Can ANI find the funding for Colombia's infrastructure gap?

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After much anticipation and speculation, and not a little controversy, formal bidding for the first components of Colombias vast new roads PPP programme finally began in September. The programme is ambitious 40 road concessions that will cost at least $26 billion in total and has an aggressive schedule. Colombias Agencia Nacional de Infraestructura (ANI) expects $6 billion of projects will be completed in 2016 alone, with 8,100km of new highways added to the national infrastructure network by 2021.

In March 2014, ANI is scheduled to pick a preferred constructor for a new road linking Giradot and Puerto Salgar, from a shortlist of 10 consortiums that features Latin American and Western European members. A further 39 road projects, each valued at between $500 million and $1 billion, will follow.

ANI is confident that it has the framework to deliver the programme on budget, and the local labour and raw materials to meet the demand from concurrent and competing projects. But potential sponsors are sceptical. Critics question both the strength of the regulatory framework and the ability of the private sector to mobilise sufficient financing and manage dozens of potentially overlapping projects.

The countrys low income levels and rugged topography compound the uncertainty, despite its recent upgrade to investment grade. Colombias terrain, for instance, will require tunnelling and bridge-building to straighten existing highways that are cut into the sides of twisting mountains.

There is, however, little doubt about the need for the new roads. Colombia is widely perceived to have an antiquated and fragmented roads network. In 2011-2012, Colombia ranked 95th globally in infrastructure quality out of 143 countries, according to the World Economic Forums Global Competitiveness Index.

Fitch Ratings, in a recent report on Colombian infrastructure, notes that transportation accounts for between 50% and 75% of logistics costs for Colombian companies. Greater investment is essential to increase the economys growth potential, improve export performance and support greater economic diversification, Fitch concludes.

The lack of multimodal transportation generates over-costs of about 80% of carbon cargo transport, according to the Colombian Chamber of Infrastructure. The chamber estimates that the cost of transporting a barrel of oil in the country is $5 about three times its cost of production.

u New law

These roads will be built and operated under Colombias new PPP law, which builds on the countrys experience with three earlier rounds of concessions. The fourth generation adds to the risk-transfer structures that featured in the third programme, while providing the legal basis for more complex projects, greater investor participation (specifically encouraging the countrys institutional investors to participate in capital markets transactions) and less potential for contractual disputes, litigation and lengthy and costly delays.

Odebrecht was involved in the flagship Ruta del Sol, a third generation project, which it says was hit with delays over environmental licences, intersections with the public services, oil pipelines and stoppages due to social order issues. The sponsor and contractor welcomes ANIs apparent efforts to boost flexibility, particularly with regards environmental licensing, land acquisition, and the relocation of utilities. But Odebrecht adds: We believe there is still a culture of mistrust in ANI due to bad experiences on previous contracts. Taking into account the large number of PPPs needed to leverage the infrastructure sector, the state needs to understand that itself, the operator and the user must be sitting on the same side of the table.

ANI acknowledges that projects in the previous programme were sometimes handled on a case-by-case basis, but contends that the new law will help facilitate a consistent and rigorous concessions framework. One important lesson we learned [from Ruta del Sol] is that it wasnt adequately structured, says an ANI official. A project was awarded without assessing the environmental component part of the corridor went through a very geographically unstable area and led to a lot of issues and renegotiations of the segment, which has been very slow as a result. We are really investing in the structuring [of these 40 roads] and are in close talks with the environmental authority, in large part to avoid problems when we get to construction.

The agency is also keen to avoid disputes and win the OECD seal of approval. So ANI devised bidding rules, regulations and a corporate governance structure that officials there say meet OECD-recommended levels of organisational transparency and anti-corruption best practices.

ANI, which is being advised on the programme by the International Finance Corporation (IFC), has a clear preference for long concessions that transfer operations and maintenance risk. The maintenance aspect of projects often gets overlooked, but it is the key to having well-functioning transportation infrastructure. Its relatively easy to build a new road, but if the year-to-year maintenance and investment isnt made, the road will quickly crumble, says a Colombian consultant who has worked closely with ANI. Maintenance [in the public sector] is subject to the political and budgetary process, but when you do a PPP you know that for 30 years at least that road will be adequately maintained.

u Dividing the projects

Past experiences have informed the financing framework. All projects will need to be financed purely with private debt and equity. Even projects that widen, extend or simply improve existing highways (and thus have existing traffic and tolls) require this new approach. ANI will no longer provide milestone payments before projects complete construction. Instead it will only make availability payments to operating projects over the life of their concessions.

In the past, Colombia had allowed concessionaires to collect revenues early in the life of contracts, which allowed sponsors to minimise their required levels of debt and equity, but often encouraged construction delays.

To cope with the size of the largest new projects, ANI may divide them into sub-projects, or functional units. But one consultant says such a strategy introduces complexity and could increase costs. If you divide a $500 million project into five sub-projects of $100 million, then you might have four financial closes, says the consultant. The concessionaire will need to put all his equity in to build the first sub-project, or equity with a construction loan, because the banks will need to wait until the five sub-projects are finished. This makes the financing for the concessionaire with the multiple financial closes expensive and highly leveraged.

