PUBLIC-PRIVATE PARTNERSHIPS:

THE ROLE OF FINLOMBARDA IN FACILITATING THE CONSTRUCTION OF SPORTS CENTERS AND SCHOOLS IN LOMBARDY

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Introduction

In the coming years, Italy will continue to face both great challenges and opportunities in utilizing public-private partnerships (PPPs) to rebuild its infrastructure and public facilities. Finlombarda, the financial agency of the regional government of Lombardy, will play a unique role in facilitating and supporting these projects. Through its ability to leverage European Union (EU) funds and various financial instruments, Finlombarda seeks to support small and medium enterprises (SMEs), support local authorities in managing their finances and investments, and develop infrastructure projects through the use of PPPs. However, the agency's experiences in facilitating and promoting PPPs is limited. This report identifies several case studies and cautionary tales from other countries that highlight some of the challenges and opportunities the public sector faces in implementing PPPs. In particular, the report focuses on employing PPPs to build sports facilities and schools, which are two pilot projects in which Finlombarda is currently involved. To maximize Finlombarda's understanding and role in these partnerships, the experience of other countries, unique considerations associated with each of these strategic markets, and how those lessons can inform Finlombarda in reaching its goals are discussed.

European Context

In the wake of the Eurozone crisis, and the banking and economic crisis, many European countries have experienced an increase in the government debt load. The governments of Europe acting under the pressure of the Troika, consisting of the European Commission, the European Central Bank and the IMF, pledged to enact austerity policies in the hope that reducing government spending and raising taxes would alleviate the debt burden, and improve consumer and investor confidence and export, leading to the anticipated economic recovery (Liu, 2013).

As the rate of Italy's growth fell more swiftly in 2015 than interest rates it pays on its debt, it now has to run a higher primary surplus (it has to raise more in tax more than it spends) in order to keep its debt profile on a sustainable path. Moreover, with the spectre of deflation haunting the Eurozone (Italy's consumer prices fell -0.56% in January compared to a year earlier) Prime minister Renzi is unlikely to be able to rely on inflation to erode the real value of the country's debt (Hirst, 2015).

Consequently, public infrastructure has been neglected and is in dire need of updates. Below is a review of cases from different regions and around the world that help show some of the pitfalls of mismanaged public-private partnerships. These cases will allow for a better understanding of these issues and how Finlombarda can frame the projects in a way that can attract private investors and help local municipalities at the same time.

Sports Facilities

Due to the out-of-date conditions of current sports facilities, over €1.3 billion is needed to update and renovate facilities in the Lombardy region. In traditional procurement procedures, the government is responsible for the entire process, including finding contractors for the building, financing, operations, and maintenance phases of projects. However, under the public funding regulation of the EU, public entities cannot utilize debt as a financing tool and must transfer risks to private players. Thus, PPPs becomes a more attractive option for rebuilding critical infrastructure in Lombardy and many other European regions.

Introduction on Lecco Sports Facilities

Finlombarda currently has several pilot projects it is prepared to fund and facilitate through PPP models in Lombardy. One project, the Al Bione sporting facility, has been allocated capital expenditure budget of €7.645 million. Al Bione, an existing multi-sport complex, will need to be refurbished using a design, build, finance, operate (DBFO) contract of at least 20 years. The facilities have been designated for both public and private use, including allowances for concession sales and commercial activities where suitable and profitable. During its operational phase, the facilities should be maintained for consistent use and availability, the public and private partners have agreed on the necessity of both a facility management contract and a property management contract for this project.

The rationale behind combining the private design, construction, financing, operations, and maintenance providers into a single Special Purpose Vehicle (SPV) is to achieve efficiency gains, revenue innovations, and quality of service improvements, and relieve public authorities of budgetary (particularly EU-imposed debt-limiting) restraints. As the following case studies will demonstrate, these theoretical gains are not always evident in practice.

Case Studies: Lessons from Other Countries

PPPs, DBFO contracts in particular, have been widely used in many countries over recent decades with varying levels of success. Reviewing past experiences of others is critical to avoid making similar mistakes while also offering insights on different approaches to mitigate potential challenges and address concerns.

Singapore Sports Hub: A 25-year DBFO Contract

Managed by SportsHub Pte Ltd, this $1.33 billion integrated sports, lifestyle, and entertainment complex developed on a 35-hectare site in Kallang, features multiple world-class sports facilities. Although managed by a high-profile construction group, Bouygues Group and a well-funded capital partner, infraRed, the Singapore Sports Hub has still suffered from an influx of complaints about the facilities' poor conditions, unqualified pitch turfs, leaking roofs, etc. (Chan, 2010). According to Singapore football players, the Sports Hub is "more about money" than it is about sports.

