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

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Master in Public Administration, SDA Bocconi
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).

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

3 December 2004: Veneto Region under the presidency of Mr. Galan declares public interest in the 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 unbankability of the project and reject 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
<table>
<thead>
<tr>
<th>Contracts</th>
<th>2009 (the Original one)</th>
<th>2013 (1° Revision)</th>
<th>2017 (Current Contract signed in June)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capex</td>
<td>1.829 million €</td>
<td>2.258 million i€</td>
<td>2.258 million €</td>
</tr>
<tr>
<td>Public Grant</td>
<td>174 million €</td>
<td>614 million €</td>
<td>914 million €</td>
</tr>
<tr>
<td>Project IRR</td>
<td>8,19%</td>
<td>10,84%</td>
<td>8,89%</td>
</tr>
<tr>
<td>Equity IRR</td>
<td>n.d.</td>
<td>14,5%</td>
<td>12,98%</td>
</tr>
<tr>
<td>Main Payment Mechanism</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1: MRG</td>
<td>Tolls with MRG (the Region has to top up the Revenues forecasted in the Financial Model)</td>
<td>Tolls with MRG (the Region has to top up the Revenues forecasted in the Financial Model)</td>
<td>Total amount of the Availability Charge (A11 model). The Region collects the Taxes</td>
</tr>
<tr>
<td>2: Bad Forecast</td>
<td>18,4 billion € (sum)</td>
<td>22,3 billion i€</td>
<td></td>
</tr>
<tr>
<td>3: Exemptions</td>
<td>14,5 million € for 30 years (+IVA)</td>
<td>29 million € for 15 years (+IVA) = 435 million</td>
<td>The Region will collect tolls (12,1 billion) and pay the availability charge for 39 years to be reduced in case of no availability</td>
</tr>
<tr>
<td>Regional Resources Necessary to top up the Tolls Revenues (Calculated on the more conservative Traffic estimates prepared by the Region in 2017)</td>
<td>7,7 billion € + IVA</td>
<td>11,3 billion i€ + IVA</td>
<td>0</td>
</tr>
<tr>
<td>Relevant Penalties for the Concessionary</td>
<td>Not Defined</td>
<td>Not Defined</td>
<td>Yes, is</td>
</tr>
<tr>
<td>1) There is no financial closing, therefore the concession is revoked</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2) Late Payment indemnity expropriation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exemptions</td>
<td>Yes</td>
<td>yes, but reduced compared to 2009</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Veneto Region
Financial impact on regional budget

-14 Billion Euro

2017 Contract

+167 Million Euro
Macro and Micro Benefits of PPP

- Close the Infra Gap
- Avoid “White Elephants”
- Control the Level of Public Debt
- Create a Financial Asset Class
- Innovate and Diversify Services
- Stimulate GDP and Innovation
- Boost Private Sector Competitiveness

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

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.

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).

Source: Vecchi V., Borgonovo E., Amodio S., Cusumano N., Gatti S. 2016
Distance between D1 and D2 represents artificial increase in perceived value due to expected political gain from project.

"Ribbon-Cutting Effect"

Actual consumer’s demand for the infrastructure remains at D1, while the administration’s demand for infrastructure increases to D2.
Administration: incentive to approve project (political gains).

Consortium: incentive to get project approved (economic interests).
Administration: incentive to approve project (political gains).

Bank: incentive to ensure a bankable investment.

Consortium: incentive to get project approved (economic interests).
Traditionally Value for Money Approach

PPP costs more

VfM = 20

But in traditional procurement there may be more risks.

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

Value for Money Analysis Issues
In a PPP there is more taxation (PV pays 2.5 billion of extra taxes to the National Gov).

Value for Money DBFM (Availability Based PPP)

Investment with CAPEX 100 mln

**Difference between PPP and PSC 169 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

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

Published on December 10, 2014
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.
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

| Cost of PPP | 7,457,531.31 |
| Cost of Traditional Public Procurement | [VALORE] |

Extra fiscal revenue of PPP: 6 mln

<table>
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<th>Extra fiscal revenue of PPP: 6 mln</th>
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<tbody>
<tr>
<td>PSC</td>
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<tr>
<td>Extra construction costs (real ex post)</td>
</tr>
<tr>
<td>Total PSC with extra financial costs</td>
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<tr>
<td>Social cost generated by delay</td>
</tr>
<tr>
<td>Total PSC with extra financial and social costs</td>
</tr>
</tbody>
</table>

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 |
Project selection on the basis of CBA

Financial appraisal

Traditional approach

PPP

Embed the VfM in the CBA, to avoid biased analysis

Value for Money test

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

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.

PPP Policy

- Rules
- VfM/Sustainability Methodologies that Matches Context
- Institutional Setting

A sustainable PPP Pipeline