Cross-Border Infrastructure: A Toolkit

Different Models of PPP

Session on Private Sector Participation

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Main Topics

- PPP Definition
- Why government should consider PPP
- Pre-requisites of a successful PPP program
- The basic types of PPP models
- Main features, application, strengths and weaknesses
- Responding to the criticisms of PPP
- Setting up the PPP program - project cycle

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PPP Definitions

So many...

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- PPPs are aimed at increasing the efficiency of infrastructure projects by means of a long term collaboration between the public sector and private business. A holistic approach which extends over the entire lifecycle is important here.

Source:
German PPP Task Force, German Transport, Construction and Housing Ministry
(Bundesministerium für Verkehr, Bauen and Wohnen)

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- The term public-private partnership ("PPP") is not defined at community level. In general, the term refers to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management and maintenance of an infrastructure of the provision of a service.

Source:
Green Paper on Public- Private Partnerships & Community Law on Public Contracts & Concessions
presented by the European Commission, April 2004

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- Standard & Poor's definition of a PPP is any medium-to-long term relationship between the public and private sectors, involving the sharing of risks and rewards of multisectors skills, expertise and finance to deliver desired policy outcomes.

Source:
Standard & Poor's PPP Credit Survey 2005

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- PPPs are long-term partnerships to deliver assets and services underpinning public services and community outcomes. Optimal structuring links private sector profitability to sustained performance over the long term, yielding robust and attractive cash-flows for invertors in return for delivering better value for money to the taxpayer.

Source:
John Laing plc

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- 'Public-Private Partnership' is a generic term for the relationships formed between the private sector and public bodies often with the aim of introducing private sector resources and/or expertise in order to help provide and deliver public sector assets and services. The term PPP is, thus, used to describe a wide variety of working arrangements from loose, informal and strategic partnerships, to design build finance and operate (DBFO) type service contracts and formal joint venture companies.

Source:
The EIB' s role in Public-Private Partnership, July 2004
European Investment Bank

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- A PPP is a partnership between the public sector and the private sector for the purpose of delivering a project or service traditionally provided by the public sector. It recognises that both sides have certain advantages, and by allowing each to do what it does best, public services and infrastructure can be provided in the most efficient manner.

Source:
European Commission

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Why Should Governments Consider PPP?

- Delivering of quality services that provides VFM (whole-life costings)
- New options for public sector finances (parallel vs. sequential development)
- Good Principles of PPP
  - VFM (also qualitative factors, not lowest costs)
  - Risk transfers (who does what best)
  - Performance standards and competition (payments upon delivery - output focus)
  - Maintain value of public assets - whole-life
  - Off balance sheet

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Example - Sharing of Risks and Rewards

- The project (Moray Coast Wastewater - Scotland)
  - Building new plants - European environmental requirement
  - USD 130 m
  - To serve NoSWA plus other areas
- Risks sharing
  - Private company - DBOFOM facilities
  - NoSWA - gets planning permits and provide land
- Sharing rewards
  - NoSWA pays Private company for usage (treated waste)
  - NoSWA shares 'extra' revenue (from other users)
  - NoSWA shares 'any re-financing gains'

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Example - Unique Project (Military)

- The project (RAF aircraft tanker and cargo transport)
  - RAF tanker aircraft old and needed replacing
  - New ones not used all the time, but have to standby
  - RAF also need charter services (cargo)
- Risks sharing
  - FOM (finance, owned, maintained) – Private company (approx USD 5 billion)
  - Availability priority to RAF
  - RAF has crew-ready responsibilities
- Reward sharing
  - Value for money - RAF pays availability & usage
  - Private company hires out aircrafts to public

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Example - Government Office

- The project (Home Office - Norton Rose)
  - Demolish existing building, and construct new ones
  - USD 500 million
- Risks sharing
  - Occupancy by government
  - DBFOT by private company (29 years, valuation at end)
  - Private company also do removal and moving
- Rewards sharing
  - Fixed revenue minus penalties for non-performance
  - Government takes lower of valuation and agreed residual value

