

Value for Money (VfM) in P3s - An overview

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Public Private Partnerships - P3s

- OECD:
 - P3 is an agreement between the government with private partners - operators and financiers
- Key factors:
 - Government service delivery objectives aligned with private partners profit objective
 - Effectiveness of alignment, a function of sufficient risk transfer to private partners
 - **Key driver - Risks:**
 - Identify (Types)
 - Assess (Probability Impact Matrix)
 - Allocate/Transfer (Public/Private)
 - Mitigate (PRTA) Prevent, Reduce, Transfer, Accept

Defining P3s

- Government:
 - specifies quality & quantity of required service from Private Partners
- Private Partners:
 - design, build, finance, operate & manage capital asset
 - deliver service to government or directly to end user
 - receive payment stream from government or end user charges levied
- Efficient operations = Sufficient transfer of risk to Private Partners
- **P3 projects yield value for money where result is a net positive gain to society > than that achieved through alternative procurement route.**

P3s?

- Contract between Public Agency & Private sector entity
- Each party shares in risks and rewards in the delivery of assets and services
- Private Party provides:
 - assets & services for use by general public to prescribed performance-based specifications linked to payment terms
 - assumes responsibility & risks for constructing, operating and maintaining the assets
 - hands back project asset to public agency in the condition required by the contract
- Contractual agreement often +30years

Why P3s

BENEFITS

- Introduces private capital
- Budgetary certainty, avoids *soft* budgetary constraint
- Whole life costing, synergies of integration
- Maximizes Private sector skills & efficiencies
- Public Sector pays on delivery
- Quality of services maintained
- Accountability
- Assets properly maintained
- Stronger customer service

DISADVANTAGES

- Reduced flexibility
- Complexity of contracts
- Procurement delays, higher procurement costs
- Loss of management control by the Public sector
- Higher Private sector cost of capital
- Public sector capacity & skills may not be available
- Potential for negative public reaction to profit and control

P3s are ...

	Service Contract	PPP	Privatization
Asset Ownership	Public Ownership	No irrevocable asset transfer	Asset ownership transfer
Public Sector Responsibility	Responsibility provision of assets services	Set policy and service levels	Regulation
Level of Services	Public responsibility	Mechanism for shared services	Authorities withdraw from service decisions
Risk / Reward	No transfer	Shared	All transferred
Mode	Service contract	Partnership	Self-interest

