

Italian PPP at a glance

Italy's level of public spending on infrastructure has lagged behind that of its EU partners. Recent studies on the level of infrastructure expenditure in the EU ranked Italy in 14th place - with a score of 54.1% compared to 63.4% by the UK and 100% by Belgium. At the same time, the Italian economy has long faced a high level of public debt to Gross Domestic Product, when compared with the OECD average. Against this background, the participation of the private sector to infrastructure investment is a very attractive option. Luigi de Pierris & Gabriele Pescarini, Unita Tecnica Finanza di Progetto, UFP

The willingness to attract greater levels of private participation in the ownership and management of historically public infrastructure has been expressed in a number of official policy statements of the Italian government.

The 2000 - 2003 Economic and Financial Planning Document states that "the involvement of the private sector in financing, building and operating infrastructures and public utility services is a priority for the South of Italy and the rest of the country".

In addition to that, the 2001 - 2004 Economic and Financial Planning Document, prepared by the Italian Government, estimated that the private sector would need to contribute E9b towards the financing of new infrastructures.

The Italian infrastructure gap		
Infrastructure level: (max - 100)		
1	Belgium	100.0
2	The Netherlands	85.2
3	Luxembourg	84.8
4	Japan	76.6
5	Denmark	72.9
6	Austria	70.2
7	Germany	68.1
8	France	64.1
9	U.K.	63.4
10	Sweden	57.7
11	Canada	57.0
12	USA	55.8
13	Norway	55.6
14	Italy	54.1
15	Ireland	44.4
16	Finland	42.0
17	Spain	35.2
18	Portugal	32.1
19	Greece	24.3

Source: CNEL 1998

The main measures taken by the Government to achieve these objectives were:

- The existing legislation enacting the EU Directives on public works was amended in 1994 and in 1998 to deal specifically with limited recourse project financing;
- Additional legislation, enacted in 1999, identified three "pathfinder" projects (two motorways: the Pedemontana-Veneta and the Salerno-Reggio Calabria; and the link between continental Italy and Sicily);
- An ad hoc team of professionals (the Unita Tecnica Finanza di Progetto or UFP) was created and entrusted with the mission of promoting PFI/PPP techniques in the infrastructure sector. The UFP started operations in July 2000;
- A provision (clause 57) was introduced in the 2001 budget law to strengthen the role of the UFP as the official advisor to the Administration in connection with large PPP projects.

It should be noted there are already many examples of the use of limited recourse project financing techniques in Italy. The liberalisation of the power production sector in the early Nineties gave rise to a number of limited recourse transactions aimed at the financing of co-generation plants. According to estimates prepared by the Italian Banking Association (ABI), total private investment in this sector exceeded E5bn. These transactions have established new contractual practices in Italy (EPC contracts, PPAs, etc) and have given unquestionable evidence of the potential of the instrument, paving the way for its application also in other public infrastructure sectors.

One should be aware, however, that legislation introduced in 1994 and 1998 (the so-called Merloni Law) allows the Administration to pay compensation to the Concessionaire only on the condition that the tariffs for

the use of the related services are regulated. Furthermore, the legislation states that compensation from the Administration to the Concessionaire cannot exceed 50% of the construction cost of the infrastructure.

While the legislation does not specify which public payments constitute compensation in exchange of the application of regulated tariffs and, conversely, which public payments are to be considered commercial consideration paid to the Concessionaire for the provision of a service, the prevailing interpretation is that all payments from the Administration to the Concessionaire should be taken into account for the calculation of the 50% threshold. The establishment of PPPs in sectors such as education, healthcare, defence, social housing, prison services - where the Concessionaire provides a service directly to the Administration, which then pays the Concessionaire in return for services provided on a commercial basis - is therefore not adequately captured by the provisions of the Merloni Law. The UFP is trying to identify adequate instruments to introduce elements of Public-Private Partnership also in these sectors, making recourse to specific contractual instruments such as leasing structures and other techniques.

