Institutional
Banking & Markets

The Future of PPPs
"The Glass is More than Half Full"

CEDA Conference

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Major Areas of Focus

- PPPs in the Context of the Global Financial Crisis
- The Rationale for PPPs Remains Virtually Unchanged
- Funding Costs – Up Across the Board
- Differentiating Economic and Social Infrastructure
- Liquidity the Real Issue
- Small to Medium Sized PPPs – Good to Go!
- A Possible Solution for the Large PPP Deals

Rationale for PPPs Remains Unchanged

- Confidence in a timely and cost-effective delivery
- Provides accountability for performance
- Access best technical and management skills
- Improved outcomes with competitive forces
- Improved focus on service
- PPPs offer an expanded way to deliver the shortfall of Aust infrastructure
  - Need for infrastructure is greater than the government's ability to deliver
- ✘ Access to Debt funding the key problem
  - Equity an issue <u>only</u> for economic infrastructure

Performance of PPPs

Report: The Allen Consulting Group & University of Melbourne (2007): KEY FINDINGS:

- “PPP’s demonstrate clearly superior cost efficiency over Traditional procurement, which can range from 30.8 percent when measured from project inception to 11.4 percent when measured from contractual commitment to the final outcome.”
- “PPP’s were found to be completed 3.4 percent ahead of time on average, while Traditional projects were completed 23.5 percent behind time.”
- “The PPP advantage increases (in absolute terms) with the size and complexity of projects.”
- “PPP projects were far more transparent than Traditional projects.”

