Concept Symposium 2006
Principles of Governance for Major Investment Projects

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Finland: Governing Major Investment Projects by Result Oriented Budgeting, Reforming Administration and Utilizing Markets Efficiently

Case Finland:
Governing Major Investment Projects by Result Oriented Budgeting, Reforming Administration and Utilizing Markets Efficiently

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Concept Symposium
September 7th – 8th, 2006
Trondheim

Structure of the presentation:

- Introduction / Background
  - Situation / challenges
- Planning / Financing Public Investments
- Project cases
- Developing technology and planning
- Public building and premises
  - Questions of costs, expertise and incentives
  - Reforming administration
  - Experiences and observations

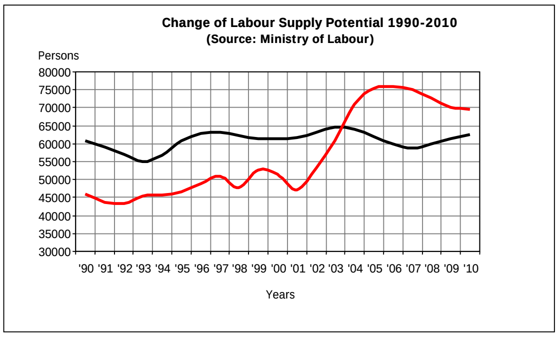
Introduction (1)

- Analysis by the Concept-program of the challenges in public investments in Norway applies to some extent also to Finland.
- *"Front End Governance of Major Public Projects", Samset, Berg, Klakegg 18.5.2006 Oslo*
- Everywhere relevant questions:
  1. **"How to ensure maximum utility and return on investment for society?"**
  2. **"How to lift the perspective beyond the delivery of the project itself (also) onto the broader issues of the project's utility and effects?"**

Introduction (2)

- Also major differences between the two countries can be perceived, deriving from defining features of national economy.
- Norway:
  - Oil Fund 135 bn.€
  - Supply/demand –ratio -> Probability of cost overruns?
- Finland:
  - State debt 60 bn.€ (35% vs GDP)
  - Ageing population
    -> Increasing pressures on public economy
    -> Emphasis on efficient use of capital and assets
  - Competition questions

Change of Labour Supply
(red: exit p.a., black: incoming p.a.)



Basic approach

1. "How to ensure maximum utility and return on investment for society?"

A combination of top->down and down->top:

- **Government: overall strategy / expenditure ceilings**
- **Line ministries: objectives for the agencies**
- **Agencies: professional expertise / competition**

Planning / Financing (1):

- Each agency plans and gives priorities to its investments in its ‘Operational and economic plan’
  - -> Investment projects reflect the objectives assigned to the agency.
  - -> Priorities: return on investment
- The relevant line ministry (LM) gives overall priorities to major investments in its administrative branch.
  - -> Return on investment
  - -> Political / democratic considerations

Planning / Financing (2):

- The strategic tool of the government is the government decision on expenditure ceilings (1+3yrs) for various administrative branches (Feb-March).
  - Comprehensive / holistic approach
  - Guidelines for the next budget (May-June)
- Each LM prepares its part of the expenditure ceilings and takes the investment needs into account.
- The final financing decision is made by the parliament in the state budget.
  - The cost estimate (ceiling) and appropriation.

Focusing on

- Professionalism
- Technology
- Transparency
- Markets / Competition
- Asset management

Domestic Terminal

- Cost Estimate 140 ->300 Mmk
  - Phase: Preliminary designs
  - Market/Competition situation: Building boom
- How to manage?
  - More capacity -> International competition
  - How to get international bids? ->Design & Build
  - Boundary values in the competition:
    - Cost ceiling 200 Mmk
    - Floor area: max 11 300 m^2
    - Functional & aesthetical grading criteria
- Outcome:
  - A well functioning, aesthetically balanced building
  - Floor space over 11.300 m^2 ; costs 180 Mmk.

National Art Museum Athenaeum / Renovation

- Challenge: Risk/Cost Management
  - Phase: Invitations for tender; cost estimate overrun
  - Market/Competition situation: Building boom
- How to manage?
  - Postpone to a market situation where there is capacity and competition?
  - Work out a balanced risk/cost sharing model?
    - **Negotiations with two contractors**
- Outcome: a contract with two target values
  - Cost target / contract sum.
  - Over it 50%-50% until a cost ceiling.
  - Works unforeseen in plans paid fully.

