

# Preparing for PPP contract expiry

An overview of practical experiences and  
lessons learned so far

March 2021

A Working Document of the EPEC membership



## **About this Report**

The European PPP Expertise Centre (EPEC) is part of the Advisory Services of the European Investment Bank (EIB). It is an initiative that also involves the European Commission, Member States of the EU, Candidate States and certain other states. For more information about EPEC and its membership, please visit [www.eib.org/epec](http://www.eib.org/epec).

This report 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 that it contains cannot be relied upon.

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## Glossary of Acronyms and Key Terms

Contracting Authority	A public authority that enters into a PPP contract with a Private Partner
DRP	The dispute resolution procedure under the PPP contract
FTIA	The Finnish Transport Infrastructure Agency, Finland
Handback	The process by which the PPP assets are handed back to the Contracting Authority (or arrangements for the disposal or alternative future use of the PPP assets) on expiry of the PPP contract
IPA	The Infrastructure and Projects Authority, UK
NAO report	The report entitled ' <i>Managing PFI assets and services as contracts end</i> ', published by the UK National Audit Office on 5 June 2020 <sup>1</sup>
PPP	Public-private partnership
PPP contract	A contract for the design, construction, operation/maintenance and financing of an asset under a PPP arrangement
PPP Unit	A government department or agency, at national or regional level (typically organised within a central ministry or regional government), that performs a central function in, for example, overseeing policy development in public infrastructure investment, providing contract guidance at a programme level or strategic support or approvals at a project level, whose policy and oversight function covers PPPs
Private Partner	A private entity that enters into a PPP contract with a Contracting Authority
SFT	The Scottish Futures Trust, UK

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<sup>1</sup> See [Managing PFI assets and services as contracts end](#)

SFT Guidance

The guidance entitled '*PPP Projects Nearing The End of Contract: A Programme Approach*' published by SFT on 15 April 2020<sup>2</sup>

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<sup>2</sup> See [PPP Projects Nearing the End of Contract: A Programme Approach](#)

## 1. Introduction

The expiry of a PPP contract presents various strategic decisions and contractual issues for the Contracting Authority to address. For example:

- Are the PPP assets needed to support the underlying public services after contract expiry?
- What condition will the PPP assets be in, are any modifications necessary or desirable and how will these assets be serviced/operated beyond contract expiry?
- What alternative uses do the PPP assets have and/or what residual value could be realised?
- What does the PPP contract say about the parties' rights over the PPP assets, the condition of the PPP assets on contract expiry and the process of transferring or otherwise dealing with the PPP assets on contract expiry?
- What are the short to medium-term financial implications of contract expiry for the Contracting Authority?

On most projects, the expectation is that the PPP assets will be handed back to the full control and responsibility of the Contracting Authority, and so the expiry of the PPP contract is commonly referred to as 'handback'. The Contracting Authority's objectives for Handback will typically be:

- ensuring the PPP assets are in a condition that fulfils the PPP contract requirements and minimises the need for significant expenditure on maintenance or renewal thereafter;
- maintaining continuity in the delivery of the underlying public services in the period up to and (if needed) after contract expiry; and
- anticipating and budgeting for the costs associated with Handback and limiting any unexpected costs or liabilities.

The misalignment of these objectives with the Private Partner's main objective – to maximise investor return through saving as much as possible on major maintenance, renewal or replacement costs – means that an effective Handback process requires active planning and management by the Contracting Authority.

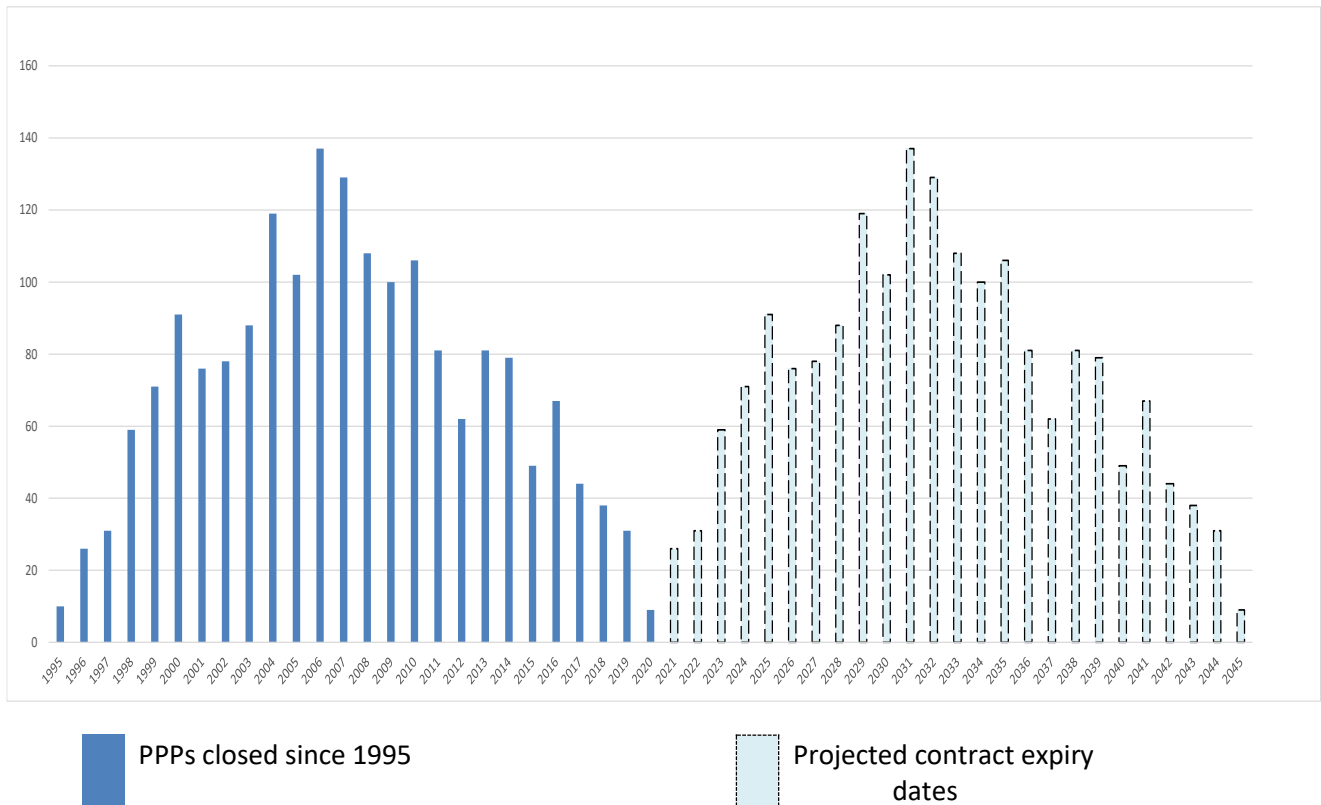
Only a small number of European PPPs have so far reached their natural contract expiry date<sup>3</sup>, which means that experience of managing Handback, and the strategic, contractual and practical issues that arise, is quite limited. However, PPP Handback activities across Europe are set to rise over the next ten years.

