Hellenic Republic Asset Development Fund

Driving the Largest State Asset Divestiture Yet

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Introduction

Greece & the Financial Crisis

Well into the fourth year of its government-debt crisis, Greece faces some of the toughest challenges in its recent history. With a declining national income for the fifth consecutive year and soaring unemployment rates at 27%, the country seems to have lost all of its credibility in foreign markets. A breakdown of the crisis will reveal internal and external deficits [Ioannides, 2013], where the country on the one hand consumed more than it could produce, and on the other hand it bought from abroad more than it could sell. This was made clear in 2009, when traditional lenders could no longer trust the country to repay its debt to them, and the spreads with the German rates propelled to extreme heights. To pay back its lenders, Greece adopted certain austerity measures mandated by the Troika (EU, ECB, IMF), the harshest of which is the heavy taxation that has brought growth to a stalemate. As Ioannides [2013] argues, growth makes servicing debt much easier, and for Greece, whose debt-to-GDP ratio reached a historical high of 170% in December 2011, robust growth would help reassure its lenders of its ability to repay back its debts, their high level notwithstanding. But to achieve growth, new infrastructure projects, reducing unemployment, and closing massive government budget black holes are warranted.

As the above problems became apparent, Greece's lenders became fearful of a sovereign default, resulting in a crisis of confidence to the country and a downgrading of its bonds to junk bonds in April 2010. This in turn caused yields to escalate and Greece could practically no longer borrow from capital markets. To restore Greece's credibility and get its debt back to sustainable levels, the IMF agreed to issue a €110 M bailout loan contingent upon the country's implementation of harsh austerity measures, long-due structural reforms, and **privatization of over €50 B** of government-owned assets by 2015, denoted in the "Medium Term Fiscal Strategy Plan 2012-2015".

Past Privatization Efforts – Reasons for Constitution of HRADF

Privatization has been shown in the past to be a good way for governments to improve their economy and spur growth. The act of privatizing is by definition selling state-owned enterprises to private investors, transferring thus control and ownership rights to these assets from the government to these individuals or groups. Given a specific economic climate, a government may want to make a significant impact on its economy to jumpstart it. By selling off assets to private investors that either bring no significant revenues to the State, or suffer from poor public management, and by entering into concession agreements with major developers

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for select assets, the government can secure an inflow of foreign capital to the country, provide the grounds for competition and development, expand the national capital markets, and reduce the levels of public debt [Blacker, 2012]. The above cannot be achieved though without a strong commitment to a carefully prepared privatization program.

The privatization process is a highly politicized undertaking, considering implications of selling state-owned land, rights and shares. According to Blacker [2012], governments that seek to implement such a privatization program may be populist, not looking for the long-term economic benefits but for a short-term relief and emergency capital, or committed, shooting for the long-term effects and getting in return investors' confidence as everyone's interests are aligned. To realize a successful privatization program, these governments need political support from the general population that may feel threatened by foreigners, economic reforms needed to ease investment processes and improve supporting policies, in conjunction with the upholding of utmost transparency and meticulous due diligence by specialists. This has major consequences for the privatization program in Greece, which is a social welfare state and such an endeavor can lead to unrest caused by a strong civil servant union that may inhibit the government's commitment to the effort.

By establishing private management in public enterprises that perform poorly, efficiency and profit-maximization are prioritized, coupled with restructuring for viability, and so revenues for the State increase without added taxation, and government spending is cut. What's more, when such enterprises become privatized, industries are opened to competitors who strive for sustainability and development to remain in the business, pushing those areas forward (i.e. energy generation/distribution). Finally, privatized entities can be traded in the capital markets, through which jobs and wealth are fostered.

