

# Health PPPs in Portugal

Single and twin SPV PPPs

**26<sup>th</sup> November 2009**



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# Banco BPI Curricular Highlights

- Banco BPI (BPI, quoted in EURONEXT) is the head of a universal financial and multi-specialist private group based in Portugal with a unique experience in structuring and financing public private partnership (PPP) projects in the infrastructure, transport, utilities and public services sectors, acting either for public authorities (as advisor) or for private bidders (as advisor and financier). Major ongoing projects in which BPI is involved include the New Lisbon Airport project, the High Speed Network project and the Portuguese road network projects.
- BPI was the first private bank to be created in Portugal (1981) and to be quoted on the stock exchange. The bank was the leader in privatisations between 1989 and 2000.
- Since 2002, BPI has been advising Parcerias.Saúde, the Portuguese Government's task force for development and implementation of the PPP Programme in the Health Sector, acting as financial advisor and coordinator of the global team of consultants, including legal and technical advisors (clinical, engineering, IT and insurance).

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# Portuguese brief history

**Since the 19<sup>th</sup>  
century...**

Partnerships between public and private sectors are an old reality in Portugal. During the Liberal period (second half of the 19th century to the beginning of the 20th century) several concessions were awarded to private companies in the communications, transports, water and energy sectors.

**Before the 1974  
revolution...**

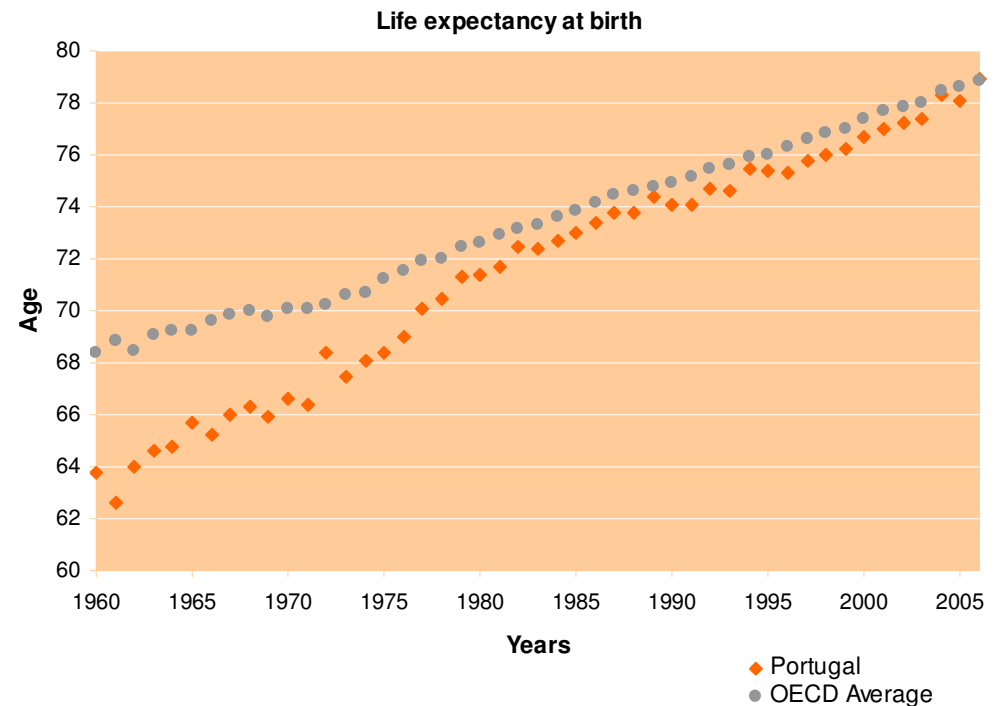
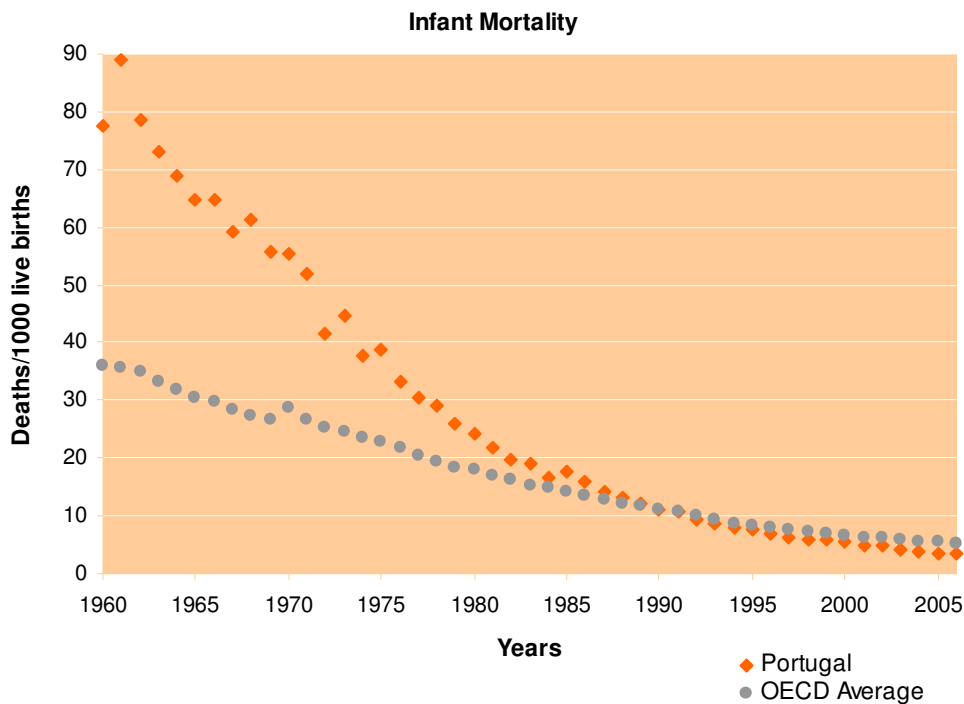
Healthcare services in Portugal, before the 1974 revolution, were mainly private, and the role of the Portuguese State was restricted to the underprivileged, who could not afford to pay private services. The not for profit entities (Misericórdias) played a central role in the Portuguese health care system by providing primary and acute health care services nationwide.