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<sup>3</sup> Some PPP contracts signed in the early-mid 1990s and some PPP contracts with a relatively short duration.

Figure 1 below shows (in dark blue) the number of PPP contracts signed in Europe each year since 1995 and (in light blue) a theoretical projection of when these will expire<sup>4</sup>. This suggests that the significant increase in PPPs created between 1995 and 2006 will be mirrored by a wave of PPPs expiring between 2021 and 2031.

**Figure 1 – Timeline and projected expiry of European PPP contracts**



In view of this, EPEC aims to raise awareness of the issues surrounding Handback and encourage a proactive approach to its preparation and implementation. Furthermore, this paper may also be useful for Contracting Authorities who may be developing PPP contracts for the first time to help ensure that the Handback provisions in those contracts reflect current good practice.

Several EPEC Members have practical experience of Handback and valuable knowledge and insight to share more widely:

- In the UK, the IPA and the SFT are supporting authorities across PPP programmes in England and Scotland respectively. The IPA has put in place a comprehensive programme aimed at assessing Contracting Authorities' readiness and raising their awareness of the issues<sup>5</sup>. The SFT has recently

<sup>4</sup> This projection is based on the premise that PPP contract duration is typically between 20 and 30 years.

<sup>5</sup> The UK's National Audit Office also recently published a report **Managing PFI assets and services as contracts end**, based on feedback from 75 Contracting Authorities in England with PPPs that have expired or are due to expire in the next seven years.



published guidance for Contracting Authorities in Scotland with PPPs nearing contract expiry in the health, education, offices and prison sectors<sup>6</sup>.

- In Finland, the Finnish Transport Infrastructure Agency managed the Handback of its Highway 4 PPP in 2012; and
- In Ireland, the East-Link Toll Bridge PPP expired and was handed back to the full control of Dublin City Council at the end of 2015<sup>7</sup>.

Drawing on these experiences, this paper:

- explores the key considerations (decisions to be made and issues to be addressed) for Contracting Authorities as their PPP contracts approach expiry (**Section 2**);
- describes lessons learned and recommended approaches to Handback (**Section 3**);
- considers the role of PPP Units in building public sector capacity for effective management of Handback (**Section 4**); and
- for those in the stages of preparing/procuring a PPP, summarises the PPP contract provisions that help create a framework for facilitating effective Handback (**Annex**).

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<sup>6</sup> See **PPP Projects Nearing the End of Contract: A Programme Approach** published by SFT on 15 April 2020

<sup>7</sup> The Finish and Irish projects featured in **Case Studies of Handback Experience with PPP** released by the US Department of Transportation in December 2017.

## 2. Key considerations for the Contracting Authority

The Contracting Authority's intentions for the PPP assets, services and underlying public services after contract expiry depend on various decisions being made and issues being addressed in the run-up to contract expiry. Timely consideration and management of these, as outlined below, will help to secure an effective Handback from the Contracting Authority's perspective.

### 2.1. Future use of the PPP assets

The starting point for Handback preparation is the future use of the PPP assets: will they continue to be used as they currently are, do they have some alternative use or have they reached the end of their useful life? This will depend largely on the underlying public service needs, the condition and suitability of the PPP assets and the availability of alternative assets.

#### *Continuing use*

If the Contracting Authority wants the PPP assets to continue to be used to deliver the underlying public service (e.g. education, housing, health), one of its main concerns will be the condition that the PPP assets will be in by the contract expiry date. While the private partner will be expected to comply with any contractual requirements in this regard, it is also relevant for the Contracting Authority to consider any modifications to the PPP assets that might be necessary or desirable to accommodate, for example:

- technological developments (e.g. digitalisation) that have or will have an impact on users' requirements;
- evolving norms and regulations relating to climate change and energy use (e.g. energy efficiency requirements for public buildings, increased use of renewables, zero carbon emissions, the uptake of electric vehicles); and
- any fundamental shifts in social, professional or business interactions (e.g. following the COVID-19 pandemic) that will affect future use of the PPP assets.

