PUBLIC PRIVATE PARTNERSHIPS

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CERTIFIED PROCUREMENT AND SUPPLY PROFESSIONAL OF KENYA

CPSP-K

2019

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PART 4

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CHAPTER 1: OVERVIEW OF PUBLIC PRIVATE PARTNERSHIPS (PPPs)…1

CHAPTER 2: THE ROLE OF PUBLIC PRIVATE PARTNERSHIPS (PPPs)….11

CHAPTER 3: PPP PROJECT APPRAISAL AND FEASIBILITY STUDIES… 12

CHAPTER 4: RISK AND VALUE FOR MONEY ASSESSMENT…………... 19

CHAPTER 5: FINANCING IN PPPs.....….......................................………..... 27

CHAPTER 6: PPP PRCUREMENT PROCESS………………………………... 41

CHAPTER 7: STAKEHOLDER RELATIONS...……………………………..... 46

CHAPTER 8: REGULATION OF PPPs…………………..…………………..... 55

CHAPTER 9: PPP BEST PRACTICES ……………………….......................... 59

CHAPTER 10: EMERGING ISSUES AND TRENDS …………....………….... 61

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CHAPTER 1

OVERVIEW OF PUBLIC PRIVATE PARTNERSHIPS (PPPs)

The PPP concept

A **public–private partnership** (**PPP**, **3P** or **P3**) is a cooperative arrangement between one or more public and private sectors, typically of a long term nature. Governments have used such a mix of public and private endeavours throughout history. However, the past few decades has seen a clear trend towards governments across the globe making greater use of various PPP arrangements

Public-private partnerships between a government agency and private-sector company can be used to finance, build and operate projects, such as public transportation networks, parks and convention centres. Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place.

PPP is a long-term contractual relationship between the public sector and the private sector for the purpose of having the private sector deliver a project or service traditionally provided by the public sector. PPP projects do not minimize the public sector's responsibility to improve public services, only the methodology for its provision and procurement is different.

Breaking down 'Public-Private Partnerships'

For example, a city government might be heavily indebted, but a private enterprise might be interested in funding the project's construction in exchange for receiving the operating profits once the project is complete.

Public-private partnerships have contract periods of 25 to 30 years or longer. Financing comes partly from the private sector but requires payments from the public sector and/or users over the project's lifetime. The private partner participates in designing, completing, implementing and funding the project, while the public partner focuses on defining and monitoring compliance with the objectives. Risks are distributed between the public and private partners according to the ability of each to assess, control and cope with them.

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Payment for Public-Private Partnerships

Although public works and services may be paid for through a fee from the public authority's revenue budget, such as with hospital projects, concessions may involve the right to direct users' payments, as with toll highways. In cases such as shadow tolls for highways, payments are based on actual usage of the service. In cases involving wastewater treatment, payment is made with fees collected from users.

Benefits of Public-Private Partnerships

Private-sector technology and innovation help provide better public services through improved operational efficiency. The public sector provides incentives for the private sector to deliver projects on time and within budget. In addition, creating economic diversification makes the country more competitive in facilitating its infrastructure base and boosting associated construction, equipment, support services and other businesses.

Risks of Public-Private Partnerships

Physical infrastructure such as roads or railways involves construction risks. If the product is not delivered on time, exceeds cost estimates or has technical defects, the private partner typically bears the burden.

The private partner faces availability risk if it cannot provide the service promised. For example, the company may not meet safety or other relevant quality standards when running a prison, hospital or school.

Demand risk occurs when there are fewer users than expected for the service or infrastructure, such as toll roads, bridges or tunnels. If the public partner agreed to pay a minimum fee no matter the demand, that partner bears the risk.

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Examples of Public-Private Partnerships

Public-private partnerships are typically found in transport infrastructure such as highways, airports, railroads, bridges and tunnels. Municipal and environmental infrastructure includes water and wastewater facilities. Public service accommodations include school buildings, prisons, student dormitories and entertainment or sports facilities.

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Common terms used in PPPs

The following terms are used in the table:

• Public means that the public sector assumes wholly or predominantly this role or responsibility.

• **Private by fee contract** means that the private sector is remunerated by a predetermined fee; established at tender stage. Incentive payments may be included but will be a marginal part of overall payment.

