DEVELOPMENT OF A MODEL FOR IMPLEMENTATION OF PFI/PPP IN CYPRUS

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The pressure for provision of new facilities and services coupled with the fiscal discipline required by the EU, have encouraged the Cypriot Government to search for alternative ways of funding major infrastructure schemes such as airports, highways, waste management facilities, and rural sanitation projects. This research indicates that the Private Finance Initiative (PFI)/ Private Public Partnership (PPP) and other concession-type contracts and partnership agreements are becoming attractive forms of delivering public facilities and services in Cyprus. However, there is no objective method or format for implementing these systems that effectively guide the Cypriot government and local companies. The aim of this paper therefore is to develop a model for successful implementation of PFI/PPP procurement system in Cyprus. Structured interviews and questionnaires have identified the constraints that currently influence the implementation of such procurement systems in Cyprus. The paper uses the findings to propose a process protocol model that can be used in practice. Although detailed testing of the model is ongoing, initial responses on the application of the model from the government and practitioners' perspectives is positive.

Keywords: Cyprus, public finance initiative, and private-public partnerships.

INTRODUCTION

The European Union (EU) is today one of the largest economies in the world and requires major investments in infrastructure especially in the 10 new accession countries In Cyprus, partnerships between the public and private sectors are becoming an integral part of service delivery. Recently the Ministry of Finance awarded contracts worth over C£600 million using public-private partnership schemes including airports, highways, waste management facilities, and rural sanitation projects. Research has shown that the following forms of public-private partnerships are commonly used in Cyprus, depending upon the type of project, its size and complexity: Service contracts, Management contracts, Leases, Concessions such as BOT, BOO, BOOT, DBOT, DBFO, BRT, BLT and BTO, and Private Finance Initiative (PFI). This paper focuses on PFI.

PFI is a concept where the private-sector provides the Government or a local authority with a complete scheme or a project that the Government would be interested in. The private party fully funds the development and operates it for an agreed period, and the services produced are purchased by the government or other stakeholders under an agreement reached for a specific period. The concept of PFI is not new. It is been around since 1992 launched in the UK as a financial mechanism to obtain private finance which could satisfy political need to increase investment in the infrastructure without affecting public borrowing and provide new investment opportunities for

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finance capital. PFI differs from privatisation in that the public sector retains a substantial role in PFI projects, either as the main purchaser of the services provided or as an essential enabler of the project. It also differs from contracting out in that the private sector is involved as a provider of the capital asset as well as a provider of services. The initiative brings private sector skills and finance into projects that use to be wholly or mainly provided by the public sector. The projects types range from financially free-standing projects, where the private sector takes on the various risks associated with such projects, to joint ventures between the private and public sectors, where the risks are shared. In theory most infrastructure projects except those being undertaken by the privatised utilities could come within the scope of the PFI, including highways, schools, hospitals and prisons. It suggests that the basic idea of PFI is to transfer the appropriate risk away from the public sector onto the private sector, whilst harnessing what the Government view as superior management skills from the private sector. Consequently the Government gains huge benefits compared with traditional procurement routes, by increasing value for money, better innovation and savings.

There have been debates about the definitions of PFI and PPP, as to whether one is the type of the other or sub-set of the other. This paper may add to the debate by defining PFI using the definition of a concession agreement given by Merna et al (1993). Therefore, PFI is defined in this paper as a contract between a Principal who will grant to a Promoter a right of privilege ‘a concession’ to carry out certain works of construction together with an obligation to operate those works for specified period of time known as the ‘concession period’. It is the vehicle by which their respective rights and obligations (e.g. funding, purchase of services, guarantees) may be set out and by which the risks taken by each party may be allocated. The action to be taken if certain eventualities occur during the concession period may also be specified.

Previous research by Gidado & Smilas (2004) has indicated that although the concepts of PFI and or PPP are universal, the constraints influencing the implementation of the concepts varies from nation to nation. This suggests that every environment may need to have its own unique model for effective delivery of projects under the PFI/PPP schemes. The government of Cyprus has already launch PFI/PPP from May 1999 to deliver a number of projects. However, research has shown that they are currently experiencing many problems and constraints in delivering these projects. Therefore, using the findings described in Gidado & Smilas (2004), this paper has developed PFI/PPP implementation model for Cyprus that addresses the current constraints and problems facing the Principal and the Promoter.

