A Guide to Preparing and Procuring a PPP Project

Public-Private Partnerships in the Western Balkans

2018

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Abbreviations

BH	Bosnia and Herzegovina
CAPEX	Capital Expenditures
ECBA	European cost-benefit analysis
EIA	Environmental impact assessment
EIB	European Investment Bank
EoI	Expression of Interest
EPEC	European PPP Expertise Centre
ESIA	Environmental and social impact assessment
EU	European Union
FYROM	Former Yugoslav Republic of Macedonia
ICT	Information and Communications Technology
NFB	Non-financial benefits
NPV	Net present value
OB	Optimism bias
OPEX	Operating expenditures
PPP	Public-private partnership
PSB	Public sector benchmark
PSC	Public sector comparator
ROE	Return on equity
SA	Suitability analysis
SIA	Social impact assessment
SLA	Service level agreement
SPV	Special purpose vehicle
TIP	Traditional Infrastructure Procurement
UK	United Kingdom
VFM	Value for Money
WBIF	Western Balkans Investment Framework

Background Note

This Guide has been prepared by the European PPP Expertise Centre (EPEC) of the European Investment Bank as part of its mandate from the Western Balkan Investment Framework (WBIF) for *Strengthening the Capacity of the Public Sector to Undertake PPPs in the Western Balkans* (Albania, Bosnia Herzegovina, FYROM, Kosovo*, Montenegro and Serbia).

This Guide to Preparing and Procuring a PPP project belongs to a series of EPEC guidance documents that aim to strengthen the capacity of the governments in the Western Balkans (the Region) to prepare and procure PPPs (Figure 1).

Additional guidance has been produced alongside this Guide as part of the WBIF EPEC assignment, namely:

- **A Guide to the Qualitative and Quantitative Assessment of Value for Money in PPPs**

  This document consists of three parts. Part 1 provides an introduction to VfM with an overview of the main objectives of VfM assessment. Part 2 focuses on qualitative VfM assessment, illustrating evidence based approaches to examining the suitability of the PPP framework in respect of given project characteristics. Part 3 presents quantitative VfM assessment, providing guidance on quantitative approaches to comparative VfM assessment, including the use of a public sector comparator (PSC).

- **PPP Procurement Handbook**

  This document describes in more detail the steps that are normally followed during the procurement phase and, more particularly, the features that would typically be included in the pre-qualification information document and tender invitation document by the public authority.

- **A Guide to the Main Provisions of an Availability-based PPP contract**

  This document provides guidance on good practice to be adopted by public authorities when considering the main provisions of an availability-based PPP contract. Whilst not specific to any sector, the guidance document considers the context of the PPP market in the region and the legislative environment of the Western Balkans countries.

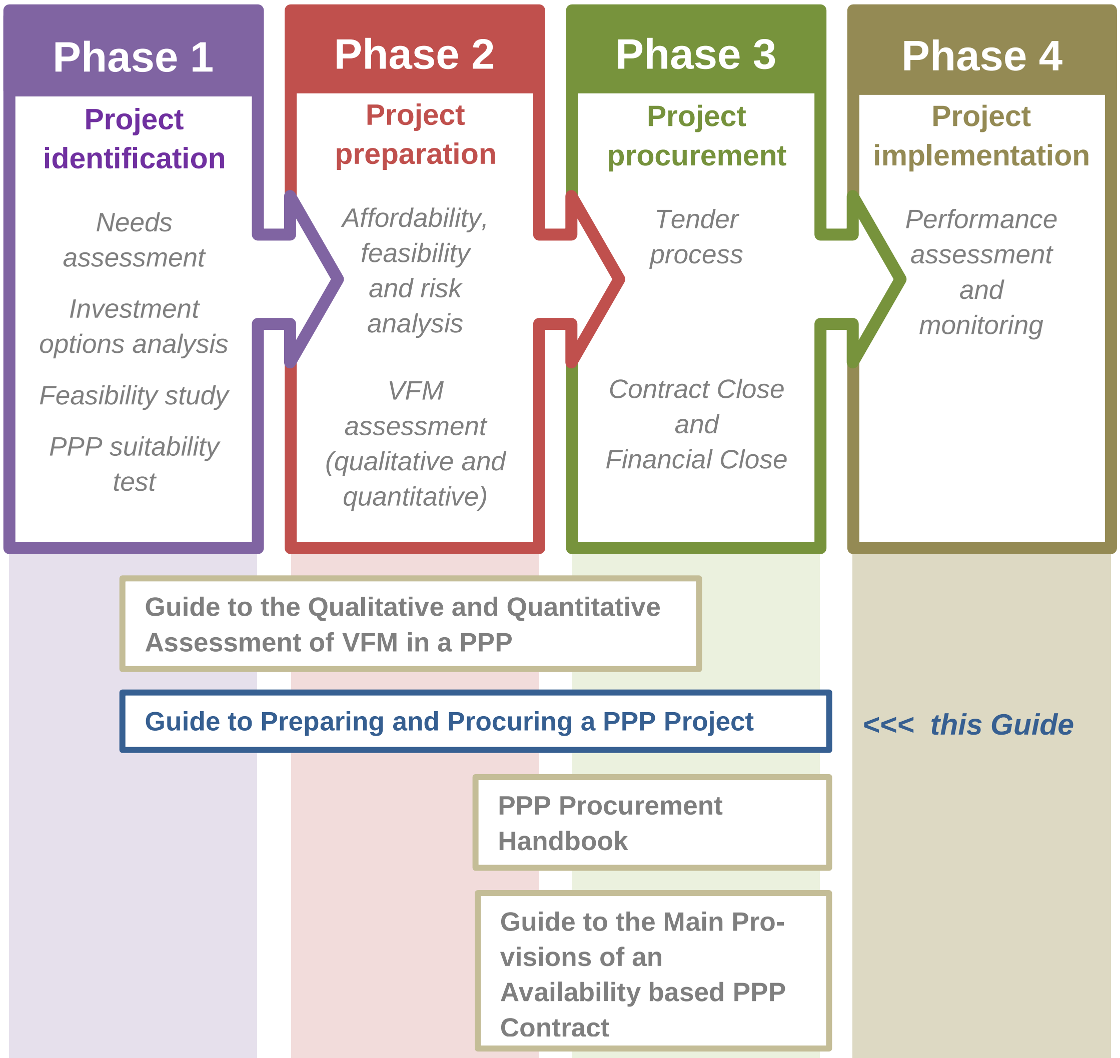
Figure 1 shows the use of the various guidance documents that have been prepared under this WBIF EPEC assignment to assist public authorities in each of the phases of a PPP project cycle.

To assist the PPP practitioner, this Guide also provides details of other sources of information and guidance relevant to the subject, where individual issues and PPP practices can be studied in greater depth.

* This designation is without prejudice to positions on status and is in line with the *United Nations Security Council Resolution 1244/99* and the *International Court of Justice Opinion* on the Kosovo declaration of independence.

In particular, this Guide makes frequent reference to the EPEC Project Preparation Status Tool (PPST or Tool). The PPST aims to assess the preparation status of a given PPP project by reference to a typical good-practice PPP project development process up to the point of determining if the project is ready for the launch of the public procurement process. The Tool assesses the preparation status of the PPP project and highlights potential gaps in its preparation.

Figure 1 - EPEC WBIF guidance documents facilitating PPP implementation



1. Introduction

Investment in social and economic infrastructure is crucial to accelerating sustainable, balanced economic growth and inclusive social development in Western Balkan countries. In the face of budgetary constraints, and with the expectation of benefitting from substantial efficiency gains through the participation of the private sector, governments in the Region are turning increasingly to public-private partnerships (PPPs) as one way to accelerate infrastructure investment, access private financing and improve service delivery.

1.1 Introduction to public-private partnerships (PPPs)

The term PPP describes a long-term contractual arrangement in which a public authority and private partner collaborate in delivering public infrastructure assets and related services. The public authority makes performance-based payments to the private partner linked to the availability and/or use of the asset and the provision of the services. Alternatively, the authority grants the private partner the right to generate revenues from the provision of the services (e.g. tolls from users of a bridge). Under this contract, the private partner bears significant risks and management responsibilities.

The types of PPP contract that are most often used are for projects that either have an availability-based payment arrangement (sometimes called a *government-pay* PPP) or rely on end user payments (i.e. *a concession*, such as a toll road), or involve both these payment types in a combined form (i.e. a *mixed* payment PPP).

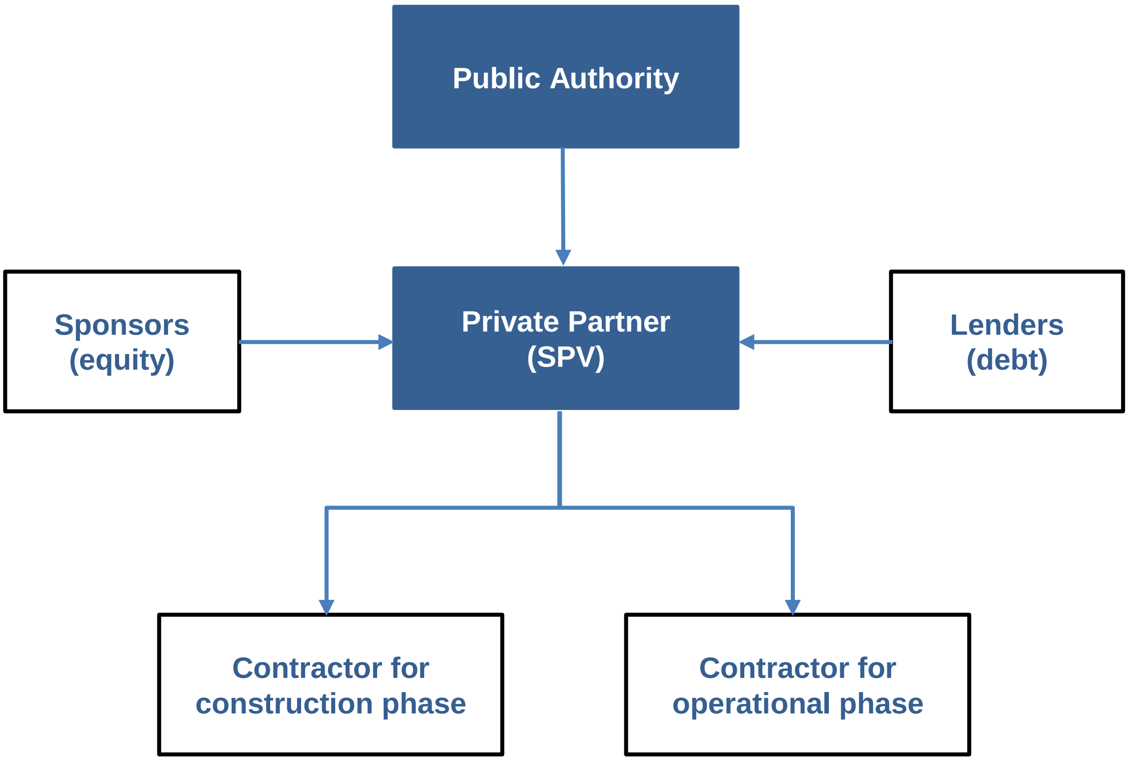
The common features of a PPP contract are listed in Box 1 below and the typical structure of a PPP is described in Figure 2.

Box 1 – Common features of a PPP

- *a long-term contract between a public authority (the **public authority**) and a private sector company (the **private partner**, usually established as a special purpose vehicle or **SPV**) set up to deliver the project and a public service;*
- *a focus on the specification of project service outputs rather than project inputs, taking account of the whole-life requirements of the project;*
- *the transfer of project risks to the private partner, notably with regard to designing, building, operating and/or financing the project;*
- *the use of private financing (most often project finance) from a lender to underpin the risks transferred to the private partner;*
- *the remuneration of the private partner either by service payments from the end users (in user-pay projects or concessions) or through payments from the public authority (availability-based projects) or a combination of both;*

- *in an availability-based PPP, the use of a systematic means of making financial deductions from the service payment to ensure the delivery of the service to the agreed quality and quantity.*

Figure 2 – Typical structure of a PPP project



The primary motivation to use a PPP procurement approach in the delivery of a project is to achieve an outcome that represents good *value for money* (or *VfM*). Common motivations for using a PPP approach to delivering a project – and getting VfM – are listed in Box 2 below.

A public authority should be able to identify its primary motivations from this list if it is to be satisfied that there is a strong, positive rationale for procuring a project as a PPP. (See the Qualitative VfM assessment checklist in *Guide to qualitative and quantitative assessment of Value for Money,* Section 5.2).

Box 2 – Common motivations for using PPP to deliver projects for VfM

- *Better long-term maintenance of assets*
- *Better quality and consistency of service delivery*
- *Better long-term management of risks*
- *Reduced interface risks through integration of design, construction and service delivery obligations*
- *Greater visibility and certainty of whole-life costs*
- *Greater certainty of on-time delivery of assets within the budget*

- *Opportunity for private sector innovation in design, construction and service delivery solutions*
- *Access to skills from the private sector that are not available in the public sector*
- *Opportunity for the public sector to focus on its core public service activities*
- *Access to third party (e.g. financier) scrutiny of project delivery proposals;*
- *Reform of current public sector practices (e.g. in procurement, project management, asset management)*
- *Mobilising private sector capital to enable additional and /or earlier service delivery*
- *More effective revenue generation through improved asset utilisation*
- *Matching of long-term benefits of infrastructure to long-term funding*

Reference guidance document

PPP Motivations and Challenges for the Public Sector, EPEC (2015)

Hurdles to PPP investments, EPEC (2016)

1.2 The PPP Project cycle

This guidance is framed in the context of the *PPP project cycle*. The project cycle is the series of steps that is followed by a typical PPP project from the time that the project scope is initially defined, through to its completion and delivery of the related services. The project cycle is divided into four phases, with each phase divided into two stages:

- **Phase 1: Project identification**
  - Project identification and selection
  - Appraise the suitability of a project as a PPP
- **Phase 2: Project preparation**
  - Managing and planning the process
  - Developing the PPP project
- **Phase 3: Project procurement**
  - The tendering process
  - PPP contract close and financial close
- **Phase 4: Project implementation**
  - Contract management
  - Ex post evaluation

Figure 3 sets out each of the four phases and the stages within each phase, together with a summary of the main activities that are performed.

Figure 3 – Phases in the PPP Project Cycle

Phase 1	**Project identification**	
Stage	Step	Activity
1. Project identification and selection	Needs Assessment	- *Conduct needs assessment*
	Investment option analysis	- *Collect data and information on the objectives and scope of the project* - *Determine appropriate investment options*
	Feasibility studies	- *Assess the technical, financial and economic feasibility of the project concept (e.g. Cost Benefit Analysis)* - *Conduct an economic viability analysis (e.g. a cost effectiveness analysis)*
	Initial assessments	- *Affordability* - *Risk allocation* - *Accounting treatment* - *Bankability*
2. Appraise suitability of project as a PPP	PPP suitability appraisal and initial qualitative VfM assessment	- *Assess a project's suitability for procurement through a PPP by examining project characteristics and framework conditions*

Phase 2	**Project preparation**	
Stage	Step	Activity
1. Managing and planning the process	Set up project team and governance structure	- *Set up the project management team* - *Define the PPP project governance structure*
	Engage team of transaction advisers	- *Identify the expertise needs of the public authority team; then* - *Select the advisers to cover these needs*
	Develop project plan and timetable	- *Identify the project activities and the critical path* - *Develop a detailed project plan and timetable*
2. Developing the PPP project	Project appraisal process	- *Feasibility studies: scoping and structuring the project* - *Affordability assessment* - *Value for Money assessment* - *Risk analysis and allocation* - *Finance-ability and bankability assessment* - *Market assessment*
	Statistical classification of contract	- *Introduction to statistical approaches*

Phase 3	**Project procurement**	
Stage	Step	Activity
1. Tendering Process	Procurement notice, invitation to pre-qualify and shortlisting of candidates	- *Issue a public procurement notice or contract notice* - *Send an information document and invitation to pre-qualify to parties who express interest in tendering* - *Shortlist the candidates who meet the pre-qualification criteria*
	Invitation to tender	- *Send tender invitation documents to the shortlisted candidates including proposed draft PPP contract*

	Interaction with tenderers	- *Hold one or more meetings with each tenderer to develop potential tendering solutions* - *Provide any necessary clarifications to tenderers and update tender documents/draft PPP contract* - *Invite final tenders*
	Evaluation of tenders and identification of the preferred tenderer	- *Evaluate compliant tenders using the pre-published evaluation criteria* - *First-ranked tender selected as preferred or successful tender*
2. PPP contract and financial close	Finalise PPP contract	- *Finalise the PPP contract details with the preferred/successful tenderer* - *Make any agreed non-material changes to the tender PPP contract*
	Conclude financing agreements	- *Lenders to the preferred/successful tenderer carry out their due diligence checks and confirm financing terms* - *With the preferred/successful tenderer, finalise the terms of the financing/ancillary agreements with the lenders*
	Contract award and financial close	- *Issue notice to unsuccessful tenderers of intention to award the contract (standstill period)* - *[Assuming no legal challenge] the PPP contract is signed (contract close) along with all related agreements and financing agreement (financial close)* - *All parties satisfy any remaining conditions precedent necessary to make the PPP contract effective*

Phase 4	**Project Implementation**
Stage	Step
1. Contract management	Attribute management responsibilities
	Monitor and manage project delivery and service outputs Manage changes permitted in the PPP contract
	Manage changes not provided for in the PPP contract
	Dispute resolution
	Arrangements for when the PPP contract ends (*handback*)
2. *Ex post* evaluation	Develop institutional framework
	Develop analytical framework

1.3 A guide to preparing and procuring PPPs

This Guide presents current good practice from the European PPP market that is relevant to the public officials in the Western Balkans Region who are responsible for launching and implementing PPP projects. It aims to provide a framework for making the many decisions that are required by a public authority when it is preparing and procuring a PPP project.

