GLOBAL TRENDS IN MAJOR PROJECT FINANCE

MAJOR PROJECTS ASSOCIATION

Highlights from the Major Projects Association event held on 18th May 2017

At a time where the need for infrastructure investment is widely acknowledged, there are no shortages of both investment opportunities and challenges. At this Major Projects Association event experts highlighted the current trends in global financing and debated the issues affecting the UK market.

From an equity perspective, markets around the world that dominate investment flows from pension schemes, insurance companies and other funds are Canada and Germany, followed by Nordic countries such as Denmark, Sweden and Finland. In Asia, Japan has recently emerged as a significant infrastructure investor seeking predictable and stable assets.

> *'Every single one of the institutions that I talk to is either looking to increase its allocation to infrastructure or keep it proportionately the same. Nobody but nobody is looking to reduce their allocation to infrastructure, so there is a monumental amount of capital chasing infrastructure assets.'*
> James Wardlaw, Partner, Campbell Lutyens & Co Ltd

For pension funds investing in infrastructure, defined benefit (DB) schemes are the main investors, rather than defined contribution (DC) schemes, which have concerns over illiquidity of unlisted infrastructure. The ongoing challenge for the global investment community is to develop a product or mechanism that can attract the growing funds of DC schemes.

An interesting development for the UK market is the requirement for local government pension schemes (LGPSs) to combine into eight pools from April 2018. These funds could be an interesting option for regional infrastructure investment in the future, particularly as cities seek further devolution, electing city Mayors and gaining new powers.

From a debt perspective, Adrian Jones of Allianz Global Investors outlined the debt sources that can be accessed by projects, with the most attractive being private placement of debt. The fixed term and fixed cost of debt mean that it is simply about the 'time transformation of money' – lending to those who have a known source of repayment. Debt investors do not want to finance construction risk, but it will fund those taking the risk. The challenge here for the UK is that contractors do not have much appetite for private financing of projects, preferring traditional target-cost arrangements.

> *'In today's market if your project is struggling to attract finance then it must have a flaw, because things are attracting finance now which should not. I think we are in a bubble and there will be an adjustment and people should be ready for that.'*
> Adrian Jones, Director, Infrastructure Debt, Allianz Global Investors

Emerging markets of course have other issues, and John Seed of Mott MacDonald explained how the multilateral development banks (MDBs) are changing their approach in order to help developing countries finance infrastructure. Rather than simply lending to projects, MDBs are moving towards advising on PPPs and working on capacity-building with the public sector. This means getting involved at earlier stages in the project cycle to ensure that business cases are done properly. In some projects, business cases are being retrofitted on to projects to demonstrate value for money and make future schemes more attractive.

Another mechanism for doing this is the Source project preparation tool, first developed by the Asian Development Bank and refined and managed by the Sustainable Infrastructure Foundation. The 30 templates in the online tool are designed to help governments prepare their projects, and once a certain level of information is developed the project can be published to the private sector. Some MDBs have now mandated the use of Source and more are expected to follow the trend.

Wherever in the world projects are located, investors need certainty and stability in the legal system, and in the regulatory and political environments. It is critical that government buys in to the fact that laws and regulations are going to be stringently implemented by the executive, and there will be efficient processes and a high degree of integrity and clampdown on corruption. Without those fundamentals investors will look elsewhere.

> *'There is always another market opportunity for international investors. Nobody needs to do your project in your jurisdiction. They can put their money somewhere else. If you create the right environment debt and equity investors will come. If not, you will just see the dust from their wheels.'*
> Andrew Ivison, Partner, Banking & International Finance, CMS Cameron McKenna Nabarro Olswang LLP

WILL THE UK REMAIN AN ATTRACTIVE INVESTMENT DESTINATION?

The fundamentals of the UK market, from its 'gold standard' legal and regulatory systems to its inherently mature investment environment, will continue to make it an attractive market for investment. But the recent political upheaval and the lack of forthcoming opportunities mean that the UK today is less attractive than it was just a couple of years ago.

> *'Today people want to invest in safe, secure assets in volume and at the moment there is a limited amount of that produced by the UK. There are lots of things that the UK can do to make itself more attractive, but ultimately the whole idea of investing in this super safe place has taken a bit of a knock.'*
> Alistair Ray, Chief Investment Officer, Dalmore Capital

One of the challenges from an investor perspective is that the risks are more difficult to price than they used to be. With currency volatility having a major impact on margins, it is more important than ever that the UK creates an attractive environment in the aspects of the market that it can control and at the same time creates bankable opportunities.

Thames Tideway was discussed as a good example of an attractive infrastructure investment proposition, with much to be learned from its structure. Although investors were asked to take an element of construction risk, this was shared with the contractors and consumers to ensure that overruns or savings are equitably shared. Despite being a new-build scheme the yield profile of the Thames Tideway Tunnel means that investors treated it as a brownfield project, greatly reducing the cost of capital. This is an important development when it comes to convincing the general public of the value of private investment at a time where privatisation of infrastructure has become a hot political issue.

Yet investors from all over the world point to the UK's regulated industries as being some of the world's best opportunities for investment, and this private capital in the water and power sectors has enabled billions to be invested in the upgrading of these critical assets. Expanding this approach to cover sectors such as road and railways could secure the investment that these assets need, thereby using private finance to stimulate the economy. But both the general public and the Government need to be convinced of the value of this approach, and providing more objective analysis on the efficiency of private organisations in asset management is critical.

> *'We have something very valuable in the UK and this could be at risk. My challenge to everyone is that in order to justify the use of private capital we need to earn our social licence. It is an important time for the private sector to demonstrate the value that it is able to bring. This is an opportunity but if we are not careful it could turn into a threat.'*
> Andrew Rose, Chief Executive, Global Infrastructure Investor Association

POINTS FOR FURTHER DISCUSSION

- As we leave the EU should a UK equivalent of the European Investment Bank be initiated to support development?
- How may the regulated asset model be expanded into roads and rail?
- What more can the private sector do to demonstrate its effectiveness in asset delivery and management?

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With grateful thanks to Arup for hosting this event.

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