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Funding Social Infrastructure in the Current Economic Climate

CEDA Forum

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Agenda

- What is “Social Infrastructure?”
- The “Great De-Leveraging”
- “Why” and “How” should infrastructure be procured?
- Funding Infrastructure
  - Competition
  - Debt
  - Equity
- Conclusion

What is “Social Infrastructure”?

- Availability payments
- Performance based
- Limited demand / usage risk
- Traditionally:
  - Hospitals, schools, justice facilities, other civic infrastructure
- Increasingly applied to:
  - Water, roads, mass transit

Not talking about toll roads, airports or market-based utilities

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The "Great De-Leveraging"

- 1992 to 2008 saw a massive increase in leverage across the globe
- Unfortunately banks amongst the worst culprits
  - Lehman Brothers Asset/Equity before collapse = 30x
  - Dexia A/E in 2007 = 37x
  - RBS A/E in 2008 = 29x
- De-leveraging will be very difficult to control and potentially economically ruinous

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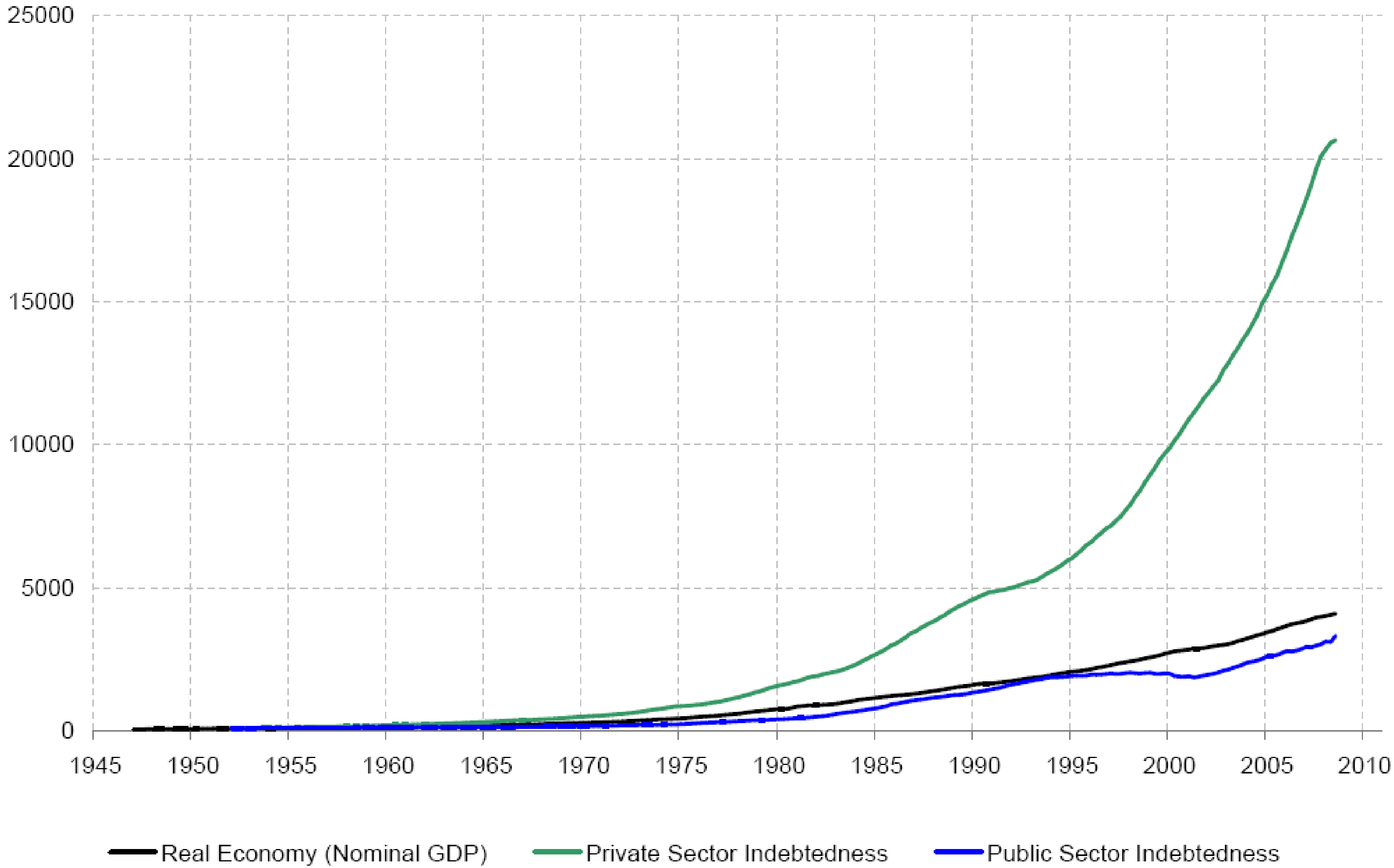
UNITED STATES: REAL ECONOMY AND FINANCIAL SECTOR
INDEX BASE 1952 = 100



