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REPUBLIC OF UGANDA

MINISTRY OF LOCAL GOVERNMENT

MoLG
AND
UNDP

PUBLIC PRIVATE PARTNERSHIPS GUIDELINES FOR LOCAL GOVERNMENTS



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FOREWORD

The primary purpose of the PPP Guidelines is to enhance the institutional and individual capacities of local level stakeholders (local governments, private sector and communities) to identify, plan, design and implement viable partnerships for decentralized service delivery.

I would like, on behalf of the Ministry of Local Government, to express our appreciation of the commendable work of Local Governments in delivering services to the majority of Ugandans. I must also point out that this effort is however confronted by daunting capacity challenges ranging from inadequate human resource to low revenue base. As a result, decentralized services are not being delivered in the most equitable, effective and cost effective manner. It is now imperative that meaningful efficiency and effectiveness of decentralized service delivery can only be a product of shared effort between Local Governments and other stakeholders, especially the private sector. This arrangement would then enable local governments to harness the complementary resources and expertise available with the private sector and other civil society actors.

As we grappled with the above dilemmas, the Ministry of Finance, Planning and Economic Development developed a National Public-Private Partnership (“PPP”) as a tool for the provision of public services and public infrastructure. The policy was approved in March 2010. The Policy provides a framework that enables public and private sectors to work together to improve public service delivery by drawing on the capabilities of the private sector in providing public infrastructure and related services. Government is also in the process of putting in place an enabling legislation to further guide the execution of this innovative undertaking that is aimed to improve service delivery and promote pro-poor growth.

The Policy gives contracting authority to local government authorities among others and it within this spirit that the Ministry with support of the United Nations Development Programme (UNDP), to which we are very grateful for the financial and technical support extended towards the development of these Guidelines.

Public-Private Partnerships are an innovative approach to addressing the problems of service delivery to the poor. I, therefore, have great pleasure, on behalf of the Ministry of Local Government, to present to you these comprehensive Public-Private partnerships Guidelines for Local Governments.

Let me add that the guidelines should be taken as a working manual which may be subject to adjustments and revisions as may be deemed appropriate to ensure they are functionally applicable.

I commend the Guidelines to Local Governments, the private sector and civil society for improved delivery of services to our people in your areas of jurisdiction.

Adolf Mwesigye

Hon. Minister of Local Government

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Patrick Mutabwire
Ag Permanent Secretary

ACRONYMS AND ABBREVIATIONS

BOT:	Build, Operate and Transfer
CBA:	Cost Benefit Analysis
CBOs:	Community Based Organizations
CC:	Contracts Committee
DBO:	Design, Build and Operate
DBOF:	Design, Build, Operate and Finance
DPSF:	Decentralization Policy Strategic Framework
EOI:	Expression of Interest
EU:	European Union
FDS:	Fiscal Decentralization Strategy
IRR:	Internal Rate of Return
LGs:	Local Governments
LIG:	Low-Income Groups (persons below poverty line)
MFPEd:	Ministry of Finance Planning and Economic Development
MoLG:	Ministry of Local Government
NGOs:	Non-Governmental Organizations
NPA:	National Planning Authority
NPC:	Net Present Cost
NPV:	Net Present Value
OBA:	Output-Based Aid Contracts
PSC:	Public Sector Comparator
PFI:	Private Finance Initiative
PPDA:	Public Procurement and Disposal of Public Assets Authority
PPP:	Public Private Partnership
PPPUE:	Public Private Partnerships for the Urban Environment
PSC:	Public Sector Comparator
REOI:	Request for Expression of Interest
RFEI:	Request for Expressions of Interest
RFQ:	Request for Qualifications
RFP:	Request for Proposals
RoE:	Return on Equity
SPV:	Special Purpose Vehicle
TA:	Transaction Advisor
UNDP:	United Nations Development Programme
VfM:	Value for Money
WLCC:	Whole Life Cycle Costing

GLOSSARY OF KEY TERMS

Design-Build (DB): The private sector designs and builds infrastructure to meet public sector performance specifications, often for a fixed price, so the risk of cost overruns is transferred to the private sector. (Many do not consider DB's to be within the spectrum of PPP's).

Finance Only: A private entity, usually a financial services company, funds a project directly or uses various mechanisms such as a long-term lease or bond issue.

Operation & Maintenance Contract (O & M): A private operator, under contract, operates a publicly-owned asset for a specified term. Ownership of the asset remains with the public entity.

Life Cycle Costing (LCC): A technique which enables the systematic appraisal of life cycle costs over a period of analysis as defined in the agreed scope.

Life Cycle Cost (LCC): Assessment expressed in monetary value, taking into account all significant and relevant costs over the life of the project (asset/facility) as defined in the agreed scope. The projected costs are those needed to achieve defined levels of performance, including reliability, safety and availability over the period of analysis.

Life Cycle (LC): This refers to the consecutive and interlinked periods of time between a selected date and the disposal of the asset/facility over which the criteria (e.g. costs) are agreed. The life-cycle period is governed by defining the scope and the specific performance requirements for the particular asset.

Whole Life-cycle Costing (WLCC): This is a tool used to determine the value of long-term cost effectiveness of the project, especially for construction projects

Net Present Value (NPV): This is the sum of the discounted future cash flows. Where only costs are included this may be termed Net Present Cost (NPC).

Build-Finance: The private sector constructs an asset and finances the capital cost only during the construction period.

Design-Build-Finance-Maintain (DBFM): The private sector designs, builds and finances an asset and provides hard facility management (hard fm) or maintenance services under a long-term agreement.

Design-Build-Finance-Maintain-Operate (DBFMO): The private sector designs, builds and finances an asset, provides hard and/or soft facility management services as well as operations under a long-term agreement.

Build-Own-Operate (BOO): The private sector finances, builds, owns and operates a facility or service in perpetuity. The public constraints are stated in the original agreement and through on-going regulatory authority.

Price Indexation: This is a performance driver for service delivery and it entails adjusting tariffs to prevailing retail price index on an annual basis. The tariff is adjusted to ensure sustainability of service delivery.

Cross-subsidization: This is where one group of consumers pays a relatively higher price thereby allowing another group to pay a relatively low price for the same service or facility.

Cost plus pricing: This is a pricing method used by companies to maximize their rate of return. It is easy to calculate and requires little information.

Price cap regulation is a form of economic regulation (generally or specific to the utility industry) where a ceiling is set on the price that the utility can charge. The cap is set according to several economic factors such as the price cap index, expected efficiency savings and inflation. It is meant to protect consumers while ensuring that the business remains profitable.

A Stakeholders is any person or organization who can be positively or negatively impacted by, or cause an impact on the actions of a private company, local government or other organization.

Equity Capital: is generally composed of funds that are raised by a business in exchange for an ownership interest in the company. This interest can be in the form of ownership of common or preferred stock or instruments that convert into stock.

Equity Investment: Money invested in a firm by its owners or holders of common stock (ordinary shares) but which is not returned in the normal course of the business. Investors recover it only when they sell their shareholdings to other investors, or when the assets of the firm are liquidated and proceeds distributed among them after satisfying the firm's obligations.

Pass-through Costs: pass-through costs are fees paid to other companies who operate and maintain the utility network (e.g. electricity). For domestic customers these are all combined into a single standing charge. Electricity charges are two forms – distribution charges and transmission charges.

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1.0 INTRODUCTION

1.1 Background

Local Governments play a vital role in realizing Uganda's development agenda through delivery of infrastructure and public services to their communities. However, most of them are constrained financially and technically. Public-Private Partnerships are now one of the innovative options introduced by the Government of Uganda to enable public sector procure infrastructure and offer opportunities to improve service delivery and assure better value for money. This is to be achieved through appropriate risk transfers, encouraging innovation, greater asset utilization and integrated whole-of-life management. It is envisaged that the PPP Programme will be the vehicle for effective private sector participation in the provision of infrastructure and services at national and local government levels. Contracts and legal agreements are at the heart of PPP transactions with sound "win-win" agreements grounded in the rule of law to achieve the objectives set forth by the Government PPP Policy Framework. In the broadest sense, PPPs cover all types of collaborative arrangements that involve an interface between the public and private sectors to deliver Government (public) policies, services and infrastructure.

1.2 Evolution of PPP in Uganda

Prior to the formulation of the PPP Framework Policy by the Ministry of Finance Planning and Economic Development (MFPED), the Ministry of Local Government was supported by the United Nations Development Programme to implement a Public-Private Partnerships for the Urban Environment (PPPUE) project (July 2002-April 2004).

The project, implemented in 6 municipalities of Uganda, was a collaborative undertaking between the Ministry and an NGO, Living Earth Uganda. It provided invaluable insights and lessons in the application of PPPs towards delivery of pro-poor services in the country. The project demonstrated that "PPP's offer an alternative to full privatization by combining the advantages of both sectors, namely (a) the social responsibility, environmental awareness and public accountability of the public sector; with the (b) finance, technology, managerial efficiency and entrepreneurial spirit of the private sector" (UNDP, PPPUE Toolkit for Pro-poor Municipal PPPs).

1.3 Objectives of the Guidelines

These guidelines are intended to outline for local governments/agencies, potential private sector bidders and the public the general direction and principles that will be adopted and used for implementing the Public Private Partnerships as alternative means of enhancing revenue in local governments for effective and efficient delivery of services and infrastructural development.

Secondly, the Guidelines provide a framework for operationalising the Public-Private Partnership Framework Policy for Uganda, approved in March 2010. The Guidelines are intended to be used by the Local Governments to assess whether a PPP is to be preferred over other forms of procurement.

1.4 Principles underlying these guidelines

The utilization of the PPP Guidelines for Local Governments is guided by the following principles:

- a. Ownership (ensuring the process is owned by stakeholders with a gender perspective);
- b. Simplicity (in usage and management);
- c. Ensuring PPPs are procured in a professional and transparent manner, minimizing tender costs and providing fair opportunity to all prospective private sector participants
- d. Flexibility (able to accommodate changes);
- e. The Government will not guarantee private sector borrowings for executing PPP projects
- f. Progressiveness (builds on existing guidelines and practices);
- g. Harmonization (this involves alignment with current practice);
- h. Equity for all parties to the partnership;
- i. Fair competition and open market approach (to ensure transparency in the process); and
- j. Assurance that the public interest is best served by the PPP arrangement and the approach selected;

1.5 Using these Guidelines

These guidelines are designed for use by the Local Governments, the community groups, advisors and other stakeholders, desiring to partner with the private sector in the delivery of infrastructure and public services in their areas of jurisdiction. These guidelines apply to a wide range of projects, and are in line with the Public-Private Partnerships Policy Framework 2010 and the related Guidelines as well as the Public Procurement and Disposal of Public Assets Act, 2003. They are intended to promote efficient and value for money procurement (including keeping transaction costs as low as possible). The guidelines will be reviewed and revised as frequently as may be deemed appropriate, to accommodate any emerging concerns and developments.

1.6 Structure of the Guidelines

Chapter 2 details the dimensions and principles of Public-Private Partnerships and highlights what they are, how they work and how they benefit the community in which they are implemented. A comparison between PPP and traditional procurement is also presented and concludes with description of roles and responsibilities of key actors and stakeholders.

Chapter 3 presents the legal and policy framework for Public-Private Partnerships in the Ugandan Context starting with the Constitution and related legal instruments regarding local governance and other national development framework and regulations. This is intended to make a case for the development of specific guidelines for the Local Governments.

Chapter 4 discusses the principal models of PPPs and how contracting will be effected by the Local Governments – for service, management, construction and divestiture modalities.

Chapter 5 addresses issues of pro-poor activities in PPPs including characteristics of pro-poor PPP options, pro-poor interventions and output-based aid contracts.

Quite often Local Governments will be barraged with unsolicited PPP Project proposals. Chapter 6 discussed the challenges and merits of such proposals and how they can be handled.

Chapter 7 contains guidance on how LGs will apply PPP approach for efficient service delivery through such processes as financial and economic analyses, project financing projections and sources, tariff considerations and subsidy provisions as well as monitoring and evaluation of the implementation of the guidelines.

Chapter 8 discusses the implementation arrangements for these Guidelines including a proposal for PPP Unit in the Ministry of Local Government, while chapter 9 makes proposals for involving stakeholders in the design of the arrangement.

Chapter 9 presents the PPP Project Cycle – with special reference to phases, stages and steps.

2.0 THE LEGISLATIVE AND POLICY CONTEXT OF PRIVATE-PUBLIC PARTNERSHIPS

2.1 The Constitution of the Republic of Uganda

The PPP Policy Framework (2010) derives its legal force from the Constitution of Uganda (1995) which provides the overall legal policy framework for the Central Government to plan and implement development program to benefit all the people in the country. It is in this light that the Ministry of Finance Planning and Economic Development developed the Public-Private Partnerships Policy.

The Constitution also mandates LGs to: a) prepare comprehensive and integrated plans within an agreed upon development planning cycle; b) to generate and apply locally generated revenues in accordance with established laws. It is in this connection that the Ministry of Local Government has undertaken to develop the Public-Private Partnership Guidelines to support implementation of the National PPP Policy Framework at the Local Government level.

2.2 The National Development Plan (2010/11 – 2014/15)

The vision of Uganda's overarching planning framework is to: transform the Ugandan society from a peasant to a modern and prosperous country within 30 years. To realize this vision, the Plan sets out a number of development objectives under the overall theme of "Growth, Employment and Socio-economic transformation for prosperity". In order to realize the development objectives the NDP positions the private sector as the engine of growth, employment and prosperity with Government actively promoting and encouraging public-private partnerships in a rational manner. The NDP recognizes that for Uganda as whole and local governments in particular, to finance the proposed interventions there is need for financial resources mobilization. For this reason a financing strategy through public-private partnerships (PPPs) was identified as one of the various viable options. PPP is defined by the Plan as the cooperation between the public and private sectors with the aim to improve the quantity, quality and efficiency of public services. Accordingly, PPPs will be encouraged and promoted in the provision of infrastructure and energy services as well as huge undertakings which require substantial financial resource outlay.

2.3 The Public-Private Partnership Framework Policy for Uganda, (2010)

In keeping with the above development strategy, the Government of Uganda adopted a policy of Public-Private Partnerships (PPP) as a tool for the provision of improved public services and public infrastructure based on the principle of better value for money, appropriate risk transfer and management and taking advantage of private sector innovations. It is also a tool

for improved fiscal moderation and control of public debt. The Policy Framework, approved in March 2010, is expected to result into the following:

- i. Better utilization and allocation of public funds
- ii. More efficient development and delivery of public infrastructure
- iii. Good quality public services
- iv. Increased economic growth and foreign direct investments

According to the policy, “Implementation will remain with the relevant Government departments and state enterprises in charge of the provision of the public service or infrastructure in question” (page 2) and “----- local government authorities shall be responsible for identifying, developing and managing PPP projects” (page 12); nevertheless, they will have to consult with the Ministry of Finance Planning and Economic Development on the policy issues and the PPP Unit for appropriate project support.

2.4 The Local Governments Act Cap. 243

The Constitution of the Republic of Uganda ratified decentralization as a system focused on bringing services nearer to the people. Specifically, Chapter Eleven, Article 176 provides for local government system and decentralization is a “principle” applying to all levels of local government and in particular from higher to lower local government units to ensure people’s participation and democratic control in decision-making.

To operationalise the above constitutional mandate, the Government enacted the Local Governments Act in 1997, as Act 1 of 1997, now Cap. 243 as at 31st December 2010¹ to, among other things, give effect to decentralization and devolution of political, administrative, and financial decision-making powers to local governments and administrative units. In addition, the LGA enhances good governance and democratic participation in and control of decision making by the people within their communities; provides for revenue and the political and administrative set up of local governments, etc.

According to the LGA, the powers assigned to Local Governments include, but not limited to, (a) making local policies and regulating the delivery of services; and (b) formulating development plans based on locally determined priorities. With this understanding, and as sated under the PPP Policy Framework, Local Governments have direct responsibility in implementing the policy since they are mandated to deliver services and, to some degree, provide infrastructure to their residents.

The Local Government Finance Commission² notes that ‘enhancement of local revenue mobilization is a critical intervention provided for under the Decentralization Policy and

¹ Referred to as Local Governments (Amendment) Act, Act No. 16/2010

² Local Governments Finance Commission, Annual Report 2010

Strategy Framework’. It further notes that ‘performances of the local revenue sources remain extremely poor, making it difficult for Local Governments to finance decentralized services’. The Commission further notes that there are innovative ways of enhancing revenue that had been recommended to Local Governments, including procedures for Public Private Partnerships for more effective revenue mobilization; and the development of a guide for prioritization and selection of revenue enhancement best practices based on Cost Benefit Analysis (CBA).

2.5 The Decentralization Policy Strategic Framework (DPSF)

The DPSF is a framework whose objective is to guide the implementation of the decentralization policy of Uganda in a more coherent and consistent manner. The DPSF is an embodiment of multiple development interventions that relate to the decentralization sector for a more coordinated approach to service delivery and poverty reduction. The framework provides a mechanism for better coordination, improved systems, effective reporting and a coherent policy of decentralization in line with the national development priorities. It also provides for local revenue enhancement in Local Governments; though local revenues remain extremely low making it difficult for LGs to finance and deliver decentralized services.

2.6 The Local Governments Financial and Accounting Regulations (LGFAR), 1998 Amended In 2007.

The regulations were formulated to support the implementation of the Local Governments Act, Cap 243as at 31st December 2010. These regulations provide the necessary guidance on budgeting, revenue collection, expenditure management, and financial management, accounting and audit issues. The Act and regulations provide the legal and operational foundation for the implementation of the Public Private Partnerships within Local Governments. They define the roles and responsibilities of the local governments, the private sector and beneficiary communities.

2.7 The Local Government Procurement Regulations

Following the enactment of the Public Procurement and Disposal of Public Assets Authority Act, 2003 (PPDA Act) the Local Governments Act was amended in 2006 to give effect to the replacement of the Tender Boards of Local Governments with Contracts Committees; regulation of procurement procedures of Local Governments; to ensure accountability in local government procurement system and to provide for other related matters.

The amended LGA also provided for establishment of Procurement and Disposal Units in every district whose functions are clearly spelt out in the PPDA Act, 2003; at the same time Municipal Contracts Committees were provided for with extended functions to serve Municipal Divisions. However, these regulations do not contain any specific provision for public-private partnerships.

2.8 The Fiscal Decentralization Strategy (FDS)

The Fiscal Decentralization Strategy (FDS) was formulated and is being implemented to allow regional and local governments to develop, approve and execute their own budgets; raise and utilize resources according to their own priorities in line with legal provisions contained in the Local Governments Act and the Regulations; and utilize conditional, unconditional and equalization or any other grant from the centre in line with central government guidelines and local priorities.

2.9 The Local Economic Development Policy (LEDP)

Local Economic Development (LED) is a Sixth Pillar of decentralization. Like PPP, local economic development approach is pegged on a tri-partite partnership arrangement between Local Government, the private sector and the community with the primary objective to establish a framework for local governments to promote private business investments, increased household incomes and revenue generation. The basic difference between LED and PPP is that the former is focusing on building private sector capacity through local economy enhancement; the latter is focusing on infrastructure and public service delivery through leveraging private sector resources and skills. The two initiatives are, however, mutually re-enforcing.

2.10 Strengthening and deepening public-private-partnership for industrial development

The Uganda National Industrial Policy prioritizes the strengthening of PPP in order to ensure a leading role for the private sector in the country's industrial transformation and economic development. The key consideration is to achieve government commitment of creating a vibrant and competitive industrial sector with an enabling environment in which the private sector can lead the country's economic growth objectives.

2.11 Other Policies

The PPP Policy and Guidelines are influenced by other national policies such as Gender, Environment, Intellectual Property, Consumer Protection, Trade and taxation policies and strategies.

3.0 THE DIMENSIONS AND PRINCIPLES OF PUBLIC PRIVATE PARTNERSHIP

Public infrastructure and services, such as roads, water, energy, health, education, and public order have traditionally been provided by governments. However, government is not the only provider of such services. Where governments have failed to provide, communities have organised to provide essential services like water and sanitation. The approach of supplying public goods and services by private companies is growing in importance not only where there is failure or the inability by public entities (national and local) to deliver services, but also due to recognised advantages and benefits of private sector participation (PSP) in public private partnerships. But what are public private partnerships?

