

Draft for Public Consultation

MINISTRY OF FINANCE
— SINGAPORE —

**PUBLIC PRIVATE
PARTNERSHIP
HANDBOOK**

FOR PUBLIC
CONSULTATION

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SECTION 1

**INTRODUCTION TO PUBLIC
PRIVATE PARTNERSHIPS**

1.1 WHAT IS PUBLIC PRIVATE PARTNERSHIP?

1.1.1 Public Private Partnership (PPP) is a model under the Best Sourcing framework. Best Sourcing encourages public agencies to engage private sector providers in delivering non-core government services if it is more efficient to do so. Public agencies can engage the private sector in many ways, such as contracting for manpower, service outsourcing or Business Process Outsourcing. Public Private Partnership (PPP) is another form of Best Sourcing that can be used to work with private sector to deliver services, particularly services that require the development of new physical assets.

1.1.2 PPP refers to long-term partnering relationships between the public and private sector to deliver services. It is a new approach that Government is adopting to increase private sector involvement in the delivery of public services.

1.1.3 Conventionally, public agencies have only engaged the private sector to construct facilities or supply equipment. Public agencies will then own and operate the facilities or equipment to deliver services. For example, a public agency might engage private companies to build a water treatment plant. Upon completion, the public agency will own and operate the water treatment plant to provide water to the public.

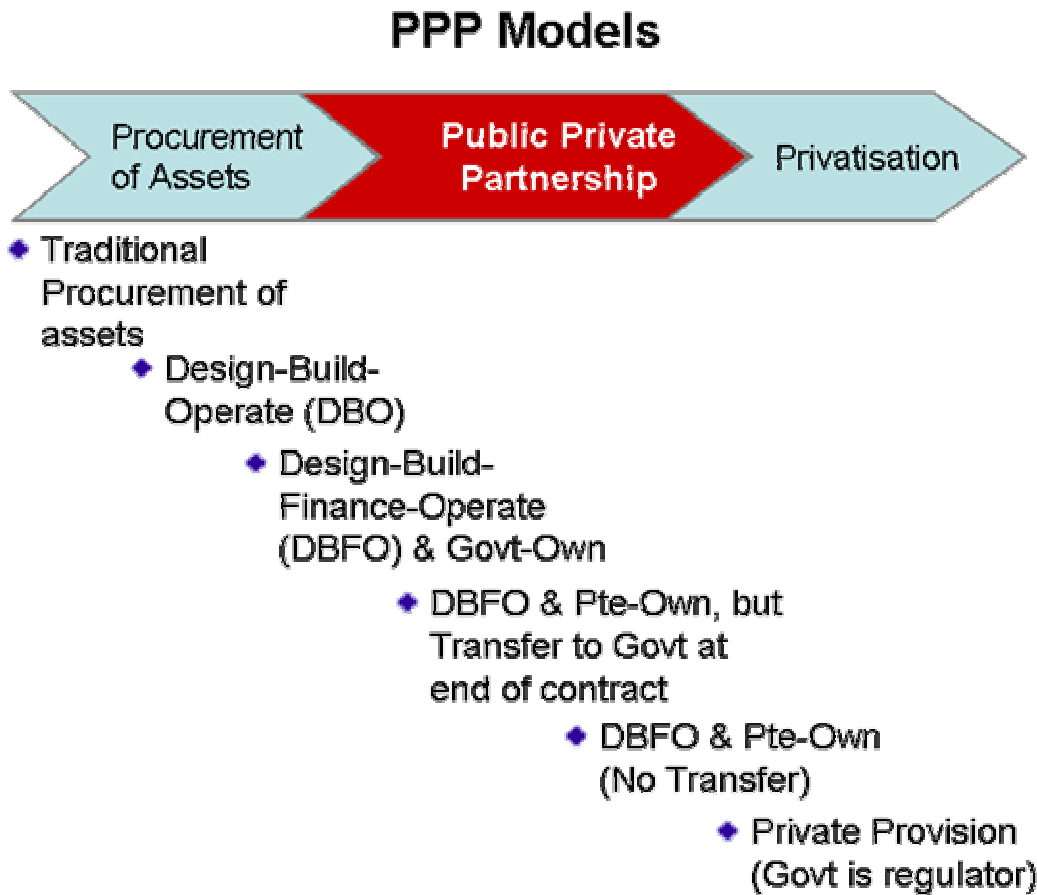
1.1.4 **With PPP, the public sector will focus on acquiring services at the most cost-effective basis, rather than directly owning and operating assets.** For example, if PPP is used to develop a water treatment plant, the private sector will be engaged to not only construct the plant, but also to design, operate, maintain and raise financing to build the plant to supply water to the public agency. Hence, instead of owning and operating the water treatment plant, the public agency purchases the water directly from the private sector. This means that the private sector has more room to introduce innovation into the delivery of public sector services.

1.1.5 Under PPP, the private sector can look forward to providing a wider range of services and over a longer contract period (usually between 15 to 30 years). Through closer collaboration with the private sector, public services can be delivered in a more value for money way by making optimal use of the public and private sectors' expertise, resources and innovation to meet public needs effectively and efficiently.

1.2 TYPICAL PPP DELIVERY MODELS

1.2.1 There are many PPP models, including joint-ventures, strategic partnerships to make better uses of government assets, Design-Build-Operate (DBO), Design-Build-Finance-Operate (DBFO), etc. Some common PPP models that can be used are shown in Figure 1. 1.

Figure 1. 1 Some Common PPP Models



1.2.2 The PPP models are typically a variation of the Design-Build-Finance-Operate (DBFO) model or the Design-Build-Operate (DBO) model.

- a) **Design-Build-Finance-Operate (DBFO) model.** DBFO is the most common form of PPP, involving the integration of these four functions, Design, Build, Finance and Operate within one PPP service provider. The PPP provider will raise financing from private financiers, e.g. banks or equity investors, to develop the facilities needed to deliver services to the public sector. The provider will then build, maintain and operate the facilities to meet the public sector's requirements. The private provider will be paid according to the services delivered, at specified performance standards, throughout the entire contract length.
- b) **Design-Build-Operate (DBO) model.** One possible variation to the DBFO model is the DBO model, i.e. the public sector provides the funds for a private sector party to design and build the facility, and then continues to engage the same private sector party to operate the facility. The private sector provider is then paid a management fee. This model may be suitable for very large projects for which the private sector is unable to finance wholly.

1.3 WHY PPP?

1.3.1 PPP offers a win-win-win solution for the public sector, the private sector and members of the public.

For the public sector:

1.3.2 PPP allows the public sector to get better value for money in the delivery of the public services. Through closer partnership with the private sector, efficiency and effectiveness gains can be reaped, particularly from the following sources:

- a) **Private sector innovation.** PPP allows Government to tap on to the private sector's capacity to innovate. This is the greatest source of value for money gain, and is achieved by Government not specifying how a service should be delivered or how an asset has to be designed and built. Instead, Government will spell out the services it need, and the desired outcomes/outputs. The private sector can then introduce innovative solutions to meet Government's objectives.
- b) **Optimal whole lifecycle costing** by outsourcing design, build, maintain and operate to the same private company (or consortium). The company (or consortium) will then be in a good position to optimise the design in the first instance so as to achieve economy in construction, operations and maintenance. This is not possible under the conventional government procurement approach where design, construction, maintenance and operations are undertaken by different entities.
- c) **Better asset utilisation by sharing Government assets/facilities with third-party users.** Some government assets/facilities can be shared with other users. For example, space in government buildings can be rented out for suitable alternative uses. Sharing government facilities with other users can contain cost increases for Government and thus public services. With PPP, the private provider, which has expertise in managing assets, will help Government determine the optimal way of using and sharing Government's assets/facilities with third-party users.
- d) **Optimal sharing of responsibilities between the public and private sector.** In a PPP project, Government and the private sector share the responsibilities of delivering a service. The responsibilities are allocated according to each party's expertise in managing and adding value to a specific part in the service delivery process. For example, Government's core competency is in identifying public needs and crafting public policies and objectives. Hence, the public sector is responsible for clearly defining the service requirements and desired outcomes. The private sector is usually better equipped to manage construction and utilisation of assets and operational issues. Hence, the private sector is typically responsible for designing, building and operating assets to deliver the service. By sharing responsibilities optimally, Government and the private sector can put together their financial and human resources and skills expertise to deliver the public service in the best value for money way.

For the Private Sector:

1.3.3 PPP offers more business opportunities to the private sector. The private sector will be engaged to deliver a full suite of services (e.g. design, construction, operations and maintenance) which were traditionally performed in-house by public agencies or performed by multiple private companies.

1.3.4 PPP also allows the private sector to move from just constructing assets according to clearly specified designs, to designing and delivering innovative solutions. The private sector has more room to innovate and offer efficient solutions for public services.

For members of the public:

1.3.5 PPP brings together the expertise of the Government and the private sector to meet the needs of the public effectively and efficiently. When structured appropriately, PPP will deliver public services that can better meet the needs of the public without compromising public policy goals and needs.

1.3.6 Government will also ensure that public interest is protected in all PPP projects and that service delivery will meet public needs at the best value for money when the private sector is brought in to provide government services. In particular, the public sector will ensure that:

- The private providers can meet the public needs effectively;
- There is clear accountability when services are delivered by the private sector and the public knows who to approach for service queries and feedback;
- Public security, health and safety will not be compromised in the PPP projects; and
- Confidentiality of information will be observed. We will protect the personal data and information of the public agency's customers.

1.4 WHICH SERVICES WILL PPP BE USED FOR?

1.4.1 PPP offers benefits to the public sector, the private sector and members of the public. However, a significant amount of effort and resources have to be put in by both the public and the private sectors in structuring a successful PPP deal where the responsibilities are optimally shared. Both the public and the private sectors have to gradually build up the competency to structure and sustain successful PPP deals.

1.4.2 For a start, Government will only be applying PPP to large value projects (namely, projects where the value of the projects is likely to be more than \$50m) in sectors where there are successful PPP examples in other countries such as the UK and Australia. Such sectors will include:

- Sports facilities.

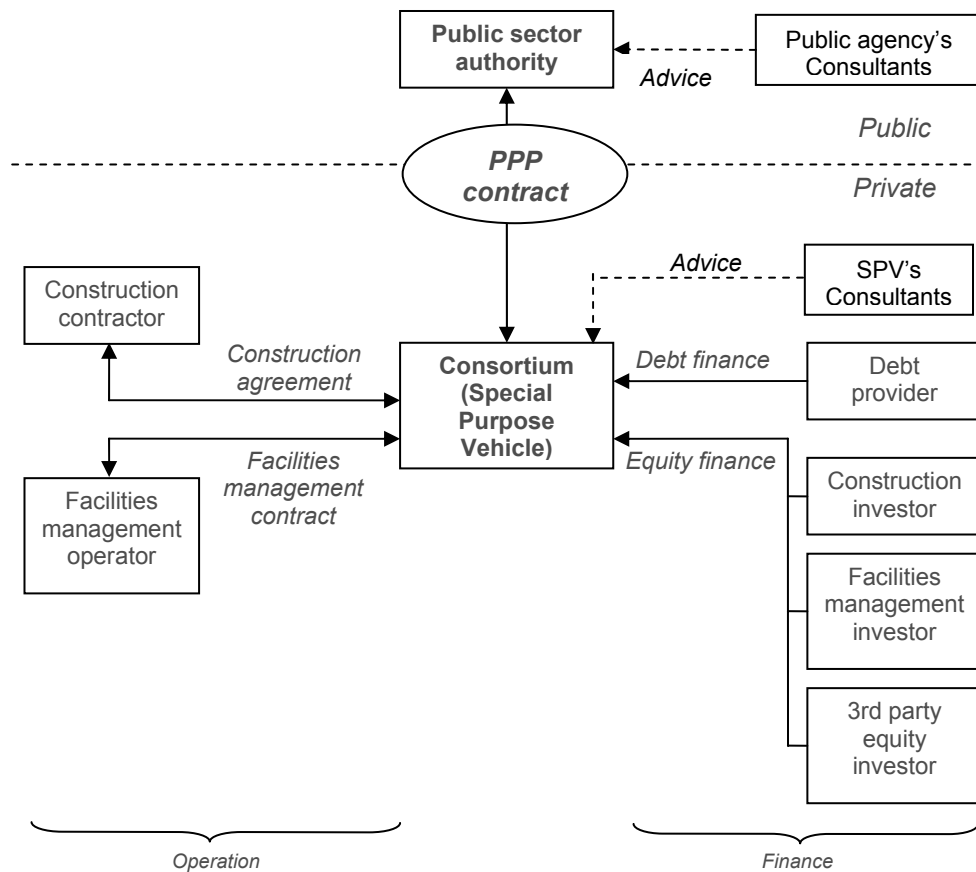
- Incineration plants, water and sewerage treatment works.
- Major IT infrastructure projects.
- Education facilities, including student accommodation facilities.
- Hospitals and polyclinics.
- Expressways.
- Government office buildings.

1.4.3 Each PPP project is unique. There is no one single PPP model that is suitable for all PPP projects. Hence, Government and the private sector should work closely together to determine the optimal scope of collaboration in each project.

1.5 ROLES OF THE PUBLIC AND PRIVATE SECTORS IN PPP PROJECTS

1.5.1 A PPP project involves collaboration between various types of private sector companies and the public agency. The PPP deal should be structured to be mutually beneficial to all the parties involved, with each party taking on the responsibilities which it is best able to manage. The roles of the public sector and the various private sector parties (including construction companies, operations companies, financial institutions and PPP consultants/advisors) in a typical PPP project under the Design-Build-Finance-Operate model are shown in Figure 1. 2.

Figure 1. 2 Typical PPP (for DBFO model) project structure



1.5.2 In general, the responsibilities of the various parties collaborating in a PPP project are as follows:

- Public agency – Purchaser of services.** As the purchaser of services, the public agency will specify the outcomes/outputs that it requires and avoid specifying the means of the delivering the services. The public agency will also pay the PPP provider (i.e. the SPV) when the services are delivered according to the contract performance standards.
- Design, Construction, and Operations and Maintenance companies – Service providers.** These private companies will form the SPV to bid for the PPP project. These companies play the critical role of proposing innovative solutions to meet Government’s objectives for the PPP project. In a typical PPP project, the SPV will manage its design, construction and operational and maintenance responsibilities, by subcontracting the construction, operations and equipment supply to suitable providers. These subcontractors may be the parent companies of the SPV (i.e. the construction, operations and maintenance companies which are the equity investors of the SPV). In addition to design/construction/operations/maintenance, the SPV is to also raise the financing it needs to build any asset it requires to deliver the services. It will need to explore the financing arrangements, such as the quantum of the debt/equity, the rates of returns required and the tenure of loan, with potential equity and debt providers. When the SPV starts to deliver the services, it will use the service

payment streams it receives from the procuring Government agency to repay its debt and equity providers, as well as its suppliers and subcontractors.

- **Equity investors and Debt providers– Private financiers.** The equity investors of the SPV are typically (but not necessarily always) the construction and operations companies who will be involved in the actual service delivery. Fund managers or other financial institutions may also take equity stakes in the SPV. Equity investors are interested in generating positive returns on their investment, and hence have a strong interest in ensuring that the services delivered meets the performance standards that were agreed between the public agency and the SPV. Debt providers, such as banks and bond holders, provide the majority of the funding (sometimes up to 80% - 90%, with the residue coming from equity investors). As debt providers, the banks and financial institutions will carry out due diligence on the SPV (such as its technical capability and financial soundness to be able to deliver on the PPP contract) and its business plan to ensure that its plans are robust. As the SPV's sole revenue source is from the PPP contract, as long as it is able to meet the service standards under the PPP contract and thus gets paid by the government procuring entity, the debt taken up by the SPV can then be repaid accordingly.
- **Consultants (if necessary) – Advisors.** The public agency and the private sector bidder may also separately decide to engage consultants (such as technical, legal and financial consultants) to help them structure a PPP tender, and to work out a viable PPP proposal respectively. Advisors who have experience in developing PPP contracts can help to highlight the best practices to adopt or the pitfalls to avoid when preparing for a PPP deal.

1.6 CONCLUSION

1.6.1 PPPs mark an exciting improvement to the way the government delivers public services. By tapping more on private sector innovation, resources and capability, PPPs can, when structured properly, give rise to better and mutually beneficial outcomes for the public, the public sector and the private sector.

1.6.2 The rest of this PPP handbook will describe in greater detail the considerations in structuring a PPP deal, entering into a collaborative PPP partnership (i.e. the PPP procurement process) and maintaining the collaborative relationship in a PPP project.

Questions for Consultation:

- Other than the (i) education, (ii) sports, (iii) healthcare, (iv) expressways, (v) water treatment and (vi) waste management sectors, what other Government projects can PPP be used for?
- What PPP models (other than Design-Build-Finance-Operate and Design-Build-Operate) can public agencies consider when working with the private sector?

SECTION 2

STRUCTURING A PPP DEAL

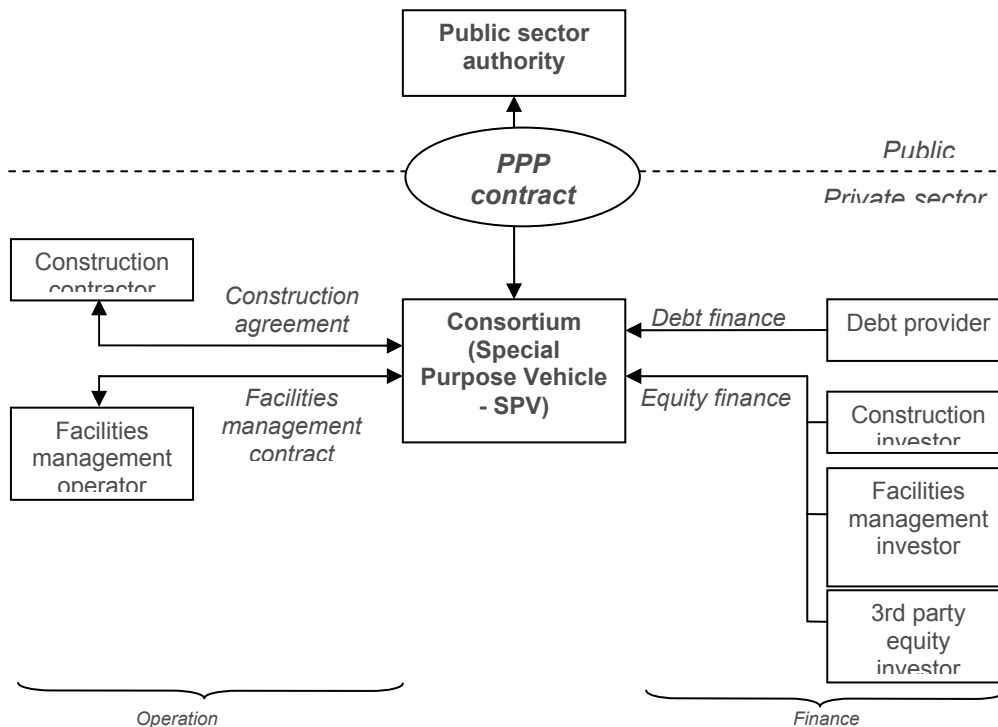
2.1 CHARACTERISTICS OF A PPP PROJECT

2.1.1 When structuring a PPP deal, it is important to fully understand the key characteristics of the PPP models. To give a comprehensive view of the characteristics of a PPP project, this section will describe the Design-Build-Finance-Operate model. This model involves the private sector in the widest range of services, and hence will give a broader view of the characteristics of PPP. Other PPP models, e.g. DBO, will share the same characteristics.

DESIGN-BUILD-FINANCE-OPERATE MODEL

2.1.2 Figure 2.1.1 illustrates the typical commercial structure of a DBFO project. The centre of the DBFO project is a PPP contract within which the public sector specifies the outputs it requires from a public service facility, the basis for payment for those outputs, and the risk-sharing arrangements between the public and private sectors, typically over 15-30 years.

Figure 2.1.1 Typical DBFO project structure



WHAT IS THE PRIVATE SECTOR RESPONSIBLE FOR IN THE DBFO MODEL?

2.1.3 Under a typical PPP-DBFO project, the private sector is engaged to perform a wide range of functions, including:

- a) **Design (D)**: The private partner designs the facility according to the output specifications set by the public sector. As far as possible, the public sector should not be prescriptive on the design, and should only set minimal input specifications on how the facility is to be designed.
- b) **Build (B)**: The private partner constructs the facility.
- c) **Operate (O)**: The private partner can provide ancillary and/or core operations services.
 - i) Ancillary: The private sector maintains the facility and provides non-core functions, such as cleaning, security, transport, etc.
 - ii) Core: The private partner delivers the core public service that the facility was built for (e.g. operating a desalination plant to provide potable water).
- d) **Finance (F)**: The private partner raises the money through e.g. bank loans, bonds and equity to finance the upfront cost to design and build the facility.
- e) **Own (O)**: Ownership of the land and PPP facilities thereon often resides with the private partner for the duration of the contract. There are, however, cases where ownership of the land and PPP facility thereon resides with the public sector even though the private partner finances it. Ownership of the land and PPP facility thereon generally has little influence over the performance of the private partner, since the private partner's profitability is affected by the payment stream from Government or the users and not by its ownership of the facility.

2.1.4 In a DBFO project, the private sector does not have to undertake all the operations related to delivering a service. The private sector will only provide the services that it is more efficient and competent at performing.

2.1.5 For example, in schools or hospitals PPP, the private partner may only construct the facilities and provide ancillary services such as catering, laundry, waste management, security, transport and maintenance services, while core education and healthcare services continue to be provided by the public sector.

2.1.6 There are also DBFO projects where the outputs can be clearly defined and measured, and thus the private provider can be involved in delivering more services. For example, for PUB's DBFO desalination plant, the private partner will not just design, build and maintain the plant, but also operate it to generate water output.

KEY CHARACTERISTICS OF DBFO PROJECTS

2.1.7 A DBFO project usually has the following characteristics:

Contractual Characteristics

- i) **Long Term contract.** PPP contracts tend to be long-term, possibly up to 30 years (though in particular cases it could be only 7 to 10 years), depending on the nature of the facilities and services to be delivered.
- ii) **Outcome/Output Specifications.** Public service requirements would normally be framed as output specifications, instead of precise input specifications and design, to give more room to the private sector to provide innovative solutions to meet the public sector's requirements.
- iii) **Special Purpose Vehicle (SPV).** The private provider is usually a consortium formed by multiple companies.
- iv) **Sharing of Responsibilities.** Responsibilities and risks for activities that can be better controlled and managed by the private partner are transferred to the SPV.
- v) **Performance based payment mechanism.** The public sector pays only when services are delivered (e.g. the private sector is not paid during the construction phase). These service payments vary depending on whether the services provided meet specified performance standards. If the PPP provider consistently fails to provide satisfactory services, the public agency concerned can terminate the PPP contract.
- vi) **Flexible contract with mechanisms for variations.** The DBFO contract entered into at the outset recognises that there will be a need for changes over the 15-30 year life of the contract. The public sector has a right to change, within limits, some aspects of the building or service provision, subject to agreement with the DBFO contractor on cost. Usually, there is also a binding dispute resolution procedure in the contract.

Financial Characteristics

- vii) **Private Financing comprising of equity and debt.** The SPV is owned by one or more equity investors, but the debt providers provide the majority (typically 80% or 90%) of the financing.
- viii) **Publicly funded.** DBFO is neither a source of free money nor a means of implementing ill-conceived, unaffordable projects. While the private sector provides the capital funding for the project, this is ultimately recovered from members of the public (as user charges/fees) and/or the public agency (as a stream of payments to the provider).

2.1.8 The following sections elaborate on the contractual and financial characteristics highlighted above.

CONTRACTUAL CHARACTERISTICS

(i) Long Term Contracts

2.1.9 PPP projects tend to be long-term, typically ranging from 15 to 30 years or more (though in particular cases it could be only 7 to 10 years). The length of the contract will typically cover the entire economic life of the asset. This ensures that the private sector partner takes a whole life-cycle view for the development of the asset. The asset will then be designed, constructed, operated and maintained such that the whole lifecycle cost of the project is minimised. The private sector operator will also ensure that the asset is well maintained for its entire economic life.

(ii) Outcome/Output Specifications

2.1.10 Outcome specifications form a vital part in encouraging innovation in PPP deals. Private sector innovation is especially critical for DBFO deals, where the private provider is expected to generate management efficiencies compared to public sector in-house provision. Hence, it is necessary for the public agency concerned to state clearly what needs to be achieved from the facilities and services while leaving room for the private sector to produce innovative, cost-effective solutions. In short, the outcome specifications detail what needs to be achieved, not how it is to be achieved.

<u>Examples of Input Specifications vs. Outcome Specifications</u>	
<u>Input Specifications</u>	<u>Output specifications</u>
<p><u>Maintaining School Playing Fields</u> Playing fields must be trimmed and cleaned thrice a week.</p>	<p>Playing fields must be capable of providing seven hours playability per week.</p>
<p><u>Maintaining Drains, sewers and gutters</u> Drains, sewers and gutters must be cleared at least once every day.</p>	<p>All drains, sewers and gullies to be maintained free-flowing and free from odours.</p>

2.1.11 Producing effective outcome specifications involves the art of defining the end without being prescriptive on the means for meeting these outcomes. The specifications should clearly and comprehensively state what is required and the standards to be achieved.

2.1.12 In a PPP project, the public agency concerned will make payments to the private sector based on whether the outcome/output specifications are met. Therefore, it is vital that both the public and private sectors have a clear understanding of how performance against these outcome/output specifications are measured and monitored. Performance measurement may be linked to an agreed set of standards or key performance indicators, which will generally relate to the quality, amount and frequency of service provision. **There has to be agreement within the PPP contract on how such performance is to be measured and monitored since the payments to the private sector are based on these performance specifications being met.**

(iii) Special Purpose Vehicle

2.1.13 Companies in the private sector typically form consortiums, also known as Special Purpose Vehicles (SPV), to bid for the Design-Build-Finance-Operate contract. Usually, the SPV is formed from a joint venture between an experienced construction contractor and a facilities management or service operations company capable of running and maintaining the asset. Other contractors required to deliver other outputs specified in the contract will also join the SPV. The SPV will produce a bid which takes into account the whole-of-life cost of the asset, incorporates the proper level of repairs and maintenance, and reflects the cost of the services provided, and the cost of private finance. Competition between bidding consortiums during the procurement process to select the PPP provider helps to ensure value for money.

(iv) Sharing of responsibilities

2.1.14 **Key to ensuring value for money benefits in DBFO projects is an optimal sharing of responsibilities between the public and private sectors. This does not mean all responsibilities should be transferred to the private sector.** Indeed, if the private sector is asked to be responsible for activities that it has no control over, it would increase the contract costs to Government, resulting in poorer value for value for both the Government and the private sector.

2.1.15 The guiding principle adopted in identifying and allocating responsibilities is that the party best able to manage a particular activity should be responsible for that activity and receive the rewards or losses associated with changes related to that activity. The allocation of responsibilities in PPP projects vary depending on the nature and objectives of the project.

2.1.16 Table 2.1.1 below describes the general types of responsibilities in a DBFO project and classifies each activity into:

- a) **Private Sector Responsibilities** – Activities which are usually transferred to the private sector;
- b) **Negotiable responsibilities** – The degree of transfer of these responsibilities is a matter of discussion at the project level, and varies with the nature and requirements of each project; and
- c) **Public Sector responsibilities** – These are responsibilities which are typically retained by the public sector.

Table 2.1.1 Project responsibilities and typical allocation in DBFO projects

Responsibility	Description of responsibility
<i>Private sector responsibilities – Responsibilities typically borne by the private sector</i>	
Construction	Construction of physical assets, including ensuring that the construction is completed on time, to budget and to specifications
Design	Design of physical assets and work processes (where applicable), including ensuring that the services are delivered at the required performance or quality standards.

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Responsibility	Description of responsibility
Maintenance	Ensuring that the assets are kept in good condition.
Operations	Operating assets to deliver services that meet performance standards that were agreed upfront between the public agency and the PPP provider.
<i>Negotiable responsibilities – Transfer of these responsibilities vary depending on nature of project</i>	
Planning	<p>Obtaining planning permission for the facilities to be developed.</p> <p>Typically, the public agency will be responsible for getting overall planning approval (e.g. approval from land authority for building a facility on a selected plot of land), but the private company is responsible for specific planning approval (e.g. adherence to fire safety regulations).</p>
Managing Demand	<p>Ensuring that demand/usage of the service match planned levels. In cases where the public sector itself is not the only user of the services provided, it is possible to require the private sector to bear part of the responsibility of meeting planned demand. For example, the private sector can be made responsible for marketing government office space to the private sector and part of its revenue could vary with the occupancy by third party users.</p> <p>However, for projects where Government is the main user, the responsibility to meet planned demand is usually retained by the public agency concerned. For example, in PPP deals for schools, the private partner typically cannot control the number of students that are sent to the PPP school, because the public sector usually influences the entry of students to schools. In such cases, it is not reasonable for the private sector to be responsible for meeting the planned demand level. The private provider will then typically be paid based on availability of the facilities, instead of the usage of the facilities.</p>
Managing Costs to meet legislations	<p>Changes in legislation can increase the cost of the project. The responsibility of managing costs to meet legislations can be shared between the public and private sector. Generally, the private sector will ensure that general legislations are obeyed and its contract price will already include the costs of abiding by general legislations. Hence, cost changes due to changes in general legislation (e.g. across the board increases in GST) will be borne by the private PPP provider.</p> <p>However, costs arising from changes in legislation that only affects PPP projects should be shared between the public and private sector because the public sector is able to partially influence such legislations.</p>
Maintaining Residual value of Assets	<p>Ensuring that the physical assets have a certain value at the end of the contract (i.e. the residual value).</p> <p>The allocation of this responsibility requires a case-by-case consideration. Sometimes, it is unrealistic to expect the private sector to maintain the assets at a particular value, if such residual value cannot be determined objectively (e.g. for specialised PPP assets such as prisons which are owned exclusively by Government). In such cases, to ensure that the asset is in reasonable working condition at the end of the contract, the public agency may require the service provider to set aside a reserve fund, which can be used to maintain/repair the building, if necessary. In the contract, the public agency should also specify the state of the asset at contract expiry.</p>
Keeping up with technology changes	<p>Ensuring that optimal technology is used to deliver the required services. Technological changes are usually not significant outside of IT-based projects. Where technological changes are probable, the responsibility of upgrading the assets according to new technology should be dealt with explicitly in the</p>

Responsibility	Description of responsibility
	contractual agreement.
<i>Retained Responsibilities – Responsibilities that are typically retained by the public sector.</i>	
Managing costs according to inflation	Ensuring that payments to the private sector is sufficient to cover cost changes due to inflation. Typically, the payment to the private sector will vary according to a general price index, e.g. Consumer Price Index. This means that the public sector will be responsible for providing sufficient payments to the provider to cover for inflation.
Making Policy Decisions	The public sector usually bears the responsibility for identifying the need of the PPP facility and the adequacy of the contract specifications to meet public expectations and making policy decisions regarding the need of the services.

(v) Performance based payment mechanism

2.1.17 The DBFO contract includes a performance based payment mechanism, where the public sector only pays when services are delivered (e.g. the private sector is not paid during the construction phase) and recurrent payments varies depending on whether the services provided meet specified performance standards. The private provider can be encouraged to improve performance beyond the specified standards through incentives or benefit sharing arrangements. On the other hand, there could be deductions/penalties to the payments if the PPP provider fails to perform satisfactorily. However, it is important to note that a mechanism that veers too much towards penalty will not encourage partnership over the PPP contract life and hence should only be used on critical performance standards.

2.1.18 If the private provider consistently fails to meet required performance requirements, the public agency can ensure that service levels are restored through the following ways:

- a) *Deductions/Penalties.* If a private provider fails to deliver the project on schedule or the services provided fall below the standard originally specified, deductions and penalties can be imposed on the payments made by the public sector. This is to ensure that the private provider will work towards remedying any shortcomings in service delivery.
- b) *Step-In to take over operations.* The public agency can also step in to take over the operations and delivery of the services *in certain circumstances* (even where there is no default), e.g. serious risk to public health, safety or the environment, serious national security implications.
- c) *Terminate the contract due to private sector default.* Where a private provider consistently fails to deliver the services to the standard specified and the private sector has failed to remedy this deficiency, the PPP contract will fall into default, giving the public sector the right to terminate the contract and step in to ensure continuity of service delivery. In these circumstances:
 - i) Projects will revert to public ownership, including the assets necessary to continue to deliver the service;

- ii) Compensation may be due to the SPV based on the termination compensation clauses as stipulated in the PPP contract; and
- iii) The public sector would then take ownership of the project itself or re-tender the opportunity to take over the project to other private sector contractors. The public agency concerned would have to proceed with legal action, as appropriate, to recover from the defaulting private partner the costs incurred in rectifying defects, and in the maintenance and management of the facility.

(vi) Flexible contract with mechanisms for variations

2.1.19 When entering into a PPP-DBFO deal, the public agency and the private provider should recognise that there will be a need for changes to the service delivered over the 15-30 year life of the contract. Where necessary, some aspects of the service requirements or service delivery methods can be changed, subject to agreement by the public agency and the private provider on cost. To ensure that agreement is reached quickly, the public sector can require a competitive tender for any works involving changes over a certain threshold. If a dispute arises regarding the scope of the changes, there is a binding dispute resolution procedure in the concession agreement.

FINANCIAL CHARACTERISTICS

(vii) Private Financing

2.1.20 The private provider will raise project finance through equity and debt finance. The SPV is usually owned by one or more equity investors. Some of these shareholders may be contractors to the consortium who undertake to carry out construction, design or facilities management work in the project. Others may be financial investors. Debt finance, in the form of bank loans or bonds, is also raised to pay for the construction and operation of the project. Both providers of equity and debt play important roles in the overall success of the DBFO project.

2.1.21 **Equity Providers** own the consortium company (i.e. the SPV). An equity investor only benefits from its investment in a DBFO project after it is completed and successfully in operation as the public agency concerned only starts paying when the asset becomes available. In addition, the value of the project to the equity investor is determined by the expected performance of the project over its whole life. Hence, the equity investor will ensure that the SPV performs up to the specified standards so that there are positive returns on investment for the company.

2.1.22 **Debt providers** provide the majority of the funding (in the UK, about 80% to 90% of financing for a DBFO project comes from debt providers). The banks and other financial institutions that lend to DBFO projects play the following key roles:

- a) *Due diligence* – When private sector financiers consider financing a project, they will carry out extensive due diligence work, aided by independent advisors in technical, insurance, legal and financial aspects of

the DBFO deal. This due diligence is intended to ensure that the SPV's business plan is robust; and

- b) *Taking overall project risk* – Debt providers hold the overall risk that their debt is not repaid. To manage this risk, they hold step-in rights to take over failing projects and bring in new contractors who can meet public sector requirements, subject to the public agency's agreement.

(viii) PPP projects are publicly funded

2.1.23 DBFO is neither a source of free money nor a means of implementing ill-conceived, unaffordable projects. While the private sector provides the capital funding for the project, this is ultimately recovered from:

- a) *Members of the public* – These are financially free-standing projects undertaken by the private sector with cost-recovery by means of user charges imposed on the users (usually a member of the public). This charging model is typically used for toll roads.
- b) *The public sector* – These are projects that involve the sale of services to the public sector, with costs recovered only from the public sector, e.g. in the defence related PPP projects.
- c) *Both members of the public and the public sector* – These are projects for services delivered to the end users with the public agency sharing the costs so that user charges imposed on the end users remain affordable. This charging model is typical for the development and maintenance of the public agency's buildings which may also be rented out to interested third party users.

OWNERSHIP OF THE PPP FACILITY

2.1.24 Under the DBFO model, the private sector can own the land and PPP facility thereon that it finances and develops. However, this is not always the norm. There are some DBFO deals where the public agency will own the land and PPP facility thereon once construction is completed. For example, in some UK Roads and Prisons PPP deals, the public sector retains ownership of the land and assets, but the contractor will be responsible for the operations. Public agencies entering into PPP deals have to decide whether Government or the private sector partner should own the facility.

2.1.25 In general, there are two ownership structures for PPP projects:

- a) **Contractor-Owned, Contractor-Operated (COCO).** In COCO, the ownership of the land and facility thereon resides with the private sector for the length of the contract. COCO is particularly suitable for projects where:
 - the facility is not dedicated for Government's use only but can be shared by other users, i.e. there is scope for generating additional revenue flows through providing services to other users;

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- Government's usage is only for a portion of the asset life. For example, if Government only needs the asset for 5 years out of its economic life of 30 years;
 - the owner can affect the productivity of the asset through enhancement, maintenance or upgrading during its life, especially when the risk of obsolescence of the asset is high; and
 - the main "productive" capacity of the asset is through its operations, i.e. the facility plays an integral role in providing the service for the users. For example, COCO is suitable for PPP water treatment plants where the private sector partner has to operate the asset to supply water to the users/Government. This is in contrast with school buildings, where the facility is meant to house the productive activities, i.e. education activities, but is not an integral part of the education services that is delivered.
- b) **Government-Owned, Contractor-Operated (GOCO).** In GOCO, the private sector will finance and develop the facility, but the public agency retains ownership of the land. Upon completion of construction, the ownership of the facility will be held by the public agency since it owns the underlying land. GOCO is suitable for critical and unique facilities that should remain under Government's ownership and control, e.g. national defence infrastructures. The contractor maintains all the properties but the land title to the properties remains with the public agency. However, with GOCO, the public sector has to assure the private provider and its financiers that their investment in the facility will be safeguarded even if they do not hold title to the asset. This can be achieved by committing under the contract termination provision of the PPP contract that the public agency will provide a minimum level of compensation to the PPP provider should the public agency terminate the PPP contract prematurely. In addition, Government also has to:
- Give a right to the operator to use the land and operate the asset on the land once it is developed so as to deliver the needed service under the PPP contract;
 - Provide sufficient compensation to the operator if Government defaults; and
 - Give the private financiers step-in rights to take over operations and find another suitable operator, subject to Government's approval, if the existing operator defaults.

Questions for Consultation:

- Are there other responsibilities (other than those listed in Table 2.1) that should be identified in a PPP project?
- In what circumstances should the GOCO model be used, instead of the COCO model?
- What should be the compensation arrangements in the event of contract termination?

SUMMARY

DESIGN-BUILD-FINANCE-OPERATE (DBFO) MODEL

- Under DBFO, there is a concession agreement where the public sector specifies the outputs it requires from the PPP facility, the basis for payment for those outputs, and the risk-sharing arrangements.
- The private sector is involved in designing, building, providing core and/or ancillary operations services, maintaining, financing and sometimes owning the PPP facilities.
- A DBFO scheme usually has the following characteristics:
 - c) **Long Term contracts**, typically 15 – 30 years.
 - d) **Outcome/Output Specifications**. Public service requirements would normally be framed as output specifications, instead of precise input specifications and design.
 - e) **Special Purpose Vehicle (SPV)**. The private partner is usually a consortium formed by multiple companies.
 - f) **Sharing of responsibilities**. Responsibilities for activities that can be better controlled and managed by the private partner are transferred to the SPV.
 - g) **Performance based payment mechanism**. The public sector pays only when services are delivered.
 - h) **Flexible contract with mechanisms for variations**.
 - i) **Private Financing comprising of equity and debt**.
 - j) **Publicly funded**. While the private sector provides the capital funding for the project, this is ultimately recovered from members of the public and/or the public sector.

OWNERSHIP OF THE PPP FACILITY

- In general, there are two ownership structures for PPP projects that agencies can consider:
 - Contractor-Owned, Contractor-Operated (COCO). In COCO, the ownership of the land and facility thereon resides with the private sector for the length of the contract.
 - Government-Owned, Contractor-Operated (GOCO). In GOCO, the private sector partner will finance and develop the facility but the public agency retains ownership of the land. Upon completion of construction, the ownership of the facility will be held by the public agency.

2.2 COMPETENCIES NEEDED TO STRUCTURE PPP DEALS

2.2.1 PPP, being a long-term service-purchase contract, can be more complex than most government procurement projects. Public agencies and potential private sector providers need to address several issues, such as crafting and understanding output/outcome specification, preparing whole lifecycle costing, structuring a viable and realistic payment mechanism, ensuring fair termination rights, etc.

2.2.2 To address such issues, public agencies and potential PPP providers need competencies in financial, legal and technical aspects of contracting through PPP. This chapter describes the competencies that the project team involved in a PPP project should have. Such competencies can be developed in-house (or might already be available in-house) or can be provided by private sector PPP advisors who have experience in managing PPP projects.

WHAT IS THE PROJECT TEAM RESPONSIBLE FOR?

Public Sector Project Team

2.2.3 Generally, the public sector project team is responsible for:

- a) Evaluating whether it is feasible to structure a PPP model for the project;
- b) Structuring the PPP tender that deliver best value for money to Government while providing sufficient business opportunities for the private sector. This could include carrying out a detailed study to recommend a feasible PPP scheme, including the financial arrangements, pre-qualifying criteria of the PPP provider and preparation of the PPP tender documents;
- c) Evaluating the tender proposals to select the best provider for the PPP contract;
- d) Preparing the final PPP contract document after the preferred bidder has been selected; and
- e) Monitor the progress and performance of the private provider's work.

2.2.4 The public sector PPP project team can be made up of public officers who understand the policy objectives and service requirements for the project. If the public officers involved in the PPP project are not familiar with the financial, legal or technical aspects of the project, private sector PPP advisors can be engaged to provide the necessary expertise to design a viable PPP deal.

2.2.5 Before appointing private sector PPP advisors, public agencies may wish to first approach the Sourcing and Partnership Unit (SPU) in Ministry of Finance for inputs and advice on the tender documents for procuring the services of a PPP advisor.

Private sector PPP project team

2.2.6 Private sector providers who are interested in tendering for a PPP project should also have sufficient competencies to:

- a) Understand the PPP model proposed by the public sector and the financial implications on the revenue, cost and cash-flow of the PPP provider;
- b) Identify business opportunities and propose innovative solutions that can meet the public sector's needs;
- c) Identify the responsibilities of the private sector in the PPP model proposed by the public sector;
- d) Identify sources of financing which offer the lowest financing cost;
- e) Structure and price a tender proposal that can meet Government's objectives with the best value for money while remaining profitable for the company; and
- f) Manage the project (if awarded the PPP contract) to consistently meet agreed performance requirements.

2.2.7 Potential private providers for PPP projects can also consider engaging PPP advisors to assist in preparing the tender proposals if they do not have sufficient in-house competencies/experience to respond to PPP tenders.

WHAT COMPETENCIES ARE NEEDED IN THE PROJECT TEAMS?

2.2.8 Both the public and private sector project teams (including their PPP advisors) should have competencies to structure and evaluate the (i) financial, (ii) legal and (iii) technical aspects of the PPP deal.

Financial Expertise

2.2.9 Generally, financial experts in the PPP project teams should have a good understanding of project financing, including an understanding of the different financial markets and financial instruments that can provide financing for the PPP project.

2.2.10 For the public sector, such financial competencies will help public agencies identify the likely financiers of the PPP project and their risk attitudes, so as to structure the PPP contract (e.g. including step-in rights, termination clauses and payment mechanisms) that are acceptable to the private financiers. Without a good understanding of the financing aspects of the project, the public sector might end up structuring a PPP contract where the PPP providers can only secure financing at expensive borrowing rates, thereby leading to higher contract cost to the public agency.

2.2.11 For the private sector bidders, a good understanding of project financing and financial markets will help them identify suitable sources of financing to meet the public sector's requirements at the lowest cost.

2.2.12 In general, financial experts on the project teams should be able to:

- a) Build up a robust business case for the PPP project. For the public sector team, this would involve developing a Public Sector Comparator (PSC), which is the cost of the project if implemented through conventional government procurement. The PSC will serve as a comparison to the PPP cost to help the public agency determine if PPP should be used.
- b) Identify the responsibilities and risks borne by the public sector and the private sector and the financial implications of such responsibilities.
- c) Structure payment mechanisms that offer the optimum balance of responsibilities, risks and rewards for the public agency and PPP provider;
- d) Prepare/Review tender proposals. The private sector will have to prepare and submit tender proposals detailing the business model and the financial costs to the public agency. The public agency's team will have to assess the accuracy of the financial models and the implications on the cost for the public agency.
- e) Identify the financial implications of the contract clauses in the PPP contract, e.g. implications of step-in rights and termination clauses.

Legal Expertise

2.2.13 Legal experts play an important role in preparing the PPP contract. The legal experts should also be able to identify the implications of contract terms, especially potential "deal breakers", such as payment mechanisms, termination clauses and step-in rights.

2.2.14 Legal experts in the PPP project teams (for the public and private sectors) should be able to:

- a) Structure and draft the tender documents, PPP contract and land lease agreements;
- b) Advise on the best procurement or bidding; and
- c) Provide general legal advice on taxation, property, planning, environmental law, banking, competition law and intellectual property.

2.2.15 If legal expertise is not available in-house, public agencies and potential PPP bidders can consider engaging external legal advisors. However, **ministries, organs of state and government departments must consult AGC for advice before seeking external legal advisors.** Statutory Boards, on the other hand, can engage private sector legal advisors without consulting AGC.

Technical Expertise

2.2.16 Technical expertise includes knowledge of technical requirements for the services purchased by Government. Some technical specialists that might be required include surveyors, engineers, architects, contractors, project managers, actuaries and other technical professions. Such technical expertise could be available in-house. Otherwise, public agencies and potential PPP providers can consider engaging external technical advisors to assist in crafting technical specifications.

2.2.17 For the public sector, technical experts can assist in:

- a) Defining output/outcome specifications and service standards for the services to be provided under the PPP tender and contract;
- b) Technical evaluation of proposals and bids, including capability of the private sector tenderers;
- c) Quality assurance during the construction phase, including ensuring contractor compliance and assessing technical risks;
- d) Valuing assets that may be sold or transferred to the PPP provider, and;
- e) Developing appropriate performance measures and monitoring systems to determine the performance of private sector providers.

2.2.18 Technical experts in public sector should avoid specifying inputs, such as how to build facilities and how to design work processes, to give the private sector providers as much autonomy as possible to determine the best means of meeting the public sector's requirements. It will still be necessary for the public sector to provide the necessary constraints in the design, construction and operation of some facilities (e.g. public agencies might wish to specify design themes if the PPP facility has to be iconic). However, public agencies should bear in mind that PPP is about procuring services, not assets. Hence, the focus should be on determining output specifications, instead of input technical requirements.

2.2.19 For the potential private sector bidders, technical experts should work on designing and constructing assets, systems, equipment and work processes that can deliver services that meets the public agency's service requirements.

CONCLUSION

2.2.20 It is important for public agencies with PPP projects and potential PPP providers to build up sufficient competencies to structure and evaluate PPP deals. Such expertise can be developed in-house or supplied by external private sector advisors. Competent project teams can help the public agency and the private sector cut down the PPP procurement time and costs.

2.2.21 As PPP is still in a nascent stage in Singapore, both the public and private sectors can learn from the experience in other countries to build up the competencies to not only structure a win-win PPP deal, but also to manage and sustain the long-term partnering relationship throughout the PPP contract.

Question for Consultation:

- What other competencies should the public and private sectors develop to structure and manage PPP projects effectively?

SUMMARY

RESPONSIBILITIES OF PPP PROJECT TEAMS

Public Sector project teams should have competencies to:

- Evaluate whether it is feasible to structure a PPP model for the project;
- Structure a win-win PPP tender;
- Evaluate tender proposals;
- Prepare the final PPP contract document; and
- Monitor the progress and performance of the private provider's work.

Private sector project teams should have competencies to:

- Understand the PPP model and the financial implications;
- Identify business opportunities and propose innovative solutions;
- Identify the responsibilities of the private sector in the PPP model;
- Identify sources of financing which offer the lowest financing cost;
- Structure and price a tender proposal; and
- Manage the project (if awarded the PPP contract).

COMPETENCIES NEEDED IN THE PROJECT TEAM:

- Financial Expertise to identify the best sources of financing for the project;
- Legal Expertise to prepare a fair PPP contract; and
- Technical Expertise to clearly specify the output/outcome specifications for the services to be provided under the PPP contract.

2.3 STRUCTURING WIN-WIN PPP DEALS

KEY FEATURES OF WIN-WIN PPP DEALS

2.3.1 PPP projects must be structured to benefit both the public sector and the private sector. Specifically, the PPP deal must deliver value for money to government and also present commercially attractive business opportunities for the private sector.

2.3.2 Public agencies will adopt a Best Sourcing approach in deciding whether to use PPP. This means that agencies will compare the PPP approach (e.g. Private sector to design-build-finance-operate) with the conventional government procurement model (e.g. private sector build and government operate). The public agencies will then select the best approach to deliver the services (either through PPP or through conventional procurement). PPP will only be used if it can deliver better value for money than conventional procurement for that project.

2.3.3 Similarly, for the private sector, there should be sufficient revenue, either from Government or directly from the users, to recover the initial investment and the costs incurred by the private sector.

2.3.4 There are several key factors which will affect whether the PPP deal can deliver value for money to Government while remaining attractive for the private sector. Public agencies should work closely with the private sector to address these issues in order to structure a win-win PPP deal.

- **Competent Private sector providers** – Are there reliable and capable private sector providers who can deliver the required services? Is it possible for the private sector to deliver services better and more efficiently than Government?

Fundamentally, PPP will only be successful if the private sector has the capabilities to add value to the delivery of public services. Hence, PPP should only be applied to projects where the private sector has the competencies to meet the service standards required by Government or the public.

In addition, there should also be multiple potential private providers who can offer different proposals and ideas that will drive continual improvement in the delivery of public services.

- **Measurable Output/Outcome specifications** – Are the performance requirements expressed clearly in terms of service outcomes and outputs? Are there meaningful Key Performance Indicators (KPIs) to measure the delivery of the service outcomes/outputs?

In a PPP project, the desired service outputs/outcomes must be clearly stated so that the private sector can have a clear understanding of Government's policies and objectives. The private sector can then introduce innovative solutions to meet Government's needs. Clearly stated service requirements also reduce the uncertainty faced by both the public agency and the PPP provider.

The service outputs/outcomes should also be measurable. A set of performance measures and targets can then be developed to incentivise the private sector to meet the objectives of the public agency. The public agency can also objectively monitor the performance of the private sector to ensure that its service requirements are met.

- **Sufficient Project Scale** – Does the project require a significant level of investment in the development or redevelopment of capital assets? Is the value of the capital assets to be developed above S\$50 million? If not, can the project be bundled with similar projects to form a larger PPP deal?

Generally, the larger the scale of the project (in terms of capital value of assets), the more potential for management efficiencies through increased private sector involvement, particularly through economies of scale. This is particularly true for services which can be easily replicated, e.g. development of school buildings.

- **Scope for private sector innovation and management efficiencies** – Is there sufficient scope for the private sector to innovate? Can the private sector improve the level of utilisation of assets? Is the private sector able to exploit economies of scale through the provision, operation and maintenance of other similar assets/services to other customers?

PPP tends to be more successful for projects where the private sector is well-equipped to introduce innovation. Therefore, the scope of the PPP project should allow the private sector sufficient flexibility to introduce new ideas, e.g. new technology, business process re-engineering, to generate efficiency gains. As far as possible, public agencies should also be open to the private sector's suggestions to share assets or facilities with other users, unless such sharing of resources undermines public policy and objectives.

- **Sufficient time to plan and procure through PPP** – Is there sufficient time to procure the services through PPP, given the timeframe of the project?

PPP projects are generally more complex than conventional government projects. Hence, more effort, time and resources have to be put in to structure and tender for a PPP project. Insufficient planning and procurement time might prevent the public agency from identifying all its requirements clearly. The private sector will also need time to examine the business opportunities in a PPP project to propose new ideas. Hence, it is beneficial to both Government and the private sector if ample time is available for both parties to fully understand the objectives of the PPP project and the potential opportunities in the project.

- **Manageable interfaces with other projects or existing contracts** – Are there other projects or contracts that interface with the PPP project? Are the responsibilities of the PPP provider and other contractors clearly stated? Are there procedures governing the relationship and interaction between the PPP provider and contractors of other projects/contracts?

In some PPP projects, the public agency might decide to engage separate contractors for specialised services that are not within the scope of the PPP project. For example, the public agency might engage a PPP provider to construct and maintain an office building, but the IT services are separately provided by another IT vendor. In such projects, there should be a clear distinction between the responsibilities of the PPP provider and other vendors (e.g. IT vendors) engaged directly by the public agency. Procedures should also be put in place to govern the interactions between the various providers, e.g. how the vendors should respond to service failures.

AVOIDING POTENTIAL PITFALLS WHEN STRUCTURING A PPP DEAL

2.3.5 Although PPP projects can be beneficial to Government and the private sector, there are some pitfalls or problems that can affect the success of PPP projects. Such problems can be mitigated if appropriate measures are put in place to address these issues upfront.

Higher Private Financing Cost

2.3.6 It can be argued that private sector financing under some PPP models, e.g. the Design-Build-Finance-Operate (DBFO) model, will result in higher financing cost for the project, since the borrowing rate for the private sector is generally higher than the borrowing rate for Government. The financing cost for the private sector might be higher because lending to the private sector could inherently be riskier than lending to Government. Private borrowing rates also include profits that private financiers have to make.

2.3.7 However, private financing is an important element of PPP projects as it helps to instil discipline in the use of capital. As the private sector is required to raise financing, there is an incentive to optimise capital investment in Government projects. Private financing also allows Government to tap into the expertise of private financiers in evaluating business proposals. The due diligence by private financiers will ensure that business proposals are robust and sustainable over the contract length.

2.3.8 In addition, the cost of private financing for the project can be controlled by managing the risks of the project. Appropriate risk mitigation measures should be put in place to ensure the private financiers of the viability and bankability of the PPP deal. Private financiers could then provide lower borrowing rates to a PPP provider.

2.3.9 With appropriate risk management measures under a win-win PPP deal structure, the higher private financing costs could be offset by the efficiency gains that private financing can provide, e.g. through better capital investment decisions.

Inflexible, long-term contracts

2.3.10 PPP projects generally involve long-term contracts, where the private sector is committed to providing services to Government or the public. Government is also committed to a payment stream over the long contract period. If no variation provisions are included in the PPP contract, the PPP contract will be too inflexible to handle unforeseen circumstances, e.g. changes in demand from the public or changes in technology.

2.3.11 To avoid this pitfall in such long-term projects, it is important to build a flexible PPP contract to allow for variations in specifications and requirements, with appropriate changes in payment to the private sector. The variation provisions should be fair to both the public and private sector. In addition, termination clauses should also be included to allow both parties to terminate the contract under exceptional circumstances, with fair compensation (to either party), where necessary.

Costly and lengthy procurement process

2.3.12 Generally, PPP would involve a longer procurement period. PPP bidders also incur higher bidding costs due to the increased complexity. Hence, only large PPP projects can generate sufficient efficiency improvements to offset the higher bidding costs from PPP procurement. Therefore, PPP should generally be used on projects which involve the development of assets with a capital value above S\$50 million.

2.3.13 Public agencies and potential private bidders should also ensure that their project teams have sufficient competencies to understand the implications of the contract clauses in a PPP contract and also to structure and manage PPP deals effectively.

Service discontinuity if private provider fails

2.3.14 If the private provider is to run into financial difficulties during the contract length, there are concerns that the government might not be able to take over the function immediately, which will ultimately affect service continuity. The risk of the private provider failing exists as long as the service is outsourced, regardless of whether a PPP model is used or not. To help mitigate the impact on service continuity, the PPP contract should include provisions for Government to step in to manage the private sector's staff and equipment to continue delivering the service. There could also be provisions for the private financiers to identify other potential providers who can take over operations, subject to Government's approval, in the event that the original provider fails.

CONCLUSION

2.3.15 It is important to structure win-win PPP deals that benefit both the public and private sectors. There should be regular dialogue between the public agency and potential private providers on the best structure of the PPP deal which can deliver the

most value to Government while offering sufficient business opportunities for the private sector. In addition, the deal should be structured to avoid the potential problems that might arise, e.g. inflexible contracts or service discontinuity.

Questions for Consultation:

- Are there other ways to mitigate the potential pitfalls in PPP projects?

SUMMARY

KEY FEATURES OF WIN-WIN PPP DEALS

PPP projects must be structured to benefit both the public and private sectors. In particular, PPP projects should be scoped and structured to ensure that there are:

- Competent Private sector providers for the scope of services to be provided by the private sector;
- Measurable Output/Outcome specifications;
- Sufficient Project scale to allow for economies of scale;
- Sufficient scope for private sector innovation and management efficiencies;
- Sufficient time to plan and procure through PPP; and
- Manageable interfaces with other projects or existing service contracts.

AVOIDING POTENTIAL PITFALLS IN PPP

In addition, public agencies and potential private bidders should work together to put in measures to avoid the following pitfalls when crafting PPP contracts:

- High Private Financing Cost, which can be avoided by identifying and managing the risks of the project.
- Inflexible, long-term contracts, which can be avoided by building in variation mechanisms to allow the public and private sector to adjust the service requirements and payments according to changes in circumstances.
- Costly and lengthy procurement process, which can be avoided by only using PPP for large scale projects with capital value above S\$50million and having sufficient competencies to manage the PPP project.
- Service discontinuity if the private provider fails, which can be avoided by including provisions for Government to step in to manage the private sector's staff and equipment to continue delivering the service, or for private financiers to identify other potential providers who can take over operations, when necessary.

2.4 THE PPP PAYMENT MECHANISM

2.4.1 The payment mechanism determines the payments that government makes to the private provider in a PPP project. This payment is often referred to as the unitary charge, as it is a payment for the delivery of units of service required by the public sector. The payment mechanism is at the heart of the PPP contract as it puts into financial effect the allocation of risk and responsibility between the public agency and the private sector.

2.4.2 The payment mechanism for any individual project will need, more than almost any other aspect of the PPP contract, to be tailored and structured to reflect the particular needs of the public agency, the users and the nature of the deal.

OBJECTIVES AND FEATURES OF THE PPP PAYMENT MECHANISM

2.4.3 The objectives of the PPP payment mechanism is to:

- a. Provide an incentive for the private provider to meet the availability and performance standards set out by the public agency;
- b. Match payments to the outcomes and outputs that the public sector agency wishes to deliver;
- c. Provide an incentive for the private provider to rectify problems promptly when availability or performance fails to meet the agreed standards; and
- d. Provide an incentive for the private provider to innovate and secure efficiency gains and deliver best value for money throughout the contract period.

2.4.4 In general, the key features of a payment mechanism in a PPP projects are:

- a. **The public agency will make no payments to the private provider until the service is available.** For example, in a water treatment project, no payments will begin until water of the required quality is received.
- b. **Payment will only be made to the extent that the service is meeting the availability and performance standards** set out in the contract and specifications.
- c. **The payment mechanisms should provide for incentives for improved efficiency or outstanding performance by the private provider, as well as penalties to be made for unavailability or sub-standard performance.** Incentives and penalties should reflect the magnitude of the improvement or severity of failure. For example, ‘no service’ will lead to ‘no payment’, but a minor failure should only cause at most a minor deduction, except in the case of prolonged failure where the public agency can increase the penalties for persistent failures.
- d. **The payment to the provider should not be related to inputs.** Since the basis of the PPP project is the procurement of a service, the unitary charge

should not be made up of elements which relate to delivery of any inputs. For example, the payment should not be related to completion of stages of construction, cost of materials or labour. As far as possible, the payment mechanism should not contain a fixed element that the provider always receives, irrespective of availability or performance of the service. For example, where possible, the payment mechanism should not commit the public agency to make a fixed payment which covers the provider's debt service obligations, even when the service is not available in the first instance.

- e. **As far as possible, there should be a single charge for the service**, not separate payments for elements relating to availability or performance. Typically, the unitary charge consists of a number of separately identifiable availability and performance elements (e.g. availability of office building space and performance of catering services). However, the public agency is buying an integrated suite of services. Hence, the payment for these elements should be integrated to ensure that no payments commence until the essential services/facilities are delivered. For example, for a student accommodation PPP project, no payments should be made if the accommodation facilities are not available even if the ancillary services, such as laundry services, are available.

PAYMENTS TO THE PPP PROVIDER VS. FEES CHARGED TO THE USERS

2.4.5 For services where the public agency will recover part or all of its costs from the users, the fees paid by the users do not necessarily have to be the same as the PPP payment, because the public agency can set the fees based on its subsidy policies. In a PPP deal, the public agency can collect the fees from the users at fee rates set by the agency. The public agency then pays the PPP provider for the PPP services that are delivered. If the fees charged are insufficient to cover the payments to the PPP provider, the public agency will have to 'top-up' the difference. This is equivalent to providing a subsidy to the users.

STRUCTURING THE PAYMENT MECHANISM

2.4.6 Appropriate consideration should be given to the payment mechanism at an early stage in the development of a PPP project. The payment parameters should be realistic and fair to support the long-term partnership. The public agency should also seek feedback from the private sector when developing the payment mechanism.

2.4.7 Before developing the payment mechanism, the public agency should ensure that:

- a. **Service delivery can be objectively measured;**
- b. **Both quantity and quality of service can be measured; and**
- c. **Availability and performance standards are measurable, recordable and realistic.**

2.4.8 The payment mechanism should also be objective, transparent and easy to operate.

ELEMENTS OF THE UNITARY CHARGE/PAYMENT

2.4.9 Depending on the nature of the project, the payment may vary with:

- **Availability of the service.** Availability payments will be made when the facility (e.g. school building) or required capacity levels (e.g. required volume of treated water) are made available at a minimum specified standard and ready to use, regardless of the extent to which it is actually used.
- **Performance quality of the service.** Performance payments are typically used for ancillary services, such as cleaning and security, where there will be penalties if the performance level is less than specified.
- **Usage of the service.** The service provider will be paid based on the extent that the service is actually used, e.g. number of transactions or number of accommodation units occupied.

2.4.10 **Many PPP projects use a combination of two or more of the above elements.** For example, a student accommodation PPP project may use an availability component associated with the availability of hostel rooms and a performance-based component for operational services, such as laundry services. It is important that these elements do not have their own independent payment regimes. The payment for these components should be integrated to reflect overall service performance and availability. For example, payment for usage should only be made when availability or performance standards were met for the essential elements of the service.

2.4.11 Whether to use availability, performance or usage as the basis for the payment depends on the nature of the function and the allocation of responsibilities between the public and private sector. The following sections summarise the key features and considerations under each payment basis.

(I) Availability

2.4.12 Under the availability basis of payment, the public agency will pay the private provider an amount, \$x, for each unit of service/facility that is made available, i.e. service at the specified performance standard is ready for use, up to an agreed quantity. **Availability payment is made regardless of the extent to which the service/facility is actually used.** The services that need to be made available may comprise physical places or units (such as courtrooms, hospital beds) or peak capacity levels (such as capacity of a water treatment plant).

2.4.13 The availability payment structure is typically used for PPP projects where:

- The public agency is more concerned about having an available service/facility, instead of the actual usage of the facility/service. In other words, the public

agency needs the facility to be available and ready to use, regardless of the extent to which it is actually used, e.g. military facilities/equipment, and the availability of a road.

- The public agency decides to bear the responsibility of managing demand to meet planned usage levels, as the demand is more within the control of the public sector than the private sector. For example, e.g. in school PPP projects where students are assigned to each school by the public education authority, the public sector can better manage the usage of the school facilities. Hence, the responsibility of ensuring that actual usage levels meet the planned usage requirements will be borne by the public agency, by paying the private provider based on the availability of the school facilities, regardless of the actual student population.

2.4.14 Availability is defined not simply by the accommodation or capacity being made available but also by the accommodation or capacity being available at the specified quality standards. For example, a PPP courtroom is only available if it is clean, safe, has suitable air-conditioning and all electrical and mechanical systems are in working order.

2.4.15 The following questions should be considered when structuring availability-based payments:

- a. When does availability/unavailability commence?** When using the availability basis of payment, public agencies must define what is meant by 'available' or what is meant by 'unavailable'. The definition must also specify the conditions that must be met if the service is to be treated as available or unavailable.
- b. Are there critical groups of facilities/services where unavailability will lead to higher penalties to the unitary payment?** The financial consequences of unavailability of a group of units/ facilities should depend on its criticality level, as some areas will be more critical to the provision of the required service than others, e.g. the availability of classrooms is more critical than the availability of, say, common areas such as corridors. In which case, the deduction mechanism should ensure that the deductions for unavailability of critical areas are sufficient deterrent to ensure that the PPP provider will keep these areas available in the first instance. Really, what matters to the public agency is that the PPP facility is available in the first instance;
- c. How long is the rectification period for the provider to rectify a problem without triggering the start of unavailability?** If the facility/service falls below standards, the provider is typically given a 'remedy' period to resolve the problem. If the problem is left unresolved at the end of the remedy period, the service will be deemed to be unavailable and payment should be reduced accordingly. If the PPP provider fails to rectify the problem further after the first deduction has kicked in, the public agency may invoke a further deduction. This is to ensure that the problem is rectified as soon as possible so as not to unduly disrupt the delivery of public services. However, a balance should be struck as to how many more further deductions to be made, as this will only complicate the payment mechanism and thus the cost of the PPP contract;

- d. **How can the public agency deal with unavailable service/facility that is being used?** There are some situations where the public agency might continue to use a service/facility, e.g. classroom, despite defects which would have rendered that part of the service unavailable. In such cases, the public agency can either (i) consider the service to be available especially when the continued use by the public agency prevents the provider from rectifying the problem, or (ii) make a smaller deduction to the unitary payment, instead of the full deduction if the service/facility is unavailable and unused.
- e. **What mechanism will be used to assess when availability has been restored following an episode of poor performance?**
- f. **Will planned maintenance of the facility be considered as unavailability?**

(II) Performance-based payments

2.4.16 Performance based payments are typically only used to address levels of service performance that do not have a direct impact on the availability of the required services/facilities. Performance based payments are also used for payment of non-essential services, e.g. school bus service for schools PPP project.

2.4.17 When developing performance-based payments, public agencies should decide on:

- a. **The standard or level of performance required;**
- b. **The means to monitor the provider's performance against the required standard; and**
- c. **The consequences of a failure to meet the required standard, e.g. quantum of penalties suffered due to a fall in performance standards.**

(III) Usage payments

2.4.18 The use of a service may in some cases determine either all or part of the unitary charge. This means that the private sector will be responsible for ensuring that actual usage levels (i.e. demand for the service) meets the planned usage levels that the PPP facilities were developed for. **The transfer of this responsibility is only appropriate in cases where the provider can reasonably influence usage/demand.**

DIRECT FINANCIAL OR INDIRECT NON-FINANCIAL INCENTIVES/PENALTIES

2.4.19 In structuring the payment mechanism, the public agency also has to decide whether to use direct or indirect incentives/penalties for each element of the service. Both direct and indirect incentives/penalties can be applied to encourage the provider to improve service delivery or remedy the failure promptly.

2.4.20 The direct approach involves immediate increases in payments for good performance or immediate reductions in payment if the provider fails to perform up to standard.

2.4.21 On the other hand, the indirect approach involves the award of performance points for above-average performance and/or penalty points for sub-standard performance. For penalty points, the number of points imposed varies according to the severity and regularity of the breach. When the private party accumulates a certain level of performance/penalty points, a range of other incentives/penalties can be imposed. For example, for accumulation of performance points for above-average performance, the public agency can reward the provider with financial bonuses. For accumulation of penalty points above a certain level, the public agency can issue formal warnings or impose financial penalties, or in extreme cases, terminate the contract as the provider's breach of the contract.

2.4.22 In constructing a points-based performance payment, care needs to be taken that unintended consequences do not arise whereby incentives cancel out the penalties due to sub-optimal performance. In addition, public agencies should also introduce caps for positive incentives (performance payments) to ensure that the provider does not put in too much resources to deliver services beyond the performance quality needed by customers/users.

MECHANISM TO MANAGE PERSISTENT POOR PERFORMANCE OR UNAVAILABILITY

2.4.23 It might be appropriate to introduce a 'ratchet' mechanism to allow penalties for unavailability or poor performance to increase if the provider consistently provides the service below the agreed standard, or if a specific failure is not rectified. A simple ratchet mechanism will work by increasing the number of penalty points awarded for a particular failure that recurs too often with a specified period. For example, if x points are awarded for a failure to achieve a particular output, then $(x+3)$ points may be awarded for each failure above a specified maximum number of failures in a pre-defined period.

VARIATIONS TO THE PAYMENT MECHANISM

2.4.24 The PPP contract will set out the unitary charge for the entire contract period. Due to uncertainties of inflation rates and certain operating costs over a long-term contract, it is usually in the interests of both the public agency and the private provider to set out provisions for varying the unitary charge in certain specified circumstances. The variation provisions help the provider address future unforeseeable changes in costs. The provider will thus not have to make such a significant provision for this risk in its bid price. The variation provisions also help the public agency ensure that the price that it agreed to pay in future years will not be in excess of future market prices for similar services.

2.4.25 There are several processes that can be introduced to vary the unitary charge:

Indexation

2.4.26 The payment mechanism can include arrangements for indexing the unitary charge agreed at contract signature, i.e. varying the unitary charge according to a price or cost index, e.g. the Consumer Price Index. Indexation is typically used to vary the price according to inflation. This means that the public sector bears the inflation risk for the project since inflation risk is typically outside the control of the provider and is difficult to forecast accurately.

2.4.27 Generally, the indexation will only apply to a part of the unitary payment, instead of being applied to the whole unitary charge.

Price reviews

2.4.28 An alternative way to indexation is to build in price review mechanisms at regular intervals of the PPP contract, say once every 5 years. However, agencies should note that this price review is generally applicable for 'soft' services, e.g. catering, cleaning and grounds maintenance. The contract should clearly define the price review procedures and basis for determining the changes in price, including who or when to initiate the review, who to be consulted on the new unitary charge and how disagreements can be resolved. Through the price review, the public agency can share in significant cost decreases arising from, for example, technological improvements. Conversely, the provider may argue that the public agency should share part of the burden of any significant cost increases outside the provider's control.

2.4.29 Public agencies should note that price reviews might involve protracted negotiations, particularly when the public agency and the private provider cannot agree on the reviewed price. For complex projects, the PPP contract can allow for the appointment of an independent reviewer at the mutual consent of both parties. This reviewer can help to revise the price during the price reviews.

Benchmarking and market testing

2.4.30 Benchmarking and/or market testing some elements of the service can also be conducted regularly to determine if the unitary charge is comparable to market price.

2.4.31 Although in theory it is sensible to compare costs to ensure that value for money continues, the practice of benchmarking and market testing are often more difficult. This difficulty may be due to (i) the inter-related nature of the services being purchased, which means that the services cannot be benchmarked or market tested separately, or (ii) the absence of a ready comparator.

2.4.32 Where possible, the PPP contract can allow for market testing or benchmarking of some operations services, e.g. sub-contracted services, at regular intervals. However, agencies should note that market testing and benchmarking are generally used for 'soft' services, e.g. catering, cleaning and grounds maintenance, which do not involve a significant capital investment in their delivery, or do not affect the value of any capital asset under the contract. Services that can affect the value of the capital asset, such as retrofitting the building and maintaining the building over the contract period, are usually not benchmarked or market tested because market testing such services can disrupt the synergy of the design, build, maintain and operational phases, and remove the incentive for the private sector to consider whole lifecycle costing in a PPP project.

2.4.33 The public agency should be aware that benchmarking or market testing can result in either an increase or a decrease in the unitary charge.

Service changes

2.4.34 A change mechanism can also be included in the contract for dealing with changes to the service, such as additions or deletions to the project facilities, new service requirements or any volume changes. Appropriate arrangements will need to be included in the contract and payment mechanism to reflect the impact of any service changes on the payment mechanism and the unitary charge. For example, in a PPP sports stadium project, the contract should state clearly the increases in payments by the public agency if it needs to use the stadium for days that the public agency has not reserved for the government's use only.

2.4.35 For service changes, the public agency and the private provider will have to agree on:

- a. The amended method of service delivery (if applicable);
- b. The adjusted price for the services or additional services;
- c. Whether there are capital payments needed; and
- d. Changes to the performance measurement system.

OPERATING THE PAYMENT MECHANISM – CONTRACT MONITORING

2.4.36 For the payment mechanism to operate effectively, there must be a mechanism under the contract that enables the public agency to easily and cost-effectively monitor the provider's performance against the availability and performance standards agreed in the contract. Monitoring involves the collection and evaluation of data that should be objective, relevant and quantifiable, and agreed with the provider. There should also be a clear connection between the data collected and the financial penalties for unavailability or sub-standard performance.

CONCLUSION

2.4.37 The payment mechanism should incentivise the PPP provider to deliver the service at the required standards. The payment mechanism should include penalties and/or incentives. The payments can be based on availability, performance and/or usage. Public agencies should ensure that the payment mechanism, including the deduction mechanism, is not too complex to administer. Trigger points for penalties should also be set such that the PPP provider has a reasonable chance to remedy a service failure. Otherwise, the provider might deem the payment stream as being too volatile and risky. Such perceived volatility and risk might in turn result in higher costs of capital when the provider seeks private financing, e.g. bank loans, for the project.

Questions for Consultation:

- When should availability, performance-based or usage-based payments be used?
- When should direct incentives/penalties be used? When should indirect incentives/penalties be used?
- What other variation mechanisms can be used to introduce flexibility into the PPP contract?

SUMMARY

KEY FEATURES OF THE PAYMENT MECHANISM

- The payment mechanism forms an important part of the PPP contract as it puts into financial effect the allocation of responsibilities between the public agency and the private sector.
- The payment mechanism should have the following features:
 - a. The public agency should make no payments to the private provider until the service is available.
 - b. Payment should only be made to the extent that the service is meeting the availability and performance standards.
 - c. The payment mechanisms should provide for incentives for outstanding performance and penalties for unavailability or sub-standard performance.
 - d. The payment to the provider should not be related to inputs.
 - e. There should be a single charge for the service.

WHEN DESIGNING A PAYMENT MECHANISM, THE FOLLOWING ISSUES SHOULD BE CONSIDERED:

- What will form the basis for the payments? The payments can vary with:
 - **Availability.** Payments will be made when the facility or required capacity levels are made available at specified quality standards, regardless of the extent to which the service/facility is actually used.
 - **Performance.** Performance-based payments are typically used for payment of non-essential, ancillary services; and
 - **Usage.** The provider is paid for every unit of service that is used. This means the private sector will bear all or part of the demand risk.
- **Should direct or indirect incentives/penalties be used?** For illustration, the direct penalty involves immediate reduction in the unitary charge for sub-standard service. An indirect penalty involves the award of performance points for sub-standard performance.
- **Should a ratchet mechanism, where persistent and prolonged poor performance will lead to higher penalties, be included in the payment mechanism?**
- **What variation mechanisms should be included to vary the unitary charge during the contract period?** Variation in the unitary charge can be due to:
 - Indexation, where the unitary charge changes based on an index;
 - Price reviews, where the public agency and private provider review the provider's cost and share significant costs increases or decreases;
 - Benchmarking and market testing, where the public agency can determine if the unitary charge is comparable to market price; and
 - Service changes, where the charge can change due to changes to the service, e.g. new service requirements.
- **What is the contract monitoring mechanism that should be put in place to easily and cost-effectively monitor the provider's performance?**

SECTION 3
THE PPP PROCUREMENT
PROCESS

3.1 INTRODUCTION TO THE PPP PROCUREMENT PROCESS

CHARACTERISTICS OF PPP

3.1.1 Unlike typical conventional procurement, PPP are highly complex and involve high capital costs, lengthy contract periods that create long term obligations, and a greater sharing of risks between the private and public sectors.

3.1.2 The goal is to deliver better services and maximize value for money by:

- (a) Allowing room for private sector innovation to achieve public service needs, such as by not unduly specifying what inputs the PPP provider is to use to deliver the required services;
- (b) Allowing the PPP provider to put the asset, which is needed for the delivery of the services required by the public agency, to third party revenue generation. With such sharing of the use of the asset with third parties, the cost of the service for the public agency is kept low; and
- (c) Letting both the public agency and the PPP provider bear the responsibilities for which they are in the best position to manage given their capabilities.

3.1.3 PPPs cover both economic and social infrastructure and typically include both a capital component (such as the construction of a new building or facility, or a major redevelopment of an existing building or facility) and an ongoing service delivery component.

OBJECTIVES OF THE PPP PROCUREMENT PROCESS

3.1.4 PPP projects are complex and span over long durations. It is therefore critical that the PPP provider is carefully chosen, so that it can deliver on its commitments and work well with the Government Procuring Entity (GPE) throughout the entire duration of the partnership.

3.1.5 This selection process can be elaborate, lengthy and costly to both GPEs and potential providers. This can deter participation from the private sector in PPP tenders. Hence, the selection process should aim at minimizing the complexity, duration and costs to both parties, while facilitating strong competition for the GPE to obtain the best value for money for the PPP.

KEY CONSIDERATIONS FOR THE PUBLIC SECTOR PROCUREMENT TEAM

a) The procurement team

3.1.6 A suitable project team is essential. They should at least include representatives from the following units:

- a) **Finance;**
- b) **The policy or service unit concerned. E.g. PPP deal for a sports complex should include officers from the sports division;**
- c) **Building development, and estate management;**
- d) **Procurement.**

3.1.7 A project director will need to be appointed for each project and be responsible to both drive the project and mobilise the appropriate skills at the required time. It is important that the team be overseen by the senior management of the agency, as such management commitment can help the team better structure the PPP deal to achieve a workable and sustainable PPP contract that meets the needs of the agency over the duration of the contract.

3.1.8 The entire procurement team will need to work with the PPP advisor, if any. While the inputs of the advisor can be useful to the execution of the PPP deal, ultimately, the decisions on the structuring of the PPP contract and the selection of the PPP provider should be made by the public agency, with the relevant inputs from the PPP advisor.

b) Transparency without compromising value for money

3.1.9 The process for selecting a PPP provider must be transparent, while ensuring value for money.

b.1) An efficient process for selecting a PPP provider

3.1.10 PPP projects span over long durations. Hence it is critical that GPEs select a PPP provider who can deliver on its commitments and work well with the GPE throughout the entire duration of the partnership. The selection process is elaborate, lengthy and costly to both GPEs and potential providers.

3.1.11 **As a general policy, GPEs should not reimburse bidding costs incurred by suppliers as such an action is tantamount to subsidizing the less successful suppliers.** Nonetheless, the process for selecting the PPP provider should aim at minimising costs to both the public and private sector while facilitating strong competition to ensure value for money. Excessive bidding costs may increase the costs for the specific PPP project concerned, and limit competition for PPP projects in the long term.

3.1.12 What then does the above mean in practice?

3.1.13 First, GPEs should seek the needed funding commitments and management approval for the PPP project, before inviting private sector

participation in PPP tenders. This is to minimise the possibility of abortive PPP tenders which are called and subsequently not awarded.

3.1.14 Second, GPEs should work with their PPP advisor to ensure that the PPP contract is a viable one before they issue the PPP tender. To do so, the GPE should conduct a pre-procurement briefing, say, 3 to 6 months before the PPP tender. For PPP procurement, therefore, agencies should not merely include upcoming PPP in its half-annual pre-procurement plan published in GeBiz, Government's one stop e-procurement portal.

3.1.15 Third, a selective tendering process can be used to identify the right PPP provider. The initial stage involves inviting the private sector to a pre-qualification round. Certain potential providers are then shortlisted and pre-qualified from all who have responded to the pre-qualification stage of the tender. **The pre-qualified players are then invited to submit their bids for the PPP tender. The pre-qualification stage is important – if executed properly, it can help to eliminate unsuitable bidders as early as possible, thus keeping bidding costs as low as possible for both the private and public sector. At the pre-qualification stage, the GPE should release information on the salient features of the PPP procurement (the PPP draft contract can be published only at the Invitation to Tender stage), so that potential bidders can make an informed decision whether to even participate in the pre-qualification stage of the PPP tender in the first instance.**

c) A robust and balanced contract

3.1.16 Given the long-term lifecycle of the project, the contract should provide flexibility to accommodate future change within defined limits. To obtain value for money, there should be optimal, not maximum, transfer of responsibilities (and the associated risks) under the project – excessive transfer impairs value for money as the risk premium will be priced into the project by the PPP provider. Responsibilities and thus risks should be borne by the party best able to manage them.

c.1) Risk-sharing arrangement

3.1.17 Optimal risk allocation is one of the principal drivers of value for money in PPPs.

3.1.18 Generally, when the public sector focuses on contracting for service outcomes rather than building and maintaining infrastructure, the risks associated with the construction and maintenance of the asset can be transferred to the private sector, which can design, build, operate and maintain the asset at minimum whole-of-life cost.

3.1.19 The public sector should retain only those risks that it can manage more effectively than the private sector. Risks that are outside the control of either party may be shared.

3.1.20 **However, some risks are difficult to allocate in advance because they may not be controllable or fully identifiable.** These risks should be determined on a case-by-case basis and may be shared or assessed when they occur. However, **it is essential that their existence is recognised and that their occurrence and consequences are specified in the contract, where possible,** to ensure that the PPP is sustainable over the contract duration.

c.2) Contractual flexibility

3.1.21 PPPs usually involve long-term contracts (typically 20 – 30 years in the UK) during which time circumstances may change. This may occur for any number of reasons, only some of which can be foreseen. The public sector therefore requires a flexible contract with suitable mechanisms for achieving necessary operational variations in a transparent, cost-effective way. Notwithstanding this, the PPP contract requires some fundamental certainty in order to be viable.

3.1.22 **GPEs could incorporate, as part of the contract, a ‘change’ or ‘variation’ procedure that provides a mechanism for the implementation of such changes and a basis for calculating the consequences for the payment to the private sector and any consequential adjustment in the project’s allocation of risk.** Within this, two basic methods can be applied: 1) in-built tolerances (eg. a right to change space needs within parameters as part of the original deal); 2) variation procedures (eg. pre-priced options for additional capacity, or specific procedures such as benchmarking and tendering to determine the costs of the variations). Stipulating variation procedures upfront in the contract is an objective way to obtain fair prices for reasonable changes in requirements. The underlying objective is the need to balance flexibility with value for money.

d) Performance specifications and measurement

d.1) Output (rather than input) specifications

3.1.23 PPPs are procurement of services. Thus, output- or outcome-based specifications should be used as much as possible to allow the private sector as much flexibility as possible to provide innovative solutions that meet the need of the GPE at the lowest possible whole lifecycle cost.

3.1.24 Nonetheless, it is hard to achieve 100% use of output- or outcome-based specifications for PPP contracts. Input-based specifications will usually be necessary, such as specifying the key defined materials to construct a building or an outline but not detailed design for the PPP provider’s reference.

d.2) Performance measurement and payment mechanism

3.1.25 The key risk transfer method under PPP contracts is performance-related payment. From the GPE’s perspective, the key elements of the payment mechanism are as follows:

- a) Payments commence only upon the provision of services by the private sector (to incentivise timely completion of the building construction);
- b) The PPP provider earns payments only to the extent that it provides services which meet the service requirements as set out in the contract.

3.1.26 To ensure that the output- or outcome-based specifications work, they should be measurable. Typical methods of performance-related payment are based on usage (i.e. payment to private sector linked directly to the level of usage of the asset), or availability (i.e. payment to private sector due if the facility was ‘available’ as contractually defined).

3.1.27 Performance measurement is critical to PPP contracts because they form the basis of the payments to the PPP provider. Performance measurement will be linked to an agreed set of standards or key performance indicators, which generally relate to the quality, amount and frequency of service provision.

d.3) Contract management

3.1.28 Unlike convention procurement that establishes the GPE and the private sector in a product supplier/ buyer relationship, PPP procurement place emphasis on both the PPP provider and the GPE working together to ensure that this long-term contract works for mutual benefit. This is central to the management of the contractual relationship, and will depend on the people and procedures in place for managing this relationship as well as the terms of the PPP contract.

3.1.29 Involving procurement and contract management personnel in the project team from the beginning will enhance their understanding of the project and enable them to form necessary relationships with the awarded private sector company prior to implementation.

CONCLUSION

3.1.30 Given the complexity of PPP procurement, the more thorough the due diligence done before the GPE calls the PPP tender, the lesser the bidding costs are likely to be for both the private and public sectors. This will in turn increase the likelihood of the GPE attracting bidding interests from strong and competent private sector players. Such due diligence includes working out a balanced and robust PPP contract, and conducting market sounding before the PPP tender is called.

Questions for Consultation:

- What mechanisms can be introduced to provide for contractual flexibility?
- Given the long selection process in PPP contracts, what measures can be introduced to reduce tendering costs?

SUMMARY

BEST PRACTICES

The key characteristics of PPPs (as opposed to typical conventional procurement) are:

- a) PPPs are highly complex and involve high capital costs;
- b) PPPs span lengthy contract periods that create long term obligations; and
- c) PPPs involve a greater sharing of responsibilities and thus risks between the private and public sectors.

The best practices for managing the process for selecting a PPP provider are:

- d) Careful selection of the PPP provider is critical to ensure sustainable service delivery throughout the entire duration of the partnership.
- e) The selection process should aim at minimizing the complexity, duration and costs to both parties, while facilitating strong competition to ensure value for money through the selection of the best partner.

CHECKLIST

Have you considered the following issues in selecting a PPP provider?

- units/disciplines, led by a project director with appropriate skills? Should a **PPP advisor** be engaged in the process of selecting the PPP provider?
- ensure that **the draft PPP contract is a bankable one**? Have you obtained the necessary **funding commitments** and **management approval** before inviting private sector participation via the PPP tender? Have you planned when and how a **pre-procurement briefing** should be conducted?
- proposed PPP contract optimum, and not excessive? Have you identified what risks should be borne by each party or shared? Have you considered risks that are difficult to allocate in advance? Does the PPP contract provide flexibility to cater for unforeseen changes during the duration of partnership?
- based specifications are used as much as possible in the PPP contract to encourage private sector innovation? Are they measurable? What are the performance measures on which payments to the PPP provider is based?

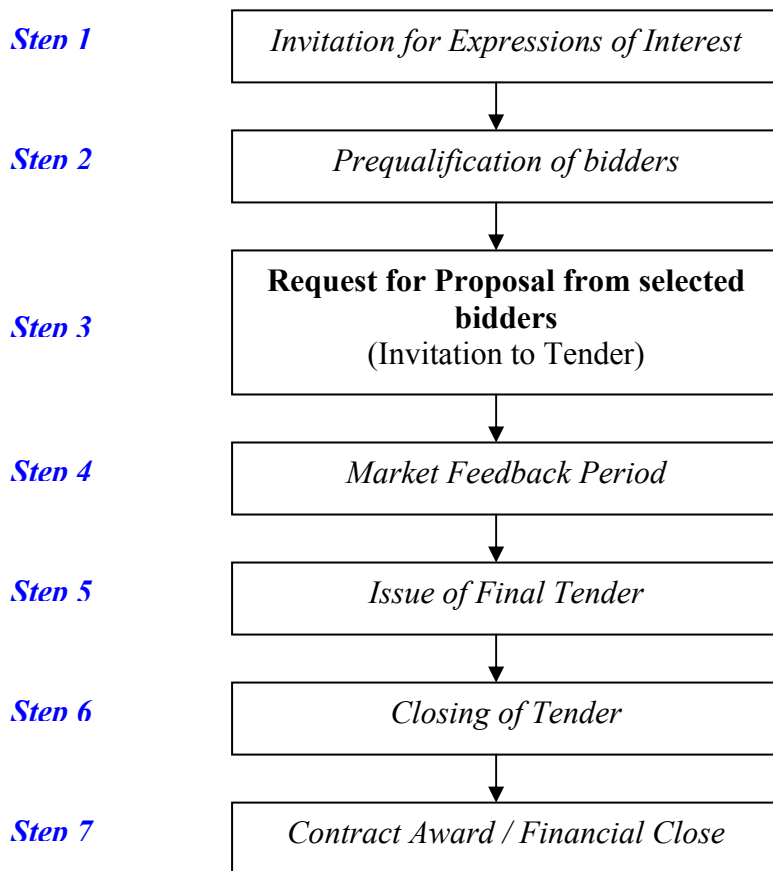
3.2 PROCEDURES FOR IDENTIFYING THE RIGHT PPP PROVIDER

3.2.1 This chapter provides guidance on the process for identifying the PPP provider. In conjunction with this guide, Government Procuring Entities (GPEs) should also comply with the guidelines in the Government's Instruction Manual (IM) 3B on selective tendering procedures (IM3B#500 –564).

3.2.2 Essentially, under the process, government procuring entities (GPEs) should:

- a) sound out the market on their proposed PPP approach, so as to gather as early as possible (3-6 months before the issue of the PPP tender), feedback from the private sector;**
- b) adopt the selective tender for the PPP tender to select the PPP provider;**
- c) pre-qualify tenderers for participation in the Invitation to Tender stage of the PPP tender;**
- d) address and consider the feedback and concerns raised by the potential bidders during the time gap between the issue of the PPP tender documents (including the draft PPP contract) and the closure of the tender. If need be, the GPE should thereafter amend the tender documents and must make known these changes openly. All potential bidders will then be aware of these revised tender documents before they submit their bids and the tender closes;**
- e) avoid negotiation with bidders once the tender is closed; and**
- f) keep proper records of the entire PPP process, including decisions and actions taken during the process and the reasons. These records should be retained for a period required by the Instruction Manual.**

Figure 3.2.1 Flowchart of the PPP Procurement Process



STEP 1: INVITATION FOR EXPRESSIONS OF INTEREST

3.2.3 Before issuing a PPP tender, the GPE should have first established the business case on whether to proceed with the procurement of the services concerned via PPP, work with the PPP advisor (if any) to structure the PPP contract, and obtained necessary approvals from the relevant authorities to proceed with PPP.

Market Sounding

3.2.4 At the very beginning, before even calling the pre-qualification, the GPE should sound out the market, where practicable with the PPP advisor’s help. **Market sounding focuses on supplier market as a whole, not individual suppliers. It does not include any element of provider selection or bid evaluation. There is no commitment of any kind from either the private sector or the GPE. Rather, market testing helps the GPE assess the likely reaction of the market to the proposed PPP procurement, and the GPE’s preliminary thinking on the salient aspects of the PPP contract.** With the feedback from the market testing stage, the GPE can better structure the subsequent PPP tender such that it is workable (e.g. whichever company is chosen subsequently as the PPP provider can raise

the needed financing from the capital market based on the PPP contract), and can attract strong bidding interest from competent potential PPP providers.

3.2.5 GPEs should ensure that the market testing is conducted in a fair and transparent manner and does not give any one potential bidder an unfair competitive advantage. **For instance, the GPE can plan a pre-procurement briefing on the PPP project, say 3-6 months, before issuing the PPP tender. At the briefing, the GPE can inform the industry of the following:**

- a) **What services does it intend to procure under this PPP deal? What is the size of the demand (e.g. a facility capable of accommodating xxx students)?**
- b) **What is the likely tenure of the PPP contract?**
- c) **What will be the role of the successful tenderer? E.g. to design, build, finance and operate the facility?**
- d) **What can the provider own in this PPP deal? E.g. land and building?**
- e) **How will the payments be structured? Will there be only availability payments, or will there be usage-related payments?**
- f) **To what extent is the provider free to generate third-party revenue streams, and how is the provider to share this revenue with the GPE?**
- g) **Which risks will the provider bear, and which will be borne by the GPE? E.g. is the demand risk to be borne by the GPE? What are some of the key risks to be co-shared between the GPE and the provider?**
- h) **What are the exit arrangements (including compensation if any) like (e.g. if PPP provider defaults, if GPE terminates, or if unforeseen events arise?)**

3.2.6 The above information, though indicative only, help the industry to give informed feedback to the GPE. GPE can then use this market testing to assess a) the potential level of bidding interest; and b) the valid concerns which the industry may have on the draft PPP structure. The PPP contract which is to be issued by the GPE subsequently at the PPP tender is more likely to be workable, thus attracting bidding interest from competent providers and keeping the bidding costs low for both the GPE and the private sector bidders.

3.2.7 If responses from the market during this market sounding phase indicate that the proposed PPP project is unfeasible or that there is not likely to be much competition during the bidding process, the GPE should review the proposed approach and structure of the PPP contract.

Invite Expressions of Interest

3.2.8 The invitation for Expressions of Interest marks the beginning of the formal process for selecting the PPP provider, i.e. the formal procurement process. **Basically, GPEs can adopt the selective tender for choosing a PPP provider.** This is allowed under our Instruction Manual (IM), and is compliant with the WTO-Agreement for Government Procurement (GPA). Briefly, selective tendering involves a pre-qualification stage. At a later stage, the pre-qualified tenderers will submit their bids, while those who had not participated

in the pre-qualification can submit their request for pre-qualification in order to submit their bids¹.

3.2.9 We now describe the pre-qualification stage of this formal provider selection process. At this stage, GPEs should publish the Invite Expression of Interest (EOI) on the Government Electronic Business system (GeBIZ), the one-stop procurement portal for our public sector <http://www.gebiz.gov.sg/>. The objective of the Invite EOI is to invite private sector players who are interested in the PPP procurement to submit their bids, so that the GPE can pre-qualify potential PPP providers. This notice should include sufficient explanation of the project, and the period of Invite Expression of Interest notice. This Invite EOI is identical to the Pre-Qualification in the current Selective Tendering process.

3.2.10 An EOI notice should not be altered after it has been published. GPEs should pay special attention to the following aspects when drafting the Invite EOI.

Period of Invite Expressions of Interest Notice

3.2.11 The Period of Invite EOI Notice refers to the time period between the publication of the Invite EOI Notice and the closing date for receipt of application for qualification from suppliers. **Given the complexity of the PPP project, the minimum period of Invite EOI Notice should not be less than 14 days. As a suggestion, GPEs may wish to keep the period at 30 days as a minimum.** GPEs shall comply with the guidelines contained in IM3B #520-535.

Information to be included in the Invite Expressions of Interest

3.2.12 The Invite EOI notice should include the following information:

- a) **Factors that will be used to evaluate whether to pre-qualify a tenderer and the relative weighting of each factor**, e.g. financial health, technical capability, track record, etc;
- b) **The procedure that will be used to select the suitable provider for the PPP project**, such as shortlisted suppliers will be invited to submit a full proposal at the later stage of the tender process (**Step 3** of the proposed process for selecting a PPP provider);
- c) **Salient aspects of the indicative PPP contract, such as those stated at paragraph 5 above.** Although there is no need for GPEs to give the full PPP contract at this stage, a summary of these salient aspects of the PPP contract will help the private sector better assess whether to participate in the pre-qualification stage of the PPP tender in the first instance. The summary can also help the bidders work with their potential financiers early on the financial viability of the PPP deal.

STEP 2: PREQUALIFICATION OF BIDDERS

3.2.13 The list of suppliers who responded to the Invite EOI and have provided the required information should be evaluated against the evaluation criteria set out in the

¹ The GPA requires that suppliers who request to participate in a bid but who may not yet be qualified, shall also be considered, provided there is sufficient time to complete the qualification procedure.

Invite EOI. The purpose of this stage is to assess the competency of the interested suppliers. It is not intended to cover proposals for that particular project and hence, factors relating to the award of the contract should only be considered at a later stage of the tendering process. The following could be done to assess the financial soundness of the bidders at this stage :

- a) The financial ratios, such as interest cover, liquidity ratio and profit ratio;
- b) The surplus cash in its balance sheets;
- c) Its order books. Bidders to provide information on the volume of contracts it is managing currently, and how many new ones it foresee in the future.
- d) What they think the bidding costs is likely to be (as a gauge of their understanding of PPP complexity), and how they intend to fund their bid costs; and
- e) How they intend to finance. For instance, a letter of undertaking from the parent companies involved of their equity investment in the SPV.

3.2.14 The GPE must not change the evaluation criteria or waive any mandatory and essential requirements or contractual terms after the closing of the Invite EOI. Any applications received after the closing date must be rejected.

Setting up of the evaluation team

3.2.15 An evaluation committee should be set up to evaluate the competence of the interested suppliers. The evaluation committee will evaluate all the applications received based on the evaluation criteria set forth in the Invite Expression of Interest notice. To ensure that the evaluation is done in a fair, open and transparent manner, the evaluation team members must declare any conflict of interest, directly or indirectly possessed and, on this basis, discontinue their involvement in the evaluation committee.

3.2.16 The PPP advisor may help furnish inputs to the Evaluation Committee on the evaluation of the responses to the Invitation for Expressions of Interest. However, the final recommendation as to which bidders to be pre-qualified should be made by the Evaluation Committee before submission to the approving authority. Given the complexity in PPP projects, public agencies can consider appointing the Tenders Approving Authority as the authority to approve the list of prequalified bidders.

3.2.17 After the prequalification stage, the GPE will have prequalified a list of suppliers who pass the evaluation criteria set forth in the Invite (EOI) notice.

3.2.18 The following general guidelines must be applied in the recommendation and approval of applications for shortlisting:

- a) the selection process is conducted fairly; and
- b) all the suppliers that complied with the evaluation criteria in the Invite Expression of Interest notice shall be pre-qualified.

3.2.19 It is important that GPEs set their prequalification criteria carefully. GPEs must not have a pre-determined number to artificially limit the number of suppliers who can qualify for the Invitation to Tender stage, as this will limit competition by depriving suppliers who are capable of fulfilling the contract from tendering. Rather, GPEs should be clear about what it is they need in the potential PPP provider, and set the

corresponding stringent pre-qualification criteria. The choice of pre-qualification criteria used must only be to ensure supplier's capability to fulfil the contract and not have a discriminatory effect.

STEP 3: REQUEST FOR PROPOSAL FROM SELECTED BIDDERS (INVITATION TO TENDER)

Refine the project appraisal

3.2.20 Before issuing the Invitation to Tender (ITT) at this stage of the PPP tender, the GPE should consider whether the assumptions of its business case analysis done before the issue of the EOI are still valid, i.e. whether PPP is likely to yield value for money for the GPE.

3.2.21 Before issuing the ITT, the GPE should as far as possible draw up a list of questions that potential bidders may raise. The response to each of the questions must be carefully drawn up and approved internally (if need be, by its legal advisor), so that the GPE is ready with its stance on the possible queries which bidders may raise during the clarification stage after the issue of the ITT. Any inter-agency issues such as indicative valuation of the land and land use planning parameters should be resolved before the calling of the tender.

Tender Notice

3.2.22 A Tender Notice (incorporating Notice of Proposed Procurement and Summary Notice) should be released on GeBiz to inform and invite the shortlisted suppliers to submit Tender Proposals for the PPP project, in accordance with instructions contained in the Invitation to Tender (ITT). GPEs shall comply with the guidelines contained in IM3B #155-163 and #560-564.

3.2.23 In addition to the information to be included in the Notice of Proposed Procurement (as specified in IM3B #155-163 and #560-564), the notice shall also contain the following information:

- (a) a statement that the GPE is inviting offers for a PPP procurement;
- (b) the draft PPP contract to be signed by the GPE and the successful PPP provider;
- (c) the timetable and the process for clarifying the set of terms and conditions of the PPP contract and for the submission of bids; and
- (d) the relevant documents to be given to potential bidders may include :
 - Step-in agreement
 - Letter of Conveyance
 - Form of Bid Bond (issued by the bank)
 - Form of Bank Acknowledgement Letter
 - Form of Letter of Intention

3.2.24 The GPE should make available for all potential bidders as much accurate and pertinent information as possible, when issuing the ITT. Such legal, financial or technical information can then help the bidders to better evaluate the PPP contract and project, thus reducing the likelihood of misunderstandings, withdrawals of bids etc. Examples of information to be given to potential bidders may include technical conditions of the site such

as the soil condition, the projected usage or user load for the amenities, bid evaluation criteria, and whether more than one successful bidder is envisaged. The GPE can consider setting up a data room where all the relevant information can be made available to bidders.

Period of Tender

3.2.25 The Period of Tender refers to the time period between the date of publication of Tender Notice and the closing date for receipt of Tender Proposals from bidders. A reasonable minimum Period of Tender should be specified for PPP projects given the complexity of tendering for PPP projects. As a guide, GPEs could consider setting 4-6 months before this PPP tender closes. GPEs shall comply with the guidelines contained in IM3B #175-181.

3.2.26 Where a decision has been made to extend the closing date, the GPE shall issue a Corrigendum to Tender Notice in GeBIZ at least one month before the original closing date to effect this. This is to give all prospective bidders adequate notice of such extension.

3.2.27 If the closing date has to be brought forward, the GPE shall issue a Corrigendum preferably one month before the new closing date. This is to give all prospective bidders adequate notice to respond on time. The period of tender can only be reduced in exceptional circumstances where there is extreme urgency or due to obvious errors with the original closing date. GPEs should be mindful that shortening the tendering period may lead to some prospective bidders being caught unawares and unable to submit a bid on time. GPEs should thus avoid this as much as possible.

Invitation to Tender (ITT) Document

3.2.28 The ITT shall be published in GeBIZ. GPEs shall comply with the guidelines contained in IM3B #190-302. GPEs should use output/ outcome-based performance specifications as much as possible in its PPP contracts, although some input-based specifications may be necessary for certain requirements of the GPE in the PPP contract. This will allow the potential bidders as much as flexibility as possible to produce innovative proposals as well as not to restrict the GPE from considering alternative proposals. GPEs should also include a clause on periodic market testing in the tender. This is to ensure that the unitary payment is a fair and viable one.

STEP 4: MARKET FEEDBACK PERIOD

3.2.29 **THIS IS AN IMPORTANT STAGE IN THIS WHOLE PROCESS TO SELECT THE PPP PROVIDER. As a guide, this market feedback period should be 3-6 months.** This market feedback period, between the issue of the ITT and the closure of the ITT, serves two significant aims:

- a) Help both the GPE and the potential bidders to understand what the terms and conditions of the PPP contract as stipulated in the PPP tender mean and the implications these terms and conditions pose. This will help the bidders evaluate the

legal and financial implications of the PPP deal, and thus better decide whether to participate in the tender; and

- b) If need be, amend the terms and conditions of the PPP contract to make it more robust and viable before the tender closes such that there will be strong bidding interests from potential providers.

3.2.30 The GPE should allow at least 1 round of feedback during this period before the tender closes. It should state the deadlines for each of these rounds of feedback. **Potential bidders should submit their written queries by these deadlines. The GPE should carefully prepare a written reply to all these queries within the specified time frame. This time frame should be reasonable to allow the GPE to revert on the queries. The GPE should also disseminate the full and same list of queries and answers openly.** This is to ensure that all potential bidders have the same and common level of understanding on the PPP project. All correspondences arising from the feedback process must be documented and kept properly within the GPE. In addition to written clarifications with the bidders, the GPEs should invite the prequalified bidders to present their proposals. The bidders can share in the presentation share with the GPEs on they plan to deliver the service, how they want to manage the service delivery and how they intend to finance the PPP deal. This will help GPEs to get early feedback on the bid formulation. The GPE should only provide feedback in response to the prequalified bidders' questions and must not negotiate with the bidders during this stage and the proposed solution. The GPE must also bear in mind not to inadvertently leak the intellectual property of the prequalified bidders during these presentation sessions. E.g. the GPE should not take a design idea from one prequalified bidder and suggest it to another bidder.

STEP 5: ISSUE OF FINAL TENDER

3.2.31 Where necessary, the GPE may issue a corrigendum to amend its ITT accordingly at the end of the cycle of market feedback rounds.

3.2.32 GPEs should consider extending the original closing date if bidders in general have difficulties complying with the stipulated period. Extension, if any must be announced through a corrigendum one month before the original closing date. This is to give all prospective bidders adequate notice of such extension.

STEP 6 : CLOSING OF TENDER

3.2.33 All information pertaining to the tender proposals, including price must be treated in confidence. The purpose of withholding the publication of tender schedule is not to assist particular participants to bring their tenders up to the level of other participants. Providing such information will result in non-compliance with Article XIV (Negotiation) of the GPA. In addition, bidders should submit a letter from the bank as part of the proposal indicating that the bank is agreeable to the PPP terms and extending financing to the bidder.

3.2.34 The ultimate aim of the evaluation process is to select the PPP provider who is best able to manage and deliver the project. The GPE must evaluate tender proposals using the evaluation model or criteria set forth in the ITT. The GPE must not at this junction change criteria or waive essential requirements or contractual terms after the closing of the tender.

Establish the evaluation team

3.2.35 Evaluation will be undertaken by an evaluation committee who is not biased toward any bidder. Evaluation team members must declare any conflict of interest, directly or indirectly possessed, and on this basis discontinue to be in the evaluation committee. Key stakeholders must be represented in the evaluation team. The evaluation team should include technical/ operational, business, financial and senior management representatives.

Evaluate tender compliance

3.2.36 In evaluating basic compliance, the GPE may be left with a limited number of complying tenders, i.e. two or fewer complying tenders. The GPE will need to make a decision whether it wishes to continue with the evaluation process or re-tender.

3.2.37 If the GPE wishes to recommence the tender process, the relevant Tender Approving Authority's approval has to be obtained. Generally, if none of the tenders can comply with the requirements of the ITT, the GPE should cancel the tender process and re-tender with revised specifications, terms and conditions, where applicable. However, such situations with its commensurate abortive bidding costs incurred by the bidders and the GPE can be avoided if the GPE has in the first instance conducted its due diligence, such as in structuring a robust PPP contract, conducting market testing before issuing the prequalification tender and allowing market feedback sessions by potential bidders during the PPP tender process.

3.2.38 Any clarification of proposals submitted by the bidders during the evaluation process must be documented by the GPE, including the need for clarification, reasons and the potential effect on other bidders. The clarification notice must be forwarded to the bidder in writing and a reasonable time frame must be set for provision of an answer. The response should be in writing and within the specified time.

Recommend PPP provider

3.2.39 Having taken into account all elements of the evaluation criteria, the GPE shall prepare a Tender Evaluation Report detailing the recommendation of the preferred bidder and justifications. The GPE will then put up a Tender Recommendation Report, which will include the Tender Evaluation Report, to the relevant Tender Approving Authority to seek approval for the recommendation.

STEP 7: CONTRACT AWARD / FINANCIAL CLOSE

3.2.40 A signed contract between the GPE and the selected PPP provider is mandatory for every PPP project. The contract must identify clearly the following:

- risk allocations and responsibilities of the GPE and the PPP provider;
- financial terms of the contract; and
- agreed upon performance standards, target dates (milestones), deliverables and options for terminating the contract.

3.2.41 The GPE should allow the PPP provider to finalise all third party agreements (for example with banks, sub-contractors, etc.) within a reasonable timeframe, and to obtain the necessary permits from the relevant authorities. As a guide, GPEs can consider giving the PPP provider 4 months to 6 months to reach financial close.

CONCLUSION

3.2.42 If agencies do the needed market sounding, structure a robust, balanced and bankable PPP contract, and conduct the procurement process in a transparent and yet efficient manner (such as clarifying with bidders during the market feedback period before the closure of the tender), this will help agencies secure bidding interests from more and competent potential PPP providers.

Questions for Consultation:

- What information (other than those identified in section 3.2) can be announced at the pre-procurement plan briefing?
- What mechanisms (other than written clarification and presentation) can be included in the market feedback period to help bidders understand the PPP contract? Is the period 3 - 6 months sufficient?

Summary	
Step 1 : Invitation for Expressions of Interest (EOI)	<ul style="list-style-type: none"> • Conduct market sounding to assess the feasibility of the PPP approach and structure for the project • Establish prequalification criteria • Publish EOI notice • Identify potentially interested suppliers
Step 2 : Prequalification of bidders	<ul style="list-style-type: none"> • Evaluate applicants against predetermined criteria • Pre-qualify bidders for ITT
Step 3 : Request for Proposal from selected bidders (ITT)	<ul style="list-style-type: none"> • Refine project appraisal • Finalise ITT document • Publish tender notice in GeBIZ
Step 4 : Market feedback period	<ul style="list-style-type: none"> • Conduct clarification/ feedback session with bidders
Step 5 : Issue of Final Tender	<ul style="list-style-type: none"> • Fine-tune and re-issue the ITT document where necessary
Step 6 : Closing of Tender	<ul style="list-style-type: none"> • Establish evaluation committee • Conduct fair and objective evaluation of the proposals. Exclude those not meeting requirements.

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	<ul style="list-style-type: none">• Seek necessary clarifications• Select the likely PPP provider
Step 7 : Contract award / Financial close	<ul style="list-style-type: none">• Recommend selected offer to Tender Approving Authority• Sign contract with PPP provider• PPP provider to finalise third party agreements

SECTION 4
MANAGING A PPP
RELATIONSHIP

4.1 CONTRACTUAL ISSUES IN PPP

PURPOSE OF THIS SECTION

4.1.1 The purpose of this section is to provide general guidance for the government procuring entity (GPE)'s management of a PPP contract with the PPP provider throughout the life of the PPP project.

PHASES OF A PPP PROJECT

4.1.2 A typical PPP project has several distinct phases:

- a. **PPP provider selection (procurement) phase:** the process leading up to contract execution, during which the GPE should establish sound contractual foundation for subsequent management over the life of the contract;
- b. **construction phase:** from the time when the PPP provider commences construction to the commissioning of the completion of the construction;
- c. **service delivery or operational phase:** covering the start of the first payments for the provision of services required under the contract to the remaining life of the contract; and
- d. **contract expiry or termination phase:** the period leading up to and after contract expiry or termination.

DIFFERENCES BETWEEN A PPP PROJECT AND A CONVENTIONAL PROJECT

4.1.3 It is important for the GPE to understand and appreciate these differences, as these differences necessitate a different approach to managing a PPP provider, as compared to managing a conventional contractor.

4.1.4 **A PPP project differs from a conventional procurement in the following significant ways:**

- a. **A PPP project is not a construction project.** GPEs should avoid the tendency to manage a PPP project the way they manage a conventional construction project, and inadvertently limiting the room for the PPP provider to innovate in the design and construction of the asset;
- b. **As the PPP provider is delivering services and not an asset, the focus should be more on the performance of the PPP provider in delivering the services according to the stipulated service levels** though the GPE might need to ensure that the asset could revert to itself in a reasonable (but not new) condition at the expiry of the PPP contract should the asset still have residual economic lifespan;

- c. **The risk allocation between the PPP provider and the GPE is more complex than that of a conventional procurement, and the GPE must be careful that the risks undertaken by the PPP provider such as construction and operational risks are not inadvertently passed back to the GPE; and**
- d. **Due to the long tenure of the PPP contract, managing the relationship between the PPP provider and the GPE becomes critical to the success of the PPP project.**

KEY ASPECTS OF WORKING IN PARTNERSHIP WITH A PPP PROVIDER

4.1.5 There are 3 key aspects of managing a PPP provider:

- a. **contract management;**
- b. **performance monitoring; and**
- c. **relationship management.**

4.1.6 **Contract management is the process that enables both the GPE and the PPP provider to meet their contractual obligations in order to deliver the objectives required from the contract.** This continues throughout the life of a contract and involves managing proactively to anticipate future needs as well as reacting to situations that arise. In contract management, the GPE ensures that the respective roles and responsibilities set out in the contract are fully understood and fulfilled to the contracted standards so that value for money is delivered. Where contracted standards are not fulfilled, the GPE would have to rely on mechanisms established in the contract to rectify any under-performance. Contract management may also involve aiming for continuous improvement in performance over the life of the contract.

4.1.7 **Performance monitoring** are specific activities within the management of the PPP provider. It **includes the day-to-day monitoring of performance, assessing whether the contracted services are delivered to the contracted standards, and evaluating the remedial actions taken by the PPP provider when the performance standards are not met.**

4.1.8 Managing the relationship with the PPP provider is covered in details in Section 4.3. Suffice to say here that **given the long tenure of a PPP project and the “partnership” nature of a PPP project where the PPP provider and the GPE are mutually dependent, the relationship management of the PPP provider is different from that of a conventional project.**

4.1.9 The players in each of the above aspects may be different, e.g. in the case of a PPP school, the principal would be responsible for performance monitoring, while MOE might be more in charge of managing the relationship with the PPP provider and contract management based on inputs from the principal.

WHY PPP CONTRACTS CAN FAIL

4.1.10 If a PPP contract is not well managed by the GPE, any or all of the following may happen, and ultimately the contract becomes unworkable:

- a. the PPP provider may take control, resulting in unbalanced decisions that do not serve the GPE's interests;
- b. decisions are not made at the right time, or not made at all;
- c. new business processes do not integrate with existing processes, and therefore fail;
- d. people (in both the GPE and the PPP provider) fail to understand their obligations and responsibilities;
- e. misunderstandings, disagreements and underestimations may arise, and too many issues would be escalated inappropriately;
- f. progress is slow or there seems to be an inability to move forward;
- g. the intended benefits are not realized; or
- h. missed opportunities to improve value for money and performance.

4.1.11 **There are several reasons why a GPE may fail to manage contracts successfully. Some possible reasons include:**

- a. contracts that are poorly drafted;
- b. inadequate resources are assigned to contract management;
- c. the GPE team does not match the PPP provider team in terms of either skills or experience (or both);
- d. personality clashes between the people in the project teams;
- e. the context, complexities and dependencies of the contract are not well understood;
- f. failure to validate the assumptions of the PPP provider;
- g. authorities or responsibilities relating to commercial decisions are not clear;
- h. a lack of performance measurement or benchmarking by the GPE;
- i. a focus on current arrangements rather than what is possible or the potential for improvement; or
- j. a failure to monitor and manage retained risks (statutory, political and commercial).

KEY CONSIDERATIONS IN MANAGING THE PPP RELATIONSHIP

a) *Get the contract right in the first instance*

4.1.12 The foundations for contract management, performance monitoring and relationship management have to be laid in the stages before contract award, including during the procurement process. This fundamentally means getting the PPP contract right.

4.1.13 Getting the PPP contract right is a very important aspect of managing the PPP provider. An ambiguous contract or a contract that is less than comprehensive could lead to disputes that could arise years later, when the personnel involved at the beginning of the PPP project might no longer be around.

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4.1.14 Indeed, given the long tenure of the PPP contract, the personnel and stakeholders involved in the PPP project at the GPE and the PPP provider are likely to have changed over the contract life. It is thus important that the contract itself stipulates clearly the contractual rights and responsibilities of the GPE and the PPP provider.

4.1.15 A comprehensive PPP contract should address the following issues identified in the table below.

Issue	Construction Phase	Service Delivery or Operational Phase	Contract Expiry or Termination Phase
Tenure and Continuing Access Rights	X	X	X
Commissioning of the completion of construction	X		
Service Delivery Performance Requirements	X	X	
Availability of Contracted Services		X	
Payment	X	X	X
Performance measurement and monitoring		X	
Price Review and Adjustments		X	
Ownership of Land and Facility	X	X	X
Intellectual Property	X	X	X
Step-in Rights	X	X	
Insurance	X	X	X
Changes in Service Requirements	X	X	
Technical Upgrade and Technology Obsolescence		X	
Change Management	X	X	
Ongoing Review		X	
Contingency Planning	X	X	
Dispute Resolution	X	X	
Termination of Contract			X
End of Term Arrangements			X

4.1.16 Good preparation is essential to deriving a sound and robust contract. An accurate assessment of needs by the GPE helps create a clear output-based specification focused on services to be delivered, not an asset or facility to be built. The procedures for selecting the PPP provider should focus on getting value for money and finding the right PPP provider who can deliver the contracted requirements over the contract life. The contract should cover pertinent aspects such as allocation of risk, the quality of service required, and procedures for variation of service scope and dispute resolution. Improvements in price, quality or service should be, where possible, built into the contract terms.

b) Getting the right people with the needed skills mix to manage the PPP contract

b.1) People, skills and continuity

4.1.17 There must be people with the right interpersonal and management skills to manage relationships at multiple levels in the organisation. Clear roles and responsibilities should be defined, and continuity of key staff should be ensured as far as possible. **A contract manager (or contract management team) should be designated early and be involved in the process for selecting the PPP provider in the first instance.** The contract management team must understand the business fully and know the contract documentation thoroughly. This is essential if they are to understand the implications of problems (or opportunities) over the life of the contract.

b.2) Flexibility

4.1.18 Management of contracts usually requires some flexibility on both sides and a willingness to adapt the terms of the contract to reflect a rapidly changing world. Problems are bound to arise that could not be foreseen when the contract was awarded. **Often, this requires a structure in place for the management of both the GPE and the PPP provider to manage the relationship between both parties on an ongoing basis.**

b.3) Change management

4.1.19 Contracts should be capable of change (to terms, requirements and perhaps scope) and the relationship should be strong and flexible enough to facilitate it. Good contract management is not reactive, but aims to proactively anticipate and respond to business needs of the future.

c) Effective monitoring and management of the PPP provider's performance

4.1.20 Effective performance monitoring requires that the GPE has to monitor whether the service is being delivered, and to the contracted standards. **The GPE should not engage in detailed management of the PPP provider. Rather, it should ensure that during the procurement phase that the selected PPP provider has acceptable performance monitoring, quality management and management information systems, and cash flows during the construction and operational phases. The GPE should audit these systems with planned and random spot checks to satisfy itself that performance is being measured and reported reliably, accurately and comprehensively.**

4.1.21 **The contract should provide for incentives and remedies to be in place to ensure that the PPP provider provides accurate and timely data to assure the GPE that the contracted service is provided to the required standards, and would continue to be so.**

4.1.22 Any contract the GPE has with independent professional advisers must contain clear arrangements for reporting the results of performance monitoring to the GPE and the PPP provider. Both the GPE and the PPP provider's financiers have a common interest, vis-à-vis the PPP provider, in the quality of the asset or facility being built, and in the services being delivered to the required standards. There may be circumstances where it is more cost effective for the GPE and the PPP provider's financiers to jointly appoint an independent

professional adviser. However, the GPE has to be careful that such a joint appointment would not introduce any conflict of interest.

4.1.23 The GPE should avoid action that could result in project risk being assumed or transferred back to the GPE or the government. For example, during the construction phase, the GPE should not approve any detailed drawings or designs. It should only need to ensure by audit checks, that the PPP provider's quality assurance system for achieving the quality of design and service standards specified in the contract is working. The GPE should focus on enforcing the PPP provider's performance of its construction obligations under the contract. The GPE has to be constantly aware that it is procuring services, not equipment or facility.

CONCLUSION

4.1.24 The unique nature of a PPP project necessitates a different, new approach and attitude towards managing the PPP provider. Mutual trust and understanding, openness, and excellent communications are as important to the success of an arrangement as the fulfilment of the formal contract terms and conditions.

4.1.25 Throughout the duration of a PPP project, there will be some tensions between the different perspectives of the GPE and the PPP provider. Managing the PPP provider is about resolving or easing such tensions to build a relationship with the PPP provider based on mutual understanding, trust, open communications and benefits to both the GPE and the PPP provider based on the PPP contract – a “win/win” contractual relationship.

4.1.26 Since the PPP project lasts for a very long time, the GPE should take a long term view of its approach in managing the PPP provider. Just as the contractual and commercial aspects are important, the relationship between the GPE and the PPP provider is equally vital to the success of the PPP project. In long term contracts such as PPP, the interdependency between the GPE and the PPP provider is inevitable, and it is therefore in the interests of both parties to make the relationship work. The switching costs involved in changing to any alternative provider in mid-term are likely to be very high and, in any case, contractual realities may make such a course of action highly unattractive.

Questions for Consultation:

- What other key contractual issues should be addressed by a PPP contract?

Summary

PHASES OF A PPP PROJECT

A typical PPP project has several distinct phases:

- a. **PPP provider selection (procurement) phase;**
- b. **construction phase;**
- c. **service delivery or operational phase; and**
- d. **contract expiry or termination phase.**

Three key aspects of managing a PPP provider

- a. contract management;
- b. performance monitoring; and
- c. relationship management.

Key possible reasons why PPP contracts can fail

- a. contracts that are poorly drafted;
- b. inadequate resources are assigned to contract management;
- c. the GPE team does not match the PPP provider team in terms of either skills or experience (or both);
- d. personality clashes between the people in the project teams;
- e. the context, complexities and dependencies of the contract are not well understood;
- f. failure to validate the assumptions of the PPP provider;
- g. authorities or responsibilities relating to commercial decisions are not clear;
- h. a lack of performance measurement or benchmarking by the GPE;
- i. a focus on current arrangements rather than what is possible or the potential for improvement; or
- j. a failure to monitor and manage retained risks (statutory, political and commercial).

CHECKLIST

- Get the contract right

Issue	Construction Phase	Service Delivery or Operational Phase	Contract Expiry or Termination Phase
Tenure and Continuing Access Rights	X	X	X
Commissioning of the completion of construction	X		
Service Delivery Performance Requirements	X	X	
Availability of Contracted Services		X	
Payment	X	X	X
Performance measurement and monitoring		X	
Price Review and Adjustments		X	
Ownership of Land and	X	X	X

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Facility			
Intellectual Property	X	X	X
Step-in Rights	X	X	
Insurance	X	X	X
Changes in Service Requirements	X	X	
Technical Upgrade and Technology Obsolescence		X	
Change Management	X	X	
Ongoing Review		X	
Contingency Planning	X	X	
Dispute Resolution	X	X	
Termination of Contract			X
End of Term Arrangements			X

- Get the right people with the needed skills mix to manage the contract;
- Have the management structure in place to manage the relationship with the PPP provider;
- Monitor and manage the performance of the PPP provider, by ensuring with audit checks that the selected PPP provider has acceptable performance monitoring, quality management and management information systems, and cash flows during the construction and operational phases; and
- Avoid action that could result in project risk being assumed or transferred back to the GPE or the government

4.2 WORKING IN PARTNERSHIP WITH THE PPP PROVIDER

PURPOSE OF THIS SECTION

4.2.1 This section discusses the key areas for managing the PPP provider which the GPE can focus on for the various phases of a PPP project.

PHASES OF A PPP PROJECT

4.2.2 To recap, the phases of a typical PPP project are as follows:

- a. PPP provider selection (procurement) phase;
- b. construction phase;
- c. service delivery or operational phase; and
- d. contract expiry or termination phase.

a) Procurement Phase

4.2.3 Preparation for the long term management of the PPP provider has to begin right at the beginning of the project, i.e. at the procurement phase. Specifically, this means that the GPE should amongst others:

- a. Get the PPP contract right, i.e. it should be balanced, robust and sustainable;
- b. Involve its own staff who will be managing the PPP contract in the procurement process as early as possible; and
- c. Ensure that the personnel who will actually be managing the PPP contract on behalf of the PPP provider are involved in the procurement process.

b) Construction Phase

4.2.4 During this phase, the GPE's primary focus should be to monitor the PPP provider's progress towards meeting the service commencement date. The contract manager should do no more than monitor the PPP provider's implementation procedures to ensure that it would be able to deliver the services on time. This may involve inspecting and commenting on plans, having access to the site, confirming compliance with procedures and agreeing with the PPP provider that it is able to commence service delivery as per the stipulated schedule. However, there must be a clear limit to the extent of the GPE's responsibilities as involvement to a greater extent than is appropriate for monitoring purposes may lead to the GPE taking back the risk (such as construction risks) which it has paid already to the PPP provider to bear under the PPP unitary payment mechanism.

4.2.5 The contract manager should only require sufficient management information from the PPP provider to retain confidence in the delivery timetable and to ensure compliance with any residual safety issues remaining with the GPE.

c) Service Delivery Phase

4.2.6 Managing service delivery means ensuring that the service as contracted is delivered, and to the required performance standards. The PPP contract will have defined the service levels and terms under which a service is provided. **Typically, under the PPP contract, the PPP provider will self-monitor its performance and submit monthly the performance forms (which must also be issued during the PPP tender and be incorporated as part of the PPP contract) to the GPE.**

4.2.7 Service level management is about assessing and managing the performance of the PPP provider to ensure value for money. **Besides the GPE's contract management team doing periodic audits on the PPP provider's service performance, the GPE contract management should also educate and involve the public officers working at the PPP facility (such as a school or a stadium) to help monitor the service performance of the PPP provider.** Specifically, when the public officers detect a service failure (e.g. the lights do not work, or there is a spillage), they should call up the one-stop helpdesk of the PPP provider and report the service failure. If the PPP provider fails to take remedial measures to correct the failure within the agreed response time limits as specified within the PPP contract, the contract management team should invoke the deduction of the PPP provider's unitary payments as agreed under the PPP contract. This though pre-supposes that the contract management team knows that the PPP provider has failed to respond to the failure. The contract management team may thus wish to consider how it can mobilise the public officers working at the PPP facility to bring to its attention instances when the PPP provider has not responded to service failure on time.

4.2.8 Managing risk is another important aspect of managing service delivery. Business continuity plans and contingency plans help the GPE to prepare for situations where the PPP provider cannot deliver. Generally, contingency events can be divided into the following three categories:

- a. events that interrupt service delivery but do not involve default by the PPP provider - for example, force majeure events;
- b. events that interrupt service delivery and involve a default by the PPP provider - for example, the PPP provider fails to maintain the facility as required by the contract; and consequently fails to deliver services meeting the output specifications; and
- c. defaults of the PPP provider that do not result in an interruption to service delivery - such defaults could include failure by the PPP provider to maintain professional indemnity insurance as required by the contract, and subsequently insolvency of the PPP provider because of a negligence claim.

d) Contract Termination or Expiry Phase

4.2.9 **As the contract draws to a close (for whatever reason), the GPE has to assess the various options available to itself. The GPE's main concern at this phase is to ensure a smooth transition of service delivery from the PPP provider to the GPE or to another service provider.** This is critical as the GPE is still responsible to deliver its core services to

the public. Depending on the options available in the contract, and on the GPE's requirements at that time, the assets or facility may be transferred to the GPE or remain with the PPP provider.

4.2.10 Some key issues the GPE should consider as it prepares itself for this phase are:

- a. What are the criteria for deciding whether to extend the services of the PPP provider, to engage another service provider, or to provide the services itself?
- b. What are the prerequisite resources (e.g. land, facility, equipment, intellectual property, manpower, documentation, etc.) that the GPE will need in order to provide the services on its own?
- c. Would the change of service provider cause a change in the way the GPE provides its core services to the public?
- d. Is there still the business need for the core services the GPE was providing?

4.2.11 If the GPE is likely to need the PPP facility even after the expiry of the existing PPP contract, the GPE should work with the existing PPP provider to ensure that the latter continues to maintain the facility (setting aside the contractually agreed portion of its unitary payment to a dedicated lifecycle maintenance account) even as the existing contract nears expiry.

GPE'S CONTRACT MANAGEMENT TEAM

4.2.12 The PPP contract defines the basis for the long term relationship between the GPE and the PPP provider. The PPP provider should be made fully aware of the GPE's contract management team and its structure, particularly the roles and responsibilities of the contract manager and its management reporting arrangements.

4.2.13 The GPE's contract management team should reflect the various skills and knowledge required to effectively discharge contract management responsibilities over the life of the project. Typical disciplines that need to be represented or be available in the contract management team are as follows:

- a. design and construction;
- b. facilities and services management;
- c. information (especially for IT projects);
- d. statutory safety and regulatory responsibilities;
- e. contractual law; and
- f. finance.

4.2.14 The main focus of the contract manager and his team will be to facilitate an "intelligent customer" approach, and not to interfere with the way the services are delivered by the PPP provider, provided the service specifications under the PPP contract are met. It is the contract manager's responsibility to coordinate inputs from the various team members in order to ensure effective and consistent contract management. Each member of the team will have varying degrees of inputs depending on the circumstances.

CONTRACT ADMINISTRATION

4.2.15 The importance of contract administration (both the GPE's and the PPP provider's procedures) to the success of the contract, and to the relationship between the two parties, should not be underestimated. Clear administrative procedures ensure that both parties understand who does what, when, and how. These include procedures governing the following:

- a. Variation, and change control;
- b. Payment of the unitary charges;
- c. Management reporting; and
- d. Mechanisms for problem solving and dispute resolution.

4.2.16 Keeping the contract documentation up to date is an important activity, and it should not be a burden. The effort required may be reduced by ensuring that the contract is sufficiently flexible to enable changes to the requirement and pricing mechanism within agreed parameters without the need to change the contract documentation.

4.2.17 Managing the contractual obligations of the government can be more complex than managing the obligations of a private party in certain cases. -The GPE's contract management team may need to coordinate the actions of other public sector entities in order to ensure that the government:

- a. can deliver on its obligations under the contract; and
- b. does not inadvertently act so as to hinder or prevent the PPP provider from meeting its obligations under the contract.

CONCLUSION

4.2.18 Each phase of a PPP project has a different set of focus areas:

- a. Preparation for the long term management of the PPP provider has to begin right at the procurement phase. The GPE must get the PPP contract right, and involve the post-procurement PPP contract management teams from both itself and the PPP bidders in the process for selecting the PPP provider;
- b. During the construction phase, the primary focus of the GPE is to monitor the PPP provider's progress towards meeting the service commencement date. The GPE should only monitor the PPP provider's implementation procedures to ensure that the latter is able to deliver the services on time;
- c. During the service delivery phase, the GPE's focus is on assessing and managing the performance of the PPP provider to meet the standards as specified in the PPP contract to realise value for money gains; and
- d. During the contract termination or expiry phase, the GPE's main concern is to ensure a smooth transition of service delivery from the PPP provider to the GPE or to another service provider. This is critical as the GPE is still responsible for delivering its core services to the public.

4.2.19 The GPE's contract management team should reflect the various skills and knowledge required to effectively discharge contract management responsibilities over the life of the project. The main focus of the contract management team is to facilitate an "intelligent customer" approach, and not to interfere with the way the services are delivered by the PPP provider provided the service specifications under the PPP contract are met.

4.2.20 Last but not least, given the long tenure of the PPP project, in view of the possible turnover of contract management staff at both the GPE and the PPP provider, contract administration processes (including clearly defined procedures and well-maintained documentation) are very crucial to institutionalize the knowledge and procedures for managing the PPP contracts.

Questions for Consultation:

- What other key processes are there for contract administration (besides those identified in Section 4.2)?

Summary

PHASES OF A PPP PROJECT

- a. PPP provider selection (procurement) phase;
- b. construction phase;
- c. service delivery or operational phase; and
- d. contract expiry or termination phase.

FOCUS AREAS OF EACH PHASE

- a. get the PPP contract right, and involve the post-procurement PPP contract management teams from both itself and the PPP bidders in the process for selecting the PPP provider;
- b. monitoring the PPP provider's work progress in the construction phase;
- c. managing the service delivery in the service delivery phase; and
- d. ensuring smooth transition of service delivery in the contract termination or expiry phase.

TYPICAL DISCIPLINES OF CONTRACT MANAGEMENT TEAM

- a. design and construction;
- b. facilities and services management;
- c. information (especially for IT projects);
- d. statutory safety and regulatory responsibilities;
- e. contractual law; and
- f. finance.

SOME KEY PROCESSES FOR CONTRACT ADMINISTRATION

- a. Variation, and change control;
- b. Payment of the unitary charges;
- c. Management reporting; and
- d. Mechanisms for problem solving and dispute resolution.

CHECKLIST

- Understand and work on the focus areas in each phase.
- Build the relevant contract management team with the required disciplines and skill sets.
- Institutionalize the knowledge and procedures for managing the PPP contract by developing the contract administration processes.

4.3 MANAGING A SUCCESSFUL RELATIONSHIP WITH THE PPP PROVIDER

PURPOSE OF THIS SECTION

4.3.1 This section discusses the key aspects of managing the relationship with the PPP provider.

ESTABLISHING THE RELATIONSHIP

4.3.2 A successful relationship in a long-term service purchase under PPP will lead to the delivery of services that meet the requirements as stated in the PPP contract. The commercial arrangement under the PPP contract must be acceptable to both parties – offering value for money for the GPE and adequate profit for the PPP provider. Nonetheless, just as these commercial aspects are important, the relationship between the GPE and the PPP provider – the way they regard each other and work together during the PPP contract life - is vital to ensuring that the PPP does indeed lead to value for money.

4.3.3 Good relations between the GPE and the PPP provider should foster a climate which encourages both parties to suggest or make improvements in the quality of services delivered. However, the relationship must not be at the expense of the PPP contract. Throughout the life of the contract, the GPE, for instance, has the responsibility of monitoring the PPP provider's compliance with its contractual obligations.

4.3.4 Management of the relationship between the GPE and the PPP provider is thus the process of ensuring that both parties can work together in meeting the requirements of the project. This entails the following two aspects:

- a. formal reporting and management arrangements – that is, governance; and
- b. 'soft' issues around the informal communications and cultural aspects.

4.3.5 Some key factors to be considered in establishing management structures for the relationship are as follows:

- a. Ensure that the partnership is championed at senior levels in both the GPE and the PPP provider;
- b. Recognise that the relationship demonstrated by the senior management of the GPE and the PPP provider will influence the tone of the relationship between both parties over the PPP contract life. The 'message' comes from the top;
- c. Make the governance arrangements equitable and the relationship as being peer-to-peer. If not, imbalances will occur;
- d. Avoid a proliferation of structures for managing the relationship, especially of the structures are seen as rigid and bureaucratic. Nonetheless, some differentiation of structures is required to ensure that long-term strategic issues

- underlying the PPP contract are considered, as well as the more day-to-day service delivery issues;
- e. Set clear roles and responsibilities for the different structures for managing the relationship between the GPE and the PPP provider at different levels;
 - f. Empower the staff involved in each such structure; and
 - g. Institute escalation procedures which should be understood and used properly – encourage an approach that seeks to resolve problems early and without escalating up the management chain unnecessarily.

FORMAL REPORTING AND STRUCTURES FOR MANAGING THE RELATIONSHIP

4.3.6 First, typically, the PPP contract should set out the management structures and the formal communications channels that will be put in place to manage the following aspects of the relationship between the GPE and the PPP provider:

- a. strategic decisions – setting and managing strategic direction, identifying opportunities for innovation, agreeing and implementing policies, managing change;
- b. the service – communication between the GPE and the PPP provider at the operational users' level, concerned with delivery of services, day-to-day service monitoring, small scale change; identifying opportunities for improvements to service delivery; and
- c. the contract – communication between the GPE contract management and the PPP provider, concerned with overall management of the contract and dealing with major changes to the contract.

4.3.7 **Second, consistent communication through the levels is important. Otherwise the differences in perspective may mask the problems in the PPP relationship.** For example, even where senior management regards the relationship as successful, serious disagreements and disputes may arise and the relationship deteriorate at the middle management level.

4.3.8 **Third, the formal point of contact between the GPE and the PPP provider should be identified.** The contract manager will be the point of contact for the GPE. Throughout the life of the PPP project, the contract manager has the responsibility of protecting the GPE's agreed contractual position and ensuring that the agreed allocation of risk is maintained and that value for money is achieved.

4.3.9 **A crucial role for the contract manager is to try to prevent disputes from arising by preventative actions. The procedures for liaising with the PPP provider and the maintenance of agreed records of performance will help to resolve problems before they escalate. To minimize the costs of dispute resolution through court settlement, an alternative formal dispute resolution procedure is necessary. The PPP contract should specify the procedure for handling disputes.**

4.3.10 Fourth, the long tenure of a PPP project can pose continuity problems. In most cases, the initial contract management team will not be present till the end of the PPP contract. **Contract management staff are likely to change several times throughout the life of the PPP contract. Forward planning succession planning is therefore important to ensure that the good working relationship and project understanding are maintained when**

new staff take over. Effective succession planning with well-managed project role handover between incoming and outgoing personnel (with appropriate induction and exit procedures) can help in ensuring that the good working relationship extends throughout the life of the project and beyond the tenure of the individuals responsible for managing each side of the relationship.

4.3.11 **Fifth, both the GPE and the PPP provider should take steps to monitor the relationship. They should put in place a means to assess (and thus a means to improve) the quality of the working relationship and management processes. This will be valuable in highlighting aspects that are perceived to be working well and those that require attention.** For example, attendance by representatives at meetings from both sides can be monitored through the minutes of meetings. If attendance by one side's representatives falls away, the other side should consider whether this indicates that the relationship between the two sides is losing strength, or that the meeting is not an effective communication and management forum.

4.3.12 Finally, the management of the relationship depends on the nature of the project, the services to be provided, and the extent to which the GPE's requirements change over time. Particular care should be paid to the beginning years of the project when the risk of problems is likely to be the highest. This may require additional resources for a limited period.

PROCEDURES FOR ESCALATING ISSUES AND DISPUTES

4.3.13 However good the relationship between the GPE and the PPP provider, and however stable the services being delivered, problems will arise over the PPP contract life. As such, procedures for handling these problems should be agreed. Clear reporting and escalation procedures help maintain the good relationship between the two parties. The objective is a relationship in which the GPE and the PPP provider co-operate to ensure that problems are recognized quickly and then resolved quickly and effectively.

4.3.14 **If a dispute cannot be resolved at the level where it arises, it will be necessary to involve a higher level of authority. This escalation process needs to be managed. Escalation procedures should allow for successive levels of response depending on the nature of the problem and the outcome of the action taken at lower levels. Every effort should be made to resolve the problem at the lowest practicable level. The levels of escalation should match those of the interfaces established between the PPP provider and the GPE. A crucial role of the contract manager is to try to ensure through prompt efforts that protracted disputes are avoided.**

SOFT FACTORS IN MANAGING THE RELATIONSHIP

4.3.15 Three key factors to a successful relationship are as follows:

- a. **Mutual respect and understanding** – The right attitudes and behaviours, based on mutual respect and understanding rather than an adversarial approach, should be encouraged. While the PPP contract underlies the basis for the a relationship, mutual respect and understanding is necessary for the

long-term partnership under PPP to work. Such mutual respect and understanding cannot be mandated within the PPP contract. Ultimately, it has to be built through actions and behaviours, rather than assertions, and is tested when problems and disagreements arise;

- b. **Open communication** – Open communication does not mean that the parties must share all information relating to the project. However, a party should share an item of information if there is no good public interest, commercial or legal reason not to share it, and sharing the information would enhance the relationship. **The three primary levels of communication in a contractual arrangement are operational (end users/technical support staff), business (contract manager and relationship manager on both sides), and senior (senior management/board of directors). 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.** For example, if an end user feels that the service is not being delivered to the required standards, he should refer this to the contract manager, who will liaise with the PPP provider’s management. It might not be appropriate for the end user to liaise directly with the PPP provider’s management;
- c. **Recognition of mutual aims** – The GPE and the PPP provider must approach the project as a mutually beneficial arrangement between them. There should be set procedures for raising issues and handling problems, so that they are dealt with as early as possible, and at the appropriate level at both sides.

CONCLUSION

4.3.16 The long-term, interdependent nature of a PPP project necessitates a good strong working relationship between the GPE and the PPP provider as compared to a traditional procurement. Both parties should enter into the relationship with the understanding and intention to build a relationship that is mutually beneficial, without compromising their respective contractual rights and obligations.

4.3.17 The three key factors to a successful relationship are mutual respect and understanding, open communication, and recognition of mutual aims. An appropriate management structure at the three levels (strategic, business and operational) is necessary to ensure consistent and open communication between the two parties. As part of maintaining the good working relationship, both parties should monitor the relationship in order to assess and improve the quality of the relationship and the management processes.

4.3.18 The clear lines of open communication between the appropriate levels of the GPE and the PPP provider help in ensuring a prompt resolution of disputes that arise. This minimises the need for escalation, and alleviate the need for formal protracted disputes. Every effort should be made to resolve the dispute at the lowest practicable level. If needed, the levels of escalation should match those of the interfaces established between the PPP provider and the GPE.

Questions for Consultation:

- Are there other areas in establishing and managing an effective working relationship

between the PPP provider and the public sector that will produce long-term benefits for both parties?

Summary

KEY FACTORS IN A SUCCESSFUL RELATIONSHIP

- a. Mutual respect and understanding;
- b. Open communication; and
- c. Recognition of mutual aims.

KEY FACTORS IN THE MANAGEMENT STRUCTURE

- a. Senior management of the GPE and the PPP provider should lead the partnership;
- b. The relationship at the senior management level sets the tone of the PPP relationship;
- c. The governance arrangements should be equitable and relationships are peer-to-peer;
- d. A large number of formal management levels should be avoided;
- e. Formal committee structures should not be seen as overly rigid;
- f. Clear roles and responsibilities should be set and the staff empowered for the different structures in place to manage the relationship at different levels;
- g. Clear escalation procedures should be instituted and followed.

THREE LEVELS OF MANAGEMENT STRUCTURE

- a. Strategic level;
- b. Business level; and
- c. Operational level.

CHECKLIST

- Understand the intent of a good strong working relationship, i.e. a mutually beneficial relationship without compromising the respective contractual rights and obligations.
- Work on the three key factors of a successful relationship – mutual respect and understanding, open communication, and recognition of mutual aims.
- Develop and maintain the three levels of management structure – strategic, business and operational.
- Monitor the relationship to assess and improve the quality.
- Make every effort to resolve dispute at the lowest practicable level, avoiding formal protracted disputes. Escalation of disputes should be made at the appropriate levels at both sides.

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PUBLIC CONSULTATION ON PUBLIC PRIVATE PARTNERSHIP HANDBOOK

List of Consultation Questions

We would like to seek your feedback and comments to the following questions:

Section 1: Introduction to PPP

- Other than the (i) education, (ii) sports, (iii) healthcare, (iv) expressways, (v) water treatment and (vi) waste management sectors, what other Government projects can PPP be used for?
- What PPP models (other than Design-Build-Finance-Operate and Design-Build-Operate) can public agencies consider when working with the private sector?

Section 2: Key Considerations in Structuring a PPP deal

- What are the responsibilities (other than those listed in Table 2.1) that should be identified in a PPP project? How should these responsibilities be allocated between the public and private sector?
- In what circumstances should the Government-Own-Contractor-Operate (GOCO) model be used, instead of the Contractor-Own-Contractor-Operate (COCO) model?
- What should be the compensation arrangements in the event of contract termination?
- Is it necessary for the PPP private provider to own the land and building in order to obtain financing from the private sector?
- What competencies (other than those listed in section 2.2) should the public and private sectors develop to structure and manage PPP projects effectively?
- What are the pitfalls of using PPP (other than those identified in section 2.3)? How should such pitfalls be avoided?
- For the PPP payment mechanism, when should availability, performance-based or usage-based payments be used?
- When should direct incentives/penalties be used in the PPP payment mechanism? When should indirect incentives/penalties be used?
- What variation mechanisms (other than those identified in section 2.4) can be used to introduce flexibility into the PPP contract?

Section 3: Key Considerations in the PPP procurement process

- What mechanisms (other than those identified in section 3.1) can be introduced to provide for contractual flexibility?
- Given the long selection process in PPP contracts, what measures can be introduced to reduce tendering costs?
- What information (other than those identified in section 3.2) can be announced at the pre-procurement plan briefing?

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- What mechanisms (other than written clarification and presentation) can be included in the market feedback period to help bidders understand the PPP contract? Is the period 3 - 6 months sufficient?

Section 4: Key Considerations in Managing a PPP relationship

- What other key contractual issues should be addressed by a PPP contract (besides those identified in Section 4.1)?
- What other key processes are there for contract administration (besides those identified in Section 4.2)?
- Are there other areas for establishing and managing an effective working relationship between the PPP provider and the public sector that will produce long-term benefits for both parties (besides those identified in Section 4.3)?