GRADUATE SCHOOL OF PUBLIC POLICY (GraSPP)
THE UNIVERSITY OF TOKYO
CASE STUDY—PUBLIC-PRIVATE PARTNERSHIPS:
THEORY, PRACTICE, AND CASES
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Risk Management

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Categories of risks in PPPs

- 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

Categories of risks in PPPs (continued)

- 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

Categories of risks in PPPs (continued)

- regulatory/political risks, resulting from planning changes, legal changes and unsupportive government policies
- environmental risks, because of adverse environmental impacts and hazards
- project default, as a result of failure of the project from a combination of any of the above

Principles of risk transfer

- QUESTION 1: *Who can bear risks in a PPP project?*
  - public authority
  - project company
  - sub-contractors
  - insurance
  - sponsors (leading investors)
  - end-users
  - *Who else?*

Principles of risk transfer (continued)

- QUESTION 2: *Is the public authority willing to or expected to take project risks in a PPP project to ensure the benefits of PPPs?*

Principles of risk transfer (continued)

- QUESTION 2: *Is the public authority willing to or expected to take project risks in a PPP project to ensure the benefits of PPPs?*

"…, the main purpose of risk transfer from the public-sector point of view is to ensure that the Project Company and its investors are appropriately incentivised to provide the service which is the subject of the PPP Contract." (page 243, Yescombe 2007)

Principles of risk transfer (continued)

- QUESTION 3: *Is it ideal or worthwhile getting all risks transferred from the public sector to the private sector?*

Principles of risk transfer (continued)

- QUESTION 3: *Is it ideal or worthwhile getting all risks transferred from the public sector to the private sector?*

"But it will not offer the best VfM for a Public Authority to try to transfer risks which are so difficult for the Project Company, its lenders or Subcontractors to limit or control, that if they do take them on they must charge heavily for doing so." (page 243, Yescombe 2007)

Principles of risk transfer (continued)

- QUESTION 4: *What criteria do you think of when you are asked to decide who should take a particular risk?*

Principles of risk transfer (continued)

- QUESTION 4: *What criteria do you think of when you are asked to decide who should take a particular risk?*

"The principle is that risks should be transferred to those best able to control them at the lowest cost." "This also implies that whoever assumes the risk must have the freedom to handle it as they think best." (page 243, Yescombe 2007)

Principles of risk transfer (continued)

- QUESTION 5: *How would lenders react if the project company retained a certain risk? And why do lenders so react?*

Principles of risk transfer (continued)

- QUESTION 5: *How would lenders react if the project company retained a certain risk? And why do lenders so react?*

"As far as lenders are concerned, a risk which is transferred to and retained by the Project Company means that it effectively becomes the lenders' risk, because the Project Company has limited resources to bear any risks: …." (page 243, Yescombe 2007)

Principles of risk transfer (continued)

Recall the key features of "project finance" (or "limited-recourse finance").

"As far as possible, therefore, the lenders wish the Project Company to be an 'empty box', with all its risks reallocated elsewhere. …. In other words, lenders are very reluctant to accept any but the most limited (and clearly-measurable) risks." (page 243, Yescombe 2007)

Principles of risk transfer (continued)

- QUESTION 6: *Why are lenders so reluctant and cautious to assume risks?*

Principles of risk transfer (continued)

- QUESTION 6: *Why are lenders so reluctant and cautious to assume risks?*

"…, lenders have no 'upside'—*i.e.* the lenders' return is fixed, whereas the equity return can be improved by generating more value in the project (*e.g.* by more efficient operation, or financial restructuring …)." (page 244, Yescombe 2007)

Principles of risk transfer (continued)

- QUESTION 7: *Who do you think should take risks related to "foreign currency availability and transfer", "a change in law", "site acquisition", "construction", or "usage or demand"?*

Risk management in practice

Hub River Power Project

HUB POWER STATION

View of Hub Power Plant

HUB POWER STATION

Night View of Hub Power Plant

Source: HUBCO

Risk management in practice (continued)

- QUESTION 8: *What is the lesson learned from the Hub River dispute?; and do you think of any risk mitigation measures other than the cover afforded by institutions such as the World Bank and bilateral public entities such as the JBIC?*

Risk management in practice (continued)

Sydney Cross City Tunnel

Source: Roads and Traffic Authority (NSW)

Risk management in practice (continued)

- QUESTION 9: *What underlying causes do you think are the most critical for the failure of the SCCT (Sydney Cross City Tunnel) project?*

Risk management in practice (continued)

- inaccurate traffic forecast
- high toll levels
- government closing off the surface roads to direct the traffic into the CCT
- flawed concession agreement
- the public client and the private consortium arguing openly in public
- no toll subsidy and/or compensation from the government
- the toll level or the possibility of a government contribution not open to negotiation

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Please feel free to send me e-mails with any question about the course or if you want to make an appointment. To help me not to miss your incoming e-mails,* ***please start the subject line with "5140489" (Course No.)* *when you send e-mails to Nishizawa and/or Miko.*