THE REPUBLIC OF UGANDA

NATIONAL PUBLIC-PRIVATE PARTNERSHIPS GUIDELINES

Annex A – Key PPP concepts

PPP Unit of the Ministry of Finance, Planning and Economic Development

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List of abbreviations

BOT	Build Operate Transfer
BLT	Build-Lease-Transfer
BOO(T)	Build-Own-Operate(-Transfer)
BTO	Build-Transfer-Operate
DBFOM	Design-Build-Finance-Operate-Maintain
MW	Megawatt
PPA	Power Purchase Agreement
PPP	Public-private partnership
SPC	Special Purpose Company
VFM	Value-for-money

1. Introduction

1.1 Background

1.1.1. In 2010, the Government of Uganda adopted a PPP policy. The policy creates a framework for the involvement of the private sector in provision of public infrastructure and services.

1.1.2. The *Public Private Partnerships Act* came into force on 1 October 2015. The *PPP Act* establishes the legal and institutional framework for the concrete implementation of PPP projects. The *PPP Act* provides for the establishment of the Public Private Partnerships Committee, the Public Private Partnerships Unit and the Project Development Facilitation Fund. The *PPP Act* also sets out the procedure for the implementation of PPP projects across all steps of the project cycle from inception to the end date of the PPP agreement. Furthermore, the *PPP Act* defines the contents of the PPP agreement.

1.1.3. Pursuant to the *PPP Act*, the Minister responsible for finance issued the *Public Private Partnerships Regulations, 2019* and the *Public Private Partnerships (Meetings of the Committee) Regulations, 2019 (*together, *the PPP Regulations 2019)* . The *PPP Regulations* prescribe the bidding methods and procedures for the selection of a Private Party.

1.1.4. The *Guidelines* presented in this document are firmly grounded in the policy and legal framework that has been put in place by the Government for the implementation of PPP projects.

1.2 This document

1.2.1. The National Public-Private Partnership Guidelines consist of a Main Document and a set of Annexes.

1.2.2. This document is Annex A, which introduces the general concepts of Public-Private Partnership (PPP). It consists of two chapters (in addition to the present introductory chapter).

(a) Chapter 2 explains the distinctive characteristics of PPP and presents the main type of PPP agreements.

(b) Chapter 3 explains the reasons for implementing a project as a PPP, instead of by conventional public procurement. It describes the advantages and disadvantages of PPP, and the driving factors behind them. This information is of use to determine the 'value-for-money' of PPP, which provides the justification of implementing a project as a PPP.

2. What is a PPP?

2.1 Definition of PPP

Importance of defining PPP

2.1.1. To determine the scope of these *Guidelines* the term *PPP* must be clearly defined. An obstacle in this respect is the fact there is no universally accepted definition of what constitutes a PPP. Many different definitions of PPP can be found in the scientific literature, as well as in guidance manuals and legislative documents issued in other countries or by international institutions. However, although different, these definitions are also all broadly similar, so that they allow to derive a set of characteristics of what is generally understood to be a PPP.

2.1.2. The mere existence of an interaction between the public and private sector does not imply that there is a PPP.

2.1.3. The definition of PPP in the *PPP Act* corresponds to this general understanding of PPP and is therefore adopted in these *Guidelines*. In Article 4 of the *PPP Act* PPP is defined as follows:

"a commercial transaction between a Contracting Authority and a Private Party where the Private Party performs a function of the Contracting Authority on behalf of the Contracting Authority, for a specified period and:

(a) acquires the use of the property, equipment or other resource of the Contracting Authority for the purposes of executing the agreement;

(b) assumes substantial financial, technical and operational risks in connection with the performance of the function or use of the property; or

(c) receives a benefit for performing the function through payment by the Contracting Authority or charges or fees collected by the Private Party from the users of the infrastructure or service, or both."

2.1.4. The above definition highlights the key characteristics of a PPP arrangement. The key characteristics are broken down and are explained in the paragraphs that follow. The clarifications in the paragraphs below allow the reader to distinguish PPP arrangements from the many other ways in which the government interacts with the private sector. A PPP, as generally understood and as defined in the *PPP Act*, refers to a specific type of public-private relationship with its own characteristics.

Commercial transaction

2.1.5. As stated in the first sentence of the definition in the *PPP Act*, a PPP is a commercial transaction between a Contracting Authority and a private contractor. Under a PPP agreement the private contractor offers services on the basis of a commercial contract with a government agency.

2.1.6. Non-commercial partnership relations between the government and development partners are therefore not PPPs as generally understood and as defined in the *PPP Act*. While these relationships may be aimed at the provision of public infrastructure and services (like PPPs are), the cooperation is

not based on a commercial contract between the government and the Private Party. This does not automatically exclude non-profit organisations from participating as Private Party in a PPP project. But if they do so, their cooperation and relationship with the government in that project is ruled by a commercial contract, and not by a conventional development partner relationship.

2.1.7. Also excluded from the scope of PPP are privately owned companies providing services to users in regulated markets. In such markets companies generally are required to apply for an operating license from a regulatory agency (for instance mobile telecommunication operators in many countries). While the license usually imposes conditions on the service provider and on the service itself (for instance with respect to financial and technical capacity, maximum user tariffs or minimum service coverage), it does not constitute a commercial contract between a government agency and the private provider.

Private Party

2.1.8. Article 20 of the *PPP Act* stipulates that the Private Party of a PPP is to be constituted as a special purpose company (SPC) incorporated under Ugandan law. The text box below explains the characteristics and functioning of a SPC.

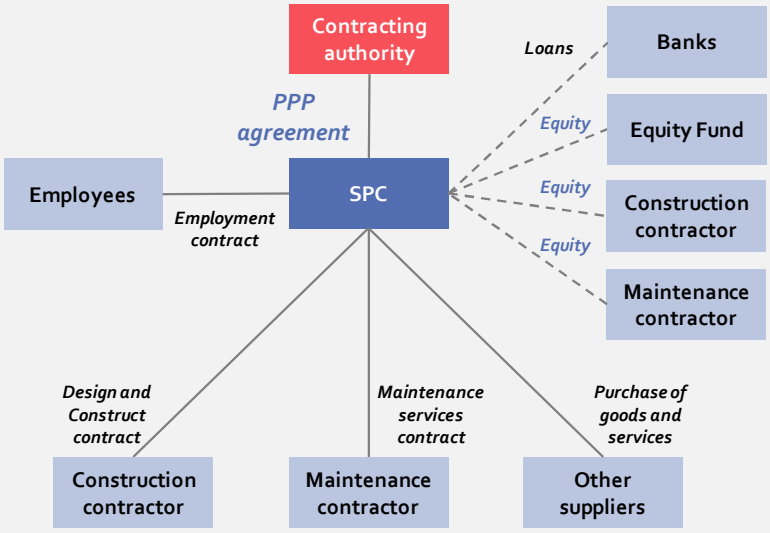
Special Purpose Company (SPC)

A SPC is a company established for carrying out a single project or a single activity. SPCs are frequently used in the power and off-shore energy industry, and also for PPP projects.

Article 20 of the *PPP Act* requires the Private Party of a PPP to be constituted as a SPC incorporated under Ugandan law. However, even without such an obligation, it is customary to establish a SPC to carry out a PPP project.

In the case of a PPP project the SPC is established prior to the signature of the PPP agreement by the leading members of the consortium that has been awarded the project. In general, the leading construction and operating companies are shareholders of the SPC. In addition, specialised equity investment funds may take a participation in the SPC.

Figure 1: Contractual relations of a SPC



The SPC signs the PPP agreement with the Contracting Authority and concludes subcontracting agreements with the consortium members that will perform the services (construction contractor, maintenance contractor, engineering firm and other suppliers). This means that the leading consortium members have a dual relationship with the SPC: they are both shareholder and subcontractor. In addition to the equity injections by the shareholders, the SPC borrows funds from banks and other lending institutions. The SPC may also have its own staff to perform operating and maintenance duties.

The reasons for carrying out the PPP project through an SPC are managerial and financial. The SPC provides a transparent vehicle for organizing the cooperation between the consortium partners. All financial flows and contractual relations pass through the SPC. Furthermore, the SPC ring-fences the risks of the project. The liability of the consortium members is restricted to their equity stake in the SPC.

From the perspective of the Contracting Authority, the use of an SPC has the same advantage as for the consortium members: it increases the transparency of the financial flows and the responsibilities. An SPC has no disadvantages for the Contracting Authority, provided that its interests are appropriately protected through the PPP agreement and appropriate due diligence is done on the prospective bidders and consortium members. The main potential risk for the Contracting Authority derives from the limited liability of the shareholders. If there are serious shortcomings in the performance of the SPC, leading to large penalties and compensation payments to be paid by the SPC to the Contracting Authority, the claims of the Contracting Authority are limited to the assets available in the SPC. However, in a PPP project these assets are usually substantial. Recall that the Contracting Authority is the owner of the assets built or acquired by the SPC (or the ownership of such assets is automatically transferred at the end of the PPP agreement) but has not fully paid for them until the end date of the PPP agreement. If the PPP agreement is terminated due to structural shortcomings of the SPC, the Contracting Authority can claim the assets and compensate the SPC only for a part of their value (the other part being subtracted as a compensation for the damages and costs incurred by the Contracting Authority as a result of the shortcomings in performance by the SPC). In this way the Contracting Authority exerts a great leverage on the SPC.

In addition, it is customary to require the SPC to post performance bonds during the course of the project. Usually these bonds consist of letters of credit that can be drawn on by the Contracting Authority for the settlement of penalties and compensations due by the SPC.

2.1.9. The *PPP Act* does not impose requirements on the nature of the shareholders of the SPC. The SPC may therefore be constituted by a profit-seeking companies, non-profit organisations (such as non-government organisations, faith-based organizations and community organisations) or, for small projects, even individuals. For large projects the Private Party usually consists of a consortium of specialised firms covering the various required areas of expertise (design, construction, equipment installation and maintenance, financing, etc.).

2.1.10. The absence of legal requirements on the nature of the shareholders of the SPC is does not mean that any organisation or individual can establish a SPC to carry out a PPP project. The *PPP Act* requires that the SPC must have the necessary technical and financial capacity for undertaking the PPP project. This capacity is provided by the shareholders by the SPC. Consequently, the shareholders of the SPC must jointly have the technical and financial capacity that is needed for carrying out the project. How the Contracting Authority verifies the technical and financial capacity of the Private Party is addressed in Chapter 5 of the Main Document of these *Guidelines.*

Contracting Authority function

2.1.11. The objective of a PPP is the performance of a public function, i.e. the provision of a public service or a public infrastructure. Projects with purely private commercial goals are therefore not PPPs, even if government agencies participate in these projects as co-investors.

2.1.12. This does not exclude PPP projects from having commercial functions, but there must be a strong public interest involved. For instance, seaport and airport services are of a commercial nature, but they are also vitally important for economic development so that they can also be categorized as public functions and as suitable for delivery under a PPP model.

2.1.13. PPP projects may be carried out in a variety of sectors, provided that a public function is involved. Article 2 of the *PPP Act* contains an extensive list of sectors that are eligible for PPP:

(a) Road, rail, subway, water and air transport facilities, including harbour and port facilities, airports and airport facilities;
(b) Information and computer technology, telecommunication and telecommunication networks;
(c) Social infrastructure, including health care facilities, correctional facilities, education facilities, accommodation facilities, public housing and court facilities;
(d) Water management facilities, including dams and water storages, water supply and distribution systems, irrigation and drainage systems and sanitation, sewerage and waste management systems;
(e) Oil pipelines, gas pipelines and gas storage, refinery, conveyance and distribution facilities;
(f) Energy-related facilities and other facilities for the generation, preservation, transmission and distribution of electricity;
(g) Sports and recreational facilities, sports grounds and space for sports and recreation, including facilities for recreational, sports and cultural activities;
(h) Tourist infrastructure facilities;
(i) Extraction and processing of mineral raw materials
(j) Agricultural processing industries; or
(k) Any other project as the Minister may, by statutory instrument, approve.

Use of Contracting Authority property, equipment or other resource

2.1.14. In many PPP projects the Contracting Authority makes available to the private contractor resources that it owns or controls and that the private contractor needs to carry out the project. That is very often the case with public land, but also other types of assets may be made available to the private contractor under a PPP agreement (for instance existing publicly-owned airport infrastructure that will be operated, renovated and expanded by a private airport operator). In general, these assets remain government property, and only the user rights are transferred to the Private Party for the duration of the PPP agreement. Even if the ownership is transferred to the Private Party, it reverts to the government upon the expiry of the PPP agreement.

2.1.15. Furthermore, all infrastructure and facilities financed and built by the private contractor under a PPP agreement are either immediately owned by the Contracting Authority, or their ownership is transferred back to government or its nominee upon the expiry of the PPP agreement.

Substantial risk transfer to Private Party

2.1.16. Point (b) of the definition of PPP in the *PPP Act* highlights the most important characteristic of PPP projects compared to conventional procurement. Under a PPP agreement the private contractor assumes substantial financial, technical and operational risks in undertaking the project and delivering the public service.

> *This is best explained by means of an example: the financing, construction and operation of a road. In the conventional procurement model the government first engages an engineering firm to make a design of the road. After the design is finished and has been approved, a construction company is appointed to build the road according to the design. The construction is included in the technical terms of reference for the procurement of the construction services. The investment costs are paid out of the government budget. Usually the government takes out a loan from a commercial bank, so that the investment costs do not have to be paid upfront but can be spread out over time. When the construction is completed, the road authority may maintain or operate the road using its own staff or outsource these activities to private service providers under operating and maintenance agreements.*

2.1.17. To summarise, in the conventional procurement model the financing, construction and operation of the road is largely outsourced to private service providers under a set of separate short-term contracts, one for each phase of the project (design, construction, financing, operations and maintenance). In each of these agreements, the risks of the private counterparty are limited.

(a) The engineering company is responsible for making a design that complies with the output specifications in the technical terms of reference. When the company delivers a design that meets these specifications and is made according to the state of the art, it receives the price as offered in its proposal. The risks of the engineering company are therefore largely limited to internal organization (in order to deliver the design on time and within the budget) and quality control. If these are well managed the engineering company faces few risks.

(b) The construction company is responsible for constructing the road according to the design specifications. If it succeeds in doing so, it receives the construction price as offered in its proposal. Usually advance and progress payments are made during the construction period, with a balance to be paid upon completion of the works. As in the engineering phase, the risks of the construction company are largely limited to internal organization and quality control. If the design turns out to be flawed, or there are unexpectedly difficult soil conditions, the construction company is entitled to additional compensation above the agreed construction price.

(c) The operation and maintenance service providers are responsible for carrying out well specified operation and maintenance activities. They are paid in function of the progress of these activities. Their risks are limited to internal organization and control. If the operation and maintenance costs requirements are higher than expected due to shortcomings in the design or construction, this will be reflected in the proposal of the operation and maintenance service contractors, so that the cost impact is passed on to the road authority.

(d) Conventional government loans have a fixed repayment schedule. The loan is repaid regardless the performance of the project that is has financed. The only risk faced by the bank

is the sovereign risk. The financing may also come from the private contractor, but the key risk of repaying the financing remains with government (regardless of the source of funds).

The consequence is that many of the project risks are borne by the government. Each of the private counterparties only assumes a limited set of risks, which are largely related to its own performance. The government is responsible for all risks that derive from the interfaces between the phases of the project (for instance design flaws leading to higher construction or maintenance costs), as well as most risks arising from unexpected circumstances (such as difficult soil conditions).

2.1.18. In a PPP agreement, on the other hand, most of the project risks are transferred to the private contractor. This is achieved by outsourcing the financing, design, construction, maintenance and operation of the project (a road for instance) in a single integrated contract. In this way the private contractor becomes responsible for the delivery of all phases of project, including all interface risks. In practice, this is achieved by the establishment of a SPC, as explained above. A PPP changes the role of government from the provider to the buyer of services/infrastructure. The SPC incorporates all the rights and responsibilities (including risks) of the Private Party under the PPP agreement.

Returning to the road project example: in a PPP agreement, the design, construction, financing, operations and maintenance will be integrated into one contract. The PPP Agreement will define the output specifications and KPIs that will need to be accomplished by the Private Party to guide its delivery of its obligations under the PPP Agreement. As such, a more substantial risk transfer is attained as the Private Party is required to develop its own design to meet the output specifications keeping in mind the KPIs that it needs to meet during the operations and maintenance stage. The investment and operational costs are mobilised by the Private Party from a mixture of debt and equity financing and the Private Party is responsible for the repayments. At the same time, the Private Party is incentivized to ensure that the design of the asset will lead to more manageable operations and maintenance expenditures. If the road project is a user fee based PPP, the Private Party has more incentives to ensure that the life cycle costs of the asset is optimized to allow the recuperation of its investments and its required equity return while ensuring that it is able to deliver its obligations set out in the PPP Agreement/

Remuneration mechanisms

2.1.19. Point (c) of the definition of PPP in the *PPP Act* specifies three types of remuneration for the Private Party in a PPP agreement:

- a fee paid by the Contracting Authority;
- a fee paid by the users or customers of the service; or
- a combination of both.

2.1.20. These three types of remuneration correspond to three broad types of PPP arrangements:

- government-pays PPPs, in which the Private Party is paid by the Contracting Authority in function of the availability of the infrastructure, facilities or services covered by the PPP agreement;
- user-pays PPPs, in which the Private Party directly collects revenues from the users of the service; or

- hybrid PPPs (user-pays with government support), in which the user revenues are supplemented by government payments or subsidies. Hybrid PPPs allow implementing a user-pays PPP model when the amount of user revenues is not sufficient to cover the costs of the private contractor.

PPP is not privatisation

2.1.21. From the definition of PPP, it is clear that PPP is not privatisation. Under a PPP agreement the Contracting Authority remains ultimately responsible for the provision public services in its area of competence. However, instead of carrying out itself the activities that are needed to ensure the provision of public services, it subcontracts these activities to a private service provider. Through the provisions in the PPP agreement the Contracting Authority retains, however, the control over the quantity, quality and price of services. Furthermore, all assets used or produced for purpose of the PPP project are owned by the government, or their ownership reverts to the government upon the expiry of the PPP agreement.

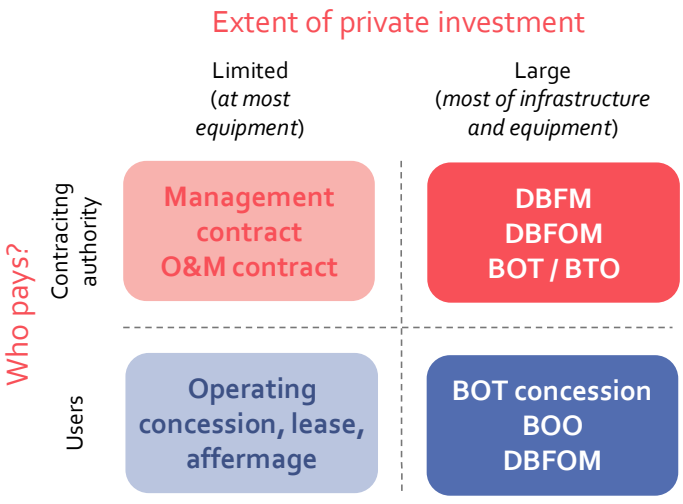
2.2 Types of PPP agreements

Distinguishing between PPP models

2.2.1. There are many variants of PPP. However, on the basis of two key characteristics four main PPP models can be distinguished (Figure 2). The two key characteristics are:

- the identity of the payer of the services: either the private user of the services (user-pays PPP) or the Contracting Authority (government pays PPP);
- the extent of private investments, which may be large (most or all of the infrastructure and equipment) or limited (at most investments in equipment).

Figure 2: Main PPP models



In the following paragraphs the main PPP models are described in more detail.

Management contract/Operations and management (O&M) contract

2.2.2. In this model the entire maintenance and operation of a public infrastructure is outsourced to a Private Party through a management contract. In contrast with the model of conventional public procurement described in the previous section the private contractor does not carry out narrowly defined maintenance and operational activities under the supervision of the Contracting Authority but manages and performs a range of activities aimed at supplying an integrated, performance-based service (for instance running a passenger train service or a water utility). Under this modality, the Contracting Authority pays to the contractor a performance-related service or management fee for the services. Performance indicators could include the number of users, response times, or efficiency gains compared to a benchmark.

2.2.3. The management contractor does not invest in its own facilities but operates the facilities of the Contracting Authority. The Private Party supplies its own personnel and possibly also some equipment (for instance information, telecommunication and office equipment). The financing requirements of the private sector are therefore very small.

2.2.4. Performance-based management contracts with a long-term contract duration are a light form of PPP, in which the commercial and financial risks are retained by the public sector. They are therefore often used as an entry type of PPP. They constitute a way to bring private expertise and management skills to the operation of public infrastructure in sectors where the commercial and financial risks are too large for more far-reaching PPP arrangements.

Example of management contract	Johannesburg Water
	The public utility, Johannesburg Water, was accountable for the delivery of water and sanitation services, in accordance with the 25year service delivery agreement signed with the municipality. The private operator was delegated; for a period of five years, the day-to-day management of the water and sanitation services, making it responsible for the utility's overall performance. The municipality remained responsible for financing investment, for setting tariff levels, and for funding any potential shortfall due to excessive operating costs or insufficient revenues.

DBFOM and variants

2.2.5. Instead of outsourcing the engineering, construction and maintenance/operations of an asset with separate contracts, these services, as well as the financing of the asset are procured with a single integrated contract: a Design, Build, Finance, Operate and Maintain (DBFOM) contract.

2.2.6. Hence, the private contractor (usually a consortium of specialised firms covering the required areas of expertise) finances, designs, constructs, maintains and often also operates the infrastructure, all

according to the specifications of the Contracting Authority. The contractor does not sell its services directly to the end-user, but to the Contracting Authority. It is paid by the Contracting Authority in the form of performance fees (payment in function of the service level), availability fees (payment in function of the availability of the infrastructure) or shadow tolls (fee per user but paid by the public sector instead of the user) for the duration of the contract. The revenues from these fees are used to cover costs and earn a return on investment.

2.2.7. Integrated contracting with financing is widely used for the delivery of public buildings (hospitals, schools, prisons, among others) and land infrastructure (roads, railroads, canals). This type of PPP comprises a wide range of contractual forms: DBFM (Design, Build, Finance, Maintain), DBFOM (Design, Build, Finance, Operate, Maintain), BOT (Build, Operate, Transfer), BOOT (Build, Own, Operate, Transfer), BTO (Build, Transfer, Operate), BLT (Build, Lease, Transfer), ROT (Rehabilitate, Operate, Transfer), etc. They mainly differ with respect to the ownership of the assets during the contract period, which may have an impact on the ease of obtaining finance. For instance, in a BOOT contract the private contractor is owner of the assets during the contract period and has therefore more collateral at his disposal (provided the assets are sufficiently liquid, so that can be easily sold in case of default).

A Design-Build-Finance (DBF) project, on the other hand, would in general not be considered as a PPP. In a DBF project the private contractor is responsible (as in a Design-Build (DB) or Engineering, Procurement, Construction (EPC contract)) for the design and construction of the public assets. Upon the completion of the works the assets are transferred to the Contracting Authority, which is responsible for maintenance and operations. Different from an DB or EPC contract the private contractor is not paid upon the completion of the works, but in fixed installments over the length of the DBF agreement (usually 10 to 25 years depending on the type of asset). However, the payments to the contractor are fixed and do not depend on the performance of the asset. Consequently there is no substantial transfer of project risks from the government to the private contractor, so that one of the key conditions of PPP is not met.

2.2.8. The contract period must be sufficiently long to amortize the investments in the fixed assets. Typical contract periods are 20-30 years, but longer durations also occur (50 years and more).

Example of DBFOM contract	*Kampala-Jinja Expressway PPP*
	The government of Uganda has commenced the procurement process for a private party to design, build, finance, maintain, operate and transfer the limited access 95km tolled expressway. The partnership will be valid for 30 years. Government has supervisory and payment obligations.

Concession / Lease, develop and operate

2.2.9. In this PPP model the public sector (usually the Contracting Authority) finances and constructs the infrastructure through a conventional public procurement procedure. Once built, the facilities are

leased or given in concession to a private operator for a specified period. The operator operates the facilities on a commercial basis, selling the infrastructure services directly to the end-user.

2.2.10. In return for the right to operate the facility on a commercial basis the operator pays a concession or lease fee to the Contracting Authority, which remains owner of the facilities. Depending on the contractual agreements the concession payment may take the form of a one-off lump sum, periodic fixed payments (lease) or a variable payment in function of the level of use. The Contracting Authority also imposes operational requirements on the concessionaire in the concession agreement, notably tariff rules and service quality standards. In this way the Contracting Authority can ensure that the interests of users and the society at large are safeguarded.

2.2.11. The length of the concession period depends among other on the size of the investment in equipment that the Private Party must undertake, and on the bargaining power of the contract parties. Operating concessions typically vary from 10-15 years. At the end of the concession period the facilities are returned to the Contracting Authority, which will usually launch a tender procedure to select a concessionaire for the next concession period.

2.2.12. An advantage of this model is that it allows to implement a user-pays PPP, while keeping prices affordable for users. If the Contracting Authority is prepared to forego a concession fee, then the tariff charged by the private operator only needs to cover maintenance and operating costs. The investment costs, on the other hand, are borne by the Contracting Authority, which has financed the construction of the infrastructure and makes it available to the private contractor free of charge. If, in addition, the Contracting Authority is prepared to subsidize the private operator (for instance through a negative concession fee) the services can be provided to users at a price even below maintenance and operating costs.

Example of operating concession	***Aquavirunga (Rwanda)***
	The private operator Aquavirunga has two PPP contracts: one of a duration of 15 years with the District of Rubavu for the operation of the Yungwe-Bikore and Mizingo- Mutura systems, and one of a duration of 14 years with the Interdistrict Association of Nyabihu and Musanze for the operation of Mutera system. Aquavirunga is responsible for the initial rehabilitation and operation of the systems. It collects receipts from water sales and pays a royalty to the districts. The latter remain responsible for investments in the extension and renewal of the systems.

BOT concession

2.2.13. In a BOT concession the Private Party finances, designs, and constructs the public infrastructure. Once built the Private Party maintains and operates the facilities on a commercial basis, selling the infrastructure services directly to the users. The Contracting Authority imposes operational requirements on the concessionaire in the PPP Agreement (with respect to tariffs, service coverage and quality, among others). In this way the Contracting Authority ensures that public interests are safeguarded.

2.2.14. The BOT concession model strongly resembles the DBFOM model described above but differs from the latter in one essential respect: the private concession holder sells its services directly to the users and assumes the commercial risk. It is not paid by the Contracting Authority. In contrast, it often pays a concession fee to the Contracting Authority for the right to operate the facility on a commercial basis.

2.2.15. BOT concessions also resemble operating concessions: both are user-pays PPPs. However, BOT concessions differ from operating concessions in the fact that the latter do not involve private finance and construction of infrastructure, but only operations (possibly including limited investments in equipment).

2.2.16. The labels BOT, BOOT, ROT and DBFOM are often used to denominate user-pays as well as government-pays PPP contracts. However, these are different forms of PPP. When confronted with contract labelled as a BOT contract (or any other of the labels cited above), one should therefore always check whether it refers to a government-pays contract (fees paid by Contracting Authority) or a user-pays contract (services supplied on a commercial basis to final users).

2.2.17. The contract period of a BOT concession must be sufficiently long to amortize the investments in the fixed assets. Typical contract periods are similar to those of DBFOM-like arrangements, i.e. 20-30 years and often even longer. At the end of the concession period the facilities are returned to the Contracting Authority, which will usually launch a tender procedure to select a concessionaire for the next concession period. In the BOT model the private contractor bears substantial commercial and financial risks. Consequently, the model is only feasible when these risks are not too large.

2.2.18. In this PPP model user revenues must be sufficiently large to cover the full capital, maintenance and operating costs of the project services. By using hybrid forms of PPP, it is nevertheless possible to adopt a BOT model even when tariffs are below the full cost level (for instance to keep the service affordable to consumers). In that case the revenues collected from users are supplemented by subsidies from the government. These subsidies can take the form of milestone payments (payments during the construction period upon completion of contractually defined parts of the works), negative concession fees or a subsidy per user served.

Example of BOT concession	*Dakar-Diamniadio Toll Motorway*
	The private developer/operator designed, built and financed the 25 km motorway, and will operate it for 30 years under a concession granted by the Senegalese State. The operator collects tolls from the users to cover its financing and operating costs.

Example of BOT concession	*Kigali Bulk Water Supply Project*
	The private developer/operator will build, operate and maintain a bulk water supply system in Kanzenze, Bugesera District, Kigali, Rwanda. The concession period is for 27 years.

BOO agreement

2.2.19. In addition to the four basic PPP models described above, it is useful to consider a fifth model that is mentioned in Section 44 of the *PPP Act*: the build, own and operate (BOO) agreement. Under this type of PPP agreement, a private contractor builds a new infrastructure, and then owns and operates the facility at its own risk and for its own profit. While the facility is private the government is partner in the contract and may provide support in the form of subsidies or a commitment to buy a certain volume of services at an agreed tariff. This offtake agreement reduces the commercial risk of the private investor and enhances the financial feasibility of the project.

2.2.20. In contrast with a BOT concession the facility built under a BOO agreement is privately owned and is not transferred to the government at the end of the agreement. A BOO arrangement is therefore situated on the border between PPP and privatization. During the contract period of the BOO agreement it is a PPP, but upon the expiry of the agreement the service is privatised.

2.2.21. Upon the expiry of the BOO agreement, the Contracting Authority can conclude a new purchasing agreement with the BOO contractor (but this time without Build-component) or with another competing service provider.

Example of BOOT project	*Bujagali Hydropower*
	The Bujagali hydropower project is a 250MW hydropower plant in installed capacity. The project is between the Government of Uganda, Blackstone Portfolio Company, Sithe Global Power and the Aga Khan Fund for Economic Development. This project is a BOOT, a variant of the BOO modality. The project is under a 30-year PPA.

2.2.22. It should be noted that at the end of the BOO agreement, no competing service providers may be available. The reason is that it is often not cost-efficient to build and operate duplicated infrastructure networks in the same service area. Consequently, for the continuations of the service the Contracting Authority is obliged to renew the contract with the original BOO contractor, resulting in a private monopoly. The degree of competition upon the expiry of the BOO agreement should therefore be a point of attention when considering this type of agreement.

Summary of main types of PPP agreements

2.2.23. The key characteristics of the main PPP models (as well as the conventional public procurement model without PPP) are recapped in the table below.

Table 1: Summary of main types of PPP agreements

	Coventional public procurement	Management contract	DBFMO and variants	Operating concession	BOT concession	BOO
Names used to indicate type of PPP agreement	Short term construction and service contracts	Management and 0&M contracts	DBFM, DBFMO, BOT, BOOT, BTO, BLT, ROT,...	Concession, lease, affermage	Concession, BOT, BOOT, BTO, BLT, ROT,...	BOO
Typical duration of agreement	0-2 yrs	2-5 yrs	15-30 yrs (and longer)	10-15 yrs (and longer)	15-30 yrs (and longer)	15-30 years
Ownership of asset	Public	Public	Public (or private transferred to public at end of contract)	Public	Public (or private transferred to public at end of contract)	Private
Responsibility						
Finance	Public	Public	Private	Public	Private	Private
Design/Build	Public	Public	Private	Public	Private	Private
Maintain/Operate	Public	Private	Private	Private	Private	Private
Payment by	Contracting authority	Contracting authority	Contracting authority	Users	Users	Users

2.2.24. The table demonstrates that, on a high level a type of PPP agreement, is defined by the following characteristics:

- the scope of the activities carried out by the private contractor under the PPP agreement (rehabilitation, expansion, development, construction, operation, maintenance and combinations thereof);
- the type of property rights (ownership, lease, use rights), and the timing of the transfer of these rights (giving rise to PPP variants such as BOT, BTO, BLT, among others);
- the remuneration mechanism: government pays, user pays or hybrid.

2.2.25. Note that in some cases the same names are used to indicate different types of agreements. That is especially the case with the forms of PPP including both construction or rehabilitation and operation and maintenance (i.e. BOT, BOOT, ROT, BTO, …). In that case the same name may be used both for agreements in which the services are paid by the government and for agreements where the services are paid by the user. The term "concession" is usually (but not always) reserved for user-pays PPP agreements in which the private contractor is paid by the users. The name of a PPP agreement is therefore not always a sufficient indicator of the characteristics of the PPP arrangement.

2.2.26. The types of PPP agreements mentioned in the *PPP Act* fall within the categories described in the preceding paragraphs and in the table above or are combinations or variants thereof.

3. Why PPP?

3.1 What is Value for Money of PPP?

Benefits in terms of cost, quality and quantity of project and risk transfer

3.1.1. The *PPP Act* defines Value for Money (VFM) as the "*optimal benefit of a public private partnership to a Contracting Authority, defined in terms of the cost, quality and quantity of the project and the risk transferred to the Private Party*".

3.1.2. Experience across the world has shown that PPP can contribute to achieving service delivery with a better price to quality ratio than traditional public service delivery through the use of private sector management skills and competencies. PPPs are able to deliver VFM by:

- **increasing the speed of implementation of projects**. Some governments find it difficult to accelerate the development of infrastructure, even if funding is available. This is mainly caused by limited project development and implementation capacity in national and local governments. Introducing PPP expands the implementation capacity through the mobilization of additional human and financial resources from the private sector.

- **increasing efficiency**. Through better risk allocation, whole life costing and stronger incentives to perform, PPPs can increase the cost efficiency of public infrastructure provision. This in turn allows to lower the cost to taxpayers or users. Further efficiency gains may derive from economies of scale (if the Private Party develops and operates several projects) and the deployment of specialized technical and managerial expertise that is not yet present within the Contracting Authority.

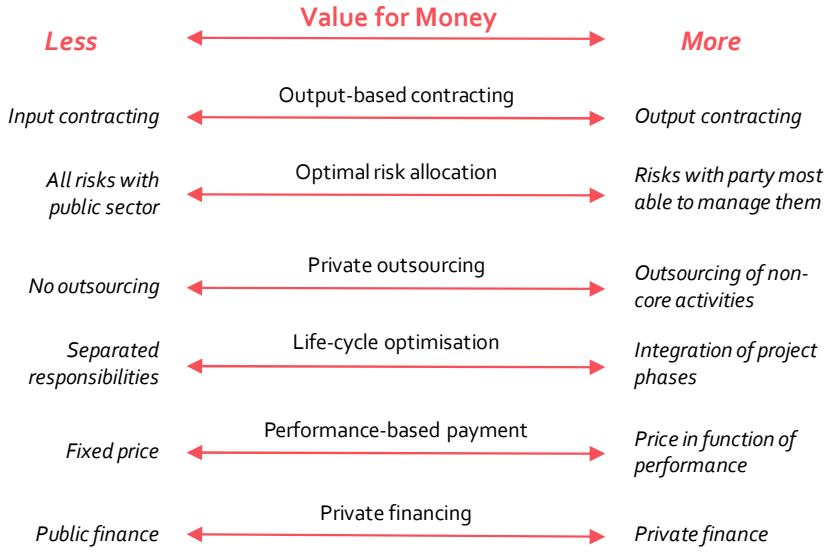
- **increasing the quality of service**. Experience shows that PPPs contribute to ensure the quality of service. This results from the better integration of services with supporting assets, the introduction of innovations in service delivery, and a higher responsiveness of the private sector to users' needs. The performance-related remuneration mechanism incorporated in a PPP contract provides strong incentives for the private contractor to meet the contractually agreed service quality standards.

- **generating commercial value from public sector assets**. The private sector can assist in unlocking the commercial value of public sector assets. The private sector's entrepreneurship and creativity will push it to exploit the full commercial potential of a project in addition to its public service function. This generates additional revenues that can be used for covering (part of) the costs of the public services produced by the project.

3.2 Drivers of Value for Money

3.2.1. VFM derives from a number of specific characteristics of PPP agreements. The figure below shows an overview of the driving factors behind the creation of VFM.

Figure 3: Value for Money drivers



In the next paragraphs each VFM driver is described in detail.

Output-based contracting

3.2.2. The use of performance-oriented (or outcome-based) specifications is an important lever for creating value in PPP contracts. In conventional procurement contracts specifications are defined in terms of inputs and activities that need to be delivered by the contractor. The technical solutions as well as the engineering and design are imposed. In a PPP project, on the other hand, the specifications are more general. They are focused on desired outcomes (minimum performance required) rather than on how to design the good or service. In other words, the Contracting Authority specifies what must be done by the private contractor, but not how. Consequently, the Private Party has a degree of flexibility in deciding how best to provide the requested services, allowing it to deploy unique technical skills or creative methods that offer better value for money than the proposals of the competitors. Performance-oriented specifications enable the Contracting Authority to harness the innovative and creative capabilities of the private sector, resulting in the delivery of public services at a lower cost to the user or at the same cost with better quality.

Optimal risk allocation

3.2.3. The basic principle of optimal risk allocation is that risks should be held by those parties best able to manage them. For instance, the building contractor has the strongest control over the management of construction activities ensuring a delivery on time and within budget. Therefore, the contractor should assume the construction risk and receive a financial penalty in case delivery is late or over budget. However, the risk of delays in the securing of planning approvals (if not due to negligence of

the private contractor) or of changes in the law having a negative impact on project profits should be allocated to the Contracting Authority because they are outside the influence of the Private Party.

3.2.4. If the risk allocation is optimal then all contract parties have maximum incentives to control risks (i.e. to reduce the likelihood and/or the consequences of risks), resulting in lower project costs. In the conventional public procurement model, most of the project risks are in the hands of the Contracting Authority. In PPP projects; on the other hand, most risks (in particular design and construction risks, operating risks and, in revenue-generating PPP projects, also revenue risks) are transferred to the private contractor. Since the private sector is indeed placed best to manage these risks and should therefore assume them, PPP achieves a risk allocation that is more optimal than in the case of conventional public procurement.

Private outsourcing

3.2.5. Through PPP the Contracting Authority can mobilize the human and technical resources of the private sector in order to complement the resources of the public sector. This creates various benefits.

- The private sector may have skills and expertise that is not available within the Contracting Authority.
- One of the main strengths of the private sector is its business process management skills, which enable it to implement projects effectively and efficiently, thus saving costs for the government and/or the end-user. PPP introduces private sector management skills and competencies in the provision of public infrastructure and services.
- By outsourcing the design, construction and operation of specific projects to the private sector, the Contracting Authority frees up its own resources to pursue other projects. In this way, PPP increases the speed of implementation of projects.
- Private companies are on averrable better able and more strongly incentivised to pursue and collect revenues than public contracting authorities.

Lifecycle optimisation

3.2.6. Integrating the design, construction and operating stages of public infrastructure reduces interface problems. A contractor who is responsible for all stages of the project life-cycle has an incentive to minimize life-cycle costs. In contrast if several contractors are each responsible for a single stage, they tend to minimise their own costs or maximise their own revenues even if this behaviour increases costs/lowers revenues in other stages. For instance, the building contractor has no incentive to spend resources on higher quality resulting in lower maintenance costs, because he will not benefit from cost savings in maintenance. In contrast, if the project stages are bundled in a single PPP contract, the contractor in charge of construction who decides to skimp on quality in order to compress costs will suffer the consequences during the maintenance phase. The contractor of a PPP project will therefore have an incentive to balance quality and costs across the entire lifecycle of the project.

Performance-based payments

3.2.7. In PPP projects the contractor is only paid upon delivery of the service. This is obvious in the case of a user-pays PPP. However, also in government-pays PPPs the payment of the availability fee is conditional on the facility being available in good condition and the services being provided according to the agreed quantities and quality standards. In contracts with milestone payments, the latter are paid upon reaching contractually specified milestones, i.e. the completion of well-defined parts of the

investments that must be undertaken under the PPP agreement according to the specifications set out in the agreement.

3.2.8. Through the performance-based character of the payments the private contractor is strongly incentivised to complete the facilities in time and deliver the services according to the contractually specified output specifications and quality standards. In this way PPP ensures timely delivery with consistent quality.

Private financing

3.2.9. Private financing has a similar effect as performance-based payments. It sharpens the incentives by increasing the financial stakes. In this manner pushes private contractors to deliver on time and according to specifications. Private financing provides especially strong incentives for timely delivery of the infrastructure. Every delay increases the financial costs of the project because the revenues needed to service the debt are postponed.

3.2.10. Secondly, private finance brings forth additional project monitoring capacity. The private financiers have strong incentives and are often better placed to monitor the operational and financial performance of the project than the Contracting Authority. If the private financiers detect shortcomings in performance, they will request the contractor to take remedial actions in order not to endanger the debt service payments.

3.2.11. Finally, private financing mobilizes additional financial resources for public resources, thus accelerating project implementation.

The drivers of Value-for-Money described in this annex underpin the method for qualitative Value-for-Money assessment presented in Annex H. In this qualitative Value-for-Money assessment the PPP suitability of a project is evaluated on the basis of the degree to which Value-for-Money drivers are present in the project, as well as on the presence of various obstacles to effectively achieving these Value-for-Money drivers.