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GOV/PGC/SBO(2014)6

Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

08-Jul-2014

English text only

**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE  
PUBLIC GOVERNANCE COMMITTEE**

**Working Party of Senior Budget Officials**

**MEETING SUMMARY**

**7TH Annual Meeting on Public-Private Partnerships**

**OECD Conference Centre, Paris  
17-18 February 2014**

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**JT03360281**

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**7<sup>TH</sup> ANNUAL OECD MEETING ON PUBLIC-PRIVATE PARTNERSHIPS  
PARIS, 17-18 FEBRUARY 2014**

**MEETING SUMMARY**

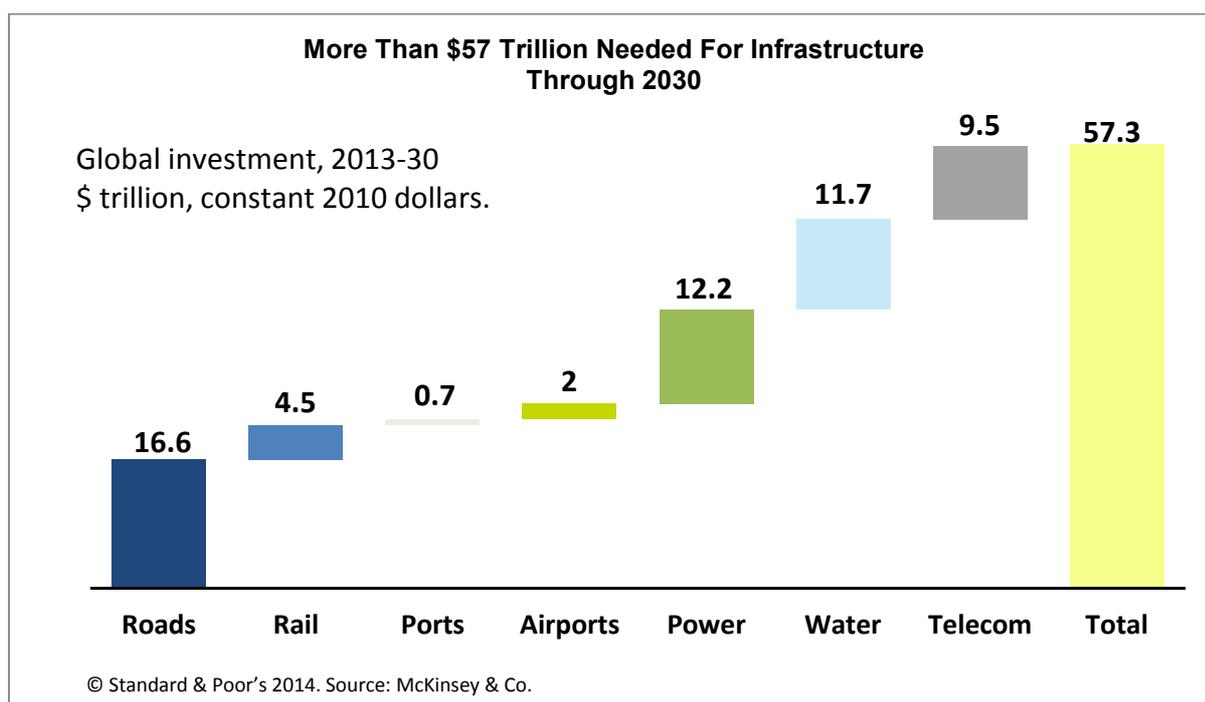
**Introduction**

The 7<sup>th</sup> Annual Meeting of Senior PPP Officials took place on February 17-18, 2014, at the OECD's headquarters in Paris. It was attended by almost 100 participants representing 42 delegations, including 30 member and non-member countries, private sector representatives, and multilateral institutions. This year, participants convened around the themes of a country's readiness for PPPs, financial and operational sustainability of projects, attractiveness factors for investors, and country case studies. It was agreed that sound and transparent legal and regulatory frameworks, a public sector equipped with adequate capabilities, projects with an underlying socio-economic value and strong value for money analysis are all essential ingredients for successful PPPs. The Annual Meeting was also an opportunity for the OECD to present its latest Review on the PPP framework in Russia, which will be published in the 2014 edition of the OECD Journal on Budgeting.

**Day 1 – Monday February 17, 2014**

***Session 2: The current PPP market***

**Mr. Robin** Burnett, Director, **Standard and Poor's** (SnP) emphasised that there is a great challenge with regards to identifying precise numbers of PPPs due to variances in definitions and data collection techniques. Data suggests that there is a yearly investment deficit of 3.4 trillion over the next 16 years (depending on the assumed investment rate), with the bulk split evenly between the US, EU, and China. In order to meet these investment demands, PPPs will play an important role. A key point in this respect is the active participation of institutional investors, which SnP suggests could provide USD 200 billion per year in additional funding if they increase their allocation to infrastructure by four percent. Requirements to attract this type of infrastructure investment include: a visible pipeline of projects, greater information transparency, and a stable political and regulatory framework.



Source: Burnett Robin (2014), "Global Infrastructure: How to Fill A \$500 Billion Hole", Presentation at the OECD's 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 17 2014

**Mr. Guy Chetrit**, Principal Advisor, European PPP Expertise Centre (EPEC), **EIB** noted that the trend of decreasing PPP deals in Europe has broken for 2013. The deal volume and numbers were up. Looking further ahead, however, is not particularly promising as the pipeline is somewhat weak. The financing of PPPs is less an issue than it was in recent years, but the quality of projects and the regulatory framework pose challenges. There seems to be a trend of projects moving away from encompassing demand risk. Projects that take place are increasingly based on availability payment rather than concessions. In terms of countries, only the UK, France and the Netherlands are interesting for institutional investors at this point.

**Mr. François Bergère**, Head of Concessions/PPP, Ministry of Finance, **France** noted that over the last 10 years, France has closed about 200 PPP projects (and up to 600 including smaller projects along sectoral variants), amounting to five percent of total gross capital formation in France. Liquidity is back, both from banks (*Caisse des Dépôts* and EIB, but also commercial banks) and from capital markets (with the first two major projects being financed by institutional investors/debt funds in 2013). For 2014 and beyond, however, developments are difficult to predict, as there are upcoming elections, new procedures for selecting projects, increasingly critical press and an increasing number of legal challenges to particular projects; stakeholders are still waiting for a roadmap by the central government as to where it wants to take PPPs. While there are challenges, it is worth noting that analysis indicates that the performance of PPPs in terms of on time completion and within budget is positive in 95% percent of projects.

