Bogotá Regional PPP Risk Allocation Workshop

INTRODUCTION

GI Hub held the third of its 2017 Regional PPP Risk Allocation Workshops in Bogotá, Colombia, on 9 November 2017, with various public sector representatives from across Central and South America as well as multilateral organisations operating in the region.

Infrastructure is the foundation of a stable and productive society, and the combination of population growth and rapid urbanisation are driving a global demand for infrastructure to unprecedented levels.

Latin America's infrastructure needs vary widely, given the sub-region's economic, political and geographical diversity. The infrastructure needed to support the growing population and thriving economies in Latin America is particularly acute. Global Infrastructure Hub's (GI Hub's) Global Infrastructure Outlook forecasts the need for infrastructure investment globally as US$94 trillion in aggregate between now and 2040, with over US$20 trillion need in the Americas[1].

Given this enormous need for infrastructure and the vast cost of developing it, governments across the region recognise that their ability to finance the growing demand is limited by fiscal and budgetary constraints and have been increasingly looking to the private sector to help provide finance and deliver efficient and sustainable projects, most notably through public private partnerships (PPPs).

To date, an important portion of infrastructure investment in Latin America has been funded by public resources. Understanding the value in both financing and expertise that the private sector can bring, governments around the region are increasingly considering PPPs as an alternative.

It was in this context that GI Hub held a Regional PPP Risk Allocation Workshop in Bogotá, Colombia on 9 November 2017 (the Bogotá Workshop), with various public sector representatives from across Latin America as well as multilateral organisations such as the Inter-American Development Bank (who presented on Colombia's 4G roads program) and the International Finance Corporation.

At the Bogotá Workshop, GI Hub in collaboration with the international law firm, Norton Rose Fulbright, led the discussions on the allocation of risks in PPPs as between the public and private sector parties, and the regulatory challenges and advancements experienced by the emerging Latin America countries in undertaking PPP projects.

[1] *GI Hub's Global Infrastructure Outlook is available at https://outlook.gihub.org.*

INGREDIENTS FOR SUCCESS IN INFRASTRUCTURE

GI Hub's InfraCompass[2] identifies the following as some of the most important policy drivers to rapidly improve the quality of infrastructure in emerging markets:

- better governance through lowering corruption levels and enhancing the rule of law
- improved regulatory quality
- simplifying permit procedures and land administration.

Specifically, key factors for successfully implementing PPP as a means of procuring infrastructure include:

- an effective and consistent PPP regulatory framework – whether through a single PPP law or series of laws addressing key areas of interest for private sector investors
- capacity across all public sector stakeholders to understand all aspects of PPP procurement, as major infrastructure projects inevitably require collaboration across multiple governmental agencies and ministries
- thorough project preparation and feasibility studies, including proper evaluation of all procurement modalities to identify optimal solution from a value for money perspective
- open, transparent and fair tender processes
- international dispute resolution procedures and an appropriate enforcement regime
- the political will to support long-term investments.

The feedback from the participants at the Bogotá Workshop was that the PPP environment in Latin America has presented each country with their own sets of challenges, including, amongst others, delays in establishing a clear and instrumental PPP legal framework, problems in the identification and appropriate allocation of risks between the public and private parties, lack of experience facing financial risks related to liquidity and the exchange rate components, and problems defining strategies to mitigate socio-environmental risks.

[2] *Available at http://infracompass.gihub.org*

However, the participants at the Bogotá Workshop also agreed that various countries had taken significant steps to address some of these challenges, including establishing centralised PPP Units, enacting PPP legislation and introducing increasingly attractive legal, financial and regulatory reforms.

Some examples of the measures being taken by the countries represented at the workshop included:

- **Colombia** – Colombia enacted the Public Private Partnerships Act in 2012 (Law 1508 of 2012), which established a new legal framework for the development of projects with private participation, introducing aspects such as compensation according to the effective services provided by the infrastructure and solid risk allocation guidelines. Additionally, the creation of the National Infrastructure Agency (ANI) in 2011 as a technical entity in charge of the structuring and managing of the PPP projects has contributed to materialise the Government's infrastructure objectives.
- **Argentina** – Argentina launched its National Infrastructure and Transportation Plan 2016-2025 that set specific infrastructure objectives, such as the increase of the average public investment in infrastructure (to 8.4% of the GDP) during the next 10 years as well as increasing the private investment. The latter will be done through a solid legal framework for PPPs enacted in 2016.

In addition to recognising effective political, regulatory and market conditions, the Bogotá Workshop participants also recognised that the success of taking an individual project to market is dependent, to a large degree, on the allocation of risks in the concession agreement between the public and private partners involved with the transaction.

While the temptation within the public sector is often to transfer as much risk as possible to the private sector, the overriding principle should be that risk sits with the party best able to manage it. In other words, only those risks that the private sector can either control or insure against can readily be assumed by the private sector. If risks are not appropriately allocated, the result is likely to be higher upfront costs, longer procurement processes, fewer bidders, less competition, less competitive tariff bids, lack of equity, reduced financing options (i.e "bankability"), poor value for money and a higher chance of market failures (i.e. insolvencies and/or renegotiations).

