

# Attracting Investors to African Public-Private Partnerships

A PROJECT PREPARATION GUIDE



THE WORLD BANK



PPIAF

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The Infrastructure Consortium for Africa  
Le Consortium pour les infrastructures en Afrique



**PPIAF**

PUBLIC-PRIVATE INFRASTRUCTURE ADVISORY FACILITY

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## ABOUT THE AUTHORS

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## ABBREVIATIONS

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BLT	build, lease, and transfer
BNA	Banque Nationale d'Algérie
BOO	build, own, and operate
BOT	build, operate, and transfer
BROT	build, rehabilitate, operate, and transfer
CDC	Commonwealth Development Corporation
DBFO	design, build, finance, and operate
DFI	development finance institution
EoI	expression of interest
FBC	final business case
ICA	Infrastructure Consortium for Africa
MPDC	Maputo Port Development Company
OBC	outline business case
PAT	PanAfrican Tanzania Limited
PFI	private finance initiative
PIM	project information memorandum
PPA	power purchase agreement
PPI	private participation in infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	public-private partnership
PPS	projects for the provision of services
PQQ	prequalification questionnaire

PUK	Partnerships UK
RfQ	request for qualification
RLT	rehabilitate, lease or rent, and transfer
ROT	rehabilitate, operate, and transfer
SEEG	Société d'Énergie et d'Eau du Gabon
SMART	specific, measurable, achievable, realistic, and timely
TANESCO	Tanzania Electric Supply Company
TDFL	Tanzania Development Finance Company
TPDC	Tanzania Petroleum Development Corporation

# 1.

## INTRODUCTION

What transforms a public-private partnership (PPP) project from a desirable project on a government “wish list” to an attractive investment opportunity in the eyes of a potential private sector partner? This guide seeks to enhance the chances of developing effective partnerships between the public and the private sectors by addressing one of the main obstacles to the effective delivery of PPP projects: having the right information on the right project for the right partners at the right time.

The World Bank’s Private Participation in Infrastructure (PPI) Project Database<sup>1</sup> suggests that other regions of the developing world have moved ahead of Africa in involving the private sector in infrastructure development (see figure 1.1), although investment commitments in Africa increased sharply in 2005–06.

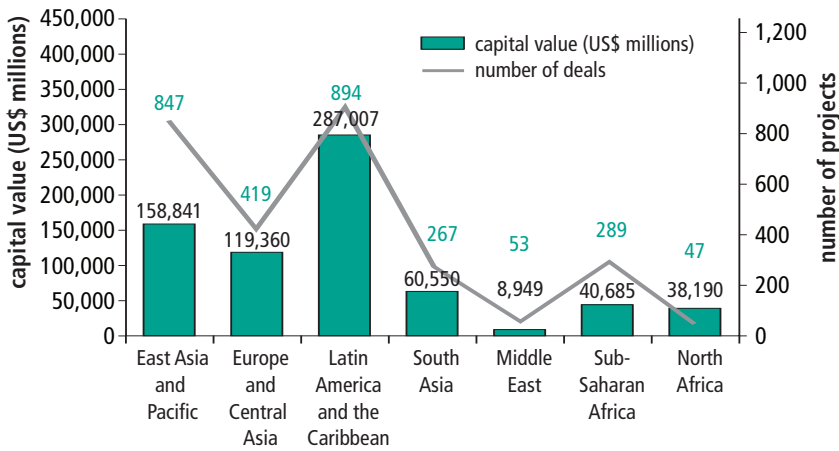
Set against the impressive growth rates in a number of African economies recently and the level of potential demand for investment (estimated at US\$38 billion a year), low *demand* for infrastructure is unlikely to be the reason for the relatively low levels of PPP activity in Africa.<sup>2</sup> Equally, if the growth of some sectors such as mobile telephony across the continent is a guide, the ability and willingness of citizens to pay for better-quality infrastructure may not be the constraint. In other words, the work required is likely to be related

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<sup>1</sup> The PPI Project Database includes projects that are not PPPs as defined here, such as privatization projects or investment in regulated sectors such as mobile telephony (see appendix A); it also does not include social infrastructure PPP projects.

<sup>2</sup> In Africa 17 countries recorded annual growth of more than 5 percent over the past decade (Africa Partnership Forum 2007). The figure for potential demand is based on preliminary findings of a World Bank Africa Infrastructure Country Diagnostic Study.

**Figure 1.1** Number and Value of Private Participation in Infrastructure Projects, by Region, 1996–2006



Source: World Bank PPI Project Database.

to factors affecting the *supply* side of PPP projects, including the obstacles to mobilizing private sector resources.

Therefore, this guide focuses specifically on what should be done, and when, beginning with the early stages of the project development cycle. It is not a project preparation manual. However, it touches on many related issues, because project preparation and interface with the private sector should go hand in hand.

### Role of Public-Private Partnerships

Many governments are turning to the private sector to design, build, finance, and operate infrastructure facilities hitherto provided by the public sector. PPPs offer policy makers an opportunity to improve the delivery of services and the management of facilities. The other benefit is that of mobilizing private capital: the estimated demand for investment in public services shows that government and even donor resources fall far short of the amount required. For this reason, access to private capital can speed up the delivery of public infrastructure.

Governments are also turning to partnerships with the private sector as a means to improve the procurement of public services. The PPP process usually requires information about the true long-term cost of service delivery,

which generates a more realistic debate on project selection. By improving the identification of a project's long-term risks and the allocation of those risks between the public and private sectors, the PPP process enables a more efficient use of resources.

The contractual nature of PPPs acts as a powerful incentive to ensure that this long-term perspective is put into practice: the public sector can no longer procure infrastructure assets while failing to maintain them properly. At the same time, the private sector has incentives, as their capital is exposed to performance risk, to design and build these assets taking into account the costs of longer-term maintenance and renewal.

PPPs require governments to think and behave in new ways that require new skills. They can be a tool for reforming procurement and public service delivery and not merely a means of leveraging private sector resources. PPPs are more than a one-off financial transaction with the private sector. They need to be based on firm policy foundations and long-term political commitment. Private sector partners look for these factors when deciding whether or not to bid for a project.

The other challenge for governments is the fact that resources are usually less readily available for the activities that lay the foundations for a successful PPP than for project-specific procurement activities. However, without the right policies, institutions, and processes, the transactions that follow often fail.

Although most forms of PPP involve a contractual relationship between the public and private parties, the long-term nature of these contracts creates a strong long-term mutuality of interest. PPPs are not just a step in the procurement process; given their long-term nature, they differ from traditional procurement contracts, which often are associated with a short-term "claims culture." Early evidence of operational contracts in more mature PPP programs shows that in many cases the parties can recognize this mutuality of interest without adversely affecting the mechanisms in the formal contract that determine performance.

## **Scope of the Guide**

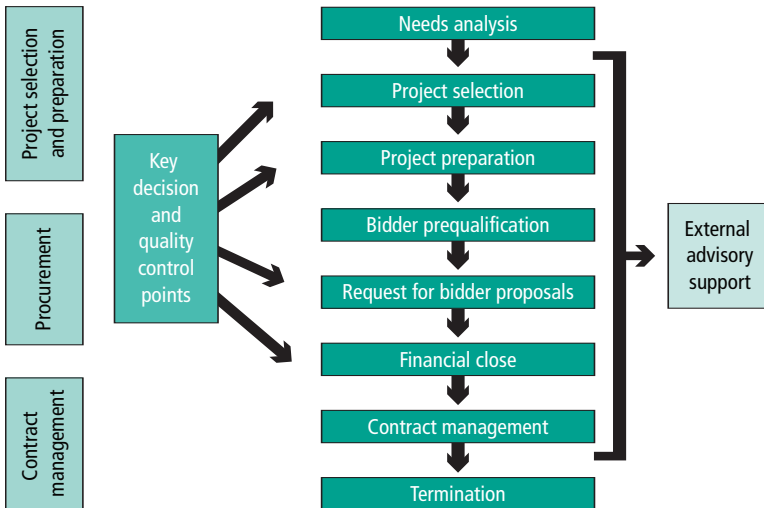
This guide starts with a review of the meaning of the term PPP, which can be difficult to define (chapter 2). This is followed by a look at the foundation blocks for engaging with the private sector (chapter 3), an assessment of the issues relevant to project selection (chapter 4), and a review of the actions involved in preparing projects for market, including how the process should be managed (chapter 5). The particular issue of managing advisers is examined in chapter 6, while chapter 7 looks at how the public sector should interact with the private sector during the project selection and preparation



phases, to ensure that decisions made during these phases are based on a realistic view of what the private sector can provide. The last two chapters look briefly at the issues of engagement with the private sector during the competitive procurement, or tender, stage (chapter 8) and after the contract has been signed (chapter 9). While contract signature is often regarded as the conclusion of the process, the true success of the project will depend on the delivery of quality services.

The proper preparation of PPP projects may appear challenging at first. However, breaking the task into a series of defined steps and processes (many of which also apply to traditional public investment projects) can greatly simplify it (see figure 1.2). Equally, the public sector cannot be expected to have all the necessary resources in-house; legal, technical, financial, environmental, and other advisers are frequently used throughout the process. The challenge is to select the right advisers and to manage them effectively.

**Figure 1.2 Key Phases of the Public-Private Partnership Project Process**



Source: Authors.

## Limits to the Guide

There are inevitable limits to the usefulness of any guide in an area as complex as PPP project development, especially where the scope of projects and the range of operating environments vary enormously. This is a guide, not a set of rules. It has been prepared with the aim of assisting public sector officials charged with delivering infrastructure projects and with ensuring that these projects attract adequate private sector interest in a competitive process. The hope, however, is that it will provide useful general principles to inform the development of more detailed practices suited to the particular circumstances of each project.



2.

## DEFINING PUBLIC-PRIVATE PARTNERSHIPS

The term public-private partnership (PPP) does not have a legal meaning and can be used to describe a wide variety of arrangements involving the public and private sectors working together in some way. Policy makers have invented an ingenious array of terms to summarize what they are trying to achieve. It is therefore necessary for them to be very clear about *why* they are looking to partner with the private sector, *what* forms of PPP they have in mind, and *how* they should articulate this complex concept.

### Privatization and Management Contracts

Many commentators show PPPs as lying on a continuum between privatization (maximum involvement of the private sector) and short-term service contracts (minimum involvement of the private sector). This can be misleading if it gives the impression that privatization, for example, is a form of PPP. There is a very clear difference between these two forms of private sector engagement: under a PPP, the public sector *retains* ultimate accountability to the citizen for the provision of a public service, whereas under privatization, accountability for delivery is *transferred* to the private party. This can be an important issue when governments seek to engage public understanding of and support for PPPs and begin to identify the skills and processes needed. Some governments have deliberately sought to brand their PPP programs to distinguish them directly from privatization. In Mexico, for example, certain PPP projects are referred to as projects for the provision of services (PPS).

The distinction between PPPs and privatization is also reflected in the fact that privatized industries may be subject to general legal regulations (for

example, regarding standards for services or returns on capital), whereas PPPs are usually subject to controls within the specific contract.<sup>1</sup>

At the other end of the spectrum, shorter-term management or lease contracts with limited private sector investment are sometimes described as PPPs. Irrigation schemes, management of rural roads, or water and sewerage projects may use this approach. These projects share some characteristics with the capital-intensive PPPs discussed in this guide, but the transfer of risks to the private sector is limited, with implications for the incentives and nature of the partnership. In particular, while the private party's profit may be at risk, only limited private sector capital is at risk, and therefore important disciplines found in PPPs, such as the lenders' due diligence and subsequent exposure to performance risk, are absent.

### Types of Public-Private Partnerships

While PPPs come in a variety of forms, this guide focuses primarily on those that arrange for a private party to provide public infrastructure under a long-term contract with a public sector body.<sup>2</sup> Under such an arrangement, the private sector party usually agrees to undertake the following:

- Design and build or upgrade the public sector infrastructure
- Assume substantial financial, technical, and operational risks
- Receive a financial return through payments over the life of the contract from users, from the public sector, or from a combination of the two
- Return the infrastructure to public sector ownership at the end of the contract (in some cases the private party may retain ownership of the asset).

Terms such as BOT (build, operate, and transfer) or DBFO (design, build, finance, and operate) are often used to describe such schemes. When the infrastructure is not returned to the public sector, it is sometimes referred to as a BOO (build, own, and operate) contract. While different sectors will have their own particular issues, these arrangements can apply across a wide range of infrastructure provision. Whether in power generation, roads, or the provision of schools or hospitals, the broad nature of the PPP is determined by what rights, obligations, and risks are assumed by the public or private parties within the partnership. In this regard, two principal forms of PPP are common: concession and availability-based PPPs.

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<sup>1</sup> Although general regulatory constraints may also apply or be reflected in the contract.

<sup>2</sup> This body is referred to in this guide as the "public authority," which may be a central, regional, or local government or an autonomous public body such as a roads agency.

### *Concession PPPs*

In a concession PPP, a public authority grants a private party the right to design, build, finance, and operate an infrastructure asset owned by the public sector. The concession PPP contract is for a fixed period, say 25–30 years, after which responsibility for operation reverts to the public authority. The private party recoups its investment, operating, and financing costs and its profit by charging members of the public a user fee (for example, a toll). Thus a key feature is that the private party usually assumes the risk of demand for use of the asset, in addition to the risks of design, finance, construction, and operation. However, demand risk may be allocated in various ways: for example, the public authority may share the risk by underwriting a minimum level of usage. User charges may be either prescribed in the PPP contract or set by the concessionaire. Typical examples of this type of PPP include toll roads, railways, urban transport schemes, ports, and airports.

Franchises are a subset of concession PPPs in which the private sector takes over existing public infrastructure, operating and maintaining it under a fixed-term contract, often with an obligation to upgrade it. They are common, for example, in the rail sector. The private party often pays an initial lump sum of money to the public authority to acquire the franchise. Clearly the dividing line between franchises and concessions is not precise. If a project involves a high level of initial investment in new or upgraded infrastructure, it may be called a concession, whereas if it involves a limited level of initial investment (even if there are long-term maintenance requirements), it may be called a franchise.

### *Availability-Based PPPs*

The other main form of PPP is similar to a concession PPP, in that it also involves the private party designing, financing, building or rebuilding, and subsequently operating and maintaining the necessary infrastructure. However, in this case, the public authority (as opposed to the user) makes payments to the private party, as, when, and to the extent that a public service (not an asset) is made *available*.<sup>3</sup> Hence the demand or usage risk remains with the public authority.

The original form of availability-based PPP is the power purchase agreement (PPA) used in power generation projects. In this case, private investors build a power generation plant and contract to sell the electricity generated

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<sup>3</sup> A hybrid of the concession (user paid, demand risk) and availability-based (public sector paid) PPP is the use of “shadow tolls” in PPP road projects: here payment is made by the public sector, based on usage by drivers.

to a publicly owned power utility.<sup>4</sup> The public authority assumes the demand risk and makes a minimum payment for availability (or capacity) of the power plant, whether or not its output is required. (A further payment is made for usage, to cover the cost of fuel for the plant.)

The PPA structure can be used for any kind of “process plant” project—that is, cases where something goes in one end and comes out the other end, such as gas converted to electricity or transported in a pipeline. The same principle can be used for waste treatment plants.

A further development of the PPA structure is also used in social infrastructure projects, such as schools, hospitals, prisons, or government buildings, as well as in other non-“self-funding” projects such as rural roads. Such PPPs are used where *accommodation* is provided or where *equipment* or a *system* is made available. In all these cases, payments are again generally based on the availability of the accommodation facility, equipment, or system and not on the volume of usage (the contractual structure is outlined in figure 4.3).

Governments have found these types of PPP to be very effective in ensuring that public facilities are delivered on time and on budget, are properly maintained, and are able to deliver public services in the context of constrained resources. The United Kingdom pioneered this form of PPP as part of its private finance initiative (PFI) program for the provision of social infrastructure, and many other countries, such as South Africa, are increasingly using this approach. For the purposes of this guide, these types of PPP are called PFI-model PPPs. In some countries these forms of PPP are referred to as annuity schemes. However, if an annuity is paid *irrespective* of performance, these schemes are just another form of government borrowing and fall outside the scope of PPPs as discussed in this guide.

Whether to use a concession or an availability-based PPP is both a policy decision and a reflection of who is best placed to pay for the service. The affordability of PFI-model PPPs is likely to be an issue in Africa because such projects do not involve user payment mechanisms.<sup>5</sup> However, concession PPPs present their own challenges with regard to demand risk and user

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<sup>4</sup> In this case the off-taker does not have to be a public authority; in countries where the electricity sector has been privatized, a private sector power distributor can sign the power purchase agreement in lieu of a public authority. This is clearly not a PPP, as only private sector parties are involved.

<sup>5</sup> Availability-based PPPs, such as power purchase agreements, have indirect user payments that are collected by an electricity distribution authority and fed back to make payments under the agreement; however, as noted, the private sector party to the agreement does not take any risk regarding either the demand for electricity or the adequacy of payments received by the distribution authority.

affordability. It is important to establish the appropriate level and scope of services, looking at the opportunities to blend concession and PFI-model approaches and to tailor overseas development assistance into longer-term, performance-based contracting support or capital grants blended with the private financing requirements.

### *Transnational Projects*

Many African infrastructure projects are transnational in nature. This characteristic can present added complexity, involving different jurisdictions and multiple procurement authorities, placing further pressure on governments (and creating additional risks), as the private sector does not expect to have to resolve jurisdictional issues. If the private sector has to resolve such issues, it will begin to question the level of public sector commitment to the project. Otherwise, most of the underlying issues of good project preparation are the same as for national projects. The transnational nature merely places a brighter spotlight on these issues. Thus throughout the project preparation and tendering process, additional attention will need to be paid to the following:

- Clear ownership of the project, especially at the *country level*
- Alignment of policies among the relevant governments as they affect the project
- Clear, appropriately aligned legal and procurement processes
- Appropriate joint governance and approval processes, with the delegation of suitable authorities from the respective governments
- The design and operation of the public sector party responsible for drawing up and managing the contracts
- The possible need for common technical, safety, environmental, social, and other operating standards.





### 3.

## SETTING THE FRAMEWORK

Time and effort spent laying the right foundations by establishing a clear public-private partnership (PPP) policy rationale, a legal framework, an investment framework (including an approval process), along with a well-organized operating framework and then informing potential investors of their existence will ensure a much better private sector response when project procurements are launched.

One immediate difficulty is that public sector resources are often made available only at the later stages of project preparation, usually at or near the tendering or procurement phase. Resources are usually much less readily available at the early stages of program or project preparation, often because the outcomes are less well defined or certain at this stage. However, investing time and effort up front in laying the right foundations can have a positive impact on the project's success and be an efficient use of public resources. In countries where public sector processes and institutional capacity are weak, managing the relatively complex PPP process is especially challenging and should not be underestimated. Governments and donors should seek to ensure that such early-stage activities are sufficiently resourced.

### **Policy Rationale**

Establishing a clear policy framework helps both the public and the private sectors to understand the core rationale for PPPs and how the public sector will go about making them happen. PPPs are difficult to deliver in an unstable policy environment. When assessing a PPP market, the private sector expects to see a PPP policy that sets out the following:

- The rationale for using PPPs
- The guidelines that the public sector will use to assess PPP projects in a consistent way
- The determination of who approves what and when throughout the process of project selection, preparation, and procurement
- The process of resolving disputes (often set out in legislation).

