Performance Based Contracts in Non-Revenue Water Reduction Programs

March 2017

Session 8: Financing, Risks, and Procurement

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Financing of PBCs

Some considerations

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What are the issues?

- How much investment is needed?
- What can be achieved and how quickly can the investment be recovered?
- What are available funding sources?
- Is a contractor required to get the job done?
- And only then the final question: PBC yes or no?

- PBCs are too often seen as a **panacea** for the lack of funds

Options for financing PBC fees and project costs

- Utility internally generated cash
  - increased revenues from reduced apparent loss and lower operational costs from reduced physical loss pays for the contractor – e.g., Thailand PBC tariff share
- Grants from government
  - leak reduction have positive externalities (e.g. water scarcity) that justify support from grants or government wants to control tariff rise – e.g., Karnataka 24/7
- Concessional loans to the water utility
  - similar to ‘grants’ and eventually paid by utility
- Debt or equity of the contractor
  - Equity investments in the contractor: Private, IFC, IIC, etc. (Manila Water)

Financing is ultimately recovered from utility revenues or government transfers

Risks

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Risks that the contractor is concerned with

Risk

1. Inflation
2. Currency devaluation
3. Incomplete or incorrect baseline data during bid
4. Non performance by utility of assigned tasks
5. Government/policy change
6. Inflexibility to change plan
7. Utility does not have capacity to measure
8. Payments are delayed

Mitigation

1. Adjustment clause
2. Currency insurance
3. Opportunity to negotiate after detailed verification
4. Clause allowing contractor to intervene
5. Fair value payout clause
6. Agree to agree clause
7. Third party specialist to measure performance
8. Guarantees

Risks that the utility is concerned with

Risk

1. Utility lacks capacity to manage the contractor
2. Contractor does not perform
3. Contractor performs but after the project NRW returns to high levels

Mitigation

1. Contract out the management with a capacity building phase
2. Performance payment & liquidated damages
3. Include a maintenance phase & capacity building; have service level conditions

Risk of no show

- If the market is not mature
- If data is not available
- If politics are not stable
- If the value is not recognized locally
- If the environment is tough
- If there are no guarantee's from a third party

There could be a no show – this is costly and embarrassing!

And more risks of no show

- Unrealistic mandatory performance targets
- Unclear and/or risky performance assessment
- Enormous negative cash flow expected (for too long)
- “Over ambitious” PQ criteria
- Available budget clearly insufficient to achieve the targets

Procurement

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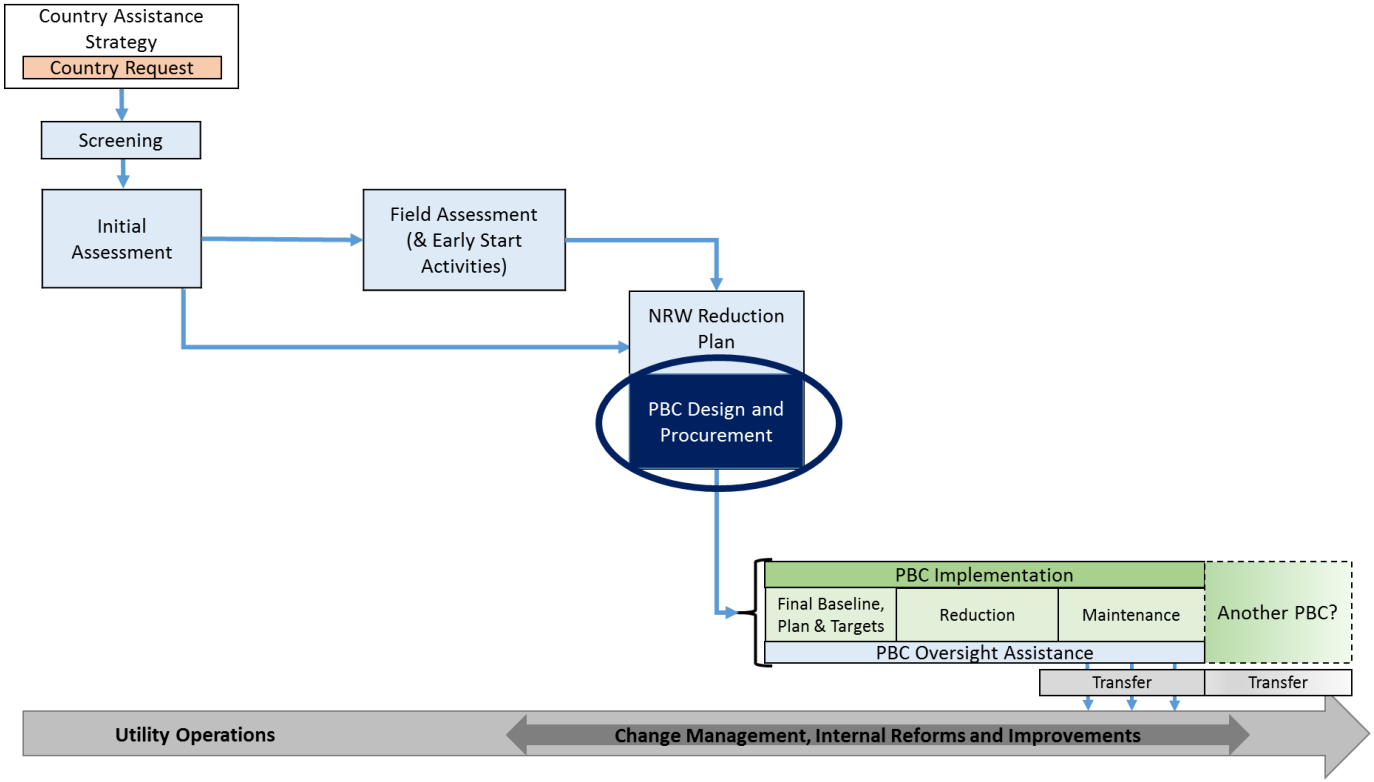
Develop Indicative Contract Design

