

NM: The local authority risk on that project was a particular issue for the banks looking at the transaction and in particular the international banks. On that project there was implicit central government backing, although the actual linkage was quite hard to prove and some further clarity over that at the outset would have been helpful

Wouter Hertzberger, Norton Rose (WH): The issue you are referring to I think is really more of an issue for international lenders entering the Dutch market than for local banks, which are used to how things work in the Netherlands.

Maarten van der Bent, BAM (MVB): It is not the case that decentralised projects are not successful. There were successful projects like the A59, Montaigne college and International School Eindhoven. The main issue is getting a sense of political commitment from all the stakeholders.

Daphne Broerse, Norton Rose (DB): The problem with the regional tram project is a problem that all decentralised projects will face, which is the fact that the tender process runs in parallel with the public, decentralised consent procedure. This is different to projects procured at a national level, where there has been a decision up-front whether to procure the project using a PPP. The risk that the public, decentralised procedure does not lead to an OK on PPP should not be a risk for the participants in the tender.

JV: I think we will see more projects at the regional level and the reason is because all the procuring authorities in the Netherlands are looking at Rijkswaterstaat as the leading procuring organisation. If Rijkswaterstaat sticks to its plan for the next few years then eventually the larger decentralised governments will understand the benefits and will go the same route.

PF: What are the advantages of the Dutch procurement process compared to its neighbours?

EN: One big advantage is that when the project gets started you know that its going to happen more or less in the time that it has been announced, and in my view thats the big difference with some of our neighbours.

GT: I agree and the second element to that is that once youre in the tender process you will have quite a certain estimate of when it will close.

JV: It comes down to professionalism. Both Rijkswaterstaat and Rijksgebouwendienst are very professional tendering authorities and have their standard contracts in place. In other countries procurement procedures are more political, so there may be some intervention along the way, which will cause a delay or which will cause the project to stop. If I could draw a comparison with Flanders, where we are involved in the A11 project, one difficulty is that the most important permit can only be approved by the government once a preferred bidder is announced.

Laurent Van Cutsem, Besix (LVC): In the Netherlands the PPP market is more mature since it started earlier than in Belgium. In Belgium were in the beginning of the learning curve, although it is true that we have more legal constraints than the Netherlands.

AH: The Belgian market has developed a long way over the last few years and they clearly have ambitions to replicate the success of the Netherlands. But when we talk about Belgium were forgetting about other countries. Were just starting in Germany now after all these years.

MVB: There are already three or four projects BAM has been involved with in Germany. I think that the Dutch market is far more professional than the German market, partly because of the standardised DBFMO contract.

PF: What do you think the advantages and potential pitfalls of increased contract standardisation are?

DB: One of the good things for procurement in the Netherlands is definitely the standardised contract. The 1.0 version versus the 3.0 version has definitely brought some advantages. I think that for lenders, especially for international lenders, the fact that we have incorporated some of the lessons into a standardised contract is a plus. That said there is also a potential pitfall in relation to standardisation. What you see in relation to certain projects is that the DBFM contract becomes non-negotiable, which could lead to a situation where theres not even a dialogue. This stands in the way of a proactive and flexible approach necessary in these economic challenging times.

GT: When we were doing the A1/A6 and the N33 evaluations, we compared the total number of dialogue meetings and specialist meetings we had had during the A15 and A12 tenders with the latest projects, and there was a huge difference. I think standardisation has been useful, for example with bid costs and tender time reduction. But if you enter into a contract with each other for 28 years or more it has to be discussed in a formal dialogue meeting with sufficient time whereas in the latest tenders we had a discussion for 45 minutes, which seems a bit too quick.

NM: Standardisation also limits the variety of projects you can look at. Obviously standardisation is good for the transport and buildings sectors, which are pretty standard in their nature in terms of project risk, but for the more complex projects maybe standardisation could be more of a limiting factor.

