**Sub-Regional Expert Group Meeting (EGM) for South-East Asian Countries**
**Financing Sources for Public-Private Partnerships (PPPs)**

# The "Kuala Lumpur" Statement on Financing Sources for Public-Private Partnerships in South-East Asia

The expert group meeting was held on 24-25 November 2015 in Kuala Lumpur and organized by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) in collaboration with the Public Private Partnership Unit (UKAS) of the Government of Malaysia. The meeting was attended by officials handling public private partnerships - in the governments and private sector from South-East Asian countries, representatives of multilateral development banks and regional funds, as well as private finance institutions, among other stakeholders.

The meeting was an opportunity to hold inclusive, open and transparent discussion on the use of public-private partnerships (PPP) as recommended in the "Addis Ababa Action Agenda" adopted at the third international conference on Financing for Development in 2015. By encouraging and promoting effective PPPs, the meeting also supported the 2030 Agenda for Sustainable Development including the 17 Sustainable Development Goals (SDGs) that were adopted by leaders of 193 member states of the United Nations on 25 September 2015.

Facing significant infrastructure gaps, countries in the region needs to mobilize additional financial resources for infrastructure development. It was recognized that PPPs can play an important role in supplementing government resources. The private sector has however to secure financing to contribute to infrastructure development. Therefore the objective of the meeting was to explore how to facilitate access to finance for PPP projects.

Some of the issues and key recommendations that came up in the discussion included the following:

*Developing a robust pipeline of projects (PPP Enabling Environment)*

The predictability of the legal and regulatory environment is crucial for PPP development as projects can be strongly impacted by changes in this environment.

1. Countries should continue to develop a stable and conducive environment to attract more private sector participation in infrastructure development. This enabling environment is a pre-condition for investors' long-term financial commitments and includes: regulatory clarity on PPP-related laws, adequate instruments to deal with land issues and effective dispute resolution mechanisms;

2. A pipeline of well-prepared infrastructure projects should be available and ready to be financed. This pipeline can only emerge if sufficient resources are allocated to project preparation and structuration (for example through project development fund and the Global Infrastructure Facility (GIF));

3. Support should be provided to capacity building activities as there are considerable training needs within government agencies both at central and local levels (for example countries could use the ESCAP e-learning series on PPP for this purpose);

4. Best international practices should be further promoted in particular with regard to risk allocation and case studies should be used to facilitate exchange of experiences;

5. Effective coordination mechanism between government agencies should be established to settle the sometimes conflicting interests of these agencies. Without this coordination, PPP project implementation could be at risk and delays encountered;

6. Public financial support should be considered when properly justified in order to make projects financially viable. Instruments should be developed for this purpose (e.g. Viability Gap Funding, tax incentives and guarantee mechanisms). Related liabilities should, however, be carefully assessed and monitored to ensure fiscal sustainability.

*Increasing Lending Capacity*

Local and international bank loans have traditionally been the main source of the private financing for PPP projects but long-term local currency loans are not always available and banks may have constrained lending capacity (for example through single-borrower and sector exposure limits and due to new regulatory frameworks on bank capital adequacy requirements).

7. Efforts should be pursued to further develop domestic banking sectors as PPP programmes need to be supported by strong local institutions (for example, this is the most sustainable way to address issues such as currency risks), although in the interim international bank loans could continue to be an important source of long-term finance;

8. PPP contracts and related regulations should ensure that projects are bankable (important issues for the banking sector includes: step-in rights; termination payments ; and security interests, the latter being challenging for infrastructure assets);

9. Project finance capacities should be increased to avoid having financing constrained by project sponsors' limited balance sheets (projects have been mainly financed through corporate loans in the South-East Asia);

10. Establishing public institutions could be considered as an option for increasing the resources available (e.g. PT SMI and Indonesia Infrastructure Finance (IIF) in Indonesia) while taking due consideration of not crowding out private institutions in the process;

11. Environmental and social standards should be in line with the "*Equator Principles*" if international financing is targeted (81 financial institutions in 36 countries have officially adopted these principles, covering over 70 percent of international project finance debt in emerging markets)[i].

*Freeing up bank resources for new projects*

Banks have typically short-term liabilities, such as customer deposits, that do not match the long-term nature of infrastructure projects.

