

UKULUNGISA PROJECT PREPARATION FUND

ANNUAL REPORT

For the period 01 July 2009 to 30 June 2010



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1. CHAIRMAN'S REPORT

The UPPF has successfully completed its second year of operations despite some challenges.

Thanks are due to the Business Trust for the confidence it has continued to show in this joint venture. Thanks are also due to PPT KZN and INCA as the two implementing partners and in particular to Mark Misselhorn and Robert Mann of PPT and to Helge Switala and Nicolette Botha of INCA all of whom have continued to drive the activities and processes and have ably dealt with many of the challenges encountered thus far. I would also like to thank Noel Jelliman for his chairmanship of the Operations Committee and to my fellow directors for their support and cooperation over the past year. Our team has proved its worth as will be evident from this report.

Probably the most notable achievement in the past year is the finalisation of the new dispensation framework following a process of intensive engagement with the Business Trust and its appointed agents, Matthew Nell and Associates. This new framework has significantly improved UPPF's product offering and has side stepped the historical barriers which had hampered the uptake of projects by the Fund. These historical barriers resulted mainly from the lack of a national procurement status and the absence of unequivocal support from national government, both of which were founding assumptions for UPPF at the time of its establishment. Under these circumstances, the initial UPPF Business model could not be successfully implemented as procurement by Municipalities became a major obstacle. A contributory factor was the perceived high cost of UPPF's services and funding. This largely relates to the fact that UPPF tends to provide a higher specification of preparation relative to that typically undertaken and needed to price for risk and the cost of finance in order to achieve the sustainable business model upon which its initial Business Plan was premised.

The new dispensation framework utilises only grant funding and UPPF has now made rapid progress in identifying suitable projects. Within three months of the end of its 2009/10 financial year, UPPF had allocated all of its available preparation funding of R7.5million and had established a significant pipeline of 24 preparation projects, spanning a wide range of different infrastructure typologies. These projects have the potential to leverage approximately R732 million in capital funding benefiting more than 136,000 disadvantaged households.

Another major achievement was that, as a direct result of UPPF's activities, CoGTA commenced with a process of more carefully assessing the need for more systematic project preparation within MIG and how this could be procured. Whilst there has not yet been any public statement in this regard, indications are that CoGTA intends to now find ways to fund project preparation and enable procurement of the necessary capacity. Irrespective of what role UPPF may play in this regard in the future, this has the potential to have significant long term and highly beneficial impacts for infrastructure delivery in South Africa.

Some of the other achievements of the year are summarized below:

- ✓ UPPF received public appreciation from the Municipal Manager of the Mandeni Municipality for its role in addressing core infrastructure necessary for several housing projects which are a priority for the national minister.
- ✓ UPPF input has been provided as an input into CIDB practice notes (including on their preparation flow charts), it being noted that these practice notes are reportedly to be utilised and referred to in future by government departments such as Public Works and CoGTA.
- ✓ All management, governance and administration structures and systems have been successfully implemented and refined where the need has arisen.
- ✓ Our 2008/9 audit was successfully completed and was unqualified.
- ✓ Project toolkits have been further enhanced.

Significant lessons can be drawn from the first two years of UPPF's operation, the most important of these are outlined below:

- ✗ The initial concept which the Business Trust and SPAID wished to test (i.e. of a sustainable private sector preparation fund) is not viable under current operating and procurement circumstances.
- ✓ It has however been determined that there is a significant demand for grant funded preparation funding as well as the additional capacity and technical support which UPPF can bring to bear within the preparation process.
- ✓ UPPF's existing preparation funding resources have been unable to meet the scale of this demand (given its funding limitations) and this suggests the potential for UPPF to consider raising additional preparation funding during FY2010/11.
- ✓ There appears to be a growing awareness within government and the private sector of the need for more rigorous and systematic project preparation (this being one of UPPF's founding assumptions), even if this is occurring in a relatively slow and incremental fashion.

