GUIDELINES FOR FISCAL COMMITMENTS AND CONTINGENT LIABILITIES (FCCL)

(FOR FEDERAL PUBLIC PRIVATE PARTNERSHIP PROJECTS IN PAKISTAN)

JANUARY 2024

Finance Division
Government of Pakistan

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GLOSSARY

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Glossary

TERM	DEFINITION
Appraisal	Conducting a series of feasibility studies that inform a decision to approve, cancel, or revisit the project before the structuring of the contract
Contingent Liabilities	Government payment commitments whose occurrence, timing and magnitude depend on some uncertain future event, outside the control of the government
Contingency Budget Estimates	Proposed financial allocations within annual budget specifically set aside to cover unforeseen expenses and risks that arise in the PPP portfolio.
Debt Sustainability Analysis (DSA)	An annual Finance Division publication to enhance debt transparency, fiscal sustainability and strengthen debt management
Direct Liabilities	Known payments from government that must be made if the PPP proceeds
Discounted Cash Flows	A valuation method that estimates the value of an investment using its expected future cash flows
Feasibility Study	A study that constitutes the basis for the decision for the project to proceed to procurement and implementation
Fiscal Affordability	The ability of a project to be realistically accommodated within theinter-temporal budget constraints of the government
Fiscal Affordability Assessment (FAA)	Report prepared by the Risk Management Unit (RMU) to assess fiscal affordability of a project
Fiscal Gatekeeper	Risk Management Unit positioned to recommend to approving bodies if a PPP project is fiscally sustainable
Fiscal Risk Statement	An annual publication by the EA Wing of the Finance Division outlining fiscal risks
Government-pays PPPs	Government is the sole source of revenue for the private party and payments depend on the asset or service being available at a contractually defined quality
Implementing Agencies	Any of the line ministries, attached departments, body

	corporates, autonomous body of the Federal Government or any organization or corporation owned or controlled by the Federal Government
Medium-Term Budgetary Framework (MTBF)	A medium-term budgetary framework which includes two major components: a strategic ‘top-down’ component which involves the preparation of a medium-term fiscal framework, a budget strategy paper, and the necessary technical underpinnings and a ‘bottom-up’ system of output-based budgeting in line ministries
Minimum Revenue Guarantee (MRG)	The revenue of a guaranteed party is guaranteed to reach a minimum amount during the guaranteed period
P3A Act (amended 2022)	A Public-Private Partnership (P3A) Act to establish a regulatory framework to execute PPP projects in Pakistan
Private-Sector Comparator (PSC)	A risk-adjusted estimate of the total cost for the lifetime of a project, including all capital, operating, financing, and ancillary costs, if a PPP project were to be financed, built, and operated through a traditional government procurement method
Project Qualification Proposal (PQP)	A proposal received by the Authority that meets the requirements as defined in Section 2(o) of the P3A Act, 2017 (amended 2022), and any Regulations made thereunder.
Project Proposal	Detailed proposal submitted by the implementing agency to the Authority after it has received approval of the project qualification proposal prepared in respect of a qualified project., as
PPP Agreement	A written agreement between an implementing agency and a private party for implementation of a project and any other agreement subsidiary or incidental to it.
Qualified Projects	A project undertaken on PPP basis that meets the criteria as defined in Section 2(v) of the P3A Act, 2017 (amended 2022).
Risk Register	A risk log maintained by the Risk Management Unit

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	(RMU) that's used to identify potential risks that could affect the execution of a P3 project
User-Pays PPPs	The private party provides a service to users and generates revenue by charging users for that service
Viability Gap Funding (VGF)	Contributions made by the Government from the Viability Gap Fund established under Section 11 of the P3A Act, 2017 (amended 2022)to support projects that are economically justified but not financially viable
Value for Money	The undertaking of a project by the implementing agency under P3 results in a net benefit accruing to the citizens.VfM is a process of comparing costs using two delivery models to determine which better value proposition is. If the PPP cost is less than the traditional procurement cost, then there is a positive VfM by procuring a project using PPP

Note: All other words and expressions used in these Guidelines but not defined herein shall have the same meanings as assigned to them in the P3A Act, 2017 (amended 2022), or, if not in the Act, as in common usage.

LIST OF ABBREVIATION

List of Abbreviation

ABBREVIATION	DEFINITION
ABS	Annual Budget Statement
CDWP	Central Development Working Party
DCF	Discounted Cash Flow
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
EIRR	Economic Internal Rate of Return
ECNEC	Executive Committee on the National Economic Council
ECT	Early Contract Terminations
FAA	Fiscal Affordability Assessment
FCCL	Fiscal Commitments and Contingent Liabilities
FRS	Fiscal Risk Statement
GOP	Government of Pakistan
IA	Implementing Agencies
IBC	Indicative Budget Ceiling
IE	Independent Engineers
IFIs	International Finance Institutions
MTBF	Medium-term Budgetary Framework
MRG	Minimum Revenue Guarantees
MoPD&SI	Ministry of Planning Development and Special Initiatives
NPV	Net Present Value
P3A	Public-Private Partnership Authority
P3WP	P3 Working Party
PFRAM	Public Private Partnerships Fiscal Risk Assessment Model
PPP	Public-Private Partnerships
PQP	Project Qualification Proposal
PSC	Public Sector Comparator
PSDP	Public-Sector Development Program
RMU	Risk Management Unit

LIST OF ABBREVIATION

ROE	Return on Equity
TA	Transaction Advisors
VfM	Value for Money
VGF	Viability Gap Funding

INTRODUCTION

Introduction

The Government of Pakistan (GOP) recognizes the significance of Public-Private Partnerships (PPPs) to enhance the quality, cost-effectiveness, and timely provision of public infrastructure in the country. With a growing need for infrastructure development, PPPs present an opportunity to bridge the infrastructure gap and leverage private sector expertise and investment.