How to develop technology & methods?

The main tool in Finland: TEKES, the Funding Agency for Technology and Innovation

- **The objective: to promote the creation of world-class technology and technological know-how.**
- **Funded in the state budget, ca 400 M€ /a**
- **Industrial R&D projects**
- **Projects in universities and research institutes**
- **Especially innovative, risk-intensive projects**
- **Ca 2,000 projects annually**

TEKES / Construction sector projects

Optimization of plans and construction:

1. **A new optimization system for road planning and building**
2. **An efficient project planning and production management system for building construction**

Some details:

- **Developed in close co-operation with Helsinki University of Technology (construction economics and management) and leading Finnish contractors and design engineers.**
- **Substantial cost savings due to better plans, shortened mass haul distances and increased effectiveness in design, resource and schedule control (incl. risk-analysis).**

Developing methods..

- **New optimization system has been used in all major infra construction projects in Finland since 2002.**
- **E18- road project Lohja – Muurla, 300 M€**
  - **Design optimization, earthwork project division and schedule planning**
- **Kerava - Lahti railroad, 331 M€**
  - **Grade line & mass haul optimization, earthwork project division**

2."How to lift the perspective beyond the delivery of the project itself onto the broader issues of the project's utility and effects?"

Case: Public building projects

- **Reforming methods / administration**
- **Utilizing markets efficiently**

Costs of Building Projects / Premises

Basic questions:
Who should decide on premises/building and who should bear the costs ?

1) Expert 'premises-agency' ?

2) (Unexpert?) user agency ?

3) A combination of 1 & 2 ?
-> User pays to expert on commercial basis

Challenges:

- **Free resource: -> over-demand**
- **Strict budgetary constraints: -> Risk of 'under investments'?**

-> Let user decide and pay.

-> More efficiency by using market/competition methods.

-> Organisation reform: from agency to state enterprise
  - Differs from 'state company', which operates under the general company legislation.

Brief history

Phase "Statsbygg"

The National Board of Public Building

- state owned premises were a free resource to users (costs: "Statsbygg")
- agencies were allowed to rent premises also from private owners (users paid the rent)

Modernisation 1995-

a) Starting points:

- **User has to pay market (oriented) rents**
  - **Users got due additional appropriations in the budget.**
- **Take into account the existing commercial RP-services**
- **Use them on competition basis**
- **Organise more capacity and competition by reforming agency-functions to competing functions.**
  - **The National Board of Public Building (ca 2000 empl) was closed 1995 and its former functions were divided: ownership - services**

Modernisation.. (2)

- **Ownership: a new State Real Property Agency (ca 200 empl; state agency – in this phase not an enterprise, but enterprise accounting)**
- **Services (planning, invitations for tender & supervising the contracts, maintenance): reformed to a new state owned company Engel plc**
  - **In the beginning ca 20% of the personnel became redundant in maintenance services.**
  - **Number of employees has grown in 1996-2004.**
  - **State has sold the shares.**

b) Government's Real Property Strategy 1998

- **The emphasis: efficient state property policy and management using markets and market oriented tools.**
- **Inventory of real property assets and a distinction between fixed assets and current assets.**
- **Fixed assets: to be held; were organised to a state-enterprise (= State Real Property Agency, now made enterprise)**
- **The users rent the premises with market rents.**
- **Users may rent premises also from elsewhere; so the state enterprise is functioning under a market / competition pressure.**

Real Property Strategy.. (2)

- **Current assets: to be developed and sold; were organised as a new state owned company, Kapiteeli plc.**
- **In Finland the state owns a significant amount of real estates, which classify as current assets.**
- **This is due to a streamlining of some state owned companies (in order to float/sell them) as well as the banking crisis in the beginning of the 90'ies (state also has due debts / liabilities).**

Organisation reform: from agency to state enterprise (SE)