Lessons Learned

Output specifications need to be clearly defined in the contract; the issue of quality control should be highlighted. Without a consistent monitoring system on the performance of private companies, the delivery of quality services and the successful implementation of PPP contracts will not be guaranteed.

Notwithstanding, the project's revenue streams involve performance-linked availability payments, in addition to event-specific income derived from commercial rents, sponsorship, ticket sales, and event-related food and beverage sales. This is a highly unique characteristic of a public-private partnership (PPP) project and one that is expected to create real value for all stakeholders.

Models in the United States

In the US, many large publicly-financed stadiums cause governments, at both state and local levels, to lose money. Large sports franchises and the leagues in which they play leverage tens of billions of dollars in public funds to build new stadiums and facilities (Long, 2013). However, revenue from those stadiums are largely kept by the private operators but still smaller municipalities are drawn to these large stadiums (Kuriloff, 2012).

- Miami's stadium utilized public bonds ($500 million) to fund the development of a new sports facility. Which, due to high interest rates, may end up costing taxpayers five times the borrowed amount over the next few decades (Uberti, 2014).
- No long-term, pre-defined contractual obligations has resulted in teams like the Detroit Tigers baseball club leaving their current stadium (publicly held) and seeking a new one, depending on whether the city chooses to fund renovations of the stadium or sponsor the building of a new one. Typically, this, leaves the city with maintenance and demolition costs that stack up over the years and are usually unpredictable (Uberti, 2014).
- In 1971, in Buffalo, NY, home of the Buffalo Bills American football team, the late owner Ralph Wilson Jr. threatened to move his franchise across the country to Seattle, WA, unless a new stadium was built nearby. A "stunned silence fell over the chambers of the [Erie] County legislature when informed of Wilson's threat"(Uberti, 2014). Then-New York governor Nelson Rockefeller stepped in soon after, saying "the state will continue to do everything it can to help Erie County and the city resolve its stadium problem" (Uberti, 2014). Two years and $22 million of public funds later – $118 million today – the new Rich Stadium held its first Bills game.
- Public officials should not spend any more than necessary to secure the participation of the local team (Kuriloff, 2012). Small cities tend to fare worse than larger ones, because they either have to offer more money to keep an existing franchise from moving to a larger market, or they have to put up more to compensate a team moving from a larger market.

Lessons Learned

Monopolistic organizations hold too much influence with public officials when negotiating for new projects. These entities often go over public officials' heads and making sensational and emotional arguments to ignite public support.

Many of the projects undertook in the United States lack revenue sharing streams with the public sector. Instead, promises of economic development and growth are made as means to compensate the local municipalities for their investments.

A lack of termination contracts and clauses often leave many local municipalities with maintenance and demolition costs once the private entities decide to abandon the facility for a new one. Pre-defining conditions in the contract that help share these costs with previous tenants and operators is necessary to help prevent these massive and unexpected costs.

Challenges for Finlombarda

The DBFO model is theoretically ideal for sports facilities because it allows the private partner the most range and flexibility to achieve efficiency throughout the lifecycle of the project. However, as these cases have shown, there are as many opportunities for failures as there are successes in utilizing PPPs to develop sports facilities. Finlombarda also faces unique challenges with implementing PPPs for relatively smaller-scale facilities and infrastructure projects, which are discussed below.

Low Competition in Market

Many challenges will arise from a lack of competition in these smaller markets; the inefficiency that results from this may generate excess returns for private investors at the expense of the public (Hellowell & Vecchi, 2012). This situation is rampant in the US, where local authorities see sports arenas as a chance for economic development, but end up being taken advantage of and often see negative economic impact or no impact at all on the region. Without competition, the private sector can behave opportunistically, especially in contract negotiations, and set their prices in a way that forces the public to pay an above-market price in the long run or be left with a huge list of expenses after the contract period expires.

EU Directives Impose Increased Costs

EU directives have further increased transaction costs and barriers to entry by requiring contracting parties to agree on terms before entering into exclusive negotiations, making it more difficult to find new partners and investors, and allowing existing parties to behave opportunistically (Hellowell and Vecchi, 2012).

Lack of Monitoring Systems

As a relatively new practice in collaborating public and private resources, there is an issue of immature standards in quality monitoring and risk allocation. On one hand, filtering out unqualified private contractors can not necessarily guarantee the delivery of quality goods and services. Thus, a consistent monitoring system should be established to protect public interests and investments. On the other hand, the PPP contracts are faced with the challenge of allocating risk between public and private parties. The shortage of risk allocation mechanisms is a cause for concern when dealing with these types of projects, especially via small public entities.

Opportunities for Finlombarda

Despite these limitations, several opportunities have been identified to ensure the successful use of PPPs for projects like Al Bione and similar-scale infrastructure and development projects in the Lombardy region. The lessons from the above cases can be applied in three broad, strategic categories: financing, risk allocation, and project management.

