Bus Fleet Renewal in Developing Countries: The experience of LAC

THE WORLD BANK

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Presentation Structure

Paratransit service provision in LAC Cities

Business practice to support bus fleet renewal

Fleet renewal and bus financing challenges

New business models for fleet renewal and bus service provision

Conclusions

Paratransit service provision in LAC Cities

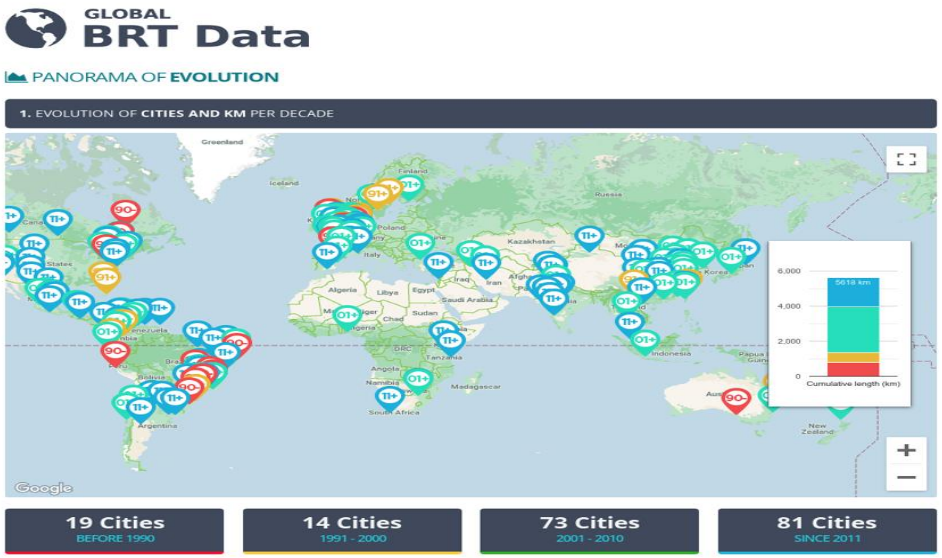
The sector has advanced in areas of formalization and bus renewal

Significant progress has been achieved in areas of bus fleet renewal. Most of this achievement has involved an important level of formalization (using PPP-type schemes)

- ~ 200 cities with BRT systems worldwide
- Several cities with bus renewal programs for non-BRT interventions (CDMX, Guadalajara, Monterrey)

Bus interventions in several developing countries have typically followed a functionally disintegrated approach, disaggregation of a project into different contracts for different components

- Early success of TransMilenio in Bogotá, Colombia and Metrobus Line-1 in Mexico City have led to that model being replicated in other urban bus reforms



Business practice to support bus fleet renewal

Soft and hard measures needed to support bus fleet renewal

Transport Authority

Legal & Institutional Reforms

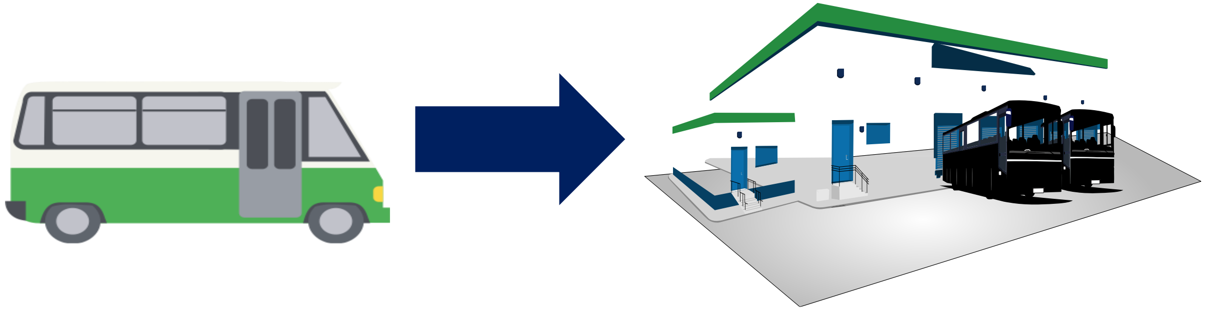
Technical Studies

Dedicated Infra & Technology

Financial Vehicle (Trust Fund)

