Public Private Partnership Assessment

Public Private Partnership Guidance Note 4

14 April 2000

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I. Introduction

Purpose and Scope of Guidance Note

1.1 This Guidance Note provides guidance for Central and Contracting Authorities on the preparation of a Public Private Partnership Assessment for an individual project. The purpose of the Guidance Note is:

- to explain the role of the Public Private Partnership Assessment within the context of the Public Private Partnership Route Map;
- to introduce the main elements of the Public Private Partnership Assessment and to provide guidance on the steps involved in completing each element; and
- to set out the roles and responsibilities of Central and Contracting Authorities in undertaking the Public Private Partnership Assessment.

1.2 This Guidance Note is one of a series of Guidance Notes which provide contextual information on Public Private Partnerships and procedural guidance for Central and Contracting Authorities covering each stage in the development and implementation of infrastructure projects using the Public Private Partnership approach. The titles of all of the other Guidance Notes are set out in Appendix A to this Guidance Note.

1.3 The Guidance Notes are designed to be informative rather than prescriptive and the aim is to reflect good practice. They are generic in that they provide guidance on the use of Public Private Partnerships across a range of projects in the roads, water and waste sectors. However, different projects will give rise to different issues and the guidance provided will have to be reviewed in the context of each individual project. For this reason it is important that Central and Contracting Authorities obtain expert advice in order to help them to make best use of the Guidance Notes and to complete a successful Public Private Partnership procurement.

Structure of Guidance Note

1.4 The Guidance Note is structured as follows:

- ***Section Two*** - sets out the Public Private Partnership Assessment within the context of the Public Private Partnership Route Map. It then provides an overview of the key components of the Public Private Partnership Assessment and concludes by describing how such an assessment should be managed;
- ***Section Three*** – provides guidance on the preparation of an initial Output Specification, which is based on the outcomes of the Project Appraisal and provides a high level definition of what is required in terms of service delivery;
- ***Section Four*** – sets out the recommended approach to assess the potential for a Public Private Partnership to deliver improved value for money;

- ***Section Five*** – provides guidance on the preliminary risk assessment, which involves the identification and quantification of significant project risks and a preliminary assessment of the most cost effective allocation of risk between the Contracting Authority and the Contractor;

- ***Section Six*** – sets out the issues that should be considered by an assessment of the bankability of any project that may be part or wholly financed by the private sector;

- ***Section Seven*** – sets out the issues that should be considered by an assessment of the legal ability of a Contracting Authority to enter into a Public Private Partnership contract;

- ***Section Eight*** – provides guidance on the selection of the most appropriate contractual form and scope of Public Private Partnership for a project;

- ***Section Nine*** – describes the parameters that should be established to test at the end of the procurement process whether the preferred Public Private Partnership tender represents value for money; and

- ***Section Ten*** – describes how the main findings and conclusions of the PPP Assessment should be presented.

1.5 The final Section provides a summary of the main issues and recommendations that are identified and discussed within this Guidance Note.

Public Private Partnership Route Map

1.6 The process of project development and implementation changes significantly when a project is taken forward as a Public Private Partnership. For this reason a Public Private Partnership Route Map has been developed.

1.7 The Public Private Partnership Route Map sets out the main stages in the development and implementation of a Public Private Partnership project that must be undertaken by the Central Authority or the Contracting Authority. The Route Map is presented in the diagram shown overleaf.

1.8 The Public Private Partnership Route Map shows how the traditional processes of project development, procurement and implementation change for a Public Private Partnership project. A more detailed description of the Public Private Partnership Route Map is provided in the separate Guidance Note entitled *Introduction to Public Private Partnerships*.

1.9 The Public Private Partnership Assessment is undertaken at an early stage in the life of a project and its role in the context of the Public Private Partnership Route Map is discussed in detail in the next section of this Guidance Note.

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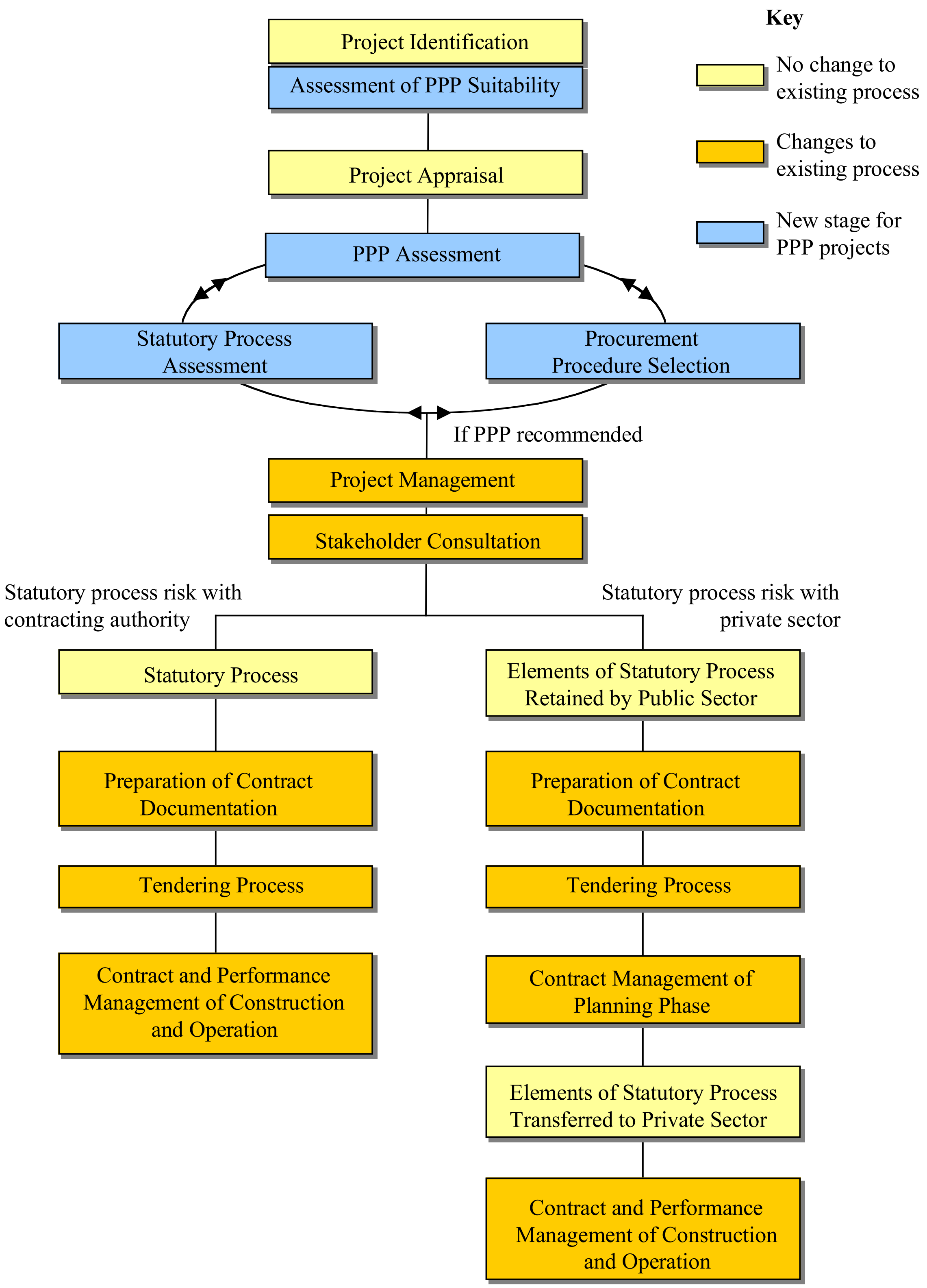
Figure 1: Public Private Partnership Route Map



II. Public Private Partnership Assessment

Introduction

2.1 This section of the Guidance Note commences by describing the four activities that comprise the Option Appraisal stage for projects identified as having the potential to be procured as Public Private Partnerships. The four activities are the Project Appraisal, Public Private Partnership Assessment, Statutory Process Assessment and Procurement Procedure Selection. It then provides an overview of the key elements of the PPP Assessment, which are described in detail in subsequent sections of this Guidance Note, and concludes by discussing the management and scope of the PPP Assessment.

Scope of the Option Appraisal Stage

2.2 New roads, water and waste projects are identified by National Development Plans, needs studies or other strategy studies and plans. The projects are then included in operational programmes and annual investment programmes that determine the list of projects to be funded.

2.3 It is during this Project Identification stage that the potential for procuring an infrastructure project as a Public Private Partnership is first considered by the Central Authority. If a project is considered to be suitable and desirable for procurement as a Public Private Partnership, then the project will be identified as a possible PPP project in the appropriate operational programmes and annual investment programmes. The criteria for reviewing the suitability and desirability of procuring a project as a Public Private Partnership are described in the separate Guidance Note entitled *Introduction to Public Private Partnerships*.

2.4 The Project Identification stage concludes with the issue of an approval from the Central Authority to the Contracting Authority to initiate the project and to commence the Option Appraisal stage.

2.5 For those infrastructure projects that have been identified as having the potential to be procured as Public Private Partnerships, the Option Appraisal stage will involve:

- Project Appraisal;
- PPP Assessment;
- Statutory Process Assessment; and
- Procurement Procedure Selection.

2.6 The above activities are described in the paragraphs that follow.

Project Appraisal

2.7 For traditional projects in the roads, water and waste sectors, the key outputs associated with the Project Appraisal process are set out in the diagram below:

Roads	**Water**	**Waste**
• Corridors and Constraints Study	• Preliminary Report	• Constraints Study
• Route Selection Study	• Site selection	• Site selection
• NRA Tolling and Viability Study (if appropriate)	• Preliminary Design	• Preliminary Report

2.8 In simple terms, Project Appraisal involves the identification of suitable options to meet service objectives, and the selection of a preferred option. Options are appraised through constraints studies and preliminary reports, which provide economic evaluations, cost estimates, outline requirements and site or route selection. Environmental Impact Statements may also be prepared as part of the Project Appraisal process.