The Guide presents the key issues to be considered when performing the various activities within Phases 1, 2 and 3 of the project cycle:

Phase 1: Project identification is addressed in **Section 2**.

Stage 1 of this phase covers such issues the assessment of the need for the project (including its objectives), an analysis of different investment options, feasibility studies, and, where a PPP option is being considered an initial assessment of issues such affordability, risk allocation and bankability.

In Stage 2 a PPP suitability appraisal and initial qualitative VfM assessment is undertaken.

Phase 2: Project preparation is addressed in **Section 3**.

During Stage 1 of this phase of the project, the public authority would typically establish its project team and governance structures for decision-making and approvals. It would also engage a team of transaction advisers (legal, financial and technical) and develop project plan and timetable for delivery.

In Stage 2, the project appraisal process that began in Phase 1 continues in more detail to verify the assumptions and conclusions made. If appropriate an initial assessment of the likely statistical classification of a PPP contract might be made.

Phase 3: Project procurement is addressed in **Section 4**

This phase includes the normal activities of a public tender (pre-qualification of candidates and selection of a preferred tenderer in Stage 1) with the added features of a PPP procurement, including (in Stage 2) the Contract Close and Financial Close processes.

While this guide has been prepared for public authorities in the Western Balkans, it must be noted that:

- the legal and institutional framework in each country must be taken into account when designing a PPP arrangement, including in the PPP appraisal and procurement processes;

- the content of the guide cannot replace the need for specialist PPP transaction advisers. The guide should, however, assist public authorities in having a more productive dialogue with their transaction advisers.

2. Phase 1- Project identification

This section provides a brief summary of the main issues of the project identification phase, which takes place before the preparation and procurement phases.

The project identification phase is the first, critical phase during which the public authority determines whether the selected project is:

- **technically, financially and economically feasible** (Stage 1); and
- **suitable for procurement** through a PPP (Stage 2). This stage often includes making an assessment to determine whether a PPP is likely to deliver better VfM than a traditional procurement approach.

Figure 4 – Project identification phase

Phase 1	Project Identification	
Stage	Step	Activity
1. Project identification and selection	Needs assessment	- *Conduct needs assessment*
	Investment option analysis	- *Collect data and information on the objectives and scope of the project* - *Determine appropriate investment options*
	Feasibility studies	- *Assess the technical, financial and economic feasibility of the project concept (e.g. Cost Benefit Analysis)* - *Conduct an economic viability analysis (e.g. a cost effectiveness analysis)*
	Initial assessments	- *Affordability* - *Risk allocation* - *Accounting treatment* - *Bankability*
2. Appraise suitability of project as a PPP	PPP suitability appraisal and initial qualitative VfM assessment	- *Assess a project's suitability for procurement through a PPP by examining project characteristics and framework conditions* - *Initial qualitative VfM assessment*

Stage 1 – Project identification and selection

2.1 Planning and prioritising investment in public infrastructure

A rigorous process of planning and prioritising public infrastructure investment is important to achieve VfM in infrastructure delivery. Prioritisation ensures that limited public authority capacities and budget resources are not used for planning less important projects. Projects are typically selected from a "long list" of projects that are part of a national (or, in some cases, sub-national) *infrastructure investment plan*.

National or regional *infrastructure investment plans* are one way to identify such needs and priorities. They are generally prepared periodically (e.g. every three or five years) to address future investment needs either at sector level (e.g. a National Transport Plan) or across sectors. These investments may consider investment in new public infrastructure and in the repair and replacement or upgrading of existing infrastructure based on forecasts of new or changed demands for services. These plans comprise a list of proposed projects, some or all of which may be suitable for delivery using a PPP.

The exercise of preparing an infrastructure investment plan should be conducted in a transparent manner. It involves discussions between many stakeholders, including government departments and/or line ministries, government agencies (e.g. national road agencies), sub-national authorities (regions, provinces, cities), the private sector and civil society. As infrastructure investments can generate controversy, it is important to consult widely with relevant stakeholders in order to generate consensus.

Based on preliminary studies and an analysis of needs and constraints, an infrastructure plan will identify a list of priority projects that warrant further assessment and development. However, it would not – at this stage in the planning process – state how such projects are to be implemented (e.g. use of a traditional procurement method or a PPP).

Reference guidance document

For more detailed questions on selecting and defining the investment see: *Project Preparation Status Tool,* EPEC (2014)

2.2 Needs assessment

Infrastructure investment policies generate important economic and social impacts. While inadequate infrastructure and insufficient provision of public services constrain economic growth and social progress, sound infrastructure investment initiatives can greatly improve people lives and stimulate business.

A *needs assessment* should assess the social and economic need for the project by following a recognised systematic approach and be based on sound and relevant data.

Typically, the need for infrastructure investment arises from circumstances such as:

- **insufficient capacity of existing infrastructure** to cope with growing demand for services (e.g. a congested road network; insufficient availability of healthcare services evidenced by long waiting lists, etc.);
- **technical obsolescence of existing infrastructure** (e.g. in national communications systems for emergency services or in the control systems for important transport infrastructure, such as railway signalling);
- existing infrastructure that **no longer complies with regulatory and/or environmental standards** (e.g. emissions from coal-fired power plants or inadequate solid waste management practices);
- a need to **replace damaged or dilapidated infrastructure** as a result of a natural disaster, poor maintenance or other destructive forces.

The outcome of a needs assessment should be the validation of the existence of an objective need for undertaking a specific investment. It identifies the gap between an agreed set of objectives and existing arrangements that the investment aims to address.

It is important to clarify that a needs analysis does not lead to the choice of the procurement approach and should not be influenced by whether the project will be delivered using a conventional or a PPP approach.

2.3 Economic Cost-Benefit Analysis (ECBA)

The *economic cost-benefit analysis* (ECBA) will assess whether the benefits brought to society by a particular public investment justify and outweigh the total costs of implementing it.

In addition to the actual monetary costs and revenues generated by the project, the ECBA should consider the social, environmental, and economic advantages and disadvantages of the investment. For example, in a transport project, the benefits that can be monetised may include estimated values for savings in travel time, enhancement in safety, reduction in pollution, lower accidents a decrease in infrastructure maintenance costs.

The main result of the ECBA is an estimation of the *economic net present value* (ENPV) of the investment, expressed as the difference between the net aggregate economic advantages (i.e. benefits) and net aggregate economic disadvantages (i.e. costs) of the project over its lifetime. These are discounted at an appropriate discount rate (normally set by government) that reflects the public perspective in making the infrastructure investment decision.

The two methodologies most commonly used for setting the discount rate are:

- the **financial perspective** (the most widely used): the discount rate is based on the average cost of borrowing for the government, measured as the yield of sovereign bonds for comparable tenors. The discount rate is liable to change over time to reflect movement in the capital markets; and

- the **socio-economic perspective**: the discount rate is determined by the government on the basis of economically-derived assumptions applied consistently across all projects. The socio-economic discount rate is normally only modified infrequently to reflect macro changes in the underlying assumptions.

In all circumstances, whatever the basis of the discount rate, only projects with a positive ENPV should be undertaken.

Reference guidance documents

Guide to Cost-Benefit Analysis of Investment Projects: Economic appraisal tool for Cohesion Policy 2014-2020, European Commission (2014)

2.4 Investment options analysis

The *investment options analysis* identifies and assesses the range of possible technical, legal and financial options for delivering a specific public infrastructure service to the required output specifications. It allows the public authority to compare alternative investments and to choose the best option for responding to a specified service need.

The typical steps of an investment options analysis include:

- the identification of all the available investment options (which may include doing nothing);
- a preliminary analysis of the financial impacts of each option considered;
- a comparative ECBA of each option considered; and
- a *preliminary affordability assessment* (see Section 3.4 for additional information).

It should be observed that the various investment options considered, while satisfying certain minimum requirements, do not necessarily have the same cost implications and are therefore unlikely to be equivalent in terms of service delivery. This implies that the outcome of an investment options analysis does not depend exclusively on objective elements, but also on qualitative and strategic aspects.

At the investment options analysis stage, the public authority will still not be in a position to make a decision on whether or not a PPP is the best way to procure the preferred investment option. This assessment will be made once the preferred investment option has been selected.

Reference guidance documents

For guidance on developing a PPP project and assessing PPP options against alternative project development options, see *Project Preparation Status Tool*, EPEC (2014)

2.5 Political support and stakeholder consultation

Consistent and strong, high-level political and public support for a PPP programme or project is essential for the successful implementation of all PPPs, particularly large-scale PPPs.

A public expression of support by government can improve coordination among public sector stakeholders and reduce uncertainties for the private sector. Such uncertainties can be further reduced if the PPP project is part of an existing national investment plan, demonstrating its contribution (and importance) to the government's development objectives.

The support of high-level policy makers and officials for a PPP project is crucial to overcome potential barriers to the development of the project (e.g. if legislation or an additional budget allocation is required) and to mediate with opposing stakeholders. In addition, a PPP *policy statement* from the government or relevant public authority can help to emphasise long-term support for PPPs in general as well as for the individual project.

Achieving broad public support for a project can contribute positively to its successful implementation by reducing opposition to plans that might otherwise result in delays. A continuous stakeholder communication and consultation process can therefore help inform stakeholders and the public in general of the expected benefits of the investment.

Stakeholder consultation should be conducted, not just throughout the project identification phase, but also during the later phases of project preparation and procurement. Involvement of the private sector can also help in the later phases when details of solutions are being prepared and when a winning tender is selected.

2.6 Pre-feasibility study

A *pre-feasibility study* is a high-level analysis of the main features of a project. Such a study may incorporate both a needs assessment and an Economic Cost-Benefit Analysis of the types already discussed in the preceding sub-sections.

The pre-feasibility study might contain a preliminary discussion of the following topics:

Technical feasibility: addressing questions such as:

- Can the technical feasibility of the project be demonstrated without any major doubt?
- Have the major technical and operational risks been identified?
- Has the land required to develop the project been identified?; and
- Is a preliminary design available (for example, to prove feasibility)?

Legal feasibility: addressing questions such as:

- Does the public authority possess the legal powers to prepare, fund, tender and implement the project?

- What are the required legal and administrative approvals, and who provides them?; and
- Will it be necessary to amend any laws or regulations?

Financial feasibility: addressing questions such as:

- What are the major cost components of the project?
- Has a preliminary market demand analysis been conducted?
- Are the tariff/price assumptions reasonable (if a concession model is being considered)?
- Is the project affordable – to either government or consumers or both?; and
- Have all the main financial and commercial risks been identified?

Social and environmental feasibility: addressing questions such as:

- What are the expected social impacts of the project?
- Are any material environmental impacts expected?; and
- Can the expected negative social and environmental impacts be mitigated?

The outputs of the pre-feasibility study should provide the public authority with sufficient information to decide whether the project justifies moving to Stage 2 of this phase and, in particular, the preparation of a more extensive *full feasibility study* as outlined in Section 3.3.

Stage 2 – Appraisal of PPP suitability

2.7 PPP suitability test

The *PPP suitability test* determines whether a project possesses the elementary characteristics required to procure it as a PPP. The test may be used either to screen individual projects, or to screen all planned projects in an infrastructure investment plan to create a pipeline of potentially suitable PPP projects. The test, however, does not aim to identify the most suitable PPP projects but to discard unsuitable projects. This can avoid the unnecessary costs and complexity of assessing a project in detail that is obviously unlikely to deliver VfM if procured as a PPP.

A checklist approach may be used, the result of which will indicate if a project is determined to be either:

- **likely to be suitable;** or
- **unsuitable**

to be implemented as a PPP.

The results of this test could be discussed with responsible senior officials in the procuring authority and, whenever reasonable, with a PPP unit, to determine if the public authority should proceed to the next phase or if the PPP option should be abandoned.

2.8 Checklist for the project identification phase

Before proceeding to the preparation phase, a public authority should check that the main issues have been adequately addressed and that the questions in the checklist in Box 3 below have been satisfactorily answered.

Box 3 – Checklist of Phase 1 activities

- ✓ *Has the need for the investment been identified in a regional/national infrastructure plan or sector investment programme?*
- ✓ *Has a preliminary study regarding the need for the investment been carried out?*
- ✓ *Has a recent analysis been carried out using a widely recognised methodology for cost-benefit analysis?*
- ✓ *Have different investment options been assessed and ranked?*
- ✓ *Is there evidence of political support for the preferred investment option?*
- ✓ *Have the interests of stakeholders been considered?*
- ✓ *Has a pre-feasibility study been conducted?*

✓ *Has a preliminary value for money assessment been carried out as to whether the technical and legal aspects of the investment are suitable for a PPP?*

Reference guidance documents

PPP Project Preparation Status Tool, EPEC (2014)

For a detailed description of an initial VfM assessment, see: *A Guide to the qualitative and quantitative assessment of Value for Money,* EPEC (2018)

Figure 5 – Initial qualitative VfM assessment checklist

Legal and regulatory framework	
B.1	Can the project be procured as a PPP within the existing legal framework?
B.2	Does the legal and regulatory framework permit the private sector to provide the public service?
B.3	Does the public authority have the required legal powers to prepare, procure and enter into the PPP contract and related agreements?
B.4	Do high-level policy makers and officials support the implementation of the project as a PPP?
B.5	Is there evidence that users and other relevant stakeholders support the project being procured as a PPP?
Public and private sector capacity	
C.1	Does the authority have access to the appropriate skills, experience and knowledge necessary to prepare, procure and manage the PPP?
C.4	Can the private sector provide access to the necessary skills/experience that are not readily available to the public sector?
C.5	Have similar PPP projects been successfully implemented in the country, or region over the last five years?
Project-specific characteristics	
D.1	Does the project offer the opportunity to integrate the design, construction, financing, operation and maintenance of the infrastructure asset in order to reduce whole-life costs?
D.3a	Are the transaction costs of preparing and procuring the project as a PPP justified in relation to the value of the project?
D.3b	For smaller individual projects, are there opportunities to spread or reduce the overall transaction costs by bundling the project or using a programme approach?
D.11	Does the project address a long-term, predictable and stable public service need which is not expected to change significantly over the duration of the PPP contract?
D.13	Is it clear that there are no obvious benefits or synergies to be gained by extending the authority's existing management of operations?

3. Phase 2 – Project preparation

In the project preparation phase, the public authority sets up the governance structure for the project and conducts more in-depth analyses of issues (such as affordability and risk) and carries out further VfM assessments (see Figure 6).

These activities lead the public authority to a position of being ready to start the public procurement phase (Phase 3), on the assumption that the project continues to demonstrate its suitability as a PPP and the potential for VfM.

Figure 6 – Phase 2 project preparation

Phase 2	**Project preparation**	
Stage	Step	Activity
1. Managing and planning the process	Set up project team and governance structure	- *Set up the project management team* - *Define the PPP project governance structure*
	Engage team of transaction advisers	- *Identify the expertise needs of the public authority team; then* - *Select the advisers to meet these needs*
	Develop project plan and timetable	- *Identify the project activities and the critical path* - *Develop a detailed project plan and timetable*
2. Developing the PPP Project	Project appraisal process	- *Feasibility studies: scoping and structuring the project* - *Affordability assessment* - *Value for Money assessment* - *Risk analysis and allocation* - *Finance-ability and bankability assessment* - *Market assessment*
	Statistical classification of contract	- *Introduction to statistical approaches*

Stage 1 – Managing and planning the process

The preparation, procurement and implementation of a major PPP project involves many challenges for the public authority. This requires the creation of clear lines of responsibility, accountability and authority for taking decisions at all stages of the project cycle.

3.1 Project team and organisation

Due to the complexity of most PPP projects, it is good practice for the public authority to set up an appropriate organisational structure to direct and manage the preparation stages of the project. A key initial task in Phase 2 therefore consists of setting up a *project team* and developing a *project plan*.

Good project governance creates decision-making mechanisms whereby those with knowledge, skills and experience are adequately empowered so that the processes adopted to implement the project can work effectively and efficiently. For larger PPP projects it is often necessary to bring in external resources in the form of transaction advisers that possess the skills and competences that might not be readily available within the public authority.

