

Delivering the PPP promise*

A review of PPP issues and activity



*connectedthinking

PRICEWATERHOUSECOOPERS 

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“ Sustained investment in infrastructure – especially transport infrastructure – is vital if Europe is to maintain its competitiveness against rapidly growing emerging economies. ”

Rt Hon Alistair Darling MP, UK Secretary of State for Transport at the 2005 PPP Transport Summit

Executive Summary

PPPs in context – public procurement models and the need for investment

The ‘infrastructure gap’, and its negative impact on economic growth, job creation and social cohesion in Europe, has been recognised for many years. Across Europe, the need to improve infrastructure, particularly in the transport sector, is seen as a necessary condition to successful economic growth. However, governments have limited financial resources to devote to increased capital expenditure for improving public services and face restrictions on their ability to raise debt, in particular due to adherence to the principles of economic convergence and fiscal restraint enshrined in the Maastricht Treaty.

In order to bridge the growing gap between the cost of the infrastructure needed and the resources available, and to ensure that the infrastructure is delivered as efficiently and cost-effectively as possible, the key question is how to deliver cost-efficient investment. In this context, Public Private Partnerships (“PPPs”) are a growing element of public sector procurement across Europe.

Advantages and Disadvantages of using PPPs

PPP procurement is only one of several options for procuring infrastructure. Consideration must be given as to whether a project is suited to a PPP structure, and whether there is strong political support for a PPP solution.

The principal reason for using PPPs is that, where the project is suitable, they can deliver better value for money than the alternatives. All arguments for and against PPPs must be considered within the context of that overriding objective.

Key advantages for using PPP procurement:

- PPPs make projects affordable
- PPPs maximise the use of private sector skills
- Under PPPs, the private sector takes life cycle cost risk
- With PPPs, risks are allocated to the party best able to manage or absorb each particular risk
- PPPs deliver budgetary certainty
- PPPs force the public sector to focus on outputs and benefits from the start
- With PPPs, the quality of service has to be maintained for the life of the PPP
- The public sector only pays when services are delivered
- PPPs encourage the development of specialist skills, such as life cycle costing
- PPPs allow the injection of private sector capital
- PPP transactions can be off balance sheet

Key challenges in using PPP procurement:

- Does sufficient private sector expertise exist to warrant the PPP approach?
- Does the public sector have sufficient capacity and skills to adopt the PPP approach?
- It is not always possible to transfer life cycle cost risk
- PPPs do not achieve absolute risk transfer
- PPPs imply a loss of management control by the public sector
- PPP procurement can be lengthy and costly
- The private sector has a higher cost of finance
- PPPs are long-term relatively inflexible structures

Current PPP activity across Europe and selected major markets

The PPP approach is increasingly being adopted to deliver new investment in infrastructure. Many countries initially develop PPPs in the transport sector and later extend their use to other sectors, such as education, health, energy, water and waste treatment, once the value for money benefits are proven and public sector expertise is established.

Geographically, the PPP market has remained concentrated. While there is evidence to suggest that the PPP concept is becoming more established across Europe with the UK market reaching a good level of maturity and strong deal flow in the pipeline for Spain, Portugal, Italy and Germany, the global spread of PPPs has been slower than many market participants had hoped.

Figure 4 on page 36, shows an updated Summary of PPPs by country and sector for the European market. Figure 10 on page 54, shows this activity for selected international markets where there is concentrated PPP activity.

Solving recurring issues

The use of PPPs raises a number of complex issues and choices, the solutions to which are often project or country specific. However, there are a number of fundamental issues raised time and again across a wide spectrum of PPPs.

Legal impediments and uncertainties regarding PPPs affect both the public and private sector. Accounting issues and balance sheet treatment provide further uncertainties which must be addressed from the outset of a project. Procurement and State Aid, affordability, and speed and costs of a PPP procurement, can all benefit from the sharing of experience and best-practice across countries as well as within countries.

Recommendations

PPPs are complex and recurring issues continue to hinder their development. Given the potential which PPPs have for the delivery of essential public services we make the following recommendations:

- Build national PPP Centres of Excellence
- Balance Sheet treatment should not drive the decision to undertake a PPP
- Develop shadow private sector bid models at the outset
- Streamline speed and cost of procurement
- Share refinancing benefits
- The EU Commission should provide guidance on PPPs for the public sector which includes guidance on procurement procedures
- Create an EU Knowledge Unit

Conclusion

The modernisation of public services and infrastructure is a promise governments have made to their citizens. We believe that Public Private Partnerships offer a viable alternative to traditional procurement methods and we would like to see the public and private sectors doing more business together. Delivering the PPP promise means delivering solutions that fund new roads, improve rail services, modernise hospitals, and build new schools and social housing, more quickly and efficiently, so that together we can close the service and infrastructure gap that currently exists within and across Europe.

Introduction

The 'infrastructure gap' in Europe has been recognised for many years and its negative impact on economic growth, job creation and social cohesion is felt across every country within the region. However, governments have limited financial resources to devote to increased capital expenditure and improving public services, and they face restrictions (including those of the Maastricht Treaty) on their ability to raise debt. Although a number of EU-level initiatives and funds have been introduced to address the investment deficit and stimulate growth, their overall impact has been limited.

In 1996, it was estimated that €400 billion would be needed by 2010 to deliver the proposed trans-European multi-modal transport network, generally referred to as TEN-T. The fourteen priority projects identified would require €125 billion over the same period.

The 2001 Commission White Paper, *A Time to Decide*,¹ proposed a programme of 60 measures and an action plan aimed at prioritising substantial improvements in the quality and efficiency of transport in Europe. This included revising the trans-European network guidelines in order to eliminate bottlenecks.

By 2003, little progress had been made and the investment need had increased. It was recognised that renewed efforts would be required to deliver the proposed investment in 75,200km of roads, 78,000km of rail, 330 airports, 270 international sea ports and 210 inland ports as well as the traffic management systems, navigation and user information systems which also form part of the TEN-T network.²

¹ White Paper: European Transport Policy for 2010: Time to Decide, COM (2001) 370 final. Available at http://www.europa.eu.int/comm/energy_transport/en/lb_en.html

² "TEN Transport Policy and Projects in the Future", Presentation by E. Thielmann, Head of Division, DG TREN, January 2005

At the same time, it was increasingly recognised at the EU-level that private sector involvement via a PPP structure could help deliver the infrastructure needed. The PPP approach had been developed in some member countries since the early 1990s, but EU institutional activity had been limited to statements and reviews and there was considerable uncertainty regarding the impact of EU legislation on PPPs.

While progress has been made, the need for investment and innovative funding solutions remains

Recognising the need to promote economic growth and improve competitiveness, the March 2005 European Council stressed the importance of infrastructure investment to boost growth and bring greater social and economic convergence. They also called on the European Union and the member countries to continue their investment efforts and to encourage public-private partnerships.³ EU-level interest in the potential for private sector involvement in infrastructure provision is growing especially as the level of investment required to deliver the TEN-T remains substantial and the costs of delay continue to grow.

This paper – aims and objectives

Effective transport links are a vital part of maintaining an efficient and competitive economy. Governments are looking increasingly to PPPs to address this investment need. In October 2005, as part of its Presidency of the EU, the UK government hosted an EU Transport PPP Summit, where officials at the most senior levels in transport and finance ministries across Europe and private sector firms came together to talk frankly about what works now – and how to get the best out of working in partnership in the future.

This paper is intended to stimulate the debate by further examining the potential of the PPP model for meeting the investment challenge in an efficient, cost-effective way. In particular, a review of PPP activity across Europe highlights examples of best practice and developing trends. Finally, the benefits of PPPs as well as the main difficulties facing the public and private sectors are explored, along with practical solutions for delivering a PPP approach.

The future looks promising for PPPs but we should act to build on the discussions and themes of the EU Transport PPP Summit.

³European Council Brussels, 22 - 23 March 2005, Presidency Conclusions, 7619/1/05 REV1

Report Structure

This paper is divided into five further sections:

- Public Procurement Models – Setting PPPs in context
- Advantages and disadvantages of using PPPs
- Review of PPP activity across Europe
- Recurring PPP issues and solutions
- Recommendations and conclusions – streamlining the procurement process

Authors

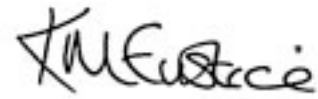
We hope you find this paper useful and we welcome debate and comments.

Our contact details are given at the back of this publication.



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November 2005

Public procurement models – setting PPPs in context

Traditional public procurement

The ‘infrastructure gap’, and its negative impact on economic growth, job creation and social cohesion in Europe, has been recognised for many years. Across Europe, the need to improve infrastructure particularly in the transport sector, is seen as a necessary condition to successful economic growth. However, governments have limited financial resources to devote to increased capital expenditure and improving public services and face restrictions on their ability to raise debt, in particular due to adherence to the principles of economic convergence and fiscal restraint enshrined in the Maastricht Treaty.

In order to bridge the growing gap between the cost of the infrastructure needed and the resources available, and to ensure that the infrastructure is delivered as efficiently and cost-effectively as possible, the key question is how to deliver cost-efficient investment. In this context, Public Private Partnerships (“PPPs”) are a growing element of public sector procurement across Europe.

But while public sector bodies across Europe increasingly choose to adopt some form of PPP to develop transport infrastructure, conventional procurement models are still important and may be more appropriate for many projects. Even in the UK, where there is significant recourse to PPPs, 85% of public investment is delivered through conventional forms of procurement.⁴

It is therefore important to understand the traditional public procurement approach in contrast to the PPP model. While there is no universal definition of traditional procurement, characteristics might include:

- The public sector procures assets, not services, from the private sector.
- Assets are input-specified; the public sector carries out design prior to procurement.
- The private sector is responsible for delivering assets, not for their long-term performance beyond standard warranty periods.
- The project management of procurement typically remain with the public sector, including the risk of successfully integrating multiple works contracts.

What are PPPs?

The term “public-private partnership” (“PPP”) has been in general use since the 1990s. However, there is no widely agreed, single definition or model of a PPP.

The term “PPP” covers a range of different structures where the private sector delivers a public project or service. Concession-based transport and utilities projects have existed in EU member countries for many years, particularly in France, Italy and Spain, with revenues derived from payments by end-users, e.g. road tolls. The UK’s Private Finance Initiative (“PFI”) expanded this concept to a broader range of public infrastructure and combined it with the introduction of services being paid for by the public sector rather than the end-users. The use of PPPs has now spread to most EU member countries and depending on the country and the politics of the time, the term can cover a spectrum of models. These range from relatively short term management contracts (with little or no capital expenditure), through concession contracts (which may encompass the design and build of substantial capital assets along with the provision of a range of services and the financing of the entire construction and operation), to joint ventures and partial privatisations where there is a sharing of ownership between the public and private sectors.⁵

The key contrast between PPPs and traditional procurement is that with PPPs the private sector returns are linked to service outcomes and performance of the asset over the contract life. The private sector service provider is responsible not just for asset delivery, but for overall project management and implementation, and successful operation for several years thereafter.

The timing of payments by the public sector to the private sector for the assets and services delivered is therefore dramatically different, as illustrated in [Figure 1](#).

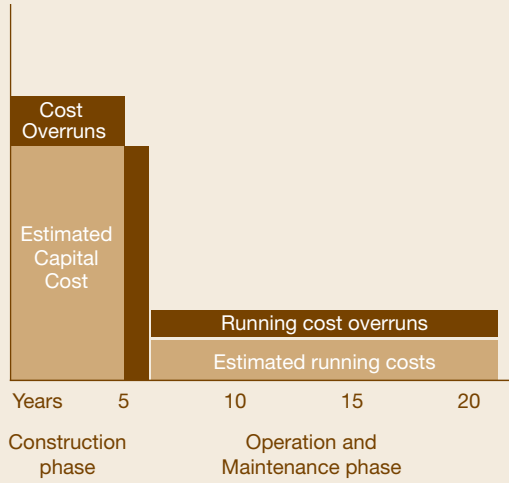
⁴PFI: Meeting the Investment Challenge, HM Treasury, 2003

⁵Developing Public Private Partnerships in New Europe, May 2004. Available on the PwC website at <http://www.pwc.com/extweb/service.nsf/docid/A2F9309C016FAADD80256EA6004F516C>

Figure 1: Contrasting public sector payment profiles of traditional and PPP procurement models

Traditional Government procurement

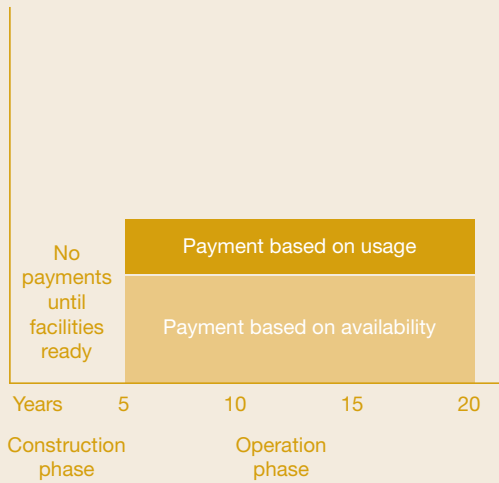
Payment profile can be depicted as follows:



- Capital and operating costs are paid for by the public sector, who take the risk of cost overruns and late delivery.

PPP procurement

Payment profile for the public sector



- The public sector only pays over the long term as services are delivered. The private sector funds itself using a large portion of debt plus shareholder equity. The returns on their equity will depend on the quality of services.

Source: PricewaterhouseCoopers

Recent PPP Definitions

At present, the EU does not have an official definition of a PPP. The Commission's 2004 Green Paper on Public-Private Partnerships referred to PPPs as "forms of cooperation between the public and private sectors for the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service."⁶

Box 1 gives a summary of some recent definitions.

Box 1 PPP Definitions

PPPs are aimed at increasing the efficiency of infrastructure projects by means of a long-term collaboration between the public sector and private business. A holistic approach which extends over the entire lifecycle is important here.

Source: German PPP Task Force, German Transport, Construction and Housing Ministry (Bundesministerium für Verkehr, Bauen and Wohnen)

The term public-private partnership ("PPP") is not defined at Community level. In general, the term refers to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management and maintenance of an infrastructure or the provision of a service.

Source: Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions presented by the European Commission, April 2004

Standard & Poor's definition of a PPP is any medium-to-long term relationship between the public and private sectors, involving the sharing of risks and rewards of multisector skills, expertise and finance to deliver desired policy outcomes.

Source: Standard & Poor's PPP Credit Survey 2005

PPPs are long-term partnerships to deliver assets and services underpinning public services and community outcomes. Optimal structuring links private sector profitability to sustained performance over the long-term, yielding robust and attractive cash-flows for investors in return for delivering better value for money to the taxpayer.

Source: John Laing plc

'Public-Private Partnership' is a generic term for the relationships formed between the private sector and public bodies often with the aim of introducing private sector resources and/or expertise in order to help provide and deliver public sector assets and services. The term PPP is, thus, used to describe a wide variety of working arrangements from loose, informal and strategic partnerships, to design build finance and operate (DBFO) type service contracts and formal joint venture companies.

Source: European Investment Bank, The EIB's role in Public-Private Partnerships, July 2004

⁶ Paragraph 1, Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions, COM (2004) 327 final

PPP Characteristics

Different types of PPPs tend to share some common characteristics. These include contracting between the public and private sectors for the delivery of services, often involving infrastructure development and management, where risks are shared between the parties. Risks are allocated to the party which is best able to manage them, i.e. reduce their impact and/or absorb their consequences. Appropriate risk allocation should therefore minimise the cost of risks. The need to utilise private sector management and experience, and not only the capability of raising finance, is also key.

Payments under PPPs tend to be based on outputs, often for the availability of services or the infrastructure. There may be contractual annual payments from governments to support inadequate revenues on projects involving direct user charging, such as road tolls or rail fares.

PPPs are not a way of avoiding payment for capital projects; rather they allow public sector bodies to spread payments for large projects over their useful life, usually over 20 to 30 years, but they differ from debt obligations as payment is only made when services are delivered.

The Commission's Green Paper considers PPP projects to be characterised by:

- Relatively long relationships, involving cooperation between the public partner and the private partner on different aspects of a planned project.
- Funding structures that combine private and public funds.
- The operator playing an important role at each stage in the project (design, completion, implementation, funding).
- The public partner concentrating on defining the objectives to be attained.
- The distribution of risks between the public sector partner and the private sector partner.

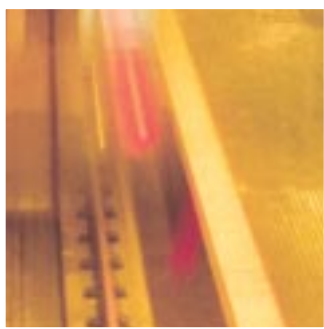
Similarly, for the purpose of a recent evaluation report on projects financed by the EIB,⁷ the evaluators agreed a set of PPP characteristics with the EIB's operational directorates, namely, a PPP should:

- Involve a clearly defined project.
- Involve the sharing of risks with the private sector.
- Be based on a contractual relationship which is limited in time.
- Have a clear separation between the public sector and the borrower, i.e. there should be a private-sector party raising project-finance based debt.

“Private sector expertise and experience has always been utilised in public sector procurement, but, where in traditional procurement, private companies built and then walked away, PFI seeks to ensure that the private sector takes responsibility for the quality of design and construction it undertakes, and for long term maintenance on an asset, so that value-for-money is achieved.”

Source: HM Treasury (UK) July 2003.

⁷Evaluation of PPP projects financed by the EIB, Operations Evaluation, EIB, March 2005. Available at <http://www.eib.org/publications/publication.asp?publ=207>



“ Procurement programmes that are perceived by the market to be efficient, well supported politically and adequately communicated to the wider community will be rewarded by a depth of competitive interest that will deliver value for money and a highly competitive cost of capital. ”

Andy Friend, Chief Executive, John Laing plc at the 2005 PPP Transport

Advantages and disadvantages of using PPPs

Why use PPPs?

It is important that any public sector authority understands that PPP procurement is only one of several options for procuring infrastructure. Consideration must be given as to whether a project is suited to a PPP structure, and whether there is strong political support for a PPP solution.

The principal reason for using PPPs is that, where the project is suitable, they can deliver better value for money than the alternatives. All arguments for and against PPPs must be considered within the context of that overriding objective.

This section summarises the key arguments for PPPs and then considers some of the difficulties associated with, and objections to, PPP procurement.

“ PPPs make additional projects affordable. By attracting private sector finance for schemes suited to the PPP model, limited public sector funds can be directed to deliver other non-PPP projects ”

Julie O'Neill, Secretary General of the Irish Department of Transport at the 2005 PPP Transport Summit

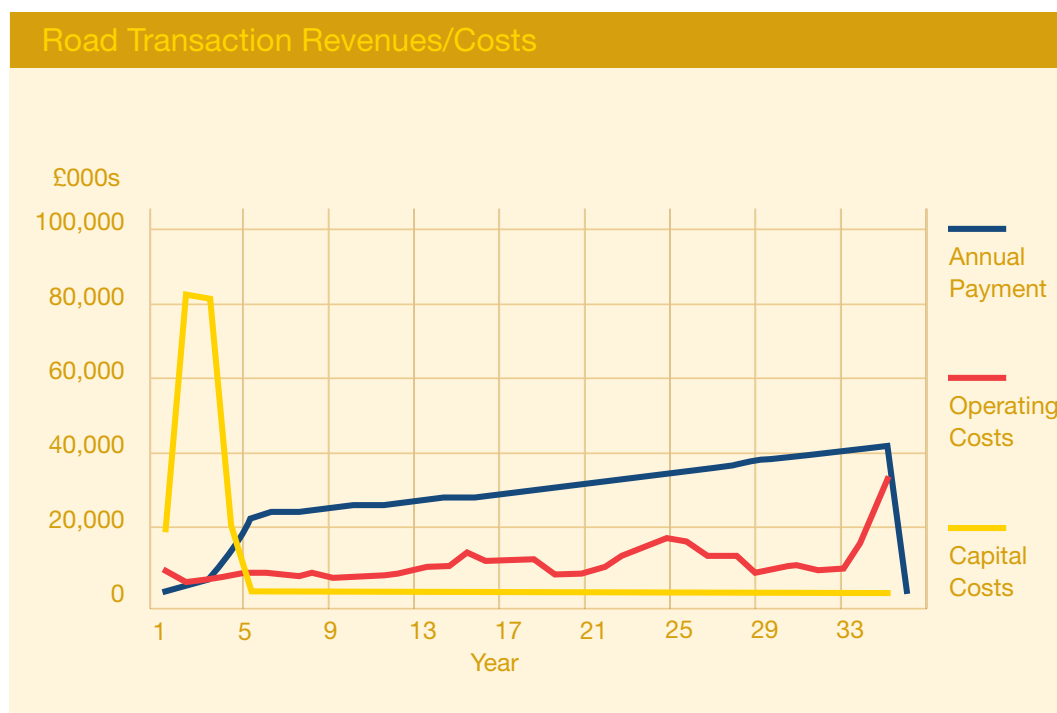
Key reasons for using PPP procurement

PPPs make projects affordable

Under PPPs, the private sector finances the construction of the project and is repaid by a service charge from the authority over time or by revenues from the project, or a combination of the two. So in circumstances when the public authority does not want to, or cannot, increase its direct levels of borrowing, PPPs make projects affordable.

