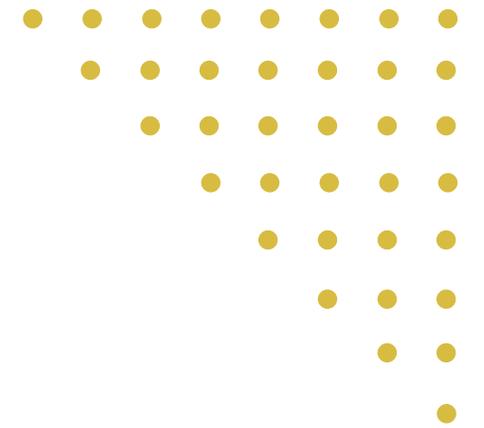


Senior Leadership Program on Public-Private Partnerships (PPP)

Strengthening Audit Oversight of Public Private Partnerships through Case Studies



PPP Concession Agreement



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Sources and References

This framework synthesizes guidance from leading international institutions and proven contract models to establish a robust foundation for PPP concession agreements.



World Bank PPP Reference Guide

Comprehensive guidance on project preparation and contract design



IFC PPP Contractual Toolkit

Standardized clause libraries and risk allocation frameworks



ADB & OECD Principles

Contract management guidelines and governance standards



UNCITRAL Legislative Framework

International legal standards for PPP transactions



Proven Contract Models

South Africa, India, and UK frameworks demonstrate implementation excellence

What Is a Concession Agreement?

A concession agreement is the **legally binding contract** between a government authority and a private sector partner that establishes the comprehensive framework for infrastructure delivery and operation.

This agreement governs the full project lifecycle across design, build, finance, operate, and maintain responsibilities, while clearly defining risk allocation, payment mechanisms, and the rights and obligations of each party.

The contract establishes enforceable performance standards and specifies the concession duration, typically ranging from 15 to 30 years depending on asset type and investment requirements.

Case Example: Chile

Chile's highway PPP framework successfully standardized concession structures across multiple road projects, creating investor confidence and attracting significant international capital through predictable contractual terms.

Why the Concession Agreement Is Critical

Project Bankability

Establishes the legal and financial foundation that enables lenders to commit long-term capital with confidence in revenue certainty and enforcement mechanisms

Role Clarity

Provides unambiguous definition of responsibilities, obligations, and decision-making authority for all parties throughout the project lifecycle

Public Interest Protection

Safeguards government objectives through enforceable performance obligations, quality standards, and service delivery requirements

Dispute Prevention

Reduces the likelihood of costly disputes or contentious renegotiations by establishing clear allocation of risks and comprehensive compensation mechanisms

Anatomy of a Concession Agreement

A well-structured concession agreement follows a logical progression that addresses all critical aspects of the PPP relationship. Each component builds upon the previous sections to create a comprehensive contractual framework.

01

Definitions and Interpretation

Establishes precise terminology and interpretive rules

03

Conditions Precedent

Requirements before contract effectiveness and financial close

05

Design and Construction

Technical requirements, milestones, and delivery standards

07

Payment Mechanism

Revenue structure, indexation, and adjustment provisions

09

Monitoring and Reporting

Performance measurement and oversight frameworks

02

Scope of the Project

Defines deliverables, technical specifications, and boundaries

04

Rights and Obligations

Comprehensive responsibilities for each contracting party

06

Operations and Maintenance

Service delivery standards and asset management requirements

08

Risk Allocation

Distribution of risks and mitigation strategies

10

Termination and Handback

Exit procedures and asset transfer requirements

Defining Characteristics of PPP Concessions

Long-Term and Performance-Based

Contracts typically span 15-30 years, aligning private sector incentives with long-term asset quality and service delivery rather than short-term cost minimization

Output Specifications

Contracts define required outcomes and performance standards instead of prescribing detailed technical inputs, allowing private sector innovation in delivery methods

Balanced Risk Allocation

Risks are systematically assigned to the party best equipped to manage them, ensuring both bankability for investors and value for money for government

Predictable Payment Models

Whether through user tariffs or availability payments, revenue mechanisms provide clarity on cash flow generation and investment returns

Regulatory Transparency

Clear frameworks for oversight, monitoring, and adjustment ensure accountability while maintaining operational flexibility

Case Example: South Africa REIPPP

South Africa's Renewable Energy Independent Power Producer Procurement Program maintains exceptionally strict performance-based requirements, including capacity availability targets and penalty regimes that have driven consistent operational excellence across the portfolio.