3.1.1 Separation of approval and project management processes

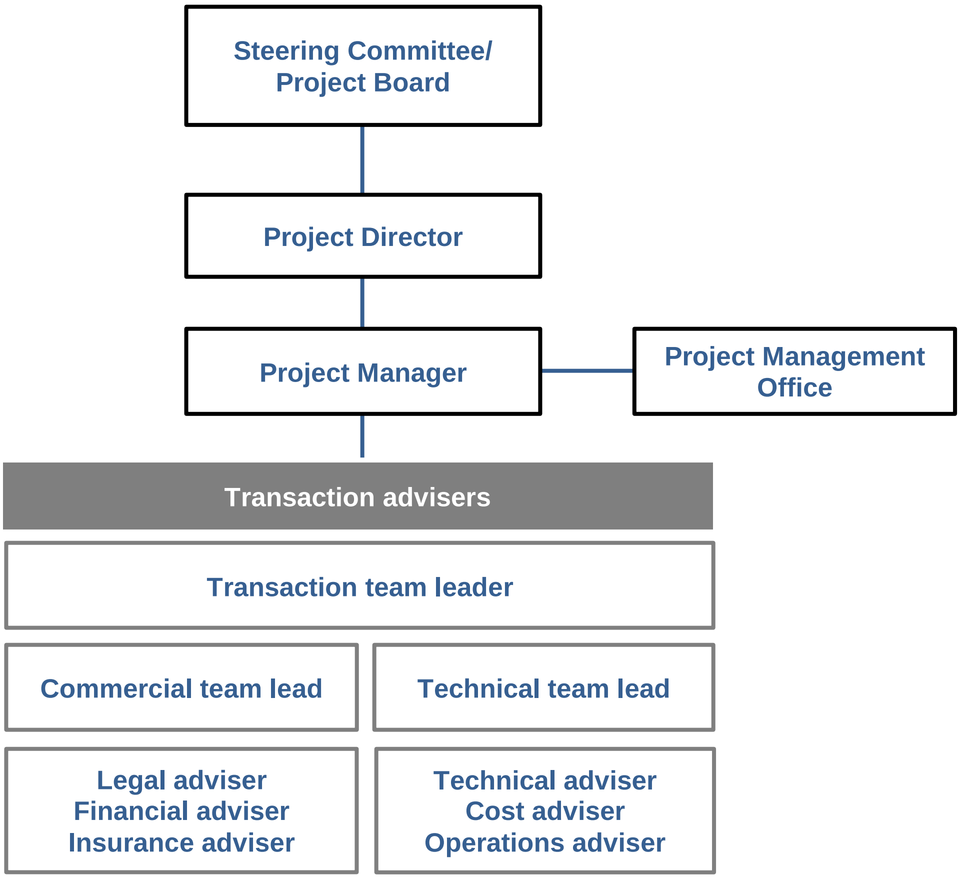
A common way of implementing PPP processes effectively is to establish a dual project governance structure (see Figure 7), comprising:

- **A steering committee**, responsible for approving the principal decisions required at key steps in the project preparation and procurement phases; and
- **A project team** responsible for putting in place the *project plan* (see Section 3.2), managing the PPP project on a day-to-day basis in accordance with the project plan (including managing any external transaction advisers) and reporting to the steering committee.

The steering committee and project team should be in place at the outset of the preparation stage. The project team will normally continue to be responsible for the procurement phase of the project (Phase 3) up until the award of the PPP contract.

Experience has also demonstrated that there are significant advantages to be gained by the public authority if some members of the project team also continue to have a role in the initial stages of the implementation phase (Phase 4), carrying valuable knowledge and understanding of the project throughout the project cycle.

Figure 7 – Typical project team structure



- ### Steering committee

The steering committee (sometimes called *project board*) is comprised of the main public sector stakeholders and led by a senior officer within the public authority.

It does not engage in the day-to-day operational matters associated with the preparation of the project but considers proposals made by the project team that are of key strategic importance to the development of the project. It will also be responsible for making and or approving important decisions referred to it by the project team (e.g. on the allocation of certain risks within the PPP or decisions affecting spending and budgets).

It is good practice to have a document that clearly defines the role and responsibilities of the steering committee, including its membership and how its decisions are made and recorded.

- ### Project team

The project team is responsible for establishing the project plan and for managing the PPP project on a day-to-day basis in accordance with that plan (including managing the transaction advisers). It is accountable to the steering committee to which it reports on the team's activities and from which it requests approvals or directions on key issues. The project team typically consists of experts from within the public authority and or relevant ministries.

It is unlikely that an authority have the full expertise required to undertake the PPP project in-house. External transaction advisers are therefore often indispensable to an authority undertaking a PPP project.

The project team may also have access to the skills and experience of a PPP unit. (In some instances, the national or regional PPP unit may play a part in the governance of the project, in which case any assistance to the project team should be mindful of any potential for a conflict of interest). See Box 4 below.

Box 4 – Potential role of a national or regional PPP unit

A PPP unit can help to coordinate, assess, develop and implement PPPs. Depending on its role and position in the administration, its responsibilities might include:

- *developing PPP policies, processes and standardised documents;*
- *strengthening public sector expertise through capacity building events;*
- *promoting PPPs within the public sector and to the private sector;*
- *supporting public authorities in identifying, preparing, procuring and monitoring PPP projects; and*
- *reviewing PPP projects within the governance and approval process.*

A PPP Unit requires sufficient financial resources to maintain a team of experienced and specialist experts.

The public authority should appoint a project director to lead the project team. For most types of PPP project, this role is a full-time position. The individual appointed should have the required skills and experience relevant to the tasks to be managed. Experience in the specific sector and in procuring PPP projects is often essential.

The project director provides overall leadership and strategic direction to the project team and to the development of the project. The person in this position also forms the primary point of contact with the Steering Committee, keeping them briefed on important matters.

The project director is supported by the project manager. The project manager is responsible for managing all day to day project activities through the project management office. The project manager is generally the person who coordinates the inputs from and gives instructions to the transaction advisers. The relationship between the project director and project manager is one of the most important within the project team and relies on close coordination and communication.

The project team should have within it the requisite expertise that covers the project management, financial, economic, technical, market/demand, tax, accounting and insurance aspects of the PPP project. The skill set should include knowledge of public procurement processes, familiarity with private business and practical experience in deal-making or contract negotiation.

The project team might be relatively small at the outset of the project but – for a PPP of moderate or larger scale – a sufficiently large and experienced full-time team needs to be in place in the early stages of the project preparation phase.

Reference guidance documents

For guidance on managing and planning the process, see *PPP Project Preparation Status Tool,* EPEC (2014)

Establishing and Reforming PPP Units: Analysis of EPEC Member PPP Units and Lessons Learnt, EPEC (2014)

- **PPP transaction advisers**

Transaction advisers will often assist the public authority at each stage of the PPP project cycle in carrying out a variety of tasks (see Box 5).

The core team of advisers usually consists of a financial adviser, a technical adviser and a legal adviser. Other specialist consultants might be required for specific inputs, e.g. on environmental, social impact, regulatory risk and insurance matters. The types of adviser needed and the tasks they perform will depend on the project and the public authority's own resources.

The entities providing PPP advisory services are typically:

– **law firms** usually experienced in public/administrative law matters as well as procurement, business, financing/banking and tax issues;

– **financial advisory companies** that may be part of an international accounting and advisory group/network, part of an investment bank or firms specialising in PPP or public service management; and

– **technical advisory firms** that are often specialised by sector (e.g. transport, social infrastructure); and public entities, such as national or sectorial PPP units that have been tasked and staffed to advise on projects.

Box 5 – Tasks typically performed by PPP transaction advisers

Legal adviser

– *Advise the public sector on the issue of the legal powers (or vires) necessary to enter into the project contracts;*
– *Assist in the assessment of the legal feasibility of the project;*
– *Advise on the appropriate procurement route;*
– *Advise on the initial contract notice;*
– *Advise on procurement documentation such as pre-qualification questionnaires, invitations to tender and evaluation criteria;*
– *Draft the PPP contract;*

- *Ensure that bids meet the legal and contractual requirements for submission;*
- *Evaluate and advise on all processes and contractual solutions throughout the procurement phase, including contract negotiation; and*
- *Provide support in the clarification and fine-tuning of legal aspects.*

Technical adviser

- *Preparation of construction and operating cost assumptions*
- *Support to the public authority with inputs to the risk, affordability and VfM assessments*
- *Draft the output requirements and specifications of the PPP project;*
- *Develop payment mechanisms in the PPP contract (with the financial adviser);*
- *Evaluate and advise on all technical solutions during the procurement phase;*
- *Undertake technical due diligence on bidders' solutions; and*
- *Carry out any site condition, planning and technical design work.*

Financial adviser

- *Support to the public authority with the risk, affordability, VfM assessments and development of the financial model*
- *Support the development of all financial aspects of the project;*
- *Advise on how to secure the public funding for the project (if any);*
- *Advise on the applicability of specific sources of finance, and how these can be optimised in the financing structure;*
- *Ensure that all financial aspects of the bidders' solutions meet the requirements for submitting a bid;*
- *Optimise, scrutinise and possibly audit the financial models submitted by bidders;*
- *Evaluate and advise on financial proposals throughout the procurement phase;*
- *Advise on the bankability issues raised by the PPP contract;*
- *Undertake financial due diligence on the submitted bids;*
- *Assist in the negotiations with the lenders; and*
- *Assist in the strategy and completion of the interest rate and currency hedging at financial close.*

Environmental adviser

- *Examine the potential environmental impact of the project;*
- *Assist in environmental due diligence, including required permits and certifications;*

- *Identify potential environmental risks and how submitted bids address them; and*
- *Consider the mitigation of such risks and the impact on the scope and technical design of the project.*

The importance of having a strong group of expert advisers in place for supporting the project preparation and procurement phases cannot be overstated. The public authority should see engaging advisers as an investment for gaining better project preparation and lower project risks (see Box 6). This should enable cost savings and better VfM.

Box 6 – Benefits of appointing external transaction advisers

Public authorities benefit from engaging advisers through their support for preparing and procuring a complex PPP project:

- *advisers offer skills, expertise and capacities otherwise not available in the public authority;*
- *advisers might transfer knowledge and capacitate the public authority ;*
- *a team of experienced advisers might increase market trust in the project preparation and thus market interest during the bidding process; and*
- *hiring advisers might also be more economical than developing in-house capacity, in particular when the public authority implements a limited number of PPP projects.*

Appointing the transaction advisers

The procurement of advisers should be conducted in a fair and transparent public procurement process. The selected advisers may be appointed either:

- **for separate, individual assignments**: a public authority with considerable experience in PPP procurement might engage advisers on *separate mandates*, with the public authority directly managing and coordinating the individual advisers and their inputs; or

- **as a single firm or a consortium:** a less experienced public authority may decide to hire a single firm or a consortium of advisers to provide the combined services under one contract. The consortium should be led by one adviser company taking responsibility for coordinating and managing the activities of the group of advisers.

Nevertheless, the public authority will still need to manage the inputs from the adviser and be sufficiently knowledgeable to discuss issues with each member of the advisory group separately to ensure that differences of opinion are noted and solutions identified.

The public authority should select advisers based on their PPP expertise and experience, demonstrated by the past activities of the companies and the individual advisers being proposed. The individual lead adviser is often critical to the success of the project and the private sector tenders should mention key individuals, their role and PPP experience.

The fee structure should incentivise the adviser to facilitate the successful preparation and procurement of the project within the parameters set by the public authority (including for cost and time), while limiting any incentive that might encourage the adviser to promote the continued development of a project that is not suitable as a PPP.

- **Potential for conflicts of interest and maintaining confidentiality**

  It is important that the public authority avoid any actual or potential conflict of interest in the adviser appointments. For example, a potential conflict of interest arises if an adviser assisted the public authority during the project preparation and later seeks to advise a potential bidder during the procurement phase.

  The procurement documents for the adviser appointment may explicitly prohibit an adviser from working on the same project for a private sector bidder.

Reference guidance documents

Role and Use of Advisers in preparing and implementing PPP projects, EPEC (2014)

3.2 The project plan and timetable

A key initial task for the project team is to develop a detailed *project plan* for the preparation and procurement phases. The plan needs to take into account all the key steps in the process, including:

– a project timetable with main tasks and their start and end dates;

– the data to be collected and assessments to be carried out;

– key documents or reports to be drawn up;

– required internal and external capacities;

– funding, financing sources;

– stakeholder consultation;

– any legal or regulatory steps to be undertaken, including permits that may need to be obtained;

– the bidding process and private sector interface; and

– the government decision-making and approval process.

PPP project preparation can be a complex undertaking, with a number of activities taking place at the same time. A *critical path* of the project team's activities should be clearly identified so that the public authority can understand the potential for delay to the overall project as a result of a key or critical task.

It is important that activities on the critical path be started at the right time and that their progress monitored closely by the project team to ensure that they proceed as planned. It is helpful to use standard project-planning software to record the project plan and to use this as a tool for managing the project preparation phase.

Reference guidance documents

For more guidance on managing and planning the PPP process, see *PPP Project Preparation Status Tool,* EPEC (2014)

Stage 2 – Developing the PPP project

3.3 Feasibility studies: defining and scoping the project

A project, whether it is a PPP or not, needs to be clearly defined and scoped before it can be procured.

Most of the work in defining and scoping a project is done during Phase 1 at *pre-feasibility* level (see Section 2.6). This involves preliminary research into the basic features of the project. It will identify the physical infrastructure to be built and assess the methods available to deliver the service outputs for the end users. Finally, it will provide a preliminary estimate of the cost of the project, i.e. the capital expenditure and whole-life operation and maintenance costs.

While these results provide preliminary evidence in respect of the feasibility of the project across its various dimensions (technical, legal, financial, socio-environmental) the definition and scope the project still requires further development and validation before any decision to launch a public procurement process.

Most PPP transactions are made on the basis of limited-recourse project financing, which is best used where the project scope is clear and straightforward and the costs and sources of revenue are predictable. Financiers are unwilling to finance complex projects where the scope and costs are unclear or where, despite detailed assessment, they remain difficult to define and predict.

The definition of the project should identify any areas where there is external dependence on inputs controlled by others. This *interface risk* is often best managed by the public authority, as the presence of such interfaces could limit the ability to transfer certain risks to the private partner under the PPP contract.

3.4 Affordability assessment

Affordability means the capacity to pay for preparing, building, operating and maintaining the project. This is either:

- **under a concession model** the capacity and willingness of users to pay for the services (such as a toll charge to use a road) or
- **under an availability-based PPP** the capacity of the public authority to pay the annual availability payment.

A PPP project is considered *affordable* if the expenditure associated with the project over the full payment period is within any limit to the public sector budget (see Box 7 on the differences between *affordability* and *VfM assessment*).

Box 7 – Affordability vs VfM assessment

An affordability and a VfM assessment analyse different aspects of a PPP project.

- *an **affordability assessment** determines whether a PPP project can be procured based on the costs and the financial resources of the authority and/or end users;*
- *a **VfM assessment** determines whether the project should be procured as a PPP or through traditional public procurement.*

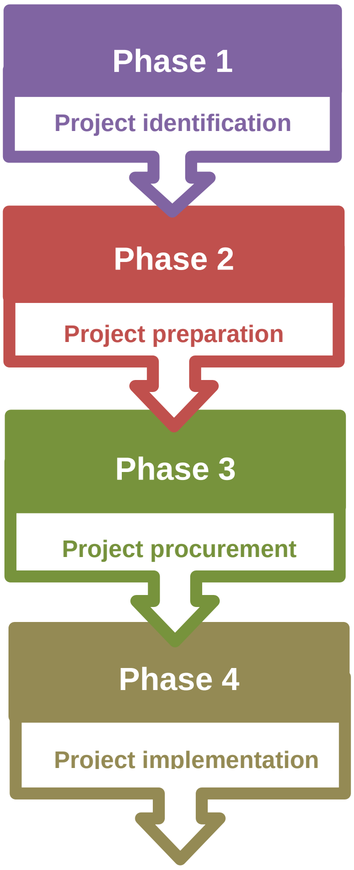
An affordability assessment and a VfM assessment both use financial tools that have similar features and, broadly speaking, employ the same underlying data and financial parameters.

An affordability assessment requires careful analysis of the expected costs and revenues of the project to determine the payments required from the authority and/or end users. These payments should cover items such as:

- the PPP transaction and financing costs,
- the sponsors' (or *shareholders*') return on equity,
- the construction, operation and maintenance costs; and
- the private partner's tax liabilities.

Based on this assessment, the expected payments required by the private partner are estimated. This may highlight, for example, in a concession-type PPP model whether existing tariffs need to be increased to recover the full costs, or a public subsidy might be needed to make the tariff affordable to users. Affordability should be assessed continuously throughout the project cycle, including during Phase 3 (see Figure 8).

Figure 8 – Opportunities for assessing affordability in the project cycle



A preliminary assessment to determine the project's likely affordability based on data from similar types of project. A further, more refined assessment could be made using the cost and revenue data used for the ECBA (see Section 2.3).

A detailed affordability assessment to determine whether the project is affordable. This assessment should rely on the data used in the financial models, and would cover costs, liabilities and revenues. Note: this assessment should be carried out before the end of Phase 2.

The cost of actual tenders received by the public authority may be compared with the Phase 2 detailed assessment. The affordability may also be assessed again if cost and revenues included in tenders are substantially different from those assumed in the Phase 2 estimate.

