Tourism Projects Financing: A Public-Private-Partnership Model
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Abstract
Tourism sector is one of the cornerstones of economic developments for most countries and a gate which integrates countries to international markets. Almost every country targets to host a greater number of foreign visitors every other year. Tourism projects generally require a high amount of initial investment for which the private financing may become impossible for most companies. Public Private Partnership (PPP) could be suggested as a viable model to finance tourism projects where tourism projects are financed and operated through a partnership of government and one or more private sector companies. This research study conducts a comparative analysis of risk transfer and cost reduction effects on various PPP models for tourism projects financing. The features of structuring a PPP model is proposed and applicable areas in tourism services are discussed. In the final part of the research, an application of the proposed PPP model is utilized. The findings support that all parties gain something which presents a win-win case.

Key words: Tourism project financing, Public-Private-Partnership (PPP), feasibility analysis, risk transfer.

INTRODUCTION
Tourism generally provides benefits a wide variety of sectors for any economy. On the other hand, it is not easy to measure the efficiency of tourism investments since the underlying sole output is the customer satisfaction. Tourism activities capture a considerable high percentage of GDP for many countries. Tourism investments do not only include hotel and entertainment constructions but also covers transportation projects (improvement and modernization of airports, railroads, seaports etc). However, budget constraints of governments and private entrepreneurs generally make big tourism investments impossible to undertake. Therefore, new financial models are needed to make tourism investments possible through some ways of cooperation of governments and private companies. Public-private-partnerships (PPP) are arrangements between government and private sector companies for the purpose of jointly investing in projects such as construction or improvement of accommodation and entertainment facilities, airports, seaports and railroads. Such partnerships are characterized by sharing investment amount, risk, responsibility and revenues between the partners. The reasons for establishing such partnerships generally involve financing, design, construction, operations and maintenance of tourism investments. The underlying mind for establishing a partnership is that both the public and the private sector have certain characteristics creating advantages on services or project delivery. PPP models consolidate the strengths of government and private sector for providing more efficient services. The roles and responsibilities of the partners may vary from project to project. For example, in some projects, the private sector partner may have a significant involvement in all aspects of service delivery, while in others, it may have only a minor role, e.g. only in construction. While the roles and responsibilities of private and public sector partners may differ at individual servicing initiatives, the overall role and responsibilities of government generally do not change. Public private partnership model is one of a number of ways of delivering tourism services. In the following sections of the paper, types of PPP models are shortly defined and compared. The following section specifies the risks incurred in tourism project financing. In the final part of the study, a PPP model for tourism project financing is proposed. The pros and cons of the suggested model is also examined through a cost-benefit analysis and risk transfer effects.

PUBLIC PRIVATE PARTNERSHIPS (PPP) IN TOURISM PROJECTS
PPP models may be suggested as a process where the public and private sectors work in co-operation to provide tourism services. Under PPP models, the private sector designs, finances, builds and also operates the asset with the partnership of public, rather than the public sector procures a capital asset by

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itself and pays the full cost. Such partnerships can be characterized by sharing of investment, risk, responsibility and revenues in between the partners. There are various factors causing governments to consider PPP models, e.g. the quality of services rendered and new options for tourism project financing. By PPPs the governments may protect their budget from fund deficit by transferring the financing solutions and the risks to private sector while they assure the quality and continuity of services provided to public. This means that governments benefit from the cost minimization effect of the PPP contracts while a long-term quality of the services provided is assured. The private sector may be called upon to provide one or more of tourism project initiation, planning, designing, financing, construction, operation, revenue collection in a PPP agreement. The access to specialized expertise and advance technology is also crucial issue in providing tourism services. Governments can hardly afford to provide or maintain such know-how in house. However, private sector companies have developed and been challenging research and development facilities that accelerates the quality and speed of the tourism services.

There are various types of PPP models that may be considered for tourism project financing. The funding and the risk transfer depend highly on the asset procurement choice. Table 1 illustrates the level of asset procurements.

The Build-Transfer (BT) model involves the public sector ordering a project and the private sector delivering it on site. The local government provides the financing for the project but engages a private partner to design and construct. The performance objectives are established by the public sector and the public partner maintains ownership of the facility. This form of PPP is applicable where the public sector maintains a strong interest in ownership but seeks to benefit from private construction and operation of a facility.

