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Policy and Institutional Approaches - UK

Edward Farquharson

Defining PPPs



Contract for Services - PFI



Concession



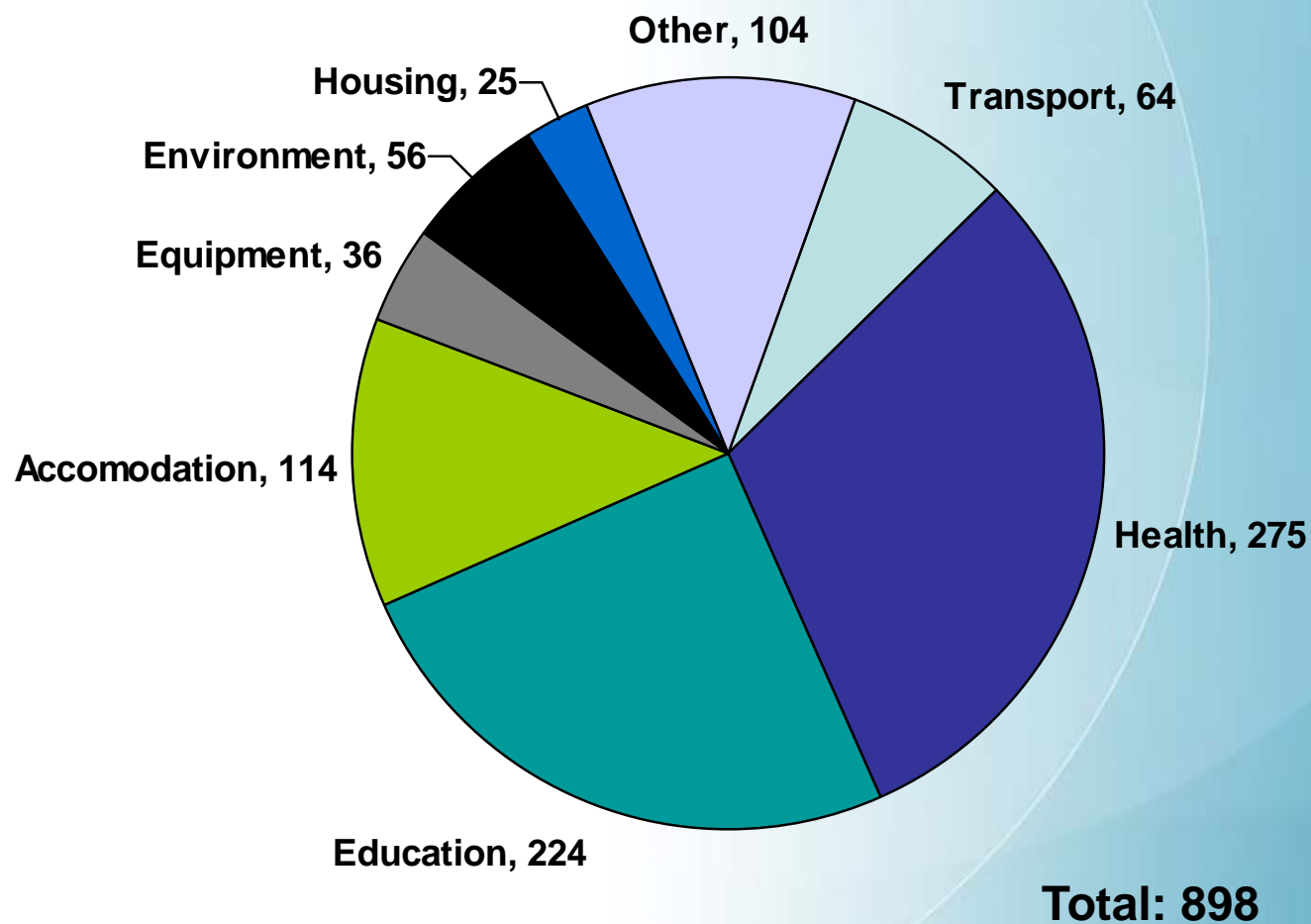
Joint Venture*



Investment Programme Management

* *Partnerships UK is an example*

Distribution of UK PPP Projects by Number



“The optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user’s requirements. VfM is not the choice of goods and services based on the lowest cost bid.” HM Treasury

“The (minimum) economic resource required to generate and sustain a desired capability” National Audit Office

