Public Private Partnerships
An Introduction

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Public-Private Partnership: a definition

- Medium to long term arrangement between public and private sector to deliver public (infrastructure) projects and services
- Whereby some service obligations of the public sector are provided by the private sector
- Where the private party bears significant risk and management responsibility over the whole life of the asset
- And where the public sector realises benefits through the involvement of the private sector "Value for Money"

Where are PPPs used?

- Economic Infrastructure
  - Transport (Roads, Ports, Airports, Railways, Bridges, Urban Transport, Intermodal Terminals)
  - Energy and Power (Generation, Distribution, Pipelines)
  - Renewable Energy
  - Water and Sanitation
  - Solid Waste
  - ICT
- Social Infrastructure
  - Schools
  - Hospitals and Healthcare
  - Social Housing
  - Justice and Correction
  - Sports and other municipal Facilities
  - Defence Infrastructure

Two main PPP models in use

- **Demand-based payment structure (Concession)**
  - Private sector bears risk of demand for service
  - Includes user-pay concession models (e.g. toll roads, airports)
  - May involve support
  - Penalties for poor performance

- **Availability-based payment structure (PPP)**
  - Public sector bears risk of demand for service
  - Regular public sector payments over operational phase
  - Private sector partner makes facilities and services available for use and operates it
  - Reduced or no payments in in case asset is not available

Why PPPs? (1)

- Value for money
- Can provide additional sources of financing
- Can spread payments over time
- May lead to better project selection
- Are more likely to be completed on time and within budget
- Can improve management and maintenance (and better quality of construction) through "Whole-of-life" approach
- Improves the efficiency of Risk Management

Why PPPs? (2)

BUT:

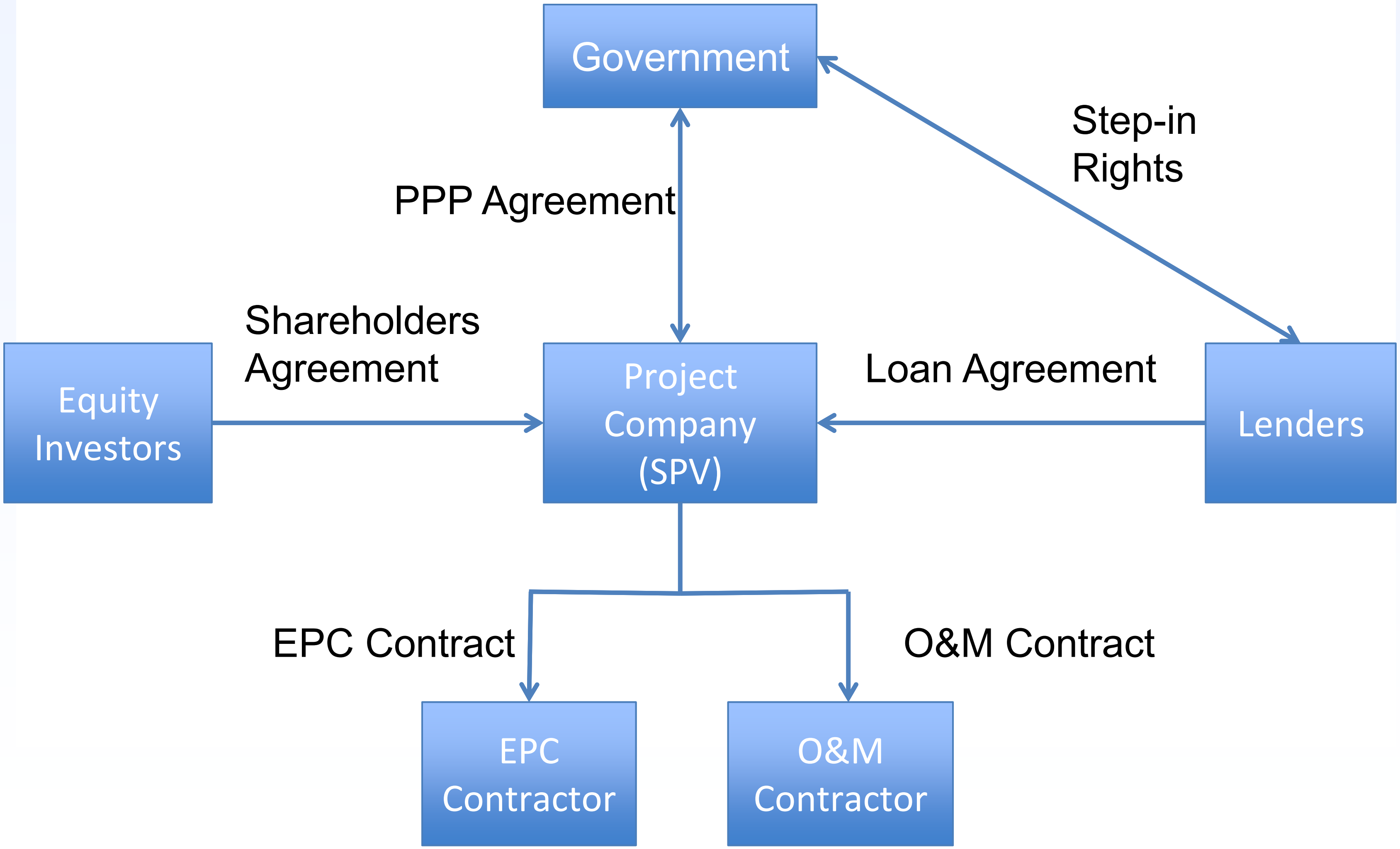
PPPs are no panacea:

- Authority still has funding commitments and takes some risks
- Implicit liabilities (moral obligations; public expectations)
- PPPs do little to improve planning
- Institutional Capacity (authority needs to structure, procure and manage PPPs)
- Unforeseen circumstances require capacity to deal with issue

Structuring (1)

- Starting point is always the public body
- Identification of a PPP Project
  - Should originate from public investment planning process (i.e. should be priority project based on cost benefit analysis)
- The one key Criteria for choice of procurement method should be Value for Money consideration:
  - Qualitative analysis
    - Size
    - Sector
    - Demand
    - Market appetite
    - Likelihood of success (precedents?)
    - Institutional Capability and Capacity
    - Technical solutions
  - Quantitative Analysis

Structuring (2)



Risk Allocation

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- Guiding principle: “who is best able to manage the risk” (who can best control the risk and its impact; who can absorb the risk at lowest cost) should take the risk
- Availability of Site
- Design and construction
- Demand risk
- Operational risk
- Political Risks (regulatory & political decisions, legal framework)
- Finance Risks (interest rates, exchange rates, inflation, refinancing)
- Force Major risks

PPP Contract

- Description of project scope
- Risk allocation
- Performance requirements
- Step-in rights
- User charges/availability payments
- Dispute resolution
- Termination/Early termination
- Provisions for changes in circumstances

Procurement

- Directive on Concessions (2014/23) applies for concessions (works and service)
- Public (Classical) Sector Directive 2014/24 – transposition by 17 April 2016

  5 Options (instead of 4):
  - Open procedure (all interested entities can submit tender)
  - Restricted procedure (only selected entities can submit tender)
  - Competitive dialogue procedure (selection of potential bidders enter into dialogue to develop one or more suitable solution on which chosen bidders will be invited to tender)
  - Competitive procedure with negotiation (selected entities are invited to bid and then negotiations to improve bid)
  - Innovative partnership procedure (interested suppliers are invited to submit ideas)
- Directive 2014/25 on procurement in water, energy, transport and postal services – transposition by 17 April 2016
  - Rules are broadly in line with Public Sector Directive but take into account specificities of utilities
- Competitive Dialogue is most prominent form of procurement for PPPs
  - For “particularly complex contracts where contracting authorities consider that the use of the open and restricted procedure will not allow the award of the contract”

Financing versus Funding of PPPs

Financing of PPPs

- = Financing investment cost during construction

Funding of PPPs over the life of PPP:

- In case of concessions: user pays
- In case of availability-based PPPs:
  - government pays
  - affordability issue (present and future)
  - Tariff flexibility

Financing PPPs (1)

- Project Finance principles (limited recourse; reliance on cash flow)
- Debt/Equity ratio
- Equity
  - Equity from “related” parties
  - “Quality” equity from institutional investors
  - Return requirements

Financing PPPs (2)

- Debt
  - Loans or bonds
  - Mezzanine and senior debt
  - Security: Pledge of physical assets and shares; direct agreement with authority
  - Guarantees offered by IFIs (e.g. project bonds)
  - Role of pension funds, insurance companies and other institutional investors
  - Role of Export Credit Agencies and National Development Banks

Project Advisors

Type of Advisor	Role
Lead transaction advisor (optional depending on market)	• Assists to coordinate the work of all advisors (may be relevant in countries with little PPP experience) – but overall responsibility needs to stay with public authority
Technical advisor	• Responsible for feasibility of technical aspects of the business case • Drafts output requirements • Evaluates and advises on all technical solutions during procurement process • Scrutinises the cost of the bidders' solutions
Financial advisor	• Takes care of all financial aspects of the business case; financial modeling, options • Develops payment mechanisms • Prepares requirements for submitting financial bid • Reviews the funding, accounting and taxation aspects of the solutions • Untertakes financial due diligence of bids
Legal advisor	• Assists the public authority the requisite powers and legal feasibility of project • Develops the contract documentation for the project • Develops legal aspects of bid • Evaluates bids from legal perspective
Environmental advisor	• Examines environmental impact • Considers risk mitigation

