A Compendium of Good Practices on Managing the Fiscal Implications of Public Private Partnerships in a Sustainable and Resilient Manner

Volume II

Country Case Studies

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PPIAF
Enabling Infrastructure Investment

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Methodology Used For Case Studies

I. Methodology Used for Case Studies

The study draws on the experiences of 10 economies representing all regions and different income groups that are at various stages of development of their fiscal commitment and contingent liabilities (FCCL) frameworks and practices. Countries with federalized political systems (Australia and Pakistan) were studied at the state level (Victoria state in Australia and Sindh state in Pakistan). The list of economies is presented in Table 1.1 below.

Table 1.1: Selected Countries for Case Studies

Country/State	Income Group	Region*
Australia (Victoria state)	High income	OECD - High Income
Chile	High income	OECD - High Income
Philippines	Lower middle income	EAP
Pakistan (Sindh state)	Lower middle income	SAR
Kenya	Lower middle income	SSA
Georgia	Upper middle income	ECA
Türkiye	Upper middle income	ECA
Peru	Upper middle income	LAC
Jordan	Upper middle income	MENA
South Africa	Upper middle income	SSA

* EAP = East Asia & Pacific, ECA = Europe & Central Asia, LAC = Latin America & Caribbean, MENA = Middle East & North Africa, OECD = Organisation for Economic Co-operation and Development, SAR = South Asia Region, SSA = Sub-Saharan Africa

I.1. Selection criteria

The main criteria used for country selection include:

- Regional and income group diversification;
- Common law versus civil law jurisdictions;
- Sovereign and sub-sovereign jurisdictions;
- Varying levels of quality of PPP frameworks, as assessed by the Economist Intelligence Unit through its Infrascope methodology, which indicates readiness and conduciveness for PPPs;
- Varying levels of development of FCCL frameworks, based on the data accumulated as part of the Benchmarking Infrastructure Development (BID) 2020 study;[1] and
- Size of a public-private partnership (PPP) program, as measured by number of projects and investment amounts relative to gross domestic product (GDP) in each economy.

It was important to select economies with meaningful PPP programs so they could, at least theoretically, have been exposed to fiscal risks related to PPP projects and have either practical tools in place to manage those risks or established FCCL frameworks. The intention was to identify cases with PPP programs that approximated a value of

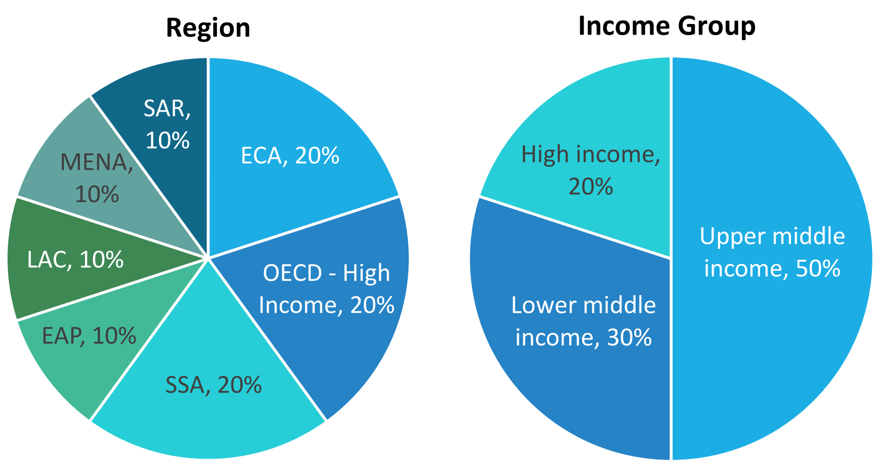
[1] Benchmarking Infrastructure Development (BID) 2020 assesses the quality of regulatory frameworks worldwide to develop large infrastructure projects, benchmarking them with internationally recognized good practices, both for PPPs and for traditional public investments (TPIs). The PPP survey measures key characteristics of a regulatory framework applicable to PPPs at the different stages of a project cycle, including its preparation, procurement, and contract management, with a special module on unsolicited proposals. Background information on regulatory frameworks and institutional arrangements is also included in the report for contextual purposes. The assessment of the preparatory stage includes several questions that are typically part of the FCCL framework and is therefore used as a proxy for quality of the FCCL framework. For more details, refer to: https://bpp.worldbank.org/.

at least 5 percent of the size of the economy as measured by GDP.[2] The province of Sindh in Pakistan was added because it's a fairly established PPP market with an appropriate PPP framework and because it highlights the challenges of a sub-sovereign PPP jurisdiction. Chile was also included, even though the size of its PPP program (although quite substantial) is less than that of its peers in relation to GDP, because the Chilean approach to FCCL management is highly regarded worldwide.

Regional and economic spread

The 10 selected economies allow for effective representation of various regions and income groups. The only income group that was not considered is the low-income group, because the PPP markets in these economies tend to be in a nascent stage, and their PPP frameworks—let alone management of fiscal commitments—are mostly not well advanced.

Figure 1.1: Regional and Economic Spread of Selected Cases



EAP = East Asia & Pacific, ECA = Europe & Central Asia, LAC = Latin America & Caribbean, MENA = Middle East & North Africa, OECD = Organisation for Economic Co-operation and Development, SAR = South Asia Region, SSA = Sub-Saharan Africa

Common law versus civil law systems

The selected cases include both common and civil law systems. The nature of the legal system is relevant for the framing of the PPP framework and the related FCCL framework. Whereas jurisdictions tend to regulate their PPP frameworks through the enactment of a PPP law and supporting implementing regulations, common law systems rely more on policy documents and guidance notes. Consequently, in the cases based on a common law system, such as Australia and South Africa, the description of the legal and regulatory framework will present the relevant policy documents and guidance notes, whereas civil law jurisdictions, such as Chile, Peru, and Georgia, will highlight the legislative reforms implemented to facilitate PPPs. Note that this distinction is not strict. There are common law countries such as Kenya that have adopted a PPP law, and there are civil law countries with PPP programs that did not adopt PPP laws.

Varying degree of capacity for PPPs

As an FCCL framework is commonly part of a broader framework for the development and implementation of PPPs, it is relevant to also take into account the overall capacity for PPPs in the selected cases. The adequacy can be approximated through benchmarking exercises provided by the World Bank and the Economist Intelligence Unit.

[2] The size of the economy was based on 2019 GDP on a PPP basis according to World Bank data.

Since 2011, the Economist Intelligence Unit has evaluated the readiness and capacity of a jurisdiction with regard to PPPs through a methodological approach called Infrascope. The methodology evaluates key components of the PPP environment, including: i) enabling laws and regulations, ii) the institutional framework, iii) operational maturity, iv) investment and business climate, and (v) financing facilities. To date, 69 jurisdictions have been reviewed, with an average score of 57 on a scale of 0 to 100. Jurisdictions with a score of 80 and higher are considered mature, 60 to 79 implies a developed PPP market, and 40 to 59, an emerging PPP market. Any score below 40 qualifies as a nascent PPP environment. The selected cases represent a mixture of mature, developed, and emerging PPP markets.

Note that these scores are purely indicative and do not always reflect the latest state of regulations and developments. In the case of Jordan, for example, the Benchmarking Infrastructure Development focuses on preparatory activities that take place prior to implementing a PPP project, ranking the country well below average, whereas Infrascope categorizes the overall PPP environment as developed and above average.

I.2. Cases were analyzed through desk review and authority briefings

Cases were developed by using various sources of information, both public and non-public. Data on the size of the PPP program, number of projects, and investment amounts were collected by referring to several project databases, information supplied by local counterparts (such as the Ministry of Finance, the National Treasury, the responsible PPP unit or agency and similar entities), and their websites. The main databases used include:

- *World Bank Private Participation in Infrastructure (PPI) database. The* PPI database can be found at http://www.ppi.worldbank.org/. It records contractual arrangements for public infrastructure projects in low- and middle-income countries (as classified by the World Bank) that have reached financial close, in which private parties have assumed operating risks, across core infrastructure sectors of energy, transport, water, and information and communication technologies (ICT). It classifies private infrastructure projects according to the following categories: management and lease contracts, brownfield projects, greenfield projects, and divestitures. The data is obtained from publicly available sources, such as commercial news databases, industry publications, and government reports, and is reliant on the availability and accuracy of this source material (this can prevent coverage of small-scale projects due to lack of information). As a result, there may be some disparity between PPI database data and a country's PPP experience, depending on factors such as PPP definition, sectors, and project risk profile.

- *Infrastructure Journal (IJ) database.* The IJ database can be found at https://ijglobal.com/data/search-transactions. Principles used in data collection for the IJ database are similar to those used for the PPI database. However, the IJ database also covers social infrastructure, such as schools, hospitals, universities, and prisons. There is some overlap of projects in the PPI and IJ databases, however certain projects can be found in one database but not the other. Therefore, using both provides a more comprehensive view of a country's PPP program.

For the purposes of determining the number of projects, ICT projects of a purely commercial nature, such as cellular network licenses, were excluded from analysis due to not meeting the definition of PPPs.[3]

Information on the regulatory set-up of the FCCL framework in each economy was obtained from the local PPP laws and regulations and fiscal management-related rules and procedures. The team also consulted analytical reports issued by the international donor and expert communities on FCCL topics that analyzed systems in different countries, as well as analytical publications, news articles, and other publicly available resources. Any missing

[3] For a definition of PPPs, refer to the PPP Reference Guide, version 3: https://openknowledge.worldbank.org/handle/10986/29052.

information, data on the performance of the PPP portfolio during COVID-19 and other crises, government responses to stress in terms of fiscal risk management, as well as any insights, were gathered through interactions with local decision makers on PPP-related fiscal risk issues. These actors vary in each economy and may be either a PPP agency, Ministry of Finance, or other responsible entity. The present study is predominantly an analytical/qualitative review; however, simple quantitative analyses were also performed where necessary to illustrate ideas from a quantitative perspective.

Chapter 1: Australia (State of Victoria)

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Acronyms and Abbreviations

AASB	Australian Accounting Standards Board
CYP	Cross Yarra Partnership
DTF	Department of Treasury and Finance
EoI	expression of interest
FCCL	fiscal commitments and contingent liabilities
GFC	global financial crisis
GSP	gross state product
HVHR	high value or high risk
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretation Committee
IPSAS	International Public Sector Accounting Standards
OPV	Office of Projects Victoria
PPM	project profile model
PPP	public-private partnership
PV	Partnerships Victoria
PVR	Partnerships Victoria Requirements
PSC	public sector comparator
RFP	request for proposal
SRO	senior responsible owner
TEI	total estimated investment
VfM	value for money
VGPB	Victorian Government Purchasing Board

Executive Summary

The State of Victoria has been supported by more than 20 years of experience in public-private partnership (PPP) skills and performance. The establishment of Partnerships Victoria (PV) in 2000 represented a defining moment for PPPs. Other Australian jurisdictions had also developed PPP policies by the early 2000s, mostly modelled on the PV framework. From 2000 to 2020, 32 PPPs were contracted, with more than $A30 billion (about US$23.1 billion) invested to construct social and economic infrastructure. Cumulatively, this translates to approximately 7 percent of Victoria's real gross state product (GSP) in 2019-20. Between 2000 and 2020, PPPs comprised approximately 25 percent of all net infrastructure investments in Victoria.

Australia does not have a specific legislative framework for PPPs; instead, the National PPP Policy and Guidelines set out the processes that authorities should follow in the investment, procurement, development, and operations stages of PPPs, along with standard risk allocations and commercial principles to be adopted. State governments have their own jurisdictional requirements that are followed in conjunction with the National Guidelines.

The State of Victoria has well-developed procedures for assessing proposed PPPs that allow for the review and control of contingent liabilities. PPP proposals are subject to Gateway reviews in compliance with the Gateway Review Process (GRP). The GRP examines projects and programs at key decision points such as at the concept and feasibility stage (based on a preliminary business case). Moreover, the state's entities are responsible for setting their own financial risk policy and objectives in accordance with the Standing Directions 2018. The Standing Directions cover areas such as financial management objectives, policies, and guidance on interest rate, counterparty, liquidity, and operational risks.

Prior to COVID-19, two of the key planks of the medium-term fiscal strategy were: maintaining an operating surplus (generally described as a surplus of at least $A100 million (approximately US$77 million), but in most years the outcome was significantly more than that); and keeping net debt to GSP at a level consistent with maintaining AAA credit ratings. The government in 2018 promised to increase the net debt to GSP ratio to 12 percent in order to fund additional investment, and the rating agencies accepted that this remained consistent with an AAA rating. The accounting treatment of PPPs in Victoria results in a project having a broadly similar fiscal impact on net debt, regardless of whether it is delivered as a traditional project or as a PPP. As a result of the COVID-19 pandemic, net debt has risen significantly above the 12 percent of GSP cap (2020: 16.7 percent), and is expected to rise further in the medium term. The initial breaching of the cap was due to the COVID-19 response pushing the operating result into deficit.

The government took action to mitigate the COVID-19 impact by implementing a range of strategies to support growth in the construction industry, actively consulting with industry stakeholders to develop a broad range of reforms to optimize the way infrastructure is procured and delivered in Victoria. Priority reforms in 2021-22 include redesigning government project development and procurement processes and improving the way past project lessons are shared across government and industry.

In November 2020, the government amended the procurement approach, embedding an incentivized target cost risk-and-reward regime. The Victorian government cited changes in market dynamics under COVID-19, recent feedback from industry engagement, and the desire to strengthen collaboration and partnership during delivery as key reasons for the change in the procurement approach. A key finding from a review during the initial COVID-19 period by the Office of Projects Victoria was that upfront investment in de-risking projects leads to more effective management of costs, fewer claims, and better schedule adherence. The government has lent its support to this approach and has invested in the early development of projects such as the North East Link.

Similar to the overall strategy adopted during the global financial crisis, the Victorian government has resorted to assessing PPP projects on an individual basis and administering specific solutions to ensure each project's success during the COVID-19 pandemic. Going forward, the elevated level of infrastructure investment proposed as part of the COVID-19 response will be a significant contributor to the medium-term growth in debt. The medium-term fiscal strategy has now been modified to focus on restoring economic growth; returning to an operating surplus; and stabilizing debt levels. Hence, though increased infrastructure investment will be part of the COVID-19 response in the next few years, there is considerable uncertainty as to whether the state will be able to maintain that level of investment in the medium to long term.

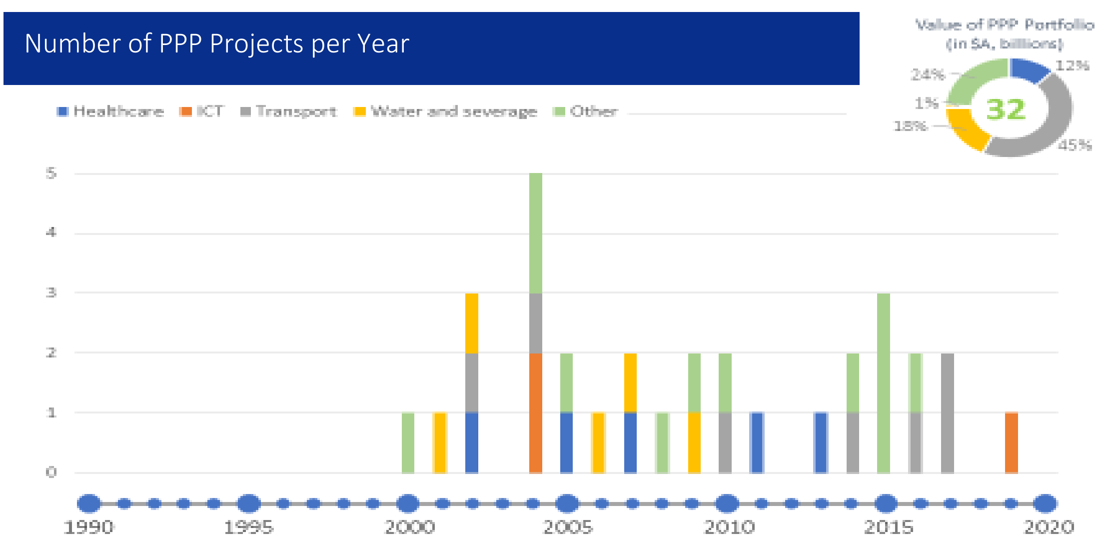
1.1. PPP Experience

The State of Victoria has the most varied PPP project portfolio of all states in Australia, including projects for the provision of utilities for economic and social infrastructure schemes and other technological services. Victoria has over 20 years of experience with PPP projects. From 2000 to 2020, 32 PPPs were contracted, with more than $A30 billion (about US$23.1 billion) invested to construct highways, hospitals, schools, correctional centers, and water projects. Cumulatively, this translates into approximately 7 percent of Victoria's real GSP as of 2019-20. Since PPPs under Partnerships Victoria (PV) began, from 2000 to 2020, they have comprised approximately 25 percent of all net infrastructure investments in Victoria.

The majority (approximately 94 percent) of PPP projects in Victoria are government-funded through availability payments, financed by the private sector, and recognized as a financial liability in the state accounts. Under this model, the state has an obligation to pay the private sector party for the delivery of the public infrastructure asset and associated services once the asset is completed and made available for use by the state. Payments are subject to asset availability and contractual service standards. The PPP asset remains in the state ownership.

Under the economic PPP model (user-charge PPP), the state grants the private sector party the right to earn revenue from third-party users of the service concession asset, for example toll road concessions. At the expiry of these concessions, the assets revert to the state. The West Gate Tunnel (currently under development) will be a toll road with future toll revenues being used to partially offset the construction cost.

Figure 2.1: Overview of the PPP Program in Victoria



Source: Partnerships Victoria PPP projects, November 2020.

Notes: To sync with the database of the Victorian government, the Metro Tunnel Project has not been included. The percentage portfolio value of the "Other" segment (24 percent) constitutes projects in sectors such as entertainment (2 percent), education (3 percent), correctional facilities (17 percent), and justice (1 percent).

Table 2.1: Contracted Projects under the PPP Program in Victoria

	2000-2005	2006-2010	2011-2015	2016-2020
No. of projects	12	8	7	5

Source: Partnerships Victoria.

Between 2000-01 and 2007-08, the net debt of Victoria averaged less than 1 percent of gross state product (GSP). However, with operating surpluses declining from 2007-08 (after the global financial crisis), new infrastructure was funded by increased borrowing, driving up general government sector net debt to 5 percent of GSP in 2011. This diminished the state's capacity to absorb significant fiscal or economic shocks. Thus, the Victorian government in its 2011-12 budget adopted fiscal consolidation measures from 2011 to 2015 in order to bring down the rising net debt levels and maintain its AAA credit rating.

From 2016-2020, only five projects (excluding the Metro Tunnel project) under the PPP program were contracted. The cumulative investment cost of $A10.2 billion (about US$7.9 billion) of the three transport projects (namely the West Gate Tunnel in 2017, the Western Roads Upgrade in 2017, and High Capacity Metro Trains in 2016) during this period accounted for 32 percent of the total investment amount of PPPs in Victoria. The construction of the Tunnel and Stations PPP work package of the Metro Tunnel project (contracted in 2017) was estimated to cost $A5.24 billion (about US$4 billion) in net present value as of September 30, 2017. The Tunnel and Stations PPP is to be delivered as an availability-based PPP under the PV framework. The significant quantum of investments (in value) under the PPP program during this period accounts for the limited number of projects in the period relative to the previous periods.

Table 2.2: Sectoral Breakdown of the PPP Program in Victoria

Category	Number of Projects	Net Present Value (US$, billions)	Avg. Amount/Project (US$, millions)	PPP as a Percentage of Real GSP
Road	5	9.1	1,826	2.6%
Water & waste	5	4.5	909	1.3%
Correctional	5	4.3	866	1.2%
Health	5	2.9	587	0.8%
Rail	2	2.0	1,021	0.6%
Educational	3	0.8	267	0.2%
Entertainment	3	0.5	183	0.2%
IT	3	0.3	102	0.1%
Justice	1	0.2	150	0.0%
Total	**32**	24.8	774	**7.0%**

Source: Partnerships Victoria.

The transport sector (i.e., the road and rail industries together) constitutes the largest component of the total PPP portfolio in value in Victoria, i.e., 44.8 percent. In terms of the number of projects per sector, the transport sector had seven, which was the largest per sector. For context, the total PPP investments in the transport sector from 2000 to 2020 represented 3.2 percent of Victoria's real GSP as of 2019-2020.

Overall, the PV program has achieved relative success considering the fact that these have comprised approximately 25 percent of all net infrastructure investments in Victoria since its inception in 2020. As the government progressively seeks ways to better the PV framework, projects procured through the PPP model will continually be a viable option in the medium to long term.

Contingent liabilities arising out of PPP projects

The State of Victoria's consolidated contingent liabilities increased from $A730 million (about US$562.1 million; 0.1 percent of real GSP) in June 2019 to $A1.42 billion (about US$1.09 billion; 0.3 percent of real GSP) in June 2020. According to the Auditor-General's Annual Financial Report of the State of Victoria: 2019–20, new contingent liabilities like the cost of the Metro Tunnel project could create risks to the state's finances.

In December 2017, the government entered into a 25-year PPP contract with Cross Yarra Partnership (CYP) to design, construct, finance, and maintain five underground stations as part of the Metro Tunnel project, a hybrid delivered project, with the underground stations being procured through a PPP option. On December 24, 2020, the state entered into settlement and amending deeds with CYP to address a range of commercial issues arising during the project delivery. The parties agreed to share the increased costs of the project on a 50:50 basis, with each party agreeing to pay $A1.37 billion (about US$1.05 billion). The state is expected to receive a higher value of assets than originally agreed.

According to the government, a number of potential obligations have been classified as non-quantifiable. Below are potential non-quantifiable obligations associated with some PPP projects in Victoria as contained in the 2021-22 Statement of Finances:

- *AgriBio Centre for AgriBioscience (formerly known as the Biosciences Research Centre).* The quarterly service fee payment obligations of Biosciences Research Centre Pty Ltd (BRC Co) on behalf of the joint venture participants (Department of Jobs, Precincts and Regions and La Trobe University) are backed by the State of Victoria under a state support deed. Under this deed, the state ensures that the joint venture participants have the financial capacity to meet their payment obligations to BRC Co, thereby enabling BRC Co to meet its obligations to pay the quarterly service fee to the concessionaire under the project agreement. The state underwrites the risk of any default by BRC Co.
- *Royal Melbourne Showgrounds redevelopment.* The state has entered into an agreement through the State Support Deed–Non-Core Land with Showgrounds Retail Developments Pty Ltd and the Royal Agricultural Society of Victoria (RASV) whereby the state agrees to support certain payment obligations of RASV that may arise under the Non-Core Development Agreement.
- *Southern Cross Station target capacity threshold.* The state has a possible liability relating to a claim from a contractor responsible for operating and maintaining Southern Cross Station. The claim relates to patronage levels at the station and the contract provides a process to assess whether modifications to the station, compensation to the contractor, or changes to the service standards are required. The claim is being considered and the financial effect is yet to be determined.

The AgriBio Centre for AgriBioscience and the Royal Melbourne Showgrounds redevelopment are both projects in which the state first formed a joint venture with a third party (La Trobe University and the Royal Agricultural Society of Victoria, respectively). In each case, the joint venture then procured new infrastructure through a PPP. The potential non-quantifiable obligations described above are consequences of the joint venture arrangements and do not exist in PPPs with more typical structures. In contrast, the non-quantifiable obligation associated with Southern Cross Station reflects a risk commonly seen in PPPs with availability payments—the risk that demand or usage exceeds the level anticipated in the contract. The fact that there is a claim related to this risk could be regarded as an indicator that the project has been a success, in that the maximum level of patronage expected to be achieved over the life of the contract has in fact been reached well before the end of the contract term.

1.2. Legal Framework and PPP Approval Process

1.2.1. PPP Governance, Institutional and Legal Framework

The State of Victoria has played an effective role in addressing the needs of multiple social and economic infrastructures under the Partnerships Victoria (PV) framework. The establishment of PV in 2000 represented a defining moment for PPPs. The PV strategy has substantially altered government participation in PPP projects by seeking greater engagement with the private sector in the implementation of value-for-money returns. This strategy reflected a quantum change from the first generation of projects in which access to private funding and the transition of almost total project liability to the private sector were the main drivers.

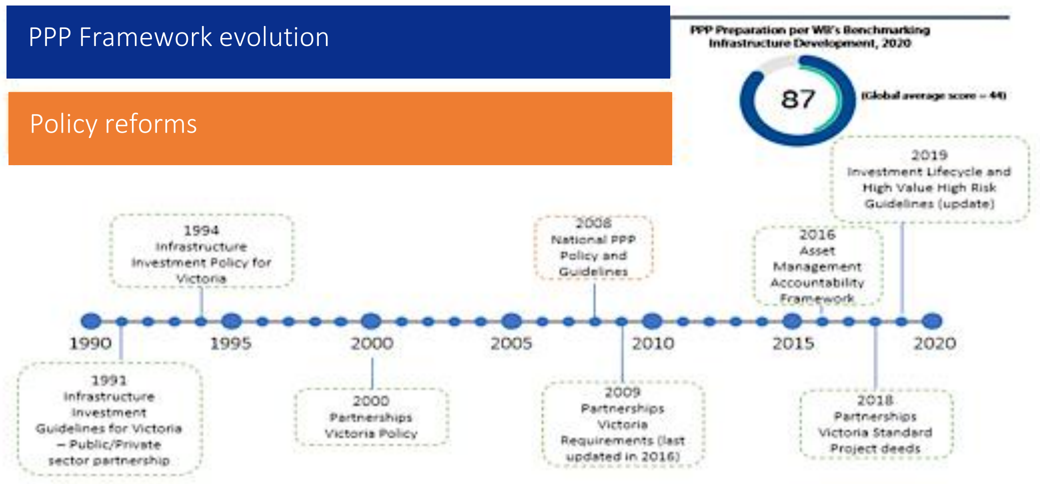
Other Australian jurisdictions also developed PPP policies by the early 2000s, mostly modelled on the PV framework. Subsequently, the PV guidelines were essentially adopted for the country as a whole, with the release of the National PPP Policy and Guidelines in 2008. At the federal level, the National PPP Policy Framework provides a common strategic direction for all states, and achieves a greater degree of consistency across Australian jurisdictions.

Australia does not have a specific legislative framework for PPPs; instead, the National PPP Policy and Guidelines set out the processes that authorities should follow in the investment, procurement, development, and operations stages of PPPs, along with standard risk allocations and commercial principles to be adopted. State governments have their own jurisdictional requirements and departures that are read in conjunction with the National Guidelines.

Furthermore, in the State of Victoria, there is no specific legislation providing a common framework for selecting, developing, managing, financing, and reporting PPP projects. Instead, these areas are addressed at the government policy level. For some projects, however, new or amended legislation reflecting their specific characteristics become necessary. For example, in June 2020, the North East Link Act 2020 was passed by parliament. The act established a state-owned company (state tolling corporation) to collect tolls for the North East Link with toll revenue going towards the cost of building and maintaining the project.

Historically, the commonwealth government's power to collect and administer funds to the states resulted in a growing degree of fiscal centralized regulation at the national level, culminating in a proliferation of detailed special purpose payment agreements. However, the revisions to federal-state budgetary agreements contained in the 2008 Inter-Governmental Agreement on Federal Financial Arrangements recognized in practice that delegating authority and oversight to states to provide programs under a finite number of large budget envelopes is a more effective way of maintaining public service delivery. After 2008, the general structure has been—at least in theory—to restrict the requirements attached to federal grants and instead focus on the state government to implement and embed the requisite public management practices within its own administration.

Figure 2.2: PPP Framework Evolution



The National PPP Policy and the PV Requirements (PVR) form the foundational backbone for the policy framework of PPPs in Victoria. The PVR operate alongside the National PPP Guidelines. The PVR supplement the life cycle of investment and high-risk guidance and other Victorian asset management programs. In the context of preparing any capital project in excess of $A50 million (about US$38.5 million), the National PPP Guidelines mandate that PPP procurement be considered. In essence, this does not mean that capital projects less than $A50 million (about US$38.5 million) are not considered for PPP procurement.

Three capital projects with investment of less than $A50 million (about US$38.5 million) have so far been executed under the PV program since 2000. All these projects were under the water infrastructure category. These are Wodonga Wastewater Treatment Plant ($A32 million or US$24.6 million), Ballarat North Water Reclamation Project ($A31 million or US$23.9 million) and Campaspe Water Reclamation Scheme ($A40 million or US$30.8 million). Although these small PPPs have largely delivered good outcomes, some administrative processes and decision-making during their operational phases have fallen short of good practice.

According to PVR, PPP project costings and budgets are developed in the same way as they would be if a project were procured using any other procurement approach as part of the business case development and investment decision process. If the PPP procurement option is approved for a project, then the budget treatment, however, differs from the one for projects procured otherwise. Thus, when a project is approved as a PPP, the estimated finance lease liability and any state capital contribution will be reflected in the budget, including forward estimates. Based on accounting advice, operating, maintenance, and life-cycle components of the service payments are reflected in the operating statement.

Under clause 33 of the PV Standard Project Deeds for Availability-based PPP projects, in some cases, the cost of a project may be so high (for example, major tunneling or road network projects) that the state may consider it appropriate and cost effective to make its financial contributions during the development phase. This will be in the form of either an additional one or two material contributions or regular smaller payments throughout the development phase. To mitigate the construction risk that the state thereby becomes exposed to, the state imposes project-specific conditions on the amount of sponsor debt and equity that must be contributed before any state contributions can be made, and will require all state contributions to be made pro rata with the additional sponsor debt and/or equity funding. In addition, state contributions during the development phase are dependent on the project company achieving specified delivery milestones.

Moreover, under clause 37 of the same standard project deed, the term "refinancing" is referred to as changes in debt finance arrangements. Because refinancing has the potential to change a project's risk allocation agreed at financial close, the state requires the right to be fully informed of any refinancing, as well as to approve refinancing other than that which was part of the original plan at financial close. The PV Standard Project Deeds provide for the state to share in 50 percent of refinancing gains, after allowing the project company to recoup any prior refinancing losses. The sharing regime is based on the principle that the state should share in gains arising from improvements in financing terms that were originally made possible by the state's long-term contractual commitment to the project, and secured by the project company. The state does not share in any losses suffered by the project company as a result of a refinancing which does not meet the refinancing assumptions that are bid and locked into the Financial Close Financial Model.

Also, under the PVR, modified financing structures are considered where they reduce project financing costs and optimize risk allocation and value for money (VfM). Typically, construction of PPP projects is fully privately financed and effectively repaid over the concession period. An alternative to full private financing is a partial public financing during the construction stage or substantial repayments at or after commercial acceptance, or at scheduled refinancing events during the operational phase of a project. In consultation with the Department of Treasury and Finance (DTF), procuring agencies can consider state capital contributions where there are liquidity constraints or where project costs could be reduced by reducing the level of private capital at risk during the operational period. The following criteria are used to assess modified financing structures against a standard PPP approach: i) risk allocation, ii) cost and complexity, iii) preservation of the benefits of private finance, iv) competitive tension, v) alignment of the tenor of finance with a project's risk profile, and vi) potential for innovation.

As a whole, the state financial risk management program seeks to manage risks and the associated volatility on its financial performance. The state's risk management framework comprises the following key components:

- The treasurer is responsible for approving and establishing the prudential framework containing policies and guidelines on financial risk management.
- The Senior Executive Group of DTF is responsible for advising the government on the management of the state's financial risks.
- DTF's Financial Assets and Liabilities Group provides oversight of the state's key financial balance sheet and financial market risks. These risks relate to the state's investments, borrowings, superannuation, and insurance claims liabilities, as well as exposures to interest rate, foreign exchange, and commodity price volatility and liquidity position.
- The Treasury Corporation of Victoria (TCV) is the state's central borrowing authority and financing advisor. An independent prudential supervisor is appointed by the treasurer to monitor TCV's compliance with its prudential framework.
- The state's entities are responsible for setting their own financial risk policy and objectives in accordance with the Standing Directions 2018.

The Standing Directions cover areas such as financial management objectives, responsibility structure and delegation, and policies and guidance on interest rate risk, foreign exchange risk, counterparty risk, commodity price risk, investment risk, credit risk, liquidity risk, and operational risk.

Figure 2.3: The Partnerships Victoria Framework that Applies to all PPP Projects in Victoria

National PPP Policy and Guidelines

National PPP Policy Framework

National PPP Guidelines Overview

Volume 1: Procurement Options Analysis

Volume 2: Practitioners' Guide

Volume 3: Commercial Principles for Social Infrastructure

Volume 4: Public Sector Comparator Guide

Volume 5: Discount Rate Methodology

Volume 6: Jurisdictional Requirements

Volume 7: Commercial Principles for Economic Infrastructure

Partnerships Victoria Requirements

Partnerships Victoria guidance

Financial analysis inputs

Financing options

Contract management

Partnerships Victoria templates

Expression of interest

Request for proposal

Project deed and commercial principles

Public interest test

Project summary

Partnerships Victoria practice notes

(internal government use only)

Whole of government infrastructure policies

Investment life cycle and high value high risk guidelines

Investment Management Standard

Gateway Review Process

Asset Management Accountability Framework

Victorian Government Purchasing Board

* Probity guide
* Contract management and contract disclosure policy

Source: Victoria State Government.

1.2.2. PPP Approval Process

The Office of Projects Victoria (OPV) is a project assurance and supervisory body that oversees the execution of all PPP projects. The OPV was established in September 2016 as an administrative office within the DTF. As stated in the National PPP Guidelines, the applicable PPP authority is the DTF.

The State of Victoria has well-developed procedures for assessing proposed PPPs that allow for the review and control of contingent liabilities. A department considering a PPP that would get its revenue from the government (not users) must first seek approval for the capital spending that would be needed if the project was financed publicly. If a PPP is used, the approval for capital spending is converted into approval for spending on the PPP's services during the operation phase of the project.

PPP proposals are subject to Gateway reviews in compliance with the Gateway Approval process. Gateway reviews are mandatory for all High Value or High Risk (HVHR) budget funded projects. Projects are designated as HVHR if they are budget funded projects that have: i) a total estimated investment (TEI) of more than $A250 million (about US$192.5 million); ii) a TEI of $A100 million-$A250 million (about US$77 million-US$192.5 million) and have been assessed as medium to high risk; or iii) have been classified as high risk regardless of TEI. The Gateway Review Process examines projects and programs at key decision points. It aims to provide timely advice to the Senior Responsible Owner (SRO) as the person responsible for a project or program. Each Gateway review takes a few days and is focused on the point before the SRO makes a decision that the project should proceed to the next phase. The Gateway analysis process is conducted by the DTF's ICT and Project Assurance unit.

Projects are reviewed at six main decision points during the Gateway Review period. The first step in booking a Gateway Review is to complete the Gateway Project Profile Model (PPM). The PPM is a DTF's risk assessment tool used to ascertain or profile a program or project's level of risk across a number of areas. The outcome of the assessment helps determining whether a program or project qualifies as a HVHR project.

The six gates are: Gate 1—Concept and feasibility (based on a preliminary business case); Gate 2—Business case; Gate 3—Readiness for market (prior to procurement taking place); Gate 4—Tender decision (prior to contract being awarded); Gate 5—Readiness for service; Gate 6—Benefits evaluation; Program review; and Project Assurance Review. Further details about each gate are as follows:

- *Gate 1: Concept and feasibility.* Reviews are not commonly completed as stand-alone reviews, because the government no longer has a two-stage budget process that includes asset filtering. Gate 1 reviews are commonly combined with Gate 2 reviews prior to lodgment of a business case in the state budget process. The questions of whether there is a clear need for a project, if it's affordable, and whether the funds required to adequately prepare the business case are available are reviewed at this stage.
- *Gate 2: Business case.* One key purpose of the review is to confirm whether the business case is robust, meets business needs, is affordable and achievable, has appropriate options explored, and is likely to achieve value-for-money. It ensures that the major investment and project-level risks are identified, and outline of risk management plans are developed.
- The DTF manual, *Preparing Project Budgets for Business Cases Technical Guide*, requires that an appropriate allowance be included within the project budget, which is needed to manage uncertainty over the life of a project. This is achieved by including two elements in the project budget in addition to the base cost estimate: i) base risk allocation—an allowance for the "most likely value" of cost increase above the base estimate to accommodate uncertainties in a project; and ii) contingency—an allowance above the "most likely value" for all costed project risks. Typically, project budgets developed for the majority of government projects including PPP projects constitute 80 percent to 95 percent of the base cost estimate and 5 percent to 20 percent of project risks.

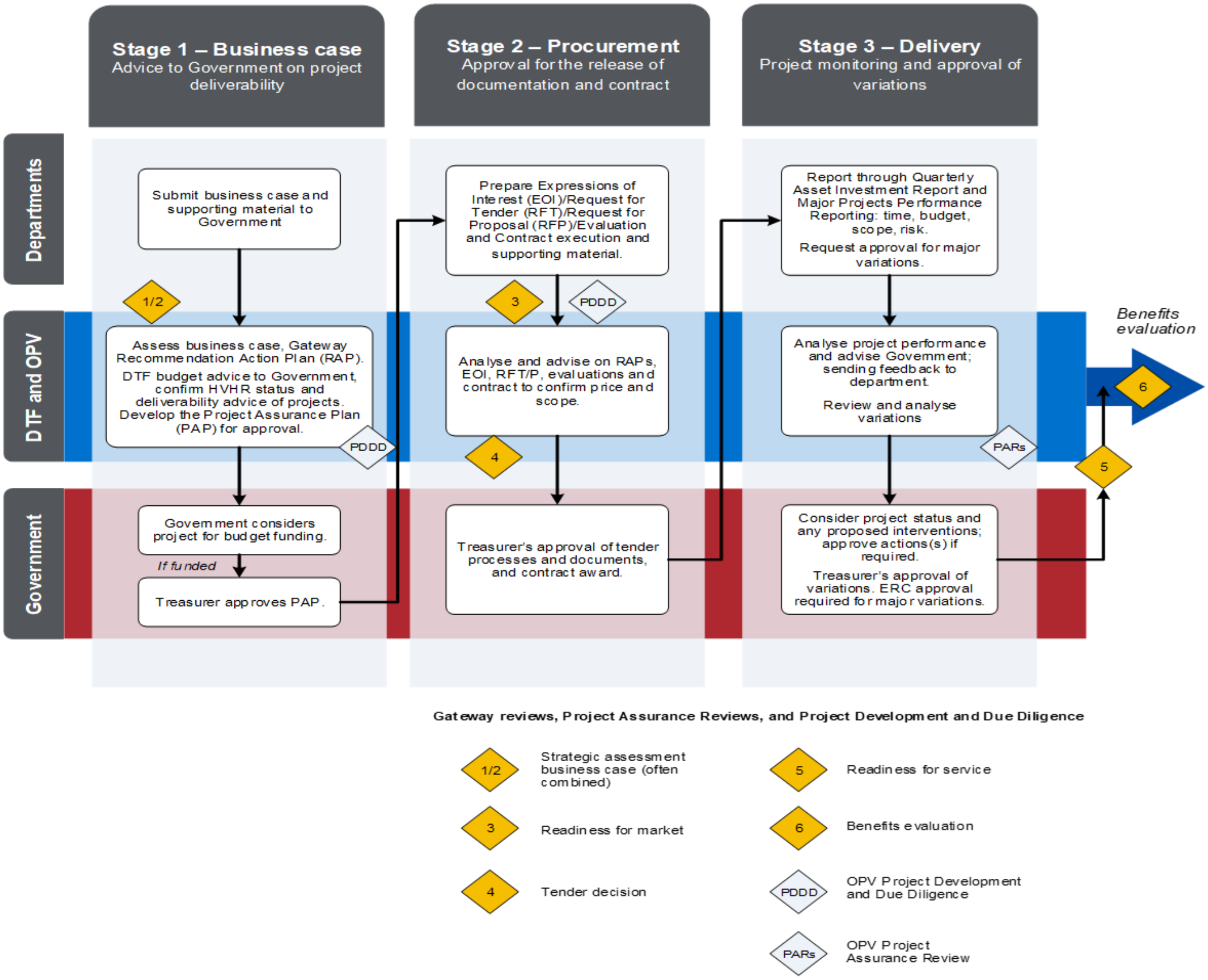
- *Gate 3: Readiness for market.* This ensures that financial controls are in place and resources are available for the whole project. Before launching procurement, the requirement is to confirm that there is a procurement plan in place to ensure compliance with legal requirements and all applicable Victorian government Purchasing Board (VGPB) rules, that the project's objectives are met and procurement timelines are minimized. At this stage, the answers are also sought for the following questions, among others: i) Is the proposed commercial arrangement likely to achieve whole-of-life VfM? ii) Are costs within current budgets? And iii) Is the project's whole-of-life funding affordable and do key stakeholders support it? VfM of PPP projects is determined through calculations and financial comparison with the public sector comparator (PSC). The primary purpose of the PSC is to provide a financial benchmark against which to form a judgment on quantitative elements of bids. The PSC is the key management tool in quantitative assessment of VfM during the tender process, evaluation, and comparison of proposals. The government approves selection of the preferred bidder following evaluation of shortlisted bids. The government or the portfolio minister in consultation with the treasurer approves contract execution. At the financial close, there is a report back to the government, from the portfolio minister on the financial close outcome; if necessary, the government approves any budget impacts arising from financial close. The portfolio minister in consultation with the treasurer approves the project summary and contractual documents for disclosure within 60 days of financial close. The portfolio minister in consultation with the treasurer approves the contract management plan within 60 days of financial close.
- *Gate 4: Tender decision.* For PPPs in Victoria, there is no Gate 4 review. This is because PPPs have other extensive checks and balances in the process leading up to the tender decision, which are absent in other delivery methods. Moreover, given the complexity of PPPs, the commercial sensitivities, and the time criticality of achieving financial close, conducting a gateway review at the point of tender award would have significant practical challenges and risks.
- *Gate 5: Readiness for service.* The purpose of the review is to confirm commissioning plans were developed and are in line with the organization's policy and industry best practice, such as to check if there are feasible and tested contingency and reversion arrangements.
- *Gate 6: Benefits evaluation.* The purpose of the review is to assess whether the business case for the project was realistic. It assesses ongoing requirements to meet the business need and if circumstances have changed, ensure the service delivery and any contracts are adapting to the new situation.

As considered in the Commercial Principles, all risks not explicitly taken by government will be borne by the private party. The fiscal impact of the risks taken by government (e.g., retained risk) are added to each proposal to show the total project delivery cost.

The government may choose to proceed with a PPP option even when, based on single-figure estimates, little or no VfM is evident (and vice versa). For instance, it is possible that a bid above a single figure PSC estimate could be considered to offer VfM compared to the PSC, because the PPP delivery mechanism provides greater cost certainty and decreases the government's risk exposure.

Additional government approvals are required when there is: i) a material change in a project including an amendment of project objectives or scope of services; ii) a significant change in the final business case assumptions, including economic and financial appraisals; iii) a material change to the project's risk profile since the last government approval stage, which requires government consideration, for example, change in market appetite, feedback or response, and/or change in law or policy; iv) a change in PSC or budget funding requirements; or v) a significant issue related to public interest.

Figure 2.4: Approval Stages in Victoria



Source: Investment Lifecycle and High Value High Risk Guidelines 2019.

The legal framework and approval process as used by the State of Victoria (and by Australia in general) remains one of the most robust PPP frameworks in the world. The World Bank's Benchmarking Infrastructure Development 2020, which assesses the quality of regulatory frameworks worldwide, benchmarking them with internationally recognized good practices, ranked Australia highly in terms of PPP preparation (87; global score: 44), procurement (71; global score: 63), and contract management (87; global score: 63). Thus, fiscal commitment and contingent liabilities (FCCL) management of PPPs is keenly addressed within the legal framework and approval process of the State of Victoria.

1.3. Analysis of Projects

1.3.1. Identifying and Evaluating PPP Projects

Victoria's investment life-cycle guidelines require a business case to outline the rationale for investment and assess procurement options. Cost-benefit analysis is undertaken as part of the decision whether to undertake a project, a requirement that was emphasized in introducing the PV policy: "Prior to a decision in principle to commit to major infrastructure projects, the Government will prepare a full cost benefit analysis of the potential project." For more complex projects, the costing should be a detailed concept estimate. Initially, this analysis is undertaken to choose between options. Once the preferred option is identified, the cost benefit analysis is revisited and further evidence, data, and details on costs and benefits are developed at a preliminary design estimate level for the preferred option. This second stage confirms if the investment provides a net public benefit, which is a benchmark for project viability.

Risk-adjusted costs are developed for different phases of the project's development. The table below provides broad guidance on cost accuracy that might be expected through the project development. Costs for the stages leading up to the business case phase of project development will necessarily have an element of uncertainty about them, but are useful to evaluate the investment and test the overall suitability and viability of a proposal.

Table 2.3: Expected Cost Accuracy for Projects at Different Stages

Section	Processes	Estimate	Description and Design Accuracy
Investment case (A focus for the preliminary business case)	**Investment logic** Problem, benefits identification, response options, indicative solutions	Order of magnitude estimate type -40% to +60%	This estimate is used for screening and is based on historical information. Order of magnitude estimates are developed when a quick estimate is needed, and few details are available. It is typically developed to support "what if" analyses. It is helpful for examining differences in high-level alternatives to see which are the most feasible. Because it is developed from limited data and in a short time, a rough order of magnitude analysis should never be considered a budget-quality cost estimate.
	Project scoping Project option appraisal, define project scope (and options for further consideration) with concept design	Concept estimate -30% to +60%	This estimate is based on concept design data. For less complex projects, this level of estimate accuracy is sufficient to robustly compare project options. Project definition is likely to be on the order of 1% to 10% complete. In many cases there will be benchmark project data that will considerably reduce uncertainty (increase accuracy). For example, if the project were a new school, then there is extensive industry benchmark data from previous school developments.

Section	Processes	Estimate	Description and Design Accuracy
Delivery case (A focus for the full business case)	**Pre-feasibility** Assessment of project options, initial risk and environmental assessment	Developed concept estimate -20% to +25%	For more complex projects, more design information would be expected to reasonably compare project options. Project design is likely to be on the order of 5% to 15%. These levels are probably more suitable for the "one off," "never been done before" type of schemes.
	Feasibility Integration of risk assessment, preliminary design, functional model, whole-of-life costing and procurement strategy	Preliminary design estimate -15% to +25%	This estimate is used to provide the approved budget estimate for the project, i.e., the business case budget estimate. Project design is likely to be on the order of 10% to 40%. Costing at this stage is expected to be a robust, defensible, risk-adjusted estimate with an appropriate contingency allowance. The estimate should be based on a well-defined project scope, a breakdown of project costs (e.g., using elemental estimating techniques) supported by reference to relevant benchmark project examples and adjusted for risk and uncertainty.
	Procurement Staged tender process including tender preparation and evaluation	Tender estimate -10% to +15%	Prior to going to tender, design specifications will be developed in more detail in order to obtain tender bids. The estimate at this stage is based on the specification and design development leading up to the tender process. Project design is likely to be on the order of 30% to 70% depending on the nature of the procurement approach.
	Negotiate contract price agreement	Tender price/contract (excluding agency administration cost) -5% to +10%	The tender price or contract estimate is based on the agreed contract price following the tender process. Note that the project should maintain a contingency allowance that exceeds this contract sum in order to manage uncertainty and unallocated risks.

Source: *Investment Lifecycle and High Value High Risk Guidelines 2019*.

A business case recommends the preferred procurement strategy (and contracting model) for the capital project. The recommendation is based on the procurement strategy that delivers the best overall outcome for the state considering a number of factors (which are normally interrelated) such as: i) delivering the lowest whole-of-life cost for the required performance standards, including effective management of the project's base costs and risks; ii) managing ongoing stakeholder requirements and issues during the project delivery phase; and iii) the prevailing market conditions.

Private sector involvement is deliberated on for project options after the following factors have been considered: i) whether a competitive market exists or can be established to provide the proposed services; ii) whether private sector provision compares to the cost and quality of provision by the public sector after taking into account the after tax rate of return required by the private sector; iii) the impact of private sector involvement upon the state's financial position; and iv) the risks of the investment and the degree to which risks can be shared with the private sector. The options analysis section considers significant impacts of project options including social, stakeholder, environmental, financial, and economic impacts and opportunities. An integrated analysis is conducted to ascertain each project option's economic, environmental and financial impacts, risk and uncertainty.

PPP procurement is evaluated as an option against value-for-money drivers when planning for any capital expenditure over $A50 million (about US$38.5 million). When a project is assessed as suitable for PPP delivery in the procurement options analysis, the development of the public sector comparator (PSC) is commenced, once the government confirms the PPP option. Value for money (VfM) is a critical focus of PPP procurement. The value for money assessment allows procuring agencies to establish whether service delivery has been structured to appropriately meet the service output while continuing to ensure reasonable stewardship of financial resources. The assessment of value for money encompasses all aspects of the proposal including both quantitative and qualitative elements.

The purpose of the PSC is to provide the government with a quantitative measure of VfM it can expect from accepting a private sector proposal to deliver the output specification compared to public sector delivery. The key characteristics of the PSC are that: i) it is expressed as the net present cost of a projected cash flow based on the project-specific discount rate over the life of the contract; ii) it represents the most efficient form of public sector delivery; iii) it includes an adjustment for competitive neutrality; and iii) it contains an assessment of the value of the risks that are to be transferred to bidders and the risks that are to be retained by the government. In most cases the role of the PSC is to drive competition. Where projects are more complex or where the government is seeking to maximize scope, a clearly defined scope ladder would be disclosed to shortlisted bidders with the full risk adjusted PSC as an affordability benchmark in the tender documents.

1.3.2. PPP Fiscal Implications

Projects suitable for PPP delivery in Victoria will usually fall within the scope of the Value Creation and Capture Framework. This ensures that there is a detailed consideration of alternative funding sources (such as land value capture) and of additional ways of delivering value from the project (for example, every major road or rail project in the metropolitan area delivers new or improved cycling infrastructure). The value creation refers to delivering enhanced public value, in terms of economic, social, and environmental outcomes. The value creation element is a driver for building better infrastructure. The value capture refers to the government capturing a portion of the incremental economic value created by government investments, activities, and policies. These actions may generate alternative revenue streams, assets, or other financial value for the government, which could assist in funding those investments and activities. The value capture element potentially lowers the fiscal burden on the government. For example, when developing rail projects, the Victorian government could consider the potential for granting rights to develop new sites created above or next to train stations for commercial and residential development. This opportunity could create economic benefits for the community (value creation), and generate alternative revenue for the government through the sale or lease of commercial properties. This revenue could partly offset the costs of delivering government services. One key objective of value capture is to keep minimal public debt and a safe AAA rating.

A high-risk project with a volatile cost profile (e.g., a large spread of potential outcomes as measured using statistical tools) may justify a contingency recommendation that lines up with a 90 percent confidence limit. In these circumstances, the contingency may be significant and, together with the base risk allocation, may be greater than the 10 percent to 25 percent expected for the majority of government projects. In contrast, for a "business as usual," low-risk project with low volatility and high certainty in its base cost estimate, the base risk allocation and contingency may be in the range of 0 to 10 percent of the recommended project budget. The philosophy underpinning risk allocation in the Victorian PPP policy is one of "optimal risk allocation." It seeks to minimize both project costs and risks by allocating risks to the party in the best position to control them.

Prior to COVID-19, two of the key planks of the medium-term fiscal strategy were: maintaining an operating surplus (generally described as a "surplus of at least $A100 million," but in most years the outcome was significantly more than that); and keeping net debt to GSP at a level consistent with maintaining AAA credit ratings from S&P and

Moody's. For some years, it was assumed that this meant targeting a maximum of debt to GSP ratio of 6 percent. However, the government in 2018 promised to increase the net debt to GSP ratio to 12 percent in order to fund additional investment, and the rating agencies accepted that this remained consistent with an AAA rating. Based on these two planks, the funding available for infrastructure investment consisted of the operating surplus plus an increase in net debt within the relevant target level of debt. When the target level of debt was reached, further debt could be raised each year proportional to the annual GSP growth.

The accounting treatment of PPPs in Victoria results in a project having a broadly similar impact on net debt, regardless of whether it is delivered as a traditional project or as a PPP. Hence, the medium-term fiscal strategy determines the state's total capacity for infrastructure investment, including investment through PPPs. As a result of the COVID-19 pandemic, net debt has risen significantly above the 12 percent of GSP cap, and is expected to rise further in the medium term. The initial breaching of the cap was due to the COVID-19 response pushing the operating result into deficit. Going forward, the elevated level of infrastructure investment proposed as part of the COVID-19 response will be a significant contributor to the medium-term growth in debt.

The medium-term fiscal strategy has now been modified to focus on restoring economic growth; returning to an operating surplus; and stabilizing debt levels. Hence, although increased infrastructure investment will be part of the COVID-19 response in the next few years, there is considerable uncertainty as to whether the state will be able to maintain that level of investment in the medium to long term.

1.4. Reporting Requirements

1.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

In 2005, the Australian Heads of Treasuries Accounting and Reporting Advisory Committee recommended the approach in which PPP assets and liabilities appear on the balance sheet of the party that bears most of the risks and rewards normally associated with ownership—an approach based on the UK Financial Reporting Standard. Under that approach, the assets and liabilities associated with many PPPs were put on the government's balance sheet.

The International Accounting Standards Board (IASB) took a somewhat different approach to the issue. International Financial Reporting Interpretation Committee 12 (IFRIC 12) says that project companies should recognize PPP assets and associated liabilities on their balance sheet if and only if they control those assets (IASB 2006). In 2007, the Australian Accounting Standards Board (AASB) adopted IFRIC 12 as Australian Interpretation 12 (AASB 2007b). The International Public Sector Accounting Standards (IPSAS) Board suggested that governments take an approach similar to IFRIC 12.

The following additional guidance is in place for accounting for PPPs:

- Australian Interpretation 12 issued by the AASB in February 2007 applicable for financial reporting periods commencing from January 1, 2008. It applies specifically to private operators (not government grantors). Private operators should not recognize property controlled by a government body.
- A consultation paper, ITC 16, of the International Public Sector Accounting Standards Board (IPSASB) on Accounting and Financial Reporting for Service Concession Arrangements, which proposes that a public sector party (referred to as a grantor) that controls the property underlying the PPP arrangement should recognize that property as an asset in its financial statements.

In line with the State of Victoria's direction on the application of Australian Accounting Standards Board (AASB) 1059 Service Concession Arrangements: Grantors, the state adopted AASB 1059 as of July 1, 2019. Prior to the issuance of AASB 1059, there was no definitive accounting guidance in Australia for service concession arrangements, which include a number of PPPs. The AASB issued the new standard to address the lack of specific accounting guidance and based the content thereof broadly on its international equivalent: IASB 32 Service Concession Arrangements: Grantors, which affects how PPPs impact the budget.

The state also adopted the AASB 16 Leases standard, which fundamentally changed lease accounting for lessees. Lessees are now required to recognize all leases on the balance sheet as "right-of-use" assets with an associated lease liability. Formerly, only finance leases were recognized on the balance sheet. Thus, certain arrangements with the private sector were assessed and disclosed as PPPs. Most of the assets and liabilities for these PPPs were recognized on the state's balance sheet when construction was completed and where they satisfied the definition of a finance lease under the old standard. However, not all PPPs were classified as finance leases, so their assets and liabilities were not reported on the balance sheet of the state. This was mostly the case where arrangements allow the private operator to charge the public directly for the use of the asset. These are now referred to as grant of a right to the operator (GORTO) liability. All such arrangements are now reported on the balance sheet of the state.

The combined impact of recognizing previously unrecognized arrangements and the full retrospective application of AASB 1059 was an increase to the state's assets of $A12.5 billion (about US$9.6 billion) and liabilities of $A8.5 billion (about US$6.5 billion) on June 30, 2019. The impact on the state's net debt as of June 30, 2019, was an increase of $A3.1 billion (about US$2.4 billion). Victoria is the first jurisdiction in Australia to implement the standard.

Furthermore, AASB 137, as published by the AASB in March 2019, discloses that an entity shall not recognize a contingent liability. Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The entity recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made. Of primary concern is termination due to force majeure. In such an event, the government party is likely to be required to pay off the outstanding senior debt and other costs resulting from early termination. The government party will not be required to compensate equity holders (or subordinated debt in the nature of equity). Although termination of a project for force majeure is extremely rare, the termination payment is a contingent liability of the state, and as such, the state should be compensated for any increase in this liability as a result of a refinancing so that it is no worse off. The entitlement to relief and compensation in the PV Standard Project Deeds generally reflects the common law principle in respect of force majeure events that the loss lies where it falls.

1.4.2. Transparency policy of PPP contracts

The main policy objective behind disclosure in Victoria is to promote a culture of transparency and openness within government. In January 2000, the government established an independent audit review of government contracts, in response to criticism regarding the lack of transparency on the part of the government, which had created public concern. This review covered many of the PPP contracts issued under the previous Liberal Kennett Government, which prior to this time had not been published. Following the recommendations of this audit review, in October 2000 the Premier of Victoria made a policy statement on "Ensuring Openness and Probity in Victorian Government Contracts," which made a commitment to maximum disclosure of government contracts with only trade secrets, genuinely confidential business information, or information that would seriously harm public interest if disclosed able to be withheld. The premier committed to establishing procedures that would make continuous disclosure an integral part of daily government work and would include making contracts and performance information of major contractors publicly available.

These commitments were adopted through the PV Framework. The audit also recommended that contracts for projects signed between 1992 and 1999 should be disclosed. This required a significant amount of negotiation by the government with the private parties and resulted in a designated website being established.

The AASB's Interpretation 129 specifies that a PPP contracting agency must provide a description of the arrangement detailing its significant terms, the nature and extent of rights to use specific assets, obligations to acquire the property, renewal and termination options, the amount of revenues, profits, and losses recognized in the period. Nevertheless, the Auditor-General's Annual Financial Report of the State of Victoria: 2019–20 stated that the nominal value of PPP commitments disclosed in the financial report were understated by $A1.7 billion (about US$1.3 billion or 0.4 percent of the state GSP) in 2019–20 and by $A1.3 billion (about US$1 billion or 0.3 percent of the state GSP) in 2018–19.

The PV principle, as defined in Clause 38 of the Updated Standard Commercial Principles (2008), is that the government is entitled to publish the project agreement and associated transaction documentation, with limited exceptions for commercially sensitive information. The principles state that, in general, only information that is exempt from disclosure under the Freedom of Information Act 1982 will be brought under such a confidentiality obligation. This approach to transparency and public accountability is also reflected in the language of the National PPP Guidelines, which state that "accountability of the executive Government to the legislature, and freedom of information for citizens, are key principles of the Westminster system of Government operating in the Commonwealth, State and Territory jurisdictions."

The Victorian government continues to demonstrate its willingness to adopt the best standards and practices in the implementation of its PV framework. Thus, despite the fiscal implication of the adoption of the full retrospective application of AASB 1059, it went ahead to implement it, making Victoria the first jurisdiction in Australia to implement the standard. Although the State of Victoria adheres to a high level of disclosure, there is work to be done to forestall issues such as noted by the Auditor General in terms of understatement of the nominal value of PPP commitments.

1.5. Performance Under Crisis

1.5.1. Impact of Global Financial Crisis on PPP Program

The global financial crisis (GFC) of 2008-09 significantly affected the costs and supply of PPP funding in many markets, including Australia. The recession of 2008-09, however, did not impact the Australian financial industry as much as that of some nations. At the same time, a drastic decline in liquidity greatly changed short-term costs of borrowing and supply of funds. The early victims of the recession were monoline guarantors that played a major role in many PPP projects. The new ventures needed bank debt and the overall tenor of bank debt reduced to five to seven years. The last pre-GFC PV project, the Royal Children's Hospital, had a senior debt consisting of 28-year three-month inflation-linked annuity bonds, with a monoline guarantee from the Financial Guaranty Insurance Company.

In the wake of the crisis, the State of Victoria worked to preserve and address the changing state of capital markets and the credibility of its advanced PPP model. This strategy involved selective and carefully considered revisions to allocation and management of a small number of financial risks in PPP ventures.

Following the onset of the GFC, PV's first project to reach a financial close was the $A255 million (about US$196.4 million) Victoria Partnerships in Schools initiative. Axiom Education Victoria (AEV), the winning bidder, reached financial close in December 2008. Even though long-term rate swaps were accessible, long-term debt financing was not available. AEV issued a debt of three to four years and took the burden of debt refinancing over the lifetime of the project. From its end, the state committed to a change in its traditional position regarding sharing of refinancing gains. Thus, the normal stance is that the state has a right to 50 percent of refinancing gains in addition to the planned refinancing gains already included in service payments to the project company. In the schools project, however, the state had a right to only 50 percent of the profit gained by AEV following a financial close: increasing debt above the level assumed in the financial model at the end of the financial period or after long-term debt funding had been secured by AEV.

The next PPP in Victoria during the GFC was the $A287 million (about US$221 million) Biosciences Research Centre Project, which closed in May 2009. The winning bidder, Plenary Research, raised a debt of $A225 million (about US$173 million) from three of Australia's four major banks, and set its base rate via interest rate swaps for the duration of the project. To ensure bankability of the project, the state and the equity supplier decided to share the burden of market disruption, enabling the banks to raise their loan prices in restricted cases if the cost of funds for two or more banks was significantly higher than the acceptable benchmark. This was the first Australian PPP project where the government decided to share market disruption risk. The state concluded that refinancing benefits and costs must also be shared with Plenary Research, the private partner.

The objective of the market disruption clause in loan documentation is to deal with misalignment of the base lending rate and the cost of the lenders' own funds. In Australia, lenders have not historically used market disruption provisions in their Australian dollar denominated credit agreements because domestic banks were initially lending Australian dollar financing. However, the GFC led market disruption clauses to be included in all loan documents with lenders so that the base rate can be adjusted to match the real cost of funds.

In PPP projects, a lender's ability to pass on an increase in its cost of funds is constrained by the cash flow available to the project company. The project company's equity providers may be able to absorb a modest increase in the lender's cost of funds. However, significantly higher increases may result in a breach of the project company's loan covenants, hence, banks and sponsors sought to pass these costs on to the government. This development explains the concept of market disruption. Nevertheless, there has never been a claim since it can only be triggered in extreme circumstances.

In September 2009, the Victorian Desalination Project, with a net present cost of $A5.72 billion (about US$4.4 billion) was the world's largest PPP project, with offers accepted in December 2008. Financial close took place in May 2009. Interaction with bidders and financial markets during the bid-out period showed that liquidity limits were likely to preclude a bidder from obtaining the complete funding needed for a project of this magnitude in Australia. The capital cost of the initiative was more than 10 times the capital costs of the PV School project and the Bioscience Research Centre. However, the project could not be delayed by the bidders' process of obtaining finance. Thus, the project team and the bidders recommended—and the state supported—that bank debt should be syndicated with the support of a temporary commercial rate guarantee. The state promised that part of the debt (slightly less than half of the senior debt) would be syndicated and the government would serve as a lender of last resort until debt had been settled completely within a certain timeframe. Victoria had a AAA national credit classification; it was therefore anticipated that a syndication guarantee would give the bidders access to substantially higher amounts of funds than was the case without such a guarantee. Under a traditional club facility, the bidders' lead bank arrangers supplied the project's outstanding debt for a set period. As with the Biosciences Research Centre Project, the state chose to share in refinancing profits and losses as well as in market disruption risk under restricted conditions. The state's syndication guarantee ended on November 16, 2009, just over two months after financial close.

The successful funding of the Victorian Desalination Project heightened financial market interest in potential PV ventures. The Peninsula Link Project, an $A849 million (about US$654 million) availability-based road project was the first to demonstrate this improved appetite in February 2010. The Peninsula Link contract was awarded to the Southern Way consortium in January 2010, with financial close occurring less than a month later. Despite the fact that the state had continued to share market disruption risk in limited situations, refinancing losses were to be met completely by the Southern Way consortium. Victoria continues to participate in any refinancing gains, except where refinancing has already been assumed in determining the state's availability payments. The main result of the GFC was that financing costs became considerably higher than before the crisis, posing difficulties for bidders looking to deliver value for capital to the economy.

1.5.2. Impact of COVID-19 on PPP Program

In 2020—as in all states and territories—the pandemic severely impacted Victoria's financial position and outlook. Before the pandemic hit, the government in its 2021-22 State of the Budget disclosed that it was planning to deliver a historically large program of capital investments with a total cumulative amount of $A104.7 billion (about US$80.6 billion) from 2020-21 to 2024-25. This would increase the net debt to GSP from 16.7 percent to 26.8 percent over this period.

This elevated level of infrastructure investments in Victoria coincided with similar increases seen in other Australian states and jurisdictions. Investment was anticipated to remain elevated over the medium term and constrain some parts of the construction industry and supply chains, placing pressure on delivery timetables and costs.

However, in 2020, the COVID-19 crisis created some uncertainty about the state's capital program. The factors impacting the capital program included managing effects of the COVID-19 pandemic, market capacity constraints, and high demand for skills and input resources. An increased volume of infrastructure spending across all states in Australia was pushing up the demand for construction inputs, forcing material and labor costs higher. This was compounded by supply side constraints, including a market structure with only a limited number of Tier 1 contractors.

The Auditor General in its report stated that the significant pipeline of assets under construction presented risks to future outlays from adverse price movements in materials and labor where demand exceeded supply, and from any unexpected delays or contractual disputes. However, the report noted that the government allowed for contingencies in its capital project budgets to partly mitigate these risks. Funding not allocated to specific purposes contingency associated with the 2021-22 Budget was estimated to be about $A7.1 billion (approximately US$5.5 billion).

International benchmarking by the OPV demonstrates these pressures are being experienced across the world on major infrastructure projects. A key finding from the review was that upfront investment in de-risking projects leads to more effective management of costs, fewer claims, and better schedule adherence. The government has shown support for this approach and has invested in the early development of projects such as the North East Link.

According to the Victorian government, a framework is in place to effectively and consistently manage the impacts of public health restrictions on state construction and infrastructure projects. The framework enables departments and agencies to consistently implement a range of responses, including extensions of time, expedited payment arrangements and support in instances of project site shutdowns. The government continues to work collaboratively with industry partners to achieve outcomes that are best for individual projects and workforces, maintain employment, and support the broader economic recovery in Victoria.

1.5.3. Measures implemented to help cope with the consequences of the COVID-19 crisis

The government took action to mitigate the COVID-19 impact by implementing a range of strategies to support growth in the construction industry, including freeing up supply chains, an extractive resources strategy, and increasing investment in skills. The government has been actively consulting with industry stakeholders to develop a broad range of reforms to optimize the way infrastructure is procured and delivered in Victoria. Through this process, the government has identified a need to improve how it works with the industry when developing and designing projects and how to leverage market innovation.

Priority reforms in 2021-22 include redesigning government project development and procurement processes and improving the way past project lessons are shared across the government and industry. The DTF will also update guidance relating to procurement and packaging for major projects, develop guidance for projects delivered through collaborative contracting models and prepare new standard-form contracts for each type of procurement model. The operation of the Construction Supplier Register and Residential Cladding Rectification Register will also be improved to better support suppliers using these services.

In November 2020, the Victorian government amended the procurement approach (including the PPP procurement model) embedding an Incentivized Target Cost risk and reward regime. Changes to project scope and risk transfer were also made. The Victorian government cited changes in market dynamics under COVID-19, recent feedback from industry engagement and the desire to strengthen collaboration and partnership during delivery as key reasons for the change in procurement approach.

During the COVID-19 pandemic, three major PPP projects in Victoria continued to take shape. However, one PPP project was terminated due to pandemic impact. Thus, the second and third Suburban Roads Upgrade packages were discontinued due to the government's response to COVID-19. The program was originally intended to be delivered in three availability-type PPP packages for western, southeastern, and northern suburbs of Melbourne. Whereas the Western Upgrades Package was awarded as a PPP in December 2017, the Victorian government decided to terminate the PPP procurement for the other two regions in July 2020, and instead deliver the work in those regions as 12 individual projects through other procurement models. The government indicated that individual projects will be contracted using an innovative procurement approach to give local construction companies more opportunities to win contracts. It said as part of the government's response to the coronavirus, consultations occurred with the smaller construction companies to understand how to best support their involvement in the Big Build program. This new model is hoped to support Tier 2, 3, and 4 companies to access these works, creating capacity in the construction sector. According to the government, works worth $A2.2 billion (about US$1.7 billion) will be progressively awarded, in 12 projects, to pre-qualified companies under the new approach. Infrastructure Partnerships Australia released a statement indicating that though it understands that the government needs to take an agile approach to managing risk in response to COVID-19, the decision to terminate a formal and active tender process will inevitably damage confidence and undermine certainty, and will not be without its costs.

The two PPP projects that were sustained during the COVID-19 pandemic were in the healthcare sector. The first one is the new Footscray Hospital, valued at $A1.5 billion (about US$1.2 billion), which had a procurement process that commenced in June 2019. In October 2020, Plenary Health consortium was announced as preferred bidder to enter into an exclusive negotiation with the government to deliver the new Footscray Hospital—the largest ever health infrastructure investment in the state. According to the Victorian Health Building Authority, on March 10, 2021, following an extensive tender process, the Plenary Health consortium was officially awarded the contract to deliver the project with parties successfully achieving financial close on March 11, 2021. Construction began in March 2021 and is on track to be completed in 2025. Equity financing is provided by Plenary (70 percent) and Sojitz (30 percent); the debt is being provided by leading domestic and international banks. This is a greenfield PPP project.

Another healthcare PPP project that withstood the pandemic although it was delayed was the Frankston Hospital. Thus, in September 2018, the Victorian government made a commitment to redevelop the Frankston Hospital with a proposed investment of $A562 million (about US$432.7 million). The project is to be delivered as an availability-pay PPP under the PV framework. Procurement commenced in September 2020 with the release of an Invitation for expressions of interest (EoI). A request for proposals (RFP) was expected to be issued to the shortlisted bidders in early-to-mid-2021. The successful bidder is expected to be announced in the early 2022. During this period, however, the TEI was revised upwards by $A43.26 million (about US$33.3 million) due to the revised project scope. The estimated completion date was also delayed to the fourth quarter of 2024-25 due to COVID-19 restrictions at work sites impacting the overall program delivery timeline. The project's cashflow was likewise revised in line with the amended project schedule. This is a brownfield development.

Finally, the third project that was ongoing during the pandemic was the North East Link, valued at $A15.8 billion (about US$12.2 billion), which is Victoria's largest road project. The $A7 billion to $A9 billion (about US$5.4 billion to US$6.9 billion) Primary Package, which is the main phase, was to be delivered as an availability-based PPP. Procurement commenced in November 2018 with the release of the EoI for both Primary and Early Works packages. The RFP for the Primary Package was released to the shortlisted consortia in late September 2019. The state expressed willingness to work more closely with the winning consortium to handle the project's cost changes due to the COVID-19 pandemic by incorporating an incentivized target cost risk and incentive regime into the North East Link PPP. The contract award was expected in September 2021.

It can be deduced from the proactive stance of the Victorian government that there is a robust system for managing FCCL issues during a crisis, which has been demonstrated across many different calamities. The most efficient strategies are strict adherence to a well-planned fiscal strategy, upfront investment in de-risking projects, and inculcating an incentivized target cost risk and reward regime. Moreover, the government effectively deployed support mechanisms like sharing of market disruption risk, syndication guarantees, and refinancing strategy to allow private investors to raise financing at reasonable terms and allow for acceptable gearing during crisis periods.

Annex 1 A: Australia, State of Victoria FCCL Principles

#	Principles	Clarification	Assessment for Victoria
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	Methodological guidance is already in place through the PVR.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like the PPP Fiscal Risk Assessment Model (PFRAM), can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	A Risk Potential Assessment: the tool is used to evaluate a range of risks for all new spending proposals. Also, the PPM, a DTF risk assessment tool, is used to ascertain or profile a program or project's level of risk across several areas.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	The OPV, an administrative office within the DTF, which is a project assurance and supervisory body, oversees the execution of all PPP projects evaluating fiscal impact as part of its processes.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	VfM of PPP projects is determined through calculations and financial comparison with public sector comparator (PSC). PSC is the key management tool in quantitative assessment of VfM during the tender process, evaluation and comparison of proposals.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	Fiscal ceilings for PPPs fall within the objective to keep net debt to GSP at a level consistent with maintaining AAA credit ratings from S&P and Moody's.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Funding available for infrastructure investment consists of an increase in net debt within the relevant target level of debt. When the target level of debt is reached, further debt could be raised

#	Principles	Clarification	Assessment for Victoria
			each year proportional to the annual GSP growth.
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure government is able to fund contingent liabilities should they materialize.	The budget contains an allowance for anticipated events that cannot be assigned to individual programs (so-called contingency reserve).
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Implementation of IPSAS on accrual basis is already in place.
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money, and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	The challenge with the PPP framework in Victoria is that it is deeply integrated with broader government frameworks. Hence, a consolidated report on all PPP projects is not available. Nevertheless, project summary report on individual PPP projects detailing fiscal commitments, VfM, etc., is disclosed to relevant stakeholders.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	The Auditor General conducts periodic audits.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure the fiscal rules for PPPs should be applied to all levels of government.	The state's entities are responsible for setting their own financial/fiscal risk policy and objectives in accordance with the Standing Directions 2018. The Standing Directions cover areas such as financial/fiscal management objectives, and policies and guidance on counterparty risks, etc.

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Chapter 2: Chile

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Acronyms and Abbreviations

BB	balanced budget
CC	Concessions Council
CGR	Comptroller General of the Republic
DGCOP	Directorate of Public Works and Concessions
DIPRES	Budget Directorate
FCCL	fiscal commitments and contingent liabilities
FET-COVID-19	Transitional Emergency Fund COVID-19 Transitional Emergency Fund
FTC	flexible-term contracts
FX	foreign exchange
GDP	gross domestic product
ITC	total revenues of the concession
LPVR	least present value of revenues
MDI	income distribution mechanism
MDSF	Ministry of Social Development and Family
MOF	Ministry of Finance
MOP	Ministry of Public Works
MRG	minimum revenue guarantee
SNIP	National Public Investment System
TEP	technical experts panel
UBRL	upper-bound revenues level
UF	Unidades de Fomento (inflation-indexed unit of account)
VfM	value for money

Executive Summary

Unlike in other countries in the Latin American region, in which public-private partnerships (PPPs) have been implemented through a PPP law, in Chile this type of scheme has been implemented through a concessions law, which dates back to the early 1990s. The concessions portfolio has mainly focused on transport sector projects, particularly roads and highways, which account for almost three-quarters of total concessions investments. The high participation in the transport sector is explained by the profitability of the projects and contractual arrangements that reduce the demand risk of the concessions, such as the use of flexible-term contracts that account for almost one-third of all concessions, and half of the ones in the transport sector.

The Concession Law has been built in a series of small improvements to the original framework, rather than with several versions and major revisions of the law, reflecting the stability of the Chilean concessional system. From the beginning, the Concession Law established the Ministry of Public Works (MOP) as the main actor in the concessions cycle, and was aimed at creating competitive bidders in commercially viable sectors. The law has been improved in many ways over the years, adopting different mechanisms to induce private proposals, enabling the allocation of risk, reducing the impact of renegotiations on the public budget, and promoting the bankability of the projects and thus providing a certain level of confidence regarding the amount of revenue that the concessionaire could expect from a concession.

Public initiatives follow the same social assessment and budget capacity analysis as any other public investment project. Private initiatives follow a slightly different project cycle before they are included in the concession portfolio. However, both types of initiatives must guarantee a specific social return rate depending on the sector of the project. Moreover, although private and public initiatives follow slightly different cycles, both create competitive conditions that increase the profitability of the project. The latter is done by including government support as an awarding criterion, since it has been shown to reduce the fiscal burden of the concessions through competition. In particular, there is some evidence of savings based on seven hospital concessions, in terms of the actual subsidy granted versus the one established in tender documents.

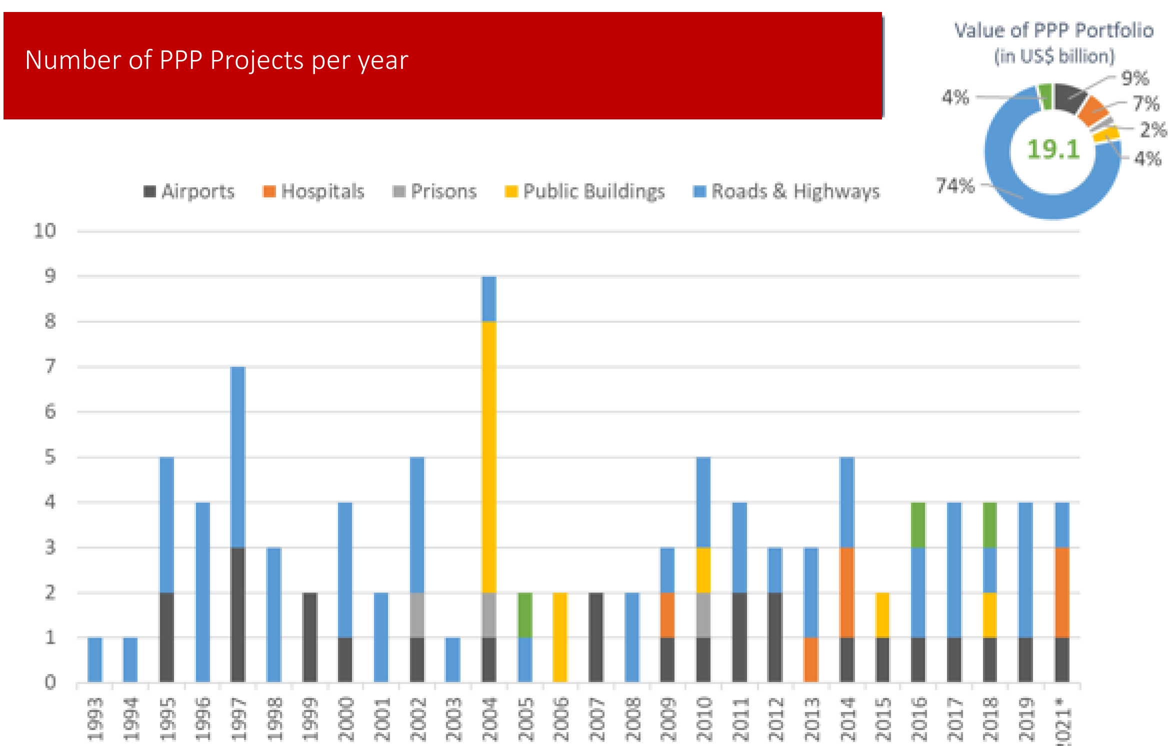
Regarding identification and allocation of risk, Chile's legislation does not follow a standardized risk matrix approach, however, much of the risk has been allocated according to the expertise that Chile has gained over the years. Contract renegotiations were a substantial source of fiscal contingencies in Chile, but the creation of a Technical Experts Panel in 2010 reduced those contingencies considerably. The assessment and report of contingent commitments is made annually by the Budget Directorate (DIPRES), and the assessment covers a wide range of operations that can have an impact on the public budget.

Chile has offered innovative solutions in times of crisis that have kept the fiscal impact to a minimum in the past. The government implemented different measures to cope with the global pandemic through an emergency fund, including a recovery plan to boost investment in the country. Although there is no explicit support to distressed projects due to the global pandemic, some concessionaires have requested government compensation, arguing that supervening events have affected the financial viability of the concession; however, the government is relying in its institutional strength to avoid costly contractual renegotiations.

2.1. PPP Experience

Chile has a very active portfolio of concessions, mainly focused in the transport sector. Since 1993, Chile has awarded about 97 concession contracts, with a total investment amount of US$19.1 billion (or an annual average of US$660 million, which represented 0.23 percent of 2019 gross domestic product). Transport infrastructure plays a major role under the Concession Law in Chile. In Figure 3.1 below, it can be seen that, with the exception of 2020, at least one airport or highway has been developed annually through a concession scheme since the law was enacted. In fact, the number of projects in these two transport sub-sectors adds up to 75 percent of all concessions granted over the whole period (74 out of 97). Furthermore, in terms of investment amounts, the upper-right graph on Figure 3.1 shows that nearly 75 percent (US$14 billion) of total investments were in the roads and highways sector. The average investment amount in social sector projects (i.e., prisons and hospitals), however, is higher than that in, for example, the airports sub-segment. Thus, total investments in prisons and hospital projects account for 9 percent of the total investments, the same as for airports. At the same time, this amount is spread among a lesser number of projects (i.e., nine projects in social sectors versus 25 airport projects), translating into an average project size of US$192.5 million in social sectors versus US$69.4 million in the airports sub-sector. In the other cases, the average project size in the highways sector was US$290 million, water sector at US$238 million, and public buildings at US$67 million.

Figure 3.1. Number of PPP Projects per Year



Source: Author's elaboration with information from the MOP.

Concessions from the transport sector are highly bankable due to a very high rate of return. The high concentration of concessions in the highways sub-sector is not a surprise given its high profitability for investors. For instance, Vergara-Novoa et al (2020)[4] documented that in the 1995-2014 period, highway concessions in Chile generated a profit of almost US$4 billion, equivalent to an average annual budget for the Ministry of Public Works. Furthermore, this profit represents a return on investment of nearly 25 percent if we consider the total investments made until 2014, and could represent a return on equity of more than 100 percent assuming that 20 percent of investments come from equity. These high returns are partially caused by an overestimation of highway tolls, which are set above the average cost. This is the opposite of the situation in social sectors, where projects are usually structured through a government-pays scheme based on an availability payment mechanism, which caps the returns in some way through performance criteria.

Chile is one of the first countries in the world to use flexible-term contracts (FTCs) for concessions. FTCs have been used in one-third of all concessions, and half of the transport sector has used FTCs. In FTCs, the length of a concession contract depends on attainment of a specified goal set in the contract (e.g., revenue level). The term is extended if revenues fall short of contractual expectations; otherwise the term is reduced. Although FTCs have provided some reduction of demand risks and potential fiscal contingencies, there are some asymmetries embedded in their design, especially when the cap imposed at the upper limit of the concessionaire's profitability is not equivalent in the case of the concessionaire having less than expected profits (because the FTC can only be compensated by extending the term of the contract until the maximum term set in the legislation). The latter feature makes this type of contract less popular among private sponsors.[5] In the case of Chile, however, FTCs were quite popular in the transport sector, with 53 percent of the roads and highways concessions (26) awarded through FTCs, and 32 percent (eight projects) of the airport concessions via FTCs. In fact, FTCs are also instrumental in limiting high returns for highway concessions.

There has been an increasing interest in developing projects in sectors that are more socially oriented, due to the pandemic, which will boost investment in the social sector in coming years. Although Chile has developed a very active concession portfolio, mainly focused on the transportation sector, which has granted at least one airport or highway project per year since the first concession in 1993, concessions in the social sector have been minimal. However, their average amount of investment is not trivial, and is expected to increase in the future, particularly with projects related to the health sector, such as hospitals.

2.2. Legal Framework and PPP Approval Process

2.2.1. PPP Governance, Institutional and Legal Framework[6]

The Concession Law has been built in a series of small improvements to the original framework, rather than with new versions and major revisions of the law, reflecting the stability of the Chilean concessional system. The regulation for concessions originated in the early 1980s, however, amendments take as a reference a concession regulation issued in the mid-1990s (marked on Figure 3.2). Specifically, the first Concession Law can be traced to 1981 with the enactment of Law 18060 (L-18060), which was a reform that enabled the Ministry of Public Works

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[4] Vergara-Novoa, C., et al. 2020. "Analysis of revenues, costs and average costs of highway concessions in Chile." *Transport Policy* 95: 114-123.

[5] Vasallo, J.M. 2010. "Flexible-Term Highway Concessions: How Can They Work Better?" *Journal of the Transportation Research Board* 2187 (1): 22-28.

[6] This section relies heavily in information provided by the Ministry of Public Works 2016 publication Ministerio de Obras Públicas (MOP) "Concesiones de Obras Públicas en Chile: 20 años" and the comparison tool provided by Chile's National Library of Congress, that allows for tracking of relevant changes in the legislation (see: www.bcn.cl).

(MOP) to award concessions for a period of up to 50 years. This amendment opened the door for the first concession regulation in 1983 (DFL-591).

Since the beginning, the Concession Law established the MOP as the main actor in the concessions cycle, and aimed to create competitive bidders in commercially viable sectors. Although no project was awarded under DFL-591, mainly due to a complex political and economic context, the regulation reflected some unique features. For instance, since those early years, the MOP was chosen as the public entity in charge of structuring, monitoring, and enforcing concession contracts. Additionally, the law defined award criteria depending on sector viability; for instance, for projects in commercially viable sectors, award criteria were based on the lowest rate to be charged to users of a concession, whereas for projects in socially viable sectors, award criteria were based on the lowest subsidy requested from the government. Finally, the law established that during the construction phase, the entire risk was to be borne by the concessionaire, which must disburse all money necessary to finish construction, even in the event of unforeseen circumstances, force majeure, or any other case.

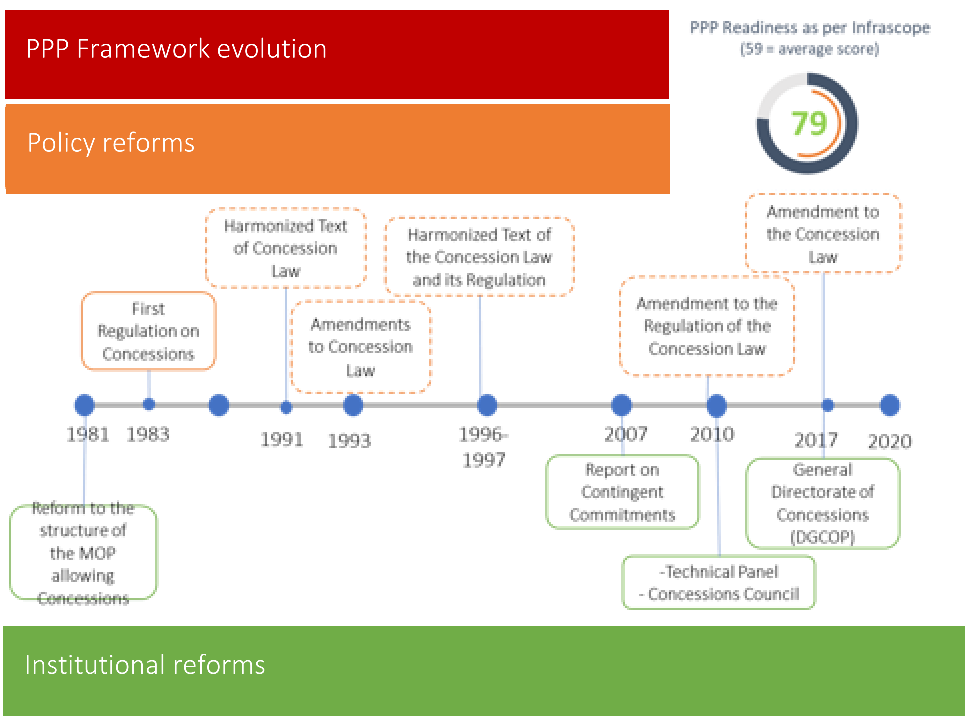
Due to the lack of private interest in concession projects, the concessions adopted different mechanisms to induce private proposals and some risk-sharing related to traffic demand. Subsequently, in 1991, the regulation was modified by Law 19068 (L-19068), which was particularly important because it introduced features that enhanced contractual arrangements and project bankability. Among the main changes, the following are especially notable: i) introduction of private initiatives; ii) definition of new award criteria based on the shortest term of a concession, the highest payment to the government by a concessionaire, and the minimum revenue guarantee (MRG) offered by government; and iii) a possibility of using concession revenues to guarantee other commitments originated by a concession. The last point was important for project bankability and was particularly relevant for infrastructure bonds that emerged later. Decree 164 (DFL-164) of 1991 is a compilation of all previous amendments into one harmonized text. It is noteworthy that, up to that year (1991), only one concession project—El Melon Tunnel—was awarded. Hence, it was evident that something was not working properly regarding the legislation since it was not capable of generating enough projects.

Enacting additional legislation enabled the creation of incentives for the presentation of successful private proposals, and amended the risk allocation in land acquisition and bankruptcy matters. To promote projects that appealed to the private sector, Law 19252 of 1993 enabled presentation of unsolicited proposals (USPs, or private initiatives). For instance, in this new legislation USPs were fully (or partially) reimbursed for costs incurred by the private sector in elaborating the proposals. The reimbursement is paid by the winner of the concession, in those cases where the winner is not the original project proponent (and is assumed in the project proposal for the originator). In this sense, there is no additional cost to the government. The government is only responsible for the reimbursement in those cases in which the tender process is declared null or void, or if it decides to award a project through another mechanism. Additionally, the new legislation enabled sharing part of the risk of land acquisition with the public sector. In these cases, the government fixes a price for land acquisition in the tender documents, which is paid by the concessionaire; if there is any extra price associated with the project's land acquisition, the government pays this difference. This was the case for some concessions, such as that for Route 60 (Camino Internacional Ruta 60 CH in Spanish), in which the tender documents established that the MOP would pay the difference if the expropriation expense was valued at more than a certain amount (see section 3.3.2.1). This contingent commitment is recorded in the Report of Contingent Commitments, published annually by the Budget Office (see section 3.4). Finally, bankruptcy was eliminated as a potential reason for contract termination, and lenders were given an option to either step into the concessionaire's rights and obligations or give approval for concession re-tendering.

Later legislation was added to reduce the impact of different contingencies on the public budget and promote the bankability of projects by providing a certain level of assurance regarding the amount of revenues that the concessionaire could expect from a concession. The 1996 Law 19460 (L-19460) included in the concessions legislation an additional award criterion based on a Concession's Total Revenues (ITC).[7] This new scheme guaranteed certain revenues to a concessionaire and opened the door for the variable-term contracts that later proved effective in efficiently managing fiscal commitments and contingent liabilities (FCCL) exposure during times of crisis, since this type of contract adjusts the term to guarantee a level of revenues to the private partner without additional fiscal cost to the government. Additionally, L-19460 set a cap on requesting additional works to the original project. In particular, the Ministry of Public Works (MOP) was allowed to modify the scope of projects unilaterally and reimburse the private sector through a mix of schemes based on higher subsidies, longer term of concessions, or higher toll rates. The legislation also established that once the term of a concession expires, the MOP must re-tender it either as a single, segmented, or combined project. All these changes were reflected in the harmonized text, Decree 900 (DTO-900), and its regulation, Decree 956 (D-956) of 1997. Both texts are referred to as the baseline of the Concession Law Regulation.

Law 20410 (L-20410) of 2010 was very important because it created the Concessions Council (CC) as an advisory body to MOP. The CC is in charge of assessing the eligibility of private initiatives, and determining the type of infrastructure to be developed through the concession system and contract modality, among other responsibilities. Additionally, L-20410 established new provisions related to contractual modifications and additional investments. In case of a unilateral request by the MOP, the additional investments cannot exceed 15 percent of the original total investment. In case of a mutual agreement, additional investments can raise up to 25 percent. D-956 adds different articles that rule changes specified by L-20410.

Figure 3.2: Milestones of Concessions Legislation



[7] Equivalent to the least present value of revenues (LPVR). The LPVR is a flexible-term concession that ends when one of the following is reached, either the maximum concession term or the present value of the income that was offered in the tender process.

The most recent change in the legislation was issued in 2017 with the aim of raising the rank of the former Concession Coordination to a directorate within the MOP, and increasing Ministry of Finance (MOF) participation. Further amendments to the legislation were relatively minor (Law 20706 and Law 20908). However, Law 21044 (L-21044) from 2017, which created the General Directorate of Concessions (DGCOP), is the most significant change in recent years. In particular, the DGCOP is located within the MOP structure and aims to act as a one-stop source to support PPP projects in Chile. Additionally, the MOP now shares the responsibility for nominating CC members with the Ministry of Finance (MoF). This move was aimed at increasing coordination between both institutions to strengthen the concession system.

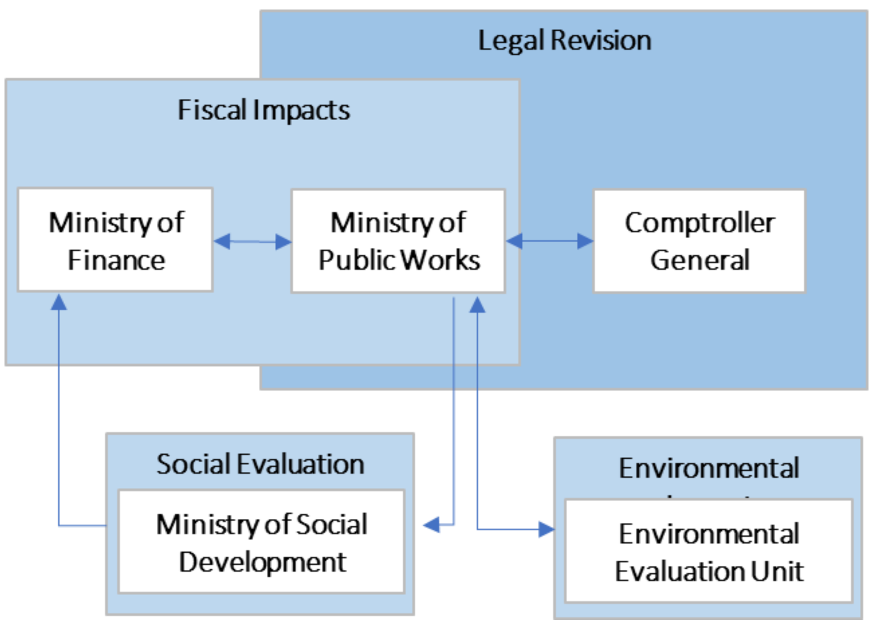
The PPP institutional framework in Chile is governed by the concession system that is formed for different institutions and processes. In particular, there are five main actors that ensure the correct operation of the concession system, including:

- **The Ministry of Social Development and Family (MDSF)** is in charge of approving an ex-ante evaluation of public investment projects. For this aim, the MDSF provides a methodology[8] for social evaluation and social prices that each project must observe, in which the minimum social return is set at 6 percent. Additionally, the MDSF is in charge of an ex-post evaluation of a project, that is, once the concession concludes, it determines if the project met the expected social returns. Lastly, the MDSF is also in charge of the Integrated Project Bank (Banco Integrador de Proyectos, in Spanish), which is a library of socially profitable projects that not only feed in the list of projects to be executed under traditional public investments, but also in the list of projects to be presented under the concession system as public initiatives.
- **The Ministry of Finance (MOF)** is in charge of verifying the budget capacity that each sector ministry has for developing investment projects, and once the project has started, it remains in charge of programming the use of public resources through its Budget Directorate (DIPRES). Furthermore, the DIPRES estimates and reports the contingent liabilities of the government, which include those related to the concession system. Lastly, the MOF performs a public comparator analysis, and assesses a project's value for money that justifies the convenience of using the concession system.
- **The Ministry of Public Works-Directorate of Public Works Concessions (MOP-DGCOP)** is in charge of formulating a project (e.g., engineering studies, and demand forecast, etc.), and submitting for approval the social evaluation to the MSDF. Additionally, the MOP is in charge of structuring a concession project (e.g., financial and contract design, business model, etc.) and tender documents, as well as awarding a contract and overseeing correct execution of a concession (through a fiscal inspector).
- **The Sectoral Ministries** participate in the concession system by issuing a mandate to MOP so they can carry out all the necessary steps in order to include a project in the concession system (e.g., the Ministry of Health has mandated the hospital concessions to the MOP, whereas the Ministry of Justice—prison concessions).
- **The Concessions Council** advises the MOP on the issues related to declaring private initiatives in the public interest; analyzing public initiative concession projects; contracting additional works; analyzing modalities of the concession that will be tendered; modifying characteristics of the works in cases of changes that are over 10 percent of the official budget; establishing tolls policy; and declaring early termination of the concession submitted by the MOP, among others.
- **The Environmental Agency** is in charge of carrying out validations to make sure that a project complies with environmental regulations.
- **The Comptroller General** is in charge of reviewing the legality and constitutionality of the tender documents in a concession, as well as conducting audits, when necessary, to ensure regulatory and contractual compliance.

[8] See http://sni.ministeriodesarrollosocial.gob.cl/evaluacion-iniciativas-de-inversion/evaluacion-ex-ante/.

Despite different actors participating in the concession cycle, the MOP acts as a one-stop source for all stages, receiving validations from the MOF, MDSF, Environmental Agency, and Comptroller General. In particular, the MOF needs to approve the version of a contract, and for this purpose, it internally assesses the fiscal impact, and the value for money (VfM) of a project. In some cases, there are public reports prepared under the instruction of sector ministries that show the results of Public Comparator and VfM analyses for specific concession programs (e.g., the Ministry of Justice publishes a report that shows the application of the Public Comparator for the prison concessions program[9]). Sector ministries also validate offers submitted by bidders, award of a project, contract modifications, and re-tendering of a concession. The Comptroller General of the Republic (CGR) participates in the approval of tender documents and verification of constitutionality and legality of the decrees and resolutions. In addition, the CGR not only guarantees compliance with the concession system regulations, and public resource audits, but also issues recommendations that could have a fiscal impact. For instance, recently, the CGR has suggested a change to the regulation to include a way in which private initiatives that are complementary to public projects could be tendered jointly.

Figure 3.3: Institutional Framework



Source: Figure adapted from MOP 2016, idem p. 122.

2.2.2. PPP Approval Process

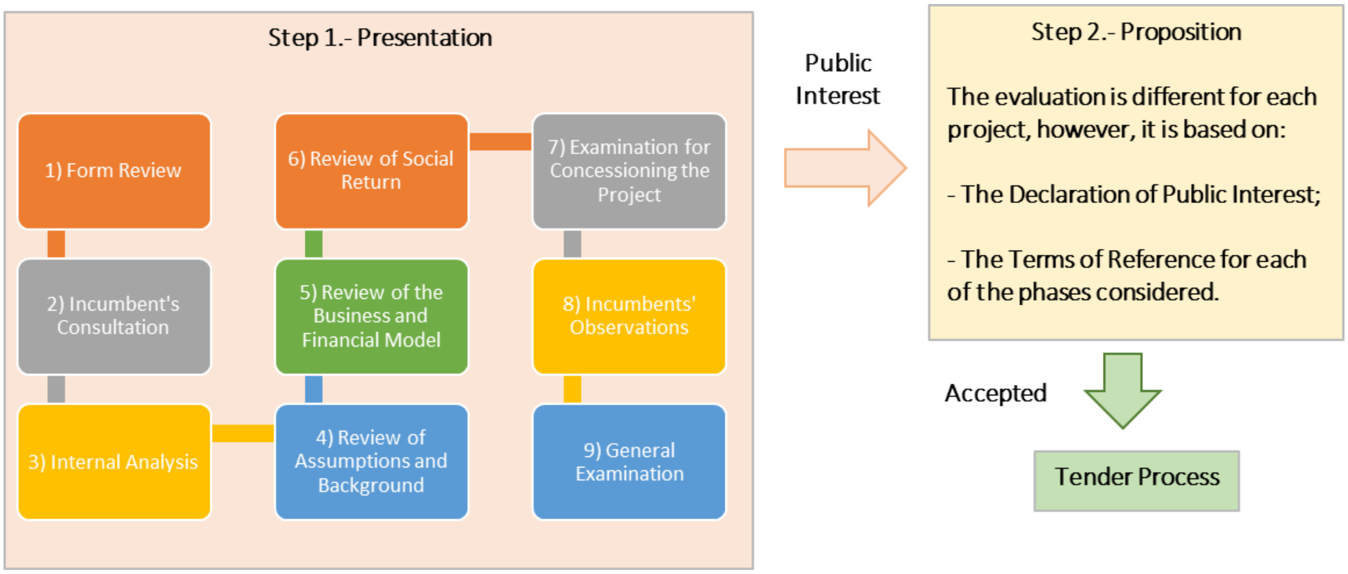
Public initiatives follow the same social assessment and budget capacity analysis as any other public investment project. In Chile, there are two types of concession projects: the ones proposed by the public sector (public initiatives) and those proposed by the private sector (unsolicited proposals or private initiatives). In this sense, public initiatives are usually the responsibility of the MOP or are entrusted by another sector ministry to the MOP. In any case, before they are included in the concession pipeline, public initiatives must be part of the National Public Investment System (SNIP, in Spanish). This is because any project that requires public financing, either to carry out studies and evaluations or to make the investment, must be part of the SNIP. In this sense, public initiatives follow the same social assessment and budget capacity analysis as any other public investment project and are then included in the concession system at the tender stage. In particular, the SNIP relies on the ex-ante evaluation of the

[9] See Aplicación del Comparador Público-Privado en los servicios penitenciarios concesionados, in http://biblioteca.digital.gob.cl/handle/123456789/917.

project elaborated by the public proponent and reviewed by the MDSF (to ensure that a project has a social return above 6 percent). It also relies on the budget capacity analysis performed by the MOF related to the fiscal space of the ministry to carry out the project.

Private initiatives follow a slightly different project cycle before they are included in the concession portfolio, however, the social return rate must be satisfied as well. In this case, the cost of proposal development is entirely borne by the private sector, however, once the project has gone to tender, it can be reimbursed by the winner of the concession (which may be the proponent itself, in which case, the cost of the studies is exchanged for the bonus points that the proponent receives in the tender). Figure 3.4: Evaluation Process for Private Initiatives below shows the milestones that private initiatives must pass before being admitted to the tender process. In the first step, the private proponent needs to provide the MOP with a series of documents and studies that shows the scope of a project (e.g., investment, risks, financial conditions, etc.). As in the case of public initiatives, the MDSF reviews the social return of any project that needs to show a social return of at least 6 percent (and is elaborated by the private proponent using the methodologies provided by the MDSF); the MOF reviews the budget capacity to carry out a project. The MOP, with the advice of the Concessions Council, MOF and other ministries that have an interest in the development of a project, determines if the project is of the public interest through a multi-criteria analysis that takes into account the information provided.

Figure 3.4: Evaluation Process for Private Initiatives



Source: Author's elaboration with information from MOP 2017, "Guía Metodológica para la Evaluación de Iniciativas Privadas."

Although private and public initiatives follow a slightly different cycle, both create competitive conditions that increase the profitability of the project. Once the project is declared to be in the public interest, a second stage requiring additional documents and a more detailed proposal begins. The second stage ends with the admission (or rejection) of a project to the tender process stage. If a project is admitted, then the intellectual property of a project is passed to the MOP in exchange for the bonus points for the proponent's bid or partial (or full) reimbursement of the costs incurred by the proponent in elaborating the project (paid by the winner of a concession). The two types of concession projects, that is, public and private initiatives, meet in the tender process stage within the concession system. Hence, although both types of initiatives slightly differ in their project cycles, in general terms they try to generate the same competitive conditions to increase the project's value for money.

2.3. Analysis of Projects

2.3.1. Identifying and Evaluating PPP Projects

A two-step validation process identifies the projects to be included in the concession pipeline. As was mentioned before, the public initiatives are identified and evaluated at the first step to be included in the SNIP. This process requires two main types of validation: the first one is from the MDSF, in which it is confirmed that the project is socially profitable, and the second one—from the MOF—confirming the budget capacity of the ministry to carry out a project. Then, the MOP advances public initiatives to the tender stage after requesting the opinion of the Concessions Council. Although the opinion of the Concessions Council is non-binding, it informs MOP decisions about projects to be developed through the concession system.

In the case of private initiatives, although the project is identified by the private party, a process of validation is performed before a project can be declared in the public interest and/or be accepted to proceed to the tender stage. These processes are presented in Figure 3.4: Evaluation Process for Private Initiatives, and include the following steps:[10]

[10] See https://concesiones.mop.gob.cl/proyectos/iniciativasprivadas/Documents/2017/Guia_metodologica_de_evaluacion_de_iniciativas_privadas.pdf.

1) The MOP reviews the form in which the private proponent presents the project, and all relevant background information (e.g., project description, demand estimate, financial analysis, and risks of a project, etc.).
2) The MOP jointly with the Concessions Council determine incumbents to be consulted regarding the decision about whether the project is in the public interest.
3) The MOP begins an internal analysis of the project from different perspectives, including engineering studies; potential needed expropriations; demand, legal and social evaluations; evaluation of private sector interest; assessment of a business model; environmental issues; land/territory; and citizen participation; among others. During this process the environmental legislation must be complied with, as validated by the Environmental Agency. The MOP also evaluates the originality of the idea, and proposes changes to the project, if necessary.
4) The MOP reviews the assumptions made by the private sector to ensure that they are consistent with those observed among other similar projects.
5) The MOP makes a replica of the business and financial models of the project proposed by the private sector with the aim of contrasting the results (e.g., private return, and required subsidy or guarantee, among others) and simulates different scenarios.
6) The MOP requests the support of the MDSF with the aim of reviewing the social return of the project.
7) The MOP checks if there is enough capability to carry out the project in its original form or if it’s better to divide it into stages or different regions (e.g., the Route 5 Santiago-Puerto Montt).
8) According to the responses received from incumbents (see No. 2 above), it is determined whether a proponent must respond to all, none, or some of the observations received or if the MOP can respond directly.
9) Finally, with the help of the information collected through the previous steps, a multi-criteria analysis is carried out to determine the convenience of declaring the project as in the public interest. If this is the case, a second step is initiated. This step is different for each project and will need to follow the Terms of Reference provided for each phase that were detailed in the Declaration of Public Interest. If the project is accepted, then the tender process can begin.

Additional public institutions provide certainty regarding the validity of the project. Both types of projects (i.e., the public initiatives, and the unsolicited proposals or private initiatives) meet at the tender stage. The MOP requests a legal review of a contract from the Comptroller General and contract approval—from MOF. If there is a contract modification, the Comptroller General and the MOF are also required to review and approve. Separately, the Concessions Council should inform the MOP about any contract modifications. The concession is awarded and signed by the president, the Ministry of Public Works, the Ministry of Finance, and the Comptroller General, and later published in the Official Gazette.

2.3.2. PPP Fiscal implications

2.3.2.1. Explicit Commitments

Including government support as an awarding criterion is a smart way to reduce the fiscal burden of concessions through competition. Although concession projects in Chile have been mainly developed in sectors that are commercially attractive to the private sector (see section 3.1), the use of subsidies and guarantees is a standard, and sometimes needed, practice for PPP projects. This practice, however, generates explicit commitments (either direct or contingent). A smart way to reduce those commitments is to make bidders compete against each other for the least amount of government support. For instance, in Table 3. (below), we can see that some award criteria used in Chile for determining the winner of a concession (according to the DTO-600 legislation) are not only related to the quality of a project but also to the amount of required government support. Although these are not the only explicit commitments caused by concession contracts, they represent the ones that can be reduced through market competition, according to the regulation.

In terms of subsidies granted by the government, the Chilean Chamber of Construction[11] has documented that some savings were observed in seven hospital concessions in terms of the actual subsidy granted versus the one established in tender documents. In particular, a concessionaire awarded a concession requested a subsidy for construction that was 18 percent lower than what was established in the tender documents, and a subsidy for operation and maintenance that was 2.3 percent lower than that originally set in the tender documents. This demonstrates the potential that award criteria can have in generating competition and reducing the number of direct government commitments. However, it should be noted that these savings were diminished (or eliminated) recently by various legal disputes in which the MOP was instructed to compensate the concessionaire for certain cost overruns during the construction stage derived from additional works and other matters.[12] Furthermore, in some cases, the delays in completing the works were not trivial (e.g., two years for Hospital Maipu and Florida).

[11] Cámara Chilena de la Construcción. 2014. "Análisis comparativo implementación de Hospitales por contrato sectorial versus Sistema de Concesiones de Obras Públicas." https://cchc.cl/centro-de-informacion/publicaciones/publicaciones/analisis-comparativo-implementacion-de-hospitales-por-contrato-sectorial-vs.

[12] CPI (Consejo Políticas de Infraestructura). 2020. "Concesionarias de hospitales piden compensaciones por obras adicionales," October 27, 2020. Consejo Políticas de Infraestructura. https://www.infraestructurapublica.cl/concesionarias-hospitales-piden-compensaciones-obras-adicionales/.

Table 3.1: Award Criteria for Concession Contracts in Chile

Art.7, DTO-900	Direct	Contingent	No impact
A) Tariff levels			X
B) Concession's term			X
C) Subsidy provided by the Government	X		
D) Payment to the Government			X
E) Minimum Revenues Guarantee		X	
F) Risk level taken by the private partner		X	
G) Tariff re-adjustment formula			X
H) Score obtained in the technical evaluation			X
I) Mix offers (in the case revenues exceed a pre-defined level)			X
J) Score obtained for providing additional services			X
K) Environmental quality			X
L) Total Revenues from the Concession			X

Source: Author's elaboration.

Additional sources of fiscal commitments are considered within the Concession Law, for instance the cost of additional works, however the legislation has established some limits. In particular, for all additional works promoted unilaterally by the MOP, the new investments can be increased by up to 15 percent of the original investment amount (Art. 19, DTO-900). Meanwhile, if both the MOP and the concessionaire make an arrangement for expanding the scope of a project and adding new works, investments can be raised by up to 25 percent of the original investment amount (Art. 20, DTO-900). Lastly, for exceptional reasons (e.g., unforeseen situations), the additional investments can be increased above 25 percent of the original investment amount (Art. 20 bis, DTO-900). The compensation scheme for this additional investment must be specified in the tender documents and can include the use of subsidies, increase of concession term, a higher present value of the concession's total revenues, adjustment of the tariff level, or a mix of these options.

Other explicit commitments can arise due to a higher price of expropriation of private assets (such as due to a legal dispute). According to the Concession Law, the expropriation expenses are entirely borne by the concessionaire, however, the Ministry of Finance may contribute totally or partially to this type of expense (Art. 15, DTO-900). In other words, the fiscal authority can absorb the difference between the initial and the final price of expropriation. This was the case for the Route 60 concession project (Camino Internacional Ruta 60 CH, in Spanish), in which the tender documents established that the MOP would pay the difference if the expropriation expense was valued at more than Unidades de Fomento (inflation-indexed unit of account; UF) 1.45 million (in 2021 it was equivalent to

US$58.7 million).[13] However, there are other projects in which the difference was only covered by the concessionaire. Hence, in terms of expropriation risk, each concession project is regulated by the tender documents, which establish the exact allocation of the risk. When the government bears the total or partial amount of the risk, contingent commitments are reported in the Report on Contingent Commitments prepared by the Budget Directorate (DIPRES). In particular, the expropriation contingency represented about US$350 million in 2020 (i.e., 0.13 percent of GDP), although it is not clear what portion of this total amount can be attributed to concession contracts (see section 3.4).

Other types of explicit commitments are caused by guarantees that Chile has granted to concessions, however Chile has established a balanced way of granting these guarantees, so that the risk of private capital remains constant. In this sense, the most widely used guarantee is the minimum revenue guarantee (MRG), which reduces demand risk for a concessionaire. As shown in the following section (section 3.3.2.2), in Chile the amount of such MRGs is not entirely discretionary, but is designed to allow the concessionaire to repay its debt service obligations while retaining the risk of the project at the same time (e.g., the amount of MRG is calculated based on the minimum capital-indebtedness ratio, mentioned in the project specifications, which allows for the design of a guarantee that covers repayment of debt as if the traffic were zero, but where the amount of invested capital is not covered).

Another guarantee with potential explicit commitment implications is the Mechanism of Exchange Rate Guarantee, which was designed at the beginning of 2000 to support concessionaires that acquired US dollar denominated debt. This mechanism sets an exchange rate band, and if the Chilean peso depreciates by more than 10 percent outside of this band, the state pays the difference to the concessionaire; if, on the other hand, the Chilean peso appreciates against the US dollar by more than 10 percent, the concessionaire pays the difference through additional works to the concession project. Although this mechanism was important for maintaining investor confidence during times of high foreign exchange (FX) volatility (and lack of banking experience), all concessionaires renounced this guarantee once perceptions of the peso's stability and banking conditions improved. Therefore, the Mechanism of Exchange Rate Guarantee was discontinued in 2005.

Contract renegotiations were an important source of fiscal contingencies in Chile. The creation of a Technical Experts Panel has reduced those contingencies. In particular, from 1992 to 2005, 47 out of 50 concessions were renegotiated with a total cost of one dollar for every four US dollars established a Technical Experts Panel (TEP) with the aim of limiting renegotiation costs. One of the most important changes introduced by the reform was an obligation to carry out a tender for any additional works agreed during renegotiations, and the original concessionaire was prohibited from participating in this tender. The TEP hears the disputes requiring any compensation from the parties, among other duties, and is formed by independent professionals with proven career track records.[14] Although recommendations issued by the TEP are non-binding, the TEP's resolutions were adopted in 40 percent of the cases, and they are taken into account if any party decides to present the dispute before the arbitration commission (which has the power to resolve the case with a binding resolution).[15] This measure proved very effective and, as demonstrated in Table 3. below, since the 2010 reform, the total number of renegotiations in the transport sector was reduced by half, while the total cost of renegotiations as a share of the total investment fell dramatically, to less than 1 percent from almost 27 percent before the reform.

[13] Bases de Licitacion, Concesion Internacional Camino Internacional Ruta 60 CH – Articulo 1.8.9 Pago del Concesionario por concepto de adquisiciones y expropiaciones.

[14] The TEP is formed by two lawyers, two engineers, and one economist/financier, proposed by the government through a public contest for a six-year term in office.

[15] Engel, E., et al. 2020. "When and How to Use Public-Private Partnerships in Infrastructure: Lessons from the International Experience." Working Paper 26766, National Bureau of Economic Research. http://www.nber.org/papers/w26766.

Table 3.2: Number and Cost of Concession Renegotiations in Chile

	Highways			Transport	
	No.	% Investment		No.	% Investment
Before 2010 reform	29	26.10%		44	27.60%
After 2010 reform	15	0.70%		25	0.90%

Source: Engel, E. et al (2020).

In the past, Chile has implemented mechanisms that offered particular solutions to the fiscal impacts of various crises. Besides the measures described above, the Chilean government designed additional mechanisms to reduce the fiscal impact of the concessions. For instance, as a result of the Asian crisis, the government gave access for concessionaires to the Income Distribution Mechanism, which acted as a type of swap among different demand growth rates. However, because this mechanism did not represent a disbursement of public resources per se, it will be discussed in more detail in section 3.5 (which considers a response that the Chilean concession system demonstrated in other crises).

One of the most innovative elements of the Chilean concession system is the Least Present Value of Revenues (LPVR) mechanism. This mechanism was important not only for limiting the incidence of contractual renegotiations in fixed-term concessions but also for reducing the costs associated with such renegotiations. In other words, this mechanism was useful for minimizing fiscal contingencies[16] (see Error! Reference source not found.). Up to 2020, about 32 concessions have used the LPVR mechanism, mainly in the transport sector. The concentration of LPVR in the transport sector makes sense since it deals with uncertainty of demand. In contrast, for other types of projects in which a significant portion of revenues does not come from users, but rather from making infrastructure available and from providing services of a certain quality (e.g., hospitals, or prisons), the LPVR mechanism is less useful. Still, LPVR may not be feasible in all circumstances, even in the transport sector. For example, in terms of demand risk mitigation it may be more useful for very long and complex concessions to provide MRGs that directly improve the medium-term liquidity of a concessionaire instead of extending the term of a concession. In fact, Gomez-Lobo and Hinojosa (2013) pointed out a middle-ground solution that combines LPVR with an explicit liquidity guarantee, such as MRG, that provides liquidity instead of subsidizing the losses, and as such, reducing the term of the concession accordingly.

[16] Gomez-Lobo, A., and S. Hinojosa, S. 2013. “Broad Roads in a Thin Country: Infrastructure Concessions in Chile.” Policy Research Working Paper, World Bank Group, Washington, DC.

Box 3.1: The Least Present Value of Revenues Mechanism

By their nature, fixed-term contracts have a high degree of uncertainty, because the realization of profits is contingent upon the correct assessment of future demand. Although this problem has usually been mitigated by using minimum revenue guarantees (MRGs), these types of guarantees can be very costly for the government. Additionally, if low demand is caused by an unforeseeable event that was not part of the initial forecast, it can be argued that the only way a concessionaire can meet its revenue expectation is through a costly renegotiation. In this sense, fixed-term contracts are not only bad at providing efficient solutions to low-demand situations, but they also do not work well in situations where actual demand exceeds expectations, because under the appropriate circumstances it may be more convenient to terminate the contract prematurely and re-tender a concession, with additional works aimed at increasing supply for the high demand. Moreover, assessing the value of a concession to compensate a concessionaire for early termination is not easy and, most of the time, is subject to legal disputes if the contract is silent on the matter.

One way to reduce the uncertainty of fixed-term contracts is through concessions with a built-in least present value of revenues (LPVR) mechanism. In these types of contracts, the bids of the firms contain the present value of revenues that they are willing to accept for a concession. The firm that requests the lowest present value of revenues wins the tender. Because the main variable is the present value of revenues, the concession term ends when LPVR matches the value submitted in the bid of the firm. In another sense, a concession has a variable term, which increases up to a maximum limit (established in tender documents) to allow the concessionaire to reach its expected income. In the opposite case, if the present value of revenues is received earlier than expected, the concession ends, and the public asset returns to the government. Among the main advantages of the LPVR mechanism are: i) the simplicity of enforcing concessions by closely monitoring the concessionaire's revenues; ii) lack of a possibility for extra profit because the concessionaire receives exactly what it offered in its bid; iii) reduced incentives for delays because they only postpone the inflow of revenues; iv) simplification of an early termination of a concession since the exact value of the concession is established (which also reduces the leverage of concessionaires in opportunistic renegotiations); v) the government can still provide revenue guarantees but at a pre-specified cost to the concessionaire (e.g., MRG); and vi) LPVR is concessionaire-friendly and allows for many competing bidders in each tender. Crucial to the calculation of LPVR is the rate used to discount future revenue flows. As we will see below, this rate is provided in the tender documents and can be either fixed or variable.

The Santiago–Viña del Mar Concession

In 1998, the concessionaire Rutas Del Pacífico offered the Chilean government US$381 million through an LPVR mechanism to construct toll roads and was awarded a concession over three other bidders that offered higher LPVRs. The basic project entailed major improvements and the extension of 130 kilometers of roads, and greenfield construction of three new tunnels. The concession had a reference period of 25 years, and the official cost of the project, according to the MOP, was US$340 million in net present value terms. The term could be shortened if the concessionaire earned the LPVR cost plus a pre-established profit in less than 25 years, or it will be extended automatically until it gets the total amount of the LPVR (before reaching the maximum term of 50 years established in the law, art. 25–DTO 900). The rate of discount offered by the MOP was a fixed rate of 10.5 percent (a risk-free rate of 6.5 percent plus a risk premium of 4 percent) or a variable rate (monthly average real risk-free rate in the financial system) plus a risk premium of 4 percent. The winner of the concession opted for a fixed rate.

Additionally, an MRG was offered separately at an extra cost of 0.75 percent of the value of the outstanding guarantees. Although the winner didn't request the MRG, two other candidates chose this option. This demonstrates the confidence that investors had in the project. Lastly, the government had an option to terminate the concession early after 12 years if traffic growth justified the development of a new project. The amount to be paid for this early termination was pre-established by a simple formula that subtracts from the LPVR offered by the concessionaire, the present value of revenues already collected plus future operation and maintenance costs. In this sense, potential disputes were limited to a relatively minor issue of estimating the present value of operating and maintenance costs.

