

# Making finance available



**LONG VIEW:** a consortium making a bid for an availability payment contract is more likely to be more interested in the longevity of port equipment

**Boudewijn Jansen, Berend Paasman and Joe Seliga** discuss the benefits of availability payments

**PUBLIC AUTHORITIES AROUND** the world are increasingly undertaking infrastructure projects through the use of availability payment contracts, under which a governmental entity makes fixed long term payments to a private contractor which is responsible for the design, construction, long-term maintenance and financing of the project. While such contracts have been used extensively in various sectors, the port sector has not applied this contract form frequently.

In our view, port authorities should consider entering into availability payment-based public-private partnership (P3s) agreements to address their capital expenditure funding gaps and improve the quality of maritime infrastructure, especially with respect to “common user facilities”, such as breakwaters, access channel dredging, connecting roads and bridges, and port expansion projects.

Seaborne trade volumes have recovered after the sharp reductions in 2008 and 2009 and many ports are dusting off their expansion plans. However, some authorities have struggled to secure financing for these projects. Typically port authorities consider two alternatives to finance their new port expansion plans: applying public capital or through long-term terminal concessions or full privatisation.

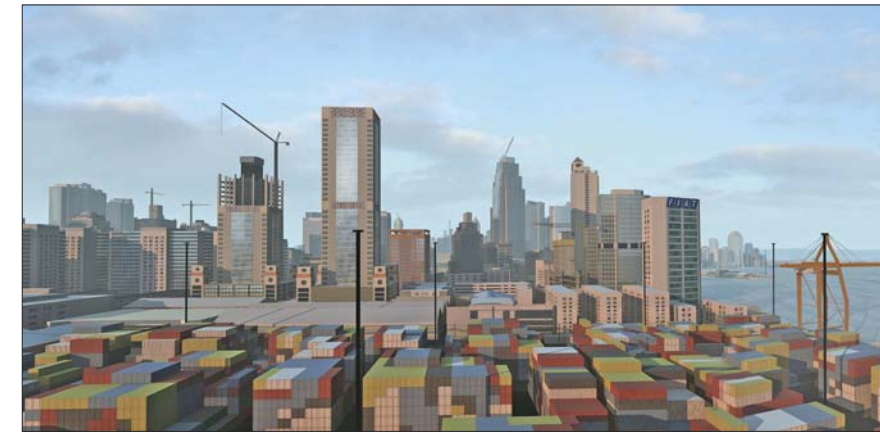
Availability payment P3s are an alternative contracting mechanism that can address the challenges facing port authorities. This model enhances the value for money of the project and is an alternative to solve funding gaps faced by port authorities.

Under the availability payment P3 model, also referred to as a “DBFM” contract, the private sector builds the infrastructure, attracts debt financing and maintains the infrastructure. The public side commits to make predetermined payments (availability fees) to the private party during a certain period (often 20-30 years). These payments are only due if the construction has been completed and if the infrastructure is “available”

“Availability payment P3s enhance the value for money of the project and are an alternative to solve funding gaps faced by port authorities”

to use under quality/service levels agreed to in the contract. In this model no (or reduced) public funding is needed to deliver the project.

In other infrastructure sectors, such as roads, availability payment P3 contracts have been regularly used by public authorities with a long track record of successfully implemented projects. In the 1980s, availability payment P3 contracts became popular first in the United Kingdom and then in other European countries, and then



**GOOD FIT:** availability finance is well suited to long term projects with a \$100m-plus price tag

Australia and Canada. The contracting method has been applied to many rail, road and other projects around the globe.

To understand the workings of an availability payment P3 transaction this article compares it with the more traditional or classic infrastructure project procurement mechanism utilised by public authorities. In the classic approach, the authority hires a contractor to build the port asset or port project. The contractor is paid before and during construction by the authority and thus the authority is financing the project. After completion of construction, the authority procures one or more maintenance contracts with maintenance contractors.

