Insight

Can P3s be top trump in quest to fund infrastructure?

By Dominic Leadsom - Head of Infrastructure, Canada

US President Donald Trump promised a $1tn infrastructure programme in his first speech to a joint session of Congress at the beginning of March. Public Private Partnership (PPP or P3) could be a prime option for leveraging the investment – but it is crucial to get the risk balance right.

All eyes were on the Oroville Dam in California in February. At close to 800 feet tall it is the USA's biggest dam and was struggling with a damaged spillway and monsoon level rainfall that meant the reservoir behind it was 98 percent full.

Fortunately-fears of the dam overtopping and mass flooding downstream on the Feather River were avoided by some clever emergency repairs. But the incident brought home to everyone that if big infrastructure were to fail, it would fail big with potentially very severe consequences.

Money needs to be spent quickly on upgrading the USA's existing infrastructure and building new to underpin economic growth. According to the American Society of Civil Engineers, the total figure required by 2020 is a staggering $3.6tn[1].

It is something not lost on President Donald Trump, who has promised to meet almost a third of this demand with an investment of $1tn of infrastructure during his term in office.

How to fund this ambition and produce results in a short period of time is the challenge, when historically delivering can be a notoriously long drawn-out process.

President Trump is not alone with the conundrum. According to the World Economic Forum, in order to support a future world population of nine billion people, an estimated $5tn needs to be invested in global infrastructure every year[2].

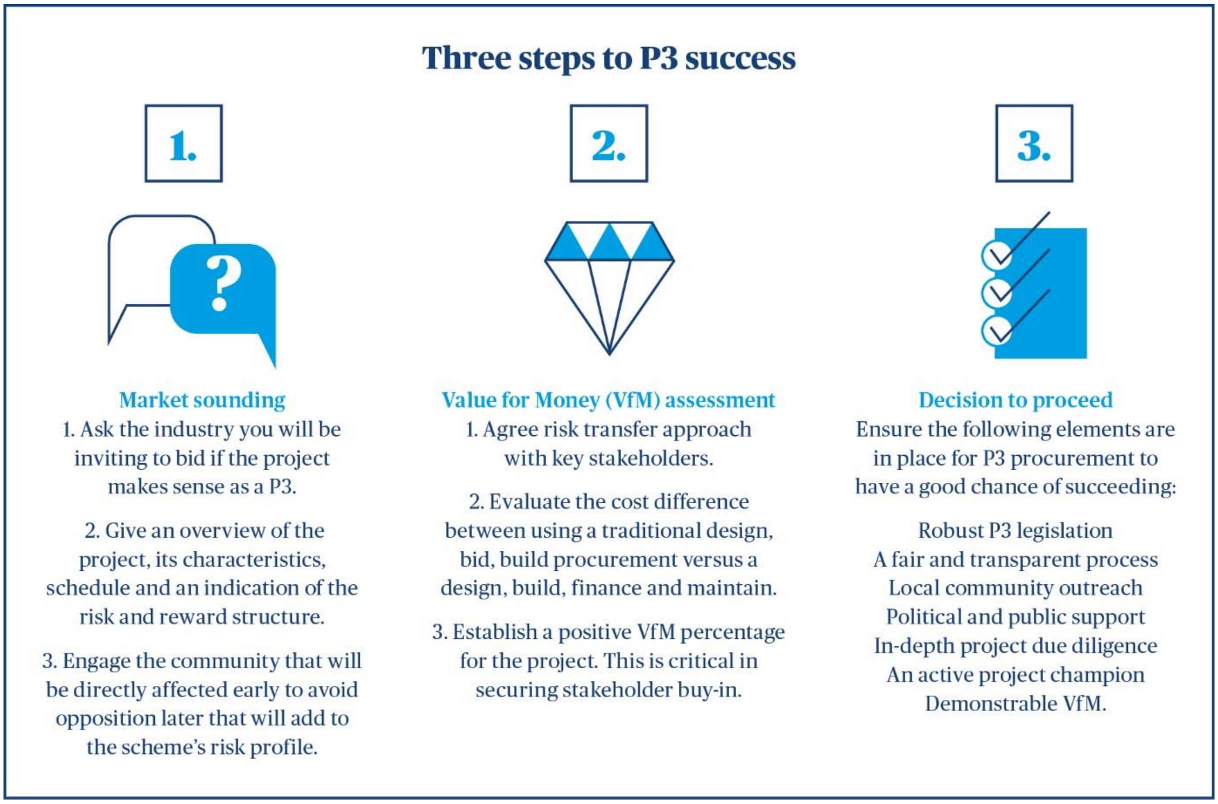
While governments do not have the spending power to meet the demand for infrastructure, need is driving a more realistic view on risk. This means private sector capital investment funds are increasingly targeting infrastructure as a stable asset class able to deliver the long-term, reliable returns their investors are demanding.

Time for P3s

Public Private Partnership procurement arrangements, or P3s as they are known in North America, are one of a suite of potential solutions which can be accessed to meet this need. It successfully combines the relative strengths of both public and private sectors in a delivery model which increases likelihood of delivering to

[1] http://www.infrastructurereportcard.org/

[2] http://reports.weforum.org/green-investing-2013/required-infrastructure-needs/



time and cost. President Trump has himself signalled that P3s will be part of his strategy.

