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ממהרות כביש 1 ועד הרכבת הקלה בתל-אביב:
סיכום ביניים ומבט אל העתיד

Public Private Financing of Transport Infrastructure in Israel
An Outlook

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Paper in Progress

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The Macroeconomic Background

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GDP Growth in Israel has been around 3%/year in the last 4 years.

Deficit/GDP ratio in 2016 has been 2,1%, the same as in 2015; the target for 2017 and 2018 is 2,9%, but probably will be lower, due to increased economic growth.

Debt/GDP ratio decreased to 62%, a considerable result, compared to other countries.

However, the deficit estimates set by Government for 2019-2020 is a rising Deficit/GDP ratio of 2,9% and a likely further increase in the Debt/GDP ratio.

According to the Bank of Israel, however,"Since the expected deficit in the medium term is higher than the Government ceiling set by law, Government decisions on tax reductions or increased expenditures that will permanently increase the deficit must be accompanied by measures that will offset the increase in the deficit".

The Macroeconomic Background

Public transport investments have been one of the core direction that Government has undertaken to increase country productivity and growth, creating a decongested access to the main production areas of the country, namely the large cities.

Preference has been given to the development and maintenance of roads, but the policy objective is to strengthen the rail network among city centers, and to develop light transit systems within and around the main cities in Israel (Jerusalem – Tel Aviv – Haifa – Beer Sheva)

However, in the next few years, notwithstanding a manageable public financial sector, the fiscal space will leave reduced room to implement needed infrastructure projects. Therefore, Private Sector involvement will become pivotal in the realization of the Government infrastructure objectives, both in construction, financing, and operation and maintenance programs.

Main Issue in Transport Infrastructure Implementation

Main Issues in Transport Infrastructure Implementation

Israel is not different from many other countries when examining infrastructure project implementation.

- Frequent changes in project specifications brought by owner or contractor tend to delay implementation time and increase costs.
- Disagreement or lack of coordination between ministries or implementing agencies and contracting companies on project contractual interpretation.
- Delays in deciding appropriate procurement model (Budget or PPP)
- Optimistic estimates on project capex (ex post estimates tend to be higher than ex ante ones), completion time, traffic flows (demand analysis)
- Delays in tender publishing, bidding procedures and related decisions
- Announcement effect tend to increase uncertainty, increase in prices and reduce competition
- Changes in government priorities and decisions and overlap of project and political election cycles
- Greater competence in project preparation of central vs. local governments

Private Participation in Transport Infrastructure

Private Participation in Transport Infrastructure

- Israel has been quite active in developing major transport infrastructure by recurring to the private sector using project finance tools, within broad PPP schemes.

- This has been done using a dynamic PPP approach where the public sector takes a proactive attitude towards the private sector involved in a particular project.

- In fact, contrarily to most European countries, there is no general PPP legislation but for each project a specific legislation is enacted or a previous law is adapted to encourage and protect the private sector participation (Cross Israel Highway, Route 6, is a typical example).

- Contrary to Europe, there is no rigid PPP policy (what you can do is established by law)

Private Participation in Transport Infrastructure

Examples

Several PPP/PF models have been adopted in Israel:

- BOT: Route 6, Scheme with Traffic safety net and revenue sharing (center and northern sections)
- DB: Route 6 southern section (due to reduced traffic forecast) (budget).
- BOT: Route 431 Shadow tolling
- BOT: Jerusalem Light Rail (Red Line) – Safety net
- BOY or O&M: Jerusalem Light Rail (other Lines)
- BOT: Carmel Tunnels
- BOT: Highway 16
- BOT: Tel Aviv Fast Lane
- DB + O&M: NTA – Tel Aviv Light Rail (Unbundled)
- DB + O&M: Haifa – Beit Shean Rail (Unbundled)
- DB + O&M: Haifa – Nazareth Illit Light Rail (Unbundled)

In Europe, transport infrastructures have been awarded on a BOT basis with availability payment on light rail infrastructures or using EIB guarantees (LGTT), shadow tolls or fiscal tools (tax credits) on road infrastructures.

Why Private Involvement

Why Private Involvement

1. Accelerate Project delivery through
    a. Increase efficiency of private sector
    b. Financing
    c. Operation&Maintenance
    d. Life cycle optimization

2. Budgetary constraints
    a. Off balance sheet treatment
    b. Lack of public funds

3. Risk transfer and Value for Money

In Israel options 1 ad 3 are the main reasons while in several European countries option 2 prevails, i.e. Private Involvement in infrastructure is primarily driven by lack of public financing resources. EU directives limit grants to 30% of project costs.

Is it the optimal decision for Infrastructure Delivery?

Private Participation in Transport Infrastructure

Yes…

if there are budget constraints!

Yes, but…

- Need of a strong and competent Public sector to decrease asymmetric information between public/private sectors (detailed contractual, legal, technical documentation and a financial model)
- Allocation of risks must be carefully carried out (standing ex-ante and ex-post simulations).
- In certain models (BOT), capital expenditures are higher than in conventional procurements, due to bundling of risks on the private agent
- Value for money must be clearly defined in favor of the public sector
- Decision making speed by the public sector should be greater than in conventional procurement
- Financial close must be reached within a pre-set date (6-12 months) from concession contract award
- There is a need to have a clear definition of the role within competent ministries: the need to establish who is in charge MOF? MOT? PM Office?

