Liquidity and the secondary PFI market

Robert Rees, Partner with Secondary Market Infrastructure Fund, charts the progress of competitive secondary markets…

Last year witnessed significant activity within the secondary market for PFI equity both in terms of investment and fundraising activity. SMIF, the first and largest of the secondary funds, has now completed the acquisition of 40 PFI interests, with over £350m of funds already committed to the market, and has completed further capital raisings of nearly £320m over the last nine months. SMIF is now well placed to achieve its initial target of £500m of investment in the secondary market.

Taking all the major funds into account, there is now over £1.5bn available for secondary market assets. On a conservative estimate of value, this would account for around 25% of the completed PFI market (more if the Tube is removed from these figures) and 20% of the signed PFI market. We estimate that around half of this has been invested.

It is clear that, whatever the public pronouncements of some, there are enough willing sellers to create liquidity in the market. And there is no doubt that liquidity, or at least the perception of liquidity, is vital if value for money arguments for PFI are to be maintained.

In addition to the weight of money headed towards secondary PFI, there are several other areas that have contributed to growth in liquidity. First, there has been a blurring of the simplistic identification of the primary/secondary market with the construction/operation phase. Some secondary funds, including SMIF, are purchasing investments still within or at the commencement of the construction phase. Many contractors have recognised this by increasing their initial stake in projects in anticipation of an early sell down to the secondary market. Second, legal structure and precedent have, in the main (with one or two important exceptions), also settled down so as to provide a stable climate in which to trade. Of key importance in this area was the definitive advice from government that secondary sales were not to be construed by the public sector as refinancings. Third, the market has proved resilient under specific shocks, such as those that befell Jarvis at the end of last year. Fourth, the wider market is coming to appreciate the unique attractions of the PFI structure and analysts are beginning to price this properly in relation to quoted PFI companies.

Secondary funds can contribute to this overall growth in liquidity in a number of ways. The accumulated spending power in the sector provides considerable opportunity for competitive tension to sellers. However, of equal importance is the ongoing value enhancement and asset management that secondary funds can offer. It is crucial to all parties and, in particular, the public sector that assets operate effectively over their full concession lives. This needs active management and, in recognition of this, many secondary funds, ourselves included, have created asset management subsidiaries to oversee all aspects of service provision. Furthermore, the existence of a traded market will aid future valuation and analysis by the wider investment community.

To summarise, the past two years have witnessed the successful creation of a liquid secondary market and the effects of this are clearly influencing tighter pricing of primary projects. As long as some current public sector concerns on refinancings can be alleviated, then the benefits of a liquid and competitively priced secondary market will be available to all.

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