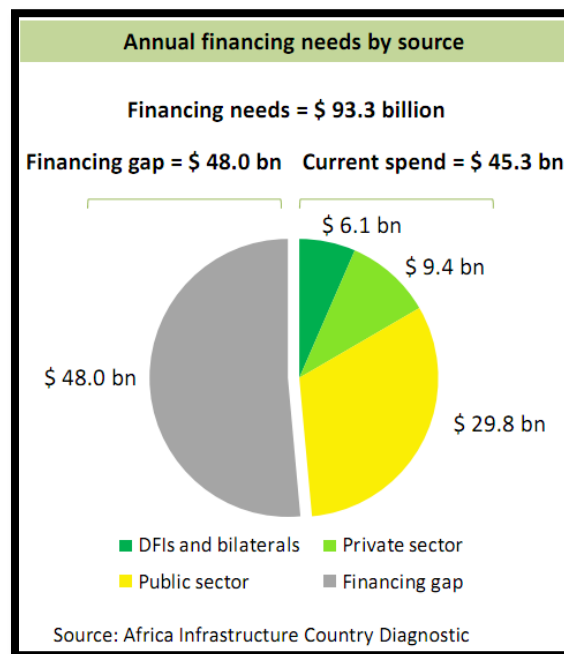


How to build a successful Public-Private Partnership (PPP): Lessons from the third African PPP Conference in Nairobi, Kenya, December 2nd 2011

This note is a summary of the lessons learned at the third African PPP Conference in Nairobi, Kenya. The seminar was attended by officers from the governments of Botswana, Kenya, Morocco, Nigeria, Uganda etc., as well as representatives from the private and banking sector such as Deloitte, CPCS TRANSCOM, CFC Stanbic Bank, and development banks including the African Development Bank. The following lessons were extracted from the verbal and written presentations at the conference.

Enabling Environments for Investment and Project Finance

Experience in African projects shows that there still is a huge need for capacity building in Africa's public sector. Growth will be sustainable only if both government stability and market attractiveness (transparency, regulatory and legal frameworks, etc.) are ensured. Inadequate infrastructure is holding back Africa's economic growth by 2% each year and reducing firms' productivity by as much as 40%. Emerging markets in East Africa have a growing demand for infrastructure, and government financing will not be sufficient to meet the needs, hence the urgency to implement successful PPPs for improved services in the region.



What is a PPP?

Any form of partnership between public authorities and the private sector for the construction, management and/or provision of an infrastructure or public service can be considered a PPP. Indeed, PPPs rely on the expectation that the private sector is better suited to provide an infrastructure or public service through:

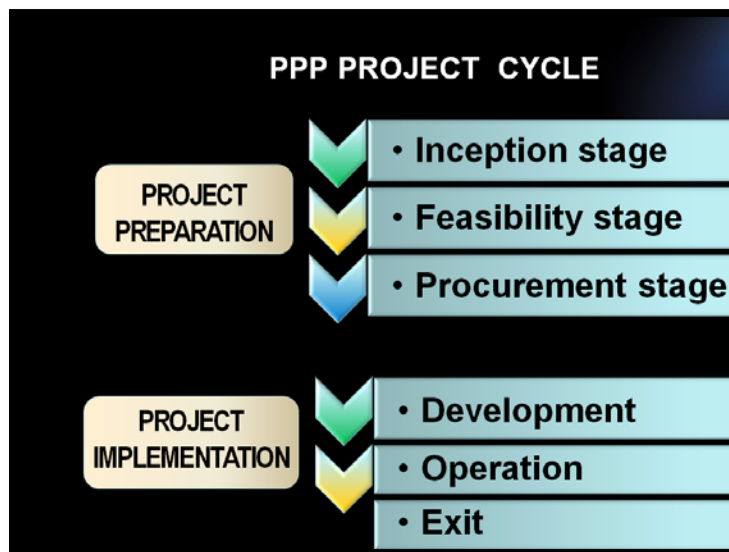
- Higher operating efficiency
- Better service quality/reliability
- More cost-efficient use of public money on other public services
- Better value for money
- Transfer of some of the risks to the private sector
- Transparency

Successful PPPs offer many advantages. At the project level, they contribute to efficient service delivery and project execution, and deliver outcomes on time and on budget. At the sector level, PPPs contribute to accelerated development of infrastructure facilities and long-term financial sustainability and affordability.

