Introduction to PPPs

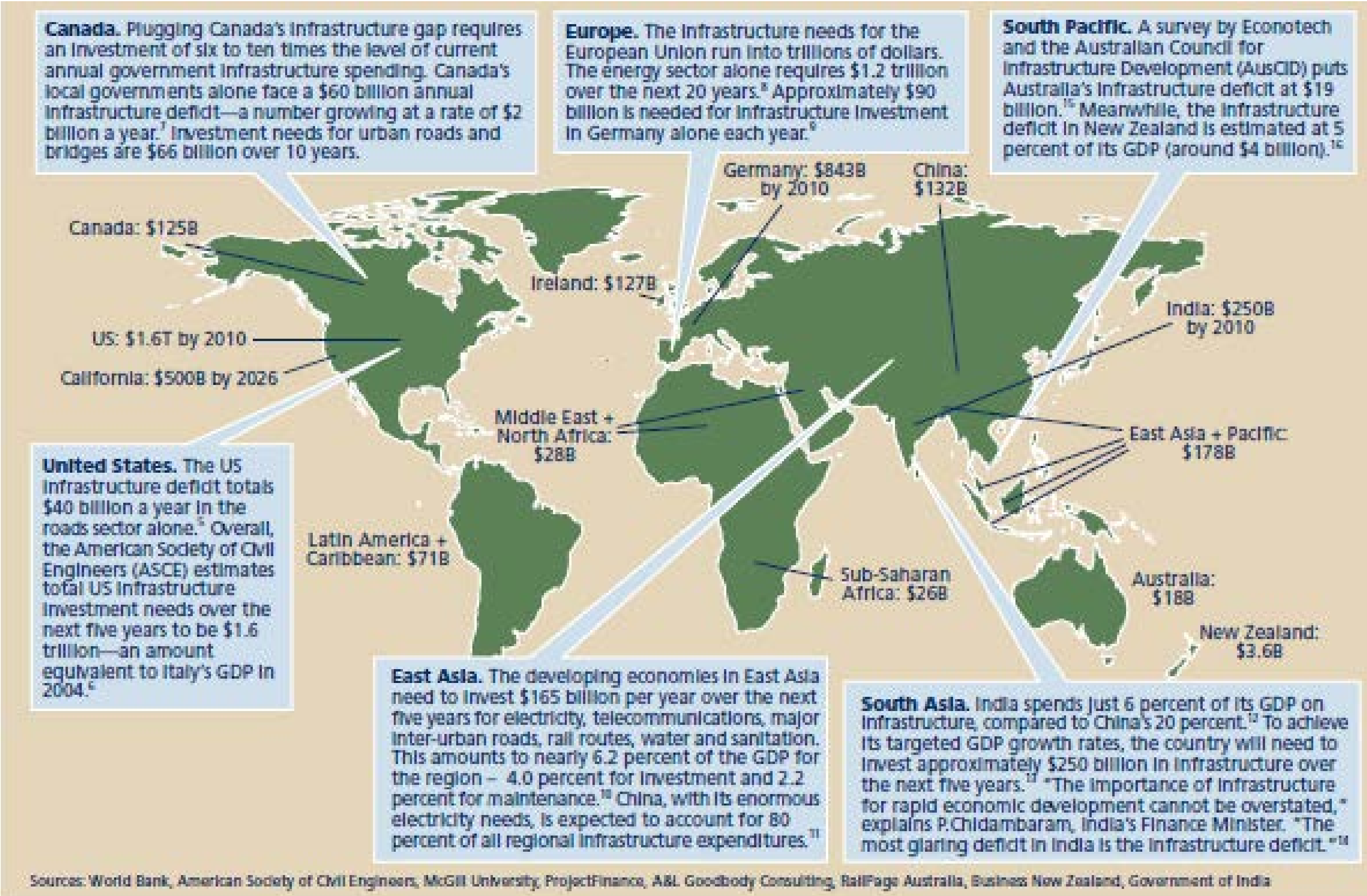
117 ITP 2015

Jayant Singh

Infrastructure scenario: India

- India is one of the fastest growing economies.
- Plagued by Inadequate infrastructure:
  - significant constraint on India's growth potential
  - retards GDP growth rate by 1-2 % p.a. (estimates)
  - acts as a major barrier to Foreign Direct Investment
  - hinders the objective of Inclusive development

The expert group on commercialization of Infrastructure estimated the loss due to poor roads and congestion at around Rs 200 billion per annum. This is just one sector…

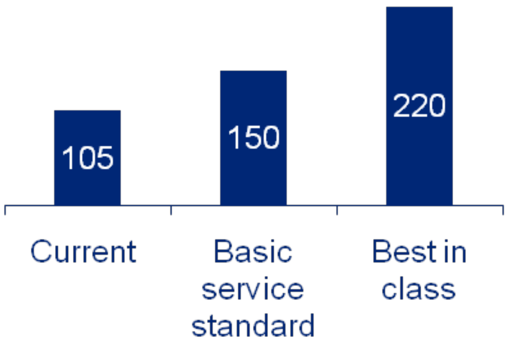


Source: Deloitte

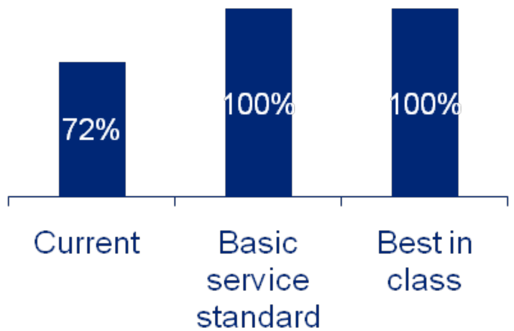
Arvind Mayaram, May 2015

Comparison of basic public services

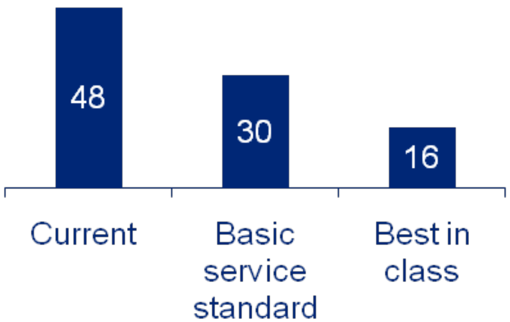
Water supply quantity
(Litres per capita per day)



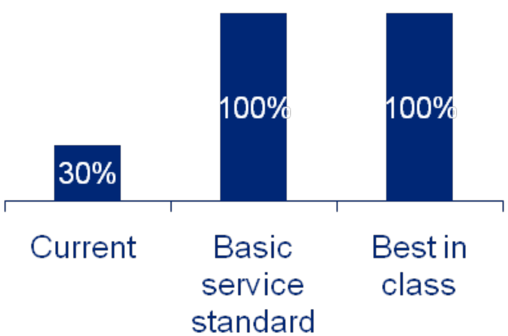
Solid waste collected
(%age of total waste generated)



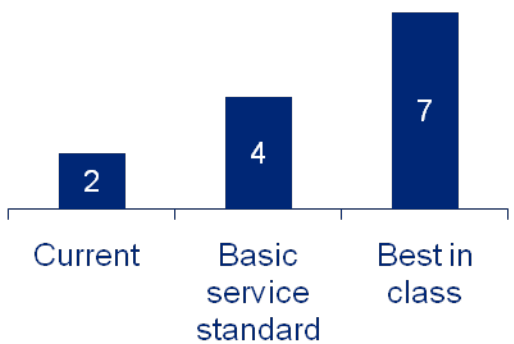
Education
(Student-to-teacher ratio in primary schools)



Sewage treated
(%age of sewage generated)



Health care
(Hospital beds per 1,000)