2.9 The process of undertaking Project Appraisals for Public Private Partnership projects will be the same as for traditional projects, unless statutory process risk is to be transferred to the private sector (see below). In such circumstances, the Project Appraisal will still be required, but possibly at a higher level of detail.

2.10 Contracting Authorities commonly appoint technical consultants to undertake the Project Appraisal. The precise requirements of the Project Appraisal are different for projects in the roads, water and waste sectors, and sector specific guidance is available from the relevant Central Authority.

2.11 The selection of a preferred option is approved by the relevant Central Authority. Approval will depend on the Project Appraisal clearly demonstrating that the preferred option meets strategic objectives in terms of delivering the required service outputs at an affordable cost. It must also show that the project is sound in economic terms and that the preferred option represents value for money.

2.12 It is following the completion of the Project Appraisal that the Contracting Authority should undertake the PPP Assessment, Statutory Process Assessment and Procurement Procedure Selection for those infrastructure projects previously identified as having the potential for procurement as Public Private Partnerships.

Public Private Partnership Assessment

2.13 The PPP Assessment is a detailed assessment of the potential for a Public Private Partnership to deliver improved value for money compared with traditional procurement. It involves a preliminary assessment of project risks, a value for money assessment, a bankability review and a legal viability assessment. Further details are provided in this Guidance Note.

2.14 The Statutory Process Assessment is an assessment of the potential to transfer statutory process risk to the private sector under a PPP arrangement. The decision as to whether to transfer statutory process risk will depend on a range of factors, including the Public Private Partnership option that is recommended, the specific characteristics of the project concerned, the procurement procedure selected, and the value for money that may be gained or lost as a result of risk transfer. Further details are provided in the separate Guidance Note entitled *Statutory Process Assessment*.

2.15 Coincidental to the assessment of the potential to transfer statutory process risk should be the selection of the preferred procurement procedure. The decision will be between the negotiated and restricted procedures, and will depend on European Union procurement law, the Public Private Partnership option that is recommended, the specific characteristics of the project, the potential to transfer statutory process risk, and the value for money that may be gained or lost as a result of the procurement procedure adopted. Further details are provided in the separate Guidance Note entitled *Procurement Procedure Selection*.

2.16 The PPP Assessment, Statutory Process Assessment, and Procurement Procedure Selection are closely related, and it will be important to establish mechanisms to facilitate iteration between these three important activities. For example, the decisions to be taken during the Statutory Process Assessment and Procurement Procedure Selection will be informed by the outcomes of the PPP Assessment. Similarly, the outcomes of the Statutory Process Assessment and the Procurement Procedure Selection might also further inform the PPP Assessment. It is strongly recommended therefore that the Guidance Notes for all three activities are read before the PPP Assessment is undertaken.

Approval from Central Authority

2.17 Once the Public Private Partnership Assessment, Statutory Process Assessment and Procurement Procedure Selection have been completed, the Central Authority will decide whether to approve the Contracting Authority to proceed with a Public Private Partnership procurement. The approval would outline:

- the preferred option arising from the Project Appraisal;
- the form and scope of Public Private Partnership to be adopted;
- the allocation of responsibility for undertaking the statutory process; and
- the procurement procedure to be followed.

2.18 The Central Authority will be required to consult with the Department of Finance before giving approval for a Contracting Authority to proceed with the procurement of a Public Private Partnership project that involves private finance and has long term implications for the Exchequer.

2.19 Once the necessary approval has been received, the Contracting Authority will establish appropriate project management structures to deliver the project, and make suitable arrangements for stakeholder consultation. Further guidance in relation to these matters is provided in the Guidance Notes entitled *Project Management* and *Stakeholder Consultation*.

2.20 The remaining sections of this Guidance Note provide advice on the preparation of a PPP Assessment.

Purpose of the PPP Assessment

2.21 A key driver of the PPP programme in Ireland is the desire to increase value for money in infrastructure procurement. To ensure that value for money is achieved, there must be clear justification for the project, a competitive procurement and the Contracting Authority should be able to demonstrate that the option selected offered better value for money than the alternatives. Whilst post procurement reviews will ultimately show whether value for money is being achieved through PPP, procedures must be in place to ensure that the options being developed are likely to deliver value for money.

2.22 The purpose of the PPP Assessment is to assess at the Option Appraisal stage the potential for a Public Private Partnership to deliver improved value for money compared with a traditional procurement. The PPP Assessment addresses two key issues in detail:

- Does the project have the potential to be procured as a Public Private Partnership?

- Which form of Public Private Partnership provides the greatest potential for improved value for money?

2.23 The PPP Assessment is therefore the fundamental tool in deciding whether or not to proceed with a Public Private Partnership procurement. The outcomes of the PPP Assessment will determine whether or not the Central Authority authorises the Contracting Authority to proceed with a Public Private Partnership procurement.

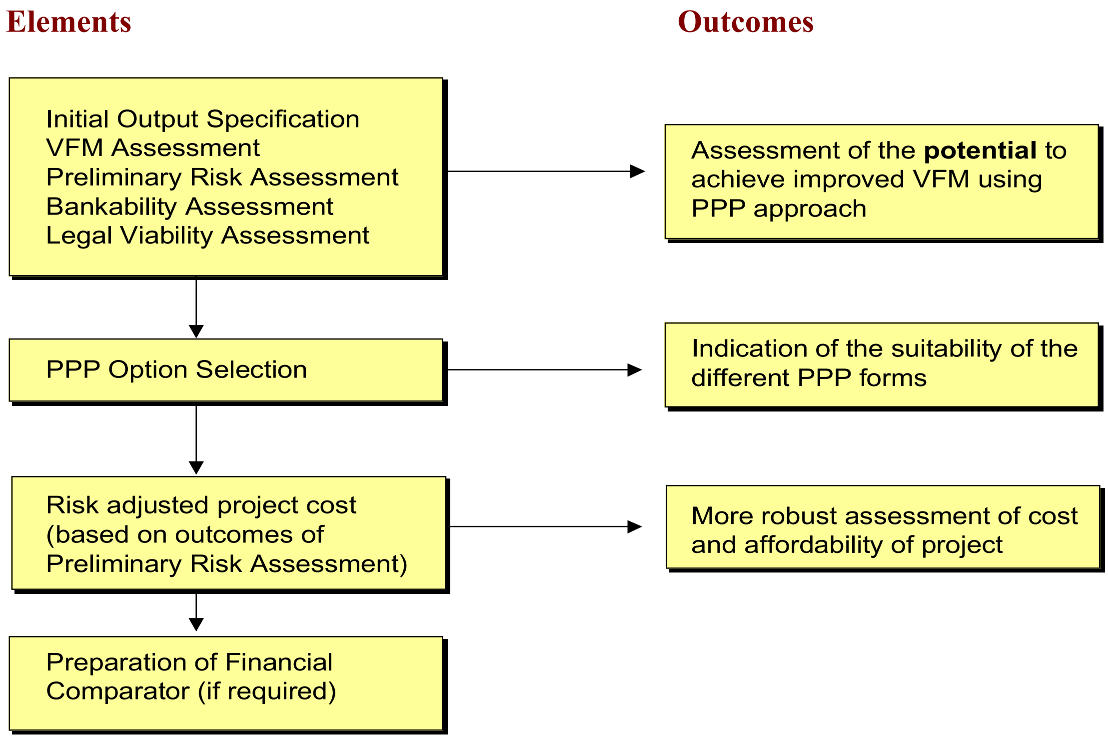
2.24 The key elements of the Public Private Partnership Assessment are summarised in Figure 2 overleaf and are described in detail in subsequent sections of this Guidance Note. The main outcomes arising from the PPP Assessment are summarised in Figure 3 that follows.

Figure 2: Key Elements of the Public Private Partnership Assessment

Initial output specification	An **initial output specification**, which is based on the conclusions of the Project Appraisal and provides a high level definition of what is required in terms of service delivery.
Value for money assessment	A **value for money assessment**, involving the identification of factors that will determine whether a project is likely to represent value for money, and a qualitative assessment of the potential of the project to deliver those factors, using tools such as precedent review and market sounding.
Preliminary risk assessment	A **preliminary risk assessment**, including the identification and quantification of key risks, initial allocation of risk between the public and private sectors, and an assessment of whether sufficient risk transfer is possible to merit a PPP approach. Preliminary views on the key contractual issues should also be included.
Bankability assessment	A **bankability assessment** of any project that may be part or wholly financed by the private sector. The bankability assessment should establish the financing issues that need to be addressed prior to a procurement proceeding as well as those that will need to be reflected in contract documentation.
Legal viability assessment	A **legal viability assessment**, to assess whether the Contracting Authority has the legal ability to enter into a Public Private Partnership contract. The legal viability assessment should also consider the legal implications of the project in relation to existing employees, assets and contracts.
PPP option selection	A **PPP option selection**, involving the selection of the contractual form and scope of Public Private Partnership that most closely meets the strategic objectives of the project and offers greatest scope for value for money.
Parameters for final VFM assessment	Identification of the **parameters** to be used at the end of the procurement process to test whether the preferred PPP tender represents value for money. In some cases this will involve the preparation of a **Financial Comparator**.
Indicative Implementation plan	An **indicative implementation plan** describing the organisational structures required to manage the procurement, and setting out an indicative timetable with target completion dates for the main activities involved in the procurement of the project.

