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People-first PPPs for services: operational needs

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Abstract. The public-private partnership is a public procurement tool that accelerates the implementation of major projects and contributes to the recovery of the economy. Based on precise and regulated principles, it is a complex tool that requires significant expertise to use. As such, digitalization can facilitate its use at each stage of its realization.

1 PPPs: a legal structure to link project investments and revenues

1.1 A long-term contract between Public & Private

In a PPP, the public partner delegates to the private sector the realization and operation of a work or service for a fixed and long-term period (generally 15-50 years including construction and operation periods). Consequently, the PPP covers several phases of the contracts with are usually split in several successive or in parallel contracts in traditional public procurement: there is one unique contract to manage design, concept, construction, commissioning, operation, and maintenance.

The advantage of having it all in one unique contract is to optimize the interface of all phases. Yet the modification of one aspect of the project is immediately impacting all phases and this makes this way of contracting less flexible than traditional procurement. This explains why one need to engage experts when contracting via PPPs.

The duration of the contract is defined so that the operation of project generates sufficient revenues which net of operating expenses will allow the private partner to repay to its financiers the loans that were necessary to finance the investment as well as to make the capital invested.

The contract is signed between the public authority and an ad-hoc company created by the private sponsors and their investors. This ad-hoc company generally called SPV (for Special Purpose Vehicle) has the project as sole object and three main objectives:

- Raise funds to finance investments (with equity and debt).
- Build, Operate and Maintain the works and deliver the service to users.
- Generate operating revenues to repay investments and debt.

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1.2 A non-recourse financing

Beyond the long-term duration all in contract another specificity of the PPP is the structure of financing. Unlike a classic company financing which is sized by the company's balance sheet, here, the company is created for the project only and exclusively for the project and therefore has no financial history and will only derive its income from the project. Thus, the financing of a PPP is based solely on the project's ability to generate operational revenue. The company is capitalized by project sponsors and/or financial investors who together raise debt proportionally to the SPV’s ability to generate operating revenues. Thus, the project is financed partly by equity and partly by debts.

Debts and equity are remunerated and repaid solely by operating revenue. So, once the financing of the project has been dimensioned in proportion to future revenue forecasts, it is no longer possible to increase the funding in the event of additional costs or delays. The principle of the PPP requires that in these cases there can be no recourse to the shareholders: the project must remain within the financial framework approved at the signature and it is the obligation of the shareholders to ensure that it is. The stakeholders therefore impose strict performance conditions on operational subcontractors (manufacturers, maintainers, operators) and demand fixed lump sum prices. These requirements are accompanied by bonds and guarantees in the event of breach of performance obligations and this motivate each party to complete its obligation on budget and on time.

1.3 Performance and societal acceptability at the heart of the PPP scheme

The project must operate economically and financially in perfect autonomy. The performance of the project over the duration of the contract is the key factor for its success. It therefore conditions the guarantee and penalty schemes applied to stakeholders.

During the preparation phase of the project the partners review all the risks that could affect the budget and the planning of the project. A sharing of the risk is agreed, from which will flow the performance obligations of the private sector and the penalty scheme and the safeguards that accompany them.

It would be easy to disuse the PPP principle either by artificially inflating revenue forecasts to borrow more funds and increase costs. It would also be easy to require subcontractors to provide levels of guarantees that provide lenders and investors with full guarantee of their investments by shifting the assumption of all risks.

However, during their due diligence, lenders conduct traffic studies with the help of their advisor to ensure the accuracy of revenue forecasts. They also ensure that the tariffs levied on users (or the taxpayer) remain socially acceptable over the life of the project.

The public entity ensures through the competitive tendering process that the construction and operating prices are the fairest in relation to the service rendered. It also ensures that the service is accessible to as many people as equitably as possible in order to maximize societal acceptance of the project and get the best value for money and the best value for people.

Finally, if the sharing of risks is too unbalanced between the public and the private, the project loses its commercial attractiveness: companies find themselves too exposed to risk

and their margin levels are no longer consistent with the level of price risk, endangering the economic plinth that they represent.

