The Federal Government of Nigeria

National Policy on Public Private Partnership

And its

Supplementary notes

TABLE OF CONTENTS

1. INTRODUCTION

Global demand for basic infrastructure services has grown over the years, quickly outstripping the supply capacity of existing assets. Many years of underinvestment and poor maintenance have left Nigeria with a significant infrastructure deficit which is holding back the country's development and economic growth. Nigeria needs to make massive investments beyond the means available to government in order to close its yawning infrastructure gap. The Federal Government ("the Government") believes that the private sector can play an important role in providing some of this new investment through Public Private Partnerships (PPPs).

2. GOVERNMENT COMMITMENT

Addressing the infrastructure deficit and improving the quality of public services has been an important component of President Yar'Adua's 7-Point Agenda, and is a pre-condition for meeting the Government's vision of being one of the top 20 global economies by 2020. Government, will therefore, develop regulatory and monitoring institutions so that the private sector can play a greater role in the provision of infrastructure, whilst ministries and other public authorities will focus on planning and structuring projects. The private sector will be contracted to manage some public services, and to design, build, finance and operate some infrastructure. It is the Government's expectation that private participation in infrastructure development through PPP will enhance efficiency, broaden access, and improve the quality of public services.

This policy statement, and its supporting Supplementary Notes, sets out the steps that the Government will take to ensure that private investment is used, where appropriate, to address the infrastructure deficit and improve public services in a sustainable way. In line with the Government's commitment to transparency and accountability, it will ensure that the transfer of responsibility to the private sector follows best international practice and is achieved through open competition. The Government has inaugurated the Infrastructure Concession Regulatory Commission (ICRC) with a clear mandate to develop the guidelines, policies, and procurement processes for PPP. The ICRC will collaborate with the States to promote an orderly and harmonised framework for the development of Nigeria's infrastructure and to accelerate the development of a market for PPP projects. The Federal Government assures investors that all contracts completed in compliance with the ICRC Act will be legal and enforceable, and that investors will be able to recover their expected return subject to compliance with the terms of the PPP contract.

3. POLICY OBJECTIVES

The Government's key policy objectives for its infrastructure investment programme and for PPP are:

Economic

- to accelerate investment in new infrastructure and ensure that existing infrastructure is upgraded to a satisfactory standard that meets the needs and aspirations of the public;
- to ensure that all investment projects provide value for money and that the costs to government are affordable after allowing for economic growth;
- to improve the availability, quality, and efficiency of power, water, transport and other public services in order to increase economic growth, productivity, competitiveness, and access to markets;
- to increase the capacity and diversity of the private sector by providing opportunities for Nigerian and international investors and contractors in the provision of public infrastructure, encouraging efficiency, innovation, and flexibility;
- to ensure that infrastructure projects are planned, prioritised, and managed to maximise economic returns and are delivered in a timely, efficient, and cost effective manner;
- to manage the fiscal risks created under PPP contracts within the Government's overall financial and budgetary framework;
- to utilise federal and state assets efficiently for the benefit of all users of public services.

Social

- to ensure balanced regional development;
- to increase access to quality public services for all members of society;
- to ensure that user charges for new or improved public services are affordable and provide value for money;
- to respect the employment rights and opportunities of existing employees and to ensure that any redundancy or other social safety net issues are resolved before final project approval;
- to enhance the health, safety, and wellbeing of the public;
- to encourage the direct or indirect participation of small and medium sized enterprises in PPP projects.

Environmental

- to protect and enhance the natural environment;
- to minimise greenhouse gas emissions and other pollutants.

Value for money

In adopting this policy for PPP, the Government is making no presumption about the relative efficiency or effectiveness of the public and private sectors in the delivery of projects and services. Rather, it will use PPP where this is likely to result in better value—and more affordable—services. All procurement decisions will be made on merit and all proposals subjected to thorough economic and financial cost benefit analysis. Value for money is a combination of the service outcome to be delivered by the private sector, together with the value of risks transferred to the private contractor and direct costs to government and users. It is discussed further in a Supplementary Note to this Policy Statement. Where value for money drivers exist, PPPs can potentially deliver significant benefits in the design, the quality of services and the overall cost of infrastructure. PPPs can draw upon the best available skills, knowledge and resources, whether they are in the public or private sector. PPP will allow Ministries, Departments and Agencies (MDAs) to focus their efforts on the delivery of core services, and use the savings generated to improve or expand other services. PPPs also have the potential to bring forward infrastructure expenditure, sometimes by combining a number of smaller projects instead of phasing capital development over a number of years because of budgetary constraints.

Innovation in PPP projects will be encouraged, and it is important that the processes for delivering a PPP project are able to evolve to reflect experience and the changing environment within which infrastructure is constructed and financed and in which services are delivered. Government will therefore monitor, review, and from time to time refine, its PPP Policy in order to achieve its wider policy objectives.

4. THE ENABLING ENVIRONMENT

The Government recognises that it will need to develop its policies and practices—and in some cases introduce or amend legislation—if it is to encourage greater private sector participation in delivering public services and attract private capital to fund the country's infrastructure and related services. The Government will:

- ensure that there is better coordination and planning of infrastructure investment and greater use of economic appraisal techniques to prioritise investment. It will develop a 15-year investment strategy in consultation with the States, civil society organisations and the public;
- provide a clear policy and regulatory framework for PPP and greater transparency and fairness in awarding contracts and resolving disputes;
- take measures to increase the depth of Nigeria's financial markets and encourage them to provide a range of financial instruments to mitigate financial risks;
- work with international institutions such as the World Bank to reduce financing costs;
- ensure that its procurement processes are fair, transparent, and well managed, and compliant with all relevant legislation;
- improve capacity and skills in the public sector to manage projects more effectively; and

- communicate its plans and policies effectively to the National Assembly, the general public, and investors, and work with the States to ensure that there is a clear and consistent approach to PPP across the Federation.

By creating an appropriate enabling environment for PPP and allowing a fair return to private investors for the project risks that they will take, the Government believes that it can harness PPP to supplement scarce public resources although government will still provide the greater part of investment funding for infrastructure across the economy as a whole. PPP can help create a more competitive and diverse supplier market, can help to improve the efficiency of public services, and can thereby reduce costs in public service delivery. It will harness the resources of both public and private sectors to secure the best outcomes and better value for money for the Nigerian citizen. Government will focus on its core public service role and give the private sector a greater operational role.

The Government will put in place a legal, financial, and institutional framework that will promote and facilitate the implementation of privately financed infrastructure projects by enhancing transparency, fairness and the long-term sustainability of projects. It will procure a small number of pilot projects initially, to gain experience in the application of its policy. It will apply lessons learned in any further refinement of its policy and the associated legal, financial, and regulatory frameworks. It will disseminate this knowledge and experience throughout the public sector and to the States, and continue to build capacity in MDAs in the planning, procurement, and management of PPP projects. It will ensure that its economic policies provide a stable and predictable environment for investors.

Legal Framework

The Government will review the legal and regulatory framework created under:

- The Privatisation and Commercialisation Act 1999;
- The Infrastructure Concession Regulatory Commission (Establishment) Act 2005;

- The Fiscal Responsibility Act 2007;
- The Public Procurement Act 2007; and
- other relevant legislation.

If necessary, it will propose amendment of existing legislation or the enactment of new legislation to:

- ensure that public authorities are empowered to enter into agreements for the implementation of privately financed infrastructure projects and can delegate their statutory functions to private companies;
- ensure that the regulation and licensing of public service operators and operations is transparent, timely, and effective;
- provide appropriate remedies for protecting the safety and integrity of public infrastructure from vandalism and other criminal activity;
- create a centre of PPP expertise within ICRC (the PPP Resource Centre) to issue guidance to all public authorities on the procurement of PPP projects and drafting of PPP contracts;
- ensure that there are no distortions created by existing tax, banking, company, or any other laws that would bias the investment decisions of public authorities for or against PPP as a procurement option, or would distort the commercial decisions of PPP investors, contractors, or operators;
- provide for transparent, efficient, and competitive procurement procedures for PPP-type contracts that encourage innovation from bidders, and allow dialogue to optimise the allocation of risks between the contracting parties;
- ensure that there is an effective disputes resolution process which can operate independently and in a timely manner to provide alternative procedures such as arbitration and expert determination;
- ensure that the proposed institutional and financial framework for PPP and the issuance of guarantees, partial risk insurance or other financial instruments by, or through, the Federal Government is consistent with the Fiscal Responsibility Act 2007 and corresponding legislation proposed or enacted in each State.

Financial Framework

The Government will strengthen its Medium Term Expenditure Framework and the Medium Term Sector Strategies of its Ministries, Departments and Agencies to:

- develop the capacity of public authorities to carry out economic appraisal of projects. It will issue guidance to all public authorities and provide support and advice on discount rates, indexation and inflation, techniques for measuring costs and benefits, and the valuation of risks;
- provide guidance to MDAs on the development of a national 15-year investment strategy which will provide a planning tool for the development of infrastructure, whether financed from public funds or through PPP contracts;
- allocate responsibility for monitoring any contingent liabilities and risks that arise from PPP contracts, and associated agreements such as Power Purchase Agreements, and any sub-sovereign or other guarantees, partial risk insurance, subsidies, or exchange rate volatility;
- ensure that its policies on user charges and tariff subsidies are sustainable and meet the needs of both investors and users;
- ensure that the regulation of Nigeria's financial and capital markets provides transparency, stability and liquidity for investors in PPP projects and permits the development of new sources of finance, such as specialised funds, as well as secondary markets.

Institutional Framework

The Government will create an institutional framework that will reinforce the accountability of Ministries, Departments and Agencies (MDAs) of the Federal Government for the delivery of public services within their areas of responsibility, whilst ensuring that they have access to appropriate guidance, training, expertise and resources to plan, procure and manage investment projects and public services efficiently and effectively, taking account of value for money and long-term affordability. It will issue guidance for the benefit of those States that propose to develop their own PPP policies and programmes, and will set up mechanisms to coordinate these and encourage the development of standardised documents where appropriate. It will coordinate communication between the public authorities across the Federation and private sector contractors and investors.

It will ensure that Federal projects will go through a rigorous appraisal as to their economic and financial viability before the project begins a competitive and transparent procurement process, and that the project business case is approved by the Government's Economic Management Team or other relevant authority. The Federal Executive Council will formally approve all PPP projects prior to the award of a contract. The ICRC will issue regulations that specify a value threshold below which these requirements will not apply.

The Government will ensure that representatives of civil society organisations, investors and contracting associations contribute to the effectiveness of the Government's investment strategy and institutional framework for managing its infrastructure investment programme. The ICRC will be tasked with making the appropriate arrangements.

5. SCOPE AND APPLICATION

The scope of the Federal Government's programme for PPP is the creation .of new infrastructure, and the expansion and refurbishment of existing assets such as:

- power generation plants and transmission/distribution networks;
- roads and bridges;
- ports;
- airports;
- railways;
- inland container depots and logistics hubs;
- gas and petroleum infrastructure, such as storage depots and distribution pipelines etc;
- water supply, treatment and distribution systems;
- solid waste management;

- educational facilities (eg schools, universities);
- urban transport systems;
- housing;
- healthcare facilities, etc

In addition, a number of State Governments are considering using PPP to develop infrastructure. Although each State is responsible for its own investment projects, many PPP projects within a State will be financed with the support of a guarantee by the Federal Government. In providing any such guarantees, the Government will have regard to best practice as exemplified by its own PPP policy and guidelines.

6. PARTIES/STAKEHOLDERS AND THEIR ROLES

The institutional framework that the Government is creating to implement its policy for PPP allocates specific roles and responsibilities to various MDAs within the Federal Government for PPP project identification, planning, approval, procurement, and implementation. The Government has issued a Supplementary Note with this Policy Statement, which provides further details on its proposed allocation of roles and responsibilities within this institutional framework. Several sectors, such as power and transport, are going through a process of reform and restructuring, within a new regulatory framework. The Supplementary Note describes how sector regulators will interface with the MDAs responsible for the delivery of public services in the transport, power and water sectors. It also provides more detail on the role of the Infrastructure Concession Regulatory Commission (ICRC), which the Government will use to coordinate and lead the implementation of its policy on PPP. The working arrangements between the various parts of the Government will continue to be streamlined to avoid duplication and ensure that processes are not overly-bureaucratic. There will need to be consistency and clear responsibility and accountability.

The ICRC

The Board of ICRC has been appointed with a mandate to develop and issue guidelines on PPP policies, processes and procedures (including those for concessions), and to act as a national centre of expertise in PPP. It will work closely with relevant MDAs to identify potential PPP projects, and will act as the interface with the private sector to promote communication on national policies and programmes. This communication will be continuous, clear, timely, and accurate.

ICRC will monitor the effectiveness of the Government's policies and processes and provide independent advice to the Federal Executive Council (FEC) on the development of its national PPP policy. It will provide an opinion to FEC on whether projects submitted for FEC approval meet the requirements of the regulations.

ICRC will also work closely with States that are developing their own PPP policies to ensure consistency, best practice, and a coordinated approach to the private sector supplier market.

Although the management of PPP agreements will be for the relevant MDA, as the contracting party on behalf of government, the Contract Monitoring Unit within ICRC will monitor compliance with the contractual terms and conditions by both parties. The ICRC will maintain a PPP project database and will retain custody of all PPP agreements as required by the legislation.

The PPP Resource Centre within ICRC will provide technical assistance to MDAs in the development and procurement of PPP projects, and a Project Development Fund will be allocated to the PPP Resource Centre to co-fund project preparation and procurement costs, particularly the costs of external project advisers. The ICRC Board will provide oversight and strategic direction to the PPP Resource Centre and the Contract Monitoring Unit through its internal governance structures.

National Planning Commission

The National Planning Commission (NPC) will be tasked with developing a 15-year investment strategy (the National Development Plan) for all infrastructure services provided by the Federal Government. MDAs will be asked to identify their long-term plans for infrastructure, and whether the investment is to be funded through PPP or from the MDA's budget.

The role of the NPC in providing tools and methodologies for the economic appraisal of investment projects to be included within the Plan will also be strengthened, and the NPC will commission research on the economic impact of the Government's infrastructure investment programmes.

Ministries, Departments and Agencies

Ministries, or their agencies responsible for managing public infrastructure and public services, will continue to be accountable through their Ministers for the quality of public services and for the management of their resources. In some Ministries, the planning and coordination roles are being devolved to new bodies. This is to ensure better integration of planning and policies and to increase accountability. PPPs are a more complex form of procurement but still need to be integrated into the overall investment strategy for that sector, as well as the Government's budgetary and financial strategy within the Medium Term Expenditure Framework.

The MDAs will therefore be required to prepare long-term plans for infrastructure investment and maintenance which will be incorporated into the Government's rolling 15-year National Development Plan by the National Planning Commission (NPC). As part of this process, the MDAs will also identify where PPP is likely to offer better value for money over other forms of direct public procurement and this will be factored into the financial projections in the Investment Strategy of the relevant MDA. The decisions on procurement options will be reviewed as projects are refined and enter the Medium Term Expenditure Framework (MTEF). The MTEF will define the forward programme of projects and allocate resources for their planning and preparation.

Following FEC approval of a PPP project, the relevant Accounting Officer of an MDA will sign the contract and will be accountable for meeting the project objectives.

Federal Ministry of Finance

The Ministry of Finance will have an important role in public financial management of PPP projects, and in evaluating and managing fiscal risks that may result from the terms of the agreements. The Ministry will need to ensure that the forecast costs for the Government—including any subsidies that may be required to make a project financially viable or to ease the transition for poor households to a full cost recovery tariff—are affordable over the life of the contract and within the Medium Term Expenditure Framework. Costs and contingent liabilities will need to be reviewed as the project design and risk valuations are refined during the project preparation and procurement phases, and any significant changes to the initial estimates notified to the Ministry

Debt Management Office

Together with the Ministry of Finance, the Debt Management Office (DMO) will need to be satisfied that any contingent liabilities are manageable within the Government's economic and fiscal forecasts. The DMO will need to be consulted in advance by project teams within an MDA which is considering the involvement of multilateral agencies such as IFC, MIGA or IDA in providing guarantees or other financial instruments[1].

Accountant General of the Federation

The Government will put in place measures through the Office of the Accountant General of the Federation to ensure that funding for payment obligations incurred through a Federal PPP contract is safeguarded to ensure prompt payment, subject to appropriate authorisation. The States will also need to develop processes to ensure that contractual payment obligations are met. Where the financial standing of the public sector contracting party is not clear then special arrangements, such as escrow accounts, may need to be set up to reduce the reliance on financial guarantees from the Government.

Bureau of Public Procurement

The Bureau of Public Procurement (BPP) plays an important role in ensuring due process in the procurement of public works and services. It uses techniques such as benchmarking to ensure that the prices paid for goods and services are fair and reasonable. The integration of different elements of a project into a single contract makes benchmarking difficult, however, and there is a risk that it may slow down the procurement timetable and increase costs for bidders as well as the authority. The Government is setting up a Procurement Department in each MDA to ensure due process is observed in all procurement. It is advisable that a member of the MDA's Procurement Department is included on the Project Steering Committee set up within the MDA to manage each project. The PPP Resource Centre within ICRC will work with BPP to develop appropriate procurement processes for PPP projects (see the Supplementary Note on PPP procurement).

