

## EPEC Membership Discussion Summary Note<sup>1</sup> Environmental & Social Benefits in PPPs

### **1. Background**

This paper summarises work carried out by EPEC during 2020 to examine the role of PPPs in delivering on environmental and social objectives in infrastructure investment. This work is important in the context of the EIB's role as the EU's climate bank and a greater emphasis more widely on environmental and social sustainability in investment. It also builds on previous discussion amongst the EPEC Membership about initiatives – in the EU and beyond – to expand infrastructure procurement from simple contracting for works and services into an opportunity to bring wider benefits to society, the economy and the environment.

One aspect of EPEC's work has been to consider the sectors or areas of investment in EU Member States' national energy and climate plans that might be suitable for a PPP approach. The other aspect of EPEC's work – the focus of this short paper – has been to identify and analyse current PPP practice in the EU in helping to deliver environmental and social benefits in projects across sectors (and not simply those projects or sectors serving an obvious energy or climate agenda).

### **2. The Environmental & Social Agenda**

The motivations and incentives for contracting authorities to pay greater attention to the environmental and social aspects of their infrastructure spending come from a variety of sources:

- i. laws and policies aimed at delivering national and local sustainability objectives, as well as commitments to global efforts on sustainable development (the UN Sustainable Development Goals<sup>2</sup>) and combatting climate change (the Paris Agreement<sup>3</sup>);
- ii. the EU increasingly channelling funding and finance towards investments in sustainable and clean infrastructure to deliver its Green Deal<sup>4</sup> commitment to be carbon neutral by 2050 (and reduce CO<sub>2</sub> emissions by half by 2030). This can be seen coming through, for example, the EUR 20 billion Sustainable Infrastructure window of the InvestEU programme, and with climate aspects at the centre of the EU's 'green recovery' from the COVID-19 crisis; and
- iii. an increasing focus on environmental and social sustainability amongst infrastructure investors appraising investment opportunities and making investment decisions on the

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<sup>1</sup> This note is a working document of the EPEC membership. It has been prepared to facilitate the exchange of information and experiences amongst EPEC members and other PPP practitioners in the field of public-private partnerships (PPPs). As a result, the findings, analyses, interpretations and conclusions contained in this report cannot be relied upon. For more information about EPEC and its membership please visit [www.eib.org/epec](http://www.eib.org/epec).

<sup>2</sup> <https://www.un.org/sustainabledevelopment/sustainable-development-goals/>

<sup>3</sup> [https://ec.europa.eu/clima/policies/international/negotiations/paris\\_en](https://ec.europa.eu/clima/policies/international/negotiations/paris_en)

<sup>4</sup> [https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en)

basis of environmental, social and governance (ESG) criteria<sup>5</sup> (i.e. non-financial aspects of investments are becoming increasingly important for financiers and investors)

Added to this, organisations such as UNECE (with its People First PPPs initiative<sup>6</sup>), Global Infrastructure Hub<sup>7</sup> and the OECD<sup>8</sup> have guidance on incorporating sustainability (including environmental and social benefits) into PPPs and infrastructure procurement. These publications mostly identify issues that relate to *project* selection and scoping (i.e. choosing what to invest in, where, why and for whom) rather than in the potential ESG enhancing aspects of PPP as a *project delivery mode*. Nevertheless, they add weight to the suggestion that this is an important topic for PPP contracting authorities to address.

### 3. Environmental & Social Benefits: a project or a PPP issue?

Indeed, it is important to recognise that the environmental and social benefits of any infrastructure investment will be largely derived from the definition of the project itself and not the way in which it is procured (traditional or PPP). Environmental or social benefits might be **inherent in the infrastructure** (or the services delivered from it), for example:

- climate adaptation through a dam or flood defence project;
- climate mitigation through a district heating project using sustainable resources;
- improved health through investment in healthcare facilities;
- improved access to education through investment in education facilities; or
- improved social equality/well-being through regeneration projects.