Conditions Precedent: Gating Project Effectiveness

1

What Are Conditions Precedent?

Conditions precedent (CPs) are specific requirements that must be fulfilled before the concession agreement becomes effective or before financial close can occur. These protect both parties from proceeding when critical prerequisites remain unmet.

2

Typical Conditions Include:

- Obtaining all required government approvals and licenses
- Completion of land acquisition and site access
- Confirmation of financial commitments from lenders
- Receipt of environmental permits and clearances
- Execution of key project agreements and insurance policies

Delays in satisfying conditions precedent represent one of the most common causes of PPP procurement failure, particularly when governments underestimate land acquisition complexity or permitting timelines.

Construction and Delivery Obligations

The construction phase provisions establish clear expectations for project delivery, quality standards, and consequences for delays or defects.

1

Milestone-Based Completion

Contracts specify key construction milestones with defined completion dates, enabling phased delivery and progressive commissioning where appropriate

2

Liquidated Damages for Delays

Pre-agreed damages for late completion protect government interests while providing cost certainty for the private partner

3

Technical Standards Compliance

Detailed specifications reference international codes and local regulations to ensure quality and safety requirements are met

4

Utility Interface Management

Provisions address coordination with existing infrastructure and utility relocations to prevent construction delays

5

Testing and Commissioning

Independent verification procedures confirm the asset meets all performance requirements before acceptance

Case Example: India Highway PPPs

India's National Highways Authority includes comprehensive liquidated damages provisions in highway concessions, with penalties calculated as a percentage of construction cost for each week of delay, creating strong incentives to avoid construction overruns.

Operations and Maintenance Obligations

The operations phase spans the majority of the concession period and requires clear definition of service delivery expectations and asset management responsibilities.

- **Minimum Performance Standards**

Quantifiable service levels across safety, availability, reliability, and quality metrics that must be continuously maintained

- **Routine and Major Maintenance**

Scheduled preventive maintenance and periodic rehabilitation requirements to preserve long-term asset value

- **Availability Requirements**

Specifications for operational uptime, lane availability, or capacity thresholds that trigger payment adjustments if not met

- **Safety and Environmental Compliance**

Ongoing adherence to health, safety, and environmental regulations throughout the operations period

- **Performance Penalties**

Deduction mechanisms that reduce payments proportionally when performance falls below agreed thresholds

Payment Mechanisms in PPP Concessions

Revenue Models and Structures

The payment mechanism is central to project bankability and determines how the private partner recovers investment costs and earns returns. Three primary models exist:

User-Charge Model

Private partner collects fees directly from users (tolls, tariffs). Revenue risk transfers to private sector but requires robust demand analysis.

Availability Payments

Government makes regular payments based on asset availability and performance, eliminating demand risk for the private partner.

Hybrid Models

Combination of fixed government payments and variable user revenues, sharing demand risk between parties.

Key Adjustment Factors

- Indexation rules tied to inflation and currency movements
- Performance deductions based on KPI achievement
- Compensation for material changes in law or policy
- Refinancing gain-sharing provisions

European Light Rail

Availability-based light rail PPPs in Europe typically include sophisticated payment deduction matrices where service failures trigger proportional payment reductions, aligning operator incentives with passenger service quality.

Risk Allocation: The Foundation of Bankability

Effective risk allocation is the cornerstone of successful PPP concessions. The fundamental principle: **allocate each risk to the party best able to manage it** at least cost.



