A CONDENSED VERSION OF THE PPP GUIDANCE MANUAL

PPP UNIT
MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT
MARCH 2006

Table of Contents

List of Abbreviations

BOO - Build Operate Own
BOT - Build Operate Transfer
CTB - Central Tender Board
DBOF - Design Build Operate Finance
DBO - Design Build Operate
EOI – Expression of Interest
PPP – Public Private Partnership
PSC - Public Sector Comparator
REOI – Request for Expression of Interest
RFP - Request for Proposal
RFQ – Request for Qualification

Section 1: The PPP Concept

1.1 What is PPP?

A PPP is an arrangement between the public and private sectors with clear agreement on shared objectives for the delivery of public infrastructure and/or public services by the private sector that would otherwise have been provided through traditional public sector procurement.

The key is to focus on what service is required, that is to specify the output, and to allow the private sector to determine what inputs are required, including infrastructure and skills, to achieve the specified output.

1.2 Reasons for using PPP

PPPs can have a number of benefits, which include:

- Operational gains - These can be achieved by focusing on outputs rather than processes: by generating economies from integrating design, building, financing and operating phases.
- Strategic clarity - Partnership contracts enhance accountability by clarifying responsibilities and focusing on the key deliverables of a service.

For a PPP project to be considered, the gains from the private operator's efficiency must be greater than the difference in borrowing costs, as the costs of private borrowing is normally higher than conventional government borrowing.

The real benefit of PPPs is the ***value for money*** derived from operational and strategic benefits. Value for money means that the private provision of a government function/service results in a net benefit to government, defined in terms of costs, price, quality, quantity or risks transfer, or a combination thereof.

1.3 Forms of PPP

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.

1.3.1 Service Contract

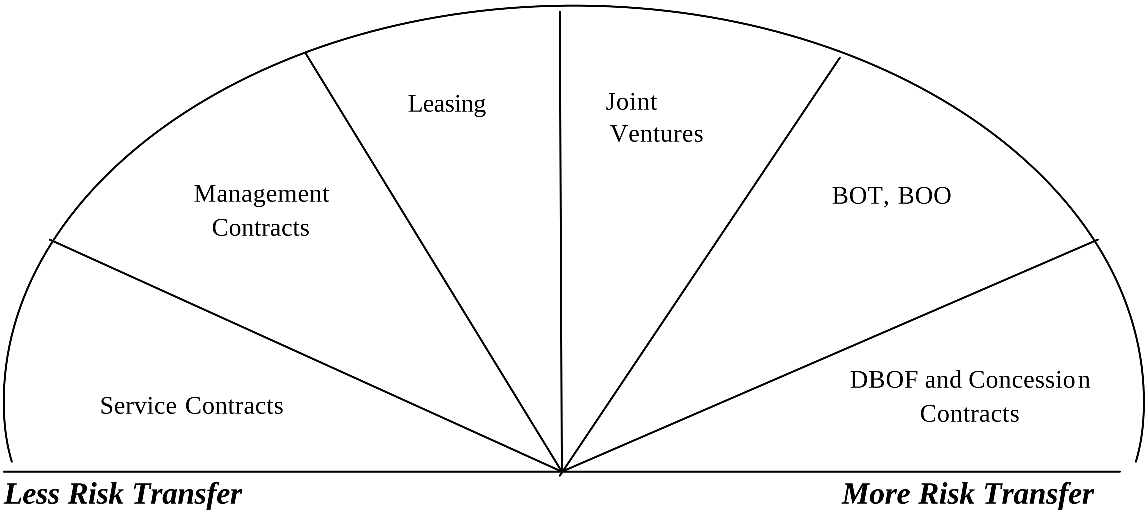
Service contracts are for short periods of time and leave coordination and investment responsibility with public sector management.

1.3.2 Management Contract

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.

1.3.3 Leasing

With leases, most commercial risks of the operations are assumed by the private provider, and the profits of the private operator depends on how much he can reduce costs.



1.3.4 Build Operate Transfer (BOT)/Build Operate Own (BOO)

In the case of the BOT, the private sector finances the construction of the facility but the facility is owned by the public sector, while in the case of BOO, legal ownership rests with the contractor.

1.3.5 Design, Build, Operate, Finance (DBOF) and Concession Contracts

Under DBOF contracts the private sector is responsible for designing, building, operating and financing the facility and recovers its costs solely out of payments from the public sector. At the end of the contract, ownership of the facility commonly transfers back to the public sector.