In addition, there are environmental and social benefits that can be achieved through the **design** and the **implementation** of a project (see Figure 1). For example:

- the infrastructure (whatever its end-use) might be designed to be energy efficient, climate resilient, make use of sustainable or re-cycled materials, restore biodiversity and eco-systems, or bring improvements to the local environment;
- during construction and operation, the project might implement low carbon methods and technologies or introduce measures to reduce/prevent pollution or minimise waste; it might offer training and employment opportunities targeted at particular groups (e.g. long-term unemployed, young people), contracting opportunities for local SMEs or social enterprises or provide occasions for local community engagement (e.g. connections with local schools or community groups to incorporate their input into the project).

#### Figure 1: Environmental & Social Benefits in a Project

<sup>5</sup> See LTIIA ESG handbook (<http://www.ltiia.org/wp-content/uploads/2015/12/ESG-Handbook-Second-Edition-Excerpts.pdf>) and Infrastructure Investors special issue on ESG ([https://d16vj43vx3i1f6.cloudfront.net/uploads/2019/10/InfraSusInv\\_Nov19-1.pdf](https://d16vj43vx3i1f6.cloudfront.net/uploads/2019/10/InfraSusInv_Nov19-1.pdf))

<sup>6</sup> [https://www.unece.org/fileadmin/DAM/ceci/documents/2018/PPP/WP/ECE\\_CECI\\_WP\\_PPP\\_2018\\_03-en.pdf](https://www.unece.org/fileadmin/DAM/ceci/documents/2018/PPP/WP/ECE_CECI_WP_PPP_2018_03-en.pdf)

<sup>7</sup> [https://cdn.gihub.org/umbraco/media/2761/gih\\_output\\_specs\\_art\\_web.pdf](https://cdn.gihub.org/umbraco/media/2761/gih_output_specs_art_web.pdf)

<sup>8</sup> See OECD Compendium of Policy Good Practices for Quality Infrastructure Investment <http://www.oecd.org/finance/oecd-compendium-of-policy-good-practices-for-quality-infrastructure-investment.htm>



Whilst these benefits might be reflected in a project regardless of the method used to *deliver* the project, EPEC's particular interest is to analyse how these types of benefits are (or could be) captured specifically with the PPP approach to procurement and contracting.

The starting point for this is to recall key features of PPP that motivate public authorities to use PPP for public infrastructure procurement in the first place, being:

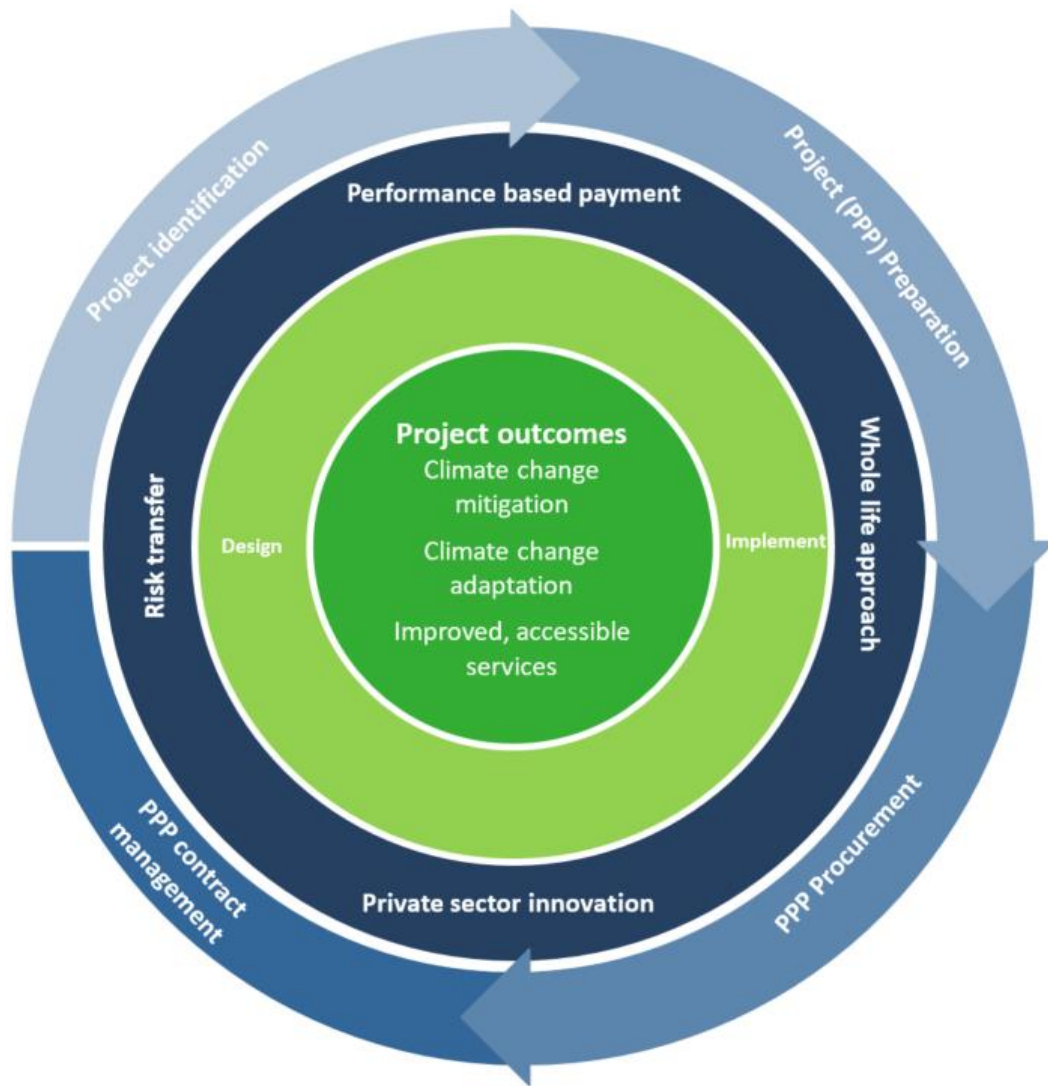
- a whole-life approach to risk and cost;
- transfer of key project risks to the private sector;
- performance-based remuneration; and
- private sector innovation.

From here we look at how these features of PPP are (or could be) applied to the environmental and social objectives of projects, and whether this makes PPP inherently more or less effective than other models for securing these objectives. In other words, can a PPP approach contribute as much, if not more, to achieving sustainability outcomes compared to more traditional project delivery approaches?

#### **4. Enhancing environmental and social benefits over the PPP project cycle**

From EPEC's analysis, including discussions with several EPEC Members who have specific initiatives on this topic, it appears that there are indeed features of the PPP delivery mode that can be used to enhance the environmental and social benefits of the underlying projects and programmes. These can be mapped against the typical PPP project cycle (see Figure 2).

**Figure 2: Environmental & Social Benefits in a Project delivered with a PPP approach**



#### 4.1. Environmental & Social Benefits: Project identification stage

Many of the environmental and social benefits inherent in the project, its design and delivery are identified at this stage along with the investment need itself. For the most part the environmental and social characteristics of projects are driven by **national/regional investment plans and priorities** as well as laws and policies applied to public infrastructure contracting or construction generally (e.g. energy efficiency regulations for public buildings, jobs and training requirements in the construction sector). As the procurement decision has not really been made at this stage, any environmental or social benefits of PPP as a delivery mode are not so relevant at this stage.

#### 4.2. Environmental & Social Benefits: PPP preparation stage

At this stage of the project cycle, the PPP option for delivering the project is developed and affordability, bankability and value for money is tested.

Whilst the environmental and social benefits themselves are largely identified with the project, decisions need to be made here as to **how they will be captured and even enhanced in the**

PPP procurement process and the PPP contract. This needs to be done in **consultation with stakeholders** and tested with the market for deliverability and bankability.

Scotland and Wales, for example, when designing their respective hub/NPD and MIM programmes<sup>9</sup> had to consider how to adapt national policies on community benefits (applicable to public infrastructure projects generally) for competitive dialogue procurements and long-term contracts. In both cases they seized the opportunity for PPPs to lead the way on these policies – going beyond what was being done on traditional procurements (and in doing so addressing some of the negative perception of PPP). Whilst the market was familiar with requirements for community benefits in traditional projects, its appetite for extending these to the operational phase and to accept the contracting authority’s right to financial remedies for non-delivery (as explained below) needed to be taken into account.

