

POVNET: Infrastructure Financing

Current Initiatives, New Opportunities

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What donors say :

- **Problems of financing infrastructure**
- **Sector-specific considerations**
- **Key issues for new financing mechanisms**
- **Recent innovations**

Opportunities and priorities for further development

- **Differences between large and small scale projects**
- **Where international and domestic financing coincide**

What donors say: Overview

- Most respondents attribute difficulty in raising investment capital (domestic **and** international) to regulatory and institutional weaknesses:
 - In domestic financial sectors, including capital markets
 - In infrastructure sectors and regulatory frameworks
- Principal focus of donor interventions is on institutional strengthening, creation of enabling environments, improving investment climate, financial sector reform
- Several new investment funds/vehicles are being established, with emphasis given to innovative mechanisms for distributing risk in larger projects
- Approaches to decentralisation, financing of O&M, governance, tariffs and subsidies focus on pro-poor and service-delivery objectives but make few linkages with investment financing

Problems of financing infrastructure in context

Strong donor consensus on the critical issues:

- Decline in ODA and public sector spending on infrastructure in the '90s not matched by increases in private sector spending
- Decline in investment leading to increasingly delapidated infrastructure, especially in LDCs
- Scale of investment needs exceeds appetite of investor community for infrastructure projects
- Absence of reliable measures of infrastructure investment needs
- Investor preferences for:
 - Energy and telecomms
 - Middle income countries (especially Asia and Latin America)



Areas of greatest need for achieving pro-poor objectives probably the hardest to address

Problems of financing infrastructure	
Problems Identified	Some Specific Issues
1. Institutional barriers to mobilising equity and long term debt in domestic financial markets	<ul style="list-style-type: none"> • Immature domestic capital markets • Low domestic liquidity • Weak legal, regulatory and policy frameworks • Complex/costly administrative processes, Institutional conflicts
2. Weak institutional capacity	<ul style="list-style-type: none"> • Weak domestic financial institutions (esp. intermediation functions) • Weak government institutions for mobilising/ coordinating resources and initiatives • Inadequate regulatory capacity • Weak domestic institutional investors
3. Absence of enabling framework for private investment in infrastructure	<ul style="list-style-type: none"> • Inadequate or ambiguous regulatory framework
4. Unattractive project financing profiles: absence of "bankable" project pipeline	<ul style="list-style-type: none"> • High project preparation costs • Future revenue stream constraints (unaffordability of service for poor consumers) limits investment-recovery potential • Lack of investor protection against future revenue stream
5. Insufficient protection for investors against risk	<ul style="list-style-type: none"> • Large number of risk elements factored into project assessments, many not currently manageable (eg country/ political risks; sector-specific; unquantifiable social & environmental risks) • Inadequate mechanisms for apportionment of risk
6. Governments give low priority to infrastructure within PRSPs	<ul style="list-style-type: none"> • Sectoral ministries take marginal role in national planning processes
7. Global trends in infrastructure not conducive to investment in DCs and LDCs	<ul style="list-style-type: none"> • Most attractive privatisations already concluded • Consolidating infrastructure corporates now focusing on performance improvement, not on new investment and geographic expansion

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Sector specific considerations (1)
<p style="text-align: center;">Transport</p> <ul style="list-style-type: none"> • Investment requirements dwarf domestic resources • Inadequate budget allocations and local administrative capacity to manage funding (investment, O&M) for rural roads • Imbalance in fundraising potential from local sources (tax revenue, voluntary labour contributions) between affluent and poor areas • Inaccurate traffic forecasts give unreliable revenue projections • Tariffs designed to address affordability do not match investors revenue expectations (and sometimes do not achieve cost-recovery) • "User pays" principle difficult to implement for road transport • "Beneficiary pays" approach to road funds most complex in poor/rural areas where difficult to identify beneficiaries • Public opinion sees road transport as a public good that should be provided free of charge by the state

