Competencies and Politicization in Public-Private Partnerships and Infrastructure Development: The Case of the Pedemontana Veneta

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Chronology

3 February 1990:
Regional counsel approves the regional transport plan with "Pedemontana Veneta Itinerary."

31 December 2003:
The operator presents the proposal with traffic studies (unsolicited proposal).

3 December 2004:
Veneto Region under the presidency of Mr. Galan declares public interest in the project.

29 March 2006:
CIPE (Prime Minister's Cabinet) approves the preliminary project.

17 October 2006:
Veneto Region opens the tender and the consortium of SIS and Itinere Infraestructuras wins *(not* the original promoter).

21 October 2009:
After three contentious years, the contract is signed.

18 December 2013: The project was renegotiated.

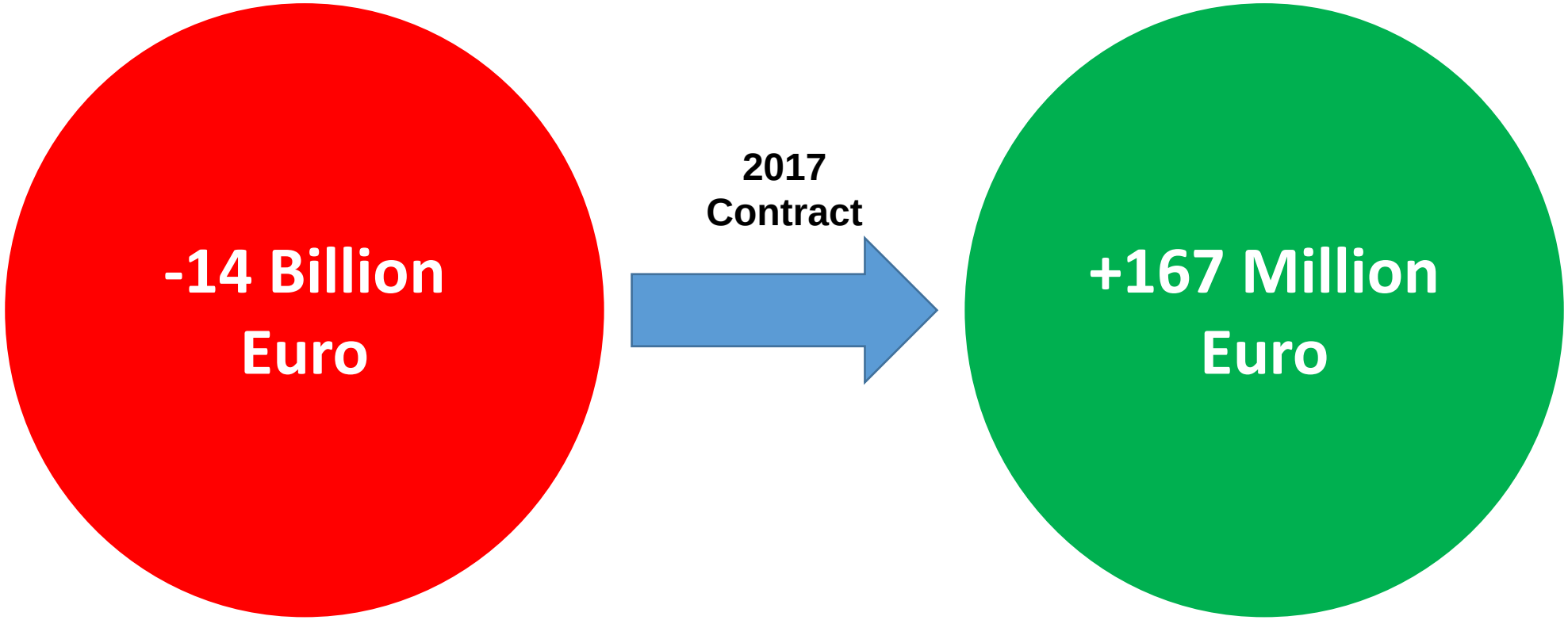
29 July 2016: CDP and EIB declare the un - bankability of the project and rejects the financial closing of the concessionaire for a bond of 1,6 billion€.