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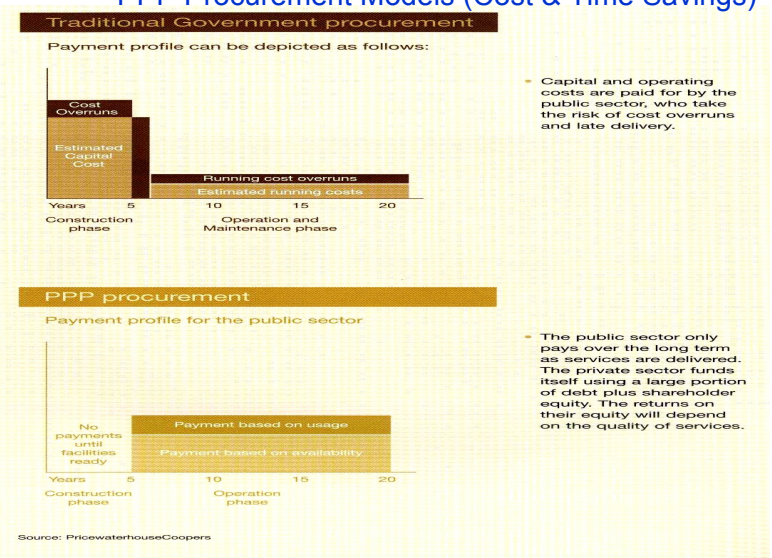
Contrasting Public Sector Payment Profiles of Traditional & PPP Procurement Models (Cost & Time Savings)



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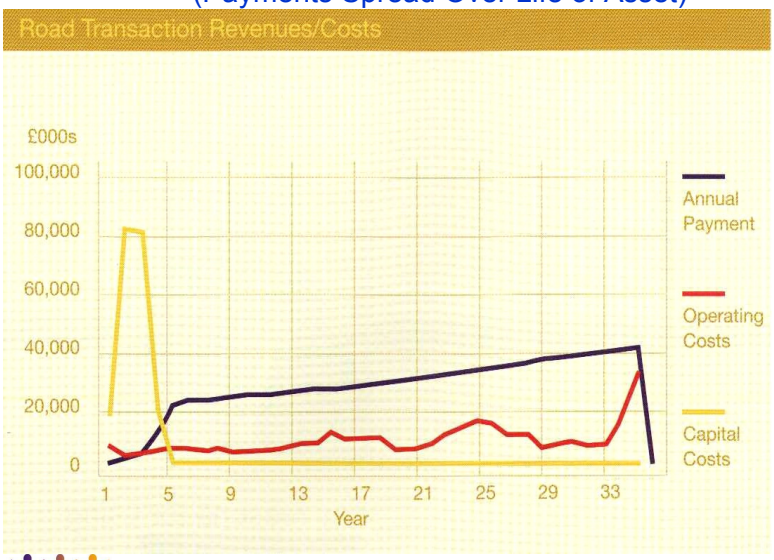
Profile of a PPP Transaction
(Payments Spread Over Life of Asset)



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Pre-Requisites of a Successful PPP Program

- Political commitment (continuity of policy)
- Enabling legislation (enabling legislation - concession laws, tax anomalies)
- Expertise (capacity-building in both sectors)
- Project prioritization (focus to improve success rates)
- Deal flow and standardization (regularity of deals based on standard contracts)

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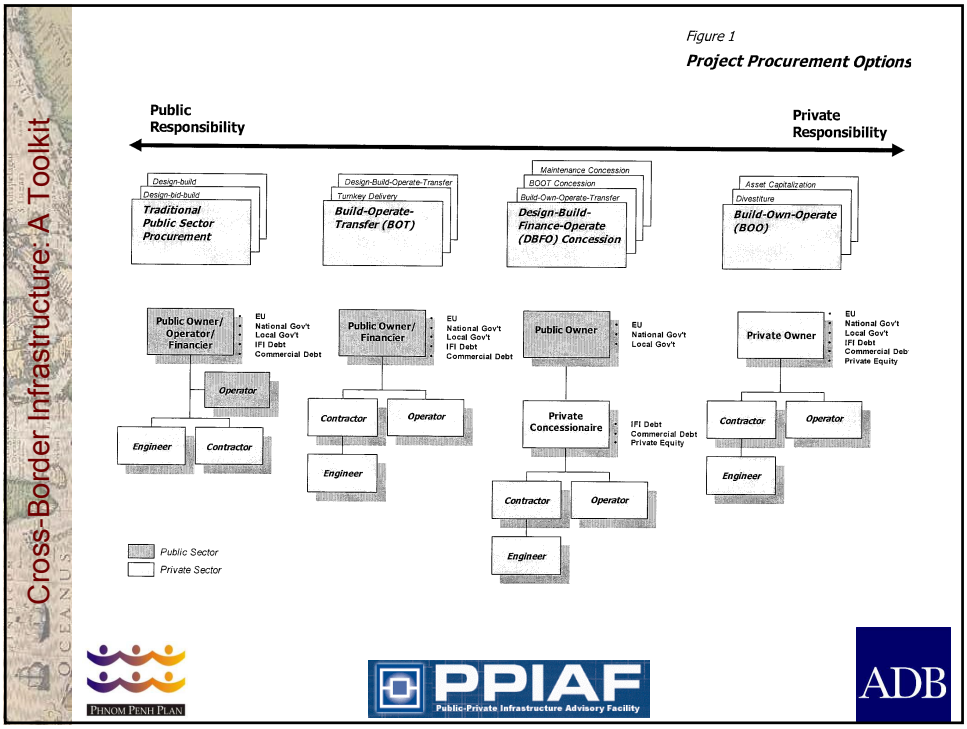

