E

Public-private partnerships

Introduction

Government is working on several reforms to strengthen public investment management and the associated value chain. These reforms include reviewing the public-private partnership (PPP) framework; putting the Infrastructure Fund into operation; and prioritising strategic infrastructure projects and building a strong project pipeline.

South Africa has considerable experience in implementing and operating PPPs. Government is improving the PPP regulatory framework and intends to expand the pipeline of externally financed public investment projects, most of which are likely to be PPPs. The impact of COVID-19 and the expected expansion of a project pipeline driven by private-sector financing have raised awareness of the fiscal risks involved in PPP projects. This applies to the design of new project financing methods, such as blended finance instruments, and to risk monitoring and reporting of contingent liabilities.

The difference between PPPs and traditional government infrastructure projects

A PPP is defined as a contract between a public-sector institution and a private party, where the private party performs a function that is usually provided by the public sector and/or uses state property by agreement. Most of the project risk (technical, financial and operational) is transferred to the private party. The public sector pays for a full set of services, including new infrastructure, maintenance and facilities management, through monthly or annual payments. In a traditional government project, the public sector pays for the capital and operating costs, and carries the risks of cost overruns and late delivery.

Reviewing the PPP regulatory framework

The PPP regulatory framework has remained unchanged for nearly 15 years. Despite the early success of the PPP model in South Africa, new project transactions have declined over the past nine years, from an estimated R10.7 billion in 2011/12 to R5.6 billion in 2019/20.

In 2019, the National Treasury commissioned a review of the entire PPP regulatory framework applicable to the three spheres of government falling under the Public Finance Management Act (1999) and the Municipal Finance Management Act (2003) and other related legislation. The review is now complete.

The current framework involves a four-step process for the National Treasury to approve national or provincial PPP projects:

- Check and approve feasibility study
- Check and approve procurement documentation before it is issued
- Check and approve bids before appointing a preferred bidder
- Check documentation before approving contract signature.

The National Treasury provides views and recommendations relating to municipal PPP projects, although it does not approve them.

Overall, the review findings indicate that certain aspects of the PPP regulatory framework compare well with international benchmarks. Nonetheless, there are critical gaps and challenges that need to be addressed to improve the operational environment. The review recommends legislative changes to improve the selection, prioritisation, planning, financing support mechanisms, procurement, implementation and monitoring of PPPs (Table E.1). These changes will enhance application and practice to improve the reliability of results and raise confidence in the overall PPP framework.

Table E.1 Recommendations of the PPP framework review

Finding	Recommendation on amendments to National Treasury Regulation 16
Policy	
• No overarching infrastructure policy framework that mainstreams PPPs as part of fiscally prudent planning process	• Develop an integrated public investment management system and PPP policy • Introduce PPP champion at senior institutional level • Define roles of key institutions
PPP legal and regulatory framework and guidelines	
• Multiple and time-consuming approvals • Lack of accountability for procuring institutions • Lack of clarity on the treatment of unsolicited proposals • Dwindling private-sector capacity and poor public engagement	• Exempt low-value projects (R1 billion and below) from procurement approvals • Set a clear time frame for approvals by regulator • Make it mandatory to continue PPP once feasibility study shows value for money, risk transfer and affordability • Establish accountability mechanism for procuring institutions • Provide guidance on treatment and incentives for unsolicited proposals • Clarify roles of different entities in managing fiscal commitments and contingent liabilities • Develop financing support mechanism to enhance bankability of PPP projects • Revise exemption clause to enable monitoring of exempt PPP projects • Adjust the BEE requirements for PPPs

