Applying PFI to the Infrastructure and Service Requirements of Developing Countries

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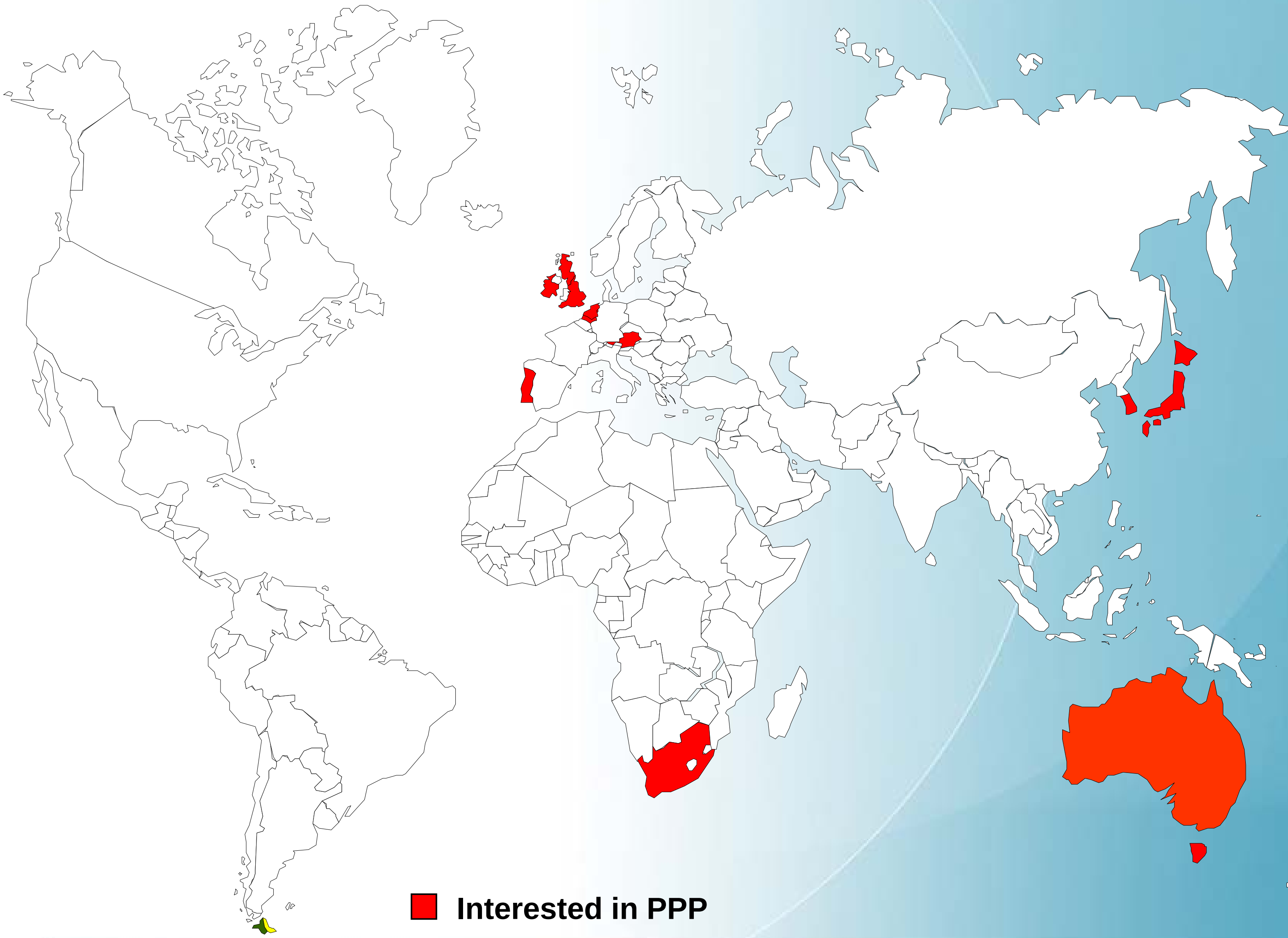
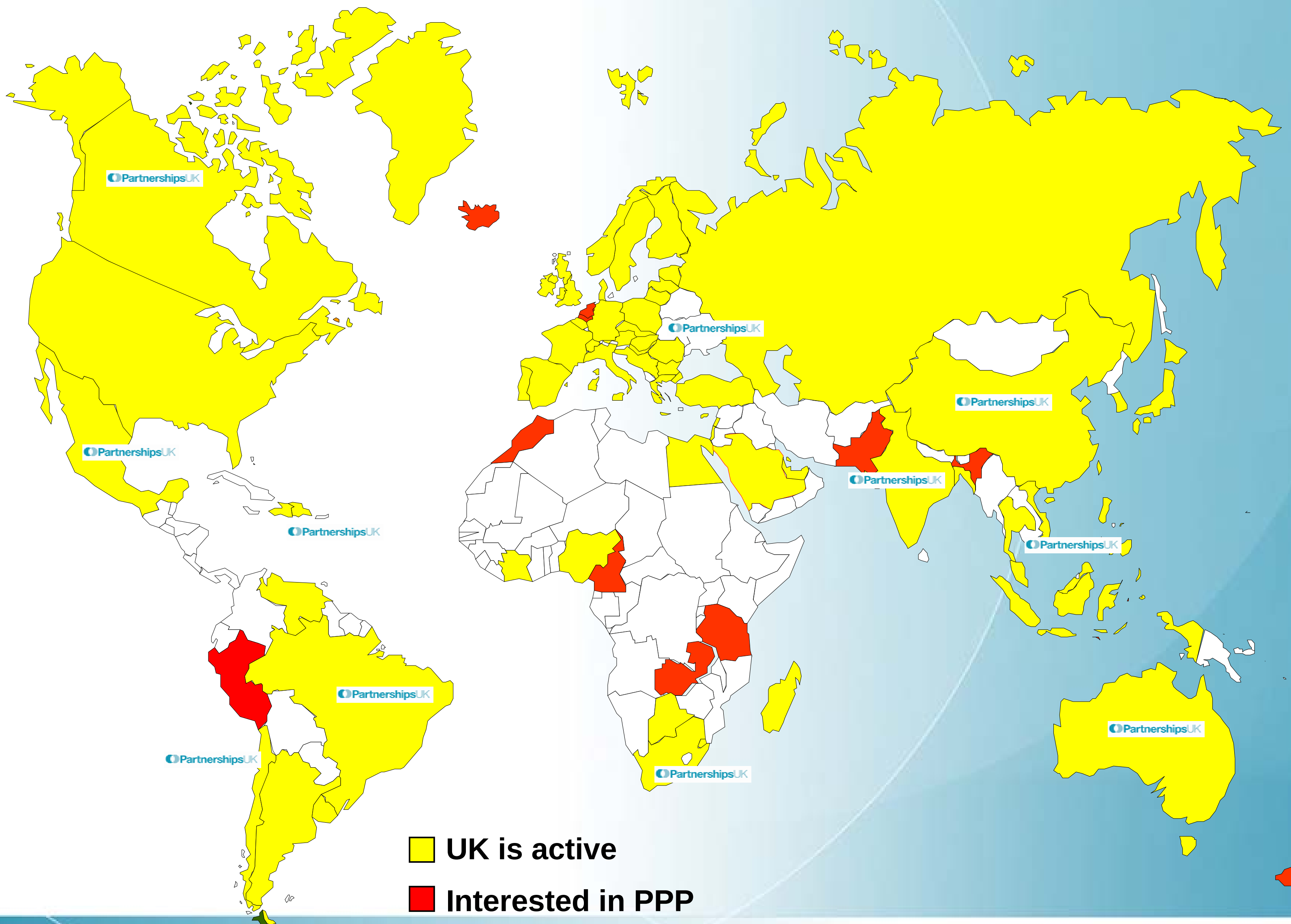
9th December 2006