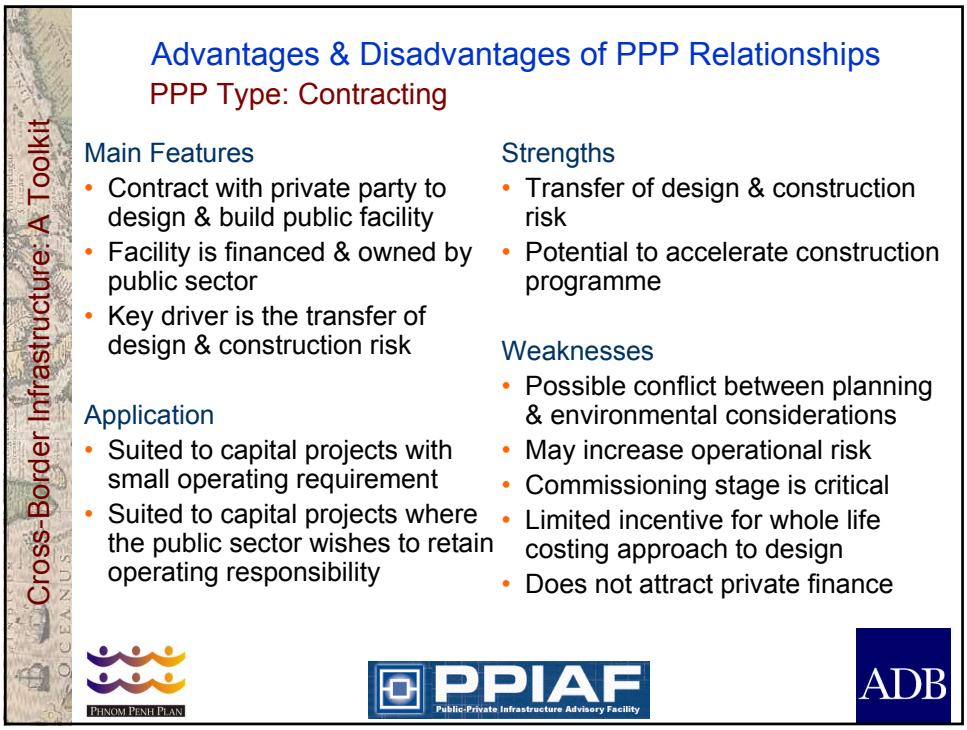

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Advantages & Disadvantages of PPP Relationships

PPP Type: BOT

Main Features

- Contract with a private sector contractor to design, build & operate a public facility for a defined period, after which the facility is handed back to the public sector
- The facility is financed by the public sector & remains in public ownership throughout the contract
- Key driver is the transfer of operating risk in addition to design & construction risk

Application

- Suited to projects that involve a significant operating content
- Particularly suited to water & waste projects

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Advantages & Disadvantages of PPP Relationships

PPP Type: BOT (*continued*)

Strengths

- Transfer of design, construction & operating risk
- Potential to accelerate construction
- Risk transfer provides incentive for adoption of whole life costing approach
- Promotes private sector innovation & improved value for money
- Improved quality of operation & maintenance
- Contracts can be holistic
- Government able to focus on core public sector responsibilities

