CATALYST 2015

COLLABORATE *to* COMPETE

36th National Conference of Chartered Accountants

Technical Session - 2

5th November from 11.00 am - 12.30 pm

PRIVATE AND PUBLIC SECTOR COLLABORATION

PRESENTED BY

- **Mr. John Davie**
  Chairman
  Altra Capital Limited
  United Kingdom

PANELISTS

- **Mr. Rajith Fernando**, Chairman, Urban Development Authority (UDA).
- **Dr. Saman Kalegama**, Executive Director, Institute of Policy Studies of Sri Lanka (IPS).

INTRODUCTION

Public &Private Partnership (PPP) is a contractual arrangement between a government entity and private firms which incentivize the private firm to design, build, maintain, and finance public infrastructure effectively and efficiently. This involves a new discipline for the public sector: it must define the service that it wants to buy over the long-term,establish a fair mechanism that incentivize the private sector to deliver that service and manage long term service contracts. When government engages with the private sector and commissions PPPs, the ultimate objective is to deliver a better service, and not merely to procure new infrastructure.

KEY POINTS OF THE PRESENTATION

The initial cost of PPP project investment is extremely high, thus a consortium is compelled to be financed by senior debt equity. Furthermore, if the PPP projects succeed, the total cost should be amortized throughout the project period otherwise the total cost incurred is identified as an expense, thus leading to a loss at the end of the project.

To ensure success of the project, and to minimize the negative cash flow, the Government must focus on high quality services, and competent expert advice, which will also guarantee revenue, secure and ensure success of the PPP projects.

With a significant amount of monies being spent on the PPP project, the only security is the remaining asset at the end of the project. If there are no losses incurred in the project, the consortium will receive dividends at the end of the project.

The Government's should also agree with lenders who are connected to the PPP project with clear specific terms & conditions with funding agencies to build up trust.

1. PPP Model

To develop the PPP model the following elements need to exist;

- Spread of capital cost amortized over all taxpayers for life of contract;
- Combined services budget cannot be raided;
- Government budgets for operation and maintenance are protected;
- Better integration of operation and maintenance with design;
- A strategic whole life approach to delivering services;
- Service paid for as they are consumed and
- Provision of assets otherwise unavailable.

2. Types of PPP

PPP can be split into two groups based on the operation of PPP contract, are as follows:

- User-pay PPP- where private firm takes revenue e.g. bridges, tunnels toll roads and water and power supply distribution system.
- Annuity based PPP- where the government retains those risks - e.g. Healthcare facilities, rural roads, schools etc.

3. How to work PPP

To operate or execute, the PPP is required the involvement of various parties together with the required resources, and being formulated with binding contract among the parties. Accordingly, the function of sponsor is to assemble consortium of organization with necessary skills and financial strengths to fulfill the project requirements over the period to work with banks or capital markets to provide the senior debt facility. While financing the project through debt and with other investors shareholders fund, project work such as architectural and ICT services typically outsourced from the consortium to sub-contractors. Guarantees, Insurance companies and rating agencies are involved to support the project companies to secure its debt capital.

4. Project Financing

PPP project financing is required a specific form of financing to secure finance for project. Project finance is the long-term financing of infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financing structure. Usually, project financing structure involves a number of equity financing as well as syndicate of bank/financial institutional that provide operational loans.

5. Key issues for Lenders in PPP projects

Financial institutions/ banks are bounded by the number of issues in financing for PPP projects which are broadly categorized into two parts based on the nature and significance of such issues:

- Micro Level - clarity on project outputs and specification, credibility of compilation undertakings, appropriate allocation of risk reflected in payment regime, low cash flow volatility, adequate termination protection, etc. and

- Macro Level – legal regime to take security and contractual rights, political commitments, competition and availability of service providers, debt market, project equity and transparent procurement process.

6. Commercial Viability – Will the project work and make money?

To aggregate the viability of the PPP project the following factors to be evaluated:

- Is there a sound market for the project or service?
- How will current and future competition affect the viability of the project?
- How are the running costs expected to escalate?
- How reliable are the input suppliers and availability of alternatives? and
- Does the project company have the resource and skills to successfully implement and manage the project?

7. Risk Identification

The most important factor of PPP project is identification of risk factors associate with projects, this can be done through qualitative and quantitative risk analysis process of such factors are Political, Environmental, Planning, Market, Economic, Natural, Technical, Design, Legal, Safety etc.

8. Risk and Risk mitigation

Risk associated with PPP projects can be managed by attracting institutional finance in managing risk and risk transfer to the party best able to manage it. The implication is that some risk will be contractually allocated to the private sector whilst other will be retained by the public sector.A well designed PPP project represent a better way to share all types of risk.

OUTCOME OF THE PANEL DISCUSSION

Infrastructure can be expanded and accelerated through PPPs, and hence PPPs can be considered as the way forward in the future of infrastructure development. In the backdrop of issues in relation to garbage, transportation and shanties in the City of Colombo, Municipal Councils and private entities can engage in PPP projects to help develop the infrastructure within Colombo.

During the discussion, the Colombo Port Development project, Sri Lanka Telecom and Railway & Expo Lanka carriages development were cited as successful PPP projects carried out in the country.

The ultimate beneficiary of the PPP will be public in the long run, due to the lowering of cost of service in creating market competition and price regulations.

However, success will also come through a strong mission, vision, and trust, which can only be attained by the parties involved in the PPP. It was also highlighted that building proper mutual understandable agreements will lead to a reduction in the mistrust among the parties involved. The panel discussion also highlighted the future PPP projects that are coming up under Megapolis Development Plan which has identified seven main corridors to Colombo and undertake the development plan in minimizing traffic in Colombo.