# PUBLIC-PRIVATE PARTNERSHIPS


PARTNERITETET KOSOVA
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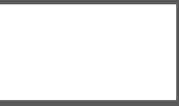
Ministria e Ekonomisë dhe Financave
Ministarstvo Privrede i Finansija
Ministry of Economy and Finance



# BRIDGING KOSOVO'S INFRASTRUCTURE GAP

In today's global economy, modern and efficient infrastructure and services are a necessary precondition for successful and sustainable economic growth.

The "infrastructure gap", defined as the difference between available resources and the amount of investment required to meet a country's core infrastructure needs, has a negative impact on economic growth and job creation.

Kosovo is in urgent need of expanded and more efficient public infrastructure and services. Nevertheless, the Government has limited financial resources to devote to capital expenditures and expanded public services. As a result, Kosovo's infrastructure gap, estimated at well over a billion Euros, is large and growing.

In order to bridge the gap between available public resources and the cost of needed infrastructure and services, as well as to ensure that infrastructure and services are delivered as efficiently and cost-effectively as possible, public authorities are turning to Public-Private-Partnerships.

Through an infusion of private capital and management, Public-Private-Partnerships (PPP) can ease fiscal restraints and boost efficiency in the provision of public infrastructure and services. Despite their potential, however, Public-Private-Partnerships are highly complex policy instruments.

That's to say, PPP have demonstrated their benefit by bringing about improvements in public infrastructure and services through shorter delivery times, better value for money and increased innovation across a range of sectors, but this does not mean that implementing a PPP program or project is easy. Indeed significant political, legal, regulatory and institutional hurdles must be overcome in order to move from a traditional, public sector model of public service delivery towards one in which public and private sectors work together.

PPP offer Kosovo the opportunity to modernize and expand its public infrastructure and services. With a new law on Public-Private-Partnerships and the establishment of a centralized PPP Unit in the Ministry of Finance and Economy, the institutional and legal framework are now in place to allow line ministries, POE's, municipalities and other budgetary organizations to begin implementing PPP across multiple sectors.

**THE GROWING INFRASTRUCTURE GAP**

The infrastructure gap – the amount of investment required to meet core infrastructure needs – is large and growing. On average, developing countries need to spend 5% of GDP on infrastructure capital expenditures in order to bridge this gap. Kosovo, as a new country, will need to invest even more.

# AN INTRODUCTION TO PPP

## WHAT ARE PUBLIC-PRIVATE-PARTNERSHIPS?

There is no single, universally accepted definition of Public-Private-Partnerships. Unfortunately, PPP often means different things to different people, which can make assessing and comparing international experience difficult at times.

In general, however, Public-Private-Partnerships refer to forms of cooperation between public authorities and the private sector which aim to ensure the financing, construction, renovation, management, operation and/or maintenance of an infrastructure and/or the provision of a service.

At their core, all Public-Private-Partnerships involve some form of risk-sharing between the public and private sector in the provision of an infrastructure or service. The allocation of risk to the private partner is the key determinant in distinguishing between PPP and the more traditional, public sector model of public service delivery.

There are two basic forms of Public-Private-Partnerships: contractual PPP and institutional PPP. Although institutional PPP have been quite successful in some circumstances, particularly in countries with well developed institutional and regulatory capacity; contractual PPP are by far the more common methodology, especially in developing economies.

Despite the fact that there is no universal consensus as to the definition of public-private-partner ships, the following elements normally characterize PPP:

- PPP are typically contractual or institutional arrangements between the public sector and a privat sector party for the private delivery of public infrastructure services or other basic services.
- The infrastructure or service is funded, in whole or in part, by the private partner.
- Risks are distributed between the public partner and the private partner, being allocated to the party best positioned to manage each individual risk.
- PPP are complex structures, involving multiple parties and relatively high transaction costs.
- Public-Private-Partnerships are a procurement tool where the focus is payment for the successful delivery of services (transfer of the performance risk to the private partner).
- PPP are output / performance based arrangements (the traditional model of public service delivery is “input-based”).
- PPP typically involve ‘bundled’ services (i.e., design, construction, maintenance and operation) in order to maximize synergies and discourage low-capital/high operating cost proposals.

In general, PPP offer a new and dynamic approach to managing risk in the delivery of infrastructure and services.

# PPP RANGE OF OPTIONS

As mentioned previously, there are wide-ranging definitions of PPP across the world, but generally speaking, public-private-partnerships fall somewhere in between the traditional public sector model of public service delivery and full privatization. Within this range, however, there are an infinite number of potential PPP transaction structures which can be employed, depending on the public sector's objectives and needs.

