Funding of Public Private Partnership Projects in CESEE Markets

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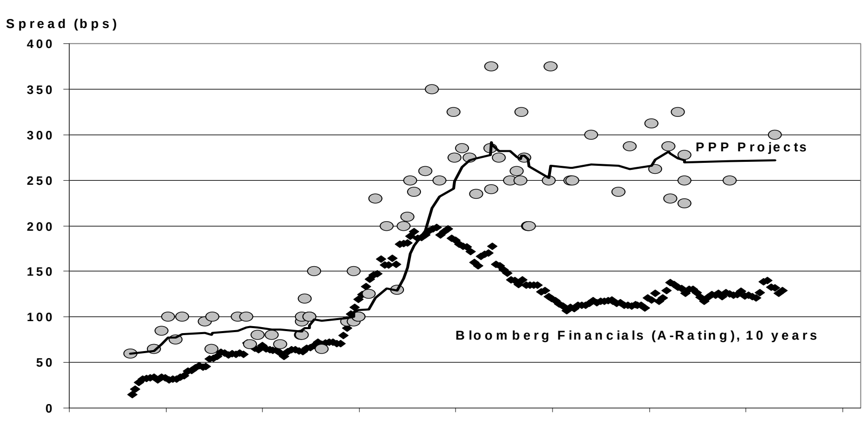
1. Financial Crisis and Funding of PPP Projects

As Public Private Partnership Projects (PPPs) require long term funding in order to match cash flow and depreciation profiles of the respective transactions, financing of large projects became very challenging when the financial crisis hit the market. Many banks faced difficulties in obtaining long term funding which banks need in order to match long-term loans for PPP projects.

Consequently a number of banks withdrew from the PPP lending altogether or focused on their home markets and reduced lending activities. Syndication markets collapsed and large PPP projects had to be funded by huge clubs of banks as opposed to a few arrangers who syndicated the transactions subsequently.

Chart 1: Spreads and Funding Costs for PPP Projects in Europe



Source: Bloomberg, Project Finance International, Infra-News.

Since the beginning of the crisis, the number of banks active in this market decreased, underwriting capacity for individual transactions dropped and loan maturities came down.

As banks were not able to obtain funding at swap rates, funding costs increased significantly and margins were adjusted upwards in line with funding costs. Chart 1 compares average funding costs for A-rated Financials based on a 10-year-maturity with margins of PPP projects closed since the start of the financial crisis in Europe.

2. PPP Projects in CESEE Markets

Public Indebtedness went up in most European countries, many states reduced infrastructure investments and some planned PPP projects were put on hold.
While a number of transactions in the CESEE markets reached financial close during the financial crisis, some sizable projects were cancelled due to funding shortfall, public sector concerns or environmental challenges.

Multinational banks such as EIB and EBRD have played an important role in the financing of PPP projects in Eastern Europe during the financial crisis, as they are able to replace shortfall in commercial debt in sizable projects and provide credibility to individual transactions. Also their capability to raise local currency funding in the markets and utilize these funds for infrastructure debt makes them a valuable project partner.

With the benefit of hindsight, a few of the transactions in tender were probably to big in order to attract sufficient funding during the financial crisis and should rather be split into digestible project volumes.

Chart 2: PPP Projects in CESEE Markets 2007–2010

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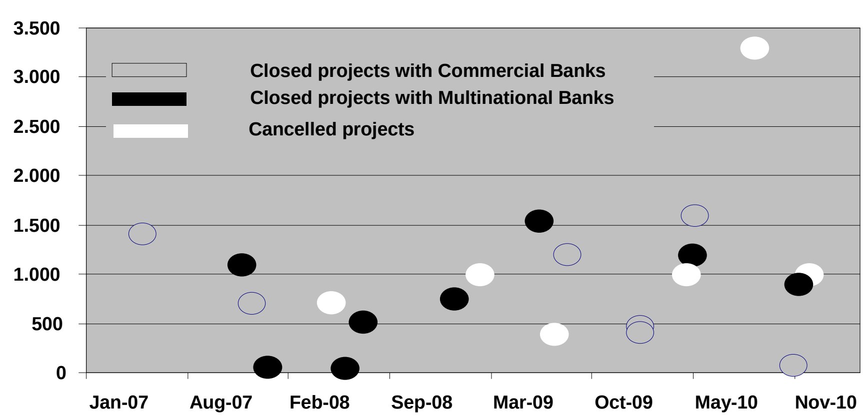


Source: Project Finance International, Infra-News.

