

**PUBLIC PRIVATE PARTNERSHIPS AS AN ALTERNATIVE
SERVICE DELIVERY OPTION:
A MULTIPLE CASE STUDY OF THE HEALTHCARE SECTOR
IN SOUTH AFRICA**

by

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DECLARATION

I, the undersigned, hereby declare that this thesis is my original work and has not been previously, in its entirety or in part, submitted at any university for a degree.

Signature:..... Date:

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ABSTRACT

This study examines the key success factors in the Public Private Partnerships (PPP) field in the Healthcare Sector in South Africa. It gives health departments insight into the factors which should be considered when using PPP procurement and when looking at possible PPP opportunities.

The development of PPP's around the world has urged governments to look at alternative service delivery methods because of increased pressures on government budgets. Public Private Partnerships presents governments with a means of generating private funds for health service delivery whilst government manages the relationship via a negotiated PPP agreement to monitor the quality of services rendered.

Different PPP models are applied all over the world depending on the specific needs of countries. Different factors impact on the success of these partnerships and it is essential that government share knowledge and best practices. The study showed that in order for PPP's to be successful the public institution must do its homework thoroughly and that the legal framework should be conducive for private sector involvement in service delivery.

The study showed that the government of a country plays a pivotal role in the PPP process by giving the necessary political support to ensure the trust of foreign investors. The legislative framework is a critical factor in the advancement of PPP procurement and the allocation of risk as an important consideration when pursuing this type of procurement.

The study examined three concluded PPP Health Sector agreements in South Africa and looked at lessons learnt, mistakes which were made and what should be avoided in the future. The three PPP's in South Africa in this study were the first though there are other health sector PPP agreements concluded. The other PPP's are still in the commencement stage and it is too early to make an assessment at

this stage. However, the three case studies conducted give departments a clear picture of the process, the lessons learnt and the impediments in the PPP process.

The uniqueness of the South African Health sector also prompted the Government to look at a model which will be best suited to the local market. Best practices from other countries provide useful information and lessons learnt from other countries are also important in a developing PPP environment.

OPSOMMING

Die studie ondersoek die sleutel suksesfaktore in die Openbare Privaat Vennootskap (OPV's) arena in die Gesondheidssektor in Suid Afrika. Dit gee gesondheidsdepartemente 'n insig oor die faktore wat oorweeg moet word wanneer Openbare Privaat Vennootskappe oorweeg word en wanneer daar na moontlike vennootskappe gekyk word.

Die ontwikkeling van OPV's in die wêreld het regerings genoop om te begin kyk na alternatiewe diensleweringsmeganismes as gevolg van die toenemende druk op regeringsbegrotings. Openbare Privaat Vennootskappe bied 'n geleentheid aan regerings om private fondse vir gesondheids dienslewering te genereer terwyl die regering die verhouding deur middel van 'n OPV ooreenkoms die kwaliteit van dienslewering monitor.

Verskillende OPV modelle word regoor die wêreld toegepas afhangende van die behoeftes van spesifieke state. Verskillende faktore impakteer op die sukses van vennootskappe en daarom is dit belangrik dat regerings kennis en beste praktyke deel. Die studie onthul dat vir OPV's om suksesvol te wees, publieke sektor instansies hul huiswerk deeglik moet doen en dat die wetgewende raamwerk bevorderlik moet wees vir die deelname van die private sektor in dienslewering.

Die studie toon dat die regering van 'n staat 'n belangrike rol speel in die OPV proses deur die nodige politieke ondersteuning te verleen. Die wetgewende raamwerk is ook van kardinale belang en 'n sterk en gesonde raamwerk verseker dat buitelandse beleggers vertroue het in die OPV proses van 'n staat. Die studie toon dat die toedeling van risiko's belangrik is veral uit die oogpunt van die openbare sektor.

Die studie ondersoek drie voltooide OPV Gesondheidssektor ooreenkomste in Suid Afrika en kyk na die lesse wat geleer is, foute wat gemaak is en wat in die toekoms vermy moet word. Die drie OPV's in die studie is die eerste in Suid Afrika alhoewel daar ook ander gesondheidssektor OPV's intussen voltooi is. Die ander OPV

ooreenkomste is nog in die begin stadium en dit is te vroeg om op hierdie stadium te bepaal of dit suksesvol is of nie. Die drie gevallestudies gee aan gesondheidsdepartemente 'n duidelike prentjie van die proses wat gevolg behoort te word, die lesse wat geleer is en die struikelblokke in die OPV proses.

Die uniekheid van die Suid Afrikaanse gesondheidsektor bied ook 'n geleentheid aan die Regering om te kyk na nuwe modelle vir die lewering van gesondheidsdienste. Beste praktyke van ander state voorsien waardevolle inligting en die lesse wat geleer word belangrik is in 'n ontwikkelende OPV omgewing.

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LIST OF ABBREVIATIONS

| | |
|--------|---|
| ADB | Asian Development Bank |
| BAFO | Best and Final Offer |
| BEE | Black Economic Empowerment |
| BOT | Build Operate Transfer |
| BTO | Build Transfer Operate |
| BOOT | Build Own Operate Transfer |
| CHM | Community Health Management |
| DBFO | Design Build Finance Operate |
| DCMF | Design, Construct, Manage and Finance |
| DBSA | Development Bank of South Africa |
| DOH | Department of Health |
| DoRA | Division of Revenue Act |
| EC | European Commission |
| ECDoH | Eastern Cape Department of Health |
| FSDoH | Free State Department of Health |
| GDP | Gross Domestic Product |
| GEAR | Growth, Employment and Redistribution Program |
| HRP | Health Revitalisation Programme |
| IALCH | Inkosi Albert Luthuli Central Hospital |
| IPFA | Institute for Public Finance and Auditing |
| JV | Joint Venture |
| KZNDoH | Kwazulu Natal Department of Health |
| MFMA | Municipal Financial Management Act |
| MTEF | Medium Term Expenditure Framework |

| | |
|------|-----------------------------------|
| MSA | Municipal Systems Act |
| NDoH | National Department of Health |
| NPM | New Public Management |
| NT | National Treasury |
| OMT | Operate, Maintenance and Transfer |
| PFMA | Public Financial Management Act |
| PFI | Project Finance Initiative |
| PFP | Public Finance Project |
| PFU | Private Finance Unit |
| PT | Provincial Treasury |
| PPP | Public Private Partnerships |
| ROC | Registration of Capability |
| ROT | Revitalise, Operate and Transfer |
| SPV | Special Purpose Vehicle |
| TA | Transaction Advisor |
| UP | Unitary Payment |

CHAPTER 1

INTRODUCTION AND RESEARCH PROBLEM

1.1 Introduction

In the last 15 years, governments around the world have experienced problems with service delivery and have been looking at alternative service delivery methods and new project finance options. Improved service delivery has been high on the agenda of governments which pursued various routes to improve the situation. The reality is that governments do not have the necessary funds to rectify the problem and have come under pressure to provide more and better public services. Hence governments have increasingly looked for partnership arrangements with the private sector to meet these growing demands.

While traditional services such as provision of water and sanitation, solid waste collection and disposal, bus and urban transit, and road construction and repair have been some of the most typical examples of public private partnerships, partnerships techniques are being applied in numerous non-traditional areas such as the provision of utility billing and collection services, school and education management, the management and operation of job training centres, the construction and operation of prisons, the construction and operation of health services, and even the provision of information technology systems for local and regional governments.

Public Private Partnerships (PPP's) permit an expansion of infrastructure provision, an expansion beyond what government on its own could achieve given budgetary constraints and lack of project management skills.

1.2 Background

PPP's have different names all over the world. In the UK it is known as the Project Finance Initiative (PFI's), in Australia it is known as Privately Financed Projects (PFP). Despite all these different names the main focus is combined service delivery methodology by the private and the public sector (Osborne, 2000:14).

The reasons why governments have pursued partnerships have varied. Governments in the United States, the United Kingdom, Australia and Canada and other industrialized economies have tended to pursue Public Private Partnerships (PPP) in order to reduce the operating cost of public services and to achieve higher levels of service quality and customer satisfaction (White, 2006:1).

In South Africa and other emerging markets like Malaysia, Thailand, Argentina and Hungary, governments have engaged in PPP's to seek new sources of long term-investment capital as well as management expertise and new technologies. However, whether governments have entered in partnerships for reasons of increased operating efficiency or expanded capital investment, public-private partners all require a high degree of project structuring in order to become financeable. What is required is innovation and mindset change from the public sector to change the way in which government approaches service delivery (White, 2006:1).

1.3 Research Problem

Due to inter alia budget constraints, governments can no longer afford to provide public health services alone without the assistance of the private sector. The conventional methods of service delivery have to make way for new, innovative ways of solving governmental problems by way of co-

operation between the public and private sector. In view of the above problem statement referring to PPP's the following research question forms the basis of the study.

- Can PPP's be utilised as a viable procurement option in the delivery of healthcare services in South Africa?

1.4 Research Objectives

The objectives of the study are:

- To examine the key success factors in Public Private Partnerships in the Healthcare sector in South Africa,
- To give provincial health departments insight into the factors which should be considered when using PPP procurement,
- To describe the health sector's perspective on PPP's, with a special focus on criteria for deciding whether and how to enter into PPP's,
- To look at the role of governments in the implementation of PPP's,
- To look at the legislative framework as a critical factor in the advancement of PPP procurement, and
- To look at best practices from other countries.

Furthermore the research will look at the following:

- The regulatory framework of PPP's in South Africa,
- The application of PPP's in the Healthcare sector in other countries,
- Steps in the PPP process, and
- A normative perspective of PPP's in the Healthcare sector.

A multiple case study of three concluded PPP Healthcare sector projects is done as one of the explorative tools in researching the application of Public Private Partnerships.

The three PPP projects are the Inkosi Albert Luthuli Central Hospital (IALCH) in Kwazulu Natal, The Universitas and the Pelonomi Hospital in the Free State and the Humansdorp District Hospital in the Eastern Cape.

1.5 Research Design

The study is a combination of an evaluative design and an empirical design based on a multiple case study. As pointed out by Benz and Newman (1998:66) the use of a case study methodology has potential for increased validity for several reasons. It is argued that because multiple data collection techniques are used (e.g. interview, document study, observation, and quantitative statistical analysis), the weaknesses of each can be counterbalanced by the strength of the others. It is also felt that checking the interpretation of information with experts may also increase the validity and there are generally a variety of data sources. Primary and secondary data as well as textual data were used. The primary literature sources included reports, planning documents and project minutes. The secondary literature sources consisted of books and journals on PPP's.

1.6 Research Methodology

The methodology is of a qualitative nature. According to Van Maanen as cited by Mouton (2001:231) qualitative research covers an array of interpretive techniques which seek to describe, decode, translate and otherwise come to terms with the meaning of naturally occurring phenomena in the social world. He argues therefore that the qualitative approach is also fundamentally a descriptive form of research.

The methodology employed in the preparation of the study involved both documentary research and engagements with role players in the Healthcare sector.

Research data was collected by means of a literature study of the available internal and external sources dealing with topics of public private partnerships, legislation affecting the health sector, national and provincial regulations and laws pertaining to PPP's. Action Group discussions were held with staff members of the Grant Thornton PPP unit in the United Kingdom (UK), Turner and Townsend PPP staff in the UK and Ashurst Lawyers in the UK. Interviews were also conducted with members of the Western Cape Department of Health and Provincial Treasury officials of the Western Cape. Discussions were also held with Herman Conradie, Project Manager for the Inkosi Albert Luthuli hospital and Claire Corke, a Lawyer on Contract Management from the legal firm, Deneys Reitz.

1.7 Limitations of the Study

The study is limited due to the fact that only the Healthcare sector has been researched. The situation in other sectors like transport, education and prisons could be different.

1.8 Significance of the Study

As previously alluded Public Private Partnerships should be at the forefront of eradicating service delivery backlogs in South Africa. However, it appears that Health departments in South Africa are losing the battle against poverty and addressing inequalities of the past. Some of the biggest areas of concern that could be ascribed to this problem are the high unemployment rate, lack of economic growth and development, lack of industrial infrastructure and inequality experienced by large sections of communities.

The high unemployment rate thus puts more pressure on state resources because communities become dependent on the state.

The research conducted in the study could be of significance to Provincial Health Departments, in the sense that it will give them a clearer indication of the type of Public Private Partnership models which can be used in the Healthcare sector. It can be useful to all Provincial Health Departments, giving them an idea what other countries are doing to address health service issues in line with the essential development needs of the community and, if not, how these could be improved or downsized to uplift the social well-being of their communities.

1.9 Preliminary Literature Review

The application of the PPP mechanism poses an opportunity to governments as it is a way to improve service delivery within the country and construct new facilities. From the literature it becomes clear that the main benefits usually attributed to PPP's are accelerated provision of infrastructure projects as a result of using private sector finance, and better value for money due to private sector innovation and whole-of-life cost minimisation, than can be obtained under conventional private sector procurement (Katz, 2006). According to Roth (1988:130) private sector participation in Health Services has been prevalent in developing countries over years.

The effective and efficient utilisation of PPP's as a procurement option is a challenge for the South African Healthcare sector, since it can be a viable procurement method to reduce the infrastructure backlogs and address service delivery challenges. This type of procurement method can also help to address the backlogs in other sectors. PPP's in the Healthcare sector are still underdeveloped and whereas other countries have thrived with this type of

procurement method, South Africa is still grappling to come to terms with this way of delivering services to the public. The National Treasury in South Africa has set up a PPP Unit in order to assist National and Provincial Government Departments to comply with the regulatory challenges and to provide expertise to assist in the PPP process, which is cumbersome. Despite efforts by the National Treasury to promote PPP's, Departments remain reluctant to pursue this type of procurement option.

Around the world governments have entered into PPP's for a number of reasons. These include:

- To access outside sources of long-term financing for infrastructure investment,
- To offer access to public services for residents previously unconnected to essential services,
- To reduce operating and maintenance costs for utilities and public services,
- To access specialized sources of management expertise of specific services,
- To access new and advanced technologies in environmental and information services,
- To improve the quality of public services and levels of customer satisfaction (White, 2006:2).

Within the South African context the three spheres of Government namely National, Provincial and Local Government, together with the private sector have become important partners in the delivery of public services. The issue of service delivery has become a major issue, especially in the South African Healthcare Sector because unemployed and poor people depend on free healthcare. The problem is further exasperated because of the deterioration of health facilities and service delivery. As a result of this the South African

Government has turned to the private sector as a partner to improve the situation.

1.10 Legislative and Regulatory Framework of Public Private Partnerships in South Africa

A large number of publications dealing with PPP's appeared during the 1990's in the UK, the United States of America, Australia, South Africa and other countries and continue to appear on a regular basis. Most of the authors agree that as part of the New Public Management (NPM) approach governments need to look at alternative service delivery methods. The international experience has shown that in order for PPP's to be successful governments need to establish a firm regulatory framework to ensure that PPP's are a sound alternative for departments to pursue (White, 2006:2).

Because of their complex nature PPP's need a wide range e.a. project management, financial, legal and technical skills. It is thus incumbent on departments to make sure that they have the capacity to implement and monitor PPP contracts. If correctly structured, PPP partnerships can be a useful service delivery option from both an operational and a strategic perspective.

PPP's in South Africa are regulated by the Public Finance Management Act, 1999 (Act No 1 of 1999), Regulation 16 and PPP's for Local Government are governed by the Municipal Systems Act, 2000 (Act No 32 of 2000) and the Municipal Finance Management Act, 2003 (Act No 56 of 2003). Municipalities are not subject to the PFMA or to Treasury Regulation 16. Provincial Treasuries can thus just give advice to municipalities but cannot enforce any legislation upon municipalities. All other Government departments are however subject to Treasury Regulation 16. The Treasury Regulations make sure that

the monetary cost of all PPP arrangements does not inflict unfavorable risks on the fiscus.

The Regulations give clear procedures on the aspect of the PPP cycle, the identification of projects and post implementation guidelines. Particularly relevant procedure deals with affordability and value for money, provision of guarantees and budgeting. Because the PPP process is such a complex process, substantial risks are involved for both the government department and the service provider, thus a more refined approach to procurement is required. The National Treasury in South Africa regulates PPP's by National, Provincial departments and Public entities, and the PPP unit at Treasury plays a pivotal role in assisting departments to comply with the regulated path.

1.11 The layout of the study

Chapter 1: Introduction

This Chapter deals with the reasons behind Public Private Partnership procurement and the research problem. It outlines the objective of the study and the methodology which was followed. It gives a review of the literature which was studied and it gives an outline of all the other chapters.

Chapter 2: Public Private Partnerships: a Theoretical Perspective

In the Chapter the background and definition of PPP's is explored. The various PPP models are studied as well as the rationale for utilising PPP's. This is followed by a discourse of risk management and the different kinds of risks in PPP contracts. Lastly contract management and the advantages and disadvantages of PPP's are explained.

Chapter 3: The Regulatory Framework of Public Private Partnerships

In the Chapter the health legislative framework, health funding and health policies in South Africa are reviewed. This is followed by an outline of the regulatory framework of PPP's in South Africa. The processes entrenched in the PPP Regulations is spelled out and the different phases are explained.

Chapter 4: The application of Public Private Partnerships: an International Perspective

In order to get a holistic overview of healthcare PPP's the Chapter focus on the application of PPP's in the Healthcare sector in other countries. The gaps in their implementations of PPP's are explained and what has work and what should be avoided.

Chapter 5: Case studies in the South African Health Sector

The Chapter entails a study of the reasons for PPP's as a procurement option. An evaluation of three completed PPP Healthcare projects in South Africa is done as part of a multiple case study.

The evaluation is done in accordance with four categories namely:

- (a) the process,
- (b) the methodology which was followed to procure the PPP,
- (c) the feasibility study and
- (d) Treasury Approvals

Chapter 6: An Evaluation of the Case Studies

The Chapter gives an evaluation of the theory and the practice as explained in Chapters 2, 3, 4. Best practices in other countries are summarized and lessons learnt from experience elsewhere are also evaluated. It also provides an evaluation of the Healthcare Sector case studies in South Africa as discussed in Chapter 5.

Chapter 7: A Normative Perspective of PPP's in the Healthcare sector

This Chapter deals with how the PPP model should look. It compares the current situation in the Healthcare sector and what the ideal situation should be. It reviews the legislation, the South African PPP models, Risk Management and the PPP Manual. It concludes with recommendations for future projects.

CHAPTER 2

PUBLIC PRIVATE PARTNERSHIPS: A THEORETICAL PERSPECTIVE

2.1 Introduction

Public Private Partnerships (PPP's) presents a means of mobilising private funds for delivering of public services whilst government manages the relationship via a negotiated PPP agreement to ascertain the quality of services rendered.

Public Private Partnerships is an integrated approach to service delivery which is in line with the New Public Management approach (NPM). The NPM emphasises the need for new ways of solving governmental problems or creating opportunities, not as public activities in themselves, but by way of co-operation between public and private actors in concrete problems or situations presenting opportunities.

The theory and practice of Public Private Partnerships has advanced significantly over the last 10 years. The history of PPP's suggests that the focus in the past was largely on the construction and management of infrastructure toll roads, hospitals and prisons. However, the focus the last years has shifted to the delivery of mainstream public services such as health, welfare and education. PPP's around the world did not develop in unison nor are they uniform in nature. Different models are currently applied around the world and countries are becoming increasingly innovative in their use of PPP's.

The participation of private organisation in the financing and delivery of infrastructure in developing countries was almost unknown a decade ago.

However, over the past decade it has become a worldwide tidal wave. It represents a fundamental change in the nature and role of governments worldwide. Solomons (1998:2) states: "It has become crystal clear that Public Private Partnerships in infrastructure is an unstoppable wave which will affect us one way or another. Either we are unable to harness and exploit its energy and vitality, or it will sweep over us and move on".

The provision of public services in South Africa is a major challenge for all three spheres of Government. Reference is made, in particular to the provision of health services, health infrastructure, education infrastructure, housing and transport. Further concerns relate to the lack of suitable district health infrastructure, to support the Public Health System. Hence the implementation of alternative service delivery methods is essential for the ongoing improvement of service delivery. The South African Government has embarked on a wide range of policy initiatives to address service delivery backlogs. One of these initiatives is the promotion of partnerships with the private sector.

PPP's can be utilised in both the delivery of Health services, core services and non-core services. Core services can be defined as those services which entail the direct delivery of community services to the public such as medical services in public hospitals. Non-core services relates to facilities management, maintenance and security.

2.2 Background

Authors agree that as part of the New Public Management (NPM) approach governments need to look at alternative service delivery methods. To date Government departments in South Africa have been reluctant to pursue the PPP procurement options because they feel that there is not enough information available on the viability of it, the specific conditions in which they work best and when they might be expected to fail (White, 2006:2).

There is also an antipathy and distrust toward the “profit motive” which government officials do not understand but which is fundamental to private sector operations.

Public sector managers and politicians furthermore argue that the PPP process is too rigid and lengthy and thus there is a reluctance to pursue this form of procurement. Detractors and critics of PPP’s argue that it does not improve service delivery and that the private sector is exploiting Government. In addition, there is a feeling that PPP’s is too expensive. This view has led to mistrust between the parties, which is unfortunate given the role which each one can play in the field of service delivery (White, 2006:3).

2.3 Definition of Public Private Partnerships

It has been argued that PPP’s is nothing else than privatisation. However, PPP’s differ from privatisation because the legal ownership of any assets created continues to rest with the public sector and it retains a key role in service specification, procurement, market regulation and contract monitoring (Business 2000). In many cases the assets can also be “joint assets”.

PPP's can be defined as a concept involving the public and private sectors working in co-operation and partnership to provide infrastructure and services. It may also be defined as co-operative ventures between a public entity and a private party, aiming to realise common projects in which they share risks, costs and profits (Van Dijk, 2006:133). It can also involve Community Public Partnerships where government and the community work together towards better service delivery for the community.

South African law (PPP Manual, 2004) defines a PPP as:

“A contract between a public sector institution/municipality and a private party, in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project”.

The South African Government recognised in GEAR¹ the need for co-operation with the private sector in order to address the infrastructure backlog (Khosa, 2001:413). Service delivery problems in South Africa have started to escalate over the last years especially at Local Government levels and this has culminated in protest actions all over South Africa. This has prompted the South African Government to come up with new strategies to address service delivery problems.

To address this problem the Department of Public Service and Administration (Bvuma & Russel, 2001:251) developed a framework for improving efficiency and service delivery during 1999-2000. The Framework reviews the need for service delivery innovation and provides uniform descriptions of a wide variety of service delivery improvement mechanisms. The Framework identified some 26 varieties of alternative service delivery options, under the four headings of

¹ GEAR – Growth, Employment and Redistribution –Strategy for Economic Growth in South Africa

Partnering, Shared Service Delivery, the creation of Public Entities and Outsourcing. PPP's is emphasized as one of the options under Shared Service Delivery.

While there are family of partnership techniques that are generally applied by governments, each project is unique and calls for the blending of partnership techniques resulting in an infinite number of potential options for structuring partnerships. The important guideline is that the technique is selected and structured to fit the unique needs of the project and of local stakeholders rather than the project being made to fit a pre-determined contract (White, 2006:2).