And Colombias roads will compete with Latin American projects with similar risk profiles for debt and equity, Odebrecht notes. Given that capital is scarce, the cost charged by private investors to finance the state is not its cost of funding but rather its opportunity cost, [compared] with different projects. It is important that the state recognises this opportunity cost; the higher the portion of equity the greater must be the contribution of the state to be able to remunerate this equity. The collection of tolls is irrelevant in the funding sources of the projects.

The president of ANI, Luis Fernando Andrade, anticipates that international construction companies will welcome Colombias projects, and thus accept the agencys underlying methodologies. Early indications are favourable: 23 international consortiums pre-qualified for the new procurements, with 15 of the worlds biggest 20 companies present, and only the leading UK companies absent.

The rate of return for equity that we are calculating on our models is 13% net of inflation, or a US dollar-equivalent rate of about 15%, Andrade says. Thats the rate of return for the investor not the builder. If you invest and build, you will also get a return on the construction, so we actually think that rate is very competitive. If you go to other countries, there are not that many options. ANI will also allow project companies to securitise future toll and availability receivables.

u Sourcing project funds

Of the $26 billion roads programme, ANI is hopeful that about $7 billion will come from Colombian banks, and that domestic pension funds will contribute another $5-7 billion. Colombian pension funds, Andrade notes, can only put 50% of their portfolio into government assets, so they need to find private opportunities, and the assets under management of the pension funds are growing faster than opportunities for investment.

Colombian pension funds, however, have yet to provide debt that bears construction risk, so they may be more likely to participate in bond refinancings post-construction. The road PPPs should eventually attract investors with annuity commitments, including both pension funds and insurance companies. Colombian insurance companies require coupons of at least 4% above inflation, which are difficult to obtain, Andrade concedes, though may be available in the road concessions.

Additional government financing should complement local banks and institutional investors. Colombias treasury plans to bolster the recently-launched Financiera de Desarrollo Nacional, which could then provide up to $4 billion in subordinate debt. The treasury expects that the bank could meet up to 20% of project costs, to reduce risks to senior lenders and minimise the need for equity.

As we talked to the banks and the financial investors, we realised that the banks were asking for a lot of equity because they had a hard time extending the maturity of their loans and they are somewhat risk-averse, Andrade says. So in order to increase the leverage and to get a more reasonable debt-to-equity profile of 70:30, the government will provide a mid-tier source of funds that stands between equity and debt and that allows the banks to have priority over payments before sub-debt is repaid. And multinational development banks may contribute guarantees and possibly funding.

International banks including well-capitalised and eager Japanese lenders could also play a role. But the extent of their involvement will depend on debt denomination. Most international project finance banks will be restricted to deals denominated in US dollars, as is common in many developing Latin American countries.

Andrade acknowledges this constraint. We have received authorisation from the finance ministry to commit a maximum of Ps3 trillion, or $1.5 billion dollars, in foreign currency-denominated payments, he says. That is a relatively small amount relative to the size of the financing needs.

The dollar-denominated funds will be used quickly. ANI has decided to put that relatively meagre allocation to work on the initial projects in the roads programme. On the Giradot-Puerto Salgar project, for instance, 30% of the government payments will be made in US dollars, Andrade says. Then, depending on how the market reacts, we might go back to the finance ministry and ask for more, he adds.

u An uneasy launch

Observers familiar with ANI say the agencys focus on the initial projects is sensible. A smooth launch will comfort anxious lenders and investors especially international players.

These participants, however, have not always welcomed ANIs methodology on early procurements. ANI shortlisted 10 groups on early concessions because the Colombian parliament mandates it. But Canadian grantors, for instance, typically shortlist three qualified bidders per PPP.

With 23 pre-qualified consortiums for the first projects, ANI used a lottery to identify the shortlists. The logic behind that decision was that rejected bidders would not be able to litigate over bad luck.

The development costs for a reasonably-priced bid dont warrant going into a process which has a one-in-ten chance, says Doug Sanders, a partner at Borden Ladner Gervais. Even if you think your actual chances are one-in-five because you are better than half of those in the shortlist, bidders just arent going to put in the money. Odebrecht, for example, spent $8 million on its bid for Ruta del Sol.

Critics contend that tougher procurement criteria would filter out unfit bidders, ensuring shorter and more respectable shortlists and thus allow greater scrutiny of the bids of a few qualified players. Odebrecht suggests that ANI require bidders to submit certificates that demonstrate their technical capacities. In early procurements, bidders did not have to meet minimum technical requirements, though most of the bidders were construction firms. The heterogeneous list of 10 bidders causes the international investor to expand the assessment criteria, including evaluating whether it is really worth investing in Colombia or seeking more equitable opportunities in other environments, Odebrecht says.

Andrade doubts that ANI will receive 10 bids, let alone shortlist all 10, on coming concessions. Consortiums that are already prequalified are likely to concentrate on PPPs that they have already won, he says, suggesting that the 23 prequalified groups may each win about two of the 40 projects.

And Andrade defends the parliaments decision to shortlist 10 bidders: If we chose a limited number of companies say five and then lets say two or three of them decided not to [participate], then we would be in a very uncomfortable position when we would have only one or two bidders. Even the most established PPP regimes can understand the agencys thinking on that front.

ANI's proposed concession structure