PROTECTING YOUR PPP

Stabilizing partnerships in uncertain times

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UNCERTAINTY

is inherent in developing and operating complex infrastructure and services projects, and it is for this very reason that government officials seek public-private partnership (PPP) partners to mitigate the most complex of risks. Yet legal and regulatory frameworks, in place for legitimate reasons (especially in emerging markets), often dampen the private sector's ability to address in an optimal manner the challenges that can and often do arise during the term of a concession.

It is important to distinguish between projects that exceed expectations—and therefore generate greater than expected financial returns to both parties, yet require additional, unan-

ticipated capital investments—and struggling projects where there is an urge by the developer to reduce ongoing investment and maintenance.

"SUCCESSFUL PPPs ARE ALL ALIKE…"

To paraphrase Tolstoy, successful PPPs are all alike, but every unsuccessful PPP is unsuccessful in its own way. Successful projects are easier to manage owing to positive cash flows, and could additionally incorporate an obligation by the developer to increase its investment according to certain capacity-related triggers on the basis of floor and ceiling for project returns. This could also be supplemented by sponsor commitments to co-investment or to extend the concession terms based on minimum returns, as well as a sponsor sinking fund to ensure independence from the uncertain and tedious public budgeting process. Very often concession agreements focus on what to do when things go wrong, but not how to continue to meet demand when things go well, especially toward the end of the concession term.

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A good example is the case of TAV Airports, which realized much higher than expected passenger traffic and recently committed to invest $75 million to expand the international terminal and car park at Istanbul Ataturk Airport six years before the end of its concession term—even though the replacement airport for Istanbul is scheduled to open before the end of its concession period. The Government of Turkey also co-invested in taxiways and aircraft stands. In this case, it was more economically and financially advantageous to sustain traffic growth at Istanbul and its role as an international hub.

Struggling projects are of course more complicated to deal with. Failures are often complex in nature and, basically, attributable to the inability of both the grantor and sponsor to adequately evaluate project risks, especially when those risks are related to the enabling environment or public practices. In this case, and in order to avoid service disruptions and political criticism, grantors and lenders are more inclined to work with sponsors to provide some

relief despite the standard provisions for step-in rights and termination.

WHEN THE PPP PROMISE FADES

In the case of struggling projects where the performance of the developer is satisfactory despite adverse effects that are beyond the control of both parties, sponsors may consider providing relief in the form of temporarily reducing or suspending the concession fee while continuing to sustain the balance of risk. The sponsor may subsequently recover its suspended revenues in the form of higher concession fees or with interest when conditions improve.

While this approach imposes a steep fiscal burden on the government, especially when external adverse impacts also affect it (such as a currency crisis), it cannot be avoided for critical projects that require business continuity and where the sponsor's operational performance is satisfactory. It is important to incorporate at the outset such safeguards in the concession agreement to ensure that relief is delivered without delay while preserving transparency and avoiding corrupt practices.

In the case of struggling projects operated by poorly performing developers, working with lenders to replace the operator (even by a management contract) may prove to be the better course of action.

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In all cases, strict safeguards should be incorporated into the concession agreement to ensure that the developer—especially toward the end of the concession term—continues to provide adequate preventative maintenance to PPP assets soon to be transferred to the sponsor. More attention should be given to the totality of the developer's obligations toward the end of the concession term. With the safeguards that this level of attention brings, PPPs face less uncertainty, greater robustness, and increased chances of success.