

Public-private partnerships in Croatia

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Although the institutional framework for public-private partnerships (PPPs) in Croatia was only properly instituted in 2008, Croatian practice has already generated a handful of successful PPP projects. This article provides a brief overview of the institutional framework for PPPs in the country and the role of the Agency for PPPs, as well as other relevant institutions. It also analyses three milestone PPP projects and looks at some of the challenges for PPPs in Croatia.

Introduction

PPPs in Croatia have had a particularly important role in the development of infrastructure projects and the provision of quality public services. Over the last decade, more challenging PPP projects emerged in practice, especially in terms of transportation, education and sciences, sports facilities, public administration buildings and the development of health and social welfare. For local governments, PPPs represent a relatively new opportunity for securing the necessary funds to construct important urban facilities. Moreover, such opportunities have also boosted the development of related legal and institutional frameworks and have resulted in a significant number of activities dedicated to the strengthening of administrative capacities at the national, regional and local levels.

This article describes the legal and strategic framework for PPPs in Croatia. It then describes the role of the Agency for PPPs (“the PPP Agency”) which has been entrusted with the approval of PPP project proposals and supervision of their implementation, and its recent initiatives. Lastly, the article analyses three milestone case studies for PPP’s development in Croatia in the transport and social infrastructure sectors and concludes by discussing some of the challenging issues surrounding PPP projects in Croatia.

Legal and strategic framework

I. Strategic framework

The basic framework and goals of PPPs are set out in the Strategic Framework for the Development of Public-Private Partnerships in the Republic of Croatia (“the Strategic Framework”), which the Croatian government adopted in October 2008,¹ shortly before the Public Private Partnership Act (“the PPP

Act”) came into force in November 2008.² The Strategic Framework recognises that PPPs can have an important positive role in raising the level of public services and accelerating economic development and public administration reforms through the transfer of special knowledge concerning the management of PPPs from the private to the public sector.³ While noting that the principles which define a successful application of PPP models are based on the political and development priorities of the Croatian government,⁴ the Strategic Framework goes on to say that the key to the successful establishment and application of PPPs is the best value for money, which includes: (a) risk distribution (in a way that the responsibility for a particular risk is allocated to the party more capable of supervising the risk and managing it); (b) the greatest possible gain from the efficiency, expertise, knowledge, skills, flexibility and innovation of the private sector for both the public and private sectors; (c) the principle of preserving the integrity of the provision of public services and the availability of the public good; and (d) the principle of transferring expert and professional knowledge from the private to the public partner, with the aim of strengthening the professional and expert capacity of the public partner in the implementation of the PPP project.⁵

Lastly, the Strategic Framework notes that the application of various forms of PPPs should be conditional on: (a) better value for money; (b) long-term budgetary sustainability and acceptable fiscal risks; and (c) readiness of the private sector to participate in a PPP (that is, fiscal profitability of the investment).⁶

II. Public Private Partnership Act

Before the enactment of the PPP Act, PPP-related matters were not covered in a single act, but rather tangentially in other acts (for example, acts on utility

services and concessions) and in the Guidelines for the Implementation of Contractual Forms of PPPs (the “Guidelines”), which did not have the force of law.⁷

The PPP Act regulates: (a) procedures for the preparation, nomination and acceptance of PPP projects; (b) rights and obligations of public-private partners; and (c) establishment and competencies of the PPP Agency.⁸

Rights and obligations of the parties to a PPP project have to be regulated either through the underlying acts of a joint-venture company, in the case of institutional PPPs, or through a PPP contract in the case of contractual PPPs. The term of such a contract should be between five and forty years, allowing for the possibility of renewal at the end of the contractual period.⁹

Public bodies are the only ones authorised to propose the implementation of a PPP project.¹⁰ A public body must submit the project proposal, together with the documentation specified in the Regulation on the Criteria for the Assessment and Approval of PPP Projects (“the Assessment Regulation”),¹¹ following which, the PPP Agency will evaluate the project proposal in accordance with the two main criteria: (i) justifiability of the project and (ii) justifiability of the PPP model.¹²

When evaluating justifiability of the project, the PPP Agency’s assessment will focus on the set of criteria relating primarily to the need for the project, the ability of the public body to implement it, the compliance with the strategies of the competent ministries and the assessment of the fiscal risks of the Ministry of Finance, as well as the profitability of the project. Specifically, the PPP Agency will assess: (a) whether it is in the public interest for the public infrastructure or public service; (b) whether the public body has the necessary authorisations for the implementation of the proposed project; (c) the opinion which, at the PPP Agency’s request, the competent ministry has to issue in connection with the proposed project’s compliance with the relevant development plans and strategies; (d) the consent which, at the PPP Agency’s request, the Ministry of Finance has to issue regarding the proposed project’s compliance with budgetary forecasts and plans, related fiscal risks and limitations, and affordability of the project proposal; and (e) the internal rate of return, whereby the net present value has to equal zero.¹³