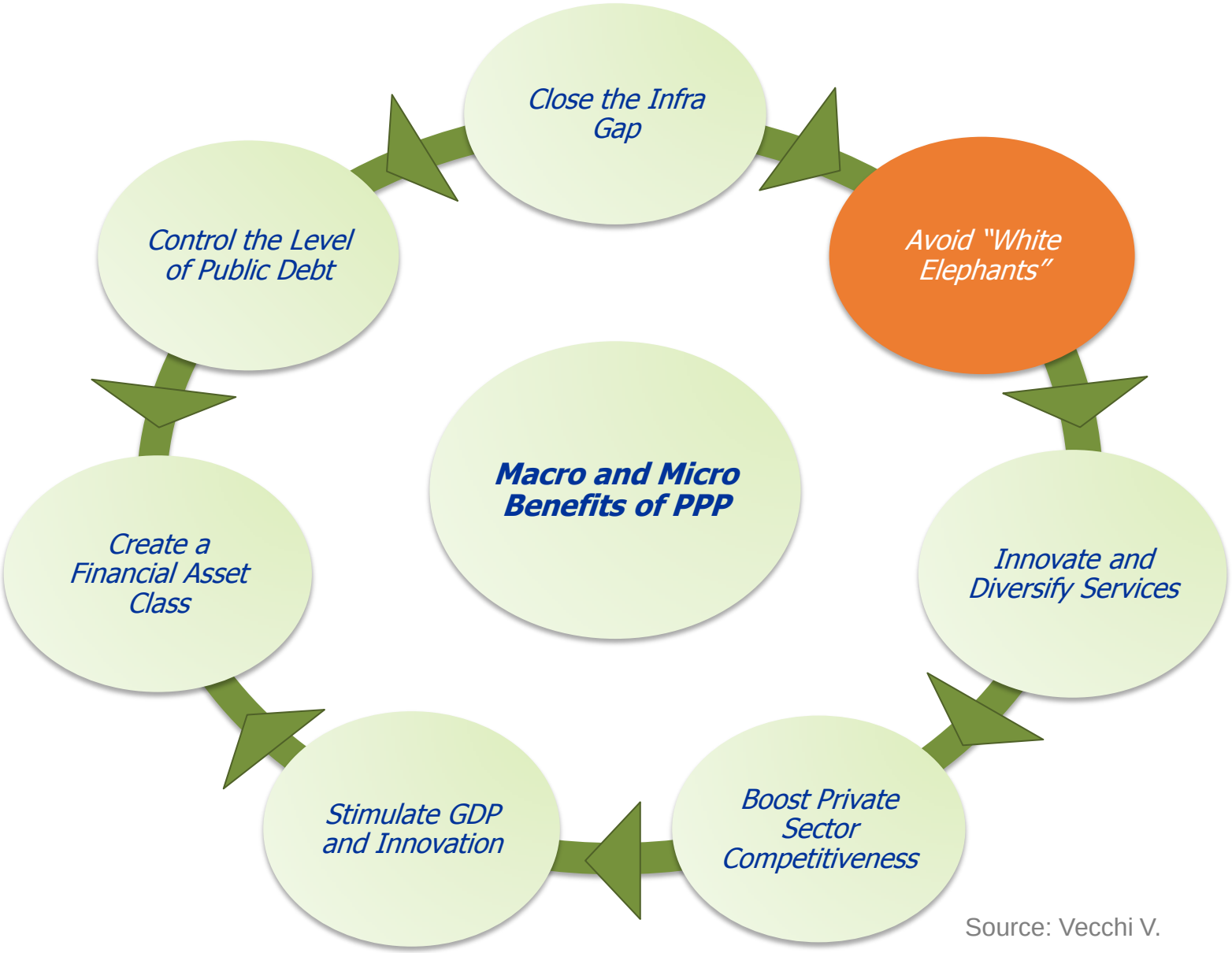
- **Length:** *95 km, with 152 km of ancillary roads*
- **Exits:** *16*
- **City Governments involved:** *32*
- **Current Status:** *30% completed*

Contracts	2009 (the Original one)	2013 (1° Revision)	2017 (Current Contract signed in June)
Capex	1.829 million €	2.258 million i€	2.258 million €
Public Grant	174 million €	614 million €	914 million €
Project IRR	8,19%	10,84%	8,89%
Equity IRR	n.d	14,5%	12,98%
Main Payment Mechanism 1: MRG	Tolls with MRG (the Region has to top up the Revenues forecasted in the Financial Model)	Tolls with MRG (the Region has to top up the Revenues forecasted in the Financial Model)	Total amount of the Availability Charge (A11 model). The Region collects the Taxes
Forecasted Tolls (Net VAT) = Revenues Included in the Financial Model Revenues were calculated on very very high Traffic Estimates	18,4 billion € (sum)	22,3 billion i€	
Availability Charge 2: Bad Forecast	14,5 million € for 30 years (+IVA)	29 million € for 15 years (+IVA) = 435 million	The Region will collect tolls (12,1 billion) and pay the availability charge for 39 years to be reduced in case of no availability
Regional Resources Necessary to top up the Tolls Revenues (Calculated on the more Conservative Traffic estimates prepared by the Region in 2017)	7,7 billion € + IVA	11,3 billion i€ + IVA	0
Relevant Penalties for the Concessionary	Not Defined	Not Defined	Yes, is 1) There is no financial closing, therefore the concession is revoked 2) Late Payment indemnity expropriation
Exemptions 3: Exemptions	Yes	yes, but reduced compared to 2009	No

Source: Veneto Region

Financial impact on regional budget





Source: Vecchi V.

