THE FINANCIAL ARCHITECTURE OF TURKISH HEALTHCARE PPPs

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Abstract

Turkey’s Healthcare Transformation Program has successfully leveraged Public-private partnerships (PPPs) to address the growing demand for infrastructure funding in the healthcare sector. Before the Covid-19 pandemic struck Turkey, the influx of private capital played a crucial role in expediting the construction and upgrading of healthcare facilities. This timely collaboration between the public and private sectors not only expanded the capacity and capabilities of the healthcare system but also ensured its readiness to address the increasing demands caused by the pandemic. This paper examines the financial aspects of healthcare PPPs in Turkey, shedding light on the economic implications, payment mechanisms, and financial sustainability of these partnerships. By emphasizing the financial mechanisms and hurdles unique to the Turkish situation, the intention of this paper is to provide valuable insights to policymakers, researchers, and practitioners engaged in healthcare infrastructure projects and present viewpoints on the broader debate concerning the long-term viability of PPP models in comparable environments.

Keywords

Public Private Partnership; Healthcare Infrastructure Finance, Private Finance

1. Introduction

The provision of healthcare services poses significant challenges for health authorities worldwide, primarily due to shifting demographics and rising healthcare costs. Policymakers grapple with the task of expanding healthcare access and ensuring high-quality services while simultaneously managing costs effectively (Kaplan and Porter, 2011). Developing countries, in particular, face an urgent need for substantial capital investment to address inadequate healthcare infrastructure that struggles to meet the growing demand for care. To tackle these challenges, financially constrained governments seek alternative methods of financing, infrastructure development, and service delivery. Consequently, an increasing number of countries are embracing public-private partnerships (PPPs) as an effective tool to achieve their objectives (World Bank, 2015).

The availability of an alternative approach to infrastructure development and service delivery can optimize the completion of public projects, thereby increasing socio-economic welfare. When properly formulated and managed, PPPs can assist governments in enhancing healthcare service delivery by attracting and incentivizing the private sector to complement public resources. By leveraging the expertise, resources, and innovation of the private sector, governments can complement their limited budgets and enhance the quality and accessibility of healthcare services through PPPs. These partnerships enable the sharing of risks and responsibilities between the public and private sectors, leading to more efficient and effective healthcare delivery. Furthermore, PPPs have the potential to drive significant advancements in healthcare infrastructure, including the construction of new hospitals, clinics, and medical facilities, as well as the renovation and modernization of existing ones.

Turkey has recently embarked on ambitious projects in constructing large-scale hospitals, actively involving the private sector to address its escalating financial needs for healthcare infrastructure. By embracing PPPs, Turkey has been able to attract private investments into the healthcare sector, thus accessing additional funding sources that might not be readily available through conventional public financing methods. Before the Covid-19 pandemic struck Turkey, the influx of private capital played a crucial role in expediting the construction and upgrading of healthcare facilities. This timely collaboration between the public and private sectors not only expanded the capacity and capabilities of the healthcare system but also ensured its readiness to address the increasing demands caused by the pandemic. Consequently, Turkey has become an interesting case study for
understanding the financial dynamics and challenges associated with implementing PPP projects in the healthcare sector.

This paper concentrates on Turkey's recent healthcare transformation and the revitalization of health facilities using the PPP model. While PPPs can be examined through various lenses as they involve politics, governance, regulation, financing, economics, risk analysis, and more (Hodge et al. 2010), this study specifically examines the financial aspects of Turkey's experience with PPPs in health infrastructure projects. Examining how these projects are financed is crucial to understanding the role of different financial stakeholders, including government entities, private investors, and international financing institutions. The subsequent sections of this study are organized as follows. Section 2 provides background information on the Turkish healthcare PPP program. Section 3 explains the partnership model selected by the administration. Section 4 discusses the characteristics of the financial model employed and the financial risks involved and their mitigation. Finally, Section 5 offers concluding remarks.