(1) Financing Initiatives

Co-financing Projects

Considering the high risks of projects in the greenfield phase, traditional equity issuing is not a very attractive investment for private investors. On the other hand, bank loans require a large warrant, which blocks SMEs out of the market. As a regional public entity and central financing body of PPP, Finlombarda can act dynamically in leveraging investment portfolios and supporting the development of SMEs.

One of the initiatives in public finance is the emergence of quasi-equity, which is a debt-like finance tool where investors own no actual shares over the organization. Such a venturesome financial instrument was first used on charitable organizations in Europe where there is a high need of capital investment, except for charitable grants. Since then, its implementation has been widened to other types of social enterprises. In a case study on the Charities Aid Foundation (CAF) and Charity Technology Trust (CTT), which together formed a rapidly growing social enterprise partnership, which was plagued by unsuccessful attempts to obtain public funding, decided to implant quasi-equity into their capital investment project. Quasi-equity shares the risk and reward of the investment between the investor and the investee by allowing the investor to take a share of future revenue streams. Adding such a financial tool into Finlombarda's blueprint will not only helps centralize its control over PPP contracts, but also bypass the EU's restriction over debt financing. Furthermore, providing guarantees for banking loans helps to relieve doubts about project return and better assist SMEs in the market.

Costs Cover Mechanism

As stated in Article 64(4) CPR-Minimum requirements to be included in PPP agreements, the escrow account should disclose the selection criteria of profitable private partners. The European Commission has also set complex standards for the bidding stage in the initial phaseof the projects. Thus, the very high entering costs for these projects cause many private partners to opt out and at the same time reduce overall transparency. Under such cases, Finlombarda could shoulder the responsibility by covering part of the increasing fees of other parties to create a more organized and cost-effective market for these types of PPP contracts.

In US cases, local municipalities don't have the benefit in contract negotiations and suffer from private operators' opportunistic and in some cases even greedy behavior. Finlombarda has the unique opportunity to leverage its consolidated purchasing power to protect local communities, especially during contract negotiations, by covering transaction and negotiation costs and ensuring private organizations do not take advantage of their position.

Standardized Contracts Establishment

Establish standardized contracts with industry-wide standards, metrics, and systems in order to reduce transaction costs in long run. Performance monitoring in the long run can be costly, but is necessary for the delivery of quality services, which the Singapore Sports Hub has demonstrated. In the context of sports facilities, standards are easily replicable and can be applied on a larger scale by using the same metrics.

Implement Regulations on Returns

Implement regulation and sharing of equity returns, to maintain investor returns at an efficient and adequate level, thus helping to minimize cost pressures on public authorities (Hellowell & Vecchi, 2012). Establish and standardize the projected rate of return for investors and require that any free cash flow above what was originally negotiated is shared with the public sector. If public authorities are to rely increasingly on equity and less on debt, regulation of equity return throughout the contracting period is necessary (Hellowell & Vecchi, 2012). This way, private investors still have an incentive to be efficient and productive, but excess benefits are shared among all stake and shareholders.

(2) Risk Allocation

Transferring risks is part of the initial reasons why public authorities opt for PPP models. Three systematic risks should be addressed: construction risk, availability risk, and demand risk. Effective arrangements of risk allocation play a big role in attracting private capital investment and implementing contracts. Considering the development of the current Italian financial landscape, Finlombarda should shelter part of the risks of PPPs by utilizing their power as a central body.

Establish Selection Criteria Standards

Finlombarda could establish selection criteria standards to support municipalities in selecting SPV contractors and reduce risks for public authorities caused by information asymmetry. This centralization of knowledge and collaboration of experts can lead to cost-savings, but may also encourage adoption of best practices among contractors (OECD, 2010).

Alleviate Some Risk Burden on Private Partners

At the same time, Finlombarda could alleviate some risk burden from private partners by taking on either some of the availability or demand risk (OECD, 2010), and making these projects attractive to investors. Ideally, risk would be transferred to private partners, but in smaller communities like Lecco, SMEs may not have the capacity to handle such risk and risk transfer may not achieve a good assessment in terms of value-for-money at this smaller scale. Therefore, Finlombarda must play a role in absorbing some of that risk in order to attract equity investors through the appropriate use of concessions or availability payments:

a. Concession scheme: Concessions allow private partners to have opportunity to make more money through operations. For smaller operators in smaller markets, public authorities can help relieve some demand risk through paying to make facilities available for public use, for local schools and community groups to utilize the space. However, when private operators stand to earn “super profits” like in the US at the expense of the public, this is where regulated equity returns become relevant.
b. Availability Contract: In these types of contracts, fixed payments are paid to the private operators from the government; theoretically, linking payments to performance can ensure good service. However, just because the facilities are available for use does not necessarily mean they are in ideal shape. As the Singapore Sports Hub has shown, performance-based availability payments may not be enough. This may be due to two factors: either the penalties are not significant enough to effect a change in the private operators OR penalties are not systematically applied.
c. Hybrid Model: Because the Al Bione facility is to be available for both public and private use, a hybrid model in which risk allocation is more balanced may be ideal: Availability payments that incentivize private operators to align their interests with the public while containing stringent penalties, along with a concession structure that incentivizes private partners to make profits while sharing revenues with the public. If private partners must share their revenues, then this may incentivize them to adhere more closely to their availability contracts. There are, however, additional considerations associated with this hybrid model, including operators increasing user costs to compensate for its “lost” income that is shared with the public, who collects those user fees, and whether those fees are used in availability payments.

