THE BOT PROCUREMENT METHOD IN UGANDA: SUCCESSES, FAILURES AND CHALLENGES

Eng. Sam Mugume
C/O Associated Consulting Engineers (1975)
P.O. Box 3007
Tel: 256-41-231305; Fax 256-41-233726, E-mail – smugume@imul.com

Abstract
The government of Uganda requires over US$ 8.2 billion to invest in infrastructure projects by the year 2010. Traditionally, infrastructure considered to be within the public domain has been funded by the public sector. But the current external debt of Uganda, which stands at US$ 3.6 billion cripples the government's capacity to meet the vital need of infrastructure development, thus creating an urgent need to find new alternative sources of financing involving the private sector.

This paper concentrates on the **Build-Operate Transfer (BOT)** model, which has been hailed by many as the most common form of private financing of infrastructure projects in developing countries. Under such a scheme, a consortium of private investors finances and builds an infrastructure system, which it can operate during a predefined concession period, at the end of which the project is transferred back to the government usually at no cost. The BOT model utilises 'project finance' structure, which renders it a high-risk venture. In Uganda a number of risks exist. These include corruption, changes in laws, delay in approval, expropriation risks, foreign exchanges risks, inflation risks, financing close, associated infrastructure, tariff adjustment, force majeure, credit worthiness of government utilities, technological risks, environmental risks and hydrological risks.

A few small-scale projects in the urban development sector have succeeded under the BOT concept. The power generation sector which has so far attracted three large scale investors in Uganda lacks supportive legal and regulatory framework to support this kind of investment in BOT projects. The Ugandan government is therefore facing an urgent challenge of putting these in place to facilitate those investors already on the ground. Further more, no standard agreement for any infrastructure sector has so far been developed in Uganda. There is substantial potential and willingness of the private sector in Uganda to finance medium scale infrastructure projects. It is proposed that this finance should be tapped through initial public offering (IPOs) to develop infrastructure project in Uganda.

Key words: BOT, Infrastructure, Project Finance and Project Risks.

The BOT Concept

In its basic form, a BOT project is one in which a government grants a concession to a private consortium to finance, build and operate an infrastructure facility, which it operates during a predefined concession period, at the end of which the project is transferred back to the government usually at no cost.

The acronym 'BOT' stands for Build Operate and Transfer or Build, Own and Transfer (the terms are used interchangeably). Many variants to this acronym have sprung up to describe the concept of using private finance to build public projects. These include; BOO, BOOT, BRT, BLT, BTO, BT, BTO, BOR, DBFO, FBOT, ROL, ROO, ROT and DCMF. In this paper, the term BOT will be used as a generic term for such projects.

The Basic Elements of BOT

The basic elements of BOT include:

Concession

A concessionaire usually a private company which is also called the 'project company' or 'promoter' is given a concession to build (or rehabilitate) and own or operate a facility that would normally be undertaken by the central or local government.

The purpose of the concession is to achieve the following principal objectives:

- To provide the promoter with the prospect of return on his investment
- To ensure that the public receives the desired quality of facility and service
- To establish and regulate the fee payable by users
- To grant the right to build and operate the faciltiy
- To provide for the return of the facility at the expiry of the concession

Financing

The project company is responsible for financing and designing the project normally through a 'project finance' structure. Project finance involves the use of non-recourse or in most cases, limited recourse debt to the parent companies in no way affecting their credit standing or balance sheet. Project financing is sometimes called the "off-balance sheet financing" or "non-recourse financing"; meaning that should the project company go bankrupt, its creditors could not claim the assets of the parent companies to be sold as a means to repay the debt of the project company. The lenders decision to lend is based on the economic technical marketing and financing soundness of the project. The principal collateral consists of the assets of the project, a security assignment of the project documents, project cash flow (off-take inclusive).

Since project finance offers recourse limited to, but secured on that project and the proceeds of sale of its product, the lenders must be protected from claims against those assets and project sponsors, whose balance sheets and credit standing remain unaffected.

