The New El Dorado Hospital

Case Study Material

Inter-American Development Bank

PartnershipsUK

Agenda

1. Outline Business Case
2. Project Objectives, scope and requirements
3. Options appraisal and selection
4. Affordability and Security of Payments
5. Risk Identification and Allocation
6. Commercial Interest/Bankability
7. Project Preparation Team and requirements
8. Commitment of sponsors/users
9. Statutory Process and Approvals
10. Tender Process
11. Role of Development Finance Institutions

PPP in Hospitals - Key Characteristics

- Output based contracting whereby public sector receives an accommodation service (ie provision and maintenance of the hospital infrastructure)
- Clinical services have *usually* been excluded from the scope of services to be provided by the private partner
- Payments commence only once the infrastructure service is satisfactorily provided (availability)
- Private partner accepts whole life-cycle investment responsibilities for the facility
- Private partner usually does not own the land, only leases it from the public sector
- Poor performance by the private partner is penalised by withholding / deducting from the regular (e.g. monthly) payment
- Very poor performance can lead to termination of the whole contract

The Outline Business Case…Audience and Purpose

- Audience:
  - Project Team and Board
  - Local Health Authority
  - Central Government
  - Other stakeholders

- Purpose: to establish that the project
  - Meets government's policy objectives
  - Is 'viable'
  - Is 'bankable'
  - Is 'affordable'
  - Is 'deliverable'

<u>Discussion Points:</u>

•Key questions addressed by an OBC

•Difference between 'viability', 'bankability', 'affordability' and 'deliverability

•Fit of this approach with existing government processes

Example of a typical Outline Business Case Process

PROJECT OBJECTIVES
What is the problem?

- Background/history
- Authority Powers
- Current status
- Authority's requirements

INVESTMENT OPTIONS
What options have we got?

- Do nothing
- Do minimum
- Invest to repair backlog
- Replace infrastructure

PROCUREMENT OPTIONS
How should we procure the Preferred Option?

- In house delivery
- Conventional Procurement
- 'DBFO' contract
- Other contractual options

INDICATIVE COSTS
How much will it cost?

- Indicative costs of proposed options
- RISK adjusted VFM assessment
- Shadow PPP model

AFFORDABILITY
Can we afford it?

- Cost or affordability assessment
- Revenue funds available and committed

BANKABILITY
Can the private sector deliver this project?

- Market testing
- Standard contract terms
- SMART specifications
- Sensible risk allocation
- Committed funding

PROJECT MANAGEMENT
Can we deliver this procurement?

- Project governance
- Authority resources
- Commitment of key stakeholders
- Realistic timetable
- Statutory obstacles
- Use of Advisers

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Defining the Scope of the Project

- Distinguishing between <u>outcomes</u> and <u>outputs</u>
  - Raising of health standards is ultimate policy **outcome**. Provision of long-term serviced accommodation for hospitals is an intermediate **output**.

- Distinguishing between <u>outputs</u> and <u>inputs</u>:
  - A hospital building is not an output, a supply of serviced accommodation is;
  - A heating plant is not an output, maintenance of a minimum acceptable temperature is;

- Framing output requirements: design outputs, availability standards and performance standards

- Standards should be SMART – Specific, Measurable, Achievable, Realistic and Timely

Output Specification

- Requirement specified in terms of service outputs required, rather than particular assets or solution – allows scope for private sector innovation and therefore competition.
- Range of on-going services included in the requirement defined - again, this offers scope for efficiencies and innovation and therefore competition.
- Specification pitched at a realistic and achievable level– private sector would price up (or not bid for) unrealistic specifications.

Things to keep in mind when reviewing:

- Often Output Specifications are very underdeveloped at OBC stage as advisers / project team may not yet be formed.
- Need to be assured that Project Team can demonstrate that they understand the principles.
- Check consistency with: Affordability model, Risk allocation, Bankability, Key terms and Conditions, Suitability of Advisors, Commitment of Sponsors / Users

Example: Output Specification

	SMART	Not SMART
Specific	Respond to key portering tasks (fire response calls, major incidents, emergency deliveries of medical gases, departmental emergencies, emergency admissions and emergency transfers) within 6 minutes of the receipt of the call	Respond to all portering task promptly
Measurable	Respond to any request for a reactive cleaning service to a circulation or waiting area within 25 minutes	Ensure hospital is kept clean
Achievable	Ensure heating can maintain internal temperature at X degrees when outside temperature is between Y degrees and Z degrees.	Ensure internal temperature is always maintained at X degrees.
Realistic	Ensure faults with heating system are rectified within 8 hours in business hours, and 16 hours outside business hours.	Ensure faults with heating are repaired within 2 hours.
Timely	Maintain log of faults and report every month.	Provide annual report on performance