International - PPP in 1999



PUK International Support - PPP in 2006



What is PFI?

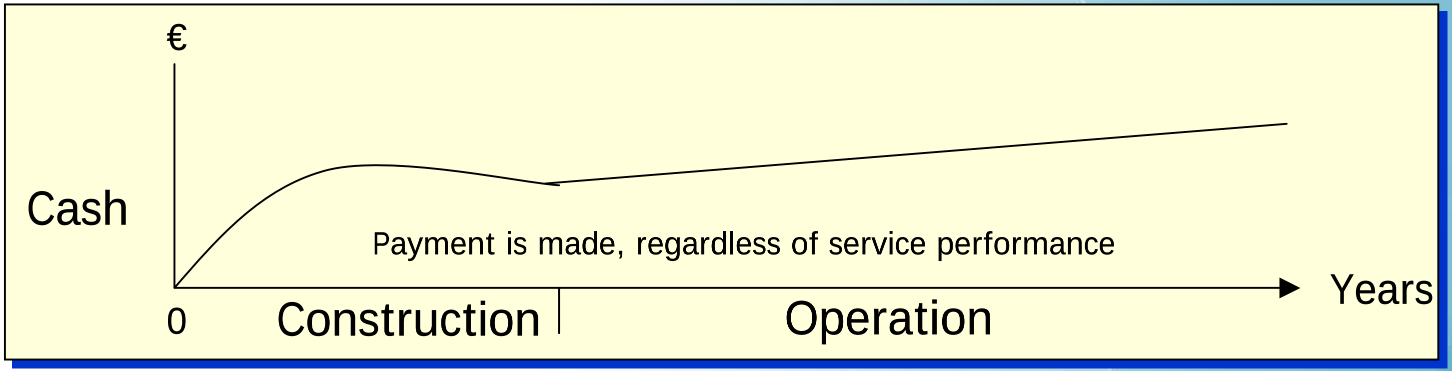
- PFI is an arrangement whereby a **public authority** contracts to purchase **services**, defined in terms of the authority's **output** requirements, on a **long-term basis**, so as to take advantage of private sector management skills, incentivised by having private finance at risk.
- The private sector contractor **designs, builds and operates** the infrastructure and, for some sectors, core services as well. Banks and/or the bond markets provide the **debt** which, typically accounts for 90% of the investment required. The balance of 10% is provided as **equity**, typically by private equity funds.
- Payments commence only once the service is up and running satisfactorily and those payments are spread fairly evenly over the whole life of the concession so that private sector returns remain at risk throughout
- The contractor is obliged to achieve the output requirements **throughout the life** of the concession. A **self-monitored** (but rigorously audited) performance measurement regime determines the **level** of payment received. A fall in performance is results in payment **deductions**. Very poor performance can lead to **termination** of the concession with little or no termination payment.