During the implementation phase, further assessments may be required where there is any permitted change in the private partner's costs, e.g. inflation-linked indexes, currency exchange rates, scope changes, change of law, force majeure and, ultimately, consideration of termination.

Reference guidance documents

For guidance on developing the affordability analysis, see: Project Preparation Status Tool, EPEC (2014)

- **Use of a financial model**

A financial model can serve different objectives during the PPP project preparation phase. In the context of an affordability assessment, the financial model allows the public authority to assess the financial commitments (and liabilities) of the project and to ensure the mid-term fiscal sustainability of the overall public budget.

A financial model, inter alia, calculates the project's overall cost and revenues, based on alternative options in terms of project scope and contractual arrangements. Cost and demand estimates could be based on similar previous projects and data from the market. This calculation requires further inputs, such as appropriate cost escalation indices, demand/traffic estimates, lifecycle needs, an assumed financing structure and preliminary PPP contract terms.

The financial model might also be used by the public authority to value project risks which may influence its decisions on which risks to transfer to the private partner, which to retain and which to share.

Testing the financial model for its sensitivity to particular inputs and under different potential scenarios can help determine the impact of changing fundamental features of the project on the project's financial model and its affordability (e.g. variations in interest and exchange rates, demand assumptions, inflation, or supply costs).

- ## Assessing fiscal risk

The public authority (and government in particular) needs to manage its fiscal risks. PPPs create long-term financial commitments that could - over time and when considered with other commitments - challenge the coherence of the public budget process and ultimately a country's fiscal sustainability and macroeconomic stability.

These risks can occur when the payment commitments on PPPs are not clearly recognised and understood and have not been centrally reported and budgeted for.

The public authority should analyse the financial impact of PPPs for fiscal sustainability. This includes assessing all PPP contracts which might represent explicit and implicit commitments as well as direct and contingent liabilities:

- **Explicit and implicit commitments**

  Explicit commitments are predictable and refer to direct fiscal commitments (e.g. availability payments, viability gap funding) of the public authority stated in the PPP contract or other legal documents.

  Implicit commitments refer to potential payments by the public authority to ensure the provision of public services, but which are not contractually committed.

- **Direct and contingent liabilities**

  Direct liabilities are predictable and relate to explicit commitments, such as availability payments.

  *Contingent liabilities are some of the most important sources of fiscal risk as their financial impact, probability and time of occurrence are unpredictable. These liabilities derive from retained risks, guarantees (e.g. minimum revenue guarantees), and compensation and termination payments. Contingent liabilities can be explicit (e.g. guarantees) or implicit (e.g. termin*ation payments) in nature.

The unpredictable nature of contingent liabilities and implicit commitments can lead to potentially significant fiscal risks. These commitments and liabilities are often subject to limited assessment, approval or recognition in national public accounts. Even explicit, straightforward long-term commitments (e.g. availability payments) might not be transparently budgeted or accounted for as budget horizons are often limited to up to only a few years.

- **Instruments to strengthen affordability**

A public authority may apply different institutional and project-level approaches to strengthen the affordability of the project and ensure fiscal sustainability, a number of which are outlined below:

- **Define a long-term infrastructure plan** to establish the overall budget for infrastructure investment, the possible procurement modes and a pipeline of potential projects.

- **Use robust bankable and enforceable (preferably standardised) contracts**, where all future liabilities with fiscal consequences are understood.

- **Assess and transparently account for all commitments and liabilities** of all national and subnational PPP projects (including concessions) beyond the short-term budget horizon.

- **Use a PPP affordability limit (or ceiling)** to reduce the fiscal risks of an unaffordable PPP portfolio by limiting the overall long-term explicit commitments of the national and sub-national PPP portfolio (excluding contingent liabilities). The limit is set at a level that depends on a public authority's required budgetary flexibility and risk appetite.

3.5 Value for Money (VfM) assessment

A Value for Money (VfM) assessment is commonly used by a public authority as a decision-making tool in the context of public investment. Such decisions are diverse and may involve, for example, the choice of which new project to initiate, the selection of the best technical solution for a particular project, the identification of the best delivery option or even the choice among PPP bids for a particular project.

Box 8 – Value for Money

Value for Money seeks to capture the relationship between cost and value:

- ***cost** usually represents all the costs incurred over the lifetime of the project to deliver the associated value, including the costs of managing the associated risks; and*

- ***value** comprises the quality and quantity of service or performance level over the same period.*

The decision to procure on the basis of a PPP should be based on the delivery of better VfM for the public authority and, ultimately, for the end users when considered over the whole life of the project.

Value for money can be analysed using qualitative and quantitative assessments:

- **A qualitative VfM assessment** examines the suitability of a project for procurement through a PPP model.

  The assessment might include consideration of the project characteristics, the institutional and legal framework, non-financial criteria and the PPP market.

- **A quantitative VfM assessment** compares public and private procurement options for the same project.

  To determine the preferred procurement option, the quantitative VfM assessment is carried out by comparing the (risk-adjusted) fiscal costs of the private sector PPP option and a best traditional public procurement option. This option is usually referred to as a public sector comparator (PSC) or a public sector benchmark (PSB). Due to the constraints of a quantitative VfM assessment, the result should not be used as the primary or only criterion for a procurement decision.

The use of a *quantitative VfM assessment* and the level of detail applied depends on the size and complexity of the project. For example,

- **for smaller projects,** a simplified VfM assessment might be appropriate to reduce high transaction costs which otherwise might constrain the project's affordability;

- **for regularly implemented projects** with a proven track record of delivering VfM, a simplified, mainly qualitative VfM assessment might be appropriate; while

- **larger and rather complex projects** should be examined using qualitative and quantitative assessments, due to their large potential fiscal impact.

The effort (time and cost) that a public authority should use in performing such an assessment and the level of detail of the assessment should therefore be proportionate to the value and complexity of the proposed PPP project.

Achieving VfM is facilitated by the presence of certain project features in PPPs:

- **a whole-life costing approach,** which in general combines the design, construction, operation and maintenance of a project of sufficient size with the aim of optimising its lifetime costs;

- **private sector technical and management know-how** and experience enable higher service quality and quantity, and/or cost savings;

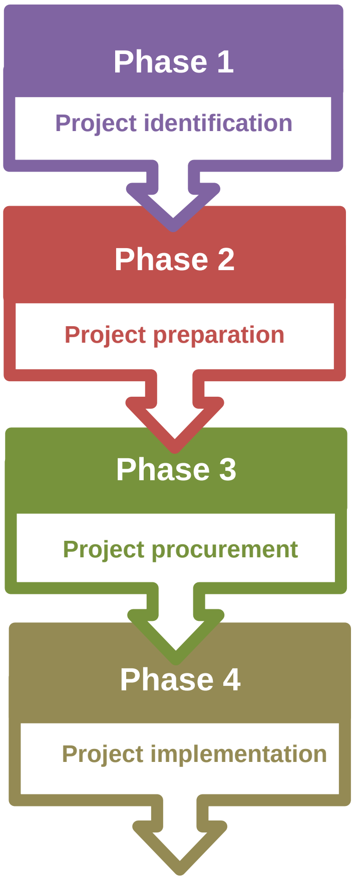
- **use of output specifications** instead of input specifications to enable cost efficiency gains and innovation;

- **private sector financing and adequate risk allocation** can reduce public liabilities and risks; and

- **VfM assessments in the project cycle**

  VfM assessment is used to help make decisions at different stages of the preparation of the project and at various approval stages in the project cycle, but most particularly during Phases 2 and 3 (see Figure 9 below).

Figure 9 – VfM assessment in the project cycle



A qualitative suitability appraisal to evaluate whether a project has the required characteristics to be procured as a PPP. Commonly based on high-level factors due to a lack of detailed data and information.

More detail examination using a qualitative and potentially a quantitative assessment to finally determine the procurement option. Carried out along with other analyses which also inform the VfM assessment (e.g. feasibility studies, risk analysis, affordability analysis, market sounding, risk identification and allocation).

Used prior to financial close to verify that the procurement process is competitive and that the selected tender offers the best VfM.

Used as part of the monitoring and reporting activities that may be required under the PPP contract, including any changes and contract renegotiations. VfM assessment might examine the actual VfM of an ongoing project or a package of projects, to check whether the estimated benefits of the PPP procurement have been achieved.

Reference guidance documents

A detailed explanation of the use of both qualitative and quantitative VfM assessments and the techniques that can be applied during each of the phases of a PPP project is presented in the A Guide to *Qualitative and quantitative Value for Money Assessment*, EPEC (2018)

Value for Money Assessment: Review of approaches and key concepts, EPEC (2015)

3.6 Risk analysis and risk allocation

An appropriate allocation of risks is a key driver for achieving VfM in a PPP project, i.e. risks should be transferred to the party best able to manage them.

More particularly the risks within the project should be allocated to the party (either the public authority or the private partner) that:

- is best able to influence the likelihood of the risk occurring; and/or
- is best able to minimise the impact if the risks occurs.

The party bearing the particular risk and who faces a potential financial loss has a strong incentive to reduce the likelihood of occurrence and potential impact of a risk. Optimal risk allocation can therefore reduce the overall project risks and costs, and so increase VfM.

A public authority should ensure that the risk allocation incentivises the private partner to provide the services in a cost-efficient manner and in the required quantity and quality. Nevertheless, the public authority needs to be aware that the private partner may require a higher payment for bearing these risks.

The transfer of risks to the private partner that the public authority can, in fact, manage more efficiently may lessen VfM because either a higher payment is required or private sector interest (and competition) is reduced.

▪ The risk management process

The risk management process can identify, reduce and mitigate project risks. It can be used to determine the value of risks and therefore help in allocating risks between the public and private partners.

The risk analysis process (which can be iterative) typically takes place in five stages:

1. Risk identification and prioritisation
2. Risk assessment and valuation
3. Risk allocation
4. Risk mitigation
5. Risk monitoring and review

Broadly speaking, PPP project risks can be classified as either commercial risks or legal and political risks:

- **Commercial risks** comprise supply and demand risks.

  Supply risk mainly concerns the ability of the PPP company to deliver. Supply risk can be subdivided into construction risk and supply-side operation risk (where construction and operation constitute the two phases of the project). Construction and supply-side operation risks include financial market risk due to, for example, changes in the cost of capital or changes in exchange rates and inflation.

  Demand risk relates to insufficient user volumes compared to base case assumptions.

- **Legal and political risks** relate to, among other factors, the legal framework, dispute resolution, the regulatory framework, public policy, taxation, expropriation and nationalisation.

In general, the private sector is better placed to manage commercial risks while the public sector is better placed to manage legal and political risks.

If a form of public guarantee is being considered for the PPP project, the public authority should first assess the impact of the guarantee on the contractual risk allocation and its possible future implications for public finances.

- **Timing of risk analyses in the project cycle**

The conduct of risk analyses should be continuous throughout the project cycle. Figure 10 below presents the main activities of each step of risk analysis that might be performed during the project life cycle. An initial risk identification takes place in Phase 1 when the first risk register is established (see Box 9). This is followed by more detailed risk identification and risk prioritisation, valuation and allocation during Phase 2.

The final risk allocation is confirmed in Phase 3 at the end of the procurement process and is reflected in the agreed PPP contract.

Box 9 – Risk Register

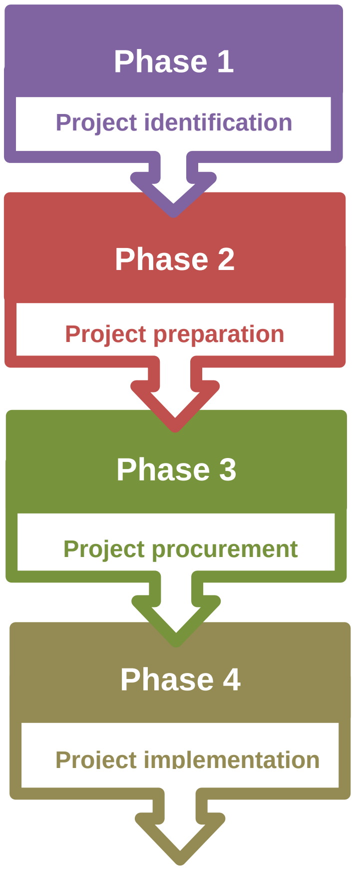
*The results of the risk analysis feed into the **risk register**.*

The risk register is a standard project management tool to monitor and manage risks throughout the project life cycle. It offers a structured overview (often in the form of a spreadsheet) of all relevant risks of the project.

A preliminary or initial risk register should first be created during Phase 1 when initial basic information on risks can be included.

The risk register is continuously expanded and updated, especially in Phase 2 when the detailed risk analysis is conducted. At the risk allocation stage, the allocation of risks to the concessionaire / private partner is added.

Figure 10 – Risk analysis in the project cycle



1. ***Risk identification and prioritisation:*** *Identify all risks relevant to the project, including during the construction and operational phases. All identified risks should be set out in a risk register (see Box 9).*
2. ***Risk assessment and valuation:*** *Determine the probability of risks occurring, the financial impact and final risk value. Prioritise risks based on impact and probability.*
3. ***Risk allocation****: Allocate risk to public and/or private parties or share the risk.*
4. ***Risk mitigation:*** *Reduce the probability of risks occurring and mitigate their impact.*
5. ***Risk monitoring and review:*** *Monitor and review risks and manage new risks during project operation. This process continues throughout the life of the PPP contract.*

Reference guidance documents

For guidance on developing the risk analysis, see: *Project Preparation Status Tool,* EPEC (2014)

Value for Money Assessment: Review of approaches and key concepts, EPEC (2015)

3.7 Finance-ability and bankability

A PPP project is usually financed by a combination of equity capital and (long-term) debt. The private partner needs to be able to secure both equity and debt if it want to be able to finance the project.

Debt finance represents the majority of third party funding for PPP projects. This is typically between 60% and 90% of the total finance required, depending on the perceived risks of the project. Debt is normally a cheaper source of finance than equity, as the provider of this type of finance carries relatively less risk.

- **Financeability**

The main difference between equity capital and debt is that, while the debt is repaid to the lenders, together with periodic interest payments, and according to a pre-agreed amortisation schedule, equity sponsors are remunerated by periodic dividends and by the net worth of the company on sale of their equity or at liquidation.

While the interest rate for the debt is contractually agreed at the inception of the transaction (between the private partner and its funders) and the principal is repaid according to an agreed amortisation schedule, the remuneration of the sponsors' equity is not agreed contractually and therefore depends on the performance of the project company (SPV).

This higher level of uncertainty for the sponsors is balanced by the possibility of a better-than-forecast rate of return on the equity invested, while the remuneration of the debt remains fixed.

The equity and debt investors adopt different approaches to the project's risks and have different preferences, so the public authority will seek to structure the contract in a way that is attractive to both of them.

A PPP project is therefore considered financeable if both debt and equity investors are willing to finance it.

- **Bankability**

Several categories of financial institutions participate in lending to PPP projects. These include international commercial banks, multilateral development banks, domestic banks, national development banks and, non-bank financial institutions. The approach that each makes to lending to a project as well as their objectives, priorities and risk-appetite can vary considerably.

Lending to PPP projects (usually referred to as non-recourse or limited-recourse finance) considers the cash flow of the project as the principal source of security.

The public authority needs to assess the financial risks on the project before proceeding to the public procurement phase. These may include consideration of the following factors:

- reliability of revenue assumptions and levels of demand (e.g. over-optimistic assumptions)
- assumptions on financing needs in the project feasibility stage (e.g. mis-calculation of the required debt);
- assumptions on potential for re-financing if shorter-term debt is used (e.g. over-optimistic assumptions on market capacity and pricing);
- interest rate risk (e.g. through use of floating rate debt); and
- potential effects of future refinancing of longer-term debt.

A PPP project is therefore considered *bankable* if lenders are willing to finance it.

Reference guidance documents

For guidance on performing market sounding and bankability analysis, see *Project Preparation Status Tool,* EPEC (2014)

3.8 Market assessment

For private sector operators, tendering for a PPP is often a more challenging (and expensive) task than bidding for a traditionally procured project. Not only does the contract require them to be able to build the infrastructure necessary to deliver the required services, but they also need to be able to maintain it and provide services for a long time. They also need to finance the project.

PPPs are therefore most successful when the conditions exist for the public and the private partners to work together efficiently. In particular:

- the public authority should prepare the project in a way that allows it to clearly communicate its needs and requirements to the market; and

- a sufficient number of interested private sector operators should have the know-how, capacity and willingness to invest time and resources to prepare a tender that appropriately addresses the needs of the public authority. They should also be able to raise equity and debt to ensure the financing of the project.

Additionally, a favourable market response needs a sufficient number of financial institutions to be willing to provide debt financing to all the tendering parties.

A public authority may consider opening a formal consultation process with the market to establish the expected market response to the project. (See also Section 4.2 of this Guide and Section 2.2 of *A Guide to the PPP procurement process* for a more detailed discussion of market engagement.)

3.9 Statistical treatment of the PPP contract

Government needs to report its financial commitments, including in relation to PPPs, according to national accounting and statistical reporting principles.

