Lim Hng Kiang: Increasing and broadening private sector participation in infrastructure development

Opening remarks by Mr Lim Hng Kiang, Minister for Trade and Industry and Deputy Chairman of the Monetary Authority of Singapore, at the World Bank-Singapore Infrastructure Finance Summit, Singapore, 29 May 2013.

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Ms Sri Mulyani Indrawati, Managing Director of the World Bank Group

Mr Cesar Purisima, Secretary of Finance of the Philippines

Mr Sergey Storchak, Deputy Finance Minister of Russia

Mr Areepong Bhoocha-Oom, Permanent Secretary of the Ministry of Finance of Thailand

Distinguished guests

Ladies and gentlemen

Introduction – infrastructure financing is crucial to maintain sustainable growth for countries

A very good morning to all of you. It gives me great pleasure to join you at the opening of this year's World Bank-Singapore Infrastructure Finance Summit. Let me extend a warm welcome to all our guests, and especially to our overseas guests.

This is our fourth meeting, and we are meeting under more stabilised circumstances. Emerging market economies have experienced a strong rebound in capital inflows post global financial crisis. McKinsey estimates that some US$1.5trn in foreign capital went to emerging markets in 2012. These flows are due in part to institutional investors' hunt for yield in the shorter term, and in part also to the longer-term shift in liquidity from the advanced to the emerging world.

The G30 Working Group on Long-term Finance has estimated that infrastructure spending must increase nearly 15% for countries to achieve even moderate levels of economic growth. The scale of spending required is significant; it raises questions on whether and how our financial system can deliver the required financing.

Policy-makers recognise this; international fora such as the G20 and APEC have made long-term investment a priority agenda topic this year. A key challenge is how we can better channel capital flows towards infrastructure development, a major element in countries' pursuit of sustainable, equitable growth.

To address this challenge, we must pursue enhancements in three areas – first, to catalyse private sector involvement in project financing; second, to optimise the project delivery value chain; and third, to build capabilities in both the public and private sectors.

Private sector investment in infrastructure is critical, and solutions must be created to support a necessary shift in sources of financing over time

Let me first turn to private sector investment in infrastructure. At present, governments drive about 60% of infrastructure spending globally. But growing fiscal pressure means that public balance sheets will not be able to sustain the current or even higher level of spending that is needed.

Bank lending has been the other main source of infrastructure financing, but this is increasingly constrained by macroeconomic factors and potentially regulatory developments. The global project finance bank loan market registered a 7% fall y-o-y in 2012. The Eurozone crisis saw many prominent project financing banks deleverage and become more selective with clients and transactions, while Basel III may lower the volume and raise the costs of project finance loans.

Hence the balance of financing sources will eventually have to shift. Policy makers have recognised the need for broader private sector participation. Long-term investors such as insurance companies, pension funds and sovereign wealth funds can be alternative sources of financing, as the life cycles of infrastructure assets match their long-term liabilities.

However, these investors are not participating actively enough in the infrastructure space, especially in debt financing. I am sure we all recognise that there are many reasons including a lack of familiarity with the asset class and bespoke nature of infrastructure projects. Some see higher perceived political risks in Asia, and a limited range of investment instruments relating to infrastructure. To catalyse broader private sector participation to complement the traditional bank lending space, a few things could be considered.

Firstly, we recognise that investors have varying risk appetites, and that the expertise to evaluate and undertake greenfield project risks still resides mainly with banks. Banks should therefore consider bringing in different types of capital at different stages as the risk profile of a project changes over time. For instance, transactions could be structured such that banks finance the construction stage of projects using their balance sheets, and the bank loan is then refinanced in the bond market post-construction. This way, institutional investors gain exposure to a steady stream of cash flows from operating projects, while banks can recycle capital to lend to new greenfield projects.

There have been precedents in other parts of the world. Last year, the Topaz Solar Farm project in California was structured with a US$1.2b debt package featuring US$850m of bonds. Banks took the construction risks, and the loans were subsequently refinanced via bond issuances.

In the Asian context, there may be additional considerations in refinancing bank loans via the capital markets, given the greater reliance on bank lending in this region. Project sponsors need to get more comfortable accessing the bond markets instead of relying solely on their relationship banks. Credit or risk guarantees provided by multilateral development banks or export credit agencies may also need to be adapted for use in the capital markets. Banks need to be innovative and develop a broader suite of financing instruments beyond bank lending in order to meet the financing needs of their clients.

MDBs/ECAs are important risk mitigants and could explore new ways to make efficient use of their funds

This brings me to the next point – the role of multilateral development banks, or MDBs, and export credit agencies in catalysing broader private sector participation. Given the scale of financing required for infrastructure, discussions at international fora have started to focus on how the multilaterals can further support the sector. For example, part of the G20 agenda for 2013 involves getting multilaterals to increase their lending capacity.

Post global financial crisis, these entities have in fact stepped up and filled project financing gaps when bank liquidity is constrained. Between 2009 and 2012, they doubled their lending to infrastructure projects globally from US$22b to US$44b.

