



Strengthening Private Sector Participation for Infrastructure in the Pacific Region

Value for Money and Business Case Development
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November 2008

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Agenda

- ▶ Business Case Development Overview
- ▶ Mechanism to Evaluate Value for Money
- ▶ The Public Sector Comparator
- ▶ The Value for Money Comparison
- ▶ Discount Rate Approaches

Business Case Development

- ▶ Formalisation of Steering Committee and Government Project Team
- ▶ Development of a Project Plan, Output Specification, Reference Project, PPP Project
- ▶ Completion of Risk Analysis, Risk Allocation Matrix, Market Sounding, Public Interest Assessment, environmental planning, cultural heritage and other specialist studies, Employee, Employment and skills development assessment
- ▶ Development of Public Sector Comparator
- ▶ Value of money assessment of Project Delivery Options
- ▶ Compilation of PPP Business Case

Purpose of the Business Case

- ▶ Provides the analytical rigour that allows for effective government decision making and value for money procurement
- ▶ Enables a detailed analysis of the delivery options that may provide Value for Money to take place
- ▶ Significant analysis of the risk and issues surrounding the project is undertaken to identify, quantify and where appropriate mitigate risks that the project may experience
- ▶ A detailed hypothetical financial model of the traditional delivery option (the reference project) is developed on a risk adjusted, whole of life basis and becomes the benchmark against which value for money assessment is made – The Public Sector Comparator

Purpose of the Business Case

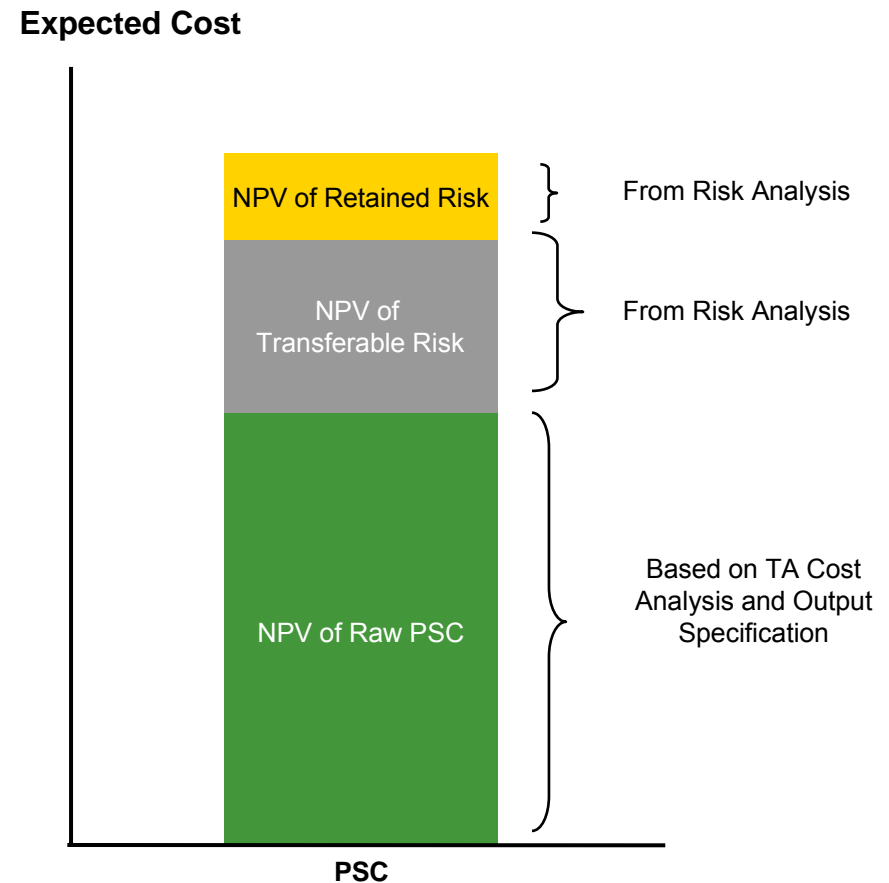
- ▶ Supporting documentation provides the next level of detail on the steps required to complete the public private partnership business case
- ▶ Summary of all aspects of Business Case development include:
 - ▶ Reference Project
 - ▶ Output Specification
 - ▶ Public Sector Comparator
 - ▶ Business Case analysis including value analysis, sensitivity and scenario analysis, bankability etc.

Mechanisms Used to Evaluate VFM

- ▶ **Public Sector Comparator – Business Case**
 - ▶ Functions as a cost benchmark
 - ▶ Based on public sector financing and coordination of delivery
- ▶ **Bid Evaluation Process – Procurement Phase**
 - ▶ Financial evaluation of bids against the PSC
 - ▶ Consider trade-offs between risk pricing and risk allocation

Public Sector Comparator (PSC)

- ▶ Retained Risk is the PSC project risk that will rest with the public sector under a PPP contract
- ▶ Transferable Risk is the PSC project risk which can be transferred to the private sector under a PPP contract
- ▶ Raw Cost is the cost of providing the services required by the output specification under traditional delivery



Public Sector Comparator (cont.)

The Common Pricing Mistake...




