

Putting the PPP in progress

01/06/2005

The development of German PPP/PFI of projects was, until last year, characterised more by plentiful discussion and controversial debate rather than actual projects. But since last year, the number of projects being realised finally resembles a continuous deal flow.

There are approximately 30 building projects underway, either being realised, in the process of negotiation or close to be officially notified. The development of PPP/PFI in Germany is still essentially a bottom-up movement, where public sector buildings – schools and administrative offices – are being promoted by local authorities. But State and Federal government have at last started to make some active headway in progressing PPP/PFI projects.

Although the federal F-Model (Fernstraßenbauprivatfinanzierungsgesetz) roads programme is on hold, the other PPP/PFI road programme – the A-Model (Autobahnausbaumodell) – is finally gathering speed.

The A-Model is tied to the heavy goods vehicle toll collection system on all German motorways which came into operation on 1 January this year after a one year delay. Some of its revenue is to fund the A-programme by way of a shadow toll to the operator. The first EU-wide call for expression of interest appeared in April with a deadline of 31 May for the first stretch of motorway (the A8 near Munich) of some 37 km length.

Run up to PPP/PFI in Germany

The overriding motive for the public sector in Germany to turn to alternative forms of infrastructure procurement is, on the one hand, growing demand for additional, replacement or modernised infrastructure, and on the other hand, declining resources together with the need to achieve greater efficiency from public sector investments.

Initially, the reunification of East and West Germany provided a stepping stone for private sector support in administrative and organisational processes of the public sector. The first wave of alternative procurement in Germany was limited essentially to alternative forms of finance, usually leasing transactions, which was very much encouraged by tax incentives for new investments in the new states of Eastern Germany.

Thus the public sector turned to the private sector as it was only the latter that could benefit under the tax system. This meant local authorities benefited from tax incentives handed out by federal government. It was in 1999, that the special depreciation opportunities were withdrawn, and simple alternative financing lost its appeal.

The fact that payments are only due after completion and after the facility has become operational is an advantage to PPP/PFI projects, as is the opportunity to use funds released elsewhere. Other aspects are cost certainty, greater cost awareness, greater time certainty and shorter construction times. Additionally, PPP/PFI projects are increasingly seen as a means to reform the administrative processes in the public sector, in order to achieve more transparency and better effectiveness in the day-to-day operations of the public sector.

Whilst Germany has seen alternative methods of public sector procurement with variations on the traditional procedure and some transfer of risk has taken place since the early 1990's, no real PPP/PFI project had been undertaken until very recently.

In all previous cases the operational phase was the responsibility of the public sector. Thus, in Germany, the concept of PPP is understood to cover a wide spectrum of organisational constellations, from minimal private sector participation to full privatisation on the other hand. One often differentiates between fully or partly developed PPP projects, also referred as real or unreal PPP projects.

Institutional parameters for PPP/PFI

Unfortunately, the specialist requirements of PPP projects are only gradually being explicitly recognised in German regulations. The prerequisite to select the most "economic" alternative is open to wide interpretation, i.e. the lowest bid in a traditional process to a net present value analysis of alternative procurement methods.

Generally speaking, the negotiated procedure has been adopted for the first wave of fully developed PPP projects. However, the specific German procurement regime – i.e. whether VOB¹ part A or VOL² part A is to be used – has been implemented differently and until now with no visible difference in outcome.

Theoretically, however, complications could occur if one or the other party were to go to court over the matter. Lately, it is the VOB that has been given priority with PPP projects, on the grounds that a substantial proportion of the contract value, most of the investment, is for construction works.

Whilst a number of guidelines have been published including a very comprehensive guide on PPP in Germany on behalf of the Federal Ministry of Transport, Building and Housing in September 2003³ and a series of practical guides by the PPP-unit of North Rhine Westphalia⁴, there exists no generally available template for the economic analysis, such as a Public Sector Comparator put forward by an official organisation as has been the case in the UK via the Treasury's Green Book or the Treasury's Quantitative Assessment User Guide.

