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Portugal – Renegotiation of PPP Highway Contracts after Global Financial Crisis

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On this page: *Case Study 4: Portugal – Renegotiation of PPP Highway Contracts where the government was able to achieve its goal to reduce the costs for the contracts because the private sector' s perspective was also taken into account.*

Background

Portugal started implementing a large PPP program in 1993, in particular in the transport and health sectors. Under its PPP program the country has approved a high number of PPPs over a short period of time. From 1995 to 2014, a total of 35 PPP projects were launched with future annual government obligations accounting for more than 0.5 percent of GDP. (A proper government control or an appropriate accounting and reporting system was not yet in place at this time.) The financial crisis of 2008 led to a broader economic crisis and recession that impacted capital flows and trade in many countries. It devastated Portugal’s economy and also had a critical impact on the country’s transport sector. Port and road infrastructure as well as the shipping industry were significantly impacted by the reduction in global trade. In the wake of this difficult economic environment, some of Portugal's PPP contracts became an unbearable financial burden for the government.

PPP Projects

In the transport sector the Portuguese government had procured a large number of PPPs to develop and manage its national highway system. Many PPP highway projects used “shadow tolls” that the government paid to the private partner per user with a high guaranteed minimum revenue. With the onset of the economic crisis, the PPP highway contracts caused unexpected and considerable stress on public finances. In the wake of this crisis the government initiated renegotiations with the respective private partners. A renegotiation of the PPP highway contracts was also one condition for financial assistance from the European Commission (EC), European Central Bank (ECB) and International Monetary Fund (IMF) that Portugal had requested. Because the PPPs were viewed as a key driver of Portugal’s unsustainable fiscal situation, the bailout package required that the Portuguese government would review its PPP program, suspend all new PPP agreements, and renegotiate some PPP contracts to reduce the financial burden caused by their current and anticipated payments.

Systematic renegotiation of the PPP highway contracts led to an overall reduction of public payments, reducing internal rates of return (IRRs) by cuts in payments for capital expenditures (CAPEX) and operating expenses (OPEX). The government was able to reduce current and future payments under each PPP by an average of 18 percent, rendering the PPPs sustainable and profitable. It had to accept that the terms of the PPP contracts it had originally agreed to were based on incorrect traffic projections and were not sustainable. Because the overall costs of the projects were lowered, the private partners also saved some costs. Shadow toll roads were converted into real toll roads with traffic risk borne by the government.

Lessons Learned

A renegotiation of several PPP contracts on the initiative of the contracting authority can be unavoidable if the need to restructure PPP contracts becomes apparent as conditions change. Full cooperation of all public and private sector partners and stakeholders and simultaneous renegotiations for all affected contracts are required to enhance transparency and sustainable outcomes in these cases. In the case of Portugal's PPPs, the government was able to achieve its goal to reduce the costs for the contracts because the private sector' s perspective was also taken into account. Although their returns were lowered, the outcome was on balance acceptable for the private sector partners given the lower risk profile and cost savings. Buy-in from the private sector was facilitated by the fact that the Portuguese government was in a distressed economic situation, and the restructuring of the PPP contracts helped to prevent bankruptcy of the contracting authority that would have ensued in default scenarios.

Sources: EPEC (European PPP Expertise Centre). 2014. Portugal PPP Units and Related Institutional Framework.

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