Table E.1 Recommendations of the PPP framework review *(continued)*

Finding	Recommendation on amendments to National Treasury Regulation 16
Inadequate institutional arrangements	
• No centralised approach to identifying and screening PPPs	• Centralise the identification of PPP projects
• No capacitated PPP regulator and no defined guidelines to perform functions	• Establish function to screen and prioritise all infrastructure proposals, including PPPs, with a screening tool for public investments
• Lack of capacity and skills at procuring institutions at provincial and national levels and PPP Unit	• Explore feasibility of provincial infrastructure funding agencies
• Dwindling private-sector capacity and poor public engagement	• Establish full-time capacitated PPP regulatory unit with operating guidelines
	• Develop guidelines, tools and methodologies to monitor and report on fiscal commitments and contingent liabilities
	• Transform PPP Unit into centre of excellence and increase staffing, including in-house sector experts, to assist procuring institutions
	• Capacitate procuring institutions with qualified project officers
	• Promote collaboration and coordination with private sector through PPP forums, policy and public consultations as part of PPP project cycle
Shortcomings in the PPP project life cycle	
• Lengthy, rigid and costly feasibility studies with some projects proving unfeasible after the process	• Make pre-feasibility studies mandatory for high-value projects at inception
• Slow pace of implementation of PPP projects, in particular delays in the procurement process	• Review and calibrate requirements for value for money and public-sector comparator requirements based on project size, nature and complexity
• Lack of sector focus and customised approach for key sectors	• Require non-negotiable draft PPP agreement with request for proposals
• Poor contract management – prone to delays	• Amend PPP manual to calibrate project preparation requirements according to size, sector and complexity and define where a one-stage bidding process would be allowed
• Lack of preparedness at exit management stage	• Engage transaction advisors throughout PPP project cycle
	• Develop sector-specific toolkits and PPP standard provisions in priority sectors, including standardised contract management templates
	• Make it mandatory to prepare high-level exit plan during project preparation phase
	• Ensure PPP Unit assists procuring institutions in preparing detailed exit management plan

Source: National Treasury

The review emphasised the importance of developing a financing support mechanism framework to grow the PPP pipeline. PPPs use project finance, making them reliant on user charges (the "pay-as-you-go" approach). Most PPP proposals come from the transport and water sectors, where there is policy uncertainty regarding pricing. Project sponsors have also been trying to meet the affordability requirements for their projects using the money in their baselines. However, with consistent cuts to baselines, PPPs have become unaffordable, and the flow of new projects has slowed.

Recommendations for the municipal PPP framework

The review recommended simplifying and rationalising the municipal PPP legal and regulatory framework; strengthening institutional arrangements and accountability; streamlining processes in the municipal PPP manual and providing clearer guidance; rationalising the public consultation processes; and simplifying the unsolicited proposal framework.

The recommendations at national and provincial level also apply to the municipal PPPs. However, additional improvements are needed to arrest deteriorating municipal finances and the loss of technical and management skills. These challenges are linked to reduced maintenance of infrastructure, inefficiencies and inadequate infrastructure investment. The successful Renewable Independent Power Producer Programme (REIPPP), which was conceived as a national priority and resourced with highly skilled professionals, illustrated the value of a programmatic approach to the development of PPPs in a specific sector, as well as the important role of an institutional champion. The improvements to the municipal PPP framework will adopt the same approach to unlock and support municipal PPPs together with legislative exemptions where necessary to support effective and timely implementation.

A professional unit dedicated to the implementation of municipal PPPs will be established with the necessary capabilities. Initially, it will focus on three priorities in municipal PPPs:

- Build-operate-transfer (BOT) contracts for desalination, reuse and wastewater treatment. Coastal cities will need to access comparatively expensive desalinated water, and South Africa will need to use treated wastewater (water reuse) to a much greater extent in the future. This is an area where private-sector skills, efficiencies and finance will be of great benefit.
- Embedded energy generation from rooftop solar, both photovoltaics (PV) and water heating. The private sector will play a critical role in developing embedded solar PV generation capacity and roof-top solar water heating.
- Municipal power purchase agreements for the supply of renewable energy. Lessons will be drawn from the national REIPPP model, with some adaptions, at a municipal level.

Additional arrangements are needed at the local government level, as summarised in Table E.2, to attract private-sector financing into PPP projects.

