

Small-Scale Municipal PPP

Background

- **Small-scale public-private partnerships (PPPs) offer a number of benefits,** especially where projects are developed by municipalities: they are close to those who need services most, respond to local demand and need, and offer opportunities for local investors and financiers that may not be available from larger projects.
- **Small-scale PPPs make up a significant share of total PPPs.** The Private Participation in Infrastructure (PPI) Database shows that in 2013, approximately 40 percent of projects globally were valued at less than US\$50 million, and approximately 25 percent of projects were valued at less than US\$25 million, even though the PPI Database

focuses on sectors more accustomed to larger projects. About 40 percent of projects in the UK Private Finance Initiative (PFI) database are below £30 million, and 20 percent are below £15 million. Some 30 percent of all projects in the Australia PPP database have a value of \$A50 million or lower in total project cost.



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Challenges

Small-scale municipal PPPs suffer from lack of scale, lack of capacity, and weak credit position. Lack of scale creates several drawbacks:

- High preparation cost. Compared to larger projects, small PPP projects require relatively disproportionate levels of due diligence and specialist support, both for the contracting authority and for investors.
- Lesser appeal to experienced investors. Experienced investors, in particular those from other countries, generally prefer larger projects to absorb risk and bid costs.
- Greater difficulty in gaining approval. The difficulty arises where approval processes are designed for larger projects, or where approval power lies at levels of government that may not be familiar with or interested in small projects.

In 2003, HM Treasury carried out an assessment of small-capital-value projects (under £20 million) using a sample of 35 projects. The small projects were found to perform as well as, and in many cases better than, large projects. But their average procurement time was around 2.0–2.5 years, which was similar to that of large projects. Small projects also had transaction and bid costs that were similar to those of large projects for both bidders and the relevant authority, largely because the small projects required the same complicated legal and technical documentation and due diligence. The relative complexity of processes made small PPPs relatively more expensive to deliver.

Source: HM Treasury, "PFI: Meeting the Investment Challenge" (London: HM Treasury, 2003).

Like lack of scale, lack of capacity creates problems for small-scale PPPs. The staff allocated to develop smaller projects, in particular local government staff, may have fewer technical qualifications and less exposure to commercial activities than staff assigned to large projects at the central-government level.

Finally, small projects—and those implementing them—may suffer from a weaker credit position than larger projects implemented by a national agency. Where the revenue stream or important guarantees are to be sourced from the contracting authority, a weak credit position can undermine bankability and increase cost of money by increasing risk premiums.

Opportunities and Solutions

- Simplify documentation and approval processes. Approval processes are generally designed for large, national PPP projects. Smaller projects may merit a simplified approval process that involves fewer approvals (and/or approvals at a more accessible level of government), less documentation (e.g., less extensive or fewer studies, reports, and consultations), less extensive publication requirements (e.g., only local press), and fewer procedural steps (e.g., no prequalification required).
- Standardize documentation and approval processes. Standard documents would facilitate the approval process by simplifying project assessment. They would also make the

project easier and cheaper to develop, easier for investors and lenders to understand, and in the end easier to fund.

- Offer centralized technical support and funding for small-scale PPP preparation. A team of PPP specialists could be formed centrally, with a mandate to provide advice and support to small PPPs. This team could be part of the central PPP unit or a separate unit. A dedicated fund for preparation of small PPPs could also help to ensure sufficient focus and support for small projects.

- Pool advisory mandates. Under a large PPP, a consortium of consultants provides transaction advice for a single project. A consortium of consultants could likewise develop feasibility studies and/or provide transaction advice for multiple small projects. This approach would introduce economies of scale that reduce total cost and possibly speed development. Pooling could also cross-fertilize lessons learned more effectively; ensure continuity of commercial terms and therefore make bidding easier and cheaper; and help coordinate when the projects are brought to market, to ensure best sequencing.

Bus Terminal and Commercial Complex in Dehradun, India

Located 236 km from New Delhi, Dehradun is the capital city of the state of Uttarakhand and is a popular tourist and educational hub in north India. The private sector was asked to design, finance, build, operate, maintain, and transfer a bus terminal and commercial entertainment complex, with a concession period of 20 years. Revenue to the concessionaire is from usage fees charged to the scheduled 750 buses per day, lease rental from the commercial-entertainment complex, and fees from other value-added services. The high-risk, low-revenue usage fees of the bus terminal were supplemented by significant commercial revenues. No expense was borne by the city for the development of the facility.

Source: "UNDP Training Module: Financing, Fare Fixation, & Cost Benefit Analyses," <http://wricitieshub.org/sites/default/files/Presentation-Financing-Fare-Fixation-Cost-Benefit%20Analysis.pdf>.

Bundling Bridges in Pennsylvania

The Pennsylvania Department of Transportation aggregated the construction and maintenance of a few hundred small bridges into a single PPP project under its old bridges rehabilitation program. The average cost of the individual bridges was as low as approximately US\$2 million, which would not have made for a viable single PPP project. Multiple jurisdictions were not involved. By bundling, the project achieved economies of scale for due diligence, project preparation, and tendering processes, and hence saved money. The final project was large enough to attract serious investors and significant competition, which would probably not have been the case with multiple small projects.

Source: US Department of Transportation, Federal Highways Administration, "Pennsylvania Rapid Bridge Replacement Project," https://www.thwa.dot.gov/ipd/project_profiles/pa_rapid_bridge.aspx.

- **Pool investments.** Small-scale projects could be pooled (or bundled) into one single investment, making it larger and more attractive for larger, more experienced investors and lenders. This approach would entail a lower cost than several small projects individually, in part because it would make the process simpler and less burdensome for purposes of due diligence and documentation.

Enhance credit. Municipalities often have poor credit positions—or a lack of information may create the perception that they do. In such cases a credit rating can be useful, particularly for institutional investors, who often rely on credit ratings to make investment decisions. Where credit ratings are not available, shadow or synthetic ratings can be used to provide similar information. Genuinely weak credit positions can be addressed through credit enhancement from entities with a better credit position, such as guarantees from the central government, multilateral entities, or others. A stronger credit position should reduce the cost of money and attract additional investors. In some cases, rather than rely on revenues or guarantees from municipalities, small projects could rely on revenues from commercial activities or other less risky sources.

Bundling Schools and Hospitals in the United Kingdom

In the United Kingdom, Partnerships for Church of England Schools was created to bundle several small schools with a new-build capital cost of around £2 million each into “geographically coherent” groups in order to facilitate the procurement of a private partner. At around the same time, the United Kingdom created the concept of “batched acute hospitals,” which bundles together projects for constructing, managing, and financing major acute hospitals for the purpose of procurement (saving money on due diligence, project preparation, and procurement). Under this approach, separate contracts are signed, given the different risk allocation needs and counterparties.

Source: HM Treasury, “PFI: Meeting the Investment Challenge” (London: HM Treasury, 2003).

Notes

An expanded version of this note can be found in Jeffrey Delmon, *Public Private Partnerships in Infrastructure: An Essential Guide for Policy Makers*, 2nd ed. (Cambridge: Cambridge University Press, 2017).

World Bank, “A Preliminary Review of Trends in Small Scale Public Private Partnership Projects” (Washington, DC: World Bank, 2014).

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INTERESTED IN BEING A PARTNER?

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