Source: Author's elaboration with information from Gomez-Lobo, A., and S. Hinojosa. 2013. "Broad Roads in a Thin Country: Infrastructure Concessions in Chile." Policy Research Working Paper, World Bank Group, Washington, DC.

2.3.2.2. Assessment of Explicit Contingent Liabilities

Although Chile managed contingency risks for many years, it was not until 2006 that a fiscal responsibility law was introduced. The Law 20128 of 2006 formally requires the MOF to: i) estimate and publish contingent obligations on an annual basis; ii) make necessary budget provisions to absorb such contingencies; iii) acquire insurance to help mitigate the impact of contingencies; and iv) collect premiums from concessionaires that receive a guarantee from the government.

Contingent commitments are assessed and reported annually by the Budget Directorate (DIPRES), and cover a wide range of operations that can have an impact on the public budget (e.g., guarantees to student loans, and credit guarantees to state-owned enterprises, among others). Regarding concessions, DIPRES estimates and publishes an assessment of contingent liabilities coming from minimum revenue guarantees (MRGs) provided by the government for concession contracts, and other contingencies stemming from legal actions by the affected population in a concession project (e.g., expropriation events or legal controversies). However, there are other contingencies that certainly fall outside the scope of this report and methodology. Their absence has more to do with the data availability issue and inability to make accurate estimates of contingencies. For instance, to obtain consistent estimates of traffic revenues, a time series of a certain length, typically 30 years or more, is needed to ensure the desirable statistical properties. Furthermore, contingencies related to events such as early termination of a contract correspond to events with a very low probability of occurrence, in which case it is very difficult to assess an ex-ante contingent liability.

The methodology for assessing contingent liabilities is briefly described in the first report published by DIPRES on this matter in 2007 (Informe de Pasivos Contingentes 2007-Anexo*)*.[17] Although the approach used is very specialized, it is not without limitations. Primarily, the methodology depends heavily on the data's availability. Furthermore, the statistical methods used work well under normal market conditions, but since past values are used to forecast the future (i.e., some inertia is present), it is very difficult to generate accurate estimates in extraordinary situations, such as the COVID-19 pandemic. Perhaps a more accurate approximation in force majeure circumstances would be an interval estimate, rather than a point estimate.

In general, the methodology for estimating contingent liabilities from MRGs can be summarized in two steps as follows:[18]

1) The first step consists of forecasting revenues. This is done through a Brownian motion equation.[19] That is, the revenues for traffic demand grow as follows:

$$X_{t+1} = X_t \, exp\left(\mu_t - \frac{1}{2}\sigma^2 + \sigma Z_t\right)$$

where X is the traffic revenues, μ is the average growth rate in revenues, Z is a random variable with normal distribution, σ is the volatility of the growth rate in revenues, and t is an index variable indicating the period of time.

[17] See http://www.dipres.gob.cl/598/articles-21701_doc_pdf.pdf.

[18] It is noteworthy that the report shows the methodology not only for obtaining the expected value of the contingency but also the value of the guarantee (as if it were a financial instrument offered by the state in exchange for a fee). The valuation of the guarantee needs an additional step and can be obtained in two ways, either through Monte Carlo simulations or through option pricing formulas (e.g., Black-Scholes).

[19] The Brownian motion equation (BME) is very popular in financial economics. In particular, it has been used widely in forecasting financial time series according to their statistical properties.

2) Then, taking into account MRG commitments established in the contract[20] and the upper-bound limit for revenue sharing by a concessionaire,[21] a contingent liability can be determined as:

$$Cont_t = \max[\,0\,, MRG_t - X_t]$$

where Cont is the resulting Contingency in the year t, that is computed as the maximum value between zero or the difference between the minimum revenue guarantee (MRG) and the traffic demand revenues (X) for a particular year (t).

The methodology is particularly useful for projects with enough historical information. An additional step is added for computing a contingent liability net of income (which takes into account the upper-bound of the revenue sharing mechanism). Although this methodology can be used for any concession for which the government has provided an MRG, it is especially useful for concessions in the transport sector. Meanwhile, for other types of contingent liabilities reported by DIPRES, there is no particular methodology, and they must be analyzed on a case-by-case basis based on information related to legal claims (e.g., for expropriations, etc.). The figures reported in the latest available report on contingent liabilities are discussed in section 3.4.

2.3.2.3. PPP risk analysis

Regarding identification and allocation of risks, the Chilean legislation does not follow a standardized risk matrix approach,[22] however, in the case of private initiatives, risk allocation is part of the proposal presented by the private proponent. Besides, risk allocation can also be part of the award criteria (see Table 3.1, subsection F). Despite not having a standardized risk matrix, like other countries in the region, Chile follows the principle that risks must be allocated to the party that is better suited to manage them. Hence, the risk allocation varies depending on the complexity of a concession, and is established in the tender documents.

Table 3.3 shows a compilation of the most common risks and how, on average, they were allocated to private and public partners in Chilean concession contracts. The list presented in Table 3.3 is not exhaustive, and tender documents ultimately regulate allocation of risks for each project. Because this can be perceived as a way of granting flexibility in allocation of risks for complex projects, such a position can also cause confusion, because on occasion the public sector has granted guarantees to the private sector that can be perceived as counterintuitive, although it usually has occurred in very specific situations for risks that are not generally shared. For instance, although foreign exchange (FX) risk is assigned to the private party most of the time, there was a particular period in Chile during which the lack of maturity of the banking system, and high FX rate volatility, threatened the sustainability of the concession system, because part of concessionaires' debt was US dollar denominated. As described earlier, FX rate guarantees were in use until 2005, and the current macroeconomic conditions of the country (i.e., a mature banking system and stable exchange rate) make sharing FX risk with the public sector very unlikely. Other types of risk—such as traffic demand—are either entirely borne by the private partner (which completely assumes the risk or buys MRG from the government), or are shared with the public party in complex projects. In any case, the final risk allocation is defined in the tender documents and in a bid submitted by the private party (in cases when government support is an award criterion, Table 3.).

[20] In Chile, MRGs are calculated in such a way that if the income from the concession were only the IMG, the concessionaire could pay the debt, but would lose all its equity. The latter keeps the risk on the project and gives the right incentives for the private party to participate in the tender process due to the project's commercial viability.

[21] Which is defined as the upper-bound level above which the concessionaire starts sharing the excess of revenues with the government. In its simplest form, this level is computed for each period *t* as: $UBRL_t = 2 * \text{Expected Revenues}_t - IMG_t$

[22] World Bank. 2020. *Benchmarking Infrastructure Development.* https://bpp.worldbank.org/.

Table 3.3: Common Risk Allocation

Stage	Risk	Public	Private	Shared
Construction	Construction cost overruns		X	
	Expropriation	X		
	Delays		X	
	Additional works	X		
	Enviromental risks			X
	Financing risk		X	
Financing	Exchange rate		X	
	Interest rate		X	
	Term		X	
	Political risk		X	
	Credit capacity		X	
	Refinancing risk		X	
Operation	Traffic demand		X	X
	Maintenance cost overrun		X	
	Deferred maintenance		X	
	Environmental risk			X
	Tariff revision	X		

Source: MOP 2016, idem, p. 82.

Although the standard risk matrix provides certain expectations regarding which risk can be shared or borne by one or another party, the concession system in Chile, with a history of structuring concessions that dates back to 1990, provides experience in correct assessment of those risks. In fact, because most of the projects have been developed for the transportation sector (75 percent), the expectations regarding risk allocation are very stable, although risk allocation can differ in some complex projects. However, this allocation can influence the decision regarding the awarding of the concession (i.e., the awarding criteria can grant higher priority to those projects with less government risk allocation), and in this sense, the allocation of risks is efficient.

2.4. Reporting Requirements

2.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

In Chile, direct commitments are reported in the annual budget as capital expenditures to be executed under the public entities' concession program. Meanwhile, contingent commitments are planned in the budget of the fiscal year after the year in which they were triggered (in cases where the contract allows it). For the rest of commitments whose payment cannot be programmed, the budgetary regulations mandate reallocation of the budget to prioritize payment of these contingencies. In rare cases, when reallocated resources are insufficient, under the approval of the Ministry of Finance, the payment of these commitments could be financed with public debt.

Additionally, Chile reports the contingent commitments on an annual basis in a special report prepared by the Budget Directorate (DIPRES), and disseminated through the DIPRES webpage, granting the public access to the report. The Report on Contingent Liabilities presents information on different contingencies assumed by the government related to, among others, the concession system, pensions, and student loan guarantees. For those contingent liabilities stemming from concession contracts, the report acknowledges three types of contingencies:

i) the minimum revenue guarantees (MRGs), ii) legal disputes, and iii) controversies in the concession system. However, the report only disaggregates the information related to MRGs in the concession system, whereas the other items are aggregated for the concessions, the pensions, etc. In particular, for MRGs, the report considers two figures for the stock of contingencies, the maximum exposure and the expected value realization, as well as a figure reflecting the current year's maximum exposure.

Although MRGs are not trivial at face value, they are very low at expected value. Figure reports the figures for MRGs in the following way: the present value of the portfolio's maximum exposure of MRG (stock maximum exposure) in green, the present value of the portfolio's expected value of MRG triggered (stock expected value) in orange, and the annual maximum exposure of the MRG (annual maximum exposure) in blue. As we can see, in 2020, the present value of all the MRGs granted by the government resulted in a maximum exposure of 1.43 percent of GDP, however only some portion of this exposure is expected to trigger in the following years, hence the present value of only those contingencies that are expected to trigger is 0.15 percent of GDP, which represent less than 10 percent of the maximum exposure in present value terms. Moreover, for the year 2020, the annual maximum exposure coming from MRGs is about 0.01 percent of GDP. This means that if the MRGs of the year 2020 are triggered for the full amount, this figure would be very manageable. It is noteworthy that even though the projections made relied on historical information about traffic demand (which increased in 2019 by 10 percent), DIPRES tried to internalize the pandemic's effect on traffic through a negative shock in economic activity of 6 percent. That is, the DIPRES reduced the positive inertia of the 2019 traffic demand through a 6 percent reduction in GDP. However, it is not clear if the negative GDP shock would allow for the correct internalization of the pandemic effect, given that in some cases the reduction in traffic revenues was as high as 31 percent on average (see Figure 3.6).

Figure 3.5: Present Value of MRG as Percentage of GDP

Source: Author's elaboration with information from Informe de Pasivos Contingentes for the years 2013-2020.

Moreover, the report on contingent commitments also contains the contingencies from legal disputes but at a more aggregated level. In these cases, we can only acknowledge that the government is taking into account these contingencies in its programming effort, but it's not possible to say what proportion of these contingencies can be attributed to the concession system. For instance, in terms of expropriations, the 2020 report mentions that the government has 713 open legal processes for US$353 million demanded (maximum exposure) coming from expropriations of concession projects, the subway (Metro, in Spanish) being one of them. Finally, related to controversies coming from the concession system, the 2020 report acknowledges that there are 74 active claims requesting a total of US$778.98 million. The maximum exposure is equivalent to 0.3 percent of 2020 GDP.

Although Chile has not established a particular ceiling for the number of commitments acquired through the concession program, like other countries in the region, it does maintain a fiscal rule based on a balanced budget (BB).[23] The BB takes into account the current budget (including different contractual commitments) for projected expenditures in the next four years, and, after computing the structural revenues, defines a medium-term ceiling. This rule is overseen and reported annually, and has been updated quarterly since 2019. The quarterly Report of Public Finance (Informe de Finanzas Publicas, in Spanish), has defined a strategy aimed at generating a budget surplus of 1 percent of GDP over the medium term (2025-2030), because, due to the pandemic, it is expected that the government will incur a budget deficit that prevents it from compliance with the BB rule in the coming years (2021-2024). The BB rule is the only fiscal rule implemented in Chile, and some Chilean economists have argued that moving to a more transparent fiscal rule, such as a debt-to-GDP ratio, could benefit the country's long-term financial sustainability.[24]

In terms of accounting, Chile has adopted the 32 norms of the International Public Sector Accounting Standards (IPSAS 2013), including IPSAS 16 and 32, which govern accounting for concessions. The Comptroller General is the institution in charge of issuing and implementing the accounting regulations. This is done through the Regulations of the General Accounting System of the Nation (Normativa del Sistema General de Contabilidad de la Nacion, in Spanish). In terms of direct commitments, if the concession requires payments by the government (e.g., availability payments), the norm establishes that those payments should be accounted for on an accrual basis as a financial liability. Meanwhile, if the concession only requires payments by the users (e.g., road tolls), they should be accounted for on an accrual basis as the concession's rights liability. These liabilities (either one or a mix of both) should match the value of the asset under concession.

According to the legislation, not all contingent commitments need to be reported in financial statements. Moreover, contingent commitments should not be recognized in the financial statements of the government, unless their trigger probability (probability of occurrence) is assessed to be more than 50 percent and the value of the contingency can be assessed consistently, in which case such contingencies should be accounted for as provisions. However, unless the probability of the outflow of resources is less than 5 percent, contingent liabilities should be disclosed in the Notes to the Financial Statements.

2.4.2. Transparency policy of PPP contracts

The concessions legislation establishes a very broad transparency policy for the documents generated in the concessions cycle. According to the Regulation of the Concession Law (art. 98): Once the decree awarding the concession contract has been authorized, all the relevant documentation for the execution of this contract will be public, that is, the bidding conditions, the drafts, projects and other studies and reports supplied by the MOP to the bidders, the bid made by the successful bidder and the acts of evaluation. The MOP must make this information available to whomsoever is interested in it, and provide the necessary facilities for its reproduction, which will be paid by the interested parties. The same procedure will be applied in the case of supplementary agreements, modifications of the rate system and other modifications to the concession contracts.

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However, there are some exceptions that apply for the full disclosure of the concession's information. The Transparency Law (Ley 20.285/2008) requires that any information that supports the administration's decisions is considered public information, with some exceptions. The information has to be published in an active way, or be provided on demand to the interested people (Art. 5). However, as with other transparency laws, there is some

[23] In a balanced budget rule, government expenditures are budgeted in line with structural revenues (i.e., revenues that would be achieved with the economy growing at their potential rate, and prices at their long-term levels).
[24] Leiva, Miriam. 2020. "Economistas plantean al CFA cambiar la regla fiscal y alertan por trayectoria de deuda," *La Tercera*, June 7, 2020. https://www.latercera.com/pulso/noticia/economistas-plantean-al-cfa-cambiar-la-regla-fiscal-y-alertan-por-trayectoria-de-deuda/5UROA5ZKNZCE3HA36KC2W7EFXE/.

information that can be exempted from public release, in particular, information that can damage commercial or economic interests, if the information is part of international agreements, and other cases (Art. 21). The exemptions apply for an initial period of five years, and can be extended for an additional five-year period; after that, the information must be fully released or be declared reserved permanently in case it affects national sovereignty (Art. 22).

Although the preservation of some sensitive information is common in practice, Chile maintains certain efforts towards transparency by publishing concession contracts and by updating the Directorate of Public Works and Concessions (DGCOP) webpage. Many countries release information related to PPP projects, contracts, and basic information on financial models or repayment schemes, but most of the financial details of the operations are kept confidential according to a bank secrecy argument, and for some other countries, even the cost-benefit analysis, the value for money assessment, or the bids received in the tendering process are not released to the public. However, among the countries in the region, Chile is one that has made public most non-financial information, because PPP contracts, contract modifications, and other documents are published on the webpage of the DGCOP of the MOP.[25] This provides some level of transparency that adds to the accountability of the PPP program.

2.5. Performance under Crisis

2.5.1. The Asian Crisis

Chile has offered innovative solutions in times of crisis that have kept fiscal impacts to a minimum. In the late 1990s, Chile was affected by the Asian financial crisis, which caused a negative shock to economic activities. This event impacted the traffic demand of certain road and highway concessions by reducing their traffic growth rate expectations. Faced with this scenario, some concessionaires raised the idea of starting contractual renegotiations due to the supervening event caused of the Asian crisis. The argument was sustained by considering that even when the crisis was over, the damage to future traffic expectations had already taken place, and the concessionaires would not obtain the expected returns on their investments. Due to the complexity of finding a solution for each distressed concession, and the costs that this discovery process would entail, the government came up with a financial instrument called the income distribution mechanism (MDI). The premise behind the MDI was that the difference in future traffic expectations of a concessionaire (pessimistic) and the government (optimistic) would give some space for negotiations. In this regard, the MDI acted as a swap that exchanged a variable revenue growth rate for a fixed one. In particular, the MDI operated in the following way: a concessionaire could adhere to the MDI on a voluntary but permanent basis. The price of the MDI was set as a percentage of total concession revenues (ITC) in present value terms, which had to be paid through construction of additional works under the same concession contract. In this way, the government offered revenues with fixed growth rates of 4 percent, 4.5 percent, and 5 percent (chosen by the concessionaire) over the real income obtained in 2002. If the income grew at a higher rate than the one chosen by the concessionaire, then the concession's term would be reduced to match the date by which the modified total revenues of the concession[26] were reached, and vice versa. The MDI helped more distressed concessions and was adopted by seven concessionaires. The government raised close to 5 million UF (Unidades de Fomento, an inflation-indexed unit of account; at current prices, equivalent to US$210 million) that were invested in additional works, at a time of reduced fiscal space.

A similar solution as the MDI in the context of the current crisis is unlikely, and Chile is betting on maintaining a position of institutional strength by not giving in to contractual renegotiations as the first solution. It might be convenient to remember that the MDI mechanism was offered during times when the main government objective

[25] See https://concesiones.mop.gob.cl/Paginas/default.aspx.
[26] Modified in the sense that the total revenues were recalculated taking into account the baseline year, and the growth rate chosen by the concessionaire.

was to demonstrate the viability of the concession system, and the access and certainty of the financial system could have been in doubt if concessions started to fail. None of these conditions are currently present. In fact, Chile has a solid financial sector that, for some concessions during COVID-19 distress, agreed to extend the repayment of credits until the end of 2022, and a concession system that is the best rated in the Latin American region, according to Infrascope (2019). Moreover, it seems that during the COVID-19 disruption the emphasis of the authorities is on enforcing concessions legislation and not yielding to renegotiations, citing that the 2010 reform was clear in establishing that supervening acts of a general nature are not subject to compensation,[27] and emphasizing that the government has lost revenues from concessions, sometimes three times more than what the concessionaires lost, so everyone must assume their share of risk.[28]

2.5.2. Impact of COVID-19 on PPP Program

Thegovernment to contain the global pandemic (COVID-19), such as reducing social mobility at the national and international level, had an impact on Chilean concessions. In particular, the decrease in traffic demand caused a reduction in revenues received by concessionaires. For instance, the Autopista Central (Norte-Sur) concession suffered a substantial 31 percent decrease in anticipated revenues since social isolation measures were implemented (45 percent if it's compared to the year-on-year (YoY) change at the lowest point, that is, June 2019 versus June 2020) (see Figure 3.6). Furthermore, the concessionaire' revenues had been affected even before the impacts of COVID-19 due to a legal dispute that the government had with the concessionaire derived from a tariff reduction that should have already taken effect some time previously. This reduction was triggered by contractual conditions related to peak-hours performance.[29] The legal dispute came at a bad time for the concessionaire, which had agreed to lower the rate in some sections, but sought to appeal to maintain the rate to the technical panel in other sections.

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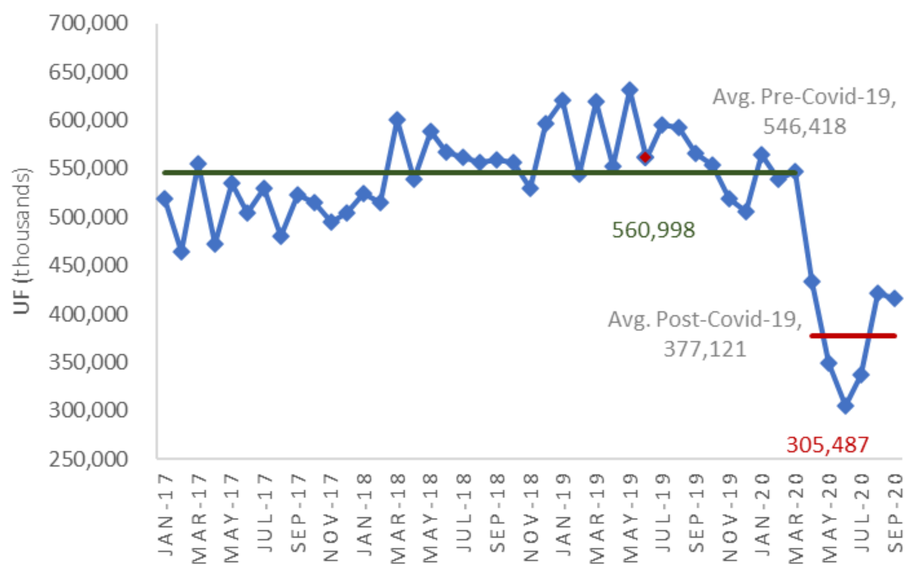
[27] Law No. 20410, Art. 19.

[28] Interview with the Minister of Public Works. 2021. "Moreno: 'Por cada peso que ha perdido el aeropuerto, el Estado ha perdido tres.'" *Pauta Bloomberg*, January 21, 2021. https://www.pauta.cl/negocios/bloomberg/moreno-por-cada-peso-que-ha-perdido-aeropuerto-estado-ha-perdido-tres.

[29] Orellana, Gustavo. 2020. "MOP anuncia rebaja de tarifas del TAG en tres autopistas urbanas y lleva a arbitraje a sus concesionarias." *La Tercera*, May 8, 2020. https://www.latercera.com/pulso/noticia/mop-anuncia-rebaja-de-tarifas-de-algunas-autopistas-urbanas-y-lleva-a-arbitraje-a-sus-concesionarias/HU5Q3PBUZ5D4ZCEFZOV3CY4RZI/.

Figure 3.6: Impact of COVID-19 on Revenues from Autopista Central (Norte-Sur)



Source: Author's elaboration with data from CAF (2020). Efectos del COVID-19 en los proyectos de APP.

2.5.3. Measures implemented to help cope with the consequences of the COVID-19 crisis

Chile has implemented different measures to cope with the global pandemic through an emergency fund. In December 2020, in response to the health emergency caused by the global pandemic, a Transitional Emergency Fund COVID-19 (FET COVID-19) was created in Chile to cover all kinds of expenses derived from the crisis. The fund contemplates an initial contribution of US$12 billion, and, among other measures, aims to support economic recovery by promoting private investments through temporary tax incentives, regulatory simplicity, and acceleration of concessions' investments. The ministries that employ resources from this fund for public investments or concession projects need to present a monthly report to the Ministry of Finance to describe the status of these projects.[30]

A recovery plan intended to boost investment in the country is considering expediting the bidding and construction of 31 projects through the concession system, with a total investment of US$8.6 billion. For the period 2020-2022, the plan projects an investment of US$4.15 billion in concession projects.[31] It is noteworthy that the pipeline of concession projects for 2021-2025 adds up to 53 projects, 37 of which have a total investment of US$11.5 billion.[32] Although this is an ambitious program that would surely help boost investments and employment, the government has not taken any action to support the distressed concessionaires.

Although there is no explicit support planned for projects negatively impacted by the global pandemic, some concessionaires have requested compensation from the government, arguing that supervening events have affected the financial equilibrium of the concessions. In fact, in 2021, three concessionaires appealed to the technical panel to request compensation due to supervening events caused by the government (related to implementation of COVID-19 measures). In two cases, concessionaires in charge of Santiago and Puerto Montt International Airports have argued that these measures caused a disequilibrium in the financial model that won't be recovered within the contracts' term. Moreover, an additional concessionaire in charge of the Hospital Felix

[30] Monthly reports: https://reporte.hacienda.cl/fondo-de-emergencia-transitorio-covid-19/.
[31] https://www.gob.cl/chileserecupera/inversion/.
[32] Agenda de Concesiones 2019 – 2025: http://www.concesiones.cl/proyectos/Paginas/default.aspx.

Bulnes in Santiago also requested compensation for additional costs due to new requirements, excess demand, and changes imposed by the authority, as a consequence of COVID-19. In all cases the panel accepted the supervening nature of the event, however, it proposed different alternatives to the ones suggested by concessionaires in each case. In the case of Santiago airport, the panel rejected proposals submitted by the concessionaire but suggested that the MOP initiate conversations to deal with potential compensation based on contractual terms.[33] For Puerto Montt airport, the panel rejected the proposal submitted by the concessionaire, but suggested that the MOP needs to acknowledge the 50 percent decrease in traffic demand, which will result in compensation granted by the government.[34] For Hospital Felix Bulnes, the panel suggested compensation for some of the items claimed by the concessionaire.[35]

The request of the concessionaires does not seem to have a solution in the short term, and it will surely go to the arbitration committee, where some specialists have argued that this type of general event is considered in the law, and as such, there is no room for compensation. Although the concessionaires have submitted their request to the Technical Panel, it is noteworthy that resolutions from the panel are not binding, and, in this sense, if one of the parties does not agree with the resolution of the issue, the next step would be to request a binding opinion from the arbitration commission, which seems to be the case for all three projects. In fact, in the case of the Nuevo Pudahuel and Aeropuerto del Sur concessionaires, some experts support the stance of the government not to renegotiate the contracts, arguing that the Concession Law of 2010 excludes this type of compensation in cases when a supervening event constitutes a legal or an administrative rule issued with general effects. In this sense, it is argued that by not ceding, the government is strengthening the concession system by attracting sponsors that rely less on renegotiations and more on their capacities to overcome challenging situations such as the COVID-19 pandemic.[36]

Chile is better prepared now to deal with a crisis than it was before. Different legal amendments to the concessions law have made this possible, strengthening its institutional capacity over the years and reducing its exposure to contingent liabilities. In particular, the flexible-term contract has been one of the most innovative schemes that Chile has implemented in its concessions contract, since it better manages the risk associated with the demand and reduces the number of costly renegotiations that use public resources. In the actual context, these contracts will automatically extend its term (up to a legal maximum) to compensate for the expected revenues of the concessionaire established in its bid price. Moreover, establishing a technical experts panel (TEP) has proven efficient in reducing the number and the value of contract renegotiations. In the aftermath of the global pandemic, the reluctance of the government to compensate certain concessions on legal interpretation grounds is going to be tested in coming years. In the meantime, the concessions projects will be moving forward through an ambitious program of recovery that aims to boost investment.

[33] https://www.panelconcesiones.cl/Repositorio/21587/RECOMENDACI%C3%93N%20D02-2021-16.pdf
[34] https://www.panelconcesiones.cl/Repositorio/21021/05.04.2021%20Recomendaci%C3%B3n.pdf
[35] https://www.panelconcesiones.cl/Repositorio/21659/RECOMENDACI%C3%93N%20D03-2021-14.pdf
[36] https://www.bnamericas.com/es/entrevistas/chile-hace-bien-al-exigir-que-los-concesionarios-asuman-los-riesgos

Annex 2 A: Chile FCCL Principles

#	Principles	Clarification	Assessment for Chile
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for contingent liabilities	Well-established methodology issued by the government since the first Report of Contingent Commitments in 2007.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	The MOF uses its own spreadsheets and macro-fiscal cost assessments under PPP risks.
	CONTROL: Assessing affordability as an input to approval		
3	Fiscal Impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated, taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	The MDSF reviews the social return of a project; the MOF reviews budget capacity to carry out a project; the MOP, with the advice of the Concessions Council, MOF and other ministries that have an interest in the development of a project, determines if the project is in the public interest through a multi-criteria analysis that takes into account the information provided.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact	The MOF performs a public comparator analysis, and assesses the value for money of a project that justifies the convenience of using concession system.

#	Principles	Clarification	Assessment for Chile
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	There is no specific fiscal ceiling for concessions, however Chile maintains a balanced budget rule in which fiscal direct commitments add to the total amount of the expenditures, hence, the fiscal commitments from concessions are regulated indirectly through this rule.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide relief to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Due to the balanced budget rule, Chile projects the expenditure/revenues for the next four years in order to plan in accordance with the rule. Although this plan is only binding for the first year, the rule allows for better planning of future commitments.
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide relief to the private partner and ensure bankability, mechanisms should be in place to ensure government is able to fund contingent liabilities should they materialize.	No mechanisms in place to budget for contingent liabilities. When a contingency is triggered, the resources need to be provided through budget reallocation or the next-year budget (either with the contracting authority's resources, or public debt).
	REPORT: Accounting, monitoring and disclosure		
8		Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Chile has adopted the 32 norms of IPSAS (2013), including IPSAS 16 and 32, which govern accounting for concessions.

#	Principles	Clarification	Assessment for Chile
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report is created on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money, and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	Direct commitments are reported in the annual budget, and contingent commitments through a Contingent Liability Report that is published annually. The Directorate of Concessions (DGCOP) discloses general information related to the PPP contracts.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	The Comptroller General is in charge of reviewing the legality and constitutionality of the tender documents in a concession, as well as conducting audits, when necessary, to ensure regulatory and contractual compliance.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including SOEs.

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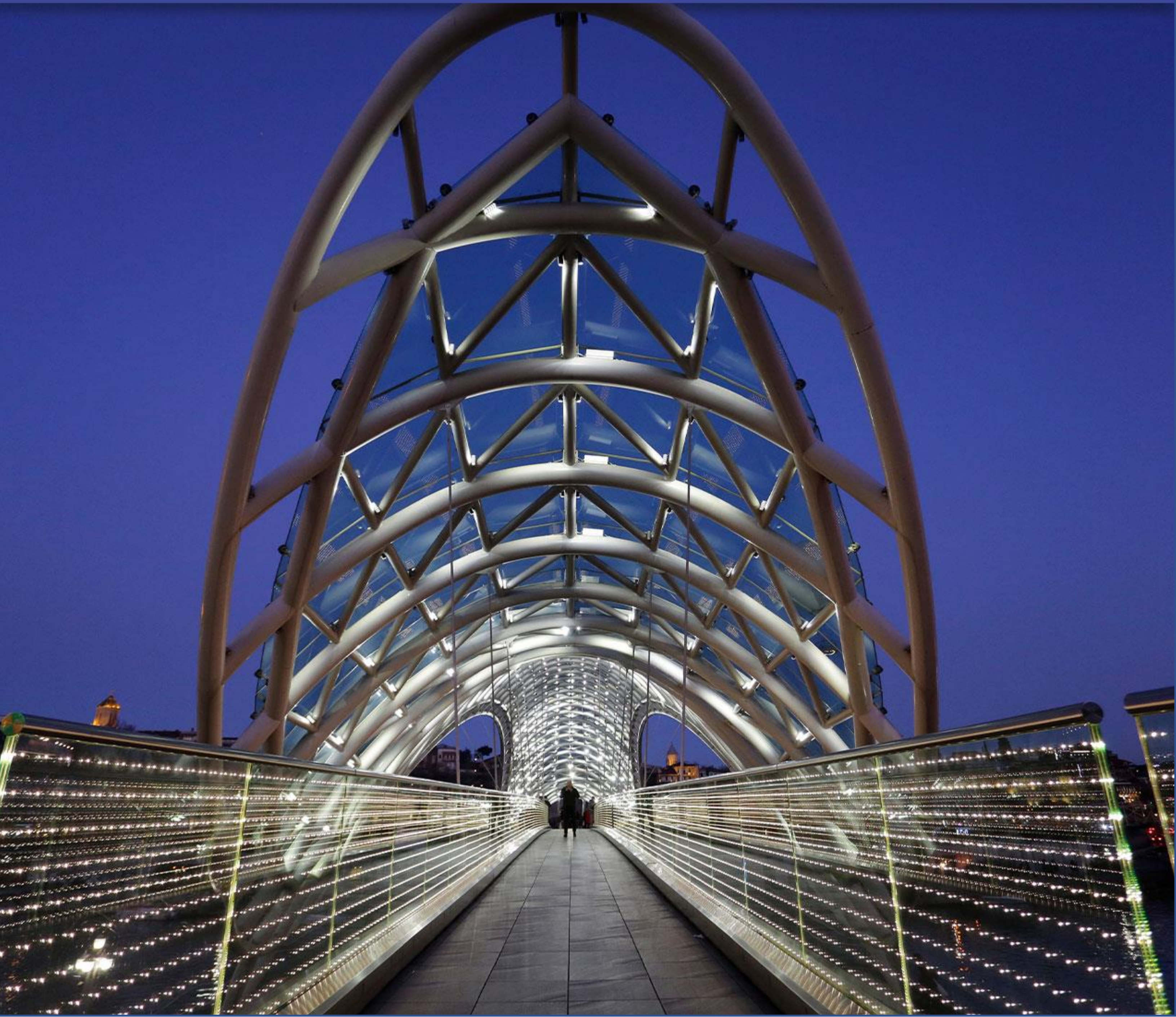
Chapter 3: Georgia



Chapter 3: Georgia

Acronyms and Abbreviations

ADB	Asian Development Bank
BOO	build-own-operate
BOT	build-own-transfer
DFI	development financial institution
EBRD	European Bank for Reconstruction and Development
ESCO	Electricity System Commercial Operator
ETA	Electricity Transmission Agreement
FCCL	fiscal commitments and contingent liabilities
GDP	gross domestic product
GEL	Georgian lari
GGI	Good Governance Initiative
GoG	Government of Georgia
GSE	Georgian State Electricity System
IFI	international financial institution
IPP	independent power producer
IPSAS	International Public Sector Accounting Standards
MDB	multilateral development bank
MoESD	Ministry of Economy and Sustainable Development
MoF	Ministry of Finance
MoRDI	Ministry of Regional Development and Infrastructure
MOU	memorandum of understanding
NBG	National Bank of Georgia
PATA	Policy and Advisory Technical Assistance
PCN	project concept note
PFRAM	Public-Private Partnerships Fiscal Risk Assessment Model
PIM	public investment management

PMCG	Policy and Management Consulting Group
PPA	power purchase agreement
PPP	public-private partnership
PSC	public sector comparator
USAID	United States Agency for International Development
USP	unsolicited proposal
VfM	value for money
WB	World Bank
YoY	year-over-year

Executive Summary

Georgia followed the path of many developing nations in that—after an initial wave of privatizations—PPPs emerged ad hoc, without any public-private partnership (PPP) or fiscal commitments and contingent liabilities (FCCL) framework or sectoral development policies in place. Because energy self-sufficiency was a critical issue, and also because independent power producers (IPPs) developed on the build-own-operate (BOO) model offered the easiest opportunities for private sector participation in infrastructure, Georgia's PPP program has evolved overwhelmingly in the energy sector. In the absence of any system to analyze corresponding government obligations or a regulated electricity market, the Government of Georgia (GoG) took on substantial fiscal risk accumulated in the form of take-or-pay style power purchase agreements (PPAs).

The country's renewed focus on integration of EU standards and its high dependence on international financial institutions (IFIs) forced Georgia to deal with the problem after the fact. Measures included substantial institutional and legislative changes as well as the development of an alternative mechanism to utilize PPAs in the energy sector. These have all been steps in the right direction, and thanks to the involvement of international development organizations, Georgia now has a robust set of regulations and guidelines that reflect best international practice. However, its catch-up approach to developing a PPP framework highlights a common problem with this dynamic. As of now, the established framework remains mostly theoretical in nature, and line ministries lack both capacity and incentives to initiate projects, which, in turn, leads to lack of experience with the newly established framework. Thus, PPPs continue to come in the form of directly negotiated unsolicited proposals (USPs) for IPP projects in the energy sector.

There have been hardly any projects (except for Nenskra HPP and a few others) that were initiated and developed by the public side, and Georgia's unique position in the IFI community might be one of the factors explaining this. The country is sometimes referred to as a "donors darling" and receives ample donor funding for various purposes. A side effect is a lack of motivation for Georgian government agencies to consider PPPs when traditional procurement is much faster and easier, and concessional finance is abundant. Georgia's newly adopted value for money (VfM) methodology has so far not been put into practice much, and the country is at this point unprepared to use complex financial tools. Both facts offer yet more evidence that Georgia's PPP framework has developed more in response to external IFI requirements than for internal reasons. Though the COVID-19 pandemic offers a chance to change this situation, such a shift has yet to be seen.

Certain pockets of expertise exist, but advancing the PPP program to the next level will require comprehensive government buy in. Although changing the mindset and capacity of the parties involved in the PPP process is a more daunting task than that of having robust regulations in place, there are already some pockets of practical expertise in the GoG that provide reasons for optimism. For example, (voluntary) work done by the Ministry of Finance (MoF) in assessing PPP assets and liabilities in accordance with International Public Sector Accounting Standards (IPSAS) 32 and contingent liabilities from PPAs in accordance with IPSAS 19, as well as disclosure of the results, has given the country greater awareness of potential fiscal risks from PPP or IPP projects, compared to similar awareness of some other developing nations. These efforts better prepare the MoF for transition to more solid accounting and disclosure frameworks, such as IPSAS. The fact that MoF considered adoption of the Public-Private Partnerships Fiscal Risk Assessment Model (PFRAM) analytical tool, developed by the World Bank Group and the International Monetary Fund (IMF), and found it to be of limited use is also notable. It shows that in the eyes of decision-makers in a country, PFRAM might not appear to add value despite that country being significantly exposed to contingent liabilities. Therefore, either more capacity building is required to ensure that all capabilities of the PFRAM model are well understood, or adjustments of certain rationales and explanations in the model itself should be made to eliminate any confusion on the part of readers and potential users.

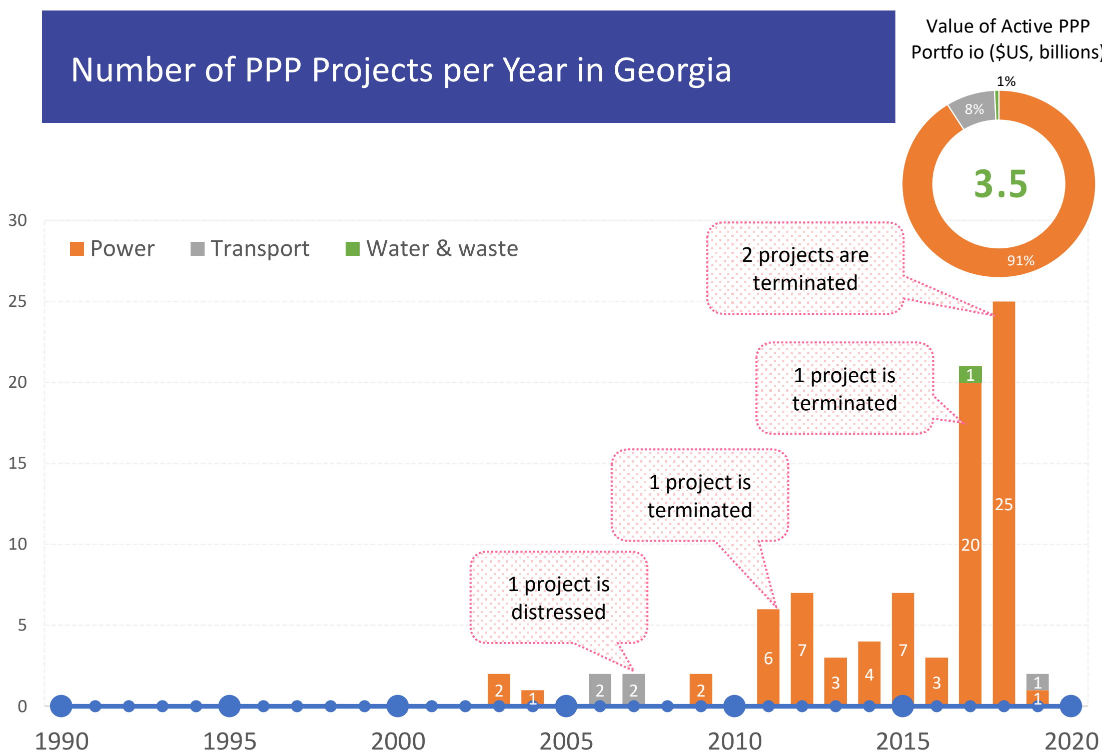
The reluctance of the GoG to support PPP projects with debt or revenue guarantees, as well the energy sector's relatively low vulnerability to COVID-19 disruptions, helped Georgia during the pandemic and prevented it from accumulating additional fiscal risk besides that related to PPAs. Essential building blocks—to ensure that the country has not wasted its efforts and can prepare for more complex and well-structured PPP projects—include: the development of sectoral strategies and priorities, expansion of line ministries' capacity in project initiation and preparation, and all parties' gaining experience with actual projects in the new system. Supporting PPPs throughout all GoG sectors means moving beyond having impressive regulations in place merely to comply with donors' requirements and to continue receiving support, but without anybody using them, to having great regulations that meet genuine needs in different infrastructure sectors in a high-quality way.

3.1. PPP Experience

Georgia has a long history of private sector participation in infrastructure, particularly via privatizations in the 1990s and 2000s. It also has some experience with PPPs and has identified the need for a revitalized PPP program to close the country's infrastructure gap.

The Georgian PPP portfolio is dominated by energy IPPs, with limited exposure in the transport and water and waste sectors. According to the available data, there were a total of 87 PPP or IPP transactions in Georgia that reached financial close, entered the construction phase, or became operational from 2003 to 2020; they generated a total investment of US$3.73 billion (including distressed and terminated projects) or an annual average of 2 percent of gross domestic product (GDP) in the years when investments were made. Out of these 87 transactions, two were concluded, one was distressed, four were terminated, and the remaining 80 are either operational or in the construction stage. Table 4.1 and Figure 4.1 below illustrate the size and main characteristics of the Georgian PPP program to date.[37]

Figure 4.1: PPP Projects that Reached Financial Close, Entered Construction or Operational Phase, 1990-2020



Source: Private Partic pation in Infrastructure (PPI) and Infrastructure Journal (IJ) databases, Ministry of Finance (MoF) and Ministry of Economy and Sustainable Development (MoESD) of Georgia.

As can be seen from Figure 4.1, the main build-up of Georgia's PPP portfolio began in 2011 and peaked in 2017-2018. Therefore, the COVID-19 pandemic is the first large-scale global crisis that the existing portfolio has faced.

[37] ICT projects of purely commercial nature, such as cellular network licenses and the like, were excluded from the analysis as not meeting the definition of PPPs. For a definition of PPPs, refer to the PPP Reference Guide, version 3: https://openknowledge.worldbank.org/handle/10986/29052.

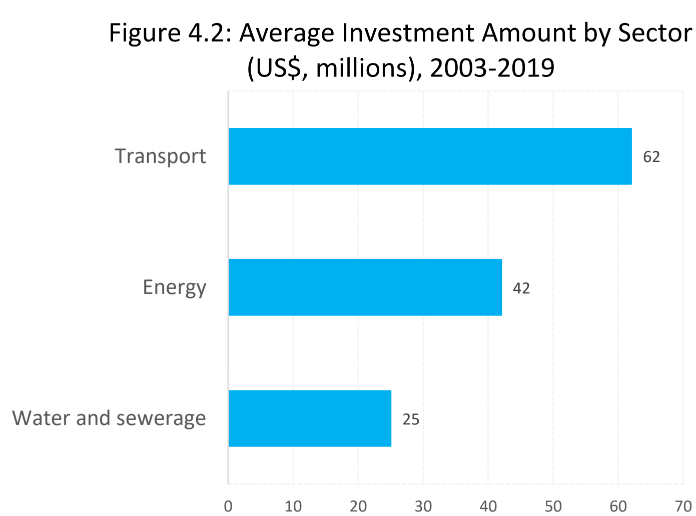
Table 4.1: PPP Projects that Reached Financial Close or Entered the Construction or Operational Phase, 2003-2019

Type of contract	Number of projects	Investment amount (US$, millions)
Greenfield (BOT, BOO)*	79	3,386
Management/lease contract	4	226
Brownfield (BROT, ROT)*	4	121
Total	87	3,733

* BOO = build-own-operate, BROT = build-rehabilitate-operate-transfer, BOT = build-operate-transfer, ROT = rehabilitate-operate-transfer

The great majority of Georgian PPP projects are in the energy sector, predominantly IPP transactions with BOO modality, based on both the number of projects (93 percent of the total) and investment amounts (91 percent). The 81 projects have an average investment amount of about US$42 million, ranging from zero for two management contracts to US$777 million for the Khudoni 700 megawatt (MW) hydropower plant. In total, there

Figure 4.2. Average Investment Amount by Sector (US$, millions), 2003-2019



Source: Private Participation in Infrastructure (PPI) and Infrastructure Journal (IJ) databases, Ministry of Finance (MoF) and Ministry of Economy and Sustainable Development (MoESD) of Georgia.

are 81 generation projects (mostly hydropower, with one wind and one thermal power plant), one electricity distribution and one transmission transaction (both concluded management contracts) and one energy generation project with a transmission component (also hydropower). In the transport sector, five transactions are divided among three port contracts (the Batumi Seaport lease, Batumi International Container Terminal rehabilitate-operate-transfer (ROT) project, and Multifunctional Marine Terminal at the Port of Poti Phase I build-rehabilitate-operate-transfer (BROT) transaction) and two airports (Tbilisi and Batumi International Airports; Tbilisi is a BROT contract and Batumi is a lease). The average investment amount in the transport sector is US$62 million and the total investment is US$321 million. Finally, there was one transaction in the water and sewerage sector, the Gardabani wastewater treatment plant and water supply infrastructure rehabilitation project structured as an ROT contract. This received only a limited investment of US$25 million.

Georgia's efforts to procure projects as public-private partnerships have been poorly defined, fragmented, and largely opaque, with the bulk of PPP exposure obtained on an ad-hoc basis without due attention to the projects' fiscal implications. The newly established PPP framework is only a recent development (since 2018), so the majority of the active PPP portfolio was acquired on an ad-hoc basis, outside of any PPP or fiscal commitments and contingent liabilities (FCCL) framework, overall infrastructure development strategy, or sector plans.[38] Many of these PPPs are regulated by standalone special agreements, resolutions, and self-regulating contracts initiated by relevant line ministries and approved by the cabinet on a case-by-case basis. Many IPP projects were initiated as USPs via memorandums of understanding (MOUs) signed between the GoG and prospective project developers and were directly negotiated. Although the GoG didn't provide any direct fiscal support to PPP projects in the form of guarantees or through other mechanisms, its previous failure to adequately account for contingent liabilities in a number of PPAs resulted in accumulation of considerable contingent fiscal exposure.

Recognizing that continuing to sign more PPAs would only lead to additional fiscal risk, the GoG started to develop an alternative mechanism, one that supports IPP developers with a so-called "green tariff" for each generated kilowatt-hour (kWh). Developers at the MOU stage (before the start of construction) are given an option to switch to this mechanism instead of signing a PPA. More projects in the future are expected to use this scheme instead of signing PPAs. The main parameters of the support scheme were approved by Government Resolution № 403 on July 2, 2020, "On Approval of the Support Scheme for Production and Use of Energy from Renewable Sources"[39] (hereafter, "Resolution on Premium Tariff"). According to this resolution, the GoG commits that during the 10 years from the date of issuance of the commissioning and production license for a power plant with installed capacity higher than 5 MW, within eight months out of the year (January to April and September to December), it will pay a premium of US 1.5 cents per 1 kWh of electricity generated and sold on the organized wholesale electricity market if the equilibrium market price for each respective hour falls below US 5.5 cents. However, if the difference between the equilibrium market price for the respective hour and US 5.5 cents is less than US 1.5 cents, then the premium tariff will be calculated as this difference. Through this mechanism the GoG limits potential losses to not more than US 1.5 cents per 1 kWh in an environment of deregulated electricity prices[40]—a major risk for the PPA mechanism.

There are no implementing regulations for this new scheme yet, and it's not clear how exactly it will be integrated into the existing PPA regime, but the guarantee on the price and output under PPAs will no longer be present and amounts to be paid under this scheme will be approved by Georgia's parliament. Some developers have already agreed to switch to the new scheme, but others are still negotiating. The MoF admits that there is a risk that developers might dispute the transfer of a power plant previously planned to be developed under a PPA to this new scheme due to changed feasibility study costs or forgone annual revenues. However, the GoG estimates that potential litigation costs from such disputes will be immaterial (in the range of hundreds of US dollars), and it is ready to face them. Nobody has gone to the courts yet, but potential reputational damages from these lawsuits are assessed to be potentially bigger than actual monetary damages. Because these projects are not operational yet (projects in operation continue to function under PPAs) there will be no financial risks from cancelling projects that are beyond the construction phase.

3.2. Legal Framework and PPP Approval Process

3.2.1. PPP Governance, Institutional and Legal Framework

As with many other countries, Georgia entered the PPP market through privatization. Many countries first gained experience with private sector participation in infrastructure via economic liberalization policies that supported privatization programs, before later developing PPP programs that built on their privatization experiences. Georgia

[38] The Georgian energy generation development plan was presented by the Georgian State Electrosystem on November 25, 2020. It was developed in consultation with French EDF and Énergies Demain with support from the French Development Agency (AFD) and presents a core document which shall guide future development of the energy sector, including through PPPs/IPPs. For more information, refer to the Presentation of the "Georgian Generation Development Plan", November 26, 2020. http://www.gse.com.ge/comunikatsia/akhali-ambebi/saqarTvelos-generaciis-ganviTarebis-gegmis-prezentacia.
[39] Government of Georgia. 2020. Resolution No. 403. July 2, 2020. https://matsne.gov.ge/ka/document/view/4914589?publication=0.
[40] Deregulation of the electricity market is to begin in 2021-2022.

is a good example of this, as it has pursued a clear policy of economic liberalization since the 1990s. Thus, Georgia enacted a series of laws to support privatization and PPPs, including the "Law on Privatization of State Enterprises" in 1991, the "Law on Procedure for Issuing Concessions to Foreign Countries and Companies" in 1994, and the "Law on Promotion and Guarantees of Investment Activities" in 1996. However, neither the 1994 nor the 1996 law explicitly referenced PPPs. The only remote connection was made in the Concessions Law, which allowed for "long-term lease agreements" under which PPPs could be implemented. Whereas the Concessions Law provided a legal basis for procurement and implementation of PPPs, and the "Law on Promotion and Guarantees of Investment Activity" included some comfort related to investor protections, they were generally limited in scope and guidance. The Concessions Law didn't define which sectors or types of projects were eligible, except for stating that concession agreements could be implemented for "renewable and non-renewable natural resources, and for other related economic activities." In addition, there was no information on identification and preparation of projects, and although the Concessions Law referenced a "competitive approach" towards procurement of concessions, there was no guidance on the selection and award process, except for an outline of basic provisions to be included within the concession agreement.

As a result of the privatization effort, by the late 1990s, more than 10,500 small enterprises were privatized, more than 1,200 medium- and large-sized companies were set up as joint stock companies, and there was some success in introducing private sector participation in infrastructure, including through PPPs and privatizations. A second round of PPPs and privatizations began in 2004 via the adoption of the "Law on Privatization of State-Owned Property." This led to the privatization of a number of state-owned assets in the transport, water, energy, and ICT sectors, and the implementation of a small number of PPPs. However, the rate of PPPs slowed considerably in the 2010s, except for the energy generation sub-sector (mostly smaller scale hydro power plants). Trying to conclude on the overall legal framework for PPPs in Georgia, in 2011, the European Bank for Reconstruction and Development (EBRD) concluded that the laws did "not constitute a sufficiently solid legal basis for development of PPPs."[41]

The GoG expressed its political commitment to PPPs in the social-economic development strategy of Georgia, known as "Georgia 2020."[42] In 2014, the GoG published the Georgia 2020 document, which outlined the government's "plans to form an efficient mechanism for public-private partnerships, which is especially important for attracting investments to infrastructure and hydropower sectors." Another trigger that supported development of PPP-specific legislation in Georgia was its Association Agreement with the EU.[43] Article 146 of this Association Agreement required the GoG to harmonize its legislation with the EU's, including EU directive 2014/23/EU on award of concession contracts. Hence, the GoG determined that specific PPP legislation was necessary to reflect EU principles and values related to environmental and social protections, value for money (VfM), equality, transparency, non-discrimination, proportionality, mutual recognition, and efficiency. This resulted in the Asian Development Bank (ADB) and EBRD supporting the GoG in the development of a PPP legal and institutional framework. Development of the Georgian PPP legislative framework began with the preparation of the PPP Policy paper, which was completed in late 2015. In launching the PPP Policy, then-Minister of Economy and Sustainable Development Dimitry Kumsishvili noted that the PPP program and PPP Policy "is a new step for attracting more

[41] EBRD (European Bank for Reconstruction and Development). 2011. Assessment of the Quality of the PPP Legislation and of the Effectiveness of its Implementation for Georgia. https://www.ebrd.com/downloads/legal/concessions/georgia.pdf.

[42] Government of Georgia. 2014. Social-Economic Development Strategy of Georgia "Georgia 2020." https://policy.asiapacificenergy.org/sites/default/files/Georgia%202020_ENG.pdf.

[43] European Union. 2014. Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014A0830(02)-20180601.

investments and to make investors feel more comfortable in our country."[44] The GoG then immediately began preparing the PPP Law, with the aim of enacting it in late 2016.[45] The law was eventually enacted on May 4, 2018.

The PPP Law defined the basic principles of the PPP process and established a dedicated PPP Agency—without any clear guidance for FCCL analysis. The PPP Law made a distinction between concession (awarded to a concessionaire) and non-concession PPPs (awarded to a contractor). The major difference between the two is the source of funding: whereas in non-concession PPPs remuneration is provided by a public entity, in concessions remuneration is provided either by the end user or a mix of end user and public entity. Additionally, unlike non-concession PPPs, concessions may be initiated by a private party (through USPs). These two types of PPPs also follow different procurement rules and procedures: whereas concessions are procured using the rules of the PPP Law, non-concession PPPs follow the process detailed in the National (Public) Procurement Law. At the same time, the National Procurement Law doesn't have any PPP-specific provisions or separate processes that would also apply to the procurement of non-concession PPPs, so such projects are essentially procured as traditional public projects. The PPP Law also established the minimum contract length and a monetary threshold for PPP contracts (five years and GEL 5 million—about US$1.6 million).

The institutional roles of the different parties in the PPP process were also defined. In particular:

- Authorized bodies remain owners of their projects, which cannot be taken over by the PPP Agency or the MoF.
- The PPP Agency was established and has a comprehensive mandate to act as PPP coordinator and knowledge hub and reports directly to the Prime Minister but doesn't sit within the MoF.
- The MoF acts as the primary technical authority on PPPs with a mandate to review all documents throughout the PPP project cycle.

The identity of the higher authority that also participates in the PPP process isn't specified and is generally referred to as the GoG—without detailing whether that means the Cabinet of Ministers, Prime Minister, a high-level committee, a council or similar. Unsolicited proposals are only allowed for concessions and are required to follow a competitive procurement route; however, a special exemption is made for the energy sector, for which contracts are permitted to be directly negotiated—though without any objective criteria for using such methods. Additionally, the PPP Law provides a list of instruments for government support of PPPs, including land transfer, grants/subsidies, availability payments, and payment guarantees. The MoF determines the available support; however, there is no clear guidance on how such measures will be analyzed and incorporated into the budget process; nor are PPP-specific limits for such support established. Finally, the PPP Law provides for a relatively comprehensive disclosure framework for PPPs during both the development and the implementation phases.

Besides the PPP Law, implementing regulations and certain guidelines were prepared, yet fiscal risk-related provisions were only adopted in 2020. Following the enactment of the PPP Law, the GoG prepared and issued Decree № 426 "On Approval of Rules of Developing and Implementing Public-Private Partnership Projects"[46] (hereafter, "PPP Regulations") in August 2018.

The PPP Regulations clarify that the PPP project cycle consists of five stages:

1) Project identification and initiation
2) Project preparation

[44] *Agenda.ge*. 2015. "Georgia creates legal framework for Private-Public Partnerships." News, December 23, 2015. *Agenda.ge*. https://agenda.ge/en/news/2015/2897.
[45] InfraPPP. 2015. "Georgia presents PPP Policy document." News, December 29, 2015. InfraPPP. https://www.infrapppworld.com/news/georgia-presents-ppp-policy-document.
[46] Government of Georgia. 2018. Decree № 426 of August 17, 2018 "On Approval of the Rules of Developing and Implementing Public-Private Partnership Projects." https://ppp.gov.ge/app/uploads/2020/04/PPP-Resolution-426-Eng.pdf.

3) Selection of a private partner
4) Project implementation
5) Post-implementation assessment

The PPP Regulations provide a standardized process for preparation of PPP projects as well as some details on separate procurement processes for concession and non-concession PPPs. Additionally, the PPP Regulations clarify the sectoral scope of both PPPs and USPs by excluding "mineral resources, oil and gas sectors and related exploration and development and/or scientific research" from sectors where PPPs can be implemented and allowing USPs only in the energy sector as stated in article 26(1): "a private initiator shall have the right to prepare and submit to the corresponding line ministry an initiative proposal about a concession in the energy sector."

In addition to the PPP Law and PPP Regulations, the GoG adopted PPP Guidelines for all phases of the PPP project cycle[47] through the Order of Minister of Finance № 100 in April 2020. These guidelines were developed with the support of the ADB and United States Agency for International Development (USAID) Georgia Good Governance Initiative (GGI) and are intended to ensure the fiscal sustainability of Georgia's PPP program as well as to incorporate a VfM methodology.

On the FCCL side, the guidelines provide basic definitions used in management of fiscal risk, introduce various instruments of government support to PPPs, and place the general obligation on the MoF to assess the reasonableness of providing support through specific instruments, with certain step-by-step instructions on how to make such a decision. They also provide operational support to public and private partners in preparing PPP projects in line with international good practice and add further detail on institutional responsibilities, processes, and outputs within each phase of the PPP cycle as well as evaluation criteria permitting a project to advance from one phase to the next. It should be noted that the finalization of the PPP Guidelines and the VfM methodology in 2020 was an important milestone for the future of PPPs in Georgia because the IMF had earlier put restrictions on expansion of the country's PPP pipeline until a VfM methodology in accordance with recommendations of IMF Technical Assistance (TA) was approved and incorporated into the PPP VfM guidelines.[48] Figure 4.3 below depicts the evolution of the institutional and regulatory framework related to PPP and concession projects.

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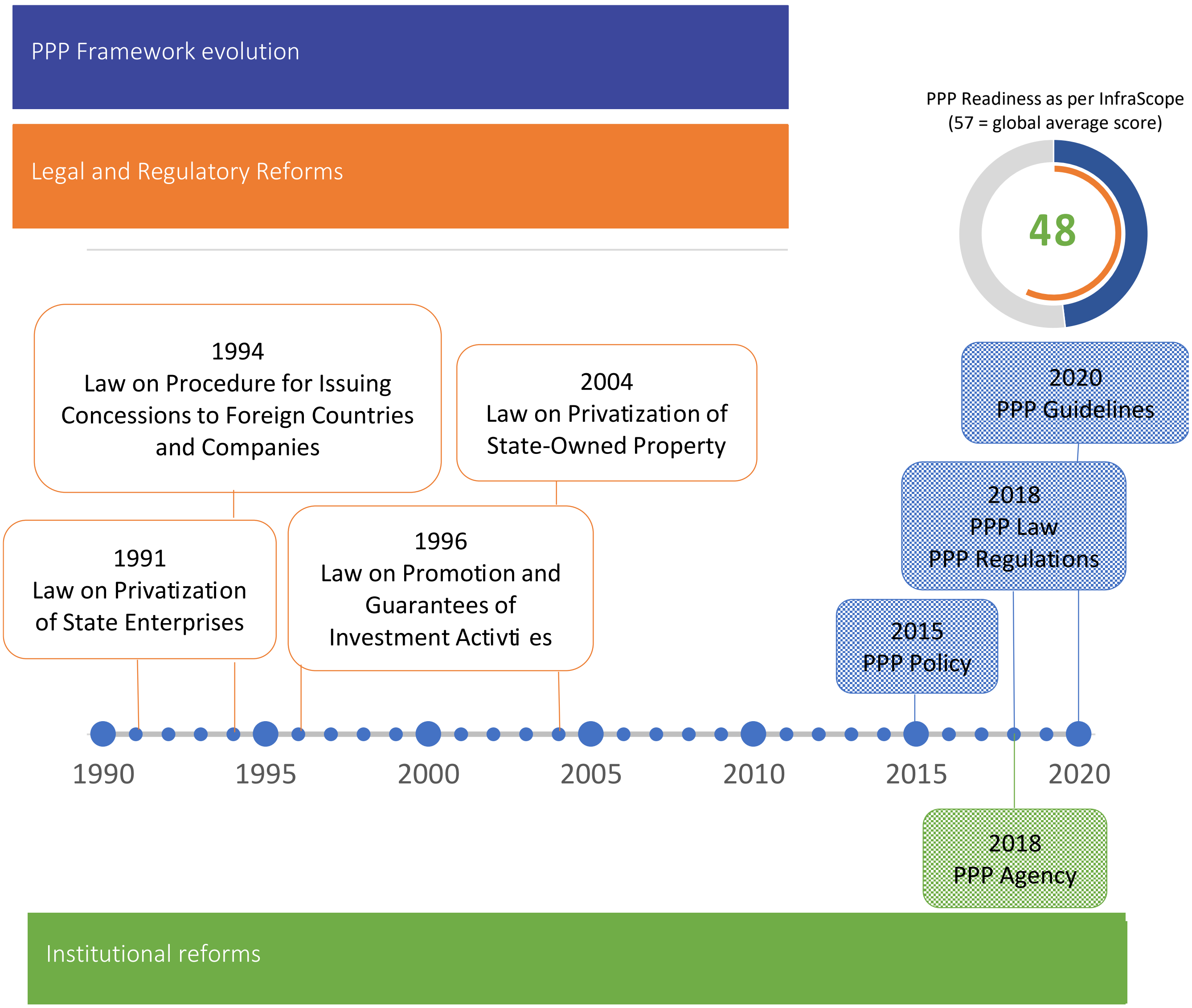
[47] Ministry of Finance of Georgia. 2020. PPP Guidelines. March 2020. https://ppp.gov.ge/app/uploads/2020/07/PPP-Guidelines-ENG.pdf.

[48] IMF (International Monetary Fund). 2019. Country Report No. 19/372, Fifth Review under the Extended Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, Modification of Performance Criteria, and an Extension of the Arrangement and Rephasing of Access. Press Release; Staff Report; and Statement by the Executive Director for Georgia. December 18, 2019; Attachment I (11): 44. https://www.imf.org/en/Publications/CR/Issues/2019/12/18/Republic-of-Georgia-Fifth-Review-Under-the-Extended-Arrangement-Requests-for-Waivers-of-48888.

Figure 4.3: Evolution of the Regulatory and Institutional Framework Applicable to PPP Projects

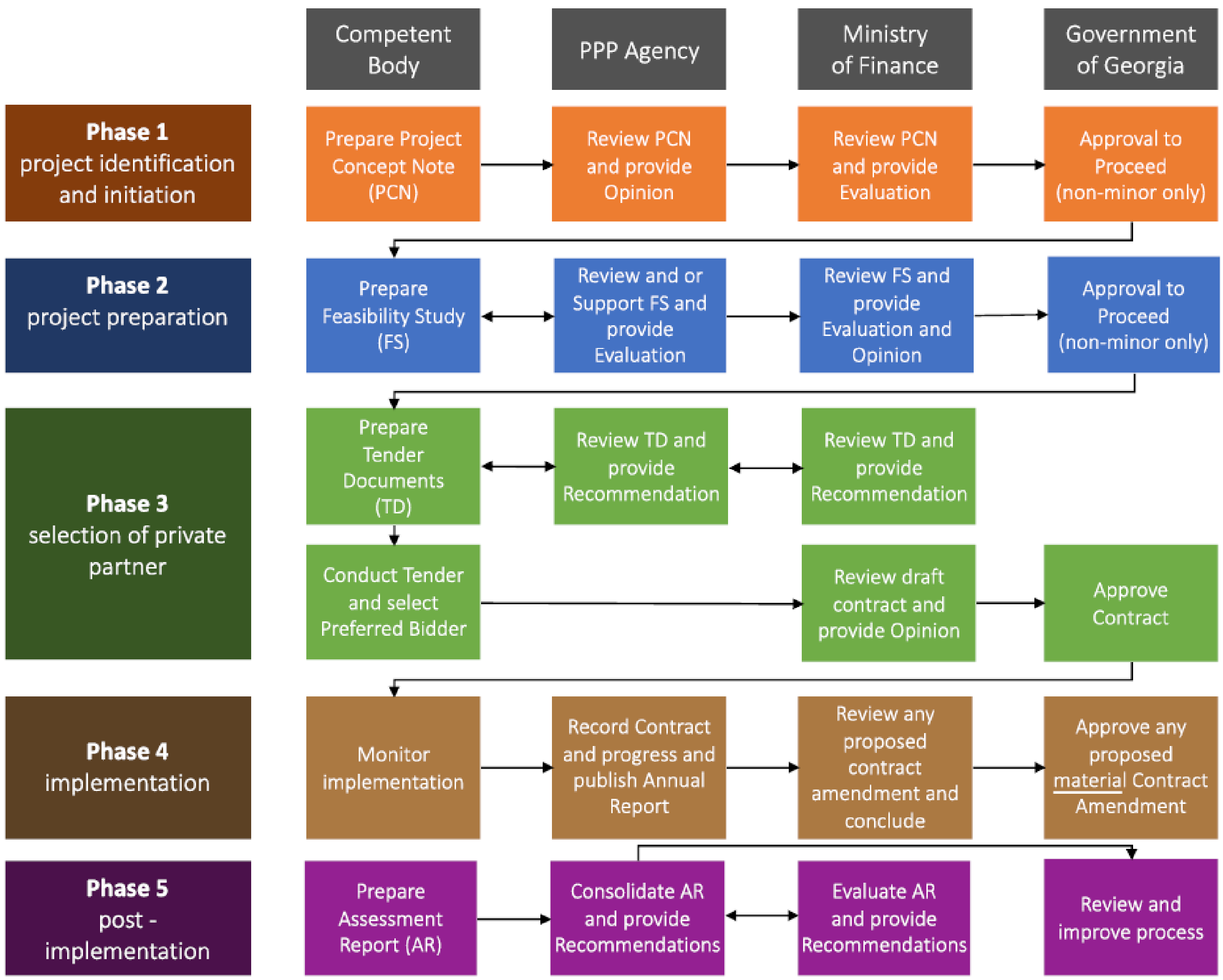


The EBRD, ADB and USAID were the main development finance institutions (DFIs) involved in development of the existing PPP legal framework. The existing PPP legislative and institutional framework in Georgia was developed in close cooperation with and support from the EBRD, ADB and USAID Georgia Good Governance Initiative (GGI). The ADB provided Policy and Advisory Technical Assistance (PATA) to Georgia in 2015, whereas the EBRD was actively involved in refinement of the PPP Regulations. The PPP Guidelines were developed by ADB consultants, and the VfM methodology (chapter) was prepared by the USAID's GGI contractor company Policy and Management Consulting Group (PMCG), which also provided the handbook on IPSAS 32.

3.2.2. PPP Approval Process

The new PPP Guidelines describe a quite rigorous PPP approval process. The PPP legislation described in the previous section (the PPP Law, PPP Regulations, and PPP Guidelines) provides an institutional framework that lays out the roles of the relevant bodies through various stages of the PPP project cycle, i.e., the GoG (assumed to be the Cabinet of Ministers), MoF, the PPP Agency and authorized bodies, as well as a selection commission or tender committee for procurement of concession and non-concession PPPs, respectively. In particular, the MoF has responsibility for ensuring the technical quality of PPP project preparation, and the PPP Agency serves as a day-to-day centralized coordinating unit for PPPs, providing technical support and guidance to authorized bodies, which initiate and implement PPP projects. A detailed account of roles and responsibilities, including review and approval functions within the PPP project cycle, is summarized in Figure 4.4 below:

Figure 4.4: PPP Project Cycle Process Flow (excerpt from the PPP Guidelines)



Source: PPP Guidelines, p. 10.

Government of Georgia

The GoG acts as the final approving authority for all major milestones in the PPP project cycle, such as a “go/no-go” decision for a project at concept stage, approval to proceed to the procurement stage, approval of a PPP contract or major changes to it. To a large extent, the GoG bases its decisions on previous conclusions and opinions formed by the MoF and may request implementation of MoF suggestions if that has not already been done. Therefore, the role of the MoF in making the work of the GoG possible is key. In terms of fiscal risks, the main approval function of the GoG concerns approval of proposed amendments to a PPP contract if the original project cost changes by more than 20 percent and fiscal risks arise or the fiscal risk profile changes.

Ministry of Finance

The MoF plays a key role in the PPP project cycle and acts as primary technical authority without whose opinion the project cannot proceed through the phases of the cycle and cannot be submitted for GoG approval. In terms of assessing fiscal risks and making FCCL-related decisions, the MoF is the key actor and will usually conduct bilateral discussions with concerned line ministries regarding fiscal risks.

According to the PPP Guidelines, the FCCL-specific responsibilities of the MoF include:

- Reviewing the project concept note (PCN) submitted by an authorized body (USP proponent) and preparing a conclusion. In particular, the MoF will assess and evaluate the affordability of the envisaged fiscal implications and suitability of a project as a PPP based on a tentative VfM analysis. Assessments that are the responsibility of the MoF include: i) assessment of accessibility to public finances; ii) assessment of the price-performance ratio; and iii) assessment of fiscal risks.
- Reviewing and assessing feasibility studies, other auxiliary studies (if any) and project related documents submitted by an authorized body (USP proponent) and providing a conclusion on feasibility studies as well as financial and economic elements of a project, especially direct and indirect fiscal obligations. The MoF must issue a conclusion on the viability of implementing a project as a PPP, judging from its economic and social value and total sustainability, and taking into account the issuance of public financing support or guarantees.
- Reviewing and providing a conclusion on negotiated PPP agreements to ensure that no material changes to the financial or FCCL impact of a project were made after negotiations.
- Reviewing the proposed amendments to the PPP contract submitted by the public partner. If the MoF identifies new fiscal risks or needed fundamental changes, and the proposed amendments change the initial cost estimate by more than 20 percent or the value of the amendments exceeds the limit set for small projects, the MoF must give an opinion on such amendments before they are approved by the GoG.

In practice, the MoF does seem to be actively involved in a PPP project's consideration and its fiscal implications. However, ultimately, certain projects might be more of a political matter than based solely on economic, social, and other more or less objective considerations. In this case, the MoF's opinion might be taken as advisory only, as was the case with Nenskra HPP project.

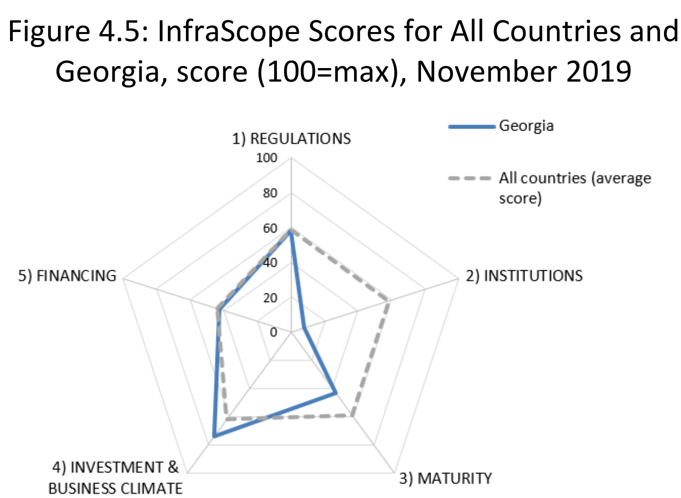
PPP Agency

As designed, the PPP Agency plays a lesser role to that of the MoF and GoG during the approval process—but it is key for promoting PPPs and yet it is also severely under-resourced. The PPP Agency will generally participate in review and advising on the project concept note, feasibility studies, tender documents, and other PPP-related documentation—without having approval authority. The PPP Agency can provide feedback and improve these documents as the project moves along the PPP project cycle, before they are submitted to the MoF or the GoG for review/approval. Additionally, the PPP Agency may identify potential PPP projects and propose them to an authorized body or assist, if necessary, an authorized body in identifying potential PPP projects. Despite the PPP Agency playing a less significant role in terms of its approval authority, it is crucial for promoting and raising awareness of the PPP program in the country. In this regard it is concerning that the PPP Agency is still led by an acting director (the position was vacant for several months) and only has three staff members and two contractors. As designed, it should have 10 core staff members and three contractors responsible for project management, financial operations and IT. Proper staffing has been challenging so far due to lack of suitably experienced PPP professionals in the country, and the inability to pay market-based salaries. In addition, the positioning of the PPP Agency outside of the MoF results in it having no significant role in assessing the financial and FCCL impact of PPPs. In practice, this may reduce the PPP Agency's traction and credibility within the PPP program.

The practical application of the PPP framework is lagging, and it might be a long time until it is fully operationalized. Based on consultations with the MoF, the implementation of the PPP Guidelines and other PPP-related regulations remains an issue, because there have not been many new projects coming in since the PPP framework was set up and, hence, there has been no chance of relevant government entities gaining any experience with it yet. Additionally, line ministries and local municipalities—which should be acting as initiating agencies that identify potential projects and carry out feasibility studies—lack the capacity to do so and aren't initiating any new projects in practice. The ADB and USAID Georgia Good Governance Initiative (GGI) provided introductory training on the new PPP Guidelines, including VfM methodology and IPSAS 32, but no further trainings have been planned. The attendees were representatives of the MoF, PPP Agency, Ministry of Economy and Sustainable Development (MoESD), Ministry of Regional Development and Infrastructure (MoRDI), Tbilisi and Batumi Municipalities, and the Ministry of Justice. Further capacity building efforts and real-life experience with projects under the new rules are necessary to bring the designed framework and practice closer together.

InfraScope indicates that PPP institutions in the country are severely underdeveloped. The fact that the quality of PPP institutions is not as envisaged in the newly established PPP framework is also confirmed through international benchmarks and assessments conducted, for example, by the Economist Intelligence Unit as part of its product InfraScope. According to this study, Georgia is still an emerging PPP market, with the quality of its institutions at a

Figure 4.5. InfraScope Scores for All Countries and Georgia



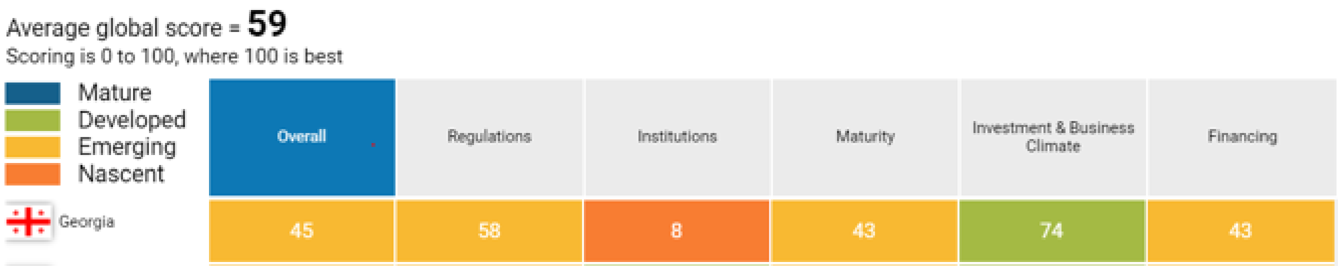
Source: InfraScope Index Model.

very low level (see Figures 4.5 and 4.6). The reason for Georgia's underdevelopment with respect to PPPs might be its motivation for establishing a PPP framework in the first place. In an ideal world, the core reason for doing such a framework is to have a proper system for PPPs to further accelerate infrastructure investments and deliver public infrastructure and related services more efficiently. However, in the case of Georgia the reasons seem to have been more external, driven by donors and DFIs. Many changes in the PPP field appear to have been implemented just to meet the compliance requirements of the Association Agreement with the EU and the IMF requirements for continuing to receive support. Indeed, Georgia is very popular among the global DFI community, and 73 percent of the Georgian public debt (92 percent of its external public debt) in 2020 was to official multilateral and bilateral donors—chiefly on concessional terms, with the extremely low weighted average interest rate of 1.33 percent per annum.[49] In an environment where cheap finance is abundant, implementing agencies have no incentive to

[49] MoF (Ministry of Finance). Government Debt Indicators. 2020. https://www.mof.ge/en/4409.

consider the PPP route, which is more complex, costlier, and with longer preparation timelines than traditional procurement. This also explains why there were hardly any PPP initiatives outside the power sector, which is largely driven by USPs, with the private investor assuming all preparation risks and delivering feasibility studies. This is also why the PPP Agency remains largely underdeveloped and a minor player. Fiscal pressures due to the COVID-19 pandemic might eventually shift this dynamic towards being more favorable for PPPs, but that development has yet to be seen.

Figure 4.6: InfraScope Scores for Georgia, as of November 2019



Source: InfraScope Index Model, November 2019, https://infrascope.eiu.com/.

3.3. Analysis of Projects

3.3.1. Identifying and Evaluating PPP Projects

The PIM system design follows best international practice, but its implementation lags. The public investment management (PIM) process in the country is governed by the PIM Guidelines[50] issued in 2016 and most recently amended in December 2019. The PIM Guidelines are designed to guide evaluation of capital investment proposals in a consistent manner, help prioritize competing projects, and provide specific criteria to ensure consistency and standardization at different stages of the PIM process. The PIM Guidelines were developed using the World Bank's unified framework for PIM[51] as a model with some adaptations made to local legal requirements and practice, transforming an eight-feature system into a six-feature one. Thus, the PIM Guidelines lay out six stages in the project development process: i) project screening/pre-selection, ii) project appraisal, iii) project selection/budgeting, iv) project implementation, v) project monitoring, and vi) ex-post evaluation. The original version of the PIM Guidelines was developed to consider PPPs as one of the possible procurement options through the description in article 9 of an additional step during project valuation in the case of PPPs. Yet the original version was criticized for not providing enough clarity regarding the timing and mechanisms of originating PPP projects, regarding how projects move from the PIM process to those under the PPP rules (and vice versa) as well as some inconsistencies found between PIM and PPP frameworks.[52] Lack of capacity within line ministries to implement the PIM framework was also mentioned as a weakness in the World Bank's Georgia PPP Country Readiness Diagnostic 2020. Until recently, the quality of project preparation also suffered from lack of support from the MoF to guide sector agencies.

[50] Government of Georgia. 2016 and 2019. Government Decree № 679 "On Amendments to the Government Decree № 191 of April 22, 2016, "On the Approval of Public Investment Management Guidelines"; December 31, 2019; contains the updated PIM Guidelines as an Attachment (in Georgian). https://matsne.gov.ge/ka/document/view/4764888?publication=0. A pre-amendment version of the PIM Guidelines in English is available here: https://www.mof.ge/images/File/laws/PIM-Guidelines-Gov-Decree-19-22.04.2016-ENG.pdf.

[51] Rajaram, Anand; Minh Le, Tuan; Kaiser, Kai; Kim, Jay-Hyung; Frank, Jonas. 2014. The Power of Public Investment Management: Transforming Resources into Assets for Growth. Directions in Development--Public Sector Governance; World Bank Group, Washington, DC. © World Bank. Source: https://openknowledge.worldbank.org/handle/10986/20393; License: CC BY 3.0 IGO.

[52] IMF (International Monetary Fund). 2018. Country Report No. 18/306, Technical Assistance Report–Public Investment Management Assessment for Georgia, May 2018: 45-47. https://www.imf.org/en/Publications/CR/Issues/2018/11/07/Georgia-Technical-Assistance-Report-Public-Investment-Management-Assessment-46338.

However, steps were taken to operationalize the PIM system and bring implementation up to standard. Following the recommendations of the IMF and with support from the World Bank (WB) and USAID Georgia Good Governance Initiative (GGI), the PIM Guidelines were revised in 2019 to provide better alignment of the PIM and PPP project cycles and clarify the roles of institutions involved in both processes (notably, the MoF). Furthermore, the WB incorporated PIM-related prior actions into its "Economic Management and Competitiveness Development Policy Operation" for Georgia (approved by the WB's Board in March 2020),[53] which should raise the baseline rate of public investment projects screened, appraised, and selected in compliance with the requirements of the PIM Guidelines from 0 percent in 2019 to 40 percent of new projects of more than GEL 5 million (about US$1.6 million) in 2021. The two prior actions were the adoption of i) GoG Decree № 679 of December 31, 2019, amending the PIM Guidelines, and ii) of the MoF Order № 411 of December 26, 2019. To meet the mandates of these prior actions, the GoG has set up two new organizational structures, a strengthened PIM Working Group at the MoF and a cross-ministerial Inter-Agency Commission. The functions of both organizational structures are summarized below:

- *PIM Working Group at the MoF.* This was established by the MoF Order № 411 in December 2019, which amended the October 2018 Decree № 385 "On Setting up a Working Group for Implementation of Activities aimed at Evaluating Investment Projects." The MoF Working Group is comprised of representatives from relevant MoF departments, including i) the Fiscal Risk Management Division (specialized unit in charge of fiscal risk analysis of state-owned enterprises, PPAs, and PPP projects), ii) the Budget Department, and iii) the Microeconomic and Fiscal Department. The work of the Working Group is curated by deputy ministers. The Working Group will centralize information on public investment projects, evaluate and prioritize them, identify and allocate financing sources, integrate the selected projects into a medium-term expenditure framework, and ensure the projects' overall integration with the budget process. In addition, the MoF Working Group is responsible for coordinating implementation of functions and duties assigned to the MoF under the PPP Law.

- *Inter-Agency Commission.* This was established by Resolution №679 in December 2019 as an amendment to the PIM Guidelines. The commission is composed of deputy ministers from the MoF, MoESD, MoRDI, Ministry of Environmental Protection and Agriculture, Ministry of Internally Displaced Persons from Occupied Territories, Labor, Health and Social Affairs, and the head of the PPP Agency. The MoF serves as secretariat of the commission. The commission is primarily responsible for prioritizing investment and capital projects submitted under PIM Guidelines.

A further improvement in the PIM framework is expected to come from the creation of an electronic public investment module (part of an e-budgeting platform), which will allow for electronic submission of project proposals, serve as a public investment project database for all projects that have been received and evaluated, and facilitate integration with the budget process. The PIM Working Group has recently endorsed the design concept of the e-PIM module, but implementation hasn't started yet.

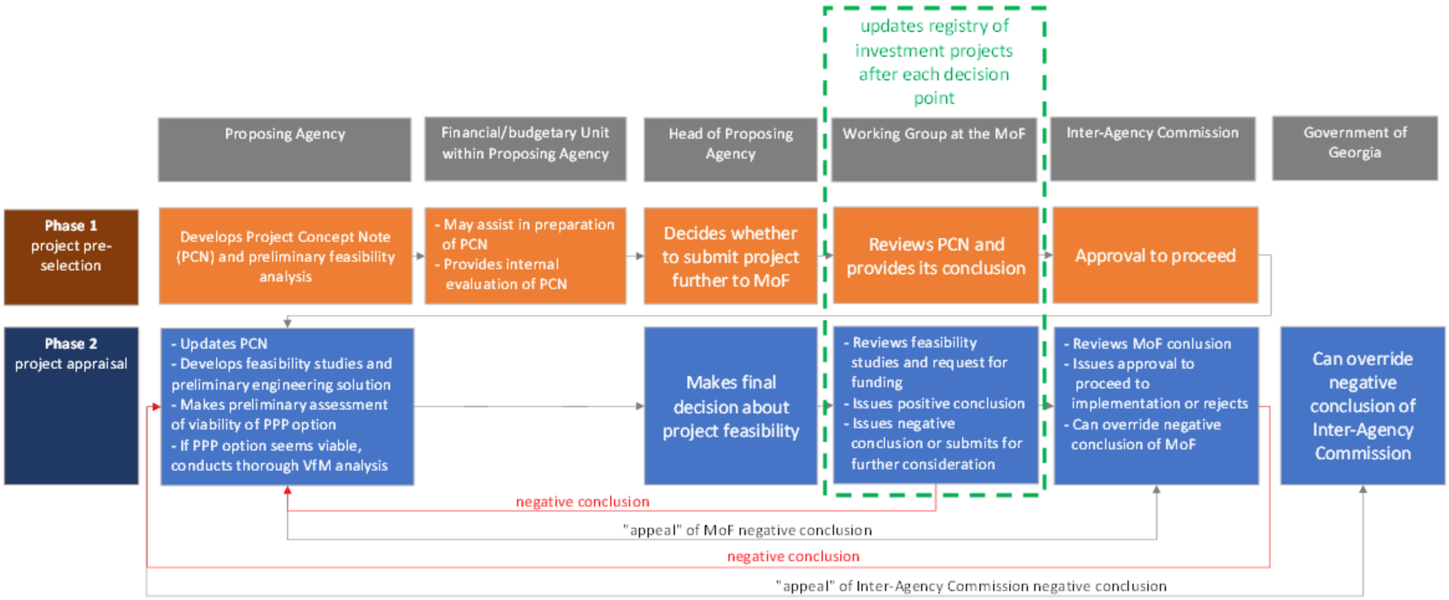
However, even follow-up measures to improve operationalization and coherence of the PIM and PPP frameworks don't work as intended. Based on consultations with the MoF, the Working Group at the MoF was indeed created with the purpose of reviewing both PIM and PPP projects and potentially converting some PIM projects to PPPs. However, in practice, the group hasn't worked well because of dispersed responsibilities: each member of the group doesn't have a specific area of responsibility but rather the group as a whole is vested with some functions. In the end, the group as an institutional formation doesn't function as intended because of lack of ownership.

The PIM Guidelines instruct on how the decision-making process should work regarding accepting or rejecting a project and choosing its procurement method (PPP versus traditional procurement). Budgeting for selected

[53] World Bank. 2020. Economic Management and Competitiveness Development Policy Operation. https://projects.worldbank.org/en/projects-operations/project-detail/P169913.

projects is described as well. For illustrative purposes, the schematic process flow based on the provisions of the PIM Guidelines is depicted in Figure 4.7 below.

Figure 4.7: PIM Project Cycle Process Flow for Phases 1 and 2



Source: Based on provisions of the PIM Guidelines.

Fiscal assessment and consideration of the PPP option will be made at both pre-selection and final appraisal stages. According to the PIM Guidelines, the first time when consideration of a PPP option will be given is at the project concept note (PCN) or project pre-selection stage, when potential procurement methods are indicated, including the possibility of realizing the project through a PPP. The PCN stage also encompasses the initial fiscal impact assessment. A much more detailed analysis of fiscal impact and a PPP option will be required at the final project evaluation or selection stage (also called appraisal stage) when the procurement strategy is prepared (for a PPP option) by the proposing agency. This strategy leads to the choice of a specific procurement modality, including through a PPP. The PIM Guidelines provide a set of criteria or testing techniques to help make a preliminary decision about whether a project might potentially be viable as a PPP. If the PPP route is considered a potential way to deliver a project, the requesting agency must perform a proper value for money (VfM) analysis in accordance with the existing PPP/VfM methodology. The criteria for a preliminary test of a PPP option include:

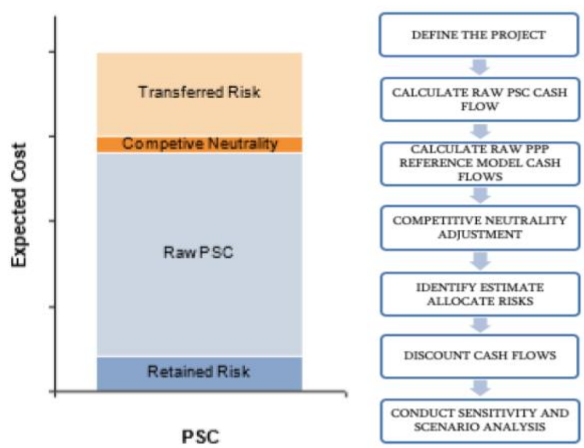
- An estimate or comparison of financial, construction, and operating costs for each alternative procurement method throughout the duration of a contract;
- Sufficient interest from potential private investors in the provision of services, and existing competition on the market;
- The clear definition, identification, and assessment of project risks, and the ability to transfer appropriate types of risk to the private sector;
- The possibility to repay part of contract payments to a private partner from amounts paid by end users; and
- Assessment of project scale in relation to operating costs associated with a PPP.

A detailed description of the PIM process is provided in Annex 4B.

After selection, projects are budgeted for and reflected in the Basic Data and Directions document; however, budgeting for PPP projects isn't well integrated into the overall budgeting process. After a positive decision is made by either the MoF, Inter-Agency Commission or GoG during the appraisal stage, the project will be reflected in a unified list of investment projects, which, in turn, will be included in the document of the GoG on Basic Data and Directions. The requesting institution can show such a project in the medium-term budget application document of the respective years, taking into account marginal volumes of allocations provided for the project in the medium term. If a project is selected during the appraisal stage but is not yet reflected in the document on Basic Data and Directions, and additional budgetary resources can be found with, for example, savings or through additional resources in the budget of the respective year, such a project can be implemented in accordance with Georgian law and will be reflected in the unified list of investment projects during the next review of the document on Basic Data and Directions. According to the MoF, budgeting is a core difference between projects under the PIM and PPP processes. Despite efforts to converge both into a single coherent process, PIM projects are more or less integrated in the budgeting process, whereas PPP projects are not.

A VfM methodology developed in accordance with best international practice was recently approved and is now available. As mentioned earlier, the requesting agency during the appraisal stage will test if a project can be delivered as a PPP. If a preliminary test indicates that the PPP option is viable, a proper VfM assessment is required. The methodology for the VfM assessment is now available in the PPP Guidelines and was developed with the assistance of the USAID Georgia Good Governance Initiative (GGI) contractor Policy and Management Consulting Group (PMCG). The VfM methodology is the recent important addition to the Georgian PPP framework and was

Figure 4.8. Components of Public Sector Comparator and Steps in Quantitative Assessment (excerpt from the PPP Guidelines)



Source: PPP Guidelines, VfM Methodology.

built with best international practices in mind. Thus, the VfM assessment requires that the risk-adjusted, whole-of-life cost of providing a particular output specification using a PPP approach be compared to that of a hypothetical public sector comparator (PSC). For each of the PSC and PPP reference cases, the requesting agency will build a financial model that forecasts cash flows of a project when procured under each relevant method. According to the VfM methodology, the PSC comprises four elements that are added together: i) retained risk, ii) raw PSC (base costing), iii) competitive neutrality, and iv) transferred risk. The components of the PSC and the seven steps to be undertaken for VfM assessment are illustrated in Figure 4.8.

The VfM assessment is supposed to be carried out by the requesting agency or private partner, but these entities are not ready to use complex tools. According to the MoF, the VfM methodology provides a rigorous framework for assessment by requesting agencies or private parties. However, when the ADB was further offering a practical tool to be used by requesting agencies or private partners in helping to prepare this VfM assessment, the reaction was unpreparedness to use complex tools for this purpose. The fact that the VfM methodology exists without much practical application is more evidence that the Georgian PPP framework is developing in response to external requirements rather than for its own reasons. As a reminder, having a VfM methodology was a major requirement by IMF in order for the country to remain in compliance with IMF conditions and receive its support—so that requirement was met on paper.

Other Required Assessments for PPP Projects

The PPP Guidelines provide a list of assessments to be included in the feasibility study of a PPP project during the appraisal stage. This is the minimum list unless any omissions can be justified (detailed guidance on how to conduct some of these assessments [e.g., fiscal support, market sounding, or VfM analysis] is provided as well):

- Strategic needs assessment: project rationale, strategic and policy context, demand analysis
- Technical feasibility: technical requirements, reference design, site assessment, technical risks, and cost estimates
- Economic feasibility
- Commercial feasibility: bankability and financial feasibility
- Fiscal feasibility: direct and contingent liabilities
- Social and environmental impact assessment: environmental assessment, social analysis and plan of land acquisition and resettlement
- Legal due diligence
- Risk analysis
- Value for money analysis: proposed PPP structure and VfM analysis
- Market assessment
- Procurement strategy
- Conclusions.

3.3.2. PPP Fiscal implications

Assessment of Direct Fiscal and Explicit Contingent Liabilities for PPP Projects

Until recently there was no specific methodology for assessing fiscal liabilities despite a general obligation. Until the approval of the PPP Guidelines in the spring of 2020, Georgia didn't have any specific legislation, regulatory provision, or specific methodology that would clarify the scope of the fiscal assessment or procedures to assess direct and contingent liabilities. There was only a general requirement to conduct such an assessment in the PPP Regulations, without a specific methodology. Thus, according to article 15(4) of PPP Regulations, during the Project Preparation stage "MoF shall provide a conclusion on the feasibility study as well as financial and economic elements of the project, especially direct and indirect fiscal obligations." According to article 28 of the PPP Law, types of support include but are not limited to: availability and performance-based payments; guarantees (for consumption, income, tariff, or cost of public services); and grants and subsidies, including grants in-kind such as transfer of land, granting of permits, licenses, and exclusive rights to intellectual property or exclusive rights to establish and maintain and/or operate and maintain a facility or to provide public services within certain territories.

The PPP Guidelines now provide some advice for project proponents on how to prepare a fiscal assessment. The PPP Guidelines establish requirements for a feasibility study that is to be prepared by the requesting agency. One of the requirements and a necessary element is the assessment of fiscal feasibility. The PPP Guidelines give some instructions on how such an assessment can be prepared, including potential ways to assess both direct and contingent liabilities. Thus, according to the PPP Guidelines, Phase 2: PPP Project Preparation, section 5 "Fiscal Feasibility," the value of required direct fiscal commitments "can be estimated from the project financial model. The value of these direct payment commitments is driven by project costs and any non-government revenues. The value of direct fiscal contribution required is usually the difference between cost of project (including commercial return on capital invested) and revenue the project can expect to earn from non-government sources such as user fees. Fiscal cost can be measured in different ways:

- Estimated payments in each year: amount that government expects to have to pay in each year of a contract, given the most likely project outcomes. This is the most useful measure when considering budget impact of a project
- NPV [net present value] of payments: If government is committed to a stream of payments over lifetime of a contract such as availability payments, it is often helpful to calculate NPV of that payment stream using appropriate yield on government bonds in Georgia [as discount rate]."

A requesting agency must also include the assessment of contingent liabilities for a project. The PPP Guidelines suggest two possible approaches for assessing contingent liabilities:

- "Scenario analysis … involves making assumptions about outcome of any events or variables that affect value of the contingent liability, and calculating the cost given those assumptions. For example, this could include working out the cost to government in a 'worst case' scenario, such as default by private party at various points in a contract. It could also include calculating the cost of guarantee on particular variable, for instance, demand—for different levels of demand outturns
- "Probabilistic analysis: an alternative approach is to use a formula to define how variables that affect value of contingent liability will behave. A combination of mathematics and computer modelling is then used to calculate resultant costs. This enables analysts to estimate distribution of possible costs, and then calculate measures such as the median (most likely) cost, the mean (average) cost, and various percentiles (for example, the range of values within which the cost is 90 percent of the time). To be useful, probabilistic models need reliable data from which to estimate probability distributions of underlying risk variables."

The PPP Guidelines suggest that assessment of the ability to accommodate a project within a long-term budget may be done from three different perspectives, each with specific tests to be conducted by the project team:

- Comparing cash flow of commitments to the government's total projected tax revenues
- Comparing cash flow of commitments to the contracting agency or sector's projected budget appropriations
- Assessing compliance with eventual overall budgetary limits and constraints.

Finally, the PPP Guidelines note that typically every PPP project includes at least one major type of contingent liability, meaning termination payments: "The value of termination payments under a number of likely default scenarios should also eventually be calculated. At least one representative event of contracting authority default, contractor default and force majeure must be included as scenarios."

Implementation of the system described above isn't in place yet, and the PFRAM model was found to be of limited use. Besides the instructions for project preparers on how to assess direct and contingent liabilities discussed above, the PPP Guidelines don't provide any further guidance on the matter. Thus, according to existing regulations, assessment of direct fiscal and explicit contingent liabilities must rely to a large extent on information provided by proposing agencies in a feasibility study. Because the system described above was only recently approved, there haven't been many new projects for which this system could be tested, hence, there isn't much practical experience with it yet. According to the PPP Country Readiness Diagnostic conducted by the WB team in 2020, an integrated framework for programmatic assessment and management of FCCL, beyond project-by-project assessments, doesn't exist in practice. According to the MoF, contingent liabilities from early termination of PPPs aren't mentioned or treated in any way in any of the official government documents. They are reviewed on a case-by-case basis without any pre-defined framework. Additionally, according to the MoF, IMF provided training on the PFRAM model, and there was willingness to use it on the MoF side. However, because the majority of the Georgian PPP portfolio and fiscal risk stems from guaranteed purchases under PPAs for projects developed on a BOO basis, the PFRAM tool isn't very helpful and, in fact, explicitly doesn't capture such situations. So, the responsible team at the MoF developed an internal Excel-based tool with the specific purpose of assessing contingent liabilities arising from PPAs in the energy sector. This tool calculates an average generation volume and makes cash flow projections, discounting them at a certain interest rate. For assessment of direct fiscal liabilities, PFRAM was also found to be of limited use because there were no new PPP projects besides IPPs on a BOO basis, and for the two PPP projects that are already in the portfolio, asset values are reported in International Financial Reporting Standards (IFRS) statements of the respective private partners, so no complex tools are necessary to assess corresponding liabilities.

However, the MoF is trying to estimate FCCL from PPPs internally, and it reports significant exposure to PPA-related contingent liabilities. Even though the framework for analysis of fiscal risks is mostly theoretical at this point, the Fiscal Risk Management Division at the MoF is leading an effort to value the stock of PPP assets and liabilities and to analyze the related liabilities from PPAs based on the relevant IPSAS 32 and 19 standards. According to the MoF, the ministry started working on identifying sources of fiscal risks in 2014 with support from IMF. The MoF disclosed its first assessment of potential fiscal risks related to PPAs in 2017. According to the WB PPP Country Readiness Diagnostic 2020, the GoG doesn't have any long-term direct commitments in ongoing PPP projects. In line with IPSAS 19, the MoF's key consideration for budget planning purposes is to accurately estimate the likelihood of contingent liabilities realized in a particular year related to existing PPAs. As was described in Part I of this report Georgia accumulated a significant stock of PPAs. In 2020, the MoF estimated that the expected total value under PPAs was about US$3 billion or 20 percent of the forecasted 2020 GDP. As described in the Fiscal Risk Statement for 2020, PPAs in Georgia are concluded with the state company Electricity System Commercial Operator (ESCO). Under a PPA, a private company is granted a construction and operating license; in return, ESCO undertakes to purchase a specific, pre-agreed amount of electricity at a pre-agreed guaranteed price. Usually, guaranteed offtake is only granted for deficient (winter) months but can be for the full calendar year; the share of guaranteed generation to be bought is usually 20 percent but also varies.

According to the MoF, despite formally ESCO being obliged to purchase energy in any case, in practice it's a government obligation, not ESCO's. ESCO usually sells the electricity purchased. In essence, these are take-or-pay commitments that create a form of guarantee on the price of output. Although ESCO isn't required to disclose PPAs in its financial statements, fiscal transparency standards adopted by the MoF require disclosure of potential fiscal costs and risks associated with PPAs. Additionally, the gradual deregulation of the electricity market, which was expected to be launched by 2021 and is now postponed until 2022-2023 tentatively, may pose additional risks if the guaranteed purchase price under PPAs significantly exceeds the market price available for imports in the region. To quantify these risks, the Fiscal Risk Management Division at MoF uses an internal Excel-based tool to model scenario analysis for PPAs at various stages of development. Fiscal risk is calculated by multiplying guaranteed purchase volumes by the difference between a guaranteed purchase price under a PPA and forecasted base electricity market price reduced by 10 percent and 30 percent in the two scenarios considered. The analysis reveals that should the worst-case scenario materialize (30 percent reduction in market price of electricity), the fiscal risk would amount to US$4.3 billion in nominal terms and US$1.8 billion in present value terms, or 11 percent of expected 2020 GDP for the present value assessment; 2024 being a year with the single largest annual would-be payout. Therefore, under certain market conditions, government exposure to a price mismatch for a large portfolio of PPAs can present a significant risk. This is acknowledged by the MoF, which stated in the summary of the Fiscal Risk Statement for 2020 that "fiscal exposure coming from PPAs stays challenging." Highlights of the scenario analysis are presented in Table 4.2 below.

Table 4.2: Possible Total Fiscal Impact of PPAs in the Energy Sector Over Full Period of PPAs, 2020-2044

	US$, millions		GEL, millions		Percentage of Forecasted 2020 GDP*
	Total	NPV	Total	NPV	US$, millions, NPV
Fiscal pressure (guaranteed purchase amount in currency)	$6,081	$3,037	20,191	10,084	20%
Fiscal expense (basic)	$883	$411	2,934	1,365	3%
Fiscal risk scenario 1 (-10% price)	$3,084	$1,245	10,240	4,133	8%
Fiscal risk scenario 2 (-30% price)	$4,273	$1,760	14,187	5,842	11%

Source: Fiscal Risk Statement for 2020, p. 109. *Note*: *This is the author's assessment based on expected 2020 GDP value of US$15.5 billion.

Volume, price, capacity, and FX risks are major factors playing into the riskiness of the large portfolio of PPAs. To summarize, the main sources of risk related to holding such a large portfolio of PPAs can be broadly classified into four categories:[54]

- *Volume risk.* All HPPs are required to sell at least 20 percent of their output to ESCO, and ESCO is obliged to buy their output regardless of whether it can efficiently transmit and sell it.
- *Price risk.* If ESCO's sale price is lower than the purchase price specified in the PPA, ESCO would bear the loss, which is further aggravated by the soon to be launched liberalized market of electricity.
- *Capacity risk.* Under the Electricity Transmission Agreement (ETA), the Georgian State Electricity System (GSE) and Energotrans are responsible for transmitting power to the export point, but power produced by HPPs may exceed the transmission capacity of the grid, or there may be congestion at the export point. Seasonality of power generation contributes to these risks as most HPPs reach peak capacity during spring and early summer.
- *Foreign exchange (FX) risk.* Changes in relative currency values could pose additional risks as domestic electricity sales are denominated in Georgian lari, whereas PPA prices are denominated in US dollars. GSE and domestic distribution companies already have dollar-denominated liabilities, but their revenues are in lari. The constant GEL depreciation against the US dollar increases the real PPA purchase price and debt-service costs of electricity companies. However, not all these cost increases are passed onto consumers. Electricity tariffs are usually raised much more slowly than the GEL depreciation rate, resulting in de facto losses for GSE and ESCO. Debts of these companies are implicitly backed by the GoG, and these contingent liabilities may threaten GoG fiscal stability.

At present, there is no provision for potential losses arising from the large portfolio of PPAs, such as through a reserve mechanism or creation of a buffer. The situation is monitored closely by the MoF and disclosed; yet at this stage there are no active mechanisms to manage this risk besides attempts to shift away from signing new PPAs via introduction of the "Green Tariff" described in Part I of this report. The only hope remains that either circumstances triggering PPA-related losses won't materialize, or, if they do, the losses in any particular year will either be minimal or the budget will have enough capacity to absorb them.

[54] World Bank Group. 2015. Macroeconomics & Fiscal Management Global Practice, Georgia Economic Update № 2, Georgia: Absorbing External Shocks: 14. https://openknowledge.worldbank.org/bitstream/handle/10986/23598/Georgia000Absorbing0external0shocks.pdf?sequence=1&isAllowed=y.

Fiscal Risk Analysis of PPPs

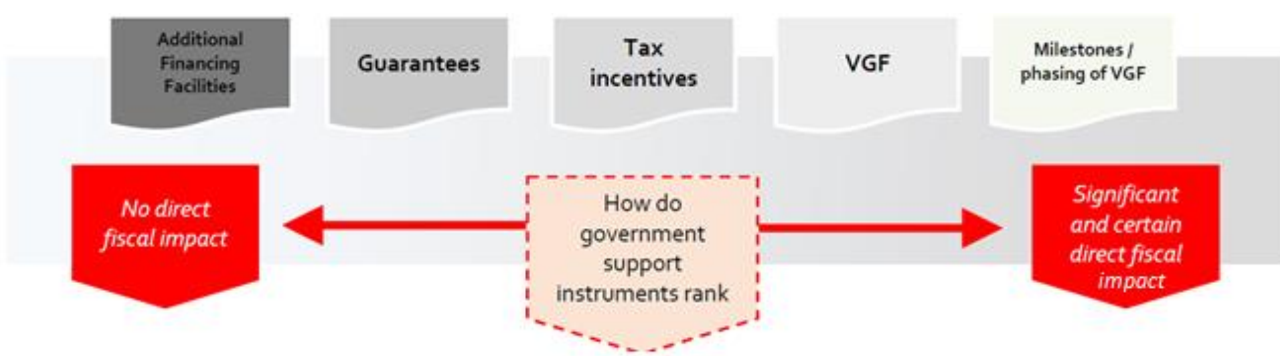
Besides risk analysis as part of the VfM methodology, the PPP Guidelines provide two specific tools for the MoF to assess requested fiscal support: i) Government Support Assessment Report Template (hereafter, "Template"; available as Annex II of PPP Guidelines, Part II: PPP Project Preparation); and ii) Government Support Alignment Guidance (available as Annex III of the same document). These are in addition to certain guidelines on risk analysis incorporated into the VfM methodology. The template represents a summary project sheet that contains a section on the assessment of the need for government support and its appropriateness. This assessment instructs that the MoF must perform the following steps:

- Identify financing challenges of a PPP project that drive the need for government support (funding, cash flow and specific risk issues as well as overall risk profile);
- Assess effectiveness of the proposed government support package to remove or mitigate financing challenges and to improve bankability of a project;
- Conclude on the necessity and appropriateness of the proposed government support package; and
- If applicable, suggest improvements for the proposed government support package.

It must be reiterated that at this point the PPP Guidelines remain mostly theoretical in nature as there have not been many new projects which came in after adoption of the guidelines and, hence, no practical experience has so far been gained with the process.

The Government Support Alignment Guidance is a more detailed explanation of various issues that should be considered during assessment of government support and that should inform the decision to be reflected in the template. Most notably, this guidance states that "for purpose of fiscal risk management, it does not matter whether a government contribution can be considered as a usual obligation. All government liabilities must be taken into account in order to evaluate fiscal affordability and sustainability of a project" after providing a short discussion about differences between government liabilities and government support. The PPP Guidelines further go into detail of discussing various types of support instruments and ranking them by potential fiscal impact (see Figure 4.9).

Figure 4.9: Government Support Instruments Ranked in Terms of Expected Fiscal Impact (excerpt from PPP Guidelines)



Source: PPP Guidelines.

The PPP Guidelines provide a useful decision tree for the MoF to follow when deciding on measures of fiscal support. As a first step, the PPP Guidelines provide a classification of problems that projects might face and that might drive the need for fiscal support, ranging from cash problems to risk problems or, in other words, from certainty to uncertainty. Based on this conceptual framework, four categories of financing problems are distinguished, ranging from significant certainty to significant uncertainty:

- Funding issues
- Cash flow issues
- Specific risk issues
- Overall risk profile issues.

Each type of issue is then discussed in detail from the government perspective, advising that the MoF should first try to resolve (or suggest methods to resolve) the underlying issue without resorting to government support. Only after all alternative ways of resolving the issue without government support are exhausted and it's confirmed that project will in principle be implemented can the measures of fiscal support be considered. At the end of this discussion, the MoF is provided with a decision tree and list of government support measures in order of declining priority; in other words, riskier support measures (from the government perspective) should only be considered after less risky ones are checked first. The more detailed account of potential issues and risks that PPP projects might face along with the decision tree are provided in Annex 4C.

For the risk analysis, no standard matrix is offered but the PFRAM risk matrix is suggested as a starting point; however, excessive reliance on generic solutions without considering project-specific factors is warned against. The risk analysis and more specifically, the risk matrix, is a required element of the feasibility study for a project during the appraisal stage. Additionally, the risk matrix is required to be able to perform a VfM analysis. Thus, the PPP Guidelines provide general instructions on how to construct such a risk matrix without supplying a ready solution; however, one of the suggestions is to use the standardized PPP Fiscal Risk Assessment Model (PFRAM) risk matrix as a starting point. At the same time, the PPP Guidelines warn about excessive reliance on standardized or generic risk matrixes that don't reflect project-specific circumstances. In fact, this is mentioned as one of the common pitfalls in risk assessment, when such factors as likelihood, impact on cash flow, or degree of control over risk are ignored. Insufficient attention to risk experiences in real projects, and to the perception of investors and lenders about risks and guarantees as well as their impact on project bankability, are also cited as issues to be careful about. Thus, according to the PPP Guidelines a comprehensive risk matrix should have the following columns:

- Name of risk
- Description of risk
- Consequences in case risk occurs (qualitative description)
- Indication of the probability of occurrence (low, moderate or high)
- Indication of impact on costs or revenues (low, moderate or high—ideally, quantitative, especially for high impact items)
- Grade of risk (product of probability and impact or consequences)
- Proposed allocation (public, private or shared)
- Proposed management and mitigation measures (at least for the high-grade risks)
- Additional remarks (if any).

An illustrative matrix for classification of material risks as suggested in the PPP Guidelines is provided in Figure 4.10 below.

Figure 4.10: Risk Classification and Identification of Material Risks

Impact	1. Rare <10%	2. Low probability 10-25%	3. Possible 25-50%	3. Probable 50-75%	5. Almost certain >75%
5. Very high	High	High	Extreme	Extreme	Extreme
4. Crucial	Medium	High	High	Extreme	Extreme
3. Important	Low	Medium	Medium	High	High
2. Average	Low	Low	Low	Medium	Medium
1. Not important	Low	Low	Low	Low	Low

Probability

Source: PPP Guidelines, Phase 2: PPP Project Preparation, Annex IV, p. 64.

A feasibility study, expert consultations, and peer projects' experiences are suggested as possible channels for developing and calibrating a risk matrix. Information to be supplied to the risk matrix may be collected from other parts of the feasibility study (e.g., legal, technical, demand analyses, environmental and social impact assessments, etc.). The draft risk matrix is also advised to be calibrated through workshops and discussions with specialist financial, legal, and technical consultants; all representatives of a public partner who will be involved substantively in the development, construction, operation, and management of a contract; and representatives of the PPP Agency and MoF. Experience from similar local and international projects should also be considered. It's advisable that, data permitting, high-grade risks be quantified. A minimal quantification would include: i) probability of risk occurrence, and ii) damage, costs, or revenue loss in case an identified risk occurs. This allows for calculation of the expected loss and maximum loss due to the risk. For quantified risks, the impact on economic and financial viability must be assessed, among other methods, by applying a sensitivity analysis and testing the robustness of financial returns. The impact of quantified high-grade risks on the financial viability of a project and on the need for government support and guarantees may be determined with a detailed financial model.

There are a few techniques for estimating probabilities of risks materializing. They include:

- *Subjective valuation technique*. The probability for each risk's materialization is based on a subjective assessment, which, as far as possible, is based on past experience, best practice, likely improvements in the future, and is supported by reliable information. All assumptions should be fully documented and defensible. Public partners should be prepared to revisit initial estimates if new information emerges that affects initial estimates. Consideration should be given to whether the probability of a risk materializing is expected to change over time.

- *Statistical valuation techniques.* These can be used to estimate the probability of a risk by constructing probability distributions and interpreting resulting outputs. Such distributions are based on professional experience, supported where available by historical information and reliable assumptions for similar recent projects. Once these distributions have been calculated, a reliable estimate of probability can then be made to a given level of accuracy (known as the confidence interval).

If it's determined that particular risks threaten the bankability of a project, remedial actions should be developed. These may comprise:

- Changes in scope or timing of a project, in a way that avoids risks or reduces their impact
- Risk management measures
- Contingent government support and guarantees that shift some risk to the government so that residual risk becomes acceptable for investors and lenders.

The detailed quantitative risk analysis should be updated in light of outcomes of applications for government support and guarantees. Assessment of effectiveness of the approved project support package on bankability-threatening risks may also be included. Further guidance is provided in the VfM methodology.

The theoretical nature of the processes described above might take years to turn into practice. To conclude, the PPP framework created with the help of the EBRD, ADB and other development institutions for the PPP process and some important assessments, such as VfM, government support alignment guidance, a feasibility study and forms of analysis, follow the best international practice and recommendations. However, significant work is still required to operationalize this framework, including through capacity building exercises and consideration of real-life projects. As of now, it might take years before processes described in this part of the report are actually followed in practice, and the main underpinning for this would be the real need for PPP projects as opposed to the simple development of various methodologies just to stay compliant with IFIs' or DFIs' requirements.

3.4. Reporting Requirements

3.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

Currently Georgia is undergoing a phased transition and structural adaptation from a national accounting framework to IPSAS with support from the IMF and World Bank Group (WBG). The MoF plan is to introduce all IPSAS standards, including full accrual. Georgia began this effort in 2012, and originally hoped to complete the introduction by 2020, with an additional transition period of two to three years for full application of the standards.[55] However, IPSAS implementation was delayed. The central government's consolidated annual financial statements were submitted for audit to the State Audit Office (SAO) for the first time in 2019; however, the statements were found to be not in compliance, including due to issues related to consolidation of financial statements as well as adoption and effective implementation of specific ISPAS standards. There are a few challenges standing in the way of transition to IPSAS, including insufficient capacity at many government units (besides the Treasury, which is championing this transition) to prepare and provide financial statements in accordance with the accounting standards. However, recent amendments to the Chart of Accounts and Ministerial Decree, as well as planned improvements in the e-Treasury Information System, are important steps forward. Both the e-Treasury and e-Budget systems have been operating successfully for many years, but they provide information on a cash basis. The e-Treasury budget execution information system was planned to be expanded in 2020 to include accounting and an asset registration component. An asset registration component is linked to implementing IPSAS but isn't operational yet and might be launched in two years' time tentatively. Due to the centralization of asset records, and linking asset records with procurement, cash expenditures, and accounting, asset records are expected to become more comprehensive and accurate. Based on international experience, it takes on average about four years (depending on the country size and circumstances) for a country to transition from the national accounting framework and fully adopt IPSAS standards. In the most recent IMF review under the extended fund facility arrangement for Georgia, the GoG expressed a commitment to "produce an annual consolidated central

[55] IMF (International Monetary Fund). 2018. Country Report No. 18/306, Technical Assistance Report–Public Investment Management Assessment for Georgia, May 2018: 43. https://www.imf.org/en/Publications/CR/Issues/2018/11/07/Georgia-Technical-Assistance-Report-Public-Investment-Management-Assessment-46338.

government sector financial report based on (IPSAS) basis" starting in 2021.[56] Although MoF Treasury staff already have sufficient capacity to implement IPSAS, the overall public sector doesn't follow the process at the same speed, so transition to IPSAS can be achieved only partially in 2021. The potentially achievable timeline for this transition might be 2023.

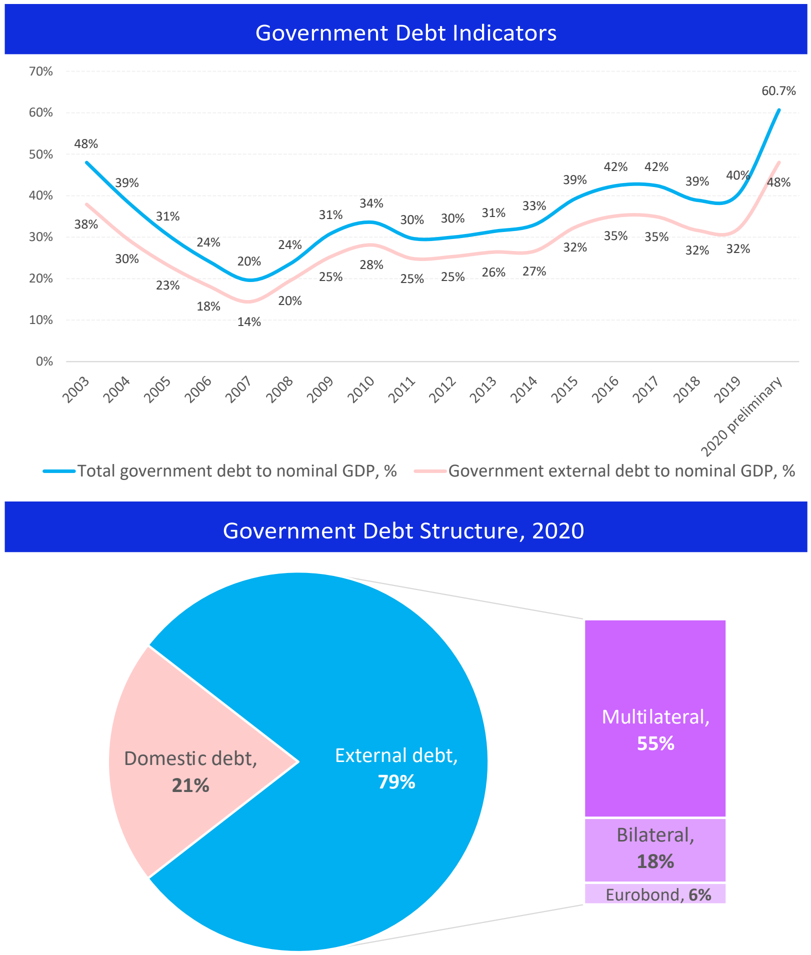
In the meantime, central government accounts are prepared on a modified cash basis. For example, total public debt is first calculated on a cash basis and then some accrual basis adjustments are made, such as, for example, for PPP liabilities assessed by the MoF in accordance with IPSAS 32. The Fiscal Risk Management Division at the MoF is leading an effort in valuing the stock of PPP assets and liabilities and is undertaking analysis of contingent liabilities associated with PPAs based on the relevant IPSAS 32 and 19. The results of this analysis are summarized in annual fiscal risk statements published on the MoF website. In 2020, the debt level surpassed the mandated threshold of 60 percent, leaving no room for assumption of more fiscal commitments from potential new PPPs. According to article 29 of the PPP Law, all PPP fiscal commitments should not exceed the established public debt threshold. This requirement is tied to the Organic Law on Economic Freedom, which restricts total public debt to 60 percent of GDP. Thus, there are no PPP-specific limits, e.g., ceilings on the annual flow of PPP payments or on the stock of PPP commitments in present value terms, as seen in some other countries.

According to preliminary data from the MoF, total government debt reached 60.7 percent in 2020, up from 40.4 percent in 2019, due to COVID-19-related fiscal stimulus and associated borrowing from the IMF, the European Union and other IFIs, such as the ADB, European Investment Bank (EIB), IBRD, Asian Infrastructure Investment Bank (AIIB), and Kreditanstalt Für Weideraufbau (KfW), etc.[57] This leaves no room to absorb further fiscal commitments from PPPs to the GoG balance sheet if additional projects (assuming they have an impact) would be sought (as of 2020). PPP liabilities are assessed in accordance with IPSAS 32 and are included in the debt-to-GDP ratio calculation through manual adjustment to the public debt figure, which is otherwise calculated on a cash basis.

[56] IMF (International Monetary Fund). 2020. Country Report No. 20/322, Seventh Review under the Extended Fund Facility Arrangement and Request for Modification of Performance Criteria. Press Release; Staff Report; and Statement by the Executive Director for Georgia. December 2020: 59. https://www.imf.org/en/Publications/CR/Issues/2020/12/18/Georgia-Seventh-Review-Under-the-Extended-Fund-Facility-Arrangement-and-Request-for-49973.