Optimism Bias

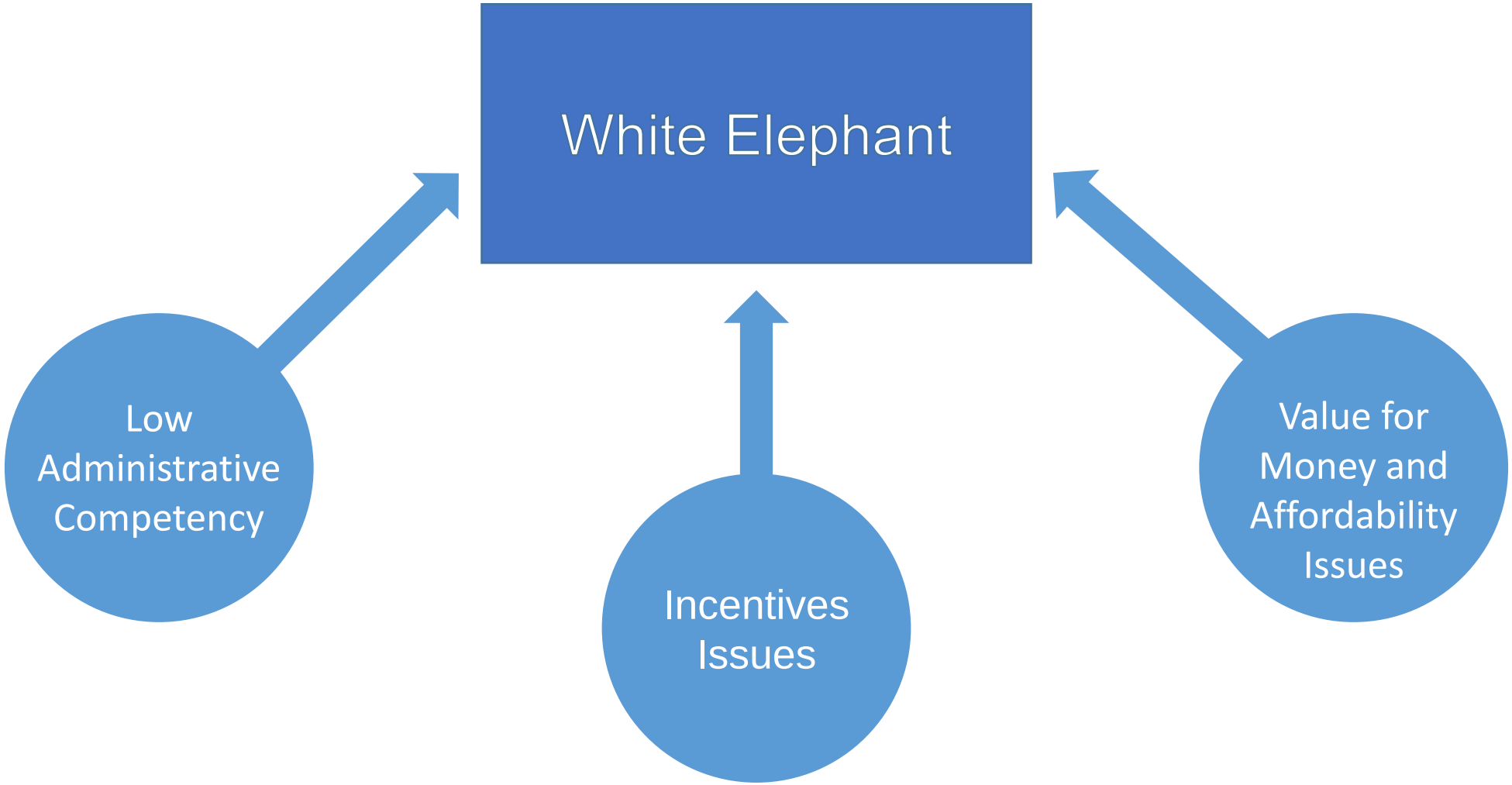
- Region’s desire to develop a project without the necessary budget availability led to the overestimation of traffic.

Poor Risk Allocation

- Minimum Revenue Guarantee placed the majority of risk on the Region.

Affordability Issues

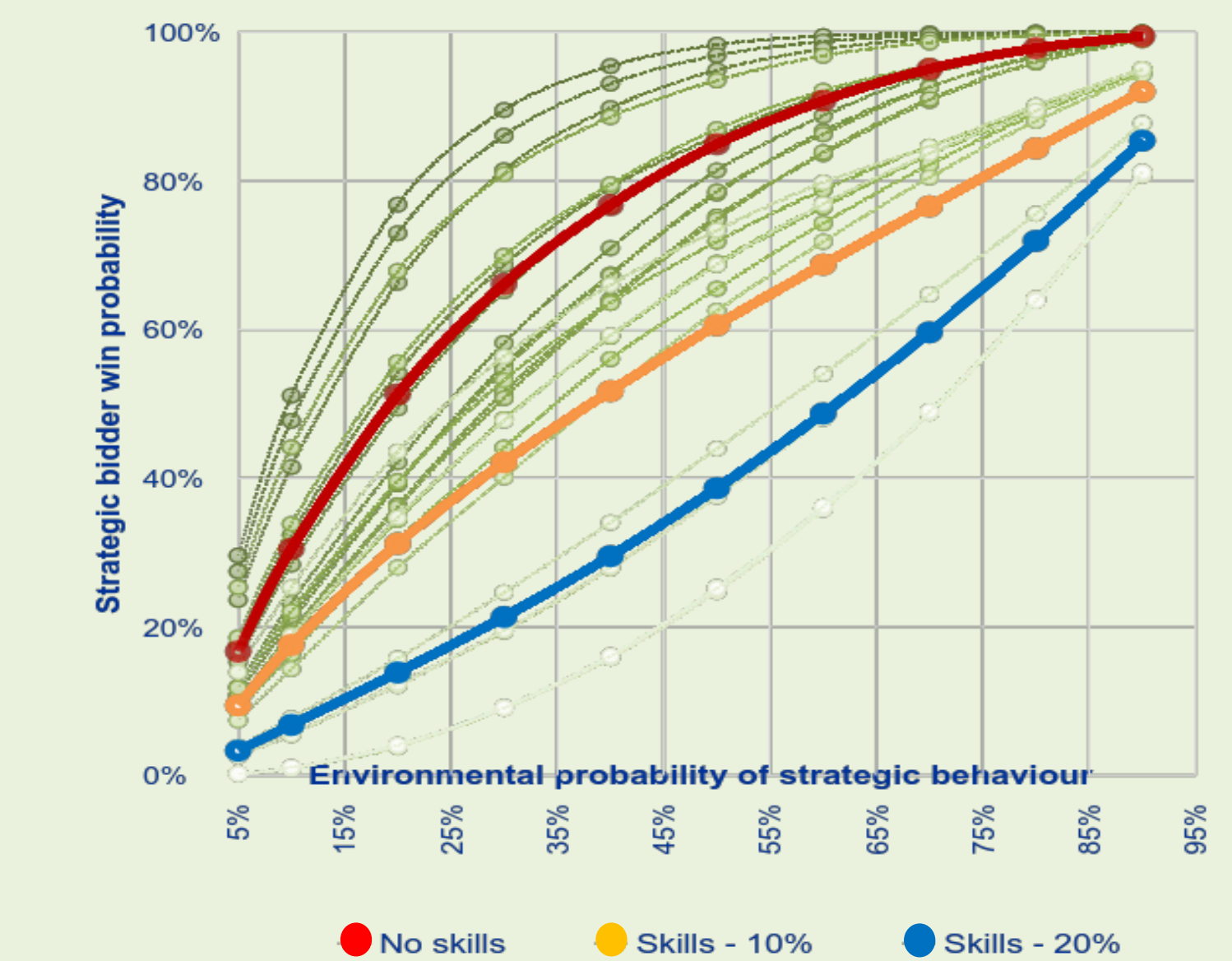
- The European Investment Bank and the Cassa Depositi e Prestiti declared the project unbankable, as the Veneto Region would default if it had to integrate revenues.