Challenges

- Poor project rationale
- Prior to signing of PPP contract:
  - Lack of PPP framework
  - unrealistic expectations
  - Politics
  - Sub-optimal project selection
  - Deficient preparation
- After signing of PPP contract
  - Commercial:
    - Construction related problems
    - Technical underperformance of asset
    - Demand lower than forecast (in case of concessions)
    - Operational issues
    - Affordability issues (Funding of Project)
    - Issues relating to the management of the contract
  - Political
    - Political interference leading to restructuring or termination
    - Changed legal and regulatory environment
  - Macroeconomic shocks

Selective PPP Projects in New Member and Candidate Countries

Motorways

- Hungary: M1/M15, M5, M60 (Hungary)
- Slovakia: R1, D4/R7 (awarded)
- Poland: A1 and A2
- Croatia: Istrian Motorway

Airports

- Budapest, Tirana, Skopje, Burgas and Varna, Zagreb, Istanbul

Water and Waste

- Apa Nova Water (Bucharest)
- Sofia Water
- Belgrade Waste (seeking expressions of interest)
- Posnan Waste (blended with EU funds)

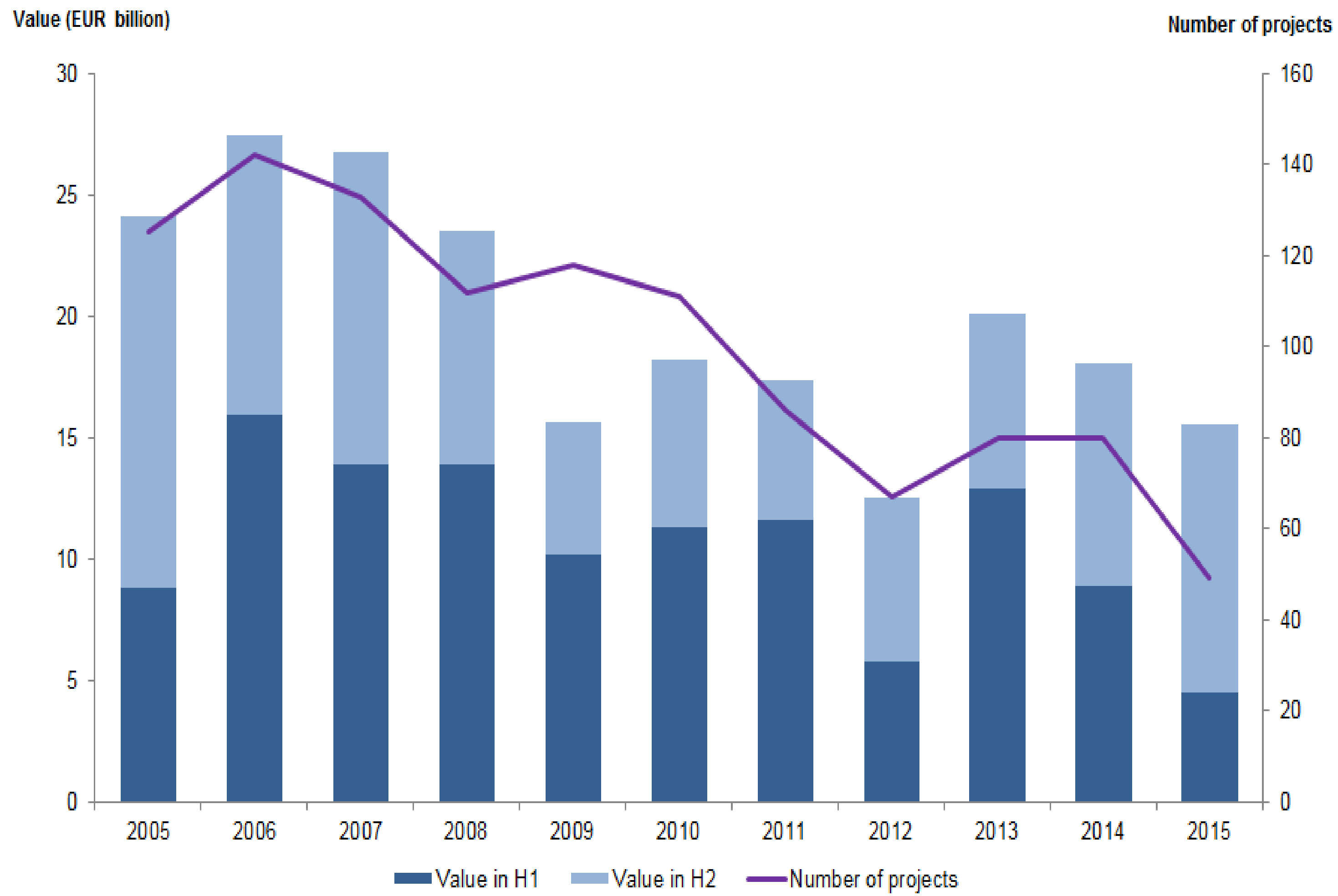
Hospitals

- Hospital Programme in Turkey

Facility Management based PPPs

- Schools, public buildings, leisure facilities

The European PPP Market 2005-2015 (EPEC)