Setting the framework: preparing the ground for private sector participation

Regulation is one of the key enablers for private sector participation. Regulations ensure that the expectations of the private investor, the government, and the public are equally and sustainably considered. Institutional and legal frameworks are also paramount to efficient private participation and are key aspects that the private sector is keen to analyze before partnering with a public body.

A key element for successful PPPs is **preparation**; only properly prepared projects will bring competition. The project cycle should involve an identification process, a feasibility study, marketing sounding, a tender process, negotiation of the contract, and the management of the contract. PPPs also need: i) to be affordable/bankable; ii) economic viability; and iii) fair allocation of risks/rewards. In several developed and developing countries, PPP units have been created to help the government meet these needs. Often located within the Ministry of Finance, these specialized bodies set strategies on how PPPs should be developed.



The case of South Africa's PPP unit

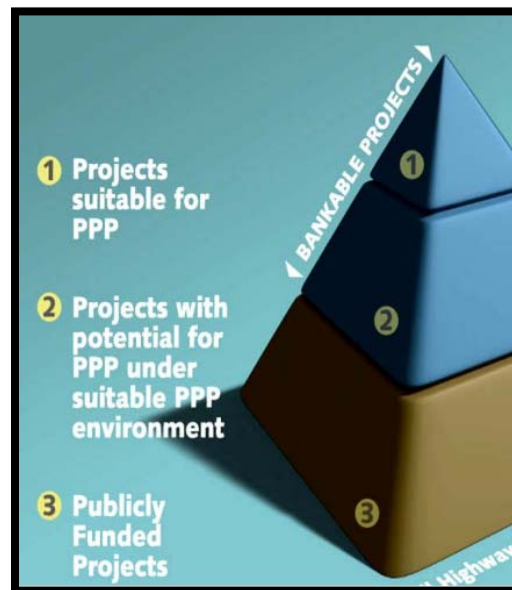
The earliest PPP projects in South Africa date back to 1997. The success of the South African PPPs builds on the implementation of projects from 1997 to 2000, which helped lay the foundations of an enabling framework for PPPs and resulted in a national PPP unit in the mid-2000s.



A key process in the implementation of a PPP unit is to define its function, which could be to control, regulate, or to act as a procuring body by identifying projects and giving priorities; when too many people/units are involved in the process, coordination between the transaction advisor, the government, the sponsor and the sponsor advisor becomes very complicated.

Project financing and financial modeling

The source of financing must be clear from the beginning (development finance institutions, government, commercial or mixed) and risk sharing modeling is an important part of the process. Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights, and interests held as secondary security or collateral. This means the value of the asset to be financed is secondary, and that **importance relies on the value that the asset will generate** (i.e. the **cash flows** generated by the asset). Hence, decision to finance a project is based on the analysis of future cash flows deriving from the project's assets, which often relies on predictions and assumptions. In project finance, the risks depend on factors that would prevent cash from flowing. If cash flows are too low there is a risk that the project could default, meaning that the public entity will not generate enough money to pay the loan back.



Due diligence is an important process of risk management. Any investor or lender would undertake a due diligence assessment of a project to investigate the proposed investment in details. Typically, this implies financial viability (development of a project financial model, analysis of financial indicators, sensitivity analysis, risk management and mitigation), assessment of the ability of the management team and all subcontractors to carry out the project, legal due-diligence, long-term viability and compliance with relevant laws.

PPPs and challenges

PPPs also face challenges. For instance, they need an upstream enabling environment and have to reach financial closure on time, which is difficult when both public and private parties do not equally share the risks and the rewards. According to CFC Stanbic Bank, PPPs face four key challenges:

Who should the government work with to develop a bankable PPP?

Governments need advisors that are active in the market to come up with practical solutions. Kenya Power is currently working with five independent power producers and the World Bank on power purchase agreements (PPAs) and a security package that is expected to result in approximately 600MW of new, privately-owned power plants breaking ground in the next six months.

How should the public entity pay?

To move away from full government guarantees in order to attract investors to PPP projects, the key is to set up agencies that are subject to public scrutiny through **private ownership of less than 50%**. Public scrutiny hence forces fiscal discipline on the agency and gives investors comfort in the creditworthiness of the agency over time. Kenya Power & Lighting Company, owned 50.1% by the Government of Kenya, is considered a strong credit in Kenya and counterparty with whom most independent power producers are happy to do business.

Can the public bear the budget of a PPP?