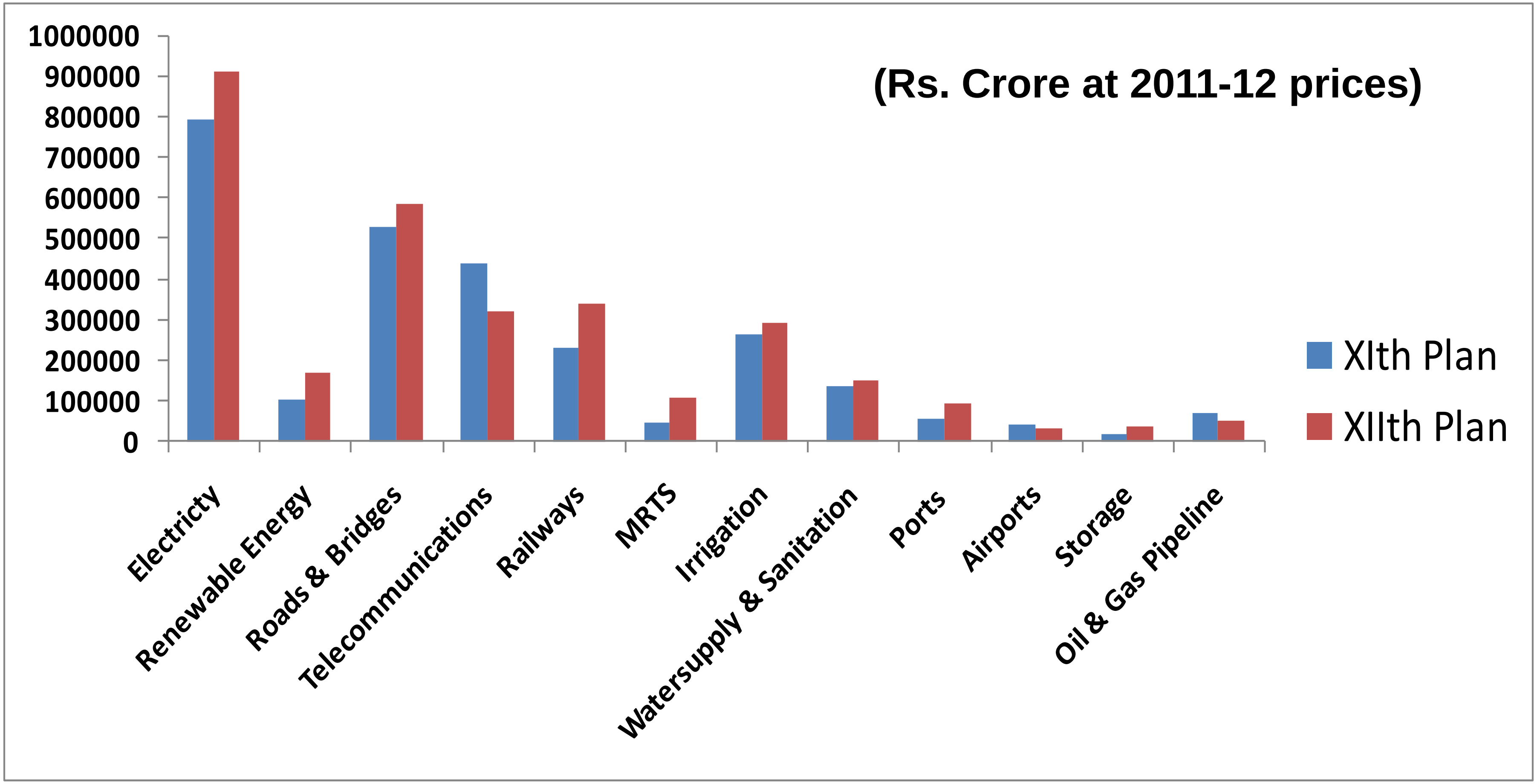
Parks and open space
(square meters per capita)

Source: India's urban awakening, April 2012, McKinsey Global Institute

Inadequate infrastructure affecting Indian cities

Revised Projections of Investments in Infrastructure

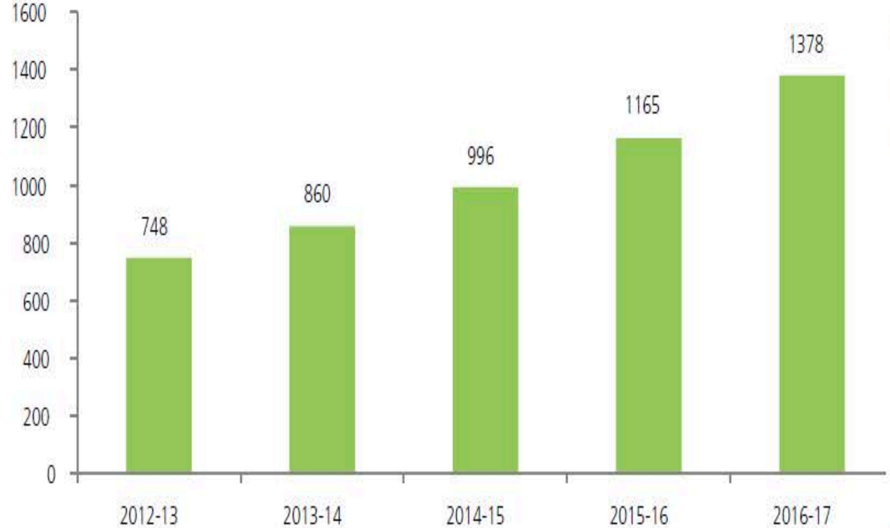
As of June, 2014



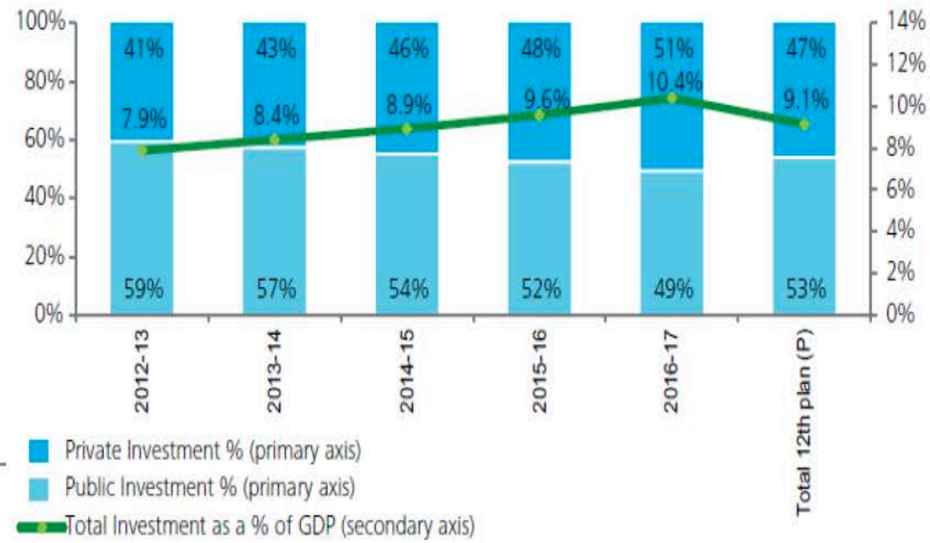
Source: Deepak Parekh Committee Report, 2014

Huge Infrastructure Investment projected for 12th Plan

Projected investment in infrastructure (Rs ‘000 Cr in 2011-12 prices)

