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# "Public Private Partnerships - an Evolving Model for Successful Infrastructure Delivery"

Plenary Session Presentation by:

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Introduction

My topic today comprises 2 elements – the first being the role that public private partnerships are increasingly filling in meeting today's transportation infrastructure demands and, secondly the evolution of the partnership models which has occurred over the past number of years.

As will no doubt be clear from the remarks by the earlier speakers, the issues surrounding public private partnerships for infrastructure delivery are reasonably well known. It is the response to those issues that has resulted in the evolution of the PPP model to which I will be referring.

My experience with PPP's has been in the highway sector and my remarks will focus on this aspect. I should also state that my background in PPP is from the private sector side of the equation and my remarks may reflect a slight bias in that regard.

I also currently serve as a Director of the Canadian Council for Public Private Partnerships, This organization, membership in which is open to anyone with an interest in PPP's, has a broader mandate. It provides a forum for discussion of key issues associated with PPP's among all stakeholders and has influenced the evolution of the PPP model in Canada.

As has already been mentioned, governments, the traditional providers of public transportation infrastructure, are under increasing fiscal constraints – demand for program funding in all areas exceeds the available resource. The response has been to move to the "user-pay" principle.

Governments are also loath to increase the level of debt carried on their books. Accordingly, they have turned to the private sector to bring investment and non-recourse borrowing capacity to projects, which can be shown to have a revenue stream through tolls – creating public private partnerships to achieve public policy objectives.

In recent years we have seen a number of initiatives throughout the world which have utilized the public private partnership model to deliver highway infrastructure with varying degrees of success. Andrew Johnson has stated that partnering succeeds when certain circumstances are present. Achieving these specific "success circumstances" has been somewhat of a trial and error process – the evolution of the model,

In Mexico, for instance, the highway concessions were granted to entities dominated by the major construction firms who viewed the projects as construction business opportunities. Construction companies, however, are hampered in their core businesses if their money is tied up in long-term concession investments rather than being available for ongoing construction activity. Coupled with the 1994 peso crisis, Mexican highway concessions underwent a massive restructuring.

This is a clear example of the absence of the required cultural change among all partners that Andrew [Johnson] identified.

Chile, with significant highway development requirements but with population (and therefore potential traffic for tolled highways) concentrated in two or three locations, and having witnessed the Mexican experience, structured its concession program to require significant equity participation by concessionaires. Given that specific routes offered for concession included substantial non-urban components and hence were unlikely to generate sufficient revenue to give comfort to investors, the government provided a revenue “floor”, measured against the traffic forecast provided with the Request for Proposal- a reasonable approach to achieving its objective of highway development.

Chile offered a series of concessions sequentially. As a result, lessons learned from prior arrangements resulted in “fine-tuning” of the concession model, including the level of government support, the level of equity required, and the toll adjustment mechanisms. This continues today as new concessions are offered.

The UK, in upgrading, expanding, and extending almost 600 km of its highway network was successful in attracting approximately $1.2 billion in private sector investment through the use of shadow tolls. One of the principles adopted by governments has been that application of tolls to existing “free” highways or extensions to them is not acceptable to the taxpaying public. Shadow tolls, paid by the government against measured traffic are used to cover the operating, maintenance and debt service costs of the highway. These arrangements are a form of government guarantee, which attracts investment, transfers risk to the private sector and avoids an increase in the public debt. This does not achieve the non-recourse financing which Steve Beatty mentioned.

The Government of Canada adopted a similar approach in the development of the Confederation Bridge, essentially guaranteeing a revenue stream equivalent to the revenues of the then existing ferry system which the Bridge replaced,

In discussing evolution, it should be noted that highway infrastructure paid for through tolls is not new. In Canada toll roads and bridges have existed from time to time, usually developed by government or quasi-governmental bodies with tolls discontinued when the cost of the particular facility had been recovered – the Autoroute des Laurentides in Quebec and the Burlington Skyway are two such examples. Here in Nova Scotia the Canso Causeway was tolled until 1992

In other jurisdictions, notably France and Italy, tolled highways have been in existence since the 1950's. In the US, quasi-governmental toll authorities have operated tolled highways for many years.

So what differentiates a Public Private Partnership from these other forms of infrastructure development?

In the first instance, a PPP involves significant shifting of risk away from the government. Steve Beatty has already touched upon this in his remarks. These include:

- traffic risk (although the degree of risk transfer varies as I will discuss in a moment)
- construction completion risk (both with respect to cost and schedule)
- operation and highway availability
- financing risk

The underlying principle for a successful PPP is that the risk be borne by the party best able to manage or influence the outcome. Much of the evolution in the PPP model hinges on the delineation of the sharing of the risk.

Coupled with this risk sharing, PPP's allow the public sector to tap the innovation of the private sector to finance (most desirably on a non-recourse basis), design, build, operate and maintain a superior highway facility without compromise to safety, quality, and environmental protection.

On the Highway 407 project, for instance, the Ontario Transportation Capital Corporation (OTCC), the special purpose entity created to execute the development, design, construction, operation, and maintenance of the highway contracted with the private sector to actually carry out the work. At the outset, the private sector also offered financing but the province, noting the premium in borrowing cost as a result of the assumption of traffic and construction risk by lenders, opted to self-finance the project and assume those risks. The subsequent sale of the concession, after the road had been in service for several years and traffic levels were known, provided a significant premium to the province over the original cost as well as obligating the concessionaire to construct new sections of highway to the east and west.