**After 1974...**

The Portuguese National Health Service (NHS) was created in 1979, supported by the ideal that healthcare services should be available for all regardless of wealth. Since its creation, healthcare services in Portugal registered great changes and there were clear improvements in the health of the population.

# The objective of health gains and increased efficiency

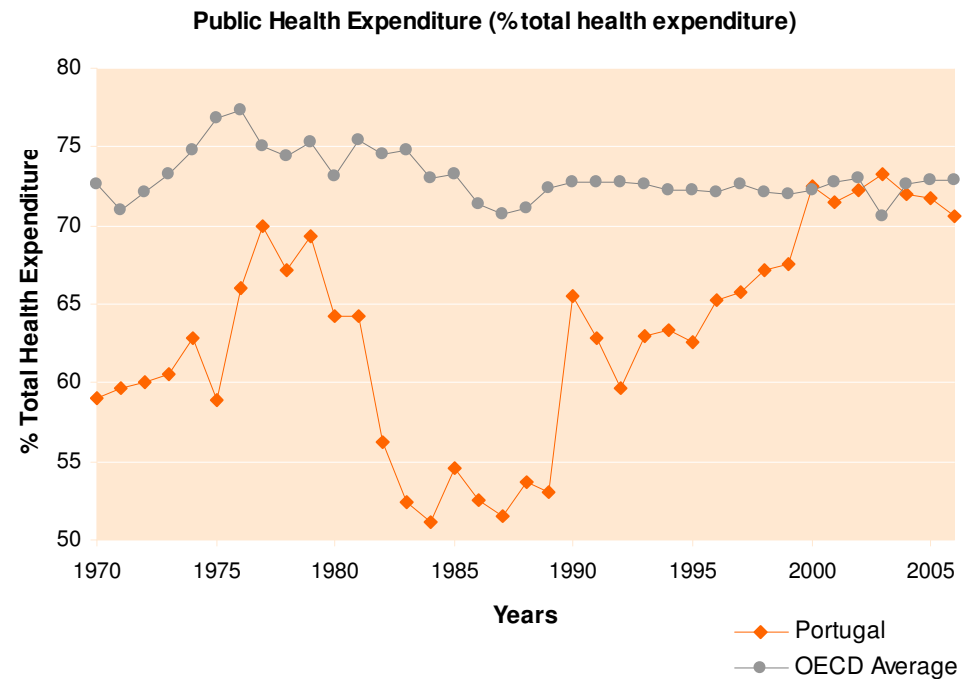
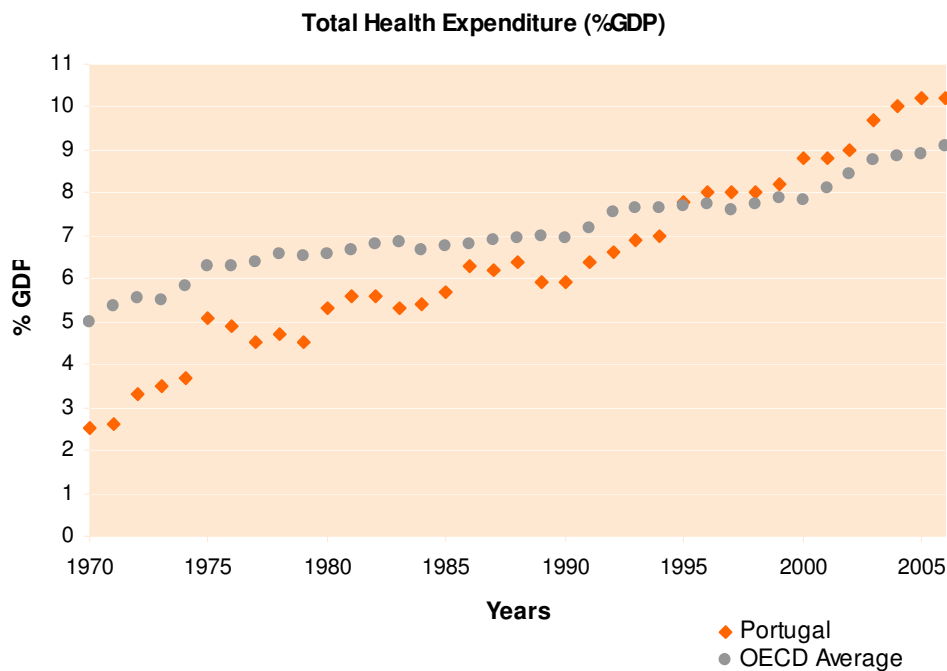
- In the last 45 years infant mortality showed a major reduction and life expectancy at birth has been steadily rising.