The private sector will also want to know about the process and what is involved, to assess how much it will cost to prepare and submit a bid for projects (such as whether and when detailed designs will have to be developed), how long the bidding process will take, how workable and transparent it will be, how the public authority will manage the partnership in the long term, and, above all, how committed is the government to the project. The more transparent the objectives, targets, and consequences of the PPP, the more effective the partnership will be.

Governments should expect to establish a clear evaluation and process map that sets out the following: key decision points along the process, timelines, criteria for project selection and eligibility, and principles or criteria for evaluating bids.

For example, the South African Treasury's Public Finance Management Act regulates and sets out the responsibilities to ensure efficient and effective government financial management. Under this act, Treasury Regulation 16 specifies the required approvals and responsibilities, and detailed guidance, in the form of a PPP manual, have been developed to cover the range of processes involved.

## **Legal Framework**

Private sector investors always examine the legal framework and its ability to ensure the effectiveness of long-term PPP contracts. Legislation may be needed to allow a private sector company to charge and collect user fees under a concession PPP. Specific laws may also be required to allow the public sector to contract with private bodies for the delivery of services hitherto provided only by the state.

The private sector may be expected to ask the following key questions of either the law or the PPP contract itself:

- Does the public sector have a robust, forward-planning program and allocation process to ensure that payments can be made when due, such as obligations against future budgets?

- Is combined procurement of construction and long-term operation and maintenance permitted (or do these phases have to be procured under separate contracts)?
- What are the investors' rights (what happens if a contract is terminated early)?
- How will repatriation of profits be treated for overseas investors, and what restrictions, if any, will there be on the use of expatriate personnel?
- What are the lenders' rights (for example, the lenders' ability to take security over the contract—lenders do not usually have security over the underlying infrastructure asset, as this ultimately belongs to the public sector—or to take over management of the asset when enforcing their security)?
- How will contract disputes be resolved, and what rights and obligations are required of either party in the event that the project does not go according to plan?
- How will payments be taxed under the project (for example, sales or value-added taxes on construction costs or service payments)?
- What forms of government support are likely to be available for certain risks (for example, minimum-traffic guarantees on a toll road)?
- How will changes to the contract be handled, and what compensation mechanisms will be used?
- Are unsolicited proposals permitted, and, if so, how will they be treated?

The extent to which these issues are covered in general administrative law or specific contracts of the project depends on the legal system concerned. But with PPP programs developing around the world, there are often benefits to be gained from adopting legal solutions used in markets with successfully operating PPP programs, as the private sector is already familiar with the approaches.

There is often a balance to be struck between a fixed legal framework and a flexible one that is able to respond to developments in best practice over time. Investors have a strong preference for certainty, detail, and clarity in the legislative framework, so long as it is a good framework. However, as a note of caution, highly detailed PPP legislation has sometimes been developed from an early stage of a program without input from the experience of actual projects (functioning either domestically or internationally). This legislation has sometimes proved to be unworkable and difficult to change. It may be preferable to set out *core principles* (based on international best practice) in framework legislation and to use administrative rules to set out more *detailed law* that may respond in a logical and consultative way over time to inevitable changes in policy and the market.

## Investment Framework

PPP programs often start with one-off projects that deliver experience and build confidence in the ability of government to develop programs later. In many countries, there may simply be only one or two projects in a sector, too few to constitute a program.

Wherever possible, an infrastructure investment plan is a good way for government to present its approach to investment to the private sector and to demonstrate top-level political commitment. Investment plans, however, must be presented carefully and in the proper context so that they are not perceived as a wish list of projects lacking credibility and coherence. Such plans generally do not commit to using the PPP process for the entire program, but instead set out the level of investment required, the links between private and public investment, and areas within the plan where government expects PPPs to play a role.

Also, wherever there is the opportunity, it makes sense to develop programs in specific sectors, as the benefits of replicability for both the costs and the quality of the PPP process can be significant for both the public and the private sectors.

Well-prepared investment plans also help the private sector to understand the general environment for individual projects. A port project may make little commercial sense unless, say, there is connecting rail transport infrastructure or reforms in transit and customs clearance.

The other useful role of investment plans, and the project pipelines that these may set out, is to encourage more bids from high-quality investors: given the costs of bid preparation, investors are more likely to take an interest in a program than in a one-off project. In a program with a series of bids they will have more than one chance to submit a winning bid and can spread some of the general costs of bid preparation over the series.

As the viability of many projects may depend on regional as well as local factors, the role of regional economic communities in facilitating projects may also be important.

## Operating Framework

While many governments understand the need for a sound policy rationale and for strong legal and investment frameworks, investors want assurances that the operating framework *within government* is capable of managing the PPP process and that policy makers and the parties implementing projects have a realistic understanding of the complexity of PPP projects. In particular, public procurement authorities often fail to appreciate the significant differences between PPPs and traditional forms of procurement and the

implications of these differences for the level of resources, the unique skills, and the new processes and institutions required. Indeed, implementing a PPP program may often lead to fundamental changes in the way a public authority perceives its role and the way it goes about its business.

Subsequent chapters discuss the frameworks for decision making or “governance” of individual projects and how the rules relating to the development, construction, financing, and operation of PPPs are made. To ensure better quality and consistency in the way the public sector goes about this, the private sector often expects to see a centralized source of PPP expertise giving support to individual public sector project teams. In this regard, the relevance of PPP units is increasingly recognized, and there is a growing body of experience and literature on this issue, which need not be covered here (see Sanghi, Sundakov, and Hankinson 2007).

However, projects are usually better being “owned” by their respective public authority throughout their life rather than being centrally procured. A PPP unit, therefore, usually only plays a *supporting* role: it helps the public authority to prepare the project and, where necessary, to select and manage specialist advisers; in addition, it ensures that the project fits into the overall PPP policy. A PPP unit may also play a role in project *approval* and *quality assurance* throughout the process of project development. Conflicts of interest between these roles can be resolved by making decisions outside the unit, even when a decision is supported by the unit’s evaluation. An important principle, however, is that, in developing operational rules and processes, government must also create mechanisms to help the public authority to follow the rules. Nevertheless, balancing the roles of project support and approval is often difficult, as it requires achieving the right level of engagement between the unit and the project team. This calls for high-quality, credible staff led by someone who commands respect across government and enjoys strong political support at senior levels. In cases where the program is sufficiently large, a sector-focused unit may also be found within the line ministry itself.

The importance of having a competent PPP unit that is staffed with highly qualified individuals able to work across government cannot be overemphasized, if a successful PPP program is to be delivered. Yet resourcing a PPP unit is often one of the most difficult challenges for governments at the early stages of program development.

Equally, the importance of reusing or retaining the experience of public officers who have been through a PPP transaction is often poorly recognized, as individuals return to their previous function or depart for the private sector. The experience of these officers is invaluable to the public sector as well

as to the private sector, which takes considerable comfort from working with public officials who have been through the process before.

Given the institutional weaknesses and challenges that exist in Africa, it may be possible to support project delivery by leveraging the project management capacity of major resource development companies, which are increasingly active in Africa. Such companies could be asked to consider delivering and managing social infrastructure services such as schools and health infrastructure alongside their commercial investment activities.

## Summary

In summary, time and effort must be spent laying the foundations for successful public-private partnerships:

- Establish and clarify the policy framework, as the private sector needs to understand the drivers that lie behind the projects
- Establish a clear legal framework, as PPPs depend heavily on contracts that are effective and enforceable
- Ensure consistency, as well as clarity, of the policy and legal framework, which reduces uncertainty for investors
- Use legal terms and approaches, where possible, that are familiar to the international private sector
- Draw up investment plans, which can be useful to demonstrate high-level political support, to indicate the potential flow of future projects, and to explain how projects fit together, even regionally
- Avoid sending out wish lists of disconnected projects that are not part of a coherent program
- Establish a clear PPP process map
- Create a PPP unit within government, with relevant commercial and legal skills, which is a key source of support for policy makers and project developers. It helps to ensure consistency and credibility. Credibility can send a powerful signal to the private sector about the public sector's competence and seriousness of intent
- Capitalize on the experience of others who have managed the process, as the private sector takes considerable comfort from working with public officials who have been through the process before
- Consider involving private sector resource companies that are engaged in other investment activities in the delivery and management of infrastructure projects.

## 4.

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# SELECTING PROJECTS

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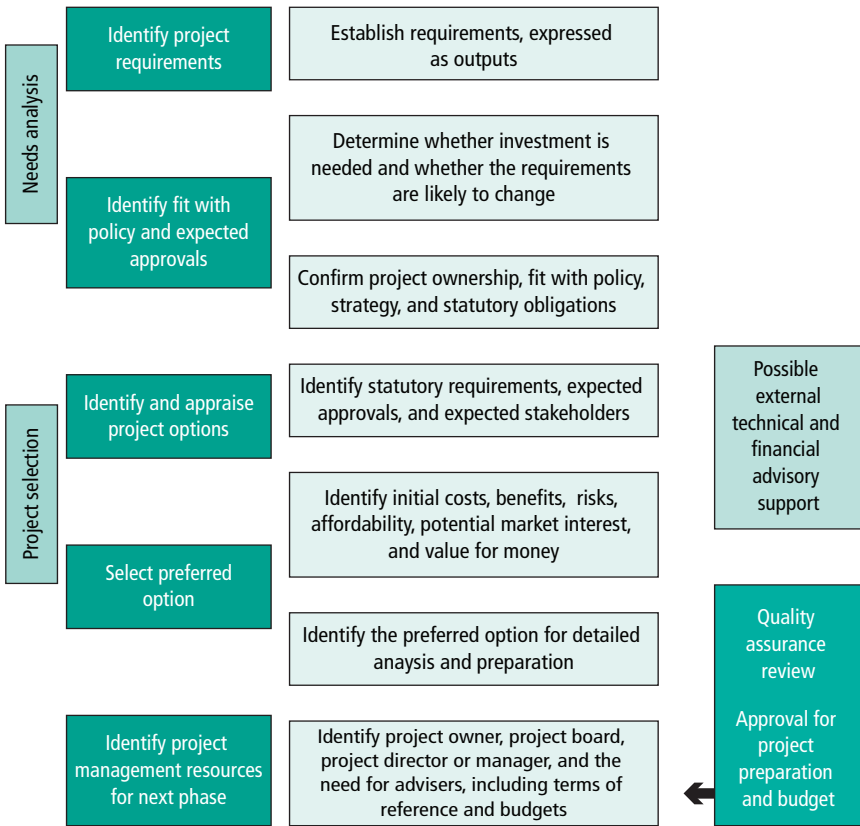
Turning a desirable concept into a realizable public-private partnership (PPP) project requires significant resources. After examining the stages of project selection, this chapter considers lessons derived from African experience to date.

It is common practice to split the project selection phase into a series of steps (see figure 4.1). The first step is to conduct a high-level review of the service need: the justification for a project and its prospects for delivery as a PPP. This step is sometimes referred to as the “strategic business case” phase. Key advisers may be contracted at this stage to help the public sector with its decision making. Projects that are unlikely to deliver the government’s overall policy requirements or that have few prospects as a PPP can be eliminated at an early stage, before incurring significant costs and damaging the credibility of the project and the government. The next step seeks to turn the projects with a greater chance of success into realistic opportunities for private sector participation, although projects may be eliminated throughout the process. This may also involve an initial market assessment.

The selection and preparation of projects are rarely a tidy sequential process; instead they are an iterative process. Thus some of the key questions posed early on will be asked again at later stages; they may simply be addressed in less detail at the early strategic business case stage. The project selection phase seeks to answer three key questions, initially at a high level and then in more detail as the project becomes defined more clearly:



**Figure 4.1 Stages of Project Selection**



Source: Authors.

- What are the project’s scope and requirements?
- Can the project be delivered as a PPP?
- Should the project be delivered as a PPP?

### Project Scope and Requirements

The basic rationale for a project may appear obvious—to upgrade a major congested intercity road link or build a power-generating facility to meet rapidly increasing demand—and it may be part of an existing higher-level investment program, where the decision may already have been made at a policy level (hence the relevance of an investment plan).

But how many lanes should the road include, what should its alignment be, or would rail be a better option? One of the fundamental causes of project failure, for *both* traditional public sector procurement and PPPs, is often a lack of clarity on the part of the public authority regarding the exact scope and requirements of the project. At the outset, lack of clarity usually means change later on. If this happens during the procurement phase, then the level of private sector interest may be significantly reduced or the procurement phase will be drawn out, which can cause higher costs and delays for both parties. If change takes place during the construction or operating phases of a PPP, this may lead to significantly higher costs for the public sector. Clarity of scope should apply to all infrastructure projects. What distinguishes PPPs is that the long-term contractual relationship requires the public sector to be very clear from the start about the outputs needed from the project. The performance-based nature of the PPP also encourages the private sector party to focus on how it will deliver the output over the long term and to take into account the consequences of poor design and construction.

A disciplined approach to establishing the scope and requirements for a project usually involves identifying the business need and then assessing the relative costs and benefits of different options for project investment (irrespective of *how* they may be procured, which also requires assessment, the subject of the section in this chapter on value for money). This can take place with increasing levels of sophistication that will be practical (or impractical) depending on the availability of reliable data, the ability to identify and measure the full costs and benefits of the project, and the existence or otherwise of established tools such as an agreed public sector investment discount rate. Such analysis needs to focus on deliverability and the potential complexity of the work in relation to the project and the tools available.

### **Expressing Projects in Terms of Outputs**

Given the contractual nature of PPPs and the eventual need to define a project in commercial terms for the private sector, the public sector's requirements need to be identified clearly and unambiguously and expressed in the form of an output requirement (for example, the availability and price of power or water or the quality of accommodation services in a school). If requirements are likely to change significantly over the contract period, a PPP may not be appropriate. For example, experience has shown that projects involving a high component of information technology are often poorly suited to private finance initiative (PFI)–model PPPs: the requirements of the project are likely to change substantially over the medium term (together with the means of delivery as technology changes).

Traditional project procurement has usually focused on *inputs*, and so PPPs involve fundamental changes in the way projects are prepared and in the information that needs to be provided to private sector investors. A collection of engineering studies, typically produced by a public works department used to viewing projects in terms of inputs, will not engage the private sector in a PPP. Private sector investors expect to see in PPP contracts a clear set of output *requirements, associated standards*, and the *terms* by which they can expect to be paid. They want to understand from an early stage the risks they will be asked to assume.

For PFI-model projects, this can be especially demanding. A useful rule when developing output requirements is that they should be SMART—specific, measurable, achievable, realistic, and timely—if they are eventually to form the basis of a contract (see table 4.1). The same principles can apply to a concession PPP (defining, for example, the service requirements in an airport concession or a rail service).

**Table 4.1 An Example of Output Specifications for an Accommodation Public-Private Partnership**

<b>Characteristic</b>	<b>SMART</b>	<b>Not SMART</b>
Specific	Refurbish or replace all dwellings on the estate to comply with the government’s “Decent Homes” standard	Refurbish dwellings to a good standard
Measurable	Ensure that all dwellings are structurally sound, with adequate ventilation, lighting, and thermal comfort	Ensure that dwellings are fit for habitation
Achievable	Maintain internal temperature at X degrees when outside temperature is between Y and Z degrees	Ensure that internal temperature is always maintained at X degrees
Realistic	Ensure that faults with temperature control system are rectified within 8 hours during business hours and 16 hours outside business hours	Ensure that faults with the temperature control system are repaired within 2 hours
Timely	Maintain a log of faults and report every month	Provide an annual report on performance

Source: Authors.

Note: SMART = specific, measurable, achievable, realistic, and timely.

## Can the Project Be Delivered as a Public-Private Partnership?

Once the scope and requirements of the project have been broadly identified, is it feasible for the project to be delivered under a PPP structure? As mentioned, selecting and preparing projects are part of an iterative process in which the scope and requirements are modified as the project requirements converge with what is possible for the private sector to deliver and what is affordable. There are three key questions:

- Who will pay for the project and how (affordability)?
- What are the risks inherent in the project, and how should these be dealt with (risk allocation)?
- Will the resulting project be able to raise the required debt financing (bankability) and attract contractors and other equity investors?

Specialist advisers usually play a major role in assisting the public authority in developing the answers to these questions (see chapter 6).

### *Affordability*

Affordability examines the level and structure of the project's overall revenue requirements in relation to the capacity of users or the public authority to pay for the infrastructure service. This requires building up a picture 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 investors. To determine this, a project financial model is developed using the best estimates of capital, operating, and maintenance costs, appropriate cost escalation indexes, and assumed financing structure and terms; this model projects the cash flow over the proposed term of the PPP contract. Development of the model is one of the main roles of the financial and technical advisers (see chapter 6). At the early stages of project selection, this exercise may be conducted at a fairly high level, but it will involve increasing levels of detail during the project preparation stage. Assessing the private sector's capacity and willingness to deliver on the projected basis forms an important part of the initial market assessment.

Once the expected revenue requirements for the project have been established, for concession PPPs the capacity and willingness of users to pay for the infrastructure service then needs to be examined. This may require significant reform to existing tariff levels. The risks of such reform may be unacceptable to private investors, or the private party may be prepared to assume such risks but will add to the costs of the project a charge for the

risks, further affecting the tariff required. If the public sector will be required to make up the difference over the operating period, will the private party accept the long-term government payment risk that is involved? This may lead to a requirement for larger government payments to meet part of the up-front capital costs (sometimes to referred to as “viability gap funding”), but are these affordable, and will they reduce the incentive of the contractor to perform?

For availability-based PPPs, where the public authority, not the user, makes the payments over the period of the long-term contract, assessment of affordability is one of the most important aspects in considering deliverability of the project. These long-term payment obligations may present challenges for government (as well as investors), which in turn affect both the scope and level of services in the project design (with implications for value for money).

Options may need to be examined that combine direct fees from members of the public with government service payments or that contribute existing government assets to the project. Examples may include co-locating fee-paying and public medical facilities in the same project or contributing publicly owned land that has high commercial potential in exchange for lower long-term service payments (as long as the value-for-money case for doing so is clear).

Project selection therefore involves an early assessment of what payment structure is feasible, what the government or the users can afford to pay (and when), the impact on the project scope, service level, structure, and the associated risks the private sector might be prepared to accept. Although of less relevance for the private sector, this exercise helps the public sector to identify and manage any long-term fiscal obligations—implicit and explicit—that may result from PPPs.

### ***Risk Identification and Allocation***

In addition to assessing the sources of revenue linked with the affordability of the project, a complete picture of the risks that flow from the project requirements also needs to be established.

*Risk identification.* Identifying risk includes determining all the risks relevant to the project, possibly breaking this down over the various phases of the project (for example, construction, commissioning, early operation). Checklists of risks that typically apply to infrastructure projects can be used together with risk workshops in which the authority and relevant stakeholders can brainstorm the expected risks. A “risk register” can be used to record all risks and to serve as a checklist throughout the life of the project. The advisers can play an important role in this process.

*Risk allocation.* This involves allocating or sharing the responsibility for dealing with the consequences of each risk between the parties. The principle is to allocate the risk to the party best able to control its occurrence and consequences as well as to the party in the best position to assess information about the likelihood of the risk within the context of what is likely to be commercially acceptable to the private sector. There are only three parties to whom the risks can be allocated: users, investors (the private sector), and taxpayers (through the government). Risk does not disappear through contractual structuring; it is simply reallocated among the parties.

