

PPP QUARTERLY

PUBLIC PRIVATE PARTNERSHIPS

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Innovative infrastructure and service delivery for national and provincial government

A NEW APPROACH TO GOVERNMENT PROCUREMENT

By Michael Schur, Acting Head PPP Unit, National Treasury



Photograph courtesy of the Development Bank Report

Two common misconceptions prevail in the public sector regarding public-private partnerships (PPPs). The first is that PPPs somehow magically enable budgetary limits to disappear. The second is that government needs to own an asset in order to deliver a service.

AFFORDABILITY

A PPP is not unlike a mortgage bond on a house, in that it allows one to finance something in advance of having the cash to do so. But as we all know, one cannot obtain any bond conceivable. There is a clear relationship between the size of the bond and one's ability to finance it over time.

Similarly, the introduction of private finance into the procurement of public services does not mean that affordability concerns can be disregarded. The Minister of Finance made this point at a recent PPP conference, suggesting that: *'It is tempting to think that if we bring private finance to the party, we will be able to afford more expensive champagne. Of course this is wrong – a PPP may shift a financing requirement from the public to the private sector, or may defer the costs incurred on budget, or may replace a tax burden with a stream of user charge payments. In none of these cases do we increase the quantum of services that the economy can accommodate; rather we change the structure of the accounting and perhaps the locus of the obligation to pay. If we are serious about public-private partnerships, then we have to be serious about our commitment to accessible services, for all. And so affordability has to be a cornerstone of our planning.'* (Trevor Manuel, Minister of Finance, Cape Town, December 2000)



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1

Government procurement

2

Department of Labour IT PPP reaches final stages

3

- Treasury PPP Unit expands
- Rand Merchant Bank behind a range of PPPs
- PPP foundation training 2002
- PPP Unit at the WEDC
- Prison goes PPP

4

National and provincial PPP projects in progress

CONTENTS

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RISK

We regularly hear that such-and-such a project does not lend itself to PPP procurement and that 'conventional procurement' makes more sense.

But what is conventional procurement? Traditionally, a new hospital were procured through Public Works, usually on the basis of a drawn-out planning process and detailed design drawings.

And who is actually building such a hospital? A private construction company, of course. But this same company has no (or very limited) obligations once construction were completed. And because the construction company's obligations cease at this point, there is no incentive to design or build with life cycle costing or maintenance in mind. In practice, this means that the initial design risk, often the construction risk (once the guarantees have ended) and certainly all the maintenance risk rests with the public sector, although the private sector has been well paid to build the hospital in the first place. Moreover, delay and cost overrun risk would typically remain with the public sector.

In a well-structured PPP, the construction company would (as part of a larger consortium) be responsible for ongoing building maintenance throughout the hospital's useful life, and would hence be appropriately incentivised to design and build with life cycle costing in mind.

DELIVERING A SERVICE

In a PPP the public sector focus would no longer be on the procurement of an 'asset' (ie a new hospital), but on a 'service', namely a maintained and serviced facility. The design risk would thus be transferred because the public sector's specifications for the new hospital would emphasise outputs rather than inputs. Furthermore, periodic payment to the private 'service' provider would be made on the basis of available service units (ie hospital accommodation, surgery, operating rooms, wards etc), and deductions would be made for non-availability. In this way, initial construction, delay and cost overrun risks are all handed over to, and managed by, the private partner.

SOUND INCENTIVES

Both conventional and PPP procurement involve a form of 'partnership' with the private sector. The real difference between the two lies in the identification and management of risk in the 'partnership', the institution of sound incentives, and the elimination, as far as possible, of perverse ones.

The introduction of private finance to public service delivery provides a degree of flexibility in the implementation of projects, even though it does not eliminate the affordability or budget constraint. Because payments are made over longer periods of time, it is possible to bring forward projects that may otherwise have been delayed.

This can be achieved as 'construction' projects become 'service' projects; where government does not make full payment for the 'construction' component up front, but rather makes periodic payments over the life of the 'service'.

DEPARTMENT OF LABOUR IT PPP REACHES FINAL STAGES



The Department of Labour IT project is the first PPP in the second wave of PPPs, which followed the establishment of the PPP Unit at National Treasury. The project has had the first Feasibility Study approved in terms of the provisions of the Treasury Regulations.

The study demonstrated that:

- Significant operational benefits could be derived from an investment in IT/IS.
- The project represents Value for Money to the Department, with the cost of the investment recovered through the savings generated from using less 'contracted in' resources.
- Additional Value for Money savings will be possible through the use of a PPP funding mechanism.
- It is possible to fund the estimated annual unitary payments to the PPP provider within the existing resources of the Department.

Through a detailed short-listing process, five private sector IT providers were identified as capable of meeting the requirements of the project. This has, through a transparent process, been reduced to two bidders, and a signed contract is expected before the end of the year.

This project represents a landmark for PPPs in South Africa for several reasons. Not only is it the first project to proceed under the new PPP Regulations, it is also the first IT PPP – often acknowledged as the most difficult.