2.4 Different forms of Public Private Partnerships

PPP's can be structured in different ways:

- **Contracting Out or Management Contracts**

This form of PPP means that the private sector is only partially involved and provides a service or manages the contract without taking any risk. This kind of arrangement is similar to a service contract for providing the management of operation and maintenance services for a utility or public service. The objective of a management contract is to bring in a specialized team of experience managers to reach specific operating goals such as reducing unaccounted for water, improving the collection ratio and reducing the cost of operations (White, 2006:3).

Management contracts usually have a term of about five years, which is long enough to analyse operations, identify problems, institute changes and to deliver the benefits of those changes to the government and the public through reduced subsidies, lower tariffs and increased profitability (White, 2006:5).

- **Joint Ventures**

It entails a contract where the private and public sector jointly finance, own and operate the facility. The United States use this type of model for their urban regeneration schemes in which the local government authorities purchase and clear blighted areas for new construction of public services like new city halls or government offices as part of downtown redevelopment (Beauregard, 1998). In this kind of project the government acts as regulator and shareholder in the operating company.

- **Leasing**

In a leasing contract the private sector is responsible for operating and maintenance of the assets while the government is the owner of the assets. An example is France where most PPP's are performed under concession contracts (essentially BOT-Type contracts) or affermage system in which a municipality has a water facility constructed and then contracts with a private company to operate and maintain the facility (Grimsey & Lewis, 2004:11). The word "affermage" literally means to "farm out" or to rent out land to those who will cultivate it and keep the harvest in exchange for a rental fee (White, 2006:8).

In order for lease contracts to be successful it must be specific about defining which decisions constitute operating and maintenance, and are therefore the responsibility of the private lessee, versus which decisions are long-term and strategic, and are therefore the responsibility of the government lessor.

- **Build Operate Transfers (BOT)**

The private sector takes primary responsibility for funding, designing, building and operating the project. The control and formal ownership of the project is transferred back to the public sector at the end of the contract. An example of this type of arrangement is the third Dartford Crossing of the River Thames linking two stretches of the M25 motorway circling London, operated (with virtually guaranteed toll income) by the vehicle company for up to 20 years, with the facility reverting to the UK Government (Grimsey & Lewis, 2004:11).

- **Build Own Operate (BOO)**

Under this arrangement the control and the ownership of the project remain in private hands. In this type of arrangement the private sector is responsible for financing, building, operating and owning of the infrastructure facility effectively in infinity. An example of this is the water treatment plants in South Australia. These facilities are financed, designed, built and operated by a private sector firm, process raw water, provided by the public sector entity, into filtered water which is then returned to the public sector utility for delivery to consumers with a purchase contract included by government (Grimsey & Lewis, 2004:11).

- **Design Build Finance Operate (DBFO)**

The DBFO model is not conventional capital asset procurement but a service procurement policy where the service outcomes and performance standards are clearly specified. It is a long term contract of 25 or 30 years. It has comprehensive requirements on payment,

service standards and performance measurement, providing an objective means to vary payment depending on performance. It usually includes one public sector and one private sector party to the contract. The DBFO concessionaire has to bear substantial risk and the intention is that the government body will be buying a road service and not just a new road (Grimsey & Lewis, 2004:60).

To encourage a high quality of service, the payment system included both incentives for good performance and abatements for bad performance. This type of arrangement is particularly prominent in the health sector (Grimsey & Lewis, 2004:60).

- **Design Build Operate (DBO)**

The DBO model is based on the traditional public sector procurement model. It integrates design, construction and maintenance within one contract. The public sector purchases the infrastructure and retains ownership thereafter. The operation of the asset is the responsibility of the private sector (Hodge & Greve, 2005:65).

- **Cooperative Arrangements**

This type of arrangement make it possible for government and private entities to make an informal arrangement for equity partnerships deals and concession-type franchise arrangements for social housing projects. In Korea and many other countries, independent power producers and self-generators (in Australia they include households with solar panels) can sell power into the national grid.

In Costa Rica and South Africa, the Government creates and maintains national parks, while private organisations develop the eco-tourism

programmes and finance some of the tourist promotion campaigns (Grimsey & Lewis, 2004:12).

Table 2.1 gives a summary of the different PPP models which can be applied.

Table 2.1: Models of Public Private Partnerships

| | |
|--------------------------------------|--|
| Management Contracts | The private sector provides a service or manages a contract to a public service department. |
| Joint Ventures | The government act as a regulator and shareholder in the operating company. |
| Leasing | The private sector is responsible for operating and maintenance of the asset while government is the owner of the assets |
| Build Operate Transfers | The private sector is responsible for funding, designing, building and operating the project. The public sector takes control and ownership of project at the end of the contract. |
| Build Own Operate | The control and ownership of the project remain in private hands. |
| Design, Build Finance Operate | Includes one private sector and one public sector party to contract. |
| Design Build Operate | A single contract is awarded to a private business which design, builds, and operates the public facility, but the public sector retains legal ownership. |
| Co-operative Arrangements | This type of arrangement makes provision for equity partnership deals and concession type franchise arrangements. |

Table 2.2 The Potential Effectiveness of Alternative PPP structures

| | Improved Service | Enhanced Operational Efficiency | Enhanced Risk Sharing | Life Cycle Costing | Accelerated Implementation | Leveraging of Public funds | Implementation Constraints |
|---------------------------------------|------------------|---------------------------------|-----------------------|--------------------|----------------------------|----------------------------|----------------------------|
| Private Outsourcing | | | | | | | |
| Management Contract | Yes | Yes | No | No | No | No | Moderate |
| Joint Ventures | Yes | Yes | Some | Some | No | No | Moderate |
| Leasing | Possible | Yes | Some | Possible | No | No | Moderate |
| Integrated Private Development | | | | | | | |
| BOT | Yes | Yes | Some | Yes | Yes | No | High |
| BOO | Yes | yes | Yes | Yes | Yes | No | High |
| DBO | Yes | Yes | yes | Yes | Yes | No | High |
| Private Investment | | | | | | | |
| DBFO | Yes | Yes | Yes | Yes | Yes | Yes | Very High |
| Concessions | Yes | Yes | Yes | Yes | Yes | Yes | High |

Source: Adapted from Guidelines for Successful Public Private Partnerships (2004:31)

Table 2.2 gives a summary of effectiveness of the PPP structures explained in Table 2.1. Private outsourcing arrangements can affect service improvements and gains in operational efficiency. Their risk sharing and life cycle costing is however limited.

BOT, BOO and DBO arrangement can enhance both operational and service indicators. They also bring life cycle cost benefits. These structures share certain risk elements but a disadvantage is that it cannot leverage public funds.

2.5 Service Delivery Management

Service delivery management in the PPP context can be divided into two categories namely risk management and performance management. Risk Management involves keeping the exposure of the project to any potential threats to an acceptable level by taking appropriate action. Performance management plays a pivotal role in PPP procurement because it must ensure that the project remains affordable for the government department, managing service delivery, value for money, quality and performance improvement. This section deals with Risk management and Performance management as the two principal issues in the PPP service delivery management context.

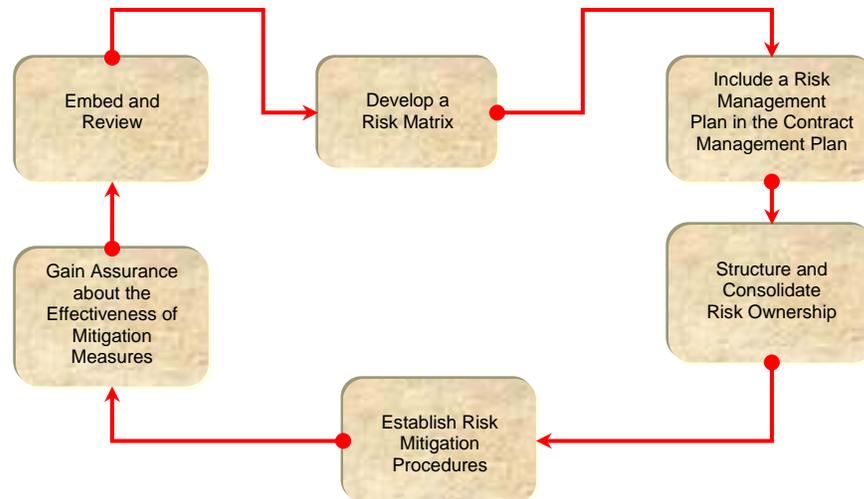
2.5.1 Risk Management

One of the key prerequisites for a PPP project is that substantial risk must be transferred to the private party. Hence Risk Management is a central component of the PPP procurement process, and additional risk management procedures are required after the signing of the PPP Contract. Figure 2.1 provides a PPP Risk Management Framework, which highlights the key tasks that the project officer and the contract management team should undertake after the signing of the PPP contract. During the PPP contract negotiation, risk allocation should be reduced to a Risk Matrix. As part of the process of developing the Contract Management Plan, the project officer should develop a Risk Management Plan based on the Risk Matrix (DPLG, 2007:35).

A risk can be defined as any cause, event or influence that threatens the successful completion of a project in terms of time, cost or quality. A key principle of PPP's is that risk should be allocated to the party best able to manage it or mitigating factors should be defined. The effective allocation of risk has a direct financial impact on the project as it will result in lower overall

project costs and will therefore provide enhanced value for money if compared to traditional procurement methods (European Commission, 2003:52).

Figure 2.1: PPP Risk Management Framework



Source: Adapted from UK HUM Treasury, *Management of Risk: 2001:3*

2.5.1.1 Different kinds of Risks

- **Construction Risk**

This is related to design problems, the cost of building overruns and project delays. Construction risk is virtually always assigned to the private party. External forces such as inflation, economic policy, embargoes, and political conflicts also have the potential to have dramatic affects on capital costs (European Commission, 2003:54).

The capital construction cost of any project is one of the fundamental factors upon which financing is based, and when cost overruns are incurred; the financial feasibility of a concession can be jeopardized. Construction delays also have detrimental effects on capital costs.

While some delays can be minimized through careful construction management, they still have the potential to arise. Other external factors, such as timely delivery of right-of way, for example, are difficult to manage.

- **Foreign Exchange Risk**

This risk can be exacerbated when governments require that concessionaires obtain a certain portion of their financing from foreign sources. Foreign exchange risk is greatest when weak currencies are involved, putting projects in emerging economies at greater risk (European Commission, 2003:54).

- **Environmental Risk**

Infrastructure projects have the potential to provoke environmental concern, and governments and citizen groups are becoming increasingly vigilant in their efforts to mitigate potential impacts. Environmental risk is usually assumed by the private party. For this reason, most would-be investors undertake thorough environmental assessments and identify likely mitigation programs before entering into a concession agreement (European Commission, 2003:54).

- **Latent Defect Risk**

It is the possibility of loss or damage of facilities arising from latent defects in the project assets (PPP Manual, 2004:64). New projects may also involve upgrading and expanding existing systems. In exchange, concessionaires usually assume responsibility for the maintenance of these facilities for the duration of their contracts. While seemingly attractive, this mechanism can be costly for concessionaires if the

facilities they inherit have unknown structural faults (European Commission, 2003:55).

- **Political Risk**

Assessments of the inherent strength and stability of local political institutions are common in the investment field and are reflected in bond ratings prepared by internationally recognised rating agencies. As political risk increases, so does the cost of obtaining financing. The long duration of most concession agreements and the common aversion to user fee increases, make PPP projects especially susceptible to political risk. This is exacerbated when new governments oversee unpopular projects instigated by previous administrations. Political risks are often assumed by host governments, but such an assignment can prove less than optimal in the face of lackluster political support for an infrastructure partnership (European Commission, 2003:55).

- **Residual Value Risk**

This risk is related to the future market price of an asset. This risk only applies to the contracts in which a value is attached to the assets when they are transferred back to the public sector at the end of the contract. Allowing for the residual value of the assets to be determined at the end of the project can mitigate this risk. However, the residual value is dependent on the maintenance of the assets during the operations. Any condition to absolve the private sector provider from this risk should be countered with a minimum maintenance standard (PPP Manual, 2001:28).

- **Force Majeure Risk**

This risk reflects the occurrence of unexpected and uncontrollable natural and/or man-made conditions, such as earthquakes, typhoons, flooding or war, which may negatively affect the construction or operation of a project. These risks are generally taken on by the project promoters and investors for at least a limited time or amount of investment. Investors will certainly take the possibility of such occurrences into account when valuing the project and determining the required rate of return (PPP Manual, 2001:26).

- **Inflation Risk**

This risk represents the possibility that the actual inflation rate will exceed the risk projected during the development of the feasibility study. Inflation risk may be mitigated by including an actual index, based on inflation, in the contract's pricing formula, or by entering into long-term supply contracts with predetermined prices (these contracts increase the counterparty credit risk). To the extent that the risk cannot be controlled by the private sector, the public sector may decide to retain the risk, reducing the cost of the project (PPP Manual, 2001:27).

- **Input and Throughput Risk**

For non-extractive projects, in which the viability of the project depends on the supply of sufficient natural resources (e.g. water, power generation and gas pipeline), the input and throughput risk is critical. As with resource risk, a proper due diligence must be undertaken to ensure that this risk is mitigated. This risk increases when the jurisdictions in which the source, throughput and ultimate consumption of the resources are different (PPP Manual, 2001:27).

- **Market (demand) Risk**

Market risk relates to the demand for services to be provided by the project. It may be affected by factors such as increases in the cost of raw material, the development of a substitute service (e.g. a new road that parallels rail tracks), overall economic conditions, governmental policy (e.g. taxes), political developments, developments in the customer industries (e.g. tourism), and environmental concerns (PPP Manual, 2001:27).

- **Technology Risk**

This risk refers to the possibility of changes in technology resulting in services being provided with suboptimal technology. This risk is difficult to control. However, when better technology decreases the cost of providing the services, the private sector provider will almost certainly implement such changes. Contracts may address this risk and set out a method for rectifying related problems (PPP Manual, 2001:28).

2.5.2 Performance Management

One of the key pre-requisites for the successful implementation of PPP's is the performance management aspect. The institution can do the monitoring itself or can appoint a consultant to monitor the project. The guidelines for the monitoring of the project must be included in the contract. The contract can make provision for penalties if services are not rendered satisfactorily. The particular approach that the public department adopts to its PPP contract management will have an important bearing on the chances for success of the project. The resources devoted to contract management are crucial for the success of a project and will be determined by the overall size and complexity

of the project and the particular stages it has reached (Department of Local Government, 2007:15).

The main objective of performance management is to ensure that:

- monitoring of the service provider's performance against the output specification is undertaken to ensure that the financial implications of any failure to perform have been taken into consideration and appropriate action taken,
- payment for the service is conditional upon the quality of performance of the service provider,
- services are delivered in accordance with the contract, and
- continuous improvement in contract performance and service delivery is maintained (DPLG, 2007:35).

To ensure that the requirements of the PPP contract and the output specification are met in terms of affordability, service delivery, quality and value for money, a department should develop a Contract Management Plan. This Plan should be based on the performance management model and should include details such as:

- Reporting obligations that will be imposed on the private party,
- The performance management system which will be used by the department,
- The mechanism that will be used to solicit end user feedback, including a complaints procedure,
- The government officials who will be responsible for monitoring of performance, and
- An estimate of the resources that the government will allocate to manage the private party performance (DPLG, 2007:35).

Key Performance Indicators (KPI's) form an integral part of Performance Management. It is important that KPI's should be quantifiable and clearly spelled out in the contract management agreement to avoid misinterpretation.

2.6 Advantages and Disadvantages of Public Private Partnerships

Different schools of thought have evolved over the years on the strengths and weaknesses of PPP's. It is worth looking at these advantages and disadvantages because they could be considered for future projects and can provide an important guideline in terms of considering the specific opportunities and threats associated with PPP's.

2.6.1 Advantages

- **Resources**

A partnership allows a pooling of resources so that larger projects or more aspects of a project can be tackled than is possible for an individual agency or it allows the agency to devote some resources targeted at one policy to be realised for use elsewhere (Osborne, 2000:19).

- **Effectiveness and efficiency**

Depending on the nature of the problem, partnership can greatly increase an individual's organisations effectiveness and efficiency, especially through improved coordination between (and within) organizations. The end result is that greater output and cost savings might be achieved (Osborne, 2000:20).

- **Legitimacy**

In terms of Community Public Partnerships the participation of the local community can build greater legitimacy for policies. The local authority can also provide resources, constitutional powers and democratic legitimacy to Public Private Partnerships (Osborne, 2000:21).

- **Optimum allocation of risks**

Risks are identified and allocated to the party who is able to deal the best with them. The advantage for the public sector is that cost overruns can be borne by the private party (Osborne, 2000:21).

- **Value for money**

Because of the private sector's expertise it can bring a more commercialised approach to projects. Value for money projects deliver greater value for money compared with that of an equivalent asset procured conventionally (IPFA, 2007:9).

- **Speed of Delivery**

By using PPP's projects can be finalised quicker because they don't have to wait for government to make funds available. The projects are also completed quicker because the private sector generally wants to earn revenue as soon as possible. The social and economic advantages flowing out of the project are also excelled. The end result of early delivery can contribute towards economic growth and increased tax income for government (Bruxel, 2005:9).

- **Trustworthiness**

PPP projects are normally delivered on time and on budget because the private sector carries the risk of cost overruns and delayed completion. The contractual commitment in this regard, which includes incentives and penalties, promotes effective management (Deloitte & Touche, 2006:8).

- **Transfer and sharing of technology**

Experts and international institutions are involved with PPP's resulting in knowledge sharing and experience sharing depending on:

- the level of partnership relations vs a contractual relationships,
- the capacity of government to absorb such new technology or expertise.

It also promotes the transfer and sharing of technology (Bruxel, 2005:8).

- **Training**

The involvement of international institutions in PPP's creates training opportunities for local staff in business methods and techniques. The partnership can draw from the combined experience and expertise of the private sector and public sector. As more PPP deals are conclude government and the private sector will become more at ease with the concept of PPP's (Deloitte & Touche, 2006:8).

- **Shifting construction and maintenance risk to the private sector**

Infrastructure projects always have cost overruns which are borne by the public sector. Budget constraints also put immense pressure on the maintenance priorities culminating in reduced spending on maintenance and the result is that maintenance is often deferred. Well designed PPP's can ameliorate the above problems by transferring certain construction and maintenance risk to the private partner. The ability to shift some of these risks to the private party can be an important benefit for the public sector (Deloitte & Touche, 2006:7).

- **Development of new business sector**

The PPP concept has created new business opportunities in Europe of firms experienced in building and operating PPP projects. Countries adopting PPP have often used foreign advisors initially but have soon developed their own skills and are now competing on the international stage for business in other countries (Harris, 2007:13).

2.6.2 Disadvantages

- **Goals**

Partnerships have failed because the aims and goals of the project have not been clearly identified. Partnerships sometimes have broad aims and this leads to misunderstandings, lack of coordination and thus conflict between partners (Osborne, 2000:22).

- **Performance enforcement**

The management of performance in a PPP contract can sometimes be problematic which can lead to bad customer relations. The issue of performance specification is problematic because it is hard to formulate in a way that is suitable for an arms-length contract (Katz, 2006:7). Arms-length contracts are fair and enforceable if both parties to the contract have relatively equal powers of negotiations upon entering the contract. Neither party has a disproportionate amount of power to strong arm the other party into an unfair deal.

Furthermore the public sector in many cases does not have the capacity to monitor these projects and the private sector can abuse the situation by not complying with agreed service standards.

- **Resource costs**

Partnerships involve a considerable amount of resource cost because of the time it takes to finalise a deal. The time spent on discussions and consultation can also cause delay and be costly. The cost of procuring the services of transaction advisors is also high and this is seen as an obstacle by departments (Osborne, 2000:22).

- **Unequal power**

There may be unequal power relations between the public and private sector which can sometimes lead to tension as the parties may try to alter another's priority. Although there are different types of power, the greatest power generally rests with those controlling resources (Osborne, 2000:23).

- **Cliques usurping power**

It could happen that the objectives of the agreements may be usurped by some actors, cliques or community groups, culminating in outcomes that increase their benefits rather than overall welfare (Osborne, 2000:23).

- **Impacts on other services**

It is argued that PPP project impacts on other services because resources are drawn from other projects reducing the effectiveness of a department. The Health Department has highlighted this as one of the big problems of PPP projects. It is argued that sometimes other projects

have to be cancelled in order to finance the unitary monthly payment of the PPP (Osborne, 2000:24).

- **Organisational difficulties**

Sometimes partnerships fail because they have difficulty in successfully coordinating the programmes and approaches. Furthermore barriers such as lack of institutional capacity can also impact on the partnership. The inability of departments to enforce agreements has been highlighted as one of the major stumbling blocks in the failure of PPP projects (Osborne, 2000:24-25).

2.7 Conclusion

Public Private Partnerships have become one of the methods of delivery services to the public. The literature research suggests that it can be used by governments all over the world as an alternative service delivery method to reduce infrastructure backlogs. Experience world-wide has shown that when implemented effectively, the delegation of service delivery to the private sector can improve efficiency, customer service, competitiveness and quality, implement best practice and even reduce costs.

Different PPP models can be applied depending on the specific needs of the public institutions and provided that the project can yield value for money. Certain models have been applied more frequently in the health sector, while other models might not suit the sector.

The importance of risk sharing in the PPP arena can't be over emphasised. Much of the debate on risks has been about the potential risks associated with PPP projects and the implications that those risk could have in terms of project

cost, timing and quality. One of the views is that risks will always revert back to the public sector if problems start to arise

The allocation of risk is crucial to the success of a PPP agreement and should be shared between the public sector and the private sector. It is important that risks should be managed carefully so that the objectives of the project could be achieved. The cost of risk is important therefore the parties should make sure that the risks are properly priced.

Another view is that government has a mistaken belief that the private sector willingly accepts risks. It is common knowledge that financiers are risk averse and thus will be reluctant to accept risks unprovokedly. Risks in the PPP sector are associated with cost. It boils down to a monetary implication should the risk event occur. The PPP contract should therefore contain detailed provision relating to the allocation of risk between the government and the private party. It is therefore important that a Risk Matrix, as depicted in Annexure 3, be included in which all risks would be specified, assigned, mitigation measures identified, and probabilities and costing calculated.

PPP agreements also have their advantages and disadvantages. One of the realities of PPP's is that it is expensive because of the time delays and the profit motive of the private sector. The international experience, as later discussed in Chapter 4, of private sector service delivery has shown that some activities can be undertaken more cost effectively with the application of private sector management disciplines and competencies.

Chapter 3

THE LEGISLATIVE FRAMEWORK OF PUBLIC PRIVATE PARTNERSHIPS IN SOUTH AFRICA

3.1 Introduction

Legislative frameworks governing responsibility for the delivery of public services are complex and restrictive. Another contributing factor is the fact the financial control mechanisms within the public sector do not anticipate public services being financed and delivered by the private sector. This has led to a situation where countries had to introduce legislation to facilitate the delivery of public services by the private sector under a PPP contract. In South Africa the PPP legislative framework is guided by Treasury Regulation 16 in terms of the Public Finance Management Act (Act no1 of 1999 as amended by Act no 2of 1999).

In accordance with section 76(4) of the PFMA the South African National Treasury has introduced Standardised Public Private Provisions in 2004. The Standardised Provisions describe the key issues that are likely to arise in Public Private Partnership projects regulated by the provision of Regulation 16 of the Treasury Regulations. The Provisions prescribes how these key issues must be dealt with in a manner that achieves the requirements of substantial risk transfer, value for money and affordability.