3.1 What Is A PPP??

A PPP is a contractual agreement involving the private sector in the delivery of public services. As the name suggests, this is based on a partnership approach, where the responsibility for the delivery of services is shared between the public and private sector both of which bring their complementary skills to the enterprise.

PPPs bring together the public and private sectors in the long term contractual relationship to deliver high quality public services. The private sector then becomes the long-term service provider rather than the simple upfront asset builder. LGs are more involved as regulators and procurers of services rather than direct providers of services to the public.

At the core of most PPPs is a signed contract (or similar agreement) between a public partner (in this case the local government) and a private partner (an individual or company, formal or informal).

3.2 PPP Objectives

- a. Enhancing significantly the availability of improved public services by contributing to increase in the quality and quantity of the investment facilities and services
- b. Realising the full potential of public sector assets to provide greater value for money for the tax payer and the wider community
- c. Removing inefficiencies and developing imaginative approaches to the delivery of public services
- d. Investing in high quality facilities that minimize long term maintenance and operating costs
- e. Managing and minimizing the cost to government of risks associated with the long-term, complex projects
- f. Allowing stakeholders such as users, taxpayers, and employees to receive a fair share of the benefits of a PPP

3.3 What form may a PPP take?

PPPs are not all alike; one major difference is the means by which the private partner receives a return on its investment:

- 3.3.1 Financially free-standing projects where the services are provided for the use of the public which pays the private partner direct. These are often economic infrastructure projects, such as toll-charging road bridges and tunnels;
- 3.3.2 Projects that provide services to the public at less than cost and the payments to the private partner involve a mix of public subsidy from the government and end-user charges imposed on consumers of the services. Examples of such services are sports centres, where the consumer pays a subsidised fee for the use or hire of facilities and equipment; and
- 3.3.3 Services that are provided direct to the government, which pays the private partner for those services. These are often social infrastructure projects, overseas examples of which include prisons, government office accommodation, and hospitals.

3.4 What Are The Benefits Of A PPP?

The introduction to Private sector management is an effective way of bringing commercial discipline into the provision of Public services. The specific benefits to the principle actors depend on the specific project. Generally benefits that may be achieved include:

3.4.1 The Public Sector:

a. Lifecycle cost Management

As the consortium has complete responsibility for the design, build, maintenance and operation of a service, it is best placed to optimize the less likely to be achieved using conventional procurement approaches where design construction maintenance and operations are undertaken by different entities. Under a PPP, greater attention to design and quality building materials is likely to lead to higher construction costs.

b. Construction management

As the consortium is not paid specifically for the construction but the delivery of a service it is fully incentivised to achieve accelerated completion of capital works projects, and substantial improvement in the quality and durability of construction, reducing the risk of cost overruns.

c. Innovative solutions

By not specifying how a service should be delivered and how an asset has to be designed and built, but by simply spelling out the services it needs and the outputs/ outcomes desired, the government (national or local) can engage can engage the private sector capacity to innovate and deliver improved value for money.

d. Sharing government assets/ facilities with third-party users

Sharing government facilities with other users can contain costs for government and provide public services more economically. Many government facilities/ assets are capable of being shared with other users for example, space in government building and government owned intellectual property such as educational material. A

consortium with expertise in managing such assets will be able to optimize the use of and return on such assets.

e. Sharing responsibilities with the private sector

Government's core competence should be identifying public needs and crafting public policies and objectives and, therefore defining the service requirements and desired outcomes. The private sector is often better equipped to actually provide services – ranging from managing construction and maintenance of assets to day to day operations.

f. Saving resources

Assuming that the savings are achieved, in comparison with the Public sector comparator (PSC), there should be a freeing of resources for other public services.

3.4.2 The Private Sector:

a. Business opportunities

Being engaged to deliver a full suite of services e.g. design, construction, operations and maintenance, some of which were traditionally performed in-house by public agencies or performed by multiple private companies.

b. Export opportunities

The experience of and base provided by the continuing stream of PPP work will increase the competitiveness of service providers when bidding for work in the region and further afield.

3.4.3 The Wider Community:

a. Bond markets

The third-party financing commonly associated with PPPs provides an opportunity to further strengthen Uganda's growing Bond market.

b. Regulation of service provision

As the procurer, rather than the deliverer of the service, the government can monitor and regulate the quality of delivery and the compliance with staff, health-related, environmental, and financial/ tariff, legal and commercial issues with less likelihood of conflict of interest, real or perceived;

c. Job creation

The opportunity to develop and expand businesses, outside the constraints of the civil service, will encourage employment opportunities.

d. Small government

Transferring the responsibility for some public services to the private sector can help constrain the size of the civil services to that required to develop policy and to deliver those services which it is considered the public sector should provide only.

3.5 What are the disadvantages of PPP

A study by PricewaterHouse has noted the following challenges in using PPP procurement

- a. The first challenge is to do with having the right information on the right project for the right partners at the right time.

- b. Does the private sector have sufficient expertise to warrant the PPP approach?
- c. Does the public sector have sufficient capacity and skills to adopt the PPP approach?
- d. It is not always possible to transfer life cycle cost risks.
- e. PPPs do not achieve absolute risk transfer.
- f. PPPs imply a loss of management control by the public sector.
- g. PPP procurement can be lengthy and costly.
- h. The private sector has a higher cost of finance (both debt and equity) which increases the overall cost of a PPP relative to traditional procurement.
- i. PPPs are long-term relatively inflexible structures.

3.6 PPP vs. Traditional Public Procurement Methods

PPPs replace traditional short term contracts with long term contracts, upfront milestone payments with ongoing performance and input specification with output specification.

The key difference between **Traditional Procurement** and **PPP** is that PPP requires the use of an output specification by Government to describe the outputs the private sector must provide as part of the complete service. Conventional procurement involves the procurement of distinct elements of a particular project through an input-based specification, whereas a PPP requires Government to focus on output not assets.

Table 3.1 below presents the major differences between conventional/traditional and PPP Approach

Table 3.1: Differences Between Conventional and PPP Approach

Conventional/Traditional Procurement	PPPs
Government purchases an infrastructure asset	Government purchases infrastructure services
Short-term design and construction contracts (two to four years)	One long-term contract integrating design, build, finance and maintenance
Input based specifications	Output based specifications
Government retains whole-of-life-asset risk	Private sector retains whole-of-life-asset risk
Payment profile has a spike at the start to pay for capital costs, with low ongoing costs	Payments begin once the asset is commissioned. The payment profile is relatively even, reflecting the level of service provision over the longer term of the contract

Convetional/Traditional Procurement	PPPs
Government is usually liable for construction time and cost overruns	Private contractor is usually liable for construction time and cost overruns
Government operates the facility	Government may or may not operate the facility
Government manages multiple contracts over life of the facility	Government manages one contract over life of the facility
Often no ongoing performance standards	Performance standards are in place. Payments may be abated if services are not delivered to contractual requirements
Handover quality less defined	End of term handover quality defined

3.7 PPP Vs Privatization

This section presents a comparison between privatization and PPP arrangements. Privatisation refers the transfer of an existing government entity or asset to the private sector in perpetuity, through an asset sale, a share sale or a management buy-out. After privatisation, government's involvement is limited to a regulatory role, if required. With a PPP, government retains ultimate responsibility for the delivery of services throughout the contract.

Privatization involves the sale of shares or ownership in a company or the sale of operating assets or services owned by the public sector. Privatization is most common and more widely accepted in sectors that are not traditionally considered public services, such as manufacturing, construction, etc. When privatization occurs in the infrastructure or utilities sectors, it is usually accompanied by sector-specific regulatory arrangements to take account of social and policy concerns related to the sale, and continuing operation of assets used for public services.

There are a few key components to the PPP process which clearly depict the difference between PPP and privatisation:

- a) The first is that the process is **"Output Based"**. PPP focuses on the outputs required to achieve policy objectives. It is about "What" is to be delivered rather than "How" it is to be delivered. By focusing on the "What", as few constraints as possible are placed on the entity that will ultimately deliver the service.
- b) The second key component relates to the **whole life, risk-adjusted cost** of delivering "the output". This means that the long-term consequences of the decision to provide a particular service includes every item of direct cost of

the delivery process as well as the costs of all the risks retained by the public sector.

- c) The third area of focus is the ***allocation of risks*** inherent between the public and private sectors. Risks should be allocated to the party best able to manage and control them.
- d) The fourth important feature of the PPP process is the development of the ***payment mechanism***. This implies paying only for the service received and then modified to include reduction in payment in case of loss of quality of service.

3.8 When and How PPPs Should Apply

3.8.1 In what circumstances should a PPP be considered?

The PPP approach is an alternative to conventional methods of procuring projects and will not be suitable in every case. There is a case for considering a PPP where:

- a. There is a major investment programme, requiring effective management of risks associated with construction and delivery; this may be a single major project or a series of replicable smaller projects.
- b. The private sector has the expertise to deliver and there is good reason to think that it will offer value for money.
- c. The structure of the service is appropriate, allowing the public sector to define its service needs as outputs/outcomes that can be adequately contracted for in a way that ensures effective, equitable and accountable delivery of public services in the long term.
- d. Where risk allocation between the public and private sectors can be clearly made and enforced.
- e. The nature of the assets and services involved are capable of being costed on a long-term, whole of life basis.
- f. The value of the project is sufficiently large to ensure that procurement costs are not disproportionate.
- g. The technology and other aspects are reasonably stable and not susceptible to short term fast paced changes. Where a project involves a facility (e.g. a hospital) where the equipment inside is subject to rapid technological development, arrangements separate from the PPP contract can be made.
- h. Planning horizons are long term, with assets intended to be used over long periods.

PPP proposals to LGs should also take account of a number of public interest criteria covering: accountability; transparency; equity; public access; consumer rights; security; privacy, and the rights of affected individuals and communities, as appropriate.

3.8.2 In what circumstances shouldn't a PPP be considered?

- a. Projects where the LG is unable to fully and clearly specify the requirements due to uncertainty over the nature and quality of the intended service.
- b. Difficulties in specifying requirements due to the rapid pace of technological change
- c. Difficulties in substituting suppliers due to the need to integrate proprietary technologies.
- d. Lack of third party finance leading to the excessive reliance on corporate borrowing by the private partner and an absence of arms length due diligence.
- e. Costs of delivering the projects being overly dominated by the annual running costs associated with delivering the service requirement, rather than being balanced by the up-front costs of investment in the project assets.

3.9 Roles and Responsibilities of different actors

3.9.1 What is the government's fundamental role in PPPs?

- a. Set policy, identify opportunities, and define objectives;
- b. Ensure transparency and probity in the procurement process;
- c. Identify and propose the allocation of risks;
- d. Identify needs in terms of output/outcome specifications that encourage flexibility and innovation in the manner of performance;
- e. Set and ensure the achievement of standards for health, safety, and the environment;
- f. Establish, monitor and enforce the levels of service;
- g. Ensure value for money is achieved;
- h. Determine and manage reward mechanisms and tariff structures;
- i. Provide a clear regulatory framework and perform regulatory functions;
- j. Safeguard the interests of customers and the general public;
- k. In some PPP projects government will still provide the front line staff;
- l. To scrutinize and consider proposals;
- m. To reflect public views and make suggestions to the Administration;
- n. To approve funding proposals in accordance with the provisions of the LGF;
- o. To consider legislative proposals, including subsidiary legislation.

3.9.2 What is the private sector's fundamental role in PPPs?

The private sector's role is to provide commercially effective solutions to assist government to achieve its outcomes by achieving defined levels of performance in service delivery; and providing:

- a. Expertise and innovation;
- b. Access to private financing, as appropriate;
- c. A sufficient return to investors and other stakeholders;
- d. Provide the facility and deliver the service efficiently and effectively.

3.9.3 Role of the General Public

The role of the general public is to express their views and suggestions to the LG Administration on proposals. This may include, for example, issues concerning location or nature of facilities, the quality and quantity of services, environmental concerns, and fees and charges.

3.10 Protecting the Public Interest

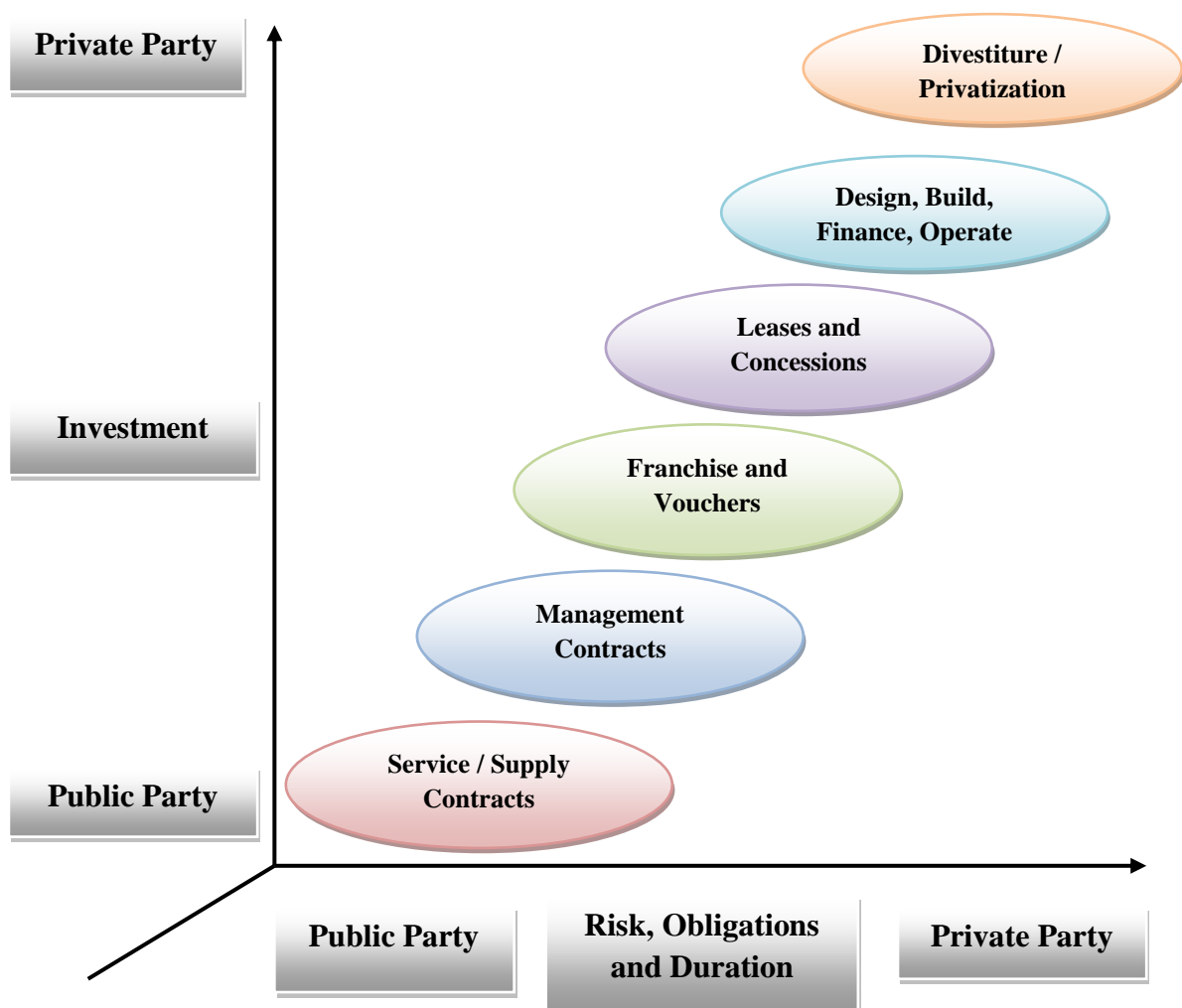
Focus on satisfying the people's interests/ needs especially the poor and vulnerable by:

1. Expanding the service systems in order to increase population coverage;
2. Providing a better quality and more affordable service;
3. Conduct stakeholder analysis to carefully identify potential partners and stakeholders and strengthen community structures and processes through mobilization and sensitization about the project;
4. Ensure political and macroeconomic stability and a predictable taxation regime;
5. Empower the poor and vulnerable groups to entail in public education, coalition building , community organizing, resource development and advocacy assistance;
6. Poverty assessment study in situations of cost-recovery policy-making with particular emphasis on :
 - ✓ What are the implications for the poor?
 - ✓ Are tariffs affordable?
 - ✓ Are the poor willing and able to pay?
 - ✓ Are there effects on livelihoods?
 - ✓ How are tariffs and collection mechanisms adapted to meet the needs of the poor?
 - ✓ How will the negative impacts be mitigated?

4.0 MODELS OF PUBLIC PRIVATE PARTNERSHIP

A wide range of PPP arrangements exists, differing in purpose, service scope, legal structure and risk sharing. One end of the spectrum shown below would be an outsourcing of some routine operation, while the other could involve the private sector conceiving, designing, building, operating, maintaining and financing a project, thereby taking a considerable proportion of risks. Figure 4.1 below illustrates the various PPP Options based on investment and risks/obligations.

Figure 4.1: PPP Options



4.1 Service Contracts

Service contracts are for short periods of time (one to two years) and leave coordination and investment responsibility with LG management. A private firm is hired to carry out one or more specified tasks or services for a period of time; it can be technical know-how; or operation and maintenance. The Local Government shall remain the primary provider and is responsible for funding any capital investment needed to expand or improve the facility or service.

4.1.1 Potential Application

- a. Where terms and evaluation criteria are clear and easily defined
- b. Where several firms have capacity to perform the contract
- c. Where the contractor does not have to make large new capital expenditures
- d. Where the contract is subject to renewal and negotiation regularly
- e. Short term contracts
- f. Examples: Waste collection, Water supply, recreation facilities, parking

4.1.2 Potential Strengths

- a. Low risk option for expanding the role of private sector
- b. Improves monitoring
- c. Increases competition
- d. Reduces costs

4.1.3 Potential Weaknesses

- a. Does not inject new capital
- b. Lowest of bidder as opposed to value for money

4.2 Management contracts

Management contracts are similar to service contracts in that the length of the contractual period typically varies around three to five years. The responsibility for operation and maintenance is transferred to the private sector while investment responsibility rests with Government. The LG shall retain overall ownership of the assets, but may delegate the responsibility for their operation to a private operator for a definite period of time. The private sector contractor recovers its costs in whole or in part from user charges appropriately negotiated to ensure fairness and to the public.

4.2.1 Potential Application

- a. Suited to projects that provide an opportunity for the introduction of user charging such as vehicle parking.
- b. Particularly suited to roads, water (non-domestic) and waste projects.
- c. Examples observed in public transport, hospitals, prison, municipal markets, recreation facilities, bus terminals, power generation and distribution (rural electrification), and water and sanitation

4.2.2 Potential Strengths

- a. As for Design, Build, Operate and Finance plus:
- b. Facilitates implementation of the Polluter Pays Principle; and
- c. Increases level of demand risk transfer and encourages generation of third party revenue.

4.2.3 Potential Weaknesses

- a. As for Design, Build, Operate and Finance plus:
- b. May not be politically acceptable; and
- c. Requires effective management of alternatives or substitutes (for example, alternative transport routes and forms; alternative waste disposal options).

4.3 Franchising and Vouchers

Franchise

Under this arrangement, the LG awards a finite-term zonal monopoly (a franchise) to a private firm for the delivery of service. The franchise award is made after a competitive qualification process. The private firm deposits a performance bond with the government and pays a license fee to cover the government's costs of monitoring. The private firm recovers its cost and profit through direct charges to the users and establishments that are served.

Voucher

The users are allowed to choose from amongst the service providers

4.3.1 Potential Application

Waste collection, Water supply, Education, Health

4.3.2 Potential Strengths

Availability of private sector investment

4.3.3 Potential Weaknesses

Monopoly tendencies

4.4 Lease purchase

Under this arrangement, the Local Government contracts with a private sector partner to design, finance, and build a facility to provide a public service. The private partner then leases the facility to the local government for a specified period of time after which the facility reverts to the Local Government. This approach is preferred where the Local Government requires a new facility or service but lacks financial resources.