So…The Core Characteristics of PFI Are…

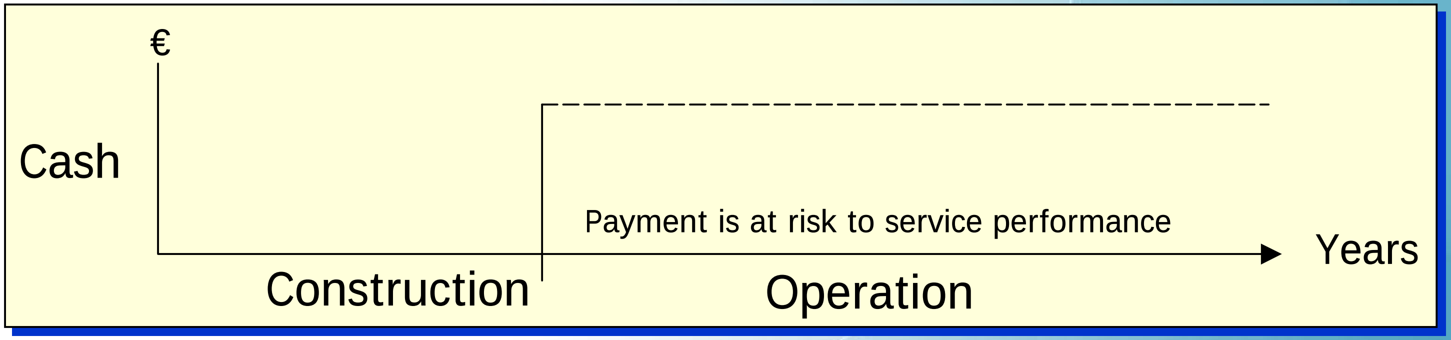
- Capital at risk
  - Private sector incentives to complete on time and at cost – high level of due diligence introduced by funders
- Fixed Price
  - Certainty of whole-life costs
  - Certainty of whole-life investment
- Output-based
  - Payment relates as closely as possible to delivery of "public good" rather than inputs

Public Sector Cash Expenditure Profiles

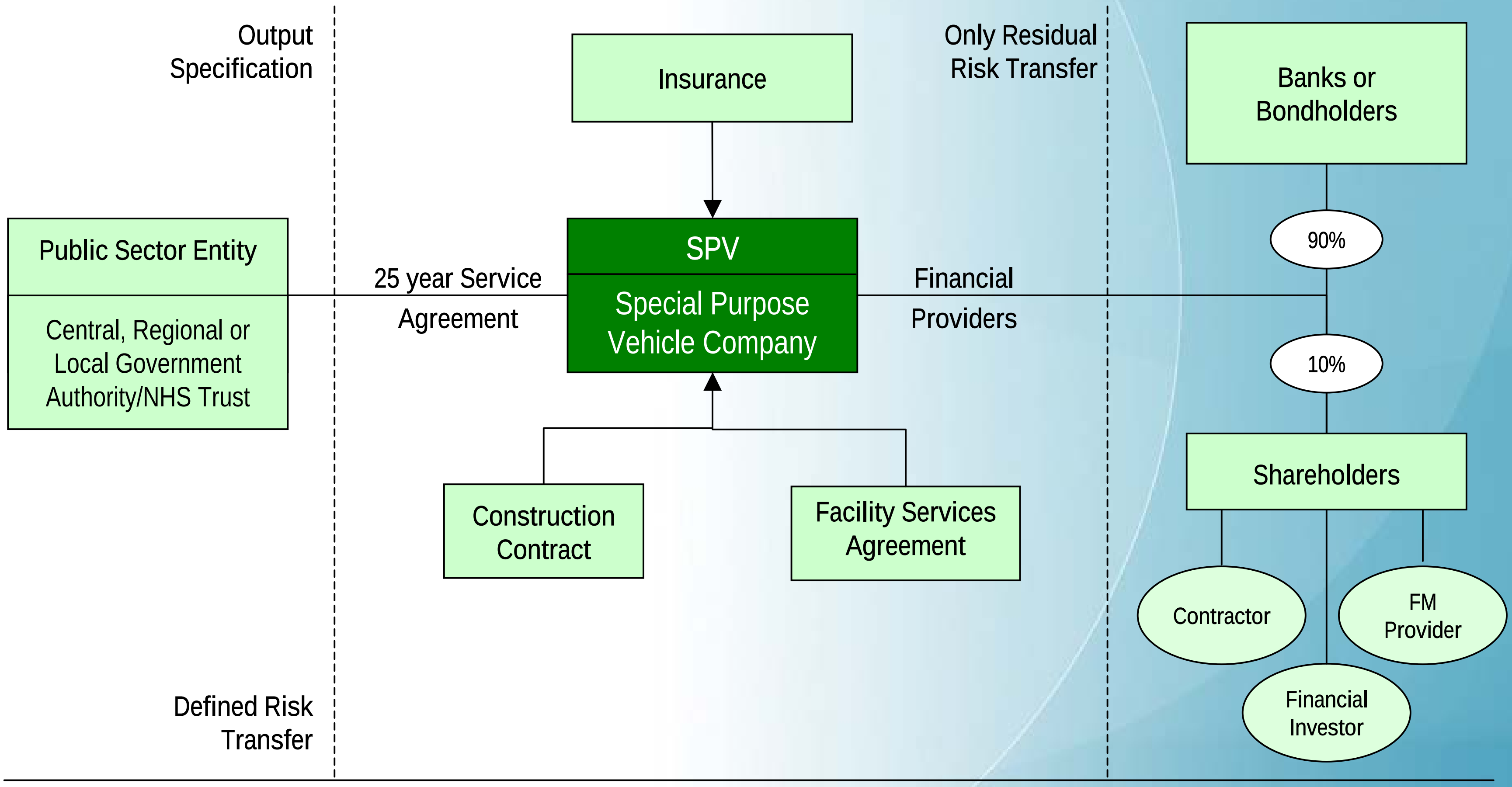
(A) Conventional (input-based) procurement