- VfM versus affordability

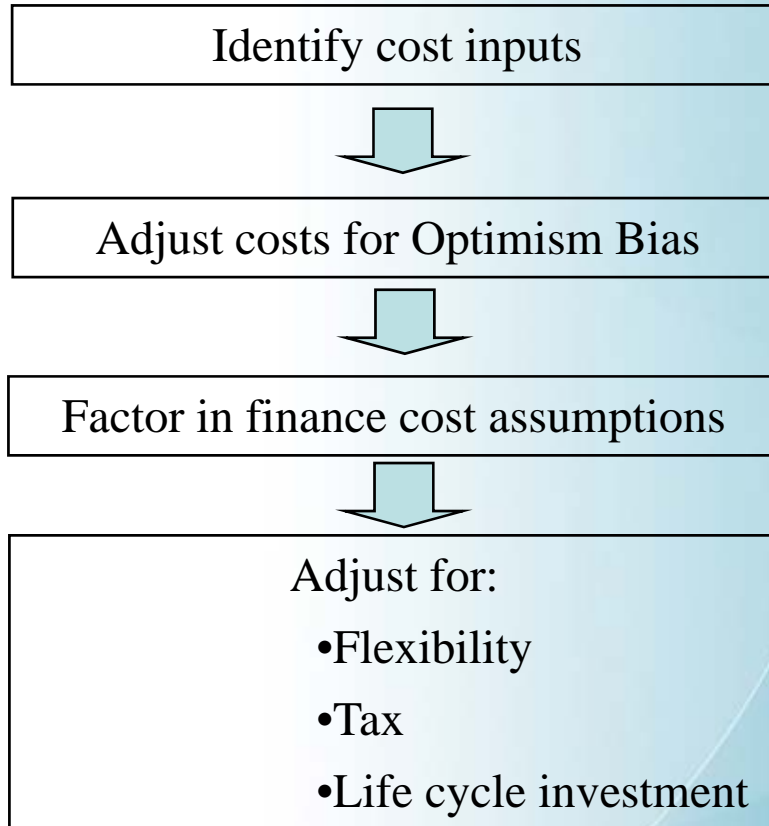
Previous UK Approach

- PSC ‘risked’ & cashflows compared with PFI
- Shortcomings:
 - Over-reliant on a single-point, cost-based test
 - Limited use of empirical data
 - Timing
 - Manipulability

UK's Revised Approach

- 3 stage approach:
 - Program level
 - Project level – pre market launch
 - Procurement level
- Balanced qualitative and quantitative assessment
- Embeds evidence-based approach
- Generic VfM model
- Technical adjustments

VfM Quantitative analysis



Technical Adjustments

- *Unbundled discount rate* - time preference rate of 3.5%
- *Optimism Bias* factored in to investment appraisal
- Monetisation of *non financial benefits and costs*
- Material *tax differentials* recognised and monetised

VfM Analysis – Input Sheet

General				
Timings	(Yrs)	Rates - Escalators & Discount	Rates (%)	Base Year
Contract period	29	CapEx escalator	4.5%	0
Initial CapEx period	5	OpEx (non employment) escalator	2.5%	0
Year when OpEx is first incurred	5	OpEx (employment) escalator	3.5%	0
		Unitary charge escalator	50%	0
		Real discount rate	3.5%	NA

Costs					
Whole Life	PSC	OB Pre (%)	OB Post (%)	PFI	OB Pre (%)
Initial CapEx (£'000)	65,250	10%	30%	71,775	10%
Lifecycle costs at each LC date (£'000)	6,535	10%	30%	1,076	10%
Lifecycle intervals (yrs)	10	NA	NA	1	NA
OpEx (non employment)(p.a.) (£'000)	1,075	10%	20%	1,183	10%
OpEx (employment per person) (p.a.) (£'000)	20	NA	NA	20	NA
OpEx (employee number)	25	NA	NA	25	NA
Transaction					
Public sector (£'000)	1,958	10%	10%	1,435	10%
Private sector (£'000)	0	0%	0%	1,077	0%

Third Party Income	PSC	OB Pre (%)	OB Post (%)	PFI	OB Pre (%)
Income (p.a.) (£'000)	475	10%	10%	575	10%

Flexibility	PSC	PFI
Scope change year	10	10
Probability factor (%)	50%	50%
Level of scope change (%)	50%	50%
Premium flexibility factor (%)	0	10%

Indirect VfM Factors	PSC	PFI
Amount (Npv)(£'000)	0	2,000

Tax	PSC	PFI
PSC adjustment factor (%)	6%	NA

Lifecycle Related Adjustments	
PSC lifecycle VfM adjustment	40%
Residual cost benchmark	50%
PSC residual cost factor if lower than benchmark	70%
PSC residual cost factor if higher than benchmark	35%

