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PPP-Newsletter

A Quarterly Publication from the PPP Unit of the Ministry of Economic Development, Financial Services and Corporate Affairs, Mauritius

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INTRODUCTION

One year has elapsed since the creation of the PPP Unit and it is an appropriate time to give an update on PPP in Mauritius.

We have already insisted on the need to establish a strong policy and legal environment and to build capacity before starting to implement PPP projects. Like most Government projects, PPP projects have a long cycle due to the need to conduct a proper feasibility study before moving into the procurement stage. It took most countries several years to implement their first PPP project.

The Policy Statement on PPP was released in May 2003 and provides clarity on PPP in Mauritius, including a definition of the concept and scope for private participation. The PPP legislation is currently under finalisation and is expected to be enacted within a few months.

A lot of effort has been put in capacity building. Complementing the PPP website, the PPP newsletter is at its 3rd edition and is already benefiting from external contributors. A few training and seminars have been organised, often in collaboration with the private sector. The most relevant event was the 2-day workshop on PPP organized by PricewaterhouseCoopers, which was attended by more than 30 civil servants in November 2002.

Around 15 PPP projects are being considered by various ministries. Ministries remain the drivers for the identification and implementation of PPP projects, whereas the PPP unit provides guidance for several projects.

Finally the PPP-Secretariat has been renamed PPP Unit, to reflect its more technical role in the implementation of PPP in Mauritius. The focus of our work is also changing, from putting in place the right environment and building capacity to providing guidance to Ministries on PPP projects.

V. Cuttaree

THE RIGHT POLICY ENVIRONMENT

This article focuses on the need and current effort to strengthen the policy and legal environment in Mauritius. Implications for the choice and implementation of projects will be detailed in another article of this newsletter.

With PPP, the size of the market plays a much bigger role than labour cost and trade agreements, as revenues are generated from the local market, rather than export. The number of users and the income per capita are key determinants of profitability. Between 1990 and 2001, 10 countries attracted 68% of the cumulative investment and accounted for 47% of the projects, which makes Mauritius less attractive than bigger countries such as Brazil, China and India.

The long-term economic and political stability and appropriate legal framework are also more important than any set of incentives that a Government can put in place. PPP contracts last up to 25-30 years and the investment made by the private sector cannot be easily repatriated in case of political and economic turmoil.

Finally, competition for attracting private investment in public infrastructure is fierce. Most countries in the world are implementing or considering PPP and foreign investors have often the choice of destination for their investments. Comparing Mauritius to Africa does not make sense when the region attracted only 3% of cumulative investment between 1990 and 2001.

Mauritius needs therefore to strengthen its already favourable policy and legal environment. Lowering further the risk for investors will reduce the return required by investors, and will contribute to attracting more private investment in infrastructure projects. Foreign investors look for clarity on Government objectives in implementing PPP. Also important is the scope of the programme, and the legal requirements that all PPP projects will need to fulfil.

The PPP Task Force and PPP Unit have made several recommendations to improve the policy and legal environment in Mauritius. The institutions involved and the process for implementing PPP projects have been defined in November 2002, and the Policy Statement was released in May 2003. Several challenging policy issues remain on the agenda, such as the mitigation of currency risk, the implication of domestic capacity for financing on the minimum size of PPP projects, the integration of PPP within the MTEF initiative.

V. Cuttaree

PPP POLICY STATEMENT

The Public-Private Partnership (PPP) Policy Statement sets the framework for implementing PPP projects. Together with the PPP Legislation, which is under finalisation, the Policy Statement contributes to the strengthening of the policy and legal environment needed to implement successful PPP projects.

The Policy Statement defines the PPP concept, the role of Government and Private Sector, as well as the spectrum of PPP arrangements, which would be considered.

PPP will be rooted in Government's broader public expenditure reform programme and thus will serve as an important tool for the better management of public expenditure. PPP will not be limited to traditional infrastructure sectors, but in the initial stage, Government will consider PPP for transport, public utilities, solid and liquid waste management, health, education, vocational training and ICT.

Affordability remains the cornerstone of all PPP projects, and no PPP project will be allowed to move to the procurement phase if the affordability criterion is not satisfied. The PPP Unit of the MEDFSCA, contracting Ministries or public bodies, and the Ministry of Finance will play an important role in the programme. Sectors with less capacity will benefit from the assistance of the PPP Unit and external transaction advisers.

Unsolicited proposals will not be encouraged in the initial years of the PPP programme, as they have often yielded mixed results. Unsolicited proposals could be considered after a few years of experience in PPP, on a case-by-case basis, but always as an exception rather than a rule for projects that demonstrate genuine innovation and/or use of proprietary technology.

The PPP Policy Statement can be consulted on the MEDFSCA web site at the following address: http://economicdevelopment.gov.mu

R. Boodhoo

PPP LEGISLATION

The PPP Bill is currently under preparation and is expected to be enacted within a couple of months. As more ministries are considering to undertake PPP projects, it is essential to understand the key features of the legislation as early as possible.

The PPP Bill was prepared based on the recommendations of the PPP Task Force and Government Lead Adviser on PPP. Experiences of other countries have been taken into account, as well as the specificities of Mauritius and the experience of the Concession Projects Act.

Mauritius already possesses a favourable environment for PPP and the legislation has voluntarily not been too prescriptive to allow for flexibility in the implementation of PPP projects. However, the focus has been put on ensuring that all PPP projects demonstrate value-for-money, risk transfer and affordability. Affordability is essential, as a Ministry must not commit to payments it cannot afford, and approval from Cabinet and the Ministry of Finance will be sought before procurement and signature of contract. Moreover, it was recognised that a transparent and fair selection process was essential. As a result, all PPP projects will be procured through open competitive tendering under the Central Tender Board Act.

The main features of the PPP Bill are as follows:

- The Contracting Authority (such as the Ministry) remains the owner of the project, from inception to the expiration of the contract.
- The PPP unit of the Ministry of Economic Development, Financial Services and Corporate Affairs will give advice and assistance to ministries on PPP projects and develop policy, procedures and best practice guidelines.
- Contracting Authorities will need to conduct a feasibility study demonstrating value-for-money, risk transfer and affordability before starting the procurement process. The feasibility study will need the approval of the Ministry of Finance and Cabinet.
- The procurement of all PPP projects will be done via open competitive bidding, through the Central Tender Board. A pre-selection of candidates will be done before requesting full proposals from the bidders.
- Approval from Ministry of Finance and Cabinet will be required before signature of contract.

V. Cuttaree

UNSOLICITED PROPOSALS

Most of the PPP projects in the world have been initiated by Government, which clearly defines the services to be delivered by the private sector. In a more limited number of cases, unsolicited proposals have been considered by some countries, where the projects were initiated by the private sector and submitted for consideration to Government.

There is some value-added in allowing proposals from the private sector: it is believed that unsolicited proposals can encourage the private sector to bring beneficial ideas for project development that might otherwise have been overlooked. However, key concerns have been raised on the way to ensure value-for-money and transparency on Government side and rewarding the private sector for its innovative proposal.

A study of the World Bank analysed the issues created by unsolicited proposals. In practice, many of the world's most controversial private infrastructure projects were unsolicited proposals such as the Dabhol Power Plant in India and many Independent Power generation plants in Indonesia.

Direct negotiation has raised several issues, such as lack of transparency or putting Government in a weak position due to the absence of competition, expertise or negotiation skills. Direct negotiation with only one supplier often takes much more time that what was originally expected and often ends up delaying the project by several years. Although there are options combining unsolicited proposals and competition, the process can be complex to ensure transparency and value-for-money while at the same time financially rewarding the firm submitting the original idea.

The PPP Task Force recently submitted recommendations regarding the way to handle unsolicited proposals. It was recommended that unsolicited proposals should not be allowed during the first 2-3 years of the initiative and that the question would be reconsidered later based on results and learning experience. These recommendations have been integrated in the Policy Statement issued by Government.

V. Cuttaree

PPP PROJECTS IN MAURITIUS

Introduction of PPP projects in Mauritius

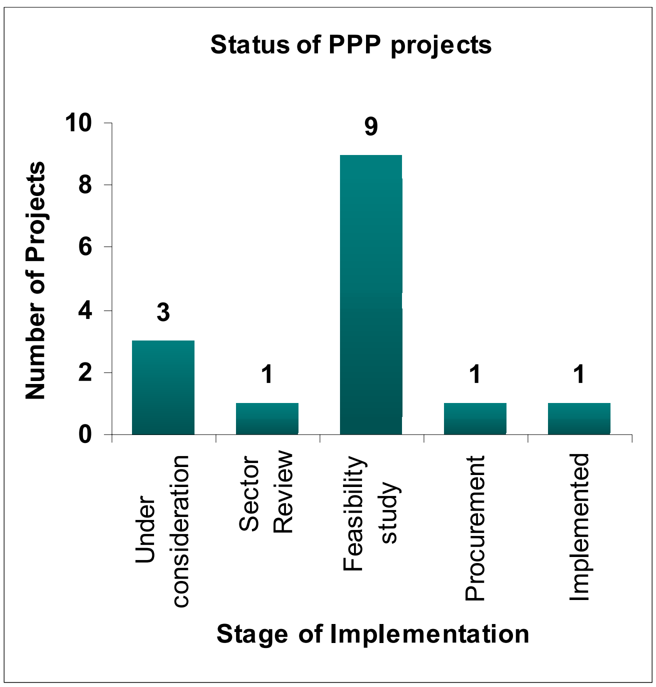
It is sometimes argued that Public-Private Partnership (PPP) projects have existed in Mauritius for many years. This argument is based on the fact that many projects involving private participation have been implemented in Mauritius. However, these projects do not necessarily correspond to the modern practice of 'Public Private Partnership', which involves a detailed feasibility study testing amongst others, the value for money, affordability and optimum risk transfer.

PPP projects in Mauritius might have originated when the Government created the Concession Projects Division (CPD) in 1997 to promote BOT-type projects. At that time, the Central Thermique de Belle Vue (CTBV) project was already considered and almost achieved financial closure stage. The Concession Projects Act (CPA) was repealed in 2001 and as a consequence the CPD and other institutions under the Act became defunct.

The strategy for private participation was re-defined in 2002 when the PPP unit, initially called PPP-Secretariat was set up in July. As from its creation, the PPP unit has been responsible for establishing the regulatory and policy framework and for assisting Ministries in implementing PPP projects. Capacity is gradually being built within the unit through appropriate local and international training programmes. A PPP Task Force including members from both public and private organizations was also created and operates under the chairmanship of the Director of this Ministry. The Task Force is responsible for vetting the policy as well as regulatory recommendations proposed by the PPP unit.

Status of PPP Projects

Various Ministries are actually planning or already using PPP for the implementation of their projects. An analysis of these projects in terms of their status is summarized in the bar chart below.



Projects Identification by PPP Unit

The initial approach used by the PPP unit was to conduct explanatory sessions with Ministries. 14 project proposals were received from Ministries out of which 3 were selected as potential pilot projects. The selection was based on the following criteria: demonstration effect, capacity building and potential value-for-money.

Government's approval was received in November 2002 for conducting feasibility studies for the three projects. Description of the projects and their status is shown in Box 1.

Box I: Progress on PPP Projects

1. Upgrading of the area around the Victoria Bus Station. This project consists of upgrading the non-traffic area of the Victoria Bus Station, found at Port Louis. The scope of work includes upgrading the area located along the motorway up to Le Pouce stream, re-housing of the hawkers operating at the Station; and the maintenance of the traffic area of the Station. A pre-feasibility study has been completed by the PPP Unit. The recommendations have to be discussed with the Ministry of Public Infrastructure, Land and Transport & Shipping.

2. Development of La Citadelle. This project consists of upgrading La Citadelle into a major touristic attraction. The PPP Unit has completed the feasibility study of the project. After approval is obtained from the Ministry of Tourism the Request for Proposal (RFP) will be finalised.

3. New Court House. The project consists of setting-up a new building comprising a number of floors and levels of basement parking to house the High Court and its Divisions.

The pre-feasibility study of the project found that the best option would still be to undertake the design and the construction of the building under the traditional procurement approach. At a later stage, however, the management and the maintenance of the building can be considered as PPP.

Ministries wishing to implement PPP projects will be required to obtain approval for the allocation of funds from the Ministry of Finance. They will then have to abide by the PPP legislation which is about to be completed.

D. Khoodeeram

LESSONS FROM CANCELLATION OF PROJECTS

This article is based on a study by the World Bank, "Infrastructure Projects: A review of Cancelled Private Projects". Lessons have also been drawn from studies carried out by the Institute of Public-Private Partnerships (IP3).

The 1990s saw a rapid and widespread move by governments around the world to involve the private sector in the provision and financing of infrastructure. Seeking private funds and managerial expertise to meet rapidly growing demands for modern energy, telecommunications, water and transport, developing countries saw investment of nearly US$755 billion in some 2500 private infrastructure projects over the period 1990 to 2001.

However, headlines from the world's financial press suggest pervasive problems with private infrastructure. There have commonly been renegotiations of projects in many developing countries. Some projects have even been cancelled exposing governments to significant compensation claims. Such problems have not been restricted to developing countries only. In fact, the telecommunications industry in Europe and the United States is struggling under a mountain of debt and has seen the bankruptcy of leading players.

A definition of cancellation

A project is considered as cancelled if before the end of the project's expected life, the private company

- sold or transferred its economic interest in the project to the public sector
- physically abandoned the project
- ceased to provide services to all customers
- halted construction of the project for around 20 percent or more of the project's expected life following the revocation of a license.

Trends in cancellation of projects

Based on the definition of cancellation, 48 projects were judged to have been cancelled in 1990-2001. This represents 1.9 percent of nearly 2,500 infrastructure projects involving the private sector that reached financial closure in developing countries during that period. The cancelled projects had attracted investment commitments of US$24.2 billion, 3.2 percent of total investment (US$754 billion) in private infrastructure projects in developing countries in 1990-2001. On average, projects were cancelled four and half years after financial closure.

The highest incidence of cancellation by sector was in toll-roads, where 5.8% of projects were cancelled, watpower er and sanitation, where 3.5% of projects have seen the exit of the private sector, and in projects involving distribution and retail responsibilities, where 1.8% were cancelled.

Reasons behind cancellation of projects

Factors leading to cancellation are mostly sector-specific and are largely determined by investors, government and regulators involved in that project

For instance, the cancellation of most toll road projects have been usually attributable to the fact that the roads could not attract the estimated number of users, hence explaining the withdrawal of the private sector. Projects cancelled in the utilities sector had difficulties enforcing and maintaining cost recovering pricing policies. (Summarised in the table which follows)

In fact, many private infrastructure schemes have encountered problems because of failure to match the financial realities of the project with the political economy of that sector. For example, many cancellation of projects with Independent Power Producers reflected difficulties in implementing and sustaining reforms in pricing.

Most water and sewerage projects have been subject to price increases and low collection rates. Attempts to raise prices have met with resistance from politicians and consumers. Meanwhile, the failure to attract sufficient customers or changes in market structure accounted for the failure of projects in the telecommunications sector. In general, many private schemes have encountered difficulties because of poor design and management of the reform process.

Experience suggests that the ultimate success of any project involving private sector participation is influenced by a range of factors including the experience of the contracting authority and its advisers, the ability of the private sector to deliver value-for-money and its willingness to accept an appropriate degree of risk transfer. In many instances, especially in developed countries, Public-Private Partnership projects that were subject to cancellation, were not properly structured and as a result they failed to deliver optimum value-for-money and risk transfer. For example, a number of projects procured in the UK did not focus on the delivery of a value-or-money solution. Equally, a number of early projects in other parts of the world were driven only be the desire to use private sector finance and not by the desire to secure a cost-effective allocation of risks.

In Mauritius where there has recently been a strong commitment to encourage private financing of infrastructure projects, it is crucial to implement PPP projects in a cautious manner. The reason being that the private sector must receive the right message regarding the potential benefits of PPP, and the reluctance to invest in government projects for fear of failure must phase out gradually. For this, it is very important to recruit experts to conduct proper feasibility studies to determine private sector's interest in the project and give an initial demand forecast so that the latter is not overestimated before implementing the project. The above coupled with the right legal and institutional framework and thorough structural reforms where necessary, will no doubt reduce the risks of project cancellation.

Sector	**Causes of project failure**
Transport (e.g, Toll Road Projects)	• Inability to attract the estimated number of users, explaining the withdrawal of the private operator; • Low collection rates.
Utility (e.g, Independent Power Projects; Water and Sewerage Projects)	• Difficulties in maintaining cost recovering pricing policies; • Difficulties in implementing and sustaining reforms in pricing; • Low collection rates; • Failure to match the financial realities of the project with the political economy of that sector.
Telecommunications	• Inability to attract sufficient customers; • Changes in the market structure; • Poor design and management of the reform process.

S.Appadoo

MANAGING RISKS IN A PPP PROJECT

The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk: the notion that the future is more than a whim of the gods and that men and women are not passive before nature. Until human beings discovered a way across that boundary, the future was a mirror of the past or the murky domain of oracles and soothsayers who held a monopoly over knowledge of anticipated events. **Peter L. Bernstein: Against the Gods - The Remarkable Story of Risk**

PPP refers to the use of the private sector to build, manage, maintain, expand, operate and/or invest in infrastructure projects and services. It is an entirely new way for the government to deliver on its social, economic and political obligations, one that is grounded on solid economic and financial principles.

One of the reasons why governments and local authorities are increasingly resorting to PPPs in the delivery of essential public services is the increasing awareness of the ability of the private sector to assume many of the risks involved in the provision of such services, thereby reducing long term costs. Risk management being central to the PPP process, this article provides a general understanding of risk concepts, and the various techniques used in assessing risk in project evaluation. It is first of all important to grasp the nature of risks in PPP projects, and in so doing also understand how the lifecycle of such projects depart from infrastructure projects under traditional procurement processes. Risk is defined as any factor, event or influence that threatens the successful completion and operation of a project in terms of cost, time or quality.

PPP & Traditional Procurement Compared

Public sector procurement has traditionally been lacking in its approach to addressing risk factors, and as the consequences of such failures are practically nil, there is no incentive to manage risks effectively. Furthermore the segregation of capital and recurrent costs induces more pressure for savings in construction costs than concern for long-term economic operations.

In this traditional arrangement, the government provides the financing, either from the current or capital budget, or from donor/ lending agencies, and contractors are appointed through tender procedure for the construction of the infrastructure. Once construction is complete, the public sector agencies assume all responsibilities for the maintenance of the facilities and the operation of the services. Apart from penalties in construction delays or material shortfall in specifications, the contractor bears practically no other risk.

By shifting responsibilities for, not only maintenance, but also operation of the facilities, to the contractor, PPPs offer better value-for-money than the traditional procurement method, and can lead to significant savings and efficiencies, have led to a greater awareness of managing risks during the entire life of the project. This awareness is reflected in the impressive list of risks now identified as being of relevance in any project tender evaluation. There has thus been a dramatic shift of focus from upfront project cost to a risk-adjusted whole life-cost.

Need for Expert Advice

Inevitably, project evaluation has become more complex. For a transaction to effectively take place (i.e. for the partnership deal to be concluded), risks have to be assessed with consistency and with a reasonable degree of accuracy, satisfying each contracting party's (government, project promoters and financiers) perspective.

To cope with these complex issues, financial advisors and practitioners have developed quite sophisticated techniques to appraise both qualitatively and quantitatively all the risk factors. The risk assessment exercise normally starts with a rigorous identification of all the risks involved in a project, and checklists ensure that no risks which could impact significantly on the project's chances of success and its economics are overlooked. The evaluation then proceeds with a qualitative assessment, leading to the construction of a risk matrix, the allocation of risks to the party best able to manage them, and the preparation of a risk management plan in respect of those risks that are retained by the public sector. Risk quantification is then carried out for significant risks transferred to the private sector and their monetary values are included in the construction of a 'public sector comparator'. This is a risk-adjusted costing of the outputs specified in a PPP project, in a hypothetical scenario that they are supplied by the public sector. For a PPP project to be acceptable and meet the value for money criteria, the cost of services provided by the contractor will have to be less than the risk adjusted costing worked out for the PSC.

Assessing and Measuring Risks

The qualitative assessment indicates the most significant risks that need to be focused on, and that require deeper analysis and quantification

Risk quantification, on the other hand, seeks to express risks in financial terms. Different techniques are used, varying in the degree of sophistication and the possibility of estimating probabilities and values of risk. A fairly common and crude method is the use of discounting rates that reflect the market evaluation of risks. Another method used by analysts is sensitivity analysis whereby, using the financial modeling technique, a range of values is used to test their effects on financial and economic viability. In the sophisticated end of the toolkit range, there are softwares like INFRISK, developed by the World Bank Institute. INFRISK uses a generic financial model to produce economic viability outputs like Net Present Value (NPV), Internal Rate of Return (IRR), and interest & debt service cover, dividend generation and social benefits. Using probability distributions that reflect different risk profiles and Monte Carlo simulation techniques, the software (which actually comes as an add-in to the excel spreadsheet) handles most of the uncertainties and risks that impact on a project's economic variables such as income, construction and operational costs, currency & financial costs.

The Ultimate Goal of PPP: Value for Money

Risk assessment is a vital link in the ultimate goal of obtaining value for money in PPP projects. Qualitative and quantitative risk assessment allows for risks to be allocated to the contracting party best able to manage it in a cost effective way. The benefits can be tremendous, as summed up by Tim Stone (KPMG global partner for PPP), in a Euromoney publication: "If the process works well, the intended outcome is that the service (road, hospital or school) is delivered to the required standard throughout its life at the lowest possible long-run cost to the national economy". The implications for the economy cannot be more obvious.

In a country like Mauritius, where public/private partnership, in the largest sense, has become a tradition and underpins all social and economic evolution, there is ground to be optimist that the PPP process will indeed work well, for the benefit of both sectors and society at large.

Deva Armoogum

Director – Business Advisory Services

KPMG