

## Developing a Public-Private Partnership Framework: Policies and PPP Units

*This note is the fourth in a series of notes on developing a comprehensive policy, legal, and institution framework for public-private partnership (PPP) programs. This series is extracted from a PPIAF-funded analysis of Uganda's enabling environment for PPPs, which was prepared by Castalia Limited in December 2008.*

To take advantage of the potential for good quality, sustainable, well-structured PPP projects to provide infrastructure services, governments may:

- Develop a clear PPP Policy
- Establish a dedicated PPP unit
- Adopt clear procedures and define responsibilities for developing and implementing PPPs
- Establish a mechanism for evaluating the PPP framework
- Legally establish the principles of the PPP framework through a PPP law

### PPP Policy

A clear policy is an important basis for a successful PPP framework. To develop a PPP pipeline, government agencies need to understand PPPs and how they may be able to use them to achieve their policy ends. Equally, clear information on the PPP program reduces the cost to potential investors of considering opportunities in the country.

Note seven outlines a proposed PPP policy, which is based on the principles outlined in note one of this series and draws on international examples of good PPP policies. The proposed PPP policy defines the extent, objectives, and guiding principles of the government's PPP program. The main points of the proposed policy are as follows:

- **PPPs are defined** as a long-term contract between a government entity and a private company to provide, or contribute to the provision of, a public service. The definition and scope of the PPP program is further specified in the proposed policy by:
  - Defining the contractual attributes, size, and duration of PPP contracts
  - Defining national and government infrastructure as the priority PPP sectors
- The main **objectives of the PPP program** are:
  - To increase the financing available for infrastructure by making use of private sector investment resources
  - To improve value for money in infrastructure projects by creating incentives for best-practice design, timely completion, and efficient operation by sharing project risk with the private sector
  - To encourage innovation in the provision of infrastructure
  - To improve the sustainability of infrastructure and infrastructure services
  - To improve accountability in public expenditure
- The **principles** by which PPP contracts will be structured, procured, managed, and reported, and the types of support the government may offer a PPP project outlined, are as follows:
  - Project specifications should focus on the end result—delivery of facilities or services at specified standards—rather than the inputs or means of delivery

- Government payments to the private party, where required, will be based on the delivery of facilities or services consistent with performance standards that are clearly defined in the PPP contract
  - User charges, where applied, will be specified in the PPP contract or subject to credible regulation
  - Where the services provided are paid for by user charges, the project cost may also be subsidized by the government, where such subsidies are consistent with the government's policy priorities. Payment of subsidies will be based on the delivery of facilities or services consistent with performance standards that are clearly defined in the PPP contract
  - The government may provide equity or debt finance to the project company—not exceeding 50% of the total equity or total debt respectively—where it expects that such an investment increases the value for money of the project
  - The government may provide land or existing assets to the project company—this may be subject to payment of concession or lease fees to the government
  - Where land is to be acquired by the project company, the government may support this process by providing appropriate way leaves
  - Project risk allocation will be clearly documented in the contract, and designed to deliver the best value for money from the project. Risk allocation principles are outlined in the following section of this policy
- **Project risks will be allocated** so that each party bears the risks they are best-placed to manage. This means risks will be allocated to the party best able to:
    - Influence the risk factor, where possible
    - Influence the sensitivity of total project value to the risk factor—that is, to anticipate or respond to risk factor, if it cannot be influenced directly
    - Absorb the risk, where it can neither be influenced nor its impact controlled.

The PPP policy also establishes the **institutional structure and processes for managing PPPs** by:

- Introducing the PPP Unit and outlining its authority, reporting structure, and mandate
- Outlining the procedures for identifying, developing, procuring, and monitoring PPP projects and summarizing the responsibilities of each government entity
- Defining the responsibility of the Auditor General to carry out value for money audits of the PPP program

In line with international best practice, the proposed PPP policy in note seven aims to establish guiding principles, the interpretation of which will vary by sector and by project. In some cases, implementing agencies at the sector level may have a sizeable potential pipeline of projects with common characteristics. Examples could include new generation assets in the energy sector, or toll roads or long-term road maintenance contracts in the transport sector. Here, the implementing agencies may publish sector-level PPP policies outlining how the central PPP policy will be applied.

## **PPP Unit**

When a government lacks capacity and experience in developing PPP projects to spearhead the PPP program, we recommend the government establishes a dedicated PPP unit.