THE CYPRUS ENVIRONMENT

The island of Cyprus is ‘strategically’ important within the global economy because of its geographical location at the crossroads of three continents (Europe, Asia and Africa) and as the gateway to the Middle East. Relentless efforts are been made by the United Nations and the leaders of the two communities in the island, in search for a political settlement in line with the association of partnership. Recently the Greek Cypriot Economy has grown at a healthy pace. It is expected to continue with an annual growth rate of about 5% at 2.8% inflation and GDP per capita at ECU18,500. The GDP is 80% of EU's average and places Cyprus first among the new 10 EU accession countries. The unemployment is at 3.4%. There is an effective network of roads within the Greek Cypriot with almost 90% of all the villages and towns connected in accordance to international standards. The national Government and

Local Authorities have built schools and colleges as part of the educational development of the people. Many dams and telecommunication projects have also been built during the last 15 years. With the unification based upon the Association Agreement becoming more likely, there would be a significant demand for similar development to take place in the Northern part of the island (Turkish Cypriot part) which has a GDP of ECU4,500 per capita with real output growth declining by 3.6% and high inflation imported from Turkey due to the use of the same currency (Turkish Lira). Recently, many projects proposed by the Government fell under the PPP/PFI system. This type of procurement route is considered by the government to be essential in order to decrease government deficit and borrowing and to attract Foreign Direct Investment (FDI) to the Country. Some local practitioners perceived the implementation of the PFI/PPP track as ‘foreignisation’ of public services, however the creation of local and international competition, increase in quality standards and employment of internationally recognised best practises and expertise are clearly recognised across the country. The financial market also received an international capital injection.

Compared to other EU countries such as UK, the Cypriot construction industry is mainly made up of small to medium size construction companies. Most of the construction companies in the island are family owned with an annual turnover between C£5 and C£10million. Recently, some of these companies have merged to form public liability companies floated in the Cyprus Stock Market. This resulted in further isolation of the smaller companies from the market, which are struggling to survive as subcontractors to the few big organisations that now dominate the market. Traditional or conventional procurement systems, where the Architect leads the project, are still the most common form of procurement. There is a strong role played by a big professional umbrella (called ETEK) that recognises only Architects, Civil Engineers, Surveyors, Quantity Surveyors and the Building or Civil Engineering Contractors. Practitioners must register with this body before they are allowed to practice. The contractors are categorised based upon their size and type of projects they are able to carry out. The most common type of contract is the lump sum contract with a unique provision for both variations and fluctuations.

CONSTRAINTS AFFECTING PFI/PPP CONTRACTS IN CYPRUS

The work described in Gidado and Smilas (2004) has identified the major constraints affecting the implementation of PFI/PPP in Cyprus. One of the major constraints identified is the lack of a fully developed legal framework that permits foreign contractors and investors to work and operate in the country. There are some important constitutional and legal issues that need to be reviewed before PFI/PPP procurement can be fully and freely implemented in Cyprus. It is essential that firm strategic decisions be made as to whether or not further legislation is required before projects are advertised, especially in the Turkish Cypriot part of the island. In the Greek part, a political decision has been made to pass specific concession laws in order to provide a firm legal framework for the granting of PFI type projects. From experiences around the world, some countries have drafted legislation in general terms to provide a high level framework, and specific powers are granted by means of further statutory instruments or secondary legislation. In other countries the legislation is specific e.g. the New Roads and Steelworks Act in the UK, roads laws in Bulgaria or concession laws in the Philippines, France and Germany. However, in the Republic of Cyprus, no specific legislation on concessions is available and the Constitution is silent on the subject. Generally, if the public sector wishes to carry out a public sector project in partnership with private investors, the Public Procurement Legislation [1997] is used as a vehicle to provide for appropriate delegation of rights to a tender board to deal with government contracts and to let these contracts within the specified public sector procurement rules. Following relaxation of the Government's policy on foreign investment in February 1997 and January 2000, administrative procedures have been simplified to allow foreign investment in special purpose vehicles (SPV) set up for the purposes of investment in projects within Cyprus. The bureaucratic process involved in setting up companies with potentially up to 100% foreign participation requires simplification for the policy to be effective. Again, the legislation covering the following issues needs to be further investigated:

- The ability of non-resident foreign companies to repatriate capital, profit, dividends and interest arising from direct investments in PFI projects;
- The rules under Company Law relating to acceptable levels of foreign investment and whether it is possible for a special purpose vehicle to be created with two or more foreign investors, or with foreign ownership of shareholdings offshore.
- All factors (including ‘double taxation’ treaties) which may inhibit the sensible and efficient structuring of a project vehicle by bidders.