Being mindful of the need for any such changes to the PPP assets in preparing for Handback could lead to cost efficiencies for the Contracting Authority. In agreement with the Private Partner, adjustments to final lifecycle maintenance plans and/or PPP contract requirements on the condition of the PPP assets on contract expiry might allow for timely execution of modifications and/or avoid unnecessary expenditure on the PPP assets.

#### *Alternative use*

The Contracting Authority might envisage an alternative use of the PPP assets for its own needs (e.g. turning a school into a cultural facility) or outside of the public sector altogether (e.g. the disposal of social housing or government office accommodation for private sector use).

This will require options analysis, weighing up factors such as:

- the expected condition of the PPP assets on contract expiry and any modifications required (e.g. to improve their suitability for the Contracting Authority's own needs, to enhance income from a disposal, or to save expenditure on planned lifecycle maintenance that will be unnecessary given the expected change in use);
- market conditions and the potential income from a disposal of the PPP assets; and
- the costs of finding and relocating to suitable alternative premises if there is still a need for the underlying service currently provided by the PPP assets.

#### *End of use*

If the PPP assets are at the end of their useful life, there could be environmental and regulatory implications and potential liabilities for the Contracting Authority to consider (e.g. decommissioning costs) as well as the search for and relocation to alternative assets if needed for the continuing provision of the underlying service<sup>8</sup>. It may also be appropriate to consider changes to the current lifecycle maintenance plans and/or Handback requirements to avoid unnecessary expenditure (and generate cost savings) in the final years of the PPP contract.

## **2.2. Choice of service/operating model for the PPP assets**

If the Contracting Authority is going to continue to use the PPP assets, the next key consideration is how it will service and operate them once the PPP contract expires.

#### *Extend the PPP contract*

Although rare, some PPP contracts expressly allow the Contracting Authority to extend the contract term. This tends to be a feature in user-pay concessions rather than government-pay PPPs. Detailed analysis of the PPP contract extension provisions, as well as value for money, affordability and procurement law compliance are amongst the issues for the Contracting Authority in considering PPP contract extension.

#### *Add to an existing service arrangement or create a new service arrangement*

If the Contracting Authority has an existing service arrangement in place of a similar nature to the services rendered by the PPP – either with an in-house team or with a separate third party provider – it might consider extending the scope of that arrangement to include the PPP assets following expiry of the PPP contract.

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<sup>8</sup> Similarly, in a scenario where the PPP assets are to remain with the Private Partner on contract expiry (in which case the PPP assets have effectively reached their end of life from the Contracting Authority's perspective), the anticipated expiry of the PPP contract should prompt the Contracting Authority to look at its options for continuing provision of the underlying service (if required).

### Box 1 – Service delivery options

The routine/daily maintenance of roads and motorways in Finland is organised by geographical region, with a service contract procured by FTIA for each region. When the Highway 4 (VT4 Järvenpää-Lahti) PPP expired in 2012, the contractor responsible for roads maintenance in that region took on responsibility for Highway 4 under an extension to its existing service contract. The need for major/heavy maintenance of the road network is continually monitored by FTIA and contracted for separately as and when required.

In the absence of a suitable existing service provider (in-house or external), the Contracting Authority's options might include creating an in-house service provision or tendering a new service contract<sup>9</sup>.

In each of these scenarios, timely decision-making and action is needed to ensure that the necessary resources and arrangements are in place by the time the PPP contract expires. Otherwise the Contracting Authority exposes itself to the risk of service disruption and having no choice but to extend the existing PPP contract (which, given the absence of competition, may not deliver good value for money and might expose the Contracting Authority to procurement law challenge).

Co-operation with the Private Partner will be key to ensuring a smooth transition to the new service delivery arrangement. The PPP contract will ideally oblige the Private Partner to provide site access and sufficient information on the PPP assets to the Contracting Authority and the new service provider to allow it to plan and mobilise resources to take over the services. Where a competitive tendering process is needed, extending that level of co-operation to prospective tenderers will be important for maintaining a level playing field as they prepare their tenders. Any unfair advantage (whether actual or perceived) to the incumbent (i.e. the Private Partner's service provider) is likely to undermine prospective tenderers' interest or could lead to legal challenge against the tender process.

#### *Employee rights*

EU rules protect employees' rights in a situation where the economic activity in which they are employed transfers to another entity<sup>10</sup>. This can sometimes apply on the transfer of a service provision arrangement on the expiry of a PPP contract. Precise application of the rules differs across Member States but, generally, employees under the existing service arrangement will transfer automatically to the employment of the new service provider, and their existing terms and conditions of employment are largely protected.

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<sup>9</sup> Tendering a new PPP contract (as opposed to a service contract) is unlikely to be appropriate unless there is a need for substantial future capital investment in the PPP assets.

<sup>10</sup> Council Directive 2001/23/EC

The legal and financial implications of any such transfer (or potential transfer) to an in-house service team or new third party service provider will need to be assessed by the Contracting Authority. Employment-related issues are always particularly sensitive, and so open and clear communication to the employees concerned will be essential to ensure service continuity.

### **2.3. Knowing the PPP assets**

A clear understanding of the PPP assets is foundational to the Contracting Authority's preparation and management of Handback. This includes the scope and physical condition of the PPP assets (e.g. technical characteristics, residual life), their suitability for future use (see Section 2.1 above) and the parties' rights in relation to them.