The decision as to the specific transaction design will depend on which risks and responsibilities remain with public authorities and which are to be transferred to the private partner.

## PPP SPECTRUM OF OPTIONS

As one moves across the spectrum of contracting options, from traditional public works and service contracts towards divestitures and privatizations, private sector risks and responsibilities increase.

For instance, with management contracts, public authorities retain ownership and investment responsibilities, but transfer management and operations to the private partner. Further along the spectrum, with concessions, Build-Operate-Transfer schemes (including BTO, BOOT, DBFO, PFI, etc.), and long term lease arrangements, public authorities retain ownership of infrastructure, but transfer both investment and operations/management responsibility to the private partner. With BOO and divestitures, the ownership, operations and investment responsibilities are all transferred to the private partner, while the public sector only retains responsibility for regulation and strategic sector planning.

In other words, different PPP contract modalities reflect distinct distributions of risk and responsibility.

# PPP GLOSSARY AT A GLANCE

In the world of Public-Private-Partnerships, acronyms are everywhere. Some of the more common PPP acronyms and models are described herein:

**SERVICE CONTRACT:**
Qeveria kontrakton një entitet privat për të ofruar shërbime të cilat i kishte ofruar qeveria më herët.

**MANAGEMENT CONTRACT (MC):**
Qeveria kontrakton një entitet privat për të operuar dhe menaxhuar një hapësirë (shërbime të shumëfishta).

**LEASE:**
The government leases the assets to a private operator for a fee. The private operator takes on the operational risk. In some instances, the lease agreement can include investment requirements (i.e, Lease-Develop-Operate contract structures).

**CONCESSION:**
The government or public authority grants a private entity exclusive rights to provide, operate, and maintain an infra structure asset for a specified period of time. The private partner assumes significant investment risk, while the public sector retains ownership of the original asset. Examples include:

- Rehabilitate, operate, and transfer (ROT): A private sponsor rehabilitates an existing facility, then operates and maintains the facility at its own risk for the contract period.
- Rehabilitate, lease or rent, and transfer (RLT): A private sponsor rehabilitates an existing facility at its own risk, leases or rents the facility from the government owner, then operates and maintains the facility at its own risk for the contract period.
- Build, rehabilitate, operate, and transfer (BROT): A private developer builds an add-on to an existing facility or completes a partially built facility and rehabilitates existing assets, then operates and maintains the facility at its own risk for the contract period.

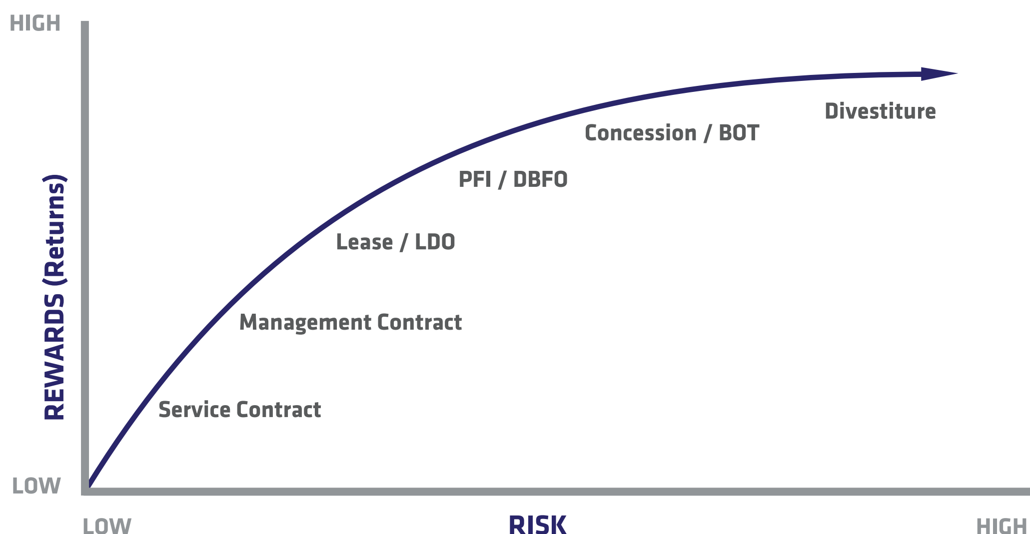
**GREENFIELD PROJECTS:**
A private entity or a public-private joint venture builds and operates a new facility for the period specified in the project contract. The facility may or may not return to the public sector at the end of the concession period. Greenfield projects can be organized into categories:

- Build, lease, and transfer (BLT): A private sponsor builds a new facility largely at its own risk, transfers ownership to the government, leases the facility from the government and operates it at its own risk up to the expiration of the lease.
- Build, operate, and transfer (BOT): A private sponsor builds a new facility at its own risk, operates the facility at its own risk, and then transfers the facility to the government at the end of the contract period. The private sponsor may or may not have the ownership of the assets during the contract period. This is also commonly referred to as a DBFO (Design-Build-Finance-Operate).
- Build, own, and operate (BOO): A private sponsor builds a new facility at its own risk, then owns and operates the facility at its own risk.
- Design-Build-Finance-Operate (DBFO): The private entity finances and constructs the asset, which gives the private entity the incentive to complete on time and within budget. The asset is only paid for by the public sector when it has been completed. This is common under the PFI (Private Finance Initiative) model.

**DIVESTITURE:**
The government transfers an asset, either in part or in full, to the private sector. Generally the government will include certain conditions with the sale of the asset to ensure that improvements are made and services continued to be delivered.

# PPP RISK-REWARD CURVE AND COMPENSATION MODELS

Given that public-private-partnerships allocate certain risks to the private partner, the private entity must be compensated for assuming these risks. Generally speaking, the greater the risk, the greater the required return.




RISK REWARD RELATIONSHIP BY CONTRACT MODALITY

In PPP arrangements, the private partner is typically compensated through either:

- User-based payments (i.e. toll roads, airport charges, etc.);
- Availability Payments from the public authority (i.e. PFI, PPA, WPA, etc.); or
- A combination of the above.

Often in the case of user-based payment structures, the government or public authority will need to provide some financial support to the project in order to mitigate specific risks, such as demand risk, or to ensure that full cost recovery is compatible with affordability criteria and the public's ability to pay. Government support mechanisms can take many different forms, such as contributions, investments, guarantees and subsidies, but should be carefully designed and implemented so as to ensure an optimal risk allocation between the public and private sectors. When government supports are present, the objective is to maximize private capital mobilization per unit of public sector contribution.

In infrastructure PPP, service providers are paid to deliver a particular level of service (not inputs). In other words, payments are contingent upon the private service provider delivering services to an agreed performance standard. Indeed the essence of PPP is, “No Delivery, No Payment”.

Availability payments are at the heart of one form of PPP, the Private Finance Initiative (PFI) model. PFI is a system for providing capital assets for the provision of public services. Born in the U.K., this model is used for a large number of infrastructure projects and provides the private sector with strong incentives to deliver infrastructure and services on time and within budget, while simultaneously allowing governments and public authorities to spread the cost of this public infrastructure projects over a long (20-30 year) period. This creates greater budget certainty, while also liberating scarce public resources for other socially priorities.

**GOVERNMENT SUPPORT MECHANISMS:**
Contracting Authorities can provide financial support to or reduce the financial risk of a project in many ways. Some common forms of government supports include the following:

- Cash subsidy - The government or public authority agrees to provide a cash subsidy to a project. It can be a total lump sum or a fixed amount on a per unit basis, and payments can be made either in installments or all at once.
- Payment Guarantee - The government agrees to fulfill the obligations of a purchaser (typically a publicly-owned- enterprise) with respect to the private entity in the case of non-performance by the purchaser. The most common example of this is when a government guarantees the fixed payment of an off-take agreement (e.g. Power Purchase Agreement (PPA), Water Purchase Agreement (WPA)) between a private entity and the publicly-owned enterprise.
- Debt Guarantee - The government secures the borrowings of a private entity. That is, a government guarantees repayment to creditors in the case of a default by a private entity.
- Revenue Guarantee - The government sets a minimum variable income for the private partner; typically this income is from user fee payments by end-use customers. This form of guarantee is most common in roads with minimum traffic or revenue set by a government.

## VALUE FOR MONEY – PPP VERSUS PURE PUBLIC INVESTMENT

It is important to note that not all projects are suitable for PPP. Public-Private-Partnerships should provide equivalent or better value for money than a 100% public sector approach. The PPP Unit understands this and will work with institutions to honestly assess PPP project viability vis-à-vis other financing and implementation options. The objective is to improve services and deliver the best "value for money".