It is also been identified that the registration of foreign Contractors may have an implication. Foreign contractors carrying out construction activities within Cyprus require permits (Article 16 Registration of Contractors Law 1992), and any limitations on the ability of contractors to obtain the necessary permits are barriers that investors often like to do without. Other constraints identified by Gidado and Smilas (2004) include the following:

- Lack of strategic managerial skills in the local contractors' organisations,
- Lack of local experience and expertise in such projects by both the public and private sector,
- The cultural environment of the country in respect of its business approaches e.g. lack of awareness of joint ventures, poor labour productivity, fear of high risk ventures, and lack of meeting required standards.

THE DEVELOPMENT OF THE MODEL

The model has been developed based upon the phases of PFI project outlined by University College of London (1997) and the Process Protocol developed by Wu, S Lee et al (1998) TIME Research Institute University of Salford & Loughborough University. The purpose of the process model is to provide the best practice for the application of PFI/PPP in the procurement of construction projects in Cyprus. The developed model breaks the project life cycle into 10 distinct phases. These 10 phases are then grouped into 4 broad stages (Pre-Project, Pre-Construction, Construction, and Post-Construction). However, in the vertical axis, the model is divided into two parts. The first part outlines the stages the public sector will need to go through, and identifies the decision processes and sub-processes that must be undertaken. Similarly, the second part outlines the stages the private sector will need to go through, and identifies the decision processes and the sub-processes that must be undertaken. During the sub-processes the relevant constraints identified through the research are flag out enabling the less informed public and private sector to identify immediately which issues are the most critical and which he/she should allocate most resources to overcome. Although the decisions and processes are shown in the model as being in serial sequence, in the real world it occurs in a cyclic sequence using the evaluation and feedback. The developed model is shown in Appendixes 1a & b.

Description of the Model

Phase Zero – Initial decision: The first component is the “Identification of Project need”, e.g. new road, school or block of offices. It then examines the possible routes through which the specific project could be delivered. This examination is through a sub-process, where the client will evaluate and identify the impact on the state economy and relevant EU regulations with regards to financing the project. The public sector will formulate a financial and economic impact assessment in order to provide a justification to its decision to use PFI. There onwards, the model takes for granted that the agreed procurement route is PFI/PPP. The public sector’s decision for PFI/PPP for the specific project will need to be pass through other sub-processes where the legal and social constraints are evaluated. Government's current regulations and policies will need to be cross-examined in relation to the legitimacy of the proposal and in order to avoid further complications during the course of the project. After the completion of the above reviews and evaluations, the Government will be in a position to formulate a procurement strategy for the project. Unless the above strategy is formulated the project will not be able to continue to the next phase of the process, that is why at this stage a hard gate is placed with a decision key.

Phase One – Establishing the arrangement: The public sector will then have to commit its organisation to the project. In order to achieve this, the public client needs to set up a steering committee that must include all relevant government departments and public stakeholders. This is achieved by deciding which government bodies will be involved in the project, the right qualified personalities (since in a PFI/PPP scheme good negotiation and communication skills are essential), the authority the committee will have and finally the hierarchy. The committee will need to specify the project's requirements by analysing the project objectives and priorities and relevant design requirements. The private sector on the other hand should evaluate the culture and business environmental envelopes in Cyprus in order to identify the business, economic and legal constraints that may affect the SPV. At the end of this sub-process the private sector will formulate the business and project drivers needed to operate in Cyprus. The deliverables at the end of the soft gate of the process will be the initial project details or requirements and the SPV's business and project strategies.

