

# **PRIVATISATION IN INFRASTRUCTURE PROJECTS**

# BASIS

- BOT MODEL
- GOVT./GOVT. ENTITY ENTERS INTO AN AGREEMENT WITH PVT COMPANY
- COMPANY AGREES TO FINANCE, DESIGN AND BUILD THE FACILITY AT OWN COST
- CONCESSION FOR A FIXED PERIOD
- OPERATE THE FACILITY, COLLECT TOLLS & REVENUES AND TRANSFERS BACK TO GOVT.

# BASIS

- INTENTION TO RECEIVE SUFFICIENT REVENUE DURING OPERATION PHASE TO
  - **SERVICE THE DEBT IN DESIGN & BUILDING**
  - **COVER WORKING CAPITAL**
  - **MAINTAIN THE FACILITY**
  - **REPAY EQUITY INVESTORS**
  - **REASONABLE PROFIT FOR INVESTORS**
- GOVT. REALLOTS THE RISK AND REWARDS IN THE DEVELOPMENT OF INFRASTRUCTURE PROJECTS TO PVT. SECTOR

# CONTRACTUAL STRUCTURE

## MAIN PARTIES

- GOVERNMENT
- PROJECT COMPANY
- INVESTORS
- LENDERS
- CONTRACTOR
- CONSULTANTS
- OPERATOR
- USERS

# GOVERNMENT

- **GRANTS CONCESSION THROUGH LEGISLATION, SPECIFIC FOR THE PROJECT – LAND RIGHTS, FUTURE DEVELOPMENT, MONETARY AND ENVIRONMENTAL CONTROLS, DEGREE OF RISK ASSUMPTION**
- **MONITOR THE PROGRESS**
- **MONITOR THE OPERATION OF THE PROJECT**
- **EXERCISE CONTROL TO ENSURE**
  - **PRODUCT ACHIEVED ON TIME**
  - **APPROPRIATE SAFETY STANDARDS ARE MET**
  - **QUALITY OF THE FACILITY AT THE TIME OF TAKE OVER HAS A LONG USABLE LIFE WITH LOW MAINTENANCE COST**

# PROJECT COMPANY

- **SINGLE PURPOSE COMPANY**
- **GRANTEE OF THE CONCESSION**
- **RESPONSIBLE FOR :**
  - **SECURING FINANCE**
  - **PROCURING DESIGN AND CONSTRUCTION OF THE PROJECT**
  - **OPERATION OF THE PROJECT AND**
  - **EVENTUAL TRANSFER BACK TO GOVT.**
  - **SERVICING THE DEBT INCURRED IN IMPLEMENTATION OF THE PROJECT**

# INVESTORS

- **TYPES**
  - **PROJECT SPONSORS-** PARTICIPATION NOT RESTRICTED TO INVESTORS – CONTRACTOR, OPEARATING COMPANY; BANKS, GOVT.
  - **LONG TERM INVESTORS** – INTEREST IS INVESTMENT, MANAGEMENT OF THE COMPANY – MEMBERS OF PUBLIC-TAKE PART IN STOCKS OF THE COMPANY

# LENDERS

- **BANKS, FINANCIAL INSTIUTIONS**
- **CURRENCY – ONSHORE, OFF SHORE**
- **PROJECT EXPENDITURE – LOCAL CURRENCY**
- **CONSTRUCTION EQUIPMENT, MATERIALS- FOREIGN**
- **REVENUE – SOLE SOURCE OF REPAYMENT- LOCAL CURRENCY; REVENUE SOURCED IN FOREIGN CURRENCY – CONTAINER TERMINAL, POWER STATIONS, OIL REFINARIES**
- **EXCHANGE CONTROL RESTRICTIONS**

# LENDERS

- **PROJECT LOANS – LIMITED RESOURCES**
- **COMPLEX RISK PROFILE**
  - **LENGTH OF PERIOD OF LOAN**
  - **SUSCEPTABILITY TO POLITICAL RISKS**
  - **LOW MARKET VALUE**
  - **LOW MARKET VALUE OF SECURITY PACKAGE**
  - **LIMITATIONS ON ENSURING SECURITY – HONKONG – GOVT. RESTRICTIONS ON ENFORCEMENT, ASSETS HAVE LOW VALUE TILL COMPLETION**