White Elephant
Low Administrative Competency
Incentives Issues
Value for Money and Affordability Issues

The Role of PA Competencies in Reducing the Adverse Selection in PPP Tendering

Low Administrative Competency

In contexts of low competency within the public administration that selects the concessionaire and with contracts protected by guarantees, the probability of a "strategic bidder" (e.g. overestimation of traffic) winning is significantly higher.



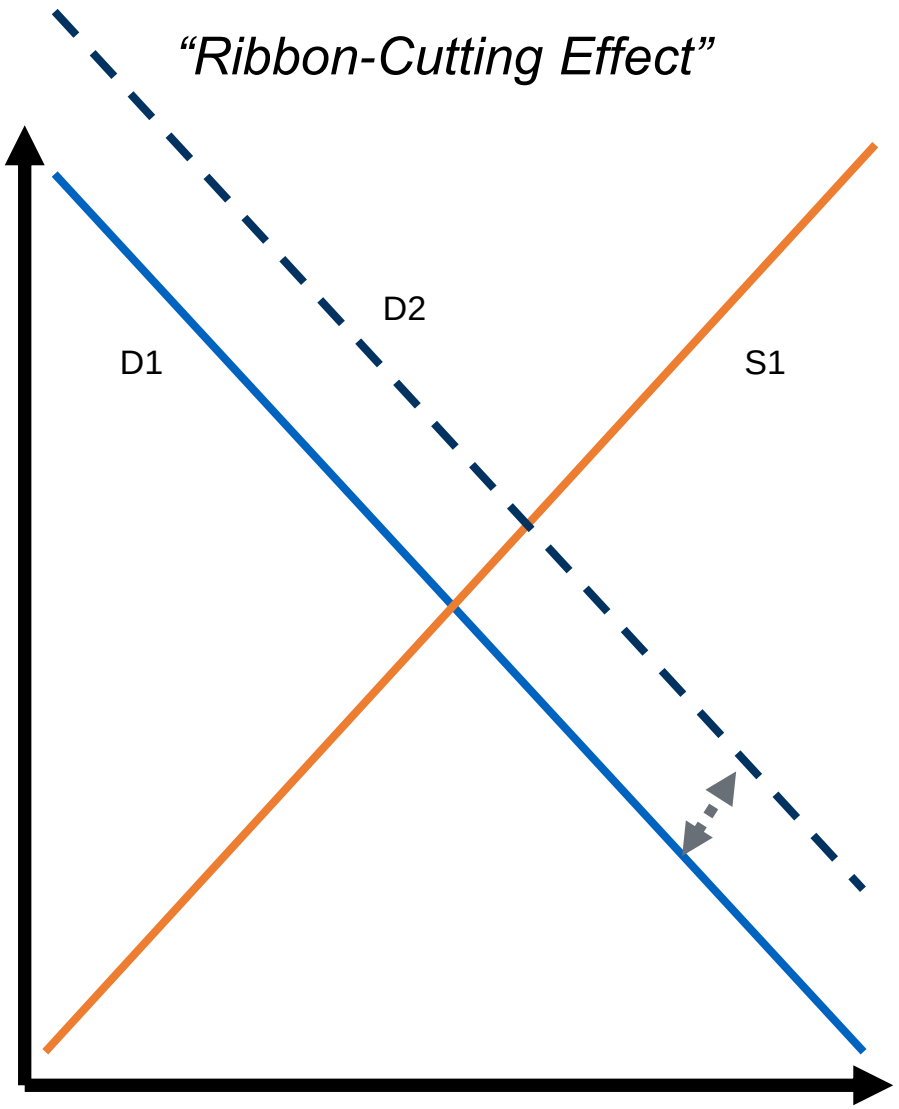
Source: Vecchi V., Borgonovo E., Amodio S., Cusumano N., Gatti S. 2016

The Galan Regional Administration worked predominately with unsolicited proposals, which can generate a higher risk of moral hazard if in a context of low competence and weak institutions.

Political pressures, and institutional weakness led to the signature of an unaffordable contract (MRG, many exemptions).

Incentive Issues

Politicization of Infrastructure



Actual consumer's demand for the infrastructure remains at D1, while the administration's demand for infrastructure increases to D2.

Distance between D1 and D2 represents artificial increase in perceived value due to expected political gain from project.

SDA Bocconi School of Management

Incentive Issues

Administration: incentive to approve project (political gains).

Consortium: incentive to get project approved (economic interests).

