

MOBILIZING PRIVATE
CAPITAL
FOR INFRASTRUCTURE

Lessons for Governments,
Private Investors, and Multilateral
Development Banks

**Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library**

Inter-American Development Bank.

Mobilizing private capital for infrastructure: lessons for governments, private investors, and multilateral development banks / Inter-American Development Bank.

26p. 20 x 20 cm. — (IDB Monograph ; 550)

1. Infrastructure (Economics) — Case studies. 2. Development Banks — Case studies. I. Inter-American Development Bank. Office of Strategic Planning and Development Effectiveness. II. Mobilizing private capital for infrastructure: lessons for governments, private investors, and multilateral development banks. III. Global Infrastructure Forum. IDB-MG- 550

JEL Codes: Q0; Q2; Q4; R0.

Other keywords: 2017 Global Infrastructure Forum, multilateral development banks, public-private partnerships, private capital mobilization.

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This document, prepared by specialists from the Inter-American Development Bank, is meant to serve as a brief summary of the main conclusions of the 2017 Global Infrastructure Forum, illustrated by just a few of the many interesting case studies that were presented at the day-long Forum. It is by no means intended to be an exhaustive account of the event. For further information, detailed case studies, and a wide variety of reports that were prepared for the Forum, please visit: <https://pppknowledgelab.org/2017giformum>.



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INTRODUCTION

The Global Infrastructure Forum (GIF) is the flagship event on collaborative financing for infrastructure development in support of the United Nations' Sustainable Development Goals. The forum is jointly organized by the multilateral development banks (MDBs) in close partnership with the United Nations. The 2017 forum was co-hosted by the European Investment Bank and the Inter-American Development Bank.

This report presents lessons from the 2017 GIF on mobilizing private capital for infrastructure projects. The report is organized to correspond to the four distinct but related aspects of project development: (1) proposal design, (2) bankability, (3) sustainability, and (4) risk mitigation.

Panelists noted that institutional weaknesses and political uncertainty at the country level are the main deterrents to infrastructure investments. This document outlines recommendations from the final GIF session on how MDBs can support countries in overcoming these challenges and mobilizing resources for infrastructure projects.

PROPOSAL DESIGN

1. Engage All Parties and Address All Objectives from the Earliest Stages of the Project

Addressing objectives such as sustainability and private sector bankability from the earliest stages of project preparation is critical to ensuring success. Retrofitting those characteristics onto an already prepared project will always be more challenging than planning them from the beginning.

For example, Costa Rica's strong commitment to sustainability made protecting the country's rich biodiversity a key priority from the earliest stages of the IDB Group's [Reventazón Hydroelectric Project](#). Taking environmental concerns into account early in the planning process allowed for building innovative features such as the "jaguar corridor" into the project design, according to Inter-American Investment Corporation Chief Investment Officer Gema Sacristán.

2. Start by Thinking about Standardization and Replicability

The cost of evaluating the technical and financial aspects of a unique infrastructure project is a major barrier for private capital looking to invest in emerging market infrastructure. MDBs can lower these costs by standardizing project design, finance, and reporting. Given the importance of standardization and replicability, specialists preparing projects should be thinking at each stage: Is this a replicable model? Standardized and replicable projects provide the dual benefit of lowering preparation costs for MDBs and making projects more palatable to investors.