4.4.1 Potential Application

This approach can be used for capital assets such as buildings, vehicle fleets, water and wastewater treatment plants, solid waste facilities and computer equipment

4.4.2 Potential Strengths

- a. improved efficiency in construction
- b. opportunity for innovation
- c. lease payments may be less than debt service costs
- d. assignment of operational risks to private sector developer
- e. improve services available to residents at a reduced cost
- f. potential to develop a “pay for performance” lease

4.4.3 Potential Weaknesses

Reductions in control over service or infrastructure

4.5 Lease- Develop-Operate or Buy

This where the private partner leases or buys a facility from the local government, expands or modernizes it, then operates the facility under a contract with the local government. The private partner is expected to invest in facility expansion or improvement and is given a specified period of time in which to recover the investment and realize a return.

4.5.1 Potential Application

Most infrastructure and other public facilities, including roads, water systems, sewer systems, water and wastewater treatment plants, parking facilities, local government buildings, airports, and recreation facilities.

4.5.2 Potential Strengths

- a. if the private partner is purchasing a facility, a significant cash infusion can occur for the local government
- b. public sector does not have to provide capital for upgrading
- c. financing risk can rest with the private partner
- d. opportunities exist for increased revenue generation for both partners
- e. upgrades to facilities or infrastructure may result in service quality improvement for users
- f. public partner benefits from the private partner's experience in construction
- g. opportunity for fast-tracked construction using techniques such as design-build
- h. flexibility for procurement
- i. opportunities for increased efficiency in construction
- j. time reduction in project implementation

4.5.3 Potential Weaknesses

- a. perceived or actual loss of control of facility or infrastructure
- b. difficulty valuing assets for sale or lease
- c. issue of selling or leasing capital assets that have received grant funding
- d. if a facility is sold to a private partner, failure risk exists—if failure occurs, the local government may need to re-emerge as a provider of the service or facility
- e. future upgrades to the facility may not be included in the contract and may be difficult to incorporate later

4.6 Concessions

Concession contracts are similar to design, build, operate and finance arrangements, except that the private sector contractor recovers its costs through direct user charges i.e. toll roads or through a combination of user charges and public subventions during a specified period of time. Concessions are awarded for the construction of a new asset/facility or for the modernization, upgrading or expansion of an existing facility within the jurisdiction of the Local Government. Concessions often extend for a period of 25 to 30 years or even longer and are awarded under competitive bidding conditions. Under this approach the Local Government retains ownership of all the assets, both new and existing ones.

4.7 Design Build

Under this arrangement, the Local Government contracts a private sector to design and build a facility that conforms to the standards and performance requirements of the Local Government and once the facility has been built, the Local Government takes ownership and becomes responsible for the operation of the facility. The key driver is the transfer of design and construction risk.

4.7.1 Potential Application

This type of partnership is suited to capital projects with small operating requirement and where the LG wishes to retain operating responsibility. Examples include public infrastructural facilities such as water and solid waste management systems, water treatment plants, building projects and road construction and maintenance.

4.7.2 Potential Strengths

- a. Transfer of design and construction risk.
- b. Potential to accelerate construction program.

4.7.3 Potential Weaknesses

- a. Possible conflict between planning and environmental considerations.
- b. May increase operational risk.
- c. Commissioning stage is critical.
- d. Limited incentive for whole life costing approach to design.
- e. Does not attract private finance (if it is required).

4.8 Design, Build and Operate (DBO)

This is a Contract with a private sector contractor to design, build and operate a public facility for a defined period, after which the facility is handed back to the public sector. The facility is financed by the public sector and remains in public ownership throughout the term of the contract. Key driver is the transfer of operating risk in addition to design and construction risk.

4.8.1 Potential Application

- a. Suited to projects that involve a significant operating content.
- b. Particularly suited to water and waste projects.

4.8.2 Potential Strengths

- a. Transfer of design, construction and operating risk.
- b. Potential to accelerate construction program.
- c. Risk transfer provides incentive for private sector contractor to adopt a whole life costing approach to design.
- d. Promotes private sector innovation and improved value for money.
- e. Improved quality of operation and maintenance.
- f. Contracts can be structured to address most concerns.
- g. Government able to focus on core public sector responsibilities.

4.8.3 Potential Weaknesses

- a. Possible conflict between planning and environmental considerations.
- b. Contracts can be more complex and tendering process can take longer than for Design and Build.
- c. Contract management and performance monitoring systems required.
- d. Cost of re-entering the business if operator proves unsatisfactory.
- e. Does not attract private finance (if it is required) and commits public sector to providing long term finance.

4.9 Design, Build, Operate and Finance (DBOF)

This is a contract with a private sector contractor to design, build, operate and finance a facility for a defined period, after which the facility is handed back to the public sector. The facility is owned by the private sector for the period of the contract and the private sector recovers its costs through public subvention. Key driver is the utilization of private finance in addition to the transfer of design, construction and operating risk. Variant forms involve different combinations of the responsibility for design, build, finance, operate, own and transfer. Table 4.2 is a schematic illustration of a typical DBOF Arrangement and describes the key players.

4.8.1 Potential Application

- a. Suited to projects that involve a significant operating content.
- b. Particularly suited to roads, water and waste projects, hospitals, schools,

4.8.2 Potential Strengths

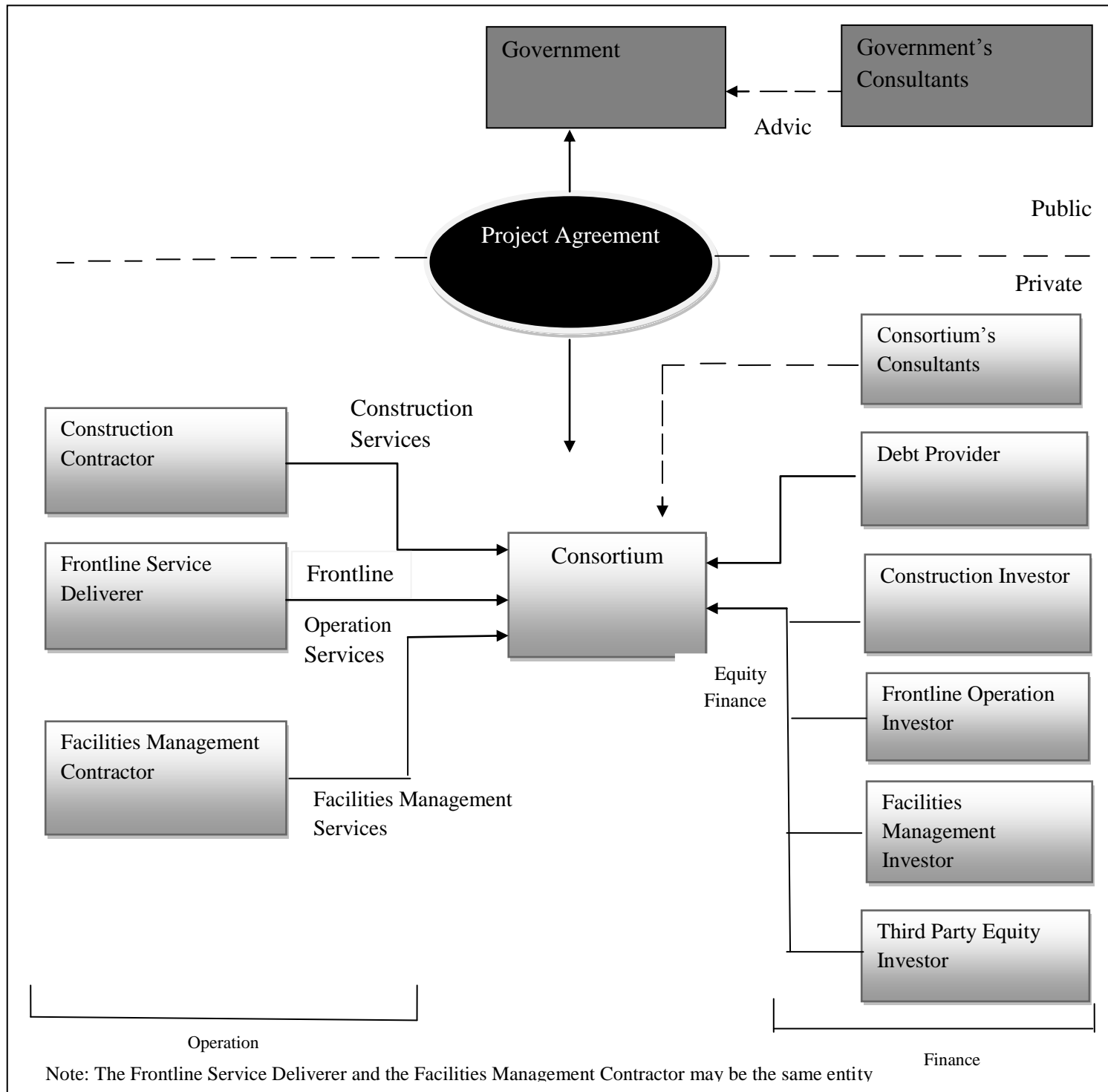
- a. As for Design, Build and Operate plus:
- b. Attracts private sector finance;
- c. Attracts debt finance discipline;
- d. Delivers more predictable and consistent cost profile;
- e. Greater potential for accelerated construction program; and
- f. Increased risk transfer provides greater incentive for private sector contractor to adopt a whole life costing approach to design.

4.8.3 Potential Weaknesses

- a. Possible conflict between planning and environmental considerations.
- b. Contracts can be more complex and tendering process can take longer than for Design, Build and Operate.
- c. Contract management and performance monitoring systems required.
- d. Cost of re-entering the business if operator proves unsatisfactory.

- e. Funding guarantees may be required.
- f. Change management system required.

Table 4.2: Schematic Presentation of a Typical DBOF Arrangement



5.0 ADDRESSING PRO-POOR ACTIVITIES IN PPPS

5.1 *Pro-Poor Interventions in the Context of PPPs*

To encourage the private provider to serve low-income groups (LIGs)³ under PPP, it is vital to examine and determine the most appropriate low-cost mechanisms of providing service, pricing structures that encourage customer payment, low-cost financing for system extension, and other contract mechanisms relevant to the specific characteristics of the low-income population groups and the particular service or facility to be financed under PPP arrangement.

There are many ways of making PPP arrangements more responsive to the requirements of low-income consumers. These include both contract provisions or content and changes in the overall approach to the reform agenda. Specifically:

5.1.1 Reform Framework

- a. The policy commitment to LIGs needs to be clarified and strengthened.
- b. There shall be common agreement on which segments of the population constitute LIGs, as well as which institutional entity is responsible for updating the definition of LIGs and monitoring their access to service.
- c. Current data shall be collected on LIGs in terms of service, preferences, and access. These data will be used to inform strategies and coverage targets and set a baseline for measuring progress. Consultation within the LIG community shall be an ongoing exercise to understand current service levels, constraints, and preferences.
- d. There shall be an affirmative decision towards (frank consideration of the role of) existing or potential small-scale providers or informal service providers and the potential to use those providers for the short to medium term to fill gaps in service until coverage through PPP is expanded.
- e. The existence of any legal prohibitions against serving informal settlements or to tailoring service standards to the constraints of a community shall be reexamined.

5.1.2 Financial considerations

- a. The government's policy on subsidies shall be re-examined in the context of cost recovery goals under PPP.
- b. There shall be consideration of whether user fees are a greater disincentive to service than the ongoing payments for service. If so, the user fee shall be reexamined in terms of level and application.
- c. Mechanisms to facilitate payment, such as prepayments, increased pay points, frequent billing, and others shall be considered.

³ Low Income Group is the proportion of a population with a persistent low household income, hence unable to afford basic life necessities such as food, decent shelter, health and medical services, clothing, education for children and cannot access development services such as bank credits

5.1.3 The PPP Contract

- a. The contract shall include the flexibility to implement the right level of service appropriate to the financial capability of the LIGs, with potential to upgrade.
- b. Likewise, the technology and construction standards shall be appropriate but low cost.
- c. The potential for LIGs to contribute in-kind through labor shall be considered.
- d. The contract shall allow for partnership or co-existence of large and medium enterprises with small-scale providers or communities where appropriate to be able to reach a particular LIG.
- e. In addition, the Contract shall specify the following issues, among other things:
 - Who will own the infrastructure at the end of the project?
 - Who is responsible for investment, if required?
 - Who must maintain the infrastructure and how frequently?
 - Who will collect revenues and how the revenues will be managed and utilized?
 - How will payments to and between partners be made and when?
 - How long a period is the partnership?
 - Who will set service delivery standards?
 - How will performance be monitored and by who?
 - What will be the penalties for non-performance?
 - What can affected communities do if the service is not right (faulty)?
 - How will tariffs be set and by who, including provisions for tariff adjustments?

5.1.4 The PPP bid process

- a. If bidders were to have obligations in terms of LIG service, they require reliable data on LIGs and make site visits to their locations. This is the responsibility of the LG.
- b. Bidders can be required to present their past experience in serving LIGs and to explain their present strategy under the PPP contract at hand.

5.2 Output-Based Aid Contracts

OBA provides a way in which international financial institutions can directly structure their financing to benefit poor people, even when the service provider is a private company.

OBA is the use of explicit, performance-based subsidies funded by the donor to complement or replace user fees. It involves the contracting out of basic service provision to a third party—such as private companies, NGOs, CBOs, and even public service providers—with subsidy payment tied to the delivery of previously specified outputs. This means that targeted and valuable subsidies to disadvantaged populations are funded through donor funds. The private partner, meanwhile, can only recover this funding by achieving specific performance outcomes. A global multi-trust fund was created in 2003, the Global Partnership for Output Based Aid, to provide increased access to reliable basic infrastructure and social services to the poor in developing countries through the wider use of OBA approaches.

Generally, OBA schemes finance three types of subsidies:

- i. **One time.** These would include subsidies for utility connections with the collected user fees covering longer-term operation and maintenance costs. These have been the most common under OBA schemes to date.
- ii. **Transitional.** Transitional subsidies are used to ease the transition of the project to charging full cost recovery tariffs.
- iii. **Ongoing.** Ongoing subsidies are linked to a sustainable source of funding such as general tax revenues, earmarked tax revenues, or explicit cross-subsidies.

These subsidies are used to complement the existing funding source. This has been less used and requires longer disbursement periods.

OBA also transfers risk to the operator in several ways. First, OBA links payment of the subsidy to performance outcomes, maintaining pressure on the operator to reach agreed upon service and commercial targets. Second, OBA schemes determine and pay the total level of subsidy ex post. Thus, the operator runs some risk should payment not be made by the government as agreed.

Typically, OBA payments relevant to pro-poor service are linked to outcomes related to consumption and coverage expansion, but OBA schemes are also applied to BOT projects that might have an indirect, positive impact on the poor.

For OBA to work there has to be a process for monitoring and verifying delivery of the specified outputs, to pay out an accurate subsidy.

6.0 HANDLING UNSOLICITED PPP PROJECTS PROPOSALS

6.1 Introduction

An unsolicited proposal is a written proposal that is submitted to a LG on the initiative of the submitter for the purpose of obtaining a contract with the Government. Usually the Local Government may be confronted with unsolicited proposals from the private sector enterprises operating within or from outside its jurisdiction.

6.2 Potential Merits of Unsolicited Proposals

Unsolicited project proposals (bids) have become a major source of innovation project ideas for the public sector. They are important in that they raise the interest of Local Governments in PPPs. Such proposals are typically submitted by private entrepreneurs in which process the Local Government gets some ideas about how services could be provided or expanded through private sector partners' involvement. This stimulates and motivates the Local Government to think creatively to address the problems which it might not have answers. Accepting unsolicited proposals allows government to benefit from the knowledge and ideas of the private sector.

6.3 Problems of Unsolicited Proposals

While unsolicited proposals have the advantage of introducing innovative solutions to problems in Local Governments (or the public sector in general), they also pose complex questions:

- 1) Does the proposal actually address a priority concern of the Local Government?
- 2) Is it an attractive and sounding proposal that will bring benefits not included in existing development plans?
- 3) Has the Local Government made sure that the proposal gives the best deal in terms of providing this service?
- 4) Is the proposal economically and financially feasible and sustainable, i.e. is there sufficient demand for the proposed service to sustain consumer willingness to pay, or a governmental acknowledgement that it needs to support the service through subsidization because the people who cannot pay need the service anyway?
- 5) Does the proposal have a well prepared, analysed and structured financing plan for the project?

6.4 Approaches to deal with Unsolicited Proposals

Approaches have been developed by some countries⁴ to deal with unsolicited proposals. Some of these include:

- a. In a formal fair and open bidding process, a predetermined bonus point is awarded to the original proponent of the project;

⁴ A Guidebook on Public-Private Partnerships in Infrastructure

- b. Ensure projects based on unsolicited proposals are subject to competitive pressure. The Swiss Challenge System allows other parties to make better offers than the original proponent within a specified period of time. If a better offer is received, the original proponent has the right to counter match any such better offer;
- c. The Local Government can purchase the project concept and then award it through competitive bidding process;
- d. Encourage private investors to develop proposals for PPP projects that address policy priorities in relevant sectors;
- e. Conduct a screening process to determine the merit of the project and its conformity with the existing national legal, regulatory and policy environment. In addition, assess the suitability and likely effects of the proposed project on the sector and market; assess the risks and how they will be shared (between the proponent and the Local Government); the responsibilities of, and liabilities on the Local Government; the financing proposal; the main terms of the contract; and the competency of the project sponsor. When a transparent procedure is in place, an initial screening is undertaken

7.0 PREPARING FOR SERVICE DELIVERY THROUGH PUBLIC PRIVATE PARTNERSHIP

This chapter presents the ways in which a PPP project can be financed. Two aspects are critical to consider: financial arrangement for the PPP itself, and affordability of the public partner and consumers of the PPP services.

7.1 Commercial, Financial, and Economic Preparation

In designing and preparing PPP, there must be a process to balance service levels with the tariff levels, creating a package of price and service which is acceptable to customers and sustainable for the provider. Critical to this analysis is the structure of payments to and revenues for the private partner, including any subsidies that might be required.

This iterative process will encompass:

- a. Technical analysis—to determine the cost of service;
- b. Market and social research—to determine what people are willing and able to pay for certain service levels;
- c. Financial analysis and modeling—to determine the cost recovery tariff required to support the desired coverage targets and service levels; and
- d. Consultation and trade-offs—to agree any transitional subsidies until cost recovery is achieved or ongoing subsidies, e.g., to low-income customers. If the subsidies are not available, coverage and service targets may need to be reduced.

7.2 Project Financing

a. Sources of project finance

The project finance may come from a variety of sources. The main sources include equity, debt and government grants. Financing from these alternative sources have important implications on project's overall cost, cash flow, ultimate liability and claims to project incomes and assets.

Equity refers to capital invested by sponsor(s) of the PPP project and others. The main providers of equity are project sponsors, government, third party private investors, and internally generated cash. The commitment of equity for project finance comes with a designated rate of return target, which is higher than the rate of borrowed capital as debt. This is to compensate the higher risks taken by equity investors as they have junior claim to income and assets of the project.

Debt refers to borrowed capital from banks and other financial institutions. It has fixed maturity and a fixed rate of interest is paid on the principal. Lenders of debt capital have senior claim on income and assets of the project. Generally, debt finance makes up the major share of investment needs (usually about 70 to 90 per cent) in PPP projects. The common forms of debt are:

- i. **Commercial loans** are funds lent by commercial banks and other financial institutions.
- ii. **Bridge financing** is a short-term financing arrangement (say for the construction period or for an initial period) which is generally used until a long-term (re)financing arrangement can be implemented. Refinancing after a project is implemented may allow more favourable lending conditions which can reduce overall borrowing costs.
- iii. **Bonds** are long-term interest bearing debt instruments purchased either through the capital markets or through private placement (which means direct sale to the purchaser, generally an institutional investor).
- iv. **Subordinate loans** are similar to commercial loans; however, they are secondary or subordinate to commercial loans in their claim on income and assets of the project. To promote PPPs, governments often provide subordinate loans to reduce default risk, reduce the debt burden and improve the financial viability of projects.

