Building bridges (and more)

INVESTMENT

Public private partnerships are a way for pension funds and other investors to invest in infrastructure. Duncan Ferris **investigates whether these investments are worthwhile for Europe's pension funds**

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Collaboration has been highlighted time and time again during the pandemic, from stressed parents juggling professional and home-schooling responsibilities, to the global scientific community coming together to help beat Covid-19. Continuing this theme, this feature will investigate the collaborative nature of pension schemes' investments within public private partnerships (PPP).

What is PPP?

While a concrete definition is somewhat tricky, PPPs are essentially collaborations between public and private sector bodies, which have teamed up to accomplish a project and then run it, such as building a hospital or improving a sewage system.

The European Investment Bank's European PPP Expertise Centre (EPEC) states: "A PPP is an arrangement between a public authority and a private partner designed to deliver a public infrastructure project and service under a long-term contract. Under this contract, the private partner bears significant risks and management responsibilities.

"The public authority makes performance-based payments to the private partner for the provision of the service (e.g. for the availability of a road) or grants the private partner a right to generate revenues from the provision of the service (e.g. tolls from users of a bridge)."

For the state, the advantages of PPP projects can offer the opportunity to begin infrastructure projects despite funds being low, the ability to call on private sector expertise to improve projects and the chance that projects will reach completion quickly by engaging multiple private stakeholders. But of course, the advantages are different for those on the private side of the fence.

Why invest?

Explaining the attraction of PPPs, ATP Global Direct Investments vice president, Niels Konstantin Jensen, says: "At ATP, we see PPPs as a part

of our investment universe and as a supplement to other investments. All investments have to be measured by the expected return compared to the expected risk.

"As a pension fund, ATP appreciates stable and predictable cashflows and can have a very long investment horizon, and this can sometimes be achieved through PPPs."

PGGM Infrastructure investment director, Natasha Mol-Knechtel, agrees that this is the main thrust of their appeal, noting that PPP investments "have always been at the low end of the risk and return spectrum" and offer "long-term government-backed revenues".

Offering more detail on this point, Aviva Investors infrastructure managing director, Darryl Murphy, looks back on common practice for pension schemes investing in PPPs, commenting: "What we tended to see with PPP was an evolution of early-stage investors and contractors investing in the early days and getting these assets to an operational stage.

"What we then saw was the emergence of what I call 'secondary equity funds' using pension fund money, who wanted low-risk,

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reasonable return assets, who could buy the secondary assets which were operational PPPs.

"By then you basically have a 20-to-30 year cashflow coming from a government entity with no usage risk, on the basis that someone could maintain and make available services from hospitals, roads etc."

But in addition to this security, there is also the motivation of what pension funds' money will be used for if it is invested in PPP, which is providing infrastructure.

Murphy explains: "There is a narrative here that has been missed. PPP offers low-risk and reasonable returns and are investments in the local community and society in which pension savers live, which is a nice virtuous circle. If you think about the end investor, investing to improve their community through PPP infrastructure, thus improving the value of their life.

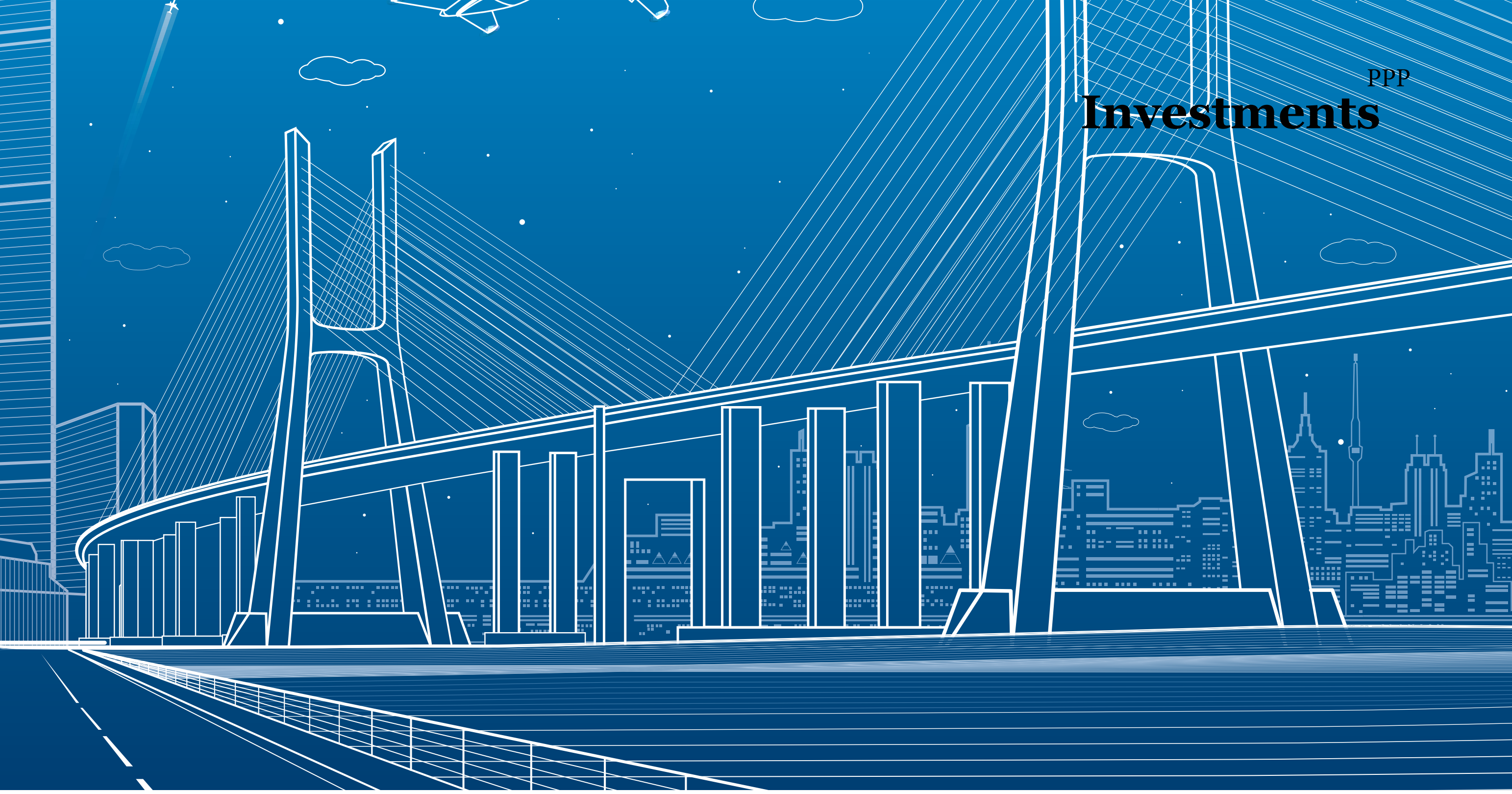
"That has been missed a bit because everyone sees PPP as something dominated by fat cats, but the reality is, most of the people invested are pension savers."