Risks associated with design, technology, construction, and operation are typically allocated to the private sector, which is usually more efficient at controlling and managing them. Other risks may be better managed by the public sector, such as regulatory, environmental, and foreign exchange risks, or may be shared, such as demand or change-of-law risks. *This exercise is one of the most important in assessing and developing the bankability of the project.* This process also helps to identify the issues that the public authority should resolve at the project preparation stage and ensures that, if the risks do in fact arise during the life of the project, both parties have agreed on what to do about them.

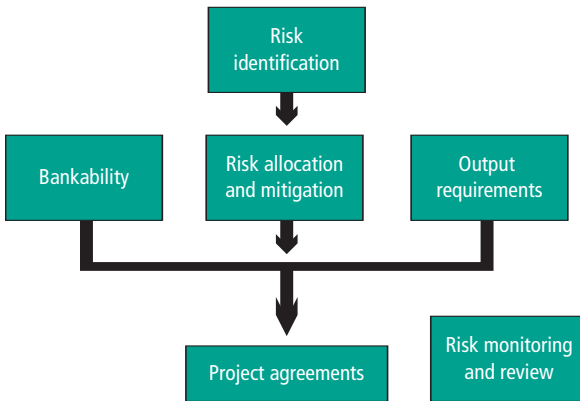
*Risk mitigation.* It is important to reduce the likelihood of risks and their consequences for the risk taker. A change in project scope can sometimes reduce risk. For example, giving the private sector party control over the fuel transport facilities for a power generation project, and including this in the scope of the project, may reduce interface risks.

*Risk monitoring and review.* Risk management is an ongoing process that continues throughout the life of the project (see figure 4.2). Existing risks need to be monitored and new risks identified as the project develops and the environment changes. The contract management team will normally update the risk management plan, which is linked to the risk register, regularly throughout the life of the project.

### ***Bankability***

The majority of third-party funding for PPP projects normally consists of long-term debt finance, which typically varies from 70 percent to as much as 90 percent of the total funding requirement (for example, in a PFI-model 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 project financing or limited-recourse financing) looks to the cash flow of the project as the principal source of security. This is quite different from corporate financing—the more usual basis on which

Figure 4.2 Elements of a Risk Management Plan



Source: Authors.

banks lend to businesses—where lenders rely on the value of the company’s assets. Infrastructure assets are effectively worthless without the underlying contractual structure,<sup>1</sup> which is why the detailed terms and conditions, and legal effectiveness, of the PPP contract are so important.

The lenders therefore take a strong interest in the performance of the project on which the repayment of their loans depends. They play a useful role in reviewing the financial viability—bankability—of the project on which their decision to lend will be based (a process known as due diligence) and in helping to ensure that the infrastructure asset is constructed and subsequently operated on time and on budget. In some markets and projects, the lenders may receive additional guarantees from the public sector in light of the perceived risks, but the availability of such guarantees must be considered carefully, as they transfer risk back to the public sector and may weaken the incentive of the lenders to care about the performance of the project (not to mention the potential fiscal liabilities these guarantees may create for the public sector).

The currency of the project’s cash flow must match the currency of the debt service, or the risk of any mismatch must be credibly covered either through hedging or by government taking the risk. As these options are either

<sup>1</sup> Even if the assets had a realizable value, lenders would not be allowed to take over, say, a road or a public hospital and then sell it to repay their debt.

difficult or very expensive to obtain for long-term debt in many African markets, one of the early considerations in assessing bankability is the availability of long-term funding that matches the currency of the project revenue. The tenure of the debt also has an impact on the affordability of the project: longer-term debt implies lower annual capital repayments and therefore lower annual costs.

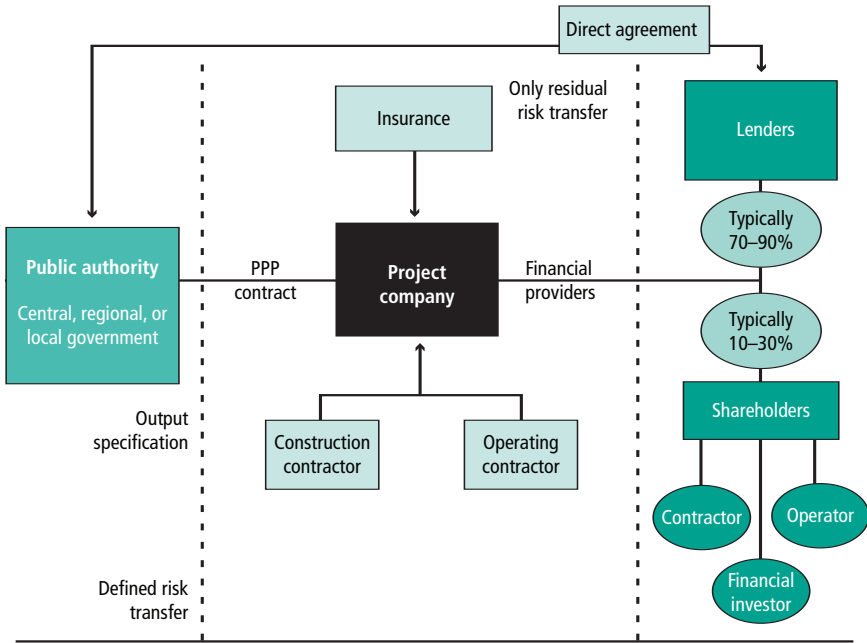
Apart from the debt, the balance of funding consists of equity, usually made available by the main contractors or by third-party financial investors. The return on equity also depends on the performance of the project after construction and operating costs. But as the return on equity is only received after the debt has been serviced, usually later in the life of the project, this higher risk implies higher returns. Equity funding is needed because the lenders require some cushion between the cash flow available from the project and that required to service the debt. Equity therefore plays a useful role in absorbing project risk and facilitating debt funding. Third-party equity investors (that is, those with no other contractual relationship with the project) can also be useful in sorting out any problems that may arise between the other private sector parties, as the return on their investment depends on the performance of the project contractors.

Thus a PPP structure involves not just the contractual relationship between the public and private sector, but also the web of contracts governing the relationship between the private sector parties themselves and the allocation of risks among them. This is summarized in figure 4.3. A special-purpose project company is usually established as the vehicle to bring all these contractual relationships together within the private sector. Lenders want to ensure that the risks allocated to the project company, to which they are lending, are in turn passed on as much as possible to the various subcontractors who will build and operate the project. The lenders therefore have a strong interest in the financial strength and technical capability of the subcontractors, in addition to the terms of the PPP contract. The availability of banks willing and able to provide project financing and the availability of strong and capable contractors go hand in hand. As shown in figure 4.3, there may also be a direct contractual relationship between the public sector and the lenders. This is not a guarantee, but a mechanism to govern the project if the lenders need to “step into” the shoes of the project company in the event that the contractors do not perform and alternative contractor arrangements are required.

Therefore, the public authority needs to develop a clear understanding of how the potential lenders perceive the risks of the project from the early stages of project selection and preparation and to establish potential terms of funding, including its tenure and currency.



**Figure 4.3 Typical Contractual Structure of a Public-Private Partnership**



Source: Authors.

### Value for Money

Even if a project can be delivered as a PPP, *should* it be? The question may often appear irrelevant if the alternative to a PPP is no project at all. This may arise where limitations on public sector funding preclude any alternative or where the project will be fully paid for by users.

Even in concession PPPs, some deployment of public resources is almost always involved. A toll is just another form of tax, and in a toll-road concession the grant of the concession carries an opportunity cost (toll revenues that could otherwise be available to the public sector or land rights that could be exploited along the highway). In addition, “contingent liabilities” for the public authority (such as a guaranteed minimum level of use) or alternative uses of public assets may need to be considered. In this case, the risks or costs of delivering the PPP project may significantly outweigh the perceived benefits. Clearly, in assessing options and contingencies, their likelihood of materializing needs to be taken into account.

For cases where there is a real possibility of a conventional public sector procurement alternative to a PPP, various quantitative approaches have been developed to help with the assessment. These approaches look at the risk-adjusted costs of adopting the PPP option versus the costs of using traditional procurement, taking into account the higher costs of private capital and the associated transaction costs, but adjusting for the value of the risk transfer between the public and private sectors. However, quantitative analysis is only as good as the available data and there is always a risk of relying too heavily on quantitative analysis, or worse, using it to justify a decision that has already been made. Other qualitative criteria, such as the expected quality of competition during the procurement phase, should also be taken into account. Such “value-for-money” methodology is beyond the scope of this guide, but a great deal of information is publicly available on how to go about it (see, for example, Partnerships Victoria 2001, 2003b; South Africa, National Treasury 2004b; United Kingdom, Her Majesty’s Treasury 2006). Experience to date suggests that such an assessment should start at the early stages of project consideration and not just at the PPP development stage, as is often the case.

While not necessarily directly relevant to the private sector’s perception of the project, such analysis underpins the project rationale and the choice, or otherwise, of creating a public-private partnership. It also underpins the allocation of risks (which is highly relevant to the private sector) and reduces the risk that the government will change its mind later on, which can damage the credibility of the PPP program in the eyes of investors.

Governments may also consider the case for a PPP project in the light of its potential impact beyond the project itself and its wider policy benefits. An example is the principle of contestability: procuring a public service through a PPP can drive change or reform, in effect holding up a mirror to the existing delivery of public services.

### **Initial Market Assessment**

At this stage, a reasonably well-developed picture of the project’s scope and its output, construction, operating, and funding requirements should be available. Projects that are unlikely to be affordable or whose funding requirements are clearly outside the scope of what may be available, can be eliminated quickly. For other projects, the answer may not be so clear. Provided that the public authority can provide a reasonably coherent picture of the intended scope and requirements of the project, it is well placed to initiate a constructive dialogue with the private sector—investors, lenders, and subcontractors—on the feasibility of the project’s scope and to establish the potential number of suppliers in the market. Such market sounding is discussed in detail in chapter 7.

## Lessons from Private Sector Engagement in Projects in Africa

An examination of recent projects in Africa, based on the World Bank Private Participation in Infrastructure (PPI) Project Database, provides some useful starting points from which to understand which sectors and types of PPI projects appear to have been developed more successfully than others (see appendix D for profiles of projects in various sectors and countries in Africa). This can be analyzed by looking at some of the key risks involved and whether or not the private sector was prepared to manage them.

### *Financial Viability*

As mentioned, private sector investors will only come to the table if the source and level of revenue to cover the project's costs are clear and predictable. The relatively low level of private sector participation in infrastructure in Africa reflects this issue. Most projects are likely to be concession PPPs, where users, rather than the public authority, are expected to pay (see figure 4.4).<sup>2</sup> For some sectors, where users have traditionally been subsidized by government (often at the expense of maintenance of the infrastructure asset itself), a realistic assessment of the true costs of subsidy often reveals that either a higher level of government support or significant tariff reform is needed. Both of these issues can carry significant risk for the private sector.

Sectors such as water or passenger rail, where revenue growth is often affected by challenges related to the level or collection of fees, are likely to be particularly difficult. Here, private sector involvement has tended to be limited to management or lease contracts involving limited capital investment. However, mobile telephony, which does not have a legacy of below-cost pricing or the social and political sensitivities of water, has been the largest recipient of private sector investment.

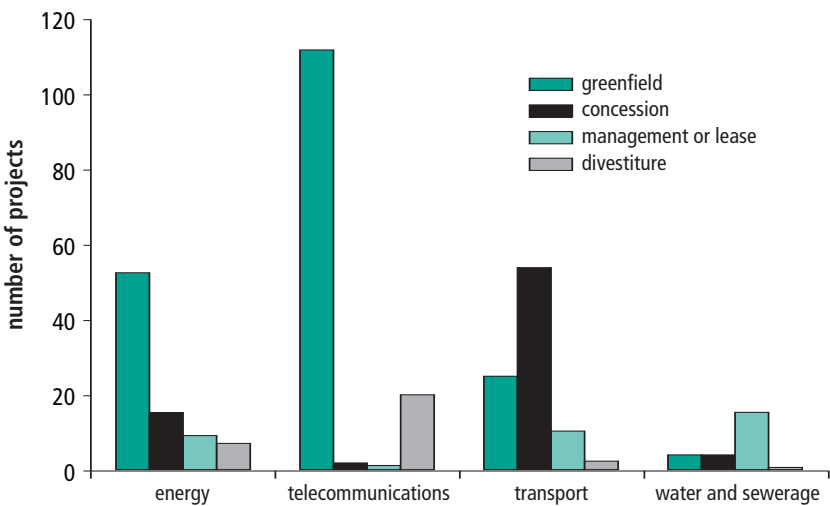
### *Demand Risk and Capital Investment*

Investors look closely at how the risk that they might bear of fluctuations in the use of the service (demand risk) is rewarded by the financial returns available and the timing and level of investment to which they are committed. For projects with high growth prospects, such as mobile telephony, investors generally consider such risk to be acceptable, especially as investment can be made in stages to fund incremental expansion of capacity and to take advantage of the potential commercial benefits of related services such as mobile banking. Where heavy initial investment is required, and the level of demand and prospects for growth are less certain, investors may be more circumspect. This is reflected in figure 4.4, with concession projects (that is, rehabilitation

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<sup>2</sup> Or availability-based PPPs for which users pay indirectly, such as in electricity generation.

Figure 4.4 Number of Private Participation in Infrastructure Projects in Africa, by Sector and Type of Contract, 1996–2006



Source: World Bank PPI Project Database.

of existing infrastructure, where use is already established) dominating in the transport sector. Overestimation of user demand is one of the principal causes of project failure in this sector. Of course in most PFI-model PPPs, not reflected in the data, demand risk usually resides with the public sector. However, this may present other constraints, such as the long-term creditworthiness of the government as purchaser of the service.

**Rehabilitation Risk**

Investors have concerns about taking on the rehabilitation of existing assets, as can be seen in the energy, telecommunications, and water sectors in figure 4.4 (but, for the reasons set out above, this may be less of an issue for many transport projects). These concerns relate to assets where the condition may be hard to assess (for example, a power generation plant or an underground water delivery network; see Leighland and Butterfield 2006). Other complications may arise out of the need to transfer an existing workforce or amend existing off-take contractual arrangements. Sometimes, a management contract will be used initially to enable the private party to learn more about the underlying assets before moving to a more capital-intensive PPP.

### *Environmental and Other Physical Risks*

Large infrastructure projects can also present environmental risks that may make investors wary, especially for greenfield projects. Transport and power projects may have adverse environmental and social impacts requiring project reevaluation, redesign, additional investment, compensation costs, and strong stakeholder engagement as well as reputation risks. Thus, despite Africa's significant hydropower potential, the number of hydropower projects funded by the private sector has so far been small in comparison with other forms of power generation. Long lead times are often needed to address environmental issues. There may be significant geotechnical uncertainties and long construction periods—if not run-of-river projects—that can make project financing difficult and expensive due to the gap between investment and revenue generation. This issue is not unique to Africa.

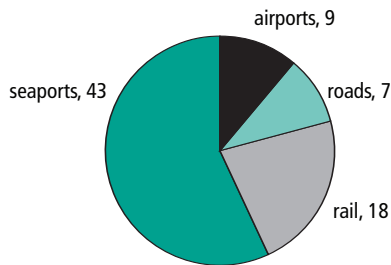
### *Interface Risk*

For projects whose output, such as power generation, is purchased by another utility, investors pay close attention to the terms of any agreement to provide and purchase the project inputs or outputs and the reliability and creditworthiness of the interface party (in the African context this is often a state-owned entity). If the connecting infrastructure is not in place or needs to be built or rehabilitated, investors want to know how this will be addressed, which, in turn, raises questions about who is responsible, where the funding will come from, whether the required infrastructure will be available when it is needed by the project, and what conditions will attach in the event that it is not. This can make such projects highly complex, as investors will need to analyze all the risks, not just of the immediate project, but also of other projects on which it is dependent for supply or sales (that is, the *external* interface risks). Faced with this, it may be better to design the project as an integrated whole: a good example of this is the Songas gas-to-electricity project in Tanzania, which comprises the Ubungo Power Plant in Dar es Salaam, a natural gas-processing plant on Songo Songo Island, and a 225-kilometer pipeline from the island to Dar es Salaam (see appendix D). The private sector is often better than the government at managing the risks of integrating such different components of a project.

### *Funding and Foreign Currency Risk*

As discussed, projects without foreign currency–linked revenue are likely to face the most significant constraints in a number of countries due to the limited availability of long-term local-currency finance. It is not surprising that seaport projects, which generally enjoy foreign currency–denominated revenue, have been more numerous than road projects, which usually earn revenues in local currency (see figure 4.5).

**Figure 4.5** Number of Transport Projects in Sub-Saharan Africa in World Bank PPI Database, by Sector, 1996–2007



Source: World Bank PPI Project Database.

Local capital markets, however, are developing rapidly in some African countries, as evidenced by the increasing number of recent issues of local-currency financial instruments with terms of up to 15–20 years. Coupled with strong investor appetite for infrastructure investment, this suggests that long-term sources of local-currency funding may increasingly be a realistic source of funding for some well-structured projects in some countries.

#### *Other Considerations When Selecting PPP Projects*

In addition to the revenue, demand, rehabilitation, environmental, interface, funding, currency, and other risks mentioned above, there are other issues to consider when assessing risk allocation and potential private sector interest in a PPP project:

- *Size.* Projects that are too small may have difficulty attracting private sector interest as the costs of preparing and managing the project will be high in relation to the investment required (and from the public sector's perspective the transaction costs may be too high in relation to the size). Projects that are too large may exceed the capacity of bidders and sources of finance (and, from the public sector's perspective, may make it difficult to transfer risks effectively).
- *Geography and complexity.* Projects may be the right size for the market, but if they involve numerous smaller components that are geographically dispersed or remote, investors may be wary of the delivery and management costs and risks involved. Bundling smaller projects to make larger ones may not always be feasible.

- *Technology*. Investors may be wary of using unproven technology or using proven technology in novel circumstances.
- *Workforce*. Investors are concerned about how the public sector manages workforce issues, particularly in projects that may transfer significant staff from the public sector.

## 5.

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# PREPARING PROJECTS FOR MARKET

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The previous chapter looks at some of the key criteria in assessing and therefore selecting projects eligible for public-private partnership (PPP). Once the initial selection has taken place, the focus moves to preparing the project for market.

The project preparation phase has two major aspects. First is the activity of ensuring that the public sector is adequately prepared and organized to manage the process. This activity is likely to include greater use of external advisers and consideration of budgets to fund the work. Second is the parallel activity of completing the full project assessment to ensure that the project is being developed on a sound basis. The activities at this stage require the public authority to undertake the following:

- Identify and assemble the project team, including advisers
- Establish the public sector's requirements for the project in a way that can be clearly articulated in contractual terms to potential public sector bidders
- Develop a high level of confidence in the potential level of private sector interest in the project, on the terms envisaged
- Determine what type of public sector support will be required (for example, to provide part of the project funding, make assets such as land available, or pay for the service)
- Confirm that the public sector can deliver on its obligations over the life of the project



- Develop a comprehensive and credible PPP contract and establish the basis for its operation, such as how disputes will be handled
- Develop the project information for bidders
- Identify all the relevant statutory processes and clearances (for example, environmental, access to land)
- Identify and consult the various project stakeholders<sup>1</sup>
- Develop a strategy for raising awareness of the project among potential investors
- Prepare for the procurement phase (strategy, budgets, timetable, and people)
- Complete the value-for-money assessments and establish the basis on which a project's success will be evaluated.

These tasks must be accomplished before private sector bidders are invited to spend serious time and effort considering the proposal. The activities are directly relevant to the project information that will eventually be made available to the private sector, as discussed in chapter 7, and they affect the credibility of the process when engaging with the private sector. See figure 5.1 for the elements of the project preparation process.