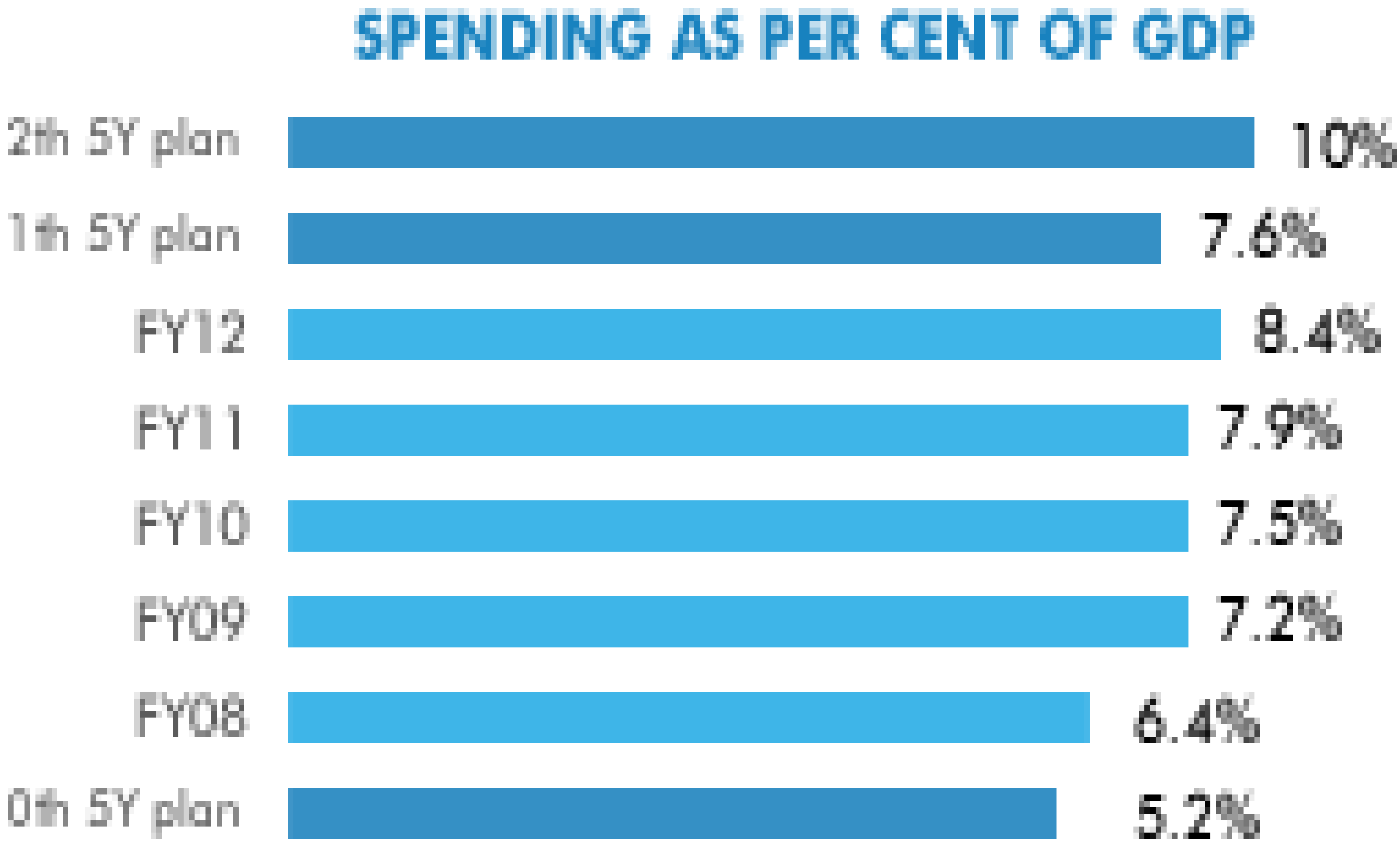


Projection for private sector in investment



Source - Interim report of the High Level Committee (Planning Commission) - Aug 2012

- Rs 51 lakh Cr is estimated as the requirement for infra development over 12th Plan, which is double that of the 11th Plan
- The share of private sector is expected to rise to 47% against 38% in 11th Plan
- Significant investments are projected for renewable energy, ports & storage
- Private sector is considered key to drive infra development


SPENDING AS PER CENT OF GDP
2th 5Y plan
10%
1th 5Y plan
7.6%
FY12
8.4%
FY11
7.9%
FY10
7.5%
FY09
7.2%
FY08
6.4%
0th 5Y plan
5.2%

India faces pressure for higher social spending at lower level of development

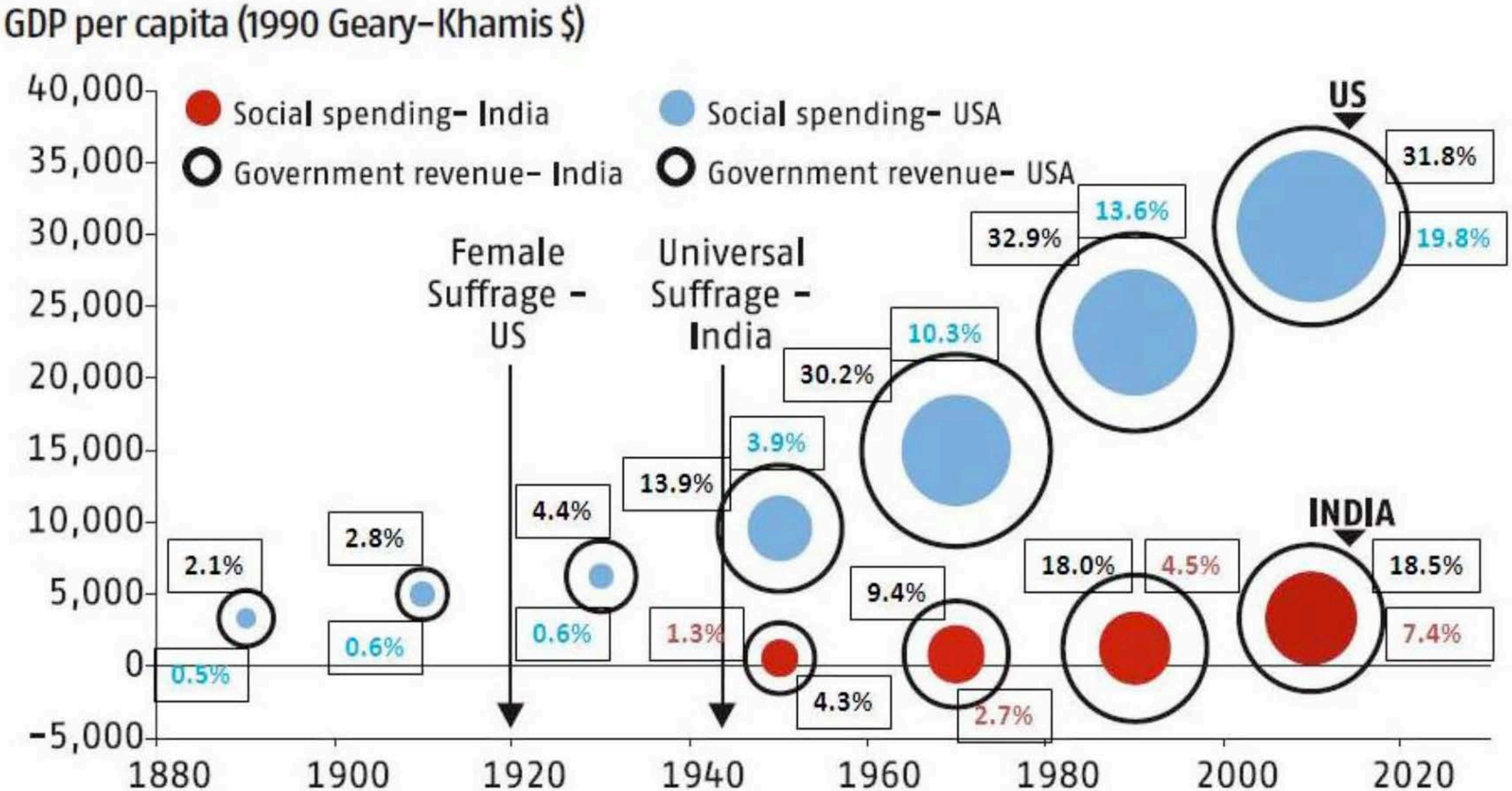
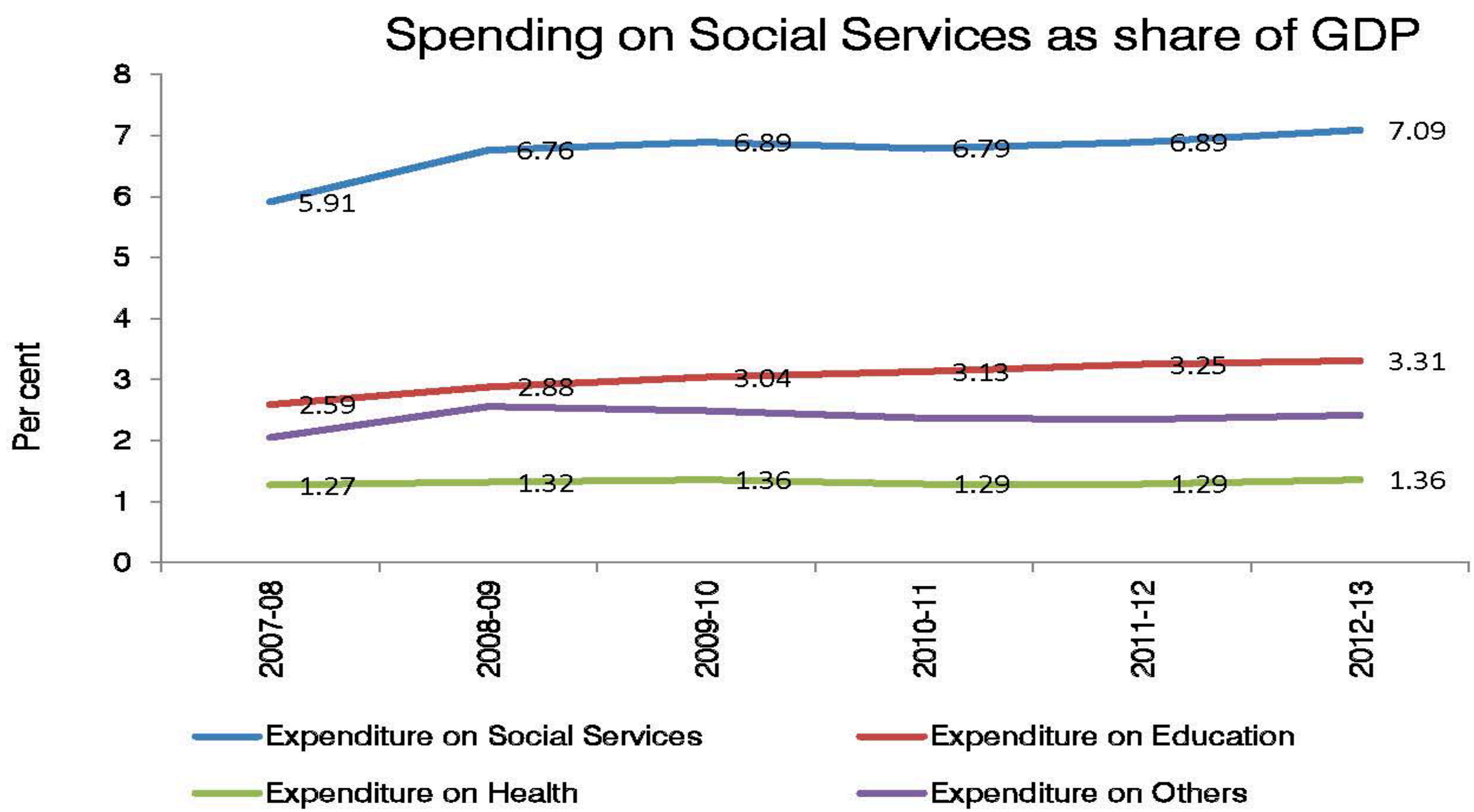


