Is a Public Private Partnership right for your next project?

TRADITIONAL FUNDING CLOSED
USE PPP ALTERNATE ROUTE
Crumbling Infrastructure, Shrinking Budgets. . . .
how do we close the gap?
Learning Objectives

- Why is there a funding gap?
- The cost of construction and waiting
- PPP’s: Do they work, and what are they?
According to the ASCE*, $1.6 trillion is required over the next five years to bring America’s infrastructure to a good condition. . . . . . that’s $1,600 billion!

...so where will the money come from to fix America’s infrastructure?

* American Society of Civil Engineers
Public Private Partnerships

Private Solutions for Public Needs
Are PPP’s really the answer?

Yes and No…….

› There is no ‘free money’ out there!
  – Most PPP’s require a creditworthy revenue stream for success.

› Most PPP’s are not about ‘selling the assets’
  – There are relatively few opportunities – along the lines of the Chicago Skyway or Indiana Tollroad – to monetize existing assets
  – Most PPP’s do not involve an upfront payment to government.

› Relatively few projects are actually suitable for delivery as a PPP
  – Internationally only 15% to 20% of capital projects are delivered as PPP’s
A decline in public investment in infrastructure between the 1970’s and 1990’s as a percent of GDP:

- Backlog in repairs for schools was estimated to be 7 billion pounds.
- Backlog for maintenance of national health facilities was 3 billion pounds.
- Similar backlogs for transportation and local facilities.
Performance under the UK Private Finance Initiative (PFI) contracts has also been consistently high over time with around 90% of PFI projects performing satisfactorily or better in every year since 1998. In October 2007, UK Treasury published statistics on the numbers and values of PFI projects signed up to that date. The results of this are detailed below:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Projects</th>
<th>Total Capital Value (£bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>86</td>
<td>4.1</td>
</tr>
<tr>
<td>Transport</td>
<td>51</td>
<td>22.7</td>
</tr>
<tr>
<td>Education</td>
<td>115</td>
<td>4.8</td>
</tr>
<tr>
<td>Health</td>
<td>93</td>
<td>10.0</td>
</tr>
<tr>
<td>Treasury, Home Office &amp; Foreign Office</td>
<td>64</td>
<td>2.9</td>
</tr>
<tr>
<td>Defence</td>
<td>51</td>
<td>5.8</td>
</tr>
<tr>
<td>The Regions</td>
<td>161</td>
<td>6.6</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>621</strong></td>
<td><strong>56.9</strong></td>
</tr>
</tbody>
</table>
Why do the UK, Canada, Australia and other countries like PPP’s so much?

It’s about achieving better “Value for Money”!

- The vast majority of PPP projects are – that is, the public agency makes availability payments based on availability and performance in maintaining the facilities.
- Value for money requires the public agency to make a fair comparison of the cost (NPV) for the public agency to complete the project under a conventional procurement process vs the cost under a PPP approach. It includes a fair estimate of the ‘lifecycle’ (i.e. total maintenance over the project life) costs under both approaches.
  - If the PPP approach offers a lower overall cost, the difference is the ‘Value for Money’ benefit achieved by the public agency.
- The UK Treasury PFI (PPP) guidelines state:
  “The Government’s aim is to meet its infrastructure and public service needs in the most effective and efficient way possible. The value for money appraisal process is therefore key to decision making. Once an investment decision is taken, procuring authorities must assess what is the most appropriate delivery model and how the procurement process can best be designed and managed.”
Why do the UK, Canada, Australia and other countries like PPP’s so much?

UK Treasury PFI Guidelines have said that:

- The choice of procurement route shall be based on an objective assessment of Value for Money.
- There is no bias between procurement options.
- Value for money does not come at the expense of employee terms and conditions of employment (guaranteed under TUPE – Transfer Undertakings for Protection of Employment – legislation).
- The use of PFI must comply with the Government’s wider public sector reform agenda.
So let’s understand PPP’s
What is a PPP?

- A **contractual** agreement between a public agency and a private sector entity.

- The **skills and assets** of each sector (public and private) are **creatively combined** in delivering a ‘**best value**’ service or facility for the use of the general public.

