European Bank
for Reconstruction and Development

EBRD PPP regulatory guidelines collection
Volume II

Chapter 3.

Recommendations on the development of municipal PPP programmes

This guidance document may be used by central government staff to prepare rules and guidelines for local government, or even formal regulations, and by municipal officials to prepare their own plans.

1. General

1.1 A municipal/sub-sovereign public-private partnership (PPP) is simply a PPP where the government entity is a municipal/sub-sovereign body and where the public asset or service is a municipal/sub-sovereign asset or service. Therefore, it is recommended that the municipal/sub-sovereign PPP programme define municipal and sub-sovereign PPPs to separate them from large infrastructure projects and take into account their specific profile, described below.

1.2 PPP is only one of many tools available to municipalities/sub-sovereigns to meet their infrastructure needs and should be viewed as such. In considering whether and why to pursue a PPP, a municipality/sub-sovereign is encouraged to weigh the pros and cons of using a PPP rather than another option to deliver the same project. While creating the PPP programme, it is essential to consider specific features of municipal/sub-sovereign projects.

1.3 The PPP programme should focus on sectors where investments are needed. Municipal authorities should be oriented to implementing projects in such sectors and developing these sectors. Moreover, focusing on and highlighting specific sectors in the PPP programme will underscore local authorities' commitment to implementing projects in these areas and making available funding to launch such projects. This may also narrow down in a positive way the scope for unsolicited proposals.

1.4 Municipal authorities may draft the PPP programme. If state government authorities develop such programmes, they are encouraged to consider the points of view of municipalities and sub-sovereigns and to cooperate with them to address their needs and promote their agendas. That said, the PPP programme shall comply with the long-term national programme for the development of infrastructure.

1.5 The municipality/sub-sovereign should follow a few general principles. The project features and structure determine the extent of the private partner's participation in the project. In turn, the extent of the private partner's involvement in the project affects the amount of risk that may be transferred to the private partner. As the private partner's role expands, so too does the amount of risk it may be asked to bear. As the private partner assumes more risk, it will require more operational control over the project to manage those risks. The PPP programme should describe the possible extent of the private partner's involvement in the PPP projects (PPP project implementation schemes and ways to allocate risks between the parties).

1.6 The private sector can perform certain functions better than the public sector. This is particularly true in terms of innovation, service delivery, commercial orientation and operational efficiency. The PPP programme may outline when PPPs are strongly recommended, which objects may be transferred in PPPs and which may not, and in which sectors other types of cooperation could be efficient.

1.7 The PPP programme should identify possible ways to screen and prepare the project, offer recommendations and measures of state support for screening and appraising PPP projects, and identify the objectives of efficient service delivery, public investment management, fiscal risk management and capital planning – that is, whether the project represents value for money.

1.8 The structure of a PPP used for a specific project is flexible, with a wide variety of options that allocate different rights and responsibilities to the parties to the PPP. The appropriate project structure can only be determined with reference to the unique context of the municipality/sub-sovereign and a specific project. The PPP programme may list permitted arrangements for the municipal and sub-sovereign PPPs or exclude several arrangements.

2. Features of municipal/sub-sovereign PPP projects

Municipal/regional PPP projects differ with regard to a number of features that should be considered when preparing a municipal/regional PPP programme:

A. Some features are associated primarily with the smaller scale of projects:

2.1 Municipal/sub-sovereign PPP projects may be expensive to prepare because they require disproportionate levels of due diligence and specialist support for the contracting authority and for investors compared with larger projects. This is one reason the PPP programme may include some flexibility and make preparation of these projects easier and less complicated. This applies to unsolicited proposals and tender procedures. For example, it can be recommended that only one-stage tenders for PPPs be used on the municipal level. However, such measures should not limit competition and must be transparent.

2.2 Municipal/sub-sovereign PPP projects are less attractive to experienced investors, Foreign investors, in particular, prefer larger projects to absorb risk and bid costs. The PPP programme may stipulate that requirements (especially in terms of experience) for the private partner be lower than for partners in large projects. National operators and investors are typically more interested in implementing PPPs at the local level.

2.3 Municipalities typically undertake few PPPs in any five-year period – some only one, for instance. As such, these smaller municipalities may not develop the same first-hand knowledge of PPPs. This is important to consider when thinking about procedures.

B. Some features relate specifically to the local nature of the projects:

2.4 Getting approval for municipal/sub-sovereign PPP projects may be more difficult because approval processes are designed for larger projects and approval power lies at levels of government that may not be familiar with or interested in municipal projects. A growing practice in municipal/sub-sovereign PPPs has led to the development of mechanisms to mitigate some of these challenges. These mechanisms may need to be implemented in the PPP programme.

