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Risks & Opportunities in PPP Projects

Risk - The possibility of an event occurring that will have an undesirable consequence on the Project or its stakeholders

Kevin Ellis
Vice President/Managing Director
Northern Europe & Russia

Kiev, 22-24 April 2012
Speed uppp Ukraine

Who we are

- Participated in over 5,000 Projects Assignments with a Total Construction Value of over US$250 Billion
- Global Leader in Project Management and Construction Claims
- Claims Management and Dispute Resolution Services have assisted our Clients with more than 25,000 Disputes Valued in Excess of US$100 Billion
- Full Range of Project and Cost Management Services Globally

Global Presence |110 Offices Worldwide

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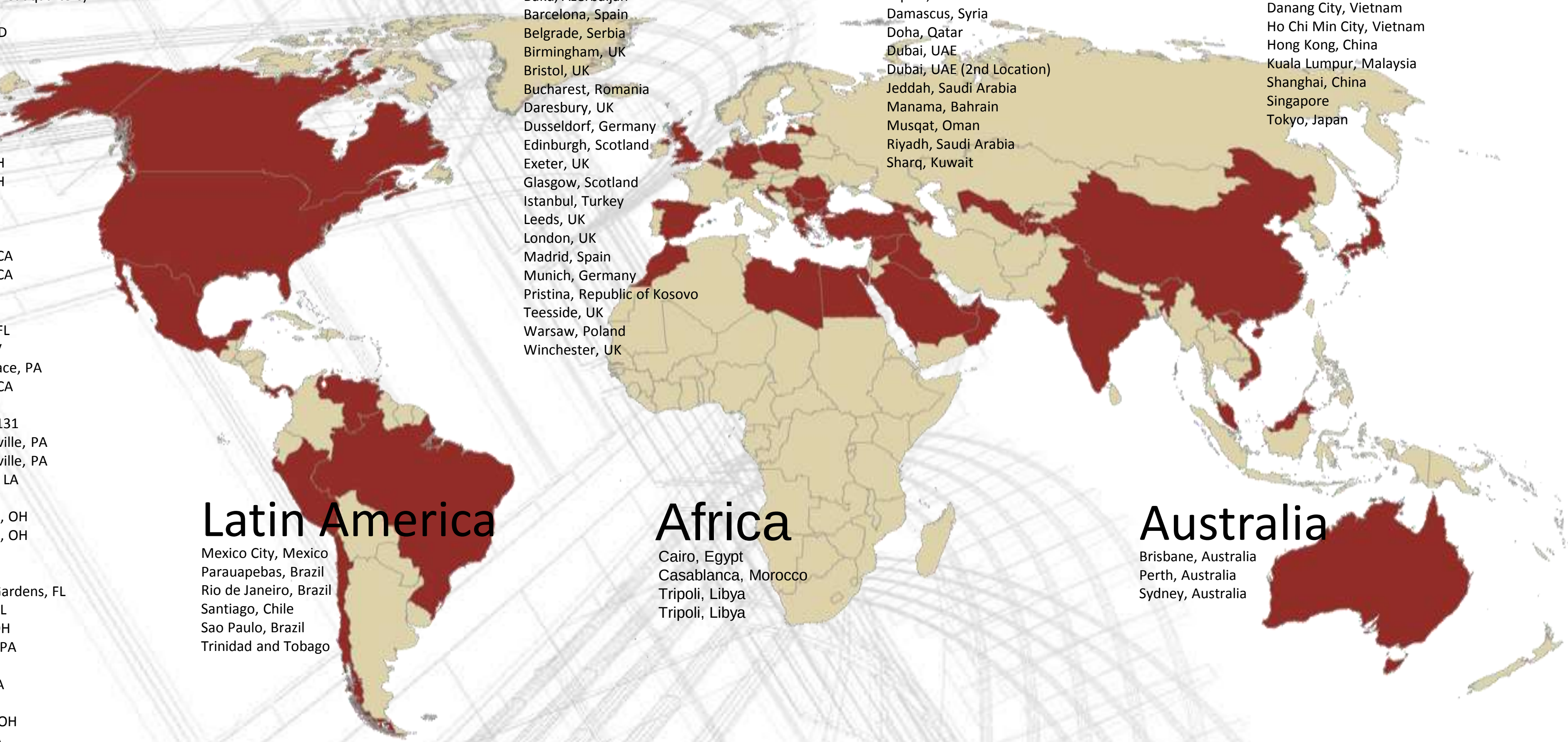