According to **Ms. Lisa Mitchell**, Director, Strategy and Policy, PPP **Canada**, there are a significant number of projects under way in sectors such as roads, hospitals and schools in Canada. For 2014, six projects have reached financial close and 20 projects (DBFOMs) have been launched at the state level. Seven projects have recently been launched at the municipal level covering areas such as sanitation and fresh water. In some cases, there has been political resistance that has led to increasing focus on community consultation. Large projects include the transnational Great Lakes Bridge between Canada and the US. There is an active bond market which is financing a number of PPPs with record-low spreads to the sovereign bond market. A CD 14 billion New Building Canada Fund has been launched as part of the

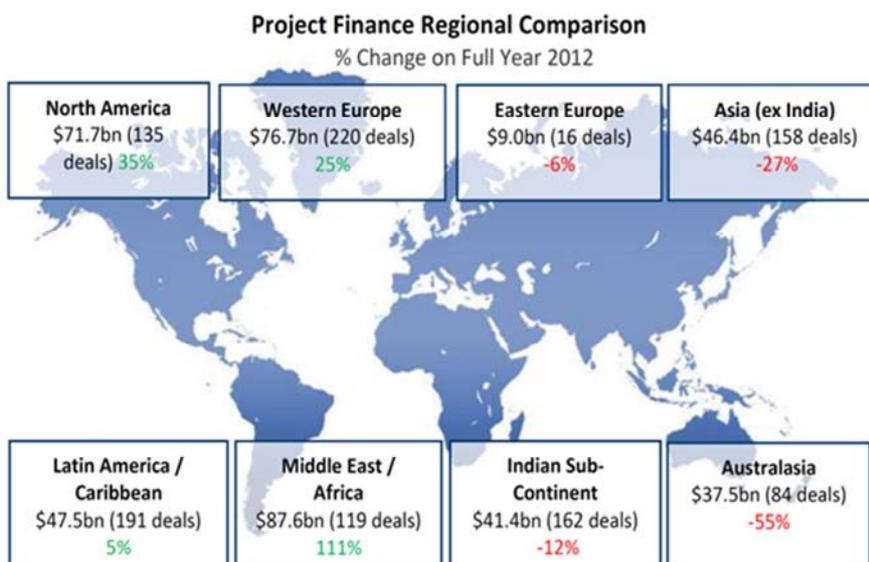
CD 53 billion “New Building Canada Plan”, with a mandatory PPP screening of projects that have a capital cost of CD 100 million or more.

There was discussion regarding what how long it should take from a project being initiated by the public sector side to the beginning of the construction stage. UK has a target of 14 months for its current schools project, whereas the EIB noted that most projects are found in a range from 18 months to 5 years. In general, delegates agreed, project gestation period should not be so long as to give rise to higher costs and uncertainty, thereby discouraging investors.

**Session 3: What makes a PPP framework attractive?**

From a project sponsor perspective, **Mr. Gilles Erdogan**, Project Director, **VINCI Concessions** emphasised that several elements must be aligned in order for VINCI to be interested in a project. The company views itself as a sponsor and private partner in charge of delivering public goods and services. In addition to aligning the public sector profit interest with the public sector welfare interest, a main criteria for the company is for the project to represent socio-economic value for the society at large. Such projects also increase the likelihood of users to pay. High political will can drive projects forward if it is supported by the needed competencies at the administrative level or through external advisors. For instance, a good preparation of the public partner for the tendering phase through feasibility studies helps assess the financial viability and technical feasibility of the project, and whether it meets SMART (specific, measurable, achievable, realistic, time-bound) objectives. This will allow the private partner to evaluate a project’s credibility before it engages in the costly bidding process. Another crucial element is the appropriate distribution of risk, which can be a great impediment or enabler to the private partner.

From a project lender perspective, **Ms. Virginie Grand**, Head of Project Finance for Europe, **HSBC** noted that the project finance market is resilient with a size of about USD 400 billion. In 2012, investments increased by 5%, 25%, and 35% in Latin America & the Caribbean, Western Europe, and North America respectively, but decreased in some regions such as Asia. Investments witnessed an increase of over 100% in the Middle East and Africa. Such investments were largely made in energy and infrastructure.



Source: Grand Virginie (2014), Presentation at the OECD’s 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 17 2014

A number of key considerations were raised, mirroring Vinci's message:

- A stable regulatory framework is essential, especially with the resurfacing of factors such as sovereign risk.
- Clear policy statements with an established PPP Law and PPP Unit will facilitate the selection of projects and private sector interest.
- A strong pipeline of projects characterised by being necessary, simple, where risks can be identified and allocated.
- A decrease of funding available for PPPs, especially in light of the new, more restrictive Basel III requirements that banks are now subject to. Banks prefer engaging alongside institutional investors, and will focus on construction financing, structuring and re-financing.

Success factors include: the use of public support for priority projects; the use of guarantees in France and the UK; the EIB's project bond initiative. Hopefully in time these types of support mechanisms will no longer be necessary.

With respect to emerging markets, political risk is the main issue. Investors will need export financing. The involvement of Export Credit Agencies (ECAs) and International Financial Institutions (IFIs) is also essential.

From a transaction advisor perspective, **Mr. Charles Lloyd**, Partner, **PWC** and former Head of PFI Policy at HM Treasury, UK emphasised four main issues:

1. The enabling context: there should be a strong government commitment, a national development infrastructure plan and a clear legal framework. Beyond a PPP law, a reliable judiciary and a clear dispute resolution mechanism create confidence in the existing framework.
2. Good capital program management is essential, including: a strong and visible pipeline of projects, public sector capacity, transparency about needs and procedures, and engagement with the private sector about needs and processes.
3. Deal delivery: Projects should be digestible (e.g. in the USD 200 million range), replicable, and affordable. Appropriate risk allocation is important.
4. Decent process management in terms of openness and dialogue: There should be a realistic project timescale in place, which is often a problem in emerging markets. There should be a plan for delivery as well as for procurement.

**Ms. Jo Fox**, Head of PPP Policy, Infrastructure UK, HM Treasury, **United Kingdom** put the accent on the importance of clarity and transparency. Ms. Fox emphasised that the current fourth version of the UK infrastructure plan is very useful for making infrastructure investment in the UK attractive in that it sets the scale and priority of projects. The plan has strong political backing, which builds credibility. Experience shows that it is important to identify what projects are potential PPPs. The public authority should be clear about what is wanted, such as the key dimensions of the project, as changes late in the process can be difficult and very expensive. If possible, ideas should be tested and the business case for the project should be clearly set out. An experienced team will be important and so will standardisation in all phases, as there is little value added to make every case tailor made. The main stakeholders should be identified, and an open door policy vis-à-vis the private side can allow for iterative interactions and discussions about the project whilst ensuring a level playing field. This includes transparency vis-à-vis the bidders. In the UK, the main criticism from the private side about the current process has been the duration of the procurement process, which the reform known under the heading "Private Finance 2 (PF2)" aims to improve.