Operator & Corporate Governance

Rolling stock



Soft and hard measures needed for creditworthiness evaluation

Transport Authority	Ensures service is provided following service standards / limits informal competition
Legal & Institutional Reforms	Enables conditions for service to be provided (concesion/permit)
Technical Studies	Provides technical basis for service (demand, OPEX, CAPEX requirements)
Dedicated Infra & Technology	Improve services, help to optimize OPEX, service exclusivity, prevents revenue leakages
Financial Vehicle (Trust Fund)	Ensures payment of obligations
Operator & Corporate Governance	Ensure best-practices in corporate governance practices

Rolling stock

The Long-term Sustainability Issue and the COVID-19 Outbreak Impact on Fleet Renewal

Despite efforts of formalization, many bus projects have struggled to attract private sector participation, and often fail to achieve long-term sustainability

- ✓ Lower than expected demand with lack of subsidies and inability to generate alternative revenue sources
- ✓ Gains from economies of scale in formalization do not entirely offset increases in operating expenditures (OpEx) and capital expenditures (CapEx)
- ✓ Corporate governance is unknowledgeable regarding improvements needed to address inefficiencies post-implementation

The COVID-19 outbreak exposed many financial vulnerabilities, especially in permit-based conventional bus systems

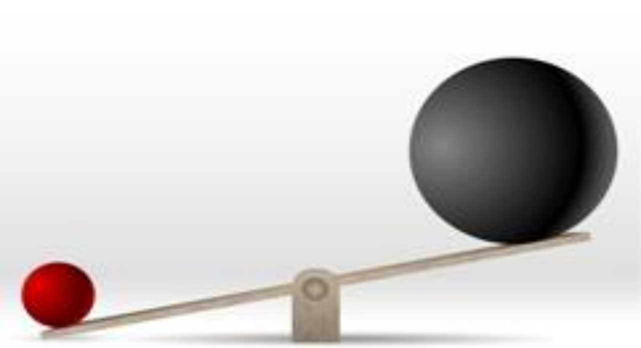
- ✓ Majority of public transport experienced significant reduction in demand levels
- ✓ Debt service for formalized transport systems were renegotiated in most cases

Fleet renewal and bus financing challenges

Limited Appetite from Commercial Banks to Finance Fleet

International Banks do not consider these projects BANKABLE

Small sized projects



High level of risk and complexity

The Role of Bus Manufacturers Financial Arms

- Bus manufacturers provides financial options to bus operators.
- These manufacturers typically offer financial service to operators that manage large fleets.
- Cash flows are evaluated, and buses are used as collateral (there is a secondary market)
- In some cases, they require a partial guarantee

Credit Conditions

- ✓ Interest rate: above what commercial banks can offer
- ✓ Maturity and grace period can be negotiated
- ✓ Equity is also financed or negotiated

Suboptimal conditions

Rolling stock being selected based on which bus manufacturer can offer better financial conditions

Cost of Capital for these bus manufacturers' financial arms are very uncompetitive

Local Commercial Banks

- Local commercial banks tend to understand local markets
- These banks evaluate cash flows and the corporate's balance sheet (if any)
- Corporate assets and buses as utilized as collateral (although, buses as collateral do not have an impact on risk reduction; banks are not "*bus dealers*")
- Partial guarantee is required in some cases (where there is market)

Credit Conditions:

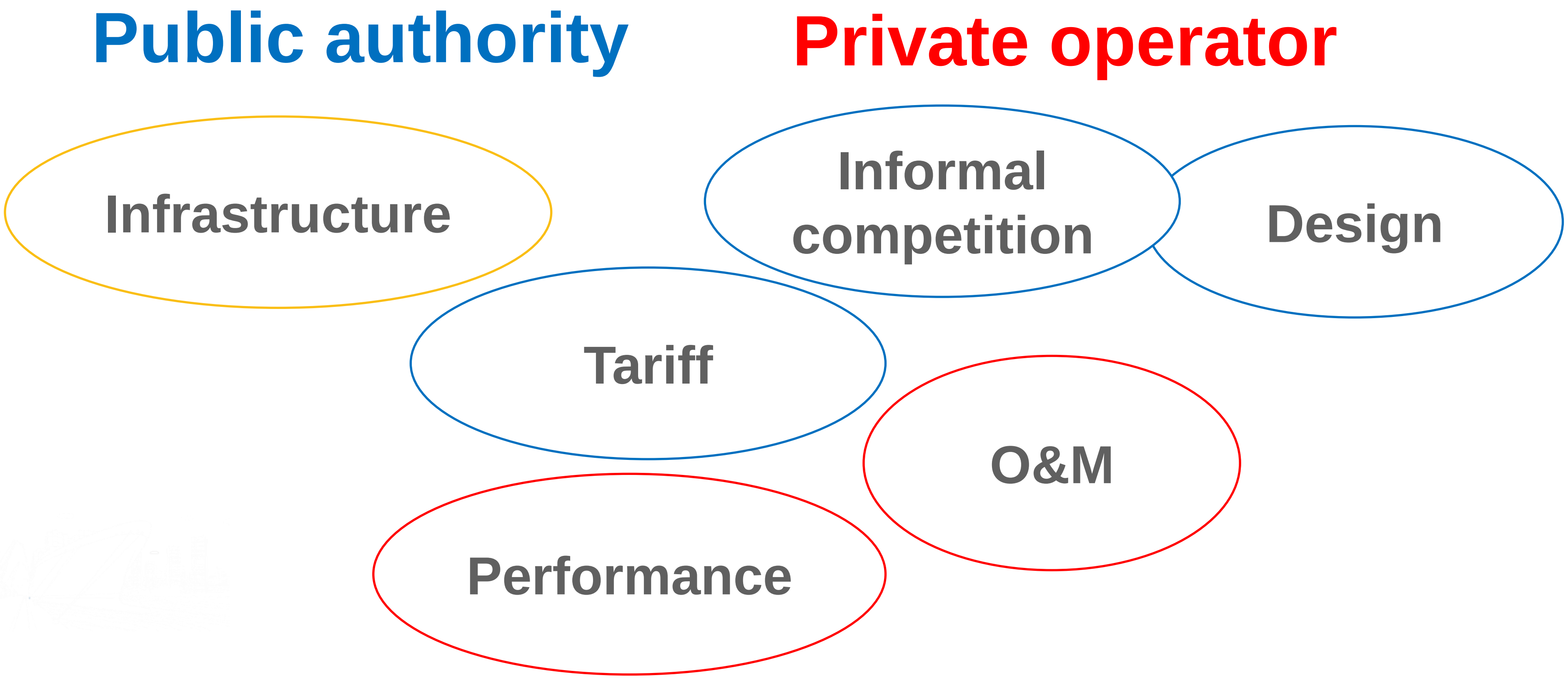
- ✓ Interest rate: more expensive compared to larger/international banks
- ✓ Include the cost of a partial guarantee
- ✓ Limited maturity term: 6 years
- ✓ 6 months grace period
- ✓ 10-20% equity

Suboptimal conditions

- Expensive
- Only available when the operator can prove credit history and has other assets that can be used as collateral.
- These assets are locked and cannot be used for any other financial operation

Paratransit Bus Renewal Challenges

In Paratransit service provision, private operators bear commercial risk that depend on the public authority



Strengths and Weaknesses of Paratransit Service Provision

STRENGHTS

- Is fundamental for the mobility of millions of urban residents
- Offers a wide variety of flexible transportation services with different types of vehicles.
- It is dynamic, agile and adaptable
- Not highly-subsidized
- Open to innovation
- Provides employment opportunities

WEAKNESSES

- A business model highly dependent on income and low social protection of service providers
- Absence of benefits due to economies of scale
- Low operational efficiency, lack of coordination, lack of integration of services, low quality standards, which affects both users and the community.
- Have a sense of "owning" their territory of operation
- Lack of sectoral organizations or recognition of them (for example, workers' unions)
- Little knowledge of the sector and little data available
- Lack sense of governance in the sector
- Significant negative externalities