The need for having robust Fiscal Commitments & Contingent Liabilities (FCCL)guidelines are rooted in the P3A Act (amended 2022),under Section 4(2) sub-paras (c and d).The guidelines primarily focus on managing long-term fiscal cost in PPPs, including direct and contingent liabilities that extend throughout a project's lifespan. Pakistan has several PPP projects under development, such as infrastructure ventures, toll road projects, and healthcare facilities, where managing fiscal costs and contingent liabilities are crucial for sustainable implementation. Given the evolving PPP market in Pakistan, it is essential to establish FCCL guidelines that ensure the basic management of fiscal commitments without hindering the development of the PPP market. By doing so, Pakistan can optimize the advantages of private sector participation while maintaining fiscal sustainability and achieving long-term infrastructure development goals.

The purpose of these guidelines is therefore to propose an operational framework for managing fiscal obligations arising from Federal PPPs in Pakistan, with a four-pronged process, namely:

i. **Analysis**
   - Identifying and quantifying fiscal commitments.
   - Methodological guidance in place to quantify fiscal impact.
   - Tools are in place to assess fiscal impact.

ii. **Control**
   - Assessing fiscal affordability as input to approval.
   - VfM is considered to warrant fiscal commitments.
   - PPP portfolio is well within the limit of fiscal affordability as percentage of GDP.

iii. **Budget**
   - Ensuring funding is available for fiscal commitments.
   - Mechanisms are in place to ensure funding is available for contingent liabilities.

iv. **Report;**
   - Fiscal commitments are adequately accounted for and documented in a consolidated manner
   - Periodic reporting is made under Fiscal Risk Statement (FRS), Debt Sustainability Analysis (DSA), bi-annual debt bulletins and Medium-Term Budgetary Frameworks (MTBF).

Furthermore, these guidelines alsoaim to provide consistent identification and assessment of PPP FCCLs at four key transaction points, namely:

i. At the time of feasibility– submission of the Project Qualification Proposal (PQP)
ii. Prior to tender launch– submission of the Project Proposal
iii. Prior to signing the PPP Agreement and
iv. During the implementation phase.

Overall, the FCCL guidelines anchor three key components, which are interlinked and mutually reinforcing:

i. **Defining roles and responsibilities:** Under these guidelines, clear roles and responsibilities for managing fiscal costs throughout the project cycle have been established. This includes identifying the key stakeholders, such as the

Implementing Agency (IA), Risk Management Unit (RMU), Public-Private Partnership Authority (P3A), Ministry of Planning Development & Special Initiatives (MOPD&SI), Budget Wing& other relevant wings of the Finance Division to ensure effective coordination.

ii. **Incorporating fiscal costs assessment as a key approving criterion:** Fiscal costs assessment and approval has been integrated into the PPP development and approval process as outlined in the PPP Act (amended 2022) and Process Flow Regulations 2021. This ensures that the fiscal implications of a PPP are thoroughly presented to and reviewed by relevant approving bodies such as the P3A Board, Central Development Working Party (CDWP) and Executive Committee ofthe National Economic Council (ECNEC) before entering a contract.

iii. **Integrating risk management as an on-going exercise:** Fiscal costs are adequately managed during both preparation and implementation stages of PPP projects. This involves monitoring fiscal costs at project and portfolio levels and to ensure proper financial management, transparency, and fiscal sustainability is achieved throughout the lifespan of PPP projects.

The FCCL guidelines predominantly focus on delineating how the Risk Management Unit (RMU) undertakes the responsibility of evaluating and managing the impact of PPP projects on the GOP'sfiscal resources. While these guidelines encompass various facets of PPP project development and execution, their primary emphasis lies in the assessment and fiscal management of these initiatives by the RMU.

These guidelines also note that the scrutiny of a project's fiscal affordability and its commitment to delivering value for money shall be an ongoing, perpetual endeavor by RMU. This ongoing evaluation involves regular checkpoints and assessments to ensure the project sustains fiscal soundness throughout its lifecycle. The framework highlighted in the FCCL guidelines empower stakeholders to proactively identify and address financial challenges, thereby averting potential fiscal consequences and sustaining project's financial viability.

The FCCL guidelines shall remain a live document, such that future provisions may be phased in the next versions of the FCCL guidelines as the PPP program expands at the federal level or when the GOP adopts new amendments to the PPP Act. The FCCL guidelines shall also remain applicable for both qualified and un-qualified projects.

OVERVIEW OF FISCAL COMMITMENTS

Overview of Fiscal Commitments

PPPs offer a dual advantage of alternative financing sources and potential efficiency gains for infrastructure development. By engaging private sector investment, the burden on public funding can be spread over an extended period, allowing for accelerated expansion of infrastructure services within existing fiscal constraints. Furthermore, the involvement of the private sector introduces efficiency gains by bundling financing, design and construction, operation and maintenance responsibilities in one contract.

