

Developing Public Private Partnership in Croatia - A pilot public building project

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Abstract

The Private Public Partnership (PPP) procurement method requires the private companies involved to take long-term responsibility for public facilities, for not only the initial construction costs, but also for building operation and maintenance costs during its defined life.

The PPP procurement method for public buildings requires involvement of private and public clients, and includes finance, design, construction, maintenance and operation of public buildings (e.g. schools, hospitals etc.). The unsatisfactory condition of public buildings in Croatia, due to lack of usable space (e.g. schools etc.), demonstrates that the traditional procurement route for public buildings, among others, might be challenged with a new (PPP) procurement method.

In this paper the first public building pilot project is described, and the barriers and difficulties affecting its application are presented.

Keywords

Public Private Partnership, Public Buildings, Pilot Project in Croatia.

1. Introduction

In Europe, Public Private Partnership (PPP) is not a new way of procuring public buildings and other public facilities. It is used and has been developed in many European countries, and it varies in the type and number of projects carried out.

Although it is recognized across the Europe, there is still no widely accepted definition of public private partnership. The European Union (EU) currently has no agreed general definition of PPP. The result of these is that challenge has been set out to a number of Member States and other European countries in forming and developing legislation on PPP (Commission of European Communities, 2004). One of the reasons why there is a need for a general definition of PPP is the fact that a narrow definition can result in

legislation which is applicable only to limited types of building projects and structures, resulting in limited use of PPP (Commission of European Communities, 2004).

One of the most comprehensive understanding of PPP is provided by European Commission - DG for Economic and Financial Affairs (2004) as follows:

“The main distinction between PPPs and alternative privatisation schemes is that the public sector plays a key role as a purchaser of services. While in the case of pure privatisation (e.g., of public utilities), the clients of the private operator are private users, in the case of infrastructure building realised through PPPs, the government normally pays for the services to be supplied or has an influence in their specification. What instead distinguishes PPPs from the traditional public procurement model is the origin of the funds to accomplish the project. Instead of relying on government borrowing, most PPPs are financed through bonds issued by the private operator“

There are a variety of reasons why governments undertake PPPs. The objective of achieving improved value for money, or improved services for the same amount of money as the public sector would spend to deliver a similar project, is often stated as the prime objective. But other objectives may also be important. These can include the desire to provide increased infrastructure provision and services within imposed budgetary constraints by utilising private sources of finance via “*off balance*” sheet structures, or to speed up the delivery of projects which might otherwise have to be delayed (Abadie and Howcraft, 2004).

PPP as an idea has, or should have, a goal of raising standards in building public facilities, as well as raising standards in the building industry in general. In many countries around the world PPP is recognised as a move away from strict cost-based procurement to whole life cost (value) based procurement (Clift and Bourke, 1999; ADBI, 2000; El-Haram et.al., 2002; Marenjak, 2004). This distinction is very important because evaluation concentrates not on the cost of the work but on the global whole life cost of financing and operating the facilities over an extended term and allocating risks to the party most capable of containing and managing them (Construction Industry Council, 2000).

PPP contracts have also introduced “payment mechanisms” and “output specifications”, where the public sector is guaranteed to pay only for those services that the private sector delivers, and the price for these services depends on the standards achieved by private sector (Fox and Tott, 1999). Payment mechanisms and output specifications provide the opportunity for the private sector to explore innovative and cost effective ways to deliver needed services in specified standards.

In recent years there has been a growing concern in the world about matters of “sustainable development”. It is expected that through PPPs, the private sector will become more involved in this matter. Large public projects, such as building health facilities, defence and education facilities, are extremely complex and expensive. These facilities also tend to consume a lot of energy and produce a lot of waste (e.g. in some hospitals, even toxic waste) and rationalisation in this matter is needed. It has been shown in the past that the private sector has introduced more innovative techniques, methods and technologies to deal with these problems and has implemented these innovations much faster than the public sector (Akintoye et.al., 2003).

There are a number of ongoing PPP projects in EU (as shown in Table 1) and the interest in the use of PPP as a procurement method for public buildings is growing from day to day. As some time has passed since the first PPP projects were procured, it is now possible to see some results, in terms of the benefits as well as the problems that have been encountered through the years (Blackwell, 2000).

The most developed PPP processes and understanding are in the UK where it has been used in wide range of projects over the last 12 years (Abadie and Howcraft, 2004). Through the UK's example and experience other countries have learned about the benefits that this method of procurement can bring. In recent years, a number of European countries have started to use PPP as a procurement method for public buildings and the number of projects carried out this way are increasing (Commission of European Communities, 2004).

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 |

Table 1: Summary of PPPs by country and sector
 (Abadie and Howcraft, 2004) – “data for Croatia” added by authors, to this source).

| | Schools | Health & Hospitals | Housing | Sports & Leisure | Defence | Prisons | Airports | Roads | Water & Wastewater | Heavy Railway | Light Railway |
|--------------------------|---------|--------------------|---------|------------------|---------|---------|----------|-------|--------------------|---------------|---------------|
| 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 | | | | | | | | | ☆ | | |
| Applicant Country | | | | | | | | | | | |
| Croatia | ○ | | | ○ | | | | ● | ● | | ○ |
| Bulgaria | | | | | | | ○ | ○ | ☆ | | |
| Romania | | ● | ○ | ● | | | | ☆ | ☆ | | |
| Turkey | | | | | | | ☆ | ○ | ☆ | ○ | ○ |

2. PPP in Croatia

PPP in Croatia is still not recognized and acknowledged as an alternative to the traditional procurement method. There have been some motorway projects that can be regarded as a type of PPP, one of which is the Zagreb-Macelj toll road.

