

**Urban Development Funds, PPPs and the Effects of the Crisis:
a Bet on the Future of Public Procurement**

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The process of urbanization in the European Union has been increasing in the last few decades. There are indeed great opportunities for integrated projects of urban development. Historical centres, heritage, industrial spaces, housing, basic infrastructures, waterways, networks, transportation, energy facilities and human resources, will require a great deal of industrial, social and financial planning. There is great activity throughout the Union member countries at a local and regional level. Considering that local and regional authorities contribute to more than 2/3 of total fixed investments of the Union, the resources being required for urban development initiatives in the EU-27 are potentially huge. The Urban Development Funds or integrated urban initiatives are – of course – a sub set of total metropolitan investments. However, looking at the list of “objects” that may enter an UDF, such instruments may become a major driver of EU urban development and restructuring initiatives in the next few years.

At the EU policy level there has been great emphasis about promoting integrated projects of urban development. The main drivers are the reinforcement of the role of “financial engineering instruments” and the strengthening of the urban dimension in EU Cohesion Policy – Bristol Accord on Sustainable

Communities (Dec 2005) and Leipzig Charter (May 2007). EU Commission (DG-Regio), which is supported by the EIB, launched Jessica as a technical assistance initiative to promote the application of financial engineering instruments to urban development in the program period 2007-2013. The Urbact Network was designed to be a learning tool. It includes: 27 Thematic Networks, 181 cities involved, around 3000 stakeholders in local support groups and around 200 Managing Authorities.

The new financial instruments have to be considered in light of the effects that the 2008 crisis has had on EU public finance framework. EU public budgets are strained and public debts have risen to the highest level since the post-war years. In order to return to the pre-crisis debt/GDP ratio, UE-27 will need - at least- a ten year fiscal adjustment process worth 1-1,5% of GDP per year. This will strongly constrain public resources for financing fixed investments. This is one of reasons behind the recent Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions entitled “Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships” (19 November 2009). To tackle the financial and

economic crisis – we read in the Commission Communication - the EU and its Member States are implementing ambitious recovery plans that aim to stabilise the financial sector and limit the impacts of the recession on citizens and the real economy. Investment in infrastructure projects is an important means to maintain economic activity during the crisis and to support a rapid return to sustained economic growth. Public Private Partnerships (PPPs) can provide effective ways to deliver infrastructure projects, to provide public services and to innovate more widely in the context of these recovery efforts. At the same time, PPPs are interesting vehicles for the long term structural development of infrastructures and services, bringing together distinct advantages of the private sector and the public sector, respectively.

The effects of the crisis, however, may have a few drawbacks for PPP initiatives. The liquidity and the low interest rates will probably be maintained by central banks for the next couple of years. However, there is strong uncertainties about what is going to happen afterwards. The deleveraging process (both private and public) may require higher inflation and higher interest rates. Moreover, the slow recovery rates may keep the real estate market depressed for some years to come. This will have two effects on PPPs initiatives: (1) higher interest rates on the

debt side and (2) higher leverage and risk on the equity side. What this means is that only integrated project which have a strong mixed of cash flow and high potential capital gain assets may be able to attract private capitals.

The needs of enormous investment in cities have thus to be seen against the background of the actual economic environment. Currently, traditional sources of senior debt for infrastructure and energy investments are severely constrained. The capital markets provide little senior debt to these sectors. Also, obtaining bank funding is currently particularly challenging due to significant liquidity and capital constraints of the major banking groups, a low volume of syndications and continuous reductions of the average amount each bank is able to commit per transaction. These factors together will make significant challenge for getting some of PPP and PFI projects off the ground, unless substantial equity, private, corporate, and public sector support is put in place.

Recently it has been argued that if the public Administrations were efficient and technically strong; given that the cost of borrowing for sovereign and public entities is the lowest on the market; then why shouldn't the public sector borrow directly the money for public investments, instead of paying an extra cost for PPP and PFI projects in terms of transaction

costs and higher profit share of private partners? The growing deficit is of course a concern, but writing “full” guarantee to private companies may not bring lasting health to the books. After the financial storm will clear, a new form of capitalism may emerge. In that new world, some argue, may it well start to seem a good idea for the government to do its own borrowing? It is rather difficult to have a fair judgment on the whole issue. Much will depend on specificities (sectors, countries, quality of Public administration, etc.). Much will depend also on market conditions. In time where, due to the effects of the crisis, the debt/GDP ratios of UE countries are projected over 100% by 2014, the temptation of Governments to rely on the magic of PPP and PFI is indeed very strong. The question is: is there a risk that the public budget will eventually have to bear the extra expenses of the PPPs? In such a case, is it fair to transfer, once again, the costs of public investments to future generations? A common problem with PPP projects is that private investors obtained a rate of return that was higher than the government’s bond rate, even though most or all of the income risk associated with the project was borne by the public sector. A number of recent studies of early initiatives to promote private investment in infrastructure reached the conclusion that, in most cases, the schemes being proposed were

inferior to the standard model of public procurement based on competitively tendered construction of publicly owned assets. One response to these negative findings was the development of formal procedures for the assessment of PPPs in which the central focus was on “value for money” rather than reductions in debt. The underlying framework was one in which value for money was achieved by an appropriate allocation of risk. The idea that private provision of infrastructure represented a way of providing infrastructure at no cost to the public has now been generally abandoned, interest in alternatives to the standard model of public procurement persisted. In particular, it has been argued that models involving an enhanced role for the private sector, with a single private sector organization taking responsibility for most aspects of service provisions for a given project, could yield an improved allocation of risk, while maintaining public accountability for essential aspects of service provision.

PPPs initiatives are then going to be, once again, a challenge for the future of public administrations. The hope is that better quality of contracts and restored future financial conditions may pave the way for a successful new generation of European Public Private Partnerships. More than a hope it will be a challenge: or rather a bet on the future.

URBACT II

URBACT is a European exchange and learning programme promoting sustainable urban development.

It enables cities to work together to develop solutions to major urban challenges, reaffirming the key role they play in facing increasingly complex societal challenges. It helps them to develop pragmatic solutions that are new and sustainable, and that integrate economic, social and environmental dimensions. It enables cities to share good practices and lessons learned with all professionals involved in urban policy throughout Europe. URBACT is 300 cities, 29 countries, and 5,000 active participants

