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Leases and Affermage Contracts: Hydropower plant

Leases and Affermage Contracts

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Leases and affermage contracts are generally public-private sector arrangements under which the private operator is responsible for operating and maintaining the utility but not for financing the investment.

When to choose Leases and Affermage Contracts

- when private equity and commercial debt are not available for water supply and sanitation;
- the awarding authority wants to combine public financing with attracting private efficiency;
- greater commercial risk is to be passed to the private operator than with a management contract, with incentives to perform.

Key Differences Between Leases, Affermage, and Management Contracts

- the operator does not receive a fixed fee for his services from the awarding authority but charges an operator fee to consumers, with
    - in the case of a *lease* a portion of the receipts going to the awarding authority as owner of the assets as a lease fee and the remainder being retained by the operator
    - in the case of an *affermage*, the operator retaining the operator fee out of the receipts (*prix du fermier*) and paying an additional surcharge that is charged to customers to the awarding authority to go towards investments that the awarding authority makes/ has made in the infrastructure;
- the operator tends to bear greater operating risk;
- the operator tends to employ the staff directly.

In the case of a ***lease*** the rental payment to the authority tends to be fixed irrespective of the level of tariff collection that is achieved and so the operator takes a risk on bill collection and on receipts covering its operating costs. In the case of ***affermage*** the operator is assured of its fee (assuming that the receipts are sufficient to cover it) and it is the authority that takes the risk on the rest of the receipts collected from customers covering its investment commitments.

The awarding authority in each case remains responsible for financing and managing investment in the assets – which is supposed to come, at least in part, from the rental payment/ surcharge. Some affermage arrangements the operator designs and manages the investment program.

In France and some other civil law countries the key provisions establishing the affermage are set out in the law and so a typical French affermage contract will be relatively short in comparison to an equivalent document in a common law jurisdiction.

Key Features of Leases and Affermage Contracts

- Medium length – typically between 8 and 15 years;
- Collection risk passed to operator in lease;
- Lease operator will require assurances as to tariff levels and increases over term of lease, and compensation/ review mechanism if tariff levels do not meet projections;

- Cost of maintenance and some replacement passed to operator (operator takes some degree of asset risk in terms of the performance of the assets);
- Operator may be put in charge of overseeing capital investment program/ specific capital works;
- Employer is paid a fixed lease fee (*lease*)/ receives net receipts from customers (less affermage fee) (*affermage*);
- Review process every 4 or 5 years to review performance, costs, tariff levels, etc.;
- Employees seconded or transferred to the operator;
- Operator to maintain asset register and operation and maintenance manuals/ records, etc.;
- Typical to include minimum maintenance or replacement provisions towards the end of the contract, so that facilities are handed back in an operational state.

Examples of Leases and Affermages

- Water and Sanitation lease and affermages
- Energy lease and affermages

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Additional Resources

- Power and Renewable Energy PPPs
- Water & Sanitation PPPs

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