Blacker [2012] suggests that Greece faces a special type of privatization "under duress", similar to those of Mexico in the 1980s, Argentina in the early '90s, and Turkey in 2001. This case differs from the others though in that the environment in Greece for such transformation efforts – from a populist to a committed government – is extremely unfavorable. The State will need to handle the disconcerted public and the strong labor unions, as well as educate the people about the positive effects of privatization and clarify that the sovereignty of the country is not lost to foreign investors. To achieve this, the Greek government had to institute an agency that would function as a platform to place and manage over 70,000 assets to be privatized. The initial estimate of the privatization sales was revised from €50 billion down to €22 billion until 2020 in January 2013, given the increased risks of implementation and fears of a euro exit, a reassessment of the actual assets that are valuable to investors, and the longer time to prepare assets for privatization given judicial and regulatory barriers.

Given the above, it is clearly understood that the privatization effort in Greece is a unique, very difficult and multifaceted task, involving many stakeholders. To succeed in this enterprise, the government established the Hellenic Republic Asset Development Fund (HRADF).

The Fund

Constitution – Organization

The Greek privatization process is the largest declared public asset divestiture in the world[†]. Its target is to draw international capital that will help stimulate the Greek economy and promote much needed economic growth in terms of jobs, quality of service to the citizens, and to reinforce the image of the country in foreign markets, by implementing crucial structural reformations at prevalent market conditions.

HRADF (the Fund) was established on July 1, 2011, by law 3986/2011 under the medium-term fiscal strategy plan. Its main reason of institution was to maximize the value from the privatization process, by reducing the sovereign debt owed by the government to foreign lenders and decoupling the privatization process from the governmental function, so as to foster a more professional undertaking of this endeavor in the context of private entity business. Following that, the Fund is not a public entity and thus is governed by private law. It was incorporated as a "societé anonyme" (public limited company equivalent) with an indefinite duration, and with sole shareholder the Hellenic Republic with a share capital of €30 million used only for its operating expenses. All assets that are being transferred to the Fund for privatization do not constitute part of its share capital. The Fund hasn't been modeled off of some existing vehicle, and in that manner is considered unique in scope and method of operation.

HRADF functions as a single point of control that oversees the privatization policy and the successful execution of the relevant transactions. It is also tasked with solving problems of either technical or legal nature related to the relevant assets or the proceeds from their privatization. The Fund's mission is to return to the Greek State €50 billion in proceeds, an exceptionally difficult objective, since over 70% of that amount rests on assets that cannot be traded in their current state and need some form of preparation to be put up for bids. Their value will ultimately depend on the prevailing macroeconomic conditions, the form of feasible privatization after the assets' preparation, the appetite of private investors for these assets and their availability and the cost of funding at the time of the transaction. The proceeds from the privatization process will be either direct up front, which will be used for the sovereign debt reduction, direct but staggered, such as license fees, which may be securitized later, or indirect, like higher tax collections from the increase in the country's economic activity.

The Fund holds that foreign investments in real estate development or infrastructure concessions will positively impact GDP growth, causing proportionate increases in tax receipts. Furthermore, a higher resource utilization and efficiency, by means of more optimal management by private entities that follow best business practices, will not only reduce current subsidies, but also multiply future growth of the GDP and its subsequent effects (higher employment, further investments, etc.).

[†] HRADF website

The Fund has an approved Asset Development Plan (EPA), which is being reassessed semiannually. The EPA is based on assumptions and facts concerning the expected revenues from each project that is being privatized, the long-term benefits to the State, and initial conditions and complexity of each project. The Development Plan adheres to three main qualities: clarity of purpose, transparency of process, and speed. In light of trust building, HRADF is charged with proving the country's credibility to its lenders. For this reason, as aforementioned, it is marketed as a business rather than a political initiative. Its management, as well as the government, believe that each successful transaction, especially in the early stages of its operation, will bolster up the trust that the markets and creditors have in Greece.

