Public Private Partnership Procurement and Opportunities.

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ABSTRACT
Pressure to improve waste management and to comply with the requirements of the new Waste Act is increasing constantly on especially the local authorities in South Africa. Sophisticated solutions are being considered more and more due to the fact that the cost of waste disposal is increasing constantly and due to the regulatory pressure to move away from landfilling.

A number of alternative technical options have been developed and implemented internationally with various degrees of success. Specific examples are waste conversion technologies such as composting, landfill-gas to energy or waste to energy plants. Due to the higher level of technology the capital costs of these facilities can be significant compared to the financial funding ability of a local authority, although studies may show it to be a financially feasible solution. It is also an unfortunate fact that very few local authorities have the technical capabilities to operate and manage sophisticated facilities. A solution to this problem can be for the local authority to enter into a Public Private Partnership arrangement with a private partner who will fund, construct and operate the facility.

In order to comply with the legal and regulatory regime in the country a local authority need to comply with a number of South African laws and regulations and National Treasury guidelines and processes. The aim of this paper will be to spell out the legal and regulatory framework in South Africa and address the typical process which should be followed in developing a PPP project. The requirements in terms of the following will be discussed:
Municipal Systems Act (Act 32 of 2000) section 78:
Municipal Finance Management Act (Act 56 of 2003) section 120.
Nationals Treasury's Municipal PPP Manual.

In summary reference will be made to some case studies to explain the application of the procedures.

INTRODUCTION

The need for proper and improved waste management services are becoming more to the fore in the media and pressure in this regard is being put on specifically the local authorities in South Africa. The new Waste Act also adds regulatory pressure. Sophisticated solutions are being considered more and more due to the fact that the cost of waste disposal is increasing constantly and due to the regulatory pressure to move away from landfilling as well as for other related reasons.

Local authorities in South Africa are also contemplating more technologically advanced solutions such as composting, landfill-gas to energy or waste to energy plants. With the rapidly escalating energy costs in South Africa the financial feasibility of waste to energy has improved significantly but a fact that remains is that, due to the higher level of technology the capital costs of these facilities can be significant compared to the financial funding ability of a local authority. A solution to this problem can be for the local authority to enter into a Public Private Partnership (PPP) arrangement with a private partner who will fund, construct and operate the facility, which will also address any capacity constraints which the local authority may have to operate and manage such facilities. It is also a fact that due to regulatory changes and siting issues the capital cost of a large landfill can be quite high and thus problematic for some local authorities to fund, and a PPP may be a suitable solution.

It is however very important to note that a PPP is not always the best option, neither will it be a solution if the project is not otherwise financially feasible, but in the cases where it is the best option it is absolutely important to structure the deal correctly. Another requirement is that in order to comply with the legal and regulatory regime in the country a local authority need to comply with a number of South African laws and regulations and National Treasury guidelines and processes.

SOUTH AFRICA: BACKGROUND TO PPPs

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

PPPs for municipal institutions are governed by the Municipal Systems Act (Act 32 of 2000) Section 78 (MSA) and the Municipal Finance Management Act (Act 56 of 2003) (MFMA). The central legislation governing municipal PPPs is in Chapter 11 of the MFMA, Goods and Services, which addresses supply chain management (in part 1) and PPPs (in part 2).

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

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

The implementation of a decision to employ an external service delivery mechanism, such as a PPP, requires a municipality to complete a feasibility study according to provisions of the MFMA and, in cases involving municipal services, according to the MSA, particularly Section 78, as well.

These Guidelines combine in one document the requirements of the two acts, harmonising them and providing sufficient detail to many of their general provisions. Where the acts do not address a specific issue, guidance is provided. As such this has become a very useful guidance document describing the methodology of addressing PPPs.

One key element of the Guidelines is a clear description of municipal services and guidance on which activities are subject to the MSA and MFMA – and which are subject to the MFMA alone. To accomplish this, the Guidelines use the MSA definitions of "municipal services", and "municipal activities reasonably necessary for, or incidental to, the effective performance of a municipality's functions and the exercise of its powers" (municipal support activities), which includes all other municipal activities that the municipality has the competency to undertake. A third category of PPPs includes partnerships in which the private sector uses municipal property for commercial purposes.