The Division of Revenue Act, 2005 (No 1 of 2005) was introduced to guide the process of health facility delivery. The Division of Revenue Act, 2005 (No 1 of 2005) Section, 13 Subsection 2 (a) and (b) requires that the Department of Health enter into, implement and manage service delivery agreements with the

Department of Transport and Public Works, to manage and undertake construction and maintenance on their behalf. Subsequently all nine provinces thus have a Department of Public Works: Health component who is responsible for the delivery of health services. These services are rendered on the basis of the needs of the Provincial Health Departments.

The Chapter provides a background of the legislation which governs Healthcare in South Africa and gives an overview of policies and guidelines for hospitals in South Africa. It also provides background information on the policy objectives of the Department of Health and the responsibilities which Health Departments must assume in implementing them. Furthermore the legislation which governs PPP's is examined and the process which departments should follow in the PPP process is sketched.

3.2 The Constitution of the Republic of South Africa, 1996 (Act No 108 of 1996)

Section 27 (1) states:

“everyone has the right to have access to health care services, including reproductive health care”

Section 27 (2) states:

“state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of each of these rights”.

3.3 The National Health Act, 2003 (Act No 1 of 2003)

Section 4 (1) (e) of the National Health Act (2003) states:

“The Minister of Health has the responsibility to prioritise the health services that the state can provide taking into consideration health

needs and resources available to prescribe mechanisms to enable a co-ordinated relationship between private and public health establishments in the delivery of health services”.

The National Health Act (2003) focuses on the following:

- setting out the rights and duties of health care providers, health workers, health establishments and users, and
- protecting, respecting, promoting and fulfilling the rights of
 - (i) the people of South Africa to the progressive realisation of the constitutional right of access to health care services, including reproductive health care.

The objectives of the National Health Act (2003) are to regulate national health and to provide uniformity in respect of health services across the nation by establishing a national health system which encompasses public and private providers of health services, and provides in an equitable manner the population of South Africa with the best possible health services that available resources can afford.

3.4 The Public Finance Management Act, 1999 (Act No 1 of 1999 as amended by Act no 29 of 1999)

The PFMA is the cornerstone of the Government’s efforts to strengthen and improve financial management in the public sector. It is the ultimate aim of the PFMA to ensure that taxpayer’s money is spent responsibly and that the intended results are realized. According to the Act the accounting officer or accounting authority is responsible for effective and efficient use of fiscal resources in the public interest. The accounting officer is responsible and criminally liable in event of mismanagement. Furthermore the Act spells out that procurement is the responsibility of the accounting officer. Part of the duties of the accounting officer is the value for money assessments for all

deals and PPP's as a choice of rendering a public service is no exception. The nature of a PPP deal entails the following:

- The allocation of risks to the party who can best manage it,
- The leverage of private sector finance and efficiencies,
- Targeted public spending, principally on outputs to agreed standards (PPP Manual, 2004).

3.5 National Treasury Public Private Partnership Regulations

PPP's in South Africa are regulated by the Public Finance Management Act, 1999 (Act No 1 of 1999 as amended by Act 29 of 1999) Regulation 16 and PPP's for Local Government are governed by the Municipal Systems Act, 2000 (Act No 1 of 2000) and the Municipal Finance Management Act, 2003 (Act No 56 of 2003). The Treasury Regulations make sure that the monetary cost of such arrangements does not inflict unfavorable risks on the fiscus.

The Regulations give clear guidance on the aspect of the PPP cycle, the identification of projects and post implementation guidelines. Particularly relevant regulations deal with affordability and value for money, provision of guarantees and budgeting. The PPP process is a complex process, substantial risks are involved for both the public sector and the service provider thus a more refined approach to procurement is required. These procedures are contained in the Treasury Regulations. The National Treasury regulates PPP's by national and provincial departments and public entities, and the PPP unit at Treasury plays hands on role in assisting projects to comply with the regulated path.

3.5.1 Provincial Public Private Partnership Regulations

Treasury Regulation 16 under the Public Finance Management Act (1999) is the overarching guideline for PPP hospital procurement at Provincial level and provides checks and balances to departments to establish their own procurement outcomes for PPP projects. The Regulation stipulates that the financial commitments to be incurred by an institution in terms of the PPP agreement can be met by funds:

- (a) designated within the institution's existing budget for the institutional function to which the agreement relates, and/or
- (b) destined for the institution in accordance with the relevant treasury's future budgetary projections for the institution.

3.5.2 Treasury Regulation 16 to the PFMA

In terms of Section 76 of the PFMA it is the duty of the National Treasury to make regulations for a range of matters which deal with the effective and efficient use of financial resources. Many of these matters are relevant to PPP's, and National Treasury's Regulation 16 provides precise and detailed instructions for PPP's.

Treasury Regulation 16 gives clear guidelines in terms of the definition of a PPP and also sets out the different phases and tests for a PPP. In terms of the regulation two types of PP are specifically defined (PPP Manual: 2004):

- (a) Where the private party performs and institutional function,
- (b) Where the private party acquires the use of state property for its own commercial purposes,

It can also include a hybrid of these types:

- (c) Payment to the private by the public sector for the service delivered,
- (d) Collecting of fees from users of the service,
- (e) A combination of these.

The Regulation clearly defines a PPP and the types of PPP that are catered for:

- PPP's are not simply outsourcing of a function where financial, technical and operational risks are retained by the private party,
- PPP's are not a donation from a private party,
- PPP's are not the privatisation of Government Assets,
- PPP's are not the commercialisation of a public function by creating a state owned enterprise, and
- PPP's do not constitute the borrowing of money by the state (PPP Manual, 2004).

The Regulation also caters for a broad variety of PPP types. It provides for a multiplicity of projects with different characteristics, combining private party risks in various ways for designing, financing, construction, operating, infrastructure and services, and for owning and transferring assets. This wide variety of PPP types is reflected in international experience. The regulation spells out that whatever the structure or payment mechanism of a PPP project all PPP projects are subject to three strict tests:

- Can the institution afford the deal?
- Is it value-for-money solution?
- Is substantial technical, operational and financial risk transferred to the private party? (PPP Manual, 2004).

3.6. Processes entrenched in the Treasury Regulation

3.6.1. Project Inception

As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing:

- (a) register the PPP with the relevant treasury,
- (b) inform the relevant treasury of the expertise within that institution to proceed with a PPP,
- (c) appoint a project officer from within or outside the institution, and
- (d) appoint a transaction advisor if the relevant treasury so requests.

3.6.2 Feasibility Study – Treasury Approval: I

To determine whether the proposed PPP is in the best interests of an institution, the accounting officer or the accounting authority of that institution must undertake a feasibility study that:

- (a) explains the strategic and operational benefits of the proposed PPP for the institution in terms of its strategic objectives and Government policy,
- (b) describes in specific terms –
 - (i) in the case of a PPP involving the performance of an institutional function, the nature of the institutional function concerned and the extent to which this institutional function, both legally and by nature, may be performed by a private party, and
 - (ii) in the case of a PPP involving the use of state property, a description of the state property concerned, the uses, if any, to which such state property has been subject prior to the registration of the proposed PPP and a description of the types of use that a private party may legally subject such state property to,

- (c) in relation to a PPP pursuant to which an institution will incur any financial commitments, demonstrates the affordability of the PPP for the institution,
- (d) sets out the proposed allocation of financial, technical and operational risks between the institution and the private party,
- (e) demonstrates the anticipated value for money to be achieved by the PPP, and
- (g) explains the capacity of the institution to procure, implement, manage enforce, monitor and report on the PPP (PPP Manual, 2004).

An institution may not proceed with the procurement phase of a PPP without prior written approval of the relevant treasury for the feasibility study.

If at any time after Treasury Approval: I has been granted in respect of the feasibility study of a PPP, but before the grant of Treasury Approval: III in respect of the PPP agreement recording that PPP, any assumptions in such feasibility study are materially revised, including any assumptions concerning affordability, value for money and substantial technical, operational and financial risk transfer, then the accounting officer or accounting authority of the institution must immediately:

- (a) provide the relevant treasury with details of the intended revision including a statement regarding the purpose and impact of the intended revision on the affordability, value for money and risk transfer evaluation contained in the feasibility study, and
- (b) ensure that the relevant treasury is provided with a revised feasibility study after which the relevant treasury may grant a revised Treasury Approval I (PPP Manual, 2004).

3.6.3 Procurement: Treasury approvals IIA and IIB

Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.

The procurement procedure -

- (a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective, and
- (b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury (PPP Manual, 2004).

The procurement deliverables includes the following:

- Pre-qualification (RFQ)
The intention of the RFQ is to ensure that the exact interest of the institution is communicated to the market. It is also to determine the extent and nature of interest in the private sector. The transaction advisor must also ensure that a competitive number of pre-qualifying

competent consortia are part of the process in an equitable and transparent way.

- Payment Mechanism

The transaction advisor is responsible for the development of rigorous payment mechanism which includes all elements of risk transfer which was established in the feasibility study.

- Bid evaluation criteria

A bid evaluation system must be set up which allows for variant bids.

- Request for proposals (RFP)

It is the responsibility of the transaction advisor to prepare RFP documents

which should be consistent with the feasibility study results. The following information must be included in the RFP:

- output specification of the institution,
- the requirements for compliant bids,
- a risk profile,
- the payment mechanism,
- BEE targets,
- The bid process,
- Evaluation criteria, and
- Bidder communication system (PPP Manual, 2004).

3.6.4 Contracting PPP Agreements - Treasury Approval: III

After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, the accounting officer or accounting authority must obtain approval from the relevant treasury:

- (a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of Regulation 16.4.2 or as revised in terms of Regulation 16.4.4,
- (b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP, and
- (c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement (PPP Manual, 2004).

3.7 Management of PPP Agreements

The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved in Treasury Approval: III for:

- (a) measuring the outputs of the PPP agreement,
- (b) monitoring the implementation of the PPP agreement and performances under the PPP agreement,
- (c) liaising with the private party,
- (d) resolving disputes and differences with the private party,
- (e) generally overseeing the day-to-day management of the PPP agreement, and
- (f) reporting on the PPP agreement in the institution's annual report.

A PPP agreement involving the performance of an institutional function does not divest the accounting officer or accounting authority of the institution concerned of the responsibility for ensuring that such institutional function is effectively and efficiently performed in the public interest or on behalf of the public service (PPP Manual, 2004).

3.8 Agreements binding on the State

According to the PPP Manual (2004) a PPP agreement or an agreement amending a PPP agreement, binds the state only if the agreement was entered into on behalf of an institution:

- (a) by the accounting officer or accounting authority of that institution, and
- (b) if all treasury approvals required in terms of this Regulation 16 have been granted by the relevant treasury in respect of the PPP.

3.9 Healthcare Funding in South Africa

The budget is the primary instrument through which governmental functions are performed and objectives are reached (Visser & Erasmus, 2002:71). The South African Government utilise different types of grants to assist Provinces and Municipalities to meet their service delivery obligations. In the Health sector the HIV/AIDS Grant, the Hospital Revitalisation Grant and the Provincial Infrastructure Grant (PIG), were introduced by the South African Government to assist Health Departments. These grants are called conditional grants. Conditional grants, sometimes called specific purpose grants is where the National Government specifies the purpose and conditions under which the Provinces and Municipalities should use the grant. The conditions attached to these grants are specified in the Division of Revenue Act (2005) (DoRA). Allocations of these grant is based on past expenditure performance and projected cash flow figures for projects.

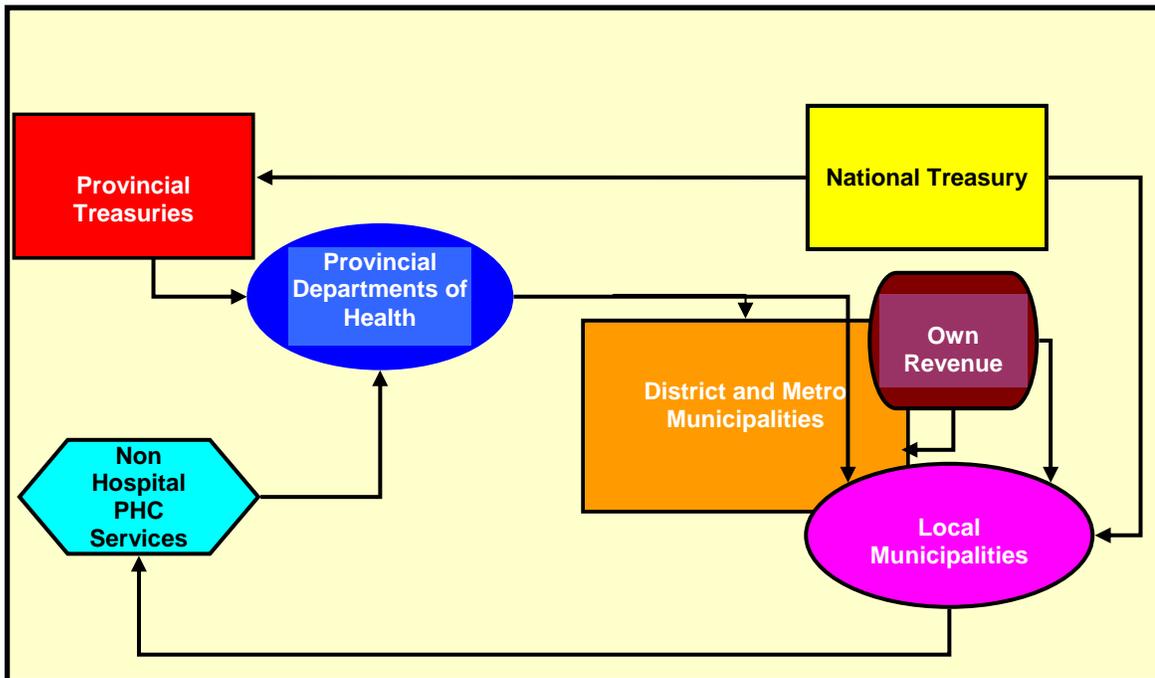
The National Department of Health (NDoH) has approached the National Treasury to address service delivery challenges currently being experienced under the Health Revitalisation Programme (HRP). In the past the NDoH has been fairly unreceptive to PPP's.

Also the HRP has essentially provided full national funding for any given project, which has made PPP's, with their ongoing unitary charges appear a relatively less attractive solution (Pautz, 2007:10).

The Treasury criteria for deciding whether to proceed with such a PPP focus on affordability, demonstrated value-for-money and appropriate risk transfer to the private sector. PPP's have, thus, been seen as mechanisms for, variously, improving efficiency, releasing public sector managers to focus on supporting clinical service provision, shifting the risk of capital investment to the private sector or tackling the public sector's infrastructure backlogs. The Treasury framework has no direct relevance to health care funding, although supporting two hospital co-location projects in which the private partner has taken on the responsibility for financing the infrastructure and equipment upgrade of the private wards (Wadee *et al*, 2004).

Figure 3.1 depicts the flow of Health Sector Funding in South Africa. National Treasury allocates funds to Provincial Treasuries who then allocate these funds to Provincial Health Departments. Provincial Health Departments allocated funds to the District Municipalities who then distribute these funds to local municipalities for provision of health services. One of the problems in the South African PPP area is that services are delivered by municipalities but the guidelines are not applicable to them.

Figure 3.1: Representation of Funding Flows Relating to Provincial Healthcare



Source: Primary Healthcare Funding Flows in South Africa: Health Report (2004:12)

3.10 PPP's in the South African Healthcare Sector

The South African Healthcare sector identified 2 broad sets of PPP's:

- (a) Those that manage relationships, include interactions such as formal and informal dialogue, policy and patient transfer protocols,

For the most part, these facilitate discussion and engagement between the sectors, building trust and providing a foundation for service delivery PPP's.

- (b) Those that support service delivery, include -

- Purchased services – refers to purchasing clinical services,
- Outsourced non-clinical services,
- Joint ventures – can be either a lease or service model,

- Private Finance Initiative (PFI) -raising capital on private money markets for infrastructure investment through a private consortium, and
- Other innovative interactions such as asset swap (Blaauw *et al*, 2004:57).

Non-clinical contracting is common at the provincial level and includes catering, security, laundry and porter services. These are primarily implemented at hospital level care and involve purchased services and joint ventures. The Western Cape Rehabilitation Centre PPP in the Western Cape is an example where some of the services like cleaning, linen and catering are outsourced to the private sector (Blaauw *et al*, 2004:57).

Service model arrangements range from Co-location Agreements (a form of lease arrangement in which spare public hospital capacity is leased to private providers) to the development of differentiated amenities within public hospitals (which may involve an agreement with private funders to allow insured patients to use the better amenities). The nature of PPP's is all-encompassing and may include formal Treasury-approved PPP's, such as the Free State Hospital Co-location Agreements, alongside other forms of interaction that do not necessarily conform to the narrow prescriptions of Treasury's PPP unit. The range of private agents involved in provincial PPP's is diverse, and includes hospital companies, private funders and specialist clinical and non-clinical companies. A new form of outsourcing that is emerging at provincial level focuses on general management functions at facility and other levels.

Private transaction advisors are being employed to manage the Treasury PPP process between provinces, Treasury and private investors/service providers. This is likely to increase as more provinces embark on PPP's that require Treasury approval (Blaauw *et al*, 2004:57-58).

Blaauw *et al.* (2004:57-58) comments that PPP's were identified at all levels of Government, although to a limited extent at the local government level where the term may have been misunderstood. In one case it was applied to private donations for infrastructure investment, which is different from the long-term contractual nature of the Treasury PPP approach. At provincial level, the provincial health department manages the PPP's with considerable support from the national level which include National Treasury and the National Department of Health (Blaauw *et al.*, 2004:58)

The funding and support from National Treasury and the National Department of Health are used to revitalise and equip existing facilities, or to build and equip new ones. This may include equipping facilities with the latest hi-tech medical and non-medical technology, such as the Nkosi Albert Luthuli Central Hospital PPP. Elsewhere the plan is to purchase non-medical equipment through a PFI. The types and forms of PPP's that are implemented vary quite considerably between areas and authorities. For instance KwaZulu Natal is keen on PPP's, Western Cape prefers co-location and Gauteng is in favour of a combination of PPP's and differentiated amenities. One innovative form of PPP's to emerge in the Western Cape is the 'asset swap' in which private investors are offered prime property owned by the province, and in return are required to rebuild and equip facilities in under-served areas (Blaauw *et al.*, 2004:59).

3.11 PPP Healthcare Projects

The National PPP Unit in South Africa currently has a portfolio of 14 health PPP projects of which 5 have reached financial closure. Of these, one project, namely the State Vaccine Institute PPP was driven at a national level; the remaining projects coming directly from the provincial departments (Pautz, 2007:8).

Pautz (2007:9) states: “What is certain is that there is a need for consensus on the application of the PPP model and on the type of projects to be procured. Without the NDoH support and commitment driven within a policy framework, the service delivery imperatives at a national level will still exist for PPP projects. “

3.12 Conclusion

The PPP legislative framework in South Africa provides the private sector protection throughout the reform process. The right legal, constitutional and financial framework is necessary to ensure the lawful implementation and financing of projects. The private sector wants assurance that PPP projects will be honored and thus an appropriate legal framework is imperative for private sector participation in service delivery. The establishment of a PPP Unit in the Minister of Finance’s office in Pretoria sends a signal that PPP’s form part of Government’s investment strategy. It also proves that financial decision makers in Government are closely involved with the work of the Unit. PPP’s are sensitive to legislative environment and political support. The South African Government has established a firm legislative framework and is seen as one of the leaders in the PPP environment in developing countries. This has been demonstrated by visits from the World Bank PPP team who brought countries in Africa and also Vietnam on study tours to the Country in July 2007. The presence of the centralised PPP unit in Pretoria ensures a consistent and coordinated approach to PPP’s.

Chapter 4

THE APPLICATION OF PUBLIC PRIVATE PARTNERSHIPS: AN INTERNATIONAL PERSPECTIVE

4.1 Introduction

Public services are generally considered to be the responsibility of government, whether central, national or local government. Because of the alarming pressure on government budgets it has become clear that government alone cannot provide these services. Governments all over the world have realised that it is an impossible task to render public services with public funding alone and in the last decade governments have become aware of the importance of the private sector as a public service delivery partner. Budget constraints in South Africa have forced provincial governments to curtail budgets for capital projects and maintenance in order to maintain public demand for delivery of services at acceptable standards.

The concept of Public Private Partnerships has been used in France to privately finance public infrastructure since the 17th century. The first concession contracts were awarded for the financing and construction of the Canal de Briare in 1638 and Canal du Midi in 1666 (Grimsey & Lewis, 2005).

While France can justifiably be seen as the founder of PPP's, the evolution of PPP's accelerated in the UK with the Private Finance Initiative (PFI) launch following the decline in investment in the UK, Australia and New Zealand in 1990 (Broadbent & Laughlin, 2003). Governments over the world have established PPP programs to address infrastructure delivery backlogs in their countries. Countries with significant PPP programmes include America, Australia, the UK, Canada, India, Brazil and Japan. An increasing number of countries has started to use PPP's for the provision of health sector

accommodation and related services. The most common form of PPP that has been used is the Design Build Finance Operate (DBFO) model, which has been used for the provision of hospitals and specialist health care units (e.g. Renal Dialysis Unit) in Great Britain and Canada. The most significant evidence of PPP delivering value for money in the provision of health sector accommodation relates to the PFI projects in Great Britain, though the cost savings achieved against the Public Sector Comparator (PSC) on such projects are often less than 5 per cent (Hoffman, 2004:55). The Public Sector Comparator is a risk adjusted costing, by the public sector as a supplier, to and output specification produced as part of the PPP procurement exercise. It is dependent on uncertain forecasts and a great deal depends on assumptions about the time cost of money. Another risk of the PSC is that it can be manipulated to show that the PFI deal is cheaper.

An overview of Public Private Partnerships in countries such as Chile, Australia, The United Kingdom, India, Brazil and British Columbia in Canada, where the concept of PPP procurement has been in operation for some time is given in this Chapter. It entails the history of PPP's in these countries, the models which have been most successfully applied, challenges and lessons learnt: and what should be avoid in implementing PPP's. It gives perspective on the application of the different models used successfully and the types of projects which are pursued as PPP's in the Healthcare sector.

The promotion of PPP's in South Africa rises from an important international development. The World Bank acts as leader in the promotion of the PPP's, by actively preaching the public-private recourse to governments all over the world.

4.2 Chile

The Chilean Government's involvement with PPP's started in 1994 and since then the 36 projects have been concluded with a total value of \$5,5 billion. The PPP environment in Chile has been underpinned by a solid institutional framework, the sharing of risks between the private and public sector and reforms to secure funding from the private sector (Minassian, 2004:30). The Chilean PPP legal framework entails a well defined PPP contract scheme and a clear description of the private and public sector's rights and obligations, which can be an effective mechanism for conflict resolution.

The sharing of foreign exchange and demand risks sharing has also furthered private sector participation. These risks are shared through the provision of guarantees by the Chilean Government. The foreign exchange risk is mitigated by the Government guaranteeing a fixed real exchange rate. A minimum revenue guarantee is granted by the Government to mitigate demand risks (Minassian, 2004:31). The minimum revenue guarantee in Chile covers 70 per cent of the projected revenue flows and this has culminated in capital market funding. The equity funding for PPP projects in Chile is usually 30 per cent of the project budget and this is obtained from international firms participating in projects. In addition to these types of PPP funding Bond funding has also come to the fore in large projects, which are constrained by the size of the Chilean domestic capital markets. Pension funds and insurance companies have also been allowed to invest in bonds issued by companies involved in PPP's.