Project finance assumes that once the project is completed, the cash flow will be adequate to cover the projects operating costs, debt service and an adequate return to the project's owner. For this reason, project finance is often called "structured financing" because it requires structuring debt and equity such that the project's cash flows are adequate to service the debt. So in theory there is no need to rely on any credit other than the project's. The only exception is for projects where the economies are skewed by government intervention in the cost structure, like in cases where the government subsidises utility rates, on which all project guarantee or a similar undertaking in support of the utility's obligations, e.g. under the power purchase agreement (PPA).

From the perspective of the borrower (sponsor) and borrower's affiliates, project financing has a number of benefits, including:

(i) off-balance sheet financing
(ii) higher leverage (typically in the range of 70/30 to 80/20 and often 75/25 debt to equity ratio rather than 50/50 or 40/60 required in traditional corporate financing
(iii) well structured, limited recourse project
(iv) the mitigation of project risks through their allocation, including political risks, among project participants. Project finance also offers similar benefits to the host government as its utilities
(v) a new source of capital for large infrastructure projects

The main advantage of project finance for the governments of developing countries is that they do not have to issue formal guarantees of repayment of the debt, and consequently the project does not raise public debt.

Concession Period

The concession period is determined primarily by the length of time needed for the project company to earn enough from the facility's revenue stream to accomplish the following:

i) Pay interest on the project debt
ii) Repay the project debt
iii) Repay the equity investment of the project sponsors and any other equity investors
iv) Pay a reasonable return (including a reasonable profit) at reasonable tariffs to the equity investors to compensate them for the use of their capital and the risk they will have undertaken.

Transfer

Upon expiry of the concession period, the facility is to be returned to the government, free of charge or at an agreed nominal fee and in good repair. For governments having no wish to become the operator of such a facility, the expiry of the concession period will be the opportunity to sell a further concession or to sell the facility outright, whether to the promoter to a third party.

In case of BOO projects, such as the AES Nile Power Project at Bujagali falls, no transfer is contemplated. Such cases arise where the financial variability of the project depends on there being non transfer date or where the government wishes to divest itself permanently to the responsibility for the provision of the facility.

Advantages of BOT

BOT projects are attractive for a number of reasons:

- It attracts foreign investment.
- There is virtually no initial capital investment by the client.
- It imports technical expertise and so offers value-training opportunities.
- It offers off balance sheet funding on national accounts.
- Development costs and risks can be transferred to sponsor.
- It may suit an overall political strategy such as privatisation of public assets.
- It could be less costly compared to procurement methods using public funds.
- Use of private sector financing to provide new sources of capital, reduces public borrowing and direct spending which may improve the host government's credit rating.
- Ability to accelerate the development of projects that would otherwise have to wait for, and compete for scarce sovereign resources.
- Use of private sector capital initiative and know-how to reduce project construction costs, shorten schedules and improve operating efficiency.
- Allocation to the private sector for project risk and burden that would otherwise have to be borne by the public sector.
- The involvement of private sponsors and experienced commercial lenders, which ensures an in-depth review is an additional sign of project feasibility.
- Technology transfer, the training of local personnel and the development of national capital markets.
- In contrast to full privatisation, government retains strategic control over the project which is transferred to the public at the end of the contract period
- The opportunity to establish a private benchmark against which the efficiency of similar public sector projects can be measured and the associated opportunity to enhance public management of infrastructure facilities

Disadvantages of BOT

BOT projects will usually confer monopolistic control to the concessionaire. Profit making concessionaires are usually granted exclusive rights say over land, tax allowances, guarantees for off take or supply and easier access to the country's foreign exchange reserves to ease repatriation of profits. Associated with political unfavourable dependency on foreigners, where the foreign input is conspicuous. BOT projects tend to be grand, complex and novel.

Types of infrastructure projects
Although BOT projects have largely been used in development of large infrastructure projects such as transportation systems, water supply systems, water treatment plants, irrigation plants, urban and rural planning, telecommunications networks, waste management systems and in energy supply systems, increasingly it is also being utilised for medium and small scale projects.