Incentive Issues

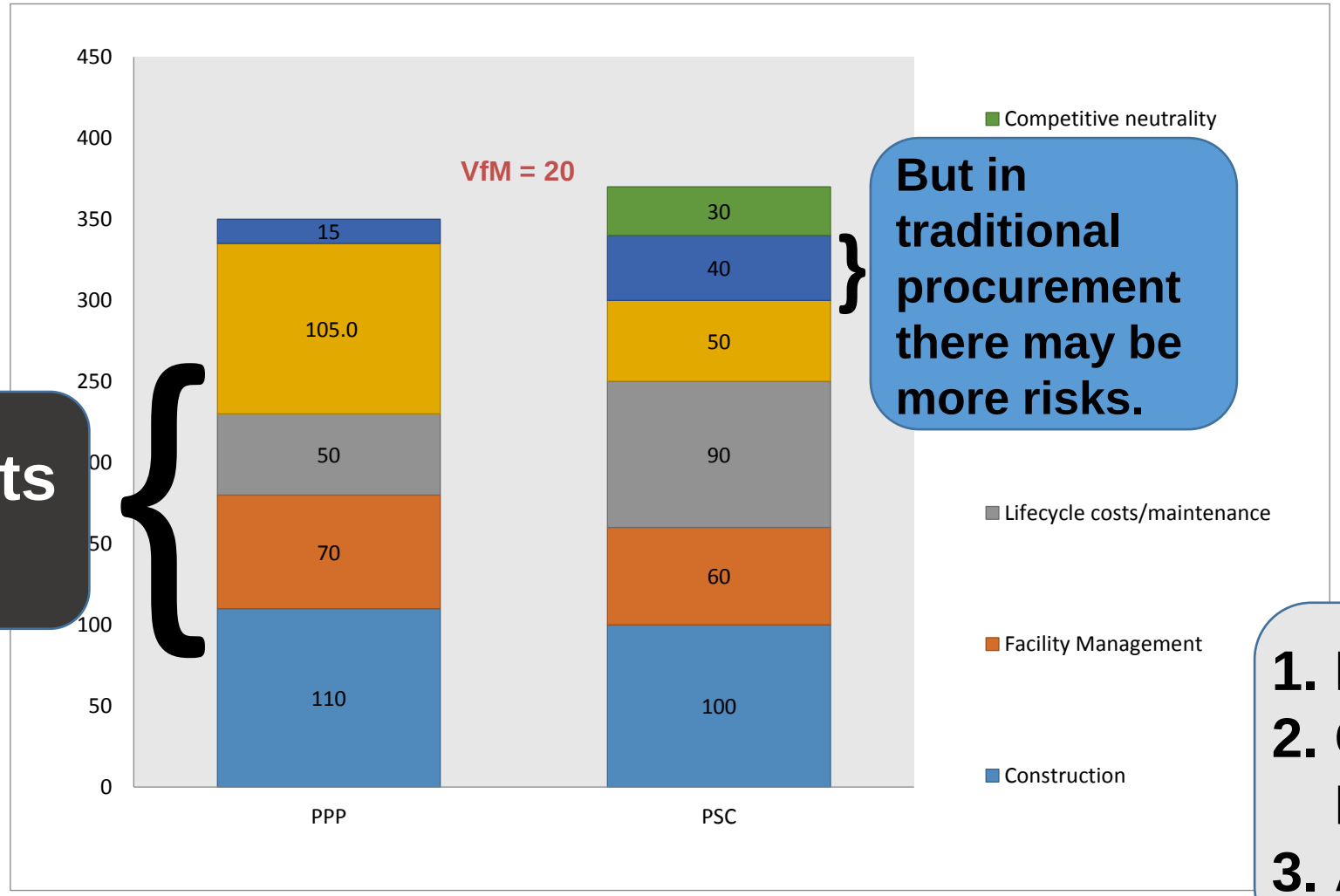
Administration: incentive to approve project (political gains).

Bank: incentive to ensure a bankable investment.

Consortium: incentive to get project approved (economic interests).

Value for Money Analysis Issues

Traditional Value for Money Approach



PPP costs more

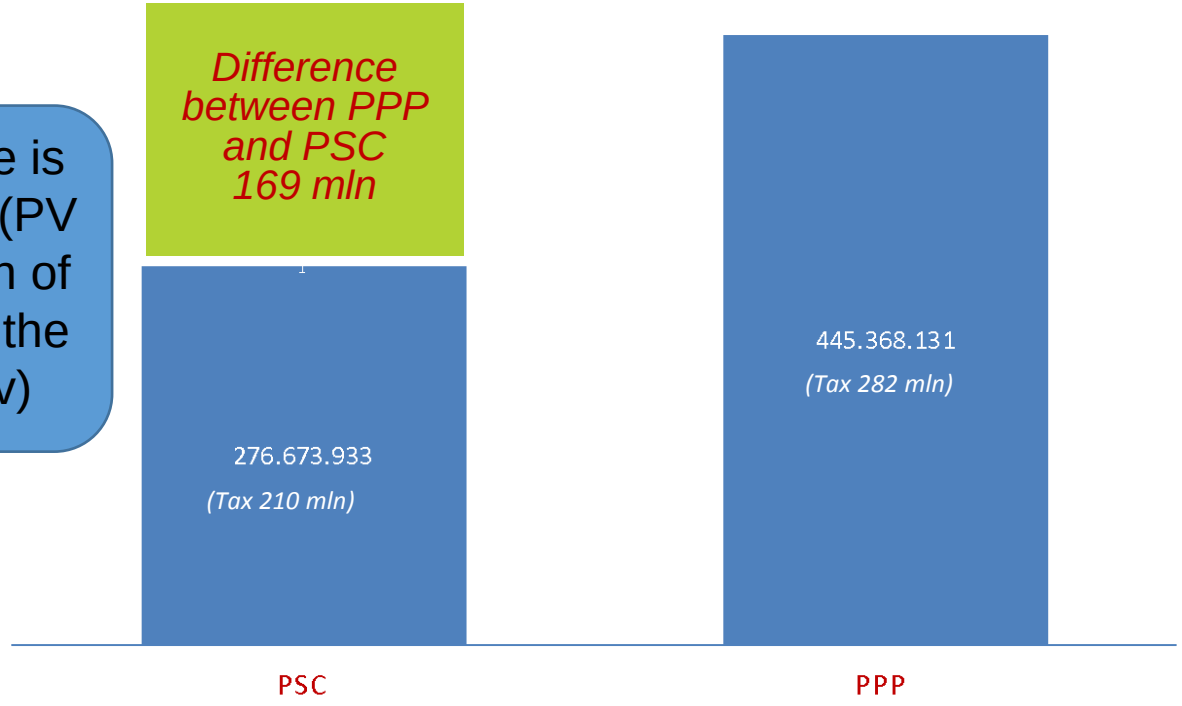
But in traditional procurement there may be more risks.