Concession contracts are similar to DBOF arrangements, except that the private sector contractor recovers its costs either through direct user charges or through a mix of user charging and public subvention. The government usually retains property and residual rights of all assets, and the latter return to Government at the end of the contract, which is usually after 25 or 30 years.

Section 2: The PPP Process

2.1 Steps in the PPP Process

2.1.1 PPP projects can be identified

- either during the budget exercise with the Ministry of Finance and Economic Development if the project has public finance implications
- or by the contracting authority itself, at any other time particularly if the project is financially free standing.

2.1.2 An important step in the PPP Process is to undertake a pre-feasibility study to identify potential PPP projects on the basis of their affordability and their potential to generate value for money through appropriate risk transfer. Where a project's viability depends on marketing aspects, it might be useful to carry out as part of the pre-feasibility study, a market sounding exercise to assess the market potential and attractiveness of the project.

2.1.3 As soon as a contracting authority identifies a potential PPP project, it

1. should inform the Financial Secretary of the expertise within its institution to implement a PPP project;
2. should if the Financial Secretary so requests, appoint a specialist consultant/transaction advisor for carrying out a feasibility study;
3. may wish to appoint a project officer or set up a project team from within or outside the institution who is capable and appropriately qualified to manage the project;
4. should submit the feasibility study to the PPP unit, which after making an assessment of the project shall put forward its recommendations to the Financial Secretary as to whether the project is affordable to the contracting authority, provides value for money and enables an optimum transfer of risks;
5. should proceed with the procurement phase of a PPP only after having written approval of the Financial Secretary on the feasibility study;
6. should after receiving approval on the feasibility study, prepare and submit to the Financial Secretary a request for proposal for his approval of the financial terms of the model agreement;
7. should after receiving approval of the Financial Secretary on the terms of the model agreement, submit the RFP to the Central Tender Board (CTB) to obtain its written authorisation to advertise, invite, solicit or call for bids subject to Section 7 of the PPP Act;
8. should consult the CTB to obtain its written authorisation to conduct a pre-selection exercise;
9. should prepare the pre-selection documents including a public invitation for applicants to apply for pre-selection and submit them to the CTB for approval before they are issued or published;

The CTB may delegate its powers to the contracting authority where it considers that the contracting authority has the necessary expertise to undertake the pre-selection exercise.

10. should prepare and submit to the CTB for written approval, a RFP and should advertise/publish the RFP;

The bids shall be received and opened by the CTB. In relation to the examination and evaluation of bids, the CTB may refer the bids to the appropriate contracting authority for examination and evaluation provided that the contracting authority has the necessary expertise to do so.

11. may be responsible for examining and evaluating the bids and submitting to the CTB its findings within such time as may be determined by the CTB;

Once evaluation has been completed there is often a negotiation stage between the winning bidder and the government to clarify some issues that arise as a result of gaps or lack of clarity in the contract documents or as a result of counterproposals made by the preferred bidder.

12. should following negotiation (if carried out) submit any change in the terms of the agreement which impacts on the approved feasibility study to the Financial Secretary for the approval of the relevant proposed changes;

13. should upon approval of the Financial Secretary, seek the final approval of the CTB for the award of the project;

14. should, as a matter of normal procedure, ensure that Cabinet approval is obtained prior to signature of the agreement; and

15. should, once the contract is signed, become responsible for managing the contract and ensure that the requirements as set out in the contract are met.

Contract management and performance management become the responsibility of the contracting authority.

2.2 Government's Policy regarding Unsolicited Proposal

The PPP Act 2004 makes no provision for unsolicited proposals. The difficulty with unsolicited proposals rests in getting the right balance between encouraging private companies to submit project ideas without losing the transparency and efficiency gains of a well-conceived competitive tender process. In view of the above, it is government's intention, in the early years of its PPP programme, to proceed cautiously and encourage competitive bidding only.

Section 3: The Appointment of Transaction Advisors

3.1 Definition of a Transaction Advisor

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.

3.2 Procedure for Selecting Transaction Advisors

The selection of transaction advisors should preferably be on the basis of proposals submitted in accordance with a comprehensive RFP.

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

(a) 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:

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

The technical proposal should also be accompanied by the relevant documents to support the above.

A threshold may also be established 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.

(b) A Financial Proposal

The components of the financial proposal are the total cost, retainer and success fee. For the evaluation of the financial proposal, the maximum number of points is awarded to the proposal with the lowest total tendered cost, being 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.

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.