Illustration1. Asset Procurement Models

<table>
<thead>
<tr>
<th>Conventional Procurement</th>
<th>Public Private Partnerships</th>
<th>Full Privatization</th>
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<tbody>
<tr>
<td>The procurement of assets by the public sector using conventional funding</td>
<td>BT, BLT, BTO, BOT, BOOT, BOO</td>
<td>Publicly regulated but privately owned in perpetuity</td>
</tr>
<tr>
<td>• High level of funding needs that may result in budget deficits</td>
<td>• Government has control on assets</td>
<td>• Lack of government control on assets</td>
</tr>
<tr>
<td>• All risks to be handled by government</td>
<td>• Full or partial risk transfer to public sector</td>
<td>• All risks transferred to private company</td>
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<td></td>
<td></td>
<td>• Prospect of failure</td>
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Build-Lease-Transfer Model (BLT) is a form of public private partnership where the private sector finances, builds and operates a public service facility for a designated period of time. During the operating period, the contractor makes lease payments to the government. In other words, it becomes the private sector supporting services to society which should be provided by government. Under most
common BLT, the private sector designs, builds finances and operates the facilities. However, each should base on the contract specifications decided by public sector. Under the BLT, the public sector does not own the asset (airport, seaport, railroad, hotel etc.) until the end of the contract period. Once the construction is completed and the facility is put in operation, the BLT contractor makes a stream of committed lease payments to the government. The contracting party under the BLT scheme is primarily awarded a space where the private contractor construct a structure in conformity with the approved building plans and specifications at the company’s expense. The contracting party is then given a 20-30 year contract at a very minimal lease rate. This allows the contracting party to recover the costs over construction which enables the private initiatives provide convenient margins for a profitable business.

On the expiration date of the contract, the ownership of the asset is transferred to public sector.

In the Build-Transfer-Operate Model (BTO), the private sector designs and builds a facility for the public sector and also usually provides the financing for it. Once completed, the private partner transfers ownership of the facility to the government. The government then leases the facility back to the private partner under a long-term lease during which the private partner has an opportunity to recover its investment and a reasonable rate of return. BTO model is used for most infrastructure facilities and other public facilities including roads, water systems, sewer systems, water and wastewater treatment plants, parking facilities, local government buildings, airports and recreation facilities.

Under the Build-Operate-Transfer Model (BOT), the government turns over development and initial operation of what typically would be a tourism project to the private sector. The private sector contractor or consortium of contractors finances the project, accomplishes the construction and operates the new facility for some specified length of time after which it is expected to transfer ownership to the government usually at no cost. This model provides the government the following options:

- The ability to minimize its capital costs while still implementing a project at a time when it would not be able to provide the required funds,
- The opportunity to take the advantage of operational efficiencies regularly associated with private sector participation,
- The chance to encourage outside investment and introduce new or improved technology.

Illustration 2. Degree of Private Sector Risk and Private Sector Involvement

Up to early 1970s, most large scale projects were generally financed by internal cash generation and commercial or governments full recourse funds. Since early 1990s, there has been a tendency to finance most large scale projects through a mixture of equity / debt financing. Until late 1980s many projects
were mainly financed by arrangements known as corporate finance, in other words, lenders would have full recourse to all assets and revenues of the company not just those related to the new project. In this model the private developer obtains exclusive franchise to finance, build, operate, maintain, manage and collect user fees for a fixed period to amortize investment. At the end of the franchise, title is reverted to a public authority.

Under Build-Own-Operate (BOO) model the government either transfers ownership and responsibility for an existing facility or contracts with a private partner to build, own and operate a new facility in perpetuity. The private partner generally provides the financing.

Each PPP model may be located in a scale of private sector risk and private sector involvement. The options available for delivery of public services range from direct provision by a ministry or government department to outright privatization where the government transfers all responsibilities, risks and revenues for service delivery to the private sector. Within this spectrum, public private partnerships can be categorized based on public and private sector involvement and the degree of risk allocation.

A MODEL PROPOSED FOR TOURISM PROJECT FINANCING

The allocation of risk between the partners is a key consideration that affects various other aspects of partnership agreements considering rewards, investments and responsibilities. The risk transfer to the private sector is basically associated with the design, construction, operation, technological change and financing. However, every project is unique and it may not be possible to compile a detailed list of all risks or rank the risks in priority. A major risk for a project may be a minor risk for another. The risks generally categorized according to the phases of the project, e.g. development phase, design and construction phase, and the operation phase. In the development phase, the government firstly undertakes feasibility and a cost-benefit analysis. Then the government accepts tender offers from individual contractors or consortiums of contractors for the best bid.

The government makes a decision on the contractor considering its historical reputation and financial strength. When all related parties sign the agreement, the development phase is then completed. Hence, the contractor can start initiating the construction by itself or employs subcontractors. All risks associated with the construction phase are assumed by the private partner. The crucial issue in this phase is the eligibility of private partner to obtain a low cost financing for the project. After the construction phase is completed, the operation period of the facility begins. The operation phase relies on the agreement between government and the private partner. During the operation period, the private partner assumes responsibility for efficient operations and maintenance of the facility. All phases of this procurement are shown in illustration 3.