However, is more lending the solution? Despite a doubling of their lending in the last three years, they only contributed 16% of project debt financing volumes globally in 2012. Conceptually, a more efficient way to utilise their financial resources may be in the form of risk mitigants such as credit or risk guarantees. The G30 Working Group on Long-Term Financing has in fact recommended that governments and MDBs should provide risk mitigation instruments to help lower the higher risks involved, especially during the early phases of long-term projects.

This is definitely worth considering. Given their status, MDBs and export credit agencies are seen as very credible counterparties that can provide risk mitigants. It is probably harder for the private sector to play such a role, especially given the long tenor of project finance. I would add that MDBs and export credit agencies already have guarantee products that mitigate credit and political risks for project loans. The issue at hand is how to extend these products to say capital market instruments to “crowd in” participation by a broader group of institutional investors. For instance, the Credit Guarantee & Investment Facility or CGIF, established by the Asian Development Bank and ASEAN+3 nations, recently completed its first guarantee transaction on a 3-year Thai baht bond issuance by Noble Group.

There must also be a concerted effort by project developers to make project delivery more cost-efficient, productive and financially viable to mitigate risks for investors

While considerable attention has been focused on increasing the supply of infrastructure financing, we also need to think about how we can “get more for less” by optimising the project delivery value chain.

Improving project implementation processes

McKinsey has estimated that productivity of the infrastructure value chain could be increased to achieve 40% savings, if project sponsors globally adopt proven best practices. This would translate to an average of US$1tn per annum in infrastructure cost savings over the next 18 years. Such best practices may include having processes in place to select projects that best address infrastructure needs, finding innovative ways to structure and execute these projects, as well as maximising the use of existing capacity.

This is not just a regulatory or public sector issue. On the part of project developers, greater attention has to be paid to productivity improvement across the entire value chain. Put simply, project developers must find ways to deliver projects on time and on budget, boost asset utilisation and undertake proper maintenance. If investors have confidence that there is “less leakage” from cost overruns, this will help to reduce financial buffers and in turn the required hurdle rate.

There are various ways in which sponsors can enhance their delivery of projects. They could invest in project design at an early stage to avoid costly subsequent changes. They could invest in technology and leaner construction methods to lower costs. For example, prefabrication and modularisation techniques enabled 14 bridges in the US state of Massachusetts to be replaced over just 10 weekends.

These improvements across the entire value chain will ultimately make infrastructure projects more “bankable” and less costly to finance. This will create a virtuous cycle of enhanced efficiency leading to lower costs for governments, the project sponsors and the financiers.

Capability building can help improve PPP standards and the “bankability” of projects, as well as assist companies in developing their talent pool across the infrastructure value chain

Capability building for governments

Finally, I would like to talk about knowledge sharing and capability building. Formalising public-private partnership (PPP) frameworks is an important pre-requisite in enhancing project delivery. Given the long-term nature of infrastructure investments, private investors also have to be assured that projects have been properly evaluated on economic viability, that there is strong political commitment to PPP, and that the broader legislative frameworks beyond PPP are conducive to investments. MDBs have actively supported countries on this front, in efforts to formalise project selection and approval processes, revenue models and concessions, and to encourage harmonisation of PPP standards in the region.

At our inaugural Summit in 2009, we announced that the World Bank-Singapore Urban Hub partnership has been established to leverage Singapore’s experiences to help developing countries structure commercially viable infrastructure projects. This was followed by the setup of the Infrastructure Finance Centre of Excellence (IFCOE), which carries out capacity building and technical assistance to increase the success of PPP in the region. Last month, IE Singapore and the Asian Development Bank jointly launched a PPP initiative that will work with regional governments to structure infrastructure projects, and also explore using capital markets to finance these projects.

Enhancing project development expertise

Besides improving PPP processes and public sector expertise, we also need to enhance the human capital in the private sector. There is already a growing base of professional services in Singapore with practices in infrastructure development, financing and public-private partnerships in Asia.

Singapore could explore whether there is a need to help companies develop their project development talent pool, so they can harness opportunities in the regional infrastructure space. This could be done by supporting on-the-job training to accelerate talent development through more project experience, and creating specialised programmes to train talent to be equipped with knowledge across the project development process – from business development, to PPP structuring, to financing.

Conclusion

Ladies and gentlemen, let me conclude by outlining again three key priorities in increasing and broadening private sector participation in infrastructure development – first, to catalyse private sector involvement in project financing; second, to enhance delivery of projects for better financial viability; third, to build up capabilities in both public and private sectors. These are necessary to help countries achieve their economic growth targets in an equitable manner, resulting in job creation and other positive social outcomes.

The real economy, financial sector and public sector players all have complementary roles to play. Conferences such as this are an excellent opportunity to bring together stakeholders in order to foster the exchange of ideas.

On that note, I wish you all fruitful discussions today. Thank you very much.