Figure 2 shows the profile of a classic PPP road project, which is financed by way of availability payments from government, rather than tolls from users. The annual payment to be made by the public sector authority is shown by the blue line on the graph. The yellow line represents the upfront payment which would otherwise have to be made to meet the capital costs of the project (on the incorrect assumption that the public sector's capital and operating costs would equal that of the PFI contractor – whereas general experience suggests public out-turn costs prove to be higher). Under PPPs, governments will pay the annual payment line, and then only if services are being successfully delivered. With traditional procurement, the public sector pays both the capital and operating expenditure and is fully at risk for the actual out-turn cost.

Figure 2: Profile of a PPP Transaction



Note that the blue line includes the private sector's cost of finance, whereas in traditional procurement this cost is not typically shown at the project level.

This PPP payment profile delivers two key benefits:

- The project may become affordable within annual authority budgets.
- Payments by the public sector more closely match the user benefits of a project as they are delivered; this is particularly so for transport projects, where user benefits grow over time.

A project may also become affordable because out-turn cost is fixed and uncertain downsides are avoided.

Because individual projects become more affordable, the public sector can afford to procure a greater number of projects in aggregate, financed over a realistic long-term period. Authorities are not constrained from taking the long-term view because of short-term budgetary and fiscal constraints.

Of course, these benefits would also support an argument for an authority to simply borrow on a long-term basis, rather than using PPPs. So affordability cannot in itself be a driver to choose PPPs, but is one beneficial factor to consider. Notwithstanding this, however, many authorities do not have the direct power to borrow, but can enter into long term contracts

for the delivery of services. For them, PPPs are a pragmatic solution to overcome a legal impediment.

In addition, in cases such as airport terminals, enhancement of port facilities and toll roads, the future revenues of the project could enable the private sector to finance the majority or even all of a project without recourse to public sector support, further improving the affordability of the project to the public sector.

It must be acknowledged that different Member States regard the potential affordability benefit of PPPs differently. Some believe that there is little difference between the affordability of the procurement methods; the public sector either has to pay a PPP contractor over the long term or raise finance itself to finance a traditional procurement, which it then repays over the long term, making a project equally affordable. For others, affordability is critical in determining the attractiveness of PPPs. This may be particularly true of local or regional authorities, who lack the capacity to borrow, but can afford long-term annual payments under a PPP scheme.

PPP makes projects affordable but also create fiscal rigidity at the same time because of their long-term commitments. Governments must consider to what extent PPPs lock in public spending and reduce the fiscal flexibility of future generations.

Box 2 N4/N6 Kinnegad-Kilcock Motorway, Ireland

Working within affordability constraints

The N4/N6 project involved a 39km stretch of road, including 35km of new construction, from Dublin to the northwest of Ireland. This was the first PPP road project signed as part of the €52 billion 2000 – 2006 National Development Plan and the third PPP scheme to close in Ireland.

The EuroLink Consortium, comprising Cintra and SIAC and financed by Banco Bilbao Vizcaya Argentaria, Banco Santander Central Hispano and the European Investment Bank, arranged a €235 million project financing package for the 30-year design-build-finance-operate (DBFO) real toll scheme. This included an EIB guarantee facility of €85 million after two years of operation. The contract was awarded in March 2003 and the 3½ year construction period began in May 2003.

Upfront capital costs on the project were estimated at €320 million, and total

investment over the life of the concession is put at €400 million. Before procuring the project, the National Roads Authority (NRA) set a maximum €170 million subsidy limit (with €70 million relating to land purchase) which would supplement the hard toll payments during the project's construction and operational phases, thereby ensuring that the project was affordable to the NRA. Budgetary certainty was also assured.

The final contract apportioned real toll risk to the concessionaires, so the greater part of the affordability risk has been transferred to the private sector. Cost overruns, for instance, would have to be funded by lenders and repaid from tolls. There are no guarantees against competing toll-free routes and there is no compensation payable on termination. In spite of the relatively aggressive risk transfer to the private sector, the project has been competitively priced.

Source: PricewaterhouseCoopers/Dealogic ProjectWare

PPPs maximise the use of private sector skills

Under traditional procurement, the private sector is responsible for delivering an asset to time and budget. In contrast, PPPs require the private sector to:

- Deliver assets on time and budget.
- Ensure that those assets deliver the service levels required by the public sector.
- Project manage the overall delivery of the project.
- Ensure that the individual assets and other elements of the project that have been procured work together to successfully deliver services. Particularly in the rail sector, such “systems integration risk”, which involves ensuring signal systems, rolling stock and track work seamlessly together, is a key project risk.
- Maintain and refurbish assets on an effective basis, so that services are delivered continuously at satisfactory levels over the long-term.

PPPs therefore offer significant opportunities to benefit from private sector skills to a far greater degree because of these additional requirements.

In considering whether to use PPPs, public sector authorities should also look at their own track record of project delivery. Have projects been delivered on time and on budget? Has systems integration risk been properly managed? Have effective project management skills been introduced? Does the public sector have the skills and resources to manage and maintain the assets effectively after their acceptance from the private sector contractor?

Public sector authorities often do not have in-house capability to deliver projects and maintain them over lengthy periods; this is largely by design, not by omission. They may only procure projects infrequently and therefore lack the necessary skills and training to implement projects, and therefore have no need to retain such a capacity in-house. Therefore, more extensive use of the private sector throughout a project's life gives best value, as the private sector parties have that experience and are repeatedly delivering projects internationally.

Under PPPs, the private sector takes life cycle cost risk

PPPs require the private sector to compete to deliver services over the long-term at the most economically advantageous price. The public sector is not interested in simply procuring the cheapest upfront capital expenditure, as with traditional procurement where the private sector is indifferent to higher maintenance costs thereafter. With PPPs, the public sector is looking to achieve the best value over the life of the asset and project.

As a result, the private sector focus has been to design and implement projects with a view to their long-term cost to the taxpayer rather than the immediate capital spend. Where PPPs have been used extensively, there is considerable evidence of increasing skills in the private sector to analyse and provide for life cycle costs and to design accordingly.

Under PPPs the private sector is designing and pricing to absorb life cycle risks, therefore its pricing at first sight will look more expensive than traditional procurement. However, under traditional procurement, the public sector retains project management and life cycle risks, which will not be reflected in the immediate pricing received from a contractor. For instance, if the public sector were managing a rail project with separate prices for rail, signalling and rolling stock contracts, none of those prices individually would include a price for the systems integration risk. But if those assets do not work well together, the public sector will find themselves facing significant extra costs to complete the project successfully.

With PPPs, risks are allocated to the party best able to manage or absorb each particular risk

PPPs are designed so that risks are allocated to the party which is best able to manage them. Where the private sector bodies have the necessary long-term project skills and the public sector does not, it follows that the risks associated with project delivery should be transferred to the private sector. In so doing, the public sector should obtain best value because those with the greatest and most relevant expertise will be best able to manage or absorb the risks, thereby pricing them more economically and minimising the costs.

However, both the public sector authorities and the private sector operators should take care not to promote or accept inappropriate risk transfer. In the context of competitive bidding in particular, there may be an increased tendency to overestimate future demand in order to demonstrate project viability. Projects delivered on the basis of this private sector "Optimism Bias" may bring short-term benefit to bidders, but are unlikely to be viable over the long-term as key risks relating to forecast demand levels may not be allocated to the party best able to manage or absorb them. For example, there are examples of tram PPPs that were rendered unaffordable and unworkable by inappropriate patronage risk transfer.

"The previous method used by the [Highways] Agency for procuring construction and maintenance of the road was to let contracts for separate tasks.... There was insufficient incentive for the parties to collaborate to maximise overall value for money for the Agency, especially in terms of whole life costs and quality.... The assumptions on which the contractors gave fixed rates often led to numerous claims.... A National Audit Office report stated an average increase of 28% between tender and out-turn price, based on a sample of 42 road construction contracts.

Design-Build-Finance-Operate (the Highways Agency term for its availability payment based PPP programme) contracts have accelerated the introduction of cost efficiencies, innovative techniques and whole life cost analysis into the design and construction of road schemes and the operation of roads.

Source: "DBFO – Value in Roads" A Case Study on the first eight Road Contracts by the Highways Agency.

Box 3

Amsterdam – Belgian Border High Speed Rail Link Project – Infrastructure, The Netherlands

Allocating risks appropriately

The project is one of the original 14 priority TEN-T projects and is the final phase of the major Paris-Cologne-Brussels-Amsterdam-London high speed rail network. The €4.5 billion HSL Zuid project (based on 2004 prices) involves the construction of a 100km high speed rail line connecting Amsterdam and Rotterdam with the Belgium / Netherlands border. The new high-speed rail lines are for passenger rail transport only and are designed for speeds of up to 300km/h.

The HSL Zuid project comprises four sets of contracts, two of which are structured as PPPs. The project consists of separate components for the civil substructure, the rail systems infrastructure, train operations, station areas and in addition the Belgian section of the line.

These separate components resulted in multiple interfaces between the various parties and one of the biggest challenges has been managing these interfaces. The Dutch Government wanted to limit the complexity of the sub projects by grouping similar types of risks and thus retained the related interface risks between the various

contractual arrangements as it was best able to manage them, functioning as the central counterpart.

The winning infrastructure consortium – Infrasppeed BV – is responsible for the €1.32 billion project to design, build, finance and maintain the railway track and associated systems until 2030. The payment mechanism is based on availability payments with deductions for non-availability, unsatisfactory asset condition and possession. Isolating the infrastructure consortium from traffic risk resulted in an efficient tender procedure and competitive financing conditions. The availability-based performance regime passes the construction risk to the consortium, i.e. the party best able to manage that particular risk, and incentivises them to achieve high availability. The HSL Zuid PPP is expected to achieve a 5% cost reduction compared with traditional procurement.

Commercial operation of the southern part of the HSL line is expected on 1 October 2006 while commercial operation of the entire HSL line is expected on 1 April 2007.

Source: PricewaterhouseCoopers

PPPs deliver budgetary certainty

At the financial close of a transaction, the future cost of a PPP project is known; the public sector will receive known outputs for known costs. This is in contrast to traditional procurement where the costs of project completion and future maintenance of the assets are uncertain and remain the responsibility of the public sector.

However, PPPs do not provide absolute budgetary certainty. Typically PPP payments by the public sector are subject to indexation and possibly periodic reviews, where the cost of delivering the underlying services is re-examined and payments are formulaically adjusted. In addition, some PPPs may be subject to service variations which may lead to additional costs.

Box 4 Spencer Street Station Redevelopment Project, Melbourne

Budgetary certainty achieved

The AU\$700 / €430 million redevelopment of Melbourne's Spencer Street Station was implemented under the State Government's Partnerships Victoria policy. The new AU\$350 / €215 million transport interchange facility in the heart of Victoria's capital city will accommodate interstate, regional and metropolitan rail and bus services and will have the capacity to handle 30,000 commuters per hour during peak periods. The complex will also include a shopping plaza, a supermarket, offices, apartments and a hotel at a further cost of AU\$350 million / €215 million.

The Civic Nexus consortium was selected in July 2002 for the design, construction, finance and long-term maintenance, and operation of the interchange facility. ABN AMRO Australia hold a 100% equity stake in Civic Nexus and other consortium members include Leighton Contractors Pty Limited (construction), Honeywell Limited (maintenance), and Daryl Jackson and Nicholas Grimshaw (design architects). Funding arranged in 2002 included an AU\$135 million (€84 million) 30-year inflation linked bond, an AU\$158 million (€99 million) 12-year nominal bullet bond and an AU\$81 million (€50 million) equity. A third bond tranche was issued in April 2003 for US\$74 million.

The PPP had a number of innovative features, including risk transfer based on a single package of railway accommodation and systems upgrade, plus commercial development. The work was planned in such a way that full train services could continue to operate from the station throughout the redevelopment and the preferred bidder was responsible for negotiating access with the third-party privatized rail operators at arm's length from the public sector sponsor body. A further key feature of the proposal was an innovative and iconic roof design.

A number of risks which had been transferred to the private sector subsequently materialised. The private sector had to deal with the effects of worksite agreements not being favourable to the constructor, with roof construction proving difficult and expensive, with complicated access issues for the rail operators, and with escalating raw material costs (especially steel prices).

Although the Victorian Government chose to step in to help the consortium negotiate additional access to the station, as the public sector had passed the risks to the private sector, the public sector has not had to meet extra payments. The Government's role has been one of facilitation. As a result of the risks materialising, the main construction contractor, Leighton, has written off AU\$110 million (€69 million) and the project has been delayed by approximately 12 months. AU\$640 million (€430 million) was wiped off Leighton's market capitalization at the time of the write-off announcement.

The station is due for completion by the end of December 2005.

Source: PricewaterhouseCoopers / Dealogic ProjectWare



PPPs deliver value for money

This is an assertion that needs to be questioned with every transaction. It is probable that the PPP approach will deliver value for money: where a PPP project is using private sector skills across a number of disciplines; where the public sector track record of project implementation is poor; where bidders are competing to provide the best services over the life of the assets; and where risks are allocated to the party best able to manage or absorb them.

“An increasing body of evidence has shown that the better risk management of PFI results in a greater proportion of assets being delivered on time and to budget.”

Source: HM Treasury Value for Money Assessment Guide August 2004

The key findings of HM Treasury’s research into 61 PFI projects were:

- 89 per cent of [PFI] projects were delivered on time or early;
- 77 per cent of public sector managers stated that their projects were meeting their initial expectations, i.e. the overall performance of the private sector partner was matching up to expectations at the time of contract close.

A study in 1999 by the UK National Audit Office found that only 30% of non-PFI major construction projects were delivered on time and only 27% were within budget, whereas the NAO’s report on PFI construction performance showed that over 70% of PFI projects were delivered on time, and no construction cost overruns were borne by the public sector.

This record reflects a number of weaknesses that have beset public procurement in the past. In particular, the full costs of projects have not been calculated accurately beforehand, risk management procedures have not been implemented, and there have been insufficient incentives, for management or organisation-wide, to ensure that projects are driven forward successfully.

Source: HM Treasury “PFI: Meeting the Investment Challenge” July 2003

In determining the benefits of a PPP approach, it has been recognised that the public sector should not focus simply on financial comparisons to the exclusion of wider qualitative considerations. While it is important to consider PPP costs against notional prices of a traditionally procured project (“the public sector comparator”), the procuring authority should first consider the qualitative factors that would suggest whether a PPP or alternative approach would potentially offer the best solution. Qualitative considerations could include whether there is a developed private sector skill base in the sector under consideration; how private sector project management skills contrast to public sector in-house capability; and whether there are conditions for strong competition between PPP bidders.

The public sector only pays when services are delivered

Usually, any PPP payments by the public authority only commence when project services begin to be delivered. If projects are late, the authority will not pay and therefore the taxpayer does not bear the cost. The level of payment made by the authority will relate to the quality of services provided and will reduce in some sort of relation to a reduction in services being delivered. The private sector contractor has a direct financial interest in ensuring that the asset is delivered on time and the required service levels are provided.

Box 5 N31 Leeuwarden – Drachten Motorway, The Netherlands

Significant value for money through improved availability and lower costs to the public sector

The N31 road is located in the north of the Netherlands. The circa €110 million PPP project involved upgrading the single lane road in each direction to a dual lane motorway and designing and building an aqueduct and a bridge. In addition, the PPP provided for the financing and maintenance of this new infrastructure and the existing dual lane motorway link for 15 years after completion.

A PPP structure was chosen so that the Dutch Highways Agency (Rijkswaterstaat) could gain experience of the Design-Build-Finance-Manage (DBFM) procurement route and assess whether a PPP could deliver value for money. The PPP approach also made the project affordable – the DBFM contract was about 13% below the Government's budget – and helped to ensure that the project was not delayed for budgetary reasons.

The N31 PPP reached financial close in December 2003 and was structured with several types of payment: a pre-availability payment for the availability of the existing

road; an intermediate availability payment once the motorway had been widened; a non-recurring payment of €40 million once all the infrastructure had been completed; and availability payments throughout the 15-year project term.

The winning Waldwei.com consortium comprised Dura Vermeer, Ballast Nedam Infra and Royal BAM Groep. Their bid was some 30% below the PSC, in part due to maintenance efficiencies. A recent evaluation assessed that the PPP provided not only improved availability but also 20% financial savings, even after a 10% adjustment for aggressive bidding by the private sector consortium. The Public Sector Comparator was found helpful in analysing and understanding the value realised by this PPP project.

The success of the N31 project has contributed to the further use of PPPs to deliver road infrastructure projects. The PPP approach must now be considered for transport infrastructure projects over €112.5 million. A standard contract for DBFM roads has been launched and several PPP road projects have been announced.

Source: PricewaterhouseCoopers / Dealogic ProjectWare

Box 6 The London Underground Limited Public Private Partnership, UK

In the LUL PPP, the private sector infrastructure companies ("Infracos") do not take passenger revenue risk, but are paid an annual payment directly related to the services delivered to passengers.

The Infracos are paid predominately in relation to their performance under three key output based measures:

- Availability: a measure of the day-to-day reliability of the trains, signalling, track and station equipment
- Capability: a measure of the passenger's typical journey time from entering the station to their destination
- Ambience: a measure of the condition and cleanliness of trains and stations

The level of deduction from the agreed annual payments an Infraco might face for poor performance is directly related to the cost to passengers of wasted time imposed on them. In this way the interests of the Infracos, public sector and passengers are aligned.

While the payment regime of the PPP is a good example of incentive alignment, it is also an example of the difficulties of procurement when there is no political consensus surrounding the use of a PPP structure. The need for strong political support to make PPP procurement effective is examined further in Section 4.

Source: PricewaterhouseCoopers

PPPs force the public sector to focus on outputs and benefits from the start

PPPs rely on developing a detailed output specification and therefore they change the fundamental nature of the public sector procurement:

- The primary focus of the public sector becomes which services it wants delivered, not the means by which those services are delivered. The public sector's expertise should therefore be focused on service levels, and not detailed design, for which the public sector often does not have the necessary in-house skills, or is simply not set up to carry out in-house.
- PPP output specifications are fixed for lengthy periods, therefore it becomes critical that the service levels are set correctly at the outset. This leads to an even greater focus on defining service levels at the beginning of a project than has historically been the case. This might necessitate tough choices between the ideal service levels an authority might want and what is actually affordable – choices that under traditional procurement are often hidden or avoided until too late in the process, leading to projects that are far more expensive than originally envisaged.
- Defining service levels in detail at the outset minimises or removes the need for “change orders”, i.e. changes to the output or specification of assets during the procurement, which is a large contributor to cost overruns with traditional procurement.

“For Highways Agency employees, the introduction of the DBFO [PPP] programme has resulted in their role changing from procuring the design and construction of a scheme, to compiling the output specification for the road service, reviewing the bidders’ proposals for the design and, following contract execution, monitoring performance.”

Source: “DBFO – Value in Roads” A Case Study on the first eight DBFO Road Contracts by the Highways Agency

This focus on output levels is a key reason why PPPs prove to be better value for money. They create a focus on costs and benefits and a discipline to the budgeting of a project, and act as a catalyst for tough political decisions, which are otherwise avoided at the outset, leading to high levels of cost overrun.

With PPPs, the quality of service has to be maintained for the life of the PPP

The quality of service under a PPP is specified at the outset and is not expected to decline throughout the life of the PPP. The price committed to by the private sector is to maintain those standards throughout. This obligation contrasts starkly with traditional procurement, where asset condition and hence service levels will often decline significantly as the asset becomes older.

“Evidence to date suggests PFI is appropriate where there are major and complex capital projects with significant ongoing maintenance requirements. Here the private sector can offer project management skills, more innovative design and risk management expertise that can bring substantial benefits. Where it is effective, PFI helps ensure that desired service standards are maintained, that new services start on time and facilities are completed on budget, and that the assets built are of sufficient quality to remain of high standard throughout their life.”

Source: HM Treasury “PFI: Meeting the Investment Challenge” July 2003

Development of specialist skills

The implementation of PPP programmes and the acceleration of projects that this has brought about, has led to significant opportunities for the private sector. A large number of companies have created specialist PPP units and have invested in the expertise and understanding of the PPP market and pricing of deals on a whole life cost basis. PPPs have created beneficial economic investment opportunities across a spectrum of public sector areas and have encouraged the development of a facilities management sector capability, skilled in operating and maintaining new facilities.

Investment in PPPs is not without risk; there are already a number of PPP projects where the private sector sponsors or sub-contractors have had to make substantial additional contributions to ensure the successful delivery of a project, at no cost to the public sector. However, the vast majority of projects have shown delivery on time and budget and the private sector parties have been rewarded accordingly. The public and private sector incentives are aligned, and the private sector makes good profits for delivering good services.

PPPs encourage the injection of private sector capital

Since 1994, the private sector has invested around US\$260 billion in PPPs across the globe, mainly in Europe, Australia and Canada.⁸ Therefore, it is clear that PPPs allow access to a large pool of additional funds, both equity and debt finance. The benefit of private sector capital is not restricted to the simple availability of cash, but also entails all of the benefits of private sector investment:

- Lenders impose strict due diligence requirements on the deal, to some extent doing the public sector's work for them. They will, for instance, appoint technical due diligence consultants to ensure all costings are robust, that revenue forecasts are realistic and that reserves for maintenance and refurbishment of projects are prudent.
- Lenders will require regular information updates to spot and forestall potential problems through preventative action, should any difficulties be forecast.
- Equity controls on a project company are the same as for general private sector companies. Under-performing management, for instance, will be quickly identified and replaced or supplemented.
- The payment structure of PPPs means that lender and equity returns can only be guaranteed if the project is successfully completed and operates satisfactorily. Incentives are therefore clearly aligned with those of the public sector.

These controls and incentives are less clear cut and much less evident in public sector managed projects. Consequently, cost overruns and technical difficulties tend to be discovered later in the project, even in construction itself when they are harder to resolve.