Environment

About 80 million tons of waste (of which around 34% are Municipal Solid Waste) are collected each year in Italy. Waste disposal has been mainly based on landfills, but recent changes in environmental legislation (see Law 22/1997, the so-called Ronchi Decree) provide strong indication to reduce waste disposal into landfills and to incentivise waste-to-energy and recycling activities. As a result, new opportunities for project finance deals are arising, mainly in the waste-to-energy sector, through BOT concessions or private/public joint

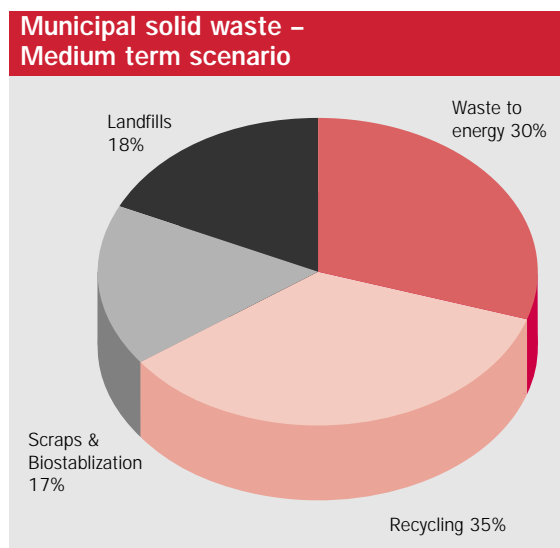
ventures. A further boost to waste-to-energy should come from the enforcement of Law number 79/1999, which pursues the complete reorganisation of the power sector in Italy. In particular, this law provides that, in order to stimulate the production of power from renewable sources, starting from 2001 power producers and/or importers must put on the electricity market a quota of production generated through renewable sources. This quota has been set by the Law at 2% of the overall power produced or imported by large power operators (exceeding 100GWh/year of sold volume, not including co-generation, self-consumption and export). It has been estimated that, in the medium term, waste-to-energy will result in an additional power production, about 4.400GWh/year.

It is estimated that since 1998 approximately 20 new plants started construction and/or operation, a number of which is being financed through PFI/PPP structures. We would mention the successful syndication of the Lomellina, Piacenza and Trezzo projects. Financial structures in this sector have taken advantage from the experience made by the banks in power deals. Debt to equity ratios have normally assumed values of about 85:15 while margins have been relatively lower than margins in power transactions. Other projects are under development, mostly in the north of Italy.

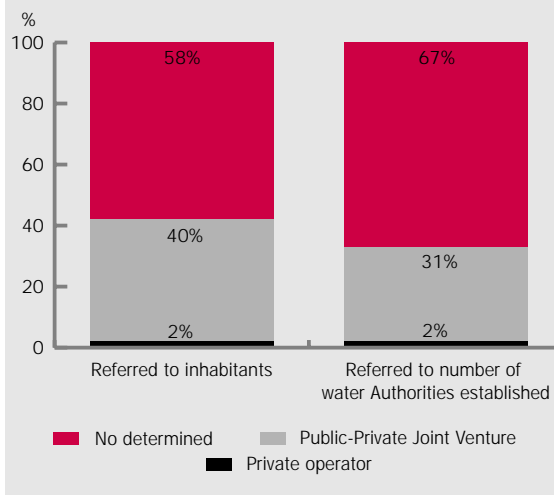
Water

Pursuing legislation enacted in 1994 (Law 36/94, the so-called Galli Law) the water sector is going through a profound reorganisation aimed at transforming a sector characterised so far by extreme fragmentation into an industrialised and integrated one. It has been estimated that in 1994 the water service was provided in Italy by over 13,000 entities, most of which run directly by the Municipalities. One of the consequences of the extreme fragmentation of the sector was its lack of efficiency, with some areas of the country left without a reliable water distribution service. This situation also requires a large amount of investment (currently estimated around E45bn in the next decade), which will obviously need the participation of the private sector.