[57] IMF (International Monetary Fund). Press Release № 20/202, IMF Executive Board Completes the Sixth Review under the Extended Fund Facility and Approves the Request for Augmentation of Access to Support Georgia Address the COVID-19 Pandemic. https://www.imf.org/en/News/Articles/2020/05/01/pr20202-georgia-imf-execbrd-complete-6threv-eff-approves-request-support-address-covid19 . Also, see Public Debt of Georgia Statistical Bulletin №15, December 2020. https://www.mof.ge/images/File/2020/biuletenebi/29-03-2021/N15_ENG.pdf.

Figure 4.11. Government Debt Indicators and Structure, percent of GDP and percent, 2003-2020



Source: MoF, https://www.mof.ge/en/4409.

The GoG doesn't have any direct long-term commitments to PPPs. As explained earlier, despite delays in adopting IPSAS in Georgia, the Fiscal Risk Management Division at the MoF values stock of PPP liabilities and contingent liabilities according to IPSAS 32 and 19. According to the MoF, the ministry started working on identifying sources of fiscal risks in 2014 with the support of the IMF. The MoF disclosed the first assessment of potential fiscal risks related to PPAs in 2017. According to the WB PPP Country Readiness Diagnostic 2020, the GoG doesn't have any long-term direct commitments in ongoing PPP projects. The current portfolio is comprised of only two projects that according to the IPSAS 32 methodology and the internal regulations of Georgia can be categorized as PPPs. These are also the only two projects that are delivered on a build-own-transfer (BOT) basis as opposed to the majority of PPP or IPP projects that are developed as build-own-operate (BOO). Therefore, obligations arising from these two projects are assessed based on principles set out in the IPSAS 32 standard and reported in the fiscal risk statements[58] prepared by the MoF. These projects are Tbilisi Shota Rustaveli International Airport and Nenskra HPP. The MoF confirmed that another project that was to be delivered on a BOT basis, Anaklia seaport, ran into problems at financial close and is currently being retendered. We couldn't confirm whether the choice of BOT versus BOO

[58] The most recent fiscal risk statement for 2020 can be found on the MoF website: https://mof.ge/images/File/publications/2021/22-01-2021/FRS_ENG_2020_Dec.pdf.

modality in the past was a result of any efficiency assessment or was simply to avoid direct government liabilities under the IPSAS methodology; there is no record of any specific assessments made to decide on that matter. According to the most recent fiscal risk statement for 2020, total asset values for these two contracts amount to GEL 389 million (about US$113.5 million) as of January 1, 2020. As was mentioned above, these PPP projects don't have any government commitments or support. Pipeline projects are not included in the fiscal risk statement because they are not yet operational. According to the MoF, liabilities from these two projects feed into the public debt figure calculation, where necessary, through manual adjustment of the debt calculated on a cash basis. A short summary of the projects is presented in Table 4.3 below.

Table 4.3: Internal Assessment by MoF of PPP Assets and Liabilities for Current Portfolio Based on IPSAS 32 Standard, as of January 1, 2020

Project Name	Comments/Status Update
Nenskra Hydro Power Plant	• GoG is obliged to construct a substation next to HPP. • Nenskra HPP's long-term assets are valued at GEL 303 million (about US$88 million). • The respective PPP liabilities are valued at GEL 267 million (about US$78 million) the asset value was reduced by contributions from the state-owned fund). • Implementation and financial close of the project have been mired in protests by the local residents. Petitions were filed through the accountability mechanisms of the EBRD and EIB calling not to sign loan contracts that were previously approved for the project. In 2020, both the EBRD and EIB concluded that Nenskra is non-compliant with the banks' own standards on indigenous peoples' rights, protection of cultural heritage, gender issues, assessment and management of environmental and social impacts, information disclosure, and engagement of local communities and other stakeholders.[59] • The position of the MoF on potential contingent liabilities from the project under the take-or-pay PPA arrangement is that should a drop in demand happen this could potentially result in large payments from the GoG. Therefore, the MoF is cautiously unsupportive of the project. However, at this point the project has become a highly political matter and is currently on standby.
Tbilisi Shota Rustaveli International Airport	• Does not include any government support (no traffic guarantee or availability payments). • GoG granted to the operator exclusivity rights by agreeing not to build any new airports within a 200 km radius of the Tbilisi airport. • According to the audited financial statements of Urban Airports of Georgia, the balance of deferred revenue (which corresponds to investments made) as of December 31, 2019, was estimated at GEL 122 million (about US$36 million). • According to the MoF, the pandemic created revenue problems for the airport; revenues declined by GEL 100 million in the first six months of 2020.

[59] Kochladze, Manana. 2020. "The never-ending saga of the Nenskra HPP." Bankwatch Network, September 17, 2020. https://bankwatch.org/blog/the-never-ending-saga-of-the-nenskra-hpp.

	However, the private operator didn't request any changes to or renegotiations of the contract, nor did it request any direct support.
Batumi International Airport	• No obligations on the part of the private operator, according to the IPSAS 32 methodology, because the operator hasn't made adequate investments and hasn't created new assets during the course of the contract. Asset value and corresponding PPP liabilities are, therefore, not considered.
Batumi Sea Port	• During the course of the contract, the investor did not create any significant long-term assets. Even in this case, IPSAS 32 obligations of the state towards this operator have not been disclosed.
Anaklia Black Sea deep seaport[60]	• Doesn't include any government support (guarantee or availability payment). The developer/lenders requested traffic guarantees, but the GoG refused. • GoG was to provide land—the port was supposed to encompass about 400 hectares of land, and the private partner was to receive exclusive and irrevocable rights to use this land for 49 years. • On January 9, 2020, the GoG terminated the contract for nonfulfillment of contractual obligations by the private partner—the investor should have raised financing without government support but failed to attract a US$400 million loan from international banks. On July 29, 2020, the private partner filed a lawsuit and began a dispute against the state. Due to this, the GoG considers it unreasonable to recognize obligations related to this project within the rules of the standard. At the end of 2018, liability deriving from Anaklia Port was estimated at GEL 170 million (about US$51 million).

Source: based on the data reported in the Fiscal Risk Statement for 2020.

3.4.2. Transparency policy of PPP contracts

The PPP Law provides for significant transparency related to PPPs; however, not all information is available yet. Georgian PPP legislation envisages extensive disclosure requirements for PPP projects at all stages of the PPP project cycle. Thus, according to article 16 of the PPP Law, "information on PPP projects, as well as on their development and implementation, shall be public, except for documentation deemed to be confidential by legislation of Georgia." Furthermore, article 30 of the PPP Law mandates that the PPP Agency create and maintain a database of both ongoing and completed PPP projects. For this purpose, an authorized body is required to submit a copy of the signed PPP agreement by request of the PPP Agency with all annexes, amendments and related documentation. This database is to be publicly available. In practice, the PPP Agency's recently launched website

[60] This project was terminated before reaching financial close but is included here for information purposes.

(that is still working in test mode) does have a dedicated section called the PPP Projects Database.[61] This database contains descriptive information for ongoing energy projects for the years 2019 and 2020. The part of the database that is supposed to display completed or older (pre-2019) projects is blank. PPP contracts (redacted or full) aren't available. Therefore, it appears that population of the database with project information has begun but it doesn't reflect 100 percent of the projects yet. Furthermore, according to article 32 of the PPP Law, the PPP Agency must also ensure publication of annual reports for all initiated PPP projects containing the following information:

- Brief description of the project
- Progress achieved within a year during implementation of a project, taking into account measures to be acted upon and which formed the basis for project approval
- Financial statements from the private partner.

In practice, the PPP Agency website does contain two activity reports for 2019 and 2020 (in Georgian).[62] For example, the activity report for 2020 contains information on investment amounts for each project; breakdown of the energy portfolio by subsector (wind, solar, hydro); the total number of projects and investment amounts during 2019 and 2020; the project map; and various non-project activities performed by the PPP Agency within the year, such as issuance of a guide, launching a website and online platform, conducting various meetings, attending conferences, etc. The details stipulated by article 32 of the PPP Law aren't part of this activity report. Therefore, it appears that the requirements of article 32 of the PPP Law aren't fully implemented yet.

It is noteworthy that the MoF publicly discloses the results of its internal assessment of PPP assets and liabilities, in accordance with IPSAS 32, and of contingent liabilities related to PPAs in the energy sector, in accordance with IPSAS 19 in fiscal risk statements,[63] despite there being no legal obligation to do so. Publishing of this report provides greater transparency for the existing PPP program, and it's expected that with adoption of IPSAS by the GoG, such disclosures will become mandatory and more regular.

3.5. Performance under Crisis

3.5.1. Impact of COVID-19 on PPP Program

The pandemic was the first global shock that the PPP portfolio experienced; COVID-19 hit the country hard. As was mentioned in part I of this report, Georgia started actively increasing its PPP portfolio in 2011, with one-off transactions until then, peaking in 2017-2018. Therefore, the COVID-19 pandemic was the first large-scale global crisis that the existing PPP portfolio has faced. The impact of the COVID-19 crisis on the Georgian economy was severe. Positive GDP growth during the first two months of 2020 turned into the deepest economic recession the country had ever experienced. In 2020, the economy shrunk by 6.1 percent year-over-year (YoY) (see Figure 4.12). The tourism, transport, and construction sectors were among the worst affected. The sharp drop in tourist flows shattered the tourism sector, which was one of the main sources of foreign exchange in the country before the pandemic. Exports in March 2020 dropped by 22 percent (-12 percent YoY for full 2020), and imports by 13.4 percent (-15.9 percent YoY for full 2020). By the end of 2020, despite the widespread FX interventions of the National Bank of Georgia (NBG), Georgian lari depreciated by 22 percent against the US dollar. The budget deficit in 2020 increased sharply to 9.1 percent of GDP from 2.4 percent in 2019;[64] revenues declined by about US$514 million whereas expenditures increased by approximately US$771 million. The GoG relied heavily on external support, mostly from multilateral and bilateral DFIs/IFIs, to stabilize the situation and secured some US$3 billion in

[61] PPP Projects Database. https://ppp.gov.ge/en/project/.
[62] PPP Agency. Activity Reports for 2019 and 2020. https://ppp.gov.ge/en/homepage/activity-reports/.
[63] The fiscal risk statement for 2019-2023 is available here: https://www.mof.ge/images/File/publications/FRS_2019_ENG.pdf .
[64] The budget deficit in 2021 is projected to be 7.6 percent of GDP.

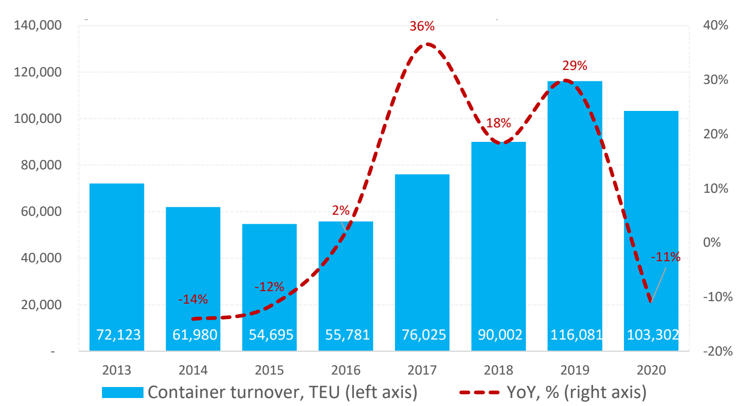
external financial support. This led to a sharp increase in public debt, which for the first time in decades hit the mandatory set limit of 60 percent, reaching 60.7 percent in 2020.

Figure 4.12: Monthly and Annual Real GDP Growth YoY, percent, Jan 2020 – Mar 2021

Source: National Statistics Office of Georgia - GeoStat. Rapid estimates of economic growth.

Significant worsening of the macroeconomic fiscal profile of the country can be both good and bad for PPPs. On the one hand, the tighter fiscal space, above threshold debt and with competing demands for non-infrastructure needs in an environment in which COVID-19 aftershocks are still felt throughout the economy and recovery appears to be long and tedious,[65] might lead to greater internal motivation to pursue projects procured as PPPs. Indeed, as was discussed earlier, until recently PPPs were mostly avoided, unless they came from the private sector. The public sector had no incentives to initiate, prepare, or develop PPPs, because cheap concessional finance was largely available, and traditional procurement appeared easier and faster. On the other hand, many of those PPPs could still require measures of government support, without which they could be prohibitively risky (expensive) or even non-viable. Before the government would be able to directly support PPPs again, it would first have to address the issue of high public debt and free some fiscal space in order to stay compliant with its own debt limitations.

Figure 4.13. Container Turnover at Abtumi Seaport, TEU



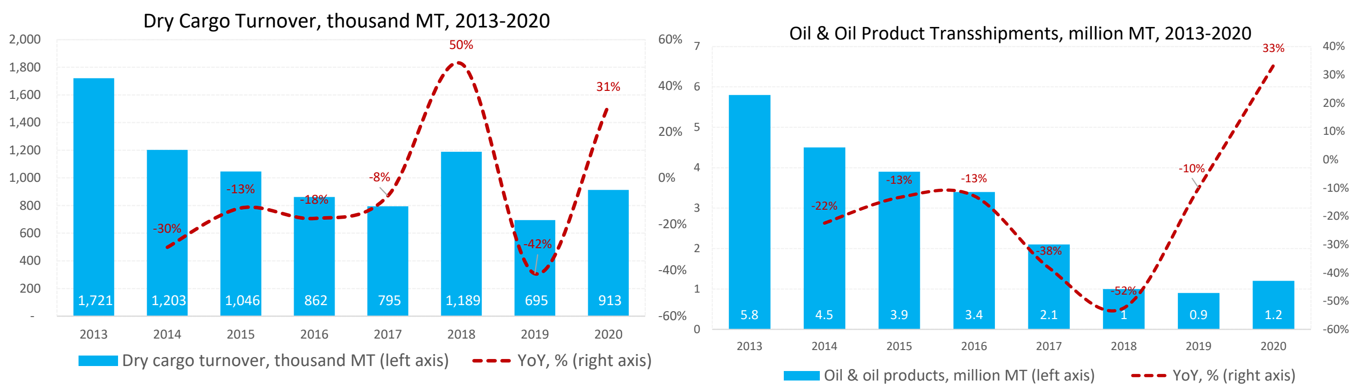
Source: https://www.batumiport.com/en/about_the_company/statistics/
* TEU = Twenty-foot Equivalent Unit

The pandemic didn't especially impact the fiscal risks of existing projects but hit hard the operations of the two airports. Based on consultations with the MoF, the main sector where Georgia currently has the bulk of all PPP/IPP projects (energy) didn't experience any significant negative impact during the COVID-19 pandemic and, in fact, showed a very low sensitivity to the crisis. Although there was a slight decrease in energy consumption in 2020, energy generation levels also declined slightly due to the decrease in water levels in 2020, impacting hydropower projects that produce the bulk of all electricity in the country. According to the operating indicators[66] of Batumi Oil Terminal LLC for 2020, the current operator of the Batumi seaport lease, the company saw mixed dynamics in its operations, ranging from a 31 percent YoY increase in dry cargo turnover (in thousands of metric tons; MTs) and a 33 percent YoY growth in oil and oil product transshipments (in millions of MTs) to an 11 percent YoY reduction in containers turnover (in twenty-foot equivalent units; TEUs). However, in retrospect

[65] According to the most recent credit rating review of Georgia by S&P Global Ratings, projections for one of the important sectors in the Georgian economy are dim: "tourism sector recovery is likely to lag behind global vaccine rollout and we don't forecast a return to 2019 tourism activity levels by 2024." Vaccination projections also do not seem to be especially optimistic. https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2603032.
[66] Operating data for 2013-2020 is available here: https://www.batumiport.com/en/about_the_company/statistics/.

some of these changes look more like a continuation of existing trends rather than specific COVID-19 impacts, with the exception of, perhaps, container turnover (see Figures 4.13 and 4.14). According to the 2020 consolidated financial statements of KazTransOil JSC—full parent of Batumi Oil Terminal LLC (BOT) and subsidiary of Kazakhstan national oil and gas company JSC NC KazMunaiGaz— "BOT recognized a net loss in its separate financial statements for 2020."[67] Therefore, it looks like port operations focused on cargo transshipments weren't as sensitive to COVID-19 shocks as more passenger-oriented transport sectors, including airports, which will be discussed next.

Figure 4.14: Operating Indicators of Batumi Seaport, thousand and million MT, 2013-2020



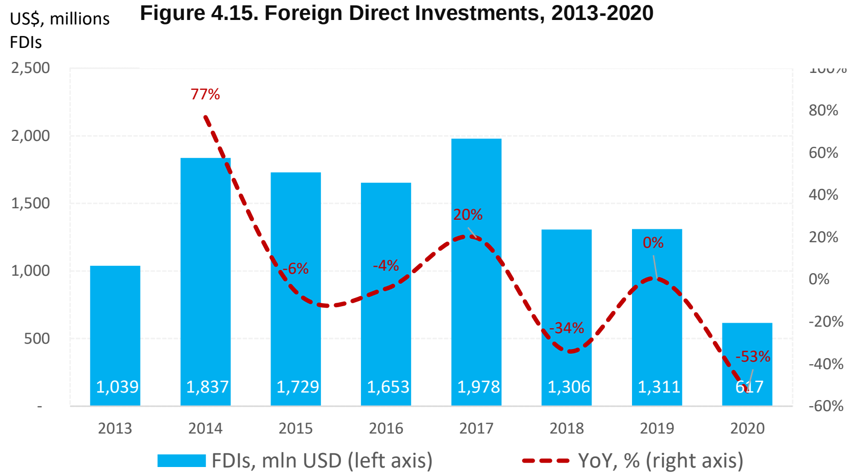
Source: https://www.batumiport.com/en/about_the_company/statistics/.
MT = metric ton

The two projects that were worst affected in the whole PPP portfolio were Tbilisi and Batumi international airports. The Tbilisi airport is a BROT concession and Batumi airport is a lease. Both projects are operated by the Turkish TAV Airports group through its two subsidiaries, TAV Urban Georgia LLC for Tbilisi airport and TAV Batumi for the Batumi one. According to the 2020 full year financial and operational results report[68] of the Turkish TAV Airports, the number of passengers served in 2020 by both Tbilisi and Batumi airports dropped by 85 percent YoY. Furthermore, according to data provided by the MoF, the Tbilisi airport experienced a reduction in revenues of approximately GEL 100 million (about US$29 million) in the first six months of 2020. According to note 36 to the 2020 consolidated financial statements for the TAV Airports group,[69] revenues of the TAV Tbilisi subsidiary declined by 78 percent YoY and profit shrunk by 88 percent YoY. At the same time, based on data from the MoF there was no attempt from operators of either airport to renegotiate or amend the contracts during the pandemic or obtain additional support from the GoG. Because neither airport received any government support or guarantees at inception and, according to the TAV group, neither is paying concession fees to the government, the GoG wasn't directly impacted by operational problems at these two airports but is monitoring the situation closely. Georgia resumed regular international flights in February 2021.

[67] KazTransOil JSC consolidated financial statements for the year ended December 31, 2020, with the independent auditor's report, p. 54. https://kaztransoil.kz/en/to_shareholders_and_investors/information_disclosure/financial_information_annual_and_interim_financial_reports/?doc=1083.
[68] TAV Airports 2020 Full Year Financial & Operational Results report. https://ir.tav.aero/uploads/documents/Documents16022021185140_.pdf.
[69] Consolidated Financial Statements as at and for the year ended December 31, 2020, for TAV Havalimanları Holding A.Ş. and its Subsidiaries, Note 36: 107-108. https://ir.tav.aero/uploads/documents/Documents16022021185101_.pdf.

3.5.2. Measures implemented to help cope with the consequences of the COVID-19 crisis

Figure 4.15. Foreign Direct Investments, 2013-2020



Source: National Statistics Office of Goergia, Geostat.
FDI = Foreign Direct Investment, YoY = year-on-year.

The PPP agenda and policies remained largely the same if not stricter with one exception. From a policy perspective, the PPP agenda wasn't directly affected by the COVID-19 pandemic—sectors where PPPs were not initiated before aren't generating any new PPPs now either. Sectoral policies regarding infrastructure investment remained the same, and there was no shift in focus to certain sectors, which would be different from what it was before. Overall, there is still a political interest in increasing PPP investments in the future to attract foreign direct investments (FDIs) and long-term investments, similar to what was able to be achieved in the energy sector. However, in view of the COVID-19 pandemic, attracting more FDIs might be a challenge because they were badly hit during crisis and reached their lowest level in seven years, declining by 53 percent YoY in 2020 (see Figure 4.15). In terms of signing new PPAs, the MoF has become more conservative and has resisted a big push to sign more PPAs in the energy sector, and any consideration for a new guarantee or PPA has become very strict. According to the MoF, that position helped in addressing the situation and preventing it from deterioration. The current crisis also increased MoF awareness and understanding of what might happen with fiscal risk at a political level should a similar disruption occur again. This includes better understanding of the role that the MoF plays in PPP/IPP decision-making and approval processes as well as future PPP policy setting from a FCCL perspective. The reaction of PPP projects to various external shocks is also clearer.

A major policy change that was made possible by the pandemic was the introduction of the "Green Tariff" as an alternative to signing more PPAs in the future, as discussed in part I of this report. The MoF confirmed that the COVID-19 crisis offered a chance to push for adoption of this support scheme, which, in essence, limits potential losses for ESCO (GoG) to not more than US 1.5 cents per 1 kWh in the environment of deregulated electricity prices. A switch to the Green Tariff from PPAs would eliminate direct agreements with ESCO. Budgeting for this subsidy would also become more straightforward as Parliament would directly approve subsidy amounts as opposed to no direct provisioning or reserving for potential losses under existing PPAs.

Annex 3 A: Georgia FCCL Principles

#	Principles	Clarification	Assessment for Georgia
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	PPP guidelines provide some guidance for project proponents on how to prepare fiscal assessment as part of a feasibility study. No appraisal guidelines for approving/reviewing authorities.
2	Tools are in place to assess the potential fiscal costs and risks	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	PFRAM was supplied to and given training for but was found to be of limited use. Instead, the MoF uses an internally developed Excel-based tool mostly for analysis of guaranteed payments under the PPAs.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal Impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	According to the PPP Guidelines, the Ministry of Finance shall review and provide recommendations at all major milestones in the PPP project cycle, including for contract amendments. In practice, MoF is indeed involved actively, but sometimes political decisions could prevail over MoF recommendations (final approvals rest with the GoG).
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	VfM methodology based on the best international practice was adopted. Requesting agency/private partner is required to perform VfM assessment as part of a feasibility study, but in practice neither the requesting agency nor private sector companies are prepared to use complex tools.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	All PPP fiscal commitments should not exceed established public debt threshold (60 percent of GDP); no PPP-specific limits established.

#	Principles	Clarification	Assessment for Georgia
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	PPP projects are not well integrated in the budgeting process, unlike public investment projects.
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to fund contingent liabilities should they materialize.	No mechanisms in place to budget for contingent liabilities.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	The country is undergoing a phased transition to IPSAS. Currently, the government reports on a modified cash basis. Additionally, the Fiscal Risk Management Division at the MoF specifically values PPPs and related liabilities in accordance with IPSAS 32 and 19.
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report is provided on all PPP projects, including their fiscal commitments (direct and contingent), progress and value for money, and is appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program	MoF reports on PPP assets and liabilities valued in accordance with IPSAS 32 and 19 and presents analysis of contingent exposure related to PPAs as part of the annual Fiscal Risk Statements on a portfolio level. VfM assessments are not part of this disclosure; progress is not comprehensively disclosed, unless a project is cancelled or terminated for those projects that fall under the reporting framework of IPSAS 32 and 19 standards.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	N/A

#	Principles	Clarification	Assessment for Georgia
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure the fiscal rules for PPPs should be applied to all levels of government.	Provisions of the PPP Law and supporting regulations apply to the Government of Georgia, ministry, legal entity of public law, any other state or municipal entity, the Government of Autonomous Republic of Adjara/Abkhazia, or any enterprise created, directly or indirectly, by more than 50 percent of state or municipal ownership.

Annex 3 B: Description of Public Investment Management (PIM) Process

Project Pre-Selection

The process shall start with project pre-selection. The PIM Guidelines mention several ways for how projects could potentially be sourced or identified:

- Screening state asset registry and asset management systems for potential assets that might be nearing the end of their useful lives and might require replacement/modification in the near future;
- Reviewing regional and sectoral strategic plans;
- Reviewing general/master plans for the main infrastructure sectors;
- Stakeholder consultations, including with local communities.

The PIM Guidelines highlight that the start of the project pre-selection process is not directly related to the budget cycle and can begin any time during the budget year. Typically, it would start as soon as a need is identified, however, it's recommended that sufficient time is devoted to analyzing a project and its alternatives. A general recommendation is to allow at least one year before the commencement of the budget year in which the project is to be implemented.

The formal document required at this stage is a Project Concept Note (PCN). A PCN must be prepared at least for the main project and a "do nothing" alternative (ideally, all project alternatives shall have their own PCNs). The PIM Guidelines advise that preparation of a PCN shall be a product of internal analysis, preferably with the involvement of technical specialists, professional project analysts, outside stakeholders and relevant government agencies. Besides basic project information and its implementer, a PCN shall contain the project essence and need, compliance with strategic documents, project costs and benefits together with costs and benefits of its alternatives, fiscal impact, its economic efficiency, and similar projects realized in the past as well as a potential procurement method (including a possibility of realizing it through a PPP), among others. A PCN shall be accompanied by the preliminary feasibility analysis prepared in accordance with the requirements laid out in the PIM Guidelines.

The proposed project shall move from within the proposing agency/initiator through to the Working Group at the MoF to be finally decided upon by the Inter-Agency Commission. A PCN shall be prepared by the relevant spending institution with the active involvement of its financial/budgetary unit. Only after the PCN and preliminary feasibility analysis pass internal evaluation by the financial/budgetary unit can the project be submitted to the head of the relevant agency for approval. The head of the spending institution shall decide on whether to submit the project further to the MoF. If the decision is positive, the PCN along with the preliminary feasibility analysis are submitted to the Working Group at MoF, which shall put information about the project in the register of investment projects, review and evaluate the received documents, including by asking the project initiator for additional details or asking that person to redo the analysis or to join the working group. At the end of this process, the Working Group shall prepare its conclusion in a report to be further submitted to the Inter-Agency Commission for approval, and update the project status in the register of investment projects. The conclusion of the Working Group can be either agreement or disagreement with the proposed project. The Inter-Agency Commission shall review the conclusion submitted by the Working Group, hear the position of the spending institution and request additional information if needed. At the end of this process, the Inter-Agency Commission submits its conclusion to the requesting agency; a conclusion can be "accepted," "rejected," or deemed to "need to be re-submitted for further consideration." The pre-selection stage is considered to be completed after the project is transferred to the next stage by the decision of the requesting institution. The PIM Guidelines reiterate again that pre-selection decision can be made any time during the budget year.

Project Final Evaluation/Selection (Appraisal Stage)

During the appraisal stage, a much more detailed analysis is required. If the project clears the Pre-Selection stage it then moves to the Final Project Evaluation/Selection stage (also called the Appraisal stage). During this stage the requesting agency shall continue with a more detailed internal evaluation, update the PCN, and prepare feasibility studies, a preliminary engineering solution and other ancillary studies by itself or with the help of external consultants. The following dimensions shall be mandatorily covered, among others:

- Strategic needs assessment
- Technical feasibility
- Economic and commercial feasibility
- Fiscal impact
- Social and environmental impact assessment
- Risk analysis—various risks that might impact a project shall be considered, including construction, demand, planning, economic, environmental, financing, legal, O&M, procurement and technological risks, among others. A mitigation strategy for each identified risk shall be devised
- Detailed analysis of project alternatives which shall be sufficient to make a choice in favor of one of them
- Procurement strategy—a choice of procurement modality shall be made, including through consideration of a PPP option. The PIM Guidelines provide a set of criteria/testing techniques to help making a preliminary decision about whether a project might be potentially viable as a PPP. If it is reasoned that the PPP route is a possible way to deliver a project, the requesting agency shall perform a proper value for money (VfM) analysis in accordance with the existing PPP/VfM methodology. The criteria for the preliminary test of the PPP option include:
    - An estimate/comparison of financial, construction and operating costs for each alternative procurement method throughout the duration of the contract;
    - Sufficient interest from potential private investors in the provision of services, and the existing competition in the market;
    - Clear definition, identification and assessment of project risks and ability to transfer appropriate types of risk to the private sector;
    - Possibility to repay part of contract payments to a private partner from amounts paid by end users; and
    - Assessment of project scale in relation to operating costs associated with a PPP.

Besides the head of the requesting agency, the Working Group at the MoF and the Inter-Agency Commission, the GoG shall also have the right to make/override decisions at this stage. Once all studies are prepared, they are submitted to the head of the requesting agency, who shall make the final decision on the project's feasibility. If a decision on project feasibility is positive, the results of the conducted evaluation together with a request for budget funds are submitted to the Working Group at the MoF. If the main project assumptions and results of feasibility studies (including cost-benefit and other analyses) at the Appraisal stage don't substantially differ from and/or change the results obtained at the Pre-Selection stage, the MoF shall approve the project. However, if the total project cost increases by more than 20 percent compared to the value at the Pre-Selection stage, positive NPV turns negative in the updated assessment and/or IRR is reduced by three percentage points, the MoF can either return a project with a negative conclusion back to the requesting agency or submit it to the Inter-Agency commission for further consideration. If the MoF returns the project back to the requesting agency with a negative conclusion, the requesting entity can directly submit the project to the Inter-Agency Commission for further consideration. If the Inter-Agency Commission decides positively, the project may proceed to the Implementation stage. Otherwise, the requesting agency can submit the project to the GoG for further consideration. Finally, if the GoG rejects the project, the work on the project shall terminate. Otherwise, the project can proceed to Implementation stage. Regardless of the outcome, the Working Group at the MoF shall update the project status in the registry of investment projects after each decision point.

Annex 3 C: Description of Different Types of Issues that Might be Faced by PPP Projects and That Shall be Analyzed by the MoF in its Decision About Government Support

Funding issues might be resolved without using government support measures. Funding issues relate to certain or at least very probable limitations on the ability of the private partner to raise sufficient private financing (debt, equity and mezzanine) to cover the capital investment requirements of a project. The PPP Guidelines suggest two possible solutions that don't involve government support:

- *Unbundling procurement of private partner and debt providers.* First, a consortium of developers, equity investors and operators is selected, using standardized debt financing conditions for determination of their bid price. After a PPP contract is awarded, a debt funding competition is held to select lenders for the winning bidder. Such a competition can be organized by a public partner, or by a private partner under the supervision of a public partner. The disadvantage of this approach is the increased complexity and the possibility of interface issues between financing agreements on the one hand, and the PPP contract, EPC and O&M agreements on the other hand; and
- *Changes in risk profile of a project.* This may sometimes substantially alter the market's perception of a project, moving it into a different asset class and changing the type of interested investors. Altering a risk profile may require additional guarantees, so some government support may be required after all.

At the same time, potential instruments of government support to address funding issues suggested include: i) additional financing facilities, ii) milestone payments, and iii) guarantee of refinancing risks.

Cash flow issues occur when baseline cash flow projections show insufficient revenues to meet debt service requirements and/or pay out dividends to equity investors. The PPP Guidelines distinguish between two types of cash flow problems—a temporary and a permanent cash flow shortage. For a temporary cash flow shortage, the PPP Guidelines suggest either using either additional financing facilities or a temporary revenue guarantee as a possible measure of government support. A permanent cash flow shortage, on the other hand, can only be resolved by government support instruments that include a grant element, i.e., a viability gap funding (VGF), contribution in kind of project assets (land, facilities), project-specific tax incentives or additional financing facilities provided by government institutions at subsidized interest rates. The PPP Guidelines also mention that if a project demonstrates a permanent cash flow shortage then it may be more efficient to implement a project as an availability-based PPP instead of a revenue-based PPP.

Specific risk issues relate to individual risks with high impact, resulting in severe costs or revenue losses and having a significant likelihood of occurrence. Examples are serious doubts about the acquisition of a right-of-way for a project, demand risk in a greenfield project without a proven user base, unknown geological conditions having an impact on costs of underground works, and uncertainty about clean-up costs of heavily polluted sites, among others. Specific risk(s) renders a project unbankable. The PPP Guidelines suggest a preferred solution, not involving government support, for dealing with individual high impact risks is undertaking actions to reduce those risks. For instance, more preparation on the right-of-way acquisition before the tendering of a project, or more research about unknown conditions having a high impact on costs or revenues. This may reduce the risks to a level that is acceptable to lenders. If the above is not possible, the appropriate government support instrument is the guarantee of a risk by the government. In some cases, it may be appropriate not to transfer the whole risk to the government, but to implement a risk sharing mechanism. In this way a private partner retains an incentive to mitigate the risks as much as possible during construction and operation of a project. In the case of the revenue risks, the risk transfer to the government takes the form of a minimum revenue guarantee. However, in that case a public partner and its consultants are advised to examine whether it is not more efficient to convert a project from a revenue-based to an availability-based one.

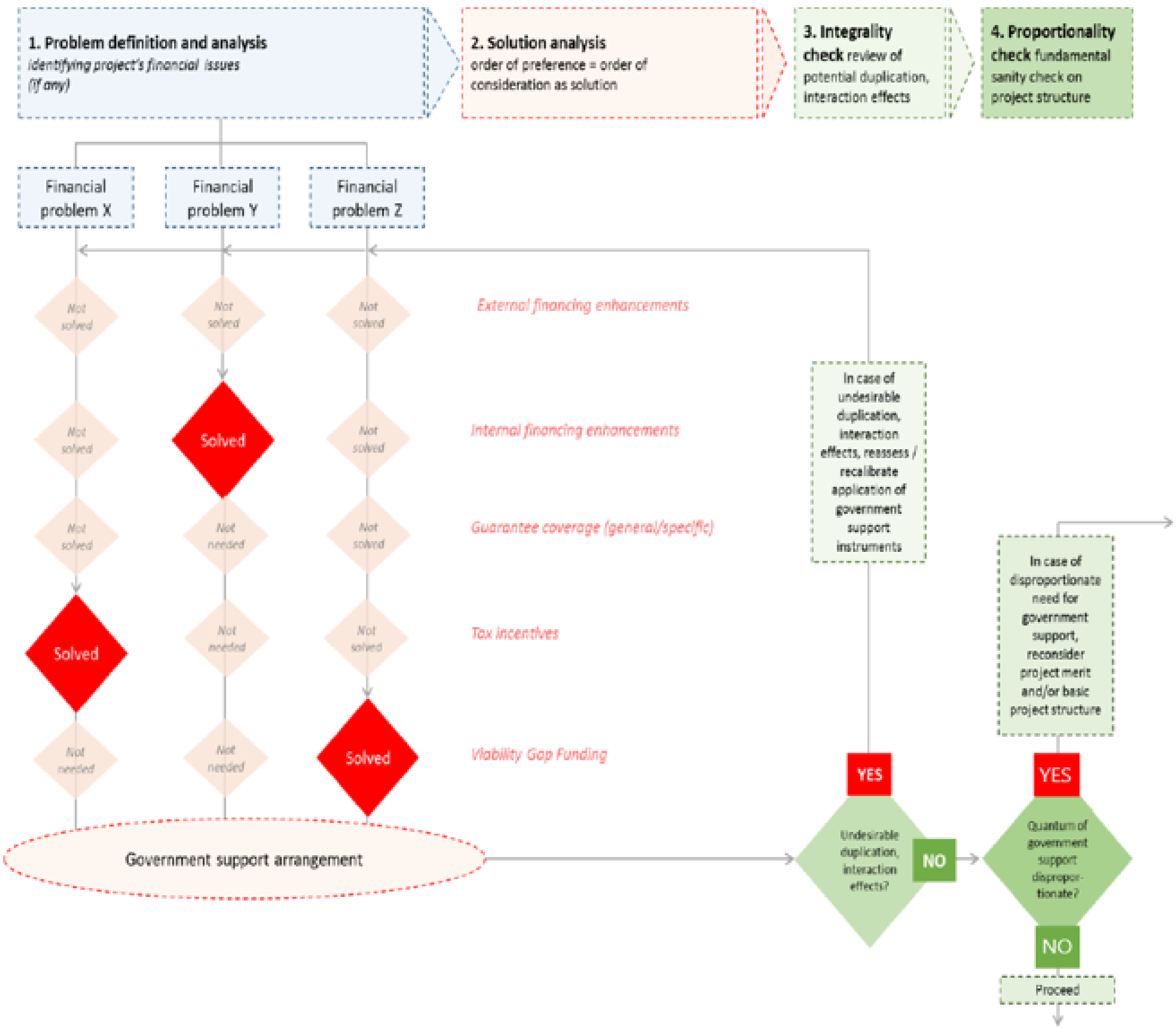
Finally, overall risk profile issues occur when no individual high impact risks can be identified, but the overall risk profile of a project is considered too high. As a result, the financial NPV to equity holders is negative. The project is not financially viable. The consequence of a too high-risk profile is the same as that of a permanent cash flow shortage. Hence, as in the permanent cash flow shortage case, the PPP Guidelines suggest using government support instruments with a grant element, i.e., VGF, contribution in kind of project assets (land, facilities), project-specific tax incentives and additional financing facilities provided by government institutions at subsidized interest rates, noting a lower efficiency of tax incentives in this case because they are usually dependent on profits and therefore provide support when it is least needed.

Furthermore, the PPP Guidelines stress that government support shall be provided only when necessary or cost-effective, and not more than is necessary or cost-effective. In particular, government support instruments should only be considered when: i) they are absolutely necessary for bankability or financial viability; and ii) although not absolutely necessary, they can achieve a significant reduction of the project financing costs by a better risk allocation. Feasibility and cost-effectiveness of solutions not involving government support should be investigated first, such as adjustment of user fees or undertaking actions to reduce risks. The scope and level of support should not be larger than what is required to resolve a financial viability or bankability issue. This means that i) a government support package shall precisely be focused on the financial issue to be addressed, and ii) the amount of support shall not result in overcompensation (i.e., a significantly positive financial NPV). To avoid overcompensation, the PPP Guidelines suggest that either the level of government support (i.e., amount of required VGF) or the level of user fees must be the subject of competitive bidding; the use of claw-back provisions or mechanisms for sharing the upward risks shall also be considered.

Optimal instrument mix shall be sought. If several types of instruments are eligible, then priority should go to the instruments with the lowest fiscal impact first. A tentative suggested ranking in order of declining priority is: i) external additional financing facilities (subordinate debt, concessional loans, guarantees, etc.) offered by multilateral or bilateral financing partners; ii) internal additional financing facilities offered by institutions of the GoG; iii) specific guarantees protecting private investors and/or lenders against specific risks; iv) project-specific tax incentives (if feasible and practical), e.g., in the form of income tax holidays or reductions, dividend withholding tax exemptions, custom duty relief etc.; and v) viability gap funding in the form of milestone payments (or, alternatively by contribution of land and government assets in kind, or by conversion of the project to an availability-based PPP). A public partner, PPP Agency, and, especially, the MoF are required to review the proposed mix of government support instruments for duplication or conflicts. The PPP Guidelines mention avoidance of wasteful deployment of overlapping and conflicting instruments as one of the key objectives of alignment of government support among various institutions.

Deviation from the principle of optimal risk allocation is not allowed. Also, provision of government support should under no circumstances lead to deviation from the principle of optimal risk allocation. Such a principle does not preclude transfer in part or whole of risks that are usually borne by the private partner. However, such a transfer should be based on a motivated argument that i) risk can indeed be better managed by government than by the private partner, or ii) the risk in question is so large and unmanageable that it can be better borne by the government (which is no better able to manage the risk but has more resources to absorb it). If a proposed project appears to be unbankable—without government support that significantly weakens private partner incentives and undermines the optimal risk allocation—then decision-makers for the funding scheme should conclude that the PPP procurement and delivery model is not suitable for this project and should be reconsidered. A schematic decision tree for the government to decide on the mix of fiscal support is presented in Figure 4C.1 below.

Figure 4C.1: Framework for the Analysis of Government Support (excerpt from the PPP Guidelines)



Source: PPP Guidelines, Phase 2: PPP Project Preparation, Annex III, p. 56.

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Chapter 4: Jordan

Chapter 4: Jordan

Acronyms and Abbreviations

CA	contracting authority
CoM	Council of Ministers
EDP	Executive Development Plan
EIU	Economist Intelligence Unit
FCCL	fiscal commitments and contingent liabilities
GBD	General Budget Department
GDP	gross domestic product
GoJ	Government of Jordan
IFC	International Finance Corporation
IPP	independent power producer
JD	Jordanian dinar
MDB	multilateral development bank
MoF	Ministry of Finance
MoPIC	Ministry of Planning and International Cooperation
MTBF	medium-term budgetary framework
NRIP	National Registry of Investment Projects
PCN	project concept note
PDD	Public Debt Directorate
PDF	project development fund
PIP	public investment project
PPA	power purchase agreement
PPP	public-private partnership
PPP-PIM	private-public partnership-public investment management
SOE	state-owned enterprise
TA	transaction advisor
TCFC	Technical Committee for Fiscal Commitments
TJCS	Trans-Jordan Communications Services
TPI	traditional public investment

Executive Summary

Jordan has developed over the past two decades a public-private partnership (PPP) portfolio encompassing some 42 PPP projects, primarily in the energy and water sector and also including the airport PPP for the Queen Alia airport. These achievements have been enabled and facilitated through a gradually evolved PPP Framework including proceedings for the management of fiscal commitments and contingent liabilities (FCCL).

One achievement was the development of an integrated private-public partnership-public investment management (PPP-PIM) governance framework that guides review of projects from their inception and steers them towards the most suitable delivery scheme, whether procured as a PPP or through traditional public investment (TPI). On paper it appears to be an effective approach—but in practice the framework is hampered by the limited understanding of PPPs by decision-makers, who tend to perceive PPPs as private investments with limited fiscal implications.

This lagging awareness of PPPs has slowed down PPP ambitions in recent years, though it is expected that post-COVID-19 recovery programs will revitalize the push for PPPs due to the limited fiscal space for the necessary infrastructure investments to reboot the economy.

Whereas on paper the regulatory context and institutional setup reflects international standards and the experiences gained, there are still several areas that need to be improved, particularly the operationalization of the FCCL framework in terms of decision criteria, methodologies, and tools necessary to identify, analyze, control, and report on fiscal commitments and contingent liabilities.

As for performance under crisis, the nature of the PPP portfolio—primarily energy and water projects—has limited the fiscal impact of the pandemic. Energy projects have been largely protected through power purchase agreements (PPAs), and water projects have been largely unaffected by the COVID-19-related restrictions. The main issue concerns the drastic revenue implications of travel restrictions for the Queen Alia airport, and for which the government is currently discussing with the concessionaire possible recovery plans to restore financial and operational performance.

4.1. PPP Experience

Jordan can be considered the most advanced PPP market in the Middle East region, with more than 20 years' history of developing PPPs. In 1997, the Government of Jordan (GoJ) granted a concession following a competitive bidding process to Trans-Jordan Communications Services (TJCS), a joint venture to provide a card phone service in Jordan for 15 years. It was maybe not the conventional type of PPP though it was one of the first occasions for the GoJ to engage a private entity to deliver a public service. At that time public infrastructure assets and services were mainly provided traditionally, either by general government units or by state-owned enterprises (SOEs). Pressures to satisfy increasing infrastructure needs within tight fiscal constraints resulted in the GoJ turning to PPPs.

Shortly after the first concession, in 1999 a management concession for Amman Water and Sanitation was awarded, and this has performed well in terms of reducing non-revenue water and increasing hours of service. There was also a concession to rehabilitate and operate the Aqaba Railway at around the same time. These were useful experiences that paved the way for the GoJ to gradually move to a more active involvement of the private sector in public infrastructure and related services.

Perhaps the most acclaimed PPP for the region was the Queen Alia International Airport PPP, which was concluded—with support from the International Finance Corporation (IFC)—in 2007.

Box 5.1: PPP Experience with the Queen Alia International Airport

In 2005 the government initiated preparation for a PPP to expand the capacity of the Queen Alia International Airport, which was built in 1983 and accounted for 97 percent of all air traffic in Jordan. The government appointed the IFC in February 2006 as lead advisor to analyze private sector participation possibilities.

The IFC recommended structuring the project with a 25-year design-build-finance-maintain and operate contract. Instead of using a negotiated arrangement with an unsolicited proposal, the IFC instead assisted the government in conducting the competitive tendering process, which involved five bids from consortia of international, regional, and local investors, including the major airport operators.

In May 2007, the Airport International Group, an international consortium composed of construction group Joannou & Paraskevaides Ltd., airport operator Aéroports de Paris Management S.A., and regional financial investors (Engineering and Development Group Investment Holdings Ltd., Noor Financial Investment Company KSCC, and Abu Dhabi Investment Company), won the bid and signed the PPP agreement. As part of its bid, the group offered the government a 54.6 percent share of gross revenue. The agreement did not include any sovereign guarantee.

The rehabilitation and expansion was successfully completed by 2013 and the airport was named the best airport of its size in the Middle East by the Airports Council International three years in a row, in 2014, 2015, and 2016.

Source: Shi, Lin, and Thomas Rehermann. 2017. "Queen Alia International Airport: the Role of IFC in Facilitating Private Investment in a Large Airport Project." EMCompass No. 35, Washington, DC, World Bank Group.

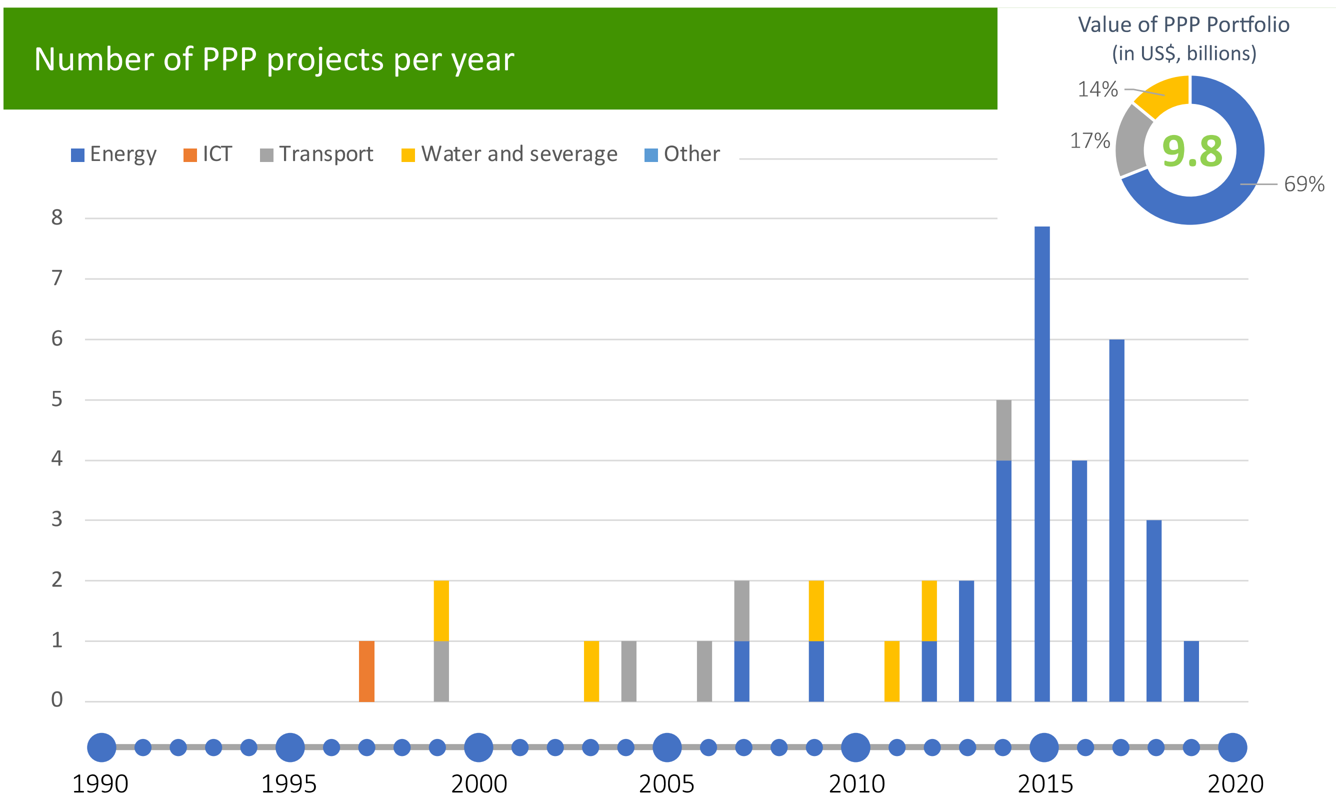
The GoJ continued using the PPP modality to deliver much-needed infrastructure. Since the mid-2000s, the increase in PPPs as a share of the overall public investment portfolio has been remarkable; it increased from 5 percent, on average, for 2000 to 2005, to 25 percent, on average, for 2010 to 2014.[70] Thus, by 2015 more than one-fourth of Jordan's public sector investment portfolio was procured through PPPs, compared to just 6 percent for the average

[70] By comparison, many emerging economies started using PPPs to procure economic and social infrastructure in the early 1990s.

of emerging countries.[71] Such a rapid increase in PPPs in Jordan has resulted in a high PPP capital stock—an estimated PPP capital stock of 12.3 percent of gross domestic product (GDP)—compared to the stock of emerging economies and peer countries.[72]

The number of concluded PPP projects has grown to 42 across the energy, transport, and water and sewerage sectors, generating total investment of more than US$9.8 billion.[73] Energy accounts for 69 percent of the investments (the majority of recent experience has related to energy generation projects that benefit from standardized PPAs that provide significant investor comfort). In relation to the size of the economy as indicated by its 2019 GDP of US$106 billion, the PPP portfolio is the largest of the countries reviewed in the sample of this benchmark, i.e., approximately 10 percent.

Figure 5.2: Breakdown of PPP Portfolio



Except for the Queen Alia International Airport, most PPPs in Jordan are government-funded projects, which require direct payments from either the government or an SOE during the operation period, and typically have significant fiscal risks for the government (e.g., termination clauses, take-or-pay clauses). Additionally, since 2003 the government has provided direct and indirect support (i.e., subsidies and guarantees) to many PPPs, impacting the

[71] IMF (International Monetary Fund). 2017. *Jordan: Technical Assistance Report—Public Investment Management Assessment (PIMA)*. IMF Staff Country Reports 2017 (366). Washington, DC: IMF.

[72] Based on data from the World Bank Private Participation in Infrastructure (PPI) Database. According to the International Monetary Fund (IMF), the capital value of investment in PPPs and PPAs since 2003 is at least JD 8.6 billion, or about 28 percent of gross domestic product (GDP) (IMF. 2020. Country Report No. 20/101, 2020 Article IV Consultation and Request for an Extended Arrangement Under the Extended Fund Facility—Press Releases; Staff Report; and Statement by the Alternate Executive Director for Jordan, April 2020. Washington, DC: IMF.). The large discrepancy confirms the limited reliability of the reporting on PPP commitments in Jordan though it can be concluded that the capital value of PPP investments exceeds the average for emerging economies, and is certainly the highest among peer countries, and even higher than some of the PPP-active Organisation for Economic Co-operation and Development (OECD) countries (e.g., UK, Chile, Portugal).

[73] World Bank PPI Database. The IMF indicates the number of concluded PPPs amounts to 47 percent of GDP (IMF 2020), again confirming the limited reliability of PPP reporting in Jordan.

government deficit. The GoJ has mostly provided support to PPAs under the renewable energy program and conventional independent power producer (IPP) projects, which now constitute the bulk of Jordan's PPP program. Payment guarantees to backstop the PPAs exposed the GoJ to direct explicit liabilities, but this practice has since been stopped.[74] According to the PPI database, 66 percent of projects are multilateral development bank (MDB) supported.

In 2021 the government's PPP pipeline included 12 projects to be procured as PPPs from 2020 to 2023. Given that the Jordanian energy market has been saturated over the past few years, very few of the projects identified by the GoJ include energy projects.[75]

Box 5.2: PPP Projects in the Jordanian Pipeline

In February 2021, at a Zoom meeting of the Higher Committee for Public-Private Partnership, the Committee Chair, Deputy Prime Minister and Minister of State for Economic Affairs Umayya Toukan, stressed the importance of speeding up public-private projects proposed by the National Public–Private Partnership Unit's (PPP) as projects for that year, noting that the feasibility and financial impact studies of the projects were ready.

He also spoke about 12 projects, with an estimated cost of about JD 1 billion, that the unit was working on with various government agencies, pointing to some of the challenges and obstacles that hindered their implementation.

The meeting tackled other projects set for implementation, in cooperation with the concerned ministries, including a project to construct buildings and freight and passenger terminals at the new border crossing at the King Hussein Bridge, which links Jordan with the West Bank, to replace current facilities.

During the meeting, members of the committee discussed the National Optical Fibre Network project, which aims to provide investment opportunities by creating business models for commercial and marketing purposes and proposing applied operating patterns.

This is in addition to operating and managing the Bus Rapid Transit (BRT) project in Amman and Zarqa, which aims to introduce a contract to manage and operate the infrastructure of the bus system in partnership with the private sector.

The BRT project also involves establishing special lanes in the middle of the streets and rehabilitating and expanding both sides of the roads to accommodate the bus routes, in addition to three lanes on each side.

The meeting also tackled a project to build 15 schools for the Ministry of Education in Amman, Zarqa and Madaba, as part of the ministry's plan to establish 600 schools across the kingdom.

Source: Jordan News Agency (Petra). 2021. "Toukan urges speedy implementation of public-private projects." Public News, November 2, 2021. https://petra.gov.jo/Include/InnerPage.jsp?ID=32273&lang=en&name=en_news.

In the King's Letter of Designation for Prime Minister Bisher al-Khasawneh upon the installment of his cabinet, King Abdullah II bin Al-Hussein stipulated: "Procedures must be facilitated for national and foreign investment, and steps must be taken to attract investments in strategic megaprojects and complete public-private partnership projects that serve development across the Kingdom," highlighting the country's commitment to PPPs. Also, in 2014, the country's national development plan adopted a National Vision and Strategy, known as Jordan 2025, which emphasizes that PPPs are to be a key mechanism for delivering public infrastructure and services.

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[74] IMF (International Monetary Fund). 2017. *Jordan: Technical Assistance Report-Public Investment Management Assessment (PIMA)*. IMF Staff Country Reports 2017 (366). Washington, DC: IMF.
[75] Harker, Rob. 2020. "Understanding Jordan's New PPP Law." DLA Piper, April 27, 2020. https://www.dlapiper.com/en/dubai/insights/publications/2020/04/understanding-jordans-new-ppp-law/.

4.2. Legal Framework and PPP Approval Process

4.2.1. PPP Governance, Institutional and Legal Framework

Up to 2014, PPP transactions were procured under the provisions of the Privatization Law or sector-specific laws such as the Renewable Energy and Energy Efficiency Law, with support from the Executive Privatization Committee. As early as 2008, a World Bank funded study from Ecorys—which was even presented to then Prime Minister Nader Dahabi and his cabinet—recommended the enactment of a PPP Law and the establishment of a PPP Unit. It took six years to draft and adopt an overarching PPP law and establish a PPP unit (which came into operation in 2013).

The PPP law (No. 31) adopted in 2014, followed by the PPP Regulations and a PPP strategy published in 2015, provided the legal framework for the government's PPP program and formalized the role of the PPP unit. The 2015 Regulations addressed the procedures for the various stages from preparation to procurement and tender process. The law required that all projects be subject to feasibility analysis, value for money, budget affordability, and risk-sharing analysis by the PPP unit at the Ministry of Finance (MoF), although standard methodologies for conducting these assessments have not yet been developed.

The PPP unit was established under the MoF and was responsible for developing the PPP framework and driving the PPP agenda, and also for preparing the FCCL assessment.

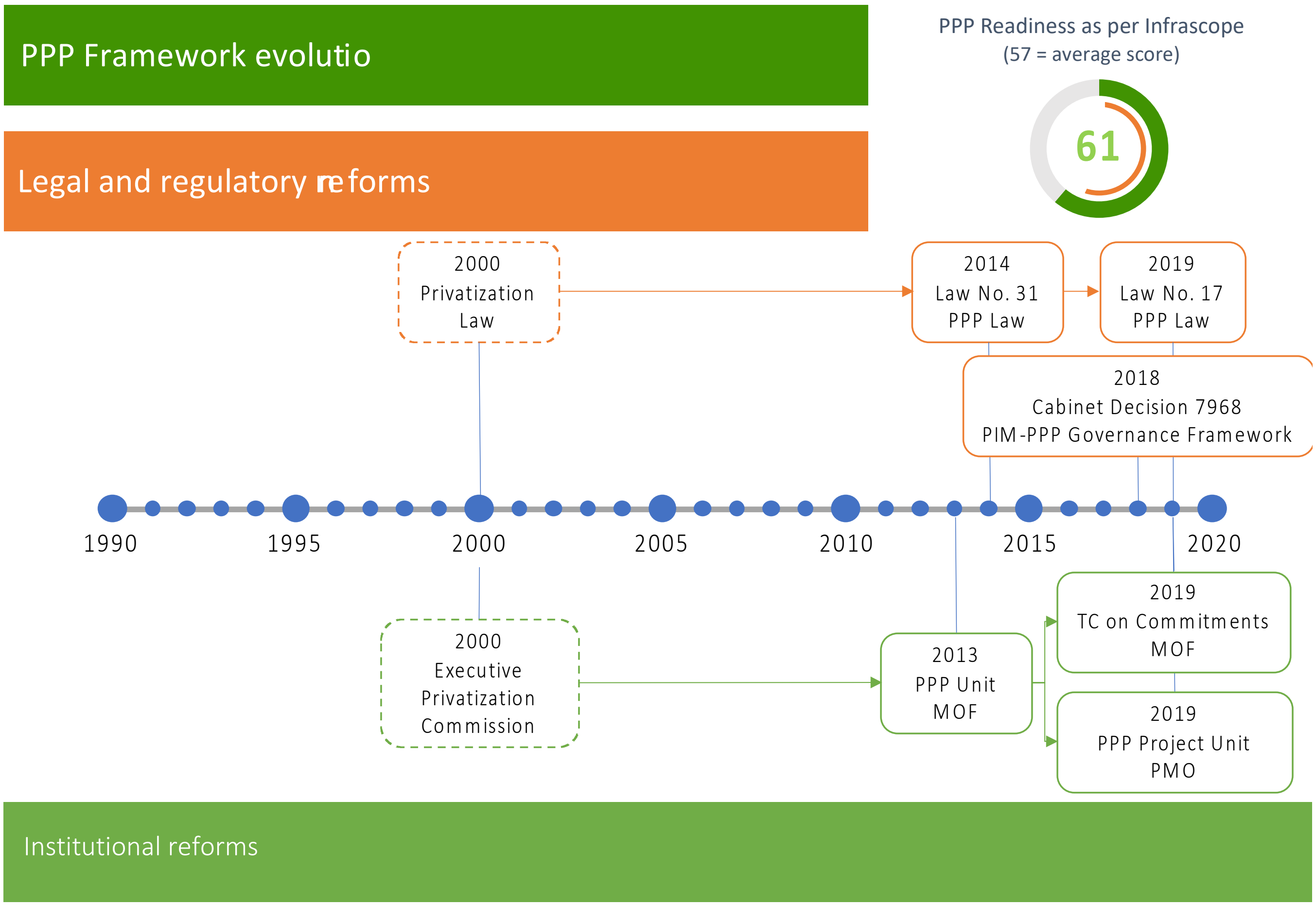
In 2019, the Jordanian government adopted PPP Law No. 17 to repeal and replace PPP Law No. 31 of 2014. This was done in consideration of the increasing significance and magnitude of PPP Projects in Jordan, as the PPP Law introduced more scrutiny and comprehensiveness to the overall PPP framework, as well as allocating a special fund for the development of PPP projects. The PPP Law was focused on reformulating PPP governance to make it more attractive for private investors, more extensive for governmental parties to utilize, and more efficient for the public to benefit from.

The PPP Law has several strengths, such as its broad coverage (i.e., applicable to all levels of government and economic sectors), and a clear approval process. Also, in line with good international practices and to avoid any conflict between approving decisions on projects and FCCL roles and responsibilities, these functions were separated by the new law. The FCCL mandate was moved to a newly created unit—the Technical Committee on Fiscal Commitments under the MoF—and the PPP Unit was moved under the Prime Minister's Office and renamed the PPP Project Unit, all with the aim of improving the effectiveness of the overall PPP framework.

A specific feature of the PPP framework in Jordan is its alignment with the public investment management framework (PIM). In 2018 the integrated Public Investment Management (PIM)–Public Private Partnerships (PPP) Governance Framework was approved by Cabinet Decision No. 7968. It was designed to strengthen the framework for managing public investments in order to improve the efficiency and the efficacy of capital expenditures, and to maximize finance for development by leveraging PPPs, where appropriate.

Though somewhat outdated (that is, before the 2019 legislative reform), Jordan's readiness and capacity for PPPs is above average and considered developed (albeit just passing the threshold) according to the Economist Intelligence Unit (EIU) Infrascope assessment, thanks to its institutions and its track record, which also demonstrates effective access to capital. However, the World Bank's Benchmarking Infrastructure Development (BID) ranking scores Jordan's capacity to prepare PPP projects as below average, primarily because of shortcomings in the PPP framework with regard to review and approval proceedings. It has to be noted that this qualification does not quite match the regulatory context, which clearly highlights a gatekeeping process conferred upon by the Ministry of Finance, though the rules and methodologies underlying this gatekeeping process need to be strengthened.

Figure 5.3: PPP Framework



The Institutional Framework

The PPP framework created institutional roles and responsibilities for all participants in PPPs to help drive a robust, systematized PPP program in the country. The key stakeholders in the PPP process are summarized below.[76]

- Contracting Authority (CA)

Each contracting authority will pursue the identification, prioritization, development, procurement, negotiation, and implementation of PPP projects. In particular, it will:

  - **Identify PPP projects** by submitting potential PPP projects in line with sector priorities to the Executive Development Plan and prepare a project concept note (PCN), with the support of the PPP Project Unit, for submission through the National Registry of Investment Projects (NRIP).
  - **Prepare PPP projects,** that is, develop the pre-feasibility study and the feasibility study with transaction advisors, and with the support of the PPP Project Unit, as well as other preparatory studies and reports as necessary in relation to a PPP project and bidding documents.

[76] Government of Jordan.The Jordan 2019 Public Investment Management Public-Private Partnership Policy.

- **Assess fiscal implications** and prepare the FCCL report with support from the transaction advisor and the Technical Committee for Fiscal Commitments (TCFC) with guidance provided by the PPP Project Unit on preparing the FCCL report.
- **Negotiate and execute the PPP contract**, with the support of the PPP Project Unit.
- **Monitor performance of PPP projects,** post-contract-award, and report on their performance, including with respect to FCCL, to the PPP Project Unit.
- **Keep records** of all matters relating to the preparation of PPP projects, the tender process for and implementation of PPP projects, and ensure that they are uploaded to the NRIP with the support of the PPP Project Unit.

- PPP Project Unit

Established under the Prime Minister's Office to serve as the coordinating body for PPPs and to further develop and oversee the PPP framework. Its tasks are to:

- **Act as a gateway for quality control** and be responsible for the project development process through technical assistance, monitoring, and evaluation. The PPP Project Unit is responsible for procedural oversight and monitoring the project development process as well as prescribing guidelines and template documents. Furthermore, the unit will provide technical support or review: i) pre-feasibility, feasibility, value for money, and affordability of a proposed PPP; ii) negotiated PPP contracts and updated project documentation to identify any material changes in risk allocation; iii) negotiations and monitoring of the performance of PPP contracts; iv) FCCL reports; and v) administration of the Project Development Fund (PDF) on behalf of the country. The unit will also provide support to and coordinate with contracting authorities when identifying and prioritizing potential PPPs, and preparing PCN(s) and periodic progress reporting.
- **Disseminate PPP best practices**. The unit will: i) build capacity among government authorities concerning the preparation and implementation of PPPs; ii) develop and promote guidelines for preparation and implementation of PPPs; and iii) develop, operate, and maintain the PPP Project Databank (which includes project monitoring tools and the centralized repository of all project-related documents) in the NRIP.
- **Operate and manage the Project Development Fund (PDF)**. The purpose of the PDF, established under the PPP Law, is to facilitate PPP investments in Jordan by supporting contracting agencies in the preparation and monitoring of high-quality PPP projects that are economically desirable, provide value for money, and are fiscally affordable (as assessed under the PIM-PPP framework). It will provide a framework for good project preparation.

- Technical Committee for Fiscal Commitments (TCFC)

The Ministry of Finance has overall responsibility for assessing, managing, and monitoring PPP related fiscal commitments and contingent liabilities (FCCL), throughout all stages of the PPP project lifecycle, and in the aggregate for all ongoing PPP projects. For these purposes, the Ministry of Finance established in accordance with the 2019 PPP Law a committee comprising representatives from the Public Debt Directorate, the General Budget Department, and the PPP Project Unit, which assesses the FCCL for each PPP project. The TCFC reports to the Minister of Finance and is required to:

- **Review any proposed government support, whether direct or indirect**, for a PPP project as set out in the pre-feasibility study, feasibility study, and the FCCL report prepared by the CAs, and make recommendations to the Minister of Finance on how to advise the High Committee on the appropriateness of the proposed support and its affordability to the government.
- **Recommend the government's parameters for contingent liabilities** in coordination with the Public Debt Management Committee and submit them at the beginning of the fiscal year to the Council of

Ministers for approval. The High Committee will take these parameters into consideration when assessing and prioritizing the proposed projects.

- **Review PPP contracts, and PPP contracts amended** after their signing prior to their submission for approval to determine that there has been no material change to the risk allocation and FCCL, including any proposed government support, as compared to the original assumptions, and to advise the Minister of Finance accordingly. In case there is material change in the risk allocation and FCCL, the PPP contract may be renegotiated based on the recommendation of the Minister of Finance and the approval of the High Committee.

- High Committee

The High Committee acts as an oversight and review authority for PPP related matters. It was formed by a decision of the Council of Ministers (CoM) and consists of a number of ministers including at least the Minister of Finance, the Minister of Planning and Industrial Cooperation, and the Minister of Industry, Trade and Supply. Its responsibilities include:

- **Approve project identification** and inclusion in the NRIP based on review and consideration of the comments submitted by the PPP Project Unit on PCNs (including the Central PIM unit evaluation) as submitted by the CAs.
- **Approve the pre-feasibility studies** prepared by the CAs with the support of the PPP Project Unit for PPP projects included in the NRIP, and review and recommend to the CoM for approval the pre-feasibility study, terms of reference for transaction advisors (TAs), and the appointment of TAs on PPP projects.
- **Review and recommend to the CoM for approval the feasibility report** (including the feasibility study and the FCCL report) prepared by the CAs, with the support of the PPP Directorate, based on whether it demonstrates institutional, legal, technical, environmental, social, economic, commercial, and financial feasibility, provides value for money and demonstrates affordability. Approval of the CoM would include permission to proceed with the commencement of the tender process.
- **Approve tender documents** (including the draft PPP contract) before issuing them to the potential bidders.
- **Recommend to the CoM for approval, the negotiated contract** with the winning bidder and approval to proceed with the signing of the PPP contract.
- **Review and recommend to the CoM for approval PPP regulations** under the PPP law.
- **Approve the guidelines and standardized documents and templates** for PPP projects.

- Council of Ministers

As indicated above, the CoM must issue decisions at three stages of the project development process, taking into account the High Committee's recommendations:

- **Approve the pre-feasibility study** and permission to hire a TA (with funding from the Project Development Fund) and proceed with the feasibility study.
- **Approve the project feasibility report** (feasibility study and the FCCL report).
- **Approve signing of the negotiated contract** with the winning bidder.
- In addition, as per Article 16 of the PPP Law, any amendment or change of a fundamental effect to a PPP agreement is subject to the approval of the CoM based on the recommendation of the High Committee. Article 16 specifically targets amendments affecting the risk distribution with respect to the PPP project, or the assumptions made in the project's feasibility study. Additionally, an obligation is imposed to terminate a PPP project and reinitiate the tendering process if an amendment to such a project increases the total costs associated with it by 20 percent or more.

- Central Public Investment Management Unit

The Central PIM Unit is set up in accordance with Administrative Directive No. 1 of 2016 by the Ministry of Planning and International Cooperation (MoPIC). The Central PIM Unit, located at the MoPIC, is the central expert body for public investment projects (PIPs), which will assist contracting authorities in providing oversight and conducting technical and economic analyses of these projects. Specifically, the Central PIM Unit will:

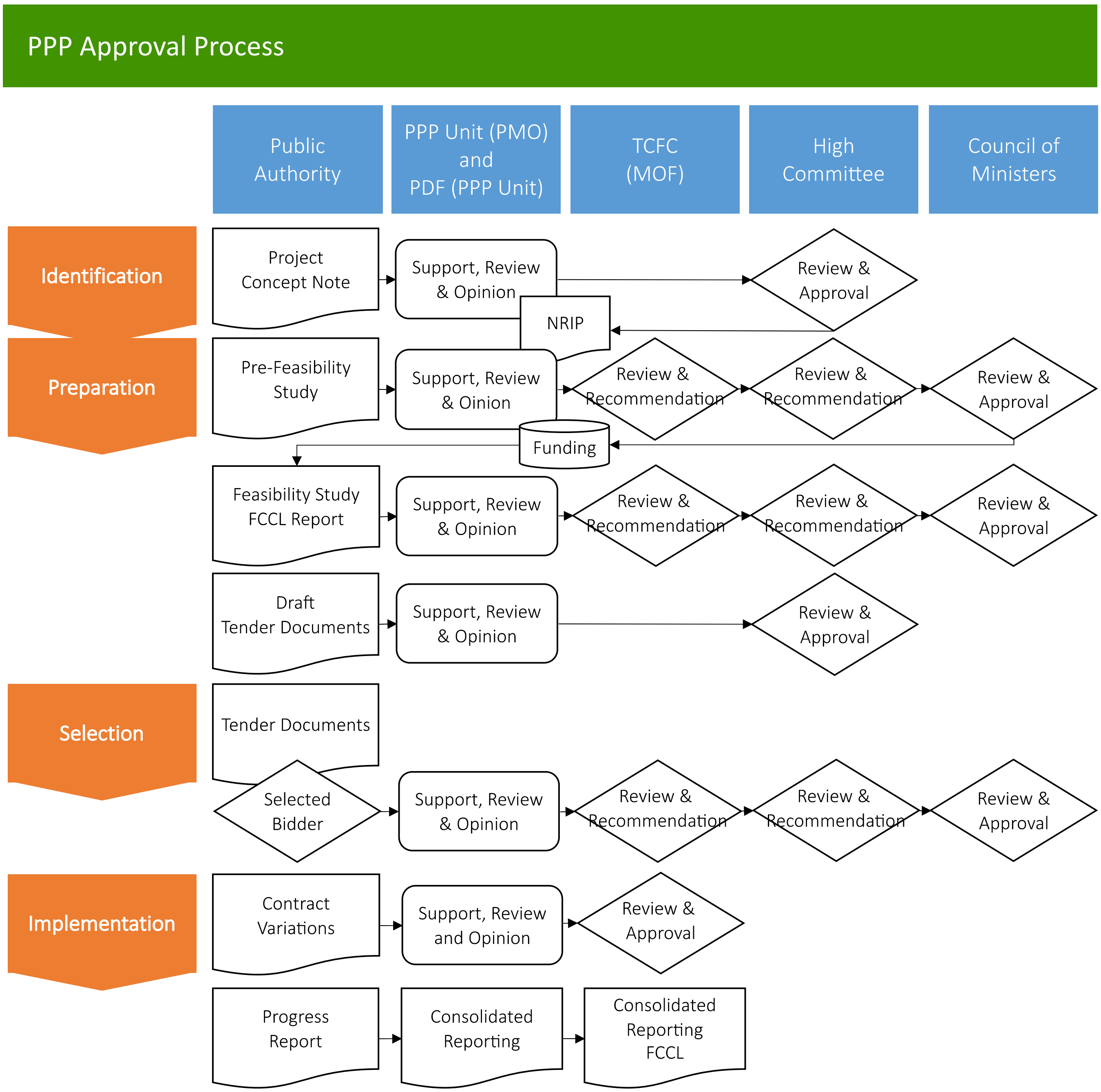
- **Collect and manage shared resources for the data** on the projects proposed by Contracting Authorities through the implementation of the 3-year rolling Executive Development Plan (EDP), which itself implements the Jordan Vision 2025, and other priority investments that are identified.
- **Oversee identification of the PIPs to be implemented via public procurement**. In this capacity, the Central PIM Unit shall (i) maintain an online National Registry of Investment Projects (NRIP) databank for EDP portfolio, including infrastructure that includes all relevant information pertaining to priority projects, and (ii) develop a transparent, standardized and central criteria and update relevant regulations to guide the prioritization and selection process of public investments.
- **Participate in the preparation of potential public investments** (to be implemented via public procurement) by developing and clarifying standards and methodologies for project development and evaluation, as well as best practices, and conducting technical and economic analyses of public investment initiatives submitted by Contracting Authorities; and
- **Assign a P-Code** - no public investment or PPP project can be funded by the Annual Budget without a unique identifying project code (P-Code) assigned to it after preliminary screening by Central PIM Unit and/or by PPP Project Unit. This P-Code will stay with the project throughout its life cycle of evaluation, procurement, development and implementation; and
- **Participate in the implementation and management of publicly procured projects** by preparing and disseminating an operating manual containing detailed descriptions of functions and responsibilities related to project management in key sectors, conducting analytical studies regarding the impact created by the completion of such projects, building institutional capacity, and monitoring and evaluating public investments; and
- **Screen project proposals, for the purposes of PPPs**, as its main objective: a) registration of the PCN, b) evaluating the alignment of the project with existing national strategies using a clear scoring mechanism; c) ensuring proper Project Concept Note (PCN) template submission by the Contracting Authority, d) preliminary indication of financing options based on PCN information (grants, donors, PIPs, PPPs, fully private etc.), and e) registration of the project into the NRIP upon approval of the High Committee. These recommendations are to be submitted to the High Committee via a standardized template.

It is to be noted that there appears to be some overlap between the PPP Project Unit and the Central PIM Unit with regard to providing support to the preparation of project concept notes and the consequent screening of these PPP initiatives. For the purpose of this review it is assumed that the PPP Unit will the primary source of support and the Central PIM Unit will be consulted and informed accordingly.

4.2.2. PPP Approval Process

Overall, the institutional roles and responsibilities lead to an elaborate gatekeeping process that is depicted in the figure below in terms of its main proceedings and check points.

Figure 5.4: PPP Approval Process



Source: Team analysis

Note: TCFC means Technical Committee for Fiscal Commitments and NRIP means National Registry of Investment Projects

There has been comprehensive World Bank Group (WBG) support to the PPP reforms spanning multiple years including:

- **Recommendations for design of a PPP framework** to enhance the further development of PPPs as set out by the consulting firm Ecorys in 2009 and presented to then Prime Minister Nader Dahabi and his cabinet. These recommendations included among others:
  - Develop a program of pilot PPP projects;
  - Set up a PPP guarantee fund to facilitate efficient access to debt financing;
  - Establish a PPP committee with the objective of facilitating and monitoring a PPP program;
  - Expand the mandate of the Executive Privatization Committee to act as a PPP unit with responsibilities including coordination, promotion, and technical assistance; and
  - Adopt a generic PPP law and supporting regulations.

- **Operationalization of the PPP framework in 2013-2014**. The Public-Private Infrastructure Advisory Facility (PPIAF) provided funding in 2013 to support the definition and establishment of a PPP Unit within the Ministry of Finance, provide recommendations to improve the legal and regulatory framework for PPPs, draft a PPP policy, and identify a pipeline of priority PPP projects. As a result of the PPIAF support, the PPP Unit was established based on the recommended organizational structure. In addition, a new PPP Law passed through Parliament and was ratified on November 2, 2014.

- **Development of a PPP project selection and prioritization tool.** The Excel-based toolkit is composed of two parts: project registration proposal form, and PPP prioritization Excel tool, which provided the inputs for the proposal form. One of the elements assessed in the tool is fiscal impact. Because a PPP project will have an impact on the government's budget planning and a fiscal impact, the tool provides the implication analysis for the project by considering whether public funds are necessary to implement the project, the fiscal cost and associated risk are reasonable, funding sources have been identified, and public resources have been approved. The tool is now used for the purpose of project registration. Questions considered are as follows:
  - What is the total estimated fiscal cost of the project?
  - Have the finance ministry and relevant agencies approved the fiscal outlay?
  - Have third-party sources of funding or financing been identified and approved?
  - Is the government expected to provide any guarantees under the PPP contract?
  - Is the government expected to share construction costs?
  - Have contingent liabilities been assessed and determined to be reasonable?
  - What is the maximum potential fiscal cost to the government in the worst-case scenario?
  - Is there additional evidence that the fiscal cost is likely to be approved?

- **Supporting development of the integrated PIM-PPP Governance Framework (2017-2018)** to improve the efficiency of public spending and support, and to ensure PPPs and private investments are brought in through efficient processes based on global good practices and appropriate risk allocation. The framework links project prioritization with the budget process, and creates a standardized process for the assessment, management, and monitoring of the government's FCCL obligations. The WBG support included recommendations on capacity building, disclosures, the role of different departments in PPP and FCCL management, a technical committee on fiscal commitment, content of feasibility studies and debt coordination with the General Budget Department (GBD) and the Public Debt Directorate (PDD).

- **Design and operationalization of an FCCL framework.** In the past Jordan lacked a dedicated FCCL framework to assess, manage, and monitor PPP projects. From 2018-2019, the World Bank assisted the GoJ to design and operationalize an FCCL framework. On an institutional level, the World Bank report on the FCCL framework identified that, despite the reference to the role of the TCFC in the PPP Law, it had not yet been effectively constituted. The World Bank report recommended that it be the TCFC's mandate to analyze

FCCL information on all PPPs, with the PPP Unit as the lead coordinator for information and data gathering. This information could then flow to the GBD and PDD and be factored into decision-making on annual budget and resource planning. Additionally, the World Bank report laid out detailed operational guidelines that covered: i) assessment of the fiscal implications of PPP projects during the preparation stage, from a very early stage of development until the financial close of the projects; ii) monitoring and reporting during the implementation stage, because project preparation is based on estimates and forecasts; and iii) aggregation of FCCL implications of individual projects on a consolidated basis, in order to allow for effective management of FCCL across Jordan's PPP program. Work is ongoing on three main pillars to help TCFC become fully operationalized: benchmarking international practice on setting fiscal limits for PPPs which can be further utilized to support the GoJ in defining its methodology for setting fiscal limits; establishing a PPP baseline of FCCL from ongoing contracts and disclosing them in an FCCL database; and developing an operational manual for TCFC, capturing various roles and responsibilities of different entities in the FCCL framework along the PPP project cycle and basis for TCFC decision-making. This work had been estimated to be delivered in September 2021.

- Fiscal Commitments and Contingent Liability Capacity Building Program, including
  - Training of PPP Unit, MoF and MoPIC staff in fiscal risk management and its link with public investment management;
  - Workshops on Jordan's FCCL framework and PIM-PPP process, delivered to 40 to 50 GoJ officials across the MoF and line ministries; and
  - Design of course material on FCCL and PIM-PPP.

- Support with the design of the Project Development Fund (PDF) to facilitate the government's making more informed decisions about PPPs and developing a strong pipeline of projects. With this support, the government can design more bankable projects, attract more bidders, and enhance competition. The PDF is provided for in the 2019 PPP Law, Article 8 under the PPP Projects Unit's authority and with the purpose of funding the preparation of PPP projects. The PDF comprises amounts allocated by the government for PPP projects, as well as gifts, grants, facilities, donations, and any other resources deposited into it, subject to the Council of Ministers' approval for amounts received from non-Jordanian persons. The PDF will be used to fund studies and reports pertaining to PPP projects, contracts entered into with consultants, the consultancy of experts, tendering processes, and costs which may arise after PPP agreements are signed. A regulation must be issued pursuant to the PPP Law, which regulates all matters pertaining to the PDF, including the formation of a supervision committee.

- Supporting preparatory activities for Road PPPs. The WB's Infrastructure Assessment Program for the road sector explored in 2019 the potential expansion of private investment in Jordan's roads sector. It assessed the sector's revenue generation potential and structuring and financing options for a PPP program, and updated the traffic counts, traffic forecasts, land requirements, and land acquisition costs. This preliminary analysis helped to prepare the terrain for more in-depth transaction preparation work (financial, technical, environmental and social, market feedback, etc.) by focusing on issues affecting the bankability and sustainability of any PPP solutions for the sector. The study identified and analyzed four to five road corridors as the basis for the Roads InfraSAP that resulted in producing five pre-feasibility studies undertaken and backed by InfraSAP and Project Selection Tool principles.

Other donors:

- In 2017-2018 USAID developed a PPP manual that is currently being updated in light of the new PPP law (2019) and PPP database.

4.3. Analysis of Projects

4.3.1. Identifying and Evaluating PPP Projects

As indicated, the PPP Law (2019) and the integrated PIM-PPP Governance Framework (2018) provide the legal framework for the preparation and potential procurement of the Jordan PPP program and provide clear processes that contracting authorities need to follow to ensure that PPP projects are prepared, procured, and implemented in accordance with the legal and institutional framework.

The framework encompasses the project life cycle, which is the process of transforming a project idea into a concrete solution through an economic analysis of alternatives to select the most profitable solution to meet the country's economic development goals, either via public procurement or a PPP. The PIM-PPP Governance Framework incorporates four phases, including the national strategic planning phase and the pre-investment phase, which are aligned with the PPP Law and form part of the preparation process for all PIM and PPP projects. The framework includes: i) development of an effective mechanism for the selection and prioritization of infrastructure investments; ii) implementation of the GoJ's integrated PIM-PPP Governance Framework and its FCCL framework, which links project prioritization with the budget process; and iii) creation of a standardized process for the assessment.

Adoption of the integrated PIM-PPP framework was done with the objective of strengthening PIM institutions, installing adequate project appraisal, and reducing the efficiency gap in the capital investment process and PPPs. The PIM-PPP framework clarifies the process in terms of consolidation and endorsement of infrastructure needs from all sectors, and the project appraisal and selection framework of PPPs is now linked to PIM.

Although the policy is overall directed by the guiding principles of fairness, transparency, and competitiveness, it is specifically intended to:[77]

- Ensure implementation of priority investment and infrastructure projects that are **aligned with the GoJ's development objectives**, national priorities and needs.
- Promote priority projects that are **affordable** to the GoJ and end-users and represent **value for money**.
- Provide a **standard PIM approach** to facilitate the identification, project registration in the National Registry of Investment Projects (NRIP), project selection, and appraising of viable projects.
- **Set out a PPP project cycle** that is rooted in the public investment management process.
- Put in place a structured, institutionalized, uniform and predictable approach to PPPs that will contribute to enhancing the country's international **competitiveness and attractiveness for private sector investments**.
- **Ensure transparency in the structuring, procurement, and implementation** of PPP projects.
- Support the development of **viable and feasible projects** as PPPs that offer reasonable returns to the private sector, while protecting the GoJ from fiscal risks.

Phase 1: Identification and Screening

In 2020, the Ministry of Planning and International Cooperation issued Guideline (I): Project Concept Note Preparation and Preliminary Screening for all public investments including PPPs in order to facilitate and standardize the gateway for identification and screening. The objective of first-level screening is to improve the quality and consistency of information received from project sponsors. This will allow properly informed decisions to be made

[77] Government of Jordan. The Jordan 2019 Public Investment Management Public-Private Partnership Policy.

on whether projects should be considered for prioritization and inclusion in the budget for funding (in the case of small projects) or allowed to continue to the next stage of project preparation (in the case of medium and large projects). Checking the quality at this early stage increases the probability of successful project results (outputs, outcomes, and impacts) and decreases the probability of poor outcomes and wasted investments. It is intended to exclude from further consideration those projects that:

- Are not needed
- Are lacking rationale or logic
- Are inconsistent with government or sector priorities
- Are unlikely to be viable
- Involve unacceptable risks
- Lack the required implementation capacity
- Have little chance of being affordable under foreseeable fiscal circumstances.

All PCN proposals (whether later implemented as a public investment project or PPP) will be registered in the National Registry of Investment Projects (NRIP), once they are submitted to the PIM Unit, by assigning a single, unambiguous identification number (P-Code). This identification number will accompany the project during its entire life cycle. If the proposal is assessed positively, it will enter into a pipeline of assessed projects to be considered for prioritization and inclusion in the budget for funding, alongside other project proposals that have achieved the same status. In the event of a delay of 12 months or more between approval and funding, a further review of the project assumptions and implementation readiness will be undertaken, before considering a project eligible for funding. The PCN is a single template that serves two related purposes depending on the scale or complexity of the proposed project:

- **For small projects (<JD 10 million, i.e., US$14 million),** the PCN will serve as the only document through which authorized public agencies can make a request for small scale capital funding for a project. It may still be possible for the PIM to request a feasibility study for a small project, for example in the case of new technologies or processes being introduced. In the case of small projects, “approval” of a project proposal and “selection” for financing should not be seen as the same thing. It is possible to approve a project as a good project without necessarily having the funds to allocate to it immediately. It may be a good project and approved through the quality check in the PCN, but not a current priority compared to other approved projects.

- **For medium and large projects (>JD 10 million, i.e., US$14 million),** the PCN will still be the only document through which authorized public agencies can make a request for capital funding for a project. However, these larger (or more complex) projects will be required to undergo more detailed appraisal (feasibility study level) under conditions that will be prescribed by further guidance. Therefore, in the event that the proposal is assessed positively, it will be allowed to progress to the next stage of preparation, which will involve more detailed preparation and appraisal during which a feasibility study (including a more detailed risk assessment) will be prepared. This feasibility study will then be assessed in accordance with further guidance material.

The PCN template provides for a comprehensive initial assessment of the project initiative in terms of its:

- Justification, objective, and relevance;
- PPP applicability;
- Economic and financial information; and
- Implementation plan.

As for PPP applicability, specific information is required on the rationale for pursuing a PPP, i.e.:

- The project is difficult to implement with financial resources or the expertise of the government alone
- Private investment would potentially increase the quality or level of service compared to what the government could accomplish on its own
- There is an opportunity for competition among private investors that may reduce the cost of providing a public service
- Private investment could allow the project to benefit from the private sector's innovation, modern technologies, knowledge, and expertise in project development and management
- The project includes the construction, rehabilitation, operation, or maintenance of public infrastructure.

In the event that one or more assessed questions of the PCN are awarded a "fail" in terms of information being inadequate, it will be rejected.

Such a sensible approach is in line with international practices. The main issue is that implementing authorities may not have the resources or expertise to provide the required information. For example, it is questionable whether all implementing agencies have the ability to suggest at this stage of the project a high-level risk allocation matrix, to tentatively assess the commercial feasibility of the project, or calculate the economic net present value. This would typically require support from expert advisors. However, an implementing agency can only access the PDF for retaining advisors once the PCN has been satisfactorily completed.

For the purposes of project registration, i.e., registering a PPP initiative in the National Registry of Investment Projects (NRIP), the Jordanian government uses the prioritization tool recommended by the World Bank to select projects as PPPs. The toolkit is composed of two parts: a project registration proposal form and a PPP prioritization Excel tool, which provides the inputs for the proposal form. Project selection is largely done by line ministries; there are some exceptions for major, externally funded projects. No stringent selection criteria are applied to initiate an appraisal process.

Phase 2: Appraisal and Structuring

In the project preparation stage, the contracting agency or line ministry will appoint a transaction advisor and prepare a feasibility study and viability report, although the appointment of a transaction advisor is not required for small-sized projects.

PPPs will only be pursued when they offer feasibility, value for money, and affordability. To that end, pre-feasibility studies, feasibility studies and FCCL reports must be prepared by the implementing authorities (also referred to as contracting authorities) with the support of the PPP Project Unit.

<u>Pre- and Full Feasibility Study</u>

After the project has been approved by the High Committee, the contracting authority will proceed with preparing a prefeasibility study in coordination with the PPP Project Unit. This pre-feasibility study will be the basis for which the High Committee will recommend to the CoM to fund the feasibility study and the FCCL report (for the TCFC's review) via transaction advisors. Upon review of the Ministerial Committee recommendation, the CoM will approve or not to proceed with the funding via the Project Development Fund (PDF). The pre-feasibility study would also give an early indication of whether the project seems technically and financially viable and can be undertaken as a PPP or not. If not viable as a PPP, the project may be referred to the Central PIM Unit for consideration as a PIP project.

Every project must be tested for feasibility across several dimensions:

- **Economic feasibility**—to determine if the project provides a net economic benefit to the government.
- **Financial feasibility**—to determine project viability, bankability, affordability, and value for money.
- **Technical feasibility**—to understand whether the project can be implemented as planned, using proven technologies, and without unreasonable technical risks.
- **Legal feasibility**—to understand whether there are any legal barriers to the project.
- **Environmental and social sustainability**—to understand whether the project complies with national environmental and planning standards.

Answering these questions will most times involve engaging transaction advisors to undertake detailed studies as needed and come up with a transaction structure. This is because PPPs are more complex than public projects, which means the contracting authority might need to engage expertise it may not have among its staff.

Value for Money

To assess whether the project represents value for money, the PPP Project Unit and the contracting authority must conduct a quantitative analysis and a qualitative analysis.

With respect to the quantitative assessment, the project cash flows will be estimated, over the life of the proposed project, both for the scenario of implementation through a PPP and for the scenario of a publicly financed project. If the net present value of the cash outflows is lower in the case of a PPP, this will be considered prima facie evidence that the project should be done as a PPP.

If the project presents value for money as a PPP and it is qualitatively considered as a candidate for a PPP, this will be evidence to pursue it as a PPP and to continue assessing its affordability.

Affordability

PPPs must be assessed as to their affordability to government with regard to direct and contingent liabilities. This function is carried out by the TCFC based on the FCCL report submitted by the CAs.

Contrary to the identification and screening phase, no detailed guidance is yet available for these assessments, i.e.

- How to appraise value for money (e.g., which discount rate is to be used, how to estimate possible efficiency gains, etc.)?
- How to appraise contingent liabilities (e.g., through scenario or probabilistic analysis)?
- How to conclude on affordability (e.g., what is the ceiling for the country's fiscal commitments from PPPs)?

Phase 3: Tendering

During the procurement phase, the CAs with the assistance of the PPP Project Unit will prepare the tender documents and conduct the tender process up until the award and negotiation of the PPP contract.

Once a PPP contract is negotiated, it is reviewed by the PPP Directorate to ensure alignment with the original project concept and design. The TCFC will also review the FCCL report prepared by the CAs, and advise the Minister of Finance accordingly that the negotiated PPP contract's fiscal commitments at the negotiation stage conform with those envisaged at the preparation stage and are in line both with government and the contracting authority budget allocations.

Based on the advice of the TCFC, the Minister of Finance recommends to the Ministerial Committee on the fiscal and contingent affordability of the PPP. The Council of Ministers, upon the recommendation of the Ministerial Committee, will decide on granting permission to the CA to sign the PPP contract or not.

After the PPP contract is signed, the project will be implemented, managed, and monitored in accordance with Phase 4, as further detailed below.

It should be noted that the tendering phase is lacking operational guidance through, for example, model tender documents or a default risk allocation matrix. As confirmed by the Ministry of Finance, tender documents are developed by transaction advisors on a case-by-case basis. This allows for optimal tailoring of the tender documents to the specifics of a project, though is also costly because these documents are developed from scratch and therefore risk of inconsistency, which is not beneficial for the overall PPP program or for the quantification of FCCLs.

Phase 4: Implementation

The contracting authority monitors the performance of the private sector party. It reports to the PPP Project Unit on the PPP's contract's performance for inclusion of relevant data in the PPP Project Unit's database. The contracting authority also reports to the GBD as regards the monitoring of direct or contingent liabilities.

No guidance appears to be in place for managing contract variations in terms of approving their fiscal implications, in relation to the benefits of the proposed contract variation. As confirmed by the Ministry of Finance, any variations are handled on a case-by-case basis without clear rules and methodologies in place. Up to now, contract variations have been limited and there have been no cases of early contract termination.

4.3.2. PPP Fiscal implications

The Jordanian PPP Law mandates the creation of a Technical Committee on Fiscal Commitment (TCFC), which makes recommendations to the finance minister on the requests for support the latter receives regarding PPP projects. The committee consists of delegates from the General Budget Department (GBD), the Public Debt Directorate (PDD), and the PPP Unit.

Under the FCCL framework designed and adopted by the GoJ, fiscal limits for PPPs were set. The work is ongoing in defining the methodology for how to set this limit and what this limit should be. Additionally, the TCFC is working to take stock of the existing FCCL under ongoing PPP projects, as confirmed also by the IMF Country Report No. 20/101 on Jordan, which states that "the authorities will complete a detailed study to identify and quantify FCCLs stemming from the existing portfolio of PPPs/PPAs by end-December 2020" (though this has been delayed for various reasons including COVID-19 impacts).

No operational guidelines for fiscal commitments and contingent liabilities of PPPs in Jordan have been put in place to date. The World Bank submitted a draft of guidelines in 2019, though these have yet to be tailored and operationalized. The revision of these draft guidelines has recently been instigated through a further technical assistance program.

4.4. Reporting Requirements

4.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

Budget preparation and execution is governed by the Organic Budget Law No. 58 of 2008, which sets out the responsibilities of the General Budget Department (GBD), a separate unit that reports directly to the Minister of Finance. The core principles relating to revenue, expenditure management, accounting, and financial control are specified in the Financial By-law No.3 (1994) as subsequently amended, and in the Application Instructions for Financial Affairs No. 1 (1995). The Budget Law includes a table laying out the annual budget summary, including public revenues, public expenditures, and the financing budget for the coming fiscal year (running from January 1 to December 31).[78] The law also includes tables laying out the total estimated public revenue and appropriations allocated for each government unit to finance its current and capital expenditure items for the coming year.

Rules limiting the extent to which a budgetary provision can be reallocated during the year are set out in each year's General Budget Law. The outturns have not exceeded the indicative ceilings set for capital expenditure since 2012. Nevertheless, on average, the budget outturn is 11 percent below the year budget and, also, the previous year's indicative forecast.[79] This situation indicates that further improvements are needed to strengthen budgeting. Regarding the projects, only the estimated costs related to the period covered by the budget are disclosed and no information related to their full costs, from their inception to their completion, is published.

Jordan's annual budget process is directly applicable to government contributions to PPP projects and the approval process for PPPs. It is therefore aligned with the FCCL analysis process laid out under Article 10 of the PPP Law, in which the Technical Committee for Financial Commitments (TCFC, comprising the PPP Unit, GBD, and the Public Debt Department) analyzes all PPP projects that require government contributions. In effect, any government contribution to a PPP project must be included within the annual budget plan of the contracting agency or line ministry administering the PPP. In the context of the PPP program, this would include any government contributions, which could include contingent explicit liabilities such as minimum revenue guarantees, which may be required to ensure the bankability of the proposed PPPs and any other FCCL incorporated in the eventual PPP structure.

Therefore, PPPs are not fully embedded in the annual budget or the medium-term budgetary framework (MTBF). PPP transactions are recorded only if they involve budget support (e.g., payments to private operators), with no additional information included in budget documentation.

This implies that no budget provisions are in place for contingent liabilities. As per discussion with the Ministry of Finance, if a contingent liability materializes it is up to the contracting agency to arrange for this. To date, no contingent liability has yet materialized. The government recognizes that further mainstreaming of PPPs also involves establishing appropriate budget proceedings for contingent liabilities, which will be addressed in the World Bank's technical assistance program for operationalizing the FCCL framework. Following international experiences, such budgetary provisions could be arranged for through dedicated mechanisms such as a guarantee fund or through a more general contingency reserve in the budget. This could possibly be linked to the current mechanism of a contingency vote, which is a separate program in the Ministry of Finance chapter of the budget under the heading "Contingent Expenditure Programme," and which is rarely used (the largest amount being JD 164 million out of a total original budget of over JD 8 billion (2 percent).

Accounting is still on a cash-basis, though the government has recently decided that its financial reports should be prepared in accordance with full accrual-based international accounting standards (at present the objective is to report in accordance with cash-based International Public Sector Accounting Standards (IPSAS)). The MoF recognizes that this will require the identification and valuation of all fixed assets, including their age and the use made of them, which can only be achieved over a considerable period of time. Some work has been initiated to review each ministry and government unit asset; for the time being each entity maintains a register of its assets, including valuations and accumulated depreciation, but these have not been consolidated.

Given that Jordan's government accounts are still on a cash-basis, PPPs are off-budget, and have no short-term impact on the main fiscal indicators (debt and deficit). In a cash basis accounting system, PPPs are recorded as

[78] Each ministry produces a cash flow forecast for the entire year in January. They are updated monthly, reflecting the results from the previous month and the year-to-date situation, including the effective cash releases made by the Treasury. Commitments are released on a quarterly basis for recurring expenditures and monthly for capital expenditures.

[79] IMF (International Monetary Fund). 2017. *Jordan: Technical Assistance Report-Public Investment Management Assessment (PIMA)*. IMF Staff Country Reports 2017 (366). Washington, DC: IMF.

deferred expenditures during the operation phase of a PPP project, but only if the government pays for the services directly to the private operator. Otherwise, there is no impact on main fiscal indicators. This is not an uncommon approach, and for contingent liabilities in line with IPSAS principles, indicating that if probability is low (which typically applies to contingent liabilities), the expected value of the liability is not to be included in the debt statistics though it is to be controlled otherwise. In Jordan, this is already done through the practice of the Ministry for Finance evaluating every guarantee and providing a recommendation to the inter-ministerial debt committee that is responsible for approving any guarantee, be it related to PPPs or otherwise.

Debt management by the Ministry of Finance (MoF) is subject to the Public Debt Management Law No. 26 (2001), which sets an overall limit on gross public debt at 80 percent of GDP and 60 percent for domestic and external debt (articles no. 21,22 and 23 of the public debt management law) and gives no role to the National Assembly in approving increases in borrowing each year. The Supply Law No. 30 (2007) requires government units to surrender their surpluses at the end of each year to the Treasury Single Account (TSA) at the Central Bank of Jordan (CBJ).

The PPP database, entitled the National Registry of Investment Projects (NRIP), was scheduled to be operationalized in accordance with the 2019 PPP law, which appears to be delayed. On the Ministry of Planning and International Cooperation Facebook page it was stated on April 26, 2021, that the National Registry of Investment Projects (NRIP) was to be launched the next month. The NRIP will manage follow-up, preparation, planning, and implementation for public projects at a strategic level. It will also further enhance the management process for public investment projects and the partnership between the public and private sectors. The Minister of Planning and International Cooperation, Nasser Shraideh, explained that the registry will provide comprehensive data for all government investment projects, as well as preserve, archive, and organize documents, studies, and reports for these projects. The registry will also determine priorities and monitor performance indicators during various stages of the project with the overall goal of improving the quality of outputs and achieving developmental goals in line with outlined financial costs and approved timelines in an effort to better manage and control public expenditure.

As part of the new system, a committee for government investment projects will be formed, and the PIM unit at MoPIC will oversee the day-to-day management of the NRIP, the updating of its data, and overall supervision.

4.4.2. Transparency policy of PPP contracts

Disclosure of PPP contracts and general information is limited. Whereas capital spending undertaken through the budget is extensively disclosed, including grants and external financing, projects not directly implemented through the budget system are typically not disclosed. There is no legal provision and requirement to disclose information on obligations under PPPs in the budget documentation. The fiscal risks resulting from these instruments are also not disclosed. It has been recommended by the World Bank that at a minimum, the contingent liabilities and any direct subsidies to PPPs should be documented in the budget and financial reports in order to improve transparency and tighten control on their financial sustainability.

It is also noted that the government does not maintain a dedicated website for disclosing its PPP program and PPP framework. This makes access to information on the regulatory and institutional framework, the PPP pipeline and track record cumbersome and will not help prospective investors, lenders, and other stakeholders to assess and engage with the government’s commitment and capacity to deliver on its PPP objectives. It is recommended that the PPP Project Unit review the World Bank’s recommendations of disclosure frameworks for PPPs and implement these recommendations accordingly.

As for contingent liabilities, according to the most recent Public Expenditure and Financial Accountability Assessment (PEFA) from 2016, fiscal risks are regularly assessed in reports produced by the IMF in discussion with the government.

In its most recent fiscal risk assessment, the IMF concluded that the net impact of PPPs and PPAs on Jordan's public sector balance sheet is estimated at -4.8 percent of GDP in 2020[80]. PPPs and PPAs generate both public non-financial assets and liabilities, when the government controls the assets (e.g., airport, highway, power plant) and bears the majority of the risks and benefits arising from them. The PPP liabilities have been estimated by the IMF at 21 percent of GDP in 2020 and the fiscal commitments related to PPAs at 37 percent of GDP in 2020. Overall, the IMF confirmed that there is no assessment or reporting of fiscal costs or risks of individual projects or total portfolio, implying a substantial fiscal risk.

Thus, fiscal costs and fiscal risks associated with PPPs are neither systematically accounted nor reported. The PPP Law requires the PPP Unit to maintain a registry of PPPs that reached financial closure after 2014; but the law provides neither guidance on reporting nor limits on overall government exposure to PPPs. The United States Agency for International Development (USAID), with a permanent long-term resident advisor, is supporting the PPP Unit of the MoF in various development areas, as well as assisting in the development of a dedicated PPP database.

The Strategy for PFM Reforms (2018–2021) targets strengthening fiscal risk reporting by 2021 through among other measures the obligation that the central government entities and agencies will quantify most significant contingent liabilities in their financial reports and that guidelines and templates for reporting on contingent liabilities have been developed.

4.4.3. Other Relevant Aspects

As part of the designed FCCL framework supported by the WB and adopted by the GoJ, binding ceilings on PPPs have been introduced and placed in the law but remain to be operationalized and defined. The GoJ has not yet set these limits for PPPs. The WBG is supporting this initiative.

Additionally, Cabinet decision No. 840 dated July 31, 2016, granted exceptions from the PPP Law to the water and energy sectors for two years. Projects in the energy and water sectors account for 60 percent of the total PPP portfolio. However, in the 2019 PPP Law, the energy and water sectors are included.

4.5. Performance under Crisis

4.5.1. Impact of COVID-19 on PPP Program

In general, Jordan's economic growth slowed to 1.3 percent in the first quarter of 2020, only partially affected by the COVID-19 pandemic. Slow growth during the quarter resulted from an improvement in net exports and the marginal contribution of government consumption, while overall economic activity remained constrained by weak private demand and muted government investments. Meanwhile, labor market indicators for the second quarter of 2020 reflected significant disruptions from the COVID-19 crisis. The already elevated unemployment rate rose to 23 percent in Q2-2020 compared to 19.3 percent in Q1-2020, while the labor force participation rate dropped by 0.4 percent during the period. Looking ahead, the pandemic will have as disruptive an impact on the Jordanian economy and its prospects as it is having on Jordan's trading partners and the MENA region as a whole; its gradual recovery over the medium-term could capitalize on lower oil prices and a steady momentum for reform to increase efficiency and boost productivity.

At the fiscal level, the pandemic is exacerbating the fiscal deficit, as revenue collection has subsided given the economic slowdown and domestic lockdown measures. Although the government has created savings—by curtailing the public sector wage bill—pandemic-related spending pressures and recurrent spending rigidities are

[80] IMF (International Monetary Fund). *Jordan: Fiscal Risk Assessment*. IMF Staff Aide Memoire 2020. Washington, DC: IMF.

limiting Jordan's ability to confine the deficit. As a result, the overall central government's fiscal deficit (including grants and the use of cash) widened to 4 percent of GDP during the first five months of 2020, almost twice as high as during the same period in 2019. The sharp deterioration in government finances, together with the slowdown in economic growth, elevated levels of public debt in the central government (including debt holdings of the Social Security Investment Fund) to 105.3 percent of forecasted GDP at the end of May 2020. In the medium-term, the fiscal stance is expected to improve once economic activity gradually recovers.[81]

As per IMF Country report No. 20/180 from May 2020, risks have increased significantly, but the IMF continues to assess public debt as sustainable, benefiting from a relatively large share of domestic and longer-term debt, and Jordan's capacity to repay the IMF's financial support through the US$1.3 billion four-year Extended Fund Facility for Jordan. Renewed fiscal consolidation and higher growth after the pandemic, supported by structural reforms, along with continued support by multilateral and official bilateral creditors, will strengthen debt sustainability over the medium term.

More recently, in March 2021, the IMF concluded that Jordan's IMF-supported program remains firmly on track, with strong progress on key reforms. The program will continue to provide flexibility to accommodate higher-than-expected COVID-19-related spending and protect the most vulnerable.

According to discussion with concerned authorities, it appears that aside from the airport PPP, the impact of COVID-19 on the PPP program has been limited. Operational PPPs are primarily in the energy and water sectors and are protected either through PPAs or through inelastic demand. PPPs in preparation have incurred some delays though not to a critical extent. The Queen Alia airport has experienced a significant revenue shortfall due to global travel restrictions and the government is discussing with the concessionaire possible recovery plans. No further details have been provided on these discussions, though the IMF's Fiscal Risk Assessment 2020 provides some further insight into the COVID-19 impact for the Queen Alia airport.

Box 5.3: Impact of COVID-19 on Queen Alia Airport PPP

A near six-month closure of the airport has led to significantly reduced revenues for the private operator (about 72 percent) as well as for the government. Private insurance has not worked as a mitigation measure, given that the latter does not cover force majeure arising from a pandemic. Staff estimated the loss in government revenues in 2020 due to lower international traffic at more than JD 160 million (about 0.5 percent of GDP) comprising i) reduced investment fees from the concessionaire and ii) reduced revenue from entry visa fees and departure taxes. Additional further losses in 2020 are likely from reduced sales taxes on other businesses connected to the airport. These reduced revenues are materializing explicit fiscal risks.

Further implicit fiscal risks have materialized in the form of payments to support the Queen Alia International Airport (QAIA) project company. Although the legal grounds for doing so are unclear, the GoJ has agreed to financially support the project company for its lost revenues during the shutdown. For the first quarter of the shutdown, the payment to the project company was JD 50 million. A similar amount might be expected to be requested for the second quarter of the shutdown. Now that the airport has re-opened with significantly reduced flights and passengers, an expectation of a further claim for the final quarter from the concessionaire is not unrealistic. If this figure is estimated at JD 30 million for the final quarter of the year, it could mean total payments of JD 130 million for 2020 (about 0.4 percent of GDP). Combined with the estimated losses of revenue for 2020, previously mentioned, the total fiscal impact for 2020 could reach JD 290 million, or about 1 percent of GDP.

In addition to fiscal risks materializing in the short-term, the QAIA is exposed to significant fiscal risks in the medium-term. The QAIA project is exposed to contract renegotiation risks, should international travel not, as

[81] World Bank. The World Bank in Jordan. https://www.worldbank.org/en/country/jordan/overview.

now expected by aviation analysts, return to pre-COVID-19 levels for some years. Even if the authorities decide to extend the contract period as a mitigation measure, there will be cash flow implications for the GoJ, through reduced revenues and the potential need to support the operator financially even after a renegotiation.

Source: IMF (International Monetary Fund). Jordan: Fiscal Risk Assessment. IMF Staff Aide Memoire 2020. Washington, DC: IMF

4.5.2. Measures implemented to help cope with the consequences of the COVID-19 crisis

The authorities have implemented a comprehensive set of measures to reduce the spread of the virus that causes COVID-19. Key actions include: i) the full closure of borders and suspension of passenger air travel; ii) the prohibition of movement of people across governorates and cities; iii) mandatory quarantines; iv) the imposition of a state of emergency and the activation of the Defense Law for crisis containment and response; v) the suspension of public and private sector operations, including trading on the Amman stock exchange, exempting critical sectors; and vi) an extensive public awareness campaign to limit the spread of COVID-19.

The authorities have also implemented a number of measures to limit the economic fallout of the shock. They established a fund to cover emergency medical outlays, exempted medical supplies from sales tax, provided temporary cash-flow relief to companies by allowing delayed payments of sales taxes and customs duties within the year as well as electricity bills until June 2020, temporarily reduced social security contributions from 21.75 to 5.25 percent and the maximum load tariff for electricity consumption of selected sectors, and introduced a cash transfer program to support the unemployed and self-employed (0.3 percent of GDP), while at the same time trying to find savings including in the wage bill, budgetary transfers, and non-essential investment. The Central Bank of Jordan (CBJ) reduced policy rates by 150 basis points, injected liquidity into the system (1.8 percent of GDP) by reducing reserve requirements on time deposits from 7 percent to 5 percent, allowed the rescheduling of loans, and improved terms of existing refinancing programs for small and medium enterprises (SMEs) and introduced new ones. Furthermore, Labor Minister Ma'an Qatamin has said that the ministry will work to list the construction contracting sector as a business battered by the COVID-19 pandemic. The delay in paying contractors' dues and the absence of new bids for 2021 will contribute to weakening the sector.[82]

According to the IMF, collectively, the package of additional or re-directed spending and additional financing measures provided by the MoF and CBJ amount to about 5.6 percent of estimated 2020 GDP. As per the IMF, this likely understates the scale of the response given that the cost of some government response policies (e.g., reductions in sales taxes) have not yet been fully quantified and are therefore not included in this total. Jordan and the IMF have also concluded a Rapid Investment Fund agreement that will see nearly US$400 million (about 1.3 percent of GDP) of emergency financial assistance made available to help the country respond to the economic and financial pressures of COVID-19.[83]

The immediate policy priority is to deal with the ongoing serious pandemic wave and mitigate its human and economic impact. The fiscal targets for 2021 aimed to support the recovery and jobs, and allow for higher social protection spending, while preserving debt sustainability. It was reiterated that "the authorities aim to enhance the efficiency of public spending; fully implement the new public-private partnerships (PPP) law to ensure effective selection and execution of viable projects in line with national priorities, and closely monitor contingent liabilities. These actions will strengthen debt sustainability."

[82] Bhatia, Neha. 2020. "Jordan and Morocco reveal Covid-19 jab plans." MEED (Middle East Business Intelligence), December 15, 2020. https://www.meed.com/jordan-and-morocco-reveal-covid-19-jab-plans.
[83] IMF (International Monetary Fund). *Jordan: Fiscal Risk Assessment*. IMF Staff Aide Memoire 2020. Washington, DC: IMF.

Annex 4 A: Jordan FCCL Principles

Overall, it can be concluded that the PPP framework in Jordan is still evolving. Whereas progress has been made in the regulatory and institutional development, the related FCCL framework needs to be further operationalized. Already a gatekeeping process is in place with review and approval responsibilities assigned to respective bodies though rules, methodologies and tools have yet to be developed and implemented. The WBG is providing technical assistance to support the government in these reforms. Sensitization and awareness raising among the decision makers will be a key priority to further mainstream PPPs and manage the fiscal commitments in accordance with best practices.

#	Principles	Clarification	Assessment for Jordan
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	Development of methodological guidance is under development with WB support.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	PFRAM is in place though is not operational because of technical issues and will be updated with WBG support.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal Impact is evaluated by the relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	The Ministry of Finance is to be consulted for every step in the development process.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	Methodological guidance is yet to be developed.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	Fiscal ceilings for PPPs are being developed with WBG support.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Any direct liabilities for the coming three years are included in the medium-term budget of the respective contracting authority.

#	Principles	Clarification	Assessment for Jordan
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure government is able to fund contingent liabilities should they materialize.	No mechanisms in place to budget for contingent liabilities.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Implementation of IPSAS on accrual basis is under development.
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money is prepared and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	No comprehensive reporting on the fiscal impact of the PPP program is in place.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	No periodic audits.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure the fiscal rules for PPPs should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including SOEs.

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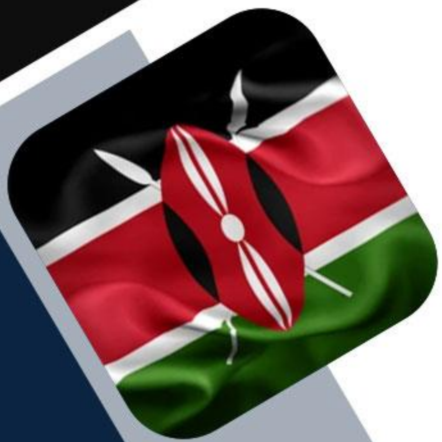


Chapter 5: Kenya

Chapter 5: Kenya

Acronyms and Abbreviations

ADB	Asian Development Bank
AFRITAC	Africa Regional Technical Assistance Center
BLT	build-lease-transfer
BOO	build-own-operate
BOOT	build-own-operate-transfer
BOT	build-operate-transfer
BROT	build-rehabilitate-operate-transfer
CA	contracting authority
CL	contingent liability
CRBC	China Road and Bridge Corporation
DARE	Djibouti Africa Regional Express
DBFMO	design-build-finance-operate-maintain-transfer
DPF	Development Policy Financing
EBRD	European Bank for Reconstruction and Development
FCCL	fiscal commitments and contingent liabilities
FCDO	Foreign, Commonwealth & Development Office
FDI	foreign direct investment
FX	foreign exchange
FY	fiscal year
GDC	Geothermal Development Corporation
GDP	gross domestic product
GoK	Government of Kenya
GSM	government support measure
HR	human resource
ICT	information and communications technology
IFMIS	Integrated Financial Management Information System

IFPPP	Infrastructure Finance Public Private Partnership Project
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPP	independent power producer
IPSAS	International Public Sector Accounting Standards
KenGen	Kenya Electricity Generating
K Sh	Kenyan shilling
KNH	Kenyatta National Hospital
KPLC	Kenya Power and Lighting Company
LoS	letter of support
MDA	ministries, departments and agencies
MDI	multilateral development institution
MoF	Ministry of Finance
MoU	memorandum of understanding
MW	megawatt
NEMA	National Environment Management Authority
PCN	project concept note
PDMO	Public Debt Management Office
PFF	Project Facilitation Fund
PFM	Public Finance Management
PIM	public investment management
PIMIS	Public Investment Management Information System
PISSA	Project Implementation and Steam Supply Agreement
PPA	power purchase agreement
PPI	private participation in infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	public-private partnership
PRG	partial risk guarantee
PSASB	Public Sector Accounting Standards Board
RAP	Roads Annuity Programme

RE	renewable energy
ROT	rehabilitate-operate-transfer
SOE	state-owned enterprise
USAID	United States Agency for International Development
USP	unsolicited proposal
VfM	value for money
VGF	viability gap finance

Executive Summary

The Kenyan public-private partnership (PPP) program is, to some extent, typical of PPP programs in many developing economies, with the majority of the portfolio occupied by independent power producers (IPPs). Although data on project financial closings vary between the World Bank's Private Participation in Infrastructure (PPI) database and sources used by the Kenyan National Treasury and Planning and the PPP Directorate, according to government sources, the only non-energy project that reached financial close and was operational during the COVID pandemic was the Road Annuity Programme (RAP) Lot 33. Two other RAP projects (Lots 15 and 18) reached financial close in 2021, but construction for these projects has not commenced yet. Another project, whose construction is already 77 percent complete, with the overall completion expected in June 2022 (but which, ironically, has not technically reached financial close yet) is the Nairobi expressway build-operate-transfer (BOT) project financed and constructed by the China Road and Bridge Corporation (CRBC). The reason for such an unusual situation is that this project's construction has been funded solely through equity thus far; no debt providers have officially committed funds yet, although this is expected to happen eventually. In this report's statistical references, this project is considered to have reached financial close. Therefore, most fiscal risks are accumulated on the side of IPP off-taker Kenya Power and Lighting Company (KPLC), which has experienced continued deterioration of its financial position since 2017, and this has been further exacerbated by the COVID-19 crisis. In fiscal year (FY) 2020, KPLC recorded a pre-tax loss of K Sh 7.04 billion (about US$64.44 million), missing some payments to IPPs and defaulting on its payment to Kenya Electricity Generating (KenGen), a major power supplier. In 2021, the president constituted a Taskforce on the Review of Power Purchase Agreements (PPAs), amid concerns about high electricity costs and KPLC losses. Recommendations were overarching, including proposed reforms at KPLC, review and renegotiation of the existing PPAs, and immediate suspension of all ongoing but unconcluded PPA negotiations, as well as institution of contract management and due diligence frameworks for IPPs and PPAs, among others. The only non-energy operational project—RAP LOT 33, availability payments for which are funded by fuel levies—did not have a big impact on the fiscus during the COVID-19 pandemic, because a dedicated fund remained very liquid for the purposes of servicing just that one project.

The fiscal commitments and contingent liabilities (FCCL) framework in Kenya is relatively comprehensive and robust, with a formal FCCL Management Framework document, related guidelines, and Excel-based tools in place, as well as capable teams. Representatives from the National Treasury and Planning assessed the framework to be generally adequate and solid. Some of the main challenges were: i) the low number of actual projects reaching financial close or being processed through the system, thereby reducing opportunities for practicing use of the framework; and ii) the lack of certain historical data, which prevented stochastic analysis (e.g., Monte Carlo simulations used, for example, in the analysis of minimum revenue guarantees). The PPP framework also envisages some sophisticated institutional arrangements, including establishment of a Project Facilitation Fund, which, among other things, is supposed to be a potential source of viability gap finance (VGF) and of liquidity to meet calls on contingent liabilities. At the same time, due to lack of funding, this fund remained largely non-operational until recently. Reporting and data exchange in a comprehensive manner for both IPPs and non-energy PPPs is also somewhat difficult, because IPPs are not considered traditional PPPs and are overseen by a separate department with information flow to the PPP Directorate and National Treasury and Planning not always occurring smoothly. Additionally, the public investment management (PIM) and PPP processes remain disconnected, and, in practice, it is not clear how projects under evaluation are selected for a PPP modality, and at what point they must be redirected to the budget framework. These are operational uncertainties requiring further work and streamlining, and might represent an area that a potential Development Policy Financing operation could focus on. Finally, prior to 2021, the system lacked a cap or ceiling for either the flow or the stock of fiscal commitments and contingent liabilities associated with PPPs, which, however, became possible with the adoption of the 2021 PPP Act. On the one hand, establishing a hard limit as a percentage of gross domestic product (GDP) in a relatively small economy would mean that this cap is reached and/or breached quickly. On the other hand, the National Treasury and

Planning is of the view that such a ceiling would help improve controls over potential government fiscal exposure that could surface if the next crisis arrive when more active projects are in the portfolio.

PPPs are being given renewed attention in the post-COVID-19 recovery effort. High hopes are being placed on PPPs—among other blended-finance solutions—to meet infrastructure delivery needs. Commensurably, the Government of Kenya (GoK) has re-prioritized the PPP pipeline, placing the most emphasis on ports, roads, power transmission, and urban development resilience, followed by transport, health, housing, affordable real estate, water and sanitation, and the blue economy. According to the 2022 Budget Policy Statement, PPPs are expected to unlock at least K Sh 350 billion (about US$3.1 billion) in 2022 in new development capital for priority projects in these sectors. Accordingly, the PPP regulatory landscape was significantly transformed in 2021, with enactment of the PPP Act 2021 and elevation in status of the PPP Unit to PPP Directorate (both being a part of the prior action under the World Bank Development Policy Funding operation "Accelerating Reforms for an Inclusive and Resilient Recovery DPF2" (P176903)). The expected influx of projects will allow for better testing of the overall framework, including its FCCL arm, and time will show how robust the overall setup is.

