COLUMN

Will PPP survive the credit crunch? - Geert Dewulf

Today, governments are confronted with increasing budget deficits. While governments have less money available big investments in infrastructure are planned to stimulate economic growth. As a reaction, private investments are needed to meet the growing demand for infrastructure. Third party investors and banks are, however, reluctant to invest or finance large projects. Many fear that the credit crisis and its impact on public financing of PPP deals will have a large impact on ambitious regeneration, health, school and infrastructure programs of both national and local authorities.

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In many western countries PPPs, mostly Design-Build-Finance-Maintenance-Operate (DBFMO) projects, were launched to find the investments needed. A DBFMO project is an arrangement between public and private organizations for the provision of an infrastructure or accommodation facility. The private consortium designs, builds, finances, maintains and sometimes operates the facility. The consortium is reimbursed by the awarding authority based on the services delivered. The principle is that the government commissions the project without paying the bill directly which is very attractive in years of budget deficits. Since the launch of the PPP program in the UK (the 'Private Finance Initiative') circa 1000 PFI projects had been signed. In 2008, however, only 34 new PFI projects were signed, the lowest number in the last decade. This year, several planned PFI projects in the UK, as hospital projects in Leeds and Leicester have been cancelled. In PPP contracts various risks are transferred to the private sector and this is the main problem today since lenders and investors are not willing and not longer in the position to accept those

risks. It should also be mentioned that many lenders to DBFMO projects are now government-owned or controlled. Another sign of the effect of the financial turmoil on PPP projects is the effective close of the wrapped bond market. A wrapped bond is a bond where the payments are guaranteed by insurance companies. The housing crisis in the US has hit the wrapped bond insurers.

It is clear that fewer banks are willing to invest or only willing to do so under very stringent conditions. A study of PWC in 2009 showed that banks are still able to participate but that they do have a preference for short term loans.

Banks also desire a shortening of loan maturities in DBFMO projects. Discussions with investors in the Netherlands revealed that market conditions for DBFMO projects have changed significantly. The combination of capital adequacy requirements, reduced liquidity and higher funding costs has increased the strain on the project finance banking model[1]. Despite these difficulties governments should stimulate PPP projects since on the long run private financing will offer more value for money than traditional procurement schemes. PPP schemes were introduced to deliver integrated solutions, to stimulate governments to work more performance-driven, and to work on time and within budgets. PPP It is not about finding the cheapest solution but about effective governance. Decisions have to be made based on long-term life-cycle calculations since PPP projects often have a time horizon of 30 or more years. In other words, the financial situation over a long term period should be taken into account. Economists have not predicted the latest financial turning-point and no one can predict what the situation will be in five or more years. The global crisis made it clear that psychological forces are driving the economy. Risks are perceptions and the government should look for ways to raise confidentiality by, for instance, introducing guarantee schemes or generating more flexibility in the contracts. The success of PPPs and partnerships in general is determined by soft issues, as trust, commitment and joint vision. A successful PPP project is a marriage between public and private partners *through thick and thin.*

[1] Based on meetings between the Ministry of Finance and third party investors; report Blanken and Dewulf: position paper for conference "From 'Revisiting and rethinking' to ' revamping and revitalising' PPPs, 28 February Hongkong