The other sources of project finance include **grants** from various sources, supplier's credit, etc. Government grants can be made available to make PPP projects commercially viable, reduce the financial risks of private investors, and achieve some socially desirable objectives such as to induce growth in a backward area. Many Governments have established formal mechanisms for the award of grants to PPP projects. Where grants are available, depending on government policy they may cover 10 to 40 per cent of the total project investment.

b. *Providers of finance*

The main providers of finance for the PPP projects are:

- i. Equity investment from project promoters and individual investors;
- ii. National and foreign commercial banks and financial institutions;
- iii. Institutional investors;
- iv. Capital market; and
- v. International financial institutions

Loans provided by national and foreign commercial banks and other financial institutions generally form the major part of the debt capital for infrastructure projects. The rate of interest could be either fixed or floating and normally loans are provided for a term shorter than the project period. Often two or more banks and financial institutions participate in making a loan to a borrower known as syndicated loan. Refinancing of the loan is required when the loans are provided for a maturity period shorter than the project period.

The capital market is another a major source of funding. Funds may be raised as both equity and debt from the capital market by placement of shares, bonds and other negotiable instruments on a recognized domestic or foreign stock exchange. Generally, the public offering of these instruments requires regulatory approval and compliance with requirements of the concerned stock exchange.

Institutional investors such as investment funds, insurance companies, mutual funds, pension funds normally have large sums available for long-term investment and may represent an

important source of funding for infrastructure projects. Generally the institutional investors provide loans as subordinated debt.

International and regional financial institutions such as the World Bank, Asian Development Bank, the European Investment Bank, the Agence Francaise de Development and Islamic Development Bank can provide loans, guarantees or equity to privately financed infrastructure projects.

When investors and financiers consider financing a project, they carry out extensive due diligence works in technical, financial, legal and other aspects of the PPP deal. This due diligence is intended to ensure that the project company's (or SPV's) business plan is robust and the company has the capacity to deliver on the PPP contract.

c. *Compensation to project sponsor/developer*

There are five main ways to compensate a private investor of a PPP project:

- i. Direct charging of users (consumers of the service or facility)
- ii. Indirect charging of (third party) beneficiaries : those that acquire and use the company's products
- iii. Cross-subsidization between project components
- iv. Payment by the Government (periodic fixed amount or according to use of the facility, product or service)
- v. Grants and subsidies (already discussed in a separate section)

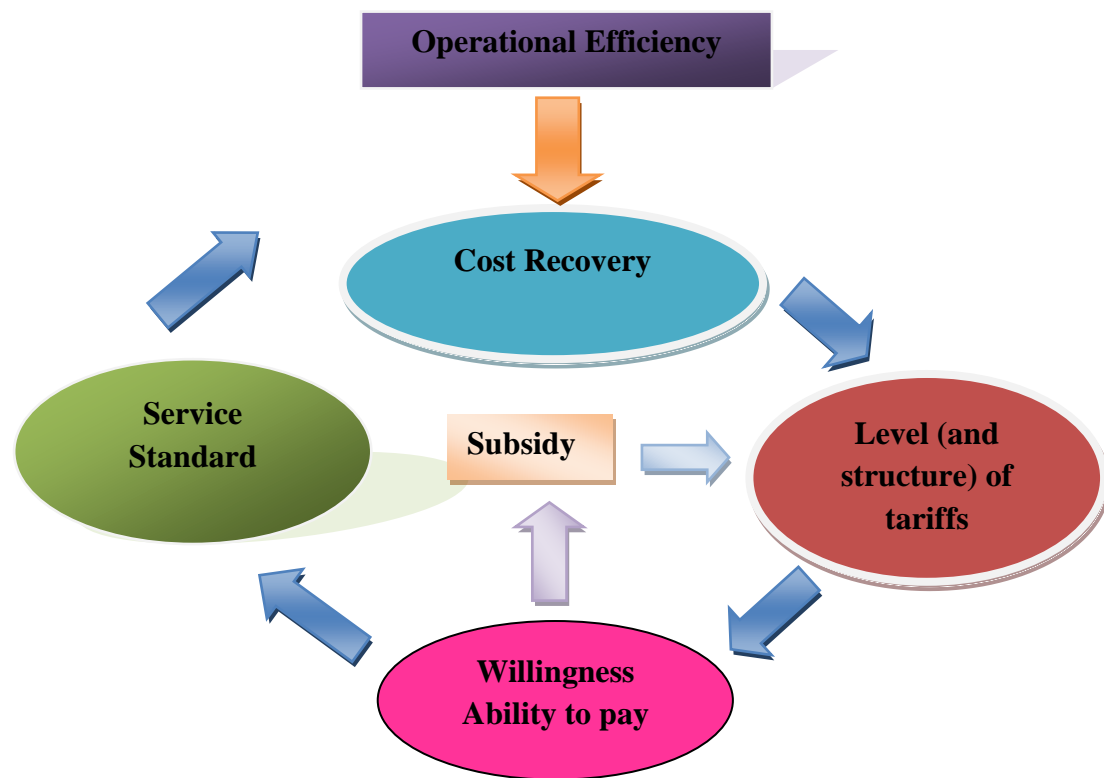
7.3 *Tariff Design*

The private partner (including individuals and companies) is a commercial enterprise that survives on profit making. If the price cannot be raised and a minimum service standard must be provided, then two important ingredients are important to minimize the cost of delivering the service, namely operational efficiency and innovativeness.

Therefore, tariffs need to balance a number of objectives:

- (i) Stipulated service standard and associated costs,
- (ii) Customers' willingness and ability to pay,
- (iii) Resulting cost recovery,
- (iv) Required economics (return on investment) for private operator, and
- (v) Need for/availability of subsidies.

Figure 7.1: The Iterative Process of Designing Tariffs



Source: Heather Skilling and Nils Janson 2006

The right combination of factors must be determined through an iterative optimization process. In essence, the private partner must be motivated to perform while the public partner must effectively oversee performance based on established/agreed service standards.

Designing Tariffs must take account of the following objectives:

- i. cost recovery/return on investment,
- ii. incentives for efficiency,
- iii. fairness and equity⁵, and
- iv. simplicity and comprehensibility

7.4 Cost recovery/return on investment

The combination of service standards (costs) and tariffs (revenues) determines the commercial viability of a project. Beyond that, the private operator has the chance to improve the ultimate financial outcome by being particularly efficient in investment and operations.

Therefore, a private operator will only get involved in a project if it sees a fair chance to make a profit given a predetermined set of service standards and tariffs.

⁵ Equity in this regard refers to the quality of being fair or impartial

The internal rate of return (IRR) and return on equity (RoE) are the most commonly used measures to assess the financial attractiveness from a private operator's perspective

7.5 Tariff Adjustments

To expect one set of tariffs, or even a tariff structure or regime, to remain viable and appropriate over the typical life of a PPP project is unrealistic. It is therefore essential to define practical rules for adjustments. This requires defining:

- i. The triggers or drivers for a price adjustment, such as changes in raw material prices (such as oil prices for power), inflation, and exchange rate fluctuations (where the operator had to assume un-hedged foreign currency exposure);
- ii. The mechanisms by which the adjustment will be made, including cost plus and price cap regulation; and
- iii. The frequency of adjustments including pass-through costs, tariff indexation, tariff resets done by for example utility companies, and extraordinary tariff adjustments.

Mechanisms

There is a difference between the regulatory requirements of utilities, such as waste management, electricity, water, and telecommunications, and other forms of public infrastructure, such as roads.

7.6 Subsidy Design

Government subsidies are instituted in situations where it is assumed that target consumers cannot pay the required user charges. They can be used to make a project commercially viable from the perspective of the private operator even if the desired combination of service and tariff levels does not result in sufficient cost recovery. This will only make sense if the aggregate cost to the government under PPP (including subsidy) is lower than the cost to the government of operating the service fully under the public sector or the cost of not providing the service at the required service levels. The question is: how will the subsidy be set up so as not to reduce the effectiveness of the PPP project?

7.6 Monitoring and Evaluation of a PPP Project This will involve putting in place the following mechanisms:

- i. Spelling out and allocating the responsibility and approach for tariff setting (if appropriate)
- ii. Spelling out and allocating responsibility and method of performance monitoring of the private sector
- iii. Determining and describing the role of consumers/stakeholders in performance monitoring and regulation

8.0 INVOLVING STAKEHOLDERS IN THE DESIGN OF THE PPP ARRANGEMENT

8.1 Identifying the stakeholders

Ideally, every project has primary and secondary stakeholders. Primary stakeholders are those directly affected by the project or who can directly affect it; secondary stakeholders are those who are less directly involved and affected by the project. Participation in decision making is the main methodology for involving people in the analysis of issues and the design of associated solutions. This ensures that the voices of the poorest and most vulnerable groups in the population are heard and taken into consideration (UNDP, PPPUE 2004).

In designing a PPP project, the LG needs to consider the interests of different stakeholders, including

- a. Contracting parties (local authorities/ service operator)
- b. Key stakeholders (those who strongly influence the pp p i.e. contracting parties, nation al and local governments, investors donors consumers and civil society)
- c. Households, Community and Gender/ Youth groups collectively defined as beneficiaries.
- d. The purpose of stakeholder analysis is to allocate responsibility to the parties (persons/ groups) based placed to manage and deal with the tasks

The LG will benefit from engaging with these groups to ensure their views are understood and that they participate—and feel they’ve participated—in the design of the arrangement.

8.2 Why carry out a stakeholder analysis?

Stakeholder Analysis:

- a. Draws out the interests of stakeholders in relation to the project’s objectives – stakeholders who will be directly affected by, or who could directly affect, the project are clearly of greater importance than those who are only indirectly affected;
- b. Identifies actual and potential conflicts of interest – a stakeholder who is vital to the project may have many other priorities and you need to know this so that you can plan how to engage with them;
- c. Identifies viability other than in pure financial terms (e.g. includes social factors) – for example staff who will be using a new system might be worried about the change;
- d. Helps provide an overall picture including potential risks, for example from negative stakeholders and their adverse effects on the project;
- e. Helps identify relationships between different stakeholders – helping to identify possible coalition.

The main processes used in identifying stakeholders include:

- a. Identification of potential stakeholders by conducting stakeholder analysis;
- b. Gathering substantial amount of information about the key stakeholder groups and their leaders;
- c. Conduct stakeholder analysis, in order to determine the potential roles and contributions of the many different stakeholders;
- d. Based on this analysis, develop a plan for how to involve each stakeholder group in subsequent stages of the project/ policy work. Specifically the information may include:
 - i. Existing and potential stakeholders (individuals, organizations and groups);
 - ii. The individuals/ leaders within the stakeholders group (key stakeholders);
 - iii. The capacity of the organization to engage in service related activity;
 - iv. The capacity and attitudes of stakeholders to work in partnership with other sectors;
 - v. The interests of each stakeholder – overt and hidden;
 - vi. The potential role of the stakeholder;
 - vii. The likely impact of the stakeholder – positive or negative;
 - viii. The risks and assumptions about stakeholder actions;

8.2 Conducting a Stakeholder Analysis

Stakeholder analysis is the process of identifying the individuals and groups or communities that are likely to affect or be affected by a proposed action, and sorting them according to their impact on the action and the impact the action will have on them individually or as a group. It helps to assess how the interest of those stakeholders should be addressed in a project plan, policy, programme or other action. Conducting a Stakeholder Analysis assists the PPP in allocating responsibilities to identified interest parties:

Below are examples of stakeholders:

- a. communities and users of the service/facility,
- b. CBOs/NGOs,
- c. local government and other government bodies (political level and technical officials),
- d. local private companies (formal and informal),
- e. business associations and consulting firms,
- f. foreign companies and investors
- g. domestic companies and investors including credit groups and cooperatives
- h. institutional investors (pension funds and insurance companies),
- i. trade unions
- j. domestic and foreign banks, experts and professionals

9.0 PPP PROJECT CYCLE: PHASES, STAGES AND STEPS

This Chapter presents elements of the PPP Project cycle in terms of phases, stages and steps, illustrated in the matrix below:

Table 9.1: The PPP Project Cycle reflecting the Phases and Steps to be followed

Phases	Stages	Steps
1. Project Identification and Inception	1.1 Project selection and definition	<ul style="list-style-type: none"> ▪ The needs analysis
	1.2 Preliminary assessment of the PPP options	<ul style="list-style-type: none"> ▪ Affordability ▪ Risk allocation ▪ Bankability ▪ Value for money
2. Detailed Preparation	2.1 Getting organised	<ul style="list-style-type: none"> ▪ Project team ▪ Advisory team ▪ Plan and timetable
	2.2 Feasibility	<ul style="list-style-type: none"> ▪ Needs Assessment ▪ Option analysis ▪ Project due diligence ▪ Value assessment ▪ Economic valuation ▪ Procurement plan ▪ Feasibility study report ▪ Revisiting feasibility study
	2.3 Before launching the tender	<ul style="list-style-type: none"> ▪ Further studies ▪ Detailed PPP design ▪ Procurement method ▪ Bid evaluation criteria ▪ Tender documents ▪ Draft PPP contract
3. Procurement	3.1 Bidding process	<ul style="list-style-type: none"> ▪ Notice ▪ Prequalification (EOI) ▪ Invitation to tender ▪ Receipt of bids
	3.2 Evaluation process	<ul style="list-style-type: none"> ▪ RFP Evaluation Process ▪ Confidentiality and Communications ▪ Conflict of Interest (Relationship) Review ▪ Approval process ▪ Contract award
	3.2 PPP contract and financial close	<ul style="list-style-type: none"> ▪ Final PPP contract ▪ Financing agreements ▪ Financial close
4. Project Implementation	4.1 Contract management	<ul style="list-style-type: none"> ▪ Management responsibilities ▪ Partnership management ▪ Service delivery management ▪ PPP Contract administration ▪ Key challenges and tasks of PPP

Phases	Stages	Steps
		<ul style="list-style-type: none"> agreement management ▪ Monitoring service outputs ▪ Changes to the PPP contract ▪ Dispute resolution ▪ PPP contract termination
	4.2 Ex post evaluation	<ul style="list-style-type: none"> ▪ Institutional framework ▪ Analytical framework

The project cycle as applied in South Africa, is a good example for Uganda Local Government to learn from, the stages of inception involve:

9.1 Project identification and Inception

9.1.1 Project selection and definition

The ultimate objective of the project selection process is to ensure that the PPP project offers value for money. Value for money refers to the best available outcome for society, account being taken of all benefits, costs and risks over the whole life of the project.

In order to consider the PPP procurement option, the LG needs to answer a set of key questions:

- i. Is the project affordable? Will users or the LG, or both, pay for the project? How will they pay (e.g. user charges, operating subsidies, public sector or CG grants)?
- ii. What are the key sources of risk in the proposed project? What is the optimal risk allocation and risk management strategy?
- iii. What are the financing sources for the proposed project? Will the project be “bankable” (i.e. capable of raising debt finance)? Will it attract investors? Will it comply with the requisites for CG funding?
- iv. Even if the project is affordable and bankable, does the project represent value for money?

The needs analysis

It is important that the LG does initial needs analysis and considers its options for meeting these needs within its mandate and strategy for delivery. The full needs analysis and solution options analysis will be done by the project officer and his or her team and the transaction advisor as part of the feasibility study. The work in the feasibility study phase must be based on the LG’s preliminary assessment of its needs and options here

9.1.2 Preliminary Assessment of the PPP option

a. Affordability

Affordability relates to the capacity to pay for constructing, operating and maintaining the project, be it the capacity to pay of the users of the services or that of the LG; whether the cost of the project over the whole project term can be accommodated in the LG’s budget, given its existing commitments.

An affordability assessment requires a careful analysis of the expected operating and maintenance costs of the project, together with the levels of cash flow required to repay the loans and provide a return to the investors in the PPP Company. The financial and technical advisers will develop a financial model to assess alternatives in terms of a range of capital, operating and maintenance cost estimates, appropriate cost escalation indexes, assumed financing structure and preliminary PPP contract terms.

The assessment of costs translates into an estimate of the required revenues to meet those costs:

- i. In PPPs where users pay directly for the service (“revenue based PPPs”), the LG’s and its advisers need to examine the capacity and willingness of users to pay, especially if tariffs need to be increased from current levels. In many Pro-PPPs, the public sector will need to subsidize the service in order to make it affordable. The use of public subsidies can impact the value for money of a PPP arrangement, requiring that the efficiency savings from the PPP option be large enough to compensate for the use of public funds.
- ii. In PPPs where the LG makes the payments (“availability-based PPPs”), the assessment of affordability is a key consideration in the design of the transaction. The LG will enter into payment obligations over the life of the PPP contract (the so-called “service fee”), which represent long-term commitments and can influence the design of the transaction and its value for money proposition.

Sometimes options that combine direct charges to users with service fees may need to be examined.

Thus affordability relates not only to the financial balance of the PPP arrangement, but also to public expenditure items in general. A PPP project is considered to be affordable if the public expenditure associated with it can be accommodated within the public sector’s budget ceiling over time.

b. Risk allocation

Achieving the value for money that justifies the PPP option also depends on the ability to identify, analyse and allocate project risks adequately. Failure to do so will have financial implications. Thus, at the project identification stage, in addition to assessing the sources of revenue linked with the affordability of the project, the LG and its advisers need to undertake a broad assessment of the risks that arise from the project requirements in order to manage them.

Risk management takes place in five stages:

- i. Risk identification: the process of identifying all the risks relevant to the project, whether during its construction phase or its operational phase;
- ii. Risk assessment: determining the likelihood of identified risks materializing and the magnitude of their consequences if they do materialize;
- iii. risk allocation: allocating responsibility for dealing with the consequences of each Risk to one of the parties to the PPP contract, or agreeing to deal with the risk through a specified mechanism which may involve sharing the risk;

- iv. Risk mitigation: attempting to reduce the likelihood of the risk occurring and the degree of its consequences for the risk-taker; and
- v. Risk monitoring and review: monitoring and reviewing identified risks and new risks as the PPP project develops and its environment changes. This process continues during the life of the PPP contract.

c. Bankability

A PPP project is considered bankable if lenders are willing to finance it (generally on a project finance basis). The majority of third-party funding for PPP projects consists of long-term debt finance, which typically varies from 70% to as much as 90% of the total funding requirement (for example, in an availability-based PPP), depending on the perceived risks of the project. Debt is a cheaper source of funding than equity, as it carries relatively less risk. Lending to PPP projects (usually referred to as non or limited-recourse finance) looks to the cash flow of the project as the principal source of security.

The LG needs to assess financial risks thoroughly. The financial risks experienced by PPP projects tend to be related to some or all of the following factors:

- i. Reliance on optimistic revenue assumptions and on levels of demand from a poorly chosen “baseline” case;
- ii. Lack of attention to financing needs in the project feasibility, which leads to larger amounts of debt in projects;
- iii. Long-term PPP projects that are financed with short-term debt, coupled with a sometimes unjustified assumption that the short-term debt can be rolled over at the same or even better refinancing conditions; floating rate debt that creates interest rate risk;
- iv. LG which ignore the incentives the PPP Company may have to renegotiate the contractual arrangements in its favor; and
- v. Refinancing that can create unforeseen benefits for the PPP Company, which the LG might not share if the contract does not explicitly provide for this possibility.

d. Value for Money

The main driver of the PPP is Value for Money (VfM), defined as ‘the optimal combination of whole life cost and quality to meet the users’ requirements’. Generally, VfM is achieved through:

- i. risk transfer which allocates risks optimally between the public and private sectors
- ii. long term nature of contracts (which embodies whole life costing)
- iii. the use of output specification which allows bidders to innovate
- iv. competition that provides fair value of the project
- v. performance-based payment mechanism
- vi. private sector management expertise and skills

A PPP project yields value for money if it results in a net positive gain to society which is greater than that which could be achieved through any alternative procurement route. It is good practice to carry out a value for money analysis (essentially a cost-benefit analysis) as part of the initial preparation of a project, regardless of whether it is procured conventionally or as a PPP.

