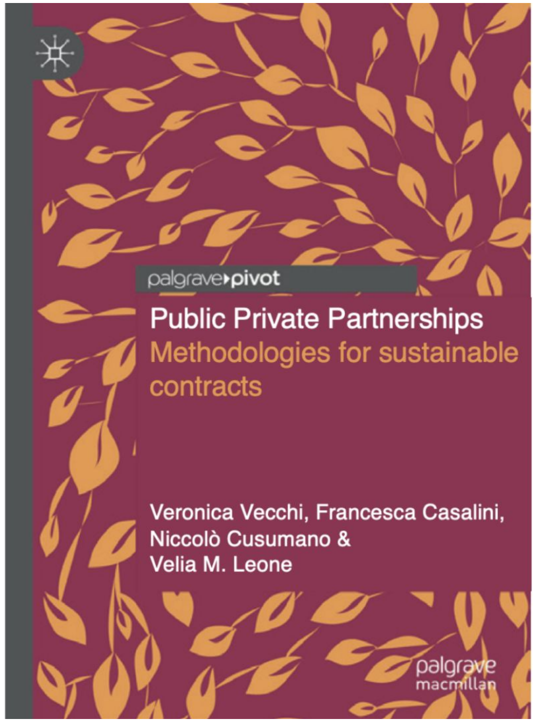
DESIGNED FOR YOUR WORLD

SDA Bocconi
SCHOOL OF MANAGEMENT



PPP CONTRACTS

Let’s make some clarity and let’s make it really working, for more public value!

Prof. Veronica Vecchi

PPP FRAMEWORK

Institutional level

	Contractual partnerships
Micro: contracts	PPP for infrastructure and service delivery Outcome-based contracts Value-based contracts Contracts awarded through strategic procurement
	Institutional partnerships
Meso: programs, institutions	Development programs Blended finance & Development banks Public private joint ventures
	Informal partnerships
Macro: policy	Lobbying Corporate Social Responsibility Impact Investing & shared value creation

PUBLIC VALUE = IT IS NO MORE A PREROGATIVE OF THE PUBLIC SECTOR

Public sector: limited budget, rigidity, risk adversion

In the market?

Focus by investors on ES(G)

Evolution and diversification of citizens needs

Global Trends (Digitalization, Technologies low cost)

Global Challenge (environment, population ageing)

What is the answer?

Public Value

Network Gov

«PPP»

HOW INFRASTRUCTURE AND SERVICES ARE FUNDED AND MANAGED: PPP IS NOT A WAY TO PRIVATIZE SERVICES

Role of the Government

In house management

Competition for the mkt

Sets the features of the contracts
May provide grants, or guarantees (in case of non-remunerative tariffs)
Regulating authorities may frame a national set of rules

Competition in the mkt

sets the rules of the game

Direct management of the service by Government or through SoEs

Concessions & PPP

Privatized services delivered thorugh Economic Infrastructure

Funding mechanisms

General taxation (public budget)

Public Debt

These services can be paid by users through tariffs (sometimes non-remunerative) or they are delivered free of charge or with a minor payment by the users, often set in order to skim/regulate the demand