12. Refinancing or takeout financing schemes should be explored as mechanisms to address any asset-liability mismatch issue of the banking sector. These schemes could release long-term commitments from banks' balance sheet and help in meeting capital adequacy requirements. In this respect, countries could learn from existing experiences in other countries such as India;

13. Securitization of infrastructure loans could be considered as a refinancing option to relieve pressure on banks' balance sheets and to create financial products in which investors could put their money (e.g. banks might have the opportunity to sell their infrastructure loans to other type of investors when projects are in their operational phase and risk is much reduced,). These solutions require, however, the pre-existence of a developed debt market.

*Finding Alternatives to the Banking Sector*

The long-term nature of infrastructure projects matches the long-term liabilities of institutional investors - like pension funds, insurance companies and Sovereign Wealth Funds (SWF). Therefore infrastructure could be an interesting asset class for these investors and might offer opportunities in terms of return, portfolio diversification and inflation protection.

14. Financial products should be developed for channeling institutional investors' funds to infrastructure projects. In this respect, initiatives should be supported to deepen domestic capital markets and in particular local currency bond markets (e.g. Malaysia has been successful in financing its infrastructure development through its bond market);

15. The emergence of domestic institutional investors should be encouraged as these investors are instrumental to the development of domestic bond markets and can play a catalytic role for the development of this industry. In addition, local institutional investors have liabilities in local currency providing them with a natural currency hedge. However many domestic institutional investors lack required skills and expertise in project finance. There should be efforts to improve their project finance capabilities through, for example, the use of external fund manager or collaboration with experienced international institutional investors;

16. Regulations on institutional investors should be designed to focus on improving capability of such investors rather than imposing prescribed limitations on certain types of investments or assigning them with narrow investment mandate as this will hamper the emergence of new asset classes including project bonds in the market;

17. The role of rating agencies, especially that of domestic rating agencies, is important for development of project bond markets in ASEAN. Domestic rating agencies should be encouraged to improve their methodologies and skills in assessing PPP projects;

18. The possibility of directly financing infrastructure projects through project bonds should be assessed while recognizing that a developed domestic currency bond market is a pre-condition. Project bonds seem to be more suited for financing projects in the operational phase than in the construction phase even though some countries have managed to finance greenfield projects through bonds;

19. The potential of indirect infrastructure financing should also not be overlooked. For instance, infrastructure-related entities could attract financing through the issuance of bonds (e.g. SOEs are

among the largest corporate bond issuers) while banks and other financing vehicles could issue local currency bonds and then on-lend these resources to infrastructure projects;

20. Project developers should envisage to obtain a “green” label for their infrastructure related bonds as there is a huge demand from investors for this type of assets;

21. There should be a tax neutrality between bonds and bank financing to avoid favoring one over the other (issues such as stamp duty were mentioned in this respect).

*Setting-up Infrastructure Funds*

Specialized skills are required for structuring and assessing infrastructure investments and it might not be efficient for every investor to develop such expertise internally.

22. The need for infrastructure funds should be considered as funds can play an intermediary role between the investors and the projects and they can also serve as a vehicle to pool resources, skills and experiences from different institutional investors and achieve economies of scale. The infrastructure funds can also be used as the platform to transfer needed skills/expertise to domestic institutional investors from more experienced international investors. For example, the unlisted Philippine Investment Alliance for Infrastructure (PINAI) fund was created in 2012 through partnership of international and domestic investors and mobilized approx. $625 million for equity investments in infrastructure projects and businesses in the Philippines. The similar model can be explored in debt funding.  On a regional level, the ASEAN Infrastructure Fund was launched in 2012 to address the region's infrastructure needs. While the fund will initially provide loans from its own resources, it is expected that it will issue debt in the coming years to increase the resources available for infrastructure financing. These debts could be purchased by central banks thereby offering a new avenue to invest foreign exchange reserves.

*Risk mitigation mechanisms*

Private investors might not be ready to support certain types of risks such as political risks, commercial and currency risks, and might not be comfortable if the level of risk perceived is too high.

23. Access should be facilitated to mechanisms that could mitigate these risks, which can include insurances and guarantees, although risk allocation might also be dealt with in the PPP contract directly. Political risk insurances are particularly needed in lesser developed PPP markets due to the high perception of risks and still to establish track records. Unfortunately, it is very often where they