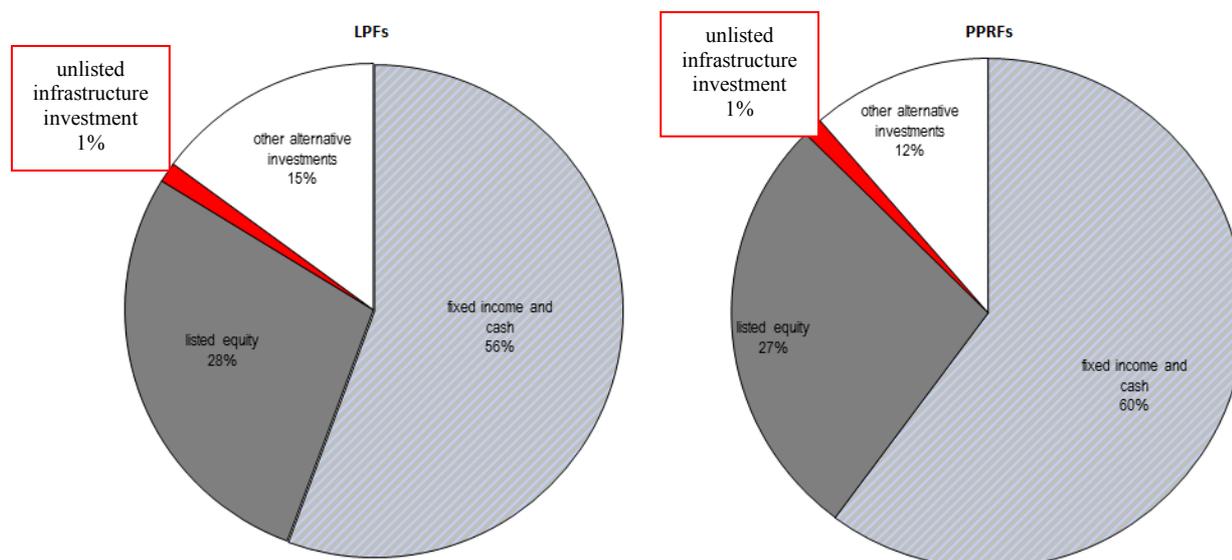
During the discussion, **Mr. Bergère** noted that France is currently working on new methods to decide on which investments to pursue. A socio-economic evaluation (cost-benefit analysis) is to be conducted for all State-level projects of over EUR 20 million CAPEX. If the project is deemed as desirable and a priority, it would then go through a second stage in the process, undergoing value for money (VfM) testing in order to decide whether to take the PPP or the TIP route. The reason for this is that the contracting model and financing of the project, by affecting its delivery date, has great impact on the overall socio-economic value generated. France now only applies its comparative VfM test for those projects that are envisioned as PPPs, but not for those planned from the beginning as TIP or concessions.

The Chairman noted that there were a number of themes that resonated throughout the various interventions, which include having appropriate capacities in the public sector, projects with a well-established socio-economic value rather than white elephants, private sector confidence in the legal framework, and a solid project pipeline.

#### ***Session 4: Instruments and incentives to attract institutional investors in PPPs***

**Mr. Raffaele Della Croce**, Senior Project Manager, Financial Affairs Division, **OECD** introduced the Institutional Investors and Long-Term Investment Project, which aims to facilitate long-term investment (LTI) by institutional investors, addressing both potential regulatory obstacles and market failures ([www.oecd.org/finance/lti](http://www.oecd.org/finance/lti)). Following a G20 request, research for the project has recently focused on financial instruments, models and regulatory and institutional conditions that can make infrastructure investment attractive for pension funds and insurers. Primary institutional investors in the OECD such as pension funds, public pension reserve funds (PPRFs), mutual funds, and insurance companies hold a combined USD 83.2 trillion in assets. The OECD survey focused on 86 large pension funds and PPRFs in OECD and G20 countries, managing over USD 10 trillion, where infrastructure was found to be a minimal part of the total asset portfolio. In order to attract pension fund investment in infrastructure and guarantee the success and sustainability of the investment in the long term, several barriers to investment need to be addressed such as the lack of political commitment over the long run or the lack of investor expertise in the infrastructure sector.

**Average asset allocation of Large Pension Funds (LPFs)  
and Public Pension Reserve Funds (PPRFs), 2012**



Source: Della Croce Raffaele (2014), “Instruments and Incentives to Attract Institutional Investors in Infrastructure”, Presentation at the OECD’s 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 17 2014

**Amb. Chris Barrett**, Ambassador and Permanent Representative, Australian Delegation to the OECD, **Australia** remarked how the current government is placing great emphasis on infrastructure investment, including how to enable institutional investors to invest in PPPs. PPPs in social infrastructure in particular have attracted institutional investors in Australia, who have provided the bulk of equity for these projects along with construction companies and banks (ex. large hospital contracts in Victoria). PPPs have a long history in the country and have been used to deliver key infrastructure assets of both an economic and social nature. They are expected to further grow in usage, but as elsewhere in the world the Australian government is focusing on how to maintain value for money and looking at what such a focus entails as to the allocation of risk.

In the subsequent panel discussion with the participation of HSBC, Legal and General Investment Management, and Hastings Funds Management, a number of points were raised.

**Ms. Katrina Haley**, Head of Structured Bonds, Europe, Middle East and Africa (EMEA), **HSBC** remarked that the use of alternative forms of financing for projects is increasing in Europe and elsewhere. For example, Slovakia was recently able to bond refinance over EUR 1 billion for a PPP project. Canada has a long experience with bonds and other debt instruments for infrastructure projects and is further exploring this tool. There are increasingly institutional investors that are involved in the financing of refinancing of Greenfield projects. The search for alternative financing and a greater use of cross border transactions will continue to be a trend next year, and is likely to increase investment opportunities globally for PPPs.

**Mr. Georg Grodzki**, Head of Credit Research, **Legal and General Investment Management** found that there is investor flexibility about the amount of money invested and the range of instruments used as long as projects are of high quality. Most importantly, projects need to pass the company’s socio-economic utility test. Infrastructure offers opportunities to gain higher returns, but can also result in higher risks to the investor. A number of important considerations come into play such as the size of the project (no projects below 10 million), having a central coordinating body, and the existence of a pipeline of projects.

