ACCC/AER Regulatory Conference

RAB vs PPP

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Global Infrastructure

S&P Global Ratings

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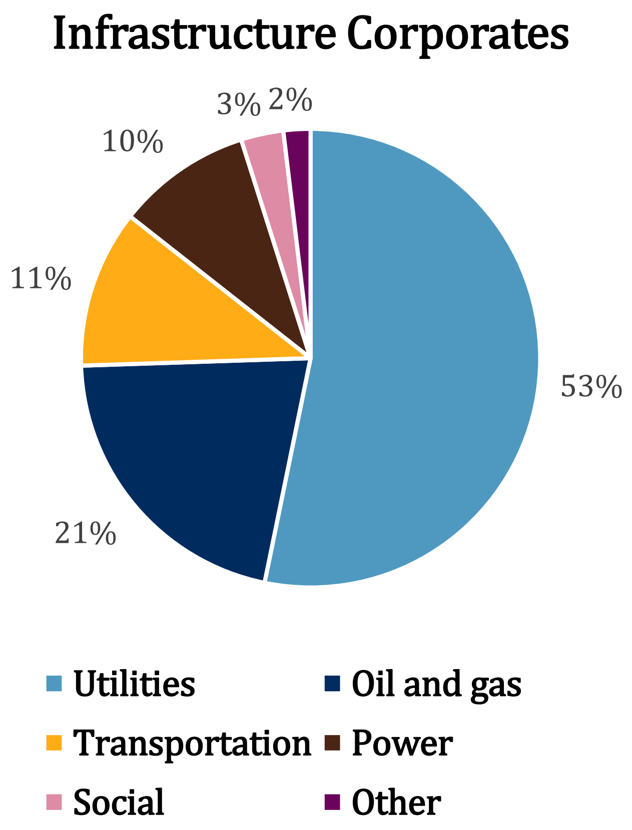
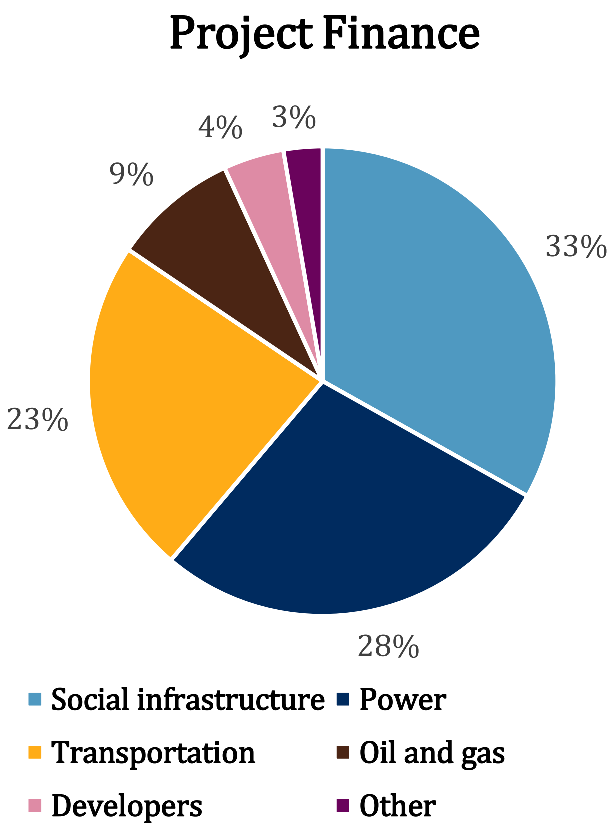
Does it matter?

Our Rated Infrastructure database comprises 77% ratings of Infrastructure Corporates and 23% Infrastructure Project Finance ratings as of 01 January 2017

Proxy for RAB



Proxy for PPP



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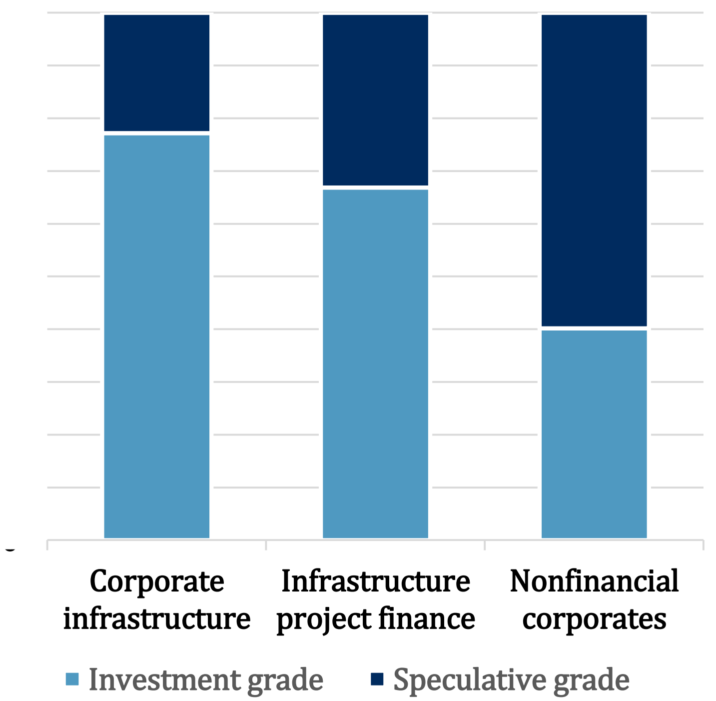
Does it matter?

