Revisit PPPs to Revive Investments

(This editorial is based on the article “Revisit PPPs to Revive Investments” which appears in BusinessLine for 15th December.)

For the overall development of the Indian economy, Public-Private Partnerships (PPP) is one of the best options.

To opt for PPP, a robust revival of private investment is needed. Getting the investment rate to go over 36% once again is imperative to get a sustained growth of over 8% per annum. This is the major challenge for the Indian economy.

What is PPP?

- Public-private partnerships between a government agency and private-sector company can be used to finance, build and operate projects, such as public transportation networks, parks, and city centers.

There has been commendable progress in addressing the problems in PPP models. Still, there is a need to revisit PPP models for greater benefits.

PPP Models

The Build Operate and Transfer (BOT): Under BOT annuity, a developer builds the highway, operates it for a specified duration and transfers it back to the government. The government starts payment to the developer after the launch of commercial operation of the project.

BOT Toll Model: In this toll based BOT model, a road developer constructs the road and he is allowed to recover his investment through toll collection. This toll collection will be over a period of nearly 30 years in most cases. There is no government payment to the developer as he earns his money invested from tolls.

Engineering, Procurement, and Construction (EPC) Model: Under this model, the cost is completely borne by the government. Government invites bids for engineering knowledge from the private players. Procurement of raw material and construction costs are met by the government. The private sector’s participation is minimal and is limited to the provision of engineering expertise. A difficulty of the model is that financial is the high financial burden for the government.

The Hybrid Annuity Model (HAM): In India, the new HAM is a mix of BOT-Annuity and EPC models. As per the design, the government will contribute 40% of the project cost in the first five years through annual payments (annuity). The remaining payment will be made on the basis of the assets created and the performance of the developer.

Opportunities

- India has systematically rolled out a PPP program for the delivery of high-priority public utilities and infrastructure and, over the last decade, developed one of the largest PPP programs in the world.
- With close to 1500 PPP projects in various stages of implementation, according to the World Bank, India is one of the leading countries in terms of readiness for PPPs. As per the 2015 Infrascope Report of the Economist Intelligence Unit, "Evaluating the environment for PPPs in Asia-Pacific 2014", India ranks first in the world in "Operational Maturity" for PPP projects, third for sub-national PPP activity and fifth overall in terms of having an ideal environment for PPP projects.
- **Public-Private Partnerships (PPPs) in infrastructure provides for the creation of public asset and service by a private partner who has been conceded the right (the "Concession") for the purpose, for a specified period of time, on the basis of market-determined revenue streams, that allows for a commercial return on investment.**
- PPPs in infrastructure represent a valuable instrument to speed up infrastructure development in India. This speeding up is urgently required for India to grow rapidly and generate a demographic dividend for itself and also to tap into the large pool of pension and institutional funds from aging populations in the developed countries.
- **India offers today, the world's largest market for PPPs. It has as such accumulated a wealth of experience in getting to this premier position.**

Challenges

- Better identification and allocation of risks between stakeholders (i.e the Govt., the Public, and the investors) is one of the major challenges in PPP projects.
- **The PPP route has been criticized for not meeting the supply-demand gap exactly in the infrastructure facilities.**
- **Six key hurdles faced by PPPs projects are as follows: policy and regulatory gaps;** inadequate availability of long-term finance; inadequate capacity in public institutions and public officials to manage PPP processes; inadequate capacity in the private sector-both developer/investor and technical manpower; inadequate shelf of bankable infrastructure projects that can be bid out to the private sector; and inadequate advocacy to create greater acceptance of PPPs by stakeholders.
- **The most important challenge for PPP projects, however, has emerged as delays in achieving commercial operation dates (COD)** which lead to time and cost overruns. It has occurred partly due to land acquisition issues, willful default by promoters, irrational biddings, huge difference between project costs as approved by the Govt. and ones that are given to lenders.
- **On the land acquisition front, issues related to the huge difference between the registered value offered and the actual market value have been very disputing.** Moreover, valuations are conducted on the basis of the current status of land, and the system does not capture the appreciation after the construction of the project.

Way Forward

- The better understanding of risk perceptions of investors and lenders and mitigating the aforementioned challenges, along with installing adequate safeguards against windfall profits, are essential for success in designing workable PPPs.
- **Genuine and transparent stakeholder consultation at the project and contract design stage with an open pragmatic approach would naturally help.** Inadequate risk mitigation and faulty design may well be the major cause of the default by IL&FS which has been the leading investor in PPP projects.
- In addition to changing mindsets, there is an urgent need to rebuild India's PPP capacities. Structured capacity building programmes for different stakeholders including implementing agencies and customized programmes for banks and financial institutions and the private sector need to be evolved.
- **Investments for treatment of sewage, augmentation of water supply for cities, completing the canal network for large irrigation projects, are all examples of needed**

investments which cannot be made financially viable through the recovery of user charges. Such projects have, therefore, been considered as not being suitable for PPPs. However, if the state, or, a public institution came in as an intermediary by agreeing to pay user charges after a transparent and fair bidding process, private investment could be brought into these non-traditional areas.

- **For infrastructure like hotels, hospitals, schools etc., providing land free through a reasonable lease rent and revenue-sharing arrangement in somewhat developed and promising locations will boost development greatly.**
- In undeveloped sites, a two-tier PPP structure may be needed. A private builder (e.g a civil contractor) could on a rental basis do the bare structure of a hotel, hospital etc for a development agency (like NDMC and Delhi Development Authority). The agency could then get a hotelier, like the Taj or Hyatt, or for hospitals get Apollo or Fortis, to do the finishing and furnishing and then run the hotel on lease rent with revenue sharing.
- **The potential for additional investment in PPP is therefore enormous. The challenge only lies in having the ambition and pragmatism to actually get large projects going with private investment.**