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Unidade Técnica de Acompanhamento de Projetos

PPP sector reform and portfolio restructuring

9th meeting of the network of public finance economists in public administration

Brussels, February 10th, 2015

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PPP portfolio in Portugal

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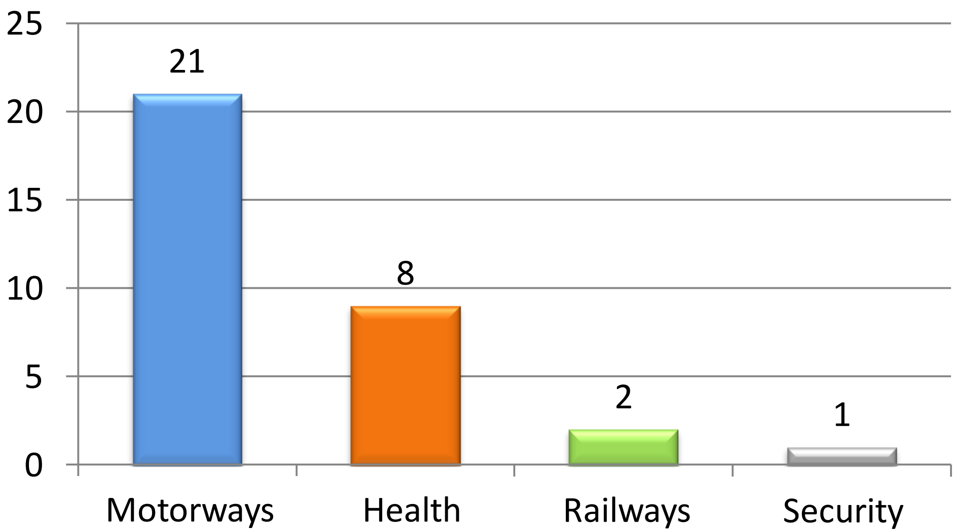
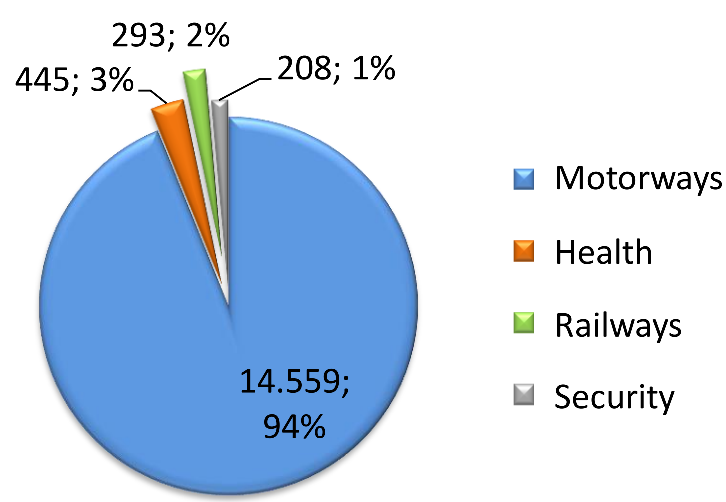
Central Government PPP – UTAP’s mandate:

- 32 contracts
- Cumulative investment of 15.500 million €

Portfolio composition



Cumulative investment



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The situation in 2011

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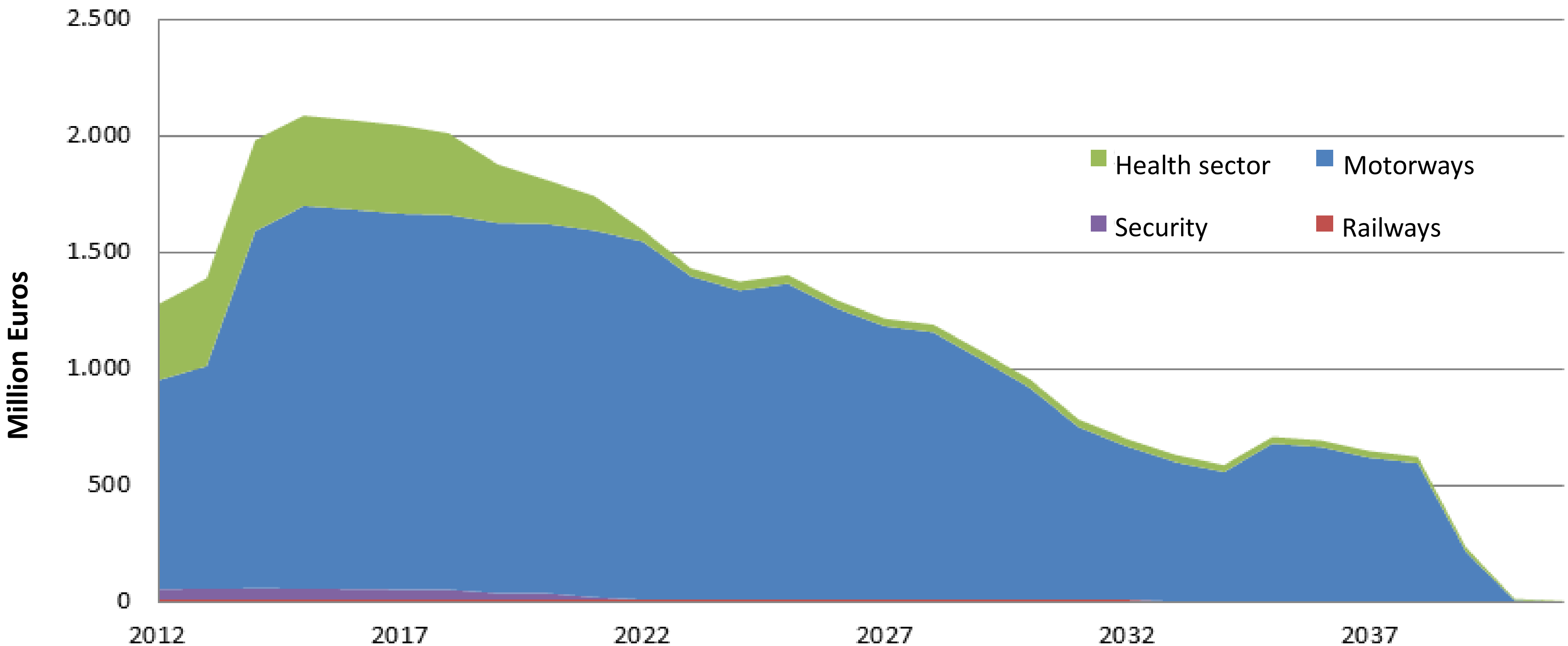
2011 debt crisis – strong fiscal sustainability concerns about PPP

- 2012 State budget – PPP sector "do nothing" scenario unsustainable from a contract lifecycle perspective