3. Perspectives

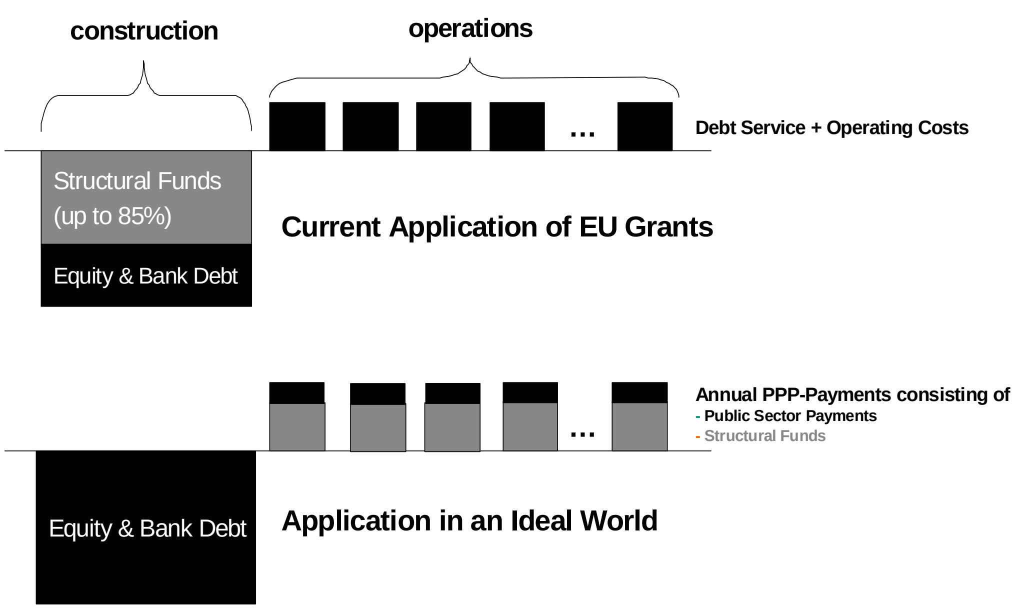
Increasing public indebtedness might on the one hand reduce future investment in public infrastructure. On the other hand, higher public debt might stimulate off-balance sheet models such as PPPs to procure public infrastructure projects.

However, as long as cash flow for individual projects derives from public sector "availability payments" as opposed to user payments (i.e. in toll road projects), long term payment capability of the public sector and therefore affordability of those projects is a key requirement.

While some countries such as Russia, Poland and the Czech Republic show healthy PPP pipelines, poor delivery of previous projects and potential mismatch of local currency project cash flow and Euro long term funding reduces appetite for some sponsors and banks.

Some relief may come from EU and EIB initiatives. Structural and Cohesion Funds from the EU can be used in PPP projects to cover part of the capital costs during the construction phase. However, the idea of a PPP project is to transfer risks from the public to the private sector. Therefore, the funding scheme can be improved by injecting the grants after completion as part of a performance-related "availability" payment during the operation phase.

Chart 3: Application of EU-Grants for PPP Projects



Source: Author's compilation.

Also the Euro 2000 Bond Initiative might provide some support for long-term funding. This initiative is set up by EU and EIB and considers the development of a bond instrument attracting long term funding from institutional investors who require long duration, such as insurance companies and pension funds. Such a bond could be adequate to complement current funding instruments for PPP projects.

References

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