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EXECUTIVE SUMMARY

Municipal Public-Private Partnership

Framework

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1.0 Introduction

This framework is specifically designed for municipal[1] governments and staff seeking to implement public-private partnerships (PPPs) to help meet their infrastructure development needs. It is written with their perspective in mind, with an emphasis on practical guidance that reflects the varied contexts and real-world challenges that city and other local governments face. This framework is modular, comprising a guidance note, 20 topic-specific modules that provide more information and guidance on key issues, and a collection of project summaries that highlight innovative approaches to municipal PPP around the world. This executive summary provides a summary of the guidance note.

[1] As used throughout this framework, the term 'municipal' is intended to cover the many forms and names of subnational government public bodies serving local communities under different administrative, legislative, and constitutional systems around the world.

2.0 Municipal PPP: What & Why

The term public-private partnership (PPP) encompasses a variety of approaches to long-term partnerships between municipalities and private entities to deliver infrastructure services, with the private partner bearing significant project risks. As used herein, a municipal PPP is simply a PPP where *the government entity is a municipal body and where the public asset or service is a municipal asset or service*.[2]

PPPs are part of a fundamental, global shift in the role of the municipal government – from being the direct provider of public services, to becoming the *planner, facilitator, contract manager and/or regulator* who ensures that local services are available, reliable, meet key quality standards, and are affordable for users and the local economy.[3] Within this broad paradigm, the structure of a PPP used for a specific project is flexible, with a wide variety of options available that allocate different rights and responsibilities to the parties to the PPP. The appropriate project structure can only be determined with reference to the unique context of the municipality and a particular project.

There are a few general principles with which the municipality should be familiar. The project structure determines the extent of the private sector's participation in the underlying project, for instance whether the private partner is responsible only for operating and maintaining an existing asset, or whether it is responsible for designing, financing, and building a new asset.[4] In turn, the extent of the private sector's involvement in the project affects the amount of risk that may be transferred to the private sector. As the private partner's role increases, so too does the amount of risk it may be asked to bear. The reverse is also true, as the private partner assumes more risk, it will require more operational control over the project in order it manage those risks.

An appropriate allocation of risks between the parties is a key determinant of project success.[5] From the perspective of the municipality, transferring risk to the private partner is a significant benefit of a PPP, for instance the risk that construction is completed on time and according to specifications. At the same time, the private partner will need to be compensated for risk borne. Thus, the more risk that is transferred to the private partner, the higher the cost of capital.[6] As a PPP is never "free" from the perspective of the municipality,[7] the cost of capital is a major factor in evaluating whether a PPP is the most desirable delivery method for a particular project. Transferring too much risk to the private partner can unduly increase the cost of the project and even result in project failure.

A PPP requires careful preparation. This begins at the earliest stage of project identification and continues through final execution of the PPP agreement,[8] as more project-specific details and data become known.[9]

If well-designed and managed, PPPs can deliver high-quality, cost-efficient infrastructure, while leveraging private capital to increase the amount of infrastructure that can be delivered by the municipality within the same budgetary envelope.[10] PPPs can help municipalities deliver better and more reliable quality of service at a better cost to the municipality when compared to what can be achieved by public sector delivery alone. By mobilizing private expertise, human, and financial resources, PPPs can accelerate the construction of infrastructure, improve the efficiency of public services, and foster innovative solutions that offer a better response to user needs than would often poorly functioning public service provision.

At the same time, PPPs are only one of many tools available to municipalities to meet their infrastructure needs and should be viewed as such. The private sector can do some things better than the public sector, in particular around innovation, service delivery, commercial orientation, and operational efficiency. When properly structured, a PPP can leverage the distinct incentives and capabilities of the private sector[11] and create "win-win" arrangements. However, a PPP will not always be the most effective option for delivering a particular project and implementing a PPP presents unique challenges for the municipality, including increased project preparation requirements, direct