Private Financing of Infrastructure Projects

Private Financing of Infrastructure Projects

Infrastructure funds

- Important role of infrastructure funds, such as Israel Infrastructure Fund and NOY, institutional investors, such as Insurance companies (Harel) or Pension funds: contrary to most European countries, they tend to participate in the greenfield phase of the project
- Important source of funds for Governments Infrastructure divestiture
- Presence of Infrastructure funds in PPP deals may mitigate possible opportunistic behaviors by contractors acting also as investors.

Banks , advisors and Financial Markets

- Israeli banking system supportive in granting long term financing (Hapoalim, Leumi, Discount, etc.) under PPP/Bot schemes;
- Good presence of financial and legal advisory firms operating on behalf of public and private sector; less conflicting role in advisors and lenders capacity;
- Capital markets (Project Bonds) have not been used so far, but at current level of interest rates, they could be an appealing asset class for institutional and private investors, and in this way freeing resources and regulatory capital from banking system
- Capital market securitization could also be enhanced by allocating public funds to create a "buffer" or "first loss" mechanism in project bonds issues (see EIB project bonds).
- No use of alternative tools such as Tax credits, Least Present Value of Revenues, Value Capture or Availability Payment mechanisms.

Private Financing of Infrastructure Projects

Infrastructure financing is carried out either with budgetary resources or with private financing (i.e. private equity and bank loans), often with demand protection on some projects, particularly in the road projects.

Looking at light rail projects, however, besides Jerusalem, they are financed on budget resources and contrary to several European cities, there is no attempt so far to introduce availability payments mechanisms.

Private Financing of Infrastructure Projects

Availability Payments

- So far availability payments have not been used as the Government support is primarily through demand safety nets and revenue sharing.

- Availability payments could enhance access to the capital market (more than a safety net guarantee), issuing Project Bonds and applying securitization techniques;

- Availability payments could help reducing dispute resolution on concession termination

- In largely congested area, such as Tel Aviv, where the demand risk could be minimal, availability payments mechanism could attract private sector financing and could trigger recourse to capital market product (Project Bond) and securitization techniques.

Private Financing of Infrastructure Projects

NTA Example

- Failure of Concession with Portuguese/German Consortium caused a recourse to a complete public funding of the project

- A complete unbundling using government resources is a *positive* development if:
  a. One can achieve a reduction in capex and completion times, giving the reduced bundling of risk on the private sector;
  b. The costs in setting up NTA functions do not exceed the potential capex reduction;

- On the *negative* side one should take into account:
  a. likely exposure to cost overrun by contractors
  b. full reliance on Government funds
  c. in complete unbundled models, the costs of creating an agency to coordinate and direct the interfaces among the various project functions could be high, and highly qualified human resources could be difficult to find

Private Financing of Infrastructure Projects

NTA Example

In NTA there is a great technical competence developed to coordinate the project functions interfaces. This expertise however could be used for the next lines in order to launch "controlled" BOT structures, i.e. where capex could be better controlled. Among the suggestions:

- Grants could be partially complemented with long term loans(US example) where the SPV refinancing could benefit both the private and public parties

- Flexibility in the use of public grants and availability payments: recent techniques in PPP governance such as the Milan Metro line 4 where Municipality is a shareholder in the SPV ,and IRR upsides of the private party could be structured in a neutral basis for the public administration.

- Availability payments, rather than demand safety net could enhance access to the capital markets

Private Financing of Infrastructure Projects

NTA Example

- Availability payments or demand guarantees require strong project monitoring to minimize potential budgetary impacts (management of contingent liabilities). Various actions could be contemplated to increase project revenues: shop concessions, parking facilities in strategic locations, feeder routes to main metro stations, joint real estate developments with the private sector in areas adjacent to the metro lines, congestion charges, reducing parking spaces in office buildings close to the stations etc.

- On the current red line there is little to do. A possible privatization of NTA in the future could be contemplated to recoup part of the government contributions.

- The above suggests that in dealing for optimal PPP structure there is a need of certain flexibility in the management of public funds, in order to maximize the benefit of public intervention.

- Related to the better efficiency of public fund management there is a growing debate on governance of PPP schemes, particularly when large part of the project is funded with public funds (grants or long term loans)

Conclusions

Conclusion

Israeli PPP experience seems satisfactory but there is room for improvement:

- **Public Finance is in good shape**, and thus it is better to shift infrastructure financing to market forces, and freeing public resources to other government needs
- Greater focus in **capex control and reduction** in project costs: this could be achieved by reducing the information asymmetry between the public and private party, and have a strong public body driving the project process with detailed technical and financial information.
- Develop an **Infrastructure Agency** (such as Infrastructure Ontario or Infrastructure UK), which should be managed as a private entity, with power to decide and accelerate infrastructure delivery from bidding stage, procurement model and financing modes. The agency should have power to reject public funded projects, if the estimate capex cost is not appropriate. This to avoid further budget appropriation if the project budget is not sufficient and shortening the decision-making timing on the procurement model (Budget or PPP)
- Enhancing flexibility in **public funds management** (from grants to long term interest free loan, to Project bond, to fiscal tools to LPVR,to public/private concessionnaires)
- Develop a **project capital market** (Project bonds), particularly in refinancing of construction loans and project **securitization "buffer"** to enhance use of public funds as a mezzanine buffer for project bonds issuance, or to create a **public funded monoline insurance**;
- Greater attention to the use of **availability payments** and management of contingent liabilities;
- More attention to **Governance** issues in PPP (Public private JV) and dispute resolutions

Thank you

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