## Why establish a PPP Unit

Many successful PPP programs depend on central PPP units. These include Infrastructure UK (formerly Partnerships UK), Partnerships Victoria in Australia, and the National Treasury PPP Unit in South Africa. These units fulfill some or all of a range of functions, which may include promoting the PPP program, supporting government departments in developing and implementing PPPs, or regulating the PPP development process by assessing and approving PPP project proposals.

There are other institutional options for implementing the PPP program besides establishing a PPP unit. For example, PPP development and prioritization could remain entirely in the hands of line ministries or contracting entities, under the guidance of sector working groups. In particular, if the potential PPP pipeline is concentrated in one or a few sectors, building capacity in developing and implementing PPPs in the relevant entities in those sectors could be the most economical approach. In South Africa, two of these options are combined. A central PPP unit oversees and supports PPP development in most sectors, but co-exists with an experienced National Roads Board which develops and implements its own toll road PPP pipeline, subject only to approval from the PPP unit.

The combination of a potentially broad pipeline, spanning many sectors and agencies, with generally poor understanding of PPP throughout a government means a dedicated PPP unit makes most sense. The purpose of creating a PPP unit is to build a centre of experience and expertise in PPP—requiring appropriate financial and human resources, as discussed below. This unit could then serve multiple functions.

## Proposed PPP Unit Functions

A PPP unit may have three main functions:

- Developing the PPP policy and program
- Supporting line agencies in developing and implementing PPP projects
- Disseminating information on the PPP program

The nature of and balance between these functions is likely to change over time. The first proposed function of a PPP unit—**developing the PPP policy and program**—will require significant effort in the early stages of the PPP program. The PPP unit should take the lead in developing the guidelines and requirements for each stage of project development, as well as standard documentation for PPPs, and procurement and dispute resolution procedures. The PPP unit may also support the relevant line ministries in introducing sector-level PPP policies interpreting the principles outlined in the central policy.

Once the policy and guidelines are in place, the PPP unit should periodically review and update them if necessary. To perform this review function the PPP unit would need to monitor and evaluate the performance of implemented PPP projects and draw lessons from this experience, based on information provided by the relevant line ministries.

We recommend that responsibility for the PPP policy and program ultimately rests with the Ministry of Finance. The PPP unit should recommend changes or updates to the PPP policy—based on its periodic reviews—to the Secretary to the Treasury for consideration. The Minister for Finance should approve any changes, advised by the Secretary and the PPP Unit.

The second proposed function of the PPP unit is to support the process of **developing and implementing PPP projects**. This process is outlined below, including the roles assigned to the PPP unit. These roles are:

- Helping line ministries and government entities identify PPP options: the PPP unit will work with planning teams within each agency to identify where PPPs could be used to meet policy objectives

- Verifying the quality of project proposals: the certification of the PPP unit would be required before developing a PPP project. This certification will be based solely on the potential technical, economic and financial viability of the proposed project and its consistency with the principles laid out in the PPP policy. Other government entities would remain responsible for assessing the consistency of the proposed project with the budget and policy priorities
- Helping line ministries with PPP procurement: PPP unit staff would be part of the team developing a project in detail, preparing the transaction documents, and (once approval is granted), conducting the PPP transaction.

The initial focus of the PPP unit under this function would be to work with line ministries and other relevant government entities to identify PPP options and develop the PPP pipeline. The effort required to fulfill this role would vary according to each entity's existing capacity and understanding of PPP. Over time, line ministries should develop the capacity to identify projects independently, reducing the need for the PPP unit's involvement. However, the PPP unit would continue to verify the quality of proposals and participate in PPP project execution.

The third proposed function of the PPP unit is to **disseminate information on the PPP program**. Initially this will require a lot of effort to educate stakeholders within and outside the government on the PPP policy and the principles behind the PPP program. Over time, this function would increasingly involve publicizing information on the PPP pipeline to engage private sector interest in PPP opportunities in the country.

Where PPP units perform several roles, concerns of conflict of interest can arise. For example, a PPP unit that plays a "deal-making" role for PPPs, and is rewarded or compensated on the basis of deals completed, should not assess the quality of proposed projects. Equally, a PPP unit that implements PPP projects may not be best-placed to evaluate the performance of these projects. It can be possible to introduce firewalls within a PPP unit to separate such conflicting functions. However, this is not practical or efficient in the early stages of a PPP program where the relevant skills and experience are in short supply and the project pipeline will not support a large unit. Instead, we have defined the PPP unit functions to minimize conflicts of interest in the following ways:

- The PPP unit is not involved in developing the initial business case or proposal for a PPP project, whose technical merits it will subsequently assess
- The PPP unit's role in assessing and approving projects is limited to a technical assessment of the project structure, based on principles that will be clearly laid out in the PPP policy. A project must be approved by the Development Committee, Cabinet, and Parliament (or their equivalents) for consistency with budget and policy priorities
- The PPP unit's role in promoting the PPP program is limited to disseminating information, not deal-making
- The PPP unit will evaluate the performance of PPP projects to inform its ongoing reviews of the PPP policy and guidelines—this evaluation will be backed up by a periodic value for money audit by the Auditor General

### **Location of the PPP Unit**

The location of the PPP unit in the government is crucial in determining its effectiveness in carrying out the proposed functions. In particular, the location affects the authority of the PPP unit and its ability to coordinate with the various government entities involved in developing and implementing PPPs. We recommend establishing the PPP unit as a unit within the Ministry of Finance, reporting to the Secretary to the Treasury.

PPP units have been established in other countries both within government ministries—most commonly the Ministry of Finance or Treasury—and as stand-alone units. The former have generally been more

successful, particularly at the early stages of a PPP program. When a PPP unit sits in a Ministry of Finance, such as in South Africa, it benefits by extension from the authority of that Ministry. Since all expenditures require Ministry of Finance approval, it is difficult for projects to be “routed around” a unit of this Ministry. In contrast, unless a stand-alone unit enjoys political support at the highest level, it may too easily be marginalized. Independent PPP units in Bangladesh and the Philippines, for example, were marginalized in this way. A PPP unit within the Ministry of Finance is also well-placed to co-ordinate and support efforts of each line ministry or government entity to integrate PPP into their sector strategies and plans. Reporting directly to the Secretary to the Treasury means the PPP unit is not subject to political pressures within the ministry itself.

The main drawback of establishing a PPP unit as a department within a government ministry is the limitations this sets on remuneration, and hence on the unit’s ability to compete with the private sector to attract relevant skills. Particularly in the early stages of the PPP program, the unit will rely on consultants and external advisors to bridge this skill gap, as discussed in the following section.

### **Structure and Staffing of the PPP Unit**

To fulfill its role in ensuring PPP projects are of good quality and well-structured, the PPP unit needs the right balance and level of skills and experience. The structure and staffing of the PPP unit should change over time as its functions change—as described above—and as the PPP program and pipeline develops.

We recommend initially establishing the PPP unit with a small core staff of permanent employees and long-term consultants. This core staff will provide in-house technical capacity for developing the PPP framework, promoting PPPs, helping to identify deals, assessing proposed PPPs, and participating in the PPP transaction process. A key role of the PPP unit will be to manage the efforts of external advisors. The staff should comprise members with the following areas of expertise:

- Project finance: financial analysis and due diligence
- Economic analysis
- Legal: contracting, legislation, and regulation
- Technical: broad understanding across infrastructure sectors
- Public relations and communications
- Contract monitoring and evaluation

Besides these areas of functional expertise, the staff should have experience covering a broad range of infrastructure sectors and in project management. Achieving the full range of functional expertise should be the focus in the early stages of the PPP unit—sector-specific expert advisors can be contracted as needed to develop specific PPP projects.

PPP-specific expertise will be needed, most likely from long-term consultants. Short-term external advisors may also be needed to help with capacity-building and to support the PPP unit in developing the PPP policy, law, guidelines, and documentation. As described below, external advisors should continue to play a key part in developing and implementing PPP transactions over time.

In keeping with the small initial scale of the PPP unit, we recommend a simple structure. We suggest the PPP unit professionals listed above initially operate as a single team under a PPP Unit Director, who reports directly to the Secretary of the Treasury. This flexible approach means the structure within this team can depend on the skills and experience of available staff. As the project pipeline develops and the PPP unit team expands, it may become clearer and more efficient to split the team on a functional basis. In particular, the PPP performance monitoring and evaluation function could be separated once this becomes substantial enough to support a dedicated team. As discussed above, some separation

between the teams implementing PPP projects and evaluating those projects would help avoid potential conflicts of interest within the PPP unit.

### Responsibilities for developing and implementing PPPs

Developing and implementing PPP projects require coordination between several government entities:

- A line ministry or other procuring entity's accounting officers and staff retain overall responsibility for identifying, developing, implementing, monitoring, and managing PPP projects in their relevant sectors
- Project teams are created from among line ministry and other government entity staff, as well as external advisors to develop and procure specific PPP projects
- The PPP unit supports the process of developing PPPs and ensures the quality and consistency of projects with the PPP policy
- Approval bodies, including the Development Committee, Cabinet, and Parliament, ensure proposed PPP projects are in line with the budget and policy priorities.