Creditworthiness evaluation influenced by these weaknesses

New business models for fleet renewal and bus service provision

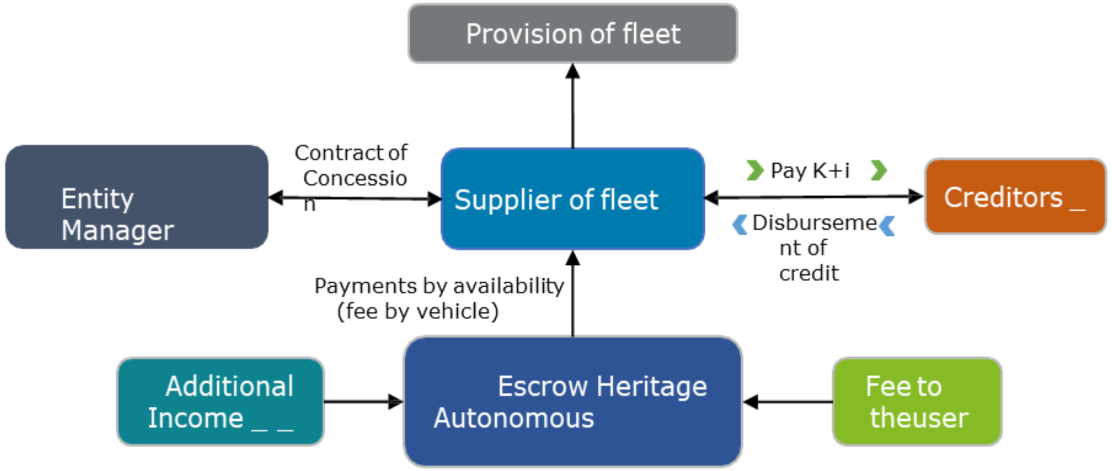
Introduction to unbundling bus

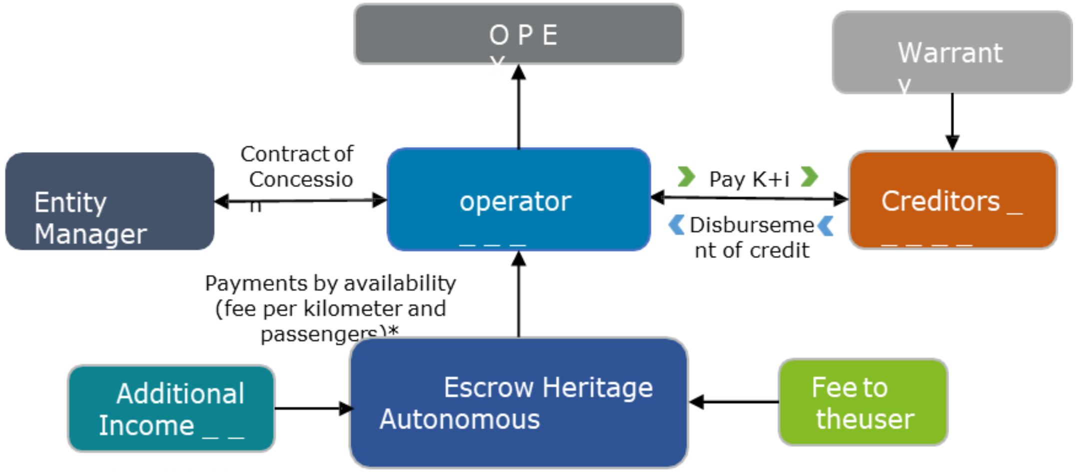
- To address the issue of bus financing, some governments have introduced models where they award **separate concessions** for fleet provision and fleet operation.
- In this model, **the public sector either provides the bus fleet itself or contracts a private sector partner to purchase the fleet for a concession**. Then they provide private operators the fleet under lease and operating contracts.
- This new unbundled approach offers many potential advantages over the traditional model including opportunities to introduce:
  - New funding alternatives
  - Clean and cutting-edge technologies
  - Increased competition
  - Increased flexibility to reallocate fleets