- **SE differs from 'state company', which operates under the general company legislation.**
- **Existing major state enterprises:**
  - **Senate Properties (SP), turnover 564 M€**
  - **Road-Enterprise 470 M€**
  - **Forest and Park Service 235 M€**
  - **Airports (Finavia) 227 M€**
  - **Piloting 35 M€**
  - **Ice-breakers / Shipping 46 M€**

State enterprise (SE) , in general

Revenues and expenditure are outside the state budget. In the state budget are decided:
*** the main service and operational goals**
*** the most important investment targets**
*** the cap for the total investments (*SP 340 M€*)**
*** the cap for new investment debt (*SP 250 M€*)**
*** the pay-out to state (*SP 32 M€*)**
The property is assigned to the SE partly as a subordinated loan (*SP 41 %, interest 5%, 15 yrs*) and partly as own capital.
The ownership of the real property belongs to the state.
The SE finances investments with incomes and loans (so SP with rents and loans).

Situation today

- **The state enterprise (renamed 2001 as Senate Properties) is nowadays, after vast property transfers in 1999-2003 the only major holder of the state-premises needed by the state agencies, universities, research and cultural institutes, prisons, and defence forces.**
- **Kapiteeli plc has developed the floating assets, and state has been able to free capital (ca 700 M€). There is a growing interest among the international investors towards the Finnish real property markets.**
- **Engel plc has developed its service business favourably; organic growth and acquiring; state sold 2004 its remaining shares in the firm.**

From Agency to State Enterprise:

What changed? What is gained? What may be lost?

A) The user side: Transparent user's cost responsibility
1) New projects
*** You pay for precisely what you want.**
-> Basis: Actual construction cost (=CC).
-> Annual rent = 7% * CC + 3% * lot
*** Lease at least 15 years.**

2) Existing premises
*** Valuable: tenant adherence.**
-> "Friendly market rent"

What changed...?

B) The provider side:
* From an administrative role to a competition, client and service orientation.
* In order to survive, SE must be a cost-efficient professional.
* It's easier to free capital from existing property and to make new investments.
* Better maintenance of the buildings.

The former administrative agency is nowadays
- an efficient client- and result-oriented professional and
- as a major player, an important developer of the branch.

What changed...

C) What happens to the quality and cost of building?

Three perspectives: Architectural - User - Owner

Architectural quality

- SP uses planning competitions and architects who have done best in competitions

-> No change in architectural quality

What changed…

User quality

- SP has a new project only if the client / user is content.
- User pays the costs
- Before, the expert role was administrative; users were naturally consulted – but if always listened to…?

-> Better user quality and more cost sensitivity

What changed…

Owner value / quality

Crucial questions for the owner / investor:

- Can the owner pay the loan with which the project is financed ?
  -> Cost and risk sensitivity
- What happens after 15 years, when the first lease ends? And as needs change ?
  -> Flexibility and market supply taken more into account
  = more owner value / quality

What might be lost ?

- **Some actors found a way to escape contracting competition: developer projects on a firm's lot, 'sold' directly to the user, very long rental agreements, risks/costs to tax-payers.**
- **More precise rules were given:**
  - * **The agencies have to submit new rental agreements to their ministry.**
  - * **If the costs during the agreement time exceed 5M€, the ministry shall have the opinion of the government's finance committee (same procedure as in other economic decisions >5M€).**
  - * **The agencies have to clarify**
    *** could the space needs be met with state-properties?**
    *** how does the proposed agreement affect the use of state-properties?**
    *** how will the rental cost be financed?**

What might be lost ..(2)

Market and competition effects / Ownership policy

- **The state enterprise does basically not compete for private-sector customers (economic position too strong).**
  - **Principal rule: facilities falling vacant from state are sold.**
- **Functions competing with the private sector have been put into a separate limited company:**
  - **Kapiteeli plc; Parliament has authorized the Government to sell it.**
- **Also when acquiring/leasing facilities to be built, government safeguards healthy competition in the construction and real estate business.**
  - **The construction and financing are put separately and transparently to tender.**

In conclusion

- In OECD countries there has been debate on how governments can get more efficiency in public operating facilities investments.
- Different countries, different circumstances, different ways.
- Case Finland :
  1. Ownership duties transferred to professionals.
  2. Rents introduced in government-owned facilities.
  3. Ownership agency made market-based enterprise.
  4. Construction, maintenance and other services through open competition.