PPP AWARENESS WORKSHOP
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IDENTIFICATION OF INFRASTRUCTURE PROJECTS

1. *THE NEED FOR A SIMPLE PROCEDURE FOR PRELIMINARY IDENTIFICATION OF POTENTIAL PPP PROJECTS.*

Experience from several countries with highly competent civil administrations indicates that most authorities have limited experience in identifying infrastructure projects potentially suitable for PPP procurement. In particular the authorities appear to have difficulties in managing the often complex identification and assessment techniques set forth in handbooks and papers on PPP.

Clearly, there is a common demand for a relatively simple procedure for preliminary identification of potential PPP projects which can be performed in-house that is without engaging external consultants and commissioning complex and time-consuming assessment studies.

2. *PREMISES FOR PRELIMINARY IDENTIFICATION OF PPP OPPORTUNITIES.*

Identification of national infrastructure needs. Public infrastructure master plans.

The need for a particular infrastructure project is usually identified and analyzed by each government agency within its infrastructure authority. The government agency will estimate the national or regional demand for electricity, transportation, telecommunication, water and sanitation and other infrastructure services to be generated by a particular project and outline the proposed location, size, technical requirements, costs, environmental conditions etc. for the project.

According to conventional, administrative practice each authority (government agency) will develop a master plan identifying all its needed and outlined infrastructure projects and defining project priorities over a period.

The authority will then focus on the possibility of satisfying its infrastructure needs by using one or another form of financing. Assuming that the authority, broadly, has followed the above mentioned identification process one of the financing possibilities may be a PPP approach.

Application of PPP concession arrangements.

A PPP is a partnership between the public sector and the private sector for the purpose of delivering an infrastructure project and/or an infrastructure service traditionally provided by the public sector. There exist a number of possible PPP structures, from service contracts, management contracts and leasing contracts to concession contracts and private divestiture, each structure requiring its particular terms and conditions (see handout on Alternative PPP Structures. A Survey).

In the following it is assumed that the majority of national authorities responsible for infrastructure development primarily are looking for PPP structures where the private partner provides for the financing of an infrastructure project, combined with the obligations to design, construct / rehabilitate and operate the project. Such PPP

concession structures have so far been applied to app. 75 to 80 % of the PPP projects currently in place world wide. Reflecting the experience that PPP concessions may be a healthy way to advance infrastructure development in countries where the availability of public capital is constrained.

For a preliminary, in-house identification of project candidates for PPP concessions the national authorities are recommended to consider the following, simplified criteria (3).

3. *CRITERIA FOR PRELIMINARY IDENTIFICATION OF POTENTIAL PROJECT CANDIDATES FOR PPP CONCESSION PROCUREMENT.*

Is the particular project a priority project in the authority's infrastructure master plan ?

Strong authority commitment is essential to the implementation of any concession infrastructure project. The private sector's interest in a concession project is therefore strengthened considerably if the project under consideration has a high priority in the authority's infrastructure master plan.

Some countries have applied a strategy according to which conventional public financing have been used for infrastructure projects with high national priority, while alternative financing, including concessions, have been advocated for infrastructure projects with lower priority rating. Experience clearly indicates that such strategy has not worked in favor of attracting private financing.

Can the particular project be made financially viable?

A crucial issue for the authority is to estimate whether a priority project can be made a financially viable entity under a concession arrangement. This is particularly important under a concession arrangement where the substantial debt of the private investors usually are repaid to the lenders from the revenues generated by the project only ("limited recourse" or "project financing"). To attract private investors and their lenders it must be demonstrated that the project most likely can generate revenues over a projected concession term sufficient for repayment of estimated construction, operation and maintenance costs and for providing a commercially acceptable rate of return on equity.

Various techniques are used to determine financial viability under different scenarios. At this preliminary in-house identification phase a simple cash flow analysis may be sufficient to indicate whether the project in question can be made financially viable and accordingly attract private investors.

Note that while the authorities tend to calculate cash flow before tax, private investors (and their lenders) obviously are more interested in net cash flow after tax.

Revenue flows are usually contract based (for energy projects by a long-term" take-or-pay purchase agreement) or market based (that is determined by utilization levels and tariffs/tolls).

Expected tariff structures and future utilization levels should be assessed realistically. At this preliminary identification phase, however, no extensive studies of, for instance, past traffic levels, future growth potential and the economic impact of options for users to drive on slower parallel routes are required.

Are the customers able and willing to pay for the concession infrastructure service?

In many cases the tariffs or fees to be paid by customers for electricity, water and sanitation services etc. may be reduced by concession arrangements.

If that ,however, is not the case, the public demand and " willingness-to-pay" for a particular, but more expensive infrastructure service may be a key factor in the successful implementation of a concession project.

Each infrastructure authority is recommended to make a preliminary assessment of whether the customer charges needed to make a concession project financially viable are publicly acceptable, including an assessment of whether:

- the charges for the service (tariffs, fees, tolls etc.) are affordable for the majority of customers ;
- the majority of customers are willing to pay toll for improved road service or increased tariffs for improved electricity, water and sanitation services etc. ;
- a concession project for any other reasons might become a politically sensitive issue. Despite the often positive aspects of private participation in infrastructure development, experience has shown that concessions can provoke political and social problems related to payment for infrastructure services, privatization under foreign ownership, fear of workers lay off and so on.

Will a concession arrangement create a private, national monopoly or extensive exclusivity which may harm future competition?