In the availability payment P3 or DBFM approach, the authority selects a consortium (SPC) that will design, build, finance and maintain the asset. The SPC will attract debt financing from banks, which are used for the construction of the asset.

Once the asset is operational, the authority will periodically make availability payments to the SPC. The payments are made for the services delivered on the basis of the “availability” of the asset. These payments are then used to pay interest and principal repayment on the loan, with the remainder as a dividend for the SPC’s equity investors. Availability payments will be reduced if the asset is not available. As a result, the private contractor bears the risk of the asset’s operation.

From a public authority’s perspective, the availability payments under a DBFM contract are constant (or partially increasing with inflation) for the term of the contract. In the classic approach, the payments fluctuate; large during construction with an irregular pattern of maintenance costs during the operational life of the asset – depending on the maintenance cycle, many assets need large maintenance every five to seven years.

The port authorities should however carefully consider the following consequences.

A DBFM procurement process is more complex to implement, especially the first time. It will require time to prepare project design and tender documents, staff resources from the authority for monitoring asset availability and the retention of experienced advisers for financing expertise.

“Availability payments will be reduced if the asset is not available. As a result, the private contractor bears the risk of the asset’s operation”

Transaction costs will be higher under the availability payment model.

Authorities should also take note that the DBFM contract model could limit future flexibility; DBFM contracts are relatively long-term contracts.

That said, DBFM contracts can be suitable for maritime infrastructure assets, including dykes, and capital dredging of navigation channels or port basins; connections related to landside port infrastructure, such as access roads, tunnels and bridges; and port expansion projects.

For DBFM to be a worthwhile consideration the asset life should be long (+20 years), and the size of the project should be at least €75m (\$107m) to be economical. Assets that need intensive maintenance over their lifetimes have more potential to bring value due to the life cycle cost benefit. **PS**

■ *Boudewijn Jansen (boudewijn.jansen@rebelgroup.com) is a consultant at Rebel Advisory specialising in the port sector. Berend Paasman (berend.paasman@hsh-nordbank.com) works in the infrastructure finance group of HSH Nordbank out of London. Joe Seliga (jseliga@mayerbrown.com) is a partner at the law firm Mayer Brown specialising in infrastructure transactions.*



## Want More?

**Martin Rushmere** wrote ‘A dose of realism’ for the April 2011 edition. Read the full article at: [www.portstrategy.com/features](http://www.portstrategy.com/features)

## A win-win for PPPs

**APART FROM ADDRESSING** budgetary challenges, the availability payment public-private partnership approach has significant “value for money” merits that make it worthwhile for port authorities to consider.

A consortium making its bid for an availability payment contract will take into account the entire costs of the project, including construction and long-term maintenance. In order to reduce future total costs, the consortium is more likely to construct the asset using better materials, which require less maintenance.

In a normal construction contract procurement, construction companies aim for the lowest price given the technical requirements. This may leave the public authority with higher long-term maintenance costs. Studies have confirmed that the availability payment P3-DBFM-approach can lead to a 10%-20% life cycle costs savings.

Additionally, the availability fee is only paid to the SPC if the asset is available. If the asset cannot be used due to malfunctioning, delays in construction or long maintenance periods, the SPC’s availability payments will be reduced. This creates a financial incentive for the SPC to ensure maximum availability of the asset and to monitor construction progress meticulously, leading to a greater chance of on-time delivery.

In DBFM contracts, risk allocation is structured along the principle that each risk is allocated to the party that can best control it, which typically reduces the required contingencies and prevents overpricing.

And as availability fees are defined before the start of construction, there is usually no compensation for construction cost overruns or higher-than-expected maintenance costs (unless the public authority changes the specifications of the project). As a consequence, the risk for construction cost overrun or maintenance cost overrun is transferred from the public side to the private side.

In the procurement documents, the technical specifications are usually defined toward output instead of input. This creates more freedom for the private party to design the asset, which results in a high degree of flexibility for the private partner to utilise innovative solutions.