Source: Bureau of Economic Analysis (NIPA Table 1.1.5) and Federal Reserve System (Flow of Funds Accounts Table L.1)

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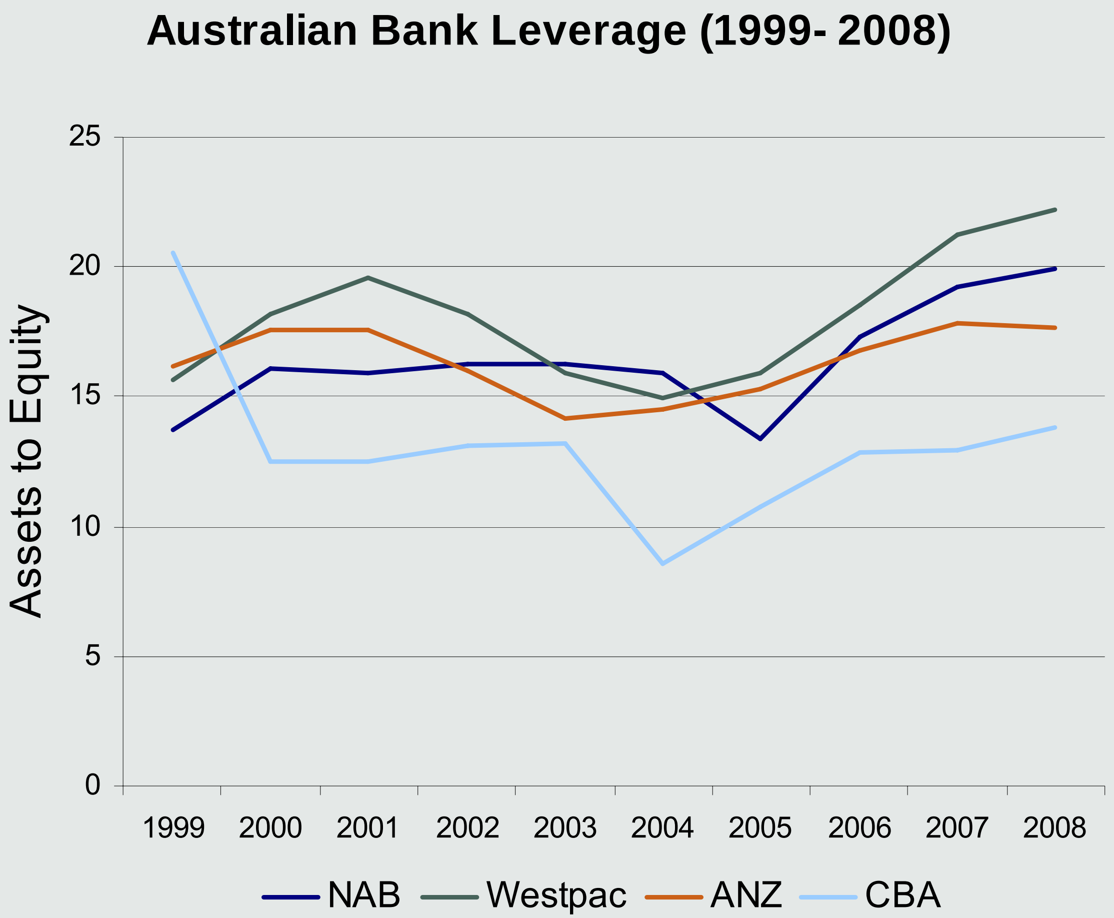
Fortunately, Australia has two major advantages...