Figure 1: The outer circles indicate Government revenue as share of GDP, and the inner solid circles indicate spending on social protection as share of GDP. The Y axis indicates GDP per capita in terms of Purchasing Power Parity.
Source: Maddison Project Data Base, Lindert Dataset, Ministry of Finance, GoI

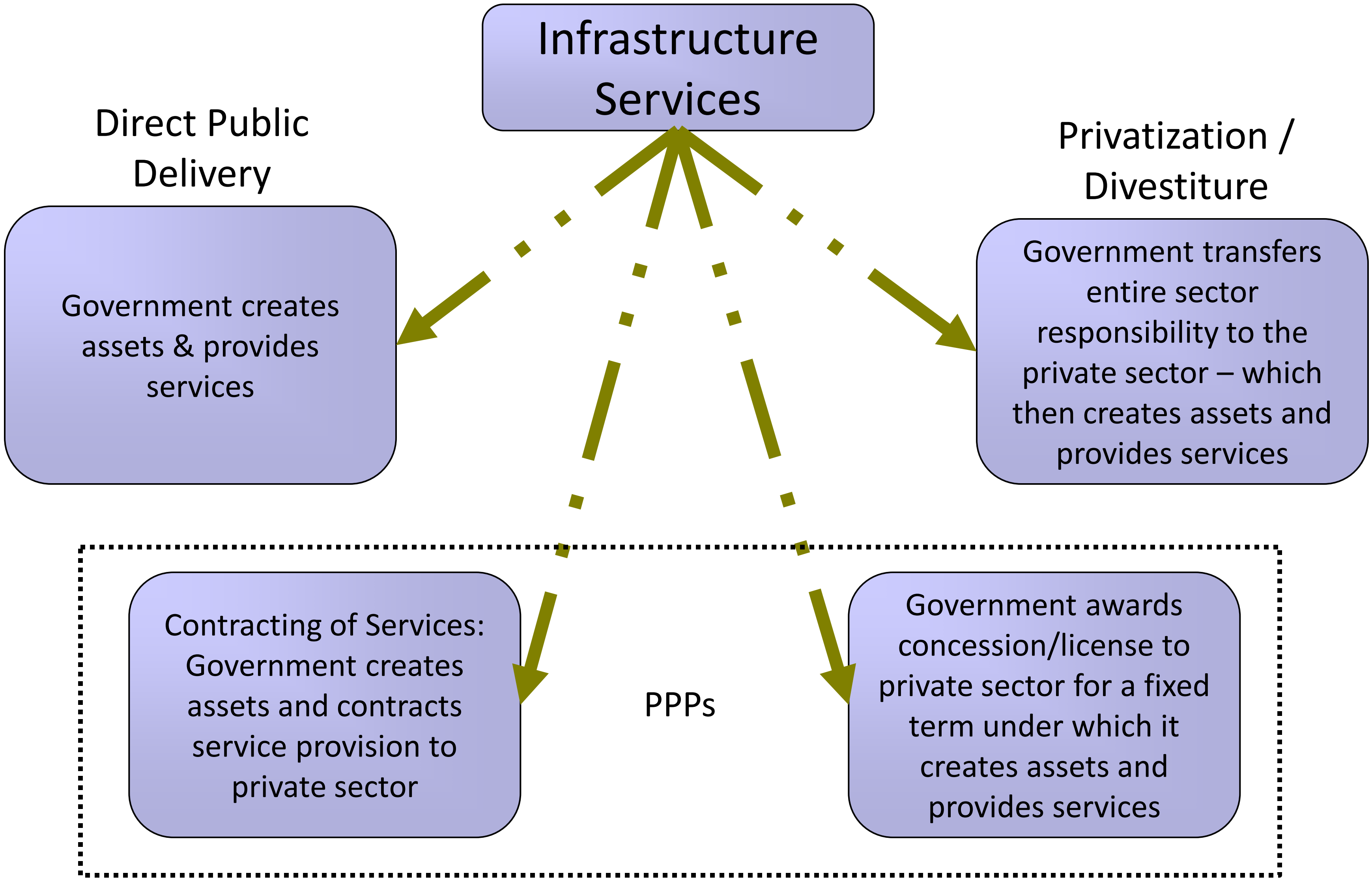
Source: Rajiv Lall, Business Standard, 6 Nov 2013

........Demand for greater social spending



Source: Economic Survey of India (2012-13)c

Public Service Delivery Options



What is PPP?

Defining PPPs

Department of Economic Affairs, Govt. of India defines Public Private Partnerships as :

- ✓ ***"An arrangement*** between ***government*** or statutory entity or government owned entity on one side and ***a private sector entity*** on the other,
- ✓ for the ***provision of public assets*** and/or related services ***for public benefit***,
- ✓ through ***investments being made*** by and/or ***management undertaken*** by the ***private sector entity*** for a ***specified period of time,***
- ✓ where there is a ***substantial risk sharing*** with the private sector
- ✓ and the private sector receives ***performance linked payments*** that conform (or are benchmarked) to specified, pre-determined and measurable ***performance standards. "***

The above are Essential Conditions in the definition. In addition there are several desirable features or good practices that can be adopted.

What is PPP?
An alternative procurement option

The final responsibility for service delivery continues to remain with the public sector agency

- PPP is only ***one of the several options*** available for procuring infrastructure.
- PPPs should not be seen as a replacement of the traditional public procurement.
- PPP should be applied only where it can provide better value for money for the public at large.
- PPPs recognize that both the public sector and the private sector have their own strengths.
- PPPs attempt to balance the strengths of both parties, to create a ***win-win combination.***

PPP is not a panacea to all our infrastructure requirements. It is a tool that should be considered along with other options of procurement.

Expectations: Govt & Pvt

Government

- **Harness private sector efficiencies (on-time, on-budget delivery; access to latest technology etc.)**
- **Augment government resources**
- **Provide better value for money**
- **Facilitate improved access and service delivery**

Private sector

- **Viable business opportunity**
- **Fair distribution of risk & responsibility**
- **Transparency in procurement**
- **Consistency in legal and regulatory framework**
- **Stable political and economic environment**

What is PPP?

Long term contractual arrangements with a private sector entity

- PPP contracts are generally long term contracts with a private sector entity

- Public authority enters into ***only one agreement*** with a private partner, who in turn contracts with designers, builders and service providers.

