GLOBAL INFRASTRUCTURE FACILITY

THIRD ADVISORY COUNCIL MEETING, CHANGSHA, CHINA, JUNE 6, 2016

Summary of Proceedings

The Third Advisory Council Meeting of the Global Infrastructure Facility (GIF) was held in Changsha, China, on June 6, 2016. It was attended by representatives of 24 Advisory Partners, 3 Technical Partners, 6 Funding Partners and two Beneficiary Partners, in addition to a number of observers and speakers. As the co-chair, **Joaquim Levy**, Managing Director and World Bank Group Chief Financial Officer, could not attend the meeting in person, **Jordan Schwartz**, Director, Singapore Infrastructure & Urban Development Hub, co-chaired the meeting with **Neil Johnson**, Managing Director, Macquarie Infrastructure and Real Assets. The meeting featured a panel discussion on the state of infrastructure finance, presentations on risks and issues in infrastructure projects and country presentations from China, India, Kazakhstan and Uganda.

Levy, in his pre-recorded opening remarks, emphasized the continued need for both the public and the private sector to bridge the infrastructure gap. Stressing the importance of the role of multilateral development banks, Levy reiterated the World Bank's commitment to expand lending to the infrastructure sectors of transport, energy, water and sanitation, and ICT. Levy emphasized that an important objective for the GIF was to help make infrastructure financing attractive for investors, as a fully-engaged private sector could make a big difference. Levy further highlighted the extraordinary potential of the GIF to mobilize private financing for infrastructure through a unique and powerful partnership of donors, client governments, investors and implementers who, together, can catalyze infrastructure investment in a sustainable way.

In his opening remarks, Johnson presented an Advisory Partner's perspective, urging participants to help the GIF consider the criteria that identify quality infrastructure projects and where the GIF should focus its efforts to achieve practical outcomes. In a status update on the GIF, Schwartz provided a summary of the GIF project pipeline: four Planning Grants were awarded in FY2016 for a total of $525,000, and one full application was received from the Solomon Islands for last-mile support of $1.1 million for a hydropower project. Schwartz discussed the importance of the GIF's engagement with its growing number of Advisory Partners, and the important role they are playing in the development of the proposed Downstream Financing Window.

Session 1: State of Infrastructure Finance in Emerging Markets and Developing Economies

A panel discussion moderated by Schwartz examined the state of infrastructure finance in emerging markets and developing economies (EMDEs). The panel included **Tony Adams**, Chief Investment Officer of Infrastructure at Eastspring Investments; **Karin Finkelston,** Vice President of the Multilateral Investment Guarantee Agency; **Gregory Liu**, Senior Vice President and Head of Global LNG and China at Sumitomo Mitsui Banking Corporation; and **Chen Huan**, Chief Officer at the Asian Infrastructure Investment Bank; who shared their respective institutional perspectives on the subject. Finkelston noted that Basel II and III restrictions were making it more expensive for commercial banks to wait out the long tenors needed for infrastructure investments, and these banks needed credit enhancements to encourage them to participate in the sector. This should be combined with an effort to increase the involvement of institutional investors in EMDE infrastructure, thus providing an opportunity for commercial banks to flip their assets into institutional hands after the construction period. She also noted the huge need for infrastructure investment in fragile and conflict-affected states, and the need to attract private equity markets into the sector. She discussed MIGA's guarantee products and how risk was pooled to provide affordable credit enhancement approaches in poorer countries. Adams noted that the sources of long-term finance were shifting in response to a low-interest environment, making infrastructure debt more attractive, and providing opportunities for new groups of investors. He added that the need for infrastructure finance increasingly spanned the globe, resulting in revenue streams denominated in local currencies and requiring assets to match long-term liabilities. Liu highlighted the constraints of the Basel III Accord for commercial banks and elaborated on the roles MDBs could play in risk comparison. He called for local banks and insurance companies to be more actively engaged as liquidity holders. Huan noted the difficulty in mobilizing financing for infrastructure in Asian markets in spite of the enormous needs and the availability of liquidity. He stressed the need to identify high quality infrastructure projects that were bankable, socially acceptable and environmentally friendly and the important role the multilateral development banks could play in addressing this. Other comments raised during the question and answer session include: the increasing demand for fixed income lending and patient capital; the need for investors to orient their thinking around the ability to undertake greenfield transactions; the importance of working collaboratively with development teams to increase deal flow; the need for improved data-collection, benchmarking and analysis; the importance of working with regulators to remove barriers to insurance flow into infrastructure; and the need to establish platforms that can work with MDBs to provide credit enhancement.