Table 4.1 clarifies the roles and responsibilities of each entity in developing and implementing PPP projects. These are in addition to responsibilities for developing and managing the PPP program as a whole, discussed below.

**Table 4.1: Responsibilities for Developing and Implementing PPP Projects**

Entity	Responsibility for Developing and Implementing PPPs
<b>Line Ministry</b>	
<b>Accounting officer</b> of the relevant line ministry or government entity	<ul style="list-style-type: none"> <li>• Overall responsibility for PPP procurement in relevant sector</li> <li>• Appoints the <b>project team</b> and <b>team leader</b> and delegates responsibility for developing and contracting a PPP project to this team, supported by the PPP unit in hiring appropriate advisors</li> <li>• For unsolicited proposals, decides whether to proceed with developing bid documents for a detailed proposal, based on the recommendation of the project team</li> <li>• Submits project for approval to Cabinet and Parliament, supported by the project team and team leader</li> <li>• Ensures the final structure and cost of the PPP is within the range approved by Parliament and signs the PPP contract</li> </ul>
<b>Line ministry or government entity staff</b>	<ul style="list-style-type: none"> <li>• Identify potential PPPs among sector and entity priorities</li> <li>• Procure external consultants to develop initial business case, supported by the PPP unit where necessary</li> <li>• Develop business case together with external consultants, or assess preliminary proposals submitted by a private sector proponent for consistency with sector priorities</li> <li>• Participate in <b>project team</b></li> <li>• Manage the ongoing relationship with contractor; monitor and report on contractor performance</li> </ul>
<b>Contracts committee</b>	<ul style="list-style-type: none"> <li>• Assess and approve project contracts and procurement process for consistency with government procurement requirements</li> </ul>
<b>PPP Unit</b>	<ul style="list-style-type: none"> <li>• Support the line ministry in identifying potential PPP projects among sector priorities, and in contracting external advisors for the initial development of the business case and for inclusion in the project team</li> <li>• Review and certify that the business case, or preliminary proposal in the case of unsolicited proposals, is in line with PPP principles laid out in the PPP policy and law</li> </ul>

Entity	Responsibility for Developing and Implementing PPPs
<b>PPP Unit</b>	<ul style="list-style-type: none"> <li>• Participate in the <b>project team</b></li> <li>• Receive and review project reports from line ministries</li> <li>• Develop, publish, and periodically update guidelines and requirements for each stage of project development, standard documentation, procurement, and dispute resolution procedures</li> </ul>
<b>Project Team</b> Appointed by the relevant Accounting Officer, comprising representatives of the line ministry, PPP Unit, other sector bodies where appropriate, and external advisors	<ul style="list-style-type: none"> <li>• Undertake a detailed feasibility study</li> <li>• Design project structure and risk allocation</li> <li>• In the case of unsolicited proposals, review and assess the detailed proposal from the private sector proponent and if approved, negotiate and finalize the project structure</li> <li>• Create a full set of draft contracts, including any proposed government guarantees, and tender documents, following the guidelines, templates, and model contracts prepared by the PPP Unit</li> <li>• Conduct the bidding process according to the process defined by the PPP Unit</li> <li>• Evaluate bids and decide on a preferred bidder. The project team may appoint an evaluation committee including additional specialists</li> <li>• Negotiate with the preferred bidder to reach final contract close</li> </ul>
<b>Project Team Leader</b> Appointed by the relevant Accounting Officer. May be a full-time position for large PPP projects, or selected from project team personnel	<ul style="list-style-type: none"> <li>• Manages all activities of the project team</li> <li>• Acts as the main point of contact throughout the procurement and negotiation processes</li> </ul>
<b>Oversight and Approval Bodies</b>	
<b>Development Committee</b>	<ul style="list-style-type: none"> <li>• Assess the initial business case according to the same criteria as other government projects—value for money and consistency with budget and policy priorities</li> </ul>
<b>Cabinet and Parliament</b>	<ul style="list-style-type: none"> <li>• Assess the project proposal for consistency with budget and policy priorities and approve the PPP for procurement</li> </ul>
<b>Ministry of Finance</b>	<ul style="list-style-type: none"> <li>• Sign any government guarantees</li> <li>• Record and report on contingent liability portfolio, including liabilities arising from guarantees to PPP projects</li> </ul>
<b>Public Procurement Authority</b>	<ul style="list-style-type: none"> <li>• May be required to review procurement processes in case of dispute, as with any government procurement activity</li> </ul>

### External Review and Evaluation of PPP Program

Among the proposed responsibilities of the PPP Unit, described above, is a periodic review of the PPP policy and program. In addition to this “internal” review of PPP performance at the project level, the performance and value for money of the PPP program as a whole should be periodically evaluated. The Auditor General should carry out value for money audits to establish the “economy, efficiency and effectiveness” of government programs, including the PPP program.