Source: OE2012, Ministry of Finance

The situation in 2011

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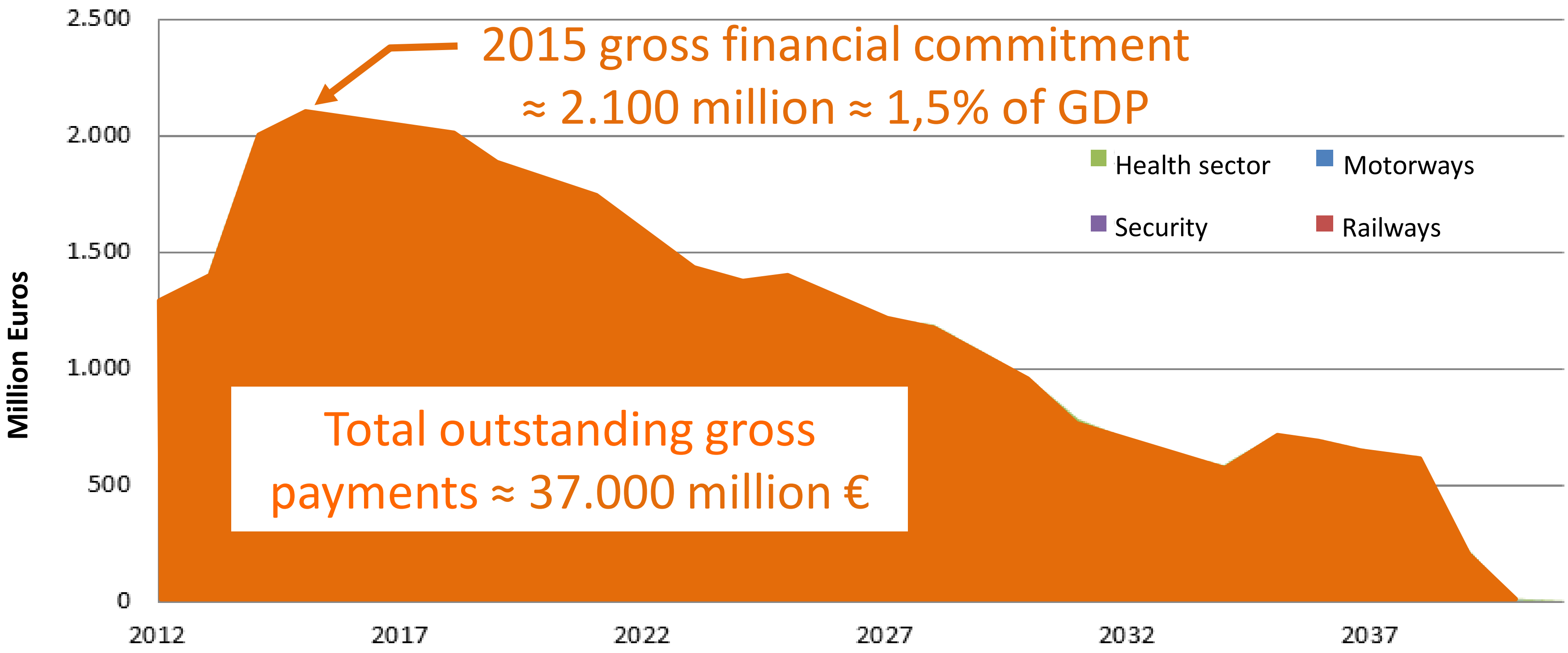

Source: OE2012, Ministry of Finance

The situation in 2011

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Context of the reform – the "MoU"

Measures put in place by the 2011 Memorandum of Understanding on Specific Economic Policy Conditionality:

3.17 Avoid engaging in new PPP before completion of the reviews on existing PPP as well as legal and institutional reforms

3.18 Assess at least the 20 most significant PPP contracts

3.19 Recruit a top tier international accounting firm to undertake a PPP portfolio audit

3.20 Put in place a strengthened legal and institutional PPP framework, within the MoF

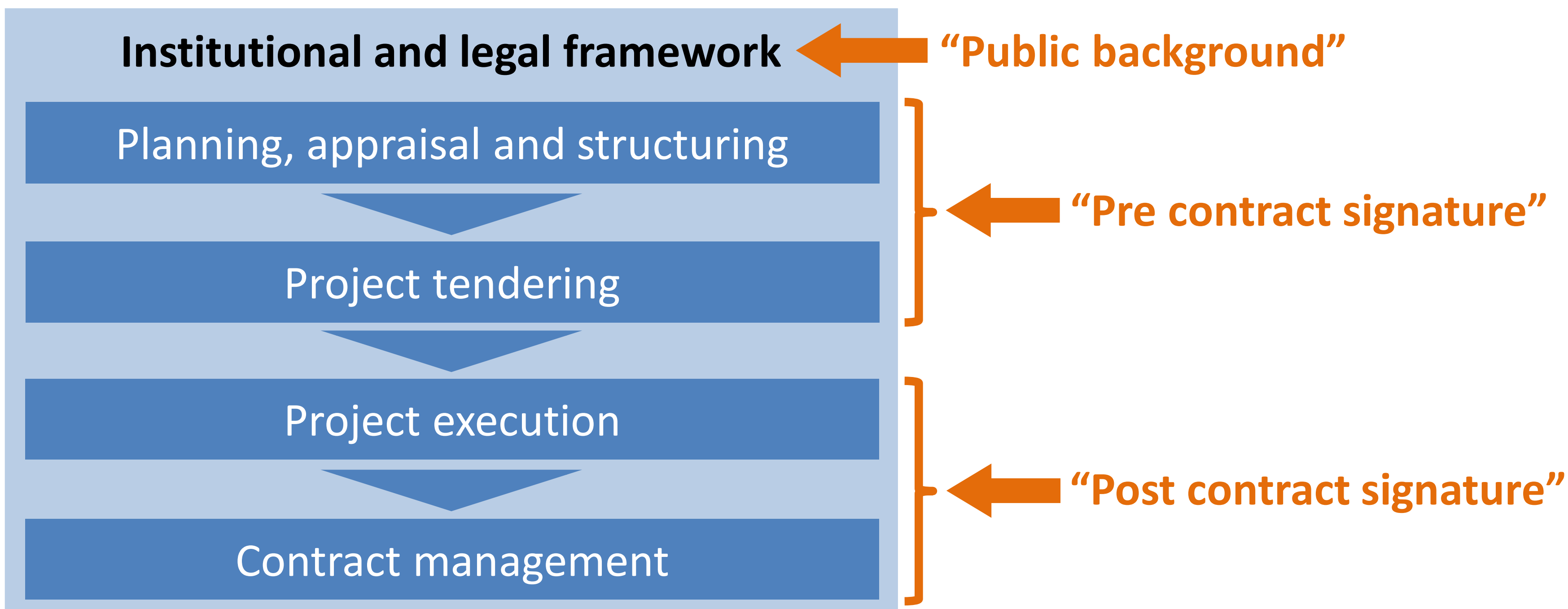
3.21 Enhance the annual PPP and concessions reports by the MoF