- Each party **shares** in the **risks and rewards** (“partners”) in the delivery of the service and/or facility.
Private sector financing takes two fundamental forms:

- **Equity investment** – the “skin in the game”, which is generally considered “at risk” for performance, and requires a higher equity return for the risk, and

- **Debt**, which requires relative certainty for return of capital, and payment of interest, in return for a lower cost of capital (interest rate). Debt will provide the bulk of the private sector investment (70% - 90%)...and will largely drive the requirements of the project.
## PPP is not privatization

<table>
<thead>
<tr>
<th></th>
<th>PPP</th>
<th>Privatization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset ownership</td>
<td>Usually no irrevocable transfer of assets</td>
<td>Transfer of ownership of assets</td>
</tr>
<tr>
<td>Public responsibility</td>
<td>Set policy and service levels</td>
<td>Regulation</td>
</tr>
<tr>
<td>Level of services</td>
<td>Mechanism for shared services</td>
<td>Authorities withdraw from service</td>
</tr>
<tr>
<td>Risk/Reward</td>
<td>Shared</td>
<td>Transferred</td>
</tr>
<tr>
<td>Mode</td>
<td>Partnership</td>
<td>Self-interest</td>
</tr>
</tbody>
</table>
Public-Private Partnerships are created when public sector entities partner with private sector entities:

- through an agreement/contract;
- to pursue a commonly shared goal;
- to leverage each other's skills/assets;
- to share risk and rewards.
Public-Private Partnerships Confusion

PPP’s are not a replacement mechanism for traditional financing approaches for many projects……

- Projects should be carefully scrutinized (through analysis under a Comparator) to determine whether the project characteristics are likely to achieve a better result under a PPP approach.

....And PPP’s are not primarily about cheaper financing!

- The UK, Canadian and Australian governments have rigorously analyzed PPP, and support its use for selected (but not all) projects even though each of these governments could fund projects at lower cost.

- The reasons these governments support PPP is because of better Value for Money created through improved delivery performance, overall lower lifecycle costing and other (non-financing related) efficiencies.
Regardless of type, PPPs are not:

**Outsourcing:** contracting with private sector for goods or services while the public sector remains responsible for their provision (no risk transfer)

**Privatization:** the shifting of complete functions and responsibilities to the private sector, including the transfer of public sector assets

PPPs are all about *Partnerships*
Factors contributing to Value for Money

› Earlier delivery of projects
  – Lower interest carrying costs
  – Fewer changes during construction

› Ability to deliver multiple facilities as needed by demand

› Risk shifted (shared) from Public to Private sector

› Cost Savings
  - Construction
  - Efficiencies/Innovation
  - Potential life-cycle costs as private sector invests more up front to save operating costs
  - Lower initial costs (e.g., pre-development; construction)
Benefits for Public Agencies from PPP

In addition to achieving Value for Money benefits….

› Positive impact on bond/debt capacity and ratings if private debt used

› Economic development catalyst/increased tax revenues
  - (e.g., create jobs, impact pty. values)

› Possible operating expense (vs. capital) treatment

› Increased flexibility for public agency

› Public sector can focus on its’ core competencies
  - More optimal risk allocation

› Innovative funding solutions

› Revenue possibilities and longer-term cash flow
Types of PPP

- Private Finance Initiative
- Turnkey
- Tax-Exempt Lease/Bond
- Sale/Lease Back
- Lease Purchase
- Lease/Develop/Operate (LDO)
- Build/Operate/Transfer (BOT)
- Design/Build/Operate/Maintain (DBOM)
- Design/Build/Maintain (DBM)
- Design/Build – CM@Risk

Degree of Private Sector Risk

Degree of Private Sector Involvement
› Traditional delivery method
Design/Build/Maintain (BOM)

› Private sector:
  – Designs and builds facility
  – Signs maintenance contracts

› Public sector:
  – Finances
  – Operates
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Build/Operate/Transfer (BOT)

› Private sector:
  – Designs and builds facility
  – Assign operation contracts for non education functions
  – Provides some or all of financing

› Asset ownership
  – Transfer to public agency varies
    • Can be at end of construction
    • Can be at end of operation/finance contract
    • Can be at the option of public agency
 Lease/Develop/Operate

› Private sector:
  – Leases or buys existing facility
  – Renovates, modernizes, expands facility

› Public sector
  – Public agency may provide operation
Lease Purchase

› Private sector:
  – Designs and builds facility
  – Provides all of financing
  – May provide operation maintenance services

