INVESTMENT

Building together

Sandra Haurant examines how public-private partnership projects are changing and the opportunities available for pension funds

In public private partnerships (PPP), the private and public sectors work together to fund and produce projects or public services that would traditionally be provided by the public sector.

The approach has traditionally been used in a vast array of fields, as Norway's largest pension company KLP senior analyst, Christian Andre Dahl, explains: "For the public sector, PPPs can be an efficient way to finance large infrastructure projects. Norwegian PPP projects come in different structures, sizes, and risks. In recent years, we have seen the Norwegian government and municipalities organise the construction of, for example, roads, schools, police stations, fire stations and public swimming pools as PPP projects."

Today, projects aimed at improving technology infrastructure are another big area for PPP activity. "The delivery of high-speed broadband is a PPP example in several countries, currently," says IFM Investors director of public affairs, Gregg McClymont. He cites GlasfaserPlus, a PPP project in which IFM Investors is working in partnership with Telekom Deutschland GmbH (TDG), a subsidiary of Deutsche Telekom AG, in the rollout and operation of an open-access optical fibre-to-the-home (FTTH) network in rural areas of Germany. "By 2028, GlasfaserPlus aims to have rolled out fibre to up to four million homes in selected rural areas," says McClymont.

What's in it for pension funds?

The PPP sphere is one that pensions have long favoured, offering, at least in theory, a win-win situation. Important projects get the finance they need, and pensions get the long-term investments that so often suit them. Indeed, says Sampension deputy chief investment officer, Jesper Nørgaard: "In the past we have found them interesting, in the sense that we would have a privileged counterpart on our projects, which might involve building office blocks, for example, which we would rent out on a long-term contract. That would mean we could harvest a long-term cashflow, with some illiquidity premium attached to it."

"Investments in PPP projects can be complex and require a lot of work," Dahl adds. "Still, they can have qualities that can make them attractive investments for KLP and other pensions funds. Both as a consequence of KLP's internal investment strategies and as a result of regulatory requirements, long-term investments with low risk are interesting for KLP and for many pension funds."

As an investment choice, PPPs also create balance within a broader portfolio, adds McClymont: "PPPs offer pension funds access to infrastructure equity and/or debt asset classes, which can provide useful diversification in a portfolio, as a source of long-term returns often uncorrelated to other asset classes."

Perfect partnerships

For KLP, PPPs are a natural extension of the organisation. "KLP is owned by Norwegian municipalities, health enterprises and businesses with public-sector occupational pensions," says Dahl. "Therefore, it is particularly appealing for us when we can allocate some of our capital back to projects in Norwegian districts."

Indeed, KLP has invested more than NOK 1 billion (almost €85 million) in loans to four Norwegian PPP projects related to the construction of schools, and in these cases, KLP was the sole lender. But the organisation has also invested in other projects as part of a consortium, such as in the construction of a new toll road, with DNB and Oslo Pensjonsforsikring, with Skanska as the construction company.

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Losing momentum?

While there are plenty of active projects underway, Dahl says that appetite for PPPs is currently low in Norway, and it's an issue faced by others in Europe, too.

Nørgaard says that in Denmark, the public sector has increasingly "chosen to run the projects themselves," instead of embarking on partnerships with private institutions.

"Projects have been fully publicly funded, or traditionally publicly funded either through the issue of Danish government bonds or, in the case of the municipalities, they have some very efficient bond insurance vehicles as well."

He goes on: "It's perhaps a local Danish issue, government debt in Denmark is actually falling, because they have been running extremely prudent budgets for the past few years. So, there hasn't been a lot of appetite from the government side to enter into these partnerships."

And, McClymont, explains: "Volumes of PPPs have declined globally over the past decade," he says. "For pension funds, expertise is necessary to participate as an equity partner. From the government side, with public budgets stretched, the attraction of pension capital is obvious, but realism is necessary with respect to the inevitably higher cost of capital when financed privately."

Back by popular demand?

Certainly, pension funds are fond of the benefits brought by PPPs, and according to a survey published in Denmark in May 2024, the public is keen, too. Sampension's research showed that 60 per cent of the Danish respondents were in favour of the new increase in PPPs within the defence sector – a shift brought in by recent policy changes, and through which certain pension funds are collaborating on projects, such as the construction of warships. However, defence is not a field that all schemes will readily get involved with, at least not without restrictions; Sampension, for example, will work on projects involving real estate for military use, such as army barracks, but those projects that involve arms are outside its remit.

Another area in Denmark that has seen calls for greater PPP implementation is the healthcare sector. The country has been moving towards a series of 'super hospitals' designed to provide centres of healthcare excellence. One such hospital, for example, should have opened in autumn 2021, but following delays, it opened just some of its wards to a limited number of patients 18 months late, and is expected to open fully in 2026. As a publicly funded project, it raised questions over whether private sector involvement could have delivered in a more efficient manner.

Calls for more

In the Netherlands, there have also been calls for greater opportunities for PPP projects. In March this year, the five largest Dutch pension schemes wrote to the government urging it to boost the PPP market with the creation of a national investment institution. ABP, PMT, bpfBouw, PME, and PFZW wrote an open letter urging the state to increase the opportunities for collaboration and emphasising that working in partnership with the government would allow them to "achieve long-term stable returns and make an important contribution to the necessary energy transition".

Looking ahead

Across Europe, there is need for investment in public infrastructure projects that allow countries to meet their goals. It's certainly the case in Norway, says Dahl. "This applies to many sectors, including the transport sector, water and waste-water, education and social infrastructure and the health sector. We think private capital and specifically pension funds will continue to have a role to play when structuring infrastructure projects. PPPs can be an efficient way to channel this capital into public infrastructure projects."

But, he adds, the area has been "politicised," with many arguing that private investors should not be involved in the financing of public infrastructure, and others saying that not all public authorities have the financial strength to allocate large amounts of capital from their limited investment budgets to finance large infrastructure investments.

Dahl asserts that: "KLP does not participate in these political discussions, nor do we try to influence these decisions." Instead, he says: "Our view is that PPPs, when structured in the right way, should give all parties the right incentives to build, operate and maintain public facilities with a long-term horizon. We maintain our view that PPPs have the potential to be sound investments for KLP."

Meanwhile, says McClymont, PPPs could well see a resurgence, particularly as Europe moves towards meeting its 'Fit for 55' emissions reductions plan, under which countries aim to reduce greenhouse gas emissions by at least 55 per cent by 2030, among other commitments.

"For larger pension funds with expertise in the asset class, the attraction is therefore obvious," says McClymont. After all, he says: "The reality is that the public balance sheet in many countries cannot sustain an approach where all the necessary transition financing is raised by government debt," and as such, McClymont argues, PPPs are likely to be the object of renewed interest.

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