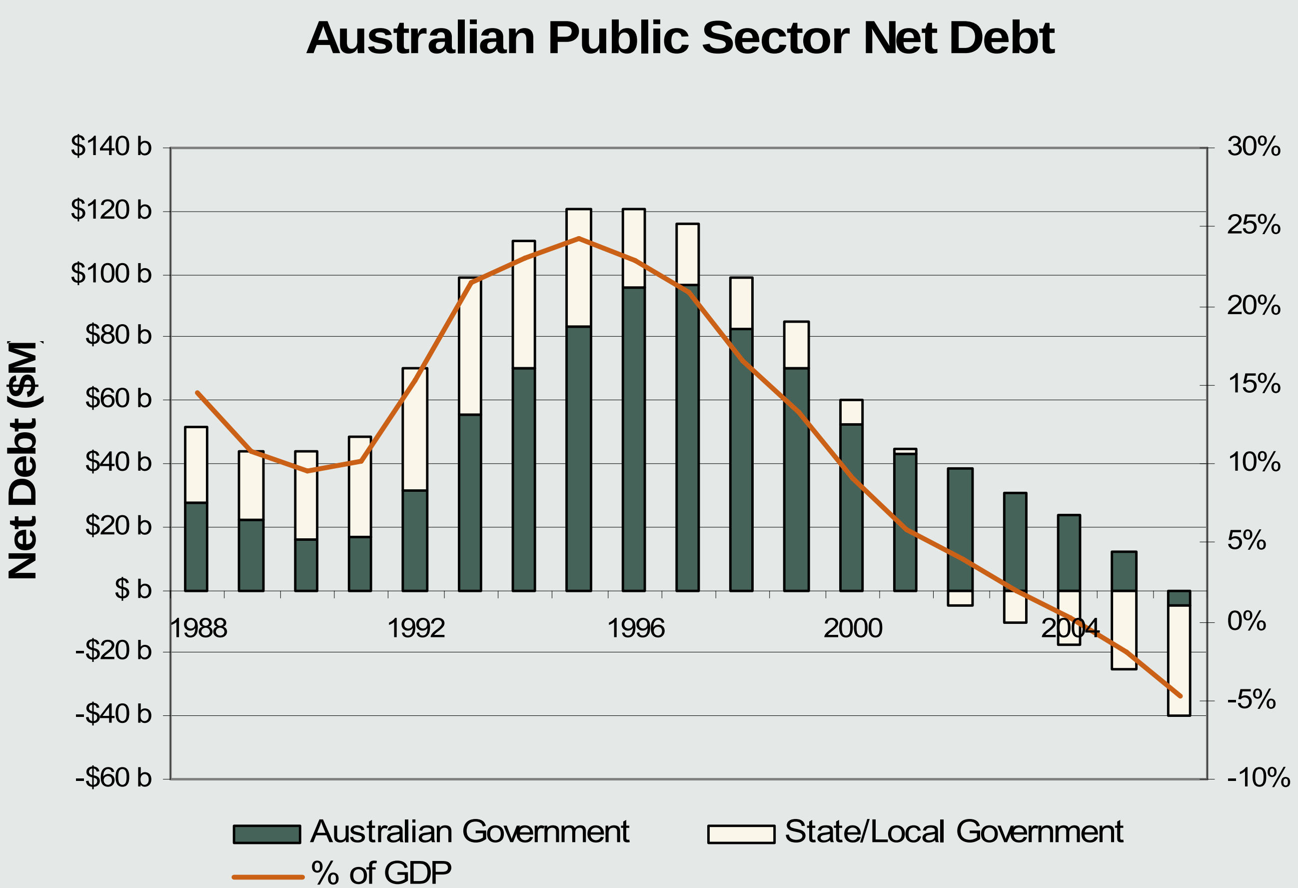
- Our banks were more considered…



Source: Respective Financial Statements Year Ends

Fortunately, Australia has two major advantages…

- Our governments used the “good times” to de-leverage …



Source: Australian Government 2007-2008 Budget

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Government’s role in managing the de-leveraging process?

- Governments must (and will) increase debt
  - Act as “economic cushion” to the inevitable decrease in private leverage
- Question is not:
  - How much public debt?
  - State or Federal?
  - Direct or Indirect?
- History will judge Governments by what taxpayers get in return
  - Infrastructure spending - all about implementation

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Infrastructure Spending - Why and How?

- Why procure infrastructure in the current economic climate?
  - Enhance long-term productivity
  - Improve service delivery
  - Create jobs (fiscal stimulus)
- How?
  - Need for speed
  - Need for discipline
    - Pick the right projects
    - Don’t “over-capitalise”

Deliver job-intensive, highly productive infrastructure…
...quickly (and cost-effectively)

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Governments Spending Wisely?

- Most governments have well-established PPP programs to procure infrastructure efficiently
- Benefits – well known
  - Design and commercial innovation
  - Cost and time certainty
  - Whole-of-life performance
- Track record – proven (Allen Consulting/Melb Uni)
  - Cost savings of up to 30.8%
  - 3.4% ahead of schedule vs. 23.5% behind schedule