“There is a large and growing appetite for PPP projects across Europe. Well structured projects, both large and small, will benefit.”

Michael Dinham, Head of Infrastructure Finance and Advisory, ING (London)

PPP transactions can be off balance sheet

Under Eurostat guidance or local accounting rules, many PPP transactions can be classified as off the public sector's balance sheet. This means the authority will only account for the annual payments it makes to the PPP company, and not for the assets and liabilities of the project, including its debt. The off balance sheet treatment of PPPs is attractive in so far as long-term obligations under PPPs do not appear under governments' overall budgets. Annual government budgets show instead the annual payments for the services received, thereby helping to keep government deficits within the reference value of 3% of GDP, as per the Stability and Growth Pact adopted in 1997 to strengthen the Maastricht Treaty provisions.⁹ An on balance sheet approach effectively forces the procuring authority to have sufficient cash allocated to the entire concession's charges at contract signature.

Although an important driver for PPP use in many countries, the off balance sheet treatment should not be the only reason to adopt the PPP approach. For a project to be off balance sheet, the majority of risks of the transaction will have been transferred to the private sector. However, the public sector must reconcile two conflicting objectives: the desire to transfer risk to the private sector so that the project-related assets and debt are not consolidated in the government's balance sheet and the desire to ensure the most appropriate risk transfer which minimises the cost to the public sector. As a result, in some cases achieving an off balance sheet classification could jeopardise obtaining optimal risk transfer and best value for money.

The balance sheet treatment of PPP transactions is considered in more detail in [Section 4](#).

“PPP arrangements work best where there is an explicit policy commitment by national governments to involve the private sector, a clear long-term political will, a high-quality partnership, transparency, clearly specified financial guarantees and an established, stable legal environment.”

Zoltan Kazatsay, Deputy Director General, DG TREN, European Commission at the 2005 PPP Transport Summit

⁸Source: Dealogic ProjectWare search results for period 1 January 1994 – 30 September 2005 for all countries.

⁹Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997 (97/C 236/01). Available at [http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y0802\(01\)&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y0802(01)&model=guichett)

The challenges of using PPPs and their mitigation

Any public sector authority considering PPPs must also understand that there may be situations when they should exercise caution. Once the public sector authority has chosen to use a PPP, there may be significant difficulties to overcome. While there will be some cases where the difficulties and costs will overshadow the perceived benefits of PPPs, there will be other instances when the benefits will outweigh the difficulties.

Before pursuing a PPP approach, the public sector authority should consider the following issues:

Does sufficient private sector expertise exist to warrant the PPP approach?

For PPPs to be attractive, the private sector must have the necessary expertise. Private sector players must be:

- Able to provide a more efficient and effective service. For example, if there is an incumbent public sector operator, the private sector should have proven additional management skills to realise service improvements and efficiency gains.
- Sufficiently numerous, with enough potential private sector bidders to allow for an effective competition.
- Experienced in pricing life cycle costs in the particular field.

- Experienced enough to allow them to manage and absorb the particular risks of the project, country or sector in which the PPP is proposed, thereby reducing the likelihood that large risk premia are included in their prices.

Where a public sector authority proposes a programme of PPPs, for instance a road building programme, any lack of expertise at the outset might be of lesser concern, because a programme of PPPs would encourage the private sector to develop expertise, and attract market entrants from other countries or sectors.

Does the public sector have sufficient capacity and skills to adopt the PPP approach?

The degree to which the public sector possess the capacity, capability and skill level for successful PPP procurement differs markedly across Europe and between different entities within governments. The precedents on which new deals must be based and the legal framework within which PPPs must be completed also vary. While these are also issues for traditional procurement, the complexity of PPPs accentuates them.

In order to enjoy the benefits of PPPs as outlined earlier in this Section, the public sector procuring authority must have, or be able to develop, the requisite capability to assess and deliver value for money, both at the initial stage when considering how particular services should be procured and formulating project specifications, and also during the bidding

Box 7 Jubilee Line Extension, London Underground

Delays and cost overruns caused by limited public sector capability in managing large, multi-discipline projects

The Jubilee line extension was an example of traditional procurement, whereby London Underground Limited directly procured the extension through an in-house project manager, the Jubilee line extension project team. The project was two years late and £1.4 billion over budget. A report by Arup identified key reasons for the project mismanagement.

“The public sector Jubilee Line Extension Project (“JLEP”) team competently handled the difficult early stages of construction of the heavy infrastructure works, but did not have the strength and experience of management that was needed for the later multi-discipline stage. The processes set up for management and control were also

swamped by the sheer scope of the project. This was not helped by the strategy that had been adopted; to divide all the works into discrete contract packages leaving many difficult interfaces to be managed by JLEP that would better have been handled by a lead contractor.

There was a significant increase in the estimated final costs of the major construction contracts. This arose from variations to the scope of the works on which the contractors tendered. The total value of this change amounted to 70% of the initial value of the works... and the administration of this overwhelmed the cost management process, turning it into a “catch up” monitoring process rather than the advance control process it was intended to be.”

Source: The Jubilee Line Extension Report by Ove Arup Partnership Limited

process, to ensure that bids prove to be better value than public procurement alternatives. The government also needs to understand whether it is making the right choice between a PPP or traditional procurement approach.

It is not always possible to transfer life cycle cost risk

A key benefit of PPPs is the transfer of life cycle cost risk to the party most competent to manage it. This means the private sector pricing, for which they are at risk, is not just for the delivery of an asset, but for the cost of running and maintaining that asset and providing related services during the life of the PPP contract. The PPP competition is not about achieving the lowest cost of an asset at the outset but the lowest price of services over the long term. And to ensure that the public sector gets best value, it transfers that life cycle cost risk to the private sector, who then are empowered to manage and maintain those assets to ensure services are delivered for the price for which they are at risk.

If life cycle risk were not transferred to the private sector, then bidders could promise life cycle benefit, but the public sector would retain the risk that these benefits would be delivered so a key objective of PPPs is to ensure this risk has been effectively transferred.

But there are examples of where that objective cannot be met. For instance, where the assets being procured cannot be separated or are part of a far wider network, such as the upgrade of part of a rail line, transferring life cycle risks to a PPP operator may not be feasible. As the assets in question are integrated into a wider network which is typically maintained by a public or private utility, then the private sector bidder cannot take life cycle risks and the incumbent utility will carry out maintenance more cost effectively. Therefore, it can be seen that life cycle risk transfer is difficult where assets cannot be separated from a wider asset base that is maintained by a third party.

In these circumstances, the public sector authority could consider whether the scope of the PPP project could be widened to encompass not only the upgrade in question, but also to take over the operation of the existing assets, so that the network can be operated as an integrated whole. This approach is appropriate where the current operations and services are not being run as efficiently as possible and could benefit from private sector management, alongside the upgrade itself. As an alternative, consideration has been given to a Design Build Finance

Transfer model (DBFT) in the UK, where completed assets would be passed over to the incumbent operator.

PPPs do not achieve absolute risk transfer

PPPs are typically constructed using highly geared Special Purpose Vehicle ("SPV") companies. Typically with high levels of debt and relatively low levels of equity, they are unable to absorb unlimited risk.

Project companies are structured to absorb a reasonable level of adverse changes, consistent with raising bank finance. But exceptional adverse events may test this capital structure. For this reason, it cannot be guaranteed that an SPV will not run into financial difficulties. An SPV's financial robustness is typically underpinned through a series of fixed price sub-contracts, but these contracts have certain limitations in terms of risk transfer and liquidated damages payable by sub-contracts on default. There are circumstances, therefore, where the private sector might fail to deliver services adequately and the public sector will have to step into a failing project to ensure the project is successfully completed.

In extremes, therefore, the public sector could be left with a partially completed project or assets that fail to deliver the required service levels unless there is material additional expenditure. So, when particular risks are transferred, that risk transfer is not absolute, and in the event of extreme project failure, incomplete or underperforming assets could revert to the Government.

To date there have been few examples of this occurring, although there have been examples of PPP restructurings to achieve different overall objectives (e.g. moving from real tolls to an availability-based road scheme). In the cases where difficulties have arisen, to protect their initial investments the shareholders and financiers have normally sorted out the problem at no, or minimal, cost to the procuring authority, in order to protect their initial investments.

Note that with PPPs, the public sector should not attempt to transfer all risks, but only those the private sector is best placed to manage. Certain risks such as force majeure/acts of God, general risks, general inflation and demographics or GDP impacts on a project, are arguably more in the control of the public sector, so it should be at risk for the impact of their occurrence. Recent experiences on light rail schemes have also dampened the private sector's appetite for revenue risks.

The public sector must recognise the disadvantages of PPPs if they adopt a PPP approach:

PPPs imply a loss of management control by the public sector

Under PPPs, management control of outputs is passed to the private sector. As long as the private sector are delivering the specified services, the public sector's ability to intervene in the management of the project and the means by which services are delivered is strictly limited. Although change mechanisms are an integral part of PPP project agreements and the public sector may still intervene, all relevant parties must agree any changes to the contract and these may involve a considerable increase of costs to the public sector. This passing of responsibility is wholly deliberate, and has a key benefit that the operation of PPP projects is shielded from regular political or administrative interference that are a common cause of cost overruns and delays.

Limiting the public sector's powers of intervention also has the benefit of improving cost efficiency overall. It is transparent that changes to the project can be costly so the public sector is forced to consider the cost implications when deciding whether these changes are absolutely necessary.

This does mean, however, that:

- The public sector has no day-to-day control over the management of public sector services.
- The public sector's ability to manage or change a project to co-ordinate with wider public sector services is limited.
- Where the public sector has a degree of expertise within a particular sector, this expertise will not be used, unless it is transferred to the contractor at the outset, which commonly happens.

Box 8 M6 Érd (near Budapest) – Dunaújváros Motorway, Hungary – Quick procurement process

The €455 million project relates to a 22-year Design-Build-Finance-Operate concession for the M6 motorway between Érd and Dunaújváros in Hungary. The procurement timetable of less than eleven months (between tender launch and financial close) shows that the procurement process need not be long and drawn out.

The tender process was launched by the Ministry of Economy and Transport on the 31st January 2004 and four consortia submitted expressions of interest by the 4th May 2004. On the 17th June 2004 the three short listed consortia were requested to submit a detailed offer by the 19th July 2004. The preferred bidder was chosen on the 9th August 2004, with whom the concession agreement was signed on the 2nd October 2004. Financial close was reached on the 20th December 2004.

Construction of the 59 km motorway began in late 2004 and commissioning of the road is scheduled for May 2006.

A number of factors helped achieve this ambitious timetable:

- A clear commitment from the Hungarian Government and the Ministry of Economy and Transport to conclude the transaction before the end of 2004;

- The experience of the Government representatives gained through the restructuring of the M5 concession road the year before in 2003;
- The use of professional advisors; and
- The appetite of the private sector for PPP projects in Central and Eastern Europe.

The winning M6 Duna consortium comprises Bilfinger Berger BOT GmbH, Porr Infrastruktur GmbH, Swietelsky International Baugesellschaft GmbH. The PPP structure is based on an availability payment mechanism. 10% of the project is financed from equity and the bank financing includes a €411 million term loan, a €22.3 million equity bridge loan, a €20.7 million VAT facility and a €1 million working capital loan. Financing is provided by the Hungarian Foreign Trade Bank (Bayerische Landesbank), Kereskedelmi és Hitelbank (KBC), Bayerische Landesbank, Commerzbank AG, KBC Finance Ireland and Kreditanstalt für Wiederaufbau.

Source: PricewaterhouseCoopers / Dealogic ProjectWare

PPP procurement can be lengthy and costly

PPPs rely on having a well structured and detailed output specification prior to the commencement of bidding. While this has clear benefits in achieving affordable and best value projects, the overall procurement timetable from inception to financial close may be relatively long and costly.

The experience of PPP procurement timetables, however, differs across Europe, with some regions achieving timetables competitive with traditional procurement alternatives.

It should also be noted that hasty procurement using traditional means can lead to a poorly defined project at the outset, resulting in cost and time overruns during project implementation. In these circumstances the benefits of faster procurement become illusory.

As at October 2005, a number of EU member countries have transposed the new EU procurement directive into national legislation. However, it is too early to comment on the impact of the new competitive dialogue on procurement costs and times. All EU member countries must adopt the directive by the 31st January 2006, and therefore its full impact may not be felt until later in 2006.

This issue is explored more fully in [Section 4](#).

The private sector has a higher cost of finance

The private sector's weighted cost of finance, both debt and equity together, is typically between 1% and 3% higher than the public sector's cost of debt on a non risk-adjusted basis. This cost of finance increases the overall cost of a PPP relative to traditional procurement, unless cost efficiencies delivered by the private sector outweigh this incremental cost.

There are, however, a number of competing arguments to consider. **First**, arguments justifying the higher cost of finance:

- The private sector's cost of finance reflects the specific risks of the project. Its cost reflects the mix of debt and equity finance, with the latter being required to absorb many of the project's risks. It can be argued that

“The tender process must be as transparent as it possibly can be, with clear bid evaluation criteria set out and made known to bidders in advance, with an open and comprehensive debrief to unsuccessful bidders.”

Gerhard Becher, Chairman of the Executive Management, Bilfinger Berger BOT GmbH at the 2005 PPP Transport Summit

Box 9 Millau Viaduct, France

Quick project procurement and delivery

The Millau suspension bridge spanning the Tarn River in the south of France was inaugurated on the 14th December 2004. It is one of the longest and highest bridges of its kind in the world, at 2.46km long and 270m above the Tarn River with a total height of 343m to the top of the pylons. The bridge was designed by UK architect Lord Norman Foster and built by the French contractor Eiffage in less than three years.

The circa €394 million PPP-type project involved the construction of a 2.46km tolled section of the A75 Millau Viaduct motorway between Clermont-Ferrand and Beziers. The formal bid process for this design-build-finance-operate project was launched early 2000, on the basis of a real toll stand-alone concession following the French standard approach of “Délégation de Services Publics”. The preferred bidder was announced in March 2001 and the

concession agreement was signed only a few weeks later in May 2001 with Eiffage SA. Construction began in December 2001 and was completed in May 2004. The project commenced operations on the 16th December 2004, only four years after the launch of the public tender.

The Millau project is not only an example of the private sector delivering a project on time but also of structuring the project to achieve optimal risk transfer without significant cost to the public sector. Bidders were allowed to propose the length of the concession period, with the aim of minimising the Net Present Value of government payments and toll receipts. The bid was awarded on the basis of a 75-year concession with no government support. Demand risk was transferred entirely to the private operator, based on Eiffage's traffic and toll assumptions.

Source: PricewaterhouseCoopers/Dealogic ProjectWare

this incremental cost of finance is simply the explicit recognition of the inherent risks of that project. In contrast, the public sector's cost of finance is the overall rate at which that authority can borrow funds, i.e. debt only not equity, and therefore does not reflect the risks of the project. To the extent that those risks occur, there is no equity to absorb those risks, rather the public sector has to find further funds or take on further borrowings to finance completion of that project.

- Focusing on the relative cost of finance misses the fundamental point of using PPP procurement. PPPs are designed to ensure that projects are delivered in the most effective way over their life and the private sector is incentivised to deliver projects on time and budget. The use of private finance imposes greater discipline on a project than is common in public sector teams. The cost efficiencies PPPs deliver should outweigh any incremental finance costs in these cases.

Box 10 Procurement of Transport PPPs in Spain

PPP procurement can be quick and successful

Spain has a long history of PPPs. The first law regulating the private development of toll roads dates back to the second half of the 19th century. During the 19th century, bridges and a number of railways were also developed by private investors. Between 1967 and 1976, 15 toll road concessions covering 1,500 km were awarded to private developers.

In recent years, the Spanish public authorities have been successful in developing PPPs. The 1972 concession law governing road PPPs was superseded in 2003 by a new concession law which provides a strong regulatory framework for PPPs across all sectors. There is strong competition between private sector operators and project procurement and delivery is achieved in record timeframes.

In spite of criticisms over subjective award criteria and the lack of international private sector sponsors, the Spanish model provides both public sector authorities and private sector operators with a reasonable risk share,

a firm and clear legal framework and a quick and economic procurement process – bidding costs in Spain are on average a tenth of those in the UK for similar projects and final award takes place in a fifth of the time.

The average timescales of designing and procuring a PPP project in Spain can be found in Figure 3.

In order to achieve these timescales, the procuring authority must complete a number of tasks prior to launching the process. These include developing the preliminary design and undertaking an environmental impact assessment, a financial feasibility study and EIB consultation – this pre-bid consultation helps ensure the “bankability” of the contract framework without lengthy negotiations between the public and private sector partners and the financiers.

This approach has been successful in delivering 22 road PPP projects with a value of more than €6 billion between 1998 and 2003; 13 of these projects are in operation.

Source: Cintra

Figure 3: Timescales for designing & procuring a PPP project in Spain

What	Who	When
Preliminary Study & Environmental Impact Assessment	Grantor	8 - 10 months
1st Public Information Process	Grantor	1 + 1 - 3 months
EIA approval & development of Basic Design	Grantor	4 months
Basic Design Approval	Grantor	1 month
2nd Public Information Process	Grantor	1 + 2 months
Tender document preparation	Grantor	2 months
Approval & Announcement	Grantor	1 month
Tender Period	Bidder	3 - 4 months
Tender Evaluation & Awarding	Grantor	2 - 4 months
Concession Co. incorporation	Bidder	2 months
Detailed Design	Bidder	2 months
Land Acquisition	Bidder/Grantor	3 months
	Ground breaking	33-40 months

Box 11

Edmonton Ring Road (Anthony Henday Drive SE), Alberta, Canada

Clear public sector goals and progressive procurement process leads to fast closure while maximising competition

The Edmonton Ring Road was the first major transport PPP project to close in Canada. It involves the construction of approximately 11km of four and six-lane divided motorway with auxiliary lanes, crossroads, property access roads, five interchanges, and 24 separate bridge structures. The winning consortium will also be responsible for the operation and maintenance of other sections of the ring road.

The total value of the 33 year DBFO PPP is estimated at C\$493 million in net present value terms, including C\$365 million of upfront investment in the construction of the Anthony Henday Drive South East.

Alberta Infrastructure and Transportation (AIT) signed the contract with the winning consortium, Access Roads Edmonton Ltd (AREL) led by ABN AMRO Canada, in January 2005, just 17 months after the initial Request for Qualification was issued.

The procurement process was designed to eliminate the need to negotiate with the selected preferred bidder, thereby allowing a strict transaction timetable.

The procurement process was progressive with the three pre-qualified bidders having to complete a highway design stage and indicative pricing and financing plan stage before entering the final pricing and financing plan stage. Committed finance was obtained by all bidders by the final pricing and financial plan stage. In parallel, the draft project agreement was discussed with bidders, updated and finalised with sufficient time for them to finalise their proposals.

Other factors contributing to the faster closure were AIT's clear goals from the outset with respect to the level of risk transfer and the underlying payment mechanism. The Province preferred to use an availability-based mechanism that incorporated operating and maintenance standards tried and tested in existing contracts.

No payments will be made to the consortium until the road is deemed traffic-worthy. However, a federal contribution of C\$75 million is payable over the 33 month construction period based on a proportion of actual costs incurred.

The road is expected to open in October 2007.

Source: PricewaterhouseCoopers

And **second**, opposing arguments querying the cost of finance:

- It can be argued that the public sector authority's cost of debt finance is the appropriate rate, because that authority undertakes a portfolio of projects and therefore its borrowing rate should reflect the lower risk of this portfolio, not the risks of a particular project.
- The private sector finance costs contain a premium for the risks of entering long-term contracts with the public sector, which the public sector clearly would not incur if it funds projects itself.

The correct answer perhaps lies between these competing considerations. Private finance costs will be higher than public, so the key question is whether their cost efficient management will outweigh that incremental cost. The public sector also needs to consider how much higher private finance costs can be. If too large a premium is put on project risks or public sector interfaces, for instance, value for money will be significantly eroded.

PPPs are long-term relatively inflexible structures

The cost benefits derived from setting relatively rigid output specifications for the life of a PPP have to be weighed against the relative inflexibility that such long-term output specifications imply. In many areas of public services, long-term planning and spending are appropriate. The degree to which services need to change and expenditure needs to be flexible are relatively limited and there are clear cost benefits from sticking to particular output levels and specifications. For instance, transport planning is relatively long term in nature, reflecting trends in GDP, growth in conurbation and regional employment over economic cycles. Arguably therefore, the level of frequent change in output specification that is desirable for a public authority is relatively limited. However, in several sectors, the need for a far higher degree of flexibility on the part of the public sector may be appropriate, which might make a long-term output specification approach difficult or counter productive. For instance, in a market that is rapidly developing, such as the secondary healthcare market or the provision of telecommunications services.

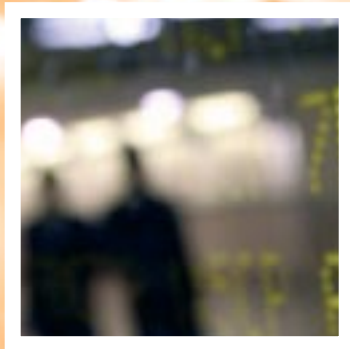
In addition, PPPs are procured under competition, and the private sector will look to have as high debt levels as possible, given the relative low cost of debt relative to equity. This results in highly-g geared and relatively inflexible PPP companies, where it may become difficult to introduce high levels of change to the output specifications should this prove desirable.