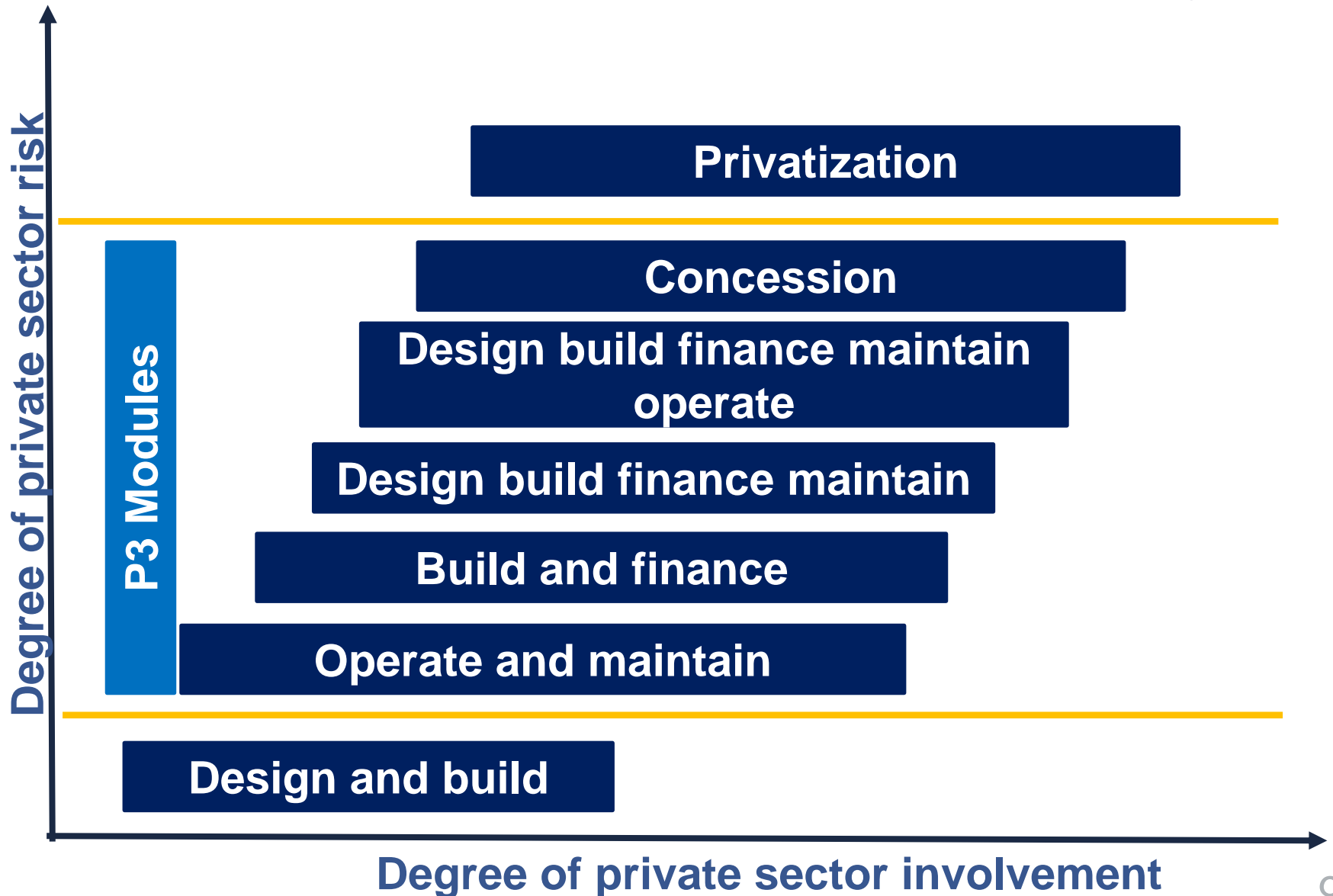
P3s misconceptions

- **NO** transfer ownership of project assets
- **NOT** a replacement mechanism for traditional financing approaches for all projects
- **NOT** primarily about cheaper financing:
 - Many governments use PPPs even though projects could be financed at a lower cost
 - **Value created through**
 - improved delivery performance
 - increased risk transfers
 - overall lower lifecycle costs through integrating design, construction, and long-term maintenance responsibilities

Key Features of a Good P3 Project - Summary

- Major investment allows for
 - effective risk transfer, allocation & management in complex projects
 - economies of scale in procurement costs
- Private Partner inputs - design & implementation expertise
- Public Partner output services definition – effective & accountable service delivery
- Competition
- Clear whole-life costing estimates with a balance between construction and maintenance costs
- Reliable technology
- **Clear & communicated VfM yields**
- Performance measurements & incentives

Range of P3s for Risk vs Involvement



“The key to understanding the role of risk in a PPP is the link between the carrying of risk and the efficiency of the project.”
OECD

Value for Money (VfM) - Risk Transfer

- Usually determined on case-by-case basis
- VfM: optimal combination of quality, features and price calculated over the project's life
- Risk: probability that actual outcome will deviate from expected outcome
- Private Partner carries risk if income (and profit) is linked to the extent that actual performance complies or deviates from expected (and contractually agreed) performance
- Reason for going the VfM route:

Effective risk transfer to Private Partner – prerequisite for VfM

- Compares the cost of P3-based provision to traditional project delivery
- Comprehensive analysis includes:
 - **Public Sector Comparator (PSC)** assesses Public Sector cost of traditional procurement against **P3**
 - Full Life Cycle (FLC) cost & revenue analysis for each option
 - Determination of most appropriate risk sharing / transfer scenarios
 - Assessment of public opinion and maintenance of transparency
- Effective risk allocation: allocating risk to the party best able to manage it.