Government's Contribution and Fiscal Commitments

The GOP’s contribution to PPP partnerships under viability gap funding (VGF), either through combination of grants, equity commitments, debt contributions etc. or through guaranteeswill result in direct or indirect fiscal commitments. These commitments serve following two broad purposes:

i. Firstly, the GOP may provide payments for economically viable projects that are not financially sustainable through user charges alone. This financial support enables the private party to earn a reasonable return on investment and encourage its participation.

ii. Secondly, the GOP’s involvement in PPPs can become crucial to achieving an appropriate risk allocation. Allocating project risks to the party best equipped to manage them efficiently is a key advantage of PPPs over traditional GOP procurement. To strike a balance between risk allocation and financial viability, the GOP may bear or share certain project risks. This can include guaranteeing a minimum level of traffic for a toll road PPP or providing credit-enhancing guarantees to mitigate overall project risks.

OVERVIEW OF FISCAL COMMITMENTS

Through commitments identified above, the fiscal commitments by the GOP in PPPs can result in both direct and contingent liabilities, as follows:

i. **Direct liabilities**. Direct liabilities are known payment requirements, such as upfront capital payments or regular payments over the contract's duration. These obligations are explicit and can be planned and budgeted accordingly. They are also relatively simple to calculate, assess and budget and can be forecasted through an updated financial model.

ii. **Contingent liabilities.** Contingent liabilities arise from uncertain future events or circumstances. They can involve payment obligations that may emerge with uncertain timing and value. Managing these contingent liabilities is difficult and must be accounted for to ensure fiscal prudence and transparency in PPP projects. It is important to proactively assess and monitor such liabilities to mitigate potential fiscal risks for the GOP in the long run.

Managing Fiscal Commitment Challenges

Effectively managing fiscal commitments under PPPs pose several challenges. Most of these commitments are long term and extend beyond the typical budgeting and planning horizon. Furthermore, the uncertainties associated with contingent liabilities can expose the GOP to fiscal risks, potentially creating budgetary uncertainties and impacting public debt sustainability. Timely and reliable honoring of government commitments is crucial to maintainingproject outcomes through appropriate risk sharing in PPP projects.Overall, the various types of fiscal commitments under both direct and contingent liabilities are outlined in Table 1.

OVERVIEW OF FISCAL COMMITMENTS

Table 1. Types of fiscal commitments in PPP projects

Fiscal commitment	Description
Direct liabilities	
Upfront	
Up-front viability payment	The government provides an up-front capital contribution to the PPP contractor (which may be phased over construction or against equity investments, but only over the initial years—that is, the construction phase—of the project lifetime).
Associated works	The government undertakes works that will contribute to the project, such as feeder roads (for a toll road) or dredging (for a port) or purely an upfront land acquisition cost.This type of support is typically one time and does not give rise to an ongoing commitment.
Ongoing	
Annuity or availability payments	The government provides a fixed, ongoing subsidy, paid (typically quarterly) over the lifetime of the project, and often not starting until the construction phase is complete. This payment may be conditional on the availability of the service or asset at a contractually specified quality. The value of the payments is usually a key financial bid criterion in the tender process to select the private contractor.
Shadow tolls	The governmentprovides a subsidy per unit or user of a service—for example, per kilometer driven on a toll road. The unit value of such a subsidy would typically be the financial bid criterion.
Contingent liabilities	
“Guarantees” on particular risk variables	The government compensates the private party for loss in revenue should a particular risk variable deviate from a contractually specified level. The associated risk is thereby shared between the government and the private party. For example, this could include guarantees on the following: • Demand remaining above a specified level, or within a

	specified range • Exchange rates remaining within a specified range • Tariffs being allowed to follow a specified formula (where tariffs are set or approved by a government entity)
Force majeure compensation clauses	The government compensates the private party for damage or loss due to certain specified force majeure events. These are typically limited to those events, for which, insurance is not commercially available, which may include certain natural disasters or pandemic like events.
Termination payment commitments	The government pays an agreed amount should the contract be terminated due to default either by the private party or by the government on their obligations under the contract, and to take control of the project assets. Typically, the defined payment is lower in case of private party default.
Credit guarantees	The governmentguarantees repayment of some, or all of the debt taken on by the project company if the project company itself defaults on the debt, regardless of the reason for the default.

Source: World Bank and Castalia 2011

INSTITUTIONAL ROLES AND RESPONSIBILITIES

Institutional Roles and Responsibilities

Implementing Agencies

The Implementing Agencies (IA) are defined in the P3A Act as any line ministries, attached departments, body corporates, autonomous bodies of the Federal Government or any other organization or corporation owned or controlled by the Federal Government. The roles and responsibilities of the IA with regards to project procurement and FCCL evaluation is outlined as follows:

- To identify, conceptualize, develop, and procure PPP transactions
- Undertake a feasibility study / appraisal for a project
- Remain responsible for continuous monitoring and implementation of the PPP project. From fiscal perspective, this means that the IA will ensure that the FCCLs are identified and evaluated as part of the project development by ensuring that the requirement to do so will be built into the Terms of Reference (TORs) for transaction advisors right from the start.
- Remain responsible for obtaining from the concessionaire, independent engineer (IE) and independent auditor (IA) in a timely manner the performance data needed to track and monitor FCCLs (such as tariff revenue data in the case of a minimum revenue guarantee (MRG), or overall financial performance measures etc.), provide the data to RMU and for responding to emerging risks with fiscal implications.
- Highlight transaction budget requirements for PPP projects into its budget requests and coordinate with the P3A, MOPD&SI and the RMU in the Finance Divisionto embed commitments in annual and medium-term budgetary frameworks.
- Engage the transaction advisor by following relevant procurement rules.

