



The build-transfer-lease scheme:
Some issues to consider

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The Build-transfer-lease scheme

- The government decides which facilities it needs to provide services such as education and accommodation
- It then decides whether to procure the facilities using public finance or private finance under the BTL scheme
- If it uses the BTL scheme, a private firm builds, operates, and maintains the facility
- In return, the government pays the firm a lease fee and an operations-and-maintenance fee.

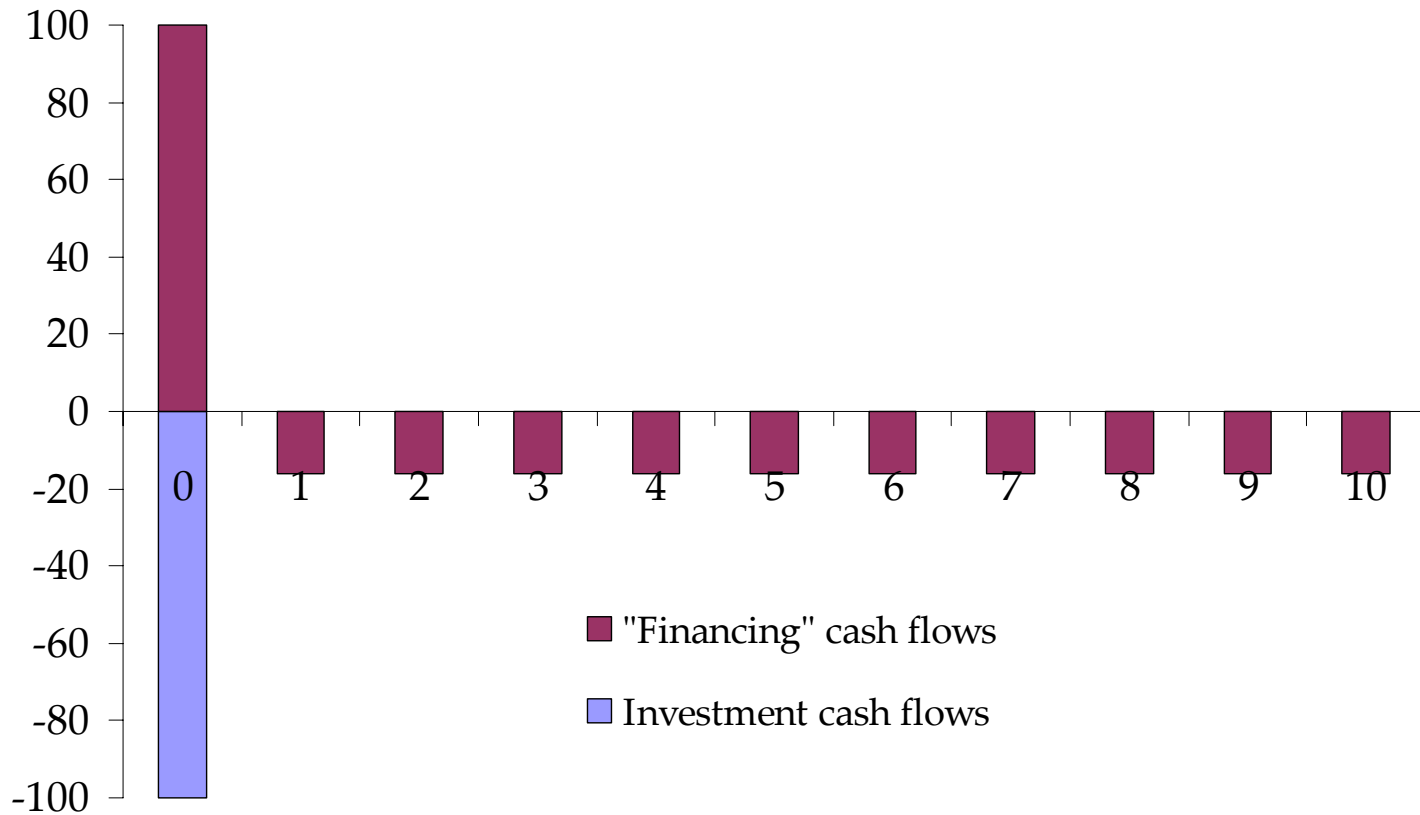
The Build-transfer-lease scheme

- The lease fee l depends only on the cost of constructing the facility k , government's borrowing rate r , a fixed risk premium α , and the term of the contract T