- Designing the contract is based largely on what both the private sector and the utility are looking to accomplish
- The following reviews and design should be undertaken to ensure the project fits within the local context
  - Objectives – alignment with the broader picture
  - Scope – minimum outcomes expected
  - Responsibilities – who wants to do and has capacity to do what?
  - Risk Allocation – depends on local capacity and contract type
- During the process the team will develop suitable evaluation criteria
  - Indicators – should be several and will depend on the scope
  - Methods of measuring indicators
  - Targets – beyond the minimum required outcomes
  - Provisions and process for adjusting baselines or targets
  - Fixed and incentive payments – purposes of both

Procurement Process Overview



- The five PBC models discussed thus far can be further customized, as necessary, to fit the local context

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Information Required

- Information from the transaction design
- Information from the business case
- Selected information from the risk analysis
- Contextual information
- Technical information
- Clearly spell out gaps and how they should be filled
- Where there is a lack of capacity or data ask for specific innovational ideas from the contractor

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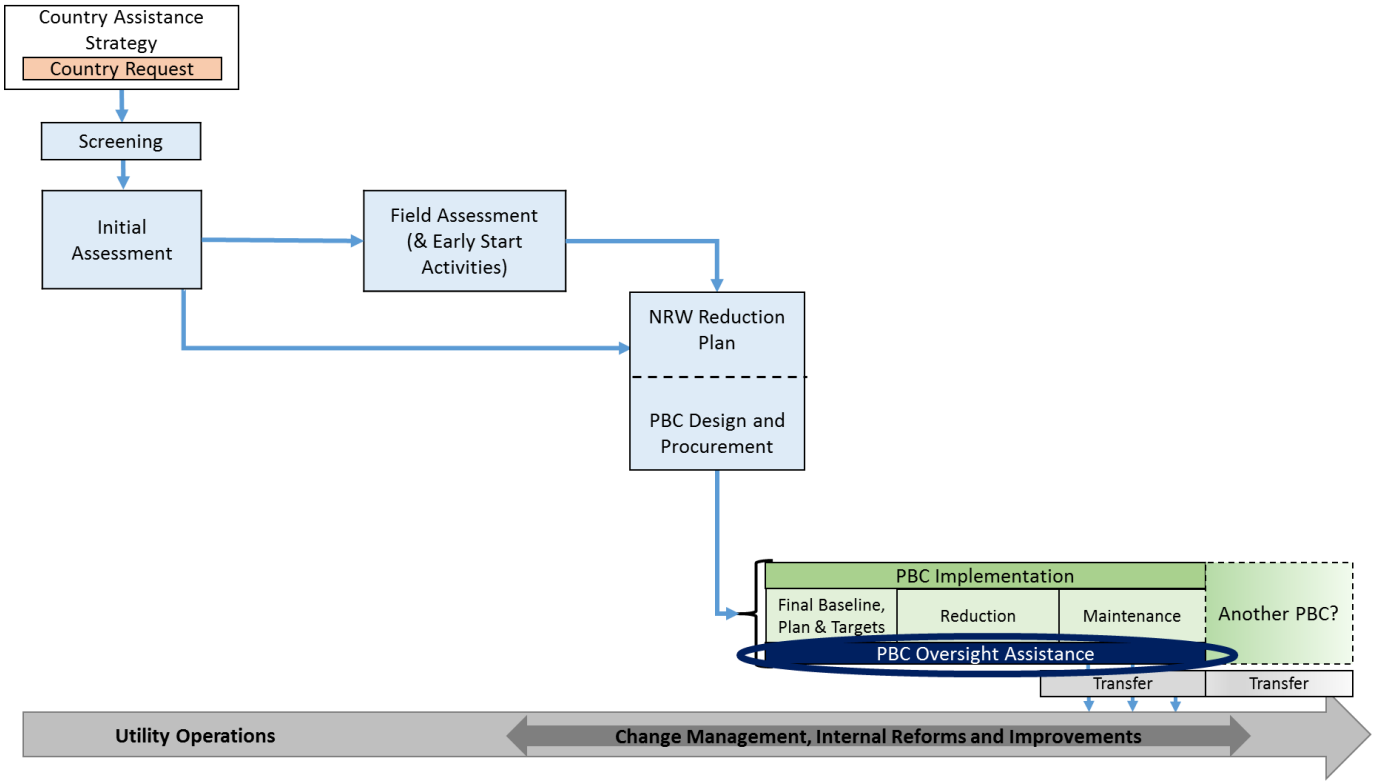
Key Decisions