› Public sector
  – Accrues equity as lease payments are made
  – Own asset at end of lease term

Private Sector Involvement

Lease Purchase
Lease/Develop/Operate
Build/Operate/Transfer (BOT)
Design/Build/Maintain (BOM)
Design/Build – CM@Risk
Sale/Leaseback

- Public sector sells asset to private company
- Public sector leases use of asset for set term
- Minimizes government liability under certain statutes
Tax-Exempt Lease/Bond

› Private sector:
  – Finances capital assets or involves private investments

› Bond/Lease payment
  – Interest payments are tax exempt under State/Federal laws

› Asset ownership
  – Transferred to public agency at beginning or end of lease/bond term
  – May be owned for non for profit Special Purpose Entity
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Turnkey

› Private sector:
  – Designs and builds facility
    • Fast-tracked construction and streamlined selection process
  – May provide financing and equity

› Asset ownership
  – Can reside with either Public or Private

Private Sector Involvement

- Turnkey
- Tax-Exempt Lease/Bond
- Sale/Leaseback
- Lease Purchase
- Lease/Develop/Operate
- Build/Operate/Transfer (BOT)
- Design/Build/Maintain (BOM)
- Design/Build – CM@Risk
Private Finance Initiative

- Model developed in UK
- Risk is mostly transferred to the private sector
- Private sector:
  - Designs and builds facility
  - Provides all of financing
  - Provides maintenance under contract
  - Provides operations of non-education functions under contract
- Public sector:
  - Accrues equity as lease payments are made
  - Own asset at end of lease term
The evolution of PPPs

Outsourcing  
Design & build, O&M contracts  
PPP contracts  
Joint Ventures & Strategic Partnerships

Input-orientation  
Output-orientation  
Outcome-orientation

Cost  
Value

Operational Focus  
Strategic Focus

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PPP Concession Overview

Public Agency
Concession Grantor

Prospective Project Company (SPV)

Equity Investor

Lenders
Legal Adviser
Financial Adviser
Insurance Adviser

Integrated Design & Construction JV
Construction Contractor
Designer

O&M Contractor
Operations
Maintenance
A PPP is largely a ‘creature of contract’

- The value of the project is as a ‘going concern’ – failure to perform can cause loss of the contract and forfeiture of the investment.
- Hence the tightness of the contract structure is critical to success.
- Optimal risk allocation is key

Thus, the relationship between the core contractors and the project sponsors is much closer under a PPP.
Now, let’s look at each key component on the diagram...
PPP Concession Overview...SPV

SPV is the “Project Company” or “Concessionaire”
- Owned by equity investors
- Thinly capitalized – a classic limited recourse structure
- Supported by the strength of its contracts
- No explicit parent guarantees

Public Agency
- Concession Grantor

Prospective Project Company (SPV)

Lenders
- Legal Adviser
- Financial Adviser
- Insurance Adviser

Integrated Design & Construction JV
- Construction Contractor
- Designer

O&M Contractor
- Operations
- Maintenance
The Equity investors (or Sponsors) will include an experienced concession operator, and may include other financial investors and core contractors (“skin in the game”).
Lenders will require that contracts ensure that minimal risk remains with the SPV – lenders will closely scrutinize creditworthiness of all parties (including the public agency), the experience of core contractors and key contract terms before agreeing to lend.
A PPP bid will require submission of a fixed price combining the construction and maintenance of the project over the concession term. Once selected, the tendered price will be written into the Concession Agreement. Change orders are very rare in PPP.

CJV will be responsible for providing a fixed or maximum lump sum price, and will need to accept design, schedule and construction cost risks.

Public Agency
Concession Grantor

Lenders
Legal Adviser
Financial Adviser
Insurance Adviser

Prospective Project Company (CJV)

Integrated Design & Construction JV

Construction Contractor
Designer
O&M Contractor is required to wrap both the day-to-day operations and regular and long-term (lifecycle) maintenance—which can be tricky. In many cases, the O&M contractor will cap his maintenance liabilities, with ultimate risk falling back to the sponsors.
Integration Risk – CJV and O&M will be required to accept the risks associated with handover of the facilities from construction to operation. This usually involves O&M participation in facility specification and design.
PPP Design