To EPEC’s knowledge there is limited practice so far of sustainability (i.e. social and environmental cost/benefits) featuring explicitly in the **value for money (VfM) analysis** i.e. PPP being chosen or not on the basis of how it compares with other models in delivering on sustainability criteria. Nevertheless, the sustainability credentials of PPP versus traditional procurement might be implied, or indirectly considered, in the VfM analysis in other ways, even if partially. For example:

- the whole-life approach of PPP, with its emphasis on *long-term* costs, might be considered to motivate project investment decisions that are inherently more sustainable; and
- the transfer of lifecycle and maintenance risk leading to higher quality and reliability of infrastructure (and, by extension, the benefits from that infrastructure)

However, given the ways in which PPP’s specific features can apply to sustainability characteristics of a project (as outlined in this paper), combined with the growing importance of the environmental and social agenda, an *explicit* inclusion of sustainability criteria in the VfM analysis may prove to become more relevant.

#### **Box 1 – Sustainability in German VfM analysis**

In German motorway PPPs, the VfM analysis includes non-financial non-measurable criteria such as GHG emissions and use of landscape. This part of the VfM analysis evaluates the magnitude and probability of benefits delivered under the traditional and PPP procurement routes using a ten point scale (with ten being high magnitude/probability and one being a very low magnitude/probability). This policy is fairly recent, however, and so far there is no detailed information or feedback available on its application.

<sup>9</sup> For information on Scotland’s hub and NPD programmes see <https://www.scottishfuturestrust.org.uk/page/hub> and <https://www.scottishfuturestrust.org.uk/page/non-profit-distributing>. For information on Wales’s MIM programme see <https://gov.wales/mutual-investment-model-infrastructure-investment>

### 4.3. Environmental & Social Benefits: PPP procurement stage

At **pre-qualification stage**, bidders' previous experience in delivering environmental and social sustainability criteria can be taken into account. The pre-qualification process for the City of Glasgow College NPD project in Scotland, for example, required applicants to describe their experience in achieving low carbon and energy efficient buildings, engaging with local communities throughout construction and providing job and training opportunities in project execution.

At the **bidding stage** it is of course common to include bid deliverables and evaluation criteria linked to specific environmental and social aspects of bidders' proposals. In most cases these will form part of the technical proposals and the overall technical bid evaluation. In some instances these might be defined as mandatory requirements, evaluated on a pass/fail basis (e.g. a design that achieves a particular energy efficient rating or a construction that employs a certain number of long-term unemployed people, such as is the policy in France).

The contracting authority may also want to allow competition on certain aspects, allowing bidders to propose more than the minimum and rewarding them accordingly. This can present several challenges:

- i) ensuring that the benefits remain relevant and valuable to the project;
- ii) incentivising bidders to propose benefits that might increase their price; and
- iii) working out how to compare and value different offerings from different bidders.

Some interesting strategies have been adopted to address these issues.

Firstly, the fact that PPPs are typically procured using the competitive dialogue procedure means that there is an opportunity to allow innovation and competition in delivering sustainable solutions to project requirements. For instance, on a road PPP in the Netherlands, the dialogue was used to discuss solutions for achieving the required energy neutrality of the project. As a result, the project ended up with renewable energy generation capacity that exceeded the needs of the signaling and lighting requirements. Thus, the competitive dialogue procedure creates space for innovation and competition in delivering benefits above the minimum requirements, whilst at the same time ensuring these benefits remain relevant and valuable to the contracting authority.

#### **Box 2 - Competing to Deliver Community Benefits in Wales**

The delivery of community benefits is an important policy aspect of all public infrastructure investment in Wales. In designing a model specifically for PPPs (the Mutual Investment Model or 'MIM'), and procuring its MIM programme in the roads and education sectors, the Welsh Government has therefore sought to maximise the opportunity for infrastructure investment to benefit local communities and, ultimately, the Welsh economy. These benefits include:

- workforce initiatives (job and training opportunities for disadvantaged people and specific target groups); and

- supply chain initiatives (opportunities for small and local businesses);

as well as others (e.g. community initiatives) that are considered relevant on a project-specific basis.

