



PPP
unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the
Public Finance Management Act, 1999

PROJECT PREPARATION PERIOD

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

PROJECT TERM

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes

Phase V

DELIVERY

- Report progress in the Annual Report

Phase VI

EXIT

- Scrutiny by the Auditor-General

PPP Manual reference

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NATIONAL
TREASURY

PPP
unit

PUBLIC PRIVATE PARTNERSHIP MANUAL

National Treasury PPP Practice Notes issued in terms of the
Public Finance Management Act

PREFACE

South Africa is proudly amongst the leading countries in the world in the law, policy and systems we have established for public private partnerships. Our public service delivery record has been enriched through PPPs in recent years, and our PPP project pipeline continues to grow, both in numbers and in the innovative value-for-money solutions it contains.

National Treasury's PPP Manual is indeed a world first. It systematically guides public and private parties through the phases of the regulated PPP project cycle for national and provincial government, unpacking policy and providing procedural clarity as it does so. It draws on South African project experience to date and on best international practice, without infringing on the authority of accounting officers and authorities. It sets rigorous risk-assessment standards by which government will make affordable project choices that best leverage private investment for quality public services. Importantly, the *PPP Manual* contains a code that will go a long way to achieving broad-based black economic empowerment in PPPs, not only in the equity and management of the contracted private parties, but in their subcontracting and in the projects' local socio-economic impacts.

Together with *Standardised PPP Provisions*, the *PPP Manual* is a powerful tool in South Africa's ongoing quest to tackle poverty and grow our economy. Where the transfer of financial and operating risk to a private partner through a PPP gives us an affordable, cost-effective solution for a service, we will pursue it. We will continue to learn as we go forward, mindful of the opportunities that PPPs present to galvanise the commitment that drives such a wide range of South Africans to play a meaningful role in our unique development agenda.



Trevor A Manuel, MP
Minister of Finance

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ABOUT THE PPP MANUAL

The South African *National Treasury's PPP Manual* is a best practice guide for PPP practitioners. Each module of the *PPP Manual* is issued as a National Treasury PPP Practice Note in terms of the Public Finance Management Act, 1999 (PFMA). It should be read with *Standardised PPP Provisions*, issued as National Treasury PPP Practice Note Number 01 of 2004.

The PPP project cycle

The PPP project cycle is the roadmap for the PPP process and the Manual. The project cycle covers the two main periods of a PPP: the Preparation Period and the Project Term. The PPP Preparation Period spans phases I to III of the project cycle: Inception, Feasibility Study and Procurement, and concludes with the signing of the PPP agreement. The Project Term spans phases IV to VI: Development, Delivery and Exit.

National Treasury's PPP Manual is chiefly concerned with the Project Preparation period, during which treasury approvals I, IIA, IIB and III are granted. The PPP project cycle clearly indicates when these approvals are required and which modules of the *PPP Manual* are relevant for the distinct phases.

The *PPP Manual* also gives guidance on managing a PPP agreement, auditing PPPs, accounting treatment for PPPs, and project finance.

The modules

Module 1: South African Regulations for PPPs

(issued as National Treasury PPP Practice Note Number 02 of 2004)

Regulation 16 to the Public Finance Management Act, 1999 (PFMA) is the regulation governing PPPs in South Africa. This module takes the user through the components of the regulation and explains how they apply to the distinct phases of the PPP project cycle, from inception to the management of the PPP agreement. Regulation 16 is reproduced in Annexure 1. The relevant section of the regulation is also included at the beginning of each module.

Module 2: Code of Good Practice for BEE in PPPs

(issued as National Treasury PPP Practice Note Number 03 of 2004)

This module is an exact reproduction of the *Code*, National Treasury's official framework for black economic empowerment (BEE) in PPPs, to be issued in terms of the Broad-based Black Economic Empowerment Act, 2003 (BBBEE

Act). The *Code* is relevant in all phases of a PPP. It describes the policy framework, how to apply BEE policy in the typical structure of a PPP and how to apply PPP BEE policy in each phase of the PPP project cycle. The *Code* includes the PPP BEE Balanced Scorecard.

Project preparation period

Phase I

Module 3: PPP Inception

(issued as National Treasury PPP Practice Note Number 04 of 2004)

Inception is the first phase of the PPP project cycle. This module details the stages of inception, which involve the institution registering the project with the relevant treasury, appointing a project officer, attracting a transaction advisor, receiving and evaluating transaction advisor bids, and finalising and signing the contract with the transaction advisor. The module outlines the procurement steps which need to be followed and explains how to apply the *Code of Good Practice for BEE in PPPs* in procuring the transaction advisor. The annexures include additional resource documents, templates and examples of the necessary documentation.

Phase II

Module 4: PPP Feasibility Study

(issued as National Treasury PPP Practice Note Number 05 of 2004)

The feasibility study is the second phase of the PPP project cycle. The feasibility study is undertaken to help the institution determine whether conventional public sector procurement or a PPP is the best choice for the proposed project. The module presents and explains the core concepts of affordability, risk and value for money. Users are taken through the following stages of the feasibility study process.

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan
- Feasibility study report for TA:I
- Revisiting feasibility study for TA:III

The second phase of the PPP project cycle concludes with Treasury Approval: I (TA:I) being granted for the successful completion of the feasibility study.

Phase III

Module 5: PPP Procurement

(issued as National Treasury PPP Practice Note Number 06 of 2004)

Covering the third phase of the PPP project cycle, this module details the procurement processes of a PPP, which include the following distinct stages:

- pre-qualification
- request for proposals
- best and final offer, where appropriate
- negotiations
- financial closure.

The module establishes best practice as it has been developed in National Treasury-regulated PPPs to date. Users are given guidance on how to produce documentation necessary for the three treasury approvals of this phase: Treasury approvals IIA, IIB and III (TA:IIA, TA:IIB and TA:III).

Project term

Phase IV

Module 6: Managing the PPP Agreement

(issued as National Treasury PPP Practice Note Number 07 of 2004)

The fourth phase of the PPP project cycle continues throughout the project term. This module is intended to help the institution put effective mechanisms in place to manage the implementation of the PPP agreement, once it is signed. The module is primarily aimed at the project officer, who will be responsible for preparing and implementing the PPP management plan. The module details key aspects of PPP agreement management, which include:

- the institution's roles and responsibilities
- the approach to PPP agreement management
- partnership management
- service delivery management
- PPP agreement administration
- key challenges and tasks of PPP agreement management
- the PPP agreement management plan and the PPP agreement management manual.

Module 7: Auditing PPPs

(issued as National Treasury PPP Practice Note Number 08 of 2004)

This module describes the powers and functions of the Auditor-General, and the scope of financial, performance and forensic audits. It explains how this applies to PPPs, particularly in relation to the management of the PPP agreement. It also outlines the role of the institution's internal audit in PPP projects.

Module 8: Accounting Treatment for PPPs

(issued as National Treasury PPP Practice Note Number 09 of 2004)

This module will be available in 2004. Go to www.treasury.gov.za to download or to order a printed insert to the file.

Module 9: An Introduction to Project Finance

(issued as National Treasury PPP Practice Note Number 10 of 2004)

This module will be available in 2004. Go to www.treasury.gov.za to download or to order a printed insert to the file.

Take note

The *PPP Manual* and *Standardised PPP Provisions* are National Treasury's founding PPP guidance documents. Building on these, the National Treasury's PPP Unit is developing specialised *Sectoral Toolkits for PPPs* which will tailor the founding guidance to particular sectoral conditions, based on PPP experience to date. Watch www.treasury.gov.za

ABBREVIATIONS

best and final offer – BAFO
black economic empowerment – BEE
broad-based black economic empowerment – BBBEE
Broad-Based Black Economic Empowerment Act, 2003 – BBBEE Act
Consumer Price Index – CPIX
debt service cover ratio – DSCR
Department of Trade and Industry – DTI
discounted cash flow – DCF
expression of interest – EoI
evaluation co-ordination committee – ECC
Generally Accepted Accounting Practice –GAAP
industrial participation – IP
internal rate of return – IRR
loan life cover ratio – LLCR
Medium-Term Expenditure Framework – MTEF
National Industrial Participation Programme – NIPP
net present value – NPV
Preferential Procurement Policy Framework Act – PPPFA
project life cover ratio – PLCR
Promotion of Administrative Justice Act, 2000 – PAJA
Public Finance Management Act, 1999 – PFMA
public private partnership – PPP
public sector comparator – PSC
Project Development Facility – PDF
project evaluation committee – PEC
record of decision – RoD
request for best and final offers – RfBAFO
request for proposals – RFP
request for qualification – RFQ
service level agreement – SLA
small, medium or micro enterprise – SMME
South African Heritage Resources Agency – SAHRA
special purpose vehicle – SPV
State Information Technology Agency – SITA
technical evaluation teams – TETs
Treasury Approval: I – TA:I
Treasury Approval: IIA – TA:IIA
Treasury Approval: IIB – TA:IIB
Treasury Approval: III – TA:III

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NATIONAL TREASURY PPP MANUAL

MODULE 1: SOUTH AFRICAN REGULATIONS FOR PPPs

NATIONAL TREASURY PPP PRACTICE NOTE NUMBER 02 OF 2004

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 02 of 2004 'South African Regulations for PPPs' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA and subsidiaries of such public entities.



PPP unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the Public Finance Management Act, 1999

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

Phase IV

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase V

DEVELOPMENT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes
- Report progress in the Annual Report

Phase VI

DELIVERY

EXIT

- Scrutiny by the Auditor-General

PPP Manual reference

Module 1
Module 2

MODULE 3

Module 6

Module 1
Module 2

MODULE 4

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 4

MODULE 5

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 5

MODULE 6

Module 7
Module 8
Module 9

ABOUT THIS MODULE

Module 1: South African Regulations for PPPs opens with brief notes on how PPPs and this Manual itself fit within South Africa's public finance management system in national and provincial government.

The substance of *Module 1* presents Treasury Regulation 16 to the Public Finance Management Act, 1999 (PFMA), the legal foundation for PPPs, in an annotated form, taking the reader through the regulations and answering frequently asked questions. The module closes with specific instructions to institutions considering application for exemption from treasury approvals required in terms of Treasury Regulation 16 to the PFMA.

The PPP project cycle depicts the phases and stages of Treasury Regulation 16 to the PFMA. This PPP project cycle is referenced throughout *National Treasury's PPP Manual*.

Treasury Regulation 16, 2004, is attached as 'Annexure 1: Treasury Regulation 16'.

Institutions and private parties will find *Module 1* useful when they first consider a PPP and want an understanding of the legal foundation for PPPs. The module is also useful as a quick reference throughout the PPP project cycle. Cross-references to other modules in *National Treasury's PPP Manual* refer the reader to detailed guidance and information about the various phases and stages of developing a PPP.

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INTRODUCTION

South Africa has established a firm regulatory framework in terms of which national and provincial government institutions can enter into public private partnership (PPP) agreements. The central legislation governing PPPs for national and provincial government is Treasury Regulation 16 issued to the Public Finance Management Act, 1999 (PFMA).

PPPs for municipal government are governed by the Municipal Systems Act, 2000, and the Municipal Finance Management Act, 2003. Municipalities are not subject to the PFMA or to Treasury Regulation 16. National Treasury will issue a separate PPP Manual for municipalities.

National Treasury's PPP Manual

National Treasury's PPP Manual and *Standardised PPP Provisions* are founded on the PFMA and Treasury Regulation 16, and have been produced for national and provincial departments, constitutional institutions, and public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D of the PFMA, and any subsidiaries of such public entities.

Each module of *National Treasury's PPP Manual*, together with *Standardised PPP Provisions*, is issued by National Treasury as a PPP Practice Note, in terms of section 76(4)(g) of the PFMA. These PPP practice notes, which will be updated from time to time, constitute instructions in terms of section 76 of the PFMA, aimed at facilitating the application of the PFMA and its regulations.

National Treasury PPP Practice Note Number 01 of 2004:

Standardised PPP Provisions: First Issue: 11 March 2004

National Treasury PPP Practice Note Number 02 of 2004:

National Treasury's PPP Manual Module 1: South African Regulations for PPPs

National Treasury PPP Practice Note Number 03 of 2004:

National Treasury's PPP Manual Module 2: Code of Good Practice for BEE in PPPs

National Treasury PPP Practice Note Number 04 of 2004:

National Treasury's PPP Manual Module 3: PPP Inception

National Treasury PPP Practice Note Number 05 of 2004:

National Treasury's PPP Manual Module 4: PPP Feasibility Study

National Treasury PPP Practice Note Number 06 of 2004:

National Treasury's PPP Manual Module 5: PPP Procurement

National Treasury PPP Practice Note Number 07 of 2004

National Treasury's PPP Manual Module 6: Managing the PPP Agreement

National Treasury PPP Practice Note Number 08 of 2004

National Treasury's PPP Manual Module 7: Auditing PPPs

National Treasury PPP Practice Note Number 09 of 2004:

National Treasury's PPP Manual Module 8: Accounting Treatment for PPPs

National Treasury PPP Practice Note Number 10 of 2004:

National Treasury's PPP Manual Module 9: An Introduction to Project Finance

The ‘instructions’ contained in *National Treasury’s PPP Manual* are presented in the form of detailed best practice guidance, based on National Treasury’s PPP Unit’s experience in PPPs to date. An institution to which Treasury Regulation 16 applies which seeks materially to deviate from this guidance should inform the relevant treasury of such intentions prior to execution, and justify its reasons for such material deviation in the relevant application(s) for treasury approvals in terms of the regulation.

The PFMA

The PFMA approach to financial management focuses on outputs and responsibilities and is a cornerstone of government’s strategy to improve financial management in the public sector.

Government is increasingly focusing its efforts on outputs and outcomes, wanting to ensure that, in spending taxpayers’ money, it produces the intended result. The PFMA makes the heads of departments (the accounting officers) of national and provincial departments and the CEOs or boards of schedule 3 public entities (the accounting authorities) responsible for implementation. They are directly accountable to Parliament or the provincial legislature for the effective and efficient management of their budgets to achieve their public mandates. These responsible officials need constantly to evaluate value-for-money choices. A PPP choice for the delivery of a public service, or to achieve a public good, warrants such investigation.

By its nature, a PPP entails:

- targeted public spending, principally on outputs to agreed standards
- leveraging private sector finance and efficiencies
- allocating risks to the party best able to manage them.

As a mechanism of delivery, a PPP is firmly in line with the intent of the PFMA.

Treasury Regulation 16 to the PFMA

The PFMA provides, in section 76, that National Treasury must make regulations for a range of matters to do with the effective and efficient management and use of financial resources. Many of these matters are relevant to PPPs, and National Treasury’s Regulation 16 provides precise and detailed instructions for PPPs. The regulations have been amended since they were first issued in May 2000 to take account of experience in implementing PPPs.

Treasury Regulation 16 to the PFMA defines a PPP, and sets out the phases and tests it will have to go through.

The gazetted regulation is reproduced here, annotated at the points at which questions are frequently asked. The regulation is also attached as ‘Annexure 1: Treasury Regulation 16’.

UNDERSTANDING TREASURY REGULATION 16 TO THE PFMA

16.1 Definitions

In this regulation, unless the context indicates otherwise, a word or expression to which a meaning has been assigned in the Act, has the same meaning, and –

“**affordability**”¹ means that the financial commitments to be incurred by an institution in terms of the PPP agreement can be met by funds –

- (a) designated within the institution’s existing budget for the institutional function to which the agreement relates; and/or
- (b) destined for the institution in accordance with the relevant treasury’s future budgetary projections for the institution;

“**institution**” means a department, a constitutional institution, a public entity listed, or required to be listed in schedules 3A, 3B, 3C and 3D to the Act, or any subsidiary of any such public entity.

Which national and provincial government institutions are subject to Treasury Regulation 16?

All references to ‘institution(s)’ in Treasury Regulation 16 are to these particular institutions of government:

- all national and provincial government departments
- all constitutional institutions listed in schedule 1 to the PFMA
- all national and provincial public entities listed in schedules 3A, 3B, 3C and 3D to the PFMA and any subsidiary of any such public entity.

The major public entities listed in schedule 2 to the PFMA are not subject to Treasury Regulation 16. Municipalities are not subject to the PFMA or to its regulations.

“**institutional function**” means –

- (a) a service, task, assignment or other function that an institution is entitled or obliged to perform –
 - (i) in the public interest; or
 - (ii) on behalf of the public service generally; or
- (b) any part or component of or any service, task, assignment or other function performed or to be performed in support of such a service, task, assignment or other function;

1. Affordability is dealt with in detail in *Module 4: Feasibility Study* and in *Module 5: PPP Procurement*.

“private party” means a party to a PPP agreement, other than –

- (a) an institution to which the Act applies;
- (b) a municipality or a municipal entity under the ownership control of one or more municipalities; or
- (c) the accounting officer, accounting authority or other person or body acting on behalf of an institution, municipality or municipal entity referred to in paragraph (a) or (b);

How is a private party defined?

The regulation defines a private party to a PPP agreement in the negative, explicitly excluding public institutions. PPPs in South Africa are thus specifically defined to exclude public-public partnerships. Not-for-profit entities are not excluded from the definition of a private party but their capacity to carry substantial financial, technical and operational risk in a project will determine the role they are able to play in a PPP.

“project officer”² means a person identified by the accounting officer or accounting authority of an institution, who is capable of managing and is appropriately qualified to manage a PPP to which that institution is party from its inception to its expiry or termination;

“public private partnership” or “PPP” means a commercial transaction between an institution and a private party in terms of which the private party –

- (a) performs an institutional function on behalf of the institution; and/or
- (b) acquires the use of state property for its own commercial purposes; and
- (c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
- (d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
 - (i) consideration to be paid by the institution which derives from a revenue fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
 - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
 - (iii) a combination of such consideration and such charges or fees;

What does a PPP entail?

A PPP is a contract between a public sector institution and a private party, in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project.

2. The project officer's role and functions are dealt with in detail in *Module 3: PPP Inception*.

Two types of PPPs are specifically defined:

- where the private party performs an institutional function
- where the private party acquires the use of state property for its own commercial purposes.

A PPP may also be a hybrid of these types.

Payment in any scenario involves one of three mechanisms:

- the institution paying the private party for the delivery of the service, or
- the private party collecting fees or charges from users of the service, or
- a combination of these.

What is a PPP not?

The way that a PPP is defined in the regulations makes it clear that:

- a PPP is not a simple outsourcing of functions where substantial financial, technical and operational risk is retained by the institution
- a PPP is not a donation by a private party for a public good
- a PPP is not the privatisation or divesture of state assets and/or liabilities
- a PPP is not the 'commercialisation' of a public function by the creation of a state-owned enterprise
- a PPP does not constitute borrowing by the state.

What types of PPP does the regulation cater for?

Treasury Regulation 16 caters for a wide variety of PPP types. It allows such projects to be developed in South Africa with a range of different characteristics, combining private party risk in various ways for designing, financing, building, operating, infrastructure and services, and for owning and transferring assets. This wide variety of PPP types is reflected in international experience.

What PPP financing structures and funding sources³ does the regulation provide for?

Treasury Regulation 16 is not prescriptive about the financing structure of a PPP. It is assumed that these will vary widely from project to project and sector to sector, and will be closely linked to the funding sources that can be secured for each deal.

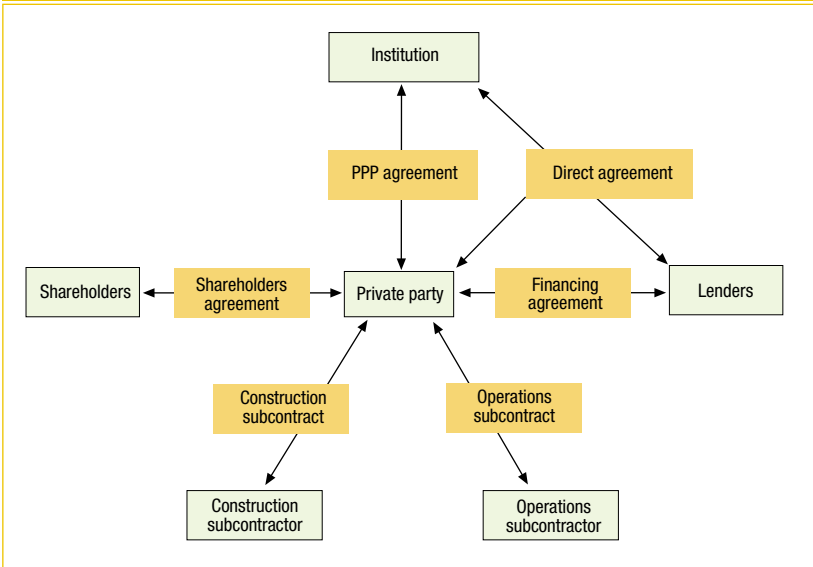
However, PPPs typically involve the private party raising both debt and equity to capitalise the project. *National Treasury's Standardised PPP Provisions* have been developed for this typical PPP financing structure and sources of funding.

PPPs may involve a degree of capital contribution by the institution to the initial costs of the project. Some PPP projects do not involve debt finance at all, being initially funded either wholly through corporate finance or by a combination of government funds and private equity. In end-user-pay projects there may also be an element of government funding support to either or both the capital and the operating costs of the project.

3. Financing structure and funding sources are dealt with in *Module 4: PPP Feasibility Study*. Refer also to *Module 9: An Introduction to Project Finance*.

In essence, Treasury Regulation 16 provides that affordability limits, value-for-money considerations and the risk profile of the project will determine a PPP project's financing structure and sources of funding.

Figure 1.1: Typical PPP structure



“**preferred bidder**”⁴ means the bidder, including any bidding consortium, to be appointed as preferred bidder in terms of regulation 16.5.4;

“**PPP agreement**” means a written contract recording the terms of a PPP concluded between an institution and a private party;

“**relevant treasury**” means the National Treasury unless delegated in terms in section 10(1)(b) of the Act;

Which treasury is the ‘relevant treasury’?

National Treasury currently has the responsibility for regulating PPPs in terms of Treasury Regulation 16 to the PFMA. These powers may be delegated to provincial treasuries, thus the regulation refers throughout to ‘the relevant treasury’.

4. The process for choosing the preferred bidder is covered in *Module 5: PPP Procurement*.

“state property” includes all movable and immovable property belonging to the state as well as intellectual property rights vested in the state;

“transaction advisor”⁵ means a person or persons appointed in writing by an accounting officer or accounting authority of an institution, who has or have appropriate skills and experience to assist and advise the institution in connection with a PPP, including the preparation and conclusion of a PPP agreement; and

“value for money”⁶ means that the provision of the institutional function or the use of state property by a private party in terms of the PPP agreement results in a net benefit to the institution defined in terms of cost, price, quality, quantity, risk transfer or a combination thereof.

16.2 Exclusive competency of accounting officers and accounting authorities

16.2.1 Only the accounting officer or the accounting authority of an institution may enter into a PPP agreement on behalf of that institution.

16.3 Project inception⁷

16.3.1 As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing –

- (a) register the PPP with the relevant treasury;
- (b) inform the relevant treasury of the expertise within that institution to proceed with a PPP;
- (c) appoint a project officer from within or outside the institution; and
- (d) appoint a transaction advisor if the relevant treasury so requests.

What does the PPP project cycle involve?

The PPP project cycle enables the three regulatory tests of affordability, value for money, and risk transfer to be applied at every stage of preparing for, procuring and managing a PPP agreement. Regulation 16 sets out six distinct phases to the project cycle. It requires that the institution apply these tests throughout, and that specific treasury approvals are given at phases II and III of the project cycle. (See the PPP project cycle chart.)

16.4 Feasibility study⁸ – Treasury Approval: I

16.4.1 To determine whether the proposed PPP is in the best interests of an institution, the accounting officer or the accounting authority of that institution must undertake a feasibility study that –

5. The transaction advisor's role and functions and the appointment process are covered in *Module 3: PPP Inception*.
6. Value for money is covered in *Module 4: PPP Feasibility Study and Module 5: Procurement*.
7. The steps in 16.3.1 are covered in *Module 3: PPP Inception*.
8. How to do a PPP feasibility study is covered in *Module 4: PPP Feasibility Study*.

- (a) explains the strategic and operational benefits of the proposed PPP for the institution in terms of its strategic objectives and government policy;
- (b) describes in specific terms –
 - (i) in the case of a PPP involving the performance of an institutional function, the nature of the institutional function concerned and the extent to which this institutional function, both legally and by nature, may be performed by a private party; and
 - (ii) in the case of a PPP involving the use of state property, a description of the state property concerned, the uses, if any, to which such state property has been subject prior to the registration of the proposed PPP and a description of the types of use that a private party may legally subject such state property to;
- (c) in relation to a PPP pursuant to which an institution will incur any financial commitments, demonstrates the affordability of the PPP for the institution;
- (d) sets out the proposed allocation of financial, technical and operational risks between the institution and the private party;
- (e) demonstrates the anticipated value for money to be achieved by the PPP; and
- (f) explains the capacity of the institution to procure, implement, manage, enforce, monitor and report on the PPP;

What are the tests for a PPP?

Whatever the PPP type, structure, payment mechanism, or sources of funding, all South African PPPs governed by Treasury Regulation 16 are subjected to three strict tests:

- Can the institution afford the deal?
- Is it a value-for-money solution?
- Is substantial technical, operational and financial risk transferred to the private party?

16.4.2 An institution may not proceed with the procurement phase of a PPP without prior written approval of the relevant treasury for the feasibility study.

16.4.3 The treasury approval referred to in regulation 16.4.2 shall be regarded as Treasury Approval: I.

16.4.4 If at any time after Treasury Approval: I has been granted in respect of the feasibility study of a PPP, but before the grant of Treasury Approval: III in respect of the PPP agreement recording that PPP, any assumptions in such feasibility study are materially revised, including any assumptions concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer or accounting authority of the institution must immediately –

- (a) provide the relevant treasury with details of the intended revision, including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study; and

- (b) ensure that the relevant treasury is provided with a revised feasibility study after which the relevant treasury may grant a revised Treasury Approval: I.

16.5 Procurement⁹ – Treasury approvals IIA and IIB

- 16.5.1 Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.
- 16.5.2 The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.
- 16.5.3 The procurement procedure –
 - (a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and
 - (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

How is the private party chosen?

The regulation sets out clear PPP procurement steps that must be followed by institutions, and prescribes distinct **treasury approvals** that must be obtained in this phase.

The Promotion of Administrative Justice Act, 2000 (PAJA), imposes a range of obligations arising from section 33(1) of the Constitution of the Republic of South Africa to effect citizens' rights to fair administrative action. These values are lawfulness, reasonableness and procedural fairness.

Each administrative action in a PPP procurement process must be in accordance with the law and prescribed procedures; there must be accountability, responsiveness and openness in the decision-making of the institution; all bidders at each stage of a procurement process must have an equal chance of competing for the contract; and no action taken by government may prejudice their competitiveness.

How is BEE¹⁰ applied in PPPs?

In providing that active measures must be taken to promote black economic empowerment (BEE) at all stages of PPPs, the regulations are in line with broader government BEE policy. *Module 2: Code of Good Practice for BEE in PPPs* informs how BEE must be approached. The code is to be issued by the Minister of Trade and Industry in terms of the Broad-based Black Economic Empowerment Act, 2003 (the BBBEE Act). The Preferential Procurement Policy Framework Act, 2000 (PPPFA) also applies.

9. The stages and steps for procuring the PPP are covered in *Module 5: PPP Procurement*.

10. BEE is dealt with in all the modules as applicable to a particular phase, stage or step in the PPP process. *Module 2: Code of Good Practice for BEE in PPPs* provides the policy and specific guidance.

- 16.5.4 After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid, and including any other information as required by the relevant treasury.
- 16.5.5 The treasury approval referred to in regulation 16.5.4 shall be regarded as Treasury Approval: IIB.

16.6 Contracting PPP agreements – Treasury Approval: III¹¹

- 16.6.1 After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –
- (a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;
 - (b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and
 - (c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.
- 16.6.2 The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.

16.7 Management of PPP agreements¹²

- 16.7.1 The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved in Treasury Approval: III for –
- (a) measuring the outputs of the PPP agreement;
 - (b) monitoring the implementation of the PPP agreement and performances under the PPP agreement;
 - (c) liaising with the private party;

11. See *Module 5: PPP Procurement*.

12. *Module 6: Managing the PPP Agreement* covers the processes in detail.

- (d) resolving disputes and differences with the private party;
 - (e) generally overseeing the day-to-day management of the PPP agreement; and
 - (f) reporting on the PPP agreement in the institution's annual report.
- 16.7.2 A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed in the public interest or on behalf of the public service.
- 16.7.3 A PPP agreement involving the use of state property by a private party does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such state property is appropriately protected against forfeiture, theft, loss, wastage and misuse.

16.8 Amendment and variation of PPP agreements

- 16.8.1 The prior written approval of the relevant treasury is required for any material amendments to a PPP agreement including any material variations to the outputs therein, or any waivers contemplated or provided for in the PPP agreement.
- 16.8.2 The relevant treasury will approve a material amendment only if it is satisfied that the PPP agreement, if so amended, will continue to provide –
- (a) value for money;
 - (b) affordability; and
 - (c) substantial technical, operational and financial risk transfer to the private party.
- 16.8.3 The accounting officer or accounting authority must substantially follow the procedure prescribed by regulations 16.4 and 16.6 for obtaining such treasury approval.

16.9 Agreements binding on the state

- 16.9.1 A PPP agreement or an agreement amending a PPP agreement, binds the state only if the agreement was entered into on behalf of an institution –
- (a) by the accounting officer or accounting authority of that institution; and
 - (b) if all treasury approvals required in terms of this regulation 16 have been granted by the relevant treasury in respect of the PPP.

Are unsolicited bids provided for?

The regulation makes no provision for unsolicited bids, and National Treasury is not in favour of them. Unsolicited bids are difficult to manage, threaten to violate constitutional protections of fair administrative process and competitive procurement, and internationally, have not proven to deliver faster or secure better value for money in PPPs. National Treasury encourages institutions to listen to innovative ideas from the private sector but, in so doing, not to acquire associated intellectual property rights, and

not to make any commitments that will undermine competitive procurement. If the ideas seem promising, institutions should register the project with the relevant treasury in terms of Treasury Regulation 16 and follow the project cycle as regulated.

16.10 Exemptions

16.10.1 The relevant treasury may, subject to any terms and conditions that it considers appropriate and upon written application from an institution, exempt that institution whether in relation to a specific PPP or in general, from complying with any or all of the provisions of this regulation 16.

Applying for exemption from Treasury Regulation 16

An institution may be exempted from obtaining the prescribed treasury approvals, and the procurement of a PPP may thus be able to go ahead without the oversight and statutory approvals of the relevant treasury.

The relevant treasury will consider two kinds of exemption application:

- for the duration of a particular project; and/or
- for the institution itself, for a specific period.

National Treasury has set the following conditions for such exemptions:

- No exemptions will be given to institutions from complying with the regulatory tests or phases of a PPP that are prescribed by Treasury Regulation 16.
- The application must clearly demonstrate the institution's capacity to manage a PPP to the standards and phases outlined in Treasury Regulation 16 by addressing the issues outlined below.
- An exemption from treasury approvals does not exempt the institution from applying *Standardised PPP Provisions*, as set out therein.
- An exemption from treasury approvals does not exempt the institution from substantively following procedures outlined in *National Treasury's PPP Manual*.
- An exemption from treasury approvals does not exempt the institution from complying with the *Code of Good Practice for BEE in PPPs*.
- No exemptions will be given retrospectively.
- Only the accounting officer/authority may apply to the relevant treasury on behalf of an institution.

Part A: Exemption for a particular PPP

The application must demonstrate the institution's capacity to manage the PPP through the phases and to the standards set by Treasury Regulation 16 without the oversight and approvals of the relevant treasury.

The following must be addressed:

1. Give a short description of the project.
2. What institutional function and/or use of state property is envisaged?
3. What is the envisaged extent of public funding and/or revenue from users?
4. What is the proposed extent of private sector capital/skill/infrastructure?
5. What risks are to be transferred to a private party?

6. What is the anticipated duration of the PPP agreement?
7. How does the institution propose to determine affordability, value for money and appropriate risk allocation for the project?
8. Give a short history of similar projects undertaken by the institution.
9. Outline the policy and actual procedures followed to date by the institution in three similar projects, specifically in relation to approving project feasibility studies, compiling and approving bid documents, managing the competitive bidding process, evaluating bids, determining value for money, establishing contract management systems and negotiating and managing contracts.
10. Outline the institution's management system for the project, attaching relevant resumés of key personnel.
11. Submit the curriculum vitae of the appointed project officer, together with his or her job description.

Part B: Exemption for an institution

National Treasury views the past experience of the institution in successfully planning for, procuring and implementing PPP projects as the key factor in granting an institutional exemption. The application must therefore demonstrate the capacity of the institution established for procuring and managing all its possible PPPs through the phases and to the standards set in Treasury Regulation 16 without the oversight and approvals of the relevant treasury. The exemption may be granted for a specific period, and re-applied for after that. The application must state the extent to which such institutional capacity relies on the experience of specific individuals.

The following must be addressed:

1. Give a short description of the institution.
2. Motivate the period of time for which an exemption is sought.
3. What institutional function and/or use of state property is envisaged for PPPs?
4. What is the extent of public funding and/or revenues from users, for projects envisaged?
5. What is the extent of private sector capital/skill/infrastructure envisaged?
6. What risks are likely to be transferred to the private sector?
7. Provide a summary of the PPP projects undertaken by the institution to date.
8. Outline the institution's policy for determining project affordability, value for money and appropriate risk allocation.
9. Outline the actual procedures established in the institution for approving project feasibility studies, approving bid documents, managing the competitive bidding process, evaluating bids, determining value for money, establishing contract management systems, and negotiating and managing PPP agreements.
10. Outline the institution's capacity to manage and administer PPPs, attaching relevant resumés of key personnel.
11. Submit the curriculum vitae of people who will be assigned as project officers for the institution's envisaged PPP projects, together with their job descriptions.

ANNEXURE

ANNEXURE 1

Treasury Regulation 16

16

**TREASURY REGULATION 16 TO THE
PUBLIC FINANCE MANAGEMENT ACT, 1999**
as published in Government Gazette, 2004.

16. Public private partnerships

16.1 Definitions

In this regulation, unless the context indicates otherwise, a word or expression to which a meaning has been assigned in the Act, has the same meaning, and –

“**affordability**” means that the financial commitments to be incurred by an institution in terms of the PPP agreement can be met by funds –

- (a) designated within the institution’s existing budget for the institutional function to which the agreement relates; and/or
- (b) destined for the institution in accordance with the relevant treasury’s future budgetary projections for the institution;

“**institution**” means a department, a constitutional institution, a public entity listed, or required to be listed in schedules 3A, 3B, 3C and 3D to the Act, or any subsidiary of any such public entity.

“**institutional function**” means –

- (a) a service, task, assignment or other function that an institution is entitled or obliged to perform –
 - (i) in the public interest; or
 - (ii) on behalf of the public service generally; or
- (b) any part or component of or any service, task, assignment or other function performed or to be performed in support of such a service, task, assignment or other function;

“**private party**” means a party to a PPP agreement, other than –

- (a) an institution to which the Act applies;
- (b) a municipality or a municipal entity under the ownership control of one or more municipalities; or
- (c) the accounting officer, accounting authority or other person or body acting on behalf of an institution, municipality or municipal entity referred to in paragraph (a) or (b);

“**project officer**” means a person identified by the accounting officer or accounting authority of an institution, who is capable of managing and is appropriately qualified to manage a PPP to which that institution is party from its inception to its expiry or termination;

“**public private partnership**” or “**PPP**” means a commercial transaction between an institution and a private party in terms of which the private party –

- (a) performs an institutional function on behalf of the institution; and / or
- (b) acquires the use of state property for its own commercial purposes; and
- (c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
- (d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
 - (i) consideration to be paid by the institution which derives from a revenue fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
 - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
 - (iii) a combination of such consideration and such charges or fees;

“**preferred bidder**” means the bidder, including any bidding consortium, to be appointed as preferred bidder in terms of regulation 16.5.4;

“**PPP agreement**” means a written contract recording the terms of a PPP concluded between an institution and a private party;

“**relevant treasury**” means the National Treasury unless delegated in terms of section 10(1)(b) of the Act;

“**state property**” includes all movable and immovable property belonging to the state as well as intellectual property rights vested in the state;

“**transaction advisor**” means a person or persons appointed in writing by an accounting officer or accounting authority of an institution, who has or have appropriate skills and experience to assist and advise the institution in connection with a PPP, including the preparation and conclusion of a PPP agreement; and

“**value for money**” means that the provision of the institutional function or the use of state property by a private party in terms of the PPP agreement results in a net benefit to the institution defined in terms of cost, price, quality, quantity, risk transfer or a combination thereof.

16.2 Exclusive competency of accounting officers and accounting authorities

16.2.1 Only the accounting officer or the accounting authority of an institution may enter into a PPP agreement on behalf of that institution.

16.3 Project inception

- 16.3.1 As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing –
- (a) register the PPP with the relevant treasury;
 - (b) inform the relevant treasury of the expertise within that institution to proceed with a PPP;
 - (c) appoint a project officer from within or outside the institution; and
 - (d) appoint a transaction advisor if the relevant treasury so requests.

16.4 Feasibility study – Treasury Approval: I

- 16.4.1 To determine whether the proposed PPP is in the best interests of an institution, the accounting officer or the accounting authority of that institution must undertake a feasibility study that –
- (a) explains the strategic and operational benefits of the proposed PPP for the institution in terms of its strategic objectives and government policy;
 - (b) describes in specific terms –
 - (i) in the case of a PPP involving the performance of an institutional function, the nature of the institutional function concerned and the extent to which this institutional function, both legally and by nature, may be performed by a private party; and
 - (ii) in the case of a PPP involving the use of state property, a description of the state property concerned, the uses, if any, to which such state property has been subject prior to the registration of the proposed PPP and a description of the types of use that a private party may legally subject such state property to;
 - (c) in relation to a PPP pursuant to which an institution will incur any financial commitments, demonstrates the affordability of the PPP for the institution;
 - (d) sets out the proposed allocation of financial, technical and operational risks between the institution and the private party;
 - (e) demonstrates the anticipated value for money to be achieved by the PPP; and
 - (f) explains the capacity of the institution to procure, implement, manage, enforce, monitor and report on the PPP;
- 16.4.2 An institution may not proceed with the procurement phase of a PPP without prior written approval of the relevant treasury for the feasibility study.
- 16.4.3 The treasury approval referred to in regulation 16.4.2 shall be regarded as Treasury Approval: I.
- 16.4.4 If at any time after Treasury Approval: I has been granted in respect of the feasibility study of a PPP, but before the grant of Treasury Approval: III in respect of the PPP agreement recording that PPP, any assumptions in such feasibility study are materially revised, including any assumptions

concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer or accounting authority of the institution must immediately –

- (a) provide the relevant treasury with details of the intended revision, including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study; and
- (b) ensure that the relevant treasury is provided with a revised feasibility study after which the relevant treasury may grant a revised Treasury Approval: I.

16.5 Procurement – Treasury approvals IIA and IIB

16.5.1 Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.

16.5.2 The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.

16.5.3 The procurement procedure –

- (a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and
- (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

16.5.4 After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury.

16.5.5 The treasury approval referred to in regulation 16.5.4 shall be regarded as Treasury Approval: IIB.

16.6 Contracting PPP agreements – Treasury Approval: III

16.6.1 After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –

- (a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;
- (b) for a management plan that explains the capacity of the institution, and

- its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and
- (c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.
- 16.6.2 The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.

16.7 Management of PPP agreements

- 16.7.1 The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved in Treasury Approval: III for –
- (a) measuring the outputs of the PPP agreement;
- (b) monitoring the implementation of the PPP agreement and performances under the PPP agreement;
- (c) liaising with the private party;
- (d) resolving disputes and differences with the private party;
- (e) generally overseeing the day-to-day management of the PPP agreement; and
- (f) reporting on the PPP agreement in the institution's annual report.
- 16.7.2 A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed in the public interest or on behalf of the public service.
- 16.7.3 A PPP agreement involving the use of state property by a private party does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such state property is appropriately protected against forfeiture, theft, loss, wastage and misuse.

16.8 Amendment and variation of PPP agreements

- 16.8.1 The prior written approval of the relevant treasury is required for any material amendments to a PPP agreement including any material variations to the outputs therein, or any waivers contemplated or provided for in the PPP agreement.
- 16.8.2 The relevant treasury will approve a material amendment only if it is satisfied that the PPP agreement, if so amended, will continue to provide –
- (a) value for money;
- (b) affordability; and
- (c) substantial technical, operational and financial risk transfer to the private party.

16.8.3 The accounting officer or accounting authority must substantially follow the procedure prescribed by regulations 16.4 and 16.6 for obtaining such treasury approval.

16.9 Agreements binding on the state

16.9.1 A PPP agreement or an agreement amending a PPP agreement, binds the state only if the agreement was entered into on behalf of an institution –

- (a) by the accounting officer or accounting authority of that institution; and
- (b) if all treasury approvals required in terms of this regulation 16 have been granted by the relevant treasury in respect of the PPP.

16.10 Exemptions

16.10.1 The relevant treasury may, subject to any terms and conditions that it considers appropriate and upon written application from an institution, exempt that institution whether in relation to a specific PPP or in general, from complying with any or all of the provisions of this regulation 16.

**NATIONAL TREASURY
PPP MANUAL
MODULE 2: CODE OF GOOD PRACTICE
FOR BEE IN PPPs**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 03 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 03 of 2004 'Code of Good Practice for Black Economic Empowerment in Public Private Partnerships' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.



NATIONAL TREASURY
PPP
unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the
Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: IIB

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes
- Report progress in the Annual Report

Phase V

DELIVERY

- Scrutiny by the Auditor-General

Phase VI

EXIT

Module 1
Module 2

MODULE 3

Module 6

Module 1
Module 2

MODULE 4

Module 6

Module 7

Module 8

Module 9

Module 1
Module 2
Module 4

MODULE 5

Module 6

Module 7

Module 8

Module 9

Module 1
Module 2
Module 5

MODULE 6

Module 7

Module 8

Module 9

ABOUT THIS MODULE

Module 2: Code of Good Practice for BEE in Public Private Partnerships is National Treasury's official framework for black economic empowerment in public private partnerships. PPPs are excellent vehicles for developing BEE in South Africa. The *Code* is relevant in all phases of a PPP, and needs to be rigorously applied.

NATIONAL TREASURY



CODE OF GOOD PRACTICE for BLACK ECONOMIC EMPOWERMENT in PUBLIC PRIVATE PARTNERSHIPS

Following public consultation and incorporation of comments, the *Code of Good Practice for Black Economic Empowerment in Public Private Partnerships (Code for BEE in PPPs)*, is submitted by the Minister of Finance to the Minister of Trade and Industry to be issued in terms of the Broad-based Black Economic Empowerment Act, 2003 (BBBEE Act).

The Code for BEE in PPPs constitutes *Module 2 of National Treasury's PPP Manual*, issued as *National Treasury PPP Practice Note Number 3 of 2004* in terms of section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA). It applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA and subsidiaries of such public entities.

This *Code for BEE in PPPs* follows the release of the *Financial Sector Charter*, and complements its commitments. It also acknowledges the development of other sectoral charters whose implementation will further support BEE in PPPs.

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DEFINITIONS

<i>“Active Equity”</i>	means, in relation to any Black Equity or in relation to any issued shares in the share capital of any Subcontractor held by Black People and/or Black Enterprises, in which such Black Equity or shares is/are held by Black People and/or Black Enterprises who will participate directly in the day-to-day management and operations of the project.
<i>“Black Enterprise”</i>	means an enterprise that is at least 50.1% beneficially owned by Black People and in which Black People have substantial Management Control. Such beneficial ownership may be held directly or through other Black Enterprises.
<i>“Black Equity”</i>	means the voting equity in the Private Party held by Black Shareholders from time to time.
<i>“Black People”</i>	means African, Coloured and Indian South African citizens.
<i>“Black Shareholder”</i>	means any shareholder that is a Black Person or a Black Enterprise.
<i>“Black Women”</i>	means female African, Coloured and Indian South African citizens.
<i>“Broad-based Black Economic Empowerment”</i>	has the meaning defined in the Broad-based Black Economic Empowerment Act, No 53 of 2003 (BBBEE Act).
<i>“Feasibility Study”</i>	has the meaning given in Treasury Regulation 16 to the Public Finance Management Act, 1999 (PFMA).
<i>“Institution”</i>	has the meaning defined in Treasury Regulation 16 to the PFMA. It means a department, a constitutional institution, a public entity listed, or required to be listed, in schedules 3A, 3B, 3C and 3D to the PFMA, or any subsidiary of any such public entity.

<i>“Management Control”</i>	means, in relation to any enterprise, the ability to direct or cause the direction of the business and management policies or practices of that enterprise.
<i>“Private Party”</i>	has the meaning defined in Treasury Regulation 16 to the PFMA. Such Private Party is typically a special purpose vehicle (SPV) incorporated in the Republic of South Africa as a private limited liability company for the sole purpose of exercising its rights and performing its obligations under the PPP Agreement.
<i>“PPP Agreement”</i>	has the meaning defined in Treasury Regulation 16 to the PFMA. It means a written contract recording the terms of a PPP concluded between an Institution and a Private Party.
<i>“Public Private Partnership or PPP”</i>	has the meaning defined in Treasury Regulation 16 to the PFMA. It means a commercial transaction between an Institution and a Private Party in terms of which the Private Party – (a) performs an Institutional function on behalf of the Institution; and/or (b) acquires the use of state property for its own commercial purposes; and (c) assumes substantial financial, technical and operational risk in connection with the performance of the institutional function and/or use of state property; and (d) receives a benefit for performing the Institutional function or from utilising the state property, either by way of (i) consideration to be paid by the Institution which derives from a revenue fund or, where the Institution is a national government business enterprise, from the revenues of such Institution; or (ii) charges or fees to be collected by the Private Party from users or customers of a service provided to them; or (iii) a combination of such consideration and such charges or fees.
<i>“Subcontractors”</i>	means the counter-parties of the Private Party to the Subcontracts including the Construction Subcontractor and the Operations Subcontractor.
<i>“SMME or Small, Medium or Micro Enterprise”</i>	means any business, trade, undertaking or other enterprise which is directly owned and managed by one or more natural persons and which has: (a) less

than [x] full-time equivalent employees; (b) an annual turnover less than [Rx] (indexed to CPIX); and (3) gross asset value (fixed property included) of less than [Rx] (indexed to CPIX), to be determined by the Institution, taking account of the sector, on a project by project basis.

“Transaction Advisor”

has the meaning defined in Treasury Regulation 16 to the PFMA. It means a person or persons appointed in writing by the Institution, who has or have the appropriate skills and experience to assist and advise the Institution in connection with a PPP, including the preparation and conclusion of a PPP Agreement.

PREAMBLE

In a concerted drive to redress the stifling economic effects of apartheid, the democratic South African government has adopted a policy of BEE which is broad-based, inclusive, and part of the country's overall growth strategy. PPPs are being used increasingly widely to implement national and provincial government's infrastructure and service delivery commitments. Regulated by the relevant treasury (currently, National Treasury) in terms of Treasury Regulation 16 to the PFMA, PPPs offer valuable opportunities for strong and sustainable BEE.

South Africa's BEE policy is articulated in the 2003 '*Strategy for Broad-based Black Economic Empowerment*' (*BBBEE Strategy*) and is given effect in the BBBEE Act. The *BBBEE Strategy* outlines government's policy instruments for achieving BEE and sets out a balanced scorecard to measure three core elements of BEE progress in all enterprises and sectors:

- direct empowerment through ownership and control of enterprises and assets;
- human resource development and employment equity; and
- indirect empowerment through preferential procurement and enterprise development.

The *BBBEE Strategy* notes that BEE criteria, reflecting the balanced scorecard, will be applied whenever government '*grants a concession to a private enterprise to operate an asset or enterprise on behalf of the state*' or '*enters into a public private partnership*', amongst others.

Section 9 of the BBBEE Act provides that the Minister of Trade and Industry may issue '*codes of good practice on BEE*'. Section 10 provides further that '*every organ of state and public entity must take into account and, as far as it is reasonably possible, apply any relevant code of good practice*' in, *inter alia* '*determining qualification criteria for the issuing of licences, concessions ...; developing and implementing a preferential procurement policy; ... and developing criteria for entering into partnerships with the private sector*'.

Section 12 of the BBBEE Act provides that the Minister of Trade and Industry may publish and promote '*a transformation charter for a particular sector of the economy*' if he or she is satisfied that such a charter '*has been developed by major stakeholders in that sector; and advances the objectives of [the BBBEE Act]*'. This *Code for BEE in PPPs* recognises that the implementation of such transformation charters in the private sector will contribute materially to achieving effective BEE in PPPs.

It is National Treasury's intention that BEE is integral to all phases of the regulated PPP project cycle, and that BEE is made contractually binding in all PPP Agreements. The provisions of the *Code for BEE in PPPs* are therefore reflected in all modules of *National Treasury's PPP Manual*, and in *Standardised PPP Provisions: First Issue: 11 March 2004*.

PART I

1. Policy on BEE in PPPs

In keeping with the principles and policy objectives of the *BBBEE Strategy*, PPP BEE policy is devised to achieve a broad-based and sustainable BEE outcome in every PPP project undertaken in terms of Treasury Regulation 16 to the PFMA. The policy is to be applied by Institutions in the two distinct procurements of the regulated PPP project cycle: firstly, in the selection of its Transaction Advisor; and secondly, in the selection of a Private Party for the PPP itself.

Transaction Advisor procurement¹

In compliance with the Preferential Procurement Policy Framework Act (PPPFA), the BEE component of a Transaction Advisor bid will constitute **10% of the bid evaluation weighting**², with the price and technical elements constituting the remaining 90%. BEE in the Transaction Advisor bid will be evaluated against a balanced scorecard for PPP Transaction Advisor appointments, and bidders must achieve a **minimum threshold of 60%** of the total BEE points. If a Transaction Advisor bid fails to pass this BEE threshold, it should not be evaluated further.

The BEE elements to be evaluated in a Transaction Advisor bid are elaborated in **Part III(1)** of this *Code for BEE in PPPs*.

PPP procurement³

BEE is a key component of South African PPP projects, each of which is structured on a combination of financial, technical and BEE components in order to achieve optimal value for money in government's delivery of infrastructure and services. In compliance with the PPPFA, the BEE component of a PPP bid will constitute **10% of the bid evaluation weighting**. The price and technical components will be weighted within the remaining 90%, as appropriate to the project. BEE in the PPP bid will be evaluated against a **balanced scorecard** designed for the project, and bidders must achieve a **minimum threshold of 50%** of the total BEE points. If a PPP bid fails to pass this BEE threshold, it should not be evaluated further.

The BEE elements that should be included in each PPP project, and the indicative targets for each element, are elaborated in **Part II** and summarised in the PPP BEE Balanced Scorecard in **Part IV** of this *Code for BEE in PPPs*.

1. Refer to *National Treasury's PPP Manual: Module 3: PPP Inception*.

2. In terms of the PPPFA, a maximum of 10% of bid evaluation weighting goes to BEE considerations if the price of the contract is above R500 000. If the price is below R500 000, the BEE weighting is 20%. Most PPP transaction advisor costs will be above R500 000.

3. Refer to *National Treasury's PPP Manual: Module 5: PPP Procurement*.

PPP project cycle⁴

No PPP may be issued to the market by an Institution without a BEE balanced scorecard for the project containing a clear and appropriate set of BEE elements, targets, minimum thresholds, and weightings, duly approved as part of the Feasibility Study for Treasury Approval: I and the bid documents for Treasury Approval: IIA in terms of Treasury Regulation 16 to the PFMA. Bids received thereafter are evaluated by the Institution, *inter alia*, for substantiation of the Private Party's BEE commitments. The quality of the BEE component of the preferred bid forms part of the value-for-money report to be submitted by the Institution for Treasury Approval: IIB, prior to the commencement of negotiations. Negotiations that follow must seek to maximise BEE benefits in the final terms of the deal, and to tie up provisions for managing the PPP Agreement post signature. These BEE commitments are part of the motivation for the final Treasury Approval: III, allowing the parties to sign the PPP Agreement. The PPP Agreement binds the parties to their BEE commitments for the duration of the PPP, stipulating the consequences of default.⁵

These phases of the PPP project cycle, as they apply to the BEE component of a PPP, are elaborated in **Part III** of this *Code for BEE in PPPs*.

Policy objectives for BEE in PPPs are:

- to achieve meaningful and beneficial **direct ownership of substantial equity interests** in the Private Party to a PPP Agreement by Black People, Black Women and Black Enterprises;
- to achieve effective **participation in the management control** of the Private Party and its subcontractors by Black People and Black Women;
- to ensure that a substantive proportion of the Private Party's **subcontracting and procurement** is to Black People, Black Women and Black Enterprises;
- to ensure effective **employment equity and skills development** in the Private Party and its Subcontractors throughout the PPP project;
- to promote positive **local socio-economic impact** from the project to the benefit of SMMEs, the disabled, the youth, and non-government organisations within a targeted area of project operations;
- to create **jobs**; and
- for Institutions to be supported in all PPP projects by **financial, legal and technical Transaction Advisors** who generally reflect South Africa's diverse population, and to build the professional skills and number of Black People and Black Enterprises in these fields.

To further support and promote BEE in PPPs, government makes three **proactive commitments** in **Part V** of this *Code for BEE in PPPs*.

4. Refer to *National Treasury's PPP Manual: Module 1: South African Regulations for PPPs*.

5. Refer to *National Treasury's Standardised PPP Provisions: First Issue: 11 March 2004*.

2. Legal basis for PPP BEE policy

This PPP BEE policy is developed with reference to the following legislation:

- The **Constitution of the Republic of South Africa, 1996**, enables organs of state to implement *‘procurement policy for (a) categories of preference in the allocation of contracts and (b) the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination’* (section 217(2)).
- **Treasury Regulation 16**, issued in terms of the PFMA for the purposes of regulating national and provincial PPPs, states that the procurement procedure for a PPP *‘must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination.’* (Treasury Regulation 16.5.3 (b)).
- The **PPPFA, 2000**, and its regulations prescribe a framework for calculating BEE points relative to ‘functionality’ and ‘price’ in government procurement.
- The **BBBEE Act, 2003**, has as its objective *‘to facilitate broad-based black economic empowerment’* and provide for the issuing of codes of good practice to be applied by organs of state and public entities, *inter alia, ‘in developing criteria for entering into partnerships with the private sector.’*
- The **Employment Equity Act, 1998** provides for improving employment equity for the benefit of historically disadvantaged individuals (as defined therein).

3. Why PPPs are good for BEE

There are key features of PPPs that make them inherently excellent for achieving BEE objectives:

- The **long-term nature** of PPPs provides an opportune instrument to grow Black Equity and black management over time.
- **Risk is clearly identified** in PPPs, clearly costed and appropriately allocated, so black participants know in advance what they are committing to.
- The formation of **private consortia** in the form of special purpose vehicles (SPVs) for many PPPs facilitates long-term beneficial partnerships between new Black Enterprises and experienced, resourced companies – both as equity partners and in project management, and both at the Private Party SPV and Subcontracting levels.
- Where government is the buyer of a service, and insofar as the service is provided to the agreed standards, there is a **steady revenue stream** to the Private Party, reducing risk to new Black Enterprises.
- Principal equity sponsors in a PPP are often also first-tier Subcontractors, building **incentives for optimal risk management**.
- PPPs provide significant subcontracting opportunities for Black Enterprises, where **early cash-flow benefits** can be derived as delivery commences.
- PPPs have far-reaching **broad-based** BEE potential: through the subcontracting and procurement mechanisms they can involve a full spectrum of large, medium

and small enterprises, and bring tangible, local, economic development benefits to targeted groups of people.

- **Return on equity** to the Private Party is competitive where risk is properly assumed.
- There is an increasingly strong demand for **black professionals** as Transaction Advisors to both Institutions and Private Parties in PPPs.
- PPPs develop **skills**.
- PPPs create **jobs**.

4. Challenges for BEE in PPPs

There nevertheless remain obstacles to achieving sustainable BEE in PPPs:

- There is a **small pool of Black Equity** in South Africa. Historically, Black People have not accumulated capital and it is a challenge for Black Enterprises to raise required levels of equity at reasonable prices.
- Sources of BEE funding are generally **expensive**, reflecting lenders' assessment of risk associated with new enterprises whose balance sheets may be relatively small, or whose experience may be relatively limited.
- Costs of **independent financial and legal advice** to Black Enterprises are an inhibiting factor in the preparation of bids, during contract negotiation, and during start-up, often leaving black partners in a consortium vulnerable to concluding disadvantageous arrangements.
- There is **limited black experience and skill** in PPPs, resulting in an uneven playing field in relation to partners that are established companies.
- Established companies in the consortia often become obliged to provide **sponsor security** for the committed BEE capital and to guarantee performance of the black partners, contributing further to the uneven playing field for consortium members.
- **Dividend distributions** typically do not occur in the earlier years of a PPP, which is hard for new Black Enterprises participating as shareholders in the Private Party.
- There are few experienced black South African **PPP Transaction Advisors**.

It is in recognition of both the value in PPPs for sustainable BEE, and the challenges, that this *Code for BEE in PPPs* has been devised.

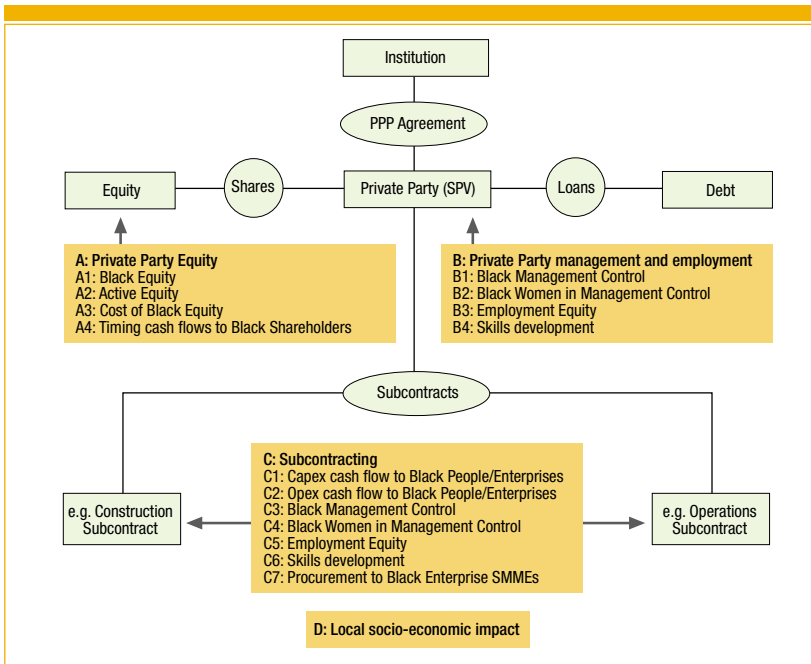
PART II

How to apply BEE PPP policy in the typical structure of a PPP

Many PPP projects are structured in the manner depicted below. The illustration shows where PPP BEE policy should be effected in all PPP Agreements. If alternative or simpler PPP structures are developed, they should seek to achieve an equivalent BEE effect. While PPP projects differ, and the BEE elements identified are not exhaustive, at least the elements listed as A1- 4, B1- 4, C1- 7 and D should be appropriately incorporated in the structure of PPP projects undertaken in terms of Treasury Regulation 16 to the PFMA. The remainder of Part II elaborates on each PPP BEE element.

Indicative targets for each element are given where appropriate. Targets for a project should always be determined during the Feasibility Study phase, in recognition of the capacity of Black Enterprises in the sector, the implementation of sectoral transformation charters, and, where appropriate, may be structured to attain stronger BEE outcomes over the project term.

The identified elements and their indicative targets are summarised in the *PPP BEE Balanced Scorecard* in Part IV.



A. Private Party equity

Substantial increases in black ownership of new enterprises is a central policy objective of government’s *BBBEE Strategy*. PPPs offer a real opportunity to grow new black ownership in long-term sustainable businesses.

Four specific elements of Private Party equity are identified for ensuring that this part of the *BBBEE Strategy* is captured in a sustainable way in PPPs:

- **A1:** the percentage of Black Equity in the Private Party;
- **A2:** the percentage of Active Equity;
- **A3:** the cost of Black Equity; and
- **A4:** the timing of project cash flows to Black Shareholders.

A1. Black Equity in the Private Party

BEE must be reflected in the percentage of Black Equity in the Private Party SPV. The actual percentage set will vary from project to project. Many PPP projects will be able to attain a ‘high’ Black Equity threshold from the outset. However, due to the scale of funding required in some large PPP projects, or by virtue of the sector, it may be necessary to start out at an initially ‘lower’ Black Equity threshold, with milestones to grow the percentage over the project term.

There will be a lock-in provision for a specified period, to contractually bind the agreed percentages and conditions of Black Equity, requiring the Private Party not to effect changes in its capital structure that will dilute Black Equity during this period.

The Black Equity commitment sought by the Institution must be costed in its Feasibility Study models, presented to the private sector in the bid documentation, identifiable in the financial models presented by bidders, demonstrated in the Private Party’s shareholders’ agreement, and committed in the PPP Agreement. The source/s of the committed Black Equity must be substantiated by bidders and verified by the Institutions during bid evaluation.

A1: Black Equity in the Private Party	PPP indicative target
	40%

A2. Active Equity

In keeping with government’s intention that black ownership should have a broad-based impact, be sustainable and active, and grow over time, Black People and Black Enterprises should not only be passive shareholders (‘pure investment’ equity) in PPPs, but should take responsibility and operational risk in the project and secure direct benefits in management. This Active Equity may be achieved in a variety of ways, determined on a project by project basis, but must show Black People and/or Black Enterprises participating directly in the day-to-day management and operations of the project, either in the Private Party only, or in the Subcontractors only, or in a combination of Private Party and Subcontractors. Passive equity would normally have no role in day-to-day management and operations, but would involve representation on the Private Party board.

A2: Active Equity	PPP indicative target
	55% of A1

A3. Cost of Black Equity

Black People and Black Enterprises wishing to participate as shareholders in Private Parties to PPP Agreements often find it difficult and expensive to raise the capital necessary to purchase shares. Funding for Black Equity is thus commonly raised through loans. These either take the form of shareholder loans, based on the strength of the project cash flow, or take the form of loans to the Black Enterprises, based on their company balance sheets. Over time, growing Black Enterprises will have an increasing option to invest their own funds as they build a capital base.

The price of equity in a PPP deal has an impact not only on the potential returns for shareholders, but also on the cost of the project to government. For the purpose of evaluating value for money in the financial component of the PPP, the cost of BEE equity must therefore be clearly shown as a separate component of the Institutions' Feasibility Study models (see **Part III**), and in the financial offers presented by bidders.

Due to the difficulty of placing a value on Black Equity that is not funded through borrowing, points will not be awarded under the BEE component of the PPP bid evaluation for the assumed value of the Black Equity in the SPV. However, the overall cost of equity in the deal will have a direct bearing on the Institution's value-for-money assessment of the bidders' financial offers, and will be evaluated accordingly.

Government is committed to facilitating the establishment of a PPP BEE equity facility with dedicated advisory services to black bidders, to help address this constraint, amongst others (see **Part V**).

A4. Timing of project cash flows to Black Shareholders

In typical PPP funding structures, operating expenditure and debt service take first call on project cash flows, and shareholders are the last in line to receive returns on their investment. This has an obviously debilitating effect for new Black Enterprises, which in such arrangements have capital tied up for the long haul and cannot expect dividends until late in the project term.

The challenge to advisors, sponsors, banks and the Black Enterprises in PPPs is to find innovative ways of unlocking value in project cash flow, particularly in structuring early cash flows for Black Shareholders. How this is to be achieved will not be prescribed, but bids should show how their funding structures effectively unlock value for Black Shareholders early and throughout the project term. Bidders' proposals on this element must be clearly demonstrated in their financial models and reflected in their shareholders' agreements. The commitment agreed between the parties will become a contractual obligation in the PPP Agreement.

B. Private Party management and employment

The *BBEE Strategy* identifies further BEE objectives to increase the number of Black People in executive and senior management of enterprises and the number of black-engendered enterprises, and to increase income levels of Black People, and reduce income inequalities. Human resource development and employment equity are also targeted elements. All PPP Agreements will bind the Private Party to minimum commitments in these matters.

Four specific elements of the Private Party's management and employment regimes are therefore identified to enable PPPs to meet these objectives in a meaningful and sustained way:

- **B1:** the percentage of Black People in Management Control in the Private Party;
- **B2:** the percentage of Black Women in Management Control in the Private Party;
- **B3:** compliance with the provisions of the Employment Equity Act, 1998 by the Private Party; and
- **B4:** skills development expenditure as a proportion of Private Party payroll.

B1. Black Management Control in the Private Party

The percentage of Management Control by Black People in the Private Party SPV should be at least commensurate with the Black Equity (passive and active) in the SPV. An initial percentage may be designed to grow by milestones over the project term.

B1: <i>Black Management Control in the Private Party</i>	PPP indicative target
	Commensurate with A1 and A2

B2. Black Women in Management Control in the Private Party

The percentage of Black Women in Management Control in the Private Party must be targeted and committed appropriately. An initial percentage may be designed to grow by milestones over the project term.

B2: <i>Black Women in Management Control in the Private Party</i>	PPP indicative target
	15% of B1

B3. Employment Equity in the Private Party

The Private Party must be in compliance with the Employment Equity Act, 1998, and produce a comprehensive employment equity plan as part of its bid.

B3: <i>Employment Equity plan</i>	PPP indicative target
	Compliance with law

B4. Skills development in the Private Party

Bidders must present a clear skills development plan and targets for the Private Party's managers and employees, and must commit a minimum percentage of their

payroll for expenditure on meeting these targets each year of the project. This sum is additional to the skills development levy prescribed by the Skills Development Levies Act, 1999, and must be applied to the skills development of staff employed in the PPP itself.⁶

B4: Percentage of payroll on skills development	PPP indicative target
	1%

C. Subcontracting

Significant opportunities for BEE reside in the Subcontracting arrangements of a typical PPP structure, where cash-flow benefits, ownership, management, women, employment equity, skills development, and procurement commitments can all be targeted for strong BEE results. If appropriate, initial target percentages may grow by milestones over the project term. While Institutions may adjust these elements on a project-by-project basis, their broad-based effect should be achieved in all PPP projects.

Although elements C1 and C2 are not prescriptive about how the participation is to be structured, the extent of such participation must be measurable as a percentage participation in the total capital expenditure cash flows and operating expenditure cash flows to the Subcontractors.

Six specific elements of the PPP subcontracting arrangements are identified in this *Code for BEE in PPPs* for ensuring broad-based and sustainable BEE in PPPs. All commitments will be binding obligations in the PPP Agreement.

6. Depending on the Institution's objectives for element D (local socio-economic impact), it may agree that if the Private Party is able to achieve its annual skills development targets without spending the minimum sum, the costs savings will be applied by the Private Party to the agreed local socio-economic targets or on new skills development targets.

C: Subcontracting	PPP indicative target
C1: Percentage participation by Black People and/or Black Enterprises in the capital expenditure forecast to be incurred by the Private Party under the Subcontracts ⁷	30%
C2: Percentage participation by Black People and/or Black Enterprises in the operating expenditure forecast to be incurred by the Private Party under the Subcontracts. ⁸	30%
C3: Percentage of Black Management Control in the Subcontractors	25%
C4: Percentage of Black Women in Management Control in the Subcontractors	15% of C3
C5: Employment equity plans of the Subcontractor	Compliance with law
C6: Percentage of Subcontractors' payrolls to be spent on skills development per annum ⁹	1%
C7: Percentage of procurement budget committed by the Subcontractors to Black Enterprise SMMEs	30%

D. Local socio-economic impact

PPP projects must be seen, and tangibly experienced, as directly beneficial to the people in whose neighbourhoods they operate. Every PPP must therefore be designed, and proactively seek, to produce a positive local socio-economic impact in any way that is appropriate to the project and its location. This must be done taking cognisance of relevant Integrated Development Plans. The targets that may be set in this element need not be limited only to Black People or Black Enterprises, but in targeting local communities must directly benefit the poor and the marginalised, and must effect local socio-economic upliftment.

This final set of PPP BEE elements must be: determined by the Institution on a project-by-project basis during the Feasibility Study phase; communicated with bidders during procurement; proposed by bidders in their plans, with costs reflected in their financial models; negotiated with the preferred bidder; and committed in the PPP Agreement.

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7. This participation may involve, amongst other things, a direct equity participation by Black People and/or Black Enterprises in the Construction Subcontractor, or the assignment of a percentage of the entire capital expenditure subcontract value to Black People and/or Black Enterprises and/or a combination of these.
 8. This participation may involve, amongst other things, a direct equity participation by Black People and/or Black Enterprises in the Operations Subcontractor, or the assignment of a percentage of the entire operating expenditure subcontract value to Black People and/or Black Enterprises and/or a combination of these.
 9. This minimum sum is additional to the skills development levy prescribed by the Skills Development Levies Act, 1999 and is to be applied to the skills development of staff employed in the PPP project itself.

Listed below is an indication of beneficial local socio-economic impacts that may be targeted under PPP element D, any of which may be qualifications to BEE elements A, B or C:

- involvement of, and direct benefits to, non-governmental organisations, religious institutions, civics, clinics, child-care centres, and the like;
- employment preference for youth in a targeted geographic area;
- employment targets for disabled people;
- employment preferences for women;
- preference for contracting with SMMEs as suppliers of materials and/or services in a targeted geographic area;
- initiatives that will support HIV and Aids education; and
- other local socio-economic impacts appropriate to the project and its location.

Such elements may be itemised individually or, on larger projects, incorporated under a requirement that the Private Party devise and implement an innovative and effective social responsibility programme as part of its operations.

PART III

How to apply BEE PPP policy at each phase of the PPP project cycle¹⁰

PPP BEE policy objectives will be pursued at every phase of the PPP project cycle, namely:

- appointment of a Transaction Advisor by the Institution;
- Feasibility Study for Treasury Approval: I;
- PPP procurement, including:
 - bid documentation preparation for Treasury Approval: IIA,
 - PPP procurement and value-for-money report on the preferred bid, for Treasury Approval: IIB,
 - negotiations with the preferred bidder, and
 - Treasury Approval: III for the final terms of the PPP Agreement and the Institution's contract management plan;
- managing the PPP Agreement.

Set out below is the approach to be adopted in each phase to ensure that PPP BEE policy objectives are appropriately achieved in every PPP project undertaken in terms of Treasury Regulation 16 to the PFMA.

1. Appointment of the Institution's Transaction Advisor¹¹

The Institution's Transaction Advisor is a consortium of professionals with appropriate skills and experience to assist the Institution with the preparation and conclusion of a PPP Agreement. The Transaction Advisor is a key player in the success of a PPP.

While at present there are few black PPP Transaction Advisors, it is government's intention:

- to be represented in its PPP transactions by teams of skilled and experienced professional financial, legal and technical advisors who generally reflect South Africa's diverse population;
- to be confident that its Transaction Advisor thoroughly knows, supports and will seek to optimise the *Code for BEE in PPPs* in the PPP project; and
- to proactively grow the number of Black People and Black Enterprises participating as professional advisors in PPP transactions.

The Transaction Advisor is hired by the Institution through an open and competitive bidding process, after the registration of the PPP project with the relevant treasury. The selection is made on a combination of technical, BEE and price considerations. A two-envelope system is used, and threshold scores are set for

10. Detailed modules on each of these phases are provided in *National Treasury's PPP Manual*.

11. Refer to *National Treasury's PPP Manual: Module 3: PPP Inception*.

both the technical and BEE elements. Only those bids that meet or better the technical and BEE thresholds are considered in respect of their price. The Transaction Advisor contracts with the Institution through a lead Transaction Advisor company, and all other members of the consortium participate either through subcontracts with the lead company or via a joint venture arrangement.

In compliance with the PPPFA, the BEE component of a Transaction Advisor bid will constitute **10% of the bid evaluation weighting**¹², with the price and technical elements constituting the remaining 90%. A minimum threshold of 60% of the total BEE points will be set. If a Transaction Advisor bid fails to pass this BEE threshold, it should not be evaluated further.

Set out below is the balanced scorecard, containing four sub-elements to the BEE element of the Transaction Advisor bid evaluation, making up 100 points, 60 of which constitute the minimum threshold. The technical and price elements are each also scored out of 100 points. The BEE score achieved (if it meets or betters the minimum threshold) by each bidder will be calculated into the bidder's overall score, using the following formula:

$$a * (\text{technical score}/100) + b * (\text{BEE score}/100) + c * (\text{price score}/100) = d$$

where:

a is the weighting for technical (either 50% or 70%)¹³

b is the weighting for BEE (10%)¹⁴

c is the weighting for price (either 20% or 40%)¹⁵, and

d is the total score achieved by the bidder.

12. In terms of the PPPFA, a maximum of 10% of bid evaluation weighting goes to BEE considerations if the price of the contract is above R500 000. If price is below R500 000, the BEE weighting is 20%. Most PPP transaction advisor costs will be above R500 000.

13. The alternative technical and price weightings (together making up 90%) vary depending on whether the fees budget is declared or not declared by the Institution. For further detailed guidance, refer to *National Treasury's PPP Manual: Module 3: PPP Inception*.

14. 10% is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000.

15. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA. For further detailed guidance, refer to *National Treasury's PPP Manual: Module 3: PPP Inception*.