The situation in 2011

UTAP

Measure 3.20 – strengthened legal and institutional framework

2011 joint Portuguese MoF and IMF study in preparation of the PPP legal and institutional framework reform, focused on the assessment of three areas:



The situation in 2011

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MoF + IMF assessment – main findings

- Lack of coordinated and centralized public action – even within the MoF
- Underdimensioned and/or poorly prepared public teams
- Asymmetry of information, resources and technical capacity between public and private actors
- Excessive resource to external advisers by the public sector – high cost of launching and managing projects
- Low capacity to accumulate experience, assess lessons learned and implement solutions
- Tendering process bureaucratic, expensive and lengthy

The situation in 2011

UTAP

MoF + IMF assessment – main findings

- Deficit of quality in some key methodologies – Cost-Benefit Analysis (CBA), public sector comparator (PSC)…
- Low capacity of the MoF resulted in preponderance of sectorial objectives and policies – long term budget planning, *fiscal affordability* and *value for money* neglected
- Accounting of long term public liabilities neglected
- Poor allocation of risks between public and private partners – often too much risk on the public side
- Poor control of risks and contingent liabilities associated, affecting long term budget planning

The situation in 2011

UTAP

MoF + IMF assessment – main findings

- <u>Lack of an effective analysis of the contractual performance of the private party</u> – poor enforcement by public contract management agencies (line ministries)
- <u>Multiple unilateral public acts</u> (administrative, legislative, etc) that might trigger requests from the private party for reinstatement of the "financial balance of contracts"
- <u>Frequent changes in project structure and conditions during construction and execution</u> – no financial impact assessment performed

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2012 PPP regime reform

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Main objectives

1. Create inside the public sector a professional and stable structure, specialized in financial and legal affairs for the development and management of PPP and other large infrastructure projects
2. Ensure the know-how and technical capacity are created (and stay) within the public sector, available to support any public entity involved in such projects
3. Reinforce the role of the MoF along the PPP lifecycle
4. Regain control over the fiscal outcome of PPP, both concerning known and contingent liabilities

2012 PPP regime reform

UTAP

Main objectives

5. Reduce the dependency and costs related to the excessive use of external advisers, relaying on in house public sector resources
6. Develop and apply more rigorous technical methodologies and criteria in structuring and launching PPP projects
7. Enhance transparency of PPP deals structuring to contract management, disclosing all documents related with those contracts
8. Extend the scope of the PPP regime to State owned enterprises

2012 PPP regime reform

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DL 111/2012 – New PPP regime issued

1. <u>Institutional reform</u>
   - UTAP created – PPP unit within the MoF
2. <u>Fiscal control measures</u>
   - Structuring and tendering – “pre contract signature” phase
   - Construction/execution and management – “post contract signature” phase
3. <u>Scope of application</u>
4. <u>Transparency and information disclosure</u>
5. <u>Other measures</u>