2.1 PPP in Motorway Projects

The €360m Zagreb-Macelj Toll Road is a project comprising a 60 km stretch from the Slovenian border to the Zagreb ring road. The motorway is intended to solve congestion in the vital Pyhrn Corridor (part of the Trans-European Network) linking Western and South-Eastern Europe. The northern part, which is located in a mountainous area, needs to be constructed and will include several artificial structures including tunnels with a total tube length of 4.7 km. The middle section consists of an existing dual carriage motorway leading from Krapina to Zapresic, which is to be remediated by the concessionaire. In the south, an existing section is to be remediated by the Republic of Croatia (RC) and upgraded by the concessionaire from a single lane to a two-lane motorway, linking with the existing Zagreb ring road. The concession period, during which the concessionaire will construct, operate and maintain the road, is 28 years. Project completion is required to be achieved 3 years from the commencement of construction, which began immediately after initial drawdown under the debt facilities.

An innovative component of the project structure is the agreement by the RC to support the project in the event that projected traffic volumes are not achieved or if actual operating and financing costs are higher than forecast. The level of support is tailored to the construction and operation phases. During construction (at which time the existing sections of the motorway will continue to be operated and tolled), the RC is obliged to supplement revenues if traffic volumes fall below the level defined in the financial model guarantee case. During operation, the RC is obligated to supplement project revenues if traffic volumes fall below the level that is required to generate sufficient revenue to meet defined debt service obligations (including debt service reserve and maintenance reserve account funding requirements), and specified operation and maintenance costs.

The project has been financed through a combination of Hermes export credit facility (€100 million), an uncovered commercial facility that included a working capital facility (€112 million), a mezzanine facility insured by the German Government (€100 million) and shareholder funds (€60 million).

2.2 PPP in Building Projects

The need for PPP in building projects in Croatia has arisen for two reasons. Firstly, the fiscal limitations in Croatia, at national and local authority level, which restrict funding of capital public investments only from budgetary resources, and secondly, inadequate infrastructure and the required increase in standards for some public buildings (e.g. schools, hospitals, university buildings etc.). However, Croatia has additional investment requirements arising from its transition.

One such requirement is identified in the need for new a secondary school in the town of Koprivnica. There have been discussions between the town and the county and the Croatian Ministry of Science Education and Sport (MoSES) about the use of the PPP procurement route and the “Design Build Finance and Operate” (DBFO) type of contract for a secondary school and sports hall, with a total net gross area of 10663 m². The economic life of the project is assumed to be 25 years. In order to comply with the rules and principles of non-discrimination, transparency and satisfactory competition, the process of selecting contractors and awarding contracts has to be adequately transparent and objective. Therefore an open

procedure is applied, and the key stages in the procurement process are shown in Table 2. Finally, the contract will be awarded to the consortium with the most economically advantageous tender.

Table 2.: **Key stages in the procurement timetable – PPP pilot building project**

| | |
|--------------|---|
| 2 months | Town and county discussions with MoSES and decision to use PPP route |
| 3 – 4 months | Formation of project team (including advisers) and preparation of a “business case” |
| | Expressions of Interest (EoI) - advertisement |
| | Contractor briefing day |
| 2 months | Prequalification responses |
| 2 – 3 months | Short-listing and issue of Invitation to Negotiate (ITN) Pre-bidding conference |
| 2 – 3 months | Receipt of bids end evaluation |
| 1 – 2 months | Announcement of preferred bidder and reserve |
| 2 – 3 months | Commercial terms agreed Financial close and start on site |
| 18 months | <i>Operation of the school starts</i> |

The objective of this first PPP pilot-project for schools in Croatia is to provide a good practical example of how to procure this type of project, and to identify all the benefits which might occur.

At this early stage of procurement the following barriers and difficulties affecting the application of PPP for building projects in Croatia have been identified, throughout structured interviews with representatives from public and private sector in Croatia:

- difficulty in the development of Public Private Comparator and Public Sector Comparator, due to lack of available and reliable historic data;
- difficulty in the preparation, tender and execution of a PPP project from the governmental authorities’ side, due to a lack of a sufficient level of expertise and understanding of the complexity of the whole process;
- emphasis on input specification, instead of output specification;
- difficulty in “meeting” and understanding transaction costs from both the public and local private sector;
- difficulty in quantification of possible risks during all phases and stages of the project;
- lack of the “culture” of partnering within the teams involved in the project;

- lack of commitment and resources to develop the necessary institutional capacity.

3. Conclusion

PPP is not just a way of procuring particular public projects; PPP is an integrated way of thinking and many techniques have been developed (e.g. whole life costing) and/or tailored from other industries (e.g. maintainability, reliability and availability analysis etc.) which can be adopted and applied to other forms of procurement, enabling governments to procure traditional projects in a more effective and efficient way. Evidence from the UK and the Netherlands demonstrates that if PPP projects are well procured and executed, it is possible to reduce whole life costs by approximately 15%. (Abadie and Howcraft, 2004).

There are legal and fiscal limitations in Croatia, as well as in other EU countries, which compose greater barriers to fund capital public investments only from budgetary resources. Therefore, the Croatian government needs to demonstrate greater political will and to commit resources to develop the necessary institutional capacity. A government PPP task force needs to be developed which could assist Ministries in the selection of a number of pilot projects in various sectors, and which could suggest a national strategy for the funding of feasibility studies and transaction costs in the public sector for identified pilot projects. The next step would be to develop a PPP unit which is able to assist in the preparation, procurement and organization of PPP projects at regional and local authority level and to ensure that knowledge and experience will be available for future projects. This will enable consistency in PPP procurement at a national level.

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