Bureau of Public Enterprises

The privatisation of many State owned assets has been led by the Bureau of Public Enterprises (BPE) since 1999. It has held the Government's assets in trust for Ministry of Finance Investments until they have been sold or commercialized. The National Council on Privatisation has had ultimate responsibility for determining which sectors should be included in the programme under the Privatisation and Commercialisation Act. BPE has used concessions as a means of Commercialisation of existing Government owned enterprises.

The lessons gained through these Concessions, and the skills and capacity developed in BPE should be made available in implementing PPP and other concession projects under the new PPP Policy and the ICRC will develop guidance in this regard. For instance, the BPE may be required to serve as “Internal Consultants” to MDA’s PPP Project teams along with any other External Transaction Advisers that may be procured by ICRC.

7. CHARACTERISTICS OF PPP

PPP includes a wide range of contractual arrangements between the public and private sectors. In general, there are three features:

- PPP combines the design, construction (or rehabilitation) of public infrastructure with its maintenance—and sometimes with the delivery of the service directly to the user. The transfer of responsibility for design, construction, and maintenance to the private contractor provides an incentive to minimise the whole life costs of the infrastructure service;

- The contract requirements are defined as outputs and service standards to be met, rather than inputs (such as exactly how the infrastructure should be designed and built). So, for example, a road contract might specify the quality of the road surface, its traffic capacity, safety standards, other environmental standards, and so on. It does not need to specify exactly how the road is to be constructed. Contractors will be able to propose their own designs and construction methods—although the roads procuring authority will need to be satisfied that the proposals are consistent with its own standards. This means that the private contractor can be innovative in its approach. But the contractor will also need to take into account the need to provide maintenance to ensure that the infrastructure continues to perform as required over the entire period of the contract;

- Payments to the contractor (or revenues from user charges in the case of a concession) are linked to meeting the specified standards of performance. If the quality of service falls below the required level, payment will be reduced accordingly. This gives the public authority the ability to enforce the contract effectively and the private contractor a strong incentive to perform. It also means that payments do not commence until the service is provided, and that design and construction is financed by the contractor. The cost of this financing is recovered from service charges (and/or user charges) over the remainder of the contract period. This method of payment provides a strong incentive to the contractor to complete the construction phase and provide the service as quickly as possible so that payments can commence. It also means that the contractor needs to continue to provide the service throughout the contract term in order to recover all of the financing costs. In effect, the public authority leases the asset (or grants the right to exploit it in the case of a concession), and transfers the responsibilities and risks of ownership to the private contractor.

These features of PPP can be found equally in a performance based contract or in a full service concession—where the contractor will be repaid by user charges—and in other types of Build, Operate, Transfer (BOT) contracts. The distinction between concessions and other forms of PPP is that concessions transfer some or all of the demand and revenue risks of the public service to the concessionaire, whereas these risks are usually retained by the public sector in other forms of PPP. For a performance-based PPP contract where the asset requires rehabilitation and maintenance only, such as an existing road, the financing costs will be relatively small and probably provided by the contractor. Where the PPP contract requires the construction of a significant new asset, however, financing will be an important part of the contractor's responsibilities. Project financing will often be used in this case, with third parties such as banks being brought in to provide most of the funding.

There is a fundamental difference between PPP and privatisation. In a privatisation, existing assets are transferred to the private sector. Legislation determines how services are provided to the public, often with an independent regulator set up to monitor—and in some cases control—prices and prevent market abuse. The regulator may issue licences that specify service standards and the framework for relations between the concessionaire or private provider. The regulator's functions will sometimes extend to overseeing competition and to ensuring that social welfare objectives are met.

In a PPP, the government retains ultimate responsibility for the public service but will delegate many of the operational tasks to private sector service providers under contract. The contract will determine the service obligations, although a regulator may impose sector-wide requirements, for example in relation to safety or environmental standards. The contract will also determine how public policy aspects are to be dealt with, particularly if there are to be user charges. In some cases, the contractor will itself set user charges and be remunerated through user payments. In others, government or the regulator may set user charges and pay the contractor only for providing the service. This may be the case even if the contractor, rather than government, collects user payments. Government may also provide subsidies to capture wider economic benefits or to make the service financially viable.

So, for example, a light rail scheme might involve the private contractor operating the trains to the frequency and standard specified in the PPP contract and collecting the fares but being paid by the relevant authority according to the quality of the service. The public authority would set the fares and determine any subsidy for specific classes of user. In this case it could be said that the contractor was taking *performance* risk but the authority was taking *demand* and *revenue* risk. A Supplementary Note on the allocation of risks in PPP projects is issued with this Policy Statement.

8. KEY PRINCIPLES OF PPP

In determining whether PPP is an appropriate procurement option for public infrastructure and services the Government will apply the following key principles.

Value for Money

Achieving the best value for money outcome in public services is the key consideration at all stages of a project's development and procurement. The project appraisal will take account not only of cost but also risks and service quality. The Government will test value for money by comparing the costs at net present value of PPP proposals against a value for money benchmark wherever possible (see the Supplementary Note on value for money). The benchmark will usually be an estimate of the costs of providing an equivalent service through public finance. Bids will only be invited when it is clear that there is scope for a private proponent to deliver value for money and the cost of the service payments are affordable to both government and users.

Public interest

Consideration of the public interest requires that:

- public authorities should ensure adequate consultation with end-users and other stakeholders prior to the initiation of an infrastructure project;

- private sector participants in a PPP project will contribute to strategies for communicating and consulting with the general public, customers, affected communities, and corporate stakeholders, with a view to developing mutual acceptance and understanding of the objectives of the public and private parties;
- private sector contractors in the provision of vital services to communities need to be mindful of the consequences of their actions for those communities and work, together with the public authorities, to avoid or mitigate socially unacceptable outcomes.

Risk allocation

The principle that the Government will follow in allocating risks will be to optimise, rather than maximise, the transfer of project risks to the private contractor. This means that, in practice, risks will be allocated to the party best able to manage them. The allocation of risk will therefore determine the chosen method of private sector involvement and allocation of responsibilities, which will in turn be based on an assessment of the public interest.

Output requirements

The formal agreement between the public authority and the private contractor will be specified in terms of verifiable service standards to be provided on the basis of output or performance-based specifications. It will contain provisions regarding responsibilities and allocations of risk in the case of unforeseen events.

Transparency

Transparency and openness are requirements of all government procurement, including PPP projects:

- fiscal discipline and transparency must be safeguarded and the potential public finance implications of sharing responsibilities for infrastructure with the private sector fully understood;
- a sound enabling environment for infrastructure investment—which implies high standards of public and corporate governance, transparency and the rule of law, including protection of property and contractual rights—will be put in place to encourage the participation of the private sector;
- public authorities will take effective measures to ensure public and private sector integrity and accountability and establish appropriate procedures to deter, detect, and penalise corruption;
- the awarding of infrastructure contracts or concessions will be designed to guarantee procedural fairness, non-discrimination, and transparency;
- private sector participants, their sub-contractors and representatives will not resort to bribery and other irregular practices, gain control over assets to gain an unfair advantage, or attempt to win favours. Nor should they be party to these practices in the course of their infrastructure operations. They will observe commonly agreed principles and standards of responsible business conduct. They will participate in infrastructure projects in good faith and fulfil their contracted commitments.

Competition

The benefits of private sector participation in infrastructure are increased by effective competition and by ensuring that business activities are subject to appropriate commercial pressures, dismantling unnecessary barriers to entry, and implementing and enforcing adequate competition laws.

Capacity to deliver

Authorities responsible for privately operated infrastructure must have the capacity to manage the commercial processes involved and to partner on an equal basis with their private sector counterparts. Strategies for private sector participation in infrastructure will be disseminated and objectives shared throughout all levels of government and relevant parts of the public administration. Training will be provided to transfer relevant skills and understanding to those involved in projects, including decision makers.

Engaging with the market

Projects to be procured within this policy must have the formal approval of the Federal Executive Council before the involvement of the private sector. Public authorities will communicate clearly the objectives of infrastructure policies and will put in place mechanisms for consultation between the public and private partners regarding these objectives. They will disclose all project-relevant information, including the condition of existing infrastructure, and the standards of performance they require, together with proposed penalties for non-compliance as part of the procurement process.

9. THE PPP PROCESS

The PPP process will be as follows:

1. Project development

- identification of need;

- a systematic appraisal of technical solutions to the identified need;
- preparation of economic, social and environmental cost benefit analysis, and an Environmental Impact Assessment, if required;
- value for money (VfM) and affordability testing of different procurement options;
- preparation of financial analysis – the pre-feasibility study

- budget allocation within the National Development Plan and, subsequently, the Medium Term Expenditure Framework (MTEF);
- approval of Outline Business Case (OBC) prior to the commencement of procurement.

2. Procurement

- creation of a project team and management structure;
- preparation of an Information Memorandum and bid documentation;
- market consultation, if appropriate;
- a competitive and transparent procurement process, with a clear audit trail for the selection of bidders and the evaluation of bids;
- approval of Full Business Case (FBC) before the decision to award a contract.

3. Implementation

- monitoring of design and construction, and subsequently operation and maintenance to ensure compliance with the required service standards;
- monitoring of payments against services delivered and any contingent liabilities.

4. Maturity

- inspection and preparation for the handover of any public assets in accordance with the specified requirements, if appropriate;

- analysis of future service delivery options and further procurement, if appropriate;
- contract close and recording of lessons learned.

The Government will provide further guidance through ICRC on the effective management of each phase of a PPP project.

1. *project development:* guidance on options appraisal, business case analysis, the definition and scope of the requirement, and value for money and affordability assessment;
2. *project procurement:* guidance on creating structured and competitive procurement processes, maintaining commercial confidentiality, allowing due diligence by third party investors, preparing a Full Business Case;
3. *project implementation:* guidance on achieving contractual and financial close, contract supervision and management, performance monitoring and change management;
4. *contract compliance monitoring:* guidance and procedures for the regular review of contractual obligations, tracking the performance of all parties to the contract, and the resolution of any disputes;
5. *project maturity:* guidance on project close and handover of any public assets (if appropriate), reviews of future service needs, and delivery options analysis.

10. PROJECT FUNDING

The Government recognises that private financing of infrastructure must provide value for money when compared to funding the investment through government borrowing. The financing of PPP projects therefore needs to be efficient and to be structured so that the returns to investors reflect the risks that they take and so that contingent fiscal liabilities are well managed. The Government will use competition during the procurement process to drive down the costs of finance, by ensuring that the Nigerian financial markets have the necessary depth and liquidity to provide the type of financing that these projects require, and that they operate transparently. It will encourage diversity in the sources of funding and ensure that different classes of investor, both domestic and foreign, are able to participate in project financing. It will use guarantees or other risk insurance provided by multilateral agencies such as the World Bank, where these provide value for money, and it will consult with the States on whether the creation of a PPP Guarantee Fund would provide additional security to investors and reduce the overall costs of finance to government.

The Government has already taken a number of measures to strengthen the Nigerian financial markets and encourage domestic savings. Its pension reforms of 2004 have created an increasing demand for a range of long-term investments, and its banking reforms have increased the capital base of Nigerian banks. Its privatisation programme has developed the expertise and capacity of the financial sector, and the market in government bonds has developed rapidly, with the recent issue of a 20-year Federal Government bond being oversubscribed. The Investment and Securities Act, 2007, has enabled companies to also raise long-term finance from the bond market.

The demand for new forms of financing for infrastructure will create new opportunities for long-term investors and the Nigerian financial markets can be expected to develop rapidly. The Government will continue to monitor these markets and will strengthen their regulation where necessary. It will work with the multilateral agencies to provide longer term financing to that currently available in the banking market and will consider the case for an Infrastructure Fund that is able to provide equity or debt financing to contracting companies under PPP arrangements.

The Supplementary Note on Roles and Responsibilities provides further background on infrastructure financing.

11. LEGACY PROJECT GOVERNANCE

This Policy Statement sets out the policies and processes that the Government will introduce to provide new investment in Nigeria's public infrastructure. The inauguration of the ICRC has been an important first step in the implementation of the Government's policy and ICRC will be expected to provide a lead in developing this policy framework further, working closely with MDAs in the Federal Government, and with the States. ICRC will also be responsible for monitoring and ensuring the efficient execution of existing concession agreements, and will review their implementation and advise the Federal Executive Council accordingly.

Private sector organisations with specialist know-how and experience in certain sectors, may have submitted unsolicited bids to MDAs, and these may not have been taken further in the absence of clear policy guidelines. ICRC will work with MDAs to ensure that such bids are evaluated and considered within the terms of the ICRC Act and has issued a Guidance Note on the Transitional Arrangements for implementing PPP and handling unsolicited proposals alongside this Policy Statement.

(Footnotes)

[1] *The various agencies of the World Bank (International Finance Corporation, International Development Agency, Multilateral Investment Guarantee Agency) work through the Federal Government, even if providing sub-sovereign guarantees to Nigerian States.*

SUPPLEMENTARY NOTES TO THE NATIONAL POLICY ON PPP

PART 1:

Procurement Processes for PPP in the Federal Government.

CONTENTS **PAGE**

1. Introduction

This Supplementary Note provides further information and background on the National Policy Statement for Public Private Partnerships. It describes the processes that the Federal Government will follow in order to ensure that the procurement of infrastructure projects using PPP principles is fair, transparent, auditable, and cost effective for both government and the private sector. The Note is designed to explain to bidders and investors the issues that the Ministries, Departments, or Agencies (MDAs) of the Federal Government will need to consider in planning, and then managing, a procurement. It also sets out the processes that private sector bidders will need to follow in order to prepare for a bidding opportunity, to submit a bid, and to arrange finance in finalising a contract with government for the provision of new infrastructure or public services. By increasing the understanding of the internal relationships and decisions within each of the parties to the transaction, the Government hopes that the procurement of these potentially complex projects can proceed in a timely and efficient manner.

This Note is one of a series issued with the Policy Statement. Other Notes describe:

- roles and responsibilities within the Federal Government for the implementation of its PPP Policy;
- assessing value for money in PPP procurement;
- an explanation of the risks in PPP projects and how they may be allocated between the parties.

These Notes, and the Policy Statement itself, will be reviewed and updated from time to time, and will be supported by Guidance Notes issued by the Infrastructure Concession Regulatory Commission (ICRC).

1.1 Structure of this Supplementary Note

The remainder of this Note covers the following topics:

- Section 2 sets out the general principles governing public procurement in Nigeria, and how these principles will be applied to PPP projects;

- Section 3 describes the procurement process from the authority's perspective
- Section 4 describes the process likely to be followed by the private sector in bidding and arranging finance for PPP projects, and the subsequent governance of the project companies.

2. General Principles Governing Public Procurement

Public procurement is the process by which government buys goods, works, or services from the private sector. Because all government expenditure is incurred on behalf of the Nigerian citizen, it is self-evident that it should increase their welfare or be for their economic benefit. In other words, the procuring authority needs to ensure that money is spent wisely and in the wider public interest. Competition is the way in which the market price for the procuring authority's specific requirements is determined, and this is usually achieved by inviting sealed bids from a number of different suppliers. The Bureau of Public Procurement (BPP) has issued a *Procurement Procedures Manual,* which sets out the principles which all public procurement in Nigeria should follow and procedural requirements for the planning and management of procurement by Federal Departments under the Public Procurement Act 2007. Only those principles that have a particular significance for PPP projects are discussed below, and reference should be made to this Manual and subsequent guidance issued by the National Council for Public Procurement or the PPP Resource Centre within ICRC for a fuller description of the principles and practice of public procurement in Nigeria.

2.1 Value for money

For the purchase of most works or goods, the lowest priced bid against a common specification or requirement is the most appropriate way of maximising the overall benefit to the public. But for service contracts, and some works projects, quality and price should both be taken into account in choosing the supplier that maximises the economic benefit to the public. Value for money is the criterion that should be applied to determine the evaluation of bids and the award of a contract. The methodologies for measuring this are discussed in a separate Supplementary Note to the Policy Statement. PPP projects are based on the principle of maximising value for money rather than simply achieving the lowest cost, and therefore the procurement process has to be devised to allow bidders to maximise value for money in their bids—within the constraints of transparency, fairness and confidentiality.

2.2 Transparency

Bidding for public or private sector contracts is a significant cost on business that has a direct impact on their profitability. Companies will only participate in the bidding process if they believe that the chances of successfully being awarded the eventual contract are proportionate to the costs incurred in bidding. This fact places an obligation on the procuring authority to set out the basis on which the successful bidder will be selected to all potential bidders from the outset, when describing the range of works or services that they will require. Potential bidders can then make an informed decision on whether to participate in the competition, and, if they do, to maximise their chances of submitting a successful bid. Given the cost of bidding for more complex projects like PPPs, it is good practice to limit the number of bidders invited to submit bids to a number sufficient to ensure effective competition and to progressively reduce the number of bidders, whilst maintaining competition. A PPP procurement will therefore use a two- or three-stage procurement process, where the first stage has the objective of selecting those bidders that are best qualified to submit fully priced bids. This stage is often referred to as prequalification, and the basis in which the shortlist of bidders will be selected should be stated clearly in the prequalification documents issued to all potential bidders. These selection criteria should also be consistent with the grounds for excluding bidders given in the Public Procurement Act. The second and third stages will progressively reduce the number of bidders based on the evaluation of priced bids until the Preferred Bidder is identified.

