



**NATIONAL
TREASURY**
PPP UNIT



MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES





**NATIONAL
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PPP UNIT**

MUNICIPAL PPP PROJECT CYCLE

Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: IIB

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes



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DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

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MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULES 1 - 3

INCEPTION AND PRE-FEASIBILITY PHASES



NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 1: REGULATIONS

ABOUT THESE GUIDELINES

Section 168(1)(d) of the Municipal Finance Management Act (2003) (MFMA) provides that the Minister of Finance may, with the concurrence of the Minister for Provincial and Local Government, issue regulations and guidelines regulating the financial commitments of municipalities and municipal entities in terms of public-private partnerships (PPPs). Section 86A of the Municipal Systems Act (2000) (MSA), read together with section 120 (1) and (2) of that act, provide that the Minister for Provincial and Local Government may issue guidelines for municipalities when assessing options for the provision of a municipal service, the different categories of municipal services and the different categories of service providers.

These National Treasury/Department of Provincial and Local Government (DPLG) *Municipal Service Delivery and PPP Guidelines* of 2007 are jointly issued by the Minister of Finance and the Minister for Provincial and Local Government, and apply to the municipalities described in section 2 of the MSA.

ABOUT THIS MODULE

Module 1 of the National Treasury/DPLG Municipal Service Delivery and PPP Guidelines opens with brief notes on how municipal PPPs and these Guidelines fit within South Africa's system of local government financial management.

This module presents the Treasury Regulations in terms of the MFMA (which is the legal foundation for municipal PPPs) and the MSA in an annotated form, taking the reader through the regulations and applicable legislation, and answering frequently asked questions.

The municipal PPP project cycle appears on the next page. It shows the various phases and stages of the regulations and applicable portions of the legislation. This municipal PPP project cycle is referred to throughout the Guidelines. Local Government: Municipal Public-Private Partnership Regulations (1 April 2005) are attached as an annexure.

Municipalities and private parties will find Module 1 useful when considering municipal service delivery options, including the legal foundation of municipal PPPs. The module is also useful as a quick reference throughout the municipal PPP project cycle. Cross-references to other modules in the *Guidelines* refer the reader to detailed guidance and information about the stages of developing a municipal PPP. Annexures provide important supplementary information.

Municipalities and private parties should be familiar with the relevant provisions of the MFMA, the MSA and the Local Government: Municipal Finance Management Act: Municipal Supply Chain Management Regulations as they bear on the assessment and procurement of a municipal PPP.



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- Compare bids with feasibility study and each other
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- Prepare value assessment report

Treasury Views and Recommendations: IIB

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- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: III

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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GLOSSARY¹

Adviser	A person or persons appointed in writing by an accounting officer of a municipality, who has or have appropriate skills and experience to assist and advise the municipality to achieve informed decisions concerning the effective delivery of the defined service, including, if appropriate, the preparation and conclusion of a PPP agreement The term is synonymous with the terms “consultant” and “transaction adviser”.
Best and final offer (BAFO)	In a negotiated procurement process, the bid containing final pricing and deliverables submitted by bidding contractors based on the outcome of the negotiations conducted during the initial bid stage.
Change management	The creation of mechanisms to address any aspect of change that could occur in relation to a project.
Contract administration	The administrative processes required to ensure that all procedures contained in a contract and all related documentation are effectively managed.
Contract maintenance	Systems and procedures to ensure that the contract and all related documentation are consistent, up to date and accessible to the relevant parties.
Contract management	The process that enables both parties to a contract to meet their obligations.
Contract management plan	A plan that sets forth the approach to managing the contract’s strategic objectives and key deliverables, partnership management principles, service-delivery management principles and contract administration requirements.

1. The definitions presented here are PPP-specific. See Schedule 1 to General Notice 112 Broad-Based Black Economic Empowerment Act (2003): *Codes of Good Practice on Black Economic Empowerment* for definitions of the non-PPP specific BEE nomenclature used in Module 2.

Delivery stage	The period in which services are provided and used.
Development stage	The period from the signing of the contract to the commencement of service delivery.
End-user	The people who use a service.
Exit stage	The period towards the end of the life of a project (whether it is terminated or expires) during which activities are undertaken to wind up the project and make new arrangements for continued service delivery.
Feasibility study	Includes both the “internal” and “external” mechanism assessments described in section 78 (1) and (3) of the MSA and the feasibility study described in section 120 of the MFMA and the Municipal PPP Regulations .
Integrated development plan (IDP)	The plan envisaged in section 25 of the MSA.
Municipality	Has the meaning described in section 2 of the MSA.
PPP agreement	A written contract recording the terms of a PPP concluded between a municipality and a private party.
PPP unit	The unit at the National Treasury responsible for regulating and facilitating PPPs.
PPP unit internal project adviser	A person appointed by the National Treasury to provide hands-on technical assistance from the date of registration to the completion of a project including, if appropriate, the signing of a PPP agreement, and in the development and delivery phases.
Private party	Has the meaning defined in Municipal PPP Regulations to the MFMA.
Procurement stage	The period from project initiation until the contract is signed.

Public-private partnership (PPP)	Has the meaning defined in Municipal PPP Regulations to the MFMA. Discussed at some length later in this Module.
Project Development Facility (PDF)	A facility in the National Treasury that provides financial support to municipalities for the procurement of advisory or other technical expertise.
Project officer	A person identified by the accounting officer of a municipality, with appropriate skills and experience, either from within or outside the municipality, who is responsible for performing the duties set out in section 116(2)(c)(i) and (ii) of the MFMA and any other duties or powers delegated by the accounting officer to him/her in terms of section 79 of the act.
Public sector comparator (PSC)	The financial model setting forth the costing of a project with specified outputs when the public sector is the supplier.
Request for proposals (RFP)	The principal tender document in a procurement, provided only to short-listed bidders.
Request for qualifications (RFQ)	The initial tender document in a PPP procurement that seeks to qualify short-listed bidders to receive a RFP.
Special purpose vehicle (SPV)	A company incorporated under the Companies Act of South Africa to provide services to a municipality in a PPP.
Subcontractors	Counter-parties of the private party to the PPP agreement, including those responsible for construction and operations.
Variation management	Systems and procedures enabling changes to a contract.

ACRONYMS

BBBEE Act	Broad-Based Black Economic Empowerment Act (2003)
DEAT	Department of Environmental Affairs and Tourism
DME	Department of Minerals and Energy
DPLG	Department for provincial and local government
DWAF	Department of Water Affairs and Forestry
EME	Exempted micro-enterprises
MFMA	Local Government: Municipal Finance Management Act (No 56 of 2003)
MSA	Local Government: Municipal Systems Act (No 32 of 2000 as amended)
MSP	Municipal service partnership
NPV	Net present value
PAJA	Promotion of Administrative Justice Act (2000)
PFMA	Public Finance Management Act (Act 1 of 1999 as amended by Act 29 of 1999)
PPPFA	Preferential Procurement Policy Framework Act (2000)
QSE	Qualifying small enterprises
TVR I, II, III	Treasury Views and Recommendations

INTRODUCTION

South Africa has established a firm regulatory framework that enables municipal, provincial and national government institutions to enter into PPP agreements.

PPPs for municipal institutions are governed by the MSA and the MFMA. The central legislation governing municipal PPPs is in chapter 11 of the MFMA, Goods and Services, which addresses supply chain management (in part 1) and PPPs (in part 2).²

With effect from 1 April 2005, the Minister of Finance, in agreement with the Minister for Provincial and Local Government, issued the Local Government: Municipal Finance Management Act: Municipal Public-Private Partnership Regulations (Municipal Public-Private Regulations), which address the PPP provisions in both the MSA and the MFMA, and other matters in the MFMA related to the procurement of multi-year PPP agreements.

The central legislation governing PPPs for provincial and national institutions is Regulation 16, issued in terms of the Public Finance Management Act (1999) (PFMA). Guidance in terms of this legislation may be found in the *Public Private Partnership Manual* issued by the National Treasury in 2004.

The implementation of a decision to employ an external service delivery mechanism, such as a PPP, requires a municipality to complete a feasibility study according to provisions of the MFMA and, in cases involving municipal services, the MSA. These two acts were passed four years apart and contain many similar provisions.

These Guidelines, prepared by the National Treasury in cooperation with DPLG, combine in one document the requirements of the two acts, harmonising them and providing sufficient detail to many of their general provisions. Where the acts do not address a specific issue, guidance is provided.

One key element of these Guidelines is a clear description of municipal services and guidance on which activities are subject to the MSA and MFMA – and which are subject to the MFMA alone. To accomplish this, the Guidelines use the MSA definitions of “municipal services”, and “municipal activities reasonably necessary for, or incidental to, the effective performance of a municipality’s functions and the exercise of its powers” (municipal support activities), which includes all other municipal activities that the municipality has the competency

2. It is important to note that all municipal PPP activities must be undertaken within the context of an adopted supply chain management policy and, if the envisaged PPP involves a multi-year agreement, the provisions of section 33 of the MFMA may apply. See section 120(7) of the MFMA.

to undertake. A third category of PPPs includes partnerships in which the private sector uses municipal property for commercial purposes.

The *Municipal Service Delivery and PPP Guidelines* are founded on the MFMA and the Municipal Public-Private Partnership Regulations, with appropriate references to the Municipal Supply Chain Regulations and the MSA, and have been produced for municipalities, municipal entities and private parties with an interest in municipal PPPs.

Each module is jointly issued by the Minister of Finance and the Minister for Provincial and Local Government. The Guidelines, which will be updated from time to time, constitute guidance in terms of section 168 of the MFMA and section 86A of the MSA, and are aimed at facilitating the application of the MFMA, its regulations, and the applicable provisions of the MSA.

The Guidelines provide best-practice guidance based on the government's experience with PPPs to date. The National Treasury may, on good grounds, approve a departure from a Treasury Regulation or from any condition imposed in terms of the act. If a municipality to which the Municipal Public-Private Partnership Regulations apply wants to deviate from them, it must inform the relevant accounting officer. He/she should seek approval of the departure from the National Treasury, in terms of section 170 of the act, before making any agreement that may be deemed a PPP in terms of the provisions of the regulations.

The MSA

Section 76 of the MSA states that a municipality may provide a municipal service through either an internal or external mechanism. An external mechanism includes a municipal entity, another municipality, an organ of state, a community-based organisation or other non-governmental organisation (NGO), or "any other institution, entity or person legally competent to operate a business activity", which includes a PPP.

Section 77 of the MSA describes the points at which a municipality *must* review and decide on a mechanism to provide a municipal service. These occasions include when an existing municipal service is to be significantly upgraded, extended or improved; when the municipality is restructured or reorganised in terms of the Municipal Structures Act (1998); when review is required by a provincial or national intervention; when a new activity is to be undertaken; when requested by the local community; when a review of the integrated development plan requires a review of the delivery mechanism; or when a performance evaluation requires a review of the mechanism.

Section 78 of the MSA provides that when a municipality undertakes an MSA section 77 review of its delivery mechanisms, it must first assess the provision of that activity through an internal mechanism, after which it may decide to explore the delivery of that activity by an external mechanism. If the municipality decides to explore service provision by an external mechanism, it must also conduct a feasibility study in terms of subsection (3).

The MFMA

The MFMA aims to modernise budgetary and financial management practices in local government, maximising the ability of municipalities to deliver services to all their residents, customers, users and investors. It also aims to put in place a sound financial governance framework by clarifying and separating the roles and responsibilities of the mayor, executive and non-executive councillors and officials. The act holds the mayor or executive committee responsible for policy and outcomes, and holds the municipal manager and other senior managers responsible for implementation and outputs.

The government is focusing on outputs and outcomes to ensure that, in spending taxpayers' money, it produces the intended result. In terms of the MFMA Chapter 8, Part 1, the municipal manager is the accounting officer, and is directly accountable for the efficient management of the municipal budget to achieve the municipality's public mandate. The accounting officer needs constantly to evaluate value-for-money choices. Such options may include a PPP for the delivery of a public service, or to achieve a public good.

By its nature, a municipal PPP entails:

- Targeted public spending, principally on outputs to agreed standards
- Leveraging private-sector finance and efficiencies
- Allocating risks to the party best able to manage them.

As a mechanism of service delivery, a municipal PPP is firmly in line with the intent of the MFMA and the MSA.

Municipal PPP regulations

The Municipal Public-Private Partnership Regulations provide precise and detailed instructions for PPPs. The regulations define the elements of a municipal PPP, and set out the stages and approvals it will have to go through. The gazetted regulations are summarised below, annotated at the points at which questions are frequently asked, or where clarification in terminology is required. The regulations are also provided in an annexure.

UNDERSTANDING THE MUNICIPAL PPP REGULATIONS

1. Definitions

In these regulations, unless the context indicates otherwise, a word or expression to which a meaning has been assigned in the Act, has the same meaning, and:

- **“Act”**: the Local Government: Municipal Finance Management Act (2003) (MFMA).
- **“Activity”**: the municipal function or the management or use of municipal property, or both, which is or is to be outsourced to a private party in terms of a public-private partnership agreement.
- **“Affordable”**: the financial obligations (if any) to be incurred by a municipality in terms of the agreement can be met by:
 - Funds designated in the municipality’s budget for the current year for the activity outsourced in terms of the agreement
 - Funds destined for that activity in accordance with the budgetary projections of the municipality
 - Any allocations to the municipality
 - A combination of such funds and allocations.

“Municipal function”:

- A municipal service³
- Any other activity within the legal competence of a municipality.

“Municipal property”: includes any movable, immovable or intellectual property, owned by or under the control of the municipality or a municipal entity under the sole or shared control of the municipality.

3. The MSA defines a “municipal service” as a service that a municipality in terms of its powers and functions provides or may provide to or for the benefit of the local community, irrespective of whether (a) such a service is provided, or to be provided, by the municipality through an internal mechanism contemplated in section 76 or by engaging an external mechanism contemplated in section 76; and (b) fees, charges or tariffs are levied in respect of such a service or not.

Which municipal institutions are subject to the Municipal Public-Private Partnership Regulations?

All references to a “municipality” are to municipality as defined in section 2 of the MSA.

- **“Private party”** excludes:
 - A municipality
 - A municipal entity
 - An organ of state, including an institution listed in any of the Schedules to the PFMA or in section 76(b)(iii) of the MSA.

How is a private party defined?

The regulations define a private party to a PPP agreement in the negative, explicitly excluding public institutions. PPPs in South Africa are therefore specifically defined to *exclude* public-public partnerships. The MSA requires a feasibility study where a municipality decides to enter into a service delivery agreement with another municipality.⁴ The MSA also indicates that a municipality may enter into a service delivery agreement with a community-based organisation or other non-governmental organisation, “legally competent to enter into such an agreement”, but their capacity to carry substantial financial, technical and operational risk in a project will determine the role they are able to play in a PPP.

“Project officer”: a person appointed in terms of Regulation 7(1).⁵

“Public-private partnership”: a commercial transaction between a municipality and a private party in terms of which the private party:

- (a) Performs a municipal function for or on behalf of a municipality, or acquires the management or use of municipal property for its own commercial purpose; or both performs a municipal function for or on behalf of a municipality and acquires the management or use of municipal property for its own commercial purposes.
- (b) Assumes substantial financial, technical and operational risks in connection with:
 - (i) The performance of the municipal function
 - (ii) The management or use of the municipal property; or
 - (iii) Both

4. Section 80(3) of the MSA.

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

- (c) Receives a benefit from performing the municipal function, or from using the municipal property or both, by:
- (i) Consideration to be paid or given by the municipality or a municipal entity under the sole or shared control of the municipality
 - (ii) Charges or fees to be collected by the private party from users or customers of a service provided to them
 - (iii) A combination of the benefits referred to in subparagraphs (i) and (ii).

What does a PPP entail?

A PPP is a contract between a municipality and a private party in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project. Two types of PPPs are specifically defined:

- Where the private party performs a municipal function
- Where the private party acquires the use of municipal property for its own commercial purposes

A PPP may also be a hybrid of these types.

Payment in any scenario involves one of three mechanisms:

- The municipality paying the private party for the delivery of the service
- The private party collecting fees or charges from users of the service
- A combination of these.

What is a PPP not?

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

- A PPP is not a simple outsourcing of functions where substantial financial, technical and operational risk is retained by the municipality
- A PPP is not a donation by a private party for a public good
- A PPP is not the privatisation or divestiture of municipal assets and/or liabilities
- A PPP is not the commercialisation of a municipal function by the creation of a municipal entity
- A PPP does not constitute borrowing by the municipality.

What types of PPP do the regulations cater for?

The Municipal Public-Private Partnership Regulations cater for a wide variety of PPP types. A list of examples is provided in Module 3.

What PPP financing structures and funding sources⁶ do the regulations provide for?

The Municipal Public-Private Partnership Regulations are not prescriptive about the financing structure of a PPP. It is assumed that these will vary widely from project to project and sector to sector, and will be closely linked to the funding sources that can be secured for each deal. However, in most PPPs the private party raises both debt and equity to capitalise the project. This is called “project financing”. In smaller municipal PPPs, the private sector often obtains any required funding on the strength of its balance sheet, which is called “corporate financing.” These Guidelines assume both of these PPP financing structures and sources of funding are used.

What is a typical PPP structure?

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

Affordability limits, value-for-money considerations and the risk profile of the project will determine a PPP project’s financing structure and sources of funding.

“Transaction advisor”: a person or persons appointed in writing by the municipality in terms of Regulation 2(1)(b) who has appropriate skills and experience to assist and advise the municipality on the preparation and procurement of the public-private partnership agreement.

“Value for money”: the performance of a private party in terms of the agreement will result in a net benefit to the municipality in terms of cost, price, quality, quantity, risk transfer or any combination of those factors.

2. Project inception

Under the MSA, a municipality may provide a municipal service through either an internal mechanism or an external mechanism.⁷ These Guidelines describe the processes to determine whether service delivery should be undertaken by

6. Financing structure and funding sources are dealt with in Module 4: PPP Feasibility Study.

7. Section 76 of the MSA.

an internal or an external mechanism, and, if by the external mechanism of a private party, the processes that must be followed.⁸

As soon as a municipality begins a project that may be a PPP, the accounting officer must appoint a project officer, a person with appropriate skills and experience, either from within or outside the municipality.⁹

As soon as the municipality identifies a project that may be concluded as a PPP as contemplated in section 120(4) of the act, the accounting officer must, in writing:

- Notify the National Treasury and the relevant provincial treasury of the municipality's intention, together with information on the expertise within the municipality to comply with that section of the act
- If requested to do so by the National Treasury or the relevant provincial treasury, appoint a person with appropriate skills and experience, either from within or outside the municipality, as the adviser to assist and advise the municipality on the preparation and procurement of the PPP agreement.¹⁰

Take note

The treasury of the province within which the municipality is located is the relevant treasury.

What does the PPP project cycle involve?

The PPP project cycle enables the three regulatory tests of affordability, value for money and risk transfer to be applied at every stage of preparing for, procuring and managing a PPP agreement. The Municipal Public-Private Partnership Regulations set out six distinct phases to the project cycle. They require that the municipality apply these tests throughout, and they solicit the views and recommendations of the National Treasury and the relevant provincial treasury before they publicly invite bids and prior to the execution of any PPP agreement.¹¹ (See the project cycle chart at the beginning of this Module.)

8. Section 76(b)(iv),(v) of the MSA.

9. Municipal PPP Regulation 7(1).

10. Municipal PPP Regulation 2.

11. Both the MFMA and the Municipal PPP Regulations require the solicitation of views and recommendations of the community and other government entities prior to the execution of any PPP agreement.

3. Feasibility study¹² – “in principle” decision

To determine whether an external mechanism, including a PPP, is in the best interests of a municipality, the accounting officer must undertake a feasibility study that:

- 3.1. Explains the strategic and operational benefits of the proposed mechanism, including a PPP, for the municipality in terms of its objectives.
- 3.2. Describes in specific terms:
 - (a) The nature of the private party’s role in the PPP
 - (b) The extent to which this role, both legally and by nature, can be performed by a private party
 - (c) Describes how the proposed agreement will:
 - Provide value for money to the municipality
 - Be affordable for the municipality
 - Transfer appropriate technical, operational and financial risks to the private party
 - Impact on the municipality’s revenue flows and its current and future budgets.
- 3.3. Takes into account all relevant information.
- 3.4. Explains the capacity of the municipality to effectively monitor, manage and enforce the agreement.¹³

A number of additional matters are to be addressed in feasibility studies, and these are reviewed in detail in Module 4.

When the feasibility study is completed, the accounting officer must present the feasibility study report, with all relevant documents, to the council for its decision “in principle” to continue with the proposed PPP.

What are the tests for a PPP?

Whatever the PPP type, structure, payment mechanism, or sources of funding, all municipal PPPs governed by the Municipal Public-Private Partnership Regulations are subjected to three strict tests:

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

12. How to do a PPP feasibility study is covered in Module 4: PPP Feasibility Study. The provisions quoted are found in section 120 (4) of the MFMA.

13. Section 120(4) of the MFMA. The MSA feasibility study requirements are found in section 78 (3) (c).

4. Procurement¹⁴

- 4.1. Procurement of a PPP must be in terms of a municipality's supply chain management policy adopted pursuant to part 1 of chapter 11 of the MFMA, including the Municipal Supply Chain Regulations issued thereunder, section 4 of the Municipal PPP Regulations and other applicable legislation.¹⁵
- 4.2. Section 13 of the Municipal Supply Chain Regulations sets forth the general preconditions for consideration of bids, in terms of information required from bidders.
- 4.3. Prior to issuing any bid documentation, the accounting officer of the municipality must solicit the views and recommendations of the National Treasury and the relevant provincial treasury.¹⁶

How is the private party chosen?

The Municipal Public-Private Partnership and Municipal Supply Chain Regulations set out clear phases that must be followed by a municipality, and prescribe distinct points in these phases where the views and recommendations of the National Treasury and the relevant provincial treasury must be solicited by a municipality's accounting officer in preparing for, procuring, concluding and managing a PPP agreement.¹⁷

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

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

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

15. Other applicable legislation includes the Preferential Procurement Policy Framework Act (2000), the BBBEE Act and the Construction Industry Development Board Act (2000).

16. Municipal PPP Regulation section 4(3)(a).

17. The PPP procurement process is detailed in Module 5: PPP Procurement and guidance on PPP agreement management is given in Module 6: Managing the PPP Agreement.

How is black economic empowerment¹⁸ applied in PPPs?

In providing that active measures must be taken to promote black economic empowerment (BEE) at all stages of PPPs, the regulations are in line with broader government BEE policy. *Module 2: Code of Good Practice for BEE in PPPs*, discusses the approach to BEE. The code is issued by the Minister of Trade and Industry in terms of the Broad-Based Black Economic Empowerment Act (2003) (BBBEE Act).

4.4. Where the value of the proposed PPP agreement exceeds R200 000 or the proposed agreement is for greater than one year, competitive bidding is required.¹⁹

4.5. After the evaluation of the bids, but prior to appointing the preferred bidder, the accounting officer of the municipality must solicit the views and recommendations of the National Treasury and the relevant treasury, in terms of:

- The proposed terms and conditions of the draft PPP agreement
- The municipality's plan for the effective management of the agreement after its conclusion
- The preferred bidder's competency to enter into the agreement
- The preferred bidder's capacity to comply with the obligations of the agreement.²⁰

4.5.1. There are basic requirements to which PPP agreements must comply. A PPP agreement between a municipality and a private party must:

- Provide value for money to the municipality
- Be affordable for the municipality
- Describe in specific terms the nature of the private party's role in the PPP
- Confer effective powers on the municipality
- Provide for monitoring the implementation of and assessment of the private party's performance under the agreement
- Provide for management and enforcement of the agreement
- Impose financial management duties on the private party, including transparent processes relating to internal financial control, budgeting, accountability and reporting

18. BEE is dealt with in all the modules as applicable to a particular phase, stage or step in the PPP process.

Module 2: Code of Good Practice for BEE in PPPs provides the policy and specific guidance.

19. Sections 19, 20, 21 of the Municipal Supply Chain Regulations.

20. Municipal PPP Regulation section 4(3).

- Provide for the termination of the agreement if the private party:
 - Fails to comply with terms or conditions of the agreement
 - Deliberately provides incorrect or misleading information to the municipality
- Restrain the private party, for the full period of the agreement, from offering otherwise than in accordance with the agreement an employment, consultancy or other contract to a person:
 - Who is an official of the municipality or a municipal entity under the sole or shared control of the municipality
 - Who was such an official at any time during a period of one year before the offer is made
- Restrain the private party, for a period of three years, from offering an employment, consultancy or other contract to an employee of the municipality directly involved in the negotiation of the agreement.
- Comply with section 116(1) of the act.²¹

5. Contracting PPP agreements ²²

- 5.1 Only the accounting officer of a municipality may sign a PPP agreement on behalf of the municipality.
- 5.2 The accounting officer may not sign a PPP agreement unless section 33 of the MFMA has been complied with.²³

6. Management of PPP agreements²⁴

The accounting officer **of the municipality that is party to a PPP agreement** is responsible for ensuring that the PPP agreement is properly **implemented, managed, enforced, monitored and reported on, including ensuring that the municipality has contract management and monitoring capacity.**²⁵

21. Section 116(1) of the MFMA generally requires contracts to be in writing, contain termination provisions for non- or under performance, contains dispute resolution mechanisms, and provides for a periodic review once every three years of any contract that is longer than three years.

22. See Module 5: PPP Procurement.

23. Municipal PPP Regulation 6. Section 33 deals with contracts having future budgetary implications.

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

25. Municipal PPP Regulation 8; section 116(2) of the MFMA.

7. Amendment and variation of PPP agreements

A PPP agreement may be amended by the parties, but only after:

- 7.1 The reasons for the proposed amendment have been tabled in the council of the municipality
- 7.2 The local community:
 - (1) Has been given reasonable notice of the intention to amend the PPP agreement
 - (2) Has been invited to submit representations to the municipality
- 7.3 The amendment is consistent with the basic essentials of PPP agreements set out in regulation 5 and other applicable provisions of the Municipal PPP Regulations.

At least 60 days before a PPP agreement is amended, the accounting officer must solicit the views and recommendations of the National Treasury and the relevant provincial treasury on the reasons for the amendment.²⁶

8. Municipal entities

No municipal entity may initiate, procure or enter into a PPP agreement on its own or on behalf of its parent municipality, but it may be a party to a PPP agreement begun, procured and entered into by its parent municipality.

Are unsolicited bids provided for?

The Municipal PPP Regulations do not mention unsolicited bids. Section 113 of the Act, which applies to PPPs,²⁷ provides that a municipality is not obliged to consider an unsolicited bid received outside its normal bidding process. If, however, a municipality decides to consider an unsolicited bid, it may do so only within a prescribed framework. This framework must strictly regulate and limit the power of municipalities to approve unsolicited bids. Regulation 37 of the Municipal Supply Chain Management Regulations sets out a detailed set of requirements for a municipal unsolicited bid consideration framework. The requirements of Regulation 37 and how they apply to a PPP are discussed in greater detail in Module 5

26. Section 116(3) of the MFMA; Municipal PPP Regulation 9.

27. Section 120(7) of the MFMA.

9. Exemptions

Section 177(1) (b) of the MFMA permits the Minister of Finance, by notice in the *Gazette*, to exempt any municipality from the application of any provision of the act for a period and on conditions determined in the notice.²⁸ It should be noted that applications for exemptions will undergo a rigorous review and will not be routinely granted.

28. Municipal PPP Regulation 11 exempts municipalities that have concluded the procurement of a PPP by 30 June 2005.

NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 2:
CODE OF GOOD PRACTICE FOR BEE IN
PUBLIC-PRIVATE PARTNERSHIP

ABOUT THIS MODULE

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

Following public consultation and incorporation of comments, the Code of Good Practice for Black Economic Empowerment in Public-Private Partnerships is submitted by the Minister of Finance to the Minister of Trade and Industry to be issued in terms of the Broad-Based Black Economic Empowerment Act (2003) in furtherance of General Notice 112 of 2007 by the Minister of Trade and Industry: *Codes of Good Practice on Black Economic Empowerment*.

This Code for BEE in PPPs follows the gazetting of the *Financial Sector Charter* and the *Construction Sector Charter*, and complements their commitments. It also acknowledges the development of other sectoral charters, implementation of which will further support BEE in public-private partnerships.



MUNICIPAL PPP PROJECT CYCLE

Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: III

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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A glossary and list of acronyms are provided at the beginning of Module 1.

PREAMBLE

As part of its drive to redress the stifling economic effects of apartheid, South Africa's democratic government has adopted a policy of black economic empowerment. BEE is a broad-based, inclusive core component of the country's overall growth strategy. PPPs are one of the key options available to national, provincial and local governments to meet their infrastructure and service delivery commitments. These partnerships, which are regulated by Treasury Regulation 16 to the PFMA (for national and provincial PPPs), and by the Municipal PPP Regulations to the MFMA (for municipal PPPs), offer valuable opportunities for strong and sustainable BEE.

South Africa's BEE policy is based on the Broad-Based Black Economic Empowerment (BBBEE) Act (2003). Section 9 of the act provides that the Minister of Trade and Industry may issue codes of good practice on BEE. Section 10 provides that *"every organ of state and public entity must take into account and, as far as it is reasonably possible, apply any relevant code of good practice"* in, among other things, *"determining qualification criteria for the issuing of licences, concessions...; developing and implementing a preferential procurement policy; ... and developing criteria for entering into partnerships with the private sector"*.

The Minister of Trade and Industry published General Notice 112: *Codes of Good Practice on Black Economic Empowerment* on 9 February 2007 ("the Codes"). That same day, the minister also published the *Financial Sector Charter* and the *Construction Sector Charter* in terms of section 12 of the BBBEE Act. This Code for BEE in PPPs recognises that the implementation of such transformation charters in the private sector will contribute materially to achieving effective BEE in PPPs.

Included in the Codes is a generic scorecard. In the absence of an applicable sectoral BEE charter, the generic scorecard applies to the qualification of firms during the request for qualifications (RFQ) portion of a PPP procurement, as described below.¹ And as also noted below, a project-specific BEE scorecard will be developed during the feasibility study assessment, and this will be included in the ensuing request for proposals (RFP) for a municipal PPP should a municipal council issue an "in principle" decision to implement a PPP.²

The National Treasury intends that BEE is integral to all phases of the regulated PPP project cycle, and that BEE is made contractually binding in all PPP agreements. The provisions of the Code for BEE in PPPs are therefore reflected in all modules of these Guidelines.

-
1. Enterprises may also qualify during the RFQ phase of a PPP as exempted micro-enterprises (EMEs) and qualifying small enterprises (QSEs), per clauses 4 and 5, respectively, of the Codes.
 2. Refer to Module 4: PPP Feasibility Study.

PART 1: INTRODUCTION

1.1 Policy on BEE in PPPs

The PPP BEE policy is devised to achieve a broad-based and sustainable BEE outcome in every PPP project undertaken in terms of the Municipal PPP Regulations to the MFMA. The policy is to be applied by municipalities at every phase of the PPP project cycle, including the two distinct procurements in the cycle, the selection of an adviser and the selection of a private party.

Adviser procurement³

In compliance with the Preferential Procurement Policy Framework Act (2000) (PPPFA), the BEE component of an adviser bid will constitute 10 per cent of the bid evaluation weighting,⁴ with the price and technical elements constituting the remaining 90 per cent. BEE in the adviser bid will be evaluated against an adviser scorecard and bidders must usually achieve a minimum threshold of 60 per cent of the total BEE points as described in part 2 below. If an adviser bid fails to pass this BEE threshold, it should not be evaluated further, except in specific circumstances discussed below.

PPP procurement⁵

Each PPP project is structured on a combination of financial, technical and BEE components to achieve optimal value for money in government's delivery of infrastructure and services. In compliance with the PPPFA, the BEE component of a PPP bid will constitute 10 per cent of the bid evaluation weighting. The price and technical components will be weighted within the remaining 90 per cent, as appropriate to the project.

BEE in the RFQ stage of a PPP bid will, in the absence of an applicable sectoral BEE sector charter, be evaluated against the generic scorecard presented in the Codes. Non-EME and non-QSE bidders must achieve a minimum threshold of 60 per cent of the total BEE points (level 5 contributor). If a sectoral BEE charter is applicable, the bidder must score an equivalent contributor level. If a PPP bidder fails to pass this BEE threshold, it should not be evaluated further.

3. Refer to Module 3: PPP Inception

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

5. Refer to Module 5: PPP Procurement.

No PPP RFP may be issued to the market by a municipality without a BEE scorecard for the project containing a clear and appropriate set of BEE elements, targets, minimum thresholds, and weightings, duly approved as part of the feasibility study for Treasury Views and Recommendations I (TVR I) and the bid documents for Treasury Views and Recommendations IIA in terms of the Municipal PPP Regulations to the MFMA. Bids received after this are evaluated by the municipality for, among other things, substantiation of the private party's BEE commitments pending the adoption of BEE accreditation processes.

The quality of the BEE component of the preferred bid forms part of the value-for-money report to be submitted by the municipality for TVR IIB, before negotiations begin. Negotiations that follow must seek to maximise BEE benefits in the final terms of the deal, and to tie up provisions for managing the PPP agreement after signature. These BEE commitments are part of the motivation for the final TVR III, before the parties sign the PPP agreement. The agreement binds the parties to their BEE commitments for the duration of the PPP and specifies the consequences of default.

These phases of the PPP project cycle, as they apply to the BEE components of the feasibility study and the RFP for a PPP are elaborated in part 3 of this module.

Policy objectives for BEE in PPPs are:

- To achieve meaningful and beneficial direct ownership of substantial equity interests in the private party to a PPP agreement by black people, black women and black enterprises
- To achieve effective participation in the management control of the private party and its subcontractors by black people and black women
- To ensure effective employment equity and skills development in the private party and its subcontractors throughout the project
- To ensure that a substantive proportion of the private party's subcontracting and procurement is to black people, black women and black enterprises
- To foster enterprise development of QSEs and EMEs
- To promote positive local socioeconomic effects from the project to the benefit of QSEs and EMEs, the disabled, the youth, and non-governmental organisations within a targeted area of project operations
- For municipalities to be supported in all PPP projects by financial, legal and technical advisers who should reflect South Africa's diverse population, and to build the professional skills and the number of black people and black enterprises in these fields.

These Guidelines in the main address larger, more sophisticated PPPs that usually involve capital investments. In smaller PPPs, adaptations of the procurement process may be required. Consideration of exemptions is discussed below.

To further support and promote BEE in PPPs, dedicated BEE equity and debt facilities have been established by a number of financial institutions.

1.2 Legal basis for PPP BEE policy

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

- **The Constitution of the Republic of South Africa** (1996), enables organs of state to implement “procurement policy for (a) categories of preference in the allocation of contracts and (b) the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination” (section 217(2)).
- The **PPPFA** (2000), and its regulations prescribe a framework for calculating BEE points relative to “functionality” and “price” in government procurement.
- The **BBBEE Act** (2003) aims “to facilitate broad-based black economic empowerment” and provide for the issuing of codes of good practice to be applied by organs of state and public entities, among others, “in developing criteria for entering into partnerships with the private sector.”
- The **Codes of Good Practice on Black Economic Empowerment** issued in terms of the BBBEE Act.
- The **Employment Equity Act** (1998) provides for improving employment equity for the benefit of historically disadvantaged individuals (as defined therein).

1.3 Why PPPs are good for BEE

Key features of PPPs make them an excellent vehicle to achieve BEE objectives:

- The long-term nature of PPPs provides an opportunity to increase black ownership and black management.
- PPPs develop skills.
- PPPs create jobs.
- Risk is clearly identified in PPPs, clearly costed and appropriately allocated, so all participants know in advance what they are committing to.

- The formation of private consortiums in the form of special purpose vehicles (SPVs) for larger municipal PPPs facilitates long-term beneficial partnerships between new black enterprises and experienced, resourced companies – both as equity partners and in project management, and both at the private-party SPV and subcontracting levels.
- Where government is the buyer of a service and the service is provided to the agreed standards, there is a steady revenue stream to the private party, reducing risk to new black enterprises.
- Principal equity sponsors in a PPP are often also first-tier subcontractors, building incentives for optimal risk management.
- PPPs provide significant subcontracting opportunities for black enterprises, where early cash-flow benefits can be derived as delivery commences.
- PPPs have far-reaching broad-based BEE potential – through the subcontracting and procurement mechanisms they can involve a full spectrum of large, medium and small enterprises, and bring tangible local economic development benefits to targeted groups.
- Return on equity to the private party is competitive where risk is properly assumed.
- There is a growing demand for black professionals as advisers to both municipalities and private parties in PPPs.

1.4 Challenges for BEE in PPPs

Nevertheless, there are obstacles to achieving sustainable BEE in PPPs:

- There is a small pool of black equity in South Africa. Historically, black people have not accumulated capital and it is a challenge for black enterprises to raise required levels of equity at reasonable prices.
- Sources of BEE funding are generally expensive, reflecting lenders' assessment of risk associated with new enterprises whose balance sheets may be relatively small, or whose experience may be relatively limited.
- Costs of independent financial and legal advice to black enterprises are an inhibiting factor in the preparation of bids, during contract negotiation, and during start-up, often leaving black partners in a consortium vulnerable to concluding unfavourable arrangements.

- There is limited black experience and skill in PPPs, resulting in inequality with partners that are established companies.
- Established companies in the consortiums often become obliged to provide security for the committed BEE capital and to guarantee performance of the black partners, contributing further to the inequality among consortium members.
- Dividend distributions typically do not occur in the earlier years of a PPP, which is hard for new black enterprises participating as shareholders in the private party.
- There are few experienced black South African PPP advisers.

This Code for BEE in PPPs has been designed to address both the value in PPPs for sustainable BEE and the challenges.

PART 2: HOW TO APPLY BEE POLICY IN A PPP

Appointment of the municipality's adviser⁶

The municipality's adviser is a professional, or team of professionals, with appropriate skills and experience to assist the municipality with the preparation and conclusion of a PPP agreement.

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

- To be represented in its PPP transactions by teams of skilled and experienced professional financial, legal and technical advisers who reflect South Africa's diverse population
- To be confident that its adviser thoroughly knows, supports and will seek to optimise the Code of Good Practice for BEE in PPPs in the PPP project
- To increase the number of black people and black enterprises participating as professional advisers in PPP transactions.

The adviser is hired by the municipality through an open and competitive bidding process, after the registration of the PPP project. The selection is made on a combination of technical, BEE and price considerations. A two-envelope system is used, and threshold scores are set for both the technical and BEE elements. Only the bids that meet or better the technical *and* BEE thresholds are considered according to their price. The adviser contracts with the municipality through a lead adviser company, and all other members of the team participate either through sub-contracts with the lead company or via a joint venture arrangement.

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

6. Refer to Module 3.

Provided that it meets the minimum threshold, the BEE score will be calculated into the bidder's overall score using the following formula:

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

where:

a is the weighting for technical (either 50% or 70%)⁷

b is the weighting for BEE (10%)

c is the weighting for price (either 20% or 40%)⁸

d is the total score achieved by the bidder.

Due to the unique nature of the adviser function and the manner in which the adviser teams are formed to reflect the individual needs of each project, an adviser scorecard has been adopted, as follows:

Adviser scorecard				
Element	Maximum score	Scoring criteria	Weighting	Points total
Percentage of black equity in the adviser team	5	25%-35% = 3 >35% = 5	6	30
Percentage of black people playing leading professional roles in the adviser team	5	25%-35% = 3 >35% = 5	6	30
Skills transfer plan	5	Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	4	20
Credible plan for structuring effective BEE for the PPP, with the necessary skill and experience in the team	5	Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skills & experience = 2 or 3 Credible plan & skill & experience = 4 or 5	4	20
Total points				100
Minimum threshold				60

- The alternative technical and price weightings (together making up 90 per cent) vary depending on whether the fees budget is declared or not declared by the municipality. For further detailed guidance, refer to Module 3.
- The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA. For further detailed guidance, refer to Module 3.

The BBBEE status calculation matrix provides for different recognition levels depending on the BBBEE status determined by application of the adviser scorecard. The matrix is as follows:

BBB status calculation matrix		
BBBEE status	Qualification, per the adjusted generic scorecard	BBBEE recognition level
Level 1 contributor	≥ 100 points	135%
Level 2 contributor	>85 but <100	123%
Level 3 contributor	≥ 75 but <85	110%
Level 4 contributor	≥ 65 but <75	100%
Level 5 contributor	≥ 60 but <65	80%
Non-compliant contributor	<60 on the generic scorecard	0%

Where the adviser is not a subcontracted team/joint venture, is one firm, and is of a small size, then the “percentage of black equity in the adviser team” criterion can be reallocated to other criteria and/or the minimum threshold of 60 per cent can be waived or lowered. The criteria for determining whether a firm is categorised as small will depend on the relevant BEE sector charter.

BEE elements in conducting the Request for Qualifications⁹

The RFQ stage is usually the first point at which there is formal project interaction with the market. It is imperative that all BEE elements and targets that the municipality intends for the project are communicated clearly with potential bidders at this early stage so that appropriate bidder consortiums can be formed and the necessary financing sourced. The BEE criteria to be applied to all bidder consortiums in the RFQ stage shall, in the absence of a sector BEE charter, be the generic scorecard (for all non-EME and non-QSE entities) as set forth in the *Codes of Good Practice on Black Economic Empowerment*, and as described in this section.

It is recommended that the proposed BEE scorecard for the project, developed during the feasibility study (discussed in part 3 below) be provided in the RFQ, allowing the bidding consortiums to comment on the proposed BEE targets in

9. For further detailed guidance, refer to Module 5.

their RFQ submissions. In most projects, the BEE targets between the RFQ and RFP phases will grow and such an intention must be clearly communicated to bidders in the RFQ.

The RFQ stage requires that bidders submit a range of information about their consortiums, enabling the municipality to select those suitably qualified to prepare bids. A key element of this qualification will be whether a private consortium has the requisite BEE characteristics and commitment. To pre-qualify in the BEE component of the RFQ stage, bidders must demonstrate the achievement of a level 5 contributor. In those instances where a sector charter is applicable, a commensurate contributor level must be achieved.

Once bidders have been pre-qualified, they will need agreement from the municipality to change their consortium's membership, and the qualifying BEE targets may not be compromised in any such change. Fronting of black people and black enterprises to win contracts will lead to disqualification.

It is important to note that the RFQ is part of the PPP procurement processes, and requires consultation with National Treasury before it is issued.

The generic scorecard

The generic scorecard is to be applied during the RFQ stage of the procurement of a PPP. The code series references set forth in the table below specify the mechanisms for measurement and calculation of each of the elements of the scorecard. While the mechanisms for measurement and calculation of each of the elements are briefly discussed in this module, the *Codes of Good Practice on Black Economic Empowerment* should be referenced for a detailed understanding of the requirements.¹⁰

Element	Weighting	Code series reference
Ownership	20 points	100
Management control	10 points	200
Employment equity	15 points	300
Skills development	15 points	400
Preferential procurement	20 points	500
Enterprise development	15 points	600
Socioeconomic development	5 points	700

10. General Notice 112 Broad-Based Black Economic Empowerment Act (2003): *Codes of Good Practice on Black Economic Empowerment*.

Based on the overall performance of a bidder using the generic scorecard, it receives one of the following BBBEE statuses:

BBBEE status	Qualification	BBBEE recognition level
Level 1 contributor	≥100 points on the generic scorecard	135%
Level 2 contributor	>85 but <100 on the generic scorecard	123%
Level 3 contributor	≥75 but <85 on the generic scorecard	110%
Level 4 contributor	≥65 but <75 on the generic scorecard	100%
Level 5 contributor	≥55 but <65 on the generic scorecard	80%
Level 6 contributor	≥45 but <55 on the generic scorecard	60%
Level 7 contributor	≥40 but <45 on the generic scorecard	50%
Level 8 contributor	≥30 but <40 on the generic scorecard	10%
Non-compliant contributor	<30 on the generic scorecard	0%

BEE element measurement mechanisms

2.1 Ownership (Code series 100)

The generic scorecard sets out ownership indicators and the method for calculating an ownership score.

The ownership scorecard ¹¹			
Category	Ownership indicator	Weighting points	Compliance target
2.1	Voting rights		
	2.1.1 Exercisable voting rights in the enterprise in the hands of black people	3	25% + 1 vote
	2.1.2 Exercisable voting rights in the enterprise in the hands of black women	2	10%
2.2	Economic interest		
	2.2.1 Economic interest of black people in the enterprise	4	25%
	2.2.2 Economic interest of black women in the enterprise	2	10%
	2.2.3 Economic interest of the following black individuals in the enterprise:	1	2.5%
	2.2.3.1 Black designated groups		
	2.2.3.2 Black participants in employee ownership schemes		
	2.2.3.3 Black beneficiaries of broad-based ownership schemes		
	2.2.3.4 Black participants in cooperatives		
2.3	Realisation points:		
	2.3.1 Ownership fulfilment	1	Refer to appendix
	2.3.2 Net value	7	Refer to appendix
2.4	Bonus points		
	2.4.1 Involvement in ownership of the enterprise of new black entrants	2	10%
	2.4.2 Involvement in ownership of the enterprise of black participants:	1	10%
	2.4.2.1 In employee ownership schemes		
	2.4.2.2 Of broad-based ownership schemes		
	2.4.2.3 Cooperatives		

11. The Code Series 100: Measurement of the ownership element of Broad-Based Black Economic Empowerment must be referenced for scoring details in terms of this scorecard.

Net value

The “net value” points in row 2.3.2 is the lower result of Formula A and Formula B, below.

Formula A

$$A = B \times (1/25\% \times C) \times 7$$

Where:

- A is the score in row 2.3.2
- B is the deemed net value for all black participants in the measured entity, the calculation of which is per Clause 3 of Annex 100 (C)
- C is the time-based graduation factor of the Economic Interest compliance target outlined below:
 - 10% for the first year after the current equity interest date
 - 20% for the second year after the current equity interest date
 - 40% from the first day of the third year after the current equity interest date to the last day of the fourth year after the current equity interest date
 - 60% from the first day of the fifth year after the current equity interest date to the last day of the sixth year after the current equity interest date
 - 80% from the first day of the seventh year after the current equity interest date to the last day of the eighth year after the current equity interest date
 - 100% from the first day of the ninth year after the current equity interest date to the last day of the 10th year after the current equity interest date.

Formula B

$$A = B/C \times 7$$

Where:

- A is the score under row 2.3.2
- B is the percentage of economic interest in the measured entity of black participants
- C is the target for the ownership indicator in row 2.2.1

If an enterprise gains a score that is more than the weighting points in row 2.3.2, that enterprise will only receive the weighting points.

2.2 Management control (code series 200)

The mechanism for measuring the management control element is a scorecard setting out the relevant indicators and calculation method.

The management control scorecard			
Category	Management control indicator	Weighting points	Compliance target
Board participation			
	Exercisable voting rights of black board members using the adjusted recognition for gender	3	50%
	Black executive directors using the adjusted recognition for gender	2	50%
Top management			
	Black senior top management using the adjusted recognition for gender	3	40%
	Black other top management using the adjusted recognition for gender	2	40%
Bonus points			
	Black independent non-executive board members	1	40%

2.2.1 Calculating the adjusted recognition for gender

The adjusted recognition for gender is calculated using the following formula:

$$A = B/2 + C$$

Where

- A is the adjusted recognition for gender
- B is the percentage of employees in the measurement category that are black people
- C is the percentage of employees in the measurement category that are black women

C is limited to a maximum of 50 per cent of the target.

2.2.2 Calculating compliance

The formula for calculating compliance for board participation and top management is as follows:

$$A = B/C \times D$$

Where

- A is the score for the measured management indicator
- B is the adjusted recognition for gender calculated in terms of 2.2.1, above
- C is the compliance target for that measurement category (up to a maximum of 50 per cent of the target)
- D is the weighting for the measurement indicator

The formula for calculating bonus points is as follows:

$$A = B/C \times D$$

Where

- A is the score in terms of the number of black independent non-executive board members as a percentage of the total number of independent non-executive board members
- C is the target for independent non-executive board members
- D is the weighting points

2.3 Employment equity (code series 300)

The mechanism for measuring the employment equity element sets out the relevant indicators and score calculation method.

Employment equity scorecard			
Management category & criteria	Weighting points	Compliance	Targets
		Years 0 - 5	Years 6 -10
Black disabled employees as a percentage of all employees using the adjusted recognition for gender	2	2%	3%
Black employees in senior management as a percentage of all such employees using the adjusted recognition for gender	5	43%	60%
Black employees in middle management as a percentage of all such employees using the adjusted recognition for gender	4	63%	75%
Black employees in junior management as a percentage of all such employees using the adjusted recognition for gender	4	68%	80%
Bonus point for meeting or exceeding the EAP targets in each category above	3		

A minimum of 40 per cent compliance with each of the above-listed targets is a requirement to receive any points for the employment equity scorecard in respect of both five-year periods.

2.3.1 Calculating the adjusted recognition for gender

The adjusted recognition for gender is calculated using the following formula:

$$A = B/2 + C$$

Where

- A is the adjusted recognition for gender
- B is the percentage of employees in the measurement category that are black people
- C is the percentage of employees in the measurement category that are black women

C is limited to a maximum of 50 per cent of the target.

2.3.2 Calculating compliance

The formula for calculating compliance for employment equity is as follows:

$$A = B/C \times D$$

Where

- A is the score for the measured management indicator
- B is the adjusted recognition for gender calculated in terms of 2.3.1, above
- C is the compliance target for that measurement category (up to a maximum of 50 per cent of the target)
- D is the weighting for the measurement indicator

2.4 Skills development (code series 400)

The mechanism for measuring skills development is a scorecard setting out the relevant indicators and score calculation method.

The skills development scorecard			
Category	Skills development element	Weighting points	Compliance target
Skills	Development expenditure in any programme in the learning programme matrix		
	Skills development expenditure on learning programmes in learning programmes matrix for black employees as a percentage of leviable amount using the adjusted recognition for gender	6	3%
	Skills development expenditure on learning programmes in learning programmes matrix for black employees with disabilities as a percentage of leviable amount using the adjusted recognition for gender	3	0.3%
Learnerships			
	Number of black employees participating in learnerships or category B, C and D programmes as a percentage of total employees using the adjusted recognition for gender	6	5%

2.4.1 Key measurement principles¹²

Measured entities receive points on the skills development scorecard only if:

- They are in compliance with the Skills Development Act (1998) and the Skills Development Levies Act (1999)
- They have registered with the applicable Sector Education and Training Authority
- They have developed a workplace skills plan and implemented programmes to develop priority skills generally and specifically for black employees

12. Not all measurement principles set forth in code series 400 are listed.

- Any skills development expenditure on adult basic education and training (ABET) is recognised at a multiple of 1.3 per cent of the actual expenditure
- Expenditure on uncertified learning programmes or category G learning programmes under the learning programmes matrix cannot represent more than 15 per cent of total skills development expenditure.

2.4.2 The learning programmes matrix

Cat	Narrative description	Delivery mode	Learning site	Learning achievement
A	Institution-based theoretical instruction alone – formally assessed by the institution	Institutional instruction	Institutions such as universities, colleges, schools, ABET providers	Recognised theoretical knowledge resulting in the achievement of a degree, diploma or certificate issued by an accredited or registered institution of learning
B	Institution-based theoretical instruction as well as some practical learning with an employer or in a simulated work environment – formally assessed through the institution	Mixed mode delivery with institutional instruction as well as supervised learning in an appropriate workplace or simulated work environment	Institution such as universities and colleges, schools, ABET providers and workplace	Theoretical knowledge and workplace experience with set requirements resulting in achievement of a degree, diploma or certificate issued by an accredited or registered formal institution of learning
C	Recognised or registered structured experiential learning in the workplace required after achievement of a qualification – formally assessed by a statutory occupational or professional body	Structured learning in the workplace with mentoring or coaching	Workplace	Occupational or professional knowledge and experience formally recognised through registration or licensing

D	Occupationally directed instructional and work-based learning programme that requires a formal contract - formally assessed by an accredited body	Institutional instruction together with structured, supervised experiential learning in the workplace	Institution and workplace	Theoretical knowledge and workplace learning, resulting in achievement of a SAQA-registered qualification, a certificate or other similar occupational or professional qualification issued by an accredited or registered formal institution of learning
E	Occupationally directed instructional and work-based learning programme that does not require a formal contract-formally assessed by an accredited body	Structured, supervised experiential learning in the workplace; may include institutional instruction	Workplace and some institutional as well as ABET providers	Credit awarded for registered unit standards
F	Occupationally directed informal instructional programmes	Structured information sharing or direct instruction involving workshops, seminars & conferences & short courses	Institutions, conferences and meetings	Continuing professional development, attendance certificates and credits against registered unit standards (in some instances)
G	Work-based informal programmes	Informal training	Workplace	Increased understanding of job or work context or improved performance or skills

2.4.3 Calculating the adjusted recognition for gender

The adjusted recognition for gender is calculated using the following formula:

$$A = B/2 + C$$

Where

- A is the adjusted recognition for gender
- B is the percentage of employees in the measurement category that are black people
- C is the percentage of employees in the measurement category that are black women

2.4.4 Measurement of skills development indicators

The formula for calculating compliance for the skills development scorecard is as follows:

$$A = B/C \times D$$

Where

- A is the score for any given criteria referred to in the scorecard
- B is the adjusted recognition for gender calculated in terms of 2.4.3, above
- C is the target for the applicable criteria referred to in the scorecard
- D is the weighting for the applicable criteria

2.5 Preferential procurement (code series 500)

The mechanism for measuring the preferential procurement element sets out the relevant indicators and method for calculating the score.

The preferential procurement scorecard			
Criteria	Weighting points	Compliance targets	
		Years 0 – 5	Years 6-10
BBBEE procurement spend from all suppliers based on the BBBEE procurement recognition levels as a percentage of total measured procurement spend	12	50%	70%
BBBEE procurement spend from QSEs or EMEs based on the applicable BBBEE procurement recognition levels as a percentage of total measured procurements spend	3	10%	15%
BBBEE procurement spend from any of the following suppliers as a percentage of total measured procurement spend: <ul style="list-style-type: none">Suppliers that are 50% black owned (3 out of 5 points)Suppliers that are 30% black owned (2 out of 5 points)	5	15%	20%

2.5.1 Key measurement principles¹³

- All goods and services procured by the measured entity not specifically excluded under code series 500 are measurable in calculating its total measured procurement spend
- If a measured entity procures goods and services from a supplier that is:
 - A recipient of enterprise development contributions from the measured entity under code series 600, the recognisable BBEE procurement spend that can be attributed to that supplier is multiplied by a factor of 1.2
 - A value-adding supplier, the recognisable BBEE procurement spend that can be attributed to that supplier is multiplied by a factor of 1.25.

2.5.2 Total measured procurement spend

In terms of private sector procurement, the following is measurable within total measurable procurement spend:

- Cost of sales
- Operational expenditures
- Capital expenditure
- Pension and medical aid contributions
- Trade commissions
- Expenditure incurred in facilitating empowerment related contribution
- Certain imports
- Non-exempted intra-group procurement.

2.5.3 Exclusions from total measured procurement spend

The following are the only exclusions from the total measured procurement spend:

- Taxation
- Salaries, wages remunerations
- Empowerment-related procurement
- Specified imported goods.

13. Not all measurement principles set forth in code series 500 are listed.

2.5.4 Measurement of BBBEE procurement spend

BBBEE procurement spend is measured in terms of the following formula:

$$A = \text{sum of } (B \times C)$$

Where

- A is the calculated total BBBEE procurement spend for the measured entity
- B is the value of procurement falling within total measured procurement spend from each supplier of the measured entity
- C is the BBBEE procurement level of each supplier of the measured entity.

2.5.5 Calculation of preferential procurement contributions to BBBEE

BBBEE preferential procurement contributions are calculated in terms of the following formula:

$$A = B/C \times D$$

Where

- A is the calculated preferential procurement score for each set of criteria in the scorecard
- B is the total BBBEE procurement spend calculated as a percentage of the total measured procurement spend
- C is the compliance target for each set of criteria specified in the scorecard
- D is the weighting points allocated to each set of criteria specified in the scorecard

2.6 Enterprise development (code series 600)

The mechanism for measuring the enterprise development element sets out the relevant indicators and score calculation method.

The enterprise development scorecard		
Criteria	Weighting points	Compliance target
Average annual value of all enterprise development contributions and sector-specific programmes made by the measured entity as a percentage of the target	15	3% of net profit after taxes

2.61 Key measurement principles¹⁴

General principles include:

- Measured entities receive recognition for any qualifying enterprise development contributions that are quantifiable as a monetary value using a standard valuation method.¹⁵
- Qualifying enterprise development contributions are recognisable cumulatively, from 9 February 2007, or an earlier date chosen by the measured entity, so long as the earlier date is less than five years before 9 February 2007.
- Enterprise development contributions are monetary or non-monetary, recoverable or non-recoverable contributions in favour of beneficiary entities by a measured entity with the specific objective of assisting the development of that beneficiary.
- The full value of category A enterprise development contributions adjusted using the benefit factor multiplied by 1.25 is recognisable:
 - A category A enterprise development contribution involves a contribution to an EME or QSE that is 50 per cent black-owned or black women-owned.
- The full value of category B enterprise development contributions is recognisable:
 - A category B enterprise development contribution involves a contribution to an EME or QSE that is 25 per cent black-owned or black women-owned, with a BEE status of between level 1 and level 6.
- A partial list of enterprise development contributions includes:
 - Grant contributions to beneficiary entities
 - Investments in beneficiary entities
 - Loans made to beneficiary entities
 - Guarantees given or security provided on behalf of beneficiaries
 - Credit facilities made available to beneficiary entities
 - Direct and overhead costs of a measurable entity attributable to enterprise development contributions
 - Provision of training or mentoring to beneficiary entities that helps to increase their operational or financial capacity.

14. Not all measurement principles set forth in Code Series 600 are listed.

15. "Qualifying Enterprise Development Contributions" is a collective term describing contributions targeting EMEs and QSEs.

2.6.2 The benefit factor matrix

Qualifying contribution type	Contribution amount	Benefit factor
Grant and related contributions		
Grant contribution	Full grant amount	100%
Direct cost incurred in supporting enterprise development	Verifiable cost including both monetary and non-monetary	100%
Discounts in addition to normal business practices supporting enterprise development	Discount amount, in addition to normal business discount	100%
Overhead costs incurred in supporting enterprise development, including people appointed in enterprise development	Verifiable costs, including both monetary and non-monetary	80%
Loans and related contributions		
Interest-free loan with no security requirements supporting enterprise development	Outstanding loan amount	100%
Standard loan to black-owned EMEs and QSEs	Outstanding loan amount	70%
Standard loan provided to other beneficiary enterprises	Outstanding loan amount	60%
Guarantees provided on behalf of a beneficiary entity	Guarantee amount	3%
Lower interest rate	Outstanding loan amount	Prime rate – actual rate
Equity investments and related contributions		
Minority investments in black-owned EMEs and QSEs	Investment amount	100%
Minority investment in other beneficiary enterprises	Investment amount	80%
Enterprise development investment with lower dividend to financier	Investment amount	Dividend rate of ordinary shareholders – actual dividend rate of contributor
Contributions made in the form of human resource capacity		
Professional services rendered at no cost and supporting enterprise development	Commercial hourly rate of professional	80%
Professional services rendered at a discount and supporting enterprise development	Value of discount based on commercial hourly rate of professional	80%
Time of employees of measured entity productively deployed in assisting beneficiaries	Monthly salary divided by 160	80%
Other contributions		
Shorter payment periods	Percentage of invoiced amount	Percentage being 15 days less the number of days from invoice to payment

2.6.3 Calculation of qualifying contributions

Qualifying contributions are calculated using the following formula:

$$A = B/C \times D$$

Where

- A is the score achieved in respect of the qualifying contributions made by the measured entity
- B is the value of all qualifying contributions made by the measured entity from 9 February 2007 or the inception date to the date of measurement
- C is the compliance target in respect of the qualifying contributions as specified in the scorecard
- D is the weighting points allocated to the criteria in the scorecard.

2.7 Socioeconomic development (code series 700)

The mechanism for measuring the socioeconomic development element sets out the relevant indicators and the scoring method.

The socioeconomic development scorecard		
Criteria	Weighting points	Compliance target
Average annual value of all socioeconomic development contributions by the measured entity as a percentage of the target	5	1% of net profit after taxes

2.7.1 Key measurement principles¹⁶

General principles include:

- Measured entities receive recognition for any socioeconomic development contributions that are quantifiable using a standard valuation method.
- Qualifying socioeconomic development contributions are recognisable cumulatively, from 9 February 2007, or an earlier date chosen by the measured entity, so long as the earlier date is less than five years before 9 February 2007.
- Monetary or non-monetary contributions actually initiated and implemented in favour of beneficiaries by a measured entity with the specific objective of facilitating sustainable access to the economy of those beneficiaries.

¹⁶. Not all measurement principles set forth in code series 700 are listed.

- The full value of socioeconomic development contributions made to beneficiaries is recognisable if at least 75 per cent of the value directly benefits black people.
- If less than 75 per cent of the full value of socioeconomic development contributions directly benefits black people, the value of the contribution made multiplied by the percentage that benefits black people, is recognisable.
- A partial list of socioeconomic development contributions includes:
 - Grant contributions to beneficiaries
 - Guarantees given or security provided for beneficiaries
 - Direct and overhead costs of a measured entity directly attributable to socioeconomic development contributions
 - Development capital advanced to beneficiary communities
 - Training or mentoring to beneficiary communities by a measured entity
 - Maintaining a socioeconomic development unit by the measured entity
 - Payments made by the measured entity to third parties to perform socioeconomic development on the measured entity's behalf.

2.7.2 The benefit factor matrix

Qualifying contribution type	Contribution amount	Benefit factor
Grant and related contributions		
Grant contribution	Full grant amount	100%
Direct cost incurred in supporting socioeconomic development sector-specific initiatives or approved contributions	Verifiable cost including both monetary and non-monetary	100%
Discounts in addition to normal business practices supporting sector-specific initiatives or approved contributions	Discount amount, in addition to normal business discount	100%
Overhead costs incurred in supporting socioeconomic development, sector-specific initiatives or approved contributions	Verifiable costs, including both monetary and non-monetary	80%
Contributions made in the form of human resource capacity		
Professional services rendered at no cost supporting socioeconomic, sector-specific initiatives or approved contributions	Commercial hourly rate of professional	80%
Professional services rendered at a discount supporting socioeconomic development, sector-specific initiatives or approved contributions	Value of discount based on commercial hourly rate of professional	80%
Time of employees of measured entity productively deployed in assisting beneficiaries and supporting socioeconomic development, sector-specific initiatives or approved contributions	Monthly salary divided by 160	80%

2.7.3 Calculation of socioeconomic development contributions

Socioeconomic development contributions are calculated using the following formula:

$$A = B/C \times D$$

Where

- A is the score achieved in respect of the socioeconomic development contributions made by the measured entity
- B is the value of all socioeconomic development contributions made by the measured entity from 9 February 2007 or the inception date to the date of measurement
- C is the compliance target in respect of the socioeconomic development contributions as specified in the scorecard
- D is the weighting points allocated to the criteria in the scorecard.

PART 3: HOW TO APPLY BEE POLICY IN THE FEASIBILITY STUDY AND IN AN RFP

3.1 PPP feasibility study¹⁷

Each of the PPP BEE elements set out in the codes must be taken into consideration by the municipality in the preparation of the feasibility study to establish the BEE contributor levels that can realistically be achieved in the project, and specifically to determine their impact on project affordability, value for money and risk.

In cases where a special purpose vehicle is envisaged, the SPV will be made up of the members of a bidding consortium that must meet the specified BEE criteria during the RFQ stage. In such a case, the BEE targets to be set for the PPP BEE scorecard shall be the standards required of the SPV's first-tier subcontractors (for example, in an accommodation PPP, a construction firm and a facility management firm). In a PPP where an SPV is not envisaged, the generic scorecard, the applicable sector BEE charter and/or the EME/QSE eligibility requirements will be applicable to the private party.

Key stages of the feasibility study for BEE are presented in Module 4. Importantly, the overall BEE analysis in the feasibility study must be sufficiently robust to enable the municipality to determine sound benchmarks for the BEE impact it can expect to achieve.

In providing the BEE inputs for the feasibility study, the municipality should investigate and cost each of the generic scorecard or applicable sectoral BEE charter elements.

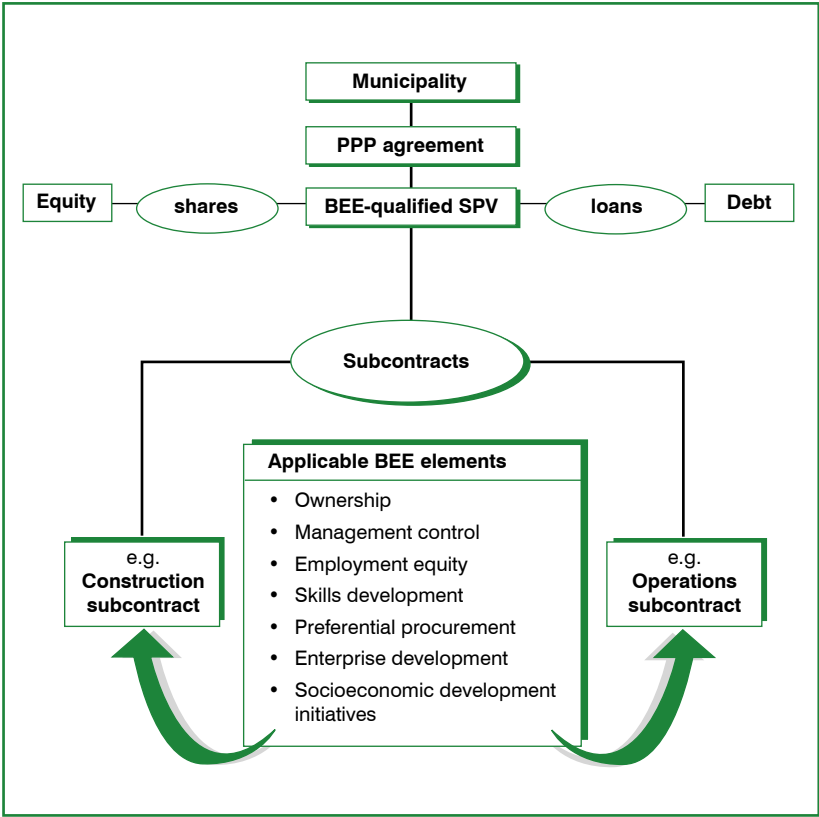
The feasibility study phase is crucial to ensuring a sound BEE outcome in a PPP. The extent to which the municipality is able to produce a thorough and comprehensive feasibility study will directly affect its ability to produce sound bid documentation for a PPP, in which appropriate BEE contributor levels are set for the maturity of the market in which the project takes place. For example, the BEE threshold in a PPP involving construction would be higher than a PPP involving scarce expertise. Getting these contributor levels right or wrong may significantly affect the project's affordability and influence the private party's willingness to assume risk – and will certainly directly affect the sustainability of BEE in the deal.

17. Refer to Module 4.

Government is willing to pay a certain premium for its BEE targets to be met. This is a necessary cost of economic transformation. However, a BEE premium is not prescribed for all PPPs, and all municipalities are working to provide affordable service delivery mechanisms. The BEE contributor levels established in the feasibility study must be justified in value-for-money terms, and risk must be properly allocated in the achievement of all outcomes.

3.2 Request for proposals for the PPP

Many larger PPP project-finance type PPPs are structured in the manner depicted below. The illustration shows where BEE policy should be effected in such PPP agreements through the specification of a contributor level for the private party. In a PPP where an SPV is not involved, the generic scorecard or the applicable sector BEE charter will be applicable to determine the private party's contributor level.



Contributor levels for a project should always be determined during the feasibility study phase. Where appropriate, these may be structured to attain stronger BEE outcomes over the project term.

In both the RFP and the required draft PPP agreement, which must accompany the RFP, BEE outcomes must be clearly presented based on the recommendations in the feasibility study. The draft PPP agreement must reflect these outcomes, with penalties prescribed for contractual non-compliance. The desired outcomes are typically presented as a required contributor level under the generic scorecard, a commensurate level under any applicable sectoral BEE charter or a particular EME/QSE level.

The BEE level of each bidder will be evaluated in accordance with the contributor level demonstrated, and added to the technical and price scores in accordance with the following formula:

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

where:

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

b is the weighting for BEE elements (10%)

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

d is the total score achieved by the bidder.

The RFP is part of the procurement phase of a PPP, and, as previously noted, it is issued to pre-qualified bidders subject to the receipt of TVR IIA.

PART 4: APPLYING BEE POLICY DURING NEGOTIATIONS, AGREEMENT AND CONTRACT MANAGEMENT PHASES

4.1 Negotiations stage

The municipality's intention to commit the bidders contractually to the BEE outcomes submitted by them in response to the RFP should be made clear throughout the procurement process. The municipality should specifically guard against the private party taking the opportunity to reduce its BEE obligations as set out in its bid.

4.2 The PPP agreement

The negotiated PPP agreement must make provision for the BEE outcomes by, among other things:

- Itemising all BEE elements to be made contractually binding
- Providing schedules that commit the private party to its BEE outcomes for each element
- Establishing performance-monitoring arrangements
- Specifying private-party reporting requirements
- Setting up the dispute resolution system
- Establishing the penalty regime and providing for empowerment penalties
- Setting up termination arrangements.

As part of its annual reporting, the private party is obliged to report on its BEE performance, including specific achievements in relation to agreed-upon targets. Regular and spot-check reviews by the municipality are provided for. In addition, the PPP agreement may provide for reviews by independent monitors.

Any proposed deviation from the foregoing provisions requires specific justification by the municipality as part of its TVR application. The municipality must obtain TVR III for the final terms of the PPP agreement for a project before signature.

4.3 Managing the PPP agreement¹⁸

Managing the PPP agreement involves three main functions:

- Partnership management
- Service delivery management
- Contract administration.

In each of these, the municipality and the private party need to establish systems for managing the BEE obligations throughout the development and delivery phases.

The private party is responsible for reporting on all its contractual commitments, including BEE. As part of its service delivery management and contract administration, the municipality must establish the ability to verify the reporting, manage remedy periods, effect contractual penalties in cases of poor performance, and manage termination if required. In large projects, it may be necessary for the parties to establish a joint independent monitor specifically for BEE.

The quality of the partnership management, and the parties' abilities to identify impediments to BEE and to resolve disputes effectively, are key to the PPP's success, not least in respect of BEE. As a general rule, penalties are a last resort.

18. Refer to Module 6: Managing the PPP Contract.

NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 3: PROJECT INCEPTION

ABOUT THIS MODULE

Module 3: Project Inception provides the rationale for the *Municipal Service Delivery and PPP Guidelines*, covers the four stages of the inception phase during which municipal service delivery alternatives are assessed and introduces the National Treasury's Project Development Facility (PDF).

SUMMARY OF APPLICABLE LEGISLATION

The applicable legislation depends on whether the activity in question is a “municipal service” as defined in section 1 of the Municipal Systems Act (MSA); a “municipal activity reasonably necessary for, or incidental to the effective performance of its functions and the exercise of its powers” in terms of MSA section 8(2) “municipal support activity”; or private-sector use of municipal property for commercial purposes. If it is a municipal service, then the MSA and MFMA apply; if it is a municipal support activity or private sector use of municipal property for commercial purposes, then only the Municipal Finance Management Act (MFMA) applies.¹ These considerations, and the applicable legislation, are discussed in detail below.

Municipal Systems Act

Section 76 of the MSA states that a municipality may provide a municipal service through either an internal or external mechanism. An external mechanism includes a municipal entity, another municipality, an organ of state, a community-based organisation or other non-governmental organisation (NGO), or “any other institution, entity or person legally competent to operate a business activity”, which includes a PPP.

Section 77 of the MSA describes the points at which a municipality *must* review and decide on a mechanism to provide a municipal service. These occasions include when an existing municipal service is to be significantly upgraded, extended or improved; when the municipality is restructured or reorganised in terms of the Municipal Structures Act (1998); when review is required by a provincial or national intervention; when a new activity is to be undertaken; when requested by the local community; when a review of the integrated development plan requires a review of the delivery mechanism; or when a performance evaluation requires a review of the mechanism.

1. In those instances where a municipal service is to be provided via a public-private partnership (PPP), both acts apply.

Section 78 of the MSA provides that when a municipality undertakes an MSA section 77 review of its delivery mechanisms, it must first assess the provision of that activity through an internal mechanism, after which it may decide to explore the delivery of that activity by an external mechanism. If the municipality decides to explore service provision by an external mechanism, it must also conduct a feasibility study in terms of subsection (3).

Municipal Finance Management Act

The MFMA aims to modernise budgetary and financial management practices in local government, maximising the ability of municipalities to deliver services to all their residents, customers, users and investors. It also aims to put in place a sound financial governance framework by clarifying and separating the roles and responsibilities of the mayor, executive and non-executive councillors and officials. The act holds the mayor or executive committee responsible for policy and outcomes, and holds the municipal manager and other senior managers responsible for implementation and outputs.

The government is focusing on outputs and outcomes to ensure that, in spending taxpayers' money, it produces the intended result. In terms of the MFMA Chapter 8, Part 1, the municipal manager is the accounting officer, and is directly accountable for the efficient management of the municipal budget to achieve the municipality's mandate. The accounting officer needs to continually evaluate value-for-money choices. Such options may include a PPP for the delivery of a public service, or to achieve a public good.

By its nature, a municipal PPP entails:

- Targeted public spending, principally on outputs to agreed standards
- Leveraging private-sector finance and efficiencies
- Allocating risks to the party best able to manage them.

As a mechanism of service delivery, a municipal PPP is firmly in line with the intent of the MFMA and the MSA.

NOTE: Feasibility study

As used in these Guidelines, the term “feasibility study” includes both the “internal” and “external” mechanism assessments described in MSA section 78 (1) and (3) and the feasibility study described in MFMA section 120 and the Municipal PPP Regulations. A feasibility study conducted in terms of these Guidelines will thus comply with the feasibility study requirements of both the MSA and the MFMA.

The need for a combined guideline

The implementation of a decision to employ an external service delivery mechanism, including a PPP, requires a municipality to complete a feasibility study according to provisions of the MFMA and, in cases involving municipal services, the MSA. These two acts were passed four years apart and contain many similar provisions. These Guidelines combine in one document the requirements of the two acts, harmonising them and providing sufficient detail to many of their general provisions. Where the acts do not address a specific issue, guidance is provided.

One key element of these Guidelines is a clear description of municipal services and guidance on which activities are subject to the MSA and MFMA – and which are subject to the MFMA alone.

Categorisation of municipal services and municipal support activities

A “municipal service” means a service that a municipality provides or may provide to or for the benefit of a community irrespective of whether (a) such service is provided by the municipality through an internal or external mechanism, or (b) fees, charges or tariffs are levied for the service.²

Under this definition, the following functional areas listed in Schedules 4B and 5B of the South African Constitution require a feasibility study in accordance with section 78 (3) of the MSA if they are to be provided by an external mechanism in terms of these Guidelines. Assessment of these services in terms of a PPP will also entail a feasibility study in terms of section 120 (4) of the MFMA.

- Ambulance services★
- Beaches and amusement facilities
- Cemeteries
- Child care facilities
- Cleansing
- Electricity and gas reticulation
- Housing★

2. Summary of section 1 of the MSA “Definitions”, “municipal service”.

- Local sports facilities
- Local tourism
- Markets
- Municipal abattoirs
- Municipal airports
- Municipal health services
- Municipal parks and recreation
- Municipal public transport
- Municipal public works
- Municipal roads
- Nature conservation*
- Pollution control*
- Pontoons, ferries, jetties, piers and harbours
- Public transport*
- Refuse removal, refuse dumps and solid waste disposal
- Storm water management systems in built-up areas
- Street lighting
- Traffic and parking
- Water and sanitation services.

*provided these services have been assigned to the municipality in terms of section 156 (4) of the South African Constitution.

All municipal support activities “reasonably necessary for, or incidental to, the effective performance of its functions and the exercise of its powers” that do not constitute a “municipal service” and which may involve the undertaking of those activities by a private party will require only an MFMA section 120 (4) feasibility study prior to a council decision to have them so provided. Examples include:

- Municipal composting activities
- Municipal fleet services
- Municipal ITC services

- Municipal office accommodation
- Industrial water supply and industrial wastewater treatment
- Meter reading, billing, and revenue management.

The above list is not exhaustive. The key characteristic is that these activities support the ability of the municipality to function. Projects may involve activities in functional areas that constitute a municipal service together with municipal activities that do not. In such instances, the National Treasury will apply its discretion to determine the overall categorisation of the projects.

As noted above, there is a third area addressed by these Guidelines: private sector use of municipal property. This is necessitated by the Municipal PPP Regulations, which include within the definition of a PPP “use of municipal property for its own [the private party’s] commercial purposes”.³ Such projects will only require an MFMA section 120 (4) feasibility study prior to a council decision to permit such use.

3. Section 1 of the Municipal PPP Regulations, Definitions, “public-private partnership”.



MUNICIPAL PPP PROJECT CYCLE

Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: III

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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A glossary and list of acronyms are provided at the beginning of Module 1.

STAGE 1: FIRST STEPS

Part 1: Identify project

Part 2: Notify government

Part 3: Appoint the project officer and the project secretariat

Part 4: Assess project budgets and consider PDF funding

Part 5: Set up the project team

Part 1: Identify project

A project can originate from an integrated development plan (IDP), which every municipality is required to complete. The major goal of the IDP is to identify the gaps in municipal services and draft a plan to eliminate these gaps. The gaps may be in an existing activity that is not meeting minimum standards, or a new activity to extend services to a new service area. The implementation plan must present recommendations to eliminate these service-delivery gaps.

In addition to project identification through the IDP planning process, projects or activities requiring a feasibility study can be mandated by the “trigger” mechanisms in section 77 of the MSA. Chapter 8, section 77 of the MSA defines when a municipality must perform a feasibility study for delivering a municipal service. The trigger mechanisms are time based and define key changes in the scale of the municipal service being considered or how the service is performed. If an existing or new service meets one or more of the 10 trigger mechanisms, the municipality is obliged to begin the feasibility study process under section 78 of the MSA.

A third means of identifying a project is the receipt, by a municipality, of an unsolicited bid that is a PPP.⁴

The requirements for undertaking a feasibility study are much narrower in Section 120 of the MFMA. Although the MFMA covers municipal support activities as well as municipal services, and is consequently much broader, the provisions of section 120 are only followed if a municipality is to consider a PPP for a particular service or activity. In contrast, section 78 of the MSA requires a feasibility study regardless of how the municipal service is currently provided.

Project identification should describe the nature and size of the activity, the current municipal budget, projected development costs and an initial list of risks.

4. The processes for handling unsolicited bids are addressed in Module 5, *Procurement*.

Extract from the Municipal Public-Private Partnership Regulations to the MFMA

2. Initiation of feasibility studies

- (1) Before a municipality initiates a feasibility study for a public-private partnership contemplated in section 120(4) of the Act, the accounting officer of the municipality must:*
 - (a) notify the National Treasury and the relevant provincial treasury in writing of the municipality's intention, together with information on the expertise within the municipality to comply with that section of the Act; and*
 - (b) if requested to do so by the National Treasury or the relevant provincial treasury, appoint a person with appropriate skills and experience, either from within or outside the municipality, as the advisor to assist and advise the municipality on the preparation and procurement of the public-private partnership agreement.*

Part 2: Notify government

Once the municipality determines that it is obliged to begin the feasibility study, the Municipal PPP Regulations require that it notify the National Treasury and the relevant provincial treasury. It would also be prudent to send the notification to the Department of Provincial and Local Government (DPLG) and any other national department that may be asked to provide its views and recommendations. For example, solid waste activities will include, at a minimum, the Department of Water Affairs and Forestry (DWAF), the Department of Environmental Affairs and Tourism (DEAT) and possibly others, such as the Department of Minerals and Energy (DME), depending on the activity being evaluated. The notification should include the following:

- A brief description of the activity and whether it is a change to an existing activity or a new activity under consideration.
- A copy of a resolution by the municipal council or its delegatee authorising commencement of the feasibility study for the specific activity⁵.
- A description of expertise within the municipality to comply with the applicable MFMA and MSA provisions.

The benefit of applying both MSA Chapter 8 and section 120 of the MFMA is that it ensures that municipalities evaluate, understand and make informed responsible decisions on providing municipal services or activities that have a “significant” impact on municipal finances, risks and organised labour.

5. A Template: Council Resolution is annexed to this Module.

It is not the intent of these Guidelines to subject every single municipal service or municipal support activity, regardless of size or scope, to the provisions of MSA Chapter 8 and/or section 120 of the MFMA. Because of the broad nature of the activities under the definitions of both municipal services and municipal support activities, it is prudent to review each project at its inception, and, based on its size, costs or risks, determine whether the activity should be subject to the feasibility study provisions of the MSA and MFMA.

If the activity is small, having minimal or no significant impacts, it may not be subject to all the feasibility study provisions. The National Treasury will make this decision on a case-by-case basis after reviewing the notification and meeting with the accounting officer. The determination will be based on a number of factors, including the nature and size of the project, the inherent risks, the municipal budget and transaction costs.

Step 1: Meet with the municipal desk at the National Treasury's PPP unit

After submitting the government notification, the municipal desk of the PPP unit will perform a brief review and may meet with the accounting officer of the municipality to discuss the proposed project.

Matters for discussion with the PPP unit

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

- What is the precise municipal function the municipality is seeking to assess? There are three types of functions a municipality may undertake and, depending on the type, different processes may apply:
 - A “municipal service”, as defined in the MSA
 - A “municipal support activity”, which means any other activity within the legal competence of a municipality that is not a “municipal service”
 - The use of municipal property by a private party for commercial purposes.
- Further considerations, depending upon the complexity of the project, are:
 - Should the internal and external investigations be simplified through possible exemptions, such as a public sector comparator (PSC)?
 - Should the procurement of any external mechanism, if found to be feasible, be simplified by, for example, combining the request for qualifications (RFQ) and the request for proposals (RFP)?
- What work has the municipality done to define its needs and assess its options for a solution?

- What budget does the municipality have for meeting these needs, and for financing project development costs, including the cost of a project officer, project management and administration, and hiring an adviser?
- Have any consultants been hired already for the project? If so, what is their brief, and on what terms?
- Is an application to the PDF for funding appropriate?
- Is there an internal senior manager who is suitably skilled and experienced to be appointed as full-time project officer?
- Is the accounting officer willing and able to assign delegations, budgets and administrative support to the project officer, and include him/her in the senior management team of the municipality?
- Is a single project envisaged?
- What is the municipality's envisaged project schedule?
- Has the accounting officer obtained the support of council for the project?

Step 2: Treasury determinations

Following receipt of the written communication from the accounting officer and any meeting with the PPP unit, the PPP unit will, in writing:

- Determine whether the activity is subject to all of the feasibility study provisions of the MFMA and MSA
- Determine whether the municipality must retain the services of an adviser
- Confirm registration of the project and its type (either a “municipal service” or a “municipal support activity”), assign a project number, and enter the project on the official database of municipal projects,⁶ in which the progress of the project will be tracked and updated throughout the project cycle
- Assign a PPP unit internal project adviser to assist the municipality.

The role of the accounting officer

The MSA and MFMA assign significant responsibilities and accountability to accounting officers to manage the resources of municipalities in the public interest and as mandated. This applies to any PPP project, and the role of the

6. This database is maintained by National Treasury's PPP unit. It can be viewed on <http://www.ppp.gov.za>.

accounting officer is set out in detail in the Municipal PPP Regulations. For the purposes of the MFMA the accounting officer is the municipal manager.

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

- Notifying the National Treasury of the municipality's intent to investigate service delivery alternatives
- Informing the National Treasury of the municipality's expertise to proceed with a project
- Appointing a project officer
- Appointing an adviser, if requested by the National Treasury to do so.

In carrying out these regulatory responsibilities, the accounting officer will, in this phase, need to:

- Provide strategic direction and vision throughout the project cycle, from the MSA section 77 review of delivery mechanisms to this inception phase and onwards, ensuring that the project's outcomes are consistent with the municipality's mandate and/or use of municipal property
- Build and secure support for the project, including support for the implementation of the internal and external delivery mechanism assessments that are required
- Ensure capacity to manage, communicate and disseminate information to stakeholders
- Provide the project officer with suitable delegations and responsibility for project management, and include him/her in the senior management team of the municipality
- Allocate suitable project resources, including budgets and personnel, to the project officer.

As the project progresses, the accounting officer will further be required to:

- Receive regular, direct reports from the project officer and provide strategic direction
- Resolve, as far as possible, disputes that cannot be resolved at project level
- Ensure smooth transitions between changing municipal personnel who may be responsible for the project at different times in the project cycle
- Represent the project publicly on behalf of the municipality.

The accounting officer's further regulatory responsibilities in PPPs are set out in section 120 of the MFMA and the Municipal PPP Regulations, and include:

- Making public the particulars of a proposed PPP and inviting the local community to submit relevant comments or representations
- Soliciting the views and recommendations of the National Treasury, the relevant provincial treasury, the DPLG and any relevant sectoral departments
- Obtaining the council's "in principle" decision to continue with the proposed PPP at the conclusion of the feasibility study, should that be the recommendation of the feasibility study
- Representing the municipality on behalf of council as signatory to the PPP agreement
- Ensuring that the PPP agreement is properly enforced.
- Ensuring that the municipal activity undertaken in the PPP is effectively and efficiently performed in the public interest, and/or that municipal property is appropriately protected.

The PPP unit's internal project adviser

The National Treasury PPP unit will assign an internal project adviser to every municipal PPP project registered in terms of the Municipal PPP Regulations.

The project adviser provides technical assistance from the date of registration to the completion of the project. The adviser:

- Supports the municipality through every step of the feasibility study and project cycle, drawing on best practice from other projects, and advising on how the municipality can best meet the requirements of section 78 of the MSA, section 120 of the MFMA and the Municipal PPP regulations, should the feasibility study conclude that a PPP is the preferred option
- Recommends a municipality's application to the PDF, if applicable
- Ensures that all requisite Treasury Views and Recommendations (TVR) are provided timeously
- Ensures that communication between the PPP unit and the municipality is managed professionally.

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

- Establish a project team
- Draft the terms of reference for the adviser
- Calculate a suitable budget for the costs of the adviser
- Make an application to the PDF, if applicable
- Procure the services of the adviser.

Part 3: Appoint The Project Officer And The Project Secretariat

The project officer

“Project officer” means a person identified by the accounting officer of a municipality, with appropriate skills and experience, either from within or outside the municipality, who is responsible for performing the duties set out in section 116(2) (c) (i) and (ii) of the MFMA and any other duties or powers delegated by the accounting officer to the project officer in terms of section 79 of the act.⁷

What does the project officer do?

The project officer is responsible for making the project work for the municipality, on time, on budget and to the standards set by the National Treasury. All the tasks and obligations detailed in section 120 of the Municipal PPP regulations, and in these Guidelines, are placed on the desk of the project officer. In effect, the content of these documents constitutes the project officer’s job and his/her responsibilities span the entire project cycle.

The project officer’s brief is an ongoing project management function requiring a suitable term contract. The intention should be that the project officer is made responsible for managing the project from inception through the feasibility study phase. Where a PPP is indicated, the project officer function will continue through the procurement phase and development phase, and into the first years of the delivery phase, when he/she will be primarily concerned with PPP agreement management functions.

Broadly, the project officer, representing the municipality, will:

- Manage the planning, procurement and implementation of the feasibility study and, where appropriate, the procurement of the PPP, exercising delegated authority
- Carry out all functions of the inception phase, including the appointment of the adviser
- Direct and manage the work of the adviser and approve payments in terms of the contract at every phase of project preparation
- Manage the PPP agreement for the project term.⁸

7. Clause 7 (1) and (2) Municipal PPP Regulations.

8. See Module 6: Managing the PPP agreement, for a detailed description of the project officer’s PPP agreement management functions throughout the project cycle.

What competencies does the project officer need?

Fulfilling these diverse and complex functions requires a wide range of skills. The chart below provides a competency model for a project officer. The model groups skills into three clusters – self, task and people skills – and indicates the desired competencies and indicators for each category. While the model is somewhat idealised, its aim is to illustrate the wide range of what is required in a project officer. Municipalities can use it as a recruitment tool, as an assessment tool in performance appraisals, and as a skills development guide.

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

Source: Adapted from UK Office of Government Commerce, *A Competence Framework for Creating Effective PFI Projects*, 2000, p.18.

The project officer is the municipality's anchor and champion for the project, and key to its success. He/she must be unquestionably honest and committed to obtaining the best value in the public interest. The project officer will be required to act and make decisions with the utmost integrity at all times, and to protect the municipality's interests and those of the public.

The project officer will require suitable facilities, including office accommodation, computer and communication equipment, filing facilities, secretarial support and, crucially, access to decision makers in the municipality.

Where does the project officer fit in the municipality?

The accounting officer should give the project officer legally sound delegations to play a driving role. The project officer should therefore be or become a member of the municipality's senior management team to ensure thorough municipal buy-in and management's contribution to key project decisions. He/she should report directly to the accounting officer or his/her delegatee and have the latter's full trust.

Formalise the project officer's appointment

The project officer may be appointed from within or outside of the municipality, depending on the municipality's capacity and resources. Either way, the municipality should enter into a contract with the project officer. The contract should clearly identify the measurable outputs of the job, and allow the municipality to terminate the project officer's services if he/she fails to deliver as agreed, or if he/she is found to be corrupt or incompetent.

Appoint the project secretariat

The project officer will need back up from a meticulous, efficient and reliable secretariat. Its primary role will be to ensure scrupulous document management and meetings administration throughout the project cycle. Well-kept project records are vital, enabling a municipality to:

- Compile its annual reports as required by the MFMA
- Supply the Auditor-General with the legally required documentation at any time
- Produce accurate project information in terms of the Promotion of Access to Information Act (2000)
- Make decisions quickly and compile project documentation accurately and efficiently, based on preceding project decisions

- Give accurate briefings to the municipality's accounting officer and senior management
- Devise and implement an effective project communication strategy for engaging with key stakeholders throughout the project cycle.

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

Part 4: Assess project budgets and consider PDF funding

Step 1: Identify budgets

An early task for the project officer is to identify the budgets needed to manage and administer the project and to hire the services of an adviser. This entails identifying budgets in the applicable line items of the municipality's budgets that may be used, and ensuring that such budgets are built into the next available budget cycle.

Step 2: Consider PDF funding

In addition, the project officer should assess the likelihood of needing to apply for PDF funding, whether the project would fit the PDF criteria, and what would be the best stage in project preparation for the municipality to submit an application for PDF funding. (More detailed information on the PDF is provided in the final section of this module.)

Part 5: Set up the project team

The municipality will require a strong team to lead and monitor the project from the start. This team should be led by the project officer and include the officials who can provide him/her with both strategic and technical support. This group should also be the secretariat of the project team.

What does the project team do?

- Provides strategic direction and ensures management and political support in all phases
- Oversees project development budgets and manages expenditure

- Ensures that the progress of the project is effectively communicated within the municipality and to the public where required
- Provides the requisite technical, human resources, financial, industrial relations, legal and administrative input and information to the adviser
- Approves the deliverables of the adviser
- Reviews and endorses documentation to be submitted by the municipality to the National Treasury, the relevant provincial treasury, the DPLG and any appropriate ministry for their views and recommendations
- Reviews and endorses documentation to be submitted to the accounting officer for the applications for council approvals
- Keeps record of all project documents, including progress reports, minutes of meetings, feasibility deliverables, and procurement reports.

Experience has shown that the absence or incompleteness of information relating to the services sought to be performed by an external mechanism can be a major problem in conducting the feasibility study required by section 120 of the MFMA and section 78 of the MSA. The municipality's project team should be the primary source of all such information to the adviser, and should take the necessary steps to obtain it. This will reduce both advisory costs and the time taken to prepare the feasibility study, and improve the quality of information.

The adviser and the PPP unit's internal project adviser should attend the regular meetings of the project team. For day-to-day project management, the project officer will need to set up structured working arrangements with both parties.

STAGE 2: PROCURING AN ADVISER

Introduction

Section 2(1) (b) of the Municipal PPP Regulation requires that, at project inception, the accounting officer “must appoint a transaction adviser, if the relevant treasury so requests”. In these combined Guidelines, the term “adviser” shall be deemed equivalent to the term “transaction adviser” as used in section 2(1) (b) of the Municipal PPP Regulations and/or “consultant” as used in section 35(1) of the Municipal Supply Chain Regulations.

What is an adviser and what does it do?

“Adviser” means a person or persons appointed in writing by an accounting officer of a municipality with the appropriate skills and experience to assist and advise the municipality in achieving informed decisions concerning the effective delivery of the defined service.

If a feasibility study recommends a PPP as a delivery mechanism, the adviser proceeds to assist the municipality to procure a PPP service provider. If the procurement option determined best for the municipality is *not* a PPP, the municipality may maintain a contractual relationship with the adviser to assist it in undertaking the recommendations of the feasibility study.

The adviser may also be required to provide PPP agreement management support to the municipality after signature of the PPP agreement, particularly in the development stage and the early years of the delivery stage.

What skills and experience are required?

The professional skills and experience of the adviser are typically in municipal law, project finance, contract and administrative law, insurance, municipal PPP procurement management, project management, BEE, and in all technical disciplines relevant to the particular project sector (for example, solid waste management, water, sanitation, and social housing). The adviser has to be sufficiently competent to complete the work in a cost-effective manner so that the municipality can meet the stringent requirements of obtaining the required views and recommendations to obtain each council approval, up to and including financial closure at the end of the procurement phase.

Advantages of using an adviser

Good advisers bring clear advantages to the municipality:

- Knowledge of municipal law and regulations
- Experience in similar transactions

- Protection against costly, avoidable mistakes
- Access to national and international best practice
- Technical strength to the municipality's team
- Enhancement of investor confidence
- An opportunity for skills development among municipal officials
- A single point of accountability for getting the job done well and on time
- An opportunity to increase the number of black consultants in the advisory market.

Getting value for money from the adviser

The adviser is an investment, not simply an expense, and is key to assisting the municipality to secure the best output possible. The municipality should therefore balance its need to obtain top-quality technical assistance with its need to keep the overhead costs of preparing the project in check. The aim is to get the best value for money from the adviser.

This involves some important prerequisites:

- The accounting officer should mandate the project officer to manage the work of the adviser directly, take certain binding project decisions, and drive the project on a day-to-day basis on behalf of the municipality.
- The adviser should be hired at the start of the project and, where the project results in a PPP, retained until after the signing of the PPP agreement at the end of the procurement phase; or, in some instances, until after PPP agreement management systems have been bedded down in the development phase of the project term.
- The adviser's terms of reference should be precise and focused on clear deliverables.
- Procurement of the adviser must be in terms of these Guidelines, despite any provisions of the municipality's supply chain policy to the contrary.⁹
- There should be one lead firm in the advisory team responsible for managing the deliverables of each member of the team; the lead firm reports regularly to the project officer.

9. Section 35(1) of the Municipal Supply Chain Regulations provides that the accounting officer of a municipality may procure consulting services pursuant to Treasury guidelines in respect thereof.

- Avoid separately retaining or subsequently hiring additional consultants for the project other than the adviser. This can create conflicting work streams and accountability.
- If there are already consultants working for the municipality on the project before its registration with the National Treasury, consider either closing these contracts before advertising for the adviser or transferring these services to the management of the adviser in a manner clearly articulated during the procurement of the adviser.
- The terms of the contract between the municipality and the adviser should provide incentives to complete milestones in the project cycle, on time and within budget.
- The project team should meet regularly with the adviser to receive progress updates, provide direction, resolve impasses, and ensure continued municipal input and support.

Procuring an adviser

Part 1: Determine applicable procurement regulations

Part 2: Establish the bid evaluation panel and bid secretariat

Part 3: Define the adviser's terms of reference

Part 4: Prepare the rest of the bid package

Part 5: Publish the advertisement, brief bidders and respond to queries

Part 1: Determine applicable procurement regulations

Part 1 of MFMA Chapter 11 requires each municipality to adopt a supply-chain management policy. The Municipal Supply Chain Regulations set out the regulatory framework for a municipality's supply chain policy, including the appointment of consultants. As noted above, these Guidelines govern the procurement of advisers, despite any provisions in the municipality's supply-chain management policy to the contrary. This guidance assumes that a municipality has adopted, and will employ, a supply-chain management policy consistent with the referenced legislation, regulations and these Guidelines in terms of the appointment of consultants. The following criteria are recommended:

- The use of a scorecard that gives more weighting to technical quality. In compliance with the PPPFA, the BEE component will constitute 10 per cent, with the price and technical elements constituting the remaining 90 per cent. The table below recommends the breakdown between technical and price elements.

Figure 3.2: Technical, pricing and BEE weighting

Evaluation element	Weighting	Threshold score
Technical	70%	65%
BEE	10%	60%*
Price	20%	

***Note:**

This requirement can be revisited if it is a small project that a single advisory firm can service. If the nature of the project is such that the advisers will need to form an advisory team to provide the necessary skills, then the advisory team shall be subject to the above threshold score.

- A two-envelope system of selection should be used where financial proposals are only opened if the technical proposals meet the minimum technical threshold.
- The appointment of the PPP unit's internal project adviser as a voting member of both the bid specification committee and the bid evaluation committee.
- The use of the PPP unit's draft adviser contract (available on the PPP unit's website).

Part 2: Establish the bid specification committee and bid secretariat

Step 1: The bid specification committee

The bid specification committee plays a key role in procuring a qualified adviser. The committee should be made up largely of the same people who constitute the project team. The PPP unit's internal project adviser should be a voting member.

The project officer should establish the bid specification committee early, so that its members can become familiar with the project, the adviser's terms of reference and assist in setting the bid evaluation criteria.

Step 2: The bid secretariat

The members of the bid secretariat should be drawn from the municipality's supply-chain office and the project secretariat and should assist the project officer and the bid specification committee to prepare the bid package.

The bid secretariat ensures that the rules of bidding are strictly followed. It plays a key role by:

- Preparing the required documentation for the bid evaluation committee
- Administering and recording the receiving of the bids
- Preparing the scoring sheets for each bid and the spreadsheets for compiling the scores consistent with the bid package
- Organising the venue and all logistical matters for the bid evaluation and ensuring that all bid documents are delivered securely to and from the venue
- Collating the scores
- Setting up the interviews with the short-listed bidders and recording the proceedings
- Ensuring that the municipality's other supply-chain management policy requirements are met and recorded.

Step 3: Define the adviser's terms of reference

The purpose of the terms of reference is to give the bidding advisers clear direction about what the municipality wants and expects.

The municipality's terms of reference together with the selected adviser's proposal will be consolidated into the deliverables schedule of the adviser contract, so it is important for the municipality to prepare comprehensive terms of reference right from the start. The internal project adviser from the PPP unit will assist the project officer and the bid specification committee with drafting this document. The better the information made available to bidders, the higher the quality of the bids will be in technical and BEE solutions and pricing. The more precise the terms, the firmer the project's footing will be when it goes forward.

The terms of reference should be drawn up based on the two different stages to be undertaken:

- **Stage 1: Feasibility study**

The feasibility study consists of two stages.¹⁰ In Stage 1A, the adviser takes the municipality through the needs analysis, the technical options analysis, and the service delivery analysis. At this point, the municipality may wish to opt for an internal option in which case the municipality either terminates or reviews the adviser's contract to assist the municipality with restructuring its service in compliance with section 79 of the MSA. If the municipality decides to analyse a preferred external mechanism in more depth, it proceeds with Stage 1B in which a thorough value assessment is conducted. At the end of Stage 1B, the municipality decides whether it wants to proceed with the procurement of an external option. If it does not, then the contract is terminated.

- **Stage 2: Procurement**

If, based on the feasibility study, the procurement of an external option is approved by the municipality, the adviser will provide the necessary technical, legal, and financial advisory support for the procurement of an external option.

When obtaining bids for the advisory work, bidders should be required to quote the costs for the above stages separately with a clear understanding that the project may be terminated at the end of any of the above stages.

The terms of reference will vary in content from project to project and sector to sector, as indicated in Stage 1: First Steps, above.

A template covering the adviser's terms of reference is provided on the PPP unit's website. It can be adapted by the bid specification committee in consultation with the PPP unit. The following additional templates will assist the procurement of the advisers and are also available on the PPP unit's website:

- Template project officer duties and responsibilities
- Template draft adviser's contract
- Template adviser advertisement
- Template code of conduct for bid evaluation panel members
- Template declaration of interest statement.

10. If the National Treasury's determination (see stage 1, part 2, step 2, above) is that the activity to be assessed is not a "municipal service", the feasibility study may only require one stage, eliminating the need for an "internal assessment".

Template: Adviser terms of reference

1. Introduction

2. Scope of work

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

3. Background

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

4. Feasibility study deliverables

- 4.1 Components of the feasibility study
- 4.2 Presentation of the feasibility study
- 4.3 Publication of particulars of proposed external option, including the report, and invitation to comment
- 4.4 Submission of the feasibility study report and solicitation of views and recommendations from the National Treasury (TVR I)
- 4.5 Submission of the feasibility study report and solicitation of views and recommendations from DPLG
- 4.6 Submission of the feasibility study report and solicitation of views and recommendations from the responsible national department for PPPs involving the provision of water, sanitation, electricity or other prescribed services (if applicable)
- 4.7 Submission of feasibility study report to council for "in principle" decision

5. PPP procurement deliverables (if applicable)

- 5.1 Treasury views and recommendations II (TVR IIA) and administration of the bidding process
- 5.2 Evaluation of bids by the bid evaluation and bid adjudication committees, demonstrating value for money (TVR IIB)
- 5.3 PPP agreement negotiations, PPP contract management plan and Treasury views and recommendations III (TVR III)
- 5.4 PPP agreement signature, close-out report and case study, financial closure and if the proposed PPP has multi-year implications, for the decision required by section 33 of the MFMA

6. Adviser skills, experience, remuneration and management by the municipality

- 6.1 Necessary adviser skills and experience
- 6.2 Remuneration schedule and disbursement arrangements
- 6.3 Management of adviser by the municipality

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

- 7.1 Rules of bidding
- 7.2 Bid submission requirements
- 7.3 Compulsory briefing session
- 7.4 Address and deadline for submission of bids
- 7.5 Bid evaluation
- 7.6 Bid evaluation criteria
- 7.7 Envelope 1: Technical and BEE proposals
- 7.8 Envelope 2: Price proposal

Appendix A: Background and supporting documentation

Appendix B: Draft adviser contract

Budgeting for the adviser's professional fees

The municipality may or may not declare the fees budget.

While the municipality should reserve a budget for the adviser when the project budget is being assessed and PDF funding considered (Stage 1, Part 4 of inception) the real extent of the adviser's work will only become evident during this preparation of the terms of reference. The project officer should carefully cost the adviser fees at this stage, referring to current market rates and to contracts for similar, recent projects. Having estimated the probable costs, the municipality must then decide whether to declare the budget limit in the terms of reference.

If the municipality is unable to secure all the necessary funds from its baseline budget for the costs of the adviser, it can make an application to the National Treasury's PDF. See the final section of this module for details of the PDF and the application procedures.

How to decide whether to declare the fees budget

A municipality will need to be familiar with the bid evaluation process to understand fully what lies behind this decision and its implications.

If the fees budget is declared, the municipality is consciously focusing its bid evaluation selection on the quality of service it can get for the available budget. If the bidders deem the budget to be reasonable or generous, they are likely to bid their price at the specified budget. If they deem the budget to be too small, they will either not bid or they will bid at a higher price in the hope that the municipality will reconsider. Where the budget is declared, the municipality is able to increase the weighting of the technical and BEE components of the bids, although given the possibility of prices above the budget, the municipality should reserve the right to reject a proposal based on affordability and to negotiate with the bidder who scores the highest on technical and BEE components. The two-envelope system means technically weak bids can be eliminated before any of the price bids are considered.

If the fees budget is not declared, bids are more likely to come in at a wide range of prices, and there may be low-cost proposals that are technically weak. In this instance, the bid evaluation system can place a heavier weighting on the price component (although never more than on the technical). The two-envelope system must be applied. The two-envelope system will push selection of the strongest technical and BEE bids, with reasonable competition for lower price. The municipality always runs the risk, when not declaring the budget, of facing a price for the job that it may not be able to afford, if price negotiations are unsuccessful.

Remuneration system and schedule

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

Professional fees should be paid in the form of fixed fees (for identified deliverables at milestones defined in the terms of reference) and a success fee upon completion of the close-out report and case study; on the successful implementation of the selected option; or on financial closure of the PPP. Fees should be payable, for example, on completion of one of the stages of the feasibility study to the satisfaction of the municipality. This payment should not be linked to the completion of the stage, but rather to a decision related to the completion of the stage. This is because the municipality may decide, based on the feasibility study, not to proceed further.

The purpose of the fixed-fee payment structure is to provide incentives to delivery at each key stage of the project cycle and the drive to decide on the delivery mechanism.

In preparing this guidance, the National Treasury is aware that the incentive mechanism will always favour continuation of the project. The National Treasury's view is that this is balanced by the principle of fair remuneration per stage and the fact that decision-making authority and accountability rests with the municipality, not the advisers.

Success fees should be reasonable – not more than 10 to 15 per cent of the entire cost of the adviser, depending on the size of the transaction. It is also prudent to specify the terms of the success fee to enable the municipality to deduct from the success fee if significant delays can be directly linked to the work of the adviser.

For cash-flow reasons, advisers will seek to be paid up front as far as possible. But it is in the municipality's interests to link payments to outputs delivered to requisite standards. The terms of reference should therefore establish a remuneration schedule that both reflects the real costs of expected inputs (in this case, professional time) and links the payments to definite outputs, while leveraging an incentive percentage for payment at final delivery. Mobilisation payments are acceptable provided they do not exceed 15 per cent of the total fee of the particular stage. Such arrangements assist small and emerging advisory companies.

Disbursement arrangements

There are two options:

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

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

Take note

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

- **Option 2: Fixed costs**

Specify that advisers must bid disbursements as part of the total fixed fee. This means that they will have to make a calculation of their anticipated overhead expenditure. The likelihood is that they will calculate this conservatively, which could have value-for-money implications for the municipality.

This option has two advantages for the municipality: first, it does not have to administer disbursement approvals on a day-to-day basis; and second, if it is able to obtain PDF support, the PDF will cover the fixed disbursement sum as part of the overall fixed cost during the procurement phase.

Part 3: Prepare the rest of the bid package

The project officer should prepare the adviser bid package with the assistance of the internal project adviser and bid secretariat.

What goes into the adviser bid package?

- Advertisement calling for advisers
- Letter of invitation
- Terms of reference
- Background and supporting documentation
- Draft adviser contract

The municipality must endorse the completed bid package before it is issued.

Prepare the bid package in the following order

Part 1: Define the terms of reference (above)

Part 2: Prepare the rest of the bid package

- Step 1: Background and supporting documentation
- Step 2: Draft adviser contract
- Step 3: Advertisement
- Step 4: Letter of invitation
- Step 5: Municipal endorsement

Step 1: Background and supporting documentation

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

This background and supporting documentation will:

- Enable bidders to calculate the time they need for all possible elements of the project
- Enable bidders to avoid costing work that has already been done
- Better inform them of what remains to be done and of the municipality's mandate
- Contribute to the value that the municipality is able to get from the adviser.

Background and supporting documentation should include:

- The initial needs assessment
- Project objectives
- The municipality's management of the project
- Copies of relevant government policy or regulations
- Any preliminary costing, budgeting, legal and/or technical due diligence

- Any preparatory studies that may have been done
- Any documentation relating to the determination of the “municipal service” or “municipal support activity” classification of the project.

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

Step 2: Draft adviser contract

To inform bidders clearly of the contractual terms under which the adviser is to be hired, attach a draft contract to the terms of reference. Bidders should be required to mark up this contract and submit it as part of their bids. See the template draft adviser contract available on the PPP unit’s website, which can be modified as required.

Step 3: Advertisement

The advertisement should be concise but informative. (A template adviser bid advertisement can also be obtained from the PPP unit’s website which can be adapted in consultation with the PPP unit’s internal project adviser.)

Bid submission deadline

Allow potential advisers at least four weeks to prepare their bids by placing the advertisement at least four weeks before the bid submission deadline. They need enough time to become familiar with the project, construct a consortium of professionals and cost the project.

Briefing session

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

Take note

In addition to hard copies for collection at the municipality’s offices, the adviser bid package **must be available electronically** from the project officer and/or easily downloadable from the municipality’s website. There should be no passwords or website registration requirements, for example, and documents should be in common formats and programmes.

Step 4: Letter of invitation

The project officer must prepare a brief, informative covering letter for the bid package, addressed to all potential advisers and signed by the municipality's accounting officer.

Step 5: Municipal endorsement

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

- The project team
- The bid secretariat's supply-chain management representative
- Senior management, either individually or in committee
- The accounting officer.

Projects requiring the appointment of advisers – in both their preparation and implementation – entail the cooperation and involvement of all components of the municipality to one degree or another. The endorsement of the adviser bid package will ensure that internal or regulatory systems or requirements have been taken care of, and that senior management is fully briefed on and supportive of the work that is about to begin.

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

Step 1: Advertise

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

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

- In the *Government Tender Bulletin*
- In prominent newspapers and/or journals
- On the municipality's website.

Take note

Municipalities can place their adviser tender advertisements on the National Treasury's PPP unit's website at no charge. PPP transaction advisers watch this website closely, so it is an effective way to reach them. Contact the website administrator for advertisement submission requirements: www.ppp.gov.za.

Step 2: Conduct the briefing session

The briefing session is an opportunity:

- To introduce the project to potential advisers, highlighting key issues and challenges, and brief them on the most important elements of the bid package
- To demonstrate the competence and commitment of the municipality, its project team and the project officer in particular.

The project officer

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

Potential advisers

- To meet the key municipal managers and ask questions
- To know who else is bidding for the job – this stimulates competitive bidding and presents opportunities for the formation of consortiums.

Attendance at the briefing session should be compulsory for any adviser intending to submit a bid.

The bid evaluation secretariat

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

The bid evaluation panel should also attend the briefing session.

The briefing session should consist of:

- An opening presentation by the project officer and the members of the project team
- A question and answer session.

The project officer's presentation should:

- Highlight the key features of the terms of reference
- Set out the municipality's approach to the project
- Give a full picture of what the project is likely to entail.

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

- The municipality's presentation(s)
- Questions asked and answers given
- A register of participants.

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

Step 3: Respond to administrative queries promptly by email

Before the briefing session

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

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

After the briefing session

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

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

STAGE 3: RECEIVING AND EVALUATING BIDS

Receiving and evaluating bids

- Part 1: Prepare for the evaluation
- Part 2: Receive the bids
- Part 3: Technical and BEE evaluation
- Part 4: Price evaluation
- Part 5: Interview and make the final choice

Part 1: Prepare for the evaluation

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

- Confirm membership
- Be briefed on the bid evaluation system, receive and confirm their understanding of the instructions to the bid evaluation panel, and receive a sample score sheet
- Sign the code of conduct (A template is available from the PPP unit's website)
- Confirm that all members understand and will abide by their responsibilities to the panel
- Diarise the dates for the evaluation
- Diarise the provisional dates for short-listed bidders to present their advisory team to the panel and answer the panel's questions
- Diarise the final meeting date for the panel to choose the adviser.

The bid secretariat should establish a spreadsheet to reflect the bid evaluation criteria and scoring. (An example bid evaluation scoring spreadsheet is available from the PPP unit's website.)

Part 2: Receive the bids

The two-envelope system

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

The technical element gets the strongest weighting

The technical element is the most important element and is weighted accordingly. Various components of the technical element need to be evaluated and scored. Only those bids that meet or better the threshold score should be considered for the BEE element and, after that, the price element.

The BEE element gets a strong weighting

In keeping with government policy, the BEE element is given a strong weighting. Government wants to be supported professionally by a team that reflects South Africa's diverse population. Module 2: Code of Good Practice for BEE in PPPs, sets out government's BEE policy on hiring advisers.

If the bid fails to pass the BEE threshold, it should not be further considered.

The price element is specifically weighted to reflect whether the fees budget is declared

See stage 2, part 3. The price is scored on a pro rata system.

Recommended weighting for bid evaluation elements		
Evaluation element	Fees budget declared	Fees budget not declared
Technical	70% (with a threshold of 65%)	65% (with a threshold of 65%)
BEE	10% (with a threshold of 60%)	10% (with a threshold of 60%)
Price	20%	25%

Step 1: Register the bids

The bid secretariat should officially receive and register bids internally, on or before the bid submission date and in the manner and at the place specified in the bid package. Consider late submissions only in exceptional circumstances and only in the manner precisely specified in the bid package. Late submissions are accepted at the project officer's discretion.

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

Step 2: Separate and secure the price envelopes

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

Step 3: Open the technical and BEE envelopes

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

Each member of the bid evaluation panel is then given access to all the technical and BEE bids. After reviewing the advisory team membership, each member is required to sign and submit to the bid secretariat the declaration of interest statement before starting the bid evaluation. ([A template declaration of interest statement](#) is available from the PPP unit's website.)

Step 4: Check the technical envelopes

The bid secretariat should then check each technical envelope for administrative compliance – namely, that they include tax clearance certificates and the CV of each team member. If any of these are missing, contact the bidders and ask them to complete their submissions within a limited period. Failure to do so means their bid will not be considered.

Part 3: Technical and BEE evaluation

Take note

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

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

- The bid evaluation panel meets in a designated venue for a number of days to undertake the entire bid evaluation process, uninterrupted.
- The project officer is the chairperson of the bid evaluation panel.
- The bid secretariat records all proceedings and files all score sheets. Everything the project officer and bid evaluation panel do and decide should be recorded accurately.
- At the start of each day's proceedings each member of the panel needs to confirm for the records their adherence to the code of conduct and to the declaration of interest.

- In the event of any conflict of interest being declared, at any stage, the chair will recuse the relevant member from further participation on the panel.

The responsibilities of panel members include thoroughly reading each bid, evaluating bids strictly according to the package criteria, and participating fully in all meetings of the panel. If a member fails to prepare evaluations properly, he/she should be removed from the panel.

Technical and BEE evaluation

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

Step 1: Score the technical bids

The scoring of each of element must be judged as excellent, acceptable or poor, and given a preset score, accordingly. (For example: excellent = 4 points; acceptable = 2 points; poor = 0 points.) Do not use ranges to indicate a score.

Each member (without discussion):

- Reads and evaluates each technical proposal
- Notes where bids are non-compliant where necessary
- Gives preliminary scores to each element and each sub-element for each bid
- Writes explanatory notes (with page references where appropriate) to substantiate each preliminary score.

Step 2: Plenary discussion

When each member has given preliminary scores to every bid, the chair calls the panel to a plenary discussion of each element of each bid. The panel must agree on any bids that should be disqualified for non-compliance at this point. Members are required to state their evaluations and to listen to other members'

evaluations. They may adjust their scores and notes if other members bring to their attention features of the bids they did not previously consider. They must initial any adjustments on the score sheets.

Step 3: Enter the scores

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

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

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

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

Step 5: Score the BEE bids

Take note

Only those bids that pass the technical threshold score will have their BEE elements scored.

The BEE component must be allocated in respect of four sub-elements for the 10 per cent point score allocation.

BEE scoring				
Element	Maximum score	Scoring criteria	Weighting	Points total
Percentage of black equity in the adviser team	5	25%-35% = 3 >35% = 5	6	30
Percentage of black people playing leading professional roles in the adviser team	5	25%-35% = 3 >35% = 5	6	30
Skills transfer plan	5	Poor plan = 1 or 2 Incomplete plan = 2 or 3 Credible plan = 4 or 5	4	20
Credible plan for structuring effective BEE for the PPP, with the necessary skill and experience in the team	5	Poor plan, poor skill & experience = 1 or 2 Incomplete plan, limited skills & experience = 2 or 3 Credible plan & skill & experience = 4 or 5	4	20
Total points				100
Minimum threshold				60

The BEE proposals must show:

- **In element 1:** how black professionals are included in all aspects of the work (legal, financial, technical and at all phases of the project cycle), and must specifically indicate those aspects where they are designated to play leading roles. Fronting of black people to win contracts will lead to contract termination by the municipality. Black members are expected to perform the work they were assigned to, and the fee sharing structure must reflect the actual work, risk and responsibility assumed by each of the team members. The cash flow earmarked for each member of the advisory team must also be shown in the price envelope, indicating how the black members will benefit.
- **In element 2:** the percentage of black equity in the companies making up the advisor consortium, with a weighted average calculated on the percentage of the work to be performed by each company as follows. The table has been completed with an example to illustrate the method used in the calculation.

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

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

- **For element 3:** that the skills transfer plan includes transparent mechanisms to enable the municipality to see the progress in this regard throughout the advisory assignment.
- **In element 4:** which member(s) of the advisory team are to be responsible for structuring the BEE elements of the project throughout the assignment, and must demonstrate their clear understanding of Module 2: Code of Good Practice for BEE in PPPs. References should be provided to substantiate claims of skills and experience.

Step 6,7 and 8

As with the scoring of the technical bids, there is a plenary discussion, the scores are entered systematically, and then announced. Only those bids that pass the BEE threshold score, having passed the technical threshold score, will proceed to the price evaluation.

Step 9: Discuss and record any reservations

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

Step 10: Confirm which bids may go forward

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

Step 11: Sign and hand in the score sheets

Each panel member signs his/her technical and BEE scoring sheets and hands them in to the bid secretariat for filing.

Part 4: Price evaluation

Step 1: Enter the prices and evaluate

It is important to note that in opening the price envelope the evaluation panel must not look only at the prices submitted. It is important to look at the price submission and apply a test of compliance, reasonableness and acceptability of conditions.

Compliance testing includes ensuring that financial bids comply with the tender rules. If, for example, the tender asks for a fixed price, the evaluation must ensure compliance with this requirement.

The tender submission requirements require the bidders to submit a marked-up version of the draft adviser contract. The panel must take into account the price impact of any proposed amendments.

The reasonableness of the prices can be established by averaging the prices from the received bids. The average price indicates the reasonable price that the market is willing to pay for the services specified in the terms of reference. Having established this, the price of the winning bid should be close to, or not significantly higher than the average price. The evaluation panel must also examine whether the prices are reasonable by establishing a link between the technical score and the price quoted. Generally there must be a relationship between the two. A tenderer who scores high on technical will have a price to reflect the inputs in the technical portion of the proposal.

The bid secretariat enters the prices on the electronic spreadsheet displayed before the panel, and calculates the price scores and the totals.

Step 2: Add up technical, BEE and price scores

The bid secretariat will do this in the electronic spreadsheet.

Step 3: Short-list the top bidders for interviews

At this point it is recommended that the panel identifies the two or three top-scoring bids for interviews, which allow the panel to clarify any outstanding questions and meet the proposed advisory team face-to-face. In preparation for these interviews, the bid secretariat must clearly minute the key issues to be raised by panel members with the bidders.

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

- Ask them to prepare a presentation for the panel
- Set a date for the interview suitable to both the municipality and the bidders, preferably within a week of the evaluation.

Part 5: Interview and make the final choice

Step 1: Interview

The interviews should take place one after the other on the same day, so that the panel can consider all the short-listed bidders.

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

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

- Adjust his/her technical and BEE scores if any of the interviews warranted this
- Initial the changes
- Write their motivations for the changes on the individual score sheets.

Step 3: Make the final choice

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

The panel reaches a conclusion on the choice of the preferred adviser immediately.

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

Best and final offer (BAFO)

In the event that the bid evaluation panel cannot make a decision between two bidders due to serious deficiencies in both bids, the municipality may choose

to approach both bidders with a request for best and final offers (BAFO). This process involves a re-bid, and should seldom be necessary if the bid process was managed according to the Guidelines. A BAFO process should only be followed in exceptional circumstances and only with the direct assistance of the PPP unit's project adviser.

STAGE 4: FINALISE AND SIGN THE CONTRACT

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

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

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

The preferred adviser should not be responsible, as a condition of being awarded the contract, for work not in the terms of reference.

It should be a condition in the terms of reference that the municipality reserves the right to negotiate price with the preferred adviser.

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

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

INTRODUCTION TO THE PROJECT DEVELOPMENT FACILITY

The National Treasury's Project Development Facility (PDF) may fund a significant portion of a project's adviser costs for MSA and MFMA feasibility studies, and/or PPP procurement. When applicable, the PDF may recover these funds from the successful bidder after the financial closure of the PPP.

The costs of undertaking MSA and MFMA feasibility studies and implementation of the recommendation of the feasibility studies can be significant, and often put a burden on the budget of the municipality. But quality advisory services are fundamental to obtaining the information necessary for a municipality to make a reasoned decision on a service-delivery mechanism. Should that service-delivery mechanism be a PPP, the advisory services are also critical to procuring affordable, value-for-money PPPs, and adherence to the PPP procurement requirements set out in the Municipal PPP Regulations.

Due to the increasing number of municipal service-delivery assessment projects requiring assistance, the National Treasury's PPP unit has established the PDF as a vehicle for municipalities to source funding for a portion of the adviser costs, reducing the impact of service-delivery assessment and procurement costs on municipal budgets. Ideally, the PDF should increase the quality and quantity of successful deals that are processed through the PPP unit's project pipeline.

While the PDF will play an important role in assisting municipalities to assess service delivery mechanisms and, where appropriate, to procure PPPs, the municipality's ownership of the project is essential to the project's success. The PDF will not assume responsibility for procuring or managing any service-delivery mechanism chosen by a municipality, including a PPP. In accordance with the MFMA, these functions reside with the accounting officer of the municipality.

TEMPLATE: COUNCIL RESOLUTION

_____ Municipal Council

Resolution _____

Resolution In Terms Of Section 2 of the Municipal PPP Regulations to the Municipal Finance Management Act (MFMA) and Section 78 of the Municipal Systems Act (MSA)

Whereas, Section 2 of the Municipal PPP Regulations to the MFMA requires the accounting officer of a municipality intending to initiate a feasibility study for a public-private partnership contemplated in MFMA section 120(4) to notify the National Treasury and the relevant provincial treasury in writing of the municipality's intention; and

Whereas, Section 78 of the Municipal Systems Act (MSA) requires a municipality that is in the process of deciding on a mechanism to provide a municipal service to first assess the provision of that service through an internal mechanism and thereafter, either decide to provide that service by an internal mechanism or explore the possibility of providing the municipal service through an external mechanism; and

Whereas, should a municipality decide to explore the possibility of providing the municipal service through an external mechanism, it must, inter alia, conduct a feasibility study in accordance with the requirements set forth in said MSA Section 78; and

Whereas, said feasibility study must be conducted not only in terms of the requirements of MSA Section 78, but also in terms of MFMA section 120(4) and the Municipal PPP Regulations should a municipal council wish to consider the possibility of providing the municipal activity through a public-private partnership (PPP); and

Whereas, the _____ Municipality wishes to undertake a complete analysis of each municipal service delivery option available to it in terms of the provision of [name of municipal service] in the most expeditious manner and without undue delay, including the ability to explore the possibility of providing said municipal service by a PPP:

Now, therefore, it is hereby resolved as follows:

1. That the Municipal Manager of _____ Municipality be, and he is hereby authorised and directed to notify National Treasury and the treasury of [name of province] of its intent to initiate processes in terms of both MSA section 78, MFMA section 120 and the Municipal PPP Regulations, to assess the appropriate mechanism, either internal or external, including a PPP, for the provision of said municipal service, which processes may entail the conducting of a feasibility study, and to register said project with the National Treasury PPP Unit;
2. That the said Municipal Manager further be, and he is hereby so authorised and directed, to conduct the internal and external assessments required by MSA section 78, and if, at the conclusion of said internal and external assessments determines, in his sole discretion, that it is in the best interests of this Municipality to conduct a feasibility study to determine the appropriateness of the provision of said municipal service by an external mechanism including a PPP, to proceed to conduct said feasibility study consistent with all applicable statutory and regulatory requirements, and report the findings of said feasibility study to this Council in due course;

3. That the said Municipal Manager further be, and he is hereby so authorised and directed to:
 - (a) appoint a suitably qualified project officer in terms of section 7 of the Municipal PPP Regulations;
 - (b) if requested by either National Treasury or [name of province] Treasury, appoint an advisor; and
 - (c) apply to the Project Development Facility (PDF) of National Treasury for funding to defray the expenses of said advisor;
4. That the findings of the feasibility study referenced in Clause 3, above, be presented to this Council in the following order:
 - (d) The findings and recommendations of the internal assessment;
 - (e) The findings and recommendations of the external assessment; and
 - (f) The recommendations to Council in terms of the way forward.
5. That the said Municipal Manager further be, and he is hereby so authorised and directed, to take such other and further actions as are necessary and desirable in order to effect this Resolution in order that the Council of _____ Municipality may be provided all relevant and pertinent information to permit a reasoned, deliberate decision on the provision of said municipal service.

Done this _____ day of _____, 200_, at _____.

[Seal]

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 4

FEASIBILITY STUDY PHASE



NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 4: FEASIBILITY STUDY

ABOUT THIS MODULE

Module 4: Feasibility Study explains in detail how a municipality should carry out a feasibility study to decide on the appropriate delivery option for the proposed project.

These Guidelines set out the feasibility study elements required by both the Municipal System Act (MSA) and the Municipal Finance Management Act (MFMA) for three basic types of projects, including PPPs:

1. Those involving the delivery of a “municipal service”, as listed in Module 3
2. Those involving performance of a “municipal support activity”, as described in Module 3
3. Those involving “the use of state property by a private party for its own commercial purposes”.

In both a municipal service and a municipal support activity project, the municipality sets delivery objectives and pays the private party for the delivery, usually in the form of a unitary payment (for example, for water and sanitation). In PPPs involving the use of state property, a municipality’s assets – land, equipment or intellectual property – are used to generate revenue for the municipality (for example, giving concessions on conservation land to private eco-tourism operators in return for a share of revenues). There are also hybrid projects that combine these types.

“Municipal service” feasibility studies involve the completion of internal and external mechanism assessments in terms of section 78 of the MSA including an in-depth value assessment, which could involve the creation of a public sector comparator (PSC). “Municipal support activity” feasibility studies are conducted in terms of section 120 of the MFMA and, where relevant, could involve the creation and analysis of a PSC. “Use of state property” feasibility studies do not require the development of a PSC.

All PPP projects require a feasibility study as do those projects envisaging the provision of a municipal service by an external mechanism that is not a PPP.

Municipalities and advisers should follow the feasibility study stages and steps presented in this module substantively for all types of delivery options. Specific project adaptations will be worked out in conjunction with the municipal desk at the National Treasury’s PPP unit.

SUMMARY OF APPLICABLE LEGISLATION

Two acts may be applicable to a feasibility study undertaken by a municipality. The applicable legislation depends on whether the activity in question is a “municipal service” or a “municipal support activity”. If it is a municipal support activity, the MFMA applies; if it is a municipal service then both the MFMA and MSA apply¹.

As used in these Guidelines, the term “feasibility study” includes both the “internal” and “external” mechanism assessments described in section 78 (1) and (3) of the MSA and the feasibility study described in section 120 of the MFMA and the Municipal PPP Regulations. A feasibility study conducted in terms of these Guidelines will therefore comply with the feasibility study requirements of both the MSA and the MFMA.

Module 1 provides a detailed summary of the applicable legislation.

Need for a combined guideline

A decision to employ an external service-delivery mechanism, including a PPP, requires a municipality to complete a feasibility study according to provisions of the MFMA and, in cases involving municipal services, the MSA. These two acts were passed four years apart and contain numerous provisions, many of which are similar. These Guidelines combine in one document the requirements of the two acts, harmonising them and providing sufficient detail to many of their general provisions. Where the acts do not address a specific issue, guidance is provided.

Although there are significant differences in the terminology of the two acts, the feasibility study provisions required to investigate potential service-delivery options and PPPs are quite similar and a common guideline is applicable. If at any time during the conduct of a feasibility study, the municipality decides to pursue an internal service-delivery option, or an external option other than a PPP, then the remainder of the feasibility study follows only the MSA provisions and the provisions of section 120 of the MFMA no longer apply.

1. See the definition of MSP in Module 1: Regulations

MUNICIPAL PPP PROJECT CYCLE

**Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000**

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: IIB

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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A glossary and list of acronyms are provided at the beginning of Module 1.

INTRODUCTION

The feasibility study assesses which of several different service-delivery methods is in the best interests of a municipality.² A feasibility study needs to be authentic and thorough. It is not merely a bureaucratic requirement, but provides the basis for the council to make an important investment decision.

The MSA, MFMA and good practice dictate that a feasibility study be undertaken when assessing any external service-delivery mechanism.³ The scope of the study is determined when the adviser's terms of reference are developed (see Module 3). It is important to bear in mind, in relation to the following guidance, that the scope of the feasibility study may be different for a “municipal services” project, a “municipal support activity” project and a “use of state lands/new municipal support activity” project.

The feasibility study is a critical part of the project preparation period:

- It provides information about costs (explicit and hidden), and indicates whether costs can be met from within municipal budgets without disruptions to other activities
- It allows for the identification, quantification, mitigation and allocation of risks
- It prompts municipalities to consider how the project will be structured
- It identifies constraints that may cause the project to be halted
- It ensures that a proper business plan is developed for the project.

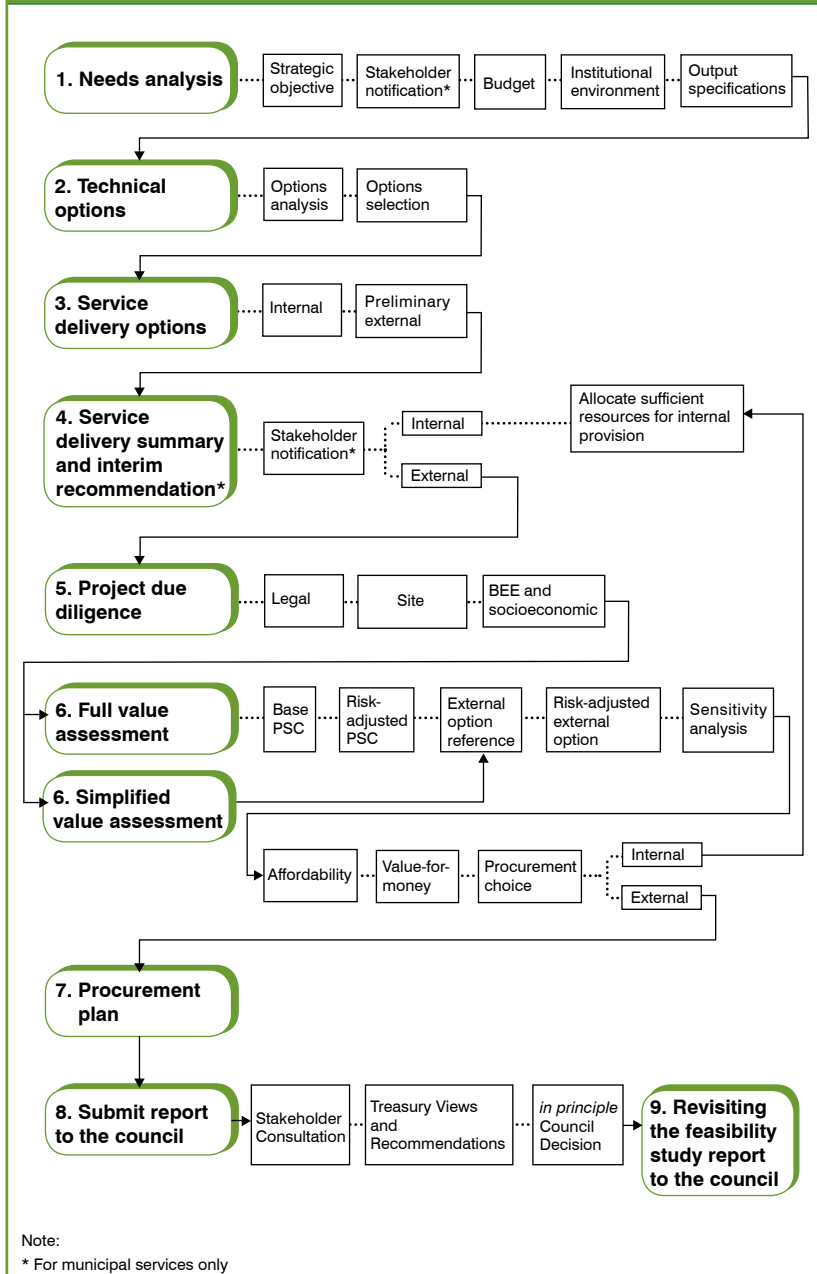
A feasibility study is an evolving, dynamic process. While it is done primarily to decide the optimum service-delivery option, it is also used in a PPP throughout the procurement phase: for continuous risk tracking; and to determine value for money and affordability at later stages in the PPP procurement process.

Figure 4.1 shows the stages of the feasibility study. The text that follows explains in detail the steps and deliverables for each stage. Working through the eight stages – following the steps closely and providing the deliverables – will ensure that the municipality provides the relevant stakeholders with all the information required to assess the proposed project for TVR I, and will avoid delays caused by incorrect or missing information.

2. The means of service delivery include an “internal mechanism” or an “external mechanism”. An “external mechanism” is further defined to include a municipal entity, another municipality, an organ of state, a community-based organisation or other non-governmental organisation or “any other institution, entity or person legally competent to operate a business activity”. Section 76 (b) of the MSA.

3. Section 78 (3) (c) of the MSA.

Figure 4.1: Stages of the feasibility



PUBLIC PARTICIPATION

Public participation is an important aspect of any service delivery project. The MSA and MFMA both include provisions for public participation at various stages in the feasibility study process. The following public participation guidelines are the **minimum** requirements. Nothing in these minimum guidelines prevents a municipality from implementing a public participation programme that exceeds these minimum guidelines. It is also noted that public participation should have occurred in the early phases of the process, such as in the preparation of the IDP and relevant sectoral plans, as well as in the environmental impact assessment process.

- **Public participation for municipal services**

- **Project inception** – No notifications required
- **Feasibility Study** –

- Step 1: The needs analysis**

1. Obtain views of organised labour. Written comments/views requested within 21 days of notification. Section 78(1)(a)(v) of the MSA. See labour notifications for details.
2. Meet the public notification and participation requirements of other related national departments including DWAF and DEAT based on the sector involved (e.g., water, solid waste).

- Step 2: Delivery mechanism summary**

The following shall apply only if an MSA section 78(2) decision is taken to investigate one or more external service-delivery options.

1. General public notification with written comments requested within 21 days of notification. Section 78 (3)(b)(iii) of the MSA. Format in accordance with section 21(1) to (5) of the MSA.
2. Obtain views of organised labour. Written comments/views should be requested within 21 days of notification. Section 78(3)(b)(v) of the MSA. See labour notifications for details.
3. Hold three informational meetings, one for the general public and two for organised labour (one of which should include all affected staff). Date and place of the informational meetings to be published in the notices listed in 1 and 2 above. See conduct of informational meetings for details.

Step 3: Submit feasibility study report

1. General public notification with written comments requested within 30 days of notification. Section 120(6)(b)(i and ii) of the MFMA. Format in accordance with section 21(1) to (5) of the MSA.
- **Public participation for municipal support activities/private sector use of municipal property**
 - **Submit feasibility study report**
 1. General public notification with written comments requested within 30 days of notification. Section 120(6)(b)(i and ii) of the MFMA. Format in accordance with section 21(1) to (5) of the MSA.

Public notifications and comments

General public notifications and comments should be made in accordance with the provisions of section 21(1) to (5) of the MSA. All notifications should include a fact sheet or summary of the subject matter for which the notification was issued. If the notification involves a specific document, it should be made available in accordance with sections 21A and 21B of the MSA. Comments must be received at the place and within the time identified within the notification. Failure to provide written comments within the allocated time shall be considered as having no objection to the matter under consideration. All comments received by the municipality shall be recorded and taken into account within the appropriate context of the feasibility study. It is also important to show that these comments were considered and how such consideration resulted in application. There is always a risk of challenge under administrative law on the grounds that the comments were not considered with an appropriate “application of mind”.

Labour notifications and meetings

All interactions with organised labour should be undertaken through the municipality’s labour relations structures and addressed to local offices of those trade unions formally recognised by the municipality. It is recommended that requests for views be sent by registered mail, return receipt requested. All requests should include a fact sheet or summary of the subject matter for which the request was issued. If the request involves a specific document, it should be included in the notification. Comments must be received at the place and within the time identified within the request for views. Failure to provide written views within the allocated time should be considered as having no objection to the matter

under consideration. All views received by the municipality should be recorded and taken into account within the appropriate context of the feasibility study.

For the purposes of obtaining and taking into account the views of organised labour relative to external basic municipal service-delivery options in accordance with sections 78(1)(v) and 78(3)(v) of the MSA, it is recommended the municipality conduct two meetings. The first meeting should be an informational meeting, during which the project will be presented along with all pertinent labour issues. A second consultative meeting should be held not less than two weeks nor more than four weeks from the first meeting to hear labour's views on the service-delivery options. In addition to views received during the consultative meeting, the comment period should remain open for an additional 10 days.

All labour meetings shall be conducted within the framework and provisions of the South African Local Government Bargaining Council Organisation Rights Agreement, 2003.

Conduct of public informational meetings

One or more informational meetings are called for in the public participation programmes. All meetings should be held at convenient locations within the community to be affected by the proposed activity. Meetings shall be noticed and conducted in accordance with the appropriate provisions of MSA Chapter 4. Informational meetings should include a presentation by the municipality or their advisers explaining the reason for the meeting, highlighting the key issues and public impacts of the activity. It is advisable that the councillors associated with the service and the affected wards be part of the presentation team. A handout document shall also be prepared for distribution at the meeting. The presentation of the key issues should be followed by a question-and-answer period where the general public will be given the opportunity to ask specific questions regarding the proposed activities. All notifications should include a fact sheet or summary of the subject matter for which the notification was issued. If the notification involves a specific document, it shall be made available in accordance with sections 21A and 21B of the MSA. Comments must be received at the place and within the time identified within the notification. Failure to provide written comments within the allocated time shall be considered as having no objection to the matter under consideration. All comments received by the municipality should be recorded and taken into account within the appropriate context of the feasibility study.

STAGE 1: THE NEEDS ANALYSIS

The needs analysis gives definition to the proposed project, preparing the way for the technical solution options analysis in Stage 2. The needs analysis performed as part of the municipality's Integrated Development Plan (IDP) will have been considered during the inception phase. During the feasibility study it will be thoroughly investigated.

Part 1: Demonstrate that the project aligns with the municipality's strategic objectives

Step 1: Summarise the municipality's mission and vision statements, its strategic objectives and government policy that determines what the municipality's deliverables are.

Step 2: Discuss the following aspects of the project, in terms of needs:

Needs identified in the IDP or by an MSA section 77 trigger:

Every municipality is required to complete an IDP to identify gaps in municipal services and establish a plan to eliminate these gaps. The gaps may be in an existing or a new activity. The implementation plan must prioritise the service-delivery gaps and present recommendations to address them. In general, gaps in meeting municipal services carry a higher priority than those meeting municipal support activities.

In addition to project identification through the IDP planning process, projects or activities requiring a feasibility study can be mandated by the MSA "trigger" mechanisms in section 77 of the MSA.

Chapter 8, section 77 of the MSA defines when a municipality must perform a feasibility study for delivering a municipal service. These trigger mechanisms are time-based and define key changes in the scale of the municipal service being considered or how the service is performed. The triggers are also based on whether the change in a specific municipal service will affect a municipality's finances, performance risks or its relationships with organised public labour. If an existing municipal service or a new municipal service meets one or more of the nine trigger mechanisms, the municipality is obliged to begin the feasibility study under section 78 of the MSA.

The mechanisms triggering feasibility studies in Section 120 of the MFMA are much narrower. Although the MFMA covers municipal support activities

as well as municipal services, the municipality only follows section 120 of the MFMA provisions if it is to consider a PPP of a particular municipal service or municipal support activity. In contrast, sections 77 and 78 of the MSA require a feasibility study regardless of how the municipal service is currently provided or the council's future intentions.

In addition, the following matters must be discussed:

- How does the project contribute to the implementation of government and municipal policy?
- What is the anticipated budget or capital expenditure required for the project?
- What are the potential cost savings for the municipality?
- Will the proposed project meet the municipality's needs in the time required?

Part 2: Identify and analyse the available budget

This analysis must include:

- A discussion of any assumptions about future budgetary commitments required from the municipality – how much will be required over what period, escalating in line with the consumer price index (CPIX).
- A discussion of any consolidation of budgets. These budgets may be internal to the municipality but may also involve identification of budgets in other public entities.
- A list of the line items in the municipality's budget for costs that may no longer be incurred because of the proposed project.
- An understanding of all revenues available to the municipality from its own funds, grants and subsidies from central government, and all other available sources.
- For activities in which user charges are collected, a discussion on billing, payment levels and tariffs, and comment on the potential to increase cash income generated.

Affordability is a cornerstone of the feasibility study phase. As a result, the budget for the project will be revisited at various stages in the feasibility study.

Refer to the National Treasury's directives on budget preparation in terms of the MFMA.

Part 3: Demonstrate the municipality's commitment and capacity

It needs to be clear that the municipality can manage, process, evaluate, negotiate and implement the project.

Step 1: Provide information on the project officer, project team and the adviser:

1. The project officer and project team <ul style="list-style-type: none">• The names of the municipality's project team members• Their roles in the project• Their relevant skills• Brief CVs• The budget available for project management.	2. The adviser <ul style="list-style-type: none">• The names of the members of the adviser's team• Their roles in the project• Their relevant skills• Brief CVs• The budget available for the adviser.
3. An assessment of <ul style="list-style-type: none">• Lines of decision-making within the municipality, particularly between project officer, senior management and the accounting officer• Any areas where a lack of capacity exists, in the project team or in the adviser• A plan on how the lack of capacity will be addressed throughout the project process• The plans for skills transfer from the adviser to the project team at various stages of the project• How staff turnover will be managed.	

Step 2:

1. Provide information on key stakeholders

Possible key stakeholders include:

- Those within the municipality
- Other government departments
- Other spheres of government
- Organised labour
- Third parties
- The public.

2. Describe the nature of each relationship and the project's impact on each stakeholder

In particular, identify anticipated effects on the funding, resources or processes of key stakeholders. This is important for ensuring that the project aligns with sector policy and long-term planning. For example, in a water services project, DWAF would be a key stakeholder and would provide

guidance on forward planning, be able to share experience gained from other areas, provide assistance on matters of water resources and effluent disposal and help identify effects on the regional and national provision of water services.

3. Include a consultation plan

The plan should detail how and when an appropriate level of consultation will take place during the project preparation period, and how the views and contributions of key stakeholders will be incorporated. Include the results of any consultation the municipality has already undertaken, and any required agreement obtained from other government stakeholders.

Part 4: Specify the outputs

Once the municipality's objectives and budget have been identified, and its commitment and capacity demonstrated, the outputs of the proposed project need to be specified.

Input vs. output: Conventional procurement vs. PPP procurement

Conventional procurement specifies the input

With conventional procurement, the municipality appoints consultants who prepare detailed specifications that describe the infrastructure required to deliver a project. The required infrastructure is then put out to tender. Once the contract is awarded, the municipality supervises the construction of the infrastructure to ensure compliance with the tender specifications. The municipality is therefore responsible for the design and planning of the project, all statutory requirements (such as environmental and heritage approvals and town planning regulations), and any unforeseen costs that may arise. The contractor is only responsible for what is covered by the tender specifications, or anything that could reasonably have been foreseen. Specifying inputs excludes the possibility for alternative solutions which bidders could come up with, and may inhibit innovation. Risk allocation will be affected as the specified input may prevent appropriate risk transfer.

PPP procurement specifies the output

The key element of a PPP project is the definition of a municipal activity through specifying the output(s). The municipality leaves the design of the infrastructure required to deliver the output to the private party selected through a bidding process. For policy or strategic reasons, the requirements may not be left entirely to the discretion of the private party, and in these circumstances the municipality may specify some inputs. PPP projects should, however, be driven substantially by output specifications, which allow for optimal risk transfer to the private party, ensuring greater value for money for the municipality. Defining the activity through specifying the outputs requires the municipality to assess what it needs to achieve, rather than how to achieve it.

Step 1: Describe the activity that the municipality needs to undertake

Step 2: Specify the outputs required to deliver that activity

Step 3: Specify the minimum standards for the outputs

This will ensure that the service delivered by the project meets the municipality's expectations.

Step 4: Assess whether the output specifications can meet the municipality's ongoing needs for that activity

It may be necessary to specify to what extent the project must provide a flexible solution.

Step 5: Specify key indicators that will measure performance

This will allow for more accurate costing of the output specifications.

Step 6: Identify service interface expectations

This concerns the interface between the project and the municipality's other services.

Step 7: List the BEE and socioeconomic targets for the project

Use the scorecard in Module 2: Code of Good Practice for BEE in PPPs as a reference.

Part 5: Define the project

In light of the municipality's needs, strategic objectives and output specifications, give a brief definition of the proposed scope of the project. This concise outline of the municipality's requirements will allow for the selection of reasonable solution options.

Briefly set out:

- A summary of how the project objectives will address the municipality's strategic objectives, as determined in part 1
- A summary of the output specifications, as determined in part 4
- A list of significant municipal assets that will be used for the project (such as land and equipment).

STAGE 2: THE TECHNICAL SOLUTION OPTIONS ANALYSIS

This portion of the feasibility study will be very project specific and depend on how the project was initiated.

If the project is an MSA 78(1) review of an existing municipal service, required by one or more MSA 77 triggers, then most of the technical options analysis does not apply since the MSA 78(1) review focuses primarily on service-delivery options. If the MSA 78(1) review is triggered by a significant expansion or upgrade of the municipal service, then technical options may need to be assessed.

If, however, the project feasibility study is initiated through the municipality's IDP needs analysis as a gap in its service delivery, there may be a range of technical options for filling that gap that will require assessment.

Choosing the best way of responding to a need: The technical solution first, then the procurement/service delivery choice

The solution options analysis sets out the range of possible technical, legal and financial options for delivering the required activity to the output specifications, allowing the municipality to weigh up the options and make a choice.

For example, if a municipality needs to provide additional potable bulk water capacity, the solution options might be:

- To optimise the current potable water treatment facility and reduce water losses
- To purchase water from an external provider such as a Water Board
- To construct a new potable water treatment facility.

If the municipality decides the **optimisation option** is the best technical solution, it will compare how well the service-delivery options will achieve the output specification. If an external option does not offer any advantages, it does not need to proceed with the next stages in the project life cycle. As this is an internal option, the municipality does not need to obtain the views and recommendations of the National Treasury.⁴

If the municipality decides the **Water Board option** is the best option, it would need to proceed to the value assessment stage, as this is an external option, and if the study shows that there is value for money, enter into a service-delivery agreement with the Water Board. As this is not a PPP, the municipality would only have to obtain the views and recommendations of the National Treasury if the contract exceeded the three-year term defined in section 33 of the MFMA.⁵

For the construction of a new potable water treatment facility, the municipality may either construct the new facility on a traditional basis, or enter into a PPP where a private party would finance, construct and operate and maintain the facility for a period of years. If the municipality decides that its preferred solution option is to build a new facility, and maintain and operate it, the value assessment stage (stage 4) of the feasibility study will explore the two procurement options: the municipality doing the construction and operating and maintaining the facility itself, and a private party doing it on behalf of the municipality. The choice of whether to procure the solution option as a PPP can only be made after this stage.

4. Good practice dictates that any investment or procurement decision should be backed up by a thorough feasibility study.
5. Section 80(3) of the MSA.

In the technical solution options analysis stage, municipalities will still not be in a position to make the decision about whether a PPP is the best way to procure the preferred technical solution option. In the technical solution options analysis, the municipality identifies and evaluates the various technical options for meeting its needs. It then recommends one of the technical options and performs a service-delivery options analysis (Stage 3) which gives an indication of whether it might be suitable for a PPP. After the project due diligence (Stage 5), comes the detailed work in the value assessment (Stage 6) required to make the decision about whether to pursue a PPP.

Take note

A PPP is not a technical solution option. A PPP may be a procurement choice for a preferred technical solution option.

The technical solution options analysis

Step 1: List all the technical solution options the municipality has considered
Step 2: Evaluate each technical solution option
Step 3: Choose the best technical solution option

Step 1: List all the technical solution options the municipality has considered

The list must cover the range of the most viable technical solution options for providing the specified outputs of the required activity.

Step 2: Evaluate each technical solution option

The purpose of the evaluation is to:

- Identify the advantages and disadvantages of each technical solution option
- Examine the risks to, benefits for and effects on the municipality associated with each technical solution option.

For each technical solution option, discuss the following, as appropriate:

1. Brief description

Briefly describe each technical solution option. Include an outline of the alignment between each option and the municipality's strategic plan, the activity it needs to deliver, and how well the solution meets the output specifications.

2. Financial impacts

Provide a preliminary view and discussion on the financial impacts of each option. For example, show the estimated initial capital expenditure, and the likely capital and operational costs over the full project cycle. (This preliminary analysis of financial impacts will provide a basis for the detailed work to come in Stage 4.)

3. Funding and affordability

How is each option to be funded? Which options are affordable? Where a contribution other than from the municipality is anticipated, this must correspond to the published medium-term expenditure framework, be in accordance with the municipality's borrowing capacity, or with specific grant or subsidy agreements. Indicate how an external procurement is likely to be financed (for example, project finance or corporate finance). The payment mechanisms (conventional budgetary, unitary payment, user pays, revenue-generating, hybrid) that may be possible for each option should also be briefly discussed.

4. Risk

Present a preliminary discussion about the risks to the municipality in relation to each option. (Stage 5: part 2 covers risk in detail.) The discussion should specifically identify the risks that may be passed efficiently to a private party.

5. BEE and other socioeconomic aspects

Provide a preliminary view on the impact of each option on the BEE targets set out in the outputs specifications, and other socioeconomic objectives the municipality may wish to achieve in the project. (Stage 5: Part 3 covers BEE in detail.)

6. Delivery arrangements

Discuss the delivery arrangements for each option, and analyse the implications of each option for optimal interface between delivery mechanisms. For example, if the municipality is assessing its options for expanded potable water delivery, how would each technical solution option deal with the integration of existing delivery mechanisms?

7. Transitional management issues

Discuss the issues that may arise in the handover from existing management arrangements in each technical solution option. For example, each technical solution option for increasing potable water capacity will have implications for how a municipality's reticulation systems are managed in the transition from the existing to the new.

8. Technical analysis

Present a comprehensive technical analysis for each technical solution option, including a municipal supply chain/interface analysis. Include an assessment of the proposed technology and its appropriateness for each technical solution option.

9. Site issues

If a technical solution option involves a physical site, issues concerning land procurement must be identified at this stage. These include land use rights, zoning rights, geotechnical and environmental issues, heritage legislation and alignment with the IDP. (Stage 4 looks at these issues in detail, but they must be identified for each technical solution option.) The likelihood of being able to resolve all site issues during the course of the feasibility study phase is a key factor in deciding on a preferred technical solution option if an external procurement is possible. The preference is to resolve all site issues during the feasibility study, before TVR I is granted.

10. Legislation and regulations

Does a particular option comply with relevant legislation and regulations? Analyse, firstly, procurement legislation and regulations, and, secondly, sector-specific legislation and regulations, such as environmental impact assessment requirements, which may affect the project, to establish a compliance list against which each option can be measured. A private party may not legally perform certain technical solution options. For example, only a municipal council may set water services tariffs, which may have an impact on a municipality's ability to pay a unitary fee for potable water services. In Stage 4, legal issues are discussed in detail. At this stage, what is required is a brief, high-level analysis.

11. Human resources

- Establish the numbers and cost of existing municipal staff that will be affected in each technical solution option, do a skills and experience audit and establish the key human resources issues for the project.
- Design and implement a suitable communication strategy for the municipality to keep staff informed of the project investigations, as required by labour law.
- Assess the following for each option, where relevant:
 - Relevant legislation and case law
 - Organised labour agreements
 - The cost of transferring staff, if applicable
 - An actuarial study of accrued benefits that may be transferred and the timing thereof
 - An initial view on the potential willingness of both staff and private parties to implement transfers.

12. Qualitative factors

There will be a number of qualitative benefits associated with a particular option, such as job creation, technology transfer and early availability of services, which may not be quantifiable and may not be considered

as offsetting costs. While financial considerations are likely to drive the affordability test in Stage 5 of the feasibility study, it is important to identify these qualitative factors early on.

13. Early considerations of suitability for external service delivery

Not all technical solution options are ideal external options. At this stage it is useful to consider whether various options, if done externally, can deliver value for money.

- **Scale**

The net present cost of the probable cash flows should be large enough to allow both the public and the private parties to achieve value-for-money outputs given the likely levels of adviser and other costs.

- **Outputs specification**

It must be possible to specify outputs in clear and measurable terms, and structure a payment mechanism accordingly.

- **Opportunities for risk transfer**

The allocation of risk to a private party is a primary driver of value for money in an external option. Where opportunities for allocating risk to the private party are limited, the potential for the external option to deliver value for money compared with a conventional procurement choice is reduced.

- **Market capability and appetite**

The project must be commercially viable and there must be a level of market interest.

Step 3: Choose the best technical solution option

Each technical solution option has now been evaluated. Use a matrix approach to evaluate the best option. (Use the list of items in step 2.) In this final step of the technical solution options analysis stage, recommend which option(s) should be pursued to the next stage.

If it appears that the preferred technical solution option can be procured externally, it will be fully tested in Stage 6 of the feasibility study; the preferred option may change in light of this test. If, after Stage 6, the preferred solution option is not affordable, it may be necessary to revisit the technical solution options analysis. If the preferred technical solution option cannot be procured through an external option, the municipality should discuss its subsequent feasibility study method with the relevant treasury.

It is preferable that only one technical solution option is chosen, and no more than two. If more than one option is recommended for which external options may be possible, each must be separately assessed in Stage 6.

STAGE 3: SERVICE DELIVERY OPTIONS ANALYSIS

Once the preferred technical solution is determined, it is time to evaluate and recommend a preferred service delivery option. The project delivery options are set out in section 76 (b) of the MSA and include:

- An internal mechanism, which may be:
 - A department or other administrative unit within its administration
 - Any business unit devised by the municipality, provided it operates within the municipality's administration and under the control of the council in accordance with operational and performance criteria determined by the council
 - Any other component of its administration.
- An external mechanism, by entering into an agreement with:
 - A municipal entity
 - Another municipality
 - An organ of state, including
 - A water services committee established in terms of the Water Services Act (1997)
 - A licensed service provider registered or recognised in terms of national legislation
 - A traditional authority
 - A community-based organisation or other non-governmental organisation legally competent to enter into such an agreement
 - Any other institution, entity or person legally competent to operate a business activity.

Municipalities will still not be in a position to make the decision about which service delivery option is the best way to procure the preferred technical solution option. In the service delivery options analysis, which can be undertaken consecutively, the municipality identifies and evaluates the various potential service provider options for meeting the municipality's needs, including an internal mechanism assessment as required by section 78 (1) of the MSA. It then recommends one of the options. If the option recommended is an external mechanism, after due diligence (Stage 5) comes the detailed work in the value assessment (Stage 6) required to make a decision as to whether an internal mechanism or an MSP, including a PPP, is appropriate.

The delivery options analysis

Step 1: List all the service delivery options the municipality has considered

Step 2: Evaluate each delivery option

Step 3: Choose the best delivery options

Step 1: List all the service-delivery options the municipality has considered

The list should address the most viable delivery options for providing the specified outputs of the required activity. Not every possible delivery option may be viable. For instance, if the output specification requires a large capital investment programme, it is unlikely that an NGO can access the finance required.

Step 2: Evaluate each delivery option

The purpose of the evaluation is to:

- Identify the advantages and disadvantages of each delivery option
- In a “municipal service” project, this would include an assessment of the service provider’s capacity to furnish the skills, expertise and resources necessary for the provision of the service; the likely impact on development, job creation and employment patterns; and the views of organised labour
- Examine the risks to, benefits for and effects on the municipality of each option.

The following should be considered, where relevant, in evaluating the viable delivery options. Note that sections 78(1) and (2) of the MSA considerations for assessment of internal and external options have been incorporated in the list below.

1. Brief description

Briefly describe each delivery option.

2. Direct and indirect costs

Briefly outline the direct and indirect costs.

3. Financial impacts

Provide a preliminary view and discussion on the financial impacts on the municipality. For example, show the estimated initial capital expenditure, and the likely capital and operational costs over the full project cycle that would be incurred by the municipality and by the service provider.

4. Funding and affordability

How will each delivery option obtain funding for any expenditure requirements? Are the municipality's costs and/or payments affordable?

5. Human resource and organisational capacity

- Determine the human resource requirements
- Determine the capacity of the delivery option to meet the human resource requirements; do a numbers, skills and experience audit if necessary
- Determine, in the case of internal mechanisms, whether reorganisation of administration and development of human resource capacity could be used to provide the service
- Establish the numbers and cost of existing municipal staff that will be affected by each service-delivery option
- Establish key human resource issues
- Assess the following for each option, where relevant:
 - Relevant legislation and case law
 - Organised labour agreements
 - The cost of transferring staff, if applicable
 - An actuarial study of accrued benefits that may be transferred, and timing of them.
 - An initial view on the willingness of staff and the various institutions to implement transfers.

6. Risk

Discuss each service provider's ability to accept the envisioned risks to be transferred. The discussion should specifically identify the risks that may be passed efficiently to the service provider and its capacity to undertake them.

7. Qualitative factors

As with the technical solution options analysis, there will be a number of qualitative and indirect benefits associated with a particular option and these may not be quantifiable or considered as offsetting costs. It is important to identify such factors early on. Considerations may include:

- Job creation and impact on employment patterns
- Impact on environment
- Skills transfer
- Early delivery of service.

8. BEE and other socioeconomic aspects

Provide a preliminary view of the impact of each service delivery option on the BEE targets set out in the outputs specifications, and other socioeconomic

objectives the municipality may wish to achieve in the project. Is the service provider capable of meeting these goals? (See Stage 5: part 3.)

9. Delivery arrangements

Discuss how each service provider will undertake the envisioned delivery, and analyse the implications of each option for optimal interface between delivery mechanisms.

10. Transitional management issues

Discuss the issues that may arise in the handover from existing management arrangements in each service delivery option. For example, each delivery option for increased potable water capacity will have implications for how the municipality manages the other components of its water services delivery plan.

11. Legislation and regulations

Does a particular delivery option comply with the relevant legislation and regulations? Analyse, firstly, procurement legislation and regulations and, secondly, relevant sector-specific legislation and regulations to assess the service provider's ability to meet legislative requirements. Certain service providers may have to undertake additional actions before becoming a delivery provider for a municipality. In Stage 4, the legal issues for the chosen option will be dealt with comprehensively. At this stage, what is required is a brief, high-level analysis.

12. Capability and appetite

Assess each delivery option using the following considerations:

- Is there the capability within the service provider to undertake the required delivery?
- Will the delivery be sufficiently reliable?
- Is it possible that such delivery would provide value for money?
- What are the BEE enterprises in the sectors and are BEE charters being implemented?
- Are there local service providers available to undertake this project?
- What market competition is there for this type of project?
- Do the output specifications restrict which service providers can be used? (It may be appropriate to use a form of market testing for the potential non-governmental service providers being considered, such as an Expression of Interest.)

One can use a matrix approach to compare delivery options. A sample matrix is provided below:

Table 4.1: Delivery options			
Option	Advantages	Disadvantages	Risk transfer
A department or administrative unit (internal mechanism)	<ul style="list-style-type: none"> • If can restructure, then in-house capacity strengthened 	<ul style="list-style-type: none"> • Lack of capacity • Lack of fundraising ability 	<ul style="list-style-type: none"> • No risk transfer
Business unit (internal mechanism)	<ul style="list-style-type: none"> • Can provide a one-point service • Can align the income and expenditure nature of the trading service • Can allow for a more devolved decision making process 	<ul style="list-style-type: none"> • Could lead to a duplication of certain functions and the reduction of responsibilities of other departments in the municipality • Limited capacity • Lack of fundraising ability 	<ul style="list-style-type: none"> • No risk transfer
Municipal entity (MSP)	<ul style="list-style-type: none"> • Ring-fenced entity with total responsibility for service delivery 	<ul style="list-style-type: none"> • Limited ability to raise on funding • Possible issues on staff and asset transfer 	<ul style="list-style-type: none"> • Ultimate risk stays with the municipality
Another municipality (MSP)	<ul style="list-style-type: none"> • Established service delivery organisation 	<ul style="list-style-type: none"> • Lack of capacity, lack of fundraising ability 	<ul style="list-style-type: none"> • Some risks can be transferred. Financial risk cannot
Organ of state – licensed service provider (MSP)	<ul style="list-style-type: none"> • Technical and managerial skills 	<ul style="list-style-type: none"> • Lack of fundraising ability 	<ul style="list-style-type: none"> • Some risk can be transferred. Financial risk cannot
Organ of state – traditional authority (MSP)	<ul style="list-style-type: none"> • Local community knowledge 	<ul style="list-style-type: none"> • Lack of fundraising ability 	<ul style="list-style-type: none"> • Little risk transfer
CBO or NGO (PPP)	<ul style="list-style-type: none"> • Local community knowledge 	<ul style="list-style-type: none"> • Lack of fundraising ability 	<ul style="list-style-type: none"> • Little risk transfer
Other institution, entity or person legally competent (PPP)	<ul style="list-style-type: none"> • Private sector expertise • Fund raising ability 	<ul style="list-style-type: none"> • Requires robust contract management by the municipality • Politically more difficult 	<ul style="list-style-type: none"> • Significant technical, operational and financial risks can be transferred

Step 3: Choose the best delivery options

Each delivery option has now been evaluated. It is preferable that only two delivery options are chosen. If more than two options are recommended each must be tested in the value assessment. Before the study proceeds to the due diligence and value assessment stages, the results of the service delivery options must be presented to the municipality, which will make a decision whether it will opt for an internal option or proceed with a more in-depth value assessment. If an external option is chosen, the value assessment will depend on the legislative requirements specific to that external option.

STAGE 4: DELIVERY MECHANISM SUMMARY AND INTERIM RECOMMENDATIONS

The harmonisation of sections 77 and 78 of the MSA with section 120 of the MFMA requires a decision at this point in the feasibility study.

Since the MSA section 77 trigger mechanisms are very broad, there may be many existing internal projects required to do an MSA internal review, which the municipality is not considering for external service delivery. A review of MSA triggers indicates that just the significant upgrade, extension or improvement of an internal municipal service will trigger an MSA internal review, even though the municipality is completely satisfied with the internal delivery and has no intention of considering external options.

The feasibility study process must give the municipality the option of completing its MSA internal review by accepting an internal service delivery option. Having made that decision, the municipality must meet the requirements of section 79 of the MSA regarding allocating sufficient human, financial, and other resources necessary for the proper provision of the service.

If the municipality opts for an internal mechanism at this point, and the project is never considered for an external option, there are no external requirements in terms of section 120 of the MFMA and MSA to consider and the feasibility study is terminated. If the municipality decides to consider one or more external options including an MSP or a PPP, the feasibility study continues with Stage 5. Where the municipality decides to consider one or more external options, the following should be undertaken:

Step1: Summarise the evaluations and findings of Stages 1 to 4

At this point, the needs analysis has been completed, the output specifications have been completed, project goals are well defined and the best technical option has been identified. Service-delivery options for implementing the preferred technical option have been presented along with the advantages and disadvantages, and a recommendation made. Although the preliminary financial impacts of both the technical and service-delivery options have been discussed, the more detailed value assessment has not been performed. The evaluations and findings of Stages 1 to 4 are summarised in a brief concise report and submitted to the municipal manager for a decision in terms of section 78(2) of the MSA.

Step 2: MSA section 78(2) decision

In accordance with section 78(2) of the MSA, the municipality, through its delegated agent, the municipal manager, may select an internal service-delivery option; continue with the assessment of internal as well as external options in accordance with section 78(3) of the MSA, and section 120 of the MFMA and the Municipal PPP Regulations; or may direct the feasibility study to discontinue the assessment of internal options and consider one or more external options in accordance with section 78(3) of the MSA, section 120 of the MFMA and the Municipal PPP Regulations. This step does not apply to municipal support activity feasibility studies.

If there has been no delegation to the municipal manager to continue with the assessment of one or more external mechanism options, then the municipality must prepare a report to council in terms of the findings of the feasibility study to date and request a council decision to assess them, before proceeding.

Step 3: Local community and labour notification

The municipality must notify both the local community and organised labour of its intentions, conduct informational meetings with each, solicit their views and take these views into account during the assessment of external service-delivery options. Details on notifications, conduct of informational meetings and receipt of comments are included in the public participation section appearing earlier in this module.

STAGE 5: DUE DILIGENCE

The due diligence stage aims to uncover any issues in the preferred technical solution and service delivery option that may significantly affect the proposed project.

Project due diligence

Step 1: Legal issues

Step 2: Site enablement issues

Step 3: BEE and other socioeconomic issues

Step 1: Legal issues

Experience has shown that legal issues not resolved during the feasibility study phase can create significant delays at the negotiations stage of the procurement phase, and in some cases have been significant impediments to concluding a service delivery agreement.

Although a preliminary legal analysis of each technical solution and service delivery option was done in the options analysis stage, a comprehensive legal due diligence of the preferred option must now be done to ensure that all foreseeable legal requirements are met for the development of the project. Although it may be costly to undertake a comprehensive legal due diligence of all aspects of the project in this early phase, it is ultimately worthwhile. Early legal certainty directly affects project costing in Stage 6 (consequently assisting in making the procurement choice) and reduces PPP bidding costs for all parties.

Common legal issues centre on use rights and regulatory matters. However, the municipality's legal advisers should conduct a thorough due diligence on all the legal issues that have a bearing on the project.

Use rights of the municipality

Obtain a legal opinion about the use of municipal property by another entity, including a private party in a possible PPP.

Take note

A municipality may not use PPPs to limit its responsibilities for performing its constitutionally mandated activities. Even though in a PPP the municipality contracts a complete or partial municipal support activity to the private party, the municipality remains accountable for efficient delivery.

Regulatory matters

The municipality performs its mandated functions within the regulations. Regulatory due diligence is only required for the PPP procurement choice. However, if the proposed project is a greenfield project and the municipality has never done this kind of project before, then a regulatory due diligence will be necessary for any kind of procurement.

Investigate any regulatory matters that may affect the private party's ability to deliver as expected. These may include:

- Tax legislation
- Labour legislation
- Environmental and heritage legislation
- Foreign exchange legislation
- Legislation governing the use of certain financial instruments
- Competition legislation
- Sector regulations, such as potable and wastewater treatment standards, solid waste transportation and disposal standards.

Step 2: Site enablement issues

Where a physical site is involved, indicate whether the municipality intends to specify a preferred site, nominate a definite site or leave the question of location open to bidders.

If the municipality nominates a particular site, it will need to identify, compile and verify all related approvals. The purpose is to uncover any problems that may affect the project's affordability and value for money, or cause regulatory delays at implementation.

Establish the following:

- Land ownership
- Land availability and any title deed endorsements
- Are there any land claims?
- Are there any lease interests in the land?

Where appropriate, appoint experts to undertake surveys of:

- Environmental matters
- Geo-technical matters
- Heritage matters
- Zoning rights and town planning requirements.

Where appropriate, establish that the necessary licenses, rights and approvals are in place (or obtainable) from the relevant sector departments (e.g., DWAF for new potable water and wastewater treatment works; DWAF and DEAT for solid waste disposal sites).

Step 3: BEE and other socioeconomic issues

Identify sectoral BEE conditions (for example, the extent to which BEE charters have been developed and implemented), black enterprise strength in the sector, and any factors that may constrain the achievement of the project's intended BEE outputs. Also identify socioeconomic factors in the project location that will need to be directly addressed in the project design.

STAGE 6: VALUE ASSESSMENT

This is the pivotal stage of the feasibility study. It enables the municipality to determine whether an external option or the internal option is the best procurement choice for the project. The three tests prescribed by both the MFMA and MSA are:

- Is it affordable?
- Does it appropriately transfer risk from the municipality to the private party?
- Does it provide value for money?

Value assessment terminology

Value for money means that the provision of a municipal service or function by a private party results in a net benefit to the municipality, defined in terms of cost, price, quality, quantity, or risk transfer, or a combination of these.

Full value assessment involves a value-for-money comparative assessment between a conventional public sector procurement and a PPP delivering the same output specifications. A risk-adjusted PSC model and external reference model must therefore be constructed for the chosen solution option. These provide costings of each procurement option in the form of a discounted cash-flow model adjusted for risk. In addition to costs, qualitative considerations may also be taken into account. This assessment also includes a determination of affordability.

A cost-benefit analysis is essentially the same as a value-for-money analysis whereby benefits are reflected in the output specifications and both quantitative and qualitative considerations are captured in the PSC and external reference models.

A PSC model is a costing of a project with specified outputs with the public sector as the supplier. Costs are based on recent, actual costs of a similar project, or best estimates.

An external reference model is a costing of a project with the identical specified outputs but with the private sector as supplier.

Comparing the two models enables a municipality to assess whether service delivery by government or by a private party yields the best value for the municipality. The three criteria are affordability, risk transfer and value for money.

A simplified value-for-money analysis is determined by assessing whether value-for-money drivers are demonstrated in the external reference model. Qualitative considerations under this analysis often take increased importance as cost differences between options may be difficult to quantify.

Risk

Risk is inherent in every project. Conventional public sector procurement has tended not to take risk into account adequately, often resulting in unbudgeted cost overruns. In a PPP, the private party manages and costs the risks inherent in the project differently. The treatment of risk in the project is a key aspect of the value assessment.

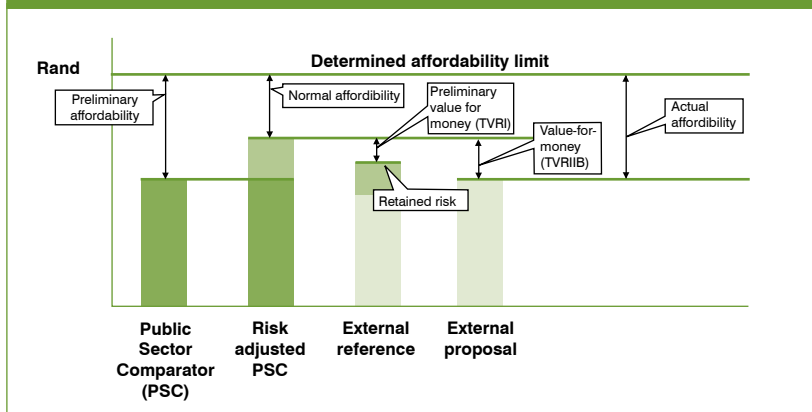
Affordability is whether the cost of the project over the whole project term can be accommodated in the municipality's budget, given its existing commitments.

Value for money is a necessary condition for PPP procurement, but not a sufficient one. Affordability is the driving constraint in PPP projects.

Demonstrating affordability

As a preliminary analysis of affordability, the risk-adjusted PSC model is compared with the municipality's budget. Then the risk-adjusted external reference model is compared with the municipality's budget. If the project is not affordable, the municipality may modify the output specifications or may have to abandon the project.

Figure 4.2: Affordability and value for money



Value assessment

- Part 1: Determine the type of value-for-money assessment
- Part 2: Construct the base PSC model (full VfM)
- Part 3: Construct the risk-adjusted PSC model (full VfM)
- Part 4: Construct the external reference model
- Part 5: Construct the risk-adjusted external reference model
- Part 6: Qualitative considerations
- Part 7: Sensitivity analysis
- Part 8: Demonstrate affordability
- Part 9: Initial value-for-money test
- Part 10: Verify information and sign off
- Part 11: Make the procurement choice

Part 1: Determine type of value-for-money assessment

Depending on the nature of the project and the capacity of the municipality, either a full value assessment or a simplified value assessment will be undertaken. This determination should have been made during the inception and development of the adviser's terms of reference.

Simplified value-for-money assessment

Carry out a simplified value-for-money assessment when the undertaking of the output to be assessed is not a realistic public-sector option. It may not be an option for a variety of reasons including a lack of funding, technical capacity or previous experience in providing the output. For example, a municipality might not possess the specialised technology needed for the output, and lack

the financial resources or the capability to raise the funds from its budget or from borrowing. Another example is where the municipality seeks an output – the development of a nature reserve – that it has not previously undertaken. In these cases, a PSC need not be created. An external reference model must, however, be created to ensure the project is affordable and to establish a benchmark against which to evaluate the bids.

If a PPP is the only option, then the value-for-money aspect of the value assessment must be demonstrated by ensuring that as many of the following value-for-money drivers, discussed in subsequent sections and modules, are met during the procurement processes and PPP agreement design:

- Project objectives expressed as measurable outputs
- Incentive for demonstrable innovation by the private party
- Transfer of substantial financial, technical and operational risks to the private party
- Competitive procurement as to which there are a sufficient number of qualified private sector firms that may bid
- Contract design reflecting good PPP contracting practices to provide for efficient monitoring and regulation.

In the case of a PPP involving the use of municipal property for commercial purposes by a private party, value-for-money is demonstrated by the extent to which the project will meet the municipality's objectives for the use of that property. These objectives may include:

- Increased direct revenue to the municipality
- Increased socioeconomic activities within the community
- Optimal use of under-performing assets
- Job creation
- BEE.

Full value-for-money assessment

A full value-for-money assessment is undertaken if the internal mechanism is a realistic option. Parts 2 to 6 describe the steps for conducting a full value-for-money assessment.

Take note

A proposed PPP project may provide value for money, but be unaffordable. Value for money is a necessary condition for an external option, but not a sufficient one. If a project is unaffordable, it undermines the municipality's ability to deliver other services and it should not be pursued. Affordability is the driving constraint in all PPP projects.

Part 2: Construct the base PSC model

What is the base PSC model?

The base PSC model represents the full costs to the municipality of delivering the required municipal service or municipal support activity according to the specified outputs via the preferred solution option using conventional public sector procurement.

The base PSC costing includes all capital and operating costs associated with the project.

The risk-adjusted PSC model includes a costing for all the risks associated with the project.

The public sector does not usually cost these risks, but it is necessary to get this understanding of the full costs to government of the proposed project.

Key characteristics of the PSC model:

- Expressed as the net present value of a projected cash flow based on the appropriate discount rate for the public sector
- Based on the costs for the most recent, similar, public sector project, or a best estimate
- Costs expressed as nominal costs
- Depreciation not included, as it is a cash-flow model.

The central functions of the PSC model:

- Promotes full risk inclusive cost pricing at an early stage
- Is a key management tool during the procurement process, assisting the municipality to stay focused on the output specifications, costs and risk allocation
- Is a reliable way of demonstrating the project's affordability
- Provides an initial indication of value for money
- Is a consistent benchmark and evaluation tool
- Encourages bidding competition by creating confidence in the financial robustness and integrity of the feasibility process
- Is sufficiently robust that the service could be procured conventionally if, at any stage, the PPP fails to show value for money.

Construct the base PSC model

- Step 1: Provide a technical definition of the project
- Step 2: Calculate direct costs
- Step 3: Calculate indirect costs
- Step 4: Identify any revenue
- Step 5: Explain all assumptions used in the construction of the model
- Step 6: Construct the base PSC model and describe its results

The base PSC model represents the full costs to the municipality of delivering the required municipal service or municipal support activity according to the specified outputs via the preferred solution option using conventional public sector procurement.

The PSC model found on the PPP unit's website provides a complete example of the process outlined step by step in Stage 4: parts 1 and 2. Readers may find it useful to work through the steps with reference to the example.

Step 1: Provide a technical definition of the project

What norms and standards will be applied in the project? What maintenance cycles are expected? Describe these carefully, bearing in mind that the same principles must apply in the external reference model to come, to allow for a comprehensive comparison.

Step 2: Calculate direct costs

Direct costs are those that can be allocated to a particular service or competent activity. These costs must be based on the most recent public sector project to deliver similar infrastructure or services (including any foreseeable efficiencies; for example, regular life-cycle maintenance), or a best estimate where there is no recent comparable public sector project. If there are no comparable projects in South Africa, draw on the experience of projects in similar environments in other countries. These costs should be checked carefully for optimism bias and appropriate adjustments made either in direct costs or in the risk assessment (see below) for likely cost outcomes.

This is necessary because typical public sector procurement projects have both time and cost overruns that are ignored in cost estimates for subsequent projects. Project estimates are consistently based on best possible outcomes. Municipalities are warned that the selection of such cost estimates is very important and must be explicitly stated. Inclusion in the risk adjustment may lead to scepticism about the quantum of risk in the project. The National Treasury therefore prefers a more realistic base PSC costing. Once this is done, however, municipalities must be careful not to double count such risks.

For example, if there is a historic outcome of 20 per cent increases in cost and 15 per cent in time overruns, these should be explicitly stated and included in the base case PSC model. The subsequent risk adjustment should then only reflect the likelihood of cost and time outcomes deviating from the base case cost – i.e., not reapplying the 20 per cent and 15 per cent factors.

1. Capital costs

Direct capital costs are specifically associated with the delivery of new services or competent activities, and may include, for example, the costs of constructing a new facility or acquiring a new asset. The PSC model should account for direct capital costs in the year in which they occur, including, but not limited to, the costs of design, land and development, raw materials, construction, and plant and equipment (including IT infrastructure). Direct capital costs should also account for the project's labour, management and training costs, including financial, legal, procurement, technical and project management services. Only the costs associated with developing and implementing the project should be included in the PSC model. It is also important to include the costs of replacing assets over time.

2. Maintenance costs

Direct maintenance costs will include the costs over the full project cycle of maintaining the assets in the condition required to deliver the specified outputs, and may include the costs of raw materials, tools and equipment, and labour associated with maintenance. The level of maintenance assumed must be consistent with the capital costs, the operating cost forecasts and the residual value treatment of any assets. Specific attention should be given to undertaking a “zero-based” costing of maintenance to the levels required as experience is showing that municipalities generally are not allocating sufficient funds for this aspect.

3. Operating costs

Direct operating costs are associated with the daily functioning of the municipal service or municipal support activity and will include full costs of staff (including wages and salaries, employee benefits, accruing pension liabilities, contributions to insurance, training and development, annual leave, travel and any expected redundancy costs), raw materials and consumables, direct management and insurance. In identifying these costs, account should be taken of the results of the audit undertaken on the numbers, skills and experience of staff and appropriate adjustments should be assumed to deal with any identified deficiencies.

4. BEE costs

Direct BEE costs are the costs of achieving the project's identified BEE objectives. The Preferential Procurement Policy Framework Act (2000) (PPPFA) provides for a ceiling on the price premium to be paid for BEE in the supply of goods and services contracted through conventional procurement. Calculate the costs of preferential procurement on the supply of goods and services as stipulated by the PPPFA 90:10 formula. Use the specific BEE targets set for the project in Stage 1: part 4.

Step 3: Calculate indirect costs

The project's indirect costs are a portion of the municipality's overhead costs, and will include the costs of: senior management's time and effort, personnel, accounting, billing, legal services, rent, communications and other service delivery resources used by the project. The portion can be determined by using an appropriate method of allocation, including but not limited to:

- Number of project employees to total municipal employees for personnel costs
- Project costs to total municipal costs for accounting costs
- Number of project customers to total municipal customers for billing costs.

Step 4: Identify any revenue

The total cost of delivering the service should be offset by any revenues that may be collected.

Project revenue may be generated where:

- Users pay for the service or a part of it
- The use of the municipality's assets generates revenue
- Service capacity exists above the municipality's requirement
- The municipality allows third parties to use the service.

Any revenue collected must reflect the municipality's ability to invoice and collect revenue. (This should have been identified during Stage 2.)

Forecasting potential revenues can be difficult, especially where there is little or no historical information. In revenue-generating or user-pays projects, this element will be a significant component of both the PSC and external reference models, and the municipality's specialist advisers should pay special attention. In the past, many municipalities recorded accounts billed as being paid. Note that in a "user pays" scenario, tariff-setting by the municipality's council

consistent with the defined needs of a specific project will be critical. In such projects, crucial areas of inquiry in terms of identifying revenue include not only the municipality's demonstrated record of cost recovery but also council's demonstrated record of setting tariffs for the municipal service in question using a realistic, cost-based methodology. In a PPP, private sector bidders will make their own assessment of the foregoing, and their perception will be reflected in any proposals submitted.

Step 5: Explain assumptions

Explain in detail all assumptions the model makes about the inflation rate, the discount rate, depreciation, treatment of assets, available budget(s), and the municipality's medium-term expenditure framework (MTEF), especially in terms of realised (not merely invoiced) revenues and tariff-setting expectations in user pay projects.

Inflation

The model should be developed using nominal values. In other words, all costs should be expressed with the effects of expected future inflation included. This also allows for easy comparison with the municipality's budget, which is expressed using nominal values. Inflation projections should be made with reference to the inflation targets set by the Reserve Bank. The MTEF budget cycle which government uses is adjusted annually by CPIX.

The discount rate⁶

For practical purposes, the discount rate is assumed to be the same as the risk-adjusted cost of capital to government. The government bond yield has been used by some municipalities as the discount rate for a particular project over a comparable period. The argument in favour of using the government bond yield is that it reflects the actual cost to government of raising funds at any given time. This ignores a number of factors that are difficult to quantify, including: various risk margins relating to increased government borrowing; various tax implications of diverting funds from private to public consumption; and government's time preference of spending.

The National Treasury does not prescribe a discount rate. The municipality, with advice from its adviser, should choose a nominal government bond yield rate over a similar term to the length of the project term as the risk free discount rate for the project. The National Treasury may be requested to help decide which bond rate is applicable to a particular type of project.

6. See "[The significance of the discount rate](#)" on the PPP unit's website.

The National Treasury does not advocate reflecting project risks as a premium in the discount rate. Risks are valued as cash-flow items.⁷

Although the National Treasury's preference is for the reflection of risk as a cash-flow numerator, there are certain projects where there are risks inherent in the project over and above the risks quantified in the cash flow for the project. This may warrant using a discount rate that is the government bond yield and an additional risk premium above the bond yield rate as a representation of additional risk in the project. It is important to note that the necessity of applying a risk premium to the risk free discount rate should be done on a project-by-project basis and only in cases where it is not possible to accurately reflect the effect of all risks in the cash flow of the project.⁸

The discount rate chosen for the project must then be applied consistently in all the feasibility study models.

As the National Treasury prefers that the PSC and the external reference models are in nominal terms, the discount rate must also be in nominal terms, so there is no need to adjust for inflation.

Depreciation

Since the PSC model is calculated on cash flow, not on accrual, non-cash items such as depreciation should not be included.

Step 6: Construct the base PSC model and describe its results

The base PSC model must be presented as a discounted cash-flow model. The complexity of the model will depend on the complexity of the project. Simple output specifications can be analysed using a simple cash-flow statement. For projects that entail capital investment and/or generation of revenues, the PSC model will need to include a cash-flow timing profile reflective of its findings, described above.

Provide a brief narrative explanation of the construction of the model and its key results. Show the net present cost of the base PSC model.

7. See "[How to calculate the value of risk](#)" on the PPP unit's website.

8. The UK has used an average margin of 1.5 per cent above its bond yield in determining the discount rate of capital.

Part 3: Construct the risk-adjusted PSC model

The risk-adjusted PSC model is the base PSC model plus a costing for all the risks associated with undertaking the project. Government does not usually cost these risks, but it is necessary to do so to understand what the full cost to government will be if it undertakes the project.

Risk and public-sector procurement

In conventional public sector procurement, risk is the potential for additional costs above the base PSC model. Conventional public sector procurement has tended not to take risk into account adequately. Budgets for major procurement projects are prone to optimism bias – a tendency to budget for the best possible outcome rather than the most likely. This has led to frequent cost overruns. Optimism bias has also meant that inaccurate prices have been used to assess options. Using biased price information early in the budget process can result in real economic costs resulting from an inefficient allocation of resources.

Much of the public sector does not use commercial insurers, nor does it self-insure. While commercial insurance would not provide value for money for government, because the size and range of its business is so large that it does not need to spread its risk, and the value of claims is unlikely to exceed its premium payments, this is a notional self-insurance: specific municipalities still bear the cost arising from uninsured risks that arise. In addition there are many examples of projects where the public sector has been poor at managing insurable (but uninsured) risk.

How to calculate the value of risk on the PPP unit's website provides an example of the process outlined step by step below. Readers may find it useful to work through the steps with reference to the example.

Construct the risk-adjusted PSC model

- Step 1: Identify the risks
- Step 2: Identify the impacts of each risk
- Step 3: Estimate the likelihood of the risks occurring
- Step 4: Estimate the cost of each risk
- Step 5: Identify strategies for mitigating the risks
- Step 6: Allocate risk
- Step 7: Construct the risk matrix
- Step 8: Construct the risk-adjusted PSC model
- Step 9: Preliminary analysis to test affordability

Step 1: Identify the risks

Two workshops

The identification of risks is best done in workshops attended by the municipality, its adviser and the National Treasury PPP unit's internal project adviser. The focus of the first workshop should be purely on identifying the risks. The second workshop should assess and quantify their impact. This is recommended because clearly identifying risks and sub-risks can be clouded by discussions about their potential financial impact. Separate workshops will also allow the advisers to prepare adequately for assessing and quantifying the financial impact of the identified risks.

Who should attend the risk workshops?

- The project officer and project management team
- Any other municipal officials who will be responsible for managing the project during the construction/development stages of the project and for contract management thereafter
- All members of the adviser, including the financial, legal and insurance advisers, and sector specialist advisers on, for example, design, engineering, facilities management and IT
- Project advisers from the relevant treasury's PPP unit and project officers from other municipalities who can share relevant experiences.

How to identify the risks

Explore each risk category in detail during the workshops, and produce a detailed, project-specific list.⁹ This list will be developed into a risk matrix for the project in Step 7. It is important to identify and evaluate all material risks. Even if a risk is unquantifiable, it should be included in the list. Do not forget to include any sub-risks that may be associated with achieving the BEE targets set for the project.

9. See "[Standardise PPP Risk Matrix](#)" on the PPP unit's website for the range of categories of risk typically found in PPP projects.

Take note

When identifying risks by referring to an established list, it is common for municipalities and advisers to omit actual risks or include unnecessary risks simply because the template risk list omits or includes such risks. At the end of the risk identification workshop, go through the various stages of the project and consider various scenarios of what might actually happen. Many of the risks that reveal themselves may already have been identified via the risk matrix, but some new risks may come up. Also be vigilant for duplicated risks. Further, carry out a common sense check on risk-cost outcomes. For example, a minor regulatory risk cannot have a multi-million rand outcome when it is firmly in the control of the municipality. Errors such as this occur because of the practice of calculating the risk based on whole life cycle costing multiplied by an estimated probability of occurrence. A very large number multiplied by a 1 per cent probability is still a large number. Where this is repeatedly done, risk analyses can deteriorate into a meaningless exercise.

It may be difficult to compile a comprehensive and accurate list of all the types of risks. The following can be helpful sources of information:

- Similar projects (information can be gathered from the original bid documents, risk matrices, audits and project evaluation reports) both in South Africa and internationally
- Specialist advisers with particular expertise in particular sectors or disciplines.

Step 2: Identify the impacts of each risk

The impacts of a risk may be influenced by:

- **Effect:** If a risk occurs, its effect on the project may result, for example, in an increase in costs, a reduction in revenues, or in a delay, which in turn may also have cost implications. The severity of the effect of the risk also plays a role in the financial impact.
- **Timing:** Different risks may affect the project at different times in the life of the project. For example, construction risk will generally affect the project in the early stages. The effect of inflation must also be borne in mind.
- **Type:** Some risks are difficult to quantify accurately.
- **Severity of the consequence:** It is essential to specify all the direct impacts for each category of risk. For example, construction risk is a broad risk category, but there could be four direct impacts, or sub-risks:
 - Cost of raw material is higher than assumed in the PSC model
 - Cost of labour is higher than assumed in the PSC model

- Delay in construction results in increased construction costs
- Delay in construction results in increased costs as an interim solution needs to be found while construction is not complete.

Each of these impacts has its own cost and timing implications.

Step 3: Estimate the likelihood of the risks occurring

Estimating probabilities is, by definition, not an exact science, and one has to make assumptions. Ensure that assumptions are reasonable and fully documented, as they may be open to being challenged in the procurement process or be subject to an audit. There are some risks whose probability is low, but the risk cannot be dismissed as negligible because the impact will be high (for example, the collapse of a new structure). In this case a small change in the assumed probability can have a major effect on the expected value of the risks. If there is doubt about making meaningful estimates of probability, it is best practice to itemise the risk using a subjective estimate of probability rather than to ignore it. Municipalities should also be prepared to revisit initial estimates, if they learn something new that affects the initial estimate. Together with estimating the probability of a risk occurring, it is also necessary to estimate whether the probability is likely to change over the term of the project.

A subjective estimation of probability is based on past experience or current best practice, and supported by reliable information, if available. Simply, realistically estimate how likely final costs are to be above or below the amount in the base PSC model. If reliable information is not available, municipalities and advisers will have to make assumptions about the logical, commonsense likelihood of a risk occurring. It is essential that all assumptions be fully documented.

However, if the probability of a risk occurring is high or the potential impact is significant, and there is sufficient reliable information, an advanced technique should be used as it can provide more conclusive results.

Statistical risk measures are more advanced and have the advantage of being based on robust economic principles. The disadvantage is that they can be more complicated to calculate and interpret, and require a large amount of reliable information. Comprehensive statistical risk analysis often requires special software and the assistance of an experienced risk analyst. Multivariable analysis techniques have been successfully used in the valuation of risks for road projects. This type of analysis requires estimating a range of possible risks together with their probabilities of occurring, and the maximum and minimum project costs for the different scenarios. It is particularly useful for considering the impact of a number of risks together. A key disadvantage of multivariable

analysis is that it shifts the focus away from the analysis of individual risks, and for risks to be meaningfully put to use in the PSC model, the potential impact of each individual risk needs to be understood.

Whatever risk assessment techniques are used, the risks and their bearing on the project must be well understood by the municipality. The method used should be agreed between the municipality and its adviser.

Step 4: Estimate the cost of each risk

Risk as a cash-flow item

The National Treasury advocates costing risk as a separate cash-flow item, and not adjusting the discount rate to indicate the level of risk in a project. The cash-flow method promotes a focus on the costs of each risk and enables an understanding of how risk can be transferred and what its financial effects are. In addition to this, valuing each risk as a separate cash-flow item accounts for the time implication of that risk (some risks may only have an impact at the beginning of a project, and the impact of other risks may diminish or escalate over the life of the project).

- Estimate the cost of each sub-risk individually by multiplying the cost and the likelihood
- Assess the timing of each sub-risk
- Cost the sub-risk for each period of the project term
- Construct a nominal cash flow for each risk to arrive at its net present value.

Step 5: Identify strategies for mitigating the risks

A risk can be mitigated either by changing the circumstance under which the risk can occur or by providing insurance for it. Indicate what the risk mitigation strategy for dealing with each particular risk will be, and the attendant cost of such mitigation.

Step 6: Allocate risk

Once risks have been identified and costed, analyse which risks the private party should carry, which the municipality should retain, and which should be shared, if this project were to be procured through a PPP. For the risk-adjusted PSC model, all risks will usually be carried by the municipality, as would be the case with conventional procurement. It is, however, necessary to do a preliminary risk allocation at this stage, as it will assist the municipality in separating out the risks which will be allocated to the private party and which risks will be kept by the municipality. This will be reflected in the external reference model.

A risk should be carried by the party best able to manage that risk. The principle for allocating risk should be value for money. Where retaining a risk presents value for money for the municipality, it should be retained.

Step 7: Construct the risk matrix

A comprehensive risk matrix is a fundamental component of PPP procurement as it is used to identify and track risk allocation throughout the drafting of the agreement, the bidding process, agreement negotiation and financial closure.

The risk matrix consolidates all identified project risks, their impacts, and their associated costs. Include all risks (retained by the municipality and transferred to the private party) in the calculation of the PSC. List those which are to be retained or transferred as these will need to be costed for the external reference model and will also be used and elaborated on during the procurement phase.

Step 8: Construct the risk-adjusted PSC model

Once costs have been established for all identified risks, the base PSC must be risk-adjusted. This is done using the following simple formula:

$$\text{Risk-adjusted PSC} = \text{Base PSC} + \text{Risk}$$

Users of the manual should closely follow the example in “A PSC model” on the PPP unit’s website for adjusting the base PSC for risk. The example is limited to one risk category – construction risk – but illustrates the steps for determining a value for risk.

Step 9: Preliminary analysis to test affordability

As a preliminary assessment of the project’s affordability, compare the risk-adjusted PSC model with the municipality’s budget for the project as estimated during the solution options analysis (Stage 2). (The budget will be examined in detail in Stage 5: part 6.) If the project looks unaffordable by a wide margin in the PSC model, it may be necessary to revisit the options analysis.

Part 4: Construct the external reference model

The external reference model is a hypothetical private party bid to deliver the specified outputs.

The external reference model is the costing of the output specifications from a private party’s perspective. Comparing the risk-adjusted PSC model with the risk-adjusted external reference model enables the municipality to assess whether service delivery by government or by a private party yields the best value for money for the municipality.

The external reference model must be developed using the identical output specifications as those used in the PSC model, but technically and financially it is very different. As the municipality will not know what a private party will charge for the outputs specifications, costs will have to be estimated. The adviser must have the necessary expertise, market knowledge and experience to construct a market-related external reference model.

Step 1: Confirm the type of external option

In Stages 2 and 3, above, the technical solution and service delivery options analyses, the type of external option would have been initially identified. At this point, this initial identification should be confirmed – i.e., a private party to provide the municipal service or municipal support activity outputs or engage in commercial activities on land owned by the municipality. The matters set forth in step 2 of Stage 2 will be revisited and confirmed.

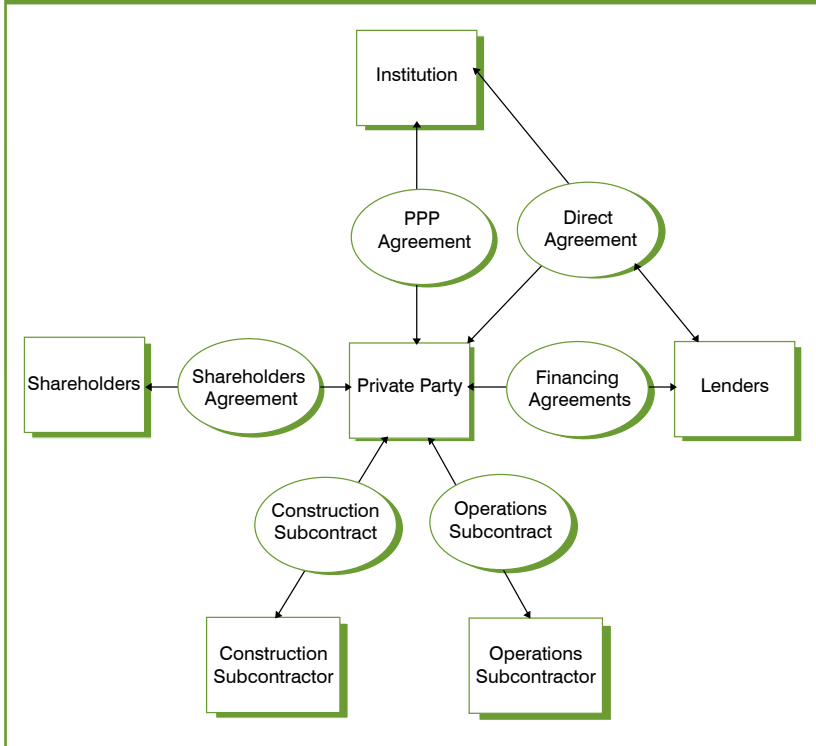
Step 2: Describe the proposed project structure and sources of funding

The proposed structure for the project needs to show the relationship between the municipality, the private party (or special purpose vehicle in the case of a project finance structure), shareholders, lenders, suppliers, subcontractors and other players. The structure will depend on several factors including the size of capital investment, sources of funding and sources of revenue. Corporate finance is usually used in projects with capital requirements below the levels at which project finance becomes cost effective, but it carries different risks for the municipality (a crude rule of thumb is capital expenditure greater than R100 million is more suitable for project finance).

The proposed sources of funding (the combination of debt and equity, and, if appropriate, government contribution) must be identified and shown in a proposed funding structure.

Appropriate equity returns, and the costs and key terms of debt financing, including debt service cover ratios (if applicable) must be shown. All assumptions must be clearly stated, as these will directly affect the cost of capital for the project.

Fig 4.3 Project finance structure



In such a project finance structure, the following must be addressed:

- Legal and financial structure and participants
- Ratios such as: annual debt service cover ratio, project life cover ratio, loan life cover ratio, debt service reserve and maintenance reserve accounts, and the cash-flow waterfall arrangement.

Corporate finance structure

In a corporate finance structure, the following must be addressed:

- Project assets should be ring-fenced within the balance sheet of the private party to allow the municipality to take security over project assets and to protect the municipality in the event of termination.

- As a corporate finance project does not have the comfort of bank due diligence (as would be the case in project finance), the municipality must expect to do a thorough due diligence on the project and take a long-term view on the balance sheet of the private party.
- Instead of being able to rely on a bank's vigilance over the private party's operations (as in a project finance structure), the onus will be on the municipality to monitor, analyse and respond to any events or information which may affect the project. The municipality needs to demonstrate its capacity and skills to do so.
- In the base case financial model, the ratios relevant for a corporate finance structure are: liquidity, asset management, profitability and debt ratios.

Municipal and general government fiscal obligations related to the project

Firm fiscal obligations

Current international trends support the use of government funding in PPPs. In South Africa where public funds often exist but the capacity to spend these funds and deliver services is limited, the use of grants such as the municipal infrastructure grant and other government grants to expedite service deliver should be considered, where appropriate and when there is a clear demonstration of value for money. The benefits include:

- Dedicated funds available for construction
- Reduced unitary payment and/or user charges
- Lower cost of capital
- In the case of funds earmarked for the poor, faster delivery.

The limitations are:

- Pre-funding of equity returns
- Risk transfer inevitably compromised
- Risk of separating construction from operations
- Reduced lender involvement reduces attention to due diligence.

The municipality's contribution must not cover all capital costs; it should only use the funds for the provision of ring-fenced project assets that will either immediately or on termination of the PPP agreement become the property of the state. These assets cannot be used as security. If such a capital contribution is anticipated, the following need to be addressed in detail:

- Budgetary requirements
- Regulatory requirements and restrictions
- Tax implications
- Treatment of assets
- Effect on the allocation of risk.

Contingent fiscal obligations

Every PPP will result in contingent obligations of one kind or another. A contingent liability is a liability that accrues to the municipality through the PPP agreement but only has an actual financial impact if a future, uncertain event occurs. The most obvious include any revenue guarantees, termination payment obligations and warranties given. These need to be explicitly identified in the feasibility study.

Step 3: Identify any revenue

While the PSC would have identified any revenues, such as revenues from user charges, the external reference model may assume improved collection rates or higher willingness-to-pay as a result of improved services, as a major component of value for money in user fee PPPs. In activities for which user charges are collected, it is important to maximise revenues from these sources to enhance the viability of the project. Below are ways in which the municipality can support improved cost recovery in such a PPP. These actions can be done separately or as part of the project:

- Audit and update the database. Often users or tax payers have not been included in the municipality's database and are using service without paying.
- Improve billing. Bills are often sent to the wrong address or contain the wrong information and amount.
- Improve collection and payment levels. For a variety of reasons, payment levels are often poor.
- Review tariff structure. Tariff structure often does not reflect the cost of providing services. Tariffs should at least cover operational costs so that the infrastructure can be maintained.
- Allow for new developments that might take place in the municipal area, particularly those that are going to make significant contribution to the cash flow.

Step 4: Develop the core components of the payment mechanism

Although the full payment mechanism is developed during the preparation of the RFP,¹⁰ the feasibility study must develop the core components. Payment mechanisms in municipal PPPs can vary depending on the type of project, risk allocation and incentives the municipality may wish to provide.

In general, payment mechanisms should meet the following principles:

- Payment should only be made for services received. Payment mechanisms should never be set up so the service provider always receives a fixed payment that covers its debt services obligations irrespective of performance.
- Payment mechanisms should provide for deductions for substandard performance and, if appropriate, for bonuses for above standard performance. Deductions should reflect the severity of the failure — no service will lead to no payment, but minor failures only cause a minor deduction. In the case of repeated minor failures, penalties may increase.
- Payment mechanisms should reflect revenue collection and tariff-setting assumptions as well as service outcomes.

In serviced facilities type PPPs (such as for office or other accommodation), where variation in usage is very limited, a unitary payment mechanism is typically employed. Under this arrangement, payment is based on a fixed amount for availability, with deductions for substandard performance. For a unitary payment arrangement, the following must be addressed:

- The amount of the single, indivisible unitary payment
- Whether any splitting of the unitary payment between services is appropriate
- Identifying the key areas of availability and performance of the services
- Preparing an initial allocation of the proposed unitary payment to these areas to verify that the appropriate incentives and penalties are created for the service as a whole.

In PPPs with varying usage, such as waste collected or disposed, recycled or composted and water produced and treated, the following must be addressed in the payment mechanism:

- The payment amount per unit of usage.

10. See Module 5: PPP Procurement: 'Annexure 1: Payment mechanism'.

- Where the private party has no control over demand risk, whether it is appropriate to have a take-or-pay component, which guarantees payment for a minimum usage, or whether it is appropriate to have elements of fixed and variable components.

Step 5: Set and cost BEE targets

Draft a proposed PPP BEE balanced scorecard for the PPP using the elements specified in the *Code of Good Practice for BEE in PPPs*, taking account of the sector, proposed PPP project type, structure, sources of funding, and the BEE issues identified in Stages 1 to 3 of the feasibility study.

Calculate how the private party would cost each of the BEE targets set for the project.

The BEE work in the feasibility study phase is crucial to ensuring a sound BEE outcome in a PPP.

Producing a proposed BEE PPP balanced scorecard for the project, through which BEE targets are appropriately set for the maturity of the market in which the project is to take place, will directly affect the municipality's ability to produce sound bid documentation for the PPP. Getting these targets right or wrong may significantly affect the project's affordability and value for money and the private party's willingness to assume risk – and will certainly have a direct effect on the sustainability of BEE in the project.

Step 6: Calculate and consolidate all costs

The categories of costs covered in the external reference model must be the same as those in the PSC model – namely, direct capital, maintenance and operating costs, and indirect costs – and over a comparable period.

The key difference is that the external reference model is expected to take into account the innovative design, construction and operational efficiencies that may realistically be expected of the external providers, in particular the private sector.

Identify these efficiencies and use them as the basis for costing.

A notable inclusion in the external reference model is the cost of capital, which should be made up of the proposed debt and equity structuring of the project. Municipalities should not assume that the cost of capital for the external reference model is linked to the government bond yield; the assumption should rather be that the project would rely on its own credit. The cost of capital must be justified by historical data and an analysis of project risk as perceived by potential funders.

The treatment of the residual value of the assets must be shown in the costing. (See part 7: step 2.)

The external reference model must also include, as separately identifiable line items, the costs of each targeted BEE element. (See step 4.)

Step 7: Construct the external reference model and explain all assumptions and indicators

The external reference model must be presented as a discounted cash-flow model, as with the PSC model. As far as possible the external reference model must rely on the same assumptions as the PSC model, including the inflation and discount rates, which are particularly important for allowing for a proper comparison between the two procurement choices. The treatment of tax, VAT, depreciation, residual value and any other assumptions must be explained in detail.

A detailed narrative commentary on the model is required. It must explain the construction of the model and its key indicators, including the net present value. Key indicators may be the debt/equity ratio, debt service cover ratio, liquidity, key sensitivities to inflation, project term and tax.

Part 5: Construct the risk-adjusted external reference model

Risk and the private sector

The risks associated with the project do not disappear because the private sector is providing the service. But the private sector does generally have the ability to avoid, mitigate or pass off these risks.

Risk is generally managed better in the private sector because of:

- A focus on outputs
- A contractual obligation to deal with specified risks
- The economies of scale generated by integrating the design, building, financing and operation of assets
- The inventive use of assets
- Innovative financial structuring.
- Managerial expertise.

It is necessary to do an independent risk assessment for the external reference model, using the costs that the external party would usually apply to cater for the risk categories already identified for the project. The municipality's adviser must do this, backed up with a market testing exercise if necessary. The risk

matrix developed for the risk-adjusted PSC model, based on the standardised PPP risk matrix, must therefore be used as reference.

While the risk categories are the same, they are dealt with differently in the two models. In the PSC model, risks are valued by assessing their cost, their likelihood of occurring and the costs of mitigation. The values are added to the base PSC model to create the risk-adjusted PSC model. In the external reference model, the PSC model's risk valuation process should not be necessary. Instead, because of the private sector's better capacity to manage risk, risk is incorporated into the costing of the project and should be reflected as:

- Specific line items in the model dealing with direct risk-related costs (for example, insurance or guarantee costs)
- Subcontractor costs
- Increased required return on equity
- Increased cost of debt.

In addition, the external reference model must reflect, as specific add-on costs, the risks retained by the municipality. As in the risk-adjusted PSC model, the private sector will price risk transferred to it. The risks that were allocated to the municipality (the retained risks) in the risk matrix for the PSC model must also be included in the external reference model.

Although the external reference model reflects an estimated private sector response to delivering the output specifications, there will still be some costs which the municipality will be liable for in a PPP, such as the costs of managing the PPP agreement.¹¹ These costs must also be calculated and clearly identified in the external reference model.

Risk-adjusted external reference model = External reference model + retained risk

The external reference model cost is an “all-in” cost to the municipality for undertaking the project.

The external reference model must clearly show what the proposed unitary payment will be to government for undertaking the project.

11. See Module 6: Managing the PPP Agreement.

Part 6: Qualitative considerations

Comparing the net present value of the PSC and the external reference provides a quantitative value on the value for money question. However, a complete value-for-money assessment might need to take into account other considerations that cannot be quantified. Qualitative considerations become more important if the PSC and the external reference model are very close or if there are important considerations that cannot be quantified. Some of these qualitative considerations include:

- The views of organised labour
- The likely impact of the project on development, job creation and employment patterns in the municipality
- Developing trends in the sustainable provision of municipal services generally
- Service quality considerations that cannot be quantified
- If the project involves a non-core function, the municipality may be freed up to focus on its core functions
- Wider benefits than an external option might bring – for example, earlier provision of services
- The introduction of new technology and systems that will benefit service provision beyond the life of the project
- The experiences and track record of similar projects by the public and by external service providers
- Strategic considerations such as the desire to provide a new delivery paradigm.

Part 7: Sensitivity analysis

A sensitivity analysis determines the resilience of the base PSC model and the base external reference model to changes in the assumptions that the model has been based on. The municipality and its adviser should test the sensitivity of key variables to test their impact on affordability, value for money and risk, such as:

- Project term
- Inflation rate
- Discount rate
- Construction costs

- Total operating costs
- BEE costs
- Service demand
- Third-party revenue, if any
- Residual value
- Financing terms.

For example, an increase in the assumed capital cost may lower an associated risk. This will allow the municipality to view the potential spread of the total cost to government under the base PSC model.

It may be important to undertake a sensitivity analysis of the external reference model using both high and low discount rates in a range of bond yield rates. If both discount rates support or reject the value for money of the project (when the NPV of the external reference model is compared with the NPV of the PSC model), the result is clear. However, if only one of the discount rates meets the value-for-money criterion, the project should be further examined, taking into consideration the sensitivity of the independent variables and how they may affect the results.

A thorough sensitivity analysis on different variables must be presented as part of the feasibility study.

Part 8: Demonstrate affordability

The budget for the project has been identified at various stages prior to this. At this stage, it must be scrutinised in detail and confirmed to demonstrate project affordability. This is especially important in those feasibility studies not requiring the development of a PSC.

Step 1: Determine the municipal budget available for the project

Municipalities should refer to their detailed budgets. Include all the applicable available amounts, namely direct and indirect costs, and any third-party revenues. Where necessary, include budgetary allocations that would be available to the project from other municipal budgets (such as capital works allocations or revenue collection budgets).

For projects involving private party use of municipal property, where the private party pays the municipality for such use, the affordability determination by the municipality consists of an examination of its budget to ensure it has the

budget to manage the PPP agreement (costs of project officer and staff), any costs that may be incurred by the municipality in providing any conservation maintenance required in terms of a PPP agreement, and the costs of any infrastructure/maintenance to be provided by the municipality to be specified in a PPP agreement. The municipality must consider these costs in determining a minimum PPP fee to be included in any procurement that may follow.

Most external options, particularly those involving private capital investments, will extend beyond the three years of the MTEF. It will therefore be necessary for municipalities to extrapolate their budgets beyond the MTEF to make meaningful comparisons with the cost of the project. As a rule of thumb, it is prudent to assume that budgets remain constant in real terms (they increase only in line with inflation) over the term of the project. Any different assumptions will need to be well argued and backed with documentation. An important ancillary use of these calculations will be in terms of the section 33 of the MFMA processes that are required for all contracts that exceed three years.

Take note

When assessing the municipality's ability to pay for the project, ensure that all costs associated with the project are into account. For example, in a water treatment plant project, the private party may be required to supply the design, construction and maintenance of the treatment facility, but the municipality will have to provide oversight for the construction and later, the maintenance and operation of the works. The municipality must ensure that it has a budget sufficient not only for the payment of the unitary payment to the private party for the design, construction and maintenance of the facility, but also for its contract administration, monitoring and management costs for the life of the project.

Step 2: Compare the risk-adjusted external reference model with the available municipal budget

If affordability cannot be demonstrated, the municipality will be obliged either to re-examine or modify the output specifications within the affordability constraint, look at other means of increasing its own revenue – such as expanding its tax base, improving billing and collection of taxes and charges, increasing tariffs – or abandon the project.

For example, if the output specification is for a sewage treatment facility that treats wastewater to standards allowing the effluent to be used in industrial applications and the model reveals that this is beyond the municipality's budget for the project, the output specification might be modified to require treatment only to standards permitting discharge into a river. Any adjustments to output

specifications must be reflected in adjustments to both the PSC model and the external reference model.

Part 9: Initial value-for-money test

Initial value-for-money test

Step 1: Check the models

Step 2: Establish the initial indication of value for money

Step 3: Assess BEE value for money

Step 1: Check the models

- Do the models (both PSC and external reference) reflect the requirements of the output specifications?
- Have all capital, operating and maintenance costs required to deliver the service according to the output specifications been included?
- Have all BEE targets been costed?
- Have all material and quantifiable risks been identified and accurately valued?
- Have all risks been summarised in the risk matrix, including their consequences, financial impacts and proposed mitigation strategies?
- Have all risks been appropriately assigned to the party best able to manage them?
- Has a sensitivity analysis been conducted on the key assumptions?
- Are all assumptions used reasonable and appropriate?

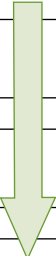

Step 2: Establish the initial indication of value for money

The Municipal PPP Regulations define value for money as meaning that the performance of an external party in terms of the agreement will result in a net benefit to the municipality in terms of cost, price, quality, quantity, risk transfer or any combination of those factors.

The value-for-money test is only conducted in the procurement phase as one of the requirements for TVR IIB when external party bids are submitted. For TVR I, municipalities are required to give an initial indication of what value for money the project is likely to provide if it were procured through conventional public sector procurement or an external model, by comparing the two models.

The models will also provide the critical benchmark for evaluating bids during the procurement phase.

Value for money is considered at this stage by comparing the risk-adjusted PSC model to the risk-adjusted external reference model on an NPV basis.

Table 4.2: Value-for-money comparison		
Value-for-money comparison	Public sector comparator	External reference
Financial model		
Legal, financial, technical, commercial, socio economic, municipality impact of the option		
Costs		
Assumptions for model (inflation, interest rate, tax, VAT, depreciation, budget and MTEF)		
Funding options		
Any contribution by government		
Net present cost	PSC	External-ref
Risk adjustments	RA	RA
Risk adjustment net present cost	RA-PSC	RA-External-ref

The use of a **net present value (NPV) calculation** in determining the cost of a project is based on the premise that a rand received today is more valuable than a rand received at some future date. The timing of cash flows in the external reference model and the PSC model are often quite different from each other, and difficult to compare without adjusting for the time value of money. By taking into account the time value of money, the discounted cash flow allows the private project proposals to be compared to each other and to the PSC model in the procurement phase. To compare the models, it is necessary to apply the same discount rate. It is acknowledged that the extent to which a rand today is worth more than a rand in future is determined by the discount rate used in calculating the NPV.

Also consider in this comparison **the treatment of residual value of assets** created during the project. Where the PPP does not pass residual value risk to the private party, an asset simply returns to the municipality for zero or nominal consideration and the private party must earn a return on its initial investment through the service charges payable. However, the municipality is left with an asset with a remaining useful economic life and theoretically there should be a deduction from the NPV of the service charges to reflect the lower true net cost

of the services provided under the contract. Where such a deduction is made from the cost of the PPP an equivalent deduction should be made from the PSC model. In each case the market value of the asset is the appropriate figure. As there is unlikely to be a material difference between these two estimates it is usually legitimate to exclude the residual value on the grounds that it will not affect the comparison.

Step 3: Assess BEE value for money

Make a value-for-money assessment of which procurement choice is going to best achieve the BEE outcomes that the municipality targeted for the project.

Part 10: Verify information and sign off

Step 1: Verify the information used in the feasibility study

Constructing the PSC and external reference models and developing the risk matrix are information-intensive exercises. The conclusions that will be drawn from the models are highly dependent on the quality and accuracy of the information they are based on. All external projects are subject to the annual audit by the Auditor-General. For this reason, and because the models will need to be referred to throughout the procurement phase, it is necessary to provide the following information as an annexure to the feasibility study:

- **A statement from the municipality and its adviser on the reasonableness of the information collected.** Describe the process by which the adviser collected the information. Demonstrate that the information collected and used was realistic and sensible.
- **A statement of qualification from the adviser about whether value for money could have been enhanced.** In many cases, a municipality's strategic objectives may prescribe how a potential PPP can be structured, which may result in a particular level of value for money. It is the adviser's responsibility to point out to municipalities how value for money might be enhanced, and to record what different combinations of public-private solutions might have been explored to optimise the municipality's desired outcomes.
- **A description of how the assumptions used in constructing the PSC and external reference model are realistic and appropriate,** taking into account past practice, performance, current practice and anticipated future developments. For complex projects or projects where there is little precedent, it is strongly recommended that an independent party checks that the assumptions are reasonable, and confirms that they have been correctly incorporated into the model to produce an accurate result (arithmetic and logic). This may have cost and time implications.

- **A record of the methodologies used for valuing various costs**, including the costs of key risks.
- **A statement on how an audit trail of all documentation has been established and maintained to date**, and how it will be managed throughout the project. This is an essential requirement, especially for the purposes of the Auditor-General and in terms of the Promotion of Access to Information Act (2000).

Step 2: Draw up a checklist for legal compliance

Legal advisers must draw up a checklist for legal compliance. (This may be a summary of work undertaken during stage 3.)

Step 3: Sign off the feasibility study

All inputs into the feasibility study must be signed off as accurate and verifiable by each of the adviser specialists.

Part 11: Make the procurement choice

If the external reference model shows that the project is affordable as an external mechanism and there is reasonable indication that an external mechanism will result in a lower net present cost to the municipality (greater value for money) than a public procurement, with a value-for-money BEE outcome, then the municipality should procure the external mechanism.

STAGE 7: PROCUREMENT PLAN

A procurement plan demonstrates that the municipality has the necessary capacity and budget to undertake the procurement of the external option.

A procurement plan must contain at least the following:

- A project timetable for the key milestones and all approvals which will be required to take the project from TVR I to TVR III
- Confirmation that sufficient funds in the municipality's budget are available to take the project to TVR III and into contract implementation
- A list of any potential challenges to the project and a discussion on how these will be addressed by the project team and adviser
- The best procurement practice and procedures suited to the project type and structure
- The governance processes to be used by the municipality in its management of the procurement, especially regarding decision-making
- The project stakeholders and the extent of their involvement in the external option
- The project team with assigned functions
- Categories of information to be made available to bidders and how such information will be developed
- A list of required approvals from within and outside the municipality
- A Gantt chart of the procurement process, including all approvals and work items necessary for obtaining these approvals (for procurement documentation as well as, for example, the land acquisitions and environmental studies to be procured by the municipality)
- Contingency plans for dealing with deviations from the timetable and budgets
- The bid evaluation process and teams
- An appropriate quality assurance process for procurement documentation
- The means of establishing and maintaining an appropriate audit trail for the procurement
- Appropriate security and confidentiality systems, including confidentiality agreements, anti-corruption mechanisms, and conflict of interest forms to be signed by all project team members.

STAGE 8: PREPARE AND SUBMIT THE FEASIBILITY STUDY REPORT TO THE COUNCIL

Step 1: Prepare the feasibility study report for public comment and views and recommendations

Section 120 of the MFMA requires the submission of the feasibility report to the council for an “in principle decision” on whether the municipality should continue with the proposed PPP.¹² Section 78 (2) of the MSA requires a council decision to explore the provision of a municipal service by an external mechanism prior to council’s ultimate decision on a particular service-delivery mechanism. It is important that the feasibility study report submitted to council reflect both the MFMA section 120 requirements and those of section 78 of the MSA. This is accomplished by reporting on the internal mechanism assessment first, and then, separately, on the external mechanism assessment.¹³

Section 120 (6) of the MFMA defines a minimum 60-day period prior to the council meeting at which the feasibility study is to be considered. During that period, the municipality is required to make public the particulars of the proposed PPP and feasibility report and to solicit comments from the local community. In addition to the public notification, publication of documents and written comments, the municipality must also solicit the views and recommendations of the National Treasury, the relevant provincial treasury and the dplg. If the PPP is for the delivery of a municipal service within the portfolio of another Cabinet member, then views and recommendations must also be solicited from them and any other national or provincial organ of state as prescribed.

Other than the over-all 60 day period, the time frames for the notifications and comments are not listed in either section 120 of the MFMA or the Municipal PPP Regulations. The municipality must receive the public comments and views and recommendations of the relevant government bodies and process these comments in time for the council meeting at which the feasibility study will be considered, all within the 60-day period.

Documents of this importance are usually distributed to the involved municipal departments for comments before being sent to the councillors for their review prior to the meeting, commonly 10 days prior to the meeting. In consideration of the foregoing, the following time frames are suggested:

12. Section 120(6)(a) of the MFMA.

13. In Module 3, *Project Inception* reference is made to a council resolution that may issue delegating to the municipal manager the authority to undertake the internal mechanism assessment and thereafter undertake the external mechanism assessment. However, the feasibility study report should still be presented in the legislated format.

- Public notification will be made and documents made available to both the general public and government bodies 60 days prior to the meeting at which the feasibility study will be considered. The notification and invitation should indicate that comments from the general public and the views and recommendations of the National Treasury and other government departments are due 30 days after notification.
- After the receipt of comments, views and recommendations, the municipality will have ten days to summarise and incorporate the comments into the feasibility study report as an annexure. The completed feasibility report will then be distributed to all pertinent municipal departments 20 days prior to the council meeting and to the council members with department comments ten days prior to the meeting.

The submission of the National Treasury views and recommendations at the conclusion of the feasibility report is referred to as TVR I.

The feasibility study report will be submitted to the municipal council, with all the information arranged as it is set out in the list of submission requirements below. The contents page of the report should mirror this list.

Take note

The feasibility study report must provide as much information as is necessary for council to assess the merits of the project.

Submit as much information as possible, making use of annexures, which have been referenced in the appropriate section of the main part of the report. All documents that have informed the feasibility study and are of decision-making relevance to the project must be part of the feasibility study report.

The feasibility study report must be submitted as a report that clearly complies with both the MFMA and the MSA with its annexures. The report must not refer to any document that has not been submitted as part of the report.

Note that both section 120 of the MFMA and the Municipal PPP Regulations specify the matters that must be addressed in the report. Municipal PPP Regulation 3 (3) provides that an MSA section 78 (3) feasibility study shall, with certain additional matters being discussed, constitute compliance with the MFMA's feasibility study requirements. All of these matters will have been addressed during the various steps outlined above, but for the sake of convenience, a template with the contents of the report follows as an annexure.

Electronic format requirements

All electronic files must be labelled clearly to reflect their contents and dated as the final version. Text-based files must be in Microsoft Word and all financial models must be in Microsoft Excel.

The financial models must be sufficiently adaptable for use by others at later stages. Sheets must be logically ordered and labelled and inputs into the model clearly identified. Formulas should have as little hard coding as possible. If possible, key inputs should be able to be changed by the relevant treasury in the model itself to test different scenarios and the veracity of the model.

The municipality and its adviser may be requested to present the feasibility study report to the relevant treasury using Microsoft PowerPoint. The executive summary and Microsoft PowerPoint presentation must be compiled in such a way that the municipality's management can use them to make decisions.

Step 2: Receive comments, views and recommendations

When the municipality receives the comments or representations from the public or other interested parties that are submitted within the time frame specified in section 120 (6) (b) and (c) of the MFMA notification and invitation and the views and recommendations of the National Treasury, dplg, the appropriate provincial treasury and any prescribed sectoral department solicited, the adviser shall consider them and make recommendations for incorporation into Section 7 of the feasibility study report to the project officer in terms of any amendments, adjustments or clarifications deemed necessary.

The project officer, together with the project team and the adviser, will then prepare Section 7 of the feasibility study report to the council on the comments, views and recommendations received. The report will consist of the following:

1. Background

This sub-section will recite the feasibility study processes from which the notification and invitation for comments or representations from the local community or other interested persons and the solicitation of the government entities originated. The number of responses received will be indicated, and listed as:

- Local community comments or representations
- Interested persons comments or representations
- Views and recommendations from government entities
 - National Treasury
 - DPLG
 - Provincial treasury
 - Sectoral departments.

2. Summary of local community/interested persons comments or representations.

In this sub-section, the comments or representations of the local community or interested persons are summarised.

3. Summary of views and recommendations

In this sub-section, the views and recommendations of the following are summarised:

- The National Treasury
- The DPLG
- Provincial treasury
- Sectoral departments.

4. Recommendations as to comments or representations

In this sub-section, the report shall indicate how each of the comments or representations made by members of the local community or interested persons were considered in terms of the specific areas of the feasibility study as to which they were made and how they were incorporated, or not, into the feasibility study.

5. Recommendations as to views and recommendations

In this sub-section, the report shall indicate how the views and recommendations of each governmental entity solicited were considered in terms of the specific areas of the feasibility study as to which they were made and how they were incorporated, or not, into the feasibility study. The project officer and the adviser shall consult, as necessary, with any solicited governmental entity whose views and recommendations are negative in terms of the recommendation of the feasibility study, and seek a consensus on the way forward. The report shall include a recitation in terms of such consultation and its results.

Step 3: Submit the feasibility report to council

The feasibility study report will be completed and forward to council within the 10-day period described above.

STAGE 9: REVISITING THE FEASIBILITY STUDY

If at any time after TVR I has been granted in respect of the feasibility study of a PPP, but before the issuance of TVR III for the PPP agreement recording that PPP, any assumptions in the feasibility study are materially revised, including any assumptions concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer of the municipality must immediately:

- a) Provide the National Treasury and the relevant treasury with details of the intended revision, including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study.
- b) Ensure that the National Treasury and the relevant treasury are provided with a revised feasibility study, after which National Treasury may grant a revised TVR I.

The requirement is to revisit the feasibility study at any time that any assumptions may differ materially from the original ones, not only prior to financial closure.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

**ANNEXURE: CONTENTS OF THE
FEASIBILITY STUDY REPORT**

ANNEXURE: CONTENTS OF THE FEASIBILITY STUDY REPORT

Introduction

Submission requirements

- Covering letter from the accounting officer requesting TVR I
- Executive summary
- Introduction
- Project background
- Approach and methodology to the feasibility study.

Section 1

Submission requirements: Needs analysis

- Municipality's strategic objectives & how the proposed PPP meets them¹⁴
- Budget
- Institutional analysis
- Output specifications¹⁵
- Scope of the project.

Section 2

Submission requirements: Technical solution options analysis¹⁶

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

14. Section 120(4)(a) of the MFMA, section 3(1)(a) of the Municipal PPP Regulations, MSA section 78(1).

15. Section 120(4)(b)(i) of the MFMA, section 3(1)(a) of the Municipal PPP Regulations.

16. Section 3(1)(b) of the Municipal PPP Regulations.

Section 3

Submission requirements: Service delivery options analysis including internal and external mechanism assessment.¹⁷

- Delegation of authority to the municipal manager, if applicable
- Options considered
- Evaluation and assessment of each option
- Report on internal mechanism assessment
- Report on external mechanism assessment
- Recommended option.

Section 4

Submission requirements: Project due diligence

- Legal aspects¹⁸
 - Use rights
 - Regulatory matters
- Site enablement
- Socioeconomic and BEE.

Section 5

Submission requirements: Value assessment¹⁹

- PSC model, if required
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates – BEE targets
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, budgets and MTEF – Summary of results from the base PSC model: NPV

17. Section 3(1)(b) of the Municipal PPP Regulations, MSA section 78 (1), (3).

18. Section 120(4)(b)(ii) of the MFMA.

19. Section 120(4)(b)(iii), section 3(1)(c),(2) of the MFMA.

- External reference model
 - Technical definition of project
 - Discussion on costs (direct and indirect) and assumptions made on cost estimates
 - Discussion on revenue (if relevant) and assumptions made on revenue estimates – Discussion on proposed PPP type
 - BEE targets
 - Proposed PPP project structure and sources of funding
 - Payment mechanism
 - Discussion on all model assumptions made in the construction of the model, including inflation rate, discount rate, depreciation, tax and VAT
 - Summary of results from the PPP-reference model: NPV
- Risk assessment
 - Comprehensive risk matrix for all project risks
 - Summary of the municipality's retained and transferable risks
 - The NPV of all risks (retained and transferable) to be added onto the base PSC model, if required
 - The NPV of all retained risks to be added onto the PPP reference model
- Risk-adjusted PSC model, if required
 - Summary of results: NPV
- Risk-adjusted external reference model
 - Summary of results: NPV, key indicators
 - Sensitivity analysis
 - Statement of affordability
 - Statement of value for money
 - Recommended procurement choice
- Information verification²⁰
 - Summary of documents attached in Annexure 1 to verify information found in the feasibility study report.

20. Section 120(4)(c) of the MFMA.

Section 6

Submission requirements: Procurement plan²¹

Section 7

Report on comments, views and recommendations

Annexures

Annexure 1: Council resolution of delegation to the municipal manager, if applicable

Annexure 2: Statements for information verification and sign-off from each adviser to the project

Annexure 3: Letter of concurrence from CFO of municipality

Annexure 4: PSC model, if applicable

Annexure 5: External reference model

Annexure 6: Risk assessment and comprehensive risk matrix

Annexure 7: Document list (list of all documents related to the project, where they are kept, and who is responsible for ensuring that they are updated)

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

21. Section 120(4)(d) of the MFMA.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 5

PROCUREMENT PHASE



NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 5: PPP PROCUREMENT

ABOUT THIS MODULE

Module 5: PPP Procurement details the procurement processes of a municipal PPP.

This module is not prescriptive. Rather, it establishes best practice as it has been developed in South African municipal PPPs to date. The Municipal PPP Regulations and the Municipal Supply Chain Management Regulations state that it is the responsibility of the accounting officer to design and manage the procurement process in a way that meets the requirements of these regulations.¹

Given the newness of municipal PPPs in the South African environment, it is expected that each project will further refine the procurement process and add to the pool of best-practice knowledge. The case studies produced at the end of this procurement phase are an important part of tracking best practice. The National Treasury, in conjunction with the DPLG, will continue to update the *Municipal Service Delivery and PPP Guidelines*, and develop sector-specific toolkits to provide further guidance.

This module provides procurement guidance for the more complex municipal PPPs. It is recognised that many municipal PPPs will be less complex and the procurement process should reflect this. During the inception phase, when the municipality and the PPP unit project adviser are developing the terms of reference for the adviser, the simplification of the procurement process should be considered.² With appropriate motivation, the PPP unit project adviser will approve a simplified procurement process. Usually, a municipal PPP not requiring the preparation of a PSC should also be a candidate for a simplified procurement process, and this module discusses such cases.

This module also addresses the process that must be undertaken in terms of the requirements of section 33 of the MFMA, contracts having future budgetary implications, and section 113 of the MFMA, unsolicited bids.

Take note

The procurement of PPPs goes through distinct stages:

- Pre-qualification (which may be included in a request for proposals for simpler PPPs)
- Request for proposals (RFP)
- Best and final offer (BAFO) where necessary
- Negotiations
- Financial closure.

1. The sections of the MSA referenced to do not put any obligations on the accounting officer. For convenience, we assume that all obligations of a "municipality" set forth in the MSA are obligations of the accounting officer.
2. See Module 3: Project Inception.

Module 5: PPP Procurement explains how to proceed through the stages, with a focus on getting the documentation right. Follow the outlines of suggested contents for the various documents closely to ensure that the municipality provides the correct and complete information for getting Treasury Views and Recommendations in terms of the Municipal PPP Regulations.

SUMMARY OF APPLICABLE LEGISLATION

Procurement of goods and services in terms of the MFMA

All PPPs must be procured in accordance with the requirements of the MSA, MFMA and the National Treasury regulations and guidelines.

Part 1: Supply chain management of chapter 11 of the MFMA, applies to the procurement by a municipality of goods and services, including procuring a PPP.³ Any such procurement must be in terms of the municipality's supply chain management policy, which must comply with any prescribed framework, including these Guidelines.

Municipal Supply Chain Management (SCM) Regulations set out the prescribed procurement framework.

Sections of the Municipal SCM Regulations applicable to PPP Procurement include:

- 13: Listing general preconditions for consideration of bids
- 20: Describing the process for competitive bidding
- 21: Listing bid documentation requirements, including a requirement that any bid documentation must take into account “any Treasury guidelines on bid documentation”⁴
- 22: Public bid invitation requirements
- 23: Procedure for handling, opening and recording of bids
- 24: Negotiation parameters⁵

3. Section 110 (1) (d) of the MFMA, section 120 (7) of the MFMA, section 83 (1) (a).of the MSA.

4. Section 21 (a) (ii) of the Municipal SCM Regulations, section 21 (a) (ii).

5. Section 84 of the MSA also lists negotiation parameters, generally consistent with section 24, and further lists public inspection and media notice requirements.

- 25: Describing a two-stage bidding process
- 26: Requiring a committee system for competitive bids
- 27: Describing the make-up and duties of bid specification committees
- 28: Describing the make-up and duties of bid evaluation committees
- 29: Describing the make-up and duties of bid adjudication committees
- 31: Processes for the procurement of IT related goods or services
- 32: Processes for the procurement of goods and services under contracts secured by other organs of state
- 35: Appointments of consultants
- 37: Unsolicited bids.

The Municipal PPP Regulations describe the processes for obtaining the views and recommendations of specified institutions during the procurement process.

In part 2 of chapter 11 of the MFMA, public-private partnerships, subsection 120(7) states that part 1 of the chapter applies to the procurement of a PPP. The Municipal PPP Regulations contain various sections applicable to such procurement.

Sections of the Municipal PPP Regulations applicable to the procurement of a PPP include:

- **Section 4:** Requiring the accounting officer to solicit the views and recommendations of National Treasury and the relevant provincial treasury on proposed bid documentation, including the proposed terms and conditions of the draft PPP agreement, at least 30 days before bids are publicly invited, the evaluation of the bids received and of any preferred bidder at least 30 days before any award is made, the proposed terms and conditions of the proposed public-private partnership agreement prior to its execution, the municipality's plan for management of the agreement and the preferred bidders competency to enter into the public-private partnership agreement and its capacity to comply with the obligations thereof.
- **Section 6:** Providing that only the accounting officer may sign a public-private partnership agreement, and may not do so unless Section 33 of the MFMA has been complied with.

These Guidelines provide direction consistent with the Municipal PPP Regulations, the Municipal SCM Regulations and the applicable sections of the MFMA and MSA.



MUNICIPAL PPP PROJECT CYCLE

Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: III

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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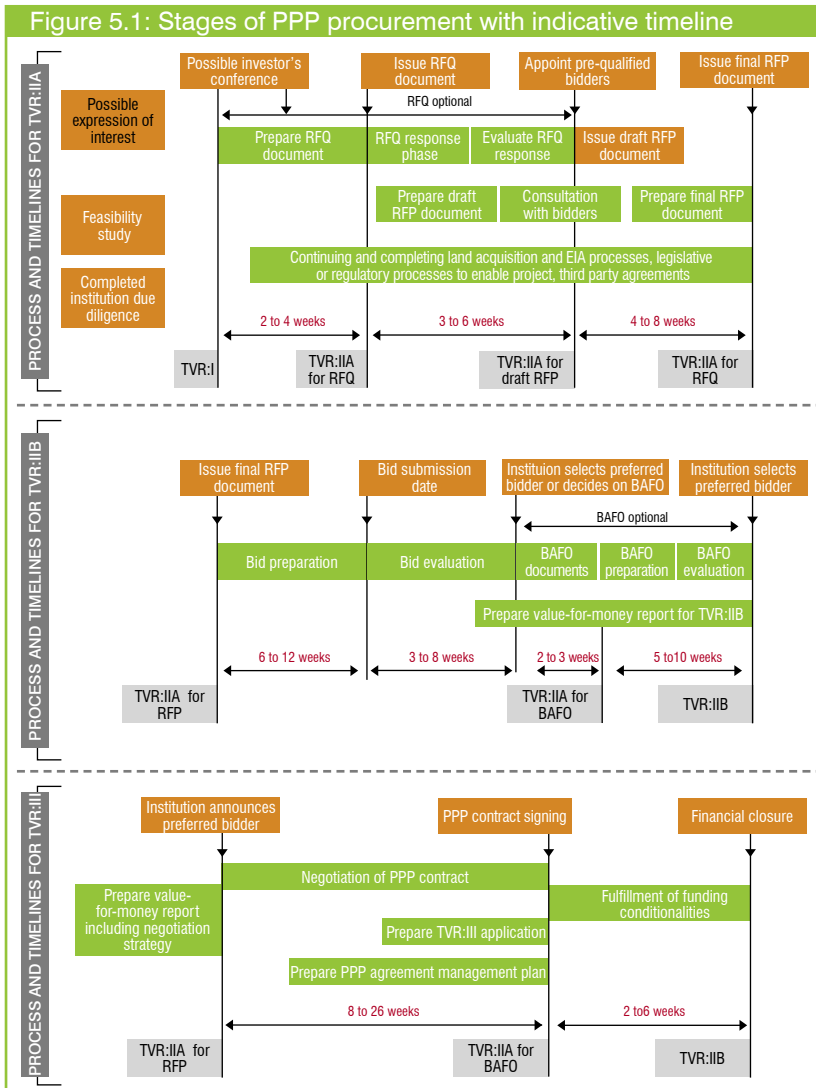
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A glossary and list of acronyms are provided at the beginning of Module 1.

INTRODUCTION

This introduction traces the key links between the feasibility study, discussed in Module 4 and PPP procurement. It also presents a broad overview of vital issues to be considered during the procurement phase. Following these broad points, the module details the various stages of procurement.

Figure 5.1: Stages of PPP procurement with indicative timeline



Links to the feasibility study

The stronger the link between a project's feasibility study and its procurement, the greater the opportunity to create a true value-for-money PPP. Key outcomes of the feasibility study that are absolutely necessary for a solid PPP procurement include:

1. A full and detailed understanding of all facets of the project
2. A clear affordability statement
3. A clear exposition of value for money and the drivers of such value
4. Procurement plan
5. Project team
6. Output specifications
7. Project type and participants
8. Third parties
9. Funding sources
10. Payment mechanisms
11. Due diligence
12. Risk matrix with costs, and sources of risk with sensitivity analyses, where applicable

1. A full and detailed understanding of all facets of the project

An understanding of the project is crucial to a successful PPP procurement. At minimum, the scope of the project must be defined and linked to a municipality's integrated development plan (IDP) for service delivery.

Before designing the procurement documents, state the project objectives and scope clearly and concisely, in terms of business outcomes, supported by expected project outputs. This statement should then be the introduction in every subsequent procurement document.

2. A clear affordability statement

The resolution of a municipal council authorising the procurement of a PPP should contain a restatement of the affordability limits set in the feasibility study. This is typically the extent of any capital contribution by the municipality to the PPP, the annual limits of the unitary payment, if there is a unitary payment, and the costs of managing the PPP agreement. In a simple municipal PPP, affordability becomes the paramount consideration.

The affordability limit in a well-constructed feasibility study is determined by four factors:

- Predicted/anticipated revenue flows
- Existing budgets for the function
- The specifications defined for the project
- The risk sought to be transferred in the PPP.

Two important warnings arise from this:

- Once the external costs of economic factors are stripped away, breaches of affordability limits during the procurement process mean that there is a mismatch between the specification used for costing in the feasibility study and the specification set out in the procurement documents. In such a case affordability limits or specifications need to be amended. Neither is a satisfactory solution, and both invariably result in delays to the project at a time when the private parties are already involved and have spent money on submitting proposals. In particular, a revised TVR I will be required.
- Even though a project appears to be affordable based on private-party proposals during the procurement process, private parties may make qualifications to the risk profile that have a direct impact on the ultimate affordability of the PPP. This is apparent in projects where the private party is able to claw back substantial gains through the term of what began as an affordable PPP.

The affordability limit set by the council is a key indicator during procurement. Deviations are to be treated with caution and must be fully justified in an application for a revised TVR I.

Use the affordability limit in preparing the procurement documentation. Use discretion to decide whether this will be an explicit statement of affordability, or whether the municipality anticipates revenue fluctuations as disclosed in the feasibility study.

3. A clear exposition of value for money

Value for money is not a vague term; in the feasibility study it is defined in monetary terms and will be subject to audit. The feasibility study must not only have defined the initial value for money in absolute terms, but also have identified the sources of such value.

It is important that the procurement documentation:

- Sets out the information to bidders so that the value-for-money drivers identified by the municipality are absolutely clear. They need to be identified as priorities, whether they are design efficiencies coupled with reduced operating costs in an accommodation project, or the risk of service extensions in a water services project. Setting out these drivers is not prescriptive, but must encourage bidders to offer their best value-for-money solution in a way that enhances these drivers.

- Establishes a way for the private party to determine and justify the value for money in each proposal.
- Encourages private sector innovation through competition.

4. Procurement plan

The feasibility study will have been accompanied by a procurement plan that sets out timelines, processes and strategies. The project officer must update the procurement plan⁶ before seeking TVR IIB, and must regularly update the procurement plan throughout the procurement phase.

5. Project team

During the feasibility study phase, information gathering and processing were the main required skills of the project team, involving a multitude of specialist functions. Procurement requires communication and analytical skills, and the project team should be pared down to members who have these skills. This should be done as soon as possible after the council approves procurement. Ideally, the project team should be constituted as the bid specification committee in terms of section 26 (1) (a) (i) of the Municipal SCM Regulations, as well.

6. Output specifications

The municipality's required outputs of the project were clearly specified in the feasibility study phase and used as the basis to develop the PSC and external reference models in complex projects. Stressing the link between the feasibility study and procurement, and particularly the link between affordability and specification, the output specifications must form the basis of the project's specifications in the RFP.

7. Project type and participants

The feasibility study will have identified, in the municipality's view, the financial structure best suited to the project's characteristics, as well as the likely participants. This would include essential information about whether the project is suitable for project finance or corporate finance, the likelihood of raising debt and equity, and the types of participants, be they sponsors,

6. The procurement plan should be one component of the general project management planning required of the project officer. This module focuses on the procurement of a project. Refer to appropriate project management literature and international best practice for overall project planning and management.

subcontractors, lenders or third party investors. Most importantly, when preparing the feasibility study, the adviser will have tested the market's appetite for the project and for some of the specific project risks.

The procurement documentation must then focus on procuring that type of project with particular types of participants. The municipality should not restrict participation to these participants, but should strike a balance in the RFP between clearly communicating its view of the project and allowing bidders to propose their own structures and participants.

8. Third parties

All third parties to agreements, whether they are landowners, users or other parties, must be identified before procurement, with a procurement plan that includes the signing of third party agreements at the appropriate times.

9. Funding sources

Procurement documentation is dependent on the intelligent identification, during the feasibility study, of the possible funding sources. The source/s of funding are closely linked to the types of project and its probable participants. To a large extent, the source/s of funding (e.g., lenders, private parties, SPV participants) dictate the terms of the PPP agreement. Some projects are suited to on-balance sheet treatment. Others are conducive to limited recourse debt in which lenders require significant levels of due diligence on the project. Limited recourse debt is best used only in certain projects whose size justifies the cost and time involved.

10. Payment mechanisms

The procurement documents must clearly set out the payment mechanism. In certain projects involving the use of municipal land, the private party will make a concession or lease payment to the municipality. In such cases, the payment mechanism in the procurement documents is a statement of the process by which that fee will be calculated and paid by the private party (the PPP fee).

Other projects, including complex PPPs, typically involve three types of revenue for the private party:

- Payments from a municipality
- User fees
- A combination of the two.

Each has different characteristics. Payments from a municipality have greater certainty than user fees because they do not have an inherent demand or collection risk and they allow the municipality to manage performance better, by making deductions for non-performance by the private party. User fees are susceptible to demand and collection risk and generally lead to keen consideration by private party bidders and in some cases to an underwriting of demand risk or user subsidisation by government. (See Annexure 1: **The payment mechanism.**)

11. Due diligence by the municipality

The project due diligence is crucial to successful procurement. The results cover, among others, existing assets, land ownership, rights and conditions, environmental scoping, heritage issues and staff.

Procurement of a PPP cannot proceed until the due diligence is complete, as any single issue can delay or destroy the project. If the due diligence was not completed before the issue of the authorisation to procure the PPP, it must be completed before any TVR IIA is sought. It is likely that such a delayed due diligence will require a revised council authorisation to procure the PPP, as project costs will vary as a result of the due diligence.

Nearly all PPPs involve the use of immovable property. Of all the items for which there needs to be certainty before procurement, land is the most important. Who owns the land and any rights over the land must be identified. It is also critical to identify ground conditions on greenfield projects and the condition of existing assets and the underlying land on brownfield projects. The due diligence on the land must be complete before council authorisation to procure. The process of acquisition should be complete before a TVR IIA is issued.

12. Risk matrix with costs, and sources of risk with sensitivity analyses

In a complex PPP involving the creation of a PSC and an external reference, the risk matrix from the feasibility study must be continually updated during procurement. Each risk is tracked in terms of where it is dealt with in the procurement documents and how bidders deal with it in their proposals. This risk-tracking is of great importance.

Critical considerations for the procurement phase

1. Should there be an explicit statement of affordability in the RFP?
2. Variant bids
3. Time allowed for bid preparation
4. Value for money in risk: issues and mitigations
5. Early works
6. Land
7. Staff
8. Competition
9. Bidder compensation
10. Shared bid costs
11. Existing municipality assets
12. Asset replacement and disposal
13. Expression of interest

1. Should there be an explicit statement of affordability in the RFP?

A statement of affordability sets out the amount of money the municipality is willing to pay via the PPP payment mechanism, except in those PPPs involving the private sector paying the municipality a concession or lease fee for use of municipal land.

The greatest benefit of disclosure in projects involving the payment of a fee to the private party is that it reduces the risk of unaffordable proposals, and bids are focused on achieving maximum value for money. It is also likely that mismatches between output specifications and price will be highlighted early in the bid process. The interpretation of output specifications can also vary widely from one bidder to the next. In the absence of a common understanding of the affordability constraints, bids will be extremely varied and evaluation will be difficult.

The disadvantages of disclosure are obvious – competition on price is limited, and evaluating variant performance specifications can also be difficult.

Even with these disadvantages, it is the strong recommendation of the National Treasury that the affordability limit be published. Consider all aspects of the project before making a decision to the contrary, and review the decision before any BAFO process begins.

2. Variant bids

Significant value for money in PPPs lies in private party innovation during bid preparation. This means that the RFP may be developed to allow for variant bids in addition to a compliant bid. However, evaluating variant bids can be particularly difficult, because they cannot easily be compared to any base or even to other bids.

Variant bids must:

- Be accompanied by a compliant bid
- Meet the specified minimum requirements set out in the RFP
- Be supported or underwritten to the same extent as the compliant bid
- Show in each element how they differ from the compliant bid, what changes to the risk allocation have been proposed, and what value for money they present to the municipality
- Be clearly separable from the compliant bid and from other variant bids, because a mixed list is impossible to evaluate and will result in protracted negotiations.

List the variants that the feasibility study showed as providing possible value for money, but do not limit bidders to these.

3. Time allowed for bid preparation

There is a direct correlation between the time allowed for preparing bids and the quality of the bids. It is also true that absolute bidder commitment must be secured before a PPP agreement can be finalised. This can be done either in a competitive bid environment or in post-evaluation negotiations with a single bidder. The former is far better value for money. Accordingly, give bidders enough time to meet all the bid requirements. Find out what bidders think is an adequate time for preparing a bid during or after pre-qualification.

4. Value for money in risk: issues and mitigations

Since PPPs are intended to maximise value for money, the RFP sets out all the elements that make up value for money for the municipality. In many cases this takes the form of a risk matrix. Bidders should be allowed to propose an alternative to any element, provided that the value for money of the alternative is set out clearly, and the compliant bid reflects the municipality's value-for-money requirement as set out in the RFP.

Among others, two important and common value-for-money considerations are:

- The use of alternative inflation indices
- Foreign exchange risk and sharing interest rate risk.

These would be treated differently in project finance and corporate finance bids.

Alternative inflation indices

Bidders commonly propose the use of specific indices that they feel better represent the inflationary pressures associated with a project. For example, a bidder may propose the use of an index that has a higher component of labour costs than CPIX inflation on a project with a large labour component.

The advantages of using CPIX in PPPs as the index of adjustment of unitary payments and user charges are:

- The simplicity of a single, common index
- The certainty of budget adjustments
- Compliance with inflation targeting
- Incentivising the private party to manage above-CPIX increases in costs.

The National Treasury's position is that the advantages are such that no index other than CPIX can be used without a clear demonstration of value for money, supported by a detailed submission by the municipality and its advisers.

Foreign exchange and shared interest rate risk

Section 47 (a) of the MFMA explicitly requires municipalities to incur debt that is denominated in rand and is not indexed to, or affected by, fluctuations in the value of the rand against any foreign currency.

In terms of shared interest rate risk, a common practice involves the use of interest rate bands, which would result in the first X per cent of an increase above the projected interest rate being for the account of the private party, the next Y per cent being shared by the municipality and the private party in a pre-agreed ratio, and the remaining Z per cent being taken by the municipality. The same banding approach would apply to decreases in the interest rate for sharing the benefits. The relevant interest rate at the time of signing is crucial, and if it is abnormal relative to the forecast rate, then the municipality should negotiate a way to adjust the banding appropriately.

5. Early works

“Early works” is work undertaken on the PPP facilities before the PPP agreement has been finally negotiated. They are also referred to as enabling works.

Early works are usually carried out by the preferred bidder's construction subcontractor in terms of a separate contract known as the early works agreement. The arguments in support of such agreements are usually time-related – fast-tracking the project requires an early start to construction.

The National Treasury is not in favour of early works agreements:

- The complexity of negotiating the agreement will probably not save the time intended.
- The municipality's bargaining position will lose strength in negotiations if the works have already started with the preferred bidder.
- The early works will invariably have started on substantially different terms from those envisaged in the PPP agreement and may not offer as much protection to the municipality.
- The final cost of these works may be more expensive than if they had been procured under the PPP agreement, as they are invariably negotiated on a cost plus basis.
- Scope creep – the incremental increase in project scope as needs change – in open-ended early works agreements can result in a significant reduction in the value of the PPP.
- If the PPP negotiations are terminated it may be difficult to get a third party in to complete the works, and the works carried out under the early works agreement may therefore lose value, especially as these works are unlikely to suit the designs of a new preferred bidder.

Circumstances that may be conducive to early works agreements:

- The work required was set forth in the feasibility study
- The risk for this work was allocated at least partially to the municipality
- Value for money is demonstrated
- The RFP sets out the terms of the early works agreement.

Early works should be limited to:

- Relocating existing services on the site
- Cleaning up existing contamination of the site
- Corrective work or maintenance to remedy latent defects on existing project facilities.

In these cases it is essential that the early works agreement passes risk on to the future private party by fully integrating the results of the early works into the PPP agreement.

Any early works agreement must be a full contract that is a stand-alone document (namely containing all essential terms). This will both cater for the risk that the PPP agreement with the preferred bidder will not be signed

and set out the terms on which the early works are incorporated into the PPP agreement. The early works agreement is made between the municipality, the preferred bidder and the preferred bidder's construction subcontractor.

The scope of the early works must be restricted to avoid scope creep, and the early works agreement must contemplate a no-fault termination arising from failure of the PPP negotiations as well as termination on signing of the PPP agreement.

6. Land

Land issues are at the forefront of bidders' minds because, in almost all cases, the land is selected and owned by the municipality for the period of the PPP agreement. This means that all property annexed to the land constructed by the private party belongs to the municipality. Bidders want certainty about their use of the land over the period of the PPP.

Strive for a balance here. The feasibility phase will have involved exhaustive investigations into title to the land – the status of any land claims, servitudes, long leases and constraints, as well as investigations into geo-technical conditions, existing contamination, utility service availability and capacity, and the environmental and heritage status of the land. Be certain to obtain all necessary filings and approvals to avoid long delays later. The information in all cases should be given to bidders in the RFP, but is not warranted unless it clearly provides value for money.

Environmental impact assessment

The National Environmental Management Act (1998) places an obligation on the municipality to “consider, investigate and assess prior to their implementation and report to the organ of state charged by law with authorising, permitting, or otherwise allowing the implementation of an activity”. As this process cannot be delegated to a private party, the municipality must seek to obtain authorisation or refusal from the relevant organ of state as soon as possible, preferably before the RFP is issued. The decision is made by the relevant organ of state (either the provincial or national department responsible for the environment) and is issued as a public record of decision (RoD). If obtained, the RoD should be made available in the RFP so that all bidders make proposals that meet all the requirements of the RoD.

The risk transfer must be made clear to ensure that all subsequent fulfilments of the requirements of the RoD must be at the cost and risk of the private party. In effect, the municipality will have created an equal opportunity for all bidders to deliver the PPP within the environmental constraints of the project. The methods used to mitigate environmental impact will vary from

party to party, and the responsibility for obtaining approvals for environmental impact assessments in terms of the Environment Conservation Act (1989) will pass to the private party.

The municipality must be confident that the preferred bidder will be able to obtain the required approvals. Private-party financiers will also conduct significant due diligence on this. The municipality should not assume any responsibility in the RFP for obtaining such approvals.

Heritage assessment

Make sufficient time available for bidders to carry out their own due diligence on the project site for heritage impacts. This due diligence will be in addition to the heritage impacts established by the municipality in the feasibility study. The results of the municipality's assessment should be made available but not warranted to bidders in the RFP.

7. Staff

The feasibility study phase requires that all project costs and risks be accounted for. Existing staff costs will play a major role in the procurement of the PPP. The RFP must spell out the requirements for the treatment of existing staff as well as the status of all communications to date, collective agreements, and, most importantly, adequate detail for bidders to cost staff transfers if this is the preferred route for the municipality. This includes staff numbers, pension and medical aid status and costs, as well as leave and other entitlements. Bidders should be required to produce personnel plans that are firm, costed commitments, completely in line with the municipality's requirements and existing staff agreements.

Communication with staff and organised labour throughout the procurement phase must be well planned and continuous.

8. Competition

PPPs are subject to the Competition Act (1998). The Competition Commission is the statutory body charged with applying the Competition Act. The purpose of the act is to encourage and maintain competition in the country to promote economic development, employment, SMME participation, and a greater spread of ownership among companies in the country. Section 81 of the act makes the act expressly applicable to the state.

The act identifies four events or activities that would require the intervention and adjudication of the Competition Commission.

8.1 Restrictive horizontal practice

Restrictive horizontal practice (section 4) is defined as an agreement between firms⁷ in a horizontal relationship, which has the effect of substantially preventing or lessening competition in a market. The key elements here are the application of the section to firms that are competitors and that enter into an agreement that has the effect of reducing competition. The onus is on private party bidders to avoid such practices.

8.2 Restrictive vertical practice

The definition of restrictive vertical practice (section 5) is largely the same as a restrictive horizontal practice, but there is a vertical relationship between a firm and its suppliers, and between a firm and its customers. The onus is on private party bidders to avoid such practices. Good procurement practice will ensure that the municipality does not infringe this section of the act.

8.3 Abuse of dominance

In section 8, the act prohibits charging excessive prices, engaging in any exclusionary acts which are anti-competitive in nature, and price discrimination by dominant firms. The application of this section to PPPs is limited: as it is unlikely that any firms in PPPs would fall within the definition of a dominant firm; price determination in PPPs is not the sole responsibility of the private sector; and exclusionary acts are unlikely to occur in a single-concessionaire type environment.

8.4 Mergers

The act applies most to PPPs in the definition of mergers (chapter 3) and the process to follow for notifying the commission and other parties of a potential merger.

Mergers are not prohibited in terms of the act. The act is intended to prevent mergers which will have the effect of substantially preventing or lessening competition, taking into account factors such as the public interest and technological or efficiency gains that might result from such a merger.

7. The definition of firms includes persons, partnerships or trusts, but clearly excludes public-sector bodies.

In terms of section 12, a merger is defined as the event that “occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm”. A number of types of merger are identified in this section and the term “control” is defined.

There are two tests for whether a transaction must be formally notifiable to the Commission:

- Whether the transaction constitutes a merger in terms of the act
- Whether the required thresholds of annual turnover and gross assets are met.

Government Notice 254 of 2001 sets out the thresholds of annual turnover and gross assets. It also outlines the method for calculating these. The higher amount of the annual turnover or gross assets of the target firm must be equal to or exceed R30 million; and the combined annual turnover and gross assets of the target firm, the acquiring firm and other group firms of the acquiring firm must be equal to or exceed R200 million for the merger to be notifiable.

Annual turnover must be ascertained with reference to the gross revenue stated in the seller’s income statement of the immediately previous financial year. Gross assets must be ascertained with reference to the gross value of assets as recorded in the seller’s balance sheet for the end of the immediately previous financial year. The notice also provides that the annual turnover and gross assets figures of all firms controlled by the target business must be added to the figures for the target firm on a consolidated basis. Similarly, the annual turnover and gross assets figures of all firms forming part of the same group as the acquiring firm must be added to the figures for the acquiring firm on a consolidated basis.

Process for competition filing

During the feasibility study phase, the municipality must have identified the competition issues likely to arise. If it is necessary in the procurement phase to approach the Competition Commission for any approval, build a competition filing process into the timeframe for the project.

The private party is responsible for compiling the documents for filing and obtaining the necessary approval from the commission, and for the costs. The RFP must indicate this clearly. The RFP must further indicate

that if the Competition Commission does not approve the project, the municipality automatically has the right to withdraw the RFP. Also, the municipality will not be liable for any damages (whether direct, indirect, special or consequential) or for any losses, costs, expenses or penalties suffered by the private party in preparing its bid documents and documents for competition filing.

Competition Commission approval must be obtained by the private party before the municipality's application for TVR III is lodged. The private party should approach the Competition Commission for approval as soon as the PPP agreement has been finalised but before its execution.

9. Bidder compensation

The general principle is that bids are submitted at the bidder's cost and risk. Bidders build in bid costs so that each successful bid has an element of the cost of past unsuccessful bids. By selecting a small number of well-qualified bidders in complex projects, the municipality minimises total bidder costs to the project and to other projects.

This principle does not apply when the size of the project makes bidding unaffordable or too risky for bidders. In this case, bid compensation should be a pre-agreed percentage of the verifiable costs incurred by a bidder in preparing its bid. This compensation should only be paid to unsuccessful bidders for a compliant bid. The successful bidder has the remuneration of the PPP itself. If the municipality terminates the procurement for any reason that is not the fault of the bidders, compensation may also be payable.

10. Shared bid costs

The costs of due diligences by private parties may be significant. Where possible, and where bidders agree, survey costs can be shared between pre-qualified bidders. If the project is so large that high survey costs could reduce the number of bidders, the costs can also be shared by the municipality.

11. Existing municipal assets

Where existing municipal assets are to be incorporated into the PPP, give bidders access to all information on the assets, including their condition and their maintenance records. Existing municipal assets are a separate risk category, and bidders may be reluctant to accept performance and availability risk if they do not have access to detailed information on which to base their due diligence. Allow bidders to demonstrate additional value for money by not using existing municipal assets.

12. Asset replacement and disposal

Bidders need to set out clear schedules for asset replacement and disposal. This is not so much for the future management of the PPP agreement, but allows the municipality to understand the basis for the private party's use of assets when the municipality is evaluating proposals. Be careful not to specify the replacement of assets, as this is not an output and will reduce the private party's ability to maximise the use of assets.

13. Expression of interest

An expression of interest is not the same as an RFQ. An expression of interest is a way of establishing the level and type of interest of a particular market sector in a particular project. It is most often used in revenue-generating projects where the broad parameters of the potential PPP are known (for example, in determining the market interest in a potential regional solid waste landfill, or in tourism developments in a conservation area).

The advantage of an expression of interest is that a municipality can make an informed decision, based on market interest, about whether to proceed with a project. If used, it should be early in the project cycle, either before or as part of the feasibility study.

An expression of interest must be more than a public advertisement calling for responses. It should consist of an advertisement and a document that includes:

- Background and aims of the municipality and the project
- A clear identification of the project as a potential PPP to be procured in accordance with Treasury regulations
- A brief summary of similar PPPs and references to more detailed sources of information
- Value for money expected in the provision of a municipal function or use of municipal property by a proposed PPP
- Expertise sought from the private sector
- Information that respondents must supply
 - Legal status of respondent
 - Respondent's details and profile
 - Why they are interested in the project
 - BEE profile
 - History of involvement in similar projects
 - Input on nature of proposed PPP
 - Contact details

- Process to be followed and subsequent communication with respondents (with timelines)
- Disclaimer of municipal liability and reservation of rights.

An expression of interest does not need to include the same detail as an RFQ. The emphasis is on providing information to the private party, not on soliciting full bids or proprietary information. An expression of interest therefore has a limited use on particular projects and should not be used spuriously.

STAGE 1: THE RFQ

Objectives of the RFQ

This part of the procurement process is known as the request for qualification, or RFQ. It is a very important part of the procurement process and must meet all the requirements of relevant legislation, regulations and best practice.

In complex projects, the National Treasury considers it best practice for a municipality to limit the number of private parties eligible to participate in a PPP procurement by carrying out a pre-qualification exercise. In simpler projects, particularly those in which the adviser's terms of reference do not include the preparation of a PSC and external reference, the matters that would otherwise be set out in a RFQ may be included in the RFP. This decision should be made at project inception.⁸

The RFQ's objectives are to:

- Select a limited number of the bidding consortiums⁹ that are qualified – technically, financially and in terms of BEE – and have sufficient experience and commitment to prepare proposals and execute the project
- Set out the rules of participation in the procurement process clearly and unequivocally
- Disseminate information on the project
- Give guidance on the expected kinds of participants in bidding consortiums
- Gather information from bidders that is verifiable and can be evaluated.

This ensures that the successful bidder will have not only the qualifications to undertake the project, but also the capacity to execute it effectively and timeously.

In complex projects, only pre-qualified bidders will be allowed to enter the RFP stage.

8. See Module 3: Project Inception.

9. In South Africa it is not often that the private party or bidder will ever be a single commercial entity. Bidding teams are formed that combine a variety of entities contributing expertise, resources (including funding), and socioeconomic and BEE components.

Critical considerations in the RFQ stage

1. Number of pre-qualified bidders
2. Bid bond
3. BEE
4. Parties eligible to participate in bidding consortiums
5. Conflict of interest.

1. Number of pre-qualified bidders

The pre-qualified bidders should be kept to a minimum of three and a maximum of four. Given the high cost to the private sector of submitting proposals, this will give pre-qualified bidders a reasonable chance of success.

Where only two or even only one bidder pre-qualifies, the project is placed at a great disadvantage, because competitive bidding is essential for getting value for money. In principle, under the MFMA's supply chain management law – and subject to the municipality's own supply chain management policy – it is not necessary to cancel a bidding process if only one bid is made. However, this may be an indication that the project has not been well structured or conceived and the municipality should follow the guidance below.

- Ascertain the likely reasons for the limited interest, and revisit the RFQ documentation and the feasibility study to see what assumptions can be revised to increase market interest. Any changes in the feasibility study must be evaluated for changes in affordability, value for money and risk transfer.
- Secure a revised authorisation from the council to procure the PPP if any changes to assumptions in the feasibility study are made.
- Carry out a second pre-qualification exercise if the project assumptions have been changed and if a revised authorisation to procure has been secured from the council.
- If the feasibility study is not revised, carry out the pre-qualification exercise again, with a wider circulation to attract a suitable number of bidders, or continue with the limited number of pre-qualified bidders, but with a revised procurement plan that uses the PSC prepared in the feasibility study as an active “competitor” for the bids.

2. Bid bond

To mitigate the risk of pre-qualified bidders dropping out of the process, a bid bond should be required from the pre-qualified bidders before the RFP is issued. Formal appointment as pre-qualified bidders should be contingent on the provision of such bid bonds being provided to the municipality in the approved format. The size of the bonds should be appropriate to the project, typically, the cost to the municipality of restarting the procurement process from RFQ stage.

3. BEE

To pre-qualify in the BEE component of the RFQ, bidders should at least demonstrate that:

- For PPPs as to which a bidding consortium will be formed, written confirmation that each proposed consortium member and first-tier subcontractor is compliant with the BEE charter applicable to its particular sector, or where there is no charter, compliance with the applicable BEE generic code¹⁰.
- For simpler PPPs for which the bidder will not be forming a consortium, proof that the bidder is in compliance with its applicable sector BEE charter, or where there is no charter, its BEE standing in terms of the applicable BEE generic code.

Once consortiums have been pre-qualified, they will need agreement from the municipality to change their consortium's membership, and the qualifying BEE targets may not be compromised in any such change. Fronting of black people and black enterprises will not be tolerated by municipalities.

4. Parties eligible to participate in bidding consortiums

Private parties

All privately owned firms that are not listed on the National Treasury's list of companies/directors/persons restricted from doing business with the public sector or listed on its Register for Tender Defaulters,¹¹ or which have not

10. See Module 2: Code of Good Practice for BEE in Public Private Partnerships.

11. To confirm whether a firm, its directors or persons have been restricted from doing business with the public sector, the National Treasury should be contacted at Restrictions @ treasury.gov.za. To determine whether the bidder is on the Register of Tender Defaulters, go to the National Treasury's website, www.treasury.gov.za, and click on the icon "Register for Tender Defaulters."

been found guilty in a court of law of fraud or corruption-related crimes, should be eligible for participation.

Not-for-profit entities

The Non-Profit Organisations Act (1997) defines “non-profit organisation” as a trust, company or other association of persons established for a public purpose, the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered. Section 21 companies are associations not for gain under section 21 of the Companies Act (1973). The act restricts these to associations that apply profits to a specific purpose and does not allow the distribution of dividends to members.

The majority of these entities rely on donor or government funding to some extent, and are vulnerable to a degree of financial uncertainty. As not-for-profit entities, they are excluded from profiting, making them not ideal as key operators or equity participants in PPPs in most cases. They may, however, play an important role in achieving the socioeconomic aims of the project. They also ensure that special interest groups are represented. Their participation is at the invitation and risk of the private party. Not-for-profit entities may, however, tender for simpler municipal PPPs, where the risks to the private party are not significant.

Public entities

The Municipal PPP Regulations’ definition of a private party in a PPP agreement explicitly excludes public entities.

PPPs seek private finance and then place it at risk in that payment is performance-based. In principle, therefore, the use of public entities as financiers, equity participants or subcontractors runs contrary to the principle of risk transfer in a PPP. Agreements formed between public entities or between municipalities and public entities are not PPPs, but may constitute municipal service partnerships.

The National Treasury views any proposed participation by public entities in a private-party consortium to a PPP as anti-competitive and as skewing the risk profile of the project for government.

The National Treasury does envisage situations where public entity financial institutions have a role to play in financing PPPs. They may have a greater risk acceptance than the private sector, be able to provide longer-term debt, and have a greater appetite for BEE funding. This role should be limited to the provision of debt that does not duplicate what the private

sector provides and is provided at competitive rates and in a competitive environment. Importantly, such debt should be made available to all pre-qualified bidders.

It is also possible that a public entity can participate as a subcontractor, provided that its services are secured in advance by the municipality via a third party agreement, available to all bidders and allowed to be provided by law. All other forms of public entity participation should be explicitly excluded in the RFQ.

5. Conflict of interest

Consortium members

To avoid any potential conflict of interest, no member of any consortium should be a member of, or in any way participate or be involved in (directly or indirectly), another consortium at any stage of the procurement process. This restriction should be backed up by the power to disqualify a consortium member or the entire consortium if there are good grounds to do so.

The restriction can be lifted for:

- Any specialist supplier, if the restriction leads to a severely limited number of consortiums
- Any non-core service provider or general supplier which is not a consortium member
- Any commercial entity whose role is strictly limited to lending money or advancing credit to the bidding consortium.

Advisers and lenders

To prevent the conflict, or potential conflict, of interest between lenders and sponsors of projects, no adviser to any consortium or member of a consortium should fulfil the role of arranger, underwriter or lead bank to the consortium. Again, there should be a suitable right to disqualify such a member.

The National Treasury is aware that the advisory market is a limited one and that competition for advisory services may therefore be reduced. However, it views the potential conflict of interest as so severe that reduced competition is justified.

Other

No member of the municipality's project team, including its adviser, or the relevant treasury's PPP unit's project adviser, may participate in, advise or have any interest in any bidding consortium.

The RFQ stage

- Step 1: Prepare the RFQ document
- Step 2: Consult with the Municipal Desk
- Step 3: Advertise and distribute the RFQ
- Step 4: Evaluate the responses
- Step 5: Communicate with bidders

Step 1: Prepare the RFQ document

The RFQ document must enable bidders to present the appropriate information about themselves. It must also clearly set out the RFQ evaluation criteria and processes. Any special requirements of the municipality must be clearly stated, and particular RFQ provisions must be developed for each PPP.

Contents of the RFQ document

Disclaimer

Terms and conditions of issuance of the RFQ

Purpose of issuing the RFQ

Outline of the contents of the RFQ

Information about the project

- Project description, background and overview
- Municipality's view of the PPP
- Land issues, where relevant
- BEE and socioeconomic requirements¹²
- Defined performance parameters
- Defined legal requirements and statutory regulations related to the PPP
- Identified financing requirements and issues
- Identified revenue parameters, as available
- Summary of the envisaged risk transfer
- Any municipality requirements for consortium membership.

Procurement process

- Stages and timelines
- Clarification processes and briefing notes
- Changes to the composition of consortiums
- Participation in more than one consortium
- Bid bond.

12. See Module 2: Code of Good Practice for BEE in PPPs.

Instructions to respondents

- Format of submissions, including compulsory forms of response as an aid to evaluation
- Late submissions
- Status and composition of respondents
- No contact policy
- Further information
- Disclosure of legal processes underway that affect bidding consortiums
- Grounds for disqualification
- Municipality contact details.

Information required about bidders

- Current workload of consortium members¹³
- Bidder's capability and strength
- If required, proposed consortium composition and structure with roles of the members clearly spelt out
- Skill and experience of relevant organisations and subcontractors in projects of a similar nature
- Strength of covenant between consortium members, subcontractors and lenders (if applicable)
- Financial and market standing
- Equity, ownership and directorship
- Ability to fulfil the project's BEE and socioeconomic objectives
- Historical and current approach to social responsibility
- Capacity to deliver
- Commitment and capacity to meet project timetable
- Ability to raise debt and equity or corporate finance and to provide security
- Project management capability
- Risk management capability
- Demonstration of understanding key project demands/complexities
- General issues raised by bidders
- Previous relationship(s) with government
- Quality assurance systems
- Approach to the PPP and integration of deliverables.

The evaluation process

- Methodology
- Evaluation criteria.

13. In smaller municipal PPP projects, the municipality may choose to permit qualifying companies to tender, without forming a consortium. In such instance, the other required information should be obtained as to the individual company.

Step 2: Consult with the municipal desk

Before issuing the RFQ, the project team must consult with the PPP unit, to review the RFQ documents as developed. This consultation with the PPP unit is important to ensure market receptivity to the tender.

Step 3: Advertise and distribute the RFQ

The method of RFQ distribution must follow the municipality's supply chain management policy and the procurement plan developed in the feasibility study. This typically involves advertising the project in relevant publications, in the *Government Gazette*, on the municipality's website, and by making press statements about the project, calling on interested parties to collect copies of the RFQ from the municipality and/or download these from its website. It may include an open briefing session for potential bidders to introduce the project and to stimulate private sector interest. Any such public briefings should be careful not to present any information that is not contained in the RFQ document.

Step 4: Evaluate the responses

Evaluation criteria must be based on the information requested from the bidders and must be included in the RFQ to focus private party responses and eliminate unnecessary information. The criteria will vary from project to project.

In the example below, each subcategory will be allocated a response of “good”, “adequate” or “poor”. The process of evaluation will include establishing evaluation teams to concentrate on the financial, technical, legal, and BEE qualifications of the bidders.

Figure 5.2: Example of some RFQ evaluation criteria

Category and subcategories	Good, adequate or poor
Respondent capability and strength	
<ul style="list-style-type: none"> • Proposed respondent composition and structure • Skill and experience of relevant organisations and key subcontractors • Construction • Operations • Advisers • Suppliers • Strength of covenant between relevant organisations and key subcontractors and respondent • Financial and market standing • Ability to raise debt and equity and to provide security 	
BEE qualifications	
<ul style="list-style-type: none"> • Written confirmation that each proposed consortium member and first-tier subcontractor, is compliant with the BEE charter applicable to its particular sector or applicable generic code • Where no consortium is to be formed, written confirmation that the bidder is in compliance with its applicable sector BEE charter or generic code 	
Deliverability	
<ul style="list-style-type: none"> • Commitment and capacity to meet project timetable • Project management capability • Current workload of consortium members • Quality assurance systems • Risk management capability 	
Project awareness	
<ul style="list-style-type: none"> • Demonstration of understanding key project demands and complexities 	

Step 5: Communicate with bidders

When choosing the pre-qualified bidders, communicate with both unsuccessful and pre-qualified bidders as soon as possible, and publicly announce the pre-qualified bidders. It is important to communicate an appropriate level of detail on the decision to unqualified bidders, complying with administrative law requirements.

Call the pre-qualified bidders to a bidders' conference where information on the RFP processes and timelines will be communicated.

STAGE 2: THE RFP

Part 1: Bidder participation in preparing the final RFP

On large, complex or innovative PPP projects, considerable value can be yielded if pre-qualified bidders participate in the preparation of the final RFP.

While the feasibility study would have tested the market, some key market responses can now be tested in detail with parties that have demonstrated their knowledge and capacity related to the project. Bidder participation in preparing the RFP can also lead to a shorter bidding process and greater bidder confidence. Decide whether to use this two-part RFP process by weighing the added value against the added cost to both the bidders and the municipality.

The municipality's procurement plan, as communicated to the pre-qualified bidders, must clearly identify the two stages, and set out the intention of and rules for each. The RFP proper is strictly competitive and bound by limited and formal communication. Bidder interaction is less formal, the end product being the incorporation of feedback from all bidders in a single, final RFP, prepared by the municipality and issued to all pre-qualified bidders.

Step 1: Prepare the draft RFP and get TVR IIA

The municipality must write the draft RFP, based on its feasibility study, following the steps set out in part 2 below. Bidders do not participate in writing the RFP. The draft RFP must be the municipality's version of a final RFP and must include a draft PPP agreement. It can highlight the areas in which bidders are being requested to provide input.

The draft RFP and its attachments, including the draft PPP agreement, must be submitted to the National Treasury and the relevant treasury for TVR IIA before being issued to the pre-qualified bidders.

Take note

Be careful not to tailor the RFP to the inputs of any single bidder. Also be aware that no bidder is likely to share proprietary or confidential information at this stage and as such the bidder interaction should focus on areas of interest to all bidders.

Step 2: Get feedback from bidders

Feedback from bidders can be a mix of oral and written, though written is preferred. To extract value from the process and not compromise procedural

fairness, bidder interaction must be well structured and not compromise confidential bidder information. Bidder interaction will normally involve a bidders' conference attended by all pre-qualified bidders, as well as one-on-one meetings between each bidder and the municipality. All conferences and meetings must be conducted according to pre-determined, written rules, and must be recorded.

Take note

The focus should be on getting useful information. Do not use this feedback to evaluate bidders.

All feedback must be considered against the municipality's position, which is based on the feasibility study. Feedback that is common to all bidders should be given more weight than isolated feedback. Feedback from a full consortium of lenders, equity sponsors and subcontractors should also be given more weight. Keep meticulous records of the source of feedback and the municipality's reasons for including or excluding particular feedback.

Part 2: The final RFP document

The RFP needs to be an effective two-way communication tool between the municipality and bidders. The RFP must communicate project data and the municipality's requirements to bidders, and set out how bidders must communicate their proposals to the municipality. As noted above, the RFP in simpler municipal PPP projects must also contain the requirement of information from the bidders that indicates they are qualified to undertake the project.

Step 1: Prepare the RFP document

Summary: Contents of the RFP document

1. General information to bidders
2. In smaller municipal PPPs, the requirement for information about bidders in lieu of a separate RFQ process
3. Essential minimum requirements
4. Service specifications
5. Standard specifications
6. Payment mechanism and penalty regime
7. Legal requirements and draft PPP agreement
8. Commitments required from bidders
9. Evaluation criteria
10. Bid formalities

1. General information to bidders

1.1 Explanation of project

The project will have been defined during the feasibility study. The RFP must communicate the background to the project, the municipality's desired outcomes for the project, and its envisaged outcomes.

1.2 External framework

Provide an explanation of the municipal environment in which the project is to take place. This includes the regulatory, physical, political and social environment.

1.3 Project framework

Set out the municipality's view of what the PPP is and how it may be structured. (Note that the PPP is more than just the project in that it includes relationships between parties). Without being prescriptive, set out the municipality's view of the envisaged kinds of contracting parties. These will differ according to the anticipated type of PPP and its envisaged financing structure.

1.4 Project assets

Core project assets must remain unencumbered for the term of the project. Where there are certain project assets that may be used by the private party for security, specifically list these as such.

The municipality must ensure that the RFP identifies all project assets or categories of project assets that the municipality will require at the end of the project term, so that this can be taken into account by the bidders in their assessment of the security package and the calculation of their bid prices.

1.5 Procurement framework and timelines

Outline how the procurement will be carried out in terms of processes and the timing of the processes. Spell out the governing legislation and regulations on the procurement, with a statement about the project's compliance with these requirements to date. The processes must be comprehensively described, including any parallel processes, such as securing approvals and consents.

1.6 Instructions to bidders

Provide a formal list of items with which all bidders must comply. Non-compliance should have implications for the acceptability of the bid. Instruct the bidders on:

- Any limitations to or specifications about the makeup of the bid consortium
- Consortium status requirements: it must be an incorporated entity when the proposal is submitted
- Consortium change requirements: a notice of any change is required and the municipality usually reserves the right to re-evaluate the consortium's pre-qualification (See Stage 3 below)
- Requirements relating to submission of proposals
- Formal communication requirements
- Site visit arrangements
- Who bears the costs of submissions
- Confidentiality issues
- Bidder responsibilities for bid security in the form of bid bonds and bidder warranties¹⁴
- Grounds for disqualification (defining non-compliant behaviour); allow for discretion on the part of the municipality
- Submission requirements: time, date, manner and place of submission
- Requirements for variant bids
- Other project-specific requirements.

1.7 Requirements related to third parties

It is very likely that the PPP will involve third parties. Third-party relationships need to be managed in two ways: communication during bidding (especially with multiple bidders) and the resultant agreement. Spell out both elements clearly, preferably providing draft third-party agreements.

The RFP must clearly stipulate how supply risk – that is, the possibility that utilities such as water and electricity may not be available – will be allocated between the parties.

14. Bidder warranties relate to misrepresentation of any kind. Warranties typically cover consortium members' tax clearance and state of solvency, and guarantee that no consortium members are undergoing corruption or criminal-related investigations or have had any past convictions.

1.8 Data room

Each complex PPP project should have a data room where all the information that bidders need is available. Make available as much information as possible to facilitate the bid process, but do not warrant the information, because all information should be verified by the bidders. This is a crucial element of risk transfer and has implications for the PPP as a whole. RFP provisions about the data room should be carefully drafted to make it clear that there are no warranties on the information unless the municipality has made a decision to the contrary.

1.9 Environmental impact assessment data

Provide data, with appropriate indemnities, about all EIA processes carried out, and set out the requirements for the work to be carried out by bidders or the private party to the PPP.

1.10 Due diligence

The importance of the bidder's due diligence before submission cannot be overstated. Any unverified assumptions by a bidder at submission stage will delay financial closure and may well jeopardise the whole procurement process. Since very little, if any, municipal information is warranted by the municipality, the due diligence must be thorough and must include technical, financial and legal due diligence. The RFP process must enable site visits by the bidders. On project finance type PPPs, lenders will duplicate the due diligence. Include the time required for bidder due diligence in the procurement plan.

1.11 Quality management system

In any PPP all stakeholders have a vital interest in the quality of the service to be provided. Specifically: the municipality retains overall responsibility for the service delivered through the PPP; the private party relies on the quality of products and services provided by consortium members, personnel, subcontractors and suppliers to meet the specifications; lenders need assurance that the service will be sufficient to continuously earn the unitary payment (and by so doing to service debt); and the users of the service must be provided with a quality that meets their requirements.

In the procurement process, the municipality must clearly state the service specifications. In addition, it must require the bidders to propose a quality management system that includes compliance reporting during both the development phase and the operations phase of the PPP. The

municipality should also reserve the right to audit or check the private party's compliance with its own quality assurance and control systems. Mechanisms for such audits or checks should be established before the signing of the PPP agreement and be included in the PPP agreement management plan.

1.12 Important definitions

The RFP must clearly list all the definitions used throughout the documents. This is to ensure clarity and to set clearly defined benchmarks. The definitions must be the same as those used in the draft PPP agreement.

2. Information required about bidders

In smaller PPPs, where a separate RFQ process is not required, the information required about bidders listed in Stage 1, above, should be set forth in the RFP here.

3. Essential minimum requirements

What is the minimum that can be expected from a bid for it to meet the pre-defined project objectives established in the feasibility study? There will be minimum requirements for at least the following:

- **Financial** (for example, demonstration of affordability, risk assumption, funding by private party, term sheets, and minimum insurance requirements)
- **Legal** (for example, any municipal requirements for the types of participant in any consortium, bidder details not previously required, term sheets or draft first tier subcontracts, and a mark up of the PPP agreement to indicate deviations from the proposed PPP agreement and to explain in their bid documents the reason for the deviation)
- **Technical** (for example, essential components making up the life cycle of the service and additional operational minimum requirements)
- **BEE** (for example, demonstrated ability to comply with Module 2: Code of Good Practice for BEE in PPPs, including private-party equity, private party management and employment, subcontracting, local socioeconomic impact)
- **Additional mandatory requirements** (for example, tax clearance certificates for all consortium members or for the private party, where there is no consortium requirement).

These minimum requirements will establish what constitutes a compliant bid. Bids that do not meet them should be rejected. However, the requirements must not stifle innovation or be so onerous that otherwise solid bids are knocked out unnecessarily early.

4. Service specifications

These specifications are a further refinement of the services determined in the feasibility study. All the outputs required to provide the service must be specified. These service specifications will form the basis of the schedules to the PPP agreement and specify the services to be performed by the private party (or in particular circumstances by the municipality).

At the RFP stage there should be draft schedules for all service elements. Some will be blank because the bidders are required to populate them in accordance with the service specifications, and the remainder will be set out by the municipality. The latter category will typically allow bidder variation, unless that particular requirement is set as a minimum essential requirement. Service specifications subject to bidder input are often contained in square brackets.

There are at least four ways to specify the PPP services and facilities:

4.1. Expressed as outputs

Services and facilities specifications are generally expressed as outputs by changing what must be done and how it is done to the required service outcome. For example, in an office accommodation PPP, “the provision of 35 cellular offices, each containing no less than nine square metres of office space” changes to “working space for 35 staff”. This specification is backed by information on the municipality’s requirements for staff working space so that the bidders can plan and cost the required service.

4.2. Specific outputs not directly related to the overall service

It is likely that a municipality may require the creation of a facility not related to the direct provision of a service, for example a laboratory to be constructed by the private party on the grounds of a wastewater treatment facility, which is to be operated by another party, such as a not-for-profit organisation. Any facility not to be used by the private party in the provision of the service would fall into this category. Although not strictly part of the PPP, there may be value for money in including it in the PPP. This kind of facility cannot be specified purely in terms of service outputs; construction outputs need to be defined.

4.3. Input specifications

Nearly all projects will have some elements of input specifications. It is essential to identify such inputs upfront and classify them separately in the RFP, because where the municipality has specific requirements for a facility that reverts to it at the end of the concession period, it may require a particular aspect of that facility to be created in a specific way, for example a water treatment facility must be situated on a particular site. These elements must be kept to a minimum as they may affect operational efficiency or impact excessively on the design of the facility. All inputs create constraints on bidders, so carefully consider their appropriateness before including them in an RFP.

4.4. Conditions-of-asset-specifications

The condition and value of assets at the end of the project term is of great importance to the municipality. Where the assets revert to the municipality they must be in a specified condition, which dictates replacement and maintenance cycles as well as financial assumptions such as residual value and depreciation. The condition is always expressed as a remaining life or already-used life, as determined by industry norms or as agreed between the municipality and the private party in the PPP agreement.

5. Standard specifications

The RFP must apply objective standards that are measurable and consistent with best practice. Make extensive use of specifications applicable to all standard components of the project. These could be construction specifications and standard operational requirements, such as SABS and ISO. Select appropriate standards with care: How applicable are they are to the project? How are they used in the industry? Are they appropriate?

6. Payment mechanism and penalty regime

The RFP must not be issued without a payment mechanism, which includes at least, for projects other than private-party use of municipal property:

- A single, indivisible unitary payment for full availability and performance of the services
- In PPPs where payment is based on volume or usage and not availability, a clear statement of the means for determining the payment
- An appropriate indexation (generally CPIX inflation)

- A mechanism for penalising partial or complete failure of the availability and performance of the service, by means of penalty deductions
- No limit to deductions for non-availability
- A mechanism for dealing with changes to service requirements.

For projects involving private-party use of municipal property, the payment mechanism in the RFP must describe the process by which the PPP fee for the use of the property will be calculated and paid by the private party. The elements of the PPP fee will have been determined during the feasibility study.

See Annexure 1: **The payment mechanism.**

7. Legal requirements and draft PPP agreement

These are all the key commercial and performance requirements necessary to sign off that the consortium has the legal status and capacity to fulfil the requirements of the PPP agreement, including, as appropriate:

- Shareholding agreements
- Corporate governance requirements
- Full disclosure of any consortium makeup, including lenders, sponsors, and parent companies.

The RFP must include a draft PPP agreement that allows for highly structured bidder input. Pending the development of a municipal PPP counterpart, it should be developed in accordance with the standardised PPP provisions applicable to national and provincial PPPs. Although standardisation provides standard terms, project-specific annexures, dealing with a range of specifications, penalties, payments and other project-specific issues, must be developed and included.

In particular, the municipality should consider the following issues:

- At the time when the RFP is being prepared and also at the bid evaluation stage, whether any additional warranties should be sought. For instance, additional warranties may be required from the private party in connection with any intellectual property included in the project assets.
- The various kinds of liabilities against which a municipality should seek to be indemnified are treated in the standardised PPP provisions. Standardisation also considers when the private party should be entitled to cap these liabilities.
- The question of municipal indemnities is treated in standardisation. Although standardisation is generally against the provision of municipal

indemnities, the municipality should carefully consider, having regard to the nature of the project, whether there are any other circumstances peculiar to the proposed project which would justify the municipality giving indemnities.

- The municipality may reserve the right to control employees of the private party, and if it does so must disclose its control requirements in the RFP.

The municipality's requirements to use intellectual property during any municipality step-in period, after the termination of the PPP agreement and after the expiry of the PPP agreement should also be specified in the RFP where appropriate. Similarly, if the municipality wishes to reserve to itself the right to extend the term of the PPP, provisions should be made in this regard.

8. Commitments required from bidders

The more and better quality information given by the municipality in the RFP, and the clearer the municipality is about what it expects to receive in bidders' proposals, the higher the quality of proposals should be.

This section is the crux of the RFP and sets out what information is required from bidders. Bidders must be required to provide information on all aspects of their bid, including legal, technical, financial and BEE. The RFP must clearly ask for at least the following information and commitments from bidders:

8.1 All technical aspects, including all relevant service details

As part of this information, bidders should be required to prepare the components of the schedules that will be part of the PPP agreement. Where the municipality has not specified these as essential minimum requirements, they must respond to the service and standard specifications in the RFP. To simplify the process of preparation, the schedules should be in the draft PPP agreement as well as in the main body of the bidders' proposals. The form and substance of the schedules will vary from project to project, but the municipality and its adviser must take great care in their development from service specifications to their final form in the PPP agreement. Bidder amendments and additions to the payment mechanism must also be required in a structured format in the RFP.

8.2 The quality management system

8.3 In complex projects, all BEE elements, with commitments for each element

Specifically, the bidder's funding structure and financing arrangements reflected in the financial models must show:

- Sources or types of black equity (e.g., black enterprises' balance sheet funds, loans to black enterprises or black shareholders, equity funds)
- Costs of black equity
- Timing on project cash flows to black shareholders
- Operating costs for all skills development, employment equity and socioeconomic programmes.

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

- Terms for black shareholders
- Sponsor support arrangements to black shareholders, if any
- Commitments in respect of black people in management control.

Subcontracts (first-tier) must show:

- Terms for black shareholders
- Black people in management control
- Black women in management control
- Skills development and employment equity commitments for first-tier subcontractors
- Procurement commitments to black enterprise SMMEs.

The marked-up PPP agreement must show:

- Any proposed changes to standardised PPP BEE provisions
- Draft schedules capturing all BEE commitments.

In smaller PPPs, adaptations of the foregoing should be considered by the municipality and its advisory, in consultation with the PPP unit.

8.4 Level of funding commitment

Who will provide the private finance? How firm is the commitment to fund debt and equity?

The level of funding commitment is determined by the quality of the municipality's RFP. An RFP that meets the requirements of this

module, based on a robust feasibility study, should be able to attract fully underwritten bids, regardless of whether project or corporate finance is proposed. Proposals that are non-committal on funding will result in protracted negotiations.

8.5 Sign off on competition, and any other statutory requirements

8.6 Corporate governance commitment

The private party's commitment to corporate governance should be shown, using the King Code on Corporate Governance 2002 as a benchmark.

8.7 Financial and project structure

The RFP must require bidders to submit financial models that allow the municipality to thoroughly interrogate the proposal (be it a compliant or variant bid) in detail. The response from bidders will depend on the nature of their approach to funding the project. Corporate finance will be provided from the balance sheet of a private company, while project finance involves limited recourse debt funding to a special purpose vehicle. Regardless of the differences, the municipality needs enough information to be able to analyse the funding structure and to determine whether or not it can be provided and sustained through the project. The project participants, including all forms of funding and the terms and conditions of funding, are crucial. Bidders must demonstrate in their bids how the interest rate risk will be managed by means of hedging arrangement and how their interest rate hedging arrangements, if any, will achieve value for money.

8.8 Security requirements

The municipality should clearly describe the type as well as the amount of any security that it will require from the private party and request that each bidder cost for this security as a separate component of its total bid price, as this will aid in the evaluation process. This should include security against late service commencement and for final maintenance obligations.

8.9 Liquidated damages

If the imposition of liquidated damages will not impact severely on the value assessment required for a PPP, the municipality should specify the level of liquidated damages (including any cap) in the RFP to enable the bidders to properly price for these damages. This will also assist the

municipality's evaluation team in exposing the “real” costs of the bid and improve competitiveness in the selection of the bids.

Contents of the financial models

Critical information is contained in bidders' financial models, and the RFP should specify the format in which this information is to be shown in the bids to allow the municipality to compare a bidder's model with the municipality's feasibility study models and with other bidders' models. A checklist for a complex PPP project is given below, which needs to be carefully refined for each project. The model requirements for simpler PPP projects and those involving the private party taking over an existing municipal function should be developed jointly by the municipality, its adviser and the PPP unit. The model **must**:

- Have a base date¹⁵ as specified in the RFP
- Be presented in electronic (computer disk) and hard copy formats and be compatible with a specified software programme
- Disclose clearly all macro, micro and general assumptions
- Be presented on a monthly basis for the development period, and thereafter on a semi-annual basis. Annual summaries are to be provided for each year through to the period of the PPP agreement
- Present all required data in nominal, real and net present value (NPV) terms (using the discount rate required in the RFP).

The model must show:

- The bidding consortium structure or corporate project structure, in detail.
- The funding structure of the project, including types and proposed levels of debt and equity.
- The likely equity input of each member of the consortium, showing the percentage of total equity or sub-debt to be provided by each member. Equity and shareholders' loan details must include the source of funds, amount of funds that each shareholder is prepared to commit, and the timing of their contribution. Alternatively, in a corporate finance structure, a full set of financial statements for the companies providing funding must be provided.

15. As the value of money changes, the RFP must set a specific point in time which is common to all bids. This is the base date.

- The cost of debt in a project finance structure or a ring-fenced corporate finance structure, clearly detailing the level of fees and margin, and full details on the basis for and factors comprising these fees and what the margins are based on and what went into them.

The model must provide:

- A thorough and detailed explanation of the model and how to operate the model
- The basis and costs of proposed interest rate hedging arrangements
- Inflation assumptions. Since inflation risk is shared, it may be appropriate to set inflation rates in the RFP as common to all bidders so as to make comparison easier
- Capitalisation of interest
- A comprehensive and detailed explanation of all VAT and other tax treatments assumed in the model
- All the key output ratios and return categories
- A detailed source and application of funds table for the project
- Capital expenditure according to the component category breakdown set out in the RFP
- Project start-up costs
- A funding plan and funding assumptions schedule identifying all sources, amounts and application of finance, conditions, terms, base costs, margins and fees
- A debt schedule for each credit facility, including a draw-down schedule, interest paid, fees and repayment schedules
- Total equity (including standby and subordinated facilities)
- Balances of all reserve accounts and insurance structures
- Total operating cost and maintenance assumptions, including replacement schedules
- Forecast balance sheets, profit and loss, and cash-flow statements
- Identification of any foreign currency denominated goods or services
- Details of all taxation assumptions and treatment and the ability to enable or disable any or all such assumptions or treatments in the model

- NPV of real revenues using discount rate required in RFP
- Projected internal rate of return (IRR) before financing and tax in both real and nominal terms
- Real and nominal return on equity as compensation to reflect the base case return on equity for the entire duration of the PPP agreement¹⁶
- Interest cover
- Sensitivity analysis of capex
- Sensitivity analysis of opex
- Sensitivity analysis of interest rates
- Sensitivity analysis: grace periods of principal repayment
- Sensitivity analysis: maturity of debt
- Sensitivity analysis: inflation
- Risk pricing
- Assumptions on penalty deductions
- Gains from refinancing.

For project finance PPPs, the model must set out:

- Debt-to-equity ratio
- Annual debt service cover ratios (DSCR), including and excluding cash
- Loan life cover ratio (LLCR)
- Project life cover ratio (PLCR)
- Any other ratios required by funders
- In the case of the PPP agreement is put out to tender again following private party default, what percentage of the total debt outstanding bidders believe should be repaid in the event that, once tendered again, the highest tender price is less than the debt
- In the case that the PPP agreement is not put out to tender following private party default, what percentage of the debt bidders believe should be repaid in the event that the adjusted estimated project value is less than the debt.

16. See *Standardised PPP Provisions*: Part 64.

9. Evaluation criteria

Give broad categories of evaluation, but in sufficient detail to focus bidders' attention on the value assessment areas of the RFP. Detailed scoring methodologies and point allocations should not be given, as this leads to proposals being tailored to the evaluation and not to the best value for the project. The number of points allocated to each category should not be disclosed in the RFP. The process and evaluation methodology should, however, be set out so that bidders take comfort from an auditable process with checks and balances.

The RFP should specify that the technical, BEE and price elements of the bid will each be scored out of 100 points. The scores achieved will be calculated into the bidder's overall score using the following formula:

Calculating the bidder's overall score

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

where

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

b is the weighting for BEE (10%)

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

d is the total score achieved by the bidder.

For the purposes of applying the formula, "technical" refers to all project factors under evaluation other than the price and BEE elements, and is synonymous with the PPPFA regulation's term "functionality."

The alternative technical and price weightings (together making 90 per cent) will vary from project to project, determined during the feasibility study and preparation of the procurement documents. Ten per cent is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA.

Minimum evaluation categories for complex PPPs are set out below. The minimum evaluation categories for simpler PPPs should be jointly developed by the municipality, its adviser and the PPP unit. Suggestions are given for further sub-categories that need to be refined on a project-by-project basis.

The evaluation will also consider the overall integrated solution offered by each bid.

9.1 Technical

9.1.1 The development phase

- Extent, quality, safety, cost effectiveness functionality and innovation of designs
- Level of design and robustness of cost estimates
- Impact on social and biophysical environment
- Deliverability and time schedules
- Integration of design, development and operations with a clear commissioning programme
- Quality management systems proposed by the bidders.

9.1.2 The delivery phase

- Extent to which proposed performance targets and measurement systems exceed minimum specifications
- Operating methodology
- Quality and type of proposed services to end users
- Extent to which asset management and maintenance philosophy supports the project objectives and maximises value for money
- Quality of proposed management structure, staffing, systems and practices
- Quality and extent of proposals on branding, promotion and public relations
- Quality of safety plans
- Integration of PPP with existing services
- Integration of PPP information into the existing IT system
- Quality management system proposed by the bidders
- Compliance with municipality's monitoring and reporting requirements.

9.2 Legal

- Bidders' SPV structures.
- Robustness of the bidders' structures: are bidders' responses or representations in the proposal reflected in their structures and shareholders' agreements? The evaluation would include the level of commitment to and undertakings of each consortium member to the consortium, and the equity participation of each member.
- Mark up of the draft PPP agreement and its risk impact.

9.3 Financial solution

- Total project cost in relation to the affordability constraints of the PPP
- Realistic forecast of operating and capital expenditure, including an assessment of whether the quality management systems have been costed in the financial model
- Robustness of the financial proposals, including their sensitivity to changes in operating and maintenance costs, inflation and interest rates, and changes in the cash-flow profiles
- Robustness of the funding structure
- Level and nature of equity in the funding structure
- Cost of BEE commitments
- Level of commitment demonstrated by the debt and equity providers and the terms and conditions linked to the provision of this funding
- Level of risk assumed, and deviation from the terms of the tender documentation
- Cost, level and nature of insurance cover proposed
- Risk allocation: The risk profile proposed by bidders in their proposals will be tested in relation to:
 - The nature and extent of the risk
 - The likelihood of risk
 - Passing down of the risk and obligations assumed by the private party in the PPP agreement to the other key contractors
- Consistency between the financing arrangement and the draft PPP agreement, as well as the extent of acceptance by the financiers of the terms of the draft PPP agreement
- What percentage of total debt outstanding the bidder believes should be repaid as compensation on private party default.

9.4 BEE

Each PPP project's BEE elements, minimum targets per element, bid evaluation points for each element, criteria for awarding points, the weightings to be given to each element and the overall minimum threshold score of 60 per cent, will all be set out unambiguously in the BEE balanced scorecard for the project in the RFP. Bidder's responses will be evaluated accordingly.

Figure 5.3: Example of BEE scorecard to be presented in the RFP

BEE element	Project target	Bid evaluation weighting
A: Private party equity		20%
A1: Black equity	40%	
A2: Active equity	55% of A1	
A3: Cost of black equity	Value for money	Evaluated in financial component
A4: Timing of project cash flow to black shareholders	Early and ongoing	
B: Private party management and employment		15%
B1: Black management control	Commensurate with A1 & A2	
B2: Black women in management control	15% of B1	
B3: Employment equity	Compliant with law	
B4: Skills development	1% of payroll	
C: Sub-contracting		50%
C1: Capital expenditure cash flow to black people/black enterprises	30%	
C2: Operating expenditure cash flow to black people/black enterprises	30%	
C3: Black management control	25%	
C4: Black women in management control	10% of C3	
C5: Employment equity	Compliant with law	
C6: Skills development	1% of payroll	
C7: Procurement to black enterprise SMMEs	30%	
D: Local socioeconomic impact	Sustainable, effective plan	15%

9.5 Price

The PPPFA requires that price be taken into account as a distinct element in the evaluation of bids. In PPPs, the price is closely linked to qualitative elements of the bid and often has explicit conditionalities. It is essential that there is a reasonable certainty about what price is attached to the bid before price points are allocated. Lack of certainty should be addressed through a BAFO, (refer to Stage 3, part 2). The municipality's RFP must therefore prescribe the form in which the price should be presented by bidders. For example, a net present value with a set discount rate may be prescribed. In addition, the qualitative financial evaluation categories set out in 8.3, above, must be closely scrutinised.

9.6 The overall integrated solution

Do all the components of the proposal add up to a single integrated solution capable of delivering value for money to the municipality?

10. Bid formalities

Spell out all bid formalities, including:

- The time, place and manner of bid submission (proposals for large projects may take up substantial space and separate secure facilities may be required for submitting bids).
- How proposals will be opened.
- Bid bonds.
- Period required for bid validity.
- Formal requirements for filling out bid forms.
- Formal processes for communication with bidders.
- The municipality's reservation of the right to terminate the process, including the right to terminate negotiation with the preferred bidder if it is unlikely that an agreement will be concluded, in which case negotiations with other bidders may begin. In addition the municipality should state that it is not bound to enter into a contract with any bidder.
- A discretion to be exercised by the bid evaluation panel in the event of non-compliance in any of the bids.
- Reservation of the municipality's right to conduct a BAFO process.

Step 2: Request TVR IIA

The complete set(s) of RFP and draft PPP agreement documentation, both in their draft form (for bidder participation as set out in part 1 above) and the final versions completed by the municipality thereafter, must be submitted by the municipality's accounting officer to the National Treasury and the relevant provincial treasury with a request for TVR IIA. None of these documents may be distributed to pre-qualified bidders until these views and recommendations have been obtained, and considered.

STAGE 3: CHOOSE THE PREFERRED BIDDER

Critical considerations for managing the bid process

Summary

1. Experienced bid managers
2. Anti-corruption
3. Prohibited suppliers
4. Clarification meetings
5. Bidders' notes
6. Changes to consortiums during bidding
7. Bidder due diligence
8. Bid validity period

1. Experienced bid managers

Both the bidders and the municipality require experienced and committed bid managers, who should be formally identified and their contact details provided. On larger projects these will be full-time positions. For the municipality, the bid manager should be the project officer, whose tasks will have been set out in the procurement plan.

2. Anti-corruption

Due to their size and complexity, PPPs are at considerable risk of being affected by some corrupt activity, or at least by the harmful perception that corrupt activity is going on. The accounting officer must sign off on an anti-corruption policy for the project, with clear requirements and processes for dealing with corrupt activities by project team members or bidders. The procurement plan and the bid processes must have the built-in safeguards of disclosure, a code of conduct, structured oversight and internal and external audit.

Disclosure

All members of the project team and bid evaluation panel, including the adviser, must disclose any potential conflict between their personal and family interests and those of the project. This disclosure must be evaluated by the accounting officer or delegated representatives. An appropriate response must be formulated and implemented, such as recusal of the official from any position where the conflict of interest could affect a decision.

See Annexure 3: **Template declaration of interest.**

Code of conduct

All the municipality's project team members, including the municipality's advisers, and all members of the municipality's technical evaluation committees, evaluation coordinating committee and project evaluation committee must sign a code of conduct that requires compliance with a range of ethical requirements in the best interests of the project. All pre-qualified bidders must also sign a similar code of conduct, developed by the municipality for the project.

See Annexure 2: **Template code of conduct for bid evaluation panel members** and Annexure 3: **Template declaration of interest**.

Structured oversight

A person other than the one who carried out the task should review all documents, all communication with bidders, and all evaluations. In addition, a project review committee, appointed by the accounting officer, should sign off on all documentation and processes.

3. Prohibited suppliers

The National Treasury maintains a database of companies, directors and persons restricted from doing business with the public sector, and it also maintains a database of Tender Defaulters (see footnote 10, above). These blacklisted companies, directors and persons are not allowed to compete for government business, including PPPs, for prescribed periods of time. The municipality should ensure that none of the bidders are on either of these databases prior to commencing bid evaluation.

4. Clarification meetings

As part of the bid process, it is advisable to hold bidder clarification meetings during their preparation of proposals. These will allow bidders to get clarity on issues in the RFP and the municipality to gauge bidder participation and commitment. These meetings should be scheduled well in advance, should allow for one-on-one meetings with bidders, and there must be a formal process for recording all such meetings and confirming points made during the meetings.

5. Bidders' notes

Formal correspondence between bidders and the municipality must always be in writing. Questions from bidders should indicate how confidential the response needs to be. Confidential answers only go to the relevant bidder;

others go to all bidders together with the question. Bidders' notes are also used to communicate decisions or confirm points from clarification meetings, and any changes to the RFP.

The municipality and bidders must keep a register of bidders' notes to ensure a complete record of information and formal correspondence. Consecutive numbering should be used. A bidder must submit its register with its proposal.

6. Changes to consortiums during bidding

In many instances consortiums formed in response to an RFQ change during the bidding stage. This is more acceptable to a municipality than a complete withdrawal of a consortium, provided that the consortium maintains its strength at least to the same level as before the change. A consortium change is never allowed without written consent from the municipality and the substance of a bid already submitted is never allowed to change.

The process should be set out in the RFP, as described:

1. The consortium advises the municipality of the proposed change, in writing, with full details of the reason for the change, the parties involved and the impact on the consortium.
2. The municipality applies the same RFQ evaluation criteria to reassess the consortium, using, where possible, the same evaluation processes. The required standard is that the changed consortium should score at least the same number of points it scored during pre-qualification.
3. If satisfactory, the municipality advises the consortium in writing.
4. If not satisfactory, the municipality advises the consortium in writing and gives it certain amount of time to propose an alternative. Failing this, the consortium is disqualified.

7. Bidder's due diligence

Bidder's due diligence requires time, and access to the project site and existing facilities and the products of the municipality's own due diligence (given without any warranty). Communication protocols for the due diligence must be defined in the RFP. These must specify how and when communication and access occurs. Where access is restricted, this must clearly be stated.

8. Bid validity period

Bidders will set a bid validity period on their proposals. The municipality may suggest such a period in the RFP.

Part 1: Evaluate the bids

The Municipal SCM Regulations state the following:

Section 26 (1) (a): A supply chain management system must provide for ... a committee system for competitive bids consisting of at least ... (ii) a bid evaluation committee and (iii) a bid adjudication committee.

In line with this, the accounting officer must ensure that:

- The evaluation process will ensure compliance with the procedural fairness provisions of the Promotion of Administrative Justice Act (2000)
- The evaluation criteria and processes are established before bidders submit proposals
- The bid evaluation teams are appointed in writing, and that all declarations and codes of conduct are signed
- The Code of Good Practice of BEE in PPPs is applied.

There are three levels of evaluation

- Technical evaluation teams (TETs) – typically, the adviser and any municipal staff counterparts
- The bid evaluation committee (EC) – appointed per section 26 (1) (a) (ii) of the Municipal SCM Regulations
- The bid adjudication committee (AC) – appointed per section 26 (1) (a) (iii) of the Municipal SCM Regulations.

All of the foregoing are appointed by the municipality's accounting officer.

Each level has its own built-in checks and balances.

Evaluate the bids

- Step 1: Technical evaluation teams
- Step 2: Evaluation committee
- Step 3: Adjudication committee
- Step 4: Clarification
- Step 5: Evaluate variant bids
- Step 6: Choose the preferred and reserve bidders
- Step 7: Obtain the views and recommendations of National Treasury and the relevant provincial treasury (TVR: IIB){ "Treasury views and recommendations (TVR)" }.

Step 1: Technical evaluation teams

In the technical evaluation, TETs analyse at least the three streams of evaluation criteria: **technical** (comprising technical solution, legal solution, financial solution), **BEE** and **price**. The overall, integrated solution is evaluated by the EC. There is no prescribed sequence of the teams' evaluations, as almost all elements of proposals are interdependent. The teams need to be made up of suitably qualified professionals, at least from within the municipality and from the adviser.

Communication between the TETs, and between the TETs, the EC and the AC is very important.

Step 1: Technical evaluation teams

1. Preliminary work
 - Separate variant bids for evaluation as separate proposals
 - Check for completeness
 - Check for compliance
2. Detailed analysis
 - Technical
 - Legal solution
 - Financial solution
 - BEE
 - Price
3. Reports to the evaluation committee

1. Preliminary work

The first function of the TETs is to do the preliminary work to establish what bids to take forward in the evaluation:

Separate variant bids for evaluation as separate proposals.

Check for completeness

Completeness refers to whether the bidder has submitted all required documents (for example, original tax clearance certificates, consortium formation documents and the like). All these formalities must have been set out clearly in the RFP. Each RFP requirement should be listed, with a reference to its place in the RFP and its description. Record incomplete bids.

Figure 5.4: Example of how to establish and sign off on completeness

Where in RFP	Description	Included		Comments by bidder	Where in proposal	Cross reference
		Yes	No			
Vol.2 Cl.34.2	Submit GANTT chart for construction programme	✓		None	Vol.2 Ann.1	

Check for qualification

The qualification check is only undertaken where there is no separate RFQ process. The qualification determination is made by following the procedure described in step 4 of the RFQ processes, above. All non-qualifying bids should be set aside. Only qualifying bids should be subject to the following actions.

Check for compliance

Compliance refers to whether the bidder has met the essential minimum requirements set out in the RFP. Use the same format as for bid completeness. Great care must be taken to ensure that the essential minimum requirements are fully met. Record non-compliant bids.

Figure 5.5: Example of how to establish and sign off on the essential minimum requirements

Where in RFP	Description	Comply		Comments	Where in proposal	Cross reference
		Yes	No			
Vol.2 Cl.21.1.2	Construction "all risks insurance cover" to set amounts	✓		ABC underwriter	Vol.6 p.34	Mark up 64 of PPP agreement Vol.2

2. Detailed analysis

The bids that are deemed to be complete and compliant are then subjected to detailed analysis by the separate TETs.

Technical

- Is the project deliverable?
- Will the required outputs be delivered?
- A solution due diligence must be carried out by this team on whether or not the solution can become a reality.
- Each element of the system service specification must be assessed from the design, development and operational perspectives. More than merely evaluating the bids, the objective here is to:
 - Confirm that the system service specification is, given bidder responses, an accurate reflection of the municipality's needs
 - Capture the particular perspective of the proposal
 - Capture the deficiencies or added benefits
 - Evaluate the response on a simple scale of inadequate/adequate/good to carry through to scoring
 - Compile a list of questions that need answering before the bid is awarded
 - Assess a value for money impact.
- The proposal must be checked against the requirements of the standard specifications. This check is required to ensure that bidders commit to meeting applicable standards specifications, such as ISO and SABS.

Figure 5.6: Example of how to set out a system service specification evaluation

Eval. aspect	RFP ref.	Impact level	Requirement	Proposal	Bid ref.	Deficiencies or added benefits (risk transfer)	Rating: 0 = Inadequate 1 = Adequate 2 = Good	Notes	Value for money impact
Layout of offices	Vol.1 Ann.5 Cl.4.1	High	Does the design meet R158 for space and functionality?	Offers 5m ² per office	Vol.3 p.3	R158 standard not met	0	Will place bidder in breach of PPP agreement Cl.34.2: compliance	Estimate R400k additional floor area

- Scoring: the National Treasury does not suggest or prescribe a scoring methodology other than that the ratings for all the technical criteria should be applied to functional weightings. This means that each technical evaluation will generate:
 - A weighted score
 - A report on the number of “inadequate” ratings. This means that a weighted score that has some overall respectability does not disguise a number of inadequacies
 - Notes requiring resolution.

Legal solution

There are two tasks in the legal evaluation:

- Legal due diligence on the bidding consortium, its structure, legal status, BEE credentials, non-listing on either the National Treasury’s database of companies, directors and persons restricted from doing business with the public sector or the Register of Tender Defaulters and the status of individual firms (including any record of insolvency or crime).
- Evaluation of the marked up draft PPP agreement
 - Capturing all marked up amendments to the PPP agreement
 - Assessing the mark-up against the risk matrix prepared in the feasibility study
 - Capturing the value assessment implications that were determined in the feasibility study, and commenting on them
 - In complex PPPs, working with the financial evaluation team to assess value for money on issues not identified in the feasibility study.

In neither of these two tasks is the output necessarily a score. In fact it can be highly misleading to calculate a score for legal compliance or PPP agreement mark-up. The National Treasury suggests that the legal evaluation be focused instead on presenting notes requiring resolution and updating the municipality’s risk matrix in respect of each bidder, in conjunction with the financial evaluation team.

Financial solution

The financial evaluation of a bid is complex. It requires a complete understanding of the project costs over its whole term, the structure of the bidder and its funding, and, most importantly, the key value assessment deficiencies or additions in each bid. The financial team requires inputs from the technical, legal and BEE teams in assessing or identifying the following:

- Affordability
- Certainty of project costs (development and operational)
- Certainty, nature and costs of funding
- Project participants and overall structure
- All items omitted by bidders from the financial model
- Project value for money, where appropriate
- Project bankability, where appropriate, which is a function of the consortium's composition, structure, risk distribution, and funding plan.

The financial team must then:

- Produce a composite score for financial evaluation
- Produce a series of notes showing matters that need resolution.

BEE

The National Treasury suggests that the evaluation of the BEE component be given predetermined levels for inadequate, adequate and good ratings for each element of the project's BEE scorecard. Bidder responses are then evaluated against these levels. The National Treasury is not prescriptive about how the ratings are converted into a score, but a minimum threshold of 60 per cent for BEE must be set, as prescribed in Module 2: the Code of Good Practice for BEE in PPPs.

Figure 5.7: Example of how to do a BEE and socioeconomic evaluation

RFP ref.	Response area	Inadequate	Adequate	Good	Bidder response	Where in bid proposal	Rating	Notes
Vol.3 Cl.9.1	Black equity in the private party	<20%	20 to 30%	>30%	40%	Vol.9 p.23	1	Check equity sources and cost in financial response

Price

The distinct price evaluation is required in terms of the PPPFA. In PPPs, price is closely linked to qualitative elements. The RFP will have prescribed the form in which price is to be presented, but the price offered by the bidder must be scrutinised with the financial solution evaluation before price points are allocated. Price points will be allocated according to the formula prescribed by the PPPFA.

It is also important to note that in opening the price envelope the evaluation panel should not only look at the prices submitted. It is necessary to look at the price submission and apply a test of compliance, reasonableness and acceptability of conditions.

Compliance testing includes ensuring the financial bids comply with the tender rules. If for example the tender asks for a fixed price the evaluation must ensure compliance with this requirement.

The tender submission requirements require the bidders to submit a marked-up version of the draft contract. The panel must take into account the price impact of any proposed contract amendments.

The reasonableness of the prices can be established by averaging the prices from the received bids. The average price indicates the reasonable price that the market is willing to pay for the services specified in the terms of references. Having established this reasonableness the price of the winning bid should be close to, or not significantly higher than the average price. The evaluation panel must also examine whether the prices are reasonable by establishing a link between the technical score and the price quoted. Generally there must be a relationship between the technical score and the price quoted. A tenderer who scores high on technical will have a price to reflect the inputs in the technical portion of the proposal.

In PPPs for private-party use of municipal property, the winning bid should be that which tenders the highest payment for use of the municipal property, calculated in the context of any payment deductions or mitigations included in the PPP agreement mark-up by that bidder.

3. Reports to the evaluation coordination committee

Each TET produces its own report and score sheets and passes these through to the EC.

Step 2: Evaluation committee

The work of the TETs will be disjointed without the EC's very hands-on role.

The role of the EC is to:

- Coordinate the TETs during their analysis through regular meetings with team leaders
- Approve all correspondence and direct communication with bidders on clarification matters

- Receive and pass through to the bid adjudication committee the TET reports on completeness and compliance, including a recommendation on which bidders to take to further analysis as compliant bids
- Receive the analysis reports from the TETs and interrogate these until the committee is satisfied that each report is fully substantiated
- Prepare its recommendations on further processes such as BAFO
- Evaluate the overall integrated solution for the project, taking into account all TET reports
- Score the overall integrated solution, and provide notes to be resolved before entering into a PPP agreement
- Compile the total project evaluation notes and reports into a single recommendation on process and outcome (preferred and reserve bidders) to pass through to the AC.

The National Treasury recommends that final scoring is not done by the EC.

Step 3: Adjudication committee

The AC is the accounting officer, supported by committee members appointed by him/her.

The role of the AC is to:

- Accept bids as complete and compliant
- Receive and evaluate the report and recommendations from the EC
- Score the bids
- Decide on a BAFO process, if necessary
- Select a preferred and reserve bidder.

Step 4: Clarification

The PPP procurement process allows for clarification during evaluation so that the evaluation reflects a full understanding of each proposal. The constitutional requirement of fairness and transparency means that any form of change to a bid or negotiation with individual bidders during the evaluation process is prohibited. The line is easily crossed if the term “clarification” is not defined and the process for clarification not clearly set out.

Clarification must involve written questions and responses. The question must refer to a specific element of the proposal and must not solicit any change to the proposal. The response must be vetted before being accepted as a clarification. If the response sets out a change to the proposal, it must be set aside and its contents ignored. In such a case, or if the response does not resolve the matter on which clarity was sought, then the interpretation of the response that results in the lowest score or the production of an evaluation note for that element of the evaluation should be used.

Step 5: Evaluate variant bids

The evaluation of variant bids that meet the requirements of the RFP takes place after the compliant bids have been evaluated. A variant bid should be evaluated as a stand-alone proposal. In practice this must be done by amending the score given to the compliant bid in the specific areas of variation.

However, to leave the evaluation as a simple add or subtract process will result in a gross oversimplification. Variant bids invariably impact on a range of other elements in the proposal and materially affect the overall risk transfer for the project. The financial and performance impacts of variant bids must be identified and evaluated, as well as quantified as far as possible. The aim here is to quantify the change in value for money that flows from any part of the variant bid. While the same form of evaluation should be used, emphasis should be placed on the evaluation notes produced by the TETs and the EC, and on the value for money generated and not just on the actual score.

Step 6: Choose the preferred and reserve bidders

The evaluation should result in the selection of one preferred bidder and one or more reserve bidders. The preferred and reserve bidders may not be announced until the value assessment report has been presented to council for notification.

Step 7: Obtain the views and recommendations of National Treasury and the relevant provincial treasury (TVR: IIB)

Preparation of the value assessment report referenced in Step 6 will involve obtaining the views and recommendations of National Treasury and the relevant provincial treasury in terms of the bid evaluation and the selection of the preferred and reserve bidder. (See part 3).

Part 2: Best and final offer

When is BAFO appropriate?

Following the evaluation of bids in complex PPPs, there may not be a clear preferred bidder and procurement may have to go into a best and final offer (BAFO) process.

There are two main reasons to extend the bidding process:

- The bids are identical or too similar to choose a clear preferred bidder
- No single bid meets the municipality's defined project objectives.

The reasons for the second scenario may include bidder misunderstanding of the objectives; evaluation criteria or processes that are not aligned with the municipality's priorities and objectives, and bids with contrasting strengths and weaknesses.

A well-structured RFP with bidder interaction – and not BAFO – is the first way of preventing such problems. Bidders cannot use a BAFO to complete incomplete bids, and municipalities should not plan for a BAFO to compensate for weak RFPs. Bidders should not assume that there will be a BAFO stage. If bidders anticipate that there will be further rounds of bidding, they may build allowances into initial bids.

Under no circumstances should the BAFO process be used as a substitute for the other requirements of the bidding stage as set out in this module. If the RFQ and RFP are properly written, there should be no BAFO process. Most projects should not need a BAFO process and the decision to initiate such a process is not to be taken lightly.

The bidding process is expensive for the private sector, and it has a legitimate desire for the preferred bidder stage to be reached as soon as possible. However, the municipality must balance these factors with the need to ensure that the best bid is chosen. The BAFO process gives the public sector an opportunity to extract the maximum benefit out of the bids. It puts competitive pressure on the bidders before a choice is made about the preferred bidder.

A BAFO may just be used as a mechanism to confirm price or other key bid parameters. It may also fundamentally change the risk allocation, or the bid prices may change.

Lessons from BAFOs

There are many local and international examples of BAFOs. Several South African and UK projects were used to draw up the following list of lessons.

- Reach a conclusion on key contractual provisions and price during BAFO, while bidders are still under competitive pressure.
- Lenders need to reconfirm their level of commitment during BAFO.
- Bidders must not be rushed during the BAFO stage. A properly managed BAFO will save time during negotiations.
- BAFO must not be used as a replacement for thorough due diligence. The needs of the municipality must be fully developed long before BAFO is applied.
- Preferred bids in evaluation provide the best value for money.
- The process must have a deadline to avoid “negotiating drift”. Bidders lose interest in the project, and no longer provide a credible negotiating alternative.
- The BAFO document must be a comprehensive description of the needs of the municipality.
- Communicate clearly to bidders that the BAFO proposal is irrevocable and forms part of the bidder proposal.
- Promote an atmosphere of collaboration and partnership. This applies as much in the BAFO as in the RFP stage. For example, a restrictive due diligence period during the RFP phase may constrain the responsiveness of the proposals.
- Consider the costs of a BAFO to the private sector. If it is significant, the municipality may agree to reimburse the costs of the unsuccessful BAFO bidders. This is a value-for-money consideration and the National Treasury’s position is that such compensation should not be automatically provided.
- Assure the private sector in good faith that the process will end on time. Set a realistic timetable.
- Describe the required outcomes clearly.
- There should only be two BAFO bidders, except in very unusual circumstances.
- Alert bidders to the possibility that the bid could enter into BAFO as soon as possible.
- BAFOs consume considerable resources and time.

The following detailed description outlines the process of carrying out a BAFO, drawing on South African and international best practice.

BAFO

Step 1: Inform the bidders

Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder

Step 3: Get TVR IIA

Step 4: Distribute the RfBAFO and the roadmaps

Step 5: Provide further clarification

Step 6: Bidders respond

Step 7: Evaluation and choosing the preferred bidder

Step 1: Inform the bidders

Inform the short-listed bidders and explain the BAFO process. Remind them that their initial offers remain valid, because, in theory, the BAFO is a refinement of the initial offer. Debrief the bidders that will not enter the BAFO process.

Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder

Revise the RFP and replace it with the request for best and final offers (RfBAFO). The RfBAFO is largely a clarification of the original RFP. It sets out changes common to the short-listed (commonly only two) bidders. Try to keep the RfBAFO document layout consistent so that it is easy to compare it with the RFP. It may be a good idea to use the original RFP with a different colour font to indicate where the document differs from the RFP.

The reasons for requiring the BAFO will usually be different for each bid. For this reason, the RfBAFO is accompanied by separate “road maps” for each short-listed bidder. This roadmap must set out, in specific terms, the municipality’s view of what each bidder needs to do to get to where the municipality needs it to be in relation to the objectives of the project. The roadmap for a bidder is confidential to that bidder. It gives the bidder a description of the shortcomings of its particular bid and explains the specific areas which require clarification. This focuses the bidder for preparing the BAFO proposal. The road map document may be presented in bullet point paragraphs. As long as the points are explicit, a great deal of narration is not necessary.

Suggested contents of the RfBAFO

Introduction to the BAFO process

Begin with an explanation of the BAFO process to initiate the bidders into the process and facilitate its success. Describe the events leading to the BAFO stage as well as the municipality’s reason for deciding to extend the bidding process.

Description of the RfBAFO structure

Outline the matters included in the RfBAFO and explain how bidders need to respond to the document.

Introduction to the roadmaps

Inform bidders that a separate roadmap will be distributed to each short-listed bidder that will ask specific and individual questions that each bidder needs to answer. Describe the common contents of the road map and how it should be used.

The municipality’s expectations

Specify what responses the municipality expects from bidders, that a full response is required as the revised bid will be evaluated on this basis, and the

deadline for submission. Remind bidders that they may improve their original bid if they are offering better value to the municipality.

Interaction and communication protocol

Set the parameters for interaction and communication between bidders and the municipality during the preparation of the BAFO bids. Explain that bidders may either schedule meetings with the municipality or submit written questions. Point out that these questions and answers may be made available to the other bidders.

Confidentiality disclaimer

Remind bidders that:

- The information provided is confidential and should only be used for the purpose for which it was provided
- Any copies of any documents made available by the municipality or its advisers should be returned to the municipality on demand
- Bidders may not communicate with the press about the project without the municipality's prior consent.

Information disclaimer

Include a disclaimer excluding liability for incomplete and inaccurate information provided to the bidders. Inform bidders that they are responsible for verifying facts.

Rules for changes to bidding consortiums

Indicate that changes in the makeup of a consortium are not permitted. The BAFO stage is intended to be a clarification of the proposals and not an opportunity to make substantive changes to the bidding team.

Acceptance of the BAFO process

Specify that by participating in the BAFO process, bidders accept the rights and discretionary privileges of the municipality during the process. Reconfirm the RFP position that the municipality may terminate the negotiation process if it is unlikely that an agreement will be concluded. In such a case, negotiations with other bidders may begin. Remind bidders that the municipality is not bound to enter into an agreement with any bidder.

Schedule

Set out the deadlines, including:

- When the RfBAFO was distributed
- When discussions about the BAFO stage take place
- When requests for interaction are submitted
- Any additional bidder due diligence required to reduce uncertainty and provide better value for money

- The deadline for receiving BAFO proposals
- When proposals will be evaluated and the preferred bidder selected
- When negotiations with the preferred bidder will be initiated.

Explain that the municipality reserves the right to change the dates, form and substance of the process at its discretion and is not liable to bidders. Indicate any changes to the schedule will be communicated as soon as possible.

Step 3: Get TVR IIA

The municipality must submit a TVR IIA request to the National Treasury and the relevant provincial treasury for the BAFO documents – as these are procurement documents – before issuing them to bidders. Follow the same processes as for RFP approval.

Step 4: Distribute the RfBAFO and the roadmaps

Schedule a BAFO conference with the short-listed bidders. During the conference, distribute the RfBAFO as well as each bidder's individual road map.

The conference gives the municipality the opportunity to describe the BAFO process to the bidders. The municipality may answer questions related to the RfBAFO, but questions related to a specific bidder's roadmap should be answered in one-on-one meetings.

Point out that the BAFO proposal will be evaluated as a complete response to the requirements of the RfBAFO and that the municipality cannot be expected to cross-reference the bidders' original RFP proposals. The bidders' initial responses to the original RFP remain valid in their own right.

Step 5: Provide further clarification

The bidders may request further clarification after they have reviewed the RfBAFO and roadmap. They may submit questions to the municipality in a one-on-one meeting or in writing. Meetings may also be held jointly between the municipality and both bidders, for all functional areas such as legal, financial and technical. The municipality must reserve the right to refuse to answer any question that would compromise the competitive nature of the process. A bidder may request that a question be asked in confidence, but the municipality reserves the right to distribute the questions and answers to the other bidder if it is common to both bidders. Minutes must be kept of all meetings, both joint and one-on-one.

Step 6: Bidders respond

The BAFO bidders respond to the RfBAFO and roadmap with a fully revised proposal, which should meet all the requirements in the RfBAFO. The municipality will only evaluate these new proposals. Although the BAFO proposal and the initial proposal may be fundamentally the same, specifically in relation to the solutions offered, bidders are allowed to change their original proposal if they believe that doing so will offer the municipality a better deal. Bidders must guide the municipality to recognise such changes.

The BAFO proposals should be submitted in writing, but the municipality may also ask for oral presentations. Oral presentations should follow shortly after the written proposals have been submitted, after the TETs and EC have had an opportunity to read them. The municipality may ask for further clarification of the bids following the presentation.

Step 7: Evaluation and choosing the preferred bidder

After the oral presentations, the evaluation process will begin, following the same route as for the RFP evaluation, and resulting in the selection of a preferred and reserve bidder by the AC.

Evaluation criteria should stay the same, because changing them could create the impression that one bidder is being favoured. Accurately selected evaluation criteria in the RFP stage are therefore essential for PPP success – a BAFO will not save a project that has inadequate evaluation criteria.

Step 8: Obtain the views and recommendations of National Treasury and the relevant provincial treasury (TVR: IIB)

Prior to initiating negotiations with the preferred bidder, the municipality must obtain the views and recommendations of National Treasury and the relevant provincial treasury (TVR: IIB) and prepare the value assessment report described in Part 3, below.

Part 3: The value assessment report

The Municipal PPP Regulations require the following

4 (1): When complying with part 1 of chapter 11 of the Act, the accounting officer of the municipality must solicit the views and recommendations of the National Treasury and the relevant provincial treasury on: ... (b) the evaluation of the bids received and of any preferred bidder at least 30 days before any award is made.

This report is known as the value assessment report.

Step 1: Write the value assessment report

A well-constructed bid evaluation process will write its own value assessment report.

Before the preferred bidder is announced and appointed, the value assessment report has to be written and submitted to the National Treasury and the relevant provincial treasury for their views and recommendations in terms of the evaluation of the bids received and the recommended preferred and reserve bidder (TVR: IIB). There can be no negotiation with the preferred bidder before these views and recommendations have been received and considered.

Receipt of the foregoing views and recommendations does not constitute an approval of the procurement process or its outcome, but rather a statement from the reviewing treasuries that the preferred bidder in a complex PPP provides the best value for money for the project and in simpler PPP projects that the bid is affordable.

See Annexure 4: **Suggested contents of the value assessment report.**

Step 2: Present the value assessment to the council for notification

The municipality's accounting officer should present the value assessment report to the council for notification. Thereafter, the preferred and reserve bidders may be announced and negotiations commence with the preferred bidder.

Both the preferred and the reserve bidders should be required to accept the appointment and extend their bid bonds as a commitment to the process. The bonds are released when the PPP agreement has been successfully closed.

The reserve bidder is crucial. The municipality may require the preferred bidder to be replaced if the bidder withdraws or if negotiations compromise value for money as approved in TVR IIA.

STAGE 4: NEGOTIATIONS

Negotiations are an integral part of the procurement phase. They are a process, not an event. Successful negotiations culminate in awarding the contract, concluding the procurement phase and starting implementation.

The municipality and the private party have different perspectives on the negotiations stage. The private party wants to reduce risk and increase its margins, while the municipality wants to reduce its costs and maximise the value of the services provided through the PPP.

The output of the negotiations must be a PPP agreement with all ancillary agreements containing the service level agreements and payment mechanism.¹⁷

Basic principles of successful negotiations

- Focus on interests, not positions
- Separate the people from the problem
- Do your homework – know what you want
- Be fair – build trust
- Be prepared to commit
- Be an active listener
- Respect the other side's priorities
- Be prepared to compromise
- Leave it aside – resolve immaterial sticking points later
- Never feel that the preferred bidder has a monopoly position
- Don't feel pressured to take a decision at any given time
- Never be emotional and reactive.

17. High-level negotiations parameters are listed in section 24 of the Municipal SCM Regulations and section 84 of the MSA.

Negotiations

- Step 1: Preparatory work
- Step 2: Initial contact
- Step 3: Engagement
- Step 4: Ongoing management
- Step 5: Resolution
- Step 6: Final bargaining
- Step 7: Formal settlement

Step 1: Preparatory work

Outline the objectives of the negotiations

- To bridge gaps, eliminate confusion, and formally clarify terms and conditions
- To structure a durable agreement that protects the interests of both parties.

Prepare a schedule for starting and concluding the negotiations within the bid validity period.

Establish a negotiation team

- Define skill mix requirements.
- Assign a lead negotiator. This person does not have to be the project officer, but must take guidance from the project officer and must have direct access to the accounting officer via the project officer.

Strategise

- Anticipate the private party's positions and interests.
- Carefully review bid evaluation reports, proposal implementation plans and performance schedules, and financial analyses and projections.
- Design a detailed negotiation plan. Predefine certain positions (fall back, alternative and no-go positions).

Step 2: Initial contact

- Invite the bidder, in writing, to a meeting.
- Specify the issues to be discussed, the municipality's suggested approach to resolution, and any additional information required for the meeting.
- Provide the date, time, location, and expected duration.
- Request the names and positions of each person on the bidder negotiation team.

Step 3: Engagement

- Begin the first negotiation meeting by making opening statements and introductions, and by clarifying roles and responsibilities.
- Create a climate of trust and cooperation.

Step 4: Ongoing management

- Continually define issues and set an agenda for each meeting.
- Identify shared, compatible, and conflicting interests.
- Jointly refine agendas to include action items and keep the meetings on track. Each meeting should focus on interests rather than positions or personalities.
- Carefully manage the tracking of evolving documentation:
 - Appoint an assigned drafter
 - Track, number and date changes on every document being negotiated
 - Keep the main draft in read-only format and create password access to documents.

Step 5: Achieving resolution

Generate options for settlement

Concentrate first on common and easily resolved issues to establish a collaborative process.

Assess the options

Choose an option by using objective criteria and based on concepts, standards or principles that the parties believe in and which will not be under the control of either party alone.

Step 6: Final bargaining

Final bargaining requires compromises so that both parties see the settlement as the best possible one under the circumstances. Be prepared to bridge affordability gaps as commercial details become clearer. Some output specifications may need to be reduced to keep the project affordable.

The municipality must strive to make the funding agreements unconditional. Conditions precedent in the PPP agreement must be limited as far as possible. This refers to matters that need to be resolved, failing which the agreement, if

signed, is not enforceable. There may be some conditions that cannot be met before signing the PPP agreement, but these must be minimised.

Step 7: Formal settlement

- Record details of negotiated points and resolutions
- Agree on how any potential conditions precedent can be minimised
- Agree to the required follow-up in contract management (of outstanding issues that do not impact on negotiated settlement) and timeframe
- Establish a preliminary schedule for signing the PPP agreement.

Take note

Every negotiation is different. There are different people involved and perhaps different cultures and risks. The parties will have to adapt accordingly.

STAGE 5: TVR III/SECTION 33 OF THE MFMA

The municipality's submission for TVR III should be a continuation of the value assessment report. It establishes the final negotiated project costs, the value for money, the final terms of the PPP agreement and the contingent liabilities incurred by the municipality. It also provides the municipality's plan for managing the PPP agreement, and confirms the legal due diligence on the competency of the parties to enter into the PPP agreement.

Most PPPs are for a period greater than three years, which requires a municipality to comply with the requirements of section 33 of the MFMA as well. These Guidelines assume the applicability of section 33 of the MFMA and suggest that the TVR III report be prepared to meet the requirements of both section 33 of the MFMA, and section (4) (3) of the Municipal PPP Regulations.

Extract from the Municipal PPP Regulations

4(3): ... the municipality must specifically solicit the views and recommendations of the National Treasury on: (a) the proposed terms and conditions of the draft public-private partnership agreement; (b) the municipality's plan for the effective management of the agreement after its conclusion; and (c) the preferred bidders (i) competency to enter into the public-private partnership agreement; and (ii) capacity to comply with his or her obligations in terms of the public-private partnership agreement.

Extract from section 33 of the MFMA

(1) A municipality may enter into a contract which will impose financial obligations on the municipality beyond a financial year, but if the contract will impose financial obligations on the municipality beyond the three years covered in the annual budget for that financial year, it may do so only if –

(a) the municipal manager, at least 60 days before the meeting of the municipal council at which the contract is to be approved –

(i) has, in accordance with section 21A of the Municipal Systems Act –

(aa) made public the draft contract and an information statement summarising the municipality's obligations in terms of the proposed contract; and

(bb) invited the local community and other interested persons to submit to the municipality comments or representations in respect of the proposed contract; and

(ii) has solicited the views and recommendations of –

(aa) the National Treasury and the relevant provincial treasury;

(bb) the national department responsible for local government; and

(cc) if the contract involves the provision of water, sanitation, electricity or any other service as may be prescribed, the responsible national department;

- (b) the municipal council has taken into account –*
 - (i) the municipality's projected financial obligations in terms of the proposed contract for each financial year covered by the contract;*
 - (ii) the impact of those financial obligations on the municipality's future municipal tariffs and revenue;*
 - (iii) any comments or representations received from the local community and other interested persons; and*
 - (iv) any written views and recommendations on the proposed contract by the National Treasury, the relevant provincial treasury, the national department responsible for local government and any national department referred to in paragraph (a) (i) (cc); and*
- (c) the municipal council has adopted a resolution in which –*
 - (i) it determines that the municipality will secure a significant capital investment or will derive a significant financial economic or financial benefit from the contract;*
 - (ii) it approves the entire contract exactly as it is to be executed; and*
 - (iii) it authorises the municipal manager to sign the contract on behalf of the municipality.*

Section 33 (1) (a) of the MFMA requires a minimum 60-day period prior to the council meeting at which the PPP agreement is to be considered. During that 60 day period, the municipality is required to make public the particulars of the proposed PPP agreement and to solicit comments from the local community. In addition to the public notification, publication of documents and written comments, the municipality must also solicit the views and recommendations of the National Treasury and DPLG. If the PPP is for the delivery of a municipal service within the portfolio of another Cabinet member, then views and recommendations must also be solicited from them and any other national or provincial organ of state as prescribed.

Within the 60-day period, the municipality must receive the public comments and views and recommendations of the relevant government bodies and process these comments in time for the council meeting at which the PPP agreement will be considered.

Documents of this importance are usually distributed to the involved municipal departments for comment before being sent to the councillors for their review prior to the meeting, commonly 10 days prior to the meeting. In consideration of the forgoing, the following times frames are suggested:

Time frames suggested by the National Treasury

Public notification will be made and documents made available to both the general public and government bodies 60 days prior to the meeting at which the PPP agreement will be considered. The notification and invitation should indicate

that comments from the general public and the views and recommendations of the National Treasury and other government departments are due 30 days after notification. After the receipt of comments, views and recommendations, the municipality will have 10 days to summarise and incorporate the comments into the MFMA section 33 report as annexures. The completed MFMA section 33 report will then be distributed to all pertinent municipal departments 20 days prior to the council meeting and to the council members with department comments 10 days prior to the meeting.

TVR III

- Step 1: Prepare the PPP agreement management plan
- Step 2: Complete the legal due diligence
- Step 3: Compile and submit the TVR III report

Step 1: Prepare the PPP agreement management plan¹⁸

Preparing the PPP agreement management plan should send a clear message to the municipality that while choosing the private party represents the end of the complex and challenging procurement phase, it also heralds the beginning of new phase that requires a different level of municipal capability.

The plan is one of the pillars of effective PPP agreement management and the project officer will need to ensure that adequate time and resources are devoted to its preparation.

The preferred bidder should be closely involved in the development of the PPP agreement management plan during the negotiation stage and this involvement should be used to develop good working relations between the two parties.

The main purpose of the PPP agreement management plan is to:

- Demonstrate to the National Treasury and the relevant provincial treasury the municipality's capacity to effectively enforce the PPP agreement
- Provide a strategic management tool to guide the contract management activities that the municipality and the private party will undertake during each stage of the project

18. Detailed guidance on the preparation of the PPP agreement management plan is given in Module 6: Managing the PPP Agreement.

- Clarify the roles and responsibilities of the municipality during each stage of the project, and identify the resources that the municipality will require to undertake these responsibilities
- Provide information on the contract management approach and contract management arrangements, which can be used to assess the performance of the municipality in discharging its obligations and responsibilities as set out in the agreement and government legislation such as the MFMA
- Provide a vehicle for addressing issues that cannot be dealt with adequately in the PPP agreement (such as attitudes and behaviour).

Take note

After the initial PPP agreement management plan has been prepared as part of the TVR III process, the approach to contract management should be updated regularly in consultation with the private party, to respond to changing policies, industry requirements, environmental standards, technology and end-user expectations.

Step 2: Complete the legal due diligence

A legal opinion must be signed by the legal advisers of both the private party and of the municipality, covering legal compliance, competence and capacity to enter into the PPP agreement. This is essential in ensuring that the parties enter into a valid PPP agreement.

Some examples of the contents of the legal opinion are:

- The project is a PPP as defined in the act
- The treasury views and recommendations have been obtained and considered
- The procurement process complied with specified legislative requirements
- All future financial commitments and guarantees have been authorised
- The municipality has the capacity to enter into the agreement.

Step 3: Compile and submit the TVR III report

The application for TVR III must be signed by the accounting officer and submitted in the form of a report to the National Treasury and the relevant provincial treasury in terms of section (4) (3) of the Municipal PPP Regulations and section 33 of the MFMA and to the DPLG and any relevant sectoral department in terms of section 33 of the MFMA. The submissions to DPLG

and any relevant sectoral department should be under a cover letter specifically indicating that the report is being submitted to them in terms of section 33 (1) (a) of the MFMA for their written views and recommendations, setting forth the time frames described above.

Suggested contents of submission for TVR III

1. The project

- Background, aims, why procured as a PPP
- Complete history of the procurement process
- PPP description, scope, responsibilities of parties.

2. Affordability

- The unitary or other payment and any pass-through or additional costs
- The basis of indexation; if the index is not CPIX the report must justify the alternative method
- Confirm budget sources with a written statement of affordability by the accounting officer.

3. Sources and conditions of funding

- Identify the impact of the proposed financial obligations on the municipality's future municipal tariffs and revenue.

4. In complex PPPs, value for money

- Details of the project infrastructure, operations, BEE
- Value-for-money table (comparison with PSC).

5. Contingent liabilities¹⁹

6. Risk transfer

- A comprehensive risk analysis summary, tracking risks as they developed through the procurement phase since the feasibility study. In complex PPPs, it is closely linked to the value-for-money calculation, and must therefore show risk values as estimated or fixed at contractual closure.

7. Legal due diligence

- Confirming the capacity of the parties to contract.

19. A contingent liability is a liability that accrues to the municipality through the PPP agreement but only has an actual, financial impact if a future, uncertain event occurs. An example is compensation payable on early termination of the PPP agreement.

8. Municipality's capacity to manage the PPP agreement

- A confirmation of the municipality's established capacity to fulfil its contractual obligations and manage the relationship with the private party.

9. Conclusion reached and justification

10. Annexures

- Annexure 1: Final draft PPP agreement
- Annexure 2: PPP agreement management plan.

MFMA section 33 report

Step 1: Receive the public comments and representations

Step 2: Receive the written views and recommendations

Step 3: Compile and submit the MFMA section 33 report

Step 1: Receive the public comments and representations

On receipt of the public comments and representations, each should be listed in a register indicating the name and contact details, if provided, and the general nature of the comment(s) received. Comments and representations should be categorised in terms of their applicability to the considerations set forth in section 33 of the MFMA:

- The financial obligations to be incurred by the municipality for each year of the proposed PPP agreement
- The impact of those financial obligations on the municipality's future municipal tariffs and revenue
- Whether the municipality will secure a significant capital investment or derive a significant financial economic or financial benefit from the PPP agreement.

Step 2: Receive the written views and recommendations

The response of the National Treasury and the relevant provincial treasury to the TVR III report shall be identified and listed in terms of the following categories:

- The proposed terms and conditions of the draft PPP agreement
- The municipality's plan for the effective management of the agreement after its conclusion

- The preferred bidders (i) competency to enter into the PPP agreement and (ii) its capacity to comply with the obligations in terms of the agreement
- The financial obligations to be incurred by the municipality for each year of the proposed PPP agreement
- The impact of those financial obligations on the municipality's future municipal tariffs and revenue
- Whether the municipality will secure a significant capital investment or derive a significant financial economic or financial benefit from the PPP agreement.

The response of DPLG and each sectoral department (if any) shall be identified and listed in terms of the following categories:

- The financial obligations to be incurred by the municipality for each year of the proposed PPP agreement
- The impact of those financial obligations on the municipality's future municipal tariffs and revenue
- Whether the municipality will secure a significant capital investment or derive a significant financial economic or financial benefit from the PPP agreement.

Step 3: Compile and submit the MFMA section 33 report

The foundation for the MFMA section 33 report to council is the TVR III report reflecting the views and recommendations of the National Treasury and the relevant provincial treasury in terms of the above-listed categories. The report shall also describe the views and recommendations of DPLG and any sectoral department, followed by a section setting forth the comments and representations in respect of the proposed PPP agreement in terms of the categories also identified above.

The following shall be attached as annexures to the report:

- Annexure 1** Certification of compliance with section 21A of the Municipal Systems Act
- Annexure 2** The register of public comments and representations received.
- Annexure 3** A copy of the TVR III report submitted for views and recommendations to the National Treasury, the relevant provincial treasury, DPLG and any sectoral department.

STAGE 6: CLOSE-OUT REPORT AND CASE STUDY

The terms of reference for PPP advisers²⁰ require that, following financial closure, the adviser must produce:

- A close-out report for the confidential and complete records of the municipality
- A case study which will become available to the public.

Take note

Advisers would do well to compile these documents continuously through each phase of the PPP project cycle.

The difference between the two documents is in the detail and confidential information which must be included in the close-out report and not in the case study.

The purpose of the PPP close-out report is to provide a comprehensively summarised municipal record, with all project documentation properly annexed, giving the details of the transaction, and including all confidential negotiated, contracted and financing matters. This is a key document for managing the PPP agreement,²¹ and for the municipality's reference in future deals.

The purpose of the PPP case study is to build a public library of South African municipal PPP experience that will:

- Secure for public record an accurate, summarised history of each PPP project from inception to financial closure, systematically documenting all salient facts
- Identify best practice and instances of value-adding innovation, for incorporation into the *Municipal Service Delivery and PPP Guidelines* and future sector-specific toolkits, and for application in future projects
- Identify deficiencies in legislation, policy, guidelines, approach, management practice or skill that impeded the attainment of value for money by the public sector, and which warrant appropriate corrective action for future deals
- Be a resource for municipal PPP training and business development.

The case studies will be posted on the National Treasury's PPP website for public access.

The close-out reports will be confidentially lodged in the municipality and in the National Treasury's PPP unit, and will be available to the Office of the Auditor-General for auditing purposes.

See annexure 5: **Template for PPP close-out report and case study.**

20. See Module 3: PPP Inception, 'Annexure 2: Template adviser terms of reference'.

21. See Module 6: Managing the PPP Agreement.

UNSOLICITED BIDS

Municipalities often receive unsolicited bids – proposals by a private sector entity that would entail some sort of participation by the municipality, financial or otherwise – that are not submitted in response to a tender. Many unsolicited bids, if accepted by a municipality would constitute a PPP, as they envisage the private sector use of municipal property for commercial purposes, the performance of a municipal service or municipal support activity necessitating compensation to the unsolicited bidder, or a combination of such elements.

If a municipality receives an unsolicited bid for a municipal service-delivery mechanism, and wants to test its worth, such a bid should be evaluated in the same manner as any other bid submitted in response to a tender.

Some of the key legislative and regulatory factors concerning such bids are excerpted below:

Extract from section 113 of the MFMA, Unsolicited bids

- (1) A municipality is not obliged to consider an unsolicited bid received outside its normal bidding process.*
- (2) If a municipality decides to consider an unsolicited bid it may do so only in accordance with a prescribed framework.*
- (3) The framework must strictly regulate and limit the power of municipalities to approve unsolicited bids.*

Extract from the Municipal SCM Regulations, Unsolicited bids

37. (1) A supply chain management policy must state that the municipality is in terms of section 113 of the Act not obliged to consider unsolicited bids received outside a normal bidding process.

- (2) If a municipality decides in terms of section 113 (2) of the Act to consider an unsolicited bid, it may do so only if –*
 - (a) the product or service offered in terms of the bid is a demonstrably or proven unique innovative concept;*
 - (b) the product or service will be exceptionally beneficial to, or have exceptional cost advantages for, the municipality;*
 - (c) the person who made the bid is the sole provider of the product or service; and*
 - (d) the reasons for not going through the normal bidding processes are found to be sound by the accounting officer.*

- (3) If a municipality decides to consider an unsolicited bid that complies with subregulation (2), the municipality must make its decision public in accordance with section 21A of the Municipal Systems Act, together with –
 - (a) its reasons as to why the bid should not be open to other competitors;*
 - (b) an explanation of the potential benefits for the municipality were it to accept the unsolicited bid; and*
 - (c) an invitation to the public or other potential suppliers to submit their comments within 30 days of the notice.**
- (4) Once the municipality has received written comments pursuant to subregulation (3), it must submit such comments, including any responses from the unsolicited bidder, to the National Treasury and the relevant provincial treasury for comment.*
- (5) The adjudication committee must consider the unsolicited bid and may award the bid or make a recommendation to the accounting officer, depending on its delegations.*
- (6) A meeting of the adjudication committee to consider an unsolicited bid must be open to the public.*
- (7) When considering the matter, the adjudication committee must take into account –
 - (a) any comments submitted by the public; and*
 - (b) any written comments and recommendations of the National Treasury and the relevant provincial treasury.**
- (8) If any recommendations of the National Treasury or provincial treasury are rejected or not followed, the accounting officer must submit to the Auditor General, the relevant provincial treasury and the National Treasury the reasons for rejecting or not following those recommendations.*
- (9) Such submission must be made within seven days after the decision on the award of the unsolicited bid is taken, but no contract committing the municipality to the bid may be entered into or signed within 30 days of the submission.*

What if an unsolicited bid is a PPP?

If an unsolicited bid is a PPP as defined in section 1 of the Municipal PPP Regulations and the municipality believes that the proposal may assist the municipality achieve its objectives, the following processes must also be undertaken:

1. The municipality must, prior to initiating the processes described in section 37 (3) of the Municipal SCM Regulations, initiate the processes described in stage 1 of Module 3. In addition to the matters discussed in step 1 of part 2 of stage 1 of Module 3, discussions with the PPP unit will include which party will fund the feasibility study in terms of Module 4, and the time frame for this study. A municipality may seek PDF funding for the feasibility study and following processes, in terms of Module 3.

2. At the conclusion of the feasibility study, an application for TVR I must be undertaken and the applicable provisions section 120 (6) of the MFMA complied with, including the publication and public notice requirements.
3. Should TVR I be provided by the National Treasury and an “in principle” decision made by council, the municipality must prepare and issue an RFQ to comply with the provisions of section 37 (3) (c) of the Municipal SCM Regulation. The processes set forth in stage 1, the RFQ, of this module shall be undertaken, including consultation with the PPP unit prior to issuance of the RFQ.
4. If there are no appropriate responses from other potential service providers to the RFQ, the municipality may proceed in accordance with the provisions in section 37 (4) and (5) of the Municipal SCM Regulation, provided that the municipality must prepare the proposed PPP agreement and obtain TVR III, and, if applicable, the MFMA section 33 council resolution referenced in this module.
5. If there are appropriate responses from other potential service providers, the municipality must determine a short-list of qualified bidders in terms of steps 4 and 5 of stage 1, the RFQ, and prepare an RFP, including a draft PPP agreement, in terms of stage 2: The RFP, in this module and obtain TVR IIA prior to issuance to the short-listed bidders.
6. Determination of the preferred bidder shall be in terms of the Municipal SCM Regulations and stage 3: Choose the preferred bidder, in this module and also in terms of providing a value assessment report and obtaining TVR IIB.
7. Negotiations with the preferred bidder shall be undertaken by the municipality in terms of the provisions of stage 4: Negotiations in this module.
8. At the conclusion of negotiations, the municipality must obtain TVR III, and, as applicable, an MFMA section 33 council resolution in terms of the provisions of stage 5: TVR III/section 33 of the MFMA of this module.
9. Where the preferred bidder is not the proponent of the unsolicited bid, and a PPP agreement is concluded with another bidder, the municipality shall compensate the proponent of the unsolicited bid its audited costs for participating in the procurement from the date of submission of the unsolicited bid to the date of selection of the preferred bidder only.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

ANNEXURE 1: THE PAYMENT MECHANISM

ANNEXURE 1: THE PAYMENT MECHANISM

Introduction

- “Payment mechanism” refers to the way the unitary payment and other payment amounts are determined or made up and the way deductions are calculated for inferior performance
- “Unitary payment” is the amount payable to the private party for the performance of its obligations in terms of the PPP agreement
- In PPPs where payment is based on volume or usage and not availability, a clear statement of the means for determining the payment
- In PPPs concerning private party use of municipal property, a description of the processes by which the PPP fee for the use of the property will be calculated and paid by the private party
- “Output” means the usable result arising from the performance of the private party's obligations.

The unitary payment

A unitary payment must be set by the municipality for all PPPs where the municipality makes a payment to the private party for its performance in accordance with the requirements contained in the PPP agreement. This excludes revenue-generating PPPs, volume based and user-charge PPPs where there are no such requirements. This also excludes PPPs for private party use of municipal property, where payments flow from the private party back to the municipality (the PPP fee).

Types of charges over and above the unitary payment

Rate-card charges

Typically, rate-card charges are for items or services that are certain to be incurred in the PPP, for example for service-related consumables where the municipality has sole control over usage levels and where it is inappropriate to place risk for usage and cost of supply with the private partner. Most sensibly rate-card charges are made by the private partner within the context of the PPP agreement on a “demand/pay” basis, rather than as part of the unitary payment. Rate-card items or services must be pre-specified and pre-priced.

Charges for additional activities or items

Be careful about entering arrangements that include charges for additional activities or items. There may be cases where this will, in fact, better protect the municipality's interests, such as for activities that are within the scope of the project but cannot be exactly defined when the arrangement begins and where placing the risk and cost of supply with the supplier is not economically viable. In such instances, it is essential for the municipality to define the exact rules for determining the pricing and payment.

Pass-through costs

Pass-through costs are paid by the supplier on behalf of the municipality, but are not included in the unitary payment. The supplier passes through the cost to the municipality in accordance with rules defined in the agreement. The definition of these rules is important for avoiding conflict. For example, it must be clear what the cost of money is between the supplier's payment and the complementary payment by the municipality to the supplier.

The elements of the payment mechanism

1. A single, indivisible unitary payment for full availability and performance of the services
2. An appropriate indexation
3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions
4. No limit to deductions for non-availability
5. A mechanism for dealing with changes to service requirements
6. Provisions about any sharing of excess profits, if applicable.

1. A single, indivisible unitary payment for full availability and performance of the services²²

Whatever service is provided must be available to the users and must meet performance standards. Broadly speaking, this applies to all PPPs.

Availability and performance are both usually defined in the negative. For example a particular water treatment facility is unavailable when the volume of treated water falls below a specified level, or a performance failure might be the failure to collect municipal solid waste on the days specified. The premise is that the absence of any availability or performance failure results in the full payment of the unitary payment.

22. "Services" as used in this clause refers to non-volume based services. Payment for volume-based services will be in terms of appropriate volume units, on a periodic basis, as set forth in the contract.

Where a single indivisible unitary payment is not practical, the unitary payment may be divided into a number of components, all of which must be subject to indexation only and not to other kinds of adjustment over the project term.

There should be no adjustment of or variation to the payment mechanism for anything not related to the services provided by the PPP. This includes any adjustments resulting from any component of the financing of the PPP.

Payment mechanisms may also take into account additional types of charges that may be included in the PPP agreement. These are dealt with below.

2. Appropriate indexation

Except for inflationary increases, there should be no other increases in the unitary payment. The reasons are:

- The municipality is limited to budget indexation and cannot afford sustained increases outside this indexation
- Other forms of indexation are invariably complex and difficult to monitor
- Each municipality is charged with inflation targeting as an overall government objective.

Value-for-money considerations may allow for deviating from the principle, but these deviations will be limited and will require clear justification.

The National Treasury prefers the measure of CPIX inflation for use in PPP agreements. CPIX is also used in cases where the ability to match the financing mechanisms to this index provide value for money.

3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions

The unitary payment is based on the provision of deliverables in accordance with the requirements contained in the PPP agreement. However, the PPP agreement must allow for partial or complete failure by the private party to deliver consistently, and provide for deductions for such failures, within specified parameters.

The PPP agreement should be based on a self-monitoring system established by the private party – in other words, the private party reports failures and monitors their rectification. The municipality monitors and audits the private party's system. A help desk system may be established where users or providers of the services report failures to a central information system.

The payment mechanism should:

- Differentiate between categories of availability/usage areas and performance components, and clearly identify critical or key areas and components
- Allocate penalty deductions according to categories, within specified parameters
- Focus the penalties on lack of availability for whatever reason, and make ancillary and lower monetary value deductions for performance-related failures
- Provide that continued performance failures escalate into unavailability
- Identify rectification times during which no penalty accrues (the rectification time is also a function of the category of availability area or performance component)
- Penalise repeated failures in either availability or performance on a ratchet system, namely where the penalties increase with repeated failures
- Allocate penalty deductions for monitoring failures
- Specify a minimum penalty deduction amount
- Set a maximum penalty for unavailability of all the services.

User-fee PPPs

In user-charge PPPs, the general rule is that partial or non-availability, or poor performance or non-performance, is penalised by reduced revenue from users, and there is no need to create any payment deduction regime. Instead, non-monetary penalties are applied, such as an accumulation of penalty points that may ultimately result in termination. The National Treasury prefers this approach because of the very high levels of demand risk in this kind of project.

In rare cases, it may be necessary for the municipality to make deductions from the user charges paid to the private party as a simulation of a unitary payment-type penalty mechanism.

The following factors need to prevail for a municipality to consider this kind of penalty mechanism:

- Substantial government contribution to capital works
- Significant socioeconomic goals for the project (where the termination of the contract for non-compliance is not warranted)
- Non-performance does not affect revenue (typically a monopolistic environment or where users are not sensitive to reduced service standards)

- The municipality requires services outside the scope of services that generate revenue.

4. No limit to deductions for non-availability

It is essential that there be no core of the unitary payment that cannot be affected by the deductions. Rather, the municipality and its advisers need to structure a payment mechanism that makes deductions for the non-availability of defined performance components. However, the maximum deduction should not exceed the amount of the unitary payment payable in the period of deduction.

5. A mechanism for dealing with changes to service requirements

The National Treasury acknowledges that there is an inherent contradiction between requiring a fixed, indivisible unitary payment and a mechanism for dealing with changes to service requirements. This contradiction must be managed by thoroughly analysing possible changes during the feasibility study phase, in the preparation of the RFP, and during the process of negotiating with a preferred bidder.

The municipality must consider:

- How the project will be affected by change
- How the effect of the change is reviewed and accommodated within the payment mechanism
- What effect this has on risk transfer within the PPP

The PPP must envisage change from the moment it is conceived. The sources and probability of changes vary from project to project. For example, in information and communication technology PPPs, technology changes are dramatic. These and other PPPs with equipment components must be expected to change over the long term of a PPP agreement.

If insufficient flexibility is allowed in the payment mechanism then a mismatch between service expectations and outcomes will grow over the term of the PPP agreement. The other extreme is too much flexibility in the payment mechanism. The municipality may end up being forced to negotiate with a sole supplier, so making the PPP less affordable over time.

Take note

Any material change to a PPP agreement requires approval from council and such other entities as prescribed by legislation and regulations. Where particular types of changes have been anticipated in the agreement, approval will not be required because the agreement itself will not be changing.

Potential changes that may affect an agreement include daily operating requirements, emerging service needs, municipal focus, economic factors and so on. Municipalities should review the impact of all types of change on the payment mechanism, and set down exactly how the payment mechanism may or may not be adjusted.

The National Treasury's guiding principles for dealing with change

- All possible change scenarios must be tested at the feasibility study phase and in the design of the payment mechanism.
- A specified and definite unitary payment is preferred, where appropriate. All deviations from such an indexed-only type payment mechanism must be justified, and value for money and clear treatment of the mechanism for dealing with price changes in the PPP agreement clearly demonstrated.
- Factors such as the type of service to be provided through the PPP, the variation in usage rates, and the possibility of changes in law may be taken into account in justifying deviations.
- Flexibility must be allowed in variations to the scope of service, provided that the method of variations, cost determinations and absolute cost limits on such variations are established. In addition, the municipality's approval process must be established, and management systems for implementing any changes to payment mechanisms during the agreement period must be in place.

Methodologies for amending unitary payments

Where a municipality can demonstrate that there is value for money in not having a unitary payment varied only by an inflation index, the following methodologies for amending unitary payments may be used.

Benchmarking

Benchmarking involves comparing the quantity and type of the private party's work, as well as quality and cost, with the market, and then adjusting the unitary payment either up or down to correlate better with current market quality and costs. In practice, the private party is able to amend the unitary payment throughout the agreement period to the market cost norm.

Difficulties in establishing benchmarks and managing the benchmarking process make this unattractive to most municipalities, and benchmarking should only

be used for determining the cost of a new service or facility. Where it is used for amending unitary payments, municipalities should not only ensure that the benchmarking concept is documented in the agreement, but also include the specific implications for payment mechanisms and their adjustment.

Sharing of excess profits

Value for money requires that the municipality pay a fair price for the service that, in turn, affords the supplier the profit that is reasonably aligned with the risks that it bears. But due to the long-term nature of the typical PPP agreement, competition and negotiation alone do not eliminate the possibility of a supplier making profits in excess of what was envisaged. Develop a view on reasonable profit levels, and ensure that the payment mechanism provides determinations for what will happen if the supplier makes excess profits. Such profits may result from generation of excess revenue, or from sharply reduced operating costs.

A well-structured, unitary payment type PPP, however, with a tested payment mechanism, should not need a provision for excess profits.

Checklist for developing the payment mechanism

Municipalities need to research payment mechanisms, especially where they do not have much experience in developing them.

1. Does the payment mechanism support the objectives of the agreement?

- Does the payment mechanism have a clear relationship with the specified outputs of the project? In other words, the municipality and the supplier should be clear about what is being paid for and why.
- Does the payment mechanism cover the full range of payments and deductions to be made under the PPP agreement? Are there rate-card charges, charges for additional activities and items, pass-through costs, and other extras?
- Does the payment mechanism take into account longer-term questions on affordability and value for money? Can additional costs arise later that may seriously impact on affordability for the municipality or the ability of the private party to generate a reasonable return in the longer term?
- Has the payment mechanism been tested by reviewing the impacts on affordability and value for money of all the change circumstances allowable under the agreement? (These may include, for example, increased or reduced requirements for deliverables, and reasonable changes in the municipality's circumstances.)

2. Is the payment mechanism workable and will it stand the test of time?

Transparency

Is the payment mechanism transparent in that it is understood and supported by all stakeholders, including other spheres of government, financiers, the municipality's users, the private party and the public?

Complexity/simplicity

- Is the payment mechanism too complex in that key performance areas are not separated from less important facets of the service?
- Is the payment mechanism based on output specifications rather than processes wherever possible?
- Has it been scenario-tested during development?

Relevance

- Is it relevant to the market and aligned to current practice in that market?

Administration

- Has any subjective opinion crept into determining a particular payment mechanism? Payment mechanisms should only be based on objective verifiable facts, whether for the completion of a deliverable or a deduction for inadequate service.
- Does the payment mechanism require disproportionate amounts of administrative effort? Payment mechanisms should avoid excessive administrative procedures and should not require gathering too much information. Requiring too much information from diverse sources will increase administration and audit/control requirements, and increase the chances for mistakes.
- Are the payment mechanisms simple and clear? Can both the municipality and the supplier's administrative staff easily understand the mechanisms? Where complexity is required, aids must be developed to ensure that administrative staff can make correct calculations with little effort.

Originality

Do the payment mechanisms have a proven track record, rather than creating such mechanisms anew? Where a suitable model in the specific local market does not exist, look for parallel markets: for example the equivalent international market, or a local market that, although different, has common characteristics with the target market.

Behaviour motivator

- Does the payment mechanism encourage the municipality's own stakeholders, like staff and clients, to make positive and proper use of the PPP's outputs? Equally important, the mechanism should discourage stakeholders from any bypassing of the specifications.
- Does the payment mechanism influence the private party's behaviour? It is useful to consider this question broadly by incorporating, for example, private party employees, subcontractors and financiers.

Manipulation

- Can the payment mechanism be manipulated by any party to the PPP agreement to achieve a particular outcome?
- Has it been tested for possible manipulation?

The elements of the PPP fee for private-party use of municipal property

The PPP fee payable by the private party is the greater of: (i) the minimum PPP fee (fixed and declared by the municipality in the RFP); and (ii) the variable PPP fee, being a percentage of gross revenue (a sum that is bid by the private party).

The National Treasury recommends the municipality set the minimum PPP fee that would meet its affordability and value-for-money criteria (as established during the feasibility study phase) and ask bidders to compete on the variable PPP fee. The municipality must make sure that the decision about the structure and price portion of the bid is correctly reflected in the RFP and PPP agreement and carried through to the evaluation of price bids.

Take note

The RFP must not be issued without a specified payment mechanism.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

**ANNEXURE 2: CODE OF CONDUCT FOR
BID EVALUATION PANEL MEMBERS**

ANNEXURE 2: CODE OF CONDUCT FOR BID EVALUATION PANEL MEMBERS

This code of conduct applies to bid evaluation panels considering adviser or PPP bids.²³

1. Background

In terms of the Constitution of the Republic of South Africa, 1996, section 217:

When an organ of state in the national, provincial or local sphere of government, or any other municipality identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

This code is issued by the National Treasury to instil standards of integrity, ethical conduct, and professionalism in the South African government's adjudication and evaluation of all procurement undertaken by municipalities governed by the Municipal PPP Regulations in relation to PPPs.

Every member of a bid evaluation panel appointed by a municipality to act on behalf of the state in the adjudication and evaluation of these bids is required to sign this code of conduct before receiving bids.

In addition, each member has to sign the attached declaration of interest statement once the municipality has announced and recorded the identities of the bidding parties.

The aims of the code

This code of conduct does not address every possible situation that may arise. It also cannot serve as a substitute for the responsibility of the accounting officer and the bid evaluation panel members to:

- Exercise sound judgment
- Act with exceptional standards of moral integrity
- Abide by all applicable laws.

This code of conduct is intended to:

- Confirm the member's commitment to all its prescripts

23. For the evaluation of PPP bids, this code of conduct must be signed by all members of the technical evaluation teams (TETs), the evaluation committee (EC) and the adjudication committee (AC).

- Guide members who are faced with ethical dilemmas in an increasingly complex operational environment
- Provide a reference for disciplinary and/or prosecuting procedures if a member is found guilty of fraud or corruption
- Serve as a public commitment by the municipality to the highest standards of ethical and professional conduct in the evaluation of bids.

Breaching the code

A member will be found guilty of breaching the code of conduct if he/she

- Contravenes or fails to comply with any provision in it
- When declaring interests, wilfully gives incorrect or misleading details.

In these cases, a member will be liable for disciplinary action in terms of the Municipal Finance Management Act (2003), and may also be liable for criminal prosecution.

The accounting officer, acting on his/her own or on a complaint by any person, may investigate any alleged breach of this code by a member of an evaluation panel and may withdraw the member from the panel during the investigation.

2. Definitions

‘Family member’ means a parent, sibling, child or spouse of a member

‘Member’ means a person appointed by the accounting officer to a bid evaluation panel, either as the chairperson, or as an ordinary member or secretariat, for purposes of conducting the evaluation of either adviser bids or PPP bids as a representative of the municipality

‘Privileged or confidential information’ means any information:

- Determined by the municipality to be privileged or confidential
- Discussed in closed session by the bid evaluation panel
- Which if disclosed would violate a person’s right to privacy
- Declared to be privileged, confidential or secret in terms of any law, including, but not limited to, information contemplated in sections 34(1); 35(1); 36(1); 37(1)(a); 38(a); 39(1)(a); 40 or 43(1) of the Promotion of Access to Information Act (2000).

3. Code of conduct

I, [insert name of member of bid evaluation panel], acting in my capacity as member of the [insert name of municipality] evaluation panel for the adjudication and evaluation of bids for advisers/private parties (delete which is not applicable) under [insert tender number] hereby undertake:

1. To act at all times with fidelity, honesty, integrity and in the best interests of the state and the general public it serves.
2. To diligently perform the duties of a member efficiently, effectively and strictly in accordance with the rules of bidding and bid evaluation, as set out in the bid documentation and according to all relevant instructions given by the municipality.
3. To properly prepare for and attend each meeting of the bid evaluation panel, and failing this to withdraw as a member.
- 4.1. To act at all times in accordance with the relevant legislation and regulations, including the MFMA, National Treasury regulations, and directives given by the municipality.
- 4.2. Specifically, to comply with any Code of Conduct for Municipal Officials, enacted in terms of section 175 of the MFMA.
5. To recognise the public's right to access to information in the interests of administrative justice.
6. To take the utmost care in ensuring that there is reasonable protection of the records of the municipality and all bid documentation.
7. Not to misuse the position or privileges of a member, or privileged or confidential information obtained as a member.
8. To carry out duties with the skill and care expected from a person of knowledge and experience, and to exercise due judgement.
9. Not to unfairly discriminate against any bidder on the grounds of race, gender, ethnic or social origin, colour, sexual orientation, age, disability, religion, political persuasion, conscience, belief, culture or language.
10. Not to abuse any position in the public services to promote or prejudice the interest of any political party or interest group.
11. To give the Auditor-General all the information and explanations it requires to carry out its functions.
12. To report to the appropriate authorities any case of fraud, corruption, nepotism, mal-administration and any other acts which constitute an offence or which are prejudicial to the public interest, arising during the bid evaluation panel proceedings.

13. To diligently, accurately and honestly declare, in the declaration of interest statement, all personal and/or business interests that I or a family member may have in any business of any bidder, and to willingly abide by any decision of the chairperson of the bid evaluation panel or the accounting officer/authority to withdraw as a member of the panel because of this.
14. To be open and honest about all decisions and actions taken regarding the bid evaluation, and to give clear reasons for these, which can be accurately recorded.
15. Not to make any dishonest allegations about any bidder.
16. Not to make any false or misleading entries into the records of the bid evaluation panel.
17. To make no contractual commitments related to the bid, to any bidding party, on behalf of the municipality.
18. To proactively protect privileged or confidential information of the bid evaluation panel from theft, unauthorised disclosure or inappropriate use, and specifically:
 - 18.1 Not respond to any queries relating to the bid evaluation on behalf of the municipality, unless expressly authorised in writing by the accounting officer/authority to do so.
 - 18.2 Not to speak to or correspond carelessly with any person (fellow member, colleague, friend, family member or otherwise) on any matter related to the bid evaluation.
19. Not to request, solicit or accept any reward, gift or favour in return for voting or not voting in a particular way on any matter, or for disclosing privileged or confidential information.
20. Not to accept or agree to later accept, any "kickbacks" in the form of money, favours, inappropriate gifts or anything else of value from a member of the public, government, a political or social movement, or any stakeholder or potential stakeholder which is or may be viewed as aimed at influencing or directing my evaluation of the bids.
21. To disclose immediately to the chairperson or the accounting officer/authority any attempted inducement or offers of perks that may be construed as aimed to influence or direct the evaluation of the bids.
22. To report to the chairperson of the panel any invitations to any kind of entertainment by any party that may be construed as being associated in any way with the outcome of the bid evaluation.

23. To not vote at, attend or participate in any other way in any meeting or hearing in relation to any matter before the bid evaluation panel, if any interest prevents me from carrying out my member functions in a fair, unbiased and proper way in accordance with this code of conduct.

Signed: [signature of member] _____

Date: [insert date] _____

Witnessed: [signature of witness] _____

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

ANNEXURE 3: TEMPLATE DECLARATION OF INTEREST

ANNEXURE 3: TEMPLATE DECLARATION OF INTEREST

The table below shows the full list of all the bidders, including the names of all the consortium members of each bid, who have responded to the [insert name of municipality] call for an adviser/PPP (delete as appropriate) bids for [insert name and tender number of project].

As a member of the bid evaluation panel,²⁴ you are required to declare any interest, as far as you are aware that you have, in any of the bidders and their consortium member companies.

An interest includes, but is not limited to:

- Your shareholding in a bidding company or any of its consortium member companies. Clearly indicate the extent of your shareholding and links to this bid.
- Family members, friends or associates employed by a bidding company or any of its consortium members. Clearly indicate the extent of this relationship and links to this bid.
- Family members, friends or associates shareholding in a bidding company or any of its consortium members. Clearly indicate the extent of their shareholding and links to this bid.
- Family members, friends or associates contracted to provide services to a bidding company or any of its consortium members. Clearly indicate these individuals' links to this bid.
- You, or any of your family members', friends or associates receiving, or in agreement to receive, any gifts, favours, payments, sponsorships, subsidies, or any other benefits from any bidders or any members of any of the consortiums, within the last 12 months of the date of this declaration.
- Any other personal interest that may reasonably be deemed relevant to protecting the integrity of the bid evaluation.

24. For the evaluation of PPP bids, this declaration of interest must be signed by all members of the technical evaluation teams, the evaluation committee and the adjudication committee.

All bidders' names and names of all consortium member companies	Interest (Yes /No)	Extent of interest

I, [insert name of member], a member of the bid evaluation panel for the [insert name of municipality and name and number of project] declare that the above information is true and correct to the best of my knowledge. I declare further that in the event of any such interests arising during the course of bid evaluation, these shall be promptly and accurately declared in writing to the accounting officer/authority.

Signed [signature of member] _____

Date [date of signature]_____

Witness [signature of witness] _____

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

**ANNEXURE 4: SUGGESTED CONTENTS
OF THE VALUE ASSESSMENT REPORT**

ANNEXURE 4: SUGGESTED CONTENTS OF THE VALUE ASSESSMENT REPORT

Covering letter

Section 1: Introduction

- Project background
- The bid process to date
- Evaluation criteria
- Evaluation approach
- Evaluation committees
- Summary of compliant and variant bids submitted.

Section 2: Evaluations

- Completeness
- Compliance
- Analysis of bids
 - Technical
 - Technical solution
 - Legal solution
 - Financial solution
 - BEE
 - Price
 - Total integrated solution
- Consolidation of analyses.

Section 3: Affordability assessment

Set out the cost of each proposal to the municipality, including the proposal cost with adjustments where appropriate and motivations for the full cost of the proposed solution.

Section 4: In complex PPPs, the value for money assessment

This section must tie in very closely with the feasibility study. Value for money is the comparison of proposals with the PSC, and considerable work is required to risk-adjust each proposal to a risk status and equivalent level of service that compares with the PSC. In addition, the risk retained by the municipality must be accounted for.

Section 5: Risk transfer assessment

Set out the risk matrixes of the bidders with particular focus on the risk matrix of the preferred bidder.

Section 6: Notes raised and bid deficiencies

Set out the bid deficiencies as captured in the EC's evaluation notes on the preferred bidder, with an assessment of the kinds of deficiencies and anticipated difficulties in resolving them.

Section 7: BAFO consideration

Report on the BAFO process (if applicable), evaluation and results in the same way as for the RFP analysis.

Section 8: Treasury views and recommendations (TVR: IIB)

Report on the views and recommendations obtained by National Treasury and the relevant provincial treasury in terms of the evaluation of the bids received and the preferred bidder.

Section 9: Negotiation plan

The negotiation plan must set out the negotiation strategy and all teams, processes and issues.

Section 10: Conclusion

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

**ANNEXURE 5: TEMPLATE FOR PPP
CLOSE-OUT REPORT AND CASE STUDY**

ANNEXURE 5: TEMPLATE FOR PPP CLOSE-OUT REPORT AND CASE STUDY

While there is a single template for both documents to ensure consistency, two distinct documents must be produced, and it is recognised that the nature and scale of each project will shape the documents. Writers should tailor the project material and shape the template in such a way that the final product meets the two sets of objectives above. Writing style is to be concise and factual, and the analytical aspects are to be confined to crisp conclusions, lessons and recommendations. The use of tables and summary boxes is encouraged.

Section 1: Project summary

- Project name
- Project description
- Project deliverables
- Project location
- Sector
- Municipality
- Accounting officer: name and contact details
- Project officer: name and contact details
- Adviser: name and contact details
- Relevant treasury's PPP unit project adviser
- Signatories to the PPP agreement
- Signature date
- Structure of the PPP (diagram)
- Agreement term
- Private party SPV: name and contact details (if applicable)
- Shareholders in the SPV: names and contact details (if applicable)
- First-tier subcontractors to the private party: names and contact details
- BEE profile of the private party and first-tier subcontractors
- Lenders and underwriters: names and contact details (if applicable)

- Lead arranger: name and contact details (if applicable)
- Total capital investment in NPV, specifying public and/or private sector sums
- Debt: equity ratio and sums in private finance structure
- NPV of unitary payments by the municipality, or revenue receivable by the municipality, specifying discount rate applied and the indexing treatment
- Value for money achieved over the PSC
- Total cost of transaction advice, from inception to financial closure, relative to value achieved
- Projected annual cost of municipality's PPP agreement management post financial closure
- Risk allocation summary table
- Jobs created/retained/lost
- Local socioeconomic impacts
- Summary BEE scorecard achieved for the project
- Timetable from inception to financial close, referenced to each stage of the PPP cycle
- List of all project documents with brief description of each
- Alphabetically listed project definitions.

Section 2: Introduction

- Description of municipality's needs analysis that led to the PPP
- Status of public service prior to PPP
- Relevant political, economic, infrastructural, legal, and budgetary context within which the project was initiated.

Section 3: Inception

- Project initiation process
- Date of registration of project with the National Treasury
- Municipality's management and decision-making mechanisms

- Characteristics and mandate of the project officer and relationship with the accounting officer
- Other municipal stakeholders and their roles in this phase
- Key elements of the adviser terms of reference
- Adviser appointment procedure
- Adviser appointed (firms and individuals)
- Adviser payment mechanism

Section 4: Options analysis

- Solutions options considered
- Solution option selected and why
- Municipality's decision-making mechanisms and timing on option choice.

Section 5: Feasibility study

- Affordability levels determined
- PSC model, if required
- Risk adjusted PSC, if required
- External reference model
- Risk allocation and costing
- Indicative value for money
- Municipality's decision-making mechanisms and timing on feasibility study
- Role of other public entities
- TVR I: process, conditions.

Section 6: Bid documentation

- RFQ specifications
- RFP: key features, particularly output specifications and bid evaluation criteria
- BAFO process, if applicable
- PPP agreement: key features that deviate from *Standardised PPP Provisions*

- Summary of key features in respect of risk, payment mechanism, penalties
- TVR IIA process, conditions

Section 7: Procurement

- Description of procurement process design
- Municipality's decision-making arrangements
- Roles played by all parties to the procurement process
- Procurement timetable
- Process of bidder engagement that occurred at each stage, noting any changes to planned process and why
- Market response
- Characteristics of qualifying consortiums
- Quality of response: strengths and deficiencies
- Contested features of the PPP agreement in bids
- Bid evaluation procedure, scoring system, decision-making mechanism
- Requests for reasons and any other responses from unsuccessful bidders
- Requests for information and any other responses from stakeholders and the general public
- Whether there was a BAFO stage, and if so why
- Changes to the leading bids that resulted from the BAFO stage
- Summary of value assessment report recommending preferred bidder, including a report on the TAIIB{ XE "Treasury views and recommendations (TVR)" } processes

Section 8: Negotiations

- Negotiations arrangements
- Roles played by all parties
- Resolutions to obstacles or disagreements
- Deal breakers and how they were resolved
- TVR III: process, conditions.

Section 9: PPP agreement management

- Summary of PPP agreement management plan²⁵
- Personnel dedicated: skills, authority, numbers
- Projected annual cost of PPP agreement management.

Section 10: Financial closure (for close-out report only)²⁶

- Issues that hindered closure and how these were resolved
- Key legal opinions and correspondence
- Summary of final PPP agreement and financing agreements in respect of risk, affordability and value for money for the municipality, referenced to TVR I and TVR III
- Description of key features of financial closure
- Schematic representation of final project structure, showing all parties and relationships in all final project documents.

Section 11: Conclusions and recommendations

Draw together the lessons from each of the preceding sections, concluding with an assessment of project quality. Findings should cover at least:

- Value for money achieved
- Best practice process highlights for inclusion in the *National Treasury/DPLG Municipal Service Delivery and PPP Guidelines* and toolkits
- Recommendations for improvements needed regarding:
 - Legislation, regulations, policy
 - Municipality's approach
 - Sponsors' approach
 - Lenders' approach
 - The *National Treasury/DPLG Municipal Service Delivery and PPP Guidelines*
 - Public sector management practice
 - Skills.

25. See Module 6: Managing the PPP Agreement.

26. The close-out report will be confidential document of the municipality, and will also be logged with the National Treasury.

Annexures to close-out report

- All project documentation, including base-case financial models, duly referenced throughout main text.

Annexures to case study

- Adviser terms of reference
- RFQ
- RFP
- PPP agreement (with confidential clauses and schedules blacked out)
- Electronic presentation of case study (45 minutes duration) for use in training, conferences, and public accountability hearings.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 6

MANAGING THE PPP CONTRACT



NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

MODULE 6: MANAGING THE PPP CONTRACT

ABOUT THIS MODULE

Module 6: Managing the PPP contract is broadly structured in accordance with the PPP contract management framework. Section 2 considers the approach to contract management that should be adopted in PPP projects, while section 3 looks at key municipal roles and responsibilities. In section 4 an overview is provided of the three contract management functions, and section 5 presents a similar overview of the stages of contract management. Each contract management function is described in some detail in sections 6, 7 and 8. Section 9 sets out the purpose of the contract management plan and the Contract Management Manual and provides guidelines that should be used to develop these important documents. Finally, section 10 explains the main characteristics of each of the four contract management stages and provides summaries of the key tasks that the project officer should do or organise during each stage.

SUMMARY OF APPLICABLE LEGISLATION

Section 116(2) of the MFMA

Subsection 2, section 116 of the MFMA provides as follows:

- (2) The accounting officer of a municipality or municipal entity must—*
- (a) take all reasonable steps to ensure that a contract or agreement procured through the supply chain management policy of the municipality or municipal entity is properly enforced;*
 - (b) monitor on a monthly basis the performance of the contractor under the contract or agreement;*
 - (c) establish capacity in the administration of the municipality or municipal entity –*
 - (i) to assist the accounting officer in carrying out the duties set out in paragraphs (a) and (b); and*
 - (ii) to oversee the day-to-day management of the contract or agreement; and*
 - (d) regularly report to the council of the municipality or the board of directors of the entity, as may be appropriate, on the management of the contract or agreement and the performance of the contractor.*

In addition, the Municipal PPP Regulations set out the following, dealing with the management of PPP agreements:

Procurement of public-private partnership agreements

4. (1) *When complying with Part 1 of Chapter 11 of the Act, the accounting officer of the municipality must solicit the views and recommendations of National Treasury and the relevant provincial treasury on –*
- (d) *the municipality's plan for the effective management of the agreement after its conclusion.*

Basic requirements to which public-private partnership agreements must comply

5. (1) *A public-private partnership agreement between a municipality and a private party must –*
- (d) *confer effective powers on the municipality –*
- (i) *to monitor implementation of, and to assess the private party's performance under the agreement;*
- (ii) *to manage and enforce the agreement.*

Project officers

7. (1) *As soon as a municipality initiates a project that may be a public-private partnership, the accounting officer must appoint a person with appropriate skills and experience, either from within or outside the municipality, as the project officer for the public-private partnership.*
- (2) *The project officer is responsible for performing –*
- (a) *the duties set out in section 116(2)(c)(i) and (ii) of the Act; and*
- (b) *any other duties or powers delegated by the accounting officer to the project officer in terms of section 79 of the Act.*

Responsibilities of accounting officers

8. *The accounting officer of a municipality which has entered into a public-private partnership agreement must, in addition to complying with section 116(2) of the Act, take all reasonable steps to ensure –*
- (a) *That the outsourced activity is effectively and efficiently carried out in accordance with the agreement;*
- (b) *That municipal property which is placed under the control of the private party in terms of the agreement is appropriately protected against forfeiture, theft, loss, wastage and misuse; and*
- (c) *That the municipality has contract management and monitoring capacity.*

Amendment of public-private partnership agreements

9. (1) *A public-private partnership agreement may be amended by the parties provided –*
- (a) section 116(3) of the Act has been complied with; and*
 - (b) the amendment is consistent with the basic essentials of public-private partnership agreements set out in regulation 5 and other applicable provisions of these Regulations.*
- (2) At least 30 days before a public-private partnership agreement is amended, the accounting officer must solicit the views and recommendations of the National Treasury and the relevant provincial treasury on the reasons for the amendment. The period may be shortened if the National Treasury and the relevant provincial treasury respond earlier.*



MUNICIPAL PPP PROJECT CYCLE

Reflecting Municipal Financing Management Act, Act 56 of 2003
Municipal Public Private Partnership Regulations, and the
Municipal Systems Act, Act 32 of 2000

PROJECT PREPARATION PERIOD

Modules 1-3

INCEPTION

- Identify project
- Notify government (National Treasury, DPLG) and determine scope of feasibility study and applicable process
- Appoint project officer
- Appoint advisor

Module 4

FEASIBILITY STUDY

- Notify/consult stakeholders
- Needs analysis
- Technical options analysis
- Service delivery analysis
- Delivery mechanism summary and interim internal/external recommendation
- Project due diligence
- Value assessment
- Procurement plan
- 60 days prior to council meeting, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: I

- Council decision whether to procure external option

Module 5

PROCUREMENT

- Prepare bid documents including draft PPP agreement as per MFMA Chapter 11

Treasury Views and Recommendations: IIA

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

Treasury Views and Recommendations: IIB

- Negotiate with the preferred bidder
- Finalise PPP contract management plan
- 60 days prior to signing of contract, give public, Treasury, DPLG 30 days to comment

Treasury Views and Recommendations: III

- Council passes resolution authorising execution of PPP contract
- Accounting officer signs PPP agreement

PROJECT TERM

Module 6

PPP CONTRACT MANAGEMENT

- Accounting officer responsible for PPP contract Management
- Measure outputs, monitor and regulate performance, liaise effectively, and settle disputes

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1. INTRODUCTION

Purpose of the Guidelines

The *Municipal Service Delivery and PPP Guidelines* are intended to help municipalities put in place effective mechanisms to manage the implementation of a PPP contract. They provide a route map for managing the contract, bringing together an outline of recommended approaches, together with models, summaries of key tasks and references to more detailed sources of advice. Most of the advice is generic in nature. While different types of PPPs (for example, water services projects or solid waste management projects) have unique features that require specific forms of treatment when managing the PPP contract, the underlying principles in this guidance should apply to all PPP contracts.

The Guidelines are specifically designed to help the municipality to meet its PPP contract management responsibilities in terms of the following sections of the Municipal PPP Regulations:

- Section 4, which requires the accounting officer to solicit the views of the national and provincial treasury on the municipality's plan for the effective management of the PPP contract
- Section 5, which sets out certain monitoring requirements with which PPP contracts must comply
- Section 6, which states that only the accounting officer of a municipality may sign the PPP contract
- Section 7, which requires the accounting officer to appoint a project officer and outlines his/her key responsibilities
- Section 8, which sets out the responsibilities of the accounting officer in regard to the management of the PPP contract.

The Guidelines are primarily aimed at the project officer, who will be responsible for the preparation and implementation of the contract management plan. While this module should also be relevant to other professionals in the municipality and the private party, the main objective is to provide practical advice and tools that can be used by the project officer throughout the period of PPP contract management.

What is contract management?

Contract management is the process that enables both parties to a contract to meet their obligations to deliver the objectives of the agreement. It involves building a good working relationship between the two parties, and continues throughout the life of a contract.

The main aim of contract management is to obtain the services specified in the output specification and ensure affordability, value for money and appropriate risk transfer. This means optimising the efficiency, effectiveness and economy of the service described in the contract, balancing costs against risks and actively managing the partnership. Contract management also includes anticipating future needs and reacting to new situations that develop. Contract management should also aim to improve throughout the contract.

The PPP contract management framework

Box 1 provides a PPP contract management framework made up of three key functions—partnership management, service delivery management, and contract administration; and four critical stages – procurement, development, delivery and exit. Change management is depicted as a core competency required in each stage and function of contract management.

Box 1: The PPP contract management framework

Critical stages of PPP contract management	Key functions of contract management			
	Partnership management	Service delivery management	Contract administration	
Procurement	<ul style="list-style-type: none"> • Develop the partnership management plan • Establish the contract management team • Prepare the contract management plan 	<ul style="list-style-type: none"> • Develop the performance management plan • Develop the risk management plan 	<ul style="list-style-type: none"> • Develop the contract administration plan 	Change management
Development	<ul style="list-style-type: none"> • Ensure a seamless transition to the new arrangements • Establish sound partnership management systems 	<ul style="list-style-type: none"> • Establish risk control procedures • Establish performance management systems • Monitor the development of the service towards the commencement date 	<ul style="list-style-type: none"> • Develop financial administration, contract maintenance and variation management procedures • Develop the contract management manual 	
Delivery	<ul style="list-style-type: none"> • Review and revise the partnership as necessary • Review and revise the contract management plan • Commission independent reviews 	<ul style="list-style-type: none"> • Ensure contracted services are provided in accordance with the output specification • Manage risks • Manage performance • Manage variations 	<ul style="list-style-type: none"> • Review and revise financial administration, contract maintenance and variation management procedures • Update the contract management manual 	
Exit	<ul style="list-style-type: none"> • Organise closure event • Integrate lessons of the partnership into the work of the municipality 	<ul style="list-style-type: none"> • Assess deliverables, value for money, quality and innovation achieved by the project • Organise post implementation review 	<ul style="list-style-type: none"> • Implement hand back procedures • Make arrangements for the delivery of the service by the municipality or re-tendering 	

The three main functions of PPP contract management are:

- *Partnership management*, which is concerned with structures of accountability and how the municipality and the private party relate to each other
- *Service delivery management*, which can be described as the systems and procedures designed to manage risk and performance
- *Contract administration* covers the administrative processes required to ensure that all the procedures contained in the contract and all the documentation relating to the contract are effectively managed.

The stages of PPP contract management are:

- The *procurement stage* – from the start of a PPP project until the signing of the contract
- The *development stage* – from the signing of the contract until the commencement of service delivery
- The *delivery stage* – the period when services are provided and used
- The *exit stage* – the phase towards the end of the life of the project (whether the project ends through expiry or termination) during which activities are wound up and the municipality makes new financial and contractual arrangements for continued service delivery.

Change management creates mechanisms to deal with possible changes in the PPP project.

Box 1 summarises some of the most important tasks to be carried out during each contract management stage. A more detailed breakdown of contract management tasks is contained in Boxes 13–16. The reader who wants a quick overview of what is required during each stage of contract management may want to read these pages first.

The foundations of contract management

The foundations for contract management are laid in the stages before the signing of the contract, including the feasibility study¹ and procurement processes. The terms of the PPP contract should include an agreed level of

1. As used throughout these Guidelines, the term “feasibility study” includes both the “internal” and “external” mechanism assessments described in section 78 (1) and (2) of the MSA and the feasibility study described in section 120 of the MFMA and the Municipal PPP Regulations. A feasibility study conducted in terms of these Guidelines will therefore comply with the feasibility study requirements of both the MSA and the MFMA.

service, pricing mechanisms, private-party incentives, contract timetable, means to measure performance, communication routes, referral procedures, variation management procedures, agreed exit strategy and agreed termination options, and all the other formal mechanisms that enable a PPP contract to function. These formal contract aspects form an essential core around which the contracted services can be delivered, value for money can be achieved and a good relationship can grow. If the contract was poorly constructed, it will be difficult to make the contract management process a success.

2. THE APPROACH TO CONTRACT MANAGEMENT

Getting the approach right

From the perspective of the municipality, the management of PPPs requires a relatively hands-off approach that respects the transfer of responsibility for key institutional functions to the private party. The focus is on quality assurance, spot checking, performance monitoring and corrective action, which in turn focuses on the service outcomes to be achieved. Effective contract management requires the municipality to move away from traditional public service methods of contract management (which tended to keep the service provider at a distance, focused on inputs and often became adversarial) and towards building constructive partnerships with the private party. The management of such a contract requires a range of soft skills in both the municipality and the private party. A key element is the partnership management framework, elaborated in the contract management plan and implemented after the signing of the contract.

The approach that the municipality adopts in its PPP contract management role will have an important bearing on the success of the project. Too much intervention by the municipality could sour relations with the private party and stifle innovation; too little intervention could lead to end-user dissatisfaction or expose the municipality to unnecessary risk.

The municipality's approach should, to a large extent, be determined by the type of industry or sector in which the PPP project operates, the risk profile of the project, and the particular stage of contract management that has been reached at any given point. Where the consequences of private party performance failure would be severe – for example, failure to deliver water services – a rigorous monitoring regime would be required. In less exacting circumstances, a more pliable system might be possible. While the contract should include provisions for the approach required by the municipality, in practice many aspects of the approach will depend on the skill, judgment and creativity of the project officer and the contract management team after the contract has been signed.

Critical success factors

Broadly speaking, a PPP contract is being managed successfully if the following conditions are being met:

- The arrangements for service delivery continue to be satisfactory to both the municipality and the private party
- Expected PPP benefits, value for money and innovation are being realised
- There is a good relationship between the municipality and the private party

- The municipality is aware of its contractual obligations and has the necessary resources and expertise to honour them
- Knowledge management and succession planning are used to retain intellectual capital and the expertise of key staff
- Disputes are resolved at the appropriate level through the partnership management system without recourse to external dispute resolution
- Changing service delivery requirements are anticipated, and variation procedures are used to minimise any negative consequences of change and maximise any opportunities brought about by change.

What can go wrong, and why?

If the municipality is not managing PPP contracts well, any or all of the following may happen:

- The municipality loses control, resulting in unbalanced decisions that do not serve its interests
- Decisions are not taken at the right time – or not taken at all
- New business processes do not integrate effectively with existing processes, and therefore fail
- People on both sides fail to understand their obligations and responsibilities, leading to unnecessary disputes
- Too many issues are referred inappropriately, slowing decision-making
- The intended benefits are not realised
- Opportunities to improve value for money and performance are missed.

Ultimately, the PPP contract becomes unworkable.

There are several reasons why parties fail to manage PPP contracts successfully. Possible reasons include:

- Poorly drafted contracts
- The people involved in contract negotiations are not the same as those given responsibility for contract management
- Inadequate resources are assigned to contract management
- The municipal team does not match the private party team in terms of either skills, experience or both

- The wrong people are put in place, leading to personality clashes and/or ineffective management
- The context, complexities and dependencies of the contract are not well understood
- There is a failure to assess private party or contractual assumptions adequately
- Authorities or responsibilities relating to commercial decisions are not clear
- A lack of independent reviews of contract management arrangements
- A focus on current arrangements rather than what is possible or the potential for improvement
- A failure to monitor and manage municipal risks
- A lack of community participation.

3. MUNICIPAL ROLES AND RESPONSIBILITIES

It is critical for effective contract management that the municipality clarify the roles and responsibilities of key individuals. Ambiguity concerning the functions of important players could lead to unnecessary delays and disputes. The primary figures involved in contract management on the municipal side are the accounting officer and the project officer.

Accounting officer

The overall role of the accounting officer in PPP projects is prescribed in sections 116 and 120 of the MFMA, and sections 4, 5, 6 and 8 of the Municipal PPP Regulations. In contract management, the main responsibilities of the accounting officer are to:

- Mobilise support for the PPP project among politicians and other key stakeholders.
- Ensure that the PPP contract complies with the basic requirements set out in section 5 of the Municipal PPP Regulations. These include ensuring that the PPP contract:
 - Confers effective powers on the municipality to assess the performance of the private party and manage and enforce the PPP contract
 - Imposes restrictions on the employment of municipal officials by the private party not contemplated by the PPP contract
 - Complies with the financial management requirements set out in section 33 of the MFMA, and the contract management requirements set out in section 116 of the MFMA.
- Ensure that the PPP contract complies with chapter 8 of the MSA, which imposes a number of conditions on municipalities seeking to provide services through an external mechanism.
- Solicit the views of National and the relevant provincial treasury on the contract management plan.
- Sign the PPP contract.
- Appoint a project officer and delegate the necessary powers to the project officer after the contract has been signed, observing the provisions of section 79 of the MFMA.

- Take reasonable steps to ensure that:
 - The outsourced activity is carried out effectively in terms of the PPP contract
 - Municipal property is protected appropriately by the private party
 - The municipality has adequate contract management and monitoring capacity.
- Resolve any disputes that the project officer is unable to settle.
- Provide executive commitment to sound partnership management.
- Provide financial oversight and ensure that the PPP project continues to operate in the public interest after the PPP contract has been signed.

The Municipal PPP Regulations require the project officer to be appointed as soon as the municipality initiates a project that may be a PPP. This is to enable the project officer to make inputs into the output specifications and the PPP contract, and ensure management continuity through each stage of the project. Once the PPP contract has been signed, the accounting officer should delegate the necessary powers to the project officer to enable him/her to ensure the implementation of the PPP contract. The accounting officer is also required to report on the management of the PPP contract in the municipality's annual report.²

Project officer

The project officer should report to and be directly accountable to the accounting officer and must have clear delegated authority and a specific budget for carrying out his/her functions. The project officer plays a central role in contract management and his/her main responsibilities are to:

- Manage the project on behalf of the municipality exercising delegated authority
- Ensure that the PPP project continues to be affordable, and provides value for money and appropriate risk transfer
- Ensure both parties meet their contractual obligations
- Ensure the requirements of the output specifications are achieved

2. Section 46 (1) (a) of the MSA also so requires.

- Appoint a contract management team with the necessary technical skills to administer municipal obligations and protect the municipality's rights under the PPP contract³
- Build a strong partnership and good working relations with the private party
- Prevent and/or resolve disputes
- Manage risks
- Monitor private party performance and take corrective action where necessary
- Develop and implement the contract management plan
- Develop and maintain the Contract Management Manual and related contract administration systems
- Monitor private party empowerment and black economic empowerment plans
- Report on the management of the contract, as required for the annual report of the municipality and as required by the Auditor-General and by any other government regulator
- Ensure that the private party maintains insurance and indemnities in force
- Manage variations
- Develop an effective communication framework, involving, in particular, councillors, ward committee members, community leaders, and traditional authorities where applicable
- Organise contract management reviews
- Administer remedies in the event of a contract breach.

While many of the project officer's responsibilities will remain more or less the same after the signing of the PPP contract, there are a number of particular challenges and key tasks that he/she will be required to perform during each stage of contract management (see section 10).

A particular responsibility of the project officer is that of liaison officer. The project officer should act as the municipality's liaison officer responsible for dispute resolution and meeting with the private party on a regular basis to consider performance reports. However, depending on the size of the project,

3. Ideally, the contract management team is composed of the same municipal staff involved in the PPP assessments required by the MFMA and the MSA.

the project officer may need to delegate some of these responsibilities to another member of the contract management team, particularly the dispute resolution procedures (see section 6).

Project officer competencies

The appointment of a project officer needs to be carefully considered, as the responsibility for undertaking the contract management functions of a major project requires a broad range of personal and technical competencies. The PPP contract will determine the legal and contractual obligations of both parties, and the project officer will be required to exercise skill and judgement to protect the municipality's interest. In addition, he/she will be responsible for assembling a PPP management team with the suitable range of technical know-how necessary to manage the interests of the municipality properly, as set out in the PPP contract.

Figure 3.1 in Module 3 provides an extensive list of required project officer competencies.

Contract management team

The resources to be devoted to contract management will be determined by the overall size and complexity of the project and the particular stage it has reached. In some cases it may be possible for the contract management function to be carried out by a single individual. However, it will be more common for the project officer to be supported by, or coordinate, a team, consisting of specialists and technical advisers with varying levels of involvement.

It should be the project officer's responsibility in consultation with the accounting officer to decide on the composition of the team, how it should be deployed, and whether and when to call on additional expertise (within the scope of the budget). The range of expertise and skills required will vary over the life of the PPP contract.

Typical disciplines that need to be represented or be available include:

- Expert subject matter knowledge
- Design and construction
- Business and product assurance
- Facilities and services management
- Information technology
- Statutory safety and regulatory responsibilities

- Regulation and law
- Human resources
- Customer service
- Public relations
- Finance
- Black economic empowerment.

As previously noted, ideally, the contract management team should be composed of the same municipal staff involved in the assessments that must take place prior to the signing of a PPP contract, in terms of the MFMA and the MSA. These individuals will have the institutional knowledge of the project necessary for its proper implementation, and should have been selected by the project officer prior to the initiation of the feasibility study mandated by the referenced legislation.

It will be the responsibility of the project officer to coordinate inputs from the various team members to ensure effective and consistent contract management. The project officer should establish a suitable structure for the contract management team well before the PPP contract begins. While individuals will change, the aim should be for continuity of contract management expertise from the procurement stage onwards. Knowledge management systems should be developed, and succession plans prepared for critical skill team members. The private party should be informed of these contract management structures established within the municipality. Usually, the private party will appoint its own contract management team to communicate with the municipality.

Where contract management expertise is brought in from outside the municipality, either on an ad hoc basis or under a long-term arrangement, it will be important to ensure that commercially confidential information held by the municipality is protected. The terms of reference, time scales and basis of fees for such advisers must be clearly defined to ensure that management of the PPP contract rests with the municipality. Any PPP contract, with independent professional advisers providing contract management services, must contain clear arrangements for reporting results of performance monitoring to the municipality and the private party.

Ethics are a critical consideration of the project officer and the contract management team. In all their dealings, the private party, the project officer and the contract management team should be guided by the provisions of the Code of Conduct for municipal staff members set out in schedule 2 of the MSA.

Box 2: The key to successful contract management in a PPP – views from project officers

“The key to PPP management is communication. This means information acquisition, information storage and retrieval, as well as timeous and effective negotiations with all relevant stakeholders. This kind of openness between stakeholders in the municipality, the private party and the community promotes trust, which is in itself an essential element of managing a PPP. Trust will greatly increase productivity and reduce the risk of messy litigation.”

Eras Botha, Concession monitoring manager, Mbombela Water Concession PPP

“Strong project management skills are key to managing a PPP. The success of an entire project can hinge on having the right person in the right place at the right time. A project officer needs to have a sound understanding not only of the needs of the community but also of how a municipality functions.”

Richard Rajah, Msunduzi Community Based Solid Waste Collection PPP

Advisers

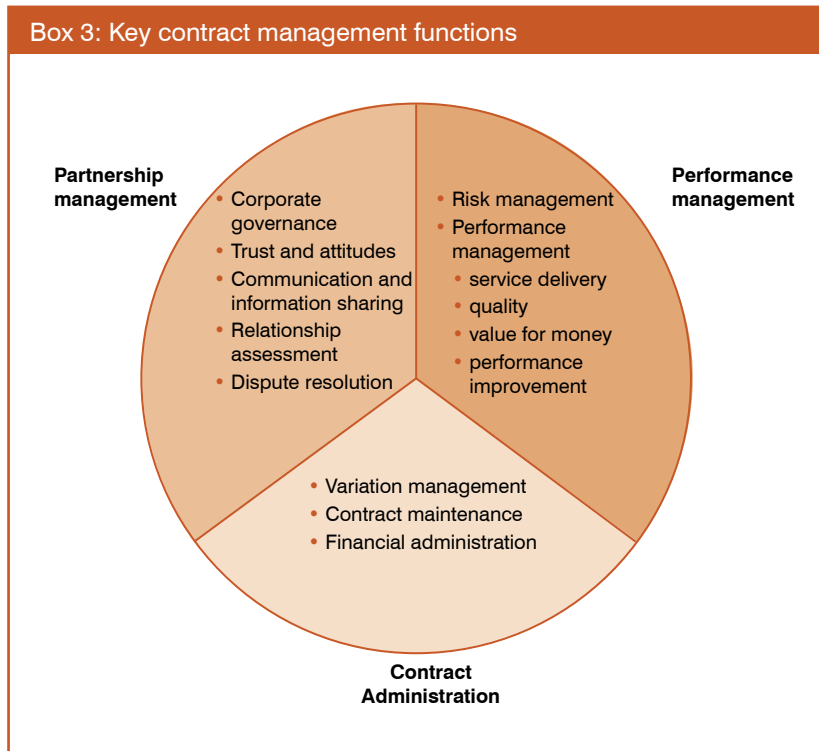
Advisers have provided important technical advice during the feasibility study and procurement processes, which are two of the main building blocks of the PPP contract.⁴ They can also play a major role in the preparation of the contract management plan. The project officer should consider what steps can be taken to ensure that the municipality has continued access to this expertise after the PPP contract has been signed. This could be achieved by either entering into long-term contracts with advisers so they can provide ongoing technical assistance when necessary; or using shadowing, mentoring, knowledge management systems and specialist training to ensure that the skills and specialist knowledge developed by advisers are transferred to other members of the contract management team. If the second option is adopted, appropriate retention strategies and succession plans would need to be developed to ensure that there is an adequate return on the investment made in those members of the contract management team who assume adviser responsibilities.

4. Clause 2(1) (b) of the Municipal PPP Regulations provides, in part, that either provincial or the National Treasury may require a municipality to appoint an adviser, upon notification by a municipality that it intends to initiate a feasibility study in terms of section 120 of the MFMA.

4. CONTRACT MANAGEMENT FUNCTIONS

The responsibilities and tasks that need to be undertaken during contract management can be divided into three main functions: partnership management, service delivery management and contract administration (see Box 3). In practice there will be a considerable degree of overlap between these functions and they will often need to be undertaken simultaneously. Nevertheless, an understanding of the purpose of each of these functions and the competencies required to perform them should help to clarify the responsibilities of the project officer and enable him/her to assemble a solid team.

Box 3: Key contract management functions



5. STAGES OF CONTRACT MANAGEMENT

Procurement, development, delivery and exit

Contract management can be divided into four principal stages: procurement, development, delivery and exit:

1. The *procurement stage* includes all the activities carried out prior to the signing of the PPP contract, such as the feasibility study, the procurement process and the preparation of the contract management plan.
2. The *development stage* covers the period from contract signature to the commencement of service delivery. It includes the transition to the new service delivery arrangements; and depending on the nature of the project, it may involve the design of facilities, the commissioning of goods and equipment or the construction of buildings. It also includes the preparation by the municipality of its Contract Management Manual.
3. The *delivery stage* incorporates the provision and use of the contracted services during the remaining period of the project.
4. The *exit stage* commences towards the end of the life of the project. It incorporates all the activities necessary to wind up the project and make new financial and contractual arrangements for continued service delivery.

During each stage, different aspects of the three contract management functions – partnership management, service delivery management and contract management – will need to be undertaken. In practice, there will often be some degree of overlap between some of these stages, particularly the development and delivery stages on the one hand; and the delivery and exit stages on the other hand. The relative importance of each stage may differ from project to project. Nevertheless, these stages provide a useful framework that can be used to consider the key challenges and tasks of contract management throughout the life of a PPP project (see Box 4).

Box 4: Stages of contract management

Stages of contract management	Year 1	Year 2	Year 3	Year 4	Year 5	Years 6-18	Year 19	Year 20
Procurement	Partnership management Service delivery management Contract administration							
Development			Partnership management Service delivery management Contract administration					
Delivery				Partnership management Service delivery management Contract administration				
Exit							Partnership management Service delivery management Contract administration	

Exit strategy

The municipality's approach to the winding up of the project is an important consideration that should be addressed at different stages of contract management. The project officer should prepare an exit strategy as part of the process of developing the contract management plan. This strategy should be based on the provisions related to termination and expiry in the contract, and should demonstrate the municipality's capacity to bring the project to an end in an efficient manner. The exit strategy should include:

- An analysis of the options for continuing the service after termination/expiry and a recommendation regarding the preferred option
- Plans for organising a post implementation review of the project, which should assess key deliverables, value for money, quality and project innovation; and be carried out within six months of the expiry/termination date
- The steps that will be taken to integrate the lessons of the project into the day-to-day work of the municipality
- An implementation plan based on the hand back procedures set out in the contract

- Details of the municipal officials who will be responsible for managing the exit strategy
- Plans to deal with the implications of any employee transfers from the private party to either the municipality or a successor body
- An estimate of the resources that the municipality will allocate to managing the exit strategy
- Plans for a closure event to celebrate the achievements of the project and prepare contract management staff and end users for their new roles.

The exit strategy should be reviewed at an appropriate point during the delivery stage, and revised as necessary to ensure that robust plans are in place well before the actual commencement of the exit stage.

6. PARTNERSHIP MANAGEMENT

A successful PPP must involve the delivery of services that meet the requirements of the output specifications. The commercial arrangements must be acceptable to both parties – offering value-for-money for the municipality and adequate profit for the private party. In addition, the partnership between the two sides – the way they regard each other and the way in which their relationship operates – is vital to making a success of the arrangement. Partnership management, which is also known as relationship management, involves the development of processes to ensure accountability and manage the relationship. The five key dimensions of PPP partnership management are:

- Corporate governance
- Trust and attitudes
- Communication and information sharing
- Relationship assessment
- Dispute resolution.

These issues need to be addressed in a partnership management plan that should be developed as part of the contract management plan.

Corporate governance

Corporate governance is concerned with the structures, systems, policies and other mechanisms of accountability within the organisation. In South Africa the policy framework for corporate governance is contained in the *King Code of Corporate Practices and Conduct*, which puts forward an “inclusive” and “balanced scorecard” approach to corporate governance.

Many elements of the *King Code* can be applied to government institutions as well as the private sector, and should be an important reference in PPP partnership management arrangements. The municipality should consider including provisions in the PPP contract that require the private party to comply with the *King Code* and monitor compliance with these obligations after signing. These provisions should include a governance structure that is consistent with the *King Code* and is headed by the accounting officer on the municipal side, and the chief executive or equivalent officer on the side of the private party. In applying the King tests of fairness, accountability, responsibility and transparency in monitoring the private party, the project officer should be guided by the provisions of the Promotion of Access to Information Act (2000) and the Promotion of Administrative Justice Act (2000).

The private party's reporting and disclosure obligations must mirror the municipality's disclosure obligations to the Accountant-General and the Auditor-General, which the project officer will be obliged to fulfil for the accounting officer.

In developing a suitable governance structure to provide oversight to the PPP contract, the municipality will need to observe the provisions of chapter 4 of the MSA, which requires the municipality to develop a culture of municipal governance that complements formal representative government with a system of participatory governance. Participatory governance must:

- Encourage, and create conditions for, the local community to participate in the affairs of the municipality
- Enhance the capacity of the local community to participate in the affairs of the municipality
- Allocate the resources necessary to enable the local community to participate in the affairs of the municipality.

Furthermore, chapter 8 of the MSA includes stipulations that the municipality must follow when it enters into a service delivery agreement such as a PPP contract. Before a municipality enters into a service delivery agreement it must:

- Establish a mechanism and programme for community consultation and information dissemination regarding the service delivery agreement
- Communicate the contents of the service delivery agreement to the local community through the media.⁵

And, once a municipal service is provided through an external mechanism such as the private party, the municipality remains responsible for:

- Regulating the provision of the service
- Monitoring and assessing the implementation of the service delivery agreement and the performance of the service provider
- Exercising its powers in regard to integrated development planning and performance in terms of chapters 5 and 6 of the act

5. Detailed guidelines on community participation are contained in the *[Toolkit for Community Participation in PPP Projects](#)*.

- Controlling the setting and adjustment of tariffs by the service provider for the municipal service in question
- Ensuring uninterrupted delivery of the service in the best interest of the local community.

Trust and attitudes

While contractual and commercial arrangements may lay the basis for a partnership that is built on common objectives and shared rewards, trust is a feature of the relationship between people. Trust cannot be mandated within the contract; ultimately it has to be built and “earned” through actions and behaviours, rather than assertions, and is tested when problems and disagreements arise.

The principle and expectation that trust should be a feature of working relationships should be stated by both the municipality and the private party. The behaviour of the individuals involved in a contractual relationship is a manifestation of their attitudes. The right attitudes will lead to the right kind of behaviour.

Communication and information sharing

Good communications are often the make-or-break in managing a partnership. Many cases of mistrust or concern over poor performance in a service relationship result from a failure to communicate at senior management level, or from each party’s failure to understand the business goals or intentions of the other side.

Sharing information between the municipality and the private party may raise legitimate concerns about how information will be used. There may, for example, be a concern that the private party could exploit information about the municipality’s plans, finances and resources for its own commercial advantage. Willingness to share information openly depends largely on trust. However, there should be a realistic balance between openness and reserving negotiating positions.

The relationship between the municipality and the private party should operate at different organisational levels, with channels of communication running horizontally between them. An example of an arrangement with three formal levels of communication is shown in Box 5. Here a PPP has been created with a provider of IT services, and information is flowing at several levels.

Box 5: Communication levels

	Government department	IT service provider
Strategic level	Accounting officer <ul style="list-style-type: none"> • Commitment • Corporate governance • Dispute resolution 	Chief executive
Business level	Project officer <ul style="list-style-type: none"> • Partnership management • Service delivery management • Contract administration 	Contract manager
Operational level	End users (government staff and general public) <ul style="list-style-type: none"> • Service delivery • Technical support 	Service delivery management

Source: Adapted from UK OGC (2002) *PPP Agreement Management Guidelines*, p. 32.

At the strategic level, the accounting officer of the government department and the chief executive of the IT company discuss corporate governance issues and provide a forum for dispute mediation if difficulties cannot be resolved at lower levels. They also promote the partnership by mobilising high-level political and financial support, and demonstrating commitment to the project in their leadership.

At the business level, the municipality's project officer and his/her counterpart, the private party's PPP contract manager, manage the contract. Services are planned and their delivery is monitored.

At the operational level, the service is delivered to end-users consisting of staff in the municipality's departments and the general public. Staff order or call off components required and receive technical support as necessary from the company's service delivery management. The private party and its sub-contractors provide the service to agreed levels. A call centre may be used in such an instance to log levels of satisfaction from end users. Day-to-day problems in the delivery of services may be resolved here; if this is not possible, they can be referred to the project officer by municipal staff or the general public to the project officer.

An important point is that the arrangement should be managed in such a way that these levels of communication are preserved even when problems arise. In terms of this diagram, diagonal lines of communication should be avoided. For example, if end user municipal employees feel the service is not being delivered to the required standards, they should refer this to the project officer, who will liaise with the private party PPP contract manager. It would not be appropriate for them to go straight to the top and liaise directly with the company's chief executive; doing so would undermine the key business level management of the PPP contract. Similarly, it would be inappropriate for service delivery management on the company side to complain about their workload to the project officer.

So a combination of communication between levels within each organisation and peer-to-peer communication between organisations is the ideal. Consistent communication at each level is also important, or differences in perspective may create difficulties in the partnership.

One mechanism that has proven to be highly effective in enhancing communication and other aspects of the partnership between the municipality and the private party is to locate contract management staff from both sides in common premises. Having a base in the same building can help to build informal communication channels and trust, smoothing formal contractual processes.

Assessing the partnership

In addition to measuring performance against financial and service performance measures, a means of assessing other aspects of the partnership should be put in place. This will be valuable in highlighting areas that are perceived to be working well and those that require attention. Assessments could be undertaken at quarterly or bi-annual review meetings attended by municipality and private party representatives, and an independent consultant could be hired to provide an outside perspective on partnership arrangements at such meetings. Periodic assessments might address issues such as:

- Whether each party is getting the benefits they expected when the contract was signed
- How well the management structures are seen to be operating
- How successful communications are seen to be, and the role of councillors, municipal officials and private party executives in disseminating information to key stakeholders
- The degree to which information is shared freely and openly between the parties

- Whether conflicts are being avoided or resolved effectively
- End-user satisfaction and perceptions of the relationship.

While such assessment factors may be largely subjective, perceptions of how each party sees the relationship can have a material effect on contract management regardless of their validity. There should be a willingness to learn from mistakes and if necessary take part in partnership development programmes if it will help to strengthen the relationship.

Dispute resolution

Section 116 of the MFMA requires the municipality to establish a dispute resolution procedure to settle any disputes between the contracting parties, and such a procedure must be included in the PPP contract. As a rule, disputes should in the first instance be referred to the municipal and private party liaison officers (in the case of the municipality, the project officer), to enable them to try to find a solution. If they are unable to resolve the dispute within an agreed period, the dispute should be referred to the accounting officer of the municipality and the chief executive of the private party. If contract cannot be reached at this level, the matter should be referred to an independent mediator, or to an adjudicator to determine the outcome as part of the fast-track dispute resolution procedure. Only if the informal and formal procedures of this escalation process have been exhausted should the dispute be settled in the courts.

The project officer therefore has an important role to play in ensuring that the dispute resolution procedure is properly understood by all members of the contract management team. His/her counterpart in the private party has a concomitant role. The main goal of the project officer should be to anticipate and prevent disputes from arising in the first place. When this is not possible, he/she should facilitate cooperation between both sides to ensure that problems are recognised and resolved as quickly and effectively as possible. If it is necessary to involve a higher level of authority, the project officer should attempt to create the best possible atmosphere for an agreement to be reached.

Whatever the nature of the problem, the project officer should ensure that:

- Problems are recorded as they occur
- The private party is notified of problems by an appropriate route and at an appropriate level
- Approaches to resolving problems are clear and documented
- The escalation procedures set out in the PPP contract are followed.

Developing the partnership management plan

The partnership management plan provides an essential vehicle for addressing the issues of corporate governance, trust, communication, partnership assessment and dispute resolution. As part of the process of developing the contract management plan, the project officer should develop a partnership management plan based on the liaison and reporting provisions in the PPP contract. The partnership management plan should include:

- A statement of the principles that will govern the partnership
- The aims, objectives and long-term goals of the partnership
- The benefits to both the municipality and the private party of a successful partnership
- Details of private party corporate governance arrangements
- The partnership management structure
- Knowledge management systems
- Succession plans for key members of the contract management team
- A communication framework
- Mechanisms that will enable the partnership to be assessed
- A summary of the dispute resolution procedures
- The roles and responsibilities of municipality officials who will be responsible for partnership management
- An estimate of the resources that the municipality will allocate to partnership management.

After the PPP contract has been signed, the project officer will need to ensure that the partnership management plan is implemented.

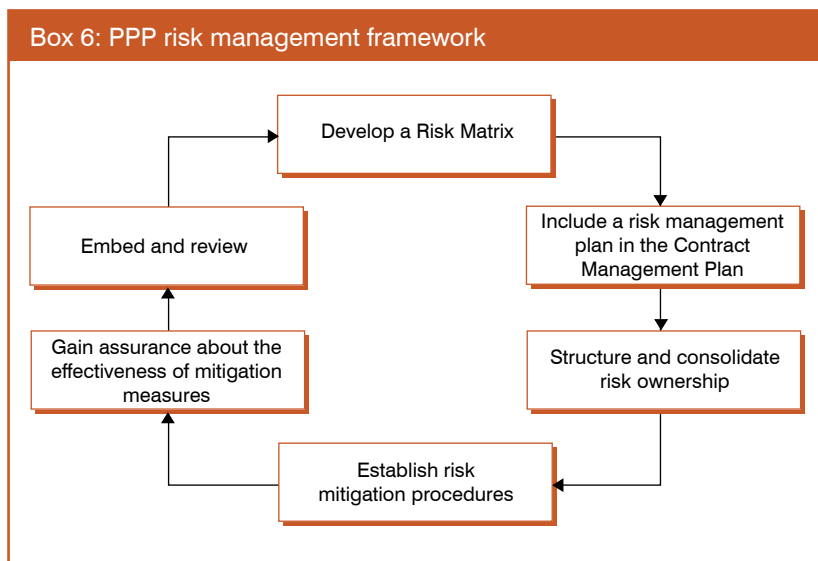
7. SERVICE DELIVERY MANAGEMENT

Service delivery management in a PPP context can be divided into two principal categories: risk management and performance management. Risk management involves keeping the exposure of the project to any potential threats to an acceptable level by taking appropriate action. Performance management is concerned with ensuring that the PPP project remains affordable for the municipality; and managing service delivery, value for money, quality and performance improvement.

The municipality's performance management role in a PPP project is different than the typical performance management function of government departments. In PPPs, managing the performance of the private party has more to do with regulation than management in the traditional sense.

Risk management

Risk management is a central component of the PPP procurement process, and additional risk management procedures are required after the signing of the PPP contract. Box 6 provides a PPP risk management framework, highlighting the key tasks that the project officer and the contract management team should undertake after the signing of the PPP contract.



Source: Adapted from UK HM Treasury (2001) *Management of Risk – A Strategic Overview (The Orange Book)*, p. 3.

The risk matrix and the PPP contract

The PPP contract will contain detailed provisions relating to the allocation of risk between the municipality and the private party. For the purposes of procurement in particular, and then during PPP contract negotiation, this risk allocation would have been reduced to a risk matrix that would specify and assign all risks, identify mitigation measures, and calculate probabilities and costings.

Risk management plan

As part of the process of developing the contract management plan, the project officer should develop a risk management plan based on the risk matrix. For each municipal or shared risk, the risk management plan should set out:

- An evaluation of the different options for treating the risk
- The municipal official who will be responsible for managing the risk
- The procedures and mechanisms that will be used to control the risk
- An estimate of the resources the municipality will allocate to managing the risk.

In the case of private party risks, the risk management plan should, for each risk, include:

- The obligations and reporting requirements which the municipality has imposed on the private party to ensure that risk is managed
- The municipal official who will be responsible for monitoring the risk
- An estimate of the resources the municipality will devote to monitoring the risk
- The mechanisms that will be used by the municipality to deal with any failure of the private party to manage the risk, i.e., penalty deductions, step in, etc.
- The business contingency plan that the municipality will follow to ensure continued service delivery in the event that the private party cannot maintain the service, or the municipality is forced to terminate the PPP contract for whatever reason.

Structuring and consolidating risk ownership

After the signing of the contract a critical next step for the municipality in risk management is to structure and consolidate the ownership of each risk. While the risk management plan will identify risk management responsibilities, this will need to be institutionalised. Ownership of each risk must be clearly

defined, documented and agreed with the individual owners at all levels, so that they understand their various roles, responsibilities and accountability. Each risk must have an owner; there may also be separate owners for the actions to mitigate the risk.

Establishing risk mitigation measures and implementing responses

While the risk management plan will explain the mechanisms and procedures that the municipality will use to manage, monitor and mitigate risk, the project officer should ensure that these mechanisms are put in place after the signing of the contract. Two instruments that have proven to be highly effective in risk mitigation are the risk register and the summary risk profile.

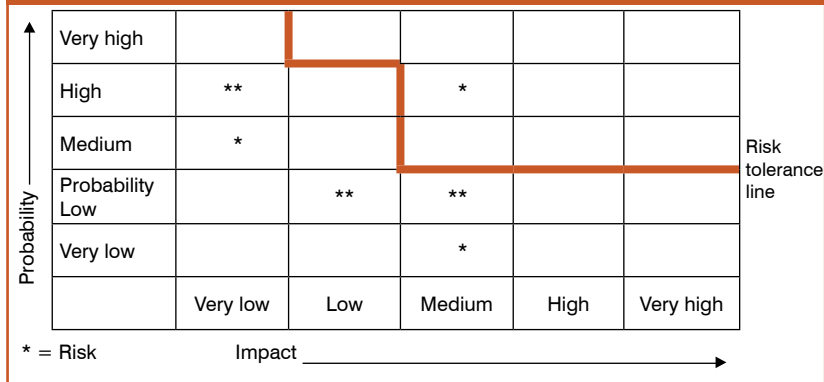
The risk register, or risk log, describes each risk and keeps all the information on the risk in one place so that a complete picture of risk exposure can be built up. Box 7 shows a basic set of contents which can be tailored as required.

Box 7: Example of a risk register										
Risk no.	Date of registration	Description of risk	Impact			Probability	Possible responses	Target date for action	Owner	Action
			Time	Cost	Quality					
1.			L	L	M	VL				
2.			H	M	M	M				
3.			H	L	VH	H				
4.										

VL: Very low; L: Low; M: Medium; H: High; VH: Very high
Source: UK OGC (2001), *Guidelines on Managing Risk* p. 15.

The summary risk profile is a simple mechanism designed to increase the visibility of risks. It is a graphical representation of information contained in the risk register. The project officer should update the risk register on a regular basis and then generate the graph that shows risks in terms of probability and impact, with the effects of mitigating action taken into account (see Box 8).

Box 8: Summary risk profile



Source: UK OGC (2001) *Guidelines on Managing Risk* p. 27.

The summary risk profile shows all key project risks as one picture so that managers can gain an overall impression of the total exposure to risk. A key feature of this picture is the risk tolerance line, indicated in Box 8 as a bold line. Its purpose is to show the overall level of risk that the organisation is prepared to tolerate. If the overall exposure to risk is above and to the right of this line, the project officer and his/her team could see that they must take prompt action with upward referral of relevant risks. Setting of the risk tolerance line is a task for experienced risk managers; it reflects the organisation's attitudes to risk in general and to a specific set of risks within a project. The parameters of the risk tolerance line should be agreed between the project officer and the accounting officer and regularly reviewed.

Gaining assurance about the effectiveness of mitigation measures

Once mitigation measures have been established and mitigation responses implemented, it is essential that assurance about the effectiveness of these actions is obtained. A reporting system should be established to enable upward reporting about how risk is being managed. This reporting system should be owned by, and ultimately report to, the accounting officer. The project officer should provide regular reports on the work done to keep risk mitigation procedures up to date and in line with contract management objectives.

Internal audit provides another important assurance mechanism. The work of internal audit should provide an independent assessment of how well the municipality is managing risk.

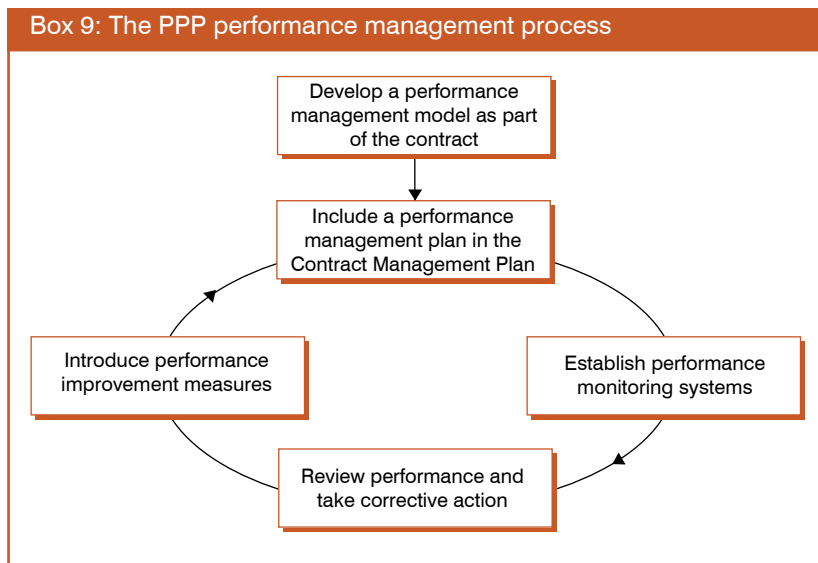
Embedding and review

Risk management needs to be embedded in the municipality by ensuring that there is an appropriate awareness of, and responsibility for, risk at all levels of the contract management team. Risk management should become an intrinsic part of the way the municipality relates to the private party, and form the core of the contract management approach.

Over the life of a PPP project the risk environment is likely to change significantly. In such circumstances, the municipality's priorities and the relative importance of risks will shift and change. The summary risk profile and the risk matrix itself will have to be revisited regularly to ensure that the risk profile contained in the PPP contract remains valid. If necessary, amendments will need to be made to the contract, through the variation procedures (see section 9), to ensure that there continues to be appropriate risk transfer to the private party.

Performance management

Contract management requires attention to performance management, as seen in Box 9.



The performance management model and the contract

The municipality must include in the contract a performance management model consisting of three key elements:

- The level of performance required to achieve the output specification
- The methods and means the municipality will use to monitor private-party performance
- The consequences for the private party of a failure to meet the required level.

In setting the performance level, efforts should also be made to ensure that standards are reasonable and objectively measurable.

The monitoring methodology included in the contract should occur at three levels: a systematic self-monitoring by the private party through a quality management system; a review of the private party's quality management system by the municipality or an independent third party; and end-user feedback on the quality and effectiveness of service delivery. The contract must also specify the way in which performance is reported for monitoring purposes.

The consequences of poor performance on the part of the private party must be handled in accordance with the contract, which should contain provisions for a number of responses to performance failure, ranging from formal warnings and penalty deductions to eventual termination for private party default.

The performance management plan

The project officer should develop a performance management plan to ensure that the requirements of the contract and the output specification are met in terms of affordability, service delivery, quality and value for money. The performance management plan should be based on the performance management model and include details of:

- The reporting obligations that will be imposed on the private party in regard to self-monitoring
- The performance management system that will be used by the municipality and/or independent third parties to review the private party's quality management system
- The mechanisms that will be established to solicit end-user feedback, including complaints
- The municipality officials who will be responsible for monitoring empowerment, affordability, service delivery, value for money, quality and performance improvement

- An estimate of the resources that the municipality will allocate to managing private party performance.

Establishing performance monitoring systems

The performance management plan will describe the mechanisms that the municipality will use to monitor private-party performance. The project officer should ensure that these mechanisms are implemented after the signing of the contract. In particular, performance monitoring systems should be established to enable the contract management team to:

- Check progress regularly to ensure that project milestones are met, including site visits
- Hold regular progress meetings with the private party and consider performance reports
- Conduct regular and random inspections of the supplied goods and/or services
- Check that all performance conditions and clauses in the contract are acted on
- Develop effective mechanisms for obtaining feedback from end-users and other key stakeholders
- Review third-party monitoring reports
- Inspect deliverables to ensure inferior goods or services are not accepted
- Review private-party empowerment plans
- Maintain comprehensive documentation on performance monitoring.

The project officer will need to assign particular monitoring responsibilities to individual members of the contract management team and ensure that they have the expertise, resources and delegated authority necessary to perform their duties.

Performance review and corrective action

Effective monitoring should provide the basis for reviewing actual private party performance against the output specification and other obligations contained in the contract. Like monitoring, reviews can be carried out by the municipality and/or independent third parties. In carrying out such reviews, the project

officer should consider the use of a generic quality assurance system, such as the South African Excellence Foundation Public Service Excellence Model,⁶ or industry-specific systems to evaluate the effectiveness of the private party's quality management system.

The action taken by the municipality to correct private party performance must be in line with the provisions contained in the contract and commensurate with the severity of the transgression. The municipality should make any formal warnings, penalty deductions, step in and other responses in a manner that is likely to achieve the best result for the municipality. An overly rigid approach may jeopardise continuing service delivery to end users, while too much lenience could encourage the private party to commit further breaches.

Performance improvement

Given the length of time over which a typical PPP project will run and the difficulties of predicting technological and other productivity improvements that may occur, it is important to ensure that adequate attention is devoted to the issue of performance improvement. Ideally, the requirement for improvement should be embodied in the terms of the contract. Seeking improvements is about working together to improve quality, performance, value for money, or other aspects in such a way that benefits both parties.

The payment mechanism contained in the contract provides some incentive for the private party to seek improvements in performance. If prices are fixed, they can increase their profit by improving efficiency; if profits are shared, they are motivated to improve economy. The municipality can also provide incentives to the private party for early commencement of services if this is affordable and provides value for money.

However, the terms of the contract may not necessarily encourage the private party to seek improvements in other areas that might benefit the municipality, especially if there is no tangible benefit for the private party. As many potential improvements cannot be foreseen when the PPP contract is signed, part of the process should be a joint commitment to improvements, which would be beneficial to both parties.

Incentives for performance improvement, which could be both financial and non-financial, should be affordable for the municipality and introduced through the variation procedures (see section 9). They should also be linked to

6. South African Excellence Foundation (1997) *Level 3 Criteria for Public Service Performance Excellence: Self-Assessment and Certificates*.

circumstances in which the private party can provide added value – something that is genuinely worthwhile to the municipality and beyond what was originally envisaged in the contract. Examples include:

- Eliminating aspects of the service that are no longer required
- The use of new technologies to provide a cheaper and/or more effective service
- Changes in procedures or practices that provide more efficient ways of delivery
- Opportunities for innovation to improve service
- Improved revenue generation and/or cash flow for the municipality.

Performance improvement is also an important issue for the municipality in terms of contract management systems. Steps should be taken to ensure that contract management procedures and ways of working are as robust as possible. One way to achieve this is to review and revise the contract management plan every three years. Another way is for the municipality to commission a comprehensive independent review of the project. Such reviews should again be undertaken in accordance with the strategies outlined in the contract management plan. Box 10 depicts performance indicators developed by a water concession PPP.

Box 10: Performance indicators developed by a water concession PPP

Key performance area	Key performance indicators (to be achieved by March 2009)
Supply everyone with a sustainable water supply that is available 24 hours per day.	All stands to have at least a basic level of water supply available for 24 hours per day.
	Basic level of supply is defined as 25 litres of potable water per person per day supplied within 200 metres of a household and with a minimum flow of 10 litres per minute (in the case of communal water points) or 6 000 litres of potable water supplied per formal connection per month (in the case of yard or house connections) available for at least 350 days per year and not interrupted for more than 48 consecutive hours per incident as well as the communication of good water-use, hygiene and related practices.
	No customer to receive any level or standard of supply less than what they were receiving in November 2004 unless this was requested or applied as a sanction in terms of the credit control policy.
	Maintain unaccounted-for water in core municipality at an average of not more than 14%.
	Reduce unaccounted-for water in all areas outside core municipality to an overall average of not more than 25%.
Ensure that all houses have access to a functioning basic sanitation facility by 2010.	Reduce average consumption in informal settlements to 500 litres or less per household per day.
	Provide project management services for the implementation of externally funded projects including technical and health, education and training in support of the programme. Basic level of sanitation is defined as a facility which is safe, reliable, private, protected from the weather and ventilated, keeps smells to the minimum, is easy to keep clean, minimises the risk of the spread of sanitation-related diseases by facilitating the appropriate control of disease-carrying flies and pests, and enables safe and appropriate treatment and/or removal of human waste and wastewater in an environmentally sound manner as well as the communication of good sanitation, hygiene and related practices.
	All stands in core municipality and identified outlying informal township to have access to a waterborne sewerage system linked to the treatment works.
	97% of all stands in another outlying informal township to have access to a waterborne sewerage system linked to the treatment works.

Key performance area	Key performance indicators (to be achieved by March 2009)
Implementation of a customer engagement package aimed at providing a better, more reliable and responsive, locally driven service in all areas.	Achieve legitimacy and relevance through accurate billing, being responsive to problems of the customer and assisting the customer to resolve their problems.
	Making the service more affordable by providing restricted supplies with a roof tank, applying the revised tariff structure, applying a leak allowance system and providing choices in the form of supply obtained.
	Apply strict sanctions to those who receive legitimate bills and who can afford to pay.
	Encourage the payment of outstanding debts.
Improved water mains and sewer renewal and maintenance programme.	Apply careful asset management techniques to ensure that renewals are targeted to give maximum value for money.
	Apply asset management techniques to ensure that appropriate levels of maintenance are applied to protect assets and to maximise their operating life.
Improved communication.	To be seen as a company representing all the people.
Financial sustainability.	Use the tariff increases to effectively support the long term sustainability of the provision of water services.
	Maintain payment levels in core municipality at an average of at least 97% of billed amounts.
	Increase payment levels in identified informal township to an average of at least 80% of billed amounts.
	Increase payment levels in another identified informal township to an average of at least 72% of billed amounts.
	Increase payment levels in another identified informal township to an average of at least 70% of billed amounts.
	Increase payment levels in peri-urban areas to an average of at least 70% of billed amounts.
Implementation of new works or refurbishment of existing works.	Completion of the projects indicated on the capital works schedule.

8. CONTRACT ADMINISTRATION

Contract administration involves the establishment of administrative processes to ensure that all the procedures and documentation relating to the contract are effectively managed. The importance of contract administration to the success of the PPP project should not be underestimated. Clear administrative procedures can help to ensure that all parties to the contract understand who does what, when and how.

Contract administration activities can be broadly grouped into three main categories:

- Variation management
- Contract maintenance
- Financial administration.

Variation management

Variation management is closely connected with contract maintenance and relates to the creation of mechanisms to enable changes to the PPP contract to be made. Such changes may be necessary as a result of a change in circumstances that could not be anticipated or quantified when the contract was signed. Variations may involve changes to works, services or the form of delivery. There are four main categories of variations:

- Variations that involve no additional costs
- Small works variations
- Municipality variations
- Private party variations.

Variations that involve no additional costs

In circumstances where a proposed variation involves no additional costs for either party, no formal variation procedure is required. The municipality and the private party should meet to discuss the best way of implementing the proposed change. If the variation will result in a reduction in costs, then the two parties will need to reach agreement about how to distribute such savings. In the case of a variation proposed by the municipality, savings should accrue to the municipality and/or end-users; while savings derived from a variation proposed by the private party should be divided between the municipality,

the private party and end-users. The two parties would be expected to reach agreement on the implementation of this category of variation without recourse to dispute resolution.

Small works variations

Where the threshold for additional capital works required by the municipality is sufficiently low for the private party to manage, a clause should be included in the contract requiring the private party to provide a schedule of rates for small works at the beginning of each year. Any dispute between the parties relating to small works variations must be determined in accordance with the dispute resolution procedures.

Municipality variations

If the municipality wishes to make a change to the project deliverables, it must first submit a municipality variation proposal to the private party. This proposal must describe the nature of the variation, and require the private party to provide an assessment of the technical, financial, contractual and timetable implications of the proposed change within a specified period. After meeting with the private party to consider its response, the municipality must decide whether the private party or the municipality should put the funding in place to implement the variation. Depending on who provides the funding, payment for the variation should be made by any necessary adjustments to the unitary payment or other forms of payment. Any dispute between the parties about municipality variations must be resolved in accordance with the dispute resolution procedures.

In situations where the municipality's requirements for variations can be foreseen to a reasonable degree before the signing of the contract, the municipality should explore the feasibility of requiring the private party to commit to pricing pre-specified variations as part of the contract. This would allow for an accelerated variation procedure after the contract has been signed.

Private party variations

If the private party wishes to introduce a variation it must submit a private party variation proposal to the municipality, setting out the details of the variation and the likely impact of the variation on the contract, particularly in regard to unitary charge payments. After meeting with the private party and giving it an opportunity to modify its variation proposal if necessary, the municipality must decide whether to accept it. If the municipality decides to accept the proposal, it will need to make the necessary arrangements for payment, depending on the funding regime that has been agreed.

Managing variations

The variation procedures must be used for all changes to the contract in regard to works, services and the means of delivery. Given the length and complexity of PPP contracts, it is likely that these procedures will be invoked from time to time to deal with changing project needs, and so variation management is a critical element of each stage of the contract management process. It must be used effectively to ensure that other important functions, such as performance management and risk management, continue to operate in line with contractual requirements and changing service delivery imperatives. The project officer must become familiar with each variation procedure and ensure that the correct steps are followed whenever the need arises.

Contract maintenance

Contract maintenance involves the establishment of procedures to ensure that the contract and related documentation are consistent, up-to-date and accessible to all the relevant parties. It also involves taking action to allow all parties to develop a common view of contractual obligations. One of the key tasks of contract maintenance is the development and updating of the Contract Management Manual, which is designed to provide a repository for the contract itself and all related documents.

Financial administration

Effective financial administration involves the development of systems and procedures to make and receive financial payments, and keep records of financial transactions. In preparing the contract, the municipality should include procedures for making unitary payments and additional payments to the private party, administering penalty deductions, calculating inflation, dealing with late payments, and receiving reports linked to unitary payments and additional payments.

Planning and implementing contract administration

In preparing the contract management plan, due consideration should be given to contract administration responsibilities. The project officer should develop a contract administration plan that sets out:

- A summary of the proposed systems and procedures for contract maintenance, variation management and financial administration
- The roles and responsibilities of the municipality and the private party in relation to contract maintenance, variation management and financial administration

- The plans for the development of the Contract Management Manual that will be used to provide details of all documents relating to the contract, and the contract maintenance, variation management and financial administration procedures
- An estimate of the resources that the municipality will devote to contract maintenance, variation management and financial administration.

After the contract has been signed, the project officer must ensure that the contract administration plan is implemented, and that the contract management team has the resources and expertise necessary to deliver the plan. Particular attention should be devoted to the development and regular updating of the Contract Management Manual.

As the PPP project comes to an end, as a result of termination or contract expiry, the project officer will need to undertake a new set of contract administration responsibilities. He/she will need to make suitable arrangements either for the return of the service and its delivery to the municipality or, alternatively, putting the service out to tender once again.

9. THE CONTRACT MANAGEMENT PLAN AND THE CONTRACT MANAGEMENT MANUAL

The contract management plan

The contract management plan provides one of the key pillars of effective contract management, and the project officer will need to ensure that adequate time and resources are devoted to its preparation. Preparing the contract management plan should send a clear message to the municipality that while the award of the contract represents the end of a complex and challenging procurement process, it also heralds the beginning of a new phase of the PPP project that requires a different level of institutional capability. The winning bidder should be closely involved in the development of the contract management plan, and this process should be used as part of the process of developing good working relations between the two parties.

The main purposes of the contract management plan are to:

- Demonstrate to the municipal council the capacity of the municipality to effectively enforce the contract
- Provide a strategic management tool to guide the contract management activities that the municipality and the private party will undertake during each stage of the project
- Clarify key municipality roles and responsibilities during each stage of the project and identify the resources that the municipality will require to undertake these responsibilities
- Provide information on the contract management approach and contract management arrangements, which can be used to assess the performance of the municipality in discharging its obligations and responsibilities as set out in the contract and government legislation such as the MFMA
- Provide a vehicle for addressing issues that cannot be dealt with adequately in the contract (such as attitudes and behaviours).

After the initial contract management plan has been prepared, it should be reviewed and updated every three years in consultation with the private party, to respond to changing circumstances as the PPP project unfolds. Changes in government policy, industry requirements, environmental standards, technology and end-user expectations could have important implications for the municipality's approach to PPP contract management.

Box 11 provides a template that should be used to prepare the contract management plan.

Box 11: Contract management plan template		
Sections	Sub-sections	Summary of contents
1. Purpose and approach	1.1 Purpose	<ul style="list-style-type: none"> • Purpose of the contract management plan
	1.2 Approach	<ul style="list-style-type: none"> • Partnership principles • Benefits to the municipality and the private party of a successful partnership • The municipality's approach to PPP contract management (see section 2)
2. Strategic objectives and key deliverables	2.1 Objectives	<ul style="list-style-type: none"> • Summary of project objectives
	2.2 Key deliverables	<ul style="list-style-type: none"> • Summary of the output specification and key deliverables
3. Partnership management	3.1 Partnership management plan	<ul style="list-style-type: none"> • Partnership management plan (see section 6)
4. Service delivery management	4.1 Risk management	<ul style="list-style-type: none"> • Risk management plan (see section 7)
	4.2 Performance management	<ul style="list-style-type: none"> • Performance management plan (see section 7)
5. Contract administration	5.1 Contract administration	<ul style="list-style-type: none"> • Contract administration plan (see section 8)
6. Exit strategy	6.1 Exit strategy	<ul style="list-style-type: none"> • Evaluation of the options for continuing the service after termination/expiry based on the provisions of the contract • Outline of the procedures, roles and responsibilities and resources required for a smooth transition to the new service delivery arrangements (see section 5)
7. Implementation plan	7.1 Development stage	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and municipality budget (see Box 13)
	7.2 Delivery stage	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and municipality budget (see Box 14)
	7.2 Exit stage	<ul style="list-style-type: none"> • Table with key tasks, target dates, responsibility and municipality budget (see Box 15)

UK Office of Government Commerce (2001) *Guidelines on Managing Risk*. www.ogc.gov.uk

Box 12 provides a template that should be used to manage key tasks in the three stages of contract management implementation.

Box 12: Implementation plan template			
Key tasks	Target date	Responsibility	Municipality budget
<ul style="list-style-type: none"> • Development stage • Establish partnership management structure • Establish performance monitoring system • Arrange staff transfers • Survey end user requirements • Other 			
<ul style="list-style-type: none"> • Delivery stage • Conduct quality assurance review • Prepare performance report • Review and revise the Contract Management Plan • Conduct regular review meetings • Other 			
<ul style="list-style-type: none"> • Exit stage • Evaluate exit options • Review contract termination/ expiry conditions • Other 			

The Contract Management Manual

The Contract Management Manual is a key component of effective contract management, and the project officer and the contract management team should ensure that adequate time and resources are devoted to its preparation. The main purposes of the manual are to:

- Provide a repository of contract management procedures, key stakeholder details and all the important documents relating to the contract
- Provide a document management tool
- Provide a resource that can be used to train newly appointed contract management staff, and orientate technical advisers and end users.

Work on the Contract Management Manual should begin immediately after the signing of the contract, and the private party should be involved in its preparation.

The different sections of the manual should be updated as necessary so that it provides a consistent, accurate and up-to-date record of contract management procedures and documents.

The manual should contain the following documents:

- The contract
- All schedules contained in the contract
- The direct agreement (if any)
- The close-out report
- The contract management plan
- Variation procedures
- The names, roles and contact details of key individuals in: the municipality, the private party, third party entities, end user organisations, and other key stakeholder groups
- All other documents relating to the contract.

10. KEY CHALLENGES AND TASKS OF CONTRACT MANAGEMENT

Each stage of contract management presents new tasks and new challenges. Boxes 13-16 provide summaries of these challenges and key tasks for the project officer and the contract management team. Box 17 provides a summary of the lessons learnt by a water concession PPP.

Box 13: Key challenges and tasks during the procurement stage

Key challenges	<ul style="list-style-type: none"> • Prepare the foundations for contract management • Assemble the contract management team and enable them to make inputs to the output specification • Develop good relations with the winning bidder and involve them in the development of the contract management plan • Develop the contract management plan • Finalise the contract
Partnership management tasks	<ul style="list-style-type: none"> • Assess bidders attitude towards contractual provisions that relate to partnership working such as joint governance arrangements and the co-location of staff • Include provisions for partnership management in the contract • Develop the partnership management plan as part of the contract management plan • Develop succession plans for the contract management team as part of the contract management plan
Service delivery management tasks	<ul style="list-style-type: none"> • Assess bidders attitude towards contractual provisions that relate to quality, value for money and performance improvement • Encourage bidders to propose innovative solutions to monitoring requirements • Develop the risk matrix as part of the contract • Develop the risk management plan as part of the contract management plan • Develop the performance management model as part of the contract • Develop the performance management plan as part of the contract management plan
Contract administration tasks	<ul style="list-style-type: none"> • Develop the contract administration plan as part of the Contract Management Plan

Box 14: Key challenges and tasks during the development stage

Key challenges	<ul style="list-style-type: none"> • Ensure a seamless transition, i.e., that the takeover of any existing facilities or arrangements take place as smoothly as possible • Establish systems and allocate resources and responsibilities in accordance with the Contract Management Plan strategies and plans • Monitor the development of the facility/service towards the service commencement date, from the point of view of both quality and timetable
Partnership management tasks	<ul style="list-style-type: none"> • Establish partnership management structures in accordance with the contract management plan • Establish close working relations with the private party including the co-location of municipality and private party contract management staff if provided for in the contract • Hire new members of the contract management team and technical advisers as necessary • Implement assigned roles of the contract management team • Review municipality succession plans and ensure that the private party has succession planning in place for their key contract management staff • Develop and implement joint partnering courses for both the municipality and private party contract management staff
Service delivery management tasks	<ul style="list-style-type: none"> • Establish risk control procedures and performance management structures in accordance with the Contract Management Plan • Confirm resources and responsibilities for risk management and performance management • Monitor the private party's progress towards meeting the service commencement date in accordance with the time tables set out in the contract • Ensure compliance with any residual health and safety issues remaining with the municipality • Ensure the integration into any existing operations and/or staff for which the municipality maintains responsibility • Obtain a schedule of rates from the private party for small works variations, which the municipality may ask the private party to carry out • Use the small works variation procedures to address any minor additional capital works required by the municipality • Monitor any ongoing construction work and deal with any contractual failures using the appropriate clauses in the contract • Deal with any compensation and/or relief events in accordance with the provisions of the contract • Determine whether any new facility is ready for occupation or use by the authority • Assess the effectiveness of the private party's quality assurance processes in relation to design and construction • Carry out building and other work inspections and take action if any defects are uncovered • Monitor compliance with regulations • Organise specialised training or placements with commercial organisations for municipality staff to enhance commercial awareness in the municipality

Contract administration tasks	<ul style="list-style-type: none"> • Establish contract maintenance and variation management procedures, and implement agreed resources and responsibilities • Establish financial administration procedures, and allocate resources and responsibilities • Prepare the Contract Management Manual and update as necessary • Keep records of design and/or construction activities • Ensure that up to date job descriptions are available for municipality and private party contract management staff
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Box 15: Key challenges and tasks during the delivery stage

Key challenges	<ul style="list-style-type: none"> • Review private party performance against the output specification and take corrective action where necessary • Implement risk control responses as necessary • Organise independent reviews of contract management arrangements as a whole at least every three years • Review the Contract Management Plan and revise as necessary every three years • Assess the robustness of the exit strategy and any arrangements for re-letting the contract contained in the Contract Management Plan
Partnership management tasks	<ul style="list-style-type: none"> • In consultation with the private party, review and revise as necessary the partnership management system and the relationship between the municipality and the private party • Implement succession plans for municipality contract management staff as necessary • Organise training and development programmes for the contract management team to ensure that their skills are in tune with the evolving requirements of contract management throughout the life of the project

Service delivery management tasks	<ul style="list-style-type: none"> • Gain assurance about the effectiveness of risk control procedures through upward reporting and internal audit • Implement risk control responses as necessary • Review and revise municipality contingency plans as necessary • Embed and review risk management in the contract management team • If necessary, use the variation procedures to amend the contract to ensure that there continues to be appropriate risk transfer to the private party • Monitor and review private party performance against the output specification and take corrective action as necessary • Implement any agreed performance improvement measures in consultation with the private party to enhance value for money, quality and innovation • Ensure that any latent and inherent defects are addressed by the private party to keep asset conditions up to the specified standards • Monitor compliance with appropriate regulations including health and safety policies, environmental standards, building and fire regulations and statutory obligations • Monitor the private party quality management system • Establish relations with any end user representatives and respond to end user feedback on private party performance • Produce monthly, quarterly and annual performance reports on behalf of the municipality, covering workload, performance history, current and projected costs • Report on the management of the contract in the municipality's annual report
Contract administration tasks	<ul style="list-style-type: none"> • Update the Contract Management Plan as required • Review and revise contract administration procedures as necessary • Manage variations • Ensure private party insurance and indemnities are maintained in force • Monitor the revenue generated from third parties where appropriate • Inspect the asset register maintained by the private party • Make unitary and additional payments to the private party, administering any penalty deductions or refinancing gains as necessary • Manage any private party requests for refinancing in accordance with the contract • Ensure the private party's books are audited in accordance with the provisions of the contract

Box 16: Key challenges and tasks during the exit stage

Key challenges	<ul style="list-style-type: none"> Based on the provisions of the contract, review options for continuing the service after the termination/expiry date and implement the agreed exit strategy
Partnership management tasks	<ul style="list-style-type: none"> Organise closure event to celebrate achievements and prepare contract management staff and end users for their new role Integrate the lessons of the partnership into the day-to-day work of the municipality
Service delivery management tasks	<ul style="list-style-type: none"> Assess key deliverables, value for money, quality and innovation achieved by the project Organise an independent post implementation review of the project, which should be completed within six months of the expiry/termination date
Contract administration tasks	<ul style="list-style-type: none"> Ensure compliance with the hand-back procedures set out in the contract which may involve surveys prior to termination/expiry and set-off of the unitary charge into a retention fund Verify the assessment of the value and fitness for purpose of the asset as provided for in the contract In the event of termination, make arrangements for any compensation that might be due to the private party Make arrangements for either: (i) the delivery of the service by the municipality after termination/expiry; or (ii) re-tendering the service Deal with any implications of employee transfers from the private party to either the municipality or a successor body, including terms and conditions of employment

Box 17: Lessons learnt by a water concession PPP

The Ilembe Water Concession is situated within the Ilembe District, centred in Ballito, a coastal town 45 km north of Durban. The area has a rapidly growing population, so this project was essential to provide water and sanitation. The concession began in 1999 as a 30-year contract between Dolphin Coast municipality and Siza Water. Ilembe municipality inherited the project in 2003.

A review of the PPP undertaken in December 2005 identified the following key lessons:

- Know your contract
- Understand the contract
- Be prepared to change
- Recognise the value of teamwork
- Ensure all team members can commit
- Make sure that users/clients/customers are represented
- Support of politicians is essential
- Get appropriate project software.

FURTHER INFORMATION

South African resources

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MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

TOOLKIT

SERVICE DELIVERY AND PPP GUIDELINES



MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

WATER AND SANITATION FEASIBILITY STUDY TOOLKIT

NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES
WATER AND SANITATION FEASIBILITY
STUDY TOOLKIT

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ACRONYMS

DWAF	Department of Water and Forestry
IDP	Integrated development plan
MFMA	Municipal Finance Management Act
MSA	Municipal Systems Act
MTEF	Medium-term expenditure framework
NPV	Net present value
PSC	Public sector comparator
VIP	Ventilated improved pit-latrine
WSA	Water Services Authority
WSDP	Water services development plan
WSP	Water services provider

1. PREPARATORY WORK

1.1 General

Delivering effective and efficient water and sanitation services to all is a core function of local government. The challenges are considerable and require harnessing a wide range of resources. Such resources are found in the municipalities themselves, in national and provincial departments, in civil society and in the private sector.

This toolkit is designed to help Water Services Authorities (WSAs) undertake an assessment that may lead to a contract with civil society or the private sector to supply water and sanitation services.

1.2 Municipal service or municipal support activity?

Module 3 of the Municipal Service Delivery and PPP Guidelines deals with the differences between a municipal service and a municipal support activity. In terms of the Constitution, the following aspects of water and sanitation services are a municipal service:

- Potable water supply systems
- Domestic sewage treatment and disposal systems

The above terms can be clarified as follows:

- Potable water supply systems – the procurement of raw water (from surface and underground resources), water treatment and purification to potable standards, the purchase of potable water, distribution, storage, reticulation and delivery to the supply point for both domestic and non-domestic use.
- Domestic sewage treatment and disposal systems – the collection of sewage from domestic users, the delivery of the sewage to treatment facilities and the treatment of such sewage to acceptable standards for disposal into natural water courses. (The same system may deal with commercially or industrially generated sewage, subject to certain controls on the standard of the effluent).

Examples of the municipal support activities of a WSA in terms of water and sanitation services include:

- Supply systems for industrial (non-potable) water
- Industrial wastewater and disposal systems
- Disposal of sludge from sewage treatment facilities

- Scientific services
- Meter reading, billing and revenue management.

The legislation relevant to PPPs refers to the provision of the service which may involve the use of consultants, contractors and specialist suppliers for the planning, design, finance, construction and maintenance of facilities. PPP legislation would not apply to a service where the WSA retains management and financial control of the work, and where a significant level of risk remains with the WSA.

1.3 Legislated process and need for a realistic decision

Based on the definitions above, the WSA and the municipal desk at the National Treasury will have to decide which of the legislated processes apply in a given situation. If the need is to improve delivery of all or part of the water services, without changing the method of service delivery, or if the proposal applies only to municipal support activities of a WSA, it will not be necessary to follow the process in terms of section 78 of the Municipal Systems Act (2000) (MSA).

Where, however, the possibility exists that the process could lead to a different method of service delivery, the both the MSA and the MFMA procedures must be followed.

Note

A municipality cannot have definitively chosen a PPP for a municipal service (as opposed to a municipal support activity) before it has followed the process as set out in section 78 of the MSA and section 120 of the MFMA. A PPP is only a possible procurement choice and must be explored in detail and compared with the possibility of delivering the service through conventional public-sector methods.

The process to decide the best mechanism for delivering water and sanitation services needs to be authentic and thorough. It is the basis for the municipality making an important decision of principle – not just a legislative requirement.

The WSA must identify the best option for delivering water and sanitation and, if a PPP is selected, must demonstrate whether the PPP choice:

- Is affordable
- Transfers appropriate technical, operational and financial risk to the external party
- Demonstrates value for money.

By following these guidelines the WSA will ensure it makes properly considered decisions and provides the municipality, the national and provincial treasuries and relevant departments, with all the information required to assess the proposed delivery mechanism.

1.4 Development and strategic planning

A municipality is required to prepare an integrated development plan (IDP) including a water services development plan (WSDP). Any proposed restructuring by a WSA must conform to the needs and principles identified in these plans.

In particular, the WSDP should have determined the levels of service that are appropriate and affordable for the different areas within the municipality, the backlogs in service delivery and the realistic methods and targets to address these backlogs. The plans will also have identified the capital works programme needed to support the required levels of service. The WSDP must be developed as a practical planning tool in addition to providing data in the standard formats required by the Department of Water Affairs and Forestry (DWAF). The plan should be practical and affordable, with the required expenditures at both operational and capital levels being supported by realistic projections of income, subsidies and grant funding.

Any other studies that may have been undertaken should be considered before assessing the best service delivery process. Examples of such studies include:

- The development of a regional treatment works as opposed to the continued operation of multiple local plants
- Possible benefits of working with an adjacent WSA to provide water services
- Possible benefits of using a water board to provide bulk services
- Whether geotechnical conditions in various areas would allow the use of ventilated improved pit-latrines (VIPs)
- Community attitudes to pre-payment water meters.

Where any of the above planning and studies has not been undertaken, the scope of any feasibility study that may follow should be expanded to include them, as appropriate.

1.5 Stakeholder consultation

The development of both the IDP and the WSDP requires wide-ranging stakeholder consultation. In addition, any feasibility study that is conducted to assess water services delivery alternatives must have clearly determined the views and expectations of stakeholders and entered into discussion on the various generic options together with the general advantages, disadvantages and costs of each.

Special attention should be paid in determining the views of the WSA staff who are responsible for the delivery of the service and their organised labour representatives. Not only do they have a personal interest in the matter, but they also have an understanding and knowledge of the challenges being faced and often have strong ideas about possible solutions.

The content and timing of obtaining the views of stakeholders during the feasibility study and prior to its presentation to council are set forth in both the MSA and the MFMA.

2. INCEPTION

2.1 Project initiation

The WSA must follow a number of legislated requirements when considering its service delivery options. The first of these are incorporated in section 77 of the MSA. Section 120 of the MFMA also contains certain process requirements if a WSA is considering a PPP for the provision of that particular water services function. Section 33 of the MFMA has to be complied with if a proposed contract (that may or may not be a PPP) has financial implications for the WSA beyond three years.

All the legislation applicable to municipalities and WSAs must also be complied with.

2.2 Project definition

In looking at water and sanitation services, it is necessary that the WSA first decide if the full water services are under consideration or only certain elements. This means assessing whether the investigation is going to:

- Cover both potable water and wastewater treatment
- Deal only with selected aspects, such as extending water services to a specific geographic area or assessing the development of a new potable or wastewater treatment plant only
- Deal with discrete parts of the overall function such as cost recovery, unaccounted for water or the provision of water services laboratory services.

The following aspects should be considered:

- Nature of the project
- Budget
- Implementation cost
- Size and complexity
- Risk quantum.

2.3 Government notification

Once the WSA identifies a project that may be a PPP, it must appoint an internal project officer and notify the National Treasury, DPLG, the relevant provincial treasury and the Department of Water Affairs and Forestry (DWAF). The project

officer should be a senior official who has the necessary skills and experience in the technical aspects of the service being assessed, as well as contractual and financial skills to allow him/her to assess the proposals being made and to monitor the work of any adviser.

The notification to national departments should include:

- Name, experience and contact details of the project officer
- A brief description of the activity and whether it is a change to an existing activity or a new activity under consideration
- Timetable for completing the project definition.

If it does not have the necessary skills, expertise or capacity, the WSA may appoint external advisers to help it assess the service delivery options.

2.4 Meet with National Treasury

Upon notification by a WSA of a water services project that may be a PPP, National Treasury may meet with the WSA to determine the nature and scope of the proposed project. National Treasury may insist on the appointment of advisers, depending on the scale and complexity of the investigation to be undertaken.

If the appointment of advisers is determined necessary, National Treasury will assist the WSA in developing the terms of reference for the advisory team, including the scope of the feasibility study that must be undertaken to determine whether the envisaged water services can be provided by an internal mechanism of the WSA or an external mechanism, which can be either a Municipal Services Partnership (MSP) or a PPP. The terms of reference will also include the responsibilities of the advisory team should a PPP be recommended as the preferred external mechanism, including the procurement of the PPP, in compliance with all applicable legislation, regulations and guidelines.

In the event that National Treasury so determines and the terms of reference for an adviser are developed, the next step for the WSA will be to procure the services of the adviser. Following this procurement, the WSA and its advisory team will next conduct the feasibility study to assess which service delivery alternative, as just mentioned above, should be recommended to council.

3. FEASIBILITY STUDY

3.1 Needs analysis

Once the advisers have been appointed, the feasibility study is undertaken. A first activity under the feasibility study is to undertake a needs analysis. An overarching principle in conducting the needs analysis is that the resulting recommendations are affordable. Typically, providing new or upgraded services is cheaper per household in urban areas than in rural areas. This is because:

- Urban areas are close to bulk service infrastructure
- Rural communities may require dedicated boreholes or storage facilities
- The density of urban housing means provision of the reticulation network is cost-effective.

As a result, in rural areas, the cost of piping water into houses is prohibitive. Sanitation is even more difficult. VIPs are reasonably easy to provide, but the cost of providing a full waterborne sewage system to a previously unserved isolated area is unaffordable under current circumstances.

The needs analysis must take into account the population and number of households at each level of service, the backlog and growth numbers for each area under consideration and the practical challenges to be addressed in achieving the identified outcome.

Levels of service

The area covered by a WSA will usually include different socioeconomic groups. The officials of the WSA should be able to offer each area a choice of service levels that are likely to be both acceptable and affordable to the residents in that area. The choices will be partly determined by the availability of facilities. For example, the decision to offer waterborne sewage depends both on the availability of a suitable wastewater treatment works and the ability and willingness of the majority of households to pay for this level of service. If the ability and willingness to pay exists but there are no facilities, then the WSA must decide if the size of this group could support the cost of the pipe network and treatment facilities.

Examples of levels of service that could be offered:

Water	Sanitation
Access to communal standpipes at no charge	Free technical assistance and advice with the construction of VIP toilets
A piped supply restricted to deliver the free basic water amount at no charge	
A piped supply restricted to deliver an agreed amount of water each month at a fixed monthly charge	Free technical assistance and advice with the installation of an on-site wet sewage system using a septic or conservancy tank
A piped supply giving an unlimited supply of water subject to the use of a pre-payment meter	Waterborne sewage subject to payment of the required monthly charges
A piped water supply giving an unlimited supply of water subject to monthly payment on the basis of the metered amount	

By identifying the levels of service to be offered, the WSA can quantify the facilities needed to provide these services. This will include the water resources that are necessary, the size and type of treatment works for purification and wastewater treatment, and the pipe systems and storage reservoirs required.

3.1.1 Current operating budget

The next step is to look more closely at the current total cost of providing the identified service and estimate any additional costs necessary for delivery. This should be done on a “ring-fenced” basis, with all costs, irrespective of which municipal department provides the service, included in the calculation. Much of this information can be extracted from the existing budget of the WSA, but often portions of other budgets have to be included to ensure that a true picture is obtained.

The current budget that reflects the direct costs for water and sanitation should be assessed to ensure that correct allowances are being made for all necessary

costs. A typical structure of a budget for a water services provider unit that treats its own water is:

Table 1: Typical budget for a water services provider

Description	% of total operating budget
Total staff costs	30 - 35
Raw water costs	5
Repairs and maintenance	10
Administration and operations	30 - 35
Capital charges	20

It is particularly important to ensure that appropriate amounts are budgeted for repairs and maintenance of all assets. The principle of asset management must be applied effectively or the WSA will not be able to achieve the anticipated benefit from its assets, and will probably have to invest capital either to refurbish or replace the asset at an early stage in its projected life. The addition of new assets on an annual basis (including those funded from grants or other external sources) places a regular additional burden on the repairs and maintenance budget.

Other budgets that may have to be analysed for indirect costs include:

- The cost of the director of technical services (or the equivalent post) plus associated support staff
- The cost of providing human resources, staff, industrial relations, and related support
- Costs incurred by using other municipal departments such as electrical, mechanical, transport, stores, printing and supply chain management
- The finance or treasury department may be responsible for managing the income of the service, including areas such as meter reading, billing, cash receipts, credit control, debt management and financial statements so their relative costs should be included where appropriate.

It is also important to estimate the income that will be generated by or allocated to the service, including all expected grants and subsidies. The total income should be adjusted to make a realistic allowance for non-payment of billed revenue.

All of this information should be combined into a 10-year income and expenditure projection. The projection should allow for realistic changes to the budget resulting from possible interventions such as adjusting staffing levels,

water demand management and more efficient operational methods, as well as changes in allocated grants and subsidies, and improvements in revenue collection. This projection of income and expenses should be produced in the form of a financial model. It will form the basis of the public sector comparator (PSC) model.

3.1.2 Current capital budget

3.1.2.1 Backlogs

A key part of the needs analysis is to understand the service delivery backlogs. The first priority is to ensure that every household at least has access to a basic level of service – communal standpipes within 200m and a VIP toilet. The second priority is to provide the higher levels of service, i.e., piped water within each yard restricted to free basic water or a full, metered supply service.

The basis for determining backlogs is generally the latest census information, but as this data could be out of date (the last census was in 2001, the next is planned for 2011) updates are required. The starting point for this is the department responsible for property valuation, which should be able to give the actual number of households, and the number of commercial and institutional buildings in each ward or community area. The next step is to obtain information from the department responsible for billing on those service points that receive a service requiring payment. For the balance of the area it will be necessary to undertake surveys or counts.

In assessing backlogs it is important to differentiate between people who may have **access** to a service (a pipe network adjacent to the house, for example) but do not receive a consistent water supply, and those who do receive at least a basic level of service as defined in the Strategic Framework for Water Services.

The Strategic Framework for Water Services (September 2003) defines basic services as:

Basic Water Supply Service:

- The provision of a facility comprising the infrastructure necessary to supply 25 litres of potable water per person per day supplied within 200 metres of a household and with a minimum flow of 10 litres per minute (in the case of communal water points) or 6 000 litres of potable water supplied per formal connection per month (in the case of yard or house connections).
- The sustainable operation of the facility (available for at least 350 days per year and not interrupted for more than 48 consecutive hours per incident).
- The communication of good water use, hygiene and related practices.

Basic Sanitation Service:

- The provision of a facility comprising the infrastructure necessary to provide a sanitation service which is safe, reliable, private, protected from the weather, ventilated, keeps smells to the minimum, is easy to keep clean, minimises the risk of the spread of sanitation-related diseases by facilitating the appropriate control of disease-carrying flies and pests, and enables safe and appropriate treatment and/or removal of human waste and wastewater in an environmentally sound manner, and which is easily accessible to a household.
- The sustainable operation of the facility, including the safe removal of human waste and wastewater from the premises where this is appropriate and necessary.
- The communication of good sanitation, hygiene and related practices.

3.1.2.2 Growth

While backlogs are the immediate challenge, the service must also allow for growth. This means identifying growth areas and the likely scale of the growth. Allowances must also be made to provide the infrastructure necessary to support growth in private-sector development (residential, commercial and industrial) as this will also be beneficial for the purposes of cross-subsidisation, local economic development and the creation of jobs.

Every new township that is developed by the private sector is required to provide bulk service contributions that can be used to provide and/or improve various services to the township and surrounding areas. The new developments will also make significant contributions to the income of the WSA and municipality through water and sewage charges, rates and so on.

When planning and assessing financial scenarios, all possibilities to increase revenue and promote economic development must be examined and, where practical, included in the future planning for the service.

3.1.2.3 Refurbishment

The facilities used to provide water services require regular maintenance and repair to ensure that they are always operating at required standards. At some point, however, some of these facilities may require a major upgrade or

refurbishment. This is particularly the case where electrical and mechanical equipment is used, and appropriate allowances should be made.

3.1.3 Water use, resources and demand management

It is necessary to measure the demand for water relative to the available resource. The resource may be restricted by natural availability or by the extraction licence. There may also be a water shortage in one area but a surplus in another. The actual demand should be checked against the theoretical demand based on the demographics of the various housing types as well as the non-domestic customers. A water balance should be prepared (even though much of the data has to be estimated) to shed light on use levels.

The analysis should identify the reasons for high levels of usage. Typical factors include:

- Incorrect bulk metering information or related assumptions
- Leaks in the reticulation system
- Water use in non-metered and uncontrolled connections
- Billing inaccuracies caused by meters not being read, incorrect addresses and so on.

It is important to assess and understand the levels of and reasons for non-payment. These indicators will guide thinking about the types of interventions that are required.

3.1.4 Operations

3.1.4.1 Systems and support

Operations and maintenance needs of the current service should be assessed. This will include assessing the numbers and skills levels of staff that are available to undertake ad hoc repairs, ongoing maintenance, and the length of time it takes to react to faults. It will also require looking at the quality of the repairs and maintenance that have been undertaken as well as considering any further work that was required and the subsequent life of the repaired item.

Further areas to be assessed will include the stores that are available as well as the other support facilities such as availability of transport for staff and materials, plant such as excavators, trucks and compactors.

Once the measurable items have been assessed an analysis should be undertaken, if possible, on the effectiveness of the operation. For example:

- Are team sizes optimal?
- Is the communication and report-back system working correctly?
- Are repairs being attended to effectively?
- Is plant being maintained at optimum levels?

3.1.4.2 Staffing

The current organisational structure of the service delivery unit should be assessed. This should include comparing staff numbers and skills levels to the outputs required and achieved, and looking at possible system improvements. The staffing assessment should include an analysis of how effectively staff is used. Examples of this include:

- Size of the teams used to respond to leaks
- Availability of transport for this work
- Availability of radio or telecommunications for team to access spare parts.

It is important to speak directly to the staff involved. Not only should they be kept informed of the thinking that may affect their jobs, but their views are crucial to understanding the challenges faced in the existing service delivery and the opportunities that may exist for improvement. The WSA should therefore discuss service delivery with staff to obtain their views, suggestions and recommendations.

The assessment should include examining the capacity and potential future capacity of the WSA to furnish the skills, expertise and resources necessary for the provision of the service. It should also explore the extent to which reorganisation of its administration and the development of human resources could be used to provide the service.

Once the skills levels and skills gaps have been identified, questions such as the ability of the WSA to attract and retain additional qualified staff have to be assessed. Major factors here are salary scales and responsibility levels as well as softer issues such as availability of suitable housing, shopping and entertainment facilities, schools, crèches and jobs for partners.

3.1.5 Financial sustainability

The current costs and budget exercise already carried out will have identified the projected income and expenditure figures for the service. The WSA must now establish the needs required to achieve financial sustainability. This involves comparing the adjusted income and expenditure estimates for the

service and ensuring that a break-even level or surplus is achieved. This may include having to allow for the provision of different levels of service or for expanding the service provision to new areas as identified in the needs analysis and as determined in the IDP and WSDP finalisation process.

It is also necessary to adjust the existing budgets to make allowance for the cost of depreciation of the existing assets. In this way the true cost of the provision of the service, including the capital cost of the assets being used, is determined and allowance is made for the replacement of these assets in the future. When determining the tariffs for the higher levels of use, it is important that such costs are included in the calculations.

A key component of this work is assessing how the income can be adjusted to cover the cost of the service. While the actual value of grants and subsidies that will be received after the current three-year medium-term expenditure framework (MTEF) budget is not fixed, reasonable assumptions, based on current levels, can be made. Allowance should also be made for any increased revenue that can be generated from middle- to high-income developments – through the bulk service charges to enhance the capital budget and through increased payment from services on the operational account.

Because of the effect of free basic water and stepped tariffs, accurately determining the income generated by payments is complex. To estimate this (apart from taking last year's figure and applying a percentage increase) requires the use of a tariff model that predicts the water use at each of the stepped tariff levels. The billing system should be structured to provide this information but it may take several years before a realistic model is developed.

The structure of the stepped tariff system should be considered carefully. There is a theory that people only notice a difference if it is greater than 15 per cent. Many tariff structures currently only show a difference of a few cents between each step. There is also a need to communicate to all users what the cost of free basic water actually is. It is therefore recommended that:

- Free basic water should be allocated a tariff equal to the basic operational cost of producing and distributing water
- A credit should be given, and clearly shown, on the account for the free basic water amount
- The steps between tariff levels should be at least 15 per cent
- The higher tariffs must be such that they cross-subsidise the lower tariffs, they cover all costs including capital charges and they recover the cost of the free basic water allocation

- The tariffs must be set to levels so that the combined cash income covers the difference between actual operating costs (inclusive of an allowance for the depreciation of capital assets) and the operating subsidies received.

The last item may entail applying greater levels of enforcement to get users to pay and may also require considerable increases in tariffs and charges.

Table 2 gives an example of what various stepped tariffs might be, using the minimum 15 per cent difference principle. The first row assumes a number of possible basic operational cost tariffs and the next rows show what the corresponding stepped tariffs might be:

Table 2: Stepped tariffs for water consumption					
Monthly Use (KI)	Range of Tarrifs				
	Option 1	Option 2	Option 3	Option 4	Option 5
0 to 6	R 2.50	R 3.00	R 3.50	R 4.00	R 5.00
Above 6 to 15	R 2.90	R 3.50	R 4.10	R 4.60	R 5.80
Above 15 to 30	R 3.40	R 4.10	R 4.80	R 5.30	R 6.70
Above 30 to 50	R 4.00	R 4.80	R 5.60	R 6.10	R 7.80
Above 50	R 4.60	R 5.60	R 6.50	R 7.10	R 9.00

3.1.6 Output specification

The final step in the needs analysis is to agree on the output specification that is relevant to the requirements of the WSA. This will form the basis against which the various options will be assessed and against which the selected option will be tested. The output specification will also serve as the specification of any outsourcing contract, whether by MSP or PPP.

Below is an example of such an output specification:

The overall objective is, within a period of six years, to establish a self-sufficient water services provider unit that:

- Provides at least a basic level of water supply service to 95 per cent of the households in the area of jurisdiction
- Has facilitated and supports the use of at least a basic level of sanitation service in 90 per cent of the households in the area of jurisdiction
- Is able to offer higher levels of service to all formal households in the defined urban areas
- Reacts to all complaints and reports of water leakages and sewer blockages in the manner and within the time periods as set out in the published Customer Charter
- Maintains customer services offices in the main shopping and community centres which have knowledgeable staff who have online access to customer statements, accounts and meter readings as well as to reported faults
- Employs dedicated, experienced and skilled staff who possess the necessary qualifications and knowledge to be able to deliver water services to the required standards and levels of service
- Has a development and training programme which ensures ongoing employee growth and satisfaction as well as career and succession planning
- Maximises opportunities for employment, entrepreneur development and economic growth for the local area
- Applies operation and maintenance procedures that optimise the use of available facilities and ensures that regular maintenance is undertaken to maximise the operational life of all equipment and assets
- Undertakes scientific testing to ensure that the required standards of water and effluent quality are maintained
- Has medium- and long-term plans in place for effective capital expenditure programmes that will protect the integrity of the water services system as well as supporting growth and development in the municipal area
- Achieves a payment rate for services of at least 95 per cent
- Is a financially sustainable unit after the allocation of 30 per cent of the equitable share allocation made to the municipality.

3.2 Options analysis

Research completed up to this point should be checked for completeness to serve the next level of requirements. Additional analysis may be required.

3.2.1 Technical solutions options analysis

A technical solution options analysis confirms and refines the definition and scope of the work involved. For example:

A coastal town needs to access additional water supplies. It has the choice of installing a desalination plant with a low capital cost and high operating cost or of purchasing water from a nearby water board with high capital cost and low operating cost. It is therefore necessary to undertake a project life cycle costing exercise for the two options so that the overall cost can be compared on a balanced basis. It is also necessary to determine the non-financial advantages and disadvantages of each option in terms of the available skills to operate the desalination plant, the importance (or not) of having in-house control over the availability of the water supply, the risks involved of using new technology or having damage to the water board supply pipeline, the implications in times of drought, etc.

In identifying these technical solution options it is also necessary to determine the extent of the responsibility to be packaged with the service. This means identifying the need in respect of the capital investment, systems, human resources (including technical expertise), support facilities, etc. These are discussed in more detail in the following sections.

3.2.1.1 Capital investment needs

Usually, a WSA has access to its own funds and grants, such as the municipal infrastructure grant, to fund social development – dealing with the backlogs and upgrading levels of service for the historically disadvantaged areas, indigent families and the previously unserved or under-served communities. There are also likely to be funding requirements for economic development in support of customers, or potential customers, who can afford to pay for the service and where the use of loans would be the optimum method of finance.

The specific funding needs of the WSA have to be identified and the various methods for addressing these needs should be listed for further consideration. In doing this it is necessary to understand the borrowing capacity of the municipality and the effect that any such borrowing in respect of water services may have on the ability of the municipality to provide other services.

3.2.1.2 Systems

The various systems used in providing the service should be assessed. Such systems include management and financial information systems, metering, billing, reporting, bulk meters, water audits and demand management, supervisory control and data acquisition systems controlling pump stations, reservoirs and treatment works, processing of new applications and development proposals, fault reporting and feedback, job cards, cost and stock control and budgeting. The extent to which these are in place and are being used will be a key factor in determining the ability of the existing organisation to cope with the proposed new service delivery method as well as in identifying the key areas for improvement.

3.2.1.3 Human resources

The assessment of the human resource capability of the service should define an optimal organisational structure, and examine the skills and numbers required to fill any gaps. Human resources are obviously the key to any successful service delivery organisation and considerable attention should be given to this aspect.

Everything that is done in this regard, however, must protect existing staff and ensure that there are opportunities for them to be effectively incorporated into the new organisation. Retraining staff may be necessary.

3.2.1.4 Support facilities

The support facilities in a service delivery organisation include plant, vehicles, mechanical and electrical, purchasing and stock, radio and telecommunications, offices and laboratories. The assessment will include determining if the available facilities are adequate for the work to be done and if the facilities are available when required. Examples of this would be assessing whether parts needed for emergency repairs are always available from the materials store; the percentage availability of plant and vehicles; the number of tests undertaken by a laboratory and the percentage of these tests that are confirmed by an independent laboratory; and the stock levels of chemicals and other consumables.

3.2.1.5 Legislation and regulation

The extent that the current method of service delivery conforms to all relevant legislation has to be determined. Typical areas where this may not be happening include:

- Consistency of achieving the quality standards for potable water and the related testing to ensure compliance
- Effluent discharge standards
- Compliance with the Occupational Health and Safety Act (1993)
- Compliance of qualifications of operators with regulated requirements
- Compliance with MFMA and supply chain management regulations
- Compliance with National Water Act (1998) and abstraction licensing requirements
- Compliance with environmental standards and requirements.

3.3 Service delivery options

If the service under consideration is a municipal service then the requirements of section 78 of the MSA have to be met. To assess the range of internal options, the WSA must compare them with equivalent external options. The various assessments undertaken in the technical solutions options section above will have informed the decision already through the determination of the strengths and weaknesses of the existing service delivery. The assessment of the service delivery options is therefore designed to identify which of the delivery options will be most suited to building on the strengths and dealing with the weaknesses.

3.3.1 Internal service delivery options

Table 3: Internal service delivery options for the provision of water services (section 78 of the MSA)

Option as defined in act	Advantages	Disadvantages	Responsibilities and risk transfer
A department or other administrative unit within its administration	Can be a good option for a smaller WSA as the other departments (finance, corporate services, etc) of the municipality provide the support services and the duplication of effort is minimised	Does lead to a division of responsibility and can reduce the quality of service provided to the public	All responsibilities and risk remain with the WSA
Any business unit devised by the municipality, provided it operates under the municipality's administration and under the control of the council in accordance with operational and business criteria determined by the council	A business unit can provide a one-stop service. It has the benefit of aligning the income and expenditure of the trading service and allowing for a more devolved decision-making process	Could lead to a duplication of certain functions and the reduction of responsibilities of other departments in the municipality.	Certain responsibilities can be delegated to the business unit but all risk remains with the WSA
Any other component of its administration	This definition allows for anything that does not fit in to the first two. The above comments would apply depending on the format of the arrangements		

The assessment of the internal service delivery mechanism must primarily focus on the following key tests:

- Can the mechanism achieve the output objectives defined in Section 3.1.6?
- Does the mechanism offer value for money?
- Is the mechanism affordable and financially sustainable?

Other aspects to assess include:

- The direct and indirect costs and benefits associated with the project, including the expected effect on the environment and on human health, wellbeing and safety
- The municipality's capacity and potential future capacity to furnish the necessary skills, expertise and resources
- The extent to which the reorganisation of its administration and the development of the human resource capacity within that administration could be used to provide a service through an internal service delivery mechanism
- The likely effect on development, job creation and employment patterns in the municipality
- The views of trade unions.

In terms of the Water Services Act (1997), the internal service delivery option is the preferred choice provided that the WSA and its internal water service provider (WSP) have the necessary resources and skills to undertake this responsibility.

The MSA requires that, should a municipality decide to provide the services through an internal service delivery mechanism, "it must – allocate sufficient human, financial, and other resources necessary for the due provision of the service and transform the provision of the service in accordance with the requirements of the Act".

A critical element of this responsibility is the ability of the WSP to ensure a revenue stream from those customers who are using services that have to be paid for. This revenue stream is not only about billing but also about collecting the money due and not allowing bad debt to accumulate above the norms expected in a business environment.

The best internal service delivery option should be determined based on the various factors recorded above.

As the WSA may take account of developing trends in the sustainable provision

of municipal services generally, the WSA should now compare this internal service delivery option with the appropriate external service delivery options.

3.3.2 External service delivery options

There are two components that make up each external service delivery option: the service provider and the contract.

Table 4: External service delivery parties (section 78 of the MSA)

Option	Advantages	Disadvantages	Responsibilities and risk transfer
A municipal entity	Creates a ring-fenced unit that has total responsibility for service delivery and is able to operate on a devolved basis from the WSA	Cannot raise its own funding and is still dependent on the balance sheet of the municipality for credit rating	Managerial and operational responsibility and risk is transferred to the entity (as the WSP) while financial risk remains with the WSA
Another municipality	Uses an established organisation normally located within the services area	Generally there is a lack of skills and capacity within that municipality unless it is one of the larger ones with greater resources	Managerial and operational responsibility and risk is transferred to the other municipality (as the WSP) while financial risk remains with the WSA
An organ of state: a water services committee established in terms of the Water Services Act	Due to their local knowledge and involvement, local water services committees can be effective in running small, dedicated systems in a village or isolated community	Generally lack the necessary financial, technical, managerial and contractual skills, have problems in collecting the required funding and have been known not to pay required charges to the WSA	Certain managerial and operational responsibility is transferred to the water services committee (as the WSP) while all risk remains with the WSA. (Probably better used as part of a larger, more sophisticated, WSP)
An organ of state: a licensed service provider registered or recognised in terms of national legislation	This is typically a water board or regional service provider that will have good technical and managerial capacity as well as considerable resources	Generally not able to bring capital funding to service delivery and they generally do not have good experience in retail customer care and revenue collection	Managerial and operational responsibility and risk is transferred to the service provider (as the WSP) while financial risk remains with the WSA

Option	Advantages	Disadvantages	Responsibilities and risk transfer
An organ of state: a traditional authority	They will be active in the community, know the consumers and probably have the ability to enforce payment for services	Most traditional authorities lack the necessary financial, technical, managerial and contractual skills required	Certain managerial and operational responsibility is transferred to the traditional authority (as the WSP) while all risk remains with the WSA. (Probably better used as part of a larger, more sophisticated, WSP)
A community-based organisation or other non-governmental organisation legally competent to enter into such an agreement	Due to their local knowledge and involvement, NGOs can be effective in running small, dedicated systems in a village or isolated community	CBOs generally lack the necessary financial, technical, managerial and contractual skills required and do not have the legal status to enter into a contract. Experience is that strong leaders can often build competent organisations but if these individuals move on the organisations break down and are no longer effective. Similar to water services committees	Certain managerial and operational responsibility is transferred to the NGO (as the WSP) while all risk remains with the WSA. (Probably better used as part of a larger, more sophisticated, WSP)
Any other institution, entity or person legally competent to enter into such an agreement	The private sector can generally bring skills, capacity, expertise and funding to the service. Their experience and motivation can bring efficiency benefits that can be greater than the profit earned	Carefully structured and worded contracts with clear outputs and requirements are necessary. Compliance with the various statutory and supply chain management procedures can be more complex and time consuming	Managerial and operational responsibility and risk is transferred to the service provider (as the WSP) and the financial risk may or may not be transferred

When considering the form of the contract, the following generic list is used as an initial reference point:

- **Service contract:** A WSA pays a fee to a public or private organisation to provide specific operational services such as meter reading, revenue collection and maintenance of equipment. Where possible, payment should be based on the output rather than the input. For example, the WSA should pay for meter reading based on the number of meters read and for realistic values rather than for time spent reading. Capital investment is usually not the responsibility of the contractor. Typical duration: one to three years.
- **Management contract:** A WSA pays a fee to a public or private organisation to assume overall responsibility for operation and maintenance of a service delivery system, with the freedom to make day-to-day management decisions. The fee could include a fixed component plus a sliding-scale fee based on performance. Capital investment is usually not the responsibility of the contractor. Typical duration: five years.
- **Lease contract:** A public or private organisation rents facilities from a WSA and assumes responsibility for operation and maintenance. The lessee finances working capital and replacement of capital components with limited economic life, but usually not fixed assets, which remain the responsibility of the WSA. Payment by the WSA could be on a unit rate basis for service supplied, a mixture of an availability fee plus a unit rate charge or on a single availability charge. Typical duration: 10 years.
- **Concession:** A public or private organisation handles operations and maintenance and finances investments in addition to working capital. Fixed assets are usually owned by the WSA, but leased and managed by the concessionaire for the period of the concession. At the end of the contract the assets are returned to the WSA in a pre-specified condition. The project is designed to generate sufficient revenues to cover the concessionaire's investment and operating costs, plus an acceptable rate of return. The WSA exercises a regulatory and oversight role and receives a concession fee for this arrangement. Concessions typically focus on operating and financing the expansion of existing system components. Typical duration: 15+ years.
- **Build-operate-transfer:** A public or private organisation takes responsibility for the financing and construction of a new facility or group of facilities. The new asset is then operated by the organisation for a fixed time period during which it recovers its costs from user charges or from bulk payments from the WSA. At the end of the period the asset reverts to the ownership of the WSA. The WSA could pay for this by way of a unit charge, a monthly charge or a combination of a fixed charge designed to cover capital costs and a unit charge designed to cover variable operating costs. This is a form of concession, with an emphasis on the construction of new stand-alone systems. The WSA may or may not receive a fee or a share of profits. Typical duration: 15+ years.

- **Sale of assets:** A public or private organisation purchases the asset(s) from the WSA and takes full responsibility and risk for the future operation, maintenance and development of the facility. The new owner sells a service either through competition in the marketplace or by competing for a contract to provide monopoly services for a defined period at an agreed price. The sale of assets in respect of water and sanitation services is not permitted under national policy. Certain competent activities may, however, be sold under considered circumstances.

It has to be stressed that the above is a list of standard generic options. In analysing the specific situation and needs of a project, the optimum solution will be based on one of the above but will be adapted to suit the identified requirements of that particular case.

Table 5: Advantages and disadvantages of the external service delivery contract options

Option	Advantages	Disadvantages	Responsibilities and risk transfer
Service contract	Good for standard, repetitive, services which have a clearly defined output and require no investment or intensive management control. Generally services that can be contracted out on an annual basis	Does not bring in additional management expertise. Does not bring in any investment – WSA still responsible for the provision of funding for any major capital items	The WSA remains responsible for the overall service and for most of the risks attached. Certain basic performance risks can be transferred to the contractor but these will be limited
Management contract	Good for operation and maintenance type services where the WSA does not have, or does not want to have, the in-house skills to manage such operations. Generally brings in external expertise and experience from operating and managing similar functions elsewhere. The training and development of municipal staff may be included in this form of contract	May not bring in any investment – WSA still responsible for the provision of funding for capital expansion	The operational and maintenance risk is transferred to the contractor. The WSA retains the risk in respect of providing capital expansion funding and any operational risk which may occur as a result of them not achieving this. The risk in respect of revenue generation may, or may not, be transferred to the contractor

Option	Advantages	Disadvantages	Responsibilities and risk transfer
Lease contract	Good for operation and maintenance type services where the WSA does not have, or does not want to have, the in-house skills to manage such operations. Generally brings in external expertise and experience from operating and managing similar functions elsewhere. Contractor can be made responsible for capital investment in limited life assets. WSA could generate a fixed income on the lease	May not bring in major amounts of capital investment – WSA still responsible for the provision of funding for the capital expansion of long term fixed assets. Lease fee is dependent on the financial viability of the facility (may have to be subsidised!)	The operational and maintenance risk is transferred to the contractor. The financial risk in respect of limited life assets is transferred to the contractor. The WSA retains the risk in respect of providing capital expansion funding and any operational risk which may occur as a result of them not achieving this. The risk in respect of revenue generation may, or may not, be transferred to the contractor depending on the viability of the operations
Concession	Contractor takes full responsibility for revenue collection and operating losses	This requires a sophisticated form of contract and the need for approval by the lenders can prolong the process	The risk on revenue is transferred to the contractor (although certain commitments may be made by the WSA or other governmental bodies)
Build-operate-transfer (BOT)	Contractor is required to finance the agreed capital expansion programme. Generally brings in external expertise and experience from operating and managing similar functions elsewhere. The contractor can be required to take responsibility for revenue collection under certain circumstances	This requires a sophisticated form of contract and the need for approval by the lenders can prolong the process. Is generally not appropriate where the right of use of an existing asset is to be transferred	The risk on the fixed assets is transferred to the contractor including the risk of construction cost. The operational and maintenance risk is transferred to the contractor. The risk on revenue may or may not be transferred to the contractor

Option	Advantages	Disadvantages	Responsibilities and risk transfer
Sale of assets	This allows a WSA to divest itself of non-core assets. Opportunities for existing staff can be created through allowing them to participate in the new venture	The WSA may have to support the new owners with a subsidy for a defined period of time to ensure viability	Subject to any subsidies or undertakings, the full risk and responsibility is transferred to the new owners

Table 6: Summary

Contract type	Use this contract when:-
Service contract	A simple straightforward service is to be outsourced
Management contract	There is a need for an outside organisation to take management responsibility for a service without having to provide any capital investment
Lease contract	There is a need for an outside organisation to take management responsibility for a service as well as having to provide capital investment for limited life assets (e.g., vehicles, equipment, machinery and plant)
Concession	Capital investment is required in a number of areas and an outside organisation is required to provide this investment and to take over long-term responsibility for a specific service
Build-operate-transfer	Capital investment is required to construct one specific facility, and an outside organisation is required to provide this investment and to recover its investment by operating the facility for about 15 years
Sale of assets	The WSA wishes to divest itself of a non-core asset to focus on its core activities

The level of transfer of operation or financial responsibility will dictate whether any of these styles of contract become a PPP. All of them, with the probable exception of the service contract, could easily be used to outsource all or some of WSP responsibilities.

The water sector in South Africa is still developing because large numbers of people were not provided with water services under previous governments. While the technical knowledge exists, this is a limited resource. Additionally, the challenge of providing services to the poor and low-income households puts pressure on the financial sustainability of service provision. To develop solutions to these challenges requires a consolidated and cooperative approach between technical, financial and customer management departments. At this

stage in South Africa management and BOT contracts probably offer the most realistic benefits.

3.3.3 Internal options benefit analysis

The WSA should decide the best internal option using the following process:

Assessment process

1. Financial effects

Compare the financial effects of each option including the estimated initial capital expenditure and the likely capital and operational costs over the full project cycle.

2. Funding, affordability and value for money

How will each option be funded? Which options are affordable? How will the establishment of an option be financed? Which options will best increase income or cut costs? Which options will provide the best value for money?

3. Risk

What is the risk profile of each option?

4. BEE and other socioeconomic aspects

Which option best meets the BEE and socioeconomic targets set out in the output specification?

6. Service delivery arrangements

Compare the service delivery arrangements for each option and analyse the implications against the output specification.

7. Transitional management issues

Compare the issues that may arise in the changeover from existing arrangements to each solution option.

8. Technical analysis

Use a comprehensive technical analysis to compare the merits of each option.

9. Legislation and regulations

Does each option comply with the relevant legislation and regulations?

10. Human resources

For each option, assess the effect of:

- The benefit or otherwise for existing staff
- Relevant legislation and case law
- Labour agreements
- The cost of transferring staff
- Accrued benefits that may be transferred, and their timing
- The potential willingness of staff and other parties to transfer.

11. Qualitative factors

The qualitative benefits associated with each option, which may not be quantifiable and may not be considered as offsetting costs. While financial considerations are likely to drive the affordability test, it is important that these qualitative factors be considered. (For example: the provision of water services is a 24 hours per day, seven days per week responsibility. While cost savings through banning overtime and shift allowances may be attractive financially they are counterproductive to providing a full service.)

The optimum internal solution needs to be compared with possible external solutions to decide which best meets the output specifications. The WSA must try to identify the best internal and external options to minimise the complexity of the decision-making process.

3.3.4 Risk assessment

A key element in assessing the delivery options, particularly in comparing internal and external options is to understand the allocation of risk that would be realistic and appropriate.

The delivery of any service involves certain risks. The terms of a contract should be based on the identification of such risks and the allocation of these risks to the WSA or to the service provider, depending on the assessment of who can best manage each risk. Each outsourced risk will generally increase the cost of the service to some extent so a balanced allocation of risk is important. During the course of the contract, the identified risks, and any new risks, should be carefully managed and controlled.

– Municipal Infrastructure Investment Unit: pamphlet on contract management

A risk matrix should be prepared that identifies all the relevant risks, assesses the level of impact of each risk, how such risks could be mitigated and whether the WSA or the WSP would be the more logical party to accept such a risk. The principle in risk allocation is generally that the party that can best manage the risk should be the party responsible for that risk. Some risks cannot be allocated specifically to one party and will end up being shared.

3.3.5 Decision matrix

Having undertaken the various analyses, the WSA must develop a decision-making matrix that combines the financial and non-financial information in a format that can be used to present the information to community and union representatives, as well as to councillors, to allow them to make informed decisions.

An example of such a matrix is shown below. It should be supported by a report that explains the reasons for each “Yes” and “No”. This approach may also be adapted by using ratings such as “Excellent”, “Good”, “Neutral”, “Bad” or by using a colour coding system. The use of a points system in such a matrix should be avoided as there is a tendency to add the numbers up to get a “result”, and the two-dimensional matrix does not allow for a weighting of the importance of each of the judgement items.

The decision-making matrix should be presented to community and labour representatives so that their comments and feedback can be received and recorded. The proposals should be reviewed and adjusted accordingly.

The final adjusted decision-making matrix should then be presented to the appropriate municipal bodies with a record of comments received from communities and labour representatives, to assist the council to make an informed decision.

Table 7: Decision-making matrix

Benefit Criteria					
	Will deal with blacklogs	Improves technical ability of service delivery	Improves service to customers	Will achieve financial sustainability	Will reduce costs
Internal	N	N	Y	N	N
Internal with Water Board Support	Y	Y	Y	N	N
Internal with Private Sector Support	Y	Y	Y	N	N
External Comparison Options					
Short Term O&M Only	N	Y	Y	N	Y
Long Term with External Funding	Y	Y	Y	Y	Y

3.4 Delivery mechanism summary and interim recommendations

If it is a municipal service it will be necessary, at this stage, for the council to consider if it accepts the internal approach or whether it wishes to explore external options. In those instances where the municipal manager has been delegated authority to proceed with an assessment of external service delivery mechanisms, the information developed during the internal service delivery options assessment will be included in the feasibility study presented to council.

The MSA requires that a council decision to adopt the internal mechanism must be supported by a capacity statement from the WSA confirming that section 79 of the MSA can be complied with. This requires that sufficient human, financial and other resources necessary for the proper provision of the service have been allocated, and that the service will be transformed in accordance with the requirements of the MSA. In the capacity statement the WSA must

show the skills levels of the existing and proposed staff as well as a realistic financial model that shows how financial sustainability will be maintained and/or achieved.

In terms of the MSA requirements, the WSA must give notice to the local community if it decides to explore the possibility of providing the service through an external mechanism.

3.5 Due diligence

Due diligence seeks to uncover issues in terms of the preferred technical solution and service delivery option that may affect the proposed project in terms of legal issues, use of municipal property by another entity, regulatory matters, site enablement issues and BEE and other socioeconomic issues.

3.6 Value assessment

The term “value” refers to the broad range of values that will be generated by the proposed delivery arrangements. While some of these are financial factors, there is a range of other, non-financial or qualitative factors that have to be assessed to determine if the proposed mechanism is going to provide a “valued” service to its customers as well as adding value to the service provided. This section will deal with these various factors.

This is the pivotal stage of the feasibility study. It enables the municipality to determine the best procurement choice for the service. The three tests prescribed by both the MFMA and MSA are:

- Does it provide value for money?
- Does it appropriately transfer risk from the municipality to the private party?
- Is it affordable?

Depending on the nature of the service and the capacity of the municipality, a full value-for-money assessment or a simplified one can be carried out.

- Simplified value-for-money analysis – a simplified analysis is carried out when public-sector provision for the output specified is for technical, funding, or capacity reasons not a “realistic public-sector option”; for example, if it is a new service that the WSA has not been providing up to now.
- Full value-for-money analysis – a full analysis is done when public sector provision is a realistic option.

The complete value assessment is undertaken for all service projects. In PPP feasibility studies involving supporting activity projects, the value assessment may only require an estimation of the probable costs to the municipality for administration of the PPP, and the affordability to the municipality, depending on various factors determined when the adviser's terms of reference were drawn up.

3.6.1 External assessment

The possible external solutions or mechanisms for the service delivery have already been identified. It is now necessary to look at these in more detail to compare the solution options with the preferred internal model. This should be done using the same approach set out in the previous section and by following the requirements of this section.

The various requirements under section 78(3) of the MSA were dealt with under section 3.3 of this toolkit. An additional requirement at this stage, however, is to obtain the views of the local community. This is a very important exercise that will be made easier if proper consultation has already been undertaken for the development of the IDP and the WSDP. It is also best if the consultation is led by a councillor, preferably the councillor responsible for the service provision.

3.6.2 Financial modelling

A comparative financial assessment using the identical output specifications must be made between internal and external service delivery. The PSC is the base case of the internal mechanism. A risk-adjusted PSC model is then compiled which adjusts the base case PSC to allow for the various risks inherent in the service provision. The reference model is the financial model for the external solution option. These provide costings of each procurement option in the form of a discounted cash-flow model adjusted for risk.

Comparing the risk-adjusted PSC and the reference models enables a WSA to assess whether service delivery through an internal or external mechanism yields the best value.

3.6.3 Public sector comparator (PSC)

The base PSC model represents the full costs to the WSA of delivering the required service according to the specified outputs via the preferred solution option using the internal mechanism. It includes all capital and operating costs associated with the project.

The key characteristics of the PSC model are:

- Expressed as the net present value (NPV) of a projected cash flow based on the appropriate discount rate for the public sector
- Based on the costs of the selected internal mechanism
- Costs expressed as nominal costs
- Depreciation not included, as it is a cash-flow model.

The central functions of the PSC model are:

- Promotes full cost pricing at an early stage
- Is a key management tool during the selection and possible procurement process, assisting the WSA to stay focused on the output specifications, costs and risk allocation
- Is a reliable way of demonstrating affordability
- Provides an initial indication of value for money
- Is a consistent benchmark and evaluation tool
- Encourages any subsequent bidding competition by creating confidence in the financial robustness and integrity of the feasibility process
- Is sufficiently robust that the service could be provided conventionally if, at any stage, the external mechanism fails to achieve the objectives or show value for money.

The base case PSC is constructed on the basis of the earlier assessment of current operating and capital budgets. These budgets must now be assessed and checked for completeness in respect of the selected internal option and adjusted where necessary.

All assumptions made in creating the model – e.g., inflation rate, the discount rate, depreciation, treatment of assets, available budget(s), and MTEF and the Division of Revenue Act (2005) allocations – should be clearly recorded.

The model should be developed using nominal values. In other words, all costs should be expressed, with the effects of projected inflation included. This also allows easy comparison with the budget of the WSA, which is expressed using nominal values. Inflation projections should be made with reference to the inflation targets set by the Reserve Bank. Since the PSC model is calculated on cash flow, not on accrual, non-cash items such as depreciation should not be included.

3.6.4 Risk-adjusted PSC

The risk-adjusted PSC model is the base PSC model plus a costing for all the risks associated with undertaking the project. A municipality or WSA does not usually cost these risks, but it is necessary to do so to understand what the full cost will be if it undertakes the service.

The risks are identified by exploring each risk category in detail and producing a detailed, project-specific list. (See Module 4 of the Guidelines). This list will be developed into a risk matrix for the defined service. It is important to identify and evaluate all material risks. Even if a risk is unquantifiable, it should be included in the list. Do not forget to include any sub-risks that may be associated with achieving the BEE targets set for the project. It may be difficult to compile a comprehensive and accurate list of all the types of risks but reference can be made to experience from other service providers or advisers.

a) Impact of the risk

The impacts of a risk may be influenced by:

- **Effect:** If a risk occurs, its effect on the project may result in an increase in costs, a reduction in revenues or in a delay, which may in turn have other cost implications. The severity of the effect of the risk also plays a role in the financial impact.
- **Timing:** Different risks may affect the project at different times in the life of the project. For example, construction risk will generally affect the project in the early stages. The effect of inflation must also be borne in mind.
- **Type:** Some risks are difficult to quantify accurately.

The severity of the consequence of the risk must be identified and it is essential to specify all the direct impacts for each category of risk. For example, construction risk is a broad risk category, but there could be several direct impacts, or sub-risks:

- Cost of raw material is higher than assumed in the PSC model
- Cost of labour is higher than assumed in the PSC model
- Delay in construction results in increased construction costs
- Delay in construction results in increased costs, as an interim solution needs to be found while construction is not complete.

Each impact is a sub-risk, with its own cost and timing implications.

b) Probability of the risk

Estimating probabilities means making some assumptions. Ensure these are reasonable and fully documented, as they may be open to being challenged in the procurement process or be subject to an audit. There are some risks whose probability is low, but the risk cannot be dismissed as negligible because the impact will be high (for example, the collapse of a structure). In this case a small change in the assumed probability can have a major effect on the expected value of the risks. If there is doubt about making meaningful estimates of probability, it is best practice to itemise the risk using a subjective estimate of probability rather than to ignore it. WSAs should also be prepared to revisit initial estimates if they learn something new that affects the initial estimate. Together with estimating the probability of a risk occurring, it is also necessary to estimate whether the probability is likely to change over the term of the project.

c) Cost of the risk

Risk as a cash-flow item

The National Treasury advocates costing risk as a separate cash-flow item, and not adjusting the discount rate to indicate the level of risk in a project. The cash-flow method promotes a focus on the costs of each risk and enables an understanding of how risk can be transferred and what its financial effects are. Also, valuing each risk as a separate cash-flow item accounts for the time implication of that risk (some risks may only have an impact at the beginning of a project, while others may diminish or escalate).

- Estimate the cost of each sub-risk individually by multiplying the cost and the likelihood
- Assess the timing of each sub-risk
- Cost the sub-risk for each period of the project term
- Construct a nominal cash flow for each risk to arrive at its NPV.

d) Strategies for mitigating the risk

A risk can be mitigated either by changing the circumstance under which it can occur or by providing insurance for it. Indicate what the risk mitigation strategy for dealing with each particular risk will be, and the attendant cost of such mitigation.

e) Allocate the risk

Once risks have been identified and costed, analyse which risks the private party should carry, which the WSA should retain, and which will be shared if the project were to be procured through a PPP. For the risk-adjusted PSC model, the WSA will usually carry all the risks, as would be the case with conventional procurement. It is, however, necessary to do a preliminary risk allocation at this stage, as it will assist the WSA in separating out the risks which will be allocated to the private party. This will be reflected in the PPP reference model.

A risk should be carried by the party best able to manage that risk. The principle for allocating risk should be value for money. Where retaining a risk presents value for money for the WSA, it should be retained.

f) Construct the risk matrix

A comprehensive risk matrix is a fundamental component of private-sector procurement as it is used to identify and track risk allocation throughout the drafting of the agreement, the bidding process, agreement negotiation and financial closure.

The risk matrix consolidates all identified project risks, their impacts, and their associated costs. Include all risks (retained by the WSA and transferred to the private party) in the calculation of the PSC. List those that are to be retained or transferred, as they will need to be costed for the reference model and will also be used and elaborated on during the procurement phase.

g) Construct the risk-adjusted PSC model

Once costs have been established for all identified risks, the base PSC must be risk-adjusted. This is done using the following simple formula:

$$\text{Risk-adjusted PSC} = \text{Base PSC} + \text{Risk}$$

See the example in Module 4 of the Guidelines.

h) Preliminary analysis to test affordability

As a preliminary assessment of the project's affordability, compare the risk-adjusted PSC model with the WSA's budget for the project as estimated during the options analysis. If the project looks unaffordable by a wide margin in the PSC model, it may be necessary to revisit the options analysis.

3.6.5 External reference model

The reference model is a hypothetical external party bid to deliver the specified outputs. It is the costing of the output specifications from an external entity's perspective. Comparing the risk-adjusted PSC model with the risk-adjusted reference model enables the WSA to assess whether service delivery through an internal or external mechanism yields the best value.

The reference model must be developed using the identical output specifications to those used in the PSC model, but technically and financially it is very different. As the WSA will not know what a private party will charge for the outputs specifications, costs will have to be estimated. The adviser must have the necessary expertise, market knowledge and experience to construct a market-related reference model.

a) Develop the probable project structure and sources of funding

The probable structure for the project needs to show the relationship between the WSA, the external party, and any subcontractors and any third parties. The proposed sources of funding (operating and capital – from revenue, transfers from the WSA, government grants, etc.) must be identified and shown in a probable funding structure.

Where applicable, rates of return and the costs and key terms of debt financing, including annual debt service cover ratio, project life cover ratio, loan life cover ratio, debt service reserve and maintenance reserve accounts, and the cash-flow waterfall arrangement, must be shown. All assumptions must be clearly stated, as these will directly affect the assessment of the model.

b) Develop the core components of the payment mechanism

Although the full payment mechanism is developed during the preparation of the request for proposals (RFP), the feasibility study must develop the core components. The following must be addressed:

- Will the contract be a time-based payment or a volume-based payment system?
- Will a time-based payment be fixed or allowed to vary over time?
- How will the volume-based payment be measured?
- Will inflation be applicable and how will it be determined?
- What factors might trigger an increase in agreed payments?

c) Set and cost BEE targets

Draft a proposed BEE balanced scorecard for the external mechanism, taking account of the sector, proposed project type, structure, sources of funding and the BEE issues already identified.

Producing a proposed BEE balanced scorecard for the project, through which BEE targets are appropriately set for the maturity of the market in which the project is to take place, will directly affect the WSA's ability to produce sound bid documentation for the project. Getting these targets right or wrong may significantly affect the project's affordability and value for money, and the private party's willingness to assume risk – and will certainly have a direct effect on the sustainability of BEE in the project.

d) Calculate and consolidate all costs

The categories of costs covered in the reference model must be the same as those in the PSC model – namely, direct capital, maintenance and operating costs, and indirect costs, over a comparable period.

The key difference is that the reference model is expected to take into account the innovative design, construction and operational efficiencies that may realistically be expected of the external mechanism. The value of these efficiencies should be estimated and used as the basis for costing.

A notable inclusion in the reference model is the cost of any capital, which should be made up of the proposed debt and equity structuring of the project. The cost of capital must be justified by historical data and an analysis of project risk as perceived by potential funders. The treatment of the residual value of the assets must be shown in the costing.

e) Construct the reference model and explain all assumptions and indicators

The reference model must be presented as a discounted cash-flow model, as with the PSC model. As far as possible the reference model must rely on the same assumptions as the PSC model, including the inflation and discount rates, which are particularly important to achieve a proper comparison between the two procurement choices. The treatment of tax, VAT, depreciation, residual value and any other assumptions must be explained in detail.

A detailed commentary on the model is required. It must explain the construction of the model and its key indicators, including the net present cost. Key indicators will include the debt/equity ratio, debt service cover ratio, liquidity, key sensitivities to inflation, project term and tax.

3.6.6 Affordability

The budget for the project has been identified at various stages prior to this. At this stage, it must be scrutinised in detail and confirmed to demonstrate project affordability.

This involves checking the available budgets and ensuring that all the applicable available amounts, namely direct and indirect costs, and any third-party revenues, have been included. Confirmation should also be made that the costs of managing a service delivery agreement have been accounted for in the relevant budgets. Most service delivery projects, particularly those involving private capital investment, will extend beyond the three years of the MTEF. It will therefore be necessary for WSAs to extrapolate their budgets beyond the MTEF to make meaningful comparisons with the cost of the service delivery project. As a rule of thumb, it is prudent to assume that budgets remain constant in real terms (increasing only in line with inflation) over the term of the project. Any different assumptions should be well argued and backed with documentation.

Each service delivery option model should be compared with the available WSA budget. If affordability cannot be demonstrated in any of the options, the WSA will be obliged to:

- Re-examine and modify the output specifications to bring them within the affordability constraint (any adjustments to output specifications must be reflected in all the financial models, to maintain comparability); or
- Re-examine the revenue potential and determine if there are opportunities to increase the income for the service; or
- Abandon the investigation of this particular option.

The key to affordability will be the level of tariffs that would have to be charged and the financial benefit relative to the other costs to be borne by the WSA as determined in the financial models. The tariffs and costs of the likely solution(s) should be compared to those of the PSC and the WSA should decide on the affordability of the likely tariffs and costs.

Take note

When assessing the financial benefit to the WSA it is necessary to ensure that all costs associated with the project have been taken into account. For example, the provision of water services may be dependent on the municipality subsidising the cost of free basic water and the provision of services to poor families. The municipality must ensure that it has budgeted for these subsidies.

If affordability cannot be demonstrated, the WSA will be obliged either to re-examine and modify the output specifications within the affordability constraint, or to abandon the project.

For example, if the output specification is for the provision of waterborne sewage to all households and the model reveals that the cost of this is not affordable to many households or that it is beyond the WSA's affordability level, the output specification might be modified to coverage only in the dense urban areas. Any adjustments to output specifications must be reflected in adjustments to both the PSC model and the new service model, to maintain comparability.

3.6.7 Initial value-for-money test

The value-for-money test is only conducted in the procurement phase when external party bids are submitted. WSAs are required to give an initial indication of the likely value-for-money indicators. The PSC model will also provide the critical benchmark for evaluating any external bids during the procurement phase.

The first step in this test is to check the models by asking these questions:

- Do the models (both PSC and new delivery) reflect the requirements of the output specifications?
- Have all capital costs, operating and maintenance costs required to deliver the service according to the output specifications been included?
- Have all BEE targets been costed?
- Have all material and quantifiable risks been identified and accurately valued?
- Have all risks been summarised in the risk matrix, including their consequences, financial impacts and proposed mitigation strategies? Have all risks been appropriately assigned to the party best able to manage them?
- Has a sensitivity analysis been conducted on the key assumptions?
- Are all assumptions used reasonable and appropriate?

Value for money is considered at this stage by comparing the risk-adjusted PSC model to the risk-adjusted service delivery options models on a NPV basis. The items to be factored into this analysis include:

- Legal, financial, technical, commercial, socioeconomic, institutional effects of the option
- Costs
- Assumptions for model (inflation, interest rate, tax, VAT, depreciation, budget and MTEF)
- Funding options
- Any contributions by government.

After applying the above adjustments, the WSA can compare the PSC and the various service delivery options models in terms of NPV. The use of **an NPV calculation** in determining the cost of a project is based on the premise that a rand received today is more valuable than a rand received at some future date. The timing of cash flows in the service delivery option model and the PSC model are often quite different, and therefore difficult to compare without adjusting for the time value of money. By taking into account the time value of money, the discounted cash flow allows the service delivery proposals to be compared to each other and to the PSC model in the procurement phase. Clearly, to compare the models, it is necessary to apply the same discount rate. The extent to which a rand today is worth more than a rand in future is determined by the discount rate used in calculating the NPV. (The use of a discount rate is discussed in Module 4 of the Guidelines).

Dealing with the value of new assets at the end of a contract

The treatment of residual value of assets created during the project (e.g., new pipelines, reservoirs or treatment works) should also be considered as part of this comparison. Where the service delivery option does not pass residual value risk to the private party, an asset simply returns to the WSA for zero or nominal consideration at the end of the contract. The private party must, therefore, earn a return on its initial investment through the service charges payable during the term of the contract. The WSA, however, is left with an asset with a remaining useful economic life, and theoretically there should be a deduction from the NPV to reflect the lower true net cost of the services provided under the contract. Where such a deduction is made from the cost of the service delivery option an equivalent deduction should be made from the PSC model. In each case the market value of the asset is the appropriate figure. As there is unlikely to be a material difference between these two estimates it is usually legitimate to exclude the residual value on the grounds that it will not affect the comparison.

The key point is to achieve consistency of approach, namely, either include a deduction for residual value in both calculations or exclude it in both calculations. Where the service delivery contract does involve residual risk being passed to the private party the WSA will usually have the option to pay an amount equal to market value at the end of the contract to retain the asset, or to pay nothing and leave the asset with the private party. In this case, no residual value deduction is needed from the NPV of the service payments to calculate the NPV of the services under the PPP. However, for the PSC model calculation, an assumption would have to be made regarding the deduction needed to avoid overstating the cost of services.

3.6.8 Qualitative factors in assessing value

In addition to the financial matters, each of the options should be analysed in terms of the service delivery objectives. Practical matters such as protecting the rights of existing staff, maintaining or improving levels of customer service and customer care and protecting the assets used to supply the service must be factored into this comparison.

This is a subjective assessment but is critical to ensure that the correct decision is made. A financial model is only one of the tools to be used in decision making and the selected option must be practical and acceptable to both the political and community structures of the WSA.

The other factors which have to be considered at this stage include:

- **Quality** of service delivery that can be achieved
- **Dealing** with backlogs and the provision of an improved service in the shortest possible time
- **Benefits** to the area in respect of job creation, BEE and SMME development
- **Economic benefit** flowing to the area from the service delivery method
- **Provision** of the necessary skills and expertise required to ensure the required standards of service delivery

- **Potential** to train, develop and grow the existing workforce
- **Advantages** of outsourcing selected elements of the service to increase revenue and protect councillors and officials from the negative aspects of generating
- **Extent** to which this outsourcing could free up municipal resources to focus on other critical areas of service delivery and economic development.

It is also necessary to consider the effect on the municipality as a whole. This would include ensuring that the municipality has a balanced income base and that it has not been using water and sanitation to subsidise other services or that water and sanitation has been subsidised by other services. In the latter case, arrangements would have to be made for such cross-subsidisation to continue, at least until such time as the service could be made financially sustainable on its own. A similar approach would have to be applied to operating costs, where care should be taken that any portions of a support service left with the municipality has a sufficient scale to support its continued operation. A possibility if the scale is too small is for the support service to be consolidated with the new service delivery and for services to be sold back to the municipality.

3.6.9 Best fit to output specification

Having completed the various assessments, the best external mechanism must now be selected. This selected external option must be compared with the internal option. This will be done by comparing the affordability, value for money and qualitative factors as determined above and by also checking to see which of the options create the best fit with the defined output specifications.

This comparison should be in the form of a short report that can be presented to the council that compares the internal and external options, possibly using a similar decision matrix to that used when examining the internal options only. The report should provide sufficient relevant information to allow the council to make an informed decision on the preferred delivery option. Experience has shown that it is preferable for the project team (officials and external advisers) to carefully workshop the findings and recommendations with key officials (the municipal manager, director of technical services, director of finance and director of corporate services) and councillors (the mayor, MMC technical services, MMC finance) before the council meetings to ensure a full level of understanding is achieved.

3.7 Procurement Plan

A procurement plan demonstrates that the municipality has the necessary capacity and budget to undertake the procurement of the external option.

A procurement plan must contain at least the following:

- A project timetable for the key milestones and all approvals which will be required to take the project from TVR I to TVR III
- Confirmation that sufficient funds in the municipality's budget are available to take the project to TVR III and into contract implementation
- A list of any potential challenges to the project and a discussion on how these will be addressed by the project team and adviser
- The best procurement practice and procedures suited to the project type and structure
- The governance processes to be used by the municipality in its management of the procurement, especially regarding decision-making
- The project stakeholders and the extent of their involvement in the external option
- The project team with assigned functions
- Categories of information to be made available to bidders and how such information will be developed
- A list of required approvals from within and outside the municipality
- A Gantt chart of the procurement process, including all approvals and work items necessary for obtaining these approvals (for procurement documentation as well as, for example, the land acquisitions and environmental studies to be procured by the municipality)
- Contingency plans for dealing with deviations from the timetable and budgets
- The bid evaluation process and teams
- An appropriate quality assurance process for procurement documentation
- The means of establishing and maintaining an appropriate audit trail for the procurement
- Appropriate security and confidentiality systems, including confidentiality agreements, anti-corruption mechanisms, and conflict of interest forms to be signed by all project team members.

4. FEASIBILITY STUDY REPORT

The feasibility study and recommendations as required by national departments must now be prepared and submitted. This study will include all the information that supports the recommended delivery process and determines the form of contract that will be used.

4.1 Public notification

The draft feasibility study and procurement process must be open for public comment for 30 days. The notice advising of the comment period must be provided to staff representatives. Comments that are received within the 30 day period must be considered and the feasibility study and procurement process must be adjusted accordingly.

4.2 Obtaining views and recommendations of departments

The adjusted feasibility study report must be presented to the appropriate national and provincial government departments for their views and recommendations. The municipality must consider their comments and adjust the feasibility study and procurement process accordingly.

4.3 Report to council

The final proposals and implementation plan, together with copies of all comments received during the public and government comment periods, must be submitted to the council for its final decision. Details on the foregoing may be found in Module 4 of the Guidelines.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

FEASIBILITY STUDY TOOLKIT: SOLID WASTE MANAGEMENT

NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES
FEASIBILITY STUDY TOOLKIT:
SOLID WASTE MANAGEMENT

ABOUT THIS TOOLKIT

The Feasibility Study Toolkit: Solid Waste Management is an appendix to the Municipal Service Delivery and PPP Guidelines. It deals with some aspects of the feasibility study for a solid waste management partnership:

- Stage 1: Needs analysis
- Stage 2: Technical options analysis
- Stage 3: Service delivery options analysis
- Stage 6: Value assessment.

The full process and procedures for considering any municipal service partnership are set out in the Guidelines. These processes and procedures must be followed carefully. Use the toolkit for the specific complementary information it provides.

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ACRONYMS

CBO	community based organisation
DEAT	Department of Environmental Affairs and Tourism
DPLG	Department of Provincial and Local Government
EIA	environmental impact assessment
HDPE	high density polyethylene
IDP	integrated development plan
IAP	interested and affected person
IWMP	integrated waste management plan
MFMA	Municipal Finance Management Act
MIG	municipal infrastructure grant
MSA	Municipal Systems Act
NWMS	national waste management strategy
PET	polyethylene terephthalate
REL	rear end loader
SMME	small, medium and micro enterprises

INTRODUCTION

A complicated service

Solid waste management is one of the most complicated services that a municipality provides. It is dramatically different from other municipal services, such as delivering water and electricity.

“Solid waste” means waste of a solid nature generated by a person, business or industry.

Delivering water and electricity mainly requires a passive system of pipelines and wires, and the municipality controls the flow of the service to the customer. The municipality can meter the flow and interrupt the service if payment is not made. But collecting and disposing of solid waste requires an active system, which relies heavily on mobile equipment and labour. It is not just one material or service, but includes numerous materials and activities. Waste is generated by the customer, who must play an active role in ensuring that it is disposed of properly. The service is very difficult to meter, and interrupting it for any reason, including non-payment, will lead to public health and environmental problems.

The environment and human health

Failure to properly manage solid waste can result in significant environmental and health impacts. Piles of uncollected or illegally dumped waste are breeding grounds for many infectious diseases. Children are often attracted to waste, scavenging for reusable materials and food. Animals, including rats, and flies and mosquitoes are also attracted to waste. Their contact with the waste and each other spreads the diseases.

“Scavenging” means the unauthorised separation of solid waste for recyclable materials and food for human consumption.

Uncollected or illegally dumped waste will also harm the environment. People often set piles of waste on fire, which pollutes the air. Waste oil and other liquids can pollute water, both underground and on the surface. And plastic bags, which we see everywhere, are unattractive to look at.

While households and others are primarily responsible for managing their own waste, there must also be an efficient, comprehensive government programme for collection and disposal to make sure that environmental and health impacts are kept within manageable limits.

Municipal service or municipal support activity?

Different legislation will apply, depending on the type of activity a municipality is assessing for service delivery options.

“Municipal service” means a service that a municipality in terms of its powers and functions provides or may provide to or for the benefit of the local community irrespective of whether: (a) such service is provided by the municipality through an internal mechanism or by engaging an external mechanism and (b) fees, charges or tariffs are levied in respect of such service or not.

The following solid waste management activities are municipal services:

- cleansing: street cleaning
- refuse removal
- refuse dumps
- solid waste disposal.

If the activity is a municipal service, the municipality must follow the provisions of the Municipal Services Act (MSA) Chapter 8. If after completion of MSA Chapter 78 (1), the municipality elects to explore external options involving a private party, the provisions of the Municipal Finance Management Act (MFMA) Section 120 also apply.

“Municipal support activity” means an activity that is reasonably necessary for or incidental to the effective performance of a municipal function and exercise of its powers that does not constitute a municipal service.

There are many solid waste management activities performed by municipalities that are not defined as municipal services as they are not provided to or on behalf of the local community, nor are they listed in Schedule 4B or Schedule 5B of the Constitution. Most of these activities are cost saving measures that reduce the overall cost of waste collection and disposal or reduce the environmental impacts of waste management, including the following:

The following solid waste management activities are municipal support activities:

- recycling
- waste minimisation
- composting
- green and garden waste
- waste processing
- methane gas recovery.

“Recycling” means the sorting, processing, and transportation of solid waste materials, products or containers for the purpose of remanufacture or reuse.

“Sorting” means the authorised separation of solid waste materials for the purpose of recycling or disposal, either at the source of generation or at a solid waste management facility.

“Landfill gas” means the gaseous byproduct of organic decomposition of landfilled waste. Landfill gas contains significant concentrations of methane gas which is explosive at concentrations exceeding 5%.

If the function is a municipal support activity, MSA Chapter 8 does not apply, and MFMA Section 120 applies only if the external option is a PPP. If not a PPP, the municipal support activity may be procured as a municipal good or service, following standard supply chain procedures.

Waste management activities a municipality should not provide

There are some solid waste management activities which are not municipal responsibilities, including the handling, treatment and disposal of hazardous waste, medical waste, and radioactive waste. Municipalities should not provide these services because they are highly technical and the performance risks are high. Handling, treating and disposing of these wastes are the responsibility of the generators of those wastes and these activities are regulated by the national Department of Environmental Affairs and Tourism (DEAT). Municipalities should, however, play an active role in assisting DEAT to enforce national regulations and guidelines about these wastes.

“Treatment” means any method, technique or process that is designed to change the physical, biological, or chemical character or composition of a waste, or to remove, separate, concentrate or recover a hazardous or toxic component of a waste, or to destroy or reduce the toxicity of the waste in order to minimise the impact of the waste on the environment.

“Hazardous waste” means any waste which by reason of chemical reactivity, or toxic, explosive, corrosive or other characteristics causes danger or is likely to cause danger to human health or the environment, whether alone or in combination with other wastes. Hazardous waste is categorised in four hazard ratings with 1 being the most hazardous and 4 being the least hazardous.

“Medical waste” means any infectious or potentially infectious waste generated by hospitals, clinics, nursing homes, doctors’ offices, medical laboratories, research facilities and veterinarians.

Development and strategic planning

Every municipality is required to complete an integrated development plan (IDP) and an integrated waste management plan (IWMP) in accordance with the national waste management strategy (NWMS).

The NWMS includes the following strategic objectives:

- Implement general waste collection services in unserved and poorly serviced areas.
- Promote waste separation at source.
- Develop recovery centres following separation at source.
- Minimise the environmental impacts of waste disposal facilities and litter.
- Ensure that sufficient waste disposal sites are planned, permitted and developed.
- Develop and implement a waste information system.
- Capacitate people and create job opportunities.

An IWMP uses the strategic objectives of the NWMS to measure the municipality's service delivery performance and establish an implementation plan for eliminating these gaps. The gap may be an existing activity which is not meeting minimum standards, or a new activity to extend services to a new service area. The IWMP may also identify gaps in meeting some of the non-mandatory environmental goals, which may not involve a basic service, but are included within the NWMS. The implementation plan must prioritise the service delivery gaps and present recommendations. In general, gaps in meeting basic municipal services should carry a higher priority than those meeting functions which are not basic services or non-mandatory environmental objectives.

MSA trigger mechanisms

In addition to being defined by an IDP or IWMP some solid waste management activities which are municipal services must undergo an MSA 78 (1) review if the service meets one of the trigger mechanisms defined in MSA 77.

FEASIBILITY STUDY

Notify/consult stakeholders

After the municipality has notified government of its intent to consider a municipal service partnership, National Treasury will determine the need for a transaction advisor and other aspects of the feasibility study.

One of the more important aspects that National Treasury will determine is the depth of the stakeholder consultation plan. If the proposed activity is a municipal service involving significant financial, labour or environmental issues, a register of interested and affected persons (IAPs) may be required. Procedures for registering as an IAP will be included in the public notification. National Treasury and the provincial Treasury, the Department of Provincial and Local Government (DPLG), and any related national department will be on the register of IAPs. The IAP register will be used for all subsequent notifications and for the implementation of all elements of the stakeholder consultation plan.

If the feasibility study is for a landfill or other activity covered by the Minimum Requirements for Waste Disposal by Landfill or other regulated activity under DEAT, an IAP register will also be required for the DEAT permit process. The IAP register for this feasibility study should include the DEAT permit process IAP register.

Stage 1: Needs analysis

If the municipality has completed an IWMP, it will have done a needs analysis to identify gaps in solid waste service provision, but this information may be too general for the feasibility study for a municipal service partnership.

Delivering effective solid waste management services requires an integrated approach, as most aspects of solid waste management are related to each other. The needs analysis must thus include all related activities. For example, a needs analysis for recycling must also assess waste generation and collection to determine the amounts of material available for recycling. And since recycling is a means of reducing disposal costs, the landfill and waste processing resources of the municipality must also be assessed to determine both current and future avoided costs.

A comprehensive needs analysis for waste management assesses:

- technical components of service delivery
- budget
- regulation and enforcement
- non-technical needs
- output specification.

Technical components of service delivery

- generation
- collection and transport
- minimisation and recycling
- treatment
- disposal.

Generation

How much waste is generated?

The estimate of how much waste is generated is usually based on population figures multiplied by a generation coefficient measured in kilograms per person per day. Waste generation coefficients will be much lower in poor, densely populated areas and higher in more affluent areas.

Table 1: Typical waste generation coefficients in South African cities

Socioeconomic level	Generation coefficient (kg/person/day)
Very high	2.1 to 2.5
High	1.6 to 2.5
Middle	0.5 to 1.1
Low/poor	0.5 to 0.6
Informal/very poor	0.2 to 0.4

Waste generation coefficients based on research are readily available in engineering reference documents.

What is the waste made up of?

Depending on the activity being assessed, the waste generation assessment should also include an analysis of the composition of the waste. For example: a recycling project will need an accurate estimate of the amount of recyclable material in the waste being generated; a waste incinerator or composting facility will need a very precise determination of waste composition, since the products will be the key economic factor in its success.

“Incineration” means the controlled combustion of solid waste employing closed combustion chambers, controlled combustion air, temperature monitoring and control to ensure complete combustion of organic matter with a minimum of undesirable air emissions and wastewater discharges.

The impact of informal recycling

In 2001 Pikitup did a detailed waste composition study to determine the amount of plastic in its waste for a proposed PPP recycling project. The study found that due to informal recycling there was not enough plastic in the waste to justify the project.

Waste composition will also be different in different income groups. Waste generated by low income, high density residential areas usually contains very few recyclable materials.

Table 2: Percentage waste composition for various income groups in Cape Town

Waste component	Low income	Middle income	High income
Paper	17%	23%	12%
Plastics	29%	23%	17%
Glass	6%	5%	8%
Metal	8%	6%	4%
Textiles	12%	6%	3%
Kitchen waste	8%	9%	5%
Garden waste	5%	16%	34%
Fines/residue	13%	12%	8%

The implications for recycling

It is very important to consider both generation and composition when designing a waste management programme. For instance, Table 2 might indicate a lot of plastics in the low income group (29% of waste generated), but that income group generates only 0.5 kg/person/day. A middle income neighbourhood

which generates a lower percentage of plastics (23%) but a higher amount of overall waste (2.5 kg/person/day), generates nearly five times the amount of plastics that the low income area generates. This indicates that a waste recycling project would not be cost effective in a low income area.

Collection and transport

Collection is the most visible waste management activity in any municipality and is usually identified in most IWMPs as being deficient in one or more areas. It is also the most costly component of any waste management service, comprising up to between 70% and 90% of total waste management costs.

There are different reasons for service delivery gaps in waste collection and transport, but usually they result from a lack of resources. Solid waste management is often well below water and sanitation as a budget priority, and waste departments must make do with old and poorly maintained equipment. The requirements of organised labour can also be a constraint. For example, limiting operations to a single shift per day prevents equipment and facilities from being fully optimised.

What are the current service levels and where are service levels below local standards?

Informal and formal township areas are often given a lower level of service than middle and high income neighbourhoods. In many townships it is difficult if not impossible to provide an adequate service because vehicle access is difficult. Communal skips at convenient locations in the township is often the kind of service that it is possible to provide. A slightly higher level of service is providing 85 litre plastic bags to households and collecting them from a communal area. However, communal areas for waste collection often become uncontrolled dumping areas if they are not serviced and maintained regularly. Middle and high income neighbourhoods are typically better serviced with 240 litre wheely bins provided to each household.

“Domestic waste” means waste emanating typically from homes and offices. Although classified as general waste, this waste contains organic substances and small amounts of hazardous substances.

Government’s free basic service policy has been relatively well defined for water and sanitation, but due to the nature of the service there is no defined level of free basic service for solid waste. Many municipalities have established lower levels of service in their township areas and define these as a basic service, and thus they do not charge the township residents a service fee. Theoretically,

middle and high income areas pay higher fees to subsidise the free basic services to the township areas.

What is the status of collection vehicles and how can this be improved?

The poor status of waste collection vehicles is often the cause of below standard waste collection. Vehicles must be maintained and replaced at the recommended intervals to maintain their availability.

Which type of collection vehicle is appropriate?

Although the rear end loader (REL) compactor truck is the most commonly used waste collection vehicle, there are many others. The type and size of the appropriate vehicle will depend on:

- size of the community
- levels of service
- types of storage containers (bags or bins)
- street patterns
- distance to the landfill.

The needs analysis for waste collection should include:

- levels of services
- storage containers
- litter and street cleansing
- vehicle inventory (age, condition)
- equipment maintenance
- ability and willingness to pay for services
- private sector resources
- informal sector resources.

Determine the location, design and operation of transfer stations

With increased environmental awareness, there is a trend towards larger regional waste disposal facilities located in sparsely populated areas. But it is generally not cost effective for collection vehicles to drive long distances, so a transfer station is used to transport waste from the collection vehicles to the landfill.

“Transfer station” means a facility that receives solid waste from collection vehicles and reloads that waste into larger vehicles for transfer to a disposal or processing facility.

The needs analysis for the transfer station should include:

- waste volume and composition
- collection methods
- distance to the landfill
- highway access
- access to rail.

Will rail transport be cost effective?

In the past 10 years there has been a lot of emphasis on transferring waste by rail. Although technically sound, waste-by-rail is usually only cost effective over long distances. Truck transport is more cost effective for short and medium hauls. Waste-by-rail requires a much higher capital investment in loading and compaction equipment at the transfer station and offloading equipment at the landfill. This is somewhat offset by lower operating costs. But the balance between high capital investment and low operating costs only becomes cost effective for long distance hauls.

Using CBO and SMME contractors

Most municipalities have goals and objectives for local employment through community based organisation (CBO) and small, medium and micro enterprise (SMME) contractors. Some aspects of waste management provide opportunities for this. For example, waste collection and street sweeping in township areas can be difficult for large compaction trucks and mechanical sweepers because of socioeconomic conditions and physical constraints, presenting opportunities for employing small local contractors. However, these arrangements are vulnerable to many technical, financial and social problems, and often poorly planned and implemented, and there are many examples of CBO and SMME systems which have failed. But there are also many successful systems, and skilled, competent CBO and SMME contractors are emerging and developing in response to the demand.

There is no one formula. Every potential CBO or SMME system must be evaluated and designed individually. The more successful systems usually use an intermediary contractor between the municipality and the CBO or SMME contractor, who provides technical, financial and management skills and training. This system is also designed to filter out political interests and favouritism.

Minimisation and recycling

The NWMS lists recycling as a national goal and objective. At present, this is a voluntary objective and seldom mentioned in IWMPs as a strategic, high priority objective.

What are the local environmental impacts?

Waste minimisation and recycling are municipal support activities not municipal services, so gaps in public health, safety or the environment are not what would justify these activities. The needs analysis for waste minimisation and recycling should be looking at local environmental impacts. However, while waste minimisation and recycling have identifiable positive global environmental impacts, the local impacts are sometimes less significant. Apply the slogan “think globally, act locally” to any needs analysis for waste minimisation and recycling.

What are the avoided costs?

There are many groups and organisations in South Africa calling for very high goals for waste minimisation and recycling.

In 2001 at the National Waste Management Summit in Polokwane, the participants adopted a resolution calling for zero waste to landfills by the year 2022 and a 50% reduction in waste to landfills for 2012. Although these goals are admirable, they are not attainable. Worldwide experience indicates a 40% to 50% reduction goal is more realistic.

For a municipality, waste minimisation and recycling must be assessed on an avoided cost basis. If a municipality has very high landfill and transport costs, waste minimisation can reduce disposal and transport costs, but this depends on many variables, including the market price of the materials being recycled. Materials with relatively high, stable market prices cost less to recycle than it would to transport and dispose of them (the avoided costs). Unfortunately, there is only a market for 20% to 30% of the waste stream at present, and the costs of programmes to minimise waste above this percentage will far exceed landfill costs. The avoided costs must be assessed in Stage 6: Value assessment.

The needs analysis for waste minimisation and recycling should include:

- waste generation and composition
- collection and transport systems
- existing recycling activities, both formal and informal
- materials market analysis
- landfill avoided costs.

Assess informal recycling activities

There is informal recycling in most communities. In some communities, such as Johannesburg, informal recycling is encouraged by buy-back centres sponsored directly by the municipality and the end markets. Although these centres eliminate

middle men and improve the markets for some materials, their overall impacts are limited and can be detrimental to a more comprehensive recycling programme with higher removal goals. Informal workers are limited in what they can collect and usually remove only the high value materials such as cardboard, office paper and metal. Many people refer to this as cherry picking. In a comprehensive waste minimisation programme, the higher value materials are needed to offset the lower value materials such as plastics or glass. By allowing or promoting informal recycling, a municipality may compromise a more comprehensive waste minimisation programme with higher removal goals.

Treatment

Even after recycling, there are treatment methods that can further reduce the volume of waste that needs to be disposed of in the landfills that most municipalities use.

Composting

The most popular treatment method in South Africa is composting, which is the logical next step in a comprehensive waste minimisation programme. Although there are some food waste composting facilities in the country, most of the successful facilities are composting only garden and green waste. Composting garden and green waste is easier to control and produces a cleaner more uniform product with fewer contaminants, and the final product can be certified as organic compost. Compost derived from general mixed waste is more difficult to control, and the product is often contaminated and can only be marketed for landscape applications.

In many cities green and garden waste can comprise as much as one third of the total waste. This is especially true in areas with high and moderate rainfall. The main challenge in composting is collecting, pre-processing and transporting the bulky material to centrally located processing facilities.

The City of Cape Town has established a goal of zero green waste to landfill. They have implemented a system of privately operated local drop-off centres where green and garden waste is collected and chipped, and then transported to a central composting facility. The system saves approximately 560,000m³ in landfill airspace per year.

Green and garden waste collection and processing is most effective when combined with bylaws prohibiting this waste to be mixed or disposed of with normal household waste.

Other waste treatment options

Although incineration, gasification, fermentation and other emerging technologies are often seen as disposal technologies, they all still produce a residue that must be landfilled. For instance, incineration can reduce the waste volume by 90%, but the remaining ash must still be landfilled. The residues are often more problematic than the original waste and more costly to dispose of. The technologies are usually promoted by the manufacturer of the technology, and municipalities must be very careful when they evaluate the need for such technologies. They are all very expensive and seldom meet the risk adjusted value-for-money test.

Landfills in South Africa are still reasonably low cost and environmentally acceptable. With the exception of composting, municipalities should only consider additional treatment options if they are proven to be less expensive than landfilling.

Disposal

Even with the most comprehensive waste minimisation and treatment programmes, there will always be some waste left to dispose of. South Africa still has enough land available in favourable geology for the location and operation of sanitary landfills, and landfills will continue to be the most cost effective disposal option here for the foreseeable future. The location, operation and closure of solid waste landfills is regulated by DEAT through a permitting process.

Evaluate existing landfills

The needs analysis must evaluate each existing municipal landfill according to DEAT regulations and its operating permit, and should include, for each landfill:

- permit status
- site classification
- waste quantities(tonnes/day, m³/month, tonnes/month)
- location, size, buffer zones
- resources (plant and personnel)
- remaining life (airspace)
- access (signage, fencing, controls)
- waste deposition (operation, cover)
- drainage and erosion
- aesthetics and nuisances (dust, odours, litter, visibility)
- health and safety
- monitoring and record keeping
- operating costs (R/month, R/tonne)
- site specific issues.

The needs analysis for a new landfill is very different from that for an existing landfill and will have been covered in the IWMP.

“Special waste” means non-hazardous waste which requires special or separate handling at a landfill. Special wastes include but are not limited to tyres, asbestos, demolition waste, non-hazardous industrial sludges, paper mill sludge, olive oil waste, abattoir wastes and petroleum waste oil.

Experience has shown that landfills operated by the private sector are more efficient and meet higher environmental standards than those operated by the public sector. This is partly because landfill operations are so specialised. But the main reason is accountability. It is often difficult to hold the public sector accountable for its performance, but the private sector must meet its performance indicators or face penalties or non-payment under the contract.

Budget

The ability of a municipality to provide effective solid waste management services will ultimately depend on its ability to establish and collect fees to cover the costs of the services. This is often the biggest challenge in implementing waste management programmes. Municipalities often do not collect all that is owed to them and the fees do not come close to covering even operational costs. Waste management includes many services: from collection from individual households and businesses to street cleaning and litter removal. The issue of free basic services also complicates the funding of waste management.

Although the “polluter pays” principle should form the basis of funding any waste programme, in reality the funding must come from a variety of sources, including user fees, tariffs and government funding such as the municipal infrastructure grant (MIG) and the equitable share.

The needs analysis for the budget should include:

- ability and willingness to pay
- service levels, including free basic services
- cross subsidies between income groups
- business, institutional and household generation and service levels
- available grants and loans.
- punitive measures for non-payment.

Regulation and enforcement

Effective solid waste management programmes are seldom successful without a strong set of local bylaws. Containers, collection times, littering, informal recycling and landfill scavenging need to be controlled through bylaws and an effective enforcement policy. The needs analysis should address the current bylaws, if any, and make recommendations for revisions based on the alternatives presented.

Non-technical needs

The above discussion has concentrated mostly on the technical needs for providing solid waste services, but many municipalities have other non-technical needs to assess.

Job creation

One very obvious need in many municipalities is job creation in township areas. Although this will come into the options analysis as well, the municipality's job creation objectives must be defined and included in the needs analysis and output specification.

Education

Since every waste management programme begins with the generator of the waste, education is a key component. The cost and implementation of an effective education programme must be included in the needs analysis.

Aesthetics and the environment

Many communities also place importance on aesthetics and environmental issues when it comes to solid waste management, and this should be included in the needs analysis.

When Knysna, a Garden Route municipality that relies heavily on tourism, began looking at waste transfer options, they were concerned about the aesthetic and environmental impacts of truck traffic to and from the transfer station, located near the harbour. This concern, defined in the needs analysis, ultimately led to a waste-by-rail transfer system. It may not have been the best technical or lowest cost option, but it met the municipality's higher aesthetic and environmental impact needs.

Output specification

The needs analysis concludes with an output specification, which is a detailed description of the activity, its current deficiencies or gaps, and most importantly the desired performance levels to remove the deficiencies. The output

specification must give enough detail to fully define the problem so that options and costs can be determined in the next phases of the feasibility study.

The output specification must define performance (what needs to be done) but not methodology (how it will be done). In considering a partnership for delivering a municipal service, the private partner must understand the performance requirements but be given the flexibility to meet those requirements in the most efficient way.

Stage 2: Technical options analysis

What are the technical options?

A municipality's IWMP may already have defined the technical options for meeting the output specifications for many of the solid waste activities identified in the needs analysis. But solid waste activities are complex, and there are many technical options for nearly every activity. For instance, the technical options for waste collection can vary from donkey carts and wheelbarrows, to farm tractors and trailers, to the most modern compaction vehicles with capacities of 25m³ or more. These must all be assessed before recommendations can be made.

What are the technical variables?

The technical options may also include many technical variables.

Some of the technical variables in a recycling programme

- separation at source or at a sorting station?
- informal or formal systems?
- which materials?
- buy-back centres?
- drop-off facilities?
- collection vehicles?
- material specifications?

In addition, many recycling programmes include a considerable amount of volunteer labour through civic organisations and schools. The technical options analysis must take this into account as an operational risk, since the volunteer labour may not be sustainable in the long term.

The technical options analysis will be driven by the needs identified in each category of service delivery: generation, collection and transport, minimisation and recycling, treatment, and disposal.

The technical options analysis should:

- define each option
- present a preliminary cost estimate
- identify the environmental and financial risks.

The objective is to develop each technical option to the point where the municipal decision makers can make an informed decision about which options to pursue.

Legislation and regulations

In assessing technical options, the municipality must consider local, provincial and national legislation and regulations.

Landfills

Every landfill disposal and treatment facility must meet the conditions of the DEAT Minimum Requirements for Waste Disposal by Landfill. These comprehensive requirements cover every aspect of locating, designing, operating and closing a landfill, and must be incorporated into landfill performance specifications regardless of whether the landfill is publicly or privately operated.

Broader regulations

DEAT's 1997 and 1998 environmental impact assessment regulations cover a broad range of activities. These national regulations are administered by provincial DEAT offices. Due to the health and safety issues involved in almost any waste management activity, the provincial DEAT office must be contacted when the municipality notifies government of its intention to consider a municipal service partnership so that DEAT can determine if and when the activity requires an environmental impact assessment (EIA). Whether there is to be an EIA or not may have an impact on the assessment of the options. For instance collecting waste sorted into recyclable materials at source may not require an EIA, but sorting recyclable materials from mixed waste at a central facility probably would. The EIA can have both technical and financial impacts.

Stage 3: Service delivery options analysis

In the service delivery options analysis, the municipality assesses the options for delivering the service. Specifically the municipality must assess the capacity for and cost of delivering the service itself.

Section 76 of the MSA defines the various service delivery options.

Internal options include:

- the municipality
- a municipal department
- a business unit under the sole control of the municipality.

External options include:

- another municipality
- a municipal entity
- a national or provincial organ of state
- any private entity, institution or person.

Municipal service

If the service being assessed is an existing municipal service, under MSA Chapter 8 the municipality should give equal importance to internal and external options, but may assess them at the same time.

The assessment of internal options must consider:

- direct and indirect costs
- capacity to deliver
- all benefits of delivering the service internally.

The internal options must then be compared with the external options, presenting the advantages and disadvantages of both. This sequence of decisions is established in the MSA Section 78(1) to (3).

Municipal support activity

If the service is a municipal support activity, the municipality must still follow the requirements of MFMA Section 120 and may designate in its feasibility study resolution that only external service delivery options should be considered. The decision only to consider external options should be based on the capacity to perform the activity internally and the associated resources and risks. For

example, recovering methane gas from a completed landfill is a municipal support activity that is highly technical and involves considerable technical and financial risks, making it difficult for municipalities to undertake this activity internally.

A municipality can save transaction costs and time spent on the feasibility study by minimising the assessment of internal delivery options.

Human resources and organisational capacity

If the service involves an existing activity, both MSA and MFMA require an assessment of the impacts on existing resources, including staff, assets, liabilities and revenue.

Both the IWMP and the feasibility study's needs analysis should have prepared an inventory of the municipality's equipment and human resources. The service delivery options analysis should refer to the equipment inventory and determine the impacts each option will have. Each option should include a plan for equipment and other assets which will be made obsolete by that option, and a plan for addressing labour issues created by each option. The human resources plan must conform to the appropriate provisions of labour relations legislation and the stakeholder consultation plan.

Solid waste collection requires equipment and labour. Disposal and treatment may also impact on existing equipment and human resources, but these activities are not as labour intensive as collection activities.

Stage 6: Value assessment

Value assessment includes the basic cost categories of labour, operations and maintenance, capital, administrative and taxes. Also included is a discussion and guideline for adjusting an option's value based on its risks.

Reducing waste: What are the avoided costs?

When a technical option for a waste management activity reduces the amount of waste being landfilled, the value assessment of that option must include the savings in landfill costs, referred to as avoided costs. These are the costs that the municipality avoids when it recycles or in some other way reduces the amount of waste which needs to be transported and disposed of. Avoided costs are further broken down into current avoided costs and future avoided costs.

Current avoided costs

Current avoided costs are the reductions in the current waste transport and landfill costs due to the reduction in the amount of waste. Most current transport and landfill costs are fixed and will not change much with a reduction in the amount of waste. For instance, labour, equipment and administration costs will not be significantly reduced by a 10% or 20% reduction in the amount of waste. Depending on the method, waste reduction affects transport costs more than landfill costs. For instance, savings on fuel and labour will be significant if waste has to be transported over long distances.

Future avoided costs

The real value in recycling and other waste reduction projects is in the future avoided costs. These are the savings due to the reduction in the required landfill airspace. In very general terms, if a municipality with a 100 tonnes/day waste stream recycles 10% of that waste, they will save 10 tonnes of landfill airspace per day or 3,650 tonnes/year.

This gets a bit more complicated when the density of the waste material is taken into account. Landfill airspace is usually measured in cubic meters (volume), while waste collection and recycling is usually measured in tonnes (weight). To assess the future avoided costs of recycling a specific material we need to know how much airspace that material takes up if it is landfilled. This is the material's landfill density.

The Municipal Infrastructure Investment Unit (MIIU) sponsored a recycling study at the Highlands landfill in the Western Cape. The study measured the landfill density of the more common recyclable materials in order to determine their avoided costs. One dramatic example is polyethylene terephthalate (PET) bottles. Since these bottles do not compact well and many people dispose of them with the caps on, their landfill density was measured to be only 14kg/m³. That means that for each tonne of PET bottles recycled the municipality saves 71.4m³ of landfill airspace. At an estimated current landfill airspace cost of R50/m³, the avoided costs for each tonne of recycled PET bottles is R3,570. Landfill airspace will certainly cost more than R50/m³ in future, so future avoided costs will be even greater.

Future avoided costs will vary for each material depending on its landfill density.

Table 3: Typical future avoided costs for different materials

Recycled material	Landfill density (kg/m ³)	Landfill airspace saved	Future avoided landfill airspace costs (at R50/m ³ cost of landfill airspace)
Newspaper	212kg/m ³	4.7m ³ /tonne	R235
Plastic PET bottles	14kg/m ³	71.4m ³ /tonne	R3,575
Plastic HDPE bottles	19kg/m ³	52.6m ³ /tonne	R2,630
Metal beverage cans	228kg/m ³	4.4m ³ /tonne	R220

The table shows that materials with a low landfill density, such as PET and high density polyethylene (HDPE) bottles, are very cost effective to recycle. These materials have a high recycle value. Even only considering current avoided costs, the income exceeds the current costs of recycling. When future avoided costs are considered as well, the benefits of recycling these materials is overwhelmingly positive. The future avoided costs of materials with a higher landfill density, such as newspaper and metal beverage cans, are less significant, so the relative value of recycling these materials is lower.

Future avoided costs are long term savings. They are only realised when the life of the current landfill is extended or a new landfill can be made smaller or have a longer life. Municipal decision makers want to see cost savings and reduced budgets immediately, and since the current avoided costs of recycling and waste reduction programmes are low, decision makers tend to be reluctant to implement them. This is the biggest impediment to implementing recycling and waste processing programmes. When assessing a recycling or waste processing option, prioritise materials by their current avoided costs and their total avoided costs. This will give municipal decision makers a better picture of the options.

Risk

One of the clauses in the MFMA defines a PPP as the transfer of “substantial financial, technical and operational risks” to the private party. One of the more important aspects of the feasibility study is to define the operational and technical risks of the activity.

Operational risks

Waste collection and recycling activities are active systems and rely heavily on equipment and labour. The major risks in performing these activities will be operational. Operational risks are transferred to the private party through the tendering and contract documents, and specifically through penalty clauses and performance standards, secured in the form of a performance bond. The feasibility study assesses the operational risks and recommends performance standards to be used in the contract.

Technical risks

Other waste management activities will include significant technical risks. The design of a landfill or the operation of a methane gas recovery system, for example, will involve significant technical risks, which should be borne by the private party. The technical risks involved in an incinerator or any treatment facility should also be totally transferred to the private party.

Shared risks

The risk assessment should also identify the risks that should be shared. These typically include changes in the law, strikes, severe weather, or any activity beyond the reasonable control of the private party. Although a contract could transfer all these risks to the private party, the cost of the activity will then increase to reflect the private party's higher exposure to risk.

CONCLUSION

This toolkit highlights aspects of the feasibility study specifically for a possible municipal service partnership to deliver waste management activities. Please work through the full Municipal Service Delivery and PPP Guidelines when considering such a partnership.

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

**TOOLKIT: MUNICIPAL PPPs FOR PRIVATE
SECTOR COMMERCIAL USE OF MUNICIPAL
PROPERTY**

NATIONAL TREASURY AND
DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

TOOLKIT:

**MUNICIPAL PPPs FOR PRIVATE SECTOR
COMMERCIAL USE OF MUNICIPAL PROPERTY**

ABOUT THIS TOOLKIT

The Toolkit: Municipal PPPs for Private Sector Commercial Use of Municipal Property is an appendix to the Municipal Service Delivery and PPP Guidelines. It focuses on the following stages in the municipal PPP project cycle:

Inception

- Stage 1: First steps
- Stage 2: Procuring an adviser

Feasibility study

- Stage 1: Needs analysis
- Stage 5: Project due diligence
- Stage 6: Value assessment

Expressions of interest

PPP Procurement

- Stage 2: The request for proposals
- Stage 3: Choose the preferred bidder
- Stage 4: Negotiations.

The full processes and procedures for considering any municipal PPP are set out in the Guidelines. These processes and procedures must be followed carefully. Use the toolkit for the specific complementary information it provides.

The Municipal PPP Regulations issued in terms of the MFMA define “municipal property” as including any movable, immovable or intellectual property, owned by or under the control of – (a) the municipality; or (b) a municipal entity under the sole or shared control of the municipality. This toolkit does not apply to private sector use of movable or intellectual property.

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ACRONYMS

DPLG	Department of Provincial and Local Government
EIA	environmental impact assessment
EOI	expression of interest
ESTA	Extension of Security of Tenure Act
IDP	integrated development plan
LUMS	land use management system
MFMA	Municipal Finance Management Act
MSA	Municipal Systems Act
MSP	municipal services partnerships
NEMA	National Environmental Management Act
PIE	Prevention of Illegal Eviction from and Unlawful Occupation of Land Act
PSC	public sector comparator
RFP	request for proposals
RoD	record of decision
RLRA	Restitution of Land Rights Act
SDF	spatial development framework

INTRODUCTION

PPPs for private sector commercial use of municipal property are intended to facilitate the more efficient management of municipal property portfolios, measured largely in financial benefits. This PPP is a way to leverage public buildings and property to generate private investment and long term public revenues. For a municipality facing a drastic and ongoing shortage of public capital, this PPP is particularly attractive.

INCEPTION

Stage 1: First steps

If a municipality has complied with Section 63 of the MFMA, it will know what its assets are and have a system for managing and accounting for them.

Is the property required for providing a basic municipal service?

Having identified a municipal property that could be used by the private sector for its own commercial use and that requires private sector finance and skills for its development, first determine whether that property is required for providing a basic municipal service, in accordance with Section 14 of the MFMA read with Section 90.

If the property is not required for providing a basic municipal service, conduct a pre-feasibility study.

Pre-feasibility study

Municipal authority to enter into a PPP

Is the municipality empowered under the MFMA to conclude a PPP with a private party in terms of which the private party would use a municipal property for its own commercial use?

Legal issues around ownership of the property

Restrictions in the title deeds

Are there restrictions in the title deeds about how the property may be used? If so, how will the municipality deal with these restrictions?

- The municipality and the private party may agree to have a title deed restriction removed from a title deed.
- The municipality itself may begin the processes for amending the provisions of its town planning or zoning scheme or for amending or removing a restriction from a title deed.

Zoning is the allocation of different uses to different areas. Its purpose is to create and then maintain the specific character of an area.

- The municipality may apply to the courts for an order that a title deed restriction be amended or removed.

However, most title deed restrictions are in favour of the municipality, for example a restriction that gives a municipality the right of access to property to repair underground utilities. If the municipality is the beneficiary of the restriction, it can waive the benefit by agreeing to have it removed, with the consent of any other beneficiaries, such as Telkom or Eskom. A court application would be expedited.

Town planning

Do the provisions of the town planning legislation impose restrictions on the use of the property? Should a town planning report be done?

Zoning

What is the current zoning of the property? Will it have to be rezoned or subdivided to meet the requirements of the proposed PPP project?

Land claims

Land claims are governed by the Restitution of Land Rights Act (RLRA). The cut off date for lodging land claims was 31 December 1998. The processing of a claim may begin at any time. A title deed does not show whether or not there is a land claim on the property. The only way of finding out is to contact the Commissioner for the Restitution of Land Rights and get confirmation in writing. If there is a land claim, consider another property for the proposed PPP project.

Illegal occupants

If there are illegal occupants on the property, at the time of the pre-feasibility study or at any time before the private party takes possession of the property, follow the process set out in the Prevention of Illegal Eviction from and Unlawful Occupation of Land Act (PIE) and the Extension of Security of Tenure Act (ESTA) to evict the illegal occupants.

Environment

Identify the applicable environmental regulatory framework for the proposed PPP project, for example the Environment Conservation Act and pollution control duties under the National Environmental Management Act (NEMA). Consider whether the municipality should start the processes for getting an environmental impact assessment (EIA) and a record of decision (RoD) to expedite the proposed use of the property by a private party.

Heritage

Identify any heritage considerations in terms of the National Heritage Resources Act (NHRA).

Current use

Identify the current use of the property, if any, including whether it is used by the municipality or leased, whether there are any rights of use, for example servitudes, and whether there are any known hazards.

Utilities

Where are the nearest utilities, for example water, electricity and sewage?

Other regulatory provisions

Are there other regulatory provisions that may impact on the proposed PPP project and the private party's ability to deliver?

- municipal employee transfers or secondments to the private party
- the National Building Regulations
- empowerment obligations
- tax allowances accruing to the private party
- contingent liabilities
- disputes.

Revenues and socioeconomic impact

The pre-feasibility study should also identify:

- potential revenues that could be generated by the municipality
- the socioeconomic impact of the proposed PPP project.

The pre-feasibility study will inform certain aspects of the feasibility study, especially the highest and best possible use of the property.

Notify government

Having conducted the pre-feasibility study, notify National Treasury and the relevant provincial treasury about the proposed PPP project. The Municipal Service Partnership Unit of the Department of Provincial and Local Government (DPLG) should also be notified.

Meet with National Treasury to discuss the proposed PPP project and what resources (human and budgetary) are already available, and to decide on the scope of the feasibility study and the appropriate manner of dealing with the

project. If National Treasury determines that the project is indeed a potential PPP for private sector commercial use of municipal property, National Treasury will:

- register the project with the Municipal Desk of National Treasury's PPP Unit
- appoint a PPP Unit internal project adviser
- determine whether the municipality must retain an adviser.

Stage 2: Procuring an adviser

If a adviser is to be retained, the municipality may apply for partial funding for the adviser from the Project Development Facility.

National Treasury will also assist the municipality to draw up the terms of reference for the adviser.

Take note

The terms of reference should include conducting a request for expressions of interest (EOI). The EOI process is described below, after Stage 6: Value assessment.

Once the terms of reference for the appointment of the adviser have been issued, National Treasury will assist the municipality in procuring the adviser. National Treasury will coordinate communications between the relevant provincial treasury and the DPLG about registering the proposed PPP project.

FEASIBILITY STUDY

The adviser will assist the municipality to conduct a feasibility study.

The legislation

Section 120(4) of the MFMA states that:

- (4) Before a public-private partnership is concluded, the municipality must conduct a feasibility study that-
- (a) explains the strategic and operational benefits of the public-private partnership for the municipality in terms of its objectives;
 - (b) describes in specific terms-
 - (i) the nature of the private party's role in the public-private partnership;
 - (ii) the extent to which this role, both legally and by nature, can be performed by a private party; and
 - (iii) how the proposed agreement will-
 - (aa) provide value-for-money to the municipality;
 - (bb) be affordable for the municipality;
 - (cc) transfer appropriate technical, operational and financial risks to the private party; and
 - (dd) impact on the municipality's revenue flows and its current and future budgets;
 - (c) takes into account all relevant information; and
 - (d) explains the capacity of the municipality to effectively monitor, manage and enforce the agreement.

The following legislation, regulations, and guidelines must all be taken into consideration when conducting a feasibility study:

- Guidelines: Module 4, read with the MFMA
- Municipal PPP Regulations
- Municipal Supply Chain Management Regulations and National Treasury's 2005 Supply Chain Management: A Guide for Officers of Municipalities and Municipal Entities.

PPPs that involve the delivery of a “municipal service” are governed by both the MSA and the MFMA. PPPs involving the performance of a “municipal support activity” and “the use of state property by a private party for its own commercial purposes” are only governed by the MFMA. Thus for a municipal PPP for private sector commercial use of municipal property, there is no need to undertake an internal assessment as required by the MSA. There is also no requirement to do a full value assessment involving a value-for-money comparative assessment

between public sector procurement and a PPP delivering the same output specification. Neither a public sector comparator (PSC) model nor an external reference model is therefore required.

Why do a feasibility study?

The critical goal of the feasibility study is to find out whether the proposed PPP is in the best interests of a municipality: financially, legally and socioeconomically.

In a municipal PPP for private sector commercial use of municipal property the feasibility study is specifically required to:

- explain the strategic and operational benefits of the proposed PPP project for the municipality in terms of its strategic objectives and other government policies
- describe in specific terms the municipal property concerned, how this property has been used, if at all, before the registration of the proposed PPP project, and the ways that a private party may legally use the property
- demonstrate the financial obligations the proposed PPP project will impose on the municipality and the affordability of the PPP for the municipality
- set out the proposed allocation of financial, technical and operational risks between the municipality and the private party
- demonstrate the anticipated value-for-money to be achieved by the municipality through the proposed PPP project
- explain the capacity of the municipality to procure, implement, manage, enforce, monitor and report on the proposed PPP project.

Stage 1: Needs analysis

Strategic objectives

Ensure that the proposed PPP project complies with the municipality's strategic objectives as set out in its:

- integrated development plan (IDP), spatial development framework (SDF), and land use management system (LUMS)
- asset management plan.

Integrated development plan

Chapter 5 of the MSA requires municipalities to prepare an IDP. In the IDP a municipality will have set out, among others, its strategic objectives for its immovable assets, including land and fixed property.

In terms of Section 26(e) of the MSA, an IDP must reflect “a spatial development framework which must include the provision of basic guidelines for a land use management system for the municipality”. An SDF is thus one of the sectoral plans of an IDP. An SDF seeks to guide the way current and desirable land uses are spatially spread within a municipality in order to give effect to the strategic objectives of the IDP. The SDF identifies opportunities and makes recommendations on where and how future local urban development and conservation can happen - so PPP opportunities in relation to specific municipal properties should already have been identified.

A municipality gives practical effect to the SDF through its LUMS. The primary aim of the LUMS is to guide and manage the development and use of land according to the IDP and SDF.

Asset management plan

A PPP for the private sector commercial use of municipal property is also subject to Section 63 of the MFMA, which requires a municipality to manage its assets and liabilities.

Asset management entails guiding the acquisition, use, safeguarding and disposal of assets to make the most of their service delivery potential, and managing the risks and costs over the entire life of the assets.

There are two components to asset management:

- a register or inventory of assets that shows exactly what the municipality owns
- a plan that sets out what asset management should achieve, and how.

Budget

Draw up the total cost to the municipality of the procurement of the proposed PPP project. Identify costs already budgeted as well as any additional costs that may be incurred by the municipality.

Costs may include:

- additional resources to procure and manage the PPP
- providing infrastructure to the property, which may include utilities
- maintaining the infrastructure over the term of the PPP agreement
- zoning or town planning activities that may be required
- overseeing the property, in recognition of the fact that ownership of the property remains with a municipality over the term of the PPP agreement and afterwards:
 - over the term of the PPP agreement to ensure that the private party only conducts agreed upon activities
 - near the end of the PPP agreement to ensure that the property is returned to the municipality in the appropriate condition
- receiving and accounting for all payments by the private party to the municipality
- determining, assessing and collecting any penalties that may be imposed on the private party for breaches of the PPP agreement.

Institutional environment

Critically assess the current internal capacity and resources of the municipality to manage the PPP agreement.

Staff and skills levels

Assess the staff and skills levels to ensure that the outputs required from the proposed PPP project are optimally managed to the benefit of the municipality. Once the skills levels and gaps have been identified, assess the ability of the municipality to attract and retain additional qualified staff. Major factors here are salary scales and responsibility levels.

Additional resources to procure and manage the PPP

Set out the steps the municipality has taken to retain a transaction advisor and appoint an internal or external (technical) project officer.

Describe the project management team the municipality has put in place to procure the proposed PPP project, and the team it will put in place over the term of the PPP agreement to ensure that all requirements are met.

Include the cost of these resources in the budget.

Stakeholder analysis

Identify all stakeholders in the proposed PPP project. Describe the communications that have taken place to date and the planned stakeholder communications processes of both the private party and the municipality.

Output specification

The final step in the needs analysis is to describe the outputs of the proposed PPP project in relation to the requirements of the municipality. This will form the basis against which the various options will be assessed and against which the selected option will be tested. The output specification will also serve as the specification for the PPP agreement.

The pre-feasibility study and the responses to the expression of interest (EOI) should provide a preliminary indication of the activities the private party will undertake on the municipality's property.

BEE and social development

Discuss the BEE and social development targets of the proposed PPP project.

Project scope

Define the scope of the proposed PPP project, including the project area and the anticipated development responsibilities of both the municipality and the private party.

Refine the scope of the proposed PPP project. This will form the basis for the development of the request for proposals (RFP). The following sections discuss how the project team can refine the scope of the project.

Stage 5: Project due diligence

The pre-feasibility study will have investigated the municipality's authority under the MFMA to enter into a PPP and the legal issues around ownership of the property. A further thorough investigation must be conducted for this due diligence part of the feasibility study.

Stage 6: Value assessment

From a strategic point of view, the municipality needs to ensure that its property portfolio is being optimally used.

Optimal use is affected by:

- the value of the existing own property portfolio
- the value of additionally leased properties
- the asset management of the portfolio
- the cost of maintaining the portfolio.

The market value of land and buildings is a benchmark for assessing under-utilisation, over-utilisation, obsolete buildings, and highest and best use.

Valuation of the entire property

Undertake a valuation of the entire property, based on the anticipated use. Then the range of appropriate lease values can be determined, which may have significant value-for-money implications.

Highest and best use

The value of a property is directly related to the way it is used. The highest and best use of the property is the reasonably likely use that will produce the highest value. The highest and best use may or may not be the way the property is currently being used.

Analyse highest and best use in two ways:

- the property “as if vacant”
- the property “as if improved”.

For the property as if improved:

- If it is non-income producing, it is the use that should be made of the property to maximise value.
- If it is an investment property, it is the use that will maximise net operating income on a long term basis. If capital expenditure is needed to renovate or improve an income producing property, these costs must provide a sufficient rate of return to the municipality.

If the property is in an area zoned for commercial use, the highest and best use of the property as if vacant will likely be a commercial use. If, however, the market preference is for, say, residential use, then the highest and best use of the property as if improved would be for residential use. If market preference

conflicts with zoning, a private party will take into account whether there will be enough profit to justify the added legal costs, extended time frame, and potential neighbourhood opposition before obtaining a zoning change and developing the site.

As long as the value of the property as if improved is greater than its value as if vacant, the highest and best use is usually of the property as if improved. If the value of the property as if vacant exceeds the value of the property as if improved (including demolition costs), highest and best use will usually dictate that improvements be demolished.

Tests for highest and best use

- Is it legally allowable?
- Is it physically possible?
- Is it financially feasible and appropriately supportable from the market?
- Does it result in maximum profitability?
- Does it achieve high socioeconomic benefits for the municipality?

Is it legally allowable?

Only legal uses can be considered as potential highest and best uses. Uses that may thus be excluded, include: those that are not now and cannot be expected to be allowed by zoning, those forbidden by government regulations, and those prohibited by title deed restrictions.

Is it physically possible?

The proposed use must be physically possible given the size, shape, topography, and other characteristics of the site.

Is it financially feasible?

The proposed use of the property must generate enough revenue to justify the costs of improvements plus a profit for the private party. For an improved property with obvious remaining economic life, financial feasibility is less relevant. For an improved property with limited remaining economic life, financial feasibility becomes a question of the maximally profitable use of the site. If the value of the property as if vacant exceeds the value of the property as if improved, then redevelopment of the site becomes the maximally profitable use of the property. Continued use of the existing improvements that do not represent the highest net value of the site is considered to be financially unfeasible.

Is it maximally profitable?

The proposed highest and best use must generate the highest net return (profit) to the private party. A property that could potentially be developed for residential, commercial or industrial use might only have one of those as its highest and best use.

Does it achieve high socioeconomic benefits for the municipality?

The proposed highest and best use should not only improve the topography of the area but also contribute to increased employment and economic growth and to local community development generally.

Business model

Prepare a budget in a spreadsheet format, which contains the following elements:

- The best and worst case private party scenarios in terms of the total revenue to be generated by the private party's commercial activities on the municipal property over the term of the PPP agreement.
- The best and worst case municipality scenarios in terms of the total costs to be incurred by the municipality in procuring and managing the PPP over the term of the PPP agreement.
- A range of concession fee payment mechanism options to reflect total turnover and concession fees accruing to the municipality. These options should reflect the values of concession fees after the valuation of the entire property.
- The best and worst case BEE procurement scenarios.

The output of the business model should be the net present value of the total revenues and total costs over the term of the PPP, to provide a basis for the affordability assessment.

Demonstrate affordability

Determine, in light of the output of the business model above, whether a concession model is viable. In either the best or worst case private party scenarios, given a range of concession fees, will the proposed PPP project be viable for both the private party and the municipality?

Confirm that the municipality can afford the proposed PPP project in the various scenarios, including determining the minimum affordability breakeven point.

Recommend a minimum concession fee.

Initial value-for-money test

Compare the benefits of the current use of the property with the revenue and strategic benefits that can be expected from the proposed PPP project.

Value-for-money is demonstrated by the extent to which the proposed PPP project will meet the municipality's strategic objectives for the use of that property, which may include:

- increased direct revenue to the municipality
- increased socioeconomic activities in the community
- optimal use of underperforming assets
- job creation
- BEE.

Expressions of interest

After the value assessment, the municipality should publish a request for expressions of interest (EOI). The advantage of an EOI is that a municipality can make an informed decision, based on market interest, about whether to proceed with the proposed PPP project. The EOI can also inform the determination of the highest and best use of the property.

Publish the EOI

An EOI does not need to include the same detail as a request for proposals (RFQ). The emphasis is on providing information to private parties, not on soliciting full bids or proprietary information.

Contents of the EOI

1. Brief description of the proposed PPP project
2. Invitation to private parties to describe their –
 - property development capabilities
 - ability to raise funding
 - BEE qualifications.

It should be clear that the invitation is not a procurement tender.

Evaluate the responses

If there are adequate responses, proceed to the next stage of the feasibility study, Stage 7: Procurement plan. Use the responses to determine a short list of firms to receive the RFP.

If there are inadequate responses, consider amending the proposed PPP project in line with the responses, or abandon the project.

PPP PROCUREMENT

The legislation

Part 2 of Chapter 11 of the MFMA (PPP), Section 120(7), provides that Part 1 of Chapter 11 (Supply Chain Management) applies to the procurement of a PPP. Thus a municipality's procurement of a PPP is regulated by:

- the appropriate provisions of the Municipal Supply Chain Management Regulations
- the municipality's own supply chain management policy
- National Treasury's 2005 Supply Chain Management: A Guide for Officers of Municipalities and Municipal Entities
- sections 4, 5 and 6 of the Municipal PPP Regulations.

If the PPP will be for longer than three years, the municipality must also comply with Section 33 of the MFMA.

Stage 2: The request for proposals

Issue the RFP to the short listed firms determined by EOI.

The RFP is a complete guide to the proposed PPP project, building on the EOI but providing the substantial additional detail required for the short listed bidders to create their proposals. The RFP should include information about submission requirements, evaluation criteria, and administrative matters such as deadlines and changes.

The RFP for a proposed private sector commercial use of municipal property PPP differs from other RFPs as follows:

Essential minimum requirements

Focus on any areas of deficiency noted in the responses to the EOI.

Payment mechanism and penalty regime

Set out the concession fee payment mechanism recommended in the feasibility study, including how the fee is calculated, the minimum fee, and the penalty regime for the private party's failure to perform. Make it clear that the municipality is seeking to form a partnership with the bidder that tenders the *highest* concession fee, calculated in the context of any payment deductions or mitigations included in the PPP agreement markup.

Stage 3: Choose the preferred bidder

The bid evaluation process for a proposed private sector commercial use of municipal property PPP differs from bid evaluation processes for other PPPs in that the successful bid is that which tenders the highest payment for use of the municipal property, calculated in the context of any payment deductions or mitigations included in the PPP agreement markup.

From the responses to the RFP, designate a preferred bidder and then negotiate exclusively with that bidder to finalise the PPP agreement.

Stage 4: Negotiations

In addition to the standard PPP agreement clauses set out in the Guidelines, the municipality may consider including the following:

Additional clauses in the PPP agreement

Parties

Term

- Start date
- End date
- Renewal term

Fee

Use

Permitted use (land/existing building)

Sublease and assignment

The private party may wish to sublease the surplus space in the property depending on what the permitted use is.

Indemnity

Maintenance, alterations and improvements

Insurance

- damaged by fire or other casualty resulting from any act or negligence
- comprehensive general liability insurance

Damage and destruction

Default

Condemnation

This sets out what will happen if a legally constituted authority condemns the building (if the property is a building) or part of it and this makes the building unsuitable for use by the private party.

Utilities

MANAGING THE PPP CONTRACT

Both the municipality and the private party wishing to engage in a municipal PPP for private sector commercial use of municipal property must be familiar with this toolkit and the Guidelines before they engage in this type of PPP.

The management of PPP agreements is more difficult and complex than the bidding process in many ways. The bidding process has predetermined milestones and can be managed with outside support, if necessary. The day to day and ongoing management of a PPP agreement will reveal any institutional weaknesses, which could be exploited by the private party.

All agreements, no matter how well drafted, will always reach a point where there is some discussion over issues that are not clear. This builds and develops the working relationship of the partnership. Judgements must be made and parties must understand each others' perspectives. Not all issues must be conceded; rather, what is important is how they are dealt with. PPP agreements need some flexibility in the implementation and interpretation of outputs, and this will inevitably happen on both sides. Good skills are required, including an understanding of the wider framework within which the proposed PPP project is happening and the implications to the municipality of any policies or laws which may be compromised in the process.

Complex PPP agreements with large capital investment by the private party and the related high risks will require very skilled and efficient management. Issues need to be dealt with in a structured manner, with good communication, record keeping and administration at all levels. The issues are regulated by the specific terms and conditions of the PPP agreement.

CONCLUSION

This toolkit highlights aspects of the inception, feasibility study, procurement and contract management phases of the municipal PPP project cycle which apply specifically to municipal PPPs for private sector commercial use of municipal property. Please work through the full Municipal Service Delivery and PPP Guidelines when considering such a PPP.

