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Cities Resilience Program

Overview of PPPs and Concessions

Agenda

1. Defining and framing PPPs
2. PPP structures and risk transfer
3. Value for money

Section 1: Defining and framing PPPs

Key drivers for considering PPPs

There are many different drivers for PPPs worldwide, these include:

1. Need to control public sector borrowing
2. Accelerate the delivery of infrastructure services
3. Transfer appropriate risk to the private sector
4. Obtain innovation and economic efficiency

In developing a PPP programme, governments will need a clear understanding of the drivers and objectives to ensure that any PPP programme is clearly understood, and that the market and the public respond to it favourably.

The 3 elements of a Public Private Partnership

Public	Private	Partnership
• Provider of public services • Ownership of assets • Pays for services • Facilitator	• Finance • Design • Build • Operate • Skills, efficiencies	• Cooperation • Risk Sharing

So, any transaction structure involving both private and public parties working together towards a common goal may be referred to as a PPP…

However, there are some important characteristics to bear in mind

*"A PPP is any **contractual relationship** between **public and private sector** parties where they come together with aligned goals **to provide public sector services**, using the guiding principle that the inherent risks are allocated to those parties best able to manage them, and **to deliver better value for money for the public purse**."*

Key characteristics:

- Mainly used for service provision over a period of time
- Often involves the construction of new assets
- Service requirement ("outputs") stated by public sector
- Public sector/users pay for provision of services
- Public sector monitors performance – penalty regime
- Concession term generally linked to economic life of asset
- Real risk transfer to private sector

Sectors using PPPs

Traditionally, “heavy” infrastructure:

Water

Roads

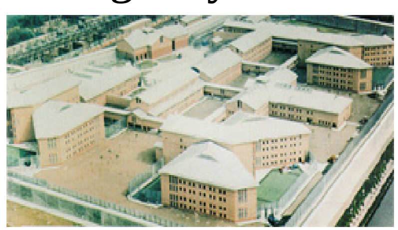
Power

Public Transport

But increasingly “social” projects, and also defence:

Education

Prisons / Emergency Services



Accommodation

Defence

Common challenges with PPPs

Even in more developed markets (national and local), PPPs face increasing scrutiny for the following reasons:

1. The private sector has a higher cost of finance;
2. The procurement can be lengthy and costly;
3. PPPs are long-term relatively inflexible structures; and
4. PPPs imply a loss of management control by the public sector

However, PPPs are <u>not</u> a

- Source of “free” money
- Way of financing unaffordable projects
- Means of implementing bad projects