2.3 Fairness

The same factors that drive the need for transparency also apply to another principle of public procurement: that of fairness to all potential bidders. This means that all bidders, or potential bidders, should have access to the same level of information about the authority's requirements, background information about the project, other historical data or reports that would have an impact on the bidder's pricing or subsequent responsibilities (for example site investigation or planning reports), and about the procurement process itself. The criteria used to select the shortlist of bidders or to evaluate bids must be drafted to obtain the optimal final outcome for the public authority, and not to favour one particular bidder or group of bidders.

The use of a market sounding exercise to test out possible commercial or technical solutions prior to the completion of the project preparation phase (up to the Outline Business Case) may be an opportunity to advertise the project to potential bidders but it should also be managed to provide equality of information to all of the firms contacted.

The Government wishes to encourage international investors, contractors, and other suppliers to the Nigerian market for infrastructure services and domestic preference clauses will not normally be applied to PPP projects. This project information should therefore be accessible to an international audience as well as Nigerian companies. The opportunity to bid for each project should be widely advertised and open to international as well as Nigerian companies, although for the reasons explained in Section 3 of this Note, international firms will often in practice partner with local companies to provide the wide range of services required in PPP projects. The Government advertises its international procurement projects through the ICRC website, the World Bank UN Business Development database, the BPP's website, the Nigerian press, and other websites, to inform potential bidders of its requirements.

It can often be useful to hold a bidders' conference before potential bidders are required to submit their Expressions of Interest. This has the benefit of providing additional background information on the project, an opportunity to visit the site, and a chance for private sector firms to identify potential bidding partners. Alternatively, the bidders' conference could be restricted only to those bidders that have prequalified and be held after the tender documents have been issued. It is then an opportunity to provide further clarification of the requirements and procurement process. A record of any questions and answers should be made and subsequently circulated to the tenderers.

2.4 Efficiency

The complexity of the procurement of PPP projects can lead to an extended procurement timetable, significant bid costs, and high procurement costs for the procuring authority. The preparation and management of the procurement needs to be systematic and efficient, as well as transparent. The public sector team needs to be well-resourced and is likely to require access to external technical, legal and financial advisers, who will themselves be appointed following a separate procurement process. The need for internal and external approvals at key decision points should be factored into the project timetable, and bidders will require sufficient time to prepare their bids. Investors will need to carry out their own due diligence on the project, the technical solution proposed, and the contract documents. Because of the costs of PPP procurement, it is important to restrict the number of bidders to the minimum necessary to ensure competition. International benchmarks set this number between three and five.

Since the value for money underlying PPP depends on both technical innovation and optimising the allocation of risks between the public and private sectors, the process needs to contain periods where both parties can exchange possible solutions and contract terms in a structured process before initial or final bids are submitted. Variant bids may also be encouraged, or even mandated, as part of the tender process, but care needs to be taken to ensure that all bids can be evaluated against the same criteria and are compliant with the same core contractual and technical requirements. The bidding process may allow a progressive reduction in bidders, based on the evaluation of the initial bids, before Best and Final Offers are invited from two remaining bidders.

Because PPP projects will also transfer the cost of financing the infrastructure capital costs to the private sector, the pricing of tenders will depend on the costs of that finance. Since some of these financing costs may not be fixed until the point at which the contract reaches financial close, it is normal to require all pricing assumptions to be included in a financial model supplied with each bid, referenced to a specified market (interest) rate. Financing is also conditional on due diligence on behalf of lenders (or a rating of the project risks by an international rating agency in the case of bond finance). Full due diligence is often completed after a preferred bidder has been selected, because of its cost, but the authority should ensure that investors are committed to financing the project, subject only to due diligence, and that the financing plan is realistic. Structuring the procurement process efficiently is therefore potentially complex and the use of project management techniques is advisable to ensure that information and decisions are systematic and are fully documented.

2.5 Accountability and Governance

From the public sector perspective, the process of defining an infrastructure project, gaining internal approval to the requirement and necessary budget, managing the procurement process and the interface with bidders, obtaining final approval and closing the contract, should be seen as a project in itself. It needs to be planned and governed so that there is a clear allocation of tasks and responsibilities and a fully documented governance process. The project team needs to have a clear mandate for the definition of all aspects of the procurement documentation, and, equally, decision makers need to be properly briefed on issues, risks, and costs. A senior official should be held accountable for delivering the project to the agreed timetable, ensuring that all stakeholders are involved in the decisions and that Ministers are briefed on the policy implications of the evolving project. The senior official may be the Accounting Officer of the Ministry or Agency and may chair the project Steering Group, or this task may be delegated to another senior official within the organisation. The Steering Group should include representatives of the key departments or business units with an involvement in the project and its outcome, including the PPP Resource Centre within the ICRC. They should be of sufficient seniority to be able to make decisions at the Steering Group on behalf of their department without having to refer back. The project team will provide a secretariat to the Steering Group and will draft most of the papers, and the Steering Group will have oversight of their budget. The Steering Group will normally act as the Tender Board, the Procurement Planning Committee, and the Procurement Committee as defined under the Public Procurement Act and in the *Procurement Procedures Manual* for the various stages of the procurement.

If there are a number of external bodies which need to be consulted as the project requirements are defined, it may be appropriate to create a separate Stakeholder Group with which to consult outside the formal project management structure. This group may include representatives of local government, utilities and local communities affected by the project.

The project team will have day-to-day responsibility for delivering the project objectives within the allocated budget, and to the project timetable. They will often need to be supported by external advisers for PPP projects because of the more specialist financial and contractual issues involved. Apart from the Project team leader, specific tasks may need to be allocated within the team as appropriate, which should include management of each team of advisers. Membership of the project team should be seen as a fulltime appointment, and one which enhances the individual's experience and career opportunities. From the preparation of the Outline Business Case to financial close is likely to be a period of one to two years for a large project. Although financial close may mark the end of the procurement project, there needs to be continuity between the team involved at this phase and the team that will manage the construction and operational phases of the project

3. PPP Project Procurement Process

3.1 Procurement Preparation Phase

The culmination of the project preparation phase will be an Outline Business Case (OBC) which will be submitted to the Government's Economic Management Team or other relevant authority for approval. Although further guidance will be issued by the PPP Resource Centre on the contents of the OBC and the methodologies that should be used in the analysis, the short description of the typical contents of the OBC given below will provide an indication of the activities that need to be completed during the procurement preparation phase. The MDA will probably require external technical, legal and financial advice for this phase of the procurement, as well as for the procurement itself, and these advisers should be procured under competition. Sufficient time should be allocated for this and a decision made on whether the advisers should be appointed for the preparation phase only, or for the entire procurement.

It may be appropriate to consult with the private sector as part of project preparation. The purpose of this market consultation may be to ensure that the private sector has the capacity required to meet the range of services required (some of these may have been a public sector monopoly in the past) and, in the case of investors, the willingness to finance the investment. The consultation may be structured and formal or conducted through informal contact. One of the functions of the PPP Resource Centre is to communicate with the private sector and advertise PPP and concession bidding opportunities. It can therefore be the vehicle for some of this consultation. There may be a number of events at which the project could be presented (subject to final project approval) and it is beneficial to give the private sector as much preparation time as possible for the reasons given in the following Section.

The Outline Business Case should include as a minimum the following topics:

- a description of the policy context and business need;
- cost benefit analysis including non-quantifiable costs and benefits;

- an evaluation of the options for meeting the project objectives;
- identification of the preferred procurement route based on value for money and the feasibility or desirability of using PPP;
- analysis of the project risks and mitigation measures;
- description of the proposed risk allocation and contract terms;
- affordability analysis, including a cash flow model of estimated costs and returns for a PPP contractor and consequent annual payments to or by the authority;
- sensitivity analysis to the key input variables.

The OBC preparation will involve the collation of project data and consideration of the basis of the risk allocation within the proposed PPP contract. It will assist the drafting of the key documentation that will be required for the first stage of the procurement phase of the project: a Project Information Memorandum, which provides bidders with the background and objectives of the project, and a Prequalification Document (see below).

The preparation phase will end with the approval of the Outline Business Case and the appropriate budgetary allocations. The approval will also confirm, with appropriate analysis, that PPP is the preferred procurement route.

3.2 Prequalification

The procurement process formally starts when the project is advertised in the press and through other media as specified in the relevant guidance. The notice will invite bidders to submit Expressions of Interest for inclusion on a short list of private parties invited to bid for the project. The notice should provide sufficient information to help firms decide whether to attempt to prequalify for the tender list, including a description of the scope of the project, its approximate value, contact details for further information (usually the Information Memorandum and Prequalification Document) and the deadline for application. The period for prequalification should allow sufficient time for firms to respond and, in most cases, form a bidding consortium. For a PPP project this should be a minimum of 30 working days.

It may be helpful to organise a bidders conference before this deadline to provide further background (including possibly a site visit) and to demonstrate the authority's commitment to the project. These conferences may provide an opportunity for firms to identify potential bidding partners or advisers.

The Prequalification Document will provide more information on the proposed risk allocation for the project and the criteria against which tenderers will be prequalified and, ultimately, the contract awarded. The *Procurement Procedures Manual* provides further information on both the criteria for selection and the contents of the Prequalification Document.

The evaluation of Expressions of Interest needs to be rigorous and use only the published evaluation criteria. The evaluation committee should include suitably qualified individuals and at least one person experienced in public procurement. The project Steering Group will need to confirm the shortlist of tenderers. The prequalification stage ends with the issue of an Invitation to Bid (sometimes also called a Request for Proposals or an Invitation to Negotiate) to all of the shortlisted tenderers.

3.3 Negotiation and tendering

PPP procurement differs from most other forms of procurement in that it requires some form of negotiation or dialogue in order to determine the most appropriate technical solution to the stated requirements, and the optimal risk allocation between the parties. The need for fairness and transparency mean that the negotiation process must be carefully planned and managed, and the requirement of commercial confidentiality means that these negotiations need to take place on a bilateral basis between each tenderer and the project team, in order that each bidder can optimise the value for money of their bid. This discussion and negotiation, and clarification of the procuring authority's requirements, will usually take place in the first stage of the negotiation phase. The authority will normally start this stage by issuing a full description of its technical requirements and proposed allocation of risks in the form of a full draft contract, risk matrix, and an output specification with required performance standards and proposed remedies against non-compliance. The PPP Resource Centre and the National Council on Public Procurement will issue further guidance on the procurement of PPP projects.

3.4 Contract close

The tender process will end with the evaluation of either the initial tenders or Best and Final Offers from at least two of the bidders This will identify the "most technically and economically comprehensive bid"[1] and the pricing and other technical information it contains will form part of the information included in the Full Business Case submitted to the Federal Executive Council for approval. This approval will be required before the contract can be closed and will define the affordability and value for money envelope for the project, as well as the limits of any Federal Government support. Provided that the final detailed negotiations remain within this envelope, the Accounting Officer of the MDA will have authority to sign the PPP contract or concession.

The process of completing the contract will involve incorporating the bidder's technical and financial proposals into the contract, and finalising the drafting of minor contractual terms. At the same time investors will be carrying out their own technical, financial, and commercial due diligence on the project in order to satisfy themselves regarding the risks that they will be accepting in financing the project. Any subcontracts between the consortium and separate joint venture companies providing design, construction, or maintenance services will also need to be finalised (see Section 4). Much of this activity can proceed in parallel, and sometimes the Preferred Bidder may commission some advance design or mobilisation work at risk, or the authority complete the process of gaining legal access to the site or carrying out advance works. Nevertheless the period between appointing a Preferred Bidder and reaching financial close may take several months. During this time the Authority will usually retain the option of reverting to the second placed bidder should agreement not be reached with the Preferred Bidder.

3.5 Financial close

The Authority will normally retain some risks between the submission of Best and Final Offers and financial close. These risks are usually limited to changes in the cost of finance (particularly interest rates) within the markets generally. In the case of projects financed in whole or in part by the bond market[2] the Authority will take some risk in the final pricing of the bond. Inflation risk during the term of the contract is normally shared between the authority and the contractor through an indexation formula. For projects financed through bank lending, contract and financial close may occur at the same time.

3.6 Project Implementation

Reaching financial close marks the end of the procurement phase of the project (subject only to recording lessons learned from the procurement and possibly periodic reviews of the project to assess whether the project objectives and assumptions were met). There may be some Conditions Precedent that have to be met (such as draw down of the financing by the contractor or granting access to the site and other licences, permits and consents by the authority) before the implementation phase commences. But the relationship between the parties then changes and the Authority's role becomes one of monitoring and enforcing the contract, and authorising payment when due. This will usually involve a different team from the procurement phase, but there needs to be an effective handover between the two teams. The Project Steering Committee, having considered the lessons learned and project review may then stand down and the project governance structure described in the contract will replace it. This may take the form of a Project Board comprising the Accounting Officer and a senior representative of the contractor providing strategic oversight, and a joint Management Board providing day to day management. The contractor, as a Special

Purpose Company, will have its own internal governance structure as described in Section 4.

The ICRC Act requires that the ICRC takes custody of PPP agreements and monitors compliance with the terms and conditions by both parties. The way in which the ICRC carries out this function will be set out in further guidance from the ICRC, but as a centre of expertise on these contracts, the ICRC will be able to provide advice to either party to the contract on its interpretation or any subsequent requirement changes. PPP contracts will include clauses dealing with the resolution of disputes, and the ICRC may in some circumstances be used to arbitrate or provide advice within its wider public sector mission.

4. The Private Sector Role in PPP Procurement

If defining and procuring a Public Private Partnership (PPP) project is complex and potentially expensive for the public sector, it is equally true for the private sector, with the additional factor that the chances of success may only be 25% at the start of a procurement process. The rewards of success, however, are a long-term contract and revenue stream and an opportunity to develop a new market that may have previously been a public sector monopoly. But it is incumbent on the procuring authority to ensure that it manages the procurement process efficiently and allows the private sector the opportunity to maximise the chances of success by submitting bids that optimise value for money. This requires effective communication, as well as efficient procurement that takes account of the private sector bidder's needs for information and that allows sufficient time for identifying potential partners and advisors, preparing bids, and obtaining the necessary internal approvals. This section describes the process typically followed by private sector bidders during each phase of the procurement so that project teams understand the consequences of requests for particular information during the procurement, and the time that bidders will need to respond.

4.1 Private sector participants in PPP

Most PPP projects require a range of skills, expertise, or resources not normally found in a single company. A number of different specialist firms will therefore collaborate to bid for the projects (without necessarily forming a formal joint venture at this stage). They will often include contractors and other construction specialists, but may include designers, or firms specialised in providing operations or services in the sector. If they are successful in winning the bid they may form a joint venture company if the project is to be contractor financed, or a Special Purpose Vehicle (SPV) if project finance is to be used. The SPV is created solely for the purposes of the project, with the members of the consortium providing equity finance and holding shares in the company. The major part of the finance will be provided by third party investors such as banks, and the financing agreements will allow these investors first call over the project revenues for the repayment of the financing, including interest charges. Although these third party investors are not shareholders, they have a strong interest in the success of the project, because if it were to fail they could lose a substantial part of their investment.

Another participant in the process of bidding for PPP projects may be equity funds. These are groups of investors who have pooled their capital under a fund manager and who specialise in providing additional equity to these types of projects and assisting in the preparation of bids and managing the SPV and its contractual relationships. They have a high appetite for risk and will normally look to sell on their interest in the project once the facilities created under the contract are operational. They can provide a useful role in providing risk capital, since senior lenders will only provide typically 80%[3] of the capital requirement. Even large construction companies will have limited amounts of equity to invest in any one project vehicle. Equity funds may also bring expertise from other projects or countries. A number of funds have already been established with an interest in the Nigerian infrastructure market.

Multilateral agencies, such as the World Bank, can have an important role to play in these types of projects because they provide access to relatively low cost finance and possibly other financial instruments such as partial risk guarantees. These provide insurance against default by the government, thus reducing the cost of third party finance. The involvement of multilateral agencies in the project financing can also provide reassurance to other investors that the project will not be subject to arbitrary political interference.

Projects may be partially financed by donor grants or other aid. However such aid should be channelled directly to the procuring authority to offset some of the costs of the contract, including any user subsidies, and not used to finance the contractor. Aid to government that is tied to a particular national supplier providing some or all of the services under the contract, or offset against other agreements in favour of the donor, cannot be part of this procurement since it would not create a level playing field for other bidders[4]. Participants in the bidding process must be commercial companies or partnerships operating under the relevant laws of their country of registration and with a good technical and financial track record.

A bidding consortium may appoint independent legal and financial advisers who will prepare the necessary bid documentation, such as a financial model, and advise on contractual negotiations with the Authority as well as drafting of agreements between the consortium members, sub contractors, and lenders. The financial advisers will also advise on the lowest cost financing structure and the likely terms of that financing. During the later stages of the procurement, the consortium may appoint an insurance adviser and an arranger for the finance. The lenders will arrange independent technical and legal advisers to carry out due diligence on the Preferred Bidder's financial and technical proposal[5] and the agreed risk allocation between the contractor and the Authority, and between the SPV, its subcontractors, and insurers.

4.2 Prequalification

Once a company has identified the Nigerian infrastructure market as one in which it wishes to participate, it will need to develop a relationship with other firms to form a bidding consortium. This may take time because it is to be expected that the most experienced firms may be approached by more than one potential partner, and some of preferred partners may have already committed themselves to another consortium. That is why government should signal its intentions with regard to PPP projects well in advance, so that when the procurement process starts some of the bidding consortia are already in course of being formed. It is also why there is a need for an extended prequalification period.