When evaluating justifiability of the PPP model, the PPP Agency’s assessment will focus on the set of criteria relating primarily to the allocation of risks and responsibilities between the public and private partners, as well as feasibility and the value for money of the project. Specifically, the PPP Agency will assess: (a) division of obligations between public and

private partners (private partner should (A) in addition to committing to design, construct and/or reconstruct public infrastructure, also assume one or more obligations, such as financing, management and maintenance, for the purposes of providing public services to end-users within the area of public partner’s competencies, or for the purposes of ensuring that the public partner has the necessary preconditions for the provision of public services within the area of its competencies, or (B) undertake to provide public services to end-users within the area of the public partner’s competencies); (b) whether, in addition to the construction risk, the private partner assumes at least one of the following two risks: the availability risk of the constructed or reconstructed building and/or market risk of demand for the relevant services; (c) positive value for money, calculated by comparing public sector costs during the proposed contractual term; and (d) the proposed term of the PPP contract, which – as indicated above – has to be between five and forty years.¹⁴

Although the adoption of special legislation on PPPs is a commendable step, the abovementioned evaluation procedure has often been criticised as unnecessarily lengthy and too demanding, to the point even of being cited as the reason for there not being more PPP projects in Croatia. However, such critiques disregard the fact that well-prepared projects and tender procedures are of clear interest to potential private investors and that, consequently, relaxing the evaluation criteria should be preceded by adoption of higher standards of project preparation. Projects that fail to meet the evaluation criteria typically have not been feasible. Thus the consequence of the prescribed procedure has been to raise the standards and increase the number of well-prepared PPP project proposals.

If the project proposal envisions that the private partner will also engage in business activities, then the PPP Agency will approve the proposal only if such business activity is related to the purpose and goals of the proposed project and if there is no other way for the private partner to achieve the required level of profitability and investment return.¹⁵

Within the period not exceeding 60 days from the day when the project proposal and the accompanying documentation were submitted, the PPP Agency must decide on the approval of the implementation of the proposed project under one of the PPP models.¹⁶ The project proposal will acquire the status of a PPP project solely on the basis of the PPP Agency’s decision.¹⁷

Before initiating the procedure for the selection of a private partner, the public body must submit to the PPP Agency, for its assessment and approval, tender documentation and all accompanying annexes.¹⁸ The PPP Agency will then issue a decision on whether these documents comply with the approved project

proposal within 30 days from the date on which it received the relevant documents.¹⁹

Before reaching a decision on the selection of the private partner, the public body must submit to the PPP Agency, for its assessment and approval, the final draft of the PPP contract, including all annexes thereto, and must also obtain consent from the Ministry of Finance to the final draft of the PPP contract.²⁰ Within 30 days from the date of receipt of the final draft of the PPP contract, the PPP Agency must grant consent to the text of the draft.²¹ The PPP Agency will issue its decision on the basis of the assessment of compliance of the draft PPP contract with the tender documents and provisions of the Regulation on the Content of PPP Contracts.²²

The abovementioned deadlines have been criticised as overly generous and not conducive to the swift functioning of the administrative machinery. Notably, however, the PPP Agency typically completes each of the steps in less than two weeks. It can also be argued that the abovementioned deadlines are entirely justified considering a strategic, long-term horizon of PPP projects. Still, an attempt has been made to simplify the project approval procedure, as a result of which the new PPP Law Proposal and related regulation (see Box below), with simplified approval procedures, is expected to be enacted by September 2012. The major change of this new law will be the introduction of a single-step approval procedure, requiring just the approval of the project proposal, after which the PPP Agency will have only an advisory role, with no formal approvals required. The major changes reflected in the new PPP Law Proposal are illustrated in the Box below.

Major changes to the proposed, new PPP Act, launched in an official approval procedure by the Parliament of the Republic of Croatia on 27 June 2012

Approval of the PPP Agency and the Ministry of Finance is needed only for the PPP project proposal with the contract draft included, before the tendering procedure is launched (now a one-step, instead of the previous three-step approval procedure).

Shortening of the approval procedure from 120 days to 30 days due to the introduction of the one-step, as opposed to the three-step approval procedure by excluding the 60-day deadline for an approval of an initial PPP project proposal; and the 30-day deadline for the approval of the final contract draft; while keeping just the 30-day deadline for a detailed project proposal approval, which corresponds to a previous tendering documentation approval.

