



Caledonian Economics

SEVEN LESSONS
TO MAXIMISE THE BENEFITS
OF OPERATIONAL PPPs



CONTENTS

INTRODUCTION

As PPPs spread around both the developed and developing world and as new projects become operational, many countries are entering a new era in infrastructure. But delivering the benefits of such investment depends on the ability of public sector clients to manage the complex PPP contracts effectively. This is especially true in social infrastructure PPPs at the interface between public service delivery and private asset management.

Scotland has had a long history of using PPP to increase investment in infrastructure. The biggest successes have been in social infrastructure – mainly hospitals and schools. Lessons learned from pilot projects in the mid 1990s prepared the ground for a comprehensive PPP programme of investment in hospitals and schools in the following years.

These contracts were signed by sub-national government bodies within a standard national framework. This is helpful because it allows lessons to be drawn from a range of individual relationships within a common context.

Many of these projects have been operational for a decade. Thus, Scotland has a large body of experience in managing operational PPP projects in the social infrastructure sector.

This short report captures the major lessons that have been taken from the Scottish experience. It is intended as a guide to good practice in the management of operational PPP projects internationally.

METHODOLOGY

We interviewed ten public sector PPP professionals all of whom have been involved in the management of operational PPPs for at least seven years, and who had been involved in the procurement of the PPP beforehand. Several are involved in the operation of more than one operational PPP project. They include accountants, lawyers, design/construction experts, and contract managers.

Between them they have experience of sixteen PPP transactions of which eleven are operational four are in construction and one is in procurement. They include nearly 60 separate buildings in densely populated cities, sparsely populated rural locations, and on offshore islands.

Each is a Design-Build-Finance-Maintain PPP with an Availability-based Payment Mechanism with some differences of emphasis within the commercial structure. All include building maintenance services within the contract, and 'soft' facilities management to varying extents.

KEY LESSONS

1 TRANSPARENCY IS KING

Governance and Management structures must provide 'head to toe' transparency, demonstrating that decisions at all levels are being taken in the interest of service users and within the terms of the partnership agreement.

2 SMART MONITORING IS BEST

Self monitoring of performance by contractors cannot universally be relied upon. In the best contracts, Public Authorities know what to verify to ensure that the Availability Payment Mechanism provides the intended incentives.

3 PUBLIC MISGIVINGS ABOUT PPP CAN BE OVERCOME

Although PPP has its critics, if the facilities are clean, well run and efficient, people quickly accept them.

4 OPERATIONAL PPPS NEED TO BE FLEXIBLE

Good partnerships find the most efficient ways of implementing changes. The contractual mechanisms work, but may not make sense in every situation. Seek the best way to make changes, and then record what was agreed.

5 DISAGREEMENTS ARE INEVITABLE

Contractual Dispute Resolution Procedures are expensive and cumbersome. Disagreements related to construction issues are easier to deal with if the builder is also involved as equity or facilities manager. Address problems at the lowest level possible within the management structure.

6 KNOWLEDGE MUST BE RETAINED

PPP contracts will outlast the careers of the people involved. Ensure that knowledge of the contract, supplementary agreements, and rationale for specific features transcends the individuals involved. This is important for Public Authorities and Contractors.

7 BEGIN WITH THE END IN MIND

Preparation for the operational phase must begin during the specification and procurement stages. The best Contract Managers understand why the building is designed the way it is, why the terms were agreed, how the parties (public sector, users, funders, contractors) think. This cannot be an afterthought.

SCOPE OF STUDY

We wanted to explore:

- how systems of Management, Governance, and Transparency vary between contracts;
- if 'self monitoring' works;
- how public views of PPP change over time;
- whether contractual 'change mechanisms' really work;
- how disagreements have been resolved;
- ways in which knowledge is retained and developed;
- whether, with the benefit of hindsight, the teams were properly prepared when the new buildings opened.

WHAT WE FOUND

“ we are getting much better at knowing when and what to monitor

Management and Governance: varying structures reflecting local needs

Governance structures within the sample projects vary in detail, but they follow similar general forms. In each case the Public Authority and Contractor representatives meet monthly to review the performance reports and agree deductions. Separate meetings are often held to discuss user feedback and monitor performance trends. One Public Authority with many project facilities dispersed over a large area augments this with an annual user satisfaction survey which provides a different, helpful perspective on the service provision.

Regular meetings at a more senior level tend to reduce in frequency as projects mature and as processes become embedded. Some Public Authorities described a ‘rapid response’ group made up of senior representatives from Authority and Contractor whose job is to resolve exceptional problems before contractual dispute resolution processes are invoked.

Transparency is universally important for building confidence in the PPP model. Some contracts entitle Authorities to send an observer to Project Company board meetings, and this is always valued.

Self-monitoring becomes active monitoring

PPP contracts generally expect Contractors to monitor their own performance and to calculate deductions from monthly Availability Payments. In only one case is the Public Authority satisfied with the self-reporting mechanism. Others do not feel that self-monitoring by contractors is sufficient. We identified a range of issues, from the relatively minor random errors in classification or calculations, to apparently systemic inaccuracies.