Table E.2 Recommendations of the PPP framework review (municipal)

Amendments to the Municipal Systems Act (2000) and the Municipal Finance Management Act (2003)	Issuing directives addressing the following areas	Dedicated institution and champion to support procuring institutions
Collapse MFMA section 33 PPP consultation requirements into a single requirement at feasibility recommendation stage	External mechanism: the interpretation of the application of Municipal Systems Act section 78 in the case of priority use cases, pending changes to the legislation	Municipal PPP championing body to play a proactive role in facilitating a municipal PPP pipeline
Reduce public consultation required to one formal public consultation process for priority use case, at the recommendation stage	BEE: an appropriate BEE framework and requirements per priority use case, pending changes to legislation	Lobby support and develop advocacy materials
Reduce labour consultation to a single consultation at the recommendation stage	Clarify application and interpretation of other relevant legislative provisions and regulations per priority use case, pending changes to legislation	Develop fit-for-purpose documents and templates for priority programmes
Revise section 78 of the Municipal Systems Act to remove impediments to processes that inhibit PPPs		Build a conducive environment and trust by creating a balance of competencies of both parties to the PPP contract
Avoid further consultation prior to PPP contract signature		

Source: National Treasury

Broad-based black economic empowerment is integral to all phases of the regulated PPP cycle and is contractually binding in all PPP agreements. As the volume of PPP projects increases, it is critical to empower small business contractors and create jobs without deterring project planning and implementation. The recommendation to adjust BBBE requirements in PPPs will be determined in consultation with the Department of Trade, Industry and Competition, which is responsible for determining the local content in PPP projects.

The National Treasury has begun implementing the recommendations from the review. It will follow the processes to align with the Public Procurement Bill and relevant existing legislation, including discussions with other departments and public consultations. The National Treasury will implement these recommendations progressively over the next 24 months.

Contingent liabilities

The National Treasury is improving its capacity to regulate the fiscal challenges related to externally funded infrastructure projects. All public investment projects can affect the public finances, whether through explicit liabilities (such as debt and interest funding) or contingent liabilities (such as guarantees and other support in PPP and BOT contracts). Therefore, understanding the nature of financing and contractual obligations, explicit or contingent, should be at the forefront of fiscal considerations for all projects. Moreover, when projects fail, there are often broader non-budgetary repercussions that may affect service delivery, particularly in a social or critical care setting, or knock-on effects in other parts of the economy. These also need to be monitored and reported on.

Most national and provincial PPPs are guaranteed by the Minister of Finance and create a contingent liability. The materialisation of such liabilities – and their costs – varies significantly. It is good practice to fully disclose all contingent liabilities that could have a bearing on the public finances.

The National Treasury uses a four-stage approval process to ensure that contingent liabilities arising from contracts are acceptable and monitors these liabilities on an ongoing basis. There are various categories of contingent liabilities, depending on whether the termination is the result of private-sector default, government default or *force majeure* – an event beyond either party's control. Compensation depends on the reason the contract ended, but termination due to government default usually results in the greatest compensation. Table E.3 shows potential termination amounts per sphere of government. Total contingent liabilities amount to R17 billion for 2021/22.

Table E.3 Contingent liabilities by category

	Termination private party default		Termination force majeure		Termination government default	
R million	**2020/21**	**2021/22**	**2020/21**	**2021/22**	**2020/21**	**2021/22**
National departments' exposure	2 878.8	2 580.3	3 663.6	3 400.5	4 707.3	3 893.0
Provincial departments' exposure	2 649.3	1 773.6	1 263.4	805.7	4 151.2	3 629.3
Public entities' exposure	353.4	300.4	299.7	254.8	443.9	377.3
Total	**5 881.5**	**4 654.3**	**5 226.7**	**4 461.0**	**9 302.4**	**7 899.6**

Source: National Treasury

Estimated contingent liabilities for PPPs that are likely to accrue to government if contracts are terminated due to government default have decreased from R9.3 billion in 2020/21 to R7.9 billion in 2021/22. This decline was expected as government continues to pay off debt and equity owed to the private sector. Of the three spheres of government, national departments account for the greatest exposure, amounting to R3.9 billion in 2021/22. Head office accommodation projects and the Gautrain Rapid Rail Link project are the biggest contributors to government's exposure to contingent liabilities. Government manages the risk emanating from PPP contingent liabilities by closely monitoring each party's performance against their contractual obligations and enforcing regulatory requirements.