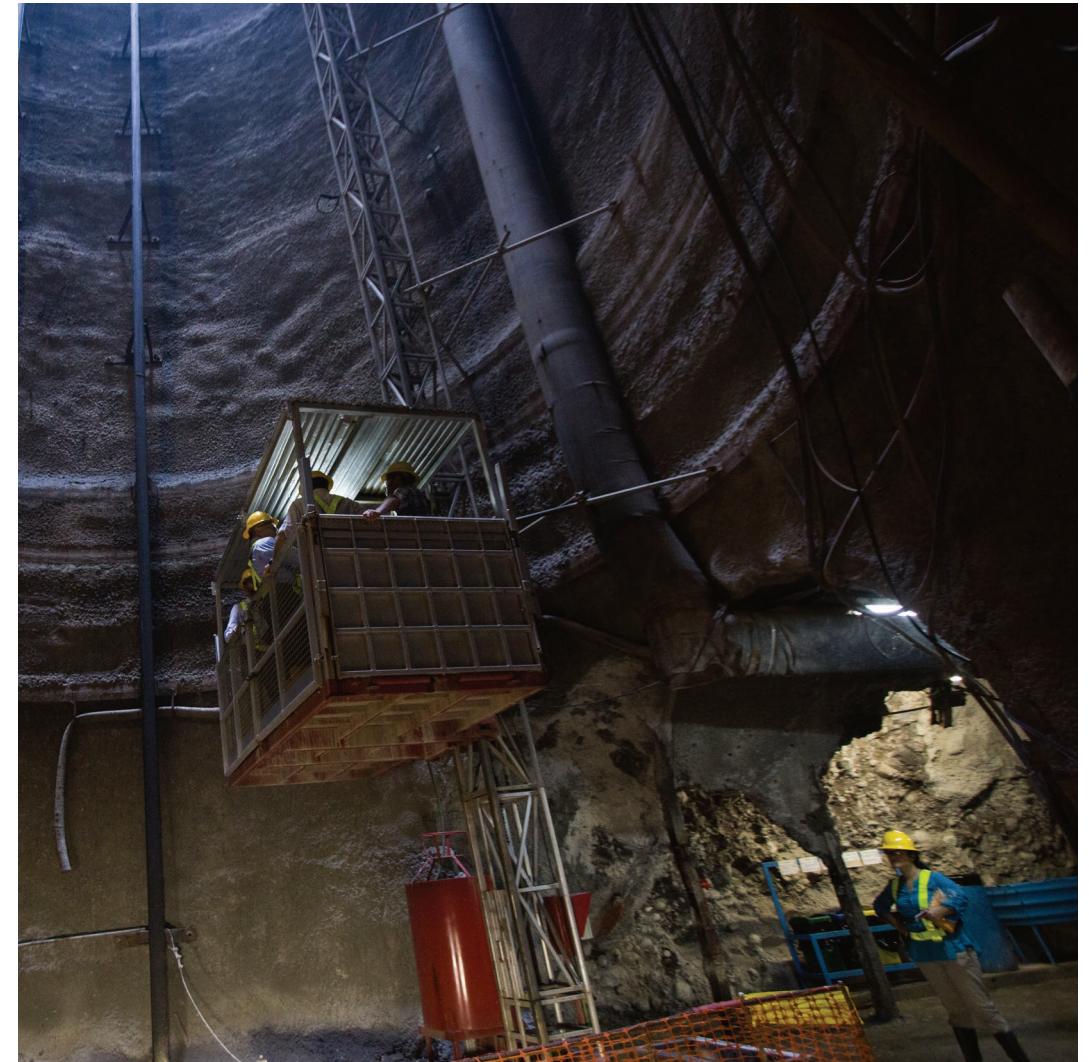
How can we improve project standardization? One way is by using standard preparation platforms like [SOURCE](#). The Chilean government has found that using SOURCE has helped streamline project preparation and made projects more attractive to investors, according to Christina Holuigue of Chile's Ministry of Public Works.

The International Finance Corporation (IFC) has made substantial efforts to standardize renewable projects in Africa. For example, the [Scaling Solar Project](#) has brought solar energy to many African countries at a low price partly because the standardization of the project process and agreements made the project consistent and transparent in the eyes of investors, according to IFC Director Bernard Sheahan.

Reventazón Hydroelectric Power Project, Costa Rica.

The Project will use the waters of Reventazón river to generate approximately 1573 GW/h of electricity per year. The energy produced by the Project will be used by ICE to supply the increased demand for electricity in Costa Rica.

Inter-American Development Bank



3. New Sectors and Emerging Markets Have the Greatest Opportunities to Standardize Infrastructure Projects

Some of the best opportunities to develop standardized infrastructure projects are in emerging markets and industries where financial, regulatory, and physical infrastructure systems can be developed from scratch rather than superimposed on legacy systems. This allows for optimal implementation of international best practices.