Phase Two – Procurement: Public Sector: At this phase the Steering Committee is to advertise the project. In Cyprus, government projects are advertised through the Official Newspaper of the Government, which circulates weekly, and on the web page of the Ministry of Communication and Work. As an EU member, such public projects may also need to be advertised through the OJEC (official journal of European Community). The private sector will be required to meet the pre-qualification criteria for preferred bidders. The process and bid appraisal must be fair, objective, transparent, accurate and using appropriate quality weightings each of the criteria above. After the expression of interest of the private sector, the investigation of the business case for the project is essential in order to review and evaluate certain constraints which involve political, economic, design, technical and legal. This will help the private sector to built the business strategy for the project, and be in a position to develop the appropriate special purpose vehicle for the project (create concession company). In order to achieve this however, possible partnerships must be evaluated with investors, contractors, suppliers, operations etc. The private sector will then be requested to submit a quality report and promoter's project proposals. At this stage of the process a hard gate is in place since the public sector will be required to select the suitable bidders, which implicate financial authority.

Phase Three –Bidding Process: The public sector is to review the project requirements and make the necessary amendments where required in order to produce the final project brief which will be the bible to any private sector to achieve success of the project. At this phase, the public sector is to select, through the process of communication and presentations, the two preferred bidders for the project. During the invitation to tender the private sector will need to generate the following information: Prepare concept designs, Production of cost plans, Prepare whole – life cycle costing, and Generate business and revenue plan. The private sector will be continuously reviewing the business and project case in respect of financial issues, partnership agreements and hierarchy of consortium organisation. It is essential and important to go through this process in order to maintain control of both the project process and financial milestones, since the aim of the private sector is the generation of profit. The developed project plan will be submitted to the public sector for further evaluation. A soft gate is in place at this stage since the public sector will be in continuous negotiation with two preferred bidders. The deliverable at this gate will be the confirmation of selected two preferred bidders.

Phase Four – Selection Process: Negotiations between the public and private sector will continue during this phase with the public sector identifying at the end the concession that is to be awarded for the project. The private sector on the other hand will revise the project plan according to the outcome of the negotiations and meetings with the public sector and will continue to reform the project business case. The resultant is marked with a hard gate since it is a milestone to the process because the project will be awarded to the selected bidder. Moreover a decision stage is placed since it requires financial authority and is the last stage of the process where the project can either continue or go back to phase 3 and be reviewed accordingly.

Phase Five – Establishing Arrangement Both private and public sector will be committed at senior level. This is due to the communication, final negotiations, organisation and set up of excellent control systems that PFI/PPP projects require in order to succeed. A hard gate therefore is essential because at the end of this phase there is project certainty.

Phase Six – Continuous Improvements / Problem Solving From this phase onwards the public sector is acting as a guardian on the project objectives and work with the private sector in the field of continuous improvements. The private sector prepares the detail designs of the project and production of information in order for the project to enter the construction phase. At the same time the business case is revised in respect of partnership agreements, communication channels and quality assurance plans.

Phase Seven – Construction The public sector continuous to act as guardian to project objectives and time schedule. This is achieved through the sub-process "Develop QA Plans to Monitor" affected by the constraint C6. The private sector is implementing is QA plans for monitoring costs, value, quality, managing construction activities, health and safety and the on site resources. A hard gate is in place at the end of phase seven since in order for the operation of the project to commence, the construction stage must be completed and fully commissioned. Therefore the deliverable at the end of this hard gate is a complete operational facility.

Phase Eight –Operation & Maintenance The public sector will monitor the private sector service provider. This will be achieved by constant evaluation and analysis of the quality of services offered to the public. The private sector will have the difficult task of operating and maintaining the facility by formulating a project logbook and at the same time achieving profitability. At the end of this phase, which will be the end of the concession contract between private and public sector, there will be a hard gate that produces a post project evaluation review document based upon the aim and objectives of the project.

Phase Nine – What happens next? Both parties will have the chance of renegotiating the contract, by reviewing the contract. If renewed is not possible then the Project log – book will be handed over to the public sector who will be responsible for the project from this stage onwards. If on the other hand renewal of the contract is possible, the need of formulating a new contract between the same or other parties could commence, which will take the whole process to the beginning of the model through the feedback bar (use and creation of legacy archive).

