Attracting Private Sector Involvement in Mega Rail Infrastructure Projects

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Introduction

- Rail is a strategic sector
- Growing demand for freight and passenger rail – but who pays?
- Government constraints
- Can the private sector carry the burdens?
- Advantages, disadvantages and constraints for the private sector
Assessing the inherent constraints of governments to fund mega rail infrastructure projects

- Cash accounting and rarely enough cash
- Inefficiencies in the Public Sector
  - Build
  - Operate
Reviewing market readiness for private sector participation in rail projects

- Who participates?
  - Manufacturers
  - Operators
  - Banks and other financial institutions
  - Venture capitalists
Reviewing market readiness for private sector participation in rail projects

• The developing PPP environment
• But
  – Economics do not always work
  – Increased “Basel” capital requirements on banks
  – Crack-cocaine? When will the securitisation market re-awaken?
• Need more imaginative solutions than BOT
Private sector Participation in Rail Projects

• Definitions:
  – Construction contracts and credit
  – Debt financing (security?)
  – Farebox or other asset securitisations
  – Sales Aid finance
  – ECA financing
  – Selective finance and operating leasing
Private sector Participation in Rail Projects

• Definitions:
  – PPP “delivery structures”
    • BOT – Build Operate Transfer
    • BOO – Build Operate Own
    • BOOT – Build Own Operate Transfer
Classic BOT Structure (simplified)

- **Government**
- **Lenders / ECAs**
- **Shareholders**

**Concession**

**Equity / financial support**

**Consortium**

**Build and deliver**

- **Infrastructure**
- **Rolling Stock**

**Loans**

**Equity**

**Operations**

- **Maintenance**
- **Operations**
Private sector Participation in Rail Projects

• Advantages
  – Takes the project “off balance sheet”
  – Pay as you go freeing resources for other government obligations
  – Mechanism to build efficiently
  – Transparency and discipline
  – Honest accounting
  – Convenient for government
  – Allocates project and operating risk between public and private sector
Private sector Participation in Rail Projects

• Disadvantages
  – How to deal with the separation of infrastructure and operations
  – Reduces government flexibility - and control
  – Service public
  – Difficult to evaluate optimum structures
  – Building in profit margins
  – Heavy contracts
Private sector Participation in Rail Projects

• Constraints
  – Differentiating rail projects
  – Need to factor in general environment, social and economic benefits
  – Long term capital (thin market)
  – Political risk and interference
  – Heavy transaction risk
Private sector Participation in Rail Projects

• Constraints – assessing asset risk
  – Build delivery
  – Specifications mismatch
  – Asset valuation and obsolescence
  – Financing costs
  – Operating risks
  – Third party liabilities
Private sector Participation in Rail Projects

- Constraints – allocating risk
  - Who should carry the risks within the consortium and the problem of cross contamination
  - Transferring risk out
  - Subcontractors
  - Buy backs and guarantees
  - Leases
Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Building risk – higher than operating risk
- Sufficient legal and regulatory infrastructure
- Tackling bribery and corruption
- “Luxembourg” solutions
THE LUXEMBOURG PROTOCOL TO THE CAPE TOWN CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

Agreed in Luxembourg 2007

Participants from 42 States and 12 international organisations at the Diplomatic Conference
Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- Luxembourg Rail Protocol – a new strategic tool for the public and private sector
- Providing a new pragmatic global regulatory framework which will
  - facilitate more and cheaper private sector investment in the railways
  - lower barriers to entry to private operators
  - stimulate a more competitive and dynamic industry
Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

• BOT and other project financings: Is it better to deconstruct vertically?
  – Can provide customised solutions and flexibility to operator
  – Leverages in future “Luxembourg” benefits
  – May maximise tax benefits
  – Facilitates multiple use of rolling stock
  – Focuses on credit lines and government support where absolutely needed
  – Efficient allocation of risk

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Addressing issues to attract uninterrupte
capital flows through Public Private Partnerships

- BOT and other project financings: Is it better to
deconstruct horizontally?
  - Allocating franchises after build
  - May minimise funding costs
  - Separates the builders from the
    consolidators
  - Provides government (agency)
    project and finance flexibility
Addressing issues to attract uninterrupted capital flows through Public Private Partnerships

- BOT and other project financings: does integrated finance make sense?
  - It depends on the circumstances
  - ... And government objectives
  - Probably not the cheapest solution
  - What governments are doing is trading convenience and expertise – the integrated solution – against cost and flexibility
Conclusion

• Private capital is urgently needed to supplement classic state structures for financing rail infrastructure

• Private sector provides solutions but have their own constraints

• BOT and other private sector project financings are not a “magic pill” – they provide a convenient one stop shop but not always the best solution
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