Output Specifications for Hospitals

- Architectural, design, engineering, safety and buildings quality requirements
- Information and communications technology requirements (including medical records)
- Non infrastructure related services (e.g. laundry, catering, security)
- Medical and non-medical equipment requirements
- Corporate and administrative requirements (including meeting rooms, academic space etc.)
- Car parking, retail

Project Objectives, Scope and Requirements

Case Study Questions and Discussion Points

Case Study Questions:

- Are the objectives and scope of the project clear and stable (e.g. policy, demographics)?
- Why do you think that Clinical Services provided by doctors, nurses, etc have not been included in the scope of the project?
- Are the requirements adequately expressed in terms of outputs?

Discussion Points:

- Familiarity of this approach to output based contracting to the public/private sector

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Options Appraisal

- **Identification of the preferred *project* option**
  - Use of a *do nothing* or *do minimum* option to assess impact of change
  - Measured against delivery of service objectives, affordability and sustainability
  - Assessment of costs and benefits
  - Role of discount rates and optimism bias
  - Combination of qualitative and quantitative factors

- **Identification of the preferred *procurement* route**
  - Value for money

Options appraisal

Case Study Questions and Discussion Points

Case Study Questions:

- Does the OBC provide a clear basis for the selection of the preferred option

Discussion Points:

- Methodology for assessing costs and benefits
- Discount rate
- In-house capacities for evaluation of projects beyond simple social cost-benefit analysis
- Other economic or financial appraisal procedures existing in the public sector for infrastructure projects

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Affordability….1

- Who will pay for the project and how?

- The cost to deliver the specified requirements
  - Contractor’s charges reflected in a “unitary charge”
  - Capital expenditures
  - Operating expenditure
  - Cost of capital/debt
  - Risks

vs

- The funds / assets available
  - Feasibility / Willingness of users to pay
  - Credibility of long term public sector payment obligations
  - Guarantee fund availability
  - Up-front capital grants / public assets

Affordability….2

- Projected PPP capital / service payments identified – computation of unitary charge
- Shadow bid assumptions of capex, opex, lifecycle etc.
- Funding assumptions in line with market – gearing, returns, cover ratios
- Identify budgeted and 3rd party sources of income
- Indexation assumptions
- Affordable over the whole life of the contract, taking into account all sources of revenue, additional income from capital receipts or third party income.
- Sensitivity analysis conducted to determine key variables which underpin affordability position.
- Affordability analysis and risks and sensitivity analysis, and their impact on budgets, accepted by budget holders.
- Fiscal reporting and multi-annual budget commitments
- Accounting treatment of contingent liabilities

Affordability

Case Study Questions and Discussion Points

Case Study Questions:

- Are the project funding assumptions reasonable?
- Assuming the assumptions are reasonable, can the authority pay this? What are the risks for the authority?
- Are budgets and approvals in place for any public-sector payment (or asset provision) obligations?

Discussion Points:

- **Expected availability of long-term fixed rate limited recourse funding**
- **Terms and conditions that lenders and equity providers typically require for the risks involved**
- **Split of the unitary charge between the public and the private sector**
- **Existence of Government credible long term payment obligations to satisfy the investors**

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Risk allocation…1

- Who?:
  - users
  - investors - the private-sector)
  - taxpayers - through the government

- Allocate risk to party best able to:

  - control its occurrence and consequences
  - assess information about the likelihood of the risk
  - within context of what is likely to be commercially acceptable to the private-sector.

- Risk does not *disappear* through contractual structuring

Risk Allocation…2

• **Planning Risk**	Failure to obtain planning permission, resulting in termination of the project or significant variation to the service solution.
• **Design Risk**	Design of the chosen solution does not allow the output requirements to be met, leading to revisions in design, changes to specification or termination of project.
• **Construction Risk**	Risks associated with the construction phase, such as latent or construction defects, archaeological discoveries or unforeseen ground conditions, leading to construction delays and cost overruns.
• **Demand Risk**	Risk of fluctuations in long term demand for the service, leading to changes to specification or termination of project.
• **Performance Risk**	Risk of not achieving performance targets set out in the output specification, leading to poor quality service to users.
• **Technology and Obsolescence Risk**	Risk that changes to technology render proposed solution obsolete, leading to expensive changes to design/scope.