INSTITUTIONAL ROLES AND RESPONSIBILITIES

Transaction Advisor: The P3A Act under Section 31 as well as Direct Contracting of IFIs as Transaction Advisors, Regulations 2023 lay out hiring of transaction advisors and experts for PPP projects. From the fiscal standpoint, the transaction advisors shall have the following responsibilities:

- Integrate fiscal assessment at every stage of the PPP project such as; i) Project Qualification Proposal (PQP) stage, ii) Project Proposal stage and iii) PPP Agreement stage to ensure that the project is financially viable and does not pose unforeseen fiscal risks in the future.
- Devise strategies to assess, quantify and mitigate fiscal risks at every stage as above, including recommending safeguards within the project structure that prevent fiscal drain and contingent liabilitiesfrom increasing.
- Work closely with the IAs to ensure that all FCCL aspects are well communicated and understood by all parties involved, and that IA is well prepared to embed the FCCLs into the project effectively.

PPP Authority: The role of the P3A is to provide technical assistance to the IAs in developing and recommending PPP projects for approval. From fiscal standpoint, this includes ensuring that FCCLs are identified early and addressed appropriately at PQP and Project Proposal stages before entering into PPP Agreement. Overall, P3Aaims to:

- Ensure that qualified project procurementis consistent with national and sectoral strategies, ensuring fiscal prudence and sustainability.
- Assess funding requirements and considerfiscal risk analysis carried out by the transaction advisors and IA's.
- Advise, facilitate, and actively support IAsto develop and structure, as needed, the qualified projects at all stages in the project cycle. Continuously review and monitor VfM of PPP projects to ensure project benefits are realized.

- Function as a regulatory body to ensure all PPP projects align with the prescribed FCCL guidelines.
- Facilitate smooth coordination between various entities such as IAs, transaction advisors, and RMU, to ensure fiscal costs and contingent liabilities have been considered.
- Coordinate submission of P3A and RMU's FCCL recommended decisionsto approving bodies, such as the P3WP, P3A Board, CDWP and ECNEC.

Risk Management Unit: The P3A Act prescribes a Risk Management Unit (RMU)to be managed, controlled, and administered by the Finance Division of the Federal Government for the PPPs.The role of the RMU is anchored in the section 12A of the P3A Actand is responsible for fiscal oversight and for evaluation of fiscal and contingent liability exposure for the following nature of projects:

i. **Qualified Projects:** For qualified projects, the fiscal cost evaluation shall be carried out with the support of the P3A.
ii. **Unqualified Projects:** For unqualified projects, each implementing agency shall submit the required information to the RMU in consultation with the Finance Division.

The role of the RMU for project FCCL evaluation is outlined as follows:

- RMU shall remain a focal institution of the Finance Division to assess, quantify and manage PPP FCCLs, for both qualified and un-qualified projects and in view of the provisos of the P3A Act.
- RMU shall remain responsible for the preparation of the Fiscal Affordability Assessment (FAA) report, which shall remain a key internal document of the RMU, outlining both project fiscal affordability and VfM.
- RMU shall prepare theContingency BudgetEstimates against the contingent liabilitiesof present value of PPP portfolioallocating up to 4 percent as part of the

annual budget exercise through budget call circular. This estimate shall be delivered to the MO PD&SI through P3A to be included within the PSDP Indicative Budget Ceiling given by Budget Wing of Finance Division.

- RMU shall maintain an accurate and an up-to-date record of all PPP commitments at both the project and portfolio levels through a Risk Register. The outline of a Risk Register is enclosed in **Annex-1**.
- RMU shall follow the process flow as presented in the **Annex-2**, providing its recommended decisions on fiscal affordability and VfM to PPP approving bodies (IA, P3A Board, CDWP, and ECNEC) for project approvals. The final project approval decisions shall remain with the PPP approving bodies (IA, P3A Board, CDWP, and ECNEC).
- RMU shall remain responsible for monitoring liabilities from PPPs at both the project and the portfolio level, maintaining updated estimates of the relevant fiscal affordability and VfM as identified in the Control chapter. The outline of calculations to estimate direct and contingent liabilities is enclosed in **Annex-3.**

Specifically, the RMU shall be responsible for ongoing evaluations of:

i. **Assessing fiscal affordability** by evaluating the long-term fiscal risks and impact of PPP projects (direct or contingent; explicit, or implicit) and determining whether they are fiscally affordable, based on the assessment provided by IA, transaction advisors and P3Aat all transaction stages.

ii. **Evaluating VfM** by confirming the appropriateness of PPPs or other kinds of GOP support by evaluating project VfM, based on the assessment provided by IA, transaction advisor and P3A at all transaction stages.Further, the evaluation of project VfM shall remain an ongoing, continuous exercise which shall be carried out by RMU through review of independent engineer and independent auditor reports.

