SURVEY Industry Watch

Private finance will play a bigger role

In our latest quarterly survey, we asked our panel of senior executives about how they expect private finance and PPPs in the rail sector to develop.

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RAIL SUPPLY INDUSTRY WATCH

To find out more about the survey and apply to join our panel, visit the RSIW website at: **www.railsupplyindustrywatch.com**

Private finance has become increasingly important for railways in recent years. There are several important factors driving this trend, not least the lack of public funding for major projects as governments grapple with increasing deficits and debt mountains.

Railways must find ways to tackle backlogs in infrastructure spending, renew rolling stock fleets and invest in additional capacity or new lines to cope with growing demand, driven by macro-economic trends such as urbanisation, road congestion and societal demands to reduce greenhouse gas emissions.

The financial sector increasingly sees rail as 'investable', as well-structured proposals offer relatively safe opportunities and steady returns, with the benefit of tacit or overt government backing. Thus, despite the requirement for a higher rate of return, private investors can become an important vehicle for financing in addition to traditional government support. The use of private capital can also bring positive benefits by putting pressure on the railway to improve its efficiency and productivity.

The structuring of deals can be complex and slow, resulting in high transaction costs. There is also the challenge of balancing risk and reward between public and private partners. Risk transfer should be arranged in such a way that each party bears the risks which it is able to control most effectively. But if the packages are properly structured there are almost limitless opportunities to invest in the rail sector.

So, how does our panel of senior executives from the railway supply industry believe private financing will develop in the future? We asked them to select one of five possible scenarios (Table I).

Just over half of the participants (54%) felt that PPPs would increase in importance in selected markets. This reflects what we have seen in recent years. Many large incumbent railways, backed by governments with strong bond ratings, have enjoyed access to cheap funding and only turn to private financing selectively to supplement their needs. Private financing has mainly been used where public funds are limited, particularly in the mass transit market (Fig 1).

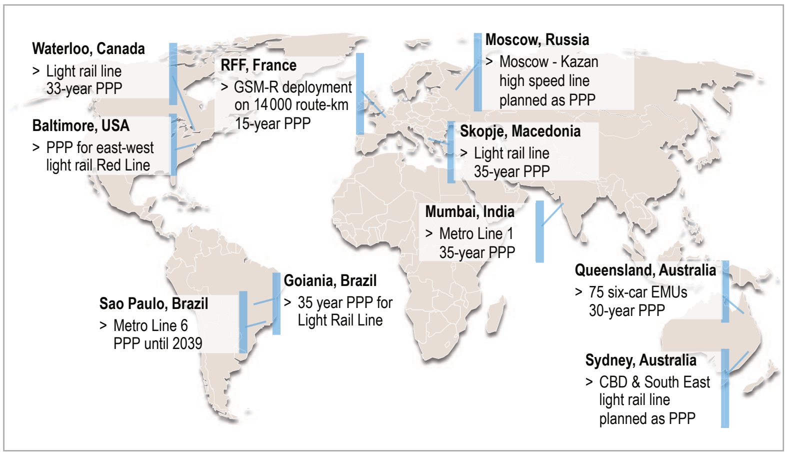

Fig 1. Metro and light rail projects are well represented in these examples of recent or current PPP schemes in the rail sector.

The second group, with 30% of the votes, felt the key issue was that PPPs would only be effective where the private partners are able to deliver efficiency gains to compensate for the added complexity. For example, if the private partners in a BOT concession can build and operate a railway or metro line more efficiently than a public entity and bear some of the risk, the PPP will add value for all the stakeholders.

One in eight of the respondents was very optimistic about the future of PPPs, believing that the use of private finance would increase significantly in all regions of the world. Only 4% felt that the use of PPPs would stagnate or decline. Interestingly, our panel seems convinced that public funding of rail investment will continue in some form; nobody voted that railways would have to become more commercial and rely entirely on private financing.

The message for the supply sector seems clear. Manufacturers and service providers need to prepare for a future in which there is a greater use of private finance for railway projects. In an increasing number of cases, simply supplying infrastructure, rolling stock or other products will not be sufficient. Some suppliers competing in the global markets have already begun to offer financing packages to support their bids, backed by banks or government funds. To compete in this new world, other firms also need to develop their skills or find partners to assist with organising access to private capital: talking to potential investors, forming a consortium, structuring deals, and lobbying governments or regulators.

The topic of alternative financing sources is examined in more detail in the World Rail Market Study 2014 (RG 9.14 p125). 'In the current global financial situation, exploring innovative ways of financing is essential in order to boost investment in the rail sector', believes Unife Director General Philippe Citroën. 'The European rail industry supports the greater use of private financing, through PPPs for example. But this should not just apply to rolling stock and infrastructure, but also to things like research. Here, Unife members are setting a good example, thanks to their commitment to funding the Shift2Rail Joint Undertaking on research and innovation in conjunction with the European Commission under the Horizon 2020 Programme.' ■

Table I. Survey responses

Option	Response
A. PPPs will grow signficantly in all parts of the world, as the benefits outweigh the disadvantages.	12·5%
B. PPPs will gain importance in some markets because of the scarcity of public finance for railway projects.	**54·2%**
C. PPPs will only be effective where private partners are able to deliver efficiency gains.	29·1%
D. The use of PPPs to fund rail projects will stagnate or decline, and their use will remain limited.	4·2%
E. Railways will have to become more commercial and rely entirely on private financing for investment.	0·0%