Bundled Approach for Bus Service Provision (Option 1)

proposals mechanisms of Financing

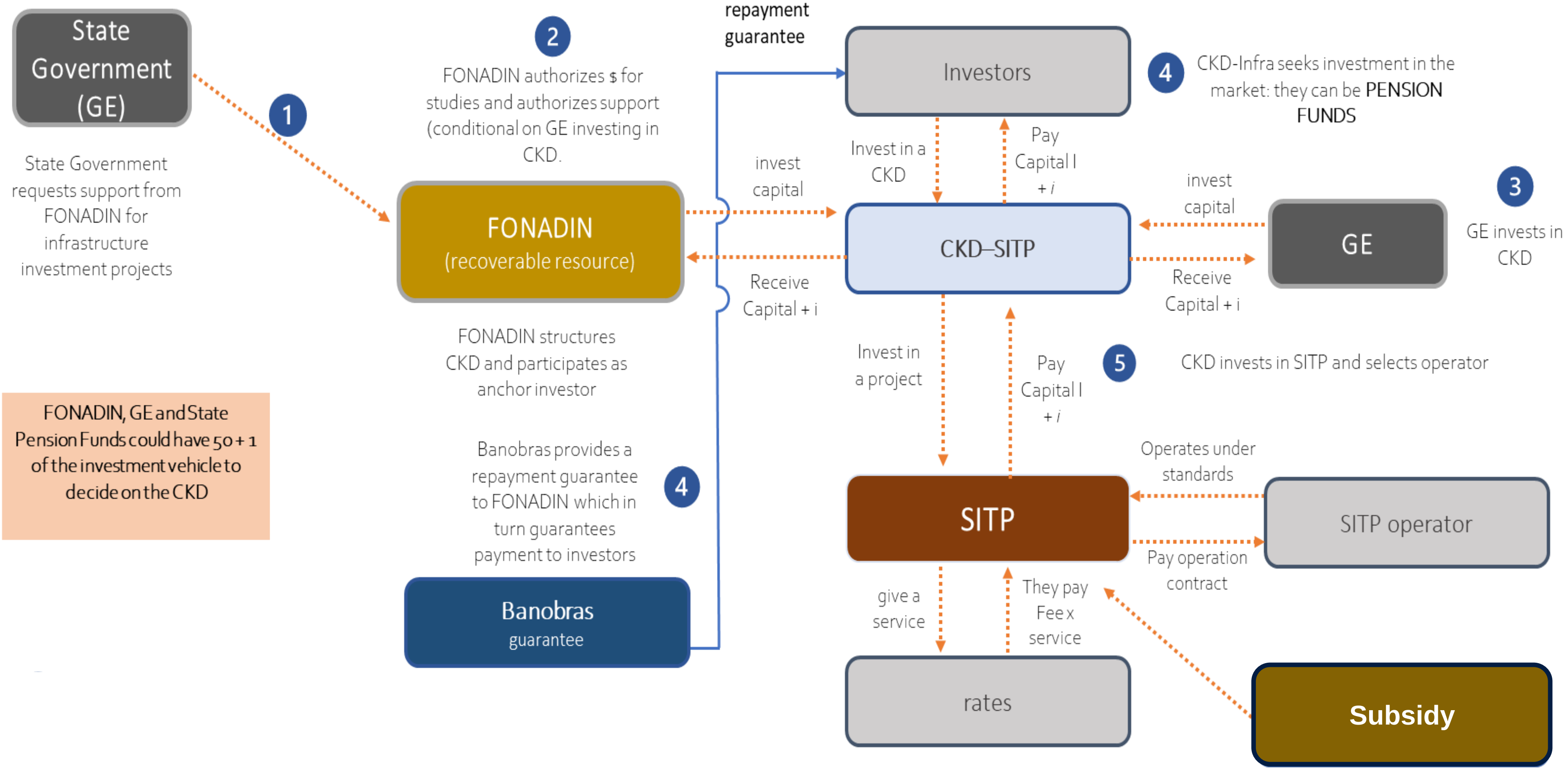
2. Separation of Risks: model of separation of the acquisition of fleet of the operation





* Components that depend of the demand and impact the income, are the that they can arrive affect the liquidity.

Bundled Approach for Bus Service Provision (Option 2)



Conclusions

- Bus renewal requires introducing some level formalization in the informal/semiformal service provision
- Project structuring and risk allocation can help to access financing for bus renewal, but also depends on how advanced the financial sector (e.g. commercial banks) is at appraising and offering credit conditions that fit the needs of the sector
- New structures (e.g. unbundling) can be implemented to overcome the high risk perception of the structures but requires a high level of sophistication at the government/agency level..

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