1. **Manipulability**
2. **Competitive Neutrality (tax)**
3. **Affordability**

Value for Money Analysis Issues

Value for Money DBFM (Availability Based PPP)

In a PPP there is more taxation (PV pays 2,5 billion of extra taxes to the National Gov)



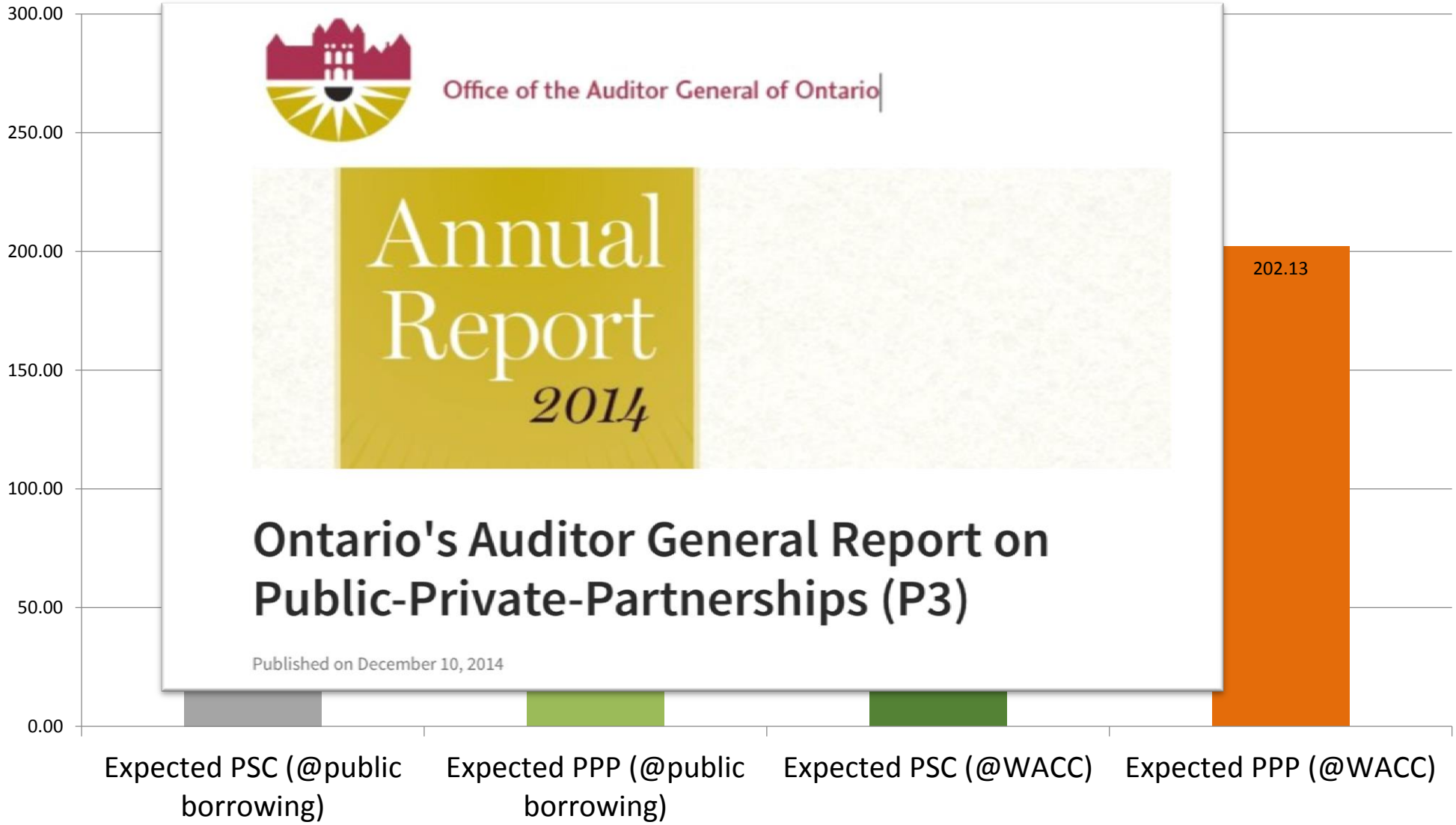
Investiment with CAPEX 100 mln

- Taxes: + 44 mln
- VA Tax: + 16 mln
- Marginal O&M: 4 mln
- Cost of the Capital: 58 mln

Wacc = 6,9%
Kd PA = 3,5%

Competitive neutrality- more taxes paid by the PPP, which are not considered in a the standard VfM analysis

Value for Money Analysis Issues



Office of the Auditor General of Ontario

Annual Report 2014

Ontario's Auditor General Report on Public-Private-Partnerships (P3)