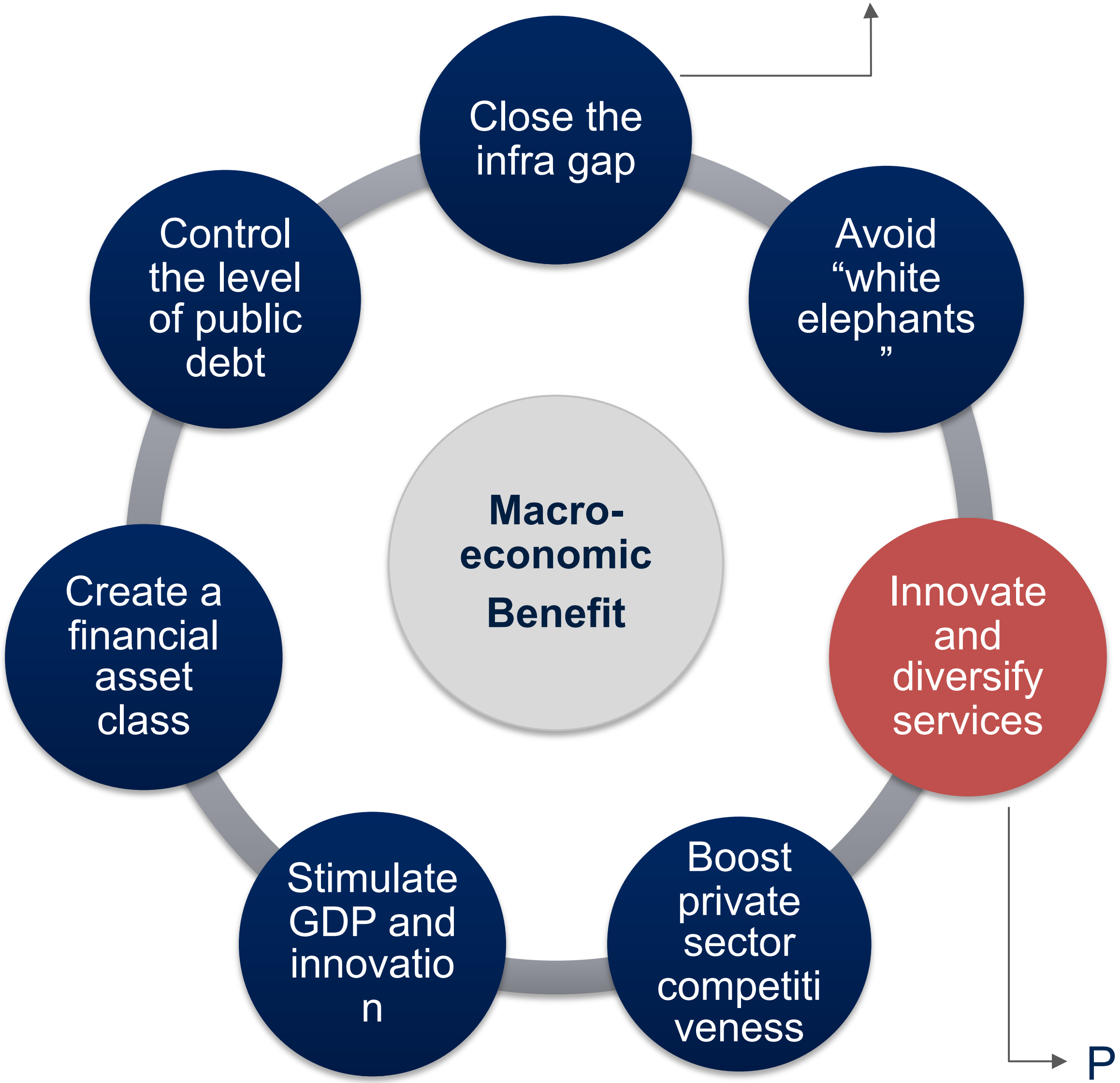
Private capitals remunerated by (remunerative or non-remunerative) tariffs or availability charge

Private capitals repaid by (regulated) remunerative tariffs paid by users

Privatization of infra is possible only for the last mile.
Infrastructure is a natural monopoly

WHY PPP?