Weaknesses

- Possible conflict between planning & environmental considerations
- Contracts are more complex & tendering process can take longer
- Contract management & performance monitoring systems required
- Cost of re-entering the business if operator proves unsatisfactory
- Does not attract private finance & commits public sector to providing long term finance

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Advantages & Disadvantages of PPP Relationships

PPP Type: DBFO

Main Features

- Contract with a private party to design, build, operate & finance a facility for a defined period, after which the facility reverts to the public sector
- The facility is owned by the private sector for the contract period and it recovers costs through public subvention
- Key driver is the utilisation of private finance & transfer of design, construction & operating risk
- Variant forms involve different combinations of the principle responsibilities

Application

- Suited to projects that involve a significant operating content
- Particularly suited to roads, water and waste projects

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Advantages & Disadvantages of PPP Relationships

PPP Type: DBFO (*continued*)

Strengths

- As for BOT plus:
- Attracts private sector finance;
- Attracts debt finance discipline;
- Delivers more predictable & consistent cost profile
- Greater potential for accelerated construction programme; &
- Increased risk transfer provides greater incentive for private sector contractor to adopt a whole life costing approach to design

Weaknesses

- Possible conflict between planning & environmental considerations
- Contracts can be more complex & tendering process can take longer than for BOT
- Contract management & performance monitoring systems required
- Cost of re-entering the business if operator proves unsatisfactory
- Funding guarantees may be required
- Change management system required

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Advantages & Disadvantages of PPP Relationships

PPP Type: Concession

Main Features

- As for DBFO except private party recovers costs from user charges
- Key driver is the polluter pays principle & utilising private finance & transferring design, construction & operating risk

Application

- Suited to projects that provide an opportunity for the introduction of user charging
- Particularly suited to roads, water (non-domestic) & waste projects

Strengths

- As for DBFO plus:
- Facilitates implementation of the polluter pays principle; &
- Increases level of demand risk transfer & encourages generation of third party revenue

Weaknesses

- As for DBFO plus:
- May not be politically acceptable
- Requires effective management of alternatives / substitutes, e.g. alternative transport routes; alternative waste disposal options

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Private Sector Requirements	SC	MC	L	BA	DC	PD	FD
Fair Profit	Required	Required	Required	Required	Required	Required	Required
Reward for Risk Mitigation			Desirable	Desirable	Required	Required	Automatic
Clear Legal/Regulatory Structure			Required	Required	Required	Required	Required
Growth Potential			Desirable		Desirable	Desirable	Desirable
Political Support			Desirable	Desirable	Required	Required	Required
Political Stability			Desirable	Desirable	Desirable	Desirable	Desirable

Required
Desirable
Automatic

SC = Service Contracts
MC = Management Contracts
L = Leases
BA = BOT Agreements
DC = DBFO Concessions
PD = Partial Divestiture
FD = Full Divestiture

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Session: Private Sector Participation

Topic 4.2. Different Models of Public-Private Sector Partnership

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Beneficiary Government Requirements	SC	MC	L	BA	DC	PD	FD
Leveraging Funding							
Accelerating Project Implementation							
Improving Service Levels							
Improving Service Coverage							
Efficiency Gains							
Ease of Implementation							

Yes
Important
Desirable

SC = Service Contracts
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Commission Requirements	SC	MC	L	BA	DC	PD	FD
Attaining European Standards							
Maximizing Societal Benefits							
Transparency/Open Competition							
Reasonable Control of Grant Funds							
Avoiding Undue Private Profit							
Efficiency Gains							
Leveraging Private Funds							

Relevant
Important
Required
Desirable
Yes

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Lender Requirements	SC	MC	L	BA	DC	PD	FD
Rigorous Financial Analysis							
Conservative Cost/Revenue Assumptions							
Certainty of Grant & State Funding							
Clear Legal Regulator Structure							
Technical Ability of Owner/Operator							
Political Stability							

Required

Desirable

SC = Service Contracts
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Responding to Criticisms of PFI

- Public finance is always cheaper than private finance.
  - Although private financing is typically 1-3% higher than public finance, the gap has been narrowing. Moreover, financing costs average only one third of the total cost of the projects and PFI only shows value if savings over whole life assets and service provision outweigh any additional margin on financing costs.