#### *Ancillary assets*

In addition to the main asset (e.g. school building, hospital, road), the Contracting Authority needs to understand all ancillary assets that play a part in the PPP project delivery. It will need to ascertain which of these need to be handed back along with the main asset and whether they are in a state of use or condition that will allow the asset and service to operate through contract expiry without disruption. Ancillary assets might include, for example:

- machinery, equipment and furniture;
- intellectual property rights (such as drawings, inventions, plans);
- authorisations, consents and licenses; rights under warranties or other similar contractual rights vis-à-vis sub-contractors or suppliers; and
- knowledge manuals and other material documents relating to the PPP assets and/or services.

#### *Legal rights*

The Contracting Authority will need to ensure it has all legal rights necessary to use or operate the PPP assets without restriction (and/or allow any incoming service provider to do so). This means identifying and dealing with, for example, third party interests or encumbrances (e.g. lender securities) over the PPP assets or leases that need renounced formally.

### **2.4. Knowing the PPP contract**

In order to devise a clear strategy and manage an effective process for Handback, the Contracting Authority needs to understand what the PPP contract says and how to use it, for example:

- the physical condition that the PPP assets must be in on contract expiry (e.g. appearance, functionality, residual life requirements<sup>11</sup>);
- procedures to be followed in order to determine that those conditions are met (e.g. surveys and inspections);
- mechanisms available to incentivise the Private Partner to comply with its obligations relating to the condition of the PPP assets on contract expiry and/or compensate the Contracting Authority for the Private Partner's failures (e.g. retentions from service payments, performance bonds); and
- provisions regarding the physical/legal transfer of the PPP assets (e.g. co-operation obligations, timing of transfers, signing of documentation, payments).

Most PPP contracts prescribe certain standards or conditions that the PPP assets must satisfy on contract expiry. However, these provisions are often only broadly drafted (e.g. they may fail to mention all of the ancillary assets relevant to Handback). Or, they may lack important detail on timing and processes (e.g. the nature and scope of surveys to be undertaken prior to Handback), or omit any meaningful financial incentives/remedies<sup>1213</sup>. This is the case in some early PPP contracts that were entered into at a time when the use of PPP was still evolving and model contracts were not yet developed.

Lack of detail has the potential to lead to disagreements or disputes. In one school PPP project, for example, the PPP contract was silent about what would happen to the classroom chairs and tables on contract expiry. Although these were clearly essential to the continued operation of the school after contract expiry, the question of whether the Private Partner would leave these once it vacated the school became a contentious issue between the parties.

Faced with a lack of detail in the PPP contract, the Contracting Authority may need to consider (and propose to the Private Partner) appropriate conditions and processes for Handback (e.g. criteria that the PPP assets must fulfil, procedures for ascertaining their condition). It will need to be particularly pro-active, as well as vigilant, in the final years of the PPP contract in using other mechanisms to incentivise proper performance (e.g. the payment mechanism, rights to inspect the PPP assets, approval of lifecycle maintenance programmes).

The variation mechanism in the PPP contract may also be relevant to the Contracting Authority if it is considering any changes to the PPP assets and services in the run-up

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<sup>11</sup> Residual life is the minimum period of time that should lapse before an asset (or component of an asset) needs to be replaced.

<sup>12</sup> In the **NAO report**, two-thirds of respondents identified some gap in their handback provisions, ranging from a lack of detail on the disputes process to failure to deal with intellectual property rights. Some had no provisions on how, and in what condition, the PPP assets should be on contract expiry.

<sup>13</sup> See the Annex for a summary of PPP contract provisions that help to facilitate effective Handback as referred to in this paper.

to contract expiry or to the Handback conditions for the PPP assets (see Section 2.1 above).

In order to understand the full extent of its rights and obligations regarding Handback, the Contracting Authority will need expert advice from legal, technical and/or financial advice. Input from these experts is also likely to be needed when engaging with the Private Partner to agree the specific criteria/parameters and appropriate variations to the Handback requirements.

## 2.5. Budget

The Contracting Authority will need to assess, and appropriately budget for, the financial implications of Handback. These might include costs incurred, for example, in:

- monitoring, inspections and surveys of the PPP assets;
- staff recruitment and/or training for managing Handback;
- staff recruitment and/or training for future service provision;
- engaging external advisers;
- preparing and tendering a new service contract (as applicable);
- reconfiguration/adaptation of the PPP assets;
- short to medium-term remediation, maintenance or renewal of the PPP assets;
- decommissioning (if the PPP assets have reached their end of life); and
- any payments to the Private Partner in exchange for transfer of the PPP assets<sup>14</sup>.

The Contracting Authority is likely to need expert advice in making a robust assessment of each of these categories of costs and enable it to make sufficient provision in future budgets.

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<sup>14</sup> This is a feature of some (mostly early) PPP deals. The amount of the payment might be specified in the PPP contract or might, for example, be based on an independent valuation carried out near to the expiry date.

## 3. How to approach to Handback

### 3.1. When to start preparing for Handback

PPP contract expiry gives rise to a number of decisions and complex issues (see Section 2), however experience so far suggests that Contracting Authorities are likely to underestimate the time required to plan and manage these effectively.