Key Challenges going forward include:

- ✗ The need to position UPPF better on the developmental agendas of national and provincial government, including in relation to CoGTA and MIG.
- ✗ The need to promote greater understanding of UPPF and what it offers among Municipalities.
- ✗ The need to raise further preparation funding for UPPF.

In closing it is important to note that UPPF is uniquely positioned to play a meaningful and value-adding role in addressing infrastructure backlogs, providing support to government and in helping to improve the lives of the poor in South Africa. We look forward to continuing to playing this role and in taking up the challenges during 2010/11.

2. NEW DISPENSATION

A revised business model for UPPF was finalized between UPPF and the Business Trust following a process of extensive engagement between the parties during the first half of 2010. The new business model, activated through an addendum to the pre-existing Services Agreement signed in July 2010, gives UPPF significantly greater operating flexibility in order to more rapidly generate a project pipeline, including a batch of demonstration preparation projects.

It is noted that the need for this revised business plan arose from a range of factors beyond UPPF's sphere of influence and was not indicative of poor performance by UPPF or due to a lack of care in managing the initiative. These factors consist mainly of the lack of unequivocal support from national government and the absence of a confirmed UPPF procurement status by government. Both of these factors were founding assumptions of the original business plan and their absence resulted, amongst other things, in unwillingness on the part of Municipalities to make use of UPPF's services. These constraints have made it impossible for UPPF to achieve the objectives of the original business plan and generate a project pipeline in terms of its confines.

The following are the principle changes to UPPF's Business Model which have been agreed:

- **Funding quantum:** The total quantum of funding made available to UPPF by the BT has been reduced from R15.5million to R11.75million. The Business Trust's main rationale for the reduction is that their original concept of an independent, private sector sustainable project preparation fund is no longer achievable within current circumstances and constraints.
- **Funding model:** Taking into account past expenses and drawdowns, the total remaining budget available for the period post 01 July 2010 is R9,580,786. It is noted that provision is made an operating overhead and an allocation for variable project administration costs in the form a fixed percentage of the total Project Budget (i.e. Project Services Fee):

Milestone based toolkits & technical assistance tools	233,081 ¹
Project Budget (Project Services Fee)	8,737,500
<i>Project preparation costs</i>	7,500,000
<i>UPPF project administration costs (@14.16% of project cost)</i>	1,237,500
Variable UPPF operating overheads (@ 6.98% of project budget)	610,205
Total	9,580,786²

¹ This amount is made up of the R180,600 initially allocated + a rollover amount of R52,481 of un-utilised operating budget from the 2009/10 financial year.

² This amount is made up of the R9,528,305 initially allocated + a rollover amount of R52,481 of un-utilised operating budget from the 2009/10 financial year.

- **Payment terms:**

Payments from the BT to UPPF are made on the following basis:

Project budget (Project Services Fee)	
Upon Opsco approval	5%
Balance upon signature of preparation service agreement	95%
Total	100%
UPPF Variable operating overhead	
Upon Opsco approval	1.74%
Balance upon signature of preparation service agreement	5.24%
Total	6.98%
Toolkit and technical assistance tools	On achieved milestones

- **Revolving Fund Projects:** Business Trust preparation funding may now be utilized without any matching INCA funding in order to fund the preparation of projects. In addition, no margin or markup has to be charged. This means that the budget provided by UPPF for preparing a project, either to a municipality or via a private sector service provider, is only for the direct costs of preparing the project and there is no additional premium or pricing for interest, risk or general UPPF overheads.
- **Designated Demonstration Projects:** As a special dispensation, Business Trust funding could also be utilized on a grant (as opposed to loan) basis on an initial batch of demonstration projects. The intention was to obtain at least one if not two demonstration projects in each of the categories listed below and to develop the appropriate scope and cost norms for preparing the projects:
 - Bulk Water Treatment
 - Bulk Waste Water and Sewerage Treatment
 - Bulk Water supply
 - Water reticulation
 - Sanitation reticulation
 - Landfill Sites
 - Roads and bridges
- **Technical Assistance Tools / Toolkits:** There is an increased emphasis by UPPF on developing preparation 'toolkits' (standard scopes of work and cost norms) for various project types as potential inputs into both CIDB and CoGTA processes focusing on the preparation of infrastructure projects. This takes the form of a specific milestone. The principle is to provide useful inputs to the CIDB and CoGTA in order to assist with the future rollout of the new CoGTA approach to the preparation of MIG projects which has been mooted.