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Sector specific considerations (2)

Energy

- Investment requirements dwarf domestic resources
- Sector structures unstable (subject to regulatory change)
- Tariff structures designed to address affordability do not match investors revenue expectations (and sometimes do not achieve cost-recovery)
- Difficulty in implementing cost reduction through controlling “non-technical” losses
- High up-front costs for alternative (renewable) energy sources

ICT


- Reluctance to invest in network expansion in rural/poor areas where population densities low and customer profitability rates unattractive
- Least developed countries particularly unattractive (low telephony penetration rates)

Water and Sanitation

- Prices do not reflect costs in all sectors
- Subsidies not targeted towards poor; ineffective cost-recovery from users who can afford service
- Political resistance to raising water prices

Key issues for new financing mechanisms*

Four principal themes:

Scope of PPPs / key trade-offs	Capital market development	Risk mitigation	Sub-sovereign development
<ul style="list-style-type: none"> • Risk levels and risk distribution • Achievable efficiency levels by sector • Rent levels remaining with operators <p style="text-align: center;"></p> <p>Higher risk levels in LDCs may warrant different risk-allocation profiles from Developed Countries</p>	<ul style="list-style-type: none"> • Linkage between local institutions and infrastructure reform • Linkage between financial institution strengthening and mobilisation of infrastructure investment (domestic and intl.) 	<ul style="list-style-type: none"> • New risk mitigation products to mobilise private capital • Governance structures of financing vehicles for infrastructure • Allocation mechanisms for currency and regulatory risks can be applied to and help reduce infrastructure-related risks • Auditing capability and accountability of institutions is correlated with creativity in financial design 	<ul style="list-style-type: none"> • Sub-sovereign fiscal capability • New instruments needed for credit enhancement/ improved creditworthiness at project and local government level

*Source: Estache, INFVP, World Bank August 2004

Recent innovations			
A number of innovative mechanisms address 4 areas of need			
Mobilising Finance	TA for Institutional Strengthening	Risk Mitigation and Guarantee Schemes	Project Pipeline Development
<ul style="list-style-type: none"> • Development Credit Authority (DCA) – USAID • Infrastructure Development Co Ltd (IDCOL) • Emerging Africa Infrastructure Fund (EAIF) • Community Led Infrastructure Finance Facility (CLIFF) • Various sector-specialist funds - KfW • Asia Private Infrastructure Financing Facility (AsPIFF) - in development • CDC Globaleq - UK 	<ul style="list-style-type: none"> • Public-Private Infrastructure Advisory Facility (PPIAF) • Technical Assistance Fund (TAF) • Foreign Investment Advisory Service (FIAS) 	<ul style="list-style-type: none"> • Local currency hedging – PIDG feasibility study • GuarantCo (not yet launched) • Currency swaps, local bond issues (project-specific) ADB • Garanties d'émission obligataire - AFD 	<ul style="list-style-type: none"> • Private Sector Infrastructure Development Project (PSIDP) • Infrastructure Investment Facilitation Centre (IIFC) • African Infrastructure DevCo - IFC • Global Partnership on Output Based Aid (GPOBA) • Public Private Partnership for Urban Environment – UNDP • InfraCo - DFID • Slum Upgrading Facility (SUF) - DFID in development
<p>Programmes are multi-donor unless otherwise specified Facility details in Annex</p>			
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Recent innovations		
<p>Few initiatives have an explicitly pro-poor focus in mobilising investment for infrastructure</p>		
<table border="1" style="width: 100%;"> <thead> <tr> <th>Pro-Poor initiatives</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> • Rural Electrification Boards (RUB) (Japan: Example from Rural Electrification Programmes, Bangladesh) • Slum Upgrading Facility (SUF) • Global Partnership on Output Based Aid (GPOBA) </td> </tr> </tbody> </table>	Pro-Poor initiatives	<ul style="list-style-type: none"> • Rural Electrification Boards (RUB) (Japan: Example from Rural Electrification Programmes, Bangladesh) • Slum Upgrading Facility (SUF) • Global Partnership on Output Based Aid (GPOBA)
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Differences between large and small projects