The contracting authority specifies minimum community benefit requirements, with the bidders' responses to these assessed on a pass/fail basis. During the competitive dialogue, proposals are then invited from bidders that exceed the minimum levels ('enhanced community benefits') and introduce new categories of benefits ('additional community benefits').

The Welsh Government seeks to encourage innovation by requiring additional community benefits. At the same time, it wants to ensure that the benefits offered are relevant and proportionate to the project in question and allow for a simple and objective comparison of proposals. It therefore uses the competitive dialogue to examine the bidders' community benefits proposals and has adopted the following approach to community benefits evaluation:

- the proposals attract up to 5% of the overall qualitative evaluation score (4% for enhanced community benefits and 1% for additional community benefits);
- considers the merits of the benefits themselves using key performance indicators and method statements for delivering the proposed benefits as the focus of evaluation; and
- sets a ceiling on the monetary value of the additional community benefits category, so that proposed benefits valued at the ceiling attract full points and no further points are awarded for benefits of a value above the ceiling.

The winning bidder's commitment to minimum, enhanced and additional community benefits are reflected in the PPP contract, and the contracting authority is entitled to financial remedies for any failure by the winning bidder to deliver these during the contract.

Secondly, some contracting authorities have taken steps to standardise and monetise the environmental and social benefits incorporated in projects. In Scotland, for example, Scottish Futures Trust (SFT) has created a 'menu' of 48 project attributes or activities that are considered to contribute to five themes of 'social value'. Each of these attributes has a value attached (either in monetary terms or as a percentage of the value of the project). At project preparation stage, the contracting authority defines minimum social value targets and identifies areas where bidders might propose additional social value (up to a certain limit). The social value menu and matrix allows bidders to understand the social value (and therefore the value to the contracting authority) of their proposals in quantitative terms. It also gives the contracting authority a clear and objective basis for evaluating what bidders propose.

### **Box 3 – Social Value in Scotland**

The concept of delivering ‘social value’ in public sector procurement is enshrined in legislation applicable across the UK. For the SFT’s ‘hub’ programme of community infrastructure projects, this is a natural successor to the ‘community benefits’ policy that previously applied.

SFT has recently released detailed guidance<sup>10</sup> on how to procure, deliver and measure social value in hub projects. This provides a framework of Themes, Outcomes and Measures (‘TOMs’) that align with national policy and the UN’s Sustainable Development Goals. Whilst the previous community benefits policy had been focussed mainly on employment, training and supply chain opportunities, the TOMs recognise a broader range of benefits related to:

- fair work;
- entrepreneurial, inclusive and sustainable economy;
- inclusive, empowered and resilient communities;
- protecting and enhancing the environment; and
- social innovation.

SFT’s guidance provides a systematic approach to deriving social value benefits from projects, facilitating the process of specifying, evaluating, managing and reporting. In the absence of a pipeline of DBFM projects, the policy has only been applied to design and build projects so far. However, it is clear to see how the approach could be replicated for DBFM projects in the future.

Similarly Rijkswaterstaat, Netherlands’ infrastructure and water management agency, has developed a systematic approach to measuring and valuing environmental aspects of transport and other economic infrastructure PPPs in the Netherlands. This approach tackles what is often considered a trade-off between sustainability and cost.

### **Box 4 – Valuing environmental sustainability in the Netherlands**

On transport and other economic infrastructure PPPs in the Netherlands, Rijkswaterstaat has developed its procurement strategy to incentivise bidders to propose sustainable solutions, even if these might cost more.

Using a bespoke tool, it estimates (in monetary terms) the environmental cost of the project over a 50-year period (based on design, materials used etc.) and applies a fictional deduction to the bid price from any bidders that can reduce that environmental cost. For

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<sup>10</sup> <https://www.scottishfuturestrust.org.uk/page/social-value>



example, a bidder with a solution that saves EUR 1 million on the environmental cost index could be credited with a fictional EUR 1.5 million reduction in its price.

