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INFRASTRUCTURE INVESTMENT

CURRENT TRENDS

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ALTERNATIVE INFRASTRUCTURE FUNDING MODELS

GOVERNMENT DIRECT INVESTMENT MODELS

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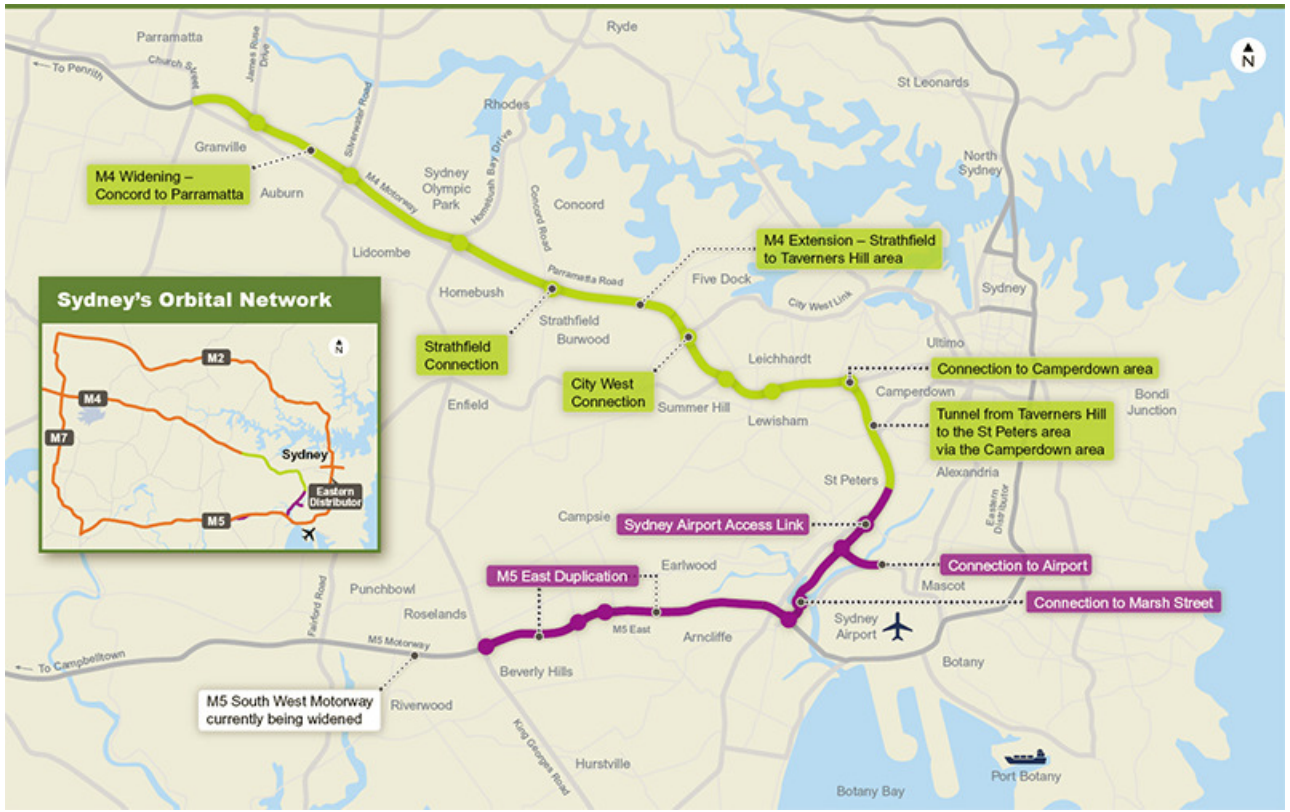
- Full government funding and sale
- Capital Contributions
- NSW WestConnex funding model



FULL GOVERNMENT FUNDING AND SALE

- Capital cost entirely funded by government
- Initially, minimal risk transfer to private sector (through construction procurement only option), however potentially lower cost to government
- Places pressure on government balance sheet
- Potential for recycling of capital through sale of asset once completed, but dependent on asset class and risk appetite of private sector
- Examples include Sydney Desalination Plant, which cost approximately $1.9b to construct, and was 100% financed by a debt loan from Tcorp
- On 1 June 2012, the plant was sold to a private consortium for $2.3b, with the majority of the proceeds being used to repay the debt incurred by the government in building the plant
- The Treasurer stated that there would be no impact on customer water bills or water security. However, Sydney Water would continue to pay an "availability charge" to the new owner of the plant as part of the arrangement.