We recommend the government initially incorporates a three-yearly evaluation by the Auditor General into the PPP policy. This external evaluation is necessary for two reasons:

- As a check on the activities of the PPP Unit, whose integrity and performance is crucial to implementing successful PPP projects
- To evaluate whether the resources spent on the PPP program—such as in staffing the PPP Unit and in project development costs—are indeed achieving the aim of improving the effectiveness of investment in infrastructure assets and services.

In carrying out these periodic evaluations the Auditor General will require support from external advisors, to provide appropriate expertise in assessing PPP projects and programs. The cost of these advisors should be factored into the PPP program.

## **PPP Law**

The PPP policy, institutional responsibilities, and procedures constitute the substance of the PPP framework. In this section we discuss the legal implications of the policy and institutional changes proposed above and recommend the government introduces a dedicated PPP law. A PPP law is the best way to provide clear and specific support to the proposed PPP framework.

There is no clear international “best practice” regarding PPP legislation. Some countries have successful PPP programs, PPP units, and procedures without these PPP frameworks being codified in law—for example the UK, Australia, South Africa, and Mexico. In these countries, the executive branch of government runs and regulates the PPP program. In many other countries the PPP program has been supported by a dedicated PPP law. Examples include Greece, Germany, France, the Philippines, Indonesia, Thailand, and Brazil.

Introducing a PPP law is therefore an option, not a requirement, for developing a PPP program. There are disadvantages to basing the PPP program on new legislation. Firstly, it will take time and effort to introduce a PPP law. This could either delay implementation of the PPP program, or mean interim measures need to be put in place to enable good quality PPP projects to be developed in the meantime. Secondly, a law is difficult to change once passed. This inflexibility contributes to some of the advantages discussed below. However, it means care must be taken that the law is flexible to the potentially changing needs of the PPP program. There is always a risk that the principles codified in a PPP law will later be found to be inappropriate as new needs emerge.

### **Advantages of codifying PPP framework in law**

A PPP law would give legal and political weight at the highest level to the principles of a PPP program. The law would define what PPP means, how the government will use PPPs, how PPPs will be structured, and what the government may bring to a PPP contract. This has two main advantages:

- Controls PPP structuring *within* the government
  - Legally establishing principles government departments or entities must follow in developing PPPs provide the strongest incentives to follow the recommended structure, and reduces the risk of opportunistic changes to the PPP policy by future administrations—an advantage to the inflexibility of a law
  - Upfront discussion in Parliament of principles of structuring PPPs makes detailed discussion of structure unnecessary on a project-by-project basis, where certification of compliance with PPP law is provided by the PPP Unit—enabling more efficient passage of PPP projects through Parliament
- Sends a clear message on commitment to PPP *beyond* the government
  - For example, highlighting the government’s commitment to honor its PPP payment obligations—provided a project has been structured and contracted according to the PPP law—gives potential private partners confidence when bidding for PPP contracts.

### **Proposed Content of PPP Law**

If governments introduce a PPP law, it should provide the clearest possible message of the government’s commitment to the PPP program, an important determinant of the likely success of PPPs. The PPP law should establish the principles of the PPP framework, which are presented in more detail in the proposed PPP policy in note seen of this series. The law should be as concise as possible, and address general principles only. There are two main reasons for this approach to the law, which is consistent with international good practice for PPP legislation. First, laws are by nature inflexible, so should not include

any details that may subsequently need to adapt to a country's changing PPP needs. For example, the law should designate responsibility for publishing PPP processes, standards, guidelines, and standard contract terms (to the PPP unit), but should not include these details within the law itself. Secondly, limiting the law to general principles ensures these principles are clearly communicated and understood—the law should avoid unnecessary detail or extension.

We recommend that the PPP law:

- Define PPPs, including the types of government entities that may enter into PPPs to provide public services
- Assign responsibility for setting the scope of the PPP program—in terms of project size, type and target sectors
- Outline principles by which PPP projects will be structured:
  - Principles by which project risks will be allocated
  - Types of support that may be provided by the government
- Define—at a high level—the responsibilities for implementing PPPs, the project development and implementation procedures and approval requirements