

# Connecting Africa: Transport Infrastructure Cape Town 20 – 22 October 2014

## **ATTRACTING PRIVATE SECTOR INVOLVEMENT IN MEGA INFRASTRUCTURE PROJECT**

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# Introduction

- The African Perspective
  - The famous PIDA \$93 bn
  - “Infrastructure that is sufficient and works properly is crucial for Africa’s economic integration. The private sector will need to play an increasingly important role. Governments will do well to create conditions where private-sector engagement is encouraged, probably through public-private partnerships (PPPs).”

WEF Africa Competitiveness Report 2013





# Introduction

- The African Perspective
  - African countries invested 15 – 25% of GDP in transport infrastructure over the period 2005–12, on average, while India and China invested about 32% and 42% of GDP, respectively, in the same period
    - UNCTAD 2011
  - Global Market for rolling Stock > \$61 bn p.a.
    - Africa/Middle East \$4.8 bn
      - Berger report 2014



# Introduction

- The African Perspective
  - “New transportation infrastructure is vital to harness these two potential sources of growth. At the top of the list is the classic form of economic infrastructure: railways. The continent is a huge landmass, well suited to railroads. Yet during the past half-century Africa’s rail network, never very extensive, has shrunk.



# Introduction

- The African Perspective
  - “Even the United States, a huge landmass with relatively low population density, has one kilometre of track for every 43 square kilometres of land. By contrast, Nigeria, home to one-fifth of the population of sub-Saharan Africa and one of its most densely populated countries, has but one kilometre of rail for every 262 square kilometres.”
    - Professor Paul Collier 2011
  - Between 2005 and 2011 usable rail tracks down from 58,000 km to 50,000 km!
    - AfDB 2012



# Introduction

- Rail is a strategic sector
- Growing demand for freight and passenger rail  
– but who pays?
- Government constraints
- Can the private sector carry the burdens?
- Advantages, disadvantages and constraints for the private sector



# Assessing the inherent constraints of governments to fund mega rail infrastructure projects

- Cash accounting and rarely enough cash
- Inefficiencies in the Public Sector
  - Build
  - Operate



# Reviewing market readiness for private sector participation in rail projects

- Who participates?
  - Manufacturers
  - Operators
  - Banks and other financial institutions
  - Venture capitalists





# Reviewing market readiness for private sector participation in rail projects

- The developing PPP environment
- But
  - Economics do not always work
  - Increased “Basel 3” capital requirements on banks
  - Crack-cocaine? When will the securitisation market re-awaken?
- Need more imaginative solutions than BOT



# Private sector Participation in Rail Projects

- Definitions:
  - Construction contracts and credit
  - Debt financing (security?)
  - Farebox or other asset securitisations
  - Sales Aid finance
  - ECA financing
  - Selective finance and operating leasing