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

MUNICIPAL SERVICE DELIVERY AND PPP GUIDELINES

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

The Guidelines, which will be updated from time to time, constitute guidance in terms of Section 168 of the MFMA and Section 86A of the MSA, and are aimed at facilitating the application of the MFMA, its regulations, and the applicable provisions of the MSA.

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

MUNICIPAL SYSTEMS ACT

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

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

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

MUNICIPAL FINANCE MANAGEMENT ACT

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

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

By its nature, a municipal PPP entails:

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

MUNICIPAL PPP REGULATIONS

The Municipal Public-Private Partnership Regulations provide precise and detailed instructions for PPPs. The regulations define the elements of a municipal PPP, and set out the stages and approvals it will have to go through.

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

Financial obligations (if any) to be incurred by a municipality in terms of a PPP agreement can be met by:

- Funds designated in the municipality’s budget for the current year for the activity outsourced in terms of the agreement
- Funds destined for that activity in accordance with the budgetary projections of the municipality
- Any allocations to the municipality
- A combination of such funds and allocations.

METHODOLOGY OF EXECUTING A PPP

In the following section a typical methodology is described for a Waste to Energy project based on the requirements of the above Acts and Regulations as a practical implementation framework.

PPP Feasibility Study

As a first step in the process it is necessary to determine the category of type of service the envisaged service will fall under. Using the criteria in the guidelines it must be determined whether the service for which a PPP solution is contemplated is considered a municipal service or if it is considered a municipal support activity.

As example it can be mentioned that waste collection, transport and disposal to landfills are considered normal municipal activities while composting and recycling are municipal support activities because they merely enhance the final disposal through the maximising landfill airspace. National Treasury has also agreed that waste conversion (waste to energy and related) is also a municipal support activity and not a municipal service as defined in the new Municipal Services Delivery and PPP Guidelines. Therefore in such a case the feasibility study will only be subject to the PPP provisions as in Section 120 of the Municipal Finance Management Act (MFMA) and not Section 78 of the Municipal Systems Act (MSA). The MFMA permits the assessment of technical and service delivery options prior to detailed public notification and input, which will then only be required in the event that the local authority proceeds with procurement of one or more of the recommended options.

Furthermore, since there are no major waste conversion technology facilities operating in South Africa that can be used as a Public Sector Comparator (PSC) and if it is unlikely that the local authority will be able to finance, construct and operate a conversion technology facility on its own, the development of a PSC is not necessary and then in such a case a simplified value assessment can be used. In executing a PPP feasibility study for a waste project the requirements of the National Treasury Municipal PPP Guidelines must be followed as described below.

Stage 1: The Needs Analysis

Waste Generation, Collection and Disposal

An analysis of the current waste management must be done starting with a status quo assessment of existing services. It is generally also prudent to do a detailed waste composition study of the waste going to the disposal or conversion facility. This will then be followed, if it has not been done previously as part of an Art 78(MSA) assessment or other studies, with a detailed needs analysis to determine the best solutions to addressing the shortcomings in the waste management service.

Avoided Landfill Costs of Landfilling

If the local authority is considering waste conversion options as a way of minimising waste that requires land filling as well as energy recovery, the assessment of conversion options must be performed in the financial context of saving landfill airspace both now and in the future, and also to include any potential savings in transport costs depending on the location of the alternative facility. A detailed review of the future airspace requirements must be done and the cost thereof determined and keep in mind that both the capital and operational costs must be taken into account. A key objective in this analysis is to determine the avoided landfill costs resulting from waste conversion, and it will include cost savings realised in the future by extending the life of the landfill. Use this total avoided landfill cost as a benchmark in later phases of the feasibility study to assess the cost effectiveness of the conversion technologies.

Waste Characteristics – Energy Value

If any energy recovery technologies are considered it is important to determine the energy value for the waste stream that will be fed into such a facility. Using pre-existing and reference waste characteristic data, perform an assessment of expected energy values for waste generated within the local authority. This assessment shall include as-received waste and take into account any planned recycling and composting operations. It is recommended that an actual determination of the calorific value of the waste be executed as well as this will be important in the feasibility study.