Despite careful planning and proof of success in England, the IFC faced immense difficulties trying to superimpose a set of well-designed public-private partnership standards from the United Kingdom onto Egyptian law, according to IFC Director Sheahan. Pre-existing legal and market structures made harmonization with a pre-written contract challenging.

By contrast, the Scaling Solar project was successful precisely because many of the beneficiary countries had limited existing power grids or markets. This meant that the legal, economic, and physical infrastructure to support the investment could be built from the ground up in a way that supported further development of renewables. Standardization of projects such as Scaling Solar helps lower costs, attract outside investments, and prepare countries for the future.

BANKABILITY

1. Projects with Built-in Cash Flow Are the Most Attractive to Investors

When thinking about whether a project is bankable, the first thing MDBs should be asking themselves is “will people pay to use it?” Investors are far more confident in returns when projects have a built-in set of users who are willing to pay. Infrastructure such as power plants, airports, and ports all

have built-in, fee-for-service elements. Infrastructure with more public good characteristics, such as roads, can be harder to fund. Even with toll roads, there are often concerns about toll evasion and usage levels.

2. Liquidity During the Investment Phase Is a Concern for Investors

A common private sector concern about infrastructure projects is the long initial investment period. From a financial perspective, the problem is two-fold. First, the construction period for large projects is very long and typically produces no revenue. Second, even when projects are completed, it may be years before they generate positive cash flows (assuming the project relies on user fees). This extended payback period diminishes project liquidity and amplifies political risk, since the project might span multiple election cycles.

MDBs could work to solve this problem by developing financial instruments that ensure the flow of funds during the planning and investment phase of an operation. The Elazig Hospital Project in Turkey employs this arrangement. For the bonds funding the PPP, the EBRD provided a liquidity facility covering both the construction phase and the litigation phase of any potential investor dispute. Moody’s Senior Vice President Andrew Davison noted that in Moody’s analysis of the project, the EBRD’s guarantees were critical for securing an investment-grade rating.

Another way investors have overcome the investment-phase liquidity problem is by investing in projects that are a combination of brownfield and greenfield assets, according to Kevin Lu of Partners Group (PG). One such PG project was a gas field in Mexico. The field had existing capacity and a pipeline that was already generating a continuous revenue stream from the initial investment when PG invested in expanding extraction and pipeline capacity to increase the value of the asset.

3. Government Priorities Matter – Projects with Strong Commitments Have a Better Risk Profile

Even after a project generates cash flow, political risk is a major concern for investors, particularly risk associated with a government’s commitment, or lack thereof, to a project or sector. Demonstrating a stable and long-term commitment, especially one that is widely supported across the political spectrum, can be an attractive feature for investors.

For example, Meridiam had access to bid on a wide variety of projects across Turkey as part of the country’s infrastructure boom. Indeed, CEO Thierry Déau recounted being solicited several times to bid on the Bosphorus Tunnel Project. The reason Meridiam chose the Elazig Hospital Project rather than the tunnel project was because the government’s political commitment to build the hospital boosted Meridiam’s confidence that the project would be completed and that Meridiam would be able to negotiate a favorable deal with the Ministry of Health.

4. Overcoming Project Size Problems

Project research costs need to be justified in line with the size of an investment and the expected return. When a project requires extensive research, but investors need to maintain a balanced portfolio, the math becomes tricky. Investments in emerging market infrastructure require extensive due diligence at the project, region, and country level. This work is expensive and requires a very specialized skillset. Due to the costs involved, the Caisse de dépôt et placement du Québec (CDPQ) does not even look at projects unless the value is at least several hundred million dollars, explained CDPQ Executive Vice President Rashad Kaldany.

The most effective way to counter this problem is standardization. By harmonizing the structuring of projects and reporting on them, MDBs can reduce the initial costs required to induce private sector investors to even consider projects. De-risking can help as well. By mitigating both

political and project risks, MDBs can help reshape infrastructure investments to more closely mimic the types of risk investors understand and already carry in their portfolios.