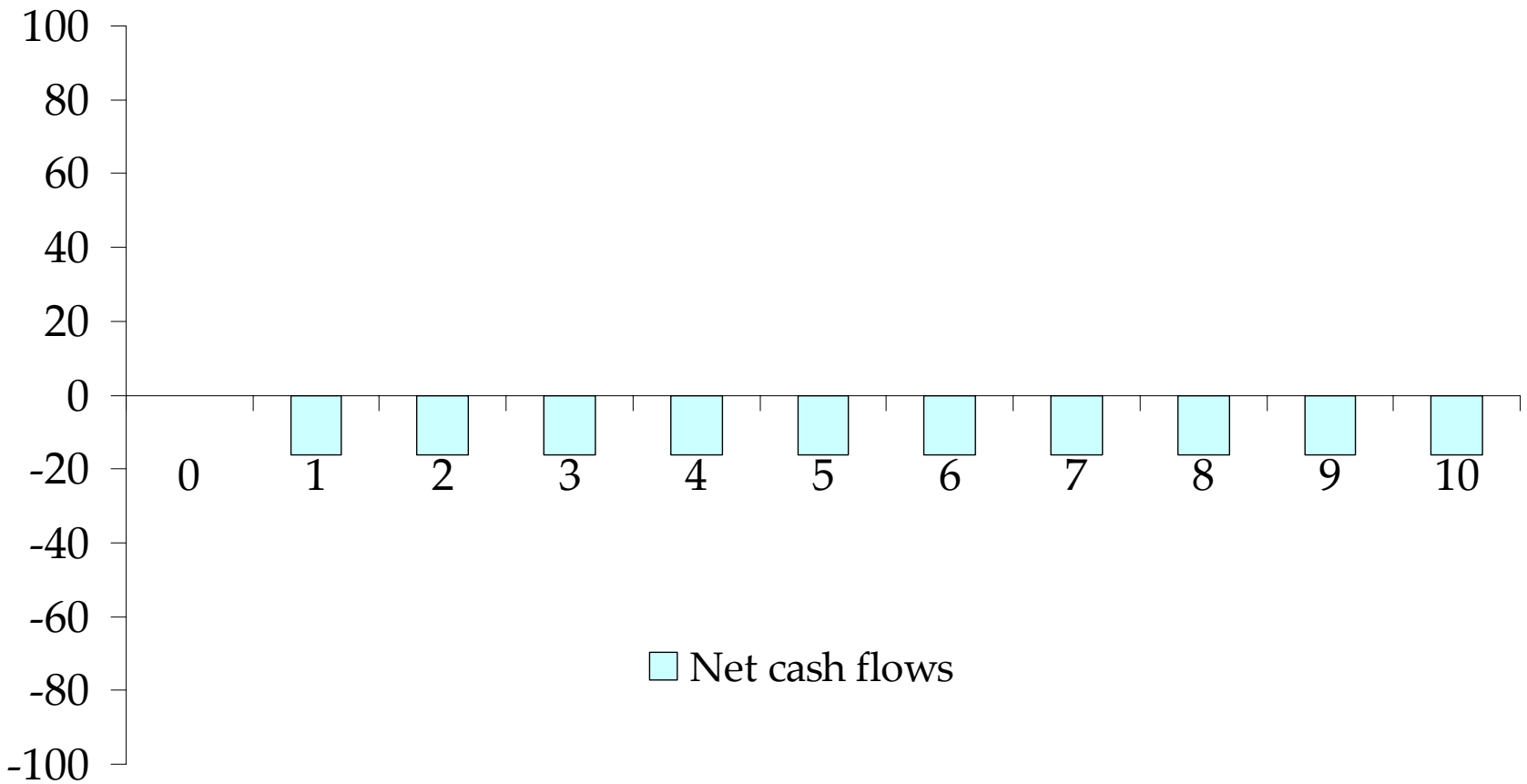
$$l = k \frac{r + \alpha}{1 - (1 + r + \alpha)^{-T}}$$

- The operating fee depends on performance. The lease fee doesn't.
- How to choose between public and BTL finance?