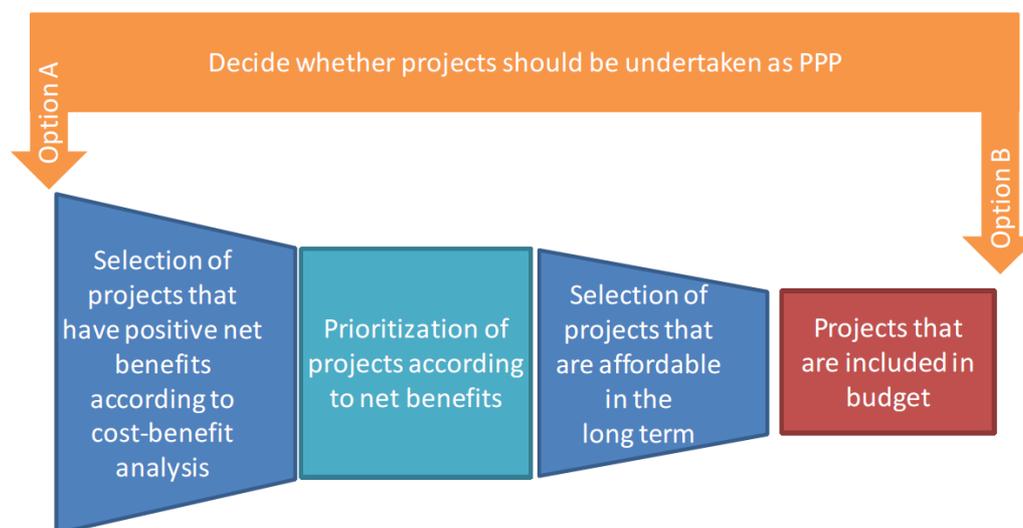
**Mr. Peter Johnston**, Executive Director, **Hastings Funds Management** shared the experience of Hastings as infrastructure investment specialists, operating from Australia and investing in Europe and the USA for the past 20 years. Infrastructure is still very much considered an alternative investment, even in a country like Australia that could be seen as a pioneer in infrastructure investment. Most money comes from large institutional investors, if they are confident. Many have tightened the definition of infrastructure projects that they can invest in, now representing less than 5% of their portfolio.

During the discussion, the risk-averse nature of pension funds was further discussed. Infrastructure is a good alternative investment for investors seeking higher returns. However, the fear of rules being changed at any moment is of big concern to institutional investors, which is why confidence building is a key factor in attracting these types of investors to a country.

***Session 5: Budgeting sustainably for PPPs and traditional capital projects in the medium and long term***

**Ms. Isabel Rial**, Senior Economist, **IMF** started the session by explaining the importance of budgeting for capital projects, whether they are procured through PPP or TIP. First, recent cuts in spending in developing and developed government worldwide affected the level and quality of capital stock. There are three options to resolve this situation: 1) increasing the rate of public investment, which doesn't always translate to productive capital assets; 2) increasing the efficiency of capital spending, or 3) relying more on PPPs. In order to generate fiscal space and maintain a certain level of capital stock, there is a need to eliminate inefficiencies in public investment processes. Efficiency gains can only be achieved if PPPs are pursued for the right reasons. In general, robust budgeting is important for the management of fiscal risks. PPPs can cause unexpected increases in government debt and contingent liabilities such as witnessed in Portugal and Greece. Budget investment decisions should be based on policy priorities, cost benefit analyses, and long term affordability considerations, not on the timing of cash flows. Whole of life cost consideration is especially important for PPPs. Upfront budget recognition such as by inscribing the project into a Medium Term Expenditure Framework (MTEF) or by showing commitment appropriation can address the affordability issue. Imposing limits on the government's commitments and liabilities (stocks and flows) is another alternative. Essentially, a strong budgeting system and support processes are needed to ensure the sustainability of capital projects in general, and PPPs in particular, in the medium to long term.

### Timing of PPP decision vis-à-vis the budget process

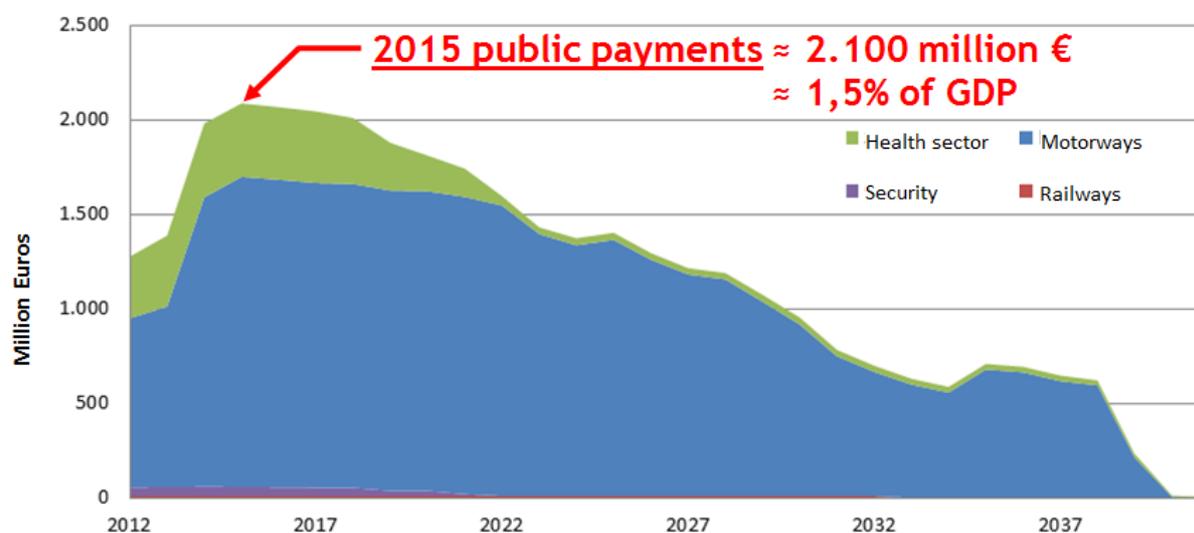


Source: Rial Isabel (2014), “Budgeting Sustainably for PPPs and Traditional Capital Projects in the Medium and Long-term”, Presentation at the OECD’s 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 17 2014

**Dr. Gisela Lehmer-Kerkloh**, Project Partnerships Germany, Federal Ministry of Finance, **Germany** spoke about how to align capital projects (both PPP and TIP) with the MTEF. Germany’s federal budget has no overall national infrastructure investment budget sub-set, except the departmental budget for transport which includes a fixed asset component. Sectoral responsibilities for infrastructure investments are divided among different levels of government. Infrastructure plans by the Federation, Federal States, and Local Authorities inform these investments and are coordinated between authorities together with EU-Network plans. The federal budget includes three main relevant components: 1) a presentation of annual expenditure/revenue, 2) five-year medium-term financial planning and 3) an overview of PPPs over their life cycle. One important issue is ensuring affordability through aligning several elements. Another important issue is estimating the infrastructure gap, which depends on the ministry and the infrastructure sector for input. Budgeting for capital projects follows a set of prescribed procedures within centralized property management in Germany. Required elements include plans, allocation of costs, explanatory notes on execution, construction-cost estimates, financing, and a timetable. A last issue of importance is managing the fiscal space available, which is now subject to a new constitutional fiscal rule that limits borrowing through structurally balanced budgets (“the debt break”). This creates an anchor for fiscal sustainability.