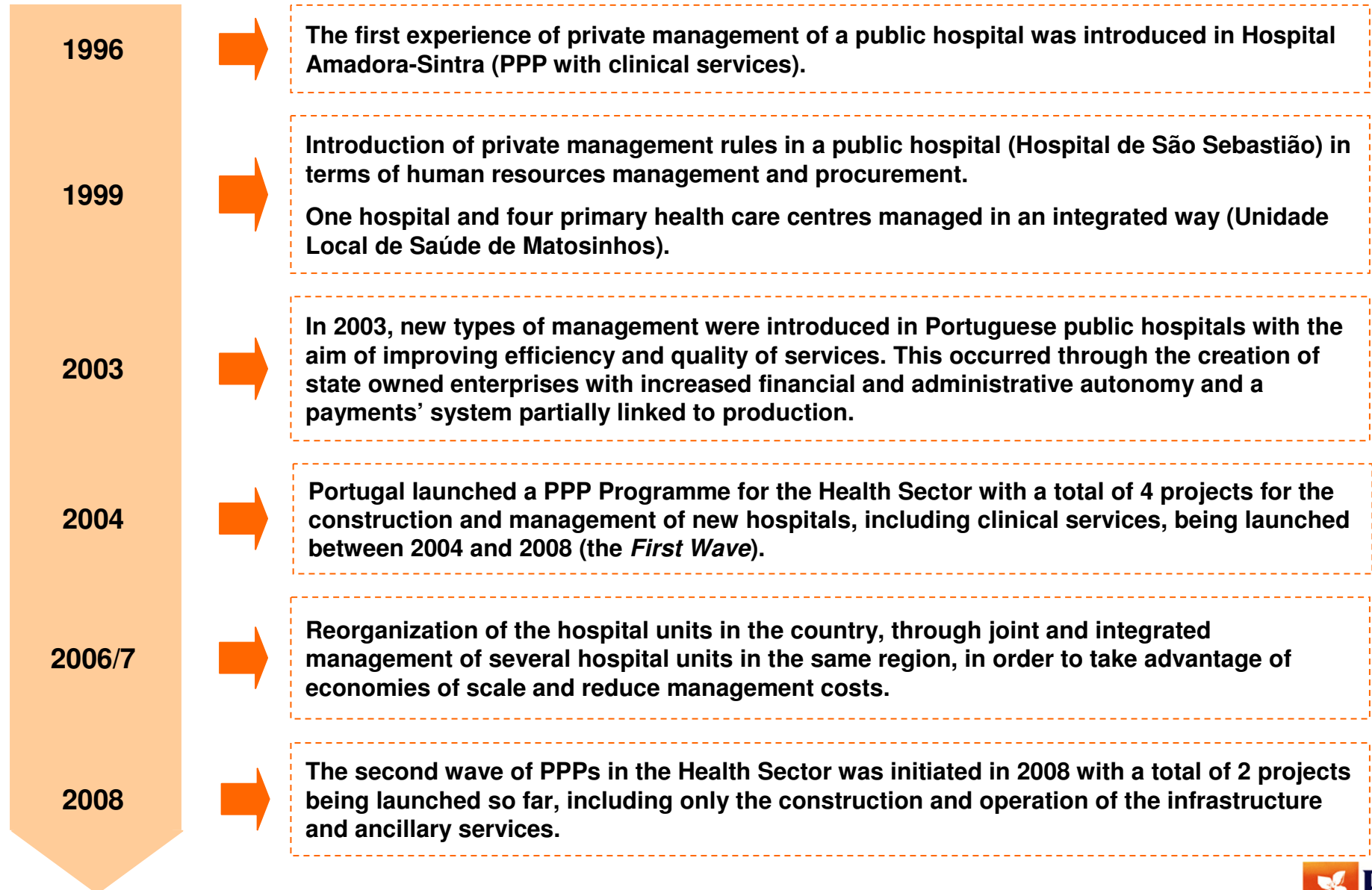
- Two main factors contributed to these changes: improvements to the population's living conditions in general and increased expenditure in the Health Sector.

# The objective of health gains and increased efficiency

- While health gains occurred, increasing financial resources were being devoted to the Health Sector. This led to the development and introduction of measures with the aim of slowing down the growth rate of health expenditure in Portugal.



# The NHS Reform – Main Landmarks





# The investment program in public hospitals

- During the last eight years, Portuguese governments initiated 16 new hospital projects motivated by the need to build modern hospitals or to substitute existing obsolete infrastructures.



**New public hospitals:**

- PPP hospital (with clinical services)
- PPP hospital (infrastructural)
- Public investment
- Model to be confirmed

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# The PPP Programme so far

| Project                      | PPP Model                        | Tender Launch  | PSC<br>(€ millions)      | Phase                        | Bidders Clinical/<br>Infrast.                                       | Bid NPV of payments (€<br>millions) |
|------------------------------|----------------------------------|----------------|--------------------------|------------------------------|---|-------------------------------------|
| Cascais Hospital             | DBFO including clinical services | September 2004 | 409 as at January 2005   | Awarded                      | HPP/ Teixeira Duarte  | 375                                 |
| Braga Hospital               | DBFO including clinical services | January 2005   | 1.186 as at January 2006 | Awarded                      | José de Mello Saúde/<br>Somague                                     | 795                                 |
| Vila Franca de Xira Hospital | DBFO including clinical services | December 2005  | 590 as at January 2007   | Preferred Bidder Negotiation | José de Mello Saúde/<br>Somague                                     | 495                                 |
| Loures Hospital              | DBFO including clinical services | February 2007  | 745 as at January 2008   | Preferred Bidder Negotiation | Espírito Santo Saúde/<br>Mota-Engil                                 | 578                                 |
| Oriental Lisbon Hospital     | DBFO (only infrastructural)      | April 2008     | 375 as at January 2008   | Bids Evaluation              | Salveo; Somague;<br>Teixeira Duarte                                 | 598; 612; 659                       |
| Algarve Hospital             | DBFO (only infrastructural)      | May 2008       | 266 as at January 2008   | Bids Preparation             | Salveo, NPS, Al-Gharb, Teixeira Duarte, Somague, A.S. Algarve Saúde | -                                   |
| Gaia Hospital                | DBFO (only infrastructural)      | -              | -                        | Launch Preparation           | -   | -                                   |

- Between 2004 and 2009, only two PPP hospital projects have been awarded, Cascais and Braga hospitals.
- It is expected that Loures Contract will be signed in December 2009 and Vila Franca Contract during the first quarter of 2010.
- The last three projects - Oriental Lisbon, Algarve and Gaia Hospital - kept the clinical services under public responsibility, transferring to the private entities only the infrastructural services and some ancillary services.

# Procurement process duration (in months)

|                              | Launch             | Bids preparation and presentation | Bids evaluation | Negotiations  | Contract signature | Operation of the new hospital |
|------------------------------|--------------------|-----------------------------------|-----------------|---------------|--------------------|-------------------------------|
| Cascais Hospital             | September 2004     | 6                                 | 6               | 17,3          | 5                  | February 2010                 |
| Braga Hospital               | January 2005       | 7,5                               | 3               | 21,7          | 1,6                | May 2011                      |
| Vila Franca de Xira Hospital | December 2005      | 6                                 | 23              | Current stage | -                  | -                             |
| Loures Hospital              | February 2007      | 6,3                               | 13              | Current stage | -                  | -                             |
| Lisboa Oriental Hospital     | April 2008         | 10                                | Current stage   | -             | -                  | -                             |
| Algarve Hospital             | May 2008           | Current stage                     | -               | -             | -                  | -                             |
| Gaia Hospital                | Launch preparation | -                                 | -               | -             | -                  | -                             |
| Average duration             | -                  | 7,2                               | 11,3            | 19,5          | 3,8                | -                             |

- Until now, it does not seem that the exclusion of clinical services has led to shorter procurement phases.
- On average, it took 3.5 years from project launch to contract signature.