# CONTRACTOR

- **PRINCIPAL SPONSOR**
- **GREATEST RISK – COMPLETION RISK**
- **LENDERS – RISK ON PROJECT SPONSORS –  
COMPLETION GUARANTEE**
- **RISK ON CONTRACTOR – TIME, COST, QUALITY  
WARRANTIES**
- **REALLOCATE LARGE RISK TO CONTRACTOR**
- **CONTRACT – MOST HEAVILY NEGOTIATED DOCUMENT**

# CONSULTANTS

- **FINANCIAL CONSULTANTS – STRUCTURING BOT, SHOULD BE FAMILIAR WITH HOST COUNTRY AND CAPITAL MARKETS, FINANCIAL INSTITUTIONS**
- **ENGINEERS & TECHNICAL CONSULTANTS – TO MONITOR QUALITY OF WORK AND PROGRESS**
- **INSURANCE ADVISERS**
- **LEGAL ADVISERS**

# OPERATOR

- **COMPLEX**
- **PREFERABLE TO SUB-CONTACT THE WORK TO AN OPERATOR HAVING EXPERIENCE**
- **PREFERABLE TO HAVE OPERATOR AS ONE AMONG THE PROJECT SPONSORS**
- **TO BE COMMITTED A SHARE HOLDER TO THE PROJECT**
- **PROJECT COMPANY MAY UNDERTAKE OPERATION OF THE FACILITY**

# USERS

- **TOLL PAYING PUBLIC IN CASE OF BRIDGES, TUNNELS AND HIGHWAYS**
- **GOVT. IN CASE OF POWER, UTILITY COMPANY, PRODUCT PURCHASER**
- **AGREEMENTS – ‘TAKE-AND-PAY’ OR ‘TAKE-OR-PAY’**

# CONFLICTS OF INTEREST

- **CONSIDERABLE CONFLICTS BETWEEN VARIOUS INTERESTS OF A PARTICULAR PARTY WITHIN THE STRUCTURE**
- **CONTRACTORS' INTEREST DIFFERENT FROM THAT OF LONG TERM INVESTORS**
  - **CONTRACTOR RECEIVES MONEY AS EARLY AS POSSIBLE**
  - **LUCRATIVE CONSTRUCTION CONTRACT**
  - **PAYMENT – PERIODIC OR STAGGERED BASIS**
- **LONG TERM INVESTORS- PAYMENT BY DECLARATION OF DIVIDENDS – NOT UNTIL PROJECT IS BUILT AND GENERATES REASONABLE RETURN**

# CONFLICTS OF INTEREST

- **VARIATION ORDERS UNDER CONSTRUCTION CONTRACTS**
- **DIRECTORS CONTEMPLATE LEGAL ACTION AGAINST THE MAIN CONTRACTOR**
- **AMENDMENTS OR VARIATIONS TO CONTRACT DOCUMENTATION**
- **OPERATING COMPANY – FAVOURABLE OPERATING AGREEMENT CONDITIONS**
- **PROJECT SPONSOR- BANK- NO DIVIDENT TO SHARE HOLDERS WITHOUT PRIOR APPROVAL OF BANK**
- **AS INVESTOR, BANKS WANT DIVIDENTS EARLY OR REPAYMENT AND INTEREST EARLY BEFORE DECLERATION OF DIVIDENDS**

# FINANCIAL ADVISER

- **FINANCIAL ENTITY AS FINANCIAL ADVISER TO STRUCTURE AND FINANCE A PROJECT**
- **FA NEGOTIATES WITH THE BANKS FOR FINANCE**
- **FA SHOULD HAVE KNOWLEDGE OF THE BEST OVERVIEW OF THE PROJECT IN TOTAL**

# CONSULTANTS

- **ENGINEERS APPOINTED BY THE PROJECT COMPANY**
- **PRIMARY OBLIGATION – ACT AS WATCH DOG OF GOVT**
- **ENSURES GOOD DESIGN, SPECIFICATIONS,  
CONSTRUCTION, QUALITY CONTROL, MAINTENANCE**

# DEALING WITH POLITICAL PRESSURES

- **LEGISLATIVE ISSUES**
  - **CONFER AND REGULATE RIGHT TO LEVY TOLLS AND OTHER FORMS OF REVENUE FROM USERS**
  - **TAXES, EXCHANGE CONTROL, FOREIGN INVESTMENT LEGISLATION**
  - **CHANGES IN LEGISLATION**
- **CONTRACTUAL ISSUES**