In some countries like the UK, Australia and South Africa which have extensive PPP programmes, a PPP project is said to achieve value for money if it costs less than the best realistic public sector project alternative (often a hypothetical project) which would deliver the same (or very similar) services. This public sector alternative is often referred to as the “public sector comparator” (“PSC”).

Carrying out a PSC exercise is part of building the business case for a PPP project. It is a legal requirement in many PPP programmes worldwide. LGs need to make various cost adjustments to be able to undertake a detailed quantitative comparison between the PPP project and the PSC.

It is generally assumed that the PPP option will be more efficient in investment, operating and maintenance costs than the PSC. So the key question in assessing value for money is usually whether the greater efficiency of the PPP project is likely to outweigh factors that might make the PPP more costly, the main ones being transaction and contract oversight costs (i.e. additional bidding, contracting and monitoring costs in a PPP setting) and financing costs (i.e. possible added costs due to private sector financing, especially equity financing).

The value for money assessment should also take into account the potential non-financial benefits of PPPs such as the accelerated and enhanced delivery of projects.

- i. There is a major investment program, requiring effective management of risks associated with construction and delivery. This may be a single major project or a series of replicable smaller projects;
- ii. The private sector has the expertise to design and implement the project;
- iii. The public sector is able to define its service needs as outputs that can be written into the PPP contract ensuring effective and accountable delivery of services in the long run;
- iv. Risk allocation between the public and private sectors can be clearly identified and implemented;
- v. It is possible to estimate on a whole-of-life basis the long-term costs of providing the assets and services involved;
- vi. The value of the project is sufficiently large to ensure that procurement costs are not disproportionate; and
- vii. The technological aspects of the project are reasonably stable and not susceptible to short-term and sudden changes.

The project identification phase therefore involves an early assessment of what payment structure is feasible, what the LG or the users can afford to pay (and when), the impact on the project scope and the service levels, and the associated risks the private sector might be prepared to accept. This exercise should help the LG to identify and manage any long-term fiscal obligations (implicit and explicit) that may result from the PPP project.

9.2 Detailed Preparation of the Project

9.2.1 Getting Organized

1. Registering the Project

When a LG decides to explore a PPP as a procurement choice for a project, and has done initial needs assessment, the accounting officer should call a meeting with the relevant technical department to discuss the possible project(s) and the existing resources (human and budgetary) available, and agree on how to approach the work that lies ahead.

The following will be important considerations for the LG to determine how best to take the project forward:

- i. What work has the LG done to define its needs and assess its options for a solution?
- ii. What budget does the LG have:
 - o For meeting these needs, and
 - o For financing project development costs, including the cost of a project officer, project management and administration, and hiring a transaction advisor?
- iii. Have any consultants been hired already for the project? If so, what is their brief, and on what terms?
- iv. Is there an internal senior manager who is suitably skilled and experienced to be appointed as full-time project officer?
- v. Is the accounting officer willing and able to assign delegations, budgets and administrative support to the project officer, and include him or her in the senior management team of the LG?
- vi. Is a single project envisaged, or are there a number of them?
- vii. Can a number of projects either be bundled into a single project or developed simultaneously in the PPP project cycle to optimize use of project development resources?
- viii. What is the LG's envisaged timeframe for the project?
- ix. Has the accounting officer obtained the support of the relevant Minister for the project?

2. Set up the project team and governance structure

The complexity and scale of most PPP projects will usually justify a team-based management approach to ensure that all the required skills are effectively applied. A common way of implementing effective project governance for PPP project development is by a system of committees.

- i. A project "steering committee", comprising the main public sector stakeholders and led by a senior officer within the LG who is responsible for delivering the project; and
- ii. A project management team, responsible for managing the PPP project (including managing advisers) and reporting to the steering committee. The committee:
 - a. Provides strategic direction and ensures management and political buy-in in all the project cycle phases
 - b. Oversees project development budgets and expenditure
 - c. Ensures that the progress of the project is effectively communicated within the institution and to the public where required
 - d. Approves the deliverables of the transaction advisor

- e. Reviews and endorses documentation to be submitted to the accounting officer/LG for the applications for the ministry approvals.
- iii. The transaction advisor should participate actively in the regular meetings of the project team. For day-to-day project management, the project officer will need to set up structured working arrangements with the transaction advisor and the project advisor.

3. Appointing a Project Officer

Appointing a project officer is of particular importance. During the intense procurement phase, this will be a full-time job. The skill set should include familiarity with private business as well as an understanding of how government administration works.

4. Attracting a Transaction Advisor (TA)

A transaction advisor is a person or group of persons (firm or company) that either possesses or has access to professional expertise in financial analysis, economic analysis, legal analysis, environmental impact analysis, contract documentation preparation, tender processing, engineering or cost estimating. A transaction advisor assists in bringing a PPP project from the concept stage through public bidding and award to actual execution.

The importance of having a strong group of expert advisers in place cannot be overstated. A well-structured and properly marketed transaction will ensure the success of the PPP and maximise the proceeds to LG /minimise payments to the private contractor. This is why transaction advisors are a useful investment and not an unnecessary expense.

The engagement of PPP advisers requires sufficient resources to be budgeted for early in the project cycle. The project management team will require different types of advisers for different phases of the PPP project preparation process. Consultants will almost certainly have been used to prepare the various feasibility reports. They may have been hired separately and in a more *ad-hoc* manner. It is when the procurement phase begins that a comprehensive plan needs to be developed for how advisers will be used:

The core team of advisers for the procurement phase will usually consist of

- i. A financial adviser,
- ii. A technical adviser and
- iii. A legal adviser (each of these composed of more than one individual).
- iv. Other consultants will be required for specific inputs (e.g. separate consultants for environmental, social impact, regulatory risk and insurance matters).

The exact nature of the broad advisory team will depend on the project and the in-house resources available (refer to EU Checklist below).

Legal adviser

- Advise the public sector on the issue of the legal powers (*or vires*) necessary to enter into the project contracts;
- Assist in the assessment of the legal feasibility of the project;
- Advise on the appropriate procurement route;
- Advise on the initial contract notice;
- Advise on procurement documentation such as pre-qualification questionnaires, invitations to tender and evaluation criteria;
- Develop the PPP contract;
- Ensure that bids meet the legal and contractual requirements for submission;
- Evaluate and advise on all processes and contractual solutions throughout the procurement phase, including contract negotiation; and
- Provide support in the clarification and fine-tuning of legal aspects.

Technical adviser

- Draft the output requirements and specifications of the PPP project;
- Develop payment mechanisms in the PPP contract (with the financial adviser);
- Evaluate and advise on all technical solutions during the procurement phase;
- Undertake technical due diligence on bidders' solutions; and
- Carry out any site condition, planning and technical design work.

Financial adviser

- Support the development of all financial aspects of the project;
- Advise on how to secure the public funding for the project (if any);
- Advise on the applicability of specific sources of funding, and how these can be optimized in the funding structure;
- Ensure that all financial aspects of the bidders' solutions meet the requirements for submitting a bid;
- Optimize, scrutinize and possibly audit the financial models submitted by bidders;
- Evaluate and advise on financial proposals throughout the procurement phase;
- Advise on the bankability issues raised by the PPP contract;
- Undertake financial due diligence on the submitted bids;
- Assist in the negotiations with the lenders; and
- Assist in the strategy and completion of the interest rate and currency hedging at financial close.

Environmental adviser

- Examine the potential environmental impact of the project;
- Assist in environmental due diligence, including required permits and certifications;
- Identify potential environmental risks and how submitted bids address them; and
- Consider the mitigation of such risks and the impact on the scope and technical design of the project.

Source: EU PPP Guidance

LGs will pay careful attention to the incentives created by different ways of engaging advisers and remunerating them. For example, if the consultants hired to carry out the feasibility work are fairly certain that they will be kept on board to advise on the transaction, they may have a disincentive to disclose major problems for fear that preparation will not

continue. Alternatively if the transaction advisers are paid a success fee in full when the PPP contract is signed, they may have an incentive to deliver a project that is not bankable and will take many months (or years) to reach financial close. It may therefore be useful at the outset of the process for the LG to hire an initial high level consultant to assist in the planning of all the technical assistance that will be needed during the process (e.g. prepare terms of reference).

9.2.2 Feasibility Study

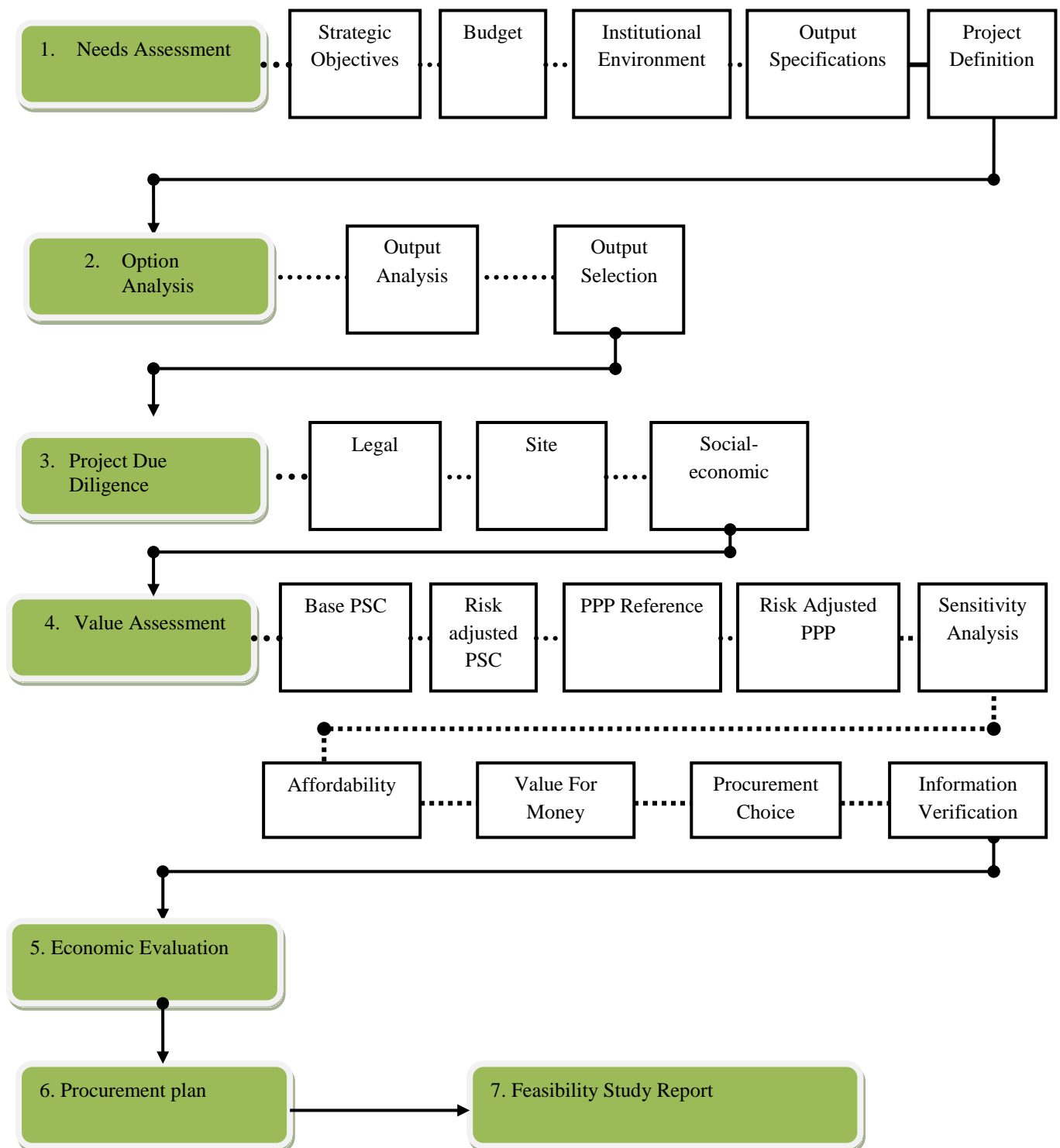
The feasibility study is a critical part of the project preparation period of the PPP project cycle. The feasibility study demonstrates "affordability", and gives an early indication of how value for money will be achieved, through appropriate risk transfer.

The feasibility study will have to

- i. Clearly demonstrate comparative advantage in terms of strategic and operational benefits of undertaking the project under the PPP agreement;
- ii. Describe in specific terms -
 - ✚ The LG's functions, the specific functions being considered in relation to the project and the expected deliverables;
 - ✚ The extent to which these functions can both lawfully, effectively and by nature be performed by a private party in terms of a PPP agreement; and
 - ✚ The most appropriate form by which the LG may implement the project under a PPP agreement.
- iii. Demonstrate that the PPP Agreement will
 - ✚ Be affordable to the public body;
 - ✚ Provide value for money; and
 - ✚ Transfer appropriate technical, operational and financial risk to the private party.
- iv. Explain the capacity of the LG to effectively enforce the agreement, including the ability to monitor and regulate project implementation and the performance of the private sector provider in terms of the agreement.

Conducting the Feasibility Study

Figure 9.1: The stages of the PPP feasibility study



Source: South Africa PPP Manual

9.2.3 Before Launching the Tender

This stage has two main goals:

- a. To further develop all aspects of the PPP design (e.g. responsibilities, risk allocation, payment mechanism) in a progressive and iterative manner, concluding with a full draft PPP contract; and
- b. To select the tendering method, decide on bid evaluation criteria and prepare the complete tender documents.

At the end of this stage, the project management team will be ready to prequalify consortia interested in bidding for the project and issue the invitation to tender. It is useful to end this stage at that point because clearance will be required before publishing the procurement notice and proceeding with the invitation to tender. The end of the stage is therefore an important milestone in the project delivery phase of the PPP cycle.

1. Carry out further studies

Even though the core technical, financial and economic studies will have been carried out during the feasibility phase, there may be a need for further, updated and more focused studies during the procurement phase:

- i. Appraising the project at the feasibility stage may have brought to light aspects where more detailed work is needed.
- ii. The studies during the feasibility phase will have been geared most of all to helping the LG take a “yes/no” decision and select from among major project alternatives, not necessarily to refine the PPP design in preparation for contract drafting.
- iii. As the PPP design advances, decisions about risk allocation may require additional studies. For example, in some projects (e.g. involving tunnels) it may be useful for the LG to carry out an initial study of ground conditions and make these available to bidders.

The LG and its team of advisers should take great care to ensure a clear delineation of the extent to which the private sector can rely on the results of information given by the Authority. Unintentional warranties given by the public sector can undermine risk transfer. Legal advice should always be sought on potential legal responsibility or liability arising out of the provision of information by the public sector to the private sector. As a general principle, the private sector should be required to do its own due diligence investigations rather than rely on information provided to it.

2. Prepare the detailed design of the PPP arrangement

All aspects of the PPP arrangement (e.g. responsibilities, risk allocation, payment mechanism) need to be developed in greater detail, with the ultimate goal of producing the draft PPP contract. It is advisable to deal with this in sub-steps rather than try to draft a full PPP contract right away. This simplifies the internal review process. It is better to focus the initial internal discussion and approval on the broad commercial aspects of project design rather than on detailed legal terms.

- i. The first step might be to prepare a document outlining the principal commercial terms (“heads of terms”). Once the heads of terms have been internally approved, the Authority should progressively develop and refine the different topics. Certain aspects (e.g. payment mechanism) might first require the advisers to prepare discussion notes presenting and assessing various alternatives.
- ii. The risk allocation of the PPP arrangement will be further developed with the help of advisers and the results checked against prevailing market conditions. Preliminary risk matrices or registers will have been used in the feasibility phase. They will be further refined in this phase. The assessment of demand risks is essential in PPP projects.
The allocation of demand risk is done through the payment mechanism in the PPP contract, which may seek to transfer some, all or none of the demand risk to the private sector
- iii. The financial model of the expected PPP (sometimes called a “shadow bid” model) is prepared initially by the Authority and its advisers for use in the feasibility analysis. In this phase, the shadow bid model should be further developed and refined and it should be used to examine alternative risk allocations and payment mechanisms.

3. Select the Procurement Method

Before engaging in the formal bidding process, the LG’s team will need to select a competitive procurement procedure. Several procedures are may be worthwhile

These procedures are not designed specifically for PPPs: they apply to all goods, works or services contracts.

a. Complexity of PPPs

The complexity of a PPP combined with the lack of specific legislation on PPPs means that it is essential for the LG to have a sound knowledge of the public procurement legal framework in advance of launching a tender. The LG’s team should include a procurement specialist who should work closely with the legal advisers to ensure compliance with national procurement legislation. In addition, it is advisable for the senior management team to have a working knowledge of the relevant procurement legislation.

b. Works and services concessions

Works and services concessions are arrangements under which the right to exploit the works or services rests with a “concessionaire”. Concessions must adhere to the basic principles (i.e. transparency, equal treatment, proportionality and mutual recognition).

c. Institutionalised PPPs

Institutionalised PPPs refer to a specific type of PPP where public and private parties establish an entity with mixed capital in which the private party takes part actively in the operation of contracts awarded to the partnership.

d. Four procedures

Procurement procedures that are used in the EU that could be benchmarked

- i. Open,
- ii. Restricted (these two are also sometimes referred to as “standard procedures”),

- iii. Negotiated (an exceptional procedure) and
- iv. Competitive dialogue (the use of which is subject to conditions).

The choices may be more limited under national laws. Specific legal advice is required for each jurisdiction.

The table below compares a few key features across the four EU procurement procedures which can be used for procuring PPPs. The LG should always take legal advice before selecting the procurement procedure.

Table 9.2: Key features of the EU procurement procedures

	Open Procedure	Restricted Procedure	Negotiated Procedure	Competitive Dialogue
Possibility to limit number of bidders	No prequalification or pre-selection is permitted. Any interested company may submit a bid.	The number of bidders may be limited to no less than five in accordance with criteria specified in contract notice (prequalification and short listing permitted)	The number of bidders may be limited to no less than three in accordance with criteria specified in contract notice (Prequalification and short listing permitted).	The number of bidders may be limited to no less than three in accordance with criteria specified in contract notice (prequalification and short listing permitted)
Discussions during process	The specifications may not be changed during the bidding process and no negotiations or dialogue may take place with bidders. Clarification is permitted.	The specifications may not be changed during the bidding process and no negotiations or dialogue may take place with bidders. Clarification is permitted.	Negotiations are permitted throughout the process. Successive stages can be used to reduce the number of bidders (further short listing)	A dialogue with the bidders is permitted on all aspects (similar to negotiated procedure, including further short listing). When the dialogue is concluded, final complete bids must be requested based on the solution(s) presented during the dialogue phase.
Discussions after final bid is submitted	No scope for negotiations with a bidder after bids is submitted.	No scope for negotiations with a bidder after bids are submitted	Not relevant because the negotiations can continue until the contract is agreed.	Only permitted to clarify, fine-tune or specify a bid. No changes are permitted to the

			There need be no “final bid” <i>per se</i> .	basic features.
Basis for award	Lowest price or most economically advantageous tender.	Lowest price or most economically advantageous tender.	Lowest price or Most economically advantageous tender.	Most economically advantageous tender.

4. Defining Bid evaluation criteria

Either at this stage or, at the latest, at the beginning of the procurement phase, a tender evaluation committee should be established. The composition of the committee will often be prescribed by national law. The role of the evaluation committee is to oversee the procurement process and take (or recommend) key decisions, such as decisions about the shortlist and the preferred bidder. The tender evaluation committee will generally be advised and supported by experienced and specialised consultants (often the transaction team of advisers). The broad aim is to select the “most economically advantageous tender”.

The choice of criteria for scoring and ranking alternative competing bids is a key decision in procuring a PPP. The objective is to tailor the PPP contract award criteria to the particular project and contract terms to achieve the best possible results (value for money).

Failure to apply award criteria properly can be a source of challenge to the procurement. The LG should, therefore, always take appropriate advice before the bid evaluation criteria are finalised.

As a rule, award criteria (and the weighting to be applied to each criterion) should be specified in advance. This may be problematic in the case of a competitive dialogue procedure, where detailed award criteria are rarely known in advance.