The firms in a consortium will need to be of sufficient size and track record to be able to raise finance, not on their own balance sheets but through an SPV. The interests of investors and government coincide, however, in that investors will only wish to contract with reputable companies. If the demand for infrastructure services is to grow significantly, government will need to ensure that the capacity of its supplier base grows at the same rate to avoid price inflation. The Government will therefore encourage new foreign contractors to participate in the market and the Nigerian Investment Promotion Commission will work with interested firms to ensure that the necessary permits are forthcoming.

Members of the consortium may provide a proportion of the equity to the SPV, or others may act as subcontractors. These subcontracts will be of significant size and the subcontractor may itself be a joint venture (JV) between some of the equity participants in the JV and others. So, for example, a major contractor may both be a shareholder in the SPV and also form a joint venture for the construction subcontract, whereas a consulting engineering partnership may be a subcontractor to the SPV (or to the JV which will then have a fixed price design and build subcontract). The Prequalification Document may require not only that the shareholders in the consortium are identified, but also some of the key subcontractors such as an independent checker of the design (for major civil engineering projects). The operation and maintenance phase will be structured in the same way as the design and construction phase, with appropriate specialist firms.

The prequalification phase will require candidates for the bidding stage to provide information on their identity and approach to delivering the project requirements. They will also need to provide some historical information such as published accounts and project references. The responses to the prequalification invitation (also known as an Expression of Interest) must be received by the Authority in a sealed envelope by the specified deadline.

4.3 Negotiation and Tendering

Having been shortlisted as a tenderer, a bidding consortium will need to establish a team to manage the bidding process and a governance structure that ensures that the management boards of the consortium members can approve the bidding strategy and the bid itself. There will be a team leader and the bid team will probably be supported by external advisers. The team may need to seek clarification of the Authority's requirements and discuss its outline proposals, and the terms in the draft contract issued by the Authority, prior to finalising its bid. Since the Authority's requirements are based on outputs and deliverables, rather than inputs, the tenderer will need to prepare an outline design as part its bid submission. It will also need to have discussed with investors the terms of any financing and the risks inherent in the project, although the financing will not be committed at this stage. All of the pricing information, including financing costs, will be included in a financial model which will be submitted as part of the bid. This will be used to calculate the annual payment that the Authority will make (or, in the case of a concession, the tariffs to be paid by the user and/or the payments to be made to the Authority from the net project revenues) for the services provided. This annual payment will cover all of the elements of the service, from design, construction, operation, maintenance, and decommissioning, and will be fixed for the duration of the contract, subject only to indexation against the general movement in prices across the economy. There may be a variable element to either costs or revenues, such as energy costs or passenger numbers, and the input assumptions for these costs or revenues will also be provided with the bid. In some cases, payments to or from the authority may vary because of changes in demand, and these circumstances will be specified by the Authority in the tender documents. In essence, however, these contracts are fixed price for the duration of the contract, with the input costs amortised to produce a unitary payment or tariff. The input costs have therefore to be estimated with some accuracy.

The financial model is important in the bidding process because it identifies all the project cash flows, including the repayment profile of the debt and the return that the equity providers expect to achieve over the duration of the contract. It is therefore used to calculate some key variables, particularly for providers of debt, who will want to ensure that the free cash flows at any point are sufficient to cover the scheduled debt and interest payments and to test the robustness of the model through sensitivity analysis against the key variables. It is the cash payments that the Authority makes or receives each year that is the key determinant both of value for money as well as the ranking of bids, as explained in the accompanying Supplementary Note on value for money.

Given the complexity of developing outline designs, operational methodologies, financial models, and construction and maintenance schedules, the bid preparation period will be at least three months. Bid documentation, which may be substantial, needs to be delivered by the specified deadline, and, subject to clarification, will normally take at least six weeks to evaluate. If there is to be further shortlisting and negotiation prior to inviting Best and Final Offers, then this period may take several months. The end of the tendering phase is the appointment of a Preferred Bidder.

4.4 Contract and financial close

The Preferred Bidder will need to finalise all of the subcontracts and financing agreements for review by the Authority as well as the PPP contract with the Authority. There will normally be a Direct Agreement between the lenders and the

Authority giving them the option to step in and replace the contractor prior to any termination for contractor default. Although the Preferred Bidder is incurring significant bid costs at this stage, it can be difficult for the Authority to maintain the project timetable during this phase because much of the drafting of the necessary documentation is for the bidder and its advisers.

Once investors have completed their due diligence on the project, then finance will be committed by the lenders' Credit Committees. This will include the multilateral agencies (where applicable) and some of this commitment for projects at the State or parastatal level may be dependent on obtaining Federal guarantees or other forms of support. There will therefore need to be good coordination between all of the parties leading up to financial close. Normally all of the contract documents between the Authority and the contracting SPV, and within the SPV, are signed simultaneously at contract close. The financing agreements, including any hedging instruments such as interest rate swaps are completed at financial close.

4.5 Project governance

The SPV will be constituted as a private company under Nigerian law and will be subject to companies and tax legislation. Its governance will also comply with relevant legislation and include executive and non-executive directors, and it will produce an annual report and accounts. The senior lenders will require to be notified if there are any breaches of the PPP contract or the performance requirements, including the award of any financial penalties or penalty points[5]. The contract may specify joint management arrangements between the authority and the contractor if this is appropriate (see Section 2.3).

Although the contract is an important document in defining the responsibilities of both parties, it is equally important that the representatives of the parties develop a good working relationship, and avoid an adversarial approach if possible. There needs to be transparency in the relationship and a recognition of the wider public interest. Both parties will continue to be accountable for their performance, and ICRC has a statutory role in monitoring the overall effectiveness of the Government's

PPP policy. It will also provide the first point of contact in the event of disputes between the parties. It should be consulted on any aspect of the Policy or these Supplementary Notes that requires clarification or that is difficult to apply in practice.

(Footnotes)

1 *This is the terminology used in the ICRC Act, which in the context of the procurement process described here can be taken to mean the bid that offers the best value for money against the criteria set out in advance by the procuring authority.*

2 *This market is undeveloped in Nigeria at present but can be expected to develop rapidly as the government bond market also develops in liquidity and term, encouraged by both the demand for this type of finance from PPP projects, and an appetite for this type of investment from long term institutional investors such as pension funds and insurance companies.*

3 *This is an indicative figure. In mature markets the "gearing" of projects may be as high as 90%, and the actual proportion of equity capital required by lenders will depend on the perceived risk of the project.*

4 *This statement does not preclude bidders including export credits within their financing plan, provided that this does not distort the fairness and transparency of the competition.*

5 *The contract may specify a penalty points regime to deal with persistent minor breaches of the performance requirement. These points may accumulate and when they exceed a defined threshold result in financial deductions or penalties.*

PART 2:

Value for Money in Public Procurement by the Federal Government.

CONTENTS **PAGE**

1. Introduction

This Supplementary Note supports the Federal Government's National Policy Statement for Public Private Partnerships. It discusses value for money and how it will be used in defining infrastructure projects and to assess whether public or private financing should be used for the investment. The Note is intended as a general explanation of the concepts set out in the Policy Statement. Further guidance on the techniques to be used in assessing value for money in PPP projects will be provided by the PPP Resource Centre in due course.

Achieving value for money requires that quality as well as cost must be an important component of the investment decision, and also requires that project risks and uncertainty must be taken into account within an overall assessment of the long-term affordability of public services. The Note also explains the need to quantify the wider economic, social or environmental benefits that will be realised from a project and the need—in assessing value for money—to consider the whole life costs of, and future demand for, the services, and not just the initial capital investment required.

Value for money should also be a factor in the evaluation of bids and in decisions on the procurement strategy of the public authority. It is therefore given considerable emphasis in the Policy Statement on PPP. Although the principle of value for money can—and, arguably, should—be applied in any form of public procurement, it is intrinsic to all PPP projects, whether the service is provided free to the public or financed through user charges. These projects are usually complex and can have a high cost and social impact, so it is important that the means for achieving value for money is understood by all parties to the procurement.

Although the Policy Statement describes the Federal Government's new approach to the long-term planning of infrastructure, from which the majority of PPP projects will emerge, there may be occasions when the Government receives unsolicited offers for concession projects from the private sector. This Note discusses how these offers should be assessed and the basis for further discussions with a project proponent. The ICRC has also issued a Guidance Note on Transitional Arrangements for Implementing PPP which provides further details on the treatment of unsolicited offers.

This Note is one of a series issued with the Policy Statement. Other Notes describe:

- roles and responsibilities within the Federal Government for the implementation of its PPP Policy Statement;
- the procurement process for PPP projects;
- an explanation of the risks in PPP projects and how they may be allocated between the parties.
-

1.1 Structure of this Supplementary Note

The remainder of this Note covers the following topics:

- Section 2 discusses value for money and describes various ways of measuring it;
- Section 3 sets out procedures for handling unsolicited bids and how value for money may be assessed in the absence of competition.

2. General Principles

2.1 Value for Money

All purchases by individuals, corporations, or public bodies require judgements about value for money and affordability. Value for money may be an absolute term, and can be taken to mean that the benefits of the purchase to the purchaser exceed the costs, or it can be a relative term meaning that one of the options for meeting the purchaser's needs provides greater benefits relative to cost than another. There is an onus on those responsible for spending decisions within government that they spend national revenues wisely and obtain value for money in both absolute and relative terms.

Each public authority is required to appoint an Accounting Officer who is held personally responsible for all public spending within the Ministry, Department, or Agency and achieving value for money from that spending. Parastatals and utility companies are also required to demonstrate that investment decisions represent value for money for their customers under the supervision of the sector regulator. However, there is no simple rule that can be used to satisfy a value for money test because both level of service to be provided and the cost of service provision are factors in determining value for money.

Demonstrating value for money is often made more difficult by a lack of relevant data on costs and outcomes with which to compare different options, and by the uncertainty around estimating future costs and risks. Even deciding what is affordable is not always obvious, particularly for PPP projects where many of the costs occur many years into the future. Many of these projects will be unique so direct comparisons with recent project outcomes can also be difficult. Often public authorities will have to rely on the advice and opinions of technical experts with regard to costs and risks in appraising project options and evaluating priced bids.

Public infrastructure usually has a long economic life. PPP contracts are also typically long, in order to transfer more of the whole life cost risk to the private sector contractor and to amortise the initial construction costs over as many years as possible. Value for money needs to be considered in the allocation of other project risks such as demand for the service over time and the residual value of the underlying asset (see the Supplementary Note on Risks in PPP) which may have a continuing public use, an alternative use, or may be a liability with disposal or clean up costs. The assessment of value for money should therefore consider the whole life costs of the service requirement not just the initial costs, and the associated risks which may have a financial impact.

The comparison of options with different future profiles of costs and benefits requires the use of discounting to reflect time preference: that it needs to take into account the general desire to receive benefits sooner rather than later and, conversely, to incur costs later rather than sooner. This is explained further below. In the public sector, the discount rate will also include the cost of financing investment through government borrowing (the so called risk-free rate), risk and uncertainty in project outcomes, and sometimes the effects of taxation. The value for money analysis should take into account price inflation—both the general movement of prices in the economy and also inflation that is specific to different sectors (for example, construction) or types of cost (for example, wages). Sometimes inflation assumptions are already factored into market prices (as in the case of interest rates) and in others it will need to be added. The analysis of value for money may be done in either real or nominal terms and should include the range of possible value for money outcomes that may result from varying the key input assumptions such as inflation or demand. A key point here is that it is important to maintain consistency: either *all* values including the discount rate should be in real terms (i.e. net of general inflation) or *all* values should be in nominal terms (i.e. including an allowance for general inflation).

2.2 Affordability

There are many public investment projects where the social and economic benefits exceed their cost, but there needs to be some rationing and prioritisation of these projects in order to achieve a balance between competing calls on public resources. The public sector provides a wide range of services, including transport, defence, health, education. A mixed economy also needs to balance public and private investment in order to grow. Budget allocations within the public sector are a way of rationing funds and achieving an overall balance across the government's spending priorities. Budgets are usually divided between capital, which is used for investment, and running costs such as maintenance and administration costs. These define what is affordable for each type of expenditure. Spending commitments should only be made by Ministries Departments and Agencies (MDAs) after they have received a relevant budget appropriation, which effectively confirms their affordability.

The Government recognises that insufficient funding has historically been allocated to the maintenance of public infrastructure, and PPP will help to address this by factoring the whole life costs of the asset into the payments to the private contractor. But payments to the contractor will also include the financing costs of the capital investment, which to the extent that capital investment has been financed by government borrowing in the past, has not previously been funded through the MDA's budget. Using historical budget allocations as the test of affordability will therefore result in very few PPP projects passing the affordability test without appropriate recognition of maintenance and financing costs.

At the margins, budget appropriations are a crude but effective way of rationing the amount of investment and encouraging MDAs to prioritise their investment projects. Because PPP defers most of the costs of new investment to beyond the three year Medium Term Expenditure Framework, there needs to be a different mechanism for ensuring that these projects are affordable in the long term, which is why the Government is developing a 15-year national plan for infrastructure and a formal review process for PPP projects before they commence procurement and before contract award. Once projects have been approved, budgets should be safeguarded for prompt payment and therefore affordability will be assured. The planning process should identify only those projects in each sector which are likely to be affordable in the long term Alternative sources of revenue, including user charges should be considered within this process and where these may need to be supported through direct or indirect subsidies. For example, many transport concessions will not be financeable from user charges alone and there will need to be a public contribution to reflect wider social benefits. The approvals process set out in the Roles and Responsibilities Supplementary Note will therefore establish an affordability envelope for each PPP project.

2.3 Risk

All investment projects involve uncertainty, and major infrastructure projects can involve risks that can have a significant impact on outturn costs or benefits. Risk therefore needs to be taken into account throughout the project lifecycle and should be factored into the project budget. Risk can be quantified in terms of: (i) its likely impact; and (ii) probability of occurrence. Quantifying risks is potentially complex and requires data on the authority's previous experience of comparable projects. Often this data is not available and a panel of experts may need to be used to systematically identify and then quantify the potential impact and likelihood of occurrence of different risks. A separate Supplementary Note to the PPP Policy Statement discusses how certain risks may be allocated to the public and private parties in PPP contracts. Risks need to be factored into the expected cost of any project or procurement option, either as a contingency or as a risk premium. MDAs will be given advice on how to incorporate risk into project appraisal and business cases in further guidance to be issued by the PPP Resource Centre within the ICRC and the National Planning Commission. The private sector's view of risk and uncertainty in a PPP project will be factored into its cost of finance and its pricing of a PPP bid Financial models are used to test bid assumptions and input costs by both the procuring authority and bidders and these are discussed further below.

2.4 Project appraisal

Project appraisal is the process by which the need for further investment is identified, the objectives of the investment project stated, and various options for meeting this need examined to identify the preferred option. The preferred option should take into account both value for money and likely affordability. The result of this process is a quantification of the expected costs of the project as well as expected benefits over the lifetime of the project. The benefits should be monetised—that is to say, a monetary value should be attached to them—wherever possible to enable net present value to be calculated. The costs and benefits should be discounted at the same public sector discount rate used for evaluating bids and procurement options. These will however be some benefits that cannot be monetised in each of the options examined, and these will need to be evaluated in qualitative terms. Various techniques are available to enable this to be done consistently and systematically, and to aid in the comparison of different options.

In a PPP project which is not constrained by a capital budget, there is a risk of over-specifying the requirement and asking for a gold plated solution when a lower cost alternative would give similar benefits and hence offer better value for money. Hence there is a need to look at a range of options for meeting the identified need including a 'Do Minimum' option in order to identify the solution most appropriate to the project objectives which maximises value for money. The 'Do Minimum' option should represent the best performance outcome that can be achieved through limited expenditure in the absence significant capital investment. It provides the 'base case' against which the costs and benefits of alternative investment projects can be evaluated. The approach is necessary, because there is otherwise a danger that significant benefits that can be achieved at modest cost will be attributed erroneously to the investment project.

2.5 Procurement options

Government is able to borrow to finance its investment programme at a competitive rate compared to private sector investors. This is because the purchase of government bonds carries minimal risk of default by the government, which has the option of raising more taxes to repay the loans. The investor in government bonds therefore takes no risk with regard to the way in which the money is invested and the outturn costs of each project, whereas the investors in PPP projects will be exposed to the project risks and to risks associated with the successful delivery of the contractual requirements. Although government can diversify its investment risks across a wide portfolio of projects, some of which will have high returns and others which will not, to use the government risk-free rate of interest (which will also incorporate market expectations for inflation) to discount costs and benefits may encourage government to invest in riskier projects (see discussion on discount rates below). Using the government risk-free rate could also crowd out private investment in the economy and ultimately limit its growth potential. Nevertheless, there may be certain projects which are inherently so risky that the risk premium for financing them through the financial markets is too great to allow a PPP solution and such projects should be financed by the public sector. A public authority should therefore consider whether procuring investment projects through a PPP arrangement, or through more traditional means using public finance, will result in better value for money.