5. Bridging the Knowledge and Data Gap Is Critical to Attracting Investment

Two of the core requirements that will enable investors to expand their holdings in emerging market infrastructure are data and knowledge. Fund managers need to have historical data to understand the characteristics of the assets in which they are investing, and they need to have a commonly accepted method for valuing assets once the holdings are in their portfolio.

For most investment instruments investors can go to a database like Bloomberg to obtain financial information and a benchmark to assess the risk-return of their portfolio and make investment decisions. For infrastructure, however, no such single comprehensive solution exists.

Besides this lack of financial infrastructure data, quantifiable information on past and current infrastructure investments is also lacking. Several initiatives, such as the [Global Infrastructure Hub](#) and [INFRALATAM](#), are under way to solve this problem, but the private sector would like to see more engagement to ensure that data solutions meet their needs.

Once resources are invested, fund managers need a valuation method for infrastructure investments that is well researched and widely accepted by fund managers for their accounting to auditors and shareholders. Developing such a valuation requires investing in a research agenda, which typically is not something the private sector does alone. Expanding the research agenda to include valuation models is one way MDBs can contribute to developing infrastructure as an asset class.

6. Think Investment-Grade, Even for Low-Income Countries

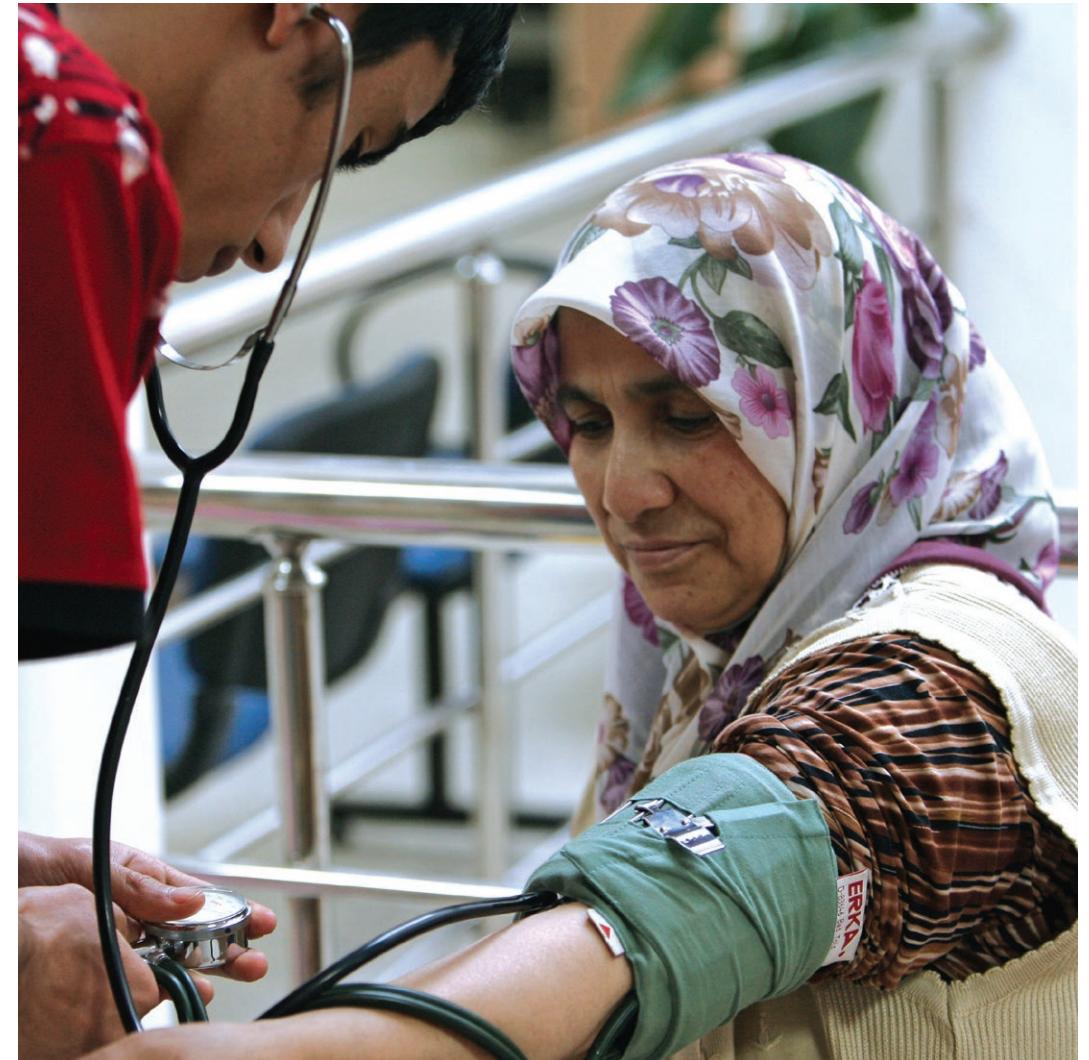
Private sector participants emphasized that their most pressing issues involve the regulatory and financial constraints imposed by financial institutions, boards, and shareholders. With few exceptions these constraints result in a very large portion of the pool of private capital being restricted to