Table 1: Document developed by relevant constraints

Constraint Title	***Relevant Document***	***Code***
Lack of having PM on site, Import personnel from overseas, Lack of skill personnel, Poor labour productivity, Lack of knowledge in such schemes.	Human Resources Manual	C 1
Lack adequate time allowed for planning & procurement, Lack of awareness of joint venture scheme	Procurement Strategy	C 2
Legal, Constitutional	Contracts, Legal	C 3
High project value of PFI/PPP schemes Fear of high risk to private sector's companies,	Financial Strategy	C 4
Lack of proper understanding Client's brief, Lack of meeting required standards, Settlement period of such schemes to be established within the industry,	Cultural Social Ethos.	C 5
Lack of large contractors who can bid, Lack of effective control systems, Lack of managerial skills, Lack of applying WLC procedures, Contractors class division.	Cultural Business Ethos	C 6

CONCLUSION

The paper suggests that there are many problems and constraints facing both the public and private parties when it comes to using PFI/PPP in Cyprus. To date, there are airports, highways, waste management facilities, marinas and rural sanitation projects that the government has approved but local companies seem to lack the expertise and financial power to engage these contracts. On the other hand, the foreign companies are constrained by the lack of a legal and financial framework. However, there is an ongoing review in legislation to facilitate such engagements especially for companies operating within the EU. To bring innovation, value, consistency and best practice, this paper has developed a model to facilitate it. The initial test results of the model indicate overwhelming evidence endorsing the model and confirmed that the model has ease of use, reliability and provides consistency. The Ministry of Communication and Works has adopted the framework of the model and are using it as a guideline for new partnered projects using the PFI/PPP.

Table 1, outlines all the constraints that need to be dealt with by the principal and promoter during the application of the model. All the constraints are bundled and fed into larger documents to produce all encompassing manuals which will aide both parties to overcome the constraints and improve their operations for the specific projects as well as for feedback and future referencing. As shown in the model, at least seventeen documents are generated by both the public and the private sector partners. The complete list of the required documents can be seen in Table 2. Although the party responsible is allocated to either public sector or private sector, it is essential that the generating of the respective documents are carried out in collaboration with each other. This means that effective communication between the principal and the promoter is essential at all times throughout the project life cycle.

Table 2: Generated Documents

Document No.	*Relevant Document to be Generated*	*Party Responsible*
D.1	Preliminary Financial & Ecomnomic Assessment	Public Sector
D.2	Project Procurement Strategy	Public Sector
D.3	Steering Committee & Authorities	Public Sector
D.4	Preliminary Project Brief	Public Sector
D.5	Evaluation of Business Environment	Private Sector
D.6	Selection - Pre-Qualification Criteria	Private Sector
D.7	Business & Project Strategy	Private Sector
D.8	SPV Formation (stakes, roles, risk sharing, etc)	Private Sector
D.9	Detailed Project Brief (functional & performance)	Public Sector
D.10	SPV's Business Grand Strategy and Plans	Private Sector
D.11	SPV's Strategies, Policies, Methods & Procedures	Private Sector
D.12	SPV's Project Management Systems (HRMS, quality, H&S, risk management, value, conflict, cost & time)	Private Sector
D.13	Performance Measuring System (economy, efficiency, and effectiveness)	Public Sector
D.14	SPV's monitoring, evaluation & control systems	Private Sector
D.15	Performance Monitoring Systems	Public Sector
D.16	Operational Log-Book	Private Sector
D.17	Revised or New Contract Agreement	Both Parties

The key strength of the model is the requirement for capture of knowledge and information contained in the 17 documents and the feedback mechanism through the "use and creation of legacy archive". The model is simple to follow and provide an in-built continuous improvement mechanism best on actual experiences.