INSTITUTIONAL ROLES AND RESPONSIBILITIES

Ministry of Planning Development & Special Initiatives (MOPD&SI): The PPP Authority, collaborating with the RMU and implementing agencies, shall provide estimates of both direct and contingent liabilities for the upcoming year and the medium-term to the MOPD&SI at the time of formulation of the PSDP. Implementing Agencies will be responsible for integrating PPP project funding needs into the annual Public-Sector Development Program (PSDP) allocations within the Indicative Budget Ceiling (IBC) allotted by the MOPD&SI every year. The PSDP serves as the primary tool for assigning budgetary resources to development projects and initiatives in line with the PFM Act 2019 and approved by competent forums, such as CDWP and ECNEC. The objective is to ensure the budget sufficiently covers both direct costs and unexpected contingent expenses when proposing the subsequent year's PSDP allocation to the Budget Wing of the Finance Division.

The key responsibilities of the MOPD&SIshall be as follows:

i. Ensure that any financial obligations due by IAs under the PPP contract align with and are incorporated within the PSDP allocation of the respective Implementing Agency within their IBC.
ii. During the execution of PPPs, the MOPD&SI shall ensure that PPP FCCLs are accurately represented in the PSDP by the Implementing Agency. In achieving this, it shall collaborate with the P3A and RMU to ensure all yearly commitments, whether direct or contingent, under PPPs are integrated into the PSDP requirements and communicated to the Budget Wing of the Finance Division.

- Should the actual PSDP fund receipts by the Budget Wing to the MOPD&SI fall short of the budgetary commitments, the MOPD&SI shall prioritize allocating funds to PPP projects first. This ensures fiscal expenditures and contingent liabilities are managed effectively and shall be in line with the Guidelines for

Commitment Control (2022) under the PFM Act 2019 and approved PC-I document.

- MOPD&SI shall ensure adherence to the contingency budget estimates in relation to the contingent liabilities against the PPP portfolio.

Budget Wing: At the start of every financial year, the Budget Wing shall be tasked with formulating a quarterly funds release strategy for the PSDP, considering the fiscal constraints, existing commitments, and historical disbursement patterns. Following this, the MOPD&SI shall highlight the strategic priorities aligned with the GOP's revenue and expenditure policies under its ministry-wise Quarterly Release Authorization Strategy.Budget Wing shall accommodate the Contingency Budget Estimates against the contingent liabilities of PPP portfolio requested by MO PD&SI as part of the PSDP Indicative Budget Ceiling.

Following the finalization and submission of the Budget Strategy Paper by the Finance Division, after incorporating financial projections vis-à-vis sectoral priorities given by the MOPD&SI, the Budget Wing shall ensure that the approved paper has PPP projects incorporated to highlight government prioritiesand shall be uploaded to the Finance Division's official website as per the timelines mentioned under the PFM Act 2019.

PPP Approval Body: All PPP transactions shall be first approved by the relevant IAs before being approved by project approval bodies.The entities responsible for project approvals comprise the P3WP during the project's concept note stage and the PQP stages, while the P3A Board and CDWP/ECNEC oversee the project proposal and the finalization of the PPP agreement stages **(refer to Annex-2 for FCCL process flow)**. The RMU shall support the approving bodies by offering their recommended decisions concerning fiscal oversight and FCCL exposure for all eligible projects.

INSTITUTIONAL ROLES AND RESPONSIBILITIES

Following tables summarize the roles of each stakeholder and highlights responsibilities during the PPP development, approval, and implementation process.

Table 2. Entities responsible in PPP process

Roles	Agency
Who are the project owners and first line of evaluators of FCCLs?	i. Implementing agencies
Who is responsible for identifying, preparing, and procuring the PPP projects?	i. Implementing agencies
Who is the relevant PPP approving body for providing approvals at project concept note and PQP stages?	i. Implementation agencies ii. P3WP (P3 working party)
Who is the relevant PPP approving body for providing approvals at project proposal and PPP agreement stages?	i. Implementation agencies ii. Board of P3A, iii. CDWP and where necessary, ECNEC approval
Who is responsible for monitoring projects post financialclose?	i. Implementing agencies, ii. P3A[1]
Who is responsible for monitoring and management of fiscal risks and liabilities for qualified PPP projects?	i. Implementation agencies ii. Risk Management Unit iii. P3A[1]
Who is responsible for monitoring and management of fiscal risks and liabilities for un-qualified PPP projects?	i. Risk Management Unit, ii. Implementing Agencies
Who is responsible for budgeting PPP direct and contingent liabilities under PSDP annual and medium-term ceilings?	i. Implementing agencies ii. MOPD&SI iii. Budget Wing of the Finance Division

Source: PPP Act (Amended) 2022

[1]As per Section 4(2)[c, d]and Section 12A (2) of the P3A Act (Amended, 2022)