Contract renegotiations are another feature of the Chilean PPP framework. This has been caused by Government changing the project scope and this has led to financial difficulties for concessionaires. These project scope changes entail the change of design and the request for additional work by Government. Another important feature of the Chilean PPP laws is that in the case of breach

of contract the concession terminates and rebidding takes place. The PPP laws in Chile establish limits to unilateral request hence Government provides compensation to concessionaires for these requests (Manassian, 2004:32).

The Chilean Government has also assumed considerable fiscal commitments under its PPP programs. PPP programs though have not yet full disclosure and reporting requirements. The budgeting and fiscal accounting rules in Chile do not require disclosure of government contingent liabilities. PPP contracts are in the public domain and the public can request information on financial commitments entered into by government (Manassian, 2004:32).

Lessons Learnt

- The provision of guarantees to the private sector has increased participation in the PPP environment. The private sector wants the assurance that PPP contracts will not be cancelled and governments must give these guarantees,
- Rights and responsibilities of parties are clearly spelled out which reduces the chances of disputes and conflict,
- The contract renegotiation provision has led to the solving of liquidity problems but not solvency problems,
- The renegotiations of contracts have resulted in a 15 percent increase in project budgets,
- To limit opportunistic behaviour in renegotiations the Chilean PPP framework provides adequate incentives.

4.3 The United Kingdom

The Public Finance Initiative (PFI) policy in the United Kingdom (UK) was introduced in 1987 with the Channel Tunnel Project. Though the British Government was optimistic that PPP's would be swamped by an innovative

and hungry private sector, the reality was different. The progress of PPP's was disappointingly slow (Grimsey & Lewis, 2005:318).

In an effort to promote PPP's as an alternative procurement option, the Private Finance Panel Executive, the Private Finance Office within the UK Treasury, and Private Finance Units were created (Grimsey & Lewis, 2005:336). The Finance Panel Executive issued guidance notes on the process and on how to write suitable contracts between the public client and the private sector provider. The net effect was yet again limited and in November 1994 the decision was taken that PPP's should be the preferred option for capital projects instead of public sector funding. There were some advantages following the changes in 1994. In 1995 there was £400 million fixed investment arising from PPP projects which had doubled by the end of 1996. By early 1997 about a hundred projects had reached the stage of appointing a preferred private sector partner for the delivery of the service, while about another hundred PPP projects had reached the shortlist stage. By the end of 2005 it was estimated that about 700 PFI projects had been signed by Central and Local Government in the UK across a wide range of sectors including education, transport, health and waste management. At the end of January 2006 the UK Government had already signed of 700 PPP projects with a total value of £44 billion (UK Trade & Investment, 2006).

The Healthcare sector in the UK makes use of different PPP models to build hospitals. A Build, Operate and Transfer (BOT) scheme is a typical form of project financing adopted for a wide variety of types of projects where limited recourse finance is provided and the economic viability of the project depends upon the revenue stream available from the completion of the project (Ashurst, 2007).

In a typical BOT project, the government grants a concession to a special purpose project company under which that company has the right to build and operate a facility, usually for a fixed period of time. The project company raises

the equity funding and borrows from lenders in order to finance the construction of the facility. Equity funds consist of local registered unit trust or foreign equity funds. The intention is that the revenues which the project company receives from operating the facility are sufficient to service the debt incurred by the project company in designing and building the facility, to cover its working capital, its operation and maintenance costs and to provide a return for its equity investors. At the end of the concession period the facility is usually, but not necessarily, transferred back to the Government (Ashurst, 2007).

In the UK the schemes under the Private Finance Initiative (PFI) are also referred to as DCMF (design, construct, manage and finance) and DBFO (design, build, finance and operate). They all relate to the same basic concept, although there are significant variations, for instance the DBFO model, where there is no transfer to the public sector party at the end of the term (a privatisation). Other projects are defined as "concessions", which may (as may be other models) involve the transfer of existing assets from the public sector to the private sector. The objective of the project will determine which variations need to be considered.

Most of the larger health PFI projects are custom-built, so do not necessarily fit into any of the acronyms. The health PFI sector covers a wide range of different areas all with different needs, and so the models while based on BOT and DBFO are all variations of the standard PFI contract to fit the needs of each health project and do not follow a "best practice" model. Recently due to political pressures on PFI schemes and the perceived costs of PFI, some projects have excluded "soft services" and have focussed on the construction and maintenance of the scheme. Soft services include catering, cleaning, laundry, gardening and security. As these schemes are due to run for 20-30 years it is currently difficult to assess them and their benefits. The projects are all subject to political pressure (timeous delivery) from the Government and the

local NHS trusts which will have different opinions and pressures as to how the standard PFI model should be adopted (Ashurst, 2007).

PFI Procurement in the National Health Service (NHS) is organised by the NHS Private Finance Unit (PFU). The role of the unit is to assist in organising procurement timetables, to assist in deal flow and to promote a consistent approach to risk transfer across all health sector PFI projects. To do this the PFU has produced essential guidance to NHS trusts involved in PFI.

One of the main objectives of the PFI initiative was the transformation of public sector bodies from being owners and operators of assets into purchasers of services from the private sector (Hodge, 2005:47). During the 1980's the UK examined the problems which they have experience with public procurement and public service delivery. The outcome was not a satisfactory one. Cost and time overruns were common in most projects. Of the major areas of concern was the conflict between contractors and the public sector on value for money in the design, maintenance and delivery standards (UK Trade & Investment, 2006).

The UK Government assessed a number of PFI contracts in 2006 in terms of value for money.

Examples of success are (UK Trade & Investment, 2006):

- In the transport sector a variety of projects including: roads, bridges and light rail have been undertaken,
- In education nearly 250 new schools have been built or refurbished and new halls of residences have been built for universities,
- 46 new hospitals and 119 other health schemes are in operation,
- 13 PPP prisons have been build and courts of justice and police stations, and

- Other projects include waste management, canals, street lighting, fire stations, Government buildings, leisure centres and social housing.

The lessons to learn from the UK experience:

- The use of different customized health models according to fit specific health needs,
- The introduction of Standard Health Project Agreements,
- Extensive participation is necessary in the process,
- The setting up of task team in 1997, consisting of experts from the public and private sector, their mandate was to look at critical issues in the PPP process and at best practices, and
- Another key success factor has been the involvement of Local Authorities through an agency known as the Public Private Partnership Programme. The agency provides practical support and guidance to all local authorities in England and Wales to enable them to improve their procurement capability, particularly for large projects, through partnership structures.

4.4 Australia

The Australian Government has extensive experience with private delivery of public infrastructure since the early 1980's. In the last decade or so, prior to the establishment of PPP policies in a number of Australian jurisdictions, Australia has had a range of privately financed infrastructure projects spread across sectors, including transport, health, education, justice, defense, energy and utilities. In 2002, overall private sector investment totaled Aus\$55 billion across the energy, water and transport sectors (European Bank, 2005:15).

As one of the countries in introducing PPP, Australia established PPP legislation and policy frameworks from the outset which created an environment for the private sector involvement mainly from international major

investors, thus providing the necessary level of competition to ensure best value for money (European Bank, 2005:3).

The Australian PPP model at the local levels is characterized by budgetary discipline which leads to low debt levels among local authorities which led to a higher credit worthiness and high market confidence. However, in order for the Australian Government to achieve this, the central and local governments had to adopt minimum debt level policies. This explains the concentration of PPP schemes in urban areas where high demand secures high and fast returns on investments. This approach may not be applicable to other countries where infrastructure is mostly supply driven, aimed at driving the local and regional economic development (European Bank, 2005:3).

Australian states have different policy documents governing the identification, establishment and operation of PPP's. These documents draw heavily on the groundbreaking and detailed set of manuals first released by the State Government of Victoria in June 2001. PPP's in Victoria are governed by the Infrastructure Investment Policy for Victoria (1994). Although each state has a slightly different process relating to developing PPP's, they all share common features, often contemplating the same main tasks in the same order (European Bank, 2005:23).

Another feature of the Australian PPP environment is that PPP transactions are open to the international bidders in most cases, culminating in the acquisition of international finance. In countries like France only local bidders are allowed to bid and this has created limited opportunities (European Bank, 2005, 22).

The situation in Australia can be attributed to good due diligence being carried out and major risks mitigated up front, which is of the reasons for their success. The high interest from international investors in PPP's in Australia

reflects the high credit rating of Australia and its local authorities. The adequateness of the legal and PPP framework and the ability of the delivering authorities also secured value for money (European Bank, 2005:21).

The Berwick Community Hospital in Victoria was constructed through the PPP route in 2001. The project is a 229 bed hospital which was completed in 2004. The contract is a 25 year contract with a value of \$378 million. The Project included the design, construction and maintenance of a hospital building, provision of nominated primary medical equipment and provision of various support services. At the end of the 25 year agreement ownership of the hospital will be transferred to the Victoria State (Grimsey & Lewis, 2004:121-122). The contract entails the provision of hospital accommodation services, information technology systems and the maintenance thereof, car parking, security services and the general maintenance of the physical buildings and grounds. The Government pays a unitary payment to the private party for provision of the abovementioned services according to pre determined agreed standards. The contract is a performance linked to specified service output criteria. Build into the contract is penalties if the delivery of services is below the required standards. This entails the deduction from the unitary payment (UP). This is the monthly fee paid to the private partner.

The Berwick Community Hospital project also experienced problems in the development phase with the withdrawal of a preferred bidder. The Project reached financial closure after four years (Grimsey & Lewis, 2004:122-125).

Lessons Learnt

- The involvement from international major investors,
- Detailed set of manual for PPP projects,
- Different processes in different states,
- Good due diligence can mitigate risks up front,

- Contracts are performance linked with specific service output criteria,
- Penalties clauses where services is below required standards,
- Unitary payments to the private sector,
- International investors contributes to a higher credit rating for Australia,
- The satisfactory legal and PPP framework secured private sector investment,
- Withdrawal of a preferred bidder in the Berwick community Hospital project lead to a delay of the project, and
- The project was a 25 year contract which shows that these projects are long-term projects.

4.5 Brazil

Public-Private Partnerships in Brazil were enacted in December 2004. The PPP law and Federal Law No 11.079 were expected to be one of the greatest apparatus for fresh investment in the infrastructure sector allowing the continuing growth of Brazilian record exports (Franco, 2007).

Until the enactment of the PPP Federal Law No 11.079, projects were limited to the so-called 1993 Procurement Law that regulated contracts of up to five years only. Under the PPP law, for example: (i) the private investor's remuneration may be paid, complemented or guaranteed by the public sector; (ii) contracts may not be for projects of less than R\$ 20 million (roughly US\$ 6,7million) because of the cost involved in such projects, (iii) the minimum term of a contract is five years, with a maximum length of 35 years; and (iv) the remuneration of the private investor is conditioned to the conclusion and proper operation of the project (Franco, 2007).

Thus, ordinary projects such as the simple purchase of assets or facilities as well as ordinary concessions are excluded from the ambit of the PPP's. With a PPP project, the State aims at contracting a long term service that may well

entail the construction of a basic facility but the operation and maintenance risks are transferred to the private sector, which is more capacitated to deal with them (Franco, 2007).

As a payment guarantee, the State is for the first time in Brazil allowed to offer assets and securities that it holds in blue chip Brazilian companies, grouped in a special fiduciary fund estimated to have a value of up to approximately US\$ 2 billion. This fund has been created under private law and will be managed by an independent institution, the Bank of Brazil. Thus, in case of default by the contracting public authority, the manager Bank of Brazil is authorized to make use of the fund's resources to cover outstanding payments to the private party, which can also sue the fund's manager if it does not respect the guarantee (Franco, 2007).

The Brazilian PPP legislative framework follows modern concepts of project finance such as the express requirement of the use by the investors of a special purpose company or Special Purpose Vehicle (SPV) to develop the project. An SPV is typically a conglomerate of banks and other financial institutions, set up to join and synchronize the use of their capital and expertise. The law requires that the public sector's share not exceed 70 per cent of the total project and – consequently – that the private investor's share be at least 30 per cent, except if pension plans participate in the PPP, in which case the ratio may be 80/20 (Franco, 2007:2).

Finally, one of the innovations included in the new statute is the express authorization for the use of arbitration as a dispute resolution mechanism. This is essential for the credibility of the PPP system so that the private sector trust can be secured (Franco, 2007:2).

The Brazil Government contracted private firms in Bahia to manage new public hospitals which was constructed and finance by government. The reason

behind the Government approaching the private sector internationally was to transfer operational risks, improving the quality of medical care, and increasing service efficiency. Through annual funding contracts can be extended for five-year periods, the private companies recruit staff, manage facilities and provide medical services for all patients coming to the hospital. The Government pays for medical services based on a target volume of patients and the operators receive reimbursement by achieving at least 80 per cent of the target (Rondinelli, 2007:8).

Lessons Learnt

- Private sectors remuneration is guaranteed by the Government,
- Projects must be a minimum term of 5 years,
- Remuneration of private sector conditioned to the conclusion and proper operation of project,
- The creation of special fiduciary fund in case of public sector default;
- Private investor's share in a SPV must be at least 30 per cent,
- The use of arbitration as a dispute resolution mechanism, and
- The contracting of private firms internationally.

4.6 India

The PPP industry in India is relatively new as in South Africa and Brazil. Cities like Visakhapatnam and Tirupur have been implementing large-scale private financing contracts in water. The State of West Bengal in India has recorded successes in housing and health projects.

The PPP agreement between the Indian State Department of Health and the Karuna Trust signifies a new approach. The contract entails the management and operation of the health centers to the trust. The Trust operates seven primary health centers, two public health units, and three health centers. The

Government provides the building and equipment, furniture, supplies and pays 75 per cent of the staff salaries. The Trust is responsible for the remaining 25 per cent. The Trust receives the facilities and uses its own funds for whatever is needed, including renovation, equipment, furniture and beds (Annigeri, 2004:17).

The model has been successful and the Government is contemplating improving their subsidy to 90 per cent to encourage more non governmental organisations (NGO's) to become involved in this type of contractual arrangements (Annigeri, 2004:17).

Despite these projects, the Country continues to face huge gaps in the demand and supply of critical social and economic infrastructure and services. The growing economy, industrial activity, burgeoning population pressure, and all-round economic and social advance have led to bigger demand for better quality and coverage of water and sanitation services, sewerage and drainage systems, solid-waste management, roads, seaports and power supply. Increased demand has put the existing infrastructure under tremendous strain and far outstripped its supply (Asian Development Bank Report, 2006:27). This has prompted the Indian Government to pursue other procurement options to reduce the backlogs. Private sector participation has thus become a crucial alternative in India.

Since 1991 eighty six (86) PPP projects have been awarded, totaling about 340 billion Indian Rupees, in twelve states and three central agencies in India. A key reason for the slow pace of generation and submission of PPP projects in India is that proposals from the states have been lack of expertise in the project sponsoring agency to structure and evaluate PPP proposals. This is a major impediment in India which other countries can learn from in the PPP arena. The lesson is that PPP proposals should be properly structured and evaluated (Asian Development Bank Report, 2006).

This problem can be overcome by establishing a PPP Unit and a National PPP training programme. This will help to build the necessary skills and training capacity in PPP's (Asian Development Bank Report, 2006).

The Asian Development Bank Report (2006) highlighted the commitment of the Indian Government to raise the investment in infrastructure from its existing level of 4.7 per cent of gross domestic product (GDP) to around 8 per cent. Infrastructure shortages in the Country are proving a key binding constraint in sustaining and expanding India's economic growth and making it more inclusive for the poor. The Indian Government is actively promoting PPP's in the key infrastructure sectors of transport, power, urban infrastructure, and tourism, including railways. Different formats and bidding procedures agreements overall execution exist in India. The private sector has emphasized the need for standardization of pre qualification and bidding procedures to ensure efficiency, predictability and ease of approval processes (Asian Development Bank Report, 2006:27).

A key impediment to successful commercialization of projects in India has been the absence of rigorous project development. Many of the projects bid out by the Indian Government have been inadequately structured and were unsuitable for PPP's. This has led to an appropriate definition of project unbalance contractual documentation, poor bid responses, extended periods of technical and financial closure, delays in project implementation, cost overruns and claims, substandard quality of assets and poor levels of service (Asian Development Bank Report, 2006:26-30).

Lessons Learnt

- The Indian Government involved trust organisations to assist with health service delivery,
- The Government provides building and equipment,

- The Government pays 75 percent of the Trust's staff salaries,
- The Trust uses its own funds for renovations, equipment and beds,
- The lack of expertise to structure and evaluate PPP proposals,
- The Government invested more in infrastructure,
- Promotion of PPP's in key infrastructure sectors such as transport, power, tourism and railways,
- The lack of standardized procedures has led to inefficiencies;
- The absence of rigorous project development,
- Projects were inadequately structured and unsuitable for PPP's,
- Delays in project implementation,
- Problems with contract documentation, and
- Poor bid responses.

4.7 British Columbia in Canada

In British Columbia, a Province in Canada, the PPP model has been in progress for a number of years from 1980 and has been successful. This can be attributed to a strong and dedicated commitment by the Government to ensure quality public infrastructure delivery that demonstrates value for money for taxpayers. The Government committed itself to those projects that are well suited for PPP arrangements and these contracts are pursued only after rigorous market sounding, feasibility studies and the development of business cases (Carson, 2004).

In 1993 the Toronto Hospital, which was a public hospital, outsourced some of its services to a PPP. Because of the complexity of the Hospital operations and the ongoing budgetary problems forced the Hospital to look for external skills and alternative resources. The management decided to outsource some of the non core services to a PPP. This included capital equipment procurement, the outsourcing of labour, property management such as parking lots and residence building (Marasco & Johnston, 2007).

PPP's in British Columbia are driven by the value for money test which is a function of the robust competition of the PPP procurement process and the efficient allocation of risks. An essential element of these factors is careful analysis to ensure taxpayer's interests are protected. Furthermore the international market has been noticing that the PPP opportunities in British Columbia are flowing. Prove of the global interest in British Columbia's PPP market is demonstrated by, for example, the establishment of Macquarie and ABN Amro Bank offices in Vancouver, both of whom are major players in the international PPP market.

The Government has also placed a lot of emphasize on solid project management as a critical factor for successful PPP agreements (Marasco & Johnston, 2007).

One of the PPP projects is the Academic Ambulatory Care Centre which was a combine effort between the State and the University of British Columbia. It entails a 34,000 square meter facility which was developed for Vancouver Coastal Health Authority and the University of British Columbia. The facility supports approximately 600 professionals, hundreds of medical students and an estimated 600,000 annual patient visits. It was the Province's first PPP project in the health care sector. The private sector partner is Access Health Vancouver and is comprised of a number of organizations with expertise on similar projects, including PCL Constructors, IBI/HPA, BLJC/Johnson Controls and ABN AMRO (Marasco & Johnston, 2007).

The estimated life cycle savings to taxpayers was estimated at \$17 million. Future developments of PPP's in British Columbia is focused on the transportation, health, recreation and advanced education sectors. The pursuance of PPP's in British Columbia PPP arena has culminated in the Government luring major banks like ABN Ambro to the Country to finance PPP

projects. This has led to the private party becoming involved in PPP's and a more open minded approach to the concept of PPP's (Marasco & Johnston, 2007).

The ongoing standardization of process and risk allocation has led to reduce transaction cost and duration for both the public and private sectors. The involvement of key stakeholders and active listening to the market has led to further streamlining of process and competition (Marasco & Johnston, 2007).

Lessons Learnt:

- PPP projects are only pursued after feasibility studies has been done,
- The PPP process is characterized by sound business cases,
- The proper allocation of risks,
- The Canadian Government place a lot of emphasis on project management,
- Combine effort of Government and Universities,
- The Government has been able to lure banks like ABN Ambro to the Country to finance PPP projects,
- Careful analysis of projects to ensure taxpayers interest are protected, and
- A more vigorous approach to the concept of PPP's.

4.8 Conclusion

The international perspective shows that PPP's are complex, demanding and time-consuming but that under the right conditions, and in the right sectors, they can offer significant benefits to government, the private sector and consumers. They have been generally more successful in sectors such as ports, telecommunications and school construction, health facility construction, roads construction, transport, eco-tourism projects and power and water

services. A recurring theme is that for PPP's to be successful, governments need to undertake thorough feasibility studies that address the issues of affordability, value for money and risk transfer.

PPP's are an important instrument in creating an environment favorable to the normal functioning of business and the attraction of private investment, an essential element in generating employment.

Countries have shown that PPP's can be utilised to address poverty issues. It is thus incumbent upon governments, especially those in the developing countries to embrace the PPP concept to improve the quality of life for the poor. Countries have tried different mechanisms to lure private investors. Government guarantees are needed to make the PPP environment attractive to private investors. Some of these include financial guarantees and a sound legislative framework.

The efficient control over infrastructure development leads to direct benefits in economic growth, poverty alleviation, and environment sustainability only if it provides services that respond to effective private sector's open market factors (supply and demand factors determining the price) and does so efficiently. To ensure efficient, responsive delivery of infrastructure services by provincial departments in South Africa, incentives need to be changed through the application of three instruments namely commercial management, competition and private sector involvement.

The provision of infrastructure needs to be conceived as a service delivery industry that responds to customer demand and is measured by customer satisfaction. The high willingness to pay for most infrastructure services, even by the poor, provides greater opportunities for user charges. Private sector involvement in management, financing, or ownership will in most cases be needed to ensure a commercial orientation to infrastructure. Competition is central to public procurement whereby tenders encourage private sector companies to come forward with innovative ideas. Competition gives consumers choices for better meeting demands and puts pressure on suppliers to be efficient and accountable to users.

Chapter 5

PUBLIC PRIVATE PARTNERSHIPS IN THE SOUTH AFRICAN HEALTHCARE SECTOR- CASE STUDIES

5.1 Introduction

Throughout the developing world, health service delivery is provided by both governments and the private sector. Some of these services can be rendered by the private sector and the beneficiaries of these services are forced to make a monetary contribution. The extent to which people can afford these services largely depend on their income and their ability to pay. In South Africa the reality is that the vast majority of the public is not capable to pay for these services and rely fundamentally on the state to provide these services. Yet, given the challenges posed by the healthcare environment in South Africa Government has no choice than to turn to the private sector to look at alternative service delivery options. Though Public Private Partnerships is not the only alternative it could well be a viable procurement option.

As part of its comprehensive development framework the World Bank encourage PPP's as an alternative procurement option to countries. Poorer countries are experiencing more pressure on their public finance budgets and the brain drain of health professionals to developed countries. This puts more pressure on governments to meet the growing demands of its citizens.

In South Africa the National Treasury is continuously encouraging the Provincial Health Departments to look at PPP's as one of the sources of funding and procurement options in reaching its goals. To date few PPP deals have been signed in the Health Sector. The reasons are not clear as to why Departments are reluctant to pursue PPP procurement but one of the reasons

is that little research and knowledge has been done to determine its success. This Chapter examines three PPP projects in the South African Healthcare sector and the lessons learnt from these projects. The case studies have been divided into three phases. The first phase of a PPP is the Project Inception. It reflects on the registration of the project, the appointment of a project officer and the appointment of the transaction advisor. The second phase deals with the Feasibility study. It contains the motivation for the project including the needs analysis, option analysis, project due diligence, value assessment, economic valuation and the procurement plan. The third phase is the Procurement phase which fleshes out some of the practical issues regarding Treasury Approval I, II and III.