However, mostly driven by the discipline and innovation of private capital

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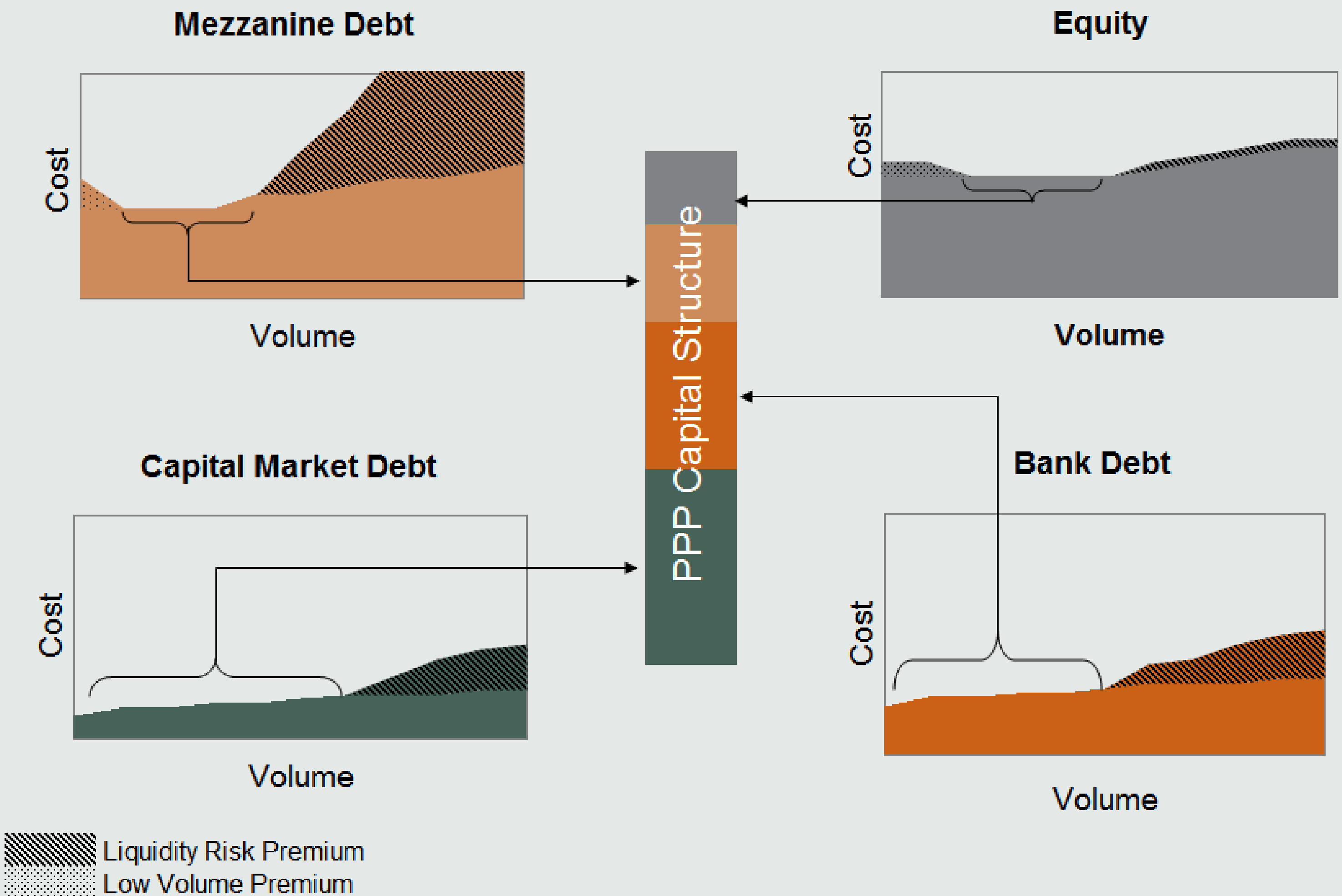
Funding PPPs in current economic environment?