Stage 2: Technical Solutions Options Analysis

- **Landfill operation:** As part of the technical solutions analysis it is required to do detailed modeling of the expected impacts which the waste conversion technology will have on the life and operation of the planned landfill. Variables will include future construction costs, environmental regulations, long term environmental risk, inflation and present worth calculation.
- **Technical Options:** Using the result of the above and in consultation with the local authority, develop a list of potential waste conversion technology options for the local authority to consider as follows.
- **Brief description**: Briefly describe each technical solution option. Include an outline of the alignment between each option and the municipality's strategic plan, the activity it needs to deliver, and how well the solution meets the output specifications.
- **Financial impacts:** Provide a preliminary view and discussion on the financial impacts of each option. For example, show the estimated initial capital expenditure, and the likely capital and operational costs over the full project cycle.
- **Funding and affordability:** How is each option to be funded? Which options are affordable? Where a contribution other than from the municipality is anticipated, this must correspond to the published medium-term expenditure framework, be in accordance with the municipality's borrowing capacity, or with specific grant or subsidy agreements. Indicate how an external procurement is likely to be financed (for example, project finance or corporate finance). The payment mechanisms (conventional budgetary, unitary payment, user pays, revenue-generating, hybrid) that may be possible for each option should also be briefly discussed.
- **Risk:** Present a preliminary discussion about the risks to the municipality in relation to each option. (Detailed risk assessments are executed later in the process). The discussion should specifically identify the risks that may be passed efficiently to a private party.
- **BEE and other socioeconomic aspects:** Provide a preliminary view on the impact of each option on the BEE targets set out in the outputs specifications, and other socioeconomic objectives the municipality may wish to achieve in the project.
- **Delivery arrangements:** Discuss the delivery arrangements for each option, and analyse the implications of each option for optimal interface between delivery mechanisms. For example, if the

municipality is assessing its options for expanded potable water delivery, how would each technical solution option deal with the integration of existing delivery mechanisms?

- **Transitional management issues:** Discuss the issues that may arise in the handover from existing management arrangements in each technical solution option. For example, each technical solution option for increasing potable water capacity will have implications for how a municipality's reticulation systems are managed in the transition from the existing to the new.
- **Technical analysis:** Present a comprehensive technical analysis for each technical solution option, including a municipal supply chain/interface analysis. Include an assessment of the proposed technology and its appropriateness for each technical solution option.
- **Site issues:** If a technical solution option involves a physical site, issues concerning land procurement must be identified at this stage. These include land use rights, zoning rights, geotechnical and environmental issues, heritage legislation and alignment with the IDP. The likelihood of being able to resolve all site issues during the course of the feasibility study phase is a key factor in deciding on a preferred technical solution option if an external procurement is possible.
- **Legislation and regulations:** Does a particular option comply with relevant legislation and regulations? Analyse, firstly, procurement legislation and regulations, and, secondly, sector-specific legislation and regulations, such as environmental impact assessment requirements, which may affect the project, to establish a compliance list against which each option can be measured. A private party may not legally perform certain technical solution options. For example, only a municipal council may set water services tariffs, which may have an impact on a municipality's ability to pay a unitary fee for potable water services. At this stage a brief, high-level legal analysis is required.
- **Human resources:** Establish the numbers and cost of existing staff that will be affected in each technical solution option, do a skills and experience audit and establish the key human resources issues. Design and implement a suitable communication strategy for the municipality to keep staff informed of the project investigations, as required by labour law. Assess the following for each option, where relevant:
    - Relevant legislation and case law
    - Organised labour agreements
    - The cost of transferring staff, if applicable
    - An actuarial study of accrued benefits that may be transferred and the timing thereof
    - An initial view on the potential willingness of both staff and private parties to implement transfers.
- **Qualitative factors:** There will be a number of qualitative benefits associated with a particular option, such as job creation, technology transfer and early availability of services, which may not be quantifiable and may not be considered as offsetting costs.
- **Early considerations of suitability for external service delivery:** Not all technical solution options are ideal external options. At this stage it is useful to consider whether various options, if done externally, can deliver value for money.
- **Scale:** The net present cost of the probable cash flows should be large enough to allow both the public and the private parties to achieve value-for-money outputs given the likely levels of adviser and other costs.
- **Output specification:** It must be possible to specify design and performance outputs in clear and measurable terms, and structure a payment mechanism accordingly.
- **Opportunities for risk transfer:** The allocation of risk to a private party is a primary driver of value for money in an external option. Where opportunities for allocating risk to the private party are limited, the potential for the external option to deliver value for money compared with a conventional procurement choice is reduced.
- **Market capability and appetite:** The project must be commercially viable and there must be a level of market interest.
- **Guarantees and Accounting Treatment:** Since most of the waste conversion technology options will include input specifications and guarantees for the waste to be supplied to the facility, commonly referred to as "Put or Pay" provisions, and off-take specifications for the energy produced, referred to as "Take or Pay", the work under this task will focus on how these commitments can be structured while limiting risk to the local authority. The MSA and MFMA and other National Treasury

