

NOTE

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Executive summary of barriers to PPP in municipal and regional public works contracts

The interest for PPP (public private partnerships) in Denmark has increased in recent years. In the fall of 2013 the Danish Competition and Consumer Authority was aware of 20 Danish contracted PPP projects in public works contracts. In addition there are five projects in tender as well as several in preliminary stages. In the fall of 2012 there were 13 Danish contracted PPP projects. The growing interest may in part be due to generally positive Danish experiences with the PPP model. The positive Danish experience with PPP is the result of a study on the first 13 Danish PPP projects. The study shows that all 13 contracting entities of the first PPPs evaluate their projects as successful. Furthermore, of the nine projects already constructed, all were completed on time and eight out of nine on budget. This can, among various other factors, be ascribed to the PPP model, which encourages municipalities and regions to focus on lifecycle costs and to share risks with their private partners.

Municipalities and regions do however experience a number of barriers to enter into PPP projects. The barriers contribute to municipalities and regions opting out of the PPP model in public works contracts. The barriers are in particular linked to lack of experience in the municipalities and regions. Municipalities and regions also experience a barrier in the Danish market for PPP construction and finance in which potential private partners have few PPP references. Additionally, the Danish regulatory framework conditions for PPP and some of the underlying arguments behind the model itself are experienced as barriers.

While the barriers may constitute obstacles to municipalities and regions in obtaining the benefit of the PPP model, some barriers may also express that the PPP model is not well suited for specific public works contracts.

The focus of the report is on barriers as they are experienced by Danish municipalities and regions. The potential barriers for PPP experienced at the state level are not addressed in this report.

The report is written by the Danish Competition and Consumer Authority based on data collected by Rambøll Management Consulting (Rambøll).

The analysis is based on a questionnaire sent to all municipalities and regions, as well as interviews with seven municipalities and two regions. The data collection took place in three different layers of management within municipalities and regions, more specifically on a political, an administrative and a technical layer. This could for example be the mayor, the director of municipal administration and the director of technical administration.

In order to carry out the questionnaire, Rambøll made contact to the three layers of management in every municipalities and regions. Rambøll received 187 replies out of a possible 309¹, which corresponds to a participation rate of 61 percent. At least one layer of management from 93 municipalities and all five regions has responded to the questionnaire.

Rambøll has conducted three interviews with representatives from the three layers of management in each of the seven municipalities and two regions. Of these, four municipalities and both regions have contracted at least one PPP while the remaining three municipalities are considering doing so.

Box 1.1

Main conclusions

72 percent of the Danish municipalities and regions are considering using the PPP model for public works contracts. Also, the municipalities and regions show a very positive attitude towards contracting out tasks such as operation and maintenance of buildings. Despite this there are few public works contracts organized as PPP's. This is, among other things, attributed to the experience of barriers by municipalities and regions, in the process of selecting the PPP model. The conditions experienced as barriers by municipalities and regions can be divided into three categories:

- **Barriers in internal conditions**
Barriers in internal conditions are ascribed to the municipalities' and regions' expectations to or experience with PPP. The conditions experienced to constitute the largest barriers by municipalities and regions are:
 - The process surrounding a PPP is time consuming and resource demanding
 - The municipality or region believes that it can create better solutions internally than by using PPP
 - Municipal and regional public works contracts are considered too small in value vis-à-vis PPP
- **Barriers in external conditions**

¹ The grand total of 309 possible replies is made up of 98 municipalities and five regions each being able to provide three replies: $309 = 3 \cdot (98 + 5)$

Barriers in external conditions are mostly present in the market for construction services and financial services. The conditions experienced to constitute the largest barriers by municipalities and regions are that:

- Private finance is considered too expensive
- Competition in the market for PPP is considered to be lax
- Potential financial investors are considered risk averse

- **Barriers in framework conditions**

Barriers in framework conditions are barriers faced in relation to legislation or characteristics of the PPP model itself. These barriers are in principle fixed and establish the framework conditions for municipal and regional PPP projects. The framework conditions experienced to constitute the largest barriers by municipalities and regions are:

- The deposit obligation that equates private finance with other sources of borrowing from the municipal and regional point of view
- Long maturities of PPP projects in the range of 15-25 years, which restricts municipalities and regions to freely dispose of their own future resources

The assessment of PPP by municipalities and regions depends on whether they have experience from a PPP project², or whether they are just considering establishing one. Almost 60 percent of representatives from municipalities and regions with PPP experience assess the PPP model as *good* or *very good*. The corresponding share of representatives from municipalities and regions considering their first PPP project is just above one third.

Results of the questionnaire also show that municipalities and regions do not experience strong drivers in favor of PPP. The drivers that some municipalities and regions do agree on are that the model encourages focus on functional features instead of processes, that PPP projects are completed on time and on budget and that risk is shared adequately with the private partner. The representatives of the case studies including seven municipalities and two regions agree on three main drivers for the PPP model: Focus on lifecycle cost, a possibility of avoiding the municipal and regional construction threshold values and reduction of the otherwise mandatory deposit obligation. The case studies also show that some case representatives consider deposit obligation reductions the single main argument in favor of PPP.