Key figures:

Value of market

- EUR 15.6 billion in 2015
- EUR 18.7 billion in 2014

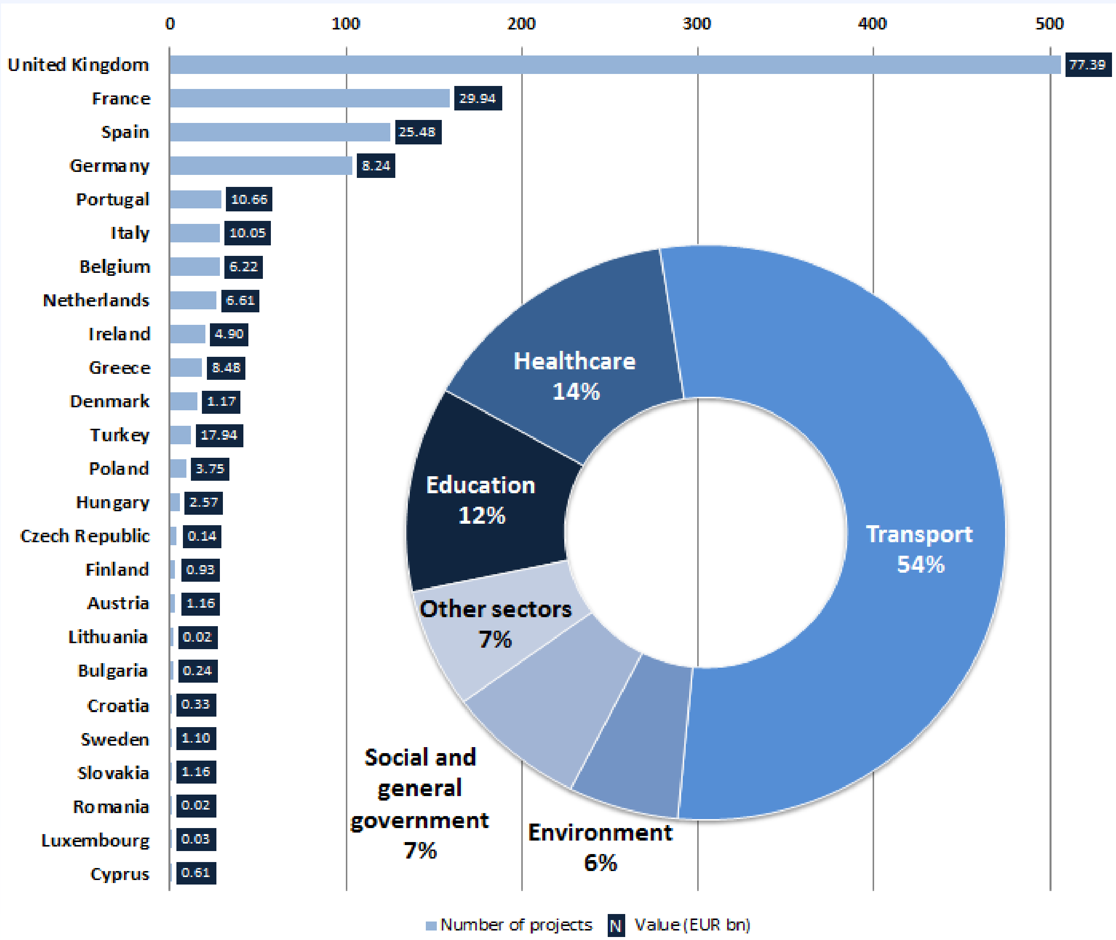
Average deal value

- EUR 319 million in 2015
- EUR 229 million in 2014

Large deals (>EUR 500 million)

- 5 in 2015
- 11 in 2014

The European PPP Market 2005-2015 (EPEC)



Highlights from 2015:

Most active markets

- UK and France by number of projects
- Turkey by value

Sectorial distribution

- Transport was the largest sector in value terms
- Education sector recorded the highest number of deals

User-pay vs. Government-pay

- Over 85% of the transactions closed in 2015 were government-pay

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