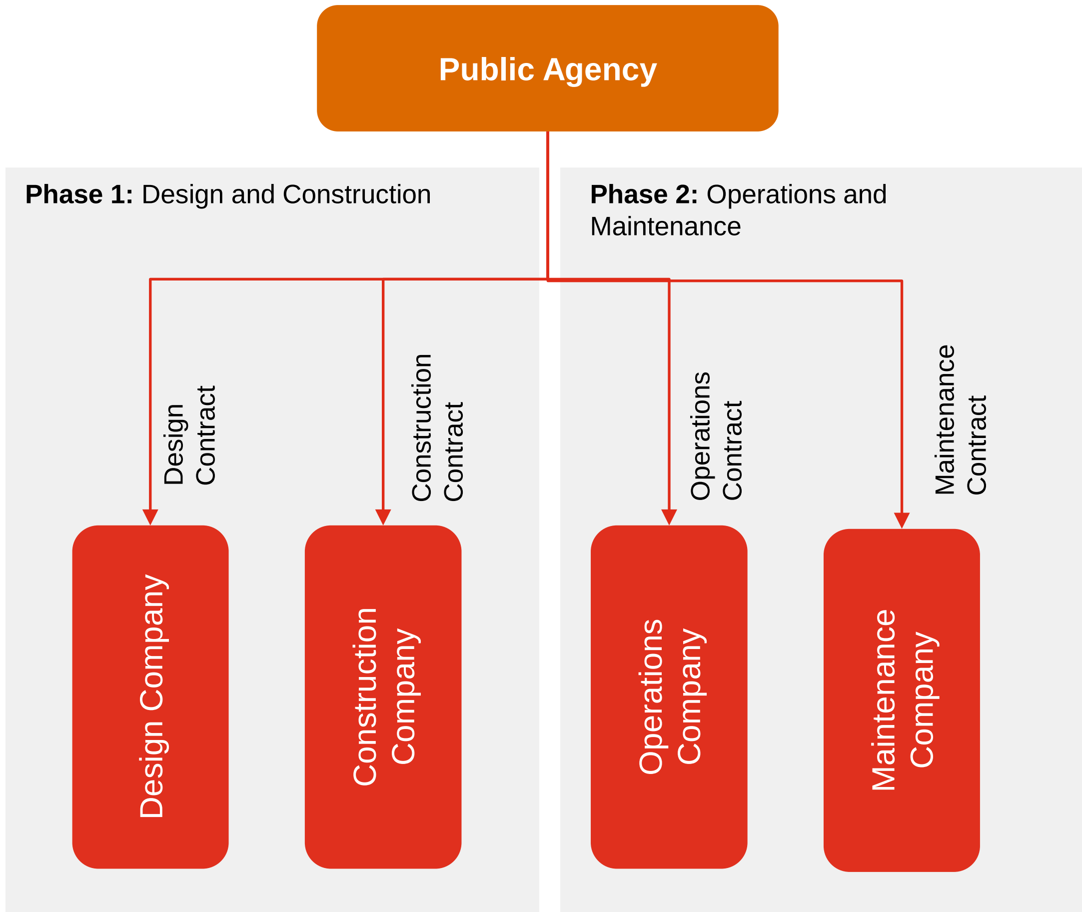
PollEV question

How PPPs fit within your procurement approach

	Traditional Procurement	Public Private Partnerships	Privatisation
Fiscal Budget	Immediate budget impact	Impact spread over a long period of time	No impact
Risks	Public sector bears risks	Risks shared	Private sector bears risks
Government Involvement	All aspects of procurement	Facilitator/ Payment for service	Regulator
Payment Mechanism	Linked to construction	Linked to performance	Company directly responsible

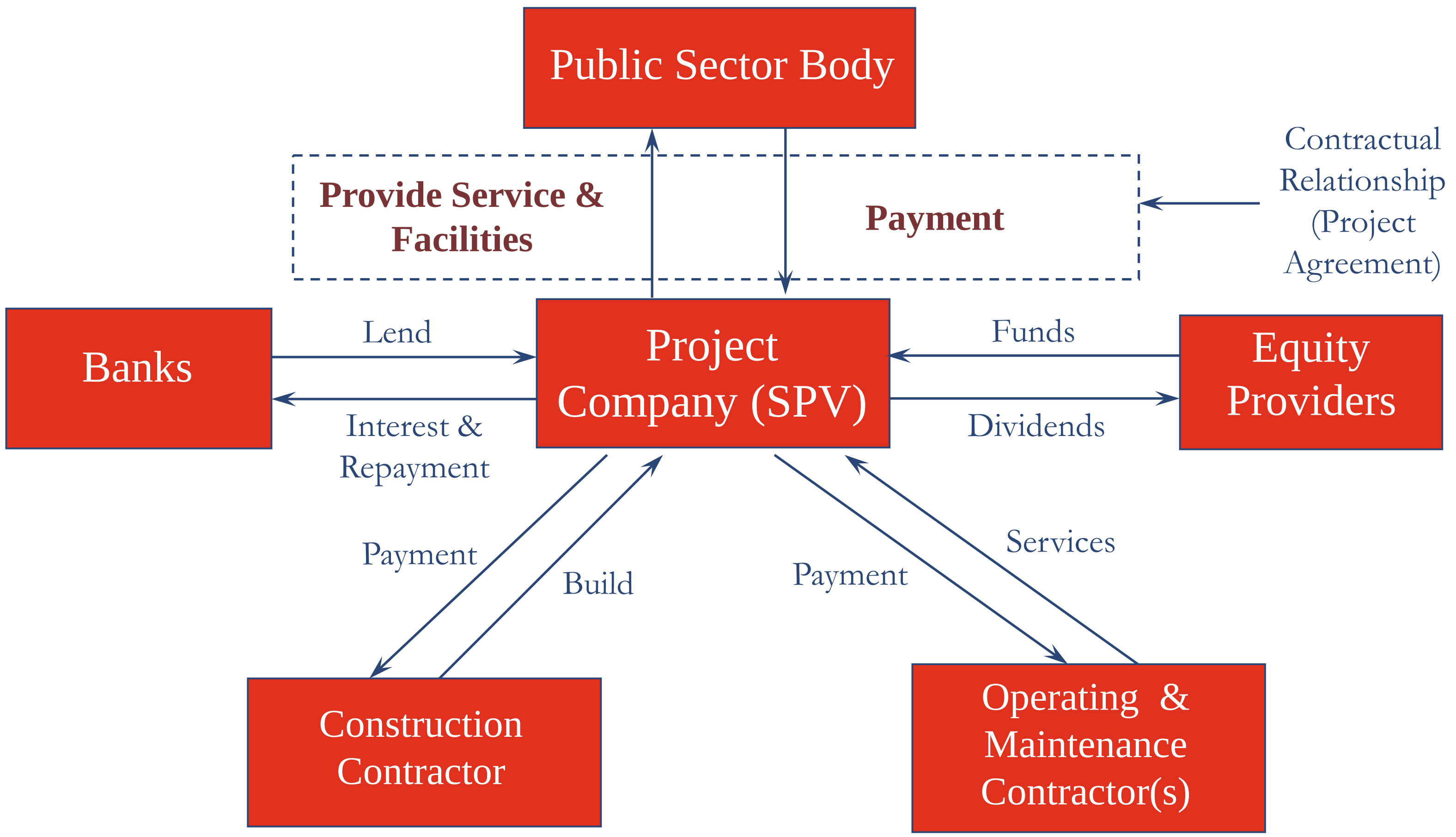
Section 2: PPP structures and risk transfer