(B) PFI (output-based) procurement



Overview: Typical PFI Structure

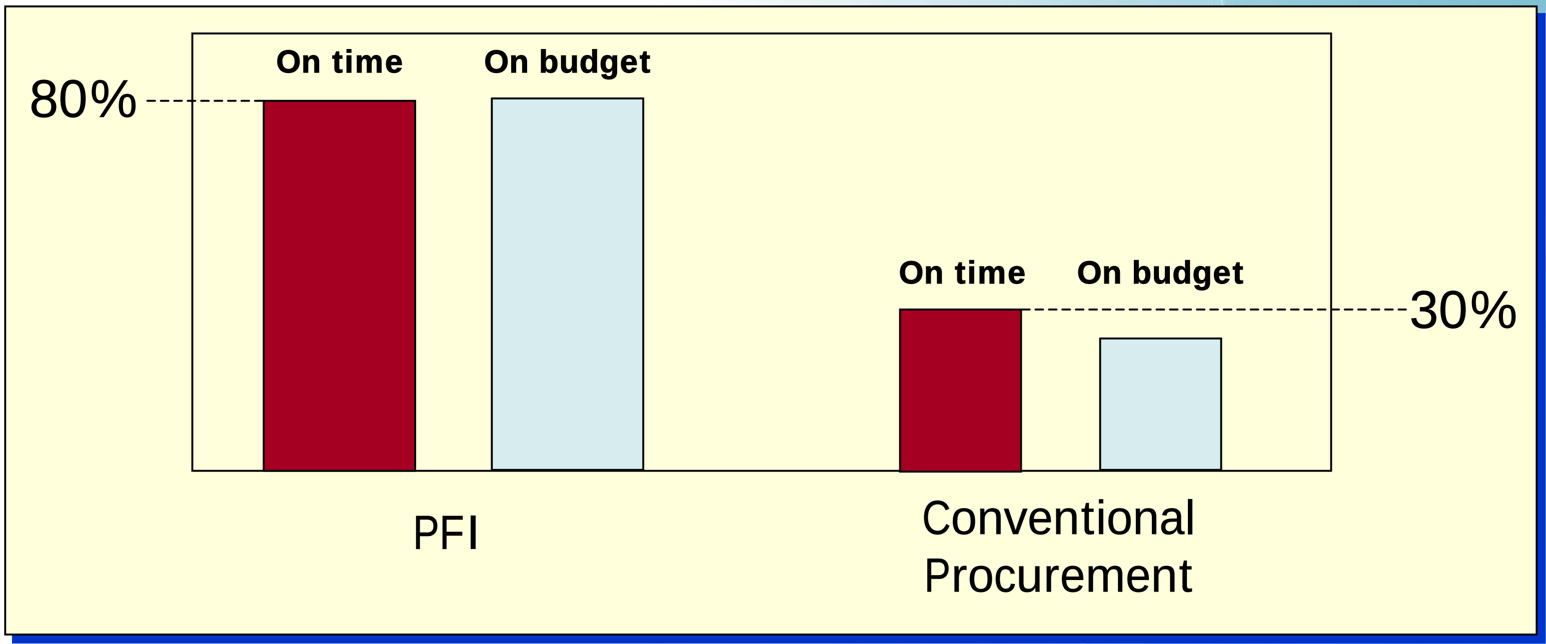


What Problems is PFI Seeking to Address in the UK?

- Government authorities having limited capacity and capability to contract manage complex infrastructure projects
- Projects being poorly prepared, leading to frequent scope changes, resulting in time and cost overruns and suffer from systematic “optimism bias”
- The infrastructure provided is frequently not maintained properly, resulting in backlogs of maintenance and a rapid erosion in the functionality of the public services delivered from that infrastructure
- The sclerotic effect of restrictive working practices