INSTITUTIONAL ROLES AND RESPONSIBILITIES

Table 3. Summary of FCCL proposed institutional roles

Entity	Role during preparation / approval	Role during PPP implementation
Implementing Agency	Identify and estimate FCCLs as part of project preparation	– Regularly obtain FCCL tracking information from PPP sponsor – Monitor and respond to FCCL related project risks – Include FCCL payments in budget requests submitted to GOP
P3A	– Support and quality assure process carried out by implementing agencies through transaction advisors – Review FCCL estimates obtained from the IA, transaction advisors and incorporate fiscal considerations in the decision making – Support project risk analysis and take into consideration overall fiscal risk consideration submitted by the RMU for qualified projects	– Oversee VfM and FCCL monitoring undertaken by IAin coordination with independent engineer and independent auditor – Coordinate with IA, independent auditors, and independent engineers for timely provision of information to RMU
Risk Management Unit	– Assess all fiscal and contingent liability exposure for all eligible qualified and un-qualified projects – Assess FCCL liabilities from fiscal affordability perspectives – Assess project outcomes from VfM perspectives	– Continue to evaluate and assess project VfM through independent engineer and independent auditor reports in coordination with P3A and IA – Incorporate updated FCCL estimates into debt analysis and reports – Provide report/analysis/informationon FCCLsto DMO/Economic Advisor Wingfor reporting purpose.

INSTITUTIONAL ROLES AND RESPONSIBILITIES

MOPD&SI	-Ensure financial obligations due by IAs under PPP align with the PSDP allocation. -Evaluate the fiscal implications of proposed PPPs in relation to PSDP priorities and constraints.	-Ensure that committed PPP FCCLs are accurately represented in the PSDP. - Prioritize allocating funds to PPP projects if PSDP fund receipts fall short.
Budget Wing	– Formulate a quarterly funds release strategy for the PSDP considering cash management, other commitments, and historical patterns. - Ensure that the budget strategy paper, which incorporates PPP projects, is ready for approval and subsequent uploading to the Finance Division's website.	- The Budget Strategy Paper shall continue to reflect government priorities by incorporating PPP projects in the annual and medium-term budgetary framework.
Approving Bodies (P3WP, P3A Board, CDWP, ECNEC)	– Assess and approve/reject FCCLsbased on recommended decisions on affordability and VfM perspectives by RMU – Assess and approve/reject resulting direct and contingent liabilities quantum on public budgets and debt management framework	– Approve or rejectresulting direct and contingent liabilities quantum on public budgets and debt management framework in case of changes in transaction scope (such as in the case of termination, contract variations, re-negotiation etc.)

ANALYSIS – IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS

Analysis – Identifying and Quantifying Fiscal Commitments

The identification of direct and contingent liabilities will be initiated in the feasibility / appraisal studyat the PQP stage (conducted by IA in coordination with transaction advisors) through the process of: (i) commercial feasibility analysis (technical, financial and legal); (ii) fiscal affordability analysis; and (iii) value for money analysis, and further refined when drafting the PPP agreement and concluded upon contract award. This will become more accurate and complete once the PPP agreement is drafted and the financial structure from the public perspective in terms and the envisaged risk allocation and fiscal requirements are finalized.

The feasibility study shall encompass crucial aspects including the contract term, co-financing strategy, and the delineation of payment mechanisms, which may involve quality, availability, or volume-based methods. This comprehensive assessment shall also detail indexation approaches and the primary components of payment schemes, encompassing criteria for availability, adjustment factors, traffic or volume bands, and other relevant features, ensuring a thorough analysis for informed decision-making. Consequently, this shall result in identification of both direct liabilities and contingent liabilities and must be quantified from a fiscal affordability perspective.

Direct liabilities: To identify direct liabilities of a PPP structure, the fiscal costs shall be assessed from a public perspective. This may be through the following modalities:

i. Grants(toco-financethecapex)and/or
ii. Servicepaymentstobegrantedtotheprivatepartnerinthecontractaswellasrelevantconditions (including timing, indexation, and potential adjustments/deductions).
iii. Other potential public party participation. For instance, the provision of financing though public equity, or debt contributions)

ANALYSIS – IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS

Quantification of direct liabilities: Direct liabilities are appraised by identifying explicit payment obligations of the IAs under a given PPP contract. Typically, one or more payment formulas are contained in the contract, which will require assumptions to forecast direct liabilities over the life of the contract. Common variables include projections of demand, foreign exchange rates and inflation rates, which will result in projections of viability gap funding for upfront equity and debt injections or continuous minimum revenue guarantee payments.

The resulting direct liabilities are therefore not fixed but rather forecasts. These forecasts need to be updated on an annual basis by the IA to account for changes in key assumptions and must capture the following:

i. Updated schedule of payments in every year for the life of the project; and
ii. Net present value of payments.

Each possible direct liability arising from the financial structure from the public perspective will be estimated in cash flow terms for the duration of the contract (an example of a format is presented in Table 4). The estimates should be aligned with the financial model developed in the feasibility study and updated upon structuring and PPP agreement stages.

To reflect the present value of these future outgoing cash flows from direct liabilities the estimates per year will be discounted. Yield on 10-year government securities (either from primary or secondary market) as the discount rate in terms of a proxy for the government opportunity cost of capital will be used.

ANALYSIS – IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS

Table 4. Appraisal of direct liabilities from a PPP contract

Year	1	2	3	4	5	6	---	PV
Land acquisition								
Annual VGF								
Co-financing								
Annuity payments								
Others								
Total								

Contingent liabilities: As indicated, the contingent liabilities refer primarily to guarantees from the implementing agency as contractually agreed to compensate the private partner should a certain event materializes. The contingent liabilities can be:

i. Specific risk variable guarantees e.g., minimum revenue guarantee etc.; or
ii. Contingent liabilities from early contract termination.