Any comparison of different procurement options must be done on a like for like basis that is each option should deliver the same quality of end service. If traditional procurement is subject to making adequate budgetary provision for maintenance, then realistic values should be used to reflect the standards of performance and maintenance interventions that will be required under a PPP contract. To do this analysis convincingly, the authority will require a robust database of outturn costs for similar projects procured under different contracts. Unfortunately, it is unlikely that authorities in Nigeria will be able to reliably estimate *ex ante* costs for each project under PPP and other forms of contract. There is a paucity of data on maintenance costs and what data there is will tend to lead to underestimation of the true cost of maintaining assets in a fully serviceable condition. Without any experience of PPP on which to draw, there will need to be a more judgmentally based analysis of which procurement route will give the best value for money. This will consider whether the private sector is capable of managing the risks inherent in the project and obtaining finance at a reasonable risk margin, and whether it will be possible to achieve effective competition throughout a PPP procurement.

The Federal Government accepts that the early PPP projects will be identified based on this judgemental approach rather than the quantitative techniques described in more detail below. It will accept Outline Business Cases drafted on this basis. Nevertheless, competition is important to establish the market price for PPP projects and the risks that they entail. Without a competitive process, it will be extremely difficult for an Accounting Officer to demonstrate that best value for money has been achieved because of the unique character of most infrastructure projects. For projects that were initiated as unsolicited bids, or where competition has failed, project teams will need to establish a value benchmark as part of the Full Business Case in order to obtain approval for the project to proceed from the Federal Executive Council.

It is possible that—in some cases—a hybrid financing arrangement may offer the best value for money solution. For example, up to 50% of the construction costs could be paid from the Federal budget on completion of the improvement with the balance being privately financed. This may reduce financing costs overall whilst preserving an appropriate performance incentive. A reduced financing requirement may, however, make the project less attractive for certain investors who incur significant fixed costs regardless of the size of the financing requirement. Mixed financing options, or even different contract terms, could be tested during the procurement by the use of mandatory variant bids, provided that the evaluation criteria are designed to be neutral between the options and the process of specifying variant options does not impose unreasonable bid costs. Partial financing by multilateral agencies may also reduce overall private financing costs, as may the use of partial risk insurance, and these options should be considered before and during the procurement stage of each project.

2.6 Discount rates

Discounting is a technique used in all types of investment appraisal to compare costs and benefits (or revenues in the case of a private company). It brings future cashflows, both positive and negative, to a present value. The sum of all of the discounted project cashflows is the net present value (positive or negative) of the project. Discounting is particularly important in the comparison of cashflows with different profiles over the project lifecycle, such as the comparison between a publicly funded project where most of the capital costs are incurred during the construction phase of the underlying asset, and PPP where the costs to the public sector are spread evenly over the period of the contract.

Discounting is also important in the evaluation of bids which may have different profiles depending on the financing and indexation proposed by each bidder. The same discount rate should be used in project appraisal, the assessment of the value for money of different procurement options, and bid evaluation since this reflects the public sector’s time preference and view of systemic project risks.

Both project appraisal and bid comparisons are sensitive to the actual discount rate used, and the Government will issue further guidance in due course on the rate to be used for Federal investment projects. MDAs should seek the advice of the ICRC and National Planning Commission in the interim.

2.7 Financial models

Financial models are used extensively in the preparation of PPP projects, and also by bidders to set out their costing assumptions and financing requirements. They are normally complex spreadsheets that allow input variables and assumptions to be flexed to test the sensitivity of the model to key inputs and therefore the robustness of the financing and costing assumptions to be tested. A bidder's financial model should be reviewed by the public authority and its advisers as part of the bid evaluation process, as well as by third party investors or rating agencies, before finance is committed. The financial model may become part of the contract documents if it is required to rebase costs as a result of a change in requirements by the public authority, in which case it should be audited and arrangements for its safekeeping by an independent third party. The financial model should include a balance sheet and other financial statements and be used to calculate tax liabilities as well as the cover ratios that investors specify as part of their financing agreements.

The public authority should also use similar models during the project preparation phase in order to estimate the likely annual cost of a PPP project as part of its affordability assessment. These Shadow Bid Models will make assumptions about the cost of private financing and financing structure, as well as pricing of risks and direct costs based on experience of similar projects, although bidders will be free to optimise their own financing proposals and make their own cost estimates. The Shadow Bid Model is therefore a planning tool and should not, therefore, be released to bidders.

Another financial model often used by the public authority in assessing whether a PPP contract is likely to offer value for money is a Public Sector Comparator or Value Benchmark. This is an estimate of the whole life costs of meeting the same service requirement as the PPP project but using an alternative publicly funded procurement option. The present value cost derived from this model can be compared to that of the bids to demonstrate which procurement route offers the best value for money, and if the public funding route appears to offer better value then the procurement can be restarted on this basis.

The Public Sector Comparator relies on estimates of costs and risks of a number of different contracts, however, including design, construction, maintenance, management and procurement costs. The model can only be as good as these estimates and, as noted in Section 2.5, the Federal government accepts that such a comparator cannot be a reliable predictor of whether an alternative procurement route would give better value for money. The Government will therefore rely on effective competition for a PPP contract rather than a theoretical model. MDAs should, over time, procure investment using a range of contract types and collate evidence of outturn costs over time in order to develop the private sector and collate evidence on value for money.

2.8 Procurement

The market price for the complex mix of obligations and allocations of risk that comprise a PPP project can only be determined through a procurement process where there is effective competition, since each project will be unique. Without competition, the process is likely to lead to the public authority being required to accept a greater share of the project risks (often through the provision of guarantees), and to difficulty in demonstrating value for money. There is also a higher risk that the parties fail to reach agreement on the contract and that wasted costs are incurred by both parties. The Public Procurement Act 2007 requires that all procurement shall be conducted according to open competitive bidding (Sections 16(1)(c) and Section (24)) and only permits exemptions from this requirement for projects below a “prior review threshold” set by the Bureau of Public Procurement (BPP) and under Section 42 of the Act. The Procurement Procedures Manual produced by BPP provides further guidance on the circumstances where direct contracting (i.e. award of a contract without competition) is permitted. These are when there is an "urgent need for the goods, works, or services" due to unforeseeable circumstances or as a result of a catastrophic event, and the procuring authority is required to justify its decision.

A number of PPP projects—let as concessions—may not require funding from the Federation share of the Consolidated Revenue Fund[1]. Nevertheless, the Public Procurement Act also applies to the disposal of public property (Sections 55 and 56) subject only to the Public Enterprises (Privatisation and Commercialisation) Act 1999. Public property includes licences or other "tangible or intangible assets which may be sold or procured for consideration" (Section 55(6)). The granting of a concession, where all costs can be met from user charges, will therefore also fall within the Act unless it is covered by the Public Enterprises (Privatisation and Commercialisation) Act 1999, under which the granting of a concession for an existing asset or activity must be approved by the National Council on Privatisation.

A procuring authority is therefore required to award PPP contracts, including concessions, through a competitive process—except in the case of an emergency—and with the prior approval of the National Council on Privatisation. This requirement also applies to projects which are identified through unsolicited offers by the private sector and Section 3 of this Note describes the process for achieving an element of competition in these cases.

3. Unsolicited offers

The United Nations Commission on International Trade Law (UNCITRAL) has prepared a *Legislative Guide on Privately Financed Infrastructure Projects* and the Federal Government has taken account of these recommendations in developing its PPP policy. One of the UNCITRAL recommendations concerns the receipt of unsolicited proposals from the private sector.

The Government recognises that in the absence of a formalised project planning framework in Nigeria in recent years, and until the new National Infrastructure Plan is finalised, the private sector has submitted proposals of its own, for instance for toll road concessions or power projects, which might be privately financed on the basis of a potential revenue stream from users. In some sectors, such as electricity generation, such approaches will be encouraged—since the Government wishes to develop a market for electricity supply—but in others, MDAs should generally identify their priorities for investment through the planning process set out in the PPP Policy Statement.

Nevertheless, MDAs are likely to continue to receive unsolicited offers and this section sets out a methodology for dealing with them. The ICRC has issued further guidance in its Guidance Note on *Transitional Arrangements for Implementing Public Private Partnership.* This requires that unsolicited proposals are submitted to the ICRC and then defines a process by which they are jointly evaluated with the relevant MDA and competition is introduced into the procurement process.

Some Unsolicited Proposals may be incorporated into an MDA's investment programme:

1. If the proposal concerns a sector with an established regulator and where a framework exists for the economic regulation of charges and other aspects of the service, then the promoter may apply to the regulator for the relevant licences in the manner prescribed;

2. If the proposal would confer rights which could create a form of monopoly in a sector without an established regulator, then the authority will consider the project in the context of its existing policies and project priorities and may adopt it into its investment programme. Once an Outline Business Case has been approved, an open and competitive public procurement can commence. If the proposal includes the intellectual property of the Proponent, the authority may need to acquire this property before starting the procurement process. In some circumstances the MDA may decide to reimburse, at its sole discretion, the project development costs incurred by the Project Proponent. Any feasibility study or business case submitted as part of the proposal would not normally need to be acquired, since it is likely to require substantial further development and due diligence in order to comply with the approvals process.

3. The Project Proponent would be able to compete for the project in the normal way, and may be able to benefit from its prior knowledge and analysis, although it would not be allowed exclusive access to information, such as elements of the Outline Business Case, prepared by the authority in connection with the project.

Alternatively the Unsolicited Proposal would proceed to competition in the manner described in the Guidance Note.

It is intended that these arrangements will be used until such time as the Government's first 15 year Infrastructure Development Plan is approved.

(Footnotes)

[1] *This is the term used in Section 15(1) of the Public Procurement Act and any procurement which requires at least 35% funding from the Fund is covered by the Act*

PART 3:

Project Risk and PPP with the Federal Government.

CONTENTS **PAGE**

1. Introduction

This Supplementary Note has been issued to provide further background to the Federal Government's National Policy Statement for Public Private Partnerships. It discusses the principles of allocating risks between the public and private parties in a PPP contract. The allocation of project risks is one of the key drivers of value for money in this form of procurement and needs to be considered throughout the project development and procurement stages. The key principle for PPP is that risks should be allocated to the party best able to manage them. The management of risk not only applies to minimising the chances of an identified risk occurring but also to mitigating the financial and other consequences if it does. It follows that, if a risk has different consequences for each party, their respective pricing of that risk will also be different. The paper discusses how project teams should systematically identify risks and how they may be quantified.

There are some risks that neither party to a PPP contract can manage and these risks will often be retained by government, which is able to diversify and absorb risks more easily because of its size. Another option may be to require the contractor to take out insurance cover for these risks, passing this risk on to other parts of the private sector. The public authority will need to understand the type and limits of insurance cover that is available in the Nigerian market, and its cost, before it can determine whether certain risks should be allocated to the PPP contractor.

Infrastructure projects also involve political risks and these are also insurable, in this case through multilateral agencies. The Government is also considering whether the creation of a guarantee fund would be a cost effective alternative to partial risk insurance from the World Bank or other agencies.

Government will often self insure against many risks because of its ability to diversify risk across a large portfolio of projects and because it has the ability to raise taxes to meet future liabilities. There is an opportunity cost to self insurance, however, and it cannot be assumed to have zero cost in a project risk assessment. It will often be appropriate to assume that the cost of the risk is the same as the cost of insuring the same risk in the local market, particularly in the early stages of project appraisal. Alternatively, an overall risk factor may be applied to cost estimates to cover both systemic risks and appraisal optimism. This factor may be reduced as project risks are identified and quantified.

This Note is one of a series issued with the Policy Statement. Other Notes describe:

- roles and responsibilities within the Federal Government for the implementation of its PPP Policy;
- the procurement process for PPP projects;
- value for money and affordability in public procurement.

The Government will review and update its Policy Statement and these Supplementary Notes from time to time, and ICRC will issue further Guidance Notes on their detailed implementation.

1.1 Structure of this Supplementary Note

The remainder of this Note covers the following topics:

- Section 2 discusses different types of risk that may arise in infrastructure projects and how they may be assessed and provisionally allocated in PPP contracts;
- Section 3 discusses how risks may be identified and measured;
- Section 4 describes how contracts will allocate risks and transfer performance risk to the contractor.

2. Risk Assessment in Infrastructure Projects

2.1 Identifying risks

Project risks can be broken down into a number of types, a process that can assist project teams in defining the project and in starting the process of assessing and quantifying those risks that are relevant to it. Risks will have an impact on the outturn cost of the project, although their final impact may be uncertain. Some risks are contingent on some future event occurring, and the cost of these risks is therefore a contingent liability. Risks can have a low probability of occurring but a high potential impact or a high probability of occurring but a low potential impact, and the allocation of all of these risks in the project will affect value for money for the public authority. It will also be a determining factor in whether the project represents additional borrowing by the authority and the State (in accounting terminology a 'finance lease') or whether the authority is buying a service through an 'operating lease'. This distinction may only be relevant to the recognition of contingent liabilities and the way these are recorded in the national accounts but should be understood by project teams because it may be relevant to how costs are allocated to departmental budgets (see Section 3.2).

The allocation of risks needs to be based on maximising value for money—but it also needs to be reasonable. Allocating too much risk to the private sector may result in a project becoming unfinanceable - that is investors are not prepared to provide finance at a reasonable cost. This situation may not become apparent until the very end of the project procurement when investors are required to commit to its financing. It is therefore important that project teams have a good understanding of the capital market in Nigeria and how this is changing over time. They may need to take advice from the PPP Resource Centre within the ICRC and their financial advisers on this.

2.2 Demand and revenue risks

The project appraisal should be based on an identified public need which can only be met by direct government intervention. It may be politically undesirable or economically impractical to pass on the costs of meeting this need by charging those that benefit for the service they receive, or it may be desirable to provide a subsidy to certain users. The appraisal of need will need to assess the future level of demand for the service and its sensitivity to external economic or social factors. So, for example, the need for a new or improved road requires assessment of the likely traffic over the next 15 or 25 years, since roads have a very long economic life and are more expensive to widen once they are in use. The project team will need to anticipate the growth of traffic, which will be sensitive to economic activity, local factors, and motoring costs (including the introduction of user charges) and develop a long-term traffic model.

Another example might be a water utility where charges may not be sufficient to cover the investment required to improve or extend the service. Even if there are no charges for the service, all infrastructure projects will have an element of demand risk and this risk will often be significant. Without user charges demand risk will be borne by government, and could represent a significant opportunity cost if demand is less than forecast, or result in higher investment in the future if it is greater.

If the Government's policy is to transfer the costs of the service to users, then it has an option to transfer some or all of this risk to the private sector under a concession contract. This can have benefits if the costs of the service are linked to demand, and can also act as an incentive to improve the quality of service in so far as this will increase demand and hence the contractor's revenues. The ability to transfer revenue risk will depend on the investors' perception of this risk and their ability to manage or quantify it. The authority may opt to share the risk, either by providing guarantees or by providing direct subsidies to construction costs, operational costs, or both. If revenue risk is not transferred, the task of collecting user charges and passing the revenues on to the authority may be given to the private sector operator, provided there are robust audit arrangements in place to prevent fraud.

In some projects, demand risk may be created by interface risks because the service to the end user is supplied through a network or grid. A good example of this is the power sector, where the failure of either the distribution or transmission system will affect the ability of a power station to generate power and to sell its output.

2.3 Availability Risks

This group of risks includes the risks that could impinge on the availability or quality of the service over the life of the project. Availability risks will often be specific to a phase of the project, such as design, construction, or operations. But there are other risks that could affect any stage. A PPP contract will often transfer most of these risks to the contractor, since the contractor will be responsible for integrating these different phases and achieving the output specification. Some risks, however, such as those which result from external events, for example extreme weather, will be borne by the public sector. These are often defined as *force majeure* and are discussed further in Section 4.5. Because many infrastructure services are provided directly to the public, this may create additional risks to the service provider, as a result either of damage to the underlying asset or a failure to pay charges. Some of these risks may be insurable or can be managed or mitigated by the PPP contractor.

Risks associated with the availability of the service will impact on the contractor's revenues as defined in the performance regime in the contract (or reduced revenue from user charges) but may also have an impact on costs (higher than expected maintenance costs, for example, as a result of poor design). The transfer of availability risks, including maintenance, to the private sector is intrinsic to value for money in PPP.

2.4 Financial risks

The transfer of financing risks provides assurance to a procuring authority that the PPP contractor will meet his contractual obligations because third party investors will have oversight of the contractor under the project financing agreements. Investors will also carry out due diligence on the bidder's proposal prior to contract award and need to be satisfied that the contract requirements will be met so that their capital and interest charges will be repaid. The financing plan for the project can be left to the bidder to optimise during the procurement phase, although the authority will need to satisfy itself that the financing proposals are realistic.

Once the contract is signed, the contractor will repay the investors as specified in the financing agreements, which will also specify the relative priority given to repaying different classes of investor. Equity providers, for example, may only receive dividends once interest has been paid to debt providers and when future cashflows are sufficient to repay the outstanding interest and capital. Third party investors will usually require a direct agreement with the authority to allow them to replace a failing contractor before the contract is terminated by the authority.