In this undertaking, the Fund faces some grave challenges. First and foremost, the market conditions under which HRADF is called to perform are the current ones, which are less than favorable and cause undervaluation of the assets to be privatized. In addition, the high sovereign risk makes the use of financial instruments such as warrants and exchangeables virtually impossible, as well as future cash flow securitization. Moreover, the general recession of the national economy has led to lower demand for all asset classes, and the Athens Stock Exchange has too low liquidity to handle large transactions. Finally, the recent government bond haircut and amount of non-performing loans further complicate the situation.

Although it appears to be a very challenging task, as the Fund leads successful privatizations, a larger impact occurs in the form of boosting competition in the market, coupled with higher efficiency and profitability, increased capital influx and employment, and public profit from direct sales and an indirect spur in the country's economic activity. Results of this activity, although probably somewhat inflated by not having taken into account the current economic conditions, indicate investment proceeds from the whole privatization process in excess of €60 billion, with GDP growing by 1% and employment by 50,000 jobs per year, and indirect tax revenues increasing by €3 billion per year. Even if exaggerated, these numbers point in a direction that stands to vastly improve the current conditions in the country and most importantly reestablish trust with foreign creditors and markets.

There is an intricate set of stakeholders who participate in the privatization process. HRADF is called to manage on one hand the demands of the government and push for regulatory changes and on the other hand the dissent of a large portion of the public towards the privatization policy. Adding to those, it must continuously apprise the Troika and Eurozone members of its operations and follow the targets set by the medium term fiscal plan, as well as provide incentives and "good deals" to foreign private investors so as to fulfill its purpose of attracting capital and reducing the sovereign debt.

In terms of the Fund's organization, the Board of Directors first of all is selected by the General Assembly for a three-year term, and consists of six members. Specifically for the positions of Chairman and CEO, the Parliamentary Committee of article 49A will have to give its opinion on the candidates before their appointment. In addition to these members, and to ensure the Fund's adherence to the mandate set by the Troika (ECB, EU, IMF) for the privatization scheme, two observers are included in the BoD, one from the Eurozone and one from the European Commission.

The Board has the absolute authority on decisions concerning the privatization of state-owned enterprises. Its decrees are to be given after taking into consideration, but not being bound by, the opinion of a Council of Experts. This Council is comprised of seven people with a breadth of experience and academic qualifications, four of which are appointed by the BoD and three by the Troika. The Board convenes on a regular basis to endorse, via simple majority, critical points of the tender process, the bidder pre-selection, the drafting of the contracts and the selection of the final investor, and is supplemented at the end with the opinion of an independent evaluator.

The Fund is staffed with experienced professionals from the fields of banking, consulting, and law, makes use of expert international advisors for each project. In order to expedite processes and facilitate decision-making, HRADF employs state-of-the-art project management systems and a flat organizational structure. A detailed organizational chart of the Fund is shown in Figure 1.

In order to uphold the utmost transparency, HRADF will publish quarterly reports, has internal regulations, internal and external auditors and is also monitored externally by the Parliament.