A common concern for the authorities and for the infrastructure customers is that a concession arrangement may create monopoly or extensive exclusivity rights for the private investor for a long-term period or "lock in" the authority to concession terms dictated by current market conditions. This may have a negative impact on the project costs and customers' payment and may constrain the authority's ability to promote competition and innovations into the service provisions at a later stage.

In worst cases private monopoly and exclusivity may provide for excessive ("windfall") profits for the private investor and preclude future developments within an infrastructure sector, as has been experienced in several emerging countries. There are efficient legal and contractual remedies against such private exploitation of concessions; but for different reasons such remedies have not always been applied.

Technical assessment. Is a concession arrangement particularly suitable to meet the technical requirements of a priority project?

When identifying potential concession candidates a technical assessment of the priority project is important. Concession arrangements are particular suitable if an infrastructure project needs:

- advanced design, state of the art technology and know-how, including equipment and processes, which public procurement of the project, currently, cannot be expected to provide ;
- faster construction of the project than conventional public design and construction currently can provide ;
- improved quality of infrastructure services to the customers in accordance with internationally recognized standards;
- enhanced management of the operation and maintenance of the project compared with the management competence and capacity of existing public utilities. By transferring the management of public infrastructure to a private concessionaire, the officials of the authority will reduce their scope of work to infrastructure planning and performance monitoring and leave the

management of day to day delivery of infrastructure services to the private investor.

Priority projects for which the need for such improvements, inherent in a concession approach, is particularly noticeable may be identified as potential concession candidates.

Is the expected support to a concession project from the responsible authority available?

To attract private sector interest in a concession project the responsible authority, as a minimum, must be able to ensure the following public support to the project:

- Acquisition of land rights or land use rights for the project;
- Available information about the ground and terrain conditions for the project;
- Access roads to the location of the project and supply from utilities;
- Acceptable environmental conditions for the project, including public arrangement for eventual displacement of population.
- Availability of national workforce for construction and maintenance of the project.

Environmental screening of each project.

For most infrastructure projects environmental screening, environmental impact assessment and the specification of environmental performance requirements according to national law are needed through all development phases.

For potential concession projects environmental issues assume a special importance since environmental requirements may have significant impact on the financial viability of the projects.

During the preliminary identification of possible concession projects the authority is recommended to perform only an initial environmental screening of each potential concession project. The screening should identify the likely impact of the project on all environmental media (air, water, soil) and also on concerned parties and impacted population, including populations needed to be displaced, if any.

Projects that at this screening stage are viewed as having significant environmental impact will obviously be regarded as less attractive by private investors than projects that have marginal environmental impact.

Is needed fuel supply for a project available and reliable?

The availability and reliability of long-term fuel supply is critical to the stability of some types of concession infrastructure projects, in particular power projects. Areas of particular interest for private investors regarding fuel supply include:

- Availability of the particular fuel needed for the project, based on long-term fuel supply agreements;
- Availability of back-up sources:
- Estimate of the reliability and creditworthiness of the potential fuel suppliers;
- Reliability of the fuel transporters if other than the fuel suppliers.

These matters are of less of a concern to private investors where the government furnishes or guarantees the supply of needed fuel.

May a concession arrangement provide additional, long-term benefits to national enterprises or regions?

The authority is recommended to assess whether a priority infrastructure project implemented under a concession contract may provide wider long-term benefits to national enterprises and/or regions.

Such additional benefits may include effects on employment, development of the skills of labor forces through work and training, access to better roads and utility services in the region, technology transfer and, in some concession projects, the establishment of long-term industrial cooperation with foreign concession companies, for instance in research and development. By including the provision of such benefits into the concession contracts some countries have developed highly competent national enterprises in partnership with the private investors.

Is it economically viable to develop the particular project by a concession arrangement?

The key purpose of the assessment of concession projects' economic viability is concerned with the best use of a country's resources rather than with the financial return to the private investors.

Economic viability or "ensuring best value for money" is a crucial criterion for selection of procurement options for infrastructure projects in countries with strong public budgets sufficient to cover infrastructure needs. When assessing whether a PPP concession contract is suitable for a particular infrastructure project in such countries, a concession contract will, in principle, only be used if it is reasonably expected to provide enhanced value for money compared with traditional public procurement methods.

For these recommendations for initial identification of potential concession projects, value for money assessment may be less important.

First, value for money assessment techniques are very complicated and time consuming and the results are only as good as the baseline information provided. At this preliminary identification stage the required baseline data will rarely be available.

Secondly, for most emerging countries the key objective by using PPP concessions is to attract much needed private investment to accelerate infrastructure provision and not the achievement of better value for money compared with traditional public financing of infrastructure.

These realities do not, however, prevent the authority from identifying master plan projects which from a broad, practical assessment may be expected to provide economic efficiency advantages under a concession contract compared with public infrastructure delivery. Factors determining value for money will obviously vary from project to project and between infrastructure sectors. Generally, however, PPP concessions will generate value improvements by such factors as:

- Competitive procurement;
- Strong performance incentives inherent in the concession structure;
- Faster construction of the project facilities;
- Reduced life cycle costs due to the long-term nature of concession contracts;
- Optimizing of project risk allocation:
- Private sector's management skill.

Recent studies in the UK and in Norway estimate the average savings (value for money) in net present cost terms of using PPP concessions at app. 20 % over the contract term.

These 10 criteria for preliminary identification of potential project candidates for concession arrangements are, of course, not exhaustive, nor are the criteria written in stone. They only highlight, in a simple form, the most relevant criteria for initial, in-house identification of possible concession projects on each authority's infrastructure master plan.