Session 2: China Country Presentation

Iris Ren, Director for Infrastructure, Energy and Export Finance, Global Banking and Markets at HSBC Bank Plc., moderated a country discussion on China in which **Han Bin**, Deputy Director General, China PPP Center, presented China's infrastructure investment program. Han Bin noted the Chinese government's strong support for PPPs which were central to the country's reform strategy. Ongoing actions included formulating a national PPP strategy, establishing a conducive regulatory framework; enhancing institutional capacity, and developing demonstration projects. The China PPP Center proposed 8 PPP projects in the energy, water, and transport sectors and highlighted the associated challenges. Han Bin pointed out the opportunities and challenges relating to each. During the Q&A session, Han Bin explained that the trend towards project finance for PPPs was a challenge for China's financial sector, which was more accustomed to corporate finance with guarantees provided by the government and state-owned enterprises. On the issue of tariffs he pointed out that the government was committed to liberalizing price controls. He further elaborated that the Ministry of Finance was formulating information disclosure guidelines that would make it easier for the private sector to access fiscal and financial data. In responding to questions about what rate of return investors should expect to earn from PPPs in China, Han Bin stated that while no floor or ceiling was imposed, private investors should expect reasonable, but not excessive, returns on their equity investments. He stressed that while PPPs were not a substitute for traditional procurement, the Chinese government was encouraging a steady increase in the share of PPPs but was not aiming at any particular percentage of total government-funded projects. It was suggested that China should consider releasing fiscal space for new projects by using the equity and debt proceeds from existing brownfield projects to fund greenfield projects.

Session 3: Kazakhstan Country Presentation

Almaz Galiev, Principal PPP Specialist, Asian Development Bank, moderated a discussion on Kazakhstan. **Zhanar Gabdullina**, Expert at the Department of Strategic Planning and Analysis in the Ministry of National Economy, presented Kazakhstan's road PPP program. Gabdullina presented the Almaty Ring Road project (BACAD), which, at preferred bidder stage, is currently at an advanced stage of preparation. She elaborated on some of the reforms and contractual adjustments the government had made through the preparation phase of the project to increase bankability. These include introducing a direct agreement to facilitate lender step-in rights, establishing formalized compensation-on-termination mechanisms in the concession agreement to provide better financial protection for lenders on concessionaire default, and giving project parties the right to apply for international arbitration in the event of unresolved disputes affecting international financiers to the project. Gabdullina also presented two road bypass projects at an earlier stage of preparation. These projects would have significantly lower traffic flows than the BACAD and were most likely to be developed on an availability payment basis, with all traffic risks retained by the government. During the Q&A session, participants inquired about the level of political support, management of currency risk, and issues related to land acquisition. Gabdullina explained that infrastructure projects enjoyed deep political support, as demonstrated by the various reforms made in support of the BACAD project. Further, the engagement of various international financial institutions ensured that the government would take its obligations seriously and continue to demonstrate its commitment to such projects. Gabdullina noted that land acquisition would be the full responsibility of the government, and that the legalization process for the BACAD project was fully under way. She also pointed out that the government was prepared to cover some of the foreign exchange risk and address the resettlement issues associated with the BACAD project.