– Capital used to compete aggressively for projects



Note: Not to scale

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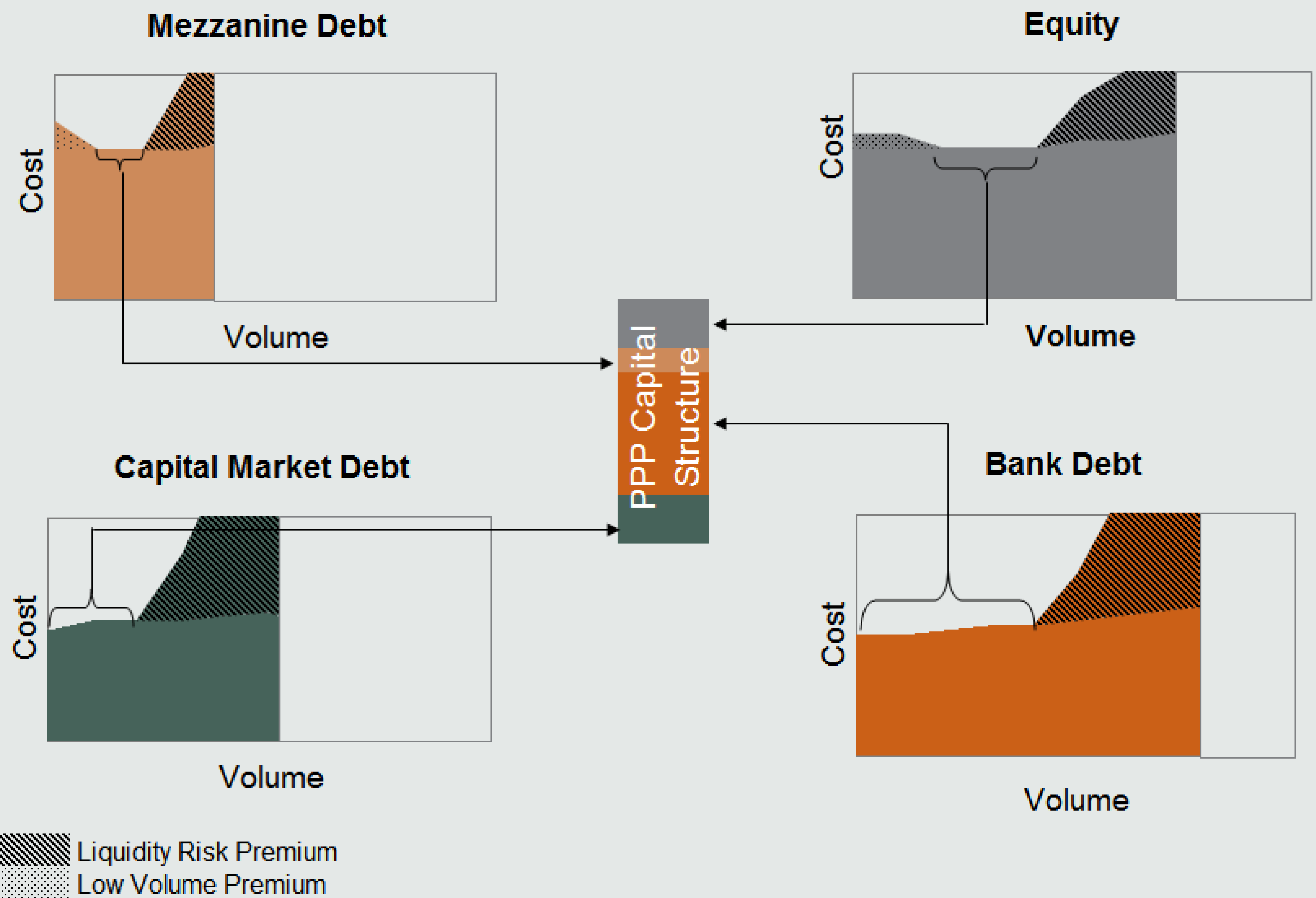
Funding PPPs in current economic environment?

- Now projects have to compete for capital



Note: Not to scale

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How do Governments recreate competition?

Debt Funding for Social Infrastructure

- Need to be realistic about private capacity
- Bank capacity has significantly decreased
  - Probably $200m - $300m of competitive financing per project
    - More available at less competitive pricing
- Capital market capacity – almost non-existent
- PPPs will compete for debt capital
  - Against private companies, public debt, other projects
- Avoid the Marginal Cost of Debt becoming The Cost of Debt
  - Only need enough private debt to ensure rigour, discipline and due diligence applied

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Debt Funding for Social Infrastructure (cont...)

- UK Solution
  - Lend alongside commercial lenders and the European Investment Bank
  - Particularly to large projects that will strain the market
- French Solution
  - Guarantee 80% of a PPP project's debt
  - Permit non-underwritten financings
- Canadian Solution
  - Increase Provincial project contributions
  - Allow Federal export agency to lend to local projects

Equity Funding for Social Infrastructure

- What happened to the "wall of money"?
- Super funds reluctant to invest into illiquid assets
  - Rebalancing portfolios
  - Redemptions and member switching
  - Foreign currency hedges