- **Institutional Form of UPPF:** UPPF remains in its current institutional form (a JV between Inca and PPT) until at least all Business Trust funding made available to UPPF has been disbursed as per the Opsco mandate for each project. UPPF may elect to continue to function thereafter or else it may elect to allocate any recovered preparation funding to PPT who would in that event continue to manage the revolving preparation funds on the same basis (i.e. to fund the preparation of selected municipal infrastructure projects) until such time as there was no funding remaining.
- **Special conditions:** In order to qualify for payment on any project, UPPF must:
 - Obtain the approval of its Operations Committee in respect of that project by 30 September 2010, and
 - Ensure that PPT concludes an agreement for the rendering of the applicable Preparation Services with the applicable municipality or private sector implementing agent by 30 November 2010.

3. PROGRESS WITH PROJECTS

Note: Progress with projects is reported as at 07th October 2010, since significant movement in project activity has taken place since the end of the financial year (30th June 2010).

3.1. Introductory comments

The new dispensation framework for UPPF has removed the main historical barriers that have hampered the uptake of projects by the fund in the past. It has also effectively changed the UPPF project identification process from one focused on marketing to one focused mainly on eliciting project nominations from private sector entities providing services to Municipalities.

To this end a project nominations proforma was drafted and provided, mainly to private sector firms to enable them to identify potential projects for possible UPPF assistance. The advantage of this approach is that private sector service providers, who have some existing or potential procurement arrangement with the Municipality, are now able to identify and champion projects from the responsible municipality. Furthermore, these service providers have an incentive to secure UPPF funding as this generates work and therefore fees and downstream project work for them.

Once PPT has received a project nomination proforma it is assessed at a pre-screening level, either internally, or through an independent outsourced evaluator. If the project receives a positive pre-screening assessment, then the nominator provides a more detailed project profile and a preliminary assessment is undertaken by PPT (or an independent outsourced evaluator). If the project receives a positive preliminary assessment it is then recommended to UPPF's Opsco for possible funding support.

During this high-intensity period UPPF extended its marketing and project identification reach through the commissioning of a number of outsourced service providers who have provided project management support in terms of pre-screening and assessing projects. Outsource service providers utilized include Mr. Charles Sellick (W. Cape based), Liesel Du Plessis (E. Cape based) and Mr. Jannie Cronje (KZN based). These service providers were tasked with both marketing UPPF to prospective clients and identifying potential projects for further assessment.

While some Municipalities (e.g. Newcastle, KZN) have provided project nominations these have generally been 'wish lists' of projects which they cannot fund in their current MIG funding envelope and for which they are hoping UPPF can source additional funding to assist them. It is hoped that municipalities will improve their project nominations once they have a better understanding of the Fund and the value it can offer, even within existing MIG funding allocations.

3.2. UPPF Approved projects

All preparation funding available from the Business Trust has been allocated to projects approved by Opsco as of 17th September 2010. A total of 24 projects have been approved and a schedule of these projects is contained in **Appendix 2**. These projects span a range of infrastructure projects including: waste water treatment, bulk water supply, land fill sites, water supply, bulk water reticulation, rural housing and special needs housing. These projects have the potential to assist approximately 136,202 disadvantaged households to give rise to capital funding leverage of approximately R732 million (assuming all projects emerge as feasible and succeed in obtaining capital funding).

Approvals were made at the following Opsco meetings:

- 9 projects were submitted to Opsco on the 24th of May 2010 of which 7 were approved ³;
- 11 projects were submitted to Opsco on the 30th of July 2010 of which all 11 were approved;
- 10 projects were submitted to Opsco on the 17th of September 2010 of which all were approved.
 - 6 are 'A string' projects and;
 - 4 are 'B string' projects which can be utilized in the event that any project does not meet its pre-scribed conditions or is terminated early.