(3) Performance Management

Despite the use of availability payments linked to performance in conjunction with concessions revenue, event attendees in Singapore were being rained on through leaky roofs, caused by poor maintenance of facilities. In some instances, such revenue structure may not be sufficient to guarantee acceptable standards of service delivery from the private operators. In Lecco, authorities want the Al Bione facilities requires ongoing maintenance, not just when specific events require it. Therefore, in the development of maintenance and operational contracts, there are additional opportunities for Finlombarda to provide guidance to local authorities.

Define Clear Performance Output

Output metrics should be established without imposing restrictions on methods of service delivery (Singapore MOF, 2012). The private companies, theoretically and hopefully, will have the expertise to scale down operations and service innovation, but public authorities must still hold them accountable for not meeting the predefined standards, especially if public safety is at risk in these stadiums.

Implement Monitoring Systems

Monitoring systems are necessary to ensure quality of construction and service delivery through the contracting period, not just at the beginning and end. Service delivery monitoring must be ongoing, but can be costly for local municipalities to be engaged at all stages. Therefore, regional standards and protocols can greatly reduce monitoring costs for these smaller municipalities that would have to develop them themselves for each project (Singapore MOF, 2012). As with contracting standards, sports facilities are prime opportunities for regional standards in maintenance and monitoring systems; a football field in Lecco should be maintained the same way a football field in Monza or any other small municipality in the Lombardy region is maintained.

Define Clear Partnership Termination Conditions

Clearly defined terms of contract violation and consequences of not meeting standards should be integrated in the contract to discourage partners from engaging in opportunistic behavior at the expense of the other party. The US cases have demonstrated that when private partners possess a disproportionate amount of market and bargaining power during negotiations, local public authorities tend to lose throughout the contracting period.

Outlook on Sports Facilities

The development and renovation of sports facilities is a very complex task, one that is easily influenced by its political, social, and market environments. Examples and cases from around the world demonstrate that there is no perfect model and that there will always be some unique concerns when engaging in PPPs. However, these cases help shed light on different considerations and precautions that should be taken when developing sports facility projects. Finlombarda has the unique ability to mitigate problems like risk allocation, financing, and performance to ensure a more fair distribution of costs and services among all the parties involved in PPPs, and more specifically in DBFO models. Finlombarda can also extend some of the experiences from these cases into other strategic areas like education and schools.

Schools

As previously discussed, the Eurozone crisis has produced a domino effect in its impact, which has led to the deterioration of the Italian school system. Italy spent just under five percent of its gross domestic product on education in 2012—the third lowest allotment in all of Europe (Nadau, 2012). Nearly 60 percent of the public schools in Italy have some sort of structural damage, according to Italian teachers' unions (Nadau, 2012).

These government policies have left local authorities with few choices going forward on how to provide adequate infrastructure. There can be no guarantee that Italy will reverse these disastrous limits on capital improvements in the foreseeable future. As such, the education system must seek out other opportunities to furnish their students with school facilities that are safe and modern.

Governance of the Italian Education System

In Italy, the State is obliged by law to provide a state-school system accessible to all youth. Accordingly, the government established a national education system to manage the creation and running of schools in Italy at various levels.

Education governance in Italy falls under a multi-level system. The Ministry of Education, University, and Research (MUER) hold ultimate authority over decisions concerning programs, funding, rules, and regulations. Besides the Ministry, there are the National Council of Public Education, the Higher Council of Public Education, the National Institute for the Evaluation of the Education and Training System (INVALSI), the National Institute of Documentation for Innovation and Research into Education (INDIRE). MUER delegates many of the detailed decisions for individual areas to the Regional School Authority (USR). The USRs are territorially responsible for the implementation of national policies as well as administrative and supervisory duties on the regional level. The USRs look to local authorities to make individual economic decisions for the individual schools and to administer HR needs.

While the system involves a top down approach, the delegation of duties from the federal to the regional and local authorities should not hinder the development process of a beneficial PPP. Despite, the top down system in terms of delegation, prima facie evidence indicates that the individual decisions will be made at the local and regional level. Full participation and buy in from both the local and regional authorities and blessing from the MUER will be necessary to avoid uncertainty among financial and developing partners.