Published on December 10, 2014

Value for Money Analysis Issues

Including the social impact in value for money test: an example

- ✓ Project: 6km Road in North Italy
- ✓ Contract: Design & Build (D&B) – in Italy it is considered a traditional procurement
- ✓ Contract signature: January 2011
- ✓ Delivery due: June 2013
- ✓ Delivery effective: October 2015 (29 month longer)
- ✓ Total cost foreseen: 25,3 million euro
- ✓ Final cost: 30 million euro (+5,7 million euro)

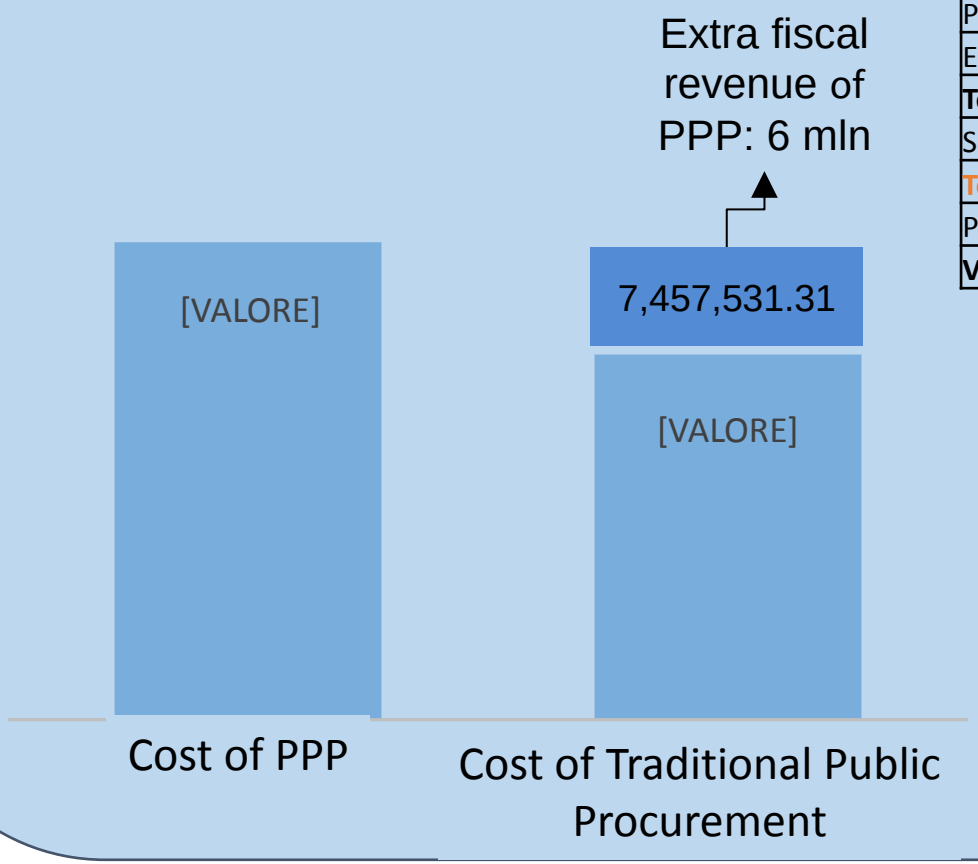
The longer length and the extra cost were due to a project change caused by an unexpected soil problem, which have also caused the need to expropriate more lands. These problems are associated to risks that can be generally transferred to the SPV within a PPP project.

Beyond the extra financial cost for the Authority, there is also an economic cost for the society due to the longer building period. To calculate this economic cost, it can be applied the cost benefit analysis methodology of the European Commission (2014), based on the following parameters.

Value for Money Analysis Issues

Example of "Empowered" Value for Money Analysis

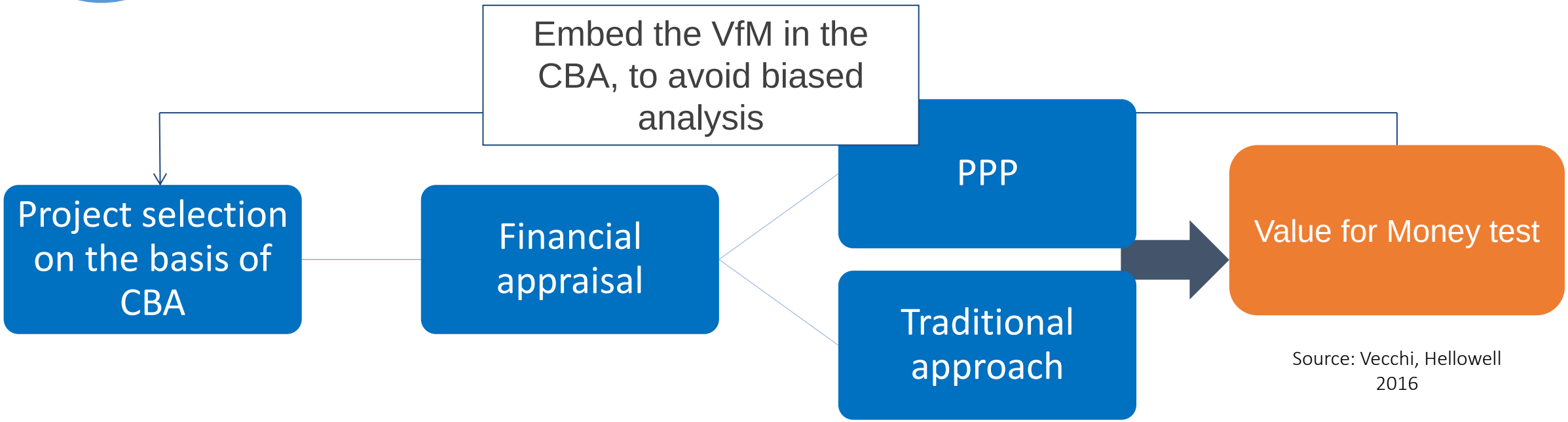
VfM Analysis on the portion of a road realized with integrated tender. Delay in realization: 29 months + 5,7 million in construction