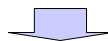
Distinct approaches are emerging for large and small scale projects

Large Scale

- Main target for most innovative donor-sponsored financing mechanisms
- Focus on attracting FDI overshadows pro-poor targeting objectives:
 - access
 - affordability
- PPP development focus largely on syndication issues and risk apportionment
- Project design driven by macro-level view (engineering, financing)

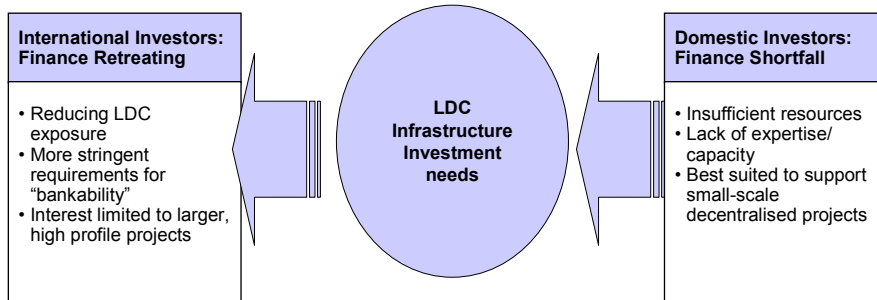
Small Scale

- Main target for domestic sub-sovereign financing mechanisms
- Greater prominence given to pro poor objectives:
 - Community participation in project design and tariff setting
 - Decentralisation of decision-making and governance
- Examples of creative valuation of non-financial inputs (local labour; collateralisation of land assets)
- Project design driven by local development needs



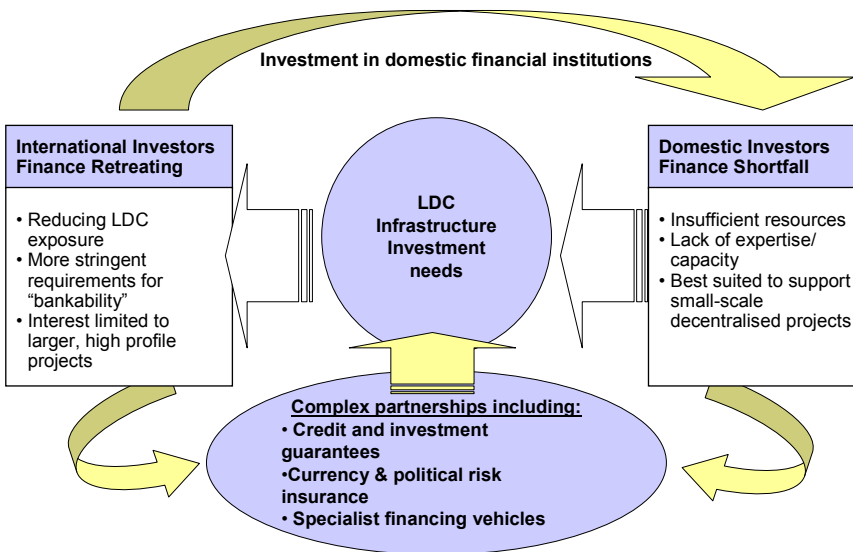
- Both large and small scale projects are demanding increasingly sophisticated project definition and deal-structuring approaches
- Opportunities exist to combine approaches and innovations in both categories to ensure pro-poor objectives are addressed – but the process must be managed

Where international and domestic financing coincide



Where international and domestic financing coincide

Two indirect routes to bridging the gap?