“A key concern with long-term PPP contracts is the level of flexibility that they offer to authorities to make changes either to the use of assets or to the level and type of services offered. Our survey findings do suggest that this concern is valid – both in terms of the time and administrative burden of making contract changes and the costs associated with a single tender action with the existing contractor.

On balance the reduced flexibility implied by PPP contracts has probably been a benefit during the construction phase of projects, forcing better up-front specification and reducing cost overruns and delays.

During the operational phase of the contract, the contract inflexibility has a negative impact compared with conventional procurement. The costs imposed on the authority by the inflexibility of the contract are likely to vary by sector. In sectors where a larger proportion of final service ‘value added’ is provided outside of the PPP contract (e.g. health and education) and where the contract interfaces are more complex (e.g. health) our expectation is that the costs will be greater.”

Source: Public Private Partnerships in Scotland, Evaluation of Performance by Cambridge Economic Policy Associates Ltd, March 2005



“ Countries need to radically improve and modernise their transport networks, but often lack budgetary resources and administrative structures to traditionally design and then procure the infrastructure they need. Even when EU funds are available, it makes sense to get the maximum leverage on those funds through project finance to postpone the budgetary impact of capital expenditure. ”

David Azema, Chief Executive, Vinci Concessions at the 2005 PPP Transport Summit

Review of PPPs by country

As noted in the Introduction, EU-level interest in the potential for private sector involvement in infrastructure provision is growing, especially as the level of investment required to deliver the TEN-T remains substantial and the costs of delay continue to grow.

In the Financial Perspectives proposed in July 2004, the European Commission recognised the significant financial requirements of the TEN-T projects and proposed allocating €20.69 billion to the trans-European network budget for 2007-2013,¹⁰ up from €4.2 billion for the seven years from 2000-2006. This is not sufficient to fund the infrastructure investment required.

Beyond the key transport routes identified at the trans-European level, individual member countries have national, regional and local transport infrastructure challenges to meet. In 2005, it was estimated that in order to attain an average EU-15 infrastructure level by 2010, the 8 new EU member countries from Eastern Europe would require investment of approximately €505 billion in their roads, railways, telecommunication, water treatment and sewerage, energy and environment sectors. €81 billion would be required to bring road and rail modernisation and construction

to the EU average density.¹¹ The European Investment Bank estimates that the total investment needed for upgrading the long-distance transport system to the level required for full integration of the new member countries into the Single Market may come to at least €90 billion.¹²

The PPP approach is increasingly being adopted to deliver new investment in infrastructure. Many countries initially develop PPPs in the transport sector and later extend their use to other sectors, such as education, health, energy, water and waste treatment, once the value for money benefits are proven and public sector expertise is established.

This section summarises PPP activity across Europe, dividing Member States into categories of high, medium and low deal activity.

¹⁰ *Financial Perspectives 2007-2013, Communication from the Commission to the Council and the European Parliament, COM (2004) 487 final. Available at http://europa.eu.int/eur-lex/en/com/cnc/2004/com2004_0487en01.pdf Proposal for a Regulation of the European Parliament and of the Council determining the general rules for the granting of Community financial aid in the field of the trans-European transport networks and energy and amending Council Regulation (EC) no. 2236/95 presented by the Commission, COM (2004) 475 final. Available at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2004/com2004_0475en01.pdf*

¹¹ *Public-private partnerships in new EU member countries of Central and Eastern Europe: An economic analysis with case studies from the highway sector, Brenck, Beckers, Heinrich and von Hirschhausen, EIB Papers Volume 10 No. 2, 2005*

¹² *Integrating the New Member States, European Investment Bank, www.eib.org*

Figure 4: Summary of PPPs by country and sector

	Central Accommodation	Airports	Defence	Housing	Health & Hospitals	IT	Ports	Prisons	Heavy Railway	Light Railway	Roads	Schools	Sports & Leisure	Water & Wastewater (incl solid waste)
Member States														
Austria	○	○			◐	○		○	◐		◐	○		○
Belgium		◐		◐					◐	○	◐	○		◐
Denmark	◐							○		○	○	◐	○	
Finland			○		○				○	○	◐	◐		○
France	◐	○	○		◐		○	◐	◐	◐ [†]	● [†]		◐	● [†]
Germany	◐	○	◐		◐	◐		◐	○	○	◐	◐	◐	◐
Greece	◐	●			○						◐	○	◐	
Ireland	○			◐	◐			○		◐	◐	◐		◐
Italy	◐	◐		◐	◐		◐	○		◐	◐		◐	◐
Luxembourg		○				◐								
Netherlands	◐		◐	○	○		○	◐	◐		◐	◐		◐
Norway (not EU)	○		○		◐			○			◐	◐	○	
Portugal	○	○		○	◐	◐	◐	○	○	◐	●	○	◐	●
Spain	◐	◐			◐		●	◐	○	◐	●	○	○	◐
Sweden			○		○				○	◐	○			
UK	●	●	●	●	●	●		●		●	●	●	●	●
New Member States														
Cyprus		◐					◐				◐			◐
Czech Republic		○	◐	○	○			○	○	○	◐	○	○	◐
Estonia			○	◐	○	○				○	○	◐		
Hungary	○	○		◐	◐	◐		◐		○	◐	◐	◐	
Latvia	○			○	○			○			○	○		○
Lithuania					○				○	○		○	◐	
Malta				○	◐	◐	○				◐	○	◐	
Poland	○	○		○			◐		○	○	◐		○	◐
Slovakia		○									○			○
Slovenia														◐
Acceding and Candidate Countries														
Bulgaria		◐ [†]					◐ [†]				◐			◐
Romania		○		◐	◐						◐		◐	◐
Turkey		◐		○	○				○	○	○			◐

Legend

- Discussions ongoing
- ◐ Projects in procurement
- ◑ Many procured projects, some projects closed
- ◒ Substantial number of closed projects
- Substantial number of closed projects, majority of them in operation

[†] Procurement activity in these sectors relates to traditional style concession contracts

High PPP usage: Strong deal flow in parts of Europe

In 2004 and 2005, around 206 PPP deals worth approximately US\$52 billion/€42 billion were closed in the world, of which 152 projects with a value of US\$26 billion/€21 billion were in Europe (in this case referring to the EU Member States, the EU acceding countries (Bulgaria and Romania), the EU candidate country Turkey, and Norway).¹³ From January 1994 to September 2005, it is estimated that PPP deals with a value of approximately US\$120 billion/€100 billion closed across Europe. Of these deals, two thirds closed in the UK, with the other PPP hotspots of Spain and Portugal accounting for 9-10% each.¹⁴

When compared to the PricewaterhouseCoopers Survey published in May 2004,¹⁵ there has been a notable increase in PPP deals, both in procurement and closed, in Germany, Spain, Italy and Hungary; in particular, school projects in Germany and projects in the health and water/wastewater sectors in Spain.

Geographically, the PPP market has remained concentrated. According to a recent Standard & Poor's report,¹⁶ the global spread of PPPs marks a much slower trend than many market participants had hoped. While the UK market has reached a good level of maturity and continues to grow in all sectors, activity in 2004 remained below expectations. However, there is strong deal flow in the pipeline for Spain, Portugal, France, Italy and Germany which suggests that the PPP concept is becoming

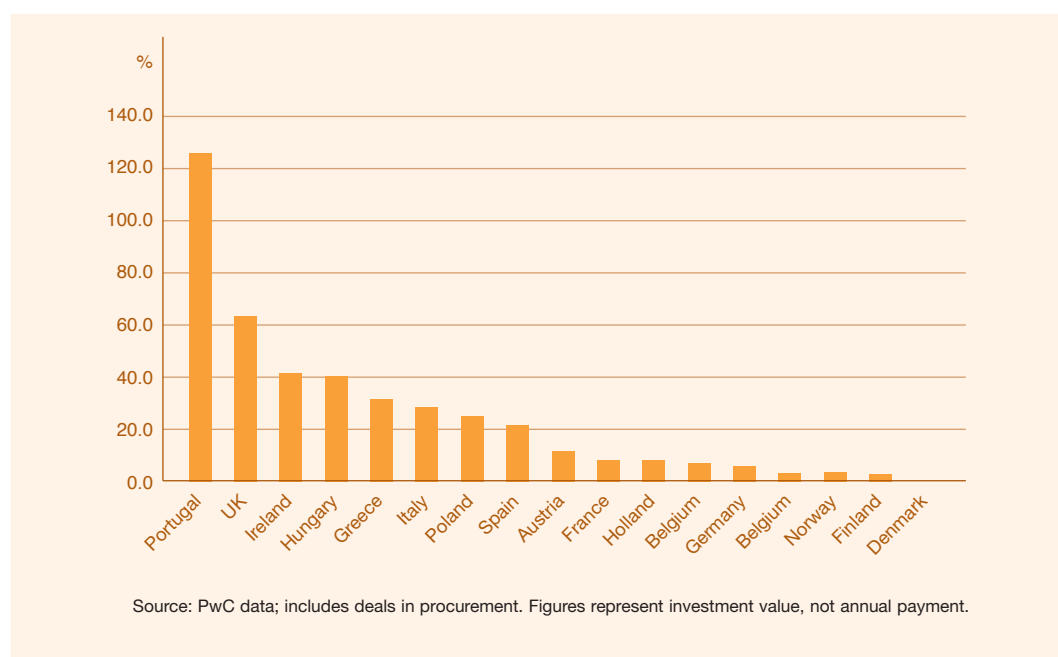
more established across Europe.¹⁷ This is confirmed by industry figures and evidence from PricewaterhouseCoopers offices across Europe.

The UK showed substantially more PPP activity than the rest of Europe with 118 deals closed in 2004 and 2005, with the next most active PPP market – Spain – closing 12 deals during the same period.¹⁸

There are a substantial number of PPP projects in procurement or announced in other EU member states. In Italy, just six deals were closed in 2004 and 2005, but there are at least 18 further projects in procurement and an estimated 40 projects in the pipeline.¹⁹ According to a recent survey by the German Construction Industry Association, 18 PPP deals closed in Germany between autumn 2003 and September 2005. It was estimated that a further 79 projects with a combined capital expenditure of circa €4.8 billion are in procurement or expected in the near future.²⁰

While the UK closed the greatest number of PPP deals in 2000-2005, if PPP activity is considered as a percentage of GDP, Portugal has the greatest involvement with PPP relative to its GDP, and countries such as Ireland, Hungary and Greece also show the impact of their major schemes. See [Figure 5](#).

Figure 5: Average 2000-2005 PPP activity as a percentage of mean GDP



¹³ Source: Dealogic ProjectWare

¹⁴ Source: Dealogic ProjectWare

¹⁵ Figure 3 Summary of PPPs by country and sector, *Developing Public Private Partnerships in New Europe*, PricewaterhouseCoopers, May 2004

¹⁶ A Global Survey of PPPs: New Legislation Sets Context for Growth, *Public Private Partnerships Global Credit Survey 2005*, Standard & Poor's, May 2005

¹⁷ A Global Survey of PPPs: New Legislation Sets Context for Growth, *Public Private Partnerships Global Credit Survey 2005*, Standard & Poor's, May 2005

¹⁸ Source: Dealogic ProjectWare

¹⁹ Source: Dealogic ProjectWare (deals closed and in procurement), PricewaterhouseCoopers (projects announced)

²⁰ Source: Hauptverband der Deutschen Bauindustrie, 2005

Below are listed key areas of activity for countries within the strong deal flow category.

Ireland

The transport and water and waste sectors have seen the most activity to date within Ireland, with the most deals closed and in procurement. In particular, there have been four road PPP projects closed in the past five years with a further six in procurement, including the €400m N6 Galway to Ballinasloe road PPP contract.²¹

In autumn 2005, the Irish Government announced an expansion of the role of the National Development Finance Agency to facilitate the establishment of a new Centre of Expertise which will be responsible for the procurement of all new PPP projects in the central government area (with the exception of road and rail). The Government has also announced a series of new PPP projects in the courts/prisons, health and education sectors and has set specific targets for projects financed through PPPs. By 2008, PPP investment should amount to almost €5 billion, comprising a target of €3.6 billion in total public funding for PPPs and a target of €1.3 billion for PPPs funded by user charges over the same period.²²

Italy

Due to the high levels of public debt and the significant infrastructure investment need in Italy in the past, there has been growing recourse to PPPs. To date, 20 PPP projects in the transport sector have closed or are in procurement and just under 30 further projects in the road and rail sectors have been announced.²³ PPP structures are also being used in the health, central accommodation and water sectors.

The Italian PPP taskforce (Unità tecnica per la Finanza di Progetto (UFP)) was established under legislation in 1999 and began operations in July 2000. It provides expertise and assistance to public administrations in identifying projects capable of attracting

private sector investment and in tendering those projects. The Legge Obiettivo (Law 443/2001) enacted in December 2001 emphasises infrastructure development of national strategic interest. In 2002, Law 166/2002 was enacted, introducing several amendments to the Merloni Law governing public works. The amendments were designed to encourage private sector participation in the construction and operation of public infrastructure facilities. In particular, the 30 year maximum concession period and the 50% maximum level of public sector grants and subsidies have been abolished.

Portugal

There has been considerable PPP activity in Portugal with limited resources and EU budget restrictions being key factors in the adoption of PPPs. In particular, Portugal has used the PPP approach extensively in the transport and water/waste sectors; approximately 20 transport infrastructure projects have closed over the last five years or are in procurement.²⁴ A new Socialist Government was elected in February 2005. Recently, the Government has announced a €25 billion investment programme including €8.3 billion in the transport sector, of which some €5.3 billion of PPP transport related projects. A PPP structure is being considered for new road concessions and potentially for part of the planned High Speed Rail network.

Spain

In December 2004, the Spanish Public Works Ministry (Ministerio de Fomento) presented the draft of an ambitious infrastructure and transport plan for 2005-2020 (Plan Estratégico de Infraestructuras y Transporte (PEIT)) which forecasts a total investment of €214 billion over the 15-year period.²⁵ Increased participation of the private sector is envisaged through PPP (Asociación Público-Privada) structures which are expected to account for almost 20% of the total investment.

²¹ Source: PricewaterhouseCoopers

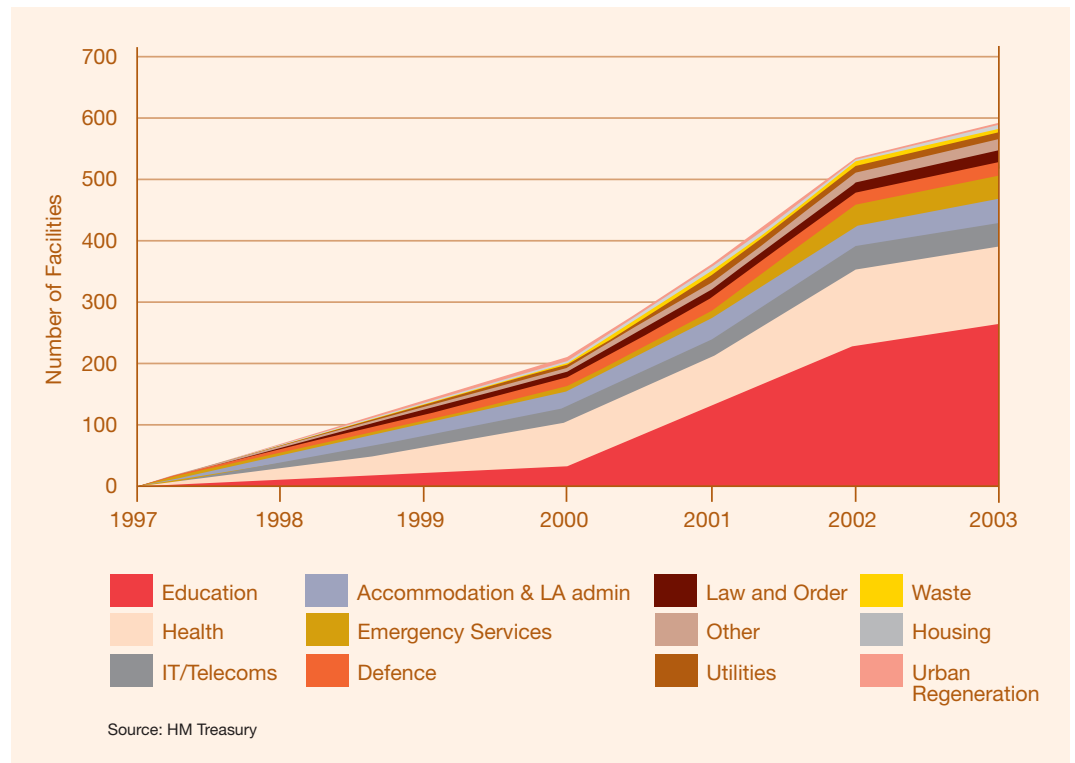
²² Observations by the Central PPP Unit, Department of Finance of Ireland on COM (2004) 327 final: Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions

²³ Source: PricewaterhouseCoopers

²⁴ Source: PricewaterhouseCoopers / Dealogic ProjectWare

²⁵ Plan Estratégico de Infraestructuras y Transporte is available at <http://peit.cedex.es/>

Figure 6: Number of operational PFI facilities in the UK



In addition to the planned use of PPPs to help deliver the central government's PEIT, the governments of the Autonomous Communities (Comunidades Autónomas) are driving the adoption of PPP structures to deliver a wide range of infrastructure projects, with planned and actual activity in the transport, water and accommodation sectors.

United Kingdom

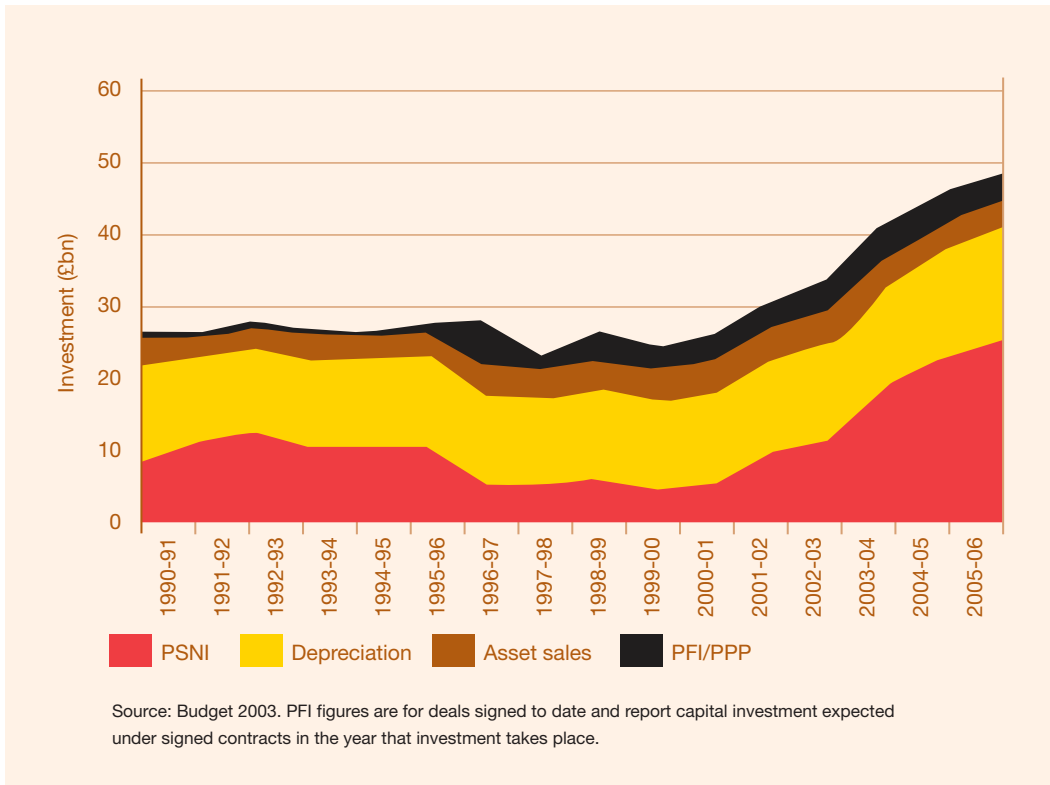
The UK continues to widen its use of PPPs across a number of sectors. According to UK Treasury figures, over 450 deals with a value of more than £34 billion (approx. €50 billion) were signed between 1999 and 2004. A number of big ticket schemes are being procured such as the widening of the M25 (circa £2.0 billion/€3 billion), Ministry of Defence Military Accommodation (circa £2.5 billion/€4 billion) and a number of large hospitals. But equally significant has been the growing use of PPPs,

sometimes on a grouped-together basis, to procure smaller facilities such as the Building Schools for the Future programme with an estimated capital investment of £2.2 billion (€3.25 billion) to be shared between the first 2005-06 wave of 180 schools and the National Health Service's Local Improvement Finance Trusts programme, with about 51 projects, of which approximately 36 projects have closed.

There are a large number of operational facilities that have been delivered using the PFI structure as seen in Figure 6.

However in spite of this considerable activity, PPPs represent a relatively small proportion of public sector investment in public services as seen in Figure 7.

Figure 7: Funding Sources for Total Investment in Public Services in the UK



Medium Usage: Slow historic uptake but increasing projects in procurement

France

Approximately 10 transport PPP projects have been closed over the last five years or are in procurement in France.²⁶ The majority of the projects currently being tendered are being procured through the ‘competitive dialogue’ which is described in more detail in Section 4.