In EU: 2 tn USD for economic Infrastructure + 1 tn € for health and education

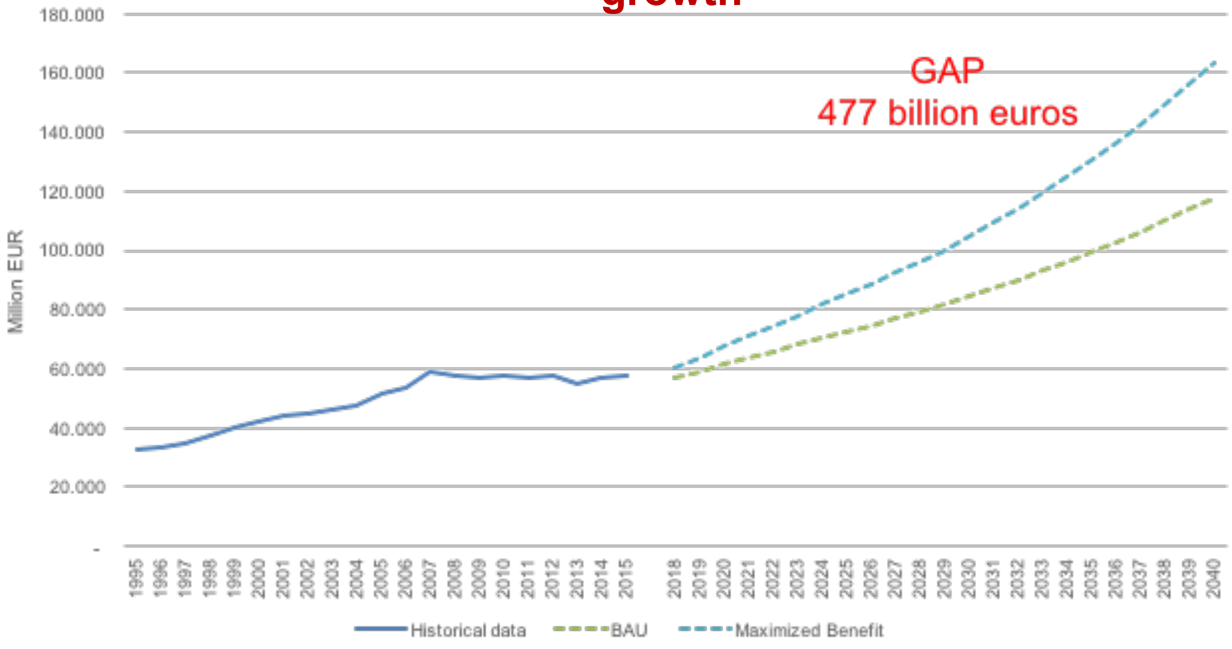


PPP not only for hard infrastructure

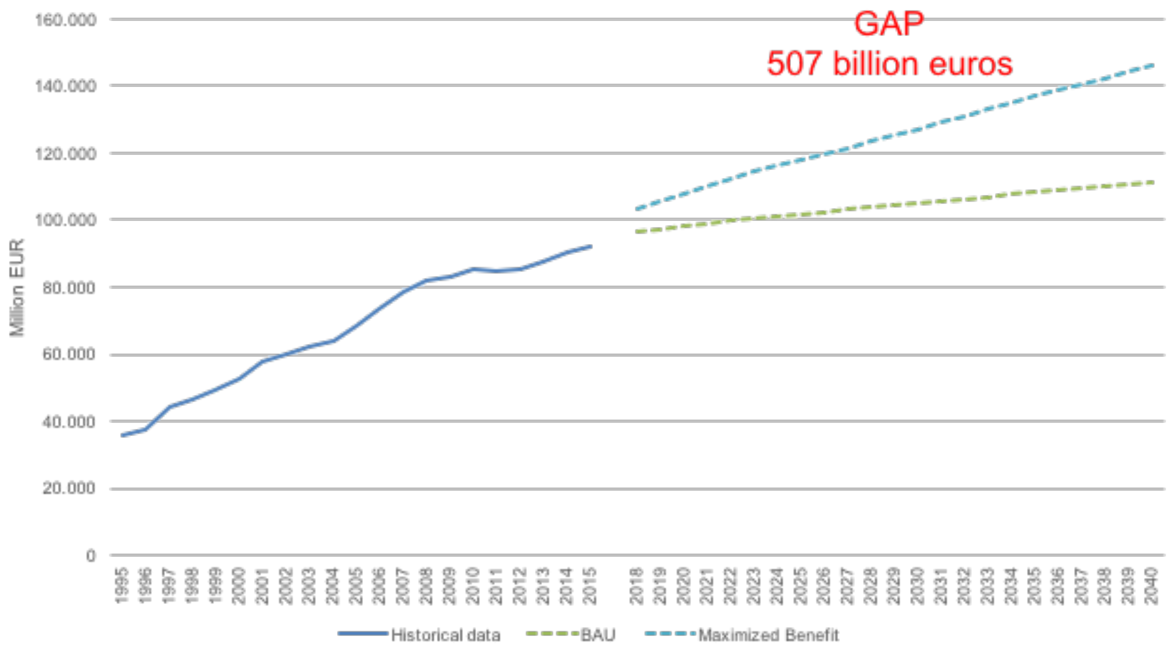
Micro-economic Benefits

On time	• To deliver the project according to the design schedule
On budget	• To deliver the project without extra costs
On quality	• The project must ensure quality and innovation of the services delivered

Healthcare past Investments and future growth



Education past Investments and future growth



European Investment Bank

SDA Bocconi estimated last year the gap in healthcare and education for the EIB

PPP: A LOOSE DEFINITION

Loose definition of PPP, but 4 are the main common features:

- A **long-term contract** between a public procuring authority and a private sector company based on the procurement of services, not assets;
- A **significant investment of private capital**;
- The **transfer of certain project risks to the private sector**, notably with regard to designing, building, operating and/or financing the project, but also the achievement of certain outcome;
- **Payments** to the private sector reflecting the **performance (results and increasingly outcomes) delivered**
  - Be careful: even when users pay fees, the demand may be rigid and therefore a system of deductions must be introduced
  - Payments can come also from the Authority in the form of tariffs or availability charges

PPP = RISKS ALLOCATION = CONCESSION

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Strategic goals to be achieved by the public sector