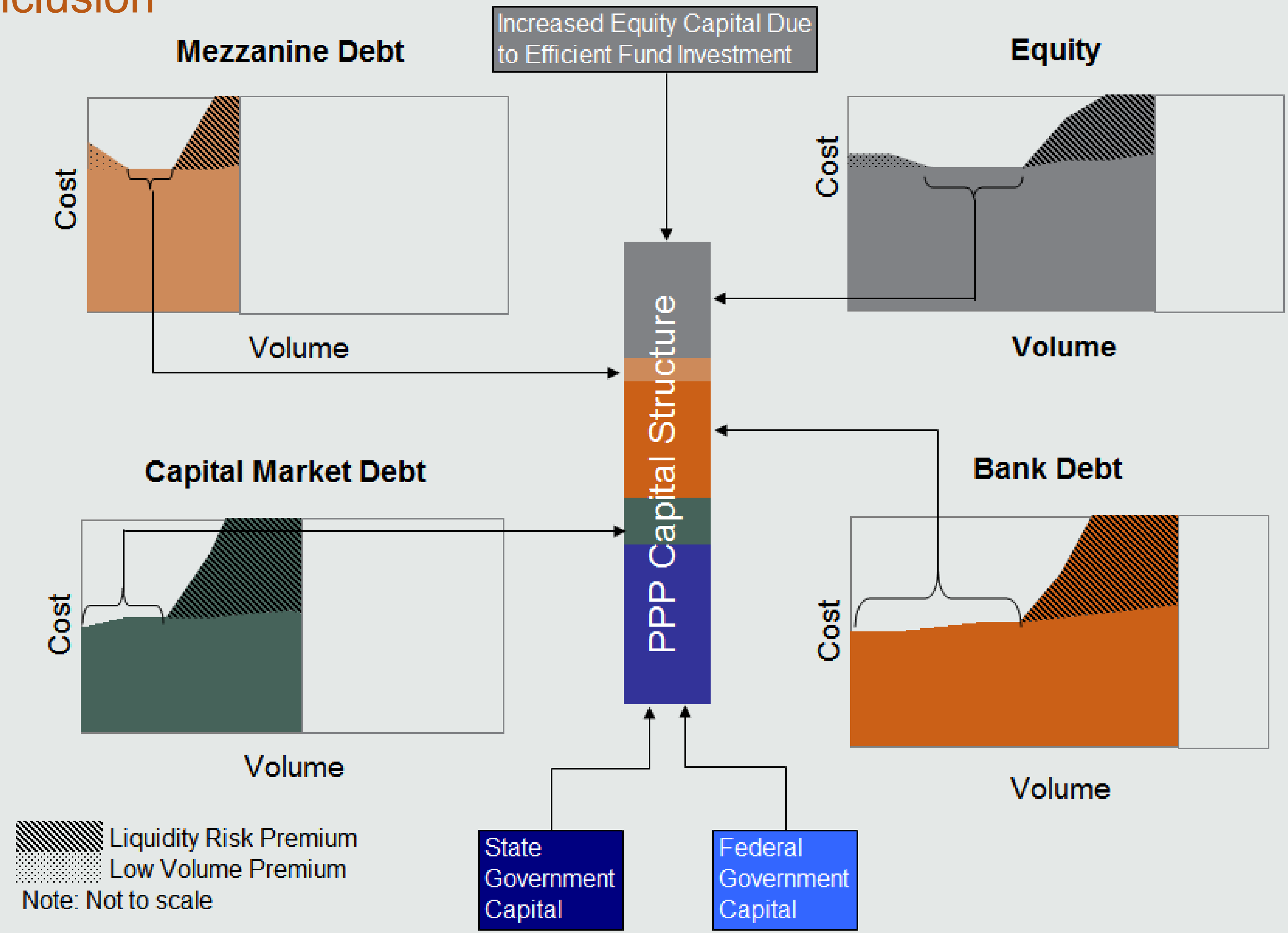
PPPs remain ideal investments for superannuation

- Long-term liability matching, predictable yield, inflation hedge, low risk
- Market needs to create better conduits between investors and assets

Conclusion

– Australian Governments need infrastructure
  - PPPs proven (and can be quick)
– Social Infrastructure can be funded in this economic climate
– Governments should contribute capital or provide project debt to avoid liquidity premiums and capacity constraints
– The market needs to develop better investment vehicles to connect superannuation with PPP assets

Conclusion



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