A PPP “Ordonnance” (edict) of June 2004 was ratified by the French parliament in December 2004, thereby creating a new form of contractual relationship (“Contrat de Partenariat”) between the public and private sectors. Therefore, in view of this new clearer legal framework as well as ongoing budget constraints and efficiency requirements, recourse to PPPs may increase in the future. Particular interest has been shown in the health and prison sectors, with a major PPP programme for 18 prisons with a total expected investment of €1 billion, currently under procurement. A €5 billion hospital renovation programme, “Hôpital 2007,” has been launched, of which a substantial part is expected to be procured using a PPP model. Over 15 units with a total value of almost €1 billion are already under procurement using PPP-like structures and approximately 12 further projects have been announced.

Moreover, the central government estimates that some €19 billion of investment could be allocated to PPP projects in the next three years.²⁷

Reports suggest that only a fraction of the planned PPP investment will be funded on the basis of genuine project lending at standard PPP-type margins. The bulk of the external debt will be lent at lower public sector/municipal risk margins under the so-called “cession creance”. Under this arrangement, lenders will be exposed to real performance risk during construction and will price their debt accordingly with or without sponsor guarantees. Once construction has been completed satisfactorily, a part of the availability payment corresponding to a percentage of the construction cost (typically representing 50% - 80% of such payments) can be fixed by the public authority, i.e. it is not exposed to performance-related risk. This portion will benefit from lower public sector or municipal debt costs. The payment balance will continue to be subject to performance-related deductions.

Germany

There is widespread acceptance of PPPs across the political spectrum in Germany. A backlog of capital expenditure in the public sector and budget constraints at all levels of government (local, state and federal), together with a greater focus on efficiency has created

²⁶ Source: PricewaterhouseCoopers/Dealogic ProjectWare
²⁷ A Global Survey of PPPs: New Legislation Sets Context for Growth, Public Private Partnerships Global Credit Survey 2005, Standard & Poor's, May 2005

an increasingly dynamic market for PPPs. In light of political support at all three levels of government and the size of the economy, the German PPP market may become one of the biggest.

Since the publication of a study on the benefits as well as the legal and institutional impediments of PPPs, completed for the Federal Ministry of Transport, Building and Housing in August 2003,²⁸ 18 PPP-style transactions have closed. PPP activity has centred on schools, public administration buildings as well as roads. Two real toll road projects are operational and following the successful launch of the Heavy Goods Vehicle Toll in early 2005, two A-Model road projects are in tender and an additional three projects have been announced. The A-Model roads projects comprise the widening of existing federal motorways and the operation of those stretches by a private concessionaire based on a 30-year contract. In return, the private partner receives an upfront grant and a share of the HGV toll collected on the specific sections of motorway.

Greece

There has been growing PPP activity in Greece, in particular in the transport sector. Analysis conducted in the context of the Strategic Development Plan for Transport Infrastructure – Greece 2010²⁹ identified the priority transport axes for the development of the country's basic road network. Their development is combined with major investment projects in points of access (ports, airports) and secondary transport networks. Three large-scale transport PPP projects have been completed and are operational, with smaller projects delivering underground parking, leisure, and cultural facilities via a form of PPP.

A new programme for expanding and improving the quality of the Greek motorway network was announced in 2001. There are seven motorway projects included in the programme which, according to current expectations, will be delivered using PPPs. The Thessaloniki submerged tunnel PPP, expected to cost approximately €370 million, and the Maliakos – Klidi motorway PPP, expected cost approximately €450 million, are currently in procurement. The other five projects, with a combined total expected cost of €3.15 billion, will be tendered in the near future.

In the absence of a specific PPP law, acts of parliament ratified the use of PPPs in the major projects mentioned above. In September 2005, a PPP Bill was ratified by the Greek

Parliament. The Bill establishes a PPP Task Force within the Ministry of Economy and Finance and sets out PPP tendering and negotiation procedures. The Bill is aimed at small to medium-sized projects with a maximum construction value of up to €200 million.

Hungary

Given the need to physically integrate the economy into the EU, the majority of the six PPP deals that have closed in Hungary relate to road infrastructure projects. Further investment in PPPs is expected across a number of sectors, including prisons, light rail and education.³⁰ In September 2005, a contract was signed for a PPP accommodation project involving the construction of a new building for Budapest's Corvinus University. The expansion of Corvinus University is part of the Education Ministry's Hungarian Universitas Programme that will see the construction of new dormitories, the refurbishment of existing ones, the construction of educational infrastructure, and the renovation of existing facilities. The programme's anticipated PPP investments until 2008 have an estimated value of €715 million.

The Netherlands

A PPP Knowledge Centre was established within the Ministry of Finance in 1999 and is staffed by experts from commerce and industry as well as government civil servants. Its remit is to disseminate PPP experience, to design clear and effective rules for collaboration between the government agencies and the private sector, to suggest appropriate projects for PPPs and to produce regular reports and studies on the results of PPPs. As the agency responsible for infrastructure (the Rijkswaterstaat) and the Government Buildings Agency become increasingly familiar with PPP projects, it is likely that the PPP Knowledge Centre will focus on developing PPPs in other sectors such as education and healthcare.

PPP activity is increasing in the Netherlands with five PPP deals closed:³¹ two road projects, one rail, one waste water and one schools project. A number of large projects are in procurement such as the €190 million refurbishment of the Ministry of Finance building as well as the circa €1 billion second Coentunnel project. Furthermore, a number of other projects have been announced, in particular in the roads and central accommodation sectors. From January 2005, a PPP approach must be considered for transport infrastructure projects over €112.5 million. In April 2005, the Dutch Council of

²⁸ PPP for the Public Building Construction Sector in Germany, PricewaterhouseCoopers, August 2003

²⁹ Greece 2010 – Strategic Development Plan for Transport Infrastructure, May 2003, Greek Ministry of National Economy

³⁰ PricewaterhouseCoopers/Dealogic ProjectWare

³¹ PricewaterhouseCoopers/Dealogic ProjectWare

Ministers announced that a PPP approach must be considered for every national government accommodation project requiring an investment of more than €25m.

Poland

The Polish authorities have made limited use of PPPs. Their use has been restricted to the road and waste management sectors. For instance, phase 1 of the A1 motorway PPP project in Poland was signed in July 2005. The PPP has a 35-year term and is based predominantly on guaranteed availability payments from the Polish Roads Authority topped up by shadow toll revenue depending on traffic volume. Completion of phase 1 is scheduled for 2008 and a request for proposals for phase 2 – a 60 km extension to the city of Torun at the southern end of the motorway – was issued on the 8th July 2005. Discussions are also ongoing in the health and sports and leisure sectors. In particular, there is growing interest among hospitals and local authorities in the PPP model for the delivery of healthcare projects.

There is a perception in Poland that PPPs are, by their nature, complicated and expensive to procure. The relevant PPP departments within the Ministries of Infrastructure and Economy are preparing standardised tender documents, PSCs, guidelines, regulations to facilitate the purchase of land and other measures to help resolve this issue.

In August 2005, the Polish President signed an Act on PPP. The Act, which came into force on the 1st October 2005, eliminates double taxation and introduces more flexible regulations regarding public contracts so that long-term budgetary commitments can be made and state funds may be used in PPPs. Typical investments to be carried out under the PPP regulations would include construction of sewage systems and waste dumps.

Low Usage: Limited recourse to the PPP model but growing interest

Austria

As of October 2005, only the Electronic Toll Collection System PPP project had been signed in Austria. There are two road PPP deals in the pipeline. Bids for the €725 million Ostregion PPP roads programme were submitted in September 2005 and the Motorway and Highways Authority (Autobahnen- und Schnellstrassen

Finanzierungs-Aktiengesellschaft (ASFiNAG)) is expected to select a preferred bidder in 2006. Invitations to Tender were also issued in September 2005 to consortia bidding for the first A-model PPP road in Austria, the A8 from Bubesheim to Augsburg West in Bavaria. Discussions are ongoing in other sectors, for instance health, education and central accommodation.

Belgium

As of October 2005, only two PPP projects had reached financial close in the previous five years.³² The first transport PPPs are currently in procurement with one road, one rail and one regional airport project under discussion. Further road and rail projects have been announced but adoption of the PPP approach has been slow in the transport sector.

Bulgaria (Acceding Country)

In 2000 the Municipality of Sofia signed the first ever water and wastewater concession in CEE, involving \$150 million investment over a 25 year term. There has also been PPP activity in the transport sector in Bulgaria. In 2004, the Bulgarian Government closed a toll motorway PPP deal for one of the two major highways which cross the country from the West to the East. If this first project is a success and delivers the expected benefits, additional PPP projects are expected for other major roads.

An international operator has taken over the airports in the two largest towns on the Black Sea coast under a 35-year concession arrangement with an estimated value of €1.5 billion over the concession term. The Bulgarian Government is also considering concession arrangements for some smaller airports and for river and sea ports.

Czech Republic

To date, there has been no PPP activity in the Czech Republic. However, pilot projects are being tendered including the modernisation of the Prague Airport Link and a DBFO contract for accommodation and parking at Prague's Military Hospital. The Czech Government also announced their approval in August 2005 for four additional pilot PPP projects submitted by the Transport and Justice Ministries. The projects include a section of the D3 motorway from Tabor to Bosilec in southern Bohemia, the DBFO of new court buildings with an estimated total capital value of €27 million in Usti nad Labem and Karlovy Vary, northern Bohemia, and the DBFO contract for a €37 million maximum-security prison.

³² Source: PricewaterhouseCoopers

A PPP Centrum, reporting to the Czech Ministry of Finance, was established in July 2004 to speed up the necessary amendments to the legal framework and practical procedures relating to PPPs. The PPP Centrum currently acts as a knowledge centre to share best practice and experience with other public sector bodies, including central and regional authorities.

In August 2005 the Czech Government approved the PPP Concession Law which changed public procurement, public property and budgetary rules, allowing the pilot schemes to proceed in late 2005.

Denmark

There has been little PPP activity in Denmark to date. However, the Danish Government PPP Unit has been assessing the potential for using PPPs and some projects are in the pipeline. A preferred bidder was appointed in September 2005 to design, build, finance and maintain the new Vildbjerg School in the town of Trehøje, the first municipal-level school PPP project in Denmark. The National Archives central accommodation project will be put to tender in early 2006. Approval has been granted for a road PPP project involving the construction of a new motorway between Sønderborg and the E45 in the Danish county of South Jutland; a tender for the €135m road project is expected in 2006.

Estonia

The first PPP project in Estonia is expected to close in the near future in the housing sector. Some modest activity is seen elsewhere with at least one local municipality preparing a school PPP. A number of other municipal projects have followed models similar to PPPs, however, the partner was Government owned and there was no competitive tender process.

Discussions on the use of PPPs have been ongoing in the defence, light rail and schools sectors which have been led primarily by local rather than central government. However, adoption of the PPP model is likely to remain slow, particularly for transport infrastructure, because attention has been focused on the EU Cohesion Fund rather than the need to seek alternative financing structures. There has been no combination of EU Cohesion monies with private finance to date, but their potential use is under consideration for future projects.

Finland

There has been little recourse to PPPs in Finland. In the transport sector, only one road PPP project has closed with another – the E18 Muurla-Lugge PPP – in procurement and expected to close in late 2005. The Ministry of Transport has been the most active in developing PPP structures and once the value for money and efficiency aspects of the current PPP project have been assessed, there is potential for the PPP market to develop further. There is no dedicated PPP unit in Finland.

Latvia

PPPs have not yet been used in Latvia but discussions are ongoing in a number of sectors including roads, schools, health, accommodation, waste and water. The Latvian government is currently working on a roads financing model with a road project the most likely major PPP to enter into procurement in the near future. The Ministry of Economy is currently coordinating efforts to draft comprehensive legislation and undertake other initiatives to encourage more widespread use of PPPs. The Latvian Investment and Development Agency, which reports to the Ministry of Economy, is responsible for exploring PPP opportunities, providing information to municipalities and private investors and initial consulting on the evaluation of project ideas. The Agency has recently sponsored feasibility studies for five potential pilot PPP projects.

Lithuania

In May 2005 a PPP Unit was established within the Ministry of Finance. The PPP Unit is developing the PPP concept for the Lithuanian market and is expected to report to the Government by the end of 2005. Although set up within the Ministry of Finance, the PPP Unit will also manage and co-ordinate the PPP activities of other Ministries and municipalities.

The combined heat and power systems of several Lithuanian cities are operated by the private sector under concession-type agreements. There have been no true PPP-type projects but discussions or feasibility studies are ongoing with regard to heavy and light rail schemes, schools and health projects. The Ministry of Transport and Communications is examining whether part of the Rail Baltica project may be delivered using a PPP model. In addition, the Vilnius municipality is undertaking feasibility studies for the Vilnius tram system as well as the renovation of its schools and multi-treatment health centres.

Luxembourg

Except for an IT infrastructure project, there has been no PPP activity in Luxembourg. As Luxembourg generates budget surpluses, investments are still financed directly by the public sector. Therefore, it can be seen that where budgetary and fiscal pressures are absent, there is less of a political imperative to find alternatives to conventional procurement of capital assets.

Malta

There has been little PPP activity in Malta, except for PPP-type projects relating to road landscaping and lighting, homes for the elderly and a Public Registry search facility. However, there is growing interest in this method of procuring public services. Four projects were announced recently including the construction of schools, a regional sports complex and improved facilities at heritage sites. The feasibility of other projects in the health and roads sectors is also being considered. The establishment of a PPP Unit within the Finance Ministry in March 2005 will help create a central core of government expertise and assistance for other ministries.

Norway (non-EU)

PPP activity has been low. In recent years Vegvesen, the Norwegian roads directorate, has tendered out three pilot road PPP projects. Two of these, the E39 (Klett to Bardshaug) and E39 (Lyngdal to Flekkefjord) have already been awarded and the first PPP road, the €140 million E39 scheme, opened to traffic in September 2005 two months ahead of schedule. The third pilot, the €250 million E18 (Grimstad to Kristiansand), has three shortlisted consortia with a preferred bidder expected in 2005-2006.

A decision on the future use of PPPs in the road sector is expected once an evaluation of

the pilots' value for money has been undertaken. The evaluation of the first pilot found that there had been considerable efficiency gains, while there had been less conclusive evidence regarding value for money. A railway PPP project was cancelled prior to procurement due to a perceived lack of value for money.

The PPP model was being considered in other sectors, in particular defence support functions where ongoing overspends and inefficiencies need to be addressed. However, the key driver behind PPP development in the rest of Europe – budgetary and fiscal limitations – is absent in Norway and the election of a new Labour Party Government in September 2005 may impact on the future use of PPPs.

Romania (Acceding Country)

There has been little PPP activity in Romania to date although three motorway PPPs have been put to tender. The Romanian Government has also established the Central Unit for Coordination of the Public-Private Partnership Activities within the Managing Authority for Infrastructure (Ministry of Public Finance). This PPP Central Unit focuses on developing policy to promote and deliver PPP projects as well as sharing best practice and experience with central and local authorities.

Slovenia

There has been little PPP activity in Slovenia to date with one exception in the water sector as a €43 million water treatment plant has been built in the municipality of Maribor and is currently operating under a PPP arrangement.³³ The Government which took up office in October 2004 has shown an interest in developing PPPs in Slovenia. The Ministry of Finance organised a PPP conference in Ljubljana in April 2005 in conjunction with the British Embassy and International Financial

Box 12 Galileo – The first pan-European PPP

Following an initial study by PwC in 2001, the Galileo Joint Undertaking (“GJU”), which is a joint venture between the European Commission and the European Space Agency, undertook to procure this €3.6bn satellite navigation project as a PPP.

The successful consortium will be responsible not only for the design, procurement, launch and implementation of the satellite constellation as well as its mid-term renewal, but for its operation throughout the concession life and for the development of markets for Galileo

navigation applications in industry sectors such as:

- Aviation;
- Maritime;
- Road-tolling;
- Oil Exploration; and
- Personal Communications

It is proposed the winning consortium will be paid by way of an availability charge dependent on meeting pre-determined performance criteria and coupled with clear incentives on all parties to develop its market successfully.

Source: PricewaterhouseCoopers

³³ Source: PricewaterhouseCoopers

Services London. The Minister of Finance has also announced their commitment to establishing a PPP unit.

Other EU Member States

PPP activity has been limited elsewhere in Europe. In Cyprus, the first PPP contract was signed in July 2005 for the €500 million development and management of the international airports at Larnaka and Paphos. There are port and road PPP projects in the pipeline. In Sweden a light rail PPP closed in 1996 however there has been no subsequent PPP activity.

There have been no reported PPP projects in Slovakia. In August 2005, the Slovak Government gave its approval to proceed with a pilot road PPP project. The scheme consists of part of the D1 Motorway which by-passes the town of Zilina. A tender for the pilot scheme is expected in November 2005.

Turkey (non-EU)

A law adopted in 1994 allows private sector companies to engage in PPP projects across all sectors, including all the transport modes. To date, only airports have been subject to PPP-type arrangements. While the operating

rights of a number of ports have been transferred to the private sector, they are not classic PPP arrangements.

European Union

A key element of the EU's TEN-T initiative is the procurement of the GALILEO global satellite navigation system. Expected to become fully operational in 2009, this project represents a major breakthrough in demonstrating how the PPP approach can be applied, and can deliver results, beyond the building of traditional infrastructure.

Review of legislative and institutional position

With greater use of the PPP model, more and more countries are establishing dedicated PPP units and/or proposing specific legislative measures to assist PPP procurement.

The section below reviews the most recent developments across Europe, in particular, an updated Summary of PPP institutional and legislative development by country is shown in Figure 8.

Figure 8: Summary of PPP institutional development

	PPP Unit	PPP Law		PPP Unit	PPP Law
Member States			New Member States		
Austria	▲▲▲	-	Cyprus	▲▲	-
Belgium	▲	■ ■	Czech Republic	▲▲	■ ■
Denmark	▲▲	-	Estonia	-	■
Finland	-	■	Hungary	▲▲	■
France	▲▲	■ ■	Latvia	▲▲	■ ■
Germany	▲▲	-	Lithuania	▲▲	■
Greece	▲	■ ■	Malta	▲▲	-
Ireland	▲▲▲	■ ■ ■	Poland	▲▲	■ ■ ■
Italy	▲▲	■	Slovakia	-	-
Luxembourg	-	-	Slovenia	▲	■
Netherlands	▲▲▲	-	Acceding and Candidate Countries		
Norway (not EU)	▲	-	Bulgaria	▲	■
Portugal	▲▲	■ ■	Romania	▲▲	■ ■
Spain	-	■ ■ ■	Turkey	▲	■ ■ ■
Sweden	-	-			
UK	▲▲▲	-			

Key

- ▲ Need for PPP unit identified and some action taken (or only a regional PPP unit existing)
- ▲▲ PPP unit in progress (or existing but in a purely consultative capacity)
- ▲▲▲ PPP unit existing (actively involved in PPP promotion)
- Legislation being proposed
- ■ Comprehensive legislation being drafted / some sector specific legislation in place
- ■ ■ Comprehensive legislation in place

Source: PricewaterhouseCoopers October 2005

Legislation

The March 2005 ECOFIN Council Conclusions on national contributions to the European Initiative for Growth noted that many countries had made efforts to develop the mobilisation of private resources in infrastructure financing, notably through improving the framework conditions for PPPs.³⁴

The lack of a uniform PPP definition creates a challenge in developing PPP legislation, as a number of Member States are discovering. If a narrow definition is taken, this can result in legislation which only applies to a restricted range of project types or structures, which may be of limited practical value.

A number of governments across Europe have adopted PPP-related legislation including:

- The 2004 PPP “Ordonnance” created a new form of contractual relationship (“Contrat de Partenariat”) between the public and private sectors in France. This allows for the classic DBFO project finance model with a private party or consortium, under which the contractor will be paid over time by the contracting public body. The contract legislation is also designed to improve security for those lenders with ownership rights over the assets involved.
- In September 2005, the Greek Parliament voted to adopt a PPP Bill governing projects or services to be delivered using a PPP. The law establishes a Special Secretariat for PPPs and defines parameters for a number of PPP-related issues, including tendering and negotiation procedures, tax, financial and accounting issues, securitisation issues, arbitration proceedings. The law will apply to projects up to a value of €200 million.
- In August 2005, the Polish President signed a PPP Act, which eliminates double taxation and introduces more flexible regulations regarding public contracts. The new law removes restrictions on long-term budgetary commitments and on the use of state funds in PPPs. The new law should allow for the growth of PPPs in Poland.

- The Ministry of Finance in Portugal, together with the relevant Minister in charge of the project, has responsibility for controlling and supervising PPPs under a PPP Law enacted in April 2003. The Law also led to the adoption of Public Sector Comparator and Value for Money concepts and imposes specific requirements to ensure that PPP-based projects are approved only if they involve a significant and effective transfer of risk. The law is intended to complement existing sector legislation and applies to all central and regional government projects.
- New concessions legislation was introduced in Spain in 2003, updating the former legal framework and allowing for the delivery of a broader type of public infrastructure service through PPPs.
- The Merloni Law (Law 109/1994) provides the general regulatory framework for the procurement of public works in Italy. It's reform in 2002 and the enactment of the Legge Obiettivo (Law 443/2001), setting out the process for the development of key infrastructure projects, prompted further PPP development.

Imminent legislation:

- In December 2004, a law governing PPP contracts and concessions was passed in Romania (Law no. 528/2004) modifying existing government ordinances. Under the terms of this law, the Ministry of Public Finance assumed responsibility for elaborating secondary legislation for the PPP law. The Romanian authorities discussed the draft secondary legislation with the European Commission in October 2005. A comprehensive procurement Act is expected to enter into force in early 2006.

Legal impediments to PPPs are considered further in [Section 4](#).