What are you doing now?
A Typical procurement approach



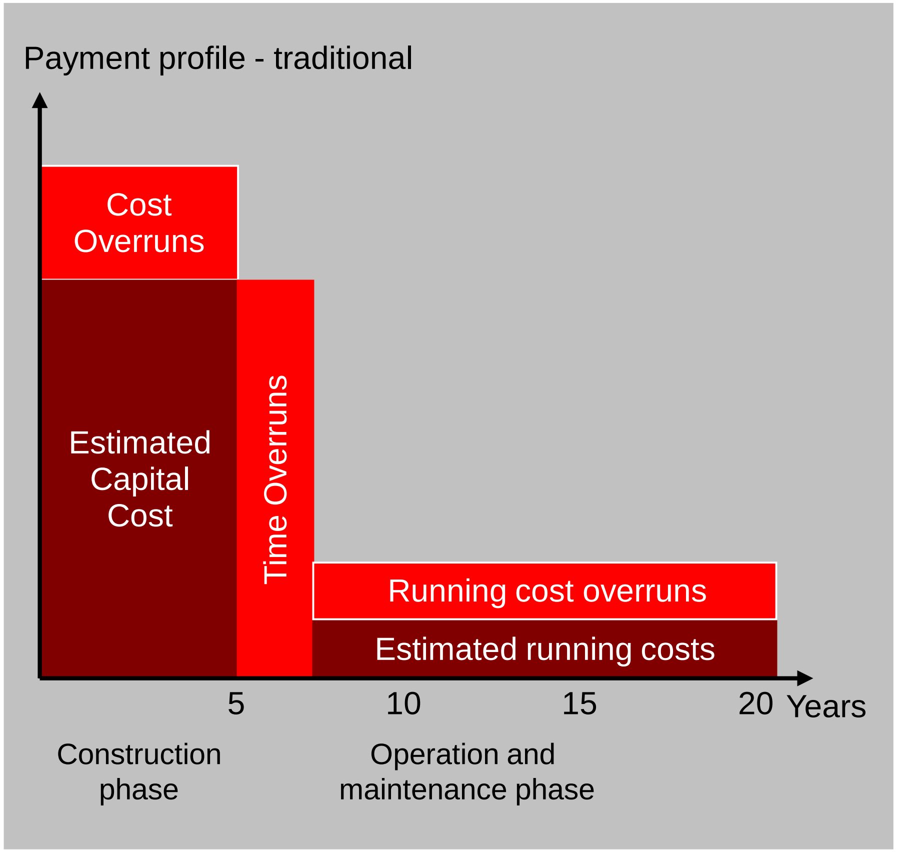
What is PPP?