Impact of COVID-19 on PPPs

Many PPP projects rely on user charges and unitary payments for services provided by the private sector. These PPPs have been particularly affected by restrictions imposed by government to contain the COVID-19 pandemic. Expected passenger and profitability growth, especially in the transport and tourism sectors, have significantly declined, and some companies are seeking financial assistance from government. This has highlighted the need for the National Treasury to better understand and manage fiscal risks in externally financed public projects. These risks can be significant when they materialise.

The National Treasury continues to engage with key stakeholders to assess potential PPP risks and contingent liabilities and identify solutions to mitigate the continued effects of pandemic-related restrictions. These stakeholders include the Gautrain Management Agency, the Western Cape Department of Transport and Public Works, the Independent Power Producers (IPP) Office, the South African National Roads Agency Limited (SANRAL) and the PPP Unit in the Government Technical Advisory Centre.

The risks to the fiscus and contingent liabilities are currently considered manageable. Operational PPPs such as the Gautrain Rapid Rail Link project, SANRAL toll roads and the Chapman's Peak toll road have lost revenue. Other operational concessions such as the REIPP[1] have not been affected by the pandemic and there is no risk that they may affect the fiscus. The project terms of IPPs that are in the construction stage have been extended, while PPPs in the planning stage may face delays in reaching financial closure as a result of the pandemic.

[1] Renewable energy independent power producers are not strictly PPPs. They are guaranteed by the fiscus and may pose a contingent liability if not managed.

Gautrain

In line with the global reduction in public transport use during the pandemic, the Gautrain's passenger demand varied between 15 per cent and 30 per cent of pre-COVID-19 ridership in 2021/22. Future demand for public transport is highly uncertain. Gauteng province, through the Gautrain Management Agency and the Bombela Concession Company, continues to improve service offerings and marketing to attract passengers to use the Gautrain. The risk-sharing mechanism between the province and the Bombela Concession Company for low passenger demand and reduced revenue remains in place.

Chapman's Peak toll road

Compared with pre-pandemic traffic levels in December 2019, traffic volumes along Chapman's Peak toll road in Cape Town had recovered to 70 per cent by December 2020 and 77 per cent by December 2021. In 2021, the Western Cape Department of Roads and Transport, which guaranteed the private-sector debt payment, had to pay about R13.6 million more to the private sector than budgeted (and R14 million more than budgeted in 2020), as lower traffic volumes affected revenue collection. Moreover, the department estimates that it will pay about R14 million more in 2022 due to reduced traffic.

The decrease in international tourism and increase in remote-working conditions continue to affect traffic volumes and revenue. This is likely to increase the Western Cape's debt payments to private lenders. Originally it was expected that the provincial government would earn revenue from this road when loans are fully repaid by 2023. However, if traffic levels do not increase to at least 80 per cent of pre-pandemic budgeted figures, this will only be achieved in 2025.

SANRAL toll roads

SANRAL operates three PPPs: the N3 toll road, the N4 East toll road and the N4 West toll road. The effect of lower traffic volumes and revenue due to COVID-19 restrictions varies; however, all the PPP agreements specify that any loss emanating from traffic volumes is borne by the private operator.

- The N3 toll road (between Cedara interchange in KwaZulu-Natal and Heidelberg South interchange in Gauteng) lost R245 million in revenue during 2020/21. Traffic volumes have gradually improved. Public violence in July 2021 led to an estimated revenue loss of R45 million.
- Volumes at the N4 East toll plazas (between Pretoria and Komatipoort) fell significantly. Between March 2020 and January 2021, total traffic volumes were about 80 percent compared to March 2019 and January 2020 levels, showing a gradual resumption of activity.
- COVID-19 regulations and the July 2021 public violence led to delays and reduced traffic movement between South Africa and Mozambique during 2020. Between March 2020 and December 2021, the private operator estimated a revenue loss of R624 million.
- Revenue losses for the Bakwena toll road (N4 West between Pretoria and Rustenburg and N1 between Pretoria and Bela-Bela) between April 2020 and December 2021 amounted to R493 million.