Finlombarda has decided to focus their PPP investment effort on Lombardi area middle schools. There are approximately 1,200 middle schools in the Lombardy Region, both traditional middle schools and middle schools that are designed to promote vocational training (Bifulco, Monteleone, Mozzana, Rolfini, 2011). As Finlombarda moves forward with its involvement in what will potentially constitute major ongoing partnerships moving forward, the many challenges and opportunities it can expect should be kept in mind. The experiences of other countries will be most helpful in this sense and are explored below.

Case Studies: Lessons from Other Countries

Using PPPs to replace failing public school infrastructure is not unique to Italy. Worldwide, national, regional, and local education agencies have implemented various forms of PPPs to address the dilemma of building new schools without evidence of their costs on the balance sheets of restricted budgets. Below are summaries and analyses of cases in Ireland, Belgium, Nova Scotia, and Australia. All cases demonstrate the various aspects to consider regarding the potential benefits and challenges Finlombarda may face in partnering with local education authorities and private contractors to rebuild and/or refurbish school infrastructure. Moreover, gaining a better understanding of the different PPP approaches of education agencies around the world can facilitate action on Finlombarda's part to seize promising opportunities for partnerships.

Ireland

Case 1

The benefits of PPPs on school improvements greatly depend on the risk transfer associated with implementation. Khadaroo (2014) uses the case of two schools in Ireland to examine how risk calculations may be biased and partly determine the success or failure of the PPP in terms of benefits to the public sector.

For both schools, the school administration consulted with financial advisors, who provided the following approach to risk transfer: "risk identification, preliminary risk allocation, risk quantification and detailed negotiation" (Khadaroo, 2014, p. 159). Project risks were assigned to the private sector partner, while "political, legal, social, and economic risks" were assigned to the school partner (Khadaroo, 2014, 159). The two partners shared natural disaster, law changes and refinancing risks (Khadaroo, 2014).

For one of the schools, the private sector partners desired to build a new building while the education authority expected to refurbish the building. Because the education authority could not afford a new building, the equity provider agreed to construct a new building at the refurbishment cost. There was much less risk involved in construction of the new building than refurbishing the old one, which would likely accumulate unexpected costs in the form of expensive upgrades. This should be a consideration for Finlombarda in attempting to match the needs of schools with what private funders are willing to offer.

Another major takeaway from this example is the recommendation that:

> Local education authorities should maximise the value of the land in advance of negotiations by obtaining at least two independent valuations, and by taking the risk of obtaining planning permission, or alternatively, by obtaining market value through disposal at public auction. (Khadaroo, 2014, p. 162).

One of the schools in Ireland had been valued at £4 million less than its actual value due to outdated and inaccurate information (Khadaroo, 2014, p. 161-162).

Missing out on such funding has the potential to cripple an already heavily burdened system. Because the Lombardy school authorities are looking to divest itself of many old properties with crumbling infrastructure, administration must take caution to ensure they receiving the maximum amount at which the properties are valued. This is also a great opportunity for Finlombarda to provide financial guidance and consulting services as it seeks its role in these types of PPPs.

Case 2

Although there is a global trend of public-private partnerships, there are still PPP cases for school facilities that failed to achieve value for money (VFM). An Irish PPP project consisting of the construction of five secondary schools provides a lesson for both the ex ante and the ex post stages of the PPP.

The Irish government appointed the preferred bidder, the private sector consortium led by Jarvis Projects Limited, to design, build, operate, and finance five schools over a 25-year period (Reeves, 2008). This decision was later criticized by Reeves and Ryan (2007), who claimed this decision was made prior to conducting a VFM test. Due to inexperience, the public partner failed to set up an affordability cap, which resulted in overspending later in the contract period.

Looking into this case, there is room for improvement. Regarding risk allocation, the public sector mainly takes demand risk, residual value risk, and industry specific regulation risk, while the private sector takes school design, construction, operation risk, and normal business regulation risk. According to the analysis, this risk allocation does not transfer a sufficient amount of risk to the private sector (Reeves & Ryan, 2007). Risk allocation is an essential element to determining the success of PPP projects. Allocating the risks to the proper parties that can best handle and control them is crucial. Finlombarda should have the knowledge of their advantages as well as those of the private partners to make risk allocation decisions.

In this case, the Irish government bundled the five schools into one project, which made it more attractive to private investors. However, the number of schools to be built became an issue. At the beginning, the parties agreed upon three schools, but the government decided to include two more schools, which increased the cost from 15 million euros to 38 million euros

(Reeves & Ryan, 2007). Bundling individual projects to make one complex project is typically a strategy used to attract private partners. However, the project must be set at a feasible scale.

