

Common questions and answers about PPPs

Public Private Partnerships (PPPs) are used to procure public infrastructure when they represent good value for money and are in the public interest. However, there are many misconceptions about PPPs. This series of Q&As is designed to address some of the commonly held misconceptions about PPPs

What is a PPP?

A PPP is a service contract between the public and the private sector where the Government pays the private sector to deliver infrastructure and related services over the long-term.

PPPs typically make the private sector parties who build public infrastructure financially responsible for its condition and performance throughout the asset's lifetime.

In a typical PPP project the government would:

- engage one party to design, finance, construct, maintain and, in some cases operate the facility
- only make payments after the facility has commenced operations
- provide payments over the term of the contract based on services delivered against the achievement of key performance indicators – with these payments being at risk for non-performance.

It is important to note that the responsibility for delivering core services is retained by government and the project must pass a rigorous public interest test. Good public policy requires that all projects must offer value for money as a government investment, independent of the delivery method. The same is true of PPP projects.

How is value for money assured?

The success of PPP projects relies upon real risk transfer reinforced by the commitment of private finance over an extended term. Best value for money is normally achieved on major and complex projects, where there is opportunity for innovation and risk sharing. This is done by stimulating innovation through competitive bidding, use of output (ie. services) rather than input specifications, appropriate transfer of risk and facilitating whole of life cost considerations.

Importantly projects will only proceed as a PPP if this provides better value compared with what the same project could achieve under a more traditional procurement method. A Public Sector Comparator (PSC) is used in this value for money comparison assessment. Good PPP policy ensures:

- the risk related to infrastructure finance, construction and operation is transferred to the party best able to manage it
- the project is allocated a whole of life cost, with an incentives regime for the private sector to complete the job on time and on budget as well as service it over its lifetime
- infrastructure and services developed by the private sector can be used in an innovative and commercial manner, thus offsetting costs by generating extra revenue that government would not normally be able to achieve.

What represents better value?

Better value is not just cheaper – it is not just about beating the PSC. It also means the overall outcomes achieved, such as a higher quality and better maintained infrastructure over the longer term. It is about obtaining the best deal for government in the delivery of infrastructure across a number of factors, including price, quality of service delivery to the community, design amenity and **sustainability** of the arrangement.

For instance, compared to traditional built infrastructure, PPPs have provided flexibility and higher quality in design. This has achieved efficiency in operations and will reduce maintenance and provide capacity to expand infrastructure to meet future needs without disruption to operations. Competition between bidders and the potential for innovation, which produces savings in operational costs or related commercial opportunities to generate revenue, reduce the overall cost to government.

But aren't they expensive to negotiate?

International experience including adopting standard commercial principles in PPP projects and increasing the use of the interactive tender process in projects has reduced the time and cost of PPP contracts significantly.

Aren't PPPs just a means to take expenditure off the Government's Balance Sheet?

The balance-sheet treatment of a project is not the driving force behind the use of a PPP delivery approach. In most jurisdictions PPP projects are included on the Government's balance sheet (and the accounts are audited each year). The decision about how a project is funded is separate to the decision of how it is delivered. PPPs compete for budget funding along with all other capital projects. Full capital

budget funding is set aside for non-self funding projects before market interest is formally sought, allowing a project to proceed to traditional delivery should private bidders not offer value for money.

Does real or effective risk transfer actually occur?

A common view is that value for money is compromised through risk transfer not being real or not being any more effective than the traditional delivery of infrastructure. PPP projects assign risks to those best able to manage them, avoiding excessive premiums for inappropriate risk transfer, and in reality, what is transferred is the financial consequences of risk occurring.

Construction costs are just one example where government can significantly benefit from transferring the risk of cost overruns to the private sector. However, there are many other areas where the risk transfer is real, including maintenance and fit-for-purpose design.

Won't long-term PPP contracts unduly lock-in future Governments?

Most infrastructure, by its very nature, is built to last for 20 years or more. No matter what mode of delivery, the government is making decisions that have long-term consequences. The benefit of a partnership approach is that the government will need to consider more fully the whole-of-life issues before entering into partnership arrangements and incorporate sufficient flexibility into the arrangements to take advantage of improvements in service delivery quality and efficiency over time.

Don't PPP projects have a higher cost because of higher private sector borrowing costs?

Effective application of the PPP model is about packaging projects in a way that ensures lower overall cost to the state and improved services to the community. Competition between bidders for a whole of life asset and related services provides scope for innovation and other factors to achieve efficiency savings above those achieved under equivalent public sector delivery and financing.

It is a myth that the value for money outcomes achieved in PPP projects are compromised by higher private sector borrowing costs. The Government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. Credit markets perceive this power as reducing the risk of their investment and therefore will lend to government at lower rates. However, when it comes to raising finance for a project, it is the risk of the individual project that determines the real cost of finance. The difference

between the private and the public sectors is that private sector capital markets explicitly price in the risks of a project into its sources of finance. This is not the case in the public sector. Instead, **taxpayers implicitly subsidise the cost of the project by bearing the risk of cost overruns, time delays or performance failures, which are not priced into the Government borrowing rate.**

The importance of the finance element of privately provided infrastructure lies in the incentive it can provide for the performance of that infrastructure, and the disciplines external financiers can provide on the delivery of projects to time and budget. While a key objective of Government is to achieve a more comprehensive upfront consideration of risks in conventionally financed projects, it is difficult to replicate the strength of private financing incentives within a conventional financing process where all risks of delivery reside with Government.

Conclusion

Public-private partnerships (PPPs) have emerged as one of the most important models governments can use to close the infrastructure gap.

Public-private partnerships are unlikely to fully replace traditional financing and development of infrastructure, but they offer several benefits to governments trying to address infrastructure shortages or improve efficiency:

1. Public-private partnerships allow the costs of the investment to be spread over the lifetime of the asset and thus can allow infrastructure projects to be brought forward by years compared with the pay-as-you-go financing typical of many infrastructure projects
2. PPPs have a solid track record of on-time, on-budget delivery
3. PPPs transfer certain risks to the private sector and provides incentives for assets to be properly maintained
4. PPPs can lower the cost of infrastructure by reducing both construction costs and overall lifecycle costs and providing opportunities for third party revenues that normally aren't provided with public infrastructure
5. Because customer satisfaction requirements can be built into the contract, PPPs encourage a strong customer service orientation
6. Because service outcomes becomes the organizing theme around which a project is built, public private partnerships enable the public sector to focus on the outcome-based public value they are trying to create like better health, better education, better customer service, rather than being preoccupied with asset management