5.1. PPP Experience

Kenya began exploring private sector alternatives to traditional public sector delivery of infrastructure as far back as 1959, when the first PPP transaction was recorded (Mtwapa and Nyali bridges concessions[84]) and has continuously reiterated its commitment to the PPP route despite some hiccups and disappointments along the way.

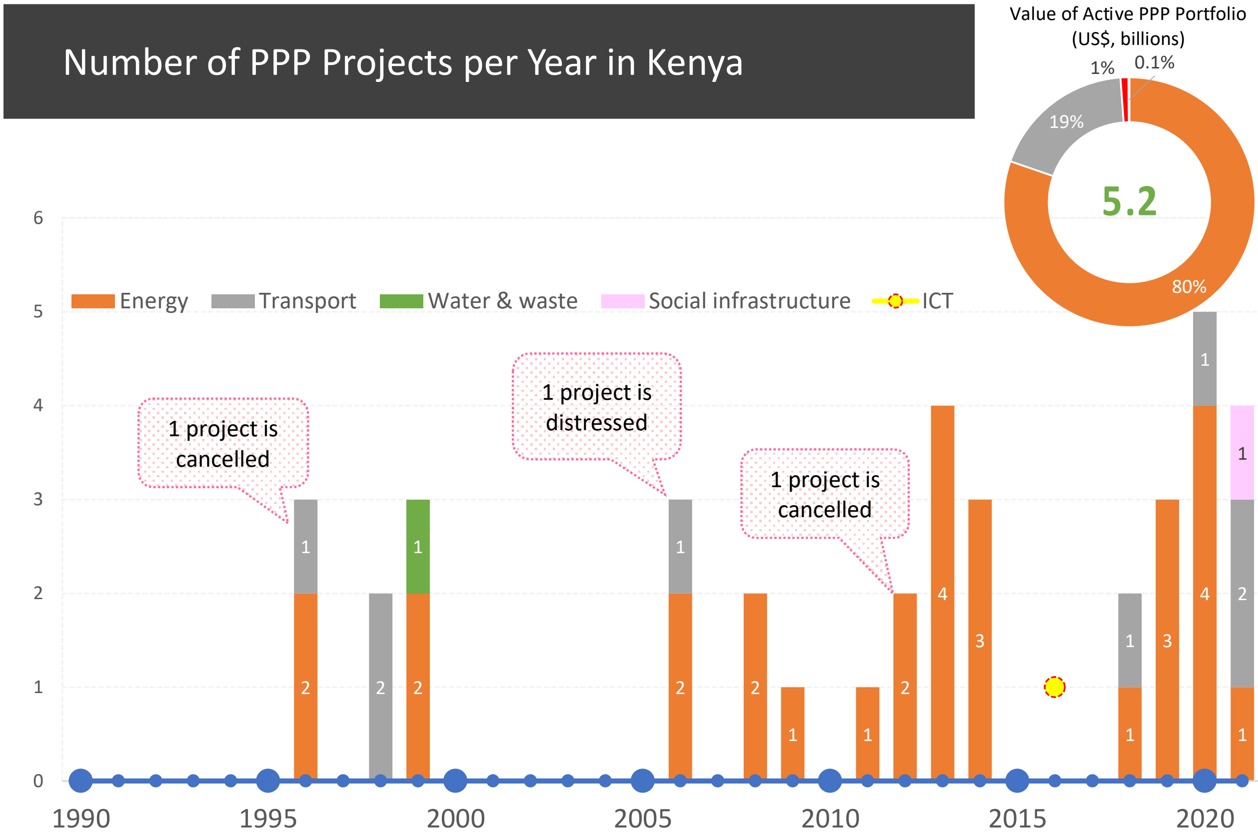
Kenya's PPP portfolio is dominated by energy IPPs, with some exposure to the transport, water and waste, information and communication technology (ICT), and social infrastructure sectors. According to the available data,[85] there were a total of 39 PPP/IPP transactions in Kenya that reached financial close or entered the construction phase from 1996 to 2021 (including cancelled and distressed projects), which cumulatively generated a total investment of about US$5.6 billion or an annual average of 0.65 percent of GDP in the years when investments were made. Out of these 39 transactions, three were concluded, two were cancelled, one is distressed, and the remaining 33 are either operational or in the construction stage. Figure 6.1 and Table 6.1 below illustrate the size and main characteristics of the Kenyan PPP program to date:[86]

[84] Kamau, Stanley K. "Kenya's PPP Experience and Pipeline Projects." Presentation. African Conference on Public Private Partnership, December 6-7, 2012, Uganda, slide 15. https://www.theigc.org/wp-content/uploads/2014/08/Session-8-Stanley-Kamau.pdf.

[85] The available data came from the following main sources: i) the World Bank's Private Participation in Infrastructure (PPI) database (http://www.ppi.worldbank.org/); ii) Infrastructure Journal (IJ) database (https://ijglobal.com/data/search-transactions); iii) Project Finance International (PFI) deals data (https://www.pfie.com/search/deal-search/pfi-deals-financed); iv) Kenya's PPP Directorate disclosure portal (http://portal.pppunit.go.ke/); v) Public Debt Management Reports issued by the National Treasury and Planning (https://www.treasury.go.ke/annual-debt-management-reports/); and publicly available project data published by the PPP Directorate, the National Treasury and other government entities. The PPI database records contractual arrangements for public infrastructure projects in low- and middle-income countries (as classified by the World Bank) that have reached financial close, in which private parties assume operating risks, across the core infrastructure sectors of energy, transport, water, and ICT. It classifies private infrastructure projects according to the following categories: management and lease contracts, brownfield projects, greenfield projects, and divestitures. The data is obtained from publicly available sources, such as commercial news databases, industry publications, and government reports, and is reliant on the availability and accuracy of this source material (this can prevent coverage of small-scale projects due to a lack of information). As a result, there may be some disparity between the PPI database data and a country's PPP experience, depending on factors such as PPP definition, sectors, and project risk profile.

[86] ICT projects of a purely commercial nature, such as cellular network licenses and the like, were excluded from the analysis due to not meeting the definition of PPPs. For the definition of PPPs, refer to the PPP Reference Guide, version 3: https://openknowledge.worldbank.org/handle/10986/29052.

Figure 6.1: PPP Projects That Reached Financial Close or Entered Construction Phase, 1990-2021



Source: PPI, IJ, PFI and PWare databases, PPP Directorate.

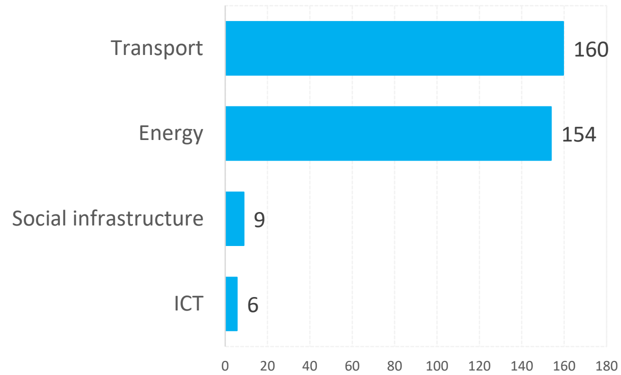
Table 6.1: PPP Projects that Reached Financial Close or Entered the Construction Phase, 1996-2021

Type of Contract	Number of Projects	Investment Amount, US$ millions
Greenfield (BOT, BOO*)	29	4,922
Brownfield (BROT, ROT*)	4	627
Management / lease contract	3	0
Rental power	3	50
Total	39	5,599

* BOO stands for build-own-operate, BROT stands for build-rehabilitate-operate-transfer, BOT stands for build-operate-transfer, and ROT stands for rehabilitate-operate-transfer

As can be seen from Figure 6.1, there was a brief period of activity on the PPP market during the four years from 1996 to 1999, interrupted by a seven-year pause; the bulk of the existing PPP portfolio, however, was transacted starting in 2006. Therefore, while Kenya had some exposure to PPPs when the Asian crisis of 1997-1998 and the global financial crisis of 2008 hit, the most notable stress-test for the existing PPP system was the COVID-19 pandemic. The majority of Kenyan PPP projects are in the energy sector, predominantly IPP transactions with a build-own-operate (BOO) modality, gauging by both number of projects (72 percent of the total) and investment amounts (77 percent). These 28 projects have an average investment amount of approximately US$154 million, ranging from zero for the 2006 Kenya Power and Lighting Company management contract to US$847 million for the 2014 Lake Turkana 300 megawatt (MW) wind power plant; 27 of these 28 PPP contracts are generation projects. It should be noted that in Kenya there is a heavy focus on renewable energy (RE) sources. Thus, 17 out of 27 (63 percent) generation projects rely on RE technology, mostly wind and solar (six projects each), followed by geothermal (two projects), and waste-to-energy, biogas, and biomass (one project each) technologies.[87] The only non-generation PPP contract is the 2006 Kenya Power and Lighting Company management contract in the electricity distribution and transmission sub-sector. Transport is the second largest sector where PPP activity was recorded (21 percent of the total by number of projects and 23 percent by investment amount), represented by eight transactions split among:

Figure 6.2: Average Investment Amount by Sector, US$ millions, 1996-2021



Source: PPI, IJ, PFI and PWare databases, PPP Directorate.
* Malindi water utility management contract did not have any investment obligations

- *Four highway contracts.* These are as follows:
    - The 2018 Ngong-Kiserian-Isinya-Kajiado-Imaroro road (90.55 km) PPP or RAP Lot 33
    - The 2020 Nairobi expressway build-operate-transfer (BOT) financed and constructed by the China Road and Bridge Corporation (CRBC)
    - The 2021 RAP Lot 15 project for the upgrading of select urban roads in six counties (Nyeri, Kirinyaga, Murang'a, Embu, Tharaka Nithi, and Laikipia)
    - The 2021 RAP Lot 18 project for the upgrading of select urban roads in four counties (Kakamega, Vihiga, Bungoma and Busia).

  Projects delivered as part of the Roads Annuity Program (or RAP)[88] form part of a comprehensive plan to upgrade or build about 10,000 kilometers of the country's small roads and highways using the government-

[87] The breakdown by technology in the RE sector does not include captive projects built for the usage of private companies and/or corporations. In the captive energy infrastructure, hydropower projects are very common: 10 of the 12 hydropower PPP projects reported in the 2022 Budget Policy Statement appear to be captive infrastructure (predominantly small-scale hydro).

[88] In June 2014, the President of Kenya launched RAP, which was later approved by the Cabinet on March 10, 2015. Pursuant to RAP, the government will: i) identify a maximum of 10,000 kilometers priority roads distributed across the country; ii) procure long-term contracts for the design, finance, construction and maintenance of identified roads under a PPP modality with payments linked to construction completion and performance-based maintenance indicators; and iii) pay for the services delivered by private contractors through the normal budget process. The Roads Annuity Fund (hereafter, Fund) was established for the purposes of meeting the government's annuity payment obligations under the RAP. Withdrawals from the Fund were authorized only for the purposes of making approved annuity payments or payments for operational expenditures. However, the RAP almost collapsed in late 2015 amid concerns of inflated construction costs, with contractors quoting per-kilometer road-building costs twice as high as what the government had budgeted. Additionally, lenders differed with the government on interest rates for the loans to be disbursed to shortlisted contractors (12 to 13 percent proposed by the GoK versus the approximately 20 percent prevailing commercial bank interest rate at the time), amid a volatile foreign exchange environment, soaring lending rates, rising

pays PPP modality. Within the National Treasury and Planning and the PPP Directorate, different parts of this program are simply referred to as RAP Lot № X. Additionally, the Nairobi expressway BOT project presents a peculiar case, in that its construction is already 77 percent complete, with the overall completion expected in June 2022, but ironically, it has not technically reached financial close yet because the construction has been funded solely through equity thus far; no debt providers have officially committed the funds yet, though this is expected to occur eventually. In this report's statistical references, this project is considered to have reached the financial close.

- *Two terminals.* The cancelled 1996 port of Mombasa container terminal management contract and the 1998 port of Mombasa grain terminal BOO.
- *One railway contract.* The 2006 distressed Kenya-Uganda railways rehabilitate-operate-transfer (ROT).
- *One airport.* The 1998 Jomo Kenyatta airport cargo terminal BOT.

The average investment amount in the transport sector is US$160 million (higher than US$154 million in the energy sector), with a total investment amount of US$1.3 billion (23 percent of the total). Uncommon in many other developing nations, the third largest sector of the Kenyan PPP market, albeit far behind the others, is social infrastructure, where the Kenya Defence Forces institutional housing build-lease-transfer (BLT) contract reached financial close in 2021 (US$8.8 million). The ICT sector recorded one deal in 2016 for the regional submarine broadband cable DARE (the Kenyan part of the investment is US$5.6 million). Finally, in the water and sewerage sector, there was only limited exposure through the 1999 Malindi water utility management contract, which didn't entail any investment obligations.

Figure 6.3: Key Statistics for PPP Projects, Excluding IPPs, 2013-2022

Source: PPP Directorate

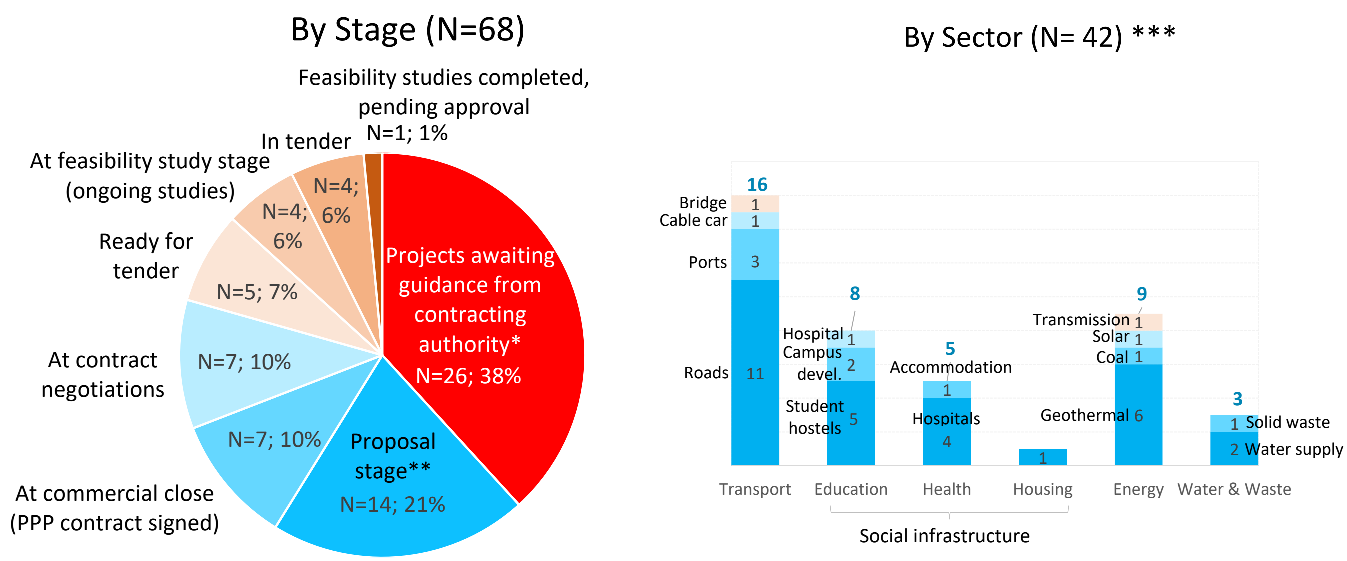
Besides projects that reached financial close, Kenya has a large PPP pipeline and projects at different stages of development pre-financial close. The PPP Directorate periodically publishes a report on the status of the PPP pipeline. The most recent report that is available is from January 2020 (the 2021 update is being prepared), and some of the listed projects are recorded in databases used to track PPP deals as already having reached financial close. Based on the cumulative information contained in these sources and certain adjustments made for project status, the PPP pipeline as of the last reporting date at both national and county levels could be estimated to have included 68 projects (80 as of December 2021, although detailed information for all projects is not available). However, the bulk of these projects (26, or 38 percent) are in an uncertain state and are classified as "projects awaiting guidance from contracting authority," which essentially means that confirmation is required about whether they remain in the ambit of the PPP framework, or if the contracting authorities have adopted alternative delivery modes for them. This categorization is based partly on whether projects have remained at the same stage for a long time and no longer appear to be a priority for the respective contracting authorities; these include projects whose tenders were cancelled, or projects in abeyance that are awaiting further guidance because of lack of funding for feasibility studies, project complexity (e.g., multipurpose dams) or shifts in priorities of the contracting

inflation, and a high risk of default among borrowers. The stalemate on interest rates led to a widespread perception that the RAP had collapsed. However, in April 2016, the National Treasury's Cabinet Secretary clarified that the RAP had not reached a dead end. Around the same time, it was reported that the GoK negotiated a K Sh 150 billion (approximately US$1.5 billion) concessionary loan from International Finance Corporation (IFC) to revamp the RAP by enabling local contractors to borrow the funds to be disbursed by the local banks at interest rates of between 5 and 6 percent.

authorities, among others. The second most common stage is the proposal phase (14 projects or 21 percent of the total), which includes projects for which procurement of transaction advisors is underway.

Transport and social infrastructure are the most common sectors in the PPP pipeline. Excluding projects that await further guidance, transport is the dominant sector, with 16 prospective deals dominated by roads and highways. Interestingly, social infrastructure, including in the health, education, and public housing sub-sectors, seems to be of high interest for PPP delivery, with 14 potential transactions under consideration. Kenya, however, is trying to enter this sector cautiously, mostly through accommodation-related facilities, such as student hostels or villages in public universities, general campus development, or housing for police and the military—nine projects out of 14 (64 percent) can be categorized in this way. The other five transactions are envisaged for hospitals, mostly teaching and referral ones, with only one fully-fledged BOT hospital, which was at the tender stage as of January 2020 (Kenyatta National Hospital (KNH) private hospital PPP project[89]; the tender for this project failed, however, and the project is now being prepared for re-tendering with a varied commercial structure, though the timing of the re-tender is still uncertain). It should be noted that preparation of many projects in the pipeline was done with the support of the World Bank's Infrastructure Finance Public Private Partnership Project (IFPPP), which is a comprehensive intervention that became active in 2013 and covers four broad areas: institutional development, regulatory reform, FCCL framework development, and preparation support for pipeline projects. The Public-Private Infrastructure Advisory Facility (PPIAF)[90] was also actively involved in this activity, along with IFC and the Foreign, Commonwealth & Development Office (FCDO) of the UK, which supported both the PPP pipeline and PPP program in various ways. Figure 6.4 below provides a snapshot of the PPP pipeline in terms of stage and sector as of January 2020.

Figure 6.4: PPP Pipeline Breakdown by Stage and Sector, percent and number of projects, as of January 2020



Source: PPP Pipeline Status Report as of January 2020, with adjustments for projects that reached financial close according to the PPI, IJ and PFI databases.

[89] Project preparation for this project is also supported by the World Bank's Infrastructure Finance Public Private Partnership Project (IFPPP).
[90] PPIAF is a global technical assistance fund that provides grants to help governments create a sound enabling environment for private participation in infrastructure through different types of activities, including: i) framing infrastructure development strategies; ii) designing and implementing policy, regulatory, and institutional reforms; iii) organizing stakeholder consultation workshops; iv) building government institutional capacity; and v) designing and implementing pioneering projects. PPIAF also produces and disseminates knowledge and best practices on private participation in infrastructure. For more information, visit the official website: https://ppiaf.org/.

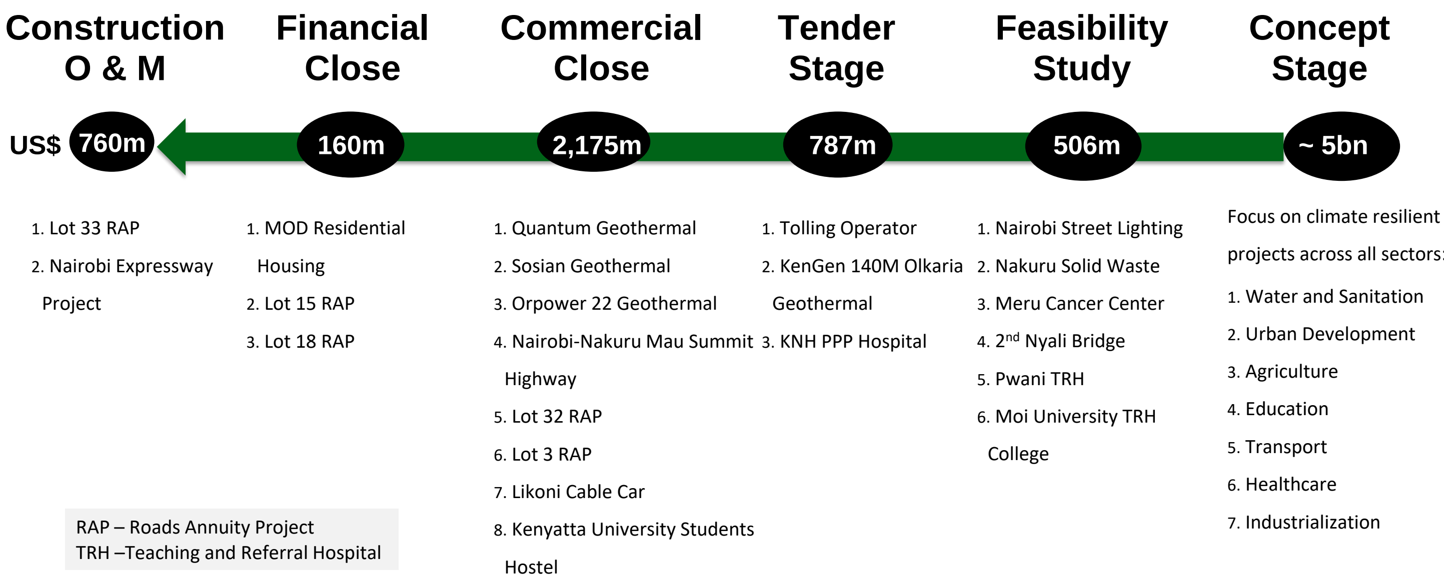
* The guidance required from contracting authorities (CAs) is whether projects remain within the ambit of the PPP framework or whether CAs have adopted alternative project development frameworks for them. This categorization is partly informed by whether projects have remained at the same stage for a while and no longer appear to be a priority for the respective CAs.

** Includes projects for which procurement of transaction advisors is underway.

*** Projects that await guidance from the contracting authority are excluded from this graph.

The PPP portfolio and pipeline from the point of view of the PPP Directorate. Additionally, Figure 6.5 below depicts both the active PPP portfolio and the pipeline broken down by stage, based on information supplied by the PPP Directorate. These projects contain only a limited number of energy projects, because only relatively new energy projects are included (whereas the bulk of the energy portfolio consists of the older transactions). The names of the projects, as well as the projects themselves, might differ from the public information contained in the PPI, IJ, PFI and other databases. However, cross-references could be made, and the data are disclosed in order to show what the PPP Directorate consider their existing PPP portfolio and pipeline. Overall, PPP pipelines are dynamic, with new projects entering and unfeasible projects exiting all the time. Therefore, the status of a pipeline can only at best represent the truth at any given point in time. The list below contains projects after the clean-up exercise performed by the PPP Directorate to remove all nonbankable, stale projects.

Figure 6.5: Kenyan PPP Portfolio and Pipeline by Stage, January 2022



Source: PPP Directorate.

Most PPP projects were developed in the absence of a comprehensive FCCL framework; energy IPPs are the largest source of FCCL-related risks. As will be discussed in Section 5.2 of the report, the more or less coherent PPP framework in Kenya was introduced in 2013 with the adoption of the 2013 PPP Law. Additionally, thanks to the involvement of the World Bank (WB) under the IFPPP project, a more formal FCCL framework was introduced in 2015. Hence, the earliest PPP projects were developed in the absence of a clear and comprehensive PPP framework, largely under privatization and public procurement laws in effect at the time; most PPP projects were also transacted without a clear FCCL framework in place. According to the latest Annual Public Debt Management Report for 2019-2020,[91] the National Treasury and Planning itself ascribes the largest source of direct and contingent fiscal liabilities to energy IPPs. It should be noted, however, that IPPs are not considered traditional PPP projects by the PPP Directorate; they are not included in the PPP portfolio and are not analyzed/monitored in the same way as

[91] Government of Kenya. National Treasury and Planning. 2020. *Public Debt Management Report 2019-2020.* National Treasury and Planning, September 2020, p.34. http://ntnt.treasury.go.ke/wp-content/uploads/2021/02/Annual-Public-Debt-Report-2019-2020.pdf.

non-energy PPPs. The National Treasury and Planning' Directorate of Public Investment and Portfolio Management, which is in charge of state-owned enterprises (SOEs), among others, oversees IPPs as well. However, the information exchange between this Directorate and the PPP Directorate, as well as the National Treasury and Planning' Public Debt Management Office (PDMO), is not very smooth, and the PPP Directorate and the PDMO have been finding it difficult to obtain comprehensive information about the IPP portfolio, despite formal requests. At the same time, there are several risks associated with IPPs that could potentially impact the GoK fiscal space, related to implications for the financial situation of the main off-taker under the power purchase agreements (PPAs) with IPPs, the Kenya Power and Lightning Company (KPLC), because the GoK would be ultimately bearing the cost of rescuing it in case of financial troubles. Under the PPAs, the cost of the purchased power from IPPs is passed through to consumers, including any potential compensation for the foreign exchange (FX) risk (power bills contain a separate line for the FX risk adjustment). The KPLC has experienced financial difficulties in recent years, reporting a pre-tax loss of K Sh 7.04 billion (about US$64.44 million) for its fiscal year (FY) ending in June 2020, but improving its financial position by June 2021, when a pre-tax gain of K Sh 8.2 billion (about US$72 million) was reported, thanks to some sanitation measures. In FY 2020, of the K Sh 87.5 billion cost of sales incurred during the period, K Sh 47.5 billion (or 54 percent) were capacity charges paid to IPPs.[92] These capacity charges can present a serious challenge to any off-taker if there is a problem with overcapacity due to poor planning and demand forecasting, when actual demand is lower than supply. A typical PPA is a take-or-pay agreement, and the IPP gets paid for all electricity produced, regardless of whether the off-taker is actually able to sell the produced power to consumers. This situation is rather distinct in Bangladesh, for example, and is an issue in Kenya as well. The Kenyan president also noted "the lack of proper demand forecasting and planning, leading to irreconcilable projections as against demand" in a statement released by his office about the results of the PPA review by the taskforce set up by him in March 2021.[93] The Presidential Taskforce on Review of PPAs (hereafter, taskforce) was constituted amid concerns about high electricity costs as well as the losses incurred by the KPLC. After the six-month review period, the taskforce presented its final report with recommendations to the president. Although the full report was not published, according to the State House press release, its main recommendations include:[94]

- Review and renegotiation of the existing PPAs (see Annex 6B for details of the proposed PPA renegotiation approach)
- Immediate suspension of all ongoing but unconcluded PPA negotiations
- Reforms at the KPLC
- The KPLC to take the lead in formulation and related PPA procurement, in accordance with the Kenyan Least Cost Power Development Plan
- Institution of contract management and due diligence frameworks on IPPs and PPAs
- Adoption of standardized PPAs and government letters of support
- Forensic audit on the procurement and systemic losses arising from the use of heavy fuel oil (thermal plants)

[92] Obulutsa George, Ayenat Mersie, and Jason Neely, "Kenya Cancels Power Purchase Negotiations, Replaces Energy Minister", Reuters, September 29, 2021. https://www.reuters.com/world/africa/kenya-cancels-power-purchase-negotiations-replaces-energy-minister-2021-09-29/.
[93] Ibid.
[94] Shah, Binti,and Nkatha Murungi Omondi, "A snapshot of the recommendations of the Presidential Task Force on Review of Power Purchase Agreements in Kenya." ENSafrica. https://www.ensafrica.com/news/detail/4862/a-snapshot-of-the-recommendations-of-the-pres?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration.

- Inclusion in the KPLC's annual reports of names and beneficial ownership of all IPPs with which KPLC has contractual arrangements.

According to the press release, the main aim of these recommendations is to reduce the cost of electricity in Kenya by more than 33 percent within four months. The review team also found a large disparity between tariffs charged by the main power producer—Kenya Electricity Generating (KenGen; a parastatal company)—and IPPs, with KenGen prices being much lower than those charged by IPPs. Based on these recommendations, the president ordered cancellation of all ongoing and incomplete PPAs under negotiation with the KPLC in September 2021, stressing that any future PPAs with the government will have to be in line with the Least Cost Power Development Plan, which emphasizes the use of renewable energy sources. The president also replaced the energy minister[95].

Another source of contingent exposure associated with IPPs are letters of support provided by the GoK to private producers. Besides FX risk, PPA-related risks discussed above, and others, another source of potential contingent exposure under the IPP program are letters of support (LoS) provided by the GoK to private producers. These LoS are negotiated between the PPP Directorate and IPPs, while the National Treasury and Planning's Public Debt Management Office provides the back-office support. In essence, LoS represent a binding undertaking for compensating termination payments in case of political-related events of two types—events that lead to termination (e.g., expropriation, civil unrest, and changes in laws), and events that disrupt project implementation but do not lead to contract termination. For the second category, LoS make a provision for compensation in terms of "hold harmless" arrangements. The types of events that are covered are clearly defined in the LoS. These letters are signed by the Cabinet Secretary of the Treasury after having been approved by the Cabinet and the Attorney General; they are further closely monitored by the PDMO. If there is a possibility of a trigger, the PDMO engages, allowing the senior management team to take appropriate action. At the same time, LoS also carries a provision requiring the establishment of a risk management committee to serve as the first line of defence against crystallization of contingent liabilities (CLs) as well as their mitigation when CLs arise. However, risk management committees are yet to be established.

There are also indemnity agreements to multilateral development institutions (MDIs) that issued partial risk guarantees (PRGs) to IPP projects. At present, MDIs have issued five PRGs (including one that was cancelled), for which indemnity agreements were signed, for energy projects as shown in Table 6.2 below. These could be triggered in case of commercial risk realizations, such as, for example, if the KPLC or Geothermal Development Corporation (GDC)—the main off-takers for energy IPPs—fail to meet their payment obligations under the respective PPAs and project implementation and steam supply agreements (PISSAs, for geothermal power). The total risk exposure under indemnity agreements, however, is relatively moderate and was assessed to be about K Sh 20.1 billion (equivalent to about US$188.7 million or about 0.2 percent of the 2020 GDP) in 2020.[96] This exposure would only materialize if all IPPs drew standby letters of credit issued to cover commercial risks in full, which would lead to an increase in debt stock by the respective amount and a reduction in the resource envelope from the World Bank and the Asian Development Bank (ADB) for development projects. At the same time, there is no portfolio level analysis of payment streams under contracted PPAs/PISSAs and their respective medium- to long-term fiscal impact; analysis of FCCL risk exposure in other sectors at the portfolio level is also not available.

[95] Obulutsa, George, Ayenat Mersie, and Jason Neely. "Kenya Cancels Power Purchase Negotiations, Replaces Energy Minister." Reuters. September 29, 2021. https://www.reuters.com/world/africa/kenya-cancels-power-purchase-negotiations-replaces-energy-minister-2021-09-29/.
[96] Ibid, p. 35.

Table 6.2: Projects with PRGs Covered by Indemnity Agreements to MDIs, as of January 2020

№	Project Name	Project Stage	Financial Close Date	Project Cost, US$ millions	PRG Amount, US$ millions	Issuer
1	87 MW Thika thermal power project	Operational	October 11, 2012	146	45	World Bank
2	83 MW Triumph thermal power plant	Operational	August 7, 2013	157	45	World Bank
3	80 MW Gulf thermal power plant	Operational	November 18, 2013	108	45	World Bank
4	OrPower4's 36 MW Olkaria III	Operational	September 2011	212	Cancelled (31)	World Bank
5	300 MW Lake Turkana Wind Power	Commissioning is ongoing	March 24, 2014	706	52	ADB

Source: Public Debt Management Report 2019-2020.

Although a significant number of PPP projects have been launched and planned, Kenya nonetheless faces certain challenges with the PPP model; yet the GoK remains committed to the PPP route. Kenya is quite familiar with the PPP model. Like in many other developing nations, early traction with PPPs was noted in the power sector, although IPPs are not viewed as traditional PPPs. At the same time, the Kenyan non-IPP pipeline features potential projects drawn from diverse economic sectors, although progress with their actual implementation remains minimal to date. The high concentration of PPPs in the energy sector comes with the typical sector-related FCCL risks, including contingent exposure through payments in foreign currency under contracted PPAs/PISSAs, as well as potential obligations under issued letters of support and indemnity agreements with MDIs for PRGs. It should be noted, however, that the execution of the PPP model in Kenya is still a work-in-progress at both the institutional and regulatory framework levels. This is partially due to the fact that the sought-after PPP program outcomes were not always as expected. For instance, one of the early PPP projects, the 1996 Mombasa container terminal management contract, was cancelled, with the private operator claiming failure by the Kenya Port Authority to meet its contractual obligations regarding both provision of equipment and transfer of proper management control over laborers. Later, the 2006 Kenya-Uganda railways ROT was cancelled, citing non-performance and also due to some shareholder abnormalities; the 2012 Kinangop Wind Park (60.8MW) experienced local opposition and land acquisition problems, ended up in arbitration, and is currently being suspended, with investors having abandoned it after losing the arbitration to the government; the 1,050 MW Lamu Coal-Fired power plant that was reported to be at the commercial close stage with the signed PPP contract in January 2020 ran into court proceedings due to environmental complications and lost an appeal before the Environmental and Land Court in Malindi, after which the GoK made a decision to terminate the transaction with procedural elements being finalized; the 105 MW Menengai Geothermal Project (comprising Sosian, Quantuam and OrPower-22, each 35 MW) was put on hold following the appointment of the Presidential Task Force to review of the PPAs; signing of indemnity agreements for each sub-project was also put on hold pending completion of the task force's work, while PRG negotiations with ADB were concluded (informed by the fact that the GoK is currently operating in a tight fiscal environment, in which bringing these three transactions on the public balance sheet is not viewed as strategic). Other disheartening examples include a number of cancelled tenders for energy and social housing projects, as well as some irrigation and health projects in abeyance. On the other hand, there are only a few examples of true success stories, with arguably the Nairobi expressway (an unsolicited proposal [USP] by the CRBC) and Lake Turkana 300 MW wind power plant being among them. Troubles experienced by several PPP projects make some critics doubt the effectiveness of the PPP modality for the purpose of public infrastructure delivery. However, as will be shown in Section 6.2 of the report, the GoK continues to remain committed to the PPP route through continuous improvement of the PPP regulatory framework, centralization of the PPP process, and some high-status PPP appointments.

5.2. Legal Framework and PPP Approval Process

5.2.1. PPP Governance, Institutional and Legal Framework

The PPP Regulations of 2009 represented the first PPP-dedicated regulatory document, which laid the groundwork for the PPP process. The very first PPP projects in the country during the 1990s were developed in a legal vacuum, because there was no specific policy, legal or regulatory framework for PPPs; those projects were largely regulated by the contract itself. It was not until after 2005—when the possibility to conclude PPP contracts was legally recognized in section 92 of the Public Procurement and Disposal Act of 2005,[97] which stated that “a procuring entity may use a procurement procedure specially permitted by the Authority which may include concessioning <…>,” among other things—that regulations clarified that concessioning may cover such modalities as BOO, build-own-operate-transfer (BOOT), BOT and similar. The true groundwork for the PPP process, however, was laid four years later with the adoption of the Public Procurement and Disposal (Public Private Partnerships) Regulations in 2009[98] (hereafter, PPP Regulations 2009), which represented the first PPP-dedicated regulatory document establishing a basic legal and institutional setup for conducting a PPP process in the country. Among other things, it enumerated the list of potential PPP contract modalities and established the PPP Steering Committee that had among its functions review of direct and indirect liabilities, assessment of contingent liability risk exposure of the government, and advising on the acceptable level of FCCLs, along with the approval function for contracts before their signing and for any material changes thereafter. The PPP Secretariat to the PPP Steering Committee was also established at the Ministry of Finance (MoF) for the purpose of general coordination, capacity building, and contract monitoring, as well as for playing the role of a focal point for PPP advice and being the source of best PPP practices, among other things. The PPP Regulations 2009 acknowledged that PPP projects should bring value for money (VfM) to contracting entities and be affordable. The government was allowed to issue binding letters of comfort to private investors and their lenders, acknowledging the investments and assuring investors that they will be given reasonable assistance with acquiring authorizations and guarantees against risks arising from government acts or omissions. Other basic requirements were defined, including the performance-based nature of PPPs, requirements for a PPP contract, and the need for annual audits; a second schedule also provided the list of main risks in a PPP. All projects were required to go through a tender, with basic tender procedures described. Institutionally, the PPP Regulations 2009 established the PPP Nodes at the contracting authority (CA) level for day-to-day management, monitoring of and reporting on PPP contracts, conflict resolution and other purposes. For contracts with a total value exceeding US$10 million, a joint cabinet memorandum by the sectoral minister and Minister of Finance were required to approve the project concept at the project preparation stage, including risk sharing arrangements. The basic requirements for USPs were defined as well.

The PPP Policy Statement of 2011 was a loud and clear promulgation of the government’s commitment to PPPs and established the basis for further consolidation and strengthening of the PPP framework. In November 2011, the Office of the Deputy Prime Minister and the Ministry of Finance published a seminal document called “Policy

[97] Government of Kenya. 2005. Public Procurement and Disposal Act № 3 of 2005. Kenya Gazette Supplement № 77 (Acts № 3), October 26, 2005. https://library.pppknowledgelab.org/documents/1453/download.
[98] Government of Kenya. 2009. Public Procurement and Disposal (Public Private Partnerships) Regulations of 2009. Kenya Gazette Supplement № 17 (Legislative Supplement № 13)), March 10, 2009. https://www.industrialization.go.ke/images/downloads/policies/public_private_partnership_regulations_2009.pdf.

Statement on Public Private Partnerships"[99] (hereafter, PPP Policy). In essence, the PPP Policy is a clear statement from the government about its adherence to and utmost support of the PPP mechanism. The PPP Policy also presented a rationale for further consolidation and strengthening of the PPP framework by requesting adoption of the PPP Law and its supporting regulations to help achieve the goals stated in the Vision 2030 document.[100] Vision 2030 aims to transform Kenya into a newly industrialized middle-income economy by 2030, providing a high quality of life to all citizens. The PPP Policy maintained most principles laid out in the PPP Regulations 2009, expanded them, added some new ones, and introduced certain institutional changes—all backed by strong language expressing overwhelming support of and commitment to the PPP route. The main highlights of the PPP Policy include restatement of the PPP definition, with as wide sector application and contract modalities as possible, some key principles being VfM and affordability. It was made clear that PPPs should be possible at all levels of government, including the county ones, and tender requirement for all PPPs were reiterated. Brief points were also added about the need for stakeholder participation and communication strategy. Additionally, the PPP Policy provided a useful recollection of sector and nation-wide legal initiatives made to improve the legal framework for PPPs at the sector and national levels until 2011.

The PPP Policy identified the need and provided a broad direction for setting up an institutional framework for PPPs, which should have included the PPP Committee, the PPP Unit and PPP Nodes. It was suggested that the PPP Steering Committee established under the PPP Regulations 2009 be transformed into the PPP Committee, with a larger number of members. Thus, besides the Treasury, the Attorney General and the ministry responsible for planning, national development and Vision 2030, the departments responsible for lands and for coordination of county and local governments were required to obtain representation in the rejuvenated structure. The number of private sector members was suggested to be increased from three to four. The PPP Secretariat at the MoF was recommended to be given a status of a PPP Unit, with the mandate to act as a national center for PPP expertise. PPP Nodes at CAs were encouraged to be retained from the PPP Regulations 2009, with the responsibility for development and management of PPPs.

The PPP Policy clarified some FCCL matters, including specific government support measures, institutional arrangements, and the need for adoption of a comprehensive FCCL framework. There were a few FCCL-specific provisions in the PPP Policy. Thus, one of the characteristics of a PPP was stated as "managing fiscal risks created under PPP contracts within the Government's overall fiscal management framework." It was specified that "the Government will facilitate issuance of guarantees for PPP contracts with International Development Finance Institutions or other institutions involved in insuring country and project risks" and that "the Government will provide, where needed, binding letters of comfort/ support to the investors and their lenders in order to reduce the premiums factored on political risks." Furthermore, section 3.3 "Government Support for PPP Projects" of the policy stated that "in order to reduce the overall cost of the project the Government may, in special circumstance, with the approval of Parliament issue a Guarantee to the private party to cover some of the country or project risks. To attract the best quality at least direct costs, the Government may provide some incentives to the project company such as tax benefits, assistance in acquiring land, relaxation of certain legal requirements such as licensing, new or improved infrastructure, use of project resources for non-profit related purposes or being allowed to bid for other projects."

The most important institutional innovation relevant to FCCL management was a declared intention to work on establishing a Project Facilitation Fund (PFF), which was to be vested with various powers, including support for project preparation, but, most importantly, it was to become a potential source of viability gap finance (VGF) and liquidity to meet calls on contingent liabilities that materialize unexpectedly during operations of PPP projects. In

[99] Government of Kenya, Office of the Deputy Prime Minister and Ministry of Finance. 2011. Policy Statement on Public Private Partnerships. https://library.pppknowledgelab.org/documents/5793/download?ref_site=kl.
[100] Government of Kenya. 2007. Kenya Vision 2030 - A Globally Competitive and Prosperous Kenya. https://www.researchictafrica.net/countries/kenya/Kenya_Vision_2030_-_2007.pdf.

fact, this was the main rationale for the development of the Government Support Measures (GSM) Policy of 2018 (see below). Thus, the PPP Policy stated that “annual budgetary allocations will be made into the Facilitation Fund to create a 'guarantee fund' capable of meeting Government contingent liabilities arising from PPP projects.” Additionally, in relation to contingent liabilities specifically, the government announced the need for continuous review of their levels in relation to national debt. All public entities, including county governments, local authorities and the PPP Unit, would be required to seek the approval of the National Treasury and Planning for all direct and contingent fiscal exposures arising from any given PPP project. Finally, the PPP Policy stated that the government should issue more comprehensive guidelines on how to structure contingent liabilities and the related approval process.

The PPP Act of 2013 was a formalization of declarations made under the PPP Policy. Two years after intentions regarding the future of PPP arrangements were declared in the PPP Policy, the PPP Act was approved by the Parliament in December 2012 and came into effect on the February 8, 2013, after receiving the Presidential Assent, thereby formalizing those intentions into law. Besides the PPP Committee, the PPP Unit, the PPP Nodes and the Project Facilitation Fund, the PPP Petition Committee was established to consider all petitions and complaints of private parties related to the tender process and the process of entering into a contract. The role of the PPP Nodes was clarified with significant powers vested in them during all stages of the project life cycle, including project identification, screening, prioritization, tendering, implementation and monitoring. It became apparent that the work of the PPP Unit and the PPP Committee would be impossible without the active involvement of and information supplied by the PPP Nodes. The tender requirement was preserved for all solicited projects, but not for USPs, which could be directly negotiated in specific circumstances. Furthermore, on December 19, 2014, the national Public Private Partnerships Regulations (hereafter, PPP Regulations 2014) were gazetted, clarifying some provisions of the PPP Act. An interesting feature of the PPP Regulations 2014 is that, unless specific exceptions are made, they apply only to projects of a certain size, which seem relatively low given the typical size of infrastructure investments. Thus, according to section 2 of the PPP Regulations 2014, if a national project involves a construction phase, the cap is K Sh 85 million (equivalent to about US$779,000); for the same type of projects at the county level, the cap is K Sh 5 million (about US$46,000); for projects without a construction element, at all levels of government, the cap is likewise K Sh 5 million. The underlying idea behind such limits was the intention to address the constitutional realities of Kenya, which adopts a devolved system of governance, and a further recognition that the PPP framework had to be calibrated to local needs and realities; transaction costs should have been commensurable to the deal size. Until December 23, 2021, the PPP Act and the PPP Regulations 2014 constituted the national-level legally enforceable framework for PPPs. Then on December 23, 2021, the PPP Act 2021 came into effect, after having been approved by the Parliament in November 2021 and having received Presidential assent on the December 7, 2021. The PPP Act 2021 was then published in the Kenya Gazette under Legal Notice № 230 (Act № 14) on December 9, 2021. The new PPP Act was originally proposed by the National Treasury and Planning in March of 2021.

A conversation about the PPP legal framework in Kenya would not be complete without highlighting the role of the World Bank’s Infrastructure Finance and Public Private Partnership (IFPPP) Project, which is a comprehensive intervention that became active on February 12, 2013 and was extended in 2017 until 2022, based on results achieved up to then; PPIAF played an active role in the delivery of the IFPPP project as well. The project comprised four main components:

- Component 1: Support to institutional development and regulatory reform;
- Component 2: Support to the preparation of a pipeline of PPP transactions;
- Component 3: Support to the improvement of the FCCL framework associated with infrastructure PPPs; and
- Component 4: Support to the overall program implementation.

In terms of regulatory support, IFPPP helped develop many governing documents, such as the PPP Regulations 2014 and the Project Facilitation Fund (PFF) Regulations of 2017 (discussed later). The IFPPP also aided the preparation of the FCCL Management Framework, which was published by the National Treasury and Planning in April 2018 and is mandatory for all national and county level PPP projects. Other documents that were developed with the support of the IFPPP include the PPP Manual, the draft Governance and Operational Manual for the PFF, and the draft regulations for the PPP Petition Committee, county governments and the National Toll Fund. The project also helped establish a PPP Disclosure Portal along with the development of the PPP Disclosure Framework and customization of the PPP Screening Tool. Institution-wise, the IFPPP helped operationalize the PPP Unit, the PPP Committee, the PPP Petition Committee and the PPP Nodes, as well as supporting capacity building for more than 300 officers at the county and national government levels. The additional financing is mainly used to support the financial close of at least three PPP projects and mobilization of US$1.25 billion from the private sector through further institutional strengthening, and support to project preparation, procurement and management.

The PFF is an important too that is not available in many other developing economies, and the PFF Regulations of 2017 clarified several FCCL-related issues. In Kenya's PPP institutional framework, the Project Facilitation Fund is important, representing a facility that is a necessity in many economies to ensure quality project development activities, including hiring transaction advisors. As was highlighted earlier, Kenya's PFF is also important in the context of FCCL management, because it is a source of VGF and short-term liquidity for the materialized contingent liabilities. The PFF Regulations that clarified many of these issues were adopted on May 12, 2017. Specifically, in the area of contingent liabilities management, section 8 of the PFF Regulations clarified that Cas must, in conjunction with the PDMO: submit annua administrator estimates of contingent liabilities arising from their eligible projects: remit to the fund a percentage of their estimated contingent liability funding requirements each financial year; and refund back to the fund any payments made out of the fund in the previous budget cycle towards satisfying materialized contingent liabilities. The Debt Management Office was given the responsibility to assess, manage and monitor all contingent liabilities arising from PPP projects. Finally, the fund administrator was required to establish and maintain a separately designated revolving contingent liability reserve account for the purpose of meeting potential contingent liability claims. It was also specified that contingent liabilities eligible for reimbursement out of the PFF are those that cannot be handled by the National Treasury and Planning under alternative frameworks or under the National Government Contingency Fund, and that do not arise from a CA's contracted obligation for which a budgetary allocation was already made by that CA; some exceptions were also made to the recoverability requirement in certain circumstances. Additionally, USPs were excluded from benefiting from the PFF. Representatives from the PDMO indicated that although the PFF was created, it remained unfunded and, hence, largely inactive. At the same time, funding of the PFF is part of the International Monetary Fund (IMF) structural benchmark for Kenya as part of its extended fund and credit facilities, under which the GoK has committed to fully operationalize the PFF by July 2021 through the creation of a budget line for its annual funding.[101]

The Government Support Measures (GSM) Policy and FCCL Framework of 2018 were the necessary complementing elements of the overall PPP regulatory framework; the PPP Disclosure Diagnostic revealed gaps to be addressed. In 2018, thanks in no small part to the World Bank's IFPPP project, important regulatory additions were adopted, including the "Policy on the Issuance of the Government Support Measures in Support of Investment Programmes" (hereafter, GSM Policy) published by the National Treasury and Planning in October 2018, and the "PPP Fiscal Commitments and Contingent Liabilities Management (FCCL) Framework" (hereafter, FCCL Framework) published by the same agency in April 2018. In the area of FCCL management, these two documents were especially important because they provided much-needed detailed guidance.

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[101] IMF. 2021. Country Report No. 21/137, "First Reviews of the Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility and requests for modifications of performance criteria and structural conditionality – Press Release; Staff Report; and Statement by the Executive Director for Kenya." IMF, June 2021: 54. https://www.elibrary.imf.org/downloadpdf/journals/002/2021/137/article-A002-en.xml.

Specifically, the GSM Policy[102] provided useful analysis of the existing regulatory and procedural gaps related to the practice of issuing GSMs and the rationale for the adoption of the GSM Policy; laid out ten policy statements; listed all possible GSM instruments and types of risks for which GSMs could be issued; clarified conditions under which those GSMs could be approved (including the limited effectiveness date and restrictions on transferability to third parties); and described procedural steps for the application, approval, monitoring, reporting and accounting for the issued GSMs, as well as direct and contingent liabilities associated with them. Finally, the GSM Policy provided for the establishment of the GSM Risk Register and Risk Management Committee to ensure early awareness of potential problems and their timely management (a more detailed discussion of the GSM Policy can be found in Section 5.3 of the report).

The FCCL Framework[103] is cross-referenced in the GSM Policy and provides step-by-step guidance for the identification, assessment, monitoring, reporting and disclosure of FCCL risks related to PPP projects. Specifically, it provides a classification scheme for direct, contingent and other risks in a PPP and defines the roles of different government actors at various project stages in relation to FCCL management; the risk matrix approach for identification and assessment of FCCLs is discussed, along with creation of a fiscal commitments register; and different assessment techniques are suggested, including scenario, qualitative and quantitative (stochastic) analyses. The FCCL Framework also supplies three Excel-based tools to aid in this assessment: the PPP FCCL Model - Kenya Portfolio; the Stochastic Analysis spreadsheet to help with the Monte Carlo simulation; and the Termination Payment spreadsheet for calculating termination payments. In addition, recommended approaches for affordability assessment, monitoring, reporting, accounting and disclosure of FCCLs are described, including suggested accrual-based accounting in accordance with IPSAS 32 and 19 despite the GoK accounting on an IPSAS cash basis. For this purpose, the framework supplies an Excel-based tool to recreate government financial statements on an accrual basis and suggests further public disclosure of this information (a more detailed discussion of the FCCL Framework can be found in Sections 5.3 and 5.4 of the report). Finally, in 2018, the World Bank, at the invitation of and with the very close participation of the GoK and the PPP Unit, conducted a PPP Disclosure Diagnostic[104] to understand the existing legal and institutional framework for PPP disclosures in Kenya, as well as established practice and key challenges; after identification of the main gaps, key recommendations were provided. The respective PPP Disclosure Portal was launched in June 2018, following its adoption by the PPP Committee, at a high-profile public forum presided over by the Cabinet Secretary for the National Treasury and Planning and with the Head of Public Service in attendance. The diagnostic itself is published on the website of the PPP Unit (reorganized into the Directorate; see discussion below; https://www.pppunit.go.ke/) under the title "PPP Disclosure Framework."

As mentioned earlier, the PPP Act of 2013 was replaced by the PPP Act of 2021 in December 2021. As advanced as the Kenyan PPP regulatory framework may seem compared to those in some other developing economies, it is not static. Information collected through a feedback loop about the application of the PPP legal framework since 2013 urged further revisions to the PPP Act. Even though this follow-up information is not officially published or disclosed, a legal analysis of the PPP Act[105] of 2021 includes this perspective. Some cited reasons for the adoption of new PPP Act include protracted delays and inefficiencies that came to be associated with PPPs, as well as unnecessary approvals and redundant processes in the PPP approval cycle, all casting doubts on the effectiveness and suitability of PPPs as a procurement mechanism for large-scale infrastructure projects. Overall, since adoption of the PPP Act in 2013, private sector interest and investments have not materialized to the extent hoped for by the GoK. During

[102] The GSM Policy applies equally to the national and county level projects. Government of Kenya, National Treasury and Planning. 2018. "Policy on the Issuance of Government Support Measures in Support of Investment Programmes." https://www.pppunit.go.ke/wp-content/uploads/2019/11/Government-Support-Measures-Policy-Final-1.pdf.

[103] Government of Kenya, National Treasury and Planning. 2018. PPP Fiscal Commitments and Contingent Liabilities Management (FCCL) Framework. https://www.pppunit.go.ke/wp-content/uploads/2019/11/FCCL-Management-Framework_2018.pdf.

[104] International Bank for Reconstruction and Development. 2018. "Improving Transparency and Accountability in Public-Private Partnerships." Disclosure Diagnostic Report: Kenya. https://www.pppunit.go.ke/wp-content/uploads/2019/11/PPP-Disclosure-Framework_Ke.pdf.

[105] Government of Kenya. 2021. The Public Private Partnerships Bill of 2021, Kenya Gazette Supplement № 19, National Assembly Bills № 6. February 26, 2021. http://kenyalaw.org/kl/fileadmin/pdfdownloads/bills/2021/ThePublicPrivatePartnershipsBill_2021.pdf.

the 2020/21 budget reading, the Cabinet Secretary of the National Treasury and Planning, Ukur Yatani, indicated that the government plans to raise more than US$2 billion from the private sector to fund the infrastructure financing gap, indicating that recalibration of the regulatory framework is planned to make it more effective and attractive for private sector investors. The implemented regulatory reforms include the removal of unnecessary approvals and redundant processes in the PPP approval cycle, strengthening the institutions involved, streamlining and standardizing credit enhancement tools, and enhancing the viability gap funding process, where necessary, to improve the bankability of some projects. The PPP Act 2021 generally brings Kenyan PPP laws in line with the best international standards and is a genuine attempt to address the shortcomings of the 2013 PPP Act. It also highlights the GoK's commitment to the PPP route in spite of everything.

The main features of the PPP Act 2021 are: transformation of the PPP Unit into the PPP Directorate; removal of PPP Nodes; introduction of local content requirements and direct procurement methods; expansion of the GSM list; and amendments to the USP process.

- Institution-wise, one of the main changes in the approved PPP Act 2021 was the transformation of the PPP Unit into the PPP Directorate. Under the PPP Act 2013, the PPP Unit served as a secretariat to the PPP Committee headed by a Director; under section 15 of the PPP Act 2021, the PPP Unit is replaced by the PPP Directorate, headed by the Director General. For purposes of the civil service grading structure, the Director General is at least two job rankings higher than the Director, coming in just below the Principal Secretary, who serves as the administrative head of a state department within a ministry.[106] The PPP Directorate still sits within the National Treasury and Planning, but it has a far broader mandate than that of the PPP Unit. It now can originate, provide guidance for, and coordinate the selection, ranking and prioritization of PPP projects. Under the PPP Act 2013, many of these functions were decentralized and were supposed to be performed by PPP Nodes at the CA level. The PPP Directorate was also given proactive license to originate and lead in project structuring. It is now supposed to have a hands-on role in assisting CAs with oversight and technical support, and CAs are required to involve the PPP Directorate at every stage of a project. Undoubtedly, this is an elevation of status for the PPP Unit. It is worth noting that a Director General of the PPP Directorate (Mr. Christopher Kirigua) was already appointed in April 2021.
- Another institutional change in the approved PPP Act 2021 is that CAs are no longer required to establish a PPP Node, an internal structure charged with initiation of the PPP process and identification and selection of projects for approval by the PPP Committee and the Cabinet. Instead, CAs are obliged to constitute a project implementation team that should liaise with the PPP Directorate, which, in turn, plays a more visible role in the identification, screening and prioritization of projects by CAs under sections 19 and 21 of the PPP Act 2021.[107] Additionally, the PPP Act 2021 centralizes certain approvals in the PPP process within the PPP Committee, while pushing others down to the PPP Directorate. For example, the PPP Committee takes over some oversight functions from the Debt Management Office, and final approval for a CA to enter into a PPP agreement now rests with the PPP Committee rather than with the Cabinet or the Parliament. These institutional changes are likely to be received positively by the private sector—doing away with PPP Nodes creates a more centralized approach, allowing for the development of PPP expertise in one place instead of it being spread across numerous nodes. Furthermore, by reducing the direct role of the government in PPPs by removing the Cabinet approval function, projects are de-politicized and are less susceptible to being derailed to meet competing political objectives.[108]

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[106] Chegge, Mary, and Brenda Cheptoo. 2021. "Kenya Seeks to Overhaul its PPP Framework." *Commercial Practice* 3, EMSI & Associates, April 2021: 2. https://emsi.co.ke/wp-content/uploads/2021/04/02042021-Commentary-on-PPP-Bill-2021-final.pdf.
[107] Ibid.
[108] Barclay, Claire, and John Woolley, "Kenya proposes 'investor friendly' PPP law reforms." Out-Law Analysis, Pinsent Masons, April 9, 2021. https://www.pinsentmasons.com/out-law/analysis/kenya-proposes-investor-friendly-ppp-law-reforms.

- Another introduction in the adopted PPP Act 2021 is local content requirements, necessitating priority for Kenyan goods and services that meet a minimum standard and the requirement to employ skilled and qualified Kenyan citizens whenever possible. Local content guidelines were not issued yet, but the PPP Directorate is obliged to develop them.
- Furthermore, section 37 of the PPP Act 2021 broadens the list of procurement methods to include a direct procurement_method; thus, there are now four available procurement methods, including open competitive and restricted tenders, direct procurement and USPs. Direct negotiation is permitted not only in instances typical for procurement legislation, such as single supplier arrangements and emergencies, but also in some unusual cases, including when costs can be reduced due to a private party qualifying for concessional funding, international cooperation arrangements, and even when the price is considered fair and reasonable in relation to other known prices[109].
- Finally, the USP process in the approved PPP Act 2021 was significantly enhanced, and adopted the recommendations contained in the Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects[110] issued by the World Bank with the support of PPIAF in 2017. This allowed for some radical improvements in the original USP process that was poorly regulated under the repealed PPP Act 2013. Thus, the new process includes a requirement for USPs to be aligned with the national infrastructure priorities and demonstrated societal needs; proper assessment of fiscal affordability and potential contingent liabilities for USPs is required to be performed as well. Additionally, the project proponent and CA may enter into a project development agreement outlining the terms under which project development activities will be undertaken. USPs now can be tendered, and if the original proponent is not the winner, it would be entitled to compensation, among other things. Figure 6.6 below depicts the evolution of the institutional and regulatory framework related to PPP projects in Kenya to date.

[109] Ibid.
[110] World Bank Group, PPIAF. 2018. *Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects*. https://ppp.worldbank.org/public-private-partnership/library/policy-guidelines-managing-unsolicited-proposals-infrastructure-projects.

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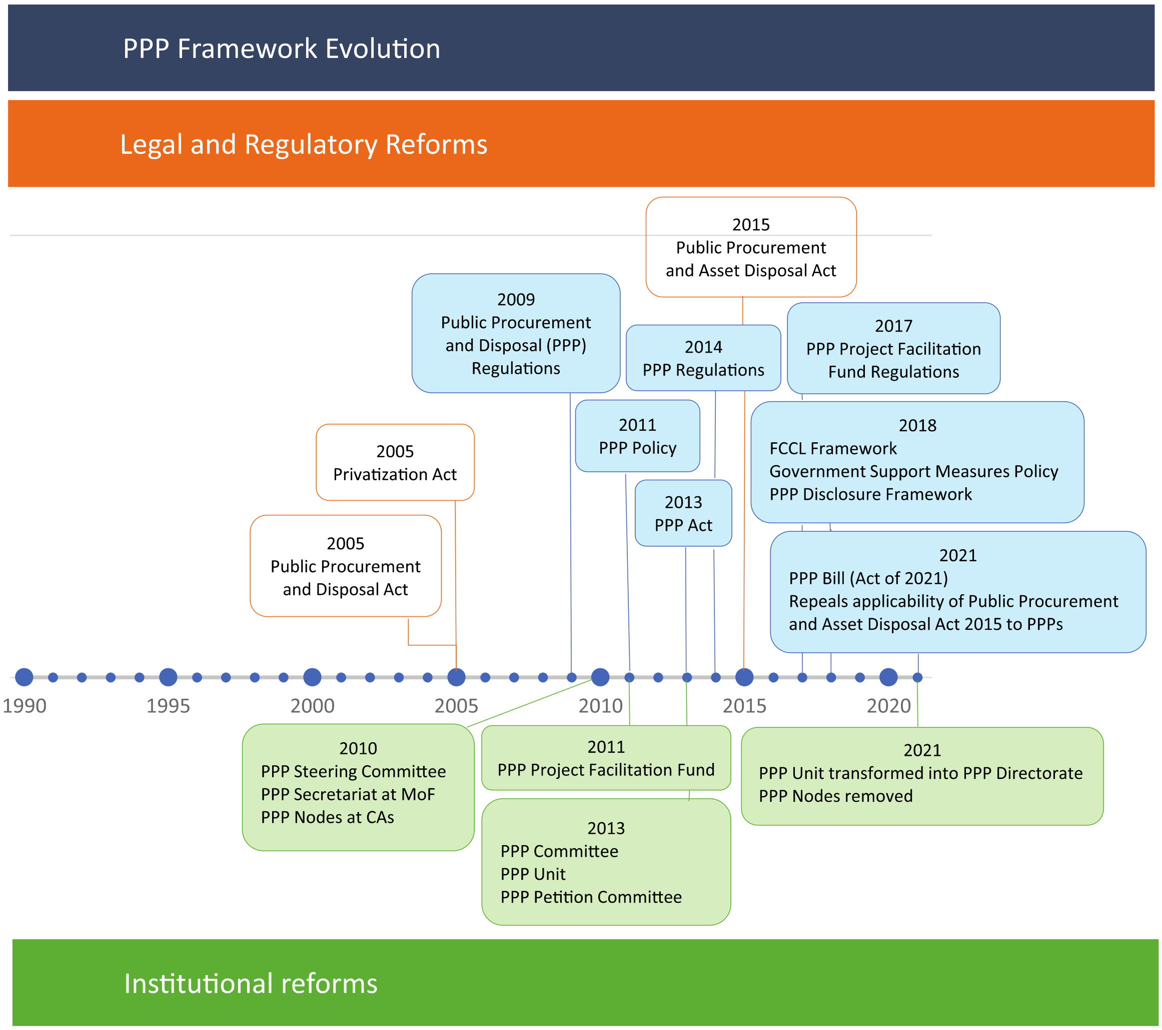
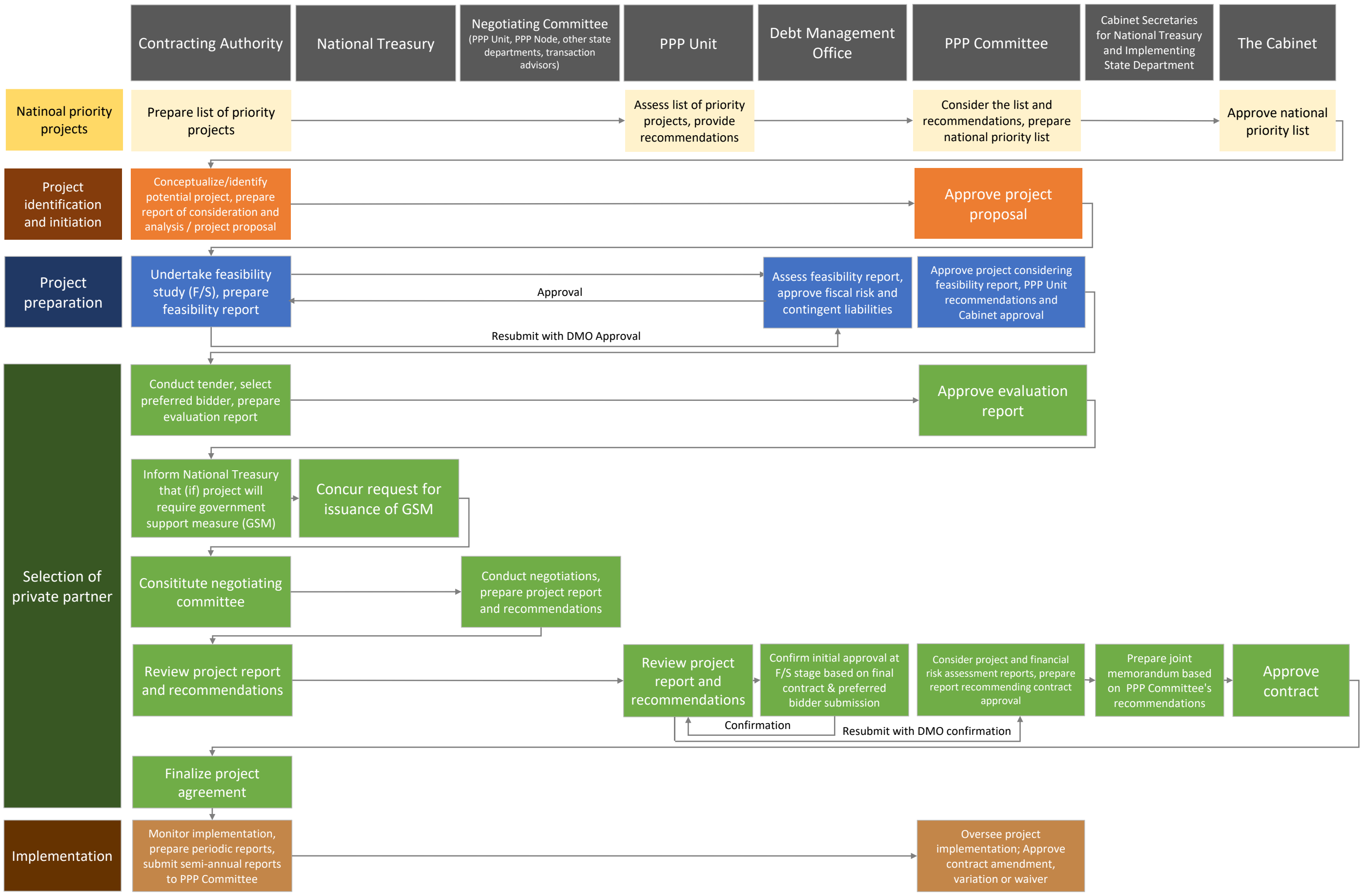
Figure 6.6: Evolution of the Regulatory and Institutional Framework Applicable to PPP Projects



5.2.2. PPP Approval Process

As was noted above, the PPP approval process in the approved PPP Act 2021 is somewhat different from that envisaged under the PPP Act 2013. Figures 6.6 and 6.7 below provide a graphic representation of the key stages in PPP approval processes for solicited projects at the national level, as provisioned in the 2013 and 2021 versions of the PPP law. Approval processes for USPs and county level projects are slightly different. Additionally, Figure 6.6 shows the approval sub-process for a government support measure for a project in accordance with provisions of the GSM Policy (also summarized in Figure 6.7).

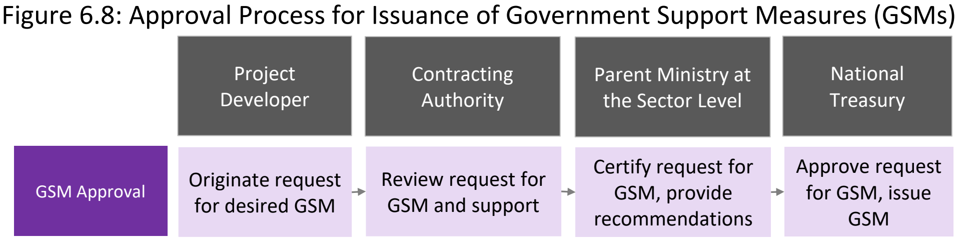
Figure 6.7: PPP Approval Process Envisaged Under the PPP Act 2013



Source: Author's visualization based on provisions of the PPP Act 2013.

According to the GSM Policy, the contracting authority should request the National Treasury and Planning' concurrence for issuance of a GSM before initiating negotiations with the winning bidder. Every GSM application to the National Treasury and Planning must contain the following documents:

Figure 6.8: Approval Process for Issuance of Government Support Measures (GSMs)



Source: Author's visualization based on provisions of GSM Policy 2018.

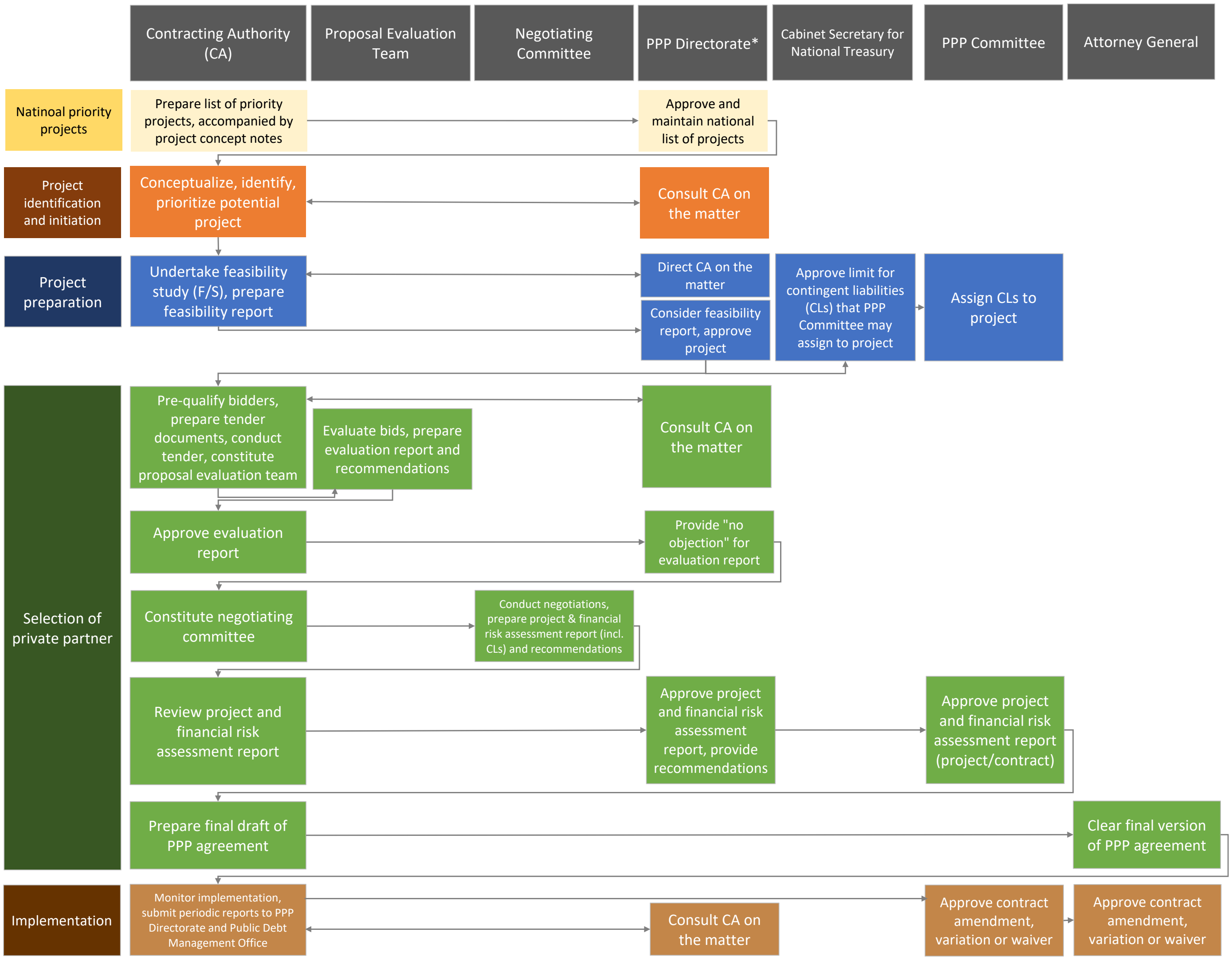
- A detailed feasibility study report showing project viability;
- A current due diligence report on investors, conducted by the CA, proving the private party's legal capacity, financial capability, technical experience, and track record in undertaking projects of a similar nature;
- An environmental and social impact assessment report, with or without National Environment Management Authority (NEMA) approval;
- An initialled or signed project agreement;

- A draft of the proposed GSM, aligned in principle terms to the GSM Policy;
- A comprehensive risk matrix, in which a CA should explicitly quantify its risk(s) either as explicit fiscal commitments and/or implicit contingent liabilities, and which should be presented in tabular format, identify key project risks allocated to public and private parties, provide an estimated financial impact value for risks allocated to the public partner, and identify the main areas, events and circumstances that are likely to trigger risk realization for risks borne by the public partner;
- A risk management and mitigation plan to reduce the likely impact of identified risks if and when they occur;
- Statements evidencing availability of adequate budgetary provisions and/or a credible financing plan to meet explicit obligations imposed on the public agency, and a strategy intended to be implemented in securing a source of liquidity to meet implicit obligations accepted under a GSM when they arise;
- A report by the CA confirming how the proposed project fits into its larger development program within the wider national development agenda; and
- A certification by the CA that the GSM application meets all requirements and the submitted documents are correct.

As can be seen from Figures 6.7 (above) and 6.9 (below), the PPP approval process in the PPP Act 2021 is a somewhat optimized version of the 2013 process with some approval sub-steps removed or consolidated and moved to a different institutional structure. Notably, *prima facie* the Debt Management Office was removed as an active participant in the approval process, and the Attorney General (rather than the Cabinet) became the final approver of the draft PPP contract. The intent to streamline the process seems to have been accomplished, but only time and experience with the new process will tell whether the rejuvenated procedure produces better results in terms of the number of PPP projects reaching financial close and doing so without unreasonable delays.

Figure 6.9: PPP Approval Process Envisaged Under the PPP Act 2021

Kenya is still refining its PPP mechanism, but even at its current stage of awareness, it is better placed than many



Source: Author's visualization based on provisions of the proposed PPP Bill 2021.

* At the project preparation stage, the PPP Directorate will also prepare and submit to the Cabinet Secretary for the National Treasury an annual report on CLs assigned during the financial year providing projections on future CL requirements based on the projects portfolio in the national list of projects.

developing nations. To summarize, Kenya undoubtedly has a relatively well-developed PPP regulatory and institutional framework, with many elements present that are absent in other developing economies, including a Project Facilitation Fund, and FCCL and disclosure frameworks, among others. Nevertheless, the country is still in the process of finding the right setup for its PPP program and keeps refining related processes, procedures and organizational structures to ensure effective realization of the PPP mechanism in its local context. It appears that decision makers came to the realization that more doesn't always mean better, especially when it comes to bureaucracy and related procedures. In this vein, it's commendable to see an effort to streamline the PPP process and reduce the red tape associated with it. While having a proper system of checks and balances is crucial for the overall sustainability of the PPP program, finding the right balance between efficiency and overregulation is important. Whether the reformed PPP process will be able to live up to the GoK's expectations, which place big hopes on PPPs for its infrastructure agenda, and whether the country will be able to find the optimal PPP setup that can result in a stable stream of successfully implemented projects is yet to be seen, but even with the present level of awareness, Kenya is much better placed than many other developing nations.

5.3. Analysis of Projects

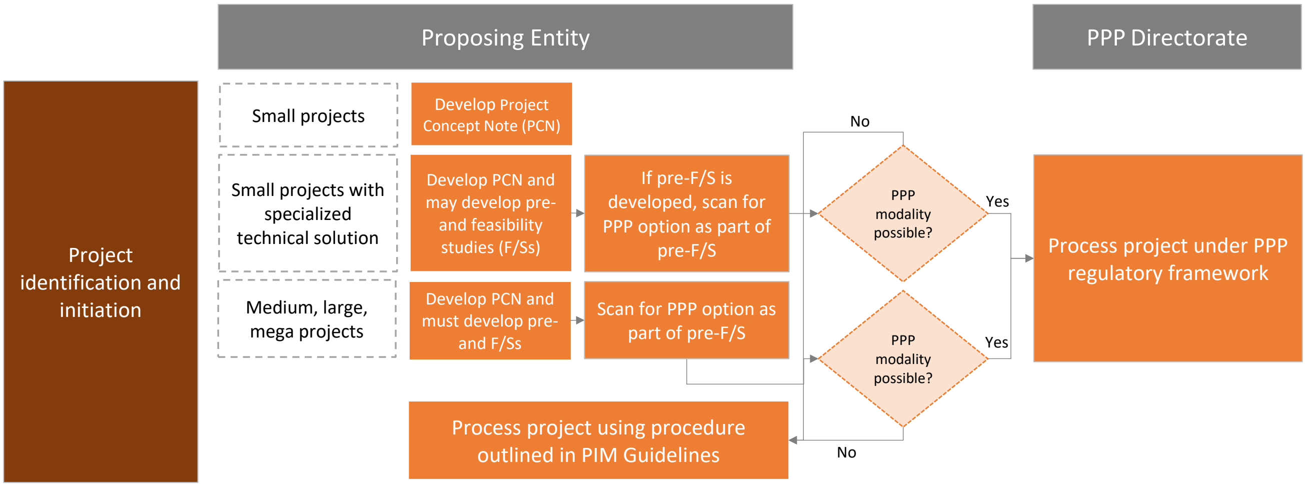
5.3.1. Identifying and Evaluating PPP Projects

A comprehensive PIM function is a relative novelty in Kenya. Kenya's PIM process is governed by the Guidelines on Public Investment Management for National Government and its Entities (hereafter, PIM Guidelines)[111] adopted in January 2020. The PIM Guidelines are designed to provide a framework for efficient and effective management of public investments, including project identification and conceptual planning; pre-feasibility and feasibility; selection for budgeting; implementation; monitoring, evaluation and reporting; closure, sustainability; and ex-post evaluation to ensure value for money (VfM) and optimal use of resources. The PIM Guidelines are also designed to ensure that budgetary allocations are only provided for projects that have positive social and economic returns. The guidelines seek to deliver a sufficient number of shovel-ready projects to government agencies to simplify their decision-making and improve private sector participation in infrastructure. Finally, the PIM Guidelines establish and maintain a Public Investment Management Information System (PIMIS) to register, track and inform decision making on public investments. The guidelines apply equally to public investment projects and PPPs, as long as the guideline's provisions do not contradict the provisions of the PPP Act. It should be noted that a dedicated PIM Unit was established at the National Treasury and Planning only in 2018, after the diagnostic studies by the World Bank and the IMF Africa Regional Technical Assistance Center (AFRITAC) East conducted in 2016, 2017 and 2018[112] recommended formation of a dedicated PIM Unit.

The pre-feasibility study should screen for a PPP alternative at the project identification stage. According to the newly adopted PIM Guidelines, a procuring authority should ensure that all projects are identified through a stakeholder consultation process using a top-down or bottom-up approach, and that no project concept note is initiated for a project that is being implemented by any other national or county government agency. Additionally, all projects should be aligned with the national and county development plans, as well as sector and strategic plans. All projects require a project concept note (PCN) in an established format. However, the requirement to conduct pre-feasibility and feasibility studies at the project identification and initiation stages varies depending on project size. Small projects (with a total investment amount of less than or equal to K Sh 100 million (about US$916,000)) do not require either study; small projects with a specialized technical solution may require them, while medium (K Sh 100 million to 500 million (about US$4.6 million)), large (K Sh 500 million to 1 billion (about US$9.2 million)) and mega (more than K Sh 1 billion) projects must be accompanied by both pre-feasibility and feasibility studies (see section 22 of the PIM Guidelines). An analysis of the possibility to conduct a project as a PPP should be performed at this pre-feasibility stage, because a pre-feasibility study is required to identify candidate projects that can potentially be delivered through a PPP option in line with the PPP Act. Once identified to be suitable for the PPP modality, the project should be forwarded to the PPP Unit (the PPP Directorate after adoption of the PPP Act 2021) and be processed in accordance with the PPP regulatory framework. Otherwise, the project should follow the steps prescribed in the PIM Guidelines. A schematic representation of this process is depicted in Figure 6.10 below.

[111] Government of Kenya, National Treasury and Planning. 2020. Guidelines on Public Investment Management for National Government and its Entities. National Treasury Circular № 16/2019. National Treasury and Planning, January 24, 2020. https://www.treasury.go.ke/wp-content/uploads/2021/03/Circular-No.16-2019-on-PIM-Guidelines-for-National-Government-Entities.pdf.
[112] The website of the AFRITAC East program, as well as its annual reports, are available at https://www.eastafritac.org/home#.

Figure 6.10: Decision-Making about PPP Option versus Traditional Public Procurement



Source: Author's visualization based on provisions of the PIM Guidelines

The PIM Guidelines do not provide specific criteria for PPP screening, just the requirement to perform such an assessment. While there is a prescribed format for a pre-feasibility study that includes detailed steps for assessing a project's potential feasibility, there are no specific criteria in the PIM Guidelines to determine whether a project could be potentially fit for a PPP option, besides the requirement to perform such an assessment. Regarding the overall pre-feasibility criteria, a scoring system is used to determine projects to be further considered for a feasibility assessment; in this vein, the third schedule of the PIM Guidelines requires the following analysis:

- *Relevance of the project idea*. Justify the need for the proposed project by:
    - Linking the project to the national/county development plan's strategic goals and objectives;
    - Linking the proposed project to the sector's strategic objectives and strategies by describing sector outcomes that the project is expected to contribute to; and
    - Analyzing and describing quantitative indicators of demand for services or goods to be delivered by the project.
- *Alternative solution / option analysis*. List all potential alternative solutions/options that can meet the end-user or customer requirement or solve the identified problem by analyzing all information gathered at the concept stage and by providing the following information for each option:
    - Describe the option and explain how it can address the problem identified.
    - Describe the assessment methods used to determine the likelihood that each alternative will meet the end-user or customer requirements or solve the identified problem. Possible methods include quality of benefits or services, cost implications, staff opinions, customer and/or end-user requirement, technology and engineering requirement, environmental and social concerns, human resource (HR) and administrative requirements, legal and institutional issues, prototypes or pilots to model results, and reviews of implementation of a similar solution in other projects, among others. For each assessment method, describe how it was undertaken and the quality of the result.
    - For each alternative option score the viability by assigning a rating from 1 (the lowest) to 10 (the highest) and describe the method used to determine this pre-feasibility score.

- Describe any risks associated with implementing each alternative option by providing a description of each risk, its likelihood of realization, the potential impact and the actions required to mitigate it.
- Describe any issues associated with implementing each alternative option by providing a description of the issue, its impact on the project and actions required to resolve it.
- List all assumptions made when assessing the viability of each alternative option.

- *Pre-feasibility ranking*.
  - Assign weights to each pre-feasibility score (criterion) of 0.5 (unimportant) to 1.5 (very important) to increase or decrease its importance in the analysis and rank the overall results. Describe the scoring/weighting mechanism used to produce the overall results.
  - From the ranking above, select the three best alternatives with the highest total score and compare the alternative options using qualitative and quantitative listing of advantages and disadvantages by applying a multi-criteria analysis, including technical and engineering, environmental and social, HR and administrative, legal and institutional analysis, among others; undertake and describe the results of a cost benefit or cost effectiveness analysis for each alternative.
- *Feasibility option*. Based on results of the assessment above, identify and describe the option with the highest assessment score and positive evaluation results using net present value/net present costs; this is the option that will proceed to a feasibility study stage. Identify and describe whether this selected option is a potential PPP candidate. Furthermore:
  - Describe the updated estimates of the project's capital costs, provide sources of information, reasons for changes in cost estimates and justification for the same.
  - Draft TORs for the feasibility study – from the findings of the pre-feasibility study describe key issues that may need further study as this may form part of the TORs for preparation of the feasibility study.

If a project proceeds past a pre-feasibility study stage, a feasibility study is prepared for it, and if (once) this assessment obtains the National Treasury and Planning' concurrence, it is included in the project pipeline, from which projects can be submitted for funding and budget allocations, provided all conditions are met. Under the pre-2021 PPP framework, the PPP Unit would provide the PDMO with the full feasibility study so it could carry out its own independent FCCL assessment. This assessment would then be submitted to the PPP Committee for a final decision on a project, and a subsequent recommendation to the Cabinet for approval. Under the 2021 framework, this flow is amended, however. The feasibility study template requires the following types of assessments be performed at a detailed level: market/demand analysis; technical and engineering analysis; environmental and social impact analysis; HR and administrative support analysis; institutional and legal analysis; financial or private evaluation analysis; economic or social evaluation analysis; distributional analysis; and risk (uncertainty) and sensitivity analysis, as well as updated project costs.

A customized PPP Screening Tool was developed as part of the World Bank IFPPP project, but it is not integrated into the PIM process. The IFPPP project helped to perform the PPP screening process and identify a PPP pipeline of 15 projects, with the assistance of the strategic advisory firm Castalia.[113] However, the tool is not integrated into the PIM process, and both PIM and PPP processes remain disconnected. For instance, it remains unclear whether the tool shall be applied at the pre-feasibility study stage, or when a potential PPP option is being analyzed, or only after that decision is made (without clear criteria) and the project is forwarded to the PPP Directorate. If the latter,

[113] Castalia. "PPP Project Screening and Prioritization for Kenya." https://castalia-advisors.com/ppp-project-screening-and-prioritization-for-kenya/.

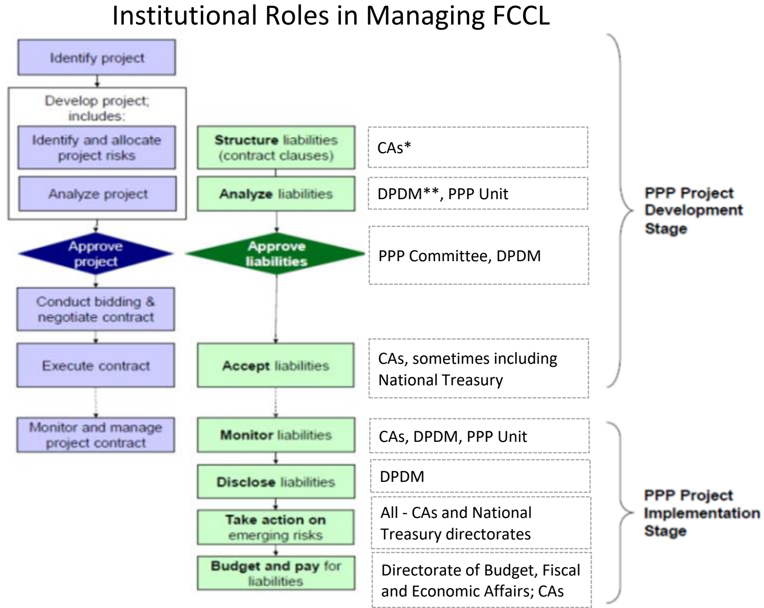
then potentially suitable projects could be missed and/or the ones that are not as suitable could be recommended for the PPP modality, and the overall coherence of the PIM-PPP process is called into question. This ambiguity is indeed present, and it is not clear how projects are selected for PPP implementation, and at what point they need to be redirected to the budget framework. These are the operational uncertainties that require further work and streamlining, and could be subject to a Development Policy Financing (DPF) operation. Representatives from the PDMO confirmed that the PPP Screening Tool is used by the PPP Directorate for all projects it receives from line ministries and as USPs. At the same time, the PPP Directorate currently does not consult the PIM Unit on the project screening and assessment processes, and both units operate largely independently.

5.3.2. PPP Fiscal implications

The FCCL Framework and GSM Policy are the two guiding documents for FCCL management. Kenya's National Treasury and Planning, with the support of the IFPPP project, adopted the FCCL Management Framework in April 2018; the use of the FCCL Management Framework is mandatory for all PPP projects submitted for consideration and approval under the PPP Act of 2013 (now repealed and replaced by the PPP Act 2021), including projects initiated by county governments. The document also acknowledged that all PPPs executed before the commencement of the FCCL Framework would be reviewed for FCCL risks, in order to collect and consolidate FCCL-related information. The FCCL Framework should be read together with the GSM Policy, because the latter cross-references the former, and different aspects of FCCL management are discussed in each document.

FCCL management follows a two-phase approach, covering all key project stages; FCCL assessment occurs in the development stage. The FCCL Framework adopts a two-stage process for managing fiscal commitments, based on the framework proposed in the World Bank operational note "Implementing a Framework for managing Fiscal Commitments from Public Private Partnerships," authored by Riham Shendy in 2014.[114] The FCCL Framework underscores the importance of FCCL control and management in all phases of PPP development, approval, and implementation, broadly subdividing the entire process into project development and implementation stages. Figure 6.11 depicts the FCCL management process, along with institutional roles in accordance with the institutional setup provided for in the PPP Act 2013 (which will require adjustment if the proposed PPP Act 2021 is adopted). Identification and assessment of fiscal commitments and risks occurs in the development stage, along with an affordability assessment. This identification and assessment process should be performed in three steps according to the FCCL Framework:

Figure 6.11: Functional Components of and Institutional Roles in Managing FCCL



Source: FCCL Management Framework 2018.
* CA = Contracting Authority
DPDM = Directorate of Public Debt Management

(1) Analysis of a project risk matrix using a risk register;

[114] Shendy, Riham. "Implementing a Framework for Managing Fiscal Commitments from Public Private Partnerships." World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/25032.

(2) Identification of fiscal commitments using a fiscal commitments register; and
(3) Assessment of fiscal commitments and fiscal risks.

No standardized risk matrix is offered, but certain conditions for the types of risks to be covered are presented in the GSM Policy; the GoK takes a conservative stance on the amount of risk it is ready to take on. The first step involves the analysis of a project risk matrix. The FCCL Framework doesn't provide a standardized risk matrix, but instead recommends assigning development of a fiscal risk matrix to an expert, with inputs to come from the project risk allocation matrix elaborated for the feasibility study, as well as from finance structure documents, the PPP agreement, etc. The risk register would contain only risks that are partially or totally allocated to the government, including such information as descriptions of risks, allocations, costs, likelihood of occurrence, fiscal impacts, and government mitigation actions. The GSM Policy provides further guidance on possible criteria that the risks covered by issued GSMs—such as letters of comfort and support, various guarantees, and binding undertakings—could satisfy. It should be noted, however, that the GSM Policy is currently undergoing an extensive review, after gaining the experience of implementing PPP projects between 2018 and 2021. As such, it remains unclear to what extent some of the proposed criteria will change after the ongoing revisions to the GSM Policy have been completed. However, in the current version of the document, they include the following:

- The GSM will be limited to the acts of the government (not inaction).
- The GSM will be controlled by material adverse impacts that impair the ability of the investor to perform their obligations under the project agreement.
- The GSM will be limited to the actions of the government that occur within Kenya.
- The GSM will be limited to a closed list of specified events.
- The GSM will set out express qualifications of liability, or exclusion of liability linked to specific events.
- The GSM will set out specific conditions for effectiveness, among others.

The existing version of the GSM Policy stresses that the issued GSM shall exclude the phrase "including but not limited to the following" to avoid the impression that the list of covered risks is merely illustrative and not conclusive. The conservative stance on issuing GSMs, and the amount of risk that the GoK is ready and willing to take on in a PPP project, can also be gauged by the following GSM Policy 2018 requirements for qualifying for a GSM (each GSM instrument must include these in its terms and conditions):

- Non-negotiable conditions that protect GoK interests upfront, such as exclusion of coverage for risks expressly allocated to the non-public actor under the project agreement, or capping GoK overall obligation under the GSM even when risk is allocated to the GoK, and excluding all insurable risks as well as project company statutory liabilities;
- A date by when the GSM becomes effective, defined by clear preconditions;
- Conditions to effectiveness (which at a minimum will include attainment of financial close, issuance of a National Environment Management Authority (NEMA) license for a project, securing all project land-related conditions, and satisfaction of any relevant conditions precedent on public agencies under the project agreement);
- A termination date;
- An amendment clause;
- A clause disqualifying transfer of GSM instrument to a third party without the consent and approval of the National Treasury and Planning (each GSM instrument will include a statement imposing its automatic lapse should it be transferred contrary to this provision);

- Explicit identification and allocation of risks to be borne by the public partner by reference to the clauses in the primary commercial or project document;
- A declaratory statement linking GSM issuance to the GoK obligation under the primary project document (no GSM will be issued where the primary project documentation does not disclose, expressly and on its face, an intention and obligation of the GoK to so issue the GSM in question); and
- Where obligations are dependent on a public agency not party to the primary project agreement, the GSM will be structured in a manner that makes the performance of such obligations a precondition to the effectiveness of a GSM, to ensure that secured contingent liabilities never materialize.

The FCCL Framework suggests using a mix of qualitative and quantitative tools for FCCL assessment depending on the type of liability. The second step in the assessment of FCCL includes identification and registering of direct and contingent liabilities, which will be consolidated in the Fiscal Commitments Register. This register will list fiscal commitments (payments) for each project, classify them into different types (direct and contingent, including a description of payment concept, periodicity and other information), describe any applicable adjustment factors and trigger events, and reference sources from where this information was obtained (e.g., feasibility study, PPP contract, and letter of support). Finally, the FCCL Framework suggests a mixture of qualitative and quantitative techniques depending on type of liability, with some bias towards quantitative tools, and supplies three spreadsheets to aid in the quantitative assessment (see Table 6.3).

Table 6.3: Methodologies for Assessment and Analysis of Fiscal Commitments and Fiscal Risks

Type of Fiscal Commitment	Estimate	Assessment Technique Depending on Available Information
Direct Liabilities		
Upfront payment	• Annual cost over life of a project • Present value of payment stream during term of a contract	
Availability payment		
Availability payment adjusted permanently by macroeconomic parameters		• Scenario analysis • Stochastic analysis
Availability payment adjusted by contingent events		• Scenario analysis • Qualitative analysis of likelihood of reaching trigger values • Stochastic analysis
Contingent Liabilities		
Revenue guarantee	• Estimated annual cost over life of a project • Estimated present value of payment stream during term of a contract	• Scenario analysis • Qualitative analysis of likelihood of reaching trigger values • Stochastic analysis
Debt guarantee		
Guarantee over annual payment by state-owned enterprise, local or subnational government	• Estimated annual cost over life of a project	

	• Estimated present value of payment stream during term of a contract	
Termination payment	Maximum value	Qualitative analysis of likelihood of reaching trigger values
Other Fiscal Risks		
	Maximum value	• Qualitative analysis of likelihood • Stochastic analysis

Source: FCCL Management Framework, 2018.

The four spreadsheet models that come with the FCCL Framework document and allow calculation of direct and contingent liabilities are as follows:

- The "PPP FCCL Model-Kenya Portfolio" spreadsheet, supplemented by the "PPP FCCL Financial Model Manual," which provides step-by-step guidance on how the spreadsheet model operates;
- The "Stochastic Analysis" spreadsheet, which allows estimations requiring stochastic analysis (Monte Carlo simulation) (the "Note on Stochastic Analysis" provides guidance on its application and usage);
- The "Termination Payment" spreadsheet, which allows project-by-project calculations of termination payments due by the GoK in any particular year (input values are derived from the "PPP FCCL Model-Kenya Portfolio" file identified above); and
- The "PPP FCCL Summary-Kenya Portfolio" spreadsheet, which provides a summary of the expected annual FCCL commitments for all PPP projects, vis-à-vis budgetary allocations per each contracting authority.

Fiscal commitments and risks that cannot be assessed quantitatively are required to be assessed qualitatively using information from the risk register, among others.

Once assessed and estimated, FCCL are required to be checked for fiscal affordability as part of the development stage. The FCCL Framework suggests three common instruments to check for fiscal affordability:

- Comparing annual cost estimates against the projected budget;
- Assessing the impact on the overall debt sustainability; and
- Introducing limits on PPP commitments.

The first instrument entails the Budget Department checking whether a project is aligned with budget constraints and priorities, by assessing if the would-be contracted fiscal commitments allow the contracting entity to achieve its fiscal targets (budget deficit or surplus, etc.). The PPP Act 2021 also recognizes the importance and centrality of this idea in terms of how it defines affordability. The FCCL Framework's suggested indicators for helping assess the fiscal affordability of a project are described in Table 6.4.

Table 6.4: Proposed Fiscal Affordability Indicators

Type of Fiscal Commitment	Cost	Indicator of Fiscal Affordability (including projections over the term of a PPP contract beyond the medium-term horizon)
Direct liabilities	• Estimated annual payments • NPV	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of national public debt • Cost as percentage of GDP
Guarantees	• Estimated annual payment, or expected average payment • NPV (base/downside cases)	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of contingency line • Cost as percentage of public debt • Cost as percentage of GDP
Termination payment	• Estimated worst-case payment or expected average payment • NPV	• Cost as percentage of national budget • Cost as percentage of contingency line • Cost as percentage of GDP
Other fiscal risk	• Estimated worst-case payment or expected average payment • NPV (base/downside cases)	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of contingency line • Cost as percentage of GDP

Source: FCCL Management Framework, 2018.

For the second and third instruments, the FCCL Framework does not contain prescriptive rules, but rather suggests that because fiscal commitments from PPPs are considered debt-like obligations, the Directorate of Public Debt Management (DPDM) may include them in the overall debt measures to determine a project's impact on the overall debt sustainability. It also advises that Kenya consider adopting specific limits on or thresholds for direct fiscal commitments arising from PPPs, as is done in many other economies.

The GSM Policy provides some more specific guidance for the government support measures that could be issued. The GSM Policy of 2018 contained the list of GSM types that may be provided by the GoK in support of public investment programs. However, because the policy is currently undergoing extensive review, the objective is to align the GSM list with the list presented in section 28 of the PPP Act 2021. It should be noted that the GSM Policy 2018 highlights that not all projects may be supported by GSMs, and that GSMs should be issued only in very exceptional circumstances, for projects that are considered strategic and of public interest as validated by the Cabinet. The updated list of GSMs in accordance with PPP Act 2021 contains:

- A binding undertaking;
- A letter of support;
- A letter of credit;
- A credit guarantee, whether partial or full;

- Approval for issuance of partial risk guarantees and political risk insurance; or
- Any other instrument chosen by the cabinet secretary responsible for matters related to finance may, on the advice of the PPP Committee, determine.

A lack of historical data and a low number of projects passing through the system are some of the major challenges for the FCCL Framework's operationalization. Representatives from the National Treasury and Planning indicated that the FCCL Framework is comprehensive and robust, and the existing institutional setup to implement the framework is adequate, as are the analytical tools. However, one of the main challenges remains the low number of projects progressing to the advanced stages of the analysis and reaching financial close, hence, the opportunity for regular practicing of rules and procedures envisaged under the framework is not always present. However, the PDMO confirmed that two projects under the RAP program—the Nairobi-Nakuru-Mau Summit Road PPP project and the Olkaria geothermal power project—were run through the model and assessed in accordance with the FCCL Framework. As a result, Analysis of Project and Financial Risk Assessment Reports were prepared for these projects. An additional challenge highlighted is the lack of historical data necessary to run some types of quantitative analyses, such as probabilistic analyses or Monte Carlo simulations, which are common in contingent risk analyses of minimum revenue guarantees, among others. While certain assumptions based on past studies and similar projects in comparator countries could be made, the PDMO felt more comfortable relying on actual market data for the results to be fed into decision-making.

Twenty-three projects are supported either with a letter of support or an indemnity agreement to DFIs; portfolio-level analysis is unavailable. As will be discussed in Section 5.4 of the report, the recently adopted regulations—including the FCCL Management Framework, the GSM Framework, and the PPP Diagnostic Study—as well as the proposed PPP Act 2021 provide for ample disclosure requirements for PPPs and related FCCL. In practice, disclosure on PPPs and their fiscal risk attributes can be found in the annual Public Debt Management Reports, as well as in the Medium-Term Budget Policy Statements published by the National Treasury and Planning. Specifically, the most up-to-date and comprehensive list of the government support measures provided to PPP projects can be found in the draft 2022 Budget Policy Statement,[115] which discloses 23 projects for which either a letter of support covering political risks, or an indemnity agreement with multilateral development institutions (MDIs) that issued PRGs to projects, or both, was provided (see Annex 5 C), including six road and 17 IPP projects at different stages of development. Results of quantitative (scenario or stochastic) analyses or of qualitative assessments discussed in the FCCL Framework could not be found in the public domain. However, the PDMO shared with the team directly the "Analysis of Project and Financial Risk Assessment" Report for the Nairobi-Nakuru-Mau Summit Road PPP Project, in which the GoK is planning to take on a revenue risk, and the "Fiscal Commitments and Contingent Liability" Report for the Lot 32 Roads Annuity Programme, confirming that such an analysis has been performed. The PDMO also noted that stochastic analysis is often prevented by unavailability of historical data on traffic levels and other related parameters, which explains the absence of a disclosure for this type of analysis. A comprehensive portfolio-level analysis is unavailable due to some data gaps, especially related to older IPP/PPA agreements.

5.4. Reporting Requirements

5.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

Kenya is undergoing a phased transition from cash basis International Public Sector Accounting Standards (IPSAS) to accrual basis IPSAS for national and county government entities. The basic document governing public finance management issues, including accounting and reporting in the public sector, is the Public Finance Management Act

[115] Government of Kenya, National Treasury and Planning. 2021. Medium Term Draft 2022 Budget Policy Statement – Accelerating Economic Recovery for Improved Livelihood. National Treasury and Planning, November 11, 2021: 94-110. https://www.treasury.go.ke/wp-content/uploads/2021/11/Draft-2022-Budget-Policy-Statement_F.pdf.

of 2012. In accordance with sections 192 to 195 of the PFM Act, the Public Sector Accounting Standards Board (PSASB) was created on February 28, 2014. One of the mandates of the PSASB is to set generally accepted accounting and financial system standards for the public sector. In July 2014, the board prescribed the first set of standards and guidelines to be applied in the preparation of financial reports for FY 2013-2014. The decision was to adopt IPSAS and International Financial Reporting Standards (IFRS) for the different categories of reporting public sector entities. The following categories of public entities and related reporting requirements were established:[116]

- National and county governments and their respective entities—IPSAS (cash basis)
- Semi-autonomous national and county government agencies—IPSAS (accrual basis)
- State and county corporations carrying out commercial activities—IFRS
- Regulatory and non-commercial state and county corporations—IPSAS (accrual basis).

Thus, the central- and county-level government financial statements are currently prepared using cash-basis IPSAS. The PSASB Strategic Plan for FY 2016-2021 states as one of its strategies the development of a roadmap for transitioning to full accrual-basis IPSAS.[117] Furthermore, the latest PSASB annual report for FY 2017-2018[118] states that the board is aiming to migrate the national and county government entities from cash- to accrual-basis accounting and is undertaking several activities to aid in achieving this goal, including identification and valuation of public assets and liabilities, strengthening of the internal audit functions within the public sector, sensitization and capacity building of preparers of financial statements, and review of the government accounting system's (IFMIS) chart of accounts to accommodate accrual-basis accounting. As of the reporting date (June 30, 2018), these activities were still ongoing. The PSASB stated that once all preparatory activities are completed, the board will roll out the applicable date for accrual-basis accounting migration in accordance with law and its mandate.

Insufficient information on the stock and value of non-financial assets is considered one of the main barriers to a transition to accrual-basis IPSAS accounting. According to the most recent Public Expenditure and Financial Accountability (PEFA) Assessment report for Kenya, for the year 2017, published by the PEFA Secretariat in March 2020,[119] one of the biggest barriers to a transition to accrual-basis IPSAS accounting is insufficient information on the stock and value of non-financial assets held by the ministries, departments and agencies (MDAs), due to inadequately maintained fixed asset registers and rudimentary monitoring of the fixed assets' stock. According to the PEFA report, putting a lot more effort into identifying all fixed assets and valuing them correctly would be considered a major priority for the GoK if it wanted to move to accrual-basis IPSAS accounting in the near future (which seemed unlikely as of the reporting date).

The GSM Policy and FCCL Framework provide some accounting guidance. In the absence of proper accounting rules for PPPs and concessions, at least at this stage, both the GSM Policy and the FCCL Framework suggest certain accounting treatment for FCCL related to PPP projects. The GSM Policy states that every entity that issues or is a recipient of a GSM from the National Treasury and Planning has an obligation to disclose any contingent liability arising from this GSM and to quantify this contingent liability in a note in its financial statements. The FCCL Framework provides more specific and practical guidance, advocating for accounting in accordance with IPSAS 32[120]

[116] This decision was adopted through Kenya Gazette Notice № 5440 on August 8, 2014.
[117] PSASB (Public Sector Accounting Standards Board). 2015. Strategic Plan for 2015/16 – 2020/21. Public Sector Accounting Standards Board: 32, 54. https://www.psasb.go.ke/sites/default/files/publications/2021-02/PSASB-Strategic-Plan-2015-2021.pdf.
[118] PSASB (Public Sector Accounting Standards Board). 2018. *Annual Report and Financial Statements for the Financial Year Ended June 30, 2018*. Public Sector Accounting Standards Board. https://www.psasb.go.ke/sites/default/files/publications/2021-02/Annual-Report-2017-2018_0.pdf.
[119] Government of Kenya, PEFA (Public Expenditure and Financial Accountability) Secretariat. 2020. *PEFA Assessment Report 2017*. March 3, 2020. https://www.pefa.org/node/586.
[120] IPSAS (International Public Sector Accounting Standards). IPSAS 32—Service Concession Arrangements: Grantor. https://www.ifac.org/system/files/publications/files/B8%20IPSAS_32.pdf.

and IPSAS 19,[121] as is done in many developed economies with robust accounting and reporting frameworks. However, because the GoK uses cash-based budgetary and accounting systems and doesn't produce accrual-based estimates, the FCCL Framework provides an Excel-based model called "PPP Fiscal Commitments Model - Kenya Portfolio.xlsm," which contains government financial statements using the IPSAS 32 approach and accrual accounting. The model also generates cash flow estimates and contains a stream of payments associated with direct liabilities (e.g., availability payments) as well as with revenue and debt guarantees. The FCCL Framework suggests disclosing accrual estimates for the income statement and balance sheet in a supplementary disclosure but recommends reporting using accrual-based accounting.

There are no limits for or ceilings on the level of stock or flow of direct fiscal commitments related to PPPs. As mentioned earlier, one of the instruments for checking for a project's fiscal affordability, per the FCCL Framework, is the introduction of limits on PPP commitments. The framework suggests that some governments adopt specific limits or thresholds on direct fiscal commitments related to PPPs, with the objective of avoiding tying up too many budgetary resources (within a specific sector or at an aggregated level) in long-term payments. At the same time, the FCCL Framework acknowledges that such limits are usually not needed in the early stages of PPP programs (as applies to the Kenyan PPP program), and could be developed later, as the magnitude and potential of the program increases. At the regulatory level, there is no provision establishing a cap on either the stock or the flow of direct fiscal commitments associated with PPPs. At the moment, the Parliament approves this cap annually. Kenya is a relatively small economy with a moderate GDP, and the concern is that establishing a ceiling on fiscal liabilities as a percentage of GDP might lead to this cap being reached and/or breached very quickly. At the same time, representatives from the PDMO noted that such a ceiling would allow for better control of potential fiscal risks associated with PPPs, including during crises, and that the office is trying to amend relevant sections of the law to introduce such a ceiling. However, the rationale for selecting a specific threshold is still unclear, and some thought will have to go into defining the relevant rules.

5.4.2. Transparency policy of PPP contracts

A comprehensive PPP disclosure diagnostic was carried out by the WB and became the basis for the PPP Disclosure Framework. From September 2016 to March 2017, the WB PPP team conducted a study using the PPP Disclosure Diagnostic template recommended by the World Bank Framework for Disclosure of Information in PPPs. During this assessment, the team examined the political, legal, and institutional environment for disclosures in PPPs, and based on a gap assessment, made specific recommendations to improve related disclosure practices. The PPP Disclosure Diagnostic became the basis for the PPP disclosure framework and, in fact, the diagnostic report itself is published under the title "PPP Disclosure Framework" on the PPP Directorate website (https://www.pppunit.go.ke/resources/). However, there were no formal PPP disclosure guidelines or legislative initiatives adopted to formalize these recommendations and give them the status of law.

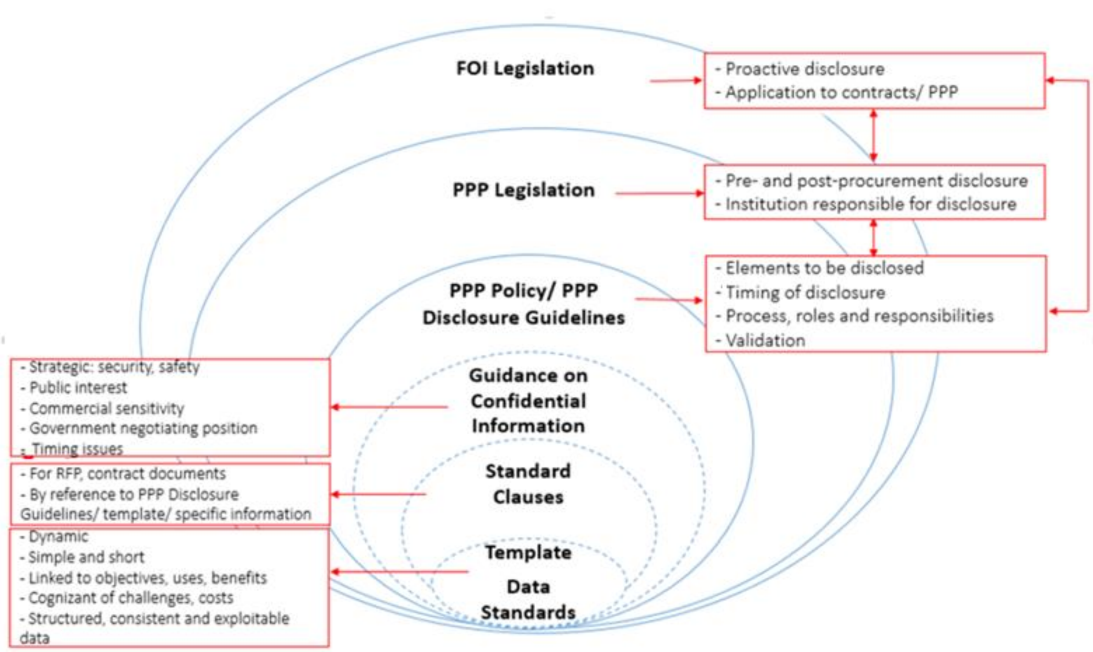
The PPP Disclosure Diagnostic concluded that specific guidance, templates, and technological and budgetary resources were lacking to ensure effective PPP disclosure. The main findings of the PPP Disclosure Diagnostic were that Kenya has basic political economy factors—such as clear support from the highest levels of government and sufficient agreement on the need for PPP disclosure among internal and external stakeholders—as well as high-level regulatory factors—including a high-level definition of confidential information and a proactive disclosure by governments and agencies—in place. However, it lacked more nuanced components, such as clear guidance on PPP disclosure-related processes, roles and timelines; availability of data sources and models; disclosure templates and standard contractual provisions; and budget and technological resources to establish an effective disclosure

[121] IPSAS (International Public Sector Accounting Standards). IPSAS 19—Provisions, Contingent Liabilities and Contingent Assets. https://www.ifac.org/system/files/publications/files/ipsas-19-provisions-c.pdf.

process for PPP-related information. Based on the identified gaps, the PPP Disclosure Diagnostic recommended adopting a six-layer design for a disclosure framework (see Figure 6.9 below), incorporating the following key items:

- Mandate to disclose, through freedom of information (FOI), PPP or other legislation/policy
- More detailed guidance on what, when, and how to disclose
- Elements of disclosure in different phases with a simple template
- Timelines for disclosure
- Guidance on confidential information
- Standard contractual clauses.

Figure 6.12: Elements of the World Bank's Recommended PPP Disclosure Framework



Source: PPP Disclosure Diagnostic 2018.
FOI = Freedom of Information
RFP = Request for Proposals

According to the diagnostic, the following legal requirements for PPP-related disclosures exist, based on a regulatory framework founded on the structure described in the PPP Act 2013 and related regulations[122] (see Table 6.5):

[122] Higher-level disclosure-related provisions contained in the Constitution of Kenya, Access to Information Act 2016 and Public Audit Act 2015 were omitted from this summary. They are non-PPP specific and can be accessed in the PPP Disclosure Diagnostic Report.

Table 6.5: Implications of Key Legislation for PPP Disclosures

Clause	Description	Implications for PPP Disclosures
PPP Act 2013 and PPP Regulations 2014		
Sections 24 and 25	Obliges PPP Unit to publish a National Priority List of projects approved by the PPP Committee and the Cabinet.	Enables early proactive disclosure of project information.
Section 45(3)	Provides restrictions on disclosure of information related to competitive dialogue.	Provides clarity on elements to be considered confidential.
Section 60	Obliges contracting authorities (CAs) to publish the following information upon signing a project agreement: • Results of the tender • Nature of the project • Successful bidder • Project cost at net present value • Tariff • Duration of the project.	Establishes specific elements and timing of disclosure of information by CAs following signing of the contract.
Section 69	Obliges SPV/project company/private party in a PPP to maintain and submit financial accounts to CAs.	CAs, as public entities and holders of such financial reports, may disclose this information in accordance with Access to Information law.
Regulation 33(3)	Obliges CAs to publish names of short-listed bidders.	Establishes the list of short-listed bidders as a key element of disclosure during the bid process.
Regulation 36(1)	Obliges CAs to publish a notice of invitation to tender.	Enables public disclosure of high-level particulars of projects under procurement.
Regulation 37	Obliges CAs to hold a pre-bid conference for clarifying issues in relation to tender. Pre-bid conference is open to all potential bidders.	Enables disclosure of information relevant to a specific tender.
Regulation 40(5)	Obliges Evaluation Committee to preserve confidentiality of the tender evaluation process.	Provides clarity on the elements that are subject to confidentiality.
Regulation 55	Obliges PPP Unit to publish model bid documents for PPP projects, guidelines for model bid documents, and model PPP project agreements on its website.	Establishes proactive disclosure of standard documents as approved by the PPP Committee.
Section 14(2)(j) Regulation 6(2)	Mandates PPP Unit to maintain a record of all project documentation. Obliges PPP Unit to maintain the following information: studies, reports, minutes of meetings, decisions, recommendations, announcements, requests, expressions of interest, letters, bidding documents, complaints, and petitions.	Establishes the role of the PPP Unit as the repository of all PPP-related information.
Public Finance Management Act 2012		
Section 33	Obliges the Cabinet Secretary to the Treasury to submit an Annual Debt Report and Debt Management Strategy to Parliament, including a statement on FCCL.	This includes PPP FCCL, currently implemented through the annual Budget Policy Statement.
Sections 37(8) and 38(1)(b)	Obliges the Cabinet Secretary to the Treasury to publicize budget estimates.	This would include disclosure of information on government budgetary support to PPPs.
FCCL Guidelines 2015		
Section 12(i)-12(iv)	Obligates the Public Debt Management Office to publish all information on PPP FCCL in the Debt Management Strategy and Annual Debt Report. Mandates PPP Unit to publish statements of FCCL on its website.	Mandates disclosure of information on all liabilities arising from PPPs.

Source: PPP Disclosure Diagnostic 2018.

FCCL-specific disclosure requirements are provided in the FCCL Framework, Public Finance Management Act 2012 and FCCL Guidelines 2015. Specifically, FCCL Guidelines 2015 require all CAs to prepare and submit quarterly (and consolidated annual) FCCL reports to the PDMO. In turn, the PDMO is required to publish this information in its Debt Management Strategy and Annual Debt Report submitted to the Parliament. The FCCL Guidelines also require the PPP Directorate to publish this information on its website. The following specific information is required to be disclosed:

- The number and term of fiscal commitments
- Contingent liabilities classified by category/sector
- Explanation of reasons for taking on contingent liabilities
- Full exposure—aggregate value of the face value of all issued guarantees
- Estimated fiscal cost at net present value of the total estimated payments and/or annual cash flows
- Risk(s) associated with contingent liabilities by sector
- Summary information on individual guarantees—purpose/reason, term, and beneficiary
- Summary information on events of realized risk and associated payments
- Information on how claims against the guarantees will be/have been paid.

The FCCL Framework proposes the following reporting template to disclose and present direct and contingent liabilities by project (see Table 6.6).

Table 6.6: Reporting Template of Fiscal Commitments by Project

PPP Project	Direct Liabilities	Annual Payments Value for 3-year Budget			Present Value of All Payments
		$Year_0$	$Year_1$	$Year_2$	$Year_0$
Project 1	Annuity payment. Indexed quarterly by inflation.				
Project 2	Annuity payment. Indexed quarterly by inflation.				
PPP Project	**Contingent Liabilities**	**Estimated Annual Payments Value for 3-year Budget**			**Present Value of Maximum Exposure**
		$Year_0$	$Year_1$	$Year_2$	
Project 1	Revenue Guarantee.				
	Termination payment in case of CA default.				
Project 2	Termination payment in case of CA default.				

Source: FCCL Management Framework 2018.

Disclosure practices are somewhat lagging the recommended setup. Despite the extensive disclosure suggestions and recommendations contained in the PPP Disclosure Diagnostic, the FCCL Framework and Guidelines, actual disclosures, including of FCCL-related information, are curtailed. For instance, as of August 2021, the PPP Unit website (https://www.pppunit.go.ke/) did not contain the national priority list of PPP projects, although this list was previously published there; the PPP pipeline report is reported as being in the preparation stage, although the promised publication date on the website is stated as the "end of June 2021" (the latest available pipeline status report is as of January 2020[123]). A brief description of PPP projects implemented before the adoption of the PPP Act 2013 is available (https://www.pppunit.go.ke/project-before-ppp-act-2013/). Additionally, the PPP portal (http://portal.pppunit.go.ke/), launched with the support of the WB IFPPP project, is designed to provide more extensive project information, including by stage (pre-, post- and procurement), sector (with a filter for USPs), and county; brief project information and reasons for considering project implementation in the case of USPs are included as well. However, depending on the date of the data extraction, information might or might not be available (e.g., as of July 2021, the data were accessible, and in August 2021, all project information disappeared), which highlights ongoing reporting irregularities. Table 6.7 below summarizes PPP disclosure practices according to the PPP Disclosure Diagnostic that existed as of the date of analysis (2017). For FCCL-related disclosures, the actual reporting is also quite limited. Thus, the 2021 Medium-Term Debt Management Strategy[124] only briefly states the proposed actions in relation to FCCL related to PPPs, without providing any actual information on the current status of these liabilities.[125] The Annual Public Debt Management Report for FY 2019-2020[126] has a more elaborate section devoted to FCCL exposure in relation to PPP projects (see Section 5.5), but only covers indemnity agreements with MDBs that issued PRGs for PPP projects, and government-issued letters of support, omitting analysis of factors such as contingent exposures stemming from PPAs with IPP projects. The section only contains the list of all indemnity agreements and letters of support with their main terms and basic descriptions, but no substantive and valuable analyses, such as the present value of maximum exposure or estimated annual values of payments, or relative measures (e.g., in relation to GDP).