A Typical PPP Structure

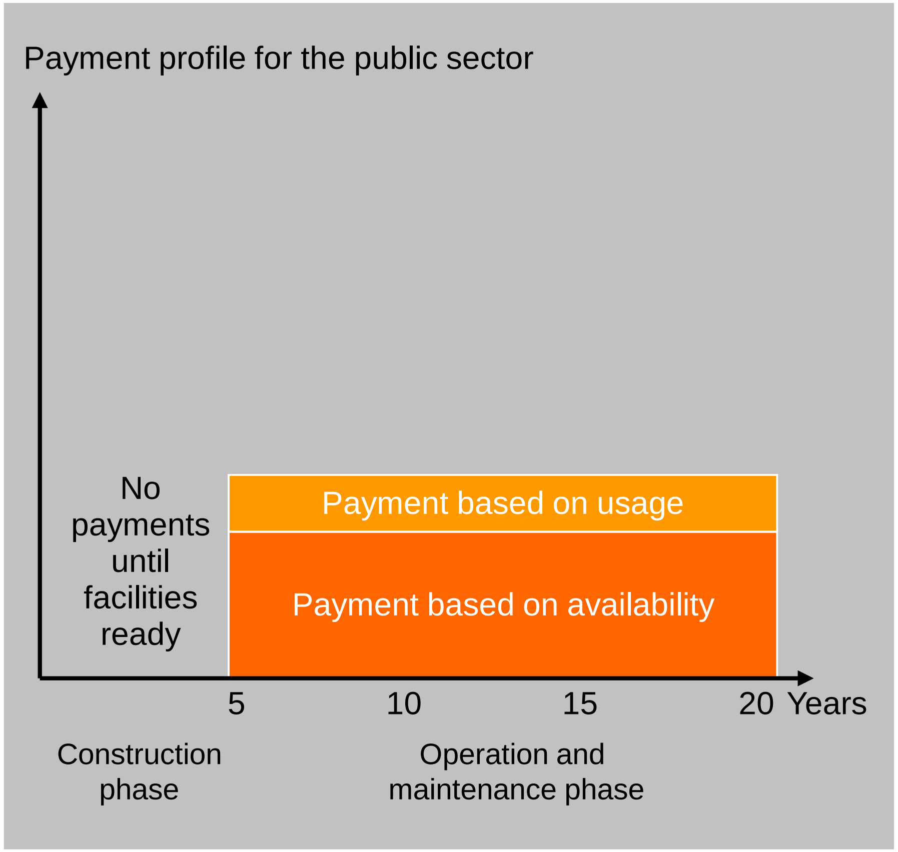


Project cashflows for government

Traditional Government Procurement



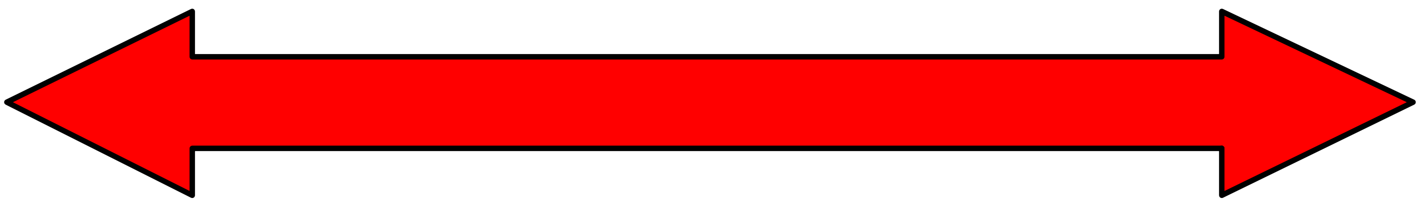
PPP Procurement



How does the public sector transfer risk?