2. Turkish Healthcare PPP Program

According to the European Investment Bank, healthcare is one of Europe's top five crucial sectors for public-private partnerships, based on the total project value per country (EPEC, 2019). Utilizing the private sector's financial capacity and extensive expertise in healthcare provision can be instrumental in successfully implementing an ambitious healthcare program. Upgrading healthcare facilities and acquiring advanced medical equipment incurs significant costs that many governments struggle to bear. Furthermore, incorporating best practices in healthcare management necessitates a broad range of expertise. By engaging in PPP models for healthcare projects, governments can leverage the financial resources and diverse experience of the private sector.

While Turkey has extensive experience with private partnerships in energy and transportation infrastructure projects, the use of PPPs in the health sector is a relatively recent development. In past two decades, Turkey has undertaken a remarkable initiative known as the Healthcare Transformation Program (HTP) to revolutionize its healthcare system. Recognizing the increasing demand for healthcare infrastructure and funding, Turkey has embraced a progressive approach by incorporating the private sector through a public-private partnership model.

As part of this ambitious program, numerous large-scale hospital projects have been successfully procured, constructed, and made operational. Enhancing the quality of healthcare services and incorporating cutting-edge technologies into hospital management are the primary objectives of the HTP. To achieve this, the Ministry of Health (MoH) aims to significantly increase the number of modern healthcare facilities. By the end of 2023, the MoH aspires to operate a total of 169,000 beds across the country.

The ongoing PPP initiative led by the MoH in Turkey consists of around 30 integrated health campuses known as "city hospitals." These campuses have a collective capacity of 43,000 beds. The estimated investment for this program surpasses $16 billion. The advancement of the program can be observed in Table 1. Presently, 16 projects have been finalized and are actively serving patients, while four more projects are currently being constructed and are projected to finish by the end of 2023. The remaining hospitals are at different stages in the tendering process.

<table>
<thead>
<tr>
<th>No</th>
<th>Project Name</th>
<th>Total Investment Cost (mil. TRY)</th>
<th>Bed Capacity</th>
<th>Construction Area (m2)</th>
<th>Current Status</th>
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<tr>
<td>1</td>
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<td>17</td>
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<td>2,400</td>
<td>607,809</td>
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<td>1,875</td>
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<tr>
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<td>1,700</td>
<td>436,172</td>
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<td>538</td>
<td>610</td>
<td>200,000</td>
<td>2023 exp.</td>
</tr>
</tbody>
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Table-1 Turkish Healthcare PPP Project Pipeline
IHC: Integrated Health Campus; ERH: Education and Research Hospital
3. The Partnership Model

In the healthcare sector, there has been a noticeable increase in the utilization of Public-Private Partnerships over the past several decades. These partnerships have emerged as a way to reduce the financial burden on the public sector for infrastructure development and risk sharing, while also aiming to control costs and improve access to healthcare services. The debate on the balance between public and private financing in healthcare continues to evolve. However, private sector involvement in PPP projects does not mean reduced government involvement, but rather a shift in its role (Jamali, 2004). Governments continue to maintain their regulatory role, especially in healthcare where accountability and public interest are crucial. A transparent and sound regulatory framework serves as a crucial foundation for private sector participation. Moreover, due to the stronger position of private partners in these partnerships, the government often needs to be more actively engaged (Scharle, 2002). Numerous studies have been conducted on the development of PPP policies in various countries, providing valuable insights into the policy landscape and implementation strategies in different national contexts such as Canada (Siemiatycki, 2015), Denmark (Petersen, 2010), Ireland (Reeves and Palsci, 2017), Russia (Mouraviev and Kakabadse, 2014), the United States (Martin, 2018).

In 2005, the Turkish Ministry of Health (MoH) implemented a policy decision aimed at revitalizing hospitals by adopting a partnership program inspired by the United Kingdom’s Private Finance Initiative (PFI). However, in Turkey, the PPP model was primarily implemented as a procurement strategy, with a focus on renewing hospitals rather than as part of a broader initiative to transform the government’s role in healthcare service planning and provision. The public sector continued to establish standards, monitor safety and quality, and ensure that citizens have adequate access to necessary healthcare services.

