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Opinion | the conundrum of PPP road projects

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The government should focus on making the project development ready at the time of award to attract more private sector interest, rather than changing the concession model

Developing road networks in a timely and cost-effective fashion plays an important role in economic development. In recent years, the government has extensively adopted the public private partnership (PPP) approach in road development. Today, India has the distinction of having the largest PPP programme globally in the roads sector. More than 560 road projects comprising a total length of 45,000 km with an estimated investment exceeding ₹200,000 crore have been awarded on PPP basis so far by the Centre and various state governments.

PPP road projects broadly fall in one of the two categories of toll or annuity, though many recent projects are being implemented under a hybrid annuity model. Toll and annuity projects vary mainly in the way the developers recoup their investment. In the former, the road developer collects toll from the users, whereas in the case of

the latter, the developer receives predefined annuity payments from the government. While the private developer assumes the demand risk in toll projects, it is not the case with annuity projects. With more than 75% of the PPP projects being implemented using the toll model, it remains the preferred approach for policy makers.

A basic difference between the toll and annuity projects is in the risk-reward equation. In the case of annuity projects, the developer does not assume any demand risk, but the upside is capped. However, in toll projects, the private developer assumes the demand risk, but would also benefit if the traffic growth is more than what is assumed.

Investment in toll projects

While PPP in roads has multiple objectives, the fundamental reason for going for the PPP route in India is that it helps to attract private sector capital. Private developers will consider bidding for toll-based PPPs if they see a sensible risk-reward balance, because the private sector by its very nature will pursue the path of higher returns rather than settle for modest returns. If the scales can be tipped towards private sector investing in toll projects, it would reduce the fiscal burden on the public sector. Under what conditions would private

developers invest in toll projects? A comparison of toll and annuity projects provides some pointers

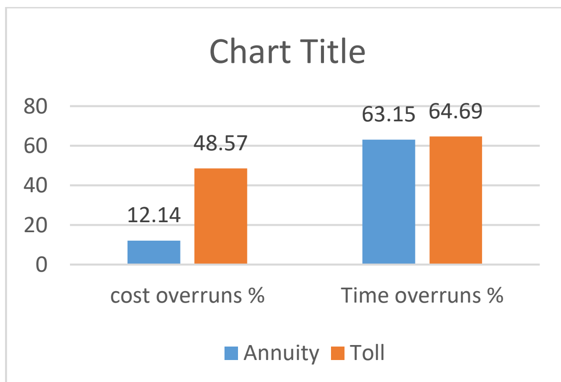
Comparison of toll and annuity road PPPs		
Characteristic (in average values)	Annuity	Toll
No. of projects	48	154
Length (in km)	68.84	95.32
Lane (in km)	130.86	197.08
Total number of structures in the stretch (major bridges, minor bridges, culverts and flyovers)	134	177
Concession period (in years)	18.2	22.9
Estimated project cost (in Crore)	320.44	392.11
Unit project cost (in crore per lane-km)	2.84	2.18
Debt to equity ratio	6.57	2.68
Net state domestic product (in crore)	17846.9	27380.11

Toll projects in general are characterized by longer stretches, and therefore higher project costs. They also have more structures as compared to annuity projects, indicating that they could have a higher degree of complexity. But the estimated unit project costs are lower, indicating that developers are able to achieve economies of scale associated with longer stretches. The average value of state domestic product indicates that toll projects are seen in those states that are more developed and where economic activity is higher, indicating the possibility of higher toll collections. It shows that annuity projects have higher debt levels indicating

that lenders perceive a lower risk in such projects. But, more importantly, we can also see that private developers are willing to invest higher equity provided the expected returns from the project are also higher. The higher number of toll projects bears further testimony to the willingness of private developers to undertake the risk.

What has gone sour?

In the last few years, it has been an open secret that the response from developers to new projects has been poor. Since many of the PPP road projects have begun operations only recently, it is too early to comment on the gap between the actual and projected traffic estimations made by the developers. However, what has happened is that the estimated project costs have significantly escalated in the case of toll projects, hitting the project economics.