US & Canada

U.S. and Canada
Marlton, NJ (Headquarters)
Atlanta, GA
Baltimore, MD
Bellevue, WA
Bellevue, WA
Bensalem, PA
Bensalem, PA
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Boston, MA
Columbus, OH
Columbus, OH
Dallas, TX
Danbury, CT
Danbury, CT
Granite Bay, CA
Granite Bay, CA
Houston, TX
Irvine, CA
Jacksonville, FL
Las Vegas, NV
Lemont Furnace, PA
Los Angeles, CA
Miami, FL
Miami, FL 33131
Montgomeryville, PA
Montgomeryville, PA
New Orleans, LA
New York, NY
North Canton, OH
North Canton, OH
Ontario, CA
Orlando, FL
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Palm Coast, FL
Perrysburg, OH
Philadelphia, PA
Phoenix, AZ
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Europe

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Teesside, UK
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Dubai, UAE (2nd Location)
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Tripoli, Libya

Australia

Brisbane, Australia
Perth, Australia
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Industry Sectors

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Transportation

Telecom & Technology

Buildings

Power

Industrial

Manufacturing

Environmental

Petroleum

Advantages/ Disadvantages of PPP (1)

- **Better Quality Public Facilities and Public Services**
  - New modern facilities designed 'fit for purpose'
  - Regularly maintained facilities
  - Scope for better service delivery and better public perception
- **Transfer of Risk to Private Sector**
  - Capital project risk is traditionally better managed by the Private Sector
  - Some risks need to be retained by Public Sector so that project is 'bankable'
- **Cash flow**
  - Authority needs to retain and pay fees of 'expert' advisor team to prepare for and undertake PPP procurement
  - Authority does not pay for capital project expenditure until 'Unitary Charge' commences when the facility is operational
  - Scope for capital gain by Authority though asset transfer to the Private Sector
- **Timely delivery of facilities and services**
  - Massive incentive for completion and delivery on time – otherwise no payment!
  - Construction is largely 'non-adversarial'

Advantages/ Disadvantages of PPP (2)

- **Change**
  - Greatly important to get procurement documentation, output spec., project agreement, etc. ‘right first time’
  - PPP variations during detailed design and construction unwelcome and costly!
- **Demand Risk**
  - To attract PPP investment and be successful, the project needs to be ‘bankable’
  - Authority needs to take *demand* risk of continuing use and effectively ‘guarantee’ minimum Unitary Charge throughout period of the PPP Agreement
- **‘Out put’ specification**
  - Can only describe desired outcome of facility and services – not the detail
  - *Crucial* that appropriate resources and budget invested by Authority, working with Advisor Team, prior to PPP procurement commencing
  - Otherwise the result may not be what is needed or wanted!

Advantages/ Disadvantages of PPP (3)

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- **Procurement time and costs**
  - Procurement of single projects relatively expensive (capital cost< 30 million Euros often not cost effective for PPP Procurement) *unless*
  - The Authority embarks on a programme of capital projects with the same Advisor/ Client team developing and reusing suitably flexible PPP documentation
  - Procurement of the initial project is often slow compared to subsequent projects
- **Civic regeneration through a PPP programme of works**
  - Scope to carryout major regeneration of Public Sector facilities and services *but*
  - The Authority's/ Government's Revenue Budget needs to be able to support the respective on-going Unitary Charges
  - Robust financial modelling required by the Authority to ensure PPP programme of works can be funded over the respective Unitary Payment periods
  - Investors may seek reassurances here

Considerations for PPP Procurement (1)

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- **Long-term Authority financial commitment**
  - Although not starting until project completion, the Unitary Charge is a financial commitment borne by the Authority typically for 25 – 30 years
- **Individual project 'bankability'**
  - Each project must be an attractive or 'bankable' investment in its own right
  - Is governed by a whole series of factors such as: credibility and planning of the programme of works; appropriate risks retained by the Authority; quality of procurement strategy and documentation; quality of Client/ advisor team; currency fluctuation; etc.
- **Appropriate Risks retained by Authority**
  - In order to ensure that PPP projects are 'bankable', the authority typically retains some of the risks such as: 'demand risk'; change in legislation; site acquisition; town planning guidance/ 'outline approval'; force majeure; etc.
- **Language**
  - The majority of PPP Consortium experience currently exists in the UK and Western Europe. Consequently procurement documentation should be produced in both English and Ukranian to potentially attract these experienced PPP Partners