Public Sector Comparator - PSC

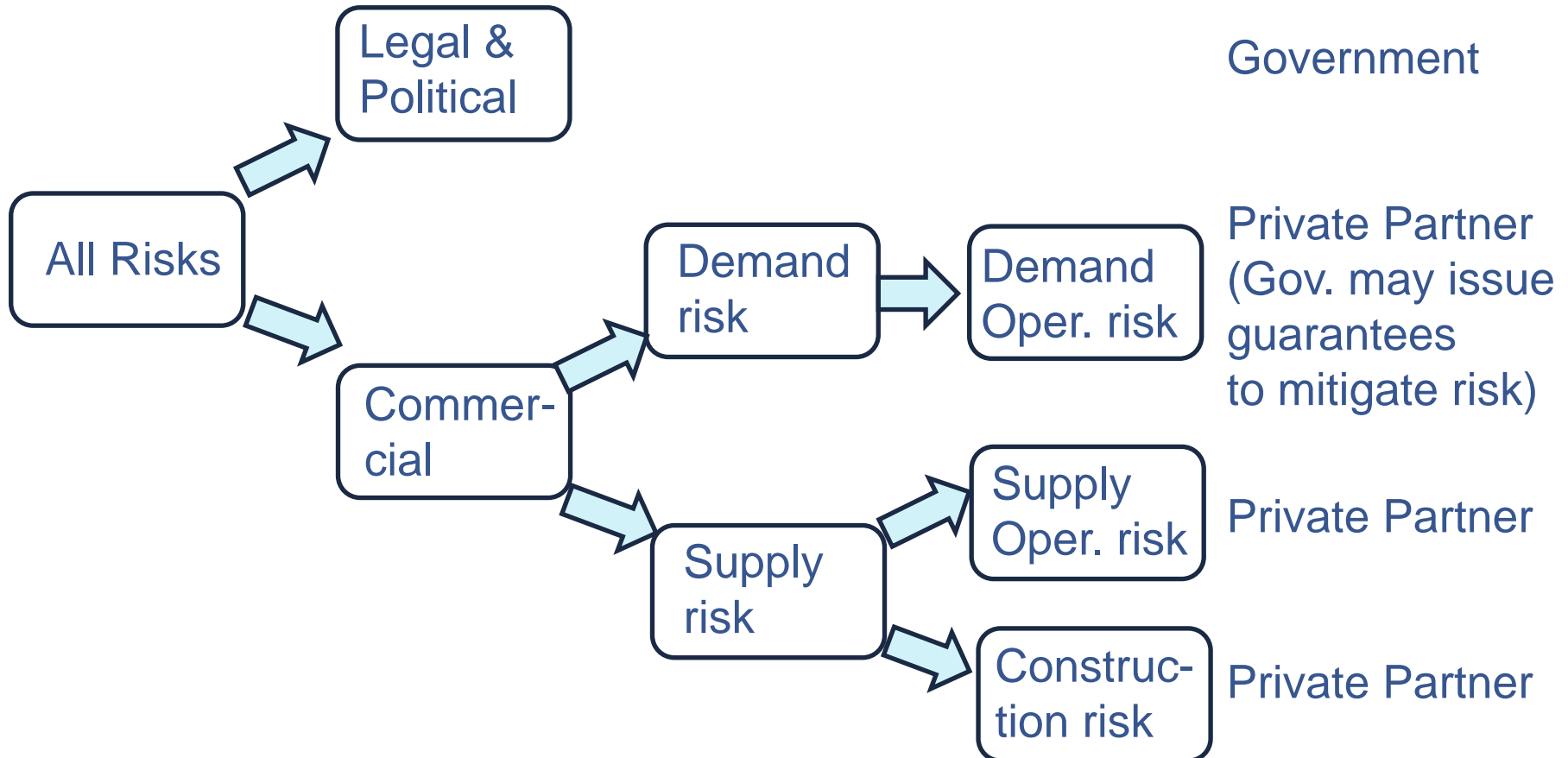
- Delivery cost under traditional delivery methods
- An estimate of risk-adjusted costs to the public
- Project costs, revenues & risks projected over the full project life:
 - Capital / construction costs (construction & ongoing O&M)
 - Operating costs (core, non-core, maintenance, insurance, personnel, replenish/replace, supplies/equipment)
 - Taxes
 - Projected income
 - Risk-related costs
- Total public cost compared against alternative (PPP)