Risk Allocation…3

• **Operating Risk**	Risk of higher than expected operating costs, making it more costly to deliver services to stated standard.
• **Third Party Income Risk**	Risk of lower than expected income from third party users, making it more costly to deliver services to stated standard.
• **Residual Value Risk**	Risk of fluctuations in the value of the asset associated with the service at the end of the contract, making the contract more expensive overall .
• **Regulatory Risk**	Risk of changes to legislation or regulations, making it more difficult or more expensive to deliver services to stated specification
• **Financing Risk**	Risk of inability to obtain finance to fund the project, or fluctuations in the cost of funds or the terms of financing anticipated at the outset – making it costlier to provide the service.

Risk Allocation…4

- A risk register has been prepared, identifying all the risks associated with the scheme, and making a preliminary risk allocation.
- The preliminary allocation, as a minimum, transfers the principal risks associated with design, build, finance and operation of the facilities to the private party.
- Consider the allocation of risks associated with demand, residual values, technology and obsolescence and changes in legislation or regulation.
- Ensure consistency with: Affordability model, Commercial interest, Key terms and Conditions, Output Specification.
- Note: there will also be allocation *within* the private sector

Risk Identification and Allocation

Case Study Questions and Discussion Points

Case Study Questions:

- Which key risks do you think have not been identified?
- Do you think hat the proposed allocation of risks is sensible?

Discussion Points:

- Appetite of the market for risk transfer
- Design risk
- Demand risk
- Payment risk

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Indication of Commercial Interest

- Geography/sector/size
- Capacity of bidding market
- Evidence of bankable contract terms and project specification
- Certainty of income stream to meet contract payments
- 3rd party income opportunities
- Adjust scope if necessary
- Evidence of commercial interest through “market sounding”

Tips for successful market-sounding

- Ensure that:
  - In line with any relevant procurement rules
  - Give best account of the public authority
  - Consider at an early stage, but not too early
  - Prepare the background documentation
  - Be clear about the issues to be discussed with the market
  - Be clear about the process to select organisations
  - Consider use of a one-to-one format but no special treatment in any subsequent procurement
  - Involve more than one individual on the public sector side, be consistent and ensure meetings are documented

- Avoid:
  - Wasting time with sales pitches / shaping the project to suit a proposal
  - Restricting scope: aim to select operators and contractors etc.
  - Focusing on outcomes rather than means of achieve them
  - Using procurement language such as ‘bidders’

Bankability

- Importance of cashflow over assets
- Limited recourse finance versus corporate finance
- Role of lenders in due diligence
- Dangers of guarantees
- Currency risks
- Tenor and affordability
- Role of equity
- Role of SPVs and allocation of risk *within* the private sector
- ‘Step-in’ rights

Key Terms and Conditions

- If the risks do in fact arise during the project life, both parties are agreed on what to do about them
- Outline contract prepared
  - Bankability of contractual terms needs to be established early on, otherwise bidders will waste time and money.
- Proposed payment mechanism that reflects risk allocation
  - Unrealistic or overly penalistic payment mechanism may not be accepted by funders/contractors, leading to delays in negotiation and/or termination.
  - Deductions vs. fines
- Use of bankable standard contract terms
- Key terms and conditions must be consistent with: Risk Allocation, Affordability, Output Specification, Bankability

Commercial Interest and Bankability

Case Study Questions and Discussion Points

Case Study Questions:

- **Is there evidence in the case study of contractor, lender and investor market interest to justify launching the project on the proposed terms?**
- **What do you think of the capacity of the local contractor market?**

Discussion Points:

- **Depth of local contractor market**
- **Role of overseas contractors**
- **Ensuring equitable treatment of all candidates**
- **Project management and facility management expertise**
- **Availability of long term fixed rate limited recourse funding**
- **Ascertaining credible market interest at the OBC stage**