It is therefore essential to find the right balance in risk sharing, in the level of performance required and, in the tax/financial burden on the user.

2 PPP typical structure

The figure below illustrates the typical PPP contractual structure. The SPV contracts with the public authority though the PPP contract. It is financed by equity from its shareholders (shareholder agreement) and by debt from the lenders. The lenders provide each a debt contracts which are manage by intercreditor agreements and common term agreements. Financing tools such as fixed interests generated hedging agreements. The surety provided to the lenders from each stakeholder are gathered in the "Security Package" which is generally constituted of several pledge agreements, performance bonds, insurances, accounts agreements …

The SPV contract with subcontractors for the construction, operation, and maintenance of the project, each of them providing the SPV with bonds pledge to the lenders and with direct agreements with the lenders in case lenders needs to step in the SPV to rescue or cure default in place of the shareholders.

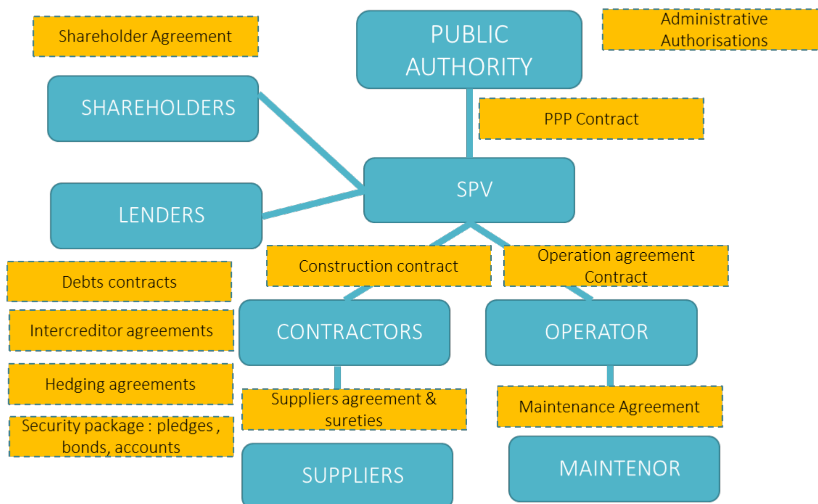

Fig. 1. The typical PPP contractual structure

3 Digitalization to improve PPPs: Operational needs

As we have seen above, the PPP involves multiple actors who, working around a common project, nevertheless have divergent objectives and different modalities of intervention. The common success factors for all these actors are found in:

1. A common definition of project parameters.
2. Precise and balanced risk sharing.
3. The definition of performance criteria and the management of performance monitoring.

It is clear that a digital tool for monitoring these parameters would bring an independent assessment enforceable against all stakeholders.

Like any project, the life of PPPs brings its share of unseen situation. However, as the structure of a PPP is less flexible than a traditional procedure, it is essential to anticipate as much as possible the semblance of events that could put the project at risk and to define in the contract how they will be treated. Nevertheless, the life of projects always gives rise to situations of disputes, arising from the understanding / interpretation of the agreements signed.

Operationally, there is therefore a strong need to monitor the project in every detail and to be able to compare the results to contractual agreements (especially with regard to the expected performance levels).

The advantage of digitalization is that it obliges the parties to limit the possibility of interpreting contracts. It could then allow:

- To gather terms and conditions and monitor all types of performance (SDG, Financial, Technical)
- To monitor project timeline and built capacity in PPPs knowhow.
- To allocate responsibilities and cure unexpected situations.
- To assist stakeholders for developing more projects.

PPPs are key tools to spread the investment expenditure inherent in major societal projects that meet the structural needs of populations.
They also bring a control of the deadlines of realization and expenses by motivating the private partners to an optimization of the interfaces of construction, operation and maintenance and incentivizing them to project commercial performance.

To achieve this, PPPs involve a large number of actors with divergent interests. To bring them together around the sole objective of project success, this requires a great deal of expertise that may be lacking in those who most need to develop these projects. Digitalization could simplify this complexity and make PPP accessible to as many people as possible.

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