In most of these cases, the road operators are able to recoup a portion of their losses through insurance agreements.

Improving the quantification of fiscal risks and contingent liabilities

Given the intent to expand PPPs, which implies an increase in continent liabilities, these partnerships need to be more closely linked to fiscal management. The current four-stage checking on contingent liabilities needs to be enhanced so that there is a systematic way of managing and monitoring them at a national level. The National Treasury will require full disclosure of all liabilities – including those creating fiscal risks that have been incurred through external project financing arrangements. This will include both new projects and those in the pipeline.

A guidance note and standard reporting template for fiscal commitments and contingent liabilities have been prepared and will be issued on the National Treasury website in 2022 to help all public institutions report on their PPPs. The note explains the nature of fiscal impacts arising from projects and how they are created; when and how to assess these fiscal impacts; whether the associated liabilities are explicit or contingent; and how operational projects should be monitored and reported.

Through this work, the National Treasury aims to manage and mitigate risks, ensure that there is a clear plan of action to deal with a risk should it materialise, and confirm that entities understand their roles and responsibilities. Training and awareness will be part of the strategy.

PPP projects completed

Table E.4 shows a list of 35 concluded PPP projects undertaken since this type of partnership was first introduced in South Africa in 1998. The total value of all projects amounts to R91.4 billion. These projects are in the health, transport and roads, and tourism sectors, as well as for head office accommodation. They have been funded through a combination of equity, debt and, in some instances, government capital contributions. Most of these projects are operational, with a few having reached the end of their project term. In some instances, project durations have been extended.

Table E.4 List of PPP projects concluded in South Africa

Project name	Government institution	Type	Date of close[1]	Duration	Financing structure	Project value R million	Form of payment
Transport							
SANRAL N4 East Toll Road	SANRAL	DFBOT[2]	Feb 1998	30 years	Debt: 80% Equity: 20%	3 200	User charges
SANRAL N3 Toll Road	SANRAL	DFBOT	Nov 1999	30 years	Debt: 80% Equity: 20%	3 000	User charges
SANRAL N4 West Toll Road	SANRAL	DFBOT	Aug 2001	30 years	Debt: 80% Equity: 20%	3 200	User charges
Gautrain Rapid Rail Link	Gauteng Department of Public Transport, Roads and Works	DFBOT	Sep 2006	20 years	Debt: 11% Equity: 2% Govt: 87%	31 800	User charges and patronage guarantee
SANRAL Gauteng Freeway Improvement Plan Toll Road	SANRAL	DFBOT	Oct 2007	20 years	Debt: 100%	20 000	User charges
Northern Cape fleet	Northern Cape Department of Transport, Roads and Public Works	DFO[3]	Nov 2001	5 years	Equity: 100%	181	Unitary payment
Chapman's Peak Drive Toll Road	Western Cape Department of Transport	DFBOT	May 2003	30 years	Debt: 44% Equity: 10%	450	User charges and guarantee
Fleet management	Eastern Cape Department of Transport	DFO	Aug 2003	5 years	Debt: 100%	553	Unitary payment
National fleet management	Department of Transport	DFO	Sep 2006	5 years	Equity: 100%	919	Service fee
Tshwane fleet management	City of Tshwane	DFO	Nov 2015	5 years	Equity: 100%	1 612	Service fee
Health							
Inkosi Albert Luthuli Hospital	KwaZulu-Natal Department of Health	DFBOT	Dec 2001	15 years	Debt: 70% Equity: 20% Govt: 10%	4 500	Unitary payment
Universitas and Pelonomi Hospitals co-location	Free State Department of Health	DFBOT	Nov 2002	16.5 years	Equity: 100%	81	User charges
State Vaccine Institute	Department of Health	Equity partnership	Apr 2003	4 years	Equity: 100%	75	Once-off equity contribution
Humansdorp District Hospital	Eastern Cape Department of Health	DFBOT	Jun 2003	20 years	Equity: 90% Govt: 10%	49	Unitary payment
Phalaborwa Hospital	Limpopo Department of Health and Social Development	DFBOT	Jul 2005	15 years	Equity: 100%	90	User charges
Western Cape Rehabilitation Centre and Lentegeur Hospital	Western Cape Department of Health	Facilities management	Nov 2006	12 years	Equity: 100%	334	Unitary payment
Polokwane Hospital renal dialysis	Limpopo Department of Health and Social Development	DBOT[4]	Dec 2006	10 years	Equity: 100%	88	Unitary payment
Port Alfred and Settlers Hospital	Eastern Cape Department of Health	DFBOT	May 2007	17 years	Debt: 90% Equity: 10%	169	Unitary payment

