

Client Alert

Latham & Watkins
Finance Department

Using Public Private Partnerships in the Education Sector

The use of PPP structures within the educational sector worldwide has been gathering momentum in recent years, with successful examples of such projects in the United Kingdom, France, Canada and the United Arab Emirates.

What is PPP?

PPP stands for a Public Private Partnership. PPPs have been in use for more than 20 years and have been particularly used in Australia and the United Kingdom in a variety of industry sectors. Their use has become more widespread in other parts of the world in recent years, including in the United Arab Emirates. Cash strapped governments have utilized them as a means of procuring large capital intensive infrastructure projects without having to resort to government borrowing to fund the same.

The term PPP embraces the concept of the public and private sectors working together to deliver services often previously provided and financed exclusively by the public sector. Key drivers behind the use of PPPs in government procurement are the desire to build strong partnerships between the private sector and the public sector, to enable the public sector to benefit from the best skills and expertise available in the private sector, to reap greater efficiencies and economies of scale and to have the

private sector participants secure the financing for these capital intensive projects.

A PPP structure typically has a fixed long term contractual arrangement (a Project Agreement) between a private sector service provider and a public sector entity. The Project Agreement will require the private sector service provider to procure the design, construction, operation and maintenance of the facilities, as well as the long term delivery of specific services to the public sector entity. The private sector service provider will be responsible for procuring the necessary capital investment required for the public sector project instead of the public sector entity having to procure the relevant capital funding from central government funding or utilize its own financial resources.

The private sector service provider is repaid for the investment and the provision of the services by way of a monthly payment process whereby the capital costs incurred in procuring the construction and the costs of providing the services and performing the maintenance obligations are recovered over the life of the Project Agreement, along with a return on investment. The private sector service provider's performance is measured in a number of ways, including:

- contractually agreed completion dates with termination for a failure to complete by a long stop date;

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- pre-agreed termination triggers for poor performance;
- deductions from the monthly payment to the private sector service provider for both unavailability of specific areas and poor service delivery; and
- minimum hand back requirements for the condition of the infrastructure asset at the expiry of the term of the Project Agreement.

The Project Agreement also provides for the transfer to the public sector entity of the facilities at the expiry or earlier termination of the Project Agreement.

Educational PPPs

As previously noted, the use of PPPs in the education sector has been increasing in recent years with projects happening around the world, including in the Middle East, where we have seen the UAE University and Paris Sorbonne University Abu Dhabi PPP Projects reach successful financial close.

While the PPP structure will involve the private sector in the operations and maintenance of the educational facilities, the use of an educational PPP structure does not involve the outsourcing to the private sector of the provision of the educational services. The day-to-day running of the educational establishment, including the setting of the curriculum, control over and performance of the day-to-day teaching and timetabling remains with the public sector/education provider. The use of the PPP structure does not alter that position but transfers the responsibility for certain non-core functions to the private sector. In fact, one of the main drivers in choosing PPP structures in educational projects is the recognition that the education provider should remain focused on its core objectives—the provision of educational services and the raising of educational standards—rather than the maintenance of buildings. Passing the responsibility for construction and day-to-day maintenance of the educational facilities to the private sector service provider should enable the public sector/education partner to concentrate more effectively on education.

There are a number of socio-economic and political drivers behind the use of such structures in the educational sector worldwide. Governments around the globe recognize that significant investment in education is one of the most vital initiatives they can adopt. Educating the children and young adults of today, who are the workforce of tomorrow, to a higher standard and providing them with increased learning opportunities and better access to educational resources should foster a more mobile and more skilled workforce in the future.

This higher educational attainment of such children and young adults should bring with it a number of benefits for the nation as a whole. The precise priorities for pursuing such educational initiative will, of course, vary from nation to nation. In some countries the intention is to raise the standards of education as a whole and provide venues for students to get a high quality comprehensive education without the need to go abroad. Whereas in the United Kingdom, for example, appearing to be doing something positive about education can be a vote winner for any political party. Additionally, the hope in the United Kingdom is that by increasing the educational standards and attainment of such children and young adults there will be an increase in national Gross Domestic Product and therefore increased whole life tax revenues in years to come. The hope being that better educated pupils will be able to obtain better-paid jobs. The “Building Schools for the Future” program is the United Kingdom government’s selected vehicle to provide “educational transformation” to bring about this result.

Making the Educational Partnership Work

Some valuable lessons can be learned from the educational PPP projects which have closed in the United Kingdom:

- *A Fully Engaged Public Sector Partner is Essential:* A successful project requires the full-time engagement of a public sector/educational partner.

Those public sector authorities who have understood and embraced the concept of PPP and are fully engaged in developing a relationship with private sector service providers have been more successful in achieving what they wanted to from the PPP transaction than those that did not so actively engage in the process.

- *The Quality of the Public Sector Team Affects the Success of the Procurement:* In preparing for a PPP project, the most important preparation which the public sector/ educational provider can undertake is ensuring it has the best educational, financial and legal team possible available to it. The public sector/ educational provider will usually be engaging in a PPP for the first time. It is crucial for the preservation of its interests that it retains specialist advisers who have experience in dealing with such projects and understand the complicated issues involved. The benefit of retaining such specialists is that it increases the likelihood a quicker and cheaper procurement and that the public sector/educational provider will achieve the results that it wishes from the PPP program in terms of the facilities and services that will be provided.
- *It Takes Longer to Close a Successful Project than You Might Think:* These projects usually require a great deal more time and work than people anticipate to be successful. A four-year timeframe from commencement of the process to the full operation of the new educational facilities is fairly standard.
- *Stakeholder Buy-In is Critical:* The involvement of the end-users in the process makes the process slower, somewhat more expensive and can, unless carefully handled, give rise to unrealistic expectations from the end-users as to what manner of facilities and services they are going to receive. But the positive aspects of their involvement outweigh those drawbacks. Such end-users often have insights and needs that are invaluable to the success of the

project. Teaching staff and students can provide “ground level” advice as to how the educational facility needs to operate in practice which those further removed from the day to day functioning of the educational facilities cannot.

- *An Appropriate Legal Framework is Vital to Secure Financing:* These projects have been funded to date primarily by way of bank debt and primarily with a debt-to-equity ratio of 90:10 and a repayment term of somewhere between 10 years and the whole of the fixed term of the Project Agreement. Financing is typically on the basis of non-recourse or limited recourse loans to special purpose vehicles which are established specifically to enter into the Project Agreement on behalf of the project sponsors.

The main asset which the special purpose vehicle possesses is the Project Agreement and its rights under that agreement. Consequently, the structuring of the legal framework within which the project will function is crucial. It is vital that the risk allocation agreed upon, both between the public sector entity and the private sector service provider under the Project Agreement and as between the private sector service provider and its construction and facilities management contractors, is a bankable one if the project is to reach a financial close successfully. The greater the attention that is placed on achieving this bankable risk allocation at the start of the project the smoother the path to securing financing should be.

Conclusion

While the educational PPP sector is not as well developed as, for example, the roads PPP sector, the use of PPP structures in education projects looks set to continue and expand in the coming years. There is a steady stream of projects in the pipeline in a number of countries and currently significant political appetite to use PPP structures as a tool to leverage the capital

expenditure required to provide first class facilities and hopefully to raise educational attainment. Finally, the lessons learned in projects successfully closed to date should ensure that the process towards financing and closing such projects becomes more efficient and smoother in the future.

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