These various requirements must be kept in balance: increasing the scope of the project may be deliverable but not affordable, or allocating certain risks may appear affordable and in line with requirements but not be deliverable by the private partner. An “outline business case” is therefore a useful tool to bring all the elements together, so that any conflicts between these factors can be resolved before approaching the private sector. This guide can be used to form the basis on which the project is assessed and approved for commencement of the procurement phase.

## **Management of the Process**

Good governance and good project management, along with risk mitigation and quality control, are essential elements of managing a successful PPP process.

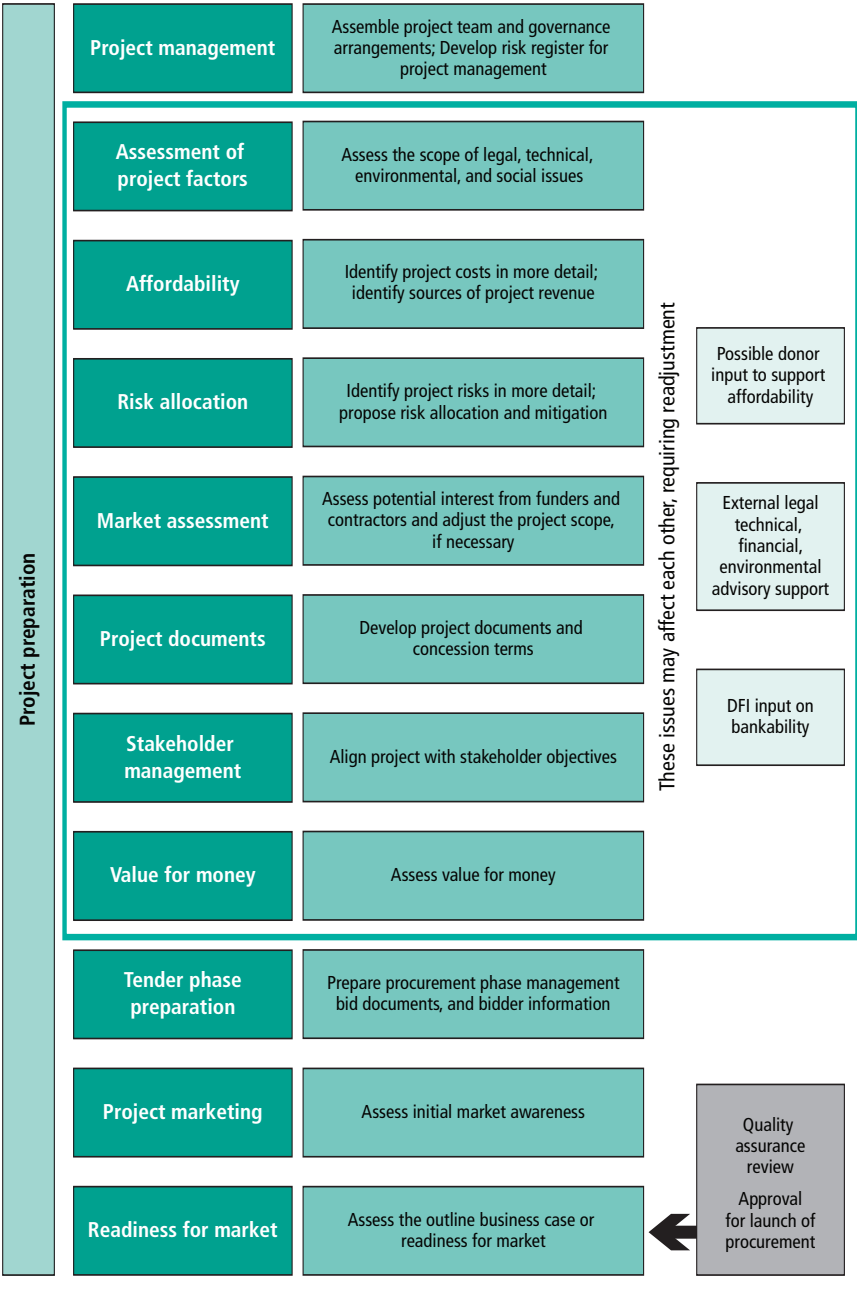
### ***Project Governance***

Managing the preparation, procurement, and operation of a PPP project involves dealing with multiple issues with stakeholders all at the same time. Later in the procurement phase, it involves approving complex decisions,

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<sup>1</sup> Stakeholders are the various parties affected by the PPP project—not just the public authority or the private party, but, in a toll road, for example, road users, those who live near or may be displaced by the road, municipalities whose local traffic will be affected by it, and so on.

Figure 5.1 Project Preparation Process



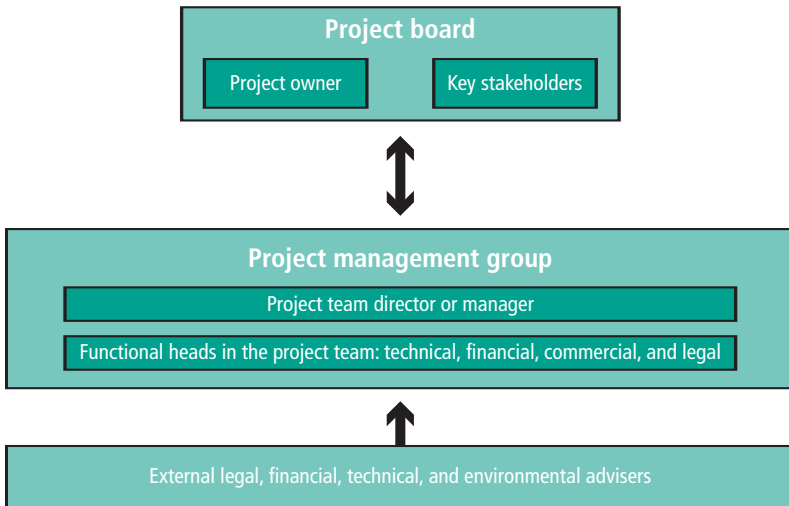
Source: Authors.

often with quite short timelines, while negotiating with private sector bidders who are likely to be highly organized and purposeful. During the construction and operation phases, it involves dealing with changes in the project, users, unforeseen events, and termination. Good project governance lies at the heart of successful delivery of the project and management of the interaction with the private sector.

In the early stage of project selection (discussed in chapter 4), governance structures may be quite fluid and simple. However, at the end of this phase or when a decision is made to devote more resources to the project, it is important to develop a more comprehensive structure of project governance (see figure 5.2).

A common way of implementing effective project governance is through a system of boards. A project board normally comprises the main public sector stakeholders and maybe even independent members capable of providing neutral, technically sound opinions; this is the regular forum for resolving key issues and for making decisions above the powers delegated to the project management group. It sets the project requirements, constraints, and boundaries, monitors the project management activities, and provides a forum for

Figure 5.2 Outline of a Structure of Project Governance



Source: Authors.

challenging and supporting the project team. Key project advisers are usually not team members, but they may be called to attend meetings of the project board when expert advice needs to be examined first hand.

For significant projects, it is helpful to identify a senior officer within the public authority, sometimes called the “project owner,” who has ultimate responsibility for delivering the project and is capable, available, and willing to show leadership and commitment. This person may chair the project board.

A full-time project director or manager is responsible for managing the project management group and reporting to the project board. The project team comprises functional managers drawn from across the public authority and deals with the day-to-day management of the project within the delegated responsibility and authority. This includes managing the project advisers. For complex projects, separate boards covering specific issues, such as wider stakeholder management, may be set up and report to the project board. The project team may draw resources from a central PPP unit (discussed in chapter 3), a member of which might also be on the project board.

When establishing the project’s governance structure, it is vital that project advocacy lies outside the project team. A senior champion within the public authority is needed, and the absence of one has often been cited as a reason for projects to falter.

Stakeholder management is also a major activity of both the project team and the project board; failing to achieve the buy-in of stakeholders until late in the process and then trying to convince them of the merits of previous decisions is a recipe for delay (see box 5.1 for common governance problems). In the early phases of a PPP program this may be especially important, as it can often entail convincing the public sector to accept that the project will involve private sector management of what has typically been a public sector activity.

### ***Program Management***

Above the project level, *program* management may offer additional benefits:

- Improve the management and coordination of the pipeline of projects and the matching of supply to demand
- Enable effective communication of policy to the market
- Improve the participation of stakeholders
- Build market confidence and supply-side capacity
- Shape the market to create newer, deeper supply capability
- Reduce transaction costs through replicability and greater use of standardization

### Common Problems in Project Governance

- A part-time project manager (that is, someone who has another full-time job inside the public authority)
- Frequent changes in the project team
- Lack of resources or excessive reliance on advisers for decision making
- Insufficient delegation of powers to the project management group so that even the smallest decision needs to be referred upward
- Interference from other bodies outside the governance structure so that no one knows who is actually running the day-to-day operations
- Poor management of the day-to-day resources, including the external advisers
- A project board that is too large and unable to meet as required to make key decisions.

- Exercise public sector bulk purchasing power in relation to risk transfer negotiations
- Enable the development of programwide quality-assurance processes.

### *Use of a Risk Management Matrix*

A good project management practice is to establish a matrix of risks that applies to the project preparation process itself. This identifies who does what, whether budgets are in place, and how risks will be mitigated. The matrix changes at different stages in the cycle. An example can be seen in appendix B. This is not the same as the risk matrix used to identify the allocation of risks within the project itself, which is a separate exercise (see chapter 4).

### *Quality Control*

PPP programs around the world also use quality-assurance mechanisms for good project and program management. These can be short external reviews to help the public authority to check that the necessary actions have been taken at important decision-making points in the PPP project development cycle (for example, before going to market or at bidder selection). Just prior to launching the procurement, a review will check, among other things, that the project's outputs are still aligned with the original requirements, that the correct project management structures are in place to manage the next phase, and that market capacity and interest exist for the project. Such a review can

## BOX 5.2

### Common Mistakes in Project Preparation

- Lack of clarity by the public authority regarding what it wants from the project
- Lack of project ownership and leadership
- Poorly resourced project teams
- Selection of advisers on the basis of cost rather than quality and experience
- Lack of effective engagement with stakeholders
- Lack of understanding of and contact with the private sector at senior levels and poorly conducted market sounding
- Expectations that the private sector will deal with issues, such as the acquisition of land, that are better handled by the public sector
- Lack of clarity about the public authority's legal powers to enter into the public-private partnership contract
- Conflict between the procurement process and procurement regulations
- Overly ambitious project preparation timetables
- Release of incomplete project information.

be carried out and delivered over a three- to four-day period and provided to the public authority. This process is not necessarily an audit but a source of challenge and comfort for the public authority to ensure that the project is ready to proceed to the next stage. An example is the project “gateway” process that is widely used across the public sector in the United Kingdom (United Kingdom, Office of Government Commerce 2007). See box 5.2 for common mistakes in project preparation.

### Funding for Project Preparation

The costs of project preparation and tendering should not be underestimated. These costs may typically be 3–4 percent of investment costs for projects costing less than US\$100 million, 2–3 percent for projects costing more than US\$100 million, and around 2 percent for projects costing more than US\$500 million (excluding significant costs of land, early works, and environmental impact assessments). As such costs may be disproportionately high, small individual projects are not generally suited to PPPs.

A wide range of project development facilities is available to help pay for the costs of project preparation, although fewer are available for upstream

framework-setting activities. An example is the Public-Private Infrastructure Advisory Facility (PPIAF) managed by the World Bank. A recent guide prepared by the Infrastructure Consortium for Africa (ICA) with support from PPIAF (ICA Secretariat 2006) provides details of more than 20 facilities, with information on how and at what stage to access them. The regional economic communities are also playing an increasing role in support for project preparation, especially for transnational projects.

Another approach to mobilizing resources for project development is for the government to establish and manage a revolving project development fund, possibly with donor support. The winning bidders effectively refinance such costs at contract signing, recycling funds back to other public authorities. An example of such a fund is the South African Treasury's PPP Project Development Facility (South Africa, National Treasury 2004a). This approach can also provide some discipline, consistency, and quality control in the appointment of advisers.

Apart from direct funding, development finance institutions (DFIs) can also play a valuable, more informal role as a sounding board throughout project development (see chapter 7).

### **Unsolicited Proposals**

Private companies often approach governments directly with new project ideas, typically referred to as unsolicited proposals. Such proposals can introduce innovative ideas and contribute to infrastructure goals where governments have limited capacity to develop projects. This may be the case particularly at the local or municipal levels of government. However, this approach can raise issues of transparency, serve special interests, suppress competition, and deliver poor value for money. For these reasons, some governments disallow unsolicited proposals, while others seek to channel such proposals into a transparent, competitive process that encompasses many of the same disciplines used to review projects generated by the public sector but requires the private sector proponent to develop the detailed proposal. The subsequent process then involves a competitive tender, where the original proponent may have an additional theoretical value attached to its bid or have the right to match a better offer or to participate in a final round of bidding. The challenge is to determine the risks that such unsolicited proposals involve for the public interest and how effective the competitive process is in practice.

Given that project proponents are encouraged to develop (at their cost) and put forward project proposals, unsolicited bids are sometimes regarded as a source of funding for project development. However, the original proponent usually expects these costs to be reimbursed if the project is awarded to

another party. While these costs may be funded out of the financing structure of the eventual project, the challenge is often to determine how to assess and control such costs and how to discourage frivolous projects, all of which require government capacity to manage. Moreover, the public sector still incurs costs related to analyzing the proposals and running the procurement process itself (see, for example, Hodges and Dellacha [2007]). There are benefits to this approach, which creates new approaches to infrastructure delivery, but the risks and potential costs need to be examined and managed carefully.

### **Project Assessment**

Assessing the various factors that affect the scope, affordability, risk allocation, value for money, and contract development of a project involves various skills. After the project selection phase, this work becomes much more intense. The allocation of activities and the steps they involve can usefully be described in terms of the different disciplines involved at this stage.

### ***Legal Assessment***

This step seeks to assess the issues that are internal to the public authority. In particular, it seeks to assure that there are no legal impediments to the public authority entering into the various project agreements and that the procurement process envisaged is legal (to ensure that proper procedures are followed and to minimize the risk of challenge that may derail the process). Project-specific issues will also arise, including assessment of the legal status of the various project assets required (for example, land use or title). In the case of refurbishment projects, the private sector needs to understand the condition of the existing assets, the proposed handling of historical liabilities, and the availability and value of any indemnities.

The legal assessment also covers the relationship between the public authority and the project and between the project and other relevant parties—that is, issues that may be considered external to the authority. For example, the drawing up of project requirements and the identification and allocation of risks need to be reflected properly in the draft PPP contract through the output specifications, payment mechanism provisions, and other terms of the contract. The legal team also needs to develop other key components of the PPP contract, including provisions for resolving disputes and mechanisms for governing changes in the project.

Many PPP projects are highly dependent on other facilities. For example, a thermal power-generating facility depends on transport infrastructure for its supply of fuel feedstock and on transmission infrastructure for its power off-take. Confirmation of the status and availability of such infrastructure is



required, reflected in the terms and conditions of the associated agreements. The creditworthiness of the counterparties (that is, the bankability of these agreements) is significant to the commercial viability of the project. Public sector investors are reluctant to spend time assessing a project's viability unless these issues are well defined in legal terms. This can be a significant component of project preparation.

A well-developed and comprehensive suite of project documents that involves the public authority has to be made available to private sector bidders during the procurement process. The time to prepare these documents is *before* the procurement phase is launched. Depending on the procurement process used, the eventual terms in these agreements, including the allocation of some of the risks, may change as a result of the interaction with the market. To engage the interest of serious bidders and enhance the credibility of the public sector and the project, a realistic allocation of risks and contractual terms must be established at the start of the process.

### *Technical Assessment*

The technical assessment determines whether the project's output requirements are technically feasible and the likely capital and operating expenditure required. Specific initial work on ground and hydrographical conditions and even archaeological surveys may be required. Designs to a reasonable level of detail may be developed in certain projects, not necessarily to instruct bidders but to illustrate how the output requirements may be interpreted and to support estimates of the likely project costs for the affordability assessment. There may also be an insurance review at this stage to assess the likelihood of transferring risk to the insurance markets, the expected costs, and the availability of insurance cover.

An important component of the technical assessment is an analysis of environmental and social issues to ensure that there are no adverse environmental or social impacts to impede delivery of the project. This involves identifying any potential environmental and social risks and looking at how such risks can be mitigated to ensure compliance with legal requirements or environmental policies (possibly by changing the scope of the project, such as amending the alignment of a road). Many project lenders, especially DFIs and banks adopting the Equator Principles, will only lend if strict environmental conditions are met. If DFI funding is likely to be needed, then it is important to anticipate the requirements in this regard. This avoids having to repeat environmental and social impact studies and, at worst, having to change the

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<sup>2</sup> A set of principles, developed by the World Bank, covering environmental and social protection eligibility lending criteria.

scope of the project to meet the criteria of DFIs or other lenders.

### *Financial Assessment*

Financial assessment involves various activities. First, by bringing together the various elements of project cost referred to above, it enables an analysis of the expected long-term project revenue requirements, which are particularly relevant to the affordability analysis. This analysis estimates the expected level and conditions of debt and equity funding required and the exposure to long-term currency mismatch or interest rate movements. All of these may have a major impact on determining whether the private sector can finance and deliver the project as well as on the structure of the PPP contract.



## 6.

# PROJECT ADVISERS

It would be unusual for the project team to have all the necessary specialist skills available internally. Professional advisers should be used where their skills will add value to the project's preparation, procurement, and management activities, but the objectives and leadership of the project should remain the public sector's responsibility. Any gaps in skills should be identified at the outset, and options should be considered for securing any additional resources required. As part of their appointment, advisers should be required to transfer their skills to the project team (for example, by preparing guidance notes or providing training at the conclusion of an assignment).

### Role of Advisers

The primary role of advisers is to give appropriate advice in their area of expertise to the project management group. External advisers likely to be required for a public-private partnership (PPP) project will usually include a technical adviser, a financial adviser, a legal adviser, and environmental advisers (see table 6.1). Other specialists, such as social impact and insurance advisers, may also be required.