- Allows the public authority to have a ***single point of responsibility and accountability.***

Comparison with Traditional procurement:

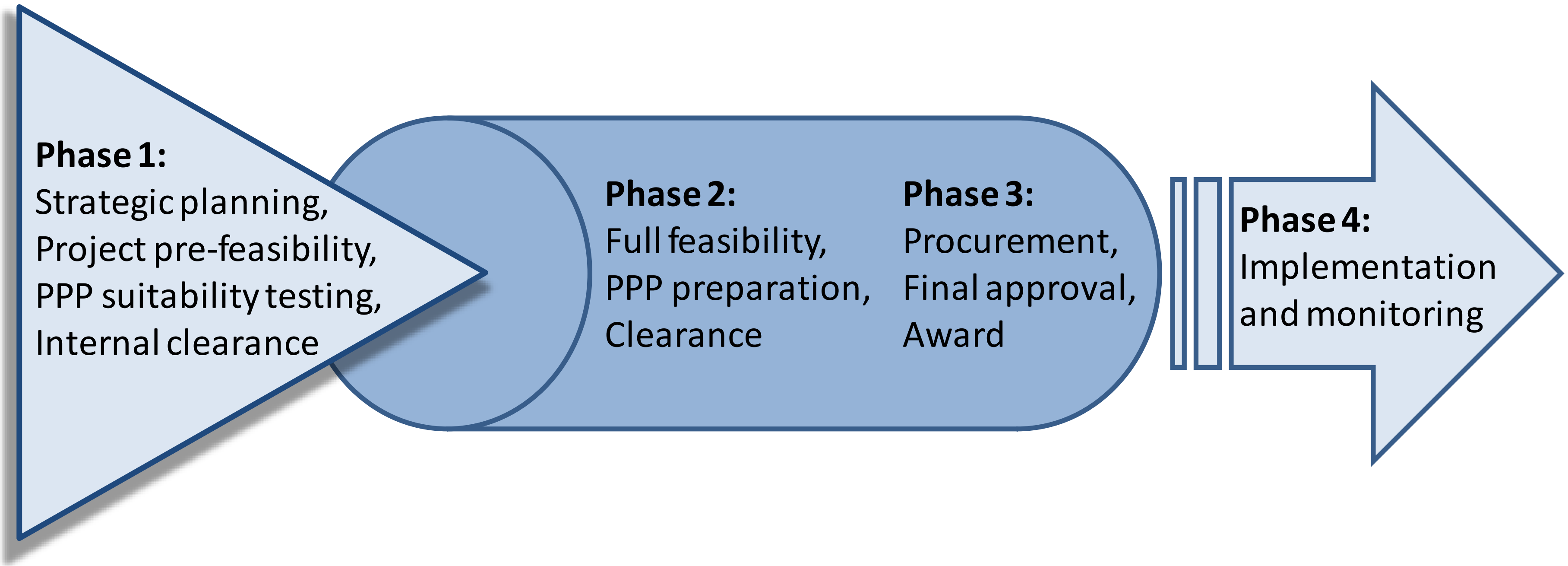
- Generally ***separate procurements*** for designing, building and operating; resulting in a less efficient service provision

- The private sector is responsible for delivering assets, not for their long-term performance beyond standard warranty periods

PPPs are generally implemented through a ***Special Purpose Vehicle*** set up by the private party

PPP Life Cycle Process

PPP identification → **PPP development pipeline** → **PPP operation**



What is PPP?

Generally implemented through a SPV

- **What is a Special Purpose Vehicle (SPV)?**
- A new company is set up to implement each project
- Usually no balance sheet support is provided by the sponsoring entity – except for the initial equity commitment
- Most obligations are addressed through contractual arrangements – financing, construction, O&M, supply of inputs and off take agreements
- It is a Bankruptcy Remote Structure
  - For the private partner: the project and sponsor are insulated from each other
  - For Government – the risks/failure of the private sponsor is delinked from the project

The benefit of using a SPV is that it is a ***bankruptcy remote structure.***

Risk allocation is key component of PPP

Type of Risk	Description
Commercial / Market	Actual demand for service (e.g. traffic levels below projections, and tariffs not sufficient
Financial / economic	inflation, exchange rates, interest rate movement, refinancing risk, currency risk.
Technical risk	Poor design, construction overruns, start-up delays, higher materials costs, engineering / geological problems
Political risk	Expropriation, arbitrary changes to contract, contract stability when government changes
Legal and regulatory	Unforeseen changes in legislation /regulatory processes

What is PPP?

Aims to achieve optimal risk allocation

- PPPs are characterized by ***significant level of risk transfer to the private sector over life of contract***
- Risks are ***allocated to the party that is best able to manage them***
- Risk allocation varies depending on responsibilities of the parties and the type of PPP structure used
- **Comparison with Traditional procurement:**
- ***Risks typically remain with the public sector***
- ***Public sector becomes liable for most of the cost and time overruns***

Aim is to ***optimize*** rather than ***maximize*** risk transfer

What is PPP?

Focus is on Output specifications

- In PPP contracts, public sector defines only basic standards of service it wants delivered, not the means by which those services are to be delivered

- This provides the private party an ***opportunity to innovate* while meeting the specified standards**

- Allows **scope for private sector's skills and knowledge to feed into public service provision**

Comparison with Traditional procurement:

- **Assets are input-specified**

What is PPP?

Focus is on Output specifications

It's not a product…

- Traditionally when government wants to build a road, it:

1. Hires an engineering company to make a design
2. Writes detailed specifications on basis of the design
3. Hires a construction company to build the road, on basis of the specifications
4. Raises finances from budgetary sources or through borrowings to meet the costs of the road
5. Does intensive project management to make sure that the road will be build properly
6. Pays the construction company during the works
7. Maintains (and operates) the road itself when it is ready.

What is PPP?

Focus is on Output specifications

…but a service!!!

- When a road is procured under a PPP contract, government:

1. Writes the output specifications of ***what* it wants (not *how*)**
2. Asks the private partner to make the detailed designs (based on the output specification), raise the needed finances, build the road and maintain it for a long period and hand it back to the government at the end of the contract
3. Checks whether the service is being deliverd correctly and (if so) pays the private consortium an availability payment for the service, periodically/ or permits collection of user charges, starting when the road is completed until the end of the contract

Output specifications: It's not a product, but a service!!!

What is PPP?

Performance linked payments

- In PPP contracts, payments to the service provider are generally linked to performance over the contract life
- Payment for the services are dependent on delivery of facilities and services to agreed standards as set out in the contract.
- ***Penalties*** are applicable in case of failure to meet the agreed terms of performance.
- Output specifications allow better linkage between performance & payments

Comparison with Traditional procurement:

- Payments for procurements paid as asset / service completed. Generally payments tend not to be performance based.
- Private sector is not incentivized to provide long term quality asset.

What is PPP?

Whole life costing

- Inclusion of operations and maintenance component ensures that the private partner focuses on the whole life cycle cost of the projects and not just on the upfront capital costs.

- Adopting whole life cycle costing approach encourages efficient design, that may reduce operating costs.

Comparison with Traditional procurement:

- Separate contracts may result in an inefficient design with higher operational costs.

- Public sector may incur significant extra costs if separated parts do not work well together.

Optimizing the life cycle costs as opposed to lowering the construction cost.

What is PPP?

Financing

- PPPs allow the injection of private sector capital into developing infrastructure.
- PPPs can also be used to leverage limited public sector finances
- Greater scope for innovative financing, e.g. "Development rights" and other add on rights being integrated with financing models in case of projects that may not be otherwise viable

Comparison with Traditional procurement:

- Availability of public capital may be constrained.
- Traditional procurement is dependent primarily on budget sanction and disbursement cycles of government; the latter may be fraught with uncertainties

Need for Private Participation

BRIDGING THE INVESTMENT GAP:

Commonest Reason cited for undertaking PPPs

1. Inadequacy of resources with government (commonest reason)

2. By leveraging on committed government funding it is possible to finance projects of much larger magnitudes

3. The 12th Plan envisages that 50% of the investment requirements (US$ 500 billion out of the total of US$ 1 trillion) would have to be met through private investment or PPPs

Need for Private Participation

ENHANCED EFFICIENCY:

Often overlooked but better reason for undertaking PPPs

1. Examples of private sector involvement in core sectors: airlines, telecom services, oil refining - private sector is able to take on large projects, complex operations and can better handle commercial risks attached to projects such as Design, Financing, Construction, Operations and Maintenance

2. Risks that often affect projects implemented by the public sector - time and cost overruns, change of scope, inadequate designs, lower construction quality, leakage of revenues, high maintenance costs – can be assumed by the private player

3. There is an incentive for the private party to use appropriate technology, develop innovative design solutions, improve project management practices, install more efficient revenue collection practices and use life cycle cost approach

4. Expected outcomes - value for money, expeditious implementation and higher quality of assets and services

Key Benefits of PPPs

1. **Rigorous project preparation** – since the focus shifts to developing bankable projects