Project Company
The project company is the concessionaire of the BOT project; its rights and obligations including the following:

- To design, develop, finance, construct, complete, test, commission, operate and maintain the project according to performance criteria.
- To pay damages to government for delay or failure to complete the project or meet expected performance.
- To provide training and employment to local employees and sub contractors.
- To maximise technology transfer.
- To protect the environment.
- To permit access and inspection of project by the government.
- To transfer the project in good working order.

In order for the project to be viable and profitable, the project company seeks to minimise its risk, maximise its monopoly and to obtain the best possible government guarantees. The concessionaire will wish to pass to the contractor the key completion risks: that the facility is delivered on time, on budget and within specification.

If the contractor is equity holder, the concessionaire will try as far as possible to minimise the contractors' long term interest in the project and is an incentive to design and build a facility that will perform for the life time of the concession with low maintenance costs and with low repair and renovation costs to achieve the standard required for the time of transfer.

Contractor
The contractor is responsible for construction of the facility. In some cases, the contractor may be an equity holder in the project company. However, contractors do not generally consider themselves as long-term investors so they will seek to get profit from the construction contract and look for an exit route, by selling their equity holding.

Sponsors
These undertake the pre-concession development of the project, a consortium (or consortia) of private sector sponsors is formerly early in the BOT process to review the request for proposals, prepare a feasibility study and submit a bid. The consortium is responsible for creating special-purpose limited liability company known as the "project company". A sponsor consortium may include the contractor, supplier and operator.

Users
Users fall into three prime categories: the public, the government and its utilities (off-takers).

The public (tax-payers) may be reluctant to pay a high fee for a service traditionally provided free of charge such as roads, bridges and water. Nshakira (1994) documented a case where some water users in the Small Towns Water and Sanitation Project at Wobulenzi town were not willing to pay a total contribution of 1.5% of the capital costs to maintain the project because of the old notion that services such as water should be provided by the government free of charge.

The Operator
Contracts with the concessionaire to operate and maintain the completed asset and to collect the revenue. The government must be able to give a guarantee if it subsidises the costs of the output on which the revenues for debt service depend.

The Government Utilities
The off taker buys the service provided by the completed asset. Through off-take agreements, the project company normally receives payments even if the off taker does not need to make use of his facility. If the demand for power means that the power station is on stand-by or the sewage facility is operating well below capacity, interest has to be paid and capital repaid and the off-take agreement should address this issue.

The reader is advised to consult UNIDO guidelines in BOT for more information on structures and BOT projects.

The Supplier
Contracts with the concessionaire to supply the raw materials, if any required for the operation of the asset.

Maitre d'oeuvre
Contracts with the client to supervise the construction and operation of the asset.

The Contact Package

The parties to the BOT contract are inter-related by contracts which must be integrated to fit together into a consistent, complimentary package which is effectively coordinated. The package defines the respective rights, obligations and risks of each party. The contract package may include the following documents:

(i) Consultant agreements – for technical, financial and legal experts/project company or host government
(ii) Consortium agreement – for sponsors/project company
(iii) The project or concession agreement – for government/project company
(iv) Off-take agreement – off-taker /project company
(v) Construction agreement – contractor project company
(vi) Equipment supply contract – various suppliers/ O & M operator/ project company
(vii) Fuel contract – fuel supplier/ project company
(viii) Operation and maintenance contract - O & M operator/ project company
(ix) Insurance contracts – insurers or re-insurers/ project company
(x) Financing contracts – lenders/ O & M operator/ project company
(xi) Security package – lenders/ O & M operator/ project company

Why BOT

The Global Trend

The World Bank has estimated that in the next ten years, developing economies alone will need to invest over US$ 200 billion per year, US$ 2 trillion by 2005, in basic infrastructure. Raising of these vast sums and effectively implementing this development is clearly far beyond the capability of the public sector alone. The world is in the midst of a revolution with regard to who is financing building, owning and operating infrastructure facilities. Privately financial projects finance on a non-recourse basis are accounting for an ever increasing portion of new facilities and according to the World bank, this global trend is expected to continue.

