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Public Private Partnerships
Whose risk and whose reward?

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PPPs- financing public infrastructure

- Private sector takes out loan
- Higher interest rate than public debt
- Loan – like a mortgage
  - Total cost x3 or 4 over 30 years
  - **20-40% annual cost is additional cost of private finance**
- State is operator of last resort
- So debt is off public sector balance sheet but is a contingent liability
- Commits state budget for 30 years
- In event of failure/early termination, state takes on higher debt than would otherwise have been the case

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Meaning of success/failure?

- Win/win for the banks
- Can be a win for public authority – but depends how they shift the costs
  - users
  - staff
  - other public bodies
  - future generations of taxpayers
- So success and failure may not be useful terms
- >> Winners and losers

Policy

- Designed by private sector
- Advisers are the global financial consultants with vested interest in the policy
- UK Treasury invited consultants to work in Treasury, design appraisal methodology, vet early projects, evaluate the policy
- Public bodies use consultants to check projects, contracts etc., but at a disadvantage

Operation of scheme

- Special purpose vehicle (SPV) – consortium
- **Legal entity - brass plate company – no employees**
- SPV obtains finance, designs, builds and operates project
- **90% Debt** and 10% equity
- **Several layers of companies – complex sub-contracting relationships – so adds bureaucracy, complexity and inefficiency**
- Contract – price, volumes, form of payment, penalties and incentives
- Performance monitoring regime
- **Allocation of risks – between contractor/state and between contractors so they can all pass the blame when things go wrong**
- End of contract – asset reverts to state

Policy rationale and objectives

- Numerous conflicting rationales
- No money
- Value for Money
  - Risk transfer
  - Private sector more efficient
  - Build to time and budget
- Robust specification
- >> Benefits outweighing the costs
- >> Lead to additional investment
- BUT……

No comprehensive evaluation

- No independent evaluations *ex ante*
- No independent evaluations *ex post*
- UK National Audit Office reports
  - Examine business case
  - The public sector comparator (PSC)
    - Very critical of individual projects
    - Can’t place undue reliance on PSC
- Research commissioned by consultants – not independent

Project collapse/renegotiation

- CTRL (rail) renegotiated within months of signing
- NATS PPP – collapsed after 3 months (9/11)
- All 3 London Underground PPPs terminated early/collapsed
- **More than half transport projects (all projects) by capital value have collapsed/terminated early**
- **Most of railway franchises were renegotiated in favour of concessionaires, some handed back early/handed back the keys**
- International: transport PPPs 55% renegotiated in Latin America and Caribbean
- Toll roads in Mexico, Hungary, Spain, Indonesia taken back into public ownership
- Recent problems in Spain and Portugal
- North America and Australia: evidence
- So PPPs do not always result in robust specification

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Why such limited 'success'?

- Yes – legal, lack of competition, lack of negotiating skills, expertise, other problems, etc
- **Key = High financing costs**
- Non-cash generative public services
  - Never run on a commercial basis/universal access
- Small capital projects – bundled together
- 'Rationalisation' and reconfiguration of services – mergers/closures, relocations
- Service element – already low paid – human services – little room for "efficiency savings" difficult to define, measure and monitor

Financial appraisal of bids

- Nearly all of these renegotiations/early terminations were foreseeable/foreseen
- NATS, rail franchises, London Underground
  - Set as student assignments
  - All could see that not commercially viable for private sector
- Hospitals
  - Obvious that not affordable – set as student assignments
- So what were financial advisors doing?

Financial costs – study of first 12 hospitals

- **Little clear or detailed financial information**
- Very expensive, £6bn over 30 years, £250m p a
- Contract drift – 20%, some up by 70%, 60% and 53% within 3-4 years
- Inflation, volume increases, contract changes, failure to specify what was needed
- So costs will rise further over next 25 years
- Took 12% income even after income rose 56%
- Trusts - financially unstable – unclear causative role of PPP – fixed cost
- Audit Commission confirmed that PPP hospitals more likely to have deficits

Financial costs – study of roads

- DBFO – some new construction, ops and maintenance, shadow tolls
- Viewed as success
- **Little clear or detailed financial information**
- High payments – little political visibility + engineering standards
- Very expensive, £6bn over 30 years, £220m pa
- 3years paid £618m, yet construction costs were £590m
- Additional cost of private finance = risk premium = £56m pa = one quarter of the total annual payment
- Impact on Highways Agency budget? Affordability?
  - £300m pa or 20% Highways Agency's budget for 8% of network
  - M25 widening >> £300m pa or 40% budget

Completed projects – toll crossings

- **Success story -Dartford Crossings**
- High traffic flows
- 16 years
- Cost of finance/revenues= 20%
- Additional cost of private finance = 8%
- Conservative, using high rate of gov interest, excludes subcontracting

- **Failure - Skye Bridge**
- Low traffics flows
- £15m public construction costs, £7m subsidies, £27m termination fee
- Terminated after 10 years
- Cost of finance/revenues= 50%
- Additional cost of private finance = 31%
- Conservative, using high rate of gov interest, excludes subcontracting

New projects

- Government is lending to the banks for PPPs but no reduction in finance costs to public authorities
- New Mersey bridge – toll charges
  - Government will provide some funding
  - Old bridge
    - Reduce number of lanes and access
    - Toll – first time toll existing free bridge
- Opposition – inquiry but report not published
- In future, no inquiries
- Traffic management scheme to force traffic to use new tolled bridge
  - **All to make new bridge commercially viable**

Risk transfer?

- High cost of private finance
- High returns on initial investment
- Risk v rewards? Yardstick?
- Re-financings
- Sale of equity stakes
- Downturn in revenue – SPV hand back the keys – little loss due to backloading of contract/low penalty
- If unsuccessful, public sector and/or public bears the risk
- State as operator of last resort – so must step in

Additional investment?

- Roads – paid out more than initial investment
- Spreads out cost over long period – displaces (higher) debt burden onto future generations
- UK gov had sufficient surplus to pay for investment (£23bn in 2000-01 alone v £14bn 1997-2001)
- Hospitals “Largest building programme in history of NHS” - but financed by largest closure programme
- Extrapolated across all PFI hospitals
  - > £400m + a year
  - additional cost of private finance = £13bn, which is more than £11bn capital cost
- So no additional investment but extra debt/liabilities

Accountability?

- Private sector as *de facto* public authorities – not subject to Freedom of Information – public sector does not disclose –"commercially sensitive"
- Poor disclosure at all stages in process
  - Strategic business case
  - Competitive bidding
  - Financial appraisal
  - Contract documentation
  - Annual disclosure
  - Contract termination
- More disclosed to stock market re bonds
- Long supply chains add bureaucracy and stakeholder conflicts
- Massive conflicts of interest at all levels
  - Unable to see whether public expenditure and investment is sustainable
- Lack of information means an informed public debate/sound decision making is impossible

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Conclusions

- Similar international evidence
- While the gov claims the policy is a success, the outcomes do not match the claims
- Impossible in cash strapped services
- Winners = financiers, losers = taxpayers, workforce and users
- Risk transfer = rhetoric to legitimise policy
- Makes distribution invisible
- Financial instability of public sector organisations
- Future obligations in recession/austerity

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- So handle with care
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- Questions?