A partner is needed; the partner must be incentivized (effective risks allocation)

- No achievement, no (lower) payment

This is in a nutshell the definition of operating risk (Directive 23/2014)

PPP = concession contract

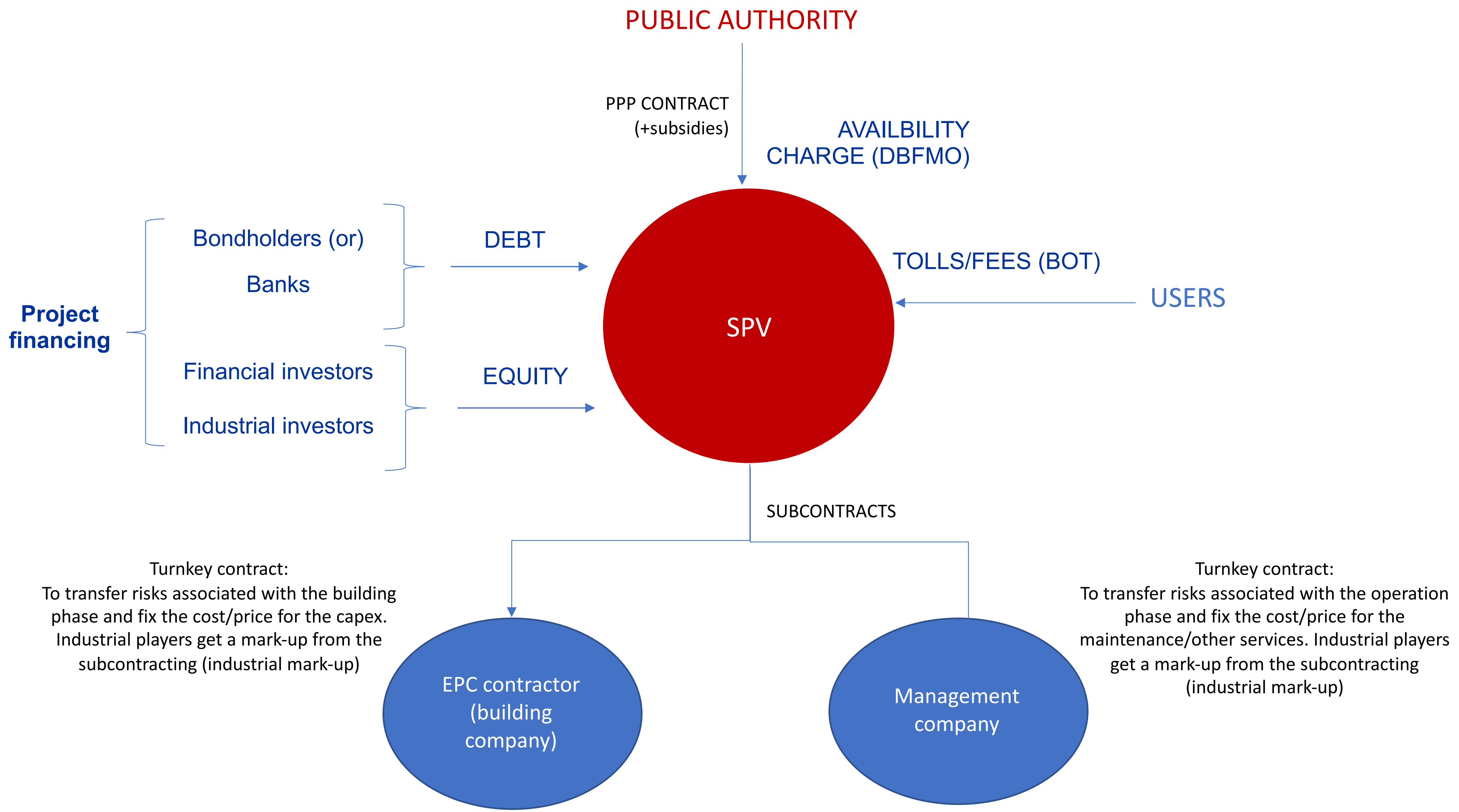
Off-balance sheet treatement for availability-based PPP contracts (those called as PPP by Eurostat)

Concept of economic & financial equilibrium

Revenues must cover opex, capex, cost of capital (debt/equity) set at the right level considering the risks really borne by investors

- *NPV* $\rightarrow$ *0*
- *IRR* $\rightarrow$ *cost of capital*

THE TYPICAL PPP STRUCTURE



TWO MODELS OF PPP

PPP
Tariff based

PPP
Availability based

Rigid demand because:
- natural monopoly
- social tariffs & specific target users