Debt Burden

Uganda is highly indebted to International Financial Institutions. The external debt still stands at US$ 3.6 billion. Debt servicing which stands at US$ 120 million per annum cripples the government's efforts to finance infrastructure development (Price Waterhouse, 1996)

Scarcity of Public Funds

There is an increasing gap between the resources available to the government to finance infrastructure developments and the demand for such investments. Scarcity of public funds and constraints in the access to sovereign loans and foreign technology have adversely affected the public sector role in infrastructure development

Structural Adjustment Programme
Structural Adjustment Programs to control external debt have severely reduced the capacity of the government to invest further in infrastructure.

Past Performance
According to Tumuhairwe (1997) public projects experience significant cost overruns, quality and maintenance problems and past performance of these projects has indicated that heavily subsidised prices like in water supply, result in insufficient funds to contribute towards repayments of loans.

Enormous Infrastructure Requirements
Uganda's infrastructure requirements are enormous. AES Nile Power Ltd has estimated that Uganda needs US$ 8.2 billion to invest in infrastructure over the next 12 years. (The Monitor, August 28 1998). (Also see table 1 below). Madhvani Group of Companies the sister parent company which has teamed up with AES corporation to build a US$460 million hydro-electric plant at Bujagali argues that the government cannot meet this need without involving the private sector (The New Vision August 13, 1998)

Table 1: Uganda Infrastructure Requirements (1998-2010)

Sector	Amount (US$)' Million	Amount (US$)' Million
Power:		
Generation	1,500	
Transmission	500	
Distribution	500	2,000
Roads:	2,000	2,000
Railways: (Including truck, permanent way, wagon, locomotives, communications, signaling)	1,500	1,500
Airports:		
Entebbe	100	
Strategic airports	50	150
Communications:		
Posts	50	
Telecommunications	1,000	1,050
Water:		
NWSC	500	
Rural Water Supply	500	1,000
Total Financing Requirements		**8,200**[1]

[1]The total financing requirements of US$ 8,200,000,000 is equivalent to 150% of annual GDP of Uganda (Source AES Nile Power Ltd)

This paper concentrates exclusively on the BOT option.

The Bot Procurement Method in Uganda

The BOT procurement method in Uganda has been used on the following projects:

2.1 Small scale projects:

- The construction of Kampala City Council markets located at Bugolobi, Nateete, Owino and Nakawa
- The rehabilitation of Queensway pedestrian bridge at Katwe

2.2 Medium scale projects:

- The proposed rehabilitation of Crested Towers
- The proposed rehabilitation of Grand Imperial Hotel formally under the management of Uganda Hotels Ltd

2.2 Large scale independent power projects

- The AES NILE power at Bujagali falls
- One at Kalagala falls, is to generate 450MW
- The one at Karuma falls is to genrate 50MW of power

Successes in Uganda's Bot

Attraction of Investors

Uganda has so far succeeded in attracting three large scale investors in the energy sector. In the urban development sector a number of small scale investors have been attracted to put up the Kampala City Council markets

Legislature

Although the government of Uganda has not yet made specific BOT laws, a number of provisions to promote the BOT schemes already exist within the laws of Uganda. These cover ownership of land, environmental issues, labour investment (taxes, incentives etc) and arbitration.

Challenges

Uganda is faced with a number of challenges in developing the BOT procurement system.