At the bidding stage for Highway 407, Proponents were invited to indicate the commercial conditions associated with two possible agreements – a concession and a design-build agreement. Accordingly, the sharing of risk between the parties was, in the first instance, defined by the Proponent. Once the government had made the decision to self-finance, a suitable agreement was negotiated.

The Cobequid Pass Highway here in Nova Scotia utilized a slightly different model – the key characteristics included:
relatively low forecast traffic levels
substantial construction cost ($112 million)
the existence of an alternative route which bypasses the tolled Cobequid Pass Highway

Offsetting these was the existence of federal-provincial funding which covered approximately 50% of the capital cost of the project.

In this case, and no doubt with benefit of the Ontario experience, the principal conditions of the contract were stipulated in the Request for Proposals. While this went some way to defining the risks to be assumed by the parties, there were matters of concern to the private sector constructor and the lenders which were the subject of extensive negotiations. Indeed, it is worth noting that very often it is the lenders who impose conditions relative to construction completion and operating and maintenance criteria.

This project was the first highway in Canada, at least in modern times, which involved private sector funding.

My next example, the Cross Israel Highway, involved the provision of a complete Concession Agreement with the Request for Proposals. While most of the terms and conditions were similar to those which might be seen in other jurisdictions, there were unique requirements, such as the exclusion of terrorist acts and acts of war from the definition of Force Majeure, which were not acceptable to either the Concessionaire or the lenders. Here is a clear example of the need for the public sector partner to assume

those risks which it can best manage or influence and which the private sector cannot reasonably undertake.

The public sector agency invited comments and alternative contract clauses from proponents and, while not all were accepted, incorporated many which assigned risks more equitably.

This approach, namely the provision of a draft concession agreement with an invitation for comments, has become more the norm for PPP's, at least in Canada. The Fredericton-Moncton Highway Project and the recent transfer of Highway 407 to the private sector followed this approach, as has the Government of Ontario in some non-highway related privatization initiatives.

Some draft agreements, usually drafted by legal counsel for the public sector agency and accordingly biased toward that client, contain provisions, which, if accepted, would transfer unacceptable risk to the private sector. Increasingly, however, provisions for comment allow proponents to point out which risk transfers are unacceptable, either because the proponent would have no control over that risk or because a monetary value cannot be determined and included in the financial model.

In a recent example in the US, all proponents indicated to the public authority that, if proposals were sought based on the draft Concession Agreement as presented for review, no proposals would be forthcoming. Remember, too, that in this case, as is usual, proponents had been prequalified and represented the 3 or 4 most credible potential concessionaires.

How successful have these public private partnerships been?

In my opinion, the Canadian examples namely, Confederation Bridge, Highway 407, Cobequid Pass and the Fredericton-Moncton Highway projects have achieved the objectives of the respective governments. While the specific objectives vary among the jurisdictions, the one overriding factor has been the speed with which the construction can be completed and new infrastructure placed into service. Traditional public works infrastructure development has been constrained, chiefly by funding availability, from rapid delivery.

In the case of Highway 407, relief of congestion on the major east-west routes through Toronto, principally Highway 401 was, and remains a key objective. The current Concessionaire is obligated to maintain capacity and hence the desirability of using Highway 407 in support of this objective. The central section of Highway 407 was completed about twenty years earlier than if the traditional approach had been adopted.

Cobequid Pass, on the other hand, was constructed to achieve the highway safety objectives of the government of the day, by bypassing the old highway 104, now Trunk 4, through the Wentworth Valley. Statistics bear out the success of this initiative. It is my understanding that there are other highways in Nova Scotia that might be candidates for a PPP approach although the current political climate in Nova Scotia with regard to tolling is in opposition to this approach.

The Fredericton-Moncton Highway, despite the decision to not assess tolls, is meeting or will shortly achieve the objectives of relieving congestion on a highway that was

experiencing heavy traffic volumes for which it was not designed and which thereby compromised safety.

Is the PPP model successful? I believe that it has proven in many instances to be the best way for governments to

- institute the user-pay principle for new infrastructure,
- leverage private sector investment,
- obtain high quality facilities at lower cost and in a much shorter period of time, and
- transfer risk of financing, design, construction, operation, maintenance and rehabilitation

Has the PPP model evolved? Without a doubt jurisdictions all over the world have, through direct experience and by studying what is happening elsewhere,

- developed a process to identify qualified candidates for partnership,
- come to understand what risks are reasonable to transfer to the private sector and which are more appropriately retained by government,
- created frameworks for presentation of partnership agreements to prospective partners and for early dialogue with respect to those agreements

Will PPP's continue to evolve? Absolutely!

Every PPP infrastructure project is unique in many respects but the underlying principles remain the same. Public and private entities will continue to seek ways to most appropriately deliver high quality facilities at the lowest cost, on schedule to meet society's requirements.

Finally, study after study by municipalities, provinces, the federal government and private institutions demonstrate that the need to maintain and develop transportation infrastructure greatly exceeds the financial capacity of our public resources. We cannot afford to ignore the PPP model. All of us, whether in the public or private sector, need to recognize this fact and find innovative ways to develop and manage the timely and effective delivery of needed infrastructure.

Thank you.