The PPP Agency to be given a more active task concerning cooperation with public bodies regarding

interpretation of best international practice and related solutions in the implementation of PPP projects.

The PPP Agency remains obliged to publish guides and manuals for the preparation, contracting and implementation of PPP projects, as well as to give instructions and explanations related to PPP, but is no longer in charge of organising training and education programmes.

Public bodies are obliged to publish an intention in advance to launch a PPP project on the PPP Agency web site.

Criteria for the approval of the PPP project proposal by the PPP Agency are defined more precisely.

Roles and risks of the private and public partners are defined more closely.

The only public procurement criteria applicable for the selection of a private partner for a PPP project is the most economically advantageous offer.

Content of PPP project proposal documentation, as well as the content of the PPP contract are determined by the PPP Act, instead of by related regulations.

So long as they are logged in the Register of PPP contracts, obligations of public bodies concerning reporting as well as the procedure to be applied in case of significant changes to the contract are the same for all PPP contracts, regardless of when they are signed, before the PPP Act is enforced, or thereafter.

Concerning related by-laws, the previous three regulations (Regulation on the Criteria for the Assessment and the Approval of PPP Projects, Regulation on the Content of the Contract, Regulation on Supervision of Implementation of PPP Projects) are replaced by just one (Regulation on the Implementation of PPP Projects), while the fourth previous regulation (Regulation on Training of Participants in Procedures for the Preparation and Implementation of PPP Projects) is no longer needed, so that the previous four regulations and one ordinance are replaced by just one regulation and a new version of the same ordinance (Ordinance on the Establishment and Maintenance of the Register of PPP Contracts).

The maximum contracted period may be beyond the 40-year limit if the PPP project is based on a concession and applicable sectorial law prescribes that a related concession may be awarded for more than 40 years.

The selection procedure of the private partner must be carried out in accordance with the Public Procurement Act and, if the implementation of the PPP project requires the granting of a concession, in accordance with the Concession Act.²³

The final version of the concluded PPP contract must be submitted to the PPP Agency, which keeps a public Register of all PPP contracts entered into in Croatia in accordance with the Ordinance on the Establishment and Maintenance of the Register of PPP Contracts (“the PPP Register”).²⁴

PPP Agency

Mission and tasks

As described above, the PPP Agency was entrusted with the selection and approval of PPP projects proposed by Croatian administration on the national, regional and local level. It acts in close collaboration with the Ministry of Finance. The PPP Agency’s key tasks specified in the PPP Act are as follows:

- (a) appraisal and approval of PPP project proposals, tender documents and final drafts of PPP contracts
- (b) publication of the list of the approved PPP projects
- (c) establishment and maintenance of the PPP Register
- (d) supervision of the implementation of PPP projects
- (e) proposal of amendments to the PPP Act and related regulations
- (f) issuing of implementing instructions under the PPP Act
- (g) decision-making on the performance of tasks within its purview, as prescribed by the PPP Act
- (h) giving expert opinions and interpretations on certain PPP-related matters
- (i) organisation of training and education programmes of participants in the preparation and implementation of PPP projects
- (j) analysis of national and foreign PPP practices and promotion of the implementation of best practices
- (k) international cooperation.²⁵

As the sole evaluator of PPP projects, the PPP Agency has been granted tremendous clout in the decision-making process over the proposed projects and, in that context, the PPP Act has been criticised as unnecessarily centralising the decision-making process. As a result and thanks to the growth of the Croatian PPP market, stronger involvement of other institutions may be an anticipated and welcome development. Recent establishment of the Centre for Follow-up of Energy Sector and Investments²⁶ in charge of supporting public sector contracting authorities in the preparation and execution of tender procedures is exactly the sort of step which indicates a further possible development in that direction.

International cooperation programme

International cooperation is an important part of the PPP Agency’s activities, its main goal being the acquisition and sharing of knowledge and expertise, as well as the promotion of best practices in the PPP implementation.

One of the key aspects of international cooperation has been the strengthening of the administrative capacities of the PPP Agency itself, mostly through the support of the EU Instrument of Pre-accession Assistance (“the IPA”). Key activities were 24 workshops with the OECD/SIGMA experts in the period between 2007-11, as well as the IPA project titled “Strengthening of the Administrative Capacity of the Agency for the Public-Private Partnership in the Republic of Croatia in Relation to the Implementation of the New Public-Private Partnership Legislation”, which was successfully implemented in 2010 with Greek partners, the Centre of International and European Economic Law (CIEEL) and the Special Secretariat for Public Private Partnerships of the Hellenic Ministry of Economy, Competitiveness and Shipping. The overall objective of the project was to develop a sound and transparent public procurement system in the area of PPPs in Croatia, in relation to the implementation of the relevant EU standards.