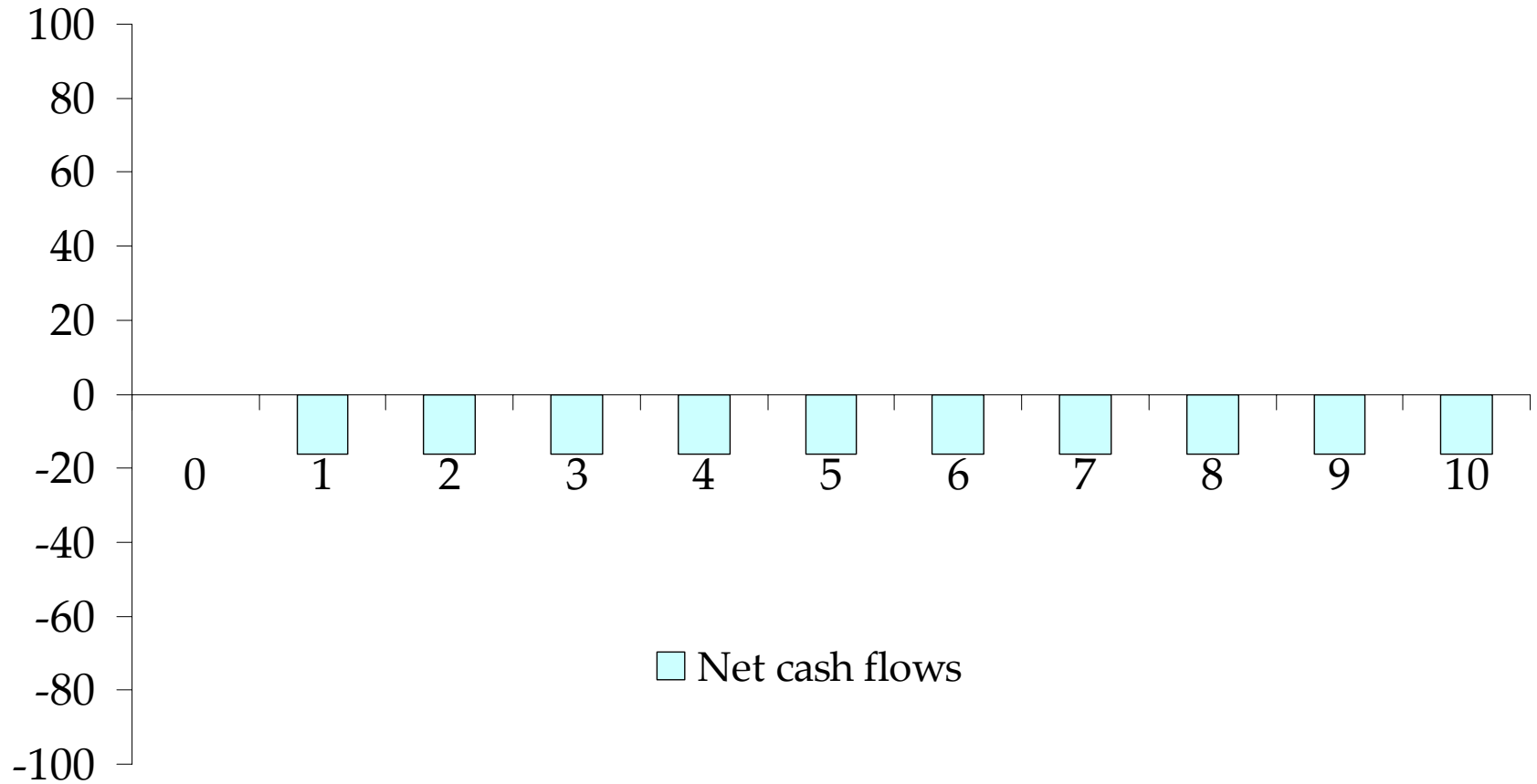
Cash flows with public finance might look like this (ignoring operating cash flows)



