Infrastructure investment in the transport sector - can PPPs deliver value?

DBSA Transport Integration Workshop

30 October 2012

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PPP'S

Key Issues in Procurement

> Key Issues in PPP Procurement:
  - Standardisation?
  - Factors that affect timing?
    - from identification of service need to ultimate service delivery
  - Factors that affect costs?

> Three distinct phases:
  - Pre-procurement- Business cases, skilling up
  - Procurement – probity, bidder strategies, BAFO's, innovation
  - Post-procurement – transition, sustainability

> Current contracting models

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The Transaction

> Procurement cost and time drivers:

- Complexity?
- Whole-of-life focus?
- Developing inputs to meet output requirements?
- Lack of a standard approach and documentation?
- Market maturity in certain sectors?

> Need to focus on service delivery timeframe not procurement timeframe!

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Focus of talk

- What Public Private Partnerships (PPPs) are and what benefits they can bring to the partners
- The key features of PPPs that lead to such benefit
- A brief review of the application of PPPs in some southern / east African rail operating concessions
- Lessons regarding the applicability of PPP to projects that may support minerals development

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What are PPP's ?

- A contract between private supplier and public agent
- To deliver a project to serve the public (road / bldg etc)
- Innovative funding options to facilitate project delivery
- Sharing of risk between public and private sectors
- Best for complex, high value projects, hence publicity!

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What are they used for?

- To increase speed and quality of procurement
- To reduce public sector financial exposure
- To circumvent public sector inertia or vested interests
- To 'market test' the value of a public product / service
- A niche in the infrastructure delivery environment

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Procurement Options – 1

- Traditional procurement: public sector designs, procures and manages contract and provides service
- Private sector design and constructs (D&C), with public sector role limited to the service provision
- Design, construct and maintain (DCM); public sector responsible for non core services – various options
- Public Private Partnership; with private sector contracted to take 'cradle to grave' responsibility

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Procurement Options – 2

- Sliding scale of public/private participation depending on the type of project, client needs

	Increasing role of the private sector			
Private party role	Infrastructure services only	Infrastructure and ancillary services	Infrastructure and partial private-to-public service delivery	Infrastructure and service delivery to users
Government role	All public-to-public services	Delivery of core public services	Delivery of core public services	No operational role
Example	Public buildings	Non-core hospital services, non-judicial court services	Community facilities linked to educational facilities (e.g. after-hours usage)	Roads, rail, port facilities, car parks

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What's in it for Government?

- Offset of public borrowing needs; payment deferral until service delivery; penalties for non-delivery
- Greater cost, time and quality certainty because of private finance bank due diligence requirements
- Hence ability to align projects with the electoral cycle or to coincide with events (2010 World Cup!)
- Ability to deliver projects that may never have proceeded (toll roads + Gautrain in South Africa)

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Public perspective on PPP's

- Initial perception of PPPs was of 'financial benefits to the private sector at the expense of the taxpayer'
- The traditional perception has been that 'public sector' control is the way to safeguard public benefit
- Successful delivery of public infrastructure and services PPPs is changing such perceptions
- PPPs increasingly accepted as a means of bringing private sector efficiency to public facilities delivery

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Do PPP's give value for money

- Net cost to government by public procurement can be cheaper – on the assumption of most efficient public sector method of providing a defined output

- But, taking account of the risks of cost and time overruns and whole life quality management, delivery by PPP offers more security of public value

- Nevertheless, in Australia, PPP is the construction industry's least preferred procurement method - they have to carry more risk, but they deliver well!

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Australia- case study

- PPP's on average have been 30% better in meeting budget and cost certainties

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Evidence in the UK

- In 2009, over 65% of PPP projects on time and budget (vs. 30% in 1999)

[Opening the UK's first High Speed Rail line]

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Why the improvement?

- Rigor in aligning design to client specification
- Hence clarity regarding outputs being purchased
- Huge incentives to private sector for timely delivery (and penalties if not!)
- Whole of life costing gives predictability to public sector budgeting

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Key characteristics

- Technical innovations and whole life costing
- Rigorous project evaluation and robustness testing
- Focus on project delivery - to time and budget
- Move from construction focus to a service culture
- Spread / share capital costs and so relieve tax burden

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Key benefits

- Efficiency and innovation – not cheap finance
- Quality outputs - specified by the public sector
- Linking public sector's social and strategic aims with private sector commercial expertise and funds
- Usually offer greater certainty of cost and delivery

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Lessons from PPP rail funding

- Underestimation of infrastructure costs + little if any control over mode choice of potential customers
- Neither the public nor the private party can afford to fill the revealed rail infrastructure funding gap
- The PPP method seems to have been applied naively to projects that have little commercial value
- Lesson: test intrinsic project value before selecting the preferred procurement / investment model

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Lessons from SOE rail funding

- Over (??) investment in rail infrastructure despite little if any control over the mode choice of users
- Funding is affordable only because of monopoly control of parallel revenue sources (ports / pipeline)
- PPP not likely because no commercial value (even though public ownership is not optimising public value)

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Do any good value propositions exist in the rail transport sector?