In the ex post analysis, the five schools' principals were interviewed on their opinions of the school operation. Answers varied across respondents, but all suggested an issue of "formality" (Reeves, 2008). The local school principals suggested that during the operation, they wanted more communication with the private sector to address their unique needs, instead of the formalized helpdesk system. The lesson here is that both centralization and decentralization are needed. In both stages of construction and operation, private sectors should individualize how they communicate with the school boards.

According to Reeves and Ryan's study of this case, the opportunistic activities also increased expenditures. This gives experiences to the later PPP projects. When making contracts, especially complex projects, the public sectors should work on specifications of the details of each stage to avoid opportunism.

Often there is information asymmetry between the public and private sectors. In Ireland's case also, the government relied too heavily on the external advisers to conduct project assessment and evaluation and provided only two civil servants for this project (Reeves, 2008). Thus, providing in-house experts for the PPP can save a lot of costs.

In conclusion, this case provides a thoughtful lesson on how to efficiently deliver PPPs to achieve VFM both in the ex ante and ex post periods.

Flanders

A recent Flemish PPP project used a long-term design, build, finance, maintain (DBFM) model to build public schools. The outdated infrastructure had amounted to a 10-year waiting list to receive subsidies on building funds from the national agency for school infrastructure (AGIOn) as of February 2013 (Gestel, Willems, Verhoest, Voets, & Van Garsse, 2014). In 2004, AGIOn implemented a two-track strategy that consisted of the following:

> *Track 1*: "large catch-up DBFM programme which would cost around 1.5 billion euro. A DBFM company (SPV) would make sustainable, modern school buildings available to school boards and take care of maintenance for 30 years. In turn, school boards would pay a performance-related availability fee for the contract period, and the building's ownership would be transferred to the school boards free of charge afterwards" (Gestel, et. al, 2014, p. 364).
>
> *Track 2*: increase in original subsidy from AGIOn

This project is particularly unique as it uses a hybrid PPP model by incorporating both contractual and participative elements. The hybrid model consisted of a "separate and mixed SPV company to execute the programme and a strict DBFM framework agreement between the SPV and the Flemish government, and separate DBM and Finance contracts between the SPV and other private partners" (Gestel, et. al, 2014, p. 366). The hybrid design allowed for the SPV to focus on the technical components of providing the infrastructure so that the school boards could focus on education. Furthermore, "the Flemish government also opted for public participation in the SPV" with a minority stake of 25% plus one share, which allowed the project to remain off the balance sheet (Gestel, et. al, 2014, p. 366).

To date, the performance of the PPP has been difficult to measure. The achievement of certain benchmarks set is still unclear and too soon to tell in some cases. For example, whether the PPP provides "maximal results with limited resources" is uncertain (Gestel, et. al, 2014, p. 368). At the same time, pooling purchases has reduced costs and project management solely by the SPV has gone over well.

Despite the uncertainty and few small successes, the case of the Flemish schools PPP depicts what may be a potentially feasible approach for schools in Lombardy, especially considering its similar complex governance structure within a complex context.

Nova Scotia (DBFO)

In 1997, Canada's province of Nova Scotia implemented one of the most ambitious programs to use public-private partnerships to facilitate the construction of new schools. By the end of 1998, as many as 41 new schools had been either completed or approved for construction under this public-private partnership program and another 12 were proposed for approval.

The key objective is to enable Nova Scotia taxpayers to get better value for their tax dollars by shifting the responsibility for the operation and/or financing of non-core activities to the private sector. In the process, the potential exists for service to improve within the same public expenditure framework, or for the same level of public service to be provided at a lesser cost to taxpayers (Utt, 1999).

Using the PPP program, Nova Scotia's Ministry of Finance requested bids from qualified developers to provide one or several school facilities built to the ministry's specifications in a designated district. Completed projects are provided on a "turnkey" basis--the developer furnishes the desks, telephones, blackboards, and computers while the school system provides teachers, principals, and students.

Prospective qualified bidders compete on price, and the cost of the project is converted into a 20-year lease with annual rent payments equal to 85 percent of the capitalized cost of the project. In effect, the school system gets to use the building for less than the cost to build and finance it, while the developer begins the lease 15 percent in the hole. In order for the developer to make up the difference in cost and earn a profit on his investment, the contract is structured so that the school system leases the building for specific hours, such as 8:30 a.m. to 3:30 p.m., Monday through Friday, September through June, as well as select off-hour periods. During the hours and days in which the public school system is not using the facility, the developer can rent its space to other approved and compatible organizations and businesses (Utt, 1999).

Such off-hours use could include renting the facility to for- and not-for-profit educational organizations, such as trade schools and refresher educational programs, day care, community colleges and universities, civic groups, religious organizations, local governments, political groups, and similar entities for which classroom-, meeting-, and auditorium-type space is essential. Organizations and businesses whose purpose and activities are not compatible with a building used primarily by children are prohibited from leasing space, and such prohibitions are defined clearly in the contract. By using the building more intensively than would be the case if its occupancy were limited to just public school functions, the developer/owner of the building would obtain more revenues and earn more profit. These extra revenues are "passed on," in effect, to the public school system in the form of below-cost rent (Utt, 1999).