Each phase above incurs different risks. The fundamental risks associated with the development phase are design, technology or obsolescence risks. In the construction phase, the project carries construction risk and the prospect of failure due to regulatory and legislation risks. The operation phase consists of performance, operating cost, demand or volume and residual value risks.

Tourism projects may primarily be classified as public investments and private investments. Public investments in tourism area may be named as airports, seaports, railways, roads and highways, power
plants, water and sewage systems. Private tourism investments may be listed as hotels, restaurants, shopping centers, entertainment centers, recreation facilities and parking facilities. It is viewed in the literature that transportation and energy investments have been mainly financed by employing either build-operate-transfer or build-operate. The construction is generally financed by the private partner while public partner provides land at no cost and some sort of privileges in operations. Private tourism investments may be financed in a similar way of public investments. Private investors may be reluctant to invest in new high risk tourism areas or facing short of funding. At this stage, government may take the initial step and offer private sector plausible ways to make critical tourism investments happen. The government may provide land at no cost, postpone or forgive all income and other taxes, be a guarantor for bank loans to reduce financing costs or/and cover part of cost of the initial investment. In this context the private partner faces much lower investment risk and much less initial cash outlay. After the construction phase, the facility is run by the private company. Private sector in this stage utilizes its advantages in flexibility and expertise in operations at a lower cost for a high service quality while facing much lower risk in return of initial investments. At year ends all operational costs plus a reasonable return for the private partner are deducted from project revenues and the remaining amount is shared between partners at prorate.

The major problem about a tourism project planning is the uncertainty in future expected stream of cash flows. Illustration 4 presents the expected and planned lifecycle of a hypothetical tourism project. The total investment cost is estimated as $50 million with an estimated 5 year construction period. The running cost is expected to be $40 million and the total revenue is expected to be $50 million per year next 25 years. Therefore, the project generates $10 million profit per year next 25 years. Overall, the project looks to be economically feasible by using a reasonable rate of discount for the projected cash flow stream.

Public procurement for big tourism projects may not be an efficient way of financing. The logical reasons may be listed as the lack of government expertise, flexibility in decision making, bureaucracy and budget deficit problems. These lead to overruns in time and in construction cost. Illustration 4 animates the likely lifecycle of the underlying project under public procurement. Although the expected total investment cost is $30 million and the estimated construction period 5 years, the cost overrun may increase to $100 million with a construction period of 10 years.

Illustration 4. Expected Life Cycle for Public Procurement

After the project being put in operations, the realized running cost may end up $50 million while realized revenues may accumulate to only $40 million per year due to inefficiencies in operations. Therefore, the project reports $10 million losses per year next 25 years. It is clearly seen that the project is black hole for the public. The construction is completed at a cost as twice expensive as the projected and as twice longer...
as the constructed period. Moreover, the project needs public financing to survive its operations next 25 years. Finally, there is no guarantee about the quality and sustainability of service.

**Illustration 5. Realized Lifecycle for Public Procurement**

PPP model for tourism projects is recommended as presented below on Illustration 6. The recommended model may avoid time overruns and minimizes initial investment costs in the construction phase while providing savings in running costs and pushing revenues upward and thus increase profit. In this model the initial investment costs are shared between government and private partner but the private partner has full responsibility in planning, designing, constructing and operating. Therefore, the private partner may have a chance to complete the construction earlier than expected by utilizing its expertise and flexibility. In the operation phase, the private partner again assumes the full responsibility; hence, this assures the quality and sustainability of the service. Efficiency in operations lowers running costs while generating higher profits. In order to minimize the risk in return of investment for the private partner, the parties in advance agree to allocate a reasonable return for the amount of investment private partner put in the project. Any profit left after covering all operational costs and reasonable return is shared by the public and private partners at a prorate basis.

**Illustration 6. Lifecycle for the PPP Model**
CONCLUSION
In this study the cost saving benefits and risk transfer effects of the PPP model for the tourism sector are discussed. Beyond the cost saving impact for government, it is clear that under the PPP models, community is provided with a higher quality and fast service than governments can. On the other hand, public private partnership models have been widely accepted in recent years compared to privatization since governments can maintain their controls on service quality, continuity and prices in PPP models. However, a critical question arises for which PPP model produces a more efficient solution for financing and efficient service production. A good answer for this crucial question may be that “there is no single model exist which can straightly be applied for all projects”. Whether the government maintains a strong interest in ownership or control of the project or not is a strong indicator of type of PPP model in choice.

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