This approach was combined with other fictional price reductions for achieving certain CO<sub>2</sub> performance certifications and a mandatory requirement (on several roads projects) for energy neutrality (i.e. road installations such as lighting and signalling should not consume more energy than is generated through measures such as the use of solar panels).<sup>11</sup>

It is important to recognise that some of these features could be (and perhaps are) adopted in traditional procurement and are not exclusive to PPPs. However, EPEC's analysis suggests that, in practice, PPPs have tended to create opportunities for innovative procurement approaches to environmental and social aspects than might otherwise have been the case.

There are several reasons for this. Firstly, innovative procurement approaches to environmental and social aspects might simply be a consequence of using different teams within contracting authorities. Secondly, the marginal complexity of adding specific environmental and social characteristics is arguably less in an already fairly complex PPP process than in a relatively simple traditional project procurement. Thirdly, because competitive dialogue (or negotiation) is more common on PPPs, it affords the opportunity to take more innovative approaches to incorporating environmental and social aspects in bids. Finally, the need to mitigate negative perceptions of PPP, where they exist, may be an incentive to be seen to increase the focus on environmental and social sustainability aspects.

#### **Box 4 – PPPs as a catalyst for change in procurement approach**

The Welsh Government's policy on community benefits applies to traditionally funded and procured projects as well as to MIM projects (MIM being Wales's specific form of PPP).

To date, however, community benefits in traditional projects have not been subject to financial remedies if they are not delivered. In addition, given that traditional projects centre on the construction of the infrastructure only, the contracting authorities tend to focus only on the benefits that can be achieved during the construction phase.

With MIM, the Welsh Government has developed standard contract documents that impose a binding obligation to deliver the benefits that the contracting authority has mandated (or that the private partner has offered in its proposals). These obligations are backed by financial remedies imposed on the private partner for any benefits that it fails to achieve (e.g. GBP x for every training opportunity not

<sup>11</sup> For information on the A6 project in the Netherlands see [https://ec.europa.eu/environment/gpp/pdf/news\\_alert/Issue\\_83\\_Case\\_Study\\_162\\_RWS.pdf](https://ec.europa.eu/environment/gpp/pdf/news_alert/Issue_83_Case_Study_162_RWS.pdf)

provided, or supply-chain opportunity not advertised to SMEs). In addition, because of the long-term nature of MIM projects, the contracts can capture the delivery of community benefits not only in the construction phase but over the whole life of the project.

#### 4.4 Environmental & Social Benefits: PPP contract management stage

There are various contractual mechanisms that incentivise the delivery of environmental and social benefits required in a project and arguably even enhance their delivery when compared with other forms of procurement. Some of these are inherent features of the PPP contracting structure, while others have been developed with a specific environmental or social focus in mind. For example:

- **No payment until completion:** environmental and social characteristics are often included in the construction completion tests (e.g. energy efficiency certification, environmental improvements on the site), with no payment until those tests are satisfied;
- The **payment mechanism** links ongoing payments to the asset and service specification and in doing so ensures and incentivises *ongoing* delivery of environmental and social benefits (e.g. a well-maintained building to provide the core environmental/social benefits; a commitment to use environmentally sustainable materials/processes in lifecycle replacement);
- The **sharing or transfer of ongoing energy consumption risk** to incentivise energy efficient design and efficient long-term operation:
  - o this can be relatively straightforward in practice in some sectors (e.g. roads where a full transfer of energy consumption risk to the private partner is common);
  - o but it can be more complex to negotiate and implement in other sectors (e.g. schools where energy consumption is heavily influenced by use of the building as well as design and operation, which makes a full transfer of risk difficult to achieve). There are numerous examples of energy risk sharing mechanisms adopted across the EU. The effectiveness of these different mechanisms in practice is a topic that may warrant further investigation.
- **Bespoke mechanisms** to capture environmental and social benefits such as:
  - o in the Netherlands, the contract provides for **payment of the fictional deduction** (see Box 3) as a penalty if the environmental cost reductions are not achieved when measured on construction completion;
  - o in Scotland and Wales, **community benefits clauses** specify the targets (e.g. jobs, training opportunities, community engagement activities) to be achieved

during each of the construction and operational phases, with penalties applied if these are not met. These sit outside the payment mechanism and are subject to a ceiling (so that they can be passed down to the sub-contractors and do not affect the bankability of the projects).