CAPITAL CONTRIBUTIONS

- PPP structure, but Government contributes proportion of capital works cost
- Capital contribution is often made at the end of construction to incentivise completion by private sector
- Can be used where insufficient private finance available at competitive margin, and sized at appropriate level to maximise value for money for Government
- Reduces reliance on private sector debt during operations period, thereby reducing overall project cost
- Model used on Sunshine Coast University Hospital, Gold Coast Rapid Transit and Victorian Comprehensive Cancer Centre

Project	Construction Cost	Capital Contribution
Sunshine Coast University Hospital	$1.8bn	$820m
Victorian Comprehensive Cancer Centre	$1bn	$300m

NSW WESTCONNEX MODEL

- Intended to be used on $10bn WestConnex toll road in Sydney
- Initial section to be built by State-owned entity from proceeds of sale of Port Botany and Port Kembla
- Once traffic numbers are established, money will be borrowed by State-owned entity against toll revenue to fund next stage of project
- Government may eventually sell shares in State-owned entity, and wholly privatise after motorway is completed

Benefits:

- Recycling of capital from investment in initial stage to fund entire project
- Efficient raising of private capital as project has an established revenue stream against which debt or equity is contributed
- Provides ability for State to raise debt on project finance basis, limiting recourse to State
- Potential to attract superannuation and infrastructure funds seeking stable inflation-linked returns

Limitations:

- State takes on project construction risk and requires large upfront capital contribution (expected to be 1.8bn, with construction of all stages expected to be approximately $10bn)
- Potential for initial stage traffic to be below expectations, limiting ability to raise private finance for subsequent stages (the “road to nowhere”)
- Extended period of project delivery and cost overruns
- Difficult to replicate model across variety of projects, as staged delivery not always feasible

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ALTERNATIVE INFRASTRUCTURE FUNDING MODELS

GOVERNMENT LENDING MODELS

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- Government Supported Debt model
- Credit Guarantee Finance (UK)

GOVERNMENT SUPPORTED DEBT MODEL

- Used on South East Queensland Schools Project, which involved the construction of 7 state schools at a cost to government of approximately $1.1bn
- Private sector provides all financing for the construction phase
- Government provides 70% of debt financing for the operations phase, as first ranking senior debt
- Still passes construction risk to private sector, but takes advantage of Government's ability to raise debt at lower cost than private sector, and pay lower service payments for duration of project term (although risks through involvement in such projects are included as part of the State's credit assessment)
- Introduces complexity regarding intercreditor issues, and conflicts of interest with State being sponsor and lender
- Potentially reduces ability of private sector to introduce financing innovations
- Still requires State borrowing, and arguably too risky for State to apply to economic infrastructure
- Anecdotal support for this model in the private sector is limited

CREDIT GUARANTEE FINANCE (UK)

- Government provides all debt to the project
- Receives credit guarantees from banks, with loan repaid on termination of concession agreement
- Enables project to take advantage of government's ability to borrow at lower rates, but private sector still takes project risk (and the risk associated with these loans is factored into credit rating assessments)
- Still relies on government borrowing and assumes creditworthiness of guarantor
- Has not been used following use on two pilot projects in the UK (£230m hospitals in Leeds (with credit guarantee provided by bank) and £225m hospital in Portsmouth (with credit guarantee provided by monoline insurer))
- HM Treasury estimates that savings from both projects amounted to approximately 3% of the ongoing unitary charge
- HM Treasury are not planning on further use of this model, which is understood to primarily be due to the lack of credit guarantee providers in the market and the administrative difficulty for government of using this procurement method
- Is also difficult to apply to economic infrastructure and requires large upfront capital contribution from Government

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ALTERNATIVE INFRASTRUCTURE FUNDING MODELS

GOVERNMENT DEBT SUPPORT

GOVERNMENT DEBT SUPPORT

- Availability payments
- Transport Infrastructure Finance and Innovation Program (USA)
- Infrastructure Guarantee Funds

AVAILABILITY PAYMENTS

- Used where limited private sector appetite for taking on revenue risk
- Still shifts up-front financing obligation and construction risk to private sector, without affecting State balance sheet
- Expensive method of procurement, placing pressure on Stage budgets for duration of project term
- Can leave open the option (on economic infrastructure projects) for State to securitise project revenues once usage is established
- Used for the procurement of the Peninsula Link tollroad project

TIFIA

- Federal US infrastructure funding program which provides financial assistance to highway, transit and rail projects of regional and national significance.
- Assistance is provided in three forms:
  - secured loans
  - loan guarantees
  - lines of credit
- Able to be used in the context of a PPP
- Budget for program was $750m for FY2013 and $1bn for FY2014 (or $690m and $920m after administration costs)
- US Department of Transportation (**DOT**) believes that this budget authority could support approximately $6.9bn in lending capacity in FY2013 and $9.2bn in lending capacity in FY2014 (dependent on risk profile and based on historic subsidy costs)

TIFIA PROGRAM

- This program has been useful in attracting private sector investment in the US. Demand for the program has vastly exceeded the funding that US congress has made available.
- Has been used on the following projects:
  - Capital Beltway Hot Lanes Project (Transurban-owned toll road) ($2.068b, with a direct loan of $589m)
  - Miami Intermodal Center ($2.043b, with a TIFIA loan of $270m)
  - Intercounty Connector ($2.399b, with a TIFIA loan of $516m)
  - North Tarrant Express ($2.043b, with a TIFIA loan of $650m)
  - Washington Metro Capital Improvement Program ($2.043b, with a guaranteed loan of $600m)