Instead, individual and project specific assumptions prevail with great emphasis on the difference in the cost of finance through the public or private sector. Clear and nationally accepted guidelines on the treatment of PPP/PFI projects in the public sector would be of further help to avoid repeatedly spending too much time in lengthy discussions between different levels of government organisations on the appropriate treatment. This would not only come as a relief to public sector organisations, but could encourage the adoption of fully developed PPP projects and thus increase their deal flow further, thereby strengthening the PPP marketplace.

Progress, however, is being made at both federal and state level. The Federal Task Force was already mentioned, which is establishing a competence network for PPP at the federal level and co-ordinates and publishes those developments, which are accounted for by the federal government. Examples are the publication of the directive for the treatment of VAT in PPP/PFI projects in the long distance road sector, both F and A programmes, and the commissioning of a number of expert reports on topics such as VAT refund systems, tax treatment of PPP/PFI projects, compatibility of funding systems with PPP/PFI projects and a general survey of PPP/PFI projects in Germany, the results of which are expected during the course of this year.

Furthermore, legislation is currently being prepared and soon to be introduced in parliament – the "PPP-Beschleunigungsgesetz" (PPP-acceleration law). This is not intended to introduce a new law but to address various articles within existing legislation that discriminate against PPP/PFI style projects. It should include, for example, amendments in taxation, procurement and budgetary laws in order to provide a more level playing field for PPP/PFI projects.

At state level there are now a number of dedicated PPP-units in operation, of which the one in North Rhine Westphalia was the first in 2002, followed by Schleswig-Holstein, Saxony-Anhalt, Hesse, Baden-Wuerttemberg, and possibly followed soon by Bavaria and Thuringia. Most other states are at least dedicating some resources towards the development of PPP/PFI projects, even if they have not established a dedicated unit.

Public buildings

Surprisingly, the public buildings sector has progressed more rapidly than the road sector despite a later start.

Official interest in the PPP/PFI approach for public buildings first surfaced in 1998 with the commissioning of a research project investigating the mechanisms and spread of PPP projects in a number of European countries including at the time the United Kingdom, Netherlands, France, and other countries on behalf of the Federal Ministry of Transport, Building and Housing.

After a lot of debate and little action a first working group dedicated to the development of PPP projects was initiated in the state of North-Rhine-Westphalia in 2002. Consequently, with the exception of the Offenbach Schools' project near Frankfurt, the first wave of fully developed PPP projects have appeared in this state. Four pilot projects, which all happened to be schools, were kick-started with a subsidy to cover some of the expenses incurred from professional consultants providing expert advice.

Three of those first four pilot PPP/PFI projects – Monheim, Frechen and Witten – are underway and have proven value for money gains of 9% to 15% against a Public Sector Comparator. This was achieved despite being projects of relatively small size requiring investments in the order of Eu13 million to Eu25 million.

Meanwhile there are many more projects underway or in the process of being negotiated at the initiation of local authorities, not only in North-Rhine-Westphalia but in other states too, including Hesse, Schleswig-Holstein, Baden Wuerttemberg and Saxony-Anhalt and also covering sectors other than schools.

Table 1 below gives an overview of fully developed PPP/PFI projects in Germany, which have reached financial close and are at different stages of operations.

Table1: PPP/PFI projects at local authority level already concluded

Location, financial close	Project description	Investment volume
Frankfurt, Oct. 2003	New build and operation of college of further education	Eu41 million
Monheim, Jan. 2004	Refurbishment and Operation of 12 schools	Eu25 million
Frechen, Rhein-Erft-Kreis, Feb. 2004	New build and operation of specialist school	Eu15 million
Münster, June 2004	New build and operation of 3 triple field sport halls	Eu6,5 million
Unna, July 2004	Refurbishment and operation of local authority central offices	Eu20 million
Witten, Aug. 2004	Refurbishment and estension of 2 schools	Eu13 million
Gladbeck, Sept. 2004	Demolition and new build of council offices	Eu20 million
Offenbach-Ostkreis, Oct. 2004	Refurbishment and operation of 49 schools	Contract value: Eu410 million
Offenbach-Westkreis, Oct. 2004	Refurbishment and operation of 41 schools	Contract value:Eu370 million
Friedrichshafen, Feb. 2005	New build and operation of administrative offices	
Cologne, April 2005	Refurbishment and operation of 5 schools	Eu30 million
Bedburg, April 2005	New build of a school complex	Eu10 million
Leverkusen, May 2005	Refurbishment and alterations to a vocational training college	Eu25 million