5.2 Reason for PPP Procurement option in Health

According to KPMG (2006:12) there are certain objectives which drive health departments to use PPP's as a procurement option. These objectives are:

- to obtain private sector efficiency and know-how, as this is their core business,
- output specification that could address the non-core needs of the department, thus enabling the Health department to focus on fulfilling its core functions (health service delivery) and quality of care,
- preventative maintenance on the buildings and medical and therapeutic equipment, thereby ensuring the environment and equipment used are appropriate and in an optimal condition for treatment of patients,
- less pressure on the limited capital budget for addressing the departments medical and therapeutic equipment needs,
- obtaining economies of scale in terms of combining the various outsourcing contracts and in-house functions,

- Services would be delivered against appropriate and measurable output specifications, which is currently not the case,
- Payment for services would be linked to the quality of service provision, and
- improved governance whereby the department oversees performance against output specification managed by a single entity.

5.3 South African Health Sector Case Studies

The following section gives an overview of three Health Case studies in South Africa. It outlines the processes which was followed and also examine the compliance with the National Treasury guidelines. The PMFA led to the development of the PPP strategic framework in December 1999. The PPP guidelines were only published in June 2001 whilst the Health PPP of the Inkosi Albert Luthuli Central Hospital and the Universitas Hospital in the Free State were already in process.

5.3.1 Case Study One: Inkosi Albert Luthuli Central Hospital (IALCH)

5.3.1.1 Background

The idea of a large new hospital in the Cato Manor suburb of Durban began in the late 1980s, with the original plan being that it would be a teaching hospital with 1000 beds. However, this plan changed in the mid-1990s, when it was decided that it should rather be an 850-bed referral hospital and not an academic institution. The reason for this decision was because of the challenges faced by teaching institutions. Institutions involved in teaching accept a wide range of referrals and provide services to a variety of patients. The involvement of universities and research funders are also crucial in an academic institution. It involves different types of stakeholders and it is

sometimes difficult to come to an agreement which will satisfy all stakeholders. The Provincial Government's vision was to create one of the best hospitals in the Country, using cutting edge technology. It intended that this hospital become the flagship for the highest level of medical care in the Province when it opened. Construction of the building began in 1996 and was still being completed when the PPP process was initiated in 2000 (National Treasury Case Studies, 2007).

The Kwazulu Natal Department of Health (KZNDoh) appointed a transaction advisor consisting of representatives from a number of different disciplines, and led by Pricewaterhouse Coopers, which set about conducting a feasibility study on the Project (National Treasury Case Studies, 2007).

The Inkosi Albert Luthuli Central Hospital has been seen as a pathfinder project, the reasons being that it was the first PPP project to run its entire course under the regulations issued in terms of the Public Finance Management Act (PFMA) 1999 (which were published on 9 April 2000) (National Treasury Case Studies, 2007).

5.3.1.2 The methodology which was followed to procure the PPP

In researching the Nkosi Albert Luthuli PPP agreement of the Kwazulu Department of Health it is important to examine how their process was in synergy with the process as contained within the PPP Manual provided to all departments within South Africa. The PPP Manual (2004) provided for different phases to which Departments should adhere to in the PPP process.

These stages are:

- Appointing a project officer and a project team,
- Appointing a transaction advisor,
- Preparation of a feasibility study,

- Prepare a request for qualification (The implementing department invite firms who qualify technically and financially to undertake the project to register. Only firms who made the short list of pre-qualified bidders are allowed to enter the RFP stages),
- Prepare a request for proposal,
- Negotiate contract with preferred bidder, and
- Sign contract

5.3.1.2.1 Phase I: The Inception Phase

(a) Appointment of Project Officer and Project Team

Mr Siphon Buthelezi was appointed as project officer and the project team consisted of officials of the Kwazulu Natal Department of Health. Mr Buthelezi was later replaced by the Chief Financial Officer (CFO) of the KZNDoH, Herman Conradie.

(b) The appointment of the Transaction Advisor

The Ezempilo Consortium was appointed as transaction advisor in March 2000. The Consortium conducted a formal feasibility study into the project using a scoping report that the KZNDoH had prepared in conjunction with the National Department of Health and other stakeholders as a basis.

5.3.1.2.2 Phase II: The Feasibility Study

(a) Treasury Approval I

According to the Practice Manual issued by the PPP unit of National Treasury (which was only published in 2004 and therefore not available to the parties at the time of conducting the feasibility study) a department must do a feasibility study to determine if the project has met the requirements of affordability, value for money and risk transfer. The feasibility study which was done indicated that the proposed PPP reference was affordable as there was sufficient budget available from the budget of the Kwazulu Natal Department of Health to pay for the PPP and also illustrated initial value for money (National Treasury Case Studies, 2007).

The purpose of this analysis was to consider alternative funding mechanisms for delivering the preferred option. In this case, the cost of delivering the non-clinical services using public funds (the Public Service Comparator) was compared against the cost of using private funds through a PPP (the “PPP Option”) (National Treasury Case Studies, 2007).

Conradie (2007) comments that it was difficult to construct a credible public sector comparator (PSC) for the IALCH. He argues that state information was simply not up to scratch and this made it hard to understand what the costs really would be for the public sector to deliver these services itself. Moreover, there was no precedent in South Africa for a PPP of this nature, which meant that there were no existing predictors, or output specifications, for example, upon which to base calculations. Comparisons between what IALCH would do and what the other hospitals in the province or in South Africa were doing at the time could not provide an accurate indicator, because they were nowhere near as sophisticated as IALCH would be. Even Pretoria Academic Hospital

did not have the same specifications for its information technology system (National Treasury Case Studies, 2007).

On 20 December 2000 the National Treasury granted approval of the feasibility study to the KZNDoh on the following conditions: (National Treasury Case Studies, 2007)

- That the KZNDoh will still bear ultimate responsibility for ensuring that the IALCH Project is affordable in terms of the budget,
- that the use of funds for the up-front purchase of equipment should be dealt with in the contract in such a way as to ensure the security of the purchase,
- that the PPP unit will continue to provide technical assistance, to ensure that the RFP documents transfer risk appropriately,
- that the project design will include the available budget less a margin of safety, as a specified limit is not to be exceeded, and
- that the KZNDoh ensure that the contract with the service provider is signed only after confirmation of all budgetary commitments, which must not deviate significantly from what is contained in the original feasibility study.

5.3.1.2.3 Request for Qualification (RFQ)

The RFQ is the process to limit the number of private parties eligible to participate in PPP procurement by carrying out a pre-qualification exercise. National Treasury recommends five critical considerations for the RFQ stage:

- A minimum of three and a maximum of four pre-qualified bidders,
- Bid Bond to mitigate the risk of pre-qualified bidders dropping out of the process,
- BEE targets of pre-qualified bidders should be in place,

- Parties eligible to participate in bidding should not be on the blacklist of the Office of the State Tender Board, and
- Conflict of interest no members of any consortium should be a member of another consortium at any stage of the procurement process (PPP Manual, 2004).

The RFQ was done in November 2000. According to the Treasury Regulations, the Government institution should not commence with the procurement phase until such time as Treasury Approval I has been obtained. However, the information memorandum notes upfront that “a dual process of obtaining approval of the National Treasury and pre-qualification procedures are taking place. It goes on to state that the required approval from National Treasury has not yet been obtained, but is expected before the pre-qualification process is finalised. According to documents which have been supplied to National Treasury, this was granted on 20 December 2000 (National Treasury Case Studies, 2007).

The RFQ for the Inkosi Albert Luthuli Central Hospital was much less formal than the Request for Proposal (RFP), and appears to lack quite a bit of the information recommended by the Manual. More particularly, the RFQ:

- does not talk about a bid bond,
- does not contain sufficiently detailed disclaimers for Government,
- fails to set out the KZNDoH’s affordability ceiling,
- does not deal with financing requirements in any great detail, and
- fails to give detail of how the bids will be evaluated (National Treasury Case Studies, 2007).

5.3.1.2.4 Phase III: Procurement

Treasury Regulation 16.6.1 (of the 2001 regulations), provides that prior to issuing any procurement documentation, National Treasury must approve such documentation as well as the draft PPP agreement. It is not clear from the National Treasury information when the approval was granted.

5.3.1.2.4.1 Request for Proposals (RFP)

On large, complex or innovative PPP projects, considerable value can be yielded

if pre-qualified bidders participate in the preparation of the final RFP. While the feasibility study would have tested the market, some key market responses can now be tested in detail with parties which have demonstrated their knowledge and capacity related to the project. Bidder participation in preparing the RFP can also lead to a shorter bidding process and greater bidder confidence.

Four consortia pre-qualified in terms of the RFQ. These were Hospitalia Consortium, Impilo Consortium, Kobimed Consortium and Mkhumbani Consortium. An RFP was issued to these shortlisted bidders on 15 January 2001 (National Treasury Case Studies, 2007).

The RFP document supplied by the National Treasury is a detailed and structured document. It meets nearly all of the recommendations set out in the PPP Manual. It includes deals extensively and comprehensively with bid formalities. It also gives comprehensive general background information to the project, which provides the bidders with a clear understanding of what its objectives are. It gives details of how the bidders should construct their proposals, and sets out the essential minimum requirements (technical, financial and legal) that should be included in the bids. Furthermore it deals

with the service specifications which are output-based and invites bidders to come up with a performance monitoring system (National Treasury Case Studies, 2007).

The documents specify that Facilities Management services must comply with applicable laws of South Africa and it imposes similar standards on medical equipment. The financial and legal proposal deals with all financial aspects in detail. It sets out the KZNDoH's affordability ceiling and invites the bidders to come up with their own payment mechanisms including an unavailability/underperformance deduction regime. It also provides the bidders with extensive detail regarding the financial model which they are expected to produce. Legal aspects are not dealt with in such detail. The RFP is detailed and clear about the comments and inputs which it expects from bidders, and the form that their proposals should take. This information is reiterated throughout the document. The RFP did not deal with the evaluation process at all, nor did it set out the evaluation criteria, which the PPP Manual says should be included (National Treasury Case Studies, 2007).

5.3.1.2.4.2 Treasury Approval III

In terms of the regulations in force at the time that the PPP Manual was prepared, Treasury Approval III should be obtained before signing of the concession agreement. However, the 2001 regulations provide that after the procurement procedure has been concluded but before the signing of the PPP agreement, the institution must obtain relevant Treasury agreement to future budgetary commitments which must be denominated in Rands. National Treasury's approval for the signing of the concession agreement was granted in October 2001. The letter explained that the annual fee payable under the PPP had increased from R230 million in the feasibility study, to R250 million at the time the application was made. It states that this was because certain functions have been moved from the KZNDoH to the private party, which it

says improves on risk transfer and accountability, and does not present problems as far as budgetary constraints are concerned, because these are expenses which the KZNDoH had to budget for in any event. The letter also points out that the exchange rate has an important impact on the project because of the significant imported component, and that the exchange rate had weakened by over 20 per cent since preparation of the feasibility study (National Treasury Case Studies, 2007).

5.3.1.2.4.3 Signing of Contract

The KwaZulu Natal Department of Health (KZNDoH) signed a PPP agreement with Cowslip Investments (Pty) Ltd, who made an initial payment and all subsequent unitary payments in return for deferred shares in Impilo Consortium for the delivery of services to the IALCH in December 2001.

Lessons Learnt

- The scope of the project changed because it was decided that it should rather be an 850 bed hospital and not an academic hospital, departments need to make sure that they know what they want from the start,
- The utilisation of cutting edge technology is important to ensure quality services and long-term cost savings. Outdated technology creates a risk because of high replacement and maintenance cost,
- Construction began in 1996 while process was still underway. This is risky because the project was not yet approved by National Treasury. The project could have been disapproved which would resulted in fruitless expenditure,
- A feasibility study was done by Price Waterhouse Coopers,
- Exchange rates fluctuations should be taken into account, and

- The annual fees in the feasibility study increased from R230, 3 million to R250 million because of the change of scope.

5.3.2 Case Study Two: The Universitas and Pelonomi PPP

5.3.2.1 Background

In mid-1996, the African National Congress (ANC)-led Government of South Africa launched its macroeconomic strategy, the Growth, Employment and Redistribution Program (GEAR). This Economic Policy called for a restructured public sector to increase the efficiency of both capital expenditure and service delivery. Against this backdrop, the Free State Department of Health (FSDoH) had restructured Bloemfontein public hospitals, which were previously classified along racial lines. Thus, instead of having two tertiary hospitals, with Pelonomi serving the black population and Universitas serving the white, the intention was to make Universitas a tertiary hospital and Pelonomi a regional hospital. But due to logistical problems some tertiary functions such as the trauma unit, burns unit, ARV centre of excellence, renal dialysis, maxilla facial, intensive care and the spinal unit remained in Pelonomi (National Treasury Case Studies, 2007).

Universitas Hospital, located on the up market western side of the city, had excellent infrastructure and a good maintenance record. It also had two unutilised 30-bed wards and a number of unused facilities, including theatres. Pelonomi Hospital is located to the south-east of the city and historically served township residents. It was built in 1964 and was in a bad state of disrepair in many areas, particularly the 7-storey Block I, which was in a dilapidated condition (National Treasury Case Studies, 2007).

The restructuring of services at Universitas and Pelonomi, was not to the latter's benefit. Indeed the change resulted in a number of its buildings standing empty – only 720 of its 1 400 beds were being utilised. In addition, the neighbouring communities were looting the buildings for anything they thought would be useful – including plumbing, which led to constant flooding of the facilities. The consequence was increased costs for the FSDoH (National Treasury Case Studies, 2007).

What made the idea of a PPP at Universitas and Pelonomi hospitals attractive was that it would solve Government's financial, maintenance backlog and excess capacity problems simultaneously. However, while partnering with Universitas was attractive to the private sector, the same principle could not be applied for Pelonomi because of its maintenance backlogs and location. To overcome this problem, the FSDoH decided to combine the two hospitals as a package in inviting tenders for the project. Thus, the private sector could not take Universitas without taking Pelonomi as well. At Pelonomi, the FSDoH wanted to achieve the following objectives through the PPP:

- utilisation of space that exceeded the needs of the hospital,
- utilisation of equipment that exceeded the needs of the hospital,
- provision of private hospital facilities in areas of Bloemfontein previously not provided with these facilities,
- the general improvement in the nature and appearance of the Pelonomi hospital precinct, and
- improvements in the public sector facilities by means of additional revenue generation and upgrades undertaken by the private partner (National Treasury Case Studies, 2007).

At Universitas, it aimed to achieve the following objectives:

- utilisation of ward space that exceeded the needs of the hospital,
- optimisation of the use of theatres and other equipment, especially equipment of a highly specialised nature,
- provision of tertiary and academic healthcare services to private sector patients,
- retention of professional staff within the public health sector; and
- enhancement of the capability and reputation of Universitas as a leading academic hospital through the benefits of the partnership (National Treasury Case Studies, 2007).

5.3.2.2 The methodology which was followed to procure the PPP

Because this PPP started before the National Treasury's PPP Regulatory Framework and PPP Manual was introduced, the FSDoH did not conduct a formal option analysis process. The FSDoH chose to go the PPP route because it served the needs of both the private and the public sector. In addition, although there would be no immediate cost to use the buildings, it would end up being an expensive option and unwise use of resources, because looting of the buildings would continue (National Treasury Case Studies, 2007).

Before finally making the decision to proceed with a PPP, the FSDoH canvassed the support of Local Government, the Premier, the MEC of Department of Public Works and the MEC for Finance. All these role players supported the project and the Department was able to proceed (National Treasury Case Studies, 2007).

The project comprised the offer of space within, and access to, facilities at the Pelonomi and Universitas Hospitals. In exchange, the private party was expected to complete certain upgrade work for the Department at Pelonomi and to make a payment for the right to use certain facilities. The fixed concession fee month is payable in advance at the first day of each month for the duration of the concession period. The amount is fixed at forty thousand rand per month for the first sixty months after which it is increased by Consumer Price Index (CPIX) annually for the remainder of the concession period. The Free State Department of Local Government and the Development Bank of South Africa contributed additional financial support (National Treasury Case Studies, 2007).

The PPP is regarded by Netcare as the first true PPP in the Healthcare sector. The net-effect of the agreement is co-location of private healthcare facilities within a public healthcare venue. This co-location agreement was also a first of a kind in South Africa.

The Pelonomi Hospital project:

- Comprise of 143 beds,
- Has a contract period of 16 to 12 years (National Treasury Case Studies, 2007).

The Universitas Hospital project included:

- Two floors of Universitas Hospital,
- 127 beds (National Treasury Case Studies, 2007).

5.3.2.2.1 Phase I: The Inception Phase

(a) Appointment of Project Officer and Project Team

Dr. Victor Lithlakanyane was appointed as project officer from inception to 11 November 2004.

(b) Appointment of the Transaction Advisor

The transaction advisor for this Project, Ignis Pty Ltd, was appointed in November 2000.

5.3.2.2.2 Phase II: The Feasibility Study

No feasibility studies documents were supplied by the FSDoH to the National Treasury.

5.3.2.2.3 Request for Qualification (RFQ)

While the PFMA was being finalized, the FSDoH embarked on a Registration on Capability (ROC) process, whereby interested parties were invited to submit proposals. As a result of this process, three organizations were advised of their eligibility to tender firm proposals for the PPP. They were Afrox Healthcare, Medi Clinic and the consortium comprising CHM and Netcare. Following a review of the legal framework and the process to date, the transaction advisors, together with the project management team, compiled a detailed request for proposal (National Treasury Case Studies, 2007).

5.3.2.2.4 Phase III: Procurement

5.3.2.2.4.1 Request for Proposals (RFP)

The RFP set out the objectives of the project, details of the facilities to be made available, terms and conditions of the bid process and a draft concession agreement to be entered into between the successful bidder and the Department.

The RFP was subject to review by the PPP Unit of National Treasury and was approved in terms of the Treasury Regulations (which has subsequently come into force). It was issued on 12 March 2001 with a closing date for submissions of 14 May 2001. According to the RFP the risk of assessing the condition of the facilities lay with the private partner. Although the public sector staff would assist in the inspection, the public sector would give no warranties on the accuracy of such information. The RFP listed the facilities that would be for the exclusive use of the private partner, those that would be shared between the parties, and support services. It stated that in addition to upgrading the two Hospitals, the concessionaire would be required to pay the FSDoH for the use of the facilities in Universitas and Pelonomi (National Treasury Case Studies, 2007).

The structuring of the project required considerable attention to determine the optimal transfer of risk as well as how to structure the payment mechanism so as to ensure compensation for risk transferred. The FSDoH gave a comprehensive draft project agreement to the bidders to ensure that these issues were adequately understood before proposals are submitted. The responses would determine how this new approach to co-location partnerships could roll out in other provinces (National Treasury Case Studies, 2007).

In order to familiarise bidders with the projects, the FSDoH held a site visit and briefing at the two Hospitals on 29 March 2001. The site visit was attended by representatives of all three bidders as well as members of the Hospitals, the Department and transaction advisor. At the request of the bidders at the site visit, the closing date for submission of bids was extended to 15 June 2001 (National Treasury Case Studies, 2007).

5.3.2.2.4.2 Treasury Approval III

The 2001 Regulations required approval from National Treasury and the authorization was granted on 21 May 2002 and included a request for approval on affordability, value for money and risk transfer.

5.3.2.2.4.3 Signing of the Contract

Netcare signed a PPP agreement with the Free State Health Department for the Universitas and Pelonomi Hospitals in Bloemfontein. This agreement entails the use of spare capacity within both institutions. The estimated Net Present value of the agreement is about R145, 8 million for the Free State Department of Health (National Treasury Case Studies, 2007). The reduced fiscal burden due to the capital investment from the private sector will enhance the efforts of the FSDoH to cope with other health projects.

Lessons Learnt

- Partnering with Pelonomi Hospital was not attractive because of its maintenance backlogs and location,
- Site visits was conducted by all three bidders,
- The combination of the two Hospitals as a package addresses capacity problems in both institutions,

- The FSDoH canvassed for additional financial support from the Department of Local Government and the Development Bank of South Africa,
- The rigour of processes such as risk allocation were compromised,
- The project negotiations took longer than expected and the project slowed down, which led to an increase in cost. Enough time should be allocated for negotiations,
- The restructuring of services at the two Hospitals was not to the benefit of Pelonomi because it resulted in a number of buildings standing empty,
- Partnering with Universitas was attractive to the private sector, because of its up market location,
- Partnering with Pelonomi was not attractive to the private sector because of its maintenance backlogs and location, and
- The combination of the two Hospitals as a tender package negated the problem of Pelonomi. The lesson is that government departments need to be innovative.

5.3.3 Case Study Three: The Humansdorp District Hospital

5.3.3.1 Background

The Humansdorp PPP project was initiated on 26 April 1999, before the promulgation of the Treasury Regulations under Public Finance Management Act (PFMA) 1999. The Eastern Cape Department of Health (ECDoH) set the process in motion by placing an advertisement in the Eastern Province Herald inviting proposals from the private sector. Four proposals were received, from Afrox Healthcare (Pty) Ltd (Afrox), Netcare, Dries Bekker and the Malesela Hospital Group respectively. After an evaluation procedure Netcare and Afrox were identified as complying with the minimum requirements and were shortlisted (National Treasury Case Studies, 2007).

In order to differentiate further between the two proposals the ECDoH then formulated a wish list, on the basis of which the two parties were asked to update their proposals. These were duly submitted on 13 March 2000. In the ECDoH's opinion, Netcare's revised proposal amounted to a Private Finance Initiative, offering a loan to the state to fund the upgrading of the Hospital. This failed to address the needs of the ECDoH, and was therefore not pursued any further because it was not in line with Government policy on borrowing, because Government does not borrow from Private Companies. Afrox (or more particularly a joint venture between Metropol Hospitals, an Afrox Healthcare group company, and Season Star Trading Close Corporation, which later chose the name Metro-Star Hospital as its trading name) was accordingly identified as the preferred bidder in June 2000 (National Treasury Case Studies, 2007). The project outputs were:

- The revitalisation and upgrading of the Humansdorp Hospital,
- The establishment of a private health facility at the Humansdorp Hospital,
- Shared use of medical facilities and services,
- Facilities management services by the concessionaire at the Hospital,
- Revenue sharing by the concessionaire with the ECDoH, and
- Socio-economic benefits (National Treasury Case Studies, 2007).

The total capital investment of the project was relatively small. The private sector contributed R13 million and the ECDoH contributed R1,5 million. The project close-out report indicates that a complete Report regarding the process followed was submitted to the Tender Board on 14 July 2000, requesting that a presentation be made to the Board in order to proceed with the project.

The project was then brought to the attention of the National Treasury PPP unit, which recognised that there was value for money in it, and therefore

recommended that it be pursued. Note that the National Treasury PPP Manual was only published in 2004 and was not yet available.