AH: Although standardisation in the roads sector has been well-received, the payment mechanisms are still viewed as quite penalising and if there were free choice some participants would rather have a UK roads payment mechanism or any of a number of alternatives.

EN: To be fair if you look at the recent past, the N33 for example, there was complete flexibility from the government side to discuss the impact of a new element that was introduced.

DZ: We actually asked all the parties to write down this paragraph on index-linked financing from scratch. The other point for any sector with a new performance regime, for example the locks, is that a lot will be left open to the bidders and then all of us will develop the best way forward together.

NM: That said the standard form has been crucial in attracting liquidity from long-term lending players. Thats part of the reason why were not seeing the long-term market playing so well in Belgium.

PF: Why has the Dutch PPP market been able to attract such enthusiasm from international lenders?

AH: Liquidity started to flow quite freely into the Dutch market because of the AAA rating, standardisation, use of English, and the history of closing deals. Latterly, this has slowed with bank appetite waning in general. To address this, ING and others are focussing on initiatives that bring alternate sources of long-term debt capital to the market. The relatively strong deal flow in the Netherlands has been a big factor for institutional money looking at these markets.

MVB: I think another important difference with Belgium is that the Dutch contractors are bigger. In Belgium there are very few big contractors aside from Besix.

LVC: Its early stages in Belgium. The biggest contractor is probably Besix and if you compare the PPP department of Besix with the PPP department of BAM, theres a big difference. Were working to close that gap but its not surprising that international banks prefer Dutch projects at this stage.

AH: The Dutch contractors over the course of the last few years have established very substantial PPP centres of expertise within their organisations. Theyre seeing projects time and time again that are being procured using a PPP method, so its a very central part of their business strategy. A similar trend is now taking place in Belgium.

EN: There is another element to this question because there is no choice to be made in the Netherlands. In my view on the assumption that I see ING not as a domestic bank but as an international bank, I think there are no domestic funders, with the exception of BNG, left in the area of infrastructure financing.

MVB: We need the German banks and the Japanese lenders in the Dutch market. Otherwise there would be no funding. Its very difficult to find enough funding from Dutch banks for larger infrastructure projects.

NM: We are seeing a difference from our point of view in terms of the Dutch market versus the Belgian market. Weve been successful as a Japanese bank lending long-term in the Dutch market but not so successful in the Belgian market at the moment because the deal flow in Belgium is smaller and the financing is still dominated by local banks.

PF: Is there enough bank liquidity for larger projects without recourse to alternative funding structures?

NM: There is still a long-term debt market for Dutch PPP projects and that was shown to be the case on the A12, the A15 and now the A1/A6. Thats not to say that I dont think there is a place for additional forms of liquidity, but I think it boils down to a case of whether the authorities are in a position where they want to take a chance with a new debt product when bank debt has been successful in closing deals post bid within a three month period. For the A1/A6 there was a choice between using the PEBBLE structure or long-term debt financing, and the long-term debt finance product was used.

AH: Right now there are banks able to fund, but is that how the market is going to evolve long-term? It seems more probable that we are going to see institutional money playing a more active role. We have to try to support our contractors in our key markets and when you look at the Dutch and Belgian banks, there are very few willing to fund 25 plus years. Were trying to look for an option that strikes a balance between the nature of how a bank is funded and the requirements of sponsors, who need to deliver on their projects.

EN: If you see whats happening now, there are a number of insurance companies and pension funds which are gearing up to invest on their own since they do not want to refinance. There may be a third way.

AH: I believe that will be the case and we are working with a number of institutions on the PEBBLE structure. What we dont want to see happen is a polarisation in the market whereby one contractor is able to fund a project but another perfectly capable one struggles because both have a role to play to ensure a competitive PPP market. We have to play a role and demonstrate to sponsors the value that institutional investors can deliver.