The chart gives a comparison of cost and time overrun between toll and annuity projects that have begun operations. While there is negligible difference in the case of time overruns, the difference in the case of cost overruns is quite significant. A comparison of the actual unit costs is even starker: the average actual unit cost for toll projects has been ₹2.94 crore per lane-km, whereas for annuity projects, it is lower by 32% at ₹1.99 crore per lane-km.

Way forward

As the government embarks on the next phase of road development by adopting the hybrid annuity model, treating the disease is more important than curing the symptoms. If the objective is to trigger renewed interest for private sector investment in road projects, changing the concession structure should not be the first action taken. It is more important to understand the reasons behind the cost escalations. While it would be easier to criticize the private sector for their optimistic bias behind aggressive bidding, results indicate otherwise.

The toll projects are not as investment ready at the time of project award as compared to that of annuity projects. For example, toll projects took an average of 12.29 months to begin construction

from date of award while the corresponding figure for annuity projects was 10.05 months. The duration from the request for quotation to project award was 13.84 months for toll projects, whereas it was 10.71 for annuity projects. These indicate that toll projects are not sufficiently ready at the time of bidding, hinting at insufficient planning. This results in the private sector assuming or handling much of the pre-development phase risks—such as clearances, land acquisition, and so on, leading to increases in cost overruns. Ideally, these risks are better managed by public authorities. So, the crux of the matter is this: the government should focus on making the project development ready at the time of award to attract more private sector interest, rather than changing the concession model. That would lead to sustainable results, else the euphoria of the hybrid annuity model will be short lived too.

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Https://www.livemint.com/opinion/zfpxfks6q8no45hgv26nlm/opinion--the-conundrum-of-ppp-road-projects.html

Analysis of PPP

December 6, 2018

Morag Baird **Senior Manager at the Global Infrastructure Hub**

Two workers maintain installations on a skyscraper in Jakarta, Indonesia.

In the face of growing infrastructure investment needs and constrained budgets, many governments are increasingly looking to the private sector to bring expertise and financing to public infrastructure, most notably through public-private partnerships.

Over the past year, the Global Infrastructure Hub—a G-20 initiative—in partnership with Turner & Townsend, has looked at a large sample of PPP projects in the economic infrastructure sectors from the over 3,700 projects that reached financial close between 2005 and 2015. The analysis identified a number of key challenges that need to be actively

addressed during contract management. Failing to do so may jeopardize future projects.

The Rise of the PPP

PPPs involve a long-term contract between a public party—the procuring authority—and a private party for construction or rehabilitation, finance, and operation of an infrastructure asset in which the private party bears significant risk throughout the life of the contract. This approach has been used in a diverse range of markets across Europe, the Americas, Asia, Oceania and Africa. The UK is commonly seen as a pioneer in developing PPPs. The largest markets by number of PPPs include Brazil and India.

The majority of the largest PPPs by value between 2005 and 2015 were in the transport sector, where project size can exceed $1 billion, according to the Global Infrastructure Hub analysis. One of the key reasons for proceeding with an infrastructure project as a PPP is to achieve value for money over the whole life span of the project. A PPP contract typically lasts for more than 20 years after procurement, through construction and operations.

Allocating Risk

At the heart of any PPP contract is the allocation of risk between the public and the private partners. A substantial amount of effort will have gone into negotiating this risk allocation and reaching financial close—a moment of celebration.

At this point, most of the people involved in negotiating the deal move on to their next project, leaving a hefty contract document in the hands of the government procuring authority. If a project is not effectively managed after financial close, the allocation of risks agreed at financial close may be seriously undermined. Even a well-structured PPP contract can end badly.

A common misconception exists where governments believe that they will need less capacity if they shift the risks and burdens that come with infrastructure projects to the private sector. This is naive optimism. Governments need to actively manage PPP contracts to be effective. The staffing requirements of the contract management team should consider the agreed risk allocation, including the risks that have been retained by the procuring authority or are inherent to the procuring authority, such as social risks or counterparty risks.

Learning from Past Partnerships

Through our analysis of PPPs, we identified common challenges and best practices. Most of the sample projects are still ongoing, with minimal cases of termination. However, almost half were renegotiated within the first 11 years, and a formal notice of dispute was issued on a quarter of the PPPs studied, for which dispute data was available.