P3 procurement not only accesses private capital for public works but brings in private sector expertise on a service basis that incentivises delivery of infrastructure to time, on budget, with potentially innovative solutions that drive value for the public purse in the long term.

A best value blend of risk sharing between public and private sector is developed ensuring effective performance of the infrastructure, from design and planning, to ongoing maintenance.

Long-term value is driven by adopting the whole-life approach to service delivery including passing maintenance and in some cases operations to the private sector for up to 30 years. Service levels are driven by an incentivised payment mechanisms that raises performance standards throughout the lifecycle. The public sector pays for this serviced asset via combined availability and performance payments, which can be off-set where third party revenue is available directly via tolls or user fees.

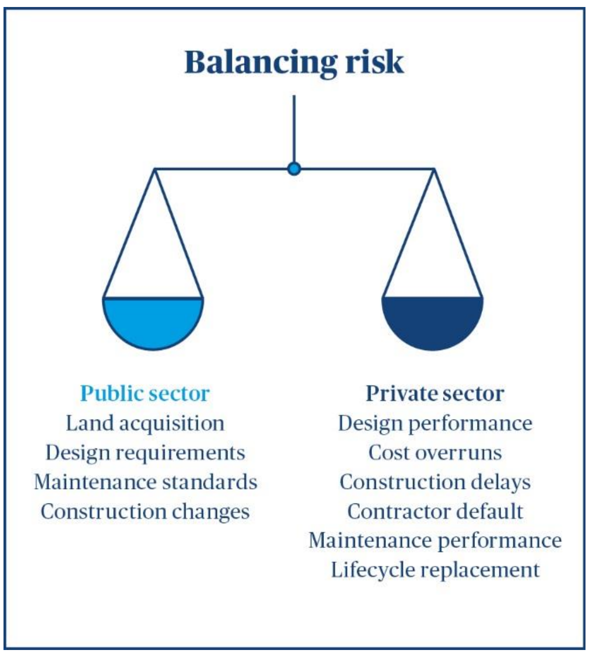
In the past, the public have been suspicious of a procurement method that has seemed to deliver super-profits to the private sector from government assets. With succeeding enhancements however, a significant proportion of these perceived super-profits are now captured by the public sector to invest in subsequent schemes.

Getting the risk balance right

For P3 clients in North America, Europe, Africa and Australia, understanding which risks to transfer and how best to transfer them to the private sector is the key to unlocking private sector investment, and demonstrating value to taxpayers and government officials.

Get the risk transfer balance right and the public sector will get an asset they need, delivered quickly and on budget, to bring benefit to the local economy. It will also mean the private sector is carrying enough responsibility at the right price for the public to see that it is getting value for money.

It’s a fine line to tread. There can be a temptation for the public sector to transfer or retain too many of the risks, for example during the establishment of the design parameters. By delivering a reference design that is too prescriptive, private sector innovation is limited. Conversely, a demonstrably deliverable scheme at a reasonable level of risk attracts bidders and will result in better value bids.



Driving real value

The more complex the asset being delivered, the more sensitive the risk transfer becomes. The key to effective risk allocation is to fully recognise the risk, establish which party is best placed to manage the risk and use the project documentation to effectively retain, share or transfer the risk. It should not be forgotten that not only are bidders competing for the investment opportunity but promoters are also competing, through the attractiveness of the deal, for private sector investment.

There is no standard template for risk transfer. The maturity of the local market, evidenced through successful closing and delivery of P3 projects, as well as the capacity of the public and private sector in the market, will determine the approach to effective risk allocation. Government agencies and end users need experienced advice, based on an understanding not only of how to structure P3 procurement documents but also what the private sector consortia and lending groups will accept.

Is P3 the right approach?

When used for the right type of asset with well-structured documentation, P3s can deliver needed infrastructure in a more cost and time-efficient manner than traditional procurement models. In a changing world, where the need for urgent infrastructure renewal is outpacing governments’ ability to pay for it, P3s can unlock private sector capital innovation, allowing alternative procurement structures to be developed. P3s could therefore form a key part of the Trump administration armoury for delivering on its infrastructure promise.

Leading the way

In recent years, Canada and Australia have been leading the way in P3 projects. In Canada almost $65bn worth of infrastructure has been built with healthcare and transportation accounting for close to $50bn of that investment.

P3 procurement enables the rigour of financial due diligence when applied to public projects, which can test whether the scheme is viable, the solution is optimum and the price is right.

The state-of-the-art Forensic Services and Coroner’s complex in Toronto is an example of a successful P3 project.

About Turner & Townsend

Turner & Townsend is an independent professional services company specialising in programme management, project management, cost management and consulting across the real estate, infrastructure and natural resources sectors.

With 97 offices in 41 countries, we draw on our extensive global and industry experience to manage risk while maximising value and performance during the construction and operation of our clients' assets.

For more information please contact
Dominic Leadsom
Head of Infrastructure, Canada
t: +1 416 925 1424
e: dominic.leadsom@turntown.com

For further information on any of our services visit our website
www.turnerandtownsend.com

© Turner & Townsend. This content is for general information purposes only and does not purport to constitute professional advice. We do not make any representation or give any warranty, express or implied, and shall not be liable for any losses or damages whatsoever, arising from reliance on information contained in this document.
It must not be made available or copied or otherwise quoted or referred to in whole or in part in any way, including orally, to any other party without our express written permission and we accept no liability of whatsoever nature for any use by any other party.