2012 PPP regime reform

UTAP

Fiscal control measures – "pre contract signature" phase

- Compulsory project affordability and fiscal impact studies
- Perform a robust sensitivity analysis regarding project variables and macroeconomic conditions
- Detailed description of project outputs, in order to enhance project structuring, appraisal and tendering
- Issue a detailed risk matrix with clear public/private risk allocation and expected fiscal impact – minimize contingencies
- Previous to launch, assessment of market conditions
- Development of contracts minimizing the room for unilateral decisions by public partners – minimize contingencies

2012 PPP regime reform

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Fiscal control measures – "post contract signature" phase

- Ex-ante fiscal affordability impact assessment of unilateral measures during contract management phase – minimize contingencies
- Compulsory impact assessment of any contract renegotiations in terms of financial (and thus fiscal) outcome, as well as any potential change in the original risk matrix

In addition, portfolio restructuring negotiations launched

- Targeting a sustained reduction in PPP payments and minimization of potential sources of contingent liabilities

2012 PPP regime reform

UTAP

DL 86/2003 PPP regime arrangements

PPP project proposal + structure
- Preliminary studies
- Strategic studies
- Cost-Benefit Analysis (CBA)
- Tender documents preparation
- Draft legal documents

Work developed by line ministry teams

"Follow-up commission"
- Analyze and further develop previous documents/studies
- Value for Money analysis, PSC

Parity of ministries:
- 1 President
- 2 line ministry
- 2 MoF

"Tender commission"
- Evaluation of bids
- Shortlist of bidders
- Negotiation phase
- Award proposal to ministries

Parity of ministries:
- 1 President
- 2 line ministry
- 2 MoF

Contract management
- Budget and fiscal follow-up

MoF leadership:
- Parpública, SGPS
- DGTF

DL 111/2012 PPP regime arrangements

PPP project proposal
- Preliminary studies
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MoF leadership:
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- 2 line ministry

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Project structuring and appraisal: leadership assumed by the MoF through UTAP

2012 PPP regime reform

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Leadership assumed by MoF through UTAP along the project lifecycle

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Motorway PPP development model

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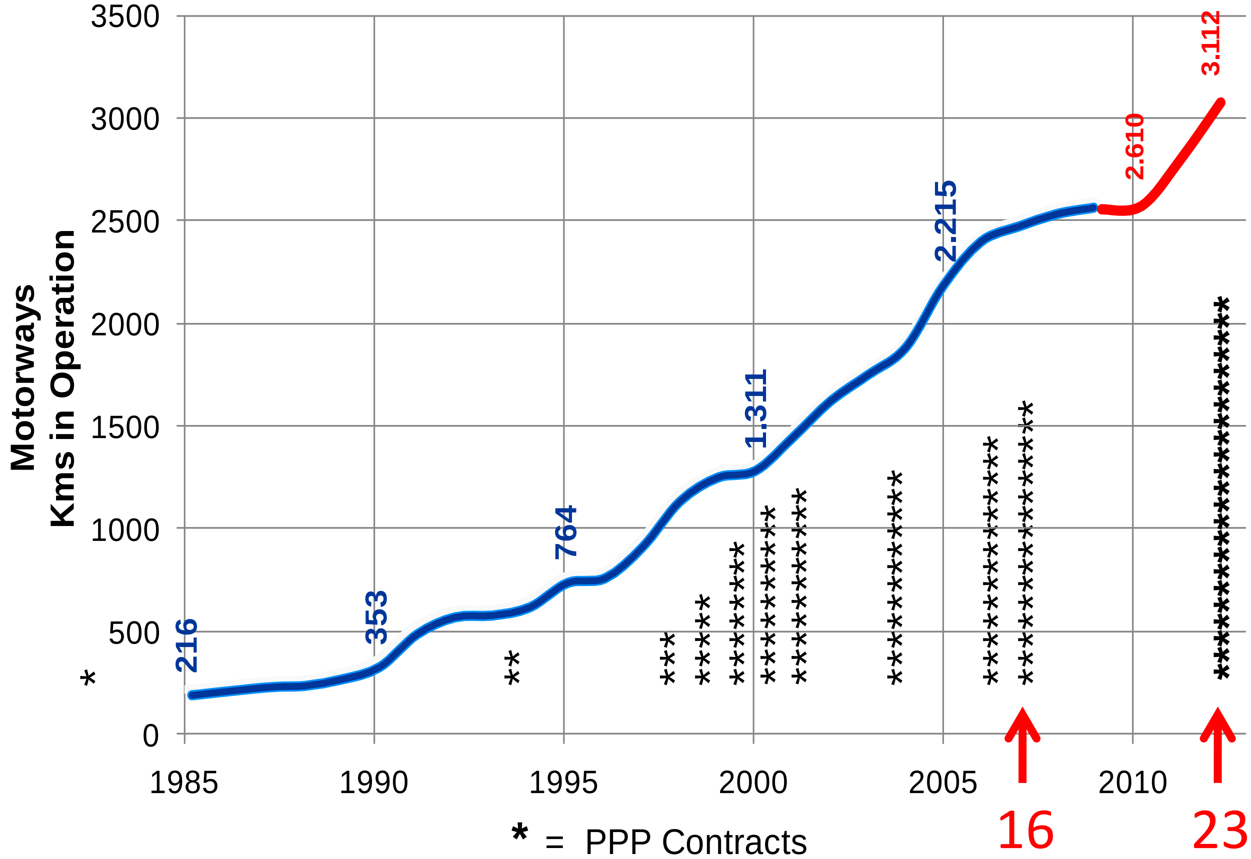
Motorway network developed 100% under PPP model