Transaction Advisor bid evaluation BEE elements	Maximum score	Scoring criteria	Weighting	Points total
1 The percentage of Black People playing leading professional roles in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
2 The percentage of black equity in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
3 A credible plan for structuring effective BEE for the PPP, with necessary skill and experience in the team	5	Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skill & experience = 2 or 3 Credible plan, skill & experience = 4 or 5	4	20
4 A credible plan for skills transfer within the consortium to directly benefit black professionals inexperienced in PPPs (may specify targeting of Black People within a geographic area)	5	Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	4	20
Total points				100
Minimum threshold				60

The Transaction Advisor bids must therefore show:

- how Black People are included in all professional aspects of the work (legal, financial and technical and at all phases of the PPP project cycle), and must specifically indicate those aspects where Black People are designated to play leading roles. Fronting of Black People for the purpose of winning contracts will not be tolerated and will lead to contract termination. Black People are therefore expected to perform the work they were assigned to, and the fee-sharing structure must reflect the actual work, risk and responsibility assumed by each of the team members. The cash flow earmarked for each member of the consortium must therefore also be shown in the price envelope, indicating how Black People will benefit;
- the percentage of Black Equity in the companies making up the Transaction Advisor consortium, with a weighted average calculated on the percentage of the work to be performed by each company;¹⁶
- that the member(s) of the consortium responsible for structuring BEE in the PPP can demonstrate insights into how to apply the *Code for BEE in PPPs*. References should be provided to substantiate claims of skills and experience in structuring BEE in PPPs; and
- that the skills transfer plan allows the Institution to see success in this respect throughout the Transaction Advisor assignment. While the leading black professionals on the team are likely to be both skilled and experienced, the intention is

¹⁶ For further guidance, refer to *National Treasury's PPP Manual: Module 3: PPP Inception*.

to encourage the Transaction Advisor consortia to include black professionals who are inexperienced in PPPs, and who can learn on the job.

Government's commitment to achieving a growing number of skilled and experienced black PPP Transaction Advisors is reflected further in **Part V**.

2. The PPP Feasibility Study¹⁷

Each of the PPP BEE elements set out in Part II above and reflected in the *PPP BEE Balanced Scorecard* in **Part IV** must be taken into consideration by the Institution in the preparation of the Feasibility Study, in order to establish the BEE targets that can realistically be achieved in the project, and specifically to determine their impact on project affordability, value for money and risk.

Key stages of the Feasibility Study for BEE are summarised in the table below.¹⁸ Importantly, the overall BEE analysis in the Feasibility Study must be sufficiently robust to enable the Institution to determine sound benchmarks for the BEE impact it can realistically expect to achieve, both by conventional means (as reflected in a public sector comparator (PSC) model using the PPPFA 90:10 formula and price premium on all procured goods and services) and in a possible PPP project (as reflected in a PPP reference model where the *PPP BEE Balanced Scorecard* targets are costed).

¹⁷. Refer to National Treasury's *PPP Manual: Module 4: PPP Feasibility Study*.

¹⁸. Not all stages of the Feasibility Study are shown in the table.

Relevant stage of the Feasibility Study	Brief description	BEE feasibility phase task
Output specifications	To clearly identify what the Institution wants to deliver	Draw up a list of BEE outputs that the Institution wishes to achieve in the project, using the <i>PPP BEE Balanced Scorecard</i> as reference.
Solution options analysis	To identify the pros and cons of each option that can meet the Institution's needs and output specifications; to examine the risks, benefits and impacts for government of each; and to select a preferred option	Set out a preliminary view of the impact of each option on the intended BEE outputs, and identify the possible BEE outcomes of the preferred option.
Due diligence	To undertake a due diligence assessing all budgetary, institutional, legal, regulatory, site, BEE and other socio-economic factors that constrain and/or enable the project	Identify project-specific BEE sectoral conditions: Black Enterprise strength, implementation of sectoral BEE charters, local socio-economic factors that could be addressed in the project location, and any constraining factors to the achievement of the intended BEE outputs.
<i>If the preferred option can be procured through a PPP, the Institution must then establish affordability, value for money and risk transfer. This entails constructing a PSC model, and a PPP reference model, both risk-adjusted.</i>		
Risk identification	To identify all possible risks in the construction and operation of the project, the probability of each arising, the value of each risk, and strategies and costs of mitigation	Identify all possible BEE risks in the project, probabilities of each such risk arising, values for each, and the strategies for, and costs of mitigation.
Public sector comparator (PSC)	Life-cycle cost model of the output specifications where the public sector takes financing, construction and operating risks	Cost the achievement of the project's identified BEE outputs if it were procured conventionally, namely calculate preferential procurement as stipulated by the PPPFA's 90:10 formula price premium for procured goods and services, and include in the model.
PPP reference model	Life-cycle cost model of the same output specifications where the private sector takes substantial financing, construction and operating risk	Cost the achievement of the project's identified BEE outputs by calculating how the private sector would cost each of the BEE elements of a proposed <i>PPP BEE Balanced Scorecard for the project</i> in the PPP reference model.
Sensitivity analysis	To test the resilience of the models to changes in assumptions and risk over the project term	Test varying BEE targets for the project, their costs and their assumptions, to assess the impact on affordability and value for money.
Value-for-money test and making the procurement choice	To reach a justified conclusion analysing the outcomes of the modelling as to which procurement route is both affordable and will achieve optimal value for the Institution	Analyse which procurement route will best achieve the identified BEE outputs for the project.
<i>If a PPP is the procurement choice, finalise the optimal proposed BEE Balanced Scorecard for the project, with appropriate elements and targets.</i>		
Economic analysis	To establish the economic rationale for the project, where required	Identify the economic benefits and opportunity cost to BEE of a 'no-project' scenario.

In providing the BEE inputs for the Feasibility Study, the Institution should investigate and cost the following for each of the *PPP BEE Balanced Scorecard* elements:

PPP BEE element	Feasibility Study considerations
A: Private Party equity	<p>A: Assess realistic targets by establishing:</p> <ul style="list-style-type: none"> • Possible Black Equity participants • Extent, possible sources, and projected costs of Black Equity, impact of assumptions on affordability and value for money • Effect of phased increase in Black Equity on affordability and value for money • Effect on affordability and value for money of early cash flow to Black Shareholders • Impact of sectoral BEE charters. <p>B: Assess targets in a sectoral analysis of:</p> <ul style="list-style-type: none"> • Black management capacity • Black Women in management • Employment equity track record • Skills shortfalls, existing initiatives to address these, training opportunities • Sources and costs of possible support. <p>C: Assess realistic targets by establishing cost and risk implications of:</p> <ul style="list-style-type: none"> • Number and capacity of existing Black Enterprises in the relevant sectors • Employment equity track record of enterprises in the relevant sectors • Range of Black Enterprise SMMEs in the market for procurement opportunities, and nature, sources and cost of support they may need. <p>D: Cost all the local socio-economic targets and assess impact on project affordability, value for money and risk assumption.</p>
A1: Black Equity	
A2: Active Equity	
A3: Cost of Black Equity	
A4: Timing of project cash flows to Black Shareholders	
B: Private Party management and employment	
B1: Black Management Control	
B2: Black Women in Management Control	
B3: Employment Equity	
B4: Skills development	
C: Subcontracting	
C1: Capital expenditure cash flow to Black People and/or Black Enterprises	
C2: Operating expenditure cash flow to Black People and/or Black Enterprises	
C3: Black Management Control	
C4: Black Women in Management Control	
C5: Employment Equity	
C6: Skills development	
C7: Procurement to Black Enterprise SMMEs	
D: Local socio-economic impact	

The extent to which the Institution is able to produce a thorough and comprehensive Feasibility Study – resulting, *inter alia*, in the production of a proposed *PPP BEE Balanced Scorecard* appropriate for the project – will directly impact on its ability to produce sound bid documentation for a PPP, in which BEE targets are appropriately set for the maturity of the market in which the project takes place. Getting these targets right or wrong may significantly impact on the project’s affordability and value for money, and on the Private Party’s willingness to assume risk – and will certainly impact directly on the sustainability of BEE in the deal. The Feasibility Study phase is therefore crucial to ensuring a sound BEE outcome in a PPP.

Government is willing to pay a certain premium for its BEE targets to be met. This is a cost of essential economic transformation, which is well understood. But

a BEE premium is not prescribed for all PPPs. All cost items of a PPP, including any costs associated with meeting BEE targets, have affordability constraints to the Institution concerned, and have value-for-money and risk considerations. The BEE targets established in the Feasibility Study must therefore be justified by the Institution, in value-for-money terms, and risk must be properly allocated in the achievement of all PPP BEE outcomes. In addition, PPP competition will drive innovation by private sector bidders, from which the Institution can expect to receive the best possible costing for achieving its intended BEE targets.

3. PPP procurement¹⁹

The PPP procurement phase entails Treasury approvals: IIA, IIB, and III in terms of Treasury Regulation 16 to the PFMA. These three Treasury approvals will, respectively, entail careful scrutiny of the BEE components of the bid documentation, the BEE component of the preferred bid, and the BEE obligations contained in the final proposed terms of the PPP Agreement and in the Institution's plan for managing the PPP Agreement.

No bid documentation (RFQ, RFP, draft PPP Agreement, Best and Final Offer RFPs) may be issued to the market without Treasury Approval: IIA. Negotiations with the preferred bidder may not commence without Treasury Approval: IIB for a value-for-money report. Signature of the PPP Agreement may only take place after Treasury Approval: III.

Scrutiny of BEE terms during a PPP project's procurement phase will be benchmarked against:

- this *Code for BEE in PPPs*;
- *Standardised PPP Provisions*; and
- the *PPP BEE Balanced Scorecard for the project*.

The PPP project's BEE profile during the PPP procurement phase must be based on the *PPP BEE Balanced Scorecard for the project* developed during the Institution's Feasibility Study (as approved at Treasury Approval: I) and will be adapted and refined as the procurement process unfolds.

The Institution should, at the outset of the procurement phase, ensure that specified members of its project team (from the Institution and its Transaction Advisor) are dedicated to managing the BEE component of the procurement process throughout. This is essential to ensure that BEE elements are not lost and that the BEE policy objectives of government are not unduly compromised through poor attention to detail.

RFQ stage

The Request for Qualification (RFQ) stage is usually the first point at which there is formal project interaction with the market. It is imperative that all BEE elements and targets which the Institution intends for the project are communicated clearly

¹⁹. Refer to *National Treasury's PPP Manual: Module 5: PPP Procurement*.

with potential bidders at this early stage so that appropriate consortia can be formed and the necessary financing sourced. It is recommended that the proposed *PPP BEE Balanced Scorecard for the project*, developed during the Feasibility Study, be provided in the RFQ, allowing the bidding consortia to comment on the proposed BEE targets in their RFQ submissions. In some projects it may be appropriate to grow the BEE targets between the RFQ and RFP phases, but such an intention must be clearly communicated to bidders in the RFQ.

The RFQ stage requires that bidders submit a range of information about their consortia, enabling the Institution to select those that are indeed suitably qualified to prepare bids. A key element of this qualification will be whether or not a private consortium has the requisite BEE characteristics and commitment for the project. Realistic, minimum BEE qualification standards must therefore be given to bidders at the RFQ stage for the purposes of evaluating RFQ submissions.

In order to pre-qualify in the BEE component of the RFQ stage, bidding consortia should be required to demonstrate:

- that they have written commitments in place for the required targets of BEE participation in the Private Party and the Subcontracts, providing verifiable company information to substantiate BEE credentials;
- that they have the ability to secure the targets of Black Management Control required for the Private Party and the Subcontracts, attaching curriculum vitae of key personnel;
- that relevant members of the consortia have demonstrable track records in devising and implementing local socio-economic programmes as part of their operations;
- that the sponsor companies are compliant with the provisions of the Employment Equity Act, 1998, and can demonstrate their own track record in BEE.

Once consortia have been pre-qualified, they will need agreement from the Institution to change their consortia membership, and the qualifying BEE targets may not be compromised in any such change. Fronting of Black People and Black Enterprises will not be tolerated.

RFP stage

Pre-qualified bidders will, in many projects, be issued with a draft Request for Proposals (RFP), containing the further refined *PPP BEE Balanced Scorecard for the project*. This draft RFP facilitates detailed engagement with the pre-qualified parties to establish their feedback on the bid specifications and criteria. The BEE elements must be clearly presented, based on the outcome of the Feasibility Study and adapted from feedback obtained in the RFQ process. The BEE elements must also be reflected in the draft PPP Agreement, with contractual non-compliance linked to the project's penalty regime.

Comments received from pre-qualified parties on draft RFP documents must be assessed by the Institution and its Transaction Advisors, and a final RFP and draft PPP Agreement drafted and issued. The Institution must ensure in this process that the broad-based impact of its *PPP BEE Balanced Scorecard for the project* is

not compromised, and that it upholds its BEE policy intent throughout, based on the thorough assessment undertaken in the Feasibility Study phase. Where appropriate, certain targets can be phased in over the project term to accommodate start-up capabilities within certain sectors.

Each PPP project's BEE elements, minimum targets per element, bid evaluation points for each element, criteria for awarding points, the weightings to be given to each element, and an overall minimum threshold score of 50%, must all be set out unambiguously in the final RFP.

Bids received from the pre-qualified parties must contain dedicated sections setting out the bidder's detailed response as to how it will address each of the BEE elements of the project, and what targets it undertakes to meet over the project term.

In addition, the following components of the bid submissions must be clearly referenced by bidders in their BEE proposals, and closely examined and verified by the Institution for substantiation of all BEE commitments:

The **funding structure** and **financing arrangements** reflected in the **financial models** must show:

- sources or type of Black Equity (e.g. Black Enterprises' balance sheet funds, loans to Black Enterprises or Black Shareholders, equity funds including exit strategy, etc.);
- costs of Black Equity;
- timing on project cash flows to Black Shareholders; and
- operating costs for all skills development, employment equity and socio-economic programmes.

Shareholders' agreements and any third party agreements thereto must show:

- terms for Black Shareholders;
- sponsor support arrangements to Black Shareholders, if any; and
- commitments in respect of Black People in Management Control.

Subcontracts (first tier) must show:

- terms for Black Shareholders;
- Black People in Management Control;
- Black Women in Management Control;
- skills development and employment equity commitments for first-tier Subcontractors; and
- Procurement commitments to Black Enterprise SMMEs.

The **marked-up PPP Agreement** must be checked for:

- any proposed changes to standardised PPP BEE provisions²⁰; and
- draft schedules capturing all BEE commitments.

The BEE offer made by the bidder will be evaluated out of 100 points, according to the targets, criteria and weightings specified in the RFP. The technical and price elements are each also scored out of 100 points as specified in the RFP. The BEE

20. Refer to *National Treasury's Standardised PPP Provisions: First Issue: 11 March 2004: Part M: Black Economic Empowerment*.

score achieved (if it meets or betters the total 50% threshold) will be calculated into the bidder's overall score, using the following formula:

$$a * (\text{technical score}/100) + b * (\text{BEE score}/100) + c * (\text{price score}/100) = d$$

where:

a is the weighting for technical elements (between 50% and 70%)²¹

b is the weighting for BEE elements (10%)²²

c is the weighting for price (between 20% and 40%)²³, and

d is the total score achieved by the bidder.

Negotiations stage

The Institution's intention to commit the bidders contractually to the targets submitted by them in response to the RFP should be made clear throughout the procurement process. The negotiation and finalisation of the PPP Agreement must therefore ensure that this transpires. The Institution should specifically guard against claw-back during negotiations.

The PPP Agreement²⁴

Standardised PPP Provisions: Part M reflects this *Code for BEE in PPPs*, making provision for BEE in the PPP Agreement by, amongst others:

- itemising all **elements** of the *PPP BEE Balanced Scorecard* to be made contractually binding;
- providing schedules that commit the Private Party to its BEE **targets** for each element;
- establishing **performance monitoring** arrangements;
- specifying Private Party **reporting** requirements;
- setting up the **dispute resolution** system;
- establishing the **penalty regime** and providing for **empowerment penalties**; and
- setting up **termination** arrangements.

The Private Party is obliged in terms of the PPP Agreement to produce an annual BEE report containing details of its achievements in meeting all BEE targets agreed. Reviews – both regular and 'spot checks' – by the Institution are provided for. In addition, the PPP Agreement may provide for reviews by independent monitors.

21. The alternative technical and price weightings (together making up 90%) will vary from project to project, determined during the feasibility study and preparation of procurement documents. For further detailed guidance, refer to *National Treasury's PPP Manual: Module 5: PPP Procurement*.

22. 10% is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000.

23. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA. For further detailed guidance, refer to *National Treasury's PPP Manual: Module 5: PPP Procurement*.

24. Refer to *Standardised PPP Provisions: First Issue: 11 March 2004*.

Any proposed deviation from *Standardised PPP Provisions* requires specific justification by the Institution as part of its relevant Treasury Approval application. The Institution must obtain Treasury Approval: III for the final terms of the PPP Agreement for a project before signature.

4. Managing the PPP Agreement²⁵

Managing the PPP Agreement involves three main functions:

- Partnership management;
- Service delivery management; and
- Contract administration.

In each of these, the Institution and the Private Party need to establish systems for managing the BEE obligations in the project throughout the development and delivery phases of PPP implementation.

Reporting obligations are substantively on the Private Party for all its contractual commitments, including BEE. The Institution must, however, establish, in its service delivery management arrangements and contract administration system, the ability to check and verify such reporting, manage remedy periods that may be provided for, effect contractual penalties in relevant events of poor performance, and manage termination should this arise. In large projects, it may be necessary for the parties to establish a joint independent monitor specifically for BEE.

Above all, the quality of the PPP partnership management, and the parties' ability to identify impediments to BEE and to resolve disputes effectively, are paramount to the PPP's success, not least in respect of BEE. As a general guide, the penalty regime should be deployed only after genuine efforts have been made by the parties to address the impediments to compliance.

²⁵. Refer to *National Treasury's PPP Manual: Module 6: Managing the PPP Agreement*.

PART IV

The PPP BEE Balanced Scorecard

The *PPP BEE Balanced Scorecard* provides a quick-reference benchmark to measure the extent to which a PPP project – in any of its phases – is successfully achieving BEE in terms of this *Code for BEE in PPPs*.

The PPP BEE **elements** (A, B, C, D) and their sub-elements shown in column 1 in the table below should be reflected in all PPP Agreements as appropriate to the project. In making any adjustments to these, the broad-based BEE effect should not be compromised.

The indicative **targets** shown in column 2 are guidelines, and will need to be adjusted according to the outcomes of the PPP Feasibility Study and procurement process, as appropriate to each project. In making these decisions, the parties may also usefully agree that such BEE targets will grow over the project term.

The recommended PPP bid evaluation **weightings** shown in column 3 guide the Institution on a balanced allocation of points out of 100 for the BEE component of the whole bid evaluation.

A **minimum threshold of 50%** of the total possible 100 BEE points must be achieved for the bid to be evaluated further.

PPP BEE element	Indicative PPP project target	Recommended bid evaluation weighting
A: Private Party equity		20%
A1: Black Equity	40%	
A2: Active Equity	55% of A1	
A3: Cost of Black Equity	Value for money	
A4: Timing of project cash flows to Black Shareholders	Early and ongoing	
B: Private Party management and employment		15%
B1: Black Management Control	Commensurate with A1 and A2	
B2: Black Women in Management Control	15% of B1	
B3: Employment Equity	Compliant with law	
B4: Skills Development	1% of payroll	
C: Subcontracting		50%
C1: Capital expenditure cash flow to Black People and/or Black Enterprises	30%	
C2: Operating expenditure cash flow to Black People and/or Black Enterprises	30%	
C3: Black Management Control	25%	
C4: Black Women in Management Control	15% of C3	
C5: Employment Equity	Compliant with law	
C6: Skills development	1% of payroll	
C7: Procurement to Black Enterprise SMMEs	30%	
D: Local socio-economic impact	Sustainable, effective plan	15%

PART V

Government's further commitments to taking BEE in PPPs forward

In recognition of the current challenges to BEE in PPPs, and the positive BEE impact that PPPs can achieve, and complementary to the commitments of the *Financial Sector Charter*, government undertakes proactively to pursue the following initiatives:

- to establish a PPP BEE equity facility that lowers the cost of capital to Black Shareholders in PPPs;
- for such a facility to support independent financial and legal advice to Black Enterprises bidding for, negotiating and implementing PPP projects; and
- to establish an internship programme to grow the number of experienced Black Transaction Advisors in South Africa's PPP market.

Together with the strong BEE measures articulated in this *Code for BEE in PPPs*, the implementation of these three steps will establish PPPs as leading contributors to South Africa's BEE over the coming years.

**NATIONAL TREASURY
PPP MANUAL
MODULE 3: PPP INCEPTION**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 04 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 04 of 2004 'PPP Inception' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

16.3 Project inception

16.3.1 As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing –

- (a) register the PPP with the relevant treasury;*
- (b) inform the relevant treasury of the expertise within that institution to proceed with a PPP;*
- (c) appoint a project officer from within or outside the institution; and*
- (d) appoint a transaction advisor if the relevant treasury so requests.*



PPP unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes

Phase V

DELIVERY

- Report progress in the Annual Report

Phase VI

EXIT

- Scrutiny by the Auditor-General

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ABOUT THIS MODULE

Module 3: PPP Inception covers the four stages of the first phase (inception) of the PPP project cycle, and introduces National Treasury's Project Development Facility (PDF).

Stage 1: First steps

A critical part of the inception phase is the appointment of the project officer. Other key activities of the first stage are: a preliminary needs analysis, registration of the project with the relevant treasury, assessing budgets and sources of funding, and setting up the project team.

Stage 2: Attracting a transaction advisor

The bulk of the work of this stage is the defining of the terms of reference for the transaction advisor. In doing so, the institution must make a range of important decisions about the potential PPP project itself. The rest of this stage involves establishing the bid evaluation panel, preparing the bid package, advertising the transaction advisor position, and preliminary liaison with potential bidders.

Take note

1. In terms of the PFMA, institutions are required to maintain appropriate procurement systems which are fair, equitable, transparent, competitive and cost-effective. This module captures these requirements and has been developed from experience. It is recommended that the institution follows the specific steps elaborated here for hiring a PPP transaction advisor and makes use of the various templates provided as annexures.

The wrong choice of transaction advisor can easily kill a project.

2. *The Code of Good Practice for BEE in PPPs* provides the BEE framework to be adopted by institutions for the selection of PPP transaction advisors, and is elaborated here.

Stage 3: Receiving and evaluating transaction advisor bids

The module explains in detail how the bid evaluation process should proceed. The separation of the technical and BEE proposals from the price proposals is a crucial element here. The conduct of the bid evaluation panel is also discussed.

Stage 4: Finalising and signing the contract

This section sets out the formalities of the arrangement between the institution and the transaction advisor.

Applying for funding from the Project Development Facility

The Project Development Facility is a possible source of funding for transaction advisor costs. This section of the module explains the requirements for being eligible for this funding, and the terms and conditions.

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INTRODUCTION

The role of the accounting officer/authority in PPPs

The PFMA assigns significant responsibilities and accountability to accounting officers/authorities to manage the resources of institutions in the public interest and as mandated. This applies equally to any PPP project and is set out in detail in Treasury Regulation 16 to the PFMA.

In this inception phase of the PPP project cycle, the accounting officer/authority is responsible for:

- informing the relevant treasury of the institution's expertise to proceed with a PPP
- registering the project with the relevant treasury
- appointing a project officer
- appointing a transaction advisor.

In giving practical effect to these regulatory responsibilities, the accounting officer/authority will, in this phase, need to:

- provide strategic direction and vision to the PPP throughout the PPP project cycle, from this inception phase onwards, ensuring that the project's outcomes are consistent with the institution's mandate and strategy for service delivery and/or use of state property
- build and secure political support for the project
- ensure that senior management supports the project and builds other stakeholder support
- provide the project officer with suitable delegations and responsibility for project management, and include him/her in the senior management team of the institution
- allocate suitable project resources, including budgets and personnel, to the project officer.

As the PPP progresses, the accounting officer/authority will further be required to:

- receive regular, direct reports from the project officer and provide ongoing strategic direction
- as far as possible, resolve disputes that cannot be resolved at project level
- ensure smooth transitions between changing institutional personnel who may be responsible for the project at different times in the PPP project cycle
- represent the project publicly on behalf of the institution.

The accounting officer/authority's further regulatory responsibilities in PPPs are set out in the regulations, and include:

- obtaining treasury approvals
- representing the institution on behalf of government as signatory to the PPP agreement
- ensuring that the PPP agreement is properly enforced
- ensuring that the institutional function is effectively and efficiently performed in the public interest, and/or that state property is appropriately protected.

STAGE 1: FIRST STEPS

First steps

Part 1: Initial needs analysis

Part 2: Register with the relevant treasury

Part 3: Appoint the project officer

Part 4: Assess project budgets and consider PDF funding

Part 5: Set up the project team

Part 1: Initial needs analysis

It is important that the institution does an initial needs analysis and considers its options for meeting these needs within its mandate and strategy for delivery.

The full needs analysis and solution options analysis¹ will be done by the project officer and his or her team and the transaction advisor as part of the feasibility study. The work in the feasibility study phase must be based on the institution's preliminary assessment of its needs and options here.

Part 2: Register with the relevant treasury

When an institution decides to explore a PPP as a procurement choice for a project, and has done an initial needs assessment, the accounting officer/authority should call a meeting with the relevant treasury's PPP unit to discuss the possible project(s) and the existing resources (human and budgetary) available, and agree on how to approach the work that lies ahead.

What does National Treasury's PPP Unit do?

National Treasury has a dedicated PPP Unit which has the following core functions:

- provides quality technical assistance to institutions embarking on PPPs, throughout the PPP project cycle, to help them achieve a quality PPP project and comply with Treasury Regulation 16 to the PFMA
- recommends to National Treasury whether treasury approvals should be granted or declined
- develops and disseminates PPP policy, manuals, standardisation and sectoral toolkits
- disseminates accurate and up-to-date information on PPP projects
- builds PPP capacity
- builds confidence and integrity in South Africa's PPP market.

Upon future delegation of Treasury Regulation 16 approvals to provincial treasuries, the provincial treasuries will establish similar PPP units. *National Treasury's PPP Manual and Standardised PPP Provisions*, as updated by National Treasury from time to time, will continue to apply through the provincial treasuries to all PPPs undertaken in terms of the PFMA.

1. *Module 4: PPP Feasibility Study* deals with how to do a full needs analysis and solution options analysis in the feasibility study phase of the PPP project cycle.

Step 1: Meet with the PPP Unit

Questions the PPP Unit will ask

The following will be important considerations for the institution to determine how best to take the project forward:

- What work has the institution done to define its needs and assess its options for a solution?
- What budget does the institution have (a) for meeting these needs, and (b) for financing project development costs, including the cost of a project officer, project management and administration, and hiring a transaction advisor?
- Have any consultants been hired already for the project? If so, what is their brief, and on what terms?
- Is an application to the PDF for funding appropriate?
- Is there an internal senior manager who is suitably skilled and experienced to be appointed as full-time project officer?
- Is the accounting officer/authority willing and able to assign delegations, budgets and administrative support to the project officer, and include him or her in the senior management team of the institution?
- Is a single project envisaged, or are there a number of them?
- Can a number of projects either be bundled into a single project or developed simultaneously in the PPP project cycle to optimise use of project development resources?
- What is the institution's envisaged timeframe for the project?
- Has the accounting officer/authority obtained the support of the relevant Minister or MEC for the project?

Step 2: Register the project

The accounting officer/authority submits a letter to the relevant treasury, requesting registration of the project in terms of Treasury Regulation 16 to the PFMA.

The relevant treasury will, in writing:

- confirm registration of the project, assign a project number, and enter the project on the official database of PPP projects,² in which the progress of the project will be tracked and updated throughout the PPP project cycle
- confirm its request to the institution to appoint a transaction advisor
- assign a PPP Unit project advisor.

2. This database is maintained by National Treasury's PPP Unit. It can be viewed on www.treasury.gov.za.

The PPP Unit's project advisor

The PPP Unit of the relevant treasury will assign a project advisor to every PPP project registered in terms of Treasury Regulation 16.

The project advisor provides hands-on technical assistance from the date of registration to the signing of the PPP agreement, and in the development and delivery phases of the project term.

The PPP Unit's project advisor

- supports the institution through every step of the PPP project cycle, drawing on best practice from other projects, and advising on how the institution can best meet the requirements of Treasury Regulation 16
- recommends an institution's application to the PDF, if applicable
- ensures that treasury approval applications are processed efficiently within the relevant treasury
- recommends to the relevant senior official of the relevant treasury whether the institution's applications for treasury approvals should be approved or declined
- ensures that communication between the relevant treasury and the institution is managed professionally at all times.

The project advisor's first tasks will be to assist the project officer to:

- establish a project team
- draft the terms of reference for the transaction advisor
- calculate a suitable budget for the costs of the transaction advisor
- make an application to the PDF, if applicable
- procure the services of the transaction advisor.

Part 3: Appoint the project officer

Extract from Treasury Regulation 16 to the PFMA

16.1 Definitions

“project officer” means a person identified by the accounting officer or accounting authority of an institution, who is capable and appropriately qualified to manage a PPP to which that institution is party from its inception to its expiration or termination.

What does the project officer do?

The project officer is responsible for making the project work for the institution, on time, on budget and to the standards set by National Treasury. All the institutional tasks and obligations detailed in Treasury Regulation 16, *National Treasury's PPP Manual* and *Standardised PPP Provisions* are placed on the desk of the project officer. In effect, the content of these substantial documents constitutes the project officer's job.

The project officer's roles and responsibilities span the whole PPP project cycle.

The project officer's is a full-time project management job, requiring a suitable term contract. The intention should be that the project manager is hired to manage the project from inception, through the feasibility study phase, the procurement phase, and into at least the development phase and the first years of the delivery phase, when he or she will be primarily concerned with PPP agreement management functions.

Broadly, the project officer will:

- manage the planning, procurement and implementation of the PPP project on behalf of the institution, exercising delegated authority
- carry out all functions of the inception phase, including the appointment of the transaction advisor
- direct and manage the work of the transaction advisor and approve payments in terms of the contract at every phase of project preparation
- manage the PPP agreement for the project term,³ representing the institution.

What competencies does the project officer need?

Fulfilling these diverse, complex and important functions effectively requires a range of personal and technical skills. Figure 3.1 provides a competency model for a project officer. The model is grouped into three main clusters – self, task and people.

Competencies are attributed to each cluster, and for each competency a number of key indicators is provided. While the model presents a somewhat idealised 'Renaissance human', its aim is to illustrate the wide range of attributes required in a project officer.

Institutions can use it as:

- a recruitment and selection tool
- an assessment tool for performance appraisals
- a development tool when the project officer is looking to keep his or her expertise aligned with the evolving requirements of the job.

3. See *Module 6: Managing the PPP Agreement*, for a detailed description of the project officer's PPP agreement management functions throughout the PPP project cycle.

Figure 3.1 Competency model for a PPP project officer

Competency cluster	Competencies	Indicators
Self	Applies professional expertise and experience	PPP knowledge and experience, from the public or the private sector Comparable project experience Relevant knowledge and skill in law, finance, public administration and document management
	Develops self and others	PPP knowledge Personal development Team development Career development of self and others
	Is resilient and motivates	Determination Self-motivation Motivation of others
Task	Implements strategy	Strategy development Strategy implementation Strategy communication
	Solves problems	Problem solving Creative thinking Decision making
	Achieves results	Project management Resource management Quality management Risk management Managing ongoing change Variation management Knowledge management Monitoring
People	Builds relationships, communicates and negotiates Leads and manages team	Partnership and relationship management Communication PPP negotiation Leadership and management Delegation

Source: Adapted from UK Office of Government Commerce, *A Competence Framework for Creating Effective PFI Projects*, 2000.

The project officer is the institution’s anchor and champion for a PPP project.

If the project officer is incompetent, lazy or unreliable, the project is bound to fail. He or she must be unquestionably honest and committed to achieving best value in the public interest. The job needs the kind of person who is prepared to live the project. It requires a passionate driver, committed to achieving an optimal project outcome, and with the skills to match. The project officer will be required to act and make decisions with the utmost integrity at all times, and to protect the institution’s interests and those of the public.

Where does the project officer fit in the institution?

The project officer should be given suitable, legally sound delegations by the accounting officer/authority for the central, driving role he or she has to play. The project officer should therefore be or become a member of the institution’s senior

management team in order to ensure thorough institutional buy-in and management's contribution to key project decisions. He or she should have the full trust of the accounting officer/authority, who will depend on the project officer to deliver the best possible project for the institution.

Formalise the project officer's appointment

The project officer may be appointed from within or outside the institution, depending on the institution's own capacity and resources. In either case, the institution is advised to enter into a contract with the project officer. (See 'Annexure 1: Template project officer duties and responsibilities.')

The contract should clearly identify the measurable outputs of the job, and provide that the project officer's services can be terminated by the institution if he or she fails to deliver as agreed, or if he or she is found to be corrupt.

Part 4: Assess project budgets and consider PDF funding

Step 1: Identify budgets

An early task for the project officer is to identify the budgets needed to manage and administer the project and to hire the services of a transaction advisor. This will entail identifying budgets in the 'professional and special services' line items of the institution's Medium-Term Expenditure Framework (MTEF) budgets that may be used, and ensuring that such budgets are built into the next available budget cycle.

Step 2: Consider PDF funding

In addition, the project officer should assess the likelihood of needing to apply for PDF funding, whether the project would fit the PDF criteria, and at what stage in project preparation the institution would be best placed to submit an application for PDF funding. (See the final section of this module, which deals with the PDF in detail, including how to apply for funding.)

Part 5: Set up the project team

Step 1: Appoint the project secretariat

The project officer will need back-up from a meticulous, efficient and reliable secretariat.

The project officer should thus be appropriately resourced with administrative support and a suitable operating budget.

The primary function of the project secretariat

The secretariat's primary role will be to ensure scrupulous document management and meetings administration throughout the PPP project cycle.

Well-kept project records are vital, enabling an institution to:

- compile its annual reports as required by the PFMA
- supply the Auditor-General with the legally required documentation at any time⁴
- produce, at any time, accurate project information in terms of the Promotion of Access to Information Act, 2000
- make decisions quickly and compile PPP procurement documentation accurately and efficiently, based on preceding project decisions
- give quick and accurate briefings to the institution's accounting officer/authority and senior management
- devise and implement an effective project communication strategy for engaging with key stakeholders throughout the project cycle.

Step 2: Appoint the PPP project team

The institution will require a strong team to lead and monitor the project from the start. This team should be chaired by the project officer and comprise the officials who can provide both strategic and technical support to the project officer. The project officer's secretariat should also be the secretariat of the project team.

What does the project team do?

- provides strategic direction and ensures management and political buy-in in all the project cycle phases
- oversees project development budgets and expenditure
- ensures that the progress of the project is effectively communicated within the institution and to the public where required
- approves the deliverables of the transaction advisor
- reviews and endorses documentation to be submitted to the accounting officer/authority for the applications for the treasury approvals.

The transaction advisor and the relevant treasury's PPP Unit's project advisor should participate actively in the regular meetings of the project team. For day-to-day project management, the project officer will need to set up structured working arrangements with the transaction advisor and the project advisor.

Take note

The project officer and the project secretariat are strongly advised to set up the PPP project management systems in consultation with the institution's internal audit⁵ unit to ensure appropriate compliance with the institution's risk management, internal controls, and governance standards.

4. See *Module 7: Auditing PPPs*.

5. See *Module 7: Auditing PPPs*.

STAGE 2: ATTRACTING THE TRANSACTION ADVISOR

Introduction

At PPP project inception, Treasury Regulation 16.3.1(d) requires that the accounting officer/authority, 'must appoint a transaction advisor, if the relevant treasury so requests'.

What is a transaction advisor?

Extract from Treasury Regulation 16 to the PFMA

16.1 Definitions

"transaction advisor" means a person or persons appointed in writing by an accounting officer or accounting authority of an institution, who has or have appropriate skills and experience to assist and advise the institution in connection with a PPP, including the preparation and conclusion of a PPP agreement.

The transaction advisor is typically a consortium of professional consultants, from one or more firms, who work collectively as a team. The transaction advisor contracts with the institution through the lead firm. All other members of the consortium participate either through subcontracts with the lead firm or via a joint venture arrangement.

What does the transaction advisor do?

The transaction advisor does all the detailed financial, technical, BEE and legal work required to prepare the institution for a PPP agreement. In Phase II: PPP feasibility study, the transaction advisor will complete a feasibility study to a standard that will enable the institution to obtain Treasury Approval: I (TA:I) if required. In Phase III: PPP procurement, the transaction advisor will prepare for and implement the PPP procurement process, including preparing all necessary documentation to enable the institution to obtain treasury approvals IIA (TA:II), IIB (TA:IIB) and III (TA:III), and complete a close-out report and case study.

The transaction advisor may also be required to provide PPP agreement management support to the institution after signature of the PPP agreement, particularly in the development phase and the early years of the delivery phase.

What skills and experience are required?

The professional skills and experience of the transaction advisor are typically in: project finance, contract and administrative law, insurance, PPP procurement management, project management, BEE, and in all technical disciplines relevant to the particular project sector (for example, facilities management, IT, security, transport, tourism). The transaction advisor has to be sufficiently competent to cost-effectively complete the work necessary for the institution to meet the stringent requirements of each treasury approval, up to and including financial closure at the end of the procurement phase.

Advantages of using a transaction advisor

Good transaction advisors bring clear advantages to the institution:

- experience in similar transactions
- protection against very costly, avoidable mistakes
- access to national and international best practice
- technical strength to the institution's team
- enhancement of investor confidence

- an opportunity for skills development among government officials
- a single point of accountability for getting the job done well and on time
- an opportunity to grow the number of black consultants in the South African PPP market.

Managing the transaction advisor

Getting maximum benefit from a transaction advisor requires good management and effective leadership and oversight by the institution – from defining the transaction advisor's tasks, to choosing the transaction advisor, and throughout their engagement with the institution. Without this, the transaction advisor's work can be misdirected, misunderstood, and may even amount to fruitless expenditure by the institution.

The project officer and the project team play a pivotal role in managing the transaction advisor. The transaction advisor should be managed on a day-to-day basis by the project officer, and will play the key technical roles in the work of the project team.

Getting value for money from the transaction advisor

The PPP transaction advisor should be viewed as an investment and not simply as an expense, and as key to assisting the institution to secure the best PPP deal possible.

The institution should therefore balance its need to obtain top quality technical assistance with its need to keep the overhead costs of preparing the PPP in check. The aim is to get optimal value for money from the transaction advisor.

This involves some important prerequisites:

- The accounting officer/authority should mandate the project officer to manage the work of the transaction advisor directly, take certain binding project decisions, and drive the project on a day-to-day basis on behalf of the institution.
- The transaction advisor should be hired at the start of the PPP project cycle and retained either until after the signing of the PPP agreement at the end of the procurement phase, or, in some instances, until after PPP agreement management systems have been bedded down in the development phase of the project term.
- The terms of reference for the transaction advisor should be precise and focused on clear deliverables.
- In line with government's constitutional mandate for the hiring of services, the procurement of the transaction advisor must be fair, equitable, transparent, competitive and cost-effective.
- There should be one lead advisor in the transaction advisor, who is responsible for managing the deliverables of each member of the consortium and who reports daily to the project officer.
- Avoid separately retaining or subsequently hiring additional consultants for the project outside of the transaction advisor. This can create conflicting work streams and accountability, and may be detrimental to both the quality and timing of the project.
- If there are already consultants working for the institution on the project before its registration with the relevant treasury as a potential PPP, consider either bringing these contracts to closure before advertising for the transaction advisor or transferring these services to the management of the transaction advisor in a manner clearly articulated during the procurement of the transaction advisor.
- The terms of the contract between the institution and the transaction advisor should incentivise quality completion of milestones according to the PPP project cycle, on time and within the budget.
- The project team should meet regularly with the transaction advisor to receive progress updates, provide project direction, resolve impasses, and ensure ongoing institutional input and support.

Attracting a transaction advisor

Part 1: Establish the bid evaluation panel and the bid secretariat

Part 2: Define the transaction advisor terms of reference

Part 3: Prepare the rest of the bid package

Part 4: Publish the advertisement, brief bidders, and respond to queries

Part 1: Establish the bid evaluation panel and bid secretariat

Step 1: The bid evaluation panel

By choosing the transaction advisor, the bid evaluation panel plays a key role in ensuring the success of the PPP.

The bid evaluation panel should be made up largely of the same people who constitute the project team. The relevant treasury's PPP Unit's project advisor should be appointed as a voting member of the bid evaluation panel.

The project officer should establish the bid evaluation panel early, so that its members can become familiar with the project itself, the transaction advisor's terms of reference and the bid evaluation criteria.

Step 2: The bid secretariat

The person or people who comprise the bid secretariat should be drawn from the institution's tendering component and should assist the project officer to prepare the bid package.

The bid secretariat ensures that the rules of bidding are strictly adhered to.

The bid secretariat plays a key role by:

- preparing the required documentation for the bid evaluation panel
- administering and recording the receiving of the bids
- preparing the scoring sheets for each bid and the spreadsheets for compiling the scores, consistent with the bid package
- organising the venue and all logistical matters for the bid evaluation and ensuring that all bid documents are delivered securely to and from the venue
- collating the scores
- setting up the interviews with short-listed bidders and recording the proceedings.

(See Stage 3 for details of the role and functions of the bid secretariat in the bidding process and the evaluation of bids.)

Part 2: Define the transaction advisor terms of reference

The purpose of the terms of reference is to give the bidding transaction advisors clear direction about what the institution wants and expects.

The institution's terms of reference together with the selected transaction advisor's proposal will be consolidated into the deliverables schedule of the transaction advisor contract, so it is important for the institution to get the terms

of reference right from the start. The project advisor from the relevant treasury's PPP Unit will provide hands-on assistance to the project officer with drafting this document. The better the information made available to bidders, the higher the quality of the bids will be in technical and BEE solutions and pricing. The more precise the terms, the firmer the project's footing will be when it goes forward.

The terms of reference will vary in content from project to project and sector to sector.

The steps below outline what to do for each part of the terms of reference. (See 'Annexure 2: Template transaction advisor terms of reference', which can be adapted in consultation with the PPP Unit of the relevant treasury.)

Contents of the transaction advisor terms of reference

1. Introduction

2. Scope of work

- 2.1 Part 1: Feasibility study
- 2.2 Part 2: PPP procurement

3. Background

- 3.1 Mandate
- 3.2 Needs
- 3.3 Objectives
- 3.4 Background documentation and preparatory work
- 3.5 Project budget

4. PPP feasibility study deliverables

- 4.1 Components of the feasibility study
- 4.2 Presentation of the feasibility study
- 4.3 Submission requirements for the feasibility study report and request for TA:I

5. PPP procurement deliverables (if applicable)

- 5.1 TA:IIA and administration of the bidding process
- 5.2 Evaluation of bids, demonstrating value for money and TAI:B
- 5.3 PPP agreement negotiations, PPP agreement management plan and TA:III
- 5.4 PPP agreement signature, close-out report and case study, and financial closure

6. Transaction advisor skill, experience, remuneration and management by the institution

- 6.1 Necessary transaction advisor skills and experience
- 6.2 Remuneration schedule and disbursement arrangements
- 6.3 Management of transaction advisor by the institution

7. Rules of bidding, bid submission requirements and bid evaluation

- 7.1 Rules of bidding
- 7.2 Bid submission requirements
- 7.3 Bid evaluation criteria
- 7.4 Bid evaluation
- 7.5 Compulsory briefing session
- 7.6 Address and deadline for submission of bids

Appendix A: Background and supporting documentation

Appendix B: Draft transaction advisor contract

Step 1: Introduction

Briefly describe the project and its objectives, and how these align with the institution's strategic vision.

Introduce the terms of reference.

Step 2: Scope of work

Outline the scope of the two parts of the work of the transaction advisor:

- feasibility study for the project
- procurement of the PPP (if applicable).

Step 3: Background

Introduce the project as comprehensively as possible:

- 3.1 The institutional mandate to proceed with the project
- 3.2. The institutional needs that led to the project
- 3.3 The objectives of the project
- 3.4 Background documentation and preparatory work: Explain and attach as 'Appendix A: Background and supporting documentation' to the terms of reference all non-confidential preliminary work which the institution has already done. Describe the challenges which the institution faces in pursuing the project, and the legal and policy framework for the project.
- 3.5 The budget for the project.

Step 4: PPP feasibility study deliverables

Set out the deliverables for the feasibility study as follows:

- 4.1 Components of the feasibility study
- 4.2 Presentation of the feasibility study
- 4.3 Submission requirements for the feasibility study report and request for TA:I.

Step 5: PPP procurement deliverables

Set out the procurement deliverables as follows:

5.1 Treasury Approval: IIA and administration of the bidding process

- 5.1.1 Pre-qualification
- 5.1.2 Payment mechanism
- 5.1.3 Bid evaluation criteria, bid process design, and BEE requirements
- 5.1.4 Request for proposals (RFP)
- 5.1.5 A draft PPP agreement
- 5.1.6 Treasury Approval: IIA
- 5.1.7 Administration of the bidding process

5.2 Evaluation of bids, demonstrating value for money, and TA:IIB

- 5.2.1 Evaluation of bids
- 5.2.2 The value-for-money report and TA:IIB

5.3 PPP agreement negotiations, PPP agreement management plans and TA:III

5.4 PPP agreement signature, close-out report and case study, and financial closure

Step 6: Required transaction advisor skills and experience, remuneration, and management by the institution

6.1 Skills and experience

- Emphasise that the individuals named in the bid are expected to be properly available and committed to the project, and that the lead transaction advisor will be held accountable for the team and the deliverables.
- List the full range of skills and experience the institution is seeking.

6.2 Budget, remuneration system and schedule, and disbursement arrangements

6.2.1 Budget for the transaction advisor's professional fees

The institution may or may not declare the fees budget.

Now is the time to cost the transaction advisor's fees

While the institution should reserve a budget for the transaction advisor during Stage 1, Part 4 of inception, the real extent of the work will only become evident during this preparation of the terms of reference. The project officer should therefore carefully cost the transaction advisor fees at this stage, referring to current market rates and to contracts for similar, recent projects. Having estimated the probable costs, the institution must then decide whether or not to declare the budget limit in the terms of reference.

If the institution is unable to secure all the necessary funds from its base-line budget for the costs of the transaction advisor, application can be made to National Treasury's Project Development Facility (PDF), established to provide such support. See the final section of this module for details of the PDF and the application procedures.

How to decide whether to declare the fees budget or not

Institutions will need to be familiar with the bid evaluation process to be able to fully understand what lies behind this decision and its implications. Please read Step 7 and Stage 3 before proceeding.

If the fees budget is declared, the institution is consciously focusing its bid evaluation selection on the quality of service it can get for the budget it has. If the bidders deem the budget to be reasonable or generous, they are likely to bid their price at the specified budget. If they deem the budget to be too small, they will either not bid or they will bid at a higher price in the hope that the institution will reconsider. In this instance, bid evaluation must rest heavily on the technical and BEE components of the bids, and the weighting of the points for these two components should be adjusted accordingly. The two-envelope system enables technically weak bids to be eliminated before any of the price bids are considered. (See Step 7.)

If the fees budget is not declared bids are likely to come in at a wide range of prices, and the cheap bids are likely to be technically weak. In this instance, the bid evaluation system must place a heavier weighting on the price component (although never more than on the technical). The two-envelope system must be applied, otherwise the

institution may be tempted to choose the cheapest, technically weakest bid, which would undoubtedly result in a failed project.

While the two-envelope system will push selection of the strongest technical and BEE bids, with reasonable competition for lower price, the institution always runs the risk, when not declaring the budget, of facing a price for the job which it may not be able to afford. It may be possible to negotiate for a portion of the above-budget price to be paid as a success fee as an initial cost to the PPP project itself, but this is not a solution that can always be relied upon, particularly for small- or medium-value PPPs where project cash flows and affordability levels are likely to be constrained.

If the institution is realistically able to cost the transaction advisor's work, it is National Treasury's preference that the transaction advisor's fees budget is declared in the terms of reference.

Figure 3:2 Recommended weighting for bid evaluation elements

Evaluation element	Weighting if fees budget declared	Weighting if fees budget not declared
Technical	70 (with a threshold of 65%)	50 (with a threshold of 65%)
BEE	10 (with a threshold of 60%)	10 (with a threshold of 60%)
Price	20	40

6.2.2 Remuneration system and schedule

Transaction advisors should be paid a fixed price for identified deliverables within the feasibility study and procurement phases (not by hourly rates), and their bids structured accordingly.

Professional fees should be paid in the form of retainer fees (for identified deliverables at milestones in the PPP project cycle) and a success fee (upon financial closure of the PPP, and upon completion of the close-out report and case study). Retainer fees should be payable, for example, on completion of the feasibility study to the satisfaction of the institution. This retainer should not be linked to the attainment of TA:I, but rather to a decision in respect of TA:I. This is because the institution may decide, based on the feasibility study, not to proceed with a PPP, or the relevant treasury may have reason to refuse the approval – and such decisions may not reflect on the quality of the transaction advisor's work, but on unsuitable conditions which the study exposes.

The purpose of the fixed fee payment structure is to incentivise delivery at each key stage of the PPP project cycle, and to incentivise the drive to close the PPP agreement.

Calculate success fees at about 10 per cent of the cost of procurement phase fees, depending on the size of the transaction. Specify the terms of the success fee to enable the institution to deduct from the success fee if significant delays can be directly linked to the work of the transaction advisor.

For cash-flow reasons, transaction advisors will seek to be paid upfront as far as possible. But it is in government's interests to link payments to outputs delivered to requisite standards. The terms of reference should therefore establish a remuneration schedule that both reflects the real costs of expected inputs (in this case, professional time) and links the payments to definite outputs, while leveraging an incentivising percentage for payment at final delivery.

6.2.3 Disbursement arrangements

There are two options here:

- **Option 1: Actual costs with a ceiling**

Out-of-pocket expenses, such as travel and materials, can be payable by the institution as a reimbursement of actual overhead costs, pre-approved, with supporting invoices, and within agreed budgetary limits. Either set a ceiling on these costs in the terms of reference, or ask the transaction advisors to bid a ceiling in their proposals. The amount does not form part of the bid evaluation criteria, but a ceiling for each part of the work should become part of the contract. The ceiling incentivises the transaction advisor to manage these costs wisely, and enables the institution to budget properly. To keep tight control throughout the contract, these expenses will need to be pre-approved by the project officer in writing (via a simple but recordable email system), on each occasion, before they are incurred. The template in the annexure to this module uses this option.

Take note

The PDF will not be able to fund disbursement costs that have not been fixed, as in this option. Thus, if project development costs are to be funded in part by the PDF, the institution will have to carry variable disbursement costs as part of its own budget during the procurement phase.

- **Option 2: Fixed costs**

Specify that transaction advisors must bid disbursements as part of the total fixed fee. This means that they will have to make a calculation of their anticipated overhead expenditure. The likelihood is that they will calculate high to cover unexpected costs, which could have value-for-money implications for the institution.

The upside for the institution in this option is two-fold: firstly, it does not have to administer disbursement approvals on a day-to-day basis, and secondly, if it is able to obtain PDF support, the PDF will pick up the fixed disbursement sum as part of the overall fixed cost during the procurement phase.

6.3 Management of the transaction advisor by the institution

Set out the appointment, reporting and decision-making arrangements under which the transaction advisor will be required to work, the roles and responsibilities of the project team, and the project officer's contact details.

Step 7: Rules of bidding, bid submission requirements and bid evaluation

The details of the bidding and bid evaluation process are covered in Stage 3. This part of the module is limited to the information that institutions must include in the transaction advisor's terms of reference. Readers may want to familiarise themselves with the bid evaluation process first, then come back to preparing the terms of reference.

7.1 Rules of bidding

Set out all rules and procedures of the transaction advisor bid process.

Take note

Care must be taken to ensure that there is no inconsistency between the rules of bidding and the bid submission requirements set out in the terms of reference, and those that may be issued from time to time by tendering components within institutions and provinces. To avoid confusion and contradictory instructions to bidders, the institution must not attach extra or pro forma tender instructions to the bid package. If these kinds of instructions are important for all institutional tenders, they should be incorporated into the relevant components of the bid package. Any tender instructions that could obstruct receiving and evaluating transaction advisor bids as set out in this module must be resolved between the relevant tender component(s) of the institution and/or province and the relevant treasury's PPP Unit before the advertisement is published.

7.2 Bid submission requirements

Explain the two-envelope system (See 7.3 below) and set out exactly what must be submitted in each envelope, and the format to be followed.

7.3 Bid evaluation criteria

Set out the criteria and minimum thresholds against which the institution will evaluate the transaction advisor bids, and give the weightings by which they will be scored.

Clear measures by which the scoring of bids will be done must be specified for each element in scorecards for the technical and BEE components.

The two-envelope system

It is strongly recommended that a two-envelope system for the evaluation of bids be used, and that threshold scores be set for the technical and BEE elements. Only those bids that meet or better the technical and BEE thresholds should have their price envelopes opened.

The technical element

The technical element is key simply because, unless the team is excellent, it is not worth having. There are also numerous components of the technical element that need to be evaluated and scored.

The BEE element

The transaction advisory work in a PPP provides an excellent opportunity for black professionals to develop specialist skills in this growing market, and for black firms to benefit and grow. If the bid passes the technical threshold, but fails to pass the BEE threshold, it should not be considered further. *The Code of Good Practice for BEE in PPPs*, presented as Module 2 of this manual, sets out government's BEE policy on hiring transaction advisors.

The price element

This is specifically weighted to reflect whether the fees budget is declared or not.

Bid evaluation weighting, minimum thresholds and formula to be applied

In compliance with the Preferential Procurement Policy Framework Act, 2000 (PPFA), the BEE component of a Transaction Advisor bid will constitute 10% of the bid evaluation weighting, with the price and technical elements constituting the remaining 90%. A minimum threshold of 60% of the total BEE points will be set and a minimum threshold of 65% of the total technical points will be set. The technical, BEE and price elements are each scored out of 100 points, and the scores achieved (if they meet the thresholds), calculated into the bidder's overall score using the following formula:

$$a * (\text{technical score}/100) + b * (\text{BEE score}/100) + c * (\text{price score}/100) = d$$

where:

a is the weighting for technical (either 50% or 70%)

b is the weighting for BEE (10%)⁶

c is the weighting for price (either 20% or 40%)⁷, and

d is the total score achieved by the bidder.

The alternative technical and price weightings (together making up 90%) vary depending on whether the fees budget is declared or not declared by the institution.

Evaluation element	Weighting if fees budget declared	Weighting if fees budget not declared
Technical	70 (with a threshold of 65%)	50 (with a threshold of 65%)
BEE	10 (with a threshold of 60%)	10 (with a threshold of 60%)
Price	20	40

7.4 Bid evaluation

Explain how the bids will be evaluated.

7.5 Compulsory briefing session

Explain the purpose of the briefing session.

Give the date, time and place.

Provide contact details for bidders to confirm their attendance.

7.6 Address and deadline for submission of bids

Give instructions on how the bids must be packaged.

Provide the physical address and the deadline for submitting bids.

Part 3: Prepare the rest of the bid package

The project officer should prepare the transaction advisor bid package with the hands-on assistance of the PPP Unit's project advisor. The bid secretariat – drawn from the tendering component of the institution – should also assist.

6. 10% is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000.

7. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA.

The completed bid package must be endorsed by the institution, in accordance with its internal procurement system, before it is issued.

What goes into the transaction advisor bid package?

- Advertisement calling for transaction advisors
- Letter of invitation
- Terms of reference
- Background and supporting documentation
- Draft contract

Prepare the bid package in the following order

Part 1: Define the terms of reference (above)

Part 2: Prepare the rest of the bid package

- Step 1: Background and supporting documentation
- Step 2: Draft transaction advisor contract
- Step 3: Advertisement
- Step 4: Letter of invitation
- Step 5: Get endorsement

Step 1: Background and supporting documentation

The project officer must collate all non-confidential project information that will be useful to potential transaction advisors in preparing and costing their bids, and attach it as Appendix A to the terms of reference, or provide a list of this documentation and refer potential bidders to the data room.

This background and supporting documentation will:

- enable transaction advisors to calculate the time they need for all possible elements of the project
- enable transaction advisors to avoid costing work that has already been done
- better inform them of what remains to be done and of the institution's mandate
- contribute to the value that the institution is able to get from the transaction advisor.

Background and supporting documentation should include:

- the initial needs assessment
- project objectives
- the institution's management of the project
- copies of relevant government policy and regulations
- any preliminary costing, budgeting, legal and/or technical due diligence
- any preparatory studies that may have been done.

If appropriate, the institution may open a data room of background and supporting documentation, giving bidders the opportunity to read and photocopy information in preparation for their bids. Such a data room must be open and supervised by the institution at specified times each day, from the date the advertisement is published to a few days before the closing date.

Step 2: Draft transaction advisor contract

To clearly inform bidders of the contractual terms under which the transaction advisor is to be hired, attach a draft contract to the terms of reference. Bidders should be required to mark up this contract and submit it as part of their bids. (See 'Annexure 3: Template draft transaction advisor contract', which can be adapted in consultation with the relevant treasury.)

Step 3: Advertisement

The advertisement should be concise but informative. (See 'Annexure 4: Template transaction advisor advertisement', which the institution can adapt in consultation with the relevant treasury.)

Bid submission deadline

Allow potential transaction advisors at least four weeks to prepare their bids by placing the advertisement at least four weeks before the bid submission deadline. They need enough time to become familiar with the project, construct a consortium of professionals (usually from different firms), and cost the project as accurately as possible.

Briefing session

Set the briefing session for approximately halfway through the bid preparation period. This allows the potential transaction advisors some time to consider which elements of the project they need clarification on in order to complete their bids.

Step 4: Letter of invitation

The project officer must prepare a brief but informative covering letter for the bid package, addressed to all potential transaction advisors who collect it. It should be signed by the accounting officer/authority of the institution.

Step 5: Institutional endorsement

Before being issued publicly, the transaction advisor bid package must be reviewed, changed, and/or expanded upon, and then finally endorsed by:

- the project team
- the tendering component (of the institution and/or the province as the case may be) from which the bid secretariat should be drawn
- senior management, either individually or in committee
- the accounting officer/authority.

PPP projects – in both their preparation and implementation – entail the co-operation and involvement of all components of the institution to one degree or another. The endorsement of the transaction advisor bid package will ensure that internal or regulatory systems or requirements have been taken care of, and that senior management is fully briefed on and supportive of the work that is about to begin.

Part 4: Publish the advertisement, brief bidders and respond to queries

Step 1: Advertise

Before publishing the advertisement, ensure that the transaction advisor bid package is complete and ready for distribution, both electronically and for physical collection.

To alert the top PPP advisory firms to the project, the advertisement should be placed:

- in the *Government Tender Bulletin*
- in prominent newspapers and/or journals
- on the institution's website
- on National Treasury's PPP website.

Take note

1. The transaction advisor bid package must be available electronically from the project officer and/or must be easily downloadable from the institution's website. There should be no passwords or website registration requirements, for example, and documents should be in common formats and programmes. While hard copies must be available for collection at the institution's offices, this must not be the only way for potential transaction advisors to get copies.
2. Institutions can place their PPP advertisements on National Treasury's PPP Unit's website at no charge. PPP transaction advisors and investors watch this website closely, so it is an effective way to reach them. Contact National Treasury's PPP Unit's website administrator for advertisement submission requirements (www.treasury.gov.za).

Where warranted, an institution may choose to advertise internationally as well. To attract the required levels of PPP expertise and experience, it would seldom be advisable to advertise only provincially.

Step 2: Conduct the briefing session

Attendance at the briefing session should be compulsory for any transaction advisor intending to submit a bid, and should be attended by the bid evaluation panel.

The briefing session is an opportunity for:

The institution

- to introduce the project to potential transaction advisors in person, highlighting key issues and challenges, and briefing them on the most important elements of the bid package
- to demonstrate the competence and commitment of the institution, its project team and the project officer in particular.

The project officer

- to answer any substantive queries that may have been received since the advertisement was published.

Potential transaction advisors

- to meet the key institutional managers and ask questions
- to know who else is bidding for the job – this both to stimulate competitive bidding and to present opportunities for the formation of consortia.

The bid evaluation secretariat

- to register all potential transaction advisors for the project and their contact details so that all subsequent queries received by the project officer can be answered in writing and copies sent to all parties
- to record questions and answers for distribution after the session.

The briefing session should consist of:

- an opening presentation by the project officer and the members of the project team
- a question and answer session.

The project officer's presentation should:

- highlight the key features of the terms of reference
- set out the institution's approach to the project
- give a full picture of what the project is likely to entail.

Distribute by email copies of the following to all registered participants not later than the end of the following day:

- the institution's presentation(s)
- questions asked and the answers given
- a register of participants.

Take note

The level of professionalism and commitment that the institution shows at the briefing session will affect the quality of the bids. If potential transaction advisors sense that the institution is ill-prepared, poorly managed, divided or confused, they will price the cost of the delays and uncertainties that are likely to arise.

Step 3: Respond to administrative queries promptly by email

Before the briefing session

Once the advertisement has been published, the project officer can expect to receive queries by email, and must be directly available to respond. The project officer should reply to all emails the same day they are received. If any telephone enquiries are received, ask the caller to email the query for a written response. Keep strict records of all correspondence.

No information that would be prejudicial to other parties may be conveyed to any one party exclusively, so refer any substantial queries to the briefing session and answer them there. All the potential transaction advisors will be represented at the briefing session, and the institution's responses will be confirmed in writing to all bidders.

After the briefing session

After the briefing session, the institution will know the names and contact details of all the potential bidders and must respond to all written queries in writing by email. Copies of all this correspondence must go to all the registered potential transaction advisors.

A deadline for receiving and responding to queries – normally 48 hours before the submission date for the bid – must be given in the terms of reference in the section on rules of bidding.

STAGE 3: RECEIVING AND EVALUATING BIDS

Receiving and evaluating bids

Part 1: Prepare for the evaluation

Part 2: Receive the bids

Part 3: Technical and BEE evaluation

Part 4: Price evaluation

Part 5: Interview and make the final choice

Part 1: Prepare for the evaluation

Well before the bid submission date, the bid evaluation panel should meet to:

- confirm membership
- be briefed on the bid evaluation system, receive and confirm their understanding of the role of the bid evaluation panel and receive a sample scoresheet (see ‘Annexure 5: Template transaction advisor technical and BEE evaluation scoresheets’)
- sign the code of conduct (see ‘Annexure 6: Template code of conduct for bid evaluation panel members’)
- confirm that all members understand and will abide by their responsibilities to the panel
- diarise the dates for the evaluation
- diarise the provisional dates for short-listed bidders to present their consortia to the panel and answer the panel’s questions
- diarise the final meeting date for the panel to choose the transaction advisor.

The bid secretariat should establish an Excel spreadsheet to reflect the bid evaluation criteria and scoring. (See ‘Annexure 8: Example transaction advisor bid evaluation scoring spreadsheet’, also provided electronically on www.treasury.gov.za.)

Part 2: Receive the bids

Step 1: Register the bids

Bids should be officially received and registered internally by the bid secretariat on or before the bid submission date and in the manner and at the place specified in the bid package. Consider late submissions only in exceptional circumstances and only in the manner precisely specified in the bid package. Late submissions are accepted at the project officer’s discretion.

The bid secretariat should have the bid evaluation arrangements ready to start evaluating the bids the day after the bid submission date.

Step 2: Separate and secure the price envelopes

On receipt, the bid secretariat should ensure that the price envelopes are separated from the technical and BEE envelopes of each bid, and that the price envelopes are locked securely in a safe until the bid evaluation panel calls for them.

Step 3: Open the technical and BEE envelopes

The project officer should officially open the technical and BEE envelopes of each bid in the presence of at least three senior officials of the institution, preferably including its chief financial officer. The bid secretariat should record the names of each of the bidding consortia.

Each member of the bid evaluation panel is then given access to all the technical and BEE bids. After reviewing the consortia membership, each member is required to sign and submit to the bid secretariat the declaration of interest statement before starting the bid evaluation. (See 'Annexure 7: Template declaration of interest statement'.)

Step 4: Check the technical envelopes

The bid secretariat should then check each technical envelope for administrative compliance, namely, that it includes tax clearance certificates and the curricula vitae of each member. If any of these are missing, contact the bidders and ask them to complete their submissions within a limited period. Failure to do so will render their bid non-compliant and they will not be considered for evaluation.

Part 3: Technical and BEE evaluation

Take note

The bid evaluation panel should evaluate the bids strictly in accordance with the system and criteria set out in the bid package.

The decisions and actions of officials representing the state need to be able to withstand any subsequent scrutiny. The bid evaluation process must be sound and fair, and the behaviour of officials must be ethical.

- The bid evaluation panel meets on an uninterrupted basis in a designated venue for a number of days to undertake the entire bid evaluation process.
- The project officer is the chairperson of the bid evaluation panel.
- The bid secretariat records all proceedings and files all score sheets. Everything the project officer and bid evaluation panel do and decide should be recorded accurately.
- At the start of each day's proceedings each member of the panel needs verbally for the record to confirm his or her adherence to the code of conduct and to the declaration of interest.
- In the event of any conflict of interest being declared at any stage, the chair will recuse the relevant member from further participation on the panel.

The responsibilities of a bid evaluation panel member include: to thoroughly read each bid, to evaluate it strictly according to the bid package criteria, and thereafter to participate fully in all meetings of the panel. If a member fails to properly prepare evaluations he or she should be expelled from the panel.

Technical and BEE evaluation

- Step 1: Score the technical bids
- Step 2: Plenary discussion
- Step 3: Enter the scores
- Step 4: Confirm the bids that have passed the technical threshold score
- Step 5: Score the BEE bids
- Step 6: Plenary discussion
- Step 7: Enter the scores
- Step 8: Confirm the bids that have passed the BEE threshold
- Step 9: Discuss and record any reservations
- Step 10: Confirm which bids may go forward
- Step 11: Sign and hand in the scoresheets

Step 1: Score the technical bids

The scoring of each element in the technical scorecard must be judged as excellent, acceptable or poor, and given a preset score accordingly (for example: excellent = 8 points; acceptable = 4 points; poor = 0 points). No ‘in-between’ points should be allowed, meaning, for example, no 1 or 6 scores, only 8, 4 or 0.

Each member individually (without discussing it with any other member):

- reads and evaluates each technical proposal
- gives preliminary scores to each element
- writes explanatory notes (with reference to bid page numbers where appropriate) to substantiate each preliminary score.

Step 2: Plenary discussion

When each member has given preliminary scores to every bid, the chair calls the panel to a plenary discussion of each technical element and sub-element of each bid. Agreement must be reached on any bids that should be disqualified for non-compliance at this point. Members are required to state their evaluations and to listen to other members’ evaluations. They may adjust their scores and notes if other members bring to their attention features of the bids they did not previously consider. Any adjustments should be initialled on the score sheets.

Step 3: Enter the scores

Once all the bids have been so discussed, the chair calls on the bid secretariat to display the bid evaluation scoring spreadsheet for the technical component so that the panel can witness each member’s scores being entered.

The chairperson systematically allows each member to call out his or her technical score for each element and each sub-element of each bid. If at any time any member believes that, based on the plenary discussion, another member’s score is unreasonable, he or she may ask for an explanation. The chair’s decision on any dispute between members will be binding on the members and on the panel.

Step 4: Confirm the bids that have passed the technical threshold score

The bid secretariat will total the aggregate scores for each technical element of each bid, and announce which bids have passed the technical threshold score, and which have failed.

Step 5: Score the BEE bids

In compliance with the *Code of Good Practice for BEE in PPPs*, the BEE component must be evaluated as set out in the BEE scorecards for PPP transaction advisors.

	Transaction Advisor bid evaluation BEE elements	Maximum score	Scoring criteria	Weighting	Points total
1	The percentage of Black People playing leading professional roles in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
2	The percentage of black equity in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
3	A credible plan for structuring effective BEE for the PPP, with necessary skill and experience in the team	5	Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skill & experience = 2 or 3 Credible plan, skill & experience = 4 or 5	4	20
4	A credible plan for skills transfer within the consortium to directly benefit Black professionals inexperienced in PPPs (may specify targeting of Black People within a geographic area)	5	Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	4	20
	Total BEE points				100
	Minimum threshold for BEE				60

Evaluation of the BEE proposals must examine:

- In element 1: how black people are included in all aspects of the work (legal, financial, technical and at all phases of the PPP project cycle), and must specifically indicate those aspects where they are designated to play leading roles. Fronting of black people for the purpose of winning contracts will not be tolerated and will lead to contract termination. Black people are therefore expected to perform the work they were assigned to, and the fee sharing structure must reflect the actual work, risk and responsibility assumed by each of the team members. The cash flow earmarked for each member of the consortium must therefore also be examined in the price envelope, indicating how black people will benefit.
- In element 2: the percentage of black equity in the companies making up the transaction advisor consortium, with a weighted average calculated on the

percentage of the work to be performed by each company as follows.⁸ The table has been completed with an example to illustrate the method used in the calculation.

Name of consortium member	Percentage of total reimbursement accruing to that consortium member (A)	Percentage of black equity in that consortium member (B)	Calculated % black equity in consortium (A) x (B)
X	80%	15%	12%
Y	10%	50%	5%
Z	10%	100%	10%
Total	100%		27%

Column B must show the percentage of ownership by individuals who are actively involved in the management of the specific company. To verify this, the proposal must be accompanied by supporting documents.

- For element 3: which member(s) of the consortium are to be responsible for structuring the BEE elements of the PPP project throughout the assignment, and must demonstrate their clear understanding of the *Code of Good Practice for BEE in PPPs*. References should be checked to substantiate claims of skills and experience.
- For element 4: that the skills transfer plan allows the institution to see the success being achieved in this respect throughout the transaction advisor assignment. While the leading black professionals on the team are expected to be both skilled and experienced, the intention is to encourage the transaction advisor consortia to include black professionals who are inexperienced in PPPs, and who can learn on the job.

Steps 6, 7 and 8

As with the scoring of the technical bids, there is a plenary discussion, and the scores are entered systematically.

Only those bids that pass the BEE threshold score, having passed the technical threshold score, will proceed to the price evaluation.

Step 9: Discuss and record any reservations

All reservations that panel members have about any element of the technical and/or BEE components of any bidder should be discussed, listed and accurately recorded by the bid secretariat for referral after the scoring of the price components. These will be used as reference in the interviews with short-listed bidders.

8. Bidders are required to provide this information in this format in their bids. See 'Annexure 2: Template transaction advisor terms of reference'.

Step 10: Confirm which bids may go forward

The chair will confirm which bids may proceed to price scoring, and will call on the bid secretariat to open those price envelopes only.

Step 11: Sign and hand in the scoresheets

Each panel member signs his or her technical and BEE scoring sheets and hands them in to the bid secretariat who will return them to members at the interview session (Part 5).

Part 4: Price evaluation

Step 1: Enter the prices and evaluate

The bid secretariat enters the prices on the electronic spreadsheet displayed before the panel, and calculates the price scores and the totals, using the formula prescribed by the PPPFA.

Step 2: Add up technical, BEE and price scores

This will be done by the bid secretariat in the electronic spreadsheet.

Step 3: Short-list the top bidders for interviews

At this point it is recommended that the panel identifies the two or three top-scoring bids for interviews.

Interviews allow the panel to clarify any outstanding questions and meet the proposed transaction advisors face-to-face.

In preparation for these interviews, the bid secretariat must clearly minute the key issues to be raised by panel members with the bidders.

The bid secretariat will then contact the short-listed bidders and:

- ask them to prepare a presentation for the panel
- set a date for the interview suitable to both the institution and the bidders, preferably within a week of the evaluation.

Part 5: Interview and make the final choice

Step 1: Interview

The interviews should take place one after the other on the same day, so that the panel can apply its mind to all the short-listed bidders. Members' technical and BEE scoresheets must be used by the panel as reference in the interviews.

Step 2: Revisit technical and BEE scores and adjust if necessary

The panel discusses all members' observations from the interviews, and the chair then asks each member to:

- adjust his or her technical and BEE scores if any of the interviews warranted this
- initial the changes
- write their motivations for the changes on the individual scoresheets.

Step 3: Make the final choice

The panel reconvenes immediately after the interviews to discuss them. The bid secretariat clearly minutes all assessments, adjusts the scores in the electronic spreadsheet, and confirms final totals.

The panel thus reaches a conclusion on the choice of the preferred transaction advisor immediately.

The chairperson will forward this choice to the accounting officer/authority or the necessary committee of the institution for approval. A letter is sent to the preferred transaction advisor, inviting the lead firm to finalise and sign the contract with the institution. The project officer should ensure that this process is concluded within the period of the validity of the bids.

Best and final offer (BAFO)

In the event that the bid evaluation panel cannot make a decision between two bidders due to serious deficiencies in both bids, the institution may choose to approach both bidders with a request for best and final offers (BAFO). This process involves a re-bid, and should seldom be necessary if the bid process was managed according to *National Treasury's PPP Manual*. A transaction advisor BAFO should only be followed in exceptional circumstances and only with the direct assistance of the relevant treasury's PPP unit's project advisor, using best practice.

STAGE 4: FINALISING AND SIGNING THE CONTRACT

The project officer will meet with the lead firm of the preferred transaction advisor to finalise the terms of the contract and complete all the necessary documentation as soon as possible within the bid validity period.

The final terms of the contract may not deviate materially from the original terms of reference or the terms of the draft contract, taking account of the mark-up (the transaction advisor's proposed changes) which will have been submitted by the transaction advisor as part of the bid.

The deliverables schedule to the contract should be a summarised version of the deliverables specified in the terms of reference and the winning proposal's response as to how they will deliver. It has to be compiled by the lead firm and agreed between the parties.

The preferred transaction advisor should not be required, as a condition of being awarded the contract, to undertake responsibility for work not stipulated in the terms of reference.

It should be a condition in the terms of reference that the institution reserves the right to negotiate price with the preferred transaction advisor.