Lack Clear Understanding of BOT Concept

In Uganda the concept of BOT is generally unclear even to policy makers and there is appreciable lack of understanding in its working, including it various forms of BOO, BLT and ROL. This is evidenced by the number of motions related to BOT projects that have been thrown out of parliament

Lack of Legal and Regulatory Framework

No standard international legal framework exists comparable to say the FIDIC conditions of contract, within which BOT projects operate. A different payment system on a case by

case basis has to be evolved to suit each contract in the concession, with due respect to the particular circumstances associated with the country of operation. This approach of preparing complicated project agreements tends to add substantially to project costs because of the time needed to draw up the agreements, the difficulties in managing them and the uncertainty they involve. It is not possible to develop standards BOT contracts, which could be used throughout the world because regulatory regimes, legal systems, cultural norms, political risks vary from country to country.

Standardisation is desirable for the satisfactory execution of complex projects such as BOT infrastructure projects. Benefits of standardised documents include:-

- Contracting parties and financing institutions are familiar with standardised forms of contract, and which maintains a fair and reasonable balance between the differing objectives of these parties, allocating fairly the risks and responsibilities.
- Standard conditions also provide a stable base for training in technology transfer.
- Contracting parties react favourably to standardised forms of contract, which reduces the likelihood of unsatisfactory performance, increased costs and disputes.
- The comparison and evaluation of bids is greatly facilitated if the bids are based on some well known contractual terms.
- Nationally standardised project agreements allow the government to plan, monitor and supervise private sector infrastructure project.
- The costs of BOT projects and time needed to prepare and develop them may be reduced greatly by using standardised documents.
- Use of standard documents can greatly facilitate subcontracting and the negotiating of other project – related contracts, including the construction contracts and the credit agreements.
- Standard documents are more carefully prepared resulting in a higher contract quality than case-by-case project agreements which are often drafted under stringent time constraints.

Risks in Uganda's BOT Projects

BOT projects are facing a number of risks as summarised in table 2 below. However, the risks of corruption, exchange rate and convertibility financial closing and inflation have proved a real challenge in the Uganda's BOT projects.

Table 2: Summary of Risks in Uganda's BOT Projects & Mitigation Measures

	Risk Category	Mitigation Measures
1.	Change in laws	• Government guarantees • Political risk insurance • Good relationship with government
2.	Corruption	• Good relationship with government • Enter into contract to prevent corruption
3.	Delay in approval	• Joint venture with local government partners • Good relationship with government • "one stop" agency to approvals
4.	Expropriation	• Political risk insurance • Support of host government
5.	Credit worthiness of government utilities or private entities	• Credit worthy off-taker • Good relationship with government • Audit government utilities/private sector entities
6.	Force majeure	• Government guarantee to extend concession • Insurance • Host government financial involvement
7.	Exchange rate & convertibility	• Foreign exchange guarantee from government • Dual – currency contracts • Hedging devices
8.	Financing close	• Government equity financial involvement • Equity stake in kind • Use initial public offerings
9.	Associated infrastructure	• Take-or-pay contract in PPA • Government to guarantee full capacity power plant for a minimum number of hours per year • Government guarantee for transmission
10.	Tariff adjustment	• Tariff adjustment formula • Good relationship with government and a positive public image • Tariff indexed to US Dollar
11.	Inflation	• Hedging devices • Standby commitment by host government

Corruption

Almost all BOT projects in Uganda have experienced cases of corruption, Boe *et al* (1997) has reported that the general attitude in Uganda towards corrupt practices is quite relaxed. Contractors in Uganda describe goals like winning a contract, getting plans approved or getting payments as being dependant on corrupt practices.

The people consider corruption merely as a necessary part of business and a way to maintain good business relations. A Ugandan contractor when asked about corruption replied: "I admit that I rarely get any jobs without paying something extra" "I have lost lots of jobs just because of my unwillingness to pay bribes" It is quite clear that corruption is a moral dilemma in Uganda.

Exchange Rate and Convertibility

These are risks of non-availability of foreign exchange to service the debt and the inconvertibility of the revenues that may be in local currency. The risk of exchange rate and inconvertibility does exist in Uganda and is generally critical.