NM: I think thats key because were finding as a Japanese bank that we can sometimes be one of only a few banks that can lend long-term so in some instances we would prefer to team up with an institutional investor. In some cases we will probably see a mixture of long-term debt plus institutional financing as weve seen recently with the N33.

PF: Does the N33 serve as a template for bringing lenders and institutional investors together?

MVB: The question is whether Rijkswaterstaat is willing to go further using an index-linked solution after its evaluation is concluded. There were some issues with the project, especially the absence of any form of guarantee from APG. The banks accepted the risks in the end but it was a close call.

EN: The forward start funding provided by the institutional investor was an awkward element of the transaction, which created complex intercreditor issues with the other lenders, funding as of day one. So I doubt that the deal can be repeated with that element in the structure.

MVB: The reason for that was that APG had no credit rating.

EN: To overcome that point you obviously need to be prepared to present something internally on your own judgment but most people need the comfort from the credit rating agencies. The other point to make is that there was only one funder in the end. I think that was because APG developed a very defined structure that was tailored to their needs.

WH: One of the preliminary questions should perhaps be whether you are tapping into an additional investor group if you include CPI linkage. Do institutional investors need CPI inflation?

AH: There are very relatively few investors in the Dutch CPI market. The bulk of the appetite is for listed fixed-rate euro instruments and there are some obviously more focussed on sterling.

GT: I think the fact that it is referred to as a pilot meant that APG didnt want this to fail so many people think that they might have adjusted the pricing on the project to make sure the deal could get done.

PF: Which type of financing structure is best suited for harnessing institutional investors to senior debt?

DZ: From a government perspective we want value for money and pre-crisis long-term bank debt was the best way to do it, but in the end its the responsibility of private consortia to arrange the financing within the qualitative requirements we set.

NM: It seems that the N33 was an expensive pilot to run given that the authority is taking full inflation risk for 25 years and while theres a bank market out there offering a cheaper alternative for the larger projects the government may prefer to go down that route for value for money reasons.

EN: There were two very good aspects to the N33. One is that it definitely opens up the market for institutional lenders and for the upcoming A9 project the funding requirements are less stringent than before. Secondly, the N33 had a clear evaluation mechanism so there was no question about how an inflation-linked bid versus a classical non-inflation linked bid was going to be prepared and that is important because it meant there was no uncertainty about the outcome whichever approach was taken.

AH: What they did do well also is to give pre-payment protection, which is an important starting point for attracting money from institutional investors. The changes that are coming about from central government procurement are beginning to open up alternate options including PEBBLE, which is important for liquidity.

GT: I think a second element is how the authority deals with this in the tender process and what they ask bidders to submit at BAFO [best and final offer stage]. I think thats why some products can be brought forward in bids and others cannot, because it is difficult to get the support letters from institutional investors in place. I think the Dutch market isnt as developed as other markets. In the UK, where we are closing a deal at the moment using institutional money, the funding for that project was sourced in a preferred bidder competition after preferred bidder announcement together with the authority.

PF: Why have Dutch sponsors been so proactive in attracting institutional equity?

GT: I think its most probably a necessity because the Dutch sponsors are contractors and its not the principle business of contractors to lock up funds in a 25-year plus concession. BAM, Strukton and Ballast Nedam have all been offloading assets because its just locking up cash which they dont have available for these purposes, as a pure investor like us would have, on a long-term basis.

WH: At the same time APG has, in addition to investing equity, also taken a different turn and theyre working closely with the ministry to see if there are alternative debt financing solutions.

AH: Its not unique to Dutch sponsors, but has been a more recent occurrence when compared to the UK market, which is more mature.

WH: One final point on the topic of alternative funding and institutional investors coming into the market, one of the difficulties we have not addressed is that for smaller projects, those less than Eu50 million, accessing long-term debt could be trickier, since banks are struggling to fund, and the interest from the institutional investors or international banks, with no presence in the Netherlands, is not there, because the projects are not big enough.

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