The time needed to prepare for Handback varies across sectors and projects, depending on, for example, the type and size of PPP assets, the number of PPP assets (e.g. a single school PPP versus a bundled school PPP), the quality of project information and records available and the likelihood that contract expiry will trigger staff transfers. The smoothest and most straightforward Handback is likely to arise on PPPs that feature the following:

- a single asset with few individual components (e.g. road);
- no staff transfers;
- clear and detailed PPP contract provisions on the condition of PPP assets on contract expiry and Handback;
- an experienced and well-resourced team within the Contracting Authority<sup>15</sup>;
- up-to-date and detailed information on the PPP assets (including maintenance and lifecycle records), available to the Contracting Authority; and
- robust contracting, monitoring and management by the Contracting Authority throughout the PPP and a good working relationship between the parties (reducing the risk of non-compliance or other unwanted surprises).

In the roads sector, a period of three years proved sufficient for a satisfactory Handback process on one project<sup>16</sup>, although in other road projects it has been recommended to start earlier<sup>17</sup>. For PPPs in the education, health, office or prison sectors, SFT recommends that Contracting Authorities start planning for Handback no later than five years before contract expiry, and eight to ten years before expiry for projects with complex assets, such as acute hospitals<sup>18</sup>. The IPA's general recommendation is that Handback preparation should begin seven years before contract expiry<sup>19</sup>.

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<sup>15</sup> For example, procuring authority of roads and motorways at a national or regional level (such as Rijkswaterstaat in the Netherlands, Highways England in the UK or FTIA in Finland).

<sup>16</sup> The Highway 4 project in Finland. See [https://julkaisut.vayla.fi/pdf3/lr\\_2013\\_ppp\\_review\\_web.pdf](https://julkaisut.vayla.fi/pdf3/lr_2013_ppp_review_web.pdf) for further information.

<sup>17</sup> The [NAO report](#) cites the example of Highways England, which has multiple road PPP contracts due to expire, and is starting to prepare for Handback seven to eight years in advance of contract expiry.

<sup>18</sup> See [PPP Projects Nearing the End of Contract: A Programme Approach](#).

<sup>19</sup> Based on draft IPA guidance referred to in the [NAO report](#).



### 3.2. Knowing the PPP assets

Contracting Authorities often struggle to obtain accurate and comprehensive information about the PPP assets, making it difficult to ensure that they will meet its needs and expectations on contract expiry<sup>20</sup>. There are, however, several ways in which the Contracting Authority can mitigate this risk.

#### *Regular monitoring in accordance with the PPP contract*

Regular monitoring of the PPP assets and the Private Partner's performance throughout the PPP contract can help to limit any surprises as Handback approaches and formal Handback surveys and inspections take place. In particular, this involves monitoring:

- the condition and performance of the PPP assets, including when and how the PPP assets or individual components are taken out of service for repair and any breakdown trends and their frequency;
- the Private Partner's compliance with planned maintenance and lifecycle programmes, including review of lifecycle fund balances and allocation of expenditure to reactive and planned maintenance, deviations between actual and planned expenditure and identifying any signs of consistent under-spending; and
- the Private Partner's records and reports on the PPP assets, including the quality and content of maintenance and lifecycle records.

#### **Box 2 – Transparency and ongoing contract management**

On the Highway 4 PPP, FTIA ensured it had good visibility on the condition of key structures (including bridges, tunnels and pavements) throughout the contract term. In addition to regular contract monitoring (including FTIA spot checks), full inspections took place every two years and major inspections every five years. The PPP contract also required the Private Partner to carry out annual checks on the condition of bridges, and submit inspection reports and repair plans to the FTIA.

The Private Partner kept registers of bridge, traffic and pavement data, which recorded the outcome of all inspections, as well as other information relating to the condition of the road. The FTIA had access to these registers at all times and used them in its contract monitoring.

With robust ongoing contract management in place, FTIA went into its Handback preparations with a good knowledge of the PPP assets. In addition, the information available to the FTIA allowed it to programme and budget for work on the PPP assets for the period after expiry of the PPP contract.

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<sup>20</sup> The [NAO report](#) discloses that around 55% of the respondents recognised the need for more knowledge on asset condition, with four out of nine dissatisfied with the condition of the assets handed back to them on contract expiry. Around 35% of respondents stated they had insufficient access rights to monitor the maintenance programme adequately.

Given that contract monitoring is often hampered by insufficient access to information, it is recommended that the Contracting Authority pay particular attention to engaging with the Private Partner, closely monitoring the condition of the PPP assets and enforcing the rights that it does have under the PPP contract (e.g. payment mechanism deductions) in the final five to seven years of the PPP contract. A visible increase in the Contracting Authority's engagement may in turn motivate the Private Partner to ensure compliance with its obligations.

### *Asset register*

A register that records the number, size, type and value of all assets used and managed by the Private Partner under the PPP should be established at the start of the contract and is an important component of the contract management process<sup>21</sup>. The asset register is particularly useful when preparing for Handback. An asset register helps the Contracting Authority:

- identify which of the PPP assets are required for ongoing service provision (and which ones are redundant);
- gather relevant information for a valuation if an amount is payable to the Private Partner for the PPP assets on expiry;
- identify the risk factors relevant to the PPP assets (for example, the volume or type of asset class will dictate the time, planning or specialist resources required for inspecting their condition); and
- keep track of the ancillary assets in the Handback process (see Section 2.3).

In preparing for Handback, the parties should engage with each other on the content of the asset register and establish a common understanding of the PPP assets. An early asset register review will reveal any practical issues concerning the PPP assets (e.g. any information in a format that is obsolete or incompatible with the Contracting Authority's systems). Identifying these practicalities early on allows the Contracting Authority and Private Partner to find appropriate solutions (e.g. information re-formatting or system integration) in time for a smooth Handback.