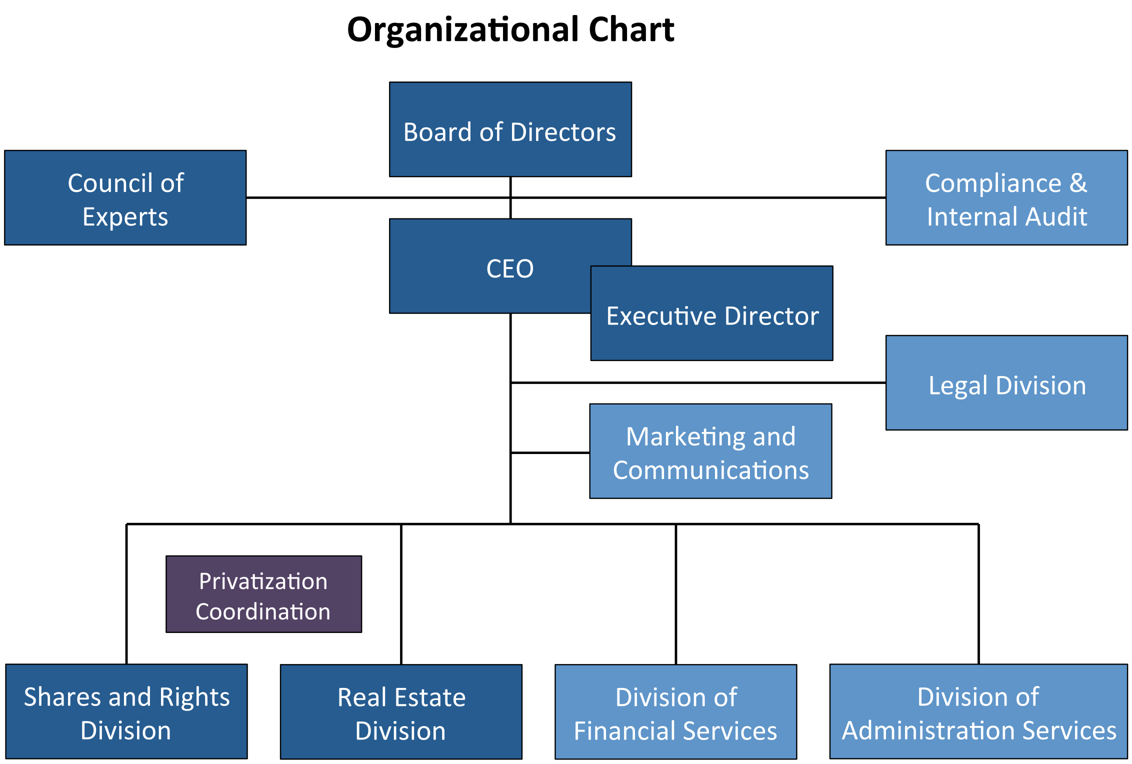

Figure 1 – Organizational Structure of HRADF

Areas of Operation

The assets and rights that the Greek government transfers to HRADF for privatization fall into three broad categories:

- Listed or unlisted **shares**
- Rights, such as licenses and concessions
- **Real estate** assets, lands as well as buildings

Shares are to be sold through trade sales, before or after the restructuring of a state-owned enterprise. Under certain circumstances, public markets are also considered. Infrastructure assets selected for privatization will be turned over to the private sector through concessions to upgrade, operate and maintain them. Bundling of such assets will be considered when it engenders increased value to the Hellenic Republic. Moreover, since Greece's tourism is one of the main contributors to the country's GDP, regional airport, cruise port and marina concessions are prioritized to upgrade the tourism sector. Land development is being focused in five key products: vacation homes, solar energy, luxury resorts and hotels, golf courses and wellness centers.

To be able to sell these assets and rights, the Fund is tasked with approaching the right investors who will be interested in them. These are by definition active or less occasionally passive investors, with a broad spectrum of risk appetite, but who possess a notable size and have a long-term investment horizon.

More specifically, for the state-owned corporates and shares that are mandated for privatization, the Fund's targets are institutional investors and large investment entities. Of the former, the most suitable are **pension funds**, which have a low to medium risk appetite and a very long investment horizon. The latter consist of either **strategic investors**, who invest in specific industries vertically to expand their market, are active with a low to medium risk appetite and very long investment horizon, or **sovereign wealth funds**, which have a medium risk appetite and seek long-term investments as well.

As far as real estate investment targets are concerned they can be broken down to two groups, one with an outlook for medium to long-term investments and one that seeks chiefly long-term investments. The first is comprised of **collective investment schemes**, funds that typically purchase real estate assets for their clients and have an average risk appetite, and **real estate limited partnerships**, which are formed for short-term projects and do not distribute cash before a project's completion, and have a high-risk appetite. The second group consists of **developers** that purchase land, finance the project and then construct it, and of **real estate investment trusts**, which principally purchase shares of companies that invest in real estate. Both of these investors have a low risk appetite and are active investors.