The following sections describe the barriers in greater detail.

² Municipalities and regions with experience are defined by having a political decision on going into a PPP-project. A subset of these municipalities and regions has contracted at least one PPP project.

Overview of the barriers

An overview of the 17 barriers and the degree to which they are experienced by municipalities and regions is shown in table 1.1. The conditions are sorted according to the proportion of municipalities and regions that find them be a barrier to enter into a PPP *to some extent* or *to a great extent*.

Table 1.1 Experience of barriers in municipalities and regions

To which extent do *you* experience the following conditions, in the decision processes in your municipality or region, as barriers to PPP?

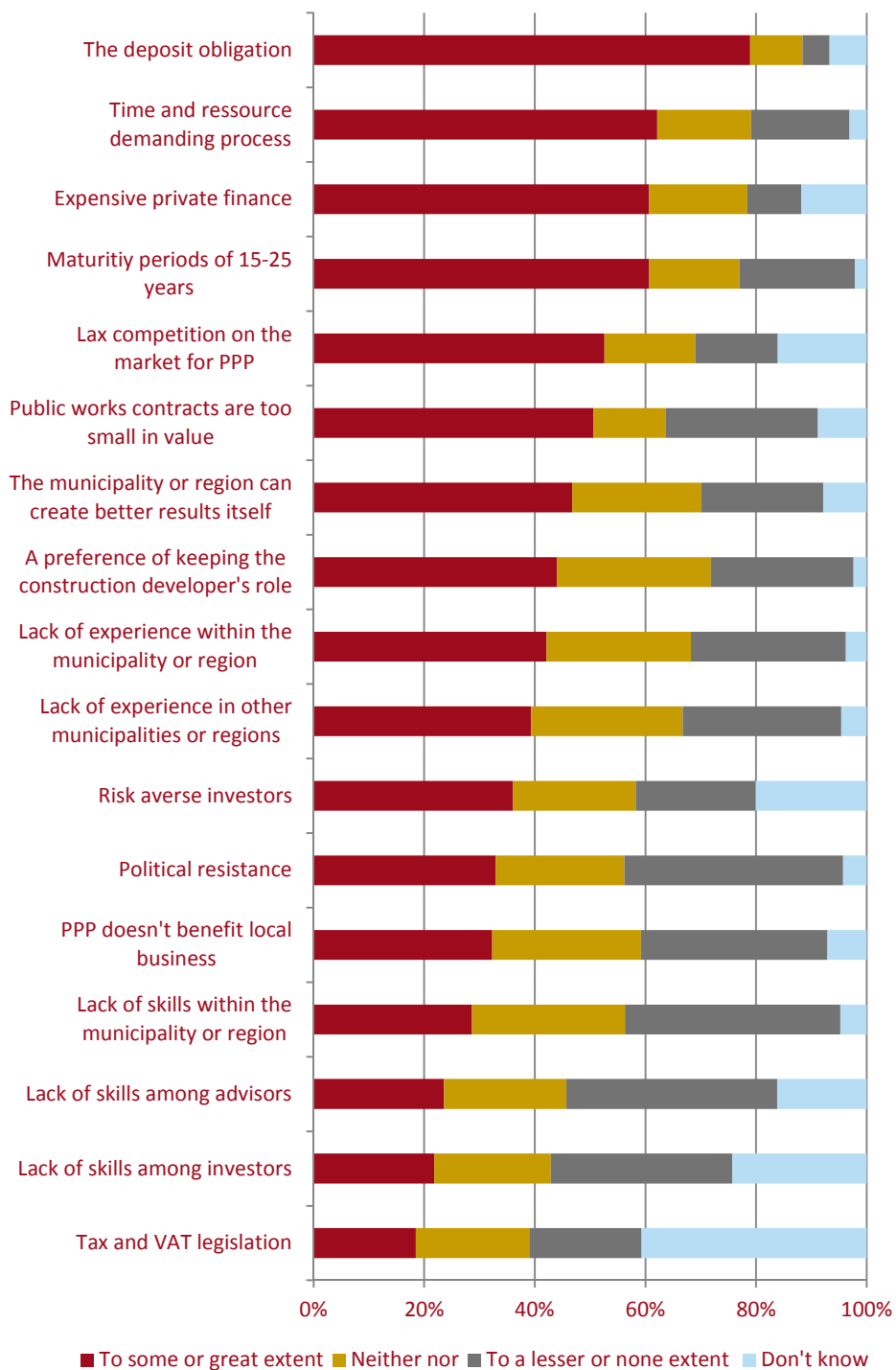


Table 1.1 shows that municipalities and regions experience the deposit obligation, the process surrounding a PPP, the cost of private finance and the maturity periods of 15-25 years as the largest barriers to engaging in a PPP project.

The 17 barriers that are examined in the questionnaire have been selected by Rambøll in cooperation with the Danish Competition and Consumer Authority. The barriers have been selected based on a series of interviews with PPP experts as well as with municipalities and regions. The case interviews have been conducted prior to the questionnaire.

