

P3 Lessons from Europe



By Robert Bain

Fifty semi-structured interviews were conducted with senior professionals involved in public-private partnerships (P3s) across Europe. Interviewees included bankers, equity providers, financial advisors, economic consultants, credit rating analysts, concessionaires and senior government officials. A variety of opinions were expressed yet recurring themes, or “lessons learned,” soon emerged. These lessons derive, not from theory or any particular political ideology, or from judiciously selected case-studies—often the case with P3 “research”—but from the collective experience of seasoned practitioners who have been working on P3s in various roles for nearly two decades.

Space constraints limit the detail that can be reported here. For the full survey results, see my website at www.robain.com.

P3s & Rail

The European experience of P3s in the rail sector—on high speed rail projects, airport links and underground metros—is one of mixed success. A number of high-profile projects have encountered problems or have failed to deliver the expected benefits. Interviewees felt that rail projects simply incorporated more risk than other asset classes, not all of which can be

anticipated at financial close.

Risks that have beset the European P3 rail sector have resulted from the sheer size (capital intensity) and complexity (technical intensity) of some deals. Large projects (\$1 billion+) may be attractive to a restricted number of bidders—limiting competition—and questions were asked about the ability of fixed-price contracts to deliver best value on highly complex projects when bidders respond by pricing-in significant contingency provisions.

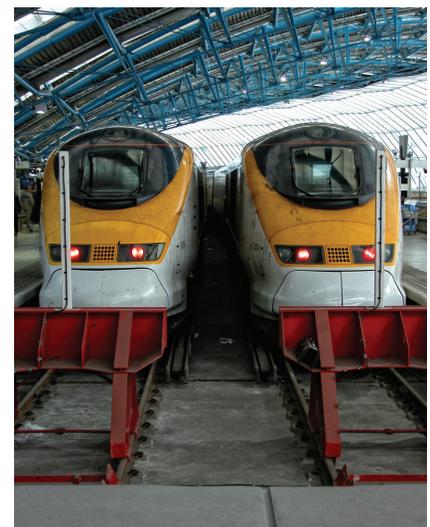
Interviewees also pointed to the multitude of interfaces with third parties that rail projects entail—over which the private sector partner may have little control—and the difficulties associated with accurate demand projections for services or passengers. High speed rail in particular requires low gradients, leading to more structures (bridges and tunnels—with increased geological risk exposure) and involves stringent engineering tolerances with low error margins.

In a number of jurisdictions, the approvals processes associated with rail—for licences, consents and permits—were reported to be unduly onerous; again exposing projects to the whims of parties disassociated with P3s (or possibly opposed to them). Additionally, resistance from within the sector was noted, from an ingrained

railway culture with traditional operating practices fighting against what it regards as creeping privatization. Finally, political risk loomed large as these projects feature prominently on politicians’ radar screens—such is their size, visibility and importance, and the fact that they typically require sizeable financial commitments from public sector budgets over many years.

P3s & Roads

Road projects on the other hand—highways, bridges and tunnels—were reported to “sit” much more comfortably with the P3 procurement philoso-



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P3s Work Best When:

- Projects have a strong policy rationale, retain characteristics of essentiality, and enjoy broad public support and political commitment.
- Service outputs can be clearly defined and specified contractually.
- The integration of various project and financing contracts makes sense.
- They are applied in mature, stable sectors where (a) the pace of development is gradual and (b) service delivery requirements and usage are predictable.
- Real competitive tension can be maintained throughout the procurement phase.
- Transaction structures avoid over-sophistication and projects retain sufficient financial (and contractual) flexibility to accommodate departures from expectations.
- Applied to straightforward assets of a modest size (P3s sit less comfortably with highly complex mega-projects involving major technical challenges).
- Risk allocation appropriately reflects stakeholders' capabilities and capacity.
- Private finance (real 'hurt money') is at risk.
- They are selected because of efficiency and their value-for-money benefits (rather than being off-balance sheet, fashionable or the only game in town).
- The procuring agency commits to a long-term active partnership, is commercially literate, has strong negotiating skills and responsive decision-making processes.
- The procuring agency selects a sustainable private sector partner, not necessarily the cheapest provider.
- Used for separate, stand-alone projects with minimal interface risks.

Warning:

A project that does not make sense—or a contract that cannot be let to the market on a sensible basis under a traditional procurement model—is unlikely to be transformed by making it a public-private partnership.

phy, characteristics and requirements. Interviewees reported positive experiences with on-time and within-budget asset delivery. There were clear design/build (and build/operate) synergies to be exploited and good examples of private sector innovation with construction design, techniques and materials were noted. Projects tend to be relatively straightforward in this mature, stable asset class—factors contrasted with sectors such as health care (about which the P3 interviewees were much less enthusiastic).

Acknowledging the readiness of politicians to cut maintenance budgets during times of fiscal stress, interviewees highlighted the benefits of P3 roads in terms of ring-fencing future

maintenance expenditure. The corollary of this, however, is that during economic downturns politicians may seek to renegotiate or terminate P3 contracts if they want to scale-back pre-committed investment aspirations. This was undoubtedly one of the reasons why the remaining London Underground P3 was recently bought-out and brought back under public sector control.

A variety of payment mechanisms are employed on P3 roads throughout Europe. Talking specifically about user-paid tolls, interviewees pointed to the widely-acknowledged problems associated with over-optimistic traffic and revenue forecasts. One leading P3 lender noted that half of the toll

roads they were exposed to were underperforming; some by as much as 50 percent. Assessing willingness-to-pay appeared to be challenging for traffic advisors in both developed and transitioning economies, especially when toll tariffs were relatively expensive. However availability and performance-based payment mechanisms—and shadow tolls—incur problems of their own. Portugal had experienced difficulty servicing the aggregate state payments due to its P3 road concessionaires. The country is currently renegotiating contracts and switching some of its roads to user-paid tolls in an effort to reduce future state obligations. Concerns were expressed by interviewees that extended use of



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payment mechanisms which simply re-profiled government commitments could cause similar long-term affordability problems in other countries.

Despite this, the use of P3s in the European road sector was reported to be largely successful. Roads have been at the forefront of many countries' P3 programs and this trend looks set to continue.

Closing Comments

Throughout the interviews, comments were made about the strengths and weaknesses of P3s in different circumstances. The key lessons learned from the survey are summarized in the panel that accompanies this article.

Other frequent observations included the fact that P3s are not just about procurement—they're about long-term relationships; active partnerships between the public and private sectors. And the partnership model continues to evolve as different countries test the traditional boundaries between state provision and private enterprise. However, one issue above others stood out from the survey. P3s deliver best value when applied to distinct, stand-alone projects that can be separated operationally, institutionally and economically from other activities. Interviewees remained skeptical about the value-for-money benefits which could be realized from projects artificially carved-out simply to make them "P3-able." ○

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Robert Bain is the head of his own independent consultancy, United Kingdom-based RBconsult, conducting infrastructure investment analysis for banks, institutional investors and infrastructure funds. He is the author of several books, including "Toll Road Traffic & Revenue Forecasts: An Interpreter's Guide," available for purchase at www.artbastore.org. He can be reached at info@robbain.com.