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<sup>21</sup> See EPEC guidance: [Managing PPPs during their contract life](#)

### **Box 3 – Asset register**

On the Highway 4 PPP in Finland, the Private Partner kept an up-to-date asset register over the contract period, to which the FTIA had full access. During the first Handback inspection, FTIA reviewed these registers to ascertain that they included all items to be delivered on expiry. The level of detail varied across the different asset types, and some of these registers were very simple, but they were an important tool for the FTIA in managing the effective transfer of the PPP assets.

In practice, asset registers are not as common as might be expected. In the NAO report mentioned earlier, for example, 50% of the respondents said no asset register was available.

#### *Initial condition survey*

Many PPP contracts provide for Handback inspections (often a joint appointment of an independent surveyor) to determine the condition of the PPP assets towards the end of the contract. Typically, these inspections are stipulated to take place one to three years before expiry. However, waiting until then to undertake a comprehensive condition survey may be too late, especially if it transpires that major remedial works are needed to bring the PPP assets to the required condition or there is disagreement on the scope or costs of the works.

In order to obtain an accurate and complete picture of the condition of the PPP assets in sufficient time to allow it to plan and manage Handback effectively, SFT recommends that Contracting Authorities undertake an initial condition survey (at their own expense) at least five years before expiry (or earlier still in the case of complex project such as acute hospitals)<sup>22</sup>. The timing of this initial condition survey is particularly strategic for the following reasons:

- **Project cash flows:** the project is still likely to have substantial cash flow (in the Private Partner's lifecycle account and future service payments until PPP contract expiry) to fund any works necessary to bring the PPP assets to the required standard. The cash flows left in the project reduces as the expiry date approaches, increasing the risk that the amounts will be insufficient for the works required;
- **Lender engagement:** senior debt may not yet be fully repaid by that time. Whilst lenders still have an interest in the project, the Private Partner has a greater incentive to collaborate with the Contracting Authority and remedy any issues identified in the initial condition survey in order to avoid triggering any default under the financing agreements;

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<sup>22</sup> The recommendation applies to PPP projects across the health and accommodation (schools, offices and prisons) sectors in Scotland. For further information see **PPP Projects nearing the End of Contract: A Programme Approach**.

- **Lifecycle review and ongoing contract management:** having a clear picture of the condition of the PPP assets at this stage still allows timely adjustments to the final maintenance and lifecycle programme. These adjustments can take account of any maintenance or replacement works identified in the initial condition survey, and any adjustments to reflect the changes in needs/use of the PPP assets after contract expiry. The initial condition survey also gives the Contracting Authority a sound basis for its contract monitoring in the final years; and
- **Budget planning:** the outcome of the initial condition survey gives an early indication of when the PPP assets are likely to require major maintenance or renewal after PPP contract expiry, in time for making any provisions in future budgetary plans.

### **3.3. Establishing a Handback team**

Managing PPP contract expiry is a project in itself, for which the Contracting Authority will need a dedicated team. In addition to in-house resources, the Contracting Authority is likely to need support from external advisers (legal, financial, technical, etc.). It might also be appropriate to consider hiring additional staff to build in-house knowledge on Handback (e.g. if the Contracting Authority has more than one PPP contract due to expire) and/or ensure sufficient resourcing of the day-to-day PPP contract management team.

As with any project, Handback needs clear management and governance. SFT recommends setting up a Handback project team under the supervision of a 'project board' (or similar structure), with clear allocation of individual responsibilities. The Contracting Authority's PPP contract manager is expected to be a key member of the Handback project team, together with someone with project management experience, to co-ordinate the different aspects of Handback. This would include managing input from external advisers, such as:

- **Legal:** detailed PPP contract review on provisions relevant to Handback; advice on legal rights and restrictions over the PPP assets; employment law advice (in the case of staff transfer); procurement advice on PPP contract extension or new service contract tendering; assistance in negotiating and resolving disputes with the Private Partner;
- **Technical:** advice on the actual and required condition of the PPP assets; assistance in scoping, procuring and interpreting initial condition surveys and other Handback inspections; assistance in analysing and understanding the asset register; assistance in negotiating and resolving disputes with the Private Partner; and
- **Financial:** advice on the valuation of PPP assets and any payments due by the Contracting Authority to the Private Partner; tax and accounting advice; advice on financial incentives/remedies available to support the Contracting

Authority's objectives with Handback; support in commercial negotiations with the Private Partner.

SFT's guidance recommends that the project board's main responsibilities are to oversee the Handback project team's delivery of Handback, monitor risk management and mitigation, review the project team's action plan and keep track of budgetary issues.

#### **Box 4 – Project team and governance**

For the Handback of the Highway 4 PPP in Finland, the FTIA established a steering committee comprised of three FTIA staff: a project leader, an internal lawyer and a technical expert. The project leader was dedicated to managing the Handback, participating in all meetings and most inspections.

The FTIA had six external consultants that it called on for support as and when required. These external consultants reported to the steering committee regularly and after each Handback inspection. The lead consultant had previously worked at FTIA and had participated in the Highway 4 project since its procurement through to the operational phase. The active involvement of an individual with such in-depth knowledge of the project helped to achieve a smooth Handback.

### **3.4. Handback programme and risk register**

A detailed Handback programme and risk register are essential tools for effective management of Handback.