Table E.4 List of PPP projects concluded in South Africa *(continued)*

Project name	Government institution	Type	Date of close[1]	Duration	Financing structure	Project value R million	Form of payment
Tourism							
SANParks tourism projects	SANParks	DFBOT	Apr 2000	Various years	Equity: 100%	270	User charges
Eco-tourism Manyeleti three sites	Limpopo Department of Finance, Economic Affairs and Tourism	DFBOT	Dec 2001	30 years	Equity: 100%	25	User charges
Blyde River Sky Walk Development	Mpumalanga Tourism and Parks Agency	DFBOT	Jul 2021	25 years	Debt: 60% Equity: 40%	400	User charges
Cradle of Humankind Interpretation Centre Complex	Gauteng Department of Agriculture, Conservation, Environment and Land Affairs	DBOT	Oct 2003	10 years	Equity: 100% opex Govt: 100%	39	User charges
Western Cape Nature Conservation Board	Western Cape Provincial Government	DFBOT	Jul 2005	30 years	Equity: 100%	40	User charges
Water and sanitation							
Dolphin Coast water and sanitation concession	KwaDukuza Local Municipality	DFBOT	Jan 1999	30 years	Debt: 21% Equity: 18% Govt: 61%	130	User charges
Mbombela water and sanitation concession	Mbombela Local Municipality	DFBOT	Dec 1999	30 years	Debt: 40% Equity: 31% Govt: 29%	189	User charges
Correctional services							
Mangaung and Makhado maximum security prisons	Department of Correctional Services	DFBOT	Aug 2000	30 years	Debt: 88% Equity: 12%	3 600	Unitary payment
Information technology							
Information systems	Department of Employment and Labour	DFBOT	Dec 2002	10 years	Equity: 100%	1 500	Unitary payment
Social grant payment system	Free State Department of Social Development	DFO	Apr 2004	3 years	Equity: 100%	260	Unitary payment
Office accommodation							
Head office accommodation	Department of Trade, Industry and Competition	DFBOT	Aug 2003	25 years	Debt: 80% Equity: 8% Govt: 12%	870	Unitary payment
Head office accommodation	Department of International Relations and Cooperation	DFBOT	Jan 2005	25 years	Debt: 81% Equity: 19%	1 959	Unitary payment
Head office accommodation	Department of Basic Education	DFBOT	Aug 2009	27 years	Debt: 90% Equity: 10%	512	Unitary payment
Head office accommodation	Department of Forestry, Fisheries and Environment	DFBOT	May 2012	25 years	Debt: 49% Equity: 15% Govt: 36%	2 731	Unitary payment
Head office accommodation	Statistics South Africa	DFBOT	Mar 2014	24 years	Debt: 54% Equity: 9% Govt: 37%	2 533	Unitary payment
Head office accommodation	City of Tshwane	DFBOT	Mar 2015	25 years	Debt: 86% Equity: 14%	2 005	Unitary payment
Head office accommodation	Department of Agriculture, Land Reform and Rural Development	DFBOT	May 2017	27 years	Debt: 54% Equity: 10% Govt: 36%	3 991	Unitary payment

1. Refers to a phase in which all contract conditions of the financing established between government, private party and lenders are closed
2. Design, finance, build, operate and transfer
3. Design, finance and operate
4. Design, build, operate and transfer
Source: National Treasury

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