Method of Operation

The mandate given to HRADF to carry out the privatization policy set at the medium term fiscal plan is based on three pillars: **consensus**, **transparency**, and **effectiveness**. The first element, consensus, is attained by following practices in congruence with governmental policies and strategies, having a clear scope of operation, and performing rigorous analysis on the effects of decisions to the stakeholders involved and communicating the advantages of the privatization efforts to them. Transparency is key for the Fund; it upholds it by implementing internationally acknowledged tender procedures, where the winner is selected solely based on the most economic offer. In addition, the media closely follows each privatization deal. An independent appraiser always evaluates the asset, and prior to signing the contract the Court of Auditors submits its endorsement. Finally, to ensure effectiveness, emphasis is given to a fast implementation of the process that ensures at the same time the highest economic benefit, with control systems in place to alert against deviation from the scope set.

As has been aforementioned, a number of assets to be privatized need to go through significant legal, operational or physical restructuring, before they can be cleared for tendering. The direction given for the privatization of assets is to only sell or offer for concession assets or rights that have been clearly defined and are unencumbered. In addition, monetization of non-marketable assets will be achieved either through grouping with other marketable or listed assets or through restructuring and liquidation.

The development procedure and stakeholders are shown in Figure 2. The Hellenic Republic transfers the assets or rights to be privatized to HRADF, and the Fund works with internal and external advisors to execute a thorough valuation of the assets and perform their restructuring to prepare for their tendering. It must be noted that any restructuring costs are considered within the operating expenses of the Fund and are financed by its initial €30 million capital as well as proceeds from previous privatizations. Once that stage is completed, HRADF will issue a publicly posted RFP and select the best bidder from a two-phase transparent tender procedure based on who gives the offer with the highest economic value. Finally, the Court of Auditors will evaluate the deal, and give its approval for the signing of the contract. Figure 3 also depicts the process in more detail, separating the functions of the government and the Fund. It should also be emphasized that **the Fund does not participate in the financing of the assets for privatization**, besides exceptional deals, which have yet to be made, as it is contrary to its mandate of attracting private foreign capital to boost the State's revenues. After the contract is signed, the authority of HRADF for the particular asset effectively ends.

The valuation of the assets is conducted with regards to providing the maximum possible value for an asset. The main considerations are the proceeds to the Hellenic Republic, in cash or accruals, the long-term benefits of the project, the complexity of the execution, which affects the time to market, and also the financial scheme that will accompany the project's implementation. When the market is available, HRADF examines also earn out and clawback schemes.

The strategy followed for the privatization is clearly defined for each of the three asset categories: corporates, infrastructure, and real estate.