Source: Institute for Mobility and Transports (IMT)

Motorway PPP development model

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Road sector model until 2007

- All motorways developed using PPP structures – 15 contracts in operation phase
- 7 SCUT contracts, concessionaire remuneration by shadow tolls – paid by the State using general budget, with partial traffic risk on private side
- 8 contracts, concessionaire remuneration by real tolls – paid by user, no State payments, full traffic risk on private side
- *Estradas de Portugal* I.P., public institute (ex General Directorate for Roads) responsible for the development, operation and maintenance of the remaining network (not concessioned parts)

Motorway PPP development model

UTAP

Road sector model from 2007 onwards

- *Estradas de Portugal* S.A. ("EP") created – State Owned Enterprise (100%) in concession regime
- SCUT (shadow toll) contracts turned into availability payment contracts (no traffic risk on private side), with real toll applied with EP ownership – renegotiation of contracts triggered, full traffic risk on public side
- EP launches 7 new "subconcessions", under availability and service remuneration schemes, with real toll applied with EP ownership – contracts signed 2008-2010
- Future sectorial trend: concessions reverting to EP at the end of the contract life or through negotiation

Motorway PPP development model

UTAP

In 2010 the new model is fully in force, BUT…

- 2011, the economic and financial crisis kicks-in:
    - General reduction of traffic levels – highly correlated with economic activity (GDP)
    - New toll policy unwelcome by users of ex-shadow toll concessions – added negative effect on traffic levels
    - Subconcessions developed under optimism bias
- EP’s financial forecasts revised: long run toll revenues expectations reduced – long term fiscal sustainability issues
- Unstable contractual structures – source of contingent liabilities
- Motorway PPP sector clearly unsustainable