**Mr. Fernando Crespo Diu**, Head of Unit, UTAP PPP Technical Unit, Ministry of Finance, **Portugal** revealed that PPPs at the central government level, mostly to finance motorways, could result in over EUR 2.1 billion of availability payments (1.5% of GDP) due in 2015 in the “do nothing” scenario. This looming fiscal strain resulted from the lack of a proper planning process in term of setting priorities, ensuring fiscal affordability, and performing a systematic cost or VfM analysis for all projects. The effect of contingent liabilities is also substantial, to the tune of EUR 3.4 billion for motorways only. Portugal is now trying to reduce its PPP payment obligations by 25%, notably by undoing previous renegotiations that resulted, for instance, in the conversion of shadow tolls into availability payments. Additionally, a new PPP law is underway, with the creation of a centralized PPP unit. Provisions to reduce fiscal risks include the development of public sector comparator (PSC) and VfM methodologies, risk allocation matrices, and a compulsory fiscal impact analysis of any renegotiation. Currently, Portugal is aiming to launch new PPPs, including in the health sector. However, it is very difficult to identify financing given that non-productive projects have effectively blocked productive projects.

**2012 State Budget projections of public payments to PPP, Portugal  
("do nothing" scenario)**



Source: 2012 State Budget, Ministry of Finance

Source: Crespo Diu Fernando (2014), "Developing PPP frameworks: the Portuguese experience", Presentation at the OECD's 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 17-18 2014

Discussion brought forth the importance of properly accounting for PPPs. International standards such as the IFRS and Eurostat rules should be followed in order to avoid biases for selecting PPPs as an off-budget option for capital projects. Measures should be taken to show the government's overall payment obligations over the medium and long term such as what is done in the UK. Another area that merits greater scrutiny is the use of government guarantees.

## **Day 2 – Tuesday February 18, 2014**

### ***Session 6: PPPs in Russia – an OECD snapshot***

**Mr. Ian Hawkesworth**, Head, Capital Budgeting and PPPs, Budgeting and Public Expenditures Division, **OECD** presented the OECD's report on the current PPP framework in Russia and its alignment with the OECD's 2012 PPP Principles. Russian authorities are broadly aware of the steps needed to establish a good public governance framework for PPPs, and are actively working on updating and strengthening the institutional and legal framework. The Principle's first heading calls for establishing a clear, predictable and legitimate institutional framework. The introduction of a new federal PPP law, which is still being reviewed by the Duma, will be a substantial step in the right direction. The capacity of the public sector is expected to continue improving and harmonizing, notably at the federal and regional levels in light of substantial needs. The second part of the Principles focuses on grounding the selection of projects in VfM. This requires more work in Russia. The infrastructure prioritisation process is comparable to what is found in many OECD countries. The Ministry of Economy and Finance is also working on developing guidelines and tools for risk management, VfM, and re-negotiation among others. Further steps are however needed to promote and ensure sufficient competition in the PPP market. Finally, under the third heading, PPP management and procurement needs to be further embedded into the relatively strong Russian budgeting framework. More tools to improve transparency about government guarantees and liabilities can help Russia manage fiscal risks and ensure affordability of PPP projects at all levels of the government.

**Mr. François Bergère, France**, who participated in the OECD's mission to Russia as a Peer Reviewer, highlighted specific challenges facing Russia, including the country's large size and different regions, its history of underinvestment in infrastructure, and the relative newness of the rule of law concept. The need for foreign direct investment (FDI) to develop infrastructure has been recognized, but there is still a lack of clarity about PPPs. Some obstacles that deter foreign investors or limit the added value of the PPP approach exist within the current administrative culture, such as a high input specification for projects, and the over-abundance of norms (legal, technical, financial), which might discourage foreign investors especially. Russia should fully harmonize relevant existing legislation (ex: Land and Budget Codes) with the new PPP law, an exercise that took years in France. A stronger VfM methodology will also be required in order to choose PPPs for the right reasons. Challenges remain in minimizing corruption in markets, but also in diversifying financial instruments for projects due to limited depth in the financial markets. There is, however, a strong political will to create an appropriate governance framework for PPPs in Russia. It is advisable to adopt a gradual approach by starting with projects that are limited in size and complexity in order to prepare for larger PPPs projects. Accompanying foreign lenders with some state institutions such as the Russian investment fund, IFIs, or State Banks could create an additional incentive for investors. The selection of a handful of pilot projects, such as a stadium for the upcoming soccer world cup in Russia, might also be a good opportunity

**Mr. Matthew Jordan-Tank**, Head of Infrastructure Policy, **EBRD** shared the EBRD's experience with capital projects in Russia. EBRD leans towards private sector led solutions, but remains agnostic towards PPPs. The PPP contract needs to make financial and socio-economic sense, should ideally benefit from underlying government support, and should have strong institutional capacity on the public sector side. The involvement of international advisors is often reassuring for private investors. Pre-tender meetings, open consultation with different stakeholders, road shows, and different outreach efforts by the public side are also viewed very positively. The value for money assessment can be viewed as esoteric and could be simplified for public consumption, to show the added value of a project as a PPP. One challenge specific to Russia is the deeply embedded tradition of state input on engineering design of projects. This may hamper innovation. As far as requirements from the private side, banks need some step in rights in the case of the failure of an operator, for instance. EBRD noted the willingness of Russian authorities to negotiate that point. Finally, the importance of SOEs in Russia should be emphasized, but perhaps authorities can help them transition into viable commercial entities, as seen in a number of countries.