The school system's 20-year lease on each facility included options to renew the lease at the same rent for up to two additional 5-year terms. The school system also had the option of buying the facility at a predetermined price if it so chooses. Most important, the school system has no obligation to rent the facility beyond the first lease term, thereby providing the developer/owner with a powerful incentive to maintain the building to its highest standard and upgrade it with the latest technology.

Unfortunately, there is no long term data for this PPP project as it was cancelled in 1999 after there was a change in government. The PPP built school operation contracts were contracted back to the school boards.

Australia

As a leader in developing and applying Public-Private Partnership (PPP) models in public infrastructures, the State of Victoria in Australia has contracted the Partnerships Victoria in Schools Project with almost $255 million of capital investment. According to the contract, Axiom Education Victoria Pty Ltd (Axiom), as the private partner, would take responsibilities for the design, construction, financing, and maintenance of 11 new public schools, while teaching and school curriculum would still be the responsibilities of the state government (DEECD, 2009). The project may also be seen as the product of Partnership Victoria, which is a strategic framework for the development of PPPs, and Victorian Schools Plan (VSP), which aims to transform state education in Victoria.

In this case, a DBFM model is used for the PPP agreement. The main purpose for government to enter PPP agreements is to increase the quality of education and cost savings. PPP projects enable principals and teachers to focus on delivering educational services without concern over maintenance issues. Packaging several schools together allows for the opportunity to reduce costs through economies of scale, as well as better efficiency and project management from private partners (Ross, 2004).

Other than Axiom and the state government, this PPP arrangement also involved several other key stakeholders: YMCA, as another private partner, who would lease facilities directly from the State to deliver their program; ABN AMRO Bank N.V., who would be the sole financier of the project and provide financial resources for stakeholders; and Abigroup

Contractors Pty Ltd and United Group Services Pty Ltd., who are engaged by Axiom as the builder and subcontractor responsible for the design, build, management and maintenance of the new school facilities. The engagements of these key stakeholders provide resources as well as expertise to conduct the project with less cost and more efficiency.

By applying the PPP model, stakeholders of the school projects would benefit in several different ways:

- The long-term PPP contract not only reserved sufficient funds for the maintenance of school facilities to a high standard, but also gave educational professionals the opportunity to focus more on the core education services in order to increase the quality and efficiency of education;
- Bidders are encouraged to evaluate and plan their proposal using a whole-of-life approach with a better tradeoff balance between the increased capital cost and lower maintenance cost;
- With the project management experience from the private partner and pre-set quality standards together with the abatement regime, the quality of assets as well as the life-cycle of the entire project would be improved;
- School facilities would be more adaptable to new technologies so that the learning environment and teaching outcomes would also be improved;
- Corporation with YMCA and other organizations on leasing part of the school facilities to them would generate revenues for the schools to reduce the cost, while the package 11 schools together may also save cost through economies of scales, besides, the winning proposal of Axiom has a net present cost of $254.8 million, which is 2.6 percent below the Public Sector Comparator (PSC) in the value for money analysis;
- Operation, maintenance, and availability risk has been transferred to private partners with clear default, termination, and step-in regimes (DEECD, 2009).

Although the State of Victoria has been successful with PPP projects using this model, there are still some challenges to be addressed before applying this specific PPP model to the Lombardy Region. The State of Victoria has developed certain treatments on various key project issues such as payment mechanism, abatement regime, and finance and security arrangements. However, these mechanisms and regimes may not be applicable to the Italian context, especially for small municipalities, the Lombardy Region may need to cultivate their own unique approach, based on the local situation and political environment.

Challenges for Finlombarda

Even though in the Lombardy Region, Small to Medium Enterprises (SME) are encouraged to participate in PPP projects, their access to financial resources is limited, often keeping them from participating. Long-term PPP projects are often affected by external economic environment of the region and the country, as such, it is necessary to preserve the integrity of those projects, especially with issues regarding refinancing gain and debt. (Foster, 2010).

There is a clear need for school infrastructure investment in the Lombardi area. However, limitations in the existing system prevent standard capital investment expenditures and more traditional procurement models that the state would normally utilize to meet these needs. The use of PPPs to close this infrastructure gap seems like the best solution to bridge the needs of the public and the limitations of the state, however, as can be seen from examples above, that it is not a given the PPP will be successful or cost effective. There will be no specific PPP that will fit every school investment need. Therefore, it will be extremely important for the Lombardy Regional Authorities to carry out detailed cost analyses to determine if the potential increased cost can be born in exchange for immediate action to repair and replace existing schools. Finlombarda is uniquely poised to help guide schools through the PPP process and to create specific hybrid models to meet the individual needs of each project and to help minimize the costs.