Table 6.7: PPP Disclosure Practices in Kenya

Document / Information	Published on PPP Unit Website	Published on Relevant CA Website
National Priority List (with basic project information)	Yes (also published in other media, such as newspapers)	No
Feasibility study report	No	No
Project information memorandum	Link available to access information from the CA website	Yes, but no organized archive
Request for qualifications	No, but announcement with links to the relevant CA website	Yes, but no organized archive
Evaluation report	No	No
Name of successful bidder	No	Yes
Contract documents	No	No
Performance reports	No	No

Source: PPP Disclosure Diagnostic, 2018

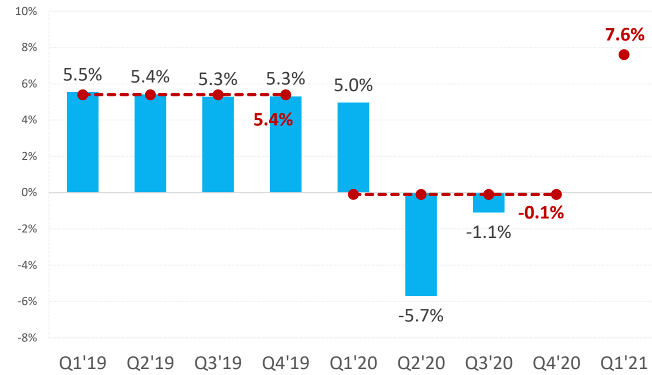
[123] Government of Kenya, PPP (Public Private Partnerships) Unit. 2020. Kenya Public Private Partnerships (PPP) Pipeline Status, January 2020. https://www.pppunit.go.ke/wp-content/uploads/2020/02/Kenya-PPP-Pipeline-Status-Report-January-2020.pdf.
[124] Government of Kenya, National Treasury and Planning. 2021. 2021 Medium Term Debt Management Strategy. https://www.treasury.go.ke/wp-content/uploads/2021/06/2021-Medium-Term-Debt-Manadement-Strategy.pdf.
[125] Ibid., pp. 16, 39, and 41.
[126] Government of Kenya, National Treasury and Planning. 2020. *Public Debt Management Report 2019-2020*. National Treasury and Planning, September 2020. http://ntnt.treasury.go.ke/wp-content/uploads/2021/02/Annual-Public-Debt-Report-2019-2020.pdf.

5.5. Performance under Crisis

5.5.1. Impact of COVID-19 on PPP Program

The COVID-19 pandemic, which hit the country hard, was the main shock that the bulk of the PPP portfolio experienced. As was mentioned in Section 5.1 of this report, although Kenya had some experience with PPPs in the late 1990s, the bulk of the existing PPP portfolio was transacted starting in 2006, with 81 percent of that taking place between 2011 and 2021. Therefore, despite some PPP exposure during the Asian crisis of 1997-1998 and the global financial crisis of 2008, the Kenyan PPP system experienced the most notable stress-test during the COVID-19 pandemic. Like many other countries, Kenya was hit hard by the COVID-19 shock. Disruptions in global trade and travel, along with containment measures put in place to limit the spread of the virus, meant that economic activity contracted sharply in Q2 2020[127] (-5.7 percent year-on-year (YoY)), coinciding with the April-June lockdown. Contraction in Q3 2020 was less acute (-1.1 percent YoY), supported by stronger performance in the construction, agriculture, forestry and fishing sectors.[128] According to IMF data, the real GDP growth rate in 2020 was negative 0.1 percent; 7.6 percent real GDP growth rate is expected in 2021.[129] Forceful early actions to support the economy included immediate temporary cuts in personal and corporate income taxes, a temporary reduction in the VAT tax from 16 percent to 14 percent, and revisions to the budget to accommodate additional spending on health and social protection.[130] Cumulatively, the resulting contraction in government income and increased spending, including COVID-19 stimulus programs, pushed the Kenyan debt-to-GDP ratio from an average of 62.1 percent in 2019 to an estimated 68.7 percent in 2020, and is forecasted to reach 71.5 percent in 2021.[131] The Kenyan shilling remains under pressure against the U.S. dollar, deteriorating by 1.8 percent, from an average of K Sh 106.0 per US$ as of May 8, 2020 to K Sh 107.9 as of June 30, 2021. Foreign direct investment (FDI) inflows in Kenya declined by 36.4 percent, to reach US$0.7 billion in 2020 from US$1.1 billion in 2019.

Figure 6.13: Quarterly and Annual GDP Real Growth Rate, YoY, seasonally adjusted, 2020-2021(forecasted)



Sources: CEIC Data, Kenya National Bureau of Statistics, IMF.

The public infrastructure sub-sector propped up the whole construction sector in 2020. In the construction sector, the public infrastructure sub-sector strived to maintain growth momentum in 2020, supported by public spending, unlike residential and commercial construction, which were the worst affected. Key impediments witnessed in 2020 included supply bottlenecks, reduction in labor, and constraints on financing. In 2021, the Kenyan government remained committed to driving large-scale infrastructure projects aimed at boosting regional integration and economic diversification. However, efforts to rein in expenditures, as well as growing scrutiny of the financial sustainability of Chinese-funded infrastructure projects, may weigh on the construction industry's medium-term

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[127] IMF (International Monetary Fund). 2021. "IMF Loan to Support Economic Recovery in Kenya." IMF Country Focus, IMF, March 18, 2021. https://www.imf.org/en/News/Articles/2021/03/17/na031721-imf-loan-to-support-economic-recovery-in-kenya.

[128] Obulutsa, George. "Kenya's economy shrinks in Q3 2020 as COVID hits tourism." Reuters, January 28, 2021. https://www.reuters.com/article/uk-kenya-economy/kenyas-economy-shrinks-in-q3-2020-as-covid-hits-tourism-idUSKBN29X0PL.

[129] IMF (International Monetary Fund). IMF Country Data. https://www.imf.org/en/Countries/KEN.

[130] IMF (International Monetary Fund). 2021."IMF Loan to Support Economic Recovery in Kenya." IMF Country Focus, IMF, March 18, 2021. https://www.imf.org/en/News/Articles/2021/03/17/na031721-imf-loan-to-support-economic-recovery-in-kenya.

[131] Makumi, Gladys, Kevin Kimotho, and Tewodros Sisay. 2021. *Economic impact of the COVID-19 pandemic on East African economies, Volume 2, Navigating new realities*. Deloitte. p12. https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/finance/Economic%20Impact%20of%20the%20Covid-19%20Pandemic%20on%20East%20African%20Economies-Volume%202.pdf.

recovery. The need for fiscal consolidation, given high levels of debt, is also expected to constrain public infrastructure investments in the medium-term and slow down the industry's growth.[132] In this context, the high degree of attention given to PPPs in government planning documents is understandable.

5.5.2. Measures implemented to help cope with the consequences of the COVID-19 crisis

The IMF provided two loans in 2020 and 2021 to weather the initial COVID-19 shock and strengthen the mid-term fiscal situation. During two pandemic years (2020 and 2021), the IMF released funds to Kenya twice. The first time was in May 2020, when the IMF Executive Board approved a US$739 million interest-free loan to be drawn under a Rapid Credit Facility (RCF) to support the authorities' response to the COVID-19 pandemic.[133] This first RCF was aimed at helping the government meet urgent balance-of-payments needs stemming from the outbreak of the pandemic, allowing it to maintain an adequate level of international reserves and providing the budget financing needed to respond to the crisis. In April 2021, the IMF Executive Board approved another 38-month arrangement under an Extended Credit Facility (ECF) and Extended Fund Facility (EFF), in the amount of US$2.34 billion, to support the next phase of the GoK's COVID-19 response and to address the urgent need to reduce debt vulnerabilities. The COVID-19 shock exacerbated the country's pre-existing fiscal weaknesses and, although Kenyan debt remains sustainable, it is at high risk of debt distress; fiscal and balance-of-payments financing needs remain sizable over the medium term. The IMF-supported program would also advance the broader reform and governance agenda, including by addressing weaknesses in some state-owned enterprises (SOEs) and by strengthening transparency and accountability through an anti-corruption framework. Additionally, the World Bank is preparing a Development Policy Funding project called "Accelerating Reforms for an Inclusive and Resilient Recovery DPF2" (P176903) to support Kenya's recovery from the COVID-19 crisis and steer a course towards green, resilient and inclusive development. This DPF operation contains four pillars, focusing on the fiscal sector and natural and human capital reforms, among others. However, the most relevant pillar for PPPs and the FCCL topic is Pillar II, devoted to the electricity sector and PPP reforms to strengthen the cornerstone utility (KPLC), place Kenya on an efficient, green energy path, and boost private infrastructure investment. One of the indicative triggers for one of the prior actions under Pillar II includes a decision on the signed PPAs that have not reached financial close or commenced construction, with a view of competitive procurement of renewable energy and reduction in the cost of supply (the work of the Presidential Taskforce on PPAs feeds into satisfying this trigger). Another prior action requires revision of the PPP Act to simplify approvals and processes and clarify roles and responsibilities of the key participants in the PPP cycle for efficient and timely delivery of PPPs. This prior action is covered by the approval of the PPP Act 2021.

PPPs received renewed attention in the post-COVID-19 recovery effort. As part of driving economic recovery and enhancing sustainable development, the GoK has re-prioritized its PPP pipeline. The key priority sectors now include ports, roads, power transmission, and urban development resilience, as well as transport, health, housing, affordable real estate, water and sanitation, and the blue economy. According to the draft 2022 Budget Policy Statement,[134] PPPs aim to unlock at least K Sh 350 billion (about US$3.1 billion) in 2022 in new development capital

[132] Makumi, Gladys, Kevin Kimotho, and Tewodros Sisay. 2021. *Economic impact of the COVID-19 pandemic on East African economies, Volume 2, Navigating new realities*. Deloitte. p. 16. *Source*: https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/finance/Economic%20Impact%20of%20the%20Covid-19%20Pandemic%20on%20East%20African%20Economies-Volume%202.pdf.

[133] IMF (International Monetary Fund). 2020. "IMF Executive Board Approves a US$739 Million Disbursement to Kenya to Address the Impact of the COVID-19 Pandemic." IMF, May 6, 2020. https://www.imf.org/en/News/Articles/2020/05/06/pr20208-kenya-imf-executive-board-approves-us-million-disbursement-address-impact-covid-19-pandemic.

[134] Government of Kenya, National Treasury and Planning. Medium Term Draft 2022 Budget Policy Statement – Accelerating Economic Recovery for Improved Livelihood. National Treasury and Planning, November 11, 2021. https://www.treasury.go.ke/wp-content/uploads/2021/11/Draft-2022-Budget-Policy-Statement_F.pdf.

for priority projects in these sectors. Climate proofing of the PPP portfolio is also targeted to be at the center of PPP project design.

The impact on the fiscus of the only active road project was relatively well managed. According to the September 2020[135] presentation by the Public Debt Management Office, the likely COVID-19 impact on PPP projects at the time was expected to include the following:

- Diminished revenue collection
- Potentially large payouts
- Possibility of bailouts of state-owned companies (SOCs) and SOEs
- Sub-optimal reallocation of resources and reduced accountability
- Institutional weakening post COVID-19.

According to the PDMO representatives, the only active non-energy project in the portfolio is RAP LOT 33, which reached financial close in February 2018, and whose operation commenced on November 1, 2020 (see Annex 5 C). During the early stages of the COVID-19 pandemic, the RAP LOT 33 project suffered operational limitations due to movement restrictions, geographic lockdowns and curfews, which altogether curtailed the project operations. As such, the project issued pandemic-linked force majeure notices, suffered construction downtime, and experienced conflicts between the project company and the contracting authority, with mediation efforts in dispute resolution being provided by the PPP Directorate. Overall, this resulted in an eight-month delay for the construction completion. The corresponding financial costs to the GoK were accommodated by the Road Annuity Fund (see explanation below). Thus, the impact on the fiscus was relatively well-managed. As a background, any RAP project is an annuity project, however, government payments under the RAP program are backed by collections of a fuel levy, which is charged to the user each time a car is fuelled up. These moneys are kept in a separate escrow account (analogous to a fund). Furthermore, the PDMO has recently analyzed the current and expected future conditions of this fund in order to see how many projects it could service, and learned that this account is quite liquid, with a layer of safety on top. Thus, because there was only one active project in the PPP portfolio that was serviced out of this fund, the GoK did not see any threats to the government fiscus in relation to this project during the COVID-19 crisis. However, this situation was more characteristic of the period from 2017 to 2020. In 2021, the government withdrew about K Sh 47 billion (approximately US$413 million) from the fund to finance the other pressing road sector priorities, greatly downgrading its liquidity position. The motivation for this withdrawal was the long delay in reaching financial close for the RAP projects. In 2022, four more RAP projects are poised to declare financial close, including RAP LOTs 13, 15, 18 and 32. As such, the fund no longer has sufficient headroom, following the declaration of surpluses and withdrawals in 2021. The current net-deficit projections, assuming that the addition of four new projects goes as expected, are estimated to be about K Sh 33 billion (about US$290 million), a sum that is to be allocated from the budget to restore the fund's liquidity.

The KPLC saw some struggles with payments under the PPAs. For IPP projects, the PDMO expressed an opinion that the KPLC—the main off-taker under the PPAs— has been experiencing a continued deterioration of its financial situation since 2017, reporting a pre-tax loss of K Sh 7.04 billion (about US$64.44 million) in the 2020 fiscal year. There were also reports of some missed payments to IPPs under the PPAs; according to some reports, the KPLC owes K Sh 20.5 billion (about US$181 million) to IPPs, even though it is not immediately clear how much of the

[135] Wafula, Ulwodi. 2020. "Managing Contingent Liabilities and PPPs in the Context of the COVID 19 Pandemic: the Case Study of Kenya." Public Debt Management, National Treasury and Planning, September 22-23, 2020, slide 9. https://www.cabri-sbo.org/uploads/files/Documents/Presentation-Dr-Ulwodi-Wafula.pdf.

amount is in default.[136] According to the KPLC Annual Report for 2020,[137] the following factors contributed to the KPLC's dire financial situation in FY 2020, leading to the opinion that there exists a material uncertainty, which may cast significant doubt on the company's ability to continue as a going concern and make it unable to realize its assets and discharge its liabilities in the normal course of business:

- The COVID-19 pandemic resulted in the closing down or scaling down of key electricity consumers, thereby largely contributing to only a marginal increase in sales of K Sh 117 million (about US$1 million) against a growth plan of K Sh 33 billion (about US$291 million).
- Debt collection from electricity customers was a challenge, because customers were unable to meet their bill payment obligations in time due to the effects of COVID-19, resulting in an increase in receivables of K Sh 3.9 billion (about US$34 million). This led to a further strain on the company's liquidity position.
- High system losses of 23.46 percent, occasioned by rapid growth in the distribution network without a commensurate growth in electricity demand, resulted in underutilized grid assets, leading to increased technical losses.
- The take-or-pay pricing model for PPAs with IPPs resulted in fixed capacity charges that are unfavorable in the absence of demand growth and during periods of declining demand, such as during the COVID-19 pandemic.
- Delays occurred in restructuring the retail tariff to reflect electricity purchases, transmission and distribution costs.
- Aggressive connectivity and grid reinforcement programs were necessitated by the government's target of achieving universal access by 2022. This resulted in utilization of internal funds and medium-term commercial debts to fund these long-term projects, without corresponding revenue inflows.

Because neither the PDMO nor the PPP Unit (Directorate) oversee the IPP program, the team was unable to obtain more details about the impact of COVID-19 on IPPs.

To summarize, COVID-19's impact on the Kenyan PPP program is quite peculiar and, in some ways, opposite to what is observed in other economies. The government's fiscal implications for the only road project were considered manageable, whereas IPP projects were hit by the deteriorating condition of the main state-owned off-taker, which was hurt in part by the COVID-19 crisis. At present, fiscal risks emanating from SOEs seem to be more prominent than those emanating from PPPs, where major exposure is under the PPAs. However, such a situation is due to the still rather low number of non-energy projects having reached financial close. At the same time, more and more projects from the RAP program will reach financial close soon, and these involve annuity payments by the GoK. Additionally, the Nairobi-Nakuru-Mau Summit Road project is nearing financial close, and the revenue risk under this project is going to be undertaken by the GoK. Furthermore, with the increased attention to blended finance solutions, including PPPs, for infrastructure service delivery in the post-COVID-19 recovery effort, more PPP projects can be expected in the future. While the main participants in the PPP system assess the framework to be adequate, in principle, to handle the expected inflow of projects, the absence of a ceiling or cap for the related fiscal obligations is feared to sidetrack attention from the issue of risk accumulation, which might backfire should another crisis strike.

[136] Ngugi, Brian, "Kenya Power to settle Sh23bn KenGen debt." *Business Daily Africa*, April 27, 2021. https://www.businessdailyafrica.com/bd/economy/kenya-power-to-settle-sh23bn-kengen-debt-3377920.

[137] KPLC (Kenya Power and Lighting Company). 2020. Kenya Power Annual Report and Financial Statements for the year ended June 30, 2020. p. 71. https://kplc.co.ke/img/full/KPLC-Book-website.pdf.

Annex 5 A: Kenya FCCL Principles

#	Principles	Clarification	Assessment for Kenya
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities	A formal FCCL framework with detailed guidelines is in place and practiced.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by the government, and identify potential mitigation measures	Specialized Excel-based tools allowing stochastic analysis, analysis of potential termination payments, risk register and others were developed as part of FCCL Framework.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close, and for any contract variations.	In the 2021 version of the PPP Law, the PPP Directorate and PPP Committee make the main decisions related to fiscal risks of projects; the Cabinet Secretary for the National Treasury and Planning approves the limit for contingent liabilities that the PPP Committee may assign to a project.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	There is a formal declaration of VfM principle that PPPs should demonstrate, albeit without any specific guidance.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	Currently, no cap or ceiling exists, although efforts are made to introduce it.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Under the pre-2021 framework, once a feasibility study obtains the National Treasury and Planning' concurrence, it is included in the project pipeline, from which projects can be submitted for funding and budget allocation, if all conditions are met.

#	Principles	Clarification	Assessment for Kenya
7	Mechanisms are in place to ensure funding is available for contingent liabilities	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to fund contingent liabilities should they materialize.	Project Facilitation Fund envisages reservations for contingent liabilities that can materialize during PPP project operations, although the fund was not operational until recently due to lack of funding. Additionally, toll road regulations foresee automatic budget payments in case the collected tolls are insufficient.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	National and county government entities report on a cash-basis IPSAS, and the country is undergoing a phased transition to accrual-basis IPSAS. Disclosure of potential contingent liabilities is required.
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money are appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	A list of all letters of support provided, and indemnity agreements concluded, in relation to PPP projects is available. However, a holistic portfolio-level analysis of fiscal risks of the whole PPP portfolio, including IPPs, is not available and not published due to some data gaps.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value-for-money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	Not specific to PPPs, but the Office of the Auditor General (OAG) is conducting audits of all public-funded entities at both national and county levels, including regulatory/financial audits, whose aim is to determine whether an entity's financial information is presented in accordance with regulatory and reporting frameworks.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPa should be applied to all levels of government.	The FCCL Management Framework applies to National Treasury and Planning, including PDMO; PPP Committee; Directorate of Budget, Fiscal and Economic Affairs; and Directorate of Accounting Services, as well as Contracting Authorities at both the national and sub-national levels.

Annex 5 B: Summary of the Presidential Taskforce's Proposed Approach to Renegotiation of PPAs for Various Types of Projects

Status of IPP Project	Taskforce Recommendation
1. In operation	• For those heavy fuel oil (HFO) thermal plants which the taskforce considers to be in material breach of the terms of their PPAs, the taskforce has recommended that the KPLC renegotiate or terminate the PPAs within four (4) months. • For the wind IPPs, the taskforce has recommended that the KPLC renegotiate the tariffs downwards using the state-owned power generator KenGen's pricing as a benchmark for the IPP tariff re-negotiation. • For geothermal IPPs, the taskforce has recommended that the KPLC renegotiate the tariff downwards to the KenGen pricing benchmark, including through a refinancing of the capital structure (interest coupon and tenor), taking advantage of the maturity of the plants.
2. Signed and effective PPAs, plant under construction	• The KPLC to re-negotiate PPA tariffs for plants whose tariffs were approved under the Feed in Tariff (FiT) Policy 2012 or earlier FiT policies, with an aim to reduce the tariffs under such PPAs to reflect certain tariff reductions (below the 2012 FiT tariff) that were achieved by the KPLC in negotiation with other IPPs following guidance from the Energy Regulatory Commission (now the Energy and Petroleum Regulatory Authority) and the Ministry of Energy.
3. Signed and effective PPAs, but construction of the plant has not started	• Subject to the demand forecast, the KPLC to negotiate a 12-to-24-month delay of commercial operation dates.
4. Signed PPAs, but not effective (that is, conditions precedent not yet fulfilled)	• Subject to the demand forecast, the KPLC to negotiate a 12-to-24-month delay of commercial operation dates.
5. Signed and effective PPAs, construction complete, but PPA has lapsed or there is a default by the IPP	KPLC to either: • Negotiate new commercial operation dates, if the capacity is required by the KPLC based on its demand forecast, or • Terminate the PPAs if the capacity is not required by the KPLC.
6. Unsigned PPAs	• KPLC to refer unsigned PPAs to the proposed new Feed-in-Tariff (2021) and reverse auction power procurement.

Annex 5 C: Government Support Measures (GSM) and Termination Terms for PPP Projects with Effective Project Agreements or PPAs

Project Name	Project Description	Term (Years)	Project Value (US$, millions)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Road Sector							
LOT 33 of the Road Annuity Programme	Construction and rehabilitation to bitumen standards of the roads in Lot 33 (90.55 km) (Ngong–Kiserian–Isinya and Kajiado–Imaroro) under a finance, design, build, maintain and transfer PPP arrangement	10	98.8	Date of contract execution: November 16, 2016 Financial Close: February 2018 Status: Construction was completed; operations commenced on November 1, 2020	Letter of support covering political risks issued on August 4, 2017	• Debt due • NPV • Sub-contractor costs	No
Nairobi Expressway	Construction of the Mlolongo–JKIA–South C Uhuru Highway–Westlands–James Gichuru (27 km) section of A8 road, a dual carriageway with Class A standard under a design, construct, finance, operate, maintain and transfer PPP arrangement	30	667.8	Date of contract execution: October 15, 2019 Financial Close: Pending Status: Early works are ongoing	Letter of support covering political risks issued on August 20, 2020	• Debt due • NPV • Contract breakage costs	No
LOT 15 of the Road Annuity Programme	Construction and rehabilitation to bitumen standards of identified roads in Nyeri, Kirinyaga, Murang'a, Tharaka Nithi, Embu and Laikipia (45 km) under a finance, design, build, maintain and transfer PPP arrangement	10	73.065	Date of contract execution: April 23, 2021 Financial Close: Pending Status: Fulfilling conditions precedent to financial close	Letter of support covering political risks issued on April 23, 2021	• Debt due • Equity • NPV • Sub-contractor costs • Statutory redundancy payments	No

Project Name	Project Description	Term (Years)	Project Value (US$, millions)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Road Sector							
LOT 18 of the Road Annuity Programme	Construction and rehabilitation to bitumen standards of identified roads in Busia, Kakamega, Vihiga and Bungoma (35 km) under a finance, design, build, maintain and transfer PPP arrangement	10	59.176	*Date of contract execution*: April 23, 2021 *Financial Close*: Pending *Status*: Fulfilling conditions precedent to financial close	Letter of support covering political risks issued on April 23, 2021	• Debt Due • Equity • NPV • Sub-contractor costs • Statutory redundancy payments of the project company	No
LOT 3 of the Road Annuity Programme	Construction and rehabilitation to bitumen standards of the Wajir–Samatar (68 km) and Rhamu–Mandera (75 km) roads under a finance, design, build, maintain and transfer PPP arrangement	10	188.88	*Date of contract execution*: July 9, 2021 *Financial Close*: Pending *Status*: Fulfilling conditions precedent to financial close	Letter of support covering political risks issued on July 12, 2021	• Debt due • Equity • NPV • Sub-contractor costs • Statutory redundancy payments for employees of the project company	No
LOT 32 of the Road Annuity Programme	Construction and rehabilitation to bitumen standards of the Illasit–Njukini–Taveta road (66.5 km) under a finance, design, build, maintain and transfer PPP arrangement	10	79.03	*Date of contract execution*: May 22, 2019 and amended on July 9, 2021 *Financial Close*: Pending *Status*: Fulfilling conditions precedent to financial close	Letter of support covering political risks issued on July 12, 2021	• Debt due • Equity • NPV • Sub-contractor costs • Statutory redundancy payments for employees of the project company	No

Project Name	Project Description	Term (Years)	Project Value (US$, millions)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Independent Power Producers (IPPs)							
Africa Geothermal International (140 MW)	25-year power purchase agreement on a build, own, operate (BOO) basis at Longonot geothermal power project adjacent to Olkaria, Kenya	25	760	*Date of contract execution*: April 3, 2013 *Date of PPA Effectiveness*: October 2, 2015 *Financial Close*: Pending	Letter of support covering political risks issued on January 29, 2015	• Total project cost depreciated at 5% per annum • Expenses incurred by the seller as a result of termination • NPV of 5 years' profits at 10%	No
Lake Turkana Wind Power (300 MW)	The wind turbine farm is being developed on a BOO basis in Loyangalani, Marsabit West, on a 20-year PPA with Kenya Power	20	847	*Date of contract execution:* May 13, 2013 *Financial Close*: March 24, 2014 *Status*: Operational	Letter of support covering political risks issued on February 28, 2013 Indemnity agreement LC to be replaced with escrow account		No
Gulf Power (80.32 MW)	The heavy fuel oil (HFO) power plant is being developed on a BOO basis, in the Athi River region, on a 20-year PPA with KPLC	20	108	*Date of contract execution:* December 17, 2012 *Financial Close*: November 18, 2013 *Status*: Operational	Letter of support covering political risks issued on July 2, 2012 Indemnity agreement covering PRG payments was signed on March 14, 2013 (PRG amounts: US$35 million and €7 million)		No

Project Name	Project Description	Term (Years)	Project Value (US$, millions)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Independent Power Producers (IPPs)							
Triumph Power (83 MW)	The HFO power plant is being developed on a BOO basis, at Kitengela near the Athi River area of Mavoko, on a 20- year PPA with KPLC	20	156.5	*Date of contract execution:* June 14, 2012 *Financial Close*: August 7, 2013 *Status*: Operational	Letter of support covering political risks issued on July 2, 2012 Indemnity agreement covering PRG payments was signed on December 5, 2012 (PRG amount: US$45 million)	• Total project cost depreciated at 5% per annum • Expenses incurred by the seller as a result of termination • NPV of 5 years' worth of profits at 10%	No
Thika Power (87 MW)	The HFO power plant is being developed on a BOO basis, located near Thika town in Kiambu County, on a 20- year PPA with KPLC	20	146	*Date of contract execution:* July 2, 2012 *Financial Close*: October 11, 2012 *Status:* Operational from August 2013	Letter of support covering political risks issued on July 2, 2012 Indemnity agreement covering PRG payments was signed on August 28, 2014 (PRG amounts: US$35 million and €7.7 million)		No
Orpower (150 MW) Olkaria III Geothermal power plant** (Expanded first plant 63.8 MW, second Plant 39.6 MW, third plant 17.6 MW, and fourth Plant 29 MW)	A geothermal plant is being developed on a BOO basis over a 20-year period, in Naivasha in Nakuru County	20	558	*Date of contract execution*: November 26, 2014 *Financial Close*: January 1999 *Status*: Operational	Letter of support covering political risks issued on April 16, 2015 Indemnity agreement LC covering PRG payments of US$31 million	• Total project cost depreciated at 5% per annum • Expenses incurred by the seller as a result of termination • Losses incurred by the seller	No

Project Name	Project Description	Term (Years)	Project Value (US$, millions)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Independent Power Producers (IPPs)							
Rabai Power Plant (90 MW)	This thermal power (diesel) plant is on a BOOT basis and is located at Rabai in Kilifi County	20	155	Date of contract execution: September 4, 2008 Financial Close: October 2008 Status: Operational	Indemnity agreement LC account	• N3M of non-escalabe capacity charges for the remaining period until the expiry of the term discounted at 12% per annum	No
Kipevu II (74 MW)	Located in Mombasa next to Kilindini seaport, the HFO power plant is on a BOO basis over a 20-year period	20	85	Date of contract execution: January 28, 2000 Financial Close: September 1999 Status: Operational	Indemnity agreement	• NPV of non-escalabe capacity charges for the remaining period until the expiry of the term discounted at 10% per annum • Expenses incurred by the seller as a result of termination • The value of the stock of fuel and other consumables and spare parts at the plant	No
Lamu Power Project (1050 MW)	Located in Manda Bay, the Lamu coal power plant is on a BOO basis over a 20- year period	25	2,000	Date of contract execution: August 4, 2017 Status: PPA not yet effective	Letter of support covering political risks issued on August 4, 2017	• Total amount outstanding and unpaid to all financing parties (debt and equity) • NPV of 5 years' worth of profits at 10% discount rate • Redundancy payments/ termination and breakage costs • Value of unpaid construction works as at termination	No

<table>
<tr><th>Project Name</th><th>Project Description</th><th>Term (Years)</th><th>Project Value (USD million)</th><th>Status</th><th>Type / Value of GSM</th><th>Amount of Termination Payment (Default by GoK)</th><th>Call on GSM (Y/N)</th></tr>
<tr><td colspan="8">Independent Power Producers (IPPs)</td></tr>
<tr><td>100 MW Kipeto Wind Power</td><td>Feed in Tariff, Wind Power Plant on a BOO basis PPA period – 20 years Location - Kajiado County.</td><td>20</td><td>323</td><td><u>Date of contract execution</u>: 17 June 2016

<u>Status</u>: Plant commissioning underway</td><td>Letter of support covering political risks issued on 4 August 2017</td><td rowspan="3">• Total amount outstanding and unpaid to all Financing Parties – Debt & Equity.
• NPV of 5 years' profits at 10% discount rate.
• Redundancy payments/ Termination & Breakage costs.
• Value of unpaid construction works as at termination.</td><td>No</td></tr>
<tr><td>35MW Geothermal Quantum Power Project</td><td>25-year Power Purchase Agreement to finance, design, construct, install, operate and operate a 35 MW geothermal power plant on a Build, Own, Operate (BOO) basis at Menengai.</td><td>25</td><td>90</td><td><u>Date of contract execution</u>: 30 October 2014

<u>Status</u>: Financial Close pending</td><td>Letter of support covering political risks issued on 4 August 2017</td><td>No</td></tr>
<tr><td>35 MW Sosian Menengai Geothermal Power Project</td><td>25-year Power Purchase Agreement to finance, design, construct, install, operate and operate a 35 MW geothermal power plant on a Build, Own, Operate (BOO) basis at Menengai.</td><td>25</td><td>79</td><td><u>Date of contract execution</u>: 30 October 2014

<u>Status</u>: Financial Close pending</td><td>Letter of support covering political risks issued on 19 December 2017</td><td>No</td></tr>
</table>

Project Name	Project Description	Term (Years)	Project Value (USD million)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Independent Power Producers (IPPs)							
40 MW Cedate Solar Power	Feed in Tariff Power Plant on a BOO basis PPA period – 20 years Location – Uasin Gishu County.	20	77	*Date of contract execution*: 5 June 2017 *Status*: Commissioning underway	Letter of support covering political risks issued on 4 August 2017	• Total project costs as derived from the audited Selenkei/Cedate Financial Model depreciated at 5% per annum. • Compensation amount to Cedate/ Selenkei shall be limited in aggregate to an amount equal to NPV calculated at 10% discount rate of the audited profit of Selenkei for the last 5 years for the loss of return on equity.	No
40 MW Selenkei Solar Power	Feed in Tariff Power Plant on a BOO basis PPA period – 20 years Location – Uasin Gishu County.	20	84	*Date of contract execution*: 5 June 2017 *Status*: Commissioning underway	Letter of support covering political risks issued on 4 August 2017		No
40 MW Malindi Solar Power Project	Feed in Tariff Power Plant on a BOO basis PPA period – 20 years Location – Kilifi County	20	82	*Date of contract execution*: 5 June 2017 *Status*: Under construction	Letter of support covering political risks issued	• Total amount outstanding and unpaid to all Financing Parties – Debt & Equity. • NPV of 5 years' profits at 10% discount rate. • Redundancy payments/ Termination & Breakage costs. • Value of unpaid construction works as at termination.	No

Project Name	Project Description	Term (Years)	Project Value (USD million)	Status	Type / Value of GSM	Amount of Termination Payment (Default by GoK)	Call on GSM (Y/N)
Independent Power Producers (IPPs)							
40 MW Alten Solar Power Project	Feed in Tariff Power Plant on BOO basis PPA period – 20 years Location – Uasin Gishu County.	20	105	*<u>Date of contract execution</u>*: 5 June 2017 *<u>Status</u>*: Review of Interconnection Facility designs underway.	Letter of support covering political risks issued on 14 December 2017	• Total project costs as derived from the audited Financial Model depreciated at 5% per annum. • The compensation amount to Alten shall be limited in aggregate to amount equal to NPV calculated at 10% discount rate of the audited profit of Alten for the last complete five (5) Contract Years prior to the date of termination of the PPA.	No
Chania Green 50 MW Wind Power Plant	Feed in Tariff Wind Power Plant on a BOO basis PPA period – 20 years Location – Kajiado County.	20	102	*<u>Date of contract execution</u>*: 24 August 2017 *<u>Status</u>*: Construction ongoing	Letter of support covering political risks issued on 26 January 2018	• Total amount outstanding and unpaid to all Financing Parties – Debt & Equity. • All amounts paid to Seller by way of subscription in Seller capital, less dividends and other distribution made to shareholders of Seller. • Redundancy payments/ Termination & Breakage costs. • Value of unpaid construction works as at termination.	No

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Chapter 6: Pakistan (Province of Sindh)

Chapter 6: Pakistan (Province of Sindh)

Acronyms and Abbreviations

ADB	Asian Development Bank
ADP	Annual Development Plan
AP	availability payment
CL	contingent liabilities
ECT	early contract termination
FCCL	fiscal commitments and contingent liabilities
FD	Finance Department
FIA	Federal Investigating Agency
FMF	fiscal management framework
GDP	gross domestic product
GoS	Government of Sindh
IPP	independent power producer
IPSAS	International Public Sector Accounting Standards
MDB	multilateral development bank
MMM	Multi-Annual Macroeconomic Framework
MRG	minimum revenue guarantee
MTBF	multi-term budgetary framework
NEC	National Economic Council
PAC	Public Accounts Committee
PDF	project development facility
PDFL	Pakistan Development Fund Limited
PIDG	Private Infrastructure Development Group
PPA	power purchase agreement
PPI	private participation in infrastructure
PPP	public-private partnership
PSF	PPP Support Facility
SFMH	Sindh Fund Management House
SMART	specific, measurable, achievable, relevant, time-bound
VfM	value for money

VGF viability gap finance

WB World Bank

Executive Summary

Pakistan has a long history with regard to private sector participation in the delivery and management of public infrastructure, predominantly in the power sector. The first arrangements date back to the 1990s, and the marketplace for power concessions has since evolved into one of the largest in the world. Despite regulatory efforts initiated in 2010 with the National PPP Policy, the country has not yet been able to expand the use of public-private partnerships (PPPs) widely to other sectors and jurisdictions. Given the federal system of the country, the development of PPPs is largely decentralized and is being led by the province of Sindh based on a PPP framework embedded in a PPP Act adopted in 2010 (and further refined in 2011, 2014, and 2018) and operationalized through an effective institutional setup and operating procedures. Although recognized as a fairly developed ecosystem for enabling PPPs, areas for further improvement can be identified, most notably: i) operationalization of the Fiscal Management Framework, ii) prioritization of value for money (VfM) considerations, iii) strengthening of legislative oversight, iv) improvement of guidelines, and v) facilitating of international arbitration.

Sindh established in 2008 a viability gap funding (VGF) fund that acts as the primary mechanism to manage its fiscal commitments from PPPs, both direct liabilities and contingent liabilities. The fund is sourced from budget appropriations from the Government of Sindh (GoS), meaning that the maximum fiscal exposure is approved annually by the legislature. The fund is used for equity contributions for projects that are not financially viable; availability payments and securing any contingent liabilities, most notably minimum revenue guarantees; and the cash deposits required by banks for ensuring availability of funding for compensation upon a possible early contract termination. The fund is scheduled to be replaced by the end of 2021 by the Project Support Facility which will essentially have the same functions though at the arm's length of the government, and which can be considered an effective contribution to the fiscal commitments and contingent liabilities (FCCL) framework.

Although PPPs have been prioritized by the provincial government in order to meet the infrastructure gap, their applicability is constrained by requirements for public support in order to enhance bankability, including low-risk revenue schemes, co-financing, and cash-funded guarantee facilities. With support from development partners, progress is being made in managing the fiscal implications of these support mechanisms in accordance with best practices in terms of their appraisal, approval, and monitoring. Sound public financial management will reduce the risk of PPPs costing the government more than expected or placing an undue burden on future generations—a responsibility that is even more critical for a sub-national authority given the limited scope of the treasury on a provincial level and the dependency on transfers from the federal budget. The pandemic has been endangering the financial sustainability of PPP arrangements, whether directly through reduced demand or indirectly through reduced financial capacity from sponsors. This increases the probability of calling on the federal government for support and thus enhancing the need to prioritize the development of a fiscal framework to ensure such fiscal exposure is identified, warranted, and affordable. On the other hand, the pandemic is also causing a need for PPPs because of related budget cuts, though the challenge will be to maximize the leverage of the reduced fiscal space.

6.1. PPP Experience in Pakistan and Sindh

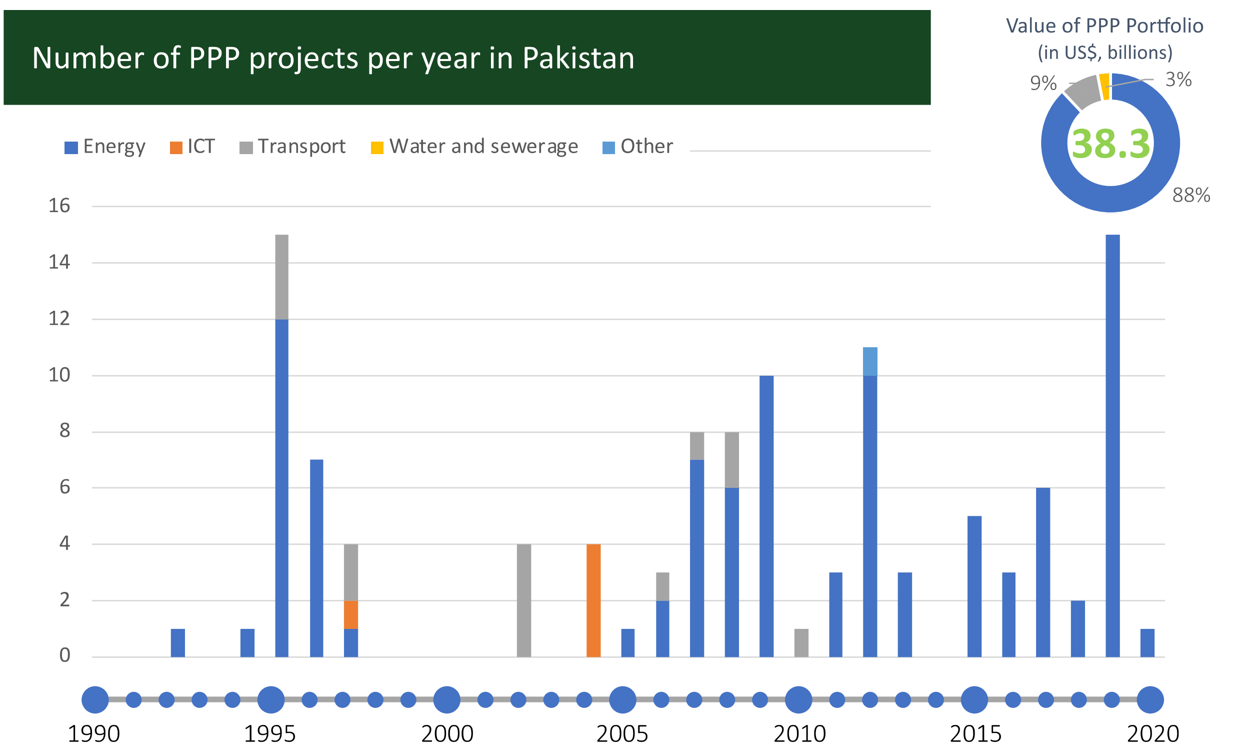
Pakistan has a relatively long history of PPPs. In the early 1990s, Pakistan introduced private sector participation in the power sector, and today it is one of the 10 largest markets in terms of investments in the power sector delivered through PPPs, according to the World Bank's Private Participation in Infrastructure (PPI) database. Total investments amount to some US$27 billion spread over 97 projects in the period from 1995 to 2019.

The program was initiated in 1994 with the establishment of the Private Power and Infrastructure Board as a one-stop facilitator on behalf of the government, and it still exists today.

The delivery model is primarily geared towards facilitating independent power producers (IPPs) by providing licenses, power purchase agreements (PPAs), and sovereign guarantees. Following an expeditious start, the program stalled in the early 2000s because of the Asian financial crisis. The model was refined after its use was picked up again, and it is has been a mature and fairly constant market for the past 10 to 15 years.

Building on these experiences the government prepared a National PPP Policy in 2010 and established the Infrastructure Project Development Fund for the funding of consulting services to improve project preparation and facilitate private sector participation in other sectors as well. However, as illustrated by the data from the World Bank's PPI database, private sector participation has not yet evolved to the same extent as in the power sector, which accounts for 88 percent of the PPP portfolio, despite the substantial infrastructure gap.

Figure 7.1: Number of PPP Projects per Year in Pakistan



Source: World Bank PPI Database as per July 2021

The National PPP Policy has not been translated into a harmonized framework for PPPs across all jurisdictions because of the federal nature of the administrative system in Pakistan. The federal government has developed a framework for projects that are within the remit of the federal government and that is based on the federal procurement policy and the establishment of the PPP Authority in 2017. To further strengthen the federal PPP framework a PPP Act has been recently ratified by Parliament, though that act only governs federal PPP projects.

In view of the regulatory limitations of the new federal PPP Act to federal PPPs and taking into account the perceived maturity of the regulatory environment for PPPs in the province of Sindh, the focus of this case study will be on Sindh. This will also allow for reflection on the approaches and challenges to fiscal management of PPPs on a sub-sovereign level.

The Sindh government is relying increasingly on PPP schemes to develop infrastructure, with the goal of increasing the efficiency of investments and asset management, as confirmed by recent statements from Chief Minister Murad Ali Shah: "The public-private partnership has assumed an important role in the development of Sindh and we are going to expand its scope for better services to our people."[138]

With 44 million inhabitants representing 23 percent of Pakistan's population and a gross domestic product (GDP) share of about 30 percent, Sindh has large infrastructure and social service needs, which exceed the provincial public resources available. Because of limited sources of revenue, federal transfers constitute 70 percent of Sindh's total of PRs 1.2 trillion (US$7.7 billion) budget estimate for 2019-2020. Only PRs 284 billion (US$1.8 billion), or 24 percent of Sindh's annual budget, was allocated to the Annual Development Plan (ADP) 2019-2020; the ADP funds infrastructure development and other initiatives, and the amount was consistent with preceding years albeit somewhat lower because of fiscal tightening.[139]

The World Bank estimated in 2013 that Sindh's annual infrastructure investments represent only 3 percent to 4 percent of expected requirements in transport, electricity, water supply and sanitation, solid waste, telecommunications, and irrigation,[140] and this estimate has probably not changed much since then. In addition, Sindh requires investments in health and education. This also highlights the GoS's inability to fully utilize the development budget for meeting its infrastructure needs under the traditional public procurement mechanism. To meet the pressing needs of infrastructure in the province, public sector investments must be augmented by more substantial private sector participation. In addition to bridging the funding gap for infrastructure investments, PPPs may also help in accelerating completion and enhancing the efficiency of operations of infrastructure projects.

In Sindh six PPP contracts have been concluded,[141] primarily roads. These are PPP arrangements in the strict sense of PPPs, i.e., including a substantial private finance component. In addition, several management contracts have been awarded in the health and education sector, though for the purpose of this analysis they have been disregarded in view of their limited fiscal implications. The PPP portfolio represents an investment value of approximately US$500 million, which amounts to approximately 0.6 percent of Sindh's GDP of US$76 billion.[142]

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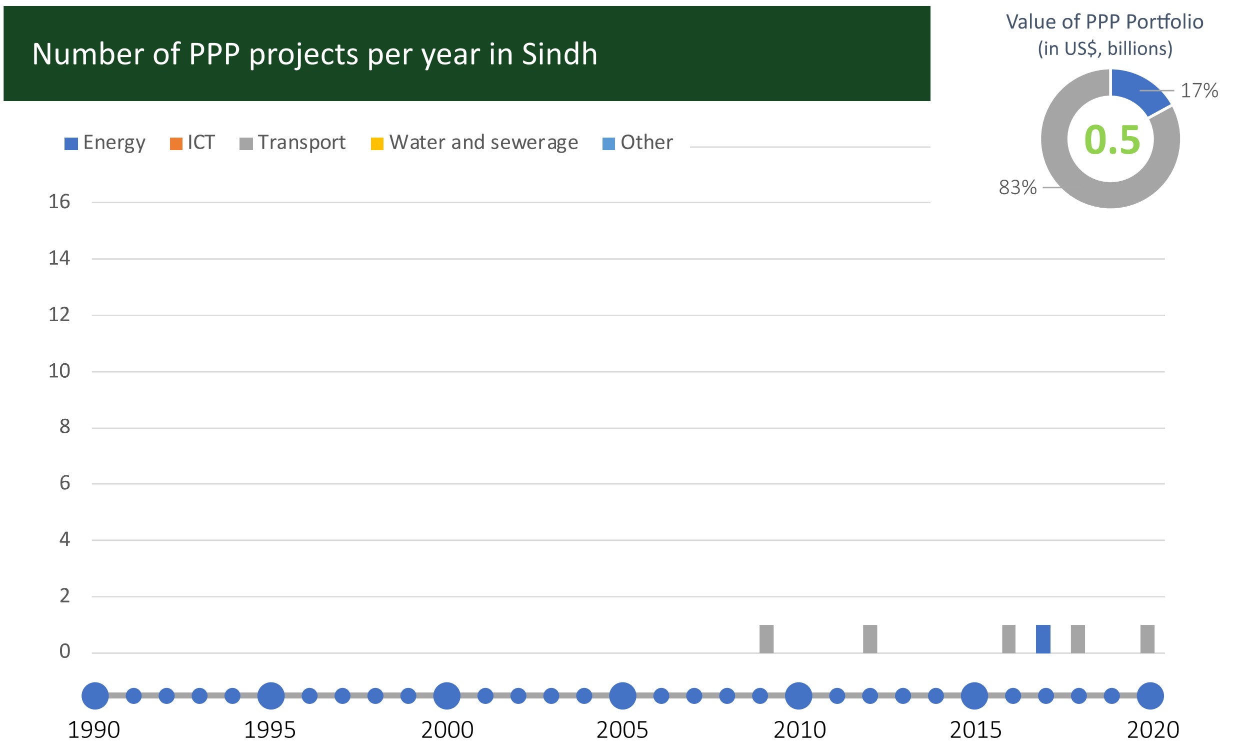
[138] Subohi, Afshan. 2018. "Public-private partnerships take root in Sindh, Punjab." *Dawn*, February 5, 2018. https://www.dawn.com/news/1387435.
[139] GoS. 2019. Budget Analysis 2019-2020.
[140] Andrés, Luis, Dan Biller, and Matías Herrera Dappe. 2013. *Reducing Poverty by Closing South Asia's Infrastructure Gap*. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/17847.
[141] In comparison with 2017, the current portfolio no longer includes the Karachi Yellow Line BRT, which has been terminated because the selected bidder was not able to raise the necessary financing and includes the recently awarded contracts for the Ghotki-Kandhkot Bridge Project and the Malir Expressway Project.
[142] https://en.wikipedia.org/wiki/List_of_Pakistani_provinces_by_gross_domestic_product.

Figure 7.2: Number of PPP Projects per Year in Sindh



Source: Sindh PPP Unitwebsite. July 2021.

The portfolio has an array of government support mechanisms to facilitate bankability, including availability payments (APs), power purchase agreements (PPAs), minimum revenue guarantees (MRGs), early contract termination (ECT) compensation guarantees and government equity or subordinated loans,[143] with impact on the government's direct and contingent liabilities.

Table 7.1: PPP Projects in Sindh and Sources of Finance, 2021

Project	*Sector*	*Project Value (US$, millions)*	*Contract Date*	*Revenue Model*	*Government Support*
Hyderabad Mirpurkhas Dual Carriageway	Roads	45	2009	Tolls	MRG Subordinated loan ECT compensation
Karachi Thatta Dual Carriageway	Roads	58	2016	AP	47% equity ECT compensation

[143] Equity is provided to fill the viability gap as a mode of revolving co-finance. This approach is unlike the more common approach of providing viability gap finance as non-revolving co-finance, i.e., as a grant, and is driven by the fact that grants are subject to income tax for the recipients.

Project	*Sector*	*Project Value (US$, millions)*	*Contract Date*	*Revenue Model*	*Government Support*
Sindh Nooriabad Power Project	Power	85	2017	PPA	49% equity ECT compensation
Jhirk Mulla Katiyar Bridge	Roads	30	2012	AP	ECT compensation
Ghotki-Kandhkot Bridge Project	Roads	92	2018	AP	47% equity ECT compensation
Malir Expressway Project	Roads	184	2020	Tolls	48% equity ECT compensation
Total		494			

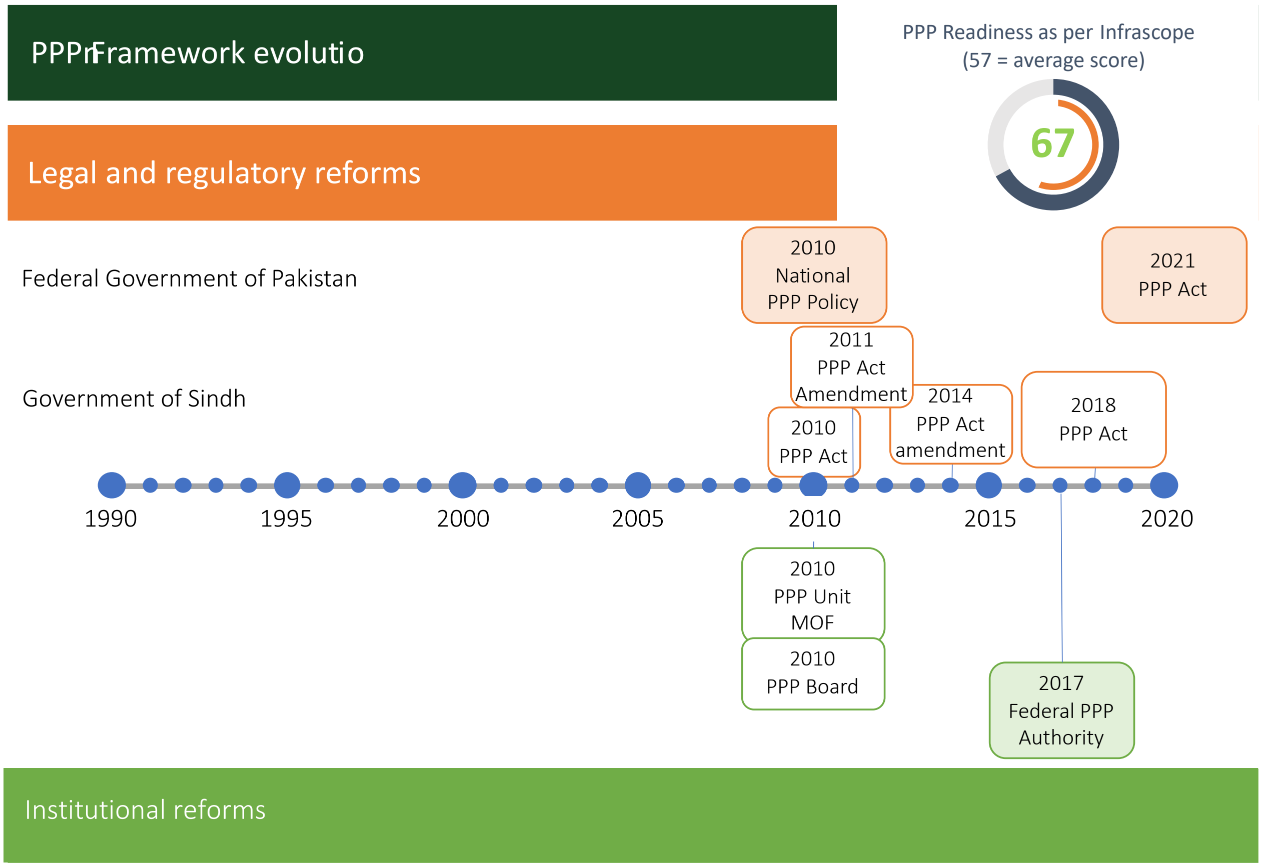
Note: MRG = minimum revenue guarantee, ECT = early contract termination

Regulatory and Institutional Framework

The 2010 Sindh PPP Act—amended in 2011, 2014, and 2018—defines the framework and established a PPP Policy Board (PPP Board) to develop policies based on strategic goals. It also established a PPP Unit within the Finance Department to assist contracting agencies in the preparation and execution of projects. The act outlines the institutional arrangements for PPPs; stipulates the rules, procedures, and responsibility for selecting private-sector partners; lists the main terms and conditions of PPP agreements; outlines the types of government support; and defines cost recovery and risk-sharing principles. Private partners are selected through an open and competitive bidding process. The PPP Unit is an independent body that is well resourced and funded. Roles and responsibilities have been defined between the unit and different provincial government agencies. The PPP Policy Board must approve all projects undertaken by the PPP Unit in coordination with various government agencies.

On a provincial level, Punjab and Sindh have been particularly active in developing a conducive environment for PPPs by adopting PPP policies and legislation, and by setting up coordinating agencies. That is the case to such an extent that for example the readiness for PPPs in the province of Sindh exceeds that of the federal government, as concluded in 2018 by the Economist Intelligence Unit through its Infrascope assessment. The main difference in the assessment of the quality of the enabling environment concerns the more advanced regulatory framework in Sindh in comparison with at the federal level and to a lesser extent also the quality of the involved institutions, where Sindh is among the leading jurisdictions in Asia (ranked second). The main issue for Sindh as well as for Pakistan as a whole is access to long-term limited recourse capital. This is illustrated, among other examples, by the risk averse behavior of local banks, resulting in the excessive cash deposit requirements for government guarantees. Also, there has been limited involvement of international banks thus far, which is due to the relatively high exchange rate volatility. Also, the World Bank's Benchmarking Infrastructure Development 2020 considers the PPP proceedings in Pakistan for the different stages of the PPP life cycle above average. The main area of concern raised by this benchmark is related to the approach for unsolicited proposals, which do not involve a competitive procurement requirement for contract award. It is notable that this benchmark does not include sub-sovereign entities, so this assessment refers to the overall PPP framework in Pakistan.

Figure 7.3: PPP Framework Evolution



One of the reasons for the relatively low number of concluded PPP arrangements is the security from the Government of Sindh required by lenders—in view of the sub-sovereign status of Sindh—which typically takes the form of cash deposits to guarantee payment of MRG or ECT compensation. These cash funded guarantees have a direct fiscal impact and are subject to the regulations on budget appropriation. These cash deposits are essentially comparable to the proceedings of a continent liability fund, in the sense that some of the budget is reserved and appropriated for any contingencies. However, the difference is that the value of these appropriations is not based on the probability of occurrence and the impact upon occurrence, but on a substantial amount of the total risk exposure. For the first projects this amounted to as much as 115 percent of the project value, however as the market has matured, this required deposit has fallen to 50 percent to 55 percent of the project value.

Box 7.1: Cash Deposited Guarantees

"Project Finance has been challenging in Pakistan, and not just in Sindh, with local banks unwilling to support projects without upfront cash guarantees", and "Funded guarantees have now reduced but it remains a challenge," Khalid Mehmood Shaikh (PPP Unit director).

The government of Sindh has been able to provide upfront cash collateral through its fund management house. The manager collects funds from various government departments of the province into a single pool, which it invests in government and commercial securities. "We extend these securities to lenders as guarantees," says Shaikh.

Commercial banks are not keen to finance projects as they do not understand either PPPs or the credit risk, according to Ali Khan (legal advisor). "If they did, I'd be doing a deal every week with Sindh province alone," he adds.

Although concession agreements protect lenders from defaults and project termination risks, banks insist on the cash guarantees. "I am to be blamed for that as I was the bank's lawyer when the first PPP was done here 15 years ago," says Khan, adding that in the first project, the government actually put up collateral that was 15 percent higher than the cost of the project.

In recent transactions, the requirement of funded guarantees has reduced to about 50 percent to 55 percent of the project's cost, according to Muhammad Danish, finance director for Sindh's PPP unit.

Source: Sharma, Rouhan. 2020. "Market Focus: The Small Provincial Authority Doing Big Things in Pakistan." Inframation News, August 24, 2020.

These excessive security requirements substantially constrain Sindh's fiscal support capacity and limit the province's PPP potential. For these reasons, Sindh has expressed its support for the federal government's initiative to establish the Pakistan Development Fund Limited (PDFL), a facility envisaged to—among other aims—remove some of the burden on provincial governments. This will free up fiscal space at the provincial level, allowing provincial authorities to increase their PPP portfolios. The strategy and structure of the PDFL are being designed with support from the Asian Development Bank (ADB).

6.2. Legal Framework and PPP Approval Process

6.2.1. PPP Governance, Institutional and Legal Framework

The framework for developing PPP projects in Sindh is embedded in the following documents:

- Sindh PPP Act (adopted 2010, amended in 2011, 2014, and 2018)
- Policy for Public Private Partnerships (adopted in 2012, amended in 2017)
- PPP Guide and Toolkit 2017 (School Education and Literacy Department)
- Guidelines for Project Development Fund 2017
- Viability Gap Fund Guidelines 2012
- Sindh Public Procurement Act 2009 (amended 2019)
- Project Screening Criteria 2019
- PPP Hedging Policy.

The Sindh PPP Act was passed in February 2010 and was amended in 2011, 2014, and 2018. It is broad and wide-ranging, defining essential topics such as institutional set up and approval processes, and it also provides guidelines on issues including acts of government employees in good faith, fair compensation to the concessionaire, arbitration, user fees, and force majeure. The PPP Act is considered to be comprehensive, and it has been helpful in increasing investor and public sector confidence in PPPs.

The act is supported by the PPP Guidelines, the Project Development Facility (PDF) Fund Guidelines, Viability Gap Fund (VGF) Guidelines, the PPP Chapter on Sindh Public Procurement Rules, and the Sindh Foreign

Exchange Hedging Guidelines for PPP projects. The PPP Act serves as the bedrock through which different policies and guidelines facilitate and aid PPP practitioners in Sindh to undertake PPP projects.

The Policy for Public Private Partnerships was prepared by the PPP Unit and approved in accordance with the PPP Act by the PPP Board in 2012 and amended in 2017. The policy provides further details on the scope of the PPP framework in terms of contract types,[144] jurisdiction and sectoral coverage, the institutional arrangements in terms of roles and responsibilities, the operating procedures for the PPP life cycle, the different facilitating financial instruments, and some high-level guidance on risk management.

The PPP Guidelines as published by the PPP Unit cover topics not included in the PPP Act—for example, the flow of PPP projects and template documents. Moreover, the PPP Guidelines go into more detail about the roles and responsibilities of different institutions and agencies, as well as the cost recovery of projects. However, the PPP Guidelines as captured in the PPP Guide and Toolkit, prepared under the auspices of the PPP node of the School Education and Literacy Department, are geared towards the education sector and do not really go beyond the operating procedures as outlined in the PPP Act and the PPP Policy in terms of methodological guidance on specific issues such as value for money analysis or risk allocation, nor do they provide any template documents.

The PDF Fund is managed by the Sindh Fund Management House (SFMH) within the Finance Department (FD). Its guidelines have been developed to provide funds for feasibility studies, transaction advisory services, and capacity building. The PDF Fund has played a pivotal role in developing the province's PPP project pipeline because it has provided a readily available source of funding for feasibility studies and transaction advisory services. The fund was set up as a revolving fund so that successful PPP projects reimburse costs for feasibility studies and project structuring to the PDF Fund at the time of financial close. However, this might not be the practice in annuity-based projects. The asset value of the fund, as of June 30, 2019, was PRs 371 million (US$2.4 million).

The VGF rules for administration and utilization are explained in the VGF guidelines document. The VGF has turned into a vehicle assuring commercial banks and investors that they will not be affected by changes and volatility in the province's annual budget estimates. The fund is not used in the classical VGF manner (i.e., by providing grants) but rather for project support in the form of sub-debt, quasi-equity, credit enhancements, funded guarantees, co-financing, availability payments, etc.

The fund is also being managed by SFMH and is being funded through GoS budget appropriations. The SFMH in coordination with the PPP Unit and Budget Wing estimate on a semi-annual basis the contingent liabilities (including guarantees, warranties, etc.) relating to the VGF. The Finance Department publishes on a semi-annual basis the total amount of contractually committed payments from the VGF and an estimate of all non-contractually committed contingent liabilities.

The amount released to the fund since its inception in 2008, until June 30, 2019, was PRs 33,4 million (US$216 million). Expenditures made from the inception of the fund were PRs 27,7 million (US$180 million). The accumulated value of investment of this fund, as of June 30, 2019, was PRs 7,7 million (US$50 million). The expenditures made by this fund to date have been in furtherance of several projects undertaken under the PPP mode. The main projects are the Hyderabad-Mirpurhas Dual Carriageway, Jhirk-Mullahkatiyar Bridge Project, Karachi-Thatto Dual Carriageway, the Nooriabad Power Project, and some others.

[144] It is to be noted that the PPP Policy introduces some contractual arrangements as PPPs that do not qualify as a PPPs according to international standards, e.g., build transfer or build, lease, transfer, because these arrangements are not based on a private partner remuneration that is exposed to demand or performance risk.

In accordance with the PPP Act, the fund is scheduled to be replaced in 2022 by the PPP Support Facility (PSF), providing a more suitable term for the scope of the facility. The PSF will be a non-profit company to be established by the GoS under section 42 of the Companies Act 2017. All project initiatives will have to be approved by the PSF before being presented to the PPP Board. Its CEO will be part of the PPP Board. In 2021 the PSF was established and has been preparing to assume its formal responsibilities.

Chapter 4 of the Sindh Public Procurement Regulatory Authority Rules 2010 (SPPRA Rules 2010) has been dedicated to the procurement of PPP projects, and Chapter 4 has precedence over other procurement rules when it comes to procurement for PPP projects. It provides basic parameters for negotiations and financial evaluation along with the procedure for handling unsolicited proposals.

The PPP Screening criteria are dated January 2019 and provide a clear set of high-level criteria to reflect the relevance of a project and its suitability for a PPP. However, the regulatory status of these criteria are unclear and no demonstration of such screening in practice has been provided.

The Sindh Foreign Exchange Hedging Guidelines for PPP projects were developed in response to market demand. Foreign investors have been interested in PPPs in Sindh since the GoS's very first PPP project. However, investors soon demanded a foreign exchange cover against depreciation in Pakistani rupees akin to the one provided by the central government to investors. The guidelines were approved for a period up to December 31, 2014, so their status is unclear at the moment.[145] However, the guidelines can be applied to specific projects on a case-by-case basis.

6.2.2. Approval Process

As defined in the PPP Act, the PDF Guidelines, and the VGF Guidelines, the PPP framework includes gateway reviews for the different stages of the PPP life cycle, although limited guidance is provided for the governance structure upon implementation. The PPP Board acts as the ultimate decision-maker, with the PPP Unit as its gatekeeper.

In accordance with the PPP Act Article 5, the following have been defined for the purpose of review and approval during the different stages of the development process:

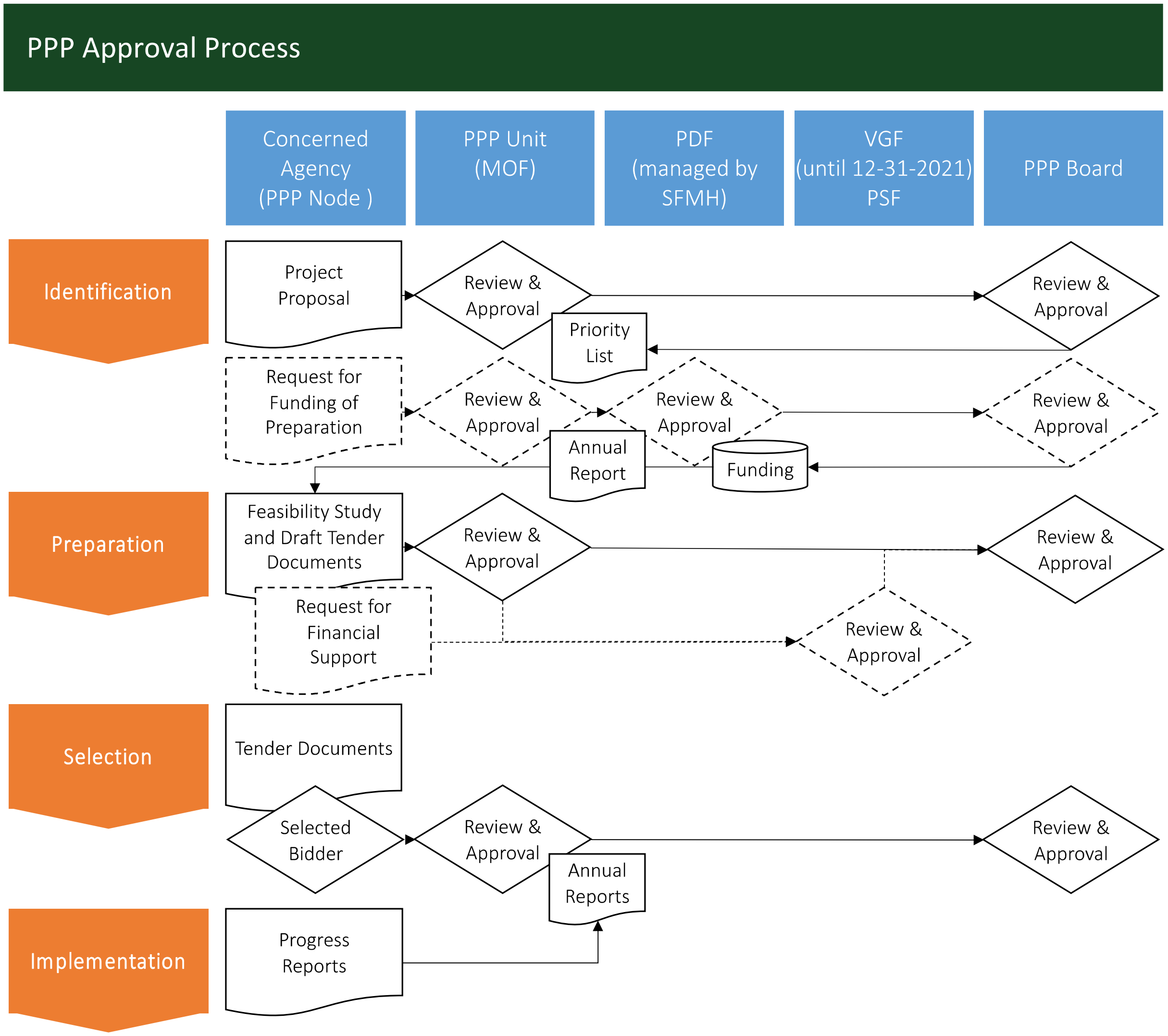
- The board approves, rejects, or sends back for reconsideration the project proposal submitted by an agency within six months
- The board approves funding for projects receiving support through the Project Development Facility
- The board approves, rejects, or sends back for reconsideration the recommendation submitted by an agency for the contract award to a private party
- The board is the final deciding authority for all the projects.

The PPP Unit, acting as the secretariat for the board, is the gatekeeper for these reviews, that is, it:

- Evaluates and prioritizes project proposals submitted by the agencies;
- Evaluates the type and amount of government support sought for a project; and
- Reviews the bid evaluation report submitted by an agency.

[145] As per para 2.1.2. "This policy is on valid for projects that achieve financial close by December 31, 2014, and GoS will bring in a revised policy to attract foreign investment after December 31, 2014."

Figure 7.4: PPP Approval Process



Note: PDF = project development fund, SFMH = Sindh fund management house, VGF means Viability Gap Fund and PSF means PPP Support Facility

Based on review of the minutes of the PPP Board meetings it can be concluded that these gateway reviews are being applied accordingly and provide for an effective governance mechanism to proceed step by step through the PPP development process.

Table 7.2: Examples of PPP Board Decisions by Phase of Development Process

Identification & Screening	Appraisal & Structuring	Tendering	Implementation
01-21-2020 *Mauripur Expressway*	*01-21-2020* *M9-N5 Link Road* *Approval of launch of*	*01-21-2020* *Malir Express*	*01-21-2020* *JMK Bridge*

Identification & Screening	Appraisal & Structuring	Tendering	Implementation
Approved PDF funding for consultants	*project for investor solicitation*	*Approved issuance of LOA and signing of CA with consortium led by J.N. & Co.*	*Approval of contract variation and additional VGF*
01-21-2020 *Korangi Sewage Treatment Plant* *Approval to engage ADB's OPPP to carry out Transaction Advisory Services*	*10-10-2018* *Approved termination of Safe City Karachi project from PPP modality*		*10-10-2018* *BRT Yellow Line* *Approval for termination of CA*

Source: Minutes of the 26th (October 10, 2018) and the 30th (January 21, 2020) meetings of the PPP Policy Board.

However, in the absence of clear decision criteria and with limited oversight from audit entities or the assembly, much is left to the interpretation and discretion of the PPP Board and, given the lack of consolidated reporting, transparency and accountability are limited. The PSF is intended to further strengthen the gatekeeping process by providing a neutral and unbiased evaluation of the fiscal risk exposure of PPP projects that require co-financing or other modes of government support.

Oversight by the provincial assembly is not regulated in the PPP Act and thus limited to management of the purse of Sindh through the approval authority of the annual budget. There is no federal oversight except for the Federal Investigating Agency (FIA).

Box 7.2: Federal Investigation into Sindh Development Projects

In November 2018, the Federal Investigating Agency (FIA) approached the Sindh chief secretary and asked for details of all development projects from 2014 through 2018. The request was part of an in-depth investigation into the transfer of billions of rupees allocated to development projects into fraudulent bank accounts, according to FIA officials.

Documents and details to be checked for misappropriation of funds include: projects under public-private partnership (PPP), government funds released to the Sindh Engro Coal Mining Company (SECMC), government funds released to the private company PPHI, funds released to private companies and non-governmental organizations (NGOs), copies of audit reports of SECMC and PPP projects, and copies of audit reports of the Health Department.

Source: Shah, Aslam. "JIT asks Sindh govt to provide details of development projects." *Daily Times,* November 4, 2018. https://dailytimes.com.pk/318237/jit-asks-sindh-govt-to-provide-details-of-development-projects/.

6.2.3. International Support in PPP Development

Since 2017 the GoS has received support from the ADB for PPPs through the project "Supporting Public–Private Partnership Investments in Sindh Province" (Project Number 46538-002). The project supports the development policies of the GoS for sustainable infrastructure provision through PPPs. The project builds on ADB's partnership with the GoS to develop the PPP framework under a program cluster created in 2009, using lessons learned from this program and the Country Assistance Program Evaluation for Pakistan. The project's goals are: i) to strengthen GoS capacity to select and develop PPP projects; ii) to effectively manage PPP project-related fiscal risk through the PPP Support Facility (PSF); and iii) to improve PPP project selection and the management capacity of line departments, finance, and planning and development departments. Progress to date has been limited. The project has a budget of US$185 million sourced from a US$100 million ADB loan, US$19 million UK grant, and US$65 million in counterpart funds from the GoS. However, to date only US$400,000 has been used for consulting services on feasibility studies—for the Dhabeij Special Economic Zone, Lab-e-Mehran Tourism, and Teacher's Training Institute.[146]

The World Bank (WB) has been supporting the GoS since 2015 with Public Sector Management Reform (P145617) through four reform areas: i) increasing tax revenue mobilization; ii) enhancing performance of public financial management systems; iii) strengthening public procurement performance; and iv) improving management of the development portfolio. Specifically, on fiscal management, the WB delivered from 2016 to 2017 the project Sindh Fiscal Management (P159810), which resulted in the 2017 Public Expenditure Review. This review included the recommendation for the establishment of a fiscal management framework (FMF) to undertake an evaluation of the fiscal cost of PPPs, which was followed up with a draft fiscal management framework (August 2017). The five components of the FMF for Sindh are tools and documents based on best practices of countries with successful PPP programs, tools developed by the World Bank, and original work developed for this task:

- Component 1: Fiscal authority gatekeeping
- Component 2: Project selection process
- Component 3: Long term budget projection
- Component 4: Accounting and risk analysis
- Component 5: Disclosure of information.

Based on the most recent information, the recommended draft FMF has neither been formalized nor operationalized, although elements have been incorporated into PSF operating procedures. Among these incorporated procedures are some dealing with the identification and quantification of contingent liabilities (CL) and contributions to the gatekeeping process.

6.3. Analysis of Projects

6.3.1. Identifying and Evaluating PPP Projects

To rationalize decision-making for the identification of relevant and suitable projects, a screening framework was developed in 2019. This framework includes the following criteria, some of which are assigned a score to aid in evaluating suitability:

- The project selected is for a priority sectoral area.
- How well is the need for this project justified? (max points: 10=very high; 6=moderate; 2=low)
- What added value/relevance does the PPP bring to this project? (max points: 10=very high; 6 =moderate; 2=low)

[146] Auditor-General of Pakistan. 2020. Financial Attest Audit Report on Enhancing PPP in Pakistan–Project in Sindh for the years 2017-18 to 2019-20. December 31, 2020.

- Are the project's results and outputs in accordance with the needs of the selected targeted groups? (max points: 10=very high; 6=moderate; 2=low)
- Please categorize the riskiness of this transaction. What are the mitigating measures suggested for this partnership? (max points: 20=not risky at all; 13=somewhat risky; 7=high risk)
- To what extent are communication activities appropriate and forceful to reach the relevant groups and stakeholders? Will the transaction require additional communication efforts? (max points: 10=little or no communication activities; 6=moderate communication activities; 2=substantial communication activities)
- To what extent does the project budget demonstrate value for money (VfM)? (max points: 20=high VfM; 15=moderate VfM; 10=low VfM)
- To what extent have environmental safeguard measures been mitigated? (max points: 10=safeguard evaluation in place; 6=moderate risks; 3=high environmental risks)

The screening framework furthermore defines 70 as the minimum score in order to proceed with it as a PPP. However, it is questionable to what extent this framework can be applied without further methodological guidance (e.g., how to demonstrate value for money or how to categorize the riskiness of the transaction) and without the support of advisors. Ideally a screening framework aims to tentatively assess relevance and suitability in order to justify the further development of the project and the associated costs for hiring advisors. Moreover, the document does not reflect the status of the screening framework, i.e., has it been adopted by the PPP Board? Nor do the minutes of the PPP Board meeting in 2020 demonstrate that this framework has been applied to support the decision to move to the appraisal phase and approve the use of the PDF for retaining consultants. For example, the decision to proceed with the development of a road program encompassing i) the Korangi Alternative Link Road, ii) Mauripur Expressway, and iii) ICI Interchange was based on a reasoned analysis of the economic merits and did not address any considerations on risks, value for money, etc.[147]

For successive phases, i.e., appraisal and structuring of the projects, no decision criteria have been defined to substantiate any investment and procurement decision and the launching of a tender. According to the PPP Act, preparation of the projects will consist of: a feasibility study, initial environmental examination, environmental impact assessment in line with Industry international best practices if required, risk analysis, analysis of the need for government support, stakeholder consultations, determination of the appropriate public-private partnership modality, and preparation of bidding documents, including a draft public-private partnership agreement.

However, no reference is provided to conclude on these preparatory activities. Additional requirements might be considered, such as: i) a positive socioeconomic appraisal to confirm the project's relevance; ii) a positive value for money assessment to confirm the suitability of the proposed arrangement for a PPP; and iii) a fiscal impact below a predefined threshold to confirm the affordability of the co-financing regime. These criteria could also be applied upon bid evaluation to conclude the tendering phase and upon implementation to approve any contract variations.

[147] Minutes of the 30th (January 21, 2020) meeting of the PPP Policy Board.

6.3.2. PPP Fiscal implications

PPPs can create specific challenges for provincial finances, given that PPP projects entail long-term fiscal implications and can be contingent on risks, without recourse to the central government and with limited tax revenues. These could impose fiscal risks for provincial financial management in the form of direct liabilities (commitments not dependent on the occurrence of an uncertain future event) and contingent liabilities (commitments whose occurrence, timing and magnitude depend on uncertain future events outside the government's control). Through PPP projects, the Sindh government is acquiring a series of fiscal commitments that may constitute a significant fraction of the provincial budget in future.

To manage this exposure, the PPP Act requires a thorough preparation of the projects, including a feasibility study, initial environmental examination, environmental impact assessment in line with industry international best practices if required, risk analysis, analysis of the need for government support, stakeholder consultations, determination of the appropriate public-private partnership modality, and preparation of bidding documents including a draft public-private partnership agreement.

Furthermore, the PPP Act requires that a draft PPP agreement include a risk allocation matrix. However, no explicit guidance has yet been provided on the default approach to risk management in general and risk allocation in a particular allocation. The PPP policy has highlighted the importance of risk management: "Identification and management of risk is an integral part of the PPP evaluation process." Fair and clear sharing of risks between public and private partners is a prerequisite for the success of PPP projects. In many countries, this function is carried out by a specialized unit. In Sindh, the government has decided to place this function with the PPP Unit until it has well trained and experienced risk management specialists to staff an independent unit. This is scheduled to be provided for through the recently established PPP Support Facility.

The analysis of the fiscal implications of a proposed PPP arrangement is critical to confirm its affordability. It has been highlighted already that the GoS has not yet adopted a comprehensive and cohesive fiscal management framework that guides the identification, appraisal, approval and monitoring of fiscal exposure from PPP projects through direct and contingent liabilities, despite the World Bank's recommendations for such a framework in 2017—although some elements have been incorporated, most notably through the PSF operations.

Box 7.3: World Bank's Recommended FCCL Process

The FMF presented in this report was developed by the WBG and is a set of methodologies, tools and practices that allow governments to manage all fiscal implications of their PPP program. The WBG made a set of recommendations pertaining to the FMF. If implemented, the FMF will help Sindh's fiscal authorities take informed investment decisions regarding the impacts on their fiscal accounts, future budgets, and fiscal sustainability from PPP projects.

Fiscal Authority Gatekeeping

Regarding the FD's role in the PPP program, the WBG recommends introducing a screening process for fiscal commitments and contingent liabilities, strengthening the existing PPP fiscal Commitment and Contingent Liabilities Committee of the FD, and keeping all current responsibilities of the FD without appearing to be a bureaucratic obstacle for project development.

Project Selection Process

The GOS should implement a two-stage project selection process. This will allow answering the questions of whether the project should be implemented and if the procurement mode selected is the one that provides the higher value-for-money.

Long term Budget Projection

The GOS should estimate the cash requirements of PPP projects, including both active projects and the pipeline. To be effective, this estimation must include all fiscal commitments and expenses involved in a PPP project, contingent or not, and an estimation of the costs of the main risks incurred by the government in the project. This instrument, if kept updated, will be key to informing authorities of the size of their commitments already undertaken and the availability of fiscal space for new projects. An estimation was made considering six active PPP projects in the province of Sindh using information provided by the PPP Unit and official financial documents of the GOS. The main conclusion is that the resources that the government expects to use to finance the commitments already undertaken through the VGF are insufficient. More resources should be allocated in order to honor current commitments. Also, additional fiscal funding is required for new PPP projects.

Accounting & Risk Analysis

The PPP Fiscal Risk Assessment Model (PFRAM) of the WBG and IMF should be used by the GOS to assess the impacts of PPP projects on their fiscal accounts. This will allow the GOS to account PPP projects following international accounting standards and include PPP projects in their fiscal reports following the rules of the Government Finance Statistic Manual 2014 of the IMF. Also, the risk matrix of the PFRAM can be used to obtain a qualitative assessment of the risks involved in a PPP project. While for projects already signed this tool will be merely informative, for projects in preparation, it can be useful for the authorities to take informed decisions regarding the risk allocation and risk mitigation measures.

Disclosure of Information

Finally, a comprehensive disclosure framework should be established using the Framework for Disclosure in Public-Private Partnership Projects as guidance. Fiscal commitments and contingent liabilities should also be disclosed and reported in official financial documents of the GOS.

Source: World Bank Group. 2017. Sindh Public Expenditure Review. World Bank, Washington, DC.

Upon review of the PPP Board's decision-making, it becomes apparent that fiscal implications are to some extent taken into consideration during the different stages of the PPP cycle. For example:

- Upon bid evaluation of user charge-based PPPs, the bids are ranked in accordance with the required government support in terms of i) GoS equity and ii) present value of minimum revenue guarantee.
- Upon consideration of a contract variation for the Jhirk Mulakatyar Bridge PPP following a change of law, an independent auditor determined the "financial impact is resulting in tax costs of PKR 379.9 Million and tax savings of PKR 1.24 Billion summing up to net positive impact of PKR 860.66 Million for GoS over the entire concession period."

No other indications of fiscal implications have been available in the sample minutes of PPP Board meetings reviewed, nor have any concerns on affordability or quantitative value for money analysis to justify the fiscal commitments been expressed during the meetings.

The most distinctive feature of the Sindh PPP framework is its VGF facility, which is being replaced by the PSF. This mechanism supports the identification and qualification of contingent liabilities (CL), contributes to the gatekeeping process, and ensures funding of CL. The VGF, as a government instrument, was subject to the risk of political interference, and the replacement of the VGF with the more independent PSF, acting more at arm’s length, aimed to reduce the risk of political interference with the fiscal risk management process.

Box 7.4: Sindh PSF Instrument

Although the VGF is mandated to support affordability for infrastructure services while ensuring commercial viability of PPP investments, it has so far been used for different purposes by providing i) funding to investments through government equity, subordinated loans, and loans to PPPs; and ii) full cash collateral to back GoS revenue guarantees and annuity payments to bank debt and equity sponsors. While such purposes appeared to address Sindh’s low creditworthiness, the initial PPP projects were not properly structured and executed, which led to i) high fiscal cost and contingent liabilities that undermined the benefits of PPPs; and ii) private concessionaires and banks being favored, with PRs 22 billion of public funding being used for only eight PPP projects signed between 2011 and 2016.

The PSF is established as a not-for-profit company to manage the new VGF, thereby enhancing corporate governance and transparency of the new VGF. The facility will receive funds from GoS (US$ 65 million), UK (US$ 19 million) and ADB (US$ 100 million) totaling US$ 184 million.

The PSF will ensure that the new VGF will enhance service affordability and VFM as determined by policies and standard operating procedures that support socially and economically viable projects and improve their commercial viability within well-defined fiscal risk limits.

The new VGF may provide upfront capital investment and guarantees to partially offset cost and risks during the construction period and reduce non-commercial risks for public service investments related to land acquisition. The new VGF may also be used to augment user fee revenue to be collected by a private concessionaire or to provide equity, quasi-equity, or subordinated debt and guarantees to a PPP.

The PSF will have strong corporate governance, including requirements for regular internal and external audits. The facility will have a board of directors composed of at least five members, of which at least three will be independent members not affiliated with the government and equipped with relevant professional experience. The board of directors will elect an independent director as its chair. The principal managers of the company will include the chief executive officer, chief financial officer, and chief risk officer. The principal manager will be an experienced professional with relevant private sector experience and will be recruited through a transparent and competitive process. The PSF will recruit staff with the skills and expertise needed to determine the appropriate level and use of VGF funding for proposed PPP projects, and to manage its execution by supervising and monitoring the performance of PPPs supported by the new VGF.

The PSF will ensure the VFM of PPPs and effectively manage fiscal risks by i) improving its selection of projects and risk management by recommending appropriate structures and risk participation, and ii) minimizing cash collateralization practice. The PSF will also provide i) early participation and feedback on PPP selection, ii) possible funding that the VGF may support, and iii) periodic reports on the contracted and contingent liabilities related to PPP projects funded by the new VGF.

Source: Asian Development Bank. 2016. *Project Administration Manual for Proposed Loan and Administration of Grant and Technical Assistance Grant Islamic Republic of Pakistan: Supporting Public–Private Partnership Investments in Sindh Province*. November 2016.

The recently established PSF continues to add value to the analysis of fiscal risks as demonstrated by its risk management report as prepared for projects requiring co-financing. The risk management report addresses the fiscal risks, provides for a quantification through scenario analysis, and reviews affordability by comparing the fiscal exposure with the medium-term development budget. This leads to observations such as:[148]

- The maximum contingent liability for the education management organization PPPs (management contracts) is PRs 45 billion, or 0.29 percent of the current Annual Development Plan, and thus provides no significant budgetary risk.
- The direct and contingent liabilities with regard to the PRs 28 billion Malir Expressway PPP range from a maximum of PRs 49 billon respectively 29 billion, to a minimum of PRs 15 billion respectively PRs 13 billion. The main risks relate to traffic, land acquisition and lead costs and need to be carefully managed by the contracting authority.

As such, for project specific review, the recently established PSF is demonstrating a more substantiated assessment of the fiscal exposure from PPPs. Its reporting includes a fairly appropriate analysis of fiscal risks though further improvement is required in terms of consolidation, consistency, and numerical reconciliation. Also, further regulations are recommended to allow for a clearer evaluation of the affordability by providing strict ceilings for fiscal exposure and criteria to warrant the fiscal exposure.

6.4. Reporting Requirements

6.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

Budget Management

The case at hand concerns a sub-sovereign jurisdiction that receives most of its revenues from the federal government. These contributions are managed by the National Finance Commission as regulated by the constitution in terms of recommending on: i) the distribution between the federation and the provinces of the net proceeds of the taxes mentioned, ii) the making of grants in aid by the federal government to the provincial governments, and iii) the exercise by the federal government and the provincial governments of the borrowing powers conferred by the constitution.

More than 80 percent of Sindh's funds are comprised of federal government transfers. These transfers include the Sindh government's share in the National Finance Commission (NFC) pool of federally collected taxes and straight transfers. The transfer of funds by the federal government is subject to the actual collection of taxes. Although the variation in the amount of transfers is manageable, the unpredictability in the timing of these transfers severely impacts the Sindh government's ability to plan and release funds to departments.

[148] Public Private Partnership Support Facility: Risk Management Report, March 29, 2021.

Unreported extra-budgetary expenditures are insignificant, being less than 1 percent of total budgeted expenditures. The monitoring of aggregate fiscal risk is an area of concern as there is a lack of consolidated risk assessment and reporting for autonomous government agencies and public enterprises.

The budget calendar is well defined and adhered to, and the budget process is adequately guided through issuance of the Budget Call Circular. Budget ceilings are also issued to line departments well in advance. Furthermore, there has been timely approval of the provincial budget by the legislature in each of the last three years.

The multi-term budgetary framework (MTBF) was introduced in 2009 and had been rolled out in six departments by 2012. However, the MTBF only covers recurrent expenditures, which largely consist of salary related items. Since there is no coverage of development expenditures in the MTBF, the link between investment budget and forward expenditures is lacking.

Accounting

As per the 2013 Public Financial Management and Accountability Assessment,[149] the comprehensiveness of the budget is generally considered satisfactory. The Sindh government uses the New Accounting Model for formulating and reporting the budget. The New Accounting Model follows robust international classification standards, namely the United Nations Classification of Functions of Government (COFOG) and Government Finance Statistics (GFS).

Financial statements are prepared according to the cash basis of accounting and are aligned with the format given by the cash basis International Public Sector Accounting Standards (IPSAS), but are fully compliant only in terms of format. The Controller General of Accounts and Auditor General of Pakistan work together to make sure full compliance with cash basis IPSAS is in place. The implication for PPPs is that direct liabilities are not accounted for as debt nor are contingent liabilities reported in the notes to the financial statements.

External audits are completed expeditiously, but there is a significant delay in the review of external audit reports by the Public Accounts Committee (PAC), creating a backlog. It has been noted that the Auditor General of Pakistan is mandated to undertake regulatory and performance audits for all jurisdictions including the provincial authorities and their projects.

Debt Management

As a province, Sindh has limited financing options to supplement its budget. Until recently, the provinces in Pakistan didn't have much use for a debt management function because the federal government held that responsibility. That changed in 2015 when Pakistan's provinces obtained the right to borrow on their own.[150]

The Sindh debt portfolio comprises two categories—domestic and external debt. The part of Sindh's total public debt that is obtained from lender agencies in foreign currency is the external loan portfolio (primarily the World Bank and ADB). However, the domestic portfolio comprises loans only from the federal government. The current position of external and domestic debt portfolios reconciled with relevant federal divisions as of June 30, 2019, was PRs 356,4 million (US$2.3 million) and PRs 13,026 million (US$100,000). At the subnational level, the federal government re-lends to the provinces on agreed financial terms with the lender. But in the case of repayment of these loans, payment is being done by the federal government

[149] Government of Sindh and Development Partners . Public Financial Management and Accountability Assessment (Report No. 84169-PK). November 2013 (The assessment was updated in 2020 though not yet published).
[150] https://blogs.worldbank.org/endpovertyinsouthasia/pakistan-music-meets-public-debt-management

at the prevailing foreign currency market rate, whenever due to the lender—but, to provinces, it is charged on an average rate decided by the federal government's Finance Division on a yearly basis.

The Sindh government is fully cognizant of the recent changes to the federal landscape for borrowing. Pakistan's fiscal architecture underwent a fundamental change with the adoption of the 18th Constitutional Amendment in 2010. The 18th Amendment permits borrowing, both domestic and external, by provinces, subject to limitations imposed by the National Economic Council (NEC).[151] On July 1, 2015, the NEC set new limits for sub-national domestic borrowing.[152]

The treasury limitations for Sindh as a sub-sovereign entity complicates the fiscal management framework, specifically with regard to:

- Defining the discount rate for calculating the present value of the fiscal commitments for the duration of the PPP agreement, which is typically set as the cost of government borrowing approximated by the yield on government bonds for an equivalent period, reflecting the country risk premium. In the absence of such instruments, this discount rate has to be approximated in an alternative manner, which could be for example the target GDP growth.

- Defining the ceiling for fiscal commitments with regard to PPPs. In some countries this is defined as a percentage of GDP, though it has been recommended to define such a threshold based on the aggregated value of debt plus PPP fiscal commitments in relation to GDP in order ensure decision-making based on value for money considerations and not an availability of funding.

6.4.2. Transparency policy of PPP contracts

The PPP Policy has assigned the following responsibilities to the PPP Unit with regard to risk management:

- Develop risk management guidelines for PPP projects.
- Examine whether requests for government support and the proposed risk sharing arrangements are consistent with the risk management guidelines and fiscally sustainable.
- Ensure the inclusion of approved government support in the government's Annual Development Program.
- Monitor the government's direct and contingent liabilities related to PPP projects.
- Monitor the financial performance of PPP projects during their operation.
- Perform any other functions as may be assigned to it by the PPP Policy Board.

Although responsibilities have been assigned, they have not been operationalized:

- No model PPP agreements are being published by the PPP Unit.
- No consolidated reporting on fiscal commitments or the financial performance of PPP projects is being published by the PPP Unit.
- The Budget 2020-2021 does not include any reference to PPPs or their fiscal commitments, except for the utilization of the PDF and the VGF.

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[151] Clause (4) of Article 167, of the Constitution (a new clause inserted by the 18th Constitutional Amendment) reads: "A province may raise domestic or international loans, or give guarantees on the security of the Provincial Consolidated Fund within such limits and subject to such conditions as may be specified by the National Economic Council."

[152] On July, 1, 2015, the NEC took a decision to allow the provinces to borrow in the domestic market. This in FY'16 translated into a gross borrowing limit of 0.5 percent of GDP (or PRs 153.4 billion) for the provinces or a net domestic borrowing limit of PRs 61.75 billion for Punjab, PRs 20.05 billion for Sindh, PRs 16.88 billion for Khyber Pakhtunkhwa and PRs 13.91 billion for Baluchistan.

In-year overall budget reports are produced on a timely basis, as are the annual financial statements that are submitted to the Auditor General for external scrutiny. Financial statements are quite comprehensive but lack information on assets and liabilities.

Information dissemination on PPPs in Sindh is coordinated by the PPP Unit and published through its website. It includes information on relevant regulations and guidelines as well as information on projects in terms of a project summary and updates on key milestones. For the awarded projects, information is provided on project costs, revenues, financial structure, contract term, benefits, etc. In some cases, even the credit rating is indicated. This constitutes a reasonable effort at disclosure and transparency, though consideration may be given to further improvement, most notably by:

- Ensuring that information is up to date, as it has been noted that the latest project update is 3 months old.
- Including minutes of PPP Board meetings, which are available on the official web portal though without any specific reference to PPPs and which are relevant for the purpose of transparency and accountability of decision-making.
- Preparing and publishing consolidated reports on projects and the overall progress of the PPP program, which is fully absent at the moment though which is essential information to stakeholders to assess the government's performance and commitment with regard to PPPs.

In 2017 it was assessed by the World Bank that the direct and contingent liabilities from the portfolio of PPP projects at that time—with a total project value of about PRs 45 billion (approximately US$300 million)—would increase gross debt, equivalent to an additional 1 to 2 percent of provincial GDP.[153]

The SFMH in coordination with the PPP Unit and Budget Wing will estimate on a semi-annual basis the contingent liabilities (including guarantees, warranties, etc.) relating to the VGF. The FD will publish on a semi-annual basis the total amount of contractually committed payments from the VGF and an estimate of all non-contractually committed contingent liabilities. The amount for each future year will be identified separately.

Budgeting of Contingent Liabilities

The VGF facility, funded through annual budget appropriations, provides for a fairly effective mechanism to ensure funding of contingent liabilities. However, the lenders' requirements to deposit cash to vouch for guarantees is an excessive strain on the government's finance that does not consider the probability of the event arising. The federal government is exploring options to ease these bankability conditions, including the operationalization of the Pakistan Development Fund Ltd. Also, the recently established InfraZamin Ltd could provide some relief. The objective of InfraZamin is to fill the current gaps in the local credit markets to catalyze greater private sector participation in the long-term, local currency financing of infrastructure in Pakistan, as an initiative of the Private Infrastructure Development Group (PIDG). InfraZamin will be providing guarantees to enhance the credit quality of local currency debt instruments to finance creditworthy infrastructure projects in Pakistan. As such it will be providing a guarantee against sub-sovereign default risk and possibly reducing the lender's requirements for cash deposited guarantees.

[153] World Bank. 2017. Sindh Public Expenditure Review 2017.

Other Relevant Aspects

Although recognized as a fairly developed ecosystem for facilitating the development of PPP projects, there are definitely some areas of the Sindh PPP framework that can be improved, most notably:

- *The Fiscal Management Framework needs to be operationalized.* Despite recommendations and despite the already substantial fiscal exposure from PPPs, the GoS has not yet fully implemented an operational mechanism to identify, appraise, approve and monitor fiscal commitments arising from PPPs, although first steps have been made, most notably through the PSF.
- *Value for money considerations need to be prioritized.* Despite the preamble in the PPP Act highlighting the objective of among others "improving efficiency of management, operation and maintenance of infrastructure in development facilities," and the rationale for PPPs reflected in the PPP policy that PPPs are promoted to "improve the efficiency and effectiveness of the public sector in the delivery of public goods and services," no mechanisms have been adopted to assess and monitor value for money.
- *Legislative oversight needs to be strengthened.* The framework grants the approval authority for PPP policies and projects to the PPP Board without any further accountability to the assembly except for the annual budget approval. No specific, measurable, achievable, relevant, time-bound (SMART) targets have been defined for the PPP program in terms of number or value of PPP projects to be implemented by a certain date, so the government cannot be held accountable for lack of progress (if any). No ceilings have been defined on PPP commitments. There is no obligation to periodically inform the assembly on the progress of the PPP program, its impact, and its fiscal implications (in terms of direct and contingent liabilities—aside from the annual budget implications), so the assembly is not aware of the progress or lack of progress.[154] To strengthen legislative oversight, it is recommended to improve information disclosure and also to introduce regulatory and value for money audits to confirm compliance with the implementing principles and the progress made.[155]
- *Guidelines need to be improved.* Although the framework already includes a fair set of guiding documents, it is also apparent that guidance needs to be expanded and improved to include, for example, fiscal risk management, value for money analysis, default risk allocation matrices, template contract provisions, etc. (It is questionable why a guide for PPPs in the education sector should be presented as the overall guide for PPPs in Sindh.) And the guidance needs to be updated, for example with regard to the scheduled PSF or the status of the hedging policy.
- *International arbitration needs be facilitated.* Assuming that the government also wants to attract international developers, it might also consider allowing for international arbitration. The current PPP act does not provide for this though it limits the location of dispute settlement and arbitration to Pakistan. This is not entertaining the requirements of international developers and lenders.

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[154] It has been noted that members of the Provincial Assembly participate in the PPP Board though this does not satisfy the responsibility of the Provincial Assembly to check upon policies, practices and performance of the government according to the constitution.

[155] Many governments include information on their PPP programs in budget documents and other financial reports. Some governments table project or contract summaries in parliament within a specified time after financial close. This gives parliament the opportunity to scrutinize the government's commitments to PPPs and hold the decision-makers responsible after the event. Parliament may also commission and receive auditors' reports on the PPP program.

6.5. Performance under Crisis

6.5.1. Impact of COVID-19 on PPP Program

COVID-19 has impacted Sindh even worse than it has other parts of Pakistan. With some 270,000 confirmed cases as of April 14, 2021, the province accounts for 45 percent of the COVID-19 cases registered in Pakistan, whereas its population accounts for only 22 percent of the total 220 million population. The reason why goes beyond the scope of this review.

6.5.2. Measures implemented to help cope with the consequences of the COVID-19 crisis

Government measures to control the pandemic are largely similar to those of other countries and include restrictions on opening hours, maximum group sizes, working from home instructions, and compulsory mask wearing.

As a result of COVID-19 and related cuts in federal transfers, the GoS had to reduce its budget substantially. The GoS earmarked PRs 155 billion for the provincial Annual Development Plan (ADP), which included traditional investment projects and PPPs for fiscal year 2020-21, and which was a massive 25 percent lower than the PRs 208 billion allocated for fiscal year 2019-20. Under the provincial ADP 2020-21, the GoS allocated PRs 120.63 billion for ongoing projects and PRs 34.73 billion for new projects, which was only 15 percent of the allocation.[156]

Box 7.5: Sindh Government Prioritizes PPPs in Wake of COVID-19

Chief Minister Syed Murad Ali Shah on May 16, 2020 said that the budget for the next financial year would be impacted by coronavirus. The chief minister said that the coronavirus emergency indicators such as increase in expenditures, decrease in government revenues, decline in exports, unemployment and loss of purchasing power were horrible and needed to be addressed with a new strategy.

He told his team that the first and top priority would be given to strengthen the health systems under which Covid-19 emergency hospitals would be established.

Talking about employment generation, Shah said that the small, medium enterprises (SMEs) were hit hardest by the Covid-19 crisis and were in need of small loans, subsidies and other concessions to sustain. He said that soft loans would be given to SMEs, apart from other concessions and subsidies. He added that short-term loans would be up to Rs500,000 to small business and Rs2 million to medium enterprises.

He said that investment would be made in the agriculture sector where soft loans for purchasing export quality seeds and urea would be advanced so that export quality rice, pulses and other crops could be cultivated.

The chief minister said that the development budget might be curtailed to create budgetary space for health services, revival of economy by advancing loans to traders, growers and in livestock and fisheries sectors. However, health department schemes, education, road sector water supply and sanitation would be given priority.

[156] Government of Sindh. 2020. Budget Analysis 2020-2021.

He said that all the mega development projects would be initiated on public-private partnership. "This will help to minimise financial pressure on the government and help in creating employment opportunities," he said.

Source: Siddiqui, Tahir. 2020. "Murad says next Sindh budget to be impacted by coronavirus. *Dawn*, May 17, 2020.

Although as a result of COVID-19 and the consequent reduction in the budget, the GoS will be considering PPPs to develop much-needed infrastructure, a reduced budget will clearly also reduce the fiscal space for new PPP initiatives and thus constrain further expansion of the PPP portfolio given the need for public finance support mechanisms for ensuring bankability.

COVID-19 will also increase the value of contingent liabilities. It can be reasoned that as a result of the restrictions, demand for economic infrastructure will temporarily drop, e.g., there will be less mobility, implying that the probability that a MRG will be called on increases. Furthermore, it could be reasoned that because of COVID-19, projects will be faced with inefficiencies (increased sick rates, inefficiencies because of work-from-home instructions, etc.) which may impact the financial performance of ongoing PPP projects. These effects may also increase the probability of contractor default and thus the need for early contract termination compensation. This is illustrated in the claim for relief brought forward by Charter for Compassion Pakistan, one of the education management organizations that manages nine schools under an operations and maintenance arrangement, as a result of the lockdown imposed by the GoS. The private company was not able to comply with the agreed upon performance standards and is claiming relief on the ground of force majeure. The issue originates from August 2020 and it was partly settled, as relief was granted wih respect to fixed costs (such as salaries and utilities).

Finally, it could be argued, as experienced already, that bidders and lenders may have less capacity to respond to PPP opportunities, whether because of reduced financial performance of their business portfolios as a whole, reduced staff capacity, or for other reasons.

Box 7.6: PPP Re-bidding Required as a Result of COVID-19

The government of Sindh has called for re-bidding for the Dhabeji Special Economic Zone (SEZ) after the developer, selected earlier through bidding, withdrew due to the disruption caused by the Covid-19 lockdown. "The preferred bidder was unable to move on with its commitment due to the severe impact of Covid-19," said Special Economic Zone Management Company (SEZMC) Chief Executive Officer Abdul Azeem Uqaili in an interview with The Express Tribune.

Source: Hanif, Usman. 2020. "Sindh govt calls for Dhabeji SEZ rebidding." December 16, 2020, *The Express Tribune*.

Annex 6 A: Pakistan, Government of Sindh FCCL Principles

For PPPs to become affordable and deliver value for money, they typically need to be highly leveraged with long-term debt. However, the current supply of private capital is concentrated on short-term financing from domestic banks (in some cases prolonged through State Bank of Pakistan's refinancing facility) and equity risk capital from family offices focused on the energy sector. Other sources of non-bank capital are limited, i.e., i) the bond market is nascent, ii) foreign direct investment is limited because of high country risk perception and non-investment grade ratings, and iii) bilateral/multilateral capital is available though accompanied by high transaction costs. These facts suggest a need for the government to address these financial market imperfections.

For this purpose, the ADB retained in January 2020 the Rebel Group from the Netherlands to recommend how the already established Pakistan Development Fund Ltd could be operationalized to effectively address these market imperfections. Recommendations had been expected in 2021.

#	Principles	Clarification	Assessment for Sindh
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	Development of methodological guidance is under development with WB support.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	Appropriate calculations are being made to quantify direct and contingent liabilities with reference to the overall development budget for the province.
	CONTROL: Assessing affordability as an input to approval		
3	Fiscal Impact is evaluated by the relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated by taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	An exemplary review and approval process is place involving checks and balances by duly authorized agencies upon critical milestones in the development process.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	Methodological guidance is yet to be developed.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments)	Fiscal ceilings for PPP are yet to be defined although fiscal exposure from specific projects is presented

#	Principles	Clarification	Assessment for Sindh
		provides a reference for the affordability of PPPs.	as a share of the overall development budget.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Funding for direct and contingent liabilities is provided through the PPP Support facility, a dedicated facility for public co-financing.
7	Mechanisms are in place to ensure funding is available for contingent liabilities	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to fund contingent liabilities should they materialize	Funding for direct and contingent liabilities is provided through the PPP Support Facility, a dedicated facility for public co-financing.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Implementation of IPSAS on an accrual basis is under development.
9	The legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	No comprehensive reporting on the fiscal impact of the PPP program is in place.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	The Auditor General of Pakistan is mandated to undertake regulatory and performance audits on all jurisdictions including the provincial authorities and their projects.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including SOEs that are under the control of the Sindh province.

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Chapter 7: Peru

Chapter 7: Peru

Acronyms and Abbreviations

APM	Multi-Annual Budget Allocation
CG	Comptroller General
CPIP	Committee for the Promotion of Private Investment
CRPAO	Certificado de Reconocimiento de Derechos del Pago Anual por Obras
DL	Decreto Legislativo
DS	Decreto Supremo
ER	evaluation report
FCCL	fiscal commitments and contingent liabilities
GDP	gross domestic product
IMIAPP	Multi-Annual Investment Report
IPSAS	International Public Sector Accounting Standards
MDB	multilateral development banks
MEF	Ministry of Economy and Finance
MML	Metropolitan Municipality of Lima
MMM	Multi-Annual Macroeconomic Framework
MRG	minimum revenue guarantee
OPIP	Agency for the Promotion of Private Investment
OSITRAN	Organismo Supervisor de la Inversión en Infraestructura de Transporte de Uso Público
PAMO	Pago Annual por Mantenimiento y Operacion
PAO	Pago Adelantado por Obras
PE	public entity
PPI	Private Participation in Infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PPO	Pago por Obras
PPP	public-private partnership
RB	regulatory body
RD	Resolucion Directoral
RM	Resolucion Ministerial
RPI	Retribucion por el Pago de Infraestructura

RPICAO	Retribuciones por Inversiones según Certificado de Avance de Obras
RPMO	Retribucion de Pago por Mantenimiento y Operacion
SNPIP	National System of Private Investment Promotion
TPI	traditional public investment
UIT	Unidad Impositiva Tributaria
USP	unsolicited proposal
VfM	value for money

Executive Summary

Peru was an early adopter of public-private partnership (PPP) legislation in the Latin America region. Since its first PPP law was enacted in 2008, the country has focused on developing economic infrastructure through this type of scheme, particularly for the transport and energy sectors. However, the global pandemic has prompted new attention to the pipeline of projects aimed at bridging the social infrastructure gap, particularly with respect to health and sanitation.

Although Peru has twice re-enacted its PPP regulations (2015 and 2018) with the aim of reducing project bottlenecks in the initial phases, each new piece of legislation has not led to a greater number of projects, and almost 80 percent of the PPP projects in execution come from when the first PPP laws and regulations came in use (2008-2015). However, Peru has assembled an ambitious pipeline for the coming years that will take advantage of the expertise gained, enhance administrative processes, and standardize guidelines on contracts and financial structuring.

A multi-institutional process, called the National System of Private Investment Promotion (SNPIP), provides checks and balances for different decisions in the PPP cycle. In fact, the country has strengthened its planning, evaluation, and assessment through a variety of methodologies and guidelines. In terms of the fiscal commitments and contingent liabilities (FCCL) framework, Peru has implemented a special methodology for assessing contingent liabilities based on stochastics models that are recorded with the project's direct commitment in the National PPP Registry (which is updated semi-annually). Additionally, the PPP framework has been improved in several dimensions, such as the early identification of projects with the greatest chances of generating value for money (e.g., eligibility criteria), the planning process (e.g., Multi-Annual Investment Reports, or IMIAPP), the evaluation, etc. Risk allocation in Peru is not standardized, and although general risk allocation principles apply (i.e., the risk is allocated to the party best able to manage it), a potential threat to correct risk allocation could come from the funding scheme for PPP projects, which can reduce or eliminate the construction and financing risks that have been recognized and that must be allocated to the private party side.

Fiscal commitments are recorded, monitored, and updated periodically in Peru in order to provide accurate figures that are reported annually in the Multi-Annual Macroeconomic Framework (MMM). The MMM provides estimates of the PPP fiscal commitments for the following three years and reports on whether the ceiling on PPP fiscal commitments is in line with legislation. Regarding national accounts, Peru bases its methodology on international standards, and has a national budget system that considers a special appropriation called the Multiannual Budget Assignment (APM, in Spanish), which seeks to determine the maximum amount up to which no additional expenses can be programmed for a public entity (PE). Although the PPP Law emphasizes transparency for PPP project information, there are some exceptions to this, particularly the information protected by other laws (e.g., bank secrecy).

Peru has responded to the global COVID-19 crisis in two ways: first, by using the large fiscal space towards the PPP ceiling, it has aimed to boost investment through the use of PPP schemes; second, in those cases in which a concession was affected by the global pandemic, by re-establishing the concession's financial equilibrium through a compensations scheme referred to in the contract. However, several areas of improvement could be implemented, with more robust methods that deal with atypical information in measuring contingent commitments, and with guidelines for contract modifications could indicate how investors could be compensated if a similar crisis occurs again.

7.1. PPP Experience

Peru was an early adopter of PPP legislation in Latin America, however, since then, the law has changed and been re-enacted two different times. As with many other countries in Latin America, Peru's experience with concessions dates back to the early 1990s.[157] In fact, Peru was among the first countries in the region to issue a public-private partnership law, in 2008. Since then, the PPP Law has been re-enacted twice, with multiple amendments in between in order to incorporate the best international practices.

The changes in the PPP Law have not, however, been translated into a greater number of projects compared to when the first PPP Law was in force. Since 2016 (see Figure 8.1), the average number of PPP projects that have reached financial close has dropped substantially. This drop can be attributed to a number of factors, such as more complex and demanding processes, gaps in the system's capacity, and a complex political context that has slowed down the process of taking projects to market. In fact, constant changes in administrations and policy agendas, combined with the need to strengthen technical and project management capacity, have encouraged procurement through unsolicited proposals. Moreover, pipeline projects are generally five years or more into the preparation stage, indicating slow processes.[158]

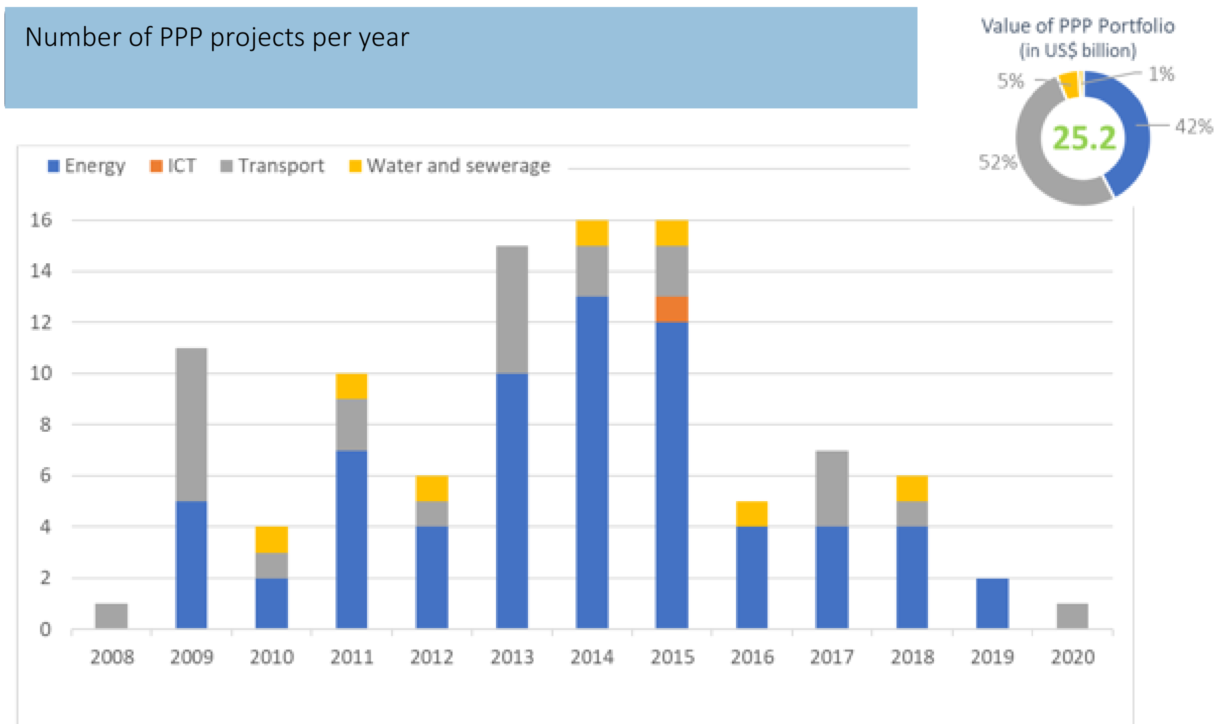
The PPP projects in Peru are very focused on developing economic infrastructure; in particular, the transport and energy sectors have dominated the PPP portfolio. According to the World Bank Private Participation in Infrastructure (PPI) database, since the enactment of the first PPP Law in 2008, Peru has initiated 100 PPP projects, with a total investment at face value of US$25.2 billion. In terms of the number of projects, the energy sector, particularly the electricity sector, has been one of the most active under the PPP Law, with 53 out of 67 projects (79 percent) reaching financial close within the period when the first version of the PPP legislation was in force (2008-2015). The transport sector also bloomed under the first version of the legislation, with 18 out of 25 PPP projects (72 percent) reaching financial close. Figure 8.5Figure 8.5: Number of PPPs by Primary SectorFigure 8.5 (below) shows the number of PPPs by sector and year of financial close. The upper-right figure shows the sector distribution of the PPP portfolio. We can see that despite the energy sector being the largest by number of projects, the transport sector is the largest in terms of investment amounts and accounts for the half of the total PPP portfolio's value. In fact, the average investment for PPP projects within the energy sector is US$159 million, whereas the average for the transport sector comes to US$518 million. The transport sector, which amounts to 52 percent of the total portfolio by investment value, is followed closely by the energy (42 percent), water and sanitation (5 percent), and telecommunication (1 percent) sectors.

However, there have been some modest attempts to bring social infrastructure into the PPP portfolio, mostly in the health sector. In particular, a consortium of advisers was selected by the government to consult on three projects related to the health sector in September 2015.[159] The result was that two new hospitals (Chimbote and Piura), for an approximate investment of US$254 million, are now part of the

[157] In the early 1990s, many Latin American countries initiated a strong program of concessions, mostly in transport infrastructure.
[158]PPIAF 2021. Technical support to ProInversión for structuring of competitive selection and contracting of PPPs in Peru. https://ppiaf.org/activity/peru-technical-support-proinversion-structuring-competitive-selection-and-contracting-0
[159] Whiteaker, Jon. 2018. "Altura Capital to advise Proinversion on healthcare PPPs." IJGlobal, January 15, 2018. https://ijglobal.com/articles/131654/altura-capital-to-advise-proinversion-on-healthcare-ppps.

government's pipeline launched in 2021.[160] These projects will accompany the Torre Bicentenario health facility project that was awarded in 2010, but which was expected to start operating in 2021.[161]

Figure 8.5: Number of PPPs by Primary Sector



Source: Author's elaboration with data from World Bank PPI database.

Although PPP projects are carried out through a multi-institutional process that seeks to speed up investment, projects still take a long time in the initial phases. Peru faces several challenges in terms of institutional capacity, because several projects sit for five or more years in the pipeline at the preparation stage,[162] and it takes on average 37 months from their inclusion in the promotion plan to financial closure.[163] Moreover, renegotiations and transparency are areas in which Peru is among the least advanced in the region; this, however, has started to change with the inclusion of stronger standardized anti-corruption clauses, and with the Ministry of Economy and Finance (MEF) taking a more active role in contract renegotiations.

Peru has an ambitious pipeline for the future that will take advantage of the expertise gained over the years. The government plans to award 20 PPPs in 2021 (11 from publicly initiated proposals, and nine from unsolicited proposals) with a value of US$2.5 billion in investment. From 2022 onwards, there are at least

[160] Ennes, Juliana. 2021. "Peru launches PPP portfolio." IJGlobal, January 22, 2020. https://ijglobal.com/articles/145108/peru-launches-ppp-portfolio.

[161] Bedoya, Daniel. 2019. "Torre de Essalud construida hace más de 40 años entraría en funcionamiento en el 2021." *El Comercio*, March 11, 2019. https://elcomercio.pe/lima/obras/torre-de-essalud-construida-hace-mas-de-40-anos-entraria-en-funcionamiento-en-el-2021-torre-bicentenario-noticia/?ref=ecr.

[162] World Bank. 2021.

[163] World Bank. 2020. "Policy Note on Attracting Private Investment to Infrastructure in Peru: Achievements, Challenges and a Way Forward."

19 projects being structured.[164] The projects are aimed at bridging the gap in economic and social infrastructure, and giving a push to the economic recovery after the recession caused by the global pandemic. Furthermore, the government has crafted a PPP portfolio that is investor-friendly with the aim of speeding up the investment that has been delayed in the last few years.

To improve the quality of projects, ProInversion—Agencia de Promoción de la Inversión Privada, Peru's private investment promotion agency—has been preparing the Standard PPP Contract and Financial Structuring Guide. These tools seek to standardize processes and generate a stable, transparent framework with predictable and clear rules for entities, and potential bidders and financiers on issues of risk allocation, guarantees, and expiration, among others.[165]

7.2. Legal Framework and PPP Approval Process

7.2.1. PPP Governance, Institutional and Legal Framework

Within 10 years of adoption of its first PPP Law, Peru changed its main PPP legislation twice and amended the regulations several times to enhance private sector participation (see Figure 8.6Figure 8.5).[166] In fact, just a few months after the first PPP Law was enacted, the 2008 global financial crisis shook the country and led the government to implement different measures to counteract the effects of crisis. These measures were intended to speed up investments in PPPs for selected projects. In particular, these measures were executed through a series of emergency decrees that granted exemptions to, initially, 12 priority projects (which later was increased to more than 52 priority projects). Among the exceptions granted by the emergency decrees, ProInversión determined discretionally the maximum level of co-funding required by projects, as well as the maximum amount of financial and non-financial guarantees. Additionally, these measures included a waiver for public entities from applying the public sector comparator (PSC) methodology for PPP projects,[167] however, this measure did not exempt the public entity from using a cost-benefit analysis. In general, all these measures were aimed at speeding up investments, and they were in force from December 2008 to 2012.

A long-standing challenge for PPP projects in Peru is the recurrence and high cost of renegotiations, however, various legislative measures have aimed to tackle this problem. Although we are not aware of any report that analyzes the efficacy of the emergency decrees for promoting private investments, nor their impact on fiscal commitments and contingent liabilities (FCCL), a more general report was published by the General Comptroller analyzing the causes and effects of contractual renegotiations in concession and PPP projects in Peru.[168] In particular, the report found that almost 85 percent of renegotiations occurred within five years of the contract signing, and almost 50 percent of renegotiations were due to incorrect definition of the scope of construction works, difficulties reaching financial close, and delays in expropriating the land.

[164] Ennes, Juliana. 2021. "Next stop: Peru." IJGlobal, February 9, 2021. https://ijglobal.com/articles/153099/next-stop-peru.

