Innovative Approaches for Financing Public-Private Partnerships in Latin America: Best Practices

Abstract

This report evaluates recent developments regarding public-private partnerships (PPPs) in Latin America, with particular emphasis on innovative schemes for financing large-scale projects combining private efforts and public backing. It considers the structuring principles of a cost model, defining remuneration for investment (RFI) and remuneration for operation and maintenance (ROM). These cost reimbursements have the same payment characteristics over time. This characteristic provides the necessary reassurance for leveraging large amounts of financing.

One of the main problems with the development of PPPs was the large amounts of capital required for sizeable investments, which even businesses with strong financial backing were not able to provide. This led Peru to introduce work progress certificates (WPCs), an innovative instrument for relieving the financial pressure created by the need for significant capital inputs.

WPCs are widely used in PPP contracts in various sectors in Peru. Since these certificates confer entitlement to future investment reimbursements, they could not be freely transferred among investors or taken up by different investors. Accordingly, certificates of recognition of PFWs (CR-PFWs) were created, followed by certificates of recognition of RFIs (CR-RFIs). While the WPC conferred entitlement to 30 semi-annual installments of investment reimbursement over 15 years, one CR-PFW was issued for each installment. For each WPC, 30 CR-PFWs were issued; their main feature was that they had a specific redemption value and a firm payment date. This means that the holder of the CR-PFW can expect payment without having knowledge of the PPP contract.

The CR-PFWs were issued by the Republic of Peru. Although this was an advantage because they could be placed on the international market relatively easily, the Ministry of Economy and Finance objected to their extensive use. In view of this objection, in the case of social security hospitals in Peru a new instrument was created with similar features but in this case it was funded by social security revenue set aside for the payment of PPP contracts.

Peru issued a debt instrument but Mexico issued a capital instrument: the development capital certificate (CKD). While the CR-PFWs or CR-RFIs were fixed-income instruments, the CKDs are variable-income instruments and their yield depends on the return on capital after reimbursement of the debt.

Using the same method as was used to analyze the CKDs, an analysis was also made of classical methods of financing demand-model PPP contracts, among which Chilean contracts are the ones most subject to structuring by banks. Chile also issued “infrastructure bonds” for purchase by pension funds and institutional investors that had previously been less inclined to assume the Government’s risk. These bonds were backed by country risk insurers known as monoliners; unfortunately, following the financial crisis, they are no longer used, because these insurers have withdrawn from the market.

Lastly, the report analyzes investment funds holding infrastructure financing instruments both at the initiative of the Government and through private initiative and notes that these institutions are still evolving and need standardized instruments in order to expand their financing coverage.

Key words: Public-Private Partnerships, cost model.