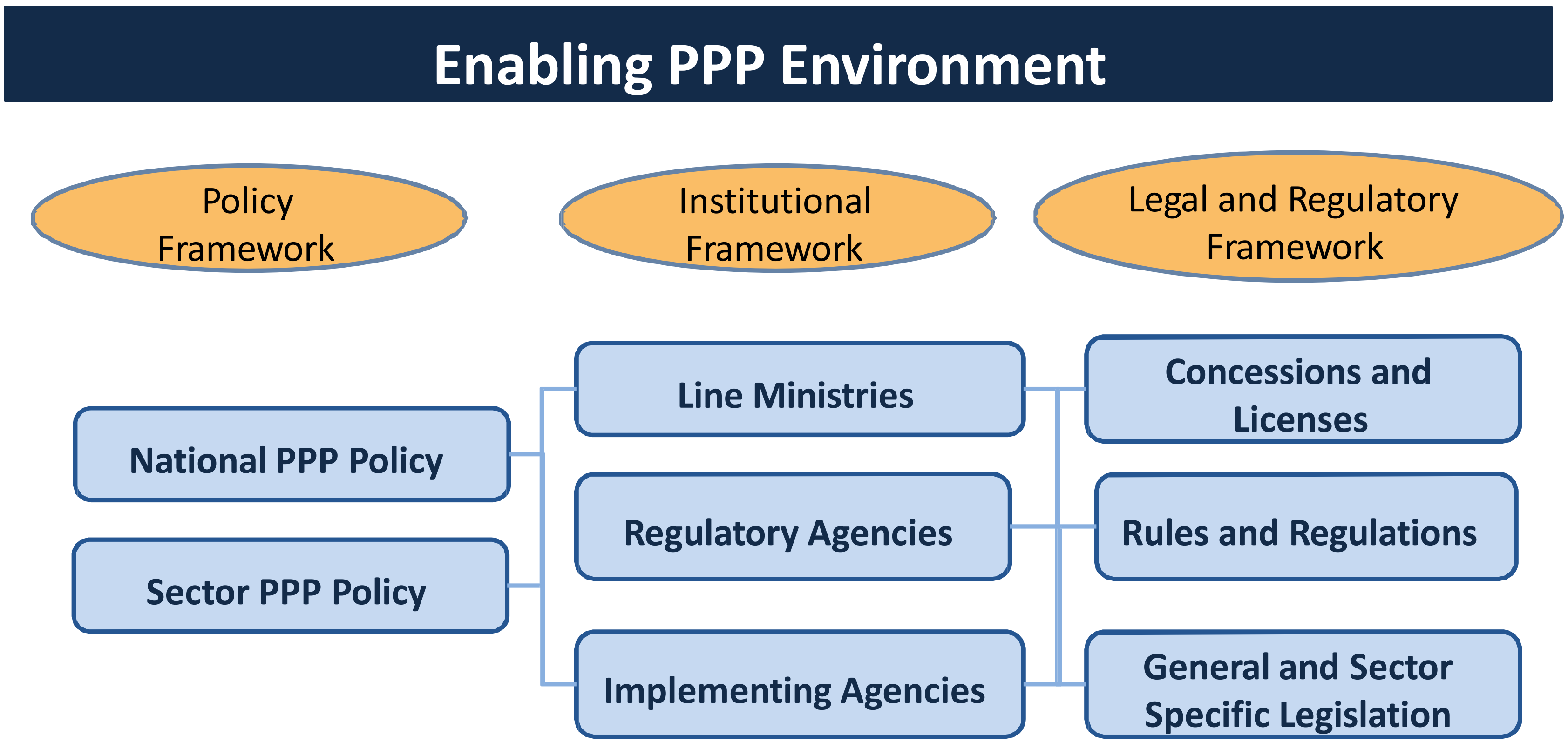
2. **Delivery of a whole life solution** – going beyond asset creation and including Operation and Maintenance (O&M)

3. **Focus shifts to service delivery** – construction responsibility is integrated with O&M obligations and together with appropriate quality monitoring and service delivery-linked payments such an arrangement could enhance the levels of service delivery

4. **It is possible to adopt a programmatic approach to infrastructure development and service delivery** – various time bound projects can be integrated under a programme and have a time-bound implementation plan

5. **Can lead to better overall management of public services** – transparency in selection and ongoing implementation

Enabling Environment for PPP



Enabling Interventions

Institutionalization	• PPPAC • State PPP Cells • Centre line Ministry ‘s PP Cell
Legal Framework	• Draft PPP Policy, Rules and Procedure • State PPP Policy or PPP Acts • Modal Concession Agreements, Sector Specific Agreements, PPP Process and Guidelines
Financial Support	• India Infrastructure Finance Company Limited (IIFCL) • Central And State VGF • IIPDF and State PDF
Capacity Building	• Knowledge Series, Case Studies, Sector Papers • Online toolkit • Training and Workshop for Government Officials across the sector • Training for Trainers
Hands on Project Support	• Pilot Project • Transition Advisory and Legal panel • Project Structuring and Financial Support
Management Support System	• State and Centre PPP Project Database • Website (s) • MIS

Pre-requisites

FOR A PROJECT TO BE UNDERTAKEN ON A PPP BASIS

The public entity should have the enabling authority to transfer its responsibility – enabling legislative & policy framework OR an administrative order to that effect

Engagement with a Private Partner should bring in **Value for Money**

The instrument of transfer is the Contract OR Concession Agreement

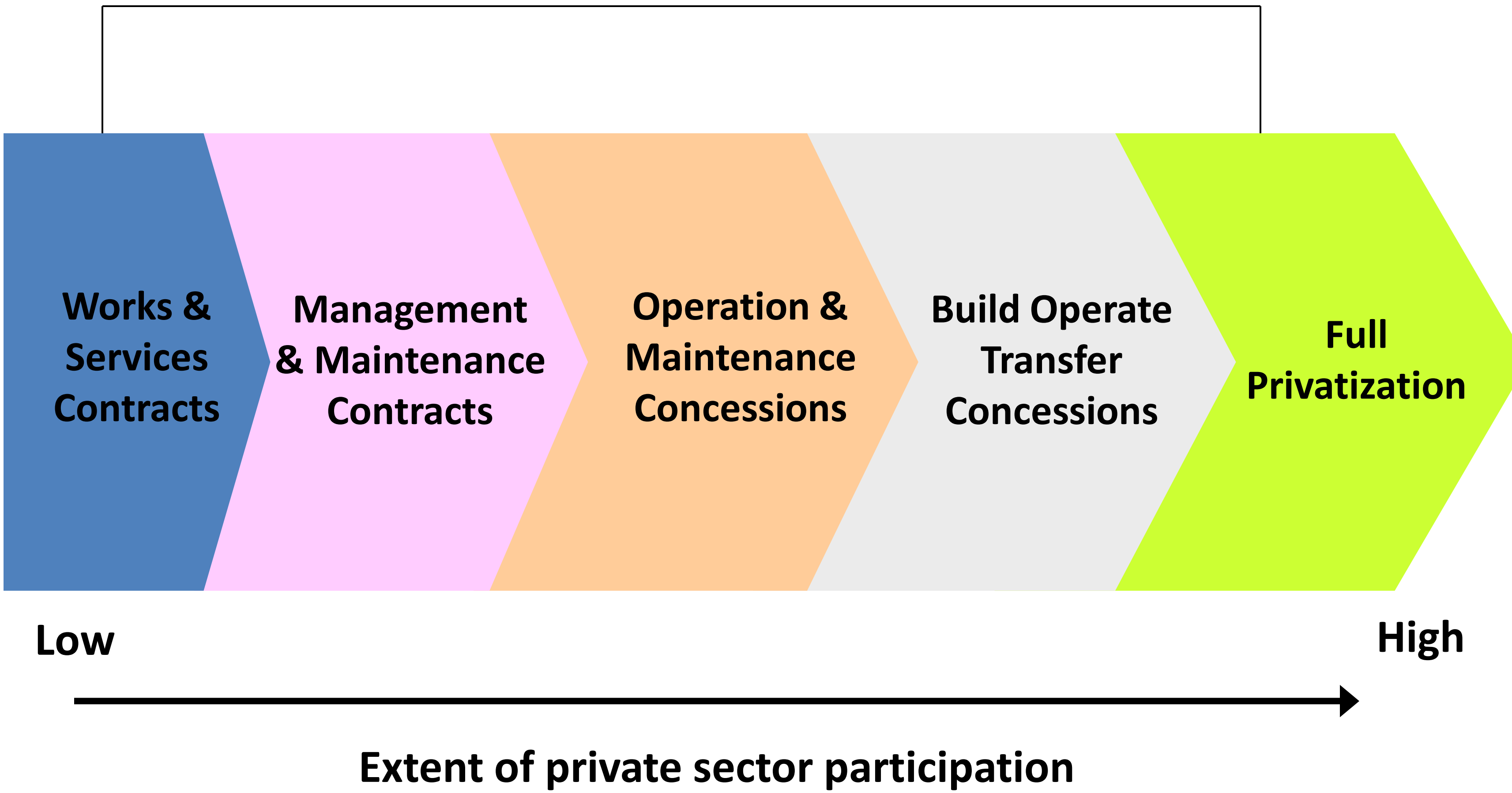
FOR A PROJECT TO BE CONSIDERED A PPP

1. There should be a significant transfer of responsibility to the private entity – usually including financial investment obligations

2. Payment to the private entity for services based on achievement of pre-specified levels and standards of performance – directly by users (tolls/user fees) or paid by the public entity (annuities for instance)

3. The nature of the relationship should be long-term in order to derive maximum benefits

PPP Options



Which of these are PPPs?