2.25 The main outcomes of the PPP Assessment can be summarised as follows:

Figure 3: Outcomes of PPP Assessment



2.26 Guidance on the completion of each element of the PPP Assessment is provided in the sections that follow.

Managing the PPP Assessment

Project Management

2.27 The preparation of a PPP Assessment for a large infrastructure project requires detailed consideration of a wide range of issues. In deciding how the PPP Assessment should be managed the following points are relevant:

- some elements of the PPP Assessment relate to public policy and public expenditure impacts that can only be addressed by the Central Authority. The Central Authority will also be best placed to ensure consistency of approach and to collate and evaluate national and international data on project experience and costs;

- many of the project specific issues are best assessed by the Contracting Authority; and

- given the complexity of PPP projects, expert technical, legal and financial advice will be required. The level of input of such experts will depend on the scale of the project and whether private finance is involved.

2.28 Thus to conduct a comprehensive PPP Assessment, a combination of Contracting Authority, Central Authority and expert advice will be required. As outlined in the separate Guidance Note entitled *Project Management*, the Contracting Authority will procure the technical advice required to complete all aspects of the Option Appraisal stage, including the Project Appraisal, PPP Assessment, Statutory Process Assessment and Procurement Procedure Selection. The Central Authority will procure financial and legal advice, which will be made available to the Contracting Authority.

2.29 As described above, one of the final elements of the PPP Assessment involves establishing the parameters to be used at the end of the procurement process to test whether the preferred PPP tender represents value for money compared with traditional procurement. In some cases this will involve the preparation of a Financial Comparator as part of the PPP Assessment.

2.30 The Financial Comparator will be prepared by the financial advisers to the Central Authority, with relevant input from the Contracting Authority and the technical and legal advisers. It is important that the results of the Financial Comparator remain confidential and therefore the Central Authority will communicate the results of the Financial Comparator to the Contracting Authority after tenders have been received.

2.31 A number of pilot projects have already been identified as being suitable for procurement as Public Private Partnerships involving private finance. To ensure speed of delivery of these projects, it is understood that where central financial and legal advice is not yet available, approval has been given to Contracting Authorities to appoint multi-disciplinary teams to act as Client Representatives. These teams will be responsible for preparing all aspects of the Option Appraisal stage and for bringing the projects through to procurement. For future projects, the Central Authority should indicate its preferred method of managing the Option Appraisal stage to the Contracting Authority once the project has been identified at the Project Identification stage as being potentially suitable and desirable for procurement as a Public Private Partnership.

2.32 Regardless of the choices made regarding the management of the Options Appraisal stage, a full report including the Project Appraisal, PPP Assessment, Statutory Process Assessment and Procurement Procedure Selection should be forwarded to the Central Authority for review and approval. The Central Authority will be required to consult with the Department of Finance before giving approval to proceed with the procurement of a Public Private Partnership project that involves private finance and has long term implications for the Exchequer.

Scope of the PPP Assessment

2.33 The PPP Assessment determines the suitability (or otherwise) of a project for procurement through a Public Private Partnership. The level of detail included in the PPP Assessment will vary according to the type and complexity of the project. Small, relatively straightforward projects will not require the same level of work as large and complex projects, and the resources allocated to complete the PPP Assessment will need to be tailored accordingly.

2.34 It will be important to ensure that a thorough examination is undertaken of all the risks associated with each project to identify the most cost-effective allocation of risk between the public and private sectors. The allocation of risk is a key determinant in the suitability of a project for procurement as a Public Private Partnership, in establishing the optimum scope of the project in terms of service requirements, and in selecting the most appropriate contractual form.

2.35 This Guidance Note is intended to provide only an indication of the structure and content of a PPP Assessment, and it will be up to the Central Authority to determine the specific needs for each project. A typical contents page for a PPP Assessment is set out in Appendix B to this Guidance Note.

III. Initial Output Specification

Introduction

3.1 Whilst the preparation of the PPP Assessment may be prompted by a proposal for capital investment, its focus must be on the specific services and outputs required. This is a fundamental principle of the Public Private Partnership approach.

3.2 Under the Public Private Partnership approach, private firms become long-term providers of services rather than simply upfront asset builders, combining the responsibilities of designing, building, operating and possibly financing assets in order to deliver the services demanded by the public sector. As a result, Contracting Authorities will increasingly become involved as regulators and will focus their time and resources on service planning, performance monitoring and contract management rather than on the direct management and delivery of services to the public.

3.3 Depending on the terms of the Public Private Partnership contract, assets may be owned by the Local Authority throughout the contract period, or they may revert to Local Authority ownership at the end of the contract.

3.4 The services and outputs required from a project are presented in the form of an output specification. The purpose of the output specification is to define what needs to be achieved, not how it is to be achieved. This provides scope for the private sector to be innovative in relation to asset design and service delivery.

Initial Output Specification

3.5 The PPP Assessment should include an initial output specification. The initial output specification should be developed from the project objectives as set out in the Project Appraisal.

3.6 To facilitate the development of an initial output specification, the project objectives should be specified in terms of the outputs that the project is required to deliver, and they should be specific, measurable, achievable, realistic and time-bounded.

3.7 The outputs specified should be capable of being assessed against clear and measurable performance criteria and defined in ways that allow their subsequent achievement to be evaluated. Describing objectives in terms of outputs and required levels of performance, rather than in terms of the inputs and resources that a project requires, will help to open up a wide range of solutions and promote innovation amongst private sector tenderers.

3.8 The initial output specification should also reflect the specific constraints on the project, as it is these constraints that will set the boundaries on how the outputs can be delivered. In particular, the initial output specification should be affordable to the public sector in both capital and operating terms. The affordability of a project should be addressed during the Project Appraisal.

3.9 The preparation of an initial output specification as part of the PPP Assessment provides a clear basis for comparing the characteristics of a project against the characteristics of different Public Private Partnership options. In this way a well defined initial output specification will enable the most appropriate form of Public Private Partnership to be more readily identified.

3.10 The preparation of an initial output specification will also assist the preparation of a detailed output specification at the commencement of the procurement process. It will also assist in the development of an appropriate set of evaluation criteria against which to measure private sector bids.

3.11 Further guidance to assist Contracting Authorities in the preparation of output specifications is presented in the Guidance Note entitled *Output Specifications*.

IV. Value for Money Assessment

Introduction

4.1 Public Private Partnerships should only be pursued where they are expected to deliver improved value for money. The assessment of value for money is therefore a fundamental requirement of a Public Private Partnership procurement.

4.2 Before entering into a PPP procurement, it is important to make an assessment of the potential for a Public Private Partnership to deliver improved value for money. This should allow some understanding of the potential for achieving cost savings or additional benefits through Public Private Partnerships.

4.3 The assessment of the potential to secure value for money is a key element of the PPP Assessment. The conclusions on value for money potential will inform the decision of the Central Authority on whether or not to proceed with a Public Private Partnership procurement, and if so, the form of Public Private Partnership to be used.

4.4 The final assessment of whether a Public Private Partnership procurement represents improved value for money can only be made at the conclusion of the competitive tendering process. The nature of this assessment is considered in Section Nine of this Guidance Note.

4.5 The assessment of the potential for a Public Private Partnership to deliver value for money has two parts:

(a) identification of the factors that will determine whether a project delivers value for money; and

(b) an assessment of the potential of the private sector to deliver value for money with regard to those factors.

4.6 These parts are described further in the paragraphs that follow. The outcomes of the assessment will help to inform not only the potential for a Public Private Partnership to deliver value for money, but also:

- selection of the most appropriate form of Public Private Partnership;
- identification of the optimum scope of the Public Private Partnership; and
- identification of the parameters that should be used at the end of the procurement process to assess whether the preferred Public Private Partnership tender represents value for money.

Factors that Determine Value for Money

4.7 The factors that determine whether a project delivers value for money will vary by type of project and by sector. Some factors will be common to a number of projects, and may relate to the strategic objectives of the Central Authority. In general, Public Private Partnerships can generate improved value for money through a number of ways including, *inter alia*:

- ***Reduced whole life costs*** - the integration of infrastructure design, build and operation, facilitating private sector innovation in design, an avoidance of over-specification and improved maintenance scheduling;

- ***Better allocation of risk*** - cost effective transfer of risk to the private sector, enabling efficiency benefits to be generated across the term of the contract;

- ***Faster implementation*** - the transfer of design and construction risks, together with the principle of no payment until commencement of service delivery, will provide significant incentives for the private sector to deliver infrastructure projects within short construction timeframes. This is highly relevant in the context of the *National Development Plan 2000 – 2006*;

- ***Improved quality of service*** – resulting from better integration of services with supporting assets, improved economies of scale, the introduction of new technology and innovation in design, and the performance incentives and penalties included in the Public Private Partnership contract; and

- ***Generation of additional revenue*** - more intensive exploitation of assets to generate additional revenues, for example from shared use of facilities or the sale of surplus assets.

4.8 Other factors will be project specific, and may be identified by considering the experience of similar projects, including projects constructed and operated using traditional approaches, and projects constructed and operated using a Public Private Partnership approach. For example, the experience of Hereford and Worcester County Council in procuring an integrated waste management service under a Public Private Partnership indicates possible ways in which the private sector might seek to deliver value for money within an integrated waste management PPP contract. These included the use of whole life costing approach to provide a long term integrated waste management solution, innovation in relation to service delivery, substantial risk transfer, maximising use of commercial management skills and commercial freedoms, and unlocking alternative uses to generate third party revenues (e.g. energy from waste).

4.9 A recent review of Public Private Partnership projects in the United Kingdom, conducted by Arthur Andersen for the Treasury Taskforce, identified that from a public sector perspective, there are six key drivers of value for money in PPP projects. These are: risk transfer, the long term nature of contracts (including whole life costing), the use of an output based specification, competition, performance measurement and incentives, and private sector management skills.

4.10 The review also identified that Public Private Partnerships are becoming well established as a procurement method in the United Kingdom, and that large and small projects have been successfully procured across a range of industry sectors. The average percentage saving in net present cost terms of using the Public Private Partnership approach, compared with traditional procurement, was estimated to be seventeen per cent (across a sample of twenty-nine projects) over the duration of the contract. The long term operational benefits, and hence value for money, of these projects will take more time to establish, and will depend on how well the private sector manages the risks transferred to it, and on the success of the public sector in managing contracts throughout their duration.

Assessing Value for Money Potential

4.11 The potential of the private sector to deliver value for money through Public Private Partnerships may be considered in terms of the experience of similar projects, particularly those that have been operational for a number of years. Such experience may be accessed through either desk-based research, or through consultations with potential private sector suppliers.

4.12 The main tools used to identify potential sources of value for money, and to assess the potential of the private sector to deliver value for money, are precedent review and market sounding. The key issues to be investigated within the precedent review and market sounding exercise will vary from project to project. However, in general, experience of similar projects should be investigated and the views of the private sector should be established in relation to the factors described above, and in particular in relation to:

- the scope of the project, including the balance between asset provision and service delivery;
- the potential for cost effective risk transfer, particularly in relation to statutory process risk, demand risk and residual value risk;
- the scope for user charges, third party revenues and alternative asset uses that might reduce the cost of the project to the Contracting Authority; and
- the potential for value for money, measured in terms of the main sources of value for money (in monetary and non-monetary terms) that were identified at the end of the procurement of similar projects, and evidence that value for money has actually been achieved in these areas during the construction and operation stages.

4.13 Documentation on previous projects, such as the Report on the Tendering Process and the project reviews undertaken at the end of the construction phase and during the operational phase, should assist in this regard. Quantitative information should be recorded wherever possible, and may include:

- ***Cost information*** – for example, the costs included in the tender submissions and the Financial Comparator (where appropriate), the actual cost to the Contractor (where available), and the actual cost to the Contracting Authority (in terms of payments made);

- ***Revenue information*** – for example, estimates of any revenue generated from third parties;

- ***Timetable for delivery* -** the actual timescale for project delivery compared with the timescale proposed in the tender submission and the timescale assumed in the Financial Comparator (where appropriate);

- ***Performance information* -** performance against the output specification; and

- ***Information on customer demand and satisfaction*** – details of the demand for the service, including any statistical evidence of customer satisfaction.

4.14 For the pilot PPP projects, it may be possible to obtain some of the above information for international projects from published reports and relevant contacts. For future PPP projects, it will be important to establish and maintain a database of information on the pilot projects to ensure that the experience of those projects is taken into account in the development of future Public Private Partnerships.

4.15 Further advice on conducting precedent review and market soundings is provided in the paragraphs that follow.

Precedent Review

4.16 Where there is an established market for the development of an asset or the provision of a service, it is desirable to undertake a review of precedent prior to commencing a detailed market sounding. The precedent review should examine experience in both local and international markets.

4.17 The review of precedent will be useful in providing background information on the level of market interest, the capabilities of the private sector, the key risks associated with projects and the willingness of the private sector to accept those risks. The market sounding process can then focus on particular issues arising out of the precedent review, and issues that are specific to the infrastructure project in question.

4.18 At the extreme, the review of precedent could highlight such a wealth of experience and information (including the results of previous market soundings) that further market sounding is not considered necessary. However, unless a project is very standard in nature, there is normally benefit to be gained from conducting at least a limited market sounding exercise to investigate the particular circumstances of the project under consideration.

Market Sounding

4.19 A Public Private Partnership project is only practicable where there are contractors able to deliver the required service and willing to accept sufficient risk transfer. Therefore, once the essential characteristics of an infrastructure project have been defined and an initial output specification produced, the nature and extent of market interest in a Public Private Partnership solution should be established by means of a market sounding exercise.

4.20 Private sector interest may be known on the basis of previous market soundings or from earlier projects. However, for large, innovative or complex infrastructure projects a separate market sounding exercise should be conducted as part of the PPP Assessment. The market sounding should focus on issues that are specific to the project in question. There are a number of elements to be considered as part of the market sounding process, including the strength of the private sector market for the project, the private sector's scope for achieving economies of scale, and its relevant expertise. The most important factors will be the likely level of interest in the project, and the capability of the market to undertake the project.

4.21 The different forms of Public Private Partnership should be explored, the private sector consulted and their interest not presumed or pre-judged. Every effort should be made to avoid implying that one solution is favoured over another. It is also recommended that the market sounding should be undertaken jointly by the relevant Authority and its appointed advisors.

4.22 The market sounding process should take the form of preliminary and confidential discussions with potential private sector partners, including consulting engineers, contractors and financiers. It is important to ensure that all those consulted, either on a formal or informal basis, clearly understand that all discussions are on a without commitment basis, and that they do not restrict or distort competition, or give one supplier an advantage over another in any subsequent formal tendering process.

4.23 To maximise the effectiveness of the market sounding process, private sector organisations will need to be provided with a Project Prospectus that sets out an indication of the likely scope and scale of the project, its service content, its anticipated key contractual terms and preliminary risk allocation (refer to Section Five of this Guidance Note). The discussions should also be supplemented with a Project Questionnaire in order to provide a formal record of responses to key questions.

4.24 To ensure the widest possible participation in the market sounding exercise, a Prior Information Notice (PIN) can be placed in the Official Journal of the European Communities inviting potential private sector suppliers to express their interest in participating in the market sounding exercise. In such circumstances, advice should be sought from the appointed legal advisors to ensure the proper use of the Prior Information Notice.

4.25 The results of the market sounding should be recorded in the PPP Assessment. If a Project Questionnaire is issued to private sector suppliers, then the responses received should be analysed and the results presented in detail. Some further useful tips on conducting market sounding are presented at Appendix C to this Guidance Note.

Shadow Bids

4.26 If there are major concerns regarding the potential for a Public Private Partnership to deliver value for money compared with a traditional procurement, then the Contracting Authority could consider asking the financial and technical advisers to develop a *shadow bid* as part of the PPP Assessment. Shadow bids can be developed in one of two ways:

(a) ***Estimating the cost savings required*** – this involves adding the additional costs of a PPP solution (e.g. cost of private finance, private sector profit margins, private sector tendering costs, and the costs of public sector regulation) to the Financial Comparator (defined in Section 9 of this Guidance Note), and then making a value judgement within the PPP Assessment, based on the results of the precedent review and market sounding, on the potential of the private sector to eliminate these additional costs; or

(b) ***Actual bid*** - developing an 'actual' bid for the PPP project from first principles. This 'actual' bid would be compared to the estimated cost of traditional public sector procurement to assess, within the PPP Assessment, the potential to achieve value for money using a Public Private Partnership approach.

4.27 Experience in the United Kingdom would however suggest that the shadow bids described in (b) above tend to be over-elaborate financial and economic models, which require substantial investment of time and money, but often provide spurious results and low levels of precision. The time and money used to prepare these models as part of the PPP Assessment could, in many instances, be more usefully applied in proceeding to a formal procurement process, which would provide a definitive assessment of the potential for value for money.

4.28 For these reasons, the use of shadow bids in the form of (b) above is not recommended in the PPP Assessment to determine the potential of a Public Private Partnership to deliver value for money.

Conclusions

4.29 The value for money assessment described above is not definitive. It provides an understanding of the **potential** for cost savings or additional benefits using the Public Private Partnership approach. The final assessment of whether PPP represents value for money can only be made at the end of the procurement.

4.30 The main findings of the precedent review and market sounding should be presented in the PPP Assessment in such a way as to facilitate consideration of:

- the potential for the private sector to deliver value for money through a Public Private Partnership;
- the forms of Public Private Partnership that provide the greatest potential for value for money to be achieved.

- the optimum scope of the Public Private Partnership; and

- the parameters that should be used at the end of the procurement process to assess whether the preferred Public Private Partnership tender represents value for money.

4.31 If the findings of the precedent review and market sounding suggest that a Public Private Partnership is unlikely to deliver improved value for money, then the Contracting Authority should not proceed with the remaining elements of the PPP Assessment, but should consider delivering the project through traditional public sector procurement.

4.32 As described previously, the conclusions of the value for money assessment will inform the decision of the Central Authority on whether to approve the Contracting Authority to proceed with a Public Private Partnership procurement. If the Central Authority decides to give such an approval, it is likely to specify to the Contracting Authority the form and scope of Public Private Partnership to be adopted. It might also highlight specific areas of the project that the Contracting Authority should investigate in more detail to determine whether there is scope for further improvements in value for money. For example, the Central Authority may consider the value for money provided by the transfer of demand risk to be an area of uncertainty. Under such circumstances it might advise the Contracting Authority to conduct further investigation on the most cost-effective allocation of demand risk prior to commencing the procurement, or even to seek variant bids during the course of the procurement.

V. Preliminary Risk Assessment

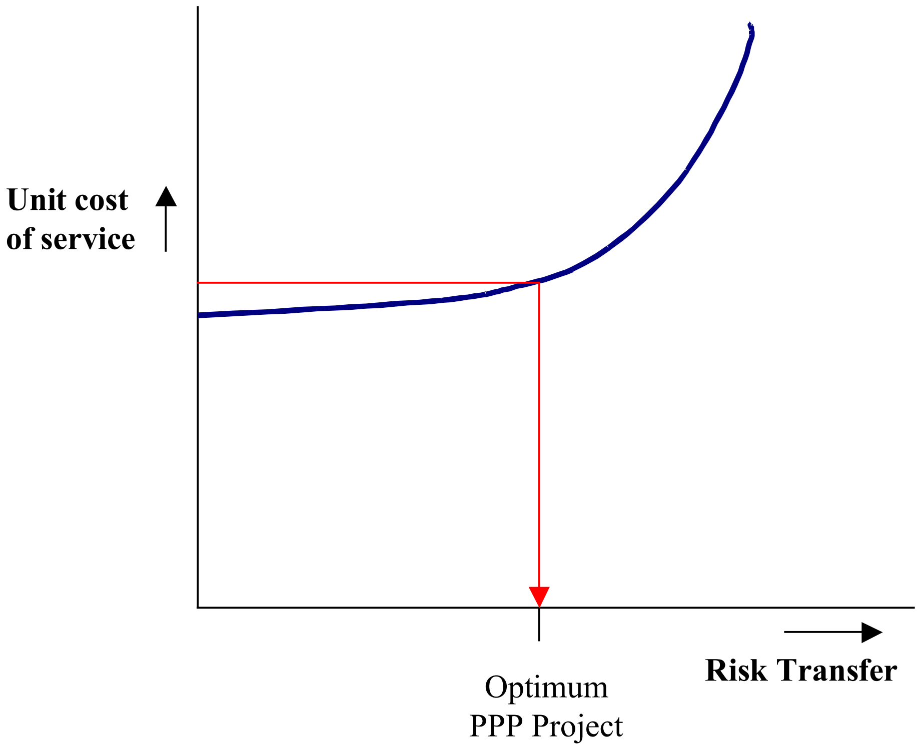
Introduction

5.1 A risk can be defined as a potential threat to the successful completion and operation of a project in terms of cost, time or quality. The efficient allocation of risk between a public sector procuring entity and a private sector supplier is an essential part of any successful procurement through Public Private Partnerships and the guiding principle is that risk should be allocated to the party or organisation best able to manage it. Although there may be policy reasons to encourage maximum risk transfer, the aim is to achieve the optimum allocation of risk and not simply the transfer of risk for its own sake.

5.2 In any Public Private Partnership project, the degree of risk transfer to the private sector will be determined by the nature of the project and will by definition vary on a project by project basis. The underlying principle is that risk should be allocated to the party best able to manage it.

5.3 It is important that this is not confused with transferring risk for its own sake. Figure 4 below shows that as risk transfer is increased beyond the optimum, the incremental increase in unit cost for an incremental increase in risk transfer increases significantly. Risk transfer above the optimum therefore results in reduced value for money, due to the premium that the supplier charges for managing those risks that they are less well equipped to manage.

Figure 4: Cost Effective Risk Transfer



5.4 The main benefit of cost effective risk transfer is that it generates the incentives for the supplier to deliver cost effective and high quality services on time.

Preliminary Risk Assessment

5.5 The purpose of conducting a preliminary risk assessment as part of the PPP Assessment is to identify and quantify the main risks associated with the project, and determine the optimum allocation of risk between the public and private sectors. The preliminary risk assessment comprises four steps, namely:

Figure 5: Steps in a Preliminary Risk Assessment

	Step Description	Outcome
Preliminary Risk Identification	Identification of the principle risks associated with the design, construction and operation of an infrastructure project	*Preliminary list of risks*
Preliminary Risk Allocation	Formation of an initial view as to whether the Contracting Authority or the Contractor is likely to be best able to manage each risk. Risks are then either allocated to the Contracting Authority, the Contractor, or identified as risks to be shared.	*Preliminary risk allocation*
Qualitative Risk Assessment	Qualitative assessment of the potential significance or impact of each risk. The results of the qualitative assessment are combined with the list of risks and the risk allocation to provide a preliminary risk matrix for the project. A risk management plan is prepared for those risks that are to be retained by the Contracting Authority.	*Preliminary risk matrix* *Risk management plan*
Preliminary Risk Quantification	Preliminary assessment of the monetary value of the most significant risks identified in the preliminary risk matrix. The monetary value of the most significant risks transferred to the Contractor is included in the Financial Comparator.	*Risk adjusted Financial Comparator*

5.6 The purpose of quantifying risk as part of the PPP Assessment is:

- to improve understanding of the size and monetary value of risk and the importance of risk management;
- to help identify the party that is best able to manage each risk, and also whether it would be cost effective to transfer the risk to the Contractor;
- to provide a more robust assessment of the cost of the project, and hence its affordability; and
- to provide a basis for developing a Financial Comparator (if required).

5.7 The preliminary risk assessment should be informed through discussions with potential private sector partners and experience to date both nationally and internationally. The precedent review and market sounding exercise should provide information on the main risks associated with particular types of project, the probability of their occurrence, the scale of their impact, and the ability of the public and private sectors to manage risks.

5.8 The preliminary risk assessment should provide a clear statement on the key risks (including their estimated value) that could be cost effectively transferred to the private sector. The conclusions of the preliminary risk assessment will inform the Central Authority's decisions on whether to proceed with a Public Private Partnership procurement, and if so, the form of Public Private Partnership to be used. For example, if the private sector is unwilling to bear the financial risk on a project, then neither Design, Build, Operate and Finance nor Concession contracts are likely to deliver optimum value for money.

5.9 More detailed guidance on the preliminary risk assessment is provided in the separate Guidance Note entitled *Risk Assessment*.

Statutory Process Risk

5.10 A unique feature of infrastructure projects in the roads, water and waste sectors is the complex nature of the statutory process through which such projects are developed. Accordingly, it is important to note that where a decision is taken to transfer statutory process risk to the private sector it will have a number of significant implications for the structure of the procurement process and the pattern of risk allocation underlying the Public Private Partnership.

5.11 The allocation of statutory process risk must therefore be decided before the procurement stage is commenced. For this reason, the allocation of statutory process risk is considered to be a separate stage in the Public Private Partnership Route Map, and is undertaken either at the same time, or immediately following, the PPP Assessment (Figure 1). As noted in Section 2 of this Guidance Note, the PPP Assessment and Statutory Process Assessment are closely related, and it will be important to establish mechanisms to facilitate feedback between the two stages.

5.12 The desirability of transferring statutory process risk to the private sector is examined in detail in the Guidance Note entitled *Statutory Process Assessment*. However, it is clear that for the pilot projects at least, Contracting Authorities should retain responsibility for the statutory process. This will enable both the public and private sectors to adapt to the requirements of Public Private Partnership projects in an evolutionary way that will help to minimise the risk of problems and delays. Once a number of projects have been progressed in each sector and the principles of Public Private Partnerships are better understood, then the potential for cost effective transfer of statutory process risk is likely to increase.

5.13 The main exception to this evolutionary approach relates to the waste sector. Under current legislation a license application to the Environmental Protection Agency for a waste treatment facility must be accompanied by specific details of the processes to be employed. As a result, statutory process risk can only be borne by the contractor responsible for the detailed design of those processes.

Contractual Considerations

5.14 The ultimate allocation of risk will depend on the terms of the contract finally signed. The PPP Assessment should therefore record preliminary views on the main contractual issues such as:

- payment mechanisms;
- termination arrangements;
- step-in arrangements;
- changes to requirements;
- changes of law;
- ownership of assets;
- service level agreements;
- length of contract; and
- arrangements for post contract monitoring.

5.15 Staff, transfer of undertakings and acquired rights issues may also need to be considered.

VI. Bankability Assessment

Introduction

6.1 The PPP Assessment should include an assessment of the bankability of any project that will be part or wholly financed by the private sector. This specifically relates to projects that are expected to be procured and managed under Design, Build, Operate and Finance or Concession contracts.

6.2 Where relevant, the bankability of a project should be assessed through precedent reviews and market soundings with financial institutions. Financial advice will be required to undertake the bankability assessment as part of the overall PPP Assessment.

6.3 In general, providers of finance for infrastructure projects will look favourably on projects with the following characteristics:

- ***Contractual balance*** - where there is a commercial incentive for all parties (including the Contracting Authority) to complete the transaction, and deliver the project throughout its life.

- ***Bankable cashflows*** – projects with characteristics that make them an attractive proposition for debt providers, possibly lowering the projects cost of financing.

- ***Security of cashflows*** – providers will have a preference for availability based payment mechanisms. They may be satisfied in some sectors by usage based payments underpinned by market testing of demand related revenues, or when the project involves an increase in existing capacity, where the level of demand is already known.

- ***Opportunity to innovate*** – projects where technical innovation is introduced can significantly reduce a component of the wholelife cost of the asset.

- ***Synergies*** – may be important where the equity provider is also the operator of complementary facilities.

- ***Opportunities for financial engineering*** - which increase the overall return on equity.

- ***Appropriate risk transfer*** – appropriate allocation of risk between the public and private sector, and between parties best able to manage the risks, should result in optimal project pricing.

- ***Environmental issues*** – limited circumstances in which the parties to the PPP project could become at risk for liability for environmental damage. In the sectors under consideration, this is likely to be an important issue.

- ***Repayment cushion*** - a reliable net revenue stream in excess of capital and interest repayment requirements, supported by sufficient equity/guarantees and loan reserve accounts, to provide sufficient funds to service debt.

- ***Sponsor credit*** - strong performance bonds or completion guarantees given by the PPP Contractors during the construction and operation phase, and any mitigants used to enhance the creditworthiness of Contractors.

- ***Vires/legislative framework*** – very clear legal powers of the public sector body to enter into the contract and to pay on termination.

- ***Technical complexity*** – a project solution that is based on proven technology, ease of replacing the operator, minimal complicating factors such as planning, licensing or environmental constraints.

- ***Residual interests*** – good alternative use value of the assets, and ease of access for the lender to utilise them.

- ***Compensation on termination*** – the contractual basis for termination does not provide either party with an incentive to terminate, but if the project is aborted a formula exists for the lenders to step in to solve the problems or be compensated, and the public sector can meet break costs on termination.

6.4 Thorough consideration of these issues should be included within the PPP Assessment, and reference should be made to the separate Guidance Note entitled *Financial Context* in this regard. The conclusions of the bankability assessment will help to establish the suitability of projects for Design, Build, Finance and Operate and Concession contracts. In addition, it will help to identify those issues that need to be addressed prior to commencing a procurement, or that need to be reflected in contract documentation.

VII. Legal Viability Assessment

Introduction

7.1 It is critical, before commencing the procurement of any project under a Public Private Partnership, to conduct a thorough legal viability assessment in order to identify any issues that need to be addressed prior to commencing a procurement, or that need to be reflected in tender documentation.

7.2 The Contracting Authority should therefore use legal advisors to undertake a legal viability assessment as part of the PPP Assessment. The principal issues to be considered by the legal viability assessment are as follows:

- Legal ability of the Contracting Authority to:
  - enter into a Public Private Partnership contract; and
  - introduce user charging.
- the implications of the Public Private Partnership for:
  - existing statutory duties and responsibilities;
  - existing employees (including stakeholder consultation);
  - existing assets; and
  - existing contracts.
- The nature and form of any property interest(s) to be granted; and
- The implications of the Landlord and Tenant Act.

7.3 Thorough consideration of these issues should be included within the PPP Assessment, and reference should be made to the separate Guidance Note entitled *Legal Context* in this regard.

VIII. PPP Option Selection

Introduction

8.1 Taken together, the initial output specification, assessment of value for money potential, preliminary risk assessment, bankability assessment and legal viability assessment should provide a rationale for:

- selecting the most appropriate form of Public Private Partnership; and
- identifying the optimum scope of the Public Private Partnership.

8.2 Further details are provided in the paragraphs that follow.

Selecting the Most Appropriate Form

8.3 The Guidance Note entitled *Introduction to Public Private Partnerships* describes the main forms of Public Private Partnership that have been identified as being the most likely to form the basis of the PPP programme in Ireland. They are:

- ***Design and Build (DB) contracts*** - contractual relationships between public sector entities and private sector suppliers for designing and building public facilities or infrastructure. The facility (or infrastructure) is financed, owned and operated by the public sector;

- ***Design, Build and Operate (DBO) contracts*** - contractual relationships between public sector entities and private sector suppliers for designing, building and operating public facilities or infrastructure. The facility (or infrastructure) is financed by the public sector, and remains in public ownership throughout;

- ***Design, Build, Operate and Finance (DBOF) contracts*** - contractual relationships between public sector entities and private sector suppliers for designing, building, financing and operating public facilities or infrastructure. The facility (or infrastructure) is owned by the private sector for the period of the contract, at the end of which ownership transfers to the public sector. The private sector supplier recovers its costs solely from public subventions; and

- ***Concessions*** **-** similar to Design, Build, Operate, Finance contracts, except that the private sector supplier recovers its costs either through direct charges on private users of the asset (e.g. tolling), or through a mixture of user charging and public subventions.

8.4 The results of the precedent review, market sounding, preliminary risk assessment, bankability assessment and legal viability assessment provide an indication of the suitability of the above forms of Public Private Partnership for infrastructure projects in the roads, water and waste sectors.

8.5 The suitability of each form of Public Private Partnership may be usefully considered in the form of impact statements or a weighting and scoring matrix. In this way the costs and benefits of each form of PPP may be presented in relation to both the objectives of the project and the factors that are likely to determine whether value for money is provided (see Section 4 of this Guidance Note).

8.6 However the assessment of suitability described above is unlikely to be definitive, and may only provide an **indication** of suitability. It may for example conclude that more than one form of PPP is suitable for the project in question.

8.7 The final selection of the PPP form should be made by the Central Authority with regard to policy and project objectives. As indicated previously, the Central Authority will be required to consult with the Department of Finance before giving approval to proceed with the procurement of a Public Private Partnership project that involves private finance with long term implications for the Exchequer.

Identifying the Optimum Scope

8.8 The optimum scope of the Public Private Partnership should be considered in terms of both geographical area and service requirements.

8.9 Often, projects will deliver improved value for money if the scope of the contract is increased to provide greater scope for innovation and economies of scale. For example, in the waste sector, Government policy favours regional co-operation to provide a more effective framework, in planning and volume terms, for the development of integrated waste management systems. A single Public Private Partnership could therefore be established for each region to provide a seamless integrated waste management service, incorporating all elements of waste collection, separation, recycling, treatment and disposal.

8.10 Some projects may however be sufficiently large and/or complex that there exists a number of sub-options to the Public Private Partnership. These options may relate to the separation of a business by function or geographical area. For example, if the Contracting Authority is considering the use of Public Private Partnerships to provide integrated waste management services in a particular region, then it could use a number of area based contracts, or separate PPP contracts for waste collection and waste treatment/disposal. Where such sub-options exist, the costs and benefits of each sub-option should be appraised in monetary and non-monetary terms and the preferred option identified in the PPP Assessment.

IX. Parameters for the Final VFM Assessment

Introduction

9.1 The final assessment of whether a Public Private Partnership represents improved value for money can only be made at the conclusion of the procurement process. The Central Authority and the Department of Finance need to be satisfied that the preferred tender represents value for money before approving the award of contract.

9.2 The achievement of value for money in a Public Private Partnership procurement is evidenced through effective competition between potential suppliers and, on projects that involve public money, through a value for money assessment of the costs and benefits of the preferred Public Private Partnership tender.

Nature of the Final Value for Money Assessment

9.3 The nature of the value for money assessment undertaken at the end of the procurement process depends on whether the Public Private Partnership project is financially free standing, generates the majority of its revenues from third parties, or is reliant on public subvention. The nature of the value for money assessment for each type of project is summarised in the paragraphs that follow.

Financially Free-Standing Projects

9.4 Financially free-standing projects require the Contractor to recover all costs through charges on the final users of the service. The public sector plays a facilitating role but no public money is involved. It is therefore the responsibility of the Contractor to determine whether the project is commercially viable and suitable for investment.

9.5 The Contracting Authority should satisfy itself through the Project Appraisal and the PPP Assessment that a Concession contract is the preferred form of PPP for the project, and that the application of user charges is appropriate. The Contracting Authority should determine its preferred approach to the setting of user charges, and develop a payment mechanism that will deliver government policy, the objectives of the project and protect the public interest. Further advice on this issue is provided in the Guidance Note entitled *Payment Mechanisms*.

9.6 Given that the project involves a commercial transaction between the Contractor and the users of the project and that there is no public money involved, there is no need to undertake a detailed value for money assessment at the end of the procurement process. Value for money is achieved through the competitive tendering process.

Concession Contracts with Public Subvention

9.7 The issues set out above for financially free-standing projects also apply to those projects where the Contracting Authority contributes a subvention but the revenues come principally from user charges.

9.8 However, such projects do involve the investment of public money and there is therefore a need to ensure that the project represents the best use of the public subvention. For this reason the benefit gained from applying the subvention to the PPP project should be compared with the benefit gained from applying the subvention to an alternative project that would otherwise not proceed. Policy priorities will be an important consideration in this regard.

9.9 Public subvention could take a number of forms, including capital grant and revenue support. Indirect costs, such as the cost to the Contracting Authority of providing connecting roads to a major road scheme, should also be taken into consideration.

Projects where the Public Sector is the Main Purchaser

9.10 In the case of projects where the public sector is the sole or main purchaser of the services being provided (i.e. direct and indirect subventions are greater than 50% of total cost), a detailed value for money assessment is required at the end of the procurement. The assessment should compare the costs and benefits (in monetary and non-monetary terms) of the preferred PPP tender with the costs and benefits of traditional procurement, or under certain circumstances, with other comparable measures. The parameters used to undertake the value for money assessment for such projects are established at the end of the PPP Assessment. Full details are provided in the remainder of this section.

Elements of the Value for Money Assessment

9.11 In the case of projects where the public sector is the sole or main purchaser, the value for money assessment undertaken at the end of the procurement process comprises two key elements:

- ***Monetary comparison*** - comparison of the cost of the preferred Public Private Partnership tender, with the cost of traditional public sector procurement, expressed in terms of discounted cashflows over the life of the PPP contract (the Financial Comparator). Under certain circumstances other measures may be used as the basis for a Financial Comparator, and these measures are described later in this section of the Guidance Note; and

- ***Non-monetary comparison*** – comparison of all the factors that are difficult to quantify in monetary terms, but their value to government and the wider public is significant. Examples include speed of project delivery, quality of service, and security of supply.

9.12 The parameters used to undertake the monetary and non-monetary comparisons are established at the end of the PPP Assessment. Full details are provided in the paragraphs that follow. The separate Guidance Note entitled *Procurement Management* describes the process of conducting the value for money assessment at the end of the procurement process.

Parameters Required for the Monetary Comparison

9.13 A monetary comparison is required for projects where the public sector is the sole or main purchaser. The monetary comparison could take one of four forms depending on the characteristics of the project and the stage of development of Public Private Partnerships in Ireland. The four forms of monetary comparison can be summarised as follows:

- ***Financial Comparator*** – involving a comparison of the cost of the preferred PPP tender with the cost of delivering the project (to the standards set out in the initial output specification) through traditional public sector procurement;

- ***Best available alternative*** - for projects where the cost of traditional public sector procurement is difficult to determine, the cost of the preferred PPP tender should be compared with the best available alternative costing;

- ***Price benchmarks*** – involving a comparison of the preferred PPP tender with reliable, comparable and independent price benchmarks or unit costs (for example, standard costs per volume); and

- ***Comparable PPP projects*** – involving a comparison of the preferred PPP tender with the cost of other comparable PPP projects.

9.14 The circumstances under which each of the different forms of monetary comparison may be used are described in the paragraphs that follow. However, it is recommended that for the pilot projects at least, wherever possible the Financial Comparator should be based on the estimated cost of delivering the project (to the standards set out in the initial output specification) through traditional public sector procurement.

Financial Comparator

9.15 A Financial Comparator is the estimated cost of delivering the project (to the standards set out in the initial output specification) through traditional public sector procurement, presented in terms of a discounted cashflow analysis. The Financial Comparator should be prepared at the end of the PPP Assessment for projects in which the public sector is the sole or main purchaser (i.e. all DB, DBO and DBOF contracts and some concession contracts).

9.16 The Financial Comparator is developed from the preferred option arising from the Project Appraisal to provide a full and adequate costing of the public sector providing all those services included within the scope of the preferred Public Private Partnership option, for the expected contract duration. In practice, if the preferred Public Private Partnership option results in the transfer to the private sector of all services included in the preferred option arising from the Project Appraisal, then the differences between the Financial Comparator and the preferred option will be limited.

9.17 The Financial Comparator should be prepared by the financial advisors to the Central Authority, with relevant input from the Contracting Authority and the technical and legal advisors. It is important that the results of the Financial Comparator remain confidential and therefore the Central Authority will communicate the results of the Financial Comparator to the Contracting Authority after tenders have been received.

9.18 To facilitate the preparation of the Financial Comparator, the construction and operating cost estimates included in the Project Appraisal should be presented separately for each element of the project or for different categories of cost. Central and Local Authorities should establish a database of project costs to assist in this regard, recording initial cost estimates and actual outturns for both traditional and Public Private Partnership projects.

9.19 Technical guidance on the preparation of Financial Comparators is set out in Appendix D to this Guidance Note.

Projects with No Track Record of Public Procurement

9.20 Ideally, the Financial Comparator should be based on the same services and service levels as the preferred Public Private Partnership option. However, for projects where there is no track record of public sector procurement, the cost of the public sector providing the service levels defined in the output specification may be difficult to determine and subject to a high level of uncertainty.

9.21 In such circumstances, the Financial Comparator should be based on the best available alternative costing, which will most likely relate to the provision of services to a lower or alternative standard. The best available alternative may relate to the cost of current provision as set out in the Project Appraisal.

9.22 It is essential that the service levels assumed by the Financial Comparator are clearly recorded in the PPP Assessment so that, at the end of the procurement process, the differences between the preferred private sector tender and the Financial Comparator can be understood and evaluated.

Projects Involving Non-Specialised Services

9.23 A Financial Comparator may not be required for projects that involve the provision of standard, non-specialised services for which there is a well established market. In such circumstances, the financial comparison could simply involve a comparison of private sector bids against reliable, comparable and independent price benchmarks or unit costs (for example, standard costs per volume). The use of price benchmarks or unit costs is likely to be most applicable to outsourcing type contracts.

Projects with a Track Record in PPP procurement

9.24 As the use of Public Private Partnerships increases in Ireland, there will be less information available on the costs of traditional procurement on which to base a Financial Comparator. Therefore, where there is a track record of Public Private Partnership procurement that has been shown to deliver improved value for money, the costs associated with these projects may be used as the basis for developing a Financial Comparator.

9.25 In such circumstances, it is necessary to take into consideration the costs associated with the differences between projects, for example in relation to the price base, requirements of the output specification, risk allocation and any geographical considerations such as land values. Financial Comparators prepared on this basis should also take into account the performance of projects during the construction and operation stages as set out in project reviews. Project reviews will therefore be increasingly important in this regard.

Parameters Required for the Non-Monetary Comparison

9.26 The monetary comparison will not take into consideration all of the factors that contribute to value for money. Many factors will be difficult to quantify in monetary terms, but their value to government and the wider public is significant. Examples include speed of project delivery, quality of service, security of supply and equity issues such as the accessibility of services. Consequently, the monetary comparison should not be approached as a pass fail test, and should be complemented with a value for money assessment of the costs and benefits of the preferred tender in non-monetary terms.

9.27 The costs and benefits of the preferred tender may be usefully compared with the costs and benefits of traditional procurement in non-monetary terms through the use of impact statements or a weighting and scoring matrix.

9.28 The non-monetary factors to be considered by the impact statements and/or weighting and scoring matrix should be established at the end of the PPP Assessment. It is expected that the factors will relate to the objectives of the project and also to those factors identified in Section 4 of this Guidance Note as being likely to determine whether value for money is provided.

Results of the Value for Money Assessment

9.29 The results of the value for money assessment that is undertaken at the end of the procurement process determine whether establishing a Public Private Partnership with the preferred Contractor will deliver improved value for money compared with traditional procurement. The value for money assessment is therefore the fundamental tool in deciding whether or not to proceed with a Public Private Partnership contract. The results of the value for money assessment will determine whether or not the Central Authority approves the Contracting Authority to enter into a Public Private Partnership contract with the preferred public sector supplier.

9.30 If the results of the value for money assessment undertaken at the end of the procurement process are not entirely positive, the Contracting Authority needs to consider the realistic options for the project and reflect these in the Report on the Tendering Process. This should include the implications of abandoning the project, the chances of an alternative being implemented (particularly if the tendering for the Public Private Partnership has been competitive), the likely market impacts and the impact of time delays. It will often be more expensive in overall economic terms to abandon an infrastructure project having gone through complex procurement.

9.31 It is essential therefore that the Report on the Tendering Process for such a project is retained by the Central Authority and made available to other Contracting Authorities to ensure that the experience of completed PPP projects is taken into account in the development of future Public Private Partnerships.

X. Indicative Implementation Plan

Introduction

10.1 The PPP Assessment should conclude with a summary of the main findings and with a recommendation on the preferred form of Public Private Partnership. The conclusions of the Statutory Process Assessment and the Procurement Procedure Selection could also usefully be presented in the PPP Assessment.

10.2 The conclusions to the PPP Assessment should also include a summary analysis to show that the project contains many of the elements needed to complete a successful Public Private Partnership Approach. This may be undertaken using the simple tick-box approach presented below.

Key Elements of a PPP Project	**Element Present**
Output or services based solution	
Significant services content	
Scope for design innovation	
Manageable sensitivities	
Availability of surplus assets	
Long term contract	
Risks largely commercial in nature	
Interested private sector suppliers	
Credible private sector suppliers	
Scope for alternative use	

10.3 The PPP Assessment should then present an indicative implementation plan describing the organisational structures that the Contracting Authority would expect to establish to manage the procurement, and including an indicative timetable with target completion dates for the main activities involved in the procurement of the project.

10.4 Contracting Authorities would then use the indicative implementation plan as a basis for developing more detailed project management tools and procedures. A separate Guidance Note entitled *Project Management* has been prepared to assist Contracting Authorities in this regard.

XI. Issues and Recommendations

Introduction

11.1 This section provides a summary of the main issues and recommendations that are discussed in this Guidance Note. They can be summarised as follows:

- Requirement to assess value for money potential;
- Assessing value for money potential;
- Selecting the most appropriate form of PPP;
- Requirements of the final value for money assessment; and
- Managing the PPP Assessment.

Requirement to Assess Value for Money Potential

11.2 A key driver of the PPP programme in Ireland is the desire to increase value for money in infrastructure procurement. To ensure that value for money is achieved, there must be clear justification for the project, a competitive procurement and the Contracting Authority should be able to demonstrate that the option selected offered better value for money than the alternatives. Whilst post procurement reviews will ultimately show whether value for money is being achieved through PPP, procedures must be in place to ensure that the options being developed are likely to deliver value for money.

11.3 The purpose of the PPP Assessment is to assess at the Option Appraisal stage the **potential** for a Public Private Partnership to deliver improved value for money compared with a traditional procurement. The PPP Assessment is therefore the fundamental tool in deciding whether or not to proceed with a Public Private Partnership procurement.

11.4 The outcomes of the PPP Assessment will determine whether or not the Central Authority authorises the Contracting Authority to proceed with a Public Private Partnership procurement. The final assessment of whether a Public Private Partnership procurement represents improved value for money can only be made at the conclusion of the competitive tendering process.

Assessing Value for Money Potential

11.5 The main tools used to identify potential sources of value for money, and to assess the potential of the private sector to deliver value for money, are precedent review and market sounding. In undertaking a precedent review or market sounding exercise, evidence should be sought on the potential for a Public Private Partnership to deliver improved value for money. Experience of similar projects should be investigated and the views of the private sector should be established.

11.6 Quantitative information should be recorded wherever possible, and in particular in relation to the potential for cost savings, additional revenue generation, accelerated project delivery, higher standards of service, increased levels of demand and higher levels of user satisfaction. For the pilot PPP projects, it may be possible to obtain some of the above information for international projects from published reports and relevant contacts. For future PPP projects, it will be important to establish and maintain a database of information on the pilot projects to ensure that the experience of those projects is taken into account in the development of future Public Private Partnerships.

Selecting the Most Appropriate Form of PPP

11.7 The results of the precedent review, market sounding, preliminary risk assessment, bankability assessment and legal viability assessment undertaken as part of the PPP Assessment will provide an **indication** of the suitability of the various forms of Public Private Partnership for the project in question. However the assessment is unlikely to be definitive and may, for example, conclude that more than one form of PPP is suitable for the project. The final selection of the PPP form should therefore be made by the Central Authority with regard to policy and project objectives.

Requirements of the Final VFM Assessment

11.8 The requirements of the value for money assessment undertaken at the end of the procurement process depend on whether the Public Private Partnership project is financially free standing, generates the majority of its revenues from third parties, or is reliant on public subvention.

11.9 In the case of projects where the Contractor will recover its costs principally from user charges, there is no need to undertake a detailed value for money assessment at the end of the procurement process. The project is primarily a commercial transaction between the Contractor and the users of the project. Value for money is achieved through the competitive tendering process.

11.10 The Contracting Authority should however satisfy itself through the Project Appraisal and the PPP Assessment that a Concession contract is the preferred form of PPP for the project, and that the application of user charges is appropriate. The Contracting Authority should determine its preferred approach to the setting of user charges, and develop a payment mechanism that will deliver Government policy, the objectives of the project and protect public interest.

11.11 There is also a need to ensure the best use of any public subvention that may be provided by the Contracting Authority to the project. The benefit gained from applying subvention to the PPP project should therefore be compared with the benefit gained from applying the subvention to an alternative project that would otherwise not proceed. Policy priorities will be an important consideration in this regard.

11.12 In the case of projects where the public sector is the sole or main purchaser of the services being provided, a detailed value for money assessment is required at the end of the procurement. The assessment should compare the costs and benefits (in monetary and non-monetary terms) of the preferred PPP tender with the costs and benefits of traditional procurement, or under certain circumstances, with other comparable measures. The parameters used to undertake the value for money assessment for such projects should be established at the end of the PPP Assessment.

Managing the PPP Assessment

11.13 To conduct a comprehensive PPP Assessment, a combination of Contracting Authority, Central Authority and expert advice will be required. It is understood that the Contracting Authority will procure the technical advice required to complete all aspects of the Option Appraisal stage, including the Project Appraisal, PPP Assessment, Statutory Process Assessment and Procurement Procedure Selection. The Central Authority will procure financial and legal advice, which will be made available to the Contracting Authority.

11.14 As described above, one of the final elements of the PPP Assessment involves establishing the parameters to be used at the end of the procurement process to test whether the preferred PPP tender represents value for money compared with traditional procurement. In some cases this will involve the preparation of a Financial Comparator as part of the PPP Assessment.

11.15 The Financial Comparator will be prepared by the financial advisers to the Central Authority, with relevant input from the Contracting Authority and the technical and legal advisers. It is important that the results of the Financial Comparator remain confidential and therefore the Central Authority will communicate the results of the Financial Comparator to the Contracting Authority after tenders have been received.

11.16 A number of pilot projects have already been identified as being suitable for procurement as Public Private Partnerships involving private finance. To ensure speed of delivery of these projects, it is understood that where central financial and legal advice is not yet available, approval has been given to Contracting Authorities to appoint multi-disciplinary teams to act as Client Representatives. These teams will be responsible for preparing all aspects of the Option Appraisal stage and for bringing the projects through to procurement. For future projects, the Central Authority should indicate its preferred method of managing the Option Appraisal stage to the Contracting Authority once the project has been identified at the Project Identification stage as being potentially suitable and desirable for procurement as a Public Private Partnership.

11.17 Regardless of the choices made regarding the management of the Options Appraisal stage, a full report including the Project Appraisal, PPP Assessment, Statutory Process Assessment and Procurement Procedure Selection should be forwarded to the Central Authority for review and approval. The Central Authority will be required to consult with the Department of Finance before giving approval to proceed with the procurement of a Public Private Partnership project that involves private finance and has long term implications for the Exchequer.

Appendices

A. Public Private Partnership Policy Guidance

Public Private Partnerships Policy Guidance

The Public Private Partnerships Policy Framework comprises a series of fifteen separate Guidance Notes, the titles of which are as follows:

- *Introduction to Public Private Partnerships*
- *Financial Context*
- *Legal Context*
- *Public Private Partnership Assessment*
- *Statutory Process Assessment*
- *Procurement Procedure Selection*
- *Project Management*
- *Stakeholder Consultation*
- *Procurement Management*
- *Output Specifications*
- *Risk Assessment*
- *Payment Mechanisms*
- *Key Contractual Issues*
- *Accounting Treatment*
- *Contract and Performance Management*

Appendices

B. Typical Contents Page for a Public Private Partnership Assessment

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C. Tips on Market Sounding

Tips on Market Sounding

Preparing for Market Sounding

Ascertain whether market sounding is actually necessary. Investigate whether a similar scheme exists for which interest levels are already known. Don't re-invent the wheel.

Set clear objectives for the exercise. What do you hope to achieve? What information do you want potential bidders to supply at this early stage?

Prepare a list of organisations you may wish to contact. Think broadly about the project, and aim to contact as wide a range of potential bidders as possible. For example, for a major roads scheme, consider:

- Consulting engineers;
- Construction companies;
- Financial institutions;
- Sector specific specialists, e.g. roadside services providers.

To ensure a wide cross-section of interest and awareness, you could consider advertising (e.g. in newspapers).

Do not be afraid to 'target' companies that you think ought to be interested. Do not assume they will read the advertisements!

Target senior executives with operational and financial backgrounds and arrange for face to face meetings. You may begin with a telephone call, but try to encourage interested parties to come to see you.

Carrying out Market Sounding

Arrange for face to face meetings at your premises. See individual companies separately or collectively, but ensure that they are aware that this will be an informal discussion, with no commitment on either part. Targeted, one-to-one meetings are generally more effective.

Ensure attendees are aware that this is NOT a formal step in the procurement process, and that they are NOT to regard themselves as chosen bidders. Attendees should be informed that a formal procurement process will begin if, and when, the PPP Assessment has been approved, funding has been ascertained, etc.

Allow enough time for discussions to take place, and for information to be exchanged. For a discussion with a group of 4 or 5 companies, expect to allow in the region of 2-3 hours.

Beware of "sales talk". The attendees will see this as an opportunity to impress you and emphasise how much they would be willing to do for you. Treat such comments with healthy scepticism at this stage!

'Market' your project well. This is your opportunity to interest potential bidders and to convince them that you are worth working with. Make sure you are clear about the aims of the scheme, the likely funding availability, areas of potential difficulties, etc, and be prepared to explain these to the attendees.

Stay in control! Remember that you want to know whether they will supply what you need, not whether you need what they want to supply.

Respect confidentiality. Interested parties may have useful suggestions, perhaps innovative ideas, which they will not share with you if they fear that the ideas will be 'leaked' to others. Make sure they are reassured about confidentiality whilst also ensuring that they are clear that you are not yet inviting them to put forward their proposals.

Golden Rules

Ensure bidders are aware that this is NOT the start of a formal procurement process. They should be aware that you may not proceed with the project at all.

Market effectively. Be well prepared, and ensure you know your (planned) project well.

Do not be railroaded into changing your project without good cause. However, do keep an open mind and be prepared to listen.

Appendices

D. Financial Comparator

Preparing the Financial Comparator

In order to undertake the monetary comparison at the end of the tendering process, a Financial Comparator is required. The Financial Comparator is the estimated cost of traditional public sector procurement to meet the service levels required in the output specification.

The Financial Comparator is developed from the preferred option arising from the Project Appraisal to provide a full and adequate costing of the public sector providing all those services included within the scope of the preferred Public Private Partnership option, for the expected contract duration. In practice, if the preferred Public Private Partnership option results in the transfer to the private sector of all services included in the preferred option arising from the Project Appraisal, then the differences between the Financial Comparator and the preferred option will be limited.

The Financial Comparator is therefore based on a hypothetical contract with the public sector to design, build and operate the project (e.g. a water treatment works) based on recent experience of actual costs. For example, for a DBO project, it will require an assessment of the likely costs of the public sector designing, building and then operating the project (using traditional methods) to provide a service level that meets the same performance standards expected of the private sector over the life of the contract.

The Financial Comparator should include the preliminary quantification of the key risks inherent in the project, covering, among other things, cost and time overruns and service under-performance. In addition, any assets made available for the project whose monetary value has not been included in the Project Appraisal need to be properly accounted for in the Financial Comparator.

The Financial Comparator should <u>not</u> include costs that will be borne by the Local Authority but will not be included in the scope of the Public Private Partnership contract.

The costs associated with the Financial Comparator should be presented in real terms in a discounted cashflow analysis. The discounted cash flow analysis should be prepared using a test discount rate of 5 per cent in real terms. Then the net present value and equivalent annual cost of the Financial Comparator should be calculated. An example of a proforma discounted cashflow analysis for a Financial Comparator is presented overleaf.

Example Financial Comparator for Roads Project

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	
	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k	
Opportunity Costs														
Land														
Capital Costs														
Element 1														
Element 2														
Element 3														
Element 4														
Residual Values														
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	ERR
Recurring Costs														
Structural maintenance														
Routine maintenance														
Traffic maintenance														
Winter maintenance														
Street lighting maintenance														
Network maintenance														
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NET COST BEFORE RISK	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	ERR

NPV of Capital and Opportunity Costs 0

NPV of Recurring Costs 0

NPV of Costs pre Risk Analysis 0

Equivalent Annual Cost pre Risk Analysis 0

Risk Analysis														
Statutory procedures risk														
Design risk														
Construction risk														
Operation and maintenance risk														
Other risk														
NET COST AFTER RISK	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	ERR

NPV of Total Net Costs 0

Equivalent Annual Cost 0