

ARE PUBLIC PRIVATE PARTNERSHIPS EFFECTIVE IN DELIVERING PUBLIC OFFICE ACCOMMODATION PROJECTS?

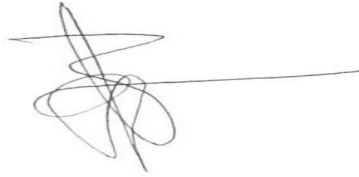
Oarona Bogopane

A research report submitted to the Faculty of Engineering and Built Environment, of the University of Witwatersrand, Johannesburg, in partial fulfilment for the requirements for the degree of Master of Science (Building)

Johannesburg 2007

DECLARATION

I declare that this research report is my own unaided work. It has been submitted for the Degree of Master of Science in Building in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University.



(Signature of Candidate)

24th Day of May 2007

ABSTRACT

The key question this thesis investigates is whether Public Private Partnerships (PPPs) are relevant and effective in delivering office accommodation projects in South Africa.

While the procurement of large infrastructure projects in South Africa. is currently dominated by PPPs, it is, however, a relatively new form of procurement and presents a steep learning curve for those participating in such projects as they evolve.

As South African PPPs are modelled on UK experiences of such partnerships, the greatest challenge we face is to adapt the model so that it recognizes and incorporates the unique South African context within which we work. Furthermore, while PPPs have been applied to a number of building-related infrastructure projects, they have only recently been applied to office accommodation ones. We thus need to explore and apply the relevant aspect of the PPP model for this particular type of accommodation.

The South African National Treasury's list of PPP projects planned for the coming years shows there is a high demand from national and local government departments for office accommodation, as well as a significant backlog for such facilities. This is placing considerable pressure not only on the delivery of such facilities, but also on the ability of government to finance the projects with funds required for other core government obligations. Government has thus had to adopt an alternative means of addressing these issues and is now engaging the private sector to provide the facilities, the financing and the services related to such accommodation.

Using a detailed survey and a study of the relevant literature, this report highlights the key aspects to be taken into consideration in determining the relevance of PPPs in the effective delivery of office accommodation and makes useful recommendations based on the outcomes of the study.

CONTENTS

Chapter 1 – Introduction

- 1. Background
- 1.1 Framework for PPP Research Question
- 1.2 Definitions
- 1.2 Summary of the findings
- 1.3 Delimitations
- 1.4 Structure of the report

Chapter 2 - Literature Review

- 2. Principles of PPP
- 2.1 Challenges with incorporating UK precedents in the South African context
- 2.2 Key value drivers and challenges
 - Robust financial solution
 - Risk Transfer
 - Performance measurement
 - Output specification
 - Socio-economic benefits
 - Partnership approach
 - Procurement process
 - Evaluation of the bids
 - Long-term nature of the project

Chapter 3 Research Methodology

- 3.1 Outline of the methodology
- 3.2 Sampling design
- 3.3 Use of data
- 3.4 Questionnaire piloting
- 3.5 Collection of Data
- 3.6 Construction and Validity of the questionnaire
- 3.7 Method of Analysis
- 3.8 Response to the Questionnaire
- 3.9 Limitations

Chapter 4 - Analysis and Interpretation of the results

Section A – Biographical details
Section B – Impact of Key Value Drivers on the effective delivery of office accommodation projects through PPPs
Section C – Challenges related to Key Value drivers

Chapter 5 – Conclusion

- 5.1 Research findings
- 5.2 Recommended areas of further Research

BACKGROUND

The South African government has recently shown an interest in using Public Private Partnerships (PPPs) to deliver some of its public services and infrastructures. The PPP procurement method is relatively new in South Africa and the complexity related to it poses a number of challenges to both the private and public sector.

The main objectives of a PPP, according to the UK Government, are:

- a) To deliver improved public services by contributing to increases in the quality and quantity of investment;
- b) To release the full potential of public sector assets, including state-owned business, and hence provide value for the taxpayer and wider benefits for the economy;
- c) To allow stakeholders to receive a fair share of the benefits of PPPs (this includes customers and users of the service, taxpayers and employees).

The South African PPP Agreements include other objectives such as:

- d) To deliver black economic benefits; and
- e) To uplift the communities in the project environment.

This study seeks to determine whether PPPs are effective in delivering public office accommodation projects and evaluates arguments for and against them as a means of service delivery. There are primarily two main schools of thought on the use of PPP for the delivery of public services. The proponents of PPPs argue that the benefits of PPPs include:

- Promoting private investment in the capital assets required to deliver public services efficiently by bringing in private sector finance and operational management on a risk-taking basis;
- Improving value for money by allocating risks to those best able to manage them in the public and private sectors;

- Encouraging the upgrading and rationalisation of government property, including that needed for service delivery;
- Allowing the transfer of trading assets to the private sector, which would benefit from better utilisation, and of surplus operational land and buildings;
- Facilitating joint ventures, giving authorities new scope to participate in companies led by the private sector and to secure the council's contribution to only such joint ventures as public expenditure, not the activities of the company as a whole; and
- Removing unnecessary obstacles to partnerships in areas of economic development and regeneration.

(The Department of Environmental Transport Region's (DETR), *Local Government and Private Finance Initiative*, 1998.)

The industry views these benefits with some scepticism, particularly in delivering public office accommodation projects in South Africa.

PPP critics argue that government can provide cheaper services than the private sector. Their criticism includes the following:

- Governments enter into PPPs primarily to avoid debt;
- the cost of service will increase to pay for the private partner's profit;
- PPPs are more costly because of the effective risk transfer to the private sector;
- PPPs result in poorer service quality and inefficient service delivery;
- PPPs make it difficult to benefit from competition due a limited number of potential private partners with the expertise or ability to participate in PPPs;
- the procurement process is long and complex resulting in high opportunity costs for private sector participants;
- the use of output specification may not work as these are very subjective and require a lot interpretation given the complexity of a construction project;
- government staff will lose under PPPs;
- government losses control and accountability to the public;

- Given the uncertainty of the markets, long-term contracts (20 years) may not always be optimal.

The above arguments in determining the effectiveness of PPP as a means of public service delivery are dealt with in the literature review. These arguments are brought into context and made relevant as far as the South African PPP environment is concerned through a survey conducted on public and private sector PPP participants as well as a case study review.

The study is premised on the argument that costs are not the only consideration in evaluating the effectiveness of PPPs in the successful delivery of office accommodation. The study investigates other factors and their significance through a survey of public and private sector opinions of the significance of the key value drivers on the delivery of office accommodation projects through PPPs in South Africa. This was done in the form of a survey and the sample was drawn from PPP participants in South Africa. The results of these reflect the arguments advanced by the proponents and critics of PPPs for the delivery of services.

CHAPTER 1

INTRODUCTION

This chapter provides a background to Public Private Partnerships (PPPs) and explores why government and the private sector engages in them. It defines the key elements of the research topic, determines the research problem and provides the scope of the research, its limitation and the key findings.

PPPs are based on the principles of government (the public sector) providing public infrastructure and services in the most economically efficient manner, by partnering with the private sector. This is intended to free government of the burden of managing the risk associated with the provision of services that could be better managed by private sector. It is assumed that the private sector is well positioned in terms of its experience and capacity to offer the best value for money, and that it will ensure quick access to technology and transfer of skills as well as capital to government without using state capital.

Some of the motivations for using PPPs in office accommodation projects are that PPPs provide government with an opportunity to save costs in constructing capital projects and in operating and maintaining services. These can be realised, for example, by combining design and construction in the same contract. The close interaction of designers and constructors in a team can result in more innovative and less costly designs. The design and construction activity can be carried out more efficiently, thereby decreasing the construction time and allowing the facility to be put to use more quickly. Overall, professional services costs for inspections and contract management activities can be reduced, and the risks of project overruns can be reduced by design-build contracts.

Furthermore, government can save costs in the operation and maintenance of facilities and service systems. Private partners must be able to reduce the cost of operating or maintaining facilities by applying economies of scale, innovative technologies, using more flexible procurement and compensation arrangements or by reducing their overheads.

PPPs also allow more innovative revenue sources to be introduced that would not be possible under conventional methods of service delivery. PPPs promote private investment in the capital assets required to deliver public services efficiently by bringing in private sector finance and operational management on a risk –taking basis.

PPPs are also used to address the social service delivery backlog. A PPP can have a significant impact on job creation during the construction and operation of the facility, in the development of small business enterprises, through skills development, community up-liftment as well as through direct and indirect economic empowerment of previously disadvantaged individuals and entities. This is achieved through equity participation in the project and opportunities emanating from the project including procurement and provision of services during the construction and the operation of the facilities. For these reasons, among others, the South African government has pursued the option of PPPs for the procurement of some of the capital-intensive public services.

Research carried out by the Institute of Public Policy Research (IPPR) encourages the use of PPPs but proposes that clear criteria be established for assessing whether or not PPPs are the right approach. These, it argues, should be social equity, value for money and accountability.

The Fitzgerald (2004) review identifies the range of potential benefits of PPP projects as:

- a) improved service outcomes
- b) better value for money
- c) appropriate risk transfer
- d) innovation
- e) greater asset utilization
- f) integrated whole-of-life asset management

(Fitzgerald 2004, p.17)

1.2 THE RESEARCH QUESTION

Research question: Are PPPs effective in delivering public sector office accommodation in South Africa?

1) Primary Hypothesis

PPPs are an effective mechanism for the delivery of office accommodation projects in South Africa.

As much as PPPs are seen as an alternative procurement method because of the benefits they provide, their effectiveness in achieving value for money in office accommodation projects has come under criticism. To determine whether they are indeed effective for office accommodation projects in South Africa, the study compares the benefits of PPPs against the challenges they present. The context of PPPs in the South African environment is also taken into account. This includes: capacity of both private and public sector to deliver PPPs; the availability of skills; the macro- and micro-economic factors; the political environment; empowerment issues; the ability of the private sector to underwrite the risks on a long-term basis; and the existence of the private sector market for PPP.

Some of the literature argues that government can provide goods and services at a lower cost than the private sector. In answering the research question, it is argued that cost should not be the only consideration in determining whether PPPs are capable of producing the desired effect i.e. value for money. The research identifies and investigates other key factors to achieve this and their significance in the delivery of office accommodation projects through PPP.

The research also investigates the challenges related to achieving the desired effect (value for money) by analyzing the key drivers responsible for delivering value for money in PPPs in South Africa.

A study carried out by Arthur Andersen and Enterprise LSE (1998) and commissioned by the UK Treasury Task Force was used to identify these key drivers.

The report evaluated a range of value drivers through a survey of public sector project managers by ranking their relative importance. Six of the 18 value drivers scored 10 points or more, which was the minimum threshold for determining the most important drivers. The six key drivers for value for money were:

- **Risk transfer**

The ability to transfer risk to the party best able and suited to manage it to ensure optimum value for money

- **Long-term nature of the contract**

The long-term contracts allows for certainty of revenues over a period of time and therefore proves a good incentive for the private sector to invest in a long-term high-quality delivery of service incorporating whole lifecycle costing which results in cost-saving benefits for the public sector

- **The use of output-based specification**

The public sector transfers a significant level of risk and responsibility to the private sector over the long-term arrangement. The contractual arrangements emphasise performance-based outcomes rather than relying solely on specifications.

- **Competition:** PPPs provide better value for money because of their competitive procurement processes and their ability to benefit from whole lifecycle costing;

- **Performance measurement and incentives:** Payments to the contractor under a PPP contract are characterised as a regular 'unitary' fee for services which must be subject to performance appraisal in relation to specific and quantified criteria in the contract –performance related reward;

- **Private sector management skills:** PPPs provides an opportunity to advance the public sector through contributions from the private sector through the transfer of skills, technology innovation, focus on customer requirements, business and management skills. This study assumes that these six key value drivers are applicable in the South African context.

Two additional key value drivers have been included in the investigation:

- **Robust Financial Solution:** PPPs provide a financial solution that is sustainable for the project, the client, the shareholders as well as the lenders to the project over the life of the project;
- **Partnership approach:** The state alone cannot support the desirable level of public services. The delivery of these essential services can be done to the mutual advantage of both the public and private sector.

The literature review investigates some of the criticism levelled at the application of PPPs in procuring public services. Furthermore, the survey evaluates some of the challenges associated with implementing the PPP key value drivers in office accommodation projects.

To test the relevance and applicability of the key value drivers identified in the literature review in the South African context, a survey was undertaken amongst people in the public and private sector who had experience in the PPP procurement process.

1.3 THE SCOPE OF THE RESEARCH

The study evaluates the effect of key value for money drivers on the delivery of office accommodation projects and the challenges in achieving value for money. It also seeks to investigate the significance of the key value drivers on office accommodation projects.

The study comprises the following main areas:

- a) Literature review of the key value drivers in PPPs and a discussion of some of the arguments both for and against aspects of PPPs;
- b) A survey of the public and private sectors' opinion on the impact of the PPP key value drivers on office accommodation projects;
- c) The findings of the study; and
- d) Recommendations on using PPPs for office accommodation projects.

1.4 LIMITATIONS

The study is focused on the requirements for achieving the effective delivery of office accommodation projects through PPPs rather than on evaluating whether PPP office accommodation projects conceived to date in South Africa have indeed achieved the key principle of PPPs, being value for money. This latter question presents an opportunity for future research once sufficient information is available for meaningful results. The current study also investigates the significance of the key value determinants.

The research does not compare PPPs to other procurement methods available to government, but rather evaluates the effectiveness of PPPs for delivering office accommodation projects against a set of requirements (PPP key value drivers).

There is very limited reliable information and experience on procuring office accommodation through PPPs in South Africa. The only project completed to date was undertaken by the Department of Trade and Industry in Pretoria, South Africa.

The relatively short history of PPPs makes it difficult to evaluate adequately their financial outcomes. This will only be measurable in the longer term. A further limitation is the lack of access to information on concession agreements, viability and performance of projects as this is usually regarded as confidential commercial information.

1.5 METHOD OF RESEARCH

A review of the literature was undertaken as well as a survey of both public and private sector's opinion on the impact of the PPP key value drivers on office accommodation projects and their challenges. The survey was aimed at maintaining a focus and relevance on PPPs within the South African context. A questionnaire was developed on the factors that impact the effectiveness of PPP in delivering office accommodation projects. These included the key value drivers identified in the literature and the related challenges in implementing them. The survey respondents comprised representatives of public and private sector who were involved in recent

PPPs for office accommodation projects (Department of Education and Department of Trade and Industry).

The responses were grouped according to the respondents' sectors (public and private) whilst participating in the PPP project. A likert scale was used to determine the level of agreement to the variables of key drivers of value and the challenges in implementing these in office accommodation PPPs.

The data was analysed using descriptive statistical measures, primarily determining the mean scores and the coefficient of variation in the responses, which tests the reliability of the mean by measuring the level of dispersion, or level of consensus, for each statement. The reliability of the central measure is represented by a low measure of coefficient of variation. In addition, the correlation was used to determine the strength of the relationship between the variables in the responses by the private and public sectors. A high correlation indicates a strong relationship between the variables and a low correlation implies a non-linear one.

1.6 DEFINITION

1.6.1 Public Private Partnership (PPPs)

National treasury Regulation 16 of the PFMA defines Public Private Partnership or PPP as a commercial transaction between an institution and a private party in terms of which the private party

- a) performs an institutional function on behalf of the institution; and or
- b) acquires the use of the state property for its own commercial purposes and
- d) assumes the substantial financial, technical and operational risks in connection with the performance of the institutional function and or use of state property; and
- e) receives benefit for performing the institutional function or from utilizing the state property either by way of
 - consideration to be paid by the institution which derives from the revenues of such institution; or
 - charges or fees to be allocated by the private party from users or customers of a service provided to them; or

- a combination of such consideration and such charges or fees.

From the government perspective, a PPP is a contractual agreement whereby a private party performs a departmental service delivery or administration function and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria.

Strategic Framework for PPP Projects, 2002, National Treasury SA, PPP Manual

From private sponsors' perspective, a PPP is essentially an act of project financing. It is characterised by the formation of a highly geared 'Special Purpose Company' as a project vehicle. This has the consequence of reliance on direct revenues to pay for operating costs and cover debt financing while giving the desired return on risk capital.

Ideally, PPPs should be contractual arrangements that allow the resources, risks and rewards of both the public agency and the private company to be combined. In this way, they provide greater efficiency, better access to capital and improved compliance with government regulations, all in providing an efficient workplace environment. The public's interests are fully assured through provisions in the contracts that provide for on-going monitoring and oversight of the operation of a service or development of a facility. In this way, the benefit of the government entity, the private company and the public is assured (Greenwood, 2000).

In all the above definitions, the PPP arrangement is focused on shifting service delivery and the associated risks from the public to the private sector.

1.6.2 Difference between PPI and PPP

Private Finance Initiatives (PFIs), the closest British equivalent to the South African PPPs, differ from PPPs in that PPPs have a wider scope. These include:

- Private ownership of state-owned businesses (full or partial privatisation of government-owned enterprise);
- Long-term service procurement arrangements, including those where the private sector provides the infrastructure (PFI); and

- Partnership arrangements to sell public services into wider markets and exploit the commercial potential of assets.

1.6.3 Adjective: Effective

Being 'effective' is defined as having an intended effect/result or being capable of producing a desired effect.

1.6.4 Office Accommodation

'Office accommodation' refers to premises used by government departments for the primary purpose of accommodating its staff to deliver public services.

1.6.5 Value for Money

'Value for money' is defined as an effective use of public funds on capital projects which come from private sector innovation and skills in design, construction techniques and operational practices, as well as from transferring key risks associated with PPP projects (Ghere, RK, 2001).

1.7 SUMMARY OF THE FINDINGS

1.7.1 Literature Review

PPPs clearly give rise to challenges for participants of both the private and public sector. The study identifies a number of these challenges and proposes how they can be managed.

1.7.2 The Survey on Key Value Drivers

The questionnaire comprised four main sections, namely:

- A) Biographical information of the respondents;
- B) Evaluation of the impact of PPP key value drivers on office accommodation projects; and
- C) Challenges relating to the implementation of the key value drivers.

The following is a summary of the key findings. The full results are detailed in the Chapter 4 of this report.

Section A – Biographical Information

The survey was conducted on 49 respondents, 65 percent of which were from the private sector. All the respondents had a reasonably high level of understanding of the PPP process, they had all previously participated in a PPP office accommodation project and 44 percent had participated in the 'Request for Proposal' stage of a bid process. Most the private sector respondents indicated that the minimum project capital amount that warranted their participation was R201-R300 million, as this allows for better economies to be achieved from a risk reward and funding perspective.

Section B – Key value drivers

All the PPP key value drivers identified and investigated in the survey appear to have a significant impact on the delivery of office accommodation projects through PPPs. The results suggest that the factors responsible for achieving value for money in PPPs are applicable and relevant for office accommodation PPPs. Both the private and public sector considered the risk transfer, output-specification and robust financial solution as having the most impact on office accommodation PPPs.

Section C – Challenges of implementing the key value drivers

a) Output Specification

The survey showed that the mismatch between various factors posed enormous challenges in achieving the effective delivery of office accommodation through PPPs. These were the specified level of performance and the affordability level (concession fee), risk of over-specifying the output with the potential of limiting the flexibility of the private sector to offer innovative design solutions.

b) Procurement Process

The greatest criticism of the PPPs procurement process was the lengthy contract-award period and the high cost of bids. Some of the recommended solutions include standardising the concession contract, pre-allocating risks, proper due diligence to all the risk aspects and performance indicators.

c) Risk Transfer

Risk transfer is a critical aspect of value for money in PPPs. The challenge is not only to transfer the appropriate risks to the party best able to manage the risks, but also to optimally allocate the risks in a fair manner that motivates the private sector to perform and ensures that the benefits exceed the extra costs associated with risk transfer.

d) Robust Financial model resulting in cost savings

The critics of PPP argue that government can provide cheaper services than the private sector. The survey results indicate that cost is not the main driver on the effectiveness of PPP in delivering office accommodation projects, but that other factors have a significant bearing on it.

However, PPP funding does present challenges. Over-reliance on cash flows linked to a performance criteria pose risks to financiers. These have to be taken into account in the overall cost structure of PPP projects. Secondly, the returns for the shareholders have to be commensurate with the risks taken, which also contributes to the cost of a PPP project. Thirdly, the premium attached to empowerment funding into the costs and the additional guarantees required from the shareholders to cover any risks must also be factored in. Comparing PPP funding to the Public Sector Comparator (PSC) must take into account the peculiarities surrounding the risk transfer benefit to the government.

To achieve effective delivery of office accommodation projects, all the key value drivers must be in place and their challenges must be addressed.

1.8 THE STRUCTURE OF THE RESEARCH REPORT

Chapter 1

This section provides an introduction and background to the research, defines the research problem and provides a summary of the findings.

Chapter 2

This section provides a review of the literature pertinent to the research problem and the research objectives. Its aim is to inform the development of the study's key objectives and recommendations.

Chapter 3

This section describes the methodology used to address both the problem and objectives of the research. The key elements are: the definition of the population to be studied; the procedure used to sample the population; the construction and validity of the questionnaire used to gather the data required for addressing the research problem; and the objectives and tools employed in analysing the data.

Chapter 4

This section presents the analysis of the data and an interpretation of the results.

Chapter 5

This section presents the conclusions, recommendations and area for further research.

Bibliography and Appendices

These sections contain the sources of the information used in the research, the questionnaire used for the survey and the data captured for the research survey.

1.10 Conclusion

This chapter summarises the report, and specifies the areas that are related and of interest to the research but that have been omitted, and provides recommended areas for further research.

CHAPTER 2

LITERATURE REVIEW

This literature review was conducted to determine factors relevant to the objective of the research as stated in Chapter 1, and explores aspects that impact on the effective delivery of office accommodation through PPPs. It also explores the key principles at the heart of PPPs - the value for money drivers. This is achieved through an analysis of the key issues relating to value for money. These are: risk transfer; output specification; procurement process; financial requirements; long-term nature of the contract; partnership approach and the capacity of the private sector to deliver the required outputs. The literature review further looks at the challenges experienced in using PPPs to deliver office accommodation projects.

2.1 Gaps in the literature

While the PPP key value drivers were identified through the literature, their importance to, and relationship with, office accommodation procurement are not explained. This gap in the literature was addressed by surveying the views of PPP participants on the importance of the key value drivers for office accommodation and the challenges associated with implementing them.

The published literature included written reports and academic research on the subject matter and related topics. Although a range of documents was accessed and time was spent in identifying and assessing the relevant documents, the list is not exhaustive. Furthermore, limited research has been carried out to date on whether PPP projects have delivered value for money as anticipated.

2.2 Areas covered by literature review

The literature covers areas relevant to value for money in PPPs as follows:

- Principles of PPPs;

- The South African Framework for PPP: National Treasury Provisions
- The South African environment for PPPs;
- Evaluation of arguments for and against PPPs;
- Arguments suggesting that government can provide goods and services cheaper than the private sector;
- Evaluation of other value for money drivers and their significance in office accommodation projects;
- Value for money drivers;
- Critical review of PPPs and challenges of value for money drivers;
- Where are PPPs most appropriate;
- Discussion on the public sector comparator (PSC).

2.3 Principles of PPP

The principles of PPPs, as outlined in the review, identify some of the value for money drivers.

The National Treasury Standardised Provisions for PPP agreements identified three key principles of PPP as achieving Substantial transfer of risk to the private party, Value for Money and Affordability of Services.

Substantial Transfer of Risks to the Private party: means optimal allocation of risk associated with PPP agreements to the private party taking into account the cost of securities to mitigate such risks whilst ensuring value for money is achieved.

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

Affordability of Services means that the financial commitments to be incurred by an institution in terms of the PPP can be met by funds designated within the institution's existing budget for institutional function to which agreement relates and/or destined for institution in accordance with the relevant treasury's future budgetary projections for the institution

As the PPP concept is relatively new to South Africa, a great deal of reliance has been placed on the British PPP/PFI experience. The UK has implemented numerous PPP projects, with varying degrees of success, and guidelines and principles have been developed in the form of the UK Treasury Taskforce Model Contract and Guidance. These guidelines and principles have been incorporated into the current model for South African PPP projects.

The South African Framework For PPP: National Treasury Provisions (March 2004) identifies three main principles for PPP as follows:

- Risk transfer to the private party
- Value for money and
- Affordability of the services.

The UK government has identified four inter-related principles at the heart of private finance initiatives (PFIs) (Hall, 1998):

- a) Risks between the public and private sector parties should be allocated to that party best able to manage them to ensure optimum value for money (genuine risk transfer);
- b) The two fundamental requirements for PFI schemes are that the public sector must secure value for money and the private sector must genuinely assume responsibility for the risks associated with the scheme (Haarmeyer and Moody, 1998).
- c) Contracts should specify the service output required by the public sector client from the private sector (output specification). In the PPP arrangement, the public sector transfers a significant level of risk and responsibility to the private sector over the long-term arrangement. The contractual arrangements emphasise performance-based outcomes rather than relying solely on specifications (Falk and Larson, 2001).
- d) PFI contracts should normally require the contractor to take the responsibility and assume risk for the performance of the asset over the long-term, at least for a

significant part of its useful life, so that efficiencies arising from long-term asset management can be realised (whole-lifecycle asset performance),

In essence, the PFI approach turns government into a user rather than an acquirer of equipment or facilities and the private sector into a service provider rather than a mere contractor. The consequence is a far –reaching exercise of risk-sharing among all parties involved - the government, the industrials and the financiers - with customised legal and financing structures on a project-by-project basis. This ensures that they assume all risk classes acceptable to the private parties. The definition of 'acceptable risks' naturally varies with the nature of the project (Bradford, 2001).

e) Payments to the contractor under a PFI contract are characterised by a regular 'unitary' fee for services, which must be subject to performance appraisal in relation to specific and quantified criteria in the contract -performance related reward.

The performance criteria must be well defined to avoid ambiguity. Any area that lacks clarity compels the private sector to regard it as an area of risk, which places a premium on it and thus affects the value for money.

2.4 The South African Framework For PPP: National Treasury Provisions (March 2004)

The National Treasury PPP Manual and Standardised PPP Provisions provides a regulatory framework in terms of which national and provincial institutions can enter into the public private partnership agreements. The Standardised provisions highlight the key issues pertinent to PPP projects as regulated by the provisions of regulation 16 of the Treasury Regulations (“Treasury Regulation 16”). It focuses on the manner in which such issues must be addressed whilst achieving substantial risk transfer, value for money and affordability. Important issues specific to Office Accommodation from the Standardised PPP Provisions are discussed in the study.

Condition of the site

The National Treasury PPP provisions (March 2004) require for the Private party to conduct a thorough investigation on the proposed project site and assume all the risks

related to the site. The public sector may achieve better value for money if it commissions (at its costs) some of the surveys that form part of the bidders investigation at the feasibility study phase and well before the signing of PPP Agreement. The public party needs to ensure that the Private party has recourse to the independent expert if such surveys are inaccurate. This however should not release the private party out of its obligation to investigate and verify the accuracy of information pertaining to the site (such as land availability agreements, existing leases, land claims, the use rights and tax considerations).

Planning consents

Where the public party is responsible for the selection of the Project site it must be responsible for obtaining any zoning, rezoning and or land use consents for the Project site. This must be achieved prior to the Project being put on tender to avoid unnecessary delays. The costs of such consents should be included in the affordability assessment forming part of the application for Treasury Application 1(TA: 1).

The private party must be responsible for identifying and obtaining all the planning and building consents required to enable the construction of the facilities on the Project site.

Environmental consents

The PPP provisions require for the private party to assume all environmental risks. The private party is often reluctant to assume all the environmental risks in particular if these cannot be quantified within acceptable levels of commercial risks. It is recommended that in cases where the Environmental Impact Assessment is a condition to obtaining the zoning, the public party should be responsible for obtaining the necessary approvals. The private party should assume any other environmental risks specific to its design and construction specifications. The private party should be indemnified for environmental contamination risks caused by activities conducted on the site or on the adjacent site before the date on which control of the site is transferred to the private party. For future contamination risks arising from ongoing activities, the private sector should rely on the remedies available to it under the common law against the polluter.

Heritage Resources

The PPP provisions require for the private party to comply with all applicable legislation relating to heritage resource. It is recommended that for value for money consideration, the public party procures the in-principle consents on the basis of general design concepts for its spatial requirements for office accommodation and surveys prior to going out on tender. The costs thereof must be incorporated into the Feasibility studies for TA1 approval. Where the private party undertakes any additional works or variation as a result of discoveries of any heritage resource, then the private sector must be compensated for such.

Utilities and Resources

The public party should undertake the thorough investigation for supply of utilities to the boundary of the site prior to going out on Tender so as to clearly identify how the risks will be shared amongst the parties and clearly assess the impact on affordability and value for money.

Warranties

The public sector must seek to provide some warranties particularly in respect to aspects where access to information is in its control provided this will result in better value for money. According to the Standardised provisions “warranty” is defined as a statement confirming the truth of the matters in the Agreement. For the public party to gain the comfort and confidence to provide any warranties in respect to information issued, the public party must at its cost arrange for appointment of independent consultants with appropriate experience and expertise to undertake the relevant survey to investigate and verify such information beforehand (at feasibility stage). Care should be taken that duplication is avoided by providing warranties in respect of risks covered by project insurance as the costs thereof will be included in the Unitary Payment.

Indemnities

The Private party may be required to provide indemnities for risks in respect of its obligations to perform that cannot be covered by project insurances (such as damage to property, breach of statutory duty, death and personal injury, other third party claims and breach of private party warranty). The costs related to such will be

provided for in a form of contingent liability and included in the bid price. The public party should provide indemnity only in cases where conduct on its part would not be covered by project insurance or compensation mechanism provided for in the PPP Agreement. The consideration should be made to an extent that this will achieve better value for money. Care should be taken to ensure that the indemnity is limited to direct losses (excluding indirect or consequential losses) of the indemnified party.

Design Risks

The design risks must be assumed by the private party however the public party must satisfy itself that the design will meet the output specifications. The public sector without micro-managing the inputs into the design must be satisfied that the preliminary design is sufficiently flexible to allow for changes and improvements effected to meet the planning and /or the environmental requirements .The reassurance to both parties is provided by an Independent Certifier who will inspect the completed works and if satisfied issue the Completed Certificate.

Acceptance and Service Commencement

The provisions stipulate that before the private sector can issue the availability certificate declaring the service commencement date, the Independent Certifier (appointed by the private party and approved by public party) has to issue a completion certificate. Once the completion has been issued, the public party can accept service commencement pursuant to the terms of the PPP agreement. Notwithstanding that the Independent Certifier provides reasonable and objective measure of ensuring that the private party completes the works in accordance with the PPP Agreement, the completion risk remains with the Private party.

Security Against Late Service Commencement

The public party needs to evaluate the losses to be suffered by way of liquidated damages in an event of delay against the cost of insurances and any other mitigation measures by the private party for security against late service commencement. The liquidated damages should be quantified and effected only to an extent that they will result in value for money. If the public party will not suffer significant losses resulting from late service commencement, then the protection allowed by the security should be waived. Considerations must be given to the cost of all types of securities

including construction bonds which should be evaluated against the costs that will result from the failure of the private party to complete the works. In addition, the public sector needs to take a view on the standby equity and sponsor support in a form undertakings and obligations in favour of the lenders to achieve service commencement on time. The adequacy of such security to provide the necessary comfort must also impact on the value for money decisions.

Availability of Services

Availability is a critical factor in the PPP. The definition of availability must be specific to the conditions and dates that must be met if the services are to be considered available. The definition must be objective, reasonably measurable and as comprehensive as possible. The processes of measuring availability should be kept simple and cost effective. The Penalty deductions should come to effect only on the basis of unavailability of specified critical aspects and for severe performance related failures. The Private party should be given a reasonable period within which to rectify the problem without triggering the penalty deductions.

The public party needs to evaluate the securities which costs are factored into the project by the private sector against the criticality of unavailability of services insured.

Maintenance

The private party should have the flexibility to amend its maintenance programme to meet the required output specifications with minimum interference from the public party. A planned preventative maintenance programme detailing replacement of plant, machinery, equipment, fixtures, fittings and/or furniture designed to maintain the facilities is a responsibility of the private party to manage. The public sector need not impose security for maintenance obligations as the comfort for this can be provided by other provisions of maintenance reserve account or other provisions such as the sinking fund. The maintenance reserve account should cater for residual value risk of the asset in an event that this has not been transferred to the private party. The public party should on a basis of value for money make a determination of the risk transfer so far as the residual value for the asset is concerned.

Performance Monitoring

The performance monitoring levels should be set by the public party based on Good Industry Practice and taking into account affordability and value for money.

Benchmarks for commercial office accommodation should be investigated and applied. The methodology for monitoring is substantially based on self-monitoring mechanism by the Private sector subject to periodic reviews by the Public party as well as the ability of users to report failures. The effectiveness of the monitoring systems depends on the accuracy of data collected and provided by the private party and ultimately impacts on the calculation of the penalty deductions. The performance measures should be as comprehensive and objective as practical but this might not be achieved in some aspects due to the complexity of serviced office accommodation. Surveys on end user satisfaction should be conducted for qualitative aspects of the performance. The penalty deduction system should reflect a clear link between the seriousness of failure, the value of the penalty deduction accrued and the potential financial impact on the private party.

Payment Mechanism

The payment mechanism comprises of a fixed single or Unitary Payment for available services over the lifetime of the project. It should not contain a fixed portion to which the private party is entitled irrespective of availability or its performance. The PPP recommends that the inflation risk above CPIX should be shared between the public and private sector and that other than inflationary increases, there should be no other increases of the Unitary Payment.

The PPP discourages benchmarking at pre-determined intervals during the service period. Amendments to the output specification resulting in an increase in the unitary payment should be dealt with in terms of variation order or as Pass Through Costs paid by the private party and reimbursed by the public party.

Insurance

The public sector should assess whether the risks transferred to the private party are priced on commercially reasonable terms and where commercial cover is unavailable to cover such risks (i.e. escalation risks above inflation), whether the premium charged by the Private party will result in value for money. Due consideration should

be given for Project insurance including legal liability insurances, professional indemnity, business interruption insurance and non-vitiation protection (protection allowing public party to claim as a co-insured for information withheld by the private party) on a basis of value for money. For uninsurable risks that are justifiably not in the control of the private party, the public sector should consider the benefits of uninsurability relief against the substantial contingency provisions to cover such risks. The relief must only be limited to cover debt service and private party's capital and operating expenditure.

The public sector should resort to economic test only where the risk of total destruction of the project assets is high and reinstatement period is lengthy. Where economic test shows that the insurance proceeds are sufficient to reinstate the project assets and such reinstatement will not impact on debt service over the originally envisaged repayment period, then the proceeds must be so applied in accordance with pre-agreed reinstatement plan otherwise the proceeds should be applied towards repayment of debt with the private sector remaining under an obligation to reinstate the project assets.

Relief Events, Compensation Events and Force Majeur

Relief Events are events which prevent performance by the private party of its obligations at any stage during the project term that are best managed by the private party (although not necessarily in its control) and for which the private party bears financial risks. Typically this includes but not limited to fire, flood, accidental loss, damage to the works/facilities, shortage of power, discovery of heritage objects, delay in obtaining any consent. The relief events are expressed by being given time and not money.

Compensation Events are designed to cater for delays which arise before the service commencement date as a result of the public party breach resulting in increased costs to the private party as well as delays occasioned by third parties under the control of the public party during the period of the project term resulting in reduced revenue. This approach provides the public sector with an incentive to manage its rights and obligations particularly during the construction phase. The compensation events are expressed by being given time and money.

Force Majeure definition should be limited to events which are out of the control of both parties and which if they continue for at least six months are likely to cause a material adverse consequence on either party and could result in termination of the PPP agreement. The consequences of an event such as Force Majeure should be shared between the parties and in absence of agreement, either party should be entitled to terminate the PPP agreement. Typically the events include war, terrorism, nuclear contamination, chemical or biological contamination.

Change in Legislation

The private party is expected to bear the risks for unforeseeable conduct by governments except where these risks are discriminatory on the basis of engaging in a PPP. It is considered that the risks would normally be the same as for any commercial transaction and the Private sector is expected to use all reasonable endeavors to mitigate any cost increases. The relief event should be effected in an event that the unforeseeable conduct has occurred.

Variations

Variations to the output specification cater for changes in the public party's requirements which could not be anticipated or quantified at signature date or external factors for which the public party has retained responsibility (for example a change of policy). Variations proposed by the private party need to be assessed whether they are mandatory and how the costs (if any) will be allocated through a well-defined procedure. A balance must be struck between maintaining the flexibility to accommodate a change in the output specification and the cost for such provision. The variation during construction phase should be paid by the public party by means of a lump sum, staged payments or sums for reasonable costs incurred by the private party in implementing such variation. Any increase in operating costs resulting from the public party variation should be met by an increase in Unitary payment.

Employment

Where transfer of staff to private party is concerned, Section 197 of the Labour Relations Act, 1995 providing for automatic transfer of the contractual obligations of employees should be considered. All the benefits that have accrued in the pre-transfer

period should be independently valued and the public party should indemnify the private party in respect of any claim by the transferring employee for such.

Black Economic Empowerment

The PPP must incorporate the government's policy objectives for BEE contained in the Code of Good Practice in respect of Broad-based Black Economic Empowerment Act, 2004 (the "BBBEE Act") which include ownership of equity, management control, participation in the subcontracting arrangements and procurement requirements, skills development, socio-economic benefits for the local community, SMMEs, the Youth, the disabled and Non-profit Organisation.

The monitoring of the implementation of the private party empowerment involves a substantial element of self-monitoring by the private sector with reviews by the public sector at scheduled intervals. The BEE commitments need to link into and be consistent with the overall payment mechanism. Noncompliance with BEE targets may attract penalties resulting in deductions against the Unitary Payment and if not remedied, cause termination of the PPP agreement.

The agreements in respect of BEE arrangements must be reflected in cash flows of the project incorporated in the financial model. The black equity must be locked-in for a specified period allowing for the whole or part thereof to be transferred only to other black shareholders.

Termination

Termination may occur prior to expiry date due to public party or private party default, force majeure (and the parties are unable to agree on a mutually acceptable solution) or corrupt acts. A fair balance need to be achieved the public part desire to be able to terminate for inadequate service provision and the private party's and its funders' interests in restricting termination to the severest of defaults when all options have been exhausted. The PPP should provide a mechanism (for example pre-termination notice) that allows the private party to remedy breaches that are capable of being remedied to avoid termination.

The termination of the PPP agreement should be without prejudice to any accrued and continuing rights and obligations of the public and the private party. The PPP agreement must provide a procedure to be followed prior to expiry date in order to determine the condition of the Project assets and whether the private sector has complied with obligations in relation to such conditions prior to handback. Compensation amount will differ depending on the cause of termination. Termination as a result of default by the institution is usually greater than that payable in the event of Force Majeure and substantially less for defaults caused by the private party.

The compensation on termination for the public party default should take into account all outstanding amounts in respect of the debt (at fixed interest rate) including breakage costs as well as premiums, third parties to the projects (for example subcontractor), shareholder loans and return on equity that reflect market value. All compensation amounts should be stipulated and payable in Rands and result in no exposure to exchange rate or currency risks to the public party.

Compensation on termination for private party default is effected under PPP for office accommodation agreements for reasons that the project asset revert to the public sector and failure to pay may unfairly benefit the public party without compensating the private party for the asset market value.

The market value approach is intended to represent the balance between protecting the public party's interests and unfair penalties on the private party while taking into account poor performance by the private party. It also encourages the Lenders to step-in to rescue the project instead of simply relying on the termination payment to recover their debt.

To address the lenders concerns in respect of the possibility of the market value being insufficient to cover the outstanding debt, compensation is based on a greater amount between payment of an agreed percentage of debt and the highest re-tendered value of the project. However the liquidity of the market in realizing a fair market value of the project in the current South African PPP environment remains a challenge. This is expected to improve as the South African PPP market matures. In the event that there is no liquidity in the market or the public party elects not to retender, the adjusted

estimated project value (unitary payment forecast from the date of termination to the expiry date) should be calculated. In this instance the compensation will be based on greater of the amounts between pre-agreed portion of debt and the adjusted estimated project value.

Compensation on Termination for Force Majeure occurring through no fault of either party should be somewhere between the compensation payable on termination for public party default and that payable on private party default. Compensation on Termination for Corrupt Acts will be equal to the debt outstanding. The debt payment will be excluded if corruption is attributable to the Lender and similarly shareholders will not be compensated for the loss in equity and shareholder loans if they played a part in the corruption act.

The PPP agreement must provide for the use of rights of licenses in respect of intellectual property made available by the private party during the public party step-in period or following the termination as the costs of these use rights will be included in the unitary payment. Access to all such information and materials should be granted to a New Private Party to facilitate the smooth hand over to it of the facilities.

The Role of Public Works Department in the PPP Process

The Public Works Department (“PWD”) is the custodian of office accommodation requirements for National and Provincial government department as well as most state-owned properties. PWD has an important role to play in the initial needs analysis stage to establish the user client office accommodation requirements as well as availing the selected site for the purposes of the development if it is state-owned or controlled. However the PWD has come under much criticism for its lack of capacity to effectively deliver PPP projects on behalf of the user clients. The processes (such as in the Department of Education PPP project) are often not streamlined and integrated with the user clients’ and treasury to provide a unified direction to the private party or bidding entities. The PWD is poorly resourced to deal with the complexities of PPP processes. The process is marred by poor communication and dissemination of information to the bidding entities. This often leaves the user-client and the private party disgruntled about the process and abortive costs resulting from

unsuccessful tendering process. The PWD has served more as a conduit between the user-client and the private party without real benefits.

The competing interests and the priority on infrastructure project places pressure on PWD to apply itself to the demands of PPP Agreement. It is thus recommended until such time that there is adequate capacity for the Department of Public Works, the User client should have the flexibility to appoint a champion independent of PWD to handle the PPP Agreement on its behalf. For a speedy and streamlined PPP process, the participation of PWD should be limited to the initial phases of the project of establishing the needs analysis, providing information and data necessary for conducting due diligence and surveys and assist in making the site available for the purposes of the development if the selected property is in its control.

2.5 South African Environment for PPP Projects

It is inherently difficult to use British precedents of PPP projects as the basis for evaluating South African PPP projects, as there are fundamental differences between them. These differences have a direct impact on pricing, risk transfer and the ability of many smaller private sector enterprises, particularly previously disadvantaged enterprises, from participating in the process. These differences are on micro- and macro-economic levels, as well as on the socio-economic level. .

a) Macro Economic Factors

Currency Fluctuations

The ability to underwrite the currency-risk over a long period, say 25 years, in an economy with a free-floating currency and with a significant import component for specialised equipment such as lifts and air-conditioning, is impaired. The South African insurance market for such long-term exposure is very small and premiums are often prohibitive. However, these insurance costs must be factored into the overall cost of a project during the construction and operational phase of the project. The UK is less affected by currency fluctuations and thus these insurance costs are significantly lower than in South Africa.

Inflation

Inflation in South Africa has only been brought under control in the last four to five years and there is no guarantee that this will remain at this level in the distant future. CPIX is the recommended indexation mechanism for PPPs as is the case for the increases in governmental institutions' budgetary allocations. Although the National Treasury Standardised PPP provisions recommends for the inflation risks to be shared by both parties, the allocation of such risks must be factored into the project costs and may put pressure on the Unitary Payment. The UK, on the other hand, has a generally low inflation economy and seems to have mastered the threat of rampant inflation.

Interest Rate

Fluctuations in interest rates have a major impact on the ability to service debt and on property related services provided over the concession period. Fixing the interest rate over the period of the concession has a major implication on the affordability threshold or unitary fee the public sector is willing to pay for the services it renders. It is often expected that these risks be borne by the private sector. Government is often reluctant to factor this security cost into the unitary payment.

b) Micro Economic Factors

The Capacity of the Market

The South African building industry is well established and capable of handling large-scale projects. The financial resources are also at the industry's disposal to invest in equity for PPP projects.

The South African lending institutions have adequate resources and an appetite for PPP projects. The expertise has been developed for very complex and sophisticated financial models for both senior and sub-ordinate debt. The main area of challenge remains the facilities management aspect of a project. The UK market has a depth of resources in the facilities management arena, and its access to continental European enterprises makes for a mature and

competitive market. Facilities management capability in South Africa has not yet matured and the existing facilities management companies often do not have the financial strength (balance sheet) required to invest equity in the concession company or the Special Purpose Vehicle (SPV). They have difficulty in comfortably underwriting the risks related to the long-term operational requirements for the facility i.e. the life cycle costs and the performance of the subcontracted companies that provide them with services. It is thus difficult in the current market to predict prices, markets and availability of large capital expenditure items over 25-years.

The vast experience in the UK results in a sense of comfort through precedence, for those participating in the PPP. In South Africa, as stated above, the entire process is new with limited capacity to handle and commit it to a long-term contract with obligations to guarantee performance, not only of the main contractors, but also of the small market of good-quality sub-contractors. Until South Africans find the same level of comfort experienced in the UK, they will demonstrate a degree of cautiousness.

**c) Socio Economic
 Empowerment**

There is fundamental need in South Africa to redress the inequalities of the past through black economic empowerment (BEE). However, the cost of capital for empowerment funding often presents financial inefficiencies, as the expected returns on the BEE equity investment are significantly higher than those of traditional funding because of perceived risks in relation to empowerment participants. This naturally puts a burden on the overall project cost.

This may not necessary be the case in the UK. Where it has occurred, the requirement has not been as vigorous as in South Africa.

Bearing these factors in mind, the concessionaire, with specific reference to the PPP Agreement, has to be intent on reaching a point where the broad principles of PPPs are met, while still taking cognisance of the unique South African business environment.

As is clear from the above discussion, the UK approach needs to be seriously adapted to fit the South African context. The Concessionaires have to place collars or limits on those items that are beyond their control and beyond the parameters of what is regarded as normal business risk whilst the public sector must achieve optimum risk transfer.

The Concessionaire, in taking an unprecedented 25-year view on developments in the South African market, is compelled not only to assess long-term micro economic factors, but also the long-term macro economic conditions and factors. Based on the findings, the concessionaire must price on the information gained and assume certain risks, bearing in mind the long-term best interest of the parties for the project. Added to this, the empowerment parties, with their limited resources, must closely evaluate the financial burden and exposure to a single major investment and the impact that this places on their businesses.

The prudent approach to be adopted by the concessionaire in light of the Standardised provisions of PPP Agreements is to price for standard business risk, but not assume the risk resulting from events beyond their ambit of control.

For the successful transfer of risk, a degree of economic stability is required. PPP projects are unlikely to succeed in an environment of hyperinflation and currency devaluation. A concessionaire should be compelled to accept the normal peaks and troughs every economy experiences. Beyond these accepted norms, it would be a deterrent for parties to embrace the PPP process. The risk-reward profile must be carefully balanced.

The above factors will largely influence the extent to which a concessionaire is willing to take the risks against the reward associated with the activities to be performed.

2.6 Value for Money Drivers

The review discusses the key value drivers and outlines some of the criticisms against PPPs. The relevant key value drivers for office accommodation PPP have been identified as follows:

- Robust and innovative financial solution
- Performance measurement and incentives
- Risk transfer
- Long term nature of the contract
- The use of output-based specification
- Procurement allowing for competition
- Partnership approach
- Private sector management skills

These value drivers are based on a study undertaken by Arthur and Enterprise LSE in 2001 commissioned by the Treasury Task force to examine the VFM aspects of operational PFI projects. Its conclusions were broadly supportive of PPP and PFI as procurement mechanisms.

The study used four approaches: a literature review and a survey of NAO reports into PFI projects; a survey of public sector project managers' opinions; scrutiny of Forward Business Cases (FBCs) and recommendations on the areas project managers should focus on to obtain value for money in PFI projects.

The key findings were as follows:

- a) From a public sector perspective, there are six key drivers of value for money in PFI projects as stated above;
- b) The gap between the cost of private sector capital and public sector borrowing has been narrowing as PFI matures and the public and private sectors gain experience, and is not as high as some of the literature suggests;
- c) The estimated average percentage saving against the Public Sector Comparator (PSC) for the sample projects was 17 percent. According to the public sector's own figures, the PFI appears to offer excellent value for money;

- d) The ongoing use of PSCs will require a periodic review to ensure their continuing relevance and application as a benchmark;
- e) The success of PFI as a procurement method is becoming well-established and a robust procurement framework has been established

Pollock and Vickers have questioned the findings of the report, in particular the conclusion that PFI is 17 percent cheaper than the PSC. They suggest that the results are skewed as more than 50 percent of the savings came from one project out of a total of 29 evaluated. They claim that if this is taken into account and normalised, the saving would only amount to an average of 6 percent.

Although this study has been criticised, it does unearth the relevant VFM aspects of PPP and PFI. The research is, in the main, based on this study but focused primarily on the key VFM drivers identified by the Anderson report and applies this to the South African context through a survey of the private sector and public sector PPP participants' opinion on the relevance of these key drivers in an office accommodation PPP project.

The Government of Victoria partnership (2001b, p.4) asserts that the best value for money to government is achieved by focusing on the output specifications, the public interest, the capabilities of both government and private sector, the optimal risk allocation environment and commercial viability. The object is to achieve effective and efficient value for money outputs.

2.7 Does the use of PPP Provide Cost of Capital Advantage?

The use cost of capital as a discount rate or measure of evaluating investment decision is argued based on the following advantages:

- a) lower borrowing cost
- b) lower investment costs in terms of staff resources employed
- c) an exception from direct and indirect taxation and some statutory charges such as stamp duty
- d) exemption from compliance with business regulations and market driven pricing policies taking into account, production costs and return on investment

It is argued (Braely, Cooper and Habib 1997; Rochester 1999) that the cost of capital differences between private and public sector have no bearing on the investment decision.

Research studies (Andersen and Enterprise LSE, 1999) suggest that cost-savings are achieved when public services are contracted out to the private sector and that the benefit of private sector management skill in a project impacts on value for money. The cost of capital is one out of many components that impacts on value for money, and thus cannot be viewed in isolation to other components such as innovation and technology, risk transfer, efficient management, whole-of-life cycle costs of assets. The cost of capital argument is largely irrelevant to the PPP debate (Regan 2005). The cost of capital in both public and private provision of services is an input to costing provision but not the only determinant on value for money.

The analysis to follow will focus on the significance of other value drivers on the effectiveness of PPP for delivery of office accommodation projects.

2.8 Do PPPs Provide Robust and Innovative Financial Solution Using Project Financing?

Proponents of PPPs argue that PPPs provide for better use of public finance through their use of project finance. The financing structure for PPP allows accelerated delivery of public infrastructure projects. By opting for a PPP long-term “leasing” solution rather than outright purchase of capital assets, the public budget can be utilised more effectively and more projects can be brought into use more quickly. The PPPs are effective for the delivery of services as they use project financing or non-recourse financing and therefore leave the balance sheet unencumbered for other capital expenditures.

The project financing is characterised by the formation of highly-g geared special purpose company for the project vehicle and consequently a reliance on direct revenues to pay for operating costs and cover debt financing while giving the desired return on risk capital (Grimsy and Lewis 2002). It is non-recourse or limited recourse

financing predicted on the financial and technical merits of a project rather than on the credit of the project sponsor. The credit appraisal of the lender is therefore based on underlying cash flow from revenue-producing contracts of the project (Jones, 2001). Therefore the success of PPP project financing comes down to cash flow. In terms of structuring levels of debt, and equity in projects, a common philosophy is to utilise as much debt as the project cash-flows permit, so as to realise an attractive return for the shareholders as often equity funding is far more expensive than debt finance.

However, the risks associated with the use of project financing demonstrate that a mere reliance on contract is often insufficient to protect the lender from the risks. Credit support from a creditworthy source is often necessary. Credit support can take a form of direct guarantees by the project sponsor or project participants, guarantees by third parties not directly participating in the project, or in the form of contingent guarantees. Commercial risks must generally be covered by credit support of the project sponsor or by a responsible third party.

The argument against the use of project financing for office accommodation is that there are cheaper sources of funding that can be applied, given the security that property offers as an asset. Furthermore, there are far cheaper financial models that do not necessarily put pressure on the sponsors for additional guarantees, which are typically required in the funding of PPP transaction by the lenders as well as the client body to cover the risk associated with project financing.

Lenders and host government (client) want to see the sponsors put equity into their projects. Government looks at equity investment as providing a level of commitment into the project by the project company, whilst lenders look at equity as providing a margin of safety. The two primary motivations for requiring equity investment in projects which lenders finance include:

- Lenders expect the projected cash flows generated by the project to be sufficient to pay operating expenses, service debt and provide very comfortable margin of safety to meet any contingencies that might arise. The more burden the debt service puts on the cash flows the greater the lender's risk.

- Lenders do not want sponsors to be in a position to walk away easily from the project. They want the sponsors to have enough at stake to motivate them to see the project through to successful conclusion.

Van Schalkwyk (1984) indicates that one of the ways of enhancing the return to shareholders is to use mezzanine finance in PPP projects, particularly for emerging or empowerment entities that may not have upfront equity to invest in a large project. The choice of a particular type of financial instrument depends on several factors including:

- The project's prospective cash-flows
- The cost of the instrument
- The legal and tax consequences of using the instrument
- The capital structure of the project company, existing and prospective
- The risk /reward perceptions of the financial institutions involved
- The size and purpose of the financing.

The attraction of providing mezzanine finance for the lending institutions stems from higher yield (approximately 4 percent above cost of senior debt), which can be obtained from this type of finance, particularly in the light of eroding margins on traditional lending. The returns expected on mezzanine finance vary and depend on the perceived level of risk of the project. Higher risk instrument examples are those used to finance emerging or empowerment entities resembling equity commands a considerably higher return on capital (approximately 20 percent or more on an internal rate of return basis).

It is often difficult to predict life-cycle costing for office accommodation in South Africa with any fair degree of accuracy, so as to ensure that the cash flows generated by the project are indeed sufficient to service the long term debt, given the relatively weak market for subcontractors who would be willing and capable of providing the necessary guarantees on the performance of the input specification of the building over the concession period (minimum of 25years).

A criticism of the PPP model is that the principal reason for governments entering into PPPs is to avoid debt. (Centre for Public Services, 2001)

A criticism of PPPs is that they are a device to move public capital borrowings off balance sheet through complex financing structures that limit transparency. The principal reasons for government becoming involved in PPPs for office accommodation are to benefit from increased efficiency, shorter implementation time, greater innovation and ultimately better value in the delivery of services brought about by increased competition. The ability to finance a project so that the debt is "off book" should not be the prime motivation for entering into a PPP. The government and the ultimate users of the service are still responsible for servicing the debt in one way or another. The emphasis should be on structuring creative and cost-effective ways of delivering services, not creative accounting.

The House of Commons Committee report asserts that the government should account for the current and capital liabilities of a PFI project separately and ensure that value for money is recognized as the main justification for PFI.

Some of the controversy around PPP is that the cost of service will increase to pay for the private partner's profit

The argument here is that government departments sometimes resist PPPs because they believe that the cost of providing the service will increase to reflect the profits the private partner must realise to stay in business. The alternate view is that while the private partner will need to make a profit, the profit must be earned within the existing or a lower price for the service. Presumably, the government would only enter into a PPP if the price of providing a given service was lower than if the government department provided it, or if a higher level of service could be provided for the same price by the private partner (This assumes that the government is not subsidising the cost of providing the service.) The PSC includes the calculation of the cost of traditional procurement, which effectively neutralises any difference between public and private sectors (Fitzgerald 2004, pp22-31). The private partner's profit can only be realised through increased productivity or expansion of service, not through higher prices

The UK's National Audit Office investigated the actual performance of a wide range of PFI projects and concluded that, on average, there were typically savings of between 10 and 20 percent over the normal public procurement process.

The perception that exists is that Government can finance the cost of services at a lower cost than the private sector.

By borrowing through the National Treasury or the Municipal Finance Authority, government can often finance projects at a lower cost than the private sector can. However, this may not always be the case. The objective of government should be to focus on the overall advantages of the PPP arrangement and its core competence areas.

A UK-based study carried out by Arthur Anderson into the value for money drivers in the PFI response to the argument is that the gap between the public sector's borrowing rate (the yield on gilts) and the private sector's weighted average cost of capital has been narrowing as the PPP sector matures and the public and private sectors gain in experience. It is expected that this will also be the case for office accommodation projects in the South African context.

Some of the arguments advanced suggesting that public borrowing is cheaper than private sector finance do not take into account the value of transfer of risks and pricing of such risks in PPP transactions. The general public would most likely bear the risk of increased future tax payments if the risks carried by government under conventional procurement contract were to materialise, an example being cost overruns.

However, this argument does not take into account the use of the PSC, which includes the calculation of the traditional procurement, which effectively neutralises any difference between the public and private sectors provision. Therefore, what accounts for value for money is the differential between the public and private sector risk pricing. For the value for money to be realised, the PPP contract must provide for the

performance or compliance with the output specification to be underwritten by the private sector.

The ability to achieve value for money does not only depend upon the private sector being able to deliver great cost savings in relation to the finance costs, but more on the risk weighted costs between public and private sector provision of service. The business cases examined by Arthur Anderson in their report suggest that the costs savings are deliverable.

The valuation of long-term projects requires the forecasting of net cash flows and the NPV using a discount rate equal to a risk free rate, with a premium commensurate with the risk profile of a project (EPAC 1995a, pp.167-9). The different approaches to application of discount rates are, and will continue to be, an irreconcilable difference between public and private sectors (Grout, 2003). Therefore, the question of capital costs benefit is less relevant than whether the risk weighted cost by private provision is lower than the cost of public or in-house provision.

2.9 Socio Economic Benefits

Increased involvement of government in PPPs can help to stimulate the private sector and contribute to increased employment and economic growth. With PPPs, governments can do a lot more with their capital expenditure budgets in delivering social services.

Sussex (2001) challenges the argument that a PFI allows for more investment than conventional funding. In his view, government decision, not funding process, is the main determinant of investment activity.

Hall (1998) argues that for PPPs to be effective for delivery of public infrastructure, the project should realise additional investment in social infrastructure. The activity created by construction and other related services has positive multiplier effects and a direct and indirect bearing on the economy.

The literature research points to a positive correlation in three sets of relationships

- 1) between infrastructure investments, technology, productivity and growth,
- 2) between capital deepening, capital productivity, infrastructure investment and leading indicators of microeconomic performance, and
- 3) investment in infrastructure makes positive contribution to macroeconomic performance and is enhanced by favourable institutional frameworks and public policy settings.

PPPs are also geared to producing benefits for black economic empowerment, community and other social interest groups.

Another criticisms is that Government staff will lose under PPPs

Both union and non-union staff sometimes fear PPPs because of potential job loss or reduced wages and salaries. Any public private partnership agreement will need to reflect the relevant labour laws and existing collective agreements. Often, the labour representatives are invited at an early stage of the process to discuss options for service delivery. Most partnership agreements that have been negotiated require the private partner to take on public staff and guarantee job security and salary levels. Any changes in staffing levels are generally consistent with labour contracts and occur through attrition rather than layoffs. Many of the benefits of PPPs, such as increased efficiency and higher quality of service, have been accomplished through former employees of government. Reasons for increased productivity include increased investment in employees through training, technology transfer and skill diversification.

The argument in relation to the negative effect of PPPs on public sector staff can be addressed by taking steps to address staff concerns through issuing guidance on disclosure of information and consultation with staff. It is necessary to have clear treasury guidance on dealing with staff pensions when staff is transferred to the private sector.

Although collective agreements and labour laws apply to PPP arrangements, there could still be adverse reactions from labour unions or government staff. To overt

some of the negative effects on staff, the support of staff and trade unions needs to be canvassed and obtained to successfully implement the PPPs procurement process.

The House of Commons Treasury Select Committee 1999 and 2000 states that there should be no negative effects for staff transferred as part of a PFI contract. Research on staffing trends within the PFI contract should be undertaken to guard against the development of two-tier employment status as between the employees from the public sector and private sector. The most productive partnerships are those in which government employees, and sometimes their unions, are actively involved in the partnership planning process.

2.10 Risk Transfer

Risk, according to Kerzner (1995) is a measure of the probability and consequence of not achieving a defined project goal and, according to Grey (1995) 'the issues which might hinder a project from being a success.

It is argued that risk transfer is a major benefit of a PPP (Hodge 2004, p.39f). The Arthur Andersen and Enterprise LSE report also confirms that risk transfer is a major value driver of PPP projects but not necessarily the only one. The survey for this research has shed some light on the degree of importance of this driver in relation to other value drivers as far as delivery of office accommodation is concerned.

With PPPs, government can share the risks with a private partner. Risks could include cost overruns, inability to meet schedules for service delivery, difficulty in complying with environmental and other regulations, or the risk that revenues may not be sufficient to pay operating and capital costs.

The Private Finance Panel, 1995 government publication identifies seven principal PFI types of risk arising from designing, building, financing and operating an asset, which should be transferred where necessary to the party best able to manage the risk to ensure best value for money. Treasury guidelines outline the indicators which show whether or not the operator (private sector) is bearing real commercial risks as follows:

- Design and construction risks
- Availability of services and performance risk
- Residual value of asset risk
- Changes in technology/Obsolescence risk
- Financing
- Changes in legislation/ regulations
- Demand (volume/usage) risk

The key risk inherent in the PPP project, from the perspective of the main parties to the project. (International Journal of Project Management, Vol.2 Issue 2, Feb 2002, pg. 107 –118)

The providers of finance identify at least nine risks associated with PPP projects:

- Technical risks, due to engineering and design failures
- Construction risk, because of faulty construction techniques and cost escalation and delays in construction
- Operating risks, due to higher operating and maintenance costs
- Revenue risks, due to non –performance
- Financial risks arising from inadequate hedging of revenues streams and financing costs
- Force majeure risk involving unforeseen and uncontrollable events (e.g. war and other calamities)
- Regulatory or political risks, due to legal changes and unsupportive government policies
- Environmental risks, because of adverse environmental impacts and hazards
- Project default, due to failure of the project from a combination of the above (

The Sponsor (Equity investor's) Perspective:

- Volume risks
- The risk of mid-life capital expenditure and asset management costs being greater than the forecast
- Operating costs
- Operating performance

Much of the risks of a PPP project come from the complexity of the arrangement itself in terms of documentation, financing, taxation, technical details, sub-agreements etc. involved in a major infrastructure venture. The nature of the risks alters over the duration of the project, for example, the construction phase will give rise to different risks from those during the operating phase. The issue of risk transfer is often a source of great debate and at the centre of negotiations between the public and private sector. The question often raised is whether the transfer of some of the risks to private sector results in value for money. The private sector would price-in the risks that it assumes into the financial structure of the project and this would affect the unitary fee payable by the public sector. The key issue is to achieve optimal risk allocation resulting in value for money.

PPPs improve value for money by allocating risks to those that are best able to manage them in the public and private sectors. No standard risk transfer template applies to all projects, as they are all different and specific (Regan, 2005). However, there are guidelines that can be used to ensure that value for money is achieved:

- The risk allocation model must ensure that the risks are allocated to the party best able to manage them;
- The market must have sufficient management quality to absorb and control the transferred risks;
- Genuine risk transfer and reliable risk allocation even under extreme circumstances; and
- The extent to which residual value risk is transferred to the private sector

The risks are allocated to either the private or public sector depending on the type and ability of the party to control and manage them. Turner & Townsend (2002), in their review of risk assessment techniques for PPPs, suggest that a preliminary allocation of risk should be used as a guide for evaluating the bids. This should be further developed during the negotiation process, with final allocation only taking place at the end of the negotiation process.

This approach provides a framework of risk allocation and flexibility to accommodate the private sector assessment of risk. If properly used, it can reduce the lengthy negotiation period associated with PPP processes.

The view that PPPs are more costly because of the effective risk transfer to the private sector stems from the argument that the private sector needs to charge a premium for the risk it absorbs and that this is reflected in the price paid by government (Hodge 2004, p.39)

A recent study of the success of PPP projects, *Public/Private Partnership: a clearer view*, published by PricewaterhouseCoopers, suggests that risk transfer should be fair and offer the private sector incentives to perform. This may be achieved by developing an optimum risk transfer profile, where specific issues on each project are taken into account and risk is allocated on the basis of the party best able to manage the risk thus offering both the public and private sector parties value for money. Megens (1997) argues that the risk profile of a PPP arrangement is not static and changes over time. The risks decline as the contract progresses and the project stabilises.

Key Variables in Risk Allocation

The National Audit Office (1999) asserts that in allocating risks and negotiating contracts, the relationship between price and risk is affected by the nature of the market and the approach adapted by individual companies. Several bids should be compared and systematically analysed to obtain the best possible understanding of the assumptions that are critical for the affordability of the individual schemes.

The House of Commons Treasury Select Committee in 1999 and 2000 recommended that risk transfer should be clearly identified to ensure that the private sector does not seek to minimise operational risk by reducing service specification once the contract is started.

The Public Sector Comparator must contain a clear statement of the risks that have been identified, quantified and included in it. Upfront disclosure of standard risk

transfer and allocation between public and private sector can go a long way towards reducing the long negotiation period associated with PPPs.

Value for money and risk allocation model in construction PPP projects is intended to help the public and private sectors reduce time spent in allocating and negotiating risks and thus help in achieving optimal VFM in PPP projects. The risk allocation model suggests that macro level risks should be retained by the public sector, meso-economic risks should be transferred to the private sector, while micro-level risks should be shared between the two sectors. Li, Akintoye ,Hardcastle, 2002.

TABLE 2: Risk Allocation in PPP Projects

	Public	Private	Shared	Preferred Risk Allocation
Nationalisation/expropriation	79.4%	8.8%	11.8%	Public Sector
Poor political decision-making process	69.0%	6.9%	24.1%	
Political opposition	62.5%	21.9	15.6%	
Site availability	60.6%	12.1%	27.3%	
Government stability	58.3%	25.0%	16.7%	
Level of public support	45.8%	41.7%	12.5%	Strongly Depending
Project approval and permit	35.1%	32.4%	32.4%	
Contract variation	33.3%	25.6%	41.0%	
Lack of experiences in PPP arrangement	13.3%	43.3%	43.3%	
Lack of commitment from public/private partner	24.1%	10.3%	65.5%	Shared
Force majeure	18.4%	13.2%	68.4%	
Legislation change	17.1%	22.0%	61.0%	
Responsibilities and risk distribution	0.0%	22.6%	77.4%	
Authority distribution between partnerships	4.0%	28.0%	68.0%	
Tax regulation change	17.9%	51.3%	30.8%	Primarily to Private Sector
Late design changes	26.3%	52.6%	21.1%	
Residual risk	22.6%	54.8%	22.6%	
Inflation	7.3%	56.1%	36.6%	
Tradition of private provision of public service	27.3%	59.1%	13.6%	
Staff crisis	6.7%	60.0%	33.3%	
Third party tort liability	3.3%	60.0%	36.7%	
Influential economic events	8.3%	69.4%	22.2%	
Financial attraction of project	3.0%	69.7%	27.3%	
Level of demanding project	7.7%	73.1%	19.2%	
Different working methods	0.0%	73.3%	26.7%	
Industrial regulatory change	0.0%	75.0%	25.0%	Solely to Private Sector
High financing cost	3.0%	75.8%	21.2%	
Interest rate	2.4%	78.0%	19.5%	
Organisation and co-ordination risk	0.0%	80.6%	19.4%	
Weather	0.0%	82.1%	17.9%	
Environment	0.0%	84.2%	15.8%	
Availability of finance	0.0%	85.3%	14.7%	
Ground condition	5.1%	87.2%	7.7%	
Operational revenue below par	2.7%	89.2%	8.1%	
Financial market	0.0%	89.5%	10.5%	
Quality of workmanship	2.5%	92.5%	5.0%	
Construction cost overrun	0.0%	92.5%	7.5%	
Frequency of maintenance	0.0%	92.5%	7.5%	
Availability of labour/material	0.0%	94.4%	5.6%	
Insolvency of subcontractors/suppliers	0.0%	94.7%	5.3%	
Low operating productivity	0.0%	94.9%	5.1%	
Design deficiency	0.0%	95.0%	5.0%	
Unproven engineering techniques	0.0%	97.0%	3.0%	
Operation cost overrun	0.0%	97.5%	2.5%	
Higher maintenance cost	0.0%	97.5%	2.5%	
Construction time delay	0.0%	97.6%	2.4%	

The above model can serve as a guideline for allocation of risk for PPP office accommodation projects in South Africa.

2.11 Performance Measurement

The study carried out by the UK Department of Finance into performance indicators, suggests that good indicators are characterised by:

- Appropriateness – the user should be able to relate the information
- The activity, output or outcome required.
- Accuracy- the data must, as much as possible, be free of error and the level of confidence must be clarified or degree of error specified.
- Comprehensiveness – all aspects of performance must be captured including quantitative as well as qualitative.
- Consistency - the indicators must deliver a clear message and reliable for future use in comparing performance over time.
- Relevance – the indicators must provide the information required
- Timely – must use the most recent data available
- Verifiable – the indicators must have a high level of accuracy, objectivity and lack of bias.
- Validity –the indicators must cover actual performance, focusing on the specified outcome.

The Audit Commission report highlights the importance of performance management in PFI projects. The report is keen to ensure that PFIs are not rejected because long-term contracts are incompatible with the principles of best value. However, it must be noted that PFI contracts remain competitive through the regular market testing of services by applying the relevant industry benchmarks.

Reduced quality or efficiency of service

If not properly structured, PPP contracts can result in a reduction in service quality, inefficient service delivery or a lack of proper facility maintenance. For example, cost-plus contracts provide little incentive for the private partner to maintain quality

or increase efficiency. Government (user client) should also consider the life-cycle cost approach in establishing evaluation criteria for projects or services.

The House of Commons Treasury Select Committee in 1999 and 2000 recommended that once the PFI projects have been implemented, a monitoring system must be put in place to continually ensure that value for money is achieved and to identify innovative approaches that could be transferred to publicly funded projects.

It is suggested that a central system of collecting information on each PFI project be established to enable comparative analyses. In particular, it should be clear which types of projects are most suitable for PFI e.g. size, expected life of the asset, type of risk.

2.12 Procurement Process

A study undertaken by DEPFA Bank plc, *PPP Report Global PPP*, 2002, based on the British experiences, shows that PPPs provide better value for money because of the competitive procurement process and the ability to benefit from whole-life costing as opposed to traditional public procurement process). The PPP model enables a better overall economic solution coupled with lower annual operating and maintenance costs over the long-term, and a resultant affordability.

The National Audit Office (NAO) report (1997) that examines the value for money of deals under PPPs in the UK indicates that procurement process is a key element in delivering value for money. It attaches significant value to maintaining competition as late as possible in the award process and further recognises the costs related to this benefit as essential for achieving value for money.

The major criticism around the PPP procurement process is that the public sector often puts out PPP projects to the market without undertaking a comprehensive analysis of the key factors for successful PPP procurement.

The NAO report sets out a systematic way for the public sector to assess projects for value for money. The report focuses on four main aspects necessary for a successful project:

- **Setting Clear Objectives**

Determining in advance what is expected to be achieved in a project and how the outcomes are to be achieved. Also choosing high priority projects based on a needs analysis and determining the best partnership approach based on a well-defined business case.

- **Applying a proper procurement process**

Relevant laws and regulations must be complied with and aimed at achieving a deal that is good value for money.

- **Selecting the best deal available**

The procurement process must deliver the best deal available in the market. A good range of solutions must be assessed, all elements of the bid must be evaluated with the aim of selecting the most economically viable and advantageous bid.

- **Ensuring that the deal is competitive**

In the final stages of the deal, more reliance is placed on negotiation with the preferred bidder to achieve best value for money. A requirement for an experienced team becomes more critical at this stage

- **Inability to benefit from competition**

The competition amongst private partners to secure the right to enter into a PPP is an important benefit for government. Competition leads to innovation, efficiency and lower costs. Government might not be able to benefit from PPPs if there are only a limited number of potential private partners with the expertise or ability to respond to a request for proposals.

Pollock (2001) in the review of the Institute of Public Policy Research challenge the view that competitive pressures between project bidders will ensure value for money. The review argues that the small number of bidders leaves the private sector in a potentially powerful position.

Lessons learned from Skye Bridge projects in Scotland whereby the overall costs of £15million were higher than planned. The NAO report found that although the Scottish Office was not able to bring competition to bear in the last stages of the deal, reliance was placed on negotiation with the preferred bidder to determine some important financing costs.

The industry concern is that bid costs remain too high and therefore making access difficult for small firms.

Factors such as relatively high cost of failure, typically large projects, lack of appropriate skills, lack of credibility in the market place and lack of resources needed to provide long term PPP contract remain a constraint for fair competition.

The general comments have indicated that more could be done to minimize the lengthy contract award period and reduce the costs by standardizing the concession agreement as well as improving the efficiency of public sector by the client having more control of the process, conducting a proper due diligence and clearly identifying the value drivers through a consultative process with the industry earlier in the process. A better understanding of the PPP process and capacity by the public sector is required to achieve effective delivery of office accommodation projects.

The industry recons that because of the complexity of the process, a lot of senior management time is spent on the transaction resulting in huge opportunity costs for private sector. This may improve with more deal flow and as the market for PPP matures in South Africa.

Does the PPP Procurement Process Result in Increased Costs?

Not all user clients (government departments) consider the true costs of providing

services when establishing their pricing policies for fees for services. For example, the costs of overhead or administration and depreciation of assets are often not included in the pricing of individual services. In some cases, there are explicit subsidies for specific services. The delivery of services through PPPs requires pricing policies and fees to reflect all relevant costs. This can have the effect of increasing user fees for specific services.

The cost of managing public controversy over increased fees or developing complex policies for staging fee increases can often negate the value of PPPs for specific services.

Recommendations made by the NAO report for departments responsible for PFI provides guidelines for avoiding some of the potential cost increases as follows:

- Appointing advisors by competition, and set cost targets for advisors fees at the earliest opportunity
- Carry out and document a comprehensive risk analysis for each private finance project
- Check the financial robustness of bids
- Where bids are conditional upon raising finance, seek independent confirmation that the financing on the proposed terms is likely to be achieved
- Ensure that competition is brought to bear on the bidders in respect of all project costs including finance costs
- Where there is no public sector comparator, a systematic financial comparison should be undertaken using realistic alternative options.

Tiong (1996) highlights the keys to successful PPPs. While there is not a set formula or an absolute foolproof technique in crafting a successful PPP, each of these factors is involved in varying degrees.

Political Leadership:

A successful partnership can result only if there is commitment from "the top". The most senior public officials must be willing to be actively involved in supporting the concept of PPPs and taking a leadership role in the development of each given