**Ms. Maria Yarmalchuk**, Head of Section, Section of PPP Development, Department of Investment Policy and PPP Development, Ministry of Economic Development of the **Russian Federation** closed the session's presentations by explaining the urgent need for infrastructure development in Russia. The investment framework in Russia is on an upward trajectory, with an increasing recent score in the World Bank's *Doing Business* index. Although the legislative framework for concessions was expanded and recently amended, the concession model remains limited for Russian regions and municipalities wishing to undertake capital projects. For this reason, several regions decided to create their own PPP legislation, resulting in 67 regional laws (30 of which are operational). In order to create a harmonized framework, the Ministry of Economic Development has developed a draft federal PPP law. The law aims to solve several existing problems with current legislation, as well as set up a central PPP unit. The Ministry has taken the lead on developing the necessary legislation and documentation in this regard, while state banks are set to help regions implement projects. The law is expected to pass in 2014, and changes to the budget and tax codes will also be taking place. The Ministry is developing key documents such as value for money methodology guides, PPP agreement templates, control and monitoring procedures, and guidelines for the adoption of PPPs at the regional level. Additionally, authorities have organized educational programs for regions and municipalities that plan to implement PPPs. A National Council of PPPs will also be formed, to include representatives from foreign companies working in Russia.

**PPP Projects in the Transport Sector in Russia  
(planned and currently being implemented)**

Project	Investments, billion USD
High-speed Railroad Moscow - St.Petersburg	18,8
International transport corridor "Europe - West China"	18,4
Railroad "Prohorovka - Batayisk"	16,8
Federal road "M-4 Don"	7,7
Federal road "M-4 The Urals"	6,5
By-pass Railroad in Omsk	4,7
Railroad "Polunochnoye - Salekhard"	4,1
Railroad "Komi - Arkhangelsk (Belkomur)"	4,1
"Vostochniy" Spaceport (First Stage)	4,0
Murmansk transport nodal point	3,5



Source: Yarmalchuk Maria (2014), "PPP: current status & perspectives", Presentation at the OECD's 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 18 2014

The subsequent discussion touched on the importance of having capacities in place at the sub-national level in order to successfully implement PPP projects in Russia. In France, most PPP projects were initially launched at the regional level. Canada's PPP industry started at the municipal level, driven by provinces in sectors such as healthcare and roads. The federal government only started engaging in this trajectory about five years ago, and is using best practice available at the provincial level. The UK has delivered several schools as PPPs at the sub-national level, and is grouping a number of schools into one package in order to attain value for money. Procurement for those is centralized at the level of the Secretary of State of Education.

***Session 7: Maintaining value for money during the operational phase***

**Mr. Michael Burnett**, PPP Expert, **European Institute of Public Administration** emphasised the need to create a performance management regime to manage and implement PPPs successfully. There are several challenges to maintaining value for money. Contracts change frequently, and this generally puts the public sector in a position of weakness. The reason for this is that there is an asymmetry of capability, notably in the negotiation skills of the public sector relative to the private sector. One of the most recent developments in the UK as part of the new PF2 regulation is to bring in public sector equity into PPP contracts, which could potentially improve access to information and thus leave the public sector better placed to tackle renegotiation. Common mistakes that can be noted in contract management include: the "sigh of relief" when the procurement award process is completed, leaving the management of contracts to less senior/competent officials with limited knowledge of the issues arising in the procurement, and ill-designed PPPs that are difficult to manage effectively. When a risk materializes, the private sector will often try to rebalance the contract even if the risk is contractually allocated to it. The public sector may be

in a position where it has to accept this risk re-allocation since other options available, such as terminating the contract or enforcing the contract, may be difficult in view of the short term operational consequences of a project's failure for all parties involved. Some examples of responses to challenges were discussed, such as the UK's National Air Traffic Services, which suffered from revenue loss due to declining air traffic after 9/11. With no investment possible from airlines into the SPV, the government's intervention was necessary in order to avoid the interruption of air traffic control. The intervention was successful and the private partner has traded successfully and profitably for several years. The EU's new public procurement directive will extend the scope of public procurement to the contract execution period. This will provide greater flexibility to change contracts but also extend the horizon of bidders in challenging the legality of changes during the execution, thus potentially leading to more challenges.

**Mr. Greg Smith**, Vice President Finance, Risk & Administration, and Chief Financial Officer, PPP Canada highlighted the importance of thinking about transferring output and risks back to the private sector during the operational phase. PPPs in Canada are relatively young, and the regulatory regime is based on practice from the UK and Australia. PPP Canada was created as a crown organization with a private sector board, which has increased its room for manoeuvre compared to more traditional public sector organizations. Experience has shown that value for money from projects, the existence of a competitive market (which also includes European contractors), and transparency about PPP benefits have been instrumental. The bond market has also evolved significantly, allowing for less reliance on banks. PPP Canada is a centre of excellence and source of expertise in PPPs. All projects with capital expenditures of CAD 100 million or more must be assessed as a potential PPP. This rule applies to all jurisdictions, as they need to present a valid business case, with a value for money assessment, in order to receive federal support. Although Canada's experience is relatively new and no experiences of failure have been recorded, PPP Canada has developed an Operational Period Initiative in order to maintain the value of existing deals. This is necessary as there is a general lack of knowledge sharing on the operational side. PPP Canada is now looking at different public jurisdictions, but also at the private sector to see how to obtain a continuity of people who manage different phases of the project. Some things it is considering are: what is needed as far as measurement metrics; the competencies of people who have to manage those contracts long term; and how bundled school projects hand off responsibilities to various school boards after being centrally procured.

**Ms. Victoria Keilthy**, Director, National Audit Office (NAO), **United Kingdom** presented four key issues that are relevant for the VfM of a project during its operational phase. 1) Demand forecasting is done during the bidding phase, but its quality only comes through during the operational phase. As exemplified by the 1996 Channel Tunnel Rail Link contract, awarded to company predicting highest passenger revenues, this has fundamental implications. It is very difficult to transfer demand risk to the private side, which is why there is often a minimum demand guarantee to boost investor confidence. 2) Considering how debt will be refinanced in light of issues that emerge during the operational phase should be secured through appropriate contractual terms. Some investors in the past benefited from big refinancing gains that were not shared with the public authority. In 2002, the government introduced a requirement to equally share such gains from refinancing, and has been constantly refocusing its contracting approach in this regard. 3) Managing maintenance and other 'soft' services are essential. Based on the experience of 76 operational hospital PPPs in the UK, the meeting of such performance criteria can be difficult. Good performance should be anchored in a performance management system that sets sufficient and appropriate penalties and incentives for the private sector. Other issues include managing contract changes to ensure that they are cost effective. All in all, even small PPP contracts should have at least one person to manage them full time. 4) Identifying and negotiating savings from operational PPPs programs allowed the UK to save GBP 1.6 billion by 2013 through removing what is not needed in practice. A more efficient and effective utilisation of space and reducing the frequency of some services are examples of things that were used to reduce costs. More can be done to reduced costs even further, but limited skills and resources to

manage this process remain a challenge. Finally, affordability remains an essential consideration along with value for money, especially considering the long term nature of PPP contracts.