Cost Performance of PPPs

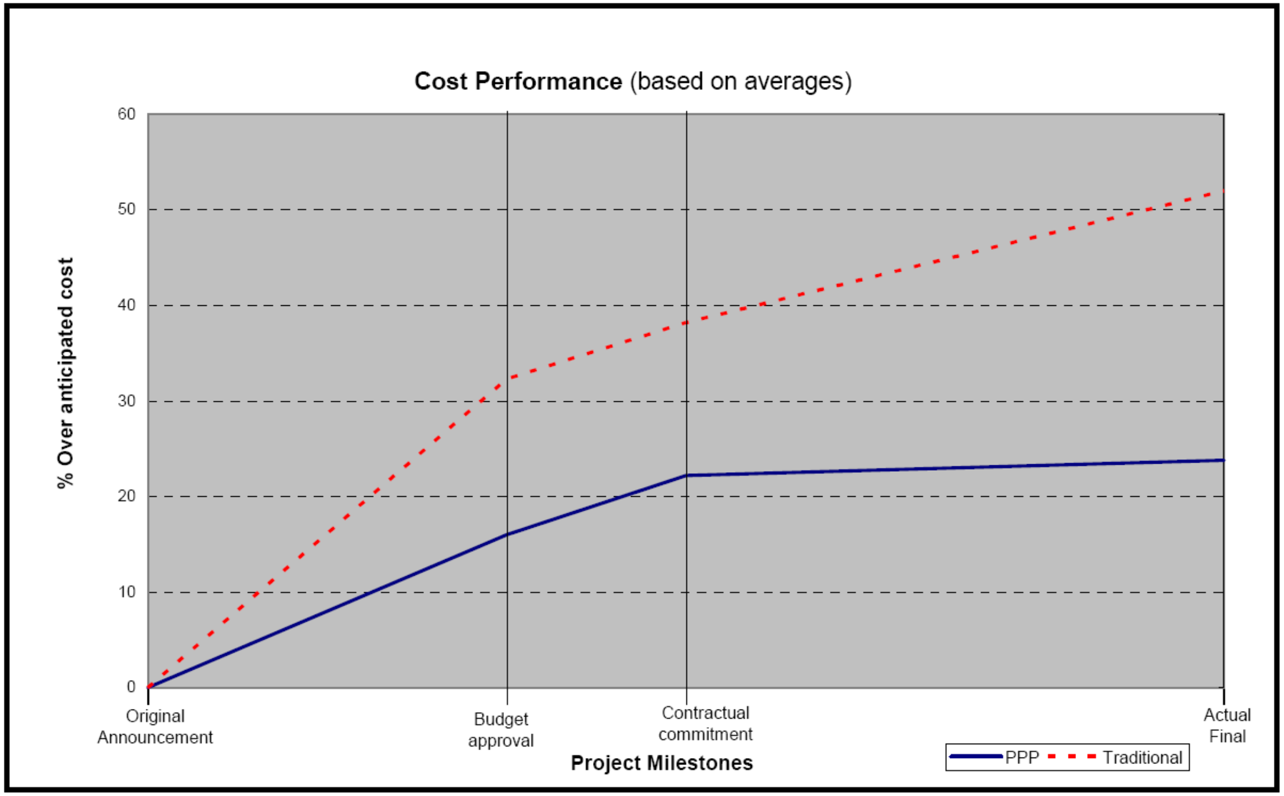


Figure 7: Cost performance over project initiation and delivery (source: Duffield 2008)