• **Private by performance**-based maintenance contract means that the private sector is paid based on the level of service of the highway infrastructure, generally comprising a standard availability fee with penalties for below-standard performance.

• **Private by concession contract** means that the private sector is paid based on user charges, availability payments or a mixture of both, as per the contract type

PPP Success Drivers

a. Standardization:

PPP Models & Documentation that can be easily replicated (Feasibility analysis, risk allocation, RFPs, PPP Contracts, etc...).

b. Deal flow:

- Quantity: Sufficient scale to justify a PPP strategy.
- Quality: Determine which candidate is appropriate as PPPs; projects must be clear and bankable.

c. Leverage: create more opportunities to attract new finance using credit enhancements to reduce sovereign risk.

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d. Capacity Building:

PPP won't work unless the public sector understands its Governance and oversight responsibilities from the beginning-to-end.

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Principles unique to PPPs

Partnership Principles

Following are the principles or criterion which a partnership has to fulfil to qualify as a PPP or PSPP.

1. **Openness and Binding Commitment**: Disclosure to partners of all relevant information and strict adherence to the important principles of cooperation. This strict adherence is usually made possible in the presence of a formal agreement between the partners. Others factors like resources put into the partnership and agreed upon goals and shared functions should also be known fully to all the partners.

2.Supervision/Control: Continuous monitoring and observation allows important lessons to be learnt from the partnership and also provide a good mechanism for collecting and analysing the feedback.

3.Successful Negotiation Process: The partnership is a strategic community of responsibility and action set up for the mid to long term, in which the partners contribute their respective inputs into the shared process of producing products and/or services. The process of decision-making by negotiation is done together, so that in the process of decision-making no-one is disadvantaged but rather, disadvantages are reduced. For the risks, the planned input and the expected profits, an efficient exchange process must be agreed. Every participant fulfils the role that is assigned to him or her within the partnership.

The equality of the roles is not essential, as long as the partners in their assigned roles have equal rights.

4. Equal Rights in Different Roles: It is not necessary for the agreed roles of the partners to be equal but it is necessary for them to have equal rights in their respective roles.

5.Clear Division of Tasks, Roles and Functions: The assignment of tasks and responsibilities is done according to the actual capabilities and expertise of the partners.

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6. Clear Goals and Objectives: Clear goals and objectives have to be decided mutually by the partners.

7. Mutual Trust: Especially in the area of "core services" (social services whose qualitative performance is not easy to measure), mutual trust between the partners contributes a lot to the successful implementation of the partnership.

8.Sympathy between the Partners: Experience shows that when the "chemistry" between the partners is good, the setting-up and running of the partnership is smooth and more productive.

9.Creation of Synergy between Partners: In negotiation processes, specific resources of the partners are brought together in such a way that usable synergy effects are generated. The focus is on achieving goals negotiated together, with which each partner can identify themselves. Thus synergy effects are made available to the partners, which would not have come about without the partnership.

10.Suitability of the Resources and Size of the Partnership: Resources for the partnership (human resources) must be adequate for the size of the partnership. Sufficient time resources must be planned for the partnership.

11. Risk Sharing: Sharing of risks and profits need to be made clear in the agreement and then strictly adhered to during the whole duration of the partnership.

12. Active involvement of the public sector throughout the project and also in the follow up stages

13.Political leadership: Active support from the political leaders is required in encouraging the two partners to share responsibilities, risks and rewards.

14.Secure public control: In case the private partner defaults or fails to fulfil its obligation, the government should ensure that it has recourse rights to maximize the opportunity to resolve the issue or to take control.

15.Limited complexity: The arrangement should be kept simple, workable and free of complexity and confusion.

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16. Legal authority: In the form of legislations and law making to encourage and protect PPP formation.

17.Specific Needs: Each partner must have a specific reason for joining a partnership, i.e. a specific need which can be fulfilled through the partnership

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Forms and structure of PPPs

i. **Service contract**

Operation and maintenance concessions (service concessions): The host countries objectives may be for the private sector to operate and maintain an already existing road, and therefore the government may grant a concession to the private participants to charge user tolls to help finance the improved operation and maintenance of the road.

ii. **Management Contract**

A management contract is an arrangement by which a private company is entrusted with various types of tasks usually performed by the public authority, relating to the organization of road maintenance operations. Usually, thefunction of the private firm is to respond to day-to-day routine maintenance requirements by contracting private companies, on behalf of the public entity, to perform the works.