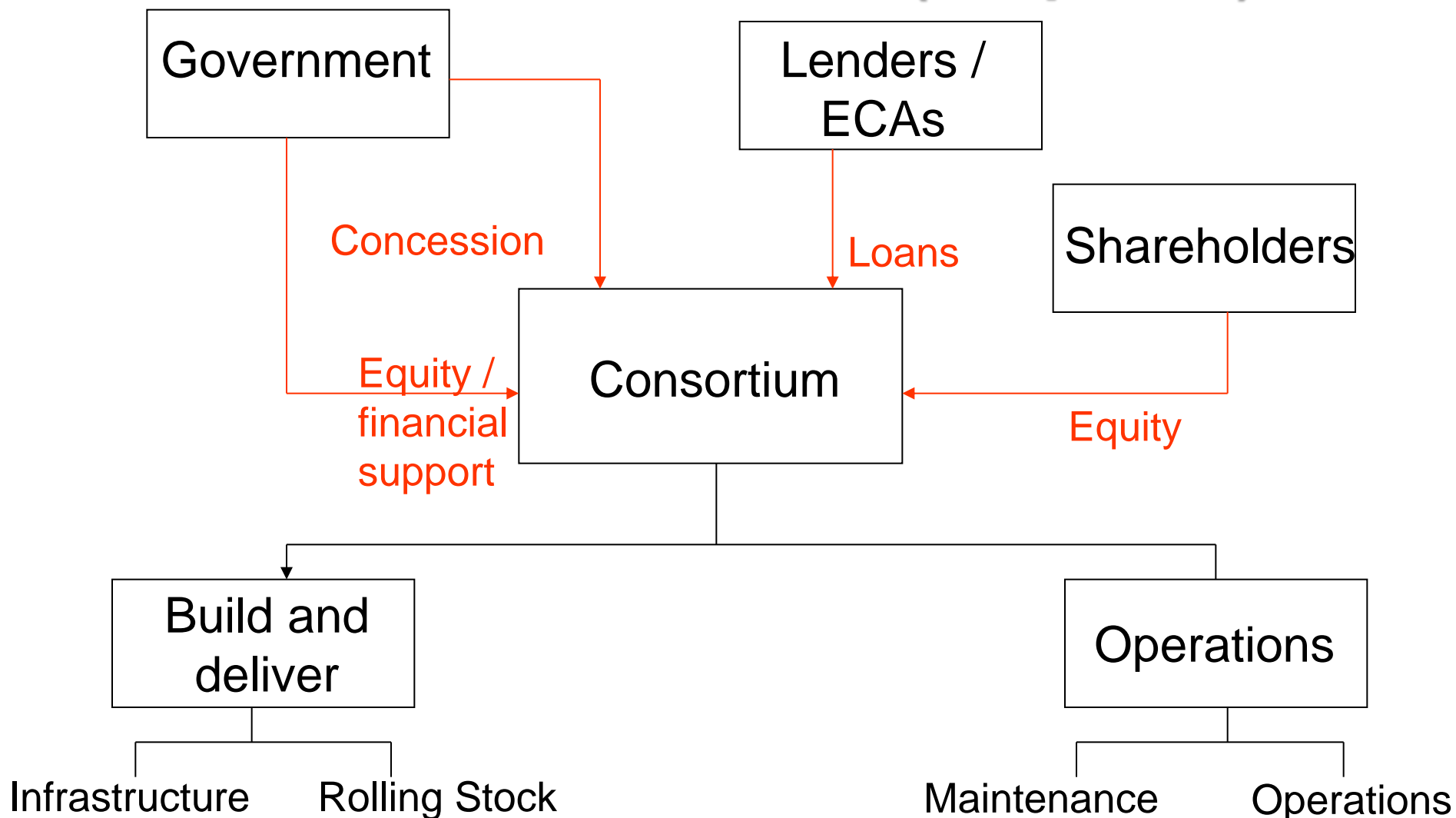


# Private sector Participation in Rail Projects

- Definitions:
  - PPP “delivery structures”
    - BOT – Build Operate Transfer
    - BOO – Build Operate Own
    - BOOT – Build Own Operate Transfer



# Classic BOT Structure (simplified)





# Private sector Participation in Rail Projects

- Advantages
  - Takes the project “off balance sheet”
  - Pay as you go freeing resources for other government obligations
  - Mechanism to build efficiently
  - Transparency and discipline
  - Honest accounting
  - Convenient for government
  - Allocates project and operating risk between public and private sector



# Private sector Participation in Rail Projects

- Disadvantages
  - How to deal with the separation of infrastructure and operations
  - Reduces government flexibility - and control
  - *Service public*
  - Difficult to evaluate optimum structures
  - Building in profit margins
  - Heavy contracts



# Private sector Participation in Rail Projects

- Constraints
  - Differentiating rail projects
  - Need to factor in general environment, social and economic benefits
  - Long term capital (thin market)
  - Political risk and interference
  - Heavy transaction risk