Above credit quality than non financial corporates for both Corporates and Infra Projects

At the beginning of 2017, approximately two-thirds of active Infrastructure credits were rated Investment Grade

68% of Infrastructure Corporate ratings

60% of Project Finance ratings



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Does it matter?

Cumulative Default Rates for the 25Y period 1991-2016	Corporates	Project Finance
Investment Grade	2.5%	9.4%
Speculative Grade	7.1%	20.4%

RAB vs PPP

	RAB		PPP	
FRAMEWORK	Licence Risk and Regulatory Risk	⟷	Long Term Contractual Risk	LITIGATION
PERFORMANCE	Outputs focus – Investment, Service Levels	⟷	KPIs focus – availability	LIMITED UPSIDE
REVENUES	Price Limits	⟷	Pre set Remuneration	LIMITED DOWNSIDE
KEY RISKS	RAB Risk CAPEX and Demand Risks	⟷	Construction Risk O&M and Lifecycle Capex Risks	
EFFICIENCIES	Market Competition, Benchmarking	⟷	Initital Competition	
FUNDING	User charges	⟷	Tax payers	

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RAB vs PPP over time

Proper Institutional arrangements to manage RAB and price determinations

Inadequate process for intertemporal adjustments

Requires well functioning and reliable Regulatory Agencies that are

- Stable, Consistent, Predictable
- Transparent
- Independent
- Accountable

Benefits of locking in construction and maintenance costs

vs

Lack of flexibility to adapt to changes in political support, counterparty risk, technology, consumer preferences or expansión needs

The actors

Generally PPPs & Concessions not much different: same actors, same processes, same market structure (CONSTRUCTION GROUPS, SERVICES GROUPS, INFRA FUNDS)

- **Top actors active across sectors and countries**
- **Greater cross-border activity than for construction in General**
- **Project size influence on competition subject to national and wider market structure**
- **Project stage influences actors and competition**

PPPs can be standardized to some extent and can be financed long term to match finite term projects with known opex and capex profiles

From a rating perspective PF provides additional protections to lenders and thus allows for higher level of ratings generally at the same level of gearing (than a corporate).

Governments and Private finance are atracted to PPPs because…

PPPs can be used in countries with less institutional capacity (Emerging Economies) and can be packed easily in CLOs, comprising loans to projects, some of them in construction or in below Investment Grade Countries. Those PPPs might benefit from external credit support in the form of guarantees or insurance policies

Those protections include
- security packages,
- offtake agreements,
- hedging,
- reserve accounts,
- distribution traps
- legal separateness and
- limitations on new debt and asset sales

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When PPPs go wrong

Hands on Management

Authority

1

Operating Company

Authority

2

Deterioration of the relationship

Operating Company

over time

Unknowable events affect the bargaining power of the contracting parties over time, either the government or the supplier may find himself in a hold-up situation.

The infelicities and oddities inherent in long term relational contracts can spawn opportunistic behavior and render renegotiations ineffective

high deductions and penalties

litigation

Amey´s GBP208mn provision in Q1 2018 in relation to the Birmingham Highways 25Y PFI contract awarded in 2010 having lost a Court Case against the Birmingham City Council

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The RAB model is a better long-term strategic option to structure private participation in infrastructure investment. It breaks down the long-term uncertainty into shorter periods, which reduces the risk pricing challenge.

RAB offers a comprehensive solution to both risk pricing and the need for flexibility over the duration of the project. On the risk pricing side, the regulated company is free to match the infrastructure procurement format to the characteristics of the project, it does not need to subscribe to fixed cost/fixed-date arrangements as the default option.

Governments and Private finance are atracted to RABs because…

Through collecting information about the firm's performance and its renegotiation setup RAB is better equipped to handle potential hold-up situations than a PPP.

With regard to flexibility, the legal framework plus the regulator's role, building its capacity over time provide a much more balanced starting point for renegotiations than in PPPs

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In a broader context, the differentials in the performance of alternative models for infrastructure delivery remain poorly understood. This issue goes beyond the PPP versus RAB and affects infrastructure contracting in general.

Thank you!

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