

MEASURES TAKEN BY MEXICO IN RESPONSE TO THE GLOBAL FINANCIAL CRISIS TO FACILITATE PUBLIC PRIVATE PARTNERSHIP

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ABSTRACT

The development of road infrastructure through PPP in Mexico has been affected by the Global Financial Crisis. Financing of projects are not easy as before, banks have put a number of restrictions on the credits offer and the concessionaires equity has reduced substantially producing a slow pace in the road infrastructure investment.

However, Mexico has the National Infrastructure Program 2007 – 2012 which must continue. Some measures have been taken to give continuity to that Program like more support to the PPP trough BANOBRAS (National Public Works and Services Bank) and the FNI (National Infrastructure Fund) with senior and subordinated credit, a reduction of the size packages of projects has been implemented to adapt them to the present market conditions and continue the construction of some of them, that are feasible from the social and economical point of view, as public works with FNI resources.

1. INTRODUCTION

The Mexican country has develop an extensive transport network with 366 thousand kilometers of highways, 26 thousand kilometers of railways, 116 ports and 85 national and international airports. However, the system performs below what is required to achieve the country's development goals, as shown in the World Economic Forum report 2010 – 2011 by: low rank in infrastructure competitiveness, 75th of 139 countries, and 62th in quality of road infrastructure; insufficient coverage, 0.18 highway kilometers / km², high dependence on roads, 67% of freight and 99% of passengers in domestic trips. There are substantial investment needs to maintain, widen and improve existing transportation infrastructure and build new infrastructure to improve safety, competitiveness and quality of service.

As part of the National Infrastructure Program 2007 - 2012, in the transport sector, the Ministry of Communications and Transport (SCT) is undertaking a road investment program of 287 billion of pesos with the participation of 159 billion of pesos of public funds and 128 billion of pesos of private resources, table 1.

Table 1 – National Infrastructure Program 2007 - 2012

Sector	Investment (billions of pesos)	Public Funds (billions of pesos)	Private Resources (billions of pesos)
Highways	287	159	128
Railways	49	27	22
Ports	71	16	55
Airports	59	32	27
Total	466	234	232

2. PPP PROGRAM, OBJECTIVES AND RESULTS

The public/private partnership models have a number of objectives. These objectives include allowing an earlier development of Mexico's toll and free roads, increasing the amount of road investments with private participation, adding value to the services offered to users, increasing the efficiency and productivity of public services and integrate transport corridors to achieve an efficient road network. Still other objectives are to create new opportunities for the private sector taking advantage of existing highways as a source for the construction of new toll roads and make a better distribution and management of highways projects risks.

In Mexico, the PPP program has been a key to achieve the goals of the National Infrastructure Program 2007 - 2012. Although, the economic and financial crisis has slowed the pace of infrastructure development through PPP models, the Mexican Government remains committed to PPPs and is implementing strategies suited to the new economic and financial conditions in order to continue the expansion of the highway network.

The public-private partnership models that the Ministry of Communications and Transport (SCT) has developed to attract private investments to highway projects are: concessions which payback mechanism is through the future flow of toll income; long-term service contracts or Service Rendering Projects with a payment mechanism based on availability and use paid by shadow tolls, and asset utilization model that combines brownfields with greenfields.

In general, the problematic generated by the financial crisis has affected these models in many issues like: difficulties for financial closure, restricted credit offer, reduction of bidders number, reduction of offered resources in equity and debt, financial periods reduction, restricted access to the financial market, increasing coverage cost, funding in local currency, leverage ratio reduction and more equity participation on the private investment is asked by the banks.