PFI Funding	
Gearing (%)	90%
Sterling swap rate (%)	5.15%
Credit spread (bps)	12
Bank margin (bps)	100
Tail for bank debt (yrs)	2
Commitment fee (bps)	50
Upfront fee (bps)	90
Grace period (yrs)	1

Unitary Charge	
Initial CapEx period payment (%)	50%

Pre Tax IRR Targets	
High	18%
Medium	15%
Low	13%

bps

CapEx

LC

NA

OB Pre

OB Post

OpEx

PSC

Basis Points

Capital Expenditure

Lifecycle Costs

Not Applicable - **no input required**

Pre-FBC Optimism Bias

Post-FBC Optimism Bias (for PSC only)

Operational Expenditure

Public Sector Comparator (i.e. conventional procurement)

Input required

Hard-wired Assumption - **no input required**

#END

Qualitative VfM criteria

- Major capital investment
- Definable and contractible outputs
- Optimum and enforceable risk allocation
- Balance of assets and non-asset services
- Whole life costing, not up front costs
- Size
- Term
- Stable delivery – technology
- Stable long term use/flexibility
- Private sector can deliver
- Procurement costs proportionate

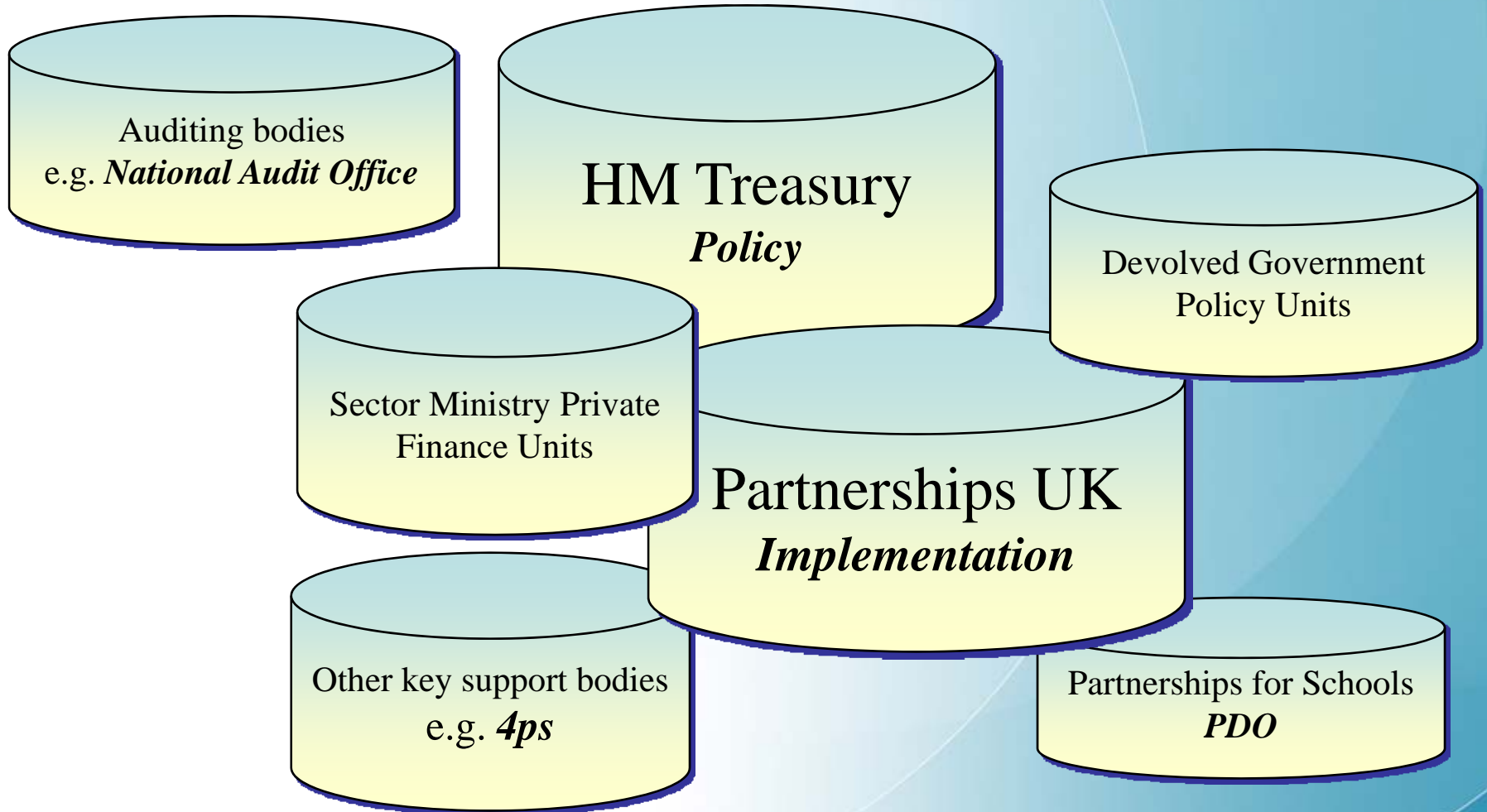
Drive the use of
PPP as a
procurement route