#### *Handback programme*

At the outset of Handback preparations, the parties should develop and agree a programme documenting the decisions and actions that need to be taken, with clear allocation of responsibilities and deadlines. This is particularly useful if the PPP contract is unclear about the roles and obligations of different parties at expiry.<sup>23</sup>

In developing and agreeing the Handback programme, the aim is to arrive at a mutual understanding of the requirements and process for Handback, and to do so sufficiently far ahead of contract expiry. Doing this early on helps to bring out any fundamental differences between the parties' expectations, giving them time to resolve these in time before contract expiry. It also reduces the likelihood of escalation to dispute. The Handback programme should be updated regularly and used as a dynamic tool to help manage the process throughout the Handback period.

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<sup>23</sup> In the **NAO report**, only one-third of respondents felt that the NAO contracts are clear about roles and obligations of the different parties leading up to expiry of the PPP contract.

### **Box 5 – Handback programme**

After the first Handback inspection on the Highway 4 PPP in Finland, undertaken three years before contract expiry in accordance with the PPP contract, the parties prepared and agreed a Handback programme that identified specific criteria and inspection timelines. This Handback programme was much more detailed than the PPP contract, and incorporated relevant FTIA guidelines and benchmarks on conditions and requirements for motorways of a similar age.

If well documented, the Handback programme can be a valuable reference point for Handback processes for other future PPPs (for the same or other Contracting Authorities).

#### *Risk register*

The risk register for Handback should record all legal, financial and reputational risks associated with Handback and the actions taken to manage/mitigate them. Examples of Handback risks include:

- **Dispute:** this risk is particularly acute where the PPP contract lacks detail on the Handback conditions and procedures;
- **Service disruption:** risk to continuity in the underlying public services (e.g. poor condition/suitability of the PPP assets on contract expiry, the need for modifications to the PPP assets, failure to secure new service arrangements or alternative premises);
- **Legal and regulatory compliance:** this can include additional operational and compliance risks for the Contracting Authority if it takes over servicing of the PPP assets (e.g. health and safety, employment obligations) or compliance with procurement rules if the Contracting Authority is extending the PPP contract or tendering a new service contract; and
- **Increased/unforeseen impact on Contracting Authority's budget:** any additional costs and liabilities for the Contracting Authority that may arise from failure to manage Handback effectively.

The risk register needs to be monitored and updated throughout the preparation and implementation of Handback, to reflect ongoing management and mitigation measures and the monitoring of progress and outcomes.

### **3.5. Engaging the Private Partner**

Early engagement with the Private Partner is necessary in order to:

- establish a common understanding and interpretation of the requirements and processes for Handback;
- agree any variations (e.g. modifications to the PPP assets, planned lifecycle programme and/or Handback conditions) to align with the Contracting Authority's longer-term needs and requirements;
- investigate the condition of the PPP assets in the lead-up to contract expiry (e.g. going through and reaching a common ground on the asset register if necessary); and
- agree a Handback programme with realistic timelines and sufficient contingency to avoid leaving matters unresolved until the last minute.

Early engagement and a pro-active approach to Handback enhances the Contracting Authority's credibility and negotiating position with the Private Partner. The earlier all issues concerning Handback (e.g. the condition of the PPP assets) are exposed and debated, the more time the Private Partner has to remedy them, and the more the Contracting Authority is able to use all available contractual mechanisms (e.g. final lifecycle programmes, payment mechanism deductions) to ensure these issues are addressed to its satisfaction before contract expiry.

#### **Box 6 – Private Partner co-operation**

A smooth Handback process is more likely if the parties enjoy a good working relationship throughout the PPP contract.

On the Highway 4 PPP in Finland, the regular reporting and sharing of information (e.g. the asset register) helped to create a transparent and open culture regarding the condition of the road. Throughout the Handback process, FTIA was able to meet with the Private Partner and the O&M contractor as often as necessary and to perform its own inspections. The Handback inspections identified the need for remedial works to the PPP assets, which the Private Partner completed before contract expiry to FTIA's satisfaction.

The Handback of Dublin City Council's East-Link Toll Bridge PPP in Ireland was smooth despite the absence of Handback provisions in the PPP contract. The parties attribute this partly to the close working relationship between the Council and the Private Partner. Three Council personnel sat on the board of the Private Partner – an arrangement stipulated under the PPP contract – which allowed for regular interaction between the parties as well as transparency over the Private Partner's management of the PPP assets throughout the contract period. With a clear view of the Private Partner's maintenance and lifecycle regime and spend, the Council was kept aware of any issues regarding the condition of the bridge and was able to ensure all material issues were resolved in advance of Handback.

## 4. A role for PPP Units on Handback

As at all other points in the PPP project cycle, Contracting Authorities are likely to need and benefit from the support of their relevant PPP Unit in dealing with Handback.

Some Contracting Authorities may have a number of PPPs in their portfolio, and can therefore build capacity and experience on Handback over time. But for many it will be a one-off experience.

In the private sector, on the other hand, ownership of operational PPPs in any given sector is often concentrated amongst a few active participants in that sector<sup>24</sup>. A Private Partner whose shareholders have interests in multiple PPP contracts, and therefore benefit from a portfolio view, is likely to have significant advantage over a Contracting Authority (particularly an inexperienced one) when implementing Handback.