The reform promotes a process of consolidation aimed at the creation of efficient integrated water utilities with a size compatible with the main industrial challenges of the sector. This reorganisation process should result in a total of 89 Water Authorities (48 has already been set up) - each of which with jurisdiction over a well-defined territory - with the mission of promoting efficiency and competition in the water sector. Until now, only two concessions have been awarded by Water Authorities under Law 36/94 (Arezzo and Valle del Chiampo), while other tender procedures are in process (Latina, Frosinone).



Approved forms of water utilities (48 of 89)



While the Galli Law clearly opts for the integrated water utility model, in a few cases the urgent need to address unacceptable water supply and treatment conditions has forced the Administration to launch tender procedures for BOT projects. The UFP is currently assisting the ad-hoc team appointed by the President of Regione Campania for the rehabilitation of five wastewater facilities in the area of Naples, for an estimated investment of E200m. Offers from private bidders are due by the end of June 2001.

Another example is a E140m water adduction scheme in Catania – Sicily, which is expected to be presented to the market later this year, subject to a clarification on the available level of EU funding.

Transport

Motorways

The traffic of goods and passengers in Italy is largely based on the existing road network, which was mainly built in the Sixties. Modal split is very unbalanced, with 90% of trips taking place on lorries or cars.

Furthermore, high quality road infrastructures and land accessibility brought Italy to have, among the European countries, the highest number of cars per capita (54 cars each 100 persons).

Due to the reduced level of investment in new roads during the last thirty years and the simultaneous increase in the numbers of vehicles, the road network - in particular motorways - has become inadequate: it has been calculated that in Italy there are 110 vehicles per kilometre of existing roads - more than twice the European Union average (47 vehicles/km).

Although the recently approved National Transport Plan aims at re-balancing the modal split, there is still a need to revamp the existing road network as well as to build and operate new motorways to reduce actual congestion.

Investments planned for the next ten years are in the region of E30bn. It is expected that the full enforcement of the Law 112/98 - which delegates to the Regions powers to manage the process related to the implementation of regional transport networks, including regional motorways – would accelerate the process of building new roads.

Rapid transport systems

The Ministry of Transport estimates total investment in this sector at E12.5bn in the next ten years. According to the Law 211/92, Rapid Transport Systems may have access to central government funding, which may cover up to 60% of the capital investment of each project. For the current year, about E750m have been committed.

Despite this, local Governments are finding difficult to attract the private sector. In the presence of the political will of maintaining low fares to end-users, it is often difficult to stay within the threshold of maximum public contribution (50%) and of the maximum concession period (30 years) set by the L.109/94 (Merloni Law).

New motorways

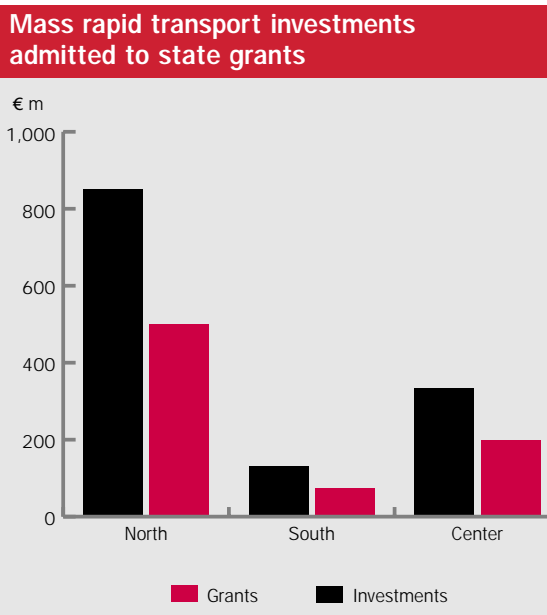
Main new infrastructures	€m
Asti-Cuneo motorway	835.6
Pedemontana Lombarda motorway	1,962.5
Milano-Brescia motorway	816.0
Pedemontana Veneta motorway	774.7
Mestre by pass road	818.1
Genova ring road	1,549.4
Ancona ring road	302.1
Siracusa-Gela motorway	891.9
Total	7,950.3

