

Case Study on PPP Fiscal Risks

In the Kingdom of Wonderland several departments in the Ministry of Finance and in the Ministry of Transport are preparing the assessment of a tram project, the OuterTram. An Outline Business Case (OBC) was prepared by a team of external consultants and has just been distributed to the relevant departments.

When OuterTram was approved by the Government two years ago, it was a tram project designed to put to use an old train line from the ancient Wondercity Central Station to Outer, in the outskirts of Wondercity, serving a population of 50,000 people and costing 90 million euros (circa 2500 Million CzK).

Now, after new studies, some changes were introduced, in order to serve a wider area and to improve quality. In order to reach the city centre with no modal change, the project includes a 2km tunnel extending the line across the Old Town. The single-track rail line will be duplicated in order to allow for faster service, because experts consider that with single-track the tram service from Outer to the centre would be much slower than the old train service in that same line, mainly because the tram has many more stations than the old service. And the line terminus is now diverted from the area with higher population density to a derelict industrial area where the government plans to develop the new university campus. The campus inauguration is not yet decided because of problems related to soil contamination but, if approved by Government, the campus could be ready in three years, serving possibly 20,000 students, at least 3,000. The new line, providing a much better tram service to a larger population (70,000 people) is now expected to require a 235 million euros investment (circa 6600 million CzK). The expected demand could reach 30,000 passengers per day, albeit the real figure will be dependent on the impact of the new express train that links Outer train station to the main subway line. The OBC considers that the project, with that demand and continuous annual real increases in fares, is able to generate enough revenue to pay for the all its costs.

The proposed contract is a PPP: the private partner will be responsible for the design and construction of the tram line and for its maintenance for 30 years, as well as for the exploitation of the service for the same period. The private partner will fully bear construction risk (with the single exception of problems due to force-majeure or to archaeological findings). The private partner revenues will come from the tram users (as the private partner

will bear demand risk, bidders are required to propose the initial fare per passenger.km that they will apply, as well as the annual per cent increase in fares, at constant prices) and from a government investment subsidy. The award criteria favour the bidders that present the lower government investment subsidy. In order to protect the private partner from Government interference, the contract provides a clause forcing Government to pay compensation to the private partners in case it decides to change the fare levels.

In order to attract potential passengers, the terminal near the university shall be a large mall with bookshops, small restaurants, printing offices and an internetcafé. These small projects will attract investors that could participate in the PPP-project. As this mall is perceived as a very profitable investment, able to co-finance the tram and the university, the contract provides for the university to pay for the construction of the terminal; the tram operator will manage the building and will share 50-50 with the university all profits from commercial renting at the terminal. In order to commit the tram operator to service to the university, the contract will give the tram operator the exclusive right to exploit all commercial areas in the campus, including the construction and maintenance (for the 30 years following construction) of the several research centres planned for the campus, as well as all mass transport activities inside the campus.

Alleging that the project is already approved by Government, that it will create no budgetary burden to Government, and the need to have the tram system ready for the campus inauguration, the OBC proposes to publish the call for tender in two months time.

Questions:

- What is your first impression of this project?
- Are the risks for the state as indicated high or low?
- Will the price of a ticket be high or low in the first years of the project?
- Regarding the idea for the campus terminal: what risks should the private partner bear and what risks should the state bear?
- What is your idea about the amount of passengers per day; is this sufficient? Will the proposed extra projects have any influence on this amount?
- Make a short list of high and low project risks and indicate who should bear them. Remember: high risks mean a higher price, low risks mean a lower price.
- Try to add extras to this project that will attract bidders.
- How can the quality of public service performance be increased in this project?