### When to Use Advisers

Advisers typically are involved at each stage of a PPP project:

- *The initial feasibility assessment.* Advisers assist in framing the outline proposals for procurement in the form of a commercial deal that can be taken to both contractors and the funding market. As part of this process, advisers should provide advice regarding what the funding market can be

**Table 6.1 Role of External Advisers**

Type of adviser	Role
Technical adviser	<ul style="list-style-type: none"> <li>• Support the development and feasibility of the technical aspects of the strategic plan and outline business cases</li> <li>• Draft the project output requirements and specifications</li> <li>• Develop payment mechanisms in conjunction with the financial advisers</li> <li>• Ensure that all technical aspects of the project meet the objectives</li> <li>• Evaluate and advise on all technical solutions throughout the procurement phase</li> <li>• Scrutinize the costs of the bidders' solutions throughout the procurement phase</li> <li>• Undertake technical due diligence on bidders' solutions</li> <li>• Carry out any site condition, planning, and design work</li> <li>• Provide support in the clarification and fine-tuning of technical issues</li> </ul>
Financial adviser	<ul style="list-style-type: none"> <li>• Support the development of the financial aspects of the project's business case, in particular, the appraisal of different options and financial modeling and liaising with the development finance institutions</li> <li>• Develop project payment mechanisms in conjunction with the technical advisers</li> <li>• Prepare the requirements for submitting a financial bid</li> <li>• Ensure that all financial aspects of the bidders' solutions meet the requirements for submitting a financial bid</li> <li>• Optimize and scrutinize the financial models submitted by bidders</li> <li>• Evaluate and advise on all financial proposals throughout the procurement phase</li> <li>• Review the funding and taxation aspects of solutions proposed</li> <li>• Undertake financial due diligence on bids submitted</li> <li>• Provide support in the clarification and fine-tuning of financial and commercial issues</li> </ul>

*(continued)*

Table 6.1 Role of External Advisers (*Continued*)

Type of adviser	Role
Legal adviser	<ul style="list-style-type: none"> <li>• Assist the public authority in assessing the requisite powers and legal feasibility of the project</li> <li>• Develop the contract documentation for the project</li> <li>• Develop other legal aspects of bid documents, including analysis of the project's assets, landownership, interface agreements, and other site-related issues</li> <li>• Prepare the legal and contractual requirements for submission</li> <li>• Ensure that bids meet the legal and contractual requirements for submission</li> <li>• Evaluate and advise on all processes and legal and contractual solutions throughout the procurement phase</li> <li>• Undertake legal due diligence on bids</li> <li>• Provide support in the clarification and fine-tuning of legal aspects</li> </ul>
Environmental advisers	<ul style="list-style-type: none"> <li>• Examine the potential environmental impact of the project</li> <li>• Identify the potential risks</li> <li>• Consider the mitigation of such risks and the impact on the scope and design of the project</li> </ul>

Source: Authors.

expected to deliver, the key constraints on the deal, and insight into the appetite of the market.

- *Development of the deal.* Advisers assist in developing the detailed deal, including development of documentation such as the draft contract, payment and performance mechanisms, allocation of risks between parties, financial models and other projections, and environmental assessment. Advisers can also assist in developing areas of tender documentation.
- *Execution of the deal.* Advisers participate in the clarification and evaluation of bids. They assist in negotiating the deal and providing analysis (legal, financial, technical, and environmental) on the implications of the positions adopted by the parties to the deal. This assistance may include advice on the optimum funding route and the timing and method of approaching the funding markets.

- *Construction and operation.* Advisers may also play a role during the operational phase, especially assisting in complex issues that may arise such as refinancing or dealing with changes in the contract.

### **Appointment of Advisers**

The competitive process for selecting advisers should aim to secure the best-quality and best-value advice. It is important to define the scope of work as closely as possible before contracting with advisers. In addition to considerations of cost, the selection of advisers ideally should involve an assessment of the depth and relevance of their expertise, their understanding of the project's requirements and processes, and information regarding the availability of the individuals being considered. The experience of the individuals put forward can often be more important than the reputation of the firm itself.

### **Role of Public-Private Partnership Units**

Advisory support can be costly, and it is important for the public sector to be a sophisticated customer of external advisers and to use their services in a focused way to maximize their effectiveness and value. PPP units can play a useful role in supporting the project team in the hiring and use of external expertise. This role can include offering advice on which advisers should be approached, the selection, appointment, and contracting process, and the terms of reference against which advisers should bid for the advisory mandate. PPP units often develop guidance in this respect and even become involved in the approval process (especially if they are also managing the funding mechanisms for project development). By developing a more coordinated and consistent approach to the market, the government can help to encourage and develop the supply of good-quality advisers.

### **Management of Advisers**

It is essential to give professional advisers sufficient access to the public authority's planning, deal development, management, and decision-making processes for them to understand the project's objectives and constraints and thus provide the best advice. It is counterproductive not to involve advisers fully in these aspects of a project as this risks their not having a complete picture and giving poor advice as a result. Advisers are not paid to agree with their clients; they are paid to offer professional, objective advice within their area of expertise.

Regular meetings should be held with advisers to monitor their performance, enable them to account for their activity in a project, and discuss the issues faced.

In addition to regular meetings, it is a good discipline to require advisers to sign off at key stages of a project indicating that the project is ready to proceed to the next stage and that the proposals and timetable are realistic and deliverable. This openness encourages advisers to exercise due care and attention. If advisers do not believe that the project is ready to proceed, their objections should be formally recorded as well.

During the initial planning stages, project teams should budget appropriately for the cost of advisers throughout the process. A PPP unit can advise on realistic costs of using advisers based on the complexity and size of the deal in question. While advisers' fees may seem expensive, in the context of deals that can exceed hundreds of millions of dollars in value, it is a false economy not to spend sufficient resources to ensure that appropriate, high-quality advice is available.

The appointment of a lead adviser who then subcontracts and manages the other advisers can simplify the procurement process and reduce the burden on the public authority, which only has to manage one adviser. However, this can sometimes deny access to the most appropriate advisers in *each* specialty. In more mature PPP markets, advisers are generally appointed separately for this reason.

Advisers may receive a part of their remuneration by way of a success fee paid when the contract is signed (and associated financing is made available). However, caution should be exercised, especially where advisory support is required at the initial stages of project development: the public sector's interests in doing the right project and the adviser's interests in closing a deal, if a large part of its fee is based on successful signing, may not always be aligned. It is generally better to pay advisers when they deliver a predefined work package, covering each identifiable phase of the project development process. PPPs are not about "doing the deal," but about doing the right deal.

Finally, the quality of the public authority's advisers is an important factor for the private sector to consider when assessing whether or not to submit a bid. Good advisers can add considerable credibility to a project.





## 7.

# MANAGING THE INTERFACE WITH THE PRIVATE SECTOR

Project selection and preparation are likely to be ineffective if they are not based on a good understanding of how private sector bidders will view the project and what the costs are likely to be. In addition to input from the project advisers, project preparation needs to be informed by continual input from the private sector market.

Can this be done without launching the procurement process itself? Market sounding (or “soft” market testing) is a tool that can provide the public authority with an opportunity to cross-check its thinking about the project with that of private sector specialists, including contractors, lenders, and equity investors, up to the end of the preparation phase (4Ps 2002; United Kingdom, Office of Government Commerce 2005). It also provides an essential opportunity for the private sector to deliver feedback on how the packaging and scope of the project could be developed to ensure private sector participation and improve competition. It may also give useful insight into the likely level of market interest, ensuring a better fit between the outcomes required by the public sector and those that the private sector can deliver. Good-quality feedback will come from sophisticated players who have participated in similar schemes in other countries. It is important to identify who these players might be and to encourage them to participate in the process.

While the approach varies depending on the scheme under consideration, the issues commonly covered by market-sounding exercises include the scope of the project, any technical issues affecting the ability of potential bidders to deliver the services, expected costs, payment mechanisms, key risks envisaged to be transferred, contractual structures and terms, and proposed timetable for the period from procurement to the commencement of services. Market

sounding is not part of the procurement process, and potential participants should be informed that they can take part in the procurement process even if they do not take part in market sounding.

### Preparation for Market Sounding

Before launching the market-sounding exercise, it is advisable to prepare a short project briefing note covering such matters as the public sector parties involved, the basic proposals developed to date, the scope of the scheme, availability of land, supporting infrastructure, employment, and any other relevant development opportunities. It is better to be transparent about what is and is not known about the project rather than to be seen as hiding critical information about it. This briefing note is not intended to sell the project at this stage, as it is still being defined, but it is intended to ensure informed feedback from the market. A list of the specific issues on which the public authority is seeking assistance or feedback from the market should be provided. Clarity about what the authority is trying to achieve is important (backed up by evidence of central government support for the project, if relevant). The list should be worded carefully to encourage the best-quality response. Potential bidders often give vague positive indications of interest in the project just to keep their foot in the door, so the purpose of the questions is to unearth real, specific issues.

Consideration should also be given to the conduct of the market-sounding exercise itself, taking particular account of the need to ensure that the parties responding to the exercise are not given an unfair competitive advantage in any subsequent bidding, that the process is conducted in an open, fair, and transparent way, and that it is properly documented. Although this is not a formal bidding process at this stage, potential bidders will be looking for clues as to how the public authority conducts itself. Thus, while the application of all the procedures governing the interface between the public and the private sectors required in a formal bidding process are not required at this stage and may even constrain efforts to get at the heart of the issues, the market will want to be assured that a solution is not being developed to suit one particular supplier with excessive influence over the public authority. Documenting the proposed process, the market participants approached, and the issues to be addressed and, in some instances, soliciting responses in writing all help to leave a transparent trail of the market-sounding activity. Nevertheless, it is important to avoid misrepresenting the exercise: this process does not seek to receive expressions of interest in the project. Equally, it is not intended to “sound out” a *particular supplier’s* ability to meet the requirements; rather it is to extrapolate from the discussions a picture of the *market’s* likely response.

Experienced advisers can make a significant difference in the effectiveness and credibility of the process, but it is important to ensure that they are impartial and do not have a vested interest in a particular outcome. Box 7.1 presents the most important elements of a successful market-sounding exercise.

The market-sounding exercise should not be carried out at too early a stage; otherwise, the public authority will run the risk of appearing vague and uncertain about its objectives, which will not inspire confidence in its ability to bring the proposal to the market. Equally, it should not be carried out at too late a stage, since the potential for legal difficulties increases as the outline proposal develops into a full procurement. Nevertheless, there may be opportunities at a later stage to harness input from bidders after the proposal becomes a formal procurement opportunity and is advertised, depending on the procurement regulations.

As part of the market-sounding exercise, an up-to-date database of likely and appropriate interested private sector contractors, lenders, and investors should be compiled.

A marketing or open day may be held for interested parties, attended by relevant organizations from the public sector sponsor of the project and by potential private sector bidders. As part of the open day (or as a follow-up), the public sector might obtain further feedback on the scope and content of the project with regard to its attractiveness to the bidding market. This can be done by gathering information through a questionnaire and holding one-on-one meetings.

### **Before the Launch**

Once the project is in a reasonably developed form, but before the procurement phase has been launched, it can be helpful to announce that the project will go to formal advertisement in the near future. This announcement can be made through the release of a brief description of the project, which enables potential bidders to prepare for the procurement process. The project information released at this stage is not extensive (and may even be as short as one page) and typically includes a short description of the nature of the project, scope of work, and possible size of investment, together with expected timing of the procurement process.

The public sector can often lose sight of the impact and role it has in shaping the market. This means that the project should not be seen in isolation, but as part of a wider program, where relevant. A common mistake is for separate procurement authorities to take similar projects to the market at similar times. This overlap may be unavoidable at times (for example, if similar projects are being procured across a whole region), but having an awareness

**Top 10 Tips for a Successful Market-Sounding Exercise**

1. ✓ Make sure that the market-sounding exercise is in line with any relevant procurement rules
2. ✓ Prepare thoroughly for any interface with the market to get the most out of the exercise and give the best account of the public authority to the world at large
3. ✓ Consider market-sounding exercises at an early stage in the project and procurement appraisal process, before formulating the procurement plans in detail
4. ✓ Invest time in preparing the background documentation, formulate and word questions carefully, avoid jargon, and be clear about the issues to be discussed with the market
5. ✓ Be clear about the process to be used to select organizations to help with the market-sounding exercise, such as selecting organizations to interview or inviting organizations to make written submissions
6. ✓ Consider use of a one-on-one format with selected organizations; be sensitive to the fact that they might not be at ease with a process that involves simultaneous discussion with two or more potential competitors but reassure all parties that no one is being singled out for special treatment in any subsequent procurement
7. ✗ Waste time receiving sales pitches; the point of the exercise is to find out what the market thinks of the proposal so far; equally, avoid being seduced into shaping the project to suit a particular proposal
8. ✗ Restrict the scope of the market sounding in any way; aim for a broad selection of the market, such as inviting both operators and construction-related firms and funders, if appropriate; keep an open mind, focusing on outcomes rather than on any one particular means of achieving them
9. ✗ Use procurement language such as “bidders” or otherwise give the impression that the market sounding is a procurement opportunity; this stage only seeks to gather information
10. ✓ Involve more than one individual on the side of the public authority, be consistent about what you say to respondents, and ensure that meetings are documented; make use of market information and feedback, which is the ultimate purpose of the market-sounding exercise.

of other projects in the pipeline is helpful to inform the timing of the project launch and the assessment of market interest. The capacity of the local contractors is often one of the main constraints once a program gets under way.

### **Perception of the Project**

The need to engage with the private sector means that the perceptions of the project among potential investors, lenders, and contractors start to be formed at an early stage. Perceptions of the government's commitment to the project, the competence of the public sector project team and its advisers, the timing and manner in which information is released to the market, and how the process is managed are as important as the quality of the information itself. The public authority must conduct itself in such a way as to sell the project's concept to the private sector. These factors are all relevant to transforming a project from a desirable activity in the eyes of government to a business opportunity capable of attracting private sector capital and management in a strong competitive process. See box 7.2 for the major concerns of project contractors and investors and box 7.3 for those of project lenders.

### **Role of Development Finance Institutions, Regional Investors, and Donors**

Development finance institutions (DFIs) can play an important role in the preparation of a project by acting as a readily accessible sounding board for the project's structure and commercial viability as well as being an important source of long-term funding. They should be involved at an early stage and may be an important component of the market-sounding activity.

DFIs can also provide early endorsement of the project by, for example, issuing indicative and conditional terms of finance that bidders may incorporate into their funding structures. While such institutions usually provide only a proportion of the likely funding required, their participation can significantly improve the credibility of the project and provide greater assurance and comfort for the other providers of long-term finance, investors, and contractors, particularly with regard to perceived political risks. Some DFIs also have guarantee instruments that provide a degree of protection for private sector parties with regard to public sector payment and other political risks (Matsukawa and Habeck 2007). Some DFI funding can also help to mitigate foreign exchange risks, by providing local-currency finance. Details of potential DFI funding terms and potential sources of risk mitigation may be included in the project information package. This would suggest that, in packaging and presenting public-private partnership (PPP) projects, the DFIs are an important part of the marketing mix, alongside the private sector investors.

### Major Concerns of Contractors and Investors

- Cost, time, and quality of the PPP bid process; are major approvals still awaited?
- The criteria for evaluating bids
- Quality of the public sector project team and its advisers
- Security of the project's income stream (demand, bankability of public sector obligations)
- Deliverables and assessment of performance: what they will be expected to deliver, and how will their performance be measured?
- Availability and cost of long-term debt funding
- Ability of the construction contractor and operator to deliver the service on time and on budget (for financial investors)
- Status and availability of connecting infrastructure and availability of inputs and terms of supply
- Effectiveness and enforceability of the PPP contract and related agreements
- Potential foreign exchange risks
- The wider operating environment for private capital
- The allocation of risks both between the public and private sectors and between the private parties
- Returns that will be commensurate with the risks they are asked to assume
- Effectiveness with which the public sector will manage the contract and make decisions
- Opportunities to refinance the debt or sell their investment.

Regional investors, mainly from South Africa, have also played an increasingly important role in many infrastructure sectors in Africa (especially in telecommunications and energy; see Schur, von Klauy, and Dellacha 2006) and are clearly an important part of the market-sounding process.

Discussions with potential donors may also be important at this stage, giving the public authority an opportunity to explore the willingness and availability of donor funds to support the long-term public sector payment obligations under availability-based PPP projects (as well as the public authority's costs of project preparation). Where long-term commitments may not be feasible, the alternative may be to access capital grant-type payments dur-

### Major Concerns of Project Lenders

- Certainty of the project cash flows for meeting debt service requirements
- Bankability of public sector obligations
- Effectiveness and enforceability of the PPP contract and related agreements
- Rights to step in if a project fails and availability of alternative contractors
- Ability of contractors to perform and the quality of their management
- Bankability of contractors and quality of contractor guarantees
- Whether the risks are understood, controllable, finite, and appropriately allocated
- Reputation (environmental, social)
- Effectiveness of insurance cover, where needed.

ing the construction period so as to reduce the amount of private finance required and therefore the level of service payments needed to support such funding. It is important, however, to ensure that there is sufficient private capital at risk to performance to incentivize genuine risk transfer.

### Transition to the Procurement Phase

Two issues are of importance during the transition to procurement: a prelaunch check and development of a strategy for a competitive process.

#### *Prelaunch Check*

Prior to entering the procurement phase, a formal project review is strongly recommended. Such a review helps to ensure that the project is well received by the market, is affordable, and is supported by the relevant stakeholders. It also helps to ensure that the public sector is prepared for the next phase, reducing the risk of potentially costly failure and embarrassment for the public authority. Table 7.1 provides a checklist of the issues that should be reviewed at this stage.

#### *Importance of Competition*

Public authorities should run a competitive process, wherever possible. A well-run competitive process usually delivers a better solution at a lower cost than one with no competition. It helps to ensure a much firmer foundation for the project by strengthening the acceptance of stakeholders. Insofar as a competitive process requires that the project be designed to elicit genuine interest



**Table 7.1. Checklist before Launching the Procurement Phase**

Issue	Questions to answer
Clarity of requirements	<ul style="list-style-type: none"> <li>• Are the scope and requirements of the project clear and stable?</li> </ul>
Risk allocation	<ul style="list-style-type: none"> <li>• Have the project risks been fully identified and their potential allocation assessed?</li> </ul>
Key terms and conditions	<ul style="list-style-type: none"> <li>• Has the draft PPP contract been prepared, reflecting the project requirements and proposed risk allocation?</li> <li>• Have issues related to external interface, agreements, terms, and conditions been identified and assessed?</li> </ul>
Indication of commercial interest	<ul style="list-style-type: none"> <li>• Is there evidence of sufficient contractor, lender, and investor market interest to justify launching the project on the proposed terms?</li> <li>• Has a project marketing strategy and list of prospective bidders been drawn up?</li> <li>• What are the expected availability and the terms of equity and debt finance?</li> <li>• Have the development finance institutions been approached?</li> </ul>
Project information	<ul style="list-style-type: none"> <li>• What plans exist to publicize the launch of the project to potential bidders?</li> <li>• Has the project team prepared a project information memorandum?</li> <li>• Have the bidder qualification and bid evaluation criteria been developed?</li> </ul>
Affordability	<ul style="list-style-type: none"> <li>• Is the project scope fully affordable?</li> <li>• Are the user tariffs realistic, and are budgets and approvals in place for any public sector payment (or asset provision) obligations?</li> </ul>
Indicative timetable	<ul style="list-style-type: none"> <li>• Is a realistic procurement timetable in place for the procurement phase?</li> </ul>

*(continued)*

**Table 7.1. Checklist before Launching the Procurement Phase (Continued)**

Issue	Questions to answer
Project team and processes	<ul style="list-style-type: none"> <li>• Is a credible and well-resourced team in place to manage the procurement phase, and is an effective bid evaluation strategy agreed upon?</li> <li>• Are project governance structures and processes in place to ensure timely and effective decision making?</li> <li>• Are credible and experienced advisers appointed?</li> <li>• Has the appropriate assessment been carried out to demonstrate that the proposed approach is expected to meet any value-for-money criteria (to the extent required by policy)?</li> </ul>
Commitment of stakeholders and users	<ul style="list-style-type: none"> <li>• Have all relevant stakeholders been identified, are they committed to the project, and are arrangements in place for continued communication and consultation?</li> </ul>
Legal processes	<ul style="list-style-type: none"> <li>• Have required approvals been identified or obtained (for example, environment, planning)?</li> <li>• Is there clarity about site and land issues?</li> <li>• Are all relevant project approvals in place?</li> <li>• Are appropriate powers confirmed for the public authority to award and enter into the long-term contracts?</li> </ul>

Source: Authors.

from multiple bidders, it helps to encourage the development of a market, reducing the dependence on an individual supplier. This may be particularly relevant if the project runs into difficulties and an alternative contractor or operator is required later on. In many countries, competition is a mandatory legal requirement. Above all, given the long-term nature of the contractual relationship under a PPP, this is the only opportunity to use extensive competitive pressure to assure the best deal. If negotiations are with only one bidder, this opportunity is lost.