Turkey: Elazig Hospital

The Elazig Hospital PPP Project will increase the access to quality health services for 1.6 million people in Eastern Anatolia. The project is part of the government of Turkey's ambitious Health PPP Program that aims to build around 30 health campuses.

European Bank for Reconstruction and Development

World Bank Group



investment-grade instruments. If MDBs are looking to tap that pool of capital, they need to be thinking about how to generate investment-grade financial products.

Bonds are typically constrained by the sovereign risk environment, making global markets inaccessible for many emerging economies. But strategic de-risking can solve that problem. For example, Meridiam, EBRD, and MIGA worked together to issue a bond two grades above Turkey's sovereign rating for the Elazig Hospital Project. MIGA is already looking at bringing similarly structured projects that entail an even larger credit support facility to International Development Association countries.

7. Bottom Line: The Money Is There, So the Challenge Is to Bridge the Gap

Participants in the forum agreed that the money to finance the infrastructure gap is available, so the challenge is to bridge the gap between projects and investors. Jim Kim, president of the World Bank Group, noted that at present \$8.5 trillion are earning negative interest rates and an additional \$24 trillion are sitting in very low interest rate government bonds. These resources could finance infrastructure if governments—with the support of MDBs—delivered well-structured, bankable projects. The clear message from the private sector is that such projects will be able to find financing. For example, HSBC Managing Director Duncan Caird noted that HSBC has financed a wide variety of private-sector-managed infrastructure projects in Latin America, including airports in Mexico City and São Paulo and a refinery in Bogota.

According to the Rock Creek Group, one way of thinking about emerging market infrastructure as an attractive form of investment is that it mimics a fixed-income instrument but with much higher return as compared to, for example, treasury bonds.

SUSTAINABILITY

1. Sustainability Can Sell Itself

MDBs are not the only drivers of sustainability; governments, civil society, and investors are all pushing for green portfolios. While fund managers have a limited appetite for risky products, adding green certification can tip the scales when considering two similar products because it contributes to corporate social responsibility.

The sustainability and climate change features incorporated into the design of the Zenata Eco-City project—financed with a EUR 150m loan from the European Investment Bank—contributed to interest in the project. In another case, HSBC found that green certification sold itself: energy efficiency improvements required for LEED Platinum certification were added to the Mexico City Airport project design simply because they made financial sense.

2. Improvement Is Needed in Defining Green Standard and Reporting on Sustainability

While there are some guidelines in defining what constitutes “green,” standards for green certification still vary widely. Green bonds earmarked to projects that have positive environmental and/or climate benefits could serve as a mechanism to help ensure universal standards for green investments. The issuance of green bonds has grown dramatically in recent years, with an expected volume of \$125 billion in 2017, according to a recent article in [The Economist](#).