[2] See Guidance Note Sections 1.1 and 1.2 for more information on defining municipal PPP.
[3] See Module 15: Sector Issues for more information on issues related to particular infrastructure sectors.
[4] See Guidance Note Section 1.2 for more information on types of PPP project structures.
[5] See Guidance Note Section 1.2 for more information on project risks and risk allocation. Also see Module 3: Project Concept Note for an example of a provisional risk allocation matrix and Module 4: Feasibility Study for information on how risk allocation is developed and evolves during the project development process.
[6] The cost of capital refers to the amount of return on investment that the private partner will require to make its investment in the project worthwhile, considering, inter alia, the risk of loss and opportunity cost of that investment.
[7] See Guidance Note Section 1.3, Remark on "Mythbusters" for further explanation.
[8] As used herein, PPP agreement refers to the contract signed between the municipality and the private partner to implement the PPP project. See Guidance Note Glossary and Section 5.1.
[9] See Guidance Note Sections 3.1 and 4.2 for more information on determining the optimal project structure.
[10] See Guidance Note Section 1.3 for more information on the benefits of PPPs.

and contingent fiscal liabilities, and oversight responsibilities.[12]

In considering whether and why to pursue a PPP, the municipality needs to consider the relative pros and cons of using PPP as compared to the other options for delivering the same project, in particular through the lens of efficient service delivery, public investment management,[13] fiscal risk management,[14] and capital planning; i.e. whether the project represents “value for money” or “VfM”.[15] To this end, the municipality should assess how PPPs factor into its broader planning and budgeting systems, and ensure adequate processes are in place to determine the most effective use of limited public resources and fiscal space.[16]

[11] See Guidance Note Section 1.3 for more information on the private sector’s distinct abilities and incentives in delivering public infrastructure services.

[12] See Guidance Note Section 1.3 for additional information on some of the challenges PPPs can present for municipalities.

[13] For further discussion, see: www.pefa.org and International Monetary Fund's Public Investment Management Assessment tool (2018).

[14] For more information, see Irwin, Timothy C, Samah Mazraani, and Sandeep Saxena. 2018. How to Control the Fiscal Costs of Public-Private Partnerships. Washington DC: International Monetary Fund.

[15] The definition of VfM will differ by municipality, depending on priorities and needs. VfM is not a strict, mathematical assessment, but rather a set of criteria to help understand whether the municipality gets a better deal from a PPP solution than other uses of public resources and opportunities.

[16] See Guidance Note Sections 1.3, 2.1, 3.1, and 3.2 for more information on the importance of planning and budgeting systems, as they relate both to good project selection and the municipality’s capacity to implement PPP.

3.0 Understanding the Context

Before attempting a particular PPP project or program, the municipality must understand the broader context in which the project will be developed and delivered. This includes the public sector context, from institutional capacity to funding PPP, and the private sector context, namely the key issues and concerns that will influence private investors' interest in investing in a PPP project.

3.1 Public

Before considering the potential to implement a PPP, it is important to first clearly understand the municipality's context as it relates to successful PPP delivery.[17] Key issues include:

- The municipality's investment planning and budgeting processes;
- The institutional capacity of the municipality to deliver a PPP, including its internal human resources and its ability to procure outside advisers to assist with project preparatory work;
- The municipality's creditworthiness, financial capacity, and overall credibility as a contractual partner; and
- The applicable legal and regulatory framework, including as it relates to the municipality's legal authority to enter into a binding PPP agreement.

Note

Funding PPP

Municipal PPPs need a robust revenue stream to fund capital and operating expenses, including debt service and equity return. The municipality should follow a hierarchy of possible revenue sources that begins with maximizing sustainable revenues from direct beneficiaries, then explores options to capture value from indirect beneficiaries. Finally, and only then, should public money or guarantees be used to enhance project viability, and only where that public support represents VfM for the government, the community, and the economy.[18]

3.2 Private

In preparing and structuring a municipal PPP, the municipality should consider the project from the perspective of a private partner.[19] In particular, a private investor will want to know that the project is well-studied and -prepared, with reliable forecasts of costs, demand, and revenue, as well as an appropriate allocation of risks. A prospective private partner will also be concerned with the broader context in which the project will operate. It will need confidence that the municipality will fulfill its contractual obligations and will have the capacity and intention to make any payments due under the PPP. If foreign investment is sought, private investors and lenders will need a means to manage foreign exchange risk and will need to trust the domestic courts to fairly adjudicate contractual claims or enforce arbitration awards, should a dispute arise. By considering issues like these from the outset, the municipality will increase the likelihood of identifying, preparing, and procuring a successful PPP.