The Turkish hospital PPPs are established through 3+25-year contracts known as Design-Build-Finance-Lease-Transfer (DBFLT) model. This model has recently emerged as a leading method of funding significant capital investments in the healthcare industry (McKee et al., 2006). These partnerships concentrate on managing the physical infrastructure and support services of healthcare facilities, while clinical services remain under the sole management of the MoH. The key objective of these PPP contracts is to ensure that the newly developed facilities consistently meet high international standards throughout their operational lifespan, thereby providing the public with access to quality healthcare services. The long-term financial consequences of a project are thoroughly evaluated, recorded, and approved by the Ministry of Finance prior to initiating procurement and finalizing a contract. The selection, evaluation, and prioritization of the project are conducted alongside other public investment initiatives, following the guidelines and strategies outlined in the national public investment plans.

Under this model, the project company takes on the responsibility of constructing the healthcare facility by securing the necessary financing. The current projects have a construction period of three years and an operational period of 25 years. The project company is accountable for both the hard and soft facilities management services, while the MoH retains sole responsibility for clinical services. If the land on which the facility will be built is owned by the treasury, the MoH arranges for the project company to use the land free of charge throughout the contract term. Additionally, the company is exempt from value-added tax (VAT) on equipment and services during the investment period, as well as from stamp tax for the contract.

To ensure the successful implementation of the project, the SPV enters into Engineering, Procurement, and Construction (EPC) contracts with experienced contractors who possess both technical expertise and strong financial capabilities. These contracts provide a clear framework for the project’s execution, ensuring that the facility is built to the required standards and specifications, and that the project stays within the established budget and timeline. By partnering with contractors who have proven track records in delivering similar projects, the SPV minimizes risks and increases the likelihood of a successful outcome.

Once the health facility is constructed according to the specifications outlined in the contract, the MoH leases the facility and employs its own staff to provide health services. The MoH pays the project company a quarterly lease payment, which is adjusted based on the Turkish Producer Price Index and the Turkish Consumer Price Index. During this lease period, the project company has the right to operate commercial areas within the facility, such as cafeterias, restaurants, shopping centers, and daycare services, for its own profit.

Overall, the use of PPPs in the Turkish healthcare sector aims to strike a balance between public and private participation, ultimately benefiting the public by providing them with quality healthcare services while also relieving the financial burden on the government. These partnerships serve to efficiently manage the construction and operation of healthcare facilities, ensuring that they meet international standards and offering additional commercial opportunities for the project company.

4. The financial framework

The design and construction of the health facility are financed by a private entity using a combination of equity and a bank loan. This private entity, referred to as the Special Purpose Vehicle (SPV), is responsible for providing at least 20% of the total capital investment as initial equity for the project. It is important to emphasize that the

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Turkish PPP model strictly separates public and private financing, meaning that public funds cannot be mixed with private funds. Consequently, the private sector financing incurs higher interest costs compared to state financing.

In order to secure the bank loan, the lenders require the SPV to start repaying the loan upon the facility's completion and continue making payments throughout its operational period. This condition serves as a strong motivation for the SPV to complete the project in a timely manner, leading to numerous socio-economic advantages. The operational term of the project spans 25 years, commencing from the date of completion, unless the MoH decides to extend or terminate it.

The termination mechanism in the projects involves various compensation factors based on the cause of termination. If the termination is due to a default by the Project Company, the compensation will include equity expenses, the senior debt termination amount, and costs incurred due to early termination. In case of default by the administration, the compensation will include the aforementioned components, as well as the loss of profit calculated according to the financial model. In the case of termination due to force majeure, the compensation will consist of the equity expenses, the termination amount of the senior debt, the costs associated with early termination, and the loss of profit calculated according to the financial model. It is important to note that the senior debt, regardless of the termination cause, is fully covered in any scenario. The senior debt termination amount will be directly paid to the lenders without any objections.

Financial Risks
Financial risk holds immense importance in any business or investment venture, encompassing the possibility of unfavorable alterations in an SPV's assets or liabilities caused by changes in prices and rates. In the context of PPP infrastructure projects, financial risks wield significant influence over the project's outcomes. It is crucial for stakeholders to grasp the intricacies of financial risks and effectively manage them to ensure stability, profitability, and long-term sustainability.

The examination of financial risk involves considering several key elements, such as exchange rates, interest rates and inflation. Among these factors, exchange rate and interest rate risks have exerted the most substantial impact on individuals and organizations worldwide.