Time Performance of PPPs

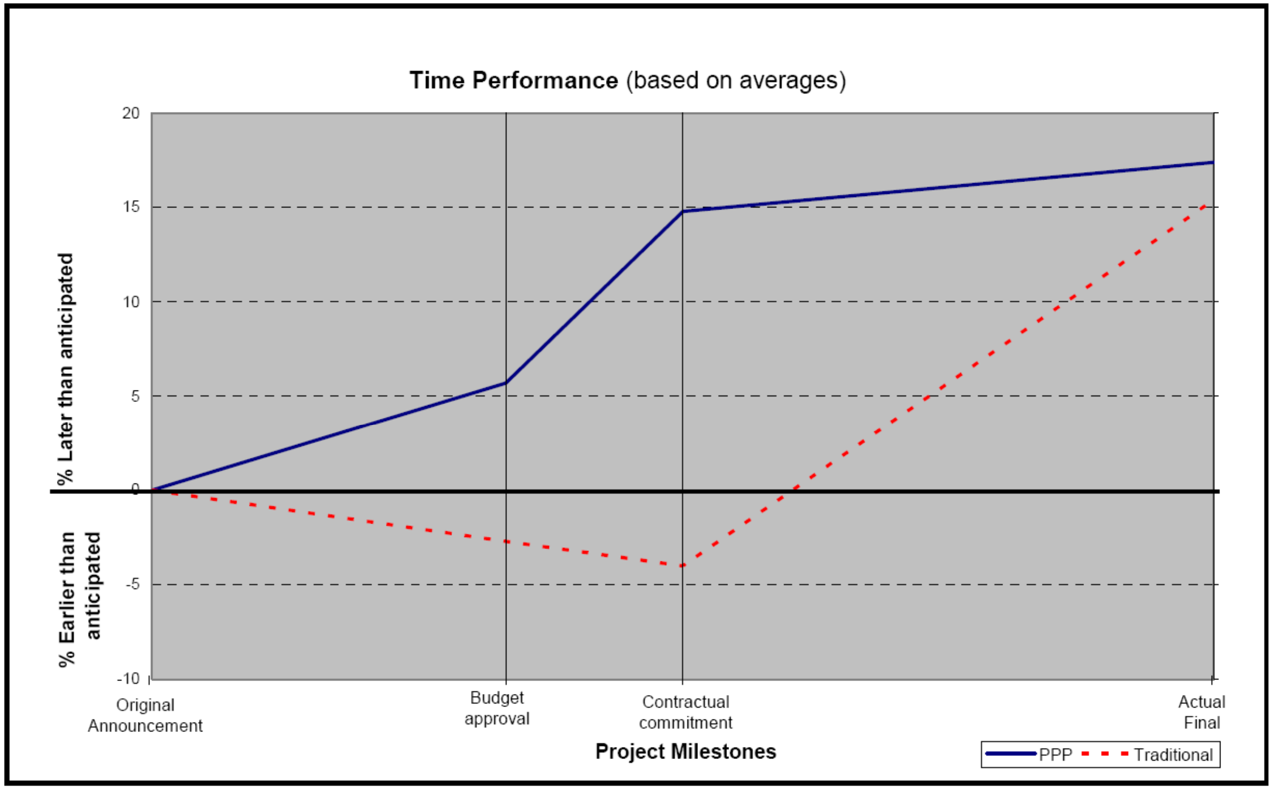