Section 4: The Feasibility Study

4.1 The Role of the Feasibility Study

The role of the feasibility study is crucial in the PPP process. The feasibility study demonstrates "affordability", and gives an early indication of how value for money will be achieved, through appropriate risk transfer.

4.2 Conducting the Feasibility Study

Best practice suggests that the feasibility study should comprise the following key sections:

- **Sector needs assessment**

Sector policies and priorities should be reviewed and assessed to know how the project fulfills sector needs.

- **Output specification**

Output specification is a statement of the needs to be satisfied and defines the services and outputs required by the contracting authority.

- **Options 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.

- **Construction of the Public Sector Comparator (PSC)**

The PSC is a rigorous examination of the “inhouse” costs of implementing the project and assigning the various risks to the appropriate party that can handle them. Further details on the PSC are provided in Section 7.

- **Demonstration of affordability**

Affordability relates to whether the cost of the project over the whole project life can be accommodated in the government's budget, given its existing commitments. If a project is unaffordable, it undermines the Government's ability to deliver other services and should not be pursued.

- **Preparation of a benchmark for value for money**

Value for money is determined by comparing the PSC to the private sector proposals on a net present value basis. Therefore the feasibility study gives only an early indication of value for money.

Section 5: Value for Money

5.1 Definition of Value for Money

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 outcomes of the value for money assessment will help to inform not only the potential for a PPP to deliver value for money, 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.

5.2 Factors that determine value for money

In general, PPP can generate improved value for money through a number of ways including *inter alia* :

- **Reduced whole life costs**
- **Better allocation of risk**
- **Faster implementation of the project**
- **Improved quality of service**
- **Generation of additional revenues.**

5.3 Assessing Value for Money Potential

Two main tools to identify potential sources of value for money, and to assess the potential of the private sector to deliver value for money, are ***precedent review*** and ***market sounding*****.**

Precedent review

The precedent review investigates the experience of similar projects both local and international markets and taps the views of the private sector in relation to the

- scope of the project;
- potential for cost effective risk transfer;
- scope for third party revenues; and
- potential for value for money.

Market Sounding

There are a number of elements to be considered as part of the market sounding exercise, including the strength of the private sector market for the project, the private sector's scope for achieving economies of scale, and its relevant expertise. The most important factors will be the likely level of interest in the project, and the capability of the market to undertake the project.

To maximise the effectiveness of the market sounding process, private sector organisations need to be provided with a Project Prospectus that sets out an indication of the likely *scope and scale of the project*, its *service content*, its anticipated *key contractual terms* and *preliminary risk allocation*. The discussions should also be supplemented with a Project Questionnaire in order to provide a formal record of responses to key questions. To ensure the widest possible participation in the market sounding exercise, a Prior Information Notice can be placed in an official journal inviting potential private sector suppliers to express their interest in participating in the market sounding exercise.

Section 6: Risk Assessment

6.1 Definition of Risk

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. 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.

6.2 Purpose of Risk Assessment

The purpose of assessing risk within a PPP project is to:

i. enable the selection of the most appropriate form of PPP for a project;
ii. allow the development of contract documentation for a project;
iii. facilitate negotiation between the contracting authority and the short listed bidders (where the negotiated procedure is followed);
iv. facilitate the comparison of tenders; and
v. facilitate an assessment of value for money provided by the preferred tender when compared to traditional procurement.

6.3 Categories of Risk

The risks associated with infrastructure projects are commonly categorised under the following headings:

? planning risk – e.g., the risk that planning permission for the construction project may be refused;

? design risk – e.g., the risk that the design solution adopted may not work satisfactorily;

? construction risk –e.g., the risk changes in labour and material costs leading to construction time and cost overruns;

? operating risk –e.g., the risk that factors such as inadequate cost management and poor maintenance scheduling may result in operating costs being more than intended and the required standards of performance and availability not being met;

? demand risk –e.g., the risk that usage of the service varies from the level forecast;

? financial risk – e.g., the risk that factors such as fluctuations in exchange rates and variations in financial costs may lead to operating or capital losses;

? legislative risk – including the risk that a regulatory or legislative change may be made that significantly affects the ability of the contractor to continue to meet its contractual obligations.

6.4 Undertaking the preliminary risk assessment

A preliminary risk assessment is required to identify the potential risks in a project and to consider how they might best be allocated between the contracting authority and a private sector operator.