Opportunities for Finlombarda

The role of Finlombarda as a public financiare has several potential applications: a financial consultancy, a risk guarantor, grant maker, and equity provider and PPP aggregator.

Financial consultants have played an increasingly large role in the development of successful PPPs. Many PPPs never make it past the value to money (VTM) test or are rejected for allocating too much risk to the government. In order to structure a PPP that is feasible and adequate, specific attention must be given to those areas which are most likely to be controversial to the government auditors. However, there is a distinct lack of experienced professionals employed by the government that are trained in PPP creation and governance. This lack of competency has made it necessary to employ outside consultants, often at great cost.

For example, in the early 2000s, the Scottish Executive implemented a large-scale PPP to finance the construction of schools, providing nearly £2 billion to 24 school authorities. With the assistance of several financial companies, the school authorities were able to conduct several cost-benefit analyses and affordability studies and draw up a contract with careful attention to approaching the balance sheet as it relates to PPPs. With the help of the consultants, the school council's "had all successfully achieved 'off balance sheet' accounting requirements" and developed marketing materials to appeal to private partners (Hannah, 2008, p. 120).

While Scotland represented a great success, these consultants and financial models cost millions of euros. There can also be substantial risk bringing in outside consultants. For example, if the consultants hired to carry out the feasibility work are fairly certain that they will be kept on board to advise on the transaction, they may have a disincentive to disclose major problems for fear that preparation will not continue. Alternatively, if the transaction advisers are paid a success fee in full upon completion of the project when the PPP contract is signed, they may have an incentive to deliver a project that is not bankable or may unfairly reject a PPP that will take many months (or years) to reach financial close (EPEC, 2011, p. 17). Finlombarda has the educational background and financial knowledge to help serve as an independent consultant to the PPP project without the potential conflict of interest or financial motive seen in independent consulting groups. These services can be offered at a reduced rate or entirely free of charge depending on the status of the project.

As the case studies have highlighted, the transfer of risk issue remains the single largest issue PPPs face in today’s market. Private companies are risk averse; subsequently this keeps them from assuming enough risk to get most PPPs off the ground. By guaranteeing the risk from the construction phase (the most risky portion of a PPP), Finlombarda can play a large role in enticing more private companies to venture into this underutilized financial model. For SMEs, this financial backing can make or break a project. In addition to Finlombarda’s substantial financial resources, their experience and financial know-how will serve to guide developers and reassure the international investment community.

Finlombarda can act as a pure capital investment equity provider. By targeting specific school PPP investments, Finlombarda can identify and invest in smaller projects aimed at local school improvements. Their knowledge of PPP financial requirements and the Italian banking system makes them uniquely positioned to make investments most in line with their stated mission. Finlombarda has the opportunity to standardize the contracting in PPP models and to create a “best practices” checklist aimed at reducing the Capex (capital investment). The Italian market does not have a large list of major developers to choose from that are honest and free of corruption. Finlombarda can identify a list of preferred partners who can be trusted to meet their goals. Additionally, Finlombarda can help PPP models structure their contracts to help pass risk on to the construction subcontractors by assessing penalties in the contract for cost overruns and incentivizing the lowering of the Capex by use of technology.

Finally, Finlombarda has the opportunity to reach SME PPPs, which are too small to reach the international investment market alone. An overwhelming majority of international investment in PPPs is greater than 50 million euros (EPEC, 2011, p. 8). By bringing together specifically-targeted PPP projects, Finlombarda can aggregate their value and launch them into the international investment market.

Conclusion

Compared to traditional procurement and financing models, PPPs offer an alternative that is compatible with the goals and financial parameters of the Italian government. Public-private partnerships present promising opportunities for the Lombardy Region to achieve its infrastructure goals, provide quality public facilities, support SMEs, and alleviate financial burdens on public authorities in the coming years. PPPs have been utilized with varying degrees of success in other countries for a variety of projects; the lessons learned from these cases play critical roles in highlighting notable shortcomings and weaknesses of the PPP model and detailing the strategies Finlombarda can utilize to mitigate these risks.

As Finlombarda looks toward its future and the role it will play in the growing prominence of Italian PPPs, the cases presented will offer opportunities for the agency to leverage its financial resources, to lower barriers and transaction costs to ease the participation of all parties. Finlombarda can utilize its expertise to allocate risks and create fair and appealing structures to attract desirable private equity. It can consolidate purchasing power to protect municipalities from opportunistic private players during negotiations, calling upon its authority as a regional body to implement standards and regulations to reduce monitoring costs, and using its influence to ensure the fair, transparent, efficient, and effective economic growth and health of Lombardy.

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