Achieving the right balance in risk allocation ensures projects are both bankable for lenders and deliver value for money for government. Excessive risk transfer to the private sector increases costs; insufficient transfer undermines PPP value.

Managing Demand Risk in User-Charge Projects

Demand risk remains one of the most challenging aspects of user-charge PPP projects, as traffic or utilization forecasts often prove optimistic, leading to revenue shortfalls and renegotiation pressures.

Critical Considerations

- User-charge projects must define realistic demand assumptions based on independent traffic studies
- Sensitivity analysis should test downside scenarios
- Historical data from comparable projects provides calibration

Risk Mitigation Tools

- **Revenue floors and caps:** Share extreme upside/downside outcomes
- **Minimum revenue guarantees:** Rarely used due to fiscal exposure
- **Hybrid payment structures:** Base availability payment plus usage component

Case Example: Portugal Toll Roads

Portugal's toll road concessions faced extensive renegotiations when unrealistic demand risk was fully transferred to the private sector. Actual traffic volumes fell significantly short of forecasts, forcing the government to provide compensation to avoid concessionaire bankruptcy ultimately costing more than if risk had been properly shared initially.

Government Support and Guarantees

While PPP projects should be structured to minimize reliance on government support, certain forms of assistance can enhance project viability without compromising value for money principles.

Viability Gap Funding

Capital grants to bridge the gap between project costs and affordable user charges, making socially desirable projects financially viable

Land Acquisition Support

Government assumes responsibility for land assembly and right-of-way clearance, reducing private sector exposure to expropriation risk and delays

Tax Incentives

Structured tax benefits such as accelerated depreciation, tax holidays, or exemptions that improve project returns without direct fiscal cost

Limited Guarantees

Letters of comfort or guarantees for specific political risks (expropriation, non-convertibility) rather than commercial risks

Critical principle: Government support mechanisms should facilitate project closure but must not be used to cover commercial risks that the private sector should appropriately bear.

Environmental and Social Obligations

Environmental and social (E&S) performance has become central to PPP project success, particularly for projects requiring international financing. Concession agreements must establish comprehensive E&S frameworks.

Key Requirements

- **National regulation compliance:** Adherence to host country environmental laws and standards
- **IFC Performance Standards:** International best practice for managing E&S risks, often required by lenders
- **Resettlement and compensation:** Fair processes for affected communities with international safeguards
- **Ongoing monitoring:** Regular reporting on E&S performance throughout operations
- **Grievance redress:** Accessible mechanisms for community concerns and complaints

Case Example: African Power IPPs

Independent power producers in Africa seeking international project finance must demonstrate strict adherence to IFC Performance Standards. These E&S frameworks, embedded in concession agreements, have become prerequisites for securing debt from development finance institutions and commercial lenders.

Monitoring, Reporting, and Performance Audits

Effective government oversight throughout the concession period ensures accountability, protects public interests, and provides early warning of performance issues.



Government Oversight Mechanisms

Dedicated contract management units within procuring authorities monitor compliance, review reports, and manage the government-concessionaire relationship



Annual Performance Audits

Independent third-party audits verify financial statements, assess technical performance, and evaluate compliance with contractual obligations



Independent Engineer

Technical expert or monitoring agency provides objective assessment of design, construction quality, and operational performance throughout the project lifecycle



Data Sharing Obligations

Concessionaires must provide regular operational, financial, and technical data to enable government oversight and inform policy decisions



Performance Dashboards

Real-time or periodic reporting systems track KPIs, availability metrics, safety records, and service quality indicators for transparent accountability

Change in Law Provisions

Changes in law during the concession period can materially affect project economics. Well-drafted provisions allocate this risk appropriately and establish clear adjustment mechanisms.

Defining Material Impact

Concession agreements must specify thresholds for when a change in law triggers compensation or adjustment rights. Typical criteria include:

- Changes that increase operating costs beyond specified percentage
- New requirements necessitating capital expenditure
- Alterations to tax regime affecting project returns
- Regulatory changes impacting service delivery or pricing

Adjustment Procedures

Contracts should establish transparent processes for:

1. Notification and documentation of the law change
2. Assessment of financial impact by independent expert
3. Negotiation of compensation amount or contract adjustment
4. Dispute resolution if parties cannot agree

Clear definition of change in law provisions prevents disputes and maintains project bankability when regulatory environment evolves.