regulations place significant constraints on municipalities in their ability to participate in private facilities or to provide financial guarantees such as those mentioned above. This may be particularly relevant to conversion technologies since some of them do not have an established history of commercial performance and a project may be difficult to finance without a strong public partner and financial guarantees. It will also be necessary to comprehensively assess the roles, responsibilities and liabilities of the local municipalities as well as their financial guarantee. After completion of the above it is necessary to prioritise the options and present recommendations.

Stage 3: Service Delivery Options

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

- A municipal entity
- Another municipality
- An organ of state, including a water services committee established in terms of the Water Services Act (1997)
- A licensed service provider registered or recognised in terms of national legislation
- A traditional authority
- A community-based organisation or other non-governmental organisation
- A community-based organisation or other non-governmental organisation legally competent to enter into such an agreement
- Any other institution, entity or person legally competent to operate a business activity.

Municipalities will still not be in a position to make the decision about which service delivery option is the best way to procure the preferred technical solution option.

Stage 4: Interim Report, Summary and Recommendations

Summarise the evaluations and findings of the above in a concise report which include all the facilities and the findings of the above evaluations. After review and consideration of the interim report, the local authority must now select one or more options to consider for implementation.

Stage 5: Due Diligence

The project team must now identify any key issues that are associated with the selected option, in particular site, traffic and environmental issues, as well as institutional standing of the proposed partners, payment mechanisms and the regulatory regimes for this project.

Stage 6: Value Assessment

As the Public Sector Comparator (PSC) is not necessary, the value assessment must consist of financial models that will focus on the affordability of the selected technical option as compared to avoided landfill costs and other financial aspects. It must also address in detail the value for money which the various options will present and if that makes the option a viable solution.

Stage 7: Procurement Plan

A Procurement Plan must be compiled as per the requirements of the Municipal PPP Guidelines, which will detail all the required steps and timeframes of the procurement phase.

Stage 8: Prepare and Submit Feasibility Report to Council

A Financial and Technical Feasibility report must be compiled of the combined project and submitted to the Municipal Council for approval as well as to National Treasury for their Treasury Views and Recommendations One (TVR1). This report will also address any changes which will be required in the rates and taxes of the local authority and partner municipalities. If the Council decides to proceed with the procurement of the project as a PPP, and NT has responded on TVR1, proceed with the procurement phase of the selected option.

Procurement Phase

Herewith the broad outline of the procurement phase:

Achieving TVR: IIA

Identifying the ways in which the outcomes of the feasibility study affect the PPP procurement, for example in relation to the affordability limits, the achievement of value-for-money, the definition of the output specifications, the identification of appropriate payment mechanisms for this project, the identification of any land issues (title, EIA issues and so forth) and the like.

The preparation of a request for qualification ("RFQ") document, consisting of:

- Determine the objectives of the RFQ
    - Prepare the RFQ document
    - Consult with the municipal desk of NT
    - Advertise and distribute the RFQ
    - Evaluate the responses
    - Communicate with bidders

The preparation of the draft Request for Proposals ("RFP") document (including the draft PPP agreement), which will include –