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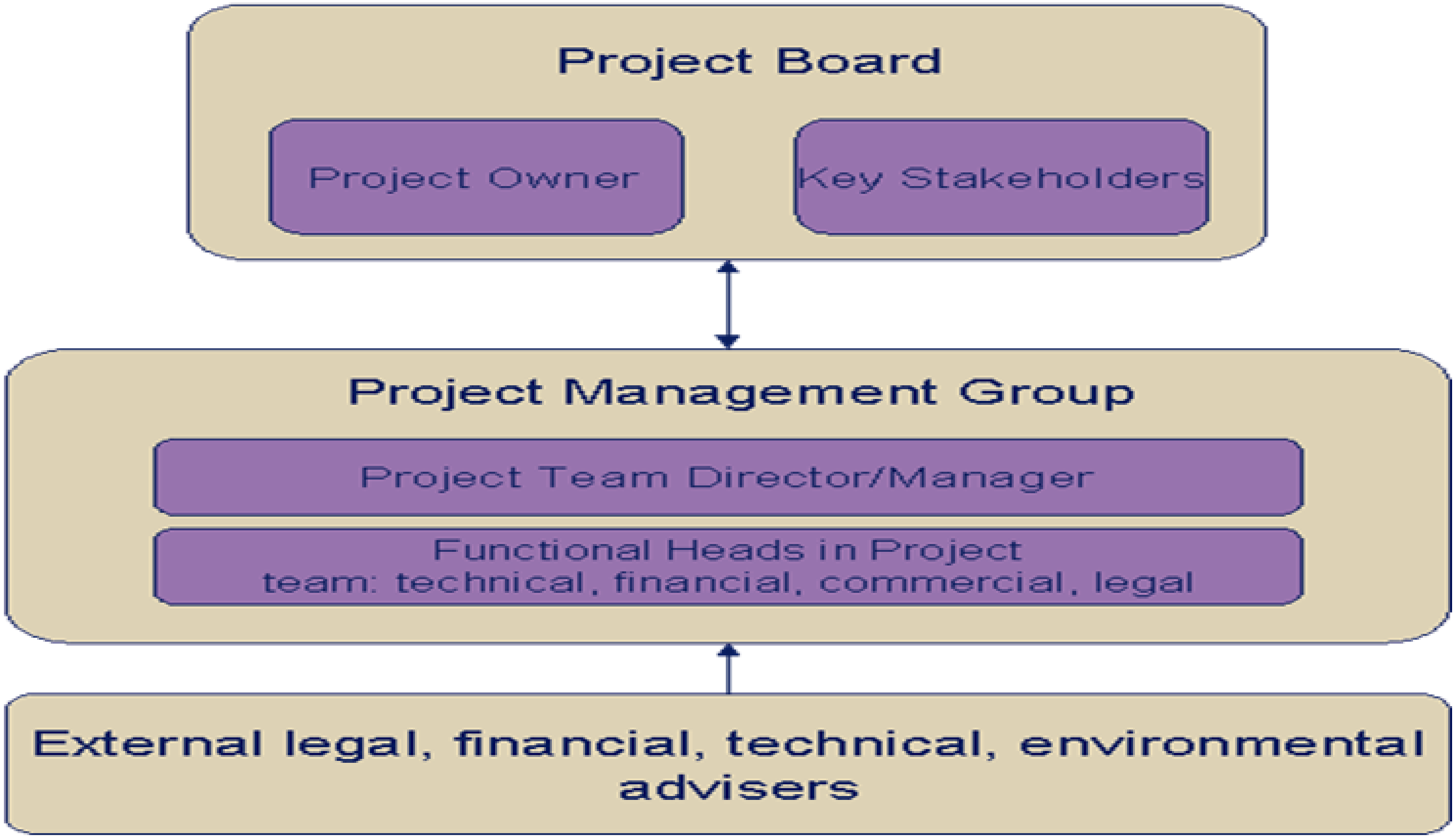
Project Team

- Appropriate project management arrangements in place – a Project Board with appropriate terms of reference and decision-making authority, and a Project Team with appropriate resources to manage the preparation and management of the project
- Project Manager with strong Project Management experience - devoted full-time to the project (not added on to his/her day job)
- Appropriate range of skills and experience, whether from advisers or in house, for the deal envisaged. Commitment to supplement any identified in-house weakness with external advisors and appropriate budgets.
- Accessible to involvement of Central PPP Unit/Taskforce

Advisers

- Arrangements for obtaining legal, financial and technical advisers, with appropriate experience in PPP – cheapest advice is not necessarily the best advice
- Willingness of advisers to share lessons and approaches, without undue confidentiality and copyright constraints
- Arrangements for periodic review of performance of advisers

Example: project governance structure



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Project management problems to avoid

- confusion about roles
- a part-time Project Manager
- frequent changes in the project team
- insufficient resources
- over-reliance on advisers for decision-making;
- insufficient delegated powers to the Project Management Group
- interference from other bodies outside the governance structure
- poor management of the day-to-day resources, including the external advisers.
- a Project Board is too large / not able to meet as required to take key decisions

Project preparation team and requirements

Case Study Questions and Discussion Points

Case Study Questions:

- In there evidence in the case study that a credible and well resourced team is in place to manage the project?
- Are credible and experienced advisers available and appointed?