The results of the Ministry of Communications and Transports using these models during the period 2007 – 2010 have been:

- 19 projects completed and in operation (1,046 km, 25,549 million of pesos)
- 7 concession under construction (291 km, 12,239 million of pesos)
- 6 projects under construction with no budgetary resources or as surrounding projects (634.1 km, 33,476 million of pesos)
- 7 concession granted and next to begin construction (371.9 km, 18,208 million of pesos)
- 3 projects into bidding process (145.3 km, 5,540 million of pesos)
- 9 linked with existing concessions next to begin construction (253 km, 18,100 million of pesos)
- 8 projects next to begin construction as public works with the National Infrastructure Fund resources (472.4 km, 22,262 million of pesos)
- 13 projects in the pipeline (671.8 km, 30,442 million of pesos)

In result, the PPP Program 2007 – 2012 has 72 concession projects to achieve the construction of 3,863.8 km of highways with an investment amount of \$165,816 millions of pesos.

3. FINANCIAL CRISIS IMPACT

At each stage of the projects development, the financial crisis has affected the PPP road infrastructure program in different ways. For the projects in operation stage, the crisis has affected and reduced the possibility of securing part of the debt or renegotiating better credit conditions. The projects under construction have suffered as a result of banks changing their strategy regarding syndicated credit structuring, seeking to minimize risk, increasing the level of supervision and imposing restrictions on credit availability.

In the case of concessions recently granted and due to begin the construction phase, concessionaires have encountered credit restrictions and difficulty in obtaining recourses due to disengagement of banks.

Concessions in the bidding process have changed bidding papers to facilitate involvement of bidders. A reduction in the size of projects has been necessary to meet banks restrictions and credit capacity under the current circumstances.

In general, the PPP road projects face difficulties regarding financial closure, restricted credit availability, reduced bidders number and consequently less competitiveness contest. Other difficulties generated by the financial crisis include: reduction of available equity and debt resources, an increase in resources asked to federal government, financial periods reduction, restricted access to financial market, increase in coverage costs, difficulty to accept local currency funding, leverage ratio reduction and more equity participation required by the banks.

4. CHANGE IN ROAD CONCESSION FINANCIAL CONDITIONS

Due to the global financial crisis, table 2 [1] describes the change in financial conditions before and after crisis. The characteristics of the banks and the increase in intermediate margin at different stages of highway projects in Mexico. The projects are financially structured in a variety of stages using a strategy that increase the basis points of the intermediate margin from the construction stage to the operation stages. This strategy helps projects have less financial costs in the early stages. The financial crisis has affected cost which translates to bigger intermediate margins, increase in commissions charged and restrictions in authorizations of lending periods and maximum leverage.

Table 2 – Change in the financial conditions of road concessions

BANK OFFER CONDITIONS	BEFORE CRISIS 2007 – Sep 2008	AFTER CRISIS Oct 2008 – to now
Characteristics	<ul style="list-style-type: none"> • Dynamic financial market • Credit facility • Securitization • High risk structures 	<ul style="list-style-type: none"> • Liquidity restrictions • Investment portfolio value decreasing • Searching for new financial conditions to improve portfolios productivity • Reduction of assets life for faster recovery

INTERMEDIATE MARGIN THROUGH DIFFERENT STAGES OF THE PROJECT (BASIS POINTS)		
Construction	150 - 180	275 – 300
Operation (Y3 - Y5)	170 - 200	300 – 325
Operation (Y6 – Y10)	195 - 250	350 – 400
Operation (Y11 -)	250 - 300	400 – 425
Commissions (%)	1.5 – 2.0	2.0 – 3.25
Maximum period (years)	18.0 – 20.0	14.0 – 16.0
Maximum leverage	70% debt – 30% equity	60% debt – 40% equity

5. PPP KEY QUESTIONS

Given the financial situation since the end of year 2008, some questions have arisen to face up the financial crisis and implement strategies to give continuity to the PPP program. These question like:

- Which should be the optimum size of the projects?
- How to combine Brownfields with Greenfields in an optimum way?
- Are the Brownfields to cheap in this moment?
- Which should be the concession grant criteria?
- How to generate competition in new concessions bidding process?
- Which supports should be created by the government to help the PPP projects?
- How to take in consideration a reduction of traffic demand in the next years?

must be taken into account to generate some measures that help to mitigate the financial crisis effects on the PPP Road Program.