5.3.3.2 The methodology which was followed to procure the PPP

The PPP unit recommended that transaction advisors (TA) be appointed to facilitate the process and to ensure compliance with the Regulations. The team was appointed in November 2001, comprising financial and legal advisors, on the understanding that the ECDoH would provide all medical expertise required by the TA in completing its tasks (National Treasury Case Studies, 2007).

According to the project close-out report, the need for the project arose from rapid population growth in the Jeffreys Bay area and a consequent shortage of hospital beds. Furthermore, a needs analysis conducted by the Department of Public Works showed that the existing Humansdorp Hospital was in desperate need of upgrading and renovation. The state's revenue collection was generally problematic, and for all these reasons the possibility of a PPP was investigated by the ECDoH.

The project outputs were:

- revitalisation, refurbishment and upgrading of the existing hospital,
- establishment of a private health facility at the existing hospital,
- shared use of medical facilities and services,
- facilities management services by the concessionaire at the hospital,
- revenue sharing by the concessionaire with the ECDoH, and
- socio-economic benefits (National Treasury Case Studies,2007)

5.3.3.2.1 Phase I: The Inception Phase

(a) Appointment of Project Officer and Project Team

Mr Eugene Jooste was appointed as Project officer by the Eastern Cape Department of Health.

(b) Appointment of the Transaction Advisor

The transaction advisor team consisting of Ignis and PHI Attorneys were appointed in November 2001 comprising financial and legal advisors.

5.3.3.2.2 Phase II: The Feasibility Study

The Treasury Regulations of April 2001 were amended in May 2002, to provide for the three-step process of Treasury Approval I, Treasury Approvals IIA and IIB, and for Treasury Approval III. Regulation 16.5.1 (as amended in May 2002) provides that “a written application for the feasibility study approval (Treasury Approval: I) must be submitted to the relevant treasury together with the feasibility study. There is no TA: I among the documents supplied to National Treasury, although correspondence indicates that it was granted on 26 September 2002 (National Treasury Case Studies, 2007).

5.3.3.2.3 Request for Qualification (RFQ)

No RFQ process was ever followed, as the Treasury Regulations were not yet in force at the time that pre-qualifying bidders were selected.

5.3.3.2.4 Phase III – Procurement

5.3.3.2.4.1 Request for Proposal (RFP)

The RFP was submitted to the National Treasury on 26 January 2003. Changes were incorporated into the documents following discussions between the ECDoH and the bidder. During the course of the project it became clear that optimal risk transfer could not be achieved if the private party only undertook the initial construction phase. The concessionaire was accordingly invited to make proposals for the facilities management of the entire complex for the duration of the agreement.

5.3.3.2.4.2 Treasury Approval III

A request for Treasury Approval: III, dated June 2003, was received by National Treasury. It contains the same value-for money Report as was used in the request for Treasury Approval: II B, though with slight amendments and variations. National Treasury granted Treasury Approval: III on 26 June 2003, saying: “I thank you for the most cooperative manner in which you have worked with the staff of the PPP unit. It is apparent that the Department has set a precedent worthy of emulation throughout South Africa (National Treasury Case Studies, 2007).

5.3.3.2.4.3 Signing of the Contract

The Concession Agreement between the ECDoH and Metro Star Hospital-Afrox Healthcare was duly signed on 27 June 2003. The concession period is 21 years and presents more opportunity for affordability by the institution than if it were for a short –term period.

Lessons Learnt

- The transaction advisor team comprised of financial and legal advisors,
- The Value for Money Report included details of the BEE component and contingent liabilities,
- The process of allowing only one bidder to make proposals for the facilities management was not fair. For transparency and fairness the process should be open to all, and
- The three case studies suggest that the procurement process is time-consuming and demanding. The Universitas and Pelonomi PPP took 29 months (June 2000-25 November 2002), the Humansdorp PPP took 50 months (April 1999-June 2003).
- The long concessionaire period of 21 years can lead to added risk in the future years. The status of the concessionaire may change and it may no longer be suitably qualified to perform the services in terms of the agreement (National Treasury Case Studies, 2007)
- There should at least be a provision for a review.

5.4 Conclusion

The three South African Healthcare sector case studies are proof that the public sector and the private sector can work together to provide health services. The Universitas and Pelonomi PPP is proof that where the public sector has redundant assets and the private sector has sound commercial reasons to utilise excess Government Assets, a co-location PPP can be established.

The public sector can benefit from the private sectors processes to get things done more quickly. To ensure efficient, responsive delivery of health services by provincial departments, private sector expertise and investment can be achieved through a PPP project. The relationship is a mutual one where the private sector gains business growth, normally over the long term, and the government delivers essential services.

Application of the healthcare PPP projects in South Africa has not reached its optimum state and predominantly because of the high cost of transaction advisors and the inadequate budgetary provision which in South Africa, conflicts with the long term nature of these projects. Latter is substantiated by the fact that government departments normally budgets over an MTEF period of 3-years while PPP projects are normally longer than 10 years. The expenditure cycle of government is three years and PPP planning can sometimes take 5 years.

Complexity and the cumbersome processes associated with PPP projects and its approval stages clearly discourages departments from pursuing PPP's. The notion is also held that between government's normal procurement processes and that of PPP's, the same procurement is achieved except that with PPP's the process is cumbersome and drawn out.

Chapter 6

AN EVALUATION OF PUBLIC PRIVATE PARTNERSHIPS IN THE HEALTHCARE SECTOR

6.1 Introduction

PPP's all over the world have their critics and also their advocates. The fundamental question is who is responsible if a partnership fails and what are the political considerations. Critics argue that PPP contracts limit the budget flexibility and policy options of future political administration because of the long-term nature of these agreements. Good projects create economic benefits and growth and create confidence in a country's economy. Bad project can create liabilities for years and it can also undermine investor confidence in a country.

The Public Private Partnership concept is still relatively new in South Africa. Opponents of PPP's in South Africa argue that not enough research has been done to determine the success of this procurement option. These opponents argued that the procurement process is too cumbersome and complex. It can sometimes take up to three to five years to conclude a PPP contract. Hence the various requests from different sectors to the National Treasury to ease the procurement process. To date only a few projects have been implemented in the Healthcare sector as a result of apprehensiveness from the public sector. Departments monitor and asses completed PPP projects before pursuing the PPP route. The solution lies in the transformation of the public sector whereby service delivery should become cost effective and the public sectors focus should shift from being an owner of assets to a purchaser of services.

The other problem within the Healthcare sector is the fact that little or no evaluation of the concluded health agreements has been done. Evaluation of projects is important to look at lessons learnt and what should be avoided. Concerns have been raised about the application of PPP in the Healthcare sector because of the complex nature of the PPP option. The success of PPP procurement in healthcare in South Africa can be determined by evaluating current projects in the South African Healthcare sector.

This Chapter evaluates the theory and practice as discussed in Chapter 2. It evaluates the legislative framework in Chapter 3 and evaluates the International trends and best practices as discussed in Chapter 4. It furthermore explores the practical experience of other countries and concludes with an evaluation of the case studies as discussed in chapter 5.

6.2 The Theoretical Perspective of PPP's

The theory on Public Private Partnerships indicates that governments will have to look for alternative service delivery methods to meet the ongoing needs of citizens. This can be done through partnerships with the private sector. The mistrust between the public and private sector will have to make way for a more collaborated approach to tackle the service delivery problems which governments experience. One of the prerequisites for the collaboration is joint decision making between the public and private sector. The notion that PPP's are nothing else than privatisation will also have to be changed through continuous training and awareness campaigns. The rationale for public private collaboration is not profit making but rather about combining different skills, expertise and other resources.

In analyzing the theory a few issues come to the fore. The first issue is that most PPP projects are long-term projects, which inevitably have a capital expenditure implication due to the fact that most of these projects will only be delivered over a period of longer than 1 year. Secondly the ability to recognize a potential PPP is crucial. The public sector should be sure that a PPP project will deliver value for money and that substantial risk will be transferred to the private sector.

Thirdly the pooling of resources for larger projects is an important advantage of PPP's. Both the private and public sector can benefit from PPP's because resources can be devoted to more than one project. PPP's can also increase the effectiveness and efficiency of an organisation because new skills and expertise can be acquired.

A fourth point is that fiscal implications are properly accounted and reported by government. In addition, departments are responsible for monitoring the project deliverables. It thus forces the public sector to focus on outputs from the start. The procurement process can be lengthy and costly and thus the public sector should do research and make sure that there is an ongoing need for the services.

Different models can be applied in the Healthcare sector ranging from management contracts, joint ventures, leasing, build operate transfer, build own operator, design build finance operator, design build operate and co-operative arrangements. A combination of these models is also possible depending on the needs of government. Countries can develop their own models which are tailor made for the markets.

Risk Management is one of the cornerstones of the PPP framework. One of the pre-requisites for PPP's is the substantial transfer of risk to the private sector. It is however important that risks should be shared between the public sector and the private sector. All risks cannot be borne by the private sector hence the public sector will have to change their approach to risk management.

6.3 PPP Legislation in South Africa

Legislative frameworks governing responsibility for the delivery of public services are commonly complex and restrictive. The complexity arises from the fact that financial control mechanisms within the public sector do not normally anticipate public services being financed and delivered by the private sector. Hence the importance of legislation to facilitate the delivery of public services by the private sector under a PPP contract. The PPP legislative framework in South Africa is regarded as strong but it does have its limitations. In order for PPP's to be successful tight laws and regulations need to be in place. It is important to have a good legislative framework because the lack of an adequate framework can influence foreign investment in a country. The lack of a framework can also affect market appetite to bid for or finance projects.

A number of concerns have been raised by various entities involved in PPP's in South Africa. This includes law firms, banks, service providers and construction companies. The lack of an overarching legislative framework and operational guidelines acting as a guide across all spheres of government seem to be a problem. There needs to be standardisation in the way PPP projects are structured. The National Treasury published the standardisation terms for PPP agreements in 2000. It was published for comment but some of the issues are still unresolved (Corke, 2007).

Some of these issues relate to relieve event, force majeure issues, caps on penalties and caps on indemnities. Government view is that the private sector should be responsible for all these risks. The private sector is of the view that they can't be responsible for all of these risks.

A typical example is the case of relieve events. If Government operators strike at a PPP site, services are affected by the striking workers and the private sector gets penalised by means of deduction from the unitary payment. Under a PPP the entity depends on the money and thus they get penalised for the action of government employees.

The legislation should make provision for small projects. Small projects should not be done by using PPP's because the transaction advisor cost is often more than the project cost. In the UK only projects above a certain threshold can be pursued as a PPP. The transaction cost involve in a PPP does not justify a small project. Another alternative for South Africa is that the process for PPP procurement should be simplified for smaller projects. A simple feasibility study could be included in the legislation for smaller projects. The legislation should also make provision for renegotiating the terms of the agreement when the PPP has been in process for a while, so that practical experience can be brought to bear on the contract. The financial model requirements should also be revised so that the PSC and public sector reference models are less onerous to compile and potentially more accurate.

6.4 Comparative Evaluation of the International Experience versus South Africa

The international perspective on PPP's has important lessons. The fundamental lesson of PPP's is the participatory approach in the delivery of public services. Mutual trust and co-operation is an important element of the relationship between government and private sector. The South African experience is one of mistrust between the public and private sector because of the notion that the private sector wants to exploit Government. This has led to a reluctance from public sector institutions to follow the PPP procurement route.

The summary of the countries best practices reinforces some important areas for the operation of PPP's in South Africa. The literature study revealed the following trends:

- The Chilean Government mitigates foreign exchange risk by guaranteeing a fixed real exchange rate. In South Africa the situation is different. The South African framework makes provision for a portion of the project revenues or turnover to be paid in foreign currency.
- Contract renegotiations are allowed in Chile when the scope of the project changes. The South African framework does not allow for renegotiation of a PPP contract.
- The utilization of pension funds and insurance companies in Chile is another strategy which is not allowed in South Africa. This is because the South African Government feels it is too risky to put public money into such high risk ventures.

- The United Kingdom has established a NHS Private Finance Unit for the health sector. This has led to better deal flows and a consistent approach in deal flow. The Unit provides important guidance to trusts involved in PPP health projects. The National Treasury in South Africa established a PPP Unit but does not have sector specific units like the Private Finance Unit in the UK.
- The UK has also introduced Standard Health Project Agreements. The South African National Treasury has introduced Standardised PPP Provisions in April 2004. However, some issues on Standardisation remain unsolved and have led to some projects in South Africa being called unbankable by lenders and unpalatable by equity holders as the risks being placed on lenders and equity holders cannot be managed by them. It is envisaged that the National Treasury will review the Standardisation provisions and it is hoped that Government will meet some of the expectations of the private sector.
- Australia has adopted minimum debt level policies over many years. This has led to the concentration of PPP schemes in urban areas where high demand secures high and fast returns on investments. South Africa adopted this strategy in Bloemfontein with the Universitas and Pelonomi Hospital.
- The provision of infrastructure needs to be conceived as a service delivery industry that responds to customer demand and is measured by customer satisfaction. The high willingness to pay for most infrastructure services, even by the poor, provides greater opportunities for user charges. Private sector involvement in management, financing, or ownership will in most cases be needed to ensure a commercial orientation to infrastructure.

- Australian states have different PPP policy documents and follow different processes depending on the specific needs and sectoral nature of the states. The South African PPP framework does not make provision for Provinces to develop their own processes which make the process rigid.
- PPP transactions in Australia are open to international bidders. This culminates in the acquisition of international finance. The South African Government advocates that competition is central to public procurement and thus have encourage private sector companies locally and internationally to tender and to come forward with innovative ideas. Competition gives consumers choices for better meeting demands and puts pressure on suppliers to be efficient and accountable to users.
- The Brazilian PPP framework aims to promote projects that entails a long term service and hence ordinary projects such as purchasing of assets and facilities are excluded from the PPP ambit.
- The use of arbitration as a dispute resolution mechanism has been seen as a good innovation in Brazil. The South African PPP regime does not make provision for arbitration.
- The Indian Government introduced incentives to the Private Sector on occupancy rates. The occupancy rates in South Africa are low and this has been highlighted as a concern in Projects like the Inkosi Albert Luthuli Central Hospital. The contract entails a 8 per cent occupancy and did not make provision for cost fluctuations in case of occupancy fluctuations. The public sector is penalised if occupancy exceed agreed levels. This agreement creates a risk for the public sector in South Africa. This is a problem because the occupancy rate in South Africa hospitals is low because of the high cost of medical services in South Africa.

- The standardisation of risk allocation and processes has led to reduce transaction cost and duration in British Columbia. It is argued that standardisation finalisation in South Africa will reduce the cost of PPP's and eased the procurement process.
- The Canadian Government places a lot of emphasis on project management. South Africa has a skill shortage and project management is one of the areas where gaps have been identified. Because PPP's are fairly new in South Africa, project management has not been up to standard and this has created delivery problems. The project manager is responsible to the client for delivering the project within the constraints of time, cost and desired outcome.

6.5 The PPP models applied in the South African Healthcare Sector

The Healthcare sector is a challenging environment hence the application of the right models is an important consideration when entering into PPP agreements. The analytical framework and the case studies on Health PPP's suggest that the preferred model for hospital infrastructure projects would feature private design and construction, private capital financing or investment, mixed public and private operations and maintenance, public ownership, and the private sector assumption of substantial degree of risk.

Different PPP models are currently applied in the South African Health Sector. The three South African case studies are co-operative arrangements. The hospitals were already built by Government and the facilities are only utilised by the private sector. The Universitas and Pelonomi PPP agreement used the Design Finance Build Operate Transfer (DFBOT) model. It is a co-location PPP.

A co-location occurs when services are operated by the public and private sector. The Public Sector is the owner of redundant assets and the private sector utilise these redundant Government Assets. This type of contract is long-term contract with substantial operational and capital cost. In this case the South African National Treasury act as a facilitator mainly by protecting the Governments assets by ensuring that there is compliance with the principles of affordability, value for money and risk transfer to the private party (National Treasury Case Studies, 2007).

The South African situation is different because most of the PPP's differs from the models as discussed in Chapter 2. The South African model can be classified as an Operate, Maintenance and Transfer (OMT) model. Another model which can be created in South Africa is the Revitalise, Operate and Transfer model (ROT). In this case the private sector could rehabilitate the existing public health facilities at its own risk, and then operates and maintain the facility at its own risk for a given period.

Though the DBFO model is the most suitable model for hospital PPP's the South African Healthcare environment is different because most cities and towns already have hospitals that can be revitalised thus the Operate, Maintenance and Transfer model would be the best suited model for the South African Health sector. The DBFO model could be use for the construction of new hospitals but the OMT model would be best suited for projects where existing government facilities are utilised. The OMT model is based on the premise that the private sector will operate and maintain the facility for a specific period after which it will be transferred to Government at the end of the concession period.

The countries that have been selected in the international perspective all have well developed PPP systems and have strived to improve it over years. There is enough indication on the PPP projects discussed in Chapter 4 to advocate that a variety of factors combine to bring about the success or failure of any project. From the international case studies the following practical ways to improve a projects chances of success are evident:

- Sound organizational planning,
- Technical and financial ability on the part of the investor,
- Promoters must be evident and their commitment to carry out the project must be evaluated,
- Thorough analysis of the projects economic and financial viability,
- Appraisal of the political and economic outlook of the host country,
- Consideration of the relative strength of the financial markets,
- Ascertainment of political will and promoting good relations with the host government, avoiding unreasonable risk allocation, and
- Establishing and effective project management structure.

In the United Kingdom, the great expenses recurrent of the partnership are foreseen in the annual budgets of the responsible departments. The budget process in South Africa also makes provision for this kind of arrangement. However, the provincial budget office and the PPP unit should work together to monitor the budgetary impacts of PPP projects.

Chile has developed a good method to manage the inherent financing risk to long term investments in infrastructure. South Africa can learn from Chile who offers concessionaires special guarantees of minimum income and mechanism to manage exchange fluctuations and bond emission to cover cost of construction.

Performance Management is another key element of the PPP process and it aims to ensure that the output specifications are met. The payment of the service is conditional upon the quality of performance. It is thus incumbent upon Government to ensure that services are rendered in accordance with the agreement with the private sector. The contract management plan thus become an important tool in performance management and should be based on the performance management model. One of the critical elements of PPP's is the monitoring and evaluation aspect. It is important that regular monitoring and periodic evaluation of the project is undertaken to ensure that objectives and benefits of the joint venture accrue as per the contract agreement.

It is important that departments set clear objectives, targets and success indicators for the project and it should be communicated to all shareholders at the signing of the contract. This will ensure that periodic evaluations can be done with ease to measure the success of the project. Another problem is that the level of information is too high. People who are reviewing the process don't have the right skills and this lead to problems. PPP's require people with financial skills, legal skills and project management skills. This is lacking in government departments and thus it leads to unsuccessful PPP's. This problem can be curtailed by ensuring that there is well trained staff, completely familiar with the PPP process. Ongoing training is important and the retention of staff members is important for the success of PPP projects.

6.6 Case Studies

6.6.1 Inkosi Albert Luthuli Central Hospital

6.6.1.1 Phase I: The Inception Phase

The project was introduced at a time when the PPP regulations were not in place. However, the KZN Health Department did register the project with the National Treasury and transaction advisors were appointed as well as a project officer as required by the Regulations.

6.6.1.2 Phase II: The Feasibility Study

Though the PPP regulations were not in place which recommends that a feasibility study be conducted for any PPP, the KZN Health Department did conduct a feasibility study. A feasibility analysis is important and explains the strategic and operational benefits of the PPP agreement for the institution.

6.6.1.3 Phase III: Procurement

6.6.1.3.1 Treasury Approval IIA

Treasury Regulation 16.6.1 (of the 2001 regulations), provides that prior to issuing any procurement documentation, National Treasury must approve such documentation as well as the draft PPP agreement. It is not clear from the National Treasury information when the approval was granted.

6.6.1.3.2 Treasury Approval IIB

According to the Treasury Regulations in force at the time that the Practice Manual was prepared, Treasury Approval IIB should be obtained after evaluation of the bids but before appointment of the preferred bidder. The 2001 regulations were not the same and simply required approval of the procurement documentation (National Treasury Case Studies, 2007).

6.6.1.3.3 Request for Proposals (RFP)

On large, complex or innovative PPP projects, considerable value can be yielded if pre-qualified bidders participate in the preparation of the final RFP. While the feasibility study would have tested the market, some key market responses can now be tested in detail with parties which have demonstrated their knowledge and capacity related to the project.

Bidder participation in preparing the RFP can also lead to a shorter bidding process and greater bidder confidence.

The RFP document supplied by the National Treasury is a detailed and structured document. It meets nearly all of the recommendations set out in the PPP Manual. It includes deals extensively and comprehensively with bid formalities. It also gives comprehensive general background information to the project, which provides the bidders with a clear understanding of what its objectives are. It gives details of how the bidders should construct their proposals, and sets out the essential minimum requirements (technical, financial and legal) that should be included in the bids. Furthermore it deals with the service specifications which are output-based and invites bidders to come up with a performance monitoring system (National Treasury Case Studies, 2007).

The documents specifies that Facilities Management services must comply with applicable laws of South Africa and it imposes similar standards on medical equipment. The Financial and Legal Proposal deals with all financial aspects in detail. It sets out the KZNDoh's affordability ceiling and invites the bidders to come up with their own payment mechanisms including an unavailability/underperformance deduction regime. It also provides the bidders with extensive detail regarding the financial model which they are expected to produce. Legal aspects are not dealt with in such detail. The RFP is detailed and clear about the comments and inputs which it expects from bidders, and the form that their proposals should take. This information is reiterated throughout the document. The RFP does not deal with the evaluation process at all, nor does it set out the evaluation criteria, which the PPP Manual says should be included (National Treasury Case Studies, 2007).

6.6.1.3.3 Treasury Approval III

In terms of the regulations in force at the time that the Practice Manual was prepared, Treasury Approval III should be obtained before signing of the concession agreement. However, the 2001 regulations provide that after the procurement procedure has been concluded but before the signing of the PPP agreement, the institution must obtain relevant Treasury agreement to future budgetary commitments which must be denominated in Rands. National Treasury's approval for the signing of the concession agreement was granted in October 2001 (National Treasury Case Studies, 2007).

6.6.1.3.4 Signing of Contract

The KwaZulu Natal Department of Health (KZNDoh) signed a PPP agreement with Cowslip Investments (Pty) Ltd, who made an initial payment and all subsequent unitary payments in return for deferred shares in Impilo Consortium for the delivery of services to the IALCH in December 2001.

6.6.1.3.5 Risk

It is difficult from the documentation provided by National Treasury to determine accurately whether all possible risks were transferred to Impilo. Some risks were foreseen such as the foreign exchange risks. The currency fluctuated to the detriment of the public sector just as the agreement was signed, and this subsequently favoured the private sector. In as far as risks to the public sector are concerned the 8 per cent occupancy and the cost associated with it is of concern because this can result into penalties for the public sector if the occupancy and other forms of usage exceed the agreed levels.

6.6.2 Universitas and Pelonomi Hospital

6.6.2.1 Phase I: The Inception Phase

The Project was registered with the National Treasury and a Project Officer was appointed. A transaction advisor team was also appointed as required by the PPP Regulations. Thus there was compliance in terms of the Regulations.