2.5 Municipal/sub-sovereign PPP projects may merit a simplified approval process, sufficient to ensure quality and compliance, without the complexity and high-level participation of large-scale processes. Simplification may include fewer approvals and/or approvals at a more familiar (and more accessible) level of bureaucracy, less documentation (for example, less extensive studies, reports and consultations, or fewer of them) and fewer procedural steps (for example, no approval at pre-feasibility is required).

2.6 Municipal/sub-sovereign PPP projects may be subject to the control of central PPP institutions (PPP units, ministry of finance and so on) depending on decentralisation rules and policy applicable. In some countries, specific subnational PPP rules apply. Lenders and investors will check the consistency and legality of the subnational law. Even in the absence of a general requirement for central approval, such prior approval may also result from the necessary guarantee (or other kinds of financial support) to be provided by the state with respect to the proper fulfilment of its obligation by the subnational contracting entity.

2.7 Local bankers and financiers may not be familiar with PPPs and may need help to understand PPP projects, their dynamics, the opportunities they provide and how to address the challenges they raise. The municipal/sub-sovereign PPP programme should set out the ways the PPP unit (or other relevant authority), local authorities and other parties involved in the project can cooperate. The PPP programme may also include provisions on training for local authorities and other steps to help personnel to become qualified in PPP.

3. Recommendations for taking into account features of municipal/regional PPPs

Commonwealth of Independent States (CIS) member states are encouraged to consider the specifics of municipal/regional PPPs as follows:

3.1 A team of PPP specialists can be formed centrally, with a mandate to provide advice and support to small PPPs. This team may be part of the central PPP unit or be a separate unit. The municipal/sub-sovereign PPP programme should stipulate an institutional framework for PPPs at the municipal/sub-sovereign level and set out ways of cooperating among institutions on different levels.

3.2 Municipal/sub-sovereign PPP projects can be made simpler to implement and manage for contracting authorities and investors. This approach would mean that the PPP programme may contain standard processes and documents that can make it easier for investors and lenders to understand the project implementation scheme and, in the end, to fund. A procurement framework can use a single process for multiple projects.

3.3 A PPP may be small in value, but create substantial fiscal liabilities. A more comprehensive approval process should be used in such a case. All projects create some form of liability. Quantifying those liabilities (actual and contingent) in an objective manner is difficult. Another approach is to limit the types of government support that a municipal/sub-sovereign PPP might receive and still be considered “small”. For example, a small PPP may be one that does not receive:

- an indemnity or guarantee from the public sector for lost revenues, lost profit, loan repayment (other than as a basis for calculating termination compensation) or other indirect damages
- any grant, loan, investment or other direct financial support from the public sector (possibly above a specified cap).

3.4 Under a large PPP, a consortium of advisers provides transaction advice for a single project. The size and complexity of the project often require one consortium to ensure focus and sufficiency of staffing. The PPP programme may give the local authorities the right to bundle small PPP projects into a single project or portfolio of projects, making the investment larger and more attractive for engaging more significant and experienced investors and lenders. The cost of advisory services is reduced by combining multiple processes into one and using one set of advisers to develop feasibility studies and/or provide transaction advice for more than one project. The cost of funding for one large project should be lower than the cost of several smaller projects, including by making the process simpler and less burdensome for due diligence and documentation of the project. Economies of scale reduce total cost and may speed development, cross-fertilise lessons learned more effectively, ensure continuity of commercial terms and, therefore, make it easier and cheaper for bidders.

3.5 Small projects often do not need limited recourse financing. The PPP programme may allow investors to finance the project's balance sheet. It will simplify the procurement process and keep costs down because there is no need to incorporate a special project vehicle and raise project financing.

4. Key recommendations and principles

4.1 The following steps are recommended while selecting municipal/sub-sovereign PPP projects:

- **Select projects intentionally:** The municipality/sub-sovereign should understand the purpose and expectations of the project and then select the project accordingly. Every project has to pass all the required assessment procedures, such as cost-benefit and value-for-money analyses. Such assessments should be carried out without emphasising the benefits and/or downplaying the costs. The municipality/sub-sovereign is encouraged to consider that PPPs by their nature can be adapted to its needs. The municipality/sub-sovereign should choose the best approach to design a PPP project based on its interests and consider international best practice and standards.

- **Select the best projects:** The municipality/sub-sovereign should choose projects that are best suited for implementation through a PPP mechanism. It is strongly advised that the authorities block poor projects. The PPP programme should include recommendations on a proper selection process that will improve infrastructure development, allocate projects with the highest chance of successful implementation as a PPP and free up limited public resources for projects that need them.

- **Do not focus on new construction:** Reconstruction and modernisation of existing assets are often more efficient than new construction.