5. Prepare the draft PPP contract

A full draft PPP contract should be attached to the invitation to tender. It should cover the following topics at a minimum:

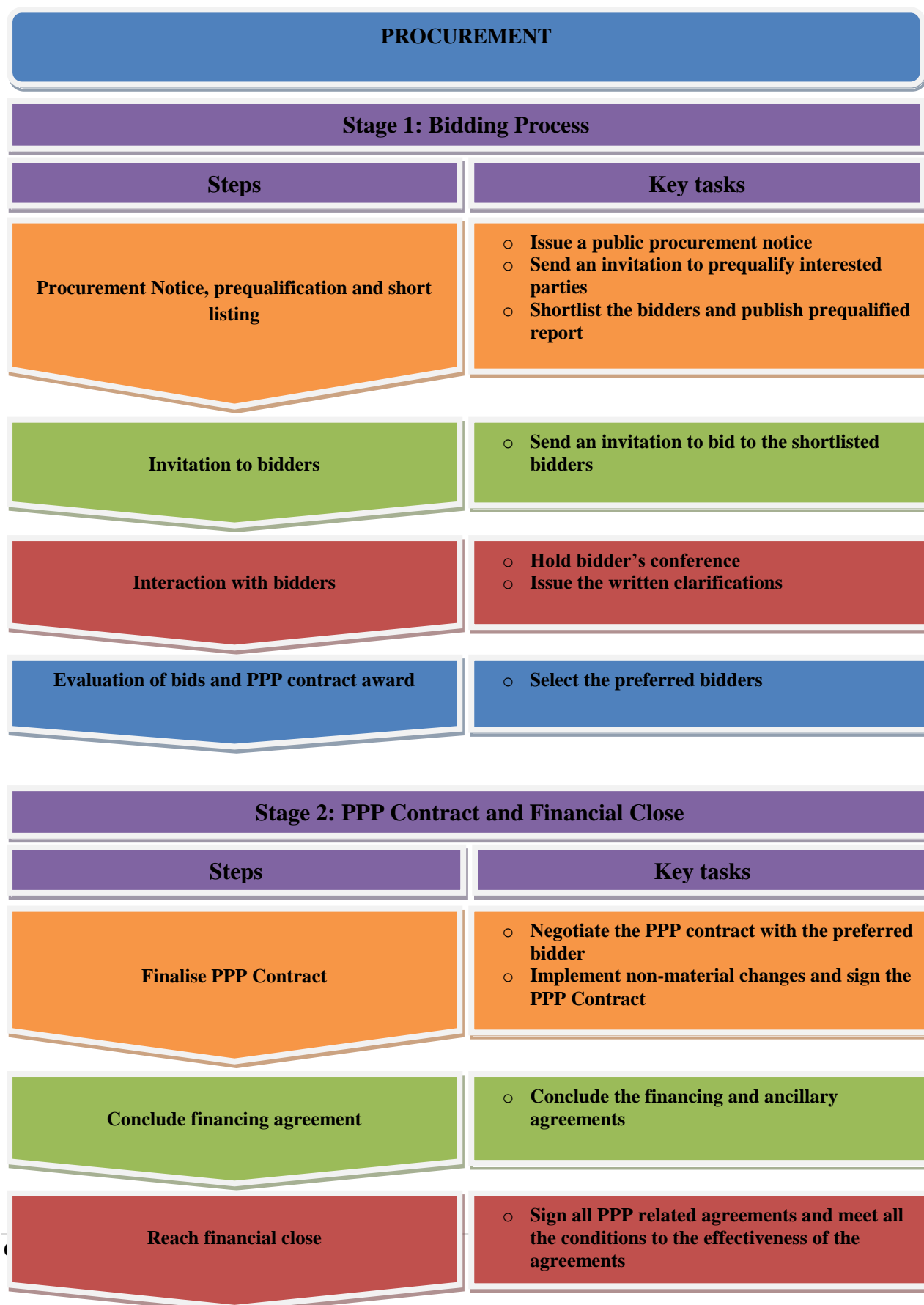
- i. The rights and obligations of the parties;
- ii. Risk allocation (this is usually achieved through setting out events which give the PPP Company a right to some compensation);
- iii. Service performance standards and targets, which need to be objective and measurable;
- iv. The procedure for permitted modifications, as well as their scope and nature;
- v. Payment mechanisms (e.g. tariffs, subsidies, grants) and adjustments to payments in response to various contingencies;
- vi. Penalties (and possibly bonuses) which have financial consequences or give rise to warning notifications (eventually leading to termination of the PPP contract);
- vii. Security and performance bonds;
- viii. Project insurances;

- ix. The term of the PPP contract;
- x. The conditions for termination (categorized by party and type of event) and compensation upon termination (for each type);
- xi. Step-in rights (both for lenders and, in emergency situations, the Authority);
- xii. The definition and impact of force majeure and changes in law; and
- xiii. The dispute resolution procedure.

In the past, practice was often limited to including a summary of the main commercial terms of the PPP contract with the invitation to tender. Nowadays, it is considered better practice to prepare and issue a full draft PPP contract with the invitation to tender. This is unavoidable in both the restricted and competitive dialogue procedures as there is no room for negotiations post final bids. Legal advisers should be involved in preparing the full draft PPP contract.

9.3 Procurement Process

Figure 9.2: The Detailed Procurement Process (Adapted from the EU Guidance)



It is noted that the PPDA Act and Regulations do not cater for the PPPs.

9.3.1 Bidding Process Notice





1. Prequalification (EOI)

An EOI enables client LGs to gauge the extent of the available market as well as tap the experience and expertise of interested parties before finalising the scope of basic requirements and additional services/facilities. EoIs are particularly useful when the LG is proposing a PPP approach in a new area. LGs should not expect potential bidders to disclose valuable or commercially sensitive information in an EOI submission.

The aim of the Request for Expression of Interest (REOI) is to obtain a list of interested bidders who have relevant experience and capacity to undertake the project.

Table 10.3: The REOI may comprise the following components:

No.	Section	Content
1	Overview	<ul style="list-style-type: none"> Background to the project Scope of the project
2	Overview of the selection process	<ul style="list-style-type: none"> Selection process stages (request for expression of interest, Request for qualification, Request for proposals) Selection process anticipated time- frame
3	Additional information sources	<ul style="list-style-type: none"> Where additional information may be obtained: website and/or hard copy with contact person If any: access to the LG's business directory to interact with other parties seeking business arrangements or to place contact information
4	Evaluation criteria	<p>Where applicable, evaluation criteria may be set to evaluate one more of the following capability:</p> <ul style="list-style-type: none"> Design capability Construction capability Operations and management experience Previous or current ownership of similar facilities Capacity to invest equity Infrastructure financing experience
5	Instructions	<ul style="list-style-type: none"> Need to direct everything through the contact person only Procedure for clarification of REOI Addenda Responsibility for cost of preparing EOI. Clarification of EOI Notification of success at the REOI stage Reservation of rights (e.g. modification of selection process, reject of any EOI without any obligation to the interested party) Limitation of damages caused to the interested party by submitting the EOI Confidentiality from the part of the LG Conditions for disqualification

6	Forms	 Form of Cover Letter  Expression of Interest Form  Further Information on Evaluation Criteria  Receipt Confirmation Form
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2. Request for Proposal

The RFP consists of the tender documents under the official letter of the implementing LG. The period of time allowed for the preparation of proposals has to be included in the RFP. The time depends on the size, nature and complexity of the project.

3. Pre-bid meeting

The implementing LG may set up a date to organize a meeting whereby the latter as well as the bidders have the opportunity to seek clarifications. This helps them to have an understanding of the issues related to the project.

The meeting may be held between **21 and 45** days after the issuance of the RFP. During the meeting, the LG provides the prospective bidders with specific information, clarifies the bidding procedures, and gets feedback from the bidders. A site inspection is organized if applicable to the project. There is a written record of the meeting which is distributed to the participants preferably on the same day.

If the LG receives any question from a bidder after the conference, it should send a copy of the response to all the pre-qualified bidders.

Questions from bidders: The LG sets a date limit for the receipt of questions from the bidders, usually, **14 days** prior to scheduled proposal submission.

Submission date: The submission date may be delayed by the LG if the latter has a valid reason for doing so.

Cancellation of the bidding exercise: The LG retains the right to cancel the whole bidding exercise at any time.

Evaluation of the bids: After the receipt of bids, the evaluation team proceeds with their evaluation. The most common method for dealing with the technical and financial evaluation is to ask bidders to submit their technical and financial offers in two separate envelopes. The technical offers are first evaluated. Their points for each criterion are aggregated and matched against the minimum qualifying points. The financial offers of those who have exceeded the minimum points are then opened and evaluated. The financial offers of the disqualified bidders are returned without being opened.

Negotiation

The LG may enter into negotiations with the preferred bidder. There are various dangers which must be avoided in this exercise:

- i. Negotiations may create an entirely new scope for the project. The LG shall stick to its needs and focus only on issues such as risk transfer, price mechanisms and affordability gaps;
- ii. The private sector has more negotiating skills on PPP projects and may influence the project affordability and value for money. In order to mitigate this danger, negotiation




- may be limited to pre-determined items and the LG should clarify its position on these before negotiations start; and
- iii. There is a lack of structure for conducting negotiations. The negotiating team may not be constituted with the right members or negotiations may take a long time. This may be solved by setting out the negotiating structure prior to the commencement of negotiations.

In case there are changes in the terms of the agreement which have a significant impact on the feasibility study, the LG will have to seek the approval of the Contracts Committee.

Award of the Project

After the evaluation exercise has been completed and negotiation completed, the next stage is for the LG for the award of the project to the selected private body. The PPP Agreement between the LG and the private body is signed at this stage.

Prior to the signature of the Agreement, the following issues should be taken into consideration:

-  Any major issue that may come up and affect the execution of the contract must be resolved
-  All measurable outputs required are clearly stipulated in the Agreement
-  The LG should ensure that it has complied with any preconditions on its part

Within receipt of advice from the LG that all requirements for award are fully complied with, the private body must sign the Agreement within the prescribed period (usually 7 days or less). In the event of refusal, inability or failure of the private body to enter into Agreement with the LG within the time allotted, the bid security should be forfeited.




9.3.2 Evaluation of proposals

Introduction: Since PPP projects are long-term undertakings, it is critical to carry out a proper evaluation of the proposals received. This section proposes the use of a point-scoring approach.

Evaluation Team: An evaluation team including the necessary expertise has to be set up

Means of Proposal Evaluation

The project procurement team must determine if selection of the bidder will be evaluated on technical considerations as well as financial consideration, or if final selection will be based on price considerations only. The evaluation should be carried out on the basis of allocation of marks. Some examples of possible weightings are:

-  For a project where technical aspects are just as important as price, the split of technical/financial procurement might be (50/50).
-  For a project where technical aspects are not as important as price, the split of technical/financial might be (30/70).
-  For a project where price or contract value only are the determinants, the split of technical/financial procurement might be (pass-fail/100).








Technical Proposal Evaluation

Technical Proposal Evaluation: Whether evaluation is done on the basis of both Technical and Financial proposals or on the basis of Financial Proposals only, the technical proposal still needs to be evaluated using weighted points. For the pass/fail option a threshold, for instance of 70, must be assumed. Once a bid passes the technical test, it is evaluated only on the basis of the financial bid.

If the evaluation procedure assigns weight to Technical as well as Financial proposals, then the points scored out of a possible 100 will, by proportion, determine the ultimate score of the Technical Proposal. For example, if the technical proposal has been assigned 40 points, and the financial proposal 60 points, then a score of 70 points for the technical will result in a weighted score of 28 points for the technical evaluation $[(70/100) \times 40 = 28 \text{ points}]$.

Financial Proposal Evaluation

The criteria used will vary from project to project and may include the following:

-  Capital structure of the bidder
-  Sources of funds for project
-  Financial analysis for project
-  Integrity of capital investment plan
-  Credibility of revenues estimates
-  Residual value of facility
-  Insurances offered

9.3.3 PPP Contract and Financial Close

1. The finalisation of the PPP arrangements

Leading to commercial and financial close, involves a series of steps summarised in the chart below. The activities involved in these steps often deal with detailed fine-tuning matters. Close interaction between the Authority, the PPP Company, its sponsors and its financiers is essential. This stage requires thorough organisation and management for it to proceed efficiently. It should be planned carefully, generally making use of experienced advisers. Many PPP projects have experienced lasting difficulties as a result of a lack of adequate planning or expert advice during this critical stage.

2. Conclude the financing agreements

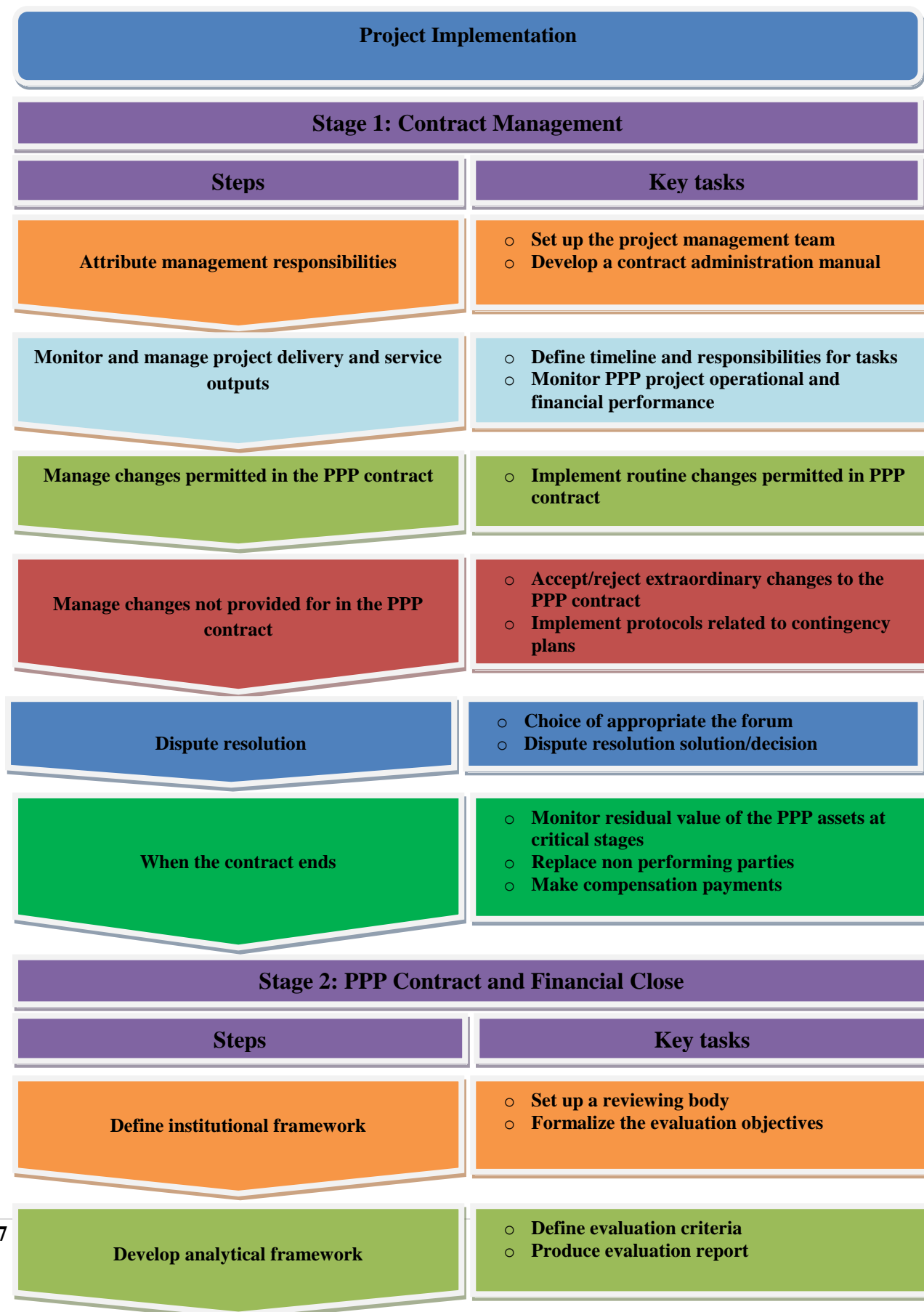
PPPs are normally financed in whole or part through project finance arrangements (see Annex 1). Insofar as possible, the Authority should require bidders to secure fully committed financing packages along with their bids. This will ensure that the finalisation of the financing agreements can take place simultaneously with or shortly after the signing of the PPP contract.

3. Reach financial close

Financial close occurs when all the project and financing agreements have been signed and all the required conditions contained in them have been met. It enables funds (e.g. loans, equity, grants) to start flowing so that project implementation can actually start.

9.4 Project Implementation

Figure 9.3: The Detailed Project Implementation highlighting the different Stages and Steps



9.4.1 Contract Management

Contract management is an important activity in PPP project administration. The management process needs to be in place from the outset to ensure timely completion and satisfactory operation of a project. A separate process may also be considered to monitor the PPP project performance. The contract management process not only helps to fix responsibilities, but also allows timely response to any deviation in project implementation or operation from the provisions in the contract agreements and thus helps to avoid disputes between the parties at later stages.

1. Management Responsibilities

After the PPP contract has been signed, responsibility for contract management will normally be transferred to a contract management team established by the LG. If a roads agency, for example, has more than one PPP contract, it makes sense on grounds of efficiency for a single contract management team to manage all ongoing PPP contracts.

A contract management team, reporting to a contract director, will carry out many day-to-day contract management activities. It is desirable to include the proposed contract director in the LG's project management team at an early stage of the procurement process, or at least to allow him/her to follow the procurement process and have access to procurement team members. A good understanding of the project and its inherent risks will enable him/her to devise an adequate contract management strategy.

Before this transfer of responsibilities occurs, the LG will need to ensure:

- i. that responsibilities are clearly defined, by appointing a team responsible for contract management separate from the project management team;
- ii. that the provisions for handling contract changes and managing failure of the PPP Company are in place;
- iii. that a system of on-going contract management review is in place; and
- iv. that there are sufficient budgetary and staff resources to undertake the contract management responsibilities.

It is important for the LG to set out, prior to choosing the preferred bidder, the basic framework under which the contract management team will operate. This will reduce the bidders' cost and obligation uncertainties. Indeed, bidders will need to incorporate monitoring and contract compliance costs into their bids. They should therefore be provided with a clear indication of the type and frequency of information required from them.

At the start of the PPP contract, the contract management team will need to develop management tools and processes, including contingency plans.

2. Partnership management

Relationship management between the private provider and the government implementing agency over the long contract tenure of a PPP project is vital for its success. Building an effective relationship that is mutually beneficial does not imply that either party has to compromise its contractual rights and obligations. The key factors to a successful relationship

are mutual understanding, open communication and information sharing, and recognition of mutual objectives. Appropriate lines of communication at strategic, business and operational levels between the implementing agency and the private party are necessary to build a successful relationship. The clear lines of communication at the appropriate levels help to ensure a prompt resolution of disputes that may arise.

3. Service delivery management

Service delivery management has two major elements: risk management and performance management. Risk management involves keeping the exposure of the project to any potential risks at an acceptable level by taking appropriate action in time. Performance management is concerned mainly with ensuring the quantity and quality of service delivery as per the contract, resource utilization, and performance improvement in the future to reflect technological and other new development as appropriate.

4. Risk management

The risks that the contract management team will need to manage can be classified as follows:

- i. Project risks contractually allocated between the parties;
- ii. Intrinsic risks borne by the LG;
- iii. Project risks not contractually allocated; and
- iv. Risks associated with changes to the PPP contract.

It is essential for the contract management team to have a clear understanding of the requirements of the PPP contract and the rationale for those requirements.

The role of the team will vary according to whether or not these risks have been identified in the contract and contingency plans have been established.

Potential problems should be identified early and acted upon. If the problem appears to be persistent and the PPP Company's first point of contact cannot deal with it, the issue should be dealt with at a more senior level.