Main Parties & Development Procedure

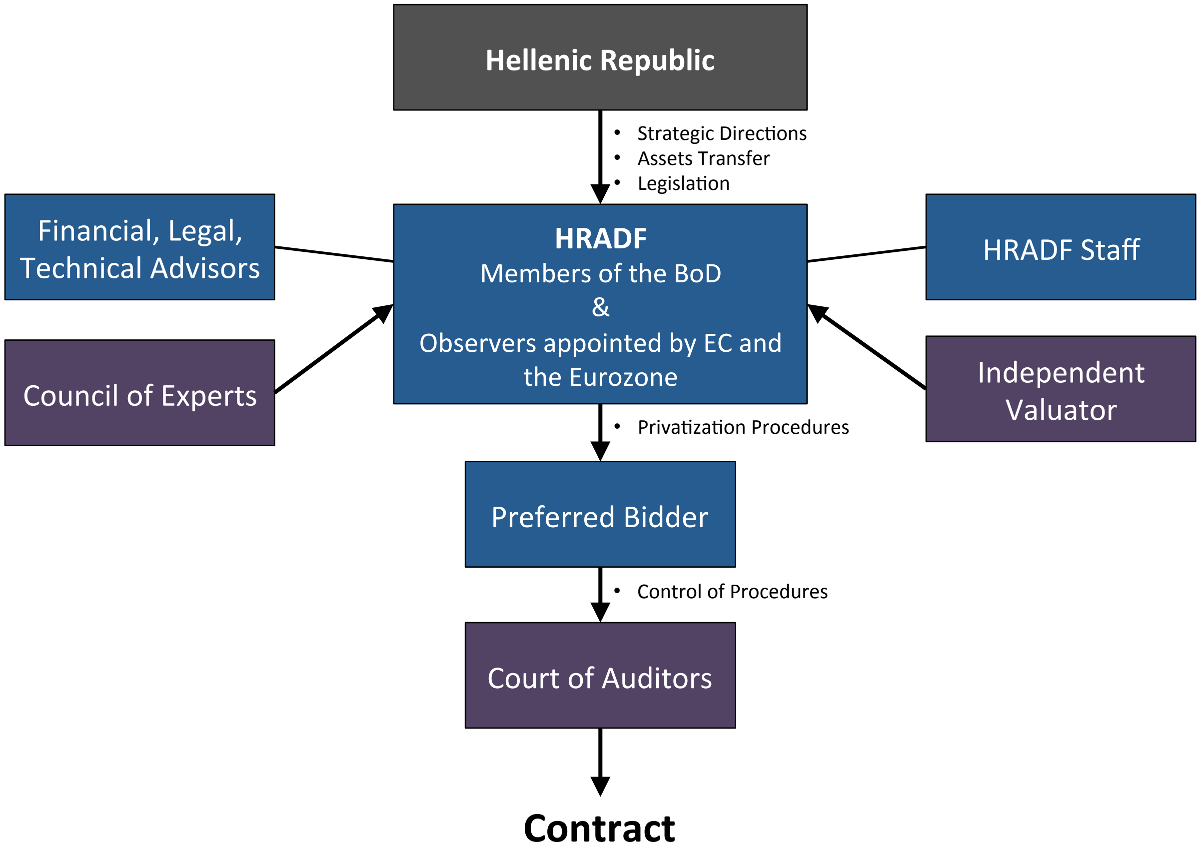

Figure 2 – Services provided by HRADF

Corporates: The portfolio compiled by HRADF contains 13 assets in four different industries: financial institutions, gaming, defense, and mining and metals. Some of these assets are bankrupt companies that require significant restructuring to be prepared for the tender, while others are broken down and their parts are sold accordingly to maximize investor value. Assets from the financial institutions are probably going to yield low proceeds given the banking sector restructuring and the shareholder dilution. Furthermore, assets in the defense industry are going to be hard to prepare for sale, as they require various government and EC approvals.

Infrastructure: HRADF holds 17 infrastructure assets in three different industries: transportation and logistics, communications, and energy, power and utilities. These assets may be put up for utilization, lease, concession development or sale of their shares. Significant reforms are needed in general for these assets to be prepared for privatization, although they may have the most positive effects for the country as they foster further development investments and attract global big investing entities.

Real Estate: As of 2012, 3,152 assets had been selected for privatization with an estimated value of €10.3 billion, driving the largest part of the privatization effort. Most of these assets are required to pass certain processes and tender procedures according to EU legislation, which may take up to 8 months depending on their scope.