Motorway PPP development model

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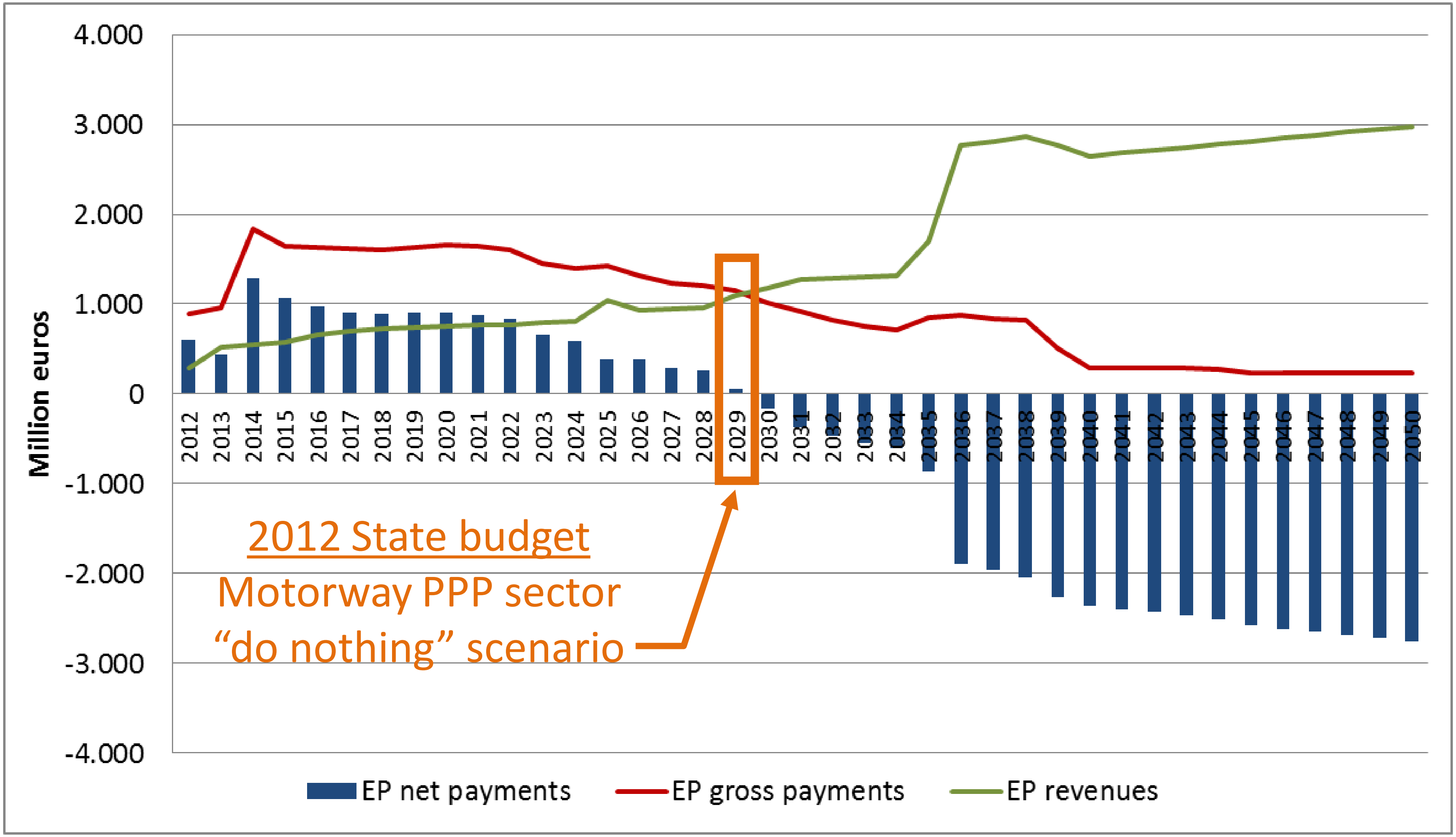

Source: UTAP

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Motorway PPP renegotiations

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Strategic position of the State – message to private partners

- The road model is not sustainable – will affect all parties
- Renegotiation will provide more rational stable contracts and remuneration schemes – reduction of sources of uncertainty and contingent liabilities
- Contingent liabilities to be included in the renegotiation – to reduce the value of claims by privates (2.400 million €)
- Overall reduction of public payments through reduction in IRR, CAPEX and OPEX
- No debt renegotiation is undertaken, as any debt negotiation would increase financial costs of contracts – position of financial institutions not changed significantly

Motorway PPP renegotiations

UTAP

January 2013, formal launch of negotiations – key issues

- Renegotiations of 16 contracts out of 21 in order to reduce the State gross payments
- The main strategic lines:
  - Paralyzing investments in course and reduction of contract scope (subconcessions)
  - Rationalization of engineering standards – regulatory reform according to international/EU standards
  - Supression of automatic payments for future CAPEX
  - Reduction of the shareholder’s IRR – to 10% maximum
- Additionally, toll revenue related measures introduced