Source: Italian Government transport plan

Expanded motorways

Main revamping and expansion	€m
A1 – Bologna-Firenze Motorway	2,995
E45 Orte-Cesena	594
Aurelia – Rosignano – Civitavecchia	870
Salerno-Reggio Calabria Motorway	5,836
Messina-Palermo Motorway	723
E45 extension (Ravenna to Mestre)	775
A28 Scile-Conegiano	129
Roma Ring Road	615
Salerno-Avellino ring	83
Napoli-Salerno Motorway	320
A4 – Torino-Milano Motorway	485
Termoli-S.Vittore (freeway)	1,033
Total	14.458

Source: National Transport Plan



Courts and prisons

Due to the phasing out of old facilities and the increase in the number of inmates, the Ministry of Justice will have to create new prison capacity in a relatively short period of time. A total amount of E400m has been earmarked towards the construction of 22 new prisons, and the introduction of PFI/PPP techniques is being considered. The maximum level of compensation payable by the Administration (the 50% threshold referred to in the introduction) may however pose a serious constraint to the implementation of PPP techniques. This being said, the Ministry of Justice, in consultation with the UFP, has undertaken a review of the existing legislation aimed at identifying suitable procedures to introduce elements of Public-Private Partnership in the construction and operation of Courts and Prisons.

Defence

The Defence sector has been of the most relevant for PFI transactions in the UK, with over E7bn of projects reaching financial closing and other E5.5bn in process.

In Italy, the first successful deal incorporating PPP features has been completed last year. The so-called Project Academy is a E125.7m asset backed transaction, which finances the construction (but not the operation) of a new academy for the Italian tax police in Bari.

The deal has involved the issue of Euro-denominated zero coupon discounted notes, backed by the receivable due under a sale and purchase contract signed between a special purpose vehicle and an existing company based in Bari, which has

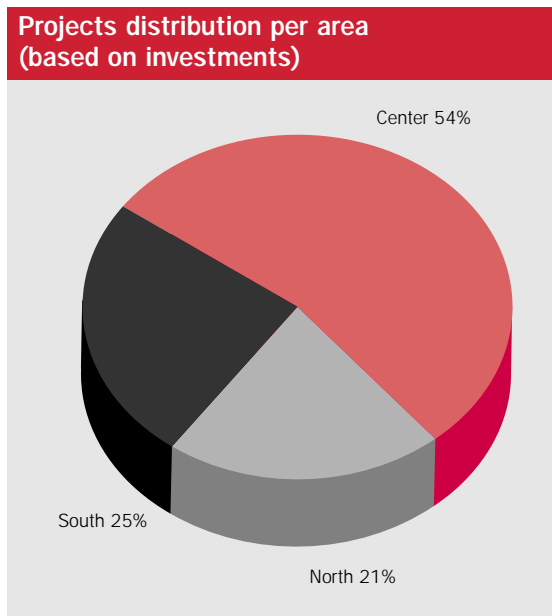
entered into a sale and purchase contract with the Italian Ministry of Finance. The transaction has been based under an article of Italian civil as an exception of the Merloni law.

Some opportunities could arise also in the area of accommodations for military personnel. It has been estimated that a total investment of around E5bn should be put in place to satisfy the needs of the families of military personnel due for relocation. In this respect, the 2001 Budget provides that the Ministry of Defence should rationalise its huge property portfolio by divesting non-strategic real estate and using the proceeds to fund the construction of accommodations in new areas and improving O&M programmes.