“Viability,
Desirability,
Achievability”

Challenges

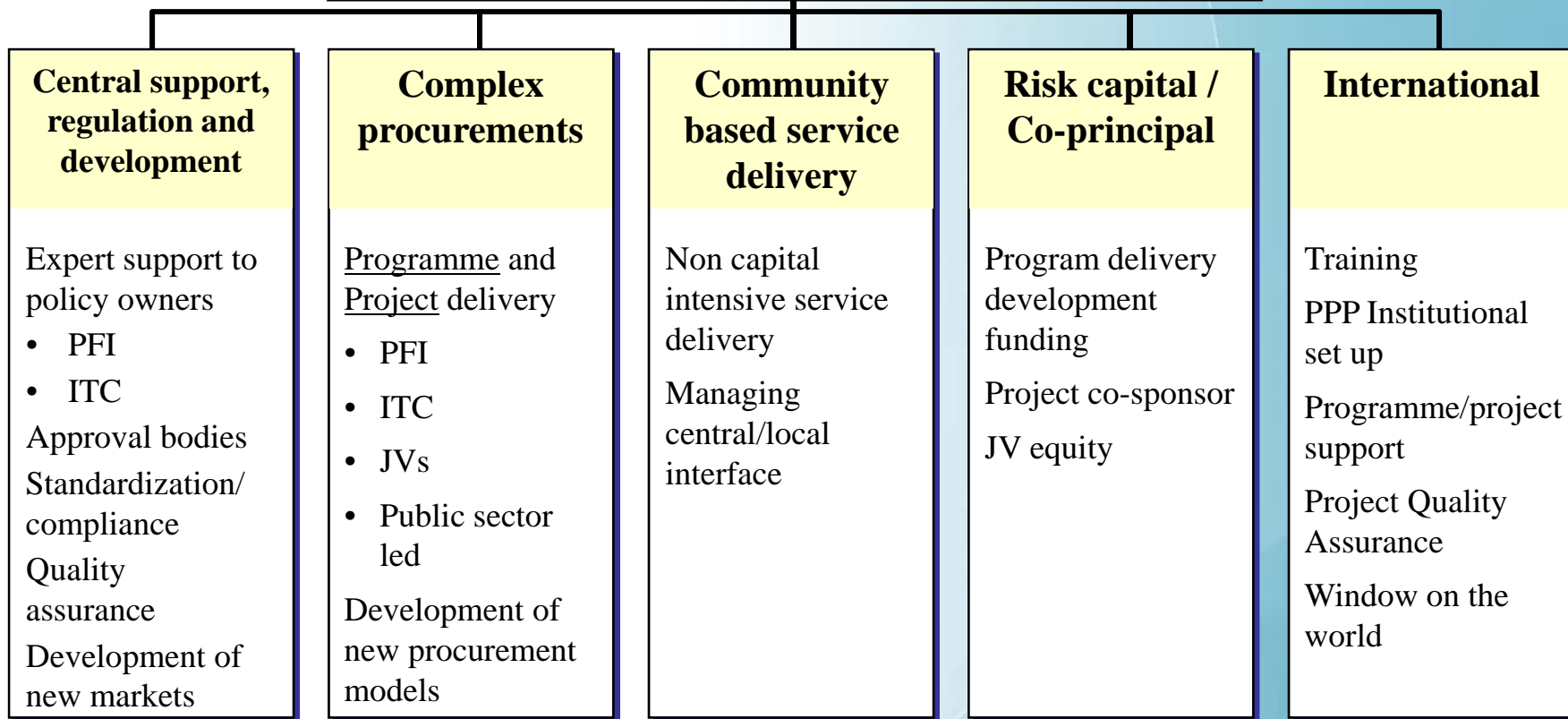
- Optimism Bias evidence base (PFI & PSC) availability
- Data management - double counting
- Limitations of a standardised approach
- Quantitative / qualitative weightings

UK Public Sector PPP Institutions



PUK Activities

Supporting public sector reform in the provision of public services



Achieving VfM

- Contractual fixed price
- **Long term commitments**
- Performance related payments
- **Private sector capital at risk**
- Competition
- **Public sector quality assurance regimes**

**Distinct
to PFI**