The most authoritative sources of such reporting include:

- the **International Public Sector Accounting Standards** published by the International Public Sector Accounting Standards Board;[1]

[1] The International Public Sector Accounting Standards Board develops accounting standards and guidance for use by public sector entities. The IPSASB receives support (both direct financial and in-kind) from, the Asian Development Bank, the Chartered Professional Accountants of Canada, the South African Accounting Standards Board, and the Governments of Canada, New Zealand, and Switzerland.

- the **Government Finance Statistics Manual**[2] published by the International Monetary Fund; and

- the **Manual on Government Deficit and Debt** issued by Eurostat[3].

The statistical treatment of a PPP contract in respect of national debt and budget deficit procedures can be an important consideration in the preparation of the PPP project.

For the Western Balkans countries, the IMF rules are perhaps more immediately relevant when considering the likely classification of a PPP contract.

Reference guidance documents

For guidance on budgeting, accounting and statistical treatment, see *Project Preparation Status Tool,* EPEC (2014)

A Guide to the Statistical Treatment of PPPs, EPEC (2016)

3.10 Checklist for assessing readiness for PPP procurement

To assess the readiness of the PPP project for the procurement phase, a checklist can be a useful device for a public authority to demonstrate to all relevant approval bodies that the necessary preparatory steps have been conducted properly and sufficiently.

The EPEC PPP Project Preparation Status Tool ("PPST" or "Tool") is one such means of systematically checking the status of the multiple activities that contribute to the development of a PPP project. The PPST aims to assess the status of the preparations of a given PPP project by reference to a typical, good-practice PPP project development process to the point of determining if the project is ready for the launch of the procurement process.

For demonstrating readiness for the procurement phase, Box 10 presents a typical final checklist for use by public authorities (in accordance with the recommended steps of the PPST.)

The PPST can serve to help the public authority to identify at an early stage in the development of the project any potential areas of weakness/incompleteness and to develop a structured approach to addressing these.

Box 10 – Checklist to assess readiness to procure the project

- ✓ *Has the analysis demonstrated that the project is affordable?*

- ✓ *Has the market sounding and bankability analysis confirmed strong potential interest from the market in the project?*

[2] See http://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf.

[3] See http://ec.europa.eu/eurostat/documents/3859598/5925693/KS-02-13-269-EN.PDF/44cd9d01-bc64-40e5-bd40-d17df0c69334.

- ✓ *Does the VfM assessment confirm that the PPP option is expected to deliver the best value for money?*
- ✓ *Is the project team, including the external advisers, in a position to manage the procurement?*
- ✓ *Are all relevant powers, authorisations, permits, agreements, approvals to implement the project in place or obtainable within the required timetable?*
- ✓ *Are all the assessments up to date and consistent with each other, in particular regarding stakeholders' feedback, affordability, risk treatment, market sounding, bankability, value for money, capacity/availability of the team, timetable and the authority's requirements?*
- ✓ *Has the steering committee and/or other relevant decision-makers approved the launch of the project procurement?*

Reference guidance documents

Project Preparation Status Tool, EPEC (2014)

4. Phase 3 - Project procurement

4.1 Purpose of the PPP procurement process

The PPP procurement process is aimed at selecting the most appropriate and competent private partner in order to achieve the public authority's desired service outcomes for the PPP project. The ultimate goal is to maximise VfM by devising a competitive tendering process for the award of the long-term PPP contract, carried out in an open, objective and transparent manner. PPP procurement should therefore aim to maximise competition between the private parties bidding for the project.

Stimulating a healthy competitive tension is conducive to the delivery of VfM. The success of the PPP procurement process depends crucially on how effectively procuring authorities are able to communicate and interact with the private sector and interpret market capacity and appetite.

The main activities performed in this phase of the project cycle are shown in Figure 11.

Figure 11 – Phase 3 PPP Project procurement

Phase 3	**Project Procurement**	
Stage	Step	Activity
1. Tendering process	Procurement notice, invitation to pre-qualify and shortlisting of candidates	- *Issue a public procurement notice or contract notice* - *Send an information document and invitation to pre-qualify to parties who express interest in tendering* - *Shortlist the candidates who meet the pre-qualification criteria*
	Invitation to tender	- *Send tender invitation documents to the shortlisted candidates including proposed draft PPP contract*
	Interaction with tenderers	- *Hold one or more meetings with each tenderer to develop potential tender solutions* - *Provide any necessary clarifications to tenderers and update tender documents/draft PPP contract* - *Invite final tenders*
	Evaluation of tenders and identification of the preferred tenderer	- *Evaluate compliant tenders using the pre-published evaluation criteria.* - *First-ranked tender selected as preferred or successful tender*
2. PPP contract and financial close	Finalise PPP contract	- *Finalise the PPP contract details with the preferred/successful tenderer.* - *Make any agreed non-material changes to the tender PPP contract*
	Conclude financing agreements	- *Lenders to the preferred/successful tenderer carry out their due diligence checks and confirm financing terms.* - *With the preferred/successful tenderer, finalise the terms of the*

	financing/ancillary agreements with the lenders
Contract award and financial close	- *Issue notice to unsuccessful tenderers of intention to award the contract (standstill period)* - *Assuming no legal challenge, the PPP contract is signed (contract close) along with all related agreements and financing agreement (financial close)* - *All parties satisfy any remaining conditions precedent that are necessary to make the PPP contract effective*

Reference guidance documents

For guidance on the procurement process, see *Project Preparation Status Tool*, EPEC (2014)

Stage 1 – The tendering process

4.2 Assessing PPP market readiness

The success of the PPP procurement process depends, among other things, on the ability of the public authority to engage with the market and to assess and stimulate market appetite for the project.

The public authority can enter into a process of consultation to generate market appetite and to help define the scope and structure of the project (including financing options) as well as the related PPP contract.

Good practice suggests that any external consultation organised by the public authority should be conducted in accordance with good procurement principles. In particular, (as stated in EU Directive 2014/24/EU on public procurement) the public authority must treat economic operators equally and without discrimination and must act in a transparent and proportionate manner (Art. 18).

Reference guidance documents

For guidance on performing the market sounding, see *Project Preparation Status Tool*, EPEC (2014)

4.3 Choosing an appropriate procurement procedure (e.g. competitive dialogue procedure)

One of the first choices to be made by a public authority following the decision on the use of a PPP as a delivery model is to select an appropriate procurement procedure.

Effective preparation and implementation of the procurement procedure can significantly contribute to the success of a PPP project.

The most recent EU Directive on public procurement is Directive 2014/24/EU (the *2014 Directive*). This reforms and supersedes Directive 2004/18/EC (the *2004 Directive*). It covers public procurement in general, laying down the principles that should apply to all works, supplies or services contracts. Legislation addressing public procurement within the Western Balkans Region conforms, in large part, to the 2004 Directive.

Directive 2014/24/EU provides four procurement approaches (i.e. *procedures*):

- the **open** procedure;
- the **restricted** procedure;
- the **competitive dialogue** procedure; and
- the **competitive procedure with negotiation**.

Legislation addressing public procurement within the Region conforms, in large part, to the 2004 Directive. National laws in the Region are therefore likely to still refer to the procedures that were available under that directive. These were the open, restricted and competitive dialogue procedures (all largely unchanged under the 2014 Directive) and the negotiated procedure (now replaced by the competitive procedure with negotiation).

The choice and suitability of procedure for PPP contracts is strongly influenced by how the procedures deal with the following:

- **restricting the number of tenderers by pre-qualifying applicants:** whether the procedure allows the public authority to limit the number of companies that participate in the tendering process;
- **the level of engagement with tenderers during the process:** whether the procedure allows the public authority to have discussions with tenderers about the PPP and their proposals for delivering it;
- **the relationship between price and quality in evaluating tenders:** the extent to which the procedure allows the public authority to consider qualitative aspects of tenders and not the tender price alone.

The size and complexity of PPPs means that the public authority is usually looking for a procedure that allows it to restrict the number of tenderers, engage in discussions with those tenderers on the details of the project and take account of the quality of tenderers' proposals as well as the prices that they offer.

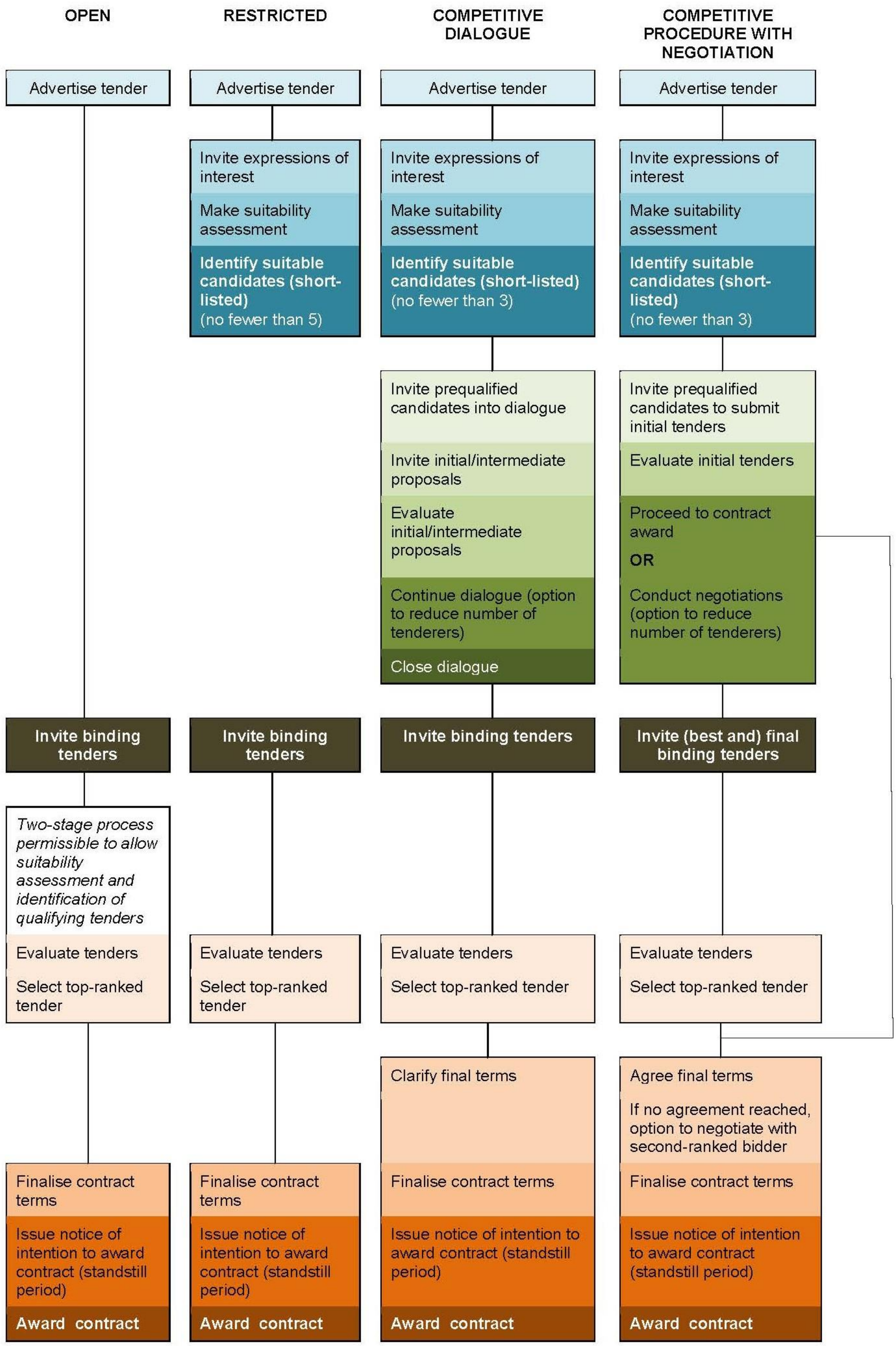
The *open procedure* is not recommended for procuring PPPs and is very rarely used in this context. Furthermore, the *restricted procedure* is also not commonly adopted for PPPs, being used in only a limited number of jurisdictions that have well developed civil codes governing public procurement and contract law.

Common practice is therefore to use a *two-stage process* such as the competitive dialogue procedure and competitive procedure with negotiation. Figure 12 gives an overview of the procedures and the main stages within each.

Reference guidance documents

For guidance on the procurement approach, see *Project Preparation Status Tool*, EPEC (2014)

Figure 12 – Overview of EU Directives and procurement procedures



4.4 Designing an appropriate procurement process

The success of a PPP procurement is strongly influenced not only by the choice of procurement *procedure* (e.g. competitive dialogue), but also by the steps that the public authority uses (the *process*) to implement that procedure.

The process should aim to maximise competition between the private parties tendering for the project to get better value for money for the public authority (and the end users of the services).

The structure of the procurement process can strongly influence the rate of participation and the competitiveness of tenders. It is important, for example, not to create a process that is unnecessarily complex and demanding (and therefore too expensive and time-consuming for tenderers). It is also important to avoid a process that is too open to participation (and therefore reduces participants' chances of success or allows participation from companies not suitably qualified for a long-term PPP contract). As finding an appropriate balance can be difficult, a market consultation conducted before launching the competition (including on the planned procurement process) can be helpful.

In deciding on the structure of the procurement process, the types of issues that the public authority needs to think about include:

- What is the optimal number of candidates to pre-qualify and invite to tender?
- How many rounds of dialogue meetings should there be and on what aspects of the PPP?
- Should there be a reduction in the number of tenderers during the dialogue?
- If so, at what point in the dialogue should this reduction take place and on what basis?
- What qualitative aspects of the tenders are important for the evaluation, and how important are they relative to the tender price?

The steps of the procurement process will also be constrained by the legal requirements of the chosen procedure (e.g. competitive dialogue).

Reference guidance documents

For guidance on the procurement process, see *Project Preparation Status Tool*, EPEC (2014)

4.5 Main steps of a two-stage PPP procurement process

The procurement process for the restricted, competitive dialogue and competitive procedure with negotiation can be considered in *two stages* (see Figure 12):

– **Stage 1: the tendering process** which comprises a number of steps leading from the pre-qualification of candidates and selection of tenderers through to the selection of the highest-ranking tender; and

– **Stage 2: the preferred tenderer negotiation period** which leads from the identification of the preferred tenderer to the conclusion of the PPP contract including contract award and financial close.

4.6 Governance arrangements for the PPP procurement process

The preparation, procurement and implementation of a major PPP project involves many challenges for the public authority. This requires the creation of clear lines of responsibility, accountability and authority for taking decisions at all stages of the project cycle.

For larger PPP projects it is often necessary to bring in external resources in the form of transaction advisers that possess the skills and competences that might not be readily available within the public authority.

Section 3.1 sets out how good project governance can create decision-making mechanisms whereby those with knowledge, skills and experience are adequately empowered so that the processes adopted to implement the project can work effectively and efficiently. This is particularly necessary during Phase 3 when the public authority is exposed to the additional risk of a legal challenge to its management of the procurement process.

It is good practice, to separate the project approval and project management processes. This can be achieved by adopting a dual project governance structure (see Figure 7 in Section 3.1), comprising:

– **a steering committee** responsible for approving the principal decisions required at key steps in the procurement process; and

– **the project team** responsible for managing the PPP project on a day-to-day basis (including managing any external transaction advisers) and reporting to the steering committee.

Further definition of roles and responsibilities is also required for the conduct of the assessment and evaluation processes associated with the pre-qualification of candidates and with the selection and award of the winning tender.

Figure 13 – Main steps in a two-stage PPP procurement process

Stage 1: Tendering Process From the contract notice to the selection of highest ranked tenderer	
Steps	**Key activities**
Procurement notice, invitation to pre-qualify and shortlisting of candidates	- Issue a public procurement notice or *contract notice.* - Send an information document and invitation to pre-qualify to parties who express interest in tendering. - Shortlist the candidates who meet the pre-qualification criteria based on the quality of their submissions.
Invitation to tender	- Send tender invitation documents to the shortlisted candidates, including the tender evaluation criteria and draft PPP contract.
Interaction with tenderers	- Hold one or more meetings with each tenderer to develop potential tender solutions. - Provide any necessary clarifications to tenderers and update tender documents/draft PPP contract, if required. - Invite final tenders.
Evaluation of tenders and identification of the preferred tenderer	- Evaluate compliant tenders using the pre-published evaluation criteria and rank them. - First-ranked tender selected as preferred or successful tender.
Stage 2: PPP contract and financial close From selection of winning tender to contract award and signing of all PPP-related agreements	
Steps	**Key activities**
Finalise PPP contract	- Finalise/clarify/negotiate the PPP contract details with the preferred/successful tenderer. - Make any agreed non-material changes to the tender PPP contract.
Conclude financing agreements	- Lenders to the preferred/successful tenderer carry out their due diligence checks and confirm financing terms. - With the preferred/successful tenderer, finalise the terms of the financing/ancillary agreements with the lenders.
Contract award and financial close	- Issue notice to unsuccessful tenderers of intention to award the contract (*standstill period*). - [Assuming no legal challenge] the PPP contract is signed (*contract close*) along with all related agreements and financing agreement (*financial close*) - All parties satisfy any remaining conditions precedent that are necessary to make the PPP contract effective.

As with the governance of the project preparation activities, it is good practice to define those individuals and teams of individuals that will be responsible for reviewing and marking submission materials, including tenders. The arrangements adopted should be defined before the submissions are received. They should consider the need to maintain close confidentiality of the evaluation process and avoid the potential for any actual or perceived conflicts of interest of the evaluation team members.

Reference guidance documents

For guidance on managing and planning the process, see *Project Preparation Status Tool,* EPEC (2014)

4.7 Procurement notices, prequalification and shortlisting

4.7.1 Procurement notices

Advance notice of a pending competition can be given by a public authority to the market with a prior information notice (or *PIN*). This can have the advantage of allowing the teams that will comprise the bidding consortia to talk to each other and make their groupings before the tender invitation documents are issued.

Publication by the public authority of a formal procurement notice (or *contract notice*) marks the start of the procurement process and gives legal effect to the proceedings that will lead to the award of a public contract. The contract notice is normally required to follow a standard format. The publication of such a notice is generally required to meet transparency requirements but will also maximise competition, so helping VfM.

The information in the contract notice should be sufficiently precise to enable interested parties to identify the nature and scope of the procurement and decide whether to request to participate in the procedure.

EU Member States must publish all such contract notices in the Official Journal of the European Union (OJEU). Publication of the contract notice may also take place on other public electronic platforms that target certain market sectors or jurisdictions. To attract the attention of a wider market (and increase competitiveness), it is also good practice to advertise larger, more significant contracts in relevant national and/or international newspapers and industry magazines.

4.7.2 Pre-qualifying and shortlisting candidates

If the market consultation has been effective and advance warning has been given of the intended start of the procurement process, a number of different groups of companies that are interested in tendering for the project will have joined forces, usually in the form of a consortium.

The primary goal of the pre-qualification process is to confirm the capacity of each of these candidate groups to undertake the PPP contract and to identify those *candidates* who are best qualified to prepare a tender for the project. At the end of the pre-qualification process, only candidates deemed capable of carrying out the PPP project in an adequate manner are invited to participate as *tenderers* in the next stage.

Candidates are selected on the basis of their technical and economic capacity and capability to undertake the project and by reason of their qualifications in respect of the requirements of the contract.

- **The pre-qualification information document**

This is the formal document whereby a public authority provides information on the project and invites interested parties to demonstrate their suitability to participate in the tender stage**.**

The suitability of a candidate to be invited to tender is determined by an assessment by the public authority of the responses submitted by the candidate to a list of specific queries that are included in the pre-qualification information document, usually in the form of a questionnaire (the *pre-qualification questionnaire* or *PQQ*).

As well as describing the project and activities that will be related to the performance of the PPP contract, the document should also describe the administrative arrangements for handling formal requests for clarification and queries during the pre-qualification process and for the receipt of submissions.

Any request by a candidate for clarification of the information document should be made to the public authority using the defined communication protocol (such as a web-enabled document platform or dedicated e-mail).

Box 11 – Pre-qualification information document

The pre-qualification information document will provide parties interested in participating in the tendering process for the PPP project with the following information:

- *an overview of the contract;*
- *a description of the procurement process to be followed;*
- *any minimum qualifications required of participants;*
- *the pre-qualification questionnaire or PQQ;*
- *any particular directions on how to complete the questionnaire;*
- *the rules of the competition, including any selection criteria;*
- *the deadline for submission of the information requested in the questionnaire;*
- *the contact details of the contracting authority and process for handling queries.*

The information provided should be sufficiently precise and informative to enable interested parties to identify the nature and scope of the procurement and decide whether to request to participate in the competition.

- **The pre-qualification questionnaire (PQQ)**

The *pre-qualification questionnaire* (or *PQQ*) is a separate document prepared by the public authority that is attached as an appendix to the pre-qualification information document. It is generally laid out in a tabular format with boxes in which the candidate is invited to provide the relevant information in response to the requests made.

Typically a PQQ would request candidates to provide information on:

- the **business activities** of the candidate (e.g. number of projects of a similar nature the candidate has implemented over a specified number of years);
- **financial information** relating to the economic capacity of the candidate (e.g. parameters such as turnover, net worth, gearing, etc.);
- **legal and corporate information** about the candidate, including any relevant litigation involving the companies that make up the candidate;
    - the **qualifications of key personnel** proposed to be involved in the project; and
    - **bank and other references** and (if required) the tender bond.

It is important for the public authority to set a realistic timetable for the pre-qualification process. Too short a period for candidates to prepare a response to the contract notice can jeopardise the subsequent implementation phases of the project by possibly limiting the number of submissions and affecting their quality.

A public authority should give itself adequate time to assess the submissions and to manage the process through the project governance structure. Delays in the process owing to over-optimism can reduce confidence in the ability of the public authority to manage the remaining stages and can affect bidder confidence.

Selection criteria for pre-qualifying and shortlisting candidates

The types of criteria that a public authority may apply when determining the suitability of a candidate for the award of a public contract fall into three categories:

- suitability to pursue the professional activity;
- economic and financial standing; and
- technical and professional ability.

The Public Procurement Guidance for Practitioners issued by the European Commission presents detailed guidelines on how to shortlist those replying to a pre-qualification information document, based on the principles of *equal treatment, consistency, non-discrimination and fairness.* The marking scheme to be used to assess the relative merits of each submission should be set out in the pre-qualification invitation document.

All requirements that have to be met by a candidate in order to be assessed as suitable must relate to and be proportionate to the subject matter of the contract.

Reference guidance documents

Public Procurement Guidance for Practitioners, European Commission (2018)

Minimum acceptance criteria are usually measured through pass/fail tests. Such tests set minimum thresholds of technical and financial experience and/or capacity which all candidates are required to have. The application of such criteria must be carried out in accordance with non-discriminatory and transparent rules which are made known to candidates in the pre-qualification information document.

Thresholds should be expressed in terms that are clear and objective and that can be applied mechanically. Furthermore, they should be neither too onerous (thereby unnecessarily limiting the number of candidates who are eligible to participate) nor so light that there is no effective discrimination.

If the application of the pass/fail tests results in a number of consortia that exceeds the maximum number pre-specified for the shortlist, then a systematic and pre-determined process for scoring or ranking should be used.

- **Assessing the submissions from candidates**

The public authority should define and document its process for the receipt and assessment of the candidates' submissions in the same manner as would apply to the receipt of a formal tender.

The submissions should first be checked to ensure that they are complete (i.e. all evidence required has been provided and all questions answered) and comply with the minimum requirements of the information document (e.g. any minimum requirements in relation to technical or financial capacity such as specific project experience or turnover.)

The submissions should be assessed by a pre-defined team comprising members of the project team. It is usual for the steering committee to be involved in the review and approval of any recommendations to select the candidates who will be invited to participate in the next stage of the competition as tenderers.

Reference guidance documents

For a more detailed discussion of the selection criteria, see *PPP Procurement Handbook*, EPEC (2018)

4.8 The invitation to tender

4.8.1 Overview of the invitation to tender process

The goal of the tendering process is to maximise VfM by creating appropriate incentives through the competitive process for the award of the long-term PPP contract.

The outcome of the pre-qualification process is the selection of a limited number of candidates that will be invited to participate as tenderers in the final phases of the tendering process.

While the process and practices adopted to shortlist candidates are generally standardised and reflect the approach of non-PPP procurement processes, the process and practices used to solicit PPP tenders from pre-qualified and shortlisted candidates vary much more widely. The approach adopted will often reflect national practices in other forms of procurement, being simply those processes and customs that are accepted within the market and are familiar to both the public and private sector participants.

Purpose of the tender invitation document

The tender invitation document contains all the information that tenderers will need in order to formulate and make a competitive offer to the public authority.

The invitation document communicates to tenderers the relevant detailed information about the project and the service requirements sought by the public authority. It conveys to tenderers the main findings and conclusions of the previous research, analyses and feasibility studies undertaken by the public authority during the project preparation phase, making available all the relevant supporting documentation.

The document should describe with precision and clarity all the steps in the process that the public authority intends to follow, leading to the appointment of a preferred tenderer. It will describe what is expected from tenderers during the course of any dialogue or interaction, how they must present their proposals to the public authority as well as the criteria that will be used for evaluating and ranking interim and final tenders.

The tender invitation documents (ITT, ITN or ITPID)

The choice of the procurement procedure determines the type of invitation document that the public authority will prepare in order to invite the selected candidates to participate in the final phases of the procurement process.

In the case of a standard procedure (open or restricted), a public authority will typically issue an *invitation to tender* document (ITT) – sometimes also referred to as a *request for proposals* or *request for tender*.

When using either the competitive procedure with negotiation or competitive dialogue, the public authority issues an invitation to participate in the next phase of the particular process – being, respectively, either an *invitation to participate in negotiation* (ITN) or an *invitation to participate in dialogue* (ITPID). Under the competitive dialogue procedure, the public authority will also subsequently issue an ITT once the dialogue has been completed and formally closed.

The nature of the procurement procedure selected by the public authority has obvious implications for how the tender invitation document is drafted, especially those sections that explain to tenderers the mechanics of the competitive process and instruct them on how they are to respond.

- **Content of the tender invitation document**

The tender invitation document will usually comprise the following component parts:

- a section giving information on the project and the requirements of the public authority;
- a section describing the procurement process and timetable;
- factual data and survey information that can be used to prepare the tenders;
- a section providing instructions to tenderers; and
- the proposed draft PPP contract and associated technical and financial schedules.

Further details on what should be included in the tender invitation document are provided in the WBIF EPEC *Guide to the PPP procurement process* document.

- **Information to be used by tenderers in preparing their tenders (data room)**

As a rule, the public authority should make available to tenderers as much information as possible to facilitate the preparation of the tenders. This information for the use of tenderers is often placed in a *data room*. The data room may either comprise a physical space with hard-copies of the data or, more usually, a secure web-enabled information platform on which tenderers are granted access to electronic copies of the data.

To introduce tenderers to the often-extensive information that is available to support the tender preparation phase, the public authority may consider convening a tenderers' conference. This event usually takes place shortly after issuing the tender invitation document and provides a forum in which tenderers may ask questions of the public authority and its advisers.

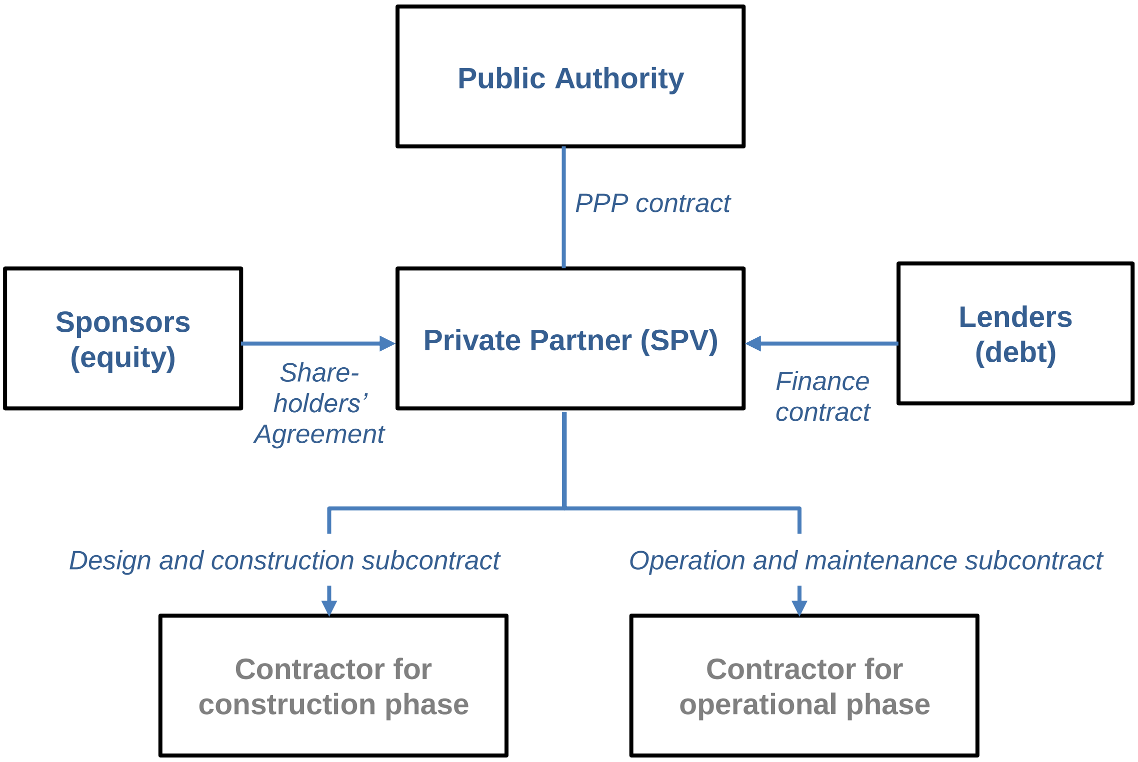
4.8.2 Draft PPP Contract

- **Main terms and conditions of the PPP contract**

It is established good practice to include in the procurement documents a full draft of the PPP contract. Disclosing the draft PPP contract simultaneously with the issuance of the procurement documents helps bidders improve their understanding of the challenges of the project when preparing their tenders. (In some jurisdictions, the public authority will publish a draft PPP contract with the pre-qualification information document.)

The draft contract may also include draft outlines showing the main heads-of-terms of the principal subcontracts (usually the design and construction subcontract and the operation and maintenance subcontract – see Figure 14).

Figure 14 – Main contractual arrangements in a typical PPP



- **Public authority's requirements (including the output specifications)**

The tender invitation document should indicate all the outputs required to provide the public infrastructure and related services.

The requirements of the public authority for the infrastructure and associated services to be provided should be set out in detailed specifications. These requirements, expressed in output terms, form part of the PPP contract and specify the minimum technical standards and level of service to be provided by the private partner.

The public authority should express its required minimum levels of service clearly and unambiguously, in order to allow the private partner to assess accurately the investment needed to provide the required level of service. The requirements may also include the need to make the asset and services available by a specific date.

The public authority should use the dialogue meetings to make sure that the tenderers understand the project requirements fully. This interaction with tenderers is also an opportunity to clarify and adjust (if necessary) these requirements, with the objective of improving each tenderer's solution and therefore the VfM of the bids (see Section 4.9).

- **Payment mechanism**

In an availability-based PPP, an essential component of the tender invitation document is the description of the payment mechanism, which will constitute the main (and in many cases the only) source of revenues for the private partner.

Payment mechanisms are usually expressed as a periodic unitary (i.e. single) payment for full availability and performance of the services (the *availability payment*), often with a time-based adjustment to a portion of the payment using an appropriate price index.

As with the technical and service requirements, the public authority should use the dialogue meetings to make sure that the tenderers understand the payment mechanism (see Section 4.9). This interaction with tenderers is an opportunity to clarify and adjust (if necessary) these requirements and improve the VfM of the bids.

- **Required insurances under the PPP contract**

The public authority typically requires insurance coverage against certain project risks to be put in place under the PPP contract.

As it is an item that can affect the pricing of the final tender, it is important for any minimum coverage requirements to be highlighted in the tender invitation document.

- **Independent certifier**

In some PPP contracts, the public authority may choose to appoint an independent party (the *independent certifier*, sometimes also called *independent engineer*) who will monitor the performance of the construction stage for compliance with the PPP contract.

The appointment of the independent certifier is usually arranged jointly by the public authority and preferred tenderer and is made prior to contract close. The cost of the services provided by the independent certifier should be included in the final tender offers.

Reference guidance documents

For guidance on service output requirements and preparing the draft contract, see *Project Preparation Status Tool,* EPEC (2014

4.9 Interaction with tenderers

4.9.1 Overview of requirements

The tendering process will usually include the opportunity for interaction between the public authority and the tenderer. This will usually take place during pre-planned dialogue or consultation meetings.

Whether using the competitive dialogue procedure or a procedure with negotiation, these meetings are generally conducted in a series of phases. Each period of consultation will generally have specific items that are to be discussed between the parties.

4.9.2 First phase of dialogue

The purpose of the first phase of dialogue is initially to ensure a common understanding of the tender invitation document. Clarification of the public authority's requirements for the project will allow the process to be optimised for all tenderers in the same manner.

The dialogue takes place with each tenderer separately and in a formal meeting format. Authorised representatives of the tenderer should attend as well as the public authority and any relevant transaction advisers (as part of the project team).

It is good practice to agree an agenda with the tenderers for each dialogue in advance of the meeting and for any pre-meeting submission materials to be provided in advance to the public authority. This will usually allow a more informed discussion to take place at the dialogue meeting.

A written record should be kept by the public authority of the dialogue meeting, including of any agreements reached on amendments to the draft PPP contract and project requirements.

4.9.3 Second (and subsequent) phase(s) of dialogue

In the second phase of the dialogue, the public authority meets with tenderers and agrees with them the PPP final tender contract that will form the basis of their final tender. Dialogue will also continue on more detailed aspects of the project requirements, allowing the public authority to discuss with each tenderer the particulars of their unique solution. Discussion will often take place on the more commercial aspects of the developing solutions, including the payment mechanism and insurances.

Care must be taken during each dialogue phase to protect the confidential information associated with each tender and to ensure that ideas from one tenderer are neither deliberately nor inadvertently transmitted to another.

4.9.4 Final tender submission

The final tender submission phase follows the public authority's closure of the dialogue and issue of an Invitation to Tender (ITT) document. The ITT will generally reiterate many of the rules and content of the earlier ITPID, but modified to reflect the conclusion of the dialogue and any changes agreed to the draft PPP contract (the tender PPP contract).

Tenderers must make a final tender submission in this phase. Tenders must continue to satisfy all the minimum project requirements. This generally means that the final tender must be presented according to a defined format with certain minimum information to be included.

4.9.5 Managing tenderer queries and requests for clarification

Any request by a tenderer for clarification of the tender document should be made to the public authority using the defined communication protocol (such as a web-enabled document platform or dedicated e-mail). The tender invitation document should describe the arrangements for handling formal requests for clarification and queries during the tendering process.

The public authority should ensure that there is a rigorous process for the management of such queries so that they are dealt with expeditiously by the relevant members of the project team.

It may be useful, when there are a large number of queries, to manage these requests in batches on, say, a weekly basis. This approach can also facilitate a process of issuing periodical notices (or *bulletins*) to the tenderers addressing any changes or updates to the tender invitation document.

4.10 Evaluation of tenders and selection of preferred tenderer

4.10.1 Tender award criteria

The tender award criteria constitute the basis on which a public authority chooses the best tender and awards the PPP contract. These criteria must be established by the public authority in advance of the issuance of the tender invitation document and must not be prejudicial to fair competition.

The criteria for the awarding of contracts are either the lowest price or the most economically advantageous tender (MEAT).

- **Use of lowest price criterion in PPP procurements**

  The lowest price criterion is simple and can be applied mechanically. However, it has the limitation of not allowing the public authority to take into account qualitative elements of the tender.

  Within PPP procurements, the complexity of projects and the nature of the services being sought will generally mean that this approach is not sufficient for judging the relative merits of the tenders received.

- **Use of most economically advantageous tender (MEAT) criterion in PPPs**

The most economically advantageous tender is generally identified through an assessment of best price-quality ratio, which should include both price and non-price elements. The non-price related criteria typically concern the quality of the proposed design and construction (including the delivery time), as well as the proposed standards of service (see Box 12 below).

The quality criteria selected should be relevant to the subject-matter of the project. The ratio of the price and non-price elements should be weighted to reflect their relative importance/priority and be focused on the requirements of the project. Any sub-criteria should also be clearly defined, with any relative weighting, again, being proportionate to their importance to the delivery of the service.

In this respect – and especially for complex projects – the public authority should seek suggestions from the transaction advisers for proposing criteria regarding the technical, environmental and economic aspects of the project. This may include the assessment of the technical robustness and relevance of solutions, and assumptions relating to demand and performance targets.

Box 12 – Non-price related criteria in Directive 2014/24/EU

In accordance with Directive 2014/24/EU:

- *quality, including technical merit, aesthetic and functional characteristics, accessibility, design for all users, social, environmental and innovative characteristics and trading and its conditions;*
- *organisation, qualification and experience of staff assigned to performing the contract, where the quality of the staff assigned can have a significant impact on the level of performance of the contract; or*
- *after-sales service and technical assistance, delivery conditions such as delivery date, delivery process and delivery period or period of completion.*

4.10.2 The tender evaluation process

Once the tenders are submitted, they must be evaluated by the public authority in order to arrive at the selection of the preferred tenderer.

Before the evaluation process starts, the tender submissions should be checked to ensure that they are complete (i.e. that no parts of the tender submission documents are missing and no key information has been omitted in error) and that the format of the tender submission complies with the rules of the invitation to tender. The public authority, in accordance with the rules described in the tender documents, may reject any tender submission at this stage that is either incomplete or does not comply.

Compliant tenders will generally be assessed first on a number of pass/fail criteria before the single preferred tenderer is decided on (e.g. that the solution meets all minimum technical requirements set in the output specification, or that the costs and financial structure are consistent with the technical solution).

Once these checks and assessments have been completed, then the individual tenders should be assessed by the tender evaluation panel in accordance with the criteria and the weights set out in the tender documents.

The application of the award criteria and their respective weights determines the ranking of the tenders, thus identifying the preferred tenderer. It is good practice for the public authority to communicate the results of the tender to all respondents.

Stage 2 – The PPP contract and financial close

4.11 Introduction to Stage 2

Stage 1 of the tendering process ends with the appointment of the preferred tenderer, based on the evaluation of its tender in accordance with the published evaluation criteria.

The nature of PPP contracts is such that it is generally not possible to sign the contract immediately after identifying the winning tender.

A number of important activities must first be managed and completed during this Stage 2 by the preferred tenderer - the *preferred tenderer period* - to the satisfaction of the public authority.

The process leading to contract and financial close involves a series of steps summarised in Figure 15 (see also Box 13).

Box 13 – Contract Close and Financial Close

The signing of the PPP contract between the preferred tenderer and the public authority (contract award or contract close) and the signing of the financing agreements between the preferred tenderer and the financiers (financial close) are separate activities that are dependent on each other.

Contract close occurs after the designation of a preferred tenderer and final award of the public contract. The date of signature marks the commencement of the obligations laid down in the PPP contract. Provisions in the contract may defer its full effectiveness (i.e. conditions precedent) which will usually include achieving financial close. In principle, no material changes to the PPP contract are possible between final tender submission and contract close.

Financial close cannot occur before contract close. Financial close is the conclusion of the financing agreements by the preferred tenderer within the period established in the tender documents and PPP contract. Financial close can take place at the same time as contract close.

Figure 15 – Main steps Stage 2 of the PPP procurement process

Stage 2:	**PPP contract and financial close** From selection of winning tender to contract award and signing of all PPP-related agreements
Steps	**Key activities**
Finalise PPP contract	- Finalise/clarify/negotiate the PPP contract details with the preferred/successful tenderer. - Make any agreed non-material changes to the PPP contract.
Conclude financing agreements	- Lenders to the preferred/successful tenderer carry out their due diligence checks and confirm financing terms. - With the preferred/successful tenderer, finalise the terms of the financing/ancillary agreements with the lenders.
Contract award and financial close	- Issue notice to unsuccessful tenderers of intention to award the contract (*standstill period*). - (Assuming no legal challenge) the PPP contract is signed along with all related agreements (*contract close*) and the financing agreement (*financial close*) - All parties satisfy any remaining "conditions precedent" that are necessary to make the PPP contract effective.

The expected Stage 2 activities will have been set out in the tender invitation document together with a timetable indicating the planned date for award of the contract. This will have been discussed in the final rounds of discussion during the dialogue process in order to obtain broad agreement from the tenderers on these important next steps.

The public authority must manage this process together with the preferred tenderer, taking responsibility for meeting the terms of the PPP contract and concluding any matters on the public side that are essential to the performance of the contract (e.g. securing any other public approvals necessary to sign the contract or obtaining final consents or permissions such as building permits).

To be effective – and to sustain competitive tension – the process must keep strictly to the timetable set out in the invitation document. This stage therefore requires thorough organisation and management by both the public and private parties for it to proceed efficiently.

4.12 Finalising the PPP contract

The tender invitation document should describe in principle, if not in detail, what the public authority expects of the preferred tenderer during this step of the process. A time limit should be given to allow the preferred tenderer to conclude these activities in readiness for contract close. This should be a practical and realistic period – typically lasting between one month and three months, depending on the complexity and size of the project.

4.12.1 Updating and fine-tuning the PPP contract

Even when the text of the PPP contract is part of the procurement documents and the tenderers have confirmed their acceptance of the terms and conditions thereof, the tender PPP contract will still need some *fine-tuning*. This part of the process will be led by the public authority, and may result in the production of the final PPP contract.

The different procurement procedures entail varying forms and intensity of discussions once the preferred tenderer has been selected. Whatever the level of engagement, a general good practice principle is that any change to the tender PPP contract should not be material to the procurement. For example, changing a fundamental aspect of the risk allocation would not be permissible under the procurement law. This is because competitive tension is no longer available, it provides an unfair advantage and exposes the process to the risk of challenge by unsuccessful tenderers.

4.13 Concluding the finance agreements

4.13.1 Putting in place the finance for the project

Typically – and for the most part – PPPs are financed through a combination of equity and debt (senior and/or subordinated/mezzanine). Tenderers will have already entered into provisional agreements with financiers to the effect that the financing will be made available as soon as the PPP contract is signed and becomes effective.

4.13.2 Timing of lenders' commitment to the financing terms for the project

- **Committed debt financing with the final tender submission**

  In mature and normally functioning financial markets, where there is a sufficient number of financial institutions available to support a number of tenderers in a given competition, it may be possible to request tenderers to make a firm and binding offer with the final tender submission.

  The terms of the debt financing agreement will be subject to a number of conditions to be satisfied by the tenderer.

  It must be recognised, however, that it may not be possible to require tenderers to offer committed financing when submitting their final tender. Lenders might be reluctant to commit to the sometimes lengthy and costly processes of making a full binding offer before having a reasonable expectation that their client will be awarded the contract. In an emerging market, capacity constraints may in any case make it very difficult to receive financially binding offers.

- **Expressions of support with final tenders and commitment to debt financing agreed during the preferred tender period**

  When the market is unlikely to be in a position to give a financing commitment at the final tender submission stage then *letters of support* equal to a stated minimum amount of financing should be sought as part of the requirements of the final tender submission.

These letters will typically follow a model form that should be provided with the tender invitation document.

Multilateral financing institutions tend to prefer this approach since - as they are generally agreeing to finance whichever tenderer is selected - it means they do not have to carry out their full due diligences on all the tenderers (a costly and resource intensive exercise).

- **Preferred tenderer debt funding competition**

Where the capacity of the project finance market is limited (e.g. where the number of banks able to finance the project on competitive terms is insufficient to ensure an appropriate competitive process), the public authority may choose to have the financing of the project arranged during Stage 2 using a *preferred tenderer debt funding competition*.

In this arrangement, the preferred tenderer would invite a list of (usually pre-selected) financial institutions to tender to provide the debt finance required (either wholly or in part). The preferred tenderer manages this funding competition under the supervision of the public authority. In this instance, final tenders will have been submitted using a common term sheet prepared by the public authority.

Reference guidance documents

Preferred bidder debt funding competitions, UK Government (2006)

4.13.3 The PPP financing documents

The financing agreements have to capture all the implications of the relationships among all the stakeholders (the public authority, the private partner and its subcontractors, the providers of equity, mezzanine and debt financing, and the insurers).

For large PPPs, the financing agreements will include the documents listed in Box 14, some of which will eventually become part of the PPP contract.

Once the financing agreements have been signed, their entry into force is subject to the satisfaction of any conditions precedent (see Section 4.14 4.14.2 below).

Box 14 – Main PPP financing agreements

- *Senior loan agreements: agreements between the senior lenders and the private partner*
- *Common terms agreement: an agreement between the financing parties and the private partner which sets out the terms that are common to all the financing instruments and the relationship between them*
- *Subordinated loan agreements (where subordinated or mezzanine debt is used in the financing structure)*
- *Shareholders' (i.e. Sponsors') agreement (as part of the constitutive documents of the company forming the private partner)*
- *Direct agreement between the lenders and the public authority*
- *Accounts agreement: this involves a bank which will control the cash flowing to and from the private partner*
- *Intercreditor agreement: an agreement between the creditors of the private partner that spells out aspects of their relationship with one another and the private partner company*
- *Hedging agreements: agreements which enable the private partner to limit its exposure to interest rate and foreign exchange rate risks;*
- *Security agreements (e.g. share pledge, charge over accounts, movables pledge, receivables pledge)*
- *Parent company guarantees and other forms of credit enhancement where the sponsors of the private partner or its subcontractors do not offer sufficient financial strength*
- *Legal opinions from the lender's legal advisers on the enforceability of the contracts and the powers of the various parties (including the public authority) to enter into the transaction.*

4.14 Contract award and financial close

4.14.1 Timing of the contract close and financial close

Once the financing arrangements are agreed, the signing of the financing agreements (i.e. financial close) may take place either at the same time as the signature of the agreed PPP contract (i.e. contract close) or sometime thereafter (i.e. separate or *split* contract and financial close). The signature of the financing agreements and fulfilment of any conditions precedent to those agreements will usually be a condition precedent to the full effectiveness of the PPP contract.

It must be remembered that after contract close, the procurement process is concluded and cannot be re-opened (e.g. to revert to the second-ranked tenderer).

- **Simultaneous contract close and financial close**

The preference in many cases is that the PPP contract and the financial agreements are signed simultaneously. This has the advantage of mitigating the risk of potential unavailability of financing after the signature of the PPP contract, even if the period between the two signatures is very short.

- **Separate (split) contract close and financial close**

In some markets the objective of agreeing and finalising the financing agreements simultaneously with the PPP contract can often prove ambitious.

Sometimes the need to separate financial close and contract close might be driven by the fact that certain activities are perceived as too complex, costly or time consuming to pursue during the tender process, but need to be completed before lenders will commit to the project. Examples include where the applicant for project permits needs to be the same legal entity that delivers the PPP contract, or where significant design development is needed in order to secure project permits.

In order to mitigate against the potentially severe consequences of not reaching financial close (and/or lenders seeking to amend aspects of the signed PPP contract), the public authority may require tenderers to provide evidence of a realistically deliverable financing plan as part of the final tender submissions. Tenderers should demonstrate that their lenders have reviewed and accepted the broad structure of the PPP and the major contractual provisions of the tender PPP contract (including the proposed risk allocation).

When the public authority intends to separate the contract and financial close processes, this must be described in the tender invitation documents. The preferred tenderer should describe clearly to the public authority the tasks to be performed and how they will be completed.

In some instances, the public authority may choose to request additional security in the event that the financial close is not achieved by the private partner, for example, in the form of a bond.

4.14.2 Satisfying the conditions precedent

- **Conditions precedent to the PPP contract**

As described earlier, there may be activities that the private partner is required to undertake, the performance of which is necessary before the PPP contract can take full effect. Typically, these relate to securing required permissions and consents from other public bodies that are linked to the design and construction of the project and to the delivery of services.

- **Conditions precedent to the financing agreements**

The financing agreements may also contain required conditions which must be satisfied to enable funds (e.g. loans, equity, mezzanine, grants) to start flowing to the project partner so that full project implementation can take place. (The private partner may initiate certain limited activities using its own funds at the start of the project.)

All conditions precedent contained in the PPP contract and financing agreements need to be fulfilled before the contract can take full effect. Box 15 lists a number of the most common conditions precedent in PPP contracts and financing arrangements (in practice the list would be much longer).

Box 15 – Common conditions precedent in PPP contracts

- *The main permitting and planning approvals have been secured;*
- *The key land acquisition steps have been achieved;*
- *The outstanding technical design issues have been clarified;*
- *Any remaining key project and financing documents have been finalised and signed;*
- *All funding approvals are in place;*
- *Proper registration of the security for the loans has been confirmed;*
- *The public authority has confirmed that the requirements of all internal approvals have been met.*

4.14.3 Notices to other tenderers, standstill period and contract award notice

The public authority should notify the unsuccessful tenderers of its intention to award the contract to the identified preferred tenderer. The issue of this notice is accompanied by a *standstill period* of 10 business days (under the EU directives) between the notification of the PPP contract award decision and contract close. The rationale for this is to communicate the public authority's decision (and the basis of the decision) to the unsuccessful tenderers and allow them an opportunity, if dissatisfied with the decision, to request a review and to consider whether to challenge the award.

Once the standstill period has elapsed (and subject to any review of the decision to award having been concluded), the PPP contract and associated project documents may be signed and completed, so achieving contract close. As has been stated, financial close may take place either simultaneously with or later than contract close.

Following the conclusion of the contract (or as soon as practicable), the public authority might issue a contract award notice giving details of the contract and the successful tenderer.

Annex – Project finance

Introduction

This Annex introduces project finance and the link to the financing structure of PPP projects. It is not meant to cover all the issues relevant to PPP financing structures, which are many and complex and often project-specific. Public authorities should rely on the expertise of financial and legal advisers to understand the relevant trade-offs in project finance issues.

PPP projects are generally financed using project finance arrangements. In project finance, lenders and investors rely either exclusively ("non-recourse" financing) or mainly ("limited recourse" financing) on the cash flow generated by the project company to obtain repayment of their loans and earn a return on their investments. This is in contrast to corporate lending where lenders rely on the strength of the borrower's balance sheet for their loans.

It is important to stress that the project finance structure should be designed to optimise the costs of finance for the project. It should also underpin the allocation of risks between the public and private sectors as agreed in the PPP contract. In particular, the project financing should ensure that financial and other risks are well managed within and between the PPP company shareholders (i.e. the sponsors) and its financiers. This should give comfort to the public authority that the PPP company, and particularly its lenders, are both incentivised and empowered to deal in a timely manner with problems that may occur in the project.

Principles of project finance

In a project, finance transaction, a PPP company would usually be set up by the sponsors solely for the purpose of implementing the PPP project. It will act as borrower under the underlying financing agreements and will be a party to a number of other project-related agreements, including the PPP contract.