Giving the following net cash flows



Net cash flows with BTL scheme might look much the same



Comparing public and BTL finance

Public finance

Get facility without having to raise taxes immediately

Must repay debt whether it needs the facility or not

Has a liability that it must report

BTL finance

Get facility without having to raise taxes immediately

Must make lease payments whether it needs the facility or not

Has a liability that it might not have to report

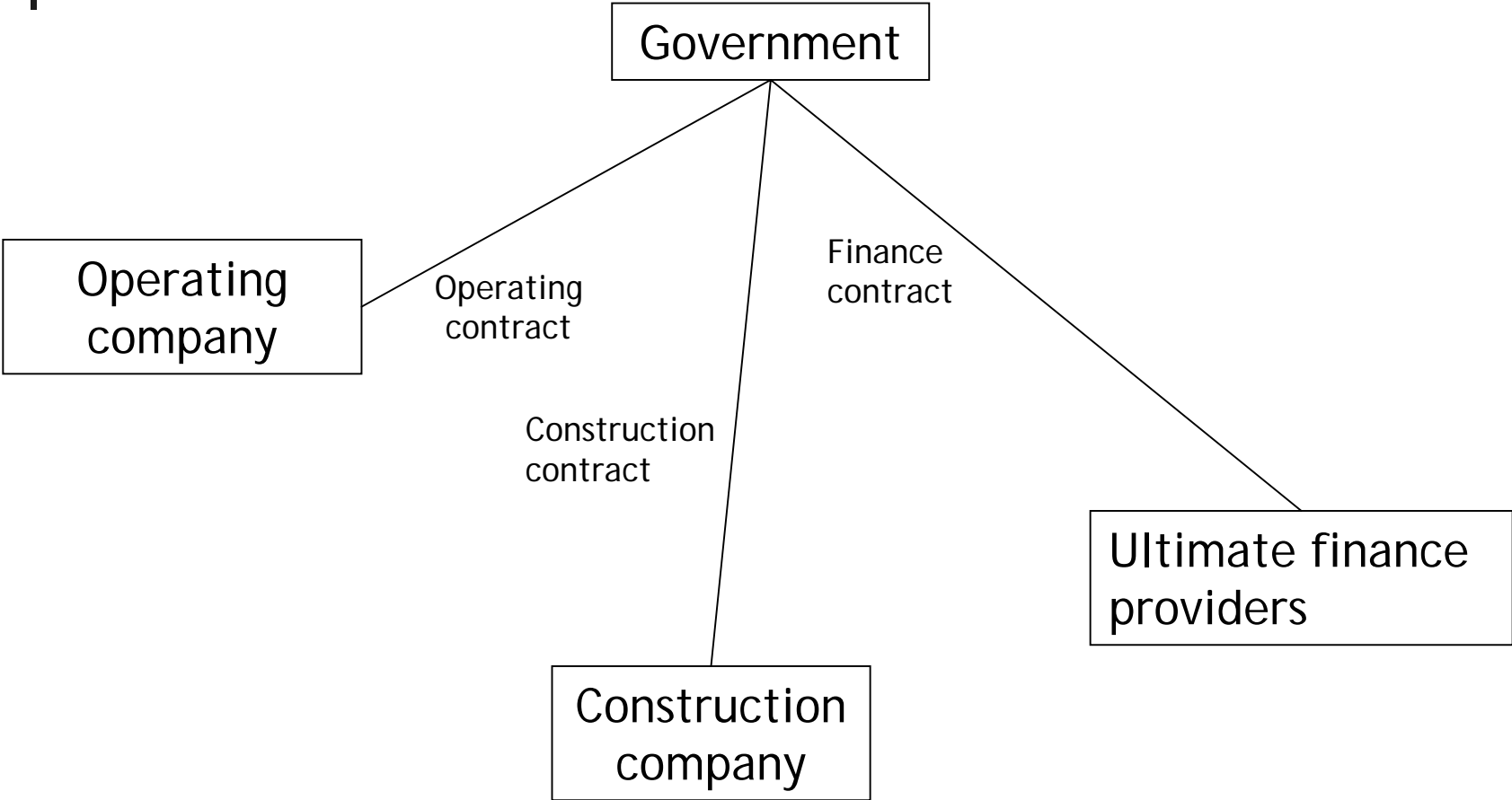
How to choose between public and BTL: Accounting?

- A government might be tempted to choose BTL finance to make its deficit and debt seem lower.
- That might be useful if it had to comply with conventional externally imposed rules (Maastricht, IMF?) that excessively discouraged public investment.
- But the use of BTL finance complicates fiscal monitoring, making the country more vulnerable to a fiscal crisis, and undermines trust in the government's financial reporting.
- Credit-rating agencies and sophisticated lenders probably aren't fooled.