Other important aspects of the PPP Agency’s international cooperation include membership and participation in activities of international PPP centres of knowledge, such as the European PPP Expertise Centre and the team of specialists on PPP of the Committee for Economic Cooperation and Integration of the United Nations Commission for Economic Cooperation with Europe, as well as cooperation with a number of leading international financial institutions such as the EBRD, the World Bank Institute and the European Investment Bank.

Lastly, yet another important focus of the PPP Agency’s international cooperation is regional as well as bilateral cooperation with leading national PPP units in other countries. Generally, the goal of such cooperation is to share knowledge and specific experiences in the implementation of certain types of PPP projects, as well as information concerning national regulation and practices.

Case studies: lessons learned

This section describes three landmark PPP projects in Croatia and lessons learned from them.

Istrian “Y” Highway

The Istrian “Y” highway is considered the first PPP project in Croatia. In the 1994 tender, the French company, Bouygues Travaux Publics, won a 32-year concession to build and operate a 131 km “Y”-shape highway in Istria, the outermost north-west part of Croatia. The concession agreement with the special-purpose vehicle (SPV) Bina Istra was signed in 1995 and the financial closing for over €500 million was completed in 1997.

The concessionaire’s obligations were to design, finance, build, operate and hand over the infrastructure at the end of the 32-year concession period. Traffic and revenue risks were mitigated by the fact that significant toll revenue was generated by the tunnel itself.

The initially accepted estimates of the traffic growth proved to be too conservative. Thus, as a result of higher-than-anticipated traffic growth, after just six years of the completion of phase I, phase II had to be launched in order to upgrade the full lengths of the highway to a full two-line highway in order to accommodate faster-than-anticipated traffic needs. Consequently, while on the one hand, the increased traffic growth generated additional income, on the other it also generated the unanticipated costs of a sooner-than-planned highway upgrade.

There are two key lessons to be learned from this project: the need for realistic traffic forecasts during the project planning stage and, even more important, a flexible approach which takes into account the need for possible major upgrade investments.

Schools and sports halls in the Varaždinsko-Križevačka county

Another significant milestone project in Croatia’s PPP development was the simultaneous construction of two new schools, reconstruction of 27 existing schools and construction of 15 school sports halls in the Varaždinsko-Križevačka county, based on the availability model.

The tender was launched at the beginning of 2006 and, by the end of the same year, contracts for a total investment amount of over €40 million were awarded mostly to Croatian companies. Their obligations were to design, finance, construct/reconstruct, operate and hand over all schools and sports halls after three years of the construction period plus 25 years of the operational period.

The project developed as planned, without any delays or additional costs. What is more, it contributed to much higher education standards, as glibly summarised in a statement by one of the school governors that, as a result of the PPP approach, he could now focus on education, rather than school administration and operation issues. Such change has also manifested itself through students’ achievements in a number of national competitions.

However, this project also pinpointed the need for the adoption of legal and institutional frameworks in order to better control related fiscal risks and ensure that adequate administrative capacities were in place. As a result, by the end of 2005, the government adopted the Guidelines, and these, in turn, paved the way for the establishment of the PPP Agency by the end of 2008, as well as for the establishment of an effective legal framework on PPPs. What is more, this project and lessons learned therefrom are being used as a precedent for other PPP projects in different sectors.

New Passenger Terminal of Zagreb Airport

On 11 April 2012, the Croatian Ministry of Maritime Affairs, Transport signed a PPP contract with ZAIC, an SPV formed by the French companies, Bouygues and Aéroport de Paris and the construction company, Viaduct, as the Croatian partner. The approximate investment value is €236 million and the concession was awarded for the construction of the new passenger terminal and 30 years of operation of the Zagreb Airport following the terminal construction.

The entire project preparation process commenced in May 2010 and represents the first major project launched and approved by the PPP Agency in accordance with the procedures set forth in the PPP Act. The real importance of this project lies primarily in its expected positive economic impact, as well as in the envisioned positioning of Zagreb Airport as a regional hub on the map of air carriers. Notably, the preparation and contracting phases have demonstrated that the Croatian PPP framework and practices are compliant with the related EU directives and best practices.