Value for Money = P3 efficiency savings

Categories of Risk

Types of Risk

General risk most
Efficient in:



Typical Risk Transfer Scenarios - P3s

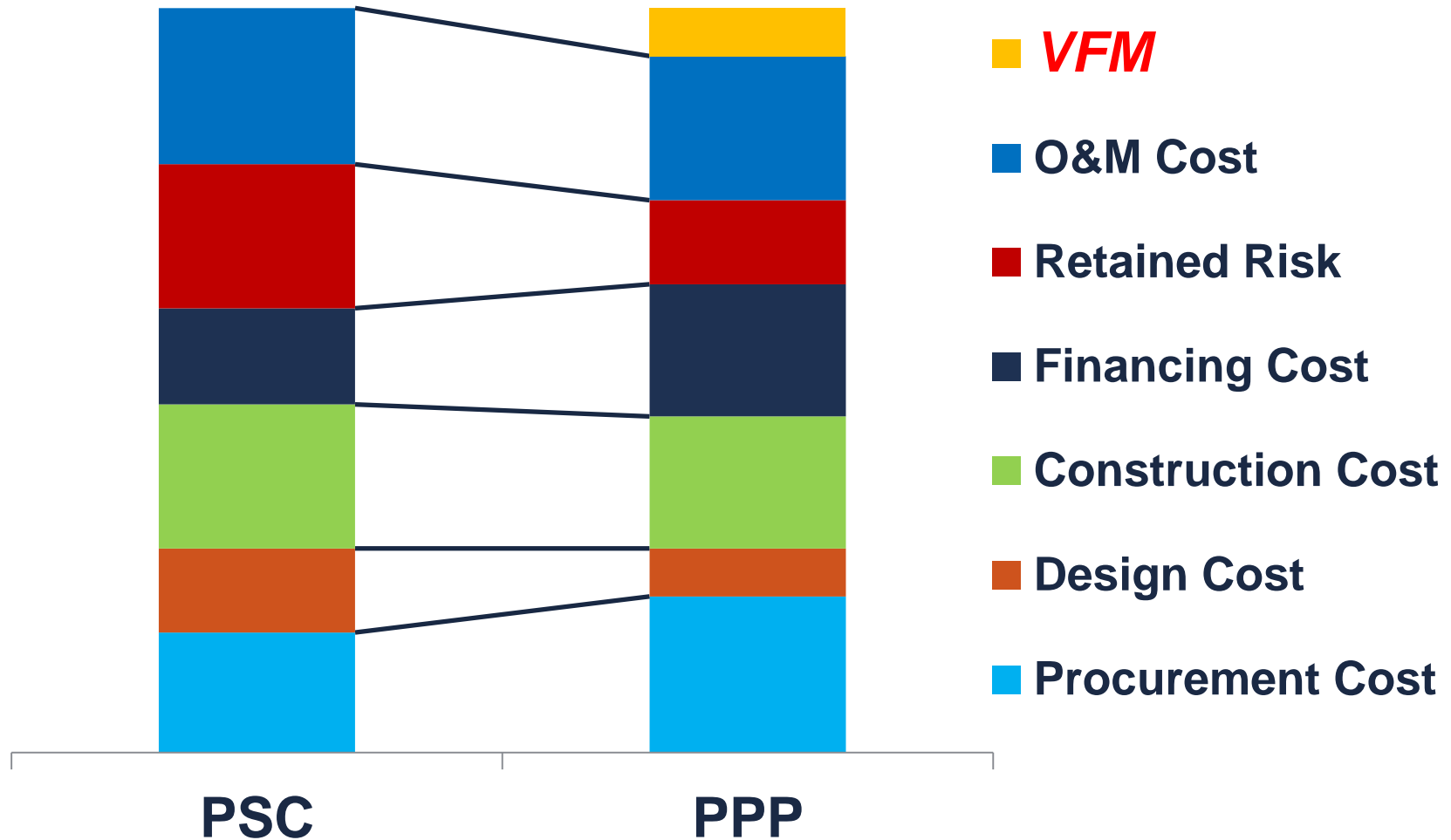
Responsibility		Public	P3s	Risk Transferred?
Development Risks	Performance	Public	Private	X
	Interface	Public	Private	X
Design Risks	Scope	Public	Shared	X
	Errors & Omissions	Public	Private	X
	Interference / Coordination	Public	Private	X
	Life Cycle	Public	Private	X
Construction Risks	Performance	Private	Private	
	Schedule	Public	Private	X
	Cost Overruns	Public	Private	X
	Changes in Scope	Public	Public	
	Force Majeure	Shared	Shared?	?