6.4.1 The steps in a preliminary risk assessment are:

- Preliminary Risk Identification

An identification of the main risks associated with the design, construction and operation of an infrastructure project

- Preliminary Risk Allocation

An initial view of who will be better able to manage each risk – the contracting authority or the private operator

- Qualitative Risk Assessment

A qualitative assessment of the potential significance or impact of each risk

- Preliminary Risk Quantification

A preliminary assessment of the monetary value of the most significant risks

6.5 Risk Management Plans

It is important that contracting authorities establish appropriate plans to manage the risks that they retain. These plans should set out

- how the retained risks will be monitored;
- the actions that will be taken by the contracting authority to manage risks if and when they occur; and
- the plans of the contractor to manage those risks that have been allocated to it.

Section 7: The Public Sector Comparator (PSC)

7.1 Definition of Public Sector Comparator

The PSC estimates the hypothetical risk-adjusted cost if a project were to be financed, owned and implemented by government. The PSC is based on the most efficient form and means of government delivery and is developed according to the required output specification.

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.

- ***Transferable Risk***;

The value of Transferable Risk to the bidder 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.

- ***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.

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

7.2 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.

7.3 Third-party revenue and the PSC

Third-party revenue may be generated where:

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

Expected third-party revenue over the life of the Reference Project reduces the net cost to government and should be deducted from total operating costs in the Raw PSC.

Raw PSC = (operating costs - third party revenue) + capital costs

7.4 Sensitivity Analysis

Sensitivity analysis should be performed on key cash flows and assumptions to determine the robustness of the PSC to potential changes in assumptions, risk components and the forecast operating environment over the term of the project.

Section 8: Request for Proposals (RFP)

8.1 Input v/s Output Specifications

Performance-based output specifications rather than **input specifications** are prescribed under PPP. Bidders are invited to propose solutions for the services required by the contracting authority. The advantage with output specification is that the private party is encouraged to come with more innovative ideas.

8.2 Duration of Contract

The duration of contracts under PPP is longer than under traditional procurement. This is because the private entity is required to undertake responsibilities such as design, maintenance, and operation, many of which are often carried out by the Government under traditional procurement.

8.3 Allocation of Risks

Under PPP, the public and private parties allocate risks to the party which is in a better position to manage them.

8.4 Modality of payment

The PPP agreement provides payment to the private party only when the project is completed and operational. The payments are effected on the basis of pre-agreed performance criteria. Penalties are deducted from payments if the services are below the acceptable performance level.

8.5 The Selection Exercise

8.5.1 Documents to be prepared

The contracting authority has to prepare all the documents pertaining to the bidding process, and if need be, with the help of a Transaction Adviser. The various documents which the contracting authority may have to prepare are as follows:

(a) Request for Expression of Interest (REOI) for the pre-selection exercise (optional)
(b) Request for Qualification (RFQ) (optional)
(c) Request for Proposals (RFP)

8.5.2 Invitation for Expression of Interest

8.2.3.1 The contracting authority should consult the CTB to obtain its authorization to conduct the pre-selection exercise.

8.5.2.1 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.

8.5.3 Request for Qualifications

8.5.3.1 Following the selection of interested bidders the Government may invite them to respond to a Request for Qualifications (RFQ) or to the RFP.

8.5.3.2 The aim of the RFQ is to evaluate the interested bidders on the basis of commercial and technical criteria.

8.5.3.3 The short list obtained after the RFQ exercise should be kept, if possible, to a minimum of three and a maximum of five organizations.

8.5.4 Preparation and Issue of the RFP Package

8.5.4.1 The next step is for the implementing body to prepare and issue the RFP. The RFP consists of the tender documents under the official letter of the implementing contracting authority. It may contain the following sections:

- Introduction
- Project Background
- Output Specification
- Project Milestones
- Instructions to Bidders
- Form of Contract
- Bid Forms
- Supplemental Information

8.5.4.2 After evaluation is carried out, the CTB may recommend the contracting authority to enter into negotiations with the preferred bidder.

8.5.4.3 If, after negotiations, there are changes in the terms of the agreement which have a significant impact on the feasibility study, the contracting authority should to seek the approval of the Financial Secretary.

8.5.4.4 After the evaluation exercise and negotiation have been completed, the contracting authority should seek Cabinet Approval for the award of the project to the selected private body. The PPP Agreement between the contracting authority and the private body is signed at this stage.