Considerations for PPP Procurement (2)

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- **Affordability Envelope**
  - A financial model estimating the design, construction and operational costs of each project should be developed by the Client/ advisor team to determine the projects 'whole life cost' and 'affordability'
  - The affordability envelope is normally based on a high level 'concept design' or 'reference project', developed by the Client/ advisor team.
  - The concept design (usually without costs) is often used as part of the brief for prospective PPP Bidders
- **Procurement Documentation**
  - Ideally should comprise main PPP Agreement with all other documents (brief, instructions to bidders, bidding process and timetable, output spec., Authority reference information, etc.) being crossed referenced to this and 'attached' as appendices
  - Needs to be both clearly and well written, and to be flexible enough to re-use for subsequent projects

Considerations for PPP Procurement (3)

- **Procurement Route/ OJEU**
  - Procurement strategy, programme of works timetable, need to be agreed before going to the market place
  - Legal advice needs to be taken to ensure that procurement strategy and documentation complies with Ukrainian Law and interpretation of European Procurement rules within Poland
- **Strength of Client in-house/ external advisor team**
  - PPP procurement is complex and very resource intensive, particularly for the first project undertaken
  - Most Authorities need to employ and rely on the expertise of PPP Technical, Legal and Financial Advisors from the beginning of the procurement process
- **Cultivation of prospective PPP Partners**
  - When details of PPP works programme agreed, need to make market place aware of planned PPP Programme of Works to attract widest possible interest
  - Often done through press releases prior to OJEU issue and Open Days as part of the OJEU selection process

Source of Risk

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Inherent Characteristics of a PFI project

- Long operating contract period
- Public/private sector interface
- Staff transfers
- The human element
- “DBFO fixed price”
- Design & Construction

- Operational phase
- Not like a car assembly
- No opportunity to perfect the process or practice
- Unwieldy process
- Teams often have never worked together
- SPV may be a new company

Source of Risk – Project Uniqueness

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- No Prototypes
- First attempt tends to be your last
- Market/price uncertainty due to:
  - Length of project
  - Bespoke designs
  - Lump sum prices given on poor information
  - Construction in the ground

Source of Risk – Risk Attitudes

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- **Funders (Banks) / Government / Authority**

  Risk Adverse – Look to transfer all risk down through the main contract (Principle Agreement)

- **Contractors / FM / Equity Providers**

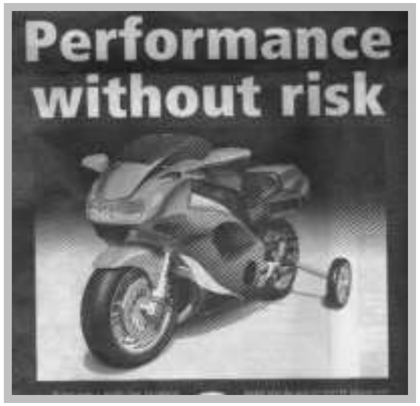
  Less Risk Adverse / more Risk Seeking – Will accept more of the risk such as Construction, Operation or Performance Risk

Risk at each Source – Whose Risk?

- Government/Authority
- Concessionaire/SPV
- Equity providers
- Funders
- Contractor/Facilities providers
- Specialist providers
- Staff/Occupants
- Other stakeholders

Source of PPP – Particular Problems

- Management of disparate groups
- Decision making
- Management control -v- Financial control
- Discharge of obligations
- Funder's concerns
- New legislation
- Title
- FM and lifecycle



Source of Risk in PPP

Why projects fail

- Poor planning - inflexible, unwieldy
- Lack of organising – ill defined responsibilities, poor communication
- Poor implementation – uncontrolled changes, underestimated complexity
- Lack of control – progress not measured, lack of authority
- Regulatory changes

Extent of Uncertainty – Operational Phase

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- Usage risk
- Facilities management costs
- Planned Preventive Maintenance (PPM) risk
- Life Cycle Reserving risk e.g. parts replacement
- Others – Financial, Performance, Contractual…
- Regulatory changes

Key Elements for Success (1)

- Interface between the public sector and private investor
- Good working relationship between professionals
- Blend of different management models
- Relationship with corporations
- Assessment methodology for the evaluation of proposals