- **Bundle small projects:** As already noted, the procedures for large PPP projects will not be suitable for smaller PPP projects because of their high price and complexity. An effective approach is to bundle projects that can leverage economies of scale – including by enlarging the perimeter of the activity to several municipalities regrouped in a syndicate of municipalities for the purpose of the contemplated joint activity – to reduce the total cost and speed of development and to make investments larger and more attractive for private parties.

- **Verify that a project complies with its primary focus:** It is important to recall why a project was structured as a PPP. Implementation may be challenging and the municipality/sub-sovereign shall periodically confirm that the project still meets its objectives. The project shall bring advantages to the region/municipality and provide best services, value for money and economic growth.

4.2 While funding PPP projects, the following should be considered:

- PPPs always need a source of financing sufficient to cover costs and loans. An adequate and predictable payment mechanism is essential for a PPP project. The municipality/sub-sovereign should understand who will reimburse a private partner and how this will be done. The municipality/sub-sovereign shall always account for the fiscal risks arising from a PPP.

- The municipality/sub-sovereign is encouraged to find all possible revenue streams and focus on maximising revenues from beneficiaries.

4.3 While preparing PPP projects, the following are advised:

- Take into account that proper preparation of a PPP project requires time and money. Preparing properly will help ensure the project's success by lowering costs on both sides, mitigating risks and improving bankability. The municipality/sub-sovereign is encouraged to use sufficient personnel and resources to deliver a quality project;

- Ensure that the municipality/sub-sovereign has a sufficient budget to prepare the project well and avoid failure. The preparation of PPPs is expensive and requires qualified personnel.

- A municipality/sub-sovereign that has limited resources should coordinate with the PPP unit and other experienced authorities. The municipality/sub-sovereign may look to engage external specialists and experts.

• It is important to lay the groundwork and ensure that the project site and necessary rights are free of encumbrances, so that the project can earn a sufficient profit for the private partner and private parties are interested in it, and that the tender process will be competitive.

• The municipality/sub-sovereign should know the views of all stakeholders, because PPPs may raise political or ethical concerns, and new management techniques may impact employees, making them subject to discipline by the contractor. The municipality/sub-sovereign should understand such concerns and address/mitigate them. To this end, the municipality/sub-sovereign should engage and communicate with all stakeholders and consider that: (i) the PPP will provide more opportunities for employees and a performance-based employment regime should not violate labour rights and (ii) the project assets remain under public ownership.

• The municipality/sub-sovereign can mix public and private money to improve value for money. This reduces fiscal constraints and creates an incentive mechanism, as both parties have a financial stake, aligning public and private interests. The municipality/sub-sovereign is encouraged to be flexible when considering sources of financing, especially when private markets are weak.

• The municipality/sub-sovereign is advised to use public finances properly to improve PPP projects. The public side is a key partner in PPPs and its support is a key element in successful PPPs. Public support, incentives and stimulating measures are an effective way to achieve better value for money.

• PPP projects should be designed to mitigate possible challenges. As PPPs are long-term relationships, the relevant contractual arrangement should anticipate possible disputes, provide parties with ways to resolve conflicts and allocate risks in a reasonable manner.

4.4 While carrying out procurement procedures:

• The municipality/sub-sovereign should avoid entering into direct negotiations just because it is more expedient and costs less (at least in the short run). Maximising competition through good, transparent public procurement is one of the key benefits of PPPs. The municipality/sub-sovereign should be open to bidders and clearly indicate milestones, criteria and results to investors. The municipality/sub-sovereign should be open to discussions with bidders because they may have useful suggestions.

• When selecting the winning bid, the municipality/sub-sovereign should keep in mind that a poorly designed competitive process may result in an unrealistic bid and a project vulnerable to changing circumstances. The municipality/sub-sovereign is advised to evaluate bids properly and do its own analysis, replicating a reasonable bid to understand the kinds of bid it is likely to receive and to identify overly aggressive bids. The municipality/sub-sovereign should exclude overly optimistic bids, as assessed by clear, objective and indisputable criteria.

• Balance should be maintained between lenders' concerns and protecting the interests of the municipality/sub-sovereign. It is important to communicate with lenders and focus on their key needs and perceived risks.

4.5 While implementing PPPs, the following are recommended:

• Regulate and monitor the PPP: The municipality/sub-sovereign is advised to create a contract management team to manage project implementation with the necessary funding.

• The municipality/sub-sovereign should be ready for changes during the project. Adequate mechanisms must be in place to address problems related to changing circumstances and other challenges. The municipality/sub-sovereign is encouraged to ensure a practical fall-back position that protects consumers.

• Include provisions in PPP agreements to resolve challenges collectively with the private partner.

• Be flexible and ready to reconsider each aspect of the PPP to find the best solution in case of a dispute or material change of circumstances.