There are other financial risks that arise in PPP contracts that are shared or retained by the authority. Firstly the risk of the cost of financing changing prior to contract close remains with the authority as a consequence of requiring bids to be benchmarked to a specified market rate at the date of bid submission. This allows automatic adjustment of bid prices as the benchmark rate changes. Once the financing is closed, the interest rate on the borrowing will often be fixed through the swaps or bond markets if appropriate financial instruments are available. But in the absence of these the procuring authority may retain some interest rate risk. The second risk that should be retained by the authority for projects not subject to economic regulation, is that of the general movement in prices over the period of the contract. Because PPP contracts are long-term, the contractor may be exposed to higher costs than expected—either because bid estimates were unrealistic or as a result of inflation. Inflation is a risk that may be shared by indexing prices to a widely available index or basket of indices. Where an independent regulator for the sector has been established, with the power to set or reset tariffs or user charges, inflation risk is borne by the users. Some projects may be exposed to the risk of changes in the Naira exchange rate and this risk may be retained either by the authority or transferred to the contractor, who will normally hedge this risk through the capital markets.

Many PPP projects will be structured to allow the PPP contractor to raise additional revenues from third parties to offset some of the costs of providing the core service. This may arise, for example, when a building such as a school is not required outside the school term or from food franchises associated with a road concession. These risks would normally also be borne by the contractor or shared with the authority through a profit share mechanism.

Changes in taxes may also be a risk for specific projects if they would directly affect the cost of the service or demand. Discriminatory tax changes will therefore be a risk that the authority will retain but general changes in taxation will be for the private sector to manage within its normal business operations.

2.5 Political and contractual risks

The private investor will be concerned that contracted payments are made when due and not when money is available in the authority's budget. They will also be concerned that the contract is not terminated by a successor government for political reasons, and will require to be compensated in these circumstances. The contractor will have the right to the payment of interest if due payment is late, and even to terminate the contract if he is not able to meet the contract requirements as a direct consequence of the authority's default on its contractual obligations (such as granting access to the site). Most political risks may be covered by partial risk insurance, where a multilateral agency such as the World Bank will provide a guarantee against default by the public authority (although it will require a counter-guarantee from the Federal Government).

The authority should also be concerned about the political, safety, economic, or environmental consequences of default by the contractor. Even if the contractor receives reduced payment or no payment at all when the service is not available, the government will have a responsibility to ensure that the public interest is protected and essential services are provided. It will therefore retain the right to step in and provide the service itself and charge the costs to the contractor. The step in may last as long as the emergency exists and, if the contractor remains in default, the contract may be terminated.

The operations of the contractor may result in a claim for compensation against the authority by a member of the public or one of its employees. To the extent that any claim is a direct result of the negligence of the contractor or caused by his failure to meet the contract requirements, the contractor should be required to indemnify the authority against any third party claims (see Section 4.2).

2.6 Changes in requirements

Because PPP contracts are long-term, it is likely that the authority's requirements will need to be modified at some point to provide levels of service that are appropriate to changing political or economic requirements. The extent of any changes should be reasonable and in proportion to the scope of the original requirement and the project team should try to anticipate the changes that may be required and factor them into the project requirements during the project preparation phase. However, in the event that changes to the requirement become necessary during the contract term, the authority will need to provide compensation or adjust payment to the contractor if additional construction or higher maintenance and operational costs result from the change. Some of these costs may be passed on to users through an adjustment to the tariff where appropriate. The contract will protect the position of the authority and may require additional works or services to go through a separate tender process or be benchmarked against market prices in order to ensure that the contractor's costs are fair and reasonable.

The Contractor must comply with all relevant legislation throughout the contract period, even if this results in higher costs. However if new legislation discriminates against the contractor, or PPP projects generally, then the contractor may seek compensation.

2.7 Residual value risks

All infrastructure assets have a finite economic life, and will therefore become functionally or technically obsolete at some point. This may be beyond the term of the contract, in which case the contract should specify that the asset is handed back to the authority in a condition which is suitable for its continuing use. Examples of these types of assets are roads, where the road pavement or structures may need to not only meet the service requirements but also have a defined residual life. If the authority is uncertain about its future need for the asset, it may retain an option either to continue the contract for a period or to purchase the asset at its market price. In other cases, the contractor should assume responsibility for the disposal of the asset or for finding an alternative use for it. An example of this type of asset would be a power station where there may be costs involved with its dismantling and with cleaning up the site, which the contractor should meet. In preparing a project, the authority will need to consider which party should be best able to manage residual value risks and whether the asset should revert to the public sector.

3. Managing and Measuring Risks

Both the public and private sector parties to a PPP contract need to identify and attempt to quantify the project risks during the project preparation and procurement phases, and manage the risks that they have been allocated once the contract is awarded. For the public sector, the most significant risk that will be retained is payment, and the financial consequences of guarantees or increased demand or inflation. It will also have to provide access to the site and possibly planning consents. These financial liabilities may have an impact on the authority's budget or on the contingent liabilities logged with the Debt Management Office (see the Roles and Responsibilities Supplementary Note).

The private sector is likely to have to manage the majority of the design, construction, maintenance and operational risks associated with the project. The contractor will do this in a number of ways. The first is to pass risks down to subcontractors. So, for example, there will usually be a fixed price turnkey design and construct sub-contract, which will pass on the interface risks of the design and construction phases of the contract—including delays to bringing the asset into service—to the subcontractor. The same principle of passing risks down to subcontractors should apply to other aspects of the service such as operations or maintenance.

The second approach to managing risk is through insurance. The authority should specify the insurance cover that the contractor is required to maintain. It may also want to be co-insured to ensure that the project benefits from any insurance proceeds. Where financing is provided through the capital markets by the issuing of bonds may be enhanced by a monocline insurer providing a 'wrap'. In other words, it will underwrite the project risks in return for a fee. The use of the capital markets in Nigeria for this kind of financing is undeveloped at present, although it can be expected to provide a competitive source of long-term finance as the PPP market develops.

Most PPP projects will be financed on a limited or non-recourse basis. That is, investors only have recourse to the project revenues and not to the assets of the shareholders or their parent companies. Parent company guarantees, where used, will therefore not be full financial joint and several guarantees for the project but may take the form of performance guarantees to ensure that the parent companies provide sufficient resources and expertise to the project company to so that it is able to fulfil its obligations..

In many forms of tendering, bidders are required to submit bid bonds or letters of credit to offset the risk that they withdraw and the authority needs to re-run the competition. Because of the higher costs of bidding for PPP projects, bid bonds are not normally demanded by the procuring authority, although it may be appropriate to retain the option of requiring a bond from a Preferred Bidder between selection of the Preferred Bidder and financial close.

3.1 Identifying and Measuring Risks

The preparation of a PPP project—and the business cases that support the procurement or investment decisions—require that project risks are identified and quantified wherever possible. The process needs to be systematic and recorded, and will often involve technical advisers. The process may involve arranging risk workshops where the project team will meet specifically to identify and quantify risks. It is often helpful to list the risks that may arise at each stage of the project and to allocate them between the contractor and the authority, or identify where a risk may be shared. Quantifying risks should be based on relevant data wherever possible or, in the absence of data, by categorising them in terms of high, medium, or low probability of occurrence and high, medium, or low impact. The quantification of risks that are transferred to the contractor is an important factor in assessing relative value for money when comparing PPP procurement with other forms of contracting which transfer less risk (see the Supplementary Note on Value for Money).

The financial consequences of risks retained by the authority will be greater under a PPP arrangement than they are under other forms of contract. This is because the contractor will not only incur direct costs and overheads if the completion of construction is delayed or the service interrupted because of a default by the authority but because it will also incur financing costs. Hence, if the authority has ownership of a risk which results in the contractor being unable to deliver the service requirement, it is likely that it will need to provide compensation to make payment as though the contractor were still meeting the performance requirement.

For example, the failure of either the gas distribution system or the transmission system will result in a loss of revenue to the operator of a power station and consequently a demand for compensation through the off-take or supply agreements. This will need to cover both the operator's overhead and financing costs. In the case of the gas supply agreement these are costs likely to be considerably greater than the charges for supplying the gas itself[1]. These consequential costs also arise for a government-owned power station, but in this case the financing costs are hidden.

3.2 Accounting for Risks

PPP projects create assets and financial liabilities, which may need to be recognised in the accounts of the contractor. In the case of government these liabilities may also need to be included in the national debt. The rules on accounting for the risks and liabilities in PPP contracts are complex and bidders or contractors will need to take professional accounting advice. For public authorities, the PPP Resource

Centre–in conjunction with the Debt Management Office–will provide guidance on the budgetary treatment of the liabilities created under PPP projects and their treatment in the national accounts.

4. Allocating Risks in a PPP Contract

The PPP contract is the document that allocates all of the project risks between the public and private sectors. It must therefore be drafted to take account of all of the circumstances that may arise that may create additional costs or reduce the contractor's revenues, and define the obligations of each party if a risk materializes. The most important way in which the contract should allocate risks should be through the output specification which should define the service levels that the contractor must achieve if he is to receive full payment. Failure to meet the service requirement will be at the risk of the contractor, except where the failure is a direct result of the authority's default on its obligations under the contract. There may be some circumstances such as *force majeure* where risks are shared

The section sets out some of the ways in which a PPP contract should allocate the project risks, although it does not describe all of the elements of this form of contract.

4.1 The Output Specification

The Output Specification or Technical Requirement contains a full description of the various elements that comprise the service that the contractor has to provide, and the standards of performance that the contractor has to meet. The output specification will usually be contained in a separate schedule to the contract. This should be mirrored by a separate schedule which contains the contractor's technical designs, method statements, or other proposals for meeting the authority's requirements. This schedule should capture all of the technical elements of the successful bid. The contractor's technical schedule is binding on the contractor but the authority's output specification will take precedence and, if either party becomes aware that the contractor's design, method statements or specifications will result in a failure to fully comply with the output specification, these will need to be changed at the contractor's cost until they do. In this way the risks of meeting the specified outputs are allocated to the contractor, but the authority will be able to retain oversight of the contractor's proposed design, construction, maintenance and operations of the asset and his approach to delivering the service. The authority's oversight is important because it retains its statutory responsibility for providing the public service, including in some cases public safety (possibly under the oversight of an independent regulator). The authority is simply contracting with the PPP contractor to provide the service on its behalf. It should satisfy itself during the bidding process that the contractor has the technical capacity and experience to meet the service requirements and that its technical proposals are also capable of meeting the output specification.

4.2 Indemnities

The contract should include a number of indemnities which are provided by the contractor for the benefit of the authority. These should include claims made by third parties against the authority because of a failure in the service. There may be other requirements on the conduct of claims but the use of indemnities maintains the authority's statutory responsibility to provide the service to the public whilst effectively allocating to the contractor the cost of claims by third parties consequential on its default.

4.3 Warranties

Another contractual device for allocating risks to the contractor is through the use of warranties. These will confirm that the contractor has carried out its own due diligence on all of the background information supplied by the authority during the tender phase and has taken this into account in preparing his technical proposal. This information should include data regarding the condition of the site, any ground investigations and hydrological or traffic data, and planning consents required. This ensures that the consequences of unforeseen ground conditions or other factors which cause the contractor to incur costs are at his risk.

4.4 Payment and performance mechanism

The payment mechanism should define what payment adjustments will be made following a failure to meet the output specification. The contract should define the unit of payment, which may simply be the availability of the service, or some other unit of output. Any elements of the service which are below the defined standard should result in a reduced payment, and if the service is unavailable then no payment should be made. The payment mechanism should therefore provide an immediate (normally deductions would be made in the following monthly invoice), and direct, incentive on the contractor to meet the output specification. The contract should define the payment consequences when the service is deemed not to be available because it falls below the minimum standard but is nevertheless being used by the authority (or the public). The contract should also allow the contractor a reasonable period of time to remedy the service failure before payments are reduced.

There should be an additional mechanism for dealing with persistent minor failures in performance, which may not in themselves result in a reduction in the unit of payment but which may result in higher risk of accidents or inconvenience to users. For example, the contract may specify the number of penalty points that may be awarded by the authority for each failure, and the threshold at which the accumulation of points will result in reductions in payments. The payment and performance mechanisms need to be supported by a monitoring regime which routinely measures compliance with the contract requirements.

4.5 Force Majeure

Force Majeure is the occurrence of an extreme event outside the control of either party and which may impose significant costs on the project or disrupt the service. Some events, such as war, terrorism, civil unrest, or extreme weather may result in the authority providing compensation to the contractor. Other events may result in the financial costs being shared. The allocation of *Force Majeure* risks will depend on the nature of the underlying asset and may be finalised by negotiation during the procurement phase of the project.

The drafting of *force majeure* clauses in a contract and other means of allocating risk will eventually be standardised in consultation with public and private sector representatives through the issue of guidance by ICRC, which has a statutory responsibility to ensure effective implementation of the Government's policy on PPP. ICRC will monitor the implementation of the Policy and these Supplementary Notes and will make recommendations to Government on how their drafting may be clarified or improved. ICRC will therefore welcome comments by those engaged in PPP project procurement and operation on the practical application of the Government's policy. ICRC will take custody of all PPP contracts as required under the legislation.

(Footnotes)

[1] For example the charge for supplying gas may be $14m per annum, but the contractor

's overhead and financing costs for the power station could be as high as $76m per annum.

PART 4:

Roles and Responsibilities for PPP in the Federal Government.

CONTENTS **PAGE**

1. Introduction

This Supplementary Note provides further information and background on the National Policy on Public Private Partnerships. It sets out the roles and responsibilities of various Ministries, Departments and Agencies (MDAs) in the Federal Government of Nigeria (FGN) in the planning and procurement of infrastructure investment projects, and in the procedures for approving and monitoring their costs. It also describes the role of the Infrastructure Concession Regulatory Commission (ICRC) in leading on the development of PPP policies and in issuing guidelines on project selection and procurement.

This Note is one of a number of supporting documents to the Policy Statement:

- procurement procedures for PPP projects;
- the evaluation of value for money in PPP procurement;
- the identification and allocation of risks in PPP projects.

The National Policy and its Supplementary Notes will apply to all infrastructure projects contracted by the Federal Government, and any State or Local Government projects that are part-funded, or in some way guaranteed, by the Federal Government.

Where the Federal Government has allocated responsibility for producing guidance for the planning of infrastructure projects, or their procurement as Public Private Partnerships, then State and Local Governments, and their parastatals, should have regard to this guidance in preparing their own programmes for infrastructure investment and procurement processes as representing best practice in Nigeria. The Nigerian Courts and various audit bodies may take compliance with best practice into account in determining disputes or reporting on management failures.

1.1 Structure of this Supplementary Note

The remainder of this Note covers the following topics:

- in Section 2 the general principles that will determine infrastructure planning, budgeting, and management in the Federal Government are set out;
- in Section 3 the characteristics of PPP projects are described;
- Section 4 sets out the roles and responsibilities of various ministries and agencies within the Federal Government, including the PPP Resource Centre, in developing PPP policy and implementing projects.

1.2 General Principles for Planning and Managing Infrastructure

This section outlines the general principles that should be followed by the Federal Government and its MDAs when developing investment programmes, making investment decisions, managing the procurement of infrastructure, monitoring contracts, and providing public services.

All infrastructure projects will progress through four distinct phases:

1. <u>Project development</u>

   a. economic, social and environmental cost benefit analysis;

   b. a systematic appraisal of a number of technical solutions to the identified need;

   c. value for money and affordability testing of different procurement options;

   d. appropriate budget allocation within the National Development Plan and subsequently the Medium Term Expenditure Framework;

   e. approval of an Outline Business Case prior to the commencement of procurement.

2. <u>Procurement</u>

   a. creation of a project team and management structure;

b. preparation of an Information Memorandum and bid documentation;

c. market consultation if appropriate;

d. a competitive and transparent procurement process, with a clear audit trail for the selection of bidders and the evaluation of bids;

e. approval of a Full Business Case before the decision to award a contract.

3. Implementation

a. monitoring of design and construction, and subsequently operation and maintenance to ensure compliance with the required service standards;

b. monitoring of payments against services delivered and any contingent liabilities.

4. Contract Maturity

a. inspection and preparation for the handover of any public assets if appropriate;

b. analysis of future service delivery options and further procurement if appropriate;

c. contract close and recording of lessons learned.

Infrastructure planning and procurement, and management should follow the principles of good governance described below.

1.3 Accountability

The Federal Government and its Ministers are accountable to the National Assembly for the development and implementation of their policies, as are State

Commissioners to the State Assemblies. This democratic principle can only be safeguarded if the members of the Assembly have access to relevant information. Ministers, senior civil servants, and the heads of parastatal bodies may be questioned on the implementation of policy and their use of public funds. The scrutiny by the National Assembly and State Assemblies of the basis on which investment decisions are made across government, and the independent audit of public expenditure by the Auditors General, are important safeguards against the misuse of public funds. The process followed in making investment decisions therefore needs to be systematic and auditable, and it is important that, in setting out due process for investment or procurement decision-making, that accountability is allocated to a specific MDA within government, and to named individuals as Accounting Officers.

The focus on policy skills in public administration, or the need to rotate individuals between different postings, has often been at the expense of the management or implementation of projects and the development of specialist skills within the public sector. It can also diminish personal accountability for decisions, particularly if more than one department or ministry is involved in the decision-making process. Public scrutiny can discourage risk-taking by decision-makers, since the consequences of mistakes may be worse than the rewards for success. The Government will address these conflicting pressures on MDAs by encouraging them to appoint dedicated project teams and to follow good project management practices, including:

- setting out a clear statement of the policy context and the objectives of the project;
- the identification of all of the relevant decision-makers at the outset;
- timely provision of information and a clear plan and timetable for the key project decisions;
- independent review at key stages, reported to the individual who is held personally responsible for the achievement of the project's objectives;
- recording of lessons learned to inform subsequent project teams.