Choice of PPP Models: O&M focus

For existing assets, usually with refurbishment obligations

Design **Build** | **Operate & maintain** | **Finance** **Own**

Public Sector

- **Design**
- **Build**
- **Finance**
- **Own**

Private Partner

- **Operate & maintain**

PPP Models

- **Management Contract**
- **Lease**

- These options do not quite allow for optimising life cycle costs and are thus preferred for Brownfield projects only.

PPP Models: Management Contracts

Case: Karnataka Urban Water Supply Improvement project

- Country: India (state of Karnataka)
- Public Partner: ULBs of Belgaum, Gulbarga and Hubli-Dharwad; KUIDFC and KUWSDB
- Private Partner: Veolia Water, France

Objective:

To implement 24X& water supply in select pilot zones in the 3 cities

Key Features and Benefits

Project Structure:	The project involved rehabilitation/ refurbishment of the distribution network across identified pilot zones of the three cities followed by O&M. The funding was through **KUIDFC grant**.
Ownership of asset:	Ownership of the existing and the rehabilitated assets inclusive of pipelines, valves, meters etc. remained with the ULBs.
O&M Responsibility:	Private operator was responsible for: •Developing improvement plan and managing contract with cap of 42 cr •Providing 100% individual house service connections, supply treated water, ensure reduction in distribution losses, generate, distribute and collect bills, although revenue accrued to the ULB.
Commercial arrangement:	Private operator received a fixed O&M fee (60% of total agreed fee paid in 15 equal quarters) and remaining 40% linked to achievement of project milestones.

Choice of PPP Models

For creating new assets

Design Build | Operate & maintain | Finance Own

Public Sector

Own

Private Partner

Design

Build

Finance

O & M

PPP Models

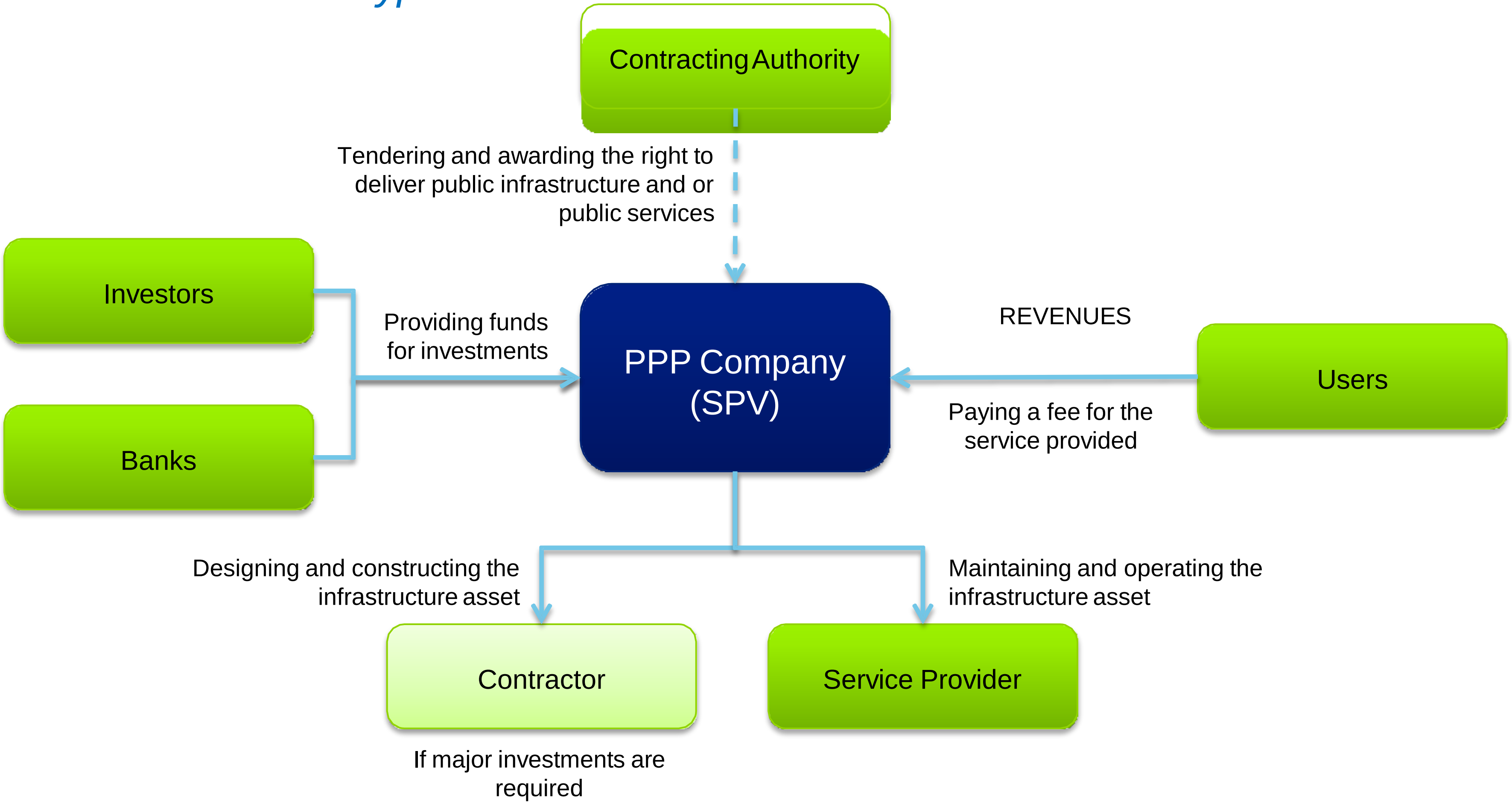
BOT / DBFO

BOT (Annuity)