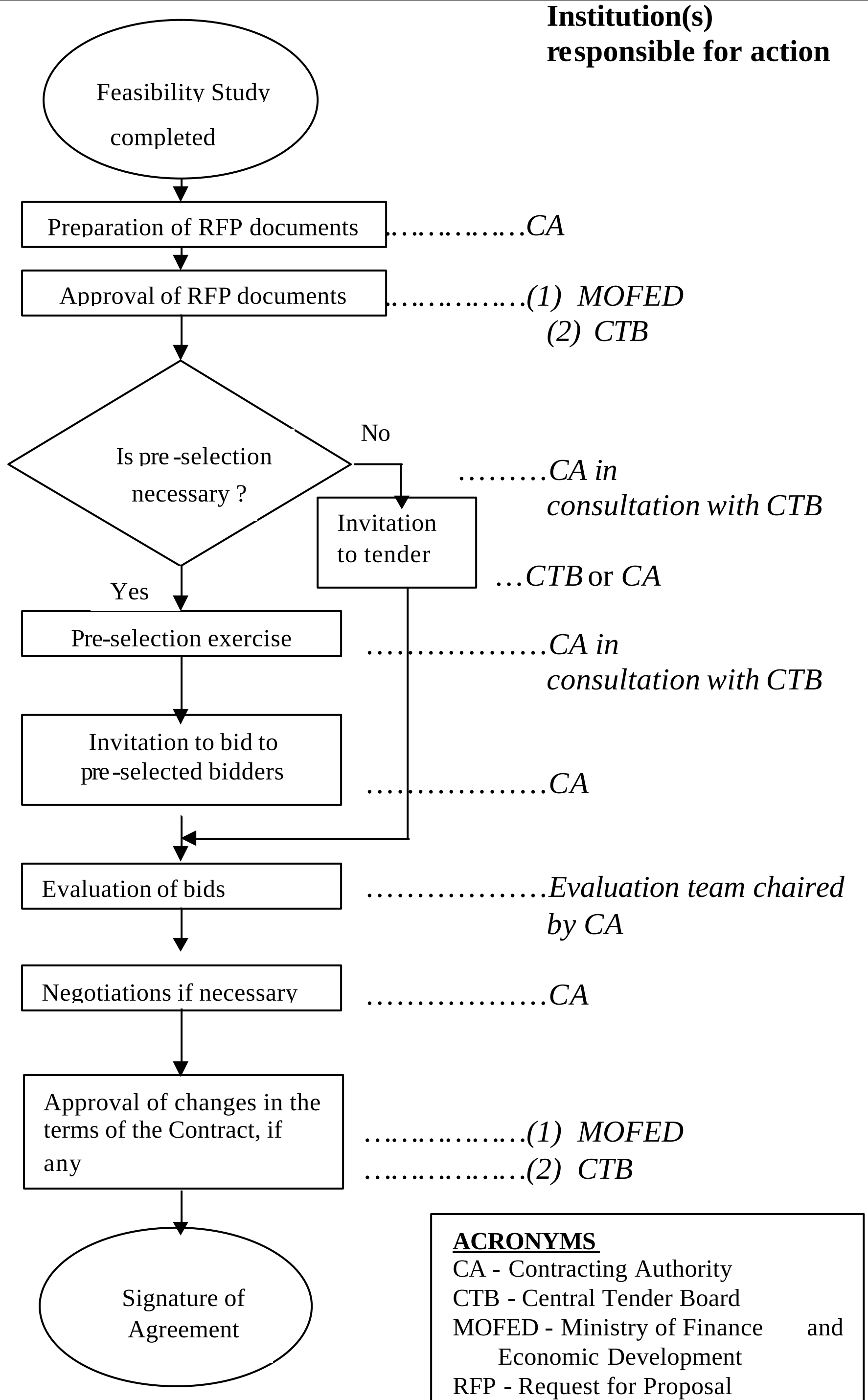
8.6 Evaluation of proposals

8.6.1 *The role of the CTB*. The PPP Legislation clearly defines the role of the CTB in the evaluation process. At section 13 (2) (b) the Legislation states that the CTB "shall examine and evaluate all the bids received". The CTB may, however, delegate this responsibility to the implementing contracting authority as stated at Section 10 (2) (c) of the PPP Act.

8.6.2 *Evaluation Team.* An evaluation team including the necessary expertise has to be set up under the chairmanship of the CTB or the contracting authority as per the decision of the former.

8.6.3 *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 the allocation of marks.

Summary of Procurement Process



ACRONYMS

CA - Contracting Authority
CTB - Central Tender Board
MOFED - Ministry of Finance and Economic Development
RFP - Request for Proposal