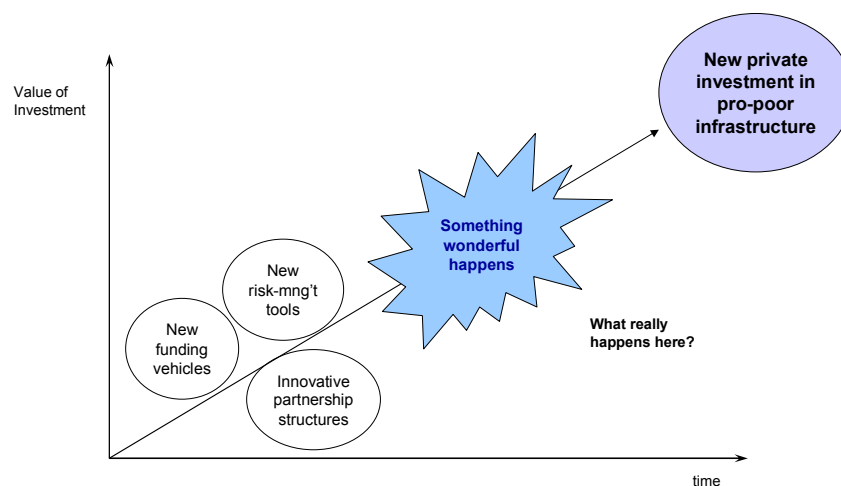


Outstanding issues: Identifying the challenges

- **Projects vs Partnerships:**
Donors tend to fund “stand-alone” investment components. Participations in PPPs (equity, debt) could contribute to lower project risk profiles
- **Investment vs. Maintenance:**
Donors could focus more on promoting mechanisms that ensure adequate finance for O&M
- **Few linkages** between interventions aimed at improving finance mobilisation and pro-poor interventions. Some exceptions:
 - USAID Development Credit Authorities
 - KfW ICT operator subsidies for rural network expansion)
- **Risk mitigation** initiatives focus on project risk, but omit management of partnership risk
- Large literature on **PPPs** focuses mainly on:
 - Financing structures
 - Governance
 - Risk apportionment between lead (FDI) investor and Government
- Little attention given to **marketing/promotion** of innovative approaches to (domestic/international) investor community and commercial financial institutions

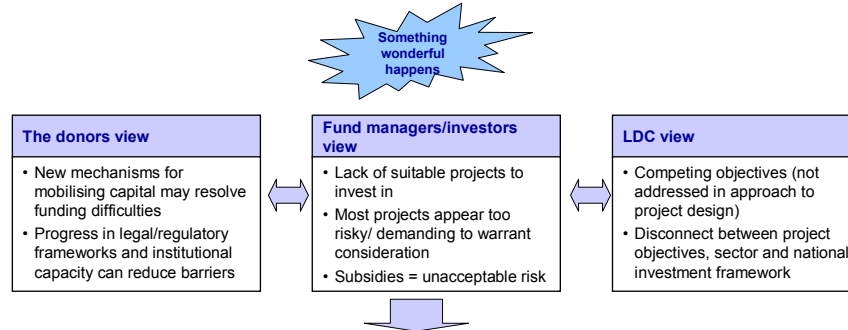
Making Private Investment in Infrastructure Real

There is still a large area of uncertainty



Closing the gap between needs, opportunities and investors

Can the views and contributions of all parties be helped to converge?



A key challenge is managing the process in a complex environment:

- Increasingly sophisticated approaches to deal-structuring and marketing needed
- Innovations in funding, risk management, pro-poor interventions not yet packaged/promoted in terms investors can easily evaluate
- More attention needed to linking innovative mechanisms to specific projects and to managing the process of deal-structuring
- Soft issues and qualitative objectives are hard to measure and manage in a quantitative environment

Appendix 1

Profiles of financing and other innovative mechanisms

Innovative Mechanisms: Mobilising Finance

Development Credit Authority (DCA) (USAID)

- Mobilises finance, shares risk between private banks and investors
eg mobilises funds through domestic bond issues for municipal finance

Community-Led Infrastructure Finance Facility (CLIFF)