If the negotiations fail to result in an acceptable contract, the institution should terminate the negotiations and invite the next-ranked bidder for negotiations. Inform the original preferred transaction advisor in writing of the reasons for terminating the negotiations. Once negotiations begin with the next-ranked firm, the institution should not re-open the earlier negotiations.

After negotiations are successfully completed, the accounting officer/authority should sign the contract, and the institution should promptly notify the unsuccessful bidders.

FUNDING FOR TRANSACTION ADVISORS THROUGH THE PDF

Introduction to the PDF

The Project Development Facility (PDF) may fund a significant portion of a project's transaction advisor costs after TA:I. The PDF recovers these funds from the successful private party bidder after the financial closure of the PPP.

The costs of procuring PPPs, and particularly the costs of transaction advisors, are significant, and often put a burden on the budget of the institution. But quality advisory services are fundamental to procuring affordable, value-for-money PPPs, and adherence to the PPP procurement requirements set out in Treasury Regulation 16 to the PFMA is essential. Due to the increasing number of PPP projects requiring assistance, National Treasury's PPP Unit has established the PDF as a vehicle for institutions to source funding for a portion of the transaction advisor costs and thus reduce the impact of PPP procurement costs on institutions' budgets. Ideally, also, the PDF should increase the quality and quantity of successful deals that are processed through the PPP Unit's project pipeline.

The PDF has been established as a fund with a limited life span. It will wind down its operations after ten years, by which time PPPs will be well established and their procurement will form part of institutions' budgeting.

While the PDF will play an important role in assisting institutions to procure PPPs, the institution's ownership of the project is essential to the project's success. Thus, the PDF will not assume responsibility for procuring or managing a PPP. In accordance with the PFMA, these functions reside with the accounting officer/authority of the institution. The transaction advisor must thus be appointed by the institution.

The PDF is not a source of grant funding to institutions. Funds are paid to the transaction advisor according to the contract between the institution and the transaction advisor. These are later recovered, in part or in full, from the successful private party bidder at the financial closure of the PPP, through the success fee.⁹

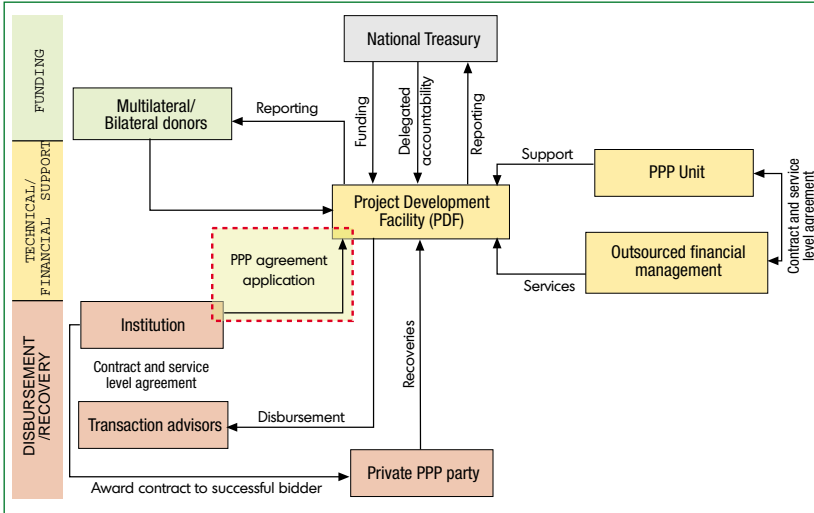
Because the PDF has to recover the funds it disburses, it requires successful deals. Thus, in all but the most unusual circumstances, PDF funding will cover the transaction advisor's costs after TA:I of the feasibility study. This has two main implications:

- the institution will have to commit funding to the project officer and to the feasibility study
- the PDF will not pre-empt the feasibility study's decision about whether the PPP is viable or not.

In addition to funds from the South African government, the PDF seeks funding from bilateral or multilateral donors. The PDF's financial management system makes provision for the specific funding and reporting requirements of potential donors. Thus, donors are able to fund projects in the specific sectors or geographic areas according to their particular financial management and reporting requirements.

9. See *Module 5: PPP Procurement*.

Figure 3.3: The PDF's relationships with other institutions



The PDF funds small, medium and large PPP projects across all sectors. The PDF projects that over the ten years of the PDF's operation a total of 45 small projects, 24 medium projects and eight large projects will be funded, and of these 75 per cent will be successfully closed. These assumptions will be tested over time. The size of a project is determined by its anticipated turnaround time (defined as Phase II: Feasibility Study and Phase III: Procurement) and annual funding requirements:

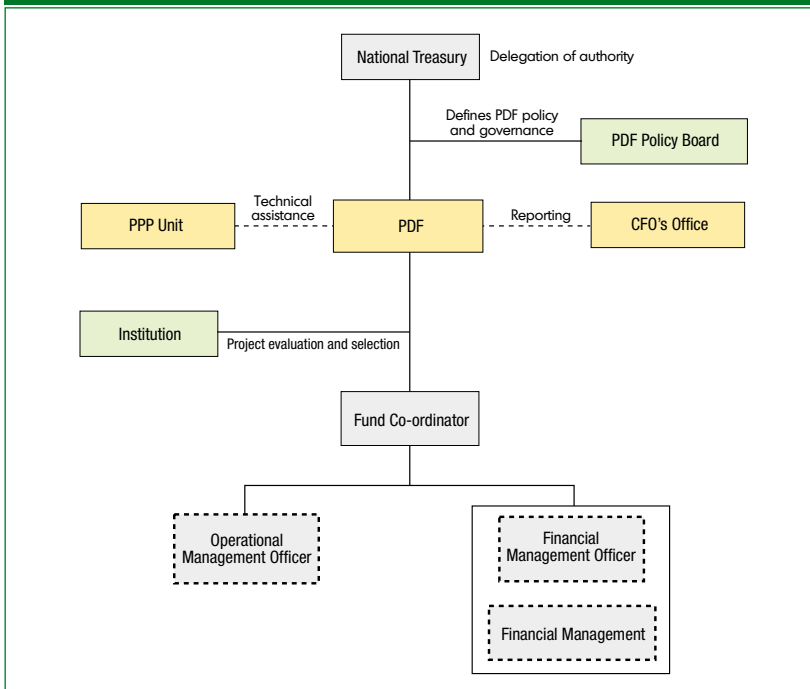
- **Small projects** are defined as having a 12-month turnaround time and annual funding requirements of R750 000. These projects allow the PDF a faster turnover of funds.
- **Medium projects** are defined as having a turnaround time of two years and annual funding requirements of R2 million.
- **Large projects** are defined as having a turnaround time of two years and annual funding requirements of R4 million.

Core activities of the PDF

- develops procedures and guidelines for choosing which projects to give funds to
- selects the projects
- establishes the terms and conditions under which funding is to be provided
- disburses and recovers (where appropriate) funding

The PDF is a single-function trading entity, created within the PPP Unit of National Treasury in accordance with the PFMA. The PDF will be administered and managed by the PPP Unit, which will also provide technical assistance to the PDF. The head of the PDF is the head of the PPP Unit, who reports to the accounting officer of National Treasury. The PDF reports on a monthly basis to National Treasury.

Figure 3.4: Organisational structure of the PDF



All PDF support functions are provided by National Treasury's PPP Unit, which carries all personnel and ancillary costs, including the financial management costs.

Good financial management and administration are an integral part of the PDF's overall management function and crucial to its success. The PPP Unit has contracted a financial management company to be its financial manager for an initial period of three years. Its mandate is to create an environment that promotes accountability and ensures that financial resources are used in an efficient, effective, economical and appropriate way. The PDF is regulated in terms of National Treasury regulations 18 and 19 and must accordingly comply with Generally Accepted Accounting Practice (GAAP). The accounting system subscribes to, and complies with, the requirements of the Accountant-General. The accounting system supplies financial information in the format and with the frequency required by National Treasury, the Auditor-General, as well as the PDF's donors.

Operational management applies the criteria for funding, facilitates the application and selection of projects to be funded by the PDF, and structures the specific funding agreements with the institution.

Applying for funding

The PDF will only provide funds once it has evaluated and approved an application by the institution and all conditions have been met.

Two initial requirements

1. The application must be for funding for a single project, which has been registered as a PPP with the relevant treasury's PPP Unit. All applications must be for individual projects, regardless of whether several projects are grouped under a single transaction advisor.
2. The application must be for funding to pay a transaction advisor, appointed by the institution, for the procurement phase of the project. Only in exceptional circumstances will the PDF fund the feasibility study.

Three opportunities to apply for funding

- pre-TA:I
- post-TA:I
- special case application

Applying before TA:I has been granted

To give accounting officers/authorities more certainty about whether they will get PDF funding, there is an opportunity to apply immediately after the institution has chosen its transaction advisor. Institutions' accounting officers/authorities are responsible for budgeting for transaction advisor costs for the feasibility study and procurement phases, so the costs of the transaction advisor will be known and work can start on the feasibility study.

Take note

Before starting the feasibility study, the institution must always reserve the right not to proceed with the procurement of the PPP, as this is contingent on the outcome of the feasibility study. This must always be a condition of the appointment of a transaction advisor.

A significant benefit of a pre-TA:I application is that an institution will not have to delay the procurement phase while it waits for approval of an application submitted to the PDF after TA:I.

Applying after TA:I has been granted

In addition to having obtained TA:I, institutions applying for PDF funding at this point must have assessed whether recovering the PDF funding from the project does not make the project unaffordable or unduly reduce the value for money of the project.

Special case applications

This category of application is for projects with special circumstances, for example:

- The project is unable to recover procurement costs
- The institution needs to cover transaction advisor costs before the project gets TA:I
- The institution needs to hire an external project officer.

Institutions with this kind of project can make a pre- or post-TA:I application, with the additional information and motivation for why the PDF needs to treat the project as a special case.

An institution must see the PDF as a fully integrated part of the overall budget cycle and must refer to the *Treasury Guidelines: Preparing Budget Submissions* before applying for PDF funding.

Eight steps in the PDF application process

Step 1: The accounting officer/authority submits the application

Step 2: The PDF acknowledges receipt of the application

Step 3: The project advisor makes a recommendation

Step 4: The PDF evaluates the application

Step 5: The project advisor informs the accounting officer/authority of the PDF's decision

Step 6: The funding agreement is prepared and signed

Step 7: The institution meets all conditions

Step 8: The PDF takes over funding the transaction advisor

The process is the same for pre- and post-TA:I applications.

Step 1: The accounting officer/authority submits the application

Address the application to:

The Head

PPP Unit

National Treasury

Private Bag X115

Pretoria 0001

For attention: Project Development Facility

Checklist for pre-TA:I applications

(See 'Annexure 10: Template application to the PDF – pre-TA:I'.)

- Provide the name and status of the institution, and give details of its mandate, enabling legislation and institutional history.
- Provide the name of the PPP project, and full details, including how it will meet the strategic goals of the institution and service delivery outcomes of the project and improvements on the current outcomes.
- Attach any additional project information.
- Confirm that the project has been registered with the PPP Unit.

- Confirm that the project will follow the procedures prescribed in Treasury Regulation 16 to the PFMA.
- Summarise any other PPPs undertaken by the institution.
- Provide details of the transaction advisor which has been appointed.
- Attach a summary of the bid evaluation process for the transaction advisor.
- Confirm that the transaction advisor has been appointed for the feasibility study phase, and that the appointment for procurement phase is contingent on the outcome of the feasibility study.
- Attach the transaction advisor's terms of reference and contract.
- Provide the total amount of the transaction advisor's fees.
- Break down the total amount of the transaction advisor's fees into Part 1 (feasibility study) and Part 2 (PPP procurement).
- Provide details of the source of the payment of fees for part 1.
- Confirm that the fees for part 2 are payable on delivery of the milestones set out in the contract.
- Attach details of project timelines and projected cash flow for payment of the transaction advisor for both parts.
- Confirm that the institution is applying for funding for part 2 of the transaction advisor costs.
- Confirm that the institution has reserved the right to recover part 2 costs as a success fee from the successful private party bidder should the project reach financial closure.
- Set out the initial estimates of the capital and operational expenditure (to show the ratio of transaction advisor fees to project value).
- Set out the institution's appointment of internal and external staff to manage the PPP process.
- Set out the institutional capacity to manage the project during procurement and operations.
- Attach any additional information on institutional capacity.
- Describe how the project will leverage private sector investment.
- Confirm that the institution is aware that PDF funding may be conditional on the outcome of the feasibility study and that the PDF reserves the right to cover the funds in the form of a success fee from the successful private party bidder at financial closure.

Checklist for post-TA:I applications

(See 'Annexure 11: Template application to the PDF – post-TA:I'.)

- Provide the name and status of the institution, and give details of its mandate, enabling legislation and institutional history.
- Provide the name of the PPP project.
- Confirm that the project has received TA:I.
- Attach the feasibility study.
- Summarise any other PPPs undertaken by the institution.
- Provide details of the transaction advisor which has been appointed.

- Attach a summary of the bid evaluation process for the transaction advisor.
- Confirm that the transaction advisor has been appointed for the feasibility study phase, and that the institution has made the decision to proceed to the procurement phase.
- Attach the transaction advisor's terms of reference and contract.
- Provide the total amount of the transaction advisor's fees.
- Break down the total amount of the transaction advisor's fees into part 1 and part 2.
- Provide details of the source of the payment of fees for part 1.
- Confirm that the fees for part 2 are payable on delivery of the milestones set out in the contract.
- Attach details of project timelines and projected cash flow for payment of the transaction advisor for both phases.
- Confirm that the institution is applying for funding for part 2 of the transaction advisor costs.
- Confirm that the institution has reserved the right to recover part 2 costs as a success fee from the successful private party bidder should the project reach financial closure, and that the feasibility study shows that this does not compromise the preliminary affordability or value for money of the project.
- Set out the institution's appointment of internal and external staff to manage the PPP process.
- Set out the institutional capacity to manage the project during procurement and operations.
- Attach any additional information on institutional capacity.
- Confirm that the institution is aware that the PDF reserves the right to cover the funds in the form of a success fee from the successful private party bidder at financial closure.

Step 2: The PDF acknowledges receipt of the application

Step 3: The project advisor makes a recommendation

The PPP Unit project advisor assigned to the project does the first evaluation, with input from the responsible budget officer in National Treasury and/or a provincial treasury representative, and/or a relevant official of the Intergovernmental Relations branch of National Treasury. A recommendation is made to the PDF evaluation committee setting out the proposed PPP project's compliance with PDF evaluation criteria. The recommendation must be lodged with the PDF within two weeks of its receiving the application.

Step 4: The evaluation

The PDF selects projects through a rigorous evaluation procedure. To qualify for PDF funding, projects need to meet the established criteria and have the right risk profile.

The PDF evaluation committee

The PDF evaluation committee is part of the PDF and is responsible for evaluating and choosing projects. The committee is made up of not more than five members. The following or their nominated delegates are permanent members: the head of the PDF; a representative of the Intergovernmental Relations branch of National Treasury, and the head of the Technical Assistance Unit of National Treasury. The other two members will be any two of the fund co-ordinators of the PDE, the financial manager of the PDE, and an appropriate representative of a donor who contributes to the PDF (where applicable).

The PDF evaluation committee sits within one week of receiving the recommendation from the project advisor.

The evaluation criteria

When making its decision to fund a project or not, the PDF asks the following questions:

About the institution

- Does the institution have funds available (on budget and from donor sources) for procuring the project?
- Has the institution included procuring the project in its MTEF budget?
- Has the institution recently procured a PPP project (successfully or unsuccessfully)?
- Will the institution's strategic goals be achieved by the project?
- Has the institution made a commitment to fund the project procurement and transaction advisor costs?
- Has the institution appointed a suitably experienced and qualified project officer?
- What is the institution's history of PPP project procurement, and does this reflect adequate commitment to the project?

About the sector

- Is it a provincial or national project?
- Is this the first time a PPP would be procured for this sector?
- Have any similar PPP projects been procured in the sector?
- Is the project in a priority sector for the PDF or the donor?
- Is the proposed project in the social services sector? If so, will the project provide a core or support function?

About the project

- Is the project registered under Treasury Regulation 16 to the PFMA?
- Has the transaction advisor been selected according to *National Treasury's PPP Manual*? Was the PPP Unit represented on the bid evaluation panel or have full transcripts of the bid evaluation procedures been provided?
- Do the milestones for transaction advisor payment put the transaction advisor at risk if financial closure is not reached?

- Are the transaction advisor costs proportional to project value? (This varies from sector to sector.)
- What is the project's capacity to generate private sector capital investment or to generate system improvements in non-capital intensive projects?
- Does the private sector demonstrate sufficient interest and capacity for collaborating on the project?
- What service delivery outcomes and improvements on current service delivery are expected from the project?

Because the PDF is not expected to recover all disbursed funds – 25 per cent non-recovery is expected – it has the flexibility to fund projects that are innovative in relation to the sector and/or the service provided.

Criteria related to funding

- Has the institution's projected transaction advisor cash flow been verified by the PPP Unit's project advisor?
- Has a project funding cash flow been established and measured against the PDF financial models for small, medium and large projects?

A project's eligibility for funding is assessed under three categories:

- priority
- risk
- how it fits in with the PDF's projected cash flow.

Each category has its own rating. Each category then feeds into a matrix which is used to decide whether funding will be provided unconditionally, on certain conditions, or no funding will be provided.

PDF priorities

The PDF policy board will set annual priorities for the types of projects to be funded by the PDF, and make these public. Projects that fall outside these priorities will not be excluded from getting PDF funding, but the PDF priority will be one of the factors taken into account.

Risk management

The PDF is fully exposed to the risk that the PPP project will not reach financial closure.

The PDF has to assess and manage two critical areas of risk:

- A PPP project may not reimburse the PDF funds (as a success fee), either because it does not reach financial closure or because the private party does not pay the success fee.
- A PPP project may require a disbursement at a time other than that scheduled in the PDF financial management cash flow.

Choosing the right project is the most important factor in mitigating risk.

The PDF evaluation committee sits within one week of receiving the recommendation and makes a decision:

- funding approved unconditionally

- funding approved subject to certain conditions
- funding not approved.

Conditions

PDF funding always comes with the following conditions:

- The institution must obtain TA:I
- The feasibility study must calculate PDF funding as a project expense.

Other conditions are set at the discretion of the evaluation committee, based on recommendations from the PPP Unit project advisor and the PDF financial management officer. One of these may be that the institution jointly funds the costs of procurement.

For pre-TA:I applications conditions may require that certain project details are confirmed before funding is committed, and that there is an assessment of the affordability and value-for-money implications of recovering procurement costs as a success fee.

For post-TA:I applications the institution may have to meet certain requirements relating to its capacity to procure the project.

Step 5: The project advisor informs the accounting officer/authority of the PDF's decision in writing

Step 6: The funding agreement

An agreement between the head of the PDF and the institution's accounting officer/authority, which includes all funding conditions, will be prepared and signed.

The PDF carries all the risk if the project does not reach financial closure, except when the institution defaults on its obligations.

Step 7: The institution meets all conditions

The accounting officer/authority must confirm in writing that the project has received TA:I and that any other conditions have been met. If all the conditions cannot be met, the accounting officer/authority may, if appropriate, apply for special case funding, as described below.

Step 8: The PDF takes over funding the transaction advisor

Once the PDF has fully accepted the application, the PDF takes over the funding of the transaction advisor, in part or in full, depending on the funding conditions.

The PDF application and funding processes have been designed as an integral part of the PPP project cycle.

The PDF will make payments in instalments against milestones set out in the deliverables schedule to the institution's contract with the transaction advisor.

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TEMPLATE PROJECT OFFICER DUTIES AND RESPONSIBILITIES

Agreements concluded in the Public Service Collective Bargaining Council from time to time, in respect of public sector contracts of employment, and the consequent determinations by the Minister for Public Service and Administration, will be applicable to the appointment of project officers if institutional budgets are used for project officer remuneration. Provisions of the Public Service Act, 1994, dealing with secondments of existing officials may also apply. Institutions are therefore advised to consult the Department of Public Service and Administration in drafting suitable contracts for PPP project officers, whether they are appointed from within or outside the institution.

Outlined here is a template description for the PPP project officer's duties and responsibilities, which, once amended by the institution as appropriate to the specific project, can be incorporated into the project officer's contract of employment with the institution.

Recommended insert (to be adapted for the specific project) into the institution's contract of employment with the project officer.

Duties and responsibilities of the project officer

1. Under the direct supervision of the [Accounting Officer/Authority], the project officer will carry out the following duties and have the following responsibilities:
 - 1.1. manage the planning and implementation of the PPP project on behalf of the [Accounting Officer/Authority], exercising delegated authority;
 - 1.2. consult with the management of the institution at all relevant stages in the project cycle and ensure ongoing consultation and buy-in from relevant stakeholders;
 - 1.3. directly support the [Accounting Officer/Authority] to comply with the requirements of Treasury Regulation 16 to the Public Finance Management Act;
 - 1.4. follow diligently, the PPP Practice Notes issued by National Treasury in terms of the PFMA;
 - 1.5. establish and manage a project team and project secretariat;
 - 1.6. draft terms of reference and secure a suitable budget for a transaction advisor;
 - 1.7. manage the procurement process to appoint a transaction advisor;
 - 1.8. direct and manage the work of the transaction advisor at every phase of the project cycle, exercising delegated authority;

- 1.9. carry out all functions of the inception, feasibility and procurement phases as delegated;
- 1.10. carry out all functions required of the institution to properly submit applications for all Treasury approvals in terms of Treasury Regulation 16 to the PFMA and respond to all queries from the relevant Treasury in respect thereof;
- 1.11. diligently manage the project from inception to the signing of the PPP agreement and financial closure, to ensure that the project is affordable to the institution, provides an optimal value for money solution for the [service delivery/use of state property], and appropriately allocates risk to the private party;
- 1.12. manage all information systems necessary for the proper planning and implementation of the project;
- 1.13. manage the PPP, into the term of the PPP agreement, in terms of the PPP agreement management plan, on behalf of the institution, specifically in:
 - 1.13.1. the development phase; and
 - 1.13.2. the [.....years] of the delivery phase, effecting appropriate hand-over to another contract manager if appropriate.
- 1.14. ensure that the PPP agreement is properly enforced in terms of Treasury Regulation 16.7 and in so doing maintain mechanisms and procedures as approved in the PPP agreement management plan for:
 - 1.14.1. measuring the outputs of the PPP agreement;
 - 1.14.2. monitoring and regulating the implementation of, and performance in terms of, the PPP agreement;
 - 1.14.3. liaising with the private party;
 - 1.14.4. resolving disputes and differences with the private party;
 - 1.14.5. generally overseeing the day-to-day management of the PPP agreement; and
 - 1.14.6. reporting on the PPP agreement in the institution's annual report.
- 1.15. ensure that the institutional function is effectively and efficiently performed in the public interest, [and/or that state property is appropriately protected];
- 1.16. establish and maintain close links to the PPP Unit of the National Treasury in order to ensure proper alignment of policy and best practice;
- 1.17. prepare and compile any information as may reasonably be required by the institution from time to time in connection with the PPP project;
- 1.18. conform to all statutory obligations and non-statutory external obligations binding upon the institution in respect of the PPP project;
- 1.19. comply with all the institution's rules, regulations, policies, practices and procedures laid down from time to time; and
- 1.20. remain honest and faithful to the institution in the performance of these duties and responsibilities, acting at all times according to good industry practice and in compliance with the public service code of conduct.

TEMPLATE TRANSACTION ADVISOR TERMS OF REFERENCE

Terms of reference for transaction advisor services to the [insert name of institution] for the [insert description of the project]

Contents

1. Introduction
2. Scope of work
3. Background
4. PPP feasibility study deliverables
5. PPP procurement deliverables (if applicable)
6. Transaction advisor skill, experience, remuneration and management by the [insert name of institution]
7. Rules of bidding, bid submission requirements and bid evaluation

Appendix A: Background and supporting documentation

Appendix B: Draft transaction advisor contract

1. Introduction

The [insert name of institution] has identified the need [describe project].¹ This will [describe objectives].² It is also in line with the institution's strategic vision of [describe strategic vision].

The [insert name of institution] wishes to explore the feasibility of this project as a public-private partnership (PPP) in terms of the relevant National Treasury regulations to the Public Finance Management Act, 1999 (PFMA). It will follow *National Treasury's PPP Manual*, which potential transaction advisors are required to be familiar with.

The [insert name of institution] thus intends to procure the services of an experienced transaction advisor to assist it through the regulated phases of the PPP project cycle.

These terms of reference invite proposals from a transaction advisor representing a team of suitably qualified and experienced financial, technical and legal advisors to help the [insert name of institution]:

- Part 1: Undertake a comprehensive feasibility study for the [describe project]

1. For example: To substantially upgrade its head office accommodation and related services.

2. For example: Help to create a working environment that is conducive to staff productivity, operational effectiveness, and quality client relations.

- Part 2: If required afterwards, provide advisory services for the appropriate procurement of the project.

The scope of work is divided into these two parts. The transaction advisor needs to submit a single bid, in the formats prescribed in this terms of reference.

(Reference to 'the transaction advisor' includes the entire advisory team, or relevant members, under the management of a single lead advisor who shall contract with the [name of institution].)

2. Scope of work

The scope of work for the transaction advisor is:

2.1 Part 1: Feasibility study

The transaction advisor will be required to produce a comprehensive feasibility study for the [insert name of institution]'s [describe project] using public sector comparator and PPP reference models. This must enable the [insert name of institution] to determine:

- full project cycle costs
- affordability limits
- risks and their costs
- optimal value-for-money methods of delivery.

Section 4 below sets out the deliverables required of the transaction advisor for the feasibility study.

2.2 Part 2: PPP procurement

If, on the basis of the feasibility study, a PPP solution is decided on, and if the [name of institution] requires it, the transaction advisor will be required to provide the necessary technical, legal and financial advisory support for the procurement of a private partner. This must be in compliance with all elements of Treasury Regulation 16 to the PFMA.

The procurement deliverables are set out in Section 5.

3. Background

3.1 Mandate

The [insert name of institution]'s mandate is [describe mandate].

3.2 Needs

The project will address the [insert name of institution]'s [describe why the institution needs the project].

3.3 Objectives

The objectives for this project are [describe objectives].

3.4 Background documentation and preparatory work

The transaction advisor will have to become familiar with all background documentation and preparatory work conducted to date by the [insert name of institution] for this project. Refer to 'Appendix A: Background and supporting documentation' for a list and/or copies of [delete as required] relevant material.

A preliminary needs analysis has been undertaken, establishing [describe what the needs analysis has established, including any initial costings].³ [Note any costings not undertaken.]⁴

The institution has identified the following challenges which it faces in pursuing the project: [list challenges].

The legal and policy framework for the project is [describe legal and policy framework].

3.5 Project budget

The base-line budget currently available for operating expenditure for the project has been identified as [insert Rand amount] in the [insert year] financial year, escalating by CPIX. In addition, a capital budget of [insert Rand amount] for expenditure over the three years [insert years] of the MTEF has been secured.

4. PPP feasibility study deliverables

The transaction advisor is required to produce, in close liaison with the [insert name of institution], a comprehensive feasibility study for [describe the project].

The feasibility study needs to clearly demonstrate affordability for the full project cycle and propose the optimal value-for-money solution for the [insert name of institution] to achieve its desired outcomes.

The feasibility study is to be conducted in compliance with *National Treasury's PPP Manual*, available on www.treasury.gov.za or from the PPP Unit.

4.1 Components of the feasibility study

In line with *National Treasury's PPP Manual, Module 4: PPP Feasibility Study*, the feasibility study must include the following:

Introduction

- Covering letter from the accounting officer/authority requesting TA:I
- Executive summary
- Introduction
- Project background
- Approach and methodology to the feasibility study

3. For example: Space planning requirements and some initial costing of capital works.

4. For example: No life-cycle costing of facilities management or IT services has yet been done.

Section 1**Needs analysis**

- Institution's strategic objectives
- Budget
- Institutional analysis
- Output specifications
- Scope of the project

Section 2**Solution options analysis**

- Options considered
- Evaluation and assessment of each option
- Summary of evaluation and assessment of all options considered
- Recommendation of a preferred option

Section 3**Project due diligence**

- Legal aspects
 - Use rights
 - Regulatory matters
- Site enablement
- Socio-economic and BEE

Section 4**Value assessment**

- PSC model
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - BEE targets
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, budgets and MTEF
 - Summary of results from the base PSC model: NPV
- PPP reference
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - Discussion on proposed PPP type
 - BEE targets
 - Proposed PPP project structure and sources of funding
 - Payment mechanism
 - Discussion on all model assumptions made in the construction of the model,

- including inflation rate, discount rate, depreciation, tax and VAT
- Summary of results from the PPP-reference model: NPV
- Risk assessment
 - Comprehensive risk matrix for all project risks
 - Summary of the institution's retained and transferable risks
 - The NPV of all risks (retained and transferable) to be added onto the base PSC model
 - The NPV of all retained risks to be added onto the PPP reference model
- Risk-adjusted PSC model
 - Summary of results: NPV
- Risk-adjusted PPP-reference
 - Summary of results: NPV, key indicators
 - Sensitivity analyses
 - Statement of affordability
 - Statement of value for money
 - Recommended procurement choice
- Information verification
 - Summary of documents attached in Annexure 1 to verify information found in the feasibility study report

Section 5

Economic valuation

- Introduction and evaluation approach
- Assumptions
- Valuation results

Section 6

Procurement plan

Annexures

Annexure 1: Statements for information verification and sign off from each advisor to the project

Annexure 2: Letter of concurrence from CFO of institution and/or provincial treasury⁵

Annexure 3: PSC model

Annexure 4: PPP reference model

Annexure 5: Risk assessment and comprehensive risk matrix

Annexure 6: Document list (list of all documents related to the project, where they are kept, and who is responsible for ensuring that they are updated)

Annexures 7, 8, 9 etc: Attach as annexures all other documents that have informed the feasibility study and that are of decision-making relevance to the project.

5. If Treasury approvals for PPPs have been delegated to a provincial treasury in terms of the PFMA, its concurrence here is not applicable.

4.2 Presentation of the feasibility study

The feasibility study, comprising all the above deliverables, must be compiled in a single report in Word format (with relevant annexures), and delivered as both electronic and hard copy documents. All financial models must be in Excel format, and must clearly set out all assumptions made, sensitivity analyses carried out, and model outputs. The financial models must be sufficiently adaptable for use by others at later stages. The feasibility study must be presented with a thorough executive summary and must be accompanied by a PowerPoint presentation that encapsulates all the key features of the study. The executive summary and PowerPoint presentation must be compiled in such a manner that they can be used by the [insert name of institution]'s management for decision-making purposes.

4.3 Submission requirements for the feasibility study report and request for Treasury Approval: I

If the [insert name of institution] decides to pursue a PPP solution for the [describe project], the feasibility study must be of a standard that will be accepted by National Treasury for the purposes of the [insert name of institution] obtaining Treasury Approval: I (TA:I) in terms of Treasury Regulation 16 to the PFMA. The transaction advisor is therefore advised to be fully familiar with the requirements of the PPP Unit as set out in *Module 4: PPP Feasibility Study of National Treasury's PPP Manual*.

5. PPP procurement deliverables (if applicable)

If the [insert name of institution] decides on a PPP procurement solution, the transaction advisor is required to work with the [insert name of institution] to manage the procurement process for securing contracts with a private party. All this needs to be in accordance with the systems and standards set out for PPPs in Treasury Regulation 16 and using *National Treasury's PPP Manual* and *Standardised PPP Provisions*.

The transaction advisor will then have to deliver the following:

5.1 Treasury Approval: IIA and administration of the bidding process

The transaction advisor must prepare a complete set of procurement documents, complying with public sector procurement law, policies and guidelines, and in accordance with the tendering systems of the [insert name of institution]. The documentation must be consistent with the results of the feasibility study and enable the [insert name of institution] to obtain Treasury Approval II: A (TA:IIA) in terms of Treasury Regulation 16.

The transaction advisor must also give the [insert name of institution] all the necessary drafting, bidder communication and administrative support necessary for the entire procurement process to be conducted in accordance with law and policy, and to the highest standards of efficiency, quality and integrity.

5.1.1 Pre-qualification

The transaction advisor must design and administer a pre-qualification (request for qualification (RFQ)) process with the intention of:

- ensuring that the [insert name of institution]'s exact interest is communicated clearly to the market
- determining the extent and nature of interest in the private sector
- pre-qualifying a competitive number of competent consortia in an equitable and transparent way.

The desired result is that every pre-qualified bidder is capable of providing the facilities and services required by the [insert name of institution].

The transaction advisor must: prepare all the necessary RFQ documentation, including advertising material; set up and administer the process by which the [insert name of institution] can pre-qualify the parties; and help the [insert name of institution] evaluate and pre-qualify bidders.

5.1.2 Payment mechanism

The transaction advisor must develop a rigorous payment mechanism that captures the elements of risk transfer established in the feasibility study.

5.1.3 Bid evaluation criteria, bid process design and BEE requirements

The transaction advisor must: set up a bid evaluation system and criteria; design a suitable bid process that will ensure comparable bids; devise effective systems for communicating with bidders; inspire market confidence; and incorporate all BEE requirements for the project. If appropriate, a system that allows for variant bids may be designed.

5.1.4 Request for proposals (RFP)

The transaction advisor must prepare an RFP document in accordance with best industry practice and *National Treasury's PPP Manual*, consistent with the results of the feasibility study. The RFP must concisely set out:

- the output specifications of the [insert name of institution]
- requirements for compliant bids
- a risk profile as established in the feasibility study
- the payment mechanism
- BEE targets
- the bid process
- evaluation criteria
- bidder communication systems.

5.1.5 A draft PPP agreement

The transaction advisor must prepare a draft PPP agreement, based on National Treasury's *Standardised PPP Provisions*. Close liaison with the [insert name of institution] management and the PPP unit of the relevant treasury is required during drafting.

5.1.6 Treasury Approval: IIA

The transaction advisor must compile all the documentation necessary for the [insert name of institution] to obtain Treasury Approval: IIA (TA:IIA) in terms of Treasury Regulation 16 to the PFMA to enable the procurement process to begin.

5.1.7 Administration of the bidding process

The transaction advisor is to provide all necessary administrative support to the [insert name of institution] for the efficient and professional management of the bidding process. This includes managing a data room, facilitating structured engagement between the [insert name of institution] and bidders, helping the [insert name of institution] communicate effectively with bidders, and receiving bids.

5.2 Evaluation of bids, demonstrating value for money and Treasury Approval: IIB

5.2.1 Evaluation of bids

The authorised staff of the [insert name of institution], helped by the transaction advisor, must evaluate bids, following guidance given in *Module 5: PPP Procurement of National Treasury's PPP Manual*.

A best and final offer (BAFO) process may be required. When costing this phase of work the transaction advisor must allow for the possibility of administering BAFO processes. If there is no BAFO process, the transaction advisor's remuneration will be adjusted accordingly.

5.2.2 The value-for-money report and Treasury Approval: IIB

Value for money must be demonstrated by comparing the net present value (NPV) of the bids received with the NPV of the PSC for [describe the project], with a suitable adjustment for risk assumed.

The results of the bidding and evaluation of bids must be presented in a single value-for-money report (with relevant annexures) that demonstrates clearly how value for money will be achieved with the preferred bidder. The report must clearly indicate the preferred and second-ranked bidders and provide motivations.

The value-for-money report must be in a suitable format and of a suitable standard for the [insert name of institution] to get Treasury Approval: IIB (TA:IIB) in terms of Treasury Regulation 16 to the PFMA. The guidance given in *Module 5: PPP Procurement of National Treasury's PPP Manual* should be followed.

5.3 PPP agreement negotiations, PPP agreement management plan and Treasury Approval: III

The transaction advisor must assist the [insert name of institution] in final negotiations with the preferred bidder. This will involve preparing suitable negotiations teams, categorising issues appropriately, developing timelines for completion, and

planning negotiation tactics and processes for reaching agreement. The transaction advisor must ensure that all agreements reached are incorporated into all the financial, commercial and legal documentation, and must assist with drafting the necessary and related correspondence.

The final terms of the agreement, each as negotiated with the preferred bidder, must be submitted by the [insert name of institution], along with the PPP agreement management plan for the [describe project], for Treasury Approval: III (TA:III) in terms of Treasury Regulation 16. The transaction advisor is responsible for compiling the necessary submissions for the [insert name of institution] to obtain this approval. (See Treasury Regulation 16.6.1(a).)

The transaction advisor must, in close liaison with the [insert name of institution], draft a comprehensive PPP agreement management plan for the [insert name of institution]. (See Treasury Regulation 16.6.1(b).) This will be in accordance with the provisions of the PPP agreement and following the guidance given in *Module 6: Managing the PPP Agreement of National Treasury's PPP Manual*.

The transaction advisor must ensure that a comprehensive legal due diligence of the accounting officer/authority has been completed. This will relate to legal compliance, competence and capacity to enter into the PPP agreement. (See Treasury Regulation 16.6.1(c).)

5.4 PPP agreement signature, close-out report and case study, and financial closure

The transaction advisor must help the [insert name of institution] with all functions related to signing the final agreement.

The transaction advisor must also compile a comprehensive close-out report and case study. These must follow the formats prescribed in *Module 5: PPP Procurement of National Treasury's PPP Manual*, and must incorporate any additional factors that may be required by the [insert name of institution].

The close-out report will be a confidential document of the [insert name of institution], and will also be lodged with National Treasury. The case study will become a public document, made available on various government websites.

Financial closure signifies that all the procurement deliverables have been successfully completed, and that the transaction advisor's work is finished, if applicable.

6. Transaction advisor skill, experience, remuneration and management by the [insert name of institution]

6.1 Necessary transaction advisor skills and experience

The transaction advisor will comprise a team, managed by a single lead advisor. The members of the team will have both the skill and experience necessary to undertake the range of tasks set out in this 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. (See 'Annexure B: Draft transaction advisor contract'.)

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

- financial analysis, with relevant PPP and project finance experience
- PPP procurement and structuring
- legal, with relevant South African experience in the drafting and negotiating of PPP agreements
- [describe project] planning management
- [describe project] facilities management
- relevant expertise in [set out elements of project]⁶
- BEE expertise with relevant PPP experience
- negotiations
- contract management
- project management.

6.2 Remuneration schedule and disbursement arrangements

The total sum budgeted by the [insert name of institution] for remuneration of professional services under this terms of reference is [insert Rand amount].⁷ Bidders are advised to bid within this figure, and to allocate resources according to the remuneration schedule below.

Remuneration of the transaction advisor will be payable in South African Rands, on a fixed price for each of 2.1 and 2.2 above (corresponding to Phase II: PPP Feasibility Study and Phase III: Procurement of the project cycle). The procurement portion of the work may or may not transpire at the end of the feasibility study, and should be costed accordingly.

6.2.1 Remuneration schedule

The following remuneration schedule is set for each part of the contract. Bidders should adhere to these in their proposals, within the total budget given.

Feasibility study	
Deliverable	Percentage
Signing of transaction advisor contract as a mobilisation allowance	10
Completion of sections 1– 2	20
Completion of section 3	20
Completion of section 4	20
Completion of sections 5– 6	15
Completion of feasibility study report (4.2) to the satisfaction of the [insert name of institution], and a decision by National Treasury about TA:1	15
Total	100

6. For example: Building design, construction, engineering, quantity surveying, and property development and planning applicable to the proposed facilities.

7. This template is for a declared fees budget. In the event that the budget is not declared, the terms of reference will have to be adapted by the project officer with the assistance of the PPP Unit.

PPP procurement	
Deliverable	Percentage
Mobilisation allowance and TA:I	10
A decision by National Treasury in respect of TA:IIA	25
A decision by National Treasury in respect of TA:IIB	25*
A decision by National Treasury in respect of TA:III	20
Success fee	10
Total	100
BAFO allowance (if applicable)	15% of *

Deliverables completed per the remuneration schedule will be approved by the project officer, after which invoices may be submitted for payment as per the remuneration schedule. The [insert name of institution] will pay within 30 days of receiving the approved invoice.

6.2.2 Disbursement arrangements⁸

Out-of-pocket expenses will be paid by the [insert name of institution] at cost within an agreed ceiling. All claims for travel and other legitimate disbursement expenditure must be pre-approved by the project officer before they are incurred. An email system for these approvals will be set up when the transaction advisor contract is signed. Pre-approved project expenditure on travel outside the province, related reasonable accommodation costs, expenditure on document reproduction, or any other legitimate pre-approved project disbursement expenditure will be reimbursed at cost. Payment will be made within 30 days of the [insert name of institution] receiving approved and substantiated invoices, and does not form part of the remuneration schedule. Bidders are required to propose a ceiling for such disbursements. This ceiling will not be evaluated as part of the price proposal.

6.3 Management of transaction advisor by the [insert name of institution]

The transaction advisor will be appointed by the [insert title of the accounting officer/authority of the institution].

A project officer has been appointed by the [insert title of the accounting officer/authority of the institution] to take full responsibility for managing the transaction advisor's work and for ensuring delivery on the project. The project officer is [insert name of project officer], and can be contacted at [insert contact details].

The project officer has established a project team to engage regularly with the transaction advisor for efficiently completing the various delivery items. The project team will meet at least monthly and the transaction advisor will report progress at these meetings, as instructed by the project officer.

8. The disbursement arrangement set out here assumes Option 1: Actual cash with a ceiling. See Module 3: PPP Inception Stage 2: Part 2.

The project officer will confirm that the transaction advisor has satisfactorily completed each deliverable before invoices can be submitted to the [insert name of institution] for payment.

7. Rules of bidding, bid submission requirements and bid evaluation

7.1 Rules of bidding

- 7.1.1 The transaction advisor must be a single legal entity with all other necessary expertise secured via subcontract, or under a joint venture arrangement. The [insert name of institution] will enter into a single contract with a single firm for the delivery of the work set out in these terms of reference.
- 7.1.2 Tax clearance certificates dated within six months of the closing date of this bid must be submitted by all South African firms submitting bids as part of a consortium or joint venture.
- 7.1.3 Foreign firms providing proposals must become familiar with local conditions and laws, and take them into account in preparing their proposals.
- 7.1.4 Bids must be submitted in South African Rands, on a fixed price basis.
- 7.1.5 The costs of preparing bids and of negotiating the contract will not be reimbursed.
- 7.1.6 The [insert name of institution] is not bound to accept any of the bids submitted, and reserves the right to call for best and final offers from short-listed bidders before final selection.
- 7.1.7 The [insert name of institution] reserves the right to call interviews with short-listed bidders before final selection.
- 7.1.8 The [insert name of institution] reserves the right to negotiate price with the preferred bidder.
- 7.1.9 Firms may ask for clarification on these terms of reference or any of its annexures up to close of business 48 hours before the deadline for the submission of bids. Any request for clarification must be submitted by email to the project officer at [insert project officer's email address]. Copies of questions and answers will be emailed to all firms that register at the briefing session, without revealing the identity of the source of the questions.
- 7.1.10 The [insert name of institution] reserves the right to return late bid submissions unopened. Late submissions will be accepted only in exceptional circumstances and only within 12 hours of the deadline for the submission of bids and at the discretion of the project officer.
- 7.1.11 Firms may not contact the [insert name of institution] or the relevant treasury on any matter pertaining to their bid from the time when bids are submitted to the time the transaction advisor contract is awarded. Any effort by a bidder to influence bid evaluation, bid comparisons or bid award decisions in any manner, may result in rejection of the bid concerned.

7.2 Bid submission requirements

Transaction advisors are required to submit their proposals in two envelopes in the following format:

7.2.1 Envelope 1: Technical and BEE proposals

- Marked with the name of the transaction advisor.
- Titled 'Technical and BEE proposal: Transaction advisor services to [insert name of institution] for feasibility study and possible PPP procurement for [describe project]'.

This envelope must contain at least the following:

7.2.1.1 A covering letter signed by the lead transaction advisor, among others:

- accepting the rules of bidding, evaluation of bids, and bid evaluation criteria set out in the terms of reference
- attaching a tax clearance certificate from South African Revenue Services for the lead transaction advisor firm and all South African firms to be subcontracted to it for this assignment, or all South African firms participating in a joint venture for purposes of this bid
- providing full contact details for the lead transaction advisor.

7.2.1.2 Information on and motivation for the lead transaction advisor, attaching his or her curriculum vitae, and setting out his or her personal, and his or her firm's:

- suitability for this assignment
- relevant skills and experience: For each relevant experience cited, outline the precise role the lead transaction advisor played, the role of the firm, contract duration, contract outcomes, and contract value
- availability to perform the work: This must be substantiated by listing the lead transaction advisor's other known professional commitments for the forthcoming two years.

7.2.1.3 Names of all proposed team members, and their firms, setting out:

- the professional role that each person will play in the assignment. This must be cross-referenced to each deliverable and to each specified technical evaluation element set out in the technical scorecard
- the suitability of each person for the proposed roles in terms of his or her relevant skills and experience
- the availability to perform the work
- one-page resumés of each person highlighting responsibilities held for experience relevant to this assignment in the last five years
- the black South African professionals on the team, clearly showing the roles they will play.

7.2.1.4 The BEE proposal, cross-referenced to each element of the BEE scorecard clearly setting out:

- the number and percentage of black professionals playing leading roles in the transaction advisor consortium
- the percentage of black equity in the companies making up the consortium, with a weighted average calculated on the percentage of work to be performed by each company, presented in the following format. (The table has been completed with an example.)

Name of consortium member	Percentage of total reimbursement accruing to that consortium member (A)	Percentage of black equity in that consortium member (B)	Calculated % black equity in consortium (A) x (B)
X	80%	15%	12%
Y	10%	50%	5%
Z	10%	100%	10%
Total	100%		27%

Column B must show the percentage of ownership by individuals who are actively involved in the management of the specific company. To verify this, the proposal must be accompanied by supporting documents.

- a credible plan for structuring effective BEE for the PPP, with the necessary skill and experience in the team, substantiated by references.
- a credible plan for skills transfer within the consortium to directly benefit black professionals inexperienced in PPPs.

7.2.1.5 Project comprehension and project management plan, setting out:

- the transaction advisor's understanding of the terms of reference, and any proposals for amendments to the terms of reference that would enhance desired outcomes
- how the transaction advisor proposes to manage the set of deliverables outlined in the terms of reference
- a proposed outline work plan with timetable for delivery
- how the transaction advisor members will be supervised
- how reporting to the project officer will take place
- any innovative ideas on how the whole assignment can best achieve its objectives.

The technical and BEE envelope must not include any price proposal.

7.2.2 Envelope 2: Price proposal

- Marked with the name of the transaction advisor.
- Titled: 'Price proposal: Transaction advisor services to [insert name of institution] for feasibility study and possible PPP procurement for [describe project]'.

This envelope must contain:

7.2.2.1 Proposed remuneration for professional fees:

- a remuneration proposal in the remuneration format outlined in 6.2.1 above, giving professional cost per deliverable item and total for each part as indicated
- VAT must be specified as a separate total for each of the feasibility study and PPP procurement parts. While VAT will be paid pro rata for each delivery item in each part of the assignment, it should be indicated as a total sum per part for purposes of this submission.

7.2.2.2 Cash flow earmarked for each member of the consortium, indicating how black people will benefit. The fee-sharing structure must reflect the actual work, risk and responsibility assumed by each member.

7.2.2.3 An estimation of anticipated disbursement costs per part of work. This information will not be used as a criterion for the evaluation of bids, and the successful bidder will not be held to this amount.

7.2.2.4 A marked-up version of the draft transaction advisor contract (attached here as Appendix B), including the proposed remuneration set out in a draft proposed payments schedule to the contract.

7.3 Bid evaluation criteria⁸

Evaluation will be based on a points system. The following is the maximum number of points that can be awarded for each element and the threshold score for each category:

Evaluation element	Weighting	Threshold score
Technical proposal	70	65%
BEE proposal	10	60%
Price proposal	20	N/A
Total	100	

The bid which achieves the highest total points out of 100 will be recommended by the bid evaluation panel as the preferred transaction advisor.

In compliance with the PPPFA, the BEE component of a transaction advisor bid will constitute 10% of the bid evaluation weighting, with the price and technical elements constituting the remaining 90%. A minimum threshold of 60% of the total BEE points will be set and a minimum threshold of 65% of the total technical points will be set. The technical, BEE and price elements are each scored out of 100 points, and the scores achieved (if they meet the thresholds), calculated into the bidder's overall score using the following formula:

8. Remember that this template is for a declared fees budget. If the fees budget is not declared the weightings will be different.

$$a^* (\text{technical score}/100) + b^* (\text{BEE score}/100) + c^* (\text{price score}/100) = d$$

where:

a is the weighting for technical (70%)

b is the weighting for BEE (10%)

c is the weighting for price (20%), and

d is the total score achieved by the bidder.

The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA.

The technical and BEE proposal will be evaluated according to the criteria and thresholds set in the technical and BEE scorecards, as follows:

Technical scorecard				
Technical proposal		Scoring (for whole or each sub-element where applicable)	Maximum points	
1	Financial analysis and project finance - Skills - Relevant experience	Excellent = 8 Acceptable = 4 Poor = 0	8 8	16
2	Legal - Skills - Relevant experience	Excellent = 8 Acceptable = 4 Poor = 0	8 8	16
3	Technical skills appropriate to the project ⁹ - Skills - Relevant experience	Excellent = 8 Acceptable = 4 Poor = 0	8 8	16
4	PPP procurement and structuring: Relevant experience and track record	Excellent = 8 Acceptable = 4 Poor = 0		8
5	Negotiations: Relevant experience and track record	Excellent = 8 Acceptable = 4 Poor = 0		8
6	Other skills and relevant experience ¹⁰	Excellent = 8 Acceptable = 4 Poor = 0		8
7	Quality of project comprehension demonstrated in proposals ¹¹	Excellent = 8 Acceptable = 4 Poor = 0		8
8	Quality of proposed work plan, project management approach and timetable for the project	Excellent = 10 Acceptable = 5 Poor = 0		10
9	Lead transaction advisor's availability for the work	Excellent = 10 Acceptable = 5 Poor = 0		10
Total technical points				100
Minimum threshold for technical				65

9. Specify, for example: working environment planning and facilities management.

10. Specify, for example: design, construction, engineering, quantity surveying, property planning.

11. Specify, for example: for design and development of environmentally appropriate buildings.

BEE scorecard					
	BEE proposal	Maximum score	Scoring	Weighting	Points total
1	The percentage of Black People playing leading professional roles in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
2	The percentage of black equity in the Transaction Advisor consortium	5	25% – 35% = 3 >35% = 5	6	30
3	A credible plan for structuring effective BEE for the PPP, with necessary skill and experience in the team.	5	Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skill & experience = 2 or 3 Credible plan, skill & experience = 4 or 5	4	20
4	A credible plan for skills transfer within the consortium to directly benefit Black professionals inexperienced in PPPs (may specify targeting of Black People within a geographic area)	5	Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	4	20
Total BEE points					100
Minimum threshold for BEE					60

7.4 Bid evaluation

A bid evaluation panel will be established by the [insert name of institution] comprising representatives of the [insert name of institution] and the relevant treasury's PPP Unit. The panel will evaluate all transaction advisor bids received by the deadline, according to the criteria indicated here. It will make a recommendation to the [insert name of institution/tender committee] on the appointment of the preferred transaction advisor.

The bid evaluation panel reserves the right to call bidders to complete any outstanding elements of their bids, make presentations of their bids, and/or present best and final offers if required.

The decision of the [insert name of institution/tender committee] will be final.

The price proposal envelopes of each bid received will be locked away until the technical and BEE proposals have been evaluated by the bid evaluation panel. The price proposals of only those bids whose technical and BEE proposals meet or better the technical and BEE threshold scores set out in the bid evaluation criteria will be considered. Those bids that do not meet the technical and BEE threshold scores will have their price proposal envelopes returned unopened and will not be considered further for selection.

Any bid which fails to submit any element of the bid submission requirements set out in 7.2 above may, at the discretion of the bid evaluation panel, be rejected as unsuitable for evaluation, and will therefore not be considered further.

7.5 Compulsory briefing session

The [insert name of institution] will hold a briefing session on the terms of reference. All potential transaction advisors are required to attend and to register their interest in submitting bids. The list of attendees will be circulated to all present to encourage the formation of appropriate consortia. No party registering interest is, however, bound to submit a bid.

Date: [insert date of briefing session]

Time: [insert time of briefing session]

Venue: [insert venue for briefing session]

Please confirm attendance by email to: [insert email address]

7.6 Address and deadline for submission of bids

Bids by transaction advisors must be submitted in a single sealed envelope, **containing the two, separate, sealed envelopes** required.

The envelope must be marked: "Transaction advisor services to [insert name of institution] for feasibility study and possible PPP procurement for [describe project]". The bid must be hand delivered to:

The bid box

Attention: [insert name]

[insert name of institution]

[insert physical address of institution]

By no later than [insert time and date (day, month, year)]

The [insert name of institution] will record all bids received by the deadline.

Appendix A: Background and supporting documentation

[insert list of available material and/or list of attached documentation]

Appendix B: Draft transaction advisor contract

TEMPLATE DRAFT TRANSACTION ADVISOR CONTRACT

General terms and conditions for the appointment of a transaction advisor between [insert name of institution] herein represented by [insert name of institution's representative] in his or her capacity as accounting officer/authority who warrants that he or she is authorised thereto (hereinafter referred to as 'the institution') and [insert name of transaction advisor company], registration number [insert registration number], herein represented by [insert name of transaction advisor representative] in his or her capacity as [insert capacity] who warrants that he or she is duly authorised thereto (hereinafter referred to as 'the transaction advisor')

Background

The [insert name of institution] wishes to provide the public with a cost-effective, efficient service [insert description of the PPP project] and related activities, and requires the services of an experienced transaction advisor in bringing the PPP project from the concept stage through feasibility approval, competitive bidding and award, to actual execution.

Pursuant thereto, the institution has entered into negotiations with the transaction advisor for the provision of services based on the transaction advisor's proposal in response to the terms of reference.

The transaction advisor has agreed to provide the services on the terms and conditions set out herein.

Now it is hereby agreed as follows:

1. Definitions

In the agreement, unless the context indicates otherwise, the following words and expressions shall have the following meanings unless inconsistent with the context:

- | | |
|-------------------|---|
| “the Act” | means the Public Finance Management Act, 1999, and the regulations promulgated thereunder and as amended from time to time; |
| “affiliate” | in relation to any person, any holding company or subsidiary of that person or any subsidiary of such holding company, and 'holding company' and 'subsidiary', shall have the meanings assigned to them in the Companies Act, 1973; |
| “agreement” | means this agreement and the schedules thereto; |
| “applicable laws” | means all applicable laws, ordinances, regulations, judgements and orders of any competent court, central bank or |

governmental agency, authority in any relevant jurisdiction within the Republic of South Africa, requirements of the PFMA, National Treasury regulations, and such other laws as may be applicable;

“business day” means any day other than a Saturday, Sunday or public holiday in the Republic of South Africa;

“commencement date” means the [insert date as agreed by parties];

“completion date” means the date on which the services by the transaction advisor are completed;

“confidential information” means any information:

- (a) determined by the institution to be privileged or confidential;
- (b) discussed in closed session by the bid evaluation panel;
- (c) which if disclosed would violate a person's right to privacy;
- (d) declared to be privileged, confidential or secret in terms of any law including, but not limited to, information contemplated in sections 34(1); 35(1); 36(1); 37(1)(a); 38(a); 39(1)(a); 40 or 43(1) of the Promotion of Access to Information Act, 2000;

“deliverables” means those deliverables as set out in the agreement documents;

“good industry practice” means using standards, practices, methods and procedures conforming to applicable law and exercising that degree of skill, care, diligence, prudence and foresight that would reasonably and ordinarily be expected of a skilled, and experienced person engaged in a similar type of undertaking under similar circumstances;

“institution” in relation to the agreement, means [insert name of the national or provincial department, constitutional institution, public entity listed in schedules 3A, 3B and 3D of the Act or any subsidiary or entity under the ownership or control of any such public entity], and includes the officials of the institution acting in the course and scope of their employment;

“institutional default”	means an act or omission by the institution which results in a breach of any of its material obligations under the agreement;
“parties”	means the institution and the transaction advisor;
“private party”	means the private party in relation to a PPP agreement contemplated in Treasury Regulation 16.1;
“PPP”	means public private partnership as defined in Treasury Regulation 16.1;
“PPP agreement”	means an agreement contemplated in Treasury Regulation 16.1 between the institution and a private party;
“project”	means a PPP as defined by Treasury Regulation 16.1;
“project officer”	means that person designated by the [accounting officer/ authority] of the institution as project officer for the project;
“proposal”	means the transaction advisor's response to the institution's terms of reference in respect of the carrying out of the services;
“services”	means those services to be provided by the transaction advisor;
“signature date”	means the date of signature of this agreement by the last signing party;
“success fee”	means the portion of the transaction advisor's compensation which is contingent upon the financial closure as more fully set out in clause 6.2;
“termination date”	means any date of termination of the agreement in accordance with clause 13 of the agreement;
“transaction advisor”	means [insert name of transaction advisor company];
“variation”	means any variation to the scope of services in terms of the agreement; and
“VAT”	means any value-added tax, or any similar tax which is imposed in place of or in addition to such tax.

2. Interpretation

- 2.1 The agreement shall be interpreted according to the following provisions, unless the context requires otherwise:
- 2.1.1 References to the provisions of any law shall include such provisions as amended, re-enacted or consolidated from time to time in so far as such amendment, re-enactment or consolidation applies or is capable of applying to any transaction entered into under the agreement;
 - 2.1.2 References to clauses, sub-clauses, annexures and schedules are references to the clauses, sub-clauses, annexures and schedules of the agreement;
 - 2.1.3 The headings of clauses, sub-clauses, annexures and schedules are included for convenience only and shall not affect the interpretation of the agreement;
 - 2.1.4 Reference to 'the agreement' shall include the agreement and its annexures, schedules as amended, varied, novated or substituted in writing from time to time;
 - 2.1.5 The parties acknowledge that each has had the opportunity to take legal advice concerning the agreement, and agree that no provision or word used in the agreement shall be interpreted to the disadvantage of either party, because that party was responsible for or participated in the preparation or drafting of the agreement or any part of it;
 - 2.1.6 Words importing the singular shall include the plural and vice versa, and words importing either gender or the neuter shall include both genders and the neuter, and 'person' shall include both corporeal and incorporeal entities;

3. Agreement to provide services

- 3.1 With effect from the commencement date, the institution hereby appoints the transaction advisor to provide the services and the transaction advisor agrees to provide the services to the institution on the terms and conditions recorded in the agreement.

4. Duration

- 4.1 The agreement shall commence on the commencement date and terminate on the termination date.

5. Scope of services

- 5.1 The scope of services to be provided by the transaction advisor in terms of the agreement is set out in the deliverables schedule, annexed hereto as Schedule A.

6. Price and payment terms

- 6.1 During the term of the agreement and in consideration for the services

provided by the transaction advisor to the institution, the institution will pay the transaction advisor that fixed fee as specified in the payments schedule, annexed hereto as Schedule B.

- 6.2 The success fee portion of the transaction advisor's compensation will be contingent upon the financial closure (with all formalities completed) of the PPP agreement between the institution and the selected private party, and of receipt by the institution of the close-out report and relevant case study reports as set out in the deliverables schedule, annexed hereto as Schedule A.
- 6.3 Payment of the mobilisation allowance will be made by the institution within 30 days of the signature date. Invoices for further instalments may be submitted to the institution by the transaction advisor upon milestones achieved, as specified in the payments schedule, annexed hereto as Schedule B, and will be paid within 30 days of receipt of invoice.

7. Project team

- 7.1 The parties shall, immediately after the signature date, form a project team, which will be responsible for the management of the agreement so as to ensure the smooth and satisfactory delivery of the services by the transaction advisor to the institution.
- 7.2 The project team shall be composed of the following:
- 7.2.1 the project officer appointed by the institution, who shall act as manager on behalf of the institution;
 - 7.2.2 such other additional members as appointed by the institution;
 - 7.2.3 a representative appointed by the transaction advisor, who shall have authority to bind the transaction advisor; and
 - 7.2.4 such other members of the transaction advisor as appointed by the transaction advisor.
- 7.3 The functions of the project team shall be as follows:
- 7.3.1 to facilitate communication between the parties;
 - 7.3.2 to review the progress on the implementation of the agreement;
 - 7.3.3 to manage and resolve potential disputes;
 - 7.3.4 to monitor and maintain alignment with institutional policy and strategy;
 - 7.3.5 to achieve agreement objectives within agreed scope, time, cost and quality;
 - 7.3.6 to provide advice and consent on scope variation;
 - 7.3.7 to facilitate all necessary institutional and treasury approvals; and
 - 7.3.8 to provide feedback to relevant stakeholders.
- 7.4 The project team shall determine an appropriate set of meetings to be held and the frequency thereof.

8. Obligations of parties

8.1 The institution undertakes:

- 8.1.1 to remunerate the transaction advisor for its services as set out in the payments schedule, annexed hereto as Schedule B;
- 8.1.2 to provide all necessary logistical support to the transaction advisor so as to enable it effectively to render the services;
- 8.1.3 to use its best endeavours to ensure that the transaction advisor has timely and adequate access to all information, personnel and documentation available to the institution that will be required by the transaction advisor to render the services; and
- 8.1.4 to co-operate with the transaction advisor at all times for purposes of facilitating a timeous and efficient delivery of the services.

8.2. The transaction advisor undertakes:

- 8.2.1 to perform the services according to good industry practice;
- 8.2.2 to devote the necessary time and attention to providing the deliverables, as set out in the deliverables schedule, annexed hereto as Schedule A, and not engage in any business or activity that will prevent the transaction advisor from providing the services;
- 8.2.3 to maintain, at all times, the highest degree of good faith towards the institution and to ensure that no conflict of interest materialises, and in the event of a conflict of interest arising, to immediately advise the institution of same, upon which advice the institution shall, in its sole and absolute discretion, decide whether to proceed with the agreement or to terminate it forthwith. Failure by the transaction advisor to advise the institution of any conflict of interest shall amount to a material breach of the agreement and shall entitle the institution to terminate the agreement forthwith;
- 8.2.4 to render the services in accordance with the deliverables, timeframes and specifications, as set out in the deliverables schedule, annexed hereto as Schedule A, as amended by written agreement of the parties;
- 8.2.5 that all actions and commitments agreed upon or pursuant to the project management committee meetings or agreed to with the project officer, will be strictly adhered to;
- 8.2.6 to maintain independence from other individuals, organisations or government bodies;
- 8.2.7 to take out, at its own cost, appropriate insurance coverage against loss arising out of negligence, malpractice or unprofessional conduct of the transaction advisor;
- 8.2.8 to observe neutrality and objectivity in its views and opinions;
- 8.2.9 to respect and observe all applicable laws;
- 8.2.10 to provide the institution with any information and reports reasonably requested by the institution in connection with the services, and which

information the transaction advisor warrants to be accurate and complete;

- 8.2.11 to maintain the professional personnel as promised and committed to by the transaction advisor in its proposal and as recorded in the deliverables schedule, annexed hereto as Schedule A, and that in the event of any dedicated member of the transaction advisor becoming incapacitated and unable to carry out his or her duties or whose performance the institution reasonably considers to be unsatisfactory in its discretion, to replace, at the transaction advisor's cost, such member, subject to the written approval of the institution.

9. Confidentiality

- 9.1 The transaction advisor shall not, during the term of the agreement and thereafter, without the prior written consent of the institution, disclose any confidential information relating to the institution and the services to anyone other than those persons who are connected to the institution and/or transaction advisor and who are required or authorised to have access to such information.
- 9.2 The obligation to maintain the confidentiality of information shall survive the termination of the agreement, but will not apply to confidential information which was in the public domain prior to being disclosed by the transaction advisor and has come into the public domain other than as a result of being divulged by the transaction advisor.

10. Ownership of material and intellectual property

- 10.1 Any information provided by the institution to the transaction advisor and any studies, reports and documentation produced by the transaction advisor in performance of the services (hereinafter 'materials') shall belong to and remain the property of the government of the Republic of South Africa as represented by the institution, and will not be used by the transaction advisor for any purpose other than in accordance with the agreement, or by written permission of the institution.
- 10.2 Upon termination of the agreement for any reason whatsoever, the transaction advisor must return to the institution all materials in its possession which belong to the institution, regardless of whether or not such materials were originally supplied by the institution to the transaction advisor.

11. Warranties and indemnities

- 11.1 The transaction advisor warrants that:
- 11.1.1 All corporate approvals and consents required for the incorporation of the transaction advisor and all resolutions of the board of

directors of the transaction advisor authorising the execution and performance of the agreement have been obtained prior to the signature date of the agreement; and

11.1.2 It will use good industry practice and skill in performing the services.

11.2 The transaction advisor indemnifies and holds the institution harmless against any claim by any third party howsoever arising in connection with any wrongful act or omission of the transaction advisor.

11.3 The institution indemnifies and holds the transaction advisor harmless against any claim by any third party arising in connection with any wrongful act or omission of the institution.

12. Liability limitation

12.1 The transaction advisor will accept liability to pay damages for losses suffered by the institution arising as a direct result of breach of contract or negligence on its part in respect of the services. The maximum liability of the transaction advisor for all claims arising out of the services provided in connection with this agreement shall be limited to an amount equal to twice the fees charged for the services.

13. Termination

13.1 The institution reserves the right to terminate the agreement or temporarily defer the provisioning of the services, or any part thereof, at any phase with immediate effect on written notice to the transaction advisor, should the institution in its sole and absolute discretion decide not to proceed with the services.

13.2 In the event of termination of the services in accordance with clause 13.1 above, the transaction advisor will be remunerated for such services as have already been rendered.

13.3 Termination on institutional default

13.3.1 On the occurrence of an institutional default, or within a reasonable time after the transaction advisor becomes aware of the same, the transaction advisor may serve notice on the institution of the occurrence (and specifying details) of such institutional default. If the relevant default has not been remedied or rectified within 10 (ten) business days of such notice, the transaction advisor may serve a further notice on the institution terminating the agreement with immediate effect.

13.4 Termination on transaction advisor default

13.4.1 Transaction advisor default means any of the following events or circumstances:

- 13.4.1.1 The transaction advisor ceasing to carry on business;
- 13.4.1.2 A resolution being passed or an order of court being made for the administration or the judicial management, winding-up, liquidation or dissolution of the transaction advisor;
- 13.4.1.3 The transaction advisor failing to maintain any required insurance in terms of clause 8.2.7;
- 13.4.1.4 The transaction advisor committing a breach of any of its material obligations under the agreement;
- 13.4.1.5 The transaction advisor ceasing to provide all or a substantial part of the services in accordance with the agreement;
- 13.4.1.6 The transaction advisor providing services that are not good industry practice.

13.4.2 Institutional options

13.4.2.1 On the occurrence of a transaction advisor default, or within a reasonable time after the institution becomes aware of the same, and while the same is subsisting, the institution may:

13.4.2.1.1 In the case of the transaction advisor default referred to in clauses 13.4.1.1 to 13.4.1.3, terminate the agreement in its entirety by notice in writing with immediate effect;

13.4.2.1.2 In the case of the transaction advisor default referred to in clauses 13.4.1.4 to 13.4.1.6, serve notice of default on the transaction advisor, requiring the transaction advisor to remedy the transaction advisor default within 10 (ten) business days.

13.4.2.2 Failure by the transaction advisor to remedy the transaction advisor default within the specified time, as stipulated in clause 13.4.2.1.2, shall entitle the institution to terminate the agreement.

13.4.3 Costs

13.4.3.1 Each party shall reimburse the other party with all costs incurred by that party in exercising any of its rights (including, without limitation, any relevant administrative expenses), on an own attorney and client basis incurred by that party in enforcing its rights under the

agreement arising out of any breach, together with all supporting documents of such amount, which amount shall not exceed twice the amount of fees payable in terms of this agreement.

14. Dispute resolution

- 14.1 Should any dispute arise between the parties to this agreement with regard to the interpretation, the carrying into effect and implementation of any one or more of the provisions of this agreement, any of the rights and obligations of either party arising from the agreement, the termination or purported termination of, or arising from the termination of, or the rectification or proposed rectification of the agreement, or out of pursuant to this agreement, or any other matter which in terms of this agreement requires agreement by the parties, the institution and the transaction advisor shall, in the first instance, attempt to come to an agreement in relation to any such dispute by consultation and negotiation in good faith.
- 14.2 In the event that the parties, after consultation and negotiation, are unable to come to an agreement, then either party may give written notice to the other party of its intention to cancel the agreement.

15. Notices

- 15.1 The parties choose as their respective *domicilium citandi et executandi* for all purposes of the giving of notices and the serving of any process, and for any other purpose arising from the agreement, as follows:
 In the case of the institution:
 Address: [insert institution's address]
 Telefax no: [insert institution's fax number]
 In the case of the transaction advisor:
 Address: [insert transaction advisor's address]
 Telefax no: [insert transaction advisor's fax number]
- 15.2 A notice shall be deemed to have been duly given:
- 15.2.1 On delivery, if delivered to any party's physical address in terms of this clause 15.1;
- 15.2.2 On despatch, if sent to any party's then telefax number in terms of clause 15.1 as confirmed by telefax confirmation printout.
- 15.3 Either party may change its address to any physical address and telefax number (in the Republic of South Africa) for this purpose, by notice in writing to the other party.

16. Entire contract

- 16.1 The agreement contains all the express provisions agreed on by the parties with regard to the subject matter of the agreement, and the parties

waive the right to rely on any alleged express provision not contained in the agreement.

17. No representations

17.1 No party may rely on any express, tacit or implied term, representation, promise, warranty or the like which allegedly induced that party to enter into the agreement, unless the term, representation, promise, warranty is recorded in the agreement.

18. Variation, cancellation and suspension

18.1 No contract varying, adding to, deleting from or cancelling the agreement, and no suspension of any right under the agreement shall be effective unless reduced to writing and signed by or on behalf of the parties.

19. Waiver

19.1 No waiver by a party of any right under the agreement shall be effective unless reduced to writing and signed by or on behalf of all the parties.

20. Indulgences

20.1 No indulgence granted by a party shall constitute a waiver or abandonment of any of that party's rights under the agreement. Accordingly, that party shall not be precluded, as a consequence of having granted that indulgence, from exercising any rights against the other party which may have arisen in the past or which may arise in the future.

21. Assignment

21.1 Save as expressly provided in the agreement, the transaction advisor shall not cede any of its rights nor delegate any of its obligations in terms of the agreement without the prior written consent of the institution.

22. Costs

22.1 Each party shall bear its own legal costs of, and incidental to, the negotiation, drafting and preparation of the agreement.

22.2 Any costs, including attorney and own client costs, incurred by a party, arising out of the breach by either party of any of the provisions of the agreement, shall be borne by the party in breach.

23. Subcontracting

23.1 The transaction advisor shall not, without the prior written consent of the institution (which shall not be unreasonably withheld), subcontract or delegate any of the services to any parties other than those listed as members of the transaction advisor as contained in the proposal and recorded in the deliverables schedule, attached hereto as Schedule A.

23.2 The transaction advisor shall not be relieved of any obligations, responsibility or liability under the agreement by the appointment of any subcontract to carry out any part of the services. As between the transaction advisor and the institution, the transaction advisor shall be responsible for the payment, performance, act, defaults, omissions, breaches and negligence of all subcontractors. All reference in the agreement to any performance payment, act, default, omission, breach or negligence of the transaction advisor shall be deemed to include any or the same by a subcontractor.

24. Governing law and language

24.1 The agreement shall be governed by the laws of the Republic of South Africa, and its language shall be English.

25. Counterparts

25.1 The agreement shall be capable of execution in counter parts, all of which when read together shall constitute one and the same document.

Signed and witnessed by the parties on the following dates and at the following places respectively:

Date:

Place:

Witness:

Signature:

For:
[insert name of institution]

Date:

Place:

Witness:

Signature:

For:
[insert name of transaction advisor]

Schedule A: Deliverables schedule

Schedule B: Payments schedule

TEMPLATE TRANSACTION ADVISOR ADVERTISEMENT

[Insert name of institution] seeks a transaction advisor for a feasibility study and possible PPP procurement for [describe project]

The [insert name of institution] has identified the need for [describe project] to [describe institution's objectives]. A public private partnership (PPP) may be appropriate.

In accordance with the relevant Treasury regulations and *National Treasury's PPP Manual* and *Standardised PPP Provisions*, a suitably skilled and experienced transaction advisor is required to assist the [insert name of institution] with:

- the feasibility study for Treasury Approval: I
- the production of all bid documents, including draft PPP agreement, for Treasury Approval: IIA
- PPP procurement and value-for-money report for Treasury Approval: IIB
- negotiated PPP agreement and PPP agreement management plan for Treasury Approval: III
- a close-out report and case study.

The procurement phase will be decided by the [insert name of institution] only on completion of the feasibility study, and the [insert name of institution] reserves the right to end the transaction advisor contract on completion of the feasibility study.

The contract for these services will be with a single transaction advisor, and all other team members must be hired by the transaction advisor via subcontract or joint venture.

High quality expertise and experience is required in:

- financial analysis and project finance
- legal
- PPPs
- negotiations
- BEE
- [insert specific areas of skill required for particular project].

Bids will be evaluated in terms of applicable procurement legislation, on technical, BEE and price considerations, and will include interviews with short-listed bidders before selection.

Terms of reference, detailing the work and bid requirements, are available from [insert name of person] at [insert email address] on [insert website address] and/or in hard copy from [insert physical address].

All queries must be directed to [insert name of person] at [insert email address] or on [insert telephone number].

A compulsory briefing session for bidders will be held at [insert physical address] on [insert date] at [insert time].

Bids must be submitted according to the specifications in the terms of reference.

Closing date: [insert time] on [insert date].