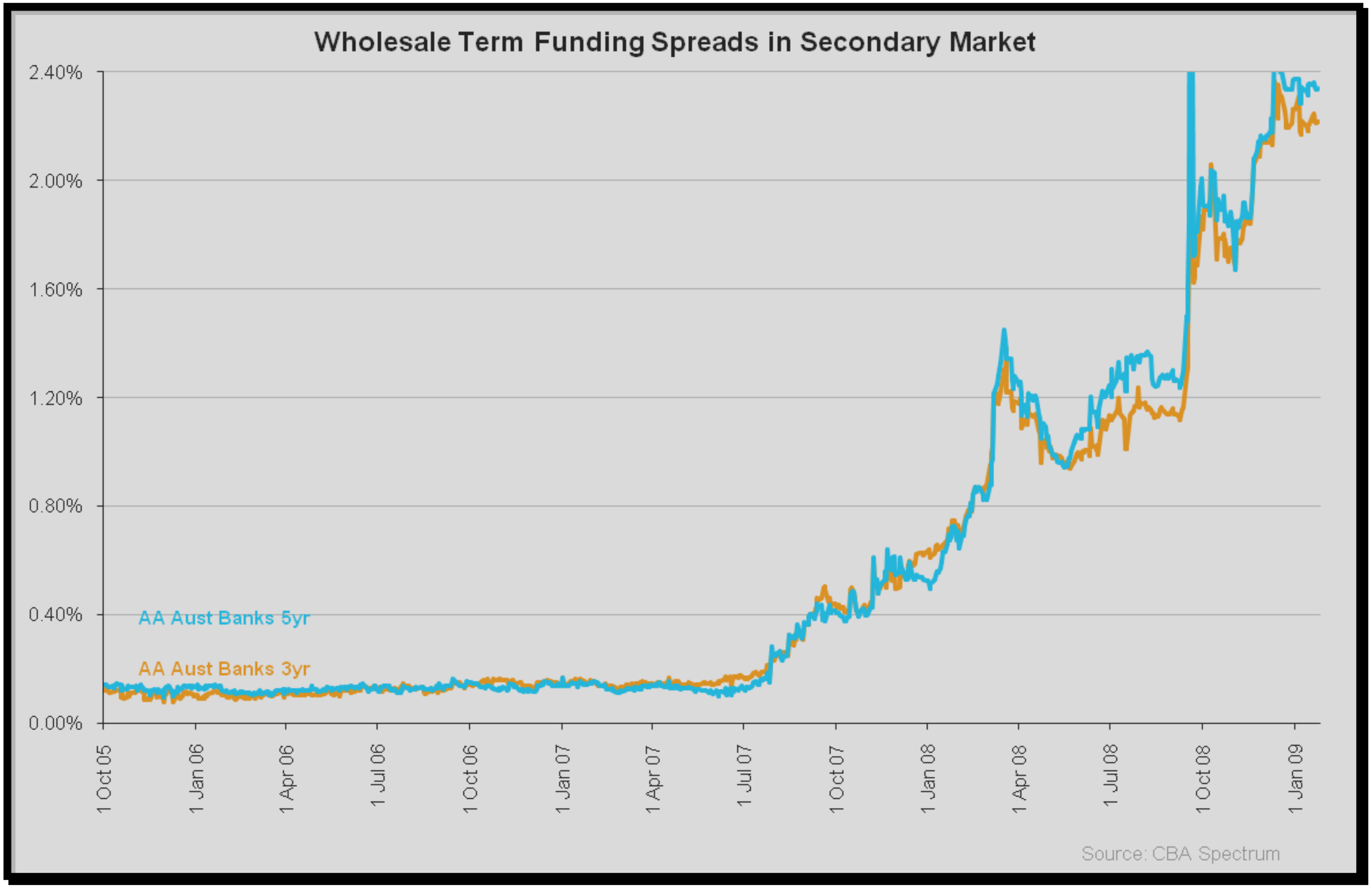
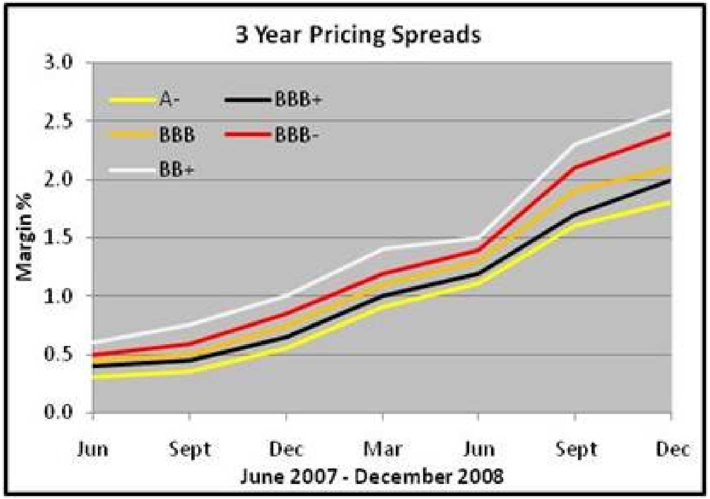