³⁴ 7148/05 Note from the Council of the European Union to the European Council, 8 March 2005

Institutional Support for PPPs is growing within European Governments

While there is no central PPP unit at the EU-level, more and more Member State governments are establishing PPP units centrally or within individual ministries. Across Europe, it can be seen that the Ministries of Finance (or equivalent) are pivotal to the use of PPPs.

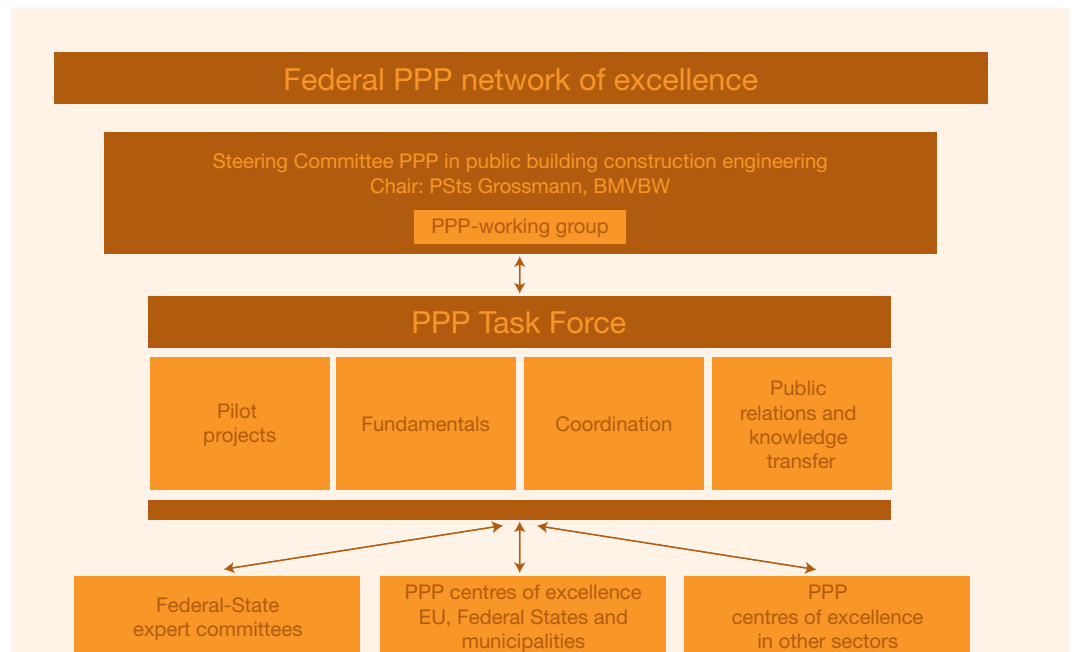
Developments in this area include:

- A Federal PPP Competence Centre opened within the German Transport, Construction and Housing Ministry (Bundesministerium für Verkehr, Bauen und Wohnen) in July 2004 and there are six Task Forces/Competence Centres or PPP Working Groups at the

regional state – Land-level. The structure is summarised in Figure 9.

- A PPP Centrum, reporting to the Czech Ministry of Finance, was established in July 2004 to assist with updating the legal framework and practical procedures relating to PPPs. The PPP Centrum currently acts as a knowledge centre to share best practice and experience with other public sector bodies, including central and regional authorities.
- The French Finance Minister recently announced the creation of a PPP Unit. The committee will consist of several ministers, or their representatives, from a range of sectors including finance, transport, health, home affairs and defence. Organisations affected by the Contrats de Partenariat (see above) will also be represented.

Figure 9: German PPP Task Force



The Federal PPP Task Force was established within the German Transport, Construction and Housing Ministry (Bundesministerium für Verkehr, Bauen und Wohnen) in July 2004. It is responsible for supporting pilot projects, coordinating work and performing public relations and knowledge transfer activities at the federal-level.

PPP projects are selected following expert recommendations and in agreement with the Steering Committee on the basis of a checklist and set criteria. The Steering Committee, established in 2002 is formed of representatives from the Federal

Government, Federal States and municipalities and from the construction and banking sectors. The Committee, under the Chairmanship of the Parliamentary State Secretary of the Federal Transport, Construction and Housing Ministry, aims to promote improvements in the overall PPP environment and the creation of a network of expertise.

The centres of excellence in the Federal states are actively promoting PPPs. Federal States are primarily involved in prison and administrative accommodation projects.

Source: Bundesministerium für Verkehr, Bau- und Wohnungswesen

- A PPP unit established in the Hungarian Ministry of Economics and Transport acts as a central knowledge centre for all other ministries. The unit also has the function of analysing and commenting on the PPP proposals of the other ministries before they are submitted for central approval. The future role may change following a recent change in Minister and Secretary of State. The Ministry of Finance is also becoming more active in the PPP area.
- A Central PPP Unit has been established in the Irish Department of Finance. Its principal role is to provide guidance on best practice in the appraisal and procurement of PPP projects with a particular focus on establishing and providing value for money. The Irish Government has also established the National Development Finance Agency to advise public sector bodies on the financing of all capital projects, including PPPs, and where appropriate, to provide financing.
- A PPP taskforce was established in the Treasury Department of the Italian Ministry of Economy and Finance in 2000. It is responsible for providing PPP-related expertise and assistance to public administrations.
- The Latvian Investment and Development Agency, which reports to the Ministry of Economy, is responsible for exploring PPP opportunities, providing information to municipalities and private investors and initial consulting on the evaluation of project ideas.
- While there is no PPP institution in Poland, PPP units have been established in the Ministries of Infrastructure and Economy as well as the General Directorate for Roads and Motorways.
- In Portugal, Párpública, a public company responsible for State participation in private entities, has recently assumed a PPP consultancy role for central and regional government.
- The PPP unit within the UK Treasury is well-established, providing detailed guidance and support to other Government departments procuring services using the PPP model. Partnerships UK (PUK) was formed in 2000 as a public private partnership, with a majority stake held by the private sector. PUK offers a mix of public and private sector commercial expertise to help public bodies deliver PPP solutions and major infrastructure programmes.
- In Turkey, a number of Government ministries and authorities may become involved in the PPP process. The 1994 PPP law sets out that the procedures governing

the model, the specifications required from the undertaking companies, scope of contracts, pricing and other related issues will be prepared with the cooperation of the Ministries of Finance, Construction and Infrastructure, Energy and Natural Resources as well as the State Planning Organization, State Treasury and State Office of International Trade. The approval of the Council of Ministers will then be sought. State-owned enterprises seeking investments and services through a PPP must apply to the Higher Board of Planning.

A review of EU involvement and support for PPPs

The EU's support for PPPs manifests itself across a number of EU bodies and initiatives. This section lists them here so that it is clear what activity is being undertaken at the EU level. However at this stage, there is a lack of clarity as to the degree of coordination between institutional developments, EU bodies and initiatives and whether this should and could be improved through some form of coordinating body. The issue of establishing an EU PPP Knowledge Unit is addressed further in [Section 4](#).

Role of EU bodies

Different sections of the EU institutions have played a role in the development, promotion and implementation of PPPs to date. These mainly comprise various Directorates-General (DGs) of the European Commission, the European Investment Bank (EIB) and ad hoc organisations or committees which have studied and reported on aspects of PPPs.

The Commission DGs with particular roles in regard to PPPs include:

- **Internal Market** – DG Internal Market is responsible for both the wider public procurement laws of the EU, which impact on how PPPs can be developed and procured, and issued the Green Paper on PPPs reviewed below.
- **Transport and Energy** – DG TREN has responsibility for the TENs programme. This has been the most active area considering PPP within an EU context. Since 2004, DG TREN has operated an informal PPP Exchange Group which brings together officials from other DGs, the EIB and PPP units or centres of excellence from

a number of Member States. The Group has been discussing particular issues on how to use PPPs to promote European transport infrastructure in general and TEN-T projects in particular. DG TREN is also the sponsoring DG for the Commission's own substantial PPP project, the Galileo satellite navigation project.

- **Regional Policy** – DG REGIO is responsible for the operation of the Structural and Cohesion Funds of the EU. There has been considerable interest in how PPP structures and approaches can be used alongside EU regional funding arrangements to further the development of European infrastructure and services. In March 2003, DG REGIO published its Guidelines for Successful Public-Private Partnerships³⁵ followed by its Resource Book on PPP Case Studies in June 2004.³⁶ The 2003 Guidelines did not attempt to provide a complete methodology or to define policy but rather to guide practitioners through a set of key issues affecting the development of successful PPP schemes. The Guidelines focused on four key topics:
 - ensuring open market access and fair competition;
 - protecting the public interest and maximising value added to citizens;
 - defining the optimal level of grant financing both to realise a viable and sustainable project but also to avoid any opportunity for windfall profits (or losses) from grants;
 - assessing the most effective type of PPP for a given project with the appropriate parameters: balanced distribution of risks, appropriate duration, clarity of responsibilities within the various regulatory environments.

The Resource Book aimed to highlight the key lessons learnt by member countries.

There are relatively few examples of projects where EU and private funding has been combined. This area is considered in greater detail below (see Use of EU funds in PPPs).

- **Economic and Financial Affairs**
DG ECFIN is responsible for ensuring the smooth functioning of the Economic and Monetary Union, including the monitoring of public finances and economic performance. As such, DG ECFIN monitors Member States' compliance with the provisions of the Stability and Growth Pact. The Director-General of DG ECFIN is a member of the Board of Directors of the EIB, representing the Commission.

The European Investment Bank³⁷

The EIB is the only EU institution which has substantial practical experience of PPP projects and their procurement. The EIB has played a major role in the development of the European infrastructure and PPP financing markets and has contributed towards developing good industry practice.

The European Council in October 2003 invited the Commission and the EIB to explore how best to mobilise public and private sector financing support of the Growth Initiative and to give further consideration as to how to assist the development of PPPs. The EIB's proposals focused on the provision of substantial additional resources, in particular for the TENs, while respecting the EIB's underlying principles. The EIB's principle of providing complementarity with other funders (both commercial banks and the capital markets) is maintained in PPP structures. Many EIB loans to PPP projects are either bank guaranteed or monoline insured either to maturity, or with release once the project has a proven operating record. However, the EIB is also able to lend to PPP projects without third party credit enhancements, where the project is important in the context of its overall policy objectives.

Eligibility for EIB funding is based on the underlying project contributing to one or more of the EIB's objectives, not the fact that it is a PPP. The PPP structure has proved an acceptable one for the EIB to support and as Appendix A shows, the EIB has been a major provider of debt finance to European PPP projects for many years. By mid-June 2005, the EIB had signed loans to the value of €19.5 billion for PPP operations.

The EIB is now lending to PPP projects in Austria, Belgium, Denmark, France, Greece, Germany, Ireland, Italy, Netherlands, Poland, Portugal, Spain, and the UK as well as in non-Member States, e.g. China and South Africa. Most projects are in the transport sector.

The EIB has increasingly been involved in assisting the Commission with a number of developments and initiatives such as the European Guarantee Instrument (see below). It was represented on the Task Force looking at the accounting treatment for PPPs and is represented on the Informal PPP Exchange Group for TENs (see DG TREN above). The EIB is also used by the EU to provide expert advice regarding individual projects, such as the renegotiation of grant applications where PPPs are involved. However, the EIB's function is to act as the lending bank for the EU and its role is not in itself to develop policy.

³⁵ Guidelines for Successful Public – Private Partnerships, DG REGIO, March 2003. Available on the European Commission website at http://europa.eu.int/comm/regional_policy/sources/docgener/guides/ppp_en.pdf

³⁶ Resource Book on PPP Case Studies, DG REGIO, June 2004. Available on the European Commission website at http://europa.eu.int/comm/regional_policy/sources/docgener/guides/pppresourcebook.pdf

³⁷ EIB overview informed by The EIB's Role in Public-Private Partnerships (PPPs) paper published by the EIB, July 2004. Available at <http://www.eib.org/publications/publication.asp?publ=189>

Eurostat

Eurostat is the statistical authority of the EU and is the institution responsible, amongst other things, for the European System of Accounts (ESA95). An important part of Eurostat's mission is to ensure consistency of government statistics in all Member States ensuring that deficit and debt figures are fully comparable between them.

Eurostat sets the rules which EU Member State Governments have to follow in their preparation and submission of economic and financial statistics to the EU. These apply to all Member States and are also relevant to prospective Member States. Within the PPP arena, the balance sheet treatment of PPPs has been a particular area of concern.

Further information on the accounting treatment for PPPs is included in [Section 4](#).

EU-level Working Groups and Recent Initiatives

The most recent EU-level initiatives and working groups include:

- In March 2005, the European Commission announced that the EU could guarantee part of the debt of priority cross-border transport infrastructure projects to stimulate private

investment in TEN projects. The guarantee would have a budget of €1 billion, which the Commission consider enough to cover over €20 billion of debt. According to the Commission, the loan guarantee would apply in particular to the private sector through PPPs such as the Lyon-Turin link or the Berlin to Verona High-Speed-Link.

- A draft report by the Dutch Ministry of Finance in December 2004 identified certain aspects of TEN-T funding from the EU that made it difficult to adopt a PPP approach in the delivery of projects.³⁸ In particular, the report recommended that the Commission should look at TEN-T finance and in particular the incompatibility of the large upfront capital grant payments available and the need for availability payments over the longer-term under PPP arrangements. In March 2005, the Commission set up a joint Commission – Member State working group to examine in more detail the TEN-T and other EU grants available for transport infrastructure investment. The working group, a subset of the Informal PPP Exchange Group above, comprise representatives from six Member States (the UK, Netherlands, Hungary, Italy, Poland and Portugal), the Commission (DGs TREN, ECFIN and REGIO) and the EIB. This group intends to propose (among others) amendments to the most relevant financial

Box 13

Athens International Airport – Combining EU funds with private finance

This €2.6 billion project involved the development of the new Athens International Airport at Spata and provides an example where private sector funds have been used with EU grants to deliver infrastructure investment in Cohesion countries.

The Greek Authorities and the European Commission had agreed within the framework of the Community Support Framework 1994 - 1999 (CSF II) to maximise private sector partnerships in the development of transport-related infrastructure. The new Athens International Airport project consisted of a 30-year BOOT concession which received EU grants amounting to approximately €250 million or 11% of the project cost. An EIB loan of €997 million supported approximately 45% of the initial project cost.

The Hellenic Republic and a private consortium created a private company, Athens International Airport SA, to own and

operate the airport for a period of 30 years. A grant from the Hellenic Republic amounted to €150 million and share capital amounted to €134 million, additional project financing came from commercial loans. A consortium led by Hochtief and also comprising ABB and TKT Krantz GmbH, undertook the construction project. Subcontractors, of which 80% were Greek companies, carried out 70% of the construction work.

Work included the construction of a runway and taxiway systems for handling up to 65 aircraft movements per hour. The airport has an existing capacity for 16 million passengers and 220,000 tonnes of cargo a year, increasing to 50 million passengers a year after development. Construction was completed in September 2000 after 51 months and after 5 months of testing, the airport opened to the public on 28 March 2001.

Source: PricewaterhouseCoopers

³⁸ *The impact of TENs co-financing and subsidy conditions on projects, and proposals for reform, Dutch Ministry of Finance, December 2004*

TENs regulations to increase grant timing flexibility and to better combine grants and private finance.

- Following a ministerial seminar on *Wider Europe for Transport* in Santiago de Compostela on 7-8 June 2004,³⁹ a high level group has been established to look into the extension of the major trans-European transport axes to neighbouring countries and regions. The ministerial seminar noted that while there are serious difficulties in funding transport investments and reliance on national budgets prevails, innovative funding solutions, such as user charges and PPPs, have to be examined.
- The European Conference of Ministers of Transport (ECMT) is based in Paris, co-located with the OECD. The OECD/ECMT Joint Transport Research Centre (JTRC) is undertaking a working group research project on Transport Infrastructure Investment: Funding Future Needs, focusing on innovative funding mechanisms, including PPPs, and aiming to identify the most appropriate project design, tendering and contractual processes and regulatory frameworks for using such mechanisms. Moreover, the ECMT's Group on Financial and Fiscal Aspects of Transport completed a consultancy project on PPPs and pricing of infrastructure use in early 2005.⁴⁰
- In March 2005, the EIB and Partnerships UK held a conference in London involving the PPP/Private Finance Units from across the EU to discuss PPP issues and exchange knowledge and experience.

Further details on the EUs involvement in PPPs can be found in Section 2 of the PwC paper *Developing PPPs in New Europe*.⁴¹

Use of EU funds in PPPs

There are a number of EU grant schemes which provide funding for delivering the TEN-T priority projects as well as for regional development and for strengthening economic and social cohesion. The most relevant to the provision of infrastructure and government services are: the TEN-T grants, the Structural Funds and the Cohesion Fund for Member States, and PHARE and ISPA for Accession and Candidate Countries.

Projects eligible for EU funding require co-financing and in the past, the Member State governments have provided most co-finance. However, the concept of using private finance is gaining ground and according to European Commission data, 23 PPP projects have been

co-financed by the Cohesion Fund, Structural Funds or IPSA. See Appendix C. Further details on the EU funds available and their use in PPPs can be found in Section 3 of the PwC paper *Developing PPPs in New Europe*.⁴²

Green Paper on PPPs and Community Law on Public Contracts and Concessions presented by the European Commission, April 2004

The Commission presented a Green Paper on PPPs and Community Law on Public Contracts and Concessions in April 2004.⁴³ The Green Paper recognised that recourse to PPP arrangements to deliver infrastructure projects had developed during the last decade at Member State level and that greater use of PPP structures could help bridge the investment gap in relation to the planned trans-European transport networks. The aim of the Green paper was to launch a public debate on whether current rules should be improved and whether EU-level intervention was needed to give economic operators across Europe improved access to the available opportunities of PPP under conditions of legal certainty and real competition.

The Green Paper focused primarily on the procurement aspects of PPPs, considering the extent to which Community rules apply when the private partner is selected and then for the duration of the contract, with a view to identifying uncertainties. It also proposed a wide set of instruments and tools available to improve the Community framework surrounding PPPs, such as interpretative communications and exchange of best practice. When considering these issues, the Paper distinguished between PPPs based on purely contractual links and arrangements of an institutional nature, involving the joint cooperation between parties in a distinct mixed-capital legal entity.

In addition to calling for practical experience of different aspects of PPPs and procurement, the Commission requested comments on a number of points, including:

- To what extent do parties agree that there is a procurement process well-suited to PPPs, for example is the competitive dialogue procedure⁴⁴ well adapted to the award of public contracts in the context of a purely contractual PPP.
- Whether the Commission should propose new legislation to cover all contractual PPPs to harmonise award arrangements of contracts and concessions.

³⁹ *Conclusions of the June 2004 seminar on "Wider Europe for Transport"* available at http://europa.eu.int/comm/ten/transport/2005_03_31_tent_consultation/doc/conclusions_santiago_de_compostela_en.pdf

⁴⁰ *Report on the Pricing of Talled Highways in Europe, Group on Fiscal and Financial Aspects of Transport, European Conference of Ministers of Transport, February 2005, CEMT/CS/FIFA (2005) 2*

⁴¹ *Developing Public Private Partnerships in New Europe, May 2004. Available on the PwC website at <http://www.pwc.com/extweb/service.nsf/docid/A2F9309C016FAADD80256EA6004F516C>*

⁴² *Developing Public Private Partnerships in New Europe, May 2004. Available on the PwC website at <http://www.pwc.com/extweb/service.nsf/docid/A2F9309C016FAADD80256EA6004F516C>*

⁴³ *Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions, COM (2004) 327 final*

⁴⁴ *Article 29 of Directive 2004/18/EC added the competitive dialogue procedure to the public procurement routes available*

- Whether PPPs set up on the initiative of the private sector are open and fair for other non-national operators and how this type of PPP could be developed further.
- Whether execution or tender evaluation practices have had a discriminatory effect on parties.
- To what extent do parties agree that certain “step-in” arrangements – where financial institutions reserve the right to replace the project manager, or to appoint a new manager, if the financial flows generated by the project fall below a certain level – may reduce transparency and equality of treatment.
- Whether aspects of the contractual framework of PPPs required additional clarification at the EU level.
- Whether more detailed rules were required on subcontracting.
- Whether the Commission should establish a network to share knowledge and experience of PPPs in different member countries and to exchange best practice.

Report on the public consultation on the Green Paper on PPPs, May 2005

In May 2005, the Commission published a report⁴⁵ on the responses to the above Green Paper with individual contributions (sent electronically and with no objection) being published in full on the Internet.⁴⁶

The Commission received some 195 replies to the 22 questions listed in the Green Paper. Responses were received from across the EU, with the exception of Cyprus, Estonia, Greece, Hungary, Latvia, Luxembourg, Malta and Slovenia. There was a high level of interest from Austria, France, Germany, Italy and the UK.

The consultation report highlighted general trends in opinion, including:

- A large majority of respondents highlighted the practical problems of applying the competitive dialogue procedure and expressed concerns that it would increase bidding costs.
- There is little appetite for more EU legislation to regulate PPPs.

Box 14 Responses to the Green Paper on PPPs

Legislation

“We are much in favour of specific legislation that would cover all contractual PPPs, including concessions. This is mostly due to the fact that we believe that there is a need for stable, homogeneous legal environment within the European Union. In our opinion, this would help reducing project cost as an effect of decreased legal risks and by attracting more bidders. The differences in procedures for the award of concessions and PPPs in general among the EU countries do not guarantee genuine competition.”

Republic of Poland, The Ministry of Infrastructure, Department for Infrastructure, Financing and European Funds, PPP Division

“The flexibility that drives innovation afforded at present would be hindered if all contractual PPPs were subject to identical award rules. The need for distinction between contracts and concession contracts is essential”

UK Government

“We advocate that no EU directive should be designed for PPPs at the present time.”