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Responding to Criticisms of PFI (*continued*)

- PFI process hinders accountability.
  - A range of scrutiny mechanisms exist, including reports by the National Audit Office. Also hospital business cases are published. These are often more transparent, measurable and effective than traditional private sector scrutiny and accountability procedures.

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Responding to Criticisms of PFI (*continued*)

- PFI is bad for public sector staff, whose terms and conditions of service are threatened.
  - Staff concerns have largely been addressed through guidance on the need to disclose information, consult staff and provide comparable pensions. Empirical evidence suggest high levels of satisfaction among transferred employees on signed deals.

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Responding to Criticisms of PFI (*continued*)

- PFI leads to the public sector disguising open-ended liabilities, and therefore lacks control over these liabilities.
  - The public sector's exposure to liabilities becomes less open-ended because payments and PFI contracts are relatively predictable and the true costs of financing and operating an asset are fully exposed. Also, estimates of future PFI commitments are published twice a year by the Treasury.

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Responding to Criticisms of PFI (*continued*)

- The PFI distorts spending priorities, because projects are taken forward on the basis of qualifying for the PFI and generating a bankable revenue stream, rather than because of their overall benefit.
  - In practice, a range of criteria have been developed for prioritising possible projects, although clearly they need to be suitable for the PFI before they can be assessed against these priorities.

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Responding to Criticisms of PFI (*continued*)

- The public sector is tying itself to present day solutions for the next 30 years.
  - This is no less true than for traditional public sector procurement. Most PFI contracts are in any event given flexibility to respond to changing public needs. In addition, the contracts usually have provisions such as benchmarking and market testing which enable the public sector to benefit from the emergence of improved methods of delivery for relevant services.

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Responding to Criticisms of PFI (*continued*)

- Twenty year service contracts may not always be optimal, as incentives for the service provider to make changes may be weak and biased towards cost cutting rather than service enhanced activities.
  - The key mechanism to incentivise ongoing performance throughout the contract term is the formulation of an appropriate payment mechanism. In addition the contract has a number of provisions to further incentivise the performance standards e.g., benchmarking, market testing, and ultimately termination provisions.

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Responding to Criticisms of PFI (*continued*)

- PFI schemes have an adverse design and environmental impact.
  - PFI can help to promote innovative design concepts and environmental efficiencies through suitable treatment of these requirements in the output specification. Issues related to design and whole-life costing have been the subject of guidance provided by the Treasury Taskforce.

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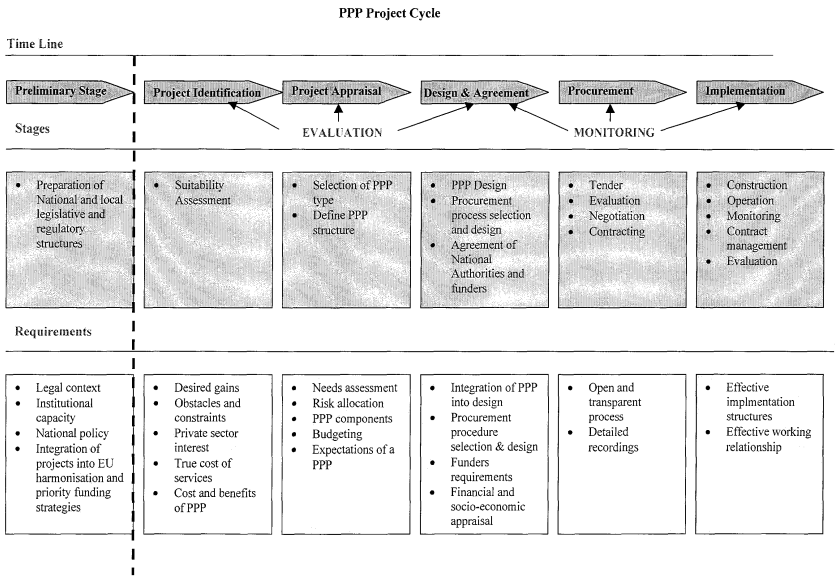

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Conclusion

- PPP is a long term relationship between public and private sectors to deliver an output (performance)
- It is based on:
  - Payment upon delivery (no deliver no pay)
  - Risks allocation (who does what best)
  - VFM - whole-life costings
  - Competition to get best value
- There are many methods, each with pros and cons
- It is important to ensure that a national PPP program is well set up

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