- Some contracts have **change or review mechanisms** that specifically refer to environmental aspects of projects (e.g. review of lifecycle plans to consider scope for more sustainable replacement of elements of the infrastructure; regular review of energy consumption and steps to reduce it). Whilst these are typically 'agreements to agree' and not substantially different from general PPP change or review mechanisms, it might be the case that by drawing (and keeping) attention to these specific aspects of the project that sustainability improvements can be achieved over time. This is another topic that may warrant further study.

With the mechanisms adopted over the contract management stage in the PPP project cycle, PPP could be said to have an advantage over other forms of procurement in delivering environmental and social benefits. The whole life approach of PPP inherently encourages innovation and a more sustainable attitude to the design, construction and operation of infrastructure. The PPP contract translates this into *long-term* commitments and incentives for delivering environmental and social benefits (as well as others) over the life of the project.

## 5. Challenges

Several challenges come with increasing the focus on environmental and social benefits in PPPs. These include:

- **complexity** in the preparation and procurement stages such as identifying and defining the benefits, engaging with a potentially wider set of stakeholders, developing an objective methodology for evaluating bidders' proposals. This demands more time and resource from the contracting authority. To some extent standardised approaches can help to address this challenge (e.g. the environmental cost index tool adopted in the Netherlands and SFT's social value matrix referred to above);
- **engagement with the market and its capacity to deliver** to ensure that bidders are familiar with and prepared to address these issues in the PPP procurement and contract;
- **lack of flexibility** to respond to changing priorities/requirements/targets over the life of the PPP. Bidders have fixed (and priced) the risks associated with certain environmental and social outcomes in the PPP contract from the outset. However, such outcomes may prove to be under-ambitious or irrelevant as time goes on as a result of policy changes. SFT has tried to address this to some extent by allowing flexibility during the contract for the contracting authority to swap benefits of the same value from the social value 'menu'; in France there is recognition that the contractor's ability to deliver employment-related benefits might vary over time and so there is flexibility for the bidder to compensate for under-delivery in one year in future years. This means that good levels of collaboration and cooperation in the PPP relationship (in other words the partnership element) are needed to optimise the delivery of

ambitious and relevant benefits over the long-term and this in turn depends on good contract management, which is not guaranteed.

## 6. Areas to explore further

There are various strands to this topic that EPEC has uncovered in its research and which are summarised in this paper. Potential areas for further in-depth investigation include:

- linking the characteristics of PPPs (whole-life cost, risk transfer etc) to environmental and social aspects in the VfM assessment (i.e. taking these into account in the decision to use, or not, PPP as a delivery option), particularly bearing in mind the opportunity to dialogue on these with bidders during the procurement and the ability to capture these in long-term contractual mechanisms in the PPP contract;
- different approaches to addressing energy consumption risk in PPP contracts; experiences and lessons-learned on what works well and what does not;
- flexibility in PPP contracts on issues that affect environmental and social sustainability (experiences, lessons-learned etc), notably through life-cycle replacement;
- more fundamentally, identifying any particular PPP models that might in themselves allow for greater collaboration, flexibility and/or indeed greater benefits. For example:
  - o long-term strategic partnering approaches that provide a local community focus and continuous improvement framework for delivering projects (e.g. the Scottish hub model, the Welsh MIM model);
  - o encouraging/requiring/evaluating investment that might be considered more aligned with a public/social/environmental mission or of investors themselves (e.g. investors with ESG at the core of their business or even charities). This might also include mechanisms under which a certain percentage of the profits from the project are diverted away from equity returns towards charitable or other social initiatives;
  - o adapting forms of social outcomes contracting (public/private contracts for social services in which remuneration is based on achieving defined social outcomes), which have a strong focus on benefit sharing and partnership. These might provide some interesting mechanisms that could be applied to create a more collaborative, less transactional, approach in PPPs.

**December 2020**