# Decision making process

- An effective and timely decision making process may lead to lower bidding costs and bring more certainty in terms of results and completion dates. In Portugal, the long list of entities and bureaucratic procedures involved on the procurement process help explain the duration of the procurement stages.

## List of entities involved:

- Ministers of Health and Finance (must approve all the major decisions);
- Commissions responsible for the tender documents' preparation (include members from the health and finance ministries);
- Commissions responsible for bid valuation and negotiations (include members from the health and finance ministries);
- Departments and entities of the Ministry of Finance (e.g.: Parpública, General Inspectorate of Finance);
- Departments and entities from the Ministry of Health (e.g. Regional Health Administrations, Partnerships in Health, Central Health Systems Administration, public hospitals);
- Teams of advisors and consultants;
- Audit Office (highest Portuguese body regulating public spending).

- As a result of long procurement processes, projects are inherited by different governments creating further uncertainties and delays.

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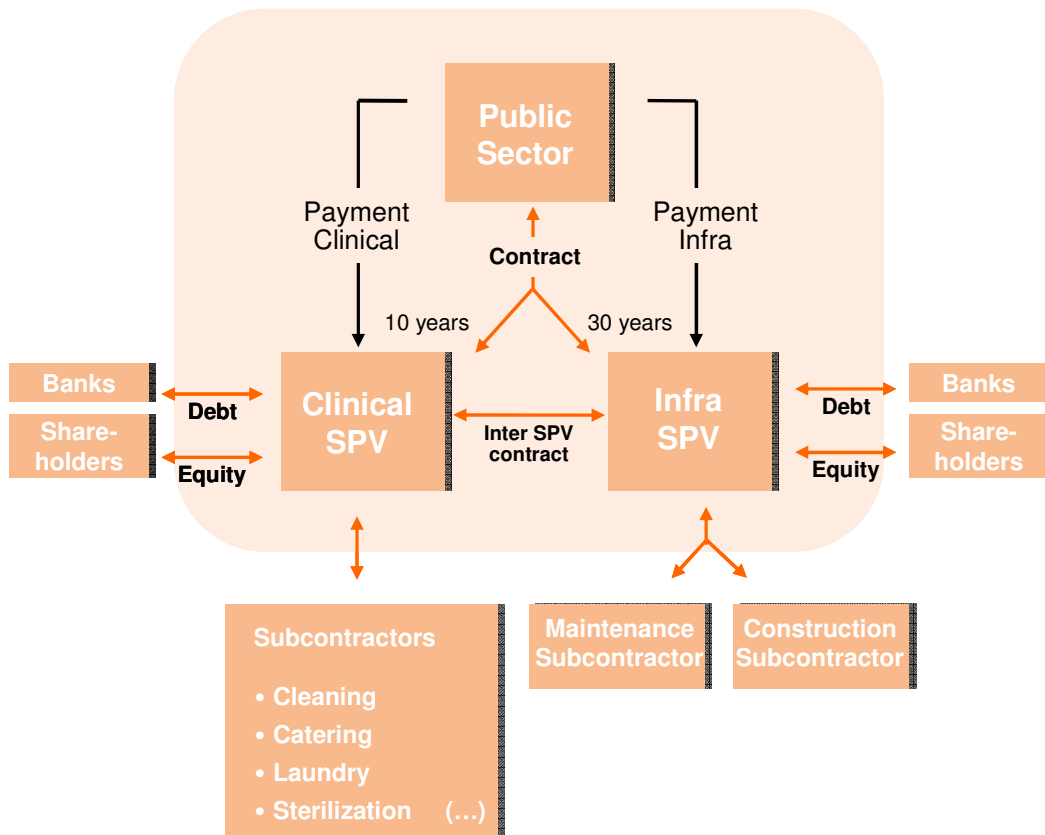
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# The *First Wave* – Contractual structure

## Scope

The *First Wave* PPPs include the provision of infrastructural as well as clinical services.



## Infrastructural SPV

It has a thirty-year contract and is responsible for the design, construction and maintenance of the hospital building and fixed equipment.