TEMPLATE TRANSACTION ADVISOR TECHNICAL AND BEE EVALUATION SCORESHEETS

Evaluation scoresheets: Tender [insert tender number]

Appointment of transaction advisor services to the [insert name of institution]
for [describe project]

Evaluation phase: Technical and BEE proposals

Name of bidder: [insert name of bidder]

Name of panel member: [insert name of panel member]

Date: [insert date]

This document is highly confidential

Signature of panel member: [signature]

TECHNICAL PROPOSAL	Maximum points	Points awarded	Reasons/motivation/remarks
<p>4. PPP procurement and structuring – relevant experience and track record</p> <p>Excellent = 8 Acceptable = 4 Poor = 0</p>	8		
Notes: Clarification needed			
<p>5. Negotiations – relevant experience and track record</p> <p>Excellent = 8 Acceptable = 4 Poor = 0</p>	8		
Notes: Clarification needed			
<p>6. Design, construction, engineering, quantity surveying, property planning – skills and relevant experience</p> <p>Excellent = 8 Acceptable = 4 Poor = 0</p>	8		
Notes: Clarification needed			
<p>7. Quality of project comprehension demonstrated in proposals for [...]</p> <p>Excellent = 8 Acceptable = 4 Poor = 0</p>	8		
Notes: Clarification needed			

TECHNICAL PROPOSAL	Maximum points	Points awarded	Reasons/motivation/remarks
8. Quality of proposed work plan, project management approach and timetable for the project Excellent = 10 Acceptable = 5 Poor = 0	10		
Notes: Clarification needed			
9. Lead transaction advisor's availability for the work Excellent = 10 Acceptable = 5 Poor = 0	10		
Notes: Clarification needed			
TOTAL technical score	100		
Technical threshold score	65		PASS / FAIL

BEE PROPOSAL	Maximum score	Score awarded	Weighting	Maximum points	Points awarded	Reasons/Motivation Remarks
1. The percentage of Black People playing leading professional roles in the Transaction Advisor consortium 25% – 35% =3 >35% =5	5		6	30		
Notes: Clarification needed						
2. The percentage of black equity in the Transaction Advisor consortium 25% – 35% = 3 >35% = 5	5		6	30		
Notes: Clarification needed						
3. A credible plan for structuring effective BEE for the PPP, with necessary skill and experience in the team. Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skill & experience = 2 or 3 Credible plan, skill & experience = 4 or 5	5		4	20		
Notes: Clarification needed						
4. A credible plan for skills transfer within the consortium to directly benefit black professionals inexperienced in PPPs Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	5		4	20		
Notes: Clarification needed						
TOTAL BEE score	100					
BEE threshold score	60			PASS / FAIL		
TOTAL technical score	100			PASS / FAIL		
TOTAL BEE score	100			PASS / FAIL		

TEMPLATE CODE OF CONDUCT FOR BID EVALUATION PANEL MEMBERS

This code of conduct is to be signed by members of bid evaluation panels appointed by institutions to evaluate:

- transaction advisor bids
- PPP bids.¹

1. Background

In terms of the Constitution of the Republic of South Africa, 1996, section 217:

When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

This code of conduct is issued by National Treasury to instil standards of integrity, ethical conduct, and professionalism in the South African government's adjudication and evaluation of all procurement undertaken by institutions governed by Treasury Regulation 16 to the Public Finance Management Act, 1999 (PFMA), in relation to public private partnerships (PPPs). It is to be applied by institutions in the evaluation of:

- transaction advisor bids
- PPP bids.

Every member of a bid evaluation panel appointed by an institution to act on behalf of the state in the adjudication and evaluation of these bids is required to sign this code of conduct before receiving bids.

In addition, each member has to sign the attached declaration of interest form once the institution has announced and recorded the identities of the bidding parties.

The aims of the code

This code of conduct does not address every possible situation that may arise. It also cannot serve as a substitute for the responsibility of the accounting officer/ authority and the bid evaluation panel members to:

- exercise sound judgment
- act with exceptional standards of moral integrity

1. For the evaluation of PPP bids, this code of conduct must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECO), and the project evaluation committee (PEC).

- abide by all applicable laws.

This code of conduct is intended to:

- confirm the member's commitment to all its prescripts
- guide members who are faced with ethical dilemmas in an increasingly complex operational environment
- provide a reference for disciplinary and/or prosecuting procedures if a member is found guilty of fraud or corruption
- serve as a public commitment by the institution to the highest standards of ethical and professional conduct in the evaluation of bids.

Breaching the code

A member will be found guilty of breaching the code of conduct if he or she

- contravenes or fails to comply with any provision in it
- when declaring interests, willfully gives incorrect or misleading details.

In these cases, a member will be liable for disciplinary action in terms of public service regulations to the Public Services Act, 1994 and may also be liable for criminal prosecution.

The accounting officer/authority, acting on his or her own or on a complaint by any person, may investigate any alleged breach of this code by a member of an evaluation panel and may withdraw the member from the panel during the investigation.

2. Definitions

“**Family member**” means a parent, sibling, child or spouse of a member;

“**Member**” means a person appointed by the accounting officer/authority to a bid evaluation panel, either as the chairperson, or as an ordinary member or secretariat, for purposes of conducting the evaluation of either transaction advisor bids or PPP bids as a representative of the institution;

“**Privileged or confidential information**” means any information:

- determined by the institution to be privileged or confidential
- discussed in closed session by the bid evaluation panel
- which if disclosed would violate a person's right to privacy
- declared to be privileged, confidential or secret in terms of any law, including, but not limited to, information contemplated in sections 34(1); 35(1); 36(1); 37(1)(a); 38(a); 39(1)(a); 40 or 43(1) of the Promotion of Access to Information Act, 2000.

3. Code of conduct

I, [insert name of member of bid evaluation panel], acting in my capacity as member of the [insert name of institution] evaluation panel for the adjudication and evaluation of bids for transaction advisors/private parties (delete which is not applicable) under [insert tender number] hereby undertake:

1. to act at all times with fidelity, honesty, integrity and in the best interests of the state and the general public it serves
2. to diligently perform the duties of a member efficiently, effectively and strictly in accordance with the rules of bidding and bid evaluation, as set out in the bid documentation and according to all relevant instructions given by the institution
3. to properly prepare for and attend each meeting of the bid evaluation panel, and failing this to withdraw as a member
4. to act at all times in accordance with the relevant legislation and regulations, including the public service regulations, the PFMA, National Treasury regulations, and directives given by the institution
5. specifically, to comply with the *Code of Conduct for the Public Service*, in Chapter 2 of the public service regulations
6. to recognise the public's right to access to information in the interests of administrative justice
7. to take the utmost care in ensuring that there is reasonable protection of the records of the institution and all bid documentation
8. not to misuse the position or privileges of a member, or privileged or confidential information obtained as a member
9. to carry out duties with the skill and care expected from a person of knowledge and experience, and to exercise due judgement
10. not to unfairly discriminate against any bidder on the grounds of race, gender, ethnic or social origin, colour, sexual orientation, age, disability, religion, political persuasion, conscience, belief, culture or language
11. not to abuse any position in the public service to promote or prejudice the interest of any political party or interest group
12. to give the Auditor-General all the information and explanations it requires to carry out its functions
13. to report to the appropriate authorities any case of fraud, corruption, nepotism, maladministration and any other acts which constitute an offence or which are prejudicial to the public interest, arising during the bid evaluation panel proceedings
14. to declare, diligently, accurately and honestly in the declaration of interest, all personal and/or business interests that I or a family member may have in any business of any bidder, and to willingly abide by any decision of the chairperson of the bid evaluation panel or the accounting officer/authority to withdraw as a member of the panel because of this

15. to be open and honest about all decisions and actions taken regarding the bid evaluation, and to give clear reasons for these, which can be accurately recorded
16. not to make any dishonest allegations about any bidder
17. not to make any false or misleading entries into the records of the bid evaluation panel
18. to make no contractual commitments related to the bid, to any bidding party, on behalf of the institution
19. to proactively protect privileged or confidential information of the bid evaluation panel from theft, unauthorised disclosure or inappropriate use, and specifically:
 - 19.1. not to respond to any queries relating to the bid evaluation on behalf of the institution, unless expressly authorised in writing by the accounting officer/authority to do so
 - 19.2. not to speak to or correspond carelessly with any person (fellow member, colleague, friend, family member or otherwise) on any matter related to the bid evaluation
20. not to request, solicit or accept any reward, gift or favour in return for voting or not voting in a particular way on any matter, or for disclosing privileged or confidential information
21. not to accept or agree later to accept, any 'kickbacks' in the form of money, favours, inappropriate gifts or anything else of value from a member of the public, government, a political or social movement, or any stakeholder or potential stakeholder which is or may be viewed as aimed at influencing or directing my evaluation of the bids
22. to disclose immediately to the chairperson or the accounting officer/authority any attempted inducement or offers of perks that may be construed as aimed at influencing or directing the evaluation of the bids
23. to report to the chairperson of the panel any invitations to any kind of entertainment by any party that may be construed as being associated in any way with the outcome of the bid evaluation
24. not to vote at, attend or participate in any other way in any meeting or hearing in relation to any matter before the bid evaluation panel, if any interest prevents me from carrying out my member functions in a fair, unbiased and proper way in accordance with this code of conduct.

Signed: _____
[signature of member]

Date: _____
[insert date]

Witnessed: _____
[signature of witness]

TEMPLATE DECLARATION OF INTEREST STATEMENT

The table below shows the full list of all the bidders, including the names of all the consortium members of each bid, who have responded to the [insert name of institution] call for a transaction advisor/PPP (delete as appropriate) bid for [insert name and tender number of project].

As a member of the bid evaluation panel,¹ you are required to declare any interest, as far as you are aware that you have, in any of the bidders and their consortium member companies.

An interest includes, but is not limited to:

- your shareholding in a bidding company or any of its consortium member companies. Clearly indicate the extent of your shareholding and links to this bid.
- family members, friends or associates employed by a bidding company or any of its consortium members. Clearly indicate the extent of this relationship and links to this bid.
- family members, friends or associates' shareholding in a bidding company or any of its consortium members. Clearly indicate the extent of their shareholding and links to this bid.
- family members, friends or associates contracted to provide services to a bidding company or any of its consortium members. Clearly indicate these individuals' links to this bid.
- you, or any of your family members, friends or associates receiving, or in agreement to receive, any gifts, favours, payments, sponsorships, subsidies, or any other benefits from any bidders or any members of any of the consortia, within the last 12 months of the date of this declaration.
- any other personal interest that may reasonably be deemed relevant to protecting the integrity of the bid evaluation.

All bidders' names and names of all consortium member companies	Interest (Yes / No)	Extent of interest

1. For the evaluation of PPP bids, this declaration of interest must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECC) and the project evaluation committee (PEC).

I, [insert name of member], a member of the bid evaluation panel for the [insert name of institution and name and number of project] declare that the above information is true and correct to the best of my knowledge. I declare further that in the event of any such interests arising during the course of bid evaluation, these shall be promptly and accurately declared in writing to the accounting officer/authority.

Signed: _____
[signature of member]

Date: _____
[insert date]

Witnessed: _____
[signature of witness]

EXAMPLE TRANSACTION ADVISOR BID EVALUATION SCORING SPREADSHEET

Please note, this example is relevant if the budget for transaction advisors is declared. The points weighting will be adjusted if the budget is not declared. Refer to *Module 3: PPP Inception*. Only some of the scoring sheets are shown here for example purposes. The full electronic version of the scoring spreadsheet is available from the PPP Unit, National Treasury. Go to www.treasury.gov.za

Cover sheet	
Department of _____ (insert department or public entity name)	
Transaction Advisor Evaluation	
Evaluation criteria	Points (insert relevant weighting)
Technical	70
BEE	10
Price	20
Total	100
Technical threshold	65%
BEE threshold	60%
<hr/>	
Evaluators (insert names)	Initials (insert initials)
Itumeleng A	IA
Themba B	TB
Maliyeng C	MC
John D	JD
Maria E	ME
Fernando F	FF
Pradeep G	PG
Johan H	JH
Isaac I	II
Number of evaluators	9
<hr/>	
Bidding companies (insert names)	
Company A	
Company B	
Company C	
Company D	
Company E	
Company F	
Company G	
Company H	

Instructions	
Section	Instructions
1 Cover Sheet	Insert all fields in <i>italics</i>
2 Technical Individual Scores	Insert technical evaluation scores of individual evaluators under relevant initials and under relevant company name. Spreadsheet is set up to calculate total scores. Insert only relevant fields in <i>italics</i> .
3 BEE Individual Scores	Insert BEE evaluation scores of individual evaluators under relevant initials and under relevant company name. Spreadsheet is set up to calculate total scores. Insert only relevant fields in <i>italics</i> .
4 Tech and BEE Total	Verify totals per company match up with individual scores. Spreadsheet is set up to calculate total scores and establish which bids have passed or failed the technical and BEE thresholds. It is not necessary to fill in any information on this sheet.
5 Price Evaluation	If company has failed the technical and BEE thresholds, do not insert the name or bid price for that company into spreadsheet. Insert only relevant fields in <i>italics</i> .
6 Total Evaluation Result	Spreadsheet is set up to calculate total result and rank bids. Rank Number 1 is the winning bid.

Average scores of the evaluators per company

Technical and BEE evaluation: total scores

Total scores	Maximum Points	Company A	Company B	Company C	Company D	Company E	Company F	Company G	Company H
		Total	Total	Total	Total	Total	Total	Total	Total
Technical Evaluation									
Financial analysis and project finance									
Skills	8	7,56	4	8	4,89	4	4	5,33	4
Relevant experience	8	4,44	4	2,67	5,44	4	4	4	4
Legal									
Skills	8	4,89	4	8	6,22	4	4	8	4
Relevant experience	8	5,33	4,89	4	4	4	4	8	4
Working environment planning and facilities management									
Skills	8	5,33	4	4,89	2	4	3	4	4
Relevant experience	8	5,33	4	4,89	4	4	2,22	3,56	4,89
PPP procurement and structuring – relevant experience and track record	8	7	7,11	7,11	6,22	4	8	4,44	7,11
Negotiations – relevant experience and track record	8	5,78	4,89	4,89	6	3	6	4,67	6,22
Design, construction, engineering, quantity surveying, property planning – skills and relevant experience									
Quality of project comprehension demonstrated in proposals for [...]	8	5,78	6,22	4,89	5,78	5,78	4,89	4,44	6,22
Quality of proposed workplan, project management approach and timetable for the project	8	4,89	7,11	6,22	5,78	6,67	5,78	5,78	5,78
Lead advisor's availability for the work	10	5,56	5	6,67	7,78	6,11	7,22	6,67	7,22
Total for Technical	100	68,33	60,22	65,01	65,33	57,89	58,67	66,11	65,22
Technical Threshold	65%								
Pass/Fail		P	F	P	P	F	F	P	P
BEE Evaluation									
The percentage of black people playing leading professional roles in the Transaction Advisor consortium	30	18	18	18	18	18	0	18	18
Percentage of black equity in the lead Transaction Advisor consortium	30	30	18	18	30	18	30	30	30
Plan for structuring effective BEE for the PPP, with skill and experience	20	13,76	16	15,56	12	6,68	11,56	9,76	13,76
Skills transfer plan within the consortium to directly benefit black professionals	20	18,24	13,76	14,24	18,24	12	12	13,76	15,56
Total for BEE	100	80	65,76	65,8	78,24	54,68	53,56	71,52	77,32
BEE Threshold	60%								
Pass/Fail		P	P	P	P	F	F	P	P

Price evaluation						
Technical evaluation Pass/Fail **	BEE evaluation Pass/Fail **	Company	Compliance passed Technical and BEE	Price		Price ranking
				Cost	Points	
P	P	Company A	Company A	R3 000 000	100	1
F	P	Company B			–	
P	P	Company C	Company C	R3 200 000	93	2
P	P	Company D	Company D	R4 200 000	60	4
F	F	Company E			–	
F	F	Company F			–	
P	P	Company G	Company G	R5 250 000	25	5
P	P	Company H	Company H	R4 000 000	67	3
		Lowest bidder		R3 000 000		

Total evaluation results								
	Technical		BEE		Price		Total	Overall ranking
Weighting	70		10		20			
Company	<i>(score ex 100)</i>	<i>Weighted score</i>	<i>(score ex 100)</i>	<i>Weighted score</i>	<i>(score ex 100)</i>	<i>Weighted score</i>	<i>(max. 100)</i>	
Company A	68,33	47,83	80	8	100	20	75,83	1
Company B			65,76	6,58				
Company C	65,01	45,51	65,8	6,58	93,33	18,67	70,75	2
Company D	65,33	45,73	78,24	7,82	60	12	65,56	4
Company E								
Company F								
Company G	66,11	46,28	71,52	7,15	25	5	58,43	5
Company H	65,22	45,65	77,32	7,73	66,67	13,33	66,72	3

TEMPLATE APPLICATION TO THE PDF – PRE-TA:I

The Head
Public Private Partnership Unit
National Treasury
Private Bag X115
Pretoria 0001

Attention: Project Development Facility
[insert date]

Dear Sir/Madam

Application for funding of transaction advisor services for a PPP

1. As the accounting officer/authority of [insert name of institution] I endorse the enclosed application for funding of transaction advisor costs for a prospective PPP for the [insert project name]. This project has been registered with the PPP Unit and will follow the process for PPPs prescribed by National Treasury regulations.
2. The [insert name of institution] is a [insert status¹] and has the following institutional functions: [set out details of mandate, enabling legislation and institutional history].
3. We have carried out the procurement of PPPs in the past, being [set out PPPs in procurement and in operation].
4. The project for which we apply for funding is [provide full details of the project as well as the strategic goals of the institution, service delivery outcomes and improvements on the current outcomes expected to be achieved by the project].
5. We have advertised the terms of reference for the transaction advisor services required for the project in accordance with *National Treasury's PPP Manual* and have evaluated the responses thereto. Following this process we have appointed [details of the transaction advisor]. Details of the assessment made of the consortium's capacity to procure a successful PPP are attached.
6. The transaction advisor has been appointed for part 1 of the project, being the work required to obtain Treasury Approval: 1. Given that the feasibility study may show insufficient value for money and that the project may either be terminated or proceed under conventional procurement, the appointment of the transaction advisor for part 2 of the project is contingent on the results of the feasibility study.

1. For example: Schedule 3b public entity.

7. The total amount of advisor fees is [insert R amount], made up as follows:
part 1 fees: [insert R amount]
part 2 fees: [insert R amount].
8. The part 1 fees will be paid by [specify the institution/other sources].
9. The part 2 fees are payable on delivery of work outputs/milestones as follows:
[insert payments schedule from contract]
10. Furthermore the [insert name of institution] has committed the following resources to manage the project procurement: [set out appointment of internal or external staff to manage PPP process].
11. Application is therefore made for the part 2 transaction advisor costs from the Project Development Facility.
12. We confirm that we have reserved the right to recover part 2 costs as a success fee from a successful bidder should this project reach financial closure as a PPP.
13. The estimated value of the project in capital expenditure and operational expenditure terms is [set out initial estimates of expenditure on the project²].
14. We envisage that the project will be able to leverage value for money through private sector investment in [set out objectives in involving private sector].
15. We have established institutional capacity to manage the project in procurement and during operations by [set out institutional capacity statement].
16. We attach details of the project timelines and projected cash flow for payment of the transaction advisor for both parts.
17. We confirm that, should funding be granted, it may be conditional on the outcome of the feasibility study, and that the PDF will reserve the right to recover the disbursed funds in the form of a success fee from any successful bidder at financial closure.

Yours faithfully

[signature of accounting officer/authority]

[insert name of accounting officer/authority]

Attached documents:

- Annex 1: Terms of reference for appointment of transaction advisor
- Annex 2: Summary of selection process for transaction advisor
- Annex 3: Terms of appointment of transaction advisor
- Annex 4: Additional project information, including initial cost estimates
- Annex 5: Additional institutional capacity description
- Annex 6: Details of project timelines and cash flow for advisor fees

2. This shows the ratio of transaction advisor fees to project value.

TEMPLATE APPLICATION TO THE PDF – POST-TA:1

The Head
Public Private Partnership Unit
National Treasury
Private Bag X115
Pretoria 0001

Attention: Project Development Facility
[insert date]

Dear Sir/Madam

Application for funding of transaction advisor services for a PPP

1. As the accounting officer/authority of the [insert name of institution] I endorse the enclosed application for funding of transaction advisor costs for a prospective PPP for the [insert project name]. This project has been registered with the PPP Unit and has received Treasury Approval: 1 for the feasibility study as prescribed by Treasury Regulation 16 to the PFMA.
2. The [insert name of institution] is a [insert status¹] and has the following institutional functions: [set out details of mandate, enabling legislation and institutional history].
3. We have carried out the procurement of PPPs in the past, being [set out PPPs in procurement and in operation].
4. We attach the feasibility study for the project in which are set out the full details of the project as well as the strategic goals of the institution, service delivery outcomes and improvements on the current outcomes expected to be achieved by the project.
5. The transaction advisor appointed is [provide details of the transaction advisor]. The appointment is based on terms of reference which are compliant with *National Treasury's PPP Manual*. Details of the assessment made of the advisory capacity to procure a successful PPP are attached.
6. The transaction advisors have been appointed for part 1 of the project and the decision has been made by [insert name of the institution] to proceed with part 2, being the procurement of the PPP.
7. The total amount of advisor fees is [insert R amount], made up as follows:
 - part 1 fees: R[insert Rand amount]
 - part 2 fees: R[insert Rand amount]

1. For example: Schedule 3b public entity.

8. The part 1 fees have been paid by [specify the institution/other sources].
9. The part 2 fees are payable on delivery of work outputs/milestones as set out in the annexes to this letter.
10. Furthermore, the [insert name of institution] has committed the following resources to manage the project procurement [set out appointment of internal or external staff to manage PPP process].
11. Application is therefore made for the part 2 transaction advisor costs from the Project Development Facility.
12. We confirm that we have reserved the right to recover part 2 costs as a success fee from a successful bidder should this project reach financial closure as a PPP, and that the feasibility study shows that this does not compromise the preliminary affordability or value for money determined for the project.
13. We have established institutional capacity to manage the project in procurement and during operations by [set out institutional capacity statement].
14. We attach details of the project timelines and projected cash flow for payment of the transaction advisor for both parts.
15. We confirm that, should funding be granted, the PDF will reserve the right to recover the disbursed funds in the form of a success fee from any successful bidder at financial close.

Yours faithfully

[signature of accounting
officer/authority]

[insert name of accounting
officer/authority]

Attached documents:

- Annex 1: Terms of reference for appointment of transaction advisor
- Annex 2: Summary of selection process for transaction advisor
- Annex 3: Terms of appointment of transaction advisor
- Annex 4: Additional project information including initial cost estimates
- Annex 5: Additional institutional capacity description
- Annex 6: Details of project timelines and cash-flow projects for advisory fees.

**NATIONAL TREASURY
PPP MANUAL
MODULE 4: PPP FEASIBILITY STUDY**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 05 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 05 of 2004 'PPP Feasibility Study' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

16.4 Feasibility study – Treasury Approval: I

16.4.1 To determine whether the proposed PPP is in the best interests of an institution, the accounting officer or the accounting authority of that institution must undertake a feasibility study that –

- (a) explains the strategic and operational benefits of the proposed PPP for the institution in terms of its strategic objectives and government policy;
- (b) describes in specific terms –
 - (i) in the case of a PPP involving the performance of an institutional function, the nature of the institutional function concerned and the extent to which this institutional function, both legally and by nature, may be performed by a private party; and
 - (ii) in the case of a PPP involving the use of state property, a description of the state property concerned, the uses, if any, to which such state property has been subject prior to the registration of the proposed PPP and a description of the types of use that a private party may legally subject such state property to;
- (c) in relation to a PPP pursuant to which an institution will incur any financial commitments, demonstrates the affordability of the PPP for the institution;
- (d) sets out the proposed allocation of financial, technical and operational risks between the institution and the private party;
- (e) demonstrates the anticipated value for money to be achieved by the PPP; and
- (f) explains the capacity of the institution to procure, implement, manage, enforce, monitor and report on the PPP;

16.4.2 An institution may not proceed with the procurement phase of a PPP without prior written approval of the relevant treasury for the feasibility study.

16.4.3 The treasury approval referred to in regulation 16.4.2 shall be regarded as Treasury Approval: I.

16.4.4 If at any time after Treasury Approval: I has been granted in respect of the feasibility study of a PPP, but before the grant of Treasury Approval: III in respect of the PPP agreement recording that PPP, any assumptions in such feasibility study are materially revised, including any assumptions concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer or accounting authority of the institution must immediately –

- (a) provide the relevant treasury with details of the intended revision, including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study; and
- (b) ensure that the relevant treasury is provided with a revised feasibility study after which the relevant treasury may grant a revised Treasury Approval: I.



PPP unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

- Prepare a feasibility study comprising:
- Needs analysis
 - Options analysis
 - Project due diligence
 - Value assessment
 - Economic valuation
 - Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes
- Report progress in the Annual Report
- Scrutiny by the Auditor-General

Phase V

DELIVERY

Phase VI

EXIT

Module 1
Module 2

MODULE 3

Module 6

Module 1
Module 2

MODULE 4

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 4

MODULE 5

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 5

MODULE 6

Module 7
Module 8
Module 9

ABOUT THIS MODULE¹

Module 4: PPP Feasibility Study explains in detail how an institution should carry out a feasibility study to decide whether conventional public sector procurement or a PPP is the best choice for the proposed project.

Requirements for Treasury Approval: I

Working through the feasibility study stages step by step will ensure that institutions provide the relevant treasury with enough information in a systematic format when they submit the feasibility study report for consideration for Treasury Approval: I (TA:I). At the end of each stage is a list of the submission requirements for that stage. These are consolidated into a full list in Stage 7.

Take note

Treasury Regulation 16 to the PFMA distinguishes between two basic types of PPP, one involving the 'performance of an institutional function' (delivering a service)² and the other involving 'the use of state property by a private party for its own commercial purposes'. In a service delivery project, the institution sets service delivery objectives and pays the private party for the service, usually in the form of a constant unitary payment (for example, for serviced office accommodation); or the users pay (for example, for using a toll road). In PPPs involving the use of state property, an institution's assets – land, equipment or intellectual property – are used to generate revenue for the institution (for example, concessioning conservation land to private eco-tourism operators in return for a share of revenues). There are also hybrid projects, which combine these types.

All PPP projects involve government commitments, in cash or kind, and so a feasibility study is necessary in all cases.

The feasibility study stages and steps presented in this module should be followed substantively for all types of PPP projects, although institutions and their transaction advisors, guided by the relevant treasury's PPP Unit, will need to adapt aspects of the module for projects other than those delivering a service for which a unitary fee is to be paid. *Sectoral Toolkits for PPPs*, based on the methodology presented in this *National Treasury's PPP Manual*, are being developed by National Treasury to guide institutions further.

-
1. This module draws on the knowledge gained by National Treasury's PPP Unit across a wide range of projects as well as on international best practice. It borrows from *Partnerships Victoria: Public Sector Comparator Technical Note*, published by the Department of Treasury and Finance, State of Victoria, Melbourne, Australia, in June 2001, and the United Kingdom's Treasury Taskforce guideline document, *How to Construct a Public Sector Comparator*.
 2. Treasury Regulation 16 uses 'for the performance of an institutional function' when it refers to delivering a service. *National Treasury's PPP Manual* uses both terms.

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INTRODUCTION

The feasibility study assesses whether conventional public procurement or a PPP is in the best interests of the institution for the delivery of the service.

Take note

An institution cannot have definitively chosen a PPP before it has done the feasibility study. A PPP is still just a possible procurement choice and must be explored in detail and compared with the possibility of delivering the service through a conventional public sector procurement.

A feasibility study needs to be authentic and thorough. It is the basis for government's making an important investment decision, not just a bureaucratic requirement. Regardless of the term and scale of a project, there are long-term implications and a great deal at stake when the procurement choice is made.

To comply with the provisions of Treasury Regulation 16 to the PFMA, institutions need approval from the relevant treasury at various points in all four phases of the PPP project cycle. TA:I is for the feasibility study (Phase II of the PPP project cycle). Through the feasibility study, institutions compare the two procurement choices for a particular option.

The feasibility study must demonstrate whether the PPP choice:

- is affordable
- transfers appropriate technical, operational and financial risk to the private party
- gives value for money.

TA:I allows the institution to enter the procurement phase (Phase III of the PPP project cycle).

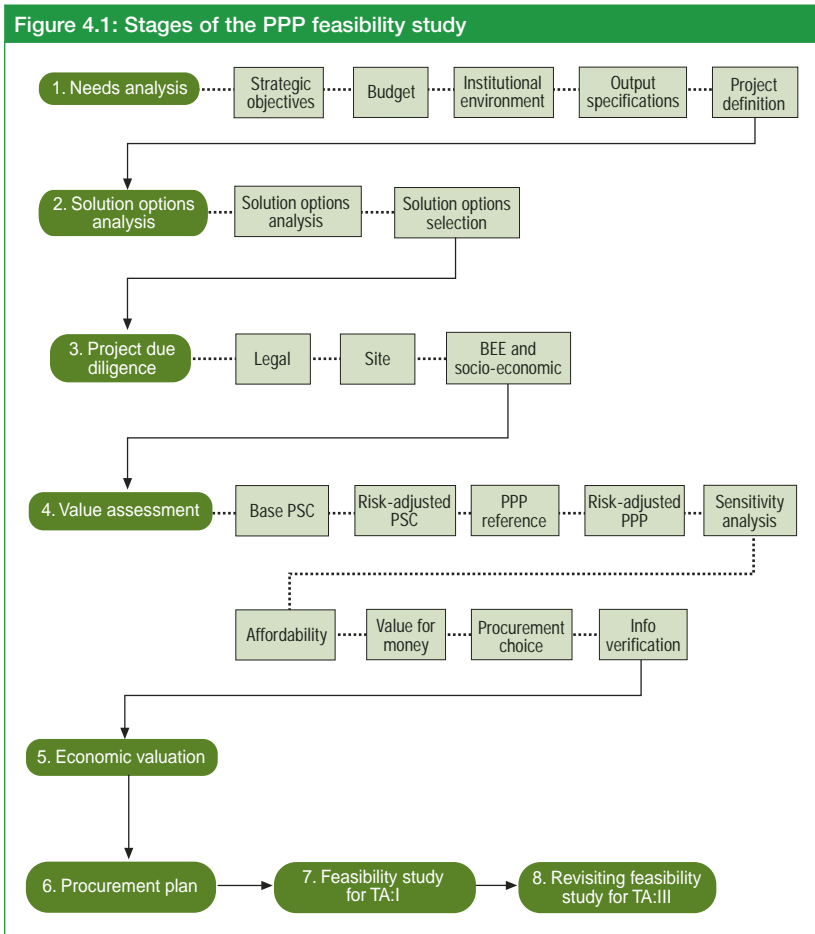
The feasibility study is a critical part of the project preparation period of the PPP project cycle:

- It provides information about costs (explicit and hidden), and gives an indication of whether costs can be met from within institutional budgets without disruptions to other activities.
- It allows for the identification, quantification, mitigation and allocation of risks.
- It prompts institutions to consider how the project will be structured.
- It identifies constraints which may cause the project to be halted.
- It ensures that the project is developed around a proper business plan.

A feasibility study is an evolving, dynamic process. While it is done primarily to decide whether or not to proceed with a PPP, should the PPP procurement choice be made, it is also used throughout the procurement phase: for continuous risk tracking; to determine value for money at Treasury Approval: IIB (TA:IIB) and Treasury Approval: III (TA:III); and to check affordability at TA:III.

Figure 4.1 shows the stages of the PPP feasibility study. The text that follows explains in detail the steps and deliverables for each stage. Working through the eight stages – following the steps closely and providing the deliverables – will

ensure that the institution provides the relevant treasury with all the information it requires to assess the proposed project for TA:I, and will avoid delays caused by incorrect or missing information.



STAGE 1: THE NEEDS ANALYSIS

The needs analysis gives definition to the proposed project, preparing the way for the solution options analysis in Stage 2, which explores the range of possible solutions to meeting the identified needs.

The needs analysis will have been considered during the inception phase.³ During this feasibility study phase it will be thoroughly interrogated.

The needs analysis

Part 1: Demonstrate that the project aligns with the institution's strategic objectives

Part 2: Identify and analyse the available budget(s)

Part 3: Demonstrate the institution's commitment and capacity

Part 4: Specify the outputs

Part 5: Define the scope of the project

Part 1: Demonstrate that the project aligns with the institution's strategic objectives

To be in an institution's best interests, a project needs to align with the institution's policy and priorities.

Step 1: Summarise the institution's mission and vision statements, its strategic objectives, and the government policy that determines what the institution's deliverables are.

Step 2: Describe the functions that the institution performs in the public interest or on behalf of the public service.

Step 3: Discuss the following aspects of the project:

- How does the project contribute to the implementation of government and institutional policy?
- Does the institution have the ability and the capacity to provide the services?
- What is the relative size of the project, in terms of its anticipated budget or capital expenditure?
- What are the potential cost savings for the institution?
- What is the capacity of the private sector to provide the services?
- How complex is the project?
- What does the public require in relation to the services?

3. See *Module 3: PPP Inception: Stage 1: Part 1*.

- Given the proposed duration of the project, will it address the broad needs of the institution over time?
- Will the proposed project meet the institution's needs in the time required?

Part 2: Identify and analyse the available budget(s)

This analysis must include:

- A discussion of any assumptions about future budgetary commitments required from government: How much will be required over what period of time, escalating in line with the CPIX?
- A discussion of any consolidation of budgets, namely, drawing funds from various budgets into a consolidated budget which will be ring-fenced for this project. These budgets may be internal to the institution but may also involve identification of budgets in other institutions, for example, the Department of Public Works.
- A list of the line items currently in the institution's budget for costs which may no longer be incurred as a result of the proposed project. For example: If a government department is housed in different buildings, there may be costs associated with delivering mail between buildings. If the proposed project is to house the department in one building, the department would no longer incur these costs, which then represent potential savings.

As affordability is a cornerstone of the feasibility study phase, the budget for the project will be revisited at various stages in the feasibility study, including Stage 2: Step 2 and Stage 4: Part 2: Step 9; and closely in Stage 4: Part 6.

Refer to the relevant treasury's directives on budget preparation in terms of the PFMA.

Part 3: Demonstrate the institution's commitment and capacity

It needs to be clear that the institution can manage, process, evaluate, negotiate and implement the project.

Step 1: Provide information on the institution's project officer and project team, and the transaction advisor

1. The project officer and project team

- the names of the institution's project team members
- their roles in the project
- their relevant skills
- brief CVs
- the budget available for project management

2. The transaction advisor

- the names of the members of the transaction advisor
- their roles in the project
- their relevant skills
- brief CVs
- the budget available for transaction advice

3. An assessment of

- lines of decision-making within the institution, particularly between project officer, senior management and the accounting officer/authority
- any areas where a lack of capacity exists, in the project team or in the transaction advisor
- a plan on how the lack of capacity will be addressed throughout the project process
- the plans for skills transfer from the transaction advisor to the project team at various stages of the project
- how staff turnover will be managed

Step 2: Provide information on key stakeholders

1. Possible key stakeholders include:

- those within the institution
- other government departments
- other spheres of government
- organised labour
- third parties
- the public.

2. Describe the nature of each relationship and the project's impact on each stakeholder

In particular, identify impacts on the funding, resources or processes of the key stakeholders. This is important for establishing where the service will begin and end. For example: In a serviced accommodation project, the State Information Technology Agency (SITA) would be a key stakeholder and this would help to define where the IT services would begin and end.

3. Include a consultation plan

The plan should detail how and when consultation will take place during the project preparation period of the project cycle, and how the views and contributions of key stakeholders will be incorporated into the project. Also include the results of any consultation the institution has already undertaken, and any required concurrence obtained from government stakeholders, such as permission from South African Heritage Resources Agency (SAHRA) to demolish a building.

Step 3: Consult with the relevant treasury

Consult with the relevant treasury about the project, especially about budgetary and affordability issues.

For national departments and public entities this will entail discussions with the Public Finance division of National Treasury and with the institutions' own accounting officers and chief financial officers.

For provincial departments and public entities, there must be consultation with the Intergovernmental Relations division of National Treasury and the provincial treasury. A signed letter from the provincial treasury stating that the project is affordable must accompany the submission of the feasibility study report for TA:I.

Part 4: Specify the outputs

Once the institution's objectives and budget have been identified, and its commitment and capacity demonstrated, the outputs of the proposed project need to be specified.

Input vs output: Conventional procurement vs PPP procurement

Conventional procurement specifies the input. The institution defines what it requires in order for it to deliver a particular service.

With conventional procurement, the institution prepares detailed specifications that describe the infrastructure required to deliver a service. The required infrastructure is then put out to tender. Once the contract is awarded, the institution closely supervises the construction of the infrastructure to ensure compliance with the tender specifications. Thus the institution is responsible for the design and planning of the project, all statutory requirements (such as environmental and heritage approvals and town planning regulations), and any costs that may arise due to unforeseen circumstances or elements that were omitted from the tender. The contractor is only responsible for what is covered by the tender specifications, or anything which could reasonably have been foreseen. Specifying inputs excludes the possibility for alternative solutions which bidders could come up with, and may inhibit innovation. Risk allocation will be affected as the specified input may prevent appropriate risk transfer.

PPP procurement specifies the output. The institution defines the service that it needs to deliver.

The key element of a PPP project is the definition of an institutional function through specifying the output(s). The institution leaves the design of the infrastructure required to deliver the service up to the private party which will be selected through a bidding process. For policy or strategic reasons, the service requirements may not be left entirely to the discretion of the private party, and in these circumstances the institution may specify some inputs. PPP projects should, however, be driven substantially by output specifications, which allow for optimal risk transfer to the private party and thereby ensure greater value for money for the institution.

Defining the service through specifying the outputs requires the institution to apply its mind to what needs to be achieved, as opposed to how it will be achieved.

The concept of output specifications entails a change in how the institution views delivering its services. Instead of procuring infrastructure, the institution should be thinking of procuring the service with specified outputs. For example, the outputs for delivering a prison service would include required standards of accommodation for inmates, security, rehabilitation, catering, cleaning, health care, maintenance, and so on. Conventional procurement would specify the design and materials required for a prison building.

Step 1: Describe the service that the institution needs to deliver

Step 2: Specify the outputs required to deliver that service

Step 3: Specify the minimum standards for the outputs

This will ensure that the service delivered by the project meets the institution's expectations.

Step 4: Assess whether the output specifications can meet the institution's ongoing service needs

It may be necessary to specify to what extent the project must provide a flexible solution that can be expanded or enhanced over time.

Step 5: Specify key indicators that will measure performance

This will allow for more accurate costing of the output specifications.

Step 6: Identify service interface expectations

This concerns the interface between the project and the institution's other services.

Step 7: List the BEE and socio-economic targets that the institution wishes to achieve in the project, using the PPP BEE balanced scorecard⁴ as reference.

Part 5: Define the scope of the project

In light of the institution's needs and strategic objectives, and the output specifications for delivering the required service, give a brief definition of the proposed scope of the project. This should be a concise outline of the institution's requirements, which will allow for the selection of reasonable service delivery options.

Briefly set out:

- a summary of how the project objectives will address the institution's strategic objectives, as determined in Part 1
- a summary of the output specifications, as determined in Part 4
- a list of significant government assets which will be used for the project (such as land and equipment)
- a brief indication of the type of PPP project that may be appropriate, and its envisaged payment mechanism, for example, a service delivery project in which a unitary fee will be paid. This will be further investigated at Stage 4: Part 3 of the feasibility study, and set out in detail in the bidding documents during the procurement phase⁵ of the PPP project cycle.

4. See *Module 2: Code of Good Practice for BEE in PPPs: Part IV*.

5. See *Module 5: PPP Procurement*.



Requirements for the feasibility study report: The needs analysis

- Institution's strategic objectives
- Budget
- Institutional analysis
- Output specifications
- Scope of the project

STAGE 2: THE SOLUTION OPTIONS ANALYSIS

Choosing the best way of responding to a service need: The solution first, then the procurement choice

The solution options analysis sets out the range of possible technical, legal and financial options for delivering the required service to the output specifications, allowing the institution to weigh up the options and make a choice.

For example, if an institution needs to provide additional accommodation services for its staff, the solution options might be:

- to rent space in another suitable building
- to refurbish the existing building
- to construct a new building.

For the rental option, the institution will rent space, move its staff, and continue operating. The institution would not need treasury approval as this is not a PPP, and would thus not need to do a PPP feasibility study.⁶

For the refurbishment option, the institution could decide to refurbish the building itself and provide its own ancillary services either internally or through separate contracts (cleaning, security, IT, furniture, etc.). Alternatively, it could enter into a PPP where a private party would refurbish the building and provide all the ancillary services and receive a fixed fee for doing so. Thus the solution option can either be procured through conventional public sector procurement (the institution refurbishes the building itself and provides its own ancillary services) or through a PPP (a private party refurbishes the building and provides the ancillary services).

The same two procurement choices would be possible for **the option to construct a new building**.

If the institution decides that its preferred solution option is to refurbish its existing building and provide the ancillary services, the value assessment stage (Stage 4) of the feasibility study will explore the two procurement options: the institution doing the refurbishment and providing ancillary services itself and a private party doing it on behalf of the institution. The choice of whether or not to procure the solution option as a PPP can only be made after this stage.

Take note

In the solution options analysis stage, institutions will still not be in a position to make the decision about whether or not a PPP is the best way to procure the preferred solution option. In the solution options analysis, the institution identifies and evaluates the various potential options for meeting the institution's need to deliver a service. It then recommends one of the options, and gives an indication of whether it might be suitable for a PPP. After the project due diligence (Stage 3), comes the detailed work in the value assessment (Stage 4) required to make the decision about whether to pursue a PPP.

A PPP is not a solution option. A PPP may be a procurement choice for a preferred solution option.

6. Good business practice dictates that any investment or procurement decisions should be backed up by a thorough feasibility study.

The solution options analysis

Step 1: List all the solution options the institution has considered

Step 2: Evaluate each solution option

Step 3: Choose the best solution option

Step 1: List all the solution options the institution has considered

The list must cover the range of the most viable solution options for providing the specified outputs of the required service.

Step 2: Evaluate each solution option

The purpose of the evaluation is to:

- identify the advantages and disadvantages of each solution option
- examine the risks and benefits for, and potential impacts on, government of each option
- identify which of the solution options may be procured as a PPP.

1. Brief description

Briefly describe each solution option, including an outline of the alignment between each option and the institution's strategic plan, the service it needs to deliver, and the output specifications.

2. Financial impacts

Provide a preliminary view and discussion on the financial impacts of each option. For example, show the estimated initial capital expenditure, and the likely capital and operational costs over the full project cycle. (This preliminary analysis of financial impacts will provide a basis for the detailed work to come in Stage 4.)

3. Funding and affordability

How is each option to be funded? Which options are affordable? Where a government contribution is anticipated, this must be agreed to by the relevant treasury or there may be delays later. Such funding must come from an existing budget line, as there are strict limitations on institutions' borrowing capacity. Indicate how a PPP procurement of an option is likely to be financed (for example, project finance or corporate finance). The payment mechanisms (conventional budgetary, unitary payment, user pays, revenue-generating, hybrid) that may be possible for each option must also be briefly discussed.

4. Risk

Present a preliminary discussion about the risks to government in relation to each option. (Risk is tackled in detail in Stage 4: Part 2.) The discussion should specifically identify the risks that may be passed efficiently to a private party.

5. BEE and other socio-economic aspects

Provide a preliminary view on the impact of each option on the BEE targets set out

in the outputs specifications, and other socio-economic targets on which the institution may wish to deliver in the project. (BEE is tackled in detail in Stage 4: Part 3.)

6. Service delivery arrangements

Discuss the service delivery arrangements for each option, and analyse the implications of each option for optimal interface between services. For example, if the institution is assessing its options for accommodation services, how would each solution option deal with the integration of IT and communications services?

7. Transitional management issues

Discuss the issues that may arise in the handover from existing management arrangements in each solution option. For example, each solution option for staff accommodation will have implications for how an institution's security, IT, delivery and despatch systems are managed in the transition from the existing to the new.

8. Technical analysis

A comprehensive technical analysis must be presented for each solution option, including a supply chain/interface analysis. Include an assessment of the proposed technology and its appropriateness for each solution option.

9. Site issues

If a solution option involves a physical site, issues around the procurement of land must be identified at this stage, such as: land use rights, zoning rights, geo-technical, environmental issues, relevant national or provincial heritage legislation, and alignment with municipal Integrated Development Plans. (These issues will be dealt with in detail in Stage 3, but must be identified for each solution option now.) The likelihood of being able to resolve all site issues during the course of the feasibility study phase of the PPP project cycle is a key factor in deciding on a preferred solution option if a PPP procurement is possible. The preference is for all site issues to be resolved during the feasibility study, before TA:I is granted.

10. Legislation and regulations

Does a particular option comply with the relevant legislation and regulations? Analyse, firstly, procurement legislation and regulations, and, secondly, sector-specific legislation and regulations, which may impact on the project, to establish a compliance list against which each option can be measured. Certain solution options may not legally be performed by a private party. If, for example, the South African Revenue Service (SARS) wants to revamp its custom office systems, can a private party legally perform a state function such as scanning imported goods on behalf of SARS? There may be legislation stipulating that only an employee of SARS or the South African Police Service (SAPS) may do so, which may limit SARS' solution options and procurement choices.

In Stage 3 the legal issues for the chosen option will be dealt with comprehensively. At this stage, what is required is a brief, high-level analysis.

11. Human resources

- Establish the numbers and cost of existing institutional staff that will be affected in each solution option, do a skills and experience audit, and establish the key human resources issues for the project.
- Design and implement a suitable communication strategy for the institution to keep staff informed of the project investigations, as required by labour law.
- Assess the following for each option, where relevant:
 - relevant legislation and case law
 - organised labour agreements
 - the cost of transferring staff, if applicable
 - an actuarial study of accrued benefits that may be transferred, and timing thereof
 - an initial view on the potential willingness of both staff and private parties to implement transfers.

12. Market capability and appetite

Assess each solution option using the following considerations:

- Is there the capability within the private sector to deliver the required services?
- Will the service delivery be sufficiently reliable?
- Is it possible that such delivery would provide value for money?
- What are the BEE enterprises in the sectors and are BEE charters being implemented?
- Are there local suppliers for this service?
- What market competition is there for this type of project?
- Do the output specifications restrict which suppliers can be used?

It may be appropriate to use a form of market testing, possibly an Expression of Interest.⁷

13. Qualitative factors

There will be a number of qualitative benefits associated with a particular option, which may not be quantifiable and may not be considered as offsetting costs. While financial considerations are likely to drive the affordability test in Stage 4 of the feasibility study, it is important that these qualitative factors be identified early. For example: Cabinet has agreed that all departmental head offices must be located in the inner city. So, although there might be a suitable building or site outside of the inner city, which may be cheaper or more appropriate for other reasons, Cabinet's decision will affect the choice of solution option.

⁷. See *Module 5: PPP Procurement*.

14. Early considerations of suitability for a PPP

Not all solution options are ideal PPPs. During this solution options analysis stage, it is useful to consider the various options' potential to deliver value for money as a PPP.

- **Scale**

The net present cost of the probable cash flows should be large enough to allow both the public and the private parties to achieve value-for-money outputs given the likely levels of transaction advisor and other costs.

- **Outputs specification**

It must be possible to specify outputs in clear and measurable terms, around which a payment mechanism can be structured.

- **Opportunities for risk transfer**

The allocation of risk to a private party is a primary driver of value for money in a PPP. Where opportunities for allocating risk to the private party are limited, the potential for a PPP to deliver value for money compared with a conventional procurement choice is reduced.

- **Market capability and appetite**

The project must be commercially viable, and there must be a level of market interest in it.

Step 3: Choose the best solution option

Each solution option has now been evaluated, including an initial assessment of its potential as a PPP. A matrix approach can be used to weigh up the evaluation of each option against another to assist in the choice of the best one. (Use the list of evaluation items in Step 2.) In this last step of the solution options analysis stage, recommend which option(s) should be pursued to the next stage.

If the preferred solution option looks likely to be able to be procured through a PPP, it will be fully tested in Stage 4 of the feasibility study, and the preferred option may change after this test. If, after Stage 4, the preferred solution option is not demonstrably affordable, it may be necessary to revisit the solution options analysis. If the preferred solution option cannot be procured through a PPP, the institution should discuss its subsequent feasibility study method with the relevant treasury.

It is preferable that only one solution option is chosen, and no more than three. If more than one option is recommended for which PPPs may be possible, each must be separately assessed in Stage 4.



Requirements for the feasibility study report: The solution options analysis

- Options considered
- Evaluation of each solution option
- Identification of which solution option(s) may be procured as a PPP
- Recommendation of a preferred solution option

STAGE 3: PROJECT DUE DILIGENCE

The due diligence stage is an extension of the solution options analysis stage and aims to uncover any issues in the preferred solution option that may significantly impact on the proposed project.

Project due diligence

Step 1: Legal issues

Step 2: Site enablement issues

Step 3: BEE and other socio-economic issues

Step 1: Legal issues

Experience shows that legal issues not resolved during the feasibility study phase of the PPP project cycle create significant delays at the negotiations stage of the procurement phase, and in some cases have been significant impediments to concluding a PPP agreement.

Although a preliminary legal analysis of each solution option was done in the options analysis stage, a comprehensive legal due diligence of the preferred option(s) must now be done to ensure that all foreseeable legal requirements are met for the development of the project. Although it may be costly to undertake a comprehensive legal due diligence of all aspects of the project in this early phase, it is ultimately worthwhile. Early legal certainty directly affects project costing in Stage 4 (thus assisting in making the procurement choice), reduces PPP bidding costs for all parties, and avoids using costly time on these issues in the negotiations stage.

Common legal issues that arise centre on use rights and regulatory matters. However, the institution's legal advisors should conduct a thorough due diligence on all the legal issues which have a bearing on the project.

Use rights of the institution

Obtain legal opinion about the extent to which the institutional function or use of state property can legally be performed by a private party in a possible PPP.

Take note

PPPs may not be used to limit an institution's responsibilities for performing its institutional functions. Even though in a PPP the institution contracts a complete or partial institutional function to the private party, the institution remains accountable for the efficient delivery of this service.

Regulatory matters

It can generally be assumed that the institution performs its mandated functions within the regulations. Regulatory due diligence is only required for the PPP procurement choice. However, if the project being explored is a greenfields project and the institution has never done this kind of project before, then a regulatory due diligence will be necessary for both conventional procurement and a PPP.

Investigate any regulatory matters that may impact on the private party's ability to deliver as expected. These may include:

- tax legislation
- labour legislation
- environmental and heritage legislation
- foreign exchange legislation
- legislation governing the use of certain financial instruments
- competition legislation
- sector regulations such as airport licensing, health standards, building codes, etc.

Step 2: Site enablement issues

Where a physical site is involved, indicate whether the institution intends to specify a preferred site, nominate a definite site, or leave the question of location open to bidders.

If the institution nominates a particular site, it will need to identify, compile and verify all related approvals. The purpose is to uncover any problems that may impact on the project's affordability and value for money, or cause regulatory delays at implementation.

Establish the following:

- land ownership
- land availability and any title deed endorsements
- are there any land claims?
- are there any lease interests in the land?

Appoint experts to undertake surveys of:

- environmental matters
- geo-technical matters
- heritage matters
- zoning rights and town planning requirements
- municipal Integrated Development Plans.

Step 3: BEE and other socio-economic issues

Identify sectoral BEE conditions (for example, the extent to which BEE charters have been developed and implemented), black enterprise strength in the sector, and any factors that may constrain the achievement of the project's intended BEE outputs. Also identify socio-economic factors in the project location that will need to be directly addressed in the project design.



Requirements for the feasibility study report: Project due diligence

- Legal aspects
 - Use rights
 - Regulatory matters
- Site enablement
- BEE and other socio-economic issues

STAGE 4: VALUE ASSESSMENT

This is the pivotal stage of the feasibility study. It enables the institution to determine whether a PPP is the best procurement choice for the project. The three tests prescribed by Treasury Regulation 16 to the PFMA are:

- Is it affordable?
- Does it appropriately transfer risk from the institution to the private party?
- Does it provide value for money?

Comparable models

To determine which procurement choice is best for a project, a comparative assessment has to be made between delivering the same service (to the identical output specifications) as a conventional public sector procurement or as a PPP. A risk-adjusted public sector comparator (PSC) model and PPP reference model must therefore be constructed for the chosen solution option. These provide costings of each procurement option in the form of a discounted cash-flow model adjusted for risk.

A **PSC model** is a costing of a project with specified outputs with the public sector as the supplier. Costs are based on recent, actual costs of a similar project, or best estimates.

A **PPP reference model** is a costing, from first principles, of a project with the identical specified outputs but with the private sector as supplier.

Comparing the two models enables an institution to assess whether service delivery by the government or by a private party yields the best value for the institution. The three criteria are affordability, risk transfer and value for money.

Risk

Risk is inherent in every project. Conventional public sector procurement has tended not to take risk into account adequately, often resulting in unbudgeted cost overruns. In a PPP, the risks inherent in the project are managed and costed differently by the private party. The treatment of risk in the project is a key aspect of the value assessment.

Affordability and value for money

Affordability is whether the cost of the project over the whole project term can be accommodated in the institution's budget, given its existing commitments.

Value for money means that the provision of an institutional function by a private party results in a net benefit to the institution, defined in terms of cost, price, quality, quantity, or risk transfer, or a combination of these.

Value for money is a necessary condition for PPP procurement, but not a sufficient one. Affordability is the driving constraint in PPP projects.

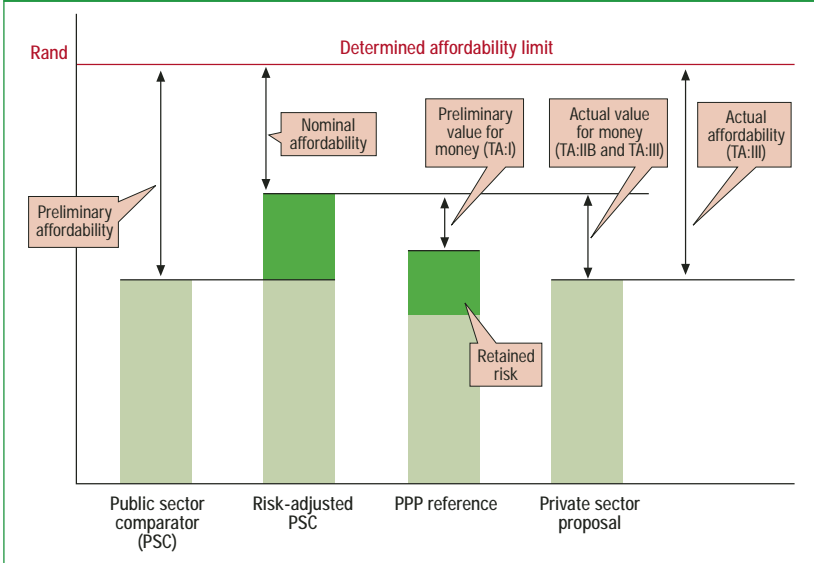
Demonstrating affordability

As a preliminary analysis of affordability, the risk-adjusted PSC model is compared with the institution's budget. Then the risk-adjusted PPP reference model is compared with the institution's budget. If the project is not affordable, the institution may modify the output specifications or may have to abandon the project.

The value-for-money test

The value-for-money test is only conducted as part of TA:II when actual private bids are submitted. But an initial indication of whether conventional public sector procurement or a PPP will provide value for money is a requirement for TA:I. The risk-adjusted PSC model provides the benchmark for value for money when compared with the PPP reference model in this feasibility study phase, and when compared with the private bids in the procurement phase.

Figure 4.2: Affordability and value for money⁸



Take note

A proposed PPP project may provide value for money, but be unaffordable if the specifications are too high. Value for money is a necessary condition for PPP procurement, but not a sufficient one. If a project is unaffordable it undermines the institution's ability to deliver other services and it should not be pursued. Affordability is the driving constraint in all PPP projects.

Value assessment

- Part 1: Construct the base PSC model
- Part 2: Construct the risk-adjusted PSC model
- Part 3: Construct the PPP reference model
- Part 4: Construct the risk-adjusted PPP reference model
- Part 5: Sensitivity analysis
- Part 6: Demonstrate affordability
- Part 7: Initial value-for-money test
- Part 8: Make the procurement choice
- Part 9: Verify information and sign off

8. This figure does not demonstrate the 'time value of money', which must be calculated in the financial models and shown as net present value (NPV), using appropriate discount rates.

Part 1: Construct the base PSC model

What is the base PSC model?

The base PSC model represents the full costs to the institution of delivering the required service according to the specified outputs via the preferred solution option using conventional public sector procurement.

The base PSC costing includes all capital and operating costs associated with the project.

The risk-adjusted PSC model includes a costing for all the risks associated with the project.

The public sector does not usually cost these risks, but it is necessary to get this understanding of the full costs to government of the proposed project.

Key characteristics of the PSC model

- expressed as the net present value (NPV) of a projected cash flow based on the appropriate discount rate for the public sector
- based on the costs for the most recent, similar, public sector project, or a best estimate
- costs expressed as nominal costs
- depreciation not included, as it is a cash-flow model

The central functions of the PSC model

- promotes full cost pricing at an early stage
- is a key management tool during the procurement process, assisting the institution to stay focused on the output specifications, costs and risk allocation
- is a reliable way of demonstrating the project's affordability
- provides an initial indication of value for money
- is a consistent benchmark and evaluation tool
- encourages bidding competition by creating confidence in the financial robustness and integrity of the feasibility process
- is sufficiently robust that the service could be procured conventionally if, at any stage, the PPP fails to show value for money

Construct the base PSC model

Step 1: Provide a technical definition of the project

Step 2: Calculate direct costs

Step 3: Calculate indirect costs

Step 4: Calculate any revenue

Step 5: Explain all assumptions used in the construction of the model

Step 6: Construct the base PSC model and describe its results

‘Annexure 1: A PSC model’ provides a complete example of the process outlined step by step in Stage 4: parts 1 and 2. Readers may find it useful to work through the steps with reference to the example.

Step 1: Provide a technical definition of the project

What norms and standards will be applied in the project? What maintenance cycles are expected? Describe these carefully, bearing in mind that the same principles must apply in the PPP reference model to come, in order to allow for a comprehensive comparison.

Step 2: Calculate direct costs

Direct costs are those that can be allocated to a particular service. These costs must be based on the most recent public sector project to deliver similar infrastructure or services (including any foreseeable efficiencies, for example, regular life-cycle maintenance), or a best estimate where there is no recent comparable public sector project. If there are no comparable projects in South Africa, draw on the experience of projects in similar environments in other countries.

1. Capital costs

Direct capital costs are specifically associated with the delivery of new services, and may include, for example, the costs of constructing a new facility or acquiring a new asset. The PSC model should account for direct capital costs in the year in which they occur, including, but not limited to, the costs of design, land and development, raw materials, construction, and plant and equipment (including IT infrastructure). Direct capital costs should also account for the project's labour, management and training costs, including financial, legal, procurement, technical and project management services. Only the costs associated with developing and implementing the project should be included in the PSC model. It is also important to include the costs of replacing assets over time.

2. Maintenance costs

Direct maintenance costs will include the costs over the full project cycle of maintaining the assets in the condition required to deliver the specified outputs, and may include the costs of raw materials, tools and equipment, and labour associated with maintenance. The level of maintenance assumed must be consistent with the capital costs, the operating cost forecasts and the residual value treatment of any assets.

3. Operating costs

Direct operating costs are associated with the daily functioning of the service and will include full costs of staff (including wages and salaries, employee benefits, accruing pension liabilities, contributions to insurance, training and development, annual leave, travel and any expected redundancy costs), raw materials and consumables, direct management and insurance.

4. BEE costs

Direct BEE costs are the costs of achieving the project's identified BEE objectives. The Preferential Procurement Policy Framework Act, 2000 (PPPFA) provides for a ceiling on the price premium to be paid for BEE in the supply of goods and services

contracted through conventional procurement. Calculate the costs of preferential procurement on the supply of goods and services as stipulated by the PPPFA 90:10 formula. Use the specific BEE targets set for the project in Stage 1: Part 4.

Step 3: Identify indirect costs

The project's indirect costs are a portion of the institution's overhead costs, and will include the costs of: senior management's time and effort, personnel, accounting, billing, legal services, rent, communications and other institutional resources used by the project. The portion can be determined by using an appropriate method of allocation, including but not limited to:

- number of project employees to total institutional employees for personnel costs
- project costs to total institutional costs for accounting costs
- number of project customers to total institutional customers for billing costs.

Step 4: Identify any revenue

The total cost of delivering the service should be offset by any revenues that may be collected.

Project revenue may be generated where:

- users pay for the service or a part thereof
- the use of the institution's assets generates revenue
- service capacity exists above the institution's requirement
- the institution allows third parties to use the service.

Any revenue collected must reflect the institution's ability to invoice and collect revenue. (This should have been identified during Stage 2.)

Forecasting potential revenues can be difficult, especially where there is little or no historical information. In revenue-generating or user-pays projects, this element will be a significant component of both the PSC and PPP reference models, and the institution's specialist advisors should consider market testing.

Step 5: Explain assumptions

Explain in detail all assumptions the model makes about the inflation rate, the discount rate, depreciation, treatment of assets, available budget(s), and the government's Medium-Term Expenditure Framework (MTEF).

Inflation

The model should be developed using nominal values. In other words, all costs should be expressed with the effects of expected future inflation included. This also allows for easy comparison with the institution's budget, which is expressed using nominal values. Inflation projections should be made with reference to the inflation targets set by the Reserve Bank. The MTEF budget cycle which government uses is adjusted annually by CPIX.

The discount rate

(See 'Annexure 2: The significance of the discount rate'.)

For practical purposes, the discount rate is assumed to be the same as the risk-adjusted cost of capital to government. The government bond yield has been used by some institutions as the discount rate for a particular project over a comparable period. The argument in favour of using the government bond yield is that it reflects the actual cost to government of raising funds at any given time. This ignores a number of factors that are difficult to quantify, including: various risk margins relating to increased government borrowing; various tax implications of diverting funds from private to public consumption; and government's time preference of spending.

National Treasury does not prescribe a discount rate. The institution, with advice from its transaction advisor, should choose a nominal government bond yield rate over a similar term to the length of the project term as the risk free discount rate for the project. National Treasury may be called upon to help with deciding which bond rate is applicable for a particular type of project.

National Treasury does not advocate reflecting projects risks as a premium in the discount rate. Risks are valued as cash-flow items. (See 'Annexure 3: How to calculate the value of risk'.)

Although National Treasury's preference is for the reflection of risk as a cash-flow numerator, there are certain projects where there are risks inherent in the project over and above the risks quantified in the cash flow for the project. This may warrant using a discount rate that is the government bond yield and an additional risk premium above the bond yield rate as a representation of additional risk in the project. It is important to note that the necessity of applying a risk premium to the risk free discount rate should be done on a project-by-project basis and only in cases where it is not possible to accurately reflect the effect of all risks in the cash flow of the project.⁹

The discount rate chosen for the project must then be applied consistently in all the feasibility study models.

As National Treasury prefers that the PSC and the PPP reference models are in nominal terms, the discount rate must also be in nominal terms and there is thus no need to adjust for inflation.

Depreciation

Since the PSC model is calculated on cash flow, not on accrual, non-cash items such as depreciation should not be included.

9. The UK has used an average margin of 1.5 per cent above its bond yield in determining the discount rate of capital.

Step 6: Construct the base PSC model and describe its results

The base PSC model must be presented as a discounted cash-flow model.

The complexity of the model will depend on the complexity of the project. Simple output specifications can be analysed using a simple cash-flow statement. For projects that entail capital investment and/or generate revenues, the PSC model will need to include a cash-flow timing profile.

Provide a brief narrative explanation of the construction of the model and its key results.

Show the net present cost of the base PSC model.

Part 2: Construct the risk-adjusted PSC model

The risk-adjusted PSC model is the base PSC model plus a costing for all the risks associated with undertaking the project. Government does not usually cost these risks, but it is necessary to do so in order to understand what the full cost to government will be if it undertakes the project.

Risk and public sector procurement

In conventional public sector procurement, risk is the potential for additional costs above the base PSC model. Historically, conventional public sector procurement has tended not to take risk into account adequately. Budgets for major procurement projects have been prone to optimism bias – a tendency to budget for the best possible (often lowest cost) outcome rather than the most likely. This has led to frequent cost overruns. Optimism bias has also meant that inaccurate prices have been used to assess options. Using biased price information early in the budget process can result in real economic costs resulting from an inefficient allocation of resources.

Much of the public sector does not use commercial insurers, nor does it self-insure (through a captive insurance company). Commercial insurance would not provide value for money for government, because the size and range of its business is so large that it does not need to spread its risk, and the value of claims is unlikely to exceed its premium payments. However, government still bears the costs arising from uninsured risks and there are many examples of projects where the public sector has been poor at managing insurable (but uninsured) risk.

Construct the risk-adjusted PSC model

- Step 1: Identify the risks
- Step 2: Identify the impacts of each risk
- Step 3: Estimate the likelihood of the risks occurring
- Step 4: Estimate the cost of each risk
- Step 5: Identify strategies for mitigating the risks
- Step 6: Allocate risk
- Step 7: Construct the risk matrix
- Step 8: Construct the risk-adjusted PSC model
- Step 9: Preliminary analysis to test affordability

‘Annexure 3: How to calculate the value of risk’ provides an example of the process outlined step by step below. Readers may find it useful to work through the steps with reference to the example.

Step 1: Identify the risks

Two workshops

The identification of risks is best done in a workshop setting with the institution, its transaction advisor and the relevant treasury’s PPP Unit’s project advisor. The focus of the first workshop should be purely on identifying the risks. A separate workshop should be held to assess and quantify their impact. This is recommended because clearly identifying risks and sub-risks can be clouded by discussions about their potential financial impact. Separate workshops will also allow the advisors to prepare adequately for assessing and quantifying the financial impact of the identified risks.

Who should attend the risk workshops?

- the project officer and project management team
- any other institutional officials who will be responsible for managing the project during the construction/development stages of the project and for contract management thereafter
- all members of the transaction advisor, including the financial, legal and insurance advisors, and sector specialist advisors on, for example, design, engineering, facilities management, IT
- project advisors from the relevant treasury’s PPP Unit and project officers from other institutions who can share relevant experiences

How to identify the risks

Explore each risk category in detail during the workshops, and produce a detailed, project-specific list. (See ‘Annexure 4: Standardised PPP Risk Matrix’ for the range of categories of risk typically found in PPP projects.) This list will be developed into a risk matrix for the project in Step 7. It is important to identify and evaluate all material risks. Even if a risk is unquantifiable, it should be included in the list. Do not forget to include any sub-risks that may be associated with achieving the BEE targets set for the project.

Take note

When identifying risks by referring to an established list, there is the possibility that in the list generated for the project, a risk not listed may have been left out by mistake (as opposed to simply not being a risk for this specific project). At the end of the risk identification workshop, go through the various stages of the project and consider various scenarios of what might actually happen. Many of the risks that reveal themselves may already have been identified via the risk matrix, but some new risks may come up. Also be vigilant for duplicated risks.

It may be difficult to compile a comprehensive and accurate list of all the types of risks. The following can be helpful sources of information:

- similar projects (information can be gathered from the original bid documents, risk matrices, audits and project evaluation reports) both in South Africa and internationally
- specialist advisors with particular expertise in particular sectors or disciplines.

Step 2: Identify the impacts of each risk

The impacts of a risk may be influenced by:

- **Effect:** If a risk occurs, its effect on the project may result, for example, in an increase in costs, a reduction in revenues, or in a delay, which in turn may also have cost implications. The severity of the effect of the risk also plays a role in the financial impact.
- **Timing:** Different risks may affect the project at different times in the life of the project. For example, construction risk will generally affect the project in the early stages. The effect of inflation must also be borne in mind.
- **Type:** Some risks are difficult to quantify accurately.
- **Severity of the consequence.**

It is essential to specify all the direct impacts for each category of risk. For example, construction risk is a broad risk category, but there could be four direct impacts, or sub-risks:

- cost of raw material is higher than assumed in the PSC model
- cost of labour is higher than assumed in the PSC model
- delay in construction results in increased construction costs
- delay in construction results in increased costs as an interim solution needs to be found while construction is not complete.

Each impact is thus a sub-risk, with its own cost and timing implications.

Step 3: Estimate the likelihood of the risks occurring

Estimating probabilities is not an exact science, and assumptions have to be made. Ensure that assumptions are reasonable and fully documented, as they may be open to being challenged in the procurement process or be subject to an audit. There are some risks whose probability is low, but the risk cannot be dismissed as negligible because the impact will be high (for example, the collapse of a bridge). In this case a small change in the assumed probability can have a major effect on the expected value of the risks. If there is doubt about making meaningful estimates of probability, it is best practice to itemise the risk using a subjective estimate of probability rather than to ignore it. Institutions should also be prepared to revisit initial estimates, if they learn something new that affects the initial estimate. Together with estimating the probability of a risk occurring, it is also necessary to estimate whether the probability is likely to change over the term of the project.

A subjective estimation of probability is based on past experience or current best practice, and supported by reliable information, if available. Simply, realistically estimate how likely final costs are to be above or below the amount in the base PSC

model. If reliable information is not available, institutions and transaction advisors will have to make assumptions about the logical, commonsense likelihood of a risk occurring. It is essential that all assumptions be fully documented.

However, if the probability of a risk occurring is high or the potential impact is significant, and there is sufficient reliable information, an advanced technique should be used as it can provide more conclusive results.

Statistical risk measures are more advanced and have the advantage of being based on robust economic principles. The disadvantage is that they can be more complicated to calculate and interpret, and require a large amount of reliable information. Comprehensive statistical risk analysis often requires special software and the assistance of an experienced risk analyst. Multivariable analysis techniques, like Monte Carlo simulation, have been successfully used in the valuation of risks for road projects. This type of analysis requires estimating a range of possible risks together with their probabilities of occurring, and the maximum and minimum project costs for the different scenarios. It is particularly useful for considering the impact of a number of risks together. A key disadvantage of multivariable analysis is that it shifts the focus away from the analysis of individual risks, and for risks to be meaningfully put to use in the PSC model, the potential impact of each individual risk needs to be understood.

Whatever risk assessment techniques are used, the risks and their bearing on the project must be well understood by the institution. The method used should be agreed between the institution and its transaction advisor.

Step 4: Estimate the cost of each risk

Risk as a cash-flow item

National Treasury advocates costing risk as a separate cash-flow item, and not adjusting the discount rate to indicate the level of risk in a project. The cash-flow method promotes a focus on the costs of each risk and enables an understanding of how risk can be transferred and what its financial effects are. In addition to this, valuing each risk as a separate cash-flow item accounts for the time implication of that risk (some risks may only have an impact at the beginning of a project, and the impact of other risks may diminish or escalate over the life of the project).

- Estimate the cost of each sub-risk individually by multiplying the cost and the likelihood.
- Assess the timing of each sub-risk.
- Cost the sub-risk for each period of the project term.
- Construct a nominal cash flow for each risk to arrive at its net present value.

Step 5: Identify strategies for mitigating the risks

A risk can be mitigated either by changing the circumstance under which the risk can occur or by providing insurance for it. Indicate what the risk mitigation strategy for dealing with each particular risk will be, and the attendant cost of such mitigation.

Step 6: Allocate risk

Once risks have been identified and costed, analyse which risks should be carried by the private party, which the institution should retain, and which will be shared, if this project were to be procured through a PPP. For the risk-adjusted PSC model, all risks will usually be carried by the institution, as would be the case with conventional procurement. It is, however, necessary to do a preliminary risk allocation at this stage, as it will assist the institution in separating out the risks which will be allocated to the private party and which risks will be kept by the institution. This will be reflected in the PPP reference model.

A risk should be carried by the party best able to manage that risk. The principle for allocating risk should be value for money. Where retaining a risk presents value for money for the institution, it should be retained.

Step 7: Construct the risk matrix

A comprehensive risk matrix is a fundamental component of PPP procurement as it is used to identify and track risk allocation throughout the drafting of the PPP agreement, the bidding process, PPP agreement negotiation and financial closure.

The risk matrix consolidates all identified project risks, their impacts, and their associated costs. Include all risks (retained by the institution and transferred to the private party) in the calculation of the PSC. List those which are to be retained or transferred as these will need to be costed for the PPP reference model and will also be used and elaborated on during the procurement phase.

Step 8: Construct the risk-adjusted PSC model

Once costs have been established for all identified risks, the base PSC must be risk-adjusted. This is done using the following simple formula:

$$\text{Risk-adjusted PSC} = \text{Base PSC} + \text{Risk}$$

Users of the Manual should closely follow the example in 'Annexure 1: A PSC model' of adjusting the base PSC for risk. The example is limited to one risk category – construction risk – but illustrates the steps for determining a value for risk.

Step 9: Preliminary analysis to test affordability

As a preliminary assessment of the project's affordability, compare the risk-adjusted PSC model with the institution's budget for the project as estimated during the solution options analysis (Stage 2). (The budget will be examined in

detail in Stage 4: Part 6.) If the project looks unaffordable by a wide margin in the PSC model, it may be necessary to revisit the options analysis.

Part 3: Construct the PPP reference model

The PPP reference model is a hypothetical private party bid to deliver the specified outputs.

The PPP reference model is the costing of the output specifications from a private party's perspective. Comparing the risk-adjusted PSC model with the risk-adjusted PPP reference model enables the institution to assess whether service delivery by government or by a private party yields the best value for money for the institution.