- a description of the project;
- the local authority requirements in respect of the service and standards specifications which the PPP must deliver;
- the payment mechanism for the project and the penalty regime (i.e. how will the private party be paid and how will it be penalised for non- or under-performance);
- the procurement process and timetable which the local authority will follow;
- instructions to bidders regarding formal compliance issues and the consequences of non-compliance;
- instructions to bidders regarding essential minimum substantive requirements (for example demonstration of the ability to handle specified quantities of various types of waste within particular time periods; demonstration of funding; demonstration of BEE);
- instructions to bidders regarding legal requirements (for example in order to demonstrate the bidder has the legal capacity and authority to undertake the project);
- any arrangements for bidders to undertake a due diligence of the project;
- the draft PPP agreement, including draft project-specific annexures relating to, for example, the project assets, the specifications and the payment and penalty provisions;
- instructions to bidders as to the commitments required from them (for example the financial models underlying their bids prepared in compliance with the local authority requirements, security requirements and the like);
- how bids will be evaluated;
- the bid formalities;

Once the above process has been completed submit the draft RFP (including the draft PPP agreement) to the National Treasury and to the Provincial Treasury, as required by the MFMA and the Municipal PPP Regulations for the purposes of obtaining TVR: IIA; and revise and finalise the draft RFP (including the draft PPP agreement), taking into account the views and recommendations given by the National Treasury.

Achieving TVR: IIB

Providing support (technical, financial and legal) to the local authority (specifically to its SCM officials) during the period that bidders are preparing their bids, for example:

- assisting the local authority to prepare technical, financial or legal clarifications to bidders' questions;
- attending bidder clarification meetings with the local authority officials;

Undertaking independent technical evaluation of the bids once bids have been submitted, including:

- undertaking a detailed analysis of the technical, legal, financial, BEE and price components of each bid;
- assisting in a briefing session with bidders, and dealing with queries during the bidding stage;
- reporting to the local authority evaluation committee on the evaluation of the bids;
- depending on the circumstances, making any further recommendations (for example that a BAFO process should be followed, if appropriate);
- assist the local authority officials in preparing the draft value assessment report, for submission to the National Treasury which will set out inter alia the results of the bid evaluation process and will identify the recommended preferred and reserve bidders; and
- assist the local authority officials in finalising the value assessment report, for submission to Council, taking into account the views and recommendations received from the National and Provincial Treasuries.

Achieving TVR: III

In this part of the process the following must be done:

- assist the local authority in negotiations with the preferred (and, if it becomes necessary, the reserve) bidder;
- effect any final amendments to the PPP agreement agreed through the negotiation process;
- assisting the local authority in preparing a contract management plan for the PPP agreement;
- preparing a legal opinion in regard to the legal compliance of the project and the parties' competence and capacity to conclude the PPP agreement and signing that opinion as legal advisers to the local authority;
- preparing the TVR: III report to the National Treasury and the Provincial Treasury (which will also, in terms of Section 33 of the MFMA, be submitted to the Department of Cooperative Governance and Traditional Affairs);
- advising the local authority on compliance with Section 33 of the MFMA, including:
    - assisting to prepare the information statement required in terms of Section 33;
    - assisting to consider and categorise the comments and representations made by the public;
    - assisting to consider and categorise the views and recommendations received from the National and the Provincial Treasuries (which may be in the form of responses to the TVR: III report); and
    - Assisting to prepare the report to Council required in terms of Section 33.

CLOSE OUT REPORT

Compile a close out report documenting all the relevant issues of the process and results achieved.

TIMEFRAMES

It must be noted that this is a comprehensive process and sufficient time must be allowed in planning. Although the actual time will depend on a number of issues and especially on the size and cost of the project, it must be noted that it can take anywhere from 18 months to 4 years or more. As an example it can be mentioned that for a technically complex project with a value in the billions of Rands and a PPP agreement duration of 20 years compiling a proper bid will take the private partner at least 6 months to prepare.

CONCLUSION

It has been shown that for a Local Authority to procure a PPP service delivery solution through a PPP process a specific regulatory process must be followed. The advantage in South Africa is that the National Treasury has been involved in a number of PPPs and has clear and comprehensive guidelines which assist significantly in facilitating the process.

REFERENCES

South African Municipal Systems Act (Act 32 of 2000)
South African Municipal Finance Management Act (Act 56 of 2003)
South African Municipal Public-Private Partnership Regulations
South African Public Finance Management Act (1999) (PFMA).