

GUIDELINE ON BUDGET SUBMISSIONS FOR LARGE STRATEGIC INFRASTRUCTURE PROPOSALS

June 2017



INTRODUCTION

The Budget Facility for Infrastructure (BFI) is a reform to the budget process that supports the execution of national priority projects by establishing specialised structures, procedures and criteria for committing fiscal resources to public infrastructure spending. As directed by Cabinet, National Treasury is working jointly with the Presidential Infrastructure Coordinating Commission (PICC) secretariat, the Departments of Planning, Monitoring and Evaluation (DPME) and Economic Development (EDD) to establish the facility. The aim is to support quality public investments through robust project appraisal, effective project development and execution and sustainable financing arrangements.

Submissions from national departments in support of large infrastructure projects and/or programmes that require budget allocations starting in 2018/19 are invited. The proposal should consist of a primary submission and supporting documentation. The closing date for submissions is 31 August 2017.

For Budget 2018, the facility will consider submissions from national departments in respect of infrastructure proposals that are:

1. Clearly identified as a national priority by the Presidential Infrastructure Coordinating Commission.
2. Very large and strategic interventions. These are interventions that imply a significant commitment of resources and which will have substantial long term impacts¹.
3. Ready for implementation and require financing commencing in the 2018/19 fiscal year.

The facility will conduct a rigorous independent appraisal of the technical merits of the submission. This will assess the proposal's value-for-money, socio-economic rationale, affordability, risk profile and readiness for implementation. The facility will prepare a recommendation report for consideration by the Ministers' Committee on the Budget (MINCOMBUD). The project sponsor will be invited to engage on the draft recommendations report before it is presented to MINCOMBUD.

Over-time, the facility will build a pipeline of infrastructure projects and programmes, where approvals are sought at each stage of project development, starting with initial concept documents. For the current cycle, however, the facility will be limited to "shovel ready" proposals that require direct budget support in the next fiscal year. It is assumed that these proposals are at an advanced stage of planning and appraisal by the sponsor.

Any queries in respect of these guidelines can be addressed to infrastructure@treasury.gov.za.

¹ Smaller capital projects, programmes or departmental asset acquisitions will not be considered by the facility, and should form part of the department's main budget submission in terms of the main MTEF guidelines, available at <http://www.treasury.gov.za/publications/guidelines>. Further guidance on planning and budgeting for capital spending is provided in National Treasury's *Capital Planning Guidelines*, available on the same page.

PRIMARY SUBMISSION

The primary submission is a concise summary of the proposals not longer than 20 pages. It is a high-level business case that clearly explains the problem that the intervention intends to address, the alternatives that have been considered to solve the problem, and the assumptions, constraints, risks, costs, and timeframes associated with implementing a chosen solution.

Proposals that fail to complete the primary submission in terms of the guidance provided in this note will not go through the technical assessment process and funding will not be considered for such proposals.

The primary submission should be an overview of the following elements which are described in more detail in the next section.

1. A description of the project or programme.
2. A clear justification or rationale for the proposal.
3. The objectives, outcomes and targets that the proposal seeks to achieve.
4. A summary of other options that could achieve the same objectives, and an explanation of the preferred choice.
5. A social and economic analysis, including estimates of economic costs and benefits associated with the intervention and anticipated social and distributional impacts.
6. A budget statement for the proposal, which includes a financial and funding model, cash flow projections, a statement of capital and operating costs as well as other budget requirements of the intervention over its full lifecycle.
7. The main risks – including technical, financial, economic, social, political and any other risks.
8. The procurement plan associated with the proposal.
9. A statement of institutional and operational readiness to implement the proposal.

SUPPORTING DOCUMENTATION AND DETAILED APPRAISAL BY THE PROJECT SPONSOR

The Public Finance Management Act (PFMA) requires all accounting officers to have a system for properly evaluating major capital projects prior to making final decisions. The Standard for Infrastructure Procurement and Delivery Management (SIPDM) sets out a control framework for infrastructure planning and delivery by prescribing the minimum standards for a concept note, pre-feasibility or a feasibility report. The National Treasury's *Capital Planning Guidelines* provide general guidance on planning and appraising infrastructure proposals.

In line with these requirements it is assumed that a comprehensive financial, economic, social and institutional appraisal of the project has been conducted by the sponsoring department. All the documentation and data that supports this appraisal should be attached to the primary submission in both hard copy and electronic format, where appropriate. **The supporting documentation cannot substitute for the primary submission.** However, the supporting documentation will also be subject to the assessment process conducted by the BFI and the primary submission should refer to supporting documentation, where necessary.

ELEMENTS OF THE PRIMARY SUBMISSION

The primary submission is a concise summary of the proposed project or programme, not longer than 20 pages. It should be a high-level analysis, clearly and concisely explaining the problem, the alternatives that have been considered to solve the problem, and the assumptions, constraints, risks, costs, and timeframes involved in implementing a chosen solution.

It should provide sufficient evidence to support its conclusions and recommendations. Assumptions should be presented clearly and transparently. It should provide easy and accessible data sources through which the reader can verify calculations and supporting evidence.

The following elements must be included:

1) DESCRIPTION

The project description is a brief summary of key information that includes the name, location, duration, goal, outputs and other main features of the project. It should also contain the details of the sponsor (which must be a national department), the legal mandate under which the implementing institutions operate, the name and contact details of the project officer within the national department and the details of other institutions (such as public entities or other spheres of government) involved in the project.

2) JUSTIFICATION

The purpose of the justification statement is to explain the need for the proposal at the highest level in a clear, coherent and logical manner. It should explain why the proposal is in the national interest and motivate the justification for shifting resources from other pressing needs to this activity.

The rationale for the intervention includes:

- A clearly identified need that the proposal seeks to address.
- Why the intervention is likely to be cost-effective (i.e. that the benefits of intervention will exceed the costs).
- A description of the potential beneficiaries of the project and an explanation for their selection over others.
- The negative consequences and risks associated with the intervention, as well as the results of not intervening, both of which must be outweighed by the benefits to justify action.

3) OBJECTIVES

This section should clearly set out the desired outcomes and objectives of the intervention. The purpose of this section is to clearly define what successful implementation will look like, by answering the following questions:

- What are we trying to achieve?
- How will society or the economy be different if the intervention succeeds?
- What would constitute a successful outcome or set of outcomes?

Objectives should be expressed in general terms so that the range of options to meet them can be considered. Objectives should be defined in such a way that progress toward meeting them can be monitored. Measurable indicators that illustrate when these objectives have been met should be suggested. They should be focussed on the factors that are critical to success, and reflect the eventual benefits to society that the project will generate.

In other words, objectives should be defined to reflect *outcomes* (e.g. improved health, crime reduction or enhanced sustainable economic growth,) rather than the *outputs* (e.g. hospital beds, prosecutions or employment created during construction), which will be the focus of particular projects.

Project sponsors may also provide information on *targets* that can be used to define progress in terms of producing outputs, delivering outcomes, and meeting objectives. Each target should be associated with an indicator that is SMART – specific, measurable, achievable, and relevant and time bound.

4) SUMMARY OF OPTIONS CONSIDERED

This section should describe the options that were considered during the development of the proposal. The purpose of options appraisal is to develop a cost-effective solution that meets the objectives of government. Creating and reviewing options helps decision-makers understand the potential range of solutions that may be considered.

Each alternative should be clearly described together with a summary of its associated advantages and disadvantages and a quantification of the preliminary costs and benefits of each option relative to the objectives of the proposal. The summary should explain why the preferred option meets the objectives more effectively than other options, and how the preferred option gives the best value-for-money for government. Evidence contained in the supporting documentation should be summarised and referenced to support the argument that the preferred solution is the best solution.

5) OVERVIEW OF SOCIO-ECONOMIC ANALYSIS

In order to justify fiscal support, a credible analysis of social and economic benefits is essential. This section of the primary submission is likely to be the most extensive. It should provide an overview of the cost-benefit or cost effectiveness analysis provided in the supporting documentation, which should be summarised and referenced to support the argument. Major costs and benefits should be described, and the values attached to each clearly shown, rather than netted off in the analysis.

A cost-benefit analysis seeks to establish whether a particular investment is the most efficient use of society's resources. It does this by identifying and quantifying the costs and the benefits to society in a manner that enables comparison of different options. A cost-effectiveness analysis is commonly used in the assessment of social infrastructure projects where benefits are not easy to measure. It is assumed that one or other of these approaches has been undertaken in the project feasibility study, and the purpose of this section is to provide an overview of this analysis in a clear, logical and concise narrative.

This analytical summary should cover the following aspects:

- The main economic costs and benefits to government and society, taking into account the full impacts on all South African citizens over the full lifecycle of the assets that will be created.
- In addition to taking into account the *direct* effects of the interventions, the wider *indirect* effects on the economy and society should be clearly specified and reviewed. Where these indirect factors result in quantifiable impacts – for instance environmental costs – these should be included in the appraisal.
- Where appropriate, the appraisal should reflect the monetary value of costs and benefits based on market prices, and also indicate the best alternative uses that the goods or services could be put to (the opportunity cost). The assumptions used to quantify costs and benefits in monetary terms should be clearly stated. Costs and benefits for which there is no market price should also be clearly specified and explained.
- The distributional impacts where appropriate to indicate who gains or loses from the implementation of the proposal. This involves identifying how the costs and benefits accrue to the different groups affected by the project. A proposal may have differing impacts according to age, gender, ethnic group, health, skill, or location. These effects should be stated and quantified wherever feasible.
- The assumptions used to arrive at the quantities underlying the appraisal. These assumptions need to be scrutinised and tested to ensure that the proposal remains viable even when project circumstances vary or change.

The valuation of costs or benefits should be expressed in present value terms as opposed to 'nominal terms' or 'current prices'. The deflators, discounting methods and other assumptions used to arrive at these values should be disclosed. National Treasury does not prescribe the discount rate. However, the discount rate should ideally be the cost of capital to government, similar to the rate government pays on a Treasury bond of a comparable period as the project.

7) BUDGET STATEMENT

The affordability of options should always be considered when appraising proposals. In addition to the analysis of socio-economic costs and benefits, the primary submission should include the following financial statements which are essential in order to plan for budget allocations over the full lifecycle of the intervention. All of these financial statements should be stated over the full useful life of the asset in current prices (i.e. nominal rand) using clearly specified rates of inflation to escalate costs.

- a) **An expenditure statement.** This should detail all the payments that will be required to deliver the proposal. The expenditure statement should cover all capital payments involved in the construction of the asset and financing charges associate with funding the proposal. It should detail the operating payments associated with running the asset over its useful life, including labour costs, machinery and equipment, utilities and expected maintenance costs of the asset. These payments would include any costs will be borne by any government or public institution, whether or not they are directly involved in

planning or executing the proposal. In particular, expenditure implications for other spheres of government or public entities should be clearly specified.

- b) **A funding statement.** This should show all the resources that will be mobilised to implement the proposal and support the operation of the asset over its full lifecycle. This might include resources redirected from within the department's baseline, additional resources transferred from the fiscus, partners and external organisations providing the resources (and in some cases cash) required, and user charges or other forms of funding internal to the project itself. Any debt or equity obligations or leasing arrangements that the project sponsor intends to mobilise in favour of the project must be clearly disclosed in the funding statement, together with their terms and provisions.
- c) **A cash-flow statement.** A comprehensive account of the annual inflows and outflows of cash associated with the proposal as a result of capital, operations and financing activities over the full lifecycle of the asset.
- d) **A contingent liability statement.** Some proposal expose the government to contingent liabilities – that is commitments to future expenditure if certain events occur. Any guarantees, provisions or other obligations that could give rise to fiscal liabilities in the future as a result of some explicit contractual eventuality should be fully disclosed.

6) **RISK STATEMENT AND SENSITIVITY ANALYSIS**

In appraisals, it is likely that there will be differences between what is expected, and what eventually happens, because of the complexities of delivering these projects as well as biases inherent in the appraisal, and risks and uncertainties that materialise. The main risks – including technical, financial, economic, social and political risks – that have been anticipated by the project sponsors should be clearly stated. The risk statement should approximate the financial impact that these factors could have on project costs and revenues. It should also assign a probability of an event occurring and provide details of the mitigating actions that could manage the risk.

The sensitivity of the economic analysis and financial statements to changes in key economic variables should also be considered. This includes alternative assumptions on the key variables which may include exchange rates, interest rates, economic growth, population growth and demand for services.

Many parameters are affected by optimism – appraisers tend to overstate benefits, and understate timings and costs, both capital and operational. Appraisers should be alert to these biases and make explicit adjustments to counter it. Sensitivity analysis should be used to test assumptions about operating costs and expected benefits. Where possible, adjustments should be empirically based, (e.g. using data from past projects or similar projects elsewhere), and adjusted for the unique characteristics of the project in hand.

8) **PROCUREMENT STATEMENT**

A procurement statement should detail the procurement methodology to be employed and how it will be managed. This should also detail how the process will adhere to the constitutional requirements for a fair, equitable, transparent, competitive and cost-effective process.

9) INSTITUTIONAL AND OPERATIONAL READINESS

Sufficient capacity to deliver the project on time, on budget and to specifications should be demonstrated. An institutional arrangement that is conducive to effective delivery is critical. The analysis should demonstrate that the institutions responsible for implementation, including project management, and operational responsibility will be appropriate to the task.

Key questions that should guide the preparation of this section include:

- Has the technical and legal due diligence been undertaken?
- Are there suitable incentives or penalties in place to ensure delivery?
- Are the lines of accountability clear and transparency assured?
- Have the necessary steps been taken to mitigate risk and allocate residual risks appropriately?
- Do relevant institutions have the required capacity, or is there a need for a capacity building?
- Have the arrangements to promote good governance by all implementing parties been put in place?
- What is the current financial position of the executing institution?
- What is the governance structure within the institution in relation to the proposed project?

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