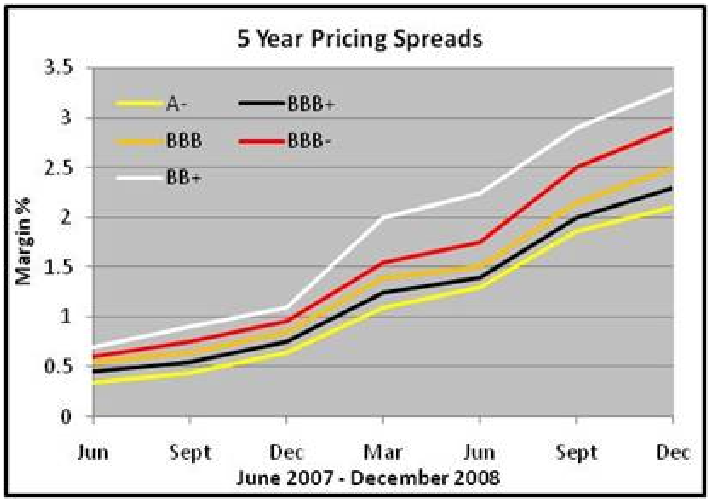
Figure 8: Time performance over project initiation and delivery (source: Duffield 2008)

Wholesale Term Funding Spreads in Secondary Market