[165] InfraPPP. 2020. "ProInversión presents new portfolio of PPP projects in Peru for 2020-2021." https://www.infrapppworld.com/update/proinversion-presents-new-portfolio-of-ppp-projects-in-peru-for-2020-2021.

[166] As is commonly the case, the enforcement of each new law is not retroactive, and projects that have already been included in the tender stage (for public-initiated), or have been declared in the public interest within 180 days of the enactment of the new PPP Law (for private-initiated), must observe the legislation in effect at that time.

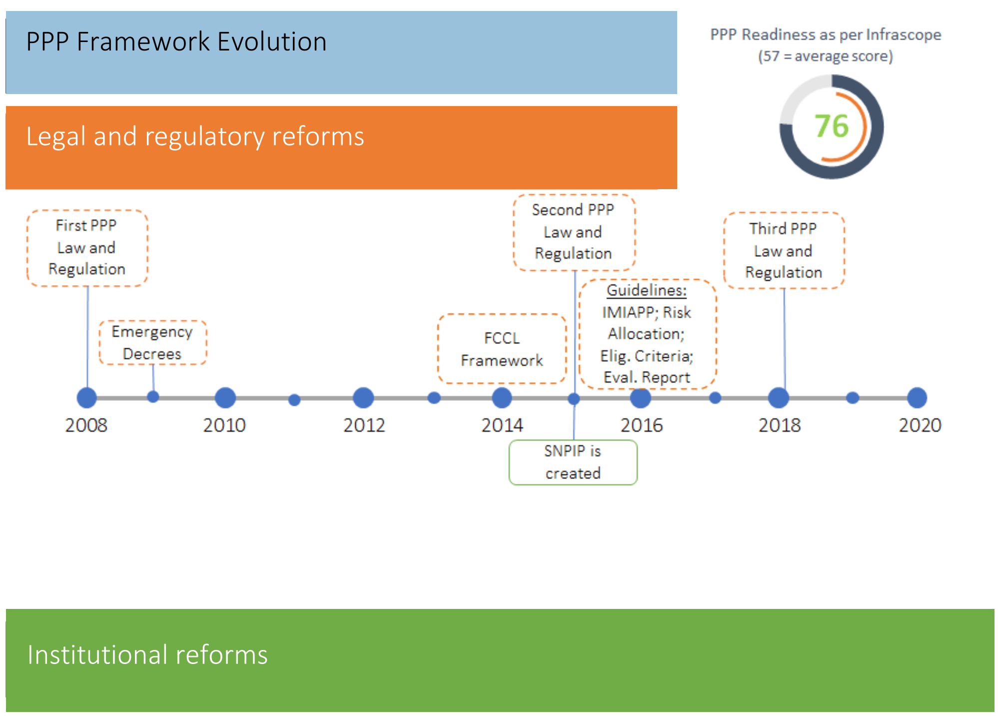
[167] A public sector comparator assessment was not required for all the projects. In particular, it was required only for those projects with co-funding of more than 30 percent of the total investment cost and with the project's total investment more than 100,000 UIT (about US$110 million at the 2009 exchange rate).

[168] Contraloría General de la República. 2015. "Causas y efectos de las renegociaciones contractuales de las Asociaciones Público–Privadas en el Perú."

An additional feature from the first PPP Law, which is still in use, is the FCCL methodology and the National Registry of PPP Contracts. These tools were implemented through a legal modification in 2014.

The second PPP Law brought changes aimed at verifying the value for money in the initial phases of the projects and increasing the ceiling for fiscal commitments. One of the most significant changes in terms of FCCL was the increase in the regulatory limit for new fiscal commitments in PPP contracts (direct and contingent) from 7 percent to 12 percent of gross domestic product (GDP).[169] Additionally, the National System of Private Investment Promotion (SNPIP) was created; the SNPIP is an organizational structure that assigns a clear role to each institution involved in the PPP cycle. Furthermore, under the second PPP Law a number of new guidelines and regulations were introduced. Among the most relevant ones were the guidelines to enhance the planning, programming, structuring, and evaluation of PPP projects. For instance, in these new guidelines Peru implemented an eligibility index, which is a qualitative tool applied at an early stage to all potential PPPs to determine how likely a project is to generate value for money (VfM) (see Box 8.2). This tool replaced the Public Sector Comparator analysis, which was applied only to projects with certain characteristics at a later stage of the PPP cycle.

Figure 8.6: Main Changes in the PPP Framework in Peru



Source: Author's elaboration.

The second PPP Law also improved the planning process and budgeting for the public entities. The new legislation established the guidelines to prepare a Multi-Annual Investment Report (IMIAPP, according to its abbreviation in Spanish), which is a report that aims to improve the planning and budgeting of PPP projects within each ministry or regional or local government. Budgeting of projects is achieved by requiring each public entity to list potential PPP projects initiated during the three previous years in its own IMIAPP.

[169] This limit is computed and overseen by the Ministry of Economy and Finance as the present value of the stock of PPP direct and contingent commitments.

The IMIAPP also improves programming of public expenditures because it includes some indicators related to available fiscal space for additional current and capital expenditures.

Additionally, the second PPP Law improved the evaluation of projects through clear guidelines and reports. Another regulation implemented under the second PPP Law was the guideline for allocation of risks between private and public sectors. These guidelines list the main risks that a PPP project faces during design, construction, and operation and maintenance phases. Although the guidelines do not present an exhaustive list of risks, their usefulness lies in identifying the sources of risks, their impact, which party is better able to manage the risk (allocation), and how to mitigate those risks (see Table 8.3). The guidelines also include a mandate to prepare an evaluation report (ER). The ER is focused on: i) describing a project and its scope; ii) estimating demand for the service(s) and evaluating economic-financial terms of a project; iii) programming the use of public resources; iv) demonstrating that there is VfM (applying eligibility criteria); v) defining a provisional schedule for the promotion plan; and vi) defining a project execution schedule. Once the evaluation report is approved, the second report is elaborated. The second report is related to the structuring stage and produces a financial model of a PPP that includes: i) a payment mechanism to be used; ii) a shadow bid; and iii) a plan for reaching financial close for a PPP project.

The third PPP Law was aimed at improving the monitoring of projects and speed up investment. The Government of Peru changed the PPP Law and its regulations for the third time in 2018. The new changes were aimed at modifying some roles within the SNPIP. Among the most important ones are that now public entities with a PPP portfolio size above 300,000 UIT (Unidad Impositiva Tributaria; about US$350 million) can create a special unit within their own institution to oversee and manage the execution of physical and financial contracts.[170] Additionally, but only for national prioritized projects, the Ministry of Economy and Finance (MEF) was put in charge of advising public entities at each step of the cycle, instead of ProInversión, with the aim of removing any obstacles that arise along the cycle. Furthermore, ProInversión is allowed to perform dissuasive tasks if projects are stuck at the same stage for longer than six months due to the public entity's lack of action (for example, ProInversión is allowed to charge fees related to any support it provides, or it can exclude a project from the promotion process[171] for a three-month period, etc.). Although it is true that this measure is aimed at speeding up investments, it is also possible that for some complex projects the six-month period is not enough to progress to the next stage. Regarding the PPP cycle, one additional feature of the new law is that it enables the use of direct competitive negotiation mechanisms for complex PPP projects.[172] This mechanism leverages the expertise of pre-qualified bidders (from two to a maximum of five bidders) to participate during different stages of the PPP cycle to define the scope of a project, and it awards the contract to the pre-qualified bidder that submits the best proposal.[173] Currently, only four projects have reached financial close under this new law, with the total investment amount of US$446 million (three in the electricity sector, and one in sanitation).

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[170] The special units are funded with the public entity's own resources (i.e., no additional budget can be requested from the Ministry of Economy and Finance), and can only support the activities for which the public entity has a responsibility within the PPP cycle. Hence, it is difficult to identify how many of such units are already in place.

[171] The promotion process includes two stages within the PPP cycle, the structuring and the transaction stages.

[172] A PPP project can have access to the direct negotiation mechanism if: i) the project is listed within the public entity's IMIAPP; ii) it is a national project in which Peru has insufficient expertise in terms of design, build, finance, operation and maintenance; iii) the total investment cost is more than 200,000 UIT (more than US$230 million).

[173] This is comparable to the competitive dialogue process applied mostly in Europe.

Box 8.2: Eligibility Criteria for PPPs

According to the regulation implemented through the second PPP Law, the first test for a project to be considered eligible for a PPP scheme is related to a brief survey that aims at determining how feasible it is for a project to produce value for money (VfM) (e.g., among the questions asked is how much risk is transferred to the private sector, or how likely it is that the traditional public investment (TPI) has cost overruns or delays in similar projects). The survey is answered by a panel of experts,[174] and each question in the survey has a particular weight that leads to a total of 100 percent, with answers that have scores ranging from 1 to 3. Additionally, a bonus point is added if the PPP is considered to be commercially viable. The final score is obtained as the weighted sum normalized at 20, plus an additional bonus point, and in those cases it applies. Hence, a higher final score indicates a greater eligibility for a project to be structured as a PPP; that is, the project is considered to have a greater probability to produce VfM. In particular, if the aggregate score exceeds 11.5 points (the maximum score is 21), then the project is eligible to be considered as a PPP. The table below shows the survey questions posed to the panel of experts, the weight of each question, the different answers, and their scores.

Table B8.1.1: Eligibility Criteria Questions, Weighting, and Scores

Weight	Criteria	Score	Answer
15%	Expected risk transfer to the private sector	1	Null/Low
		2	Medium
		3	High
10%	Have indicators been developed that allow the implementation of a system of rewards and penalties based on performance?	1	Null
		2	Yes, but only at the international level
		3	Yes, Peru has developed their own measures
20%	Is there any evidence that support the idea that TPI generates cost overruns or delays?	1	No, there is no supporting evidence
		2	Yes, some anecdotical evidence in similar projects
		3	Yes, some quantitative evidence in similar projects as Peru
20%	Does the public entity have the capacity to carry out the operation and maintenance during the life of the project?	1	Yes, high capacity
		2	Yes, medium capacity
		3	Null capacity
20%	What's the expected total investment?	1	National Gov: 10,000 UIT < Total Investment < 50,000 UIT Regional/Local Gov: 7,000 UIT < Total Investment < 25,000 UIT
		2	National Gov: 50,000 UIT < Total Investment < 250,000 UIT Regional/Local Gov: 25,000 UIT < Total Investment < 100,000 UIT
		3	National Gov: Total Investment > 250,000 UIT Regional/Local Gov: Total Investment > 100,000 UIT
10%	What's the expected number of bidders?	1	At least 2 bidders
		2	Between 2 and 5 bidders
		3	Above 5 bidders
5%	Does the contracting public entity have a special PPP unit?	1	No
		2	Yes
Bonus point based on funding considerations			
	Is the project commercially viable (i.e. revenues cover at least 40% of the Investment Cost)?	0	No
		1	Yes

Source: Author's elaboration based on Resolución Directorial N ° 004-2016-EF/68.01.

This is a good approach because it provides thoughtful consideration of the project in the very early stages without the need for expensive studies, but it is based on previous evidence and the expertise of people who have experience with the topic. That is, the eligibility criteria provide an inexpensive way to qualitatively assess if the project would produce value for money. However, this assessment can be limited, and for some projects, a quantitative assessment, such as the public sector comparator, can provide better answers. This was the case in Peru before the second PPP Law, in which it was required that there be an elaboration of a public sector comparator for PPP projects that were above certain investment levels.

The PPP framework in Peru has improved over the years and is ranked among the top three within the region of Latin America and the Caribbean, however, it still has clear deficits in terms of renegotiations and transparency, although that has begun to change. According to the Economist Intelligence Unit Infrascope 2019 analysis, in terms of the best environment for PPPs in Latin America, Peru shares second place with Colombia, closely behind Chile. This position is achieved thanks to Peru's high score for investment and business climate, and financing, but the scores for regulations (13 out of 20), institutions (9 out of 20), and maturity (9 out of 20) are not as high—although higher than the world and regional averages. Renegotiations and transparency and accountability are the weak areas of the Peruvian PPP framework. Thus, Peru ranks the third worst in the region in terms of renegotiations (just above Venezuela, Barbados, and Trinidad and Tobago), and the third worst in terms of transparency and accountability (just above Venezuela, Ecuador, and Barbados). Although renegotiations are an area of struggle for Peru,[175] the MEF can improve its authority on the issue, and there are signs that it has started to play a more active role in the area. For instance, the MEF recently used its authority to submit a negative review of the request of the Metropolitan Municipality of Lima (MML) to renegotiate its contract, arguing that renegotiations affect the financial equilibrium, and that the anti-corruption clause proposed in the renegotiated contract is laxer than the standard one used by ProInversión. Without the favorable opinion of the MEF, MML cannot renegotiate its contract.[176]

7.2.2. The National System of Private Investment Promotion (SNPIP)

Peru's multi-institutional process of collaboration through the PPP cycle is called the National System of Private Investment Promotion (SNPIP). The SNPIP groups different institutions involved in the PPP cycle into five main actors, assigning to each a specific role in elaboration, review and approval of documents and studies that are required by the legislation to execute a PPP project (see Figure 8.Figure 8.7). In particular, the main documents that need to be elaborated and approved to progress to the next stage in the PPP cycle are: i) the Multi-Annual Investment Report (IMIAPP), which is a planning document in which each public entity lists the potential PPP projects to be promoted in the next three years; ii) the evaluation report, which is elaborated using the information coming from the pre-feasibility studies, and which is aimed at analyzing the convenience of carrying out a project as a PPP from technical, financial, and legal perspectives; iii) the promotion plan, which in a general way details the procurement method that will be used to award a contract, and a potential schedule of activities for different stages up to the contract signing; iv) the integral evaluation report, which is an extension of the evaluation report that includes technical information coming from feasibility studies; v) tender documents; vi) financial model; vii) the initial version of the contract; and viii) the final version of the contract. The SNPIP is then integrated by the following public institutions (see Figure 8.Figure 8.7: PPP Cycle):

- **The Ministry of Economy and Finance (MEF)** is in charge of reviewing the Multi-Annual Investment Report (IMIAPP), and reviewing and submitting binding opinions for the evaluation report (ER), the integral evaluation report, the initial and final versions of the contract as well as contractual modifications. This is particularly important for countries like Peru that have struggled with contract

[174] The panel of experts is chosen by the public entity based in the candidates' qualifications and years of experience. For instance, it is required that the experts have at least 10 years of experience in the topic, of which five years needs to be recent experience. Additionally, at least two experts are required for evaluating each project, as well as a moderator who presides over the meeting, all of whom need to have similar academic and professional credentials.

[175] Contraloría General de la República. 2015.

[176] Garcia, Elias. 2021. "Las razones del MEF para oponerse adenda al contrato con Rutas de Lima," *Gestion Magazine*, April 29, 2021. https://gestion.pe/economia/las-razones-del-mef-para-no-firmar-adenda-para-rutas-de-lima-noticia/?ref=gesr.

renegotiations before. The MEF is also in charge of admitting the contract to the National Registry of PPP Contracts, and the Registry of PPP Commitments. In cases of national projects that have been prioritized,[177] the MEF is responsible for support of the public entity at each step of the cycle with the aim of speeding up the investment.

- **The Public entity (PE) that sponsors a project (either a ministry, or a regional or local government)** is in charge of elaborating the IMIAPP and either elaborating it itself or delegating it to its respective Agency for the Promotion of Private Investment (OPIP, in Spanish) pre-feasibility studies. Additionally, the PE is in charge of reviewing and submitting a binding opinion for the initial and final versions of a contract; reviewing and submitting the required information to the National Registry of PPP Contracts; and elaborating, reviewing, and approving contractual modifications.
- **The regulatory body for the relevant sector** is in charge of reviewing and submitting non-binding opinions on the initial and final versions of a contract, and their modifications. Additionally, regulatory bodies submit information required for inclusion of a PPP contract in the National Registry of PPP Contracts.
- **The Agency for the Promotion of Private Investment (OPIP, for its acronym in Spanish)**[178] is in charge of supporting the elaboration of pre-feasibility studies as well as elaborating and approving the evaluation report, the promotion plan, the tender documents, the integral evaluation report, the financial model, and the initial and final versions of a PPP contract.
- **The Comptroller General (CG)** is in charge of reviewing and submitting an opinion about the final version of a PPP contract and its modifications, although the CG's opinion is non-binding. Additionally, the CG periodically audits PPP projects using its Guidelines for Audit PPP Compliance (Guía de auditoría de cumplimiento a las Asociaciones Público Privadas, in Spanish), in which it verifies the fulfillment of contractual clauses and identifies foreseeable risks.

Besides approving the legislation, the legislature does not have any other role within the PPP cycle, and the SNPIP is the only articulated system that deals with the PPP process. Unlike other countries in the region such as the Dominican Republic, Guatemala, Honduras, and El Salvador, the legislative branch in Peru doesn't have any role in approving a PPP project, which is considered a more objective approach. To varying extents, some countries in the region require the approval of more than one organization (ex-ante awarding), but all of them are located within the same executive branch. Adding an extra layer to the approval process that is not located within the same branch of power can politicize decisions. In fact, some empirical evidence suggests that in case of US states, investors are heavily discouraged from participating in PPP projects in those states where the state's legislative branch needs to approve the PPP project after

[177] The projects that have been prioritized are usually listed in the Government Gazette or as a special document. For instance, in the National Infrastructure for Competitiveness Plan are listed 52 prioritized projects.

[178] The OPIP is a generic name that can involve a different institution depending on the scope of the PPP project. For instance, ProInversión takes all the PPP projects which satisfy at least one of the following conditions: i) national projects proposed by the government that are multi-sectoral; ii) national projects proposed by the government with a total investment of more than 40,000 UIT (about US$5 million); iii) national unsolicited proposals that are self-funded; iv) national, regional, or local unsolicited proposals that are co-funded; v) projects which will be developed by direct competitive negotiation. For all the other cases, each ministry, or regional or local government must assign the project to its own Committee for the Promotion of Private Investment (CPIP, in Spanish), which is a committee formed with three high-level public officials within each public entity. Hence, depending on the characteristics of the project, the OPIP in charge of it could be ProInversión or the CPIP.

it has been awarded.[179] Whereas in Peru, the approval of the final version of a contract is done by OPIP together with the favorable opinion of the MEF.

7.2.3. PPP approval process

In Peru, projects can be defined in four different dimensions, two depending on the entity that proposed the project, and the other two depending on the funding scheme. In particular, PPP projects can be proposed by the public sector (public-initiated), or the private sector (private-initiated, or unsolicited proposals). Regardless of which party proposed a project, it can be funded by the government (co-funded), or by the users of services (self-funded). A project is considered self-funded if it doesn't require payments from the government and either or both of the following conditions are met: i) financial guarantees provided by the government are set below 5 percent of the total investment cost, or ii) non-financial guarantees have an attachment probability (i.e., probability that the guarantee will be triggered) of less than 10 percent. Meanwhile, a PPP project is considered co-funded if it demands a full or a partial payment from the government due to the nature of services provided by a project (e.g., availability of payments), or financial and non-financial guarantees requested by the project are above the ceiling established for self-funded projects. The implications of the classification in terms of processes are twofold, one related to the PPP cycle and the other related to the calendar in which the proposals can be presented. For instance, although the presentation of public-initiated PPP projects is commonly related to the budget cycle, the private-initiated co-funded PPP projects have to be presented within 30 working days (or 90 working days) after the national (or regional or local) government indicates its interest in a particular project. The private-initiated, self-funded PPP project can be presented at any time of the year.

However, the most important difference in terms of PPP classification is the one related to the PPP cycle, and it depends on which party presents the proposal, regardless of the funding scheme. There are three slightly different PPP cycles, two that vary depending on the type of party that proposed a project (i.e., public, or private, for unsolicited proposals), and the third one, which applies to a new mechanism established in the current PPP Law, for direct competitive negotiations. Figure 8.3 below presents a general framework for the PPP cycle in Peru, taking as the baseline the PPP cycle for projects that were proposed by the public sector, regardless of their funding scheme.

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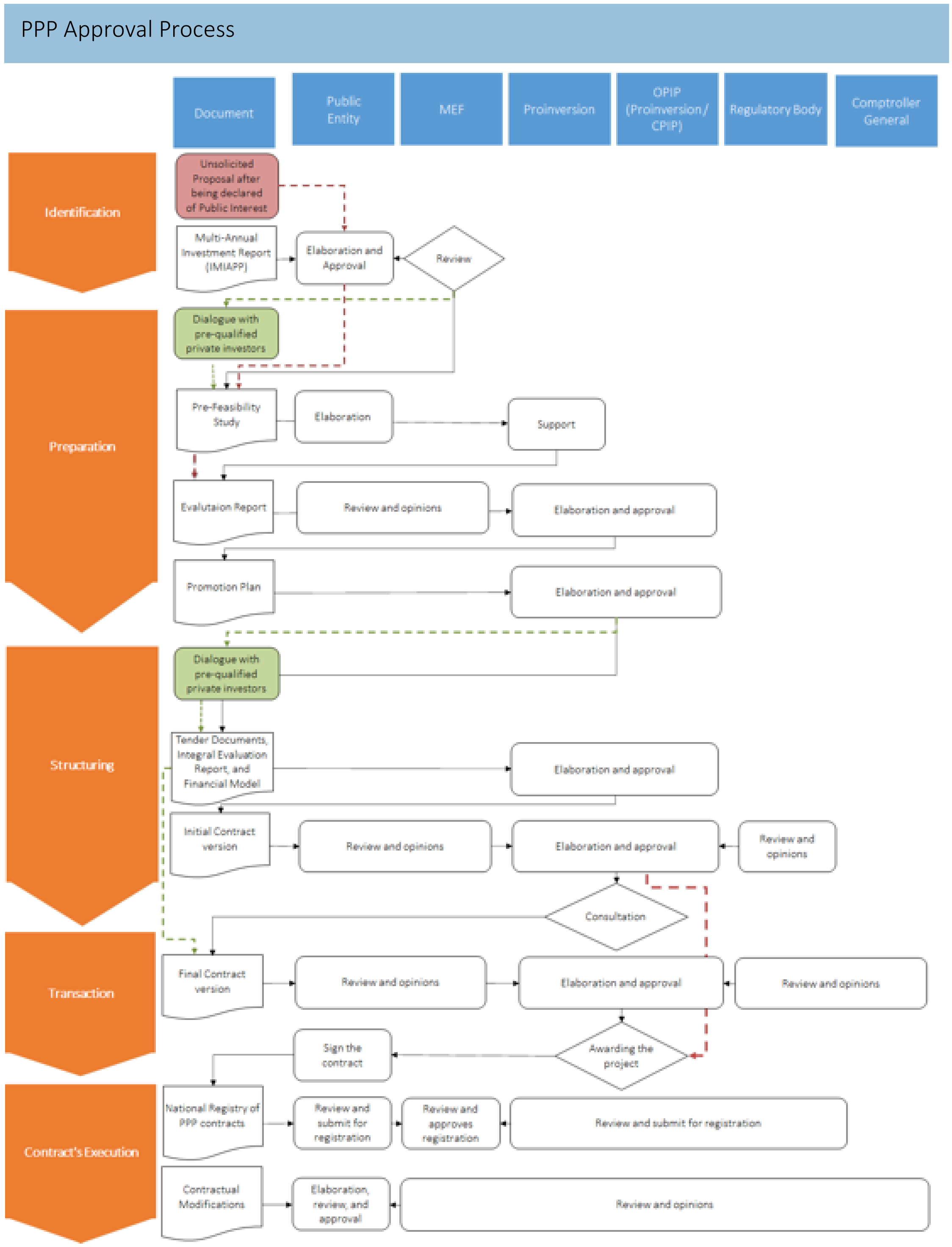
[179] Geddes, R. Richard, and Benjamin Wagner. 2013. “Why do U.S. states adopt public-private partnership enabling legislation?” *Journal of Urban Economics* 78: 30-41.

Figure 8.7: PPP Cycle



Source: Author's elaboration. *Note*: Baseline PPP cycle: Public self- or co-funded proposals (white box, black straight line); Unsolicited proposals and Direct competitive negotiation presents variations to the baseline PPP cycle in the spots represented by the red and green figures respectively.

7.2.4. Variations to the baseline PPP approval cycle

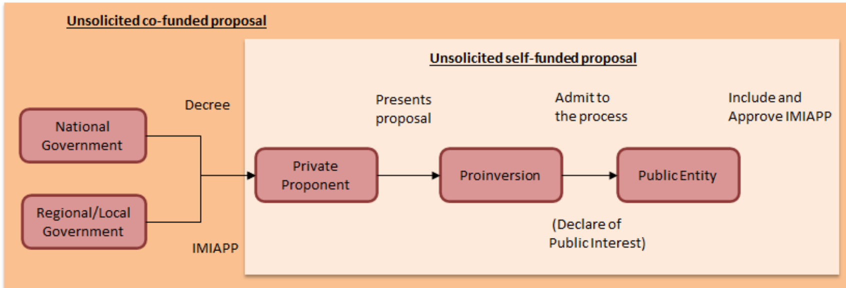
Direct competitive mechanisms and unsolicited proposals show some differences from the baseline PPP approval cycle. These differences are presented in Figure 8.Figure 8.7 with green dashed lines and boxes (in the case of direct competitive mechanism) and red dashed lines and boxes (in the case of unsolicited proposals). In the case of a direct competitive mechanism, it is clear that a dialogue with the pre-qualified investors is performed in the preparation and structuring stages. These dialogues help define the scope of the pre-feasibility and feasibility studies, the tender documents, and the final version of a contract. Because pre-qualified investors are participating in the elaboration and structuring of a project and the related contract, there is no consultative or initial version of a contract; instead, the final version of a contract is directly drafted and awarded. Meanwhile, in the case of unsolicited proposals (USPs), the differences mainly lie in the identification stage before the proposal is included in the IMIAPP. Also, because proposals are presented by a private party, the private proponent is in charge of the elaboration of pre-feasibility studies. Lastly, in cases in which no other investors are interested in competing for a project, there is no consultation process, and the project can be awarded directly to the initial proponent. If there are other investors interested in competing for the project, then the normal consultation process is performed. Figure 8.4 provides a brief description of the main differences in the approval process of USPs before they are included in the IMIAPP.

Unsolicited proposals that are co-funded start their cycle directly with the interest of the public entity (either national, or regional or local government), which includes the project in a decree (national government) or in its IMIAPP (regional or local). Then, the private proponent presents a proposal that needs to be admitted to the process by ProInversión. Once the proposal is admitted to the process, the public entity needs to review the proposal, and make sure it meets the set requirements. If this is the case, the public entity includes the project and approves the IMIAPP. One interesting feature is that unsolicited, co-funded proposals can only be presented within the first 90 calendar days of the year (for regional and local governments), and within the first 30 working days after the decree is published (for the national government). These restrictions are oriented to keep some consistency with the budget's planning.

Meanwhile, unsolicited proposals that are self-funded start their cycle directly with the interest of the private sector entity, which submits a proposal to the OPIP (which can be represented by ProInversión or the Committee for the Promotion of Private Investment—CPIP, in Spanish). The process is similar to the one for unsolicited co-funded proposals without pre-establishing a public interest for a project through a decree or IMIAPP. This type of proposal can be presented at any time of the year.

Regardless of the PPP cycle, all PPP schemes are subject to a competitive process. Following the principles established in Peru's PPP Law, the PPP promotes competition and equal treatment among bidders, and avoids anti-competitive or collusive conduct. In this sense, regardless of the PPP scheme or cycle, all the projects are subject to a competitive tender when more than one participant is interested in developing the project. When there is only one participant interested in the project, the PPP can be awarded directly.

Figure 8.8: USP Co-Funded Initial Cycle



7.2.5. International Support in PPP Development

Different institutions have provided technical assistance to Peru to strengthen its PPP projects and institutional framework. For instance, since the PPP Law was enacted in 2008, the Public-Private Infrastructure Advisory Facility (PPIAF) has provided technical assistance on project-specific topics or sectors, and on improvement of the regulatory framework. Table 8.1 below shows the different interventions.

Table 8.2: Peru-PPIAF Interventions Timeline

Peru - PPIAF interventions timeline			
			US$
2020	Advisory Support for the Power Sector Modernization Reform	N.A.	$200,000
	Technical support to Proinversion for structuring of competitive selection and contracting of PPPs	Assessment of the major constraints and delays in the PPP promotion process by assessing recommendations in the competitive selection process like risk allocation, procurement, and project financing on a cost-effective basis.	$150,000
	Lima Urban Cable Car System – Institutional and PPP Business Model Development Support	Analysis of the business model for private operation and maintenance of the San Juan de Lurigancho (SJL) cable car project in Lima, Peru.	$100,000
2019	Technical Assistance to SEDAPAL Investment Planning & Tariff Study	Review of the tariff impact of Obras de Cabecera (OdC), a bulk water development PPP project being structured by Proinversion with advisory support from IFC. The review included the development of a draft financial model and associated scenarios. Subsequent work focused on further development of the utility's financial model to allow for more detailed estimates of the probable impact of the proposed PPP project on tariffs and on the utility's planned investment program.	$180,000
	Lima PPP metro network and institutional arrangements	Objective of this collaboration is to strengthen the institutional capacity and governance of the GOP to implement new Urban Transport Authority (ATU).	$150,000
2017	Developing a Transit Oriented Development Project via PPP in Lima - Evaluation of potential for Lima Metro's Line 2 Project	Exploring possibilities for land value capture to finance transit-oriented development alongside Line 2 of the Metro system.	$300,000
2014	Institutional Strengthening and Capacity Building Support to Lima Metro Lines 2&4	Strengthening OSITRAN as an institution so that it can play its role as independent regulator to properly enforce the contractual obligations of the Line 2 & 4 PPP projects, and at the same time function as a catalyst to build consensus and coordinate the various federal and municipal agencies involved with the reform of the transportation system in the large Lima metropolitan area.	$156,550
2013	Strengthening the PPP Project Cycle and Capacity Building Program with Proinversion and Line Ministries	Identifying practical recommendations to improve the efficiency of the project cycle for PPPs. This activity builds the institutional capacity of Proinversión and PPP units housed in line ministries to select, structure and procure PPPs.	$100,000
	Economic and Financial Assessment of PPP Projects Through a Value-for-Money Methodology	Assisting the Government of Peru's infrastructure investment agenda by reducing the barriers to implementing efficient PPPs. The assistance will help to strengthen the PPP process, from project identification to financial closure, by ensuring that the decisions concerning when and how to use PPPs are based on a sound economic and financial assessment of projects in the pipeline.	$75,000
2012	PPP Options for Irrigation Infrastructure	Advising the government on how to improve the prospects for PPP in irrigation in the country in general and, more specifically, to provide recommendations on how to improve the Chavimochic PPP model in order to achieve a successful deal	$75,000

Source: Public-Private Infrastructure Advisory Facility (PPIAF).

Peru has benefited from extensive technical advice on issues related to the regulatory framework, and on specific project and sectoral issues. With respect to the PPP framework, interventions have been focused on strengthening the PPP project cycle, ensuring value for money on PPP projects, and, more recently, finding the bottlenecks that interfere with PPPs, as well as defining a better risk allocation, and generating more competition in the bidding for projects**.** Other advice has been related to project-specific topics (e.g., Lima's Metro, urban cable, and others). Additional advice is likely to be necessary in order to strengthen the processes that will accompany the government's response to the global pandemic.

7.3. Analysis of Projects

7.3.1. Identifying and Prioritizing PPP Projects

In Peru, any project that will be structured as a PPP must be included in the Multi-Annual Investment Report (IMIAPP), regardless of whether it was proposed by the public or private sector. The IMIAPP is a report prepared by each public entity (i.e., ministry, regional or local government) which lists the potential PPPs to be included in the promotion plan within the next three years, as well as current PPP projects. Additionally, the report is a tool for public budget programming because the direct and contingent commitments for

PPPs and the general budget of the public entity are projected over a 15-year horizon. This projection is used to compute two indexes of budget rigidity: PPP current expenditure rigidity, and PPP capital expenditure rigidity.[180] Although both indexes and direct and contingent liabilities are computed for information purposes only, the Ministry of Economy and Finance is in charge of reviewing the IMIAPP and submitting its binding opinions regarding the budget's capacity and the convenience of carrying out a project as a PPP. The minimum required information that a public entity must include in an IMIAPP is: i) strategy for developing PPPs, ii) medium-term strategy for closing the infrastructure gap that was identified in different plans (e.g., multiannual, national, sectoral, regional, or local), iii) the project's investment amount, iv) expected value for money determined with the help of eligibility criteria (see Box 8.2), and v) direct and contingent fiscal commitments (with a 15-year projection) and budget rigidity indexes. No PPP can start its project cycle without being included in the IMIAPP first, and although there is no uniform methodology for project prioritization within the IMIAPP—that is, public entities define their own prioritization methodologies—the medium-term plans are supposed to guide public entities on this matter.

Several public entities have established an ambitious pipeline of PPP projects through their IMIAPPs, however, based on past experience, it is unlikely that all the projects will see the light. From 2018 to 2020, seven ministries, one regional government, and one municipality approved an IMIAPP for a total number of 61 potential PPPs. However, given the low number of projects reaching financial close in the last five years (i.e., 14 projects), it is very unlikely that a significant proportion of these projects will reach financial close in the near future. In fact, even when projects are included in the promotion plan in the following three years, there is evidence that projects can take an average of 37 months to progress from the promotion plan stage to financial close.[181]

There are other documents, in addition to the IMIAPP, that aim to provide further information about project return and to offer an accurate assessment of fiscal commitments. The projects listed in the IMIAPP can move forward to the preparation stage (see Figure 8.7: PPP Cycle). In this stage, different technical studies are elaborated at the pre-feasibility level. The document that incorporates all this information is the evaluation report. The evaluation report determines whether it is technically, economically and legally convenient to develop a project as a PPP. In particular, the report presents a preliminary version of the project's structuring and identifies significant contingencies that could delay the promotion process, mainly related to legal, financial, and technical aspects. The OPIP is the entity in charge of elaborating and approving the evaluation report, however, the favorable opinion of the Ministry of Economy and Finance is required in order to move forward. The Ministry of Economy and Finance submits its opinion regarding correct classification of the PPP type (i.e., funding scheme and origin of a proposal), the budget capacity if public resources are required (direct and contingent), the value for money (through eligibility criteria), and the project's impact on the market. Once the promotion process has started and feasibility studies are prepared, an additional evaluation report (i.e., the integral evaluation report), is elaborated with the aim of increasing the accuracy of estimations. This means that the estimates for direct and contingent commitments are refined as more precise information is received. At the end of the consultation period that results in the final version of the contract and once the tender winner is declared, the commitments that are registered in the National Registry of PPP Contracts proceed. As we will see in the next section, Peru has implemented a special methodology for assessing contingent liabilities. This assessment is registered in the National Registry of PPP Contracts, and is updated every six months or whenever an adverse event triggers realization of the contingency.

[180] The indexes are computed as follows: $Index1._t = \frac{PPP.Tot.Capital\ Comm_t}{Tot.Current\ Expenditure\ _t}$; and $Index2._t = \frac{PPP.Tot.Current\ Comm_t}{Current\ Expenditure\ of\ the\ Pub.Ent_t}$

[181] World Bank (2020), idem.

7.3.2. Assessment of PPP Fiscal Implications

Peru has a special methodology for assessing contingent liabilities based on probabilistic models. This methodology requires the use of historical data (with at least 30 years of information), or, in cases when there is not enough information, it relies on the use of a panel of experts formed by 10 independent professionals with significant expertise, by submitting to them the parameters needed for assessing contingent commitments in accordance with the established methodology (a general overview of the methodology is included in Annex 7 B).

The aim of the methodology is to provide estimates on the contingent liability assumed by the government, and is updated periodically. This methodology was established by the Ministry of Economy and Finance, and both public entities and the OPIP (either ProInversión or the CPIP) use it to assess contingencies for their inclusion in the IMIAPP and the (integral) evaluation report. Given that the assessed value of contingent and direct liabilities in the integral evaluation report feeds into the final contract version, it can be deduced that these estimates are also the ones that are recorded in the National Registry of PPP Contracts for the first time. Once in the registry, this information must be updated semi-annually by the public entity using the cited methodology. If there is not enough information to assess the contingencies using Monte Carlo simulations, a panel of experts is formed with specialists from the public entity. The Ministry of Economy and Finance is in charge of ensuring that the stock of direct and contingent liabilities net of revenues is below the established limit of 12 percent of GDP.

Although the methodology serves its purpose reasonably well, its limitations should be taken into account. One of the most important ones is the fact that statistical methods used in the methodology are well-suited for regular, normal market conditions, as they are based on Least Square methods,[182] however, since the model relies on historical values for making projections, the use of atypical data or outliers (e.g., those observed in the crisis scenario of the 2020-2021 pandemic) can be problematic. In this sense, the MEF should propose a strategy and set guidelines for how public entities should apply the methodology in these atypical circumstances, or else there is a risk that the estimates produced by the current methodology would cause a bias in the estimates.

7.3.3. PPP Risk Analysis

Although each PPP project faces different challenges, which are sometimes difficult to generalize, there are certain risks that are common to all PPP projects. In a PPP contract, allocation of these risks between the private and the public sector is not trivial and needs to be studied carefully, since the success of a project and its ability to generate value for money (VfM) depends, to a large extent, on this allocation. In Peru, regulation Resolución Ministerial (RM) N ° 167-2016-EF-15 lists the most common types of risks in PPP projects, as well as provides some suggestions regarding which is the party most capable of bearing the risk. This allocation is very similar to some documented international best practices.[183] Although this list is not exhaustive, the guidelines consider the Peruvian and international experience when providing guidance to public entities in allocating the risks in PPP contracts. The guidelines also refer to the different impacts that

[182] Least Square approach (e.g., Ordinary Least Squares estimation) assigns very high weight to outliers, which can result in biased estimates and predictions when data is produced at abnormal times. More robust methods that deal with outlier observations can be implemented, for instance the ones that use a Least Absolute Deviation approach (e.g., Robust MM-estimation). In this sense, both approaches can be used to provide more informed values at atypical times.

[183] APMG PPP certification Guide, section 5.8 Introducing the Main Project Risks and their Potential Allocation. https://ppp-certification.com/ppp-certification-guide/58-introducing-main-project-risks-and-their-potential-allocation56.

a particular risk can have on a project's cost and the way in which it can be mitigated. A brief exposition of PPP project risks and suggested risk allocation is shown in Table 8.3***Error! Reference source not found.*** (below).

Table 8.3: Risk Allocation Between the Public and Private Sectors

	Risk	Allocation
Design and build stage	Design	Private
	Build	Private
	Land expropriation	Mostly Public (sometimes shared with the Private)
	Geological or geotechnical	Public, Private, or Shared
	Interference or affected services	Public, Private, or Shared
	Environmental	Public or Private
	Archaeological	Mostly Public (sometimes Private)
	Obtaining permits and licenses	Private
	Existing infrastructure transferred to the concessionaire	Mostly Private (sometimes shared)
	Additional investments	Public
	Early termination of contract	Public or Private
	Financing	Private
	Inflation	Private
	Interest rate	Private
	Exchange rate	Mostly Public (sometimes shared)
	Force majeure events	Shared
	Regulatory or normative	Shared
	Accidents and damage to third parties	Private
Operation and maintenance stage	Revenues	Mostly Private (sometimes shared)
	Operating cost overruns	Mostly Private (sometimes shared)
	Inflation	Public
	Force majeure events	Shared
	Regulatory or normative	Shared
	Exchange rate	Mostly Public (sometimes shared)
	Early termination of contract	Public or Private
	Political or Default	Private

Source: Author's elaboration with information from RM N° 167-2016-EF-15.

However, a potential threat to correct risk allocation could come from the funding scheme of a PPP project. Indeed, as was recognized by the World Bank in a recent report,[184] Peru has applied a payment mechanism based on construction milestones and certificates backed with full sovereign guarantees to most PPP infrastructure projects, namely the Certificate of Acknowledgment of Annual Payment Rights (CRPAO, in Spanish) and the Remuneration for Investments According to the Work Progress Certificate (RPICAO, in Spanish). This payment mechanism proved effective in raising private sector financing in the early years of the PPP program. However, its continued replication for a large portion of the PPP program has skewed risk allocation away from private operators and towards the state. Financing structures have therefore ended up resembling traditional procurement for construction projects as opposed to the risk allocation and financial structures typically seen in PPP contracts. At the same time, the core rationale for using a PPP instrument is to transfer those project risks to the private sector, which it is better placed to manage them. This includes risks associated with long-term financing. In Peru, this rationale has gradually been lost.

Although both CRPAO and RPICAO have proven useful in raising private financing and reducing construction risk (which is normally assigned to the private sector in PPP best international practices), their treatment within the government and perceived risk are different. For instance, CRPAO are negotiable certificates issued in US dollars at the NY Exchange that are backed with the irrevocable payment of the government for the full value of the milestone completed. Meanwhile, the RPICAO are certificates denominated in the local currency (Peruvian soles), with only the shortfall amount of the project's revenues acting as a

[184] World Bank. 2020. "Policy Note on Attracting Private Investment to Infrastructure in Peru: Achievements, Challenges and a Way Forward."

contingent obligation. According to Apoyo & Asociados (2018),[185] the different classifications of these instruments with respect to sovereign debt should be as follows:

Table 8.4: Funding Schemes and Risks

Instrument	Sovereign Bond	CRPAO	RPICAO
Format	Negotiable note	Negotiable note	Contractual obligation
Type	External debt	External debt	Contingent obligation
Currency	Foreign (USD)	Foreign (USD)	Local (Peruvian Soles)
Public entity	MEF	Other public entity (MTC)	Other public entity (MVC)
On-the-government balance	100%	Net present value of issued CRPAO	Only the expected value if probable
Cross default	Yes	Yes	No
Legal	National debt	National debt	National budget
Annual budget appropriation	100% of the annual payment	100% of the annual payment	Only the shortfall in project's revenues
Law	Law of the State of New York	Law of the State of New York	Law of the Republic of Peru
Notching with respect to the sovereign bond	0	0	-1

Source: Apoyo & Asociados (2018). RPICAO: Retribuciones por Inversiones según Certificado de Avance de Obras. CRPAO: Certificado de Reconocimiento de Derechos del Pago Anual por Obras.

There is no unique risk allocation in PPP contracts in Peru. Although the risk allocation described in the regulations is indicative and not exhaustive, the general rule that whichever party is best qualified to assume the risk is the one that must assume it prevails in PPP contracts. The risk allocation regulation must be continuously improved because as the PPP portfolio expands to sectors in which Peru does not have much experience, it will be necessary to update and monitor the correct allocation.

7.4. Reporting Requirements

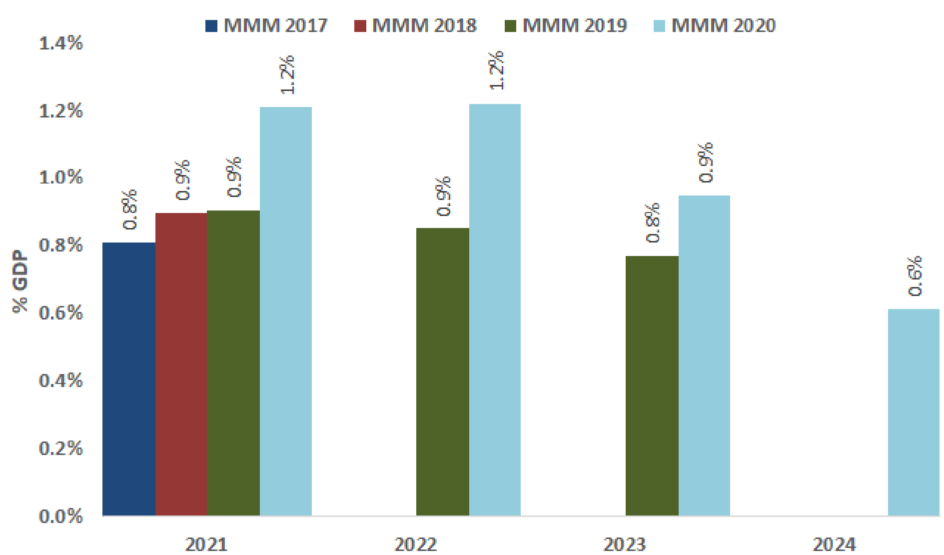
7.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

Fiscal commitments are recorded, monitored, and updated periodically in Peru in order to provide accurate figures for the Multi-Annual Macroeconomic Framework. Each semester, public entities that have an active PPP project need to submit to the National Registry of PPP Contracts the updated information related to their direct and contingent commitments. These commitments are recorded according to type of payment, guarantee, or contingency. For instance, regarding direct commitments, the payment could be linked to the

[185] Apoyo & Asociados. 2018. "Emite una nueva metodología referida a Calificaciones de Obligaciones de Contraparte del Sector Público en Asociaciones Público Privadas (APPs)." https://www.aai.com.pe/wp-content/uploads/2018/11/Nota-de-Prensa-Ejemplos-Nueva-Metodologia-11-2018.pdf.

investment stage,[186] or to the operation and maintenance stage.[187] Meanwhile, the information regarding contingent commitments is recorded depending on the type of contingency (e.g., emergency maintenance, and minimum revenue guarantee (MRG), among others). The sum of both types of commitments, direct and contingent, is considered to be the stock of PPP commitments. A medium-term horizon on the stock of commitments is reported every year through the Multi-Annual Macroeconomic Framework (MMM, in Spanish). The MMM provides a four-year projection of the main macroeconomic variables, including contingent liabilities, with the aim of ensuring fiscal transparency and accountability. The document is first published in August (in the official gazette and in the institutional portal of the MEF) and is updated in April of the next year. Figure 8.5 below shows projections of the direct and contingent liabilities related to PPPs for each MMM since 2017. Thus, in 2021, the stock of commitments from MMM 2017 to MMM 2019 was about 0.8 percent of GDP, whereas the projection for MMM 2020 was updated to 1.2 percent of GDP. This was due to inclusion of new projects that required additional public resources, an update of the value of contingent commitments and variations in GDP during the pandemic.

Figure 8.9: PPPs' Direct and Contingent Commitments



Source: Author's elaboration with information from Multi-Annual Macroeconomic Framework (MMM) 2017-2020.

The MMM provides estimates of the PPPs' fiscal commitments for the following years and reports that the ceiling on PPP fiscal commitments is in alignment with the legislation. Although the numbers provided in Figure 8.5 are useful to have a glimpse of the stock of PPP fiscal commitments in the coming four years, it is worth noting that this is not the PPP limit overseen by the Ministry of Economy and Finance. In particular, the MEF computes the present value of the stock of PPP commitments net of revenues with information

[186] The payments linked to the investments take different names in Peru according to the timing of the payment and the items paid. For instance, Pago por Obras (PPO) is the payment that covers part of the planned infrastructure, and Pago Adelantado por Obras (PAO) is the payment for a particular milestone of the infrastructure. Likewise, the Retribucion por el Pago de Infraestructura (RPI) is capital grants paid in deferred installments.

[187] The payment linked to the operation and maintenance, or current expenditure, takes different names in Peru. For instance, Retribucion de Pago por Mantenimiento y Operacion (RPMO) is the payment due to the operation and maintenance established in the contract, meanwhile, the Pago Annual por Mantenimiento y Operacion (PAMO) is the annual payment for maintenance and operation.

supplied by public entities every six months with the aim of enforcing the ceiling on PPP commitments, which is set at 12 percent of GDP. According to the MMM 2020, the present value of the stock of PPP commitments net of revenues was 2.47 percent of GDP in 2019[188] (see Table 8.5 below).

In Peru, direct and contingent liabilities arising from PPPs are recorded in national accounts using International Public Sector Accounting Standards (IPSAS).[189] IPSAS ensures some consistency in the way PPPs are treated on the government's balance sheet, reducing the risk of creating a false fiscal space by treating PPPs as off-balance sheet commitments.

In addition, the national public budget system law considers a type of special programming called a Multiannual Budget Allocation (APM, in Spanish), which seeks to determine the maximum amount up to which no additional expenses can be programmed. The APM presents the schedule for the next three fiscal years (binding for the first year, and informative for the second and third years). Moreover, according to Directive No. 001-2020-EF/50.01, the public entity must list in the APM each project that is in any PPP cycle stage. For projects up to the contract execution stage, an estimated payment schedule must be indicated. Meanwhile, for projects in the contract execution stage, the payment schedule must be reported as well as its updates, in case of contract modifications.

7.4.2. Transparency Policy on PPP Contracts

The PPP Law establishes some principles that govern the PPP scheme, among which is transparency (art. 4). In this regard, it is mentioned that all the quantitative and qualitative information used for decision-making during project evaluation, development, implementation and accountability is considered public information, under the principle of publicity established in article 3 of the Transparency Law (Law No. 27806). In this sense, the transparency policy for PPP projects was implemented through different channels of information detailed below (not exhaustive):

- The Ministry of Economy and Finance[190] presents in general terms the types of PPPs contracted and their characteristics (origin, funding). It publishes the current legislation on PPPs and members of the Private Investment Promotion Committees, as well as, in a very aggregated way, statistics related to awarded PPPs.
- ProInversión,[191] as the main OPIP player, presents information related to the PPP portfolio (e.g., the status of a project, different contract versions, the timeline, etc.) and a brief description of projects in which it has participated since 1992 (more details about those projects can be found on its webpage: https://www.proyectosapp.pe/).
- OSITRAN,[192] as the regulator in charge of transport concessions, provides information about projects that were awarded and are currently under execution. OSITRAN also presents information related to projects, the toll rates, contracts, and their modifications, among other details.

However, this broad concept of transparency has some exceptions. For instance, confidential information that is protected by bank secrecy, or information related to financial advice that could affect debt negotiations, is exempt from complying with the Transparency Law for an initial period of five years, but it

[188] This number doesn’t include the financial guarantees.
[189] RD Nº 006-2014-EF/51.01.
[190] The general information published by the Ministry of Economy and Finance regarding PPPs can be consulted here: https://www.mef.gob.pe/es/asociaciones-publico-privadas.
[191] The general information of Proinversión regarding PPPs can be consulted here: http://www.investinperu.com.pe/.
[192] The webpage of the regulator in charge of transport concessions is https://www.ositran.gob.pe/.

can be extended under some circumstances. Thus, although the law provides the means to access the information, these exceptions can impose some barriers to the transparency of some projects.

7.5. Performance Under Crisis

7.5.1. Impact of COVID-19 on Concessions

In general, PPP schemes in Peru have remained operating without further delays despite the global pandemic and the policy measures implemented. In other words, the construction, operation, and deadlines for complying with administrative or contractual procedures for the PPP projects are not suspended. In addition, an economic reactivation plan has been issued that includes PPP projects to be tendered. Despite not having granted specific support to concessionaires, mechanisms for compensating for lost income or justifying non-compliance with deadlines have been implemented for the concessionaires that have been affected by the policy measures caused by the pandemic, as long as economic equilibrium and the other obligations have been maintained.[193]

Fiscal commitments are expected to rise in the coming years, as has been already reported in the Multi-Annual Macroeconomic Framework. Although it is too soon to know the full impact of the pandemic on PPP projects, the Ministry of Economy and Finance has recognized that measures such as border closures, and social isolation, impacted service provision at airports and roadways as well as the quality of public services.[194] The first sign of the impact of those measures on PPP projects can be seen in the 2020 Multiannual Macroeconomic Framework (MMM 2020), which was published at the end of August 2020, that is, five months after the measures to limit the spread of COVID-19 were implemented in Peru. Figure 8.5 shows that the number of government commitments in 2021 for PPP projects in the execution stage increased by about US$350 million or 0.3% of GDP (MMM 2020) compared to what was expected for the same year in the previous report (MMM 2019). This adjustment is not explained by a larger portfolio of projects, because the MMM 2020 report has fewer projects (40) than the MMM 2019 does (44) due to the exclusion of some projects for various reasons.[195] For the next year's projections, that is, 2022, there is an increase of US$600 million in government commitments from what was projected in 2019 to what is projected in the 2020 MMM report (still 0.3% of GDP due to a higher GDP projection for 2022).

The stock of PPP commitments overseen by the Ministry of Economy and Finance is on track, and total 2.5 percent of GDP, however, a scenario of maximum exposure (i.e., no revenues) that includes the triggering of financial guarantees can take this number up to 13 percent of GDP, which is above the stock ceiling defined in the PPP legislation (12 percent of GDP). Table 8.5 presents information regarding the maximum exposure under financial guarantees granted to PPP contracts, and those that are planned to be called upon (panel A). It also shows information on the maximum exposure of contingent commitments according to the sector in which a PPP project is developed (panel B). Finally, it shows a computation of the stock of direct commitments attributed to PPP contracts (panel C), as well as the estimate of the revenues generated by these projects (panel D). In this sense, it can be intuited that the numbers shown in this table will increase, since they are represented as percentages of GDP.[196] Taking the 2019 numbers as a reference, we observe that present value of the maximum exposure of contingent commitments and financial guarantees

[193] Sattler, Veronica, and Alejandro Manayalle. 2020. "10 Questions about the Impact of COVID-19 on Public Private Partnerships in Peru (PPP)." Member article, World Services Group, June 2020.
https://www.worldservicesgroup.com/publications.asp?action=article&artid=16471.

[194] RD N° 003-2020-EF/68.01.

[195] Two projects completed their term and returned to the government; two projects were suspended; one project was stopped.

[196] In fact, the reduction in commitments from 2018 to 2019 is due to a higher estimate for 2019 GDP.

represented 1.64 percent of GDP in 2019, which is not trivial. Given that in most co-financed PPPs the revenues from tolls, tariffs or equivalent sources are used to cover part of direct commitments,[197] if an extreme scenario of zero revenues is realized, the total exposure in terms of direct commitments would add up to 13 percent of GDP. If, on the other hand, project revenues remain as expected and guarantees are not triggered, the present value of the stock of commitments would be 2.47 percent of GDP in 2019, which is way below the ceiling of 12 percent defined for PPP commitments.

Table 8.5: Maximum Exposure of the PPP Portfolio (% GDP)

	2018	2019
A) Financial guarantee	**0.53**	**0.5**
A.1) Current	0.13	0.11
A.2) Planned	0.4	0.39
B) Contingent commitments	**1.62**	**1.14**
B.1) Risk associated with demand or income	1.14	1.08
Transport	0.81	0.79
Sanitation	0.33	0.29
B.2) Risk associated with costs	0.08	0.06
Transport	0.04	0.04
Irrigation	0.02	0.01
Others	0.01	0.01
Total contingencies with guarantees (A + B)	**2.15**	**1.64**
Total contingencies without guarantees (B)	**1.62**	**1.14**
C) Stock of PPP direct commitments		**11.36**
C.1) Direct payment		7.49
C.2) Deferred payment		3.87
D) PPP revenues		**10.03**
D.1) Revenues (e.g., tolls)		7.56
D.2) Remuneration for the public entity		2.47
PV maximum exposure with no revenues (A+B+C)		**13.00**
PV maximum exposure with no revenues/guarantees (A+B+C)		**12.50**
PV maximum exposure with revenues and no guarantees (B+C-D)		**2.47**

Source: Author's elaboration using information from the MMM 2020, pp.165-169. PV: Present Value

7.5.2. Measures Implemented to Help Cope with the Consequences of the COVID-19 Crisis

Two policy measures were established to mitigate the impact of the pandemic on PPP projects. The first has to do with the projects that are currently under execution (Resolucion Directoral (RD) N° 003-2020-EF/68.01), and the second, with the new PPP projects that seek to promote investments in public infrastructure in the country (Decreto Legislativo (DL) Nº 1500).

[197] MMM 2020: 169.

7.5.2.1. Guidelines for the Compensation of PPP Contracts in the Execution Stage

Regarding the first policy measure, the Ministry of Economy and Finance established a channel through which the concessionaires can request compensation from the government as a result of the financial losses caused by restrictive measures implemented in Peru (Decreto Supremo (DS) N ° 044-2020-PCM). Through this measure, a concessionaire can request compensation only in cases when it can show a clear causal effect of the measures adopted by the government on the financial performance of a PPP project. For this, the event date is defined as the date on which the restrictive measures were published in the Official Gazette (March 2020 according to DS N ° 044-2020-PCM). After that date, a concessionaire needs to identify and show how the measures taken by the government had an adverse impact on the project's financial performance, and how the risk allocation established in a PPP contract makes the government a bearer of such risk. Then the concessionaire must propose a way to fix the imbalance through a mechanism such as the extension of a PPP term, monetary disbursement by the public entity, increments to the toll rate, or reduction of obligations, among other actions. The compensation mechanism can be considered so long as it maintains the established economic-financial balance between the parties and the allocation of risks. Once a request is made by a concessionaire, the public entity must determine the best solution and either confirm the validity of the current contract to make up these differences or amend the current contract to include a different agreed solution. In the former case, both parties renounce their right to future litigation, and in the latter—they must observe the process established in regulation RM N° 461-2017-EF/15 (i.e., guidelines for the evaluation of proposals for contractual modifications to PPP contracts).

7.5.2.2. Promoting Priority Projects

The second policy measure partially resembles what was enacted in 2008 as a response to the global financial crisis—that is, a push on investment through national prioritized projects and PPP projects. At that time, a series of emergency decrees declared a list of 52 projects as in the national interest and exempted them from complying with certain guidelines. During the COVID-19 pandemic, however, the push toward investment has been slightly different. First, before the pandemic hit the country, the government published a National Infrastructure Plan for Competitiveness in 2019, declaring 42 projects as in the national interest and, through Emergency Decree Nº 018-2019, granting those projects favorable conditions in certain administrative processes (e.g., priority on the budget, a more agile process for expropriation, etc.). In fact, the MEF was instructed to support these nationally prioritized projects during all stages to speed up investments in a prudent way. Second, through Decree Nº 1500 from 2020, in response to the pandemic, the government extended those favorable conditions for those PPP projects that are being executed, and that have been awarded, or that will be awarded within the period covered by Emergency Degree Nº 018-2019—that is, within three years. The measure is intended to give a push to investment to help the economic recovery of the country.

The two measures implemented for Peru follow the pattern of other countries' responses to the global pandemic and are adequate in providing a boost to investment through the use of PPP schemes and very limited support to the few concessionaires that were affected by the policy measures. In particular, Peru is taking advantage of the current situation to promote sanitation infrastructure, for a total value of the PPP sanitation portfolio, prioritized according to the sector, of more than $1.3 billion.[198] Additionally, the guidelines approved for contractual modification provide a transparent way for dealing with the

[198] Ennes, Juliana. 2020. "ProInversión Q&A–Peru resumes sanitation PPPs." IJGlobal, October 7, 2020. https://ijglobal.com/articles/150290/proinversi-n-q-and-a-peru-resumes-sanitation-ppps.

compensations or renegotiations in those cases in which the concessionaire has shown the impact of the pandemic in its operations.

Although it is difficult to plan for the next crisis, it is feasible to plan for how to react to those situations in terms of compensation. This topic is particularly important for Peru, given its long history of struggling with renegotiations. Moreover, having guidelines on this matter can help investors to know what to expect if a similar situation occurs in the future. The current guidelines on contract modifications and the methodologies that measure the contingent commitments can be modified to more robust methods to deal with these situations.

Annex 7 A: Peru FCCL Principles

#	Principles	Clarification	Assessment for Peru
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	Well-established methodology issued by the government since 2015 that assesses quantitatively the contingent liabilities.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by the government and identify potential mitigation measures.	The MoF uses its own spreadsheets and macro-fiscal cost assessments under PPP risks.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal Impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated by taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	The National System of Private Investment Promotion (SNPIP), integrated for relevant authorities, provides the checks and balances throughout the PPP cycle, although the MoF takes the lead and much of the process cannot continue without its approval.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making for the justification of any fiscal impact.	Value for money is assessed in a qualitative manner in Peru for all the projects at an early stage. Although a public sector comparator methodology for large-scale projects existed in the past, it was replaced for the eligibility criteria (qualitative assessment).
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP	A fiscal ceiling based on the present value of the stock of fiscal commitments (direct

#	Principles	Clarification	Assessment for Peru
		fiscal commitments) provides a reference for the affordability of PPPs.	and contingent) minus revenues is established in the PPP Law.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	A Multiannual Budget Assignment is in place for the next three years, which allows for correct budget planning, although only the first year is binding.
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to fund contingent liabilities should they materialize.	No mechanisms in place to budget for contingent liabilities.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Legislation regarding the implementation of all IPSAS have been issued since 2013 in Peru.
9	The legislature and other stakeholders are periodically informed on the jurisdiction’s fiscal exposure from PPPs.	A consolidated report is prepared on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	The MoF in its Multi-annual Macroeconomic Framework provides a five-year projection of the PPP direct commitments for each contract (as well as the contingent commitments that are expected to be active). Moreover, they disclose the aggregate amount of PPP commitments as a way to oversee the enforcement of the PPP fiscal ceiling.
10	Periodic audits are undertaken to confirm reliability and	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government	The Comptroller General periodically audits PPP projects using its

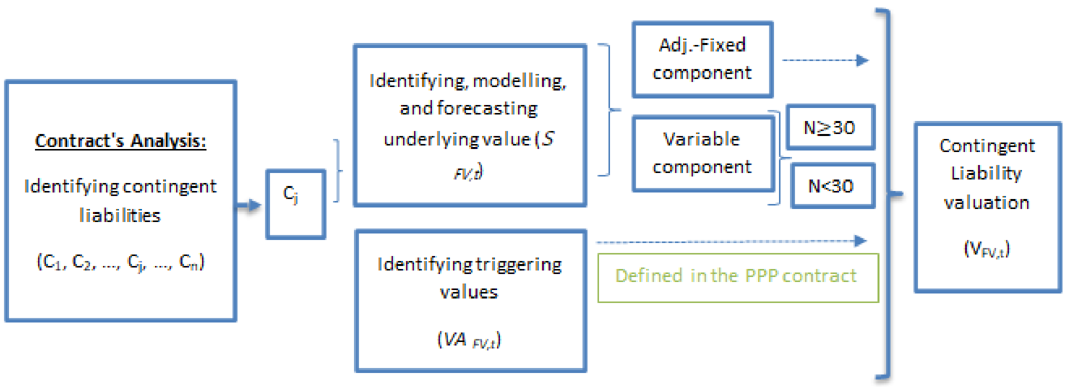
#	Principles	Clarification	Assessment for Peru
	compliance of fiscal exposure.	finances and performance to parliaments and to the public.	Guidelines for Audit PPP Compliance. Additionally, it has issued special reports in the past that are disclosed to the public when some issues are brought to its attention (e.g., contract renegotiation in 2016). The World Bank has signed an agreement with the Comptroller General to provide assistance for strengthening its capacities.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including SOEs.

Annex 7 B: Assessment of Explicit Contingent Liabilities Methodology

Contingent liabilities in Peru are regulated by the guidelines RM N° 048-2015-EF/52 from 2015 Annex A and B. In them, a methodology is proposed to measure quantifiable (explicit) contingent liabilities at two different stages in the PPP cycle, before the contract award, and after, semi-annually. This information is recorded in the Registry of PPP Contracts, and uses the same methodology to assess contingent commitments, with the only exception that for the semi-annual report, if needed, the public entities are allowed to use an in-house panel of experts (i.e., a group of experts coming from the same public entity), instead of an external panel of experts.

In general terms, the process of evaluating contingent liabilities can be described by Figure 8B.1 (below):

Figure 8B.1: Roadmap to contingent assessment



Source: Author's elaboration using information from the MMM 2020, pp.165-169. PV: Present Value

From the figure above, we can see that after identifying each of the contingent liabilities included in the PPP contract, the next step is modelling and forecasting the underlying value $S_{FV,t}$ for each of these contingencies. For this, the guidelines propose to estimate the underlying value as a function of a fixed and variable component as follows:

$$S_{FV,t} = f_t(CFa^1_{FV,t}, CFa^2_{FV,t}, \dots\ CFa^r_{FV,t};\ X^1_{FV,t}, X^2_{FV,t}, \dots, X^m_{FV,t})$$

where

$S_{FV,t}$ is the underlying value at valuation date t (i.e., FV,t); f_t is a functional form described below; $CFa^r_{FV,t}$ is the r-th fixed component that is adjusted at valuation date t; and $X^m_{FV,t}$ is the variable component m-th at valuation date t.

For the first set of variables (CFa), the assessment consists of getting for the r-th fixed component a convenient flow of values that reflects the adjustment experienced simply based on the passage of time. This adjustment is usually done using a particular forecast of the price index or the exchange rate. In the guidelines defined by Peru, the way of forecasting those values is using a PERT probability density function (pdf) with parameters defined in some way by the monetary policy for the price index (i.e. [min, mean, max] = [1%,2%,3%]), and using bootstrap simulations with monthly data from the last 15 years for defining the parameters of the PERT pdf for the exchange rate (i.e., [min(x), mean(x), max(x)] = [E[min(x)-10,000], E[mean(x)-10,000], E[max(x)-10,000]]). Then, the CFa flow is merely the initial value—which is usually defined in the PPP contract (e.g., initial traffic revenue)—adjusted by the forecasted price and exchange rate values.

Regarding the second set of variables (X), the assessment is a little more complicated, and the guideline poses two scenarios, one in which there exists enough historical information—requiring at least 30 years of annual observations—and the other in which there is not enough information or information is nonexistent. A brief explanation is below:

- *Scenario 1: Enough historical information (N≥30).* Regarding the second set of variables (X), the assessment is a little more complicated. Without going into much detail, the procedure to estimate the m-th variable component ($X^{m}_{FV,t}$) is by estimating certain parameters that later will be used to calibrate either a geometric Brownian motion function, or some other distribution function that better fits the data. To decide between different functions, some statistical tests (e.g., Kolmogorov-Smirnov test) are performed. Among the parameters that need to be estimated for calibrating the functions are: i) the expected growth rate of X—computed as the multiplication between the elasticity of X with respect to the real GDP, and the growth rate of the real GDP; ii) the volatility of the growth rate of X—approximated as the standard deviation of X; iii) a parameter that represents the market risk of X—computed as a function of the expected return of the market, its standard deviation, the risk-free interest rate, and a correlation coefficient between the return of the market and the variation of X; and iv) a stochastic shock—formed with the matrix correlation between X across PPP projects.
- *Scenario 2: Not enough historical information or information is nonexistent.* In this scenario, the guidelines consider three alternatives for determining the parameters to be used for the forecast
    - *If there is no data or the available data is greater than 10 observations but fewer than 30:* Then there should be a comparison between the estimation described in scenario 1 (using the available data), and the average parameters that resulted from a survey of experts. If there are no significant differences, then the estimates coming from available information should be used in calibration;
    - *If there is some data but fewer than 10 observations:* Then the comparison should be done between the results from the survey of experts, and the parameters found in other PPP contracts. If there are significant differences, then the parameters from the closest PPP project should be used in the calibration;
    - *In cases where there is no information from the variable component (X):* Then the initial value of the variable component is used to define a uniform distribution with min-max parameters equivalent to 80 percent to 100 percent of the value.

The contingent liability valuation at t ($V_{FV,t}$) is then equal to max (0, $S_{FV,t} - VA_{FV,t}$), or vice versa (depending on if the triggering value is defined as a ceiling or a floor). Lastly, an additional step is done to reduce the potential bias coming from a particular stochastic process. This step is done computing the expected value from 10 Mont Carlo simulations with 10,000 iterations, which constitute the value for contingent liability that is reported after deducting the income provided by a PPP to the government.

A very similar process is followed to evaluate contingencies arising from non-financial guarantees. In this case, the only notable difference is that they include the Auto Regressive Integrated Moving Average (ARIMA) model as an additional method that can be used for estimating parameters needed for calibration (in addition to those mentioned above). Additionally, as non-financial guarantees are only accounted as contingencies when their probability of using public resources is more than 10 percent, instead of doing the evaluation in terms of quantities, they use the probability function to define if $\Pr\left(S_{FV,t} \leq VA_{FV,t}\right) \leq 10\%$ (or vice versa, depending on if the triggering value is defined as a ceiling or a floor).

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Chapter 8: Philippines

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Acronyms and Abbreviations

APT	Asset Privatization Trust
ASEAN	Association of Southeast Asian Nations
BBB	Build, Build, Build
BLT	build-lease-transfer
BOO	build-own-operate
BOT	build-operate-transfer
BT	build and transfer
BTO	build-transfer-operate
BTR	Bureau of the Treasury
CAG	Corporate Affairs Group
CCPSP	Coordinating Council for Private Sector Participation
CIIP	Comprehensive and Integrated Infrastructure Program
COA	Commission on Audit
COP	Committee on Privatization
CRS-IT	Civil Registry System Information Technology
DBCC	Development Budget Coordination Committee
DBM	Department of Budget and Management
DOF	Department of Finance
DTI	Department of Trade and Industry
EIU	Economist Intelligence Unit
EO	executive order
ERP	Economic Resiliency Plan
FCCL	fiscal commitments and contingent liabilities
FIRR	financial internal fate of return
FX	foreign exchange
GFI	government financing institution
GOCC	government-owned and controlled corporation
GPRAM	Generic Preferred Risk Allocation Matrix

IA	implementing agency
ICC	Investment Coordination Committee
ICC-CC	ICC Cabinet Committee
IFRS	International Financial Reporting Standards
IIG	Industry and Investment Group
IPP	independent power producer
IRR	Implementing Rules and Regulations
JICA	Japan International Cooperating Agency
LGU	local government unit
MDGs	Millennium Development Goals
MWSS	Manila Water and Sewerage System
NEDA	National Economic and Development Authority
NGA	national government agency
NLEX	North Luzon Expressway
ODA	official development assistance
PDMF	Project Development and Monitoring Facility
PDP	Philippines Development Plan
PIP	Philippine Public Investment Program
PPI	Private Participation in Infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	public-private partnership
RA	Republic Act
SCBA	social cost-benefit analysis
SUCs	state universities and colleges
USP	unsolicited proposal
VfM	value for money
VGF	viability gap funding
WSP	Water and Sanitation Program

Executive Summary

The Government of the Philippines has promoted infrastructure development through the build-operate-transfer (BOT) scheme since the 1980s, making it the oldest public-private partnership (PPP) country in Asia. Since 2010, the government has made institutional and policy arrangements to facilitate implementation of PPP projects to spur infrastructure development in the country. At present, the government is explicitly focusing on finding ways to streamline the PPP process and on being more open to PPP projects proposed by private entities. The government also made pronouncements encouraging smaller-scale and regionally diversified projects, given the intent of the administration to improve infrastructure development in the countryside and areas outside the metropolis.

Institutional openness with respect to PPPs started with the passing of the first BOT Law (Republic Act № 6957) in 1990, the fourth among Association of Southeast Asian Nations (ASEAN) countries. The first BOT Law served as the legal framework for infrastructure development through private sector initiatives. In 2010, the legal framework for PPPs was further strengthened to accelerate the development and implementation of PPPs as a major policy initiative with the passing of Executive Order № 8 of 2010. The executive order (EO) reorganized and renamed the BOT Center the PPP Center and laid down its mandate. Organizationally, the PPP Center was moved from the Department of Trade and Industry (DTI) to the National Economic and Development Authority (NEDA) to enhance the PPP governance structure. Additionally, the Implementing Rules and Regulations (IRR) of the amended BOT Law were revised in 2012.

The Philippines scored 79 compared to a global average score of 44 in terms of PPP preparation, according to a 2020 World Bank Benchmarking Report, and had a thematic score of 94 for contract management compared to a global average score of 63. According to the 2018 Infrascope Report by the Economist Intelligence Unit (EIU), the Philippines ranked second out of the countries in Asia evaluated by the EIU, joining Thailand and China in the group of mature PPP markets based on both qualitative and quantitative criteria. In the World Bank Group's *Procuring Infrastructure: Public-Private Partnerships Report 2018–Assessing Government Capability to Prepare, Procure, and Manage PPPs*, the Philippines is ranked first in the East Asia and Pacific Region in terms of preparation of PPPs, contract management and unsolicited proposals, and third in terms of the procurement of PPPs.

In the approval process of the Philippines PPP program, risk assessment is carried out to determine the inherent risks of a project and the way they can best be allocated to the party that is best placed to manage each risk. With the support of the Australian government, a Generic Preferred Risk Allocation Matrix (GPRAM) was developed to serve as a guide for government entities and the private sector in structuring PPPs. To ensure fiscal sustainability, the PPP Center and the Department of Budget and Management formulated the Joint Memorandum Circular 2018-01 to standardize the reporting and monitoring of public and private sector spending on PPPs, including contingent liabilities arising from PPPs. In a bid to enhance the ability of implementing agencies to discharge their obligations for managing risks allocated to them, and to improve the terms of financing for PPP projects, a contingent liabilities fund was supposed to be created—which should have been financed through dedicated budgetary appropriations and contributions from budgets of implementing agencies, or might also have been sourced from bid premiums. However, this did not materialize. The 2016 change in administration led to a shift away from PPP programs; the new president and the new finance minister believed the government was giving too much away in termination payments (or contingent liabilities) to the private sector, so the initiative to implement the PPP reporting measures never picked up steam in the new administration.

During the Asian financial crisis in the 1990s, PPP projects suffered, and this situation necessitated reforms, which eventually helped their performance during the global financial crisis of 2008. The impact of the Asian financial crisis on all Asian economies and their financial systems was immediate. Furthermore, the crisis affected the power sector of the Philippines negatively and power programs were faced with increased costs, renegotiations, and a contraction of the private power market. The global financial crisis also highlighted two areas that required more attention: i) fiscal reforms and measures to increase resources needed to achieve the Millennium Development Goals (MDGs), and ii) measures to revive private investments in the Philippines. During the COVID-19 pandemic, no new national PPP projects (including publicly financed projects) were undertaken in the Philippines. Although disruptions affected various projects, most players found ways to restructure their transactions—except for a few that filed claims for loss of revenue. These claims are currently being evaluated.

The PPP Center for a number of years advanced measures to strengthen the PPP process to help withstand future economic disruptions. The government received support and technical assistance from multiple international development organizations, including the World Bank's Public-Private Infrastructure Advisory Facility (PPIAF), the Australian government and the Asian Development Bank (ADB) in the areas of PPP procurement and management of fiscal commitments and contingent liabilities (FCCLs). In an interview with officials from the PPP Center, it became apparent that although a lot of work has been put into improving the PPP process, there is still work to be done in the areas of assessment and management of FCCLs and their related disclosure. The PPP Center put forward proposals for the creation of a national database of PPP projects in a bid to take proper stock of FCCLs emanating from PPP projects. Additonally, a proposal was forwarded to the Investment Coordination Committee (ICC) about how PPP projects should be screened going forward to ensure that FCCL issues are adequately identified from the outset. The Philippine government also publishes annually a Fiscal Risk Statement that includes analyses of debt sustainability and the contingent liabilities of government. The statement is prepared by the Department of Budget and Management (DBM) for the Development Budget Coordination Committee (DBCC).

The Philippine PPP Center is incorporating resilience, sustainability best practices and operational architecture to ensure that the program withstands any future disruptions and delivers long-lasting PPPs.

8.1. PPP Experience

The Philippines, with over 20 years' experience in public-private partnerships, was the first country in Asia to promote private sector participation in infrastructure and development projects. It started when the Philippines became the first country in Asia to give PPPs a legal framework through the Republic Act (RA) 6957, or the Build-Operate-Transfer (BOT) Law of 1990. It was amended and replaced by the Revised BOT Law and its Implementing Rules and Regulations (IRR) in 1994 (Republic Act 7718), adding variants such as build and transfer (BT), build-own-operate (BOO), build-lease-transfer (BLT), etc. The late 1990s saw a good number of notable achievements in PPPs. One of the most distinguished projects was the privatization of the Manila Water and Sewerage System (MWSS), which is one of the largest PPPs of public water utilities in the developing world. The North Luzon Expressway (NLEX), the Civil Registry System Information Technology (CRS-IT) and the Mandaluyong City Marketplace Shopping Mall are also among the country's successful PPP projects.

The IRR was further revised in 2012, and the Revised BOT Law and its Revised IRR of 2012 form the legal and regulatory framework governing public–private partnerships (PPPs) in the Philippines. The Government of the Philippines also passed the Local Government Code in 1991 (Republic Act 7160), which encourages local government units (LGUs) to procure and implement infrastructure and development projects through PPPs.

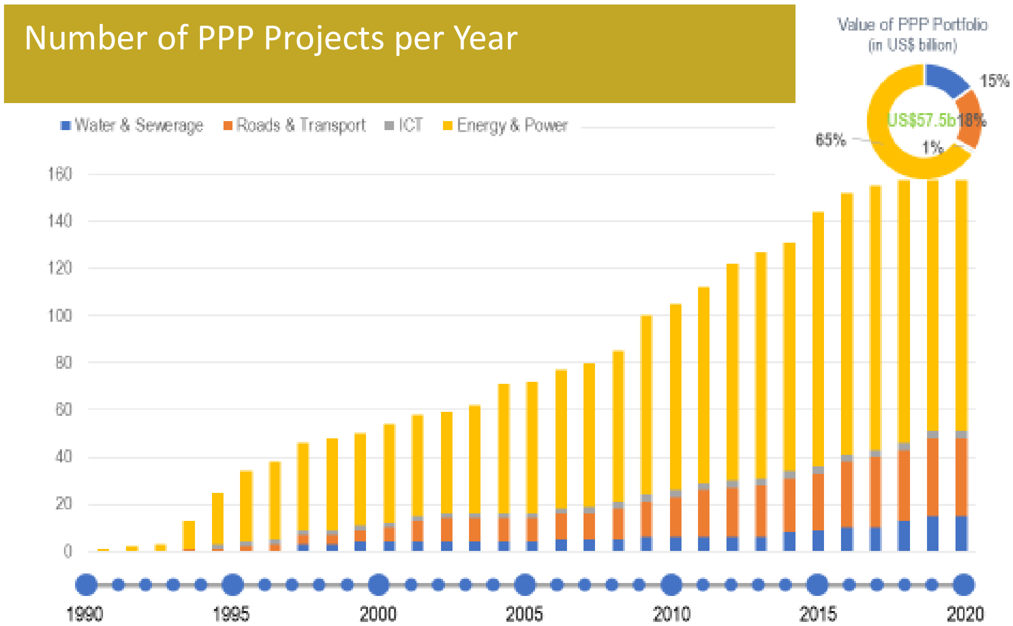
Over the last three decades, PPPs have been a key component of the overall strategy and development agenda of the Government of the Philippines for inclusive growth. In 2016, the new government included the PPP program in its 10-point economic program highlighting its commitment to facilitate private sector participation in infrastructure investment. The government has prioritized infrastructure development and adopted the 2017–2022 Development Plan and targeted spending on infrastructure projects to reach US$180 billion between 2017 and 2022. PPPs at the LGU level are also a priority investment area in the 2017–2022 Development Plan, consistent with the current administration's directive to accelerate infrastructure development in the countryside. LGUs are increasingly encouraged to pursue more PPPs based on the Local Government Code of 1991.

PPP Portfolio Analysis

An analysis of PPP projects undertaken from 1990 to 2020 (according to the World Bank's Private Participation in Infrastructure (PPI) database) indicates the following:

- One hundred sixty-seven PPP projects were recorded to reach financial close, with a total investment of US$57.5 billion and an average amount of US$344.3 million spent per project. Ten projects representing 11.05 percent of total investments were either cancelled or are in distress.
- One hundred sixteen out of 167 projects are in the energy/power sector. This represents 69.5 percent of the total number of projects, an average of US$1.2 billion spent per project and a total investment amount of US$37.4 billion, which is more than 65 percent of the total investment amount for the period under review.
- This is followed by the roads and transport sector, with 33 projects (19.8 percent), an average of US$340 million spent per project and a total investment of more than US$10.5 billion (18 percent).
- Water and sewerage is the third largest sector, with a total investment amount of about US$8.85 billion (15 percent), an average of US$290 million spent per project and 15 projects in total (19 percent).

Figure 9.1: Sector Breakdown of PPP Investments



Source: World Bank Private Participation in Infrastructure database.

As of August 31, 2020, data gathered from local resources indicate that there are 177 projects at various stages of development, which is 10 projects more than the number reported in the PPI database. This difference could be due to various reasons, including the fact that the PPI database only shows projects that have reached financial close and are above a certain monetary investment threshold, among other possibilities. These projects cut across sectors such as: transport, power, water and sanitation, information technology, health, education, tourism, etc., and are currently being handled by the three types of implementing agencies (IAs): government-owned and controlled corporations (GOCCs)—95 projects (54 percent); LGUs—48 projects (27 percent); and national government agencies (NGAs)—34 projects (19 percent). Additionally, the country's PPP Program has projects across almost all sectors including local government projects such as local markets. However, a review of the PPP portfolio indicates a concentration in the roads and transport, energy and power, and water and sanitation sectors in terms of number of projects and investment involved.

The Government of the Philippines aims to develop infrastructure through the use of PPPs because this arrangement frees the public sector from the need to meet financing requirements from its own revenues (such as taxes) or through borrowing. Thus, the current government has made infrastructure development part of its priority development program because it has identified infrastructure as one of the key drivers of economic growth.

8.2. Legal Framework and PPP Approval Process

8.2.1. PPP Governance, Institutional and Legal Framework

Addressing the infrastructure gap is a continuing effort critical to the development agenda of the Philippine government. With aging infrastructure, a growing population, and the need to be more competitive in the global market, different administrations have sought alternatives to cope with the need to build more projects in sectors like transportation, power, and roads. However, the country's infrastructure agenda is constrained by a limited fiscal space. In this context, the government looks to the private sector as a reliable partner in infrastructure development. Over the years, PPPs in the Philippines have evolved, with each administration implementing different strategies for engaging the private sector in development efforts. The legal framework is replete with laws and regulations that track the evolution of PPPs and their connection to the political and economic environment of the time.

The current PPP program in the Philippines, some can argue, takes its roots from the 1986 diversification drive that took place soon after the end of the Martial Law regime spearheaded by the Asset Privatization Trust (APT) and the Committee on Privatization (COP). However, PPPs in their true sense began in 1990 with the passage of the Build-Operate-Transfer (BOT) Law through Republic Act (RA) № 6957, "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector." The law recognized and introduced the private sector into the planning and execution of public infrastructure projects. In 1993, the then president recognized the importance of BOTs/PPPs and brought the program under the oversight of the president by directing the creation of a BOT Center, leading to the amendment of the BOT Law into what is currently known as RA № 7718 of 1994.

In 1998, when a new president took office, the BOT Center was transformed into the Coordinating Council for Private Sector Participation (CCPSP), thus expanding the BOT Program into other forms of private sector participation. It was at this time that the concept of technical assistance support was introduced to support implementing agencies in the delivery of projects.

In 2002, the new administration converted the CCSP back into the BOT Center with an executive order and placed it under the Department of Trade and Industry's Industry and Investment Group (IIG) and tasked it with promotion and marketing of BOT projects. This marked the real beginning of PPPs in the Philippines because the government of the day decided to anchor the National Infrastructure Plan with PPPs.

Another reorganization of the BOT Center took place in 2010 with the executive order renaming the BOT Center the PPP Center of the Philippines. The PPP Center was also detached from the Department of Trade and Industry and moved to the National Economic and Development Authority (NEDA), which leads and coordinates agency contributions to the formulation of the Philippines Development Plan (PDP), the Philippine Public Investment Program (PIP) and the Comprehensive and Integrated Infrastructure Program (CIIP). The then administration saw PPPs as a powerful tool to help push the national economic development agenda. As per Executive Order № 423 of 2005, section 8, "the NEDA, in consultation with the Government Procurement Policy Board (GPPB), shall issue guidelines regarding joint venture agreements with the private entities with the objective of promoting transparency, competitiveness and accountability in government transactions, and, where applicable, complying with the requirements of an open and competitive public bidding."

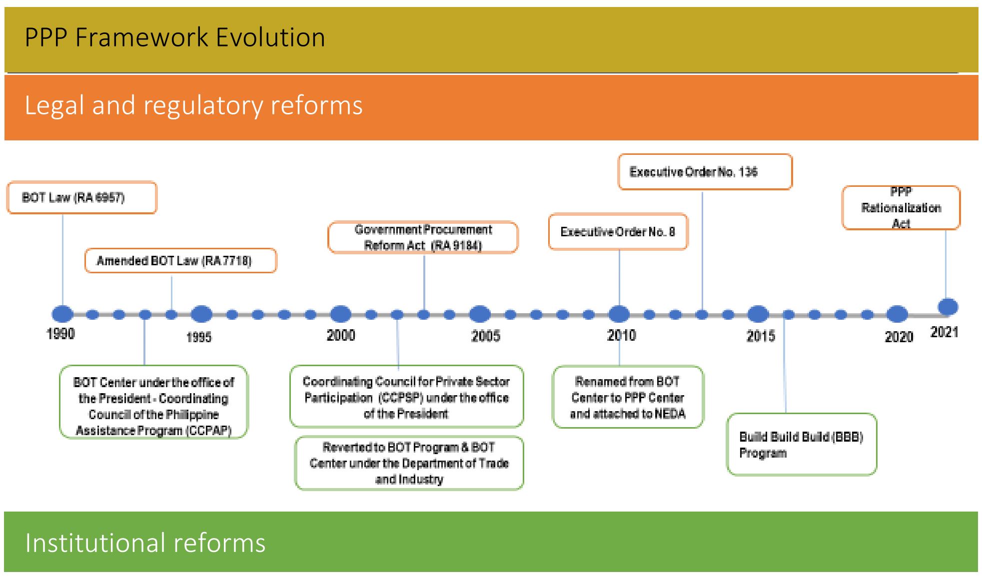
The PPP agenda was further strengthened in 2013 when an executive order was issued for the creation of the PPP Governing Board to be co-chaired by the Socioeconomic Planning and Finance secretaries. The influential board also included Secretaries of Budget and Management, Justice, Trade and Industry, the

Executive Secretary and the private sector co-chair of the National Competitiveness Council. The PPP Governing Board was mandated to act as the overall policy-making body for all PPP-related matters, including the Project Development and Monitoring Facility (PDMF). It is responsible for setting the strategic direction of the country's PPP program and creating the enabling policy and institutional environment for PPPs in the country.

The Philippine government and the PPP Center identified the need to also prioritize local government PPP projects to supplement national projects and to help local governments to achieve their infrastructure goals. This led to the development of the Local Government Units (LGUs) PPP Strategy, which was launched in 2017.

The PPP Center provides the same level of support for LGUs' PPP projects as for national ones, including support from the PDMF and establishment of the consultants panel to support local implementing agencies. The whole objective is to ensure that local PPP projects are resilient.

Figure 9.2: Timeline for the PPP Legal and Regulatory Framework in the Philippines



Source: Private-Public Partnership Center. Historical Background https://ppp.gov.ph/ppp.program/historical-background/.

According to section 20 of article II of the Philippine Constitution of 1987, the state acknowledges the invaluable position of the private sector, promotes private entrepreneurship, and offers incentives for needed investments. Recognizing the role of the private sector in sustainable development, Congress enacted two primary laws to implement the private sector agenda: i) the Republic Act № 9184 of 2003 or the Government Procurement Reform Act (RA 9184), for the procurement of goods, supplies, and services; and ii) the Republic Act № 6957 of 1990 as amended by the Republic Act № 7718 in 1994, or the Philippine Build-Operate-and-Transfer (BOT) Law, which provided a more focused PPP framework.

With the passing of RA 6957, local government units (LGUs) were able to enter into cooperative agreements with the private sector to undertake infrastructure projects via two models—build-operate -transfer (BOT) and build-transfer-operate (BTO).

RA 7718 builds on the terms of RA 6957 by expanding the list of PPP government implementing entities to include government-owned and controlled corporations (GOCCs), government financing institutions (GFIs), and state universities and colleges (SUCs). It also created incentives for attracting private sector investments in PPP projects, allowed unsolicited proposals, and permitted the use of other contractual modalities for execution of PPPs.

According to the revised BOT legislation and its Implementing Rules and Regulations (IRR), joint collaboration between the government and the private sector can take a range of forms. The BOT Law defines certain specific variants and provides a catch-all clause for any additional variants that could be discovered later. However, proposals to be undertaken through contractual arrangements other than those defined under section 2 of the act must be authorized by the president of the Philippines. In this case, the head of agency or must forward details of a proposed project to the NEDA Board through the Investment Coordination Committee (ICC), which will then evaluate the proposal and forward its recommendations to the president. Such projects will be considered approved by presidential consent once the approval is received at a NEDA Board meeting chaired by the president.

In 2010, the PPP legal framework was further strengthened to accelerate the development and implementation of PPPs as a major policy initiative with the passing of the Executive Order (EO) № 8 of 2010. The EO reorganized and renamed the “BOT Center” the “PPP Center” and laid down its mandate. Organizationally, it moved the PPP Center from the Department of Trade and Industry (DTI) to the National Economic and Development Authority (NEDA) to enhance the PPP governance structure. Additionally, the Implementing Rules & Regulations (IRR) of the amended BOT Law were revised in 2012. The relaunch of the PPP program in 2010 was premised on three core pillars:

- To address major infrastructure gaps that constrained economic growth and the overall development of the country, the government decided to lean on private sector resources and expertise. The goal was to derive value for money (VfM) through more efficient delivery of infrastructure services by the private sector.

- The reform also sought to address costly mistakes encountered in the 1990s by some PPP projects, especially independent power producer (IPP) contracts. The impact of these badly structured IPPs was further exacerbated by the 1997 Asian financial crisis, which triggered an economic recession and significant exchange rate depreciation. IPP contracts of the 1990s were mostly dollar-denominated take-or-pay style power purchase agreements leading to high energy costs, thereby creating high contingent liabilities for the government. Unfortunately, huge debts stemmed not only from the power sector but also from the failed Metropolitan Waterworks concession, the termination of the Metro Rail Transit Line 3 (MRT-3) project, and problems associated with the Ninoy Aquino International Airport (NAIA) Terminal 3 project.

- The third reason for the reform was to correct for the lack of transparency and poor compliance with procedures that had blighted procurement of some projects in the past. The new focus shifted attention from unsolicited to solicited proposals consistent with, if not drawn from, the country’s Development Plan.

In May 2021, the Philippine House Committee on Public Works and Highways approved, subject to amendments, the PPP Rationalization Act. The proposed law aims to optimize the government’s value for money in the projects and provide efficient approvals and incentives, among other objectives. National PPP projects worth up to ₱5 billion (US$103 million) must be approved by the PPP Center, unless overturned by the Investment Coordination Committee of the National Economic and Development Authority (NEDA-ICC) within 30 days of the approval date. Projects worth more than ₱5 billion (US$103 million) must be approved by the NEDA board upon the recommendation of the ICC. PPPs at the local level must be approved by local sanggunian or councils regardless of project cost, provided that the projects with government involvement and using national government funds have PPP Center approval.

8.2.2. The PPP Center and its Significance to the Economy

The PPP Center is authorized to facilitate and coordinate PPP programs in the Philippines. The center currently manages a revolving fund called the Project Development and Monitoring Facility (PDMF), which has in excess of US$100 million in its coffers and is used to provide implementing agencies (IAs) technical advisory support for project development, management and monitoring of PPP priority projects. Thus, the PDMF addresses capacity gaps of IAs undertaking PPPs. Project companies are required to pay the costs of transaction advisory services back to the PDMF because the fund is only meant to be used for project preparation and development; it doesn't provide a buffer for absorbing potential fiscal commitments. Organizationally, the PDMF is located under the administration and management of the PPP Center and its funding is an integral part of the PPP Center's operations and is fundamental to the center's ability to deliver on its mandate. This revolving fund was set up with a total investment of US$84 million from the Philippine government and US$18 million from the Australian government administered through ADB, which oversees transaction advisory services. The Japan International Cooperating Agency (JICA) also provided assistance in the form of studies and training courses.

The PPP Center is tasked with the provision of the following services:

- Technical assistance to local government units (LGUs) throughout the PPP project life cycle;
- Training of LGUs to undertake PPP projects and enhance PPP competencies;
- Acting as an intermediary between project owning agencies and NEDA units or technical committees;
- Formulation of policies and guidelines related to PPP transactions;
- Management of the Project Development and Monitoring Facility (PDMF) Fund; and
- Establishment of a central database of PPP projects.

8.2.3. PPP approval process

In the Philippines, final approval of major capital projects rests with the NEDA Board chaired by the president of the Philippines. Prior to consideration by the NEDA Board, however, the project has to be cleared by the NEDA-ICC. The ICC is tasked with advising the president on a broad perspective of the impact major projects may have on the economy and the government's economic programs. The NEDA-ICC consists of an ICC Cabinet Committee (ICC-CC or "CabCom"), which vets projects prior to formal consideration by the ICC Technical Board. The CabCom is chaired by the secretary of finance, which indicates the primacy given to the fiscal perspective in deliberations and assessment of major infrastructure projects.

The formal approval criteria currently applied by the government for infrastructure projects reflect the country's historic economic situation of limited foreign exchange reserves and its fiscal constraints, necessitating the need to manage government resources judiciously. Thus, the NEDA criteria emphasize fiscal, monetary, and balance of payments implications of major capital projects. The NEDA Board recommends to the president the timeline for implementation of these projects on a regular basis, considering the following factors:

- Peso requirements of a project in terms of the current and capital outlays directly or indirectly from the national government or government financial institutions;
- Foreign exchange requirements of a project in terms of the current and capital outlays directly or indirectly from bilateral or multilateral sources;
- Sources of funds;
- Terms and conditions of the proposed financing; and
- Where applicable, compliance with foreign debt ceilings (under Republic Act 4860), as amended, per certification of the Bureau of Treasury.

It should be noted, however, that the historical focus of these approval criteria may no longer be exactly relevant in the context of the current economic situation and PPP program developments. For instance, the country no longer faces severe foreign exchange (FX) constraints and has adequate access to international capital markets. The country also has access to official development assistance (ODA) sources, and economic managers are assessing the relative advantages of ODA financing. The government also needs to ramp up the infrastructure program; therefore it might be appropriate to focus also on quick execution rather than the application of stringent controls. The National Economic Development Authority (NEDA) Board's approval criteria are oriented toward managing foreign exchange resources and fiscal expenditures. In the case of PPP projects, the financing of infrastructure projects is shifted to the private sector and the government's main concern is the risks retained by the government in the overall risk allocation, along with management of direct as well as contingent liabilities incurred by each project and at the aggregate level. When evaluating PPP projects, the NEDA Board's economic managers must consider retained risks and contingent liabilities.

The head of the implementing agency recommends a project to the Development Budget Coordination Committee (DBCC) for inclusion in the national budget and for PPP implementation. The PPP Center reviews the pre-feasibility study for assumptions, financial analysis, and viability gap funding (VGF) requirements and provides recommendations to the DBCC. The DBCC endorses the project to the Department for Budget and Management (DBM) for inclusion in the budget, and the IA endorses a project to NEDA for inclusion in the CIIP and PIP.

The ultimate purpose of a PPP project's preparation is to recommend it to the ICC for tender and subsequent implementation. It involves the development of a complete project feasibility study and other documentary requirements that will enable the ICC to review the merits of a project (e.g., ICC project evaluation forms) as well as assist the IA in preparation of tender documentation.

As part of its efforts to ensure that FCCL issues are detected early and managed properly, the PPP Center has made a proposal to the ICC, which, if accepted, will result in the PPP Center getting involved in the screening of projects prior to their approval to ensure early identification and addressing of fiscal risks.

Stages of the PPP Project Approval Process

IAs such as departments or charters (including GOCCs, SUCs, etc.) authorized by law to contract for and undertake infrastructure or development projects are required to prepare their infrastructure or development programs aligned with the Philippines Development Plan (PDP). For solicited projects, there are four stages in the PPP life cycle:

1) Identification, selection, and prioritization;
2) Project preparation, evaluation and approval;

3) Tendering and negotiation; and
4) Implementation, operations, and hand-over.

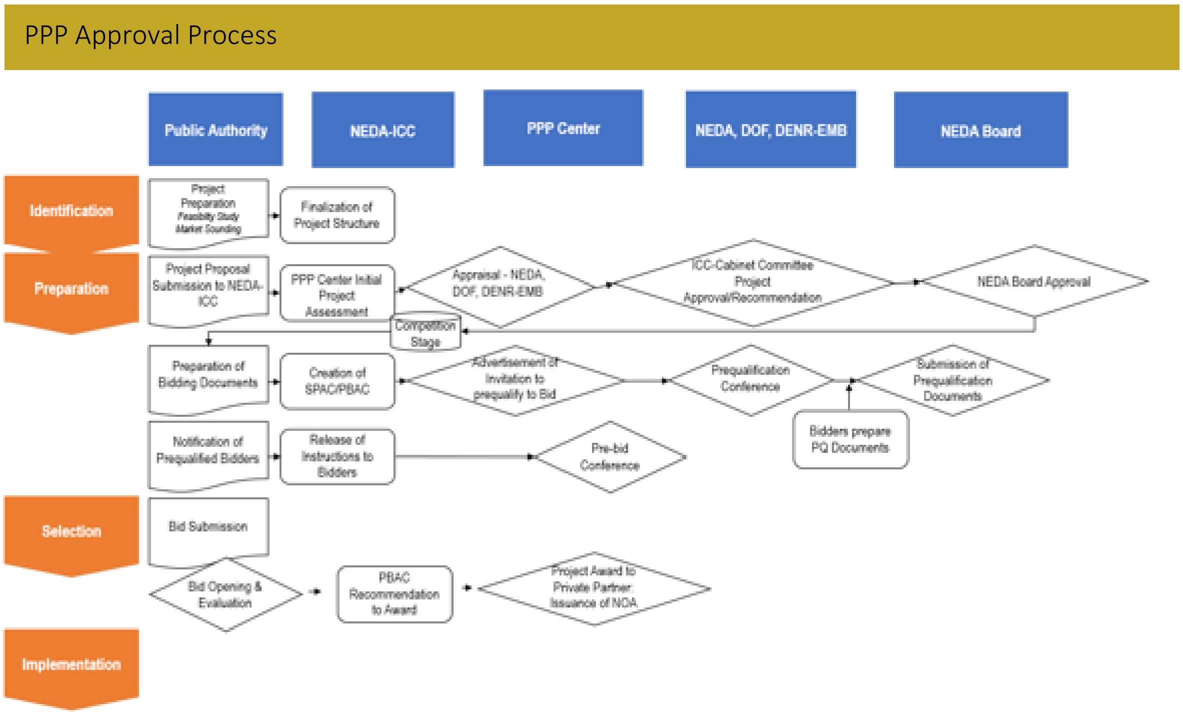
However, for the purposes of this sub-section the first two stages are the most important and are analyzed in detail in Table 9.1 below:

Table 9.1: Stages of the PPP Project Approval Process

Stage	Description
Identification, selection, and prioritization	Priority projects, including a list of PPP projects as required by section 2.3 of the revised IRR of the BOT Law, are defined and considered for inclusion in the Philippine Public Investment Program (PIP) and Comprehensive and Integrated Infrastructure Program (CIIP) by the National Economic and Development Authority (NEDA). Working closely with the Department of Budget and Management (DBM), NEDA compiles a national list of prioritized infrastructure programs, which include the PIP and CIIP. The CIIP, in particular, provides a list of infrastructure initiatives that follow the Philippine Development Plan's (PDP) priorities and objectives. Normally, two main types of project proposals are considered—solicited and unsolicited ones. For solicited proposals, project development is supported by the government and approved by the ICC, whereas unsolicited proposals (USPs) are developed by the private sector and are initially assessed by the IAs following the existing framework before eventual submission to the ICC for approval. A USP may be accepted for deliberation and evaluation by an IA if it adheres to the following principles: - It involves a new concept or technology which is not part of the list of priority projects in the PIP, CIIP and provincial/local investment plans. - It does not include a direct government guarantee, equity or subsidy. - It has to go to the ICC for the determination of reasonable financial internal rate of return (FIRR) and approval to negotiate with the original project advocate.

Stage	Description
Project preparation, evaluation, and approval	The overall goal of PPP project planning is to recommend to the NEDA Investment Coordination Committee (ICC) the suggested PPP projects for tendering and eventual implementation. The NEDA Board is the authorizing body for projects with investment value of up to ₱300 million (US$6.2 million). For national projects costing more than ₱300 million, the project paperwork is forwarded to the ICC Technical Board for analysis and endorsement by the ICC Cabinet Committee, which in turn endorses and forwards it to the NEDA Board. The NEDA Board examines the proposal and, if approved, sends it out to bid. Regional development councils are in charge of local projects costing from ₱50 million to ₱200 million (US$1 million to US$4 million). Provincial development councils oversee local projects costing ₱20 million to ₱50 million (US$400,000 to US$1 million) and city development councils oversee local projects costing ₱50 million (US$1 million) and less, whereas municipal development councils oversee local projects costing ₱20 million (US$400,000) and less. The Revised Implementing Rules and Regulations (IRR) of the BOT Law provide a system for awarding USPs. After the approving body approves the project for bidding, the head of the implementing agency negotiates the project scope and contract using the ICC's contract specifications. A certificate of negotiations is signed after the proposed contract is checked by the Office of the Attorney General or the Office of Government Corporate Counsel, as well as the Department of Finance (DOF), if necessary, and is accepted by the IA. The “Swiss Challenge” model introduces a competitive aspect into the USP process. The draft contract agreements serve as the framework for the Swiss Challenge or bid terms of reference, which elicit comparable or strategic proposals from challengers. Proposals from challengers are comparable if they meet the minimum technical criteria and are consistent with the specified terms and conditions of the bid terms or reference; and are competitive—if a financial proposal provides a greater value than the one specified in the bid terms of reference. If the challengers present a stronger plan, the initial private sector project proponent is given an option to match the lowest bid. Unsolicited proposals may be accepted on a negotiated basis, provided that all the following conditions are met: i) the project involves a new concept and/or technology, as determined by the implementing agency, and/or is not included in the list of priority projects of the agency; ii) no direct government guarantee, subsidy, or equity is required; iii) the implementing agency will publish a call for comparative proposals for three consecutive weeks in a newspaper of general circulation, and no other proposal is received within 60 working days.

Figure 9.3: Project Approval Process Flowchart



8.2.4. International Support in PPP Development

Over the years, the National Economic Development Authority (NEDA) has engaged several international development organizations such as the World Bank (WB), Asian Development Bank (ADB), Australian Agency for International Development (AusAID), and United States Agency for International Development (USAID) to provide support and guidance for PPP arrangements.

The PPP Center was set up with the assistance of the Asian Development Bank (ADB), which continues to provide technical assistance to the Philippine government in the areas of strengthening evaluation and management of fiscal costs associated with PPPs. Additionally, the ADB administers a technical assistance grant on behalf of the governments of Australia and Canada aimed at the procurement of information and communication technology (ICT) resources for the PPP knowledge management portal. The portal seeks to generate and disseminate operationally relevant knowledge with respect to development operations in developing member countries. It emphasizes increasing collaboration, improving the quality and efficiency of knowledge services, making knowledge work more attractive, and using a country-focused approach—all of which contribute to ADB's value addition, boost client satisfaction, and bolster ADB's role as a trusted knowledge provider.

A 2002 World Bank study on public sector reforms and the water sector resulted in the Philippine government passing the Procurement Reform Act. Regarding PPPs, the International Finance Corporation (IFC) and the International Bank for Reconstruction and Development (IBRD) supported the Manila Water Company; the IFC also undertook some power privatizations.

The World Bank took a leadership role in the Philippines Development Forum that built on the earlier outreach efforts and sought to widen the consultative group process to include civil society, the private sector, and other stakeholders in the PPP process. The forum proved effective in building consensus among donors and country stakeholders on the developmental issues confronting the Philippines. The outreach, coupled with strong upstream support to address critical issues and a focus on service delivery, enhanced the outlook for PPPs. The World Bank Group's close relationship with the Philippine government, despite differences in views on policy and transparency matters, allowed for a candid dialogue and meaningful actions.

Recognizing an opportunity, the Water and Sanitation Program (WSP), part of the World Bank Group's Water Global Practice, started working with the PPP Center. The partnership aimed to develop a framework to streamline assistance provided by the PPP Center, in collaboration with the Department of Interior and Local Government (DILG) and the National Water Resources Board (NWRB), to support scaling up PPPs in water supply services nationwide.

The Australian government through AusAID has also given significant assistance to the Philippine PPP Program, including funds for project execution. However, perhaps the most enduring legacy of the assistance from Australia occurred in 2009, under the Partnership for Economic Governance Reforms (PEGR), in the establishment of a toolkit and recommendations on value analysis and PPP structuring. The Philippine government, through NEDA, found flaws in the BOT-PPPs procurement mechanism and sought AusAID's assistance to develop recommendations that would ensure the productivity and effectiveness of infrastructure projects aimed at stimulating economic growth. The predominant goal of this project was to act as a roadmap for PPP structuring by IAs and local governments in order to achieve value for money in BOT-PPP projects.

In June 2021, The World Bank's Board of Executive Directors approved a US$400 million loan to support reforms that will assist the Government of the Philippines in achieving a resilient financial sector and help ensure a more inclusive recovery from the COVID-19 pandemic.

The Philippines First Financial Sector Reform Development Policy Financing Loan is the first of two programs supporting three reform areas including strengthening financial sector stability, integrity, and resilience; expanding financial inclusion for individuals and firms; and promoting disaster risk finance that protects national budgets and businesses as well as the lives and livelihoods of families from the impacts of disasters.

The Cities Development Initiative for Asia, a multi-donor trust fund managed by the Asian Development Bank (ADB) has also collaborated with the government in the areas of capacity building, knowledge products, and project development towards implementation of local PPP projects by LGUs.

Private participation through PPPs has a critical role in reducing the infrastructure gap in the Philippines, especially in sectors that require technical expertise and innovative technologies. Traditional infrastructure still remains a priority for the government and the available capital augmented from official development assistance (ODA) and domestic and foreign investors makes traditional infrastructure projects highly competitive. The expansion of private participation in non-traditional areas of infrastructure, such as renewable energy projects and other social infrastructure, is a step in the right direction towards achieving the government's ambitious infrastructure goal of 7.4 percent of its gross domestic product (GDP) by 2022.

8.3. Analysis of Projects

8.3.1. Identifying and Prioritizing PPP Projects

When national government agencies (NGAs) prepare their list of projects for inclusion in the CIIP/PIP, a two-step procedure is used to properly define, pick, and prioritize (at an early stage) projects that can be delivered as PPPs. The two-step procedure includes: i) identification and selection using initial screening via multi-criteria analysis (MCA) and preliminary social cost-benefit analysis (SCBA); and ii) project prioritization by means of a pre-feasibility study (PFS), including SCBA outcomes. Table 9.2 below shows drivers and criteria used in the MCA screening.

Table 9.2 Full MCA Screen with Weighted Drivers and Criteria

Drivers (Weights)	Criteria (Variables)	Relative Weight of the Criteria /Variable
Economic Desirability (20%)	• **Qualitative Criterion:** significant level of economic benefits can be identified. • **Quantitative Criterion:** EIRR in the judgement of the reviewer is likely to be greater than the defined hurdle rate. • Others	40% 40% 20%
Market Acceptability (20%)	• Existence of market appetite from PPP proponents. • Existence of a strong debt funding market locally and/or availability of international funding for local projects.	50% 50%
Manageable Life-Cycle Costs (15%)	• Land is acquired, or acquisition is substantially complete, for the project and the proposed site is functionally convenient to the project's objectives. • Site offers manageable challenges for the engineering, procurement and construction contractor during construction. • Manageable environment, health and safety, gender, resettlement or other vulnerable-person issues are foreseen that should not adversely impact project costs during construction or operations. • Operations and maintenance (O&M) costs are high but responsive to improved technology and management, OR otherwise O&M costs for this type of project are stable and predictable.	30% 30% 20% 20%
Predictable and Stable Revenues (15%)	• For *concession (user-pay) PPPs*, revenues are backed by a Government of the Philippines (GPH) support package for demand and tariff adjustments, either in the form of viability gap funding (VGF), output-based aid (OBA), minimum revenue guarantee or other such instrument. For *availability-based PPPs*, revenue is predictable due to payment based on a take-or-pay arrangement. • Demand for service is inelastic relative to its price given the nature of a project where there is no immediately viable alternative for the service. This variable is particularly relevant for concession (user-pay) PPPs, whereas availability-based PPPs automatically score high on this variable. • A do-minimum scenario (e.g., address a gap or need using administrative action rather than undertaking the proposed project) has been considered and the conclusion is that the demand for the service cannot be accommodated in this manner.	40% 40% 20%
Appropriate Risk Sharing (20%)	• Acceptability of the appropriate risk sharing mechanism.	100%
Fit into Legal and Regulatory Framework (10%)	• Regulatory and institutional frameworks are in place and would require limited reform for the project to be successfully implemented, or projects can potentially be regulated by a contract.	100%

Projects that demonstrate a positive financial internal rate of return (FIRR), with or without financial government support, and an economic internal rate of return (EIRR) hurdle rate, as defined by the investment coordination committee (ICC) from time to time can be considered priority PPP projects for a full feasibility study. Projects that successfully pass the MCA screening process must then be ranked by their commercial viability (which is key to attracting private sector interest) or the socioeconomic desirability (which is crucial for the government's decision about supporting its development and implementation). IAs can undertake an initial prioritization exercise using a PFS in their project planning and preparation process. IAs can use internal resources to undertake a PFS or apply for funding from the PDMF or other such funding sources.

8.3.2. Assessment of PPP Fiscal Implications

PPPs come with financial implications and fiscal risks for the government, and it is, therefore, critical that guidelines and systems are in place to properly assess, manage and monitor FCCL throughout the project life cycle. The financial commitments from the government can be in the form of direct liabilities, such as viability gap or availability payments, or contingent liabilities, whose payment is dependent on the occurrence of uncertain future events outside the control of the contracting government.

Currently, the Philippines does not have a well-developed FCCL framework that would be expressed in detailed guidelines and regulations. At the same time, a formal framework for managing contingent liabilities would enable the government to make informed decisions about calibrating the amount of core and noncore risks to be assumed in PPPs, thereby striking a balance between minimizing exposure to fiscal costs, on the one hand, and offering an attractive risk-return proposition to ensure adequate investor response, competitive tension, and bankability, on the other. An FCCL framework would also enhance investors' overall perceptions about the country's risk and would clarify a process to safeguard the country's fiscal sustainability. The provisioning and funding component of such a framework would also mitigate appropriations and liquidity risks if contingent liabilities materialized.

The government's position on management of all guarantees and contingent liabilities can be found in different statements that are part of existing laws and policy documents. Thus, as early as 1977, Presidential Decree 1177 on budgetary reforms stated that "the contingent liabilities of government shall be evaluated as part of the budget process, subject to such limits and guidelines as may be approved by the President" and required that contingent liabilities should be included in budget estimates of government entities and should be reported periodically to the secretary of finance and the budget commissioner. More recently, statements in the Philippines Development Plan, the Financial Reform Plan, and proposed revisions to the BOT Law express the government's objectives and intent for establishing prudential limits for contingent liabilities, which should be approved by government agencies for each project, and introduce provisions related to FCCL disclosure and provisioning practices.

The government's policy on contingent liabilities is also reflected in the praxis that IAs and oversight agencies follow when establishing requirements for analysis of contingent liabilities to be submitted by transaction advisers during project preparation, as well as in the information required in NEDA approval forms, and in the project teams' decisions regarding undertaking certain projects and contingent liabilities granted to certain projects in their draft concession agreements. The Bureau of the Treasury (BTR) has also initiated a contingent liability monitoring process through an interagency technical working group that meets regularly to assess the developments of ongoing PPP projects and their contingent liability status. At this stage, it would be appropriate for the government to formally adopt a framework for the management of contingent liabilities to be guided by a definitive statement of policy to be incorporated as a proposed amendment to the BOT Law. Establishing the contingent liability management framework as part of the law would also ensure the institutional sustainability of contingent liability management policy.

As is the case in other countries, there is no single statement expressing the government's policy for managing contingent liabilities. There are references to the government's policy or policy intent in: i) 2010–2016 Philippines Development Plan adopted by the Aquino administration; ii) the Philippines Financial Management Reform road map adopted in January 2011 by lead agencies in the Government Integrated Financial Management Information System project; and iii) in the draft amendments to the BOT Law.

Thus, the 2010–2016 Philippines Development Plan states the following: "Contingent Liability Management—Considering the fiscal impact of realized contingent liabilities from existing BOT and GOCC projects that are guaranteed by the national government, a joint ICC Development Budget Coordination Committee (DBCC) resolution will be issued to strengthen contingent liability management through the preparation of the Contingent Liability Management Plan by implementing agencies, training for value analysis and/or value engineering and contingent liability assessment, evaluation by the Department of Finance (DOF) of contingent liability for every financing/procurement option, and full disclosure of required budget for contingent liability that will become real liabilities and will thereby need funding."

The Philippines Financial Management Reform Road Map Toward Improved Accountability and Transparency, 2011–2015, which was crafted by the Government Integrated Financial Management Information System (GIFMIS) committee consisting of senior officials from the DOF, Department of Budget and Management (DBM), and Commission on Audit (COA), commits to a "Management of Contingent Liabilities Project," a major component of the reform program aimed at promoting fiscal responsibility and good governance through transparency and accountability in financial transactions in the Philippine government. The contingent liabilities project explicitly refers to the PPP program. An executive order (regulation) was issued in 2011 and a Public Financial Management (PFM) Committee was established to manage the reform program. Technical assistance from the International Monetary Fund (IMF), WB and the Australian Department of Foreign Affairs and Trade (DFAT) was instrumental to the progress made.

To ensure fiscal sustainability, enhance the ability of IAs to discharge their obligations to manage the risks allocated to them, and to improve the terms of financing for PPP projects, a contingent liabilities fund was to be created, which would be financed through dedicated budgetary appropriations and contributions from IAs' budgets or might also have been sourced from bid premiums. The fund was intended to offer a reliable pool from which disbursements for payment of government obligations for liabilities that had materialized could be drawn. As such, it was planned that any contributions to the fund should be permanently appropriated and should not revert back to the general fund if not disbursed during the life of a project. The fund was to be managed by the Department of Finance following fiduciary standards for fund management. Fund operations could be enhanced through official development assistance. As part of the budget submission, the Department of Finance was to submit an annual report on the status of this fund to Congress. Proceeds of the fund were to be invested in risk-free highly liquid assets. The governance structure, specific functions and responsibilities related to operations of the fund would have been specified in the IRR of the Act. Unfortunately, the fund never materialized. After a change in administration in 2016 and given the shift away from PPP programs with the new president and the new finance minister, there was a sense that government was giving too much away in termination payments or contingent liabilities to the private sector, and the initiative to implement the fund never picked up steam in the new administration.

In practice, IAs follow the government's policy on contingent liabilities by ensuring that transaction advisers capture FCCL-related issues in their analysis of contingent liabilities during preparation of project documents and studies, which is required by approving authorities, including NEDA. However, such practice often results in inconsistent reportage of fiscal commitments and contingent liabilities in the national budget as the quality of project appraisal varies from one implementing agency to another. The PPP Center is in charge of submitting reports on pipelines, and on awarded, ongoing, and completed projects to the Department of Budget and Management for inclusion in the Budget of Expenditures and Sources of Financing.

Under the law, national government agencies (NGAs) can only source funds from budget appropriations. If there is no budget appropriation for a contingent liability that materializes in the middle of the year, the implementing agency will have to include that in its proposed budget for the following year. If Congress approves the proposed appropriation, the implementing agency can make the payment one to two years after the contingency has materialized. If Congress disapproves the proposed appropriation, the implementing agency will have to try again the following year. Investors and lenders are, therefore, subject to appropriation risk and are likely to price this into their bid and lending rates.

As part of a technical assistance package, the strategic advisory firm Castalia was tasked with developing a contingent liability model for the Philippine government in 2008. Castalia recommended, and according to our understanding, the Government of the Philippines agreed, that a relatively modest monitoring and management program under DOF would be sufficient at the time to manage PPP-related fiscal risks.

The model was to be applied for each concession PPP, and a Monte Carlo simulation was to be used to stress test each individual project for changes in different variables, including demand, interest and FX rates, among others. The model output supplied a distribution of expected costs, and an expected value. Previously, termination formulas were input in each contract for new projects from 2010 onwards. Additionally, termination payments are considered as contingent liability values.

Contingent liabilities and other fiscal risks created by investments of LGUs and public corporations are not systematically assessed by the national government at the planning stage, whereas during implementation, the Bureau of the Treasury monitors GOCCs' fiscal risks. The DOF has a dedicated unit that reviews PPP projects' fiscal viability and handles contingent liabilities. Also, the department, through the BTR, prepares a fiscal risk statement annually as part of the budget documents. The Corporate Affairs Group (CAG) of the DOF monitors the financial performance of GOCCs and their impact on fiscal position.

The Philippine government also publishes annually a fiscal risk statement that includes analyses of debt sustainability and contingent liabilities of the government. This statement is prepared by the DBM for the DBCC.

8.3.3. PPP Project Risk Analysis

In the approval process of PPP projects, risk assessment is carried out to determine the inherent risks of a project and the best way to manage them by allocating them to the party that is best placed to manage them. With the support of the Australian government, a Generic Preferred Risk Allocation Matrix (GPRAM) was developed to serve as a guide for the government entities and the private sector in structuring PPPs.

The recommended matrix, which was adopted by the ICC in 2010 and updated in 2014, covers risks under the following 10 broad categories of risks: site risk; design, construction, and commissioning risk; sponsor and financial risk; operating risk; demand risk; network and interface risk; industrial relations risk; legislative and government policy risk; force majeure risk; and asset ownership risk.

The table below lists some risk allocation preferences and mitigation measures to be considered by IAs in the development and implementation of projects.

Table 9.3: Project Risk Allocation and Mitigation

Risk Type	Risk Allocation To	Possible Risk Mitigation Measures
Financing Risk	Private Partner The private partner should be responsible for the non-availability of the required financing for a project. If the private partner fails to secure such required financing and the same results in delays and/or non-completion of a project, it should be liable for damages in accordance with the terms of the contract. The government may also be entitled to collect the sum due to it under the private partner's performance bond. To ensure a successful and viable project management team, the agency or LGU concerned should ensure that the potential private partner meets the financial capability requirement under the Section 5.4 I of the Implementing Rules and Regulations (IRR) of RA 695714, as amended, to determine its creditworthiness.	• Include rigorous financial capability requirements in the selection criteria and assess bids robustly. • Financial close should be a condition precedent to the start of construction. • Government to hold bid bond until financing is in place. • Tranche out concession/premium payments to limit private partner's upfront financing requirement. • During the dire economic situations for projects that are very big and socially important, the government may consider financing a project itself (e.g., implement it as a BTO PPP).
Third Party Risk	Party at fault Although PPP contracts are commercial agreements which place service delivery and other obligations on the private partner, users and other community members may see the government as being ultimately responsible for these obligations. It is appropriate that the private partner indemnifies the government, or provides full compensation, should such third parties sue the government.	• The government should address major implementation issues prior to contract signing, after which it will coordinate with the private partner and other stakeholders to come up with possible solutions when such instances arise. • The clearer and more comprehensive is the risk allocation in the contract, the clearer it should be which party is at fault should a suit eventuate.
Changes in Law/Policy	Private Partner Preferably allocated to the private partner— for all changes in law and/or policy up to a materiality threshold, beyond which government bears.	• Government to define jurisdictions of LGUs and the national government over a project (such as national project within one or several LGUs). • Government to monitor and limit (where possible) changes, which may have negative effects or consequence on a project. • Government to only pay compensation upon private partner demonstrating a direct material adverse effect (i.e., above the established threshold level). • Government to require the private partner to effect the change in a way that the cost and financial effect on government is minimized (for example, pay on a progressive scale). • In concession PPPs, the government is to seek a pass through of the costs of risks it bears to end users.
Economic Regulation	Government	• The way in which tariffs/tolls can rise over time, and the timing for adjustments, will be clearly set out in the contract. • Private partner to make appropriate representations to the economic regulator supporting the tariff/toll increase, just as government-owned and controlled corporations (GOCCs) would need to. • The government is to ensure that the following information will be part of the PPP contract terms: i) specifics of the type of protection to be offered by the government; and ii) mechanisms through which such protection will be offered.
Availability of Government Appropriations	Government	• When applicable, proposed multi-year appropriations (i.e., multi-year obligation authority, or MYOA) should be obtained before contract signing. • Establishment of the government PPP contingent liability fund is required.