Key Decisions	Principal Criteria / Analyses
How many and which firms, among those who have expressed interest, should be selected in the qualification process?	• The water utility, IFC, and other local stakeholders should review prequalification submissions and select a group of firms that meet the basic criteria
What evaluation criteria should be emphasized most given the local context?	• Corporate technical experience on projects of similar scope and scale • Personnel proposed • Adherence of the proposed plan of action to the NRW-Reduction Plan • Innovation in the methodology • Familiarity with NRW in the country • Performance references • Cost per unit of NRW-reduction, and total cost • Weighting of technical and financial parameters in the selection process—QBS, QCBS, or least cost
Selection of the best PBC contractor for the situation/ project	• Score as evaluated according to the evaluation rules and formula

Oversight Contract or In-House Control



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After the Initial Contract…

It is important to think about – and answer – some critical questions

- Does the utility have the capacity to take over?
- Should the contract be extended into a maintenance phase?
  - Capacity building
  - Large firms should also build capacity, not simply perform the work and leave. This may require a longer contract.
- What measures will be put into place to ensure sustainability?
  - Fast-tracking growth for local companies

Bid Process

- How have other utilities generated interest in a project?
  - Existing professional networks
  - Advertisements: Expression of Interest (EOI), Request for Qualifications (RFQ)
- Key parameters to firms bidding
  - Clarity
    - Especially regarding performance requirements and risks to the private sector
  - Transparency
  - Size of contract/award – particularly for larger firms
  - Credibility of the granting authority
    - Firms do not want to be associated with a project that has the potential to fail and want to ensure timely payment
  - It is important to recognize that the private sector is, ultimately, trying to make money. As such, the method in which the project is presented to the private sector will vary depending on the local context and the size of potential bidders (e.g. large companies may only be interested if there is opportunity for future work)

Bid Evaluation and Contract Types

- What is a good way of comparing different methods and teams?
  - Contract designers must be very clear in the EOI that they are looking for added value and sustainability, not just a temporary solution with high OPEX
  - Teams; experience in the region and/or similar circumstance
  - Net Present Value (NPV) or Internal Rate of Return (IRR) to the utility of the proposed solution(s) – business case
- Typical problems when evaluating different methods and teams
  - Long term CAPEX intensive vs. short term OPEX intensive
    - OPEX intensive adds little value if the utility cannot bear the increased annual costs
    - CAPEX intensive reduces the annual operating cost and is more sustainable
- Performance fee versus fixed fee
  - In mature markets, higher performance fees usually lead to higher profit margins (and higher risks) for the private sector.
  - In nascent markets, companies tend to look for a greater portion of the contract to be paid via fixed fee.

Recommendations

- Always prequalification
- QCBS – at least 70/30
- Technical evaluation similar to a consultant selection
- Key criteria
  - Experience as NRW reduction contractor
  - Project team – specify key positions
  - Comprehensiveness of the approach
- Minimize duration of procurement process
  - No gaps between PQ-tender-evaluation-award
- A good option: NRW maintenance PBC after the end of the main contract


New Sources of Water
1. New Dams
2. River Sharing
3. Rain Water Harvesting
4. Desalination
5. Icebergs
JUST PLUG THE LEAKS!!

Questions? Contact me

Roland Liemberger

Sr. NRW Management Advisor

roland@liemberger.cc

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