TIFIA – SECURED LOANS

- flexible terms
- amount may not exceed 49% of project costs
- interest rate equal to or slightly greater than treasury securities of comparable maturity date
- repayments can start up to 5 years after substantial completion to allow time for facility construction and ramp-up
- senior debt service and reserves generally rank ahead of TIFIA debt service and reserves
- DOT seeks to restructure repayments in a way that encourages borrowers to replace the TIFIA loan with capital markets debt when project economics support this (allowing recycling of funds for other projects)

TIFIA – LOAN GUARANTEES

- DOT may give preference to applications for loan guarantees rather than any other forms of credit assistance
- Under loan guarantee, DOT pledges to pay third-party lender all or part of the debt service on borrower's debt obligation
- On payment default, lender will receive payment from DOT, and DOT will pursue borrower under reimbursement agreement
- Amount of loan guarantee, in combination with any other form of TIFIA credit assistance, may not exceed 49% of project costs
- Interest rate on guaranteed loan is negotiated between guaranteed lender and the borrower, subject to DOT consent
- Debt amortisation must commence no later than five years after completion of the project

TIFIA – LINES OF CREDIT

- DOT provides a contingent loan that may be drawn down after completion to supplement project revenues during the first 10 years of operations
- May only be used to pay debt service
- May not exceed 33% of project costs (and in combination with loan or guarantee may not exceed 49%)
- Interest rate is greater or equal to 30 year US Treasury security on the date of execution of the line of credit agreement
- Repayments must commence no later than 5 years after the 10 year availability period and be fully repaid within 25 years of completion

TIFIA – CREDIT RISK AND CAPITAL ALLOCATION

- DOT is required to allocate capital, in the form of budget authority, to cover expected losses
- To determine credit exposure on each credit instrument, it looks at variables such as the repayment structure, the drawdown assumptions, the nature of the dedicated revenues securing the TIFIA credit instrument, and the ratings assigned to the credit instrument
- Capital reserve adjustments occur annually
- Also, a project cannot receive TIFIA credit assistance unless the senior debt obligations funding the project (or the TIFIA credit instrument if it ranks ahead of the senior debt) receive investment grade credit ratings from at least two credit rating agencies

PARTNERSHIP TO BUILD AMERICA ACT

- A bill has just been introduced in the US congress to create a $50bn infrastructure fund to provide loans or loan guarantees to states and municipalities to finance major infrastructure projects
- Although untested, sponsors of the bill are claiming that the $50bn fund could be leveraged into supporting $750bn of infrastructure spending

INFRASTRUCTURE GUARANTEE FUND – THE UK GUARANTEES SCHEME

- Created in 2012 to enable the Treasury to incur expenditure in providing financial assistance to any person in connection with the provision of infrastructure.
- In return for the payment of guarantee fees charged at market rates, UK Treasury will provide a guarantee, payable on non-payment of scheduled principal and interest owing under an underlying debt instrument
- The form of financial assistance able to be provided by Government is not restricted to just guarantees or other forms of sureties, but also includes loans, indemnities and any other kind of financial assistance (actual or contingent)
- Amount of expenditure and actual or contingent liabilities incurred in giving infrastructure assistance is capped at £50bn
- Projects must be nationally significant, construction ready, financially credible, dependent on guarantee and not otherwise financeable within a reasonable timeframe, and good value for money for the taxpayer

INFRASTRUCTURE GUARANTEE FUND – THE UK GUARANTEES SCHEME

- Has been applied to guarantee a £75m loan for the UK based power generator Drax to part-finance conversion of a power plant to biomass
- Is reported to be earmarked for £1bn extension of the Northern Line extension to Battersea, the financing for the £4bn Thames Tideway super sewer, the £600m Mersey Gateway toll bridge and new nuclear power stations
- Standard & Poor's considers that the scheme could stimulate the UK infrastructure project bond market by substituting the UK sovereign credit rating of 'AAA' for that of the underlying debt instruments, and that the scheme resembles to a large extent the form of a monoline insurer's financial guarantee

INFRASTRUCTURE GUARANTEE FUND - SWEDEN

- Since 1996, the Swedish Debt Office has given major guarantee undertakings for infrastructure projects
- Examples include:
  - guarantees of loans to support maintenance and investment in nationally significant buildings;
  - guarantees of loans related to project investments outside of the Nordic region provided to promote internationalisation of various sectors and industries, such as infrastructure, energy, telecommunications, environment and heavy industry; and
  - financed the building of the Öresund Bridge between Sweden and Denmark by issuing government guaranteed bonds on the international credit market.
- Charges a fee for the risk of credit losses that it assumes
- Debt Office estimates that its expected losses from guarantees are covered by fees charged and recourse claims against borrowers

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