Privatization Process & Related Work Streams

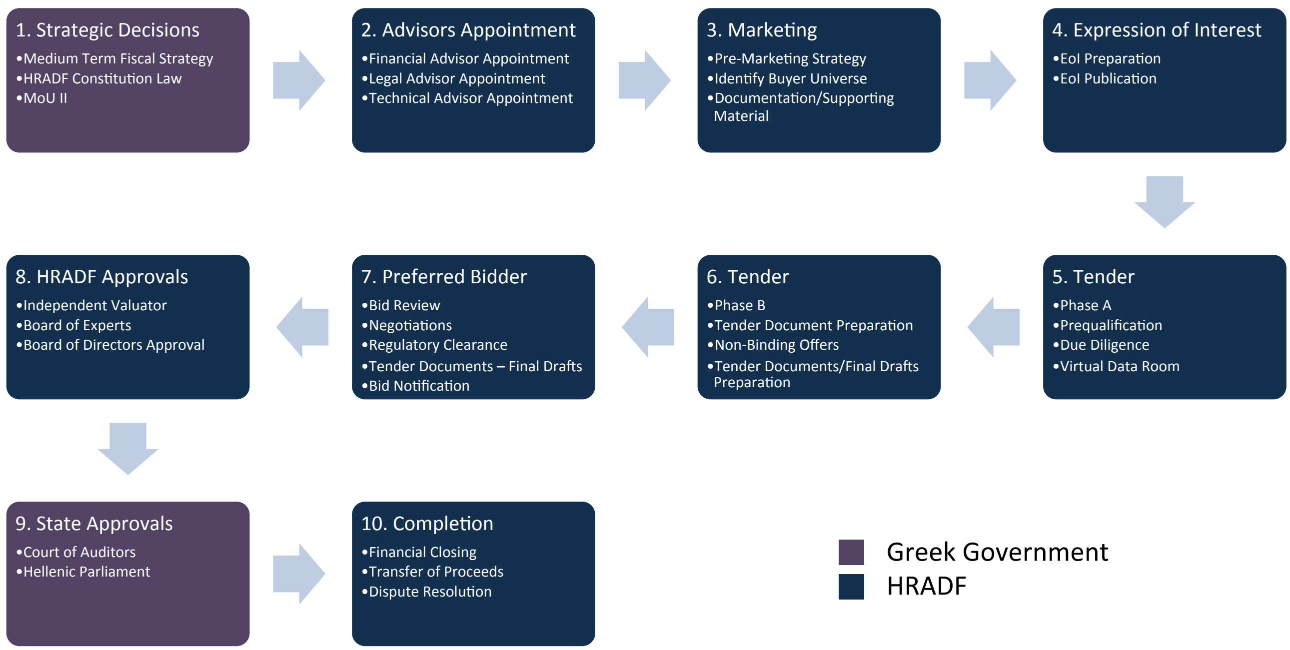

Figure 3 – Privatization Process

Expected Results – Underlying Indirect Effects

As has been aforementioned, the privatization efforts are conducted with regards to reducing the sovereign debt of the Hellenic Republic and jumpstarting the economy by attracting foreign private investors and developers, while at the same time striving to reestablish trust with the country's creditors. The target proceeds to be raised are €11.1 billion by 2016 and €25 billion by 2020.

Despite the above, there are indirect effects that the Fund achieves with its operation. Given Blacker's [2012] identification of governments as either populist or committed with regards to privatization policies, it can be said that while the Greek State began as the former, to secure quickly capital to repay its debts, through this effort it tends to be transformed to the latter. The Fund's decoupling from the government, the transparent methods it follows, and the regulatory changes it achieves as part of its operations on a traditionally strong and inflexible State are remarkable. An example is that of legislation 3986/2011, where for the first time 99-year leases could be signed for state-owned land, to overcome the barrier and fear of "sovereign loss" created by the public. Moreover, its efforts are on the verge of breaking the state-owned monopolies in the energy sector, to name one important industry, bringing competition and business investment and development to an inefficient area for which the government sinks huge amounts of capital to sustain. Examples include the Public Power Corporation, which vertically controls the energy sector in Greece, and DEPA, the Public Gas Corporation.

The effects that the privatization process has on the public must also not be undervalued. The Greek people are by nature very patriotic, a fact that on its own is a great and respected value for a nation with such a history, but when combined with a lack of information, communication and commonly enough education, they associate the privatization of assets with loss of sovereign property or land, having the misconception of an "invasion" by foreign powers. The Fund is tackling this problem by bringing in the public as one of the key stakeholders in its mission, having clear and frequent channels of communication to educate it about its objective and the benefits it will bring to the country, without any actual risk of sovereign loss. Furthermore, HRADF passes the message about how quality of life will be improved in the rural regions of the country when investors will undertake the development of assets in these areas.