At the stage that a project enters the forward programme, the relevant MDA will appoint an Accountable Officer at Director level, who will be responsible for oversight of the preparation and procurement phase and chair a Project Steering Committee. It is recommended that the Steering Committee includes a representative from the PPP Resource Centre within ICRC. At this point, a Project Director and project team will also be appointed, including, if necessary, external advisers, who will be responsible for preparing all of the project business cases, the procurement documents, and the bidding process up to contact award. They will report progress to the Project Steering Group, which will make the key policy decisions. The Government will provide dedicated funding for the additional costs of external financial and legal advisers that will fall on the early pathfinder PPP projects as they develop appropriate templates for the key project documents.

All PPP projects will require the approval of each project's Outline Business Case by the Government's Economic Management Team or other relevant authority before procurement can commence, and the approval of a Full Business Case by the Federal Executive Council before a contract can be awarded. Guidance on each of these approvals and other aspects of the PPP procurement process will be provided by the ICRC. In due course, a PPP Unit within the MDA may be set up to provide further guidance specific to PPP in the relevant sector.

It is important that public authorities share information on pricing and lessons learned in procurement and standardise documentation where possible, so that they can become better customers and make procurement decisions based on reliable and consistent information. There should be a culture of continuous improvement in procurement, and benchmarking. The use of cost databases can be a useful tool for achieving this. For the market for government works or services to work efficiently—and for transaction costs to be minimised—different levels of government, including parastatal bodies, may need to cooperate or share information to ensure that they are not competing against each other for the attention and limited resources of the supplier base.

1.4 Commercial confidentiality

Federal Ministers will not be involved in the evaluation of bids or the selection of a preferred bidder. This is to ensure that bidders for PPP projects can be confident that their bids will be considered on merit against the evaluation criteria issued with the procurement documents, by preventing inappropriate lobbying or political interference and ensuring that there are no perceived conflicts of interest. Ministers will of course be involved in the final investment decision for significant projects, since this decision will be made by the Federal Executive Council.

For competition to work effectively, it is vital that bidders have confidence that their pricing and innovative ideas are confidential between them and the authority[1]. Procedures will be adopted to minimise leaks of confidential information, including restricting access to pricing or other sensitive information in bids only to those who are directly involved in the evaluation process. The Bureau of Public Procurement will continue to be responsible for auditing compliance with due process, and its certificate of 'no objection' will be part of the Final Business Case for approval by the Federal Executive Council. Unsuccessful bidders who feel aggrieved that due process has not been followed will have redress through the courts. The Government will consider alternative appeals procedures as part of its review of the Public Procurement Act. In cases where due process has not been followed, the procurement may need to be repeated or other remedies applied.

1.5 Government Accounting and Budgeting

Cash budgets for capital and maintenance spending on infrastructure need to be planned a number of years ahead to allow time for feasibility studies, planning, outline design, and procurement. PPP projects would not normally result in any payment until construction is completed and the public infrastructure services are available for use.

Currently, MDAs submit their spending plans for the following year to the Ministry of Finance (MOF) and once agreed the Government presents its consolidated draft budgets to the House of Representatives and Senate. These are amended or accepted by both Houses and finally signed by the President before the start of the new financial year in January. If there is a delay in approving the consolidated budget, the President may authorise the MDA to spend the proportionate amount for the corresponding period in the immediate preceeding financial year for a period not exceeding six months.

The 2007 Fiscal Responsibility Act strengthens the budgetary process. Federal budgets are now determined over a three-year cycle (the Medium Term Expenditure Framework). The planning of infrastructure across the economy is coordinated and approved by the National Planning Commission (NPC), which was created under the National Planning Commission Act 1993 within the Office of the President (although with its own Minister of State). The NPC is developing an infrastructure investment strategy that will consider investment requirements over a fifteen-year period and become a new National Development Plan. In future, therefore, budgeting and planning will be longer term and this will assist in the development of a sustainable PPP programme alongside direct public funding of infrastructure.

Once budgets have been approved by the National Assembly and the President, MDAs are permitted to move spending between different budget headings within their overall allocation and there are established procedures for doing so. MDAs may also submit Supplementary Estimates through the Ministry of Finance to the National Assembly during the year for unforeseen expenditure. MDAs must not enter contractual commitments without an appropriation from the budget, but once such commitments are made then the Government will ensure that future payment liabilities will be ring-fenced within future budgets.

The Debt Management Office (Establishment, etc) Act 2003 provides a framework for managing the Federal debt and those contingent liabilities created by Federal guarantees of borrowing by the States. (States are allowed to borrow internally, but all external borrowing has to be approved and guaranteed by the Federal Government). The Debt Management Office will, therefore, have a role in monitoring liabilities created by Federal PPP projects and those State projects that require Federal guarantees. Credit insurance provided by the World Bank (through MIGA) as partial risk guarantees in a PPP project, or for State borrowing, require a Federal Government counter-guarantee that also has to be approved by the Debt Management Office. The Government is considering the merits of creating a Guarantee Fund to make provision for the liabilities it may incur under PPP and similar arrangements.

Both the National Planning Commission (NPC) and the Federal Ministry of Finance have a role in capital projects that are funded wholly or partly by donors or multilaterals, even where a project falls under the jurisdiction of an individual State. So, for example, World Bank or African Development Bank loans are channelled through the Ministry of Finance and the NPC acts as National Authorising Officer for EU and other grant funded projects, even where the service which the grant is provided to support is a State or local government obligation. In these cases, the respective State will sign a Memorandum of Understanding with the Federal Government on the use and application of the respective funds.

The majority of spending by States is disbursed from the Federation Account which consolidates all national revenues. It is distributed in accordance with a formula recognising location, population, area and other factors. The Excess Crude Account is disbursed on a similar basis.

Since the budgets of MDAs are cash-based, so is the reporting of expenditure (though not accruals) through the annual accounts. These are audited by the Auditor General's department usually by the joint appointment of independent auditors with the relevant ministry. Each State has its own Auditor General.

Contractual commitments for payment, insurance or other guarantees provided under PPP projects may need to be consolidated into the national accounts for statistical purposes but should, in any case, be recorded and in some cases formally approved in accordance with the processes described later in this Supplementary Note, because they are likely to involve spending commitments beyond the budgetary period. These considerations apply not only to State or Federal ministries and parastatals but also to corporations or public companies where the public sector is the sole or majority shareholder. The Ministry of Finance will monitor risks created under Government contractual commitments arising from Federal PPP projects and will issue guidance on their accounting and budgetary treatment.

1.6 The Role of Regulators

The privatisation and commercialisation of public services and public assets as well as Private sector participation in the provision of public services have often been accompanied by regulation—where competition is absent or limited—to promote investment and operational efficiency and to prevent abuse of a monopoly position, and so protect consumers. The regulators have statutory powers to grant operating licences and may have powers to set prices or tariffs. The price review process takes account of not only input costs and efficiency but also the need for new investment, sometimes to comply with new legislation. In this role, regulators can sometimes use benchmarking against a group of similar suppliers as a guideline.

The role of the regulator is to prevent market abuse or to determine appropriate environmental or safety standards where this is not already provided for by the Federal Environmental Protection Agency or similar bodies. Regulators therefore provide the framework that enables private investors to make investment decisions and quantify commercial risks. It is important that they remain independent of government and establish a track record that provides some stability and certainty to the private sector. PPP projects will operate within this framework.

2. Public Private Partnerships in Nigerian Infrastructure

A wide range of contract forms—in turn represented by numerous acronyms (BOT, DBFO, BOOT, etc.[2])—falls within the scope of the term 'public private partnership'. It can be said to include: outsourcing and partnering; performance-based contracting; design, build, finance and operate (or build operate transfer) contracts; and, sometimes, concessions. These forms of contract have the following characteristics:

1. They are long-term contracts (typically between 5 and 30 years) between a public sector authority and private sector contractor for the provision of a public service. The contract may require the construction of new public infrastructure or other assets, in which case the private sector contractor may finance the investment and recover its financing costs over the remainder of the contract from tolls, service charges or payments by the public authority.

2. Payment to the contractor is linked to the quality, and sometimes also quantity, of the service delivered. This means that the contract includes an output specification rather than a definition of inputs. Payment may be based on the availability of an asset, such as a road, provided it is meeting the standard required in the specification.

3. There is more risk transferred to the contractor than is the case with other traditional forms of procurement. The general principle is that the project risks should be allocated to the party best able to manage them. Often these risks arise at the interfaces between the different phases of a project so these will be integrated into one contract—for example design, construction, maintenance and operation. This feature, when combined with a contract term that matches the economic life of the underlying asset, means that there is an incentive on the contractor (provided the contract is awarded under competition) to minimise the whole life costs of providing the service. These incentives are much weaker in the public sector, which will usually contract for each phase separately and where typically there is an emphasis on the lowest up front cost (possibly leading to higher maintenance costs later).

2.1 Sectors considering PPP in Nigeria

The focus for PPP in Nigeria is the creation of new infrastructure or expansion of existing ones, such as:

- power generation plants and/or transmission/distribution;
- roads and bridges;

- water supply, treatment and distribution systems;
- ports;
- airports;
- railways;
- inland container depots and logistics hubs;
- gas and petroleum storage depots and distribution pipelines;
- solid waste management;
- educational facilities;
- urban transport systems;
- housing;
- healthcare facilities etc.

It is estimated that over the next years six years, Nigeria will need to invest over USD 100bn in just four key sectors of the economy if it is to meet its annual growth targets and become one of the 20 largest economies in the world by the year 2020:

- power (USD 18-20 billion);
- railways (USD 10 billion);
- roads (USD 14 billion);
- oil and gas (USD 60 billion).

The Government expects that some of this investment will be provided by private finance under PPP arrangements.

2.2 Concessions as PPP

Concessions are included in the broader definition of PPP since they have most of the features of PPP described above. But they also transfer some or all of the demand and revenue risks within the projects to the private party that has been granted the concession. The output specification may include requirements with regard to the frequency of services or levels of charges. This is because the service may create a local monopoly and political considerations may require some element of cross-subsidy between different users, or a minimum frequency of services for wider social reasons[3]. Since the underlying purpose of these contracts is the provision of a service to the public, it is important that the political aspects are considered fully at the outset, including the need for some public subsidy to capture wider social benefits and ensure that the tariff structure is affordable for all potential users. Concessions and other forms of PPP can also allow a clearer separation between the policy and regulatory aspects of public services and their day-to-day management and operation. Policy risks must inevitably remain with government, but regulation can be applied through an independent regulator or through legislation. Risks should be allocated to the party best able to manage them, and some risks may continue to rest most appropriately with the owner of the underlying asset. The use of private finance to fund capital costs may also make the true cost of the service more transparent, since all investment projects carry a degree of risk and this will be reflected in the cost of financing the investment.

Concessions have also been used as a form of commercialisation of public enterprises or their activities. For example, the Nigerian Ports Authority granted concessions for the operation of certain ports facilities in Nigeria, under the Privatisation and Commercialisation Act. The Bureau of Public Enterprise tendered these concessions, which were subsequently approved by the National Council on Privatisation. The programme of privatisation and commercialisation is well advanced (except in the power sector), however, where concession is involved the ICRC and the relevant MDAs will assume responsibility and take the lead. The role of the regulator of a sector will be the same, regardless of whether a concession is granted through the National Council on Privatisations or through PPP under the management of the relevant Ministry.

2.3 Partnering and Joint Ventures

In some projects the full scope of the service requirement may not be clear at the outset, or the underlying technology may be subject to rapid change. Defining a long-term contractual requirement under a PPP may be difficult and these contracts are less flexible in responding to changing circumstances, particularly where further investment may be required. The Government will consider other options for working with the private sector to increase operational efficiencies where this is appropriate. These options include partnering contracts or the creation of a joint venture company to manage the project or operate the services. The Government recognises that these arrangements may be more complex, however, and there may be potential conflicts of interest between the private sector objective of maximising profit and the public sector objective of maximising social benefits[4]. It will ensure that the involvement of the public sector in day-to-day management of the service does not create conflicts between its policy and operational roles, and in managing

Project Finance

The techniques of project finance were developed in the 1970s and 1980s when high cost investments were required in the oil, gas, and power sectors. The capital value of a project was often greater than the value of the companies contracting to design, construct and operate it. Investment was therefore provided through bank debt (or now through the bond market as well) where the investors had limited, or no, recourse to the parent companies in the event of project failure. To achieve this a Special Purpose Company was created to deliver the project under contract to the client (under a Take or Pay or Power Purchase Agreement). The Special Purpose Company (also known as a Special Purpose Vehicle or SPV) then entered into financing agreements with investors and subcontracted with specialist firms for the design, construction or operation of the project assets. The third party investors would have first call on the after tax project revenues and would ensure through the use of a financial model that the project revenues would under most scenarios be sufficient to repay the capital and interest costs. They would also require the project sponsors to have a certain amount of equity capital in the Special Purpose Company and this provided an incentive on the sponsors (often the construction companies themselves) to manage the project risks effectively. They would realise a return on their investments through dividends and/or capital gains.

This project financing structure matched the cost of finance to the risk taken by the investor, with senior lenders taking less risk and accepting a lower return than the providers of equity. The same approach is taken in most PPP projects where there is a need for a significant capital investment up front to construct the public infrastructure, such as the road, water treatment plant, rail track and signalling, etc. from which the public service is to be delivered.

Project finance uses competition (either between banks, or between banks and the bond market), to drive down the cost of finance. The Government will use competition in the procurement of PPP to ensure that the different elements of the project, including the pricing of risk, are provided at the lowest economic cost, although all of these elements will be combined to give a single overall price for delivering the service. Financial models are used during the bidding process to provide transparency of costing to both the public authority and investors, and these models can be tested using sensitivity analysis to ensure that the pricing is robust against changes in the input assumptions. The involvement of international financial institutions such as the African Development Bank can help to reduce the cost of finance by providing some of the senior debt, or other financial instruments to reduce political risk or other financial risks.

operational risks such as demand, safety, or maintenance. The creation of regulators that are at arm's length from the government is an important safeguard for both the investor and the Government as owner and policy maker. There will be a clear separation between the public authority role in determining policy, the regulator's role in implementing that policy, and the Government's potential role as investor or joint venture partner. The way that this separation of the Government's role as investor from its policy role may be achieved is discussed further below in the context of funds.

2.4 Risk and the Financing of Projects

All projects may entail a number of specific risks that need to be managed. Some of these risks can be quantified and others may be difficult to quantify but can be identified as having a potentially high or low impact, and high or low probability of occurrence. Public transport projects often have a particularly high level of risk and there is strong data to suggest that the promoters of these projects usually underestimate their cost and overestimate their benefits[1]. In the private sector, the riskiness of an investment project will have an effect on the cost of its finance. Project finance structures have been developed to allocate risks efficiently to different types of investor (see box) and thus reduce the overall costs of finance.

The Government will develop techniques to take account of risks in its appraisal of projects and allocation of resources between competing demands for public investment. This can be done through the calculation of the expected cost of risks in the project cash flows, and the inclusion of an optimism bias factor in the discount rate used in economic appraisal[2]. By properly considering risk throughout the project lifecycle, the Government will also be able to reduce risk by appropriate structuring of the project or commercial environment, and thus reduce the overall costs of investment.

The Government will issue guidance through the National Planning Commission on how the risks inherent in these projects should be factored into the appraisal process, and on how to compare the costs of public versus private financing (which already incorporates the cost of risk) on a comparable basis through the use of a test discount rate. Separate Supplementary Notes on how the Government will meet its objective of obtaining better value and lower overall cost for PPP projects and how risks should be allocated to the party that is best able to manage them have also been issued in support of the National Policy on PPP.

PPP procurement is a complex process and the planning process will require early identification of those sectors where it may be effective in delivering public services because of the effect on budgets. It will require an understanding of the risks associated with the long-term delivery of public services, including demand, the residual value of underlying assets, and operational/lifecycle costs. A failure to properly identify these issues before procurement starts is likely to result in delay, increased costs for bidders, and reputation damage to the procuring authority and government. The Government will ensure that projects are only brought to market having been reviewed by a centre of expertise and approved by the Economic Management Team or other relevant authority, and that the market is properly prepared for the bidding process.

2.5 Third Party Equity and the Role of Funds

PPP projects have increasingly been seen as an attractive investment opportunity because they provide relatively predictable long-term revenue streams which can match the long-term liabilities of institutional investors such as pension funds. The bond market can be used to match the needs of these investors with the relatively low risk and therefore low cost financing of the senior debt in the SPV. The Federal Government will encourage the use of capital markets for funding these projects because of the wider economic benefits of increasing the use of the bond market as an option for corporate finance. Competition between bond and debt finance may also help to drive down the cost of private finance more generally.

Equity plays an important role in the financing and management of PPP projects. Providers of equity are the effective 'owners' of the SPV created to deliver the project, although their management of the company is constrained by the various agreements it enters into with other investors and the public authority. Equity takes a greater share of the risk but can achieve potentially higher returns through dividends, interest on subordinated debt and the future sale of its ownership to other (secondary) investors.

Investors can also diversify risk by investing equity in these projects through a fund, and the use of funds has increased internationally in recent years. Many of these funds specialise in particular markets or classes of infrastructure. Project sponsors have sometimes been able to sell on their equity in the SPV to funds, acting as secondary investors once the project enters the lower risk operational phase. The recycling of equity to other projects is beneficial since contractor equity is a relatively scarce resource. Funds can also help to spread expertise and management resource across different projects, since the equity fund, as part 'owner', will participate in the management of the SPV (and often assist in the bidding process). Funds have therefore helped to increase the availability of capital, and enabled investors to spread risks across a portfolio of different projects. Equity funds that specialise in emerging markets such as Nigeria already exist and it is likely that more will continue to emerge in future.

Funds can also be used to involve multilaterals such as the World Bank, or even government itself, in the management and funding of these projects. This role of government acting as a minority investor in SPVs—in order to improve understanding and communication between the public authority acting as client and the private sector acting as service provider—is still developing. But it could lead to better management of services as these evolve over time and help achieve continuous improvement in service delivery. It may also encourage third party investors to participate in projects where there is a high degree of political risk or regulatory uncertainty. The Government is considering whether the creation of an Infrastructure Fund and a Guarantee Fund would be beneficial to the implementation of its PPP policy and will consult further on these issues in due course.

2.6 Government Equity in PPP Projects

In some cases Government capital may be used as equity in a Special Purpose Vehicle (SPV) or Joint Venture that contracts to provide services to a public authority. This mechanism can provide confidence to private sector investors and encourage best practice in the procurement and governance of PPP joint ventures. Including equity from both central and local government in the SPV, could provide a mechanism for continuing involvement by a government centre of expertise in the joint venture arrangements. It could give confidence and support to both the local government and private partners in the ongoing relationship and help to change the behaviour of both public and private parties, helping to avoid the potentially adversarial nature of the customer-provider split sometimes found in PPP contracts. Company law also provides a structure for the continuing governance and respective responsibilities of the parties to the arrangement (in conjunction with a Shareholders Agreement).

In order to avoid a conflict of interest, and ensure a clear separation between the policy and provider roles, government investment in project equity will need to be managed on commercial lines and at arm’s length from the rest of government. It could, for example, have a target rate of return and participate directly or through a fund, along similar lines to the Africa Finance Corporation model.

3. **PPP Roles and Responsibilities across Government**

This Section of the Supplementary Note provides further detail on the roles and responsibilities within the Federal Government for planning infrastructure, allocating budgets, and managing fiscal risks. It also allocates responsibilities for providing further guidance and support to PPP projects including a new PPP Resource Centre. The Government has taken account of international experience in developing the institutional framework in the PPP Policy Statement. It will also keep this framework under review as its use of PPP as a procurement tool evolves and develops.

3.1 The Infrastructure Concession Regulatory Commission

The Infrastructure Concession Regulatory Commission (Establishment, etc.) Act 2005 permits the granting of PPP-type contracts or concessions by any "Federal Government ministry, agency, corporation, or body". The term "concession" as used in the Act does not imply that rights to any revenue stream from user charges are also transferred to the private sector operator (defined as the "Project Proponent"), but it does include an obligation to finance the infrastructure. The Act includes an illustrative list of infrastructure to which it may be applied but also allows the Federal Executive Council to approve any other form of infrastructure and development project. It places an obligation on each ministry of the Federal Government to prioritise its infrastructure projects and for a formal approval of the investment decision by the Federal Executive Council as set out in the National Policy Statement.

The Act requires that the approved projects should follow a competitive procurement process that is openly advertised. It also requires that any subsequent guarantee, letter of comfort, or undertaking given by the ministry may only be given with the prior approval of the Federal Executive Council. The Act therefore provides the statutory basis for the procedures set out in the National Policy for PPP.

The Act creates the Infrastructure Concession Regulatory Commission as a statutory body, and this will incorporate the PPP Resource Centre with the functions described below and in the Policy.

3.2 The PPP Resource Centre

In general terms, international experience demonstrates that the development of PPP in a country can be enhanced through the establishment of a central PPP unit. The Government therefore proposes to create a PPP Resource Centre within the Infrastructure Concession Regulatory Commission. It will play an important part in the institutional framework that the Government is creating to support its PPP policy.

This arrangement will give the Resource Centre some independence from the Federal Government ministries and enable it to recruit (or second) staff directly from the private sector. It will be able to provide a support role to similar units within the States and it will act as an effective interface between the public and private sectors in relation to PPP policy and practice. It may also have a role in managing government equity in projects, should the Federal Government decide that this is appropriate. In this role it would ensure that its investment decisions were made on commercial rather than political grounds.

An important role for the Resource Centre will be capacity building in the private sector, through publicity, conferences and other meetings. It will therefore act as a bridge between the public and the private sectors and will ensure that the PPP programme across the Federation has sufficient scale and ambition to encourage international players into the market, probably to team up with the smaller and medium sized local contractors. It will be responsible for ensuring that the Government's PPP programme is effectively marketed and that both investors and potential bidders have confidence in the ability of the procuring authorities working together to manage a procurement process efficiently. The Resource Centre will comprise a mix of public and private sector personnel, with legal, financial, and public sector backgrounds, to provide the wide range of skills that a programme of PPP projects across a number of different sectors requires.

The role of the Resource Centre will be:

- to provide advice to the Federal Government on the development of policy for PPP;

- to issue guidance, in conjunction with the National Planning Commission (NPC), on the identification of PPP projects and programmes within the Government's investment strategy;

- to provide advice on the value for money assessment and affordability analysis of infrastructure projects that are being considered for PPP;

- to develop a communications strategy for PPP across the Federation and with all private sector stakeholders;

- to assist MDAs with project appraisal, the appointment of external advisers where required, and the preparation of Outline and Final Business Cases;

- to provide technical assistance to MDAs in the procurement of PPP projects including defining appropriate output requirements, a payment mechanism, risk allocation, evaluation criteria, and draft contractual terms;

- to provide, through the ICRC Board, advice to the Federal Executive Council on the approval of all significant infrastructure projects;

- to support MDAs during the operational phase of projects when required, for example in contract change or refinancing;

- to coordinate the PPP policies and programmes of the State and Federal Governments, working with similar units in the States or Ministries to ensure consistency of approach and a steady flow of projects to the market.

The PPP Resource Centre will be allocated a Project Development Fund to support the cost of external project and policy advisers for the pathfinder PPP projects.

3.3 Contract Compliance Centre

The Contract Compliance Centre will:

- take custody of every concession agreement and monitor compliance with the terms and conditions of such agreement;
- ensure efficient execution of any concession agreement or contract entered into by the government;
- develop guidance and procedures for monitoring of such agreement;
- maintain a database on concessions and other PPP contracts entered into by the Government.

3.4 The National Planning Commission

The National Planning Commission (NPC) will have the lead role in the preparation of the Federal Government's new National Development Plan, based on the sector plans of the MDAs and subject to the final approval of the Federal Executive Council. This will set out the Government's 15-year investment strategy covering all forms of procurement that will be financed in whole or in part from the Federal budget. The investment strategy will match infrastructure needs against predicted financial resources for all sectors, based on the Medium Term Sector Strategies prepared by each ministry. The investment strategy will identify those infrastructure projects that will be financed by borrowing, in effect transferring some of the costs of investment to future generations, as well as those projects that will be financed from current revenues.

NPC will also be a centre of expertise in economic appraisal, developing guidance on procedures and economic assumptions for cost-benefit analysis and discounting, and for assessing whether private or public borrowing will have the lowest economic cost for projects or programmes. Guidance will also be provided on how risk and appraisal optimism should be taken into account within the project cost estimates provided by MDAs.

NPC will monitor the economic benefits that result from government investment and use this data to prioritise those projects that offer the highest economic or social return. The investment strategy will be presented to the National Assembly as part of the budgetary process.

3.5 Line Ministries and their Agencies

Line Ministries, or their agencies responsible for service delivery, will continue to be accountable through their Ministers for the quality of public services and for the management of their resources. In some cases, such as power and transport, the planning and coordination roles are being devolved to new bodies. The creation of new executive bodies such as the Federal Roads Authority will also increase accountability.

PPPs are a more complex form of procurement, but they need to be integrated into the overall investment strategy for the relevant sector, as well as cross-sectoral plans such as the Medium Term Expenditure Framework. MDAs will therefore be required to prepare long-term plans for infrastructure investment and maintenance which will be incorporated into the Government's 15-year Development Plan by the National Planning Commission[7]. As part of this process the MDAs in consultation with the ICRC will also identify where PPP is likely to offer better value for money over other forms of procurement and this will be factored into the budgetary estimates in the Plan. The NPC in consultation with ICRC will provide guidance on the criteria that MDAs will use to measure value for money and provide budgetary estimates of costs and risks.

Decisions on procurement options will be reviewed as projects are refined and enter the three-year Medium Term Expenditure Framework (MTEF). The MTEF will define the forward programme of projects and allocate resources for their planning and preparation. At the stage that a project enters the forward programme, the relevant MDA will appoint an Accountable Officer at Director level who will be responsible for oversight of the preparation and procurement phase and chair of a Project Steering Committee. At this stage a Project Director and project team will also be appointed, including if necessary external advisers, who will be responsible for preparing all of the project business cases, the procurement documents, and the bidding process up to contract award. The team will need to plan the handover of the project management to the managers who will be responsible for its implementation, supervision, and management.

There will be a minimum of two consents required from the Federal Executive Council (or the Economic Management Team or other relavant authority) before the project can proceed to subsequent stages. These consents will be based on Outline and Full Business Cases which will be completed before the procurement can proceed or before a PPP contract can be awarded. Guidance on each of these approvals and other aspects of the PPP procurement process will be provided by the new PPP Resource Centre. In due course a PPP Unit within the MDA may be set up to provide further guidance specific to PPP in the relevant sector.

The relevant Accounting Officer of the MDA will sign PPP contracts on behalf of the Federal Government and will be responsible for both the project procurement and its implementation.

3.6 The Bureau of Public Enterprises

The privatisation of many State owned assets has been led by the Bureau of Public Enterprises (BPE) since 1999. It has held the Government's assets in trust for Ministry of Finance Investments until they have been sold or commercialized. The National Council on Privatisation has had ultimate responsibility for determining which sectors should be included in the programme under the Privatisation and Commercialisation Act. BPE has used concessions as a means of Commercialisation of existing Government owned enterprises.

The lessons gained through these Concessions, and the skills and capacity developed in BPE should be made available in implementing PPP and other concession projects under the new PPP Policy and the ICRC will develop guidance in this regard. For instance, the BPE may be required to serve as "Internal Consultants" to MDA's PPP Project teams along with any other External Transaction Advisers that may be procured by ICRC.

The BPE will however continue to lead and take responsibility for the full or partial Privitization of all State Owned Enterprises slated for Privatization under the National Council on Privatization Act.

To continue to achieve the goals of both the Privatization and Commercialization as well as PPP Policies of government, there is need to sustain reforms in the legal and regulatory environment. The ICRC and BPE should therefore, work closely in this regard to expand the space and opportunities for private sector investment in the Nigerian economy.

3.7 Federal Ministry of Finance

The Ministry of Finance will have an important role in the public financial management of PPP projects. It will need to ensure that the forecast costs for the Government are affordable within the Medium Term Expenditure Framework. Budgets will need to provide for any subsidies that may be required to make a project financially viable or to ease the transition to a full cost recovery tariff for poor households. Costs and contingent liabilities will need to be reviewed as the project design and risk valuations are refined during the project preparation and procurement phases. The Government will consider setting up a Risk Management Unit within the Ministry as a centre of expertise on the kinds of risks that commonly arise in PPP projects.

3.8 Debt Management Office

The Debt Management Office (DMO) has an important role in supervising the financial and capital markets and ensuring that they are working efficiently and developing the range of financial instruments that will be required to manage financial risks in PPP projects. For example, the secondary market in government bonds is developing rapidly in both liquidity and depth and will eventually provide a reference interest rate for PPP financing.

DMO will need to be satisfied that any contingent liabilities are manageable within the Government's economic and fiscal forecasts. The DMO will advise the Federal Executive Council as part of the approval process for individual projects. The DMO will also need to be consulted in advance of requesting approvals by project teams who are considering the involvement of multilateral agencies such as IFC, MIGA or IDA in providing guarantees or other financial instruments[8].

3.9 Accountant General of the Federation

The Government will put in place measures through the Office of the Accountant General of the Federation to ensure that funding for payment obligations incurred through Federal PPP contracts are safeguarded to ensure prompt payment, subject to appropriate authorisation. The States will also need to develop processes to ensure that contractual payment obligations are met. The Government will consult with the States on whether the creation of a PPP Guarantee Fund would provide additional security to investors against both actual and contingent liabilities should this be required.

The Government will consider the case for an Infrastructure Fund that is able to provide equity or debt to contracting companies under PPP arrangements.

3.10 Bureau of Public Procurement

The Bureau of Public Procurement has a statutory role in regulating public procurement in Nigeria under the Public Procurement Act 2007. It prescribes guidelines for the membership of Tender Boards in each procuring entity in the Federal Government; and has a statutory authority to issue a certificate of no objection before a procurement can be finalised and funds may be dispersed by the

Accountant General. The Government will subsume this procedure into its approval of a Final Business Case by the Federal Executive Council.

The Government will review the Procurement Act to ensure that it allows for tender evaluation procedures based on economic value as well as lowest price. The ICRC and the BPP will continue to develop appropriate procurement processes for PPP Projects.

4. STAGES IN PPP PROJECT LIFECYCLE

1. Development

Stage	Task	Sub Task	Responsibility	Approvals
Project Initiation	Development of a Long-term Master Plan	Recognition of need Review and approval by NPC and inclusion of Project in 15 year Master Plan	Ministry NPC	NPC
Project Identification	Identify Viable PPP Projects	Cost benefit analysis and prioritisation Definition and Scope of Requirement Preliminary Project Appraisal Registration in 3 year MTEP	Ministry with PPP Resource Centre support	NPC MOF
Preparation of OBC	Approve OBC	Option Appraisal of form of Procurement Selection of Preferred Option Value for money assessment Affordability Assessment Approval of OBC-Entry into Procurement	Ministry with PPP Resource Centre support	Economic Management Team

2. Procurement

Stage	Task	Sub Task	Responsibilities	Approvals
Preparation	Competitive Procurement Process	Design Procurement Plan Prepare Finance Plan, Risk Matrix and Shadow Cash Flow Prepare Summary IM Commence preparation of Bid Docs Carry out Market Testing	Ministry with PPP Resource Centre support	
EoI	Identify Suitable Bidders	Prepare EoI Evaluation Criteria Prepare & Issue Invitation to Submit EoIs Receive & Evaluate EoIs Prepare Bid Evaluation Criteria Finalise Bid Documentation	Ministry with PPP Resource Centre support	
Bidding	Select & Approve Preferred Bid	Issue Bid Docs to Short-Listed Bidders Hold Bidders' Conference Evaluate Bids Negotiate and Select Preferred Bidder Value for Money Test Finalise PPP Contract	Ministry with PPP Resource Centre support	
FBC		Prepare FBC	Ministry	FEC
Contract Close		Contract Negotiation / Close	Ministry	FEC if significant deviation from FBC approval

3. Implementation

Stage	Task	Sub Task	Responsibilities	Approvals
Construction	Commission Asset	Appoint Technical Advisor Monitor Design & Construction Receive & Evaluate Progress Reports Take Part in Commissioning Tests Confirm Construction Completion	Ministry	
Operation & Maintenance	Effect Oversight of Project	Monitor Contract Compliance Performance Monitor Contingent Liabilities (Annually)	Ministry/ICRC	

4. Contract Maturity

Stage	Task	Sub Task	Responsibilities	Approvals
Survey	Assess Assets & Needs	Carry out Detailed Asset Inventory & Survey Assess Asset Condition & Remaining Life Discuss Findings with Operator Assess Future Needs	Ministry/ICRC	
Review	Analyse & Decide on Options	Identify & Assess Options Select Most Economically Favourable Option Implement New Procurement Process	Ministry/ICRC	
Conclusion	Conclude the PPP	Finalise New Arrangements Formally Confirm End of PPP Contract.	Ministry/ICRC Ministry/ICRC	

(Footnotes)

[1] *Exceptionally, the introduction of competition to unsolicited bids may be excluded from this requirement*

[2] *BOT: build, operate, transfer. DBFO: design, build, finance, operate. BOOT: build, own, operate, transfer.*

[3] *An example of these considerations may be a light rail project where certain fares may be controlled and a minimum service specified during the working day and at weekends.*

[4] *In some sectors these conflicts may be resolved by a regulator taking into account service quality and business viability as well as the lowest possible tariff.*

[5] *See Flyvbjerg, B., Skamris Holm, M. and Buhl, S. (2002),*
'Underestimating costs in public works projects: error or lie?
Journal of the American Planning Association, Vol 68.

[6] *Discounting is a technique for reflecting time preference for receiving benefits now and paying for them later. Cash flows or benefits that occur in the future will have a lower value than those that occur now and the higher the discount rate the lower this value.*

[7] *Parastatals and the separate (government-owned) companies created within the power sector will prepare their own business and investment plans. Once these plans are approved by the relevant sponsoring line ministry then these businesses will plan their own implementation, driven by customers and business need. However, the need for direct government funding and guarantees will still need to be incorporated into the overall planning and monitoring process through the relevant line ministry.*

[8] *The various agencies of the World Bank (International Finance Corporation, International Development Agency, Multilateral Investment Guarantee Agency) will only work through the Federal Government even if providing sub-sovereign guarantees to Nigerian States.*