³ Subsequently 2 of these projects have fallen off due to difficulties encountered with the responsible Municipality, details on this issue will form part of the next UPPF progress report.

3.3. Demonstration projects

Project Type	Project Name	Municipality	Province
Bulk Water Supply	**ORIO Application	Illembe DM	KZN
Bulk Water Supply	Refurbishment of Waainek Bulk Water Supply	Makana LM	Eastern Cape
Waste Water Treatment Works	Upgrading of the Klipplaar WWTW	ikwezi LM	Eastern Cape
Landfill Sites	Hlabisa Landfill	Hlabisa LM	KZN
Landfill Sites	Jozini Regional Landfill	Umkhanyakhude DM or Jozini LM	KZN
Water reticulation - bulk supply & reticulation	*KwaHloko	uThungulu	KZN
Rural Sanitation	*Melville	KwaDukuza	KZN
Rural Water Supply	*Riebeck East (Alt water supply)	Makana LM	Eastern Cape
Rural access roads, bridges	*Khakhu to Mangwele Access Road	Mutale LM	Limpopo

Notes:

* Demonstration projects added in OpsCo approvals subsequent to the initial batch of demonstration projects approved in May 2010 in order to cover gaps in project typologies targeted.

** The Orio application was approved in the demo batch on the 24th of May however it is actually an application for international funding, does not include significant classic feasibility work and will thus not significantly assist UPPF in developing its toolkits. However there are additional projects in this category to complete the toolkits.

The demonstration water treatment project for Clarkson has been cancelled. It is however noted that there is a similar project on UPPF's 'B String' list of replacement projects in the form of the Alicedale water Treatment plant.