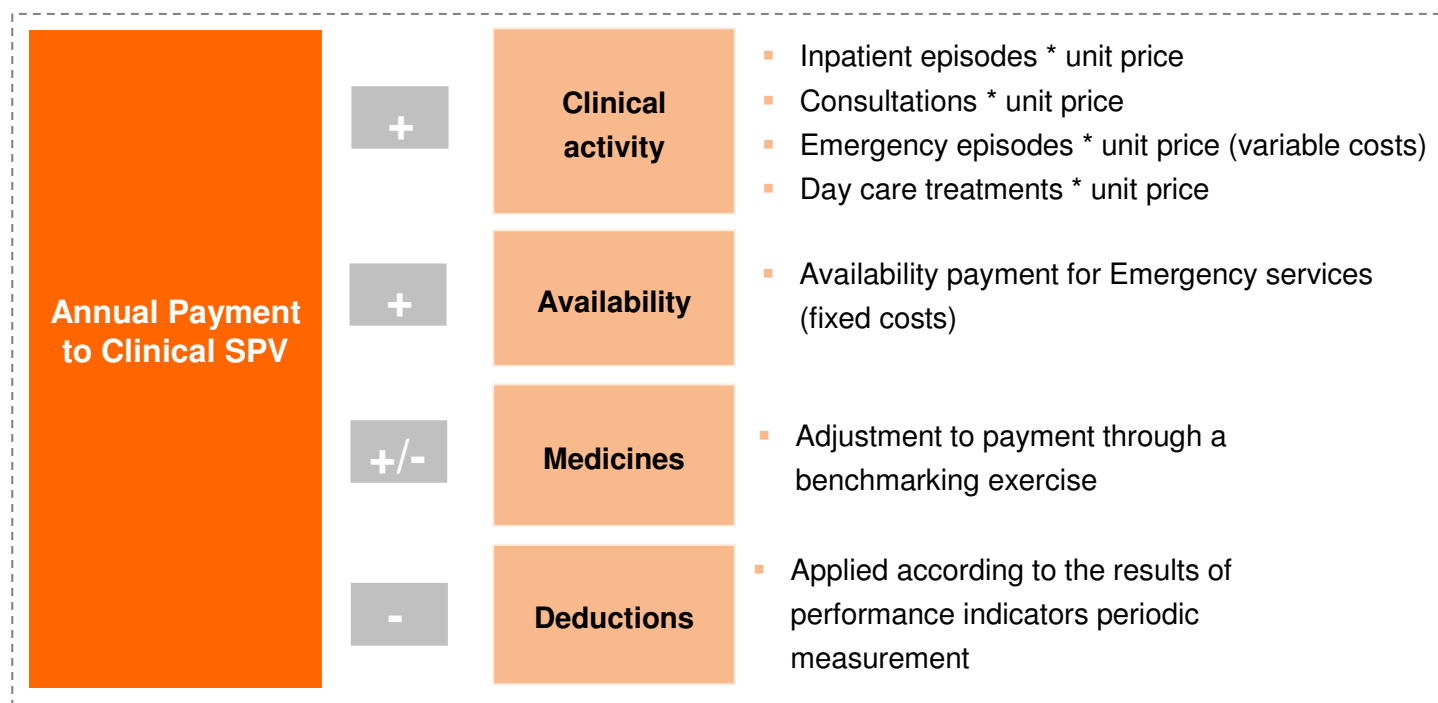
## Clinical SPV

The Clinical SPV has a ten-year contract and is responsible for clinical services, ancillary services and medical equipment acquisition and replacement. Smaller investment needs and difficulties defining clinical specifications led to a shorter contract duration.

- A contract between the two SPVs ensures coordination and both groups are joint and severally liable to the grantor.

# The *First Wave* – Payment mechanism

- The annual payment to Clinical SPV includes the following:

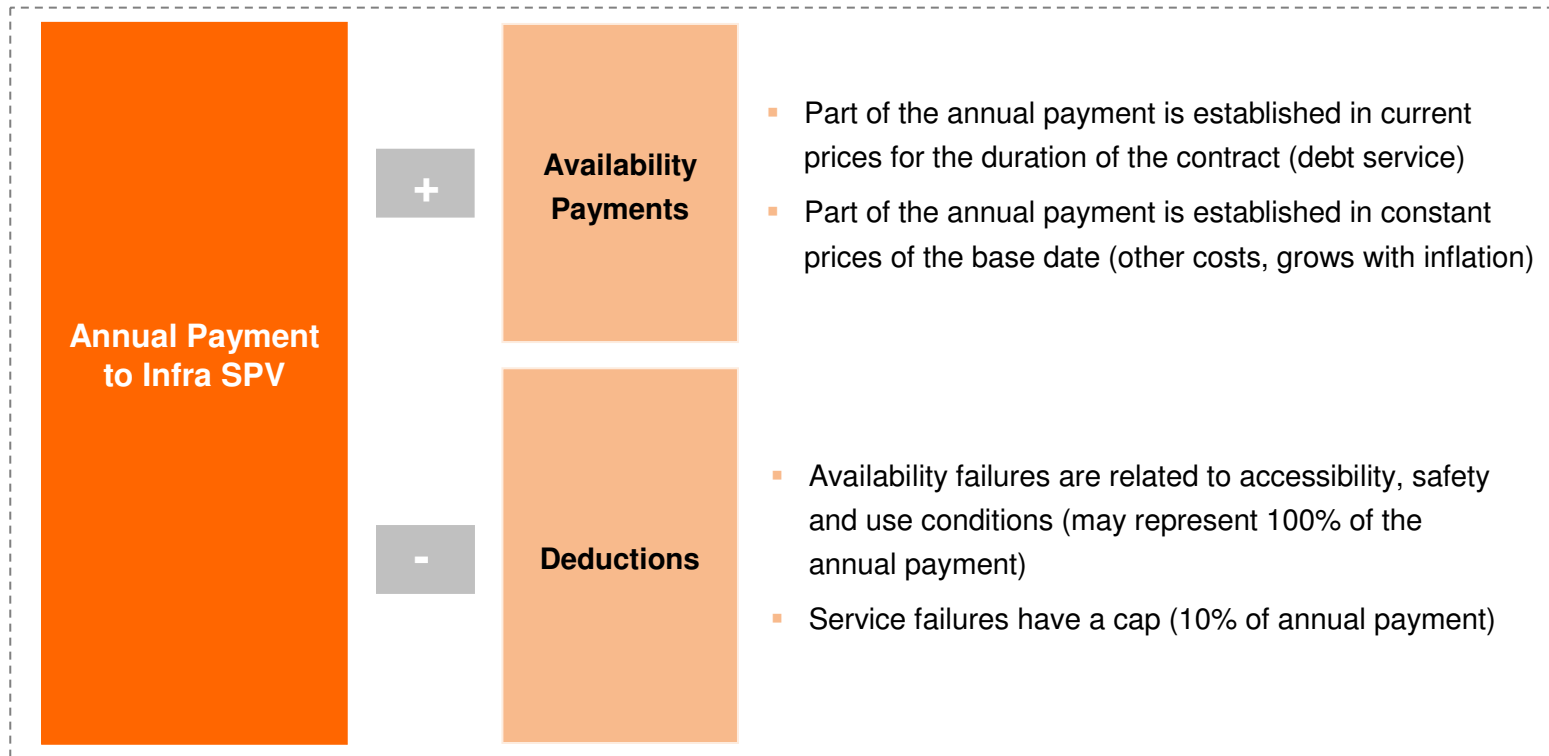


- Prices grow annually at the inflation rate plus a mark-up (which in most cases is 0.0% due to the competitive pressure created by the tender process);
- Maximum production per type of acute care activity is negotiated annually, except for the emergency services which have no cap;
- The annual payment to the Clinical SPV cannot be higher than the payment that would result from applying the prices used by the public sector (benchmarking);
- There are limits to the clinical activity that may be delivered (i) to patients from outside the geographic area (max. 10%); (ii) within the private sector (max. 10%);
- Revenues obtained from third parties (ex. Insurance companies) are shared with the public sector.