› Undertaken in consultation with the ultimate users…
› Quality of design is generally a key factor
› Ease and efficiency of maintenance is also key
   – Lower life-cycle costs
   – PPP contractor will have to maintain
› Durability of materials and finishes versus cost
Balancing Risk with Costs

- The greater the transfer of risk, the higher the price
- Project costs could grow and become prohibitively expensive
- Transfer risk when it makes good economic sense
<table>
<thead>
<tr>
<th>Risk</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reputation</td>
<td>Thorough pre-screening of partner</td>
</tr>
<tr>
<td></td>
<td>- Include stakeholders in process</td>
</tr>
<tr>
<td></td>
<td>- Clearly communicate status at every milestone</td>
</tr>
<tr>
<td>Expectation</td>
<td>Unrealistic expectation</td>
</tr>
<tr>
<td>Project</td>
<td>Select partner that can bring resources to accomplish goals</td>
</tr>
<tr>
<td></td>
<td>Private partner unable to deliver due to financial resources or experience</td>
</tr>
<tr>
<td>Legal</td>
<td>Research laws prior to RFP/RFQ process and ensure the document is compliant</td>
</tr>
<tr>
<td></td>
<td>Project being derailed due to violations of procurement or delivery laws</td>
</tr>
<tr>
<td>Political</td>
<td>Get political agreement prior to process</td>
</tr>
<tr>
<td></td>
<td>Process can derail due to political fighting</td>
</tr>
</tbody>
</table>
Traditional funding of projects contains peaks and valleys in spending.

PPP creates a steady, predictable, and affordable financing source.
Construction Schedule

RESPONSIBILITY
Private

KEYS
Stipulated in contract
Construction Costs

RESPONSIBILITY

Private

KEYS

Fixed price
(Guaranteed Maximum Price)
Permitting Process

RESPONSIBILITY
Public

KEYS
Private partner to assist

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Public Private Partnerships – Private Solutions For Public Needs

**Financing Procurement**

**RESPONSIBILITY**

Varies but mainly Private

**KEYS**

Funds can be 100% private or a mixture of Public and Private
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Debt Service Payback

RESPONSIBILITY

Varies, but mainly resides on Public Sector

KEYS

Stipulated in contract
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Operating Costs and Functions

**RESPONSIBILITY**

Varies

**KEYS**

Shifts to Private if functions are outsourced
Responsibility: Varies

Keys: Shifts to Private if there is a maintenance contract
Resposnsibility: Varies

Keys: Based upon PPP model chosen
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Technology Performance

RESPONSIBILITY

Varies

KEYS

Initial and long term upgrading
So what does the PPP process look like?
Let’s examine the procurement process for a PPP...

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Commitment from lenders will require…

› Agreed technical project scope, risk allocation and commercial terms, and

› Bank credit commitment, or

› Rating Agency review and assessment of project, which can only be done when agreement is reached - $$$$$

   – Bond insurance wrap to achieve investment grade (based on rating agency review) - $$$$$
When can lender commitments be obtained?

Need for defined scope and defined risk allocation to obtain lender commitments.

PPP Process
An overview

The project is technically defined, and risks identified

Negotiation to agree final scope, terms and price.

Consider technical response and indicative financing structure

Lender Commitment

Define Project
Feasibility Study
Outline Business Case

Project Approval
Marketing and Shortlisting

Information Memorandum

Issue RFP

Tender Evaluation
Select Preferred Bidder

Tender

Financial Close

Program & Project Planning
Marketing
Solicitation & Evaluation
Award

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PPP – A Combining of Strengths
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Combining of Strengths

**Public Sector**

- Legal authority
- Protection of procurement policies
- Broad perspective to meet public needs
- Personnel is dedicated but constrained
- Capital resources and under utilized assets

**Private Sector**

- Management efficiency
- Workplace efficiencies
- Capital management
- Newer technologies
- Cash flow management
- Personnel expertise

100% Effectiveness

(Result of market competition)
so why have so few PPP’s been completed in the US, despite huge infrastructure needs?

- Lack of political support for a true P3 approach
  - Inadequate value for money analysis (to justify P3 approach)
  - Opposition by public sector unions
- Inappropriate/inadequate risk definition or risk allocation.
  - Lack of definition or sufficient certainty around revenue sources
  - Inadequacy of revenue sources
  - Improper structuring of payment or performance mechanisms