# Private sector Participation in Rail Projects

- Constraints – assessing asset risk
  - Build delivery
  - Specifications mismatch
  - Asset valuation and obsolescence
  - Financing costs
  - Operating risks
  - Third party liabilities





# Private sector Participation in Rail Projects

- Constraints – allocating risk
  - Who should carry the risks within the consortium and the problem of cross contamination
  - Transferring risk out
    - Subcontractors
    - Buy backs and guarantees
    - Leases



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Building risk – higher than operating risk
- Sufficient legal and regulatory infrastructure
- Tackling bribery and corruption
- “Luxembourg” solutions



# Cape Town October/November 2001

participants from 58 States and 11 international organisations at the Diplomatic Conference

- adopted the Cape Town Convention on International Interests in Mobile Equipment
- and the Aviation Protocol thereto



# **THE LUXEMBOURG PROTOCOL TO THE CAPE TOWN CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT**

**Agreed in Luxembourg 2007**

**Participants from 42 States and 12 international organisations at the Diplomatic Conference**



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Luxembourg Rail Protocol – a new strategic tool for the public and private sector
- Providing a new pragmatic global regulatory framework which will
  - facilitate more and cheaper private sector investment in the railways
  - lower barriers to entry to private operators
  - stimulate a more competitive and dynamic industry



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Luxembourg Rail Protocol creates
  - ✓ a new type of security, internationally recognised with established priorities
  - ✓ Registerable and searchable in a public registry, 24/7
  - ✓ new uniform system for unique identification of assets (URVIS)



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Luxembourg Rail Protocol provides a global system for recognition and registration of security interests in rolling stock, thereby:
  - ✓ Reducing risks and costs of financing rolling stock
  - ✓ Resolving cross border security and conflict of laws issues
  - ✓ Facilitating operating and finance leasing and other private sector finance



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships



TRANSNET has secured a R6bn funding guarantee from US export credit agency US-Exim for the funding of the diesel locomotives the company is buying from General Electric (GE). The group CE of the state-owned ports, rail and pipeline company, Brian Molefe, said .. that the guarantee was "a massive thumbs-up from the international investor community, affirming Transnet's credit-worthiness and South Africa's attractiveness as an investment destination."

Memo to Mr Molefe: "It's cheaper with Luxembourg"

*Howard Rosen Solicitors*



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- BOT and other project financings: Is it better to deconstruct vertically?
  - Can provide customised solutions and flexibility to operator
  - Leverages in future “Luxembourg” benefits
  - May maximise tax benefits
  - Facilitates multiple use of rolling stock
  - Focuses on credit lines and government support where absolutely needed
  - Efficient allocation of risk



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- BOT and other project financings: Is it better to deconstruct vertically?
  - Rolling stock forms about 1/3 of the total rail market
  - In RSA:
    - Projected to grow from \$2 bn to \$2.29 bn p.a. 2017-19
    - Infrastructure spend declines from \$313 mio. to \$286 mio 2017-19
      - Berger report 2014 (at €/ \$ current rates)



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- BOT and other project financings: Is it better to deconstruct horizontally?
  - Allocating franchises after build
  - May minimise funding costs
  - Separates the builders from the consolidators
  - Provides government (agency) project and finance flexibility



# Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- BOT and other project financings: does integrated finance make sense?
  - It depends on the circumstances
  - .... And government objectives
  - Probably not the cheapest solution
  - Governments are trading convenience and expertise – the integrated solution – against cost and flexibility



## Conclusion

- Private capital is urgently needed to supplement classic state structures for financing rail infrastructure
- Private sector provides solutions but have their own constraints
- BOT and other private sector project financings are not a “magic pill” – they provide a convenient one stop shop but not always the best solution



## Conclusion

- But the key to avoid the funding gap is more private sector lenders
- The key to private sector finance at an acceptable price is security
- A “complication occurs because the rolling stock keeps crossing borders. Unless there is a co-ordinated approach to legal recourse, the engines and cars cannot be used as collateral for loans, which will make the financing cost unnecessarily high” - Paul Collier





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