REFERENCE

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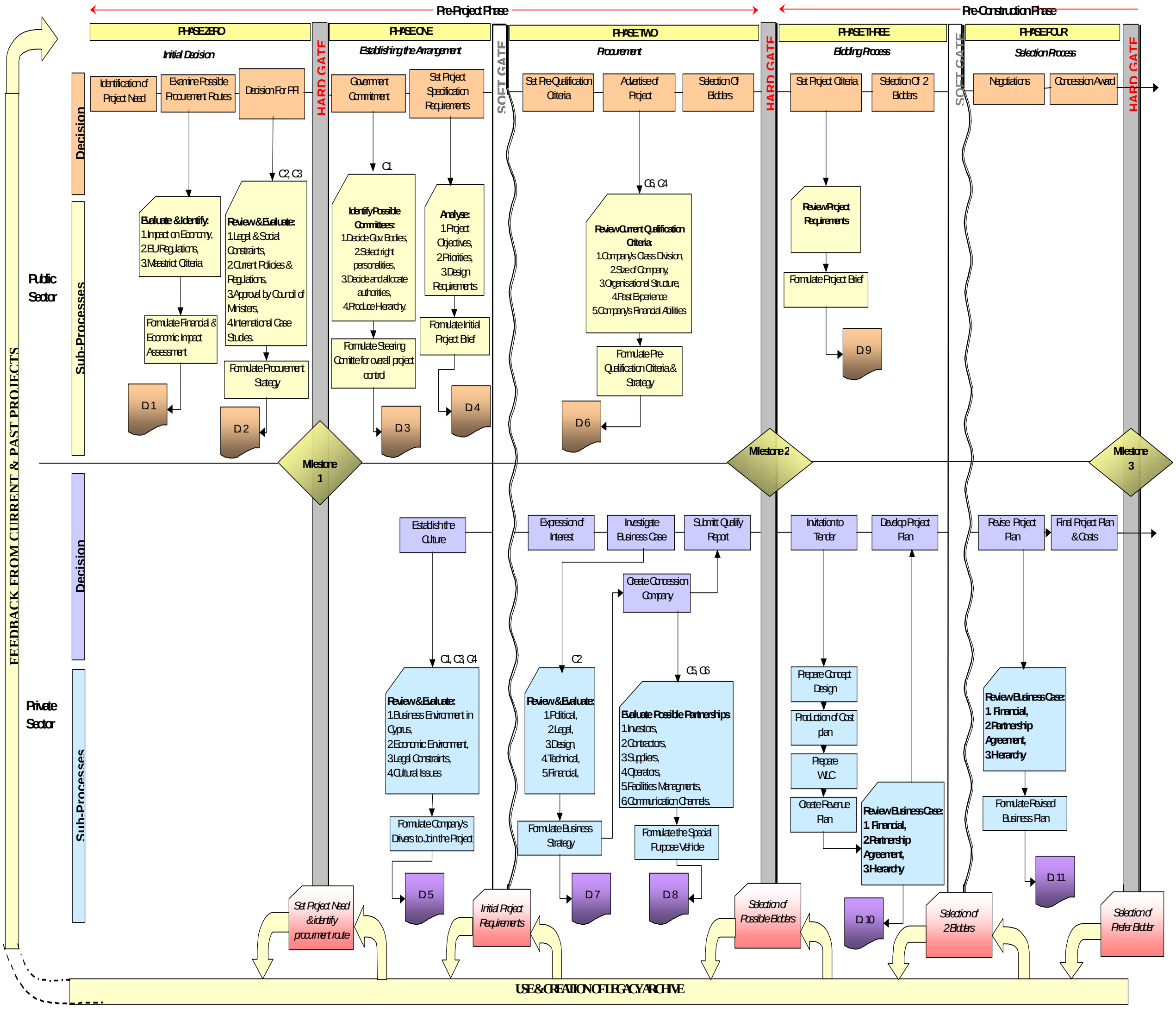
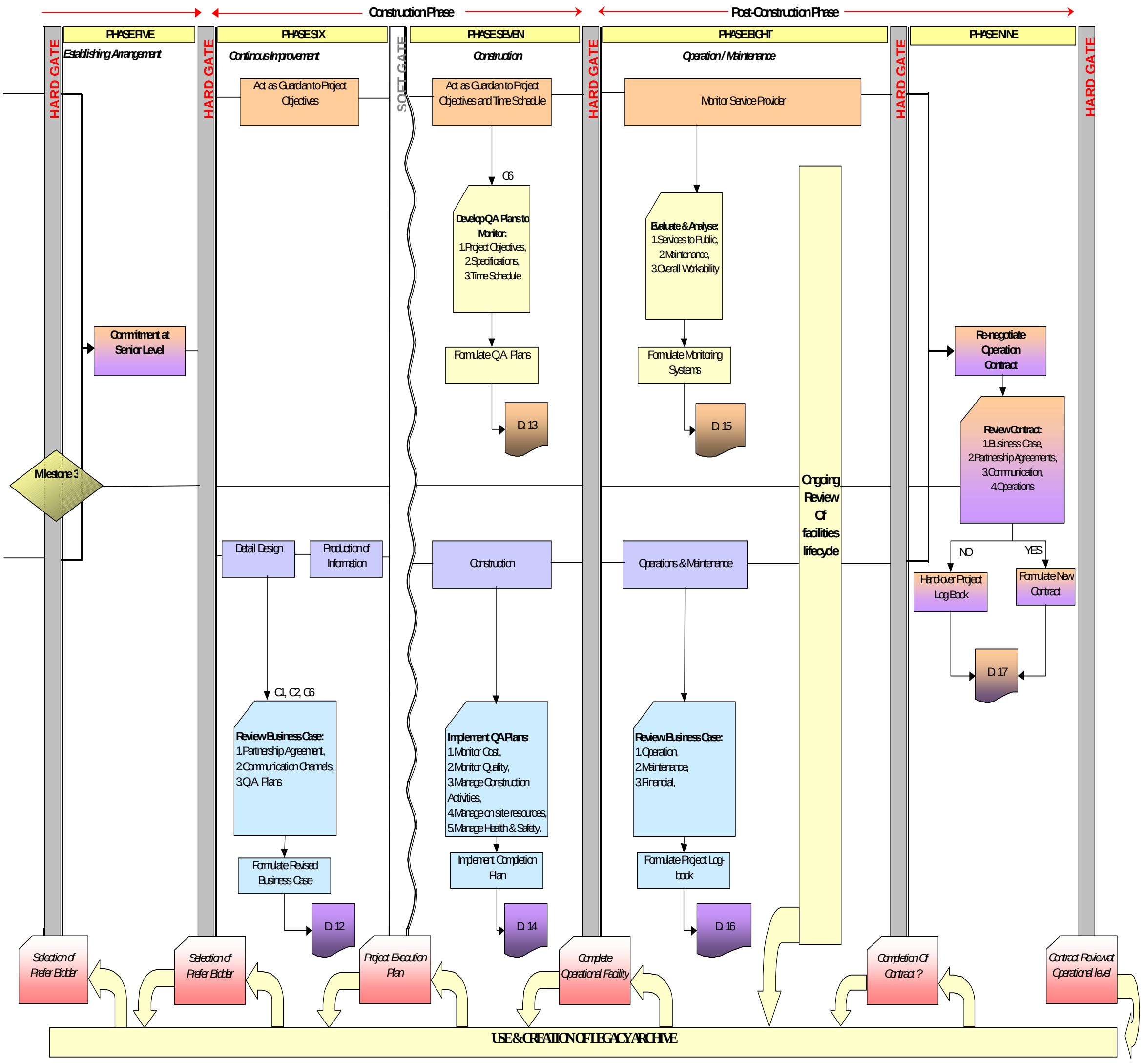
APPENDIX 1 a &b: The model for the implementation of PFI/PPP in Cyprus