Value for money is a key driver in public private partnerships. Value for money does not simply equate to selecting the cheapest bid or lowest price for an asset; it means opting for the best long-term solution for service delivery. It involves analyzing the total long term costs (life-cycle costs) of service delivery and evaluating the concomitant benefits to the public at large.

When compared to a public sector approach, incremental benefits of PPP may accrue from:

- Speedier implementation of infrastructure projects;
- Better service and coverage;
- Life-cycle focus of service delivery / reduced life-cycle (long-term) costs;
- Improved efficiency and innovation; and
- Risk sharing designed to create incentives to succeed.

# BENEFITS AND CHALLENGES OF PPP

It is unlikely that public-private-partnerships will ever entirely replace the traditional public sector model of public service delivery. PPP are just one tool, amongst many, available to governments and public authorities for the development of infrastructure and services.

That being said, however, PPP have shown their potential for addressing infrastructure shortages and achieving good value for money. Some obvious benefits of PPP include:

- Speedier implementation of infrastructure projects: Due to the fact that payment is tied to infrastructure and service delivery, PPP have a solid track record of completing construction on time or ahead of schedule. Additionally, given that PPP generally allow the public to spread the cost of the infrastructure investment over the lifetime of the asset, the public sector can advance infrastructure projects without the need for significant upfront capital. This allows the public to benefit from the investment much sooner than with traditional "pay-as-you-go" financing.

- Budget Leveraging / Additional Capital: By shifting financing responsibilities to the private party, public-private-partnerships result in an infusion of private capital into public infrastructure and services. This mobilization of additional capital allows governments to increase the overall level of investment in infrastructure development.

- Optimal risk sharing: PPP shift specific life-cycle risks to the private partner, thereby creating incentives for better and more cost-effective service delivery. For instance, by shifting construction, operation, and maintenance risk to the private partner, powerful incentives are created for delivering a high quality facility which are ideally suited for operations and not prone to break downs. Likewise, by tying payment to infrastructure availability and service delivery, the private partner is economically motivated to deliver infrastructure on-time and provide high quality services.

- Customer Service Orientation: Given the use of performance based incentives, PPP have a proven track record of improving quality and service levels. Specialist private service providers offer improved expertise, while private sector innovation facilitates the provision of quality services. Furthermore, as the public sector divests itself from day-to-day service provision, it is able to act as a more effective regulator, focusing more on ensuring that the private operator delivers desired customer service levels.

- Improved Efficiency and Cost Savings: Private sector efficiency, coupled with an optimal risk allocation, can create significant cost savings in the delivery of public infrastructure and services. Cost savings from PPP typically materialize in the form of lower construction costs, reduced life-cycle costs, improved efficiency, and lower costs of associated risks.

- Generation of Additional Revenues: Innovation and the private sector profit motive can create incentives for the private partner to develop new and creative sources of revenue from public infrastructure. These new sources of income can be shared with the public, creating additional sources of revenue for other social priorities.

- Private Sector Development / Investment Opportunities: As the cornerstone of any modern economy, the private sector is constantly in search of new investment opportunities. PPP provide stable, long term investment possibilities for the private sector, as well as the opportunity to enter into service sectors previously monopolized by public authorities.

- PPP Allow the Public Sector to Focus on Strategic Functions and Outcomes: By liberating the public sector from the direct provision of non-strategic services, governments can focus their scarce resources on their core mission.

> “PPP hold the promise of increasing the supply of infrastructure without overburdening a country’s public finances. An infusion of private capital and management can ease fiscal constraints and boost efficiency …”
> IMF, Finance & Development, December 2004

Despite their potential, however, PPP are not a panacea.
Public-Private-Partnerships do entail some unique challenges, which need to be recognized:

- PPP are complex and relatively inflexible structures.
- PPP procurement and implementation can be lengthy and costly, making it unsuitable for some projects.
- PPP place additional responsibility on the public sector, which must be prepared to act as a competent counterpart and regulator. This may require a different set of government proficiencies, i.e. managers skilled in negotiation, contract management and risk analysis.
- PPP may lead to higher user charges once implicit or explicit subsidies are removed. This is not necessarily a direct consequence of PPP, but the public may perceive the increased rates and charges as a consequence of the private partner’s required return on investment.
- PPP do not achieve absolute risk transfer. The public sector will retain some risks.
- Not all projects are suited for PPP.

Indeed, although PPP hold significant benefits as an infrastructure delivery tool, when done incorrectly, PPP can generate considerable problems. For this reason, governments and public authorities should look to experts to ensure that PPP programs and projects achieve their intended objectives, while maximizing value for money.