Most Public Authorities have increased the manpower devoted to contract monitoring during the operational period. Some have employed a special Project Monitoring Team to visit sites and confirm that the payment mechanism deductions regime is operating correctly.

On projects with multiple buildings, and where the facilities are spread over a wide area, Public Authorities have developed a ‘smart monitoring’ methodology which prioritises inspection towards areas with a higher impact on service delivery, areas where there have been problems in the past, and areas that may not be immediately visible to service users.

“ there is a general view that we’ve got good buildings and so the negative PPP sentiment has evaporated

Public relations – a storm in a teacup?

PPP remains controversial in many countries. Most of the PPP professionals in our survey commented that they had encountered negativity during the preparation and procurement stages of their projects, but that this gradually dissipated as the facilities became operational. Several interviewees told us that there is wide recognition that the PPP buildings are of a better standard and better maintained than non-PPP buildings.

Public Authorities’ efforts to communicate directly with stakeholders including politicians, school management, teachers, parents and community groups have been largely successful. There is a broad understanding of how the interface between the service users and PPP contractors should operate. As this understanding has become stronger, so the negative perceptions have weakened.

Change mechanisms – not the only way to achieve change

Every project within our sample has introduced changes to the service standards or the buildings. Some changes have been minor, others involved significant additional expenditure.

We found that the experiences vary considerably, but Public Authorities generally find it hard to agree costs and to show that changes carried out under the terms of the contract are good value. Responses to this situation vary and one Authority now avoids making any changes under the contractual mechanism.

We also found positive experiences. One Authority told us about several successful applications of the contractual change mechanism. This has included large additional investments, such as the installation of roof-mounted photovoltaic panels on several buildings.

“open, flexible and helpful”

A third route to implementing changes outside the contractual conditions has been found by other Authorities and their Contractors. By bypassing the contractual change mechanism and agreeing to a ‘side letter’ directly between the parties, the required changes have been effected quickly and at a low cost.

“ seeking practical solutions ... not [being] contractually aggressive

Disagreements and disputes – a flexible approach yields dividends

We found several examples where construction-related issues continued to affect operations many years into the contract. While the issues are generally minor, they have required managing by both parties. We found that these situations are easier to resolve if the construction contractor has a stake in the project, either as an equity investor or in an operational capacity.

One of the Authorities emphasised the importance of linking the design/construction phase through to the operational phase. We were told that operational difficulties had been encountered because the building design failed to consider operational matters, and some were only resolved after lengthy negotiations at a senior level.

We found no situations where an Authority resorted to the contractual Dispute Resolution mechanisms. This suggests that the vaunted partnership working of PPPs is working. We were told that a firm negotiating position and a good understanding of rights under the contract were important, but that the best agreements are reached by consensus.

However the most common theme was that issues are best dealt with at the lowest level within the chain of command. Everyone we spoke to told us that the people closest to a problem are the ones who are best able to find the solution

Continuity and corporate knowledge – room for improvement on both sides

Everyone we spoke to agreed that continuity of knowledge and good succession planning were

“essential for a successful project”

Continuity of staff from procurement through construction and into operations helped ensure smooth transitions between these phases. However, everyone told us that too much knowledge is now concentrated in too few people. This situation is compounded if a Project Manual does not exist. There are doubts about how some Public Authorities would cope if an experienced member of staff were to leave suddenly.

This concern also applies to the Contractor side of PPPs. We were told that staff turnover in the Project Companies and Facilities Management contractors is higher than in the Authorities, and has caused issues due to lack of PPP project expertise.

Some Authorities have produced Project Manuals designed to ensure that knowledge is retained and that internal structures and processes are understood and followed when staff move on and new people take their place.

It seems that continuity planning, despite being a cornerstone of good resource management, is often neglected on both sides of PPP deals.

“ you cannot start planning for operations early enough

Readiness to launch – if only there was more time

Many PPP professionals told us that they were not well prepared for the start of the operational phase. They felt that whilst the procurement, design and construction phases follow their own highly project-managed structure with clearly defined dependencies and milestones, the operational phase is different. They told us about being surprised by the volume of information that needed to be processed for monthly payment reports, and in some cases disappointed by the standard and accuracy of the reports provided by the contractor.

The nature of the procurement and construction phases make them very demanding of the project team's time especially as financial close approaches, and again when handover of the completed facility draws near. However many Authorities told us that they regretted not devoting more resources to planning for operations.

One Authority told us that if they were doing another PPP they would set up a separate operations team that developed and perfected the processes for the handover and operational phases at least a year before the buildings were to be handed over.

CONCLUSIONS

We have learned many lessons from a decade of operational PPPs in Scotland. While each national context is different, many of these lessons should be applied by countries with ambitions to address inequality by using PPP to improve health, social care and education.

ABOUT THE AUTHORS

Caledonian Economics helps national and regional governments plan and implement PPP projects, especially in the social infrastructure sector (education and healthcare). We were established in the late 1990s in response to the need for public sector bodies to have access to impartial, specialist strategic and financial advice on PPPs. We have advised the Scottish Government, every Local Authority and many national agencies and health boards on infrastructure planning and PPP implementation. We have helped governments and agencies across four continents build their capacity and develop better projects



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