**Mr. Carsten Greve**, Professor, Copenhagen Business School, **Denmark** emphasized the importance of skills to ensure good contract management. This can be organized in different ways such as by combining in-house skills with those of hired external advisors. PPP units can play a role in organizing contract management capabilities. For instance, Partnership British Columbia has about 50 personnel members, creating a concentration of knowledge and procurement management ability. The PPP unit's role needs to be combined with a capable audit practice in order to increase vigilance and focus in managing PPP contracts. The UK audit office notably does a lot of reporting in this area.

There are several upcoming publications around PPP contract management, such as the EIB's guide on how to manage PPP contracts during the operational side, or the NAO's review of the public sector comparator, where a wealth of comparative data about PPPs will be made available.

### ***Session 8: Developing PPP frameworks – where do you begin?***

**Mr. Gordon McKechnie**, Chair of the OECD's Annual PPP meeting, launched the 2-day meeting's final session by summarizing various factors that are important for PPPs:

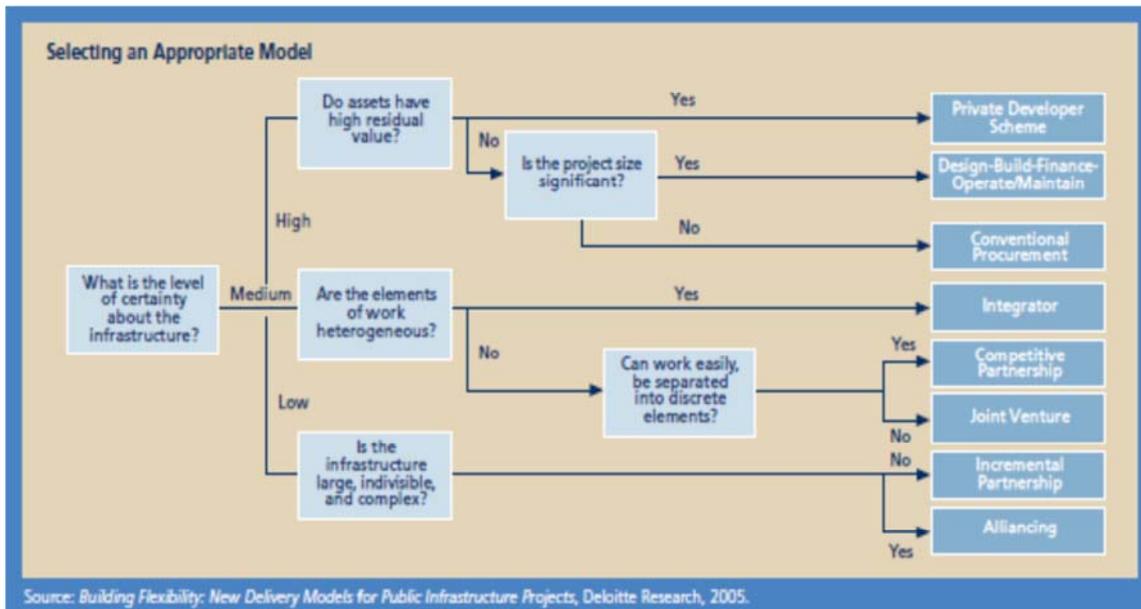
- A PPP unit with the needed capabilities in place to do its job
- Underlying socio-economic value for PPP projects
- Well planned projects, which requires a substantial amount of work upfront
- Investor confidence in the legal and regulatory framework
- Good and transparent dialogue between the public and private sector by understanding one another's needs and requirements
- A gradual approach to PPP projects
- Value for money as the criteria for selecting PPPs, not balance sheet treatment
- A credible, viable, and transparent pipeline of projects

**Mr. Charles Lloyd**, Partner, **PWC** and former Head of PFI Policy at HM Treasury, UK presented the main building blocks to start developing a PPP framework: a strong legal framework, the availability of a deal pipeline, and centralized market management. The legal framework: when countries require separate legislation to execute PPPs, the framework should be enabling rather than too prescriptive in order to allow for flexibility of contracts. Deal pipeline: the preparation of an attractive deal pipeline should be managed by experienced people, and should be focused on markets that are PPP friendly. Clear communication to the market is also essential. In the early days of UK PPPs, HM Treasury's 'motto' used to be "deals not rules" in order to first get some experience in the market. Market management: it is best done through a single contact point in the country, such as a PPP unit. It is especially important to gather support in early stages of a PPP program by getting attention from the market. The PPP unit needs to be a state entity, but it could use external consultants if needed. Other building blocks can be developed at a later point as more experience is gained by countries. A skeleton is needed for the governance and process framework, but not a full body of guidance, as it will naturally evolve over time. Standard contracts can also be "borrowed" from already existing good practice countries before being refined over time. All these building blocks for a good PPP framework can be bolstered through managed public relations, political support, and a sustainable economic context.

**Mr. Fernando Crespo Diu**, Head of Unit, UTAP PPP Technical Unit, Ministry of Finance, **Portugal** shared that the country has invested USD 15 billion in PPPs up to 2012. These include mostly motorways, but also some rail and health sector contracts. In the 90s, the motivation for building motorways as PPPs (more than 3 000 kms are under operation) was to use SOEs to get infrastructure investments off balance sheet. The legal framework was a bit too permissive, the project pipeline was too big, and some projects were not sound. No public sector comparator (PSC) or other VfM analysis was performed for motorway PPPs. After a hospital PPP was plagued with problems in 1995, the government started to develop a strong sectoral framework, a number of PSC methodologies, and much more complex contracting structures in hospitals than in motorways. Public sector capacity problems persist due to underinvestment in the public sector's own resources. Teams suffer from poor project preparation, a low capacity to accumulate experience, and information asymmetry vis-à-vis the private sector. Key methodologies such as fiscal affordability analysis or PSC are often neglected, and the quality of some projects can be low due to poor risk allocation. A sound PPP framework would require several elements: a strong institutional and legal framework, a good selection of projects, capacity at both the Ministry of Finance and line ministerial level, external advisors (but without substitution of public sector responsibilities), and abiding by a strong VfM methodology.

**Mr. Peter Livesey**, Head of Capital Finance, Central Capital Unit, Department of Education, **United Kingdom** described another approach to PPPs. Before considering PPPs, countries should explore if they are the right solution. There are several questions governments can ask themselves to see if they doing PPPs for the right reasons: 1) Is there a need for investment? Is there socioeconomic value in the project? 2) Does it make financial sense to engage in such a complex project type? The rule of thumb in the UK is that any project less than GBP 20 million does not make sense as a PPP, and will probably not produce sufficient value for money due to the high transaction costs of PPPs; 3) Does the government fully understand the product it is investing in? Is it a stable asset that can be well defined? Sometimes this is not possible in fast-evolving sectors such as ICT in which case PPPs should probably be avoided; and 4) Can the private sector deliver? After determining the need, the next step is the selection of the right PPP model and partner that will deliver a government program's objectives. The difference between various models is the risk transfer, and the market pricing. PFI is right around the middle between low risk and the low pricing of risk (concessions), and building and operating completely from the private side (BOO). The decision of which PPP model to choose depends on where the governments wants to stand on that scale.

