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Due Diligence Process in Asset Recycling

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On this page: *Find operational criteria in selecting an appropriate asset as the subject of an asset recycling transaction. Read more below, or visit the Guidelines for Implementing Asset Recycling Transactions section and Content Outline, or Download the Full Report.*

The Relevant Authority should conduct asset due diligence as part of the transaction preparation leading up to the asset recycling transaction.

The objectives of the due diligence process are to:

- Review of the asset to assess its physical condition.
- Review service standards provided under the current operations of the asset.
- Review the financial status of the asset and its financial feasibility if operated and managed by a private sector partner.
- Determine measures that can be implemented to enhance the asset's value through an asset recycling transaction, including any capital improvements (if required).

Asset Due Diligence

The Due Diligence process should cover technical, commercial, financial (including accounting and taxation), legal, environmental and social review of the asset and the proposed transaction. A high-level checklist for this is provided below with links to detailed description for each respective component provided in subsequent sections.

Table 3: Asset Due Diligence Checklist

Asset Due Diligence Checklist

Technical Due Diligence	• Technical data: Assess availability and accessibility of existing data for the asset. • Historical performance and asset condition: Assess the existing asset condition and service levels, including gap analysis of the service levels where efficiencies of the private sector can enhance asset performance or service delivery. • Capital and life-cycle expenditure plans: Based on the scope of improvements, identify future capital expenditure plans and impact on financial feasibility. • Operations: Assess operation costs for operations and maintenance of the asset and assess any areas for costs savings. • Technical reports for bidders: Produce technical reports for the data room to inform bidders on key technical aspects of the asset.

Commercial Due Diligence	• Review historical demand / traffic / patronage.
	  ◦ Identify future demand / traffic / patronage trends.
	  ◦ Identify government policies and future developments that may impact demand in the near- to medium-term.
	• Undertake future forecast of demand and patronage.
	• Review adequacy and robustness of tariff policy, tariff setting mechanism, ensuring certainty over the project period.
	• Assessment of cost (capital and operating expenditure), including working capital requirements, for efficient capacity and operations of the asset.
	• Review current staffing and assess need for re-deployment or transfer to the private sector entity.
	• Review existing commercial principles (structure, payment mechanism, revenue model and risk allocation) between Government and the Relevant Authority and assess the need to modify for a private sector counterparty.

Financial Due Diligence	• Capital structure and debt serviceability: Assess the historical debt serviceability through project cash flows using appropriate metrics such as minimum DSCR; whether project cash flows are sufficient to support envisaged levels of debt if held by the private partner. • Profitability assessment in terms of operating profits (EBIT and EBITDA) and in terms of net income (pre- and post-tax). • Cashflow and return expectations: Determine the minimum equity IRR that the project is expected to generate - benchmark comparable projects and with private sector investors’ expectations.

Legal Due Diligence and Review	• Existing regulatory framework – review existing regulations and approvals to analyse any "gaps" and present solutions to resolve them (e.g., ability of private sector to operate, charge fees, collect revenues). • Agreements – review existing agreements (property and leases, customer revenue contracts, supply contracts, service agreements for assets or systems, offtake contracts) identifying risks and opportunities to improve value, such as exercising options or renewing near expired agreements. • Identify legal risks – future regulation of prices, issues employing workforce, transfer of contracts. • Legal Report for bidders – a report for the data room and successful bidder to rely on.
Accounting and Tax Due Diligence	• Undertake tax and accounting due diligence to assess implications for the Relevant Authority that is the asset owner and identify the attendant tax risks. • Ensure accounting treatment of asset recycling program is correctly booked for accounting purposes; and • Allow considerations to provide for efficient tax structuring.
Environmental and Social Due Diligence	• Environmental and social impact assessment. • Historical performance and asset condition: Assessment of GHG emissions baseline of the Asset recycling, • Opportunities to increase efficiency and GHG emissions reductions).; • Historical climate data and natural disaster events affecting the Asset. Also share hazard maps on earthquakes, floods, storm surges, tsunami, landslides, and volcanic eruptions, among others. • Review of climate-related risks, natural disasters and environmental risks that may impact the Asset.
Asset Valuation Methodology	• Appropriate techniques and methodology should be applied with respect to the nature, facts, circumstances of the asset and use of reasonable market data and technical assumptions. • Due to uncertainties inherent in estimating the fair value for the asset, care should be applied in exercising judgement and making the necessary estimates. • All available information that may materially impact the valuation should be factored in. • Proper assessment of quality and reliability of all the data used in valuation.

Related Content

- **The PPPRC Asset Recycling Section**
- **Executive Summary: Asset Recycling**
- **Asset Recycling Projects**
- **Asset Recycling Programs**
- **Table of Contents for Asset Recycling**

Additional Resources

- Due Diligence Checklist for Legal and Institutional Enabling Environment for PPP Issues

Subsections



Technical Due Diligence in Asset Recycling



Commercial Due Diligence in Asset Recycling



Financial Due Diligence in Asset Recycling



Legal Due Diligence and Review in Asset Recycling

This section has not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the content will be reviewed and adapted for specific transactions.

This is a new section of the website and is currently in draft form. For feedback on the content of this section or to suggest additional links or materials, please contact the PPP Resource Center using the feedback form.

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