The requirement for a competitive process *requires a procurement strategy to be worked out in advance*, which has implications for what information is released to contractors and funders and when and how this is done. This issue is discussed in the next chapter.



## 8.

# MANAGING PROCUREMENT

During the procurement phase the level of interaction with the private sector increases substantially, but all the important groundwork should already have taken place. During this phase increasingly detailed information about the project is shared with bidders, and information about bids and bidders is received. The main challenge is to manage the large amount of information that starts to flow in both directions, while maintaining strong competitive tension and ensuring an auditable trail of activities.

This chapter provides a brief overview of the procurement phase and the expected nature of the interaction with bidders. It is not intended to prescribe a particular procurement process, nor does it cover this complex phase in any detail. This chapter is designed simply to indicate what might be expected, particularly in relation to engagement with the private sector. In most jurisdictions, the procurement process is regulated by law. Governments with active PPP (public-private partnership) programs have developed detailed procurement guidance: examples include South Africa's National Treasury, Australia's Partnerships Victoria, Singapore's Ministry of Finance, and United Kingdom's Her Majesty's Treasury, to name a few. Readers should refer to these as examples of best developed practice.

### **Outcome of the Procurement Phase**

The purpose of the procurement phase is to develop and conduct a process that accomplishes the following:

- Selects a bid
- Maximizes the benefits of competitive tension between bidders

- Delivers the best bid from the most competent bidder
- Minimizes time and cost
- Stands up to scrutiny from citizens and both the public and private sectors.

These objectives may affect one another: it is possible to select a winning bid quickly and cheaply, but is the best bid the cheapest one or the one that offers the best value for money (and how is this defined)? It is also possible to select the best bid, but will the process be challenged, and will it be efficient? How these issues are balanced is a matter of policy, procurement regulations, and the art of the possible, but it is important for the bid process to recognize that these issues need to be considered and agreed upon from the beginning.

### **Role of Advisers**

As mentioned in chapter 6, advisers are central to the procurement phase, particularly in the evaluation of bids, where specialist financial, legal, and technical input may be required, and in the comparison of bid proposals. Well-drafted and comprehensive bidding and submission documents are vital to the smooth running of a project, and the advisers are closely involved with this. The quality of the public authority's advisers is an important consideration for potential bidders in deciding whether or not to participate. An experienced set of advisers, well-managed by the public authority, can make a substantial difference to the outcome of the process.

### **Role of Development Finance Institutions**

Unlike commercial lenders, development finance institutions (DFIs) are usually not able to align themselves with a particular bidder, which presents certain challenges to the procurement process. For example, DFI lending requirements may require changes to the terms of the project after the procurement process is complete. To reduce this risk it is important for the public authority to engage DFIs early in the process and to ask them to provide a sheet of common terms and to make this sheet available to all bidders (see chapter 7). Clearly the DFI will not be able to commit funding until it is satisfied with the quality of the winning bidder.

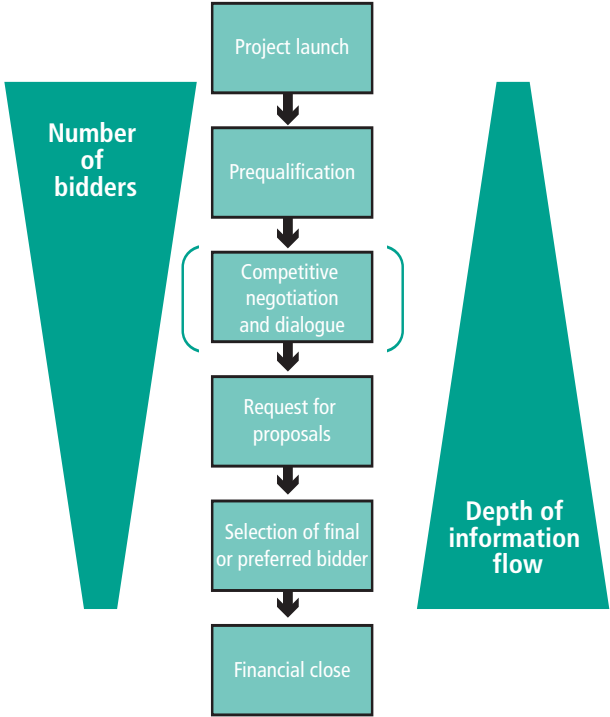
### **Bid Stages**

The PPP bidding process is usually divided into a series of steps. These steps ensure that increasingly detailed information is provided by both the public and the private sectors and that evaluation takes place to ensure an effective

process while minimizing the time and costs required of both parties (see figure 8.1). The other important objective is to elicit comparable bids. Throughout the process, the public authority needs to be mindful of the output requirements and affordability limits of the project.

In the later stages, the public authority is usually more interested in the quality than in the quantity of bids. Higher-quality bids (and better information on which to base a decision) are likely to be received from a smaller number of well-qualified bidders. With the costs of preparing a bid potentially running into millions of dollars, bidders will put more effort into their submission if a limited number of bidders is involved. Nevertheless, while reducing the number of bidders to a manageable size, the public authority also needs to have enough bidders to ensure a healthy dose of competition. A target of three to five bidders at the final stages of the procurement process is common.

Figure 8.1 Outline of the Procurement Process



Source: Authors.

## Project Launch

At this stage, the process is about attracting as wide a range of bidders as possible (bidders usually comprise a consortium of parties, as described in chapter 4). This process should already have begun during the project preparation phase (see chapter 5). The main aim is to ensure strong competition between bidders. As time goes on, bidders that clearly are not equipped to compete are removed (and there may be a procedure to debrief them at this stage).

The bid process is normally launched by formally releasing details of the project in an official publication that announces public tenders. This helps to ensure transparency, avoid discrimination in the release of information about the project, and attract widespread attention. Public sector Web sites and procurement platforms may also be used. Extensive publicity at this stage is required to ensure that the net is cast as widely as possible, both domestically and internationally, so that the best potential bidders are encouraged to participate. It is important to take legal advice when issuing public tenders to ensure compliance with procurement law.

The information disclosed at this stage should be sufficient to explain the project and to attract potential bidders, but it is not the basis on which bidders will be expected to make firm long-term commitments. It should give details of the scheme as envisaged and indicate the volume and scope of the services required, expressed in terms of either details of the project or expected monetary values of the project, with details of the proposed public sector contracting authority. The information required at this stage is intended to help bidders to determine whether the project is of sufficient interest for them to invest time and resources in investigating the prospect further and to start identifying partners for a possible bidding consortium.

The information should include details of the conditions for prequalification—that is, the information that will be required from bidders to assess their economic and financial standing and technical capacity to prequalify.

The notice may also set out the award criteria for the tender itself (for example, lowest price or the most economically advantageous) and the relative weighting of the evaluation criteria if relevant, providing assurance, through such transparency, that bids will be evaluated against *consistent* criteria.

The information normally emphasizes that the project is a PPP scheme and that the bidders will be expected to bear a significant portion of the risks associated with delivery of the project.

Potential bidders may also be invited to obtain a project information memorandum (PIM), which amplifies the details of the project launch notice and prequalification criteria (see box 8.1).

**Project Information Memorandum (PIM)**

Key project information is normally set out in the form of a project information memorandum, which generally covers the following areas: project sponsor, project information, and proposed procurement process.

**Project sponsor**

- Details on the public sector parties involved in the project
- How the public sector team is organized to manage the procurement process
- Details of public sector advisers.

**Project information**

- Project rationale and strategic objectives
- Outline of project requirements—scope, services, size, location, potential capital investment, and potential risks expected to be borne by the private sector
- Anticipated payment mechanism (user fees, availability fees, or a combination of these)
- Status of all project approvals, planning consents, and environmental assessments
- Status of public consultation
- Possibly an outline of model designs and design requirements
- Information on enabling works, status, and availability of infrastructure services on which the project may depend
- Potential funding sources (including potential DFI finance).

**Proposed procurement process**

- Stages and anticipated timetable (which might be dictated by legislation)
- Details of any proposed bidders' conference
- Outline of what will be required of bidders at each stage
- Outline of information that will be released at each stage
- Outline of the evaluation at each stage.

Bidders may also be invited to visit the project site and to meet the public authority (see box 8.2). Good bidders will be very interested in assessing the quality of the public sector team and its advisers before deciding whether to prequalify. Bidders also have formal procedures for developing bids, including establishing budgets to cover their own, often extensive, bid development costs.



### Bidders' Conference

When procurement begins, the public authority may organize a bidders' conference (also known as bidders' open days). These events are usually organized once the PIM and prequalification questionnaire (see chapter 8) have been issued to potential bidders. A bidders' conference allows the public authority to provide potential bidders with more comprehensive information about the project than is included in the PIM and for potential bidders to seek answers to issues on which they are unclear. Such a conference may also facilitate partnering between different consortium members.

Bidders' conferences may not always be appropriate, especially if the project requirements are relatively straightforward. Instead, some public authorities may prefer to rely on the PIM and to encourage bidders to seek written clarification on any issues of uncertainty. Procurement law may also prevent bidders' conferences.

The conference involves presentations by the senior public official with overall responsibility for the project and members of the project board or project team. This can be particularly useful if there is any doubt among bidders about the commitment of the public authority to the proposals. Effectively, it is an opportunity for key stakeholders to market the scheme. Using a video presentation to outline key aspects of the project is preferable to using numerous speakers.

Individual "one-on-one" sessions may also take place giving each potential bidder expressing an interest the opportunity to hear more details about the project, either as a separate exercise or in conjunction with formal presentations.

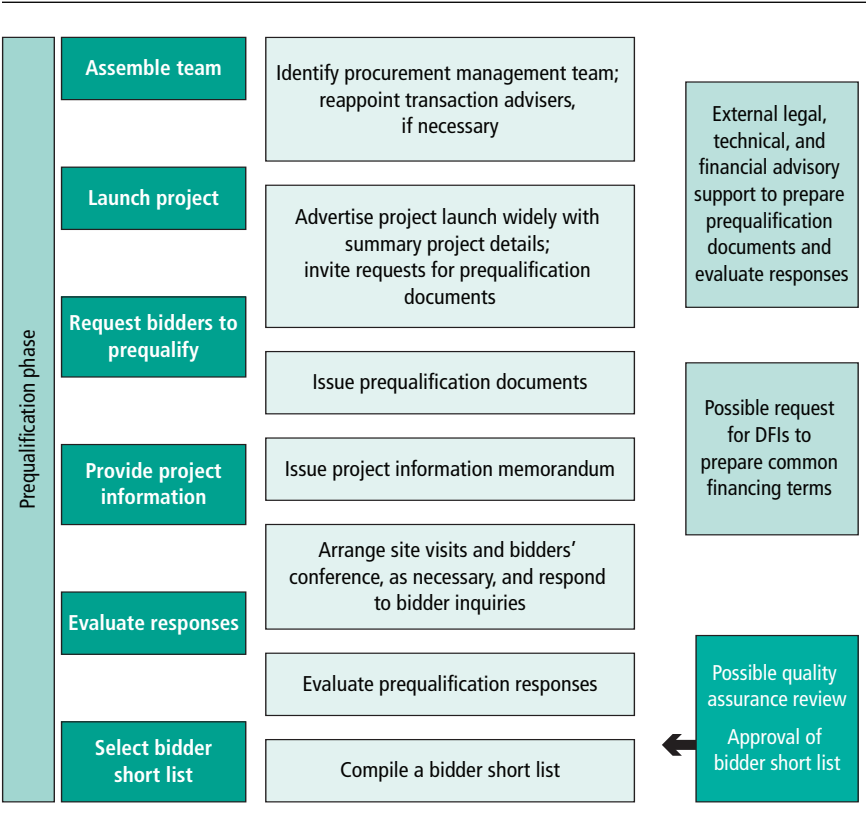
Whatever approach is adopted, it is important to remember that the overriding purpose of the bidders' conference is to "sell" the project and to demonstrate to potential bidders that the public authority has the skills and expertise in place (in the project board or team) to deliver the project. It is important for the bidders' conference to be considered early in the procurement process to determine how it fits with other arrangements. Details of the bidders' conference should be included in the project launch notice and the PIM.

## Prequalification

The prequalification stage is intended to screen out those bidders that do not meet a threshold of technical and financial capacity to deliver the project (see figure 8.2). This helps to discourage bidders that clearly are unlikely to deliver the project from investing further time and effort in the process, while enabling the public authority to focus on bidders that are more likely to deliver the required project.

Having received preliminary details of the project, bidders wishing to participate in the competition are required to request, complete, and return a request for qualification (RfQ) document, sometimes referred to as a prequalification questionnaire (PQQ) or an expression of interest (EoI). The public

Figure 8.2 Outline of the Prequalification Phase



Source: Authors.

authority then evaluates the RFQ, PQQ, or EoI responses according to the selection criteria set out and produces a short list of qualified bidders. An evaluation report sets out the process that was followed and how the decision was reached.

At this point, bidders should not be expected to spend significant resources reviewing the project in detail. Information on the quality and capacity of the bidders, not their bids, is what is required. The approach can involve a limited number of objectively measurable pass-fail criteria, as shown in the example given in box 8.3. If there are more bidders than the required short list, then a scoring or ranking of criteria may be used. Policy may require that consideration be given to encouraging local market participants. The criteria may also involve a wider range of both qualitative and quantitative factors (as found, for example, in the approaches undertaken in Australia, Singapore, South Africa, and the United Kingdom). This approach can provide a more comprehensive picture of the capability and suitability of bidders and reduce

### BOX 8.3

#### Summary of a Model Request for Qualification (RfQ) for Public-Private Partnership Projects, Government of India

To prequalify, bidders must pass separate technical and financial capacity tests (see India, Ministry of Finance 2007):

- **Technical experience.** The bidder must, over the past five years, have experience of similar projects equal to the estimated project cost. Eligible projects are defined, and the experience is scored by applying to these numbers a weighting, with the highest weighting going to projects that involve comparable project experience in the sector and the lowest weighting going to projects that involve construction experience but that are still in the broader infrastructure sector.
- **Operation and maintenance experience.** The bidder must have had a minimum of five years of operational and maintenance experience in the sector in a project of equivalent size.
- **Financial capacity.** The bidder must have a minimum net worth of 25 percent of the project's estimated capital costs.

A limit of up to six bidders may be short-listed (there are some exceptions for multiple projects and for certain power projects). The short list must be announced within 50 days after release of the RfQ.

the risk that better bidders will be screened out. However, it may involve more subjective scoring of qualitative issues.

Bidders will start to coalesce into consortiums. They must be given time to do so, as the assessment will be on the collective capabilities of the group. Nevertheless, the consortiums should not be required to constitute formally at this stage, as this may require premature expense and commitment by bidders, which could discourage their participation.

## Request for Proposals

The purpose of the request-for-proposal phase is to encourage the delivery of bids of sufficient quality and comparability from the prequalified group of bidders. From these, a bid can be selected that best meets the public authority's criteria, while at the same time ensuring that the process will stand up to scrutiny and is in line with procurement rules.

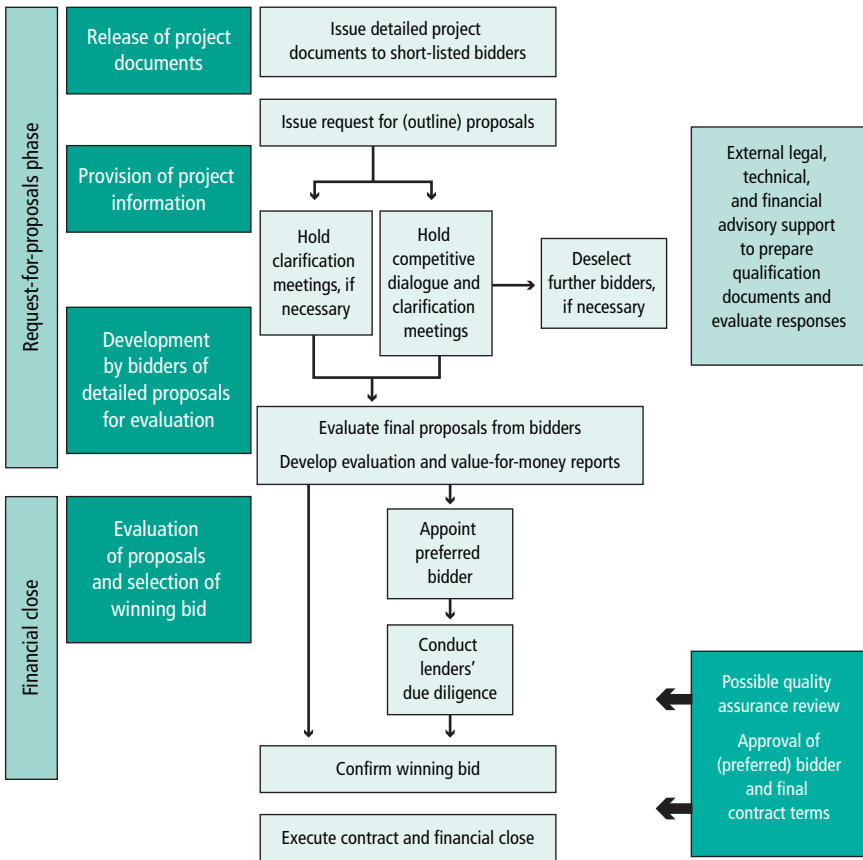
One of the most important factors at this stage is the quality and clarity of the bid documents, including the instruction to bidders, the output specifications, the proposed contract documents, and the efficiency with which the process is run. At this stage good advisers can make a significant difference. The clearer the bid documents and the process are, the clearer the responses will be and the quicker and easier it will be to measure and compare bids. Having an efficient process helps to reduce the costs of submitting a bid, which can be significant for both sides.

This stage may involve a single submission of bids from prequalified bidders within an established timetable. This may be preceded by a process in which prequalified bidders seek clarifications about the bid requirements. Once bids are submitted, there may be a mechanism to clarify details of the submissions, but without further changes to the scope of the project or the bids submitted.

Other processes can involve a form of structured dialogue between the bidders and the public authority *before* arriving at a smaller number of comparable bids from which to select a winning bid that best meets the public sector's requirements. This approach may be appropriate for complex projects, but it requires greater sophistication in managing the dialogue in a transparent, competitive, and efficient way. Such a process is used, for example, in the European Union, where it is known as "competitive dialogue." The use of such an approach also depends on what the procurement regulations permit.

At the end of the single-tender submission or dialogue phase, selection of a final or preferred bidder takes place following a predetermined evaluation (see figure 8.3). This evaluation may be as simple as a single parameter, such

**Figure 8.3 Outline of the Request-for-Proposals and Financial Close Phases**



Source: Authors.

as the lowest overall price, share of revenue, or lowest subsidy, or it may involve a more sophisticated balance of quality as well as price—sometimes referred to as the “most economically advantageous tender.” An approach that evaluates both price and quality may lead to a better long-term choice of bid and bidder than a single parameter-based decision, but it may involve more complex evaluation of both quantitative and qualitative criteria. While a predetermined and detailed scoring mechanism is used with carefully man-

aged evaluation teams and audit trails of decisions, such an approach clearly has implications for ensuring objectivity and transparency of the process and the time and cost involved.