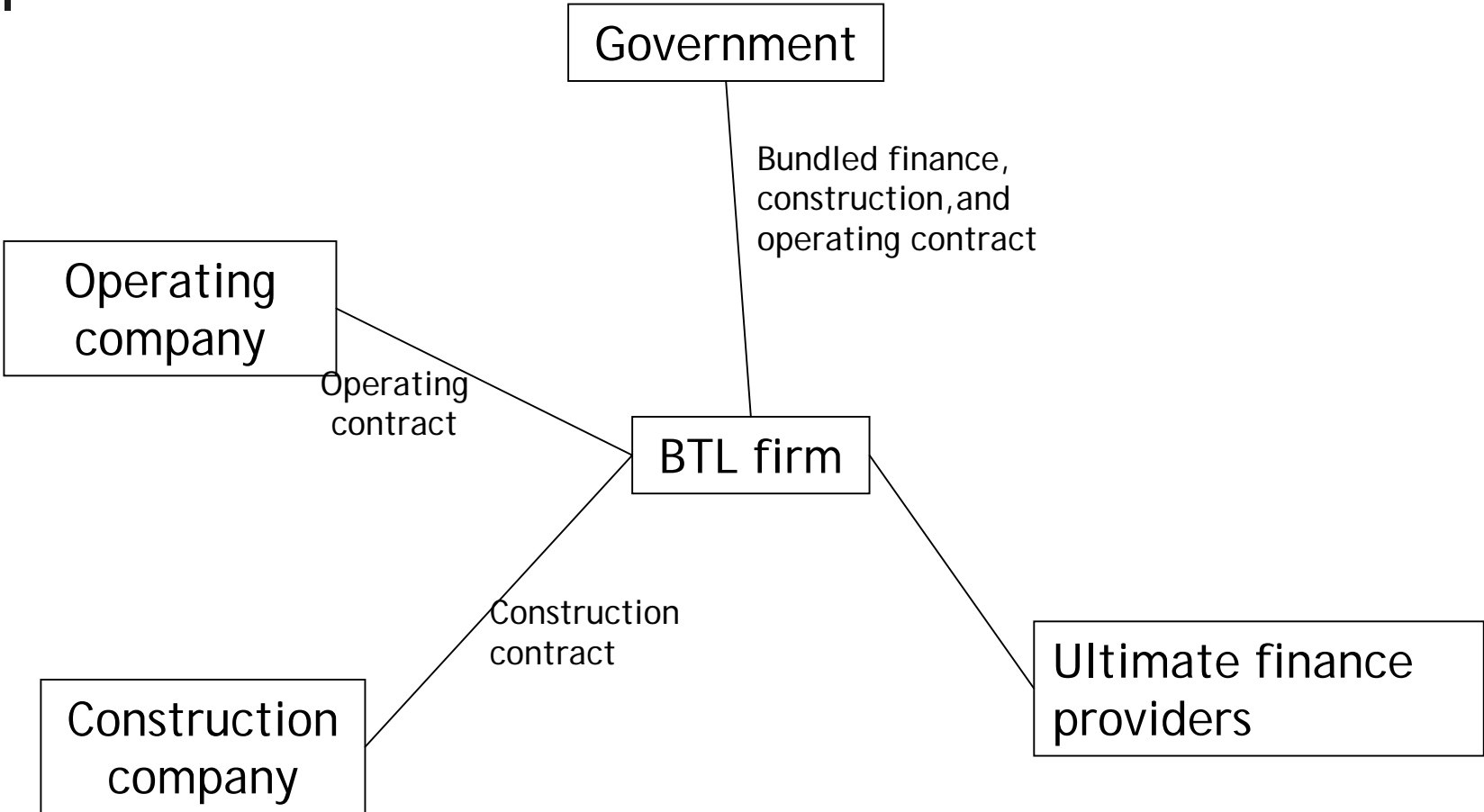
How to choose between public and private finance: Cost?

- When might private finance be cheaper than public finance, for a given quality of service.
- Consider the two options more closely, assuming that, under public finance, the government
 - Borrows from banks or by issuing bonds
 - Contracts out construction under a turnkey contract
 - Contracts out operations and maintenance under a separate operating contract, or series of operating contracts.

Consider public finance with separate construction, operating, and financial contracts



Compare private (BTL) finance



When might private finance be cheaper?

- Private finance could be expected to be cheaper when
 - The government can specify the service it wants over the life of the facility, can measure whether it gets it, and can pay only if it gets it, and
 - The cost of operations and maintenance depends on construction, so that minimizing total (whole-of-life) costs requires careful, interdependent choices, and
 - The BTL firm is better than the government at making these choices.
- Otherwise, public finance with separate construction and operating contracts may be as good as or better than BTL finance.

Issues to think about: Financial reporting and budgeting

- Does the government's financial reporting include BTL lease obligations as liabilities alongside debt?
- Do government agencies require approval in the budget process to incur the full capital cost of BTL projects before signing the contracts?
- If not, there's a risk of using BTL projects when public finance would be cheaper and of complicating fiscal monitoring.

Issues to think about : Use of the BTL scheme

- Can the government specify the services it wants and measure whether it is getting them?
- If not, does BTL finance make sense? Would public finance combined with separate turnkey construction contracts and operating contracts be more efficient?
- If yes, why separate the lease and operating fees? Why not have one payment for the service whose amount depends on the extent to which the service has been provided?