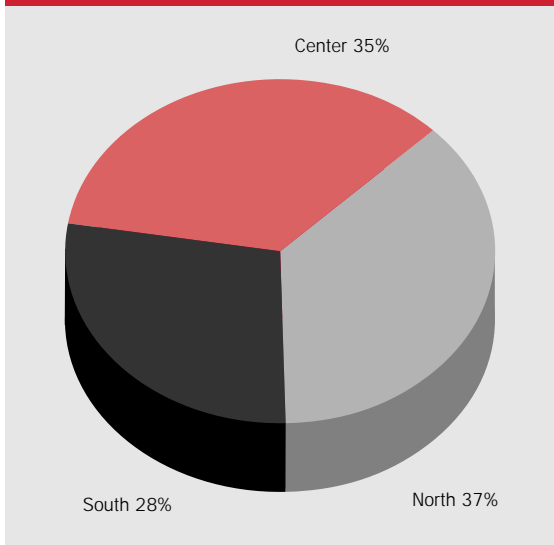
Healthcare

During year 2000, total healthcare capital expenditure has reached E7bn. Recent changes in the sectoral legislation (Law 502/92 and 229/99) have delegated more powers to the Regions in the management of healthcare services. This is likely to stimulate the recourse to PFI also in this sector.

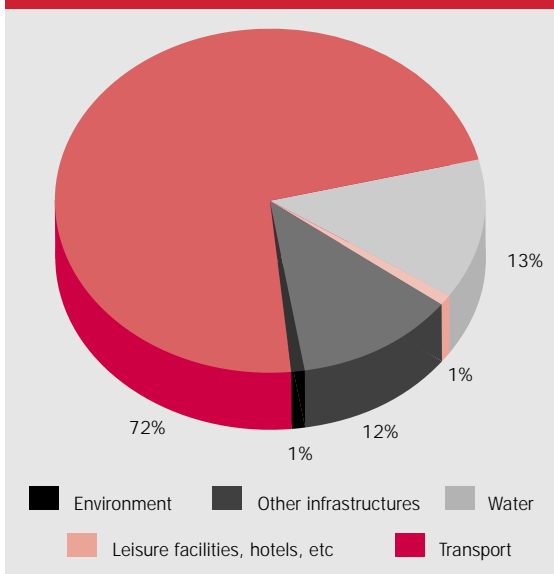
Local Healthcare Authorities (Aziende Sanitarie Locali, ASL) are now required to act as private entities and are subject to stringent economic and financial constraints: the new legislation introduces limits to the amounts that the ASL may borrow (15% of annual revenues) and to the tenor of their debt (maximum 10 years). As a result, Local Healthcare Authorities have now greater accountability in managing operating costs as well as financing of capital expenditures and therefore they have greater motivation in exploring the opportunities that



**Projects distribution
(based on number of projects)**



**Projects distribution per sector
(based on investments)**



PFI/PPP methodologies can offer. One should be aware, however, that the healthcare sector presents the same constraints as prisons and courts with respect to maximum level of compensation payable by the Administration (the 50% threshold referred to in the introduction).

The activities of the UFP

Since July 2000, UFP has started advisory work for central and local administrations on more than 50 projects, for an overall amount of over E7bn. More precise statistics on this activity will be disclosed in

the first annual report of the UFP to the Government this coming July 2001. Of the over 50 projects under examination, they are quite homogeneously distributed among north, centre and south of Italy. Sectors vary from transport and water to healthcare, conference centres, office districts and national heritage. Moreover, as the reader of this paper would certainly realise, one of the challenges facing the development of PFI/PPP in Italy is the ability to identify workable solutions to the problems created by a very prescriptive civil law system. For instance, it is a fact that the reformed legislation on public works is not fully consistent with sectoral legislation governing industries such as water and public transport and that it does not deal easily with transactions in which the infrastructure does not generate directly user revenues.

The UFP is working towards the identification of the key factors having a negative impact on the full development of PFI/PPP techniques in Italy with the objective of indicating to the market workable solutions. The UFP has so far devoted particular attention to sectors such as water and wastewater, public transport, healthcare, courts & prisons.

Finally, the UFP is also entrusted with a policy making role, and is entitled not only to indicate a set of best practices to the market, but also to recommend legislative reform aimed at promoting the participation of the private sector in the investment of public infrastructure.

**Projects distribution per sector
(based on number of projects)**