Compensation Events vs. Relief Events

Concession agreements distinguish between events that warrant financial compensation and those that provide schedule relief without payment obligations.

1

Compensation Events

Events caused by government action or policy decisions that financially harm the concessionaire

- Government breach of contract
- Discriminatory policy changes
- Delayed government approvals
- Changes in law (when applicable)

Remedy: Extension of time plus financial compensation for increased costs or lost revenue

2

Relief Events

Events outside either party's control that impact project delivery or performance

- Force majeure circumstances
- Natural disasters
- Labor strikes (unrelated to concessionaire)
- Unexpected site conditions

Remedy: Extension of time and suspension of performance obligations, but typically no financial compensation unless specified

Both mechanisms include defined procedures for notification, substantiation, and determination of extensions or compensation amounts to ensure fair treatment while preventing abuse.

Dispute Resolution Framework

Even well-drafted concession agreements encounter disputes. A multi-tiered resolution framework encourages efficient settlement while preserving the option for binding resolution.

1

Negotiation

Senior management from both parties attempt to resolve disputes through direct discussion within specified timeframe (typically 30-60 days)

2

Mediation

Neutral third-party mediator facilitates discussions to reach mutually acceptable solution, preserving contractual relationship

3

Expert Determination

Independent technical or financial expert provides binding or non-binding opinion on specific technical or valuation issues

4

Arbitration

Formal binding arbitration under recognized rules (UNCITRAL, ICC, LCIA) provides final resolution with limited appeal rights

Case Example: International Arbitration

Lenders financing cross-border PPP investments typically require international arbitration clauses to ensure neutral forum and enforcement under the International Convention. This provides confidence that disputes will be resolved fairly without local court bias.

Termination Provisions and Payment Mechanisms

Termination provisions protect both parties' interests while ensuring lenders can recover investments in defined circumstances. The concession may terminate for several reasons, each with distinct payment consequences.

- 1 Termination for Concessionaire Default**
Material breach or insolvency by private partner. Government may step in or retender. Termination payment typically limited to outstanding senior debt, minus costs to complete and cure defaults.
- 2 Termination for Government Default**
Material breach by government authority. Concessionaire entitled to compensation including debt, return of equity, reasonable profit, and costs associated with early termination.
- 3 Termination for Prolonged Force Majeure**
Extended force majeure making project impossible or uneconomic. Payment typically covers debt and equity invested, but not expected future profits given no-fault nature.
- 4 Termination for Public Interest**
Government exercises right to terminate for policy reasons. Full compensation provided: debt, equity, lost profits calculated using discounted cash flows, and termination costs.

Termination payment formulas must be predictable and fair, protecting lender interests to maintain bankability while ensuring value for money for government.

Handback Requirements and Asset Transfer

As the concession period concludes, well-structured handback provisions ensure the public authority receives assets in acceptable condition to continue service delivery without interruption.