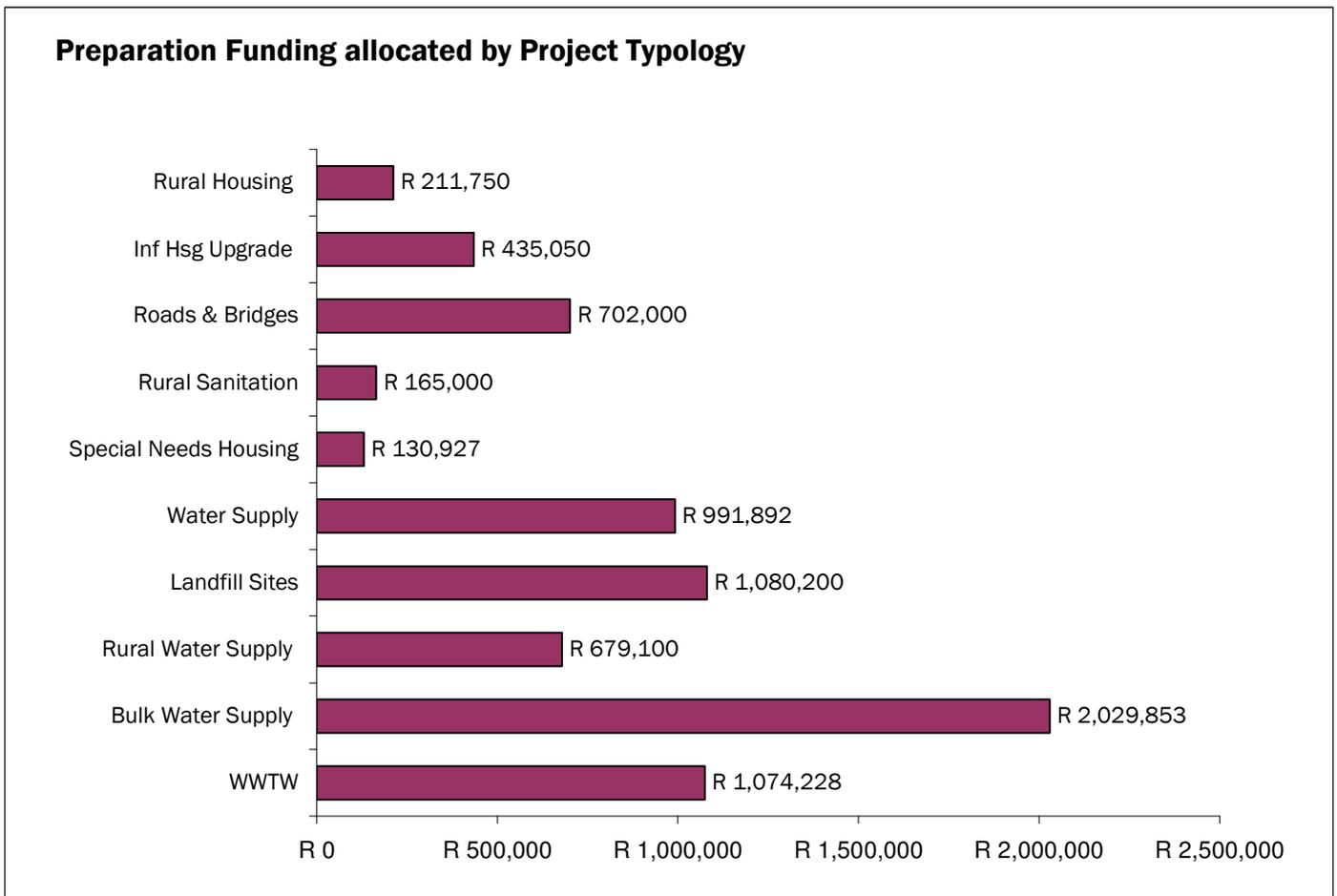
3.4. Pre-screening and assessments

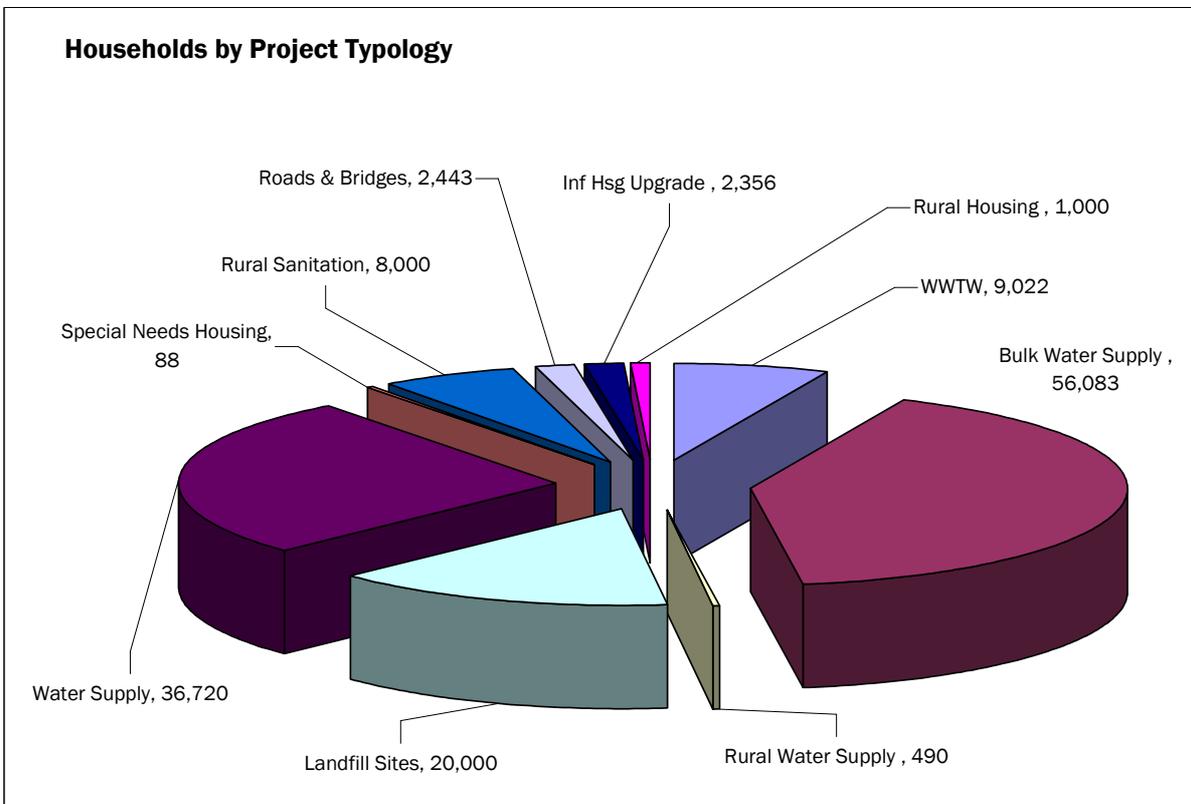
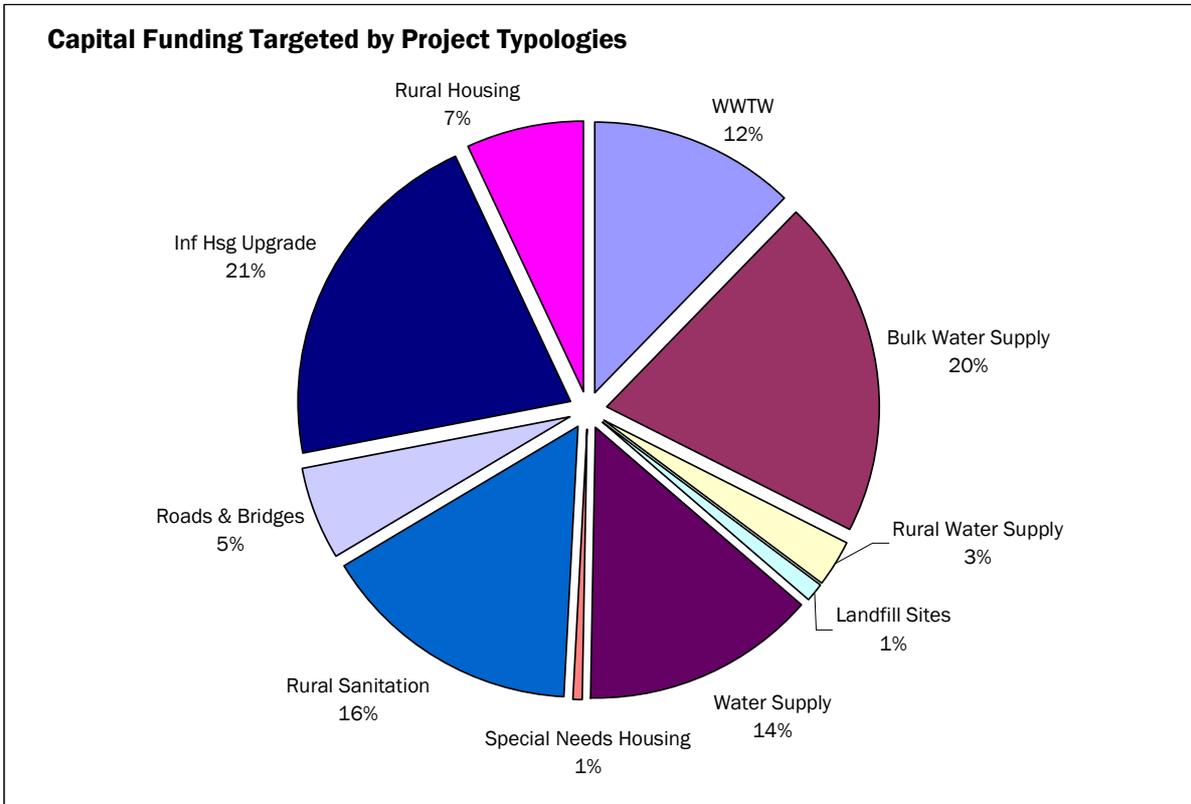
On the new dispensation, a total of 124 projects have been identified and pre-screened, 35 of which have been subject to full preliminary assessments and 24 of which have been approved by Opsco. This is over and above projects arising from the 'old' dispensation where 93 were identified of which 61 were subjected to assessment and pre-screening (but with only one project becoming approved - KwaMbotho). Please refer to Appendix 3 for schedules of all identified and assessed projects.