Comparison with Non-PFI Procurement - Evidence

<u>Delivery on time and on budget</u>



Performance of completed projects – No. of Projects

<u>Sources</u>
National Audit Office – UK Parliament - Expenditure Auditor

UK Experience - PFI

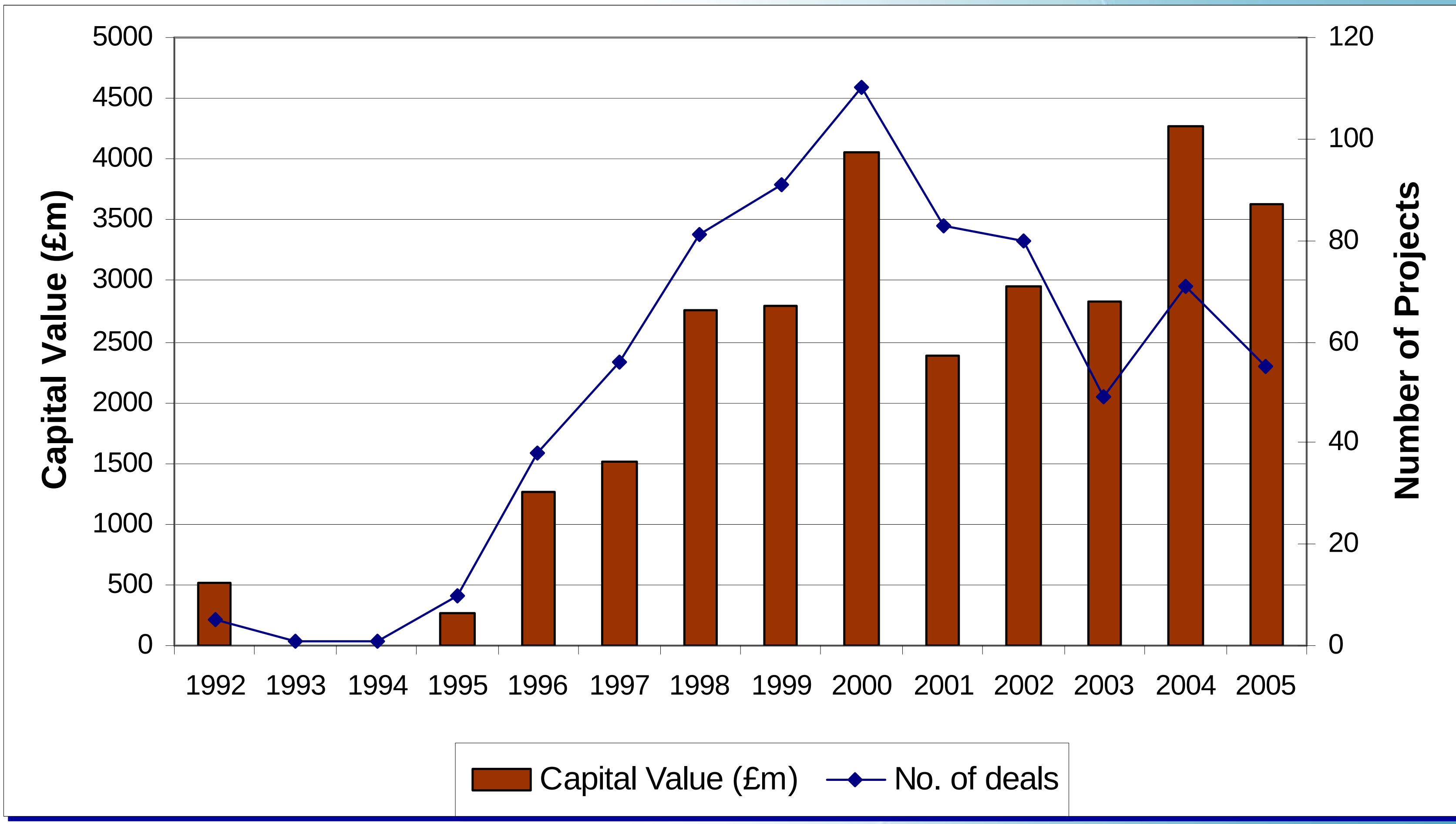
Almost 700 PFI Contracts Signed

£40 Billion Capital Value

Over 450 Projects now operational

£4 Billion p.a. of new projects in procurement

Signed Deals and Capital Value by Financial Year



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Modernising Public Sector Client-Side Skills and Transaction Capability

Key Objectives
- Do deals
- Standardise contracts
- Develop departmental capability

Private Sector Expertise

1997 — **Treasury Task Force**

Taskforce, recruited from private sector, is launch pad for PFI / PPP implementation

1999/00 — PartnershipsUK

Task Force evolves into PUK, with additional remit for Wider Markets and Commercialisation

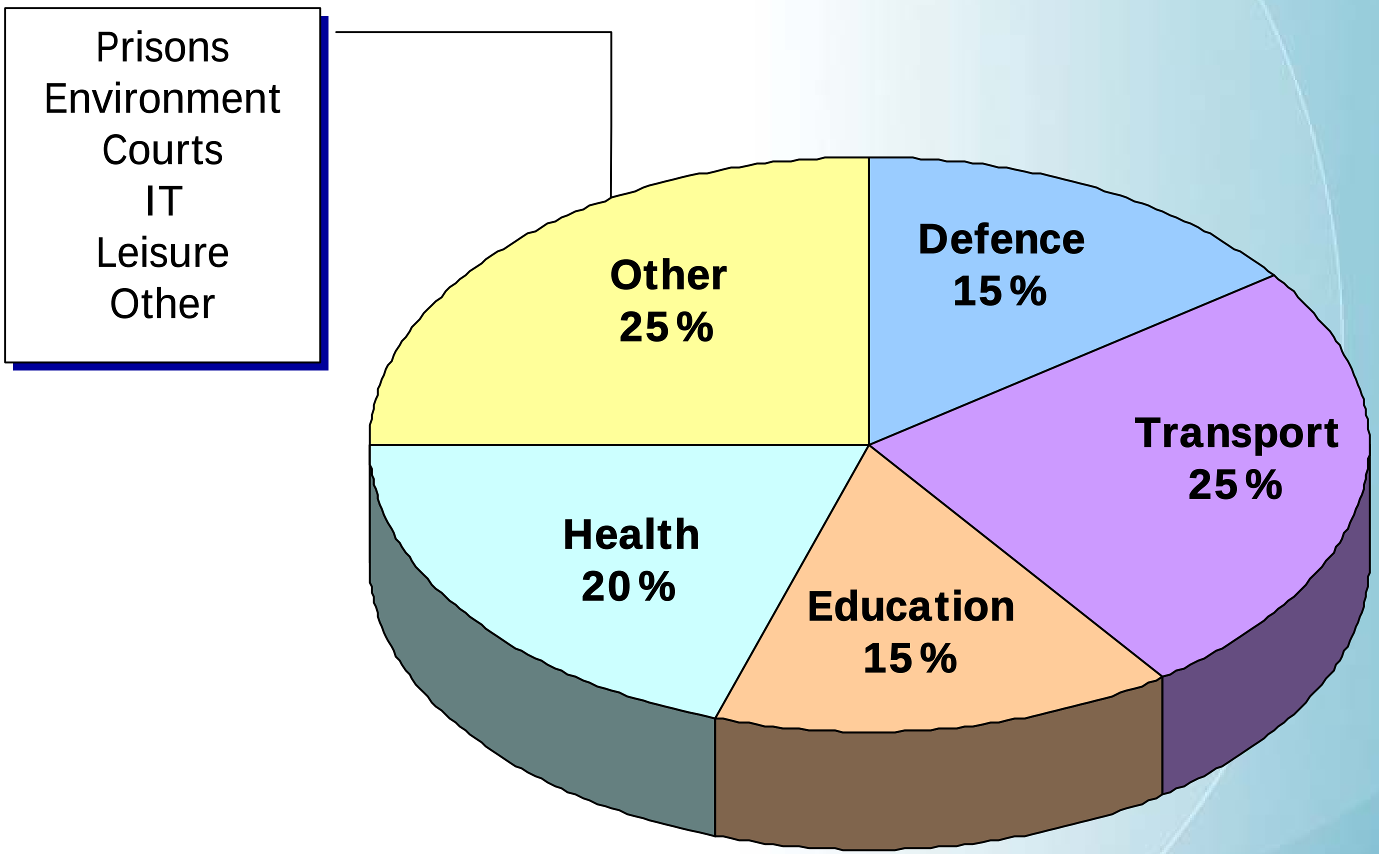
2001 — PartnershipsUK

PUK becomes a private sector company, raising £45m from external investors. Current shareholdings: 51% private / 49% public sector

2006 — PartnershipsUK

PUK today:
- Advisor to public sector clients
- Commercialisation advise
- Equity investments
- JVs – PfH, PfS

Sector Analysis



Capital Values

Public Expenditure Context

PFI represents 11% of UK total public sector Investment during 1998-2004.