[17] See Guidance Note Section 2.1 for more information on the municipal context. Also see Module 1: Municipal Readiness, which provides a tool for assessing a municipality's readiness to implement a PPP.

[18] For more information and guidance on funding PPP, see Guidance Note Section 2.4 on Funding PPP, Module 1: Municipal Readiness, Module 2: Project Concept Assessment Tool, Module 3: Project Concept Note, Module 4: Feasibility Study, Module 16: Harnessing Land Value Capture, Module 17: Capturing Commercial Value, and Module 20: Summary Practical Advice for Decision Makers.

[19] See Guidance Note Section 2.2 for more information on the private sector context. Also see Module 19: Private Sector Context for a deeper discussion of the relevant issues.

4.0 PPP Project Cycle

The full life-cycle of a PPP consists of four phases: i) selection; ii) development; iii) procurement and award; and iv) implementation.[20] These phases are not necessarily linear, a project may move back and forth between these phases as needed to ensure that it is well prepared. Furthermore, in some jurisdictions the applicable legal and regulatory framework may set out specific requirements and processes that must be followed with respect to some or all the stages in the project cycle.

Implementing a successful PPP requires significant upfront investment, both in terms of time and money, but this investment will generate substantial benefits over the life of the project and greatly reduce the likelihood of costly changes or otherwise incurring significant liabilities from the project in the future. A robust development process will help ensure, among other things, that the project:

- Provides value for money to the municipality versus other delivery options;
- Does not expose the municipality to excessive liabilities;
- Attracts more and higher quality bidders, which increases competition and so may reduce the project cost, and makes it more likely that the winning bidder will have the capacity to deliver the project to the municipality's specifications;
- Minimizes or eliminates negative environmental or social impacts from the project; and
- Provides high quality and affordable services to the project's beneficiaries.

Failure to invest adequate time and resources for project development can reduce the value of the project, result in significant costs for the municipality, and make the project more likely to fail. The municipality is unlikely to have sufficient internal human resources in this regard, especially when undertaking its first PPP project or program. Internal human resource capacity can and should be developed over time, through appropriate hiring, formal trainings, and direct, on-the-job experience with PPPs. In many respects, expertise is best acquired by actually working on a PPP (i.e., learn-by-doing), provided that emphasis is placed on knowledge sharing to ensure that lessons learned are shared among staff and preserved within institutions despite staffing changes.

In the interim, gaps in internal capacity can be overcome by seeking external assistance with project development. To this end, recourse may be made to national or state-level PPP units and other government departments and entities at the local or national level with PPP experience that can provide hands-on support to the municipality. In addition, the municipality will almost certainly need to procure qualified, third-party consultants for project-level advisory services. This may include assistance with initial project selection, preparation of a feasibility study, and transaction advice through to selection of the private partner, signing the PPP agreement, and financial close. Costs for these services vary significantly based on the size and complexity of the project and the capacity of the municipality. These services may be paid for by national or local PPP units or by the municipality directly from various funding sources (e.g., technical assistance from development partners, or special funds created for such purpose at the national or state-level, among others).[21]

4.1 Project Selection & Prioritization

In the selection phase, the municipality identifies and selects a project for development as a PPP. The purpose of the selection stage is to determine which projects appear most suitable for delivery via PPP and then to prioritize those projects, in view of the municipality's priorities and capacity as well as the private sector appetite for investment.

Screening potential projects for PPP suitability should occur as part of the municipality's regular investment planning processes and should include consideration of projects to improve or expand existing services, not only new builds,[22] as well as ad hoc projects that may arise from time to time, for instance as a result of a natural disaster.