Key challenges include:
Transitions:
All PPP projects go through major transitions between different phases of the project, from financial close to construction, construction to operations, and operations to handback. Each of these transitions is inevitably a period of substantial change. If handled inadequately, issues that arise during a transition period can persist throughout the life of the project.

Performance monitoring:
The procuring authority needs to closely monitor the performance of the project company to ensure that the service is being delivered as agreed. Shared understanding of the key performance indicators should be established from the outset, since parties may have an incentive to take advantage of ambiguous KPIs. Our research found

that 20 percent of disputes involved KPIs or performance monitoring.

Disputes:
Given the long-term nature and complexity of PPP projects, it is not uncommon for some sort of disagreement or dispute to occur during the contract management period. When disputes do arise, they need to be dealt with swiftly and in a cost-effective manner. The research found that a formal notice of dispute was issued in 25 percent of the PPPs studied (for which dispute data was available), with many occurring in the first four years after financial close.

Renegotiation:
Our data found that 45 percent of projects were renegotiated within the first ten years after financial close, with the highest rate of renegotiation being in the transport sector. Renegotiations can be necessary as a response to external changes and provide opportunity for better outcomes. However, they also have the potential to reduce transparency and jeopardize the credibility and efficiency of a competitive PPP procurement process, so they should be limited and managed properly.

Stakeholder management:
By their very nature, infrastructure PPPs involve a vast array of interconnecting relationships. The

success of any project depends on good engagement with end-users, businesses and the community, and this comes out very strongly in our detailed case studies. Proactive engagement with stakeholders was found to contribute to better project outcomes, as illustrated in the improvements in design of exits from the I-495 Express Lane project in the U.S.

Interfaces with other projects and agencies:
Relationship management and communication between government agencies and other infrastructure and utility providers is an important aspect. A major infrastructure project rarely exists in isolation to others, as illustrated in the Daang Hari-SLEX Link Road case study, for example. The identification of any adjacent and/or competing projects has now been introduced to the Philippine PPP Centre's project development and tender evaluation processes to mitigate the associated risks from the outset.

Insolvency:
Although insolvency of the project company itself was found to be rare (3 percent), the insolvency of key contractors was more than doubly common (7 percent). In the case of an insolvent contractor, the project company will seek to replace a key contractor as soon as possible. Working with the project company to agree to the appointment of an

appropriate replacement contract will typically be in the best interests of the project and the procuring authority.

Avoid Cruise Control

Our analysis found that pressure to fast-track issues at early stages tended to cause significant delays down the track. In projects where we have data on cause of dispute, “environmental and social” factors were cited as a cause in 17 percent of projects, and “land acquisition and settlement” was cited for 11 percent of projects.

PPPs can play an important role in addressing the global infrastructure gap. They can potentially draw benefits by using the best skill sets of both the public and private sectors. But it is important to recognize that they cannot be put in cruise control after the jubilance of reaching financial close.
https://www.brinknews.com/we-analyzed-over-3700-public-private-partnerships-heres-what-we-found/

Indian Government clears proposals to privatise six more airports

12 Novemeber 2018

The Government of India has approved a proposal to manage and develop Ahmedabad, Jaipur, Lucknow, Guwahati, Thiruvananthapuram and Mangaluru airports under a public-private partnership (PPP) model. The airports will be handed over to PPP operators that are currently managed by the Airports Authority of India (AAI). The government's experience of managing five airports in Delhi, Mumbai, Bengaluru, Kochi and Hyderabad through the PPP model has been encouraging.

In addition, the government has decided to use the same methodology to manage a further six aerodromes. A group of secretaries from the Ministry of Civil Aviation and departments of economic affairs and expenditure, headed by NITI Aayog CEO Amitabh Kant will decide the deal's scope.

The latest government decision is expected to attract more foreign investment in airport infrastructure and deliver efficiency, as well as professionalism in airport service delivery.

PPPs in airport management has enabled the government to gain substantial revenue and use the model for better air connectivity between the country's cities.

The latest cabinet decision comes 12 years after Delhi and Mumbai airports were privatised.

Civil aviation market in India has been expanding at a rate of 19% over the last four years. It is estimated to be the third largest in the world by 2025, behind the US and China.

The government seeks to boost passengers' number from 265 million in 2017 to approximately one billion over the next ten to 15 years.