The top-tier financing provided by lenders or capital market investors, usually referred to as *senior debt*, typically forms the largest but not the sole source of financing for the PPP company. The rest of the required financing will be provided by the sponsors in the form of equity or junior debt.

Even though responsibility for arranging the financing of a PPP rests with the private sector (the PPP company is the borrower), it is important for the public authority's officials and their advisers to understand the financing arrangements and their consequences, for the following reasons:

- When the public authority evaluates a bidder's proposal, it must be able to assess whether the proposed PPP contract is bankable and whether the proposed financing is deliverable in light of the market conditions and practices prevalent at the time. Awarding the PPP contract to a company that ends up being unable to finance the project wastes time and resources.

- The allocation of risks in the PPP contract can affect the feasibility of different financing packages and the overall cost of the financing.
- The financing can have an impact on the long-term robustness of the PPP arrangement. For example, the higher the debt-to-equity ratio, the more likely it is that in bad times the PPP company will run the risk of a loan default, possibly terminating the project.
- If the PPP includes State guarantees or public grants, the authority will play a direct role in some part of the financing package.
- The amounts and details of the financing can directly affect contingent obligations of the authority (e.g. the payments the public sector would have to make if the PPP contract were terminated for various reasons).
- The authority's financial advisers should have a thorough understanding of what will be needed to make the PPP project bankable, given market conditions and practices prevalent at the time.

Financing structure

As outlined above, the financing of a PPP project consists principally of senior debt and equity (which may sometimes be in the form of junior shareholder loans). The financing structure may also include other forms of junior debt (such as "mezzanine" debt, which ranks between senior debt and pure equity) and in some cases grant funding.

As a general principle, the higher the gearing of a project, the more affordable it is likely to be to the public sector. This is because senior debt is less expensive than other forms of financing (except grants). Other things being equal, project gearing (i.e. the level of debt senior lenders will provide relative to the level of equity) will be determined by the variability of a project's cash flow.

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Glossary of main terms and expressions

Affordability

Affordability relates either to the ability of the public authority to make performance-based payments to the private partner from the public budget (in *a government-pay PPP*) or the ability and willingness of users to pay the tariffs/tolls charged by the private partner (in a *concession*).

Availability payment (and availability-based PPP)

In an availability-based PPP (a type of *government-pay* PPP), the public authority pays the private partner for the provision and use of public infrastructure and related public services. Payment is linked to the availability of the asset and/or the services for the duration of the PPP contract (the *availability payment* or *unitary payment/unitary charge*). The availability standards and service requirements of the public authority are defined in the PPP contract.

In most contracts of this type, payment to the private partner only starts once the construction phase is complete and the services can be delivered.

Bankable (and bankability)

A PPP project is considered bankable if lenders are willing to finance it.

Candidate

A company or group of companies (usually in the form of a consortium or joint venture) that submits a response to an invitation to pre-qualify for a project as part of the procurement process.

Concession

A concession (sometimes called a *user-pay PPP*) is a type of PPP in which the public authority grants a private partner the right to generate revenues from the provision of a service. The private partner is paid by the users of the service and normally assumes the risk of any change in the users' demand for the service. The service requirements of the public authority are defined in the concession contract. (e.g. keeping a bridge open to traffic, collecting tolls from users of a bridge).

Conditions precedent

Conditions that need to be fulfilled before the PPP contract becomes effective or before drawing on the debt. Either party might be responsible for fulfilling the conditions in a particular PPP contract, but the private partner usually has a greater responsibility in this respect.

Contract close (and commercial close)

Contract close (sometimes called *commercial close*) is the point at which the PPP contract is signed by the public authority and the private partner. The main terms of the PPP contract will be completed at financial close.

Credit enhancement

The credit profile of a project finance structure can be improved by various forms of credit enhancement; for example:

- **credit support** in the form of guarantees by the sponsors relating to the performance of the SPV's obligations, financing facilities that provide temporary liquidity to deal with specific risks and insurance against certain project related risks.

- **public sector support** such as direct funding through a capital contribution (e.g. from national, regional or other funds) or contingent support or guarantees for certain types of risks which cannot otherwise be effectively managed or mitigated by the SPV, lenders or subcontractors.

Default (and event of default)

A material breach of contract by one party (including persistent breach) which entitles the other party to terminate the contract. The PPP contract will often define defaults by reference to precise contractual provisions.

Direct agreement

A direct agreement is a contract, linked to the PPP contract, which creates a contractual relationship between participants in the project whose main contractual relationships are with the private partner. The principal direct agreement is between the public authority, private partner and lender and allows the lender to exercise step-in rights to the PPP contract. The public authority may also have direct agreements with the private partner's sub-contractors that allow it to step-in to the sub-contract in an event of private partner default.

Economic Cost Benefit Analysis (ECBA)

The ECBA assesses whether the benefits brought to society by a particular public investment justify and outweigh the implementation costs. It will usually consider the social, environmental, and economic advantages and disadvantages of the investment as well as to the actual monetary costs and revenues generated by the project.

Equity (and equity investors)

The equity in a PPP is the portion of the project's CAPEX that is contributed as share capital in the SPV (i.e. pure equity) and subordinated debt (usually through shareholder loans and sometimes also called *junior debt*). The equity investors (also sometimes called *equity providers*, *sponsors* or *shareholders*) usually hold both the pure equity and subordinated debt and generally control the SPV. Some equity investors may not take an active role in the management of the PPP contract.

The public authority may sometimes provide equity to the SPV, either directly or through a public investment fund. Public participation in the equity of the SPV (including any rights of control) can influence the statistical treatment of the PPP contract.

Financial close

Financial close is the point at which the financing documents for the PPP contract (including the direct agreement between the lenders and the public authority) are signed and the financing becomes available for the project. It is usually the point at which the interest rate for the project is fixed using an *interest rate swap*. Financial close usually happens at either the same time as or shortly after contract close.

Fiscal risk

PPPs create long-term financial commitments that could (over time and when considered with other commitments) challenge the coherence of the public budget process and ultimately a country's fiscal sustainability and macroeconomic stability. Fiscal risks can exist when the actual and contingent commitments on PPPs are not clearly recognised or understood and where they have not been reported and budgeted for centrally.

Lenders

The term *lenders* in these WBIF EPEC Guides generally refers to the organisations who provide finance to the PPP in the form of senior debt to the private partner. They can include commercial banks, multilateral and bilateral development banks and finance institutions, and institutional investors such as pension funds and insurance companies.

Life-cycle costs (and whole-life costs)

This is the total cost of creating an asset and managing it to the end of its useful life (or for the duration of the PPP contract). It includes the initial cost of construction and the cost of all subsequent maintenance works that ensure that the asset continues to perform at an acceptable or minimum standard. The PPP contract defines the minimum standard of performance to be met by the private partner.

Needs assessment

Assessment of the gap between an agreed set of objectives and existing arrangements that the investment aims to address.

Net Present Value (NPV) and discount rate

The NPV is the discounted value of a project's cash inflows minus the discounted value of its cash outflows. It is calculated based on a *discount rate*. This subject is discussed more fully in the *WBIF EPEC Guide to the qualitative and quantitative assessment of Value for Money in PPPs*.

On and off balance sheet (statistical) treatment of PPPs

A public contract is recorded as either on or off the central government's balance sheet according to the national system of accounts (commonly referred to as the *statistical treatment* of a contract). The treatment of a PPP contract within the government's balance sheet can be an important consideration in the preparation of the project.

Optimism bias

Optimism bias is the systemic behaviour of public authorities (based on project experience) to both i) underestimate the duration of the construction phase of a project and its CAPEX and OPEX and ii) to overestimate the benefits/revenues it will produce.

Output specification (and user requirements)

These are the public sector's requirements defined as a clear set of outputs that are directly measurable in accordance with quality performance standards. The output requirements (sometimes also *user requirements* or *authority requirements*) can include technical requirements and service requirements. They are a distinctive feature of PPP projects in comparison to the input requirements normally used in traditional project procurement.

Payment mechanism

The payment mechanism is the principal means or mechanism within the PPP contract for remunerating the private partner. In a government-pay PPP the two main types of payment mechanism are

- *availability-based*, in which the payments made by the public authority to the private partner are linked to the infrastructure being available for use and services being performed as defined by the PPP contract. The *availability payment* is subject to deductions if the infrastructure is unavailable or where the services are performed poorly. The public authority takes the risk of variation in the demand for the services; and

- *demand-based*, where the payments to the private partner are linked to the level of usage of the infrastructure.

In a concession, the payment mechanism might regulate the basis on which the private partner is entitled to charge users and otherwise generate revenues.

Persistent breach

A persistent breach occurs when the private partner consistently fails to observe provisions of the PPP contract, e.g. fails to comply with the same provision on a repeated number of occasions or accumulates financial or contractual penalties over a defined period.

PPP contract

This is the main contractual document between the public authority and the private partner. It sets out the responsibilities of the private partner for the design, construction, finance, operation and maintenance of the asset and the delivery of the associated public services. The PPP contract allocates project risks between the parties and contains the payment mechanism.

The PPP contract is described more fully in the WBIF EPEC *Guide to the main provisions of an availability-based PPP contract.*

PPP unit

A specialised public organisation that provides PPP expertise in the public sector. This can include advice and support to public authorities in devising and implementing PPP projects and/or PPP policy. It may also have an assurance or approval role. It is usually a part of a government ministry or central public agency, such as the ministry of finance.

Preferred tenderer

The tenderer who has submitted the best compliant tender for a PPP project and with whom the public authority intends to sign the PPP contract. The preferred tenderer becomes the *private partner* when the PPP contract is signed.

Private partner

The private sector company that enters into the PPP contract, with responsibility for delivering and maintaining the public infrastructure and related public services for the duration of the contract. It usually takes the form of an SPV.

Procurement procedure

EU Directive 2014/24/EU (the 2014 Directive) provides four procurement procedures:

- the open procedure;
- the restricted procedure;
- the competitive dialogue procedure; and
- the competitive procedure with negotiation.

The 2014 Directive reforms and supersedes Directive 2004/18/EC (the 2004 Directive). It covers public procurement in general, laying down the principles that should apply to all works, supplies or services contracts. Legislation addressing public procurement within the Western Balkans Region conforms, in large part, to the 2004 Directive.

Procurement process

The WBIF EPEC guides use this expression to describe the steps and activities that the public authority adopts to implement its chosen procurement procedure. In defining the procurement process the public authority will consider matters such as timetable for the procurement (including key milestones), numbers of tenderers to pre-qualify, number and format of meetings with tenderers.

Project cycle

The project cycle is used in the WBIF EPEC guides to describe the series of steps that is followed by a typical PPP project from the time that the project scope is initially defined, through to its completion and delivery of the related services. The project cycle is divided into four phases:

- Phase 1: Project identification phase
- Phase 2: Project preparation phase
- Phase 3: Project procurement phase
- Phase 4: Project implementation phase

Project finance (and project finance structures)

PPP projects are generally financed using *project finance* structures. A project finance structure seeks to optimise the availability of finance and underpin the allocation of risks to the parties best able to manage those risks.

The project assets and revenues are usually ring fenced within an SPV. The SPV's lenders and investors rely either exclusively (i.e. *non-recourse* financing) or mostly (i.e. *limited recourse* financing) on the cash flow generated by the project as their security for the repayment of their loans or to earn a return on their investment. This is in contrast to corporate finance where lenders rely on the strength of the borrower's balance sheet as security for repayment of their loans.

Project identification phase

The identification phase is the first phase of the *project cycle*. At the end of this phase the public authority determines whether the selected project can (and should) be further developed as a PPP and whether to proceed to the project preparation phase.

Project implementation phase

The implementation phase is the fourth and final phase of the *project cycle*. It follows financial close and includes the management of the PPP contract and regular monitoring of the private partner's performance.

Project preparation phase

The preparation phase is the second phase of the *project cycle.* It includes the development of the potential project in readiness for the project procurement phase. The public authority will establish the project's governance structure (i.e. project team and steering committee), conduct further detailed assessments of the project and prepare relevant documents for the procurement phase. The assessments include the detailed affordability analysis, risk allocation and VfM assessment. The public authority defines the preferred procurement procedure and process, evaluation criteria and draft PPP contract.

Project procurement phase

The procurement phase is the third phase of the *project cycle.* It follows the preparation phase and starts with the publication of the procurement notice. It includes all the activities associated with the procurement process up to the award of the PPP contract through to contract close, and ends with financial close.

Public authority

The public sector body (sometimes called the *procuring authority* or *contracting authority*) that plans to enter into a PPP contract with a private sector partner. In an availability-based PPP, it is also the public body who is responsible for paying the availability payment to the private partner.

Public-Private Partnerships (PPP)

The term PPP describes a long-term contractual arrangement in which a public authority and a private partner collaborate to deliver public infrastructure (or assets) and related services. Under a PPP contract, the private partner bears significant risks and management responsibilities. The two main types of PPP contract are a *government-pay* PPP (which includes *availability-based and demand-based* PPPs) and a *concession* (sometimes called a *user-pay* PPP).

Public sector comparator (PSC)

The PSC is a risk-adjusted cash flow model of delivering a project using a traditional public procurement option (sometimes called the *public sector benchmark, PSB*). A comparison of the net present values of the PSC and PPP options for a particular project may be used as part of a quantitative VfM assessment.

Qualitative and quantitative VfM assessments

A *qualitative VfM assessment* often involves testing the PPP project delivery option against a set of pre-defined suitability (i.e. qualitative) criteria to determine the potential for the PPP option to provide VfM.

A *quantitative VfM assessment* usually involves estimating and comparing the costs of a PPP project delivery option with a traditional public project delivery option (i.e. a PSC) where the project risks have been valued. The estimated cost of each delivery option is calculated on a present value basis using an appropriate discount rate.

This topic is discussed more fully in the WBIF EPEC *Guide to the qualitative and quantitative assessment of Value for Money in PPPs.*

Risk management

Risk management is a process that helps to identify, analyse, price and allocate project risks. It starts during the project identification phase and continues for the duration of the PPP project (including the monitoring and review of risks during the implementation phase). This topic is discussed more fully in the WBIF EPEC *Guide to the qualitative and quantitative assessment of Value for Money in PPPs.*

Senior debt

This is the main form of debt raised by the private partner and ranks above other forms of debt (e.g. junior or subordinated debt). The senior debt lenders usually have first priority for loan repayment by the private partner and (in an event of default) over its assets or revenues. The senior debt lenders also have priority of decision-making powers if they exercise rights to step in.

Suitability (as a PPP)

Suitability refers to the appropriateness of using the PPP option to deliver a particular project. A project is, in principle, considered suitable as a PPP if it possesses certain project specific characteristics and the national legal, institutional and market environments are supportive. This topic is discussed more fully in the WBIF EPEC *Guide to the qualitative and quantitative assessment of Value for Money in PPPs.*

Special Purpose Vehicle (SPV) or Special Purpose Company (SPC)

See *private partner.* A legal corporate entity whose sole purpose is to implement the PPP project and which is generally incorporated in the country where the project is located.

Step-in rights

A step-in right is a contractual provision that allows someone to step into the place of a party that has defaulted on is obligations so that the party *stepping in* may rectify the default (and prevent termination of the contract). The two principal types of step-in rights in a PPP are those given to the public authority and those given to the project's lenders.

Subordinated debt

Debt that is generally provided by the shareholders of the SPV and in the same proportion to their respective shareholdings. This debt is subordinated to other debt (i.e. ranks below senior debt).

Supervening event

A supervening event is an event that occurs during the course of the PPP contract that is outside the control of either party. Such events are treated in the PPP contract as either a *compensation event*, a *relief event* (or *delay event*) or as a *force majeure event*. These events are described more fully in the WBIF EPEC *Guide to the main provisions of an availability-based PPP contract.*

Tenderer

A company or group of companies (usually in the form of a consortium or joint venture) that has been pre-qualified (and perhaps also shortlisted) by the public authority as a candidate in the procurement process for the PPP project with the intention of being invited to submit a tender.

Traditional public procurement or delivery

A traditional public procurement or delivery approach involves the provision and funding of public infrastructure and related services by the public authority. The public authority is responsible for the long-term operation and maintenance of the infrastructure. The public authority also bears most of the risks associated with the integration and optimisation of the various activities within the project.

The most commonly-used traditionally procured contracts are:

- a build (or construction) only contract (usually with a separate contract for the design of the infrastructure);
- a design-build contract;
- an engineering, procurement and construction (EPC) contract; and
- an operations and maintenance only contract.

Value for Money (VfM)

VfM is considered as the relative balance between the *value* and the *cost* of the different delivery options that are available (i.e. as between a traditional delivery approach and a PPP approach), where:

- the *value* aspect comprises the quality and quantity of the service (i.e. the performance level) of the different options, delivered over the period of the PPP; and

- the *cost* aspect usually represents the cost to the payer (i.e. the public authority and/or end-user) over the same period to deliver the different options (including the cost of managing the risks).

A *VfM assessment* will identify the delivery option that represents the best balance of long-term risk-adjusted value and cost.

This topic is discussed more fully in the WBIF EPEC *Guide to the qualitative and quantitative assessment of Value for Money in PPPs.*

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