Table 1 lists all true PPP/PFI projects that have been concluded at local level. Currently there are approximately a further 12 projects in the process of being tendered at various stages throughout Germany.

The pattern of development demonstrates a combination of a top-down and bottom-up approach, where the odds of success seems to favour projects at local level with a clear cut target and strong local political support. Construction companies involved include Hochtief, Bilfinger Berger, Müller Altvater/Wayss & Freitag (Royal BAM), Strabag (Bau Holding), SKE and Kirchner.

A typical feature of German PPP is the use of a project finance model that is subsequently transformed into a forfeiting structure, where the right to receive a stream of payments in return of services performed is forfeited (at least partially) to the bank providing the financing in return for a lump sum (the amount often in keeping with the volume of investment required), and the principal's promise to pay without exception, substantially reducing the risk to the bank.

This is usually backed up by some kind of performance guarantee by the parent company on behalf of the PFI provider. This usually reduces the level of interest by up to 0.5% (all costs considered) compared with conventional, non-recourse project finance. However, as the market matures and the risks involved are better understood, the differential is likely to diminish and allow more scope for non-recourse project finance, reducing the risk to the principal in due course.

Projects at state level are progressing, albeit at a fairly slow pace due to their more complex nature in terms of size and number of stakeholders. This is especially the case with prisons, of which two are in the process of being progressed to the point of tendering. At most, about 35% to 40% of prison staff can be transferred to private sector operators under German law. Table 2 below provides an overview of some PPP/PFI projects being prepared for tender at state level.

Road Infrastructure

Whilst the public building sector has experienced a greater level of activity over the last few years, the road sector is finally seeing an upturn in the development of PPP/PFI projects since the conclusion of the Warnow crossing at Rostock had become operational in September 2003 and the Lübeck tunnel is expected to open to traffic during the latter half of this year.

As pointed out earlier, there are two types of programmes underway in the road infrastructure sector which adopt the PPP/PFI principle. In 1994 the "Fernstraßenbauprivatfinanzierungsgesetz – FstrPrivFinG" (Act on the Construction and Funding of Federal Trunk Roads by the Private Sector) – was passed and provided the regulatory framework to allow PPP projects at network bottlenecks of motorways and for dual carriageway roads. This takes into account that under EU regulations there cannot be a time dependent charge in operation at the same time as a user toll⁵.

State subsidy of up to 20% of construction costs is possible under this law. So far, in all the time since 1994, only two projects have happened as described below. The Warnowquerung is experiencing substantially lower traffic levels than predicted. Especially lucrative HGV vehicles are not using the shortcut offered.

Of the initial list of 10 projects under the so called F-model, including both projects mentioned above, one further project has failed in tender in 2003 (Strelasundquerung) for unrealistic traffic forecasts and the requirement to maintain an already existing alternative crossing to the island of Rügen.

Four more projects have been put forward for tendering in the near future:

- i) Hochmoselübergang (B50) Wittlich/Bernkastell, approx. Eu131 million. investment,
 - ii) Alaufstieg (A8) Mühlhausen/Hohenstadt, approx. Eu348 million.,
 - iii) Weserquerung (A281) Bremen, approx. Eu237 million, and
 - iv) Elbequerung (A20) northwest of Hamburg, approx. Eu511 million,
- and are currently undergoing the planning approval process. For example, the outline design and land purchasing requirements have been put out to tender for the Elbequerung (A20) near Hamburg earlier this year.