Loan Markets: Pricing



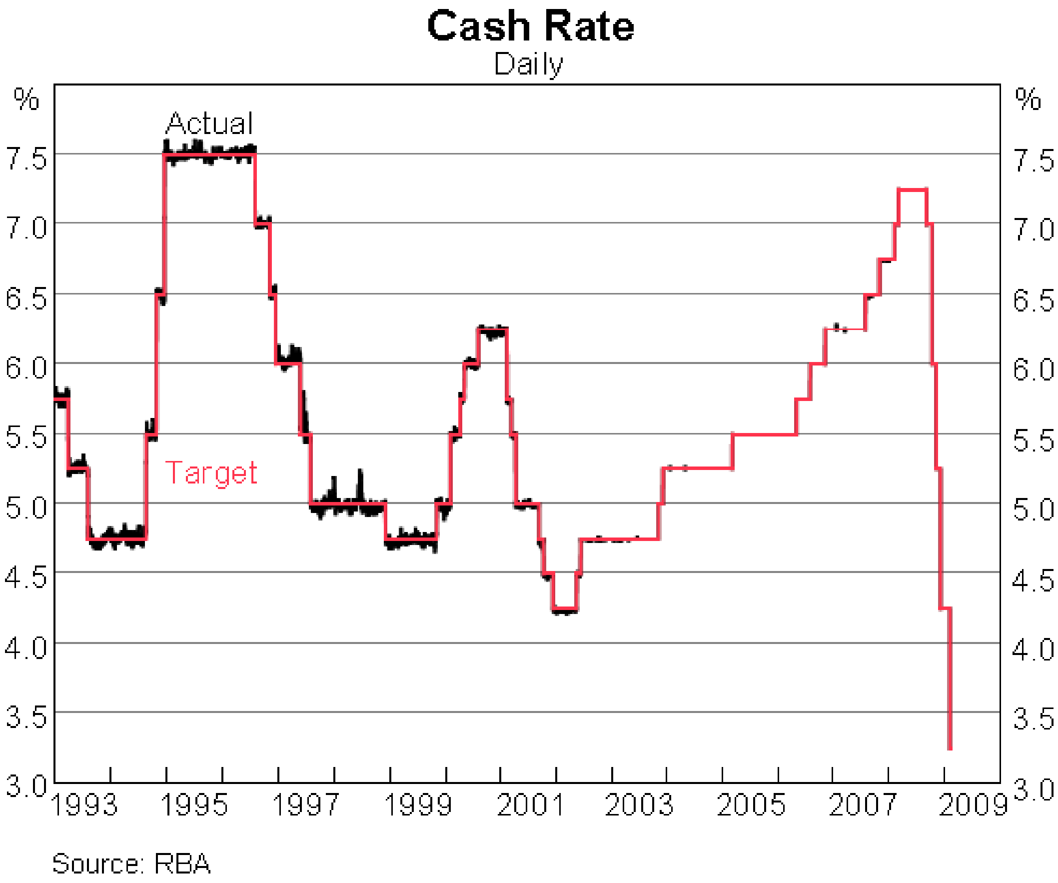


Prices have trebled since December 2007.

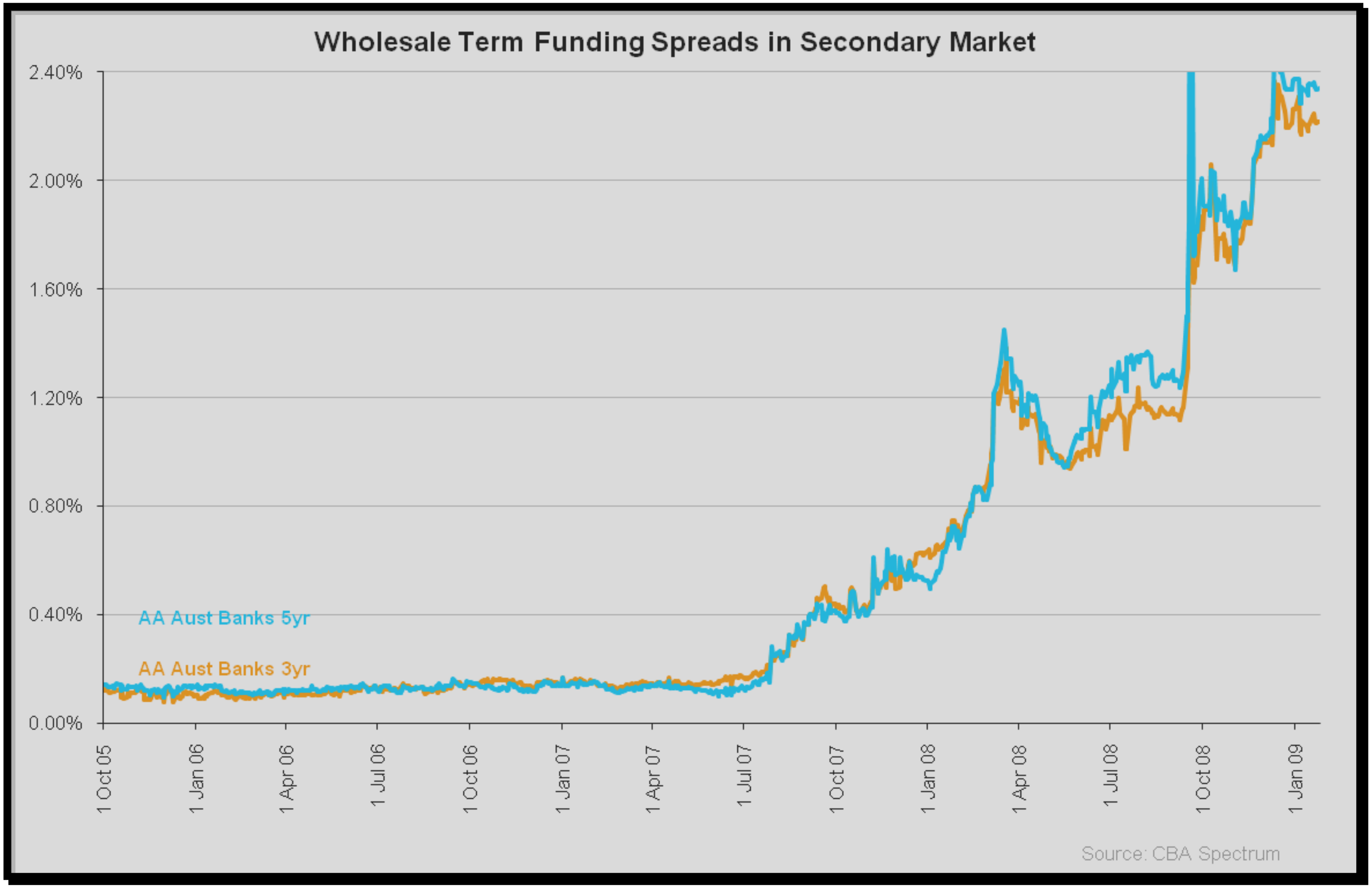
In addition:

- Establishment fee levels increased
- Incorporation of prepayment and cancellation fees within facility agreements
- MAC clauses
- Reduced underwritten duration
    - Market disruption

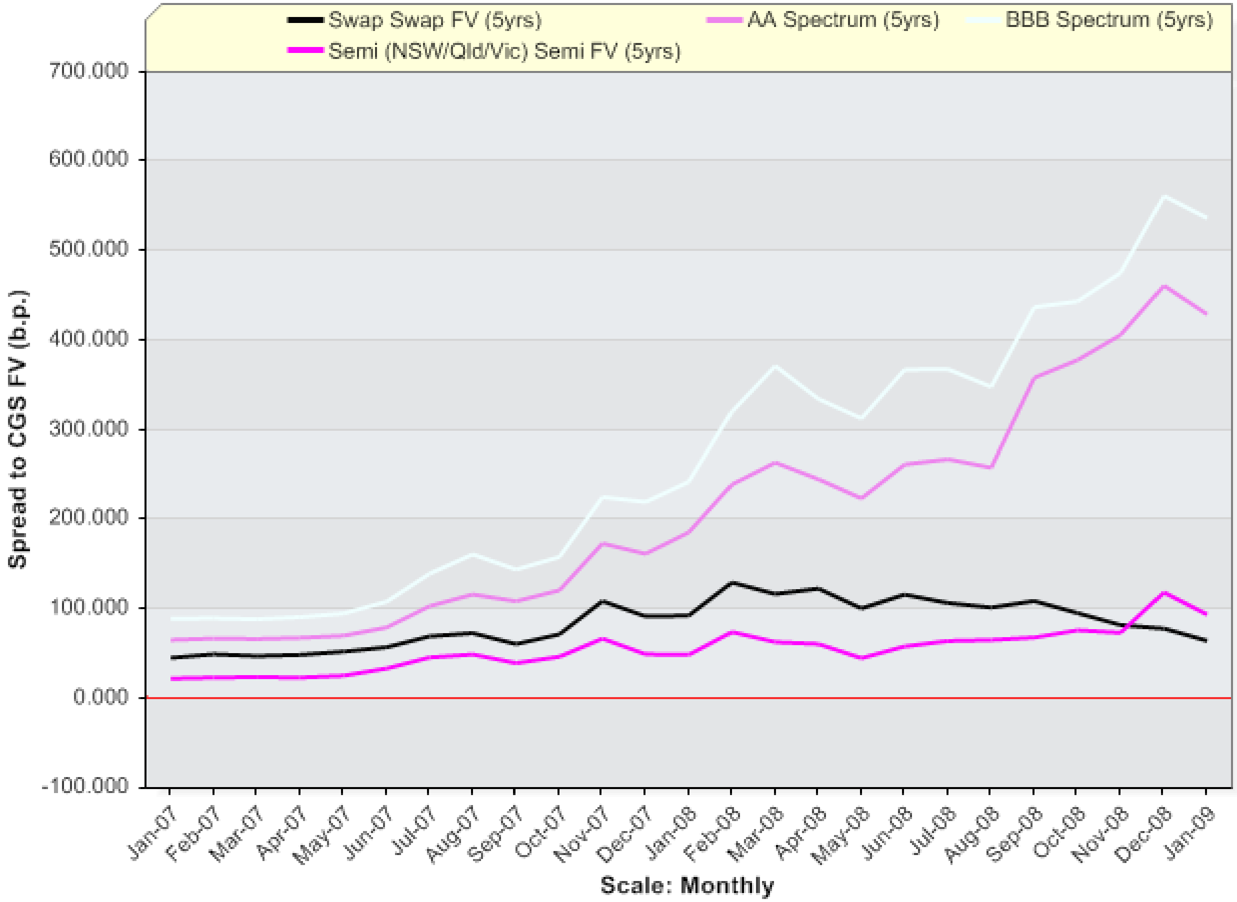
RBA Cash Rate



Wholesale Term Funding Spreads in Secondary Market



Financial Markets: Corporate vs Government



- **Impact of Commonwealth guarantee on swap spreads**

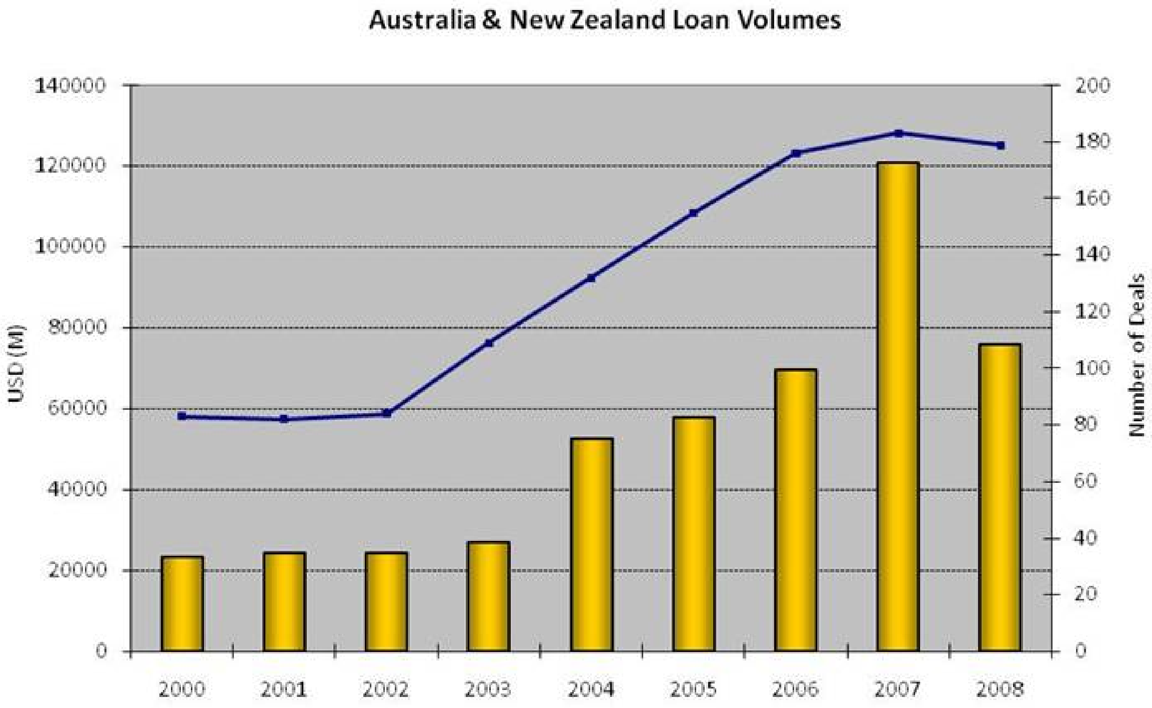
Economic Infrastructure – Market Reaction