PFI is an important technique for procuring public services but is **only** one of a family of procurement methods.

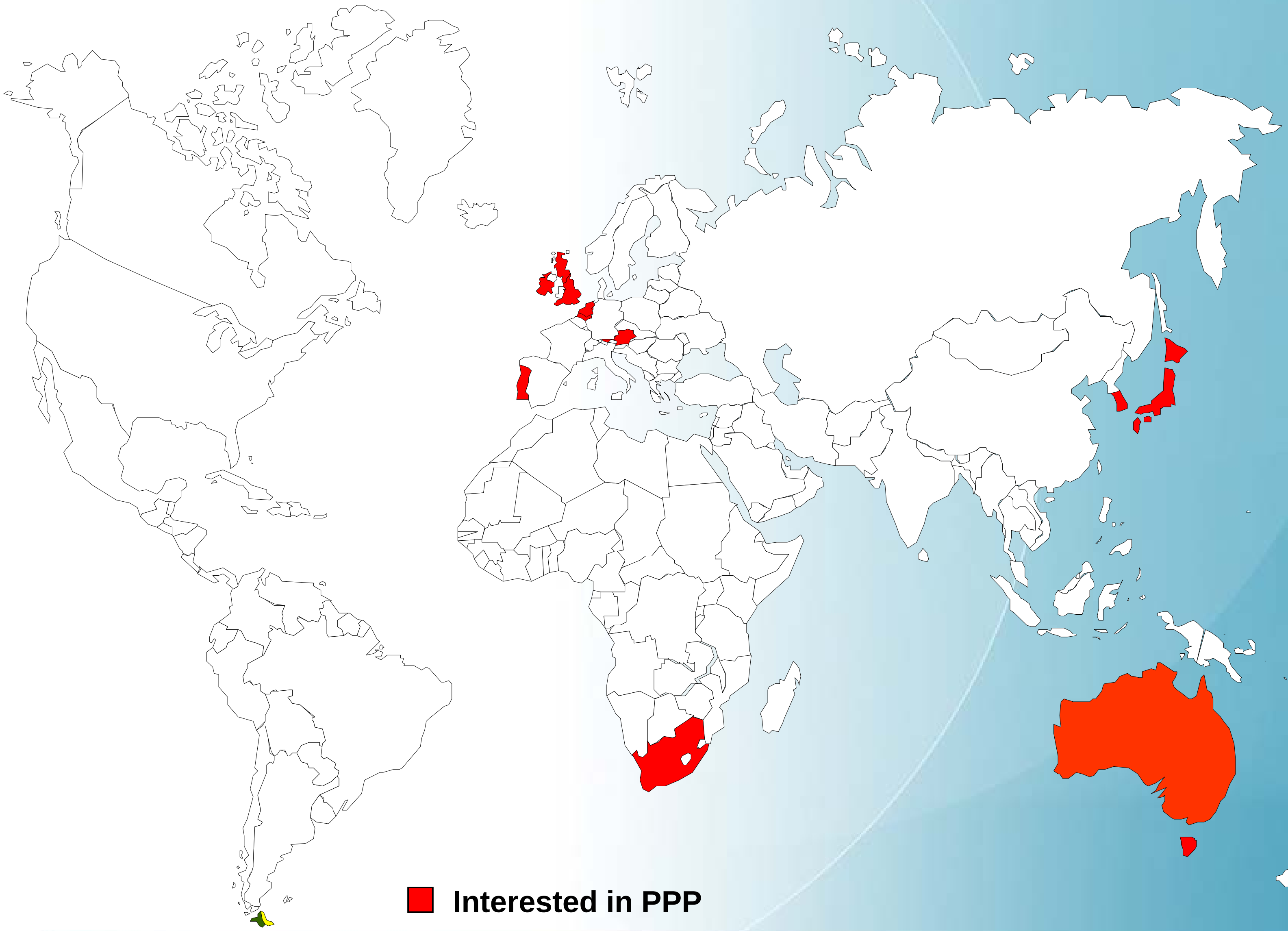
International Context

Countries with active / developing PFI programmes include: Australia, Brazil, Canada, Chile, Czech Republic, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Malta, Mexico, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Taiwan and UK.

Why are so many Countries Embarking on PFI Programmes?

- Improved value-for-money procurement of public services (better articulation of public service requirements, better preparation, greater discipline about changes to requirements).
- Provides radical opportunity to reform/modernisation of public services (change labour practice, champion the **consumer** and place distance between the government and the **producer** of a public service).
- Introduces contestability and choice in delivery of public services.
- Antidote to short-termism in both public and private sectors.
- Improved transparency of costs of public services delivery.
- Overcomes capital budget constraints to accelerate the pace of change in public services.