Portuguese Foreign Office, Directorate-General of European Affairs

“Since PPPs are hard to be defined and vary greatly across Europe, a purely legislative approach from the Commission is not sufficient. The Forum suggests a provision of EU guidelines to the Member States on PPPs since there are significant levels of uncertainty on how EU legislation applies to PPP. This uncertainty adds to the overall financial risks of undertaking such projects. The risks apply to both the public and private sectors, and inevitably result in higher costs.”

European Energy and Transport Forum

“We believe that unless the EU is able to adequately define PPPs, and to achieve a broad consensus in the market that this definition is appropriate, it would not be right for the Commission to proceed with a legislative approach.”

Response to the Green Paper from PricewaterhouseCoopers

⁴⁵ Report on the Public Consultation on the Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions, SEC (2005) 629

⁴⁶ Responses available at http://www.europa.eu.int/comm/inter_na_l_market/publicprocurement/ppp_en.htm#consultation

“The Federal Government does not believe that additional legislation is necessary. This applies not only to service concessions but also to contractual PPPs. It would be very difficult to implement a legislative framework at the Community level as there is no firm PPP definition and PPPs take very different forms.”

Federal Government of Germany

Competitive Dialogue

“In our opinion, competitive dialogue is an extremely useful tool that will allow output-based procurement, thus improving value for money offered by PPPs. However, we also think that the procurement procedure itself will become much longer and therefore more expensive. It will also require more supervision to ensure the equality of treatment of the bidders.”

Republic of Poland, The Ministry of Infrastructure, Department for Infrastructure, Financing and European Funds, PPP Division

“The current European legislation offers, in the opinion of the Dutch government, enough opportunities to realise a PPP. The Dutch government holds the opinion that the competitive dialogue will result in a positive contribution to the realisation of a PPP.”

Observations by the Dutch Government (English summary version)

“Our belief is that competitive dialogue is not particularly well adapted to the procurement of PPPs. While there may be some instances in which it is appropriate, in many cases the use of competitive dialogue would not satisfy the needs of the public procurement authority to undertake an efficient and effective procurement.”

Response to the Green Paper from PricewaterhouseCoopers

“It is the French Government’s opinion that the competitive dialogue procedure should only be used for its intended purpose, i.e. when the public authority considers that a competition between private sector partners is needed to define the appropriate solutions for its requirements. On the other hand, the negotiated procedure should continue to be the rule for concessions, where discussions on the contract terms are more important than defining solutions to be implemented, given that in most cases the public sector body is able to define how its requirements should be met.”

French Government

Barriers

“We have not identified specific measures or practices that act as barriers to the introduction of PPPs at the European level. The complexity of PPPs as a means of procurement does, of course, present a series of challenges in terms of the skills and knowledge of the public sector, the interaction of various public policies, and the capacity of the private sector.”

Observations by the Central PPP Unit, Department of Finance of Ireland

PPP Knowledge Centre

“Sharing of knowledge and experience of successful structures between different national circumstances would be a positive step in furthering development of PPPs in different member states.”

UK Government

“We would sincerely welcome the establishment of an EU PPP Observatory, with a small information office (for collecting and diffusing information on PPPs) and a network of research institutes, PPP units and PPP partners.”

Portuguese Foreign Office, Directorate-General of European Affairs

- There is strong support for establishing a European PPP agency, a centre of knowledge / resources and documentation centre or an observatory.
- Many stakeholders considered that the rules of the EU’s requirement for co-financing under EC regional policy impede PPP development.
- There is little support for EU-level initiatives on the contractual framework for PPPs and in the area of sub-contracting.
- Lender step-in rights are considered essential to raising debt and not seen as a barrier to open and fair competition.

While these were the general trends, there were a range of opinions expressed as demonstrated in the selection of views quoted in [Box 14](#).

The Commission issued a Prior Information Notice (PIN) in March 2005 for advisors to complete a study on some aspects of the Green Paper. The start of the contract award procedure was scheduled to start at the end of October 2005. The Commission envisages adopting a Communication before the end of 2005 as a follow-up to the Green Paper and responses.

Review of activity in key PPP markets outside Europe

The need for sustained infrastructure investment is also keenly felt outside Europe. Budgets are constrained and governments are under pressure to achieve improved value for money and efficiency when delivering public capital assets and services. Interest in the potential for private sector involvement in infrastructure provision is growing at all levels of government – national, state/provincial and local – responsible for public service delivery.

As in Europe, many countries initially develop PPPs in the transport sector. The health and education sectors follow closely, seeking to take advantage of private sector finance and skills to deliver much-needed social infrastructure.

As noted above, around 206 PPP deals worth approximately US\$52 billion/€42 billion were closed in the world in 2004 and 2005, of which 54 were outside Europe with an estimated value US\$26 billion/€21 billion.⁴⁷ So it can be seen that while the non-European markets closed significantly fewer projects, the level of investment to be delivered via PPP structures is similar to Europe.

As Figure 10 shows, the most active PPP markets have been Australia, Canada and Japan, in particular in the roads, health, education and water and wastewater sectors.

This section summarises PPP activity in key markets outside Europe (in alphabetical order).

Australia

PPPs in Australia have been used to deliver economic infrastructure such as toll-roads, with the private sector taking full market risk, and social infrastructure such as hospitals, prisons and schools, which are based principally on payments for availability and Key Performance Indicators. The largest toll-road has been the AU\$2.5 billion Mitcham to Frankston scheme, known as EastLink, which includes the building of around 40km of motorway in Melbourne. Others during 2004-2005 include the AU\$1.5 billion Western Sydney Orbital, the AU\$640 million Cross City Tunnel and the AU\$800 million Lane Cove Tunnel, both in Sydney. The flagship social infrastructure schemes have been the A\$250m Brisbane Southbank Education and Training Precinct and the \$A350m Victoria's Royal Women's Hospital PPP deals, closed in June 2005. As in the UK, a number of PPPs are operational, for instance the Victoria County Court, Casey Hospital and NSW Schools.

Figure 10: Summary of PPPs by country and sector

Country	Central Accommodation	Airports	Defence	Housing	Health & Hospitals	IT	Ports	Prisons	Heavy Railway	Light Railway	Roads	Schools	Sports & Leisure	Water & Wastewater (incl solid waste)
Australia	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Canada	●				●			○		●	●	●	●	●
Japan	●	●	○	●	●	○	●	○	○	○	○	●	●	●
Mexico		●			●			○		●	●	●		○
Singapore	○		●		○						○	●	●	●
South Africa	●	○			●	○		●	●		●	○	●	○
United States		○	○	○	○		○	●	○	●	●	○	○	●

Legend

- Discussions ongoing
- ◐ Projects in procurement
- ◑ Many procured projects, some projects closed
- ◒ Substantial number of closed projects
- Substantial number of closed projects, majority of them in operation

Source: PricewaterhouseCoopers October 2005

⁴⁷ Source: Dealogic ProjectWare

Full adoption of the PPP model varies considerably across jurisdictions. Victoria and New South Wales (NSW) are at the forefront. Queensland, Western Australia and the Northern Territories have each completed one PPP. The Federal Government and other jurisdictions all have PPP policies in place but as yet have not completed a project. However, the Prime Minister, John Howard, recently announced that all major federal projects will be considered for private sector involvement so there should be additional PPP opportunities and a clearer focus in the future.

In all jurisdictions except for the Commonwealth and Queensland governments, the state's Treasury manages PPP policy and guidance and has some oversight of projects. The Department of Finance and Administration controls the policy for the Federal Government and the Director General's Office for Queensland. There are no general laws governing PPP procurement. Policies and guidelines have been developed by state governments – broadly based on Partnerships Victoria's PPP policy and guidelines, although there are material variations between the states on matters such as fair value compensation on termination, change in law and change of control provisions. Two of the standard market criticisms are that policy needs to be implemented more consistently to reduce bid costs, and that most of the states, with the exception of Victoria where the Premier and the Treasurer have both been vocal in support of well structured PPPs, would benefit from more determined political leadership and advocacy. The National Council for PPPs, a forum for coordination between Federal and state ministers and officials, was set up in mid 2004 as part of the move towards a more consistent approach across the country.

Financial structures largely follow international models, but beneath this familiar pattern are uniquely Australian features. In particular, Australia is the home of the so-called ABN model, which for a period in 2001-2003 saw most deals won by investment bank led consortia who took most or all of the equity, specified the terms on which subcontractors would participate and underwrote the debt; and bond finance rather than bank funded most of the early deals.

Overall the market is at an interesting stage. 2004 and 2005 have seen the closure of enough deal and the creation of enough deal flow to give Australia critical mass to match its financial sophistication. But there are some underlying instabilities in the market. 2006-2007 will show whether this becomes the second most important market in the world or whether that honour goes to the US or Eurozone.

Canada

After a lengthy development process, the PPP model is gaining ground in Canada. The provinces of Alberta, Ontario and British Columbia have been the most active supporters of the PPP framework while interest in Quebec is also growing.

British Columbia has seen the most activity having successfully closed eight transactions since mid-2004,⁴⁸ including the Richmond Airport Vancouver Rapid Transit and the Sea to Sky Highway. Activity has been driven by the need to expand social infrastructure within budget constraints. In June 2002, the province established Partnerships British Columbia (PBC), created to provide "public agencies with expert advice and support to explore and, where supported by a sound business case, to implement P3s (PPPs) and other innovative approaches to provide public infrastructure and services".⁴⁹

In Ontario, like in British Columbia, interest has been driven by provincial budget constraints and growing social and economic infrastructure needs. The State is establishing the Ontario Infrastructure Projects Corporation which will provide public sector transaction guidance for projects approved under the province's Alternative Financing and Procurement (AFP) approach. The AFP model covers a broad spectrum of procurement approaches, including a re-branding of PPPs, but also some elements of more traditional procurement methods. According to a recent report by Standard & Poor's, about C\$2.3 billion of a C\$30 billion 5-year infrastructure spending programme will be undertaken under Ontario's AFP approach.⁵⁰

There has been little PPP activity in Alberta, with only the Edmonton Ring Road and Calgary Court House procured using the model. Future activity is likely to centre on education and transport infrastructure.

Although no PPP projects have closed in Quebec to date, the PPP model has become more established in the past few years. The PPP unit – Agence des partenariats public-privé – was established in December 2004 to advise the provincial government on PPP issues, in particular with respect to procurement and contracting. Three accommodation/real estate projects are in procurement including the construction of a new concert hall for the Montreal Symphony Orchestra and the replacement of the Montreal Olympic Stadium roof. And two major road/bridge projects in the Montreal region will be put to tender shortly (A-25, A-30).

⁴⁸ *Canadian Public-Private Partnership financing gaining traction despite labor opposition, Standards & Poor's, October 2005*

⁴⁹ *Partnerships British Columbia 2002 – 2003 Annual Report*

To date, Canada can be seen as two distinct markets, east and west. In Western Canada (dominated by BC) the market has been developing with nine deals closed in the last 18 months. However, each transaction seems to follow a unique procurement process with limited use of precedent or convergence of terms. Eastern Canada in contrast has seen limited political support, although the establishment of PPP agencies in both Ontario and Quebec may kick start the market. The challenge over the next year or two from a government perspective will be for the Provinces to maintain the level of political support for PPP in light of an improving fiscal position, and to achieve critical mass by harmonising procurement processes, maintaining deal flow and improving the consistency of terms.

Japan

There has been significant PPP activity in Japan across a number of sectors, including central accommodation, education, health, water and waste management and recreational facilities. The first prison deal is currently in procurement and there is a strong deal flow in other sectors. For instance airports there are three separate PFI projects at the new Haneda International Airport currently being put to market: the passenger terminal, cargo terminal and apron. The passenger terminal project will be close to \$1 billion in value.

While Japan's budget deficit was the initial driver for activity, the PPP market is expected to grow as more public authorities seek to take advantage of the substantial value for money benefits generated by PPP projects. A PPP Promotion Law was passed in 1999 and facilitated the adoption of the PPP approach. A PPP Unit sits within the Japanese Cabinet Office and is responsible for promoting PPPs.

There are principally three models for projects: free-standing, joint-venture, and service-provision structure, where the public sector pays for the asset and service with a classic performance related payment stream. The last category dominates the market. A unique feature of the Japanese PFI is that the ownership of the asset tends to be transferred to the public sector at completion. This is called BTO, and represents more than half of the Japanese PFI deals to date, primarily because BTO offers better VFM given that public sector is free from taxes whereas under PFI the awarding authorities need to pay for the taxes which will be levied to the private sector.

The financial structure is similar to UK models. In the service-provision PFI projects, the gearing is about 90/10 or 95/5. In free-standing PFI projects, the gearing is around 70/30 to 80/20, depending on the demand risk. Target equity returns are low by international standards. To date, debt has been provided in the form of senior loans and subordinated loans. The major players of the senior debt market are Japanese and foreign banks, leasing companies and insurers.

Mexico

Mexico has experience of the public and private sectors working together under concession agreements in the airport, rail and water/wastewater sectors and in arrangements closer to the PFI/PPP model in the health, prisons, education and roads sectors.

PFI activity started formally in 2004 when four pilot projects were developed: two roads, one hospital and one university. The US\$70 million Irapuato-La Piedad road, funded mainly by availability-based payments, reached financial close in 2005. Four road concessions with an estimated value of US\$497 million were granted recently and a US\$600 million light rail concession was granted in Mexico City in August 2005. In October 2005, there were four PFI road projects in procurement.

There are additional projects in the pipeline in the health and education sectors and the opportunities to use PPPs in the prisons sector are being assessed.

At the federal level, regulations describing the PPP procurement process have been issued and some states have passed PPP laws or adapted existing legislation. While the President's Office and the Ministry of Finance actively promote PPPs in Mexico, the Ministries of Finance and Public Works approve projects.

Singapore

Singapore is a small island state with excellent infrastructure – the recent introduction of PPP into government procurement is focused on the need to achieve better Value for Money rather than accelerate infrastructure investment.

The Ministry of Finance (MoF) published the "PPP Handbook" in October 2004, providing general guidance on PPP procurement, and dictating that all government infrastructure projects in excess of \$50million should be assessed for PPP. In addition, the MoF have created a PPP Advisory Council whose aim is to create awareness of PPP, draft PPP policy and provide guidance on PPP matters.

⁶⁰ Canadian Public-Private Partnership financing gaining traction despite labor opposition, Standards & Poor's, October 2005

The Council also oversees the progress of major PPP projects and facilitates resolution of inter-agency issues. MoF is working closely with procurer-agencies for each of the upcoming PPP projects with a view to standardising procurement policy and guiding the procuring agencies in the selection of advisors. A further role played by MOF is to facilitate any changes that are required to the regulatory framework under which different Government Agencies operate. As PPP procurement is adopted across more Ministries or their Statutory Boards, so the framework governing each agency will develop.

A number of key sectors have been identified by MOF as suitable for PPP – these include sports and leisure, water treatment, education and health facilities, expressways, government buildings and large IT infrastructure deals. Two PPP projects have closed in Singapore to date: the Hyflux Desalination Plant and NEWater Ulu Pandan. The most recent PPP projects to come to market are: the 5th Incinerator Project, the Singapore Sports and Leisure Infrastructure PPP, the National University of Singapore (NUS) 6,000 bed hostel, the Defence Science and Technology Agency's Basic Wing Course fighter training jets, and the PPP procurement of a new campus for the Institute of Technical Education (ITE).

Singapore's procurement pipeline is strong. The Ministry of Finance are firmly behind the use of PPP in government procurement, creating the necessary government ownership of the programme. With the momentum that has been gained on both water transactions, the 5th Incinerator Project, the Sports Hub PPP and NUS and ITE.

South Africa

South Africa has been actively using PPP structures since around 2000. All levels of government – National, Provincial and Municipal – have participated in PPPs with 12 deals signed to date and another 56, at either the feasibility stage or in procurement. Projects have come to market from a variety of sectors and have ranged from the more usual accommodation, prison and health projects to the more unusual ones such as eco-tourism and the design, build and operation of an Antarctic supply ship.

PPP activity and deal flow is supervised by a PPP Unit established within the National Treasury and governed by a robust legal framework. A PPP manual has been issued to assist all participants and a standardised set of provisions forms the basis of transactions.

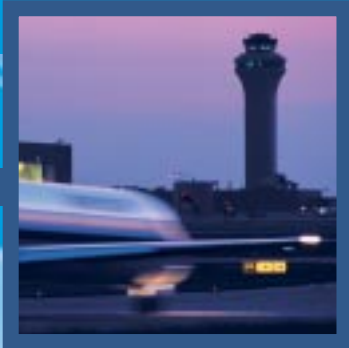
An important feature of South African PPP projects is the importance of Black Economic Empowerment (BEE). All qualifying bidders must meet minimum levels of BEE in terms of equity, management and subcontractor support, and BEE scoring forms an important part of bid evaluation.

Beyond South Africa, PPP activity has recently started to develop as an alternative procurement strategy in other parts of southern Africa, for instance Botswana. The necessary legal and regulatory environment, as well as institutional support is currently being established. In the meantime two pilot office accommodation projects for government departments are now in procurement. In addition, the Southern African Development Community has completed a feasibility study to develop a new headquarters building as a PPP in Gaborone, Botswana.

United States

Until recently, the US PPP market was limited to a handful of projects primarily structured to take advantage of US tax-exempt financing which has limited or excluded equity participation. However, the market, particularly in the transport sector, has changed significantly in the past 18 months. The successful sale of the Chicago Skyway to a consortium including Maquarie and Cintra for US\$1.8 billion in late 2004, the Comprehensive Development Agreement award to Cintra/Zachry for the Trans-Texas Corridor in early 2005, and the sale of the Dulles Greenway to Maquarie in mid 2005, among others, has generated considerable interest in transport PPPs across the United States. Oregon, Georgia, New Jersey, New York, Virginia and many others are now taking a serious look at PPPs and launching PPP programmes.

As in other emerging PPP markets, attention has initially focused on road and rail infrastructure development. Tight state budgets and the opportunity to generate funds either through selling an asset or transferring the costs of building and operating the asset to the private sector are key drivers behind PPP development in the US. Political support is growing as PPPs will allow the federal and state governments to fund infrastructure development without relying solely on the tax base. In addition, states increasingly recognise that involving the private sector and accessing private sector finance will enable them to build an asset or develop infrastructure significantly faster than depending only on traditional procurement routes and funding sources.



Recurring PPP issues and solutions

The use of PPPs raises a number of complex issues and choices, the solutions to which are often project or country specific. However, there are a number of fundamental issues raised time and again across a wide spectrum of PPPs. This section highlights a number of these issues and summarises our recommended solutions to address them.

Legislative impediments to transport PPPs

Source: Freshfields Bruckhaus Deringer

Legal impediments and uncertainties regarding PPPs affect both the public and the private sector. Lack of an adequate legal framework is a factor the Rating Agencies take into account for their country ratings and will affect market appetite to bid for or finance projects in the country concerned.

Examples are:

- national law imposes complex requirements for tendering sub-contracts (e.g. Germany).
- changes to the membership of a bidding consortium are not legally admissible (e.g. Germany).
- uncertainties exist about the interpretation of EU procurement law in the national courts (e.g. Germany in relation to the boundary between a services concession as opposed to a works concession).

- national law restricts the availability of the negotiated procedure (e.g. France).
- national law restricts the creation or transfer of security over assets used in the provision of public services (e.g. Belgium).
- step in rights are not available (e.g. Poland).
- national law places restrictions on the payment of compensation that can be offered to shareholders or lenders, and on giving indemnities (e.g. Belgium).
- there is a lack of broad national enabling legislation (e.g. Czech Republic).
- restrictions are imposed on the ability of regional or local governments to contract (e.g. Czech Republic).
- it is difficult to structure projects which are co-financed from the EU's Structural and Cohesion Funds as PPPs (recently acceded States).
- public finance law restricts long-term budgetary commitments (e.g. Poland).
- PPP contracts extend beyond the period for which funds can be budgeted (EU Commission).

Some countries have taken significant steps to strengthen or clarify national law to provide a framework for PPP procurement. Examples are the new PPP law and laws facilitating security structures for PPP projects in France, and the F-Model and A-Model structures for PPP projects in the German road sector and the PPP Acceleration Law passed in Germany in July 2005.

Eurostat recommends that the assets involved in a PPP should be classified as non-government assets, and therefore be recorded off the balance sheet of the government, if both of the following conditions are met:

- 1 the private partner bears the construction risk; and
- 2 the private partner bears at least one of either availability or demand risk.

The three key risks are:

- 1 construction risk – where a government's obligation to start making regular payments to a private partner without taking into account the effective state of the assets would be evidence that the government bears the majority of the risks;
- 2 availability risk – a government will be assumed not to bear availability risk if it is entitled to reduce significantly its periodic

payments, "like any 'normal customer' could require in a normal contract"; and

- 3 demand risk – a government will be assumed to bear this risk where it is obliged to ensure a given level of payment to the partner, independently of the effective level of demand expressed by the final user, rendering irrelevant the fluctuations in level of demand on the partner's profitability.

It is acknowledged that in some cases, where risk analysis does not provide a clear outcome, additional elements in the partnership contract should also be taken into consideration. These could include: the nature of the partners, the importance of government financing, the effects of government guarantees, or provisions relating to the final allocation of the assets.

Source: Eurostat

Governments are also seeking private sector help to identify legislative uncertainties and impediments to PPP and to develop best practice for the future. The German government's federal PPP competence centre has commissioned reports from the private sector to assist in future development. PricewaterhouseCoopers has supplied reports on tax issues and on the use of public sector comparators. Freshfields Bruckhaus Deringer has supplied a report on the legal aspects.