The PPP reference model must be developed using the identical output specifications as those used in the PSC model, but technically and financially it is very different. As the institution will not know what a private party will charge for the outputs specifications, costs will have to be estimated. The transaction advisor must have the necessary expertise, market knowledge and experience to construct a market-related PPP reference model.

Construct the PPP reference model

Step 1: Confirm the type of PPP

Step 2: Describe the proposed PPP project structure and sources of funding

Step 3: Develop the core components of the payment mechanism

Step 4: Set and cost BEE targets

Step 5: Calculate and consolidate all costs

Step 6: Construct the PPP reference model and explain all assumptions and indicators

Step 1: Confirm the type of PPP

There are two types of PPP defined by Treasury Regulation 16 to the PFMA: one involving the performance of an institutional function by a private party, and one involving the use of state property by a private party for its own commercial purposes. A project may be a hybrid of these types. Each type (or hybrid) may also have various characteristics, influenced largely by the expected sources of funding (see Step 2) and the anticipated payment mechanism (see Step 3).

Important considerations in confirming the PPP type will include:

- Which type is best suited to meeting the output specifications?
- What risks is the private party likely to take on?
- How much debt would be needed in the project?
- How long is the concession period?
- How will any assets in the project be treated? If ownership of an asset transfers between the institution and the private party at any stage during the project, how will residual values, depreciation, transfer costs and hand-back conditions be treated?

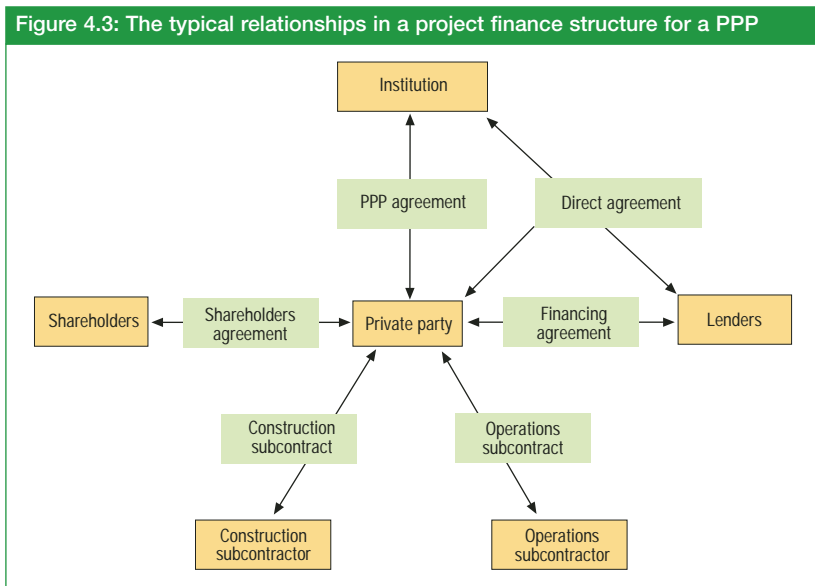
Step 2: Describe the proposed PPP project structure and sources of funding

The proposed structure for the project needs to show the relationship between the institution, the special purpose vehicle (SPV) (if required), shareholders, lenders, suppliers, subcontractors and other players.

The proposed sources of funding (the combination of debt and equity, and (if appropriate) government contribution) must be identified and shown in a proposed funding structure.

Appropriate equity returns, and the costs and key terms of debt financing, including debt service cover ratios (if applicable) must be shown. All assumptions must be clearly stated, as these will directly affect the cost of capital for the project.

Project finance structure¹⁰



In such a project finance structure, the following must be addressed:

- legal and financial structure and participants
- ratios such as: annual debt service cover ratio, project life cover ratio, loan life cover ratio, debt service reserve and maintenance reserve accounts, and the cash-flow waterfall arrangement.

10. See the preface to *Standardised PPP Provisions* for an explanation of the project finance structure, and see *Module 9: An Introduction to Project Finance*.

Corporate finance structure¹¹

Corporate finance should be treated as the exception for the structuring of PPP projects. It is used in projects with capital requirements below the levels at which project finance becomes cost-effective, but it carries different risks for the institution.

In a corporate finance structure, the following must be addressed:

- Project assets should be ring-fenced within the balance sheet of the private party to allow the institution to take security over project assets and to protect the institution in the event of termination.
- As a corporate finance project does not have the comfort of bank due diligence (as would be the case in project finance), the institution must expect to do a thorough due diligence on the project and take a long-term view on the balance sheet of the private party.
- Instead of being able to rely on a bank's vigilance over the private party's operations (as in a project finance structure), the onus will be on the institution to monitor, analyse and respond to any events or information which may impact on the project. The institution needs to demonstrate its capacity and skills to do so.
- In the base case financial model, the ratios relevant for a corporate finance structure are: liquidity, asset management, profitability and debt ratios.

Capital contribution by government

Current international trends support the use of government funding in PPPs. The benefits include:

- dedicated funds available for construction
- reduced unitary payment and/or user charges
- lower cost of capital.

The limitations are:

- pre-funding of equity returns
- risk transfer inevitably compromised
- risk of separating construction from operations
- reduced lender involvement reduces attention to due diligence.

National Treasury's view is that the use of government funds for capital works should be considered on a clear demonstration of value for money. The contribution by government must not cover all capital costs; the funds should only be used for the provision of ring-fenced project assets that will either immediately or on termination of the PPP agreement become the property of the state, and the assets thus purchased cannot be used as security. If such a capital contribution is anticipated, the following need to be addressed in detail:

- budgetary requirements
- regulatory requirements and restrictions

11. See the preface to *Standardised PPP Provisions* for an explanation of the corporate finance structure, and refer to *Module 9: An Introduction to Project Finance*.

- tax implications
- treatment of assets
- effect on the allocation of risk.

Step 3: Develop the core components of the payment mechanism

Although the full payment mechanism is developed during the preparation of the request for proposals (RFP),¹² the feasibility study must develop the core components.

For a unitary payment arrangement, the following must be addressed:

- the amount of the single, indivisible unitary payment
- whether any splitting of the unitary payment between services is appropriate
- identifying the key areas of availability and performance of the services
- preparing an initial allocation of the proposed unitary payment to these areas in order to verify that the appropriate incentives and penalties are created for the service as a whole.

Step 4: Set and cost BEE targets

Draft a proposed PPP BEE balanced scorecard¹³ for the PPP using the elements specified in the *Code of Good Practice for BEE in PPPs*, taking account of the sector, proposed PPP project type, structure, sources of funding, and the BEE issues identified in stages 1 to 3 of the feasibility study.

Calculate how the private party would cost each of the BEE targets set for the project.

The BEE work in the feasibility study phase is crucial to ensuring a sound BEE outcome in a PPP.

Producing a proposed BEE PPP balanced scorecard for the project, through which BEE targets are appropriately set for the maturity of the market in which the project is to take place, will directly impact on the institution's ability to produce sound bid documentation for the PPP. Getting these targets right or wrong may significantly impact on the project's affordability and value for money, and the private party's willingness to assume risk – and will certainly impact directly on the sustainability of BEE in the project.

Step 5: Calculate and consolidate all costs

The categories of costs covered in the PPP reference model must be the same as those in the PSC model – namely, direct capital, maintenance and operating costs, and indirect costs – and over a comparable period.

The key difference is that the PPP reference model is expected to take into account the innovative design, construction and operational efficiencies that may realistically be expected of the private sector.

¹². See *Module 5: PPP Procurement: 'Annexure 1: Payment mechanism'*.

¹³. See *Module 2: Code of Good Practice for BEE in PPPs*.

Identify these efficiencies and use them as the basis for costing.

A notable inclusion in the PPP reference model is the cost of capital, which should be made up of the proposed debt and equity structuring of the project. Institutions should not assume that the cost of capital for the PPP reference model is linked to the government bond yield; the assumption should rather be that the project would rely on its own credit. The cost of capital must be justified by historical data and an analysis of project risk as perceived by potential funders.

The treatment of the residual value of the assets must be shown in the costing. (See Part 7: Step 2.)

The PPP reference model must also include, as separately identifiable line items, the costs of each targeted BEE element. (See Step 4.)

Step 6: Construct the PPP reference model and explain all assumptions and indicators

The PPP reference model must be presented as a discounted cash-flow model, as with the PSC model.

As far as possible the PPP reference model must rely on the same assumptions as the PSC model, including the inflation and discount rates, which are particularly important for allowing for a proper comparison between the two procurement choices. The treatment of tax, VAT, depreciation, residual value and any other assumptions must be explained in detail.

A detailed narrative commentary on the model is required. It must explain the construction of the model and its key indicators, including the net present cost. Key indicators may be the debt/equity ratio, debt service cover ratio, liquidity, key sensitivities to inflation, project term, and tax.

Part 4: Construct the risk-adjusted PPP reference model

Risk and the private sector

The risks associated with the project do not disappear because the private sector is providing the service. But the same risks will typically entail lower costs for the private sector.

Risk is generally managed better in the private sector because of:

- a focus on outputs
- the economies of scale generated by integrating the design, building, financing and operation of assets
- the inventive use of assets
- innovative financial structuring
- managerial expertise.

It is necessary to do an independent risk assessment for the PPP reference model, using the costs that the private sector would usually apply to cater for the risk categories already identified for the project. This must be done by the institution's transaction advisor and backed up with a market testing exercise if necessary. The

risk matrix developed for the risk-adjusted PSC model (see Part 2), based on the Standardised PPP Risk Matrix (attached as Annexure 4), must therefore be used as reference.

While the risk categories are the same, they are dealt with differently in the two models. In the PSC model, risks are valued by assessing their cost, their likelihood of occurring and the costs of mitigation. The values are added to the base PSC model to create the risk-adjusted PSC model. In the PPP reference model, the PSC model's risk valuation process should not be necessary. Instead, because of the private sector's better capacity to manage risk, risk is incorporated into the costing of the project and should be reflected as:

- specific line items in the model dealing with direct risk-related costs (for example, insurance or guarantee costs)
- subcontractor costs
- increased required return on equity
- increased cost of debt.

In addition, the PPP reference model must reflect, as specific add-on costs, the risks retained by the institution. As in the risk-adjusted PSC model, the private sector will price risk transferred to it. Thus the risks which were allocated to the institution (the retained risks) in the risk matrix for the PSC model, must also be included in the PPP reference model.

Although the PPP reference model reflects an estimated private sector response to delivering the output specifications, there will still be some costs which the institution will be liable for in a PPP, such as the costs of managing the PPP agreement.¹⁴ These costs must also be calculated and clearly identified in the PPP reference model.

Risk-adjusted PPP reference model = PPP reference model + retained risk

The PPP reference model cost is thus an 'all-in' cost to the institution for undertaking the project through a PPP.

The PPP reference model must clearly show what the proposed unitary payment will be to government for undertaking the project through a PPP.

Part 5: Sensitivity analysis

A sensitivity analysis determines the resilience of the base PSC model and the base PPP reference model to changes in the assumptions which the model has been based on.

The institution and its transaction advisor should test the sensitivity of key variables to test their impact on affordability, value for money and risk, such as:

¹⁴. See *Module 6: Managing the PPP Agreement*.

- project term
- inflation rate
- discount rate
- construction costs
- total operating costs
- BEE costs
- service demand
- third-party revenue, if any
- residual value
- financing terms.

For example, an increase in the assumed capital cost may lower an associated risk. This will allow the institution to view the potential spread of the total cost to government under the base PSC model.

It may be important to undertake a sensitivity analysis of the PPP reference model using both high and low discount rates in a range of bond yield rates. If both discount rates support or reject the value for money of the project (when the NPV of the PPP reference model is compared with the NPV of the PSC model), the result is clear. However, if only one of the discount rates meets the value-for-money criterion, the project should be further examined, taking into consideration the sensitivity of the independent variables and how they may affect the results.

Take note

A thorough sensitivity analysis on different variables must be presented as part of the feasibility study.

Part 6: Demonstrate affordability

The budget for the project has been identified at various stages prior to this. At this stage, it must be scrutinised in detail and confirmed in order to demonstrate project affordability.

Step 1: Determine the institutional budget available for the project

Institutions should refer to the *Estimates of National Expenditure* and their own detailed budgets. Include all the applicable available amounts, namely direct and indirect costs, and any third-party revenues. Where necessary, include budgetary allocations that would be available to the project from other institutional budgets (such as capital works allocations on the Public Works vote).

Most PPP projects, particularly those involving private capital investment, will extend beyond the three years of the MTEF. It will therefore be necessary for institutions to extrapolate their budgets beyond the MTEF to make meaningful comparisons with the cost of the PPP project. As a rule of thumb, it is prudent to assume that budgets remain constant in real terms (they increase only in line with

inflation) over the term of the project. Any different assumptions will need to be well argued and backed with documentation.

Take note

When assessing the institution's ability to pay for the project, ensure that all costs associated with the project have been taken into account. For example: In a school project, the private party may be required to supply the design, construction and maintenance of the school buildings, but the Department of Education may continue to provide teachers. The department must thus ensure that it has sufficient budget for not only the payment of the unitary payment to the private party for the design, construction and maintenance of the school, but also for its own teachers, who will work there. Costs of managing a PPP agreement must also be accounted for in the budget.

Step 2: Compare the risk-adjusted PPP reference model with the available institutional budget

If affordability cannot be demonstrated, the institution will be obliged either to re-examine and modify the output specifications within the affordability constraint, or to abandon the project.

For example, if the output specification is 24 hours, 7-days-a-week coverage of all movements inside a prison and the model reveals that this is beyond the institution's budget for the project, the output specification might be modified to such coverage only in the high-security block. Any adjustments to output specifications must be reflected in adjustments to both the PSC model and the PPP reference model, in order to maintain comparability.

Part 7: Initial value-for-money test

Initial value-for-money test

Step 1: Check the models

Step 2: Establish the initial indication of value for money

Step 3: Assess BEE value for money

Step 1: Check the models

- Do the models (both PSC and PPP reference) reflect the requirements of the output specifications?
- Have all capital costs, operating and maintenance costs required to deliver the service according to the output specifications been included?
- Have all BEE targets been costed?
- Have all material and quantifiable risks been identified and accurately valued?
- Have all risks been summarised in the risk matrix, including their consequences, financial impacts and proposed mitigation strategies? Have all risks been appropriately assigned to the party best able to manage them?
- Has a sensitivity analysis been conducted on the key assumptions?
- Are all assumptions used reasonable and appropriate?

Step 2: Establish the initial indication of value for money

Treasury Regulation 16.1 to the PFMA defines value for money as: ‘a net benefit to the institution, defined in terms of cost, price, quality, quantity, or risk transfer, or a combination thereof.’

The value-for-money test is only conducted in the procurement phase as one of the requirements for TA:IIB when private party bids are submitted. For TA:I, institutions are required to give an initial indication of what value for money the project is likely to provide if it were procured through conventional public sector procurement or a PPP, by comparing the two models. The models will also provide the critical benchmark for evaluating PPP bids during the procurement phase.

Value for money is considered at this stage by comparing the risk-adjusted PSC model to the risk-adjusted PPP reference model on a net present value (NPV) basis.

Figure 4.5: Value-for-money comparison

Value-for-money comparison	Public sector comparator	PPP reference
Financial Model		
Legal, financial, technical, commercial, socio-economic, institutional impact of the option		
Costs		
Assumptions for model (inflation, interest rate, tax, VAT, depreciation, budget and MTEF)		
Funding options		
Any contributions by government		
Net present cost	PSC	PPP-ref
Risk adjustments	RA	RA
Risk adjustments net present cost	RA-PSC	RA-PPP-ref

The use of **an NPV calculation** in determining the cost of a project is based on the premise that a Rand received today is more valuable than a Rand received at some future date. The timing of cash flows in the PPP reference model and the PSC model are often quite different from each other, and therefore difficult to compare without adjusting for the time value of money. By taking into account the time value of money, the discounted cash flow allows the private project proposals to be compared to each other and to the PSC model in the procurement phase.¹⁵ Clearly, in order to compare the models, it is necessary to apply the same discount rate. It is acknowledged that the extent to which a Rand today is worth more than a Rand in future is determined by the discount rate used in calculating the NPV. (The use of a discount rate has been discussed in Part 1: Step 5, and is elaborated on in

15. See *Module 5: PPP Procurement*.

‘Annexure 2: The significance of the discount rate’.)

Also consider in this comparison, **the treatment of residual value of assets** created during the project. Where the PPP does not pass residual value risk to the private party, an asset simply returns to the institution for zero or nominal consideration and the private party must earn a return on its initial investment through the service charges payable. However, the institution is left with an asset with a remaining useful economic life and theoretically there should be a deduction from the NPV of the service charges to reflect the lower true net cost of the services provided under the contract. Where such a deduction is made from the cost of the PPP an equivalent deduction should be made from the PSC model. In each case the market value of the asset is the appropriate figure. As there is unlikely to be a material difference between these two estimates it is usually legitimate to exclude the residual value on the grounds that it will not affect the comparison. The key point is to achieve consistency of approach, namely, either include a deduction for residual value in both calculations or exclude it in both calculations. Where the PPP contract does involve residual risk being passed to the private party the institution will usually have the option to pay an amount equal to market value at the end of the contract in order to retain the asset, or to pay nothing and leave the asset with the private party. In this case, no residual value deduction is needed from the NPV of the service payments to calculate the NPV of the services under the PPP. However, for the PSC model calculation, an assumption would have to be made regarding the deduction needed to avoid overstating the cost of services.

Step 3: Assess BEE value for money

Make a value-for-money assessment of which procurement choice is going to best achieve the BEE outcomes that the institution targeted for the project.

Part 8: Make the procurement choice

If the PPP reference model shows that the project is affordable as a PPP and there is reasonable indication that a PPP will result in a lower net present cost to the institution (hence greater value for money) than a public procurement, with a value-for-money BEE outcome, then the institution should procure a PPP.

Part 9: Verify information and sign off

Verify information and sign off

Step 1: Verify the information used in the feasibility study

Step 2: Draw up a checklist for legal compliance

Step 3: Sign off the feasibility study

Step 1: Verify the information used in the feasibility study

Constructing the PSC and PPP reference models and developing the risk matrix are information-intensive exercises. The conclusions which will be drawn from the models are highly dependent on the quality and accuracy of the information they are based on. All PPP projects are subject to an annual audit by the Auditor-General.¹⁶ For this reason, and because the models will need to be referred to throughout the procurement phase, it is necessary to provide the following information, as an annexure to the feasibility study:

- **A statement from the institution and its transaction advisor on the reasonableness of the information collected.** Describe the process by which the transaction advisor collected the information. Demonstrate that the information collected and used was realistic and sensible.
- **A statement of qualification from the transaction advisor about whether value for money could have been enhanced.** In many cases, an institution's strategic objectives may prescribe how a potential PPP can be structured, which may result in a particular level of value for money. It is the transaction advisor's responsibility to point out to institutions how value for money might be enhanced, and to record what different combinations of public private solutions might have been explored to optimise the institution's desired outcomes.
- **A description of how the assumptions used in constructing the PSC and PPP reference model are realistic and appropriate,** taking into account past practice, performance, current practice and anticipated future developments. For complex projects or projects where there is little precedent, it is strongly recommended that an independent party checks that the assumptions are reasonable, and confirms that they have been correctly incorporated into the model to produce an accurate result (arithmetic and logic). This may have cost and time implications.
- **A record of the methodologies used for valuing various costs,** including the costs of key risks.
- **A statement on how an audit trail of all documentation has been established and maintained to date,** and how it will be managed throughout the project. This is an essential requirement, especially for the purposes of the Auditor-General and in terms of the Promotion of Access to Information Act, 2000.

Step 2: Draw up a checklist for legal compliance

Legal advisors must draw up a checklist for legal compliance. (This may be a summary of work undertaken during Stage 3.)

Step 3: Sign off the feasibility study

All inputs into the feasibility study must be signed off as accurate and verifiable by each of the transaction advisor specialists.

¹⁶ See *Module 7: Auditing PPPs*.

Requirements for the feasibility study report: Value assessment

- PSC model
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - BEE targets
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, budgets and MTEF
 - Summary of results from the base PSC model: NPV
- PPP reference
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - Discussion on proposed PPP type
 - BEE targets
 - Proposed PPP project structure and sources of funding
 - Payment mechanism
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, tax and VAT
 - Summary of results from the PPP-reference model: NPV
- Risk assessment
 - Comprehensive risk matrix for all project risks
 - Summary of the institution's retained and transferable risks
 - The NPV of all risks (retained and transferable) to be added onto the base PSC model
 - The NPV of all retained risks to be added onto the PPP reference model
- Risk-adjusted PSC model
 - Summary of results: NPV
- Risk-adjusted PPP-reference
 - Summary of results: NPV, key indicators
 - Sensitivity analysis
 - Statement of affordability
 - Statement of value for money
 - Recommended procurement choice
- Information verification
 - Summary of documents attached in Annexure 1 to verify information found in the feasibility study report

STAGE 5: ECONOMIC VALUATION

Take note

A project which is not economically viable will not easily be awarded TA:I.

An economic valuation may be warranted in:

- greenfield projects
- capital projects
- projects that warrant an analysis of externalities (such as major rail, port, airport projects).

A range of well-known micro-economic techniques exists for undertaking an economic valuation, requiring the analysis to:¹⁷

- Give a clear economic rationale for the project.
- Identify and quantify the economic consequences of all financial flows and other impacts of the project.
- Detail the calculation or shadow prices/opportunity costs for all inputs and outputs, including:
 - foreign exchange
 - marginal cost of public funds
 - opportunity cost of public funds (discount rate)
 - high, medium and low skill labour
 - tradable and non-tradable inputs
 - tradable and non-tradable outputs (including consumer surplus, where relevant, based on financial or other model quantities).
- Identify an appropriate ‘no-project’ scenario and calculate the associated economic flows, treating them as opportunity costs to the project. (A ‘no-project’ scenario is not the same as a PSC model.)
- Identify the economic benefits to BEE, and the opportunity costs to BEE of a ‘no-project’ scenario.
- Provide a breakdown of the economic costs and benefits of the project into its financial costs and benefits, and various externalities.
- Do a detailed stakeholder analysis, including the project entity, private sector entity, government, and others.

Submission requirements: Economic valuation

- Introduction and valuation approach
- Assumptions
- Valuation results

17. Refer to sections 38 (1) and 51(1) of the PFMA when undertaking the economic valuation.

STAGE 6: PROCUREMENT PLAN

A procurement plan demonstrates that the institution has the necessary capacity and budget to undertake the procurement of the PPP.

A procurement plan must contain at least the following:

- a project timetable for the key milestones and all approvals which will be required to take the project from TA:I to TA:III
- confirmation that sufficient funds in the institution's budget are available¹⁸ to take the project to TA:III and into contract implementation
- a list of any potential challenges to the project and a discussion on how these will be addressed by the project team and transaction advisor
- the best procurement practice and procedures suited to the project type and structure
- the governance processes to be used by the institution in its management of the procurement, especially regarding decision-making
- the project stakeholders and the extent of their involvement in the PPP
- the project team with assigned functions
- categories of information to be made available to bidders and how such information will be developed
- a list of required approvals from within and outside the institution
- a GANTT chart of the procurement process, including all approvals and work items necessary for obtaining these approvals (for procurement documentation as well as, for example, the land acquisitions and environmental studies to be procured by the institution)
- contingency plans for dealing with deviations from the timetable and budgets
- the bid evaluation process and teams
- an appropriate quality assurance process for procurement documentation
- the means of establishing and maintaining an appropriate audit trail for the procurement
- appropriate security and confidentiality systems, including confidentiality agreements, anti-corruption mechanisms, and conflict of interest forms to be signed by all project team members.

18. See *Module 3: PPP Inception for information on funding for transaction advisor costs from the Project Development Facility (PDF)*.

STAGE 7: SUBMIT THE FEASIBILITY STUDY REPORT

Submit the feasibility study report to the head of the relevant treasury, with all the information arranged as it is set out in the list of submission requirements below. The contents page of the report should thus mirror this list.

Take note

The feasibility study report must provide as much information as is necessary for the relevant treasury to assess the merits of the project.

Submit as much information as possible, making use of annexures which have been referenced in the appropriate section of the main part of the report. All documents that have informed the feasibility study and are of decision-making relevance to the project must be part of the feasibility study report.

The feasibility study report must be submitted as a single report with its annexures. The report must not refer to any document that has not been submitted as part of the report.

1. Contents of the report

Introduction

Submission requirements

- Covering letter from the accounting officer/authority requesting TA:I
- Executive summary
- Introduction
- Project background
- Approach and methodology to the feasibility study

Section 1

Submission requirements: Needs analysis

- Institution's strategic objectives
- Budget
- Institutional analysis
- Output specifications
- Scope of the project

Section 2

Submission requirements: Solution options analysis

- Options considered
- Evaluation and assessment of each option
- Summary of evaluation and assessment of all options considered
- Recommendation of a preferred option

Section 3

Submission requirements: Project due diligence

- Legal aspects
 - Use rights
 - Regulatory matters
- Site enablement
- Socio-economic and BEE

Section 4

Submission requirements: Value assessment

- PSC model
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - BEE targets
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, budgets and MTEF
 - Summary of results from the base PSC model: NPV
- PPP reference model
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates
 - Discussion on proposed PPP type
 - BEE targets
 - Proposed PPP project structure and sources of funding
 - Payment mechanism
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, tax and VAT
 - Summary of results from the PPP-reference model: NPV
- Risk assessment
 - Comprehensive risk matrix for all project risks
 - Summary of the institution's retained and transferable risks
 - The NPV of all risks (retained and transferable) to be added onto the base PSC model
 - The NPV of all retained risks to be added onto the PPP reference model
- Risk-adjusted PSC model
 - Summary of results: NPV
- Risk-adjusted PPP reference model
 - Summary of results: NPV, key indicators
 - Sensitivity analysis
 - Statement of affordability
 - Statement of value for money

- Recommended procurement choice
- Information verification
 - Summary of documents attached in Annexure 1 to verify information found in the feasibility study report

Section 5

Submission requirements: Economic valuation

- Introduction and valuation approach
- Assumptions
- Valuation results

Section 6

Submission requirements: Procurement plan

Annexures

Annexure 1: Statements for information verification and sign-off from each advisor to the project

Annexure 2: Letter of concurrence from CFO of institution and/or provincial treasury¹⁹

Annexure 3: PSC model

Annexure 4: PPP reference model

Annexure 5: Risk assessment and comprehensive risk matrix

Annexure 6: Document list (list of all documents related to the project, where they are kept, and who is responsible for ensuring that they are updated)

Annexure 5, 7, 8, 9 etc: Attach as annexures all other documents that have informed the feasibility study and that are of decision-making relevance to the project.

2. Electronic format requirements

All electronic files must be labelled clearly to reflect their contents and dated as the final version. Text-based files must be in Microsoft Word and all financial models must be in Microsoft Excel.

The financial models must be sufficiently adaptable for use by others at later stages. Sheets must be logically ordered and labelled and inputs into the model clearly identified. Formulas should have as little hard coding as possible. If possible, key inputs should be able to be changed by the relevant treasury in the model itself to test different scenarios and the veracity of the model.

The institution and its transaction advisor may be requested to present the feasibility study report to the relevant treasury using PowerPoint.

The executive summary and PowerPoint presentation must be compiled in such a way that they can be used by the institution's management for decision-making purposes.

19. If Treasury approvals for PPPs have been delegated to a provincial treasury in terms of the PFMA, its concurrence here is not applicable.

STAGE 8: REVISITING THE FEASIBILITY STUDY

Extract from Treasury Regulation 16 to the PFMA

16.4.4 *If at any time after Treasury Approval: I has been granted in respect of the feasibility study of a PPP, but before the grant of Treasury Approval: III in respect of the PPP agreement recording that PPP, any assumptions in such feasibility study are materially revised, including any assumptions concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer or accounting authority of the institution must immediately –*

- (a) provide the relevant treasury with details of the intended revision, including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study; and*
- (b) ensure that the relevant treasury is provided with a revised feasibility study after which the relevant treasury may grant a revised Treasury Approval: I.*

Take note

The requirement is thus not to revisit the feasibility study only prior to financial closure, but at any time that any assumptions may differ materially from the original assumptions.

ANNEXURES

ANNEXURE 1		
A PSC model		48
ANNEXURE 2		
The significance of the discount rate		55
ANNEXURE 3		
How to calculate the value of risk		59
ANNEXURE 4		
Standardised PPP Risk Matrix		63

A PSC MODEL

Example: Providing a hospital and related services²⁰

Overview

Output specifications²¹

The Gauteng Department of Health needs to provide a hospital and related services (to include medical equipment, catering and parking) in the Ekurhuleni area. The department has decided that the outputs will not include the provision of core medical services and direct patient care. The hospital must cater for 300 beds. The project term is assumed to be 12 years with a construction period of two years.

Options analysis

The solution options the department looked at were to build a new hospital in the area or to renovate and upgrade another hospital 40km away. For a variety of reasons, building a new hospital in the area was the preferred option.

The base PSC model assumes that the department will appoint a contractor for the design and construction work through a conventional public sector procurement process. All operational and maintenance work will be undertaken by the department itself.

20. This example is of a typical PSC model, but should not be copied or used as a template. It has been adapted from *Partnerships Victoria: Public Sector Comparator Technical Note*, published by the Department of Treasury and Finance, State of Victoria, Melbourne, Australia, in June 2001.

21. If the needs analysis and the options analysis have been conducted separately from the rest of the feasibility study it is necessary to provide a brief overview here, restating the output specifications, the options analysed and the preferred option, before embarking on the requirements of the value for money, affordability and risk assessment. If considerable time has passed, the social, economic and political conditions may have changed. The objective and scope of the project will then need to be re-examined.

Costs and revenue

The costs for the base PSC model are based on the recent building of a hospital elsewhere in South Africa, and on the expert research and opinion of the department's transaction advisor.

Costs	Amount (R million)	Description
Direct capital costs		
Land acquisition and development	5.0	The market price for the land
Design and construction contract price ²²	100.0	Based on a recent bid for a similar construction project
Payment to consultants	10.0	Legal advisors, engineers, town planners, etc
Plant and equipment	50.0	Current market price for medical, catering and cleaning equipment
Capital upgrade of facility expected in year 5	15.0	
Capital expenditure over project cycle	40.0	Three-year capital expenditure cycles, once operation of the hospital begins, in years 5, 8 and 11
Direct maintenance costs		
Maintenance and repairs on buildings, plant and equipment	4.0 p.a.	
Direct operating costs		
Personnel (wages, salaries and benefits)	5.0 p.a.	
Running costs (water, electricity, telephone, etc.)	2.0 p.a.	
Management	1.0 p.a.	
Indirect costs		
Project management overheads	1.0 p.a.	Cost of managing the project during the construction period
Operating overheads	0.2 p.a.	Portion of department's costs attributable to the new hospital
Administration overheads	0.5 p.a.	Cost of ongoing facilities and project management
Third party revenue		
Revenue expected	5.0 p.a.	From car parking fees and retail (net of costs)

Assumptions

Assumptions	Amount (R million)	Description
Budget	R33m p.a.	Budget available to the department
Inflation	6% p.a.	Assumed to increase at 6% p.a. on all costs
Discount rate	10%	An assumed rate for the purposes of this example

22. When constructing the PSC, the impact of the Preferential Procurement Policy Framework Act, 2000 (PPPFA) 90:10 formula should be included in costing the project's BEE targets. The PPPFA places a ceiling on the price premium for BEE on all goods and services contracted through conventional procurement.

Discounted cash-flow model

Base PSC: Cash-flow timing profile													
	Year												
	0	1	2	3	4	5	6	7	8	9	10	11	12
DIRECT COSTS													
Capital costs													
Land costs	100%												
Design and construction contract price	15%	35%	35%	15%									
Payments to consultants	33%	33%	33%										
Plant and equipment	10%	30%	60%										
Capital upgrade						100%							
Life-cycle capital expenditure						33%			33%			33%	
Maintenance costs				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Operating costs													
Wages and salaries				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Running costs				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Management costs				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
INDIRECT COSTS													
Construction overhead costs	100%	100%	100%										
Operating overhead costs				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Administrative overhead costs				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
LESS													
Third-party revenue				100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Base PSC: Nominal cash-flow (R thousands)													
	Year												
	0	1	2	3	4	5	6	7	8	9	10	11	12
DIRECT COSTS													
Capital costs													
Land costs	5,000												
Design and construction contract price	15,000	55,650	39,326	17,865									
Payments to consultants	3,333	3,533	3,745										
Plant and equipment	5,000	15,900	33,708										
Capital upgrade						20,073							
Life-cycle capital expenditure						17,665			21,039			25,058	
Maintenance costs				4,764	5,050	5,353	5,674	6,015	6,375	6,758	7,163	7,593	8,049
Operating costs													
Wages and salaries				5,955	6,312	6,691	7,093	7,518	7,969	8,447	8,954	9,491	10,061
Running costs				2,382	2,525	2,676	2,837	3,007	3,188	3,379	3,582	3,797	4,024
Management costs				1,191	1,262	1,338	1,419	1,504	1,594	1,689	1,791	1,898	2,012
INDIRECT COSTS													
Construction overhead costs	1,000	1,060	1,124										
Operating overhead costs				238	252	268	284	301	319	338	358	380	402
Administrative overhead costs				596	631	669	709	752	797	845	895	949	1,006
LESS													
Third-party revenue				5,955	6,312	6,691	7,093	7,518	7,969	8,447	8,954	9,491	10,061
Subtotal: Base PSC	29,333	76,143	77,903	27,036	9,721	48,042	10,923	11,578	33,311	13,009	13,790	39,674	15,494
Discount factor: 10%	1.0	0.91	0.83	0.75	0.68	0.62	0.56	0.51	0.47	0.42	0.39	0.35	0.32
Discounted cash flow	29,333	69,221	64,383	20,313	6,640	29,830	6,166	5,941	15,540	5,517	5,316	13,906	4,937
NPV of base PSC	277,043												

Risk valuation

	Effect on PSC base cost assumption	Impact of risk (R 000s)	Likelihood of risk occurring (%)	Value of risk (R 000s)
Design and construction (D&C) risk				
Cost overrun (percentage of D&C cost: R100m)				
Below base PSC	-5%	-5,000	5%	-250
No change from base PSC	0%	-	10%	-
Overrun: Likely	15%	15,000	50%	7,500
Overrun: Moderate	30%	30,000	20%	6,000
Overrun: Extreme	40%	40,000	15%	6,000
				19,250
Time overrun (% of D&C Cost: R100m)				
No time overrun	0%	-	15%	-
Overrun: Likely	10%	10,000	50%	5,000
Overrun: Moderate	15%	15,000	25%	3,750
Overrun: Extreme	20%	20,000	10%	2,000
* Likely: 1 year delay. Moderate: 1.5 year delay. Extreme: 2 year delay				10,750
Provision of similar service (R5m per year during delay)				
No delay	0%	-	25%	0.0
Cost: Likely	100%	5,000	40%	2,000
Cost: Moderate	200%	10,000	30%	3,000
Cost: Extreme	200%	10,000	5%	500
* Likely: 1 year delay. Moderate: 1.5 year delay. Extreme: 2 year delay				5,500
Upgrade costs (% of project cycle capital expenditure: R40m)				
Below base PSC	-5%	-2,000	5%	-100
No change from base PSC	0%	-	10%	-
Overrun: Likely	15%	6,000	50%	3,000
Overrun: Moderate	30%	12,000	20%	2,400
Overrun: Extreme	40%	16,000	15%	2,400
				7,700
Operating risk (% of direct operating costs: R8.25m p.a.)				
Below base PSC	-5%	-413	5%	-21
No change from base PSC	0%	-	25%	-
Overrun: Likely	15%	1,238	40%	495
Overrun: Moderate	30%	2,475	25%	619
Overrun: Extreme	40%	3,300	5%	165
				1,258
Performance risk (R5m p.a. for underperformance)				
No deviation	0%	-	70%	0.0
Overrun: Likely	100%	5,000	30%	1,500
Overrun: Moderate	0%	-	0%	-
Overrun: Extreme	0%	-	0%	-
				1,500
Maintenance risk				
General maintenance risk (% of maintenance cost: R4m per year)				
Below base PSC	-5%	-160	5%	-8
No change from base PSC	0%	-	25%	-
Overrun: Likely	15%	480	40%	192
Overrun: Moderate	30%	960	25%	240
Overrun: Extreme	40%	1,280	5%	64
Assume 80% of hospital is general area, thus base is 80% of R4m per year				488
Patient area maintenance risk (percentage of maintenance cost: R4m per year)				
Below base PSC	-5%	-40	5%	-2
No change from base PSC	0%	-	15%	-
Overrun: Likely	45%	360	45%	162
Overrun: Moderate	75%	600	25%	150
Overrun: Extreme	120%	960	10%	96
Assume 20% of hospital is patient area, thus base is 20% of R4m per year				406
Technology risk (percentage of plant and equipment: R50m)				
Below base PSC	-20%	-10,000	20%	-2,000
No change from base PSC	0%	-	10%	-
Overrun: Likely	30%	15,000	40%	6,000
Overrun: Moderate	40%	20,000	20%	4,000
Overrun: Extreme	50%	25,000	10%	2,500
				10,500

Base PSC: Nominal cash flow (R thousands)													
RISK	Year												
	0	1	2	3	4	5	6	7	8	9	10	11	12
Design and construction risk													
Cost overrun		3,061	7,570	8,024	3,645								
Time overrun			1,613	3,763	3,763	1,613							
Similar service provision			825	1,925	1,925	1,925							
Upgrade cost			8,652										
Operating risk				1,498	1,588	1,684	1,785	1,892	2,005	2,126	2,253	2,388	2,532
Performance risk				1,787	1,894	2,007	2,128	2,255	2,391	2,534	2,686	2,847	3,018
Maintenance risk													
General maintenance risk				581	616	653	692	734	778	824	874	926	982
Patient area maintenance risk				484	513	543	576	610	647	686	727	771	817
Technology risk				1,251	1,326	1,405	1,182	1,253	1,328	1,408	1,492	1,582	1,677
Subtotal: Risk	-	3,061	18,659	19,312	15,269	9,830	6,363	6,744	7,149	7,578	8,033	8,515	9,026
Discount factor: 10%	1.0	0.91	0.83	0.75	0.68	0.62	0.56	0.51	0.47	0.42	0.39	0.35	0.32
Discounted cash flow	-	2,783	15,421	14,510	10,429	6,104	3,592	3,461	3,335	3,214	3,097	2,984	2,876
Present value of risk	71,805												

Risk-adjusted PSC model

Base PSC: Nominal cash flow (R thousands)													
	Year												
	0	1	2	3	4	5	6	7	8	9	10	11	12
Direct capital costs	28,333	75,083	76,779	17,865	-	37,738	-	-	21,039	-	-	25,058	-
Direct maintenance costs				4,764	5,050	5,353	5,674	6,015	6,375	6,758	7,163	7,593	8,049
Direct operating costs	-	-	-	9,528	10,100	10,706	11,348	12,029	12,751	13,516	14,327	15,186	16,098
Indirect costs	1,000	1,060	1,124	834	884	937	993	1,053	1,116	1,183	1,254	1,329	1,409
Less: Third-party revenue	-	-	-	5,955	6,312	6,691	7,093	7,518	7,969	8,447	8,954	9,491	10,061
Subtotal: Base PSC	29,333	76,143	77,903	27,036	9,721	48,042	10,923	11,578	33,311	13,009	13,790	39,674	15,494
Risk value	-	3,061	18,659	19,312	15,269	9,830	6,363	6,744	7,149	7,578	8,033	8,515	9,026
Total cash flows	29,333	79,204	96,562	46,348	24,990	57,872	17,285	18,322	40,461	20,587	21,822	48,189	24,520
Discount rate: 10%	1.0	0.91	0.83	0.75	0.68	0.62	0.56	0.51	0.47	0.42	0.39	0.35	0.32
Discounted cash flows	29,333	72,004	79,804	34,822	17,069	35,934	9,757	9,402	18,875	8,731	8,413	16,890	7,813
Present value of risk-adjusted PSC	R348,847												

Risk matrix

Risk	Description	Consequence	Risk value (R thousands)	Mitigation	Allocation	Risk tracking (RFP and negotiation)
1. Design and construction risk	The risk that the construction of the physical assets is not completed on time, budget or to specification.	Cost and delay	43,200	Private party may pass risk to subcontractor but maintain primary liability. Institution will not pay until service commencement.	Generally allocated to Private Party (PP)	
1.1 Cost overruns	1.1.1 Increase in the construction costs assumed in base PSC model.	Cost	19,250	PP in fixed term, fixed price contract with subcontractor.	Transfer: PP (PP may pass risk onto subcontractor but remains liable for risk.)	
1.2 Time overruns	1.2.1 Increase in the construction costs assumed in base PSC model as a result of delay in the construction schedule	Delay resulting in additional cost	10,750	Institution will not pay until service commencement.	Transfer: PP + pass on to subcontractor	
	1.2.2 Cost of interim solution. Results in additional cost of maintaining existing building or providing a temporary solution due to inability to deliver new facility as planned.	Cost of interim solution	5,500		Transfer: PP	
1.3 Upgrade costs	1.3.1 Increase in construction costs if the planned facility is not sufficient and additional capacity needs to be added.	Cost of upgrades	7,700	Minimise likelihood by ensuring specifications meet Institution's needs; careful planning of Institution's likely output requirements over term of contract.	Retain: Institution	
2. Operating risk	The risk that required inputs cost more than anticipated; are inadequate quality or are unavailable.	Cost increases and may impact on quality of service. Cost p.a.	1,258	Managed by PP through supply contracts to assure quality/quantity. Can be addressed in design.	Transfer: PP	
3. Performance risk	Risk that services may not be delivered to specification	Service unavailability. Inability of Institution to deliver public service. Alternate arrangements may need to be made to ensure service delivery, with additional costs. Cost p.a.	1,500	Institution to carry out due diligence on selected PP for capacity. Guarantees and assurances by PP. Penalties for underperformance. Termination of agreement.	Transfer: PP	
4. Maintenance risk	Risk that design/construction is inadequate and results in higher than anticipated maintenance costs. Higher maintenance costs generally.	Cost increases. May impact on Institution's ability to deliver public services.	894	PP to manage through long-term supply and subcontracts.	Generally transfer: PP	
4.1 General maintenance risk	Risk that design/construction is inadequate and results in higher than anticipated maintenance costs in general area. Higher maintenance costs generally.	Cost increases. May impact on Institution's ability to deliver public services. Cost p.a.	488	PP to manage through long-term supply and subcontracts.	Transfer: PP	

ANNEXURE 1: A PSC MODEL

Risk	Description	Consequence	Risk value (R thousands)	Mitigation	Allocation	Risk tracking (RFP and negotiation)
4.2 Patient area maintenance risk	Risk of higher than anticipated maintenance costs in patient area for which Institution is responsible.	Cost increases. May impact on Institution's ability to deliver public services. Cost p.a.	406	Institution to ensure design is able to accommodate planned maintenance.	Retained: Institution	
5. Technology risk	Risk that technical inputs may fail to deliver required output specs or technological improvements may render the technology inputs in the project out-of-date.	Cost increases.	10,500	Obligation on PP to refresh technology. Penalty deductions for failure to meet output specifications.	Transfer: PP	

THE SIGNIFICANCE OF THE DISCOUNT RATE

Introduction

The PSC and PPP reference models are based on a discounted cash-flow (DCF) analysis, which sees the cost of a project as the net present value (NPV) of its future cash flows. Cash flows are forecast over the life of the project and then adjusted to a common reference date. The sum of the discounted cash flows for the full term of the project gives its NPV a Rand figure.

The formula for calculating the NPV

$$\text{NPV} = \text{CFn} * [1/(1 + r)^n]$$

CF = cash flow for each period of the project

r = discount rate

n = number of periods over which the project is being considered

The NPV is a useful measure because it is easily interpreted and readily comparable to other projects or bids modelled in the same way for the same reference date. For example, the timing of the cash flows for a PPP and conventional public sector procurement are often quite different and therefore difficult to compare. Discounted cash flows take into account the time value of money, making the NPVs comparable. In the feasibility study phase, the NPVs of the PSC and PPP reference models need to be compared. In the procurement phase, the NPVs of the various private bids will be compared with each other and with the PSC model.²³

The discount rate

A Rand today is more valuable than a Rand at some future date. The discount rate is a measure of this time preference of money: the extent to which that Rand loses value over time. The higher the discount rate the less significant the present value of a Rand will be in the future. By the same token, the lower the discount rate, the higher the present value of the Rand will be in the future, although it always will be less than a Rand today. It is critical that an appropriate discount rate be used when constructing the discounted cash-flow models for the PSC and PPP reference models.

(There are several methods for determining an appropriate discount rate. National Treasury's recommendations are set out under Stage 4: Part 1.)

²³. See *Module 5: PPP Procurement*.

Example 1: The effect of different discount rates on the value of cash flow

Example 1 shows the effect of a change in the discount rate on the value of a constant cash flow of R100 per year for 15 years (including year 0). As the discount rate increases, the cumulative value of the cash flow decreases (shown at the bottom of the table). This is due to the reduced significance of the cash flows as time goes by. Therefore, the net present value (NPV) of a cash flow with a 20 per cent discount rate is about 50 per cent of the value of the same cash flow using a five per cent discount rate over 15 years.

Example 1						
Year	Cash flow	Discount rate				
		0%	5%	10%	15%	20%
0	100	100	100	100	100	100
1	100	100	95	91	87	83
2	100	100	91	83	76	69
3	100	100	86	75	66	58
4	100	100	82	68	57	48
5	100	100	78	62	50	40
6	100	100	75	56	43	33
7	100	100	71	51	38	28
8	100	100	68	47	33	23
9	100	100	64	42	28	19
10	100	100	61	39	25	16
11	100	100	58	35	21	13
12	100	100	56	32	19	11
13	100	100	53	29	16	9
14	100	100	51	26	14	8
Total	1,500	1,500	1,090	837	673	561

Example 2: The effect of different cash flows on the value of cash flow

On the other hand, Example 2 shows the effect of a change in cash flow on the value of discount cash flows. In all three scenarios, the aggregate value of the cash flows is R1,500 and the discount rate is 10 per cent. The value of a back-loaded cash flow, as seen in scenario B, is significantly less (about 1/3) than the value of the front-loaded cash flow in scenario C.

The concepts described above are applied in the following two examples. The significance of cash flows and the discount rate for analysing projects is clear.

Example 2

Year	Scenario A		Scenario B		Scenario C	
	Cash flow	Discount cash flow (discount rate: 10%)	Cash flow	Discount cash flow (discount rate: 10%)	Cash flow	Discount cash flow (discount rate: 10%)
0	100	100	5	5	195	195
1	100	91	5	5	195	177
2	100	83	5	4	195	161
3	100	75	5	4	195	147
4	100	68	5	3	195	133
5	100	62	100	62	100	62
6	100	56	100	56	100	56
7	100	51	100	51	100	51
8	100	47	100	47	100	47
9	100	42	100	42	100	42
10	100	39	195	75	5	2
11	100	35	195	68	5	2
12	100	32	195	62	5	2
13	100	29	195	56	5	1
14	100	26	195	51	5	1
Total	1,500	837	1,500	593	1,500	1,080

Example 3: Project generating insufficient revenue to cover costs

The discounted cash flow in Example 3 is for a service for which the institution will be required to pay regularly over the 10-year life of the project. Any revenues (taxes and/or fees) that may be generated by the institution in providing the service are insufficient to cover the cost of the service. It should also be noted that the PSC model reflects a capital cost to the department in the first year (year 0), while the private sector project (Project A) will be responsible for financing the project and will recover the cost of the financing and the principal throughout the life of the project. An example of a PPP that would have these characteristics is an IT project that would require a significant capital investment at the beginning of the project if undertaken by the institution on its own behalf. If the IT project is undertaken by a private sector provider, it would finance the project and settle the financing over the life of the project.

Example 3

Year	PSC			Project A		
	Net cash flow	Discount rate 10%	Net present value of cash flow	Net cash flow	Discount rate 10%	Net present value of cash flow
0	R2,500	1.00	R2,500	R500	1.00	R500
1	R450	0.91	R409	R550	0.91	R500
2	R400	0.83	R331	R600	0.83	R496
3	R300	0.75	R225	R650	0.75	R488
4	R300	0.68	R205	R650	0.68	R444
5	R300	0.62	R186	R650	0.62	R404
6	R300	0.56	R169	R650	0.56	R367
7	R300	0.51	R154	R650	0.51	R334
8	R300	0.47	R140	R650	0.47	R303
9	R350	0.42	R148	R650	0.42	R276
10	R375	0.39	R145	R650	0.39	R251
Total	R5,875		R4,612	R6,850		R4,362

Note that even though the cost of the project, in absolute terms, is greater for Project A than for the PSC (R6,850 vs. R5,875), the discounted cost of Project A is R250 less than if the institution were to undertake the project on its own behalf.

Example 4: Project generating revenue in excess of costs

In Example 4 the DCF is that of a 10-year project in which the institution continues receiving fees in excess of costs on providing an existing service. The private sector party, which will also benefit from the fees collected, will in turn pay the institution for the use of its assets and rights to the concession. An example of a PPP that may have these characteristics would be the granting of a concession on a toll road or port, in which the project revenues are derived from the fees charged to the users of the service. In this example, although the NPV of the future cash flow is slightly greater should the institution retain the service (PSC), the total value (not discounted) of the private sector providing the service will be greater.

Example 4						
Year	PSC			Project B		
	Net cash flow	Discount rate 10%	Net present value of cash flow	Net cash flow	Discount rate 10%	Net present value of cash flow
0	R500	1.00	R500	R350	1.00	R350
1	R500	0.91	R455	R400	0.91	R364
2	R500	0.83	R413	R450	0.83	R372
3	R500	0.75	R376	R500	0.75	R376
4	R500	0.68	R342	R550	0.68	R376
5	R500	0.62	R310	R550	0.62	R342
6	R500	0.56	R282	R550	0.56	R310
7	R500	0.51	R257	R550	0.51	R282
8	R500	0.47	R233	R550	0.47	R257
9	R500	0.42	R212	R600	0.42	R254
10	R500	0.39	R193	R600	0.39	R231
Total	R5,500		R3,572	R5,650		R3,513

Determining the discount rate that is to be used in producing a DCF analysis is one of the most contentious issues in this process. In the two examples above, should a 6 per cent discount rate have been used rather than 10 per cent, the results would have been reversed.

HOW TO CALCULATE THE VALUE OF RISK

Example: The construction of a new hospital²⁴

A new hospital is to be built in Gauteng by the Gauteng Department of Health, with a construction cost of R100 million, and an expected 18-month construction period.

Identify the risks

Construction risk

Identify and cost the impacts of construction risk and strategies for mitigating these, and estimate the likelihood of the impacts occurring

Construction risk has four material impacts:

- cost overruns
- time overruns, which may result in increased costs
- the cost of providing an alternative solution in the case of delays
- the cost of upgrades should the facility not meet the needs of the Department of Health.

As these impacts cannot be mitigated, it is necessary to assess the likelihood of their occurrence.

Cost overruns

Based on a similar project undertaken recently, the following probabilities show that the actual construction costs in relation to those assumed in the base PSC model:

- are the same as assumed in base PSC: 15 per cent likelihood
- exceed base PSC costs by 10 per cent: 40 per cent likelihood
- exceed base PSC costs by 15 per cent: 25 per cent likelihood
- exceed base PSC costs by 25 per cent: 15 per cent likelihood
- are less than base PSC by 5 per cent: 5 per cent likelihood.

Time overruns

The cost of delay is assumed to be R4 million per year. The institution and its transaction advisor have assumed the following for the completion of the hospital:

- completed on time: 15 per cent likelihood
- delayed by 1 year: 50 per cent likelihood
- delayed by 18 months: 25 per cent likelihood
- delayed by 2 years: 10 per cent likelihood.

24. Adapted from *Partnerships Victoria: Public Sector Comparator Technical Note*, p.45, published by the Department of Treasury and Finance, State of Victoria, Melbourne, Australia, in June 2001.

Cost of providing similar services during the delay period, using the existing facilities

The increased cost of using the existing facilities is assumed to be R3 million per year. The likelihood is directly linked to the likely time overruns and therefore exactly the same.

Calculate the value of construction risk

Calculate the value of each impact. The assumptions made by the Department of Health and its transaction advisor on the cost and likelihood of the impacts can be valued as follows:

Risk valuation table				
Scenario	Effect on base PSC construction cost (R million)	Cost of risk (R million)	Likelihood of risk	Value of risk [impact x likelihood] (R million)
Cost overrun				
Below base PSC	95	-5	5%	-0.3
No change from base PSC	100	0	15%	0.0
Overrun: Likely	110	10	40%	4.0
Overrun: Moderate	115	15	25%	3.8
Overrun: Extreme	125	25	15%	3.8
				11.3
Time overrun				
No time overrun	100	0	15%	0.0
Overrun: Likely	104	4	50%	2.0
Overrun: Moderate	106	6	25%	1.5
Overrun: Extreme	108	8	10%	0.8
				4.3
Provision of similar service				
No delay	10	0	15%	0.0
Cost: Likely	103	3	50%	1.5
Cost: Moderate	104.5	4.5	25%	1.1
Cost: Extreme	106	6	10%	0.6
				3.2
Upgrade costs				
No upgrade	100	0	20%	0.0
Cost: Likely	105	5	40%	2.0
Cost: Moderate	107	7	30%	2.1
Cost: Extreme	110	10	10%	1.0
				5.1
Total value of risk				23.9

The timing of each impact needs to be assessed. The different impacts of construction risk could each have different timing implications. For illustrative purposes, all impacts are assumed to occur between years 1 and 3. In reality these impacts may be distributed later in the project term.

Timing of impacts				
Impact	Year 1	Year 2	Year 3	Basis of allocation
Cost overrun	70%	30%		Pro rata construction period
Time overrun	70%	30%		Based on delays
Similar service provision		70%	30%	Based on delays
Upgrade cost		100%		Estimate of when upgrade may be necessary

Subtotal cost of each impact in time				
Impact	Subtotal (R million)	Year 1	Year 2	Year 3
Cost overrun	11.3			
Impact		70%	30%	
Cost of impact (R million)		7.9	3.4	0.0
Cost of impact calculation		(11.3x70%)	(11.3x30%)	
Time overrun	4.3			
Impact		70%	30%	
Cost of impact (R million)		3.0	1.3	
Cost of impact calculation		(4.3x70%)	(4.3x30%)	
Similar service provision	3.2			
Impact			70%	30%
Cost of impact (R million)		0.0	2.2	1.0
Cost of impact calculation		(3.2x70%)	(3.2x30%)	
Upgrade cost	5.1			
Impact			100%	
Cost of impact (R million)			5.1	
Cost of impact calculation			(5.1x100%)	

Construct a nominal cash flow for construction risk.

Nominal cash flow for construction risk (R million)				
Cost	Year 0	Year 1	Year 2	Year 3
Cost overrun		7.90	3.40	
Time overrun		3.00	1.30	
Similar service provision			2.20	0.96
Upgrade cost			5.10	
Real cost		10.90	12.00	0.96
Nominal cost (assume inflation at 6%)		10.90	12.72	1.08
Discount rate (assume 10%)	1.00	0.91	0.83	0.75
Discounted cash flows		9.91	10.51	0.81
Net present value	21.23			

Thus, the net present value of the identified components of construction risk for the new hospital project is R21.23 million.

The process discussed above for construction risk must be repeated for all material risks identified in the project. Through this risk valuation process, the intention is to arrive at a single net present value for all risks in the project, which can be added to the base PSC to arrive at a value for a risk-adjusted PSC.

Construct the risk matrix

Risk matrix extract						
Risk	Description	Consequence	Value of risk (R million)	Mitigation	Allocation	Risk Tracking (RFP and negotiation)
1. Construction risk	The risk that the construction of the physical assets is not completed on time, budget or to specification.	Cost and delay	21.23	Private party (PP) may pass risk to subcontractor but maintain primary liability. Institution will not pay until service commencement.	Generally allocated to PP	
1.1 Cost overruns	1.1.1 Increase in the construction costs assumed in base PSC.	Cost	9.99	PP in fixed term, fixed price contract with subcontractor.	Transfer: PP (PP may pass risk onto subcontractor but remains liable for risk.)	
1.2 Time overruns	1.2.1 Increase in the construction costs assumed in base PSC as a result of delay in the construction schedule.	Delay resulting in additional cost	3.80	Institution will not pay until service commencement.	Transfer: PP + pass on to subcontractor	
1.3 Similar service provision	1.3.1 Cost of interim solution. Results in additional cost of maintaining existing building or providing a temporary solution due to inability to deliver new facility as planned.	Cost of interim solution	2.54	Transfer: PP		
1.4 Upgrade costs	1.4.1 Increase in construction costs if the planned facility is not sufficient and additional capacity needs to be added.	Cost of upgrades	4.21	Minimise likelihood by ensuring specifications meet Institution's needs; careful planning of Institution's likely output requirements over term of contract.	Retain: Institution	

STANDARDISED PPP RISK MATRIX

Risk matrix				
No.	Categories	Description	Mitigation	Allocation
1.	Availability risk	The possibility that the Services to be provided by the Private Party do not meet the output specifications of the Institution.	Clear output specifications. Performance monitoring. Penalty Deductions against Unitary Payments.	Private Party.
2.	Completion risks	The possibility that the completion of the Works required for a project may be (i) delayed so that the delivery of the Services cannot commence at the Scheduled Service Commencement Date, or (ii) delayed, unless greater expenditure is incurred to keep to the Scheduled Service Commencement Date, or (iii) delayed because of variations.	Special insurance (project delay insurance). Appointment of an Independent Certifier to certify the completion of the Works. Liquidated damages, construction bonds and other appropriate security from the Private Party to achieve completion, unless caused by the Institution. Relief Event.	Private Party, unless delay caused by Institution (including, Institution Variations).
3.	Cost overrun risk	The possibility that during the design and construction phase, the actual Project costs will exceed projected Project costs.	Fixed price construction contracts. Contingency provisions. Standby debt facilities/additional equity commitments; provided that these commitments are made upfront and anticipated in the base case Financial Model.	Private Party.
4.	Design risk	The possibility that the Private Party's design may not achieve the required output specifications.	Clear output specifications. Design warranty. Patent and latent defect liability Consultation with and review by Institution (but review must not lead to input specifications by Institution). Independent Expert appointment to resolve disputes on expedited basis.	Private Party.
5.	Environmental risk	The possibility of liability for losses caused by environmental damage arising (i) from construction or operating activities (see operating risk) during the Project Term, or (ii) from pre-transfer activities whether undertaken by the Institution or a third party and not attributable to the activities of the Private Party or the Subcontractors.	Thorough due diligence by the bidders of the Project Site conditions. Independent surveys of the Project Site commissioned by the Institution at its cost. Institution indemnity for latent pre-transfer environmental contamination, limited by a cap (subject to value for money ("VFM") considerations), for a specified period. Remediation works to remedy identified pre-transfer environmental contamination as a specific project deliverable. Independent monitoring of remediation works.	In relation to (i), the Private Party. In relation to (ii), the Institution, but Institution's liability to be capped (subject to VFM considerations).
6.	Exchange rate risk	The possibility that exchange rate fluctuations will impact on the envisaged costs of imported inputs required for the construction or operations phase of the Project.	Hedging instruments (e.g. swaps).	Private Party.
7.	Force Majeure risks	The possibility of the occurrence of certain unexpected events that are beyond the control of the Parties (whether natural or "man-made"), which may affect the construction or operation of the Project.	Define "Force Majeure" narrowly to exclude risks that can be insured against and that are dealt with more adequately by other mechanisms such as Relief Events. Relief Events. Termination for Force Majeure.	If risks are insurable, then they are not Force Majeure risks and are allocated to Private Party. If risks are not insurable, then risk is shared insofar as Institution may pay limited compensation on termination.

ANNEXURE 4: STANDARDISED PPP RISK MATRIX

No.	Categories	Description	Mitigation	Allocation
8.	Inflation risk	The possibility that the actual inflation rate will exceed the projected inflation rate. This risk is more apparent during the operations phase of the Project.	Index-linked adjustment to Unitary Payments or user charges.	Institution bears risk of inflationary increases up to the limit of the agreed index. Increases in excess of this are for the Private Party.
9.	Insolvency risk	The possibility of the insolvency of the Private Party.	SPV structure to ring-fence the Project cash flows. Security over necessary Project Assets. Limitations on debt and funding commitments of the Private Party. Reporting obligations in respect of financial information and any litigation or disputes with creditors. Institution has right to terminate the PPP Agreement. Substitution of Private Party in terms of the Direct Agreement. Substitution of the Private Party with a New Private Party if there is a Liquid Market and the Retendering procedure is followed.	Private Party.
10.	Insurance risk	The possibility (i) that any risks that are insurable as at the Signature Date pursuant to the agreed Project Insurances later become Uninsurable or (ii) of substantial increases in the rates at which insurance premiums are calculated.	In the case of (i), at the option of the Institution, self-insurance by the Institution or, if the uninsurable event occurs, then termination of the PPP Agreement as if for Force Majeure with compensation to the Private Party. Reserves.	In relation to (i), if the Private Party caused the Uninsurability or, even if it did not, but the Private Party cannot show that similar businesses would stop operating without the insurance in question, then the Private Party bears the risk. Otherwise, the risk is shared between the Private Party and the Institution. In relation to (ii), the Private Party (unless caused by Institution variations).
11.	Interest rate risk	These are factors affecting the availability and cost of funds.	Hedging instruments (e.g. swaps). Fixed rate loans.	Private Party.
12.	Latent defect risk	The possibility of loss or damage arising from latent defects in the Facilities included in the Project Assets (compare, the treatment of latent pre-transfer environmental contamination, see environmental risk).	Wherever possible, the design and construction of the Facilities must be performed or procured by the Private Party. If, however, a project involves the take-over by the Private Party of existing Facilities, then the bidders must undertake a thorough due diligence of these Facilities to uncover defects. The procedure for and cost of the remediation of such discovered defects can then be pre-agreed with the Private Party. Reporting obligation on Private Party to promptly disclose discovered defects.	If the Private Party (or any of the Subcontractors) designs and constructs the Facilities, the Private Party. If not, then the Institution, but only if there is no or insufficient insurances available to mitigate this risk and if the Institution's liability is capped (subject to VFM considerations).
13.	Maintenance risk	The possibility that (i) the cost of maintaining assets in the required condition may vary from the projected maintenance costs, or (ii) maintenance is not carried out.	Clear output specifications. Penalty regime and performance monitoring. Adequate O&M contract. Substitution rights. Special insurance and special security in the form of final maintenance bonds.	Private Party.

No.	Categories	Description	Mitigation	Allocation
14.	Market, demand or volume risk	The possibility that the demand for the Services generated by a project may be less than projected (whether for example because the need for the Services ceases or decreases, or because of competitors entering into the relevant market, or because of consumer opposition to the outsourcing of the Services).	In a Unitary Payment type PPP, the Unitary Payment must be paid based on availability (not actual usage by the Institution).	In relation to a Unitary Payment funded project, the Institution. In relation to a user-charge funded project, the Private Party.
15.	Operating risk	Any factors (other than Force Majeure) impacting on the operating requirements of the Project, including projected operating expenditure and skills requirements, for example, labour disputes, employee competence, employee fraud, technology failure, environmental incidents and any failure to obtain, maintain and comply with necessary operating Consent.	Clear output specifications. Penalty regime and performance monitoring. Adequate O&M contract. Substitution rights. Special insurance.	Private Party.
16.	Planning risk	The possibility that the proposed use of the Project Site in terms of the PPP Agreement and, in particular, the construction of the Facilities on the Project Site will fail to comply with any applicable laws relating to planning, land-use or building (for example, any town-planning or land-zoning scheme) or any Consent required pursuant thereto, or that any such Consent will be delayed or cannot be obtained or, if obtained, can only be implemented at a greater cost than originally projected.	The Institution must identify at the feasibility phase any macro-level planning Consents not required for the detailed design and construction proposal for the Project, such as, any land-use and zoning Consents. These Consents must be obtained before the Project is put to tender. The Private Party must identify all planning Consents that are required for the Project having regard to its design and construction proposal. It must make adequate provision in its Works programme for such Consents to be obtained. Relief Event for delays in Private Party obtaining Consents but only if the delay is not attributable to the Private Party.	In relation to any land-use and zoning Consent, the Institution, unless Project Site selection is the Private Party's responsibility. In relation to any building Consent or other design or construction specific planning Consent, the Private Party.
17.	Political risk	The possibility of (i) Unforeseeable Conduct by the Institution or by any other government authority that materially and adversely affects the expected return on Equity, debt service or otherwise results in increased costs to the Private Party, or (ii) expropriation, nationalisation or privatisation (collectively, "expropriating actions") of the assets of the Private Party. This risk overlaps with some financial risks (e.g. tax rate change risk).	Limit risk to Unforeseeable Conduct for which there is no other relief in the PPP Agreement and to expropriating actions. Distinguish between general and discriminatory Unforeseeable Conduct. In relation to discriminatory Unforeseeable Conduct, special compensation. In relation to expropriating actions, termination and compensation.	In relation to discriminatory Unforeseeable Conduct and expropriating actions, the Institution. In relation to general Unforeseeable Conduct, the Private Party.
18.	Regulatory risk	The possibility that Consents required from other government authorities will not be obtained or, if obtained, can only be implemented at a greater cost than originally projected (compare, the treatment of planning and environmental Consents, see planning risk and environmental risk).	During the feasibility phase of the Project, a legal scan is undertaken by the Institution to identify all such Consents. Implementation by the Institution of an inter-governmental liaison process with the responsible government authorities before the procurement phase. Due Diligence by Private Party to identify the Consents required for its operating requirements. If permitted under applicable law and if this is practical, obtain all such Consents before the Signature Date.	If any such Consents (other than those relating to Private Party's operating requirements) can be obtained before the Signature Date and they are capable of transfer to the Private Party, the Institution. In relation to the Private Party's operating requirements, the Private Party.

ANNEXURE 4: STANDARDISED PPP RISK MATRIX

No.	Categories	Description	Mitigation	Allocation
19.	Residual value risk	The risk that the Project Assets at termination or expiry of the PPP Agreement will not be in the prescribed condition for hand back to the Institution.	Obligations on Private Party to maintain and repair. Audit of Project Assets towards the end of Project Term. Security by the Private Party in favour of the Institution, e.g. final maintenance bond or deduction from Unitary Payment. Reinstatement obligations on Private Party.	Private Party.
20.	Resource or input risk	The possibility of a failure or shortage in the supply of the inputs or resources (for example, coal or other fuels) required for the operation of a project including deficiencies in the quality of available supplies.	Supply contracts for supply of total project requirements, such as take and pay contracts. Relief Events but only if failure or shortage not attributable to the Private Party.	Private Party, unless the inputs are supplied by the Institution.
21.	Subcontractor risk	The risk of subcontractor (first-tier and below) defaults or insolvency. This risk may arise at the construction and/or operations phases of the Project.	Subcontractors must have expertise, experience and contractual responsibility for their performance obligations. Replacement Subcontractors to be pre-approved by the Institution. Due diligence by the Institution must include review of first-tier Subcontracts to confirm the pass through of risks down to the first-tier Subcontractors.	Private Party.
22.	Tax rate change risk	The possibility that changes in applicable tax rates (income tax rate, VAT) or new taxes may decrease the anticipated return on equity.	If change arises from discriminatory Unforeseeable Conduct, then special compensation.	In relation to tax increases or new taxes arising from discriminatory Unforeseeable Conduct, the Institution. Otherwise, the risk is the Private Party's.
23.	Technology risk	The possibility that (i) the technology inputs for the outsourced institutional function may fail to deliver the required output specifications, or (ii) technological improvements may render these technology inputs out-of-date ("technology refresh or obsolescence risk").	Obligation on Private Party to refresh technology as required from time to time to meet the output specifications. Penalty Deductions for failure to meet output specifications.	Private Party.
24.	Utilities risk	The possibility that (i) the utilities (e.g. water, electricity or gas) required for the construction and/or operation of a project may not be available, or (ii) the project will be delayed because of delays in relation to the removal or relocation of utilities located at the Project Site.	Emergency back-up facilities, e.g. generators. Emergency supply contracts. Special insurance (project delay or other business interruption insurance). Provision by the Institution of off-site connections. In the case of (i), Relief Event for off-site interruptions in the supply of utilities (unless attributable to the Private Party). In the case of (ii), Relief Event for delays in the removal or relocation of utilities (unless attributable to the Private Party).	Private Party unless the Institution is the responsible Utility. In the case of (i), even if the Institution is not the responsible Utility, the Institution may share in this risk in circumstances where insurance is not available or unaffordable, but only if this will ensure better VFM.

**NATIONAL TREASURY
PPP MANUAL
MODULE 5: PPP PROCUREMENT**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 06 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 06 of 2004 'PPP Procurement' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

16.5 Procurement – Treasury approvals: IIA and IIB

- 16.5.1 *Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.*
- 16.5.2 *The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.*
- 16.5.3 *The procurement procedure –*
- (a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and*
 - (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.*
- 16.5.4 *After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury.*
- 16.5.5 *The treasury approval referred to in regulation 16.5.4 shall be regarded as Treasury Approval: IIB.*

16.6 Contracting PPP agreements – Treasury Approval: III

- 16.6.1 *After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –*
- (a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;*
 - (b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and*
 - (c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer's or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.*
- 16.6.2 *The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.*



NATIONAL
TREASURY
PPP
unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the
Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance,

Phase V

DELIVERY

- liaise effectively, settle disputes
- Report progress in the Annual Report

Phase VI

EXIT

- Scrutiny by the Auditor-General

Module 1
Module 2

MODULE 3

Module 6

Module 1
Module 2

MODULE 4

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 4

MODULE 5

Module 6
Module 7
Module 8
Module 9

Module 1
Module 2
Module 5

MODULE 6

Module 7
Module 8
Module 9

ABOUT THIS MODULE

Module 5: PPP Procurement details the procurement processes of a PPP. Treasury Regulation 16 to the PFMA states that it is the responsibility of the accounting officer/authority to design and manage the procurement process in a way that meets the regulation's requirements. This means that this module is not prescriptive, but rather establishes best practice as it has been developed in National Treasury-regulated PPPs to date. Given the newness of PPPs in South Africa, it is expected that each project will further refine the procurement process and add to the pool of best practice knowledge. The case studies produced at the end of this procurement phase are an important part of tracking best practice. National Treasury will continue to update *National Treasury's PPP Manual*, and to develop sector-specific toolkits to provide further guidance.

Take note

The procurement of PPPs goes through distinct stages:

- pre-qualification
- request for proposals
- best and final offer, where appropriate
- negotiations
- financial closure.

This is different from a conventional tender process. A conventional tender process has a single stage when an offer is made which an institution can accept or not.

Module 5: PPP Procurement explains how to proceed through the stages, with a focus on getting the documentation right. Follow the outlines of suggested contents for the various documents closely to ensure that the institution provides the correct and complete information for getting treasury approvals IIA, IIB, and III (TA:IIA, TA:IIB and TA:III) in terms of Treasury Regulation 16 to the PFMA.

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INTRODUCTION

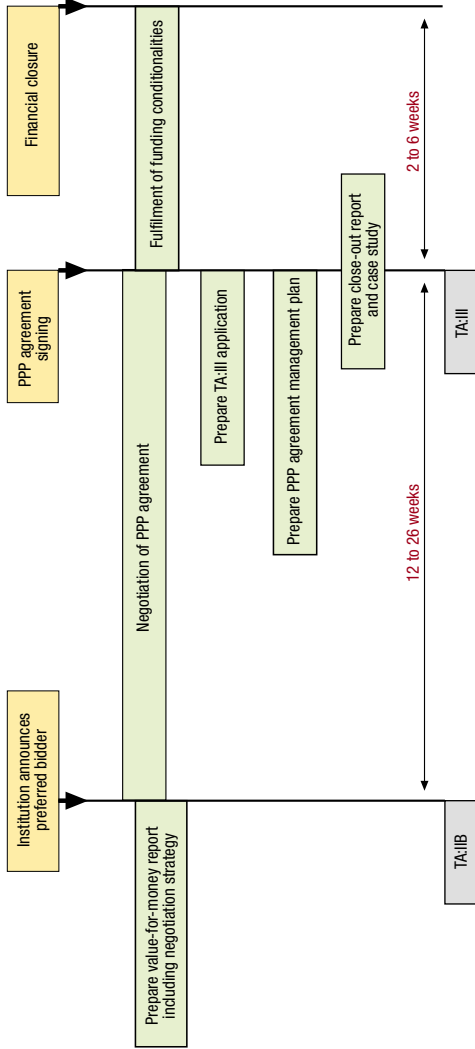
Take note

National Treasury's Standardised PPP Provisions (Standardisation) have a very specific and well-consulted risk profile. The provisions are intended for use on limited recourse type projects¹ with a unitary payment made by the procuring institution to the private party. It is obligatory to use the standardised provisions when preparing procurement documents for projects with these characteristics. The only exception is where institutions satisfy the relevant treasury that alternative provisions provide better value for money. It is important that all the PPP procurement documents (including the request for proposals (RFP) documents and the draft PPP agreement) reflect the same risk profile as established in Standardisation.

In projects that do not have the characteristics of a PPP subject to Standardisation, the provisions should be applied to all procurement documents in so far as they are applicable to the project.

1. See also *Module 9: An Introduction to Project Finance*.

PROCESS AND TIMELINES FOR TA:III



LINKS TO THE FEASIBILITY STUDY

The stronger the link between the project's feasibility study and its procurement, the greater the opportunity to create a true value-for-money PPP.

As *Module 4: PPP Feasibility Study* shows, the feasibility study is much more than a theoretical exercise in satisfying Treasury Regulation 16 to the PFMA.