# The *First Wave* – Payment mechanism

- The annual payment to the Infrastructural SPV includes the following:

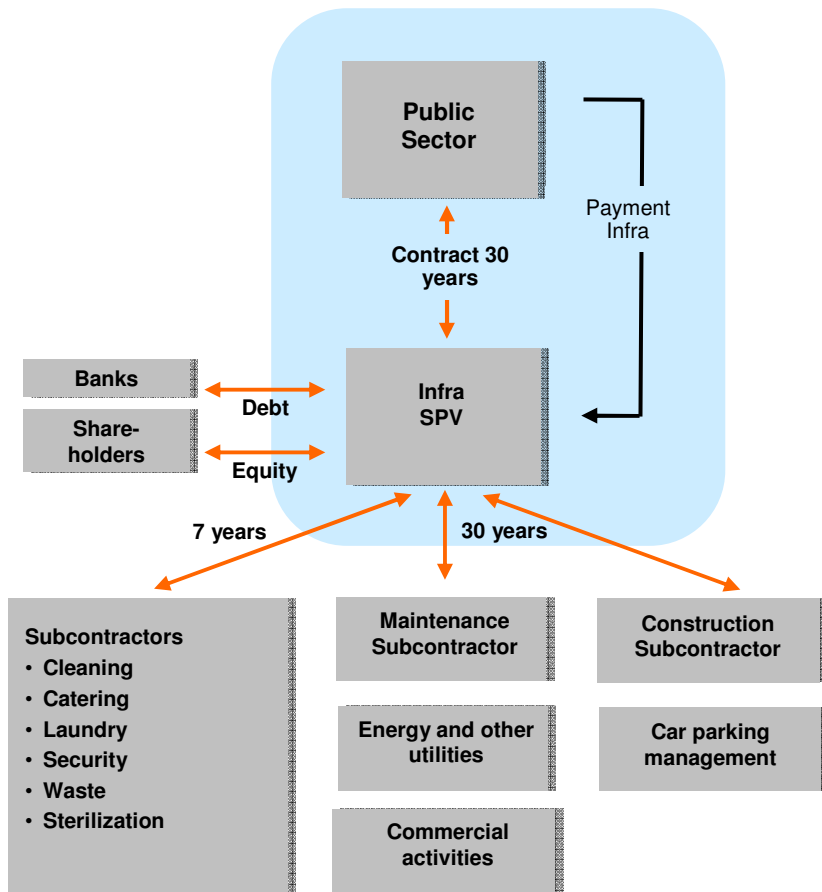


- Revenues obtained from commercial activities (ex. Car parking) are shared with the public sector.

# The *Second Wave* - Contractual structure

## Scope

The *Second Wave* PPPs include only the infrastructural services, keeping the clinical services in public responsibility.



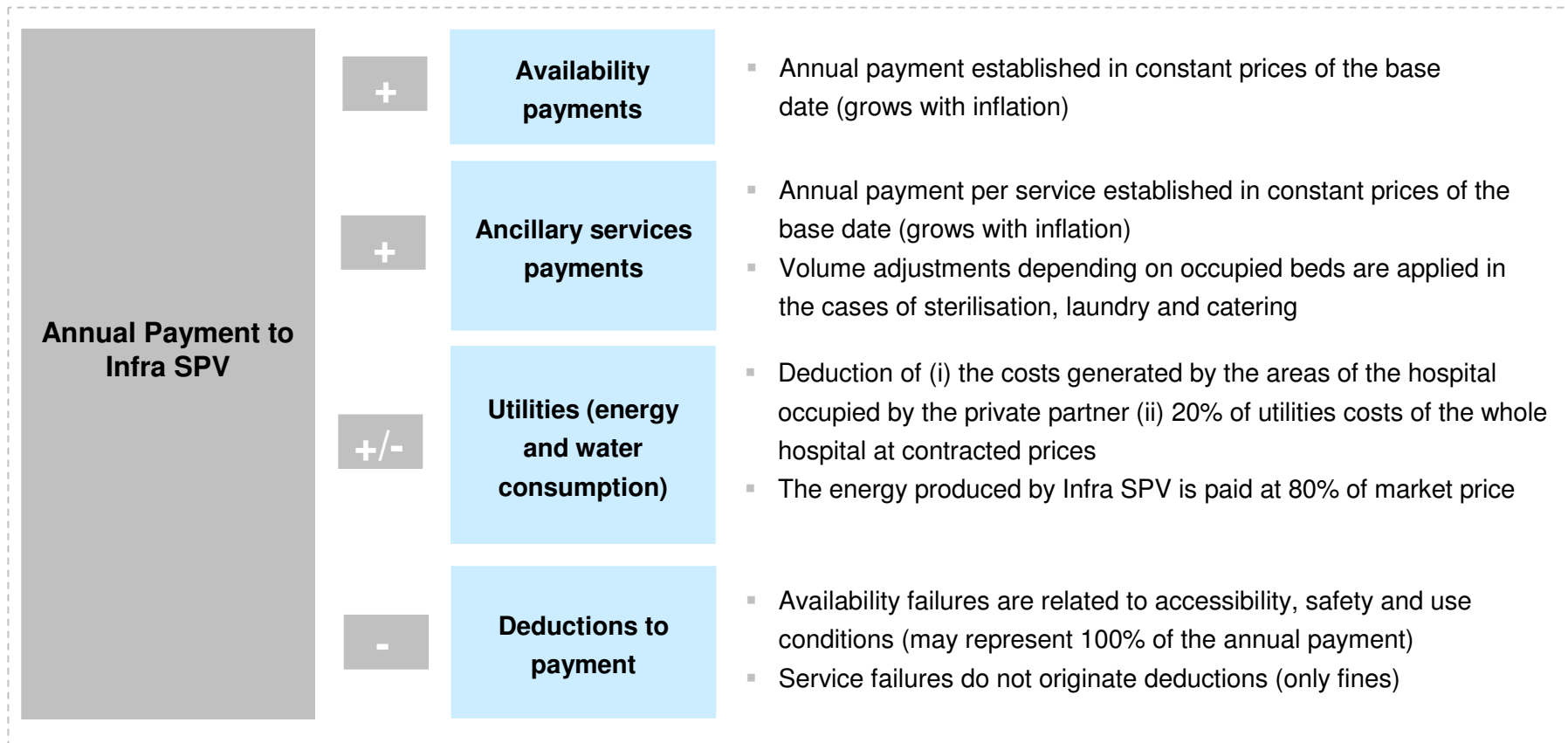
## Infrastructural SPV

As in the previous case, the Infrastructural SPV has a thirty-year contract and is responsible for the design, construction and maintenance of the building and fixed equipment.

The soft facilities services have a 7 year duration and currently there is a debate in Portugal concerning the scope of soft facilities to be included in the PPP contract.