## GLOBAL TRENDS IN PPP

Public-Private-Partnerships are a growing segment of public procurement across the world. Over the past ten years, governments and public authorities have increasingly turned to PPP as an infrastructure delivery tool in multiple sectors and this trend shows no sign of slowing.

Although the PPP experience can vary greatly from country to country or region to region, the following table summarizes some principal PPP infrastructure opportunities that may be appropriate for Kosovo:

| SECTOR | SUB-SECTORS | INDICATIVE PPP MODELS |
| --- | --- | --- |
| TRANSPORT | ■ Airports<br>■ Roads<br>■ Railroads | BOT, BTO, BOOT, PFI, Concession, MC, divestiture, other. |
| ENERGY | ■ Electricity<br>■ Natural Gas | BLT, BOOT, Concession, MC, divestiture, other. |
| WATER AND SEWERAGE | ■ Treatment Plants<br>■ Utility | BT, BLT, BOOT, Concession, MC, divestiture, other. |
| EDUCATION | ■ School Infrastructure<br>■ Research Facilities<br>■ University Facilities and Services | DBFO / DBFOM (PFI), MC. |
| HEALTH | ■ Hospital Infrastructure<br>■ Clinical and non-clinical Services<br>■ Hospital Master Concessions | DBFOM (PFI), MC, other. |
| MUNICIPAL WORKS URBAN RENEWAL SOCIAL WELFARE | ■ Public Buildings<br>■ Public Housing<br>■ District Heating<br>■ Sports & Leisure<br>■ Parking / Transport<br>■ Others | PFI, BTO, BOT, BOOT, BOO, other |
| PRISONS | ■ Correctional Facilities | DB, DBOM, BTO, BOO, MC |
| OTHER | ■ IT<br>■ Tourism<br>■ Environment<br>■ Industrial Parks | DB, DBFOM (PFI) BOO, MC, other. |

# THE PPP LIFE-CYCLE

When implementing Public-Private-Partnerships, it is important to adopt a life-cycle perspective. Success depends, in great part, on the government's capacity to execute and manage innovative partnerships.

All too often, too much emphasis is placed on the transaction, overlooking other critical factors. Certainly, the transaction is an important component of PPP, but it is only one small part of a broader framework. Equally important are establishing the legal, regulatory, institutional, and policy framework for PPP; ensuring stakeholder buy-in; managing the change process; applying appropriate risk models; developing adequate oversight and monitoring structures; and incorporating PPP into broader sector strategies. In other words, in order for Public-Private-Partnerships to be successful, they need to be implemented within a broader policy framework which takes into account all phases of the PPP life-cycle.

The PPP life-cycle generally involves three major phases:

**1. POLICY AND PLANNING PHASE**: This phase, includes the establishment of the legal, regulatory, institutional and policy framework for PPP. Budget organizations should develop clearly articulated policies and priorities prior to implementing PPP projects. PPP should be considered within a broader framework of objectives and priorities. The policy and planning phase is critical to determining the eventual success or failure of any PPP initiative.

**2. TRANSACTION PHASE**: The purpose of the transaction phase is to secure the best value for money. This is achieved through a quantitative and qualitative analysis of project options (feasibility studies) and the establishment of performance standards and incentives. It is imperative to structure the deal so that it is bankable, while simultaneously achieving optimal risk allocation. Competitive incentives involved in the procurement process also help achieve better value for money. The transaction phase is completed when project agreements have been formalized and the private partner has achieved financial close for the project.

**3. PARTNERSHIP PHASE**: During this phase, the private partner operates the infrastructure facility, while the budget organization provides oversight and compliance monitoring. The partnership phase involves a number of different stages, including: (i) construction; (ii) operations and management; and (iii) termination / asset handover. Other activities during this stage may include dispute resolution, renegotiations, regulation, etc. Indeed, this long-term relationship requires an effective governance structure, as well as trained public officials who can act as competent PPP counterparts.