A PPP Unit is likely to be uniquely placed to help address this imbalance, acting as a centre of expertise on Handback, sharing best practice, guidance and lessons-learned across PPPs within its jurisdiction. Depending on the structure and resources of the PPP Unit, it may also have the opportunity to provide support such as:

- strategic advice and/or oversight on individual projects;
- targeted or hands-on advisory support to Contracting Authorities with particularly challenging Handback issues or on particularly large or strategic PPP projects; and
- advice on external advisory appointments (e.g. appointing advisers on a programme/framework arrangement, or even contributions to advisory costs).

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<sup>24</sup> In England for example, as highlighted in the [NAO report](#), the ten Contracting Authorities with the largest number of PPP contracts represent 18% of the total number of PPP projects. In contrast, the ten private investors with the largest PPP portfolios own more than 50% of the PPP contracts in the UK, and the top six PPP management companies are responsible for managing almost 45% of the contracts.



### Box 7 – Support from PPP Units

In the UK, PPP Units such as SFT and IPA have developed programmes aimed at offering practical support to Contracting Authorities with PPP projects nearing contract expiry.

For PPPs in Scotland, SFT is looking to build Contracting Authorities' capabilities on Handback by:

- facilitating the sharing of knowledge on individual Handback experiences across Contracting Authorities;
- issuing guidance on a common approach and issues on Handback, based on successful examples and lessons learned;
- developing and promoting the use of standardised documents that commonly feature in Handback preparation (e.g. template terms of references for consultants, scope of initial condition survey);
- funding certain elements of the handback preparation (e.g. cost of the initial condition survey); and
- strategic support at an individual project level (e.g. participation in the project board responsible for overseeing Handback).

The IPA is taking a programme approach to managing the expiry of PPP contracts in England, currently focussed on those due to expire in the next seven years. Using a standard 'contract expiry health check tool' that it has developed, the IPA is deploying an independent team of legal, commercial, financial and technical experts to review projects and assess their readiness for Handback. The standard reviews are structured around five aspects:

- PPP contract documentation and awareness of the Handback preparation and process;
- Private Partner relationship and co-operation;
- PPP asset condition and information;
- commercial position on contract expiry and PPP asset transfer; and
- strategy on future contract and service provision and the Contracting Authority's capability and staffing.

The expert team will make recommendations to the Contracting Authority on an appropriate Handback plan, based on the findings of its review.

## 5. Concluding remarks

PPP Handback is a dynamic process, involving many inter-related issues to consider and decisions to make for the Contracting Authority. Many risk factors exist that could undermine a smooth transition and service continuity, and increase potential liabilities for the Contracting Authority. Some of the common risk factors include:

- misalignment of interests giving rise to the likelihood of disputes;
- lack of trust and collaboration between the Contracting Authority and the Private Partner;
- lack of detail in the PPP contract on Handback requirements and processes or inadequate financial incentives or recourse to the Private Partner in the event of its failure to comply with these;
- the lack of visibility and transparency on the scope and condition of the PPP assets;
- insufficient contract monitoring by Contracting Authority throughout the PPP contract (giving rise to surprises once it engages on Handback); and
- limitations in resource and specialist skills to allow the Contracting Authority to effectively plan and manage Handback.

In light of these risks, an early start to Handback preparation and proactive engagement with the Private Partner is crucial for the Contracting Authority. PPP Units have an important role to play in strengthening Contracting Authorities' awareness and preparedness for Handback by offering them practical guidance and support.

## Annex: PPP contract provisions that support effective Handback

The list below is a summary of PPP contract provisions that help to mitigate Handback risks and facilitate an effective Handback process. Not all of these provisions relate exclusively to Handback and the list is non-exhaustive (i.e. the PPP contract as a whole, should be approached from the perspective of ensuring a smooth transition to expiry of the PPP contract):

- a right for the Contracting Authority to carry out inspections or surveys of the PPP assets as required throughout the term of the PPP contract (e.g. at regular intervals or on an ad-hoc basis when there is reason to believe the Private Partner has not been fulfilling its maintenance obligations);
- a right for the Contracting Authority to initiate an initial condition survey five to seven years before contract expiry (or earlier as appropriate)<sup>25</sup>;
- an obligation on the Private Partner throughout the PPP contract term to keep, and make available to the Contracting Authority, an accurate and up-to-date register of the PPP assets (including ancillary assets) and information on their condition;
- a right for the Contracting Authority to access information on planned preventative maintenance and lifecycle expenditures, and the use and balance of lifecycle funds (if any) from time to time;
- provisions that clearly define the condition that the PPP assets are expected to be in on contract expiry;
- a process that allows for timely identification of the condition of the PPP assets and any remediation work required to bring them to the required condition before contract expiry (e.g. joint appointment of an independent survey, development of a remediation timetable, final independent survey);
- provisions on the transfer of assets and legal rights (where required) to the Contracting Authority (or third party) for continuing service provision, including manuals, know-how, contractors'/suppliers' warranties, asset registers and other material documents; and
- robust incentives on the Private Partner to comply with its obligation to ensure the PPP assets are in the required condition on contract expiry and protection for the Contracting Authority against the risk of the Private Partner's non-compliance. This is typically achieved through either (a) an obligation on the Private Partner to provide a bank guarantee or bond or (b) provision for the Contracting Authority to make retentions from the service payments in the final

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<sup>25</sup> This could be combined with the right to survey mentioned above.

year(s) and to pay these into a separate account. The amount of the bond or retentions should be sufficient to cover the cost of remediation works required to bring the PPP assets up to the required condition. To the extent that the Private Partner fails to comply with its obligations, the Contracting Authority can call on the bond or use the service payment retentions. Otherwise, the bond is released or service payment retentions paid to the Private Partner.