	Highway Istrian Epsilon	29 schools (2 new, 27 reconstructed) and 15 new school sports halls in the Varaždinsko-Križevačka county	New passenger terminal at Zagreb Airport
Total investment amount	€680 million	€41 million	€236 million
PPP model used	Service based (32-year concession)	Availability based (PFI, 25 years)	Service based (30-year concession)
Year of the main agreement	1995	2006	April 2012
Year of the financial agreement	1997	2006	2012 (expected)
Year of the construction completion	2005 phase I 2011 phase II (extension to full profile in full length)	2009	2015 (expected)

Future challenges

Croatia's PPP market is reaching new levels of maturity with a substantial project pipeline.

In that context, on 19 April 2012 the Croatian government adopted the Framework Programme for the Construction, Reconstruction and Upgrade of Public Buildings Using Contractual PPP Model ("the Framework Programme") for the next four years. The Framework Programme envisions PPP projects based on the availability scheme model in the field of sciences, education, health, justice, culture, social welfare and defence, with a total estimated investment value of €2 billion. Furthermore, additional PPP projects based on the service scheme are in preparation in the field of energy production and transportation.

Nevertheless, this foreseen increase in the number of PPP projects also represents a new challenge and requires further improvements of the existing institutional and legal frameworks.

As the first step in that direction, in February 2012 the Croatian government adopted the Act on the Centre for Monitoring of Energy Sector and Investments.²⁷ The Act stipulates the establishment of the Centre for Monitoring of Energy Business and Investments ("the Centre"), which will be the central authority for managing state-owned companies and PPPs in the energy sector.²⁸ The Centre's main goals are to enhance the financial efficiency and transparency of the state-owned energy sector to direct investments into projects which ensure the best long-term economic outcomes, and to speed up the decision-making process.²⁹ The Centre will be financed by contributions from investment project stakeholders and from other resources gained in the course of performing its tasks. In addition, donations, EU funds and so on may also be additional sources of income for the Centre.³⁰

Further, on 27 June 2012 the Croatian government adopted and submitted to the Croatian parliament the proposed new PPP Act, in order to ensure the efficiency of procedures and involved institutions, as well as the clarity of criteria applied in the assessment and approval of PPP projects. What is more, Croatia's forthcoming EU membership is also likely to foster development of the Croatian PPP market by increasing its potential on both the supply and demand fronts. Therefore, the forthcoming years may, in fact, provide opportunities for the Croatian PPP market.

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¹ *Strateški okvir za razvoj javno-privatnog partnerstva u Republici Hrvatskoj* [hereinafter: the Strategic Framework], available at:

http://www.javnabavava.hr/userfiles/file/STRATE%C5%A0KI%20DOKUMENTI/Strateski_okvir_za_razvoj_JPP.pdf (last visited on 24 March 2012).

² *Zakon o javno-privatnom partnerstvu*, Official Gazette Numbers 129/08 and 55/11 [hereinafter: the PPP Act].

³ The Strategic Framework, *supra* note 1, at 3.

⁴ *Id.*, at 6.

⁵ *Id.*

⁶ *Id.*

⁷ See *Smjernice za primjenu ugovornih oblika javno-privatnog partnerstva*, Official Gazette No. 98/06.

⁸ The PPP Act, *supra* note 2, Article 1.

⁹ *Id.*, Article 6(1).

¹⁰ *Id.*, Article 10.

¹¹ *Uredba o kriterijima ocjene i odobravanja projekata javno-privatnog partnerstva*, Official Gazette 56/09, Article 3.

¹² *Id.*, Article 4(2).

¹³ *Id.*, Article 6.

¹⁴ *Id.*, Article 7.

¹⁵ *Id.*, Article 8.

¹⁶ The PPP Act, *supra* note 2, Article 12(1).

¹⁷ *Id.*, Article 12(2).

¹⁸ *Id.*, Article 13(1).

¹⁹ *Id.*, Article 13(2).

²⁰ *Id.*, Article 14(1).

²¹ *Id.*, Article 14(2).

²² *Id.*, Article 14(3).

²³ *Id.*, Articles 15(1) and 15(2).

²⁴ See *Pravilnik o ustroju i vođenju Registra ugovora o javno-privatnom partnerstvu*, Official Gazette No. 147/10.

²⁵ The PPP Act, *supra* note 2, Article 24(1).

²⁶ See *Zakon o Centru za praćenje poslovanja energetskeg sektora i investicija*, Official Gazette No. 25/12.

²⁷ *Zakon o Centru za praćenje poslovanja energetskeg sektora i investicija*, Official Gazette No. 25/12.

²⁸ *Id.*, Article 5.

²⁹ *Id.*, Article 6.

³⁰ *Id.*, Articles 11(2) and (3).