### ***Information Provided to Bidders***

The information provided to the bidders during this phase is much more detailed. It includes the full PPP contract documents, including the output specifications, payment mechanisms, risk allocation, model designs, and plans, with detailed background information that may be required for bidders and lenders to carry out their detailed due diligence of the project. The public authority may also set out its ideas on the financial structure for the project but generally allows the bidding consortiums to determine the structure. Details of the process, evaluation criteria, and timetable are also provided.

It is important for the timetable to be realistic, as bidders are being asked to commit substantial amounts of capital over long periods of time. They need to assemble their own bid teams and appoint advisers, carry out their own due diligence of the project information, firm up detailed arrangements between consortium members and often numerous subcontractors (which, in turn, need to be assessed for their capability, as discussed in chapter 4), obtain necessary approvals, develop detailed financial models, and, in some cases, seek firm commitments of long-term funding from lenders. A frequent private sector complaint is that the timetable is too short. An excessively ambitious timetable may leave substantial problems for later, when issues that were not properly resolved during the competitive process are opened up again by the selected bidder in a noncompetitive environment. Equally, the public authority must be organized to respond quickly to bidder requests and keep the momentum going.

A project data room may also be established where detailed project documents can be reviewed. Unless there are strong value-for-money reasons to do otherwise, the public authority should not warrant the accuracy or otherwise of the project information provided. Further site visits may also be organized for bidders.

### ***Information Required from Bidders***

The invitation sets out what information is required from bidders on their bids and when. To ensure comparability, especially where information on legal, financial, and technical criteria is required, a series of common headings and financial and economic assumptions may be provided so that bidders, in turn, can submit detailed information in a common format on the relevant aspects of their bids.

## Preferred Bidder and Financial Close

Following any clarification of bids submitted at the end of the request-for-proposals or dialogue phase, the public authority then selects a bid based on the evaluation criteria previously provided to the bidders. Evaluation teams, assisted by the transaction advisers, may be established to examine different aspects of the bid. Their findings will be reported to the project board, which will choose the winning bid. The processes should be recorded, and a clear audit trail of the decision process maintained.

It is not unusual for this stage to be followed by a period in which the potential lenders finalize their detailed due diligence of the project before long-term financial commitments are made and financial close of the project is achieved.<sup>1</sup> In this case, a “preferred bidder” may be selected, to be confirmed once committed financing proposals are submitted and the final terms of the contract are established. The advantage of this approach is that it reduces the requirement for lenders to assess in detail several different bids, which can add substantially to the costs. The risk is that changes may be required of the project as a result of the lenders’ due diligence on the preferred bid and after competitive tension has been lost. In some cases this risk may be transferred to the contractor, if the terms of the concession are not negotiable, by requiring bidders to provide a financial bond (a “bid bond”) to the public authority, which may be called for payment if the bidders are appointed but fail to complete the financing and commit contractually. The decision to use bid bonds will depend on the circumstances. It may be an effective disincentive to bidders with poorly developed finance plans. However, the complexity of the project may require bidders to invest heavily in the process, therefore demonstrating commitment. As an additional cost, the requirement for a bid bond may act as a disincentive, especially if there is concern about attracting enough bidders to the process. The transaction advisers can help the public authority to determine the best approach.

Prior to contract signing, a formal approval process often takes place within the public authority. This confirms whether the final terms of the deal deliver the requirements on an acceptable basis, whether the procurement process has been carried out in accordance with procurement procedures, and whether decisions have been recorded correctly with the appropriate audit trail. If a standardized form of contract is used, there may be a check to review and assess the justification for the departure from any standard terms. There may also be a further value-for-money assessment, which may focus, in particular, on the quality of the competitive process.

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<sup>1</sup> “Financial close” means that both the contract and the financing documentation have been signed and that all conditions required by these documents have been met.

## 9.

# AFTER SIGNING

A public-private partnership (PPP) project should be considered a success not simply at financial close, but when construction is complete and a satisfactory level of the services contracted for is being delivered on a regular basis. Unlike a privatization project, the “regulation” of a PPP project takes place within the terms of the contract. Contract management is a process that takes place throughout the life of the PPP contract. Therefore, arrangements for contract management, including the team, the budgets, and the process, should be established prior to contract signature. Contract management is not just a “legal exercise”; rather, it seeks to ensure the delivery of public services, which will be determined by all the components of the project, including the design, construction, and operation of the facility. In order to facilitate success, human and financial resources and the necessary governance arrangements will need to be established for the construction phase, the commissioning stage, and the operations stage.

The PPP contract should require the private sector partner to provide regular information on the performance of the project. An “independent engineer” and other specialists may be appointed to inspect the development of the project on a regular schedule and to report to the public authority on progress, safety, and environmental issues, especially at the commissioning stage. Both the public authority and the lenders have a vested interest in ensuring that construction is managed properly. During the operational phase, private finance initiative (PFI)-model contracts give the public sector the right to inspect and audit whenever necessary and oblige the private party to carry out and submit regular user surveys.



In the case of availability-based PPPs, the mechanism for making long-term, regular public authority payments against the provision of services in accordance with the terms of the contract depends heavily on the quality of the contract monitoring process. Detailed contract performance data should be fed back to the public authority on a regular basis to help it to determine both performance-based payments and deductions (with strong penalties in the contract for misrepresentation). User surveys and monitoring groups made up of relevant stakeholders can also be used to inform contract performance.

At the same time, it should be expected that changes will need to be managed. A well-structured PPP contract must set out the provisions for handling change and managing failure of the contractor or other adverse events. The key message is to plan for managing the contract within the terms of the contract (as opposed to managing the changes *to* the contract, which may result from not having prepared and negotiated contracts properly in the first place).

The requirements of contract management are often overlooked (see box 9.1). During the project preparation phase, *consideration must be given to establishing a proper budget for the public authority's cost of monitoring the long-term contract, identifying the contract manager and the team, and ensuring that they are trained and familiar with the terms of the contract.* As those involved with the procurement phase are often not involved with contract management, it is useful to involve, in the final stages of the procurement phase, those who will be managing the contract so that they become familiar with the project and the PPP contract terms. Involving contract managers in the procurement phase can also help to ensure that operational issues are better reflected in the terms of the contract, as tensions may arise if operational issues have to be dealt with in the early stages of operations. Failing to involve contract managers in the formulation of contract payment and performance documents can exacerbate problems.

By way of example, the relationship between the various parties involved in contract management activities, depending on the nature of the project, could involve a structure as shown in figure 9.1.

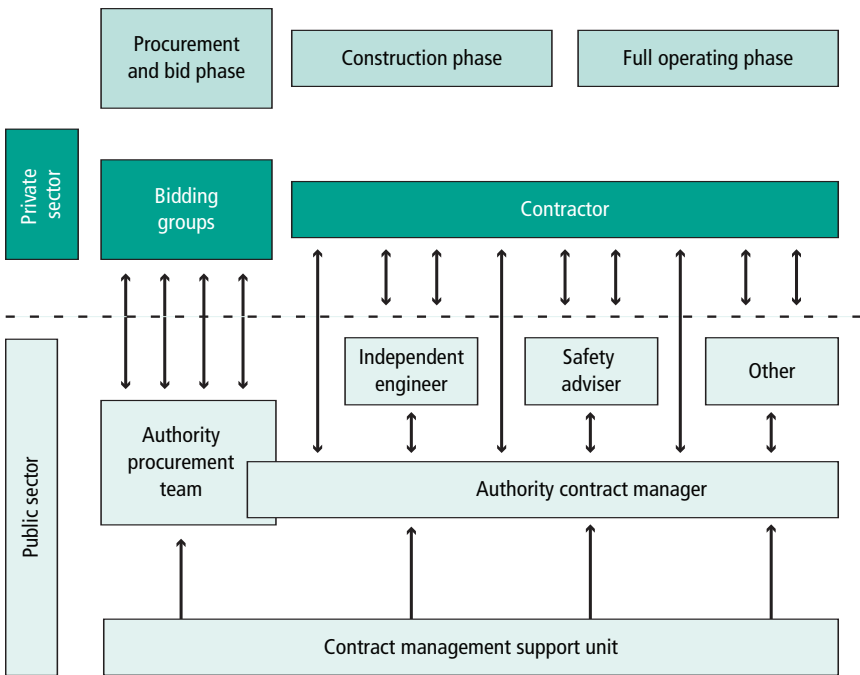
In addition to the management of activities at the interface of the public authority and the private partner, a governance mechanism also needs to be in place within the public authority to link activities at the project management level with the authority's wider corporate governance processes and to ensure proper oversight of those managing the contract. An increasing amount of guidance on these issues is publicly available (Partnerships Victoria 2003a; South Africa, National Treasury 2004c; United Kingdom, Her Majesty's Treasury 2007).

### Tips on Contract Management

- Consider establishing an experienced support group in the PPP unit to help contract managers to handle less frequent but more complex issues, such as changes or refinancing
- Consider reengaging the advisers employed during the procurement phase (and include provision for this in the procurement of advisers and their terms of engagement and necessary budgets)
- Develop a *contract administration manual* to bring together information on the terms of the contract and the processes and procedures for managing it, including responsibilities and timelines
- Maintain key contract documents on a shared basis with the private party to avoid misunderstanding
- Consider producing user guides to assist service users who are involved in contract monitoring
- If a payment mechanism is involved, carry out a trial run of the mechanism before the contract is signed to test out the system in “real life” scenarios
- Focus on maintaining operational performance throughout the operational period even when there are changes in the public authority’s requirements, rather than concentrating solely on “managing the contract”
- Consider holding planning and training days involving both the authority and the private party to encourage better understanding between them
- Ensure continuing review and monitoring of risks using the risk register developed during the project preparation phase
- Have a detailed communications strategy for dealing with the private party, service users, and stakeholders, and review and update it regularly. Good communication is key to ensuring that issues can be resolved.

Evaluation of PPP projects is important, not only as a means to ensure that policy objectives are being met (for example, value for money) and benefits are being realized, but also as a vital source of information. Such information may provide lessons that can be fed back into further development of the PPP process, improving, for example, the approach to the market.

Figure 9.1 Structure of Contract Management



Source: Authors.

When to evaluate is an open question, although a balance is needed between getting useful information quickly to inform current processes and getting meaningful data on performance. Evaluation 12–18 months after the commencement of operations will provide information on the bidding process, the delivery of the project asset, and initial performance. Subsequent evaluations will provide better information on operational performance.

Evaluation requires the establishment of relevant criteria and methods and the capacity within government to carry out the process. The detailed processes are beyond the scope of this guide, but examples of how this can be done are publicly available (United Kingdom, National Audit Office 2006). Making such reports publicly available also helps to ensure greater transparency by informing a wider audience of policy makers and citizens on the issues and leading to more informed debate.

PPP units themselves also have a role to play in continually examining the process, and acting as the link between lessons learned and the continuous improvement of PPP projects' procurement and management. Markets should be expected to change, and successful implementation and management of PPP programs need to both shape and respond to such changes.



## APPENDIX A

# WORLD BANK PRIVATE PARTICIPATION IN INFRASTRUCTURE PROJECT DATABASE

The World Bank PPI Project Database is divided into sectors as follows:

- Energy (electricity and natural gas)
- Telecommunications
- Transport (airports, seaports, railways, and toll roads)
- Water and sewerage (treatment plants and utilities).

It does not include social infrastructure projects and therefore excludes most PFI-model PPPs (see chapter 2). Within these four sectors the database identifies four types of projects: management and lease contracts, concessions, greenfield projects, and divestitures.

### **Management and Lease Contracts**

In management and lease contracts, a private entity takes over the management of a state-owned enterprise for a fixed period, while ownership and investment decisions remain with the state. There are two subclasses of management and lease contracts:

- *Management contract.* The government pays a private operator to manage the facility, while the operational risk remains with the government.
- *Lease contract.* The government leases the assets to a private operator for a fee, while the private operator takes on the operational risk.

These contracts share some, but not all, the characteristics of PPPs as defined in this guide.

## Concessions

In concessions, a private entity takes over the management of a state-owned enterprise for a given period during which it also assumes significant investment risk. The database classifies concessions according to the following categories:

- *Rehabilitate, operate, and transfer (ROT).* A private sponsor rehabilitates an existing facility and then operates and maintains the facility at its own risk for the contract period.
- *Rehabilitate, lease or rent, and transfer (RLT).* A private sponsor rehabilitates an existing facility at its own risk, leases or rents the facility from the government owner, and then operates and maintains the facility at its own risk for the contract period.
- *Build, rehabilitate, operate, and transfer (BROT).* A private developer builds an add-on to an existing facility or completes a partially built facility and rehabilitates existing assets and then operates and maintains the facility at its own risk for the contract period.

All of these would be concession PPPs as defined in this guide.

## Greenfield Projects

In greenfield projects a private entity or a public-private joint venture builds and operates a new facility for the period specified in the project contract. The facility may return to the public sector at the end of the concession period. The database identifies four types of greenfield projects:

- *Build, lease, and transfer (BLT).* A private sponsor builds a new facility largely at its own risk, transfers ownership to the government, leases the facility from the government, and operates it at its own risk up to the expiry of the lease. The government usually provides revenue guarantees

through long-term take-or-pay contracts for bulk supply facilities or minimum-traffic revenue guarantees.

- *Build, operate, and transfer (BOT)*. A private sponsor builds a new facility at its own risk, operates the facility at its own risk, and then transfers the facility to the government at the end of the contract period. The private sponsor may or may not own the assets during the contract period. The government usually provides revenue guarantees through long-term take-or-pay contracts for bulk supply facilities or provides minimum-traffic revenue.
- *Build, own, and operate (BOO)*. A private sponsor builds a new facility at its own risk and then owns and operates the facility at its own risk. The government usually provides revenue guarantees through long-term take-or-pay contracts for bulk supply facilities or minimum-traffic revenue guarantees.
- *Merchant*. A private sponsor builds a new facility in a liberalized market in which the government provides no revenue guarantees. The private developer assumes construction, operating, and market risk for the project (for example, a merchant power plant).
- *Rental*. Electricity utilities or governments rent mobile power plants from private sponsors for periods ranging from 1 to 15 years. A private sponsor places a new facility at its own risk and owns and operates the facility at its own risk during the contract period. The government usually provides revenue guarantees through short-term purchase agreements such as a power purchase agreement for bulk supply facilities.

The first three of these subcategories would be PPPs as defined in this guide.

## Divestitures

In divestitures a private entity buys an equity stake in a state-owned enterprise through an asset sale, public offering, or mass privatization program. The database identifies two types of divestitures:

- *Full*. The government transfers 100 percent of the equity in the state-owned company to private entities (operator, institutional investors, and the like).
- *Partial*. The government transfers part of the equity in the state-owned company to private entities (operator, institutional investors, and the like). The private stake may or may not imply private management of the facility.

These would not be PPPs as defined in this guide.





## APPENDIX B

# SAMPLE EXTRACT OF A RISK MANAGEMENT REGISTER FOR MANAGING THE PUBLIC-PRIVATE PARTNERSHIP PROJECT PROCESS

XYZ Project Risk Register: General  
Updated on XYZ

Identification number	Owner	Date identified	Date last updated	Risk description	Risk status	Impact	Mitigating action	Target date	Actual closure date	Current risk status	Risk to
1	X	1/4/2007	7/9/2007	Late commissioning of advisers	Medium	High	Draft scope of service and tender as soon as possible in order to meet the end of February deadline	5/2007	6/2007	Closed	
2	X	1/4/2007	1/2/2008	Inadequate central team staff resource	Medium	High	Monitor requirements	4/2008	Ongoing	Unchanged	Program management
3	X	1/4/2007	7/9/2007	Technical support not up to speed	High	High	Clarify quality and capacity of consultants; determine a process of how we are going to measure consultant's performance	5/2007	5/2007	Closed	Program management
4	Legal team	1/4/2007	1/2/2008	Land issues for project sites	High	High	Identify issues associated with any of the sites that can have an adverse impact on costs and scheduling of works for the whole program, such as ownership of site, covenant, contamination, and utilities issues	3/2008		Unchanged	Program management
5	Project board	1/4/2007	12/3/2008	Affordability	High	High	If there is a funding gap, flag it as soon as possible and identify other sources to support the program; alternatively scale down size of the works	11/2009		Unchanged	Final business case (FBC)
6	X	1/4/2007	12/3/2008	Difficulties with stakeholder buy-in	Medium	High	Secure in principle agreement letters; more work required for samples	3/2008		Reducing	Outline business case (OBC)

## APPENDIX C

# PUBLIC-PRIVATE PARTNERSHIP WEB SITES

### Africa and Middle East

Regionwide	<i>Infrastructure Consortium for Africa</i> <a href="http://www.icafrica.org/en/">http://www.icafrica.org/en/</a>
Egypt	<i>Ministry of Finance, PPP Unit</i> <a href="http://pppcentralunit.mof.gov.eg">http://pppcentralunit.mof.gov.eg</a>
Mauritius	<i>Ministry of Finance, PPP Unit</i> <a href="http://www.gov.mu/portal/sites/ncb/ppp/index.htm">http://www.gov.mu/portal/sites/ncb/ppp/index.htm</a>
South Africa	<i>National Treasury, PPP Unit</i> <a href="http://www.ppp.gov.za/">http://www.ppp.gov.za/</a>

### Asia and Pacific

Regionwide	<i>Asian Development Bank, Private Sector Operations Department</i> <a href="http://www.adb.org/PrivateSector/Finance/default.asp">http://www.adb.org/PrivateSector/Finance/default.asp</a>
Australia	<i>New South Wales Treasury, Working with Government</i> <a href="http://www.treasury.nsw.gov.au/wwg/">http://www.treasury.nsw.gov.au/wwg/</a> <i>Partnerships Victoria</i> <a href="http://www.partnerships.vic.gov.au">http://www.partnerships.vic.gov.au</a>

- India *Ministry of Finance, PPP Unit*  
<http://www.pppinindia.com/index.asp>  
*Planning Commission, Committee on Infrastructure*  
<http://infrastructure.gov.in/>
- Singapore *Ministry of Finance, PPP Unit*  
<http://www.mof.gov.sg/policies/ppp.html>

## North America

- Canada *Partnerships British Columbia*  
<http://www.partnershipsbc.ca>  
*Infrastructure Ontario*  
<http://www.infrastructureontario.ca>  
*Canadian Council for Public-Private Partnerships*  
<http://www.pppcouncil.ca>
- United States *Federal Highway Administration, Public Private Partnerships*  
<http://www.fhwa.dot.gov/PPP/>

## Europe

- Regionwide *European Bank for Reconstruction and Development*  
 Report on best international practices in public-private partnerships with regard to regional policy issues:  
<http://www.ebrd.com/country/sector/law/concess/ppp/atkins.pdf>  
*European Commission*  
 Guidelines for successful public-private partnerships:  
[http://ec.europa.eu/regional\\_policy/sources/docgener/guides/ppp\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf)  
 Resource book on PPP case studies:  
[http://ec.europa.eu/regional\\_policy/sources/docgener/guides/pppresourcebook.pdf](http://ec.europa.eu/regional_policy/sources/docgener/guides/pppresourcebook.pdf)  
*European Investment Bank*  
 Role of the European Investment Bank in public-private partnerships: <http://www.eib.org/projects/publications/the-eibs-role-in-public-private-partnerships-ppps.htm>