The monetary developments from 1966 – 1998 reveal that the official exchange rate which was seven Uganda shillings (U.Shs.) per United States (US) Dollar in 1966 has grown to 1055(U.SHs.) in 1997/98, (see table below). Disregarding the numerous changes in currency that occurred during this period, this change represents an average depreciation of 425 percent per year, which is very significant according to the analysis by Bank of Uganda. This shows that the value of the Uganda Shillings has suffered severely over the last 30 years.

Table 3: Exchange Rates/Inflation Rates 1966 – 1998)

Year	Exchange Rate (U.Shs/Dollar)	Inflation Rate (% p.a)		
		L.I	M.I	H.I
1966	7.14	1.6	(5.5)	(10.9)
1967	-	4.0	5.8	5.2
1968	-	7.8	4.7	2.5
1969	-	2.9	7.5	15.3
1970	-	2.1	(10.4)	2.1
Oct. 1971	7.14	3.4	24.8	15.8
1972	-	4.6	1.2	(3.0)
1973	-	12.0	12.9	24.4
1974	-	36.2	49.5	67.2
Dec. 1975	-	16.2	18.9	20.2
1976	-	30.4	38.8	46.6
1977	-	39.2	74.9	88.5
1978	-	29.5	47.6	36.5
1979	-	n/a	n/a	216.6
1980	7.50	n/a	n/a	11.9
May 1981	76.97			
Aug. 1982	99.30			
June 1984	300.00			
Dec. 1985	1,401.40			
Feb. 1986	1,470.00			
Aug. 1886	1,400.00			
Dec. 1986	1,400.00		358.4	144.1

May 1987	60.00			
July 1988	150.00			
Dec. 1988	165.00			
Dec. 1989	n/a			
Dec. 1990	540.00		57.6	
July 1991	750.00			
1992	n/a		45.4	
1993	1,000.00		4.1	
1994	933.00		6.9	
1995	1,023.00		3.4	
1996	1,041.00		8.0	
1997	1,055.00		7.7	
Aug. 1998	1,230.00			
Sept. 1998	1,300.00			

Inflation Risk
Table 3 above shows that the country enjoyed a relatively low rate of inflation between 1966 and 1972.

The annual inflation rate of the middle income group declined by 5.5% in 1966 and rose by 1.2% in 1972. The low rate of inflation was attributed to the relatively good performance in the economy.

The period 1973 to early 1980s produced years of economic decline and hardships triggered off by the expulsion of the Asians. This caused inflationary pressures to intensify during the first half of the 1980s and reached the highest level of 358.4% annual rate of inflation for the middle income group in 1986 and 144.1% for the low income group in this period.

Since 1986 when the National Resistance Movement took power, immediate steps were taken to restore order and stability by pursuing tight monetary and fiscal policies. This orientation of policy contributed to a dramatic improvement in the economy's performance as the rate of growth in real terms accelerated while inflationary pressures subsided. Since 1987 the inflation rate has dropped from 163% for the middle income group to an annual rate of 7.7% in 1997. From the above analysis, the rate of inflation follows the same trend as the performance in the economy. As long as there is good governance, there is a relatively low rate of inflation.

Financing Close
For a project to achieve a financing closing, all contracts to do with the assembling of debt, equity and credit enhancement have to be signed.

According to IFC (1996) average financial closure for IFC funded projects has been seventeen months for 1994 fiscal year and eleven months in 1996.

AES Nile power has succeeded in raising equity (from its parent companies) and debt from foreign financial institutions, it has not yet got credit enhancements it expects from the government of Uganda (The Monitor, August 03 1998). The credit enhancement of the Uganda Government giving a guarantee on behalf of its utilities (UEB) to off-take the output and the element of 'take or pay' in the off-take agreement caused the members of parliament sitting on the 7/8/98 to suspend the debate on this project for some time. (The Monitor August 28,1998).

It is expected that for some time the risk of financial closure will remain as long as we still have to depend on foreign debt to finance large – scale infrastructure projects and as long as the Uganda Government will be expected to give credit enhancements (like guarantees) for its utilities.