Session 4: India (State of Rajasthan) Country Presentation

In a session moderated by **Haihai Yuan**, Managing Director and Head of Corporate Finance for China, at the Standard Chartered Bank, **Devendra Gupta**, Additional Chief Secretary, Public Works Department Secretariat, Government of Rajasthan, presented PPP projects in Rajasthan, India. Gupta spoke about the Rajasthan State Highway Development Program, which is proposed on a PPP Annuity mode (i.e. availability payments). Gupta highlighted the state's adoption of a hybrid annuity model in which the concessionaire would partly finance, construct and manage the project and would be responsible for the structural design, finance, construction and operations and maintenance (O&M). Under the model, the Authority's responsibility would be road alignment, land acquisition and environment clearance. The Authority would also pay 50% of project cost as construction support during construction, and the balance as an annuity payment. Participants raised concerns about the delays in project implementation due to the government's failure to address land acquisition issues, and about the 65 levels of clearance required for project approvals. Gupta explained that policy changes had been made that allowed states and district committees to negotiate prices during land acquisitions. Further, Rajasthan was currently taking active measures to streamline the clearance process and had created a single window for clearances; Rajasthan was now the number 3 state in Doing Business in India and was generating increasing interest from foreign investors, Gupta pointed out.

Session 5: Uganda Country Presentation

Larry Li, Executive, Diversified Sector, Client Coverage at the Standard Bank Group, moderated the Uganda session. In presenting Uganda's PPP program, **Lawrence Kiiza,** Director Economic Affairs, Ministry of Finance, Planning and Economic Development noted that Uganda's infrastructure needs were estimated to be around $25 billion over the next 10 years and highlighted key challenges to infrastructure implementation, including limited capacity to develop, negotiate, and accurately estimate costs and revenue streams; lack of depth of the local financial market and sources of long term debt; inadequate legal and regulatory regimes; and inadequate public awareness and high public expectations. As an example, Kiiza presented an overview of the Bujagali Hydropower project, a 250 MW power generating facility developed under a PPP arrangement at a total cost of approximately $900 million. Kiiza further discussed lessons learned after the Uganda Electricity Transmission Company Ltd. failed to honor its obligations under the power purchase agreement for which the Government of Uganda had provided a sovereign guarantee. During a Question and Answer session, participants sought assurances that the government had fully taken on the lessons learned from the Bujagali Hydropower project. Kiiza explained that the government was building its internal capacity to undertake PPPs and exploring ways of transferring the lessons learned from its experience to other sectors such as water and transport. He identified delays in land acquisition as one of the key impediments to implementing infrastructure PPP projects. In relation to traffic risk in toll road PPPs, Kiiza highlighted the inability of project companies (or other stakeholders) to adequately forecast traffic volumes, thus imposing a strain on project revenues and creating a potential source of default. Traffic guarantees were suggested as a demand risk mitigant for toll road projects and off-taker guarantees for power distribution projects.

Session 6: Risks and Issues in Infrastructure projects

Neil Johnson moderated a panel discussion on the risks and issues in infrastructure projects comprising **Matthew Bull**, Senior Infrastructure Finance Specialist at the Global Infrastructure Facility, **Vivian Tsang,** Associate Managing Director and North Asia Head at Moody's Investor Service, and **Yasushi Kanzaki,** Vice President, Japan International Cooperation Agency. The presentations covered issues relating to demand risk, foreign exchange risk, refinancing risk and off-taker risk. During the individual presentations, JICA introduced its programs to support PPP projects through ODA loans; the GIF outlined approaches to reducing and managing traffic risk; and Moody's discussed credit enhancement instruments used by MDBs to increase bankability. Participants discussed how contingent guarantees contributed to uplift project bonds in the case of EIB's Project Bond Initiative, and the potential role of MDBs in catalyzing private finance. Linking the traffic risk discussion to the four country presentations, road PPP projects and their related risks were discussed by participants. Participants emphasized the importance of robust industry-standard traffic forecasting exercises and the critical need for both governments and developers to incorporate such exercises. In allocating traffic risks, the discussants also underlined the need to appropriately allocate and manage traffic risk according to the specifics of each project through careful project preparation and deal structuring.

In his closing remarks, Schwartz notified participants that the next Advisory Council meeting was scheduled to be held in October, 2016, during the Annual Meetings in Washington DC, and would be co-chaired by Citibank. The meeting was followed by a site visit to the Maglev magnetic levitation train, Changsha's flagship PPP project, and a dinner hosted by the China PPP Center.