5. PPP Contract administration

Contract administration involves the establishment of administrative processes to ensure that all the procedures and documentation relating to the contract are effectively managed. The three major activities in contract administration are: variation management, maintaining the integrity of the contract, and financial administration. Clear administrative procedures for these activities help to ensure that all parties to the contract agreement clearly understand their individual responsibilities, time and procedure of action.

6. Key challenges and tasks of PPP agreement management

The following challenges may arise in the course of a PPP contract:

- i. Benefits not being shared with the Government. This requires rigorous negotiation to protect Government's interests and adequate supervision;
- ii. Bottom line considerations assuming disproportionate importance. Avoid underbidding by consortia, equitable variation conditions;

- iii. Does sufficient private sector expertise exist to warrant the PPP approach? Conduct a private sector survey and maintain an inventory.
- iv. PPPs demand a strong public sector with managerial, negotiation and contract management and risk analysis skills, i.e. does the public sector have sufficient capacity and skills to adopt the PPP approach? Prior sensitization and negotiation with the private sector will be undertaken by the LG.
- v. Inability to take into account the interests of the stakeholders especially the poor and vulnerable groups when developing and concluding PPP contracts. LG will establish database on stakeholders and their primary interests or rights.
- vi. PPP procurement can be lengthy and costly, also long-term relatively inflexible structures. LGs shall have to undertake adequate preparation before engaging the private sector.
- vii. PPP imply a loss of management control by the public sector. This is a risk worth taking. LGs will institute strict monitoring and evaluation function for PPPs.
- viii. It is not possible to transfer life-cycle cost risk and to achieve absolute risk transfer
- ix. The private sector has a higher cost of finance (both debt and equity combined) which increases the overall cost of a PPP project relative to traditional procurement modality

7. Monitoring service outputs

The PPP contract should have clearly stated the obligations of the PPP Company and defined the expected service characteristics, outputs and quality standards.

Effective contract management depends; in the first place, on getting the PPP contract right. This implies setting out the procedures that guarantee close monitoring of the PPP Company's performance and general compliance with the agreed contract.

The contract management team will normally start by agreeing with the PPP Company all the tasks that each party needs to undertake and the appropriate timeframes for their completion. These operational details need to be set out in the contract administration manual (consistent with the project contracts) at the start of the project implementation phase.

Effective contract management will help to identify and monitor the PPP Company's construction and operational performance. It will enable the LG to manage the project risks over the life of the PPP contract.

8. Regular monitoring of Service Outputs

In order to effectively monitor the implementation of the project, the PPP Company will need to provide the contract management team with operational and financial data on an ongoing basis. The PPP contract should have set out the basic information requirements and frequency. Often, more detailed requirements are specified at the start of the implementation phase. The contract management team should limit its request for information to the data necessary for effective monitoring and *ex post* evaluation of the project.

The contract management team will, for example, need to:

- i. Monitor the attainment of key performance indicators;
- ii. Review quality control and quality assurance procedures to ensure that these systems are in place and effective;
- iii. Establish and manage the day-to-day relationship with the PPP Company; and
- iv. Report regularly to the stakeholders.

9. Changes to the PPP Contract

a) Managing changes permitted in the PPP contract

The PPP contract will set out the triggers and methodologies for agreeing and implementing changes to the PPP contract. However, it may not specify all the logistical or administrative steps that need to be taken in order to agree or implement permitted changes.

The contract administration manual should specify logistical and administrative details such as:

- i. The person to whom a request for a change must be sent;
- ii. The person who will assess the impact of the proposed change;
- iii. The persons authorised to agree a change on behalf of the LG and the PPP Company; and
- iv. The person responsible for overseeing and verifying implementation of the change.

Changes permitted under the PPP contract are often complex and need to be decided at senior level. They typically include material changes in output specifications, refinancing or the consequences of a change in the law. Many PPP contracts contain provisions governing the potential refinancing of the project, in particular the sharing of gains from such refinancing. It should be noted that the consent of the PPP Company's lenders may be required before certain changes to the PPP contract are implemented.

For unplanned or unexpected events that threaten the regular provision of services, a set of rules consistent with the responsibilities set out in the PPP contract can cover scenarios such as:

- i. Business continuity and disaster recovery planning;
- ii. Public sector step-in planning; and
- iii. Default planning.

In all of the above cases, the Authority must respect the terms of the PPP contract, taking advice as appropriate

b) Managing changes not provided for in the PPP contract

Given the long life of PPP contracts, unforeseen changes in contractual specifications (during construction or operation) are not unusual. The contract management team needs to address these issues and strike a satisfactory balance between:

- i. Encouraging the PPP Company to manage its risks; and
- ii. Preventing poor performance by the PPP Company from endangering the viability of the PPP contract.

10. Dispute resolution

The legal basis for the settlement of disputes is an important consideration in implementation of PPP projects. Private parties (concessionaire, financiers and contractors) feel encouraged to participate in PPP projects when they have the confidence that any disputes between the contracting authority and other governmental agencies and the concessionaire, or between the concessionaire and other parties (for example, the users or customers of the facility), or between the private parties themselves can be resolved fairly and efficiently.

Disputes may arise in all phases of a PPP project namely, construction, operation, and final handover to the government. The agreed methods of dispute resolution between the parties are generally mentioned in the contract agreement as allowed under the legal framework of dispute resolution in the country.

11. PPP Contract Termination

A PPP contract should include detailed provisions dealing with its termination. The main issues to be addressed are:

- i. The circumstances in which the contract may be terminated by a party ahead of its scheduled expiry;
- ii. The payment (if any) that must be made by the Authority to the PPP Company upon termination (depending on the circumstances); and
- iii. The condition of the assets when they are “handed over” to the LG following termination.

Grounds for termination

The typical grounds for termination are:

- Expiry of the PPP contract term;
- Default by the PPP Company;
- Default by the LG;
- A voluntary decision by the LG; and
- Termination in the event of prolonged force majeure.

The PPP contract should describe in detail the circumstances that allow a party to terminate the contract, in particular where the other party has defaulted on its obligations.

9.4.2 Ex Post Evaluation

PPPs in LGs shall be subject to EX-Post Evaluation. This shall entail:

- i. Identifying the public body that will undertake the review of a particular PPP project;
- ii. Ensuring the independence of that body *vis-à-vis* the teams responsible for implementing and managing the PPP contract; and
- iii. Defining the questions that need to be answered in the evaluation exercise
- iv. Documenting lessons to be learned from projects that have already been implemented (successes and failures). These lessons can improve future decisions on whether to take the PPP route, how to design PPP contracts and ultimately how best to prepare and implement PPP projects.

1. Define the Institutional Framework

The Reviewing Body

Evaluation shall be conducted by MOLG around 12 to 18 months after the commencement of operations. Subsequent annual evaluations will provide better information on operational performance and the actual delivery of the expected value for money.

In order for this process to be successful, it is important that the LG and the MOLG:

- a. Define the set of questions they would like to see answered; and
- b. Decide on who is best placed to answer those questions.

In some instances, *ex post* evaluation can be contracted out to a consulting firm, especially when in-house expertise is not available within a MOLG.

But whatever form it takes, the LG will have to ensure that the body conducting the evaluation is independent from the teams responsible for delivering and implementing the PPP project subject to evaluation.

2. Develop an Analytical Framework

Once responsibilities have been assigned and the aim of the *ex post* evaluation study has been defined, it will be necessary to decide which analytical framework will be most appropriate for achieving the aims of the study.

This implies defining:

- a. The evaluation criteria and expected outcomes of the project; and
- b. The appropriate alternative (i.e. what would have happened if the project had not been implemented as a PPP?).

A well-designed PPP contract should provide for sufficient information, collected during the monitoring phase, to support this evaluation exercise.

PPP projects will normally be defined in terms of value for money. This implies identifying both the benefits derived from project outputs and the cost of delivering those outputs (benefits and costs being both monetary and in terms of timing). However, more qualitative benefits and costs, such as service quality, contract design and risk allocation, also need to be considered in the evaluation.

In addition to examining the benefits and costs, the evaluation will need to identify which alternatives should have been looked at. These can be alternative procurement models to PPPs or different project delivery and implementation procedures. It is common practice to use the public sector comparator as a relevant alternative.

9.5 Monitoring and Evaluation of these Guidelines






- i. These Guidelines will be subject to periodic Reviews and Adjustments to accommodate new requirements
- ii. The Ministry of Local Government will, through the PPP Unit, conduct periodic monitoring and support supervision on the progress of implementing the guidelines.
- iii. Capture lessons learned to inform the review process.
- iv. At the end of 5 years, carry out a full evaluation of the impact of the guidelines on service delivery

APPENDICES

Appendix 1 Construct the base Public Sector Comparator model

The PSC is a risk-adjusted costing, of what the output would have cost to government, had the government provided it through traditional procurement. It is based on the recent actual public method of providing that defined output and takes full account of the risks it would encounter, including risks associated with known or probable inefficiencies encountered in the public sector (delays, cost overruns etc.).

Some Key Characteristics of a PSC

-  It is expressed as the Net Present Cost (NPC) of a projected cash flow based on the specified government discount rate over the required life of the contract;
-  It is based on the most recent or efficient form of public sector delivery for similar infrastructure or related services;
-  It includes Competitive Neutrality adjustments so that there is no net financial advantage between public and private sector ownership;
-  It contains a realistic assessment of the value of all material and quantifiable risks that would reasonably be expected to be transferred to bidders if the project is implemented under a PPP scheme; and
-  It contains an assessment of the value of the material risks that are reasonably expected to be retained by government if the project is implemented under a PPP scheme.

To clarify the PSC construction process, the PSC can be categorised into the following four core elements namely:

Raw PSC

The Raw PSC includes all capital and operating costs, both direct and indirect, associated with building, owning, maintaining and delivering the service (or underlying asset) over the same period as defined in the project proposal and to a defined performance standard as required under the output specification. The Raw PSC does not include any valuation of risks to which government remains exposed.

Transferable Risk;

The value of Transferable Risk to government needs to be included in the PSC to allow for a like-with-like value for money assessment with private sector bids.

Competitive Neutrality;

Competitive Neutrality adjustments remove any net competitive advantages that accrue to a government business by virtue of its public ownership. All the circumstances surrounding the project and the market for potential bidders should be reviewed, to identify any material advantages or disadvantages peculiar to government under a public sector delivery method.

Retained Risk.

Any risk not to be transferred to a bidder is retained by government. The cost of Retained




Risk should be included to provide a comprehensive measure of the full cost to government in a PSC. For projects where Retained Risk is included in the PSC, its value will need to be added to each of the private sector bids to allow a meaningful comparison.

PSC = Transferable Risk + Competitive Neutrality + Raw PSC+ Retained Risk

The PSC Reference Project

The Reference Project is the most likely and efficient form of public sector delivery that could be used to satisfy all elements of the output specification, as outlined in the Project Brief.

The Reference Project should:

-  reflect the most likely and achievable procurement approach by the relevant department to satisfy all elements of the output specification if the project were to proceed on a traditionally funded basis;
-  provide the same level and quality of service as expected to be provided by bidders to enable a like-with- like comparison; and
-  Be framed to be a conforming bid as if it were part of the bidding process.

Steps in formulating the PSC Model




The following paragraphs provide a brief outline of the key steps in constructing a PSC. A flexible approach should be adopted according to the specific characteristics and circumstances of individual projects.

Step 1: Formulate Output Specifications

The output specifications set out the range of services which the LG seeks to procure and the performance levels required for each of the services.


Step 2: Define Reference Project

The Reference Project should:

-  Reflect the most efficient and achievable form of public sector delivery that can be employed to satisfy all elements of the output specifications, basing on current best practices
-  Provide the same level and quality of services as expected to be provided by bidders to enable a like-with-like comparison
-  Be framed to be a conforming bid as if it were part of the bidding process.

Step 3: Identify All Raw PSC Components

The Raw PSC represents the base cost to the Government of producing and delivering the Reference Project. It comprises the following components:

-  **Direct costs**, which are costs that can be traced or assigned to a particular service, which include:
 - **Capital costs** e.g. costs for design and construction of a new facility, procurement of the required equipments and purchase/lease of land, other development costs, etc.
 - **Capital receipts**, e.g. as a result of upfront sale/lease/disposal of assets not involved in the provision of services (such receipts should be deducted from the

cash flows of the Raw PSC, basing on their expected timing, if the same opportunity is also available to bidders)

- **Maintenance costs**, e.g. costs of raw materials, tools/equipments, labour, etc. required for maintenance
- **Operating costs**, e.g. costs of inputs and staff directly involved in the provision of services, insurance, etc.

✚ **Indirect costs**, which are other costs incurred that are not directly related to the provision of services, i.e. costs that contribute to the provision of a service but are not incurred exclusively for that one service, which include:

- **Capital costs**, e.g. costs for partial commitment of plants/equipments, partial usage of administration buildings, etc.
- **Operating costs**, including corporate overheads (e.g. ancillary running costs of power, cleansing, stationery, non-core IT and equipments for administration, etc.) and administrative overheads (e.g. costs for employees not directly involved in the service provision, facilities management and project management, etc.)

✚ **Expected third-party revenue**, which over the life of the Reference Project reduces the net cost to the Government and should be deducted from the operating costs in the Raw PSC. Third-party revenue may be generated where:

- Third-party demand exists for the infrastructure or related services
- Service capacity exists above the government requirements
- The Government allows third-party utilization.

Step 4: Calculate Raw PSC

✚ **The Raw PSC** should be calculated using the following formula:

$$\text{Raw PSC} = (\text{Capital Costs} - \text{Capital Receipts}) + \text{Maintenance Costs} + (\text{Operating Costs} - \text{Third-Party Revenue})$$

Expected cash flows of the components of the Raw PSC need to be forecast over the life of the Reference Project and should be expressed in terms of NPV using a discounted cash flow analysis that adjusts the future value of the expected cash flows to a common reference date.

Step 5: Calculate Competitive Neutrality Adjustments

Competitive Neutrality removes the net competitive advantages/disadvantages which accrue to a government business by virtue of its public sector ownership. By including equivalent costs which will be incurred by bidders, it allows a fair and equitable comparison between a PSC and other private bids.

Competitive advantages from public sector ownership (amounts that should be added to a PSC) include exemption from rates, government rent, taxes, duties, fees and charges, accommodation costs, legislation/regulation, etc. which are only levied on or paid by private enterprises, while competitive disadvantages (amounts that should be deducted from a PSC) may also arise, e.g. heightened public scrutiny and reporting requirements which are not faced by private enterprises.

Competitive neutrality costs should be identified and included as NPVs of the projected cash flows over the life of the Reference Project.

Step 6: Identify All Material Risks

In the context of a PSC, risks reflect the potential for additional costs above the base case assumed in the Raw PSC or for revenue below it. It is therefore necessary to include a comprehensive and realistic pricing of all quantifiable and material risks in the construction of a PSC.

For valuation purpose, a PSC only includes quantifiable and material risks. However, efforts should be made to identify and document all risks associated with the project. It should be noted that a number of similar risks, which may be immaterial by themselves, may become material when aggregated. The reasons for excluding unquantifiable risks from a PSC should also be properly recorded.

Step 7: Quantify Consequences of Risks

Once all material risks have been identified, it is necessary to assess and quantify the possible consequences, both direct and indirect, of each risk eventuating, including the effect of any timing issues as different risks typically have different cost/time profiles over the term of a project.

A useful tool for identifying the consequences and financial impacts of risks is a risk matrix, which should indicate how each risk should be allocated (transferred, retained or shared), and identify the main consequences, financial impacts and potential mitigation strategies for each risk.

Step 8: Estimate Probabilities of Risks

Having identified the material risks and assessed the variety of potential consequences, it is then necessary to estimate the probability of each of the consequences occurring and to consider whether the probability is expected to change over time.

There are various risk valuation techniques which can be used to provide probability estimates, ranging from simple techniques that provide a subjective estimate of probability to more advanced multivariable statistical techniques. The technique that is adopted for a particular project or a particular risk depends on the significance of the project and the complexity of the risks within it.

Step 9: Calculate Value of Risks

As there is often more than one possible consequence for a particular risk, the value of each risk is then the sum of all these probability weighted consequences.

In addition, although a particular risk may be identifiable, it may be much more difficult to readily assess all the financial impacts associated with that risk. A contingency factor should therefore be included in each major risk category to account for any unobservable costs which will otherwise lead to undervaluation of the risk.

The value of each risk should be calculated individually using the following formula:

$$\text{Value of Risk} = (\text{Consequence} \times \text{Probability of Occurrence}) + \text{Contingency}$$

Step 10: Identify Desired Risk Allocation

It will then be necessary to classify these values into Transferable Risks, which the LG will allocate to bidders and Retained Risks, which risks the Government will bear itself, basing on an optimal level of risk transfer.

Step 11: Calculate Transferable Risk and Retained Risk

The value of Transferable Risk measures the cost that the LG is willing to pay for those risks which it proposes to transfer to bidders.

The value of Retained Risk measures the cost of those risks which the LG proposes to bear itself. Including the cost of Retained Risk in a PSC provides a comprehensive measure of the full cost to the LG for the Reference Project, and its value can be added to each of the private bids to allow a meaningful comparison, particularly when different bidders accept different levels of risk transfer.

There may be situations where specific components of a particular risk are allocated between parties, or where an overall risk is shared. Under these circumstances, it is necessary to separate the risk into Transferable and Retained Risk components. Risk sharing may be dealt with according to an agreed formula contained in a negotiated contract.

Once all the Transferable Risks and Retained Risks have been identified, the size and timing of the expected cash flows associated with each risk needs to be expressed as a NPV over the life of the Reference Project. Each of the risks should be included as a separate cash flow item and then aggregated to form the Transferable and Retained Risk components of a PSC. This allows for a detailed analysis of the key risks and their sensitivity to the overall PSC.

Step 12: Calculate PSC

Finally, a PSC should be calculated as the sum of the four components, in terms of NPV, as follows:

$$\text{PSC} = \text{Raw PSC} + \text{Competitive Neutrality} + \text{Transferable Risk} + \text{Retained Risk}$$

Note: With acknowledgements to 'Partnerships Victoria Guidance Material: Public Sector Comparator - a technical note' (June 2001)

Appendix 2: Receiving and evaluating Transaction Advisor Bids

The selection of transaction advisors should preferably be on the basis of proposals submitted in accordance with a comprehensive Request for Proposal (RfP). Usually for large projects, companies are asked to submit Expression of Interest to obtain the RfP packages. The Expression of Interest will outline in broad terms the qualifications and experience of the transaction advisor. These can be used by LGs for producing a preliminary shortlist of firms who will receive RfPs.

Prospective transaction advisors could preferably be required to submit proposals in two sections:

i. A Technical Proposal;

The technical proposal should normally carry the highest weighting of 60-70 percent of the overall assigned scores for evaluation. The technical proposal should consist of the following sections:

- a. Company and staff experience (about 75 percent of the total weight assigned to the technical proposal)
- b. Proposed execution plan (around 10 percent of the total weight assigned to the technical proposal)
- c. Understanding of transaction requirements (some 15 percent of the weight assigned to the technical proposal).

The technical proposal should be supported by the following documents amongst others:

- a. A summary of transactions that the firm claims as experience;
- b. A detailed curriculum vitae of each proposed staff member, which provides a
- c. detail of his/her verifiable transaction accomplishments and availability for the project;
- d. Audited company financial statement for the last three years;
- e. Corporate registration documents.





It could be useful to establish a threshold in terms of which a prospective transaction advisor's proposal must achieve a minimum number of technical evaluation points for that bid to be further evaluated on the basis of its financial proposal. This is to avoid the selection of inadequate proposals on the basis of cost alone. The threshold would depend largely on the technical complexity of the transaction.

ii. A Financial Proposal

- f. For the evaluation of the financial proposal, the maximum number of points is awarded to the proposal with the lowest total tendered cost, this could be the aggregate of a retainer and a success fee. The retainer fee consists of the sum disbursed regardless of the success or financial closure of the project. The success fee on the other hand, is contingent on the success or financial closure of the project.
- g. The other proposals are awarded on a pro rata number of points, calculated on the percentage difference in cost between their tendered costs and the lowest tendered total cost.