[20] See Guidance Note Sections 3-6 for more information on each step in the project cycle.

[21] For more information and guidance on understanding and building internal capacity and accessing external assistance with project development, see: Guidance Note Section 3.2, box on Project Inception Support, Guidance Note Section 3.3 on Preparation Funding, Guidance Note Section 4.3 on Hiring Advisers, Module 1: Municipal Readiness, Module 3: Project Concept Note, Module 5: Managing Consultants, Module 6: Sample Consultant Terms of Reference, and Module 13: Capacity Building.

[22] See Guidance Note Section 3.1, Note on "The Temptation of New Build."

This might require reversing the municipality's usual approach to infrastructure investment planning. Common planning processes focus on the efficient allocation of public funding, and therefore the most feasible projects are generally allocated public funding and financing. More risky or complicated projects tend to be relegated to private development, including PPP. However, private financing is risk based, i.e. private financing for more risky projects attracts a higher financing cost, less risky projects can be financed at a lower interest rate. Therefore, the usual allocation dynamic should be reversed—the least risky, most feasible projects should be developed with PPP. For example, there are countries where for every project that asks for public funding, the project team must elaborate why the project cannot be implemented through a PPP structure.

In general, projects should be evaluated and screened based on the strength of the underlying rationale for the project, institutional readiness to implement the project, project readiness, and PPP suitability, using common and objective criteria and scoring.[23] As part of the analysis, the municipality should prepare a concept note to capture key summary information (that is, need, project description, project rationale, identified sources of revenue and financing).[24] Projects that are more 'ready' and more attractive candidates for PPP will move on to the next phase.

The municipality must then prioritize the potential projects,[25] in view of its development priorities and capacity, including resource constraints, in terms of both staffing and funding, that may limit the number of PPPs that can be pursued at one time. In addition, the municipality should consider the market appetite and its expected evolution in the short to medium term, which will influence the number projects that should be prepared as a priority to fit with and avoid exceeding market appetite.

Note that at the selection phase, the amount and quality of data is likely to be very poor. Definitive decisions should not be taken against such preliminary data, but rather indicative to help guide the municipality and identify additional data required and further analysis to be done. This initial assessment should be updated and repeated as appropriate where new data is accessible.

[23] See Guidance Note Section 3.1 for more information on project screening. Also see Module 2: Project Concept Assessment Tool and Module 3: Project Concept Note for more guidance on evaluating projects.
[24] See Module 3: Project Concept Note for a template and sample project concept note.
[25] See Guidance Note Section 3.2 for more information on project prioritization.
[26] See Guidance Note Section 2.6 for more information on small projects.
[27] See Guidance Note Section 2.6, box on "Small Project, Small Liabilities?".

Note

Implementing Small Projects

One common initial screening criteria is the size of the project cost. 'Small' projects, generally referring to those that cost less than US$ 5 million equivalent, have a number of disadvantages in terms of PPP delivery, in particular transaction costs are not proportionately lower for small projects and therefore tend to be disproportionately high. So, small projects may be screened out early, on this basis.

However, a growing practice in small PPP has led to the development of mechanisms to mitigate some of these challenges.[26] These mechanisms may need to be implemented at the national level, by the municipality, or by the PPP team as they develop projects. Some of these mechanisms include:

- A simplified approval process for small PPPs;
- Standard processes and documents that can make similar types of small projects easier and cheaper to prepare and deliver; and
- Aggregating small projects (i.e., pooling or bundling them into one project), to leverage economies of scale to reduce total cost and speed development, while also making the investment larger and more attractive for larger, more experienced investors and lenders.

At the same time, it is important to note that small projects do not necessarily mean small liabilities for the municipality.[27] Accordingly, consideration should be given to the full extent of fiscal liabilities created by a project and the municipality may consider limiting the type or amount of government support available to small PPP.