Quantification of contingent liabilities: To quantify contingent liabilities, following analysis shall be applied:

i. **Scenario analysis:** Scenario analysis will involve making assumptions regarding the outcome of any events or variables that affect the value of the contingent liabilities and calculating the cost given those assumptions. This could include working out the cost to GOP in a “worst case” scenario. For instance, for a MRG for a road PPP, this assessment would include calculating the cost at different levels of traffic outturn. It could also include calculating the cost to the GOP of early contract terminations (ECT) for different reasons.
ii. **Probabilistic analysis:** Probabilistic analysis could be applied by seeking the historical trend and applying a probability to assess future commitments that may materialize.

Guarantees for specific risk variables (such as MRGs) will be reflected at present value and can be consolidated in an aggregated value of the GOP's fiscal exposure.The use of an updated financial model will enable precise calculations of MRGs and will also guide stakeholders to evaluate their present value, considering the time value of money. This would mean that MRGs will not be viewed in isolation but will instead be integrated into an aggregated assessment of the GOP's fiscal exposure. By updating MRGs on a continuous basis, it becomes possible to gain a comprehensive understanding of the potential financial impact of MRGs within the broader fiscal context for GOP.

Similarly, the financial model underpinning PPP project will be updated in response to any changes in law. This process will remain instrumental in quantifying and calculating the fiscal impact of legal alterations. Through a systematic evaluation, the potential financial consequences of legal changes will be identified and translated into concrete financial impact, ensuring that fiscal considerations remain at the forefront of project management. This proactive approach will enable stakeholders to adapt, strategize, and safeguard the financial sustainability of PPP initiatives in the face of evolving legal landscapes.

On the other spectrum of contingent liabilities is a case for early contract termination. The guarantees for compensating the private partner for early contract termination will not be discounted or aggregated becausethis will imply that every year, there isa probability that a guarantee exists to compensate the private partner in case of an ECT is called upon. However, such an event could only happen once during the contract period and hence the fiscal exposure of the GOP should not be the sum of the probability and annual financial impact but an indication of a contingent liability exposure that may arise the next year.An example has been outlined in **Annex-3** to calculate contingent liabilities that may arise in the future and how to quantify it.

ANALYSIS – IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS

Tools to calculate FCCLs: It is important to use a robust, quantitative driven tool to analyze and calculate FCCLs. The IA in coordination with the transaction advisor at the time of PQP, project proposal and PPP agreement stageswill evaluate fiscal costs on a project-by-project basis and share their estimates with both RMU and P3A for review and evaluation. Later during project implementation and as part of an ongoing project fiscal risk evaluation, RMU will useone of the following tools to assess FCCLs on both project-by-project and consolidate them at portfolio levels:

i. Public Private Partnerships Fiscal Risk Assessment Model (PFRAM); or
ii. In-house excel spreadsheet framework (such as method outlined in **Annex-3**);

PFRAM is an analytical tool developed by the IMF and the World Bank to assess the potential fiscal costs and risks arising from PPP projects. Following data inputs on project structuring, PFRAM assists the users to identify the main risks arising from a PPP project, their allocation, likelihood, impact, as well as potential mitigation measures, and finally a sense of priority of required actions. Information provided by the users is summarized in a Risk Register as outlined in **Annex-1**.

On the other hand, in-house excel sheet can also be structured to receive input data relevant to the project, such as costs, revenues, financing details, and contractual obligations. Calculation formulas can be incorporated within the sheet to compute FCCLs based on the provided data for both direct and contingent liabilities.It could then allow for sensitivity analysis by modifying key variables or assumptions. By changing inputs, users can assess the impact on FCCLs, providing insights into potential risks and variations in project outcomes.

CONTROL – ASSESSING AFFORDABILITY AS INPUT FOR APPROVAL

Control – Assessing Affordability as Input for Approval

The RMU will monitor the fiscal commitments of the GOP. The quantified fiscal commitments and contingent liabilities must be assessed for approval, primarily keeping in mind two considerations, that i) the projects approved are fiscally affordable in the long run i.e., their funding is adequate within GOP budgets, and ii) they offer value for money i.e., the benefits of doing a project under PPP mode outweigh their costs of doing a project undertraditional procurement.

Fiscal Affordability Assessment Report: The Fiscal Affordability Assessment (FAA) report will be an important project specific documentprepared by RMU to evaluate the fiscal affordability and VfM for both qualified and un-qualified projects and will be updated at all transaction points. This assessment will play a pivotal role in conclusion reached by the approving authorities with regards to fiscal sustainability and optimal allocation of resources by GOP. By conducting a comprehensive analysis of affordability and VfM, the RMU will aim to ensure that PPP projects are aligned with the available fiscal capacity of the GOP while delivering maximum benefits and efficiency to citizens.The FAAwill comprise of the following salient features, including but not limited to:

i. **Financial Analysis:** This involves conducting a detailed financial analysis of the proposed project, considering factors such as capital and operational costs, revenue generation potential, funding sources, and financial sustainability over the project's lifecycle.

ii. **Affordability Evaluation:** The assessment includes an evaluation of the affordability of the project within the GOP's budgetary constraints. This analysis considers the available fiscal resources, debt obligations, revenue projections, and the impact of the proposed project on the overall financial position.

iii. **Risk Assessment:** A comprehensive risk assessment will be conducted to identify potential fiscal risks associated with the proposed PPP project. This includes analyzing factors such as cost overruns, revenue shortfalls, inflationary pressures, and external economic risks that may impact the project's affordability and financial viability. The risk assessment shall be maintained by RMUvia a comprehensive risk register (details at **Annex-1**).

iv. **Value for Money (VfM) Analysis:** The assessment incorporates a value for money analysis to evaluate the expected benefits and costs of the proposed project. This involves comparing alternative options, assessing the efficiency of resource allocation, and examining the economic and social impacts of the project using a public-sector comparator approach.