Current Situation – Framework for Assessment

Right now, the first priority of the Fund is to gather €11.1 billion by 2016, €2.6 billion of which are to be realized in 2013. This is still an achievable target, even though there are many challenges for HRADF, including the crisis, limited funding, investor appetite and important asset preparation prior to introduction to the market. Important deals that were recently achieved were the State Lotteries privatization for a total of €1.5 billion in 12 years, and the Piraeus Port Cargo Facility deal with COSCO for a concession of €4.3 billion over 35 years. The deal for the Public Gas Corporation is in the final negotiations phase with Gazprom, and numerous other concession and corporates sales tenders have been launched. With support from the government and public, and establishment of trust with foreign investors following successful privatizations, HRADF is fulfilling the purpose of its constitution and proving to be a successful vehicle to carry out this process with international best-practice standards.

To provide a closing evaluation of the Fund's value as a sovereign development fund, a framework developed by Dr. Monk of the Global Projects Center at Stanford University will be used, which touches on some key aspects of Sovereign Development Funds' functions. The Fund is assessed for each aspect on a scale of 1 to 4, with 4 defined as highest value.

1) Commercial Orientation 4

The Hellenic Republic artfully set the Fund as a private independent entity with a robust set of internal and external advisors. Combined with transparent processes, publicly available information and auditing by a Court of Auditors for every deal, HRADF is positioned to provide the best value to investors and establish their trust in investing in Greece.

2) Governance 4

International tender procedures and a clear, flat organization, accompanied by a Council of Experts, advisors and auditors set a robust governance that facilitates foreign due diligence. Information on the Fund's activities is readily accessible on its website, and tenders are published online to attract the attention and be followed by all involved stakeholders.

3) Local Access 3

HRADF has been instituted and mandated by the Hellenic Republic to privatize a wide portfolio of state-owned enterprises. As such, its knowledge of these assets is unparalleled. That in turn is also reinforced by the due diligence and valuation methods it follows for each asset. Despite that, the Fund is limited by its own scope, and cannot access or bring forth for development assets that the government hasn't issued for privatization. In addition, its function as a platform to prepare projects and issue RFPs for them coupled with its eschewal of getting directly involved in investing don't leave a lot of space for de-risking assets for foreign investors.

4) Top Talent 4

The Board of Directors of the Fund has been carefully handpicked based on each member's vast experience in the areas of investment, public policy and governance. This team is supplemented by a Council of Experts in the fields of banking, consulting and law and a retinue of internal and external advisors for each deal, as well as project managers from similar areas.

5) Local Voice 3

HRADF acts as the focal point of the privatization process and as such it leads it. All investors need only take their concerns and suggestions to the Fund and it will lobby the policy makers on their behalf. Given the market conditions though and the tough position that Greece is in, the strength of the labor unions and the public unrest it faces, there's only so many regulatory changes that HRADF can push for at a time for any given project, and this may lead to delays in the program.

6) De-Risking 1

A profusion of factors preclude the Fund from de-risking privatization projects. On one hand, the debt crisis weighs heavy over the markets and sources of funding are very limited. On the other hand, the Fund itself does not invest in the projects and so cannot take seniority in any losses on investments. The only de-risking that projects can secure is during their preparation for tendering and after when the deal is negotiated with the preferred bidder.

Based on the above, and assuming even weights for all the elements of the framework, the Fund's evaluation score yields **3.2 out of 4**, mostly due to its limited ability, given the market conditions and its mandate, to de-risk projects. It should be reminded that this is a rough quantification of mostly qualitative criteria.

Two years after its formation, HRADF is issuing and managing numerous small and large projects to drive the largest privatization effort in the world so far, striving hard to reestablish trust between Greece and the foreign capital markets and to modernize and reboot the country's tattered economy.

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