GraSPP—5140489 Summer 2013—Nishizawa
Lecture Note 1—April 8, 2013

LECTURE NOTE ON BASIC CONCEPTS

The Nature of PPPs ("Public-Private Partnerships")

"PPPs can be defined as arrangements whereby private parties participate in, or provide support for, the provision of infrastructure, and a PPP project results in a contract for a private entity to deliver public infrastructure-based services." (page 2, Grimsey&Lewis [2004])

"The essence of a PPP is that the public sector does not buy an asset; it is purchasing a stream of services under specified terms and conditions. This feature is the key to the viability (or not) of the transaction since it provides the right economic incentives." (page 6, Grimsey&Lewis [2004])

"A common misconception about PPP projects is that they are principally about private sector financing of public infrastructure. This is not strictly correct. Financing is only one element." (page 6, Grimsey&Lewis [2004])

"The distinctive feature of current PPPs is the bundling of finance, design, construction, operations, and maintenance. Because these functions are highly specialized, private sector providers tend to be consortia consisting of engineering and project management firms, construction companies, financial underwriters, and operating enterprises that come together to develop a particular facility." (page 7, Grimsey&Lewis [2004])

"Our central proposition is that the PPP is a strongly incentive-compatible contracting arrangement. The cost effectiveness of a PPP relative to traditional procurement is a result of upfront engineering of the design solution and the financing structure combined with downstream management of project delivery and the revenue stream. All of this is a consequence of the incentives built in to the services payment mechanism and the risk transfer in the PPP model." (page 6, Grimsey&Lewis [2004])

"*Participants*. A PPP fairly obviously involves two (or more) parties, and at least one of them has to be a public body." (page 13, Grimsey&Lewis [2004])

"*Relationship*. Partnerships need to be enduring and relational." (page 13, Grimsey&Lewis [2004])

"*Resourcing*. Each of the participants must bring something of value to the partnership." (page 13, Grimsey&Lewis [2004])

"*Sharing*. PPPs involve a sharing of responsibility and risk for outcomes (whether financial, economic, environmental or social) in a collaborative framework." (page 13, Grimsey&Lewis [2004])

"*Continuity*. Underpinning the partnership will be a framework contract, which sets out the 'rules of the game' and provides the partners with some certainty." (page 13, Grimsey&Lewis [2004])

"In theory, the conception of risk allocation with a PPP is straightforward. The government frees itself entirely from asset-based risk (including design, construction, operation and possibly residual value risk), and becomes the purchaser of a product that is risk-free in the sense that government does not pay if the service is not delivered, or is not delivered to the specified standards." (page 106, Grimsey&Lewis [2004])

"In practice, risk allocation in a PPP is more complex. Rather than shifting all risk to the private sector, the policy aims at allocating risk to the party that is best suited to manage it and demonstrating value for money for any expenditure by the public sector." (page 106, Grimsey&Lewis [2004])

"The private party's uneasiness becomes more acute when the risk is not within its control." (page 8, Grimsey&Lewis [2004])

Categories of Risks in PPPs

Quoted from page 172, Grimsey&Lewis [2004]

- ✓ technical risk, due to engineering and design failures;
- ✓ construction risk, because of faulty construction techniques and cost escalation and delays in construction;
- ✓ operating risk, as a result of higher operating costs and maintenance costs;
- ✓ revenue risk, e.g. because of traffic shortfall or failure to extract resources, the volatility of prices and demand for products and services sold (e.g. minerals, office facility, etc.) leading to revenue deficiency;
- ✓ financial risks arising from inadequate hedging of revenue streams and financing costs;
- ✓ *force majeure* risk, involving war and other calamities and acts of God;
- ✓ regulatory/political risks, resulting from planning changes, legal changes and unsupportive government policies;
- ✓ environmental risks, because of adverse environmental impacts and hazards; and
- ✓ project default, as a result of failure of the project from a combination of any of the above.

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