4.2 Project Development

In the development phase, the municipality undertakes a comprehensive feasibility study to assess the viability of the project: technical, economic, financial, fiscal, environmental, social, legal, risk allocation, and so on. In addition to providing a detailed assessment of the feasibility of the project as initially conceived, this stage may involve significant revisions to the project as more information becomes known. The findings of the studies undertaken for the feasibility study may, for instance, necessitate or advise changes to the project's size, scope, outputs, structure, and financing and funding mechanisms. In brief, in the feasibility study the project is not only analyzed and assessed but also further developed and elaborated.

At this stage, if not earlier, the municipality must appoint a project manager. The project manager is responsible for supervising and managing the PPP project on a daily basis.[28]

Recommendation

The Feasibility Study

The better and more complete the feasibility study, the more sustainable the project will be. Any temptation to cut corners to save money on this analysis, or when time is scarce and when expectations are unrealistic, must be avoided. Municipalities, even large ones, in general do not have the required human resources to carry out a full feasibility study by themselves. Therefore, feasibility studies are prepared by an external adviser or firm hired by the municipality.

The feasibility study report informs the decision-making body in the municipality about the feasibility and desirability of undertaking the project as a PPP, and about the readiness of the project to proceed to procurement.[29]

Project preparation and development needs to involve the community, those directly affected by the project and those less immediate, the poor, women, and disenfranchised groups.[30]

In addition, at this stage if not before, the municipality should consult the market to understand project structures that meet market requirements and market appetite for certain projects and sectors. Market consultations should be performed at various times during project selection and preparation, with the extent, participants, and location (e.g. foreign or domestic) determined by the circumstances of the particular project.[31]

[28] See Guidance Note Section 4.1 for more information on the project manager. Also see Module 1: Municipal Readiness, for guidance on internal staffing needs.

[29] For more information and guidance on the feasibility study and procuring and supervising external advisers to complete this study, see: Guidance Note Section 3.3. on Preparation Funding, Guidance Note Section 4.2 on Feasibility Study, Guidance Note Section 4.3 on Hiring Advisers, Guidance Note Section 4.5 on Approval for Tender, Module 1: Municipal Readiness, Module 2: Project Concept Assessment Tool, Module 4: Feasibility Study, Module 5: Managing Consultants, and Module 6: Sample Consultant Terms of Reference.

[30] See Module 18: Community Engagement. Also See Module 14: Communication Strategy.

[31] See Guidance Note Section 4.4 for more information on market consultations. Also see Module 6: Sample Consultant Terms of Reference for additional information on the role of advisers in market soundings.

4.3 Procurement & Award

In the procurement and award phase, the municipality conducts an open, competitive procurement process to select a private partner for the realization of the project.[32] The particular processes and requirements for procurement are likely governed by local or national procurement laws and regulations, which will vary by jurisdiction. The guidance note and related modules address the basic steps and provide model documents for both a single-stage and two-stage procurement process,[33] which will need to be adjusted to fit the particular context of the municipality and the project. As with the other stages of the project cycle, the municipality will likely require external assistance in preparing the tender documents[34] (i.e., requests for qualification[35] and proposals[36] and the draft PPP agreement[37]) as well as with evaluating bids and negotiating the final PPP agreement with the preferred bidder.[38]

Note

The Procurement Process

The procurement process generally entails soliciting and evaluating bids that set forth the qualifications, technical proposals, and financial proposals of interested bidders.[39] Once a preferred bidder is selected, the final PPP agreement is negotiated and signed; this is referred to as 'commercial close.' 'Financial close' is the moment when the lending agreements become binding on the lenders.[40]

Note that the municipality may at times receive an unsolicited proposal (USP). A USP is submitted by a private party to the municipality to undertake a PPP project at the private firm's initiative, rather than as a response to a request from the government. It is advisable for the municipality to exclude USPs entirely,[41] as many countries do, particularly until it has a significant depth of experience in PPPs. An open, competitive process with no particular advantage to any bidder is the best way to implement a successful PPP. In certain cases, direct negotiations with a single, preferred private partner may be permitted, for example in a national state of emergency or for small changes to existing projects (where there is no real prospect of competition). Nonetheless, the municipality should obtain expert advice when approaching such negotiations, which can be complex.

[32] See Guidance Note Section 5 for more information on procurement and award. Also see Module 7: Procurement.
[33] See Guidance Note Section 5.2 for more information and guidance on procurement options.
[34] See Guidance Note Section 5.1 for more information and guidance on preparing the tender documents.
[35] Module 8: Sample Request for Qualifications (RFQ).
[36] See Module 9: Sample Request for Proposals (Single Stage) and Module 10: Sample Request for Proposal Document Two-Stage Bid Process.
[37] See Guidance Note Section 5.1 for more information on the key terms of the PPP agreement. Also see Module 11: Sample PPP Agreement.
[38] Provincial or national government may have approval rights over the project at various stages, in particular where government financial support is to be provided. The approval stages should be mapped out to manage appropriately.
[39] See Guidance Note Section 5.2 for more information on bidders, particularly regarding special purpose vehicles.
[40] For more information and guidance on the procurement process and accessing external assistance, as well as model tender documents, see: Guidance Note Section 3.3. on Preparation Funding, Section 4.3 on Hiring Advisers, and Section 5 on Procurement and Award. Also see Module 1: Municipal Readiness, Module 5: Managing Consultants, Module 6: Sample Consultant Terms of Reference, Module 7: Procurement, Module 8: Sample Request for Qualifications (RFQ), Module 9: Sample Request for Proposal Single-Stage Bid Process, Module 10: Sample Request for Proposal Document Two-Stage Bid Process, and Module 11: Sample Municipal PPP Agreement.
[41] See Guidance Note Section 5.4 for more information and guidance on USPs, including best practices for jurisdictions where USPs are allowed.

4.4 Implementation

During the implementation phase, the project is constructed, the private sector begins operations, and services are delivered. The role of the municipality in this phase consists of contract management and the monitoring of the performance of the private operator.[42]

Managing a PPP agreement requires a different approach from managing a conventional public procurement contract. A conventional public procurement contract is short term (usually at most two or three years) and pertains to the execution of precisely defined activities. A PPP agreement, on the other hand, is long term and output based. The key success factor of effective contract management is a good relationship between the municipality and the private partner. The essence of PPP is that both parties proactively work together to manage conflict, avoid defaults, and deliver public services.

On project implementation, the project manager should be replaced by a contract manager to act as the primary point of contact of the municipality with the private partner. In some cases, the contract manager may be assisted by a contract management team that combines the various disciplines that are needed to monitor the performance of the private partner and manage the PPP contract.[43] A contract management plan (CMP) determines the composition and function of this team. The CMP is prepared (usually by the transaction adviser) even before the award and signing of the PPP agreement, and is updated after the signing of the PPP agreement.[44]

The contract manager and team are generally responsible for:[45]

- Monitoring the performance of the private partner and checking it against the contract requirements;
- Budgeting and settling payments due from the municipality under the PPP contract (if any);
- Handling contract events according to the provisions of the PPP contract (for instance, tariff adjustments, non-compliance with performance requirements, changes in law, contract amendments, force majeure, refinancing, disputes, and early termination);
- Reporting on the performance of the PPP to the municipality and to stakeholders; and
- Preparing for the handover of the project's residual assets from the private partner to the municipality, in accordance with and on conclusion of the PPP agreement. Note that the municipality must decide how the project services will be provided after the termination of the PPP agreement well before the end date of that agreement, in order to ensure uninterrupted service delivery.

[42] See Guidance Note Section 6 for more information on the municipality's role during the implementation phase. Also see Module 12: Contract Management.

[43] See Guidance Note section 6.1 for more information on the project manager and project management team.

[44] See Guidance Note Section 6.2 for more information on the CMP.

[45] See Guidance Note Section 6.3 for more information and guidance on contract management. Also see Module 12: Contract Management for more detailed guidance on contract management procedures.

5.0 List of References

Irwin, Timothy C, Samah Mazraani, and Sandeep Saxena. 2018. *How to Control the Fiscal Costs of Public-Private Partnerships.* Washington DC: International Monetary Fund.