Management contracts can also (or only) focus on operation management. In this case, typical tasks entrusted to the private sector are: traffic counting, axle-load weighing and providing traffic information, traffic management including surveillance, stand-by services for accidents, traffic regulation, toll collection (usually not remunerated on the basis of the amounts collected but rather on a fixed rate basis).

iii. **Lease/Affermage**

Leases and affermage contracts are generally public-private sector arrangements under which the private operator is responsible for operating and maintaining the utility but not for financing the investment.

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Key Features of Leases and Affermage Contracts

- Medium length - typically between 8 and 15 years;
- Collection risk passed to operator in lease;
- Lease operator will require assurances as to tariff levels and increases over term of lease, and compensation/ review mechanism if tariff levels do not meet projections;
- Cost of maintenance and some replacement passed to operator (operator takes some degree of asset risk in terms of the performance of the assets);
- Operator may be put in charge of overseeing capital investment program/ specific capital works;
- Employer is paid a fixed lease fee (*lease*)/ receives net receipts from customers (less affermage fee) (*affermage*);
- Review process every 4 or 5 years to review performance, costs, tariff levels, etc.;
- Employees seconded or transferred to the operator;
- Operator to maintain asset register and operation and maintenance manuals/ records, etc.;
- Typical to include minimum maintenance or replacement provisions towards the end of the contract, so that facilities are handed back in an operational state.

Examples of Leases and Affermages

- ✓ Water and Sanitation lease and affermages
- ✓ Energy lease and affermages

iv. BOT/PFI

Under a BOT, the responsibility of the concessionaire is not limited to operation and maintenance of the infrastructure but also comprises an initial construction, upgrading or major road rehabilitation component.

Massive investment and consequent mobilization of private funding sources is therefore required from this company and is to be repaid from the revenue collected from road users (usually tolls). BOT (Build Operate Transfer) stresses the responsibility of the private entity during construction and operation of the road and the handing over (transfer) of the assets to the public entity at the end of the operation period.

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The high initial investment required from the private sector and the consequent long concession period make the distribution of risk between the parties a key element of success in such schemes

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v. BOO

BOO (build, own, operate) is a public-private partnership (PPP) project model in which a private organization builds, owns and operates some facility or structure with some degree of encouragement from the government. Although the government doesn't provide direct funding in this model, it may offer other financial incentives such as tax-exempt status. The developer owns and operates the facility independently.

vi. Concession

A concession or concession as an agreement is a grant of rights, land or property by a government, local authority, corporation, individual or other legal entity.

Public services such as water supply may be operated as a concession. In the case of a public service concession, a private company enters into an agreement with the government to have the exclusive right to operate, maintain and carry out investment in a public utility (such as a water privatisation) for a given number of year

vii. Divestiture and Asset Sales

Full divestiture, also known as, privatization, occurs when all or substantially all the interests of a government in a utility asset or a sector are transferred to the private sector.

A divested or privatized utility or public service is distinguishable from a private commercial enterprise in that the government generally retains some indirect form of control or mechanism for regulation over the privatized utility, in the form of a license granted to the entity to deliver the service to the public.

Full privatization is distinguishable from partial privatization and joint venture arrangements between public and private where the public sector maintains a significant interest. For more, go to Joint Ventures.

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Form of Divestiture/ Privatization

Typically a government intending to divest of utility assets will sell shares in the utility or transfer assets into a special purpose company and sell shares in that company, although divestiture can be via a sale of assets.

Whether the divestiture is via an asset or share sale will depend on the circumstances of the utility and local issues such as tax treatment of such sales. The share sale is often favoured as it allows the government to retain an indirect or veto interest in the privatized utility through a "golden share".