5. Finalizing and signing the contract with the TA

A key initial task for the project management team or its advisers is to develop a detailed project plan, including a timetable for project preparation and procurement. The plan needs to take into account all the key steps in the process, including:

-  Document development;
-  Stakeholder consultation;
-  The bidding process and private sector interface; and
-  The government approval process.

PPP preparation is a complex undertaking with parallel activities feeding into critical paths. It is important that activities that are on the critical paths be initiated at the right time and monitored closely to ensure that they proceed as planned and do not cause delays to other activities.

Appendix 3: Conducting Feasibility Study

1. The Needs Assessment

The needs analysis will have been considered during the inception phase. During this feasibility study phase it will be thoroughly interrogated.

Prioritisation of the project is based on a number of issues including:

- i. How the project contributes to the implementation of government policy;
- ii. The capacity and ability of the LG to render the services;
- iii. The relative size of the project;
- iv. Potential cost savings to the public body;
- v. Market interest in providing the services;
- vi. Capacity of the private sector in providing the services;
- vii. Complexity of the project;
- viii. Requirements of the public;
- ix. Prospect for meeting the "affordability" and "value-for-money" criteria based on preliminary analysis.

a) Strategic Objectives

Demonstrate that the project aligns with the LG's strategic objectives. It is in the interest of the LG that project needs are aligned with the LG's policy and priorities.

Step 1: Summarise the LG's mission and vision statements, its strategic objectives, and the government policy that determines what the institution's deliverables are.

Step 2: Describe the functions that the institution performs in the public interest or on behalf of the public service.

Step 3: Discuss the following aspects of the project:

- i. How does the project contribute to the implementation of government and institutional policy?
- ii. Does the institution have the ability and the capacity to provide the services?
- iii. What is the relative size of the project, in terms of its anticipated budget or capital expenditure?
- iv. What are the potential cost savings for the institution?
- v. What is the capacity of the private sector to provide the services?
- vi. How complex is the project?
- vii. What does the public require in relation to the services?
- viii. Given the proposed duration of the project, will it address the broad needs of the institution over time?
- ix. Will the proposed project meet the institution's needs in the time required?

b) Identify and Analyse the Available Budget(s)

This analysis must include:

- i. A discussion of any assumptions about future budgetary commitments required from government: How much will be required over what period of time, escalating in line with the consumer price index?
- ii. A discussion of any consolidation of budgets, namely, drawing funds from various budgets into a consolidated budget which will be ring-fenced for this project. These budgets may be internal to the LG but may also involve identification of budgets in other institutions, for CG and donors.

- iii. A list of the line items currently in the LG's budget for costs which may no longer be incurred as a result of the proposed project. For example: If a government department is housed in different buildings, there may be costs associated with delivering mail between buildings. If the proposed project is to house the department in one building, the department would no longer incur these costs, which then represent potential savings.

c) Demonstrate the Institution's Commitment and Capacity

It needs to be clear that the LG can manage process, evaluate, negotiate and implement the project.

Step 1: Provide information on the LG's project officer and project team, and the transaction advisor

Table 10.0: Illustrates the Information to be given per title

TITLE	INFORMATION REQUIRED
The project officer and project team	<ol style="list-style-type: none"> a. The names of the institution's project team members b. Their roles in the project c. Their relevant skills d. Brief CVs e. The budget available for project management
The transaction advisor	<ol style="list-style-type: none"> a. the names of the members of the transaction advisor b. their roles in the project c. their relevant skills d. brief CVs e. the budget available for transaction advice
An assessment of:	<ol style="list-style-type: none"> a. lines of decision-making within the institution, particularly between project officer, senior management and the accounting officer/authority b. any areas where a lack of capacity exists, in the project team or in the transaction advisor c. a plan on how the lack of capacity will be addressed throughout the project process d. the plans for skills transfer from the transaction advisor to the project team at various stages of the project e. how staff turnover will be managed

Step 2: Provide information on key stakeholders (see Chapter 8 for details)

1. Possible key stakeholders include:

- a. Those within the institution – the local government
- b. Other government departments
- c. Other spheres of government
- d. Organized labor
- e. Third parties
- f. The general public.

Step 3: Describe the nature of each relationship and the project's impact on each stakeholder

In particular, identify impacts on the funding, resources or processes of the key stakeholders.

d) Specify the Outputs

Once the LG's objectives and budget have been identified, and its commitment and capacity demonstrated, the outputs of the proposed project need to be specified. Output specification is a statement of the needs to be satisfied and defines the services and outputs required by the LG.

To facilitate the development of an initial output specification, the project objectives should be specified in terms of the outputs that the project is required to deliver, and they should be specific, measurable, achievable, realistic and time-bounded.

The outputs specified should be capable of being assessed against clear and measurable performance criteria and defined in ways that allow their subsequent achievement to be evaluated. Describing objectives in terms of the outputs and deliverables that a project requires, will help to open a wide range of solutions and promote innovation amongst private sector bidders.

Step 1: Describe the service that the institution needs to deliver

Step 2: Specify the outputs required to deliver that service

Step 3: Specify the minimum standards for the outputs

This will ensure that the service delivered by the project meets the institution's expectations.

Step 4: Assess whether the output specifications can meet the institution's ongoing service needs

It may be necessary to specify to what extent the project must provide a flexible solution that can be expanded or enhanced over time.

Step 5: Specify key indicators that will measure performance

This will allow for more accurate costing of the output specifications.

Step 6: Identify service interface expectations

This concerns the interface between the project and the institution's other services.

2. Option Analysis

The options analysis is conducted to select the most appropriate form of procurement - traditional procurement or PPP. The selection of the most appropriate option would be based on the ease of implementation, maximisation of benefits to stakeholders, and the ability to control and manage risks.

a. The Option Appraisal Stage

For those projects that have been identified as having the potential to be procured under PPP, the Option Appraisal stage will involve mainly:

-  **Project Appraisal;**
-  **PPP Assessment; and**

Statutory Process Assessment;

i. Project Appraisal;

In simple terms, project appraisal involves the identification of suitable options to meet service objectives, and the selection of a preferred option. Options are appraised through constraints studies and preliminary reports, which provide economic evaluations, cost estimates, outline requirements and site selection. The process of undertaking project appraisals for PPP projects will be the same as for traditional projects, unless statutory risk is to be transferred to the private sector. In such circumstances, the project appraisal will be required but possibly at a higher level of detail.

ii. PPP Assessment

A key driver of the PPP programme is the desire to increase value for money in infrastructure and service delivery procurement. To ensure that value for money is achieved, there must be a clear justification for the project, a competitive procurement and it should be clearly demonstrated that the option selected offers better value for money than the alternatives.

Whilst post procurement reviews will ultimately show whether value for money is being achieved through PPP, procedures must be in place to ensure that the options being developed are likely to deliver value for money.

The purpose of the PPP Assessment is to assess, at the Option Appraisal stage, the potential for a PPP to deliver improved value for money compared with traditional procurement. The PPP Assessment addresses two key issues in detail:

- *Does the project have potential to be procured as a PPP?*
- *Which form of PPP provides the greatest potential for improved value for money?*

The PPP Assessment is therefore a fundamental tool in deciding whether or not to proceed with a PPP procurement. Some key elements of a PPP Assessment are:

- a. An initial output specification, which is based on the conclusions of the Project Appraisal and provides a high level definition of what is required in terms of delivery.
- b. A value for money assessment, involving the identification of factors that will determine whether a project is likely to represent value for money, and a qualitative assessment of the potential of the project to deliver those factors
- c. A preliminary risk assessment, including the identification and quantification of key risks, initial allocation of risk between the public and private sectors, and an assessment of whether sufficient risk transfer is possible to merit a PPP approach. Preliminary views on the key contractual issues should also be included.
- d. A bankability assessment of any project that may be partly or wholly financed by the private sector. The bankability assessment should establish the financing issues that need to be addressed prior to a procurement processing as well as those that will need to be reflected in contract documentation.
- e. A legal viability assessment, to assess whether the public body has the legal ability to enter into a PPP contract. The legal viability assessment should also consider the legal implications of the project in relation to existing employees, assets and contracts.

- f. A PPP option selection, involving the selection of the contractual form and scope of PPP that most closely meets the strategic objectives of the project and offers greatest scope for value for money.
- g. Identification of the parameters to be used at the end of the procurement process to test whether the preferred PPP tender represents value for money.
- h. An indicative implementation plan describing the organizational structures required to manage the procurement, and setting out an indicative timetable with target completion dates for the main activities involved in the procurement of the project.

The PPP Assessment will vary according to the type and complexity of the project. Small, relatively straightforward projects will not require the same level of work as large and complex projects, and the resources allocated to complete the PPP Assessment will need to be tailored accordingly.

It is to be noted that the "options analysis" determined at this point may well change after the affordability test has been conducted. If affordability is not demonstrated, it may be necessary to revisit the original option.

iii. Statutory Process Assessment

This refers to an assessment of the potential to allocate to the private sector contractor the risks associated with the statutory process as part of the PPP arrangement. The decision on whether or not to allocate statutory process risk will depend upon a range of factors including the nature of the project itself and the value for money that may be gained or lost through statutory risk transfer. For example, a LG is in a better position than a private party to manage the risks associated with land acquisition where Compulsory Purchase Orders are likely to be required.

3. Project Due Diligence

The due diligence stage is an extension of the solution options analysis stage and aims to uncover any issues in the preferred solution option that may significantly impact on the proposed project.

a. Legal issues

Although a preliminary legal analysis of each solution option was done in the options analysis stage, a comprehensive legal due diligence of the preferred option(s) must now be done to ensure that all foreseeable legal requirements are met for the development of the project. Although it may be costly to undertake a comprehensive legal due diligence of all aspects of the project in this early phase, it is ultimately worthwhile. Early legal certainty directly affects project costing in Stage 4 (thus assisting in making the procurement choice), reduces PPP bidding costs for all parties, and avoids using costly time on these issues in the negotiations stage.

Common legal issues that arise usually centre on use rights and regulatory matters. However, the LG's legal advisors should conduct a thorough due diligence on all the legal issues which have a bearing on the project.

i. Use rights of the institution

Obtain legal opinion about the extent to which the LG function or use of Government property can legally be performed by a private party in a possible PPP.

PPPs may not be used to limit an LG's responsibilities for performing its institutional functions. Even though in a PPP the LG contracts a complete or partial LG function to the private party, the LG remains accountable for the efficient delivery of this service.

ii. Regulatory matters





It can generally be assumed that the institution performs its mandated functions within the regulations. Regulatory due diligence is only required for the PPP procurement choice.

b. Site enablement issues






Where a physical site is involved, indicate whether the LG intends to specify a preferred site, nominate a definite site, or leave the question of location open to bidders.

If the LG nominates a particular site, it will need to identify, compile and verify all related approvals. The purpose is to uncover any problems that may impact on the project's affordability and value for money, or cause regulatory delays at implementation.

Establish the following:

-  land ownership
-  land availability and any title deed endorsements
-  Are there any land claims?
-  Are there any lease interests in the land?

Appoint experts to undertake surveys of:

-  environmental matters
-  geo-technical matters
-  heritage matters
-  zoning rights and town planning requirements
-  LG Integrated Development Plans.

c. Socio-economic issues

Identify socio-economic factors in the project location that will need to be directly addressed in the project design.

4. Value Assessment

Value for Money in PPP projects is gained through the engagement of private sector efficiency, effectiveness, and economy and through the appropriate allocation of risks in the

project. The assessment of the potential to secure value for money is a key element of the PPP assessment.

The conclusions on value for money potential will inform the LG on whether or not to proceed with a PPP procurement, and if so, the form of PPP to be used. The final assessment of whether a PPP procurement represents improved value for money can only be made at the conclusion of the competitive tendering process. The assessment of the potential for a PPP to deliver value for money has two parts:

- a. **Identification of the factors that will determine whether a project delivers value for money services; and**
- b. **An assessment of the potential of the private sector to deliver value for money with regard to those factors.**

The outcomes of the value for money assessment will help to inform not only the potential for a PPP to deliver value for money services, but also:

- ✚ Selection of the most appropriate form of PPP;
- ✚ Identification of the optimum scope of the PPP; and
- ✚ Identification of the parameters that should be used at the end of the procurement
- ✚ Process to assess whether the preferred PPP tender represents value for money.

Factors that determine value for money

The factors that determine whether a project delivers value for money will vary by type of project and by sector. Some factors will be common to a number of projects, and may relate to the strategic objectives of the LG. In general, PPP can generate improved value for money through a number of ways including *inter alia*:

- i. **Reduced whole life costs** - This can be achieved through the integration of infrastructure design, construction and operation; by facilitating private sector innovation in design; through the avoidance of over-specification and through improved maintenance scheduling;
- ii. **Better allocation of risk** - Cost effective transfer of risk to the private sector enables efficiency benefits to be generated across the term of the contract; sometimes, certain risks cannot be totally transferred to one party and have to be shared.
- iii. **Faster implementation**- The transfer of design and construction risks, together with the principle of no payment until the commencement of service delivery, will provide significant incentives for the private sector to deliver infrastructure projects within short construction timeframes;
- iv. **Improved quality of service** - This results from better integration of services with supporting assets, improved economies of scale, introduction of new technology, innovation in design, and the performance incentives and penalties included in a PPP contract; and
- v. **Generation of additional revenue** - more intensive exploitation of assets to generate additional revenues, for example from shared use of facilities or the sale of surplus assets.

5. Risk Assessment

A risk can be defined as any factor, event or influence that threatens the successful completion and operation of a project in terms of cost, time or quality. One of the principles of PPP is that risk should be allocated to the party best able to manage it. Cost effective

allocation of risk between a LG and the private operator will result in lower cost of construction and operation for infrastructure projects, and will provide enhanced value for money when compared to traditional procurement. In a PPP project, the degree of risk transfer to the private sector will be determined by the nature of the project and will by definition vary from project to project.

5.1 Objectives of Risk Transfer

Within a PPP project, the primary objectives of transferring risks from a LG to a private sector contractor are to:

- i. reduce the long-term cost of a project by allocating a risk to the party that is able to manage it in the most cost effective way;
- ii. provide an incentive to the contractor to deliver a project on time, to the required standard and within budget;
- iii. improve the quality of customer service and increase revenue through a better management of risk; and
- iv. provide a more consistent and predictable profile of the LG's expenditure on a project, by converting variable capital and operating costs into more consistent and predictable unitary payments.

5.2 Purpose of Risk Assessment

- i. Risk assessment is required to enable the objectives of risk transfer to be achieved. It is a determining factor in many of the activities that have to be undertaken during the course of a PPP project. The purpose of assessing risk within a PPP project is to:
 - a. Enable the selection of the most appropriate form of PPP for a project;
 - b. Allow the development of contract documentation for a project;
 - c. Facilitate negotiation between the LG and the shortlisted bidders (where the negotiated procedure is followed);
 - d. Facilitate the comparison of tenders; and
 - e. Facilitate an assessment of value for money provided by the preferred tender when compared to traditional procurement.

5.3 Preliminary Risk Identification

The identification of risks may be undertaken by means of a brainstorming exercise in a workshop or series of workshops. The purpose of the workshop should be purely to identify risks at this stage, without attempting to quantify them. The process of identifying risk is:

- i. Select the parties for the brainstorming session carefully and include those that are responsible for quantifying and managing project risks
- ii. Use a generic list of risks to structure the brainstorming session
- iii. Focus on risks that are specific to the project
- iv. Focus on the most significant risks
- v. Provide a clear and unambiguous description of each risk identified
- vi. Check for missed risks and duplicated risks
- vii. Categorize the risks

5.4 Preliminary Risk Allocation

The guiding principle of risk allocation is that risk should be allocated to the party better able to manage it. At the Option Analysis stage, the price charged by a Contractor for taking on a risk will not be known. The preliminary risk assessment should therefore focus on

determining in principle, whether the LG or the Contractor is better able to manage the risk, or whether the risk should be shared.

In considering the most appropriate allocation of risk, the following issues should be taken into account:

- a. The capacity of the LG to manage the risks and its ability to control them
- b. The capacity of private sector contractors to manage the risks and their ability to control them
- c. The preferred allocation of risk, given any public interest issues.

The preliminary allocation of risk should reflect the specific characteristics of the project and the underlying strengths and weaknesses and capacities of each party. The degree of risk transfer to the private sector will vary on a project by project basis and will be informed by the precedent review and market sounding exercise. Moreover, the preliminary allocation of risk will influence the selection of the preferred form of PPP.

The process for risk allocation is as follows:

- i. Focusing on deciding which party is best able to manage each risk
- ii. Using the results of the market sounding
- iii. Using either a typical risk allocation or an actual risk allocation for a similar project as a starting point documenting the reasoning behind the preliminary risk allocation so that it can be referred to at the procurement stage.

6. Economic Valuation

An economic valuation may be warranted in:

- b. Greenfield projects
- c. Capital projects
- d. Projects that warrant an analysis of externalities

A range of well-known micro-economic techniques exists for undertaking an economic valuation, requiring the analysis to:

- a. Give a clear economic rationale for the project.
- b. Identify and quantify the economic consequences of all financial flows and other impacts of the project.
- c. Detail the calculation or shadow prices/opportunity costs for all inputs and outputs, including:
 - i. Foreign exchange
 - ii. Marginal cost of public funds
 - iii. Opportunity cost of public funds (discount rate)
 - iv. High, medium and low skill labor
 - v. Tradable and non-tradable inputs
 - vi. Tradable and non-tradable outputs (including consumer surplus, where relevant, based on financial or other model quantities).
- d. Identify an appropriate 'no-project' scenario and calculate the associated economic flows, treating them as opportunity costs to the project. (A 'no-project' scenario is not the same as a PSC model.)

- e. Provide a breakdown of the economic costs and benefits of the project into its financial costs and benefits, and various externalities.
- f. Do a detailed stakeholder analysis, including the project entity, private sector entity, government, and others.

7. Procurement Plan

A procurement plan demonstrates that the institution has the necessary capacity and budget to undertake the procurement of the PPP.

A procurement plan must contain at least the following:

- i. A project timetable for the key milestones and all approvals which will be required to take the project
- ii. Confirmation that sufficient funds in the LG's budget are available to take the project into contract implementation
- iii. A list of any potential challenges to the project and a discussion on how these will be addressed by the project team and transaction advisor
- iv. The best procurement practice and procedures suited to the project type and structure
- v. The governance processes to be used by the LG in its management of the procurement, especially regarding decision-making
- vi. The project stakeholders and the extent of their involvement in the PPP
- vii. The project team with assigned functions
- viii. Categories of information to be made available to bidders and how such information will be developed
- ix. A list of required approvals from within and outside the institution
- x. A GANTT chart of the procurement process, including all approvals and work items necessary for obtaining these approvals (for procurement documentation as well as, for example, the land acquisitions and environmental studies to be procured by the institution)
- xi. Contingency plans for dealing with deviations from the timetable and budgets
- xii. The bid evaluation process and teams
- xiii. An appropriate quality assurance process for procurement documentation
- xiv. The means of establishing and maintaining an appropriate audit trail for the procurement
- xv. Appropriate security and confidentiality systems, including confidentiality agreements, anti-corruption mechanisms, and conflict of interest forms to be signed by all project team members.

8. Submit the Feasibility Study Report

Submit the feasibility study report to the technical committee, with all the information arranged as it is set out in the list of submission requirements below.

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1. Hong Kong, Serving the Community by Using the Private Sector: An Introductory Guide to Public Private Partnerships (PPPs); March 2008 (Second Edition)
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4. Mauritius, Ministry of Finance and Economic Development, PPP Unit, Public Private Partnership Guidance Manual 2006
5. South Africa; National Treasury, PPP Unit, Public-Private Partnerships Manual
6. New South Wales, Australia Public Private Partnerships Guidelines, updated in 2012
7. British Columbia, Canada, Public Private Partnership, A Guide for Local Government, 1999
8. European PPP Expert Centre (EPEC), The Guide to Guidance: How to Prepare, Procure and Deliver PPP Projects
9. UNDP, 2004 Public Private Partnerships for the Urban Environment Toolkit
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11. Government of Uganda, PPP Framework Policy: Promoting Quality Services to the Public, Ministry of Finance Planning and Economic Development, 2010