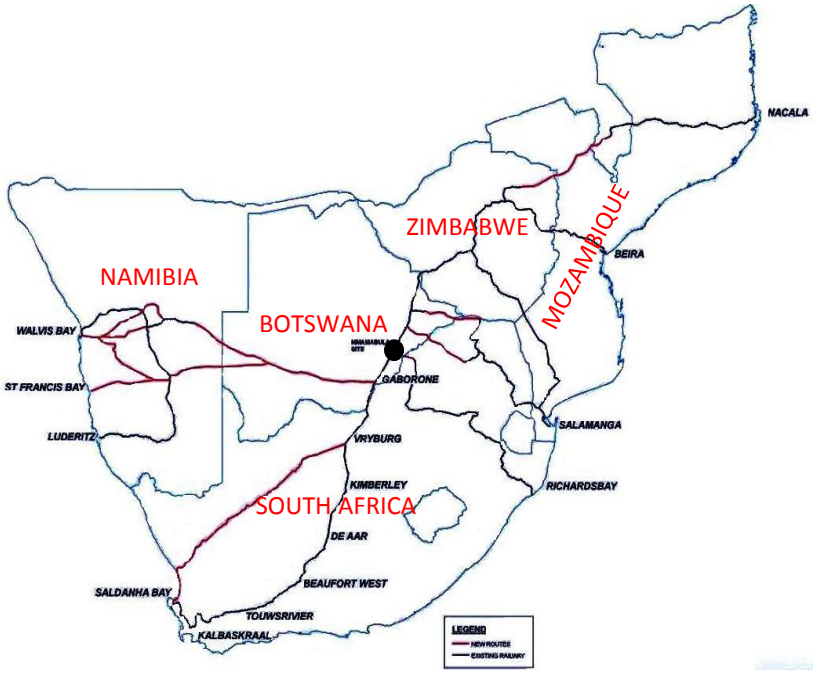
- YES – for very high bulk mineral transport
- YES – long distance, double-stack containers
- YES – urban transit in dense metro areas
- NO – general freight of low and medium volumes

Case Study

Background to TKR

- Botswana/ Waterberg endowed with significant coal resources
- Landlocked - coal stranded with no export outlet
- Richards Bay rail line severely constrained
- Coal producers want to capitalise on limited window of opportunity - coal will not be fuel of choice in the long term
- Concept studies undertaken looking at various export options - option to go West deemed as best option.

Concept Study Routes



Case Study

Background to TKR

1. **PRIVATE, COMMERCIAL 1600km, Heavy–Haul Rail Line with Freight Capacity**

2. **Connecting RSA, Botswana and Namibia**

3. **Associated Port and Terminal facility**

4. **CAPACITY – 1st phase 50 - 80 Mil ton / year with subsequent phases subject to demand**

Case Study

Background to TKR – the Challenge

Service existing market

- BPC expansions are expected to increase Morupule's market in the short term
- Morupule's existing market is not expected to grow significantly in the medium and long term as future power expansion programmes are expected to be linked to coal mine development projects
- Existing power markets will not deliver the growth required by Morupule management, shareholders and other stakeholders

Establish a link to RBCT

- A rail link from Botswana to Witbank is not in Transnet's or Botswana Rail's immediate plans
- Should such a line ever be established, the current Witbank to Richards Bay line will still result in a bottleneck without a significant upgrade
- Indicative cost calculations are in excess of R30bn for the upgrade alone
- Can Transnet and Botswana Rail deliver?

Secure offtake on a new rail line

- Any new line will take 5 years to implement and construct
- The line will require Government approval
- Botswana and Namibia have agreed at government level that a Trans Kalahari line is a commercial imperative
  - Government support will be the deciding factor as to which route will be developed

Case Study

Background to TKR

- A Private Consortium proposed the establishment of a Trans Kalahari railway line that will primarily link the Botswana and Waterberg coal resources to a Namibian port through which coal and other commodities can be exported:
  - Dedicated heavy haul commodity bulk line
  - To be built and operated on international best practice
  - Optimum efficiency
  - Dedicated port capacity

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Conclusion

- A case for Government involvement occurs when there is demonstrable public benefit but where this cannot be captured fully either by private sector risk taking or by pure Government funding.

- So Government takes advantage of private financial and technical efficiencies together with Government funding as a means of securing public objectives.

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Conclusion (c'tnue)

- In the case of SA's Gautrain, PPP has led to efficient procurement. The main economic value of the project lies not in the procurement efficiencies (nor indeed in the immediate transport efficiencies) but in the urban economic benefits which the project supports.

- Project succeeds because a PPP was used in the context of an appropriate technology being applied to clearly identified economic value. The public sector is 'purchasing' public value from the private sector concessionaire.

PPP'S

Conclusion (c'tnue)

- In many African rail concessions inadequate attention was given to the ability of the technology (general freight rail) to deliver the value that the respective parties thought they were purchasing.

- As a consequence, one or more parties in the PPP lose out. This has not been because there is anything intrinsically wrong with the PPP method but simply that the value proposition was wrongly understood and technology inappropriately applied.

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Conclusion (c'tnue)

- Where public value can be demonstrated and the application of technology is appropriate to the business in hand and the project can be fully funded privately, public sector partnership with the private party is not a project necessity, though Government participation may be sought e.g. for strategic economic reasons

- Very high volume bulk mineral exporting railways, as some in Australia, (and possibly Trans Kalahari coal?), and transcontinental container railways in the USA

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Conclusion (c'tnue)

1. Where the basic public value proposition is poor and / or the technology application inappropriate, then a PPP cannot 'magic' a viable solution

2. Where the public value proposition is good and the technology application appropriate, yet private funding is insufficient to capture the public value, then a PPP might well be the right solution.

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Conclusion (c'tnue)

3. Where the value proposition is good and technology application appropriate, and private funding is sufficient, then a PPP is probably not needed.

4. However, if a Government does want to secure a share in the public value creation, it could still consider a PPP as an option, although simple equity participation might be a better approach.