POLICY AND PLANING PHASE

TRANSACTION PHASE

PARTNERSHIP PHASE

# ABOUT PARTNERSHIPS KOSOVO THE CENTRALIZED PPP UNIT IN THE MFE

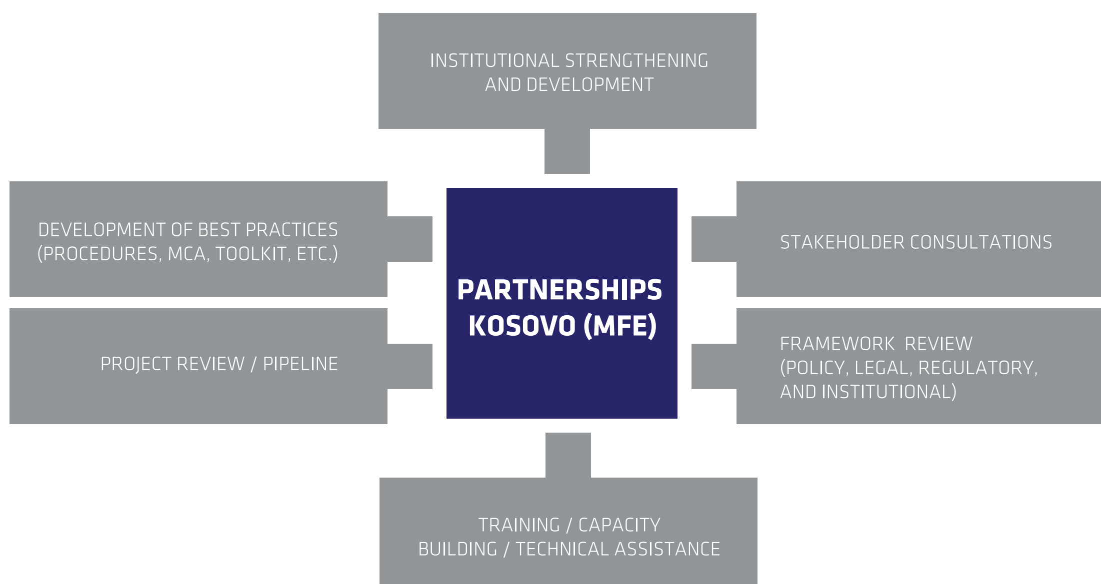
## MISSION STATEMENT

To promote and help implement Public-Private-Partnerships across multiple sectors in order to achieve efficient and cost effective forms of public service delivery.

## OBJECTIVES OF PARTNERSHIPS KOSOVO

- Manage a centralized PPP Program across multiple sectors
- Champion a proper enabling framework for PPP;
- Act as an effective link between political priorities and institutional structures;
- Establish, promote, and disseminate project identification, development, and implementation standards and best practices;
- Establish and promote standardized tender processes to foster consistency and predictability;
- Provide investment opportunity information to potential investors;
- Promote education, training and capacity building;
- Coordinate the presentation, analysis and selection of projects with line ministries, POEs, municipalities and other budgetary organizations;
- Serve as a liaison with stakeholders;
- Vet and appraise PPP projects and approve all projects that seek government supports (contributions, guarantees, subsidies, etc.).
- Provide the necessary guidance, technical assistance and support to line Ministries, POEs, Municipali ties and other budgetary organizations;
- Maintain a close liaison with the oversight and monitoring units within the line Ministries, POE, municipalities and other budgetary organizations while projects are underway.

### PARTNERSHIPS KOSOVO ACTIVITIES:



Partnership Kosovo objectives:

- Improved public governance of infrastructure and utilities
- Optimized financial performance of infrastructure assets
- Value for money in service delivery
- Strategic engagement of private sector partners

## How Partnerships Kosovo can assist your Organization:

The PPP Unit offers advisory services relating to virtually all phases of the public-private-partnership life-cycle. We take an integrated, holistic view of PPP and work with institutions to ensure successful and sustainable PPP initiatives which provide the best value for money.

The following is a representative list some of the Partnerships Kosovo services:

Policy and Planning Phase:

- Legal and regulatory framework strengthening;
- Institutional Development and Capacity Building
- Creating standardized practices and toolkits
- Development of Procedures and Tools for project analysis
- Policy Development
- Preparation of Pilot Projects / Project Pipeline
- Strategic Planning for PPP Initiative
- Marketing / Public Relations
- PPP Program Management

Transaction Phase:

- Assessing Financing and Implementation Options for PPP project candidates
- Financial modeling for value-for-money, public vs. private and transaction design decisions
- Legal and institutional environment due diligence
- PPP transaction and procurement management
- Design of project oversight and governance structure.

Partnership / Implementation Phase:

- Transition Assistance
- Contract oversight and monitoring
- Development of Contract Governance Models
- Contract Management Assistance
- PPP Project and Program Assessment
- Capacity Building and Training
- Benchmarking Best Practices

The Partnerships Kosovo is committed to working with public institutions to honestly assess all finan cing and implementation options.

**CONTACT INFORMATION**

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