"Risks should be allocated to the party best able to manage them"

Public | Shared | Private



Public

- Outline planning permission
- Discriminatory regulatory risk

Shared

- Volume risk
- Inflation risk
- General regulatory risk
- Force majeure

Private

- Detailed planning permission
- Design
- Construction
- Commissioning
- Operating performance
- Project finance
- Technology obsolescence

Example 1 - risk transfer
Construction Risk

- **Project Agreement** normally has a ‘long stop’ date by which the asset must be completed – if not the public sector will terminate the contract

→ Risk of delay is transferred

- **Project Agreement** states the SPV will be paid a Unitary Charge for constructing and operating the asset
- **Project Agreement** will include an Output Specification which has to be met before the Unitary Charge will be paid

→ Risk of cost overruns is transferred

Example 2 - risk transfer
Whole Life Cost Risk

- Project Agreement will include a **Payment Mechanism** with purpose to incentivise the SPV to maintain the asset at a desired quality throughout the project
- Deductions can be made against the Unitary Charge for poor performance
- Bonuses may be paid if performance/quality exceeded

⟶ Risk of poor quality asset transferred

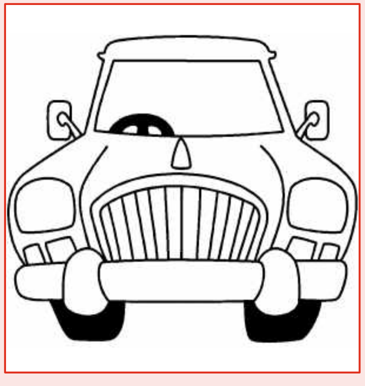
⟶ Public Sector can budget to pay for service

Section 3: Value for money

What is Value for Money?

“ VFM can be defined as the *optimum combination of Whole-Life-Cycle Costs and Quality of a good or service to meet the user's requirement*. It is not just the choice of goods and services based on lowest cost bids. ” – HM Treasury, UK

It is important to note that VFM is a relative concept and is assessed based on comparison of two or more ways of providing the specified goods or services.



When buying a car, do you just buy a car of lowest price?

No!! You look at multiple aspects like

- Price of the car
- Mileage of the car
- Diesel/petrol/etc
- Features in the car
- Maintenance cost
- Other considerations

Only after careful consideration these factors i.e. Price, Quality, Long term costs, etc, you make an optimum choice.

In other words, car that provides you with good **value for money**.

Qualitative VFM – Basic Concept

Viability	Desirability	Achievability
• Will the project work as a PPP? • Can objectives and desired outcomes be contractualised, measured and incentivised	• Do the benefits of PPP (e.g. innovation, risk transfer, quality) outweigh the additional costs and any other disadvantages?	• Can the proposed project be delivered? • Market appetite, timescales, adequacy of authority resources

Quantitative VFM – Basic Concept

Public Sector Comparator

Raw cost
Competitive Neutrality
Transferable Risk
Retained Risk

Financial NPV
(PSC)

PPP Option

Developmental Costs
Service Payments
Retained Risk

Financial NPV
(PPP)

BASIC CONCEPT

Compare the **cost incurred by the authority** in both the procurement routes through the project lifecycle

Value For Money (VFM) Comparison

Assessing the cost

Public Sector Comparator

- **Raw Costs:** All direct and indirect costs for the entire project cycle. (design and constructions activities, capital costs, O&M cost (exclude any valuation of risks)
- **Competitive Neutrality:** Add the additional benefits enjoyed by a publicly procured project e.g. tax benefits
- **Transferable Risk:** Cost the government is expected to pay for transferred risk.
- **Retained Risk:** Value of risks retained by the government is added to both PSC & PPP Cost.

PPP Cost

- **Service Payments:** Annuity projects / revenue shares.
- **Retained Risks**
- **Developmental Cost:** This refers to the costs incurred by the Authority from the project identification stage up to the contract award.

Where PPP is likely to provide VfM

- Major investment involved, which would benefit from the effective management of project risks.
- The private sector has the expertise to design and implement complex projects;
- The public sector is able to define its service needs as outputs that can be written into the PPP contract ensuring effective and accountable delivery of services in the long run;
- Risk allocation between the public and private sectors can be clearly identified and implemented;
- It is possible to estimate on a whole-life basis the long-term costs of providing the assets and services involved;
- The value of the project is sufficiently large to ensure that procurement costs are not disproportionate; and
- The technological aspects of the project are reasonably stable and not susceptible to short-term or obsolescence.

Any Questions?