Typical Risk Transfer Scenarios - P3s

Responsibility		Public	P3s	Risk Transferred?
Financing Risks	Funding/Financing	Public	Private	X
	Schedule Slippage/Addition	Public	Private	X
	Interest Rate	Public	Private	X
Maintenance & Life Cycle	Maintenance level	Public	Private	X
	Deferred, Maint. /Repair/Replace	Public	Shared	X
	Defective Components	Private	Private	
	Residual Value	Public	Shared	X
Operations Risks	Revenue	Public	Shared	X
	Performance Risks	Public	Shared	X
	Service Level and Quality	Public	Shared	X

P3 vs Traditional Procurement

Cost of risk



VfM Assessment Steps

- Base PSC - calc. total costs, revenues
- Risk-adjusted PSC - total costs, revs, & risks @ NPV

- P3 reference model
- Risk-adjusted P3 reference model

- Sensitivity analysis
- (Demonstrate affordability)
- **VfM test**

- Procurement choice
- Verify information and Sign-off

PSC Model - steps

Base PSC Model

- Project technical definition
- Identify revenues
- Calculate direct costs:
 - Capital costs
 - Maintenance costs
 - Operating costs
 - Other
- Identify indirect costs (overhead, staff time, personnel, accounting,)
- Explain the assumptions

Risk-adjusted PSC Model

- Identify risks
- Identify impact of each risk (effect, timing, type, severity)
- Estimate risk probabilities (subjective or statistical)
- Estimate cost of each risk (!)
- Identify strategies for mitigating the risks
- **Allocate risk**
- Risk matrix

Risk-adjusted PSC = Base PSC + Risk

P3 Model - steps

Reference P3 Model

- Confirm P3 type
- P3 project structure & funding sources
- Core payment mechanism components
- Calculate & consolidate costs
- PPP reference model & assumptions

Risk-adjusted P3 Model

- Identify risks (as for PSC)
- Assess the cost of each risk:
 - Direct risk-related costs (insurance, guarantee)
 - Subcontractor costs
 - Increased Return on Equity
 - Increased Cost of Debt
- Retained Risk
(force majeure /political risk)

Risk-adjusted P3 ref = P3 ref + Retained Risk

VfM Risk Analysis

- List main risk sources
- Describe consequences
- Quantify dimensions – impact & probability
- Prioritize risks
- Compile risk register

Probability					
VH (0.9)	4.5%	9%	18%	36%	72%
H (0.7)	3.5%	7%	14%	28%	56%
M (0.5)	2.5%	5%	10%	20%	40%
L (0.3)	1.5%	3%	6%	12%	24%
VL (0.1)	0.5%	1%	2%	4%	8%
	VL (0.05)	L (0.1)	M (0.2)	H (0.4)	VH (0.8)
	Impact				

- **High Risk >20%: Assess & modify risk mitigation strategy**
- **5% < Med Risk < 20%: Control & monitor Develop emergency plans**
- **Low risk <5%: Update risk register Anticipate emergency plans**

P3 VfM – a Risk Summary

VfM

Economic value

**Social,
Ecological
... value**

Economy

Efficiency

Effectiveness

**Max. Objective
value**

**Max. Subjective
value**

Key Learnings

- **Pre-discussions to understand culture, strengths & weaknesses**
- **Quality Input builds transparency & trust**
- **Building multi-disciplinary teams (Stolichnaya St. Petes)**
- **Are always risks - PRTA critical (JV Lipetsk)**
- **Clearly identifying & communicating VfM**
- **Each party's strengths deserve respect & recognition**
- **Long term process – no short cuts**
- **Learn from each war story - I did**