As a second step towards better defining green standards, more comprehensive reporting around project outcomes is needed. As the number of certified projects expands, investors and MDBs alike need more tools to evaluate the potential impact of projects on such matters as climate risk.

3. Adaptability Is an Increasingly Important

Many of the countries and regions where MDBs work are already experiencing the effects of climate change, and those effects are likely to increase in the years ahead. The construction of sustainable infrastructure in a context of increasingly frequent extreme weather events requires building adaptable and resilient infrastructure that can withstand a range of conditions.

Anticipating the risk of floods in Haiti, the IDB included extensive flood mitigation features in the design of the Caracol Industrial Park, which the bank co-financed. Floods indeed inundated the region shortly after completion of the project, but the prescient project design enabled the park to re-open for business shortly after waters receded, according to IDB Infrastructure and Energy Sector Manager José Agustín Aguerre.

RISK MANAGEMENT

1. Political Risk Is Among Investors' Top Concerns

Infrastructure projects are typically long-term investments that take a decade or more to mature. The long tenor of infrastructure as an asset amplifies its political risk, which is already a major concern for investors who may have only passing familiarity with the politics of emerging market economies. Risk products offered by many development organizations are complex, lack standardization, and involve an extended dispute settlement period before paying out. The structure of these products means they often fail to ameliorate investor concerns about political risk.

Only months before Meridiam's Elazig Hospital bonds were to be issued, CEO Thierry Déau woke up to news reports of a possible coup in Turkey. Understandably, investors were deeply

concerned about the sovereign risk environment. However, political risk guarantees from MIGA, an EBRD liquidity facility to cover payments during investor disputes, and a strong PPP contract mitigated those concerns and enabled Meridiam to float an investment-grade bond in November 2016, only five months after the unrest.

2. Risk Mitigation Goes Beyond Guarantees: Project Agreements Are Critical

Conversations around risk mitigation often center on guarantees: the core of PPP arrangements is a strong contract that guarantees predictable responses in the event of exogenous shocks. When rating infrastructure projects, for example, Moody's closely examines PPP contracts, according to Senior Vice President Andrew Davison.

The PPP agreement between the Turkish Ministry of Health and Meridiam for the Elazig Hospital Project includes provisions for 100 percent compensation in the event of termination, even if the project company is at fault, as well as a built-in provision that mitigates currency risk, an important component not included in MIGA's political risk guarantee. The clear language behind these two assurances is a critical component of the credit rating of the Elazig bonds.

3. Strategic De-risking Is an Important Role for MDBs

Managers of the capital that MDBs are seeking to attract toward infrastructure investment have very limited capacity to evaluate the political and project risk for such projects. As previously noted, investors in the United States and Europe have limited experience with emerging markets, while domestic investors in emerging markets have little experience with infrastructure. MDBs can maximize their leverage by focusing on strategically de-risking the aspects of projects about which investors are most concerned.

Scaling Solar: Unlocking Private Investments in Solar Power

Launched in 2015, this project is a one-stop shop solution that brings together Governments and investors to catalyze investments in the solar energy sector in the fastest and cheapest possible way.

International Finance Corporation



4. Working Together to Combine Products Is Important

MDBs can achieve far more by working together as a system than by working independently. Many projects are simply too large, risky, or complex to be funded by a single multilateral. Combining resources, leveraging diverse expertise, and sharing risk allow countries to build innovative infrastructure projects that address increasing economic demands in a sustainable manner. Neil Saravanamuttoo, who participates in the G20 on behalf of Finance Canada, noted that shareholders would like to see the multilaterals working together as a system.

For example, the Reventazon Hydroelectric project in Costa Rica required the expertise and financing capability of both the IDB and the IFC. The Elazig Hospital Project, led by the private sector, required guarantees from both the EBRD and MIGA, with each entity's financial products focusing on its specific area of business.