6.6.2.2 Phase II: The Feasibility Study

The Treasury Regulations, introduced during the course of this Project, were different from those in force in 2004, at the time that the PPP Manual was prepared. For the sake of clarity those in force at the time of the Project will be referred to as the 2001 regulations. No reference is made specifically to Treasury Approvals I, IIA and IIB, or III, in the 2001 Regulations, which simply provide for approval of the feasibility study, acceptance of the procurement documents and more particularly the main terms of the PPP agreement, as well as National Treasury agreement to future budgetary commitments which must be denominated in Rands (National Treasury Case Studies, 2007).

6.6.2.3 Phase III: Procurement

6.6.2.3.1 Treasury Approval IIA

Regulation 16.3.1 required treasury approval in writing prior to initiation of the procurement process. However, such approval was not obtained for this project because the procurement process preceded the issue of the Treasury Regulations in terms of Public Finance Management Act (PFMA) 1999, which took place on 9 April 2000.

6.6.2.3.2 Treasury Approval IIB

No reference is made specifically to Treasury Approvals I, IIA and IIB, or III, in the 2001 regulations, which simply provide for approval of the feasibility study, acceptance of the procurement documents and more particularly the main terms of the PPP agreement, as well as National Treasury agreement to future budgetary commitments which must be denominated in rands (National Treasury Case Studies,2007).

6.6.2.3.3 Request for Proposals (RFP)

The RFP set out the objectives of the Project, details of the facilities to be made available, terms and conditions of the bid process and a draft concession agreement to be entered into between the successful bidder and the Department.

The RFP was subject to review by the PPP Unit of National Treasury and was approved in terms of the Treasury Regulations (which has subsequently come into force). According to the RFP the risk of assessing the condition of the facilities lay with the private partner. Although the public sector staff would assist in the inspection, the public sector would give no warranties on the

accuracy of such information. The RFP listed the facilities that would be for the exclusive use of the private partner, those that would be shared between the parties, and support services. It stated that in addition to upgrading the two hospitals, the concessionaire would be required to pay the FSDoH for the use of the facilities in Universitas and Pelonomi (National Treasury Case Studies, 2007).

The structuring of the project required considerable attention to determine the optimal transfer of risk as well as how to structure the payment mechanism so as to ensure compensation for risk transferred. The FSDoH gave a comprehensive draft project agreement to the bidders to ensure that these issues were adequately understood before proposals are submitted.

The responses would determine how this new approach to co-location partnerships could roll out in other provinces (National Treasury Case Studies, 2007).

In order to familiarize bidders with the projects, the FSDoH held a site visit and briefing at the two hospitals on 2 March 2001. The site visit was attended by representatives of all three bidders as well as members of the hospitals, the Department and transaction advisor. At the request of the bidders at the site visit, the closing date for submission of bids was extended to 15 June 2001 (National Treasury Case Studies, 2007).

The RFP comply in nearly all respects with the PPP Manual. The financial, legal, technical and BEE requirements were included in the RFP. The standard and service specifications are set out in the document and includes output specifications and risk transfer. The payment mechanism is described and spells out that the concessionaire is to pay a concession fee to the FSDoH, made up of a fixed fee, a variable usage fee and a service fee (National Treasury Case Studies, 2007).

6.6.2.3.4 Treasury Approval III

The authorisation granted by the National Treasury indicates that acceptance of the procurement documentation was not obtained because this preceded the April 2001 regulations, in terms of which formal approval became a prerequisite for proceeding with the contract.

However, Andrew Donaldson, Deputy Director General: Budget Office at National Treasury, notes in his letter that “the close cooperation of your department with the PPP unit in the preparation of the documentation is noted with appreciation”, and he granted the necessary approval (National Treasury Case Studies, 2007).

The FSDoH complied with the requirements of the 2001 Regulations. A request for approval of the affordability, value for money and risk transfer was obtained from National Treasury. The FSDoH agreed to future budgeting commitment as was required by Regulation 16.7.1 (a) of the 2001 Regulations. National Treasury approved the final PPP agreement as was required by the 2001 Regulations (National Treasury Case Studies, 2007). Though the Regulations were not yet a prerequisite the FSDoH did comply with some of the requirements.

A value for money report was submitted to National Treasury as required by the PPP Manual. The value for money report does not deal with contingent liabilities and sources and conditions of funding, as suggested by the PPP Manual. The Treasury approval III application provides the institution’s plan for managing the PPP agreement. It confirms the legal due diligence on the competency of the parties to enter into the PPP agreement. The FSDoH complied with this requirement (National Treasury Case Studies, 2007).

In order to manage the contract, the parties to the PPP made use of service level agreements and a code of conduct. It is important for parties to a PPP to make sure that roles and responsibilities are clearly spelled out. This arrangement can ensure that parties adhere to the contract and it makes the contract easier to manage. From the documents provided it would appear that this arrangement has made the PPP management easier and both parties have comply with the requirements of the agreement.

6.2.3.5 Signing of the Contract

Netcare signed a PPP agreement with the Free State Health Department for the Universitas and Pelonomi hospitals in Bloemfontein. This agreement entails the use of spare capacity within both institutions. The estimated Net Present value of the agreement is about R145, 8 million for the Free State Department of Health (National Treasury Case Studies, 2007). The reduced fiscal burden due to the capital investment from the private sector will enhance the efforts of the FSDoH to cope with other health projects.

The concession period of the agreement is 16 years and 6 months. According to the PPP Manual, an extended concession period such as this provides better opportunities for the FSDoH to yield value for money. A caution, however, is that long concession periods also create more risk, as the status of the concessionaire may change over such a long period, and it may no longer be suitably qualified to perform the services in terms of the agreement (National Treasury Case Studies, 2007)

6.6.2.3.6 Risk

One of the primary reasons for entering into PPP's is the transfer of risk from the public sector to the private sector. In this Project the public sector used a certain amount of coercion to get private sector buy-in for the projects, by making obtaining a licence to operate a private hospital conditional on entering into the PPP. It would appear that the private partner is battling to make money. They may also have battled if they had to build a hospital from scratch. The threat of not being able to obtain a license without entering into a PPP may have caused the private partners to take on more risk than they would normally have (National Treasury Case Studies, 2007).

It is important for the public sector to realise that risk transfer should not be to the extent that it prejudices the sustainability of the private partner. A threat to the sustainability of the private partner is a threat to the sustainability of the PPP.

6.6.3 Humansdorp District Hospital

6.6.3.1 Phase I : Inception Phase

The project adhered to the requirements of the PPP regulations registering the project with National Treasury, appointing a project officer and the appointment of a transaction advisor. The Department thus complied with the regulations as prescribed by the National Treasury.

6.6.3.2 Phase II : The Feasibility Study

A comparison between this agreement and the Standardised PPP Provisions contained in practice note 01 of 2004 indicates substantial compliance with all the standard requirements. The agreement contains conditions which are not advocated by the practice note, but which in reality are difficult to avoid. However the contract states that these conditions may be waived by the ECDoH, because they are entirely for its benefit. Throughout the contract the concessionaire (private party) purports to take on full risk. This is standard procedure in construction contracts of this nature, and is therefore not unique to the concession agreement or this particular PPP contract. Nor does it necessarily mean that there is a full transfer of risk.

The agreement states that the concession period is 21 years. This is long, and therefore presents more opportunity for affordability by the institution than if it were a short-term period. However, the downside of such a long concession period is that with time comes risk. The status of the concessionaire may change and it may no longer be suitably qualified to perform the services in terms of this agreement. The real evaluation of the bids took place before the issue of the Treasury Regulations, and without RFQ's or RFP's being issued.

A request for TAIll, dated June 2003, is on file. This contains the same value-for money report as was used in the request for TAIIB, though with slight amendments and variations.

From the documentation questions could be asked about the procurement process. It would appear from the information provided by National Treasury that only one bidder was requested to make proposals for the facilities management services. This is unfair and Departments should guard against this practice. It can undermine the process and the credibility of Government institutions.

6.6.3.3 Phase III : Procurement

6.6.3.3.1 Treasury Approval IIA

The next step is the preparation of the bid documents and on this basis to obtain Treasury Approval II A. Regulation 16.6.1 provides that prior to the issuing of procurement documentation to any prospective bidders, the institution must obtain approval from the Provincial Treasury for the procurement documentation, including at least the main terms of the proposed agreement, the aspects of affordability, value for money and risk transfer. Regulation 16.6.2 goes on to say that this approval will be referred to as TAIIA (National Treasury Case Studies, 2007).

National Treasury could not find an application for Treasury Approval II A on file, and the correspondence makes it clear that no application was made for such approval at this stage (National Treasury Case Studies, 2007).

6.6.3.3.2 Treasury Approval: IIB

A request for TA: IIB was made in June 2003, which included a value-for-money report. Ahmad granted TA: IIB on 12 June 2003, noting that issues of final value for money, staffing and affordability would still have to be worked through with the bidder before the granting of Treasury Approval: III. According to the project close-out report, these differences were resolved during two days of intensive negotiations on 13 and 14 June 2003. The request complies with the requirements of the 2001 Regulations. It included the value for money report.

6.6.3.3.3 Request for Proposal (RFP)

The RFP was submitted to the National Treasury on 26 January 2003. Changes were incorporated into the documents following discussions between the ECDoH and the bidder. During the course of the project it became clear that optimal risk transfer could not be achieved if the private party only undertook the initial construction phase. The concessionaire was accordingly invited to make proposals for the facilities management of the entire complex, for the duration of the agreement.

6.6.3.3.4 Treasury Approval III

A request for Treasury Approval III, dated June 2003, was received by National Treasury. It contains the same value-for money Report as was used in the request for Treasury Approval II B, though with slight amendments and variations. National Treasury granted TA III on 26 June 2003, saying. "I thank you for the most cooperative manner in which you have worked with the staff of the PPP unit. It is apparent that the Department has set a precedent worthy of emulation throughout the Country (National Treasury Case Studies, 2007).

6.6.3.3.5 Signing of the Contract- Treasury Approval III

The Concession Agreement between the ECDoH and Metro Star Hospital-Afrox Healthcare was duly signed on 27 June 2003. A comparison between this agreement and the standardised PPP provisions contained in practice note 01 of 2004, indicates substantial compliance with all the standard requirements.

6.6.3.3.6 Risk

The Report contains a risk analysis summary, but this does not include risk values as the Practice Manual says it should. It does, however, set out a risk matrix, allocating risks between the parties and providing comments in each instance. The standardised risk matrix supplied in the manual has four columns, headed categories, description, mitigation and allocation, which is not unlike the kind of detail which has been included in this Report; this section is not neatly and clearly set out, and does not include the kind of detail recommended by the manual; and has a conclusion and a justification for that conclusion (National Case Studies, 2007).

The Report does not deal with sources and conditions of funding, and does not talk of a legal due diligence or a management plan, which the Practice Manual says it ought to do.

The contract management plan which was provided by the ECDoH appears to comply broadly with all the requirements of the Treasury Regulation. The person ultimately responsible for the project is the accounting officer. The plan also provides for the appointment of an operational implementation team to monitor the implementation phase.

6.7 The South African PPP Manual

The PPP Manual (2001; 2004) published by National Treasury gives clear guidelines on the PPP process. The steps in the PPP process are clearly spelled out in order for department to comply. The Manual also give templates for the different documentation needed in the PPP process and this is a helpful tool to departments and it also help to ease the burden on administrative personnel.

Departments and legal people have complained that it is difficult to keep track of all the information in the Manual. It is a comprehensive document which takes a lot of time to read. A more consumer friendly and concise manual would assist departments and the private sector.

6.8 PPP Units

South Africa also has a dedicated PPP Unit who plays an active role in ensuring that project adhere to the tests of affordability, value for money and risk transfer. The PPP unit also provides support to government departments, provinces and municipalities in terms of training, legal advice, technical assistance and Treasury Approvals during the pre-contract phases. Government departments can also second PPP unit staff to work for periods of 6- 12 months on PPP projects within South Africa and other countries to learn.

The establishment of a PPP unit is crucial if governments wanted to promote PPP's as an alternative to traditional procurement. The unit can play a pivotal role in assessing proposed projects and can give advice and support to project sponsors. This type of guidance and support can include standard contracts, concession agreements or contract clauses and detailed procedures for identifying, evaluating and procuring PPP's.

A review of international practice shows that PPP units also provide advisory support and funding to line departments and agencies in developing PPP's. In some instances PPP units also play a role in closing the transaction and receive compensation for deal closure. PPP units can also bring in new knowledge, skills, mindsets and experience. The UK Government has an active PPP unit involved in PPP promotion.

6.9 Conclusion

The theory on PPP's and the International experience shows that PPP's should be viewed as long-term initiatives as the real value of the partnership is delivered over time. Furthermore it is inevitable that both the public and private sector should be prepared to share risks when entering into a PPP contract. These risks should be calculated and both parties should benefit from the agreement. An important aspect for the public sector is that an effective and supportive institutional framework is necessary to support the implementation phase of the PPP.

The current trend in South Africa is that line departments develop PPP's in an institutional vacuum. The result is that departmental initiatives are fragmented with no co-ordination point. Another problem in South African public sector departments is capacity. Departments don't have the institutional capacity to manage the PPP process. This problem is further aggravated because of the lack of financial, technical and managerial skills in the public sector in South Africa. An effective and supportive institutional framework is necessary to catalyse the implementation of the PPP framework.

Chapter 7

A normative perspective of PPP's in the Healthcare Sector

7.1 Introduction

The list of key success factors in PPP procurement represents those factors considered to ultimately determine the outcome of a PPP project. Firstly, a factor which must be considered is the ability to recognize a potential PPP. The department should be sure that the project will deliver value for money and operational efficiency appropriate to the project. Secondly the success of a PPP depends on both the public and private party. In many instances, if the public sector does not deliver, neither can the private partner. Examples include the late payment of bills and lack of public sector appreciation of the needs of the private sector hampered the private partners ability to deliver at the Humansdorp District Hospital. Thirdly PPP's are long term projects which inevitably have a capital expenditure implication due to the fact that most of these projects will only be delivered over a period of longer than five years.

This Chapter takes a normative perspective of PPP's in South Africa. It deals with procurement and personnel within PPP's and make recommendations. The issue of risk management is explored and how it should be dealt with by both the public and private sector.

7.2 Procurement

The procurement process is pivotal in any PPP project and public sector departments should take the following into account to implement successful PPP agreements:

- Design a fair and transparent, cost effective procurement process. The normal presumption should be that PPP projects would be competitively tendered. Competition is central to public procurement, both as a means of securing value for money and to help guard against corruption or the perception thereof,
- Communicate the aims and objectives properly and with all the necessary requirements and expectations that the inviting department has with adequate time for interested parties to prepare,
- Advertisements for a PPP should be advertised widely and over international boundaries, especially where technical, technological and scientific expertise will form the essence of the PPP, and
- Pre-qualification processes are an advantage to the invitation of a PPP because it avoids that interested parties incurs excessive cost in preparing detailed technical proposals and it helps the government department to do a preliminary test on the market.

7.3 The Contract Management Plan

Treasury Regulation 16.7.1(b) provides that the institution must provide a contract management plan, explaining the capacity of the institution to enforce the agreement effectively, as well as to monitor and regulate its implementation and performance by the parties under the agreement. This requirement was only introduced in the May 2002 amendment to the regulations.

Conradie (2007) pointed out that PPP's need to be managed by a competent contract manager and that the National Treasury PPP unit needs to support the contract manager on an ongoing basis. Furthermore he suggested workable succession plan for contract managers. Succession planning is important because of the high turnover rate in government departments, while PPP's often last for a long time.

7.4 Risk Management

Risk allocation between the private and public sector is one of the key elements of a PPP agreement. One of the pre-requisites for the successful implementation of a PPP is risk management. The main objective of a PPP is not to transfer all risks to the private party but to allocate risks to the party best placed to manage it. Another aspect which should be borne in mind is that PPP agreements in its very nature are legally orientated.

The issue of risk is therefore a factor which should be carefully considered by a department. Besides the private sector risks associated with delivering required service levels and achieving profitability within the agreed financial framework, the risk of private sector defaulting on service delivery ultimately resides within Government. The consensus seems to be that the public sector will ultimately turn to the Government of the day, should the private sector fail to deliver (Hoffman, 2004:125).

7.4.1 Risk Management Plan

As part of the process of developing the Contract Management Plan, it is advisable that departments develop a Risk Management Plan based on the Risk Management Framework in Chapter 2. The Risk Management Plan should set out:

- An evaluation of the different options for treating the risk,
- The departmental official who will be responsible for managing the risk,
- The procedures and mechanisms that will be used to control the risk, and
an estimate of the resource the department will allocate to managing the risk.

With respect to private party risks, the risk management plan should, for each risk include:

- The obligations and reporting requirements which the public sector has imposed on the private party to ensure that the risk is managed,
- The public official who will be responsible for monitoring the risk,
- An estimate of the resources the public sector partner will devote to monitoring the risk,
- The mechanism that will be used by the public sector partner to deal with any failure of the private party to manage the risk, i.e. penalty deductions, and
- The contingency plan that the public party will follow to ensure continued service delivery in the event that the private party cannot maintain the service, or the public partner is forced to terminate PPP contract for whatever reason (DPLG, 2007:30)

Therefore the following risks in a health PPP's should be carefully considered.

7.4.2 Construction Risk

It is recommended that the construction risks be transferred to the PPP contractor. Sometimes delays in construction, which can be due to weather, industrial action, late delivery of equipment and supplies, can result in cost overruns and this can have an impact on the project budget. One of the features of PPP construction is that the public party only starts paying for the services after completion of construction. Construction risk can be mitigated through output specifications and performance payment regimes (Hodge and Greve, 2005:67).

Site risks can also become a problem and should therefore be build into the PPP agreement and should clearly be specified. This includes such risks as access, environmental, planning and heritage considerations. Allocation of these type of risks will depend on site ownership. If the private party enter into a construction joint venture with a subcontractor joint and several liability should be build into the agreement. The public party should also ensure that there is no residual construction risk with the private party. The failure of a contractor to satisfy performance guarantees can be mitigated by a performance guarantee. Poorly defined specifications can have considerable effect on the construction cost. These potential problems can be reduced with the conduction of careful studies of engineering before the contract is signed.

7.4.3 Inflation Risk

The possibility that the actual rate of inflation will change during the development of the feasibility is always there. This can be mitigated by including an actual index, based on inflation, in the agreements pricing formula (PPP Manual, 2001:27). Another option is to enter into long-term supply contract with predetermined prices. Inflation risk at project level can also be passed on to consumers.

7.4.4 Market Risk

The cost of raw material can sometimes increase during the construction of the project. Other factors which can also changes relates to the overall economic conditions in a country, government policies on taxes, environmental concerns and the political development in a country. These risks can have an influence on the project and can be mitigated by the private sector requesting certain conditions in the management agreement.

These types of request can be exclusive rights by the private party to provide the services or an automatic rate increase under certain conditions (PPP Manual, 2001:28). It is recommended that this be build into the PPP agreement.

7.4.5 Technological Risk

It can sometimes happen that technological changes can occur during the period of the PPP agreement. This includes computer technology and changes in equipment and machinery which are use in the provision of services. It is thus important that PPP contracts should address this risk and set out a method for rectifying related problems. The Inkosi Albert Luthuli Central Hospital for example included a five year equipment refreshment cycles to prevent equipment becoming obsolete.

7.4.6 Exchange Risk

Exchange risk happens when the partnership is making use of external sources. The fluctuations in exchange rates can have an effect on the affordability of the project. If the currency of the contracting country is weak, the greater the risk will be. The risk can be managed by entering into a hedge agreement with the supplier or a third party financial institution, in which the project is assured a certain exchange rate.

7.4.7 Latent Defect Risk

This type of risk occurs when the public sector grants the private sector the right to use an already existing government asset to help finance the construction of the new facility. The private partner in exchange assumes responsibility for the maintenance of the installations for the length of the contract.

This type of arrangement can cost the private sector a lot of money when it inherits installations with unknown structural imperfections. It can be minimized by doing a thorough inspection of the installations to be transferred, before the signature of the contract.

The following recommendations are made to manage risks.

- Prepare a detailed due diligence and risk matrix,
- Introduce a risk register,
- Penalise operators for bad performance and build this into the PPP agreement,
- Ensure that the transfer of risk to the private party does not make the partnership unsustainable.

7.5 Addressing the disadvantages of PPP's

- **Goals**

The problems in PPP's can be addressed in different ways. The goals of the projects should be clearly identified by the public sector partner. The aim of a project is sometimes too vague and too broad. It should be narrowed down to achievable deliverables and within realistic timeframes. Agreement on the main principles needs to be obtained from the start to avoid later misunderstandings.

- **Performance Enforcement**

The performance enforcement can be addressed by implementing monitoring mechanisms so that the private sector can comply with the agreed service standards. Monitoring and Evaluation forms an important part of PPP projects to ensure success.

Departments should ensure that there is a clear allocation of responsibility. The most important thing is to appoint an official or a team who will be responsible for monitoring of the project.

- **Resource Cost**

Public Private Partnerships is a complex and cumbersome process. The cost involved in finalising the deal is another drawback of PPP's. The negotiation process is also long and costly. However, these problems could be addressed by reducing the time spent on consultation and the processes can also be shorter. The argument is that PPP's are long-term projects and thus a thorough analysis should be part of the process. Development agencies such as the Development Bank of South Africa can be part of the process to finance feasibility studies.

- **Unequal Power**

The issue of unequal power can be addressed in an amicable way if both the public sector and private sector realise that both don't have a monopoly on the negotiations process. Teamwork amongst those involved in the project is crucial for the success of a PPP project. A steering group needs to be established comprising both public and private sector officials.

- **Impacts on other services**

Prioritisation within Departments is part of the budget process. Departments should do thorough planning and do detailed costing and budgets so that other services are not neglected. The business plan of the PPP should make provision for funding from different sources because PPP's cannot rely on one or two partners.

The Universitas and Pelonomi hospital obtained from the Free State Department of Local Government and the Development Bank of South Africa.

- **Organisational Difficulties**

The question of capacity has been highlighted as one of the problems in PPP projects. This can be addressed by appointing a dedicated team to deal with the project. Resource requirements should be dealt with upfront and staff requirements need to be clearly specified from the outset.

7.6 South African PPP Manual

The PPP Manual (2001; 2004) published by National Treasury gives departments clear procedures on the PPP process. The steps in the PPP process are clearly spelled out in order for department to comply. The Manual also gives templates for the different documentation needed in the PPP process and this is a helpful tool to departments and it also help to ease the burden on administrative personnel. The only drawback of the Manual is that legal people are complaining that it is difficult to keep track of all the information. It is a comprehensive document which takes a lot of time to read. A more consumer friendly and concise manual would assist departments and the private sector.

The feasibility study should, according to the Practice Manual, include a needs analysis, which demonstrates that the Project aligns with the institution's strategic objectives, identifies and analyses the available budget, demonstrates the institutions commitment and capacity, specifies the outputs and defines the scope of the project. This is followed by the solutions options analysis, which should list all the solution options that have been considered, evaluate each of these, and choose the best option.

A project due diligence is important in the context of PPP's and should look at the legal issues, site enablement issues and BEE and other socio-economic issues. This is then followed by a value assessment including the public sector comparator (PSC), the risk-adjusted PSC, and should also look at affordability, value for money and risk transfer.