# The *Second Wave* – Payment mechanism

- The annual payment to the Infrastructural SPV includes the following:



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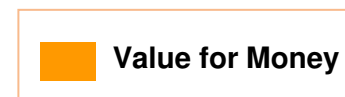
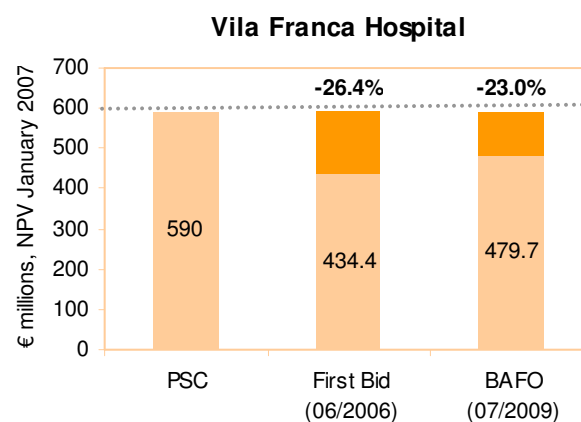
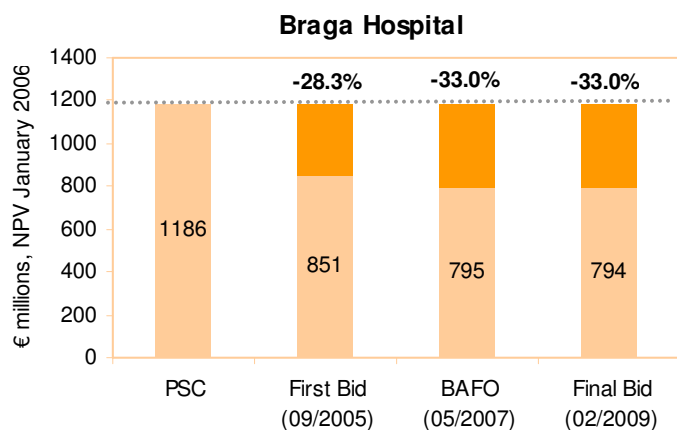
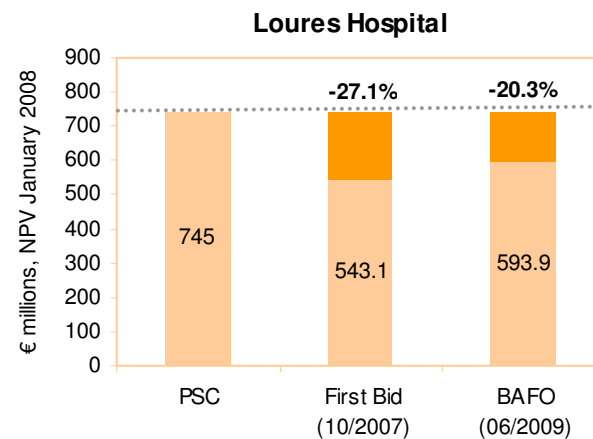
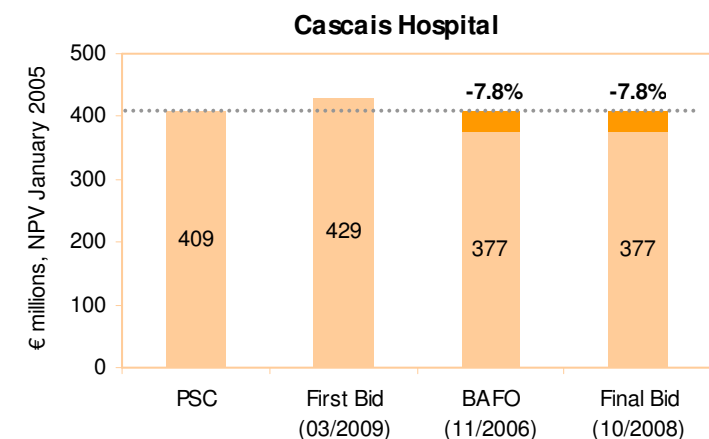
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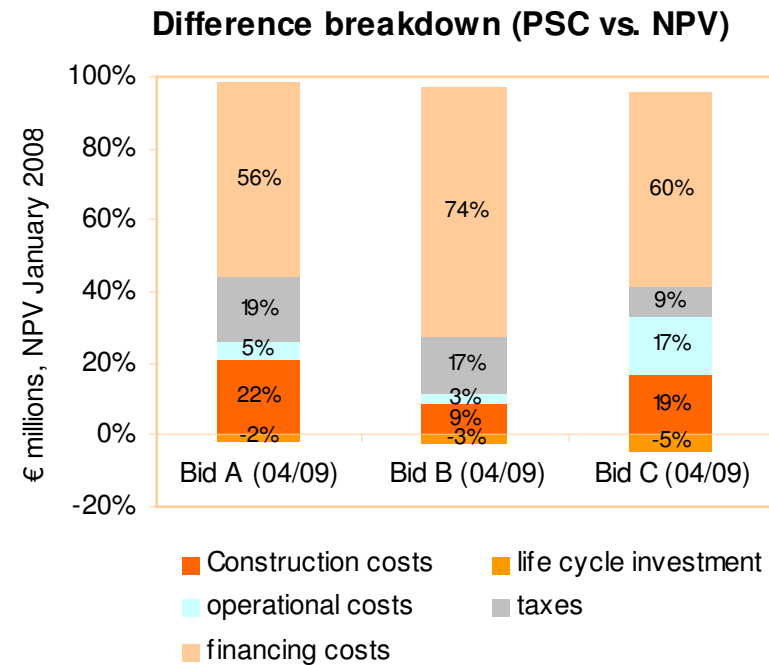
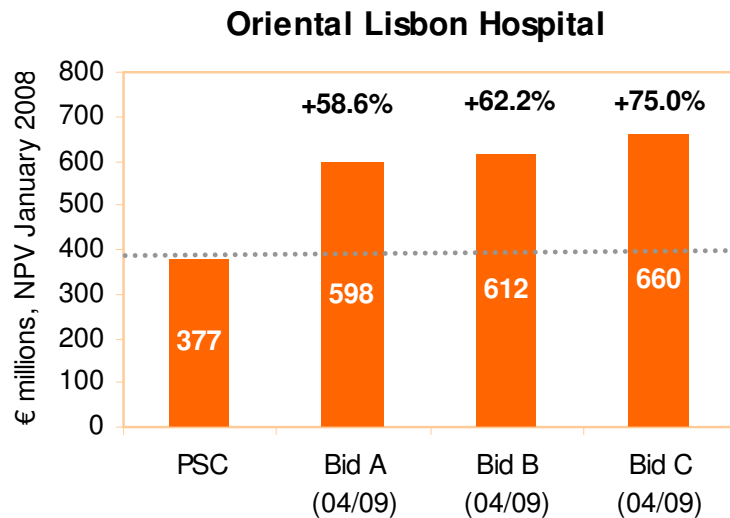
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# Public Sector Comparator and NPV of Payments (1st wave)