CONCLUSION:

The Role of Multilateral Development Banks in Infrastructure Investment

While there is plenty of capital available, one of the main hurdles to infrastructure investment is a shortage of projects that are suitable for private investment. In the concluding session, participants drilled down on the underlying factors that prevent the translation of clear opportunities and needs into investments. These factors are at the country level and relate to policy and institutional environment weaknesses, including the following:

- Neither developed nor developing countries are working on infrastructure policies, but rather on infrastructure projects. In order to be effective, they need to be working on infrastructure policy as well as projects, and there needs to be a programmatic approach to developing that policy, according to Rolf Alter, Director of Public Governance at the OECD.

- Risk premia in infrastructure projects is high because of lack of certitude and clarity regarding long-term funding, which in turn is related to policy decisions. Who will ultimately pay for the infrastructure? Is it going to be funded by user tariffs, tax revenues, land value capture, or a combination of those? The answers to these questions are often not obvious, and most governments are unprepared to provide them, as stated by Amar Bhattacharya, Senior Fellow at Brookings Institution.
- Government-induced policy risk is the biggest deterrent to investment. Infrastructure policies need to be credible and clear. At the same time, governments need to be predictably flexible, because situations change over time. Most governments have not put in place institutions that are at the same time credible, predictable, and flexible, according to professor Nicholas Stern from the London School of Economics.

1. MDBs and the Global Development Agenda Are Key to Overcoming Infrastructure Challenges

MDBs are well positioned to help governments develop adequate project preparation, planning, and institutional capacity. In carrying out their supporting role, MDBs should work more closely with local governments, as most infrastructure projects are carried out at that level, not at the central government level. MDBs should also look at the private sector as a client. Most private institutions are willing to work with MDBs but find it hard to do so.

The Sustainable Development Agenda is supported by almost 200 countries and has at its core sustainable infrastructure. It is comprised of three global agreements: the Sustainable Development Goals (September 2015), the Climate Agreement (December 2015), and the Addis Ababa Agreement

on Financing Sustainable Development (July 2015). Over the next 15 to 20 years, the world will double its infrastructure. If these projects are not carried out in a sustainable manner, they will lock in carbon-emitting infrastructure and an opportunity will be lost. The global agreements are key to overcoming this challenge.

2. MDBs Need to Align Incentives for Staff with

Goals around Sustainability and Resource Mobilization

Mobilizing private capital for infrastructure is not simply a matter of matching projects to funds. Internal changes to MDB structures may be necessary as well. MDBs need to align internal incentives with stated goals. World Bank President Jim Kim expressed concern that at the World Bank (as well as other development banks), specialists are oriented towards maximizing loan approvals and have little incentive to bring bankable projects to the IFC for private financing once preparatory work is completed.

If the goal of the MDBs is to crowd in private capital for development, their priority for each project they fund should be to ensure that private capital is not crowded out.

Standardization of Finance, Reporting, and Project Preparation Will Help Private Capital

A core cross-cutting issue for private investors is standardization at every stage of the process from project preparation to evaluation. If MDBs want to mobilize investors to think about infrastructure as an asset class and to invest in volume, investors need standard ways to compare, evaluate, and value assets. This means standardizing project agreements, preparation processes, reporting, and the availability of historical data.

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EDITORS

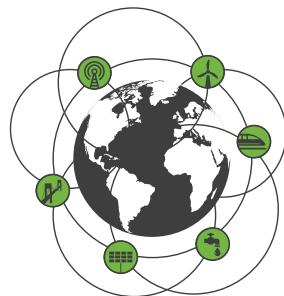
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© 2017 Inter-American Development Bank
1300 New York Avenue, N. W.
Washington, D.C. 20577
publications.iadb.org

PRINTED IN UNITED STATES OF AMERICA



2017 Global Infrastructure Forum

Delivering Inclusive and Sustainable Infrastructure

April 22, 2017. Washington D.C.

The Global Infrastructure Forum aims to enhance coordination among multilateral development banks and their development partners to better develop sustainable, accessible, resilient, and quality infrastructure for developing countries, and focuses on how governments and their working partners can attract more resources for infrastructure.

This 2017 forum was co-hosted by the European Investment Bank and the Inter-American Development Bank and held in IDB headquarters in Washington, DC on April 22, 2017.