Risk Type	Risk Allocation To	Possible Risk Mitigation Measures
Force Majeure Risk	Shared	• Private partner to purchase insurance for insurable risks, level of "property" insurance should be sufficient to cover reinstatement of facility. Private partner should provide to the government annually the details of the insurance policy. • Where relevant "property" risks become uninsurable during the term of a contract, the contract needs to clearly outline actions and which party should bear the risk. • Tender specification requirements, and resultant private partner design specifications, to take into account the foreseeable risks related to site selection (e.g., flooding, earthquake tolerance). • Private partner to maintain clear separation of its PPP project from its ancillary commercial business activities.
Default and Termination	Dependent upon cause of default and termination, i.e.,: • Private Partner • Government • - Force Majeure	N/A

Over the years, the Philippines was more concerned with tackling risks of individual projects rather than dealing with risks at the national level in a comprehensive and uniform manner. The government, however, realized the need to look at the project and fiscal risks emanating from PPP projects nationally at the portfolio level, thereby taking stock of FCCL issues as they arise and putting together a framework to handle them effectively, which was reflected in the adoption of the fiscal risk statement, which is published annually by the DBM for the DBCC.

The stock of contingent liabilities arising from 41 PPP projects for 2020 is estimated to be about ₱311.8 billion (US$6.2 billion; 1.3 percent of GDP). The ₱78 billion (US$1.56 billion; 0.3 percent of GDP) increase from 2019 is attributable mainly to the addition of newly awarded projects and the updating in the valuation of several existing projects as they advanced in the project implementation cycle. Big ticket projects such as the Cavite-Laguna Expressway, MRT Line 7, Metro Manila Skyway (Stage 3), and Clark International Airport Expansion Project—EPC matured in construction and contributed significantly to the increase. For the same reason, the corresponding estimated flow (the amount of contingent liabilities that may materialize within the fiscal year, taking into consideration each project's risk factors) of contingent liabilities in 2020 have increased to ₱33.1 billion (US$662 million) from ₱22.8 billion (US$456 million) in 2019. By the end of 2021, a net increase of 24 projects that have an impact on fiscal risk is expected. Specifically, 25 projects that are currently in the Investment Coordination Committee (ICC) pipeline are expected to be awarded by the end of 2021, assuming these projects commence the tender stage not later than February 2021. On the other hand, the fiscal exposure of the government to the Casecnan Multi-Propose Irrigation and Power Project is expected to end as the project concludes by November 2021.

8.4. Reporting Requirements

8.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

The Philippine government is following the trend observed in the other countries trying to adopt modern accounting and financial reporting standards so that cash flows are reported in the statement of cash flows, whereas non-cash costs and revenues are reported in an income statement. The trend towards adoption of international accounting standards such as International Financial Reporting Standards (IFRS) superseding the local standards is an overall positive development. The International Public Sector Accounting Standards

(IPSAS), adapted from IFRS for government purposes, have been developed by the International Public Sector Accounting Standards Board and are considered worldwide as a credible set of accounting and reporting standards. In addition, the International Monetary Fund (IMF) created an accrual accounting standard for government financial statistics.

In the Philippines, the Department of Budget and Management (DBM) reports to the Office of the President and is responsible for issuing annual fiscal risk statements, which provide a comprehensive view of the country's exposure to macroeconomic risks and contingent liabilities, including those related to PPPs. The information contained in these statements usually comes from such project documents as pre-feasibility and feasibility studies.

8.4.2. Transparency Policy on PPP Contracts

At the micro level of the individual implementing agency or GOCC, the disclosure of contingent liabilities is prescribed by the Philippine Government Accounting Standards in the following manner: "contingent liabilities, such as those arising from guarantees against debt default, shall be presented and explained in the notes to financial statements, indicating, among other things, the name of the debtor, the creditor, the amount of debt guaranteed, the maturity date of the debt and other relevant information." At the macro level, the appropriate venue for disclosing contingent liabilities would seem to be in the annual General Appropriations Act and in the fiscal risk statement which the Philippine government started to issue in 2012.

The Philippines is currently in line to be the first Asian country to participate in the IMF's Fiscal Transparency Assessment exercise, a voluntary surveillance tool that elaborates on the country's fiscal position based on three pillars: fiscal reporting, forecasting, and risk analysis. Based on the IMF's updated Transparency Code, the Fiscal Transparency Assessment replaces the Fiscal Report on the Observance of Standards and Codes initiative of the IMF and World Bank and responds to key weaknesses in surveillance which were brought to the fore in recent episodes of crisis. The Fiscal Transparency Assessment has been piloted in Ireland, Costa Rica, and Bolivia. At present, the main avenue for the disclosure of contingent liabilities is the reference to the government's exposure to contingent liabilities included in the fiscal risk statement. Until the government makes specific progress in shifting to accrual accounting and resolving the issues raised by Irwin (2007), the standard of reporting contingent liabilities will not likely be on par with the accrual-based accounting practice in the private sector.

Engagements with PPP Center officials indicate that IAs are allowed to disclose all Information about PPP projects and there are no national restrictions on disclosures about PPP projects except for the fact that the contents of draft contracts should not be published. However, the framework's major weakness is the absence of a portal or system that encapsulates disclosures on all PPP projects nationwide.

Governments need to account for and report on their financial commitments, including those under PPP contracts—an additional reason for the DOF to keep a centralized register of financial commitments under PPP contracts, both direct and contingent. When reporting is done well, it encourages the government to scrutinize its own fiscal position. Making financial reports publicly available enables other interested parties—such as lenders, rating agencies, and the public—to reach an informed opinion on the government's public financial management performance.

8.5. Performance Under Crisis

8.5.1. The Asian Financial Crisis

The Philippine economy did not escape the impact of the Asian financial crisis, which hit the region in July 1997. The crisis was caused by the collapse of FX rates and started in Thailand before sweeping through East and Southeast Asia. The financial crisis heavily damaged currency values, stock markets, and other asset prices in many East and Southeast Asian countries. The causes of the Asian financial crisis are complicated and disputable. A major cause is considered to be the collapse in the "hot money" bubble. During the late 1980s and early 1990s, many Southeast Asian countries, including Thailand, Singapore, Malaysia, Indonesia, and South Korea, achieved massive economic growth—an 8 percent to 12 percent increase in GDP—which was known as the "Asian economic miracle." However, a significant risk was embedded in such fast growth. The economic developments in these countries were mainly boosted by growth in exports and foreign investments. Therefore, high interest rates and fixed FX rates (pegged to the US dollar) were implemented to attract "hot money." Also, FX rates were generally pegged at a level favorable to exporters. However, both the capital market and corporations were exposed to FX risk due to this fixed FX rate policy.

The crisis experience offered valuable lessons for the Philippines, the rest of Asia, and indeed, emerging markets around the world. The lesson is that policies matter: economic reform, particularly of the financial system, can have a demonstrable impact on a country's ability to weather a crisis, even if the crisis originates elsewhere and is spread by contagion. Had the Philippines not undertaken its financial sector reforms, the crisis undoubtedly would have been worse.

The financial crisis equally had a large impact on the power sector in the Philippines, because major private investments in power generation were severely affected. These private power programs were threatened by issues such as increased power costs, default threats and renegotiations, and the contraction in the private power market. Electricity costs in the Philippines soared as dollar payments had to made to several operating independent power producers (IPPs) and seven PPP projects representing 26.38 percent of the total, with an investment amount of US$5.38 billion, were discontinued or cancelled during this period. Stress washed over the IPP market in the late 1990s following the Asian financial crisis. The fiscal and monetary disruption flowing from the crisis had an immediate impact on the IPP sector in the Philippines, making the take-or-pay or capacity payments included in the power purchase agreements unsustainable. Even facing this burden, the Philippine government continued to honor the basic offtake obligations in the IPP contracts for several years, until a 2001 electric industry reform law mandated an inter-agency review of the IPP contracts. This review process led to a widely publicized renegotiation effort in the IPP sector.

Projects attracting higher levels of domestic finance are less susceptible to FX rate volatility (although they may be vulnerable to interest rate hikes). In the Philippines, local debt financing of IPPs equalled only 3 percent, thus exposure to risk of mismatch between project revenues denominated in local currency and hard currency obligations to project lenders was significant. Furthermore, the Philippine government took up a fairly significant portion of risks by issuing sovereign guarantees to cover such risks as fuel supply, inflation, and FX risks. This step was vital for successful financing of the different early projects. With a now mature market, the country reduced guarantees offered to new projects, and some projects are being financed without the sovereign guarantees. However, the introduction of the Electric Power Industry Reform Act (EPIRA), the country's power industry has transformed from a fiscally dependent industry to a net tax payer, which reduced high levels of debt that had been incurred by the government prior to the reform.

Other Asian countries like Malaysia and Thailand subsequently started procuring new power generation using competitive bidding methods as opposed to the single tender system used extensively before the Asian crisis, lowering wholesale tariffs. Meanwhile, most IPP projects in Indonesia and many early projects in the Philippines were concluded through direct negotiations with project sponsors.

8.5.2. Global Financial Crisis

The Philippines was also not spared from the fallout of the global financial and economic crisis of 2008-2009, as GDP growth decelerated considerably in the fourth quarter of 2008 and the first six months of 2009. Asset prices experienced volatility but unlike the 1997 Asian crisis, the financial sector remained fairly stable. Unemployment increased moderately but was more pronounced in the manufacturing sector, which felt the brunt of the slowdown mainly through export channels. The conservative stance of the Philippine banks led to only marginal exposure to derivatives or structured products. Dynamic risk management instruments, such as financial derivatives including interest rates swaps, can be conveniently adjusted and incorporated into PPP project financing to mitigate associated financial risk exposures. Adequate information disclosure practices and implementation of banking reforms are now yielding fruit, particularly in terms of better risk management and consolidated supervision. These measures contributed to the limited impact of the global financial crisis on the Philippine financial markets. However, the Philippine equity market was under considerable stress in 2008 and stock prices declined.

The crisis magnified existing structural problems that were prevalent in the Philippine economy such as a widening fiscal deficit, which was largely due to the need to increase government expenditures to offset lower consumption, investment, and exports. The government used the crisis as a trigger to start designing and implementing wide-ranging reforms. Many comprehensive analyses of the Philippine economic situation were performed at the time, which covered extensive policy recommendations (for example, ADB 2007, and Manasan 2007).[199, 200] However, the global financial crisis highlighted the importance of two areas—fiscal reforms, including measures to increase resources needed to achieve Millennium Development Goals (MDGs), and measures to revive private investments in the Philippines.

The crisis also took a toll on the macroeconomic balances of the Philippines. Thus, the fiscal deficit of the national government was expected to balloon to 3.2 percent of GDP in 2009. The target set in July 2008 was 0.5 percent and this was subsequently changed to 1 percent in November 2008 in the wake of the crisis. The actual fiscal deficit in 2008, however, was only 0.9 percent of GDP.

The Philippine government, through the Department of Finance and National Economic and Development Authority (NEDA), then crafted a ₱330 billion fiscal package, formally known as the Economic Resiliency Plan (ERP), to respond to the global crisis. The ERP was geared towards stimulating the economy through a mix of government spending, tax cuts, and public-private partnership projects. The ERP initially involved an increase in the capital outlay in 2009 amounting to ₱275 billion or 3.3 percent of GDP. This was higher than the amount in 2008, which was ₱225 billion. Subsequently, the ERP was announced as a ₱330 billion package that would prioritize "easy to implement projects" like repair and rehabilitation of roads, hospitals, bridges and irrigation facilities, and school and government buildings.

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[199] Asian Development Bank. 2007. *Philippines: Critical Development Constraints.* Mandaluyong City: Asian Development Bank.

[200] Manasan, R. G. 2007. "Financing the Millennium Development Goals: The Philippines." PIDS Discussion Paper, 2007-06. http://publication.pids.gov.ph/details.phtml?pid=4129.

These projects included construction, repair, or rehabilitation of irrigation systems, and rural roads. The government intended to frontload infrastructure spending in the first half of the year. The agencies indicated commitments to spend 60 percent to 80 percent of their infrastructure budgets in the first semester. Progress was to be regularly monitored by the economic managers. In 2010 and beyond, ₱100 billion was to utilized to fund big-ticket items under public-private partnerships. These projects would normally take longer as they entail complex engineering plans and approval processes.

8.5.3. Impact of COVID-19 on Concessions

The COVID-19 pandemic has significantly impacted the development and life cycle of PPP projects around the world in areas such as: i) incapacity of the workforce to work normally due to health impact, site closures and travel restrictions, including for immigrant workers; ii) demand shock in certain sub-sectors, most notably transport; iii) additional expenses incurred to keep facilities running and available in the sectors where demand did not decline (such as in healthcare projects); and iv) lockdowns and legally imposed isolation to minimize the risk of the spread of COVID-19. Cumulatively, this has led to disruptions in trade, production, and supply chains as well as sharp declines in consumption and investments. Generally, there are four avenues for relief in PPP contracts that are relevant in the context of COVID-19, including: i) force majeure events, ii) general changes in law, iii) discriminatory changes in law, and iv) scope changes, each of which may grant or trigger time relief, compensation, or termination rights. Each must be assessed separately against the impact of COVID-19 on the affected party.

In the midst of the COVID-19 pandemic, the Philippine government delayed infrastructure projects. In efforts to stop the spread of COVID-19, several projects such as the Ninoy Aquino International Airport (NAIA), New Manila International Airport and Sangley International Airport, all procured as public-private partnerships, had to be delayed. The Department of Transportation in the Philippines has also suspended all the meetings until further notice. The regional government-managed infrastructure projects were also affected due to the measures taken by the central government. The Government of the Philippines has also deferred the sale of its 20 percent stake in Tollways Management Corporation (TMC). The decision was taken due to the community quarantine situation in Manila amid the spread of COVID-19. The transaction is now in a “suspended till further notice” state.

Previously, the office of Privatization and Management Office (PMO) had intended to accept offers for the stake by March 20, 2020. TMC operates and maintains toll roads in major expressways in the capital region. It is a unit of NLEx Corp, a subsidiary of Metro Pacific Tollways Corp. NLEx Corp. is the builder-concessionaire and operator of North Luzon Expressway and Subic-Clark-Tarlac Expressway.

Additionally, the provincial government of Cavite in the Philippines also selected a consortium of MacroAsia and Chinese Communications Construction Company Ltd (CCCC) as the preferred bidder for the Sangley Point International Airport concession. The concession involves the development of a new international airport in Sangley Point, Cavite, in the Calabarzon region of the Philippines. The airport is proposed to be developed on a 1,500-hectare site, will have four runways and will handle about 130 million passengers. The proposed concession period is 50 years. The project will transform the existing Sangley Airport into an international air hub. The project was awarded on February 15, 2020, but the consortium is facing difficulties completing qualification requirements, due to the coronavirus disease outbreak in China. The disease outbreak is keeping officials from CCCC from visiting Manila, Philippines. The authority has given 60 days to complete the post-qualification requirements before the contract can be signed.

Although disruptions affected various projects, most players found ways to restructure their transactions except for a few that filed claims for the loss of revenue. These claims are currently undergoing validation by the PPP Center. Indeed, the continuation of shovel-ready infrastructure PPPs is seen as a feature of the recovery efforts and the government's spending is expected to focus on smaller-scale projects that might be carried out more rapidly.

Funding from the Duterte Government's Build, Build, Build (BBB) infrastructure plan issued in 2016 has given new life to PPPs. The plan spans 2017–2022 and was allocated a budget of ₱8 trillion (approximately US$164 billion). As of August 2020, there were 30 projects (out of 104; 29 percent) in the BBB list that were to be financed through PPPs in different sectors such as urban redevelopment (including disaster risk mitigation), transport and mobility, water resources, and power and energy. Projects that have greater potential to revive the economy amid the COVID-19 pandemic will be prioritized because the government has encouraged PPP procurement for the program.

8.5.4. Measures Implemented to Help Cope with the Consequences of the COVID-19 Crisis

Key strategies in response to the COVID-19 pandemic to be implemented in the Philippine infrastructure sector include:

- Realigning expenditure priorities in 2021 by providing more space for the relevant health-related expenditures and improving the digital infrastructure.
- Ensuring unhampered movement of agricultural goods and services through efficient transport and logistics systems. This would involve the construction of better road, transport, and other infrastructure for agriculture.
- Conducting comprehensive vulnerability and risk assessments for critical infrastructure, particularly in the areas considered COVID-19 hot spots. This would include public buildings that may be used as isolation or treatment facilities.
- Construction and/or rehabilitation of hospitals or designated quarantine holding facilities in LGUs, airports, and major seaports.
- Under the Universal Health Care Law, strengthening the health system through the establishment of facilities and laboratories and acquisition of necessary hospital equipment to address COVID-19 and possible recurrence of virus contagion, among others.

Learning lessons from previous economic disruptions like the Asian and global financial crises and the impact they had on PPP projects, the Philippine government took further initiatives and approached the Public-Private Infrastructure Advisory Facility (PPIAF) to benefit from the World Bank's COVID-19 PPP Rapid Response Umbrella Program. The program is aimed at providing remote, targeted technical advice to undertake an assessment of the impact of COVID-19 on the Philippine PPP program and provide international benchmarks. There were two options for conducting this assessment, including:

- *Option 1.* To focus on the study of high- and portfolio-level fiscal implications of COVID-19 on selected PPP projects. The lead here would be the Department of Finance (DOF); or
- *Option 2.* To focus on introducing the global best practices for contract adjustments, which were necessitated by the pandemic. The lead for this option would be the National Economic and Development Authority (NEDA).

The PPP Center would be one of the co-implementing agencies for both options. Officials of the PPP Center have indicated that most reforms that are currently underway to ensure the resilience of the Philippine PPP program were a direct result of the rapid assessment exercise conducted with the support of PPIAF. As a result of this assessment, the PPP Center put in place a local strategy to be implemented from 2020 as depicted in Table 9.4 below:

Table 9.4: Short-, Medium- and Long-Term Strategies to Enhance Resilience of the Philippine PPP Program to COVID-19

Short Term (2020)	Medium Term (2022)	Long Term (within 6-8 years)
Have a robust pipeline of local PPP projects in expanded priority sectors	Successful showcase of projects for replication	Acquisition of expertise for continuous project development
Institutionalization of reforms in the Project Development and Monitoring Facility (PDMF)	Development of an updated capacity building PPP curriculum	Development of the PPP network
Develop sector specific PPP guidebooks with the piloting of the guidebook on solid waste management facilities		Nationwide operationalization of the PPP Project Information Management System
Ongoing enhancement of the network of collaborative alliances in order to improve the existing network of institutional partners of the PPP Center		

As part of the strategy, the PPP Center also implemented the following policies in response to COVID-19:

- Project management and development
  - Extended online technical assistance for preparation, packaging, structuring, approval, and bidding of PPP projects by implementing agencies.
  - Considering risks and impacts of COVID-19 in PPP project preparation and structuring.
  - Continued rollout of the Project Development and Monitoring Facility, especially for fiscally constrained local implementing agencies.
- Policy formulation and advocacy
  - Recommending policies in response to COVID-19 to address PPP policy gaps mainly through the amendment of the Philippine BOT Law.
- Project monitoring
  - Assessment of the impact of COVID-19 on PPP contracts especially in terms of contingent liabilities.

As part of these strategy and policy decisions, the PPP Center continues to sensitize all players in the PPP sector on the need to collaborate and work together during the life of a project, especially during the implementation phase, to forestall disruptions and avoid excessive claims.

It has been observed based on information available on all the reforms carried out by various Philippine governments (including the current one) that the country has acknowledged the critical role PPPs can play in addressing infrastructure gaps while supporting economic development as well as the potential pitfalls of not doing it the right way, and therefore it constantly strives to improve upon its PPP program. The lessons learned during the Asian crisis serve as a warning of what could go wrong if fiscal commitments and contingent liabilities are not properly accessed, managed and reported clearly. The Philippine government has demonstrated its willingness to use PPPs the right way and this is clearly demonstrated by its desire to partner with key institutions such as the World Bank Group, AusAID, and ADB to continuously improve the process.

It is clear that the various reforms to strengthen the Philippine PPP program seem to be working, which is evident in the seemingly resilient way the program has survived the COVID-19 disruptions. It is recommended that the government continue to improve its systems especially in the area of disclosures.

Annex 8 A: Philippines FCCL Principles

#	Principles	Clarification	Assessment for Philippines
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	Currently, the Philippines does not have a well-developed FCCL framework that would be expressed in detailed guidelines and regulations.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigations measures.	With the support of the Australian government, a Generic Preferred Risk Allocation Matrix (GPRAM) was developed to serve as a guide for the government entities and the private sector in structuring PPPs.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	Department of Finance (DOF) manages and monitors the fiscal impact of PPP projects.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	The PPP Rationalization Act aims to optimize the government's value for money in the projects and provide efficient approvals and incentives, among others.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	National PPP projects worth up to ₱5 billion (US$103 million) shall be approved by the PPP Center, unless overturned by the Investment Coordination Committee of the National Economic and Development Authority (NEDA-ICC) within 30 days from the approval date. Projects worth more than ₱5 billion (US$103 million) shall be approved by the NEDA board upon recommendation of the ICC.
	BUDGET: Ensuring funding is available for fiscal commitments		

#	Principles	Clarification	Assessment for Philippines
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Private partners are responsible for the non-availability of the required financing for the project. Potential private partners must meet the financial capability requirement under Section 5.4 (c) of the Implementing Rules and Regulations (IRR) of RA 695714, as amended, to determine creditworthiness.
7	Mechanisms are in place to ensure funding is available for contingent liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to fund contingent liabilities should they materialize.	No mechanisms in place to budget for contingent liabilities.
	REPORT: Accounting, monitoring and disclosure		
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	Implementing agencies are allowed to disclose all Information about PPP projects, and there are no national restrictions on disclosures about PPP projects except for the fact that the contents of draft contracts should not be published. However, the major weakness in this respect is the absence of a portal/system that encapsulates disclosures on all PPP projects nationwide.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	No periodic audits.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure the fiscal rules for PPP should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including NGAs.

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Chapter 9: South Africa

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Acronyms and Abbreviations

ASB	Accounting Standards Board
BEE	black economic empowerment
BOO	build-own-operate
BROT	build-rehabilitate-operate-transfer
CA	contracting authority
CSP	concentrated solar power
DA	direct agreement
DBSA	Development Bank of Southern Africa
DFID	Department for International Development
DMRE	Department of Mineral Resources and Energy
DPLG	Department of Provincial and Local Government
EBW	expedited bid window
FCCL	fiscal commitments and contingent liabilities
FMIP	Financial Management Improvement Programme
FX	foreign exchange
FY	fiscal year
GDP	gross domestic product
GFSA	Government Framework Support Agreement
GIZ	Deutsche Gesellschaft für Internationale Zusammernarbeit
GoSA	Government of South Africa
GRAP	Generally Recognized Accounting Practice
GTAC	Government Technical Advisory Centre
HR	human resource
IA	implementation agreement
IASB	International Accounting Standards Board
IF	Infrastructure Fund
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IPP	independent power producer
IPSAS	International Public Sector Accounting Standard
IRP	Integrated Resource Plan
ISA	Infrastructure South Africa

KSCC	Kutama-Sinthumule Maximum Security Correctional Centre
MCC	Mangaung Maximum Security Correctional Centre
MDB	multilateral development bank
MDI	multilateral development institution
MFM	Municipal Finance Management
MoA	memorandum of agreement
MoU	memorandum of understanding
MTBPS	Medium-Term Budget Policy Statement
MW	megawatt
NDP	National Development Plan
NERSA	National Energy Regulator of South Africa
NT	National Treasury
PFM	public finance management
PICC	Presidential Infrastructure Coordinating Commission
PIM	public investment management
PPA	power purchase agreement
PPP	public-private partnership
PSC	public sector comparator
PV	photovoltaic
QoQ	quarter-on-quarter
R	South African rand
RE	renewable energy
REIPPPP	Renewable Energy Independent Power Producer Procurement Programme
ROT	rehabilitate-operate-transfer
SANP	South African National Parks
SANRAL	South African National Roads Agency SOC Ltd
SIP	Strategic Infrastructure Project
SOE	state-owned enterprise
TA	Treasury Approval
USAID	United States Agency for International Development
USP	unsolicited proposal
VfM	value for money
WB	World Bank
WB-PPIAF	World Bank-Public-Private Infrastructure Advisory Facility
WGC	Whole-of-Government Consolidation
YoY	year-on-year

Executive Summary

The South African public-private partnership (PPP) program represents a peculiar case of a practice-informed regulatory framework development, when the lessons learned from a few pilot PPP transactions in different sectors informed formulation of the first PPP-dedicated provisions. Thus, even though the first PPP project was recorded in 1990, it was not until after 1997 that a conscious decision to adopt a specialized PPP framework was made; actual implementation occurred during the early 2000s, and change continues to this day. Another peculiarity of the South African system is its multitier structure. Thus, a separate set of provisions govern the national and provincial as well as municipal-level PPPs. Additionally, the independent power producer (IPP) program is regulated by a stand-alone set of laws and regulations. Therefore, almost two-thirds of the existing PPP program does not fall under the purview of what is traditionally considered to be the South African PPP regulatory framework, because about 65 percent of the portfolio is comprised of projects procured under the Renewable Energy IPP Procurement Programme (REIPPPP). IPP-related regulations bypass many rigors and checks embedded in regulations for traditional PPPs and are managed and reported on independently by a separate IPP Office that is technically unconnected to the existing PPP structures, such as the two PPP Units. Finally, because the South African legal system borrows many elements from the English common law system, the country did not adapt a stand-alone specialized PPP law or act, but rather incorporated core PPP-related provisions into broader public finance management and budget related legislation, supported by a series of detailed guidelines, including the PPP Manual. Not all areas of the PPP cycle are comprehensively covered by the existing regulations, however, including the area of fiscal commitments and contingent liabilities (FCCL) management.

The FCCL framework is currently lacking some important elements, although attempts are being made to address the gaps. The existing regulatory set-up in the area of fiscal risk management only contains some provisions in the Public Finance Management and Municipal Finance Management Acts regarding approval of state guarantees and indemnities, as well as quite detailed instructions in the PPP Manual (which does not apply to IPPs) on how to construct a risk matrix and conduct value for money (VfM) and public sector comparator analyses as part of preparing a feasibility study. At the same time, there is no guidance on the FCCL management process itself, including on how to perform assessment, measurement, typology and reporting of either direct or contingent liabilities, despite some disclosure being actually available. There is also no guidance on the related reserves or ceilings policies for PPP-related fiscal exposure and on the roles of the different actors involved in the fiscal risk management process, among others. Nevertheless, the National Treasury has partnered with the World Bank to improve the methodology for quantification of contingent liabilities, including for the development of a draft guidance note and a template for reporting on contingent liabilities as well as formulating measures to evaluate the private sector's ability to deliver on its contractual obligations and debt repayments. If all clearances are obtained, a draft guidance note might eventually be included in the PPP Manual as a separate Practice Note.

The majority of the existing fiscal exposure is presumably accumulated in a substantial substantial IPP portfolio. However, because IPPs are not formally considered PPPs and are not covered by existing PPP reporting, there is no specific information on how big and/or potentially troublesome the accumulated exposure is. One indication of the less-than-ideal situation in this area is the fact that the fifth round of REIPPPP was delayed by almost three years due to the difficult financial situation of the country's state-owned utility Eskom (the off-taker under the power-purchase agreements (PPAs)), and the renegotiation of PPAs awarded during the fourth round. The IPP Office does not publish a detailed analysis of fiscal risks associated with IPPs, and the team was not able to gather the IPP Office's feedback despite multiple attempts. At the same time, the COVID-19 pandemic is not expected to have caused significant distress for the existing IPP portfolio (beyond risks that were already accumulated), because the energy sector showed relative resilience during this period. The hardest hit sector during the COVID-19 crisis was transport, with two projects (Gautrain and the Chapman's Peak toll road) seeing the triggering of the minimum revenue and debt guarantees having an impact on the budget, which the National Treasury, however, considered manageable. Overall, because the relative share of non-energy PPPs in the total portfolio of public investment projects is minor (about 2 percent), the National Treasury does not consider them to pose significant risks to the fiscus. At the same time, the renewed focus of the government on blended-finance solutions for delivering its ambitious infrastructure agenda in the post-COVID-19 recovery effort, including through PPPs, means that addressing the legal, institutional and capacity gaps in the existing FCCL framework would help avoid unpreparedness risks, should the PPP portfolio expand according to the government's aspirations, as well as potential fiscal problems that could arise in the next distress situation with a presumably larger PPP portfolio. Additionally, harmonization of the reporting and disclosure practices for both IPPs and PPPs would significantly improve the overall understanding of the fiscal risks stemming from a unified PPP portfolio and, hence, their management in a holistic way.

9.1. PPP Experience

Among the 10 economies studied in this volume, South Africa is a relatively mature PPP market. At the same time, the history of PPPs in the country is relatively short—the first PPP transaction was recorded in 1990, when a five-year management contract for the N2 Oribi Toll Road was concluded (it was extended for another five years in 1994). As in many other economies and as will be discussed in section II of the report, the first PPP projects in the country were realized without any PPP or FCCL framework in place because a decision to create an enabling environment for PPPs was made by the Cabinet only in 1997, with the actual operationalization happening in the late 1990s to early 2000s.[201]

Before 2012, the South African PPP portfolio was quite diverse sector-wise, with a number of water, health, social and transport projects; however, several rounds of the massive Renewable Energy IPP Procurement Programme (REIPPPP) tilted the scales heavily towards the energy sector. According to the available data, there were a total of 142 PPP/IPP transactions in South Africa that reached financial close from 1990 to 2021 (including cancelled and concluded projects), which cumulatively generated a total investment of about US$31.4 billion or an annual average 0.49 percent of gross domestic product (GDP) in the years when investments were made (being higher than 1 percent of GDP, however, in six years during this period and reaching the highest rate of 1.45 percent of GDP in 2012). Out of these 142 transactions, 17 were concluded, one was cancelled and the remaining 124 are either operational or in the construction stage. Table 10.1 and Figure 10.1 below illustrate the size and the main characteristics of the South African PPP program to date:[202]

Table 10.1: PPP/IPP Projects that Reached Financial Close or

Entered the Construction Phase, 1990-2021

Type of Contract	Number of Projects	Investment Amount, US$, millions
Greenfield (BOT, BTO BOO, DBFO, DBFMO, DBOT, DFBOT, PFI, Design-Finance-Manage)	120	30,212
Management/lease contract	12	46
Brownfield (BROT, ROT)	8	1,166
Equity partnership	1	10
Rental power	1	6
Total	**142**	**31,440**

Source: PPI, IJ, PFI and PWare databases, National Treasury, Government Technical Advisory Centre (GTAC).

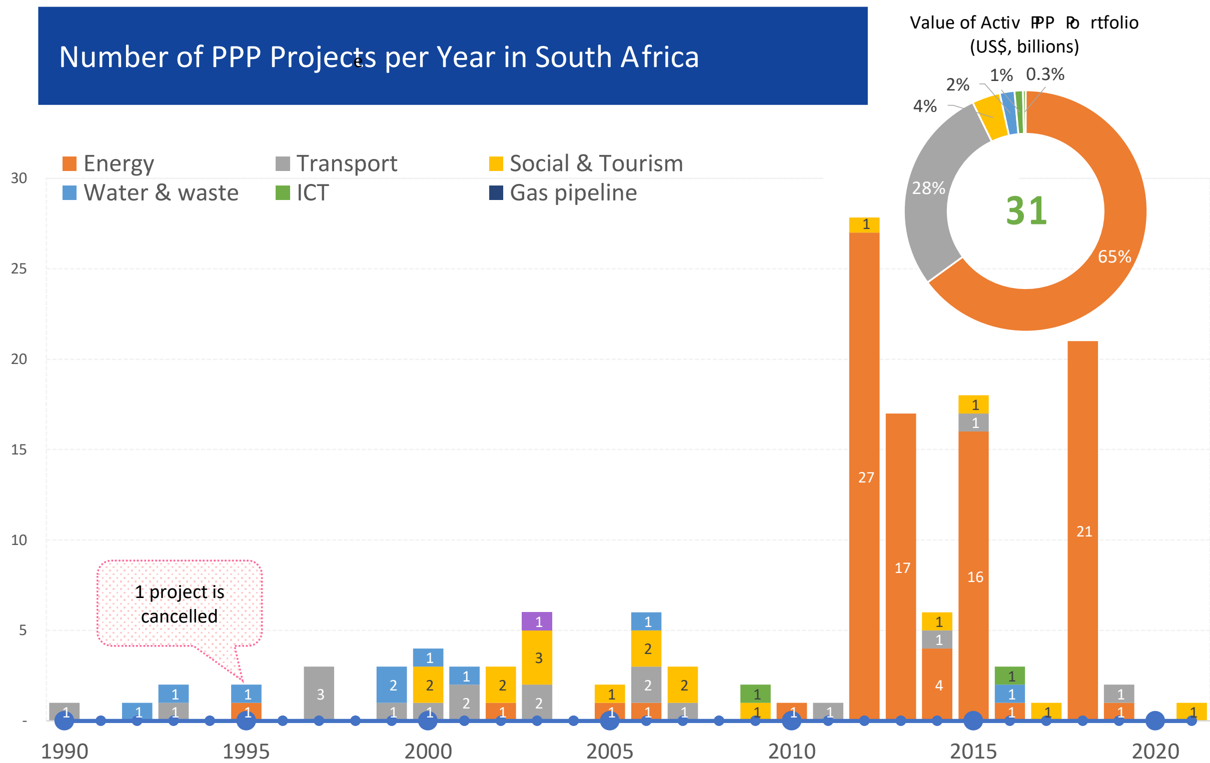
Note: BOO = build-own-operate, BOT = build-operate-transfer, BROT = build-rehabilitate-operate-transfer, BTO = build-transfer-operate, DBFMO = design-build-finance-maintain-operate, DBFO = design-build-finance-operate, DBOT = design-build-operate-transfer, DFBOT = design-finance-build-operate-transfer, PFI = private finance initiative, ROT = rehabilitate-operate-transfer.

[201] Aiello, James. 2014. "Health Care Public Private Partnerships in South Africa—what has worked and what has not." Government Technical Advisory Centre, National Treasury, December 2014. https://slideplayer.com/slide/335784/.

[202] ICT projects of a purely commercial nature, such as cellular network licenses and the like, were excluded from the analysis as not meeting the definition of PPPs. For the definition of PPPs, refer to the PPP Reference Guide, version 3: https://openknowledge.worldbank.org/handle/10986/29052.

South Africa

Figure 10.1: PPP Projects that Reached Financial Close and Active Portfolio,



Source: PPI, IJ, PFI and PWare databases, National Treasury of South Africa, the Government Technical Advisory Centre (GTAC).

1990–2021

As can be seen from Figure 10.1, PPP projects in the energy sector were rather scarce until 2012 owing in part to a large government presence and high centralization of the sector. Thus, before 2012, most PPPs were in the social and tourism (e.g., hospitals, government buildings, and prisons, etc.), transport (mostly toll roads, but also some airport and fleet management contracts) and water sectors. In 1998, the government published a white paper on energy policy, approved as a government policy in December 1998, which constituted a comprehensive blueprint for transforming the sector.[203] Among other initiatives, the government was planning to introduce competition in the industry, especially in its generation sub-sector. A regulatory framework would be put in place to ensure participation of IPPs and diversification of primary energy sources. After years of trying to determine how much energy could be procured from IPPs, which party should be the responsible entity for managing the related procurement, and what should be the price paid for electricity generated by IPPs, the IPP procurement process received Cabinet approval in December 2003. However, the Electricity Regulations on New Generation Capacity,[204] which established the rules and guidelines for an IPP bid program, were only gazetted in May 2011 (and further amended in 2015 and 2020).

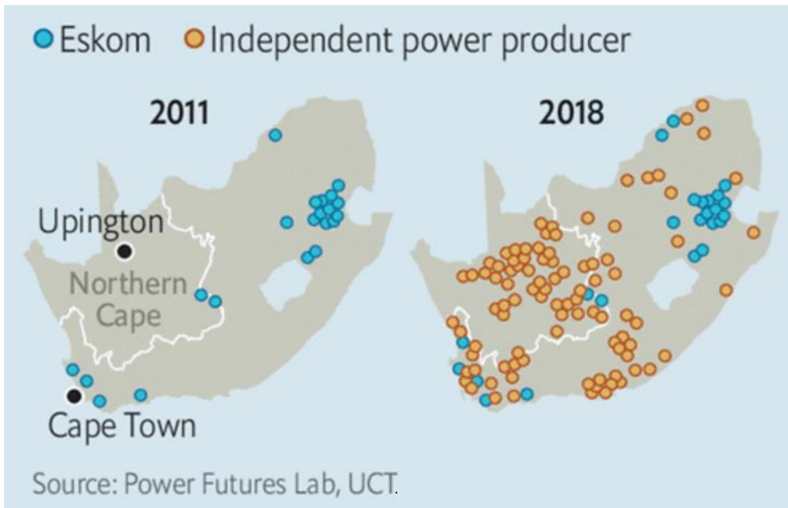
REIPPPP saw a sharp fall in bid prices and was touted as "the most successful PPP program in Africa in the last 20 years." In 2011, the government launched the Renewable Energy Independent Power Producer

[203] van der Heijden, Tracy. 2013. "Why the Lights Went Out: Reform in the South African Energy Sector." University of Cape Town's Graduate School for Development Policy and Practice, April 2013. http://www.mandelaschool.uct.ac.za/sites/default/files/image_tool/images/78/10%2Bcasestudy_eskom_final_july.pdf.

[204] Government of South Africa Department of Energy. Electricity Regulation Act. Electricity Regulations on New Generation Capacity. https://www.gov.za/sites/default/files/gcis_document/201409/32378721rg9116.pdf.

Procurement Programme (REIPPPP), effectively implementing the vision outlined in the Integrated Resource Plans (IRPs) and replacing the feed-in tariff system, which was introduced in 2009. IRPs are developed by the Department of Mineral Resources and Energy (DMRE) to make determinations on what new generation capacity is needed, from which sources, and whether it should be from Eskom (the South African electricity public utility) or IPPs. To date there have been three such determinations for the REIPPPP. The first required a maximum of 3,725 megawatts (MW) to be generated from renewable energy (RE) sources. Following a significant positive response to the REIPPPP, the Minister of Energy permitted an additional 3,200 MW in 2012 and another 6,300 MW in 2015 to be allocated to the program. Consequently,

Figure 10.2: Power Plants in South Africa by Ownership Type, 2011 vs. 2018



13,225 MW (subject to change with further ministerial determinations) is available for allocation to RE projects, with just under half of this already procured or in various stages of development, with the remainder available for future bid rounds.[205] From 2011 to 2015 four bidding rounds of reverse auctions were held with an additional round for concentrated solar power (CSP) technology only (see Table 10.2). Competition was fierce, with 390 submissions resulting in just under a quarter (92) of these being selected for procurement of 6,328 MW amounting to R 193 billion (an equivalent of about US$20.5 billion[206]) in investments. Prices fell sharply, from an average bid price of 151 US cents per kilowatt-hour (kWh) in Round 1 to 68 US cents per kWh in Round 4 for wind technology, and from 329 US cents per kWh in Round 1 to 82 US cents per kWh in Round 4 for solar photovoltaic (PV) technology. As a result, the projects of selected bidders were among the lowest priced grid connected RE projects in the world. Additionally, an expedited bid window (EBW) was run in 2015, designed primarily for projects that were unsuccessfully tendered during the prior rounds with a second opportunity to bid; 1,800 MW was made available for tender under this expedited bid window, with bid submissions in November 2015.[207] In March 2021, after almost a three-year delay, the South African Minister of Mineral Resources and Energy launched the fifth round of the REIPPPP. It was originally planned for 2018 but was delayed several times due to the difficult financial

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[205] Eberhard, Anton, and Raine Naude. 2017. "The South African Renewable Energy IPP Procurement Programme. Review, Lessons Learned & Proposals to Reduce Transaction Costs." University of Cape Town, Graduate School of Business, January 2017: 4. https://www.gsb.uct.ac.za/files/EberhardNaude_REIPPPPReview_2017_1_1.pdf

[206] Based on the US dollar to South African rand rate of 9.4.

[207] Eberhard, Anton, and Raine Naude. 2017. "The South African Renewable Energy IPP Procurement Programme. Review, Lessons Learned & Proposals to Reduce Transaction Costs." University of Cape Town, Graduate School of Business, January 2017: 1. https://www.gsb.uct.ac.za/files/EberhardNaude_REIPPPPReview_2017_1_1.pdf

situation of the country's state-owned utility Eskom (off-taker under the PPAs) and a renegotiation of PPA contracts initially awarded in the fourth round.[208] During these auctions, all compliant bids are assessed on the price (70 percent weight) and a basket of economic development criteria (30 percent weight), with the weight of the price criterion being increased to 90 percent in the fifth round, indicating a distinct emphasis on the tariff. It is worth noting that projects procured under REIPPPP were exempt from following the same rules for project development and approval as non-energy PPPs in that IPPs did not require as rigorous affordability, VfM and other assessments usually requested for PPPs but followed their own technical process (see section 10.2 of the report). Overall, the program made some progress towards achieving the National Development Plan's (NDP) interim target of adding 7,000 MW of *operational* RE generation capacity by 2020 (installed capacity from RE sources was 5,027 MW in 2020[209]) and towards reaching the target of 17,800 MW from RE generation by 2030.

Table 10.2: Results of the Auction Rounds of the REIPPPP and the Proposed Fifth Round, 2011-2021

Auction Number	Auction Date/Preferred Bidders Announced	Capacity Allocated
Round 1	December 7, 2011	1.4 gigawatts (GW)
Round 2	May 21, 2012	1 GW
Round 3	October 29, 2013	1.4 GW
Round 3.5	December 15, 2014	
Round 4(a)	April 16, 2015	200 MW allocated to solar
Round 4(b)	June 7, 2015	
Round 5	March 18, 2021 (this is the launch date)	*1 GW of solar and 1.6 GW of wind power to be allocated

Source: IEA/IRENA Renewables Policies Database: https://www.iea.org/policies/5393-renewable-energy-independent-power-producer-programme-reippp.
PV Magazine, Research by University of Cape Town Graduate School of Business.

Payments under PPAs are passed through to consumers. It should be noted that once IPPs are appointed as preferred bidders they are required to sign standardized, non-negotiable, South Africa rand-denominated 20-year power purchase agreements (PPAs) with Eskom. Prices are indexed to inflation. Each PPA is supported by an implementation agreement (IA) between the IPP and the government (Department of Mineral Resources and Energy), which, along with the Government Framework Support Agreement (GFSA), is supposed to guarantee Eskom payments. The GFSA is an agreement between DMRE, the National Treasury, Eskom and the National Energy Regulator of South Africa (NERSA), under which IPP payments are ring-fenced and passed through to consumers. Such a design is supposed to protect revenue flow to IPPs if Eskom defaults on the payments, by preventing the sovereign guarantee contained in the IA from being called upon. There is also a standard direct agreement (DA) between the IPP, Eskom, DMRE and lenders, which provides the latter with step-in rights in the event of default.[210] However, a deterioration in Eskom's financial position would increase the risk of both Eskom defaulting on IPP payments and a call on a sovereign guarantee (Eskom indeed has experienced governance-related and financial troubles in recent years).

[208] Calitz, J.R., and J.G. Wright. 2021. *Statistics of utility-scale power generation in South Africa in 2020*. http://hdl.handle.net/10204/11865. (Summary also available at: https://www.evwind.es/2021/03/15/renewable-energy-contributed-10-to-sas-grid-in-2020/79815.)
[209] Bellini, Emiliano. 2021. "South Africa launches tender for 1 GW of PV." *PV Magazine*, March 19, 2021. https://www.pv-magazine.com/2021/03/19/south-africa-launches-tender-for-1-gw-of-pv/.
[210] Eberhard, Anton, and Raine Naude. 2017. "The South African Renewable Energy IPP Procurement Programme. Review, Lessons Learned & Proposals to Reduce Transaction Costs." University of Cape Town, Graduate School of Business, January 2017: 2. https://www.gsb.uct.ac.za/files/EberhardNaude_REIPPPPReview_2017_1_1.pdf

According to the Medium-Term Budget Policy Statement (MTBPS) for 2016[211] published by the National Treasury (the most recent detailed analysis available), guarantees related to the IPP program exposed the Government of South Africa (GoSA) to a potential R 200 billion (an equivalent of about US$13 billion, or approximately 4.6 percent of 2016 GDP) in payments as of fiscal year (FY) 2016's end should Eskom default on its PPA-related payments. Therefore, potential contingent exposure from PPAs is considerable. The REIPPPP is run by a separate DMRE IPP unit, which is led by a management team seconded from the PPP Unit of the National Treasury (NT). The Department of Mineral Resources and Energy (DMRE), NT and the Development Bank of Southern Africa (DBSA) established the IPP Office for the specific purpose of delivering on REIPPPP objectives. In November 2010, the DMRE and NT entered into a memorandum of agreement (MoA) with DBSA to provide the necessary support to implement REIPPPP and establish the IPP Office. A new MoA was agreed upon by all parties in May 2016 for an additional three years, then again in April 2019 for another year, and in March 2020—for an additional three-year period until 2023.[212] The DMRE IPP Unit also obtained substantial input from local and international technical, legal and financial transaction advisors.

Energy, transport and social and tourism are the most prominent sectors in the South African PPP program. Due to the massive procurement effort under the REIPPPP, the absolute majority of the South African PPP projects are in the *energy sector*, predominantly IPP transactions with a build-own-operate (BOO) modality, gauging by both number of projects (65 percent of the total) and investment amounts (64 percent). These are 92 projects with an average investment amount of about US$219 million, ranging from US$3 million for the 1995 PN Energy Services (Pty) Ltd build-rehabilitate-operate-transfer (BROT) contract in the distribution sub-sector to US$959 million for the 2019 Redstone Concentrated Solar Thermal Power (CSP) plant; 91 out of these 92 PPP contracts are generation projects. Due to the heavy focus on renewable energy as part of the REIPPPP and ample solar and wind potential in different parts of the country, 87 out of 91 (or 96 percent) generation contracts are in the RE segment, dominated by solar (54 percent) and wind (39 percent) technologies; there are also three hydro projects (3 percent) and one of each in the waste-to-energy, biogas and biomass segments. The second largest sector varies depending on whether its size is measured by the number of projects or investment amounts. If gauged by the number of projects, then the *social and tourism* sector comes second with 21 projects (15 percent), closely followed by the *transport* sector with 18 projects (13 percent). If, on the other hand, investment amounts are taken into consideration, then the transport sector (28 percent of the total) comes far above the social and tourism sector (5 percent) owing to the larger investment needs for the transport infrastructure (see Figure 10.3 for the average investment amounts per sector). In the social and tourism sector, headquarters office accommodations and hospital projects are the two most commonly occurring transactions (eight projects in each sub-sector) with many of those contracts being of a shorter duration and having been concluded already. There were also three deals in the tourism segment and two prisons. The transport sector is dominated by toll roads (10 projects), followed by airports and fleet management contracts (three projects each). There is also one railways and port transaction. Other less active PPP sectors include *water and waste* (eight deals or 6 percent of the total by the number of projects and 0.3 percent—by investment amount), *information communications technology ICT* (two transactions or 1.4 percent by the number of projects and 1.1 percent—by investment

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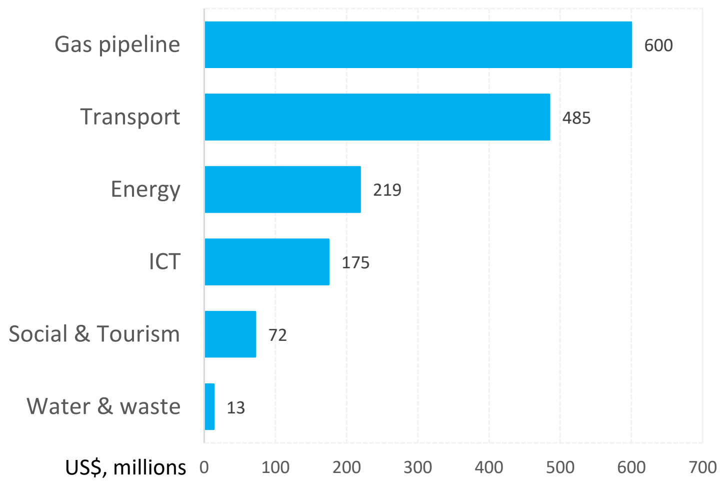
[211] Government of the Republic of South Africa, National Treasury. 2016. Medium-Term Budget Policy Statement, 2016, Annexure "Fiscal Risk Statement." October 26, 2016: 55. http://www.treasury.gov.za/documents/mtbps/2016/mtbps/MTBPS%202016%20Full%20Document.pdf.
[212] Independent Power Producer Procurement Programme. https://www.ipp-renewables.co.za/.

amount) and one intra-regional *gas pipeline* project (0.7 percent by the number of projects and 1.9 percent—by investment amount).

Figure 10.3: Average Investment Amount by Sector, 1995-2021



Source: PPI, IJ, PFI and PWare databases, National Treasury of South Africa, the Government Technical Advisory Centre (GTAC).

Government support to existing non-energy PPPs is mostly limited to transport projects. The government support measures issued to the existing PPP projects include:[213]

- Patronage guarantee for the 20-year financing, design, build, and operation and maintenance concession for Gautrain light rail system that reached financial close in 2006. A patronage guarantee is a subsidy provided when a private operator's total revenue is below a contractually agreed amount (in essence, a minimum revenue guarantee).
- Guarantee of the private-sector debt payment for a 30-year BROT concession contract for Chapman's Peak Drive signed in 2003.

Additionally, according to 2016 MTBPS,[214] a guarantee was put in place to support the expansion of the South African National Roads Agency SOC Ltd (SANRAL) toll roads portfolio. The tolling dispensation was implemented for Phase 1 of the Gauteng Freeway Improvement Project, when road users were allowed a 60 percent discount from November 2015 to May 2016 on settlement of the outstanding amounts. Furthermore, according to 2020 MTBPS,[215] SANRAL is in a difficult financial situation and is unable to meet its financing obligations, incurring annual average losses of R 2.5 billion (about US$167 million) since 2014-15. The National Treasury expected it to not generate sufficient cash from its toll roads portfolio to settle operational costs, and debt redemptions were set to fall due in March and September 2021. Consequently, the first phase of the Gauteng Freeway Improvement Project did not receive periodic maintenance, and the second and third phases were delayed. The result is increased congestion and deterioration in the quality of Gauteng's highway network. According to the National Treasury, other national toll roads are also

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[213] Government of the Republic of South Africa, National Treasury. 2021. Budget 2021. Budget Review, Annexure E. February 24, 2021: 168-170. http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf.

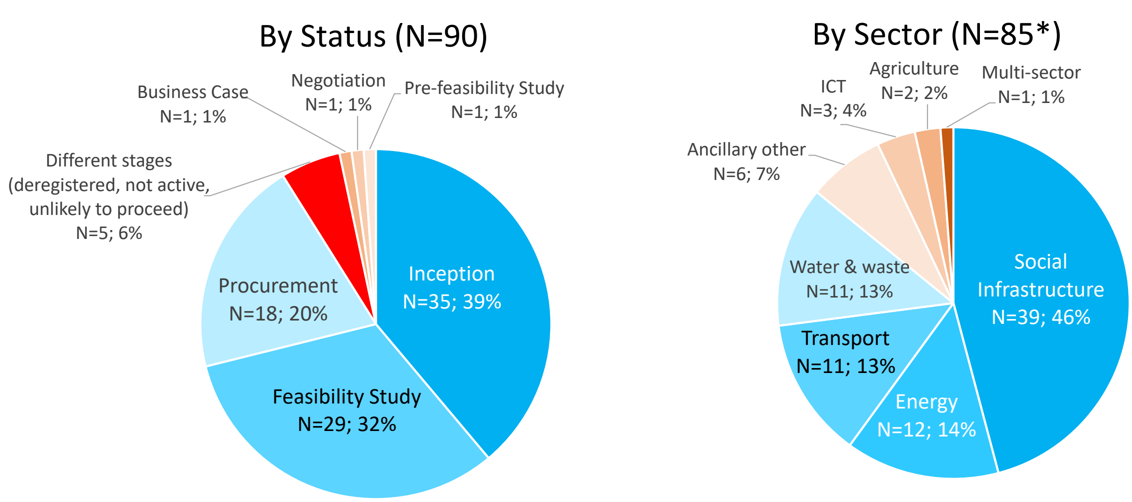
[214] Government of the Republic of South Africa, National Treasury. 2016. Medium-Term Budget Policy Statement, 2016, Annexure Fiscal Risk Statement. October 26, 2016: 55. http://www.treasury.gov.za/documents/mtbps/2016/mtbps/MTBPS%202016%20Full%20Document.pdf.

[215] Government of the Republic of South Africa, National Treasury. 2020. Medium-Term Budget Policy Statement, 2020, Annexure A, Fiscal Risk Statement. October 28, 2020: 53-56. http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf.

experiencing financial difficulties, because toll tariff increases granted by the Minister of Transport were below what was agreed to in the toll concession contracts. This shortfall was expected to cost the fiscus an additional R 300 million (about US$20 million) in 2020-21. As of March 31, 2020, SANRAL used R 39 billion (about US$2.6 billion) of its total government guarantee of R 37.9 billion (about US$2.5 billion). Overall, direct fiscal exposure in the existing non-energy PPP projects (monitored separately) is assessed by the National Treasury as limited, however. The impact of the COVID-19 pandemic on the performance of these projects and the related government obligations are discussed in more detail in section V of the report.

In addition to projects that have reached financial close, South Africa has a hefty PPP pipeline and projects at different pre-financial close stages of development. The Transaction Advisory Service Unit within the Government Technical Advisory Centre (GTAC), responsible for providing specialized transaction advisory services related to PPP projects among other duties, publishes the list of PPP projects in the pipeline. The list includes all potential transactions that fall under the respective Treasury Regulation for PPPs at different levels of government, including national and provincial departments, public entities, and municipalities. The list as of April 2021 includes 90 projects, with the majority of them being at the inception stage (35 projects or 39 percent), followed by projects at the feasibility study (29 projects or 32 percent) and procurement stages (18 projects or 20 percent). Additionally, five projects (6 percent) were recorded as deregistered, inactive or unlikely to proceed. Finally, one project each exists at the business case, negotiation, and pre-feasibility study stages. Sector-wise, social and tourism infrastructure dominates the pipeline with 39 projects (46 percent). These are mostly headquarters (HQ) office accommodations, tourism and health facilities. Energy (12 projects), transport (11) and water and waste (11) sectors are the other segments where preparatory work is underway for delivering potential PPP transactions. The REIPPPP projects are excluded from this list because they are subject to a different regulatory regime and are generally exempt from many checkpoint requirements that exist for non-energy PPPs. Figure 10.4 below provides a snapshot of the South African PPP pipeline in terms of project status and sector as of April 2021.

Figure 10.4: PPP Pipeline Breakdown by Status and Sector, as of April 2021



Source: Government Technical Advisory Centre.
* Projects that are deregistered, inactive or are unlikely to proceed are excluded from this graph.

Overall, the PPP program is South Africa is relatively successful, but several issues have arisen over the years, forcing the NT to review and revise the PPP regulatory framework. During the period since 1990, there have not been as many cancellations or projects in distress as seen in some other economies. However, a certain track record of termination, renegotiations, and disputes is present. Thus, a 10-year management contract for the operation of water and waste services for the municipality on the Eastern Cape awarded in 1995 was cancelled due to the municipality starting to default on its payments and claiming that the contract was invalid owing to a lack of public notice and the court agreeing with this decision. A few renegotiations occurred as well. For example, a 30-year rehabilitate-operate-transfer (ROT) concession contract awarded in 1999 by local the government for management of the supply of water and wastewater services in the Dolphin Coast experienced some problems because at some point the private operator claimed it was unable to pay the annual concession fee due to the expected market size falling short of expectations and the cost of water charged by the bulk water supplier increasing by 20 percent. When the contract was renegotiated, the concession payments were halved until 2006, investment commitments were lowered, and a tariff increase of 37 percent was accepted. Another example is a 30-year BROT concession contract for Chapman's Peak Drive signed between the Western Cape Government and the Black Economic Empowerment (BEE) consortium Capstone in 2003, which also went through some hurdles because from 2003 to 2009 the toll road was only open intermittently and, in 2009, after many road closures, the government announced it was proposing either a renegotiation or a cancellation of the contract (the contract eventually stood). Additionally, as mentioned earlier, the fifth round of the REIPPPP was delayed by almost three years in part due to the renegotiation of PPA contracts awarded in the fourth round. Finally, the most recent example is a long litigation over the 2016 Tshwane broadband network development BOT contract, when the newly elected city government from the opposition party decided to cancel a contract concluded by the previous administration and the original court judgement supported it; the Supreme Court of Appeals of South Africa, however, reversed that decision in 2020, but the project was effectively put on hold and some destruction to infrastructure has occurred already. Disclosure on the PPPs contained in the 2021 Budget Review published annually by the National Treasury[216] mentions that although PPPs were quite successful in South Africa, a number of challenges have arisen over the years, reflected in the reduction in the number of new PPP transactions (excluding IPPs monitored separately) between FY2011-12 and FY2019-20, in part due to perceived high costs associated with these projects. As a result, in September 2019, with support from the World Bank, the National Treasury initiated a review of the PPP regulatory framework to address these challenges and recommend changes to the PPP framework to improve its effectiveness and encourage private-sector participation (for more details on the regulatory framework in South Africa, refer to section II of this report).

9.2. Legal Framework and PPP Approval Process

9.2.1. PPP Governance, Institutional and Legal Framework

A decision to adopt a specialized PPP framework was made in 1997. The very first PPP projects in the country during the early 1990s were developed on an ad hoc basis without a specific policy, or legal or regulatory framework for PPPs and were largely regulated by contract. In April 1997, the South African Cabinet approved the appointment of an inter-departmental task force team to advance both legislation and policy to facilitate the adoption of a PPP framework.[217] Following this decision, from 1997 to 2000, the government piloted six PPP projects, including a 30-year concession contract for the design, construction and operation of the N4 toll toad (Mozambique-South Africa) of 1997 and a 30-year BOT contract for the construction, rehabilitation, and operation of the N3 Toll Road that reached financial close in 1999—both concluded by the South African National Roads Agency SOC Ltd (SANRAL). The other contracts included a 25-year contract

[216] Government of the Republic of South Africa, National Treasury. 2021. Budget 2021, Budget Review, Annexure E, February 24, 2021. http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf.

[217] Burger, Philippe. 2006. "The Dedicated PPP Unit of the South African National Treasury." Department of Economics, University of the Free State, 2006: 6. https://www.oecd.org/mena/governance/37147218.pdf.

to build and operate a maximum-security prison in Bloemfontein and a 25-year design, construction, financing and operation concession for a maximum-security prison at Louis Trichardt—both concluded by the Department of Public Works and Correctional Services in 2000. There were also two water service concessions at the municipal level and a tourism concession concluded by the South African National Parks (SANP). After gathering some initial feedback and lessons learned from these projects, specific steps to adopt a strategic framework for PPPs started to be made in 1999.

The Public Finance Management (PFM) Act of 1999, Municipal Systems Act of 2000 and Municipal Finance Management Act of 2003 laid the foundation for national, provincial and municipal PFM systems and opening the door for PPPs. The first of these steps was the adoption of the Public Finance Management Act[218] (hereafter, PFM Act) in March 1999 (in force since 1 April 2000; last amended in 2018). The PFM Act is a fundamental piece of the legislation in the area of public financial management establishing the National Treasury and defining the roles, relationships and responsibilities of the different government actors and public entities involved in the PFM process in the country. Although the PFM Act does not cite PPPs specifically, it does contain a group of provisions that are directly applicable to PPPs and government support measures that might be issued in support of PPP projects. Thus, section 66 of the PFM Act specifies the approval body for any guarantee, indemnity or security that might be issued by different levels of government or public entities subject to the PFM Act.[219] For example, any guarantee that binds the National Revenue Fund (essentially, a budget) must be obtained through the responsible Cabinet member acting with the concurrence of the Minister of Finance; at the provincial level this person is the member of an Executive Council of a province responsible for finance in that province. For public entities, the accounting authority of that entity is the approving body. According to the 2010 joint World Bank-Public-Private Infrastructure Advisory Facility study of FCCL practices[220] in select economies, including in South Africa, as of the reporting date within the National Treasury, a Guarantee Certification Committee advised the minister on whether to concur with the proposed guarantees for national and provincial projects. This provision is considered relevant to any third-party guarantees of obligations in a PPP contract, but not to financial commitments that might be considered guarantees.[221] Finally, certain types of public entities not explicitly listed in the PFM Act are prohibited from issuing a guarantee, indemnity or security that may bind them to any type of future financial commitment. The PFM Act, however, does not apply to municipalities. In turn, the Municipal Systems Act[222] of 2000 (in force since March 2001) and the Municipal Finance Management Act[223] (hereafter, MFM Act) of 2003 (in force since July 2004) define the fundamentals of the municipal-level PFM system. The MFM Act does have a separate section devoted to PPPs describing related conditions and processes. Among other features, these conditions include a requirement for the proposed PPP project to provide value for money (VfM), be affordable and transfer the appropriate technical, operational and financial risks to the private party. Additionally, the MFM Act requires a feasibility study for each project, publication of a feasibility study report and solicitation of feedback from the local community and other interested persons on the proposed project; the National Treasury's views and recommendations

[218] Government of the Republic of South Africa, National Treasury. 1999. Public Finance Management Act № 1 of 1999. http://www.treasury.gov.za/legislation/PFMA/Public%20Finance%20Management%2041534.pdf.
[219] Ibid. Section 66.
[220] Irwin, Timothy, and Tanya Mokdad. 2010. "Managing Contingent Liabilities in Public-Private Partnerships. Practice in Australia, Chile, and South Africa." World Bank, PPIAF (Public-Private Infrastructure Advisory Facility, 2010. https://ppiaf.org/documents/1919/download.
[221] The PPP standardization document refers to this part of the PFM Act when it discusses indemnities, but not when it discusses termination payments.
[222] Local Government: Municipal Systems Act № 32 of 2000. https://www.ffc.co.za/docs/acts/Local%20Government%20Municipal%20Systems%20Act%20No%2032%20of%202000%20as%20amended.pdf
[223] Government of the Republic of South Africa, Financial and Fiscal Commission. 2020. Local Government: Municipal Finance Management Act. http://mfma.treasury.gov.za/MFMA/Legislation/Local%20Government%20-%20Municipal%20Finance%20Management%20Act/Municipal%20Finance%20Management%20Act%20(No.%2056%20of%202003).pdf.

should be sought as well. In terms of issuing guarantees, section 50 of the MFM Act requires the approval of the National Treasury before a municipal guarantee can be issued and obliges a municipality to either:

- Create and maintain for the duration of a guarantee, a cash-backed reserve equal to the guarantee's total potential financial exposure; or
- Purchase and maintain for the duration of a guarantee, an insurance policy issued by a registered insurer, which would cover the full amount of the municipality's potential financial exposure as a result of this guarantee.

Both the national and provincial governments are prohibited from guaranteeing the debt of a municipality or a municipal entity, apart from certain exceptions contained in the PFM Act.

More PPP-specific institutional and regulatory changes at the national level started to be made in 2003. In 2003, the PPP Unit within the National Treasury was established. Unlike in some other economies and, because South Africa never adopted a stand-alone PPP act or law, there is no formal regulatory promulgation for the PPP Unit or a clear definition of its functions. The mandate of the unit within the National Treasury with respect to PPPs is derived from the division and allocation of responsibilities within the National Treasury. In turn, the National Treasury's establishment as well as its functions and powers are set out in sections five and six of the PFM Act. The set-up of the PPP Unit was supported with technical assistance from the United States Agency for International Development (USAID), the Deutsche Gesellschaft für Internationale Zusammernarbeit (GIZ, German Aid) and the Department for International Development (DFID, UK).[224] Until 2014, the PPP Unit generally had dual functions, including regulation of PPPs and provision of transaction advisory services. The combination of these two functions in one unit made sense in the early stages of the PPP program because it allowed for a quicker accumulation of project development and appraisal skills as well as for building the necessary skills in the PPP area. However, at a certain point, especially when more projects started to reach the procurement stage, the issues of transparency, competitiveness, impartiality and absence of conflicts of interest started to become more acute and the decision was made to split those two functions between two different organizational units. Besides, the advisory arm was allowed to fully capitalize on its mandate and engage closely with procuring authorities that had weak project development capacity and needed solid technical assistance. Thus, in March 2012, the Government Technical Advisory Committee (GTAC), an agency within the National Treasury to assist government institutions with procurement of infrastructure, among other duties, was promulgated[225] and became operational on April 1, 2014. With that, in 2014, the PPP unit was split and a new unit that is now part of the Budget Office within the National Treasury became responsible for the regulation of PPPs, whereas the PPP unit within the GTAC became responsible for providing advisory services only. Therefore, the head of the PPP Unit at GTAC acts as an advisor and the head of the Budget Office within the National Treasury is a regulator of PPPs.[226] Following its establishment, the PPP Unit published several detailed guidelines, the first one being the "National Treasury Standardized PPP Provisions"[227] issued on March 11,

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[224] Arimoro, Augustine Edobor. 2018. "Legal Framework for Public-Private Partnership: South Africa and Nigeria in Focus." *University of Maiduguri Law Journal*, October 2018: 7. https://www.researchgate.net/publication/328018725_LEGAL_FRAMEWORK_FOR_PUBLIC-PRIVATE_PARTNERSHIP_SOUTH_AFRICA_AND_NIGERIA_IN_FOCUS.

[225] President of the Republic of South Africa. 1994. Amendment of Part A of Schedule 3 to the Public Service Act, 1994: Government Technical Advisory Centre, Proclamation by the President of the Republic of South Africa. Government Gazette № 35194, March 30, 2012. https://archive.opengazettes.org.za/archive/ZA/2012/government-gazette-ZA-vol-561-no-35194-dated-2012-03-30.pdf.

[226] World Bank. 2020. Benchmarking Infrastructure Development 2020, South Africa Economy Data, Regulatory and Institutional Framework Thematic Area. https://bpp.worldbank.org/economy/ZAF.

[227] Government of the Republic of South Africa, National Treasury. 2004. National Treasury Standardised PPP Provisions ("Standardisation"). National Treasury PPP Practice Note № 1 of 2004, March 11, 2004. https://www.gtac.gov.za/Publications/1280-Standardised%20Public-Private%20Partnership%20Provisions.pdf.

2004, and the second, the "PPP Manual,"[228] likewise issued in 2004. Both the Standardized PPP Provisions and the PPP Manual were issued pursuant to the PFM Act and, quite paradoxically, Treasury Regulation 16, which itself was only published afterwards—in March 2005. The Standardized PPP Provisions document was presented as the National Treasury PPP Practice Note № 1 of 2004. It discusses provisions that should be present in PPP contracts and provides examples of drafts. Specific to contingent liabilities management are provisions governing early contract termination and associated compensation payments because early contract termination is considered by the National Treasury to be the main type of contingent liabilities in PPPs (see section 10.3 of the report). Thereby, the Standardized PPP Provisions play a key role in controlling for contingent liabilities that the public sector may potentially incur in relation to PPP contracts.[229] The PPP Manual aggregated the National Treasury PPP Practice Notes № 2 to 8 of 2004. The topic areas covered by the practice notes consolidated in the PPP Manual are the following:

- PPP Practice Note № 2 of 2004: module 1: South African Regulations for PPPs;
- PPP Practice Note № 3 of 2004: module 2: Code of Good Practice for Black Economic Empowerment (BEE) in PPPs;
- PPP Practice Note № 4 of 2004: module 3: PPP Inception;
- PPP Practice Note № 5 of 2004: module 4: PPP Feasibility Study;
- PPP Practice Note № 6 of 2004: module 5: PPP Procurement;
- PPP Practice Note № 7 of 2004: module 6: Managing the PPP Agreement; and
- PPP Practice Note № 8 of 2004: module 7: Auditing PPPs.

Additionally, module 8: Accounting Treatment for PPPs, and module 9: An Introduction to Project Finance, were promised to be published later. Finally, in March 2005, the Treasury Regulations, including Regulation 16 dedicated to PPPs, was published. Treasury Regulation 16 is a relatively short (five pages) instruction for various stages of the PPP project cycle and related required approvals. None of these documents, however, provide detailed guidance for the assessment of fiscal risks or FCCL management, just the general requirement to perform such assessment and include assessment of contingent liabilities in the feasibility study.

Municipal PPPs became covered by the Municipal PPP Regulations and an analogue of the PPP Manual. Subsequently, at the municipal level, two important PPP guiding documents were adopted. The first one is the Municipal Public-Private Partnership Regulations,[230] which came into force on April 1, 2005, and the Municipal Service Delivery and PPP Guidelines[231] of 2007 (hereafter, Municipal PPP Guidelines). Similar to Treasury Regulation 16 for PPPs at the national and provincial levels, the Municipal PPP Regulations provide step-by-step guidance at different stages of the PPP project cycle for accounting officers at municipalities interested in conducting a PPP project. These also include requirements to prepare a feasibility study and PPP agreements as well as the necessary consultations, reviews and approvals. No specific instructions regarding assessment of fiscal risks or FCCL management are contained in the document. The Municipal PPP Guidelines document is an analogue of the PPP Manual for municipal level PPPs that expands on the provisions contained in the Municipal Systems Act, MFM Act, Municipal PPP Regulations and other pertinent

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[228] Government of the Republic of South Africa, National Treasury. *Public Private Partnership Manual*. National Treasury PPP Practice Notes issued in terms of the Public Finance Management Act. 2004. https://www.gtac.gov.za/wp-content/uploads/2022/03/GTACs-Public-Private-Partnership-Manual-Module-2-Code-of-Good-Practice-for-BEE-In-PPPs.pdf.

[229] Irwin, Timothy, and Tanya Mokdad. 2010. "Managing Contingent Liabilities in Public-Private Partnerships. Practice in Australia, Chile, and South Africa." World Bank, PPIAF (Public-Private Infrastructure Advisory Facility, 2010: 29. https://ppiaf.org/documents/1919/download.

[230] "*Local Government: Municipal Finance Management Act 2003 Municipal Public Private Partnership Regulations*", 2005. *Source*: http://www.saflii.org/za/legis/consol_reg/mppr493.pdf

[231] PPP Unit, National Treasury. 2007. Municipal Service Delivery and PPP Guidelines. 2007. https://www.gtac.gov.za/Publications/1090-Municipal%20Service%20Delivery%20and%20PPP%20Guidelines%20new.pdf.

legislation and provides detailed guidance on a number of issues. The guidelines are organized in six modules and additionally contain three toolkits. Thematic areas covered in these modules and toolkits are summarized below:

- Module 1: Regulations
- Module 2: Code of Good Practice for BEE in Public-Private Partnership
- Module 3: Project Inception
- Module 4: Feasibility Study
- Module 5: PPP Procurement
- Module 6: Managing the PPP Contract
- Toolkit: Water and Sanitation Feasibility Study
- Toolkit: Feasibility Study Toolkit: Solid Waste Management
- Toolkit: Municipal PPPs for Private Sector Commercial Use of Municipal Property.

In terms of fiscal risks, the Municipal PPP Guidelines contain in Module 4: Feasibility Study the requirement to undertake a feasibility study, including a detailed description of the municipal and general government fiscal obligations related to the project, such as firm and contingent fiscal obligations. Additionally, the sub-section on firm fiscal obligations discusses the benefits and limitations of using municipal infrastructure grants, establishes that a municipality's contribution must not cover all capital costs and should only use funds for the provision of ring-fenced project assets that will either immediately or on termination of a PPP contract become the property of the state. Should a capital contribution be used, the guidelines define what additional information needs to be included in a feasibility study. No further specific instructions on FCCL management are provided; however, identification and assessment of project risks as well as construction of a project risk matrix as part of the risk-adjusted public sector comparator (PSC) analysis are discussed.

Important accounting guidance for PPPs was issued in 2008 and replaced in 2013. In November 2008, the Accounting Standards Board (ASB)[232] of South Africa issued the Guideline on Accounting for Public-Private Partnerships,[233] which addressed accounting and reporting of assets, liabilities, revenues and expenditures by the grantor in a PPP arrangement. This guideline was developed based on the International Financial Reporting Interpretations Committee (IFRIC) interpretation 12 Service Concession Arrangements[234] initially published by International Accounting Standards Board (IASB) in November 2006. In 2011, the International Public Sector Accounting Standards (IPSAS) Board published IPSAS 32 Service Concession Arrangements: Grantor.[235] Following this, in 2013, the ASB issued the Standard of Generally Recognized Accounting Practice (GRAP) 32 Service Concession Agreements: Grantor,[236] which replaced the accounting Guidance of 2008 and was based on IPSAS 32. GRAP 32 is an accrual basis standard, which became effective for reporting periods beginning on or after April 1, 2019;[237] the national and provincial governments, however, still report on a modified cash basis with relevant disclosure for PPPs required (for more details on the accounting framework, refer to section 10.4.1 of the report). GRAP 32 provides guidance for accounting of both service

[232] Accounting Standards Board. https://www.asb.co.za/.

[233] Accounting Standards Board. 2008. Guideline on Accounting for Public-Private Partnerships. Accounting Standards Board, November 2008. https://www.gtac.gov.za/Publications/1140-PPP%20-%20Guideline%20on%20Accounting%20for%20PPPs.pdf

[234] IFRS (International Financial Reporting Standards) Foundation. IFRIC 12 Service Concession Arrangements. https://www.ifrs.org/issued-standards/list-of-standards/ifric-12-service-concession-arrangements/#about.

[235] International Federation of Accountants. International Public Sector Accounting Standard (IPSAS) 32, "Service Concession Arrangements: Grantor." International Federation of Accountants. https://www.ifac.org/system/files/publications/files/B8%20IPSAS_32.pdf.

[236] Accounting Standards Board. 2019. GRAP 32, "Service Concession Arrangements: Grantor" (Including IGRAP 17: Service Concession Arrangements Where a Grantor Controls a Significant Residual Interest in an Asset, Presentation for pronouncement. Accounting Standards Board, August 2019. https://www.asb.co.za/wp-content/uploads/2019/08/Recording-GRAP-32-and-IGRAP-17.pdf.

[237] Accounting Standards Board of South Africa. https://www.asb.co.za/grap-32/.

concession assets and related liabilities as well as for presentation and disclosure of related information. Because GRAP 32 effectively relays the main principles outlined in IPSAS 32, a control approach is used for a decision about whether to recognize an asset; if recognized, the asset is measured at fair value and must be identified separately in annual financial statements. If the asset is recognized, the related liability should also be recognized using either financial liability, grant of right to operator, or a combined model depending on the type of payment arrangement and source of revenue for the private operator (e.g., availability payments or user fees, etc.). The main principle for presentation and disclosure is making sure that users of the information are able to evaluate the significance of service concession agreements on the financial position, performance and cash flows of a contracting entity.[238]

The IPP program has received attention since 2010. Starting in 2010, important regulatory and institutional steps for the future REIPPPP were made. As mentioned in section I, in November 2010, DMRE and NT entered into a memorandum of agreement (MoA) with DBSA to provide the necessary support to implement REIPPPP and establish the IPP Office. The Electricity Regulations on New Generation Capacity,[239] which established the rules and guidelines for an IPP bid program, were gazetted in May 2011[240] (further amended in 2015[241] and 2020[242]). The regulations are a relatively concise document of 10 pages defining the scope of their application and objectives, stating that any new generation capacity from RE sources needs to be done in accordance with an integrated resource plan, mandating preparation of a feasibility study, defining the identity of the entity to carry out the IPP procurement process and establishing requirements for PPAs, among other measures. It should be noted that IPP projects do not follow the provisions of the PPP Manual and other documents guiding the process for non-energy PPPs. These exemptions were made to speed up acquisition of the urgently needed additional generation capacity from the private sector. Thus, IPP projects followed their own technical process and were not subject to affordability, VfM and other assessments typically required for non-energy PPPs. Representatives from the National Treasury expressed an opinion that the overall perception about the regulatory framework for REIPPPP is that it is not as rigorous as the one for other PPP projects and there was not direct scrutiny of the REIPPPP from a fiscal risk perspective whereby the National Treasury would look at the issue in detail.

The Infrastructure Fund of 2020 sought to elevate the PPP program through an increased number of PPPs realized. Finally, the most recent institutional change that, although indirectly, aims at increasing the number of PPP projects in the coming years as envisaged by the National Treasury is the newly established Infrastructure Fund (IF). In August 2020, the National Treasury, the Department of Public Works and Infrastructure: Infrastructure South Africa (ISA) and the Development Bank of Southern Africa (DBSA) signed a tripartite memorandum of agreement to establish an infrastructure fund and capture its mandate. The Infrastructure Fund is currently housed in the DBSA with the aim of transforming public infrastructure through bespoke blended financing solutions by sourcing and blending capital from the private sector, institutional investors, development finance institutions and multilateral development banks (MDBs). The

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[238] Ibid. Slide 13.

[239] Government of South Africa, Department of Energy. Electricity Regulation Act. Electricity Regulations on New Generation Capacity. Government of South Africa, Department of Energy. https://www.gov.za/sites/default/files/gcis_document/201409/32378721rg9116.pdf.

[240] Government Gazette. 2011. Electricity Regulation Act № 4 of 2006 Electricity Regulations on New Generation Capacity. Government Gazette № 34262, May 4, 2011. http://www.energy.gov.za/files/policies/Electricity%20Regulations%20on%20New%20Generation%20Capacity%201-34262%204-5.pdf.

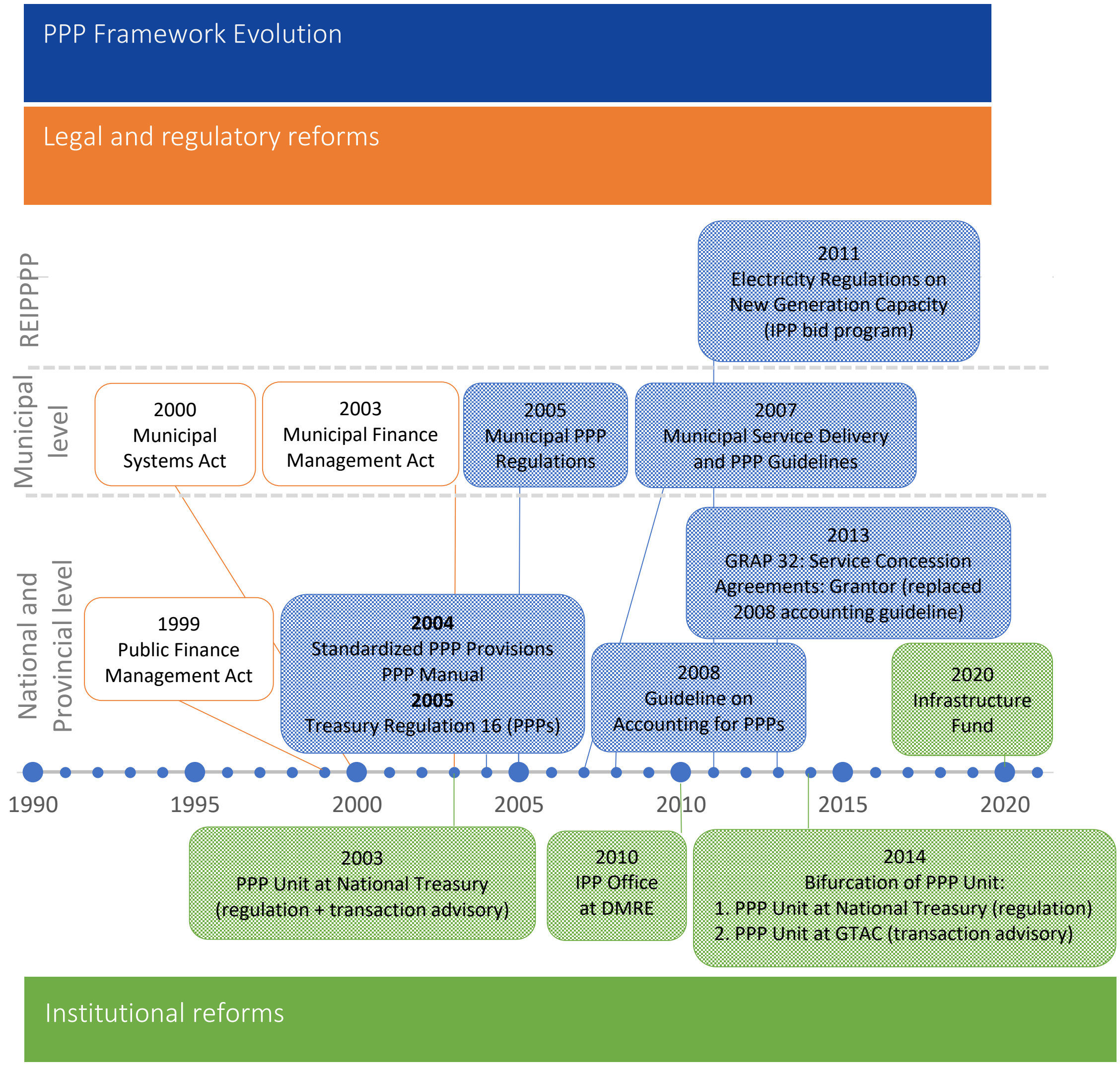
[241] Government Gazette. 2015. Electricity Regulation Act, 2006 Amendment of the Electricity Regulations on New Generation Capacity, 2011. Government Gazette № 38801, May 19, 2015. http://www.energy.gov.za/files/policies/Amendment-of-Electricity-Regulations-on-New-Generation-Capacity.pdf.

[242] Government Gazette. 2020. Electricity Regulation Act, 2006: Amendment of Electricity Regulations on New Generation Capacity, 2011. Government Gazette № 43810, October 16, 2020. http://www.energy.gov.za/files/policies/Gazette43810-Amendment-of-Electricity-Regulations-on-New-Generation-Capacity.pdf.

IF was seed funded by the National Treasury in the amount of R 100 billion (an equivalent of about US$6.8 billion) over a 10-year period. The contribution is intended to be key to the structuring of blended finance solutions. This seed funding is targeted at catalyzing R 1 trillion (about US$67.8 billion) in infrastructure delivery within the country. In the 2021 budget, the National Treasury allocated a total of R 18 billion (about US$1.2 billion) over the next three-year cycle: FY2021-22: R 4 billion (about US$271 million); FY2022-23: R 6 billion (about US$407 million); and FY2023-24: R 8 billion (about US$542 million). Blended finance solutions within the IF are intended to address market failures to improve the risk profile and infrastructure project bankability. The IF will structure these solutions across the following value chain: project identification, design and conceptualization, preparation, structuring, budgeting, financing, procurement and implementation. This is to be done by managing the appropriate financing structure and sources of revenue. Some of the instruments that are to be offered as part of the IF include grants, interest rate guarantees, various incentives for projects, capital contributions, along with softer solutions, such as financial models, user-pay and financial delivery mechanisms. Where appropriate, the IF will also arrange, coordinate, structure and engage with financial institutions and markets to develop financial instruments that will enable investments in projects by investors. The IF is expected to help scale up the PPP program in the country. Figure 10.5 below depicts the evolution of the institutional and regulatory framework related to PPP projects in South Africa to date.

South Africa

Figure 10.5: Evolution of Regulatory and Institutional Framework Applicable to PPP Projects



Revisions to the PPP regulatory framework are sought. Similar to some other economies, the existing PPP regulatory framework in South Africa is not static and is in the process of optimization. Thus, according to the most recent Budget Review 2021,[243] in September 2019, the National Treasury with the support of the World Bank initiated a review of the PPP regulatory framework to address challenges seen in recent years with the PPP program, such as the decline in the number of non-IPP transactions, partially due to the perception of high costs associated with them. The result is a set of recommended changes to the framework to improve its effectiveness and encourage private-sector participation. According to the disclosure on PPPs contained in the Budget Review 2021, both public and private sectors provided important suggestions to this work, which, alongside lessons learned, were incorporated into the draft final recommendations report. The National Treasury (NT) then presented these recommendations to stakeholders and PPP practitioners at validation workshops and through reference groups to ensure that

[243] Government of the Republic of South Africa, National Treasury. 2021. Budget 2021. Budget Review. National Treasury, Republic of South Africa, Annexure E, February 24, 2021. *Source*: http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf.

proposed changes reflect the views of the different stakeholder groups and are incorporated accordingly in the final report. The process now largely remains within the National Treasury itself along the following three dimensions:

- Internal approval of the proposed recommendations within the NT by the Director General. According to representatives from the NT, this process has already been launched and is ongoing.
- Alignment of the proposed recommendations with the Public Procurement Bill, deciding on what should be included and what left outside of the bill to allow for flexibility of the changes that are sought to be made. This process also involves any necessary changes that would be required to be made in the Treasury Regulation 16 devoted to PPPs.
- Any changes that would be required to be made to the PFM Act and the MFM Act.

These three processes are being run in parallel and are already starting to impact existing regulations on PPPs. According to the Budget Review 2021, preliminary recommendations included:

- Integrating PPP policies into infrastructure delivery management systems
- Amending regulations and legislation to exempt smaller projects from onerous requirements, taking specific conditions into consideration
- Centralizing and improving the screening and assessment of projects and proposals
- Establishing a PPP regulator, and country- and sector-specific benchmarks for cost and efficiency
- Standardizing project preparation requirements for certain smaller projects and contract templates across sectors
- Building PPP capacity across government institutions including contract management practices.
- Setting out clear timeframes for different project phases to reduce the PPP project planning cycle
- Building and retaining the skills required in the public sector to improve the planning and management of PPPs
- Implementing measures that facilitate market consultation to obtain feedback on projects and inform the procurement strategy
- Simplifying VfM assessments and introducing economic valuations of all projects above a certain threshold
- Streamlining the procurement evaluation process for PPPs to reduce the time it takes to appoint a preferred bidder
- Installing a system that monitors and evaluates projects to draw lessons for better project planning and implementation.

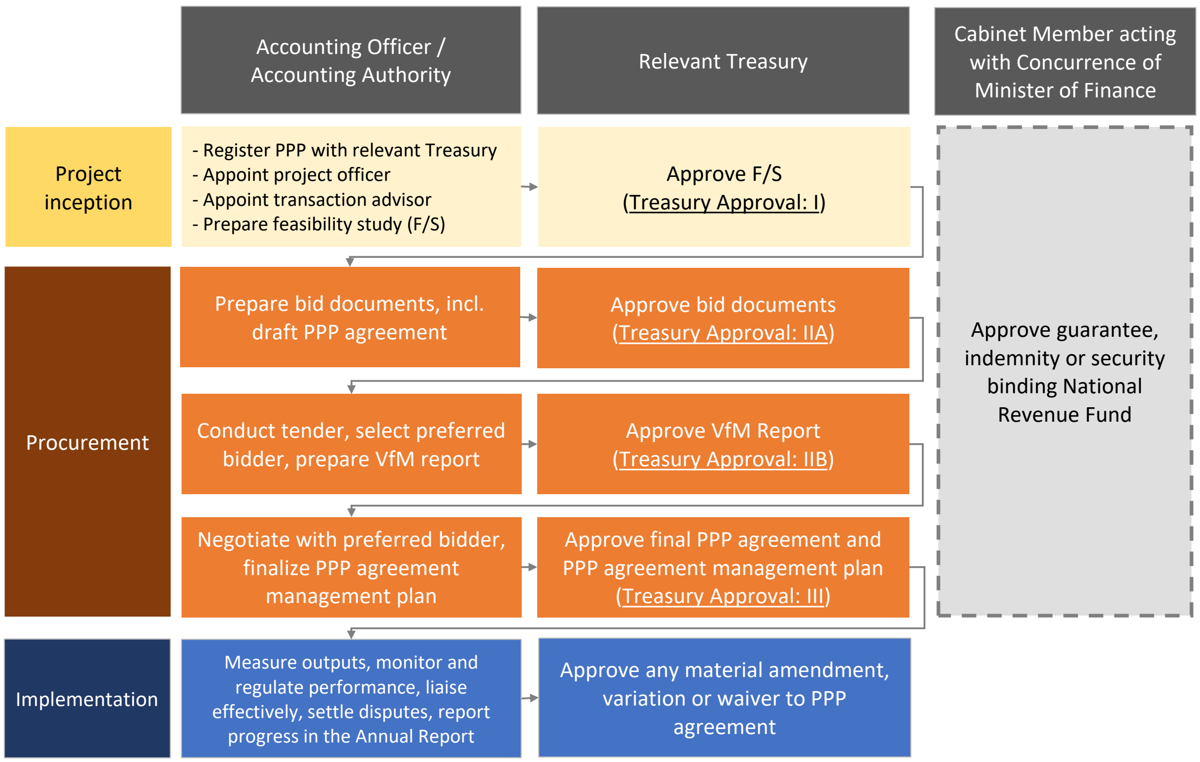
In addition, the review of the municipal PPP framework specifically recommended reducing the number of public consultations, increasing involvement of the Municipal Infrastructure Support Agency and simplifying the unsolicited proposal (USP) framework in line with municipal regulations. NT representatives confirmed that these initial recommendations are broadly kept the same throughout the alignment and confirmation process; however, certain changes might ensue, or details might change as a result of it, including due to the necessity to be compliant with higher legislative acts like the Constitution, among other requirements.

9.2.2. PPP approval process

At the national level, the National Treasury retains the gatekeeping role at important milestones in the PPP approval process. According to Treasury Regulation 16, the relevant treasury (National Treasury at the national level) keeps a tab on the major milestones during the PPP life cycle. Specifically, the relevant treasury must approve the feasibility study and any material changes to the feasibility study that occur after obtaining the original approval. After evaluating the bids but before appointing a preferred bidder, the relevant treasury must approve the evaluation report showing how the criteria of affordability, VfM and transfer of substantial technical, operational and financial risks to the private party were applied during the bid evaluation process. Furthermore, the relevant treasury must approve the final PPP agreement and management plan for this PPP agreement detailing the capacity of a contracting institution, and the proposed mechanisms and procedures for effective implementation, management, enforcement, monitoring and reporting on the concluded PPP contract. The treasury should also be satisfied that proper due diligence was completed for both the accounting officer (authority) and the proposed private party in relation to their respective competencies and capacities to enter into a PPP agreement. Any material changes, variations or waivers to the concluded PPP contract are subject to treasury approval as well. According to the 2010 World Bank-Public-Private Infrastructure Advisory Facility (WB-PPIAF) study,[244] in 2006, influenced in part by the potential size of contingent liabilities associated with the Gautrain project, the National Treasury reviewed the way it managed contingent liabilities in PPPs. One of the outcomes of this review was to reallocate review of the proposed PPPs within the National Treasury. Part of the thinking behind this change was that the PPP unit was not in a position by itself to judge whether large liabilities associated with PPPs were acceptable to the government; that judgment required involvement of the different parts of the National Treasury, such as the asset-and-liability-management group, which could take a broad view of the government's financial position. In particular, the Guarantee Certification Committee mentioned earlier became the reviewer of liabilities associated with (large) PPPs as part of Treasury Approval (TA) III. To reflect that change, the committee was renamed the Fiscal Liability Committee. Representatives from the National Treasury confirmed that any additional fiscal exposure stemming from an individual project before the PPP contract is signed is being scrutinized by the Fiscal Liability Committee in terms of compliance with broader rules and regulations on fiscal exposure. Although the PPP Unit remained the key advisor on PPPs before being bifurcated in 2014, the control function was shared with other parts of the National Treasury. Figure 10.6 below illustrates the PPP approval process at the national level.

[244] Irwin, Timothy, and Tanya Mokdad. 2010. "Managing Contingent Liabilities in Public-Private Partnerships. Practice in Australia, Chile, and South Africa." World Bank, PPIAF (Public-Private Infrastructure Advisory Facility, 2010: 29-30. https://ppiaf.org/documents/1919/download.

Figure 10.6: PPP Approval Process Envisaged under the Treasury Regulation 16,
Public Finance Management Act of 1999 and PPP Manual for National and Provincial PPP Projects

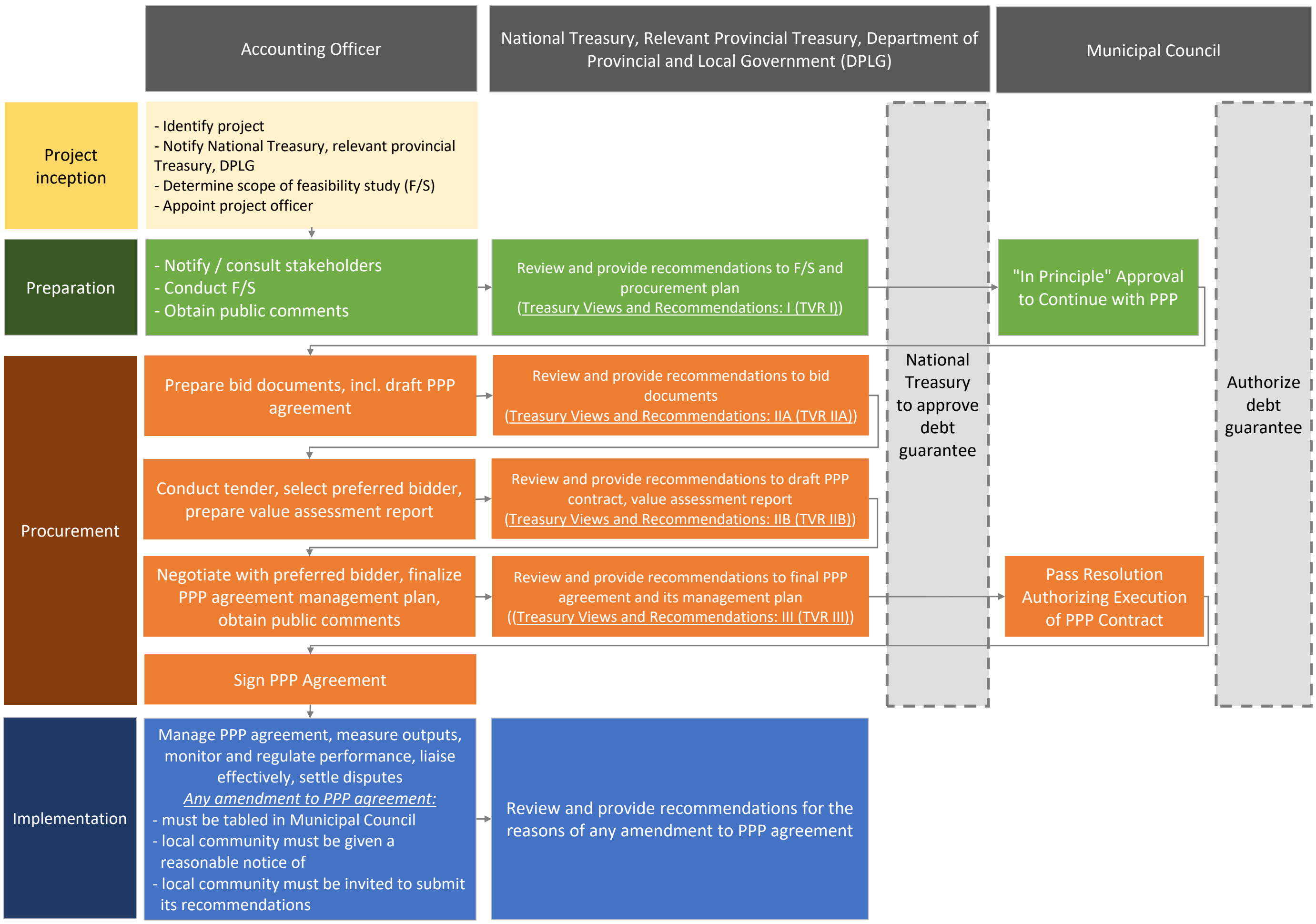


Source: Author's visualization based on provisions of the Treasury Regulation 16 and PPP Manual.

At the municipal level, the approval process is somewhat different, with the relevant treasury having a reviewer role and the municipal council being the final approver. Approval of municipal PPP projects though somewhat similar to that of the national projects has some important differences. Thus, at the local level, the National Treasury and relevant provincial treasuries have a somewhat softer role: accounting officers of a municipality seeking to enter into a PPP contract are required to solicit views and recommendations of these treasuries instead of having to receive their approval. Instead, the final approver role is moved to the municipal council, which must give "in principle" approval to continue with the project at the preparation stage and pass a resolution authorizing execution of a PPP contract before the final agreement with the private party is signed. A schematic illustration of the approval process for municipal PPPs is presented in Figure 10.7 below.

Figure 10.7: PPP Approval Process Envisaged under Municipal PPP Regulations of 2005, Municipal Finance Management Act of 2003 and Municipal Service Delivery and PPP Guidelines of 2007 for Municipal PPP Projects

The South African PPP regulatory model is unusual in many ways and is still in the process of optimization.



Source: Author's visualization based on provisions of the Municipal PPP Regulations of 2005, Municipal Finance Management Act of 2003 and Municipal Service Delivery and PPP Guidelines of 2007.

To summarize, the South African PPP program and regulatory model is relatively young and unusual in that it did not adapt a specialized PPP law or act, but rather incorporated core provisions allowing for a PPP process into broader PFM and budget related legislation, supported by a series of detailed guidelines, including the PPP Manual, the Accounting Guidance, and standard contractual provisions, among other measures. Such an approach is more typical for common law countries; South Africa has a mixed legal system, borrowing certain elements from Roman Dutch civilian law, English common law, customary law, and religious personal law. Unusual also is the approach of running several pilot projects in various sectors to be learned from and to be used to shape up the future PPP regulatory framework—instead of its being purely theoretical. Commendable also is the tactic used with the IPP program; although it is very typical for IPP programs to dominate PPP programs in many economies, it is not uncommon to see them being developed on an ad hoc basis in the absence of any electricity generation development or resource plan or PPP framework. In South Africa, however, the massive IPP program was not launched until after the integrated resource plan was developed and approved and the pertinent regulations for the IPP bid program (although quite basic) were adopted, indicating a higher level of consciousness while moving ahead with such a massive and important, yet potentially very fiscally expensive program if not managed properly. In many developing economies, impromptu ways of building up IPP portfolios result in fiscal problems that are only realized post factum when they reach hard-to-manage scales, including due to overcapacity problems. The existence of a specialized IPP Office also highlights the importance attached to the proper management of the IPP program. At the same time, PPP guidance available in the public domain does not provide a lot of clarity on the FCCL management process itself, including assessment techniques used to measure direct and contingent liabilities, related reserves or ceilings policies, and the roles of the different actors involved, among others, besides quite thorough instructions on risk assessment to be performed during development of feasibility studies as part of the public sector comparator (PSC) analysis. Furthermore, recommendations sought to be introduced into the PPP regulatory framework (see above) indicate that the government is looking to streamline the whole process to make it faster, and more predictable and agile, in an attempt to beat the common downsides of the PPP procurement option such as the increased complexity, prolonged delays and high costs involved. Characteristic is the fact that the same process is occurring in Kenya, where the government is attempting to centralize its PPP capacity and simplify the PPP approval process.

9.3. Analysis of Projects

9.3.1. Identifying and Prioritizing PPP Projects

Strategic procurement decisions, including a choice of a PPP versus traditional public procurement modality, are made before the pre-feasibility stage. The Standard for Infrastructure Procurement and Delivery Management,[245] which came into effect on July 1, 2016, established a supply chain management system for infrastructure procurement and delivery management by organs of the state that are subject to the PFM and MFM Acts and provides a control framework for planning, design and execution of infrastructure projects, among others. According to the Standard for Infrastructure Procurement, the public investment management cycle in the infrastructure space begins with Stage 0 “Project Initiation.” At this stage, projects or groups of projects having a similar high-level scope are identified and appraised and should be those that address particular strategic needs or business opportunities, which fall within the organ of state’s legislated or sanctioned mandate. Objective decision-making criteria, including those related to strategic objectives, national, provincial, or regional priorities, the level of stakeholder support, legislative compliance, risk considerations and financial justification, should be used to justify the inclusion of a project in the infrastructure plan. The end-of-stage deliverable for Stage 0 is an initiation report that outlines the high-level business case together with the estimated project cost and the proposed schedule for a single project or a group of projects having a similar high-level scope. Stage 0 is complete when the initiation report is accepted. The next stage is Stage 1 “Infrastructure Planning.” The main outcome of this stage should be an infrastructure plan, which should identify and prioritize projects and packages against a forecasted budget over a period of at least five years. Such a plan should be:

- Described by the high-level scope of work for each project, the proposed time schedule, the estimated total project cost and annual budget requirement, the geographical location, any known encumbrances and estimated timeframes for removing these encumbrances
- Aligned with all prescribed planning, budgeting, monitoring and reporting requirements.

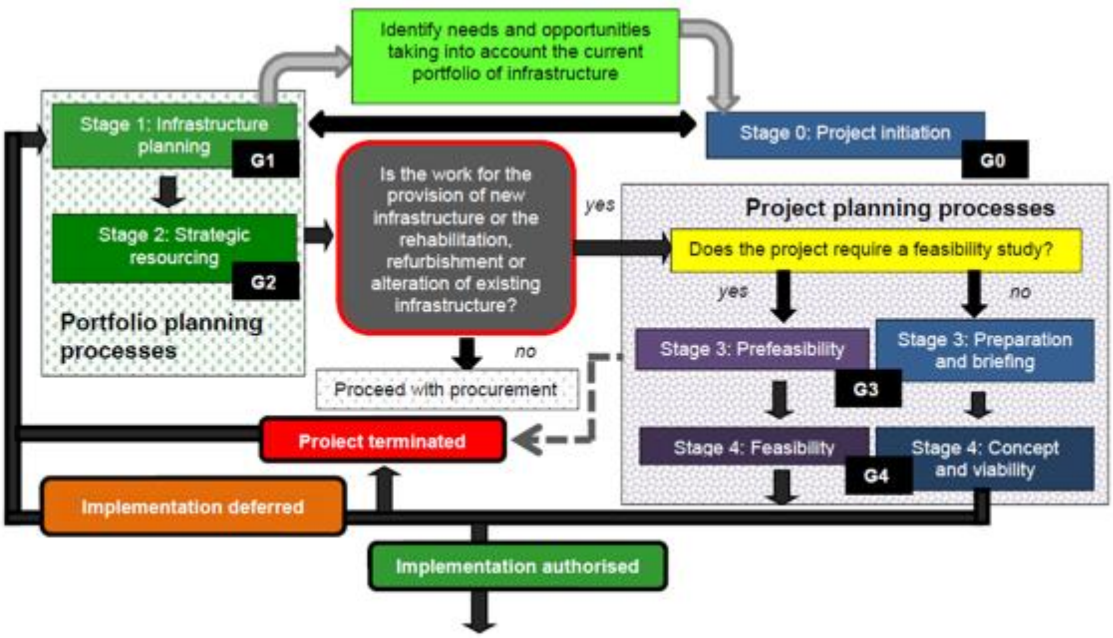
Stage 2 is called “Strategic Resourcing.” At this stage, a delivery management strategy should be developed by conducting a spending, organizational and market analysis. Such a strategy should indicate how needs are to be met for each category of spending through one or more of the following delivery options:

[245] Government of the Republic of South Africa, National Treasury. 2015. Standard for Infrastructure Procurement and Delivery Management. National Treasury, October 2015. http://www.treasury.gov.za/legislation/pfma/TreasuryInstruction/Annexure%20A%20-%20Standard%20for%20Infrastructure%20Procurement%20and%20Delivery%20Management.pdf.

- A public-private partnership
- Another organ of state on an agency basis
- Another organ of state's framework agreement
- Own resources
- Own procurement system.

If the needs are to be met through a PPP, the National Treasury regulations on PPPs should be followed. Only after Stages 0 to 2 are complete do the pre-feasibility and feasibility stages follow. A partial excerpt of the figure illustrating this process from the Standard for Infrastructure Procurement and Delivery Management is shown in Figure 10.8 below.

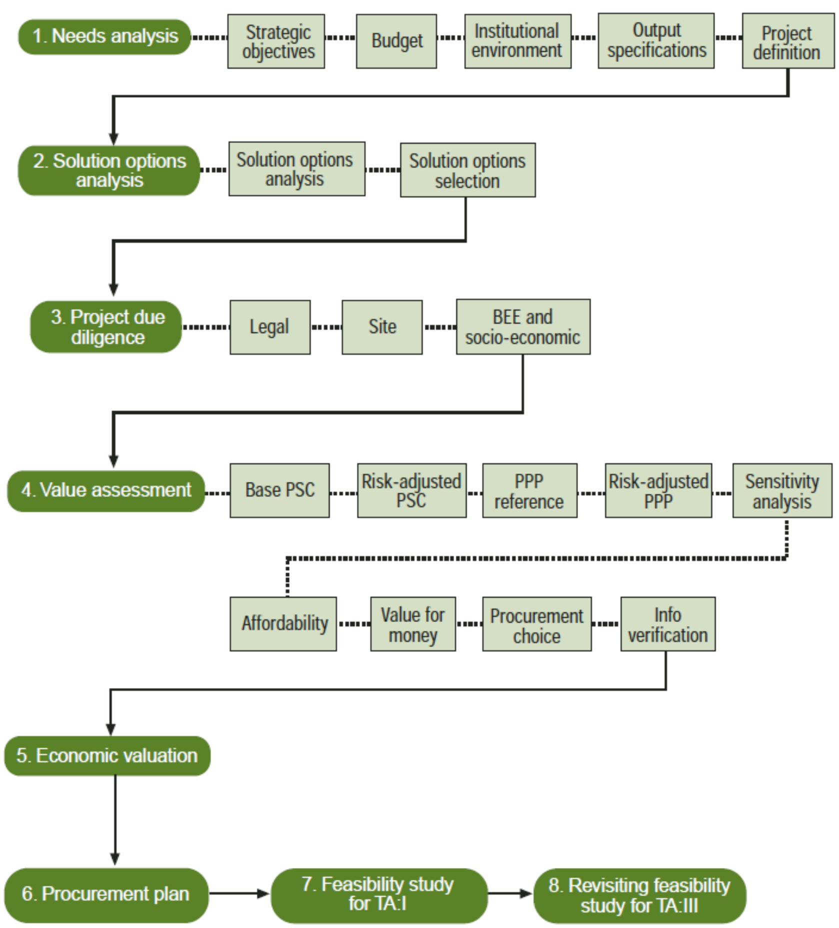
Figure 10.8: Stages and Gates Associated with the Control Framework for Infrastructure Delivery Management



Source: Excerpt from Figure 1 of the Standard for Infrastructure Procurement and Delivery Management.
Note: Procurement may take place whenever external resources are required to advance the project or package. G1 to G9 are gates.

The Standard for Infrastructure Procurement and Delivery Management does not provide specific criteria for PPP screening, just the requirement to identify a delivery mode; the feasibility study as per the PPP Manual is a detailed guidance for this purpose. Nothing in the standard indicates how a decision about a potential project's suitability for a PPP should be made and which decision criteria should be used to decide on the delivering modality. Even though the National Treasury PPP Regulations provide more detailed guidance on the assessment of potential PPP projects before they are approved for implementation, guiding principles for the initial choice of a project out of a larger pool of projects to be potentially fit for a PPP are unclear. Representatives from the National Treasury confirmed that there is currently no formalized pre-screening process for all public investment projects regarding their potential PPP suitability. Despite the PPP Manual providing detailed guidance for final confirmation of a project's viability as a PPP, the process according to the manual begins with project registration as a PPP with the National Treasury. Therefore, somebody has to decide that the project can potentially be suitable for the PPP modality before registration occurs—although there are no formal criteria on how to arrive at this decision. Furthermore, NT representatives indicated that this weakness in the PIM-PPP synchronization process was pointed out as part of the regulatory review of 2019-2021 (see section 10.2 for more details) and is expected to be addressed through regulatory changes expected to be introduced as a result of this regulatory review. According to the PPP Manual, the feasibility study is the tool that is used to assess whether conventional public procurement or a PPP is in the best interest of an institution for the delivery of public services.[246] It is further clarified that an institution cannot have definitively chosen a PPP before it has prepared a feasibility study and a PPP is still just a possible procurement choice, which must be explored in detail and compared with the possibility of delivering the service through conventional public sector procurement. The PPP Manual stresses that a feasibility study needs to be authentic and thorough because it is the basis for the government's making an important investment decision, not just a bureaucratic requirement. Essentially, through the feasibility study, institutions should compare the two procurement choices (traditional public procurement versus a PPP) for a particular option. Figure 10.9 below illustrates the stages of the PPP feasibility study as per the PPP Manual (for national and provincial level projects).

Figure 10.9: Stages of the PPP Feasibility Study



Source: Excerpt from the PPP Manual, Module 4: Feasibility Study.

[246] Government of the Republic of South Africa, National Treasury. Public Private Partnership Manual. National Treasury PPP Practice Notes issued in terms of the Public Finance Management Act, the National Treasury, Module 4: 210. https://www.gtac.gov.za/Publications/1160-PPP%20Manual.pdf.

Early considerations for PPP suitability include scale, outputs specification, opportunities for risk transfer and market capacity and appetite. For each stage and type of assessment indicated in Figure 10.9 above, the PPP Manual provides detailed guidance and expected deliverables. In particular, early considerations of suitability for a PPP should be weighed for each option during Step 2: "Evaluate Each Solution Option" of Stage 2: "The Solution Options Analysis." These early considerations that might indicate a potential for VfM if delivered as a PPP include the following:

- *Scale.* Net present cost of the probable cash flows should be large enough to allow both the public and private parties to achieve VfM outputs given the likely levels of transaction advisory and other costs.
- *Outputs specification*. It must be possible to specify outputs in clear and measurable terms, around which a payment mechanism can be structured.
- *Opportunities for risk transfer*. The allocation of risk to a private party is a primary driver of VfM in a PPP. Where opportunities for allocating risk to the private party are limited, the potential for a PPP to deliver VfM compared to a conventional procurement choice is reduced.
- *Market capability and appetite*. The project must be commercially viable, and there must be a level of market interest in it.

At the end of the solution options analysis stage, each option should be evaluated, including an initial assessment of its potential to be delivered as a PPP. The manual recommends a matrix approach to weigh up evaluation of each option against the others to assist in the choice of the best one. The end result of this analysis should be a recommendation for the option(s) that should be pursued to the next stage. If the preferred option looks likely to be able to be procured through a PPP, it will be fully tested in Stage 4: "Value Assessment," and it is acknowledged that the preferred option may change after this test. If, after Stage 4, the preferred option is not demonstrably affordable, it may be necessary to revisit the solution options analysis. If the preferred option cannot be procured through a PPP, the institution should discuss its subsequent feasibility study method with the relevant treasury. The PPP Manual advises choosing only one solution option and no more than three. If more than one option is recommended for which a PPP may be feasible, each must be separately assessed during Stage 4.[247]

Stage 4: "Value Assessment" is the final and thorough assessment of suitability of the PPP procurement option versus traditional public procurement. According to the PPP Manual, the three core questions, answers to which should determine whether a PPP is the best delivery mode for a project, are:

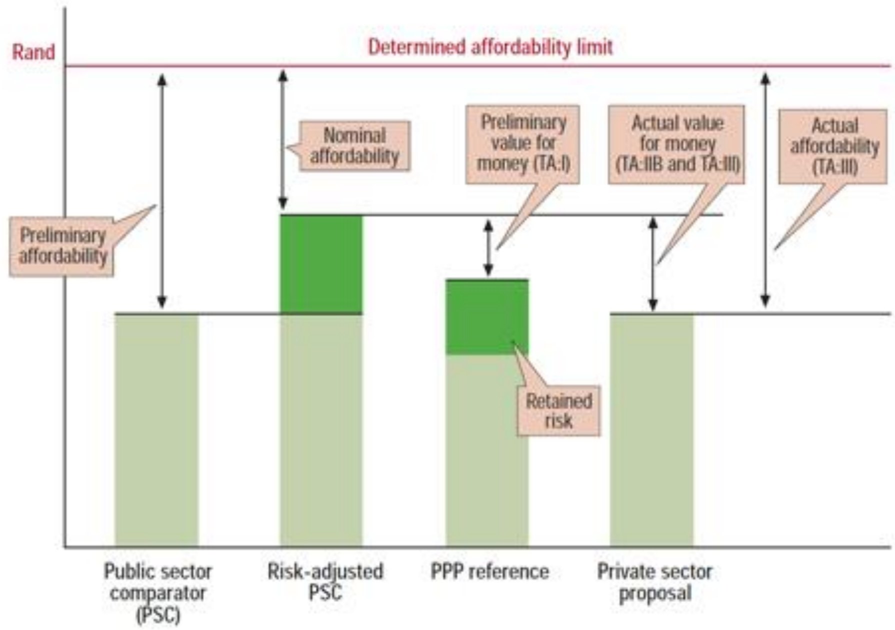
- Is it affordable?
- Does it appropriately transfer risk from the institution to the private party?
- Does it provide value for money?

Furthermore, it is clarified that to determine which procurement choice is best for a project, a comparative assessment must be made between delivering the same service (to the identical output specifications) as a conventional public sector procurement or as a PPP. To do this, a risk-adjusted Public Sector Comparator (PSC) model and a PPP reference model must be constructed for the chosen solution option, and the three criteria are affordability, risk transfer and VfM. The PPP Manual clearly states that VfM is a necessary condition for PPP procurement, but not a sufficient one, whereas affordability is the driving constraint for PPPs. A proposed PPP project may provide VfM but be unaffordable if specifications are too high. If a project is unaffordable, it undermines the institution's ability to deliver other services and should not be pursued. Therefore, affordability is the main constraint for pursuing a PPP option. Affordability shows whether the

[247] Ibid., p. 222.

cost of a project over its whole life can be accommodated in the institution's budget, given existing commitments. As a preliminary analysis of affordability, the risk-adjusted PSC and PPP reference models each should be compared to the institution's budget. If the project is not affordable, the institution may modify output specifications or may have to abandon the project. The VfM test is only conducted when the actual bids are submitted. However, an initial indication of VfM can be obtained through a risk-adjusted PSC model, which may serve as a VfM benchmark when compared to the PPP reference model during the feasibility study stage and confirmed later when private bids are received during the procurement stage. A schematic representation of affordability and VfM tests is provided in Figure 10.10 below.

Figure 10.10: Affordability versus Value for Money



Source: Excerpt from the PPP Manual, Module 4: Feasibility Study.

9.3.2. Risk Analysis of Projects

The PPP Manual provides extensive guidance on the risk analysis of potential PPP projects that is in line with the best international practice. The guidance on risk identification, assessment, allocation and mitigation is contained in Part 2: "Construct Risk-Adjusted PSC Model" of Stage 4: "Value Assessment" of the feasibility study preparation as described in the PPP Manual. The risk-adjusted PSC model is the base PSC model plus a costing of all risks associated with undertaking a project. The government usually does not cost these risks and is often subject to optimism bias, which leads to frequent cost overruns and biased price estimates used to assess different options. In order to cost for these risks, they should be identified first. The PPP Manual suggests carrying out two workshops for this purpose. The recommended attendance for the workshops is the institution itself, its transaction advisor and the relevant treasury's PPP Unit's project advisor. The rationale for the two workshops is to separate the process of identifying the risks from the process of trying to assess and quantify their impact, because clearly identifying risks and sub-risks can be clouded by discussions about their potential financial impact and some risks might be missed as a result. The goal of the first workshop is to explore each risk category in detail and produce a detailed, project-specific list. The PPP Manual suggests a standardized PPP risk matrix for the categories of risk typically found in PPP projects along with possible mitigation strategies and potential allocation (see Annex 9 B). The typical risks considered in the standardized risk matrix include availability, completion, cost overrun, design, environmental, foreign exchange (FX) rate, force majeure, inflation, insolvency, insurance, interest rate, latent defect, maintenance, market, demand or volume risks as well as operating, planning, political, regulatory, residual value, resource or input, subcontractor, tax rate change, technology and utilities risks. At the same time, the PPP Manual warns against being restrained by the standardized risk matrix. It further clarifies that when identifying risks by referring to an established list, there is a chance that a risk for a specific project could be left out by mistake simply because it is not listed in the standardized risk matrix. Therefore, the PPP Manual suggests at the end of the risk identification workshop to go through the various project stages and consider various scenarios of what might actually happen, and some risks that are not already contained in the standardized risk matrix may come up.

A comprehensive risk assessment is an inseparable step in the overall process to demonstrate affordability and VfM, and to make the final choice of procurement modality. Once all the risks are identified, the following steps are prescribed:

- Identify impacts of each risk, which might be influenced by effect, timing, type or severity of the consequence of a risk.
- Estimate likelihood of risks occurring, which can be done by using both subjective assessment and statistical risk measures (such as multivariable analysis or Monte Carlo simulation).
- Identify strategies for mitigating the risks, either by changing circumstances under which the risk can occur or by providing insurance for it.
- Allocate the risks between public and private party.
- Construct the risk matrix, consolidating all identified project risks, their impacts, and their associated costs.
- Construct the risk-adjusted PSC model by adding the identified risk to the base PSC.
- Perform the preliminary analysis to test affordability by comparing the risk-adjusted PSC model with the institution’s budget for a project as estimated during the solution options analysis. If a project looks unaffordable by a wide margin in the PSC model, it may be necessary to revisit the options analysis.

Other steps that follow include construction of a PPP reference model, performing of a sensitivity analysis, demonstrating affordability, conducting an initial VfM test and making a procurement choice of either traditional public procurement or a PPP. The process of risk assessment and the choice of procurement modality contained in the PPP Manual for municipal PPP projects is similar to the one described above for national and provincial projects.

9.3.3. Assessment of Direct Fiscal and Explicit Contingent Liabilities of PPP Projects

Published guidance does not contain instructions for FCCL management; minimum revenue guarantees seem to be not considered contingent liabilities. The existing guidance on the PPP process contained in the public domain does not provide instructions on how to perform assessment, measurement, typology and/or reporting and disclosure of either direct or contingent fiscal liabilities related to PPP projects. At the same time, according to the PPP disclosure contained in the Budget Review 2021, most national and provincial PPPs are guaranteed by the Minister of Finance and create a contingent liability, which (as stated) is only realized when a contract is terminated early. Strangely enough, a minimum revenue guarantee is not considered a contingent liability in the above-mentioned disclosure, which states that “PPP agreements can also impose other fiscal obligations on government that are not defined as contingent liabilities. For example, where the private sector collects user charges from the public, government usually guarantees the minimum revenue, which imposes a fiscal obligation and requires budget allocations."