However, a private purchaser may be unwilling to accept all of the existing liabilities of the utility and only be willing to accept a portion of the assets and liabilities. In such case the assets will be transferred to a special purpose company. The prospective purchaser will be interested, however, in knowing that the company has a track record and so the government may be required to run the new company for a few years prior to privatization to establish such track record.

viii. Corporatization

Corporatization is the process of transforming state assets, government agencies, or municipal organizations into corporations. It refers to a restructuring of government and public organizations into joint-stock, publicly listed companies in order to introduce corporate and business management techniques to their administration.

The result of corporatization is the creation of state-owned corporations where the government retains a majority ownership of the corporation's stock.

However, in many cases, corporatization is a precursor to partial or full privatization, which involves a process where formerly public functions and public enterprises are sold to private business entities by listing their shares on publicly traded stock exchanges.

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Principles that distinguish the different forms of PPPs

The following are the main general principles of the PPPs:

a) PPPs are aimed at the satisfaction of collective needs

b) PPPs often involve long term arrangements

c) PPPs involve the total or partial financing of the project

d) PPPs are output oriented.

e) The private partner bears a significant number of risks

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CHAPTER 2

THE ROLE OF PUBLIC PRIVATE PARTNERSHIPS (PPPs)

Role OF PPPs in Economy

i. Acceleration of high priority projectsby packaging andprocuring services in new ways
ii. Turning to the private sector to provide specialized management capacity for large and complex programs
iii. Transfer of new technology developed by private entities tothe public sector.
iv. Drawing on private sector expertise in accessing and organizing the widestrange of private sector financial resources
v. Encouraging private entrepreneurial development, ownership, and operationof highways and/or related assets
vi. Public Sector Financing Gaps
vii. Demand for Government resources to finance core functions
viii. External funding resources in form of loans and grants
ix. Lesson from other countries which have succeeded to improve infrastructure services through PPPs

Areas where PPPs operate

- ✓ **Parks**: private maintenance and operations agreements for federal, state, and local parks
- ✓ **Education**: leveraging private real estate for public schools
- ✓ **Transportation**: operations of public roads and highways
- ✓ **Gaming**: state lottery operations
- ✓ **Information technology**: high speed internet access for all cities
- ✓ **Energy sector-**Coal Energy by Centum Investment
- ✓ **Heath sector-**Thika Level 4 hospital and Mt Kenya University

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Factors that determine suitability of PPPs

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

- ✓ The government's economic policy, including experience with PPP projects,
- ✓ Market conditions, including the level of development of the financial market and competition of the public procurement market,
- ✓ The legal system;
- ✓ Institutional preparation (institutional capacity)

Key issues in designing PPPs

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

- the **rights** and **obligations** of the parties;
- **risk allocation** (this is usually achieved through setting out events which give the PPP Company a right to some compensation);
- **service performance standards and targets**, which need to be objective and measurable;
- the procedure for **permitted modifications**, as well as their scope and nature;
- **payment mechanisms** (e.g. tariffs, subsidies, grants) and adjustments to payments in response to various contingencies (see ***Payment mechanism***for more information);
- **penalties** (and possibly bonuses) which have financial consequences or give rise to warning notifications (eventually leading to termination of the PPP contract);
- **security and performance bonds**;
- **project insurances**;
- the **term** of the PPP contract;
- the **conditions for termination** (categorised by party and type of event) and compensation upon termination (for each type);

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- **step-in rights** (both for lenders and, in emergency situations, the Authority);
- the definition and impact of **force majeure** and **changes in law**; and
- The**dispute resolution** procedure.

Transaction advisors and their role

The skills and experience required in the transaction advisory team are as follows:

a. Financial analysis, with relevant PPP and project finance experience through to financial close
b. PPP procurement and structuring
c. Legal, with relevant law and experience in the drafting and negotiating of PPP agreements
d. Technical due diligence and advice on PPP structuring and contracts
e. Project planning management
f. Project facilities management
g. Relevant expertise in renewable energy power generation and IPPs
h. Negotiations
i. Contract management
j. Project management.

NB

The transaction advisor will comprise a team, managed by a single lead ADVISOR.

The members of the team will have the skill and experience necessary to undertake the range of tasks set out in these terms of reference.

Each individual on the team must be personally available to do the work as and when required.

The lead advisor will be held accountable, in terms of the transaction advisor contract, for ensuring project deliverables and for the professional conduct and integrity of the team

Basic Concepts of a feasibility study

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