Key outcomes of the feasibility study which are absolutely necessary for a solid PPP procurement

1. A full and detailed understanding of all facets of the project
2. A clear affordability statement
3. A clear exposition of value for money and the drivers of such value
4. Procurement plan
5. Project team
6. Output specifications
7. Project type and participants
8. Third parties
9. Funding sources
10. Payment mechanisms for the private party
11. Due diligence
12. Risk matrix with costs, and sources of risk with sensitivity analyses

1. A full and detailed understanding of all facets of the project

An understanding of the project is perhaps the most difficult outcome to define, but it is key to a successful PPP procurement. A minimum requirement is that the scope of the project is defined and linked to a long-term strategy or institutional plan for service delivery.

A key point here is that, to a great extent, PPPs lock in institutions for long periods of time to particular service outcomes. Flexibility can be built into PPP agreements through certain amendments and variations which are permissible under Treasury regulations. But these are mechanisms dealing with unforeseeable events, the non-occurrence of events, or changes in public sector delivery culture over time. They are not a way of getting around poor planning in the feasibility study phase.

Before designing the procurement documents, restate the project objectives and scope clearly and concisely, in terms of business outcomes supported by expected project outputs. This statement should then be the introduction in every procurement document, from the RFQ to the final version of the PPP agreement.

2. A clear affordability statement

TA:I will always contain a restatement of the affordability limits set in the feasibility study. This is typically the extent of any capital contribution by the institution to the PPP, the annual limits of the unitary payment, and the costs of managing the PPP agreement.

The affordability limit in a well-constructed feasibility study is always determined by three factors:

- existing budgets for the function
- the specifications defined for the project
- the risk sought to be transferred in the PPP.

Two important warnings arise from this:

- Once the external costs of economic factors are stripped away, breaches of affordability limits during the procurement process mean that there is a mismatch between the specification used for costing in the feasibility study and the specification set out in the procurement documents. In such a case affordability limits or specifications need to be amended. Neither is a satisfactory solution, and both invariably involve delays to the project at a time when the private parties are already involved and have spent money on submitting proposals. In particular, a revised TA:I will be required.
- Even though a project appears to be affordable based on private party proposals during the procurement process, private parties may make qualifications to the project risk profile which have a direct impact on the ultimate affordability of the PPP. This is apparent in projects where the private party is able to claw back substantial gains through the term of what began as an affordable PPP.

The TA:I affordability limit is a key indicator during procurement, and deviations (above or below) must be treated with caution and must be fully justified in an application for a revised TA:I.

Use the affordability limit in preparing the procurement documentation. Use discretion to decide whether this will be an explicit statement of affordability, or whether the institution will only use the risk profile and specifications used in the feasibility study.

3. A clear exposition of value for money and the drivers of such value

In its most basic form, value for money is the reason for an institution to enter into a PPP. Value for money is not a vague term; in the feasibility study it is defined in monetary terms and will be subject to audit. The feasibility study must not only have defined the initial value for money in absolute terms, but must also have identified the sources of such value.

It is therefore important that the procurement documentation:

- Sets out the information to bidders so that the value-for-money drivers identified by the institution are absolutely clear. They need to be identified as priorities, whether they are design efficiencies coupled with reduced operating costs in an accommodation project, or the risk of technology refreshments on an information and communication technology project. Setting out these drivers is not prescriptive, but must encourage bidders to offer their best value-for-money solution in a way that enhances these drivers.
- Establishes a way for the private party to determine and justify the value for money in each proposal.
- Encourages private sector innovation through competition.

4. Procurement plan

The feasibility study will have been accompanied by a procurement plan that sets out timelines, processes and strategies. The project officer must update the procurement plan² before applying for TA:IIA, and must regularly update the procurement plan throughout the procurement phase.

5. Project team

During the feasibility study phase, information gathering and processing were the main required skills of the project team, involving a multitude of specialist functions. Procurement requires communication and analytical skills, and the project team should be pared down to members who have these skills. This should be done as soon as possible after TA:I is given.

6. Output specifications

The institution's required outputs of the project were clearly specified in the feasibility study phase and used as the basis to develop the PSC and PPP reference models. Stressing the link between the feasibility study and procurement, and particularly the link between affordability and specification, the output specifications must form the basis of the project's specifications in the RFP.

7. Project type and participants

The feasibility study will have identified, in the institution's view, the financial structure best suited to the project's characteristics, as well as the likely participants. This would include essential information about whether the project is suitable for project finance or corporate finance, the likelihood of raising debt and equity, and the types of participants, be they sponsors, subcontractors, lenders or third party investors. Most importantly, when preparing the feasibility study, the transaction advisor will have tested the market's appetite for the project and for some of the specific project risks.

The procurement documentation must then focus on procuring that type of project with particular types of participants. The institution should not restrict participation to these participants, but should strike a balance in the RFP between clearly communicating its view of the project and allowing bidders to propose their own structures and participants.

8. Third parties

All third parties to agreements, whether they are land owners, users or other parties, must be identified before procurement, with a procurement plan that includes the signing of third party agreements at the appropriate times.

2. The procurement plan should be one component of the general project management planning required of the project officer. This module focuses on the procurement of a project. Refer to appropriate project management literature and international best practice for overall project planning and management.

9. Funding sources

Procurement documentation is dependent on the intelligent identification, during the feasibility study, of the possible funding sources. The source/s of funding is closely linked to the types of project and its probable participants. To a large extent, the source/s of funding (e.g. lenders, corporates) dictate the terms of the PPP agreement. Some projects are suited to on-balance sheet treatment. Others are conducive to high levels of limited recourse debt in which lenders require high levels of due diligence on the project. In creating a private party that is capable of servicing debt through the PPP, the value added is considerable, namely, by performing in terms of its obligations for the period of the PPP agreement. This means that the interests of the lenders and the institution can be aligned, although much effort is required in designing and managing this kind of procurement process. Limited recourse debt is thus optimally used in certain projects whose size justifies the cost and time involved.³

10. Payment mechanisms

The procurement documents must clearly set out the payment mechanism.

There are three types of revenue for the private party:

- payments from an institution
- user fees
- a combination of the two.

Each has different characteristics. Unitary payments from an institution have greater certainty than user fees because they do not have an inherent demand or collection risk and they allow the institution to manage performance better, by making deductions for non-performance by the private party. User fees are susceptible to demand and collection risk and generally lead to keen consideration by private party bidders and in some cases to an underwriting of demand risk by government. (See 'Annexure 1: The payment mechanism'.)

11. Due diligence by the institution

The project due diligence is crucial to successful procurement. The results cover, among others, existing assets, land ownership, rights and conditions, environmental scoping, heritage issues and staff.

Procurement of a PPP cannot proceed until the due diligence is complete, as any single issue can destroy or at best delay the project. If the due diligence was not completed before the issue of TA:I, it must be completed before any TA:IIA is granted. It is likely that such a delayed due diligence will require a revised TA:I, as project costs will vary as a result of the due diligence.

Nearly all PPPs involve the use of immovable property. Of all the items for which there needs to be certainty before procurement, land is the most important. Who owns the land and any rights over the land must be identified. It is also critical to identify ground conditions on greenfield projects, and conditions of existing assets

3. See *Module 9: An Introduction to Project Finance*.

on brownfield projects. The due diligence on the land must be complete before TA:I. The process of acquisition should be complete before issuance of any TA:IIA.

12. Risk matrix with costs, and sources of risk with sensitivity analyses

The risk matrix from the feasibility study must be continually updated during procurement. Each risk is tracked in terms of where it is dealt with in the procurement documents and how bidders deal with it in their proposals. This risk-tracking is of great importance.

CRITICAL CONSIDERATIONS FOR THE PROCUREMENT PHASE

Critical considerations for the procurement phase

1. Should there be an explicit statement of affordability in the RFP?
2. Variant bids
3. Time allowed for bid preparation
4. Value for money in risk: issues and mitigations
5. Early works
6. Land
7. Staff
8. National Industrial Participation Programme
9. Competition
10. Bidder compensation
11. Shared bid costs
12. Existing institution assets
13. Asset replacement and disposal
14. Expression of interest

1. Should there be an explicit statement of affordability in the RFP?

A statement of affordability sets out the amount of money the institution is willing to pay via the PPP payment mechanism.

The single greatest benefit of disclosure is that it reduces the risk of unaffordable proposals, and bids are focused on achieving maximum value for money. It is also likely that mismatches between output specifications and price will be highlighted very early in the bid process. The interpretation of output specifications can also vary widely from one bidder to the next. In the absence of a common understanding of the affordability constraints, bids will be extremely varied and evaluation will be difficult.

The disadvantages of disclosure are obvious – competition on price is limited, and evaluating variant performance specifications can also be difficult.

Even with these disadvantages, it is the strong recommendation of National Treasury that the affordability limit be published. Consider all aspects of the project before making a decision to the contrary, and review the decision before any BAFO process begins.

2. Variant bids

Significant value for money in PPPs lies in private party innovation during bid preparation. This means that the RFP may be developed to allow for variant bids in addition to a compliant bid. However, evaluating variant bids can be particularly difficult, because they cannot easily be compared to any base, such as the PSC, or even to other bids.

Variant bids must:

- be accompanied by a compliant bid
- meet the specified minimum requirements set out in the RFP

- be supported or underwritten to the same extent as the compliant bid
- show in each element how it differs from the compliant bid, what changes to the risk allocation have been proposed, and what value for money it presents to the institution
- be clearly separable from the compliant bid and from other variant bids, because a shopping list of elements of variant and compliant bids is impossible to evaluate and will result in protracted negotiations.

List the variants that the feasibility study showed as providing possible value for money, but do not limit bidders to these. Examples include a variant concession period, creating additional facilities capable of generating third party revenue, or alternative uses of existing facilities on the project site.

3. Time allowed for bid preparation

There is a direct correlation between the time allowed for preparing bids and the quality of the bids. It is also true that absolute bidder commitment must be secured before a PPP agreement can be finalised. This can be done either in a competitive bid environment or in post-evaluation negotiations with a single bidder. The former is far better value for money. Accordingly, give bidders enough time to meet all the bid requirements. Ascertain what bidders view to be adequate time for preparing a bid during or after pre-qualification.

4. Value for money in risk: issues and mitigations

Since PPPs are intended to maximise value for money, the RFP sets out all the elements that make up value for money for the institution. In many cases this takes the form of a risk matrix. Bidders should be allowed to propose an alternative to any element, provided that, in each case:

- the value for money of the alternative is set out clearly
- the compliant bid reflects the institution's value-for-money requirement, as set out in the RFP.

Amongst others, two important and common value-for-money considerations are:

- the use of alternative inflation indices
- sharing interest rate and foreign exchange risk.

These would be treated differently in project finance and corporate finance bids.

Alternative inflation indices

Bidders commonly propose the use of very specific indices that they feel better represent the inflationary pressures of the particular project. For example, a bidder may propose the use of an index that has a higher component of labour costs than CPIX on a project that has a large labour component.

The advantages of the common use of CPIX in PPPs as the index of adjustment of unitary payments and user charges are:

- the simplicity of a single, common index
- the certainty of budget adjustments
- compliance with inflation targeting

- incentivising the private party to manage above-CPIX increases in costs.
- National Treasury's position is that the advantages are such that no index other than CPIX can be used without a clear demonstration of value for money, supported by a detailed submission by the institution and its advisors.

Shared interest rate and foreign exchange risk

Section 67 of the PFMA explicitly prohibits provinces and provincial public entities from entering into future financial commitments denominated in a foreign currency or concluded on a foreign market. National government may only do so in terms of Section 66, through the Minister of Finance.

Pure financial hedges may not provide value for money for a PPP. In some PPPs there has been a tendency to structure currency hedges through financial institutions. The economic theory behind foreign exchange variations is simple, and is known as the purchasing power parity principle – the exchange rate will depreciate by the difference between the local and foreign interest rates. This is a long-term trend, and financial hedges simply project the depreciation over specific periods of time. The shorter the hedge period, the more accurately the hedge can be costed. With long-term PPP projects, hedges increase in cost because the hedge period increases. Financial hedges simply pass currency risk to a third party (a financial institution). It is the third-ranked solution in the avoid-mitigate-pass-off hierarchy of dealing with project risk. It also locks all contracting parties into long-term currency contracts with high breakage costs.

Examine the value for money of such financial hedges. The feasibility study for every PPP must have examined the potential for avoiding currency mismatches as well as for locally sourcing input components and stimulating local development using the purchasing power of the PPP. In addition, raw material and equipment suppliers should be encouraged to enter into forward contracts or other measures that stimulate risk-sharing between the seller and purchaser of goods and services.

It is also quite feasible that the best value for money will be found in allocating bands of foreign exchange changes to different contracting parties – the institution, suppliers or banks. The use of bands would result in the first x per cent of an increase above the projected exchange rate being for the account of the private party, the next y per cent being shared by the institution and the private party in a pre-agreed ratio, and the remaining z per cent being taken by the institution. The same banding approach would apply to decreases in the exchange rate for sharing the benefits. A similar banding approach is used for interest rates. In both cases the relevant foreign exchange rate and interest rate at the time of signing is crucial, and if it is abnormal relative to the forecast rate then the institution should negotiate a way to adjust the banding appropriately.

5. Early works

Early works are construction works undertaken on the PPP facilities before the PPP agreement has been finally negotiated. They are also referred to as enabling works.

Early works are usually carried out by the preferred bidder's construction sub-

contractor in terms of a separate contract, the early works agreement. The arguments in support of such agreements are usually time-related – fast-tracking the project requires an early start to construction.

National Treasury is not in favour of early works agreements:

- The complexity of negotiating the early works agreement will probably not save the time as intended.
- The institution's bargaining position will lose strength in negotiations if the works have already started with the preferred bidder.
- The early works will invariably have started on substantially different terms from those envisaged in the PPP agreement. The early works agreement may not offer as much protection to the institution as if the works had been carried out under the terms of the PPP agreement.
- The final cost of these works may be more expensive than if they had been procured under the PPP agreement as they are invariably negotiated on a cost plus basis.
- The scope creep – the incremental increase in project scope as needs change – in open-ended early works agreements can result in significant reduction in the value of the PPP. It makes negotiating a PPP agreement difficult, because it is a 'moving target'.
- If the PPP negotiations are terminated it may be very difficult to get a third party in to complete the works, and the works carried out under the early works agreement may therefore lose value, especially as these works are unlikely to suit the designs of a new preferred bidder.

Circumstances that are conducive to early works agreements:

- The work required was stipulated in the feasibility study.
- The risk for this work was allocated at least partially to the institution.
- Value for money is demonstrated.
- The RFP sets out the terms of the early works agreement.

Early works should be limited to:

- relocating existing services on the site
- cleaning up existing contamination of the site
- corrective work or maintenance to remedy latent defects on existing project facilities.

In these cases, it is essential that the early works agreement passes risk on to the future private party by fully integrating the results of the early works into the PPP agreement.

Any early works agreement must be a full contract that is a stand-alone document (namely, containing all essential terms). This will both cater for the risk that the PPP agreement with the preferred bidder will not be signed, and set out the terms on which the early works are incorporated into the PPP agreement. The early works agreement is thus between the institution, the preferred bidder, and the preferred bidder's construction subcontractor.

The scope of the early works must be restricted to avoid scope creep, and the early works agreement must contemplate a no-fault termination arising from failure of the PPP negotiations as well as termination upon signing of the PPP agreement.

6. Land

Land issues are at the forefront of bidders' minds simply because, in almost all cases, the land is selected and owned by government for the period of the PPP agreement. This means that all property annexed to the land, constructed by the private party, belongs to government. Bidders want certainty about their use of the land over the period of the PPP.

Strive for a balance here. The feasibility phase will have involved exhaustive investigations into title to the land, that is the status of any land claims, servitudes, long leases and constraints, as well as investigations into geo-technical conditions, existing contamination, utility service availability and capacity, and the environmental and heritage status of the land. Be proactive about obtaining all necessary filings and approvals to avoid long delays later. The information in all cases should be given to bidders in the RFP, but not warranted unless it clearly provides value for money to do so.

Environmental impact assessment

The National Environmental Management Act, 1998, places an obligation on the institution to 'consider, investigate and assess prior to their implementation and report to the organ of state charged by law with authorising, permitting, or otherwise allowing the implementation of an activity'. As this process cannot meaningfully be delegated to a private party, obtain authorisation or refusal from the relevant organ of state as soon as possible, preferably before the RFP is issued. The decision is made by the relevant organ of state (either the provincial or national department responsible for the environment) and is issued as a public record of decision (RoD). This RoD should be made available in the RFP so that all bidders make proposals that meet all the requirements of the RoD.

The risk transfer must be made clear to ensure that all subsequent fulfilments of the requirements of the RoD must be at the cost and risk of the private party. In effect the institution will have created an equal opportunity for all bidders to deliver the PPP within the environmental constraints for the project. The methods used to mitigate environmental impact will thus vary from party to party, and the responsibility for obtaining approvals for environmental impact assessments in terms of the Environment Conservation Act, 1989, will pass to the private party.

The institution must be confident that the preferred bidder will be able to obtain the required approvals. Private-party financiers will also conduct significant due diligence on this. The institution should not assume any responsibility in the RFP for obtaining such approvals.

Heritage assessment

Make sufficient time available for bidders to carry out their own due diligence on the project site for heritage impacts. This due diligence will be in addition to the heritage impacts established by the institution in the feasibility study. The results of the institution's assessment should be made available but not warranted to bidders in the RFP.

7. Staff

The feasibility study phase requires that all project costs and risks be accounted for. Existing staff costs will play a major role in the procurement of the PPP. The RFP must spell out the requirements for the treatment of existing staff as well as the status of all communications to date, collective agreements, and, most importantly, adequate detail for bidders to cost staff transfers if this is the preferred route for the institution. This includes staff numbers, pension and medical aid status and costs, as well as leave and other entitlements. Bidders should be required to produce personnel plans that are firm, costed commitments, completely in line with the institution's requirements and existing staff agreements.

Communication with staff and organised labour throughout the procurement phase must be well planned and continuous.

8. National Industrial Participation Programme

The principle of industrial participation (IP), in line with the policy developed by the Department of Trade and Industry (DTI), states that where state funds are expended on contracts for goods and services where the imported content is US\$10 million or more, this expenditure must be accompanied by one or more of the following – investment, export opportunities, job creation, increased local sales, small, medium and micro enterprises (SMMEs) and BEE promotion, R&D, and technology transfer – up to a value of not less than 30 per cent of the imported content value.

The National Industrial Participation Programme (NIPP) requirements are compulsory. PPPs are not exempt from them and the RFP must draw bidders' attention to this.

The NIPP form

Form ST18 at the Office of the State Tender Board (and its successor/s after its demise in 2004) sets out the NIPP requirements and should be used in the RFP. Bidders should complete this form and ensure that by the time they submit their proposals they have made appropriate arrangements with the DTI to satisfy the NIPP requirements. The form, signed by the DTI to signify compliance with the NIPP requirements, must accompany bidders' proposals. The institution should not accept any responsibilities or risk arising from any compliance or failure to comply with the NIPP.

9. Competition

PPPs are subject to the Competition Act, 1998. The Competition Commission is the statutory body charged with applying the Competition Act. The purpose of the Act is to encourage and maintain competition in the country in order to promote: economic development, employment, SMME participation, and a greater spread of ownership amongst companies in the country. Section 81 of the Act makes the Act expressly applicable to the state.

The Act identifies four events or activities that would require the intervention and adjudication of the Competition Commission.

Restrictive horizontal practice

Restrictive horizontal practice (Section 4) is defined as an agreement between firms⁴ in a horizontal relationship, which has the effect of substantially preventing or lessening competition in a market. The key elements here are the application of the section to firms which are competitors and which enter into an agreement that has the effect of reducing competition. The onus is on private party bidders to avoid such practices.

Restrictive vertical practice

The definition of restrictive vertical practice (Section 5) is largely the same as a restrictive horizontal practice, but there is a vertical relationship between a firm and its suppliers, and between a firm and its customers. The onus is on private party bidders to avoid such practices. Good procurement practice will ensure that the institution does not infringe this section of the Act.

Abuse of dominance

In Section 8, the Act prohibits charging excessive prices, engaging in any exclusionary acts which are anti-competitive in nature, and price discrimination by dominant firms. The application of this section to PPPs is limited: it is unlikely that any firms in PPPs would fall within the definition of a dominant firm; price determination in PPPs is not the sole responsibility of the private sector; and exclusionary acts are unlikely to occur in a single-concessionaire type environment.

Mergers

The Act applies most to PPPs in the definition of mergers (Chapter 3) and the process to follow for notifying the commission and other parties of a potential merger.

Mergers are not prohibited in terms of the Act. The Act is intended to prevent mergers which will have the effect of substantially preventing or lessening competition, taking into account factors such as the public interest and technological or efficiency gains which might result from such a merger.

In terms of Section 12, a merger is defined as the event that 'occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm'. A number of types of merger is identified in this section and the term 'control' is defined.

There are two tests for whether a transaction must be formally notifiable to the Commission:

4. The definition of firms includes persons, partnerships or trusts, but clearly excludes public sector bodies.

- whether the transaction constitutes a merger in terms of the Act
 - whether the required thresholds of annual turnover and gross assets are met.
- Government Notice 254 of 2001 sets out the thresholds of annual turnover and gross assets. It also outlines the method for calculating these. The higher amount of the annual turnover or gross assets of the target firm must be equal to or exceed R30 million; and the combined annual turnover and gross assets of the target firm, the acquiring firm and other group firms of the acquiring firm must be equal to or exceed R200 million in order for the merger to be notifiable.

Annual turnover must be ascertained with reference to the gross revenue stated in the seller's income statement of the immediately previous financial year. Gross assets must be ascertained with reference to the gross value of assets as recorded in the seller's balance sheet for the end of the immediately previous financial year. The notice also provides that the annual turnover and gross assets figures of all firms controlled by the target business must be added to the figures for the target firm on a consolidated basis. Similarly, the annual turnover and gross assets figures of all firms forming part of the same group as the acquiring firm must be added to the figures for the acquiring firm on a consolidated basis.

Process for competition filing

During the feasibility study phase, the institution must have identified the competition issues likely to arise. If it is necessary in the procurement phase to approach the Competition Commission for any approval, build a competition filing process into the timeframe for the project.

The private party is responsible for compiling the documents for filing and obtaining the necessary approval from the commission, and for the costs. The RFP must indicate this clearly. The RFP must further indicate that, if the Competition Commission does not approve the project, the institution automatically has the right to withdraw the RFP. Also, the institution will not be liable for any damages (whether direct, indirect, special or consequential) or for any losses, costs, expenses or penalties suffered by the private party in preparing its bid documents and documents for competition filing.

Competition Commission approval must be obtained by the private party before the institution's application for TA:III is lodged. The private party should approach the Competition Commission for approval as soon as the PPP agreement has been finalised but before its execution.

10. Bidder compensation

The general principle is that bids are submitted at the bidder's cost and risk. Bidders build in bid costs so that each successful bid has an element of the cost of past unsuccessful bids. By selecting a small number of well-qualified bidders, the institution minimises total bidder costs to the project and to other projects.

This principle does not apply when the size of the project makes bidding unaffordable or too risky for bidders. In this case, bid compensation should be a pre-agreed percentage of the verifiable costs incurred by a bidder in preparing its

bid. This compensation should only be paid to unsuccessful bidders for a compliant bid. The successful bidder has the remuneration of the PPP itself. If the institution terminates the procurement for any reason that is not the fault of the bidders, compensation may also be payable.

11. Shared bid costs

The costs of due diligences by private parties may be significant. Where possible, and where bidders agree, survey costs can be shared between pre-qualified bidders. If the project is so large that high survey costs could reduce the number of bidders, the costs can also be shared by the institution.

12. Existing institution assets

Where existing institution assets are to be incorporated into the PPP, give bidders access to all information on the assets, including their condition and their maintenance records. Existing institution assets are a separate risk category, and bidders may be loath to accept performance and availability risk if they do not have access to detailed information on which to base their due diligence. Allow bidders to demonstrate additional value for money in not using existing institution assets.

13. Asset replacement and disposal

Bidders need to set out clear schedules for asset replacement and disposal. This is not so much for the future management of the PPP agreement, but allows the institution to understand the basis for the private party's use of assets when the institution is evaluating proposals. Be careful not to specify the replacement of assets, as this is not an output and will reduce the private party's ability to maximise the use of assets.

14. Expression of interest

An expression of interest (EoI) is not the same as a Request for Qualification (RFQ). An EoI is a way of establishing the level and type of interest of a particular market sector in a particular project. It is most often used in revenue-generating projects where the broad parameters of the potential PPP are known (for example, in determining the market interest in a potential hospital co-location PPP in a particular location, or determining investor interest in tourism developments in a conservation area).

The advantage of an EoI is that an institution can make an informed decision, based on likely market interest, about whether to proceed with a project. If used, it should be early in the project cycle, either before or as part of the feasibility study.

An EoI must be more than a public advertisement calling for responses. It should consist of an advertisement and an EoI document. The EoI document must include:

- Background and aims of the institution and the project
- A clear identification of the project as a potential PPP to be procured in accordance with National Treasury regulations

- A brief summary of similar South African PPPs and references to more detailed sources of information
- Value for money expected in the provision of an institutional function or use of state property by a proposed PPP
- Expertise sought from the private sector
- Information that respondents must supply
 - Legal status of respondent
 - Respondent’s details and profile
 - Why they are interested in the project
 - BEE profile
 - History of involvement in similar projects
 - Input on nature of proposed PPP
 - Contact details
- Process to be followed in the EoI and subsequent communication with respondents (with timelines)
- Appropriate disclaimer of institution liability and reservation of rights.

An EoI does not need to include the same detail as a RFQ. The emphasis is on providing information to the private party and not on soliciting full bids or proprietary information from private parties. An EoI therefore has a limited use on particular projects. Be careful not to abuse the process by spuriously calling for EoIs without proper preparation or the intention to follow them up as they inevitably create market expectation.

STAGE 1: THE RFQ

Objectives of the RFQ

National Treasury considers it to be best practice for an institution to limit the number of private parties eligible to participate in the PPP procurement by carrying out a pre-qualification exercise.

This part of the procurement process is known as the Request for Qualification or RFQ. It is a very important part of the PPP procurement process and must meet all the requirements of procurement legislation, regulations and best practice.

The RFQ's objectives are to:

- select a limited number of the bidding consortia⁵ that are qualified – technically, financially and in terms of BEE – and have sufficient experience and commitment to prepare proposals and execute the project
- set out the rules of participation in the procurement process clearly and unequivocally
- disseminate information on the project
- give guidance on the expected kinds of participants in the bidding consortia
- gather information from bidding consortia that is verifiable and can be evaluated.

This ensures that the successful bidder will have not only the qualifications to undertake the project, but also the capacity to execute it effectively and timeously.

Only pre-qualified bidders will be allowed to enter the RFP stage.

Critical considerations in the RFQ stage

Critical considerations in the RFQ stage

1. Number of pre-qualified bidders
2. Bid bond
3. BEE
4. Parties eligible to participate in bidding consortia
5. Conflict of interest

1. Number of pre-qualified bidders

The pre-qualified bidders should be kept to a minimum of three and a maximum of four. Given the high cost to the private sector of submitting proposals, this will give pre-qualified bidders a reasonable chance of success.

Where only two or even only one bidder pre-qualifies, the project is placed at a great disadvantage, because competitive bidding is essential for getting value for money. In

5. In South Africa it is not often that the private party or bidder will ever be a single commercial entity. Bidding consortia are formed that combine a variety of entities contributing expertise, resources (including funding), and BEE components.

principle, under South African procurement law – and subject to the institution’s procurement policy – it is not necessary to cancel a bidding process if only one bid is made. However, this may be an indication that the project has not been well structured or conceived and the institution should follow the guidance below.

- Ascertain the likely reasons for the limited interest, and revisit the RFQ documentation and the feasibility study to see what assumptions could be revised to increase market interest. Any changes in the feasibility study must be evaluated for changes in affordability, value for money and risk transfer.
- Secure a revised TA:I if any changes to assumptions in the feasibility study are made.
- Carry out a second pre-qualification exercise if the project assumptions have been changed and if a revised TA:I has been secured.
- If the feasibility study is not revised:
 - carry out the pre-qualification exercise again, with a wider circulation to attract a suitable number of bidders, or
 - continue with the limited number of pre-qualified bidders, but with a revised procurement plan that uses the PSC prepared in the feasibility study as an active ‘competitor’ for the bids.

2. Bid bond

To mitigate the risk of pre-qualified bidders dropping out of the process, a bid bond should be required from the pre-qualified bidders before the RFP is issued. Formal appointment as pre-qualified bidders should be contingent on the provision of such bid bonds being provided to the institution in the approved format. The size of the bonds should be appropriate to the project, typically, the cost to the institution of restarting the procurement process from the RFQ stage.

3. BEE

To pre-qualify in the BEE component of the RFQ, consortia should at least demonstrate that:

- they have written commitments in place for the required targets of BEE participation in the private party and the first-tier subcontracts, providing verifiable company information to substantiate BEE credentials
- they have the ability to secure the targets of black management control required for the private party and the first-tier subcontracts, attaching curriculum vitae of key personnel
- relevant members of the consortia have demonstrable track records in devising and implementing local socio-economic programmes as part of their operations
- the sponsor companies are compliant with the provisions of the Employment Equity Act, 1998, and can demonstrate their own track record in BEE.

Once consortia have been pre-qualified, they will need agreement from the institution to change their consortia membership, and the qualifying BEE targets may not be compromised in any such change. Fronting of black people and black enterprises will not be tolerated by institutions.

4. Parties eligible to participate in bidding consortia

Private parties

All privately-owned firms that are not blacklisted by the Office of the State Tender Board (and its successor/s after its demise in 2004) or by professional bodies, or which have not been found guilty in a court of law of fraud or corruption-related crimes, should be eligible for participation.

Not-for-profit entities

The NonProfit Organisations Act, 1997, defines a 'nonprofit organisation' as a trust, company or other association of persons established for a public purpose, the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered. So-called Section 21 companies are associations not for gain under Section 21 of the Companies Act, 1973. The Act restricts these to associations that apply profits to a specific purpose and it does not allow the distribution of dividends to members.

The majority of these entities rely on donor or government funding to some extent, and are therefore vulnerable to a degree of financial uncertainty. As not-for-profit entities, they are excluded from profiting, making them not ideal as key operators or equity participants in PPPs in most cases. They may, however, play an important role in achieving the socio-economic aims of the project. They also ensure that special interest groups are represented. Their participation is at the invitation and risk of the private party.

Public entities

Treasury Regulation 16's definition of a private party in a PPP agreement explicitly excludes public institutions.

PPPs seek private finance and then place it at risk in that payment is performance-based. In principle, therefore, the use of public entities as financiers, equity participants or subcontractors runs contrary to the principle of risk transfer in a PPP. Agreements formed between public entities or between institutions and public entities are not PPPs, but some other form of procurement.

National Treasury views any proposed participation by public entities in a private-party consortium to a PPP as anti-competitive and as skewing the risk profile of the project for government.

National Treasury does, however, envisage situations where public entity financial institutions have a role to play in financing PPPs. They may have a greater risk acceptance than the private sector, be able to provide longer-term debt, and have a greater appetite for BEE funding. This role should be limited to the provision of debt that does not duplicate what the private sector provides and is provided at competitive rates and in a competitive environment. Importantly, such debt should be made available to all pre-qualified bidders.

It is also possible that a public entity can participate as a subcontractor, provided that its services are:

- secured in advance by the institution via a third party agreement
- available to all bidders
- allowed to be provided by law.

All other forms of public entity participation should be explicitly excluded in the RFQ.

5. Conflict of interest

Consortium members

To avoid any potential conflict of interest, no member of any consortium should be a member of, or in any way participate or be involved in (directly or indirectly), another consortium at any stage of the procurement process. This restriction should be backed up by the power to disqualify a consortium member or the entire consortium if there are good grounds to do so.

The restriction can be lifted for:

- any specialist supplier, if the restriction leads to a severely limited number of consortia
- any non-core service provider or general supplier which is not a consortium member
- any commercial entity whose role is strictly limited to lending money or advancing credit to the bidding consortium.

Advisors and lenders

To prevent the conflict, or potential conflict, of interest between lenders and sponsors of projects, no advisor to any consortium or member of a consortium should fulfil the role of arranger, underwriter or lead bank to the consortium. Again, there should be a suitable right to disqualify such a member.

National Treasury is aware that the advisory market is a limited one and that competition for advisory services may therefore be reduced. However, it views the potential conflict of interest as so severe that reduced competition is justified.

Other

It is obvious that no member of the institution's project team, including its transaction advisor, or the relevant treasury's PPP Unit's project advisor may participate in, advise, or have any interest in any bidding consortium.

The RFQ stage

- Step 1: Prepare the RFQ document
- Step 2: Get TA:IIA
- Step 3: Advertise and distribute the RFQ
- Step 4: Evaluate the responses
- Step 5: Communicate with bidders

Step 1: Prepare the RFQ document

The RFQ document must enable bidders to present the appropriate information about themselves. It must also clearly set out the RFQ evaluation criteria and processes. Any special requirements of the institution must be clearly stated, and particular RFQ provisions must be developed for each PPP.

Contents of the RFQ document

Disclaimer

Terms and conditions of issuance of the RFQ

Purpose of issuing the RFQ

Outline of the contents of the RFQ

Information about the project

- Project description, background and overview
- Institution's view of the PPP
- Land issues, where relevant
- BEE and socio-economic requirements⁶
- Defined performance parameters
- Defined legal requirements and statutory regulations related to the PPP
- Identified financing requirements and issues
- Identified revenue parameters, as available
- Summary of the envisaged risk transfer
- Institution requirements for consortium membership

Procurement process

- Stages and timelines
- Clarification processes and briefing notes
- Changes to the composition of consortia
- Participation in more than one consortia
- Bid bond

Instructions to respondents

- Format of submissions, including compulsory forms of response as an aid to evaluation
- Late submissions
- Status and composition of respondents
- No contact policy
- Further information
- Disclosure of legal processes underway that affect bidding consortia
- Grounds for disqualification
- Institution contact details

6. See *Module 2: Code of Good Practice for BEE in PPPs*.

Information required about bidders

- Consortium capability and strength
- Proposed consortium composition and structure with roles of the members clearly spelt out
- Current workload of consortium members
- Skill and experience of relevant organisations and subcontractors in projects of a similar nature
- Strength of covenant between consortium members, subcontractors and lenders (if applicable)
- Financial and market standing
- Equity, ownership and directorship
- Ability to fulfil the project's BEE and socio-economic objectives
- Historical and current approach to social responsibility
- Capacity to deliver
- Commitment and capacity to meet project timetable
- Ability to raise debt and equity and to provide security
- Project management capability
- Risk management capability
- Demonstration of understanding key project demands/complexities
- General issues raised by bidders
- Previous relationship(s) with government
- Quality assurance systems
- Approach to the PPP and integration of deliverables

The evaluation process

- Methodology
- Evaluation criteria

Step 2: Get TA:IIA

Before issuing the RFQ, the project team must have obtained the following approvals:

- the approval of the accounting officer/authority, who is responsible for implementing the institution's procurement policy under the PFMA
- any other approvals that may apply to the particular institution
- Treasury Approval: IIA (TA:IIA) for the RFQ.

Step 3: Advertise and distribute the RFQ

The method of RFQ distribution must follow the institution's procurement plan. This typically involves advertising the project in relevant publications, in the *Government Gazette*, on the institution's website, and by making press statements about the project, calling on interested parties to collect copies of the RFQ from the institution and/or downloading these from its website. It may include an open briefing session for potential bidders to introduce the project and to stimulate private sector interest. Any such public briefings should be careful not to present any information that is not contained in the RFQ document.

Step 4: Evaluate the responses

Evaluation criteria must be based on the information requested from the bidders and must be included in the RFQ to focus private party responses and eliminate unnecessary information. The criteria will vary from project to project.

In the example below, each subcategory will be allocated a response of ‘good’, ‘adequate’ or ‘poor’. The process of evaluation will include establishing evaluation teams to concentrate on the financial, technical, legal, and BEE capacity of bidders.

Figure 5.2: Example of some RFQ evaluation criteria

Category and subcategories	Good, adequate or poor
Respondent's capability and strength	
Proposed respondent composition and structure	
Skill and experience of relevant organisations and key subcontractors	
Construction	
Operations	
Advisors	
Suppliers	
Strength of covenant between relevant organisations and key subcontractors and respondent	
Financial and market standing	
Ability to raise debt and equity and to provide security	
BEE capacity	
Written commitments for BEE equity participation in private party and first-tier subcontracts, with verifiable company information	
Ability to secure black management in private party and first-tier subcontracts	
Participants' track record in local socio-economic programmes	
Employment equity programmes in place in sponsor companies	
Sponsor companies' track record in BEE	
Deliverability	
Commitment and capacity to meet project timetable	
Project management capability	
Current workload of consortium members	
Quality assurance systems	
Risk management capability	
Project awareness	
Demonstration of understanding key project demands and complexities	

Step 5: Communicate with bidders

Upon choosing the pre-qualified bidders, communicate with both unsuccessful and pre-qualified bidders as soon as possible, and publicly announce the pre-qualified bidders. It is important to communicate an appropriate level of detail on the decision to unqualified bidders, complying with administrative law requirements.

Call the pre-qualified bidders to a bidders' conference where information on the RFP processes and timelines will be communicated.

STAGE 2: THE RFP

Part 1: Bidder participation in preparing the final RFP

On large, complex or innovative PPP projects, considerable value can be yielded if pre-qualified bidders participate in the preparation of the final RFP.

While the feasibility study would have tested the market, some key market responses can now be tested in detail with parties which have demonstrated their knowledge and capacity related to the project. Bidder participation in preparing the RFP can also lead to a shorter bidding process and greater bidder confidence. Decide whether to use this two-part RFP process by weighing the added value against the added cost to both the bidders and the institution.

The institution's procurement plan, as communicated to the pre-qualified bidders, must clearly identify the two stages, and set out the intention of and rules for each. The RFP proper is strictly competitive and bound by very limited and formal communication. Bidder interaction here is less formal, the end product being the incorporation of feedback from all bidders in a single, final RFP, prepared by the institution and issued to all pre-qualified bidders.

Step 1: Prepare the draft RFP and get TA:IIA

The institution must write the draft RFP, based on its feasibility study, following the steps set out in Part 2 below. Bidders do not participate in writing the RFP. The draft RFP must be the institution's version of a final RFP and must include a draft PPP agreement. It can highlight the areas which bidders are being requested to provide input on.

The draft RFP and its attachments, including the draft PPP agreement, must be submitted to the relevant treasury for TA:IIA before being issued to the pre-qualified bidders.

Take note

Be careful not to tailor the RFP to the inputs of any single bidder. Also be aware that no bidder is likely to share proprietary or confidential information at this stage and as such the bidder interaction should focus on areas of interest to all bidders.

Step 2: Get feedback from bidders

Feedback from bidders can be a mix of oral and written, though written is preferred. To extract value from the process and not compromise procedural fairness, bidder interaction must be well structured and must not compromise confidential bidder information. Bidder interaction will normally involve a bidders' conference attended by all pre-qualified bidders as well as one-on-one meetings between each bidder and the institution. All conferences and meetings must be conducted according to pre-determined, written rules, and must be recorded.

Take note

The focus should be on getting useful information. Do not use this feedback to evaluate bidders.

All feedback must be considered against the institution's position, which is based on the feasibility study. Feedback that is common to all bidders should be given more weight than isolated feedback. Feedback from a full consortium of lenders, equity sponsors and subcontractors should also be given more weight. Keep meticulous records of the source of feedback and the institution's reasons for including or excluding particular feedback.

Part 2: The final RFP document

The RFP needs to be an effective two-way communication tool between the institution and bidders.

The RFP must communicate project data and the institution's requirements to bidders, and set out how bidders must communicate their proposals to the institution.

Step 1: Prepare the RFP document

Contents of the RFP document

1. General information to bidders
2. Essential minimum requirements
3. Service specifications
4. Standard specifications
5. Payment mechanism and penalty regime
6. Legal requirements and draft PPP agreement
7. Commitments required from bidders
8. Evaluation criteria
9. Bid formalities

1. General information to bidders

1.1 Explanation of project

The project will have been defined during the feasibility study. The RFP must communicate the background to the project, the institution's desired outcomes for the project, and its envisaged outcomes.

1.2 External framework

Provide an explanation of the institutional environment in which the project is to take place. This includes the regulatory, physical, political and social environment.

1.3 Project framework

Set out the institution's view of what the PPP is and how it may be structured. (Note that the PPP is more than just the project in that it includes relationships between parties.) Without being prescriptive, set out the institution's view of the envisaged kinds of contracting parties. These will differ according to the anticipated type of PPP and its envisaged financing structure. For example, a project finance PPP requires lenders with very different participants from a corporate finance PPP.

1.4 Project assets

Core project assets must remain unencumbered for the term of the project. Where there are certain project assets that may be used by the private party for security, specifically list these as such.

The institution must ensure that the RFP identifies all project assets or categories of project assets that the institution will require at the end of the project term, so that this can be taken into account by the bidders in their assessment of the security package and the calculation of their bid prices.

1.5 Procurement framework and timelines

Outline how the procurement will be carried out in terms of processes and the timing of the processes. Spell out the governing legislation and regulations on the procurement, with a statement about the project's compliance with these requirements to date. The processes must be comprehensively described, including any parallel processes, such as securing approvals and consents.

1.6 Instructions to bidders

Provide a formal list of items which all bidders must comply with. Non-compliance should have implications for the acceptability of the bid. Instruct the bidders on:

- any limitations to or specifications about the make-up of the bid consortium
- consortium status requirements: it must be an incorporated entity when the proposal is submitted
- consortium change requirements: a notice of any change is required and the institution usually reserves the right to re-evaluate the consortium's pre-qualification. (See Stage 3 below.)
- requirements relating to submission of proposals
- formal communication requirements
- site visit arrangements
- who bears the costs of submissions
- confidentiality issues
- bidder responsibilities for bid security in the form of bid bonds and bidder warranties⁷

7. Bidder warranties relate to misrepresentation of any kind. Warranties typically cover consortium members' tax clearance and state of solvency, and guarantee that no consortium members are undergoing corruption or criminal-related investigations or have had any past convictions.

- grounds for disqualification (defining non-compliant behaviour): allow for discretion on the part of the institution
- submission requirements: time, date, manner and place of submission
- requirements for variant bids
- other project-specific requirements.

1.7 Requirements related to third parties

It is very likely that the PPP will involve third parties, for example, a municipality or utility provider. Third party relationships need to be managed in two ways: communication during bidding (especially with multiple bidders), and the resultant third party agreement. Spell out both elements clearly, preferably providing draft third party agreements.

The RFP must clearly stipulate how so-called ‘utilities supply risk’, that is, the possibility that utilities such as water and electricity may not be available, will be allocated between the parties.

1.8 Data room

Each project should have a data room where all the information that bidders need is available. Make available as much information as possible to facilitate the bid process, but do not warrant the information, because all information should be verified by the bidders. This is a crucial element of risk transfer and has implications for the PPP as a whole. RFP provisions about the data room should be carefully drafted to make it clear that there are no warranties on the information unless the institution has made a decision to the contrary based on a careful consideration of value for money, and to set out the rules of access.

1.9 Environmental impact assessment (EIA) data

Provide data, with appropriate indemnities, about all EIA processes carried out, and set out the requirements for the work to be carried out by bidders or the private party to the PPP.

1.10 Bidders’ due diligence

The importance of bidder due diligence before bid submission cannot be overstated. Any unverified assumptions by a bidder at submission stage will delay financial closure and may well jeopardise the whole procurement process. (These assumptions may then become negotiating tools, or levers for raising unitary payments or decreasing service levels.) Since very little, if any, institution information is warranted by the institution, the bidders’ due diligence must be thorough and must include a host of technical, financial and legal due diligence. The RFP process must enable site visits by the bidders. On project finance type PPPs, lenders will duplicate the due diligence. Include the time required for bidder due diligence in the procurement plan.

1.11 Quality management system

In any PPP, all stakeholders have a vital interest in the quality of the service to be provided. Specifically: the institution retains overall responsibility for the service delivered through the PPP; the private party relies on the quality of products and services provided by consortium members, personnel, subcontractors and suppliers to meet the specifications; lenders need assurance that the service will be sufficient to continuously earn the unitary payment (and by so doing service debt); and the users of the service must be provided with a quality that meets their requirements.

In the procurement process, the institution must clearly state the service specifications. In addition, it must require the bidders to propose a quality management system that includes compliance reporting during both the development phase and the operations phase of the PPP. The institution should also reserve the right to audit or check the private party's compliance with its own quality assurance and control systems. Mechanisms for such audits or checks should be established before the signing of the PPP agreement and be included in the PPP agreement management plan.

1.12 Important definitions

The RFP must clearly list all the definitions used throughout the documents. This is to ensure clarity and to set clearly defined benchmarks. The definitions must be the same as those used in the draft PPP agreement.⁸

2. Essential minimum requirements

What is the minimum that can be expected from a bid for it to meet the pre-defined project objectives established in the feasibility study? There will be minimum requirements for at least the following:

- **Financial** (for example, demonstration of affordability, risk assumption, funding by private party, term sheets, and minimum insurance requirements)
- **Legal** (for example, any institution requirements for the types of participant in the consortium, bidder details, term sheets or draft first-tier subcontracts, and a mark up of the PPP agreement to indicate deviations from the proposed PPP agreement and to explain in their bid documents the reason for the deviation.)
- **Technical** (for example, essential components making up the life cycle of the service and additional operational minimum requirements)
- **BEE** (for example, private party equity, private party management and employment, subcontracting, local socio-economic impact)
- **Additional mandatory requirements** (for example, tax clearance certificates for all consortium members).

These minimum requirements will establish what constitutes a compliant bid. Bids which do not meet them should be rejected in the evaluation process. However, the

8. See *Standardised PPP Provisions*.

requirements must not stifle innovation or be so onerous that otherwise solid bids are knocked out unnecessarily early.

3. Service specifications

These specifications are a further refinement of the services determined in the feasibility study. All the outputs required to provide the service must be specified. These service specifications will form the basis of service level agreements (SLAs), which are schedules to the PPP agreement and specify the services to be performed by the private party (or in particular circumstances by the institution).

At the RFP stage there should be draft SLAs for all service elements. Some will be blank because the bidders are required to populate them in accordance with the service specifications, and the remainder will be set out by the institution. The latter category will typically allow bidder variation, unless that particular requirement is set as an essential minimum requirement. Service specifications subject to bidder input are often contained in square brackets.

There are at least four ways to specify the PPP services and facilities.

1. Expressed as outputs

Services and facilities specifications are generally expressed as outputs by changing what must be done and how it is done to the required service outcome. Thus, in a hospital PPP, 'the provision of five patient trolleys and two porters with eight hour shifts in a 24-hour service' changes to 'the movement of patients by the private party as scheduled or requested by the hospital's clinical staff between beds, wheelchairs, trolleys and tables and between wards and departments with 24-hour availability'. This specification is backed by information on the institution's requirements for patient numbers so that the bidders can plan and cost the required service.

2. Specific outputs not directly related to the overall service

It is likely that an institution may require the creation of a facility not related to the direct provision of a service, for example, a clinic to be constructed by the private party on the hospital grounds, which is to be operated by another party, such as a not-for-profit organisation. Any facility not to be used by the private party in the provision of the service would fall into this category. Although not strictly part of the PPP, there may be value for money in including it in the PPP. This kind of facility cannot be specified purely in terms of service outputs; construction outputs need to be defined.

3. Input specifications

Nearly all projects will have some elements of input specifications. It is essential to identify such inputs upfront and classify them separately in the RFP, because, where the institution has specific requirements for a facility that reverts to the institution at the end of the concession period, it may require a particular aspect of that facility to be created in a specific way, for example, a hospital must be situated on a particular site. These elements must be kept to a minimum as they may affect

operational efficiency or impact excessively on the design of the facility. All inputs create constraints on bidders, so carefully consider their appropriateness before including them in an RFP.

4. Conditions-of-asset-specifications

The condition and value of assets at the end of the project term is of great importance to the institution. Where the assets revert to the institution they must be in a specified condition, which dictates replacement and maintenance cycles as well as financial assumptions such as residual value and depreciation. The condition is always expressed as a remaining life or already-utilised life, as determined by industry norms or as agreed between the institution and the private party in the PPP agreement.

4. Standard specifications

The RFP must apply objective standards, which are measurable and consistent with best practice. Make extensive use of specifications applicable to all standard components of the project. These could be construction specifications and standard operational requirements (SABS and ISO are prime examples). Select appropriate standards with care: How applicable are they to the project? How are they used in the industry? Are they appropriate?

5. Payment mechanism and penalty regime

The RFP must not be issued without a payment mechanism, which includes at least the following in a unitary payment arrangement:

- a single, indivisible unitary payment for full availability and performance of the services
- an appropriate indexation (CPIX, unless the feasibility study demonstrates an alternative indexation as providing value for money)
- a mechanism for penalising partial or complete failure of the availability and performance of the service, by means of penalty deductions
- no limit to deductions for non-availability
- a mechanism for dealing with changes to service requirements.

See 'Annexure 1: The payment mechanism'.

6. Legal requirements and draft PPP agreement

These are all the key commercial and performance requirements necessary to sign off that the consortium has the legal status and capacity to fulfil the requirements of the PPP agreement, including:

- shareholding agreements
- corporate governance requirements
- full disclosure of the consortium makeup, including lenders, sponsors, and parent companies.

The RFP must include a draft PPP agreement that allows for highly structured bidder input. It must be developed in accordance with *Standardised PPP Provisions*.

Although Standardisation provides standard terms, project-specific annexures, dealing with a range of specifications, penalties, payments and other project-specific issues, must be developed and included.

In particular, the institution should consider the following issues:

- At the time when the RFP is being prepared and also at the bid evaluation stage, whether any additional warranties should be sought. For instance, additional warranties may be required from the private party in connection with any intellectual property included in the project assets.
- The various kinds of liabilities against which an institution should seek to be identified are treated in Standardisation.⁹ Standardisation considers when the private party should be entitled to cap these liabilities.
- The question of institutional indemnities is treated in Standardisation. Although Standardisation is generally against the provision of institutional indemnities, the institution should carefully consider, having regard to the nature of the project, whether there are any other circumstances peculiar to the proposed project which would justify the institution giving indemnities.
- The institution may reserve the right to control employees of the private party, and if it does so must disclose its control requirements in the RFP.

The institution's requirements to use intellectual property during any institution step-in period, after the termination of the PPP agreement and after the expiry of the PPP agreement, should also be specified in the RFP where appropriate.

7. Commitments required from bidders

The more and better quality information given by the institution in the RFP, and the clearer the institution is about what it expects to receive in bidders' proposals, the higher the quality of proposals should be.

This section is the crux of the RFP and sets out what information is required from bidders. Bidders must be required to provide information on all aspects of their bid, including legal, technical, financial and BEE. The RFP must clearly ask for at least the following information and commitments from bidders.

7.1 All technical aspects, including all relevant service details

As part of this information, bidders should be required to prepare the components of the service level agreements (SLAs) that will be part of the PPP agreement. Where the institution has not specified these as essential minimum requirements, they must respond to the service and standard specifications in the RFP. To simplify the process of preparation, the SLAs should be in prescribed schedules to the draft PPP agreement as well as in the main body of the bidders' proposals. The form and substance of the SLAs will vary from project to project, but the institution and its transaction advisor must take great care in their development from service specifications to their final form in the PPP agreement. Bidder

⁹. See *Standardised PPP Provisions: Part 9*.

amendments and additions to the payment mechanism must also be required in a structured format in the RFP.

7.2 The quality management system

7.3 All BEE elements of the balanced scorecard, with commitments for each element

Specifically, the bidder's funding structure and financing arrangements reflected in the financial models must show:

- sources or type of black equity (e.g. black enterprises' balance sheet funds, loans to black enterprises or black shareholders, equity funds including exit strategy, etc.)
- costs of black equity;
- timing on project cash flows to black shareholders; and
- operating costs for all skills development, employment equity and socio-economic programmes.

Shareholders' agreements and any third party agreements thereto must show:

- terms for black shareholders;
- sponsor support arrangements to black shareholders, if any; and
- commitments in respect of black people in management control.

Subcontracts (first-tier) must show:

- terms for black shareholders;
- black people in management control;
- black women in management control;
- skills development and employment equity commitments for first-tier subcontractors; and
- procurement commitments to black enterprise SMMEs.

The marked-up PPP agreement must show:

- any proposed changes to standardised PPP BEE provisions; and
- draft schedules capturing all BEE commitments.

7.4 Level of funding commitment

Who will provide the private finance? How firm is the commitment to fund debt and equity?

The level of funding commitment is determined by the quality of the institution's RFP. An RFP that meets the requirements of this module, based on a robust feasibility study, should be able to attract fully underwritten bids. Proposals that are non-committal on funding will result in protracted negotiations.

7.5 Sign off on competition, NIPP and any other statutory requirements

7.6 Corporate governance commitment

The private party's commitment to corporate governance should be shown, using the King Code on Corporate Governance 2002 as a benchmark.

7.7 Financial and project structure

The RFP must require bidders to submit financial models that allow the institution to thoroughly interrogate the proposal (be it a compliant or variant bid) in detail. The response from bidders will depend on the nature of their approach to funding the project. Corporate finance will be provided from the balance sheet of a private company, while project finance involves limited recourse debt funding to a special purpose vehicle. Regardless of the differences, the institution needs enough information to be able to analyse the funding structure and to determine whether or not it can be provided and sustained through the project. The project participants, including all forms of funding and the terms and conditions of funding, are crucial. Bidders must demonstrate in their bids how the interest rate risk will be managed by means of hedging arrangements and how their interest rate hedging arrangements, if any, will achieve value for money. Furthermore, they must demonstrate during the RFP stage, how exchange rate and currency risks will be managed and how they impact on affordability.

7.8 Security requirements

The institution should clearly stipulate the type as well as the amount of any security that it will require from the private party, and request that each bidder cost for this security as a separate component of its total bid price, as this will aid in the evaluation process. This should include security against late service commencement and for final maintenance obligations. These terms are explored in *Standardised PPP Provisions*.

7.9 Liquidated damages

If the imposition of liquidated damages will not impact severely on the value for money required for a PPP, the institution should specify the level of liquidated damages (including any cap) in the RFP in order to enable the bidders to properly price for these damages. This will also assist the institution's evaluation team in exposing the 'real' costs of the bid and improve competitiveness in the selection of the bids.

7.10 Contents of the financial models

Critical information is contained in bidders' financial models, and the RFP should specify the format in which this information is to be shown in the bids in order to allow the institution to compare a bidder's model with the institution's feasibility study models and with other bidders' models. The checklist below needs to be carefully refined for each project.

The model must:

- have a base date¹⁰ as specified in the RFP

10. As the value of money changes, the RFP must set a specific point in time which is common to all bids. This is the base date.

- be presented in electronic (computer disk) and hard copy formats and be compatible with a specified software programme
- disclose clearly all macro, micro and general assumptions
- be presented on a monthly basis for the development period, and thereafter on a semi-annual basis. Annual summaries are to be provided for each year through to the period of the PPP agreement
- present all required data in nominal, real and net present value (NPV) terms (using the discount rate required in the RFP).

The model must show:

- the bidding consortium structure or corporate project structure, in detail
- the funding structure of the project, including types and proposed levels of debt and equity
- the likely equity input of each member of the consortium, showing the percentage of total equity of sub-debt to be provided by each member. Equity and shareholders' loan details must include the source of funds, amount of funds that shareholders are prepared to commit, and the timing of their contribution. Alternatively, in a corporate finance structure, a full set of financial statements for the companies providing funding must be provided
- the cost of debt in a project finance structure or a ring-fenced corporate finance structure, clearly detailing the level of fees and margin, and full details on the basis for and factors comprising these fees and what the margins are based on and what went into them.

The model must provide:

- a thorough and detailed explanation of the model and how to operate the model
- the basis and costs of proposed interest rate hedging arrangements
- the basis and costs of proposed currency hedging arrangements
- inflation assumptions. Since inflation risk is shared, it may be appropriate to set inflation rates in the RFP as common to all bidders so as to make comparison easier.
- foreign currency exposure and hedging strategies and Rand exchange rate computations
- capitalisation of interest
- a comprehensive and detailed explanation of all VAT and other tax treatments assumed in the model
- all the key output ratios and return categories
- a detailed source and application of a funds table for the project
- capital expenditure according to the component category breakdown set out in the RFP
- project start-up costs
- a funding plan and funding assumptions schedule identifying all sources, amounts and application of finance, conditions, terms, base costs, margins and fees
- a debt schedule for each credit facility, including a draw-down schedule, interest

- paid, fees and repayment schedules
- total equity (including standby and subordinated facilities)
- balances of all reserve accounts and insurance structures
- total operating cost and maintenance assumptions, including replacement schedules
- forecast balance sheets, profit and loss, and cash-flow statements
- identification of any foreign denominated goods or services
- details of all taxation assumptions and treatment and the ability to enable or disable any or all such assumptions or treatments in the model
- net present value (NPV) of real revenues using discount rate required in RFP
- projected internal rate of return (IRR) before financing and tax in both real and nominal terms
- real and nominal return on equity as compensation to reflect the base case return on equity for the entire duration of the PPP agreement¹¹
- interest cover
- sensitivity analysis of capex
- sensitivity analysis opex
- sensitivity analysis interest rates
- sensitivity analysis: grace periods of principal repayment
- sensitivity analysis: maturity of debt
- sensitivity analysis: inflation
- sensitivity analysis: devaluation of Rand and currency treatment
- risk pricing
- assumptions on penalty deductions
- gains from refinancing.

For project finance PPPs, the model must set out:

- debt to equity ratio
- annual debt service cover ratios (DSCR), including and excluding cash
- loan life cover ratio (LLCR)
- project life cover ratio (PLCR)
- any other ratios required by funders
- in the case of retendering the PPP agreement following private party default, what percentage of the total debt outstanding bidders believe should be repaid in the event that, on retendering, the highest tender price is less than the debt
- in the case that the PPP agreement is not retendered following private party default, what percentage of the debt bidders believe should be repaid in the event that the adjusted estimated project value is less than the debt.

8. Evaluation criteria

Give broad categories of evaluation, but in sufficient detail to focus bidders' attention on the value-for-money areas of the RFP. Detailed scoring methodologies

11. See *Standardised PPP Provisions: Part 64*

and point allocations should not be given, as this leads to proposals being tailored to the evaluation and not to the best value for the project. The number of points allocated to each category or sub-category should not be disclosed in the RFP. The process and evaluation methodology should, however, be set out so that bidders take comfort from an auditable process with checks and balances.

The RFP should specify that the technical, BEE and price elements of the bid will each be scored out of 100 points. The scores achieved will be calculated into the bidder's overall score, using the following formula:

$$a * (\text{technical score}/100) + b * (\text{BEE score}/100) + c * (\text{price score}/100) = d$$

where:

a is the weighting for technical (between 50% and 70%)

b is the weighting for BEE (10%)

c is the weighting for price (between 20% and 40%), and

d is the total score achieved by the bidder.

For the purposes of applying the abovementioned formula, 'technical' refers to all project factors under evaluation other than the price and BEE elements, and is synonymous with the PPPFA regulation's term 'functionality'.

The alternative technical and price weightings (together making 90 per cent) will vary from project to project, determined during feasibility study and preparation of procurement documents. Ten per cent is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA.

Minimum evaluation categories under the technical, BEE and price elements are set out below. Suggestions are given for further sub-categories that need to be refined on a project-by-project basis.

The evaluation will also consider the overall integrated solution offered by each bid.

Technical

8.1 Technical solution

8.1.1 The development phase

- extent, quality, safety, cost effectiveness, functionality and innovation of designs
- level of design and robustness of cost estimates
- impact on social and biophysical environment
- deliverability and time schedules
- integration of design, development and operations with a clear commissioning programme
- quality management systems proposed by the bidders

8.1.2 The delivery phase

- extent to which proposed performance targets and measurement systems exceed minimum specifications
- operating methodology
- quality and type of proposed services to end users
- extent to which asset management and maintenance philosophy support the project objectives and maximise value for money
- quality of proposed management structure, staffing, systems and practices
- quality and extent of proposals on branding, promotion and public relations
- quality of safety plans
- integration of PPP with existing services
- integration of PPP information into existing IS system
- quality management system proposed by the bidders
- compliance with institution's monitoring and reporting requirements

8.2 Legal solution

- bidders' SPV structures
- robustness of the bidders' structures: Are bidders' responses or representations in the proposal reflected in their structures and shareholders' agreements? The evaluation would include the level of commitment to and undertakings of each consortium member to the consortium, and the equity participation of each member.
- mark up of the draft PPP agreement and its risk impact

8.3 Financial solution

- total project cost in relation to the affordability constraints of the PPP
- realism of operating and capital expenditure, including an assessment of whether the quality management systems have been costed in the financial model
- robustness of the financial proposals, including their sensitivity to changes in operating and maintenance costs, currency fluctuations, inflation and interest rates, and changes in the cash-flow profiles
- robustness of the funding structure
- level and nature of equity in the funding structure
- cost of BEE commitments
- level of commitment demonstrated by the debt and equity providers and the terms and conditions linked to the provision of this funding
- level of risk assumed, and deviation from the terms of the tender documentation
- cost, level and nature of insurance cover proposed
- risk allocation: the risk profile proposed by bidders in their proposals will be tested in relation to:
 - the nature and extent of the risk
 - the likelihood of risk
 - passing down of the risk and obligations assumed by the private party in the PPP agreement to the other key contractors.

- consistency between the financing arrangement and the draft PPP agreement, as well as the extent of acceptance by the financiers of the terms of the draft PPP agreement
- what percentage of total debt outstanding the bidder believes should be repaid as compensation on private party default

BEE

Each PPP project's BEE elements, minimum targets per element, bid evaluation points for each element, criteria for awarding points, the weightings to be given to each element, and the overall minimum threshold score of 50 per cent, will all be set out unambiguously in the BEE balanced scorecard for the project in the final RFP. Bidders' responses will be evaluated accordingly.

Figure 5.3: Example of BEE scorecard

BEE element	Project target	Bid evaluation weighting
A: Private party equity		20%
A1: Black Equity	40%	
A2: Active equity	55% of A1	
A3: Cost of Black Equity	Value for money	
A4: Timing of project cash flow to Black Shareholders	Early and ongoing	
B: Private party management and employment		15%
B1: Black Management control	Commensurate with A1 & A2	
B2: Black Women in management control	15% of B1	
B3: Employment equity	Compliant with law	
B4: Skills development	1% of payroll	
C: Subcontracting		50%
C1: Capital expenditure cash flow to Black people/Black Enterprises	30%	
C2: Operating expenditure cash flow to Black People/Black Enterprises	30%	
C3: Black Management control	25%	
C4: Black Women in management control	15% of C3	
C5: Employment equity	Compliant with law	
C6: Skills development	1% of payroll	
C7: Procurement to Black Enterprise SMMEs	30%	
D: Local socio-economic impact	Sustainable, effective plan	15%

Price

The PPPFA requires that price be taken into account as a distinct element in the evaluation of bids. In PPPs, the price is closely linked to qualitative elements of the bid and often has explicit conditionalities. It is thus essential that there is reasonable certainty as to what price is attached to the bid before price points are allocated. Lack of certainty should be addressed through a BAFO (refer to Stage 3

Part 2). The institution's RFP must therefore prescribe the form in which the price should be presented by bidders, for example, a net present value with a set discount rate may be prescribed. In addition, the qualitative financial evaluation categories set out in 8.3 above must be closely scrutinised.

Overall integrated solution

Do all the components of the proposal add up to a single integrated solution capable of delivering value for money to the institution?

9. Bid formalities

Spell out all bid formalities, including:

- the time, place and manner of bid submission (proposals for large projects may take up substantial space and separate secure facilities may be required for submitting bids)
- how proposals will be opened
- bid bonds
- period required for bid validity
- formal requirements for filling out bid forms
- formal processes for communication with bidders
- the institution's reservation of the right to terminate the process, including the right to terminate negotiation with the preferred bidder if it is unlikely that an agreement will be concluded, in which case negotiations with other bidders may begin. In addition the institution should state that it is not bound to enter into a contract with any bidder.
- a discretion to be exercised by the bid evaluation panel in the event of non-compliance in any of the bids
- reservation of the institution's right to conduct a BAFO process.

Step 2: Get TA:IIA

The complete set(s) of RFP and draft PPP agreement documentation – both in their draft form (for bidder participation as set out in Part 1 above) and the final versions completed by the institution thereafter – must be submitted by the institution's accounting officer/authority to the relevant treasury with an application for TA:IIA. None of these documents may be distributed to pre-qualified bidders until the approval has been obtained.

STAGE 3: CHOOSE THE PREFERRED BIDDER

Critical considerations for managing the bid process

Summary

1. Experienced bid managers
2. Anti-corruption
3. Prohibited suppliers
4. Security environment
5. Clarification meetings
6. Bidders' notes
7. Changes to consortia during bidding
8. Bidder due diligence
9. Bid validity period

1. Experienced bid managers

Both the bidders and the institution require experienced and committed bid managers, who should be formally identified and their contact details provided. On larger projects these will be full-time positions. For the institution, the bid manager should be the project officer, whose tasks will have been set out in the procurement plan.

2. Anti-corruption

Due to their size and complexity, PPPs are at considerable risk of being affected by some corrupt activity, or at least by the harmful perception that corrupt activity is going on. The accounting office/authority must sign off on an anti-corruption policy for the project, with clear requirements and processes for dealing with corrupt activities by project team members or bidders. The procurement plan and the bid processes must have the built-in safeguards of disclosure, a code of conduct, structured oversight and internal and external audit.

Disclosure

All members of the project team and bid evaluation panel, including the transaction advisor, must disclose any potential conflict between their personal and family interests and those of the project. This disclosure must be evaluated by the accounting officer/authority or delegated representatives. An appropriate response must be formulated and implemented, such as recusal of the official from any position where the conflict of interest could affect a decision.

See 'Annexure 3: Template declaration of interest'.

Code of conduct

All the institution's project team members, including the institution's advisors, and all members of the institution's technical evaluation committees, evaluation co-

ordinating committee and project evaluation committee must sign a code of conduct that requires compliance with a range of ethical requirements in the best interests of the project. All pre-qualified bidders must also sign a similar code of conduct, developed by the institution for the project.

See 'Annexure 2: Template code of conduct for bid evaluation panel members' and 'Annexure 3: Template declaration of interest'.

Structured oversight

A person other than the one who carried out the task should review all documents, all communication with bidders, and all evaluations. In addition, a project review committee, appointed by the accounting officer/authority, should sign off on all documentation and processes.

Internal and external audit¹²

Provide for an internal and external audit of the bid process against the procurement plan. This is particularly relevant when proposals are being evaluated. The emphasis should be on compliant processes. For example, were the evaluation criteria established before the RFP was issued? Such processes are easily audited for compliance, and should be managed rigorously.

3. Prohibited suppliers

The Office of the State Tender Board (and its successor/s after its demise in 2004) maintains a list of prohibited suppliers of goods and services. These blacklisted companies are not allowed to compete for government business, including PPPs, for prescribed periods of time.

4. Security environment

Include in the procurement plan a security plan to prevent all forms of industrial espionage, including the protection of document confidentiality, secure meeting rooms and the like. The National Intelligence Agency provides services like this to institutions.

5. Clarification meetings

As part of the bid process, it is advisable to hold bidder clarification meetings during their preparation of proposals. These will allow bidders to get clarity on issues in the RFP, and the institution to gauge bidder participation and commitment. These meetings should be scheduled well in advance, should allow for one-on-one meetings with bidders, and there must be a formal process for recording all such meetings and confirming points made during the meetings.

¹². See *Module 7: Auditing PPPs*.

6. Bidders' notes

Formal correspondence between bidders and the institution must always be in writing. Questions from bidders should indicate how confidential the response needs to be. Confidential answers only go to the relevant bidder; others go to all bidders together with the question. Bidders' notes are also used to communicate decisions or confirm points from clarification meetings, and any changes to the RFP.

The institution and bidders must keep a register of bidders' notes to ensure a complete record of information and formal correspondence. Consecutive numbering should be used. A bidder must submit its register with its proposal.

7. Changes to consortia during bidding

In many instances consortia formed in response to an RFQ change during the bidding stage. This is more acceptable to an institution than a complete withdrawal of a consortium, provided that the consortium maintains its strength at least to the same level as before the change. A consortium change is never allowed without written consent from the institution, and the substance of a bid already submitted is never allowed to change.

The process should be set out in the RFP, as described:

1. The consortium advises the institution of the proposed change, in writing, with full details of the reason for the change, the parties involved and the impact on the consortium.
2. The institution applies the same RFQ evaluation criteria to re-assess the consortium, using, where possible, the same evaluation processes. The required standard is that the changed consortium should score at least the same number of points it scored during pre-qualification.
3. If satisfactory, the institution advises the consortium in writing.
4. If not satisfactory, the institution advises the consortium in writing and gives it a certain amount of time to propose an alternative. Failing this, the consortium is disqualified.

8. Bidders' due diligence

Bidder due diligence requires time, and access to the project site and existing facilities, and the products of the institution's own due diligence (given without any warranty). Communication protocols for the due diligence must be defined in the RFP. These must specify how and when communication and access occurs. Where access is restricted, this must clearly be stated.

9. Bid validity period

Bidders will set a bid validity period on their proposals. The institution may suggest such a period in the RFP.

Part 1: Evaluate the bids

Treasury Regulation 16 to the PFMA requires the following:

16.5.1 *Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.*

16.5.2 *The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.*

16.5.3 *The procurement procedure –*

- (a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and*
- (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.*

In line with this, the accounting officer/authority must ensure that:

- the evaluation process will ensure compliance with the procedural fairness provisions of the Promotion of Administrative Justice Act, 2000
- the evaluation criteria and processes are established before bidders submit proposals
- the evaluation teams and committees are appointed in writing, and that all declarations and codes of conduct are signed
- the Code of Good Practice of BEE in PPPs is applied.

There are three levels of evaluation

- Technical evaluation teams (TETs)
- Evaluation co-ordination committee (ECC)
- Project evaluation committee (PEC)

Each level has its own built-in checks and balances.

Evaluate the bids

- Step 1: Technical evaluation teams
- Step 2: Evaluation co-ordination committee
- Step 3: Project evaluation committee
- Step 4: Clarification
- Step 5: Evaluate variant bids
- Step 6: Choose the preferred and reserve bidders

Step 1: Technical evaluation teams

In the technical evaluation, TETs analyse at least five streams of evaluation criteria: **technical** (comprising technical solution, legal solution, financial solution), **BEE**, and **price**. The overall, integrated solution is evaluated by the ECC. There is no

prescribed sequence of the TETs' evaluation, as almost all elements of proposals are inter-dependent. The TETs need to be made up of suitably qualified professionals, at least from within the institution and from the transaction advisor.

Communication between the TETs, and between the TETs, the ECC and the PEC is very important.

Step 1: Technical evaluation teams

1. Preliminary work
 - Separate variant bids for evaluation as separate proposals
 - Check for completeness
 - Check for compliance
2. Detailed analysis
 - Technical solution
 - Legal solution
 - Financial solution
 - BEE
 - Price
3. Reports to the evaluation co-ordination committee

1. Preliminary work

The first function of the TETs is to do the preliminary work to establish what bids to take forward in the evaluation:

Separate variant bids for evaluation as separate proposals.

Check for completeness

Completeness refers to whether the bidder has submitted all required documents (for example, original tax clearance certificates, NIPP certification, consortium formation documents and the like). All these formalities must have been set out clearly in the RFP. Each RFP requirement should be listed, with a reference to its place in the RFP and its description. Record incomplete bids.

Figure 5.4: Example of how to establish and sign off on completeness

Where in RFP	Description	Included		Comments by bidder	Where in proposal	Cross reference
		YES	NO			
Vol.2 Cl.34.2	Submit GANTT chart for construction programme	✓		None	Vol.2 Ann.1	

Check for compliance

Compliance refers to whether the bidder has met the essential minimum requirements set out in the RFP. Use the same format as for bid completeness. Great care must be taken to ensure that the essential minimum requirements are fully met, including the specified minimum thresholds for BEE. Record non-compliant bids.

Figure 5.5: Example of how to establish and sign off on the essential minimum requirements

Where in RFP	Description	Comply		Comments	Where in proposal	Cross reference
		YES	NO			
Vol.2 Cl.21.1.2	Construction 'all risks insurance cover' to set amounts	✓		ABC underwriter	Vol.6 p.34	Mark up 64 of PPP agreement Vol.2

2. Detailed analysis

The bids that are deemed to be complete and compliant are then subjected to detailed analysis by the separate TETs.

Technical solution

- Is the project deliverable?
- Will the required outputs be delivered?
- A solution due diligence must be carried out by this team on whether or not the solution can become a reality.
- Each element of the system service specification must be assessed from the design, development and operational perspectives. More than merely evaluating the bids, the objective here is to:
 - confirm that the system service specification is, given bidder responses, an accurate reflection of the institution's needs
 - capture the particular perspective of the proposal
 - capture the deficiencies or added benefits
 - evaluate the response on a simple scale of inadequate/adequate/good to carry through to scoring
 - compile a list of questions that need answering before the bid is awarded
 - assess a value-for-money impact.
- The proposal must be checked against the requirements of the standard specifications. This check is required to ensure that bidders commit to meeting applicable standards specifications, such as ISO and SABS.