Exchange rate risk pertains to the vulnerability faced by SPVs when their assets and liabilities are denominated in foreign currencies. Fluctuations in exchange rates between the domestic currency and foreign currencies can lead to potential gains or losses for these entities. The impact of exchange rate fluctuations can affect the overall profitability, assets, and liabilities of businesses operating in international markets.

On the other hand, interest rate risk refers to the potential changes in market interest rates that can impact SPVs relying on external sources of funding, such as loans or bonds. This risk arises due to the sensitivity of borrowing costs to fluctuations in interest rates. PPP projects often involve significant capital investments, and the debt-to-equity ratio is typically high. For example, in PPP hospital projects procured by the Turkish government, the debt-to-equity ratio often falls within the 80/20 range. An SPV that has secured a long-term loan with a variable interest rate may encounter financial challenges if interest rates rise significantly during the loan tenure. The increased cost of servicing the debt can strain cash flow and profitability.

Inflation risk represents another significant financial risk that can impact SPVs. Inflation can lead to increases in input costs, including labor and construction materials, thereby creating unforeseen expenses for companies undertaking PPP projects. Moreover, accurately assessing the impact of inflation is crucial for determining future prices and estimating borrowing needs accordingly. Failure to adequately account for inflation can result in financial difficulties and cost overruns during project execution.

Payment Mechanism
The financial model of the project relies on three distinct sources of cash flows for debt service that play a crucial role in ensuring the project's sustainability and financial viability. The first source is the quarterly "lease payments" (LP), which constitute the largest portion of the cash flows to the project company. These payments are contingent upon the “availability” of the facilities and serve as compensation for making the facilities accessible. However, deductions may be applied to these lease payments if the facilities fail to meet service level requirements or provide insufficient accessibility. This ensures that the project company remains accountable for maintaining high standards and meeting the agreed-upon terms. Moreover, there is a maximum deduction limit of 10% imposed on these payments, ensuring that the project company retains a significant portion of the funds. This safeguard prevents excessive deductions that could adversely affect the project company's financial stability.

The determination of LPs takes into account various factors, including the construction cost of the facilities, the value of medical equipment involved, and the income generated from renting out commercial areas to other businesses such as cafeterias or shopping centers. By considering these elements, the LPs reflect the comprehensive nature of the project and provide a fair compensation mechanism for the project company.

Importantly, the LPs are decoupled from the occupancy rate of the hospital, providing a stable and predictable cash flow stream that contributes to the project's financial sustainability.
The LPs are denominated in the local currency (TRY) but they are indexed to inflation, specifically based on the average of the consumer price index (CPI) and producer price index (PPI) as determined by the Turkish Statistical Institute. This indexing mechanism ensures that the cash flows remain adjusted to the changing economic conditions, allowing for stability and protecting the project company against inflationary pressures. Additionally, if the project company obtains credit in foreign currency and there are differences in the exchange rate at the time of LP's revaluation compared to the average of the PPI and CPI, the exchange rate difference is calculated and added to or subtracted from the LP based on the proportion of total borrowing in foreign currency. This constitutes a treasury guarantee to protect the project company against currency fluctuations in the case of borrowing in foreign currency.

The second source of cash flow for debt service is the monthly "service payments" (SP). These payments cover the costs associated with providing both hard and soft facility management services. The outsourced services within the model can be categorized into two types: obligatory services and optional services for the project company. Obligatory Services refer to "hard facilities management services" and primarily encompass the maintenance and management of the infrastructure assets associated with healthcare facilities. This includes activities such as ensuring the proper functioning of medical equipment, maintaining the physical structure of the hospital, and managing utility systems. On the other hand, optional services are classified as "soft facilities management services" and pertain to the support services of the hospital. These services encompass a wide range of non-clinical activities that support the efficient operation of the healthcare facility. Examples of these services include housekeeping, laundry services, waste management, security, catering, and administrative support. Like LPs, SPs are denominated in the local currency (TRY) and indexed to inflation based on the average of the CPI and PPI.

