

# Can we fix it? PPPs can...

The construction industry needs a serious boost and the public-private partnership model might just be the way to give it the kick it needs – but who will take the first step to recovery?

**T**HEY WERE ONCE hailed as the pioneering way to plug the infrastructure deficit; a means of getting roads, schools, prisons and hospitals built without burning a hole in the State's bank account. But with the advent of the banking and fiscal crisis, public-private partnerships have become unviable, with flagship projects postponed and other contracts stalled. So are PPPs off the table for good, or could this funding model eventually serve as an economic stimulus that helps Ireland play catch up once again?

No major public-private partnership (PPP) infrastructure project has secured funding since the advent of the financial crisis three years ago, the Department of Transport recently said, while a database used by the last government to monitor PPP projects, ppp.gov.ie, has not been updated since March 2010.

Minister for Transport Leo Varadkar identified the problem when he postponed the PPP for the Metro West line between Ballymun and Tallaght earlier this year: PPPs in Ireland have been undermined by a double funding bind. The reluctance of the international debt funding market to stump up the cash to finance projects in Ireland has come at a time when the exchequer is unable or unwilling to make a contribution of its own.

It has been "extremely quiet", confirms Michael Flynn, a partner at Deloitte who specialises in PPPs. The banks are focused on deleveraging rather than lending and the 20-year-plus time horizon on a typical PPP project just isn't in their interest when sovereign risks are high.

But though the scarcity of capital is putting the kibosh on large-scale transport projects,

Flynn believes that smaller PPP bundles for projects such as schools, in the order of €50-€60 million, are "certainly bankable, with one or two banks" – they just require the go-ahead from Government. This echoes the view of the National Development Finance Agency – the agency charged with an advisory role on all PPPs. It believes that projects with relatively low funding requirements retain an interest for the debt and equity funding markets.

There is, according to Flynn, "a level of interest" overseas in Irish PPP projects – despite "the odd hiccup", there have been many successful roads schemes that have served as a good precedent. However, from the contractor's point of view, any deals done in the current environment would need to have simpler structures than some of the PPP business models favoured in the past, he says.

Even "bite-sized deals" are easier said than done, however, at a time when Ireland's capital spending budget is seen as a more suitable target for cuts than current spending (though there are plenty of people, from business groups to fans of using capital programmes for economic stimulus, who will be attempting to persuade the Government otherwise).

A document prepared for Varadkar's department starkly blamed the failure of the National Roads Authority to finalise negotiations in the Gort to Tuam motorway bypass on "concern in the capital markets regarding Ireland's overall financial situation". But Ireland's current failure to meet the minimum sovereign credit rating requirements of international banks is by no means a permanent problem, says Shane Lyons, director at PricewaterhouseCoopers' corporate finance division.

"The capital markets see the Irish credit risk declining – bond yields and CDS spreads are coming down. The capital markets are real-

ly saying that Ireland is getting on the right track, and if this is sustained, eventually the ratings agencies are likely to follow," says Lyons. "But the Government still needs to have an actual spending programme."

Are PPPs in the best interest of taxpayers? At the end of 2010, the State had an outstanding commitment of almost €4.3 billion to some 37 projects already in place, covering roads, schools and medical projects. Some €1.9 billion has already been spent. However, the report of the Comptroller and Auditor General published in September noted that estimates were unavailable for future PPP commitments where contracts had not been signed because of the complexities involved, including the cost of borrowing. It also noted that just three PPPs

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reached contract stage last year.

Some old-style road schemes were badly affected by timing issues. The National Roads Authority estimates that it will be obliged to compensate the operators of the M3 motorway in Co Meath and the N18 Limerick tunnel next year because traffic volumes have failed to meet "traffic-related guarantees" included in the original agreements. The private sector companies involved are also bearing losses as a result of these over-optimistic projections.

This form of contract is now gone, says Mary Dunne, a partner and legal expert in PPPs at Byrne Wallace. It has been replaced with a more standard contract whereby the private bidder pays for the design and construction of the project and the State pays a monthly payment, "almost like a mortgage". There are penalties for the contractor if they fail to maintain the roads, but traffic forecasts have been taken out of the equation, and it's the financiers that have called a halt.

"Eight years ago, the banks were willing to take that kind of risk on population projections, but now they won't," says Dunne. The risk the banks are now mulling is whether or not the Irish Government will make its repayments. At the moment, they're shying away.

"It's a confidence issue. There's a lack of confidence," she says. One London-based syndicate on the verge of financing a "cookie-cutter" Irish roads PPP walked away earlier this year "just for absolute confidence reasons", she says. "If solid London banks that have funded loads of these projects are getting cold feet, then it's a real line in the sand."

Like Flynn and Lyons, Dunne sees the financiers returning once this confidence issue in Irish sovereign debt is resolved. For global private equity funds, a deal with a central government department in Ireland should still be worth a look. "A lot of the guys I'm dealing with are sniffing around Poland and Croatia at the moment," says Dunne. "The companies are in a frenzy to see what comes out of Croatia, and Croatia is much less solid than we are, and it hasn't got the experience."

PPPs can be treated as off-balance sheet expenditure by the Government, which during belt-tightening times makes them an easier commitment than an upfront outlay. But the accounting treatment may artificially heighten the benefits of some projects – a recent report by the UK's Treasury Select Committee argued that stricter criteria were needed to govern its private finance initiative programme. "PFI means getting something now

and paying later. Any Whitehall department could be excused for becoming addicted to that," said the committee's chairman Andrew Tyrie MP. In other words, the ability of governments to use the model to keep projects off-balance sheet skews the incentive away from traditional procurement methods, which might be more efficient.

But many of the original attractions of PPPs for the construction of public infrastructure still remain, in theory. They were attractive because they allowed the costs of an investment to be spread over the lifetime of assets such as roads, rail-tracks or ports, thereby allowing large-scale projects of economic value to be brought forward.

Lamenting that "too many separate departments" are responsible for PPPs, a report produced by business group Ibc and accountants KPMG in March called for the establishment of a specific National Infrastructure Authority to identify projects and take responsibility for funding strategies. This, it said, would prevent delays in planning and at the pre-procurement stage. The report also complained of a lack of clear visibility on pipeline projects, which it said was needed "in order to attract and maintain interest from international banks and investors in Irish PPP projects".

Supporters of the funding model have also pointed out that experience and skills gained by Irish construction contractors during the good times have allowed them to become profitable exporters, as they win bids for partnerships in markets such as the UK and Poland. Construction group Sisk is the leading light in this category. Almost half of its turnover now comes from Britain as a result of its involvement in the London 2012 Olympic athletes' village and a section of the UK capital's crossrail tunnel.

They have been helped by standardised models of PPP contracts across the world, says Dunne, and she should know – she drafted the template PPP for Ireland. Based "95 per cent" on the UK's PFI model, similar contracts are now used in other markets. "Irish contractors are completely familiar with them. There's nothing to stop an Irish contractor bidding for a PPP in Canada or Australia or anywhere," says Dunne.

Lyons describes PPPs as "one form of procurement"; part of the Government's toolkit. "I wouldn't espouse PPPs in every circumstance, but it has successfully delivered a big proportion of our national motorway network and is also making a significant contribution in the education sector."

Despite the current squeeze on both public and private participation in PPPs, it seems clear that major projects such as Metro North and the Dart Underground won't happen in the future unless the model becomes workable again. Or as Varadkar put it bluntly in May: "If PPPs are not a runner, then loads of these big projects are gone."

The fate of the not-so-big projects is even less clear. ■