International - PPP in 1999



Interested in PPP

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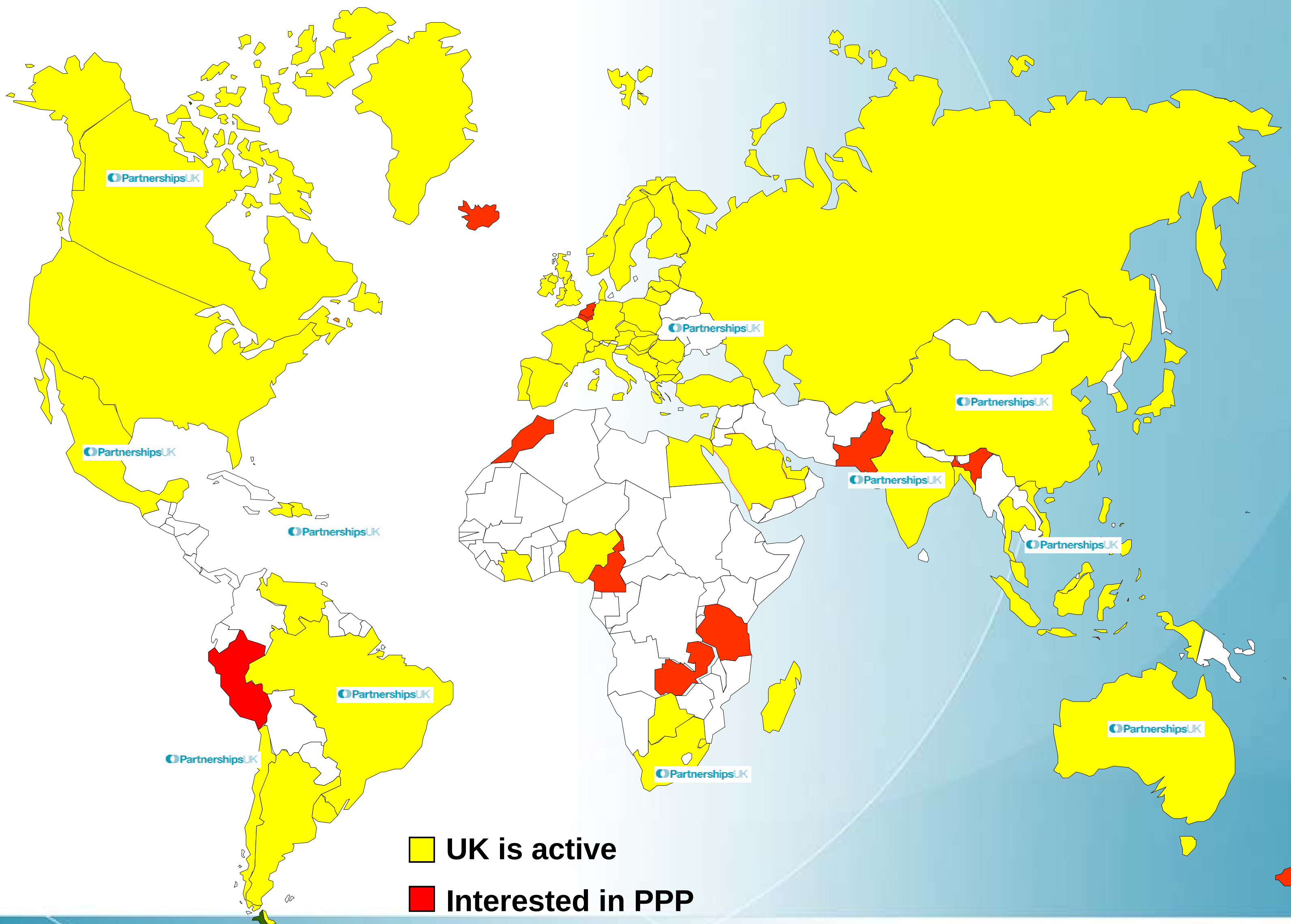
PUK International Support - PPP in 2006



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What is the PFI Market Looking For From International Opportunities?

- Strong contractual covenant (vires risk)
- Clear legislative framework (seizure risk)
- Stable and predictable cash flow from the contracting authority (contracting authority default)
- Good client skills and capabilities
- Well-prepared project
- A significant pipeline of opportunities

i.e. private capital is content to accept project risk but not political risk

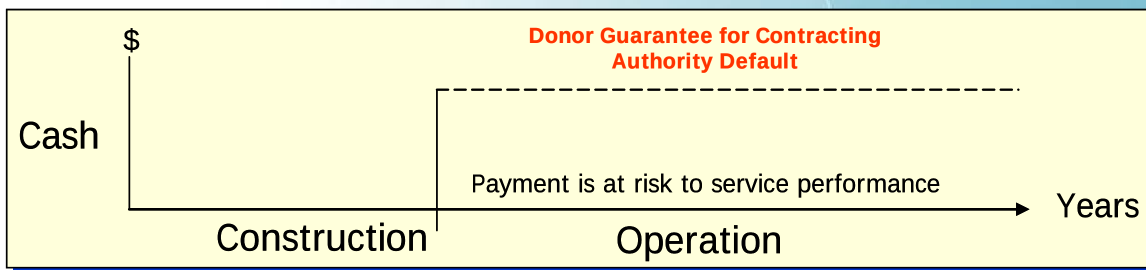
Impact of a Long-Term Donor Committed Funds 1 – Absorbing the Political Risk

- Unlocking capital flows - long term committed donor funds
- Take the covenant risk – provide assurance to private financiers that contracting authority default will be back-stopped
- Donor funds better placed to take this risk due to leverage through future grant-giving programmes
- Done either by **guarantees** or by introducing a credit-enhancing, deeply-discounted **equity** slug

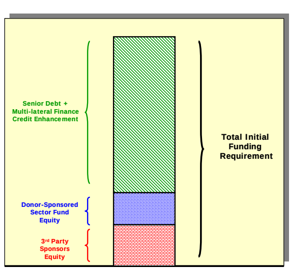
Credit Enhancement - Guarantee or Equity Shield