- ▶ **Output Specification of Old School:**
 - ▶ Lower quality materials / design - not designed with a whole-of-life approach.
 - ▶ Back-log maintenance regime
 - ▶ No performance deductions
 - ▶ Lower operating requirements




- ▶ **Output Specification of New School:**
 - ▶ Designed and built on a whole-of-life basis
 - ▶ Stringent maintenance regime to ensure fitness for purpose over the contract duration.
 - ▶ Penalties for under-performance

Public Sector Comparator - Cashflows

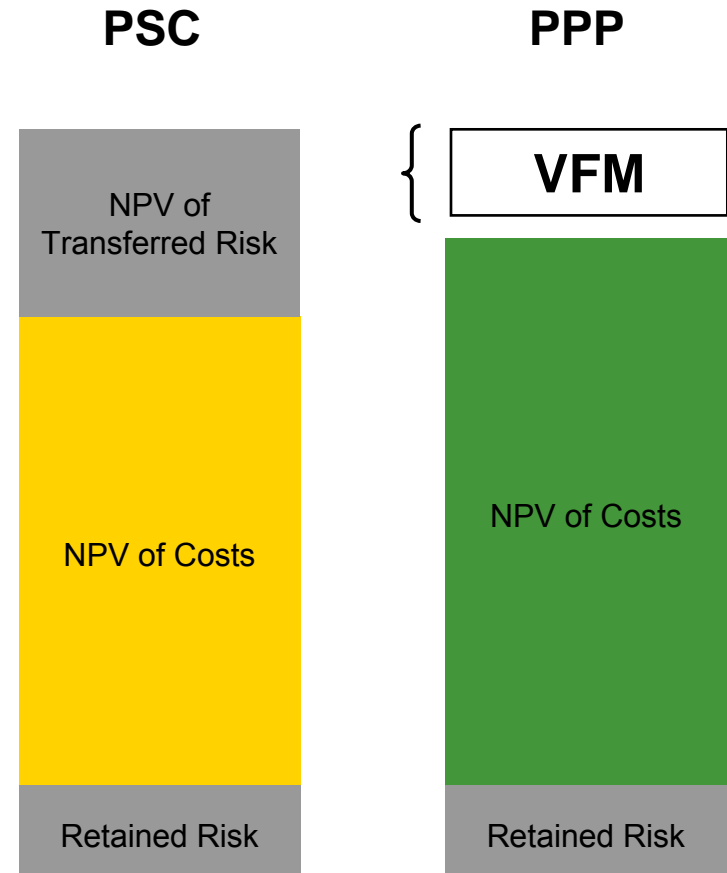
	NPV	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6	Yr7		Yr30
Design and Construct	x	x								
Operating cost			x	x	x	x	x	x	x	x
Life Cycle cost				x			x			x
Raw PSC	x	x	x	x	x	x	x	x	x	x
Retained Risk	x	x	x	x	x	x	x	x	x	x
Transferred Risk	x	x	x	x	x	x	x	x	x	x
Risk Adjusted PSC	x	x	x	x	x	x	x	x	x	x

PPP Model - Cashflows

	NPV	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6	Yr7		Yr30
Availability Payment	(x)			(x)	(x)	(x)	(x)	(x)		(x)
Design and Construct Cost		x	x							
Operating cost				x	x	x	x	x		x
Life Cycle cost				x			x			x
Transferred Risk	x	x	x	x	x	x	x	x	x	x
Debt Service	x	x	x	x	x	x	x	x	x	x
Taxation	x	x	x	x	x	x	x	x	x	x
Dividend payments (to meet target IRR)	x	x	x	x	x	x	x	x	x	x

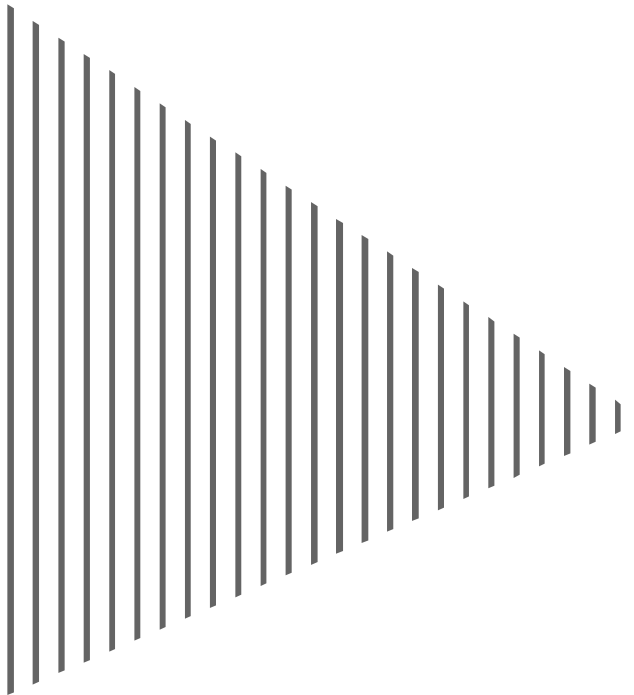
The VFM Comparison

- ▶ The PSC is at the heart of PPP procurement:
 - ▶ Used to confirm that the Government is getting VFM
 - ▶ Used to price the project
 - ▶ Used as a tool to evaluate bids
- ▶ Note importance of discount rate to the VFM decision
- ▶ Private sector can only deliver VFM if it manages **cost** and **risk** more effectively than under PSC
- ▶ Existence of VFM drivers provides platform for the private sector to do this



Discount Rate approach

- ▶ **Social Infrastructure (e.g.: School, Hospital)**
 - ▶ Project risk priced into cashflows
 - ▶ Discount Rate is, therefore, a “risk free rate”
 - ▶ Small adjustment made to reflect “systematic” risk transfer under PPP model
- ▶ **Economic Infrastructure (e.g.: Toll Road)**
 - ▶ Project risk, ex Market Risk, priced into cashflows
 - ▶ Market Risk reflected in discount rate



Thank you

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