PSC	24.196.488,43
Extra construction costs (real ex post)	5.700.000,00
Total PSC with extra financial costs	**29.896.488,43**
Social cost generated by delay	14.182.058,80
Total PSC with extra financial and social costs	**44.078.547,23**
PPP	31.654.019,74
VfM	**12.424.527,49**

n. daily vehicle	8.485
average net daily income (euro)	75,45
average net per minute income (8h/day)	0,16
delay per vehicle (minutes)	20
working days per year	220
monthly working days	18,3
months of delay	29
Firm cost per month (euro)	489.036,51
Total firm cost totale for the firm (euro)	**14.182.058,80**

Value for Money Analysis Issues



Source: Vecchi, Hellowell 2016

INDIANA TOLL ROAD COMPARISON

Maintain, Manage, and Improve contract purchased by ITRCC for $3.8bil 2006

→

ITRCC goes bankrupt 2014

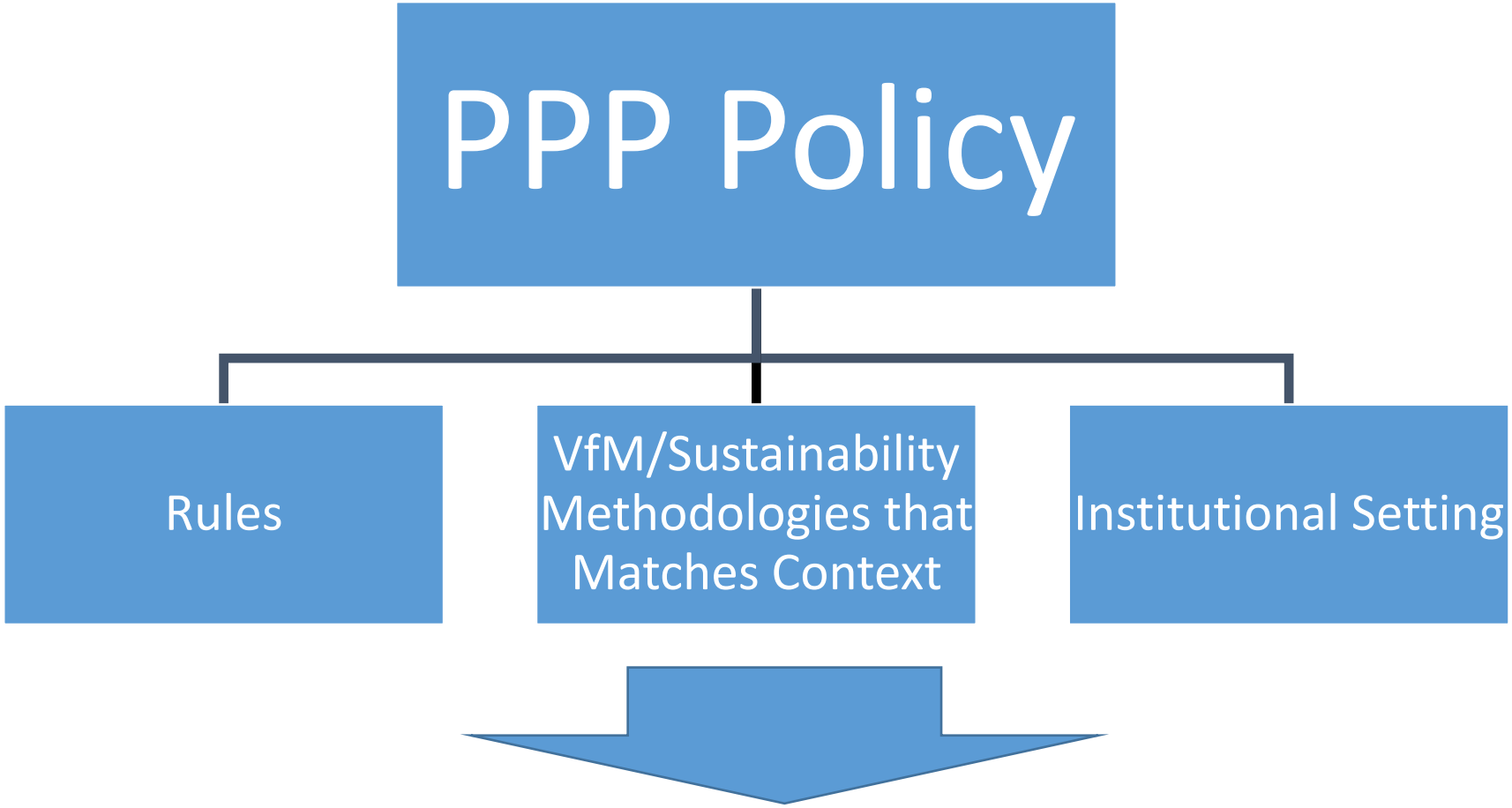
→

IFM purchase the remainder of the 75-year contract for $5.8bil 2015

Source: "How and when to use private money in infrastructure projects?" *The Economist,* Apr 22 2017.

Similarities to Pedemontana Veneta

- Pre-recession traffic studies proved too optimistic.
- Poor risk allocation lead to the financial unsustainability of the project.
- Politicization of infrastructure.



A sustainable PPP Pipeline