3.5. Capital funding leverage

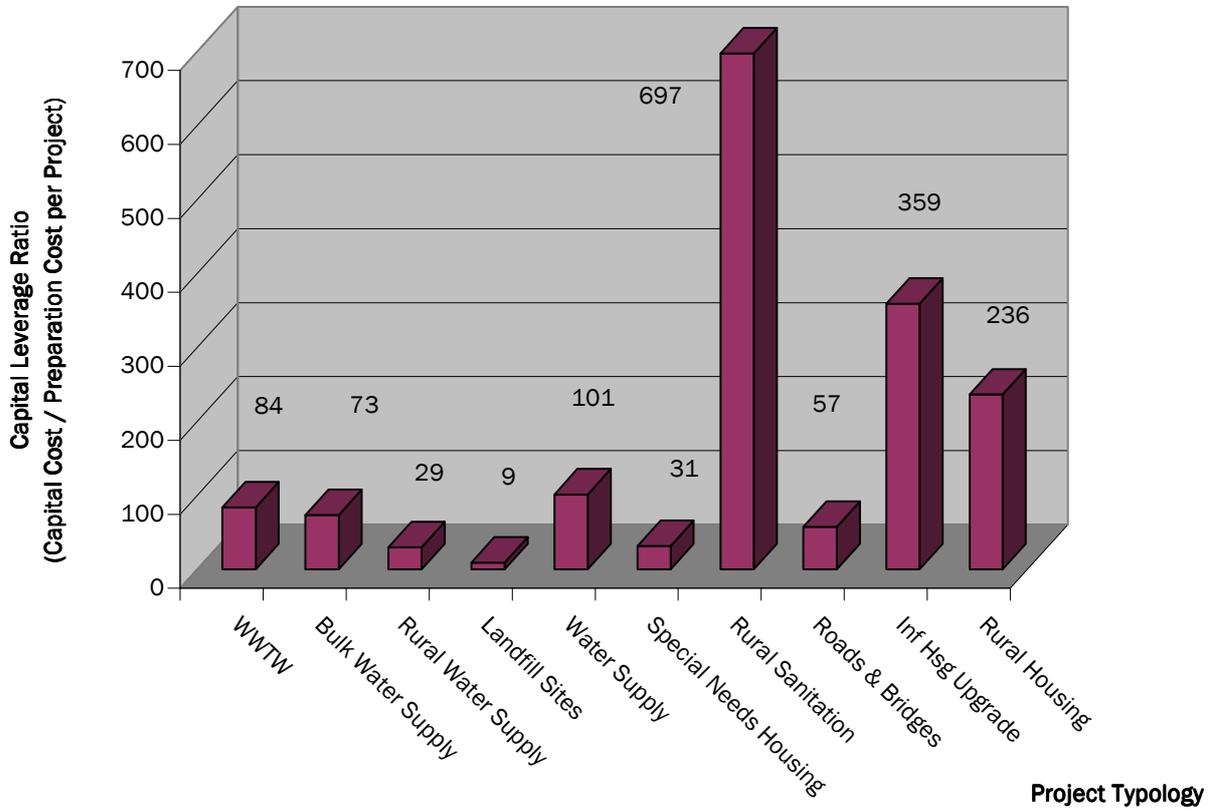
No capital leverage has yet been secured.