To manage the burgeoning number of travellers, the government has announced plans to start a big airport-building and upgrade project estimated to cost nearly Rs2tn ($27.57bn) over the next ten years.

https://www.airport-technology.com/news/heathrow-selects-sita-transform/

Revival of PPP model and alternative funding for infra projects future of infrastructure development

Published: September 17 , 2018 by UNI

Revival of PPP model and alternative funding, like InvITs and credit enhancements, after the exit of PSU banks from infrastructure lending, are the way forward for infrastructure development of the country.

The PSU banks have moved away from infrastructure lending, owing to the asset liability mismatch in their balance sheets and tightening of the RBI norms, a senior official of IIFCL said at a panel discussion on India's Infrastructure Needs at MCCI Economic Forum. "The average maturity period of deposits with PSU banks is five years,

whereas they need to fund infrastructure projects for 20-25 years, which has caused the asset-liability mismatch in their balance sheets, causing piling up of NPAs," the official said.

Faulty project appraisals were also cited by RBI for the rising NPAs of the PSU banks and as many as 11 PSU banks went under the central bank's scanner under its Prompt Corrective Action (PCA) framework, he added. The senior official said that IIFCL was spearheading credit enhancement scheme for the government. "While bank deposits have a lower maturity period, pension insurance schemes have a longer maturity period and are ideal for infrastructure projects. However, the pension funds require investment in projects with a minimum of AA, and infrastructure projects are rated BBB or less," he said.

IIFCL was piloting a scheme, where the company would give a non-fund based guarantee, raising the rating of the infrastructure project to AA, he said. Some projects under this scheme have been successful, he informed. "InvITs, in which assets are housed in the mutual fund and the investors can buy those units, are also happening," he said, and added that a developed corporate bond market was also essential for the development of infrastructure in the country, which was "not happening at the moment".

Private sector lending to infrastructure projects have also ceased as the government has moved away from BOT(Build, Operate, Transfer) model, he said. "The government has very timely realised that the BOT model is stalled for some time, and brought in the Hybrid Annuity Model(HAM)," he remarked and added that the IIFCL was the front-running lender of the NHAI's project under this model.

http://www.uniindia.com/revival-of-ppp-model-and-alternative-funding-for-infra-projects-future-of-infrastructure-development/states/news/1352812

Will Public-Private Partnerships Be Productive for India?

By **Nandika Chand** -August 6, 2018

The Government of India has been working towards evolving the people's power in governance as functionaries and facilitators. Public-Private Partnership (PPP) model is the core of it. This is an arrangement of a government and a private entity, for-profit or non-profit, undertaking a traditional public activity. PPP is also described as one government unit and a consortium of private firms created to initiate and bring about major civic redevelopment projects.

Government budgets and aid alone cannot ensure that everyone gets access to sanitation, water, and electricity. But reports show that there is no guarantee that PPP models will lead to successful achievements of set goals. According to UNECE's *Revised Guiding Principles on People-First Public-Private Partnerships for the United Nation's Sustainable Development Goals*, "most of the PPPs have been undertaken in fully developed Western countries with mature economies."

World Bank Group's senior director for infrastructure and public-private partnerships, Laurence Carter said PPPs can involve the private sector in making public services more sustainable, more efficient and cost-effective.

"In India's Odisha state, an International Finance Corporation (IFC) supported PPP has upgraded street lighting while cutting energy consumption by up to 80 percent. This is a win for both the environment and strapped municipal budgets."

However, the PPP model remains to be much better identified on the basis of many common issues. The *Revised Guiding Principles on People-First Public-Private Partnerships for the United Nation's Sustainable Development Goals* argues

that "governments using PPPs introduces a dangerous profit motive in the delivery of public services."

The government and its partners need to work in a transparent and committed manner. According to the World Bank, enabling a framework for PPPs needs to be strengthened with independent regulators. "In terms of transactions, India needs to focus on sectors other than transport and power and customize the PPP architecture to suit each sector.

A people-first approach is needed. This will prioritize the value for people. It will also foster access to essential public services for all where sustainable development as its objective and putting people first at the core.

https://thepolicytimes.com/will-public-private-partnerships-be-productive-for-india/

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