The A-Model programme was presented in October 2001 with an anticipated investment volume of approx. Eu3.6 billion spread over 10 projects initially and now amounting to 12 projects throughout Germany. This includes the transfer to

the private sector of particularly congested stretches of existing motorways for the purpose of widening with an additional lane each way, and the operation and maintenance of this stretch of motorway over a period of 30 years.

The state allows for a subsidy of up to 50% of construction costs, but intends to subject the level of this up-front payment to competition as one of the key criteria for awarding the concession. Revenue for the operator is dependent on the flow of HGV's over 12 tons, whose toll payments are collected by the Toll Collect consortium (itself a PPP project) on behalf of the federal government.

Agreement was reached between Toll Collect and the federal government on 29 February 2004 to have the satellite based system in operation by 31 December 2004, and a light version was operational with the fully developed version to be operational next year. This will add a host of services to satisfy a number of logistic information requirements. With revenue finally being generated at close to the predicted level, there is now no excuse to delay the implementation of the first wave of pilot projects any further, which were announced on 25 February and include:

- i) A8, Bavaria, Jct. Augsburg-West – Jct. Munich Allach, 37 km,
- ii) A 4, Thuringia, Jct. Waltershausen – Jct. Herleshausen
- iii) A 1/A 4, North-Rhine-Westphalia, Jct. Düren – Jct. Köln Nord,
- iv) A5, Baden-Wuerttemberg, Jct. Baden-Baden – Jct. Offenburg-Süd, 38.9 km, and
- v) A1, Lower Saxony, Jct. Buchholz – Jct. Bremen, 74.8 km,

Expressions of interest were invited for the section of the A8 in Bavaria in March with a deadline for the end of May. The stretch of A4 in Thuringia is in preparation and should be next in line to be put out to tender.

The Verkehrsinfrastrukturfinanzierungsgesellschaft mbH – VIFG (Transport Infrastructure Financing Company Ltd.) – is the wholly publicly owned company to administer the income and investment under the HGV tolling system. It has stated that some of the difficulties in the detail of the A-model will be dealt with during the tendering process of the first projects and that by this time next year more will be known.

A problem arises hereby, since the government is currently of the opinion that the operator should only be entitled to payments that have actually been received by the client in revenue. This explains the worries voiced by the private sector over the reliability of the toll collection system and the nature of the relationship between public sector and toll collection concessionaire.

A further aspect central to the risk analysis is the treatment and transfer of demand risk under the A-programme. It is envisaged that under some circumstances compensation payments are due to the operator if certain thresholds are exceeded, since the operator has no influence over the level of toll charged to compensate for such risks. But again, the details will have to be agreed on a project-by-project basis.

The outlook

Until very recently, and with only few exceptions, progress in the field of PPP/PFI was very much limited to the building sector, in which local authorities have driven the development of true PPP/PFI projects. The number of projects is growing every month but due to a lack of central co-ordination it is anybody's guess what projects are coming up next.

However, German PPP is a potentially vast market. Progress of PPP/PFI projects at State level has picked up with the very first project out to tender in Hesse and a number of additional projects in the pipeline across Germany. Similarly the federal roads programme bodes well. But, and despite the urgent demand for new infrastructure, it may be years before the German PPP market rivals that of other EU states.

Footnotes:

1 VOB: *Verdingungsordnung für Bauleistungen* (contract conditions for construction work). Part A concerns procurement regulations for the public sector.

2 VOL: *Verdingungsordnung für Leistungen* (contract conditions for work other than construction work).

3 See homepage of the PPP Task Force at the Federal Ministry of Transport, Building and Housing:

www.ppp-bund.de

4 See Public Private Partnership – Initiative NRW: www.ppp.nrw.de

5 A time dependent user charge for HGV's was in operation on German motorways until 2003.

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

If you have been given this article by a subscriber, you can contact us through www.ijglobal.com/sign-in, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.