Core Handback Elements

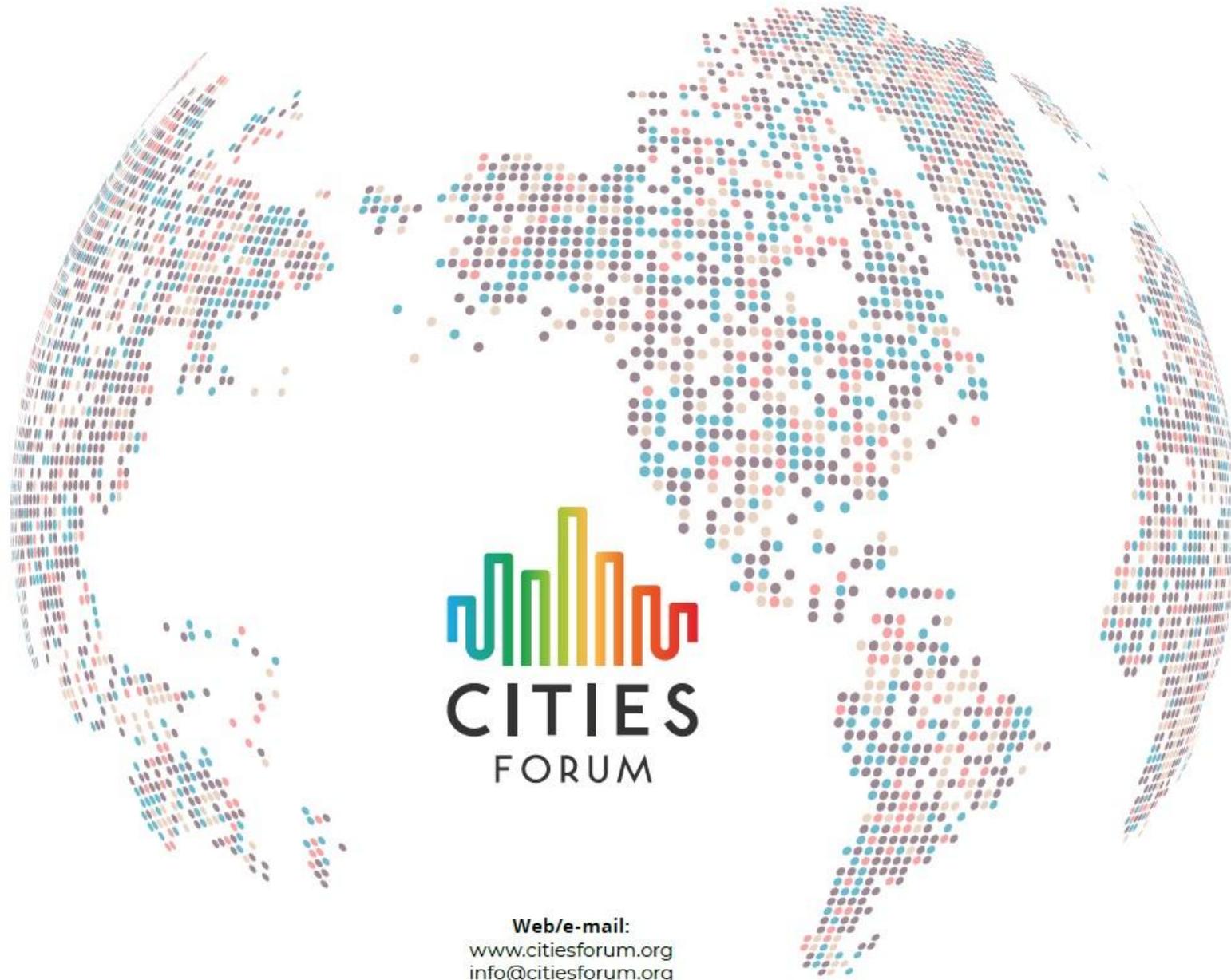
- **Condition assessment:** Independent surveys conducted 3-5 years before expiry establish asset condition and required remediation
- **Reserve accounts:** Dedicated funds for major maintenance ensure resources available for late-term rehabilitation
- **Handback protocols:** Detailed procedures for inspections, defect rectification, documentation transfer, and operational transition
- **Performance incentives:** Bonuses for superior condition or penalties for substandard handback align long-term asset management

Case Example: Singapore PPPs

Singapore's PPP framework requires comprehensive asset condition surveys five years before concession expiry. This lead time enables orderly planning for rectification works and ensures smooth transition of well-maintained assets back to government control.

Key Points

- Concession agreement is the foundation of a PPP project
- Must clearly define obligations, risks and payment mechanisms
- Predictability and transparency ensure bankability
- Balanced contract reduces renegotiation risk
- Strong E&S, monitoring and termination clauses protect public interest



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