Redefining the models for private sector investment in infrastructure – The RAB Model

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Questions

- What is the problem?
- Why has the PFI / PPP model not delivered?
- How does the RAB model work?
- Which sectors could it be applied to?
- What might be the benefits?
- What are the next steps?
What is the problem?

- The time inconsistency problem
- Regulatory and political risk
- Impact on the cost of capital
Why has the PFI / PPP model not delivered?

- The basic structure of PFI deals
- Combination of CAPEX and OPEX with sunk cost recovery
- The problem of bidding
- *Ex post* interventions
- Cost of capital impacts
How does the RAB model work?

The legacy assets

Sunk Investment

RAB

The business

Current CAPEX

Current OPEX

Allowed expenditure
The CAPEX process

- Tendering
- Financing
- Capex Project
- RAB
- Regulator assesses efficient value
- Debt financed
- Equity + project financed
The split cost of capital

**Competitive tendering**
- CAPEX + OPEX
  - Equity & project finance

**Duty to finance functions**
- RAB
  - Debt-only

**WACC**
- Marginal cost of equity
- Marginal cost of debt

*(massive) Financial arbitrage*
What sectors could it be applied to?

- Waste
- Roads
- London transport / london underground
- Flood
- Renewables
Waste model

- Collection
- Sorting
- Energy from waste plants
- Anaerobic digestion plants
- Landfill
- Hypothecated council tax contribution
- Industry charges
- Waste charge
London underground / London transport model

- Existing underground track & stations
- OPEX
- REPEX
- Fare-box
- Treasury contribution
- CAPEX
- TfL contribution

Treasury contribution

TfL contribution
Roads model

- OPEX
- REPEX
- CAPEX
- Road fund licence fees
- Charges
- Gov’t contributions – local & central

RAB

Existing Roads
Floods model

- User charges
- Water levy
- Gov’t contributions
- Housing & planning contributions
- CAPEX (ex EA)
- OPEX (ex EA)
- Flood defence infrastructure

RAB
Renewables model

WIND FARMS
CCS
SOLAR INSTALLATIONS
NUCLEAR

RAB "WRAPPERS"

PENSION FUNDS
LIFE FUNDS
UTILITY BOND

GREEN INVESTMENT BANK
Regulatory consequences

Highways Agency → ORRT → ORR

G.I.B. = Renewables “Wrapper”

OWWF → Ofwat → Waste (local authority functions)

EA economic regulation
What might be the benefits?

Cost of capital > 10% real

Project CAPEX

Completed asset

Equity & project finance

Debt

Cost of capital < 5% real

Refinancing point
Applied to £500bn CAPEX requirement

- 1% ↓ cost of capital ⇒ ↓ £5 billion PER ANNUM
- Assigns political and regulatory risk where best managed
- Creates major new low-risk investments
  for savings ↑
What are the next steps?

- NIP programme
- Case-by-case evolutionary approach

And....

- Buy back existing PFI....
For information:

- “Infrastructure and infrastructure finance: The role of the government and the private sector in the current world”, EIB Papers, vol. 15 (2) on *Infrastructure and infrastructure finance*.
- “Rethinking the Economic Borders of the State”, *Social Market Foundation*, November 2010.
- “Utility regulation, the RAB and the cost of capital”, Competition Commission Spring Lecture 2009.

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