6. GOVERNMENT FINANCIAL SUPPORT

Since the PPP projects need credit resources, private capital, and in some cases, an initial grant, the Federal Government has create some instruments and supports through two entities, BANOBRAS (National Public Works and Services Bank) and FNI (National Infrastructure Fund).

The objectives of these institutions are to promote, attract and support Public Private Partnership infrastructure projects, through taking risks that the market can't assume, provide grants to make socially valuable projects and financially attractive to the private sector, improve private banks long term credit conditions with guaranties and participation in risk equity.

To carry out these objectives BANOBRAS and FNI have created some financial products, that are designed and applied for each specific project, like initial grants, credit, senior debt, subordinated debt, guaranties and risk equity. Those institutions offer equal stapled financial packages to the participants in a bidding process offering credits up to 70% of the total cost of the project. The credits makes 30% of the total debt in subordinated debt and the remainder in senior debt.

In some projects, that at the present seem to have low or uncertain demand levels, FNI will provide funds to develop them as public works and once in operation they will be concession to the private sector

7. CHANGES IN THE INFRASTRUCTURE SECTOR

The severe economic and financial crisis that has affected most countries has also impacted Mexico's PPP program in the highway sector. Such impacts have become evident through: lower availability of funds for infrastructure development (debt and equity), higher interest rates and shorter terms for available loans, higher returns on equity, project size has decreased substantially due to debt and equity restrictions, the number of interested participants has decreased sharply both in the financial and the infrastructure sectors, all of them are behaving very cautiously and the toll-based revenues have decreased in real terms.

8. STRATEGY TO CONTINUE HIGHWAY INFRASTRUCTURE DEVELOPMENT THROUGH PPP'S

To ensure the applicability of México's public-private partnerships under prevailing conditions, a strategy to adjust and adapt them has been put in place since the financial crisis began to affect the highway program [2].

The SCT's strategy to ensure the continuation of its highway infrastructure and to achieve the goals of its program with private participation includes the following measures:

- ✓ Efficient combination of "greenfields" with "brownfields" and reduction of project size to make the financial closure easier
- ✓ Participation of BANOBRAS, the National Public Works and Services Bank, in the financial structures to be implemented for each project, through credits made available to bidders under equal conditions
- ✓ Development of some new projects, with low or uncertain traffic demand, as public works with funds provided by the National Infrastructure Fund. Once in operation, these projects will be concession to the private sector as brownfields
- ✓ Restructuring of existing concessions extending concession period and increasing toll levels to allow development of new infrastructure associated to the original concession
- ✓ Design of a second package of long-term service contracts or Service Rendering Projects with availability-based methods of payment to reduce traffic demand risks
- ✓ Design of new infrastructure financing options with participation by pension funds

- ✓ Review of bidding documents to facilitate the participation of interested parties organizing workshops between SCT and concessionaires, bidders and financial institutions
- ✓ Improvement of the legal framework, in particular the authorization of a new PPP Law and some changes in the Expropriation Law to facilitate the right of way acquisition,
- ✓ Given the changes in the infrastructure financial and economic sectors, adapt the scope and characteristics of its PPP program to the existing environment.
- ✓ Continues review of the evolution of the financial markets and adapt its PPP models, projects and programs in order to ensure their success.
- ✓ Looking forward to keep close contact with financial institutions, pension funds, concessionaires, infrastructure funds and other stakeholders to ensure the competitiveness of Mexico's transportation infrastructure PPP programs.

9. CONCLUSIONS

SCT is committed to achieve the National Infrastructure Program goals in the highway sector and therefore requires the continuation of the PPP program. Given the changes in the infrastructure financial and economic sectors, SCT has adapted the scope and characteristics of its PPP program to the existing financial environment. The permanent review of the evolution in the financial markets is necessary to adapt its PPP models, projects and programs in order to ensure their success.

SCT is looking forward to keep close contact with financial institutions, pension funds, concessionaires, infrastructure funds and other stakeholders to ensure the competitiveness of Mexico's transportation infrastructure PPP programs.

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