# BENEFITS OF PRIVATISATION

- **ACCELERATE GROWTH IN ECONOMY**
- **RELIEVES GOVT OF FINANCIAL AND ADMINISTRATIVE BURDEN**
- **INCREASED EFFICIENCY, PRODUCTIVITY, BETTER SERVICE TO PUBLIC**
- **SUCCESS DEPENDS ON COUNTRY'S LEGAL SYSTEM, GOVERNMENT'S COMMITMENT TO PRIVATISATION, POLITICAL STABILITY**
- **BENEFITS AND RISKS SHOULD BE BORNE IN MIND WHEN NEGOTIATING CONTRACTUAL STRUCTURE**

# RISK ASSESSMENT

- Project Risk
    - Technical Risk – Use of New Materials, applying existing methodology to a new conditions
    - Schedule Risk – Delay in Execution
    - Commercial Risk – Cost Escalation
- (Most of the risks can be borne by the private sector)

# RISK ASSESSMENT

- Structural Risks
  - Planning and Permit Risks – Delay in Planning Procedure, Negative Environmental Assessment, Not Granting Construction Permits
  - Political Risks – New Govt., Change in Plans
  - Regulatory Risk – Change in Design Rules  
(Cannot be shifted to the Private Sector – public character of risk; to be borne by the public sector)

# TYPES OF PPP

- **Basic PPP** – Public and Private Partners Team up for Operating a Specific Project and Outsource all non-core activities
- **Controlled PPP** – Provider of the Financial Resources is formally included in the project; participate in decision making; control project risks; investor acts as a continuous auditor
- **Integrated PPP** – Incorporates all stake holders during the life cycle (involves the constructor also as a partner)

# OPTIONS AND STRUCTURES FOR PPP

- Corporatisation
- Service Contracting
- Management Contracting
- Lease
- Concession
- Divestiture and Asset Sales

# Corporatisation

- Assets and Liabilities of the Govt. Dept., are carved out into a Corporation
- Govt. is Sole Shareholder
- Govt., controls the Board of Directors
- Employees are Transferred from Civil Servants to Corporate Employees
- Revenues are kept in the Corporation rather than sending to Govt.
- Accrual based Accounting – Measurement of Financial Performance; full cost recovery analysis
- Outside Private Lenders can finance operating and capital budgets

# SERVICE CONTRACTING

- Specific Area of Service is Unbundled from the Sector – Maintenance of Billing & Collection
- Prior Full Cost Analysis of Specific Service to bench mark current performance and compare with competitive bids
- Capital Requirements are low
- Asset lives are 3-5 years
- Contractors are paid per unit of work performed
- Operational Efficiency is the main objective
- Labour Issues are critical

# MANAGEMENT CONTRACTING

- Public Corporation Identifies Specific Priority Operating Problems
- Private Firms Bid Competitively For The Right To Provide Management Services
- Management Contractor Identifies Specific Target Operating & Performance Levels that the Contractor must meet with
- Ownership of the Assets with the Govt
- Contract term usually for 3-5 years

# LEASE CONTRACTS

- Govt. Identifies Specific Long Term and Short Term Problems
- Private Firms Compete for Right to Lease the Assets in exchange of a lease fees
- Contract Term – 7-15 years
- Contract Specifies Performance Measures and Targets (Incentives & Penalties)
- Lease Contractor Provides Management, O&M Decisions, spare parts, working capital and keeps residual profits
- Govt., Maintains the Ownership of Long Term Assets

# KEY ISSUES IN SELECTING PPP PROJECT

- PPP Project Selection – Not the ‘Worst First’
- Independent Specialised Feasibility Study
- Competition for the Market is Must
- Transparency is the Procurement
- Experienced Advisors and Realistic Risk Allocation

# CRITICAL PRE-REQUISITES OF PPP IDENTIFICATION & SELECTION

- Role of Govt- Long Term commitment to PPP
- Clear Articulated Objectives for PPP
- Clear Political Leadership
- Deep Supported Policy
- Public Capacity to Monitor and Regulate the Project
- Willingness to Engage Private Sector, Users and Other stake holders for a dialogue
- Clear Defined Institutional Roles
- Minimisation of Credit Risk
- Avoid Conflict of Interest in Project Selection and Implementation

# OBSTACLES IN PPP

- Lack of Good, Strong and Well developed Projects
- Lack of Clear and Unambiguous Legal, Regulatory and Procurement Frameworks for Project Finance
- Lack of Capacity across Govt. Agencies to understand the full requirements of projects
- Govt. not fulfilling its role in creating enabling conditions and capacity building
- Lack of Appreciation that PPP is a Leverage and not a replacement for public finance

Thank you....