- Piloted in India, provides bridge finance and technical assistance to community-led urban regeneration projects.. www.theinclusivitycity.org/cliff.htm

Private Sector Infrastructure Development Project (PSIDP) (Multi-Donor)

- Infrastructure Investment Facilitation Centre (IIFC) : a private sector company working with governments to develop projects for PSP/PPP
- Infrastructure Development Co Ltd (IDCOL) – uses international finance to encourage private sector investment through co-financing and other incentive-based options

Emerging Africa Infrastructure Fund (EAIF) (Multi-Donor)

- Fund provides long-term lending on commercial terms to private infrastructure projects in Sub-Saharan Africa. www.emergingafricafund.com

Specialist Funds (KfW)

- Fund for Securing Investments for Financing Geothermal Energies
- KfW Carbon Fund through Clean Development Mechanism
- Feasibility studies to mobilise funds from ICT operators through subsidies to promote basic network expansion in rural areas.
- Sub-sovereign lending for decentralisation and commercialisation of utilities.

AsPIFF

- PIDG is commissioning a feasibility study for a new infrastructure debt fund for Asia
Contact: j-hodges@dfid.gov.uk.

Innovative Mechanisms (TA for Institutional Strengthening)

PPIAF (Multi-Donor)

- Advises governments on improving the enabling environment (policies, laws, regulations and institutions) for private sector participation in infrastructure. www.ppiaf.org

Technical Assistance Fund (TAF) (Multi-Donor)

- Local Capacity Building Technical Assistance Fund provides grants for local capacity building alongside projects funded by PIDG facilities.

Foreign Investment Advisory Services (FIAS) (Multi-Donor)

- TA to streamline processes and regulatory frameworks to promote investment and mobilise local capital.
- Strong focus on land reform and collateralisation of assets, not specifically for infrastructure.

Innovative Mechanisms (Risk Management and Guarantee Schemes)

GuarantCo (Multi-Donor)

- Provides guarantees to encourage local currency funding of infrastructure investment by domestic financial institutions and municipalities. Contact: siansson@guarantco.com

Garanties d'émission obligataire (AFD)

- With Proparco, currency swaps and hedging facilities

Local currency hedging

Following a scoping study, the PIDG is commissioning a feasibility study of how to strengthen the availability of local currency hedging instruments.
Contact: C-lutyens@dfid.gov.uk.

Local currency financing (ADB)

- Currency swaps and local bond issues
- Project specific instruments to eliminate currency risk for private borrowers

Innovative Mechanisms (Project Pipeline Development)

DevCo Advisory (Multi-Donor)

- Project development facility, operated by the IFC, which provides transaction advice to governments on bringing in private ownership and investment into infrastructure. Contact: ddonaldson@ifc.org

Private Sector Infrastructure Development Project (PSIDP) (Multi-Donor)

- Infrastructure Investment Facilitation Centre (IIFC) : a private sector company working with governments to develop projects for PSP/PPP

InfraCo (DFID)

- A new project development company – to be funded by PIDG and privately managed – that will put together infrastructure projects to the stage of being financeable, and then tender these to private investors. Contact: j-hodges@dfid.gov.uk.

Innovative Mechanisms (Pro-Poor Focus)

Rural Electrification Boards (RUB) (Japan: Example from Rural Electrification Programmes, Bangladesh)

- Rural electrification co-operatives receive initial investment funds from RUB
- Facilities owned by co-operatives
- Incentives for achieving high tariff collection rates include improved operations (under contractual terms with RUB)

Public-Private Partnership for the Urban Environment (UNDP)

- Promotes collaboration between municipalities, business and civil society for the delivery of infrastructure services to the urban poor. www.undp.org/ppue

Slum Upgrading Facility (DFID)

- Provides technical assistance, capacity building and bridge finance to municipalities and local NGOs and CBOs to design projects for financing by public, private or donor sources.
- Contact z-hensby@dfid.gov.uk

