



The Return of PPP: Mediterranean Governments Relying on the Private Sector for the Next Wave of Expansion

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Public private partnerships (PPP) had traditionally been justified on a project-specific basis, with only a handful of projects under review at any point in time. The economic crisis has changed that paradigm: heavily-indebted governments worldwide will need the private sector to realize the next wave of capacity expansions. The motivation for PPPs is changing, and this will change the balance of power between port authorities and terminal operators. Port authorities will need to sign longer-term agreements that cover a broader range of logistical activities and offer them a greater say in the structure of the agreements.

THE RECENT RESURGENCE OF TRAFFIC AND RATES

Based on Q1 results, one may be tempted to think that resurging volumes will allow port authorities to revert to their pre-recession expansion path by assuming that continued higher revenues will fund their capital expansion plans, thereby bumping PPP to a lower priority. Indeed, traffic has begun to spring back. Regional Mediterranean exports are forecast to surge at about 12% this year, according to *The Economist*, while imports will increase by about 8%. Traffic in France and Spain, which dominate the Med block trade, seems to have turned the corner.

- Traffic at Marseille-Fos increased by 17% in Q1. Its breakbulk traffic was up 52% in Q1 on the reactivation of an ArcelorMittal steel mill, and Asian and Chinese trades rose 30-40%, respectively. A host of new services came onstream, including CSAV's Asia-Eastern Mediterranean service, a Med-Gulf Express service to the United States and Mexico, CMA-CGM's container service to Morocco, a container-ro-ro operation to Algeria, Delmas' new service to West Africa, and two ro-ro services to the eastern Mediterranean. Vopak will build a liquid bulk terminal at Algeciras, and Port Said negotiated a new bunkering contract with Sonker Bunkering Company.
- Exports from Spain are forecast to rise 17%, and from France 11%, in 2010. This translates to more machinery and equipment, petroleum products, and chemicals flowing from France to Spain and Italy; more transport equipment flowing from Spain to France, Germany, Italy, and Portugal; and more liquid bulk flowing from Italy to France (in addition to the UK, Netherlands, US, and Germany). The recovery means more textiles, phosphorus, electrical equipment, and leather products flowing from North African countries to Italy, Germany,

Spain, UK, and other countries. (The weight of Greece's trade relations with non-Mediterranean countries should limit its impact on the Mediterranean shipping community.)

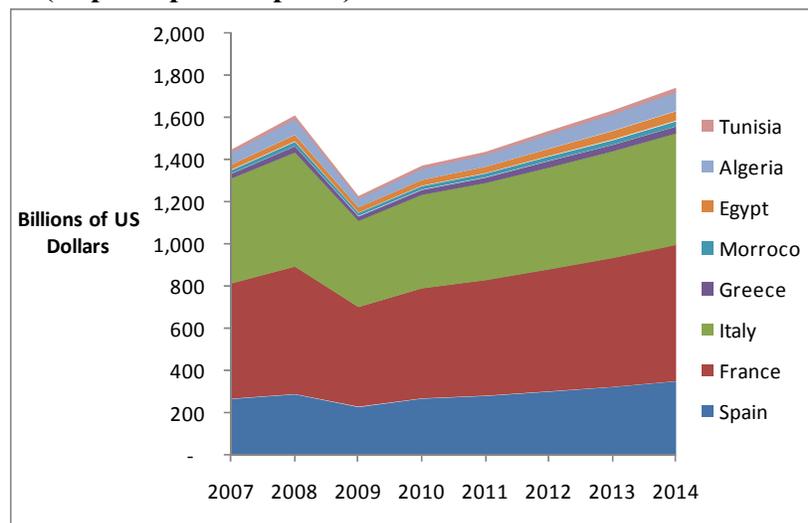
- Shipping lines have raised rates, which could also trigger increases in terminal operating revenues. Rates have doubled since last year at this time (or more, in some cases). MSC also applied a \$100/container surcharge in February from Spain to all points in the Middle East and Asia on the strength of those markets. UASC also raised rates in February.

THE LONG-TERM ECONOMIC OUTLOOK AND PROSPECT OF A DOUBLE-DIP

However, the picture is not as rosy as it may seem, at least for the near future.

Total trade into and out of the region fell almost twice that (23-24%) in 2009 as it rose in 2008 (exports were up 11% and imports were up 13%). Overall traffic fell 30% in Barcelona, 25% at Marseille-Fos, and 19% in Turkey (imports). The drop in trade volume was so severe that the combined volume of exports plus imports for the region as a whole will only attain 2008 levels again in 2013.