Motorway PPP renegotiations

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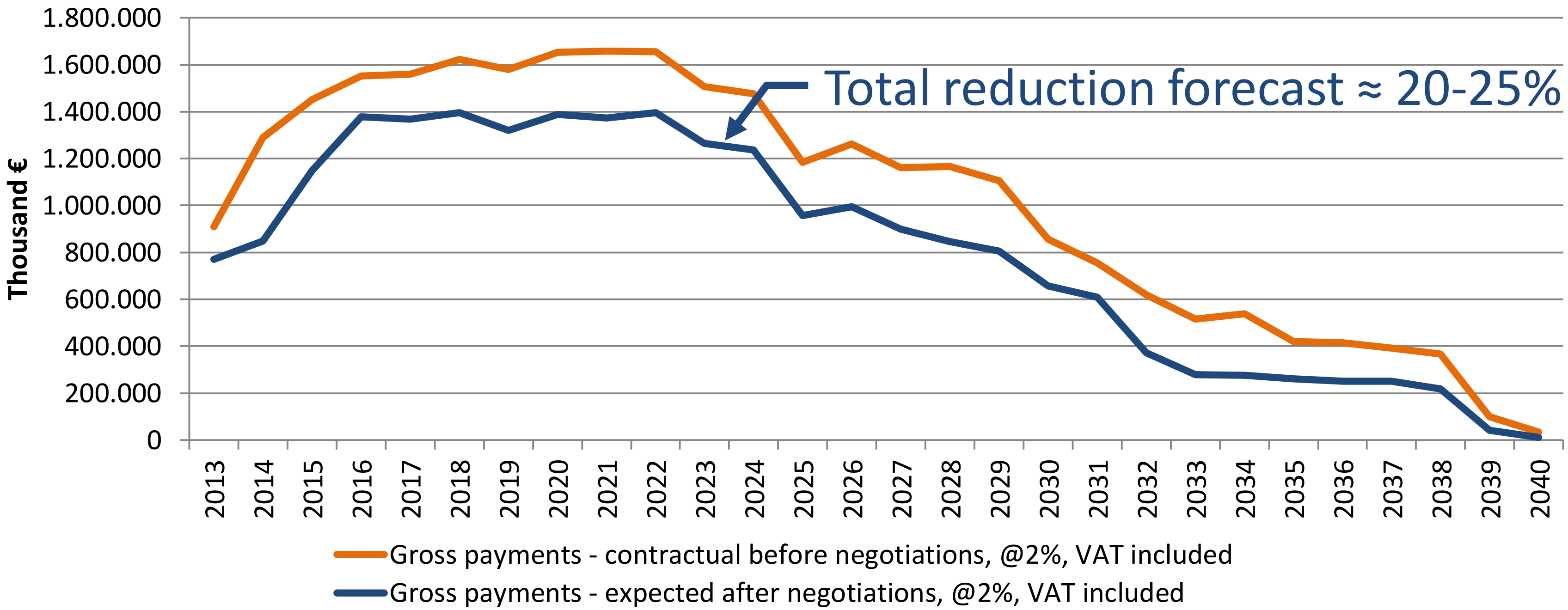
Negotiation outcome – impact so far

- 2013 = 208 million €
- 2014 = 374 million €

Negotiation outcome – contract lifecycle forecast



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Comments and conclusions

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- PPP structures have showed success in delivering projects
- Portfolio volume and value raised affordability issues – fiscal and public accounts sustainability concerns triggered in 2011
- Motorway PPP sector, a source of contingent liabilities
- Main causes:
    - Public sector poorly prepared and not coordinated
    - MoF unprepared to deal with PPP complexities
    - Preponderance of sectorial policies over long run fiscal sustainability and lack of coordinated investment planning
    - Several key PPP related methodologies neglected – CBA, PSC, VfM, fiscal affordability, long term budgeting...

Comments and conclusions

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- Main objective of the 2012 reform: to <u>regain fiscal control over PPP</u> – both consolidated and contingent liabilities
- <u>The need to give the MoF a pivotal role in PPP</u> planning, structuring and tendering
- <u>Legal and institutional framework reform</u> implemented:
  - Creation of UTAP, the central PPP unit – <u>providing the MoF leadership throughout project lifecycle</u>
  - New PPP legislation focused on <u>fiscal sustainability issues</u>
  - Effort to <u>promote transparency and enhance neglected key PPP related methodologies</u>
- <u>Motorway PPP portfolio renegotiation</u> – reduce liabilities

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