BOT (Annuity): Demand risk is not transferred to the private party

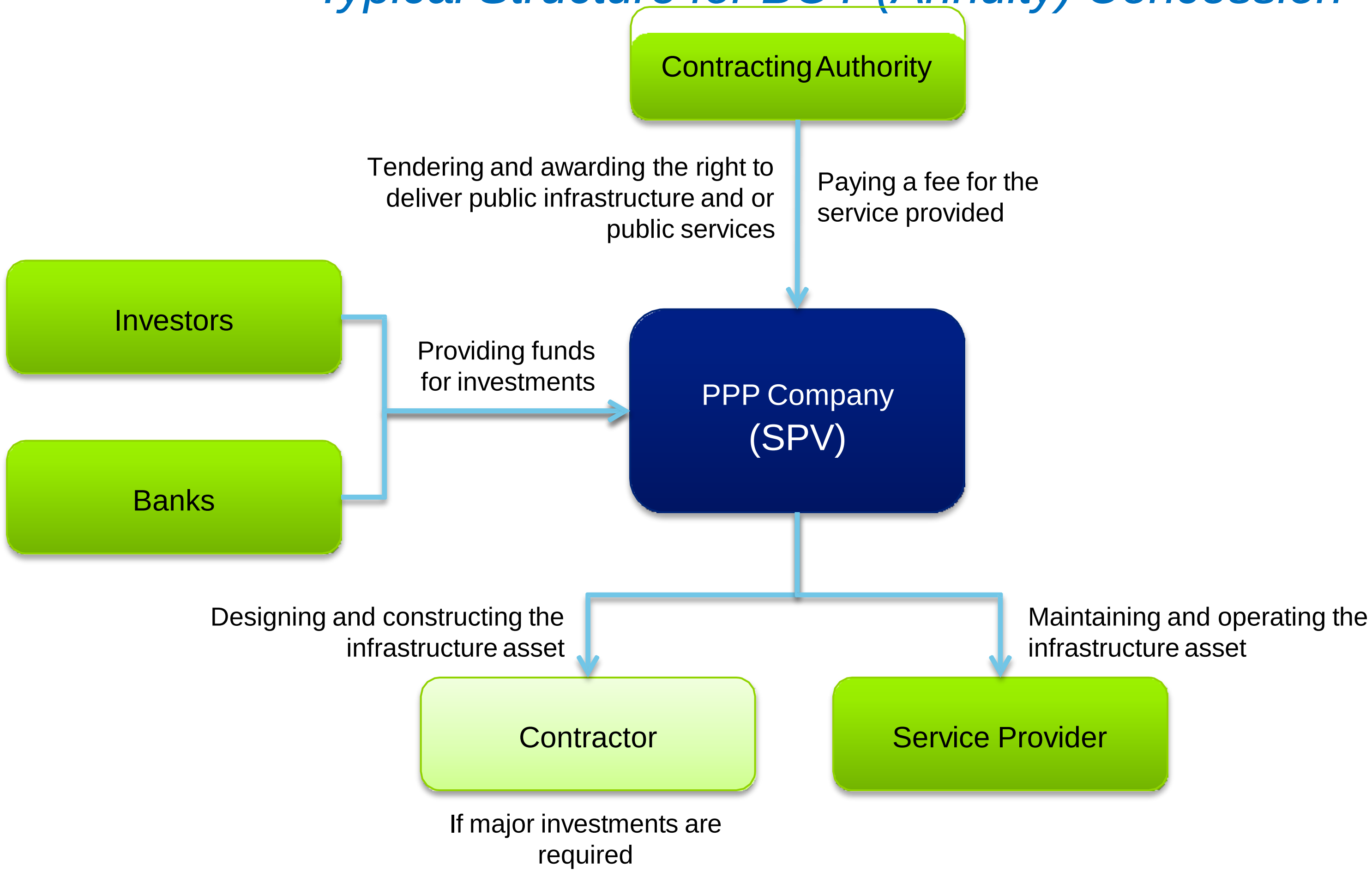
Choice of PPP Models

Typical Structure for BOT/ DBFO Concession



Choice of PPP Models

Typical Structure for BOT (Annuity) Concession



What a PPP is & what it is not

1. **PPP is not privatisation or disinvestment**

2. **PPP is not about borrowing money from the private sector**

3. **PPP is more about creating a structure**

... in which greater value for money is achieved for services

... through private sector innovation and management skills

... delivering significant improvement in service efficiency levels

4. **This means that the public sector**

... no longer builds roads, it purchases kilometres of maintained highway

... no longer builds prisons, it buys custodial services

... no longer operates ports but provides port services through world class operators

... No longer builds power plants but purchases power

PPP, Common Myths and Concerns

Myth/Concern	Clarification
• Profit motive of private sector is incompatible with the service motive of public sector	**No.** The key is to harness private sector's profit motive, by incentivizing them to provide better quality service and earn ***reasonable return***.
• PPPs increase user tariffs	**Not Necessarily.** When appropriate safeguards like effective regulation and/or adequate competition are in place. However in sectors where existing tariffs are inadequate to cover costs of specified level of service tariffs may initially require some upward adjustment. Over time efficiency gains expected to rationalize tariffs.
• Money for PPPs comes from private sector "pockets"	**Initially, YES.** But private sector would make those investments provided they can recover those investments either from users or the government with reasonable return.
• Once a private sector partner is brought in, there is little or no role for the public sector	**No.** Public sector's role changes from direct involvement in construction and service provision, to ensuring that the PPP delivers value for money for the government and better services for users.

To sum up...
Public procurement: Traditional v/s PPP

Characteristic	Public procurement	PPP
Focus	Procuring Assets	Procuring Services
Project management	Public sector is responsible for all project management roles	Private sector manages overall project - design, construction, operations and maintenance. Focus on project life cycle expected to bring efficiency.
Service Delivery	Public sector directly responsible for service delivery to users	Private sector directly responsible for service delivery to users
Financing	Public sector responsible for financing the project. Thus financing impacted by budgetary allocations and then actual disbursements	Private sector may contribute finance through debt and equity issuances
Risk Sharing	Public sector bears all project risks. Risk sharing limited to the extent of warranties.	Risks allocated to parties which can manage them most efficiently
Contractual Arrangement	Short term, generally segregated contracts for asset creation and maintenance.	Long term contracts- Public sector/users pay for services linked to performance.

TEN PARTNERSHIP PRINCIPLES OF PPP

1) ***Purpose is clear, aligned and realistic***

2) Availability of appropriate financial and human resources

3) Clarity of motivations, roles, capabilities and contributions

4) Sufficient organisational processes and procedures that foster collaboration

5) Alignment of partners and policies

6) Commitment, ownership and responsibility of partners towards the partnership

7) Partnership is participative and empowering

6) Culture of collaboration, trust and openness

8) Defines success monitors and reports its performance

9) Partnership is continually engaging with others,

10) Clear attribution of benefits, risks and blame

OECD (2008: 133-134), a heuristic listing of ten ‘good practices’ in the public-private partnership process’ as their guidance.

Number	Good Practice
1	Affordability and value for money
2	Value for money (primary objective)
3	Fiscal rules and expenditure limits
4	Risk sharing
5	Competition and contestability
6	Budget documentation and transparency
7	Regulatory risk and legal framework
8	Institutional capacity: the PPP unit
9	Public sector comparator
10	Political support (from the highest level)

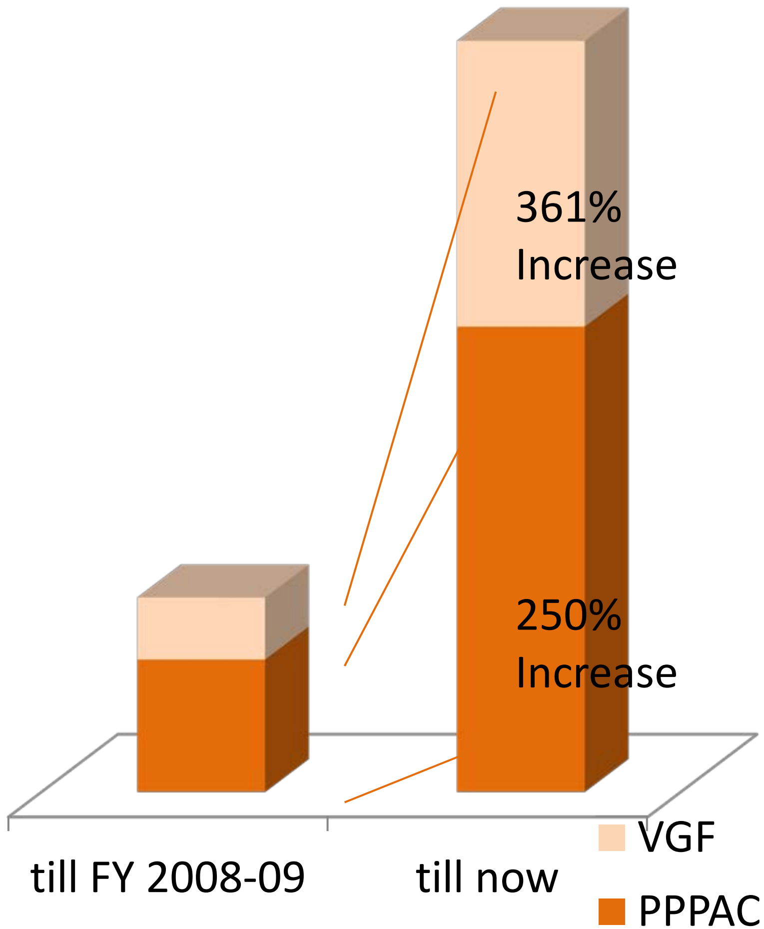
Current outlook of PPP in India:

- Rising twin deficits + Inflation + Rupee volatility + high Interest Rates + Rising oil prices
- Stalling of projects due to delays in land acquisition, defence/environment clearance, last-mile connectivity (including by rail), etc
- Adverse impact due to judicial orders (Mining) and slowing trade
- Equity constraints for Developers - over leveraged at parent-company level
- Banks: no headroom for fresh lending/rising NPAs due to slow/stalled projects
- Lack of alternatives for financing/take-out
- Disputes/Arbitrations, Time & Cost over-runs

Bad news: Stalling projects, loss of appetite for PPP in banks and Pvt Sector

Good News: Most issues are governance issues, can be (are being) addressed

Rapid acceptability of PPPs projects



Various Sources

- 570% jump in PPP projects approved in 8 years, since 2006 to 2013 (FY)
- Projects value: USD 48,894.5 million

- 900% jump in VGF approved in 8 years, since 2006 to 2013
- Projects value: USD 14,250.0 million
- 38 projects granted final approval with USD 906.0 million as VGF outgo, TPC is USD 4,563.0 million

Over 1300 PPP projects at various stages of delivery

Thank you….