Downturn?

Despite this there has been a downturn in PPP deals. EPEC's most recent annual review of the market, published in March 2020, showed that 29 PPP transactions reached financial close for an aggregate value of €9.8 billion in 2019. This sounds like a lot, but the market actually decreased by 31 per cent in value terms compared to the year before, and by 24 per cent in terms of the number of projects.

Additionally, the average transaction size also declined, dropping from €375 million in 2018 to €338 million in 2019. The review also showed that the number of PPP transactions reaching financial close reached its lowest level since 1996.

This has continued into 2020, as figures from the World Bank's *Half Year on Private Participation in Infrastructure* report showed that investment commitments during H1 dropped by 56 per cent from the



same period in 2019 to $21.9 billion (€18.1 billion). Commitments in Europe and Central Asia were hit harder, falling by 72 per cent to $1.3 billion.

The report said Covid-19 meant that "existing infrastructure projects were delayed or cancelled due to supply chain disruptions, travel and shipping restrictions, and other obstacles", while governments around the world were redirecting funds towards healthcare and benefits and private investors had been deterred by "macroeconomic turbulence".

Explaining the slowdown in PPP over the longer period, EPEC principal adviser, Guy Chetrit, says: "The reasons that the old PPP model has been suffering over recent years are numerous. The first one is policy decisions on the part of important PPP countries, such as the UK and France, which used to be very significant PPP markets for Europe."

He continues: "There have also been issues with the ability of public sector entities to use the PPP tool to deliver public services and there has been a realisation that it is a complicated thing to do. A lot of governments, especially at the regional and local level, were quite keen to use PPP but have now realised that it was actually quite difficult to put together, difficult to procure and they became discouraged.

"I suspect, more generally, that there has also been a slowdown in public investment across the board anyway. If the general level of public investment is going down, PPP is going to go down as well."

With infrastructure challenges facing nations worldwide and government funds having been hoovered up by the pandemic, could we see a resurgence of private participation in infrastructure?

PPPs' future

PPPs might have been on the decline over the last decade, but that doesn't necessarily mean that they are on the way out.

Kempen Capital Management head of investment strategy, Nikesh Patel, comments: "Use of PPP (and PFI more broadly) should be an easier political sell today given our starting point today of an economic trough, though this is not enough – the new generation of such financing models must address the wider concerns particularly around excessive profits.

"Certainly, some PPP projects – designed well – will have a huge role to play in both developing and multiplying infrastructure spending as we recover from the pandemic. We believe particular subsets of this, like the inflation-linked infrastructure debt market, should be at the centre of such models, aligning well between taxpayers and private pension investors (or indeed public pension investors)."

Mol-Knechtel argues that a "huge gap in infrastructure spending" in Europe has been made "glaringly obvious through the pandemic", meaning that "cash-strapped governments may lean more to the private sector to fund recoveries".

But keen investors do not have to wait for new PPP projects, as Murphy adds: "The PPP model may not be used as much at the moment, but obviously a lot of those assets still exist and will be there for perhaps 20-plus years.

"So, the opportunity to invest in existing PPPs will remain for a long time. The UK had a very active secondary market and I think we are going to see more of that across Europe." ■