Some of the barriers are primarily an indication of the PPP model being poorly suitable in the case of certain projects. To the extent that municipalities and regions, for instance, can create solutions superior to those offered in the PPP market, it is the case of a barrier that cannot and ought not to be broken down.

The 17 barriers can be divided into three different categories: internal conditions, external conditions and PPP framework conditions. The three categories differ in the sense that they can be controlled and mitigated by different stake holders.

The division of barriers into three categories creates an overview of the barriers. Additionally, the division aims to allow for targeted initiatives, which can be put in place in order to mitigate unwanted barriers.

Barriers in internal conditions

Barriers to PPP in internal conditions are located with the expectations and experience of municipalities and regions. They are able to affect the size of these barriers. It is also internal conditions that municipalities and regions are most able to mitigate on their own.

There are seven internal conditions that municipalities and regions experience as barriers to PPP³:

- Time and resource demanding process
- The municipality or region can create better results itself
- Public works contracts are too small in value
- Lack of experience within the municipality or region
- A preference of keeping the construction developer's role
- Political resistance
- Lack of skills within the municipality or region

³ Barriers in internal barriers are sorted by experienced size. That is, the largest barriers are in the top.

Barriers in external conditions

Barriers in external conditions exist on the market for constructions services and financial services as well as with other municipalities and regions. In effect these are barriers that municipalities and regions cannot mitigate on their own. However, a development of a market for PPP can contribute to reduce these barriers in a long run perspective.

There are seven external conditions that municipalities and regions experience as barriers to PPP⁴:

- Expensive private finance
- Lax competition in the market for PPP
- Risk averse investors
- Lack of experience in other municipalities and regions
- PPP doesn't benefit local business
- Lack of skills among investors
- Lack of skills among advisors

Barriers in framework conditions

Barriers in framework conditions are barriers related to legislation or characteristics of the PPP model itself. These barriers are in principle fixed and establish the framework conditions for municipal and regional PPP projects.

There are three framework conditions that municipalities and regions experience as barriers to PPP⁵:

- The deposit obligation that equates private finance with other sources of borrowing from the municipal and regional point of perspective
- Long maturities of PPP projects in the range of 15-25 years, which restricts municipalities and regions to freely dispose of their own future resources
- Tax and VAT legislation

Drivers for PPP

The questionnaire also asked for PPP drivers. The questionnaire shows that there are no single drivers for PPP that appear to be of high importance or particularly crucial to municipalities or regions. The drivers that have the broadest consensus among the questionnaire's municipalities and regions are:

⁴ Barriers in external barriers are sorted by experienced size. That is, the largest barriers are in the top.

⁵ Barriers in framework conditions are sorted by experienced size. That is, the largest barriers are in the top.

- The PPP model encourages focus on functional features instead of processes
- An expectation to or experience with projects being completed on budget
- The possibility of adequate risk sharing with a private partner

During the case interviews that Rambøll carried out with a number of municipalities and regions, the interviewed representatives had a particular focus on two drivers for PPP:

- Economically advantageous projects. Partly due to coupling of construction, maintenance and operation and partly due to presence of private sector skills
- Exemption from construction threshold values and reductions in the otherwise mandatory deposit obligation

Expectations and evaluation of PPP by municipalities and regions

The questionnaire shows that municipalities' and regions' overall assessment of the PPP model in public works contracts is slightly positive. 40 percent of the questionnaire participants reported that PPP as a model for public works contracts is *good* or *very good*. Furthermore the questionnaire shows that the municipalities' and regions' assessment of the PPP model depends on whether they have contracted a PPP project or whether they are considering establishing one. 60 percent of municipalities and regions with a contracted PPP project indicate that the PPP model is *good* or *very good*. The corresponding share in municipalities and regions that are considering a PPP projects is just above one third.

The questionnaire also shows that 72 percent of the participating municipalities and regions have considered the PPP model in relation to public works contracts. In slightly less than 20 percent of the municipalities and regions this has led to the establishment of a PPP. According to the questionnaire, more PPP projects can be expected in the years to come. 42 percent of the municipalities and regions indicate that it is *probable* or *very probable* that the PPP model will be chosen for upcoming construction projects.

Outline of the report

Chapter 2 contains a description of the PPP model and provides an overview of the current number of Danish projects. In addition the chapter presents the general attitude of municipalities and regions towards exposing publicly provided services to competition, their assessment of the PPP model as well as their expectations of using the model in the future.

Chapter 3 introduces barriers to PPP as they are experienced by municipalities and regions. The chapter also divides the barriers into three different categories which are examined in the following chapters.

Chapter 4-6 contain the analyses of barriers in internal and external conditions as well as in frame work conditions from the municipal and regional point of perspective.

Chapter 7 presents the drivers for PPP as they are experienced by municipalities and regions. The chapter focuses on the financial constraints that municipalities and regions face and the economic advantages that the PPP model exhibits in comparison to other organizational forms in municipal and regional constructions projects.

Chapter 8 presents the analytic approach and method of the analysis. This includes the collected data on which the analyses are formulated and also the selection of municipalities and regions to case interviews as well as the division of labor between Rambøll and the Danish Competition and Consumer Authority.