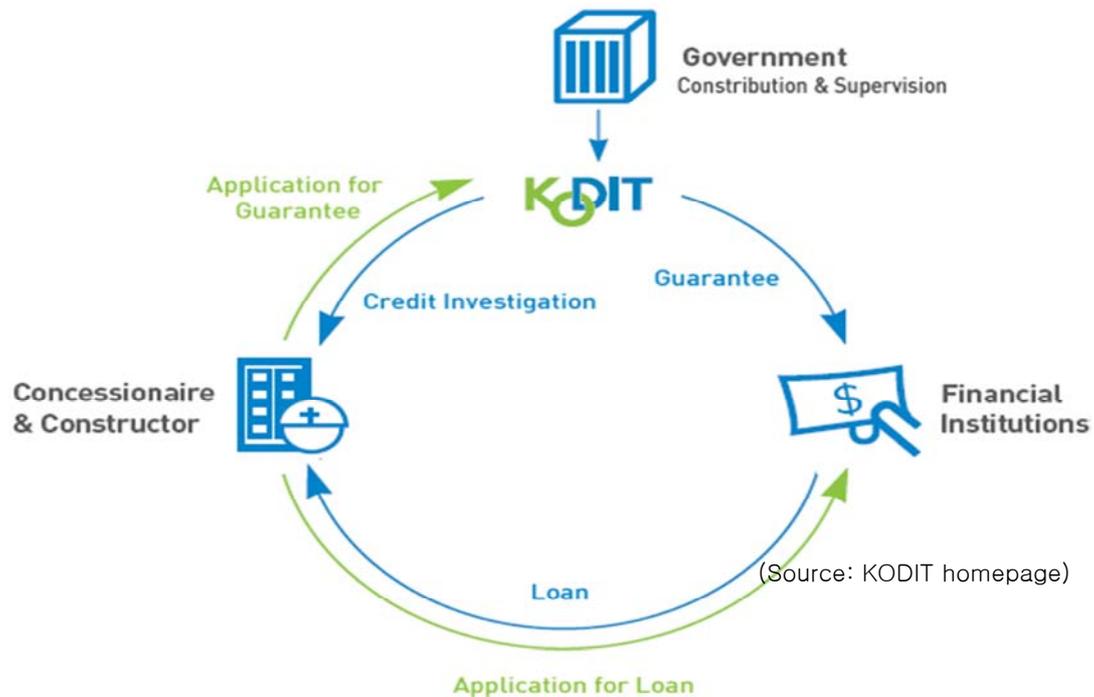
**Which PPP? How to Decide?**



Source: Livesey Peter (2014), “Public Private Partnerships – Where do you start? A Personal View”, Presentation at the OECD’s 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 18 2014

**Dr. Kangsoo Kim**, Executive Director, PIMAC, **Korea** shared that 633 PPP projects are currently in construction or in operation in Korea, with more than 120 projects implemented in 2007 alone. The Asian financial crisis initiated a social consensus about inviting private capital into infrastructure financing in Korea, and facilitated the introduction of PPPs. Several factors contributed to their success, starting with the legislative framework. Since 1994, there have been improvements to the PPP law, which can *de facto* override other laws if there is a conflict. Korea also has Basic Plans for PPPs, which direct government policy. Contracts benefited from proper risk sharing schemes and government’s support. On the financial markets side, the Korea Development Bank shepherded projects by financing PPPs at early stages, before investment banks joined in with long term financing. Infrastructure bonds were launched through the Korea Credit Guarantee Fund to make project financing even more viable for PPPs. The Public and Private Infrastructure Investment Management Centre (PIMAC) plays a key role in integrating public investment management and budgeting for PPPs. It is the merger of the PPP unit with the public investment unit, and assumes both roles. This is needed in order to achieve consistency in project assessment and efficiency in human resource management. One key factor for establishing an appropriate PPP framework is a learning-by-doing approach, by starting with small projects that can pave the way for larger PPPs. Capacity building at the institutional level is also a continuous exercise that should be supported by the government and through international cooperation.

### Korea Credit Guarantee Fund Mechanism



Source: Kim Kangsoo (2014), “Developing PPP – where do you begin?”, Presentation at the OECD’s 7<sup>th</sup> Annual Meeting of Senior PPP Officials, Paris, February 18 2014

**Mr. Rui Monteiro**, Senior Public-Private Partnership Specialist, **World Bank Institute** emphasized the importance of good governance, which should be a pre-requisite for PPPs. There is a need for a governance structure able to identify projects that will add socio-economic value, especially in the case of developing countries where there may be a resistance to PPPs. The legal framework should not be the only focus. For example, countries like Poland and El Salvador didn’t need a PPP law to do PPPs. A PPP law in itself may thus not be necessary, as long as legislation surrounding capital projects is robust. Concerning the project pipeline, governments cannot only rely on one or two flagship projects. There is also a need to build market management capabilities on the public sector side. In order to align all these components for a PPP framework, a process must be created on the public sector side to align the good governance of PPPs with public interests. This is where a PPP unit should ensure the right launch of a PPP program.

During the discussion, UNCITRAL presented its latest work on developing legislative model templates for PPPs. It is impossible to have a standard model given all the legislative differences between countries. For this reason, it is important for the legislation surrounding PPPs to be harmonized such as the investment and budget codes.

### **Future Work**

In the closing session, **Dr. Bernhard Müller**, Head of Division, Project Partnerships Germany, Federal Ministry of Finance, **Germany** graciously highlighted the work of the Network and its delegates. The Network had given Dr. Müller clear ideas that could be used in Germany when the country built its own PPP network. The Chairman thanked Dr. Müller for his steadfast support of the Network.

**Mr. Ian Hawkesworth, OECD** spoke about the OECD's new initiative in Southeast Asia, which aims to bring the OECD's experience to a region with great dynamism through the sharing of ideas and best practices from member countries. The project on Operationalizing PPPs in Tunisia was also presented to delegates, with a call for knowledge exchange as the project progresses. The OECD will also be developing a PPP readiness framework, building on the insight from the meeting. Finally, the UK has agreed to be reviewed according to the OECD's 2012 Principles for Public Governance of PPPs. The review will be presented at the next annual Network meeting, which will take place in Paris on **23-24 March, 2015**.