Consumers often cannot afford the real cost of the service provided, requiring government subsidy to the PPP provider. But private investors are often uncomfortable with a reliance on government subsidies to generate the necessary project cash flows. The reason for this is that **subsidies are often subject to the political process** and the overall budgetary position of a country.

How to get competitive, long-term funding in local currency?

Long-term local currency financing is essential for a PPP to be successful. Given the fact that revenues generated by a PPP will be in local currency, the challenge is how to get long-term funding especially if the local financial system is weak. Tanzania's PPAs are a good example of the issue, where too much time was spent on modeling a conceptual framework for PPAs, and the issue of how to finance these projects was not properly addressed. Most of the time, the natural home for long-term local currency PPP financing is pension and life funds. Solutions to this problem include:

- Development and expansion of **local and regional pension fund** and life insurance markets
- Development and expansion of **local and regional bond trading markets** to facilitate PPP bond liquidity
- Development of **tenor extension and refinancing guarantee products** to backstop lenders who are tenor-constraint insurance companies

PPP challenges in Transport

Transportation projects are structurally exposed to the risk of demand (also called "market risk"), irrespective of the sub-sector (roads, ports, airports, aviation, railways) involved. Indeed, below-estimates demand may be the result of flaws in project preparation (defective cost-benefits analysis, inaccurate traffic projections, unaffordable tariffs) or may derive from unfavorable government action, external factors etc. Demand/traffic risk can be mitigated in several ways, including:



- Off-take agreements
- Availability payments
- Minimum traffic guarantees
- Good visibility over "dedicated" transport infrastructures

Realistically, demand/traffic risk is often unavoidable. Project sponsors and lenders should conduct their own traffic projections to be in a good position to assess this risk.

Lessons from Africa: Morocco and Nigeria

Lessons from the Morocco PPP unit

There was an existing framework for PPPs in Morocco, but the Ministry of Finance identified areas of improvement for greater projects. With support from PPIAF, it was decided to improve the legal and institutional frameworks and to look at pre-feasibility and pilot projects to implement a PPP unit.

In May 2011, the unit was established within the Ministry of Finance to identify and prioritize projects and to contribute to good practices within all the ministries involved in infrastructure projects with private participation. The PPP unit identified two priority sectors for PPPs: health and education.



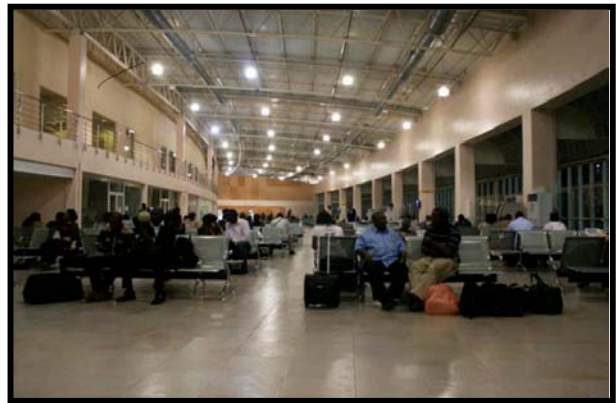
According to the unit, PPPs can provide innovative ways for health and education services. In the education sector for instance, all **non-teaching activities** such as construction rehabilitation and even lunch related services (canteens) **can be transferred to the private sector**.

Lessons from Nigeria: The General Aviation Terminal (GAT) concession

Background

In April 2003, a contract agreement was signed between the Federal Airports Authority of Nigeria (FAAN) and Bi-Courtney Limited. A supplementary agreement was signed in July 2004 (mainly increasing construction period from 18 to 33 months). The concession period was extended from 12 to 36 years with the addendum agreement signed in February 2007.

There was a disagreement over the operation of GAT by FAAN, the tenure of the concession (36 years) and the exclusivity clause in the agreement.



Lessons

According to Eng. Mansur Ahmed, CEO of the Infrastructure Concession Regulatory Commission in Nigeria, the dispute was caused by:

- Inadequate experience in public and private sectors
- Inappropriate political involvement at the implementation level
- Asymmetry of knowledge between the concessionaire and the government
- Not enough due diligence by the contracting authority
- Weakness in project preparation

The way forward, Nigeria's challenges

To attract investors, Nigeria must develop and sustain:

- A sound legal, regulatory, and institutional PPP framework which inspires confidence
- An integrated and coherent infrastructure development plan

- Capacity to identify, prioritize, and develop projects which are bankable and attractive to private investors
- Open, competitive and transparent procurement processes which ensure, and are seen to ensure value for money.