"There is a revulsion against greed. The social mood has changed."

"This is more than a cyclical change; it's a structural change in terms of their ability to run their model."

Hugh Giddy, Managing Director, Cannae Capital Partners
SMH Feb 28, 2009

Loan Markets



- Risk aversion and reduced appetite
- Club loans versus larger syndicated
- Smaller holds by banks
- Lack of liquidity – impact on underwriting
- Expanded mandated lead arranger groups to spread syndication risk
- Establishment fee levels have increased

Source: LoanConnector

Social PPP Market: Equity

1) Equity returns

- PPPs seen as a “safe bet” in volatile times
- Upward pressure on returns tempered by reductions in risk free rate
- Portfolio realignment
  - Relative returns have become more attractive in sectors other than infrastructure
  - Fall in listed equities values means certain institutional investors now long infrastructure
- Refinance Risk

2) Decreased competition

- Decline of investment banks including infrastructure houses
- Aggregation issues for lenders

3) Balance of power changes (at the project level)

- Less competitive tension in debt markets
- Requirement for equity to have more skin in the game
- Increased control of transfers

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Social PPP Market: Debt

Current state of loan markets are directly impacting the PPP market.
The market is requiring:

1) Increased margins and gearing

- Reduction in gearing i.e. sub 90% / Pricing at 200bp+
- Increase to Debt Service Cover Ratio (DSCR) i.e. 1.20x+
- Shorter tenors i.e. 3yr to 5yrs (7 at a pinch)

2) Tighter debt sizing and covenant packages

- Forward Debt Service Cover Ratio / Loan Life Cover Ratio
- Debt tail from 6mths to 12mths

3) Underwriting appetite

- Limited players + small holds = reduced market capacity
- Market uncertainty = limited underwriting appetite (vs. hold)
- Market volatility = reduced underwrite period and MAC / price flex

4) Increased scrutiny re: consortium players

- Aggregation issues
- Balance Sheet capability

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Tweaking the PPP Procurement Model

- Each project has its own characteristics – size is important!
- Is ‘three to the death’ really necessary
- Change the rules, but transparency up-front
  - Mid-stream changes create uncertainty and potential for challenges
- Governments needs to ensure parties do not stay in the tender process if they are unlikely to win

Potential Solution for Large PPPs

Government top up of Bank Debt ‘Pari Passu’

- Political will needed - untested model
  - Intercreditor mindset shift – trust banks to act in all lenders’ best interest
- Still drives debt funding competition between consortia
  - Each consortia must have a partial debt underwrite
  - Weight assessment for higher % of private commitments
- Could require non-exclusivity for banks
- Also, possibly all banks released post-preferred
- Government funding via an SPV above projects level (potential Fed g’tee)
  - SPV could raise debt in bond market (AAA)
- Government debt term at least matches bank debt
  - Government refi must be underwritten
- Government tranche price escalation post-completion
  - Forces equity to seek refinance of Government tranche
  - Reinforces Government as a bridge reflecting liquidity crisis
  - NEEDS PRIOR EDUCATION AND SUPPORT OF LENDERS!

Summary: the Glass is More than Half Full

- PPPs can still be used to meet growing demand for infrastructure
- PPP model saves 30% or more in project costs - on time (avge)
- The private sector and government must work together to overcome market conditions
- A range of model tweaks exist to ensure competition remains
  - Project specific tailoring
- Government involvement in debt solution for large PPP projects
- Private sector is still willing and able to invest in social infrastructure

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