Be careful!
availability charges may be higher that historical costs, but the authority has to consider also:
- Cost of risks transferred (avoid optimism bias)
- Social costs, due to low service quality with traditional approaches

Important features

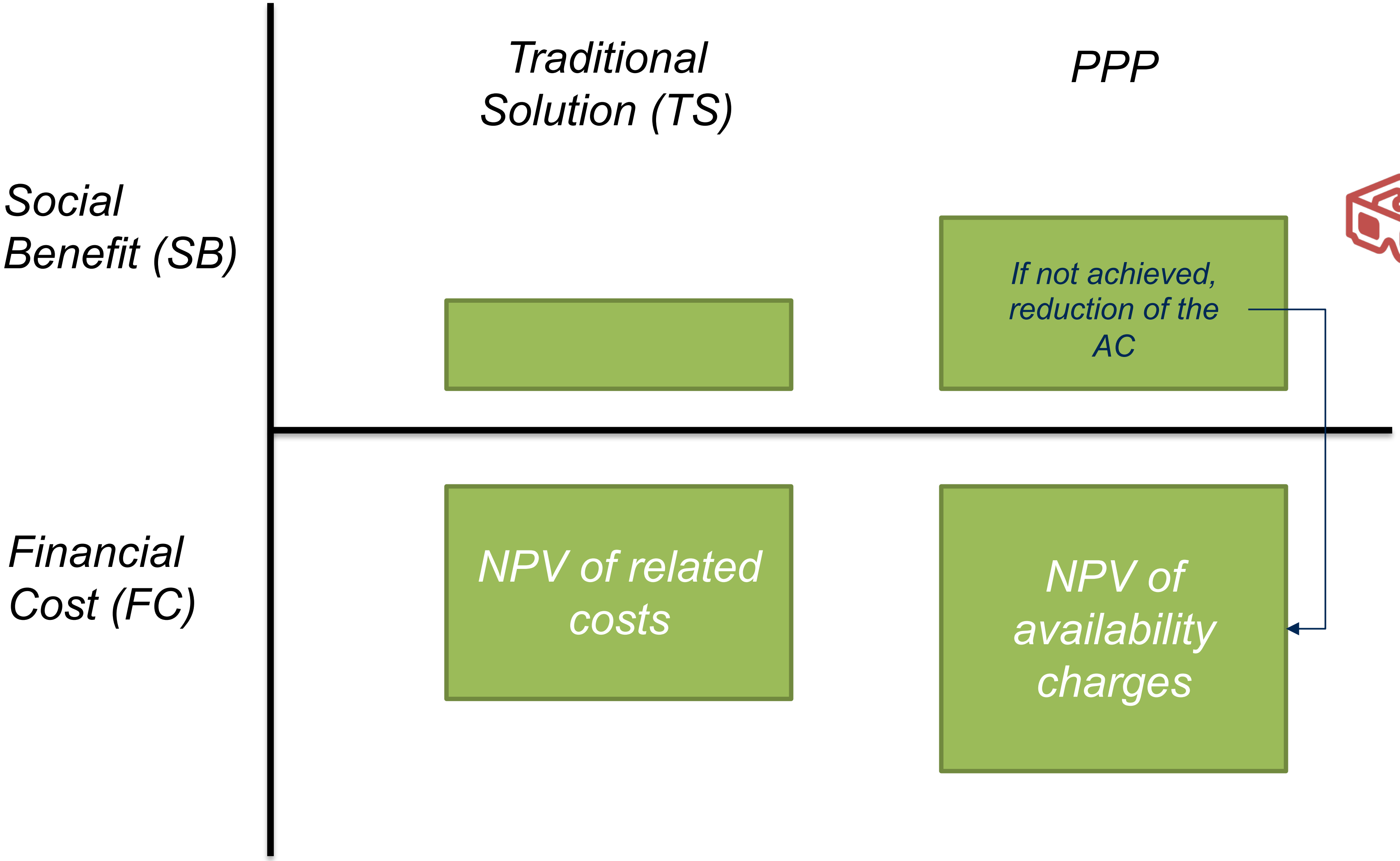
Payment mechanism & RPI indexation (never fully indexed)

Length.. Never too long

Grants may be useful

The challenge:
To incorporate mechanisms to reward the economic operator for the societal/impact achievements (it means looking more at the service!)

MEASURING THE VALUE OF A PPP CONTRACT



PPP should be based to different business models compared to traditional solutions in place