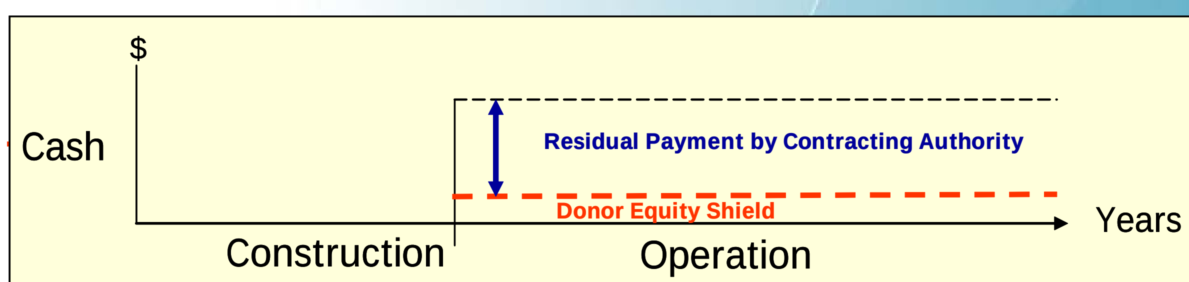
PFI (output-based) procurement

By guarantee



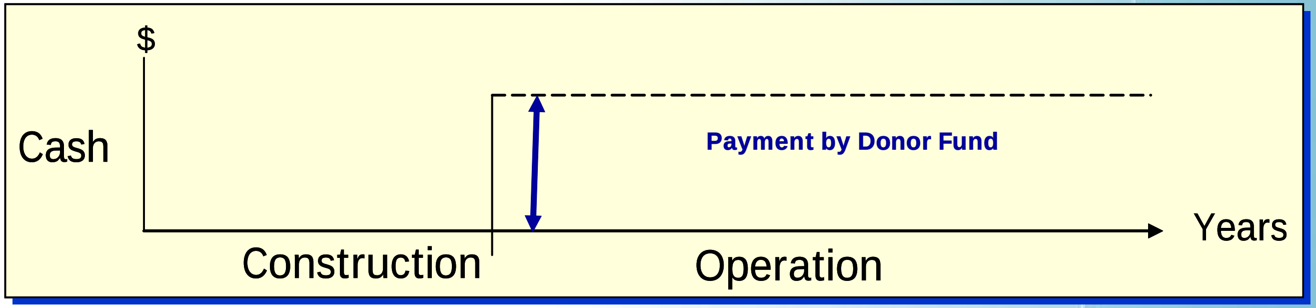
By equity

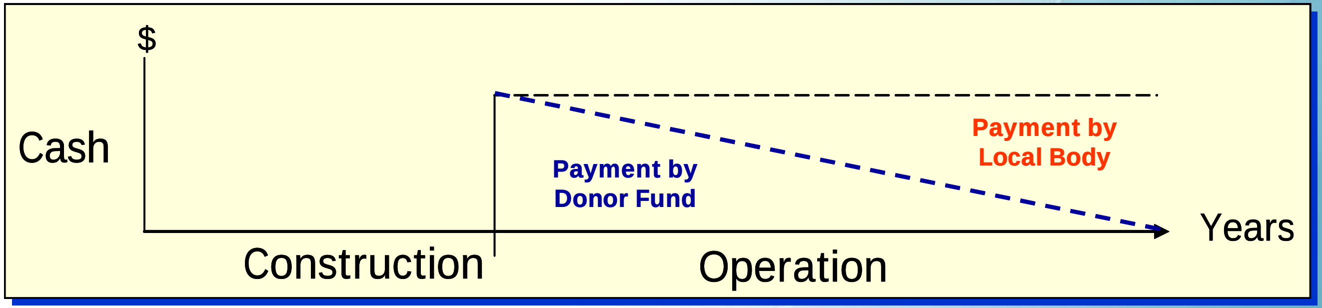




Impact of a Long-Term Donor Committed Funds 2 – Funding the Revenue Consequences of New Investment

- Donor funds committed in the long term used to provide all of some of the primary funding required to pay annual revenue impact of investment in services and infrastructure (more than credit enhancing)





Embedding Sustainability into Output Requirements and Contracts for Services

- Develop local transaction capability
- Contractual targets for use indigenous workforce
- Contractual targets for apprenticeships
- Obligatory use of indigenous supply chain
- Ancillary investment in intangibles such as clinical education and training

A Few Thoughts From The Man on Mars

- **Martian Observation 1** - The “exclusivity” effect of private languages

- **Martian Observation 2** or “Feacham’s Pendulum” - When I receive a $100 donation have I been given the license to fund 1 person with an actuarial lifetime need of $100 or have I been given the license to fund 10 people with a year 1 need of $10 each?

- **Martian Observation 3** – Is a donor fund:
  - A fixed-term grant giving body;
  - A pension fund;
  - An insurance pool;
  - A venture fund?

  You have the operating practices of the grant giver but the conscience of the pension fund

Martian Observation 4 - Radelet's Box of Social Return?

Country Maturity	Low		High
High	**FTSE/Fortune 500** Medium/low Internal Rate of Social Return per $ Spent • Some leakage • Reasonable health bang per buck	**Gilt-edged Securities** High Internal Rate of Social Return per $ Spent • Little leakage • Big health bang per buck	
Low	**The Worried Well** **Medium/Low Internal Rate of Social Return per $ Spent**	**Social Venture Capital** Medium Internal Rate of Social Return per $ Spent •High leakage •Big health bang per buck *The ethics of rejecting the needy*	**Club Pass?** **Minimum Hygiene Threshold**

Low **Comparative Health Gain Per $ Reaching Target Poor** High

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