Figure 5.6: Example of how to set out a system service specification evaluation

Eval. aspect	RFP ref.	Impact level	Requirement	Proposal	Bid ref.	Deficiencies or added benefits (Risk transfer)	Rating: 0 = Inadequate 1 = Adequate 2 = Good	Notes	Value-for-money impact
Layout of ICU wards	Vol.1 Ann.5 Cl.4.1	High	Does the design meet R158 for space and functionality?	Offers 5m ² per bed	Vol.3 p.3	R158 standard not met	0	Will place bidder in breach of PPP agreement Cl.34.2: compliance	Estimate R400k additional floor area

- Scoring: National Treasury does not suggest or prescribe a scoring methodology other than that the ratings for all the technical criteria should be applied to pre-determined weightings. This means that each technical evaluation will generate:
 - a weighted score
 - a report on the number of ‘inadequate’ ratings. This means that a weighted score that has some overall respectability does not disguise a number of inadequacies
 - notes requiring resolution.

Legal solution

There are two tasks in the legal evaluation:

- Legal due diligence on the bidding consortium, its structure, legal status, BEE credentials, and the status of individual firms (including any record of insolvency or crime)
- Evaluation of the marked up draft PPP agreement
 - capturing all marked up amendments to the PPP agreement
 - assessing the mark-up against the risk matrix prepared in the feasibility study
 - capturing the value-for-money implications that were determined in the feasibility study, and commenting on them
 - working with the financial evaluation team to assess value for money on issues not identified in the feasibility study.

In neither of these two tasks is the output necessarily a score. In fact, it can be highly misleading to calculate a score for legal compliance or PPP agreement mark-up. National Treasury suggests that the legal evaluation be focused instead on presenting notes requiring resolution and updating the institution’s risk matrix in respect of each bidder, in conjunction with the financial evaluation team.

Financial solution

The financial evaluation of a bid is complex. It requires a complete understanding of the project costs over its whole term, the structure of the bidding consortium and its funding, and, most importantly, the key value-for-money deficiencies or additions in each bid. The financial team thus requires inputs from the technical, legal and BEE teams in assessing or identifying the following:

- affordability
- certainty of project costs (development and operational)
- certainty, nature and costs of funding
- project participants and overall structure
- all items omitted by bidders from the financial model
- project value for money
- project bankability, which is a function of the consortium’s composition, structure, risk distribution, and funding plan.

The financial team must then:

- produce a composite score for financial evaluation
- produce a series of notes showing matters that need resolution.

BEE

National Treasury suggests that the evaluation of the BEE component be given predetermined levels for inadequate, adequate and good ratings for each element of the project's BEE scorecard. Bidder responses are then evaluated against these levels. National Treasury is not prescriptive about how the ratings are converted into a score, but a minimum threshold of 50 per cent for BEE must be set, as prescribed by the *Code of Good Practice for BEE in PPPs*.

Figure 5.7: Example of how to do a BEE and socio-economic evaluation

RFP ref.	Response area	Inadequate	Adequate	Good	Bidder response	Where in bid proposal	Rating	Notes
Vol.3 Cl.9.1	Black Equity in the private party	<20%	20 to 30%	>30%	40%	Vol.9 p.23	1	Check equity sources & cost in financial response

Price

The distinct price evaluation is required in terms of the PPPFA. In PPPs, price is closely linked to qualitative elements. The RFP will have prescribed the form in which price is to be presented, but the price offered by the bidder must be scrutinised with the financial solution evaluation before price points are allocated. Price points will be allocated according to the formula prescribed by the PPPFA.

3. Reports to the evaluation co-ordination committee

Each TET produces its own report and score sheets and passes these through to the ECC.

Step 2: Evaluation co-ordination committee

The work of the TETs will be disjointed without the ECC's very hands-on role.

The role of the ECC is to:

- co-ordinate the TETs during their analysis through regular meetings with team leaders
- approve all correspondence and direct communication with bidders on clarification matters
- receive and pass through to the project evaluation committee the TET reports on completeness and compliance, including a recommendation on which bidders to take to further analysis as compliant bids
- receive the analysis reports from the TETs and interrogate these until the committee is satisfied that each report is fully substantiated
- prepare its recommendations on further processes such as BAFO
- evaluate the overall integrated solution for the project, taking into account all TET reports

- score the overall integrated solution, and provide notes to be resolved before entering into a PPP agreement
- compile the total project evaluation notes and reports into a single recommendation on process and outcome (preferred and reserve bidders) to pass through to the PEC.

National Treasury recommends that final scoring is not done by the ECC.

Step 3: Project evaluation committee

The PEC is the accounting officer/authority, supported by committee members appointed by him or her.

The role of the PEC is to:

- accept bids as complete and compliant
- receive and evaluate the report and recommendations from the ECC
- score the bids
- decide on a BAFO process
- select a preferred and reserve bidder.

Step 4: Clarification

The PPP procurement process allows for clarification during evaluation so that the evaluation reflects a full understanding of each proposal. The constitutional requirement of fairness and transparency means that any form of change to a bid or negotiation with individual bidders during the evaluation process is prohibited. The line is easily crossed if the term 'clarification' is not defined and the process for clarification not clearly set out.

Clarification must involve written questions and responses. The questions must refer to a specific element of the proposal and must not solicit any change to the proposal. The response must be vetted before being accepted as a clarification. If the response sets out a change to the proposal, it must be set aside and its contents ignored. In such a case, or if the response does not resolve the matter on which clarity was sought, then the interpretation of the response that results in the lowest score or the production of an evaluation note for that element of the evaluation should be used.

Step 5: Evaluate variant bids

The evaluation of variant bids that meet the requirements of the RFP takes place after the compliant bids have been evaluated. A variant bid should be evaluated as a stand-alone proposal. In practice this must be done by amending the score given to the compliant bid in the specific areas of variation.

However, to leave the evaluation as a simple add or subtract process will result in a gross oversimplification. Variant bids invariably impact on a range of other elements in the proposal and materially affect the overall risk transfer for the project. For example, a variant bid may offer a lower margin on debt should debt service be untouched by any penalties under the payment mechanism, resulting in a substantially different risk profile for the institution with implications for more

than a mere decrease in the project cost. The financial and performance impacts of variant bids must be identified and evaluated, as well as quantified as far as possible. The aim here is to quantify the change in value for money that flows from any part of the variant bid. Thus while the same form of evaluation should be used, emphasis should be placed on the evaluation notes produced by the TETs and the ECC, and on the value for money generated, and not just on the actual score.

Step 6: Choose the preferred and reserve bidders

The evaluation should generally result in the selection of one preferred bidder and one or more reserve bidders.

The preferred and reserve bidders may not be announced until TA:IIB has been obtained by the institution for the value-for-money report. (See Part 3 below.)

Part 2: BAFO

When is BAFO appropriate?

Following the evaluation of bids, there may not be a clear preferred bidder and procurement may have to go into a best and final offer (BAFO) process.

There are two main reasons to extend the bidding process:

- the bids are identical or too similar to choose a clear preferred bidder
- no single bid meets the institution's defined project objectives.

The reasons for the second scenario may include: bidder misunderstanding of the objectives; evaluation criteria or processes that are not aligned with the institution's priorities and objectives; bids may have contrasting strengths and weaknesses. These circumstances may arise if the bidders do not fully understand or acknowledge the project objectives or evaluation criteria, do not fully elaborate on their offers, or adopt different commercial approaches to the project.

A well-structured RFP with bidder interaction – and not BAFO – is the first way of preventing such problems. Bidders cannot use a BAFO to complete incomplete bids, and institutions should not plan for a BAFO to compensate for weak RFPs. Bidders should not assume that there will be a BAFO stage. If bidders anticipate that there will be further rounds of bidding, they may build allowances into initial bids.

Under no circumstances should the BAFO process be used as a substitute for the other requirements of the bidding stage as set out in this module. If the RFQ and RFP are properly written, there should be no BAFO process. Most projects should not need a BAFO process and the decision to seek BAFOs should not be taken lightly.

The bidding process is expensive for the private sector, and it has a legitimate desire for the preferred bidder stage to be reached as soon as possible. However, the institution must balance these factors with the need to ensure that the best bid is chosen. The BAFO process gives the public sector an opportunity to extract the maximum benefit out of the bids. It puts competitive pressure on the bidders before a choice is made about the preferred bidder.

A BAFO may just be used as a mechanism to confirm price or other key bid parameters. It may also fundamentally change the risk allocation, or the bid prices may change.

Lessons from BAFOs

There are many local and international examples of BAFOs. Several South African and UK projects were used to draw up the following list of lessons.

- Reach a conclusion on key contractual provisions and price during BAFO, while bidders are still under competitive pressure.
- Lenders need to reconfirm their level of commitment during BAFO.
- Bidders must not be rushed during the BAFO stage. A properly managed BAFO will save time during negotiations.
- BAFO must not be used as a replacement for thorough due diligence. The needs of the institution must be fully developed long before BAFO is applied.
- Preferred bids in evaluation provide the best value for money.
- The process must have a deadline to avoid 'negotiating drift'. Bidders may lose interest in the project, and thus no longer provide a credible negotiating alternative.
- The BAFO document must be a comprehensive description of the needs of the institution.
- Communicate clearly to bidders that the BAFO proposal is irrevocable and forms part of the bidder proposal.
- Promote an atmosphere of collaboration and partnership. This applies as much in the BAFO as in the RFP stage. For example, a restrictive due diligence period during the RFP phase may constrain the responsiveness of the proposals.
- Consider the costs of a BAFO to the private sector. If it is significant, the institution may agree to reimburse the costs of the unsuccessful BAFO bidders. This is a value-for-money consideration and National Treasury's position is that such compensation should not be automatically provided.
- Assure the private sector in good faith that the process will end on time. Set a realistic timetable.
- Describe the required outcomes clearly.
- There should be only two BAFO bidders, except in very unusual circumstances.
- Alert bidders as soon as possible to the possibility that the bid could enter into BAFO.
- BAFOs consume considerable resources and time.

The following detailed description outlines the process of carrying out a BAFO, drawing on South African and international best practice.

BAFO

Step 1: Inform the bidders

Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder

Step 3: Get TA:IIA

Step 4: Distribute the RfBAFO and the roadmaps

Step 5: Provide further clarification

Step 6: Bidders respond

Step 7: Evaluation and choosing the preferred bidder

Step 1: Inform the bidders

Inform the short-listed bidders and explain the BAFO process. Remind them that their initial offers remain valid, because, in theory, the BAFO is a refinement of the initial offer.

Debrief the bidders that will not enter the BAFO process.

Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder

Revise the RFP and replace it with the request for best and final offers (RfBAFO). The RfBAFO is largely a clarification of the original RFP. It sets out changes common to the short-listed (commonly only two) bidders. Try to keep the RfBAFO document layout consistent so that it is easy to compare it with the RFP. It may be a good idea to use the original RFP with a different colour font to indicate where the document differs from the RFP.

The reasons for requiring the BAFO will usually be different for each bid. For this reason, the RfBAFO is accompanied by separate 'roadmaps' for each short-listed bidder. This roadmap must set out, in specific terms, the institution's view of what each bidder needs to do to get to where the institution needs it to be in relation to the objectives of the project. The roadmap for a bidder is confidential to that bidder. It gives the bidder a description of the shortcomings of its particular bid and explains the specific areas which require clarification. This focuses the bidder for preparing the BAFO proposal. The roadmap document may be presented in bullet point paragraphs. As long as the points are explicit, a great deal of narration is not necessary.

Suggested contents of the RfBAFO

Introduction to the BAFO process

Begin with an explanation of the BAFO process to initiate the bidders into the process and facilitate its success. Describe the events leading to the BAFO stage as well as the institution's reason for deciding to extend the bidding process.

Description of the RfBAFO structure

Outline the volumes included in the RfBAFO and explain how bidders need to respond to the document.

Introduction to the roadmaps

Inform bidders that a separate roadmap will be distributed to each short-listed bidder that will ask specific and individual questions that each bidder needs to answer. Describe the common contents of the roadmap and how it should be used. The questions will be divided into separate functional areas.

The institution's expectations

Specify what responses the institution expects from bidders, that a full response is

required as the revised bid will be evaluated on this basis, and the deadline for submission. Remind bidders that they may improve their original bid if they are offering better value to the institution.

Interaction and communication protocol

Set the parameters for interaction and communication between bidders and the institution during the preparation of the BAFO bids. This communication is vital for bidders to prepare high quality and targeted responses. Explain that bidders may either schedule meetings with the institution or submit written questions. Point out that these questions and answers may be made available to the other bidders.

Confidentiality disclaimer

Remind bidders that:

- the information provided is confidential and should only be used for the purpose for which it was provided
- any copies of any documents made available by the institution or its advisors should be returned to the institution on demand
- bidders may not communicate with the press about the project without the institution's prior consent.

Information disclaimer

Include a disclaimer excluding liability for incomplete and inaccurate information provided to the bidders. Inform bidders that they are responsible for verifying facts.

Rules for changes to bidding consortia

Indicate that changes in the makeup of a consortium are not permitted. The BAFO stage is intended to be a clarification of the proposals and not an opportunity to make substantive changes to the bidding team.

Acceptance of the BAFO process

Specify that by participating in the BAFO process, bidders accept the rights and discretionary privileges of the institution during the process. Reconfirm the RFP position that the institution may terminate the negotiation process if it is unlikely that an agreement will be concluded. In such a case, negotiations with other bidders may begin. Remind bidders that the institution is not bound to enter into an agreement with any bidder.

Schedule

Set out the deadlines, including:

- when the RfBAFO was distributed
- when discussions about the BAFO stage take place
- when requests for interaction are submitted
- any additional bidder due diligence required to reduce uncertainty and provide

- better value for money
- the deadline for receiving BAFO proposals
- when proposals will be evaluated and the preferred bidder selected
- when negotiations with the preferred bidder will be initiated.

Explain that the institution reserves the right to change the dates, form and substance of the process at its discretion and is not liable to bidders. Indicate any changes to the schedule will be communicated as soon as possible.

Step 3: Get TA:IIA

The institution must get a TA:IIA from the relevant treasury for the BAFO documents – as these are procurement documents – before issuing them to bidders. Follow the same processes as for RFP approval.

Step 4: Distribute the RfBAFO and the roadmaps

Schedule a BAFO conference with the short-listed bidders. During the conference, distribute the RfBAFO as well as each bidder's individual roadmap.

The conference gives the institution the opportunity to describe the BAFO process to the bidders. The institution may answer questions related to the RfBAFO, but questions related to a specific bidder's roadmap should be answered in one-on-one meetings.

Point out that the BAFO proposal will be evaluated as a complete response to the requirements of the RfBAFO and that the institution cannot be expected to cross-reference the bidders' original RFP proposals. The bidders' initial responses to the original RFP remain valid in their own right.

Step 5: Provide further clarification

The bidders may request further clarification after they have reviewed the RfBAFO and roadmap. They may submit questions to the institution in a one-on-one meeting or in writing. Meetings may also be held jointly between the institution and both bidders, for all functional areas such as legal, financial and technical. The institution must reserve the right to refuse to answer any question that would compromise the competitive nature of the process. A bidder may request that a question be asked in confidence, but the institution reserves the right to distribute the questions and answers to the other bidder if they are common to both bidders. Minutes must be kept of all meetings, both joint and one-on-one.

Step 6: Bidders respond

The BAFO bidders respond to the RfBAFO and roadmap with fully revised proposals, which should meet all the requirements in the RfBAFO. The institution will only evaluate these new proposals. Although the BAFO proposal and the initial proposal may be fundamentally the same, specifically in relation to the solutions offered, bidders are allowed to change their original proposal if they believe that doing so will offer the institution a better deal. Bidders must guide the institution to recognise such changes.

The BAFO proposals should be submitted in writing, but the institution may also ask for oral presentations. Oral presentations should follow shortly after the written proposals have been submitted, after the TETs and ECC have had an opportunity to read them. The institution may ask for further clarification of the bids following the presentation.

Step 7: Evaluation and choosing the preferred bidder

After the oral presentations, the evaluation process will begin, following the same route as for the RFP evaluation, and resulting in the selection of a preferred and reserve bidder by the PEC.

Evaluation criteria should stay the same, because changing them could create the impression that one bidder is being favoured. Accurately selected evaluation criteria in the RFP stage are therefore essential for PPP success – a BAFO will not save a project that has inadequate evaluation criteria.

Part 3: The value-for-money report

Treasury Regulation 16 to the PFMA requires the following:

16.5.4 After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury.

This report is known as the value-for-money report.

Step 1: Write the value-for-money report

A well-constructed bid evaluation process will write its own value-for-money report.

Before the preferred bidder is announced and appointed, the value-for-money report has to be written and submitted to the relevant treasury for approval. There can be no negotiation with the preferred bidder before it has been approved.

The value-for-money report is not an approval of the procurement process or its outcome, but rather an approval that the preferred bidder provides the best value for money for the project and that the bid is affordable.

Suggested contents of the value-for-money report

Covering letter applying for TA:IIB

Section 1: Introduction

- Project background

- The bid process to date
- Evaluation criteria
- Evaluation approach
- Evaluation committees
- Summary of compliant and variant bids submitted

Section 2: Evaluations

- Completeness
- Compliance
- Analysis of bids
 - Technical
 - Technical solution
 - Legal solution
 - Financial solution
 - BEE
 - Price
 - Total integrated solution
- Consolidation of analyses

Section 3: Affordability assessment

Set out the cost of each proposal to the institution, including the proposal cost with adjustments where appropriate, and motivations for the full cost of the proposed solution.

Section 4: Value-for-money assessment

This section must tie in very closely with the feasibility study. Value for money is the comparison of proposals with the PSC, and considerable work is required to risk-adjust each proposal to a risk status and equivalent level of service that compares with the PSC. In addition, the risk retained by the institution must be accounted for.

Section 5: Risk transfer assessment

Set out the risk matrixes of the bidders with particular focus on the risk matrix of the preferred bidder.

Section 6: Notes raised and bid deficiencies

Set out the bid deficiencies as captured in the PEC's evaluation notes on the preferred bidder, with an assessment of the kinds of deficiencies and anticipated difficulties in resolving them.

Section 7: BAFO consideration

Report on the BAFO process (if applicable), evaluation and results in the same way as the RFP analysis.

Section 8: Negotiation plan

The negotiation plan must set out the negotiation strategy and all teams, processes and issues.

Section 9: Conclusion

Step 2: Get TA:IIB

The institution's accounting officer/authority must submit the value-for-money report to the relevant treasury with an application for TA:IIB. Only when this approval has been received may the preferred and reserve bidders be announced and negotiations commence with the preferred bidder.

Both the preferred and the reserve bidders should be required to accept the appointment and extend their bid bonds as a commitment to the process. The bonds are released when the PPP agreement has been successfully closed.

The reserve bidder is crucial. The institution may require the preferred bidder to be replaced if the bidder withdraws or if negotiations compromise value for money as approved in TA:IIB.

STAGE 4: NEGOTIATIONS

Negotiations are an integral part of the procurement phase. They are a process, not an event. Successful negotiations culminate in awarding the contract, concluding the procurement phase, and starting implementation.

The institution and the private party have different perspectives on the negotiations stage. The private party wants to reduce risk and increase its margins, while the institution wants to reduce its costs and maximise the value of the services provided through the PPP.

The output of the negotiations must be a PPP agreement with all ancillary agreements containing the service level agreements and payment mechanism.

Basic principles of successful negotiations¹³

- Focus on interests, not positions.
- Separate the people from the problem.
- Do your homework – know what you want.
- Be fair – build trust.
- Be prepared to commit.
- Be an active listener.
- Respect the other side's priorities.
- Be prepared to compromise.
- Leave it aside – resolve immaterial sticking points later.
- Never feel that the preferred bidder has a monopoly position.
- Don't feel pressured to take a decision at any given time.
- Never be emotional and reactive.

Negotiations

- Step 1: Preparatory work
- Step 2: Initial contact
- Step 3: Engagement
- Step 4: Ongoing management
- Step 5: Resolution
- Step 6: Final bargaining
- Step 7: Formal settlement

Step 1: Preparatory work

Outline the objectives of the negotiations

- to bridge gaps, eliminate confusion, and formally clarify terms and conditions
- to structure a durable agreement that protects the interests of both parties

13. The list is not exhaustive, and prospective negotiators should refer to further literature on the subject.

Prepare a schedule for starting and concluding the negotiations within the bid validity period

Establish a negotiation team

- Define skill mix requirements.
- Assign a lead negotiator. This person does not have to be the project officer, but must take guidance from the project officer and must have direct access to the accounting officer/authority via the project officer.

Strategise

- Anticipate the private party's positions and interests.
- Carefully review bid evaluation reports, proposal implementation plans and performance schedules, and financial analyses and projections.
- Design a detailed negotiation plan. Pre-define certain positions (fall back, alternative or BATNA [best alternative to a negotiated agreement], and no-go positions).

Step 2: Initial contact

- Invite the bidder, in writing, to a meeting.
- Specify the issues to be discussed, the institution's suggested approach to resolution, and any additional information required for the meeting.
- Provide the date, time, location, and expected duration.
- Request the names and positions of each person on the bidder negotiation team.

Step 3: Engagement

- Begin the first negotiation meeting by making opening statements and introductions, and by clarifying roles and responsibilities.
- Create a climate of trust and co-operation.

Step 4: Ongoing management

- Continually define issues and set an agenda for each meeting.
- Identify shared, compatible, and conflicting interests.
- Jointly refine agendas to include action items and keep the meetings on track. Each meeting should focus on interests rather than positions or personalities.
- Carefully manage the tracking of evolving documentation:
 - appoint an assigned drafter
 - track, number and date changes on every document being negotiated
 - keep the main draft in read-only format and create password access to documents.

Step 5: Achieving resolution

Generate options for settlement.

Concentrate first on common and easily resolved issues to establish a collaborative process.

Assess the options

Choose an option by using objective criteria and which is based on concepts, standards or principles that the parties believe in and which will not be under the control of either party alone.

Step 6: Final bargaining

Final bargaining requires compromises so that both parties see the settlement as the best possible one under the circumstances. Be prepared to bridge affordability gaps as commercial details become clearer. Some output specifications may need to be reduced to keep the project affordable, provided that quality and value for money are maintained.

The institution must strive to make the funding agreements unconditional. *Standardised PPP Provisions* require that conditions precedent in the PPP agreement be limited as far as possible. This refers to matters that need to be resolved, failing which the agreement, if signed, is not enforceable. There may be some conditions that cannot be met before signing the PPP agreement, but these must be minimised.

Step 7: Formal settlement

- Record details of negotiated points and resolutions.
- Agree on how any potential conditions precedent can be minimised.
- Agree to the required follow-up in contract management (of outstanding issues that do not impact on negotiated settlement) and the timeframe.
- Establish a preliminary schedule for signing the PPP agreement.

Take note

Every negotiation is different. There are different people involved and perhaps different cultures, and risks. A good negotiation process should be customised for that particular negotiation's unique needs.

STAGE 5: TA:III

The institution's application for TA:III should be a continuation of the value-for-money report. It establishes the final negotiated project costs, the value for money, the final terms of the PPP agreement, and the contingent liabilities incurred by the institution. It also provides the institution's plan for managing the PPP agreement, and confirms the legal due diligence on the competency of the parties to enter into the PPP agreement.

Extract from Treasury Regulation 16

16.6 Contracting PPP agreements – Treasury Approval: III

16.6.1 After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –

- (a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;*
- (b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and*
- (c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer's or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.*

16.6.2 The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.

TA:III

Step 1: Prepare the PPP agreement management plan

Step 2: Complete the legal due diligence

Step 3: Compile and submit the TA:III report

Step 1: Prepare the PPP agreement management plan¹⁴

Preparing the PPP agreement management plan should send a clear message to the institution that while choosing the private party represents the end of the complex and challenging procurement phase, it also heralds the beginning of a new phase that requires a different level of institutional capability.

¹⁴ Detailed guidance on the preparation of the PPP agreement management plan is given in *Module 6: Managing the PPP Agreement*.

The plan is one of the pillars of effective PPP agreement management, and the project officer will need to ensure that adequate time and resources are devoted to its preparation.

The preferred bidder should be closely involved in the development of the PPP agreement management plan during the negotiation stage, and this involvement should be used to develop good working relations between the two parties.

The main purpose of the PPP agreement management plan is to:

- demonstrate to the relevant treasury the institution's capacity to effectively enforce the PPP agreement
- provide a strategic management tool to guide the contract management activities that the institution and the private party will undertake during each stage of the project
- clarify the key roles and responsibilities of the institution during each stage of the project, and identify the resources that the institution will require to undertake these responsibilities
- provide information on the contract management approach and contract management arrangements, which can be used to assess the performance of the institution in discharging its obligations and responsibilities as set out in the agreement and government legislation such as the PFMA
- provide a vehicle for addressing issues that cannot be dealt with adequately in the PPP agreement (such as attitudes and behaviour).

Take note

After the initial PPP agreement management plan has been prepared as part of the TA:III process, the approach to contract management should be updated regularly in consultation with the private party, to respond to changing policies, industry requirements, environmental standards, technology and end-user expectations.

Step 2: Complete the legal due diligence

A legal opinion must be signed by the legal advisors of both the private party and of the institution, covering legal compliance, competence and capacity to enter into the PPP agreement. This is essential in ensuring that the parties enter into a valid PPP agreement. Some examples of the contents of the legal opinion are:

- The project is a PPP as defined in the Act.
- The treasury approvals have been validly obtained.
- The procurement process complies with specified legislative requirements.
- All future financial commitments and guarantees have been authorised.
- The institution has the capacity to enter into the agreement.
- The authorised signatory has the capacity to enter into the agreement on behalf of the institution.

Step 3: Compile and submit the TA:III report

The application for TA:III must be signed by the accounting officer/authority and submitted in the form of a report.

Suggested contents of application for TA:III

1. The project

- Background, aims, why procured as a PPP
- Complete history of the procurement process
- PPP description, scope, responsibilities of parties

2. Affordability

- The unitary payment and any pass-through or additional costs
- The basis of indexation. If the index is not CPIX the report must justify the alternative method.
- Confirm budget sources with a written statement of affordability by the accounting officer/authority.

3. Sources and conditions of funding

4. Value for money

- Details of the project infrastructure, operations, BEE
- Value-for-money table (comparison with PSC)

5. Contingent liabilities¹⁵

6. Risk transfer

- A comprehensive risk analysis summary, tracking risks as they developed through the procurement phase since the feasibility study. It is closely linked to the value-for-money calculation, and must therefore show risk values as estimated or fixed at contractual closure.

7. Legal due diligence

- Confirming the capacity of the parties to contract

8. Institution's capacity to manage the PPP agreement

- A confirmation of the institution's established capacity to fulfil its contractual obligations and manage the relationship with the private party

9. Conclusion reached and justification

10. Annexures

- Annexure 1: Final draft PPP agreement
- Annexure 2: PPP agreement management plan

15. A contingent liability is a liability that accrues to the institution through the PPP agreement but only has an actual, financial impact if a future, uncertain event occurs. An example is compensation payable upon early termination of the PPP agreement.

STAGE 6: THE CLOSE-OUT REPORT AND CASE STUDY

The terms of reference for PPP transaction advisors¹⁶ require that, following financial closure, the transaction advisor must produce:

- a close-out report for the confidential and complete records of the institution
- a case study which will become available to the public.

Take note

Transaction advisors would do well to compile these documents continuously through each phase of the PPP project cycle.

The difference between the two documents is in the detail and confidential information which must be included in the close-out report and not in the case study.

The purpose of the PPP close-out report is to provide a comprehensively summarised institutional record, with all project documentation properly annexed, giving the details of the transaction, and including all confidential negotiated, contracted and financing matters. This is a key document for managing the PPP agreement,¹⁷ and for the institution's reference in future deals.

The purpose of the PPP case study is to build a public library of South African PPP experience that will:

- secure for public record an accurate, summarised history of each PPP project from inception to financial closure, systematically documenting all salient facts
- identify best practice and instances of value-adding innovation, for incorporation into *National Treasury's PPP Manual* and future sector-specific toolkits, and for application in future projects
- identify deficiencies in legislation, policy, guidelines, approach, management practice or skill that impeded the attainment of value for money by the public sector, and which warrant appropriate corrective action for future deals
- be a resource for PPP training and business development.

The case studies will be posted on National Treasury's PPP website for public access. The close-out reports will be confidentially lodged in the institution and in National Treasury's PPP Unit, and will be available to the Office of the Auditor-General for auditing purposes.

Template for PPP close-out report and case study

While there is a single template for both documents to ensure consistency, two distinct documents must be produced, and it is recognised that the nature and scale of each project will shape the documents. Writers should tailor the project

16. See *Module 3: PPP Inception*, 'Annexure 2: Template transaction advisor terms of reference'.

17. See *Module 6: Managing the PPP Agreement*.

material and shape the template in such a way that the final product meets the two sets of objectives above. Writing style is to be concise and factual, and the analytical aspects are to be confined to crisp conclusions, lessons and recommendations. The use of tables and summary boxes is encouraged.

Section 1: Project summary

- Project name
- Project description
- Project deliverables
- Project location
- Sector
- Sphere of government
- Institution
- Accounting officer/authority: name and contact details
- Project officer: name and contact details
- Transaction advisor: name and contact details
- Relevant treasury's PPP Unit project advisor
- Signatories to the PPP agreement
- Signature date
- Structure of the PPP (diagram)
- Agreement term
- Private party special purpose vehicle (SPV): name and contact details
- Shareholders in the SPV: names and contact details
- First-tier subcontractors to the SPV: names and contact details
- BEE profile of the private party and first-tier subcontractors
- Lenders and underwriters: names and contact details
- Lead arranger: name and contact details
- Total capital investment in NPV, specifying public and/or private sector sums
- Debt: equity ratio and sums in private finance structure
- NPV of unitary payments by the institution, or revenue receivable by the institution, specifying discount rate applied and the indexing treatment
- Value for money achieved over the public sector comparator (PSC)
- Total cost of transaction advice, from inception to financial closure, relative to value achieved
- Projected annual cost of institution's PPP agreement management post financial closure
- Risk allocation summary table
- Jobs created/retained/lost
- Local socio-economic impacts
- Summary BEE scorecard achieved for the project
- Timetable from inception to financial close, referenced to each phase of the PPP project cycle
- List of all project documents with brief description of each
- Alphabetically listed project definitions.

Section 2: Introduction

- Description of institution's needs analysis that led to the PPP
- Status of public service prior to PPP
- Relevant political, economic, infrastructural, legal, and budgetary context within which the project was initiated

Section 3: Inception

- Project initiation process
- Date of registration of project with the relevant treasury
- Institution's management and decision-making mechanisms
- Characteristics and mandate of the project officer and relationship with the accounting officer/authority
- Other institutional stakeholders and their roles in this phase
- Key elements of the transaction advisor terms of reference
- Transaction advisor appointment procedure
- Transaction advisor appointed (firms and individuals)
- Transaction advisor payment mechanism

Box: Lessons in point form

Section 4: Options analysis

- Solution options considered
- Solution option selected and why
- Institutions' decision-making mechanisms and timing on option choice

Box: Lessons in point form

Section 5: Feasibility study

- Affordability levels determined
- PSC model
- Risk adjusted PSC
- PPP reference model
- Risk allocation and costing
- Indicative value for money
- Institution's decision-making mechanisms and timing on feasibility study
- Role of other institutions
- TA:I: process, conditions

Box: Lessons in point form

Section 6: Bid documentation

- RFQ specifications
- RFP: key features, particularly output specifications and bid evaluation criteria
- BAFO process, if applicable

- PPP agreement: key features that deviate from *Standardised PPP Provisions*
- Summary of key features in respect of risk, payment mechanism, penalties
- TA:IIA: process, conditions

Box: Lessons in point form

Section 7: Procurement

- Description of procurement process design
- Institution's decision-making arrangements
- Roles played by all parties to the procurement process
- Procurement timetable
- Process of bidder engagement that occurred at each stage, noting any changes to planned process and why
- Market response
- Characteristics of qualifying consortia
- Quality of response: strengths and deficiencies
- Contested features of the PPP agreement in bids
- Bid evaluation procedure, scoring system, decision-making mechanism
- Requests for reasons and any other responses from unsuccessful bidders
- Requests for information and any other responses from stakeholders and the general public
- Whether there was a BAFO stage, and if so why
- Changes to the leading bids that resulted from the BAFO stage
- Summary of value-for-money report recommending preferred bidder
- TA:IIB: process, conditions

Box: Lessons in point form

Section 8: Negotiations

- Negotiations arrangements
- Roles played by all parties
- Resolutions to obstacles or disagreements
- Deal breakers and how they were resolved
- TA:III: process, conditions

Box: Lessons in point form

Section 9: PPP agreement management

- Summary of PPP agreement management plan¹⁸
- Personnel dedicated: skills, authority, numbers
- Projected annual cost of PPP agreement management

¹⁸. See *Module 6: Managing the PPP Agreement*.

Box: Lessons in point form

Section 10: Financial closure (for close-out report only¹⁹)

- Issues that hindered closure and how these were resolved
- Key legal opinions and correspondence
- Summary of final PPP agreement and financing agreements in respect of risk, affordability and value for money for the institution, referenced to TA:I and TA:II B
- Description of key features of financial closure
- Schematic representation of final project structure, showing all parties and relationships in all final project documents

Box: Lessons in point form

Section 11: Conclusions and recommendations

Draw together the lessons from each of the preceding sections, concluding with an assessment of project quality. Findings should cover at least:

- value for money achieved
- best practice process highlights for inclusion in the *PPP Manual* and sectoral *PPP toolkits*
- recommendations for improvements needed regarding:
 - legislation, regulations, policy
 - institution's approach
 - sponsors' approach
 - lenders' approach
 - *National Treasury's PPP Manual*
 - public sector management practice
 - skills

Annexures to close-out report

- All project documentation, including base-case financial models, duly referenced throughout main text

Annexures to case study

- Transaction advisor terms of reference
- RFQ
- RFP
- PPP agreement (with confidential clauses and schedules blacked out)
- Electronic presentation of case study (45 minutes duration) for use in training, conferences, and public accountability hearings

19. The close-out report will be a confidential document of the institution, and will also be lodged with National Treasury.

ANNEXURES

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THE PAYMENT MECHANISM

Introduction

- 'Payment mechanism' means the way the unitary payment and other payment amounts are determined or made up, and the way deductions are calculated for inferior performance.
- 'Unitary payment' is the amount payable to the private party for the performance of its obligations in terms of the PPP agreement.
- 'Output' means the usable result arising from the performance of the private party's obligations.

The unitary payment

A unitary payment must be set by the institution for all PPPs where the institution makes a payment to the private party for its performance in accordance with the service level agreement contained in the PPP agreement. This excludes revenue-generating PPPs and user-charge PPPs where there is no such service level agreement.

Types of charges over and above the unitary payment

Rate-card charges

Typically, rate-card charges are for items or services that are certain to be incurred in the PPP, for example, for service-related consumables where the institution has sole control over usage levels and where it is inappropriate to place risk for usage and cost of supply with the private partner. Most sensibly, rate-card charges are made by the private partner within the context of the PPP agreement on a 'demand/pay' basis, rather than as part of the unitary payment. Rate-card items or services must be pre-specified and pre-priced.

Charges for additional activities or items

Be very careful about entering arrangements which include charges for additional activities or items. There may be cases where this will, in fact, better protect the institution's interests, such as for activities that are within the scope of the project but cannot be exactly defined when the arrangement begins, and where placing the risk and cost of supply with the supplier is not economically viable. Such arrangements may also be required where, for example, additional work may arise in the term of the PPP, which can only be performed by the private partner (for technological or confidentiality reasons, for example). In such instances, it is essential for the institution to define the exact rules for determining the pricing and payment for these additional items.

Pass-through costs

Pass-through costs are paid by the supplier on behalf of the institution, but are not included in the unitary payment. The supplier passes through the cost to the institution in accordance with rules defined in the agreement. The definition of these rules is important for avoiding conflict. For example, it must be clear what the cost of money is between the supplier's payment and the complementary payment by the institution to the supplier.

The elements of the payment mechanism

1. A single, indivisible unitary payment for full availability and performance of the services
2. An appropriate indexation
3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions
4. No limit to deductions for non-availability
5. A mechanism for dealing with changes to service requirements
6. Provisions for any sharing of excess profits, if applicable

1. A single, indivisible unitary payment for full availability and performance of the services

Whatever service is provided must be available to the users and must meet performance standards. Broadly speaking this applies to all PPPs.

Availability and performance are both usually defined in the negative. For example, a particular facility is unavailable when it has ambient lighting below a specified level, or a performance failure might be the failure to maintain a facility in a specified state of cleanliness. The premise is that the absence of any availability or performance failure results in the full payment of the unitary payment.

Where a single indivisible unitary payment is not practical (and it is acknowledged that projects vary to the extent that this will occur) – for example, there may be a number of discrete output components – the unitary payment may be divided into a number of components, all of which must be subject to indexation only and not to other kinds of adjustment over the project term.

There should be no adjustment of or variation to the payment mechanism for anything not related to the services provided by the PPP. This includes any adjustments resulting from any component of the financing of the PPP.

Payment mechanisms may also take into account additional types of charges that may be included in the PPP agreement. These are dealt with below.

2. An appropriate indexation

Standardised PPP Provisions state clearly that, except for inflationary increases, there should be no other increases in the unitary payment.

The reasons are:

- The institution is limited to budget indexation and cannot afford sustained increases outside this indexation.
- Other forms of indexation are invariably complex and difficult to monitor.
- Each institution is charged with inflation targeting as an overall government objective.

As with all standardised provisions, value-for-money considerations may allow for deviating from the principle, but these deviations will be limited and will require clear justification.

The budget index used by government is the GDP deflator, but National Treasury prefers CPIX (Consumer Price Index, excluding interest rates on mortgage bonds as published monthly by Statistics South Africa) for use in PPP agreements, although this index differs slightly from the GDP deflator. CPIX is also used in cases where the ability to match the financing mechanisms to this index provides value for money.

3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions

The unitary payment is based on the provision of deliverables in accordance with the service level agreement contained in the PPP agreement. However, the PPP agreement must allow for partial or complete failure by the private party to deliver consistently, and thus provide for deductions for such failures.

The PPP agreement should be based on a self-monitoring system established by the private party – in other words, the private party reports failures and monitors their rectification. The institution monitors and audits the private party's system. A help desk system may be established where users or providers of the services report failures to a central information system.

The payment mechanism should:

- differentiate between categories of availability areas and performance components, and clearly identify critical or key areas and components
- allocate penalty deductions according to categories
- focus the penalties on lack of availability for whatever reason, and make ancillary and lower monetary value deductions for performance-related failures
- provide that continued performance failures escalate into unavailability
- identify rectification times during which no penalty accrues (the rectification time is also a function of the category of availability or performance component)
- penalise repeated failures in either availability or performance on a ratchet system, namely, where the penalties increase with repeated failures
- allocate penalty deductions for monitoring failures
- specify a minimum penalty deduction amount
- set a maximum penalty for unavailability of all the services.

User-fee PPPs

In user-charge PPPs, the general rule is that partial or non-availability or mal- or non-performance is penalised by reduced revenue from users, and there is no need to create any payment deduction regime. Instead, non-monetary penalties are applied, such as an accumulation of penalty points which may ultimately result in termination. National Treasury prefers this approach because of the very high levels of demand risk in this kind of project.

In very limited circumstances, it may be necessary for the institution to make deductions from the user charges paid to the private party as a simulation of a unitary payment-type penalty mechanism.

The following factors need to prevail for an institution to consider this kind of penalty mechanism:

- substantial government contribution to capital works
- significant socio-economic goals for the project (where the termination of the contract for non-compliance is not warranted)
- non-performance does not affect revenue (typically a monopolistic environment or where users are not sensitive to reduced service standards)
- the institution requires services outside the scope of services which generate revenue.

4. No limit to deductions for non-availability

Some argue that there should be a core of the unitary payment that is never attacked by deductions. This core consists of all debt service amounts and operating costs (leaving operating profits and returns on equity). The argument is based on the premise that there is no value for money in punishing parties not responsible for the poor service, and that appropriate deductions can be made without having to reduce the debt service capacity.

The problems with this approach are that the debt service amounts are dependent on the gearing on the project, and operating costs are within the control of the private party. It is therefore essential that there be no core of the unitary payment that cannot be affected by the deductions. Rather, the institution and its advisors need to structure a payment mechanism that makes deductions for the non-availability of defined performance components. However, the maximum deduction should not exceed the amount of the unitary payment payable in the period of deduction.

5. A mechanism for dealing with changes to service requirements

National Treasury acknowledges that there is an inherent contradiction between requiring a fixed, indivisible unitary payment and a mechanism for dealing with changes to service requirements. This contradiction must be managed by thoroughly analysing possible changes during the feasibility study phase, in the preparation of the RFP, and during the process of negotiating with a preferred bidder.

The institution must consider:

- how the project will be affected by change
- how the effect of the change is reviewed and accommodated within the payment mechanism
- what effect this has on risk transfer within the PPP.

The PPP must envisage change from the moment it is conceived. The sources and probability of changes vary from project to project. For example, in information and communication technology PPPs, technology changes are dramatic. These and other PPPs with equipment components must be expected to change over the long term of a PPP agreement.

If insufficient flexibility is allowed in the payment mechanism then a mismatch between service expectations and outcomes will grow over the term of the PPP agreement. The other extreme is too much flexibility in the payment mechanism. The institution may end up being forced to negotiate with a sole supplier, thus making the PPP less affordable over time.

Take note

Any material change to a PPP agreement requires approval from the relevant treasury. Where particular types of changes have been anticipated in the agreement, approval will not be required because the agreement itself will not be changing.

Some potential changes

- **Daily operating requirements** may change, for example, volumes of consumables or catering requirements.
- **Emerging service requirements**, which were not originally envisaged, may become necessary and may only be able to be delivered by the service provider in the context of the agreement.
- **The institution's focus:** For example, strategic direction, objectives, key performance areas or key performance indicators may all change.
- **Economic factors:** The long-term nature of PPPs requires institutions to take a broad view of all economic factors that may influence affordability and value for money.
- **Market change:** This particularly affects projects that have relatively low capital investment, but are highly dependent on ongoing operation and maintenance, including a refreshment of technology based on current market circumstances. In addition, standards of service that were acceptable at the beginning of the PPP may become materially below generally accepted market standards and less acceptable over time.

Institutions must review the impact of all types of change on the payment mechanism, and set down exactly how the payment mechanism may or may not be adjusted.

National Treasury's guiding principles for dealing with change

- All possible change scenarios must be tested at the feasibility study phase and in the design of the payment mechanism.
- A specified and definite unitary payment is preferred. All deviations from such an indexed-only type payment mechanism must be justified, and value for money and clear treatment of the mechanism for dealing with price changes in the PPP agreement clearly demonstrated.
- Factors such as the type of service to be provided through the PPP, the variation in usage rates, and the possibility of changes in law may be taken into account in justifying deviations.
- Flexibility must be allowed in variations to the scope of service, provided that the method of variations, cost determinations and absolute cost limits on such variations are established. In addition, the institution's approval process must be established, and management systems for implementing any changes to payment mechanisms during the agreement period must be in place.

Methodologies for amending unitary payments

Where an institution can demonstrate that there is value for money in not having a unitary payment varied only by an inflation index, the following methodologies for amending unitary payments may be used.

Benchmarking

Benchmarking involves comparing the quantity and type of the private party's work, as well as quality and cost, with the market, and then adjusting the unitary payment either up or down to correlate better with current market quality and costs. In practice, the private party is able to amend the unitary payment throughout the agreement period to the market cost norm.

Difficulties in establishing benchmarks and managing the benchmarking process make this unattractive to most institutions, and benchmarking should only be used for determining the cost of a new service or facility. Where it is used for amending unitary payments, institutions should not only ensure that the benchmarking concept is documented in the agreement, but also include the specific implications for payment mechanisms and their adjustment.

In preparing the RFP, ensure a competitive subcontracting environment. Where possible, consider requiring cost component rates at the time of bids and include variation scenarios in the bid evaluation.

6. Provisions for any sharing of excess profits, if applicable

Value for money requires that the institution pay a fair price for the service that, in turn, affords the supplier the profit that is reasonably aligned with the risks that it bears. Normally, both parties enter into the agreement from a competitive tender basis followed by negotiation. But due to the long-term nature of the typical PPP agreement, competition and negotiation alone do not eliminate the possibility of a supplier making profits in excess of what was envisaged. Develop a view on reason-

able profit levels, and ensure that the payment mechanism provides determinations for what will happen if the supplier makes excess profits.

Two forms of creating excess profits

Generating excess revenue

Excess revenue applies only to user-charge type projects, where there is no unitary payment and hence no payment mechanism. The private party takes significant downside risk, so be sensitive about excessive interference by the institution with higher than expected returns. The RFP can encourage a suitable arrangement, in which profit made in excess of a certain return on equity (RoE) is shared. This is justifiable because: the threshold RoE can be based on the bidder's financial proposal (including a detailed financial model); excessive profits made on government services are prejudicial to the sustainability of the project; and the institution is incentivised to maximise project revenues.

Reduced operating costs

Reducing operating costs on unitary payment type PPPs is more problematic. Ensure that the specified levels of performance and availability are met, which means applying the payment mechanism rigorously. A well-structured, unitary payment type PPP, with a tested payment mechanism, should not need a provision for excess profits.

Checklist for developing the payment mechanism

Institutions need to research payment mechanisms, especially where they do not have much experience in developing them.

1. Does the payment mechanism support the objectives of the agreement?

- Does the payment mechanism have a clear relationship with the specified outputs of the project? In other words, the institution and the supplier should be clear about what is being paid for and why.
- Does the payment mechanism cover the full range of payments and deductions to be made under the PPP agreement? Are there rate-card charges, charges for additional activities and items, pass-through costs, and other extras?
- Does the payment mechanism take into account longer-term questions on affordability and value for money? Can additional costs arise later that may seriously impact on affordability for the institution or the ability of the private party to generate a reasonable return in the longer term?
- Has the payment mechanism been tested by reviewing the impacts on affordability and value for money of all the changed circumstances allowable under the agreement? (These may include, for example, increased or reduced requirements for deliverables, and reasonable changes in the institution's circumstances.)

2. Is the payment mechanism workable and will it stand the test of time?

Transparency

Is the payment mechanism transparent in that it is understood and supported by all stakeholders, including other spheres of government, financiers, the institution's users, the private party and the public?

Complexity/simplicity

- Is the payment mechanism too complex in that key performance areas are not separated from less important facets of the service?
- Is the payment mechanism based on output specifications rather than processes wherever possible?
- Has it been scenario-tested during development?

Relevance

- Is it relevant to the market and aligned to current practice in that market?

Administration

- Has any subjective opinion crept into determining a particular payment mechanism? Payment mechanisms should only be based on objective verifiable fact, whether for the completion of a deliverable, or a deduction for inadequate service.
- Does the payment mechanism require disproportionate amounts of administrative effort? Payment mechanisms should avoid excessive administrative procedures and should not require gathering too much information. Requiring too much information from diverse sources will increase administration and audit/control requirements, and increase the chances for mistakes.
- Are the payment mechanisms simple and clear? Can both the institution and the supplier's administrative staff easily understand the mechanisms? Where complexity is required, aids must be developed to ensure that administrative staff can make correct calculations with little effort.

Originality

- Do the payment mechanisms have a proven track record, rather than creating such mechanisms anew? Where a suitable model in the specific local market does not exist, look for parallel markets: for example, the equivalent international market, or a local market that, although different, has common characteristics with the target market. Be cautious about mapping models directly onto the project. The institution's transaction advisor must establish whether the proposed mechanism will, in fact, be workable in the project's target market. Market testing in the feasibility study is essential, and can be followed by bidder interaction before the final RFP is issued.

Behaviour motivator

- Does the payment mechanism encourage the institution's own stakeholders, like staff and clients, to make positive and proper use of the PPP's outputs? Equally important, the mechanism should discourage stakeholders from any bypassing of the specifications.¹
- Does the payment mechanism influence the private party's behaviour? It is useful to consider this question broadly by incorporating, for example, private party employees, subcontractors and financiers.

Manipulation

- Can the payment mechanism be manipulated by any party to the PPP agreement to achieve a particular outcome?
- Has it been tested for possible manipulation?

Take note

The RFP must not be issued without a specified payment mechanism.

1. The classic South African example of this is a hospital where patients are wheeled from the ward to a room next to the operating theatre by the private party and to the theatre by the institution's staff, because the payment mechanism left out the item of transporting patients from ward to theatre.

CODE OF CONDUCT FOR BID EVALUATION PANEL MEMBERS

This code of conduct is to be signed by members of bid evaluation panels appointed by institutions to evaluate:

- transaction advisor bids
- PPP bids.¹

1. Background

In terms of the Constitution of the Republic of South Africa, 1996, section 217:

When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

This code of conduct is issued by National Treasury to instil standards of integrity, ethical conduct, and professionalism in the South African government's adjudication and evaluation of all procurement undertaken by institutions governed by Treasury Regulation 16 to the Public Finance Management Act, 1999 (PFMA), in relation to public private partnerships (PPPs). It is to be applied by institutions in the evaluation of:

- transaction advisor bids
- PPP bids.

Every member of a bid evaluation panel appointed by an institution to act on behalf of the state in the adjudication and evaluation of these bids is required to sign this code of conduct before receiving bids.

In addition, each member has to sign the attached declaration of interest statement once the institution has announced and recorded the identities of the bidding parties.

The aims of the code

This code of conduct does not address every possible situation that may arise. It also cannot serve as a substitute for the responsibility of the accounting officer/authority and the bid evaluation panel members to:

- exercise sound judgment
- act with exceptional standards of moral integrity
- abide by all applicable laws.

1. For the evaluation of PPP bids, this code of conduct must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECO), and the project evaluation committee (PEC).

This code of conduct is intended to:

- confirm the member's commitment to all its prescripts
- guide members who are faced with ethical dilemmas in an increasingly complex operational environment
- provide a reference for disciplinary and/or prosecuting procedures if a member is found guilty of fraud or corruption
- serve as a public commitment by the institution to the highest standards of ethical and professional conduct in the evaluation of bids.

Breaching the code

A member will be found guilty of breaching the code of conduct if he or she

- contravenes or fails to comply with any provision in it
- when declaring interests, wilfully gives incorrect or misleading details.

In these cases, a member will be liable for disciplinary action in terms of public service regulations to the Public Services Act, 1994, and may also be liable for criminal prosecution.

The accounting officer/authority, acting on his or her own or on a complaint by any person, may investigate any alleged breach of this code by a member of an evaluation panel and may withdraw the member from the panel during the investigation.

2. Definitions

“**Family member**” means a parent, sibling, child or spouse of a member;

“**Member**” means a person appointed by the accounting officer/authority to a bid evaluation panel, either as the chairperson, or as an ordinary member or secretariat, for purposes of conducting the evaluation of either transaction advisor bids or PPP bids as a representative of the institution;

“**Privileged or confidential information**” means any information:

- determined by the institution to be privileged or confidential
- discussed in closed session by the bid evaluation panel
- which, if disclosed, would violate a person's right to privacy
- declared to be privileged, confidential or secret in terms of any law, including, but not limited to, information contemplated in sections 34(1); 35(1); 36(1); 37(1)(a); 38(a); 39(1)(a); 40 or 43(1) of the Promotion of Access to Information Act, 2000.

3. Code of conduct

I, [insert name of member of bid evaluation panel], acting in my capacity as member of the [insert name of institution] evaluation panel for the adjudication and evaluation of bids for transaction advisors/private parties (delete which is not applicable) under [insert tender number] hereby undertake:

1. to act at all times with fidelity, honesty, integrity and in the best interests of the state and the general public it serves
2. to perform diligently the duties of a member efficiently, effectively and strictly in accordance with the rules of bidding and bid evaluation, as set out in the bid documentation and according to all relevant instructions given by the institution
3. to prepare properly for and attend each meeting of the bid evaluation panel, and failing this to withdraw as a member
4. to act at all times in accordance with the relevant legislation and regulations, including the public service regulations, the PFMA, National Treasury regulations, and directives given by the institution
5. specifically, to comply with the *Code of Conduct for the Public Service*, in Chapter 2 of the public service regulations
6. to recognise the public's right to access to information in the interests of administrative justice
7. to take the utmost care in ensuring that there is reasonable protection of the records of the institution and all bid documentation
8. not to misuse the position or privileges of a member, or privileged or confidential information obtained as a member
9. to carry out duties with the skill and care expected from a person of knowledge and experience, and to exercise due judgement
10. not to discriminate unfairly against any bidder on the grounds of race, gender, ethnic or social origin, colour, sexual orientation, age, disability, religion, political persuasion, conscience, belief, culture or language
11. not to abuse any position in the public service to promote or prejudice the interest of any political party or interest group
12. to give the Auditor-General all the information and explanations it requires to carry out its functions
13. to report to the appropriate authorities any case of fraud, corruption, nepotism, maladministration and any other acts which constitute an offence or which are prejudicial to the public interest, arising during the bid evaluation panel proceedings
14. to declare, diligently, accurately and honestly in the declaration of interest statement, all personal and/or business interests that I or a family member may have in any business of any bidder, and to abide willingly by any decision of the chairperson of the bid evaluation panel or the accounting officer/authority to withdraw as a member of the panel because of this

15. to be open and honest about all decisions and actions taken regarding the bid evaluation, and to give clear reasons for these, which can be accurately recorded
16. not to make any dishonest allegations about any bidder
17. not to make any false or misleading entries into the records of the bid evaluation panel
18. to make no contractual commitments related to the bid, to any bidding party, on behalf of the institution
19. to protect proactively privileged or confidential information of the bid evaluation panel from theft, unauthorised disclosure or inappropriate use, and specifically:
 - 19.1 not to respond to any queries relating to the bid evaluation on behalf of the institution, unless expressly authorised in writing by the accounting officer/authority to do so
 - 19.2 not to speak to or correspond carelessly with any person (fellow member, colleague, friend, family member or otherwise) on any matter related to the bid evaluation
20. not to request, solicit or accept any reward, gift or favour in return for voting or not voting in a particular way on any matter, or for disclosing privileged or confidential information
21. not to accept or agree to accept later, any 'kickbacks' in the form of money, favours, inappropriate gifts or anything else of value from a member of the public, government, a political or social movement, or any stakeholder or potential stakeholder which is or may be viewed as aimed at influencing or directing my evaluation of the bids
22. to disclose immediately to the chairperson or the accounting officer/authority any attempted inducement or offers of perks that may be construed as aimed at influencing or directing the evaluation of the bids
23. to report to the chairperson of the panel any invitations to any kind of entertainment by any party that may be construed as being associated in any way with the outcome of the bid evaluation
24. not to vote, attend or participate in any other way in any meeting or hearing in relation to any matter before the bid evaluation panel, if any interest prevents me from carrying out my member functions in a fair, unbiased and proper way in accordance with this code of conduct.

Signed: _____
[signature of member]

Date: _____
[insert date]

Witnessed: _____
[signature of witness]

TEMPLATE DECLARATION OF INTEREST STATEMENT

The table below shows the full list of all the bidders, including the names of all the consortium members of each bid, who have responded to the [insert name of institution] call for a transaction advisor/PPP (delete as appropriate) bids for [insert name and tender number of project].

As a member of the bid evaluation panel,¹ you are required to declare any interest, as far as you are aware that you have, in any of the bidders and their consortium member companies.

An interest includes, but is not limited to:

- your shareholding in a bidding company or any of its consortium member companies. Clearly indicate the extent of your shareholding and links to this bid.
- family members, friends or associates employed by a bidding company or any of its consortium members. Clearly indicate the extent of this relationship and links to this bid.
- family members, friends or associates' shareholding in a bidding company or any of its consortium members. Clearly indicate the extent of their shareholding and links to this bid.
- family members, friends or associates contracted to provide services to a bidding company or any of its consortium members. Clearly indicate these individuals' links to this bid.
- you, or any of your family members, friends or associates receiving, or in agreement to receive, any gifts, favours, payments, sponsorships, subsidies, or any other benefits from any bidders or any members of any of the consortia, within the last 12 months of the date of this declaration.
- any other personal interest that may reasonably be deemed relevant to protecting the integrity of the bid evaluation.

All bidders' names and names of all consortium member companies	Interest (Yes / No)	Extent of interest

1. For the evaluation of PPP bids, this declaration of interest must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECC) and the project evaluation committee (PEC).

I, [insert name of member], a member of the bid evaluation panel for the [insert name of institution and name and number of project] declare that the above information is true and correct to the best of my knowledge. I declare further that in the event of any such interests arising during the course of bid evaluation, these shall be promptly and accurately declared in writing to the accounting officer/ authority.

Signed: _____
[signature of member]

Date: _____
[insert date]

Witnessed: _____
[signature of witness]

NATIONAL TREASURY PPP MANUAL

MODULE 6: MANAGING THE PPP AGREEMENT

NATIONAL TREASURY PPP PRACTICE NOTE NUMBER 07 OF 2004

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note 07 of 2004 'Managing the PPP Agreement' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

There are numerous sections of Treasury Regulation 16 to the PFMA dealing with the management of PPP agreements.

16.3 Project inception

16.3.1 *As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing –*

....

- (c) *appoint a project officer from within or outside the institution; and*

The definition of a project officer in Treasury Regulation 16 is: a person identified by the accounting officer or accounting authority of an institution, who is capable of managing and is appropriately qualified to manage a PPP to which that institution is party from its inception to its expiry or termination;

16.6 Contracting PPP agreements – Treasury Approval: III

16.6.1 *After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –*

....

- (b) *for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP;*

16.7 Management of PPP agreements

16.7.1 *The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved in Treasury Approval: III for –*

- (a) *measuring the outputs of the PPP agreement;*
- (b) *monitoring the implementation of the PPP agreement and performances under the PPP agreement;*
- (c) *liaising with the private party;*
- (d) *resolving disputes and differences with the private party;*
- (e) *generally overseeing the day-to-day management of the PPP agreement; and*
- (f) *reporting on the PPP agreement in the institution's annual report.*

16.7.2 *A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is*

effectively and efficiently performed in the public interest or on behalf of the public service.

16.7.3 A PPP agreement involving the use of state property by a private party does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such state property is appropriately protected against forfeiture, theft, loss, wastage and misuse.

16.8 Amendment and variation of PPP agreements

16.8.1 *The prior written approval of the relevant treasury is required for any material amendments to a PPP agreement including any material variations to the outputs therein, or any waivers contemplated or provided for in the PPP agreement.*

16.8.2 *The relevant treasury will approve a material amendment only if it is satisfied that the PPP agreement, if so amended, will continue to provide –*

(a) value for money;

(b) affordability; and

(c) substantial technical, operational and financial risk transfer to the private party.

16.8.3 *The accounting officer or accounting authority must substantially follow the procedure prescribed by regulations 16.4 and 16.6 for obtaining such treasury approval.*



NATIONAL TREASURY



unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance,

Phase V

DELIVERY

- liaise effectively, settle disputes

Phase VI

EXIT

- Report progress in the Annual Report
- Scrutiny by the Auditor-General

Module 1
Module 2

MODULE 3

Module 6

Module 1
Module 2

MODULE 4

Module 6

Module 7

Module 8

Module 9

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Module 2
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MODULE 5

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Module 9

ABOUT THIS MODULE¹

Module 6: Managing the PPP Agreement is intended to help the institution put effective mechanisms in place to manage the implementation of the PPP agreement.

The module is designed to help the institution meet its responsibilities in a number of phases of the PPP project cycle:

- in terms of Treasury Regulation 16.3.1(c), which requires the accounting officer/authority to appoint a project officer to manage the PPP agreement
- in terms of Treasury Regulation 16.6.1(b) to obtain Treasury Approval: III (TA:III) for a PPP agreement management plan
- in terms of Treasury Regulation 16.7, which makes the accounting officer/authority responsible for the proper management of the PPP agreement
- in terms of Treasury Regulation 16.8 which allows for material amendments to a PPP agreement with treasury approval.

Take note

Managing the PPP agreement:

- starts in the inception phase of the PPP project cycle
- is designed in detail towards the end of the procurement phase
- is put into practice after the signing of the PPP agreement, for the development, delivery and exit phases.

The module is primarily aimed at the project officer, who will be responsible for preparing and implementing the PPP agreement management plan.

Most of the advice in the module is generic. While different types of PPP projects in different sectors have unique features that need specific forms of treatment with regard to managing the PPP agreement, the underlying principles in this module should apply to all PPP agreements.

1. This module has been compiled with reference to the UK Office of Government Commerce and the UK Treasury Task Force.

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SECTION 1: WHAT IS PPP AGREEMENT MANAGEMENT?

PPP agreement management is the process that enables both parties to a contract to meet their respective obligations in order to deliver the objectives required from the PPP agreement. It involves building a good working relationship between the two parties, and continues throughout the project term. Another dimension of PPP agreement management is managing proactively to anticipate future needs as well as reacting appropriately to unforeseen situations that arise.

The central aim of PPP agreement management is to obtain the services specified in the output specifications and ensure ongoing affordability, value for money and appropriate risk transfer.

This means optimising the efficiency, effectiveness and economy of the service described in the PPP agreement, balancing costs against risks, and actively managing the partnership between the institution and the private party. PPP agreement management should also involve aiming for continuous improvement in performance over the life of the PPP agreement.

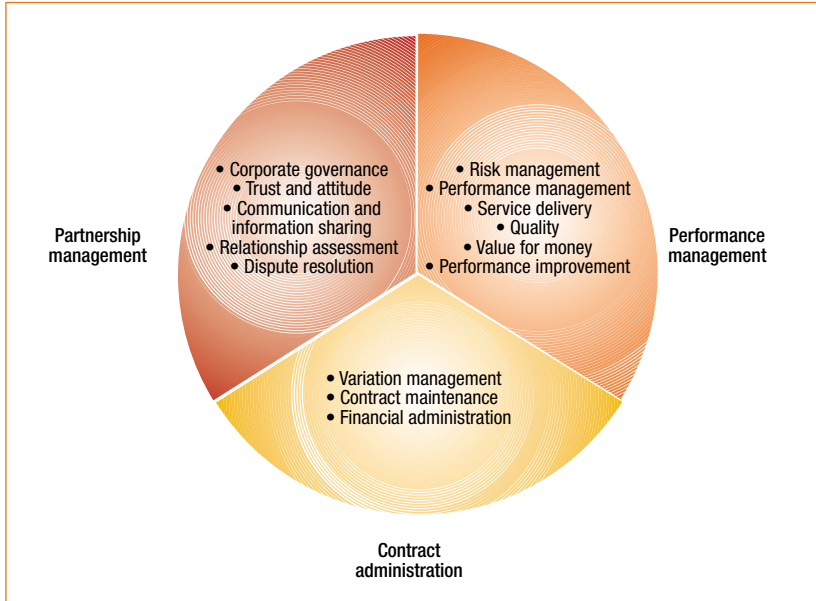
Functions of PPP agreement management

The various responsibilities and tasks that need to be undertaken during PPP agreement management can broadly be divided into three main functions:

- **Partnership management** is concerned with structures of accountability and how the institution and the private party relate to each other.
- **Service delivery management** can be described as the systems and procedures designed to manage risk and performance.
- **PPP agreement administration** relates to the administrative processes required to ensure that all the procedures contained in the PPP agreement and all the documentation relating to the PPP agreement are effectively managed.

In practice there will be a considerable degree of overlap between these functions, and they will often need to be undertaken simultaneously at any particular phase of the project. Nevertheless, an understanding of the purpose of each function and the required competencies will clarify further the responsibilities of the project officer and enable him or her to assemble a PPP agreement management team with the necessary attributes.

Figure 6.1: Key PPP agreement management functions



The three functions are each discussed in detail in sections 4, 5 and 6.

Phases of PPP agreement management

Take note

PPP agreement management starts with the appointment of the project officer in the inception phase of the PPP project cycle and continues throughout the PPP project cycle. It is a set of functions, with related responsibilities and tasks, which apply at different phases of the PPP project cycle.

- **The inception phase and feasibility study phase** cover the periods from the inception of the project by the institution until it has obtained TA:I for the feasibility study.²
- **The procurement phase** covers the period from when the institution has obtained TA:I until the signing of the PPP agreement, including all the TA:II and TA:III activities carried out before the signing of the PPP agreement.³

2. See modules 1 to 4.

3. See *Module 5: PPP Procurement*.

- **The development phase** begins from the signing of the PPP agreement and lasts until service delivery begins. It includes the transition to the new service delivery arrangements, and, depending on the nature of the project, may involve the design of facilities, the commissioning of goods and equipment, or the construction of buildings.
- **The delivery phase** refers to the period when services are delivered and used according to the PPP agreement's specified outputs throughout the remaining life of the project.
- **The exit phase** is towards the end of the life of the project – whether the project is ending through expiry or termination. Activities are wound up and the institution makes new financial and contractual arrangements for continued service delivery.

In practice, there will usually be some degree of overlap, particularly between the development and delivery phases and the delivery and exit phases. Furthermore, in different types of projects the relative importance of each phase may differ. Nevertheless, dividing PPP agreement management into these phases provides a framework for considering the key challenges and tasks of PPP agreement management throughout the project term.

During each phase, different aspects of the three PPP agreement management functions – partnership management, service delivery management and PPP agreement management – will need to be undertaken.

The PPP agreement management framework

Figure 6.2 below illustrates a PPP agreement management framework comprised of the three key functions and the critical phases. It summarises some of the most important tasks to be carried out during each phase. A more detailed breakdown of tasks is contained in figures 6.8-6.11. The reader who wants a quick overview of what is required for PPP agreement management at each phase of the PPP project cycle may want to read these pages before reading the rest of the module

Figure 6.2: The PPP agreement management framework

Critical phases and illustrative timeframe		Key functions		
		Partnership management	Service delivery management	PPP agreement administration
Years 1 to 2	Inception and feasibility	Appointment of project officer Establishment of project team Deciding on project type and procurement method	Establish the project's output specifications, affordability limits, value-for-money benchmarks, and risk allocation	Establish tracking and document management systems Identify budgets Establish financial management systems
Years 2 to 3	Procurement	Develop the partnership management plan Establish the PPP agreement management team Prepare the PPP agreement management plan	Develop the payment mechanism and performance management plan Develop the risk management plan	Develop the PPP agreement administration plan
Years 3 to 5	Development	Ensure a seamless transition to the new arrangements Establish sound partnership management systems Manage change	Establish risk control procedures Establish performance management systems Monitor the development of the service towards the commencement date Manage variations	Develop financial administration, PPP agreement maintenance and variation management procedures Calculate, record, deduct penalties Develop the PPP agreement management manual
Years 5 to 20	Delivery	Review and revise the partnership as necessary Manage change Review and revise the PPP agreement management Commission independent reviews	Ensure contracted services are provided in accordance with the output specifications Manage risks Manage performance Manage variations	Review and revise financial administration, PPP agreement maintenance and variation management procedures Calculate, record and deduct penalties Update the PPP agreement management manual
Years 18 to 20	Exit	Manage change Organise closure Integrate lessons of the partnership into the work of the institution	Assess deliverables, value for money, quality and innovation achieved by the project Make arrangements for the delivery of the service by the institution or inception of a new PPP project Organise post-implementation review	Implement hand-back procedures Implement transition, which may involve inception of a new PPP project

Take note

The foundations for PPP agreement management are laid in the phases of the PPP project cycle before the signing of the PPP agreement, including the inception, feasibility and procurement phases. This is why the appointment of a good project officer at the outset is so vital to PPP success. The terms of the signed PPP agreement will guide its management and form the core around which the contracted services can be developed and delivered, value for money can be achieved, and a productive relationship can grow. If the PPP agreement was poorly constructed, it will be much more difficult to make PPP agreement management a success.

Exit strategy

The project officer should prepare an exit strategy as part of the process of developing the PPP agreement management plan.⁴ This strategy should be based on the provisions contained in the PPP agreement in relation to termination and expiry, and should demonstrate the institution's capacity to bring the project to an end efficiently and ensure ongoing service delivery. This may be achieved either by continuing the functions in-house or by setting up the inception phase of a new PPP project.

The exit strategy should include:

- an analysis of options, within the parameters of the PPP agreement, for continuing the service after termination or expiry, and an initial recommendation on the preferred option
- plans for organising a post-implementation review of the project, which should:
 - (i) assess key deliverables, value for money, quality and project innovation; and
 - (ii) be carried out within six months of the expiry or termination date
- the steps that will be taken to integrate the lessons of the project into the day-to-day work of the institution
- an implementation plan based on the hand-back procedures set out in the PPP agreement
- plans to deal with the implications of any employee transfers from the private party to either the institution or a successor body
- an estimate of the resources and personnel that the institution will allocate to managing the exit strategy
- plans for a closure event to celebrate the achievements of the project and prepare PPP agreement management staff and end users for their new role.

The exit strategy should be reviewed at appropriate points during the delivery phase, and revised as necessary to ensure that robust plans are in place three years in advance of the expiry of the project term.

4. See *Module 5: PPP Procurement*.

SECTION 2: THE INSTITUTION'S ROLES AND RESPONSIBILITIES

A critical aspect of effective PPP agreement management for the institution is to clarify the roles and responsibilities of key individuals.

Ambiguity about the functions of important players in the PPP agreement management process could lead to unnecessary delays and disputes. The primary figures involved in PPP agreement management on the institution side are the accounting officer/authority and the project officer.

The accounting officer/authority⁵

In relation to PPP agreement management, the main responsibilities of the accounting officer/authority are to:

- mobilise support for the PPP project amongst politicians and other key stakeholders
- appoint a project officer as soon as the institution identifies a possible PPP,⁶ as required by Treasury Regulation 16.3.4, to enable the project officer to make inputs into the output specifications and the PPP agreement, and ensure management continuity through each stage of the project
- obtain TA:III from the relevant treasury for the PPP agreement management plan⁷
- sign the PPP agreement
- delegate the necessary powers to the project officer after the PPP agreement has been signed to enable him or her to ensure the implementation of the PPP agreement
- resolve any disputes which the project officer is unable to settle
- provide executive commitment to sound partnership management
- provide financial oversight and ensure that the PPP project continues to operate in the public interest after the PPP agreement has been signed
- ensure that the PPP agreement is properly enforced
- report on the management of the PPP agreement in the institution's annual report.

5. See *Module 3: PPP Inception*, for an explanation of the overall role of the accounting officer/authority in PPP projects.

6. See *Module 3: PPP Inception*.

7. See *Module 5: PPP Procurement*.

The project officer⁸

Required competencies

The project officer is appointed in the earliest stage of PPP inception, in the knowledge that he or she will be required to play a central role in managing the PPP agreement. As noted in *Module 3: PPP Inception*, the appointment of a project officer needs to be carefully considered, as the responsibility of undertaking the contract management functions of a major project requires a broad range of personal and technical competencies. In addition, Treasury Regulation 16.3.1(c) requires that the project officer be capable and appropriately qualified. While the PPP agreement will determine the legal and contractual obligations of both parties, the project officer will be required to exercise skill and judgement in order to effectively protect the institution's interests. In addition, he or she will be responsible for hiring a team with the range of technical know-how to properly manage the interests of the institution as set out in the PPP agreement.

Module 3: PPP Inception provides a competency model for the project officer. It can be used:

- as a recruitment and selection tool in the inception phase of the PPP project cycle, when the institution is seeking to appoint a project officer
- as an assessment tool throughout the PPP project cycle, when the project officer is undergoing a performance appraisal
- as a development tool when the project officer is looking to keep his or her expertise aligned with the evolving requirements of PPP agreement management.

Main responsibilities

The project officer's main responsibilities in relation to managing the PPP agreement are to:

- manage the project on behalf of the institution, exercising delegated authority
- ensure that the PPP project continues to be affordable, and provides quality, value for money and appropriate risk transfer
- ensure both parties meet their contractual obligations
- ensure the requirements of the output specifications are achieved
- appoint a PPP agreement management team with the necessary technical skills to administer institutional obligations and protect institutional rights in the PPP agreement
- build a strong partnership and good working relations with the private party
- prevent and/or resolve disputes
- manage risks
- monitor private party performance and take corrective action where necessary
- develop and implement the PPP agreement management plan⁹

8. See *Module 3: PPP Inception*.

9. See *Module 5: PPP Procurement*.

- develop and maintain the PPP agreement management manual and related PPP agreement administration systems
- report on the management of the PPP agreement, as required, among others, for the institution's annual report, and by the Accountant-General,¹⁰ the Auditor-General¹¹ and any other government regulator
- ensure that the private party maintains insurance and indemnities in force
- manage approved variations
- develop an effective communication framework
- organise PPP agreement management reviews
- manage consequences of contract breach.

Section 7 sets out the project officer's PPP agreement management tasks and responsibilities for each phase of the PPP project cycle in detail.

A particular responsibility, which is a requirement of *Standardised PPP Provisions* (Standardisation) (Part H: 38), is the appointment of a liaison officer by each of the parties. Standardisation states that the project officer should act as the institution's liaison officer, who is responsible for dispute resolution and meeting with the private party on a regular basis to consider performance reports. However, depending on the size of the project, the project officer may need to delegate some of these responsibilities to another member of the PPP agreement management team, particularly the dispute resolution procedures set out in Part S:86 of Standardisation. (See Section 4 of this module.)

The PPP agreement management team

The resources to be devoted to PPP agreement management will be affected by the overall size and complexity of the project and the particular stage it has reached. In some cases it may be possible for the PPP agreement management function to be carried out by a single individual. This team will have evolved since its role as a project team in the inception, feasibility and procurement phases, taking on different technical skills and experience as needed throughout the PPP project cycle.

It is common for the project officer to be supported by, or to co-ordinate, a PPP agreement management team, consisting of a range of specialists and technical advisors with varying levels of involvement.

Typical expertise

It should be the project officer's responsibility, in consultation with the accounting officer/authority, to decide on the composition of the team, how it should be deployed, and whether and when to call on additional expertise (within the scope of the budget). The range of expertise and skills required will vary over the life of the PPP agreement. Membership of the team will reflect the various competencies

10. See *Module 8: Accounting Treatment for PPPs*.

11. See *Module 7: Auditing PPPs*

required to effectively discharge PPP agreement management responsibilities during each stage of the PPP agreement. Typical expertise that needs to be represented or available is:

- knowledge of the subject matter
- design and construction
- business and product assurance
- facilities and services management
- IT (especially, but not only for IT projects)
- statutory safety and regulatory responsibilities
- law
- finance
- Black Economic Empowerment (BEE) monitoring.