During the project's operational phase, the SPV often opt to hire a "service integrator" who acts as an intermediary, managing subcontracts for individual services, thereby facilitating a streamlined process and ensuring effective coordination among various service providers. To ensure the quality and cost-effectiveness of outsourced services, regular market testing is carried out. Except for extraordinary maintenance services, all services undergo market testing every five years, starting from the sixth year of operations. This evaluation helps gauge the competitiveness and efficiency of service providers, enabling adjustments or changes as needed.

To ensure financial stability and incentivize private partners, the administration guarantees minimum payments for volume-related services. These payments correspond to a 70% occupancy rate during the operating period, ensuring a minimum revenue level for the project company and fostering a sustainable partnership between the public and private sectors. The deduction for these payments is limited to 20% of the total amount.

The third source of cash flow for SPV's debt service stems from the income generated by renting out commercial areas within the project. These designated spaces are accessible to the public and allow contractors to operate various businesses, such as cafeterias, shopping centers, or other facilities. By leasing these spaces to other businesses, the project company generates additional income that contributes to meeting its debt service obligations. The revenue from renting commercial areas adds diversification to the project's cash flows, reducing dependency on lease and service payments alone. However, the income from renting commercial areas may be subject to market dynamics and occupancy rates. Therefore, active management and promotion of these spaces by the project company are crucial to attract potential tenants and ensure a steady flow of rental income.

To facilitate the payment of LPs and SPs, the project company relies on the Central Administration Budget and/or the budget of the revolving fund enterprise of the Administration or its affiliates. This indicates that the project is supported by the government or related entities, providing a level of financial stability and ensuring the availability of funds for debt service.

In summary, the cash flow for debt service in this project depends on three main sources: quarterly lease payments (LPs), monthly service payments (SPs), and income generated from renting commercial areas. These sources are carefully designed to provide a stable and sustainable cash flow stream to the SPV. By incorporating local currency denominations, inflation indexing, and governmental support, the model aims to mitigate risks and ensure the financial viability of the endeavor.

Involvement of international Financial Organizations
International financial organizations such as the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the European Bank for Reconstruction and Development (EBRD), have been actively involved in Turkey's healthcare PPP program. They have assisted in bringing in private investments and minimizing risks. This support has improved the likelihood of successful agreements and encouraged long-term commercial financing that was previously unavailable in Turkey.

The IFC has been instrumental in bringing private sector investments to upgrade Turkey's public hospital network. It supported the Health Transformation Program (HTP) from 2004 to 2015 through two Adaptable Program Loans (APLs). In 2015, an additional loan was provided to strengthen the government's capacity to manage the broader PPP program. The IFC actively monitored the program by working with project sponsors, financiers, and Turkish counterparts. This approach helped secure long-term commercial financing that was
previously extremely limited in Turkey. The IFC directly financed $240 million, and other lenders contributed $430 million to support four pioneering projects (World Bank, 2018). The IFC collaborated with the MoH to align contract structures with international best practices. By developing models that appealed to more investors, subsequent PPP projects were able to leverage these frameworks effectively. This collaboration and expertise encouraged new investors to enter the healthcare sector in Turkey. The success of these projects earned international recognition, establishing Turkey as an attractive destination for healthcare investments.

The Multilateral Investment Guarantee Agency (MIGA) helped mobilize private capital for Turkey's hospital PPP program. They provided political risk insurance amounting to $816 million, attracting $763 million in private investments for six projects, including two joint initiatives with the IFC (World Bank, 2018). This insurance protected investors from potential political risks, boosting their confidence in the healthcare sector. MIGA's political risk insurance, combined with the liquidity facilities from the EBRD, significantly reduced the risks associated with these transactions. As a result, the projects received a higher rating from Moody's than Turkey's sovereign debt rating. Moreover, the IFC's direct investment of €80 million in the project bond further increased investor confidence (World Bank, 2018). These comprehensive risk mitigation measures, along with robust financial structures, enabled PPP projects to secure funding.

5. Concluding Remarks

Turkey's healthcare sector has witnessed significant transformations through an ambitious reform program initiated in 2003. Turkey has undertaken large-scale hospital projects, actively engaging the private sector through the PPP model to address its growing infrastructure finance needs. The Turkish PPP program has not only addressed the pressing infrastructure requirements during pandemic but has also laid a foundation for sustainable growth and development in the healthcare domain. Through PPPs the Turkish government has been able to distribute the risks associated with healthcare projects to private partners. The involvement of private entities introduced innovation and efficiency into the healthcare system by leveraging their expertise and knowledge in project management and operations.