3.6. Graphs and charts





Project Typologies by Capital Funding Gearing



4. PROGRESS WITH TOOLKITS

Scope of work (as per revised Business Plan)	Progress
<p>i Initial meeting(s) and / or telephone discussions with the CIDB or their professional team in order to elicit CIDB interests & requirements in respect of toolkits.</p>	<p>The latest CIDB practice notes were sourced from Jan Watermeyer on 31st August 2010 following a short telephone discussion. PPT project toolkits specimens were sent to Ron on 01st September. The latest practice notes and flow charts were studied by PPT. Detailed comment was provided by PPT to Ron on 09th September (refer to copy of email attached). This comment included some of PPT's concerns on a range of key issues. Further examples of document formats useful to the CIDB from a procurement perspective were provided to PPT by Ron on 13th September. Sufficient engagement has now occurred to guide PPT in the further development of its toolkits. It is however emphasized that, whilst PPT will make adjustments to extent practical, it does not have budget to develop entirely new toolkits specific for the CIDB and any amendments or additions will need to take place within the broad structure and function of UPPF's existing toolkits. One of the possible changes currently under consideration by PPT is to slightly refocus the toolkits so as to enable them to assist more effectively with procurement (e.g. placing the scope of work in tabular format with guidance notes alongside each each work package to assist the client side project manager / client).</p>
<p>ii Further development and refinement of PPT's existing project toolkits for demonstration project types outlined above (or as amended in agreement with the BT). This will consist of the following elements:</p> <ul style="list-style-type: none"> • Scope and cost norms which identify and describe individual professional work packages, including the indicative costs, professional skills and timeframe required for each one. • Information on primary capital funder targeted including: specific funder requirements / decision making criteria, decision making flow chart where available, proforma funder documents / application forms, relevant funder guidelines (e.g. relating to project specification). • Project risk profile (identifying the typical main risks / threats to project success and how they can be mitigated through project preparation). • Explanatory user comments for each project type. 	<p>All toolkits have been internally reviewed by UPPF's National Co-ordinator. PPT is currently in the process of further refinement through reviews by external specialist engineers.</p>

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iii Review of each project toolkit by a suitably qualified and experienced engineer and revision to each toolkit based on this input.	One engineer (Charles Sellick) has already been engaged and is in the process of reviewing both the format of the toolkits as well as the content for the two water supply toolkits. A detailed telephonic meeting has already taken place and initial feedback on structural issues obtained from Charles. PPT is in the process of finalizing its selection of two additional engineers for the other toolkits.
iv Provision of the above project toolkits to the CIDB for comment.	Comment has already been obtained from the Ron Watermeyer on draft toolkits in terms of their structure. Ron does not envisage providing detailed comments on the scope of work and cost norms.
v Limited amendment to toolkits based on CIDB comments.	The process of amendment is already underway (see above).

5. FINANCES

Elsewhere in this report mention was made of the New Dispensation that UPPF entered into since the start of the FY2010/11. This financial report covers the year ending 30 June 2010, i.e. during the period that the previous dispensation was still in place. The audited financial statements are attached hereto. These were prepared in accordance with South African Statements of Generally Accepted Accounting Practice and in the manner required by the Companies Act of South Africa.

Ukulungisa's finances remain on a healthy footing. The company was audited by Deloitte & Touche and the auditors provided an unqualified audit opinion.

UPPF is a small service company with insignificant own assets. The approval of the KwaMbotho project resulted in the payment of PPT Services Fees of R43,733 during the year. This was funded by a R13,333 contribution from the Business Trust and a loan of R30,400 from INCA's Revolving Credit Facility. The project finance liability of R32k on the statement of financial position reflects this advance and its accrued interest to date. In the New Dispensation the Revolving Credit Facility will not have to be accessed any longer.

The accumulated deficit of R48k relates to certain expenses incurred but not yet recouped from Business Trust, viz. Audit fees for the current year and other smaller expenses like bank charges.

Revenue in the form of Establishment Services Fees of approximately R1.03 million was paid by the Business Trust for establishment services rendered. These funds were used to pay operating expenditure of the Fund, which were incurred mainly by the two joint venture partners. These payments were done on the basis of approved VAT invoices, once the cash was received from the Business Trust.

UPPF is established and set up with financial controls in place positioning it well to pursue any new opportunities that may arise in future.