Key Elements for Success (2)

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- Match structure and service targets
- Well-defined Level of Services
- Well-defined quality standards
- Balance between area, expected production, required specifications and expected consumption
- Supply programme associated to the expected consumption
- Performance tied to the management of the core business

Key Elements for Success (3)

Lessons Learnt

- Clash of cultures
- Need to foresee behaviours
- Need to align management models with payment mechanisms
- Need to align non- compliance with relevant sanctions
- Ability to export improved behaviours

Overview of PPP Process

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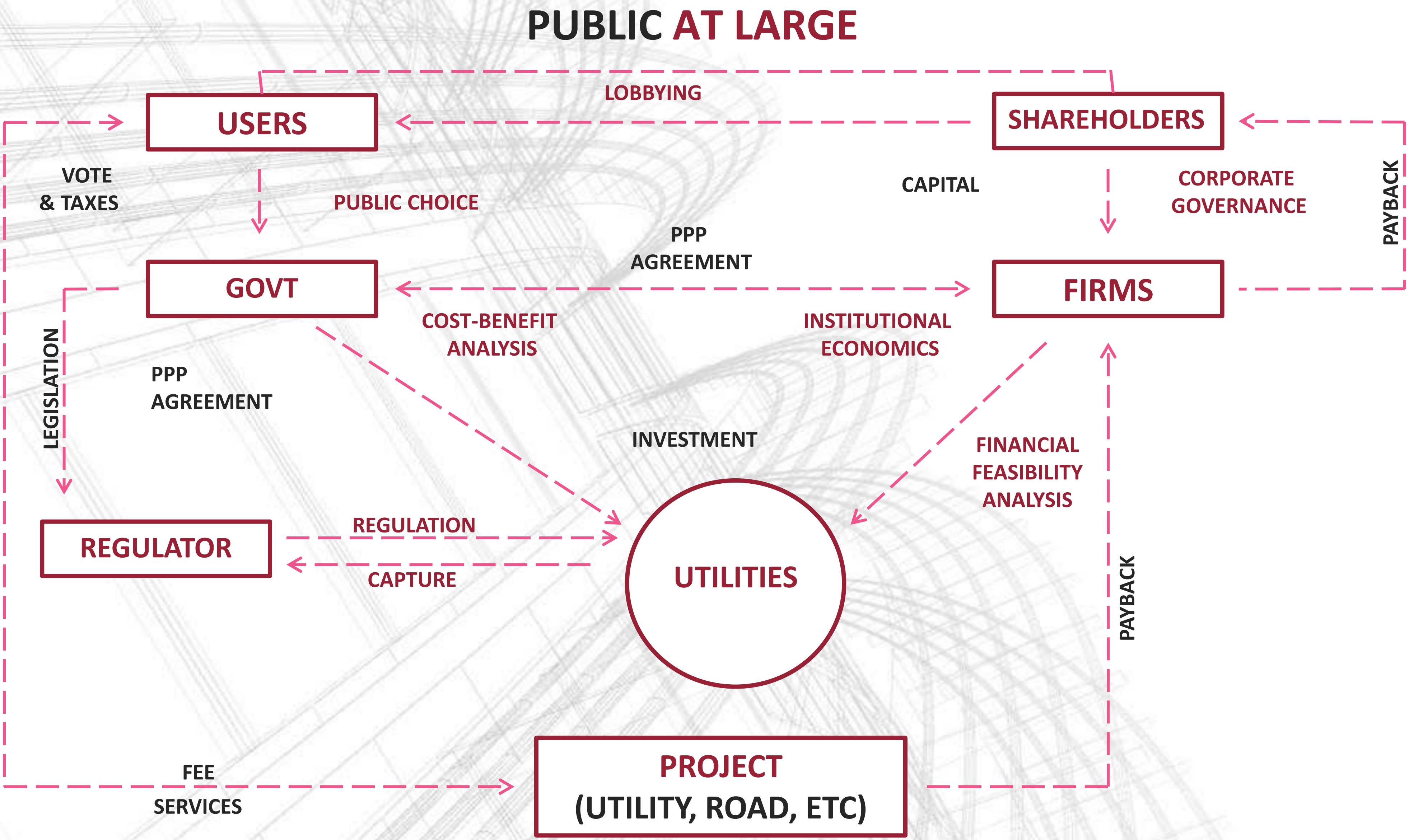

Thank you for your attention!

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