7.7 Personnel in Public Private Partnerships

- Ensure that knowledge is retained in the department through career pathing and good staff retention strategies,
- Provincial Treasuries can devote staff members to departments on a full time basis to manage training of departmental personnel,
- Establish business units within departments to manage PPP contracts and to do research on PPP's,
- Establish a Provincial PPP forum consisting of all Departments in the Province with the Provincial Treasury as the driver of the forum,
- Put in place effective knowledge management and succession plans to ensure transfer of knowledge from the key project staff who leave,
- Develop structures to provide training and ongoing support to contract managers,
- Build a library of documents and case studies in the department, and
- Consult with all stakeholders such as labour unions (Ashurst,2007).

7.8 Lessons Learnt

The three projects, demonstrated a number of lessons which could be replicated in other PPP's. The first one is that a group of committed decision makers should drive the procurement process. All the PPP's made use of international expertise and case studies. The choice of transaction advisors is also crucial. A transaction advisor team should contain experts in all of the

areas to be covered by the PPP. The transaction advisor team should investigate value for money and sustainability for both the private and public partners; otherwise they do the public partner a disservice.

It is also essential for PPP projects to specify requirements in output and performance term and to concentrate on stating what is needed and not how to provide it. The focus should be firmly on the service that is required and not on the asset that will help provide it. The reason for relying on output requirement is to give supplier the maximum scope to innovate its skills and experience to design efficient solutions without being constrained by past practices.

The PPP's should have the full support and involvement of people in the highest positions within both the public and private organizations. This is important because PPP's require perseverance and commitment. The PPP's may also made use of international expertise and case studies because there was a lack of local expertise in South Africa. The South African parties could learn from the international expertise and these lessons can be incorporated in future PPP projects.

Finally the case studies show that new and innovative thinking is needed when structuring PPP deals. This is particularly evident in the Inkosi Albert Luthuli Hospital. Government provided upfront funding for the private sector, which made the deal more affordable.

7.9 Conclusion

There is enough indication on PPP projects around the world to advocate that a variety of interrelated factors combine to bring about the success or failure of any project. The PPP environment is a developing one and thus it remain a challenge to improve the implementation thereof.

The review of the three PPP hospitals in South Africa suggests that PPP's can be a viable procurement option for Health Departments in South Africa. There are enormous potential for PPP's in South Africa. The question which can be asked is whether PPP procurement can be an option to outsourcing in Health. The answer is that it can be if the institution has done its homework, if specifications are reasonable, if the department has a clear vision of where they want to go, if the project is big enough and if there is complete commitment to the procurement process. It is not an option if departments think it is the easy way out and that they can abdicate their responsibilities and if departments think it is going to save them millions.

The conclusion of the study is that PPP's can be a viable procurement option in the Health Sector. The answer is that PPP's are an alternative service delivery option for the health sector where the budget for refurbishment and new hospitals is limited. It can deliver value for money, risk transfer for the public sector and it can yield improved service delivery benefits to the public. Further studies can look at the development of a PPP model for the South African Healthcare sector.

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**ANNEXURE 1
CHECKLIST FOR PROJECT PREPARATION PERIOD OF PPP**

| Inception Phase | | |
|--|--|--|
| <ul style="list-style-type: none"> • Have you inform the PPP unit of you intent to set up a PPP? • Did you inform the PPP unit of the available expertise in your department? • Has the project been registered with Treasury? • Have you appointed a Project officer and a Project Team? • What resources are available to achieve the identified needs? | | |
| <ul style="list-style-type: none"> • Is the term of Reference for the Transaction Advisor defined? • Is the Project Scope clear? • Methodology (describe the method or strategy employed (e.g. survey, weighting, modelling, benchmarking, and simulation) to evaluate the proposed system to arrive at a feasible alternative. | | |
| Feasibility Study | | |
| <ul style="list-style-type: none"> • Needs analysis • Was there a community inventory, needs assessment and an evaluation of community and stakeholder resources? • Is the project aligned with the institution's strategic objectives? • Does the institution have the capacity and ability to render the services? • What are the potential cost savings to the department? | | |
| <ul style="list-style-type: none"> • Option Analysis • Have you decided on a method of delivery? • Has the range of possible technical, legal and financial options for delivering required service been explored? • Is a single project envisaged, or a number of interrelated projects? • Would an application for PDF funding be appropriate? | | |
| <ul style="list-style-type: none"> • Have you done a Project Due Diligence? | | |

| | | |
|--|--|--|
| <ul style="list-style-type: none"> • Have all legal issues been resolved? • Have all regulatory matters be investigated? • Have all site enablement issues be resolved? • Have all socio –economic and BEE issues being resolved? | | |
| <ul style="list-style-type: none"> • Have you done the Value Assessment? • Base and Risk – Adjusted PSC and PPP reference model • Have you decided on a discount rate? • Nominal Value • Did the institution do a budget analysis, affordability and value for money test? • Is value for money obtained? • Can the department afford the deal? | | |
| <ul style="list-style-type: none"> • Economic Valuation: • Is there a clear economic rationale for the project? • Are all relevant costs required for the service e.a the operating costs and BEE costs included? | | |
| <ul style="list-style-type: none"> • Procurement Plan • Is there a project timetable for the key milestones? • Is there a contingency plan for dealing with deviations from the timetables and budgets • Is there a project team with assigned functions? • Is there an appropriate quality assurance process for procurement documentation? | | |

ANNEXURE 2

REQUIRED CONTENTS OF A TA III REPORT

1. The project

- aims, why procured as a PPP
- Statement of objectives and how these will be achieved through the PPP
- Complete history of the procurement process
- PPP description, scope, responsibilities of parties

2. Affordability

- The unitary payment and any pass-through or additional costs
- The basis of indexation. If the index is not CPIx the report must justify the alternative method.
- Confirm budget sources with a written statement of affordability by the accounting officer/authority.
- Clear statement of revenue assumptions and terms of sharing (if any)

3. Sources and conditions of funding; Security and Structure

- Complete breakdown of private sector funding including parties, percentage splits between sources, organogram and values:
 - Senior debt
 - Junior Debt
 - Equity
 - Quasi equity (shareholder loans)
 - Standby debt and equity
 - BEE funding structures and conditions thereto.
- Sponsor undertakings related to performance of the Private Party and/or sub contractors (if any)

- Main terms and conditions of the funding agreements being
 - Base rates, fees and margins, tenure
 - IRR on equity
 - Summarised hedging policy (interest and/or forex)
 - Any conditions precedent
 - Reserve accounts
- Assumptions and outputs of the project financial model including key ratios over the term of the PPP Agreement, including as a minimum:
 - DSCR (Minimum and average)
 - LLCR
 - PLCR
 - Dividend Lock up ratios
 - Project IRR
 - Equity IRR

4. Value for money

- Quantitative Value-for-money determination by comparison with the PSC as well explicit comparison with the VFM determinations at TA1 and TA2B.
- Qualitative description of how the project infrastructure, operations and BEE components will provide VFM to the Institution over the period of the PPP Agreement

5. Contingent Fiscal Obligations

A contingent fiscal obligation is an obligation of the State in terms of the PPP Agreement to make or receive payments that are not certain.

- These are to be divided into three categories:
 - Within government control

- Unforeseeable Discriminatory Government Conduct
- Indemnities and warranties
- Tax changes
- Compensation Events
- Refinancing gain sharing
- Disputes requiring resolution by external parties
- Late payment
- Termination for Institution Default *
- Variation Orders
- Amendments to the PPP Agreement
- Within private party control
 - Penalty deductions
 - Termination for Corrupt Gifts *
 - Termination for private party default including hedge breakage costs and premiums *
- Not within either party's control
 - Changes in Foreign Exchange Rates *
 - Insurance proceed sharing *
 - Insurance premium sharing *
 - Government self insurance
 - Private party Insurance non-availability
 - Relief and Force Majeure Events
 - Termination for Force Majeure
 - Any Revenue Guarantee *

Where marked with * the report must quantify the maximum fiscal obligation per distinct period (e.g. construction and operations) and the year in which the maximum fiscal obligation occurs. Where the liability is uncapped the report must state assumptions made in quantifying the maximum fiscal obligation.

In all cases the report must summarise the terms of the agreement related to this event. For all events the report must separate the likelihood of each event occurring into: Probable / Likely/ Unlikely categories.

6. Risk transfer

- A risk matrix show risk values as estimated or fixed at contractual closure.
- The risk matrix must show where in the PPP Agreement and ancillary agreements the particular risk is dealt with and that this treatment is consistent through all such agreements.
- A risk transfer summary that shows how the transfer of high impact risks has changed from RFP issuance to final PPP Agreement as well as any new risks identified during the procurement phase.

7. Legal due diligence

- Confirming the capacity of the parties to contract.

8. Institution's capacity to manage and report on the PPP agreement

- Details of the institution's established capacity to fulfil its contractual obligations and manage the relationship with the private party.
- A detailed PPP Agreement Management plan showing how the Institution will manage the contingent fiscal obligations.
- Details of the manner in which the Institution will report on annual financial and non-financial indicators identified for this project.

9. Conclusion reached and justification

10. Annexures

- Annexure 1: Final PPP Agreement, Financing Agreements and Sub Contracts
- Annexure 2: PPP Agreement Management Plan

ANNEXURE 3
RISK MATRIX

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|---|---------------|----------------|--------|
| 1.1 | Failure to design to brief | Failure to translate the requirements of the Trust into the design. | | | |
| 1.2 | Continuing development of design | The detail of the design should be developed within an agreed framework and timetable. A failure to do so may lead to additional design and construction costs. | | | |
| 1.3 | Change in requirements of the Trust | The Trust may require changes to the design, leading to additional design and construction costs. | | | |
| 1.4 | Change in design required by operator ² | This is the risk that the operator will require changes to the design, leading to additional design and construction costs. | | | |
| 1.5 | Change in design required due to external influences specific to PFI projects, health projects or PFI providers | There is a risk that the designs will need to change due to legislative or regulatory changes specific to local authorities. | | | |
| 1.6 | Failure to build to design | Misinterpretation of design or failure to build to specification during construction may lead to additional design and construction costs. | | | |

Construction and Development Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|--|---------------|----------------|--------|
| 2.1 | Incorrect cost estimates | The estimated cost of construction may be incorrect. | | | |
| 2.2 | Incorrect time estimate | The time taken to complete the construction phase may be different from the estimated time. | | | |
| 2.3 | Unforeseen ground/site conditions | Unforeseen ground/site conditions, including archaeological finds, may lead to variations in the estimated cost. | | | |
| 2.4 | Delay in gaining access to the site | A delay in gaining access to the site may put back the entire project. | | | |
| 2.5 | Responsibility for maintaining on-site security | Theft and/or damage to equipment and materials may lead to unforeseen costs in terms of replacing damaged items, | | | |

² The operator is the private sector company which receives payments from the Trust for providing the services

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|------|---|---|---------------|----------------|--------|
| | | and delay. | | | |
| 2.6 | Responsibility for maintaining site safety | The Construction, Design and Management (CDM) regulations must be complied with. | | | |
| 2.7 | Third party claims | This risk refers to the costs associated with third party claims due to loss of amenity and ground subsidence on adjacent properties. | | | |
| 2.8 | "Relief Events" | An event of this kind may delay or impede the performance of the contract and cause additional expense. | | | |
| 2.9 | "Compensation Events" | An event of this kind may delay or impede the performance of the contract and cause additional expense. | | | |
| 2.10 | Force Majeure | In the event of Force Majeure additional costs will be incurred. Facilities may also be unavailable. | | | |
| 2.11 | Termination due to force majeure | There is a risk that an event of force majeure will mean the parties are no longer able to perform the contract. | | | |
| 2.12 | Legislative/ regulatory change: health / PFI specific | A change in health or PFI specific legislation/regulations, leading to a change in the requirements and variations in costs. | | | |
| 2.13 | Legislative/ regulatory change: non specific | A change in non specific legislation/regulations, taking effect during the construction phase, leading to a change in the requirements and variations in costs. | | | |
| 2.14 | Changes in taxation | Changes in taxation may affect the cost of the project. | | | |
| 2.15 | Changes in the rate of VAT | Changes in the rate of VAT may increase the costs of the project. VAT should generally be refundable to the Trust. | | | |
| 2.16 | Other changes in VAT | Changes in VAT legislation other than changes in the rate of VAT payable. | | | |
| 2.17 | Contractor default | In the case of contractor default, additional costs may be incurred in appointing a replacement, and may cause a delay. | | | |
| 2.18 | Poor project management | There is a risk that poor project management will lead to additional costs. For example, if sub-contractors are not well co-ordinated, one sub-contractor could be delayed because the work of another is incomplete. | | | |
| 2.19 | Contractor or sub-contractor industrial action | Industrial action may cause the construction to be delayed, as well as incurring additional management costs. | | | |
| 2.20 | Protester action | Protester action against the development may incur additional costs, such as security costs. | | | |

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|------|---|---|---------------|----------------|--------|
| 2.21 | Incorrect time and cost estimates for decanting from existing buildings | The estimated cost of decanting from existing buildings may be incorrect, there may also be delays leading to further costs. Public sector risk unless delays and cost attributable to the private sector operator. | | | |
| 2.22 | Incorrect time and cost estimates for commissioning new building | The estimated cost of commissioning new buildings may be incorrect, there may also be delays leading to further costs. | | | |
| 2.23 | Sub-contract Disputes | Risk of disputes between sub-contractors or sub-contractor and SPV must be managed by SPV: there will be no joinder of disputes. | | | |

Availability and Performance Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|------|---|---|---------------|----------------|--------|
| 3.1a | Latent defects in new build | Latent defects to the structure of the building(s), which require repair, may become patent. | | | |
| 3.1b | Defects in existing buildings | Defects in the structure of existing building(s) which require repair, may become patent. | | | |
| 3.2 | Change in specification initiated by procuring entity | There is a chance that, during the operating phase of the project, the procuring entity of the services will require changes to the specification. | | | |
| 3.3 | Performance of sub-contractors | Poor management of sub-contractors can lead to poor co-ordination and under-performance by the Contractors. This may create additional costs in the provision of services. | | | |
| 3.4 | Default by contractor or sub-contractor | In the case of default by a Contractor or sub-contractor, there may be a need to make emergency provision. There may also be additional costs involved in finding a replacement. | | | |
| 3.5 | Industrial action | Industrial action by staff involved in providing facilities services would lead to higher costs and/or performance failures. | | | |
| 3.6 | Failure to meet performance standards | There is a risk that facilities management (FM) will not provide the required quality of services. This may be costly to correct, and the operator may incur financial penalties. | | | |
| 3.7 | Availability of facilities | There is a risk that some or all of the facility will not be available for the use to which it is intended. There may be costs involved in making the facility available. | | | |
| 3.8 | "Relief Events" | An event of this kind may delay or | | | |

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---------------|--|---------------|----------------|--------|
| | | impede the performance of the contract and cause additional expense. As defined in TTF Guidance. | | | |
| 3.9 | Force Majeure | In the event of force majeure additional costs will be incurred. Facilities may also be unavailable. | | | |

Operating Cost Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|---|---------------|----------------|--------|
| 4.1 | Incorrect estimated cost of providing specific services under the contract: within market testing periods | The cost of providing these services may be different to that expected, because of unexpected changes in the cost of equipment, labour, utilities, and other supplies. | | | |
| 4.2 | Incorrect estimated cost of providing specific services under the contract: at point of market testing | The cost of providing these services may be different to the expected, because of the unexpected changes in the cost of equipment, labour, utilities, and other supplies. The risk would be shared as the PFI contract envisages that changes in cost at the point of market testing are shared between the Trust and the operator. | | | |
| 4.3 | Legislative or regulatory change having capital cost consequences: health authority specific | Health authority specific changes to legislation/regulations may lead to additional construction costs, and higher building, maintenance, equipment, or labour costs. | | | |
| 4.4 | Legislative regulatory change: non specific to PFI/health | Non specific changes to legislation/regulations may lead to additional construction costs, and higher building, maintenance, equipment, or labour costs. | | | |
| 4.5 | Changes in taxation | The scope and level of taxation will affect the cost of providing services | | | |
| 4.6 | Changes in VAT | This may increase the cost of provision of services to the Trust. However changes in VAT are generally refundable to the Trust. | | | |
| 4.7 | Incorrect estimated cost of providing services | The cost of providing services may be different to the expected. These costs may include: staff, recruitment, training, equipment, and supplies. | | | |
| 4.8 | Incorrect estimated cost of maintenance | The cost of building and engineering maintenance may be different to the expected costs. | | | |
| 4.9 | Incorrect | Failure to meet energy efficiency | | | |

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|------|--|--|---------------|----------------|--------|
| | estimated cost of energy used | targets or to control energy costs. | | | |
| 4.10 | Patient/visitor injury caused by poor facilities management | There is a risk that an injury to a patient or visitor could be traced directly to the actions of staff employed and managed by the facilities manager. This may include, for example, food poisoning and injuries from broken windows. This risk may lead to legal costs if the patient/visitor takes legal action. | | | |
| 4.11 | Patient/visitor injury other | Patient/visitor injury caused by staff employed by the procuring body. This risk may lead to legal costs. | | | |
| 4.12 | Estimated cost of transferring the employment of staff to new employer is incorrect | The estimated cost of transfer of the employment of staff, under TUPE, may be incorrect. | | | |
| 4.13 | Estimated cost of restructuring the workforce providing services under the contract is incorrect | The estimated cost of restructuring the workforce at any time during the operating phase, such as recruitment costs and redundancy payments, may be incorrect. | | | |

Variability of Revenue Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|--|---------------|----------------|--------|
| 5.1 | Non availability of facilities | The operator will incur deductions from the unitary charge for non-availability. | | | |
| 5.2 | Non performance of services | Payment will only be made by the Trust for services received. | | | |
| 5.3 | Poor performance of services | The operator will incur deductions from the performance payment for the poor performance of services. | | | |
| 5.4 | Changes in the size and allocation of resources from the provision of hospital facilities | There is a risk that the resources allocated to the area are reduced or increased. If such changes occur, there may be a need to re-scale the provision of services. | | | |
| 5.5 | Changes in the | There is a risk that the volume of | | | |

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|--|--|---------------|----------------|--------|
| | volume and demand for the provision of hospital services | demand for hospital services will change eg because of changes in treatment methods or changes in the size of the population or opening/closure of other facilities. | | | |
| 5.6 | Unexpected changes in technology | Unexpected changes in technology may lead to a need to re-scale or reconfigure the provision of services. | | | |
| 5.7 | Unexpected changes in the demographics of the people in the catchment area | Unexpected changes to the demographics of the people in the catchment area may lead to a reconfiguration or re-scaling of the provision of services. | | | |
| 5.8 | Estimated income from income generating schemes is incorrect | There is a risk that income generating schemes, such as car parking, generate less income than expected. (Subject to this being the responsibility of the operator). | | | |

Termination Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|--|--|---------------|----------------|--------|
| 6.1 | Termination due to default by the procuring entity | There is a risk that the procuring entity defaults leading to contract termination and compensation for the private sector. | | | |
| 6.2 | Default by the operator leading to step in by financiers | The risk that the operator or individual service providers' default and financiers step in leading to higher costs than agreed in the contract. | | | |
| 6.3 | Termination due to default by the operator | The risk that the operator defaults and step in rights are exercised by financiers but that they are unsuccessful leading to contract termination. | | | |

Technology & Obsolescence Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|--------------------------------------|--|---------------|----------------|--------|
| 7.1 | Technology change/asset obsolescence | Buildings, plant and equipment may become obsolete during the contract, and the Trust may need to alter the output specifications. | | | |
| 7.2 | Technology change | The operator is required to supply, maintain and repair and replace all equipment to meet the output specifications. | | | |

Control Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|---|---------------|----------------|--------|
| 8.1 | Control of services provided under the PFI contract | The operator should retain control of these subject to 8.2. | | | |
| 8.2 | Control of hospital services | The Trust retains control of hospital services, which means that it retains significant control of the nature of services provided by the operator. | | | |

Residual Value Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|-----|---|--|---------------|----------------|--------|
| 9.1 | Procuring entity no longer requires assets to end of contract | The risk that the procuring entity will wish to vacate the asset at the end of the contract period, and that the operator may be faced with decommissioning costs. | | | |

Other Project Risks

| No. | Risk Heading | Definition | Public Sector | Private Sector | Shared |
|------|--|---|---------------|----------------|--------|
| 10.1 | Incorrect cost estimates for planning approval | Estimated cost of receiving detailed planning permission is incorrect, including the cost of satisfying unforeseen planning requirements. | | | |
| 10.2 | Delayed planning approval | A delay in receiving planning permission may have broader cost implications for the project, as well as the loss of potential savings. | | | |
| 10.3 | Land sale receipts | The estimated receipts from the sale of surplus land (if any) may be incorrect. | | | |
| 10.4 | Inflation | To the extent that actual inflation runs at a higher or lower rate than is assumed within the financial model. | | | |
| | | | | | |

ANNEXURE 4

TREASURY APPROVAL III CHECKLIST

| | |
|---------------------|--|
| Project Name | |
| Department | |

Step 1: Prepare the PPP agreement management plan

1. Does the institution have the capacity to enforce the PPP agreement?
2. Has all the roles and responsibilities of the institution been clarified?
3. Has the contract management arrangements being sorted out?

Step 2: Complete the legal due diligence

1. Has treasury approvals been obtained?
2. Does the procurement process comply with the prescribed legislative requirements?
3. Has all future financial commitments and guarantees been authorized?
4. Has the institution the capacity to enter into the agreement?
5. Has the signatory the authority to enter into the agreement on behalf of the institution?

Step 3: Compile and submit the TA:III report

1. Has the aims of the project been clearly identified?
2. Has the institution conduct an Affordability study?
3. Has the institution conduct a Value for Money study?
4. Has the institution conduct a comprehensive risk analysis?
5. Has the constitution conduct legal due diligence analysis?

ANNEXURE 5

CHECKLIST FOR FEASIBILITY STUDY OF A PUBLIC PRIVATE PARTNERSHIP

| Feasibility Study | Yes | No | Comments |
|--|-----|----|----------|
| <ul style="list-style-type: none"> • Needs analysis • Was there a community inventory, needs assessment and an evaluation of community and stakeholder resources? • Is the project aligned with the institution's strategic objectives? • Does the institution have the capacity and ability to render the services? • What are the potential cost savings to the department? | | | |
| <ul style="list-style-type: none"> • Option Analysis • Have you decided on a method of delivery? • Has the range of possible technical, legal and financial options for delivering required service been explored? • Is a single project envisaged, or a number of interrelated projects? • Would an application for PDF funding be appropriate? | | | |
| <ul style="list-style-type: none"> • Have you done the Value Assessment? • Base and Risk – Adjusted PSC and PPP reference model • Have you decided on a discount rate? • Nominal Value • Did the institution do a budget analysis, affordability and value for money test? • Is value for money obtained? • Can the department afford the deal? | | | |
| <ul style="list-style-type: none"> • Economic Valuation: • Is there a clear economic rationale for the project? • Are all relevant costs required for the service i.e. the operating costs and BEE costs included? | | | |
| <ul style="list-style-type: none"> • Procurement Plan • Is there a project timetable for the key milestones? • Is there a contingency plan for dealing with deviations from the timetables and budgets • Is there a project team with assigned functions? • Is there an appropriate quality assurance process for procurement documentation? | | | |

ANNEXURE 6

GENERIC PPP PROJECT LIFE CYCLE

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Reflecting Treasury Regulation 16 issued May 2002 in terms of the Public Finance Management Act, 1999

