Sovereign Debt Management Forum 2014

Summary Note for Breakout Session 7

The Role of Debt Managers in Infrastructure Financing

I. Summary of session

Alison Harwood, Practice Manager, Finance & Markets Global Practice at the World Bank, introduced the topic by highlighting a few figures to emphasize that there is a high infrastructure investment need in the emerging countries and that the big focus is on how to mobilize institutional investor funds (insurance and pension sectors) to help finance these investments. In addition to the size of this need, fiscal and regulatory constraints on the banking side create a challenge. Bond markets could be a major way to help bring institutional funds into these infrastructure projects, though the domestic markets in the emerging world need to be further developed, with well-established yield curves and institutional investors better acquainted with infrastructure finance. To tap those funds, there is need to develop different kind of instruments to provide good risk and return for financial instruments. Debt managers can play an important role in developing these solutions and help crowd-in private investment.

The session revolved around key questions raised by the moderator.

In his speech, **Stanley Kamau, Director of PPPs for the Kenyan government**, stated Kenya's objective to boost the economic growth and the role of the infrastructure investment in achieving this goal. To create this growth, Kenya needs a total of $4 billion investment in infrastructure in the next five years, of which the current investment amount is currently $2 billion. The government seeks funding sources for ambitious investment projects, notably in the energy and transportation sectors. To attract private investors, the government aims to have bankable projects, sound regulatory and institutional framework and deep domestic market.

The steps undertaken by the Kenyan government to access local funding sources and one of the most important prerequisites is to have a well-established government bond yield curve to support the price discovery for infrastructure financing. Other factors taken into account are the structure of the money markets, the regulatory and institutional framework and issues related to governance such as the transparency in the secondary market. On the corporate bond market, Kenyan government aims to change the regulation of the pension funds to include the infrastructure investments into the asset class.

Stanley highlighted the products explored by the Kenyan government to attract the investors such as asset-backed securities or the treasury mobile direct which is a way of developing the access to finance. Backed by multilateral organizations, Kenya does not provide sovereign guarantees for its PPP projects, so the exposure to the explicit contingent liabilities is limited.

Clemente del Valle, President and CEO of FDN, outlined the Colombian context, emphasizing that the challenges faced are similar to the Kenyan case, with an ambitious growth target and big obstacles for the mobilization of financing for the infrastructure investments. Due to these challenges, the Colombian government ebuilt over the last four years a sound framework to support the financing of the transportation investments (40 projects amounting to $26 billion in capital expenditures) and is now at the process of implementation. Once the government realized that the mobilization of resources could not be done at the speed of the market sources, it established the development institution, FDN.

The main role of FDN is to access all kind of domestic and external long term project financing sources, an important factor from efficiency and competition point of view. FDN shares part of the investors' risk by committing capital to the projects to attract other investors. As a result of FDN's efforts, Colombian commercial banks started showing more interest for project financing. International capital markets and multilaterals are also considering investing in these transportation projects. The products considered by the FDN to attract institutional investors which are the biggest institutional investors in Colombia and a good candidate for infrastructure finance as they can provide stable long term profits. The first one is a standard project finance product with a partial risk from FDN to mitigate the risk and appeal to the pension funds. The second one is day zero bond trying to mitigate the construction risks from the beginning. Another product is a structured bond where the proceeds would not be disbursed for the project from the initial stages.

Clemente stressed that in Colombia, the expectation is for the debt managers not to crowd-out the domestic market for the infrastructure investors but at the same time help build a liquid yield curve and develop instruments, for example inflation-indexed securities, to open the foreign markets to Colombian peso instruments. Another important role for the debt managers is to manage the contingent liabilities due to availability payment commitments and minimum traffic guarantees due to the inability to cover the cost of the roads through tolls. The credibility of assessing these contingent liabilities gives confidence to the private sector players. It is also useful for the government to provide FX protection against the debt servicing of foreign borrowing.

Fernando Bravo, Managing Director, Goldman Sachs, shared his insights from the international capital markets perspective. From the demand side, institutional investors with an increasing assets base, have been looking for high return investments in a low interest rate environment. From the supply side, this environment allows countries to raise funds for their infrastructure investments with positive impact on the economy overall. However, the project bonds should be tailored in order to mitigate the main risks regarding the infrastructure investment projects such as the construction risk, the negative carry, and the FX risks. Fernando argued that this tailoring involves various incentive schemes which can provide flexibility across the different domestic and external funding sources, and lead to big efficiency gains for

governments. He also highlighted the need to educate some investment funds for managing their assets.

II. Key insights from presentations and discussion

The Q&A session revolved around the issue of accountability and ways of dealing with the contingent liabilities generated by the PPP projects. Lars Horngren, Head of the Swedish National Debt Office made an intervention where he emphasized the importance of including the expenditures for the PPP projects on the budget. He stressed that a discussion on the all-in costs of these projects would be beneficial and should include less apparent concession costs such as changing tax laws. He argued that the arguments on domestic market development are valid for all kind of government securities irrespective of whether they are issued to finance infrastructure or the budget deficit. Lars also indicated that PPP projects present a challenge regarding transparency as they are very hard to understand even for experts.

In response, all the speakers agreed that it is very important, for transparency purposes, to share all the direct and contingent liabilities of these infrastructure projects with the public and account for them in the budget.

In conclusion, the session demonstrated that countries with high infrastructure needs are facing challenges to fund their projects. This leads governments to develop new instruments and tools to tap the domestic and external investors of which the institutional investors.

Debt managers have a role in supporting the financing of the infrastructure investments by working towards the improvement of the domestic bond market, and by evaluating and assessing the contingent liabilities from these investments. A third argument is for the governments to not crowd-out the domestic market by creating a fiscal space, thus leaving room for the investors to participate in the infrastructure finance programs.