Construction Phase
Post-Construction Phase
PHASE FIVE
Establishing Arrangement
PHASE SIX
Continuous Improvement
PHASE SEVEN
Construction
PHASE EIGHT
Operation / Maintenance
PHASE NINE
HARD GATE
SOFT GATE
Act as Guardian to Project Objectives
Act as Guardian to Project Objectives and Time Schedule
Monitor Service Provider
C6
Develop QA Plans to Monitor:
1.Project Objectives,
2.Specifications,
3.Time Schedule
Evaluate & Analyse:
1.Services to Public,
2.Maintenance,
3.Overall Workability
Formulate QA Plans
Formulate Monitoring Systems
D 13
D 15
Commitment at Senior Level
Re-negotiate Operation Contract
Review Contract:
1.Business Case,
2.Partnership Agreements,
3.Communication,
4.Operations
Milestone 3
Ongoing Review Of facilities lifecycle
Detail Design
Production of Information
Construction
Operations & Maintenance
NO
YES
Handover Project Log Book
Formulate New Contract
D 17
C1, C2, C6
Review Business Case:
1.Partnership Agreement,
2.Communication Channels,
3.QA Plans
Implement QA Plans:
1.Monitor Cost,
2.Monitor Quality,
3.Manage Construction Activities,
4.Manage on site resources,
5.Manage Health & Safety.
Review Business Case:
1.Operation,
2.Maintenance,
3.Financial,
Formulate Revised Business Case
Implement Completion Plan
Formulate Project Log-book
D 12
D 14
D 16
Selection of Prefer Bidder
Selection of Prefer Bidder
Project Execution Plan
Complete Operational Facility
Completion Of Contract ?
Contract Review at Operational level
USE & CREATION OF LEGACY ARCHIVE