Some internal procedures or established practices for approval and monitoring of contingent liabilities seem to exist. Despite there being no published document or procedure for FCCL management, according to the PPP disclosure in the Budget Review 2021, the National Treasury uses a four-stage approval process to ensure that contingent liabilities arising from PPP contracts are acceptable and it monitors these liabilities on an ongoing basis (see section 9.2 of the report, Treasury Approvals I, IIA, IIB and III, in particular). Furthermore, these contingent liabilities are classified into various categories, depending on whether the termination is the result of a private-sector default, government default or a force majeure. Compensation depends on the reason the contract has ended, but termination due to government default usually results in the greatest compensation. The government manages the risk emanating from PPP contingent liabilities by closely monitoring each party's performance against its contractual obligations and enforcing regulatory requirements. Potential termination payments for each category of contingent liabilities and different types of national and provincial contracting entities calculated by the National Treasury and reported about in the Budget Review 2021 are presented in Table 10.3 below. These numbers do not reflect contingent exposure in relation to energy IPP projects.

Table 10.3: Contingent Liabilities from PPP Projects by Category and Type of Contracting Agency, FY2019-20–FY2020-21

R, millions	Termination Due to Private Party Default			Termination Due to Force Majeure			Termination Due to Government Default		
	2019-20	2020-21	2020-21 as % of 2020 GDP	2019-20	2020-21	2020-21 as % of 2020 GDP	2019-20	2020-21	2020-21 as % of 2020 GDP
National Departments' Exposure	3,324.5	2,878.8	0.05	3,536.8	3,663.6	0.07	5,002.4	4,707.3	0.09
Provincial Departments' Exposure	3,159.3	2,649.3	0.05	1,889.1	1,263.4	0.02	4,514.0	4,151.2	0.08
Public Entities' Exposure	415.8	353.4	0.01	352.6	299.7	0.01	522.2	443.9	0.01
Total	**6,899.6**	**5,881.5**	**0.11**	**5,778.5**	**5,226.7**	**0.09**	**10,038.6**	**9,302.4**	**0.17**

Source: **Budget Review 2021, the National Treasury, Department of Statistics of South Africa, author's calculations based on available data.**

According to the numbers in Table 10.3 above, of the three spheres of government, national departments account for the greatest contingent exposure related to PPPs, which was equivalent to approximately 0.17 percent of the 2020 nominal GDP. Head office accommodation projects and the Gautrain Rapid Rail Link project were the biggest contributors to this exposure. In all three categories of contingent liabilities, estimated payment amounts that are likely to accrue to the government due to early termination of contracts declined slightly in 2020/21 because the government continued to pay off the debt and equity owed to the private sector under PPP contracts. Overall, the exposure in relative terms seemed to be modest. Analysis of the direct fiscal obligations or other types of contingent exposure as well as payment stream obligations under the signed PPAs for IPP projects contracted under the REIPPPP is unavailable. The only metric related to potential contingent exposure related to guarantees for PPAs could be found in the Medium-Term Budget Policy Statement for 2016,[248] according to which should Eskom default on its PPA-related payments, the GoSA would be exposed to a potential R 200 billion (an equivalent to about US$13 billion or approximately 4.6 percent of 2016 GDP) in payments as of FY2016 end. At the same time, this analysis is not systematic and could not be found in more recent Budget Policy Statements; the related analysis and more detailed explanations are also unavailable.

Guidelines and a template for contingent liabilities are sought to be developed. The 34 PPPs in operation (which exclude any IPP projects) that the National Treasury reports on as part of the PPP disclosure contained in the Budget Review 2021 account for 2 percent of the total public-sector infrastructure expenditure budget (as reported). Therefore, the National Treasury does not consider them posing significant risks to the fiscus. Over the medium term, however, the National Treasury anticipates the share of PPP projects to increase through engagement of the Infrastructure Fund. In anticipation of this increase, the National Treasury partnered with the World Bank to improve the methodology for quantification of contingent liabilities. Improvements that are being explored in 2021 include designing a guideline and a template to help public-sector institutions reporting on contingent liabilities, as well as formulating measures to evaluate the private sector's ability to deliver on its contractual obligations and debt repayments.[249] As part of this process, the draft Identification, Assessment and Management of Explicit and Contingent Liabilities in Infrastructure Financing Guidance Note was developed and eventually might be included in the PPP Manual as a separate Practice Note if all clearances are obtained. The purpose of this Guidance Note is to help GoSA officials understanding potential fiscal impacts that may arise from externally financed public investment projects (including PPPs) and how to manage and monitor related risks. In particular, it explores the nature of fiscal impacts arising from projects and how they are created, explains when and how to assess these fiscal impacts whether they are real (explicit) or potential (contingent) as projects are identified and developed. Finally, when projects become operational, guidance is provided on how such projects and risks should be monitored and reported.

An overall relatively comprehensive system for risk assessment would benefit from clearer FCCL management guidance. Overall, the PPP Manual outlays a rather comprehensive analysis that should be performed by the proposing institution, which, in most cases, would be done by its technical advisors, specifically in the risk analysis, risk matrix construction and PSC model application. For FCCL management specifically, however, no detailed guidance was found in the public domain that would provide procedural instructions, guidelines for assessment and decision-making steps to be performed by an approving authority (e.g., the relevant treasury), so it is unclear how the process works internally once the feasibility study with risk and relevant contingent liabilities assessments is submitted for approval and whether there are any defined decision criteria or procedures used to arrive at a final conclusion about a project, although the relevant practice might exist. Contingent exposure is said to be monitored throughout the year, although it is not very clear what techniques are used to do that. In this context, development of the draft Guidance Note on the subject is a step in the right direction.

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[248] Government of the Republic of South Africa, National Treasury. 2016. Medium-Term Budget Policy Statement, 2016, Annexure "Fiscal Risk Statement," The National Treasury, Republic of South Africa, October 26, 2016: 55. http://www.treasury.gov.za/documents/mtbps/2016/mtbps/MTBPS%202016%20Full%20Document.pdf.

[249] Government of the Republic of South Africa, National Treasury. 2021. Budget 2021. Budget Review. National Treasury, Republic of South Africa, Annexure E, February 24, 2021: 170. http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf.

9.4. Reporting Requirements

9.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

National and provincial governments still report on a modified cash basis; conversion to accrual basis might take years. The national and provincial departments in South Africa account in accordance with the modified cash standard.[250] This means that they report cash revenues and expenses along with a partial balance sheet showing financial assets and liabilities, but not the physical assets or liabilities, including those that are sometimes recognized in relation to PPPs. Therefore, the issue of whether PPPs appear on or off the public sector's balance sheet does not arise. However, since the 2006 review of the management of contingent liabilities related to PPPs, the National Treasury's accounting guidelines for departments require a presentation of a "disclosure note" on PPPs[251] (see Disclosure sub-section below for more details). According to the Public Expenditure and Financial Accountability (PEFA) assessment conducted at the national level for South Africa in 2014[252] (the most recent available), the national public entities keep their accounts on an accrual basis, which are separately aggregated and converted back to modified cash basis for purposes of aggregate consolidation; municipalities also account on an accrual basis. Furthermore, the whole-of-government consolidation (WGC) of accounts, which is not a legal requirement, can only happen after all levels of government have moved to full accrual basis. In this regard, the main difficulties and immediate efforts so far were focused on consolidation of information from different accounting bases, specifically, converting accrual information from municipalities and public entities into the cash basis that is used by national and provincial governments. There is also considerable work to ensure that budgeting and reporting is consistent with the formal economic reporting format and the Standard Chart of Accounts. Although the National Treasury is, in principle, committed to migrating national and provincial accounting bases from cash to accruals (with strategy developed as part of the Result Area 2 of the Financial Management Improvement Programme (FMIP) II), there is an understanding that achieving full conversion might take 10 years or more. It should be noted that there was substantial work already done related to assessment of the control environment through the Public Finance Management (PFM) Capability Maturity Model as well as extensive training on the GRAP standards. This work, however, only scratched the surface in relation to what needs to be done to run the full conversion.[253]

The IPP Office follows International Financial Reporting Standards (IFRS) for accounting purposes. As an important actor on the South African IPP Market, the IPP Office deserves a separate note. According to the Department of Energy Annual Report for FY2019-20,[254] the IPP Office is a stand-alone unincorporated and unlisted entity with its own management structure and management accounts. The management of the IPP Office is responsible for preparing annual financial statements in accordance with generally accepted accounting principles applied in accordance with DBSA policies, namely IFRS. Its financial statements only include assets and liabilities ring-fenced through a memorandum of agreement from other assets and/or liabilities of the DMRE, DBSA and GTAC, which formed it.

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[250] Government of the Republic of South Africa, National Treasury. 2021. Accounting Framework, "Modified Cash Standard." FY'2021-22 version. http://www.treasury.gov.za/legislation/pfma/TreasuryInstruction/Annecure%20A%20Modified%20Cash%20Standard.pdf.

[251] Irwin, Timothy, and Tanya Mokdad. 2010. "Managing Contingent Liabilities in Public-Private Partnerships. Practice in Australia, Chile, and South Africa." World Bank, PPIAF (Public-Private Infrastructure Advisory Facility, 2010: 32-33. https://ppiaf.org/documents/1919/download.

[252] Jacobs, Davina F., Tony Bennett, and Charles K. Hegbor. 2014. "Public Expenditure and Financial Accountability 'Repeat' Assessment for the Republic of South Africa." PEFA Program, October 27, 2014. https://www.pefa.org/sites/pefa/files/assessments/reports/ZA-Oct14-PFMPR-Public.pdf.

[253] Ibid., p. 88.

[254] Department of Energy. 2019. Annual Report 2019/2020. https://www.gov.za/sites/default/files/gcis_document/202101/doe-annual-report-2019-20.pdf.

There are no established ceilings or limits for either the incremental or total fiscal exposure from PPPs. Representatives from the National Treasury confirmed that before each PPP contract is signed, potential fiscal obligations stemming from a project are analyzed by the Fiscal Liability Committee, comprising the Asset & Liability Management Division,[255] the Budget Office,[256] and the Public Finance Division,[257] which oversees some key infrastructure-related units. Representatives from the Asset & Liability Management Division clarified that each project request is considered on its own merits, and no specific limits exist for any type of fiscal exposure, including PPP-related. The main role of the Fiscal Liability Committee is to deliberate on the proposal and consider the existing level of fiscal exposure in relation to the government's capacity to increase it further, for which there are really no limits. This is rather determined by looking at what would have been deemed to be the government's fiscal capacity at the time of either the budget or MTBPS preparation.

9.4.2. Transparency Policy on PPP Contracts

The PFM Act provides some legal basis for reporting obligations of fiscal risks for PPPs. Section 70, sub-sections 3 and 4 are relevant for reporting requirements for FCCL risks since they provide the primary legislative basis for action. Concerning the issue of guarantee, indemnity or security, sub-section 3 compels "Cabinet Members" to provide the Minister of Finance with "all relevant information as the Minister may require regarding the issue of such guarantee, indemnity or security and the relevant financial commitment." This allows the minister to demand any required information about explicit and contingent liabilities both ex-ante and ex-post. Sub-section 4 requires the responsible Cabinet member to report annually at a minimum on "circumstances relating to any payments under a guarantee, indemnity or security issued, to the National Assembly for tabling in the National Assembly." This creates a legal basis for reporting obligations and fiscal risks under PPP projects and other externally financed projects.

Certain requirements for disclosure on PPPs are also established in the Modified Cash Standard. Thus, according to section 47 of Chapter 3 of the standard, other required disclosures for arrangements entered into by the national and provincial departments include PPPs. More specifically, to the extent that a department is party to a PPP, it should disclose, as part of the secondary financial information, the following information to enable users determining the impact of a PPP on the department:

- A description of the nature and amount of any unitary fees paid to a private party in a PPP agreement, indicating the fixed and indexed components of these payments
- A description of the nature and amount of any concession fees received from a private party in a PPP agreement indicating the base fee and variable fees
- A general description of significant terms of a PPP agreement, along with a description of the parties to the agreement, and the date of commencement thereof.
- An analysis of the indexed component of the contract fees paid

[255] The Asset and Liability Management Division is a unit within the National Treasury responsible for managing the government's annual funding program in a manner that ensures prudent cash management and an optimal portfolio of debt and other fiscal obligations. It also promotes and enforces prudent financial management of state-owned entities through financial analysis and oversight.

[256] The Budget Office coordinates the national budgeting process, which includes coordination of the resource allocation to meet the political priorities set by the government. The division also provides fiscal policy advice, oversees expenditure planning and the national budget process, leads the budget reform program, coordinates international technical assistance and donor finance, supports PPPs, and compiles public finance statistics.

[257] The Public Finance Division is primarily responsible for assessing budget proposals and reviewing service delivery trends in national government departments and their entities. The division also manages the National Treasury's relations with other national departments, provides budgetary support to departments, and advises the mnister and the National Treasury on departmental and government cluster matters.

- The value of any rights, including tangible or intangible capital assets, to be provided to a private party under a PPP agreement
- The value of any other obligations the department might have in terms of a PPP agreement, including prepayments and advances.

After checking several annual reports of various national departments, it can be confirmed that required PPP disclosure under the Modified Cash Standard is indeed done in practice. For an example of such a disclosure presented in the Annual Report of the Department of Correctional Services for FY2019-20,[258] refer to Box 10.1 below.

[258] Department of Correctional Services. 2019. Annual Report 2019/2020. Note 30, "Public Private Partnership": 203-204. https://www.gov.za/sites/default/files/gcis_document/202012/corectional-services-annual-report-201920.pdf.

Box 10.1: PPP Disclosure in the Annual Financial Statements by Department of Correctional Services, 2019-2020

Description of Arrangement

To design, finance, build and manage a maximum-security correctional center for a contract period of 25 years. The contractor Bloemfontein Correctional Contracts is currently operating Mangaung Maximum Security Correctional Centre (MCC) in the Free State Province and the contractor South African Custodial Services is currently operating Kutama-Sinthumule Maximum Security Correctional Centre (KSCC) in the Limpopo Province. The PPP contracts for MCC commenced on July 1, 2001 and will end on June 30, 2026. The PPP for KSCC commenced on February 16, 2002, and will end on February 15, 2027.

Table B10.1.1: PPP-related Disclosure

	Note	2019/20 R'000	2018/19 R'000
Unitary fee paid		**1,037,997**	**1,090,725**
Fixed component		-	84,545
Indexed component		1,037,997	1,006,180
Analysis of indexed component		**1,037,997**	**1,006,180**
Goods and services (excluding lease payments)		1,037,997	1,006,180
Capital		**-**	**84,545**
Property		-	84,545

Significant Terms of Arrangement that May Affect Amount, Timing and Certainty of Future Cash Flows

Cash flow models for two PPP projects were created. Cash flow models enable the department to determine the estimated costs of two projects over their 25-year contract period. The contract fee is based on the daily available bed spaces. This fee is split into fixed and indexed components for each year. The indexed component is escalated on each review date (every six months) as stipulated in the contract. The fixed components will, however, remain the same for a period of 15 years (Bloemfontein) and 17 years (Limpopo), after which the fixed fee will cease.

The nature and extent of:

Rights to use specified assets: assets are managed and maintained by the contractor for the duration of the contract period.

Intellectual property rights: all rights in data, reports, drawings, models, specifications and/or other material produced by or on behalf of the department shall vest in and be the property of the state, and the contractor is granted an irrevocable non-exclusive and royalty-free license to use such material for the purpose of the agreement.

Obligations to provide or rights to expect provisions of services: Contractor: construct correctional center; maintain and operate correctional center for 25 years; keep inmates in safe custody; maintain order, discipline, control and safe environment; provide decent conditions and meet inmates' needs; provide structured day programs; prepare inmates for reintegration to community; deliver correctional center's services and involve with the community.

Department of Correctional Services: ensure that there are always inmates placed in available inmate spaces, pay contractor on a monthly basis; manage contract on a monthly basis, and release offenders.

Obligations to acquire or build items of property, plant and equipment: original buildings constructed according to departmental specifications. Any further changes/alterations and additions to be negotiated.

Obligations to deliver or rights to receive specified assets at the end of the concession period: all assets including equipment become the property of the state after expiry of the contract period.

Renewal and termination options: can be negotiated if so directed by the government.

Other rights and obligations: all maintenance obligations are the responsibility of the contractor for the entire contract period.

Changes in the arrangement occurring during the period: may be done by means of negotiations between both parties.

Commitments: the department is committed for the remainder of the two PPP contracts. The index fee for MCC is committed until 2026, whereas the fixed fee commitment for MCC ended on June 30, 2016. The index fee for KSCC is committed until February 15, 2027, whereas the fixed fee commitment for KSCC ended on February 15, 2019.

Table B10.1.2: PPP-related Disclosure

Approved and contracted	2019/20 R'000	2018/19 R'000
Current Expenditure (Index fee)	7,393,627	8,581,068
Total	**7,393,627**	**8,581,068**

The Annual Budget Review document contains an annex with the PPP disclosure on a portfolio level. At a portfolio level, for PPP projects that exclude IPPs contracted under the REIPPPP, the annual Budget Review document contains some analysis. Specifically, Annexure E is devoted to public-private partnerships. The annexure provides information on recent regulatory changes (such as the 2019-2021 review talked about in section II of the report); a separate sub-section briefly discusses contingent liabilities associated with termination payments in non-energy PPPs (see section 9.3 of the report) and performance of the select projects during the COVID-19 pandemic (see section 9.5 of the report); the list of concluded PPP contracts closes the annexure. At present, however, it looks like potential contingent liabilities from PPPs are mostly considered to stem from early termination because that is the only type of event for which a somewhat detailed analysis in quantitative terms is presented. It would also be helpful to have a similar type of analysis for debt and revenue guarantees provided to PPPs or guarantees issued for payments by state-owned enterprises (SOEs) or sub-national governments, aggregating the data for IPP projects with non-energy PPPs to give a comprehensive view of the overall PPP portfolio.

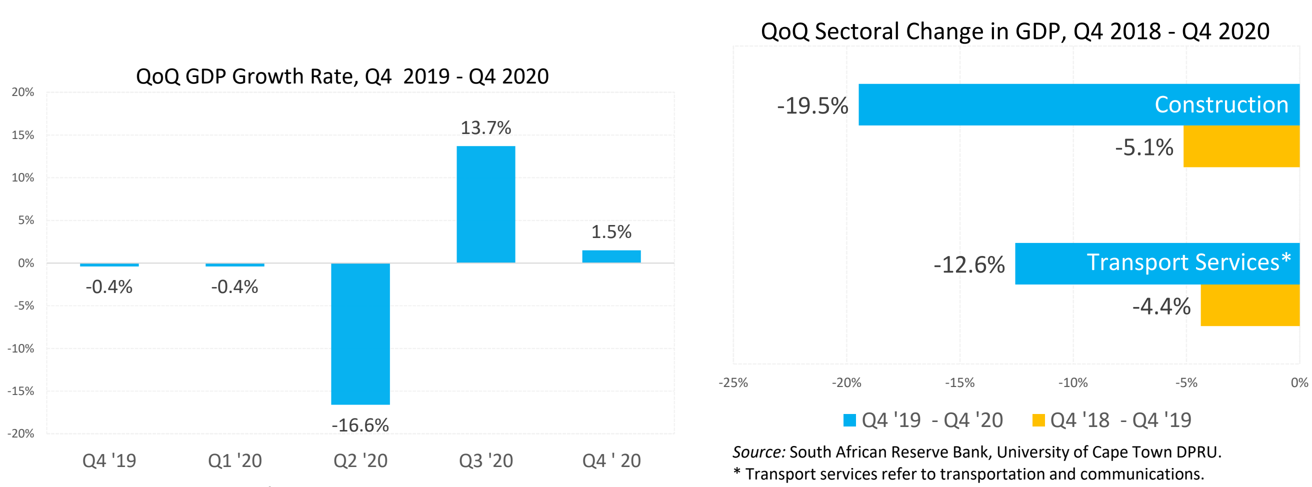
The existing practices provide a decent level of disclosure with some missing bits that would otherwise be helpful. Overall, the existing level of disclosure on PPPs in South Africa provides a certain picture of both individual projects (when reported in the annual financial statements of various departments) and at the portfolio level, including analytical portions covering contingent exposure. At the same time, the current PPP regulations and Treasury Regulation 16, in particular, are insufficient to deal with ex-post monitoring and reporting of fiscal risk. Although some ex-post requirements are mentioned in National Treasury Regulation 16, section 7, they relate almost exclusively to the management of a contractual relationship with the private partner, and a systematic approach to FCCL reporting is missing. Thus, some missing parts, especially in FCCL-related matters, include the lack of an aggregated portfolio-level analysis of direct fiscal liabilities for PPPs, including from IPP projects, and their relative size and impact on the government's budget and fiscal position. The policies in terms of the ceilings for PPP-related fiscal exposure and potential reservation requirements do not appear very clear in the existing disclosure either.

9.5. Performance under Crisis

9.5.1. Impact of COVID-19 on Concessions

The COVID-19 pandemic undermined an already weekend economy. The COVID-19 pandemic and South Africa's efforts to contain it had a considerable impact on economic activity in the country. Since the beginning of the pandemic, like many other economies, South Africa has imposed varying restrictions. Thus, a National State of Disaster was declared on March 15, 2020, and the country was put under hard lockdown on March 26, 2020, for five weeks. The lockdown was stringent: restricting mobility to essential travel only, prohibiting sale of alcohol to take pressure off the health system, and making no allowances for non-essential activities outside the house. Most economic functions across the country came to an immediate halt, apart from a set of essential services including healthcare, security, agriculture, and transport of select goods. Annex 9 C shows the dates when varying restrictions were put in place throughout the pandemic, and what each level of restrictions entailed. As of mid-2021, South Africa was believed to be entering a third wave of infections with varied levels of restrictions. Before the onset of COVID-19, the South African economy was already struggling. Two consecutive periods of negative GDP growth in Q3 and Q4 2019 meant that the economy entered a technical recession at the beginning of 2020 (see Figure 10.11). Several reasons—such as unstable electricity supply, low consumer and business confidence, diversion of departmental funds to bail out state-owned enterprises, and a lack of structural reforms—were cited to explain the South African economic malaise. The COVID-19 pandemic, and associated restrictions on economic activity, thus placed further strain on an economy that was already not performing well. These underlying reasons for pre-pandemic poor performance are unlikely to be resolved in the short term and are likely to also impact the country's ability to recover from COVID-19-induced economic shocks.[259] Interestingly, such industries as construction and transport services were already shrinking before the pandemic and COVID-19 only accelerated the decline in these sectors (see Figure 10.11 below).

Figure 10.11: Quarter-on-Quarter GDP Growth Rate, Total and by Sector, Q4 2018–Q4 2020



Source: OECD 2021, University of Cape Town DPRU.

Source: South African Reserve Bank, University of Cape Town DPRU.
* Transport services refer to transportation and communications.

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[259] Asmal, Zaakhir, and Christopher Rooney. 2021. "The Impact of COVID-19 on Industries without Smokestacks in South Africa." University of Cape Town, Development Policy Research Unit (DPRU), AGI Working Paper 32, July 2021: 1-3.

The GoSA defined infrastructure investments, including through blended finance solutions and PPPs, as one of the priority actions in the post-COVID-19 recovery effort. Motivated by the need to respond to the COVID-19 pandemic with economic measures, the government is planning investments in infrastructure as part of its recovery strategy. It has already been made clear that financing of these investments should come from a variety of sources, both internal and external. To this end the GoSA is working on several reforms, including the PPP Framework Review (see section II), operationalization of the Infrastructure Fund, formulation of Strategic Infrastructure Projects (SIPs) through Presidential Infrastructure Coordinating Commission (PICC) structures and building of a project pipeline under Infrastructure South Africa (ISA). Therefore, the COVID-19 pandemic did not curtail interest in PPPs and blended solutions but, in contrast, accelerated and expedited the effort to optimize the regulatory framework to allow for more PPPs and blended-financed projects in the future. Representatives from the National Treasury indicated that currently there is an ongoing internal discussion on how to balance the two competing objectives and interests—the strong push for private sector financing in the upstream and advisory wing of the government, on the one hand, and concerns for the related fiscal risks and potential obligations that come together with this expansion as well as the preparedness of the GoSA for a significant uptake in PPPs and blended-financed projects, on the other—an issue that is a primary concern for the National Treasury. Therefore, the system is said to be balancing itself along these two dimensions, and any formally adopted decisions are expected to reflect a balanced view of the government in this regard.

In the existing PPP portfolio, transport projects were the hardest hit, whereas energy IPPs were not impacted significantly. The PPP Disclosure in the Budget Review 2021 provides some insight into how PPP projects fared during the COVID-19 pandemic. According to the available disclosure, restrictions on activities to contain COVID-19 imposed in late March 2020 significantly affected the revenues of several PPP projects. In April 2020, the National Treasury, supported by the World Bank, engaged with key stakeholders to assess potential PPP risks and contingent liabilities as well as to identify solutions to mitigate the effects of these restrictions. The stakeholders included the Gautrain Management Agency, the Western Cape Department of Transport and Public Works, the IPP Office, SANRAL and the PPP Unit in the GTAC. As of the reporting date, the impact on risks to the fiscus and contingent liabilities was considered manageable. At the same time, operational PPPs, especially in the transport sector, such as the Gautrain Rapid Rail Link project, SANRAL toll roads and Chapman’s Peak, all lost revenue. Other operational concessions, specifically those contracted under the REIPPPP, were not affected much, and it was judged that there was no risk that they could impact on the fiscus. The project terms of IPPs that were in the construction stage at the time were extended, and meanwhile PPPs in the planning stage were expected to face delays in reaching financial closure as a result of the crisis.[260]

The MRG and debt guarantee for the two transport projects got triggered during the crisis. In the transport sector, more details are available for the following projects:

- *Gautrain*. In November 2020, passenger demand was 30 percent of pre-COVID-19 levels after a slow recovery from the shutdown of all rail transport during the strict lockdown. The Gautrain has a patronage guarantee (MRG) as part of the PPP agreement signed with the private operator, Bombela Concession Company. The private operator is partly liable for losses if revenue drops below a certain amount. In 2020-21, the private operator was expected to lose about R 700 million (an equivalent to about US$47.5 million) and the provincial government’s patronage guarantee was expected to exceed its existing budget by R 400 million (about US$27 million). The Gauteng Department of Roads and Transport was expected to absorb this amount. As of the reporting date,

[260] Government of the Republic of South Africa, National Treasury. 2021. Budget 2021. Budget Review. National Treasury, Republic of South Africa, Annexure E, February 24, 2021: 169-170. http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf.

the number of people using public transport was still projected to remain below pre-COVID-19 levels for some time as a result of the slow economic growth and probability that more people would continue working from home. It was concluded that the overall impact of COVID-19 on projects such as the Gautrain was unknown at the time and would need to be assessed and quantified in future.

- *Chapman's Peak toll road*. Traffic volumes along Chapman's Peak toll road in Cape Town declined by 99 percent in April 2020 compared to volumes observed in April 2019, recovering to 70 percent of the December 2019 levels by December 2020. The Western Cape Department of Roads and Transport, which guaranteed private-sector debt payment, has had to pay about R 14 million (about US$950,000) more to the private sector than budgeted for in 2020 because lower traffic volumes affected revenue collection. Moreover, the department estimated that it will have to pay about R 10 million (about US$679,000) more in 2021 due to reduced traffic. The decrease in tourism and the increase in remote work were expected to continue affecting traffic volumes and revenues. This was likely to increase the Western Cape's debt payments to the private sector. However, the loans were expected to be fully repaid by 2023, after which the provincial government is expecting to earn revenues from this road.
- *SANRAL toll roads*. SANRAL is operating three PPPs: the N3 toll road, N4 East toll road and N4 West toll road. The effect of lower traffic volumes and revenue due to restrictions varied; however, all three PPP agreements specify that any loss emanating from traffic volumes is to be borne by the private operator.
    - Revenue collection on the N3 toll road was affected by restrictions on interprovincial travel and the hospitality industry. As of the reporting date, revenue losses were not quantified yet. The private operator was expected to claim these losses from its insurer.
    - Traffic volumes at the N4 East toll plazas (between Pretoria and Maputo) dropped to 18 percent YoY of pre-COVID-19 levels during the strict lockdown imposed in March 2020. Total March 2020 to January 2021 traffic volumes were about 80 percent YoY, showing a gradual resumption of activity. Additional COVID-19 regulations imposed at borders caused delays and reduction in traffic between South Africa and Mozambique during 2020, and the December 2020 closure of border posts significantly affected toll revenue collections. From August 2019 to July 2020, the private operator estimated a revenue loss of R 298.7 million (about US$20 million).
    - Revenue for the N4 West Bakwena toll road (between Pretoria and Rustenburg) was estimated to have dropped to 20 percent YoY of pre-COVID-19 levels in March and April 2020. From March to September 2020, revenue losses amounted to R 371.3 million (about US$25 million). The private operator was pursuing this claim from its insurer.

9.5.2. Measures Implemented to Help Cope with the Consequences of the COVID-19 Crisis

To summarize, the COVID-19 pandemic did not cause significant distress for the government budget despite guarantees for two projects (MRG for the Gautrain project and debt guarantee for the Chapman's Peak toll road) being triggered, with payments coming from the budget. Part of the reason for such a moderate impact is the fact that demand risk for some toll roads, which were heavily hit by the lockdowns, were insured instead of being guaranteed by the government through, for instance, MRGs. At the same time, the relatively small size of non-energy PPP programs may have also been a factor. If the PPP program had represented a larger and significant portion of the public investment portfolio, and the government guarantees had been more prevalent in that portfolio, the potential impact on the government fiscus could have been worse. With the GoSA emphasizing blended-finance solutions, including PPPs, for the post-COVID-19 recovery effort, and expected uptake in PPP projects in the future, addressing some of the gaps in the existing FCCL framework—including the lack of guidance for the FCCL process within the government, with clear roles and decision criteria articulated, as well as ambiguity regarding decision-making about approval of incremental fiscal exposure, and lack of clarity on caps or ceilings for such exposure—could be helpful in ensuring that the system is well prepared for the expected expansion and the next shock. The fragmented nature of reporting, analysis and disclosure for PPP and IPP portfolios also contributes to the limited understanding (including by the public) of the fiscal risks pertinent to the PPP projects as a whole—an issue that could be improved.

Annex 9 A: South Africa FCCL Principles

#	Principles	Clarification	Assessment for South Africa
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	A draft guidance note on quantifying direct and contingent fiscal liabilities from PPPs was developed with WB support but has not been adopted yet.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	The National Treasury conducts assessments of contingent liabilities for non-energy PPPs from related to the early contract termination, depending on the type of default, which assumes the presence of certain analytical tools. However, their exact nature is unclear.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated according to the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	National Treasury approval is required at major steps in the PPP cycle, including during project inception and procurement, and for all material changes.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	The PPP Manual provides detailed step-by-step guidance on how to conduct VfM and PSC analyses as part of preparing a feasibility study.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	There are no caps or ceilings for PPP-related fiscal exposure.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	During affordability assessment, PPPs enter budgets of contracting authorities for the duration of the Medium-Term Budgeting Framework period in terms of direct funding needs. Those monies are ring-fenced and guaranteed during the budgeted period.
7	Mechanisms are in place to ensure	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to ensure the government is able to	For municipal projects, there are reserve/ring-fencing requirements for the amount of the total potential

#	Principles	Clarification	Assessment for South Africa
	funding is available for contingent liabilities.	fund contingent liabilities should they materialize.	financial exposure under the issued municipal guarantee. For national or provincial projects, there are no such requirements.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized and reflected as such in the financial statements.	National and provincial governments report on a modified cash basis, with a mandatory disclosure note on PPPs required. National public entities and municipalities account on an accrual basis and are separately aggregated and converted back to a modified cash basis for the purposes of total consolidation. IPP Office accounts are based on International Financial Reporting Standards (IFRS).
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report is prepared on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	Some disclosure on non-energy PPPs is available, including information on contingent liabilities from early termination. The fiscal risks of the IPP program are not disclosed on a consolidated basis.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	There are no PPP-specific audits, but the Auditor-General of South Africa (AGSA) conducts regular audits of the national and provincial government departments, identified public entities, municipalities and municipal entities, as well as discretionary audits (e.g., performance and special audits and investigations, etc.). Its audit reports are made public and are tabled in Parliament, provincial legislatures and municipal councils. AGSA also publishes general annual reports with analyses of audit outcomes at the national, provincial and municipal levels.
11	Fiscal management proceedings apply to all agencies that are under direct or	To control and avoid unwarranted sub-sovereign fiscal exposure the fiscal rules for PPPs should be applied to all levels of government.	Different sets of rules apply to the national/provincial and municipal-level PPPs, although general steps in the PPP process are comparable for both types.

#	Principles	Clarification	Assessment for South Africa
	indirect control of the government.		The PFM Act covers select public entities, including certain business enterprises. The MFM Act covers all municipal entities. The IPP program is regulated by a standalone set of regulations with many checks omitted.

Annex 9 B. Standardized PPP Risk Matrix

№	Categories	Description	Mitigation	Allocation
1	Availability risk	The possibility that the Services to be provided by the Private Party do not meet the output specifications of the Institution.	Clear output specifications. Performance monitoring. Penalty Deductions against Unitary Payments.	Private Party.
2	Completion risks	The possibility that the completion of the Works required for a project may be i) delayed so that the delivery of the Services cannot commence at the Scheduled Service Commencement Date, or ii) delayed, unless greater expenditure is incurred to keep to the Scheduled Service Commencement Date, or iii) delayed because of variations.	Special insurance (project delay insurance). Appointment of an Independent Certifier to certify the completion of the Works. Liquidated damages, construction bonds and other appropriate security from the Private Party to achieve completion, unless caused by the Institution. Relief Event.	Private Party, unless delay caused by Institution (including, Institution Variations)
3	Cost overrun risk	The possibility that during the design and construction phase, the actual Project costs will exceed projected Project costs.	Fixed price construction contracts. Contingency provisions. Standby debt facilities / additional equity commitments; provided that these commitments are made upfront and anticipated in the base case Financial Model.	Private Party.
4	Design risk	The possibility that the Private Party's design may not achieve the required output specifications.	Clear output specifications. Design warranty. Patent and latent defect liability Consultation with and review by Institution (but review must not lead to input specifications by Institution). Independent Expert appointment to resolve disputes on expedited basis.	Private Party.
5	Environmental risk	The possibility of liability for losses caused by environmental damage arising i) from construction or operating activities (see operating risk) during the Project Term, or ii) from pre-transfer activities whether undertaken by the Institution or a third party and not attributable to the activities of the Private Party or the Subcontractors.	Thorough due diligence by the bidders of the Project Site conditions. Independent surveys of the Project Site commissioned by the Institution at its cost. Institution indemnity for latent pre-transfer environmental contamination, limited by a cap (subject to value for money ("VFM") considerations), for a specified period. Remediation works to remedy	In relation to i), the Private Party. In relation to ii), the Institution, but Institution's liability to be capped (subject to VFM considerations).

№	Categories	Description	Mitigation	Allocation
			identified pre-transfer environmental contamination as a specific project deliverable. Independent monitoring of remediation works.	
6	Exchange rate risk	The possibility that the exchange rate fluctuations will impact on the envisaged costs of imported inputs required for the construction or operations phase of the Project.	Hedging instruments (e.g., swaps).	Private Party.
7	Force Majeure risks	The possibility of the occurrence of certain unexpected events that are beyond the control of the Parties (whether natural or "man-made"), which may affect the construction or operation of the Project.	Define "Force Majeure" narrowly to exclude risks that can be insured against and that are dealt with more adequately by other mechanisms such as Relief Events. Relief Events. Termination for Force Majeure.	If risks are insurable, then they are not Force Majeure risks and are allocated to Private Party. If risks are not insurable, the risk is shared insofar as Institution may pay limited compensation on termination.
8	Inflation risk	The possibility that the actual inflation rates will exceed the projected inflation rate. This risk is more apparent during the operations phase of the Project.	Index-linked adjustment to Unitary Payments or user charges.	Institution bears risk of inflationary increases up to the limit of the agreed index. Increases in excess of this are for the Private Party.
9	Insolvency risk	The possibility of the insolvency of the Private Party.	SPV structure to ring-fence the Project cash flows. Security over necessary Project Assets. Limitations on debt and funding commitments of the Private Party. Reporting obligations in respect of financial information and any litigation or disputes with creditors. Institution has right to terminate the PPP Agreement. Substitution of Private Party in terms of the Direct Agreement. Substitution of the	Private Party.

№	Categories	Description	Mitigation	Allocation
			Private Party with a New Private Party if there is a Liquid Market and the Retendering procedure is followed.	
10	Insurance risk	The possibility i) that any risks that are insurable at the Signature Date pursuant to the agreed Project Insurances later become Uninsurable or ii) of substantial increases in the rates at which insurance premiums are calculated.	In the case of i), at the option of the Institution, self-insurance by the Institution or, if the uninsurable event occurs, then termination of the PPP Agreement as if for Force Majeure with compensation to the Private Party. Reserves.	In relation to i), if the Private Party caused the uninsurability or, even if it did not, but the Private Party cannot show that similar businesses would stop operating without the insurance in question, then the Private Party bears the risk. Otherwise, the risk is shared between the Private Party and the Institution. In relation to ii), the Private Party (unless caused by Institution variations).
11	Interest rate risk	These are factors affecting the availability and cost of funds.	Hedging instruments (e.g., swaps). Fixed rate loans.	
12	Latent defect risk	The possibility of loss or damage arising from latent defects in the Facilities included in the Project Assets (compare with the treatment of latent pre-transfer environmental contamination, see environmental risk).	Wherever possible, the design and construction of the Facilities must be performed or procured by the Private Party. If, however, a project involves the take-over by the Private Party of existing Facilities, then the bidders must undertake a thorough due diligence of these Facilities to uncover defects. The procedure for and cost of the remediation of such discovered defects can then be pre-agreed with the Private Party. Reporting	In relation to any land-use and zoning Consent, the Institution, unless Project Site selection is the Private Party's responsibility. In relation to any building Consent or other design or construction specific planning

№	Categories	Description	Mitigation	Allocation
			obligation on Private Party to promptly disclose discovered defects.	Consent, the Private Party.
13	Maintenance risk	The possibility that i) the cost of maintaining assets in the required condition may vary from the projected maintenance costs, or ii) maintenance is not carried out.	Clear output specifications. Penalty regime and performance monitoring. Adequate O&M contract. Substitution rights. Special insurance and special security in the form of initial maintenance bonds.	In relation to discriminatory Unforeseeable Conduct and expropriating actions, the Institution. In relation to general Unforeseeable Conduct, the Private Party.
14	Market, demand or volume risk	The possibility that the demand for the Services generated by a project may be less than projected (whether for example because the need for the Services ceases or decreases, or because of competitors entering into the relevant market, or because of consumer opposition to the outsourcing of the Services).	In a Unitary Payment type of PPP, the Unitary Payment must be paid based on availability (not actual usage by the Institution).	If any such Consents (other than those relating to Private Party's operating requirements) can be obtained before the Signature Date and they are capable of transfer to the Private Party, the Institution. In relation to the Private Party's operating requirements, the Private Party.
15	Operating risk	Any factors (other than Force Majeure) impacting on the operating requirements of the Project, including projected operating expenditure and skills requirements, for example, labor disputes, employee competence, employee fraud, technology failure, environmental incidents and any failure to obtain, maintain and comply with necessary operating Consent.	Clear output specifications. Penalty regime and performance monitoring. Adequate O&M contract. Substitution rights. Special insurance.	
16	Planning risk	The possibility that the proposed use of the Project Site in terms of the PPP	The Institution must identify at the feasibility phase any macro-level	In relation to any land-use and

№	Categories	Description	Mitigation	Allocation
		Agreement and, in particular, the construction of the Facilities on the Project Site will fail to comply with any applicable laws relating to planning, land use or building (for example, any town-planning or land-zoning scheme) or any Consent required pursuant thereto, or that any such Consent will be delayed or cannot be obtained or, if obtained, can only be implemented at a greater cost than originally projected.	planning Consents not required for the detailed design and construction proposal for the Project, such as any land-use and zoning Consents. These Consents must be obtained before the Project is put to tender. The Private Party must identify all planning Consents that are required for the Project with regard to its design and construction proposal. It must make adequate provision in its Works program for such Consents to be obtained. Relief Event for delays in Private Party obtaining Consents but only if the delay is not attributable to the Private Party.	zoning Consent, the Institution, unless Project Site selection is the Private Party's responsibility. In relation to any building Consent or other design or construction specific planning Consent, the Private Party.
17	Political risk	The possibility of i) Unforeseeable Conduct by the Institution or by any other government authority that materially and adversely affects the expected return on Equity, debt service or otherwise results in increased costs to the Private Party, or ii) expropriation, nationalization or privatization (collectively, "expropriating actions") of the assets of the Private Party. This risk overlaps with some financial risks (e.g., tax rate change risk).	Limit risk to Unforeseeable Conduct for which there is no other relief in the PPP Agreement and to expropriating actions. Distinguish between general and discriminatory Unforeseeable Conduct. In relation to discriminatory Unforeseeable Conduct, special compensation. In relation to expropriating actions, termination and compensation.	In relation to discriminatory Unforeseeable Conduct and expropriating actions, the Institution. In relation to general Unforeseeable Conduct, the Private Party.
18	Regulatory risk	The possibility that Consents required from other government authorities will not be obtained or, if obtained, can only be implemented at a greater cost than originally projected (compare with the treatment of planning and environmental Consents, see planning risk and environmental risk).	During the feasibility phase of the Project, a legal scan is undertaken by the Institution to identify all such Consents. Implementation by the Institution of an inter-governmental liaison process with the responsible government authorities before the procurement phase. Due Diligence by Private Party to identify the Consents required for its operating requirements. If permitted under applicable law and if this is practical, obtain all such Consents before the Signature Date.	If any such Consents (other than those relating to Private Party's operating requirements) can be obtained before the Signature Date and they are capable of transfer to the Private Party, the Institution. In relation to the Private Party's

№	Categories	Description	Mitigation	Allocation
				operating requirements, the Private Party.
19	Residual value risk	The risk that the Project Assets at termination or expiry of the PPP Agreement will not be in the prescribed condition for hand back to the Institution.	Obligations on Private Party to maintain and repair. Audit of Project Assets towards the end of Project Team. Security by the Private party in favor of the Institution, e.g., final maintenance bond or deduction from Unitary Payment. Reinstatement obligations on Private Party.	Private Party.
20	Resource or input risk	The possibility of a failure or shortage in the supply of the inputs or resources (for example, coal or other fuels) required for the operation of a project including deficiencies in the quality of available supplies.	Supply contracts for supply of total project requirements, such as take and pay contracts. Relief Events but only if failure or shortage not attributable to the Private Party.	Private Party, unless the inputs are supplied by the Institution.
21	Subcontractor risk	The risk of subcontractor (first tier and below) default or insolvency. This risk may arise at the construction and/or operations phases of the Project.	Subcontractors must have expertise, experience and contractual responsibility for their performance obligations. Replacement Subcontractors to be pre-approved by the Institution. Due diligence by the Institution must include review of first tier Subcontracts to confirm the pass through of risks down to the first-tier subcontractors.	Private Party.
22	Tax rate change risk	The possibility that changes in applicable tax rates (income tax rate, VAT) or new taxes may decrease the anticipated return on equity.	If change arises from discriminatory Unforeseeable Conduct, then special compensation.	In relation to tax increases or new taxes arising from discriminatory Unforeseeable Conduct, the Institution. Otherwise, the risk is the Private Party's.
23	Technology risk	The possibility that i) the technology inputs for the outsourced institutional function may fail to deliver the required output specifications, or ii) technological	Obligation on Private Party to refresh technology as required from time to time to meet the output	Private Party.

№	Categories	Description	Mitigation	Allocation
		improvements may render these technology inputs out-of-date ("technology refresh or obsolescence risk").	specifications. Penalty Deductions for failure to meet output specifications.	
24	Utilities risk	The possibility that i) the utilities (e.g., water, electricity or gas) required for the construction and/or operation of a project may not be available, or ii) the project will be delayed because of delays in relation to the removal or relocation of utilities located at the Project Site.	Emergency back-up facilities, e.g., generators. Emergency supply contracts. Special insurance (project delay or other business interruption insurance). Provision by the Institution of off-site connections. In the case of i), Relief Event for off-site interruptions in the supply of utilities (unless attributable to the Private Party). In the case of ii), Relief Event for delays in the removal or relocation of utilities (unless attributable to the Private Party).	Private Party unless the Institution is the responsible Utility. In the case of i), even if the Institution is not the responsible Utility, the Institution may share this risk in circumstances where insurance is not available or unaffordable, but only if this will ensure better VFM.

Source: PPP Manual, Module 4: PPP Feasibility Study, Annexure 4 "Standardized Risk Matrix."

Annex 9 C: COVID-19 Alert Levels and Associated Restrictions

Date	Level	Description of Restrictions
March 27, 2020—initially for three weeks, extended for two further weeks	Alert level 5[261]	Only essential services and businesses are operating. No alcohol or cigarette sales are permitted, and citizens may not travel or attend any form of gathering (Turner, Le Grange and Nkgadima 2021).
May 1, 2020	Alert level 4	Borders remain closed. No travel between provinces, except transportation of goods and under exceptional circumstances. Public transport capacity limitations. Range of goods allowed to be sold widened. Restrictions remain in place in certain sectors such as bars, conference and convention centers, and entertainment venues. No gatherings allowed (South African Government News Agency 2020a).
June 1, 2020	Alert level 3	Opening of most economic sectors subject to health protocols and social distancing. High-risk activities remain prohibited. These include: restaurants, bars, and taverns (except for delivery or collection of food); accommodation and domestic air travel (except for business travel); conferences, events, entertainment, and sporting activities; and personal care services, including hairdressing and beauty services (South African Government News Agency 2020b).
July 12, 2020	Alert level 3, adjusted	Restrictions adjusted to ban alcohol sales to alleviate pressure on the healthcare system. A 9 p.m. to 4 a.m. curfew is also introduced, and family visits are prohibited (Turner, Le Grange, and Nkgadima 2021).
August 18, 2020	Alert level 2	Inter-provincial travel restrictions lifted. Ban on alcohol and tobacco products lifted. Family visits allowed. Gyms reopened. Gatherings limited to 50 people. Curfew between 10 p.m. and 4 a.m. (Qukula 2020).
September 20, 2020	Alert level 1	Most normal activity can resume, with precautions and health guidelines followed at all times.
November 11, 2020	Alert level 1, adjusted	Relaxation of international travel and alcohol trading restrictions eased (ENCA 2020).
December 28, 2020	Alert level 3, adjusted	Curfew extended from 9 p.m. to 6 a.m.; non-essential establishments to close by 8 p.m.; masks mandatory in public; alcohol sale banned; 22 additional hotspot areas declared—beaches, parks and pools in

[261] The alert level system was only explained later; however, using the later introduced levels terminology, this lockdown period corresponded to the strictest level of restrictions, level 5.

		hotspot areas to be closed. Limitations on gathering numbers (Davis 2020).
March 1, 2021	Alert level 1, adjusted	Most normal activity can resume, with precautions and health guidelines followed at all times. Limitations on gatherings. Curfew 12 a.m.–4 a.m. (Madisa 2021).
May 31, 2021	Alert level 2, adjusted	Curfew adjusted to 11 p.m. to 4 a.m. Non-essential establishments to close by 10 p.m. Gatherings limited to a maximum of 100 people indoors and 250 people outdoors. Venues too small to accommodate these numbers with appropriate social distancing restricted to 50 percent capacity (South African Department of Health 2021).

Source: “The impact of COVID-19 on industries without smokestacks in South Africa.”

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Acronyms and Abbreviations

BOO	build-own-operate
BOT	build-operate-transfer
BLT	build-lease-transfer
CPI	Consumer Price Index
DAA	debt assumption agreement
DHMI	General Directorate of State Airports Authority
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EU	European Union
FCCL	fiscal commitments and contingent liabilities
FX	foreign exchange
GoT	Government of Türkiye
HTP	Health Transformation Program
HPC	High Planning Council
IFC	International Finance Corporation
IFI	international financial institution
IMC	IMC Worldwide Ltd
KGM	General Directorate of Highways
MoH	Ministry of Health
MoT	Ministry of Transportation and Infrastructure
MoTF	Ministry of Treasury and Finance
MRG	minimum revenue guarantee
MW	megawatt
PPI	private participation in infrastructure
PPP	public-private partnership
SBO	Strategy and Budget Office
SPV	special purpose vehicle
TOR	transfer of operating rights
VfM	value for money
WBG	World Bank Group

Executive Summary

In order to maintain a strong gross domestic product (GDP) and employment growth, Türkiye needs to further improve infrastructure investments both in terms of quality and quantity. In this vein, Türkiye has embraced an ambitious agenda of large-scale infrastructure projects in the sectors of energy, transport, health, education, and others. Investment in public-private partnership (PPP) projects has gradually increased from a low base in the 1990s up to 2013. Since 2013, a significant increase in PPP contracts has been observed. The total value of PPP contracts concluded from 1986 to 2018 is estimated at US$140 billion (with an aggregate contract amount of 17.9 percent of 2018 GDP) for a total of 242 projects.

The country's PPP program developed through the procurement of a large number of major projects in a relatively short period of time to meet immediate and future demand for infrastructure services. The program was successful in leveraging private sector investments and in increasing the capacity of Turkish contractors and banks in delivering project-finance PPPs. PPPs in Türkiye were mostly implemented through four key contractual structures: build-own-operate (BOO), build-operate-transfer (BOT), build-lease-transfer (BLT), and transfer of operating rights (TOR). In terms of investment amounts, projects in the energy and transport sectors (with minimum revenue guarantee commitments) were predominantly BOTs and TORs, whereas all health sector projects (with availability payment commitments) were BLTs.

Among the relevant institutions involved in PPP processes, the ministries are the key entities to implement projects. Türkiye's PPP gateway process is characterized by an approval at an early stage of preparation (prefeasibility or feasibility) by the Presidential Office, for those projects that are subject to PPP approval under the legislation, when the structure and risk allocation are still to be fully assessed. All related project management cycles are under the responsibility of implementing agencies where the Strategy and Budget Office and the Ministry of Treasury and Finance have several roles depending on the review and authorization procedures articulated in the related PPP regulations. Since 1980, a fragmented PPP legislative framework has evolved together with the development of a large number of PPP projects, under various PPP models, and customized to specific sectors.

The main challenge for the Turkish PPP program remains a patchwork of legislation used to develop different projects while, at the same time, there were ongoing public consultations to develop a single, uniform law that would cover all types of PPPs in all sectors. At present, although it is possible to report the realized fiscal payments for infrastructure PPPs ex post, information for the whole portfolio is not aggregated, which makes it difficult to estimate and understand the extent of both direct and contingent fiscal commitments created by the PPP program in the medium and long term. Lack of independent and publicly transparent monitoring and evaluation of ongoing PPP projects has fuelled public criticism and concerns about feasibility and sustainability of some large-scale projects and PPP programs. The disclosure and transparency practices of the Turkish PPP market show that there is no formal framework of disclosure requirements for PPPs in the country.

Türkiye still faces issues regarding management of associated fiscal risks from PPPs. The key challenges include: i) the ongoing work on enactment of the uniform PPP law regulating the mandates of different central government institutions, procedures and workflows for different types of PPP models, and strengthening the central risk management function of the Treasury; ii) further development of quantification techniques to estimate the costs and risks of demand guarantees and debt assumption commitments; and iii) the absence of a ceiling on contingent commitments of public institutions other than the Treasury.

There are several policies and actions taken for fiscal risk mitigation of Türkiye's existing PPP commitments. The COVID-19 pandemic has led to the realization that the sustainability and resilience of the PPP program will require a paradigm shift, one where risks are re-evaluated, and appropriately shared and allocated between project partners with respect to unforeseeable future adverse events. In the short term, in relation to existing PPP contracts, a proactive and flexible infrastructure delivery approach, including providing additional government support for private sector stakeholders, is seen to be both covering the unmet demand via increasing the payment frequency to support liquidity, and enabling a sound cash flow to support the projects, including refinancing options. Moreover, revisiting capital investment planning (giving priority to the existing investments under construction) and re-prioritization of infrastructure sectors (i.e., healthcare and urban transport) and projects have also been observed.

2019 and 2020—when the Turkish lira's depreciation and the pandemic clashed—represented a full stress-test period for the Turkish PPP program. However, the government performed quite well. It honored all its commitments, not delaying a single guarantee payment, by using effective contract amendments and by prioritizing existing PPP contracts, when they were revised, in an effort to mitigate further accumulation of risk. Despite not having a single PPP law, the existing fiscal precautions and systems in place allowed the PPP program to withstand the crisis effectively; the most efficient instruments in this effort were the contract amendments in motorway and airport projects, and the restructuring of the financial features of the ongoing under-construction hospital projects to speed up the COVID-19 response.

10.1. PPP Experience

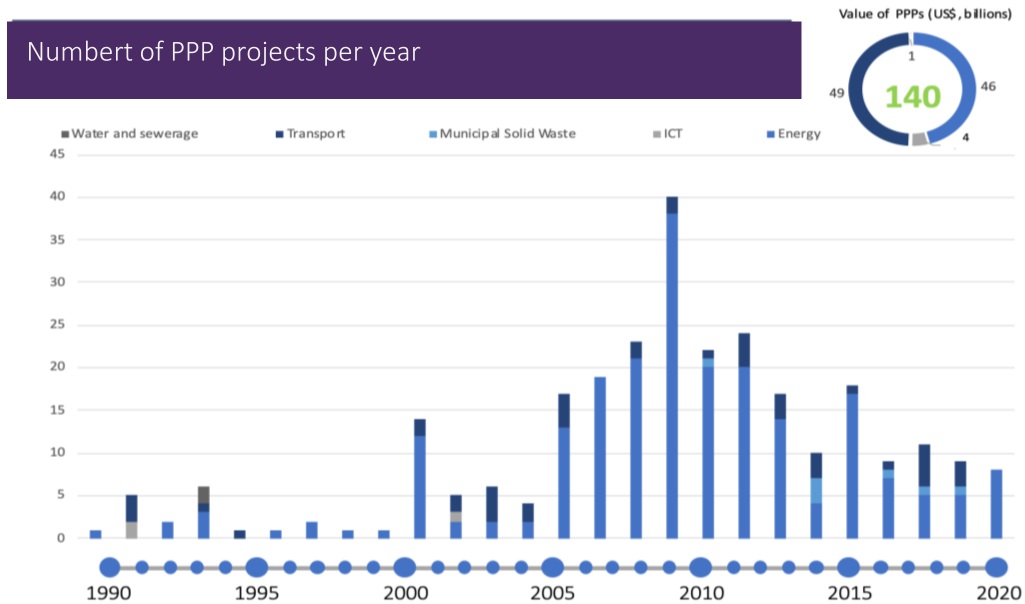
In order to maintain a strong GDP and employment growth, Türkiye needs to further improve infrastructure investments, both in terms of quality and quantity. In this vein, Türkiye embraced an ambitious agenda of large-scale infrastructure projects in the sectors of energy, transport, health, education, and others. Key objectives of the 11th (2019-2023) Development Plan emphasized that high-quality public-sector infrastructure investments would increase production capacity by stimulating private sector investments and would also contribute to a productivity-based growth dynamic.

Türkiye has delivered an impressive number of infrastructure projects through public-private partnership (PPP) modalities. The Turkish PPP program is well known internationally, given its reach across sectors, including power, transport, and modern health facilities. Türkiye has a long history of private participation in infrastructure, dating back to the Ottoman era's use of concession contracts with the private sector for delivery of public services. More recently, the liberalization of the energy sector in the 1980s was followed in the 1990s and 2000s by a second generation of projects in the transport and healthcare sectors. The country is also recognized in the World Bank's Private Participation in Infrastructure (PPI) database as one of the global leaders both in terms of PPPs in operations and a PPP pipeline under preparation and implementation. In addition to traditional PPP sectors, Türkiye has entered the third generation of PPP projects in new sectors such as railways, is assessing PPP models for irrigation, and urban and social infrastructure, and is exploring transfer of operating rights in existing infrastructures.

Investment in PPP projects has gradually increased from a low in the 1990s to 2013. Since 2013 a significant increase in PPP contracts has been observed. The total value of PPP contracts in Türkiye from 1986 to 2018 is estimated at US$140 billion (a contract amount of 17.9 percent of 2018 GDP) by the Strategy and Budget Office (SBO) in a total of 242 projects.[262] Based on the World Bank's PPI database, the number of projects in the main sectors breakdown can be seen in Figure 11.1.

[262] According to the Strategy and Budget Office website, in 2019 the motorways sector attracted 30.1 percent of all investments in PPPs, with US$23.6 billion going to 42 projects. This was followed by the airport sector, with an investment of US$19 billion (24.4 percent of all investments), in 18 projects. The next most active sector in terms of investment values was the energy sector, with US$18.2 billion spread across 99 (including mining sector) projects. The health sector came in fourth, with US$11.6 billion in 20 projects.

Figure 11.10: Sector Breakdown of Number of PPP Contracts



PPPs in Türkiye have been implemented through four key contractual structures: build-own-operate (BOO), build-operate-transfer (BOT), build-lease-transfer (BLT), and transfer of operating rights (TOR). The BLT model can be customized for certain sectors (e.g., health and educational facilities) for which the involvement of the state during the operational phase is crucial and the state is still under an obligation to provide public services alongside the privately run facilities.[263] In terms of investment amounts, BOT and TOR models are mostly used for projects in the energy and transport sectors, whereas all projects in the health sector are implemented as BLTs. Up to now, there has been no education project contracted via the PPP model. Based on use of these different PPP contract models, key sector specific developments can be summarized as follows:

Energy: Türkiye first opened its energy sector to private investments in 1984, and, after 2001, a new energy market law was established, launching energy market reforms. Several PPP models were used in the power generation sub-sector, namely BOT, TOR, and BOO. The BOT model was used for commissioning of 24 power plants, with total installed capacity of 2,450 megawatts (MW) from 1984 to 2001. These were supported by the government's PPP-specific investment guarantee policies, including such support mechanisms as take-or-pay, input and loan repayment guarantees, etc. Compared to the BOT model, the BOO model was laid out with a clearer legal framework and assumed transfer of the plant ownership to private investors. BOO projects were similarly supported by power purchase agreements with a pre-determined power price and standard terms and conditions. Because Türkiye depends heavily on energy imports, current energy policies set specific targets to diversify the energy mix and utilize more domestic resources to reduce dependence on imports.

Motorways and Bridges: The Ministry of Transport and Infrastructure (MoT) launched an ambitious PPP program to implement large-scale motorway projects, including upgrading existing motorways to improve the level of service and reduce accidents and mortality rates. PPPs for motorways and bridges were mostly delivered through the BOT model by the MoT's General Directorate of Highways. Government support mechanisms for the PPP program in the sector include demand and/or traffic guarantees, exemptions from paying value-added taxes and other taxes, and debt assumption for early contract termination.

Airports: In the Turkish airport sub-sector, since the mid-1990s, the General Directorate of State Airports Authority (DHMI), a state-owned enterprise, has made extensive use of the BOT model for greenfield projects and

[263] Herguner Bilgen Ozeke Attorney Partnership. 2016. Newsletter. Winter 2016.

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brownfield projects along with the TOR model for development of airport terminal infrastructure. The DHMI has completed construction of six terminal buildings in Istanbul, Ankara, Izmir and Antalya by using the TOR model. More recently, the DHMI has used the BOT model to develop greenfield airports in Zafer and the Third Istanbul Airport. Several airport projects are planned to be traditionally procured as well.

Ports: The PPP program in the ports sub-sector was largely successful, with active interest from investors and financiers. Port projects were mostly developed through a combination of TOR and BOT contracts, for a total of 18 projects under operation from 1984 to 2018. Under the TOR structure, the project's risk profile is decreased by allowing investors to implement capital expenditure programs while obtaining operating rights for the brownfield assets with established revenue sources denominated in foreign currency. Under the BOT structure, construction of infrastructure is financed by the public sector whereas superstructures—through private financing.

Healthcare: The PPP model is widely used in the Health Transformation Program (HTP) where, since 2003, the ultimate aim has been to expand access to universal healthcare in Türkiye. Under the HTP, Türkiye launched an ambitious PPP plan, which initially included more than 30 health campuses with a total bed capacity of 41,538. There are currently 18 PPP healthcare projects (11 in operation) already awarded under BLT contracts with a total investment of approximately US$12 billion. Overall, under the HTP there have been a total of 31 BLT projects in different stages including design, tendering, and contract signature. However, since 2019, 10 of the selected city hospitals at the design and approval stages were amended to be procured traditionally rather than as PPPs. These 10 projects were included in the Turkish Annual Investment Program for the year 2020 within the category of "projects to be implemented after 2020" and include Antalya, Aydin, Denizli, Diyarbakir Karapinar, Ordu, Rize, Sakarya, Samsun, Istanbul Sancaktepe and Trabzon.[264]

Municipal Sector: Municipalities realize most of their PPP projects under State Tender Law No. 2886 ("Law No. 2886") with similar BOT and/or land value capturing contract models. In practice, however, most municipal PPP projects are structured to involve the lease of municipal land to a private company in exchange for the commitment to construct a facility on this land and to operate it for a certain period of time. There have also been several PPP projects in solid waste and wastewater management developed under the BOT Law in the last decade.

Overall, the country's PPP program has allowed for the procurement of many large projects in a relatively short period of time to meet the immediate and future demand for infrastructure services. The program has been successful in leveraging private sector investments and in increasing the capacity of Turkish contractors and banks in delivering project-finance PPPs. The size of the Turkish PPP program and the large size of the projects themselves also attracted international investors, lenders, and supply chain contractors. The projects have generally been delivered on time with reduced construction periods, especially in the motorway sub-sector, compared to the timelines observed for traditionally procured motorway projects in the last two decades.

10.2. Legal Framework and PPP Approval Process

10.2.1. PPP Governance, Institutional and Legal Frameworks

Of the relevant institutions involved in implementation of PPP processes, the ministries are the key entities in the Central Administration. Pursuant to the Turkish Constitution, the management of the state is divided into two principal categories, namely the central and the local government.[265] For local governments, municipalities are responsible for services at a local level with limited economies of scale and regional effects (for example, solid waste disposal, maintenance of large roads and avenues, wastewater, maintenance of streets, and small parks,

[264] SBO. 2020. Annual Investment Program. http://www.sbb.gov.tr/wp-content/uploads/2020/03/2020_Yatirim_Programi.pdf.

[265] The types of municipalities in Türkiye are set forth by Municipality Law No. 5393, Metropolitan Municipality Law No. 5216, and Law. No 6360. Metropolitan municipalities are responsible for the delivery of services assigned by law and their borders are identical to the province in which they are located. Metropolitan municipalities have been regulated under Metropolitan Municipality Law No. 5216 since October 2004.

etc.). This principle has the following implications for PPP transactions sponsored by ministries and other central administration entities:

- Budgets of public entities within the central administration are operated on a consolidated basis, as opposed to each separate agency or department freely operating its own budget.
- Any revenues received by these entities go directly to the state Treasury.
- Assets of these entities constitute "state assets" allocated for the purposes of fulfilment of state functions, and those assets cannot be subject to any attachment or seizure procedures.

In terms of institutional arrangements at the national level for PPP project planning, structuring and approval, Türkiye has neither a general PPP law nor a central governmental PPP authority. However, although not identified as a central PPP authority, the Strategy and Budget Office (SBO) and the High Planning Council (currently re-organized under the Presidential Office) have duties that relate to initiation, structuring and approval of PPP projects, depending on the nature of the sponsoring entity and the type of PPP transaction being used as defined in the related PPP legislation.

Institutional arrangements for budgeting in relation to PPP projects are as follows: The objectives set out in the Development Plans, Medium-Term and Annual Programs[266] are reflected in the budgets of public institutions. Accordingly, those budgets are highly dependent on the decisions made by the Ministry of Treasury and Finance (MoTF), SBO and the president (and the Presidential Office). The budget procedure starts with the president's acceptance of the Medium-Term Program, and the Medium-Term Financial Plan prepared by these central agencies.

As for the public investment management framework for PPPs, each procurement agency in Türkiye is responsible for identification, selection, and prioritization of projects. Project prioritization, however, could be biased towards smaller project sizes and certain modalities by public debt limits, accounting rules, and investors' appetite for certain projects. In effect, the use of PPP schemes opens a new window of opportunity to expand investments that could not be implemented because of budget issues.

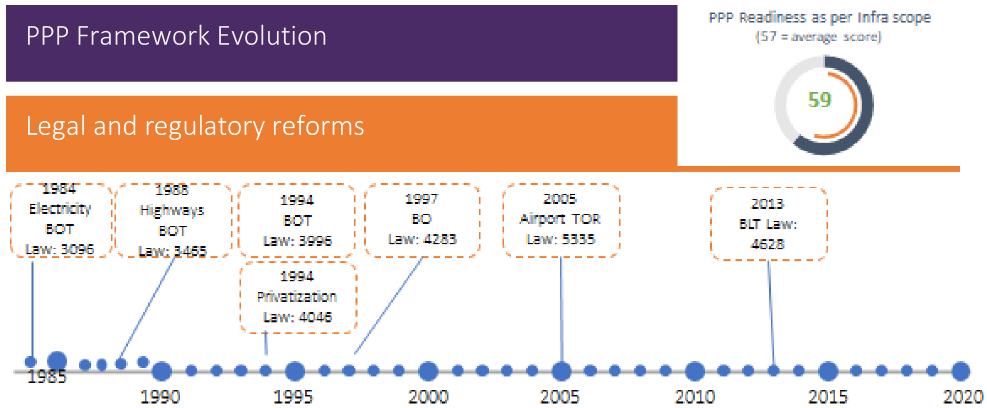
A fragmented PPP legislative framework has evolved with Türkiye's delivery of its large number of PPP projects, under various PPP models, and customized for specific sectors. Since the 1980s, following the private sector boom and the enactment of many laws and regulations, Türkiye has made several amendments to its Constitution to provide a functioning legal framework under which many PPP transactions have taken place. Concession Law No. 576 of 1910, until the 1980s, served as the legal basis for the involvement of private entities in the delivery of infrastructure projects and services. The Concession Law, consistent with the Turkish civil law tradition, codified and regulated the delegation of rights to provide public services to private entities by relevant administrative bodies through concession contracts, which are subject to the administrative law.

Since the 1980s, the legislative agenda has focused more on creating private law-governed contractual schemes for PPPs, which allow for more flexibility and a balanced contractual arrangement between private and public entities. Some acts date back to the 1990s and even to the 1980s, e.g., the Privatization Law № 4046 of 1994, which applies, in particular, to private sector selection procedures, and the BOT Law № 3996 of 1994. A stream of sector-specific laws that are applicable directly to private sector participation in infrastructure in the electricity sector has been developed since 1984, in the roads sub-sector since 1988, and in the airports and ports sub-sectors since 2005. In the health sector, the Law on Construction, Renovation and Operation of Facilities by the Ministry of Health through the PPP Model ("BLT Law," or Law № 6428 of 2013) regulates a number of possible PPP models for Ministry of Health (MoH) PPP applications. In addition, secondary legislation is applicable to PPPs

[266] Medium-Term Programs include macro policies, principles, and economic figures as targets and indicators, in line with the development, strategic plans and requirements of the general financial conditions, and are published in the Official Gazette.

in select sectors as well. A historical background information on the PPP legal framework is summarized in the Annex 10 A.

Figure 11.2: PPP Framework Evolution



Although initial legislative attempts to address healthcare BLT projects were made as early as 2005, it was not until 2010 that the first tender was held. During these five intervening years, work on the legislative framework continued and resulted in the issuance of the BLT Law (Law № 6428) for healthcare sector projects. This law was specifically set up to define the legal basis for healthcare BLTs in 2013. The BLT Law addresses legislative necessities experienced since the actual launch of the BLT projects in 2010 and the outcomes of a number of lawsuits initiated against the decisions made during the tendering stage for some BLT projects. The BLT Law is unique in the sense that compared to other PPP-related legislation in Türkiye, it makes more references, albeit in a very general manner, to the lenders' step-in rights and their ability to reach an agreement with the administration to take over projects that face problems.[267]

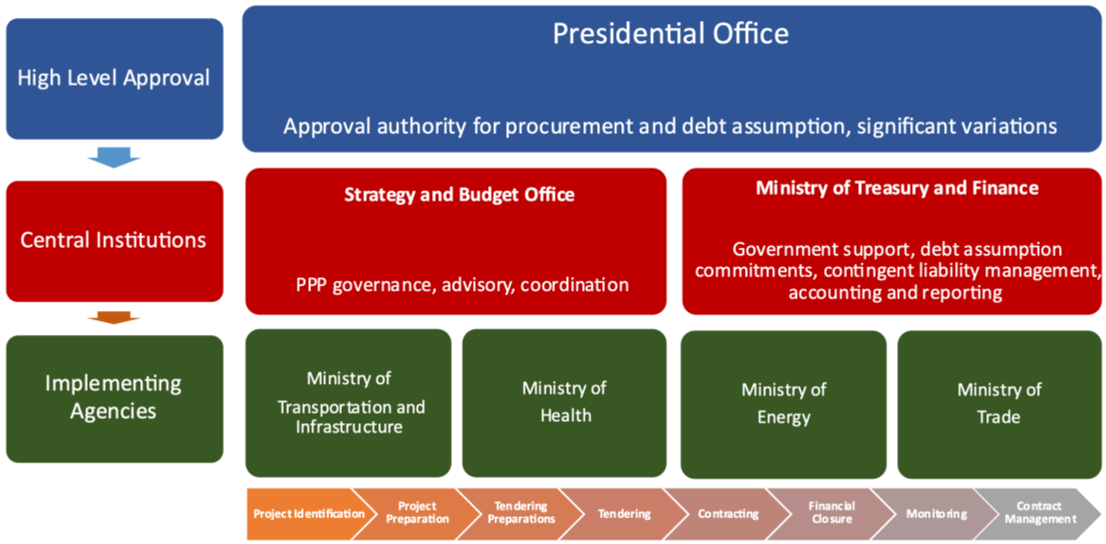
Though a central PPP framework law has been under discussion since 2007, Türkiye does not currently have a central PPP law despite the ongoing effort in the central government, since 2016, to enact one. Because of the dynamics of the PPP market in Türkiye, it is believed that a tailor-made legal framework is needed for sector-specific PPP governance arrangements, especially in the social and municipal services sectors in order to have more standardization of procedures and provide guidance to agencies that have limited experience in PPP project preparation and management. According to the recently published Economic Reform Program (March 2021), the PPP Framework Law preparations are targeted to be finalized by the end of 2021, under the supervision of the SBO.[268]

10.2.2. PPP Approval Process

The Turkish PPP gateway process is characterized by an approval at an early stage of preparation by the Presidential Office. All related project management cycles are the responsibility of implementing agencies where the SBO and MoTF have key roles depending on the review and authorization procedures articulated in the related PPP regulations. For the candidate projects for PPP approval, the procuring agency should prepare a feasibility study to address the key project features, including the financing and funding structure and risk allocation (referring to such critical risks as cost estimates, demand volumes, social and environmental issues, and amount of government support, etc.). (See Figure 11.3.)

[267] Herguner Bilgen Ozeke Attorney Partnership. 2016. Newsletter. Winter 2016.
[268] MoTF. 2021. Economic Refrom Program. https://ms.hmb.gov.tr/uploads/2021/03/Ekonomi-Reform-Takvimi.pdf.

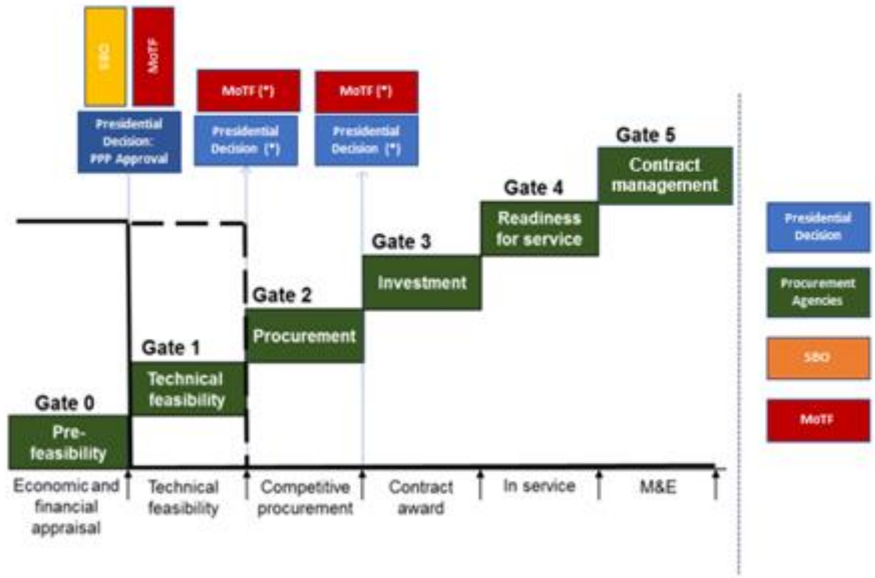
Figure 11.3: PPP Governance and Key Roles



***Source*: IMC Worldwide.**

There is no further approval from the Presidential Office or the fiscal authority, unless the project deviates substantially from its original concept in the BOT and BLT models after the initial PPP approval. The only exception is related to projects where the MoTF debt assumption commitment is provided. According to Law № 4749 and its regulations, a draft contract is reviewed by the MoTF in relation to clauses directly impacting the debt assumption scheme and, moreover, a Presidential Decree is required for debt assumption authorization. The draft contract is further reviewed by the MoTF before signing in case of any further changes during the contract negotiations. For the final gateway, the MoTF is also involved in financial negotiations and leads negotiations around documentation, of which the debt assumption agreement is a part.

Figure 11.4: PPP Gateway Process



Note: * For a project which is subject to MoTF debt assumption commitment.

Fiscal oversight responsibilities in Türkiye are divided between the SBO and the MoTF and are limited to the earliest project preparation phases, providing greater autonomy to procuring authorities. The MoTF does not have overall control of assessment, approval and regulation of availability payments and minimum revenue guarantees, etc., which are directly provided by procuring authorities. Therefore, there is no centralized view of the overall cross-sectoral fiscal impact at the portfolio level from PPPs coming from different sectors. There are several estimates and forecasts presented in feasibility reports where the revenue guarantees or availability payments are referred to, but in the decision-making process, the MoTF does not have an official role to approve the level of support provided and related fiscal commitments. The only exception is the Treasury debt assumption scheme, which is provided directly by the MoTF and the MoTF is required to review the draft contract before and after a tender; the MoTF is also involved in finalizing the financing agreement with creditors (at financial close), which also requires the approval of the president. This limits the understanding of all the fiscal risks and commitments associated with the overall PPP portfolio.

10.2.3. PPP Government Support Mechanisms

Under the BOT Law, public authorities are entitled to offer different payment support and credit enhancement mechanisms depending on the needs of specific projects. Public authorities, in general, may: i) make direct payments as unitary charges, ii) make contribution payments either to support user fees, or in the form of shadow tolls, or iii) extend demand guarantees. It is also a statutory requirement for project agreements to include a mechanism articulating a revenue sharing mechanism between the public authority and the special purpose vehicle (SPV) in cases where demand for and/or revenues from goods and services exceed the defined level in the contract. Under the BLT Law in the healthcare sector, depending on the context of a project, the private sector receives payments comprised of availability payments for the facility and service payments for the provision of non-clinical services. Payments are made from the revolving fund of the MoH in addition to allocations from the state budget.[269]

The Treasury Investment Guarantee mechanism (commonly used until 2001) is included in foreign financing regulations specifically for PPP projects (Law 4749). It is defined as "guarantees extended by MoTF in accordance with and restricted to relevant law provisions as to BOT, BO and TOR models." According to Law 4749, in addition to demand guarantees extended by public authorities, under the BOT structure, the MoTF may extend the following investment guarantees (that had been used in the first era of electricity generating projects in the 1990s) provided that the tender specifications and project agreement so enable:

- Against the payment obligations of public authorities that undertake to pay for produced services
- For the payment obligations of public institutions arising under relevant contracts should they fail to provide the input material committed under the respective contract
- Against the financial commitments of funds and public institutions according to the project
- For the repayment of bridge loans
- In favor of lenders for payment obligations of public institutions and their companies, their subsidiaries, or local administrations, which assume foreign credits in the event that the enumerated entities buy a project and/or SPV's shares in accordance with the provisions of the project agreement.

Although there are no legal and regulatory obstacles contrary to the extension of Treasury Investment Guarantees, the MoTF has not provided any investment guarantees since 2001. Up to 2001, these guarantees were extended as PPP investment guarantees for different obligations of public institutions in the first 17 energy projects. Instead, currently, each procurement authority is providing demand risk coverage guarantees like minimum revenue guarantees or tariff regulations, etc., for their PPP projects. It can be seen that this policy shift represents a decentralization of the PPP guarantee support mechanism to individual procurement authorities.

To improve credit enhancement tools for international financers, since 2012, as per the Public Finance Law (Law № 4749) the MoTF is assigned to assume foreign debt in the case of an early termination of certain PPP projects. Under such debt assumption commitment agreements, the MoTF can agree to assume foreign debt obligations owed by SPVs to their senior debt providers in circumstances where the underlying project agreement is terminated prematurely. To date, the MOTF has extended debt assumption commitments for transport projects, however, none of the healthcare BLT projects have benefited from the MOTF debt assumption commitments. The Debt Assumption Regulation applies to:

- BOT projects with a minimum total investment amount of TRY 1 billion (about US$116 million) tendered by:
    - Granting authorities under general budget, a.k.a line ministries, or
    - Special budgeted authorities, for example.
- BLT projects in healthcare and education sectors with the minimum investment amount of TRY 500 million (about US$58 million).

[269] Availability payments are denominated in Turkish liras and payable to the SPV. They are subject to annual revision according to the inflation rate at the beginning of each year. In addition, if the calculated increase in excess of the buying rate of the Central Bank of Türkiye in the current basket is larger than the arithmetic mean of the Consumer Price Index and Producer Price Index, then the availability payment formula is multiplied with a correcting factor to mitigate the currency exchange risk.

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Table 11.6: PPP Motorway Projects under Treasury Debt Assumption

Project Name	PPP Model	Debt Assumption Agreement Year	Loan Amount (US$, millions, equivalent)
Eurasia Tunnel	BOT	2012	960
Northern Marmara Motorway (Odayeri-Paşaköy inc. Bridge)	BOT	2014	2,318
		2016	420
Gebze-Orhangazi-İzmir Motorway (inc. Bridge)	BOT	2015	4,956
Çanakkale-Malkara Motorway	BOT	2018	2,800
Ankara-Nigde Motorway	BOT	2018	1,311
Northern Marmara Motorway - Kurtköy-Akyazı Section	BOT	2019	2,840
Northern Marmara Motorway- Kınalı-Odayeri Section	BOT	2019	1,595
TOTAL			17,200

* As of December 31, 2019.

The debt assumption commitment guarantee allowed the government to convert implicit contingent liabilities associated with early termination risk to explicit ones. This is also seen as the added benefit of reducing the moral hazard since the early termination risk is monitored closely. On the other hand, early termination is typically costly for both parties, and is a last resort measure with a remote probability of occurring—only after other avenues of resolving a conflict have been exhausted.[270] Therefore, the government has a stake in tailoring the debt assumption payments in such a way that debt providers always have an interest in keeping the contract alive and services operational, inducing them to step in before issues of poor performance lead to default by the private party. Since the initiation of the Treasury debt assumption scheme, no actual early termination event has occurred. To manage the associated contingent liabilities, the MoTF sets the rules and conditions for extending this type of guarantee and provides for certain credit risk management measures. The key measures are summarized below:

- *Scope and coverage.* The first assumption limit specified under the Debt Assumption Regulation relates to the amount of debt that the MoTF can assume. As per the regulation, before the December 2019 amendment, the MoTF could commit to assume:

    - Eighty-five percent of the senior facility, in cases of termination of concessions due to the SPV's default; and
    - One hundred percent of the senior facility, in case of defaults other than ones that were the SPV's fault.

    However, due to negotiations and existing project discussions, it has been observed that during financial close, lenders tend to avoid taking on the risk of the uncovered portion in case of SPV default (15 percent of the senior loan) and to request further securities from sponsors (e.g., seen in the existing transactions of Nigde-Ankara Motorway Project and Canakkale-Malkara Motorway Project, among others). Following these discussions, the MoTF decided to halt the partial assumption structure and enacted new legislation in

[270] World Bank Group. 2014. "How Do Countries Measure, Manage, and Monitor Fiscal Risks Generated by Public-Private Partnerships?" World Bank Group Policy Paper, 2014. https://openknowledge.worldbank.org/bitstream/handle/10986/20375/WPS7041.pdf?sequence=1&isAllowed=y.

December 2019, increasing the equity contribution requirement from 20 percent to 30 percent for PPP projects benefiting from a MoTF debt assumption commitment.

- *Eligibility.* As per the Debt Assumption Regulation, the following eligibility requirements must be met:
    - The project agreement annexed to tender specifications should clearly provide for the debt assumption and set out the necessary provisions mentioned in the Debt Assumption Regulation;
    - The MoTF's no objection opinion must be obtained for the extension of the debt assumption both prior to and after the tender;
    - The granting authority (if a special budget agency) should not have any overdue liabilities to the MoTF; and
    - The assumption should be that within the debt assumption undertaking, the limits are determined in the relevant year's budget law.

- *Payment methods.* The MoTF has an absolute right to decide whether to pay the assumed amount following the original debt repayment schedule (assumption) or to make a bullet payment (debt payment). Debt assumption agreements cannot provide anything to the contrary. Moreover, a partial payment can also be made. In addition, in case the MoTF elects to make a bullet payment, the date of such a payment cannot be shorter than two months, starting from the notice of the MoTF to the creditors in this respect.

- **Annual undertaking limit for debt assumption:** An annual limit is determined in every year's budget for debt assumption commitments of the MoTF. For example, in 2020, the MoTF might have assumed a total debt of US$4.5 billion.[271] This limit does not apply to outstanding payment obligations stemming from these undertakings. Therefore, the MoTF is obligated to pay the actual amounts due under the debt assumption agreements if the underlying concessions are terminated without being subject to any cap.

10.2.4. International Support in PPP Development

Due to limited public resources and the need for the private sector's innovative approach, Türkiye attaches great importance to the involvement of foreign project partners, including international financial institutions (IFIs), in infrastructure projects. In the development of the Turkish PPP market, IFIs' involvement also played a key role in improving capacity to do PPPs in different sectors to various extents based on observations of a broad range of IFI activities.

International Finance Corporation (IFC) plays an important role in financial development of the Turkish PPP market. Key areas of IFC support are structuring and implementation, investor marketing, transaction closing, and environmental and social sustainability procedures. Moreover, IFC Advisory Services in PPPs is aiming to help the Government of Türkiye (GoT) to set the conditions to attract private sector participation and investments and to provide better quality and more efficient public services by drawing on the resources and expertise of the private sector.

The European Bank for Reconstruction and Development (EBRD) has also played an important role in upstream support for value for money (VfM) analysis and financing of PPPs in Türkiye. The EBRD has been a lead financial lender and intermediary at the project and program level, supporting a constructive policy dialogue environment with the MoH and other policy partners and providing technical support in project preparation, VfM assessments and project implementation addressing international practices. Following the EBRD's involvement in the first phase, the IFC and other related multilateral development banks (MDBs) also increased their interest and played a dominant lender role compared to commercial lenders. The EBRD approved the "Hospital Facilities Framework"

[271] Türkiye, 2020 State Budget Law, Article 12-3.

in 2014, in order to make available up to €950 million (with an increase from €600 million) extended to debt or equity financing for the EBRD's own account for up to eight hospital facilities management projects.

10.3. Analysis of Projects

10.3.1. Identifying and Evaluating PPP Projects

During 2010-2020, Türkiye's fiscal space was significantly constrained while demand for physical and social infrastructure continued to rise. In this context, the government authorities consciously chose a PPP structure to finance infrastructure investments without always evaluating efficiency improvements or undertaking a proper due diligence analysis. PPPs are now mostly being used to leverage private financing for infrastructure and for carrying out the needed infrastructure investments with minimal or no upfront investment from the public sector.

Most PPP projects follow the process outlined for BOT projects, even if they present a different PPP modality. According to BOT Law 3996, the procuring agency intending to implement a PPP project should seek the approval of the Presidential Office as a Presidential Decision. PPP project feasibility reports are evaluated by the related units in the SBO and MoTF. There are no set evaluation criteria in the legislation. Pursuant to article 5 of Regulation for Law 3996, each procuring authority must submit its PPP project proposal to the SBO. This step is a coordination point rather than a stage of approval. A formal approval process starts with the submission of the feasibility report, technical analysis and other documents by the procuring agency to the SBO.

The project is assessed via a feasibility study, which should show a discussion on the advantages of a PPP model over a traditional public procurement method. The elaboration on the qualitative and, if possible, quantitative Public Sector Comparator and VfM analyses are also required in the legislation, however, there is no written publicly available guidance on how to assess and analyze the VfM. The SBO evaluates a project with a view toward ensuring that a project will add value economically, financially, and socially, and is in line with sectoral, regional, and other policies. The SBO also consolidates reviews from the MoTF related to fiscal, financial, and economic assessments. Based on the analysis carried out by the SBO and MoTF, the SBO prepares a comprehensive review and submits it to the deciding authorities, which approve the project to be included in the pipeline. If the SBO finds the technical preparations insufficient, it may ask for revisions in a feasibility study.

VfM assessments are weak and there is a need for capacity building in procuring agencies. Proper implementation of VfM assessments was started for the management of hospital facility PPP projects with the EBRD initiative. In healthcare projects, where the HTP is responsible for delivering the new hospital facilities in a cost-effective manner and at a high service standard for the public, each project under the program is intended to deliver a better value from an all-in life-cycle cost perspective when compared to the public sector alternative, providing a high VfM to the MoH. The EBRD provided technical assistance to develop the VfM capabilities of the MoH and other related agencies.

PPP projects were tendered with a limited level of preparation, lacking comprehensive technical, economic, legal, and financial feasibility assessments. There is room for improvement in Türkiye for better preparation of projects for improved structures. Different agencies have different qualities of preparation and there is no standardized level of preparation. Transaction advisory services from the consultancy market have also not been contracted by public agencies in Türkiye so far. As observed in the hospital PPP projects, the limited information provided during the tender stage has resulted in protracted negotiations during and post-tender stage, and higher risk perception by bidders, requiring a significant level of support from the public sector to make projects bankable.

Because of the long-term nature of PPP contracts, effective contract management and close monitoring during the operational period are important factors for evaluating the efficiency of a PPP modality. For example, BLT projects providing healthcare services are quite different from PPPs in other sectors, because the delivery of quality healthcare services requires more qualified employee profiles, constant improvements, and introduction of innovative enhancements. For that reason, specifying outputs and ensuring continuous improvement of services are crucial during the formation phase. Key performance evaluation measures are important to link to improved productivity and make explicit productivity efficiencies.

10.3.2. PPP Fiscal implications

The MoTF plays a crucial central agency role in direct and contingent liability management. In a PPP structure, procurement agencies are considered the sovereign entities to be solely responsible for making government payments under a project. It is crucial to monitor and follow the budget preparation and payment policies as well as actual budget allocations to ensure that agreed budget payments are made on time by each procurement agency.

Türkiye has an increasing level of direct and contingent liabilities that have arisen due to its PPP portfolio. PPPs generate direct liabilities (which are fixed payment commitments) or contingent liabilities. Most of the risks arise from contingent liabilities because of their uncertain nature. The triggers for risk realization are usually such key risk parameters as the number of passengers in airports, traffic on roads and bridges, and service availability (e.g., imaging services, laundry services) in hospitals, etc.

There are other types of contingent risks that are more difficult to assess in the portfolio. In projects with early termination compensation payments (MoH hospital projects), debt assumption guarantee payments (MoT motorway projects) and loan guarantees (used in the past for energy projects), there are also risks related to government actions, force majeure, and poor performance of a project company that can result in early contract termination. The definition of these risks and their mitigation are regulated in a PPP contract and other supporting agreements. The optimization of public financial resources in support of project bankability, particularly for mega projects, requires detailed economic and financial appraisal to evaluate different scenarios and possible solutions to create VfM for users and taxpayers.

Further strengthening of contingent liability management is needed in Türkiye**.** According to the International Monetary Fund (IMF), the key areas are: i) enhancement of investment prioritization procedures with a strict selection procedure for PPP projects that provides VfM even under adverse macroeconomic scenarios; ii) establishment of comprehensive PPP legislative and institutional frameworks with strong central oversight and a centralized database; and iii) comprehensive and regular fiscal risk reporting (IMF 2018). The SBO and MoTF are working to develop the PPP system to address these obstacles. The Article IV IMF review in 2021 also highlighted that fiscal structural reforms would support consolidation and mitigate fiscal risks in Türkiye. Furthermore, ongoing efforts to strengthen oversight and management of PPPs should be finalized, including by publishing a monitoring report and finalizing the new PPP law. It was also underlined that it would be important for this legislation to ensure that PPPs are fully integrated with the overall budgetary process, including project appraisal and authorization (IMF 2021).[272]

10.3.3. Fiscal Risk Management Framework

In 2002, Türkiye implemented structural reforms in the area of public financial management, including debt and risk management functions. As part of this effort, a primary law on Public Finance and Debt Management (Law 4749) was enacted whereby existing guarantees were regrouped under Treasury repayment guarantees for external loans, Treasury investment guarantees for PPP projects, and then, in 2012, Treasury debt assumption commitments were added. Various measures were initiated to manage the risks arising from these Treasury guarantees. Meanwhile, for PPP projects benefiting from Treasury repayment and investment guarantees, which have been used since 2001, there is currently a well-established evaluation framework. However, the same does not apply to projects that received different support from line ministries, public companies, or sub-nationals for managing the demand and revenue risks. This may lead to the country losing sight of the overall fiscal risk exposure

[272] IMF. 2021. Türkiye: Staff Concluding Statement of the 2021 Article IV Mission https://www.imf.org/en/News/Articles/2021/01/25/mcs012521-Türkiye-staff-concluding-statement-of-the-2021-article-iv-mission

coming from PPPs, which might have a significant impact on the central government budget. This section will list the key fiscal risk management principles, tools, and policies applied in Türkiye.

The MoTF plays a critical part in ensuring affordability of the government's PPP program. In PPP projects, a government guarantee constitutes a contingent liability, for which there is uncertainty as to whether the government may be required to make payments, and, if so, how much and when it will be required to pay. However, there is a need for the MoTF and other implementing ministries to build their capacity to understand all the risks associated with PPP contracts. Although the MoTF is primarily concerned with fiscal risk, other PPP project risks and the PPP program governance risks, in general, can increase the probability of and impact on fiscal risk specifically considering the minimum revenue guarantee and availability payment commitments.

Türkiye caps the annual flow of guarantees. In attempts to limit their fiscal risk and exposure, many countries establish ceilings either on the stock or the flow of fiscal commitments, or both. Türkiye limits the nominal amount of guarantees committed annually and also puts a ceiling on foreign sovereign borrowing. The enforcement of these ceilings requires a sound database of information about the stock and recent flows of the new guarantee issuances in the internal MoTF assessments. In Türkiye, three annual limits are prescribed each year in the budget laws: i) a single limit covering external debt repayment guarantees provided to state banks, SOEs and local government; ii) a single limit for PPP debt assumptions (as one of the PPP de-risking instruments); and iii) a limit on on-lent domestic debt. A separate yearly limit (US$3 billion for 2014 for the first time) is defined for the debt assumption commitments and this limit is about US$4.5 billion as of 2021, or 0.56 percent of GDP.

Risk-based guarantee fees and risk account reserves are applied in the Turkish fiscal limits and contingent liabilities (FCCL) framework; however, these tools do not cover PPPs. Considering a risk-based fee can moderate the demand for guarantees and force greater discipline in their use (OECD 2013). In Türkiye, risk-based and upfront fees are linked to expected losses but capped at 1 percent of the nominal amount guaranteed as defined in Law No 4749. However, these fees apply only to the traditional Treasury repayment guarantees, not PPP-related guarantees. Moreover, the Turkish Central Bank maintains a "risk account" for payments under on-lending and repayment guarantees. This risk account, however, does not cover any PPP-related commitments, either.

Clear PPP contract clauses help control for possible contingencies. In Türkiye, PPP contracts should detail an itemized list of default events for the private sector partner, which include major events like bankruptcy or insolvency of the partner, failure to reach milestones, service delivery failure, fraud, and change of ownership without consent, etc. A similar itemized list of the contracting authority events of default is also included to cover major events like non-payment of sums due (availability fee), breach of contractual obligations that impede the ability of the private partner to perform, and failure to grant project clearances, etc. At default, clearly defined provisions for a cure period, mechanism of conflict resolution, termination process and lender step-in rights guide termination procedures. The clarity of the important contract provisions guiding the termination process helps control for and minimize unpredictable payments related to PPP contract termination.

10.4. Reporting Requirements

10.4.1. Fiscal Commitments in the Budget, Medium-Term Framework, and National Accounting

In Türkiye, according to the public financial management legislation, public accounts should ensure that all expenditures, guarantees, liabilities and assets of the public administrations, and transactions having financial consequences or causing a decrease or increase in equity must be recorded. Public revenues and expenditures should be indicated in the accounts of the fiscal year of their accrual. Budget revenues should be booked in the year of collection and budget expenditures in the year of payment. In 2015, the MoTF published the General Communiqué on Accounting Treatment of PPP Projects (Communiqué) which is applicable to PPP projects conducted by all public authorities, except state-owned enterprises (SOEs). As per the Communiqué, commitments, realizations, cost updates due to escalations, acquired assets, and liabilities undertaken by granting authorities must be monitored and regulated by the Communiqué. According to the Communiqué, the total amounts under demand guarantees, purchase guarantees, and debt assumption commitments are monitored in off-balance sheet accounts, whereas any accrued payments under these arrangements must be taken to on-balance accounts and be linked to the budget in the year of realization.

The Communiqué also requires granting public authorities, which extend debt assumption commitments, to monitor the disbursements and repayments of foreign financings for specific off-balance sheet projects. Once an underlying concession is terminated, the PPP undertakings of public authorities are linked to the relevant budget account depending on the phase of the project under the responsibility of each public agency that commits to a PPP supporting instrument. For example, in the case of debt assumption, it is under the account system of the MoTF, whereas in the case of a minimum revenue guarantee (MRG) for a motorway, it is under the accounts of the General Directorate of Highways (KGM, in Turkish).

The way the payment of a realized contingency is handled in Türkiye can be demonstrated with an example from the transport sector, where demand guarantees have been issued for PPP projects before. There, once a risk triggering condition is met—for example, the number of vehicles is less than the guaranteed minimum traffic volume—the actual payment obligation under the MRG to a PPP project company is transferred to the KGM's next year's sector budget, thus being converted to a direct liability of the KGM. Although this method might protect the current year's budget from an immediate untimely and unknown payment, if the contingency starts realizing consistently, it would hinder the medium-term planning ability and long-term fiscal outlook. At present, although it is possible to report ex post on realized fiscal payments for infrastructure PPP projects, the information for the portfolio as a whole is not available, which makes it difficult to estimate and understand the extent of fiscal commitments created by the PPP program in the medium and long term.

BOT contracts are accounted as service concessions. The assets in BOT arrangements under which i) services are provided by a private party, ii) prices of such services are controlled by public authorities, and iii) assets are to be reverted to public authorities at the end of the concession period are monitored in the tangible assets' accounts. Such classified assets are registered based on the fair value. In case the SPV is entitled to collect user fees or to earn revenues from other revenue generating assets, then in addition to the registry of the tangible assets, a liability registration is made for the total amount of revenues that are left to a private party by the public authority.

BLT contracts are treated as financial leases for budgetary purposes. Accordingly, completed healthcare facilities are recorded in the MoH's on-balance accounts as tangible assets with a value equal to the lesser of i) the fair value of such an asset, or ii) the net present value of availability payments. Any costs in relation to availability payments are not recorded in liability accounts but are directly reflected in the account classification as a budget expense.

The Treasury debt assumption regulation outlines the treatment of payments and necessary rules. The assumed debt amount has to be recorded as a capital loss in the responsible ministry's or institution's budget at the time of the project termination and, if undertaken by the MoTF, collected according to the rules defined in the assumption agreement. For projects not benefitting from Treasury guarantees, each public institution or line ministry may or may not allocate appropriations in the annual budget, depending on the agreement with the project SPV and budget practice. Therefore, information on the amount of provisions for projects without a Treasury guarantee is spread throughout different accounts and is often difficult to track.

No specific provisioning is envisaged for payment requirements under the PPP projects except for the risk account maintained by the MoTF. In Türkiye, the only the risk account that exists and is established is the one to cover the payment obligations of the MoTF under Treasury guarantees and unforeseen payments in terms of risk management. The amounts in this account may be utilized by the MoTF to make urgent payments under debt assumption agreements if the concession is terminated. This account is funded with budget allocations, on-lending fees payable to the Treasury stemming from conventional lending arrangements, guarantee fees, returns of payments from the account, and interest accrued on the fund.

10.4.2. Disclosure of Information

The disclosure and transparency practices in the Turkish PPP market seem to indicate that there is no disclosure framework for PPPs in the country. Lack of independent and publicly transparent monitoring and evaluation of ongoing PPP projects has fuelled public criticism and concerns about the feasibility and sustainability of some large-scale PPP projects and programs.

In terms of fiscal commitments, some information is shared by the SBO such as the list of all PPP projects and investment amounts through a publication called “Developments of PPP implementations in the world and in Türkiye.” Although the list of projects is announced in this publication, the contracts themselves are not publicly available or disclosed. The only publicly available affordability-related study is observed in a sub-section of the annual PPP report prepared and published by the SBO.[273] In this study, the fee and lease payments to and from the GoT in relation to PPP projects are calculated and reported. These figures, however, do not include payments associated with minimum revenue guarantees for motorway projects. The published figures show that the total projected payments from the MoH in relation to 18 BLT hospital projects are forecasted to be about US$30 billion for a 25-year horizon ending in 2042, whereas Istanbul Airport-related lease payments that are going to be transferred to the GoT budget are estimated at US$26 billion in 2017 prices. Since 2017, although several similar studies have been conducted, none of them or any related data have been published yet.

The MoTF only provides the list and investment amounts for the projects benefitting from a Treasury guarantee and debt assumption payments. Türkiye reports these contingent liabilities through an internal quarterly fiscal risk bulletin. This bulletin presents estimates of expected losses from Treasury investment guarantees and analyzes different debt assumption and minimum revenue guarantee scenarios. This information, however, is insufficient to gauge the amount of contingent liabilities arising from PPP contracts, which hinders transparency principles. The MoTF is also performing several technical adjustments in order to disclose information on fiscal commitments for PPP contracts, but these have not been realized yet. Additionally, the internal evaluation of the explicit contingent liabilities is not shared outside of the MoTF, and commitments provided by line ministries to PPP projects, beyond Treasury guarantees, have never been compiled, so an aggregate figure is not available.

10.5. Performance Under Crisis

10.5.1. Impact of COVID-19 on Concessions

As in other countries, the pandemic has inflicted a heavy human and economic toll on Türkiye. The policy reaction, which focused on monetary and credit expansion, led to a strong rebound in growth after the initial shock, but, at the same time, exacerbated pre-existing vulnerabilities. This left the economy more susceptible to domestic and external risks. Additional pandemic-focused fiscal support from the government and the IMF is temporary and reinforces the need for a credible plan for medium-term fiscal consolidation. It also focuses financial sector and structural reforms on mitigating the risk of long-term adverse effects of the pandemic with targeted measures to support the most vulnerable, encourage labor market flexibility and facilitate corporate debt relief. [274]

Türkiye has had an increase in foreign debt stock. Türkiye's gross foreign debt stock was US$450 billion as of the end of 2020 and its net external debt stock was US$267 billion (37.5 percent of GDP). Foreign debt stock with a Treasury repayment guarantee was US$14.7 billion.[275] EU-defined public debt stock was TRY 1.99 trillion (39.5 percent of GDP). Gross external private debt in Türkiye had reached to US$255 billion by the end of 2020 and was related to non-financial institutions which also included the PPP financing loans borrowed by the private sector

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[273] SBO. 2016. Annual Developments in the PPP Sector. http://www.sbb.gov.tr/wp-content/uploads/2018/10/D%C3%BCnyada-ve-T%C3%BCrkiyede-Kamu-%C3%96zel-%C4%B0%C5%9Fbirli%C4%9Fi-Uygulamalar%C4%B1na-%C4%B0li%C5%9Fkin-Geli%C5%9Fmeler-2016.pdf

[274] IMF. 2021. Article IV Review Press Release. https://www.imf.org/en/News/Articles/2021/01/25/mcs012521-Türkiye-staff-concluding-statement-of-the-2021-article-iv-mission

[275] Of this, US$11.67 billion consisted of public debt (financial institutions, US$9 billion, and non-financial public institutions, US$1.9 billion) and US$3.1 billion was owed by the private sector.

and had an aggregate stock amount of US$151 billion at the end of 2020. [276] The IMF observes in 2021 that debt management should continue to be strengthened by lengthening borrowing maturities and lowering reliance on domestic foreign exchange (FX) borrowing. Moreover, mitigating the risks of the long-term adverse effects of the pandemic on labor markets and non-financial corporations should be addressed through targeted measures in Türkiye. The Turkish economy is seen as flexible and entrepreneurial, which bodes well for adapting to the post-pandemic economy.

The main vulnerability related to PPP commitments is Turkish lira depreciation because many government support measures to PPPs are hard currency denominated and financed via external debt. The Turkish currency hit record lows against the euro and US dollar in 2021, and this fall came as the effects of the global pandemic and poor economic policy converged. However, Turkish lira depreciation started long before the pandemic, in August 2018, and has continued since then. The 2018 Turkish currency and debt crisis was a financial and economic crisis in Türkiye, which was characterized by the Turkish lira's plunge in value, high inflation, rising borrowing costs, and correspondingly rising loan defaults. The foreign financing in the PPP portfolio and the hard currency related fiscal commitments and contingent liabilities (FCCL) commitments in PPPs have also been impacted due to these market fluctuations and Turkish lira depreciation, leading to the government needing further precautions like additional borrowing for budget support.

The crisis was caused by the Turkish economy's excessive current account deficit and large amounts of private foreign currency denominated debt. Though the crisis was notable for waves of major FX devaluation, later stages were characterized by corporate debt defaults, and finally by contraction of economic growth. With the inflation rate stuck in the double digits, stagflation ensued. The crisis ended a period of overheated economic growth, built largely on a construction boom fuelled by foreign borrowing, easy and cheap credit, and government spending. The Turkish lira traded at about 8.2 per US dollar in early April 2021, not far from a near all-time low of 8.5 hit at the end of March, after the country's consumer price inflation rose to 16.19 percent, its highest level since mid-2019. The rate came in well above the central bank's target of 5 percent, keeping up pressure on the central bank to maintain tight monetary policy. The lira fell sharply in 2021 due to several political decisions which also triggered investors' fear that the potential currency crisis could hurt the Turkish economic recovery and accelerate already rampant inflation.[277]

The global coronavirus outbreak is an international crisis negatively affecting demand, supply and financing appetite across sectors and borders. Almost 25,000 Turkish people have died and 2.4 million have been infected by COVID-19. Virus containment measures helped prevent an even steeper toll, but, at the same time, led to an unavoidable steep fall in economic activity. As the eventual magnitude and time frame of the pandemic remain unclear, it is currently not possible to accurately assess the full impact on individual companies including PPP project companies and their shareholders.

10.5.2. Measures implemented to help cope with the consequences of the COVID-19 crisis

There were several policies and actions taken for PPP fiscal risk mitigation and related commitments as a result of the pandemic in the Turkish market. The COVID-19 crisis has brought about a realization that the sustainability and resilience of the PPP program will require a paradigm shift where risks are re-evaluated, appropriately shared, and allocated between project partners vis-à-vis unforeseeable future adverse events. In the short term, for the existing PPP contracts a proactive and flexible infrastructure delivery approach was followed, including providing additional government support to private sector stakeholders. Moreover, revisiting the capital investment planning and prioritization among different infrastructure sub-sectors and projects was also observed. As such,

[276] MoTF, 2021. Public Debt Management Report. https://ms.hmb.gov.tr/uploads/sites/2/2021/03/Public_Debt_Management_Report_March_2021.pdf , page 34.
[277] Trading Economics, 2021, https://tradingeconomics.com/Türkiye/currency

several measures prevented negative crisis outcomes, including contingent liability management, and limiting fiscal risks and attributed costs, as listed below and discussed in more detail thereafter.

Table 11.2: Key Policies and Actions during the COVID-19 Pandemic Affecting the PPP Program

Area	Response and Actions
Regulatory	PPP Framework Law—to be finalized by the end of 2021.
Pipeline Development	Next 10 city hospital projects were shifted from PPP to public procurement delivery modality. Motorway PPP project developments to continue in line with high level transport planning. 2021 Annual Investment Program—sector prioritization and infrastructure investment plans and the country specific developments were linked to PPP policies.
Government Support and Risk Sharing	Treasury Debt Assumption Agreement (DAA) Secondary Regulation modified to increase the equity requirement from 20% to 30% and ending partial DAA coverage policy in case of company default/early termination risk (there was a 15% cut in case of SPV default). Effective and close monitoring of contingent liability management and current Treasury-supported PPP stock in loan disbursements and repayment realizations. Continue the DAA annual commitment limit and policy advice from MoTF for re-structuring the existing financing and re-financing options.
Hospitals	Benefits of the in-operation PPP hospitals in COVID-19 and facilitating the BLT hospitals to be in operation.
Motorways	New procurements to be designed to bid for unit price rather than minimum concession period that would lead to new tenders with a fixed operation period (2019). Pricing unit tolls—shifting the frequency to semi-annual (2019). Guarantee payments to shift from annual (April) to semi-annual instalments (April-October).
Airports	Deferring the payments for TOR projects and Istanbul Airport (BOT) for two years.

Since 2016, there has been an ongoing process in the central government to enact a uniform, national-level PPP framework law. At the same time, based on the dynamics of the Turkish PPP market, it is believed that a tailor-made legal framework is needed for sector-specific PPP governance issues. Nevertheless, according to the recently published Economic Reform Program (March 2021), the PPP framework law preparations are in process to be finalized by the end of 2021 under the supervision of the SBO. [278]

The next 10 city hospital projects have been shifted from PPPs to public procurement modality. The Health Transformation Program in Türkiye has further plans to increase the number of city hospitals in the country. Based on the accumulated experience with the existing PPP hospital projects and the cost comparison with the alternative models, the GoT decided to change the contracting model to traditional public procurement. The next 10 city hospital projects,[279] which were previously planned to be delivered as PPPs, are now to be delivered as traditional public procurement projects and were already included in the Turkish Annual Investment Program for the year 2020 within the category of "projects to be implemented after 2020." They will be implemented in the medium term; the MoH has already finalized the design for three of them.

Investment policies have been revisited for the new PPP motorway pipeline. Motorway PPP projects are planned to continue in line with the high level of transport planning (2021-2023). Moreover, related to 2021 Annual Investment Program preparations, the sub-sector master plans, project prioritization and infrastructure investment plans and the country specific developments are also aligned with PPP policies. Updated post-COVID-19 demand forecasts and changes in prioritization are also under way.

Government support and risk sharing policies have been amended. Treasury DAA Secondary Regulation was modified at the end of 2019 to reflect the following changes: i) for projects benefiting from the MoTF debt

[278] MoTF website, 2021, Economic Reform Program - https://ms.hmb.gov.tr/uploads/2021/03/Ekonomi-Reform-Takvimi.pdf
[279] Antalya, Aydin, Denizli, Diyarbakir Karapinar, Ordu, Rize, Sakarya, Samsun, Istanbul Sancaktepe and Trabzon.

assumption program, the minimum equity share requirement increased to 30 percent, and ii) the coverage rate under the partial debt assumption program increased from 85 percent for early termination due to private sector default to 100 percent of the senior foreign debt. The MoTF continues to provide debt assumption to motorway PPPs and the current contingent liability stock due to the committed debt assumptions was closely monitored in project revenue payments, senior loan disbursements and repayment realizations. In cases of contract modifications, the MoTF was giving its consent when debt assumption-related circumstances changed and/or were affected. Moreover, the MoTF was also involved in negotiations, provision of backstop support to and oversight of the MOH's BLT project re-structuring and contract management processes.

Türkiye benefitted a lot from the PPP hospitals during COVID-19 where the already operational hospitals were also treating coronavirus patients.[280] In healthcare, since the first detected COVID-19 case in Türkiye on March 11, 2020, the GoT took precautions and measures to prevent further spread of the virus and to protect its citizens. The attention that Türkiye pays to the health sector was already evident in the 2020 budget with its allocation of US$27 billion to healthcare services in a total budget of US$278 billion (or 9.7 percent). The 2020 budget allocated US$8.4 billion directly to the MoH, which ranks it the fourth largest among the top 10 government institutions in terms of budget allocations. COVID-19 response-related policies and precautions in Türkiye were quite timely and largely welcomed. Already operational BLT hospitals played a critical role in this effort, including the Istanbul and Konya ones, where treatment of COVID-19 patients was initiated in 2020 (see Box 11.1). Moreover, in the first half of 2020, progress was made regarding key outstanding issues related to five hospital PPP transactions, which were under restructuring and were a high priority for finalization to be able to launch operations in 2020.

Box 11.1: Previously Criticized City Hospitals Turn into Saviors During Pandemic

"Facing harsh criticism until March 2020 with regard to 'City Hospitals', the concept of giant modern health care complexes, with a total cost of around $9 billion, Türkiye now enjoys gaining already more than 13 thousand patient beds in the last 2 years, mostly in single rooms, each with the capacity to be converted to intensive care unit beds when needed. By the end of June, 3 newly built City Hospitals with around 4,000 bed capacity are planned to be put in service. … [T]here are currently 25 thousand intensive care unit (ICU) beds and 17 thousand ventilators. Having 46 ICU beds per 100,000 people puts Türkiye among the countries with the highest ICU bed capacity while Germany has 29.2 and US has 34.7."[281]

For motorway PPPs, contract modifications, payment adjustments and new procurement policies have been made. The existing motorway projects were priced at a fixed unit rate in hard currency, which was indexed to FX and inflation changes at the beginning of each year. Due to FX fluctuations, since 2019 the indexation frequency for unit prices has been changed to semi-annual via contract modifications for the ongoing projects. Likewise, the minimum revenue guarantee payments which were designed to be paid annually were modified to be paid in semi-annual installments in order to increase projects' cash liquidity. Since the time of award of the first motorway PPP contract, the MoT has preferred to use the contract term as the key bidding parameter. Starting in 2019, however, the MoT shifted to fixed-term contracts and the bidding was structured around unit price rather than minimum concession period. This shift was seen as a potential benefit for the lenders, which could increase loan maturities for contracts with fixed operational periods. The results of this shift have not been tested yet because the new projects have not yet reached financial close.

[280] Anadolu Agency, May 4, 2020 - https://www.aa.com.tr/en/health/Türkiye-s-healthcare-system-vigilant-against-covid-19/1828167.
[281] Demir, G. 2020. "Rapid Response: Facing the Pandemic in Türkiye," Letter to the Editor, *The BMJ*, April 26, 2020. https://www.bmj.com/content/369/bmj.m1548/rr-8.

For airport PPPs, revenue payment deferments have been made. The procurement agency, the DHMI, deemed the pandemic a force majeure event and provided airport operators a two-year extension in operating periods for TOR contracts and two-year lease payment deferral for lease contracts as the general COVID-19 response policy for privately operated airports. Private companies that provided services at the airports operated by the DHMI received cancellations of rent payment obligations to the DHMI for a period from April to December of 2020; rental fees for 2021 and 2022 are to be reduced by 50 percent (Presidential Decree No. 3536/Feb 10, 2021). Likewise, Istanbul Airport received a deferral of rent payments for two years and a two-year extension of the operating period of its contract as published by the DHMI in February 2021.

In conclusion, 2019 and 2020, when both the Turkish lira's depreciation and the pandemic coincided, was a full stress-test period for the Turkish PPP program. However, the government performed quite well, by honoring all its commitments and not delaying a single guarantee payment with an effective contract amendment, and by giving priority to existing PPP contracts where they were revised in attempts to mitigate accumulation of further risk. Despite not having a single PPP law, the existing fiscal precautions and systems allowed the economy to withstand the crisis effectively. The most efficient instruments in this effort were the contract amendments in motorway and airport projects and the restructuring of the financial features of the ongoing under-construction hospital projects to speed up the COVID-19 response.

Annex 10 A: Türkiye FCCL Principles

#	Principles	Clarification	Assessment for Türkiye
	ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact.	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for the contingent liabilities.	A new draft PPP Law and the corresponding development of guidance and stocktaking of the existing pipeline are under development in the MoTF and SBO.
2	Tools are in place to assess the potential fiscal costs and risks.	Spreadsheet based applications, like PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by government and identify potential mitigation measures.	The MoTF uses its own spreadsheets and macro-fiscal cost assessments under PPP risks.
	CONTROL: Assessing affordability as input to approval		
3	Fiscal Impact is evaluated by relevant level of authority throughout the PPP life cycle.	The fiscal impact is evaluated taking into account the level of development upon initial project screening, before tender launch, before commercial close and for any contract variations.	The MoTF and SBO are involved in the feasibility stage and the MoTF is to be consulted for every step in the development process if the Treasury debt assumption is provided.
4	Value for money is considered to warrant fiscal commitments.	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact.	PPP regulations require a VfM assessment before PPP approval. Methodological guidance is yet to be developed and there were several capacity building activities provided by the EBRD to the line ministries.
5	Thresholds have been defined to cap fiscal exposure from PPPs.	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.	Fiscal annual ceiling for PPPs has been used since 2013 for termination debt assumptions by the MoTF.
	BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to ensure funding is available for direct liabilities.	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.	Any direct liabilities for the coming year are included in the budget of the respective contracting authority.
7	Mechanisms are in place to ensure funding is	To provide comfort to the private partner and ensure bankability, mechanisms should be in place to	Any contingent liabilities (minimum revenue guarantees and debt assumptions) are also in

#	Principles	Clarification	Assessment for Türkiye
	available for contingent liabilities.	ensure government is able to fund contingent liabilities should they materialize.	the accounts of the related line agencies and annual budgeting is in place.
	REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner.	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.	Implementation of IPSAS has been used since 2015, according to the PPP accounting regulations led by the MoTF.
9	Legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs.	A consolidated report on all PPP projects including their fiscal commitments (direct and contingent), progress and value for money and appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.	The SBO is working with PPP line agencies to consolidate a PPP pipeline progress report annually.
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure.	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public.	Periodic audits and project or concept-based auditing activities are in place by supreme audit authorities.
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government.	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.	Fiscal management proceedings to the extent available apply to all jurisdictions including SOEs and local governments.

Annex 10 B: PPP Legal Framework

1910	**The Law of Concessions Regarding the Provision of Public Services** (**Law No. 576 of 1910**), enacted during the Ottoman era and still in force, created the initial legal framework for concession-style arrangements in Türkiye.
1984	**The Electricity BOT Law (Law No. 3096 of 1984**) was the first sector-specific enactment for public-private infrastructure collaborations. The Electricity BOT Law gave the private sector the opportunity to invest in the production, transmission, distribution and trade of electricity, using both the BOT and the TOR models.
1988	**The Highways BOT Law (Law No. 3465 of 1988)** offered investors the opportunity to use the BOT model in the highways sector. The Highways BOT Law removed the monopolistic control of the General Directorate of State Highways over highways and allowed the private sector to engage in the construction, operation, and maintenance of highways and service stations.
1994	**The BOT Law (Law No. 3996 of 1994)** governs BOT-model infrastructure projects requiring both advanced technology and large financial resources. The 1994 BOT Law deals with the construction, operation and transfer of various investments and services such as bridges and tunnels; drinking and utility water systems and treatment plants; communications; geothermal and wastewater facilities and heating facilities; the generation, transmission, distribution and trade of electricity; highways and heavy traffic routes; railways, rail systems.
1994	**The Privatization Law (Law No. 4046 of 1994)** deals with the different methods and rules governing the privatization of state assets. One of the forms of "privatization" outlined in this legislation is the so-called Transfer of Operational Rights (TOR) model, which allows for the transfer of operational rights associated with state-owned infrastructure.
1997	**The Built-Operate Law (Law No. 4283 of 1997)** pertains exclusively to thermal power stations.
1999	**Amendment of the Constitution** to set a constitutional basis for privatization as a delegation of public services and investment to private entities via PPP contracts based on private law.
2005	**The Omnibus Law (Law No. 5335 of 2005)** allowed the State Airports Authority (SAA) to transfer the operating rights of SAA airports to the private sector for a maximum period of 49 years. The law permits the use of the lease and/or TOR methods under the Privatization Law for this purpose.
2006	Introduction of an additional article into the 1997 BO Law, which designated all of the agreements under the scope of the 1997 law as "private law" contracts.
2012	**Law No. 4749** Concerning Public Financing and Debt Management was amended in June 2012 to provide the possibility of debt assumption by the Treasury for BOT and BLT projects. The Council of Ministers was authorized to decide on the Treasury's assumption of the project company's debts to foreign lenders upon termination of the project agreement.
2013	**Law No. 6428** Concerning the Construction of Facilities, Renovation of Existing Facilities and Purchasing Service by the MoH by PPP (the "New Law"), effective as of March 9, 2013, with the aim of ensuring continuance of pending health PPP projects by remedying the deficiencies determined in the Council of State's July 2012 decision. Pursuant to the New Law, the MoH is required to issue a regulation setting forth the principles and procedures of implementation of this law.
2018	**Law No. 7151** on the Amendment of Certain Laws and Decrees regarding Healthcare ("Law No. 7151") entered into force and accordingly certain articles of Law No. 6428 and Amendment of Certain Laws and Decrees are amended.[282]
2019-2020	The secondary legislation of Law No. 4749 regarding the Treasury debt assumption and the secondary legislation of Law No. 6428 had also been amended on December 24, 2019, and January 25, 2020, respectively.

[282] With the introduction of the amendment, the definition of "service payment" under Article 1 (Purpose, Scope and Definitions) paragraph two, subparagraph (e) of Law No. 6428 is amended. Accordingly, whereas it was previously regulated that the service payment should be updated with a five-year periodic market test, with the amendment, it is regulated that the service payment should be updated with a five-year periodic market test and for the optional services subject to the amount indicated under the agreement and medical support services should be updated with a 10-year periodic market test. Moreover, with the amendment to Article 3 (Tender Rules, Procedures and Principles), paragraph 12 of Law No. 6428, it is regulated that the security amount obtained for the tender in the operating phase should be increased each year at the rate of the increase in the domestic producer price index determined by the Turkish Statistical Institute.

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