- Financial value for money (VfM) reached EUR 34 million in the Cascais Hospital and EUR 391 million in the Braga Hospital. In the Loures and Vila Franca projects, VfM is expected to reach EUR 151 million and EUR 110 million.
- These figures are particularly impressive considering that in the case of clinical services the net present value calculations are not influenced by public spending postponement, as occurs in purely infrastructural projects.

# Public Sector Comparator and NPV of Payments (2nd wave)



- On April 2009, bids were received for the first infrastructural PPP (Oriental Lisbon Hospital) and, on average, the NPV of Payments was 65.3% higher than the PSC.
- On average, financing costs explained 63% of the difference, taxes 15% and investment and operational costs the remaining 22%.

# The impact of the current credit situation

- Using examples of bids received between 2006 and 2009, the following table helps identify some consequences of the financial crisis, including debt margins growth, maturity reduction, introduction of mini-perms and cash sweep schemes and increases in the cost of capital:

|   | Bid A (Jun 2006) | Bid B (Oct 2007) | Bid C (Nov 2008) | Bid D (Feb 2009) | Bid E (April 2009)                                     |
|---|------------------|------------------|------------------|------------------|--|
| <b>Senior debt (million euros)</b>            | 75               | 71               | 57               | 105.25           | 320.0  |
| <b>Maturity (years)</b>                       | 26.5             | 28.2             | 26               | 12               | 27 (soft mini-perm with total cash sweep after year 9) |
| <b>Fixed interest rate (mark-up included)</b> | 4.47%            | 4.50%            | 4.65%            | 3.93%            | 4.35%  |
| <b>Margin (%)</b>                             | 1,00% - 1,15%    | 0,95 - 1,15%     | 0.90% - 1.00%    | 1.75% - 1.90%    | 3.30% - 3.60%  |
| <b>Equity/(Debt + Equity)</b>                 | 12.59%           | 11.58%           | 15.00%           | 20.42%           | 14.76%   |
| <b>IRR Shareholders funds (nominal)</b>       | 9.70%            | 11.72%           | 8.89%            | 9.13%            | 11.92%   |
| <b>IRR Debt (nominal)</b>                     | 7.14%            | 6.76%            | 6.72%            | 8.45%            | 10.84%   |
| <b>WACC (nominal)</b>                         | 7.73%            | 7.73%            | 7.17%            | 8.65%            | 11.29%   |

Internal Rate of Return (IRR), Weighted Average Cost of Capital (WACC)

- In PPPs the private partner must be more efficient than the public sector to compensate for higher financing costs.
- The increase in WACC, measured against the nominal discount rate of 6.08% used to assess the bids, leads to a reduction in value for money.

# Examples of measures introduced to overcome the financial crisis

## Cascais Hospital

### Interest rate risk

- Due to the high volatility of the financial markets, the Negotiation Commission and the private partner agreed to share interest rate change risk between November 2007 and financial close (February 2008). This mechanism was subsequently not authorized by the Audit Office because it hadn't been established in the tender documents.

### Financing entities

- The project was entirely financed by the state owned bank (Caixa Geral de Depósitos).

## Braga Hospital

### Payments' anticipation

- During the selected bidder negotiation phase financing costs increased (eg. Senior debt margins increased from 0,9% to 1,05% in the competitive negotiation phase to 1,75% to 1,90% by contract signature) and the maturity of senior debt reduced (from 27 to 12 years). In order to compensate higher financing costs without increasing the NPV of payments a solution of payments anticipation was introduced.

### Financing entities

- The project was entirely financed by the state owned bank (Caixa Geral de Depósitos) which replaced three international commercial banks (BNP Paribas, Caja de Ahorros y Monte de Piedad de Madrid and Société Générale).

## Loures Hospital

### Refinancing operation

- In order to compensate worsening financing conditions the Negotiation Commission allowed the private entities to incorporate a refinancing operation in the financial models (only additional gains are to be shared in the future). This led to an immediate transfer of future refinancing gains to the state and to a decrease in the NPV of payments. The public sector assumed the obligation to decide about future refinancing operations in a maximum period of three months.



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# Lessons learned

## Objectives

Reduce procurement costs and duration

## Measures

- PPP Programs are recommended given the high costs of procurement for both the public and the private sectors
- Availability of appropriate skills in the public sector is essential given the complexity of bids valuation and contract negotiation
- Procurement processes' simplification is needed in terms of the number of entities involved and procurement phases
- Tender documents and contract standardization would avoid the need to negotiate standard clauses
- Guidelines on project analysis, Public Sector Comparator calculation and valuation criteria would reduce procurement costs and duration

Value for money

- Tender documents standardization facilitates market acceptance and contributes to increased value for money
- Tender documents flexibility is essential to accommodate changes in the financial markets (eg. public sector intervention in financing, interest rate risk sharing)
- Appropriate contract management skills is crucial for value for money

# The question

The ultimate question that needs answering is: in the end, will PPP's in Health provide value for money for the public sector?

- As in all PPP contracts, final value for money assessment must take into account not only the performance delivered under the contract over its full term but also the costs and delays involved in the procurement process.
- In order to secure maximization of the partnership value for money, the public sector must ensure the appropriate management skills. This can be achieved through the training and involvement of multidisciplinary dedicated teams (ideally with a mix of experienced public staff and external consultants for specific areas or tasks).
- Only adequate monitoring and constant performance evaluation will ensure that the risk transfer principles foreseen in the contract are effectively implemented and, consequently, that the cost and quality of the services provided reach the expected levels.