The main focus of the project officer and the PPP agreement management team will be to develop an appropriate arms-length approach and not to interfere with the way the service is delivered by the private party, provided the output specifications are met.

Structure

It will be the responsibility of the project officer to co-ordinate inputs from the various team members in order to ensure effective and consistent PPP agreement management. The project officer should establish a suitable structure for the PPP agreement management team well before the PPP agreement comes into force. While individuals will change, the aim should be for continuity of PPP agreement management expertise from the procurement phase onwards. To this end, knowledge management systems should be developed and succession plans prepared for critical team members. The private party should be made fully aware of the PPP agreement management structures that have been established within the institution. Usually, the private party will appoint its own PPP agreement management team to act as its interface with the institution.

Outside expertise

Where contract management expertise is brought in from outside the institution, either on an ad hoc basis or under a long-term arrangement, it will be important to ensure that commercially confidential information held by the institution is protected. The terms of reference, timeframes and the basis of fees for such advisors must be clearly defined to ensure that management of the PPP agreement rests with the institution. Any contract with independent professional advisors providing contract management services must contain clear arrangements for reporting the results of performance monitoring to the institution and the private party.

Ethics

In all their dealings, the private party, the project officer and the PPP agreement management team should be guided by the provisions of the *Code of Conduct* contained in the public service regulations.¹²

12. Regulations to the Public Services Act, 1994, published as Regulation No 6979, Government Notice R1, *Government Gazette* 21951 of 5 January 2001.

SECTION 3: THE APPROACH TO PPP AGREEMENT MANAGEMENT

From the perspective of the institution, the management of PPP agreements requires a relatively hands-off approach that respects that the performance of key institutional functions has been contracted to the private party.

Effective PPP agreement management requires the institution to move away from traditional public service methods of contract management (which tend to keep the service provider at a distance, focus on inputs, and often become adversarial) and towards building constructive partnerships with the private party. The focus is on the service outcomes to be achieved, using appropriate mechanisms for quality assurance, spot-checking, performance monitoring and corrective action.

The management of a PPP agreement requires a range of 'soft' skills in both the institution and the private party. The approach which the institution adopts will have an important bearing on the chances for project success. Too much intervention could sour relations with the private party and stifle innovation; too little intervention could lead to end-user dissatisfaction or expose the institution to unnecessary risk. There is a balance that should be achieved in the PPP agreement, elaborated in the PPP agreement management plan, and implemented after the signing of the PPP agreement.

The institution's approach should to a large extent be determined by the sector in which the PPP project operates, the risk profile of the project, and the particular phase of PPP agreement management that has been reached at any given point. Thus, where the consequences of private party performance failure would be severe – for example, hygiene in a hospital operating theatre – a rigorous monitoring regime would be required. In less exacting circumstances, a more flexible monitoring system might be possible. Similarly, the penalty deduction mechanism might be applied with greater flexibility during the development phase compared to during the delivery phase.

While the PPP agreement should include provisions for the PPP agreement management approach required by the institution, in practice many aspects of the approach will depend upon the skill, judgment and creativity of the project officer and the PPP agreement management team after the PPP agreement has been signed.

Critical success factors

Broadly speaking, a PPP agreement is being managed successfully if the following conditions are being met:

- the arrangements for service delivery continue to be satisfactory to both the institution and the private party
- expected PPP benefits, value for money and innovation are being realised
- there is a good relationship between the institution and the private party
- the institution is aware of its contractual obligations and has the necessary resources and expertise to honour them

- knowledge management and succession planning are used to retain intellectual capital and the expertise of key staff
- disputes are resolved at the appropriate level through the partnership management system without recourse to external dispute resolution
- changing service delivery requirements are anticipated, and variation procedures are used to minimise any negative consequences and maximise any opportunities brought about by change.

What can go wrong, and why

If the PPP agreement is not well managed by the institution, any or all of the following may happen:

- the institution loses control, resulting in unbalanced decisions that do not serve the institution's interests
- decisions are not taken at the right time – or are not taken at all
- new business processes do not integrate effectively with existing processes, and therefore fail
- people (from both sides) fail to understand their obligations and responsibilities, leading to unnecessary disputes
- too many issues are escalated inappropriately, which can slow down decision-making
- the intended benefits are not realised
- opportunities to improve value for money and performance are missed.

Ultimately, the PPP agreement becomes unworkable.

If PPP agreement management is failing, it is likely to be due to any one or more of these factors:

- a poorly drafted PPP agreement
- the people involved in negotiating the PPP agreement are not the same as those given responsibility for managing it
- inadequate resources are assigned to PPP agreement management
- poor institutional leadership and/or misunderstanding of the PPP agreement
- the institution team does not match the private party team in terms of skills or experience (or both)
- the wrong people are put in place, leading to personality clashes or ineffective management
- the context, complexities and dependencies of the PPP agreement are not well understood
- there is a failure to assess private party or institutional assumptions adequately
- authorities or responsibilities relating to commercial decisions are not clear
- a lack of independent reviews of the PPP agreement management arrangements
- a focus on current arrangements rather than on what is possible or the potential for improvement
- a failure to monitor and manage institution risks.

SECTION 4: PARTNERSHIP MANAGEMENT

Partnership management, also known as relationship management, involves the development of processes to ensure accountability and to manage the relationship between the institution and the private party.

A successful PPP delivers the services that meet the requirements of the output specifications through a commercial arrangement that is acceptable to both parties – offering value for money for the institution and adequate profit for the private party. In addition, the way the institution and the private party regard each other and the way their relationship operates are vital.

Take note

The partners in a PPP agreement have different but complementary interests, not necessarily common interests.

Five key dimensions of PPP partnership management

Five key dimensions of PPP partnership management

1. Corporate governance
2. Trust and attitudes
3. Communication and information sharing
4. Relationship assessment
5. Dispute resolution

1. Corporate governance

Corporate governance is concerned with structures, systems, policies and other mechanisms of accountability within an organisation.

The King Code

In South Africa the policy framework for corporate governance is contained in the *King Code of Corporate Practices and Conduct*, which puts forward an inclusive and balanced scorecard approach for a company board to:

- move from the single bottom-line of financial performance to the triple bottom-line, which embraces the financial, environmental and social aspects of a company's activities
- apply the tests of fairness, accountability, responsibility and transparency to all acts and omissions
- be accountable to the company
- be responsive and responsible towards key stakeholders.

It includes: the role and responsibilities of company boards and directors; risk management; internal audit; integrated sustainability reporting; accounting and auditing; relations with shareholders; and corporate communications.

The King Code should be an important reference in PPP partnership management and should relate to the liaison and reporting requirements of *Standardised PPP Provisions* (Part H: 38). The governance structure should be consistent with the King Code and headed by the accounting officer/authority on the institution side, and the chief executive or equivalent officer on the private party's side.

Other corporate governance guidance and obligations

In applying the King Code tests of fairness, accountability, responsibility and transparency in its monitoring of the private party, the project officer should be guided by the provisions of the Promotion of Access to Information Act, 2000, and the Promotion of Administrative Justice Act, 2000.

The private party's reporting and disclosure obligations will be specified in the PPP agreement¹³ and must mirror the institution's disclosure obligations to the Accountant-General¹⁴ and the Auditor-General.¹⁵

2. Trust and attitudes

While contractual and commercial arrangements may lay the basis for a partnership that is built on common objectives and shared rewards, trust is a key feature of a successful partnership.

Trust cannot be mandated in the PPP agreement, and although it may be anticipated, ultimately it has to be built and earned through actions and behaviours, rather than assertions. Trust is tested when problems and disagreements arise. Trust can seem a very intangible concept, but tangible efforts can be made to try to engender or promote a spirit of trust within the partnership. State publicly the principle and expectation that trust should be a feature of working relationships, and make it a feature of awareness campaigns.

The behaviour of individuals in a contractual relationship is a reflection of their attitudes, and the right attitudes will lead to the right behaviour.

The accounting officer/authority, the project officer and others responsible for managing the partnership have a major influence on the way behaviours develop and are perceived by people in the private party. Careful thought should be given to identifying the values and attitudes required of the staff who will fill key posts. This is not to say that the institution's PPP agreement management team should become a 'soft touch'. Commitment to managing the partnership and to long-term success requires active and assertive, not passive and submissive, behaviour.

13. See *Standardised PPP Provisions: Part H and Part P*.

14. See *Module 8: Accounting Treatment for PPPs*.

15. See *Module 7: Auditing PPPs*.

3. Communication

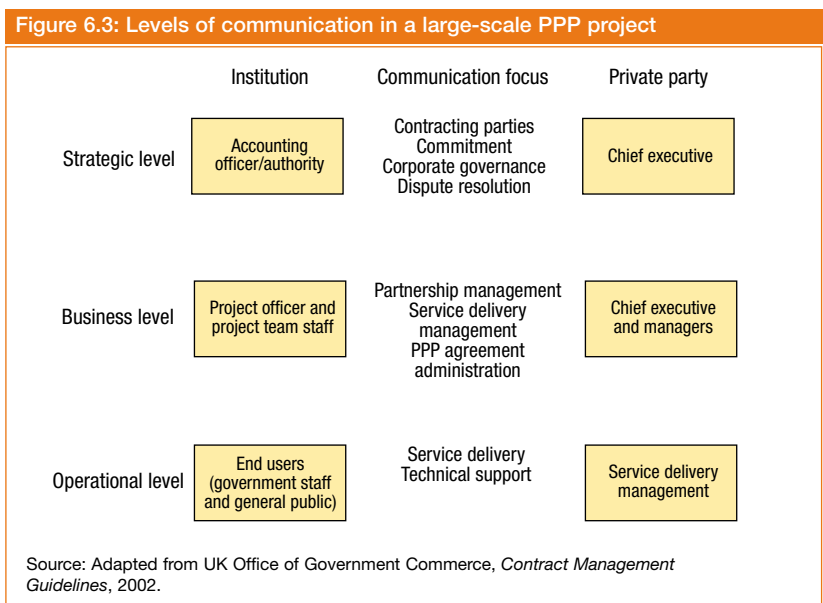
Good communication is often the make or break in managing a partnership.

It is vital that the parties agree to formal disciplines about how they communicate in the project, and that they do not break protocols or stray into informalities. For example, discussions on a golf course between a government minister and a senior manager in the private party are not an appropriate way to make decisions in a PPP project.

Many cases of mistrust or concern over poor performance in a service relationship result from a failure to communicate at senior management level, or from each party's failure to understand the business goals or intentions of the other side.

Levels of communication

The relationship between the institution and the private party should generally operate at different organisational levels, with channels of communication running horizontally between equivalent levels on both sides. An example of an arrangement with three formal levels of communication is shown in Figure 6.3 below. This large-scale PPP project has information flowing at several levels.



The strategic level

The accounting officer/authority and the chief executive are the contracting parties. To this end, they need to establish commitment to making the partnership work, mobilising political and financial support, and 'leading from the front.' Ultimately this level must deal with dispute resolution if difficulties cannot be resolved at the business level by the project officer.

This is not, and should not be allowed to become, the level where day-to-day project matters are managed. The chief executive of the private party and the accounting officer/authority must be careful to manage this level of the partnership accordingly.

The business level

The business level is the level at which the PPP agreement is formally managed by the institution's project officer (with his or her project team) and his or her private party counterpart (with his or her managers). This is where the day-to-day partnership is managed, services are planned and their delivery is monitored.

The operational level

The operational level is where services are delivered to end users comprised of staff in the institution and the general public. Staff order or call off components as they require them and receive technical support as necessary from the private party's service delivery management. The private party and its subcontractors provide the service to agreed levels. A call-centre may be used to log levels of satisfaction from end users. Day-to-day problems in the delivery of services may be resolved here. If this is not possible, they can be escalated to the relevant member of the project officer's project team and, if necessary, to the project officer at the business level.

Channels of communication

These levels of communication should be preserved even when problems arise, and diagonal lines of communication avoided. For example, if end-user institutional employees feel the service is not being delivered to the required standards, they should refer this to the relevant member of the institution's project team, who will liaise with his or her counterpart in the private party. It would not be appropriate for them to go 'straight to the top' and liaise directly with the private party chief executive; doing so would undermine the key business level management of the PPP agreement. Similarly, it would be inappropriate for service delivery management on the private party side to complain about their workload to the project officer.

The ideal is a combination of vertical communication between levels within each organisation and horizontal, peer-to-peer communication between organisations.

Consistency

Consistent communication between levels is also important, or differences in perspective between, say, the accounting officer/authority and the project officer may create difficulties in the partnership.

The physical location of the partners

A mechanism that has proved to be effective in enhancing communication and other aspects of the partnership between the institution and the private party is the co-location of PPP agreement management staff from both sides in common premises. Having a base in the same building can help to build communication channels and trust, which in turn can help to smooth the way for more formal contractual negotiations.

Trust

Sharing information between the institution and the private party may raise legitimate concerns about how information will be used. There may, for example, be a concern that information about the institution's plans, finances and resources will be exploited by the private party for its commercial advantage. Willingness to share information openly depends largely on the element of trust. However, there should be a realistic balance between openness and reserving negotiating positions.

4. Relationship assessment

As well as measuring performance against financial and service performance measures, a way of assessing other aspects of the partnership between the institution and the private party should be put in place. This may involve hiring an independent reviewer every few years, on a shared-cost basis, to identify problem areas and how these can be resolved. This will be valuable in highlighting areas that are perceived to be working well and those that require attention.

Periodic assessments might address issues such as:

- whether each party is getting the expected benefits when the PPP agreement was signed
- how well the management structures are seen to be operating
- how successful communication is seen to be
- the degree to which information is shared freely and openly between the parties
- whether conflicts are being avoided or resolved effectively
- end-user satisfaction and perceptions of the relationship.

While issues like these may be perceived subjectively to a large extent, these perceptions by each party of the relationship can have a material effect on PPP agreement management, regardless of their validity. There should be a willingness to learn from mistakes and, if necessary, to take part in partnership development programmes if they will help to strengthen the relationship.

5. Dispute resolution

Standardised PPP Provisions (Part S: 86) prescribe a dispute resolution procedure that must be included in the PPP agreement.

The prescribed dispute resolution procedure requires that all disputes should, in the first instance, be referred to the institution and private party liaison officers (in the case of the institution, the project officer) for them to try to find a solution. If they are unable to do this within an agreed period, the dispute should be referred to the accounting officer/authority of the institution and the chief executive of the private party. If PPP agreement cannot be reached at this level either, the matter should be referred to an independent mediator or to an adjudicator to determine the out-come as part of the fast-track dispute resolution procedure. Only if the informal and formal procedures of this escalation process have been exhausted should the dispute be settled in the courts.

The project officer therefore has an important role to play in ensuring that all members of the PPP agreement management team properly understand the dispute resolution procedure. His or her counterpart in the private party has a concomitant role.

The main goal of the project officer should be to anticipate and prevent disputes from arising in the first place.

When this is not possible, he or she should facilitate co-operation between both sides to ensure that problems are recognised and resolved quickly and effectively. If it is necessary to involve a higher level of authority, the project officer should attempt to create the best possible atmosphere for an agreement to be reached.

Whatever the nature of the problem, the project officer should ensure that:

- problems are recorded as they occur
- the private party is notified of problems using the mechanism set out in the PPP agreement
- approaches to resolving problems are clear and documented
- the escalation procedures set out in the PPP agreement are followed.

Developing the partnership management plan

The partnership management plan provides an essential vehicle for addressing corporate governance, trust, communication, partnership assessment and dispute resolution. The project officer should develop a partnership management plan, based on the liaison and reporting provisions in the PPP agreement, as part of the PPP agreement management plan,¹⁶ in the procurement phase of the PPP project cycle.

The partnership management plan should include:

- a statement of the principles that will govern the partnership

¹⁶. See *Module 5: PPP Procurement*.

- the aims, objectives and long-term goals of the partnership
- the benefits to both the institution and the private party of a successful partnership
- details of private party corporate governance arrangements
- the partnership management structure
- knowledge management systems
- succession plans for key members of the PPP agreement management team
- a communication framework
- mechanisms that will enable the partnership to be assessed
- a summary of the dispute resolution procedures
- the roles and responsibilities of institution officials who will be responsible for partnership management
- an estimate of the resources that the institution will allocate to partnership management.

After the PPP agreement has been signed, the project officer will need to ensure that the partnership management plan is implemented.

SECTION 5: SERVICE DELIVERY MANAGEMENT

Service delivery management in a PPP context can be divided into two principal categories:

- **Risk management** involves keeping the exposure of the project to any potential threats at an acceptable level by taking appropriate action.
- **Performance management** is concerned with ensuring that the PPP project remains affordable for the institution and manages service delivery, value for money, quality and performance improvement.

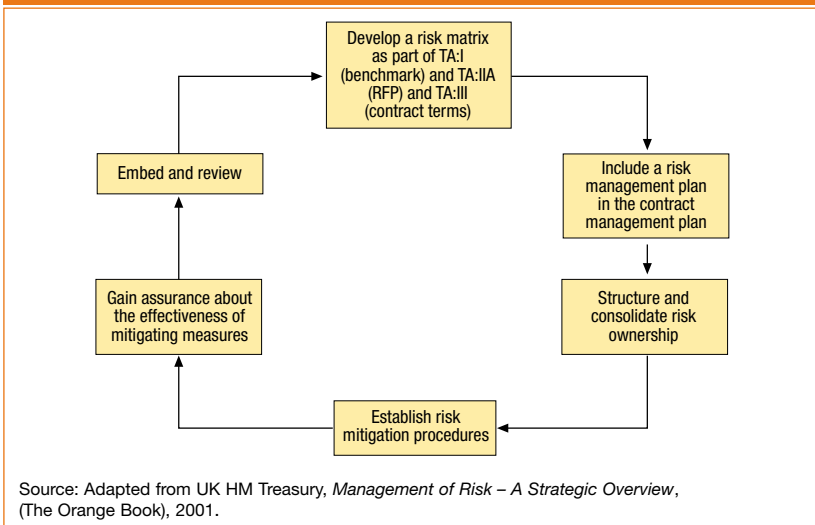
Take note

The institution's performance management role in a PPP project is in many ways quite different from the performance management role that government departments normally play. In PPPs, managing the performance of the private party has more to do with regulation than 'management' in the traditional sense.

Risk management

Risk management is a central component of the PPP procurement process, and additional risk management procedures are required after the signing of the PPP agreement.

Figure 6.4: PPP risk management framework for after the signing of the PPP agreement



1. Develop a risk matrix

The PPP agreement will contain detailed provisions about the allocation of risk between the institution and the private party. For TA:I and TA:IIB in particular, and then during PPP agreement negotiations, this risk allocation would have been reduced to a risk matrix¹⁷ in which all risks would be specified, assigned, mitigation measures identified, and probabilities and costings calculated.

2. Include a risk management plan in the PPP agreement management plan

As part of the process of developing the PPP agreement management plan¹⁸ during the procurement phase of the project cycle, the project officer should develop a risk management plan based on the risk matrix.

For each institutional or shared risk, the risk management plan should set out:

- an evaluation of the different options for treating the risk
- the institution official who will be responsible for managing the risk
- the procedures and mechanisms that will be used to control the risk
- an estimate of the resources that the institution will allocate to managing the risk.

For each private party risk, the risk management plan should set out:

- the obligations and reporting requirements which the institution has imposed on the private party to ensure that risk is managed
- the institution official who will be responsible for monitoring the risk
- an estimate of the resources that the institution will devote to monitoring the risk
- the mechanisms that will be used by the institution to deal with any failure of the private party to manage the risk, namely penalty deductions, step-in, etc.
- the business contingency plan that the institution will follow to ensure continued service delivery in the event that the private party cannot maintain the service or the institution is forced to terminate the PPP agreement for whatever reason.

3. Structure and consolidate risk ownership

After the signing of the PPP agreement a critical next step for the institution in risk management is to structure and consolidate the ownership of each risk. While the risk management plan will identify risk management responsibilities, this will need to be institutionalised. Ownership of each risk must be clearly defined, documented and agreed with the individual owners at all levels, so that they understand their various roles, responsibilities and ultimate accountability. The owner of the risk may not be the person tasked with the assessment or management of the risk, but he or she is responsible for ensuring the process is applied.

Each risk must have an owner. There may also be separate owners for the actions to mitigate the risk.

¹⁷. See *Module 4: PPP Feasibility Study*.

¹⁸. See *Module 5: PPP Procurement*.

4. Establish risk mitigation procedures

While the risk management plan will explain the mechanisms and procedures that the institution will use to manage, monitor and mitigate risk, the project officer should ensure that these mechanisms are put in place after the signing of the PPP agreement.

Two highly effective risk mitigation instruments are

- the risk register
- the summary risk profile.

The risk register

The risk register, or risk log, describes each risk and keeps all the information on the risk in one place so that a complete picture of risk exposure can be built up. Figure 6.5 below provides a basic set of contents which can be tailored as required.

Figure 6.5: Example risk register

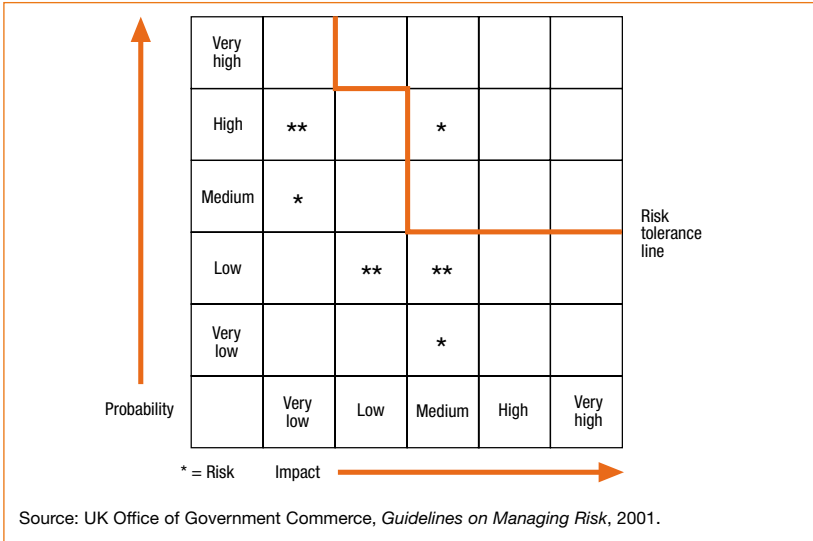
Risk number	Date of registration	Description of risk	Impact			Probability	Possible responses	Target date for action	Owner	Action
			Time	Cost	Quality					
			L	L	M	VL				
			H	M	M	M				
			H	L	VH	H				

VL: Very low; L: Low; M: Medium; H: High; VH: Very high
 Source: UK Office of Government Commerce, *Guidelines on Managing Risk*, 2001.

The summary risk profile

The summary risk profile is a simple mechanism designed to increase the visibility of risks. It is a graphical representation of information contained in the risk register. The project officer should update the risk register regularly, and then generate the graph which shows risks in terms of probability and impact, with the effects of mitigating action taken into account.

Figure 6.6: Example summary risk profile



The summary risk profile shows all key project risks as one picture, so that managers can gain an overall impression of the total exposure to risk.

A key feature of this picture is the risk tolerance line. It shows the overall level of risk that the institution is prepared to tolerate. If the overall exposure to risk is above and to the right of this line, the project officer and the PPP agreement management team will be able to see that they must take prompt action with upward referral of relevant risks.

Setting the risk tolerance line is a task for experienced risk managers: it reflects the institution's attitudes to risk in general and to a specific set of risks within a project.

The parameters of the risk tolerance line should be agreed between the project officer and the accounting officer/authority and regularly reviewed.

Effective risk mitigation instruments like the risk register and the summary risk profile will indicate courses of action to be taken to mitigate risk.¹⁹ Using such instruments, the project officer and the PPP agreement management team will need to ensure that they have the necessary resources, expertise and authority to implement the appropriate mitigation responses.

19. For a more detailed explanation of the risk register, the summary risk profile and other risk management tools, see UK Office of Government Commerce, *Management of Risks – Guidelines for Practitioners*, 2003.

5. Gain assurance about the effectiveness of mitigation measures

Once mitigation measures have been established and responses implemented, it is essential to be sure about the effectiveness of these. A reporting system should be established to enable upward reporting about how risk is being managed. This reporting system should be owned by, and ultimately report to, the accounting officer/authority. The project officer should provide regular reports on the work done to keep risk mitigation procedures up to date and in line with PPP agreement management objectives.

Internal audit provides another important assurance mechanism. The work of internal audit should provide an independent assessment of how well the institution is managing risk.

6. Embed and review

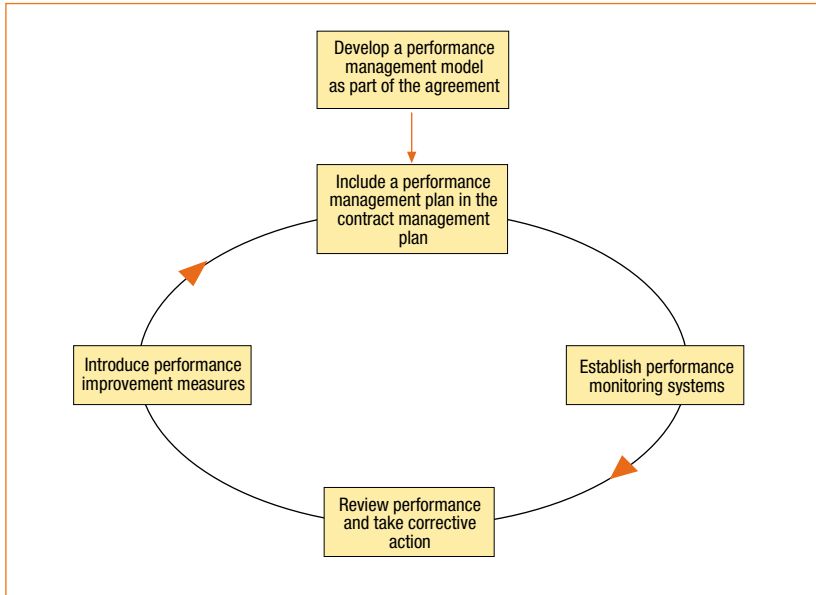
Risk management needs to be embedded in the institution by ensuring that there is an appropriate awareness of, and responsibility for, risk at all levels of the PPP agreement management team. Risk management should become an intrinsic part of the way the institution relates to the private party, and form the core of the PPP agreement management approach.

Over the life of a PPP project the risk environment is likely to change significantly, and thus the institution's priorities and the relative importance of risks will shift and change. The summary risk profile and the risk matrix itself will have to be revisited on a regular basis and reconsidered in order to ensure that the risk profile contained in the PPP agreement remains valid. If necessary, amendments will need to be made to the PPP agreement through the variation procedures to ensure that there continues to be appropriate risk transfer to the private party. (See Section 6.)

Performance management

Affordability, service delivery, quality, value for money and performance improvement are major considerations from the inception of the PPP project and other modules of *National Treasury's PPP Manual* address these issues. PPP agreement management requires additional procedures for dealing with these.

Figure 6.7: The PPP performance management process



1. Develop a performance management model as part of the PPP agreement

Standardised PPP Provisions (Part F: 33) require the institution to include in the PPP agreement a performance monitoring methodology, namely a performance management model, comprised of three key elements:

- **The level of performance required to achieve the output specifications**
In setting the performance level, ensure that standards are reasonable and objectively measurable.
- **The means that the institution will use to monitor private party performance**
The monitoring methodology included in the PPP agreement should occur at three levels: a systematic self-monitoring by the private party through a quality management system; a review of the private party's quality management system by the institution or an independent third party; and end-user feedback on the quality and effectiveness of service delivery. The PPP agreement must also specify the way in which performance is reported for monitoring purposes.
- **The consequences for the private party of a failure to meet the required level**
The consequences of poor performance on the part of the private party must be handled in accordance with the PPP agreement, which should contain provisions for a number of responses to performance failure, ranging from formal warnings and penalty deductions to eventual termination for private party default.

2. Include a performance management plan in the PPP agreement management plan

As part of the process of developing the PPP agreement management plan, the project officer should develop a performance management plan to ensure that the requirements of the PPP agreement and the output specifications are met in terms of affordability, service delivery, quality, and value for money. The performance management plan should be based on the performance management model and include details of:

- the reporting obligations that will be imposed on the private party in relation to self-monitoring
- the performance management system that will be used by the institution and/or independent third parties to review the private party's quality management system
- the mechanisms that will be established to solicit end-user feedback, including a complaints procedure
- the institution officials who will be responsible for monitoring affordability, service delivery, value for money, quality and performance improvement
- an estimate of the resources that the institution will allocate to managing private party performance.

3. Establish performance monitoring systems

The performance management plan will describe the mechanisms that the institution will use to monitor private party performance. The project officer should ensure that these mechanisms are implemented after the signing of the PPP agreement. In particular, performance monitoring systems should be established to enable the PPP agreement management team to:

- regularly check progress to ensure that project milestones are met, including site visits where necessary
- hold regular progress meetings with the private party and consider performance reports
- conduct regular and random inspections of the supplied goods and services
- check that all performance conditions and clauses in the PPP agreement are acted upon
- develop effective mechanisms for obtaining feedback from end users and other key stakeholders
- review third party monitoring reports
- inspect deliverables to ensure inferior goods or services are not accepted
- maintain comprehensive documentation on performance monitoring.

The project officer will need to assign particular monitoring responsibilities to individual members of the PPP agreement management team and ensure that they have the expertise, resources and delegated authority necessary to perform their duties.

4. Review performance review and take corrective action

Effective monitoring should provide the basis for reviewing actual private party performance against the output specifications and other obligations contained in the PPP agreement. Like monitoring, reviews can be carried out by the institution and/or independent third parties. In carrying out such reviews, the project officer should consider the use of a generic quality assurance system, such as the South African Excellence Foundation Public Service Excellence Model,²⁰ or industry specific systems, to evaluate the effectiveness of the private party's quality management system.

The action taken by the institution to correct private party performance must be in line with the provisions in the PPP agreement and commensurate with the severity of the transgression. The application of formal warnings, penalty deductions, step-in and other responses should be undertaken in a manner that is likely to achieve the best result from the institution's point of view. An overly rigid approach may jeopardise continuing service delivery to end users, while too much lenience could encourage the private party to commit further breaches.

5. Introduce performance improvement measures

Seeking improvements is not about extracting more from the private party against their will, but about working together to improve quality, performance, value for money, or other aspects, in a way that benefits both parties.

In the PPP agreement

Given the length of time over which a typical PPP project will run and the difficulties of predicting technological and other productivity improvements that may occur, it is important to ensure that adequate attention is devoted to the issue of performance improvement. Ideally, the requirement for improvement should be embodied in the terms of the PPP agreement.

The payment mechanism²¹ contained in the PPP agreement provides some incentive for the private party to seek improvements in performance. If prices are fixed, they can increase their profit by improving efficiency; if profits are shared, they are motivated to improve economy. The institution can also provide incentives to the private party for early commencement of services if this is affordable and provides value for money.

A joint commitment agreement

However, the terms of the agreement may not necessarily encourage the private party to seek improvements in other areas that might benefit the institution, especially if there is no explicit or tangible benefit for the private party. Moreover,

20. South African Excellence Foundation, *Level 3 Criteria for Public Service Performance Excellence: Self-Assessment and Certificates*, 1997.

21. See *Module 5: PPP Procurement: 'Annexure 1: The payment mechanism'*.

many potential improvements cannot be foreseen when the PPP agreement is signed. Thus, part of the improvement process should be to aim for a joint commitment towards improvement so that both parties are actively pursuing this goal and deriving benefits when the goal is achieved.

Adding value

Incentives for performance improvement, which could be both financial and non-financial, should be affordable for the institution and introduced through the variation procedures. (See Section 6.) They should also be linked to circumstances in which the private party can provide added value. Added value means bringing something to the partnership that is genuinely worthwhile to the institution and beyond what was originally envisaged in the PPP agreement.

Examples of adding value include:

- eliminating aspects of the service that are no longer required
- the use of new technologies that would provide a cheaper and more effective service
- changes in procedures or working practices that provide more efficient ways of delivering the service
- opportunities for innovation, where the private party is given the chance to implement or devise new solutions that will improve the performance of the service.

PPP agreement management systems

Performance improvement is also an important issue for the institution in terms of PPP agreement management systems. Steps should be taken to ensure that PPP agreement management procedures and ways of working are as robust as possible. One way to achieve this is to review and revise the PPP agreement management plan every three years. Another way is for the institution to commission a comprehensive independent review of the project. Such reviews should again be undertaken in accordance with the strategies outlined in the PPP agreement management plan, and used to identify opportunities to improve PPP agreement management arrangements, quality, value for money and the scope for innovation.

SECTION 6: PPP AGREEMENT ADMINISTRATION

PPP agreement administration involves the establishment of administrative processes to ensure that all the procedures and documentation relating to the PPP agreement are effectively managed.

The importance of PPP agreement administration to the success of the PPP project, and to the partnership between the institution and private party, should not be underestimated. Clear administrative procedures can help to ensure that all parties to the PPP agreement understand who does what, when, and how.

Three main categories of PPP agreement administration

Three main categories of PPP agreement administration

1. Variation management
2. PPP agreement maintenance
3. Financial administration

1. Variation management

Treasury Regulation 16.8 deals with amendment and variation of PPP agreements as follows:

16.8 Amendment and variation of PPP agreements

16.8.1 The prior written approval of the relevant treasury is required for any material amendments to a PPP agreement including any material variations to the outputs therein, or any waivers contemplated or provided for in the PPP agreement.

16.8.2 The relevant treasury will approve a material amendment only if it is satisfied that the PPP agreement, if so amended, will continue to provide –

- (a) value for money;*
- (b) affordability; and*
- (c) substantial technical, operational and financial risk transfer to the private party.*

16.8.3 The accounting officer or accounting authority must substantially follow the procedure prescribed by regulations 16.4 and 16.6 for obtaining such treasury approval.

Variation management is closely connected with PPP agreement maintenance and relates to the creation of mechanisms to enable changes to the PPP agreement to be made. Such changes may be necessary as a result of a change in circumstances that could not be anticipated or quantified when the PPP agreement was signed. Variations may involve changes to works, services or the form of delivery.

Four main categories of variation

Standardised PPP Provisions (Part K: 50) provide for four main categories of variation:

- variations that involve no additional costs
- small works variations
- institutional variations
- private party variations.

There are procedures for all these categories, which must be used for all changes to the PPP agreement regarding works, services and the means of delivery. Given the length and complexity of PPP agreements, it is likely that these procedures will be invoked from time to time to deal with changing project needs.

Variation management is a critical element of the development, delivery and exit phases of the project term.

It must be used effectively to ensure that other important functions, such as performance management and risk management, continue to operate in line with contractual requirements and changing service delivery imperatives. The project officer must become familiar with all the intricacies of each variation procedure and ensure that the correct steps are followed whenever the need arises.

Take note

The relevant treasury must be notified of all material amendments and variations before they are implemented. Variations that will have an impact on affordability or result in an increase in the unitary payment will require new TA:I and TA:III approvals.

Variations that involve no additional costs

In circumstances where a proposed variation involves no additional costs for either party, no formal variation procedure is required. The institution and the private party should meet to discuss the best way of implementing the proposed change. If the variation will result in a reduction in costs, then the two parties will need to reach agreement about how to distribute such savings. In the case of a variation proposed by the institution, savings should accrue to the institution and/or end users, while savings derived from a variation proposed by the private party should be divided between the institution, the private party and end users. The two parties would be expected to reach agreement on implementing this category of variation without recourse to dispute resolution procedures.

Small works variations

The small works variations procedure is designed to provide an efficient mechanism for dealing with additional capital works required by the institution. Where the threshold for such works is sufficiently low for the private party to manage, a clause should be included in the PPP agreement requiring the private party to provide a schedule of rates for small works at the beginning of each year. Any dispute between the parties relating to small works variations must be determined in accordance with the dispute resolution procedures.

Institutional variations

Institutional variations should be limited to changes to the services requirements, the specified constraints on inputs, and the limits or scope of the project insurances. If the institution wishes to make a change to the project deliverables, it must first submit an institution variation proposal to the private party. The variation proposal must describe the nature of the variation, and require the private party to provide an assessment of the technical, financial, contractual and timetable implications of the proposed change within a specified period. After meeting with the private party to consider its response, the institution must, subject to treasury approval in terms of Treasury Regulation 16.8, decide whether the private party or the institution should put the funding in place to implement the variation. Depending on who provides the funding, payment for the variation should be made by any necessary adjustments to the unitary payment or other forms of payment. Disputes between the parties relating to an institution variation (which does not involve a decrease in the scope of the service or adversely affect the private party's risk profile) must be resolved in accordance with the dispute resolution procedure.

In situations where the institution's requirements for variations can be foreseen to a reasonable degree before the signing of the PPP agreement, the institution should explore the feasibility of requiring the private party to commit to pricing pre-specified variations as part of the PPP agreement. This would provide for an accelerated variation procedure after the PPP agreement has been signed.

Private party variations

If the private party wishes to introduce a variation it must submit a private party variation proposal to the institution, setting out the details of the variation and the likely impact of the variation on the PPP agreement, particularly in relation to unitary charge payments. After meeting with the private party and providing it with an opportunity to modify its variation proposal if necessary, the institution must decide whether to accept it or not. If the institution decides to accept the proposal and has obtained the approval of the relevant treasury in terms of Treasury Regulation 16.8, it will need to make the necessary arrangements for payment depending on the funding regime that has been agreed.

2. PPP agreement maintenance

PPP agreement maintenance involves establishing procedures to ensure that the PPP agreement and related documentation are consistent, up-to-date and accessible to all the relevant parties. It also involves taking action to allow all parties to develop a common view of contractual obligations. One of the key tasks of PPP agreement maintenance is the development and updating of the PPP agreement management manual, which is designed to provide a repository for the PPP agreement itself and all related documents.

3. Financial administration

Effective financial administration involves the development of systems and proced-

ures to make and receive financial payments, and to keep records of financial transactions. In preparing the PPP agreement, the institution should include procedures for: making unitary payments and additional payments to the private party; administering penalty deductions; calculating inflation; dealing with late payments; and receiving reports linked to unitary payments and additional payments.

Planning and implementing PPP agreement administration

In preparing the PPP agreement management plan, give due consideration to PPP agreement administration responsibilities.

The project officer should develop a PPP agreement administration plan, which sets out:

- a summary of the proposed systems and procedures for variation management, PPP agreement maintenance and financial administration
- the roles and responsibilities of the institution and the private party in relation to variation management, PPP agreement maintenance and financial administration
- the plans for the development of the PPP agreement management manual that will be used to provide details of all documents relating to the PPP agreement, and the variation management, PPP agreement maintenance and financial administration procedures
- an estimate of the resources that the institution will devote to variation management, PPP agreement maintenance and financial administration.

After the PPP agreement has been signed, the project officer must ensure that the PPP agreement administration plan is implemented, and that the PPP agreement management team has the resources and expertise necessary to deliver the plan. Particular attention should be devoted to the development and regular updating of the PPP agreement management manual.

As the PPP project comes to an end, as a result of termination or expiry, the project officer will need to undertake a new set of PPP agreement administration responsibilities. He or she will need to make suitable arrangements for: either (i) the hand back of the service to the institution and the delivery of the service by the institution; or (ii) the retendering of the service.

SECTION 7: KEY CHALLENGES AND TASKS OF PPP AGREEMENT MANAGEMENT

Each phase of PPP agreement management presents particular challenges that need to be addressed and tasks to be undertaken. The project officer and the PPP agreement management team should respond to these challenges and carry out or organise these tasks.

Figure 6.8 Key challenges and tasks during the procurement phase

Challenges	<ul style="list-style-type: none"> • Prepare the foundations for PPP agreement management • Assemble the PPP agreement management team and enable them to make inputs to the output specifications • Develop good relations with the winning bidder and involve them in the development of the PPP agreement management plan • Develop the PPP agreement management plan
Partnership management tasks	<ul style="list-style-type: none"> • Assess bidder's attitude towards PPP agreement provisions that relate to partnership working, such as joint governance arrangements and the co-location of staff • Include provisions for partnership management in the PPP agreement • Develop the partnership management plan as part of the PPP agreement management plan • Develop succession plans for the PPP agreement management team as part of the PPP agreement management plan
Service delivery management tasks	<ul style="list-style-type: none"> • Assess bidder's attitude towards PPP agreement provisions that relate to quality, value for money and performance improvement • Encourage bidders to propose innovative solutions to monitoring requirements • Develop the risk matrix as part of the PPP agreement • Develop the risk management plan as part of the PPP agreement management plan • Develop the performance management model as part of the PPP agreement • Develop the performance management plan as part of the PPP agreement management plan
PPP agreement administration tasks	<ul style="list-style-type: none"> • Develop the PPP agreement administration plan as part of the PPP agreement management plan

Figure 6.9 Key challenges and tasks during the development phase

<p>Challenges</p>	<ul style="list-style-type: none"> • Ensure that the takeover of any existing facilities or arrangements takes place as smoothly as possible • Establish systems and allocate resources and responsibilities in accordance with the PPP agreement management plan's strategies and plans • Monitor the development of the facility or service towards the service commencement date from the point of view of both quality and the timetable
<p>Partnership management tasks</p>	<ul style="list-style-type: none"> • Establish partnership management structures in accordance with the PPP agreement management plan • Establish close working relations with the private party, including the co-location of institution and private party PPP agreement management staff if provided for in the PPP agreement • Hire new members of the PPP agreement management team and technical advisors as necessary • Implement assigned roles of the PPP agreement management team • Review institution succession plans and ensure that the private party has succession planning in place for the key PPP agreement management staff • Develop and implement joint partnering courses for both the institution and private party PPP agreement management staff
<p>Service delivery management tasks</p>	<ul style="list-style-type: none"> • Establish risk control procedures and performance management structures in accordance with the PPP agreement management plan • Confirm resources and responsibilities for risk management and performance management • Monitor the private party's progress towards meeting the service commencement date in accordance with the timetables set out in the PPP agreement • Ensure compliance with any residual health and safety issues remaining with the institution • Ensure the integration into any existing operations and/or staff for which the institution maintains responsibility • Obtain a schedule of rates from the private party for small works variations which the institution may ask the private party to carry out • Use the small works variation procedures to address any minor additional capital works required by the institution • Monitor any ongoing construction work and deal with any contractual failures using the appropriate clauses in the PPP agreement • Deal with any compensation and/or relief events in accordance with the provisions of the PPP agreement • Determine whether any new facility is ready for occupation or use by the institution • Assess the effectiveness of the private party's quality assurance processes in relation to design and construction • Carry out building inspections and take action if any defects are uncovered • Monitor compliance with planning regulations • Organise specialised training or placements with commercial organisations for institution staff to enhance commercial awareness in the institution
<p>PPP agreement administration</p>	<ul style="list-style-type: none"> • Establish variation management and PPP agreement maintenance and procedures, and allocate agreed resources and responsibilities • Establish financial administration procedures, and allocate resources and responsibilities • Prepare the PPP agreement manual and update as necessary • Keep records of design and/or construction activities • Ensure that up-to-date job descriptions are available for institution and private party PPP agreement management staff

Figure 6.10: Key challenges and tasks during the delivery phase

Challenges	<ul style="list-style-type: none"> • Review private party performance against the output specifications and take corrective action where necessary • Implement risk control responses as necessary • Organise independent reviews of PPP agreement management arrangements as a whole at least every three years • Review the PPP agreement management plan and revise as necessary every three years • Assess the robustness of the exit strategy and any arrangements for re-letting the PPP agreement contained in the PPP agreement management plan
Partnership management tasks	<ul style="list-style-type: none"> • In consultation with the private party, review and revise as necessary the partnership management system and the relationship between the institution and the private party • Implement succession plans for institution PPP agreement management staff as necessary • Organise training and development programmes for the PPP agreement management team to ensure that their skills are in tune with the evolving requirements of PPP agreement management throughout the life of the project
Service delivery management tasks	<ul style="list-style-type: none"> • Gain assurance about the effectiveness of risk control procedures through upward reporting and internal audit • Implement risk control responses as necessary • Review and revise institution contingency plans as necessary • Embed and review risk management in the PPP agreement management team • If necessary, use the variation procedures to amend the PPP agreement to ensure that there continues to be appropriate risk transfer to the private party • Monitor and review private party performance against the output specifications and take corrective action as necessary • Implement any agreed performance improvement measures in consultation with the private party to enhance value for money, quality and innovation • Ensure that any latent and inherent defects are addressed by the private party in order to keep asset conditions up to the specified standards • Monitor compliance with appropriate regulations including health and safety policies, environmental standards, building and fire regulations and statutory obligations • Monitor the private party quality management system • Establish relations with any end-user representatives and respond to end-user feedback on private party performance • Produce monthly, quarterly and annual performance reports on behalf of the institution, covering workload, performance history, current and projected costs • Report on the management of the PPP agreement in the institution's annual report
PPP agreement administration tasks	<ul style="list-style-type: none"> • Update the PPP agreement management plan as required • Review and revise PPP agreement administration procedures as necessary • Manage variations • Ensure private party insurance and indemnities are maintained in force • Monitor the revenue generated from third parties where appropriate • Inspect the asset register maintained by the private party • Make unitary and additional payments to the private party, administering any penalty deductions or refinancing gains as necessary • Manage any private party requests for refinancing in accordance with the PPP agreement • Ensure the private party's books are audited in accordance with the provisions of the PPP agreement

Figure 6.11: Key challenges and tasks during the exit phase

Challenges	<ul style="list-style-type: none"> Based on the provisions of the PPP agreement, review options for continuing the service after the termination/expiry date and implement the agreed exit strategy
Partnership management tasks	<ul style="list-style-type: none"> Organise closure event to celebrate achievements and prepare PPP agreement management staff and end users for their new role Integrate the lessons of the partnership into the day-to-day work of the institution
Service delivery management tasks	<ul style="list-style-type: none"> Assess key deliverables, value for money, quality and innovation achieved by the project Organise an independent post-implementation review of the project, which should be completed within six months of the expiry/termination date
PPP agreement administration tasks	<ul style="list-style-type: none"> Ensure compliance with the hand-back procedures set out in the PPP agreement, which may involve surveys prior to termination/expiry and set-off of the unitary charge into a retention fund Verify the assessment of the value and fitness for purpose of the assets, as provided for in the PPP agreement In the event of termination, make arrangements for any compensation that might be due to the private party Make arrangements for either: (i) the delivery of the service by the institution after termination/expiry or (ii) retendering the service Deal with any implications of employee transfers from the private party to either the institution or a successor body, including terms and conditions of employment

SECTION 8: THE PPP AGREEMENT MANAGEMENT PLAN AND THE PPP AGREEMENT MANAGEMENT MANUAL

The PPP agreement management plan

The PPP agreement management plan provides one of the key pillars of effective PPP agreement management, and the project officer will need to ensure that adequate time and resources are devoted to its preparation. Preparing the PPP agreement management plan should send a clear message to the institution that while the award of the contract represents the end of the complex and challenging procurement phase, it also heralds the beginning of new phases of the PPP project that require a different level of institutional capability. The preferred bidder should be closely involved in developing the PPP agreement management plan towards the end of the procurement phase, and this should be part of the process of developing good working relations between the two parties.

The main purpose of the PPP agreement management plan is to:

- demonstrate to the relevant treasury the capacity of the institution to effectively enforce the PPP agreement as part of the TA:III process
- provide a strategic management tool to guide the PPP agreement management activities that the institution and the private party will undertake during each stage of the project
- clarify key institution roles and responsibilities during each stage of the project and identify the resources that the institution will require to undertake these responsibilities
- provide information on the PPP agreement management approach and PPP agreement management arrangements, which can be used to assess the performance of the institution in discharging its obligations and responsibilities as set out in the PPP agreement, and required by government legislation such as the PFMA
- provide a vehicle for addressing issues that cannot be dealt with adequately in the PPP agreement (such as attitudes and behaviours).

After the initial PPP agreement management plan has been prepared as part of the TA:III process, it should be reviewed and updated every three years in consultation with the private party, so that it can respond to changing circumstances as the project unfolds. Changes in government policy, industry requirements, environmental standards, technology and end-user expectations could have important implications for the institution's approach to PPP agreement management.

Figure 6.12: Template PPP agreement management plan

Sections	Subsections	Summary of contents
1. Purpose and approach	1.1 Purpose	<ul style="list-style-type: none"> • Purpose of the PPP agreement management plan
	1.2 Approach	<ul style="list-style-type: none"> • Partnership principles • Benefits to the institution and the private party of a successful partnership • The institution's approach to PPP agreement management (see Section 3)
2. Strategic objectives and key deliverables	2.1 Objectives	<ul style="list-style-type: none"> • Summary of project objectives
	2.2 Key deliverables	<ul style="list-style-type: none"> • Summary of the output specifications and key deliverables
3. Partnership management	3.1 Partnership management plan	<ul style="list-style-type: none"> • Partnership management plan (see Section 4)
4. Service delivery management	4.1 Risk management	<ul style="list-style-type: none"> • Risk management plan (see Section 5)
	4.2 Performance management	<ul style="list-style-type: none"> • Performance management plan (see Section 5)
5. PPP agreement administration	5.1 PPP agreement administration	<ul style="list-style-type: none"> • PPP agreement administration plan (see Section 6)
6. Exit strategy	6.1 Exit strategy	<ul style="list-style-type: none"> • Evaluation of the options for continuing the service after termination/expiry based on the provisions of the PPP agreement • Outline of the procedures, roles and responsibilities and resources required for a smooth transition to the new service delivery arrangements (see Section 1)
7. Implementation plan (see Figure 6.13)	7.1 Development phase	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and institution budget
	7.2 Delivery phase	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and institution budget
	7.3 Exit phase	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and institution budget

Figure 6.13: Template implementation plan

Key tasks	Target date	Responsibility	Institution budget
1. Development phase Establish partnership management structure Establish performance monitoring system Arrange staff transfers Survey end-user requirements Other			
2. Delivery phase Conduct quality assurance review Prepare performance report Review and revise the PPP agreement management plan Conduct regular review meetings Other			
3. Exit phase Evaluate exit options Review PPP agreement termination/ expiry conditions Other			

The PPP agreement management manual

The PPP agreement management manual provides another key pillar of effective PPP agreement management, and the project officer and the PPP agreement management team should ensure that adequate time and resources are devoted to its preparation.

The main purpose of the PPP agreement management manual is to provide:

- a repository of PPP agreement management procedures, key stakeholder details and all the important documents relating to the PPP agreement
- a document management tool
- a resource that can be used to train newly-appointed PPP agreement management staff, and orientate technical advisors and end users.

Work on the PPP agreement management manual should begin immediately after the signing of the PPP agreement, and the private party should be involved in its preparation. The different sections of the manual should be updated as necessary so that it provides a consistent, accurate and up-to-date record of PPP agreement management procedures and documents.

The PPP agreement management manual should contain the following documents:

- the PPP agreement
- all schedules contained in the PPP agreement
- all financing agreements
- financial models
- the close-out report
- the PPP agreement management plan
- variation procedures
- the names, roles and contact details of key individuals in: the institution; the private party; third party entities; end-user organisations; and other key stakeholder groups
- all other documents relating to the PPP agreement.

**NATIONAL TREASURY
PPP MANUAL
MODULE 7: AUDITING PPPs**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 08 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 08 of 2004 'Auditing PPPs' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

16.7 *Management of PPP agreements*

16.7.1 *The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved in Treasury Approval: III for –*

- (a) measuring the outputs of the PPP agreement;*
- (b) monitoring the implementation of the PPP agreement and performances under the PPP agreement;*
- (c) liaising with the private party;*
- (d) resolving disputes and differences with the private party;*
- (e) generally overseeing the day-to-day management of the PPP agreement; and*
- (f) reporting on the PPP agreement in the institution's annual report.*

16.7.2 *A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed in the public interest or on behalf of the public service.*

16.7.3 *A PPP agreement involving the use of state property by a private party does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such state property is appropriately protected against forfeiture, theft, loss, wastage and misuse.*



NATIONAL
TREASURY
PPP

unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the
Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

PROJECT TERM

Phase I

INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

Phase II

FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

Phase III

PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP agreement signed

Phase IV

DEVELOPMENT

- Measure outputs, monitor and regulate performance,

Phase V

DELIVERY

- liaise effectively, settle disputes
- Report progress in the Annual Report

Phase VI

EXIT

- Scrutiny by the Auditor-General

Module 1

Module 2

MODULE 3

Module 6

Module 1

Module 2

MODULE 4

Module 6

Module 7

Module 8

Module 9

Module 1

Module 2

Module 4

MODULE 5

Module 6

Module 7

Module 8

Module 9

Module 1

Module 2

Module 5

MODULE 6

Module 7

Module 8

Module 9

ABOUT THIS MODULE

Module 7: Auditing PPPs describes the powers and functions of the Auditor-General, and the scope of financial, performance and forensic audits. It explains how this applies to PPPs, particularly in relation to the management of the PPP agreement. It also outlines the role of the institution's internal audit unit in PPP projects.

The Module has been compiled by National Treasury in co-operation with the Office of the Auditor-General.

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INTRODUCTION

The auditing of PPPs regulated by Treasury Regulation 16 to the PFMA is done in terms of the Public Finance Management Act, 1999 (PFMA) and the Auditor-General Act, 1995, founded on the relevant provisions of the Constitution, 1996.

While a PPP changes the means of delivering services, and the use of state property may change hands, the institution is still accountable for ensuring that services are delivered or that state property is used properly.

Not only is sound financial management required by law, but the accounting officer/authority is required to follow regulations precisely and to be able to account for administrative processes and expenditure. These are fundamental features of good governance, and the institution will be audited accordingly.

THE AUDITOR-GENERAL

The powers and functions of the Auditor-General

The Auditor-General can be regarded as an independent auditor acting on behalf of taxpayers, and auditing and reporting on the activities of all government institutions.

The powers and functions of the Auditor-General are set out in the Constitution of the Republic of South Africa, 1996, the Auditor-General Act, 1995. (See Annexure 1: 'Section 188 of the Constitution of the Republic of South Africa Act, 1996', and Annexure 2: 'Extracts from Section 3 of the Auditor-General Act, 1995'.) Specific auditing procedures and requirements are set out in the PFMA in respect of national and provincial institutions.

The Auditor-General audits all the accounts and regulatory compliance of all accounting officers/authorities of all spheres of government, and of all other persons in the national, provincial or municipal services entrusted with public assets and trust property, and reports the results to Parliament or the relevant provincial legislature.

All these reports must be made public. This is essential for transparency and accountability – the guiding principles of the Office of the Auditor-General.

The Auditor-General must express an opinion on:

- whether or not the financial statements of the institution, in all material respects, fairly present the results of the institution's operations in accordance with the prescribed accounting practice; and
- whether or not any transactions comply with the laws and regulations which apply to financial matters.

The scope of the Auditor-General's audits

The Auditor-General will determine the scope of any audit, but all entail comprehensive auditing, whether they are regularity audits, performance audits, forensic audits or any other audits.

Regularity auditing

Regularity audits are conducted annually for all institutions. These involve both compliance and financial auditing:

- **Compliance auditing**

Compliance auditing is an independent external evaluation of the extent to which an institution complies with any legislation, regulations, policy, control measures, procedures, motivations and authorisations related to financial matters and which apply to the institution. A compliance audit includes an examination, on a test basis, of the evidence supporting compliance.

- **Financial auditing**

Financial auditing is an independent external evaluation of accounting systems and of samples taken from evidence transactions, to form an objective opinion on the following questions:

- Do the institution's financial statements, together with their notes, fairly and materially present the institution's financial position at a particular date, and fairly represent the results of its operations and cash flow for the period, in accordance with the identified reporting framework?
- Are these statements in conformity with generally accepted accounting practice, and do they comply with legal requirements?
- Are all income, expenditure, assets and liabilities recorded and accounted for?
- Are the institution's accounting records accurate, complete, and of high quality?
- Is there sufficient and acceptable documentation for all authorised expenditure?
- Has revenue been collected properly?
- Are sufficient and applicable internal control procedures, which are essential for sound financial management, in place and maintained?

In terms of the PFMA, the Auditor-General must audit the institution's financial statements and submit a report within two months of receiving the statements. Within five months of the end of a financial year, the following are submitted to the relevant treasury:

- the audited financial statements of the institution
- the Auditor-General's report on those statements
- the institution's annual report.

A department or public entity must also submit these to the responsible executive authority. The costs of regularity audits are budgeted for by the institution.

Performance auditing¹

Performance auditing is about management practices and the use of resources. Although these are, to some extent, covered in the annual regularity audit, in addition the Auditor-General conducts performance audits. These may take the form of specific focus reports.

Subsection 3(4)(d) of the Auditor-General Act requires that the Auditor-General should be reasonably satisfied that 'satisfactory management measures have been taken to ensure that resources are procured economically and utilised effectively and efficiently'. The Auditor-General must report to the legislative bodies concerned if the utilisation of resources is uneconomical, inefficient or ineffective, or if the use of resources is not in the best interests of the state or statutory body concerned.

Performance audits can be conducted by the Auditor-General on a cyclical basis should the Auditor-General determine it necessary. The institution itself may also request performance audits.

1. See 'Annexure 2: Extracts from Section 3 of the Auditor-General Act, 1995'.

The cost of a performance audit is borne by the institution or the relevant treasury, as agreed before the audit is carried out.

Forensic auditing

If at any stage during regularity auditing or performance auditing, the Auditor-General suspects that fraud or corruption may have been committed in respect of any aspect of the institution's financial affairs, the Auditor-General may institute a forensic audit. This forensic audit may be conducted by the Office of the Auditor-General itself, or may be outsourced to a private company specialising in such audits. A forensic audit may be instituted by the Auditor-General, or may be requested by the institution.

The cost of forensic auditing is borne by the institution concerned.

How does this apply to PPPs?

Providing information as required by the law

Treasury Regulation 16.7 explicitly requires that **the institution's accounting officer/authority reports on the management of the PPP agreement in the institution's annual report.**² The scope of this report is prescribed by the PFMA – specifically section 40 for accounting officers, and section 55 for accounting authorities – and it is audited by the Auditor-General.

In auditing the annual report of the institution, the Auditor-General will review the information presented to ensure that it is not inconsistent or does not contradict the information in the audited financial statements.

Institutions must ensure that the PPP agreement contains adequate provisions for allowing the institution access to all necessary information about the PPP which is in the private party's hands. A standard clause for this purpose is provided in *Standardised PPP Provisions* Part P:75 and should be applied accordingly.

The standard clause is provided because a private party to a PPP agreement must be under an ongoing obligation to disclose to the institution all the information that the institution may reasonably require for it to fulfil its financial reporting obligations. This must extend, for example, to providing for the institution's disclosure obligations under other legislation, such as the Promotion of Access to Information Act, 2000 and legislation governing health and safety and the environment.

In devising the necessary reporting arrangements in a PPP agreement, institutions should note that, in terms of the Auditor-General Act, the Auditor-General has the discretion to:

- determine the nature and extent of any audit carried out by it (s3.3)
- investigate whether any property or any other assets of an institution, including any institution assets, are being used efficiently and effectively (s5(b)(ii))

². See *Module 6: Managing the PPP Agreement*.

- investigate any matter relating to expenditure on the part of the institution (s5(b)(ii))
- publish details of the use of the assets or resources of an institution and of its expenditure which the Auditor-General determines is uneconomical, inefficient, ineffective or detrimental, including commenting on and publishing any issues that arise in relation to performance.

In addition to the reporting obligations in respect of the PPP agreement itself, the institution must meticulously keep records of all processes and decisions and expenditures in respect of the inception, feasibility and procurement phases of the PPP project cycle for audit purposes.

The compliance audit component of the regularity audit

As part of the regularity audit of an institution, the Auditor-General will determine whether the institution (the auditee) is involved in any PPP projects. Once a PPP project is identified, specific compliance auditing begins, and the Auditor-General will seek to verify whether or not the requirements of the PFMA and Treasury Regulation 16 have been met. Existing PPP agreements with private parties as well as future contemplated PPP agreements will be evaluated against the characteristics of PPP agreements defined by Treasury Regulation 16.

The audit procedures will be determined by the phase at which the project is in the PPP project cycle.

Registration of the project with the relevant treasury, appointment of the project officer and transaction advisor (Phase 1: Inception)³

The Auditor-General will establish whether or not the project was registered as prescribed, and whether or not a suitable project officer and transaction advisor (the latter if required by the relevant treasury) have been appointed by the institution.

Treasury approvals⁴

The Auditor-General needs to be satisfied that the relevant treasury has granted the written approvals which apply to the various stages of the PPP project cycle as prescribed by Treasury Regulation 16:

- Were formal Treasury approvals I, IIA, IIB and III obtained from the relevant treasury (Treasury Regulation 16.4, 16.5, 16.6)?
- If any of these approvals was granted conditionally, have all the conditions been complied with to the satisfaction of the relevant treasury?
- Were any other approvals necessary in terms of Treasury Regulation 16 prior to Treasury Approval: III, specifically relating to any changes to the feasibility study assumptions (Treasury Regulation 16.4.4)?

3. See *Module 3: PPP Inception* for details on the appointment of the project officer and the transaction advisor.

4. See *Module 4: PPP Feasibility* for detailed information on TA:I and *Module 5: PPP Procurement* for TA:II and TA:III.

- Has the accounting officer/authority established mechanisms and procedures for properly managing a PPP agreement (Treasury Regulation 16.7)?
- Has any material amendment or variation to a PPP agreement obtained the necessary treasury approval (Treasury Regulation 16.8)?

The financial audit component of the regularity audit

According to the specimen annual financial statements issued by National Treasury for provincial and national departments, the institution is required to include in the 'Notes to the annual financial statements', for each PPP the institution has entered into, the following information:

- a description of the project
- significant terms of the PPP agreement that may affect the amount, timing and certainty of future cash flows
- the nature and extent of:
 - rights to use specified assets
 - obligations to provide or rights to expect the provision of services
 - obligations to acquire or build items of property, plant and equipment
 - obligations to deliver or rights to receive specified assets at the end of the concession period
 - renewal and termination options
 - other rights and obligations (for example major overhauls)
- changes in the terms of the PPP agreement that may occur during the period of reporting.

Is the note correct?

Given that the Auditor-General needs to express an audit opinion on the 'Notes to the annual financial statements', the note on PPPs will be subjected to the normal audit process. To determine whether the note is correct in all material respects, supporting information and evidence will need to be obtained from the accounting officer/authority. The accounting officer/authority is therefore required to keep all documentation related to PPP agreements, including information from all stages of the PPP project cycle and all project information and supporting documentation that will have an impact on the financial statements.

What is the financial impact on the institution of the PPP agreement?

The Auditor-General will also consider the financial impact of the PPP agreement. The Auditor-General will therefore have to get an overall understanding of the agreement, specifically those conditions with a financial impact, to be able to evaluate both the accounting treatment applied, and the institution's compliance with the specific requirements of the PPP agreement.

Should the institution account for any project assets or resources?

From the specific PPP agreement, the Auditor-General will consider whether the institution should account for any project assets or resources. The accounting

treatment of these items needs to be in accordance with the institution's accounting policy and the directives of the Accountant-General.⁵

Performance audits

The Auditor-General may conduct performance audits on any aspect of a PPP – for example, of the appropriateness of the feasibility study – and the accounting officer/authority will be required to provide all the relevant supporting documentation. Another example is that the Auditor-General may conduct a performance audit after the PPP agreement has been signed and operations have begun to evaluate the long-term affordability of the PPP or to determine whether it provides value for money by measuring the actual outputs against those specified in the PPP agreement.

Forensic audits

The Auditor-General may conduct a full forensic audit on any aspect of a PPP if fraud or corruption is suspected. For example, a forensic audit will be conducted into any or every aspect of the PPP procurement process if foul play is suspected. This would include an audit of all procurement procedures followed, by detailed examination of documents, and by interviews with all relevant participants. Criminal and/or disciplinary procedures would follow against relevant parties if the Auditor-General reported findings indicating fraud or corruption. As with all reports of the Auditor General, the forensic audit report would be made public.

The Auditor-General's report

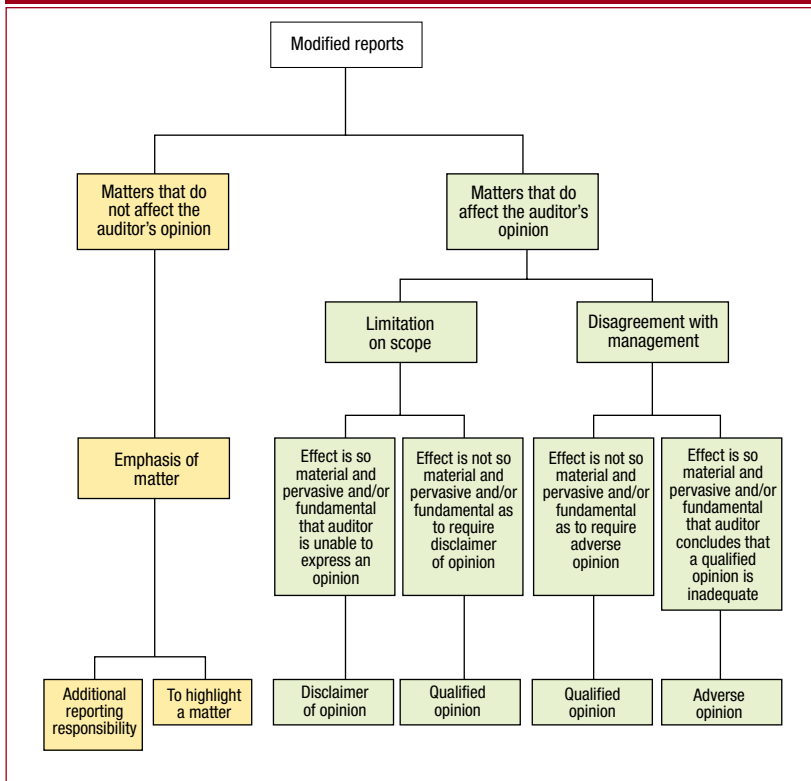
The Auditor-General's report on an institution is submitted to Parliament or the relevant legislature with the institution's (the auditee's) financial statements and annual report. The Auditor-General may issue a report either as:

- An unqualified report on the institution; or
- A modified report (which may contain either a qualification, adverse opinion, or a disclaimer of opinion).

The options for modified reports issued by the Office of the Auditor-General are illustrated here.

5. See *Module 8: Accounting Treatment for PPPs*.

Figure 7.1 Formats of modified reports issued by the Office of the Auditor-General



Special audit reports, such as performance audits and forensic audits, are not included in the institution's annual report to Parliament or to the relevant legislature, but a reference to the existence of such special audit reports is made in the annual report. Special audit reports are summarised in the portfolio summary of the General Report of the Auditor-General and are available to the public.

INTERNAL AUDIT

Internal auditing can be defined as the independent review function within the institution.

The objective of the internal audit function is to assist the executive and management of an institution by providing them with information and advice. An institution's internal audit unit is responsible for this function.

Treasury Regulation 3 to the PFMA sets out the requirements for establishing an audit committee and the roles and functions of the internal audit unit. The purpose, authority and responsibility of this audit committee must be formally defined in an institution's audit charter. The regulation provides that the internal audit unit may be partly or wholly contracted to an external organisation with specialist audit expertise.

Scope of internal audit

The scope of the internal audit function is broadly defined as:

- **Risk management:** The internal audit unit identifies, evaluates and assesses significant risk management methodologies and controls, including a fraud prevention plan.
- **Internal controls:** The internal audit unit provides an independent evaluation of the adequacy of internal controls to determine their effectiveness and efficiency, and develops new controls and provides recommendations for improving the existing controls. The controls should encompass the information systems environment, the reliability of financial and operational information, the effectiveness of operations, the safeguarding of assets, and compliance with laws, regulations and controls.
- **Governance:** The internal audit unit evaluates and develops systems for improving the process through which objectives and values are established and communicated, the accomplishment of objectives is monitored, accountability is ensured, and corporate values are preserved.

Internal audit plans are required by Treasury Regulation 3 to comprise:

- **a rolling three-year strategic internal audit plan**, based on the unit's assessment of key areas of risk for the institution, and bearing in mind the institution's current operations, those proposed in its strategic plan, and its risk management strategy
- **an annual internal audit plan** for the first year of the rolling three-year strategic internal audit plan
- **plans indicating the proposed scope of each audit** in the annual internal audit plan
- **a quarterly report to the audit committee** detailing the unit's performance against the annual internal audit plan, to allow effective monitoring and possible intervention.

The responsibility for the adequacy and reliability of internal controls rests entirely with the management of the institution – the accounting officer/authority in terms of s38(1) and s51(1) respectively of the PFMA. The internal audit unit thus reports directly to the accounting officer/authority.

Effective communication between the internal audit unit and the Office of the Auditor-General is necessary to attain optimal audit coverage. As part of its work, the Auditor-General will consider the activities of the internal audit and its effect on external audit procedures. An effective internal audit unit may prompt the Auditor-General to follow a ‘control test’ approach rather than a substantive route to its regularity and performance audits.

The role of internal audit in PPPs

From the date a PPP is registered with the relevant treasury, the internal audit unit should include the PPP in its audit plans and reports, and should present these for approval to the audit committee. The internal audit unit will need to develop a specific and appropriate approach for reviewing a PPP under each of its areas of responsibility.

In terms of these audit plans, the PPP project officer should be required to ensure that the PPP’s document management and decision-making system is in keeping with the risk management, internal controls and governance standards set by the internal audit unit and endorsed by the audit committee. The project officer and the project secretariat should be required to maintain these standards throughout the PPP project cycle, from inception phase, through the feasibility and procurement phases, and throughout the term of the PPP agreement.

Due to their size and complexity, PPPs are at risk of being affected by some corrupt activity, or at least by the harmful perception that corrupt activity is occurring. The accounting officer/accounting authority is therefore advised by National Treasury to sign off on an anti-corruption policy for a PPP project, with clear requirements and processes for calling for forensic audits if fraud or corruption are suspected, and for dealing swiftly with any corrupt activities by project team members or bidders.

In particular, the PPP procurement plan and the bid process must have built-in safeguards of disclosure, a code of conduct⁶, and structured oversight – specifically, the oversight of at least the internal audit component, and on larger projects, the oversight of an external auditor as well.

6. See *Module 5: PPP Procurement: ‘Annexure 2: Template code of conduct for bid evaluation panel members’ and ‘Annexure 3: Template declaration of interest statement’.*

ANNEXURES

ANNEXURE 1

Section 188 of the Constitution of the Republic of
South Africa, 1996

12

ANNEXURE 2

Extracts from Section 3 of the Auditor-General Act, 1995

13

SECTION 188 OF THE CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA, 1996

- (1) *The Auditor-General must audit and report on the accounts, financial statements and financial management of*
 - (a) *all national and provincial state departments and administrations,*
 - (b) *all municipalities; and*
 - (c) *any other institution or accounting entity required by national or provincial legislation to be audited by the Auditor-General.*
- (2) *In addition to the duties prescribed above, and subject to any legislation, the Auditor-General may audit and report on the accounts, financial statements and financial management of –*
 - (a) *any institution funded from the National Revenue Fund or a Provincial Revenue Fund or by a municipality; or*
 - (b) *any institution that is authorised in terms of any law to receive money for a public purpose.*
- (3) *The Auditor-General must submit audit reports to any legislature that has a direct interest in the audit, and to any other authority prescribed by national legislation. All reports must be made public.*
- (4) *The Auditor-General has the additional powers and functions prescribed by national legislation.*

EXTRACTS FROM SECTION 3 OF THE AUDITOR-GENERAL ACT, 1995

3. Functions of the Auditor-General

- (1) *The Auditor-General shall, in addition to the powers and functions conferred upon or entrusted to him or her in terms of section 193 of the Constitution, have the powers and perform the duties specified in the Act.*
- (2) *Notwithstanding the provisions of any other law but subject to the provisions of the Constitution, the Auditor-General shall perform the functions vested in him or her by virtue of any other law, in accordance with the provisions of the Auditor-General Act in relation to –*
 - (a) *the accounts which shall be audited;*
 - (b) *the procedure according to which auditing shall be done; and*
 - (c) *the steps to be taken by the Auditor-General as a result of an audit.*
- (3) *The Auditor-General may at his or her discretion determine the nature and extent of the audit to be carried out and request the details and statements of account which he or she considers necessary, provided that he or she may, notwithstanding the provisions of any other law, also determine the format in which and the date on which such details, statements of account and financial statements shall be submitted to him or her.*
- (4) *The Auditor-General shall reasonably satisfy himself or herself that:*
 - (a) *reasonable precautions have been taken to safeguard the proper collection of money to which an audit in terms of this Act relates, and that the laws and instructions relating thereto have been duly observed;*
 - (b) *reasonable precautions have been taken in connection with the receipt, custody and issue of, and accounting for, property, money, stamps, securities, equipment, stores, trust money, trust property and other assets;*
 - (c) *receipts, payments and other transactions are made in accordance with the applicable laws and instructions and are supported by adequate vouchers; and*
 - (d) *satisfactory management measures have been taken to ensure that resources are procured economically and utilised efficiently and effectively.*

**NATIONAL TREASURY
PPP MANUAL
MODULE 8: ACCOUNTING TREATMENT FOR PPPs**

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 09 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 09 of 2004 'Accounting Treatment for PPPs' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

**NATIONAL TREASURY
PPP MANUAL**

MODULE 9: INTRODUCTION TO PROJECT FINANCE

**NATIONAL TREASURY PPP PRACTICE NOTE
NUMBER 10 OF 2004**

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 10 of 2004 'Introduction to Project Finance' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.