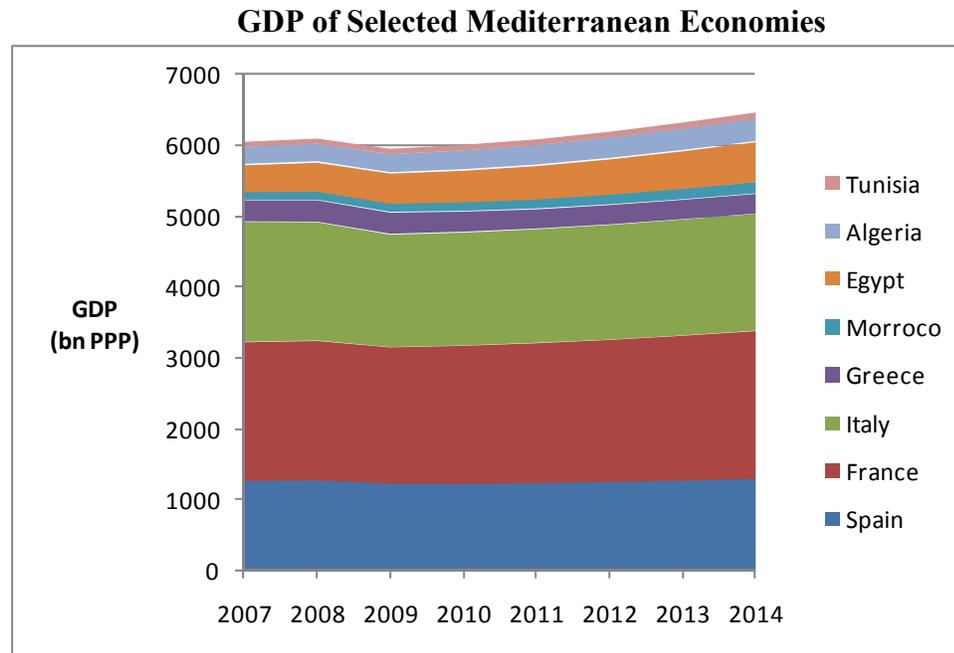
Trade (Exports plus Imports) for Selected Mediterranean Countries



Source: Boston Strategies International analysis of data from The Economist Intelligence Unit.

In addition, several key Mediterranean economies will stagnate, limiting local traffic growth. France and Italy will eke out 0.5% to 1.5% growth in 2010. France will experience slower growth in 2011 after stimulus funds run out. Spain and Greece will continue in recession throughout 2010. Spain will be slightly negative (-0.4%) in 2010 and recover (+1%) in 2011. The Greek economy will contract at 4.6% in 2010 and 4.1% in 2011, but will return to positive growth (barely) in 2012. On the bright side, North Africa (Morocco, Tunisia, Algeria, and Egypt,

and Libya) will grow before, during, and even (albeit a little slower) after the recession, at about 2-5% per year.



Source: Boston Strategies International analysis of data from The Economist Intelligence Unit.

Finally, public debt and unemployment will continue to limit the availability of public funds for capital investment. Greece's debt, currently 104% of its GDP, will rise to 140% before falling to 97% as a result of its recent debt restructuring. To cover its debt burden, the Greek government has invited Abu Dhabi's Mar group to take over Hellenic Shipyards near Athens after ThyssenKrupp pulled out. Italy and France will remain mired in debt through at least 2014. Italy's debt exceeds its annual GDP and will grow through 2014. France's debt, which was 64% of its GDP in 2007, will rise to 94% by 2014. Related to the debt load, Spain's unemployment is currently peaking at almost 20%, and Greece's, currently 12%, will rise until about 2012.

STRUCTURING THE DEAL

As a result of the fragile economy, port authorities now have a greater interest in shifting debt and risk from what has traditionally been government investment and expenditure to the private sector in the form of PPP investments. Concessions and management contracts of various kinds have been tendered worldwide, including for example at Singapore, France, Syria (the port of Latakia is under a five-year management contract with NDP and Tartous is under a new contract). In addition, Turkey recently loosened its legal frameworks to facilitate foreign investment.

However, in exchange for shouldering more risk, savvy private operators and investors like DP World, APM, and Hutchison may ask public agencies and authorities to sweeten the pot by offering them:

- A broader range of outsourced activities in order to spread the risk and increase the opportunity for profit
- Longer contracts, in order to delay the expenditure of initial capital and extend the years of profitable payback
- Limited upfront investment commitments
- Guaranteed contract extensions with fewer options, indexes, and flexible terms that could shift risks from the government to the operator

Some long-term concession and operating agreements are indicative of the trend, for example:

- In water ports, the Port of Oakland signed a 50-year concession agreement in March. The \$700m deal involved multiple financial and legal advisors, and requires \$2.5b in investment over the term of the agreement. In addition, COSCO signed a 35-year concession agreement to operate the port of Piraeus.
- In rail, Armenia let a 30-year concession contract (with optional 20-year renewal) after inviting tenders to bidders from 40 countries.
- In airports, Sydney Airport (Australia) outsourced multiple aspects of cargo handling on a profit-sharing basis. It outsourced five areas, and allowed the use of subcontractors in many areas, and the consortium used an elaborate system of KPIs to monitor performance and award compensation to the prime operator.

Any oversights or misjudgments in such agreements will extend from Day 1 for up to 50 years. In addition, distortions and inequalities would quite likely amplify as traffic volume grows. Therefore, all parties to such long-term commitments should be sure to engage adequate operational, financial, legal and tax expertise in the early stages of negotiation.

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