Understanding and Managing the Fiscal Risks of PPPs

PUBLIC-PRIVATE PARTNERSHIP CONFERENCE

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Main Points

1. PPPs impose fiscal obligations on the government
2. They may not be large compared to e.g. financial sector but they require attention
3. Most effective measures to contain fiscal risks are:
   - Robust project selection and procurement, including careful assessment of what risks to bear and project viability
   - Effective contract management
   - Better understanding of fiscal costs and risks will lead to better selection of which projects to do as PPPs
4. Governments can also proactively report liabilities to increase transparency
PPPs impose two types of obligations on governments

• Contractual obligations to make payments related to asset availability/service delivery
  ➢ Obligations to make payments under PPPs are like debt

• Contractual obligations in the event of risks materialising under the PPP contract
  ➢ Risk-bearing by governments under PPPs produce obligations like guarantees
Governments don’t always assess and manage fiscal costs properly….

• **Lack of long-term focus:**
  - Many governments don’t have long-term budget frameworks, so PPP spending in future years is often not recognized
  - Costs of problems often incurred by next government given project lead times

• **Lack of equivalent assessment processes:**
  - Publicly-funded projects have a defined approval process against other funding priorities, PPPs may not
  - Whole Life Costs of the PPP project are not always factored into the equivalent assessment

• **Willingness to absorb risk:**
  - Government feels service disruption/lack of delivery keenly…
  - Temptation to disguise debt as PPPs
Evidence of government’s willingness to absorb risk

- High rates of renegotiation: (e.g. 100% of contracts in Chile saw post-award adjustment)
- Project cancellation rates are low\(^1\):

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage of Projects With Private Sector Exit (1990-2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>3.6%</td>
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<tr>
<td>Telecoms</td>
<td>4.4%</td>
</tr>
<tr>
<td>Transport</td>
<td>4.7%</td>
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<tr>
<td>Water and sewerage</td>
<td>8.8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4.7%</strong></td>
</tr>
</tbody>
</table>

Improving public sector capacities for managing the fiscal risks of PPPs

- Key steps for the government:
  - Ability to assess magnitude and likelihood of risks materializing (risk assessment)
  - Analysis should include payment commitments (ordinary liabilities) of the sponsor as well as an assessment of contingent liabilities
  - Negotiation skills on a par with the counter party and their advisors (risk allocation)
  - Standard contracts or terms can help disseminate accepted practices on risk bearing

- Effective processes for project approval
  - Multi-stage review involving Ministry of Finance is often seen
  - Early involvement of MoF can reduce gold-plating and weed out potentially expensive projects
Lessons from Chile

• The government has guaranteed the revenue of many of the toll roads and airports
• PPPs approved by the Minister of Finance, based on analysis and advice on contingent liabilities from a small Contingent Liabilities and Concessions Unit
• This includes the unit estimating the cost and risk of the revenue guarantees using a stochastic model
• The government publishes information on contingent and direct liabilities under PPPs in annual reports on public finance and contingent liabilities
Chile discloses the cost of its PPP obligations
(Present values of commitments in US$ million. Note: GDP is about US$110 billion)

<table>
<thead>
<tr>
<th></th>
<th>Subsidies and annuity-type payments</th>
<th>Commitments made in renegotiations</th>
<th>Maximum guarantee spending</th>
<th>Expected guarantee spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Route 5</td>
<td>706</td>
<td>62</td>
<td>3,482</td>
<td>224</td>
</tr>
<tr>
<td>Other intercity roads</td>
<td>204</td>
<td>63</td>
<td>962</td>
<td>78</td>
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<td>...</td>
<td>...</td>
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<td>...</td>
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<tr>
<td>Total</td>
<td>2,328</td>
<td>780</td>
<td>5624</td>
<td>335</td>
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</tbody>
</table>
Chile – annual estimation of concession guarantees

Gráfico III.3.1
Flujo Anual Estimado por Garantías en el Sistema de Concesiones
(en millones de pesos 2009)

Fuente: Dirección de Presupuestos.
Lessons from South Africa

• Relatively large program of PPPs, including toll roads, the Gautrain, and several accommodation-related projects
• Some revenue guarantees and also obligations to make termination payments tied to debt in case of project failure
• The National Treasury must approve projects at each of four stages
• The PPP unit is the key advisor in the National Treasury, but other parts of the Treasury are now involved
• National Treasury requires analysis of contingent liabilities as part of project preparation
• Public reporting is by line ministries who include a disclosure note on PPP in their accounts
Lessons from the United Kingdom

• Extensive program of PPPs – the majority based on availability payments under long-term contracts
• Line ministries approve PPP projects based on their own delegated authority from HM Treasury
• Municipal authorities undergo a two stage approvals process with HM Treasury (currently under review). Approval is based on the authority finance officer and political leader committing to the projected affordability profile of the project.
• All PPP projects have contracts reviewed against the standard form prior to contract award (approvals process managed by HM Treasury)
• UK public reporting of the fiscal implications of PFI projects is at a project level every 6 months
• HMT has taken steps recently to provide level playing field between PFI and public sector projects:
  – Abolishing PFI credits
  – PFI liabilities included in unaudited whole of government accounts to improve transparency
UK discloses committed payments to PPPs (Unitary Charge profile)

Source: http://www.hm-treasury.gov.uk/ppp_pfi_stats.htm
Simple reporting formats can be helpful

- Publish contracts or summaries of them
- For long-term payment obligations

<table>
<thead>
<tr>
<th>Project name</th>
<th>Project cost</th>
<th>Actual unitary and construction-subsidy payments</th>
<th>Forecast unitary and construction-subsidy payments</th>
<th>NPV of forecast payments, 1 January 2009 (at x%)</th>
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<td>2006 2007 2008 2009 2010 2011 2012 ... ... ... ... ... ...</td>
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- For guarantee-like obligations

<table>
<thead>
<tr>
<th>Project name</th>
<th>Project cost ()</th>
<th>Contingent liability that creates the largest exposure</th>
<th>Estimated payment required if contract had been terminated for that reason on March 31, 2009 ()</th>
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<td>[e.g., termination payment for contractor default equal to 90% of outstanding debt due to senior lenders]</td>
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Managing unanticipated costs during implementation

• Even countries with strong institutional capacity can have “unanticipated” costs rises during implementation:
  ➢ UK$1: “changes to operational PFI deals are often poor value for money” GBP 180mn spent on these changes in 2006 (many changes are actually aspects taken out of contract specification pre-bid to save money!)
  ➢ Chile: additional expenditures of approximately 39% of original investment, most determined via negotiations and is additional investment requested by the government

• Solutions:
  ➢ Anticipate costs where possible in project development (user groups, consultation, etc.)
  ➢ Tighten scrutiny of contract adjustment (possibly involve Ministry of Finance?)
  ➢ Proactive contract management with adequate resources

Thank You

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Global PPP Network (http://pppnetwork.ning.com/)