Helping governments with developing PPP markets to better understand effective risk allocation in PPP projects is a key focus for GI Hub. In 2016, GI Hub, in collaboration with Norton Rose Fulbright, developed an interactive online tool (freely accessible at www.ppp-risk.gihub.org in English and Spanish), that provides information on risk allocations between the public and private sectors in PPP transactions for 12 sample projects in the transport, energy and water and sanitation sectors, including related information on measures to mitigate risks and typical government support arrangements.

KEY ISSUES IN PPPs

The Bogotá Workshop also included a session covering the key risks in PPPs in the region. Of these, the following risks were identified as being of particular significance, based on the participants' practical experience in the region.

Land acquisition and resettlement

The participants identified issues surrounding the acquisition of land in PPP transactions, particularly in relation to (i) the exercise of compulsory acquisition powers for procuring authorities and (ii) the attainment of titles of property and construction licences and permits.

A potential solution put forward – based on experience in more developed PPP markets – involved the allocation of risks in a shared way between the public and private sectors, with the public sector being responsible for the risk during the period before the handover of the land, and the private sector being responsible for the risk after the acquisition of the land. In this sense, it was discussed that one feasible way to do so was through the performance of a detailed terrain, environmental and social assessment by the procuring authorities, who should disclose the corresponding information to the private partner as part of the bidding process.

To the maximum extent possible, the procuring authorities must ensure that they fully understand the risks involved in securing the site and those that will affect the construction and operation of the road, including indigenous land rights that may impede the use of land.

Attracting foreign investment

The participants identified the difficulties in attracting foreign investment for PPP projects. The key factors for promoting PPP projects to foreign investors that were discussed included:

- the need for a clear and viable pipeline of projects, given that the investment cost associated with bidding for projects is considerable and will not be recoverable by the investors if unsuccessful
- political risk protection to address risks such as expropriation of the asset in the future, change in law, currency convertibility and repatriation of funds – to be addressed either through implementing policy reform or, potentially, through the availability of political risk cover from international financial institutions
- appropriate risk allocation in the concession agreement which reflects international norms, subject to any adjustment required to reflect the changes in risks associated with operating in emerging versus developed markets and other jurisdiction-specific considerations.

There was also discussion of alternate methods of financing and the more innovative sources of funding which are available in mature markets, such as the use of rated bonds offered in debt capital markets to attract institutional investors.

Interest and Exchange Rates

The participants also showed special interest regarding the identification and management of financial risks, particularly the interest and exchange rate fluctuation risk throughout the execution of a certain project and the ways in which this could affect its structuration.

In respect to toll road projects, it was discussed that the devaluation of the local currency beyond a certain threshold may constitute an event that triggers a non-default termination or a subsidised arrangement with the procuring authority. Issues related to the convertibility of the currency and the restrictions imposed on the repatriation of funds are also of interest for bank financing in cases of termination in emerging markets.

In this sense, as a way to mitigate such risk, the private party may:

- seek a coverage arrangement under the financial documents; or
- transfer such risk to the users adjusting the toll charges.

SPECIFIC PROJECT ISSUES

Demand risk in toll road projects

The participants discussed the issue of demand risk in the context of toll road projects in view of the difficulties of accurately predicting availability in traffic volume. They also mentioned the challenges in the tendency of allocating this risk to the private sector by default, especially if the revenues from tolls are insufficient to cover the costs of financing and operating a project, as well as to cover eventual contingencies.

Possible solutions to mitigating demand risks were discussed and included:

- making a full assessment of the risk of the demand before the launch of the procurement process to ensure that the concession contract adequately covers and assigns the risk of the specific factors that may affect the demand
- providing minimum revenue guarantees (procuring authorities)
- offering the ability to generate third-party revenue by, for example, building shopping centres along the road
- developing a comprehensive market strategy to manage the implementation of the project.

Disruptive technology

The participants identified the important and disruptive role that technology plays in the PPP environment; particularly in the context of photovoltaic solar projects where newer, more cost-effective technology means that the tariff under most recent solar power purchase agreements is more competitive than the earlier power purchase agreements, affecting dispatch priorities and ultimately investor returns on the earlier projects. The participants agreed that PPP projects, which are structured as long-term investments, must be prepared for change brought about by advances in technology.

Technology is increasingly offering innovative, efficient and market-changing solutions across critical areas such as transportation, and energy and water supply. It is also challenging even the most basic of services: cities around the world struggle to manage the disruption created by Uber in the provision of decades-old taxi services, which has implications for governments considering upgrading or expanding their mass public transit infrastructure.

The advent of digital technology is transforming the way that people live and work. Embedded sensors combined with cloud computing, data analytics and mobile technology offer the next generation of networked transport infrastructure.

Autonomous vehicles, drones and robotics, electric vehicles and charging infrastructure, intelligent parking systems, asset mapping and monitoring, renewable energy, micro-grids and energy storage, smart street lighting, digitisation of payments and ticketing, demand-driven pricing mechanisms, and ride sharing will all impact the policy and planning decisions of governments looking to future-proof infrastructure.