Overall, Turkey's strategic collaboration between the public and private sectors in healthcare infrastructure development has yielded significant benefits. These partnership efforts have resulted in the successful implementation of over 20 PPP projects. The early involvement of international financial organizations has played a crucial role in mitigating financial risks for the PPP program. Their participation has allowed Turkey to attract private investments into the healthcare sector, tapping into additional funding sources that may not be readily available through traditional public financing methods. The arrival of private capital has enabled the timely development and upgrade of healthcare facilities in Turkey, enhancing the healthcare system's capacity and capabilities to address the increasing demands amid the Covid-19 outbreak.

However, the involvement of a private sector partner in the design, construction, and operation of healthcare facilities under complex contracts introduces a range of new challenges that must be addressed. Primarily, the financial aspect assumes a vital role in the overall success of PPP projects. One of the principal benefits of PPPs is their ability to transfer a portion of the financial burden from the government to the private sector. This approach empowers the government to allocate its limited resources more efficiently, guaranteeing the long-term viability of healthcare investments. However, in order to attain project feasibility and durability, stakeholders must meticulously evaluate and manage diverse financial risks. Exchange rate volatility, interest rate fluctuations, and inflationary pressures are three significant factors that can influence the feasibility and sustainability of PPP projects.

The Turkish PPP program presents a range of key attractive features that make it an appealing choice for participants and enhances the financial viability of the projects.

The lease payments made by the Administration to the SPV at the beginning of each quarter serve as compensation for the utilization of health facilities during the corresponding period. It's important to note that the payments are not linked to the occupancy rates of the hospitals, ensuring a fixed income for the project company. The payments are made in Turkish Lira and are guaranteed by the MoH to ensure their secure delivery. To safeguard the SPV's financial stability, a maximum deduction limit of 10% is imposed on these payments, allowing the SPV to retain a significant portion of the funds and preventing excessive deductions. Similarly, for service payments, deductions are capped at 20% of the service cost to maintain a reasonable limit. The program ensures that deductions and penalties are not double-counted, preventing unfair or excessive financial burdens on the service providers.

To account for economic factors like inflation and currency devaluation, the payments are adjusted quarterly using a correction factor (CF). The CF factor aligns the foreign currency value of the lease payments with the prevailing economic conditions. In cases where the devaluation of the currency surpasses the inflation rate, the CF prevents a decrease in the foreign currency value of the lease payments compared to the preceding period. This provision acts as a protective measure, shielding the SPV's income from the adverse impacts of currency devaluation.
Another notable aspect is the market testing for services, which takes place every five years. This allows for periodic evaluation and assessment of the services provided, ensuring their continued effectiveness and efficiency. Additionally, participants in PPP projects benefit from a value-added tax exemption for capital expenditures, providing financial advantages.

The program also includes protection against changes in the law, safeguarding the interests of the parties involved. Additionally, lenders are required to sign direct agreements with the MoH, establishing a direct relationship and enhancing the transparency and accountability of the PPP projects. In the event of termination, the program provides for compensation for both the loan and equity components, offering a measure of financial security to the participants. Moreover, if insurance coverage is unavailable, the MoH assumes the insurance risk, ensuring that unforeseen circumstances do not pose an undue burden on the participants.

Lastly, the program adopts the ICC International Arbitration as the dispute resolution mechanism, promoting a fair and impartial process for addressing any conflicts that may arise. This international arbitration platform helps maintain the integrity and credibility of the program while ensuring effective resolution of disputes.

In summary, the Turkish PPP program offers a wide range of appealing characteristics that enhance its attractiveness and feasibility for participants. These include various payment mechanisms, establishments of commercial areas, market testing opportunities, VAT exemptions, safeguards against changes in the law, direct agreements with lenders, fair deductions and penalties, compensation provisions on termination, insurance risk management, and access to international arbitration. Collectively, these elements contribute to the overall appeal and feasibility of participating in the program.

References