Global Partnership on Output Based Aid (GPOBA) (Multi-Donor)

- Supports the design and piloting of performance-based approaches for targeting public funding on the delivery of basic services to the poor. www.gpoba.org

Appendix 2

Summary of consolidated donor questionnaire returns

Problems of Financing Infrastructure (1)							
Institutional barriers to mobilising equity and Long Term Debt in domestic financial markets							
	Japan	KfW	USAID	SIDA	DFID	SECO	AFD
Issue Cited	✓	✓	✓	✓	✓	✓	✓
	<ul style="list-style-type: none"> • Immature capital markets • Weak financial intermediation capabilities • Low domestic liquidity (domestic savings frozen in non-performing loans to SOEs and/or absorbed by government bonds) 	<ul style="list-style-type: none"> • Insufficient donor pressure on government to mobilise national resources • No fiscal decentralisation aligned with administrative decentralisation: local financial resources untapped; lack of reliable local contract partner 	<ul style="list-style-type: none"> • currency mis-matches, • lack of domestic banking capacity, • lack of domestic institutional investor capacity to mobilize sufficient funds, 	<ul style="list-style-type: none"> • No additional comment 	<ul style="list-style-type: none"> •No additional comment 	<ul style="list-style-type: none"> •No additional comment 	<ul style="list-style-type: none"> •No additional comment
Additional Comments							

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Problems of Financing Infrastructure (2)					
Institutional barriers to attracting equity and long term debt from international investors					
	DFID	KfW	USAID	AusAid	Japan
Issue Cited	✓	✓	✓	✓	✓
	<ul style="list-style-type: none"> • Bureaucratic barriers deter private sector entrants 	<ul style="list-style-type: none"> • Regulatory frameworks weak • Risk of regulatory capture by interested parties 	<ul style="list-style-type: none"> • Weak legal, regulatory and policy frameworks • Administrative bottlenecks • Public sector corruption • increase in equity risk premium for forex investors in emerging markets, • oecd institutional investor dis-interest in emerging market infrastructure asset financing, • limitations of official and other credit enhancement schemes offered by donor agencies and banks (offerings inadequate or insufficient to attract private finance due to "market" perception of limitations of programs and empirical experience showing official program schemes, and co-financing, often do not provide the degree of protection implied) 	<ul style="list-style-type: none"> • Weak policy frameworks • Weak governance structures • Poor accountability 	<ul style="list-style-type: none"> • Cherry-picking of projects by region/sector: difficulty in attracting investors to rural/poor areas or network expansion • Instability of FDI (global capital mobility)
Additional Comments					

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Problems of Financing Infrastructure (3)						
Weak institutional capacity						
Issue Cited	DFID	Japan	AFD	AusAid	KfW	DCI
	Additional Comments	✓	✓	✓	✓	✓
	<ul style="list-style-type: none"> Local institutions (financial and government) lack capacity to develop and implement infrastructure projects (especially with complex private sector participation) 	<ul style="list-style-type: none"> Weak financial institutions and systems Weak policy-formulation capability 	<ul style="list-style-type: none"> Domestic financial institutions lack capacity to raise and distribute domestic investment 	<ul style="list-style-type: none"> No additional comment 	<ul style="list-style-type: none"> No additional comment 	<ul style="list-style-type: none"> No additional comment

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Problems of Financing Infrastructure (4)					
Absence of enabling framework for private investment in infrastructure					
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Problems of Financing Infrastructure (5)

Other (Cited by only one respondent)

DCI

Governments give low priority to infrastructure within PRSP

- Sectoral ministries don't engage in national planning processes (reliance on capital budget support from international institutions).

SECO

Global trends in infrastructure not conducive to new investment in DCs and LDCs

- Consolidation of large private sector players: fewer entities promoting new projects.

AFD

Scale of investment needs

- FDI interests not aligned with investment needs
- Inadequate provisions for O&M finance