Transaction points: The transaction points at which FAA report will be prepared and updated by RMU are defined as follows:

Stage 1: Upon Feasibility Study / PQP Stage:The FAA report will prepare and evaluate the expected budgetary requirements of direct and contingent public sector liabilities over the duration of the proposed PPP project. The main output is the analysis submitted by the IA in coordination with the transaction advisors to P3A which will then forward the same to RMUalong with its recommendations.This will enable RMU to assess whether the project is an affordable proposition for the GOP over the duration of the complete project and help finalize the FAA report.

Stage 2: Prior to Tender Launch / Project Proposal Stage: At this stage, the IA along with transaction advisors will submit a project proposal which will incorporate comprehensive details of the proposed transaction structure with all supporting documents including a complete techno-economic feasibility study, and together with all associated and supplementary studies. Based on the project proposal, RMU will update the FAA report based on the finalized structure from the public perspective and the corresponding contractual provision reflecting the payment mechanisms, the risk allocation and the related guarantee scheme. RMU will also review the impact of the project in terms of contingent liabilities, fiscal affordability, and budgetary impact with inputs from line agencies, Debt Management Office (DMO), P3A and transaction advisors. RMU will advise and provide its recommended decision to the approving authorities on the ability or otherwise of the GOP to sustain the fiscal commitments directly related to the PPP Project including both direct and contingent liabilities as well as guarantees arising from the PPP Project.

Stage 3: Prior to signing PPP Agreement: At this stage, the FAA will only be updated by RMU if there is a deviation with the original terms of the project proposal which had been approved by the P3A Board, RMU or CDWP/ECNEC[2]. RMU will provide its feedback to P3A for subsequent submission toCDWP/ECNECfor approval of the project / preferred bidder.

Stage 4: During Implementation: The guidelines envisage risk management as an ongoing exercise. Risks, whether stemming from changes in scope, contract variations, concerns about value for money, or the need for re-negotiations, will be subject to continuous evaluation and mitigation throughout the project's lifecycle by RMU.

a. **Regular risk assessment:**Regular and systematic assessments to identify new risks and re-evaluate existing ones will be consideredby the RMU which could arise from changes in project scope, contractual adjustments, or shifts in market conditions. The FAA report will be continuously updated by RMUas proactive risk mitigation strategy for identified risks, which may involve revisiting contractual terms, enhancing project controls, or adjusting financial models.

[2] As per Process Flow Regulations 2021, Chapter 2, Section 9(9)

CONTROL – ASSESSING AFFORDABILITY AS INPUT FOR APPROVAL

b. **Contract Variation / Re-negotiation:** There may be a need for contract variations and renegotiation. Since contract variations (through relief events, force majeure etc.) have considerable impact on both parties, they require careful examination and analysis by the IA, independent auditors, independent engineers, P3A and RMU. The IA shall monitor the financial health of the project to identify risks and potential issues that could lead to renegotiation or contract variations. If the IA and/or the private party wishes to engage in contract variations, the IA will first inform the P3A of such request, which shall undertake its own assessment and provide its recommendationsto the RMU.RMUwill evaluate P3A's assessment and shall provide its own recommended decisions regarding:

   a. The reason for contract variation / re-negotiation
   b. Expected outcome on risk allocation and project scope
   c. Potential impact on fiscal affordability to GOP finances and
   d. Potential impact on project VfM.

The RMU shall submit its feedback to P3A for subsequent submission to the approving authorities (P3A Board, CDWP/ECNEC)which shall decide on the appropriateness of contract variation / renegotiation and whether to proceed with the request or not.

Decision criteria for project approval: The RMU shall follow two project approval criterions for PPP projects when providing its recommended decision to PPP approval bodies. The two criterions include:

i) Assessment of fiscal affordability and

ii) Justification of the fiscal exposure in terms of project VfM:

CONTROL – ASSESSING AFFORDABILITY AS INPUT FOR APPROVAL

i. **Assessment of fiscal affordability**

Present value of PPP portfolio (direct and contingent liabilities) as percentage of GDP: The RMU shall calculate on an ongoing basis that the present value of the total PPP portfolio (direct and contingent liabilities) shall not exceed 3% of the country's Gross Domestic Product (GDP). This criterion shallhelp assess the scale and affordability of PPP commitments relative to the overall economic output of the country.A brief illustration of how direct and contingent liabilities can be calculated for the purpose of fiscal risk affordability is enclosed in the **Annex-3** of the report.

ii. **Justification of the fiscal exposure in terms of VfM.**

To confirm the VfM of the fiscal implications, two main indicators shallapