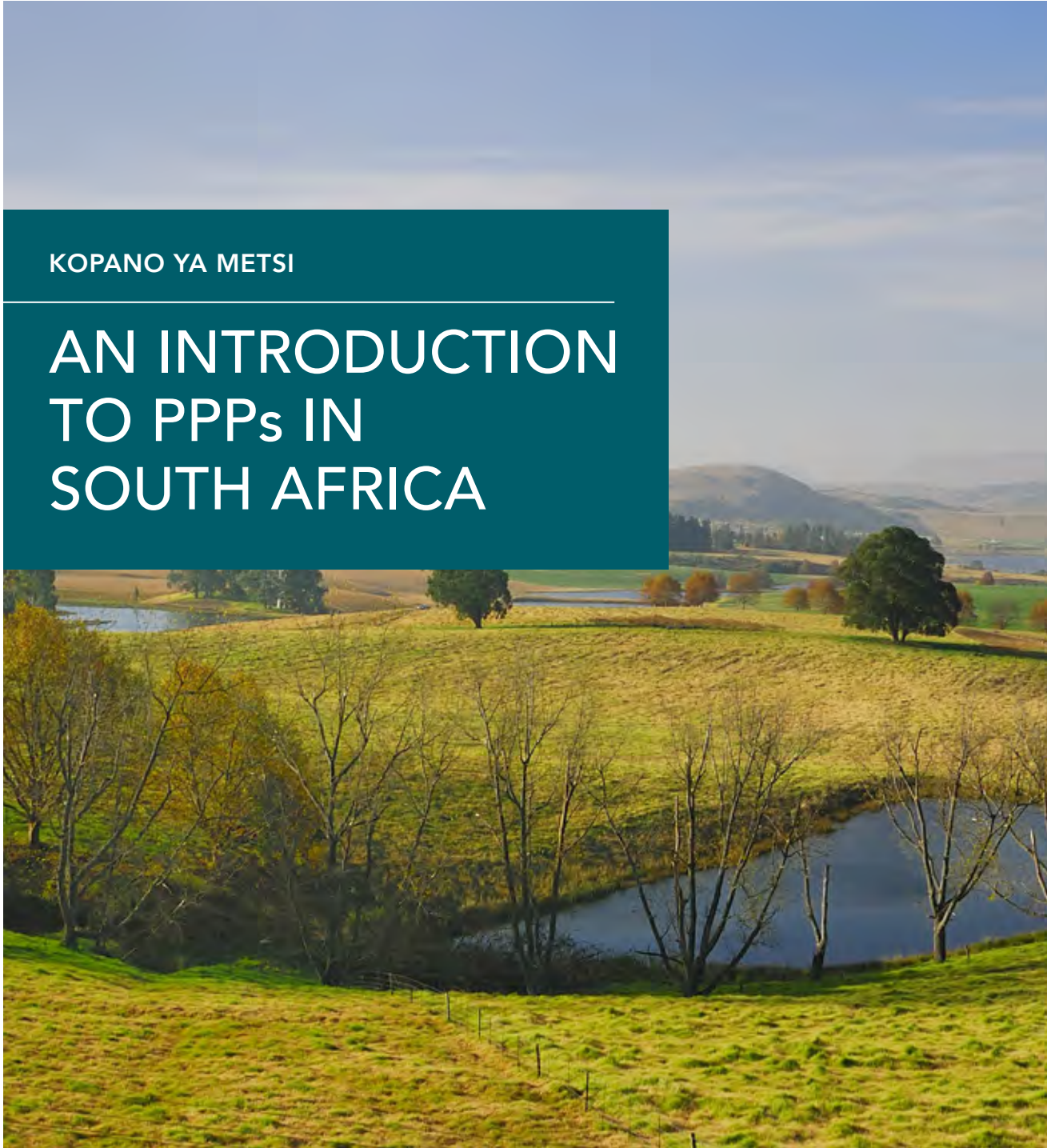


KOPANO YA METSI

# AN INTRODUCTION TO PPPs IN SOUTH AFRICA



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# KOPANO YA METSI

“THE WATER AND SANITATION SECTOR IS CURRENTLY NOT FINANCIALLY SUSTAINABLE”  
National Water and Sanitation Master Plan, 2018<sup>1</sup>

## WATER MANAGEMENT IN SOUTH AFRICA REQUIRES URGENT ACTION

Drought and poor water service delivery is already constraining economic growth and hampering livelihoods. The water sector funding gap is R330 billion over the next ten years, with major infrastructure refurbishment and improved maintenance required. At least a third of the municipalities delivering water services are considered to be dysfunctional. Many water institutions are not credit-worthy and accumulated municipal water debt is now over R13 billion.

The National Water and Sanitation Master Plan states that a ‘turn-around towards financial sustainability is not optional’ and calls for enhanced revenues, cost reductions, an analysis of alternative service delivery models and increased private sector investment.

Kopano ya Metsi (‘meeting for water’ in Sesotho) was initiated in 2017 by the National Business Initiative (NBI) in partnership with the Confederation of Danish Industry (DI) and Voluntas Advisory, to understand how water investment can be unlocked in South Africa.

Kopano ya Metsi speaks directly to the need to investigate alternative delivery models and ways to improve the sector’s financial viability, as outlined in the National Water and Sanitation Master Plan.

## THROUGHOUT ITS DURATION KOPANO YA METSI HAS SOUGHT TO UNDERSTAND 4 ISSUES:

- **How can water finance be unlocked?**
- **What is the potential role of formal Public Private Partnerships?**
- **How can municipal water management be strengthened?**
- **How can we solve for a specific challenge, wastewater treatment?**

Over a period of 18 months, Kopano ya Metsi has engaged with hundreds of water experts in South Africa through 8 major roundtables, conferences and workshops held across 4 cities (Durban, Pretoria, Johannesburg and Cape Town), as well as a series of individual meetings. Participants have included civil society partners, national government, local government, industry bodies, local government associations, researchers, private sector implementers, development banks, commercial banks and investors. The findings of Kopano ya Metsi are a reflection of this consultation process.

[www.yametsi.co.za](http://www.yametsi.co.za)

[www.nbi.org.za](http://www.nbi.org.za)

<sup>1</sup> DWS (2018) *National Water and Sanitation Master Plan, Volume I: Call to Action*. Version 10.1, October 2018, p48

# KOPANO YA METSI REPORT SERIES

- 
- 01 UNLOCKING WATER INVESTMENT IN SOUTH AFRICA**  
Paper 1 summarises the main challenges to be addressed in the water sector from a financing and investment perspective, outlines key solutions and charts a course for the future.
- 
- 02 STRENGTHENING SOUTH AFRICA'S WATER SERVICES AUTHORITIES**  
Paper 2 provides recommendations on how municipal water management can be improved over time, with an emphasis on revenues, finance and institutional capacity.
- 
- 03 AN INTRODUCTION TO PPPs IN SOUTH AFRICA**  
Paper 3 provides a primer on formal PPPs, introducing their main characteristics, potential benefits, key success factors and governing legal framework.
- 
- 04 WATER PPP OPPORTUNITIES IN SOUTH AFRICA**  
Paper 4 assesses where the main opportunities for formal water PPPs are likely to be located at both a geographic and value chain level.
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- 05 PUBLIC PERCEPTION OF WATER PROVISION THROUGH PPPs**  
Paper 5 considers the findings of a public perception survey conducted among urban households in 2017, including the implications for a PPP approach to water provision.
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- 06 BARRIERS AND SOLUTIONS TO IMPLEMENTING MUNICIPAL WATER PPPs**  
Paper 6 identifies the key barriers to implementing water PPPs within local government and outlines relevant solutions to address these challenges.
- 
- 07 SOLVING FOR MUNICIPAL WASTEWATER TREATMENT**  
The final paper applies the findings of Kopano ya Metsi to improving the state of municipal wastewater treatment in South Africa.
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## EXECUTIVE SUMMARY

This paper provides essential background on Public Private Partnerships (PPPs) in South Africa, introducing their main characteristics, potential benefits, key success factors and governing legal framework.

Concepts such as risk transfer and value for money are further introduced. A simplified PPP project cycle is also provided.

The paper draws directly on well-known public sector documents in order to summarise the most authoritative information. The document is intended to serve as a basic primer only, and reference is made to key sources and guidance material for further reading.

# UNDERSTANDING PUBLIC PRIVATE PARTNERSHIPS

## INTRODUCING THE CONCEPT OF PPPs

Simply put, a PPP is a procurement choice that is available to the public sector.

However, a PPP is not the short-term outsourcing of a public function to a private party. Rather, PPPs are long-term contracts between the public and private sector that require risk transfer to the private party.

In addition, within a PPP the private sector's role goes beyond normal aspects such as the design and construction of infrastructure, extending into areas such as project financing, staffing and the operation of specific assets.

The private party then receives payment for this full set of services rendered.

## IN SUMMARY, THE KEY CHARACTERISTICS OF A PPP ARE AS FOLLOWS:

- A long-term contract between the public and private sector for a clearly defined project (contracts are typically 5 to 30 years in duration)
- Includes private sector involvement in design, construction, financing and implementation
- The private party sources most or all of the finance required
- Payment to the private party occurs based on agreed upon outputs, related to the provision of services and/or infrastructure
- Requires the transfer of risk from the public to the private sector

## AS NATIONAL TREASURY MAKES CLEAR, A PPP IS NOT:

- A simple outsourcing of functions
- A donation by a private party for a public good
- The privatisation of state assets and/or liabilities
- A way of avoiding payment for capital projects. Rather, PPPs allow the procuring institution to spread payments for large projects over the project's lifetime
- A solution option. Rather, a PPP is a *procurement choice* that may assist in achieving a *desired solution*

## DEFINING PPPs

The above characteristics form the basis for developing a formal definition of a PPP<sup>2</sup>. Under South Africa law a PPP is defined as a contract between a government institution and private party, where:

- The private party performs an institutional function and/or uses state property in terms of output specifications
- Substantial project risk (financial, technical, operational) is transferred to the private party
- The private party benefits through unitary payments from government budgets and/or user fees

**It should be noted that a separate legal definition of PPPs has been developed for local government PPP contracts.** This definition is outlined in the Municipal PPP Regulations, which can be accessed [here](#). This separate legal definition applies to any PPP entered into by a municipality and a private party.

<sup>2</sup> This formal definition of PPPs is drawn from National Treasury (2007) *Introducing Public Private Partnerships in South Africa*, p5. User fees are paid directly by the users of a particular service, while unitary payments are made by the procuring institution to the private party.

## THE CONCEPT OF RISK TRANSFER

The idea of risk transfer is central to PPPs, as highlighted above, but may not be widely understood.

**In simple terms, risk transfer implies that the private sector takes on certain risks related to project delivery that are appropriate to them, whether these relate to the project's design, financing, construction or operation.**

In reality 'only those risks that the private party is best able to manage are transferred... Risks are allocated to the party most able to carry them' (National Treasury, 2007 p6-7).

By way of example, the private sector ordinarily takes on certain financing and delivery risks, as outlined below:

**"The private sector typically puts its own capital at risk, funding its investment in the project with debt and shareholder equity. Because of the financial risk the private sector takes, it is motivated to provide a high level of service, as good returns on equity will depend on the quality of services it delivers"**

(National Treasury, 2007 p4)

In addition, if a government institution has strong procurement capacity but limited operational capability, it can pass on its operational risks to the private sector.

## THE CONCEPT OF VALUE FOR MONEY

The term value for money is key for understanding the motivation behind establishing a PPP. Value for money also has a very specific meaning in the context of a PPP.

**Put simply, value for money is the reduction in cost achieved over the lifetime of a project by employing a PPP approach in comparison to other options.**

It is the responsibility of the PPP feasibility study (a detailed assessment undertaken before deciding whether to go the PPP route or not) to determine if a PPP will provide value for money in comparison with traditional procurement.

In technical terms, preliminary value for money is determined by whether the risk-adjusted PPP reference case is affordable relative to a risk-adjusted public sector comparator. The PPP reference case is a virtual bid that is constructed by transaction advisors, and which prices in typical private sector risks. The public sector comparator assumes traditional procurement and prices in typical public sector risks.

If the PPP reference case compares favourably with the public sector comparator, then value for money is expected and a PPP procurement process can be undertaken.

**The PPP training courses and training materials offered by the Government Technical Advisory Centre (GTAC) provide a strong entry point for getting to grips with PPPs in South Africa, and the concept of value for money in particular. The latest South Africa PPP Foundation Training materials can be accessed [here](#).**

# THE OPPORTUNITY PRESENTED BY PPPs

The main potential benefits of a PPP transaction can be summarised as follows<sup>3</sup>:



**PPPs leverage private party capital to fund infrastructure.** The private sector can help finance a project by securing loans (debt) or by attracting investors (equity).



**PPPs leverage private sector skills.** A private party's skills can supplement a government institution's existing in-house skills. Skills transfer to the procuring institution is a key consideration in PPP contract development.



**The private sector takes financial risk over the lifecycle of the project.** Financial returns on debt and equity are only secured if a project is successfully completed and operating properly. This provides an incentive to the private party to implement and manage the project well.



**PPPs deliver budgetary certainty.** Within a PPP, payments due to the private sector over the project lifetime are known in advance. In traditional procurement, the costs of completing the project and maintaining the assets in the future are not certain and remain the responsibility of the procuring institution.



**The public sector pays only when services are delivered.** Payment is carefully linked to the quality of services being provided. If services are not being delivered to the institution's satisfaction and in line with the PPP agreement, the private party may also be liable to pay penalties.



**The quality of service has to be maintained for the duration of the PPP.** This can contrast strongly with traditional procurement, when the condition of an asset declines as the asset gets older and so the service levels decline over time.

Despite considerable potential benefits, it is also true that in some instances a PPP is not correctly designed or negotiated, with the result that the above benefits do not fully accrue to the procuring institution. Ensuring that the right conditions for a successful PPP are in place is important to realise the value they can bring.

<sup>3</sup> This section is adapted from National Treasury (2007) *Introducing Public Private Partnerships in South Africa*, p10-12.



# I WHEN IS A PPP APPROPRIATE?

A PPP is certainly not a one-size fits all solution. Rather, PPPs work well where certain conditions are in place. Key factors that determine whether a PPP is a suitable mechanism are outlined below<sup>4</sup>. These key factors have been divided between a project's setup phase, and its subsequent implementation phase.

## KEY SUCCESS FACTORS IN THE SETUP PHASE:

- The procuring institution knows exactly what it wants as outcomes of the PPP
- The PPP process has a dedicated internal champion
- The PPP process has clear support from the relevant politicians and top public officials
- The private sector bidders have the capacity, skills and capability to deliver the project
- The procuring institution has sufficient capacity and budget to oversee the PPP procurement process
- An effective and transparent stakeholder consultation process is undertaken
- There are good transaction advisors in place who understand the procuring institution's requirements and service delivery mandates
- A thorough and rigorous feasibility study is conducted. Based on verified information, the feasibility study indicates that appropriate risk can be transferred to the private sector and that the PPP provides value for money
- The public sector institution can afford the envisaged fee. In other words, the public sector's budget is able to cover the required payments to the private sector over the project lifetime
- Payment risk to the private party has been adequately addressed
- A sufficiently capable project officer is appointed
- Strong Black Economic Empowerment outcomes are achieved

## KEY SUCCESS FACTORS IN THE IMPLEMENTATION PHASE:

- The procuring institution has sufficient contract management skills
- A proper monitoring and evaluation model is in place to ensure strong project outcomes
- The private sector is incentivised to transfer skills

<sup>4</sup> Adapted from National Treasury (2007) *Introducing Public Private Partnerships in South Africa*, p22-23.

# OVERVIEW OF THE PPP LEGAL FRAMEWORK

SOUTH AFRICA HAS A WELL-DEVELOPED PPP REGULATORY FRAMEWORK THAT ENCOMPASSES ALL SPHERES OF GOVERNMENT

## THE MAIN LEGISLATION GOVERNING PPPs AT A NATIONAL AND PROVINCIAL LEVEL ARE:

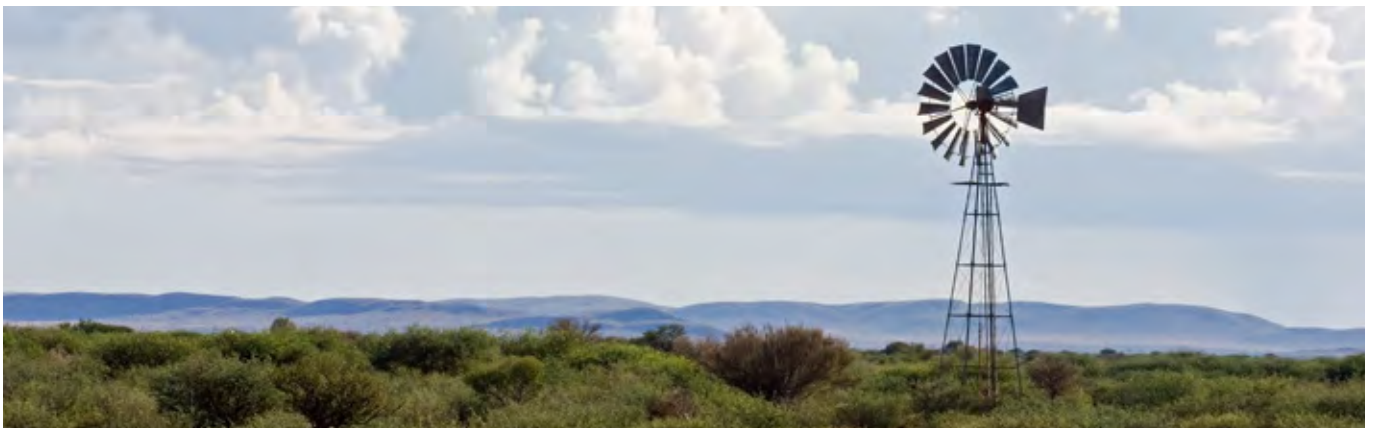
- The Public Finance Management Act (PFMA), 1999
- Treasury Regulation 16 to the PFMA, 2000

## THE MAIN LEGISLATION GOVERNING MUNICIPAL PPPs ARE:

- The Municipal Finance Management Act (MFMA), 2003
- The Municipal Systems Act (MSA), 2003
- The Municipal PPP Regulations, 2005
- The Municipal Supply Chain Management Regulations, 2005

## WHEN EMBARKING ON A MUNICIPAL PPP, SPECIFIC CONSIDERATION WILL NEED TO BE GIVEN TO THE FOLLOWING:

- Any contract with a duration longer than 3 years will require a municipal council resolution for this contract to be awarded (under section 33 of the MFMA)
- Any municipal PPP will need to comply with section 76, 77 and 78 of the MSA. Section 78 of the MSA outlines the criteria to be considered and consultation process required if a municipality is considering providing a municipal service through an 'external mechanism' (i.e. through a PPP)



# INTRODUCING THE PPP PROJECT CYCLE

A simplified overview of the PPP project cycle is provided in Figure 1 below. Please note that there are variations in the requirements for a municipal PPP in comparison to a provincial or national PPP, as they are governed by different legislation.

FIGURE 1: SIMPLIFIED OVERVIEW OF THE PPP PROJECT CYCLE



SOURCE: Adapted from National Treasury (2007) *Introducing Public Private Partnerships in South Africa*

## PLEASE NOTE:

The PPP project cycle is explained in significantly greater depth in the PPP Manual (for national and provincial PPPs) and the Municipal Service Delivery and PPP Guidelines (for local government PPPs). See the section on Further Reading below.



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## APPENDIX I: ACKNOWLEDGEMENTS AND FURTHER READING

### Key sources:

The direct use of relevant public sector documents within this paper is specifically acknowledged. The key sources used throughout this document are as follows:

- National Treasury (2007) **Introducing Public Private Partnerships in South Africa**. This document provides a useful starting point for understanding PPPs in an accessible manner.
- **GTAC (undated) PPP Foundation Presentation**. These South Africa specific PPP training materials are an invaluable aid. Accessible [here](#).

### Further reading and guidance:

- Guidance on the development of a national or provincial PPP is provided in **National Treasury's PPP Manual**. Accessible [here](#).
  - Specific guidance on the development of a municipal PPP is provided in the **Municipal Service Delivery and PPP Guidelines**. Accessible [here](#).
  - The **Municipal PPP Regulations** are essential reading for anyone considering embarking on a municipal PPP. Accessible [here](#).
  - GTAC offers free **Foundation and Municipal PPP training courses**. Further detail on this training can be accessed [here](#).
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The National Business Initiative (NBI) is an independent and voluntary coalition of South African and multinational businesses launched in 1995 by former President Nelson Mandela. Today we have over 100 member companies that work together towards sustainable growth and development in South Africa.

## FOR MORE INFORMATION ON KOPANO YA METSI

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