We recommend that national governments continue to work to identify and eliminate legal uncertainties and impediments to PPP. Information sharing between EU countries on these issues could be facilitated by an EU knowledge unit. In addition, the private sector can and should also contribute actively to this work.

Accounting issues and the Balance Sheet treatment of PPP transactions

Accounting issues

For some time there had been considerable uncertainty as to what the accounting and statistical rules relating to PPPs were in an EU context, with some Member States having their own specific rules but with no central guidance or rules relating to PPPs. In 2001, Eurostat issued broad guidelines on the evaluation of the public sector budget and debt impact of various types of project financing mechanisms. Following the rapid increase in the use of PPP structures, the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) and Eurostat published a news release in February 2004 outlining a new set of rules for the accounting treatment of PPPs.⁵¹ Further guidance was included in a specific chapter on PPPs in Eurostat's ESA95 Manual on Government Debt and Deficit published in August 2004.⁵² The ESA95 version of the European System of Integrated Economic Accounts (ESA) establishes the conceptual framework to obtain reliable and comparable statistics for evaluating national accounts data.

⁵¹ Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) and Eurostat news release (STAT/04/18) February 2004

⁵² ESA95 Manual on Government Debt and Deficit – Long term contracts between government units and non-government partners (Public-Private Partnerships) (Part IV), 30 August 2004. Available at http://epp.eurostat.cec.eu.int/cache/ITY_OFFPUB/KS-BE-04-004/EN/KS-BE-04-004-EN.PDF

The ESA95 guidance provides that assets involved in a PPP can be considered as non-government assets

“only if there is strong evidence that the partner is bearing most of the risk attached to the specific partnership”.

This follows the ‘substance over form’ approach that has been used by a number of governments in developing their own accounting regulations for PPPs. The ESA95 chapter on PPPs states that PPP assets should be classified off-balance sheet for government if both of the following risks are met:

- The partner bears the construction risks.
- The partner bears at least one of either availability risk or demand risk.

Box 15 provides further information on this issue.

Therefore, the EU rules regarding the accounting treatment of PPPs in national accounts are less restrictive than many governments and industry commentators previously feared. However, it is worth noting that ESA95 covers government accounting only from an EU statistical standpoint. There is no requirement that national accounting standards (including specific public sector rules) should follow ESA95. Many Member States have their own public sector rules for PPPs which provide more onerous tests, while other Member States do not yet have clear public sector rules for PPPs. There is therefore still some degree of uncertainty in this area. It is also worth noting that International Accounting Standards covering this area are currently being drafted.

Balance Sheet Treatment

At the heart of a PPP lies the transfer of risk in the project to the private sector. Depending on the accounting standard applicable to the public sector authority in question, as well as the nature of the risks being transferred, there is an opportunity for a large number of PPPs to be off balance sheet for the public sector authority. This means that the assets of the project and the related liabilities do not appear on the authority’s balance sheet nor score against the overall national debt of the country.

In our view, the balance sheet treatment of a transaction is only an indication of the risk transfer involved. It focuses on only a narrow set of risks, and therefore many transactions are accounted for on balance sheet even though optimal risk transfer to the private sector has been achieved.

Many transactions involve the upgrade and refurbishment of existing assets as well as the development of new facilities, with the assets together forming an integral whole. As a result, the risk share of the PPP transaction itself would have to be sufficiently large not only to get the immediate assets of the transaction off balance sheet, but all the related historic assets whose value may be considerably larger than the transaction under consideration. This could only be achieved with high levels of risk transfer, probably way beyond the optimal level.

“It is important to note that, simply because a PFI asset is reported on departmental or authority balance sheets, that does not mean that there has been no effective sharing of risks with the private sector, or that the PFI project has secured value-for-money gains by doing so. The appropriate sharing of risks in a PFI project, leading to their better management, is an important source of its value for money benefits. However, the accounting treatment of PFI assets depends only on a subset of the risks involved in a project, in particular the risks of ownership.”

Source: HM Treasury “PFI: Meeting the Investment Challenge” July 2003

For these reasons, balance sheet treatment should not, in our opinion, be a key driver for undertaking a PPP. Indeed, to remove those obligations from the public sector’s balance sheet entirely would arguably understate the public sector’s likely future payments. It is clear that when the private sector enters a PPP contract, it has every intention of delivering the required services and therefore will receive the service payments from the public sector as due. From the private sector’s viewpoint, they would consider it unlikely that the payments from government would not pay off the majority of finance raised, both debt and equity. In addition, in the majority of PPPs, the termination arrangements should the project end early normally include a “fair value” provision, whereby the private sector would be paid a sum equal to the assets it has delivered. While this

may not equal the full value of future payments, it is likely that it would be a very high percentage of those payments. So in most circumstances the public sector is going to pay out all or the vast majority of its future service payments. Not to disclose these obligations in some way in national accounts could be argued as being an understatement of the authority's overall future obligations.

This reality has been recognised clearly in the UK. Already 57% of PPP transactions in the UK have been classified on the Government's balance sheet. This is because the UK has not used Eurostat but rather UK accounting conventions, where off balance sheet classification is more difficult to achieve.

While a PPP's ability to be classified as off balance sheet is a clear benefit to a number of public sector authorities, the balance sheet treatment of a transaction should not be the sole determinant of whether a PPP solution is the best form of procurement. Irrespective of its balance sheet treatment, we recommend that public sector authorities consider disclosing their future obligations under PPP arrangements.

Procurement and State Aid issues

Source: Freshfields Bruckhaus Deringer

Transport PPPs take many forms. Some are works or services (or, rarely, supply) contracts, some are works or services concessions and some take the form of a joint venture. Different procurement rules apply to different forms of PPP. This can make it difficult for the public sector to be sure it is satisfying applicable requirements. And in some member states budgetary laws impose additional restrictions on the use of flexible procurement procedures (e.g. the negotiated procedure).

In contrast to the new competitive dialogue procedure, to date the "negotiated procedure" with prior publication of a contract notice (now provided for in Article 30 of the new public sector procurement directive and Article 40 of the new utilities directive) has been used for the procurement of many transport PPPs. It can be used in cases where the nature of the works or services (or under the new directive supplies) or the risks involved do not permit prior overall pricing by all parties. It has been frequently used for PPPs, before the

introduction of the new competitive dialogue procedure.

The negotiated procedure allows some flexibility to adjust the PPP arrangements post tender to meet the concerns of lenders. However, there has been controversy over its use in some relatively commoditised PPP sectors in the past and the availability of the new "competitive dialogue" procedure may lead to a more restrictive approach to its use in future.

The Commission's new competitive dialogue procedure (Article 29 of the new public sector procurement directive) is intended to be well adapted for many PPPs. The procedure involves a dialogue with candidates selected via a prequalification process. The dialogue continues with all bidders until the public sector can identify the solution or solutions which meet its needs. All private sector participants then tender on the basis of the identified solutions. This process raises a number of issues:

- strictly, the dialogue only applies for works, services and supply contracts, and then only for "particularly complex contracts". It is not clear whether all PPPs would be considered "particularly complex contracts". There is no provision for the competitive dialogue procedure to be used in the utilities sector, presumably because the negotiated procedure with prior publication of a contract notice is freely available to utilities;
- it is expected that the competitive dialogue procedure will involve substantial costs because all bidders are kept in the competition for longer. This will be an issue for private sector participants unless the public sector agrees to meet/contribute to bid costs;
- many PPPs are highly leveraged and lenders take a close interest in the PPP arrangements. Because of cost concerns, lenders may be unwilling to conduct due diligence during the early stages of the competitive dialogue. When they do conduct due diligence at a later stage they may ask for comfort by way of adjustments to the PPP arrangements;

“Early experience of the competitive dialogue (in France and elsewhere) is more encouraging than some had feared. It is quite flexible in practice, and well advised public authorities are trying to overcome the market's concerns. Sharing best practice will be key to its effective use in future.”

Sally Roe, Partner, Freshfields Bruckhaus Deringer

- therefore lenders' approach of conducting due diligence at a late stage may give rise to problems. The public sector's ability to negotiate after bids have been submitted is very limited in the competitive dialogue procedure. It is not yet clear whether there will be sufficient flexibility to accommodate concerns raised by lenders at a late stage;
- one possibility is that the use of the competitive dialogue procedure will lead lenders to conduct due diligence earlier in the process. Public sector willingness to contribute to bid costs may be an issue here.

Where there are doubts about the procurement procedure that should be used, or where there have been material adjustments to the PPP arrangements post preferred bidder, it may be difficult to demonstrate that PPP arrangements do not involve State Aid – or, where they do, that the aid can be justified on public service grounds.

Guidance on PPPs for the public sector should include guidance on procurement procedures. In our view, until the competitive dialogue is proven as a PPP procurement route, such guidance should include guidance on the availability and use of the negotiated procedure as an alternative. The EU should give clarity over any State aid implications of post preferred bidder adjustments needed to satisfy lender requirements.

Affordability issues

Because the public sector pays for PPPs over the contract term rather than for assets at the time of commissioning, PPP procurement makes projects affordable and therefore can accelerate the number of projects that can be brought about.

However, there are limits to the private sector's ability to smooth costs, driven ultimately by the overall costs of the scheme in question. Included in the overall costs is the private sector's cost of finance (both debt and equity). The cost of the project and the cost of the private sector's finance together set a floor to the level of service payments from the government in each year of the PPP.

So, if a project is too grand in its scope and service level aspirations, it may ultimately prove unaffordable. The private sector contractor does have the ability to contour the payments it receives from government, for instance, reducing them in the early years to make a project affordable within current shorter term spending limits. But this would lead to higher payments being required in later years to compensate.

Public sector authorities should not embark on a PPP if it is clearly not going to be affordable:

- If this were clear upfront, the project would lack credibility in the market and a strong competition would not be forthcoming.
- If bids proved to be unaffordable once received, given unrealistic forecasts, the procuring authority would have to undertake a costly and time-consuming round of bid reiteration as bidders are asked to fit within affordability levels.
- If a project has to be changed materially after the appointment of a preferred bidder to meet affordability caps, this risks a procurement challenge from the disappointed bidder and may also raise State Aid issues, if the structure of the original transaction were changed materially.
- If bids prove a project is unaffordable, it will force difficult political decisions, for instance downscaling the size of the project, which would be best made earlier so that either the project procurement would not have been started, or significant time and resources would not have been wasted on pricing the wrong project.

To minimise these risks, public sector authorities should model a prospective shadow private sector bid, including life cycle costs and their cost of finance, prior to commencing the project's procurement.

A shadow private sector bid model should be produced prior to starting the procurement so that the authority has a realistic view of the affordability of the project.

The speed and cost of PPP procurement

There is a shared view across the public and private sectors that the cost and speed of PPP procurement could be lowered and improved. On lengthier deals, there are examples of bid costs equalling 3-4% of the value of the capital expenditure of that project. In addition, there is certainly an unquantifiable loss to the public sector of the delay in many projects that slow PPP procurement brings about.

The speed of procurement of projects varies across Europe. We have seen procurement periods in excess of 24 months and in some cases between three and five years. Those with successive rounds of bids reducing bidders from four to two, then to a best and final offer and perhaps further bids thereafter, are likely to be lengthy processes.

The competitive dialogue is being transposed into national legislation in 2005-2006. Its impact on the speed and cost of procurement remains to be seen.

There are several measures that can be taken to reduce the time to procure and its related cost:

- Ensuring the private sector receives well-defined output specifications and contracts with proven, optimal risk share allocation, right from the start of the procurement process.
- Ensuring that the public sector has realistic affordability expectations and can avoid bid reiterations.
- Delaying lender involvement, in some cases until preferred bidder stage, so that due diligence and negotiations are held in a concentrated period rather than effectively twice over.
- Using standardised documentation and risk share proposals to avoid negotiating large parts of the transaction when clear precedents exist. For example in the UK, all PFI contracts must comply with the terms and conditions set out in the latest version of the “Standardisation of PFI Contracts” document (SoPC3), developed by the UK Treasury with the private sector.⁵³ All project-specific derogations must be approved by

the UK Treasury. The SoPC3 aims to provide a common understanding of the main risks, consistency of approach and pricing and reduced procurement times and costs. It provides standard terms for previously contentious issues, such as the definition and application of force majeure, compensation on termination by the public authority or contractor, dispute resolution and authority step-in, refinancing gains.

- At the outset of each transaction, critically assessing the number of bidders and bidding rounds that the project requires.
- Setting clear (and sufficiently flexible) rules for the competition at the outset and sticking to them. This will minimise the risk of delays through legal challenge to the procurement process.
- Understanding that “the best is the enemy of the good”. In many deals, the parties keep negotiating to try to get the very best deal. This process can take several months. Often the parties lack the experience to understand when an acceptable deal has been reached and that closing the deal rather than continuing negotiation is in everyone’s best interest. This is a difficult decision to make, given how public the oversight and subsequent audit of PPP deals can be. Therefore procuring authorities might benefit from a degree of central government experience and guidance in this area, so they can understand better when a deal is sufficiently acceptable to proceed to financial close.

In summary we recommend the public authority critically assesses the number of bidders and bid rounds necessary for a particular project. It is often better to reach financial close on a good deal rather than negotiate ad nauseam for the best deal. A degree of central government guidance to procuring authorities might help such sensible decisions be made.

⁵³ The SoPC3 is available on the UK Treasury web site at: http://www.hm-treasury.gov.uk/documents/public_private_partnerships/key_documents/ppp_keydocs_index.cfm

Building a PPP Centre of Excellence

Countries that have established a central PPP unit, for instance within their ministry of finance, have undoubtedly benefited from this investment PPP units offer:

- Knowledge base – a central source which can disseminate details of successful deals, precedents and good procurement practices.
- Guidance – a unit can give guidance on particular risk issues, contract forms, or approaches to procurement and also act as a sounding board from the private sector for their preferred approaches on risk issues and other procurement matters.
- Standardisation – a unit can encourage or impose a standardised approach to speed up deals and avoid discussion in areas where the market has already determined a precedent.
- Deal experience – a unit can give experience of transactions, structures, market players and financier requirements to individual procuring authorities.
- Approval of acceptable deals – a unit may be able to advise authorities when a deal is sufficiently attractive for financial close to take place.

We consider it would be helpful to have a similar unit providing an EU-wide service so that successful precedents can be easily shared between member states and private sector parties. [Section 3](#) described the increasing level of PPP activity and initiatives across Europe. A central EU unit could ensure these separate activities are as co-ordinated or aware of each others' successes as possible. This unit would not have the authority to impose particular risk share structures or deal precedents on member states, but certainly would be able to give guidance and demonstrate international precedents to prevent member states reinventing the wheel on particular risk issues that have already been addressed successfully elsewhere in Europe. It would be difficult, however, to try and determine a Europe-wide PPP structure and standardised terms, given PPP structures depend on precedents within a particular country, the level of PPP market development is different in each state and country risk factors will affect what is possible in each state.

There is clear value in having a central unit giving guidance and policy on PPP issues within each EU country. Developing an EU knowledge unit would also be very effective, but it should only attempt to give guidance and demonstrate precedents, not impose a common EU-wide approach.

The sharing of refinancing benefits

At financial close of a PPP transaction, the private sector company's debt and equity structure reflects the future risks of the project and in particular the higher risks that exist at the outset of the project, namely the construction and implementation phase.

Once a project is successfully implemented, the original finance pricing tends to look high for the remainder of the project, as its risks are lower. In these circumstances, the need for equity is reduced and the private sector shareholder has an opportunity to refinance, both lowering its cost of debt as the risks have been reduced and possibly increasing debt levels to finance dividends to shareholders earlier than originally anticipated.

Such refinancing benefits are not a new phenomenon of PPPs. They are a typical method of financial engineering used in all projects once the riskier initial phase has been completed.

A key political question is whether or not governments should look to share in such refinancing benefits. There are a number of opposing arguments:

If a project underperforms, the private sector endures the loss. Therefore, governments should not share in the financial gains should a project be delivered on time and budget. Otherwise governments only share upside, not risk (except the risk that a PPP company fails entirely).

Governments should share some of the refinancing gain particularly when it is far greater than anticipated. With many PPPs, equity is injected very late in the implementation phase, which means that an early refinancing might lead to extremely high levels of equity returns, way above normal expectations.

If governments take a share of refinancing gains, then the upside of a particular project will be reduced. To compensate for this, equity investors would increase the original rate of return they require in PPP projects.

Where the public sector has asked for a share in refinancing gains, there is no evidence that the equity rate of return requirements of the private sector have increased. Indeed, competition has pushed equity returns in the opposite direction. With no evidence of increased equity prices, the public sector can therefore enjoy some refinancing gains without adversely affecting equity pricing.

If the government takes any material share in refinancing gains, the incentive on the private sector to refinance will be lost and therefore neither party will enjoy the reduction in finance costs that otherwise would have been obtained.

This is an argument for ensuring the public sector share is not excessive, but it does not invalidate the case for a share at some level.

There is no one correct answer as to the right level of refinancing share the public sector should take, if any. Clearly the greater share it takes, the less incentive there will be to refinance, so the opportunity for both parties to benefit might be lost. The standard refinancing share in the UK of 50% each sounds, in principle, an equitable sharing arrangement. However, it is not yet proven that this level is always sufficient to provide adequate incentive for the private sector to refinance.

Some public authorities have given consideration as to whether they should receive any share in the gains on the sale of equity stakes in PPP projects. Similar arguments for and against to those above can be made; but for equity the ramifications of an incorrect policy would be more severe, as restrictions on equity sales could lead to a very big disincentive to investors and therefore a significant reduction in capital available to the PPP market. Authorities need to consider whether they require the original shareholders in a project to remain as shareholders for an initial specified period to ensure access to the expertise they deliver, limiting the short term ability of shareholders to sell their equity stakes.

In our view the market can accept a degree of debt refinancing sharing, without there being an adverse effect on the equity rate of return required by PPP investors. The public sector must ensure that it is not disincentivising the market by demanding too onerous a refinancing share or attempting to take a share in equity sales, that could lead to a drying up of available PPP capital.



“ At a European level, we need to ensure that we capture the lessons learned from one project and hand them on to the next, across European boundaries. ”

Rt Hon Alistair Darling MP, UK Secretary of State for Transport at the 2005 PPP Transport Summit

Recommendations and Conclusions

The investment challenge faced by governments in the modernisation of public infrastructure and services continues as a focus for European agendas. The political and public controversy of past years has lessened and PPPs are now more generally accepted as a viable means of procuring and delivering this required modernisation and they are being increasingly adopted. There is strong deal flow in a significant number of countries within Europe, increasing uptake in project procurement in countries where activity has previously been low, and increasing interest in PPP models across the rest of the region. And more and more countries are establishing dedicated PPP units or enacting legislation to assist in streamlining the procurement process.

However, PPPs are complex and recurring issues continue to hinder their development. Given the potential which PPPs have for the delivery of these essential public services we believe it is vital to share experiences, look at precedents for the market, and find resolutions to key impediments, thus enabling the advancement of PPPs across Europe.

We make the following recommendations for streamlining the procurement process:

■ **Build national PPP Centres of Excellence**

While an EU Knowledge Unit would be effective in promoting the use of PPP approaches, it should not impose a common EU-wide approach. There is clear value in having a central unit giving guidance and policy on PPP issues within each EU country. Countries that have established a central PPP unit have benefited from this investment as PPP units also offer deal experience and can promote standardisation.

■ **Balance Sheet treatment should not be a key driver for undertaking a PPP**

The balance sheet treatment of a transaction should not determine whether a PPP solution is the best form of procurement. Irrespective of its balance sheet treatment, we recommend that public sector authorities disclose their future obligations under PPP arrangements.

■ **The EU Commission should provide guidance on PPPs for the public sector which includes guidance on procurement procedures**

Until competitive dialogue is proven as a PPP procurement route (and the majority of consultation responses suggest that competitive dialogue is ill-suited to PPP procurement), such guidance should include guidance on the availability and use of negotiated procedure. The EU Commission should also clarify its position on the State Aid implications of post-preferred bidder adjustments to satisfy lenders.

■ **Shadow private sector bid model**

Public sector authorities should model a prospective shadow private sector bid, including life cycle costs and costs of finance, prior to starting procurement so that the authority has a realistic view of the project's affordability.

■ **Streamline speed and cost of procurement**

The public authority should critically assess the number of bidders and bid rounds necessary for a particular project. It is often better to reach financial close on a good deal rather than endlessly delay a project for the sake of a "best deal".

■ **Create an EU Knowledge Unit**

National governments should continue to work to identify and eliminate legal uncertainties and impediments to PPPs. However, the creation of an EU Knowledge Unit would facilitate sharing of information and best-practice between EU countries. It could also give guidance and demonstrate international precedents for delivering projects so that Member States have the benefit of the rest of Europe's experience. The private sector should actively contribute to this Unit's work.

■ **Sharing refinancing benefits**

We believe there should be a degree of debt refinancing sharing between the public and private sectors. However, the public sector must ensure that it does not disincentivise the market with an inequitable share of the refinancing, and we do not recommend any material sharing in equity sales proceeds as this could lead to a drying up of available PPP capital.

Conclusion

The modernisation of public services and infrastructure is a promise governments have made to their citizens. We believe that Public Private Partnerships offer a viable alternative to traditional procurement methods and we would like to see the public and private sectors doing more business together. Delivering the PPP promise means delivering solutions that fund new roads, improve rail services, modernise hospitals, and build new schools and social housing, more quickly and efficiently, so that together we can close the service and infrastructure gap that currently exists within and across Europe.



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