Belgium	<i>Vlaams Kenniscentrum Publiek-Private Samenwerking</i> Public-private partnership process approach: <a href="http://www2.vlaanderen.be/pps/english/process_eng.html">http://www2.vlaanderen.be/pps/english/process_eng.html</a>
Czech Republic	<i>PPP Centrum</i> Useful documents: <a href="http://www.pppcentrum.cz/index.php?cmd=page&amp;id=1197">http://www.pppcentrum.cz/index.php?cmd=page&amp;id=1197</a>
France	<i>Ministère de l'Économie et des Finances, Mission d'Appui PPP/PPP Task Force</i> <a href="http://www.ppp.minefi.gouv.fr/">http://www.ppp.minefi.gouv.fr/</a>
Greece	<i>Ministry of Economy and Finance, Special Secretariat for PPPs</i> <a href="http://www.ppp.mnec.gr">http://www.ppp.mnec.gr</a>
Ireland	<i>Department of Finance, Central PPP Policy Unit</i> <a href="http://www.ppp.gov.ie">http://www.ppp.gov.ie</a>
United Kingdom	<i>Her Majesty's Treasury</i> U.K. general PPP/PFI guidance: <a href="http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm">http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm</a> <i>Partnerships UK</i> U.K. general PPP/PFI guidance: <a href="http://www.partnershipsuk.org.uk">www.partnershipsuk.org.uk</a> <i>National Audit Office</i> Value-for-money reports: <a href="http://www.nao.org.uk/recommendation/reportList.asp">http://www.nao.org.uk/recommendation/reportList.asp</a> <i>4Ps</i> Local government PPP guidance: <a href="http://www.4Ps.gov.uk">www.4Ps.gov.uk</a> <i>Office of Government Commerce</i> Procurement guidance, gateway processes: <a href="http://www.ogc.gov.uk/what_is_ogc_gateway_review.asp">www.ogc.gov.uk/what_is_ogc_gateway_review.asp</a> <i>Department of Health</i> Health: <a href="http://www.doh.gov.uk">www.doh.gov.uk</a> <i>Partnerships for Schools</i> Education: <a href="http://www.p4s.org.uk/">http://www.p4s.org.uk/</a> <i>Highways Agency</i> Transport: <a href="http://www.highways.gov.uk/roads/dbfo">www.highways.gov.uk/roads/dbfo</a>
Scotland	<i>Scottish Government, Financial Partnerships Unit</i> <a href="http://www.scotland.gov.uk/Topics/Government/Finance/18232">http://www.scotland.gov.uk/Topics/Government/Finance/18232</a>

## Other Multilateral Agencies

World Bank Group	<i>Public-Private Infrastructure Advisory Facility</i> <a href="http://www.ppiaf.org/">http://www.ppiaf.org/</a> <i>Global PPPI portal</i> <a href="http://www.worldbank.org/etools/PPPI-Portal/">http://www.worldbank.org/etools/PPPI-Portal/</a> <i>World Bank Institute</i> <a href="http://go.worldbank.org/11IKUNJWD0">http://go.worldbank.org/11IKUNJWD0</a> <i>International Finance Corporation</i> <a href="http://www.ifc.org/">http://www.ifc.org/</a> <i>Multilateral Investment Guarantee Agency</i> <a href="http://www.miga.org">http://www.miga.org</a>
United Nations agencies	<i>United Nations Commission on International Trade Law, Procurement, and Infrastructure Development</i> <a href="http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure.htm">http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure.htm</a> <i>United Nations Development Programme</i> PPPs for the urban environment: <a href="http://www.undp.org/pppue/">http://www.undp.org/pppue/</a> <i>United Nations Economic Commission for Europe</i> <a href="http://www.unece.org/ie/ppp/">http://www.unece.org/ie/ppp/</a>
Other	<i>Private Infrastructure Development Group</i> <a href="http://www.pidg.org/">http://www.pidg.org/</a>
Nongovernmental organization	<i>Bank Information Center</i> International financial institution transparency resource: <a href="http://www.ifitransparencyresource.org/">www.ifitransparencyresource.org/</a>
Consultant	<i>E. R. Yescombe, PPP consultant</i> Comprehensive list of international PPP Web sites “Useful Links” page and links to published reports, studies, and guidance on PPPs (“Public-Private Partnerships: Principles of Policy and Finance” and “Bibliography” pages): <a href="http://www.yescombe.com">www.yescombe.com</a>

## APPENDIX D

# PROFILES OF FIVE AFRICAN PUBLIC-PRIVATE PARTNERSHIP PROJECTS

This appendix describes five public-private partnership projects undertaken in Africa in the past decade or so: a power plant project in Tanzania, a ports project in Mozambique, a desalinization plant in Algeria, a hospital project in Lesotho, and a water and electricity distribution project in Gabon.





## Songas Processing Plant in Tanzania

Type of project	Build, own, and operate integrated gas-fired power plant, including (a) construction and operation of a gas-processing facility on Songo Songo Island offshore from Tanzania, (b) a 225-kilometer subsea and onshore gas pipeline from the island to Dar es Salaam, and (c) a 190 megawatt Ubungo power plant
Date of financial close	Original project: October 2001; expansion project: November 2004
Capital value	Original project: US\$32 million; expansion project: US\$60 million
Consortium	Globeleq (54%); Tanzania Petroleum Development Corporation (30%); Tanzania Electric Supply Company (10%); Tanzanian Development Finance Company (6%). Globeleq holds the "A" preference shares; "B" preference shares are held as follows: Netherlands Development Finance Company (82%) and Tanzanian Development Finance Company (18%)
Financiers	International Development Association and European Investment Bank, both via the government of Tanzania, which on-lent the funds to the project

Faced with severe power shortages and a dependence on external fuel supplies, the government of Tanzania, with assistance from the World Bank and its other development partners, sought to develop an alternative source of power based on offshore gas. Commonwealth Development Corporation (which in 2002 formed Globeleq and transferred its holding in Songas to the new energy provider) became involved in development of the project in 1996, investing an initial sum of US\$18 million at financial close in late 2001. In 2003, during the crisis in the international power sector, Globeleq took the role of lead sponsor of the project, completing construction on schedule in 2004. A year later, Globeleq completed a 60 percent expansion of the project in response to the urgent need of Tanzania Electric Supply Company (TANESCO) for more generation capacity.

The key components of the Songas project are five production wells within the Songo Songo Island gas field that supply gas to a processing plant. The processing plant removes the liquid hydrocarbons and water from the natural gas, which then flows through a 225-kilometer undersea pipeline to a

power plant in Ubungu, Dar es Salaam. The Ubungu power plant has six gas turbines with a combined capacity of 190 megawatts. Part of the project involved converting four existing turbines from jet fuel to gas. Songas then sells the power to the government-owned electricity utility, TANESCO, under a 20-year contract power purchase agreement providing nearly 40 percent of the country's power. It is one of the cheapest sources of power on the TANESCO system.

Payments under the power purchase agreement are supported by the government of Tanzania through a liquidity account from which funds can be drawn in the event that TANESCO experiences any short-term liquidity problems. Payments comprise a fixed monthly capacity charge and an energy charge, denominated in U.S. dollars. The power purchase agreement is accompanied by a suite of agreements governing the supply of gas to the plant between the government of Tanzania, Songas, Tanzania Petroleum Development Corporation (TPDC), and PanAfrican Tanzania Limited (PAT), formerly the gas development company Ocelot International, with operations in several African countries. In these agreements, TPDC transfers certain gas-processing and transportation assets to Songas. Under a related operatorship agreement, Songas subcontracts to PAT the management and operation of the gas-processing facilities and certain related upstream assets in connection with the production and delivery of gas reserved by Songas for the generation of electricity by the Ubungu plant. These gas agreements set out Songas's right to the gas from the Songo Songo field, the price of the gas supplied to Songas, and the rights of PAT and TPDC to market and sell gas not required to operate the project (subject to certain limitations).

The project offers the following lessons for future projects:

- The project benefited from a realistic matching of the security arrangements to the perceived risks at the time. A stable political environment enabled it to attract significant long-term investment.
- Combining the various project components in a credible contractual structure reduced the overall risks to project delivery.
- The project's structuring made explicit the long-term obligations for both the government of Tanzania and the various private sector partners, allocating risk to the parties that were able to absorb or manage it most efficiently.
- The government of Tanzania and the various development finance institutions worked closely together from the early stages of project development.
- The project demonstrated that projects take time to develop.



## Maputo Port in Mozambique

Type of project	15-year concession to finance, rehabilitate, operate, and upgrade the ports of Maputo and Matola; the consortium has the option to continue managing the port for another 10 years
Date of financial close	April 2003
Capital value	US\$70 million
Consortium	Initial consortium: Maputo Port Development Company (MPDC): 51% is owned by an international consortium of foreign investors comprising Mersey Docks Group (United Kingdom), Skanska (Sweden), and Liscont (Portugal); 49% is owned by the Mozambique government (33% by the Mozambique National Ports and Rails Authority and 16% by the central government)
Financiers	Development Bank of Southern Africa was the leading bank, and 17 international banks were also involved

The port of Maputo wanted to increase its share of southern African freight traffic. After long years of decay during the civil war, the port was rehabilitated through a public-private partnership (PPP) between foreign investors and the government of Mozambique. This was the first port project in Africa based on a PPP model.

On April 2003, the government of Mozambique awarded the concession to manage the port to the Maputo Port Development Company (MPDC), a consortium majority owned by European investors. During the 15-year concession, MPDC provides all marine services within the jurisdiction of the Maputo Bay port. The consortium is investing US\$70 million as part of the rehabilitation and development of the port; this includes modernizing quays and port equipment and supplying new tugs as well as transport connections by road and rail to neighboring countries. The government of Mozambique subsequently signed a railway concession operating from the South African border to the port of Maputo with the South African rail company Spoornet.

Through improved management of operations and investment, the concession has improved efficiency and doubled handling volumes. It has improved the access of Mozambique's products to world markets, created new jobs, and generated economic activity in the Maputo area.

The favorable location of the port is attracting companies not only from South Africa but also from landlocked Botswana, Swaziland, Zambia, and Zimbabwe. The four countries do not have their own ports, and Maputo offers them an alternative route for foreign trade, allowing them to reduce their dependence on transit traffic through South Africa.

However, the biggest customers for Maputo port are South African exporters and importers. In fact, Johannesburg, South Africa's economic center, is closer to Maputo (about 500 kilometers) than to Durban, South Africa's largest port city. The project is an important component of the wider Maputo Development Corridor.

The project offers the following lessons for other projects:

- The contract clearly defined the investment and operational obligations of the consortium.
- The government used the knowledge acquired in the port deal to close the rail deal more quickly and efficiently than might otherwise have been the case.
- The project was part of a wider special development initiative, which ensured that the project was linked to other infrastructure development (such as the N4 toll road).
- The project enjoyed strong political support by both the South African and the Mozambican governments at the very highest level.
- Good stakeholder management by an entity helped to shape the vision for the overall corridor, taking into account both public and private sector issues.
- The project was part of a larger project that involved two governments, two transport authorities, and numerous institutions.
- Creditworthy anchor customers and links with other transport infrastructure were important elements in the success of the project.



## Skikda Desalination Plant in Algeria

Type of project	25-year contract to finance, design, build, own, and operate a seawater desalination, reverse-osmosis plant with a nominal capacity of 100,000 cubic meters per day in Skikda, Algeria, near the frontier of Tunisia
Date of financial close	July 2005
Capital value	US\$110.6 million (80% debt, 20% equity)
Consortium	Geida Consortium: Abengoa's Befesa and Codesa (50%); Actividades de Construcción y Servicios (25%) through Cobra-Tedagua; Sacyr (25%) through Sacyr
Financiers	Banque Nationale d'Algérie

Algeria suffers a severe shortage of fresh water since most of its territory is either arid or semiarid. In addition, factors such as growing demand, drought, and pollution have contributed to the critical shortage of fresh water in the country. The Algerian government decided to tackle the shortage of both drinking and irrigation water through a PPP scheme, with local funding.

The *Projet de Dessalement d'Eau de Mer de Skikda* is part of the government's ambitious plan to construct up to 28 large-scale desalination plants along the 1,300-kilometer coastline of Algeria before 2020. This project consists of the design, construction, financing, ownership, and exploitation of a seawater desalination plant producing 100,000 cubic meters of water a day using the reverse-osmosis procedure.

The Algerian Energy Company awarded the project in April 2004 to the Spanish Geida Consortium, and financial close was reached on July 31, 2005. Construction works started in November 2005, and the plant is expected to be operational in 2008. The build, own, and operate concession contract will run for 25 years, which may be extended by mutual agreement.

The Skikda desalination plant will be one of the largest of its kind in the world and is expected to supply 500,000 people in the eastern coastal area of

the country, near Tunisia.

The primary importance of this project lies in its financing. This US\$110 million desalination plant is the first ever PPP in Algeria to be financed by a local bank, the Banque Nationale d'Algérie (BNA). Motivated by high levels of liquidity in Algeria due to high energy prices, the government decided to involve the local banking system in the financing of PPP projects, allocating PPP deals to different banks. This allowed the government to spread expertise and project finance know-how around the local finance and advisory sectors. This local expertise will be very valuable in the further development of Algeria's ambitious water infrastructure development program.

The government-financed BNA provided the Spanish consortium with a 17-year term loan in local currency at a very favorable fixed rate. The terms of the nonrecourse long-term funding by BNA allowed the project to eliminate foreign exchange rate risk and permitted it to achieve a ratio of debt to equity of 80:20.

The project offers the following lessons for other projects:

- The government developed a well-structured pipeline of deals, which was attractive to the market.
- The government took a strategic approach to developing and spreading PPP expertise and project finance know-how around the local financial and advisory sectors.
- The terms of the nonrecourse long-term funding allowed the project to eliminate foreign exchange rate risk and increase its gearing.



## Lesotho National Referral Hospital

Type of project	18-year contract to design, build, partially finance, equip, and operate a 390-bed national referral hospital at a greenfield site as well as to refurbish, upgrade, and operate three urban filter clinics
Date of financial close	December 2007
Capital value	US\$107 million
Consortium	Netcare Consortium: Netcare (40%), a leading private health care provider with operations in South Africa and the United Kingdom; Excel Health (20%), an investment company for Lesotho-based specialists and general practitioners; Afri'n nai (20%), an investment company for South Africa-based specialists and general practitioners; Mohloli (10%), the investment arm of the local Chamber of Commerce; Basotho Women's Investment Company (10%)
Adviser and financier	Adviser: International Finance Corporation; financier: Development Bank of South Africa

The government of Lesotho, with support from the World Bank Group, International Finance Corporation, and other development organizations, is undertaking long-term reform of the health sector. Lesotho urgently needs to replace the country's main hospital, Queen Elizabeth II, an aging facility functioning at a minimal level. To maximize the use of limited resources, increase the chance of delivering the project on time and on budget, and ensure the long-term improvement in facilities and higher-quality services, the government adopted a public-private partnership scheme to design, build, finance, and fully operate the new hospital. This new national referral hospital will also serve as the district and regional hospital for the 500,000 people living in Maseru.

Delivery of the project is still at an early stage; however, in December 2007 the Lesotho government, through an internationally competitive bidding process, selected a consortium headed by Netcare, a leading South African health care provider, as the preferred bidder to undertake the project, one of the largest such schemes in the region to date. Under an 18-year contract, the Netcare Consortium will design, build, partially finance, equip, and operate

the new 390-bed public hospital in Maseru, refurbish three primary care clinics, and provide all operational and clinical services at the facilities. Services at the refurbished urban clinics will start in early 2009. The private sector consortium will be paid by government as services are made available at the contracted level of performance over the contract period. Operator performance will be monitored independently, and the facilities will be required to receive and maintain accreditation throughout the 18-year contract.

The PPP project allows government to maximize the quality and quantity of health services available to citizens within its constrained budget, without increasing the minimal charges that all patients pay today for hospital services. This partnership is expected to provide an important boost to the local economy, as Lesotho investors, doctors, and service providers form a large part of the consortium.

This project will be the first of its kind in the region to include the provision of clinical services for the general public. South Africa has developed a number of PPP hospital schemes using a model in which the private partner provides and maintains health infrastructure facilities to the public sector under a long-term contract. The project is expected to be a pilot for future public hospital projects in Africa and to demonstrate the applicability in the region of PPPs for the large-scale provision of affordable medical services.

The project's strengths include the following:

- Strong support from government at the highest levels, from existing hospital staff, and from the community
- Ability to attract a robust private sector consortium, led by a health care provider with existing international experience of hospital PPP schemes in South Africa and the United Kingdom
- The involvement of local and regional stakeholders, including investors, doctors, and service providers.





## Water and Electricity Services Provision in Gabon

Type of project	20-year concession for the production, transport, and distribution of both water and electricity in Gabon; the contract can be extended for several periods based on an addendum to the contract
Date of financial close	July 1997
Capital value	US\$135 million
Consortium	Société d'Énergie et d'Eau du Gabon (SEEG): Vivendi Water (51%); local shareholders (49%)
Financiers	The 49% of shares sold through a public offer was the first of its kind in Gabon; employees were able to buy up to 5 percent of those shares

The first contract to involve private sector participation in the water sector in Africa was awarded in 1960. To date, 27 such contracts have been signed. However, this politically sensitive sector remains one of the least popular for private investment. Nevertheless, it is possible to find successful projects within the sector. According to a report commissioned by the World Bank and the Public-Private Infrastructure Advisory Facility, the contract for the management of water and electricity utilities in Gabon was a relative success thanks to the strong political commitment of the government (PPIAF 2002).

In July 1997, a 20-year concession contract for the provision of both water and electricity services was signed between the government of Gabon and the Société d'Énergie et d'Eau du Gabon (SEEG), which is majority-owned by the French Vivendi Water. SEEG grew out of private municipal companies that provided water and electricity services in the two main urban centers, Libreville and Port-Gentil, which together contain half of the country's total population.

This contract was the first “real” water concession in Africa, as it defines investment obligations and sets coverage targets for the private sector provider. For instance, the contract includes the obligation of SEEG to invest

a minimum of US\$135 million in rehabilitation (60 percent in water) and sets coverage targets for expanding service to previously unconnected rural areas. SEEG's electricity business, particularly electricity revenues from the two main towns, cross-subsidize the relatively less developed water business. SEEG has informally committed to investing another US\$130 million over the life of the contract to improve performance and coverage of the network.

A 10-year period of preparation was necessary to allow important reforms, such as the definition of a legal framework, an increase in tariffs to levels reflecting costs, and a reduction of staff between 1989 and 1997. Vivendi won the project on the basis of a proposed 17.25 percent reduction in prices for water and electricity services.

PPIAF (2002) reports that the private operator has, in the first five years, "performed well in its existing service areas, often exceeding targets, but less progress has made in more isolated areas." The report continues, "SEEG has posted good profits since the start of its operations, paying shareholders a 20 percent dividend per share in 2000. The coverage targets, with penalties for non-achievement, have provided effective incentives for quickly increasing network density in newly served areas ... The multi-utility service provision has allowed cost reduction through sharing of resources, particularly at head-quarter level. Cross-subsidization has also been effective in getting 60 percent of investment into the water sector, which only accounts for 15 percent of SEEG's turnover."

The project offers the following lessons for success:

- The government supported the project from its conception.
- The government prepared the ground for private sector participation by developing an appropriate legal framework and by increasing tariffs to reflect costs.
- The contract defined the investment obligations and set coverage targets for the consortium.
- The provision of various utilities allowed cross-subsidization of less profitable areas and economies of scale.



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