The key factors which have contributed towards the success of this project include:

- strong commitment from the Department to the delivery of the project;
- an advisory team from KPMG which includes effective project management, extensive experience in IT deals and international PPP expertise;
- support from other bodies – in particular SITA and the National Treasury's PPP Unit.

TREASURY PPP UNIT EXPANDS

Two additional staff joined the National Treasury's PPP Unit this quarter. The Unit now numbers six professionals, and two administrative staff.



Advocate Uven Bunsee was formerly head of the Department of Labour's legal division. He brings with him valuable experience from the DoL's IT PPP project where he has played a leading role, and will be taking on a number of IT-related PPP projects. He can be contacted on Tel: (012) 315 5525.



Nelisiwe Mtsweni joins the Unit from Marcus Evans where she honed her skills in data administration. She is responsible for the Unit's project tracking system and a range of administrative functions. She can be contacted on Tel: (012) 315-5741.

PPP FOUNDATION TRAINING 2002

The highly successful two-day PPP Foundation Training course, conducted jointly by the National Treasury PPP Unit and the NBI's PPP Resource Centre, will run again every quarter throughout 2002. Book now to avoid disappointment. Costs are R540 per person plus travel and accommodation.

DATES: • 11 – 12 March 2002 • 4 – 5 June 2002
• 27 – 28 August 2002 • 5 – 6 November 2002

Contact Ms Faye Dolley at NBI:
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PPP UNIT AT THE WORLD ECONOMIC DEVELOPMENT CONGRESS

The National Treasury's PPP Unit took part in the WEDC 2001 in Kuala Lumpur, Malaysia in June. This is arguably the premier international infrastructure forum for the year, with a focus on private sector participation in public infrastructure provision and financing.

Alice Rennie, a Chartered Financial Analyst, currently seconded to the PPP Unit from Investec, presented an update on infrastructure projects in South Africa.

The forum provided an opportunity to share PPP experience worldwide, and to encourage potential investors to explore development opportunities in South Africa.

Alice Rennie CFA



RAND MERCHANT BANK BEHIND A RANGE OF PPPs



Rand Merchant Bank's Project and Infrastructure Finance team has played an active role in South Africa's initial PPP and Municipal Finance initiatives. It was central to structuring and closing the N3 Toll Road and Louis Trichardt Prison transactions, each being awarded as Africa's Deal of the Year by Euromoney in 1999 and IFR in 2000 respectively.

The RMB team is also the advisor and arranger to the Impilo Consortium, the preferred bidder for the Inkosi Albert Luthuli Central Hospital in Durban. Other current activities include involvement with consortia in respect of five projects listed in PPP Quarterly's projects table, as well as two toll road scheme developments. The team is particularly active in Africa across a range of sectors including ports, water, power, rail and telecoms. Debbie Opperman can be contacted on (011) 282-8322 for further information.

BLOEM PRISON GOES PPP



The first PPP in the facilities environment, the Mangaung Maximum Security Prison in Bloemfontein, is now operational.

ARCUS GIBB introduced leading UK prisons operator, Group 4 Securitas, to Murray & Roberts in 1994, anticipating private financing of prison construction in South Africa.

Request for Qualification documents were issued by the Dept Public Works for a 1 500 bed prison in May 1997, and the Ikhwezi Consortium achieved preferred bidder status in July 1998. The period to March 2000 was spent in negotiations, doing further design changes to accommodate 2 928 inmates and to improve viability. By April 2000 work had started on site, and hand over was achieved in July 2001, three months ahead of schedule.

Key lessons learnt:

- Government has a responsibility to be clear about what it wants and can afford. The costs to the private sector of constant changes are significant.
- There is a limited number of players in the South African market that can deliver PPPs in the tough time scales of private finance. Government has to encourage this market by running professional PPP procurement processes.
- The welding together of previously opposing market forces, now united by a common goal under PPP principles, yields impressive benefits.
- Involving government, operator, financier, contractor and designer from day one results in value for money to the taxpayer.

NATIONAL AND PROVINCIAL PPP PROJECTS IN PROGRESS: SEPTEMBER 2001

This PPP projects table is a regular feature of PPP Quarterly. It updates the status of work-in-progress projects, indicates their managing departments and, where applicable, notes the transaction advisors and private partners.

DEPARTMENT/ PROVINCE	PROJECT	STATUS	TRANSACTION ADVISORS	CONTACT OFFICIAL
Dept Labour	IT	Bidders' proposals being evaluated. Financial closure target: Dec 2001	KPMG	Deon Haasbroek (012) 309-4551
State Vaccine Institute	Strategic partnership	Bids received from two bidders. Financial close expected by end Sept 2001	PriceWaterhouseCoopers	Gerrit Muller (012) 312-0717
Dept Social Development	IT	Options Analysis being conducted	Deloitte Consulting	SJ Jehoma (012) 312-7746
Dept Foreign Affairs	Head Office building	Heritage impact assessment underway	Credit-Agricole Indosuez, Decathlon, and Masons	Luke van Eck – DPW (012) 337-2329
Dept Education	Head Office building	RFP issued 9 July. Bids due 9 Oct 2001	KPMG and KMMT	Anselm Umoetok – DPW (012) 337-2292
Dept Trade & Industry	Head Office building	Feasibility Study completed June 2001, RFQ issued Aug 2001	Credit-Agricole Indosuez	Peter Aborn (012) 310-1564
Dept Land Affairs	Electronic deeds registration system	Options Analysis completed	Tsa Mafatshe Consortium (KPMG, KMMT, Matlala, KLegal, MacRobert, RL)	Jan Slothouber (012) 338-7203
Dept Water Affairs & Forestry	Western Cape Working for Water project: secondary industries	Options Analysis finalised	KPMG, KMMT, Stellenbosch University	Christo Marais (021) 405-2200
Dept Water Affairs & Forestry	Diepwalle State Forest – Southern Cape eco-educational facility	RFP to be issued Sept 2001	In-house	Ngcali Nomtshongwana (012) 336-7460
Dept Water Affairs & Forestry	State forests Mbazwana and Manzengwenya in Maputaland, KZN	TOR for TA issued Aug 2001	Not yet appointed	Maud Dlomo (012) 336-7768
Gvt Communication and Information Service	Range of services	TOR being drafted for Transaction advisors	Not yet appointed	Patti McDonald (012) 314-2399
Dept Arts, Culture, Science & Technology	Robben Island hospitality facilities development	Negotiations with preferred bidder underway	In-house with Mallinicks Attorneys	Andre Odendaal (021) 959-2935
Dept Correctional Services	Electronic monitoring	In-house study drafted of prisoners	Not yet appointed	Elias Leshabane (012) 315-5467
Eastern Cape Bayworld (PE museum, snake park, oceanarium)		TOR for TA issued Sept 2001	Not yet appointed	Sylvia van Zyl (041) 586-1051
Eastern Cape Dept Health	Hospital co-location projects	Feasibility Studies underway		Dave Collins (012) 312-0663
Eastern Cape Dept Transport	Fleet management	TA to be appointed	Not yet appointed	Lize Hoole (012) 309-3832
Free State Dept Education	Schools	TA bids submitted 3 Aug 2001	Not yet appointed	George Ingram – DoE (051) 430-8989
Free State Health Dept	Universitas and Pelonomi Hospitals – co-location	Preferred bidder announced, financial close expected by Oct 2001	Credit-Agricole Indosuez and Naudes Attorneys	Gert van Zyl (051) 405-3556
Gauteng Blue IQ	Hi-speed train	Feasibility Study under review by National Treasury	Khuthele, Arcus Gibb and Kagiso Financial Services	Gautrans (011) 355-7300
KwaZulu-Natal Dept Health	Inkosi Albert Luthuli Hospital equipment and maintenance	Negotiations with preferred bidder. Financial closure target Oct 2001	PWC, White & Case, EC Harris, Aloecap, Hiltron	Herman Conradie (033) 395-2019
KwaZulu-Natal: Ezemvelo KZN Wildlife	Eco-tourism: Vivane resort, and Pongolapoort dam	Vivane financial closure. RFP issued for Pongolapoort houseboats	In-house	Hilton Bedingham (033) 845-1977
Mpumalanga Dept Economic Affairs, Gaming & Tourism	Eco-tourism: Zithabiseni Resort	RFP issued Jul 2001 Bids due Sept 2001	White & Case and KPMG	Christabel Hlatshwayo (013) 766-4136
Northern Cape Dept Transport, Roads & Public Works	Fleet management	Negotiations with preferred bidder. Financial closure target Aug 2001	Deloitte & Touche	Tshego Motaung (053) 839-2109
Northern Province Dept Public Works	IT GIS web-enabled MIS for the province	TA to be appointed Sept 2001	Not yet appointed	Baldwin Ramasobane (015) 293-9000
Northern Province Dept Finance Economic Affairs and Tourism	Eco-tourism: Manyelethi and Letaba Ranch for Pungwe, Khoko Moya, Honey Badger, North Letaba	Preferred bidders selected Financial closure due Sept 2001	Palaborwa SDI team and White & Case	Charles Maluleke (015) 288 0049
Northern Province Dept Health	Emergency vehicles fleet management	TA to be appointed	Not yet appointed	John McCutcheon 083 264-0520
North West Parks & Tourism Board	Eco-tourism: Rustenburg, Boskop Dam, Borakalalo, Oog Malemani	Negotiations underway for Rustenburg: RFPs issued for Boskop, Borakalalo, Oog Malemani	In-house	Paul Daphne (018) 386-1225
North West Dept Transport	Bus Transport-NTI	TA to be appointed	Not yet appointed	Teboho Molaba (018) 387-2443
Western Cape Chapman's Peak Toll Road	Toll road Concession	Four bidders pre-qualified Tender documents issued end-Jul 2001	Credit – Agricole Indosuez; Jeffares and Green; Hofmeyr, Herbstein & Gihwala; Intertoll (Pty) Ltd	Ben Veldman (021) 483-2427
Western Cape Dept Health	Hospital co-location projects	Feasibility Studies underway		Japie Du Toit (021) 483-5844
Western Cape Nature Conservation Board	Eco-tourism: 13 sites	TOR being drafted for TA	Not yet appointed	David Diatz (021) 483-5356