Discussion Points:

- Project management arrangements used to date in PPP pathfinder projects
- General experience of external advisers
- Depth of the external advisers market
- Procurement processes and budgets enabling appointment of the right advisers

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Commitment of Sponsors/Users

Case Study Questions and Discussion Points

- Demonstrate support from all key sponsors and, where appropriate, users. Consultation with all other stakeholders.

Case Study Questions:

•Who are the key stakeholders in the case of El Dorado Hospital?

•Is there any evidence of their commitment to the project?

•Are there any arrangements in place for continued communication and consultation?

Discussion Point:

•Identification of Project sponsors

•Consultation as part of government process

•Experience (good or bad) in managing stakeholders

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Statutory Processes

- Ensure that Statutory Process (planning, public enquiry, consultation) has been considered and the timetable incorporates any implications that compliance to statutory process may entail.

- Ensure that risk of compliance with statutory processes is properly shared with private sector

- Statutory Processes must be consistent with: Timetable, Risk Allocation

Statutory Processes

Case Study Questions and Discussion Points

Case Study Questions:

- Have required approvals been identified /obtained to build the hospital (e.g. environment, planning)?
- Are there any site or land ownership issues that need to be resolved?
- Are all relevant project approvals in place?
- Is the required collateral infrastructure (e.g. roads, power, water, waste) in place to insure the success of the New El Dorado Hospital?

Discussion Point:

- Land title a frequent issue? Who normally deals with this issue?
- Local authorities capacity to award and enter into long-term contracts
- Other key statutory obligations which pose problems (e.g. archaeological concerns)

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Engaging with the Private Sector: Commercial Strategy

- Manage the PPP supply market (to generate interest, understand constraints, familiarise with procurement process and manage expectations)
- Determine achievable share of whole-life project risks
- Determine the scope of the competition (e.g. Information Management &Technology)
- Determine the number of competitors
- Design the nature of the competition (process and timing)
- Determine the bidder requirements

Engaging with the Private Sector: Deciding Tactics

- How many stages of selection are most appropriate?
- How much information to request at prequalification / pre qualification criteria?
  - capability tests (2/3 bidders) / more extensive
- When to seek fully costed proposals?
  - early negotiation of contract documents leads to better, more complete bids
- When to select a preferred bidder?
  - after full and final bids
  - completion of discussion on commercial terms
  - after third-party funding is committed?

Procurement Documentation

- Output specifications
- The Invitation to Tender/requests for proposals specific as to:
  - Services required, in output terms
  - Boundaries or constraints on service, scope, location or engineering
  - Proposed contractual terms (including contract length and payment mechanism)
  - Timetable and process for developing acceptable terms and for submission of bids (including nature of project and user support to bidders during the bidding process)
  - Bid requirements (form and content of information required from bidders at different stages of procurement)
  - Criteria for evaluating bids
  - Extent to which bidders are encouraged to submit variant bids (e.g. variations on duration, risk allocation etc)
- Discussion with pre-qualified bidders to clarify/explain background/raise points of principle

Procurement Process

Case Study Questions and Discussion Points

Case Study Questions:

- What is your view on the proposed tender phase time-table
- What is your view on the Prequalification criteria
- What plans exist to publicise the launch of the project to potential bidders?
- Has a project information memorandum been prepared by the project team?
- Have the bidder qualification and bid evaluation criteria been developed?

Discussion Points:

- Requirements of local procurement law
- Balancing a fast and transparent bidder selection process with selection of the right solution
- Bid bonds
- Who bears bid costs ?
- Short List vs. Long List after Pre-qualification document /PQQ
- Unsolicited proposals
- Participation of national companies

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Role of Development Finance Institutions

Development finance institutions (DFIs)

- DFIs can play an important role in the preparation of a project by acting as a readily accessible sounding board for the project's structure and commercial viability as well as being an important source of long-term funding.
- DFIs can also improve the credibility of the project and provide greater assurance and comfort for the other providers of long-term finance, investors, and contractors, particularly with regard to perceived political risks.
- They should be involved at an early stage and may be an important component of the market-sounding activity

Role of Development Finance Institutions

Case Study Questions and Discussion Points

Case study questions:

- Does the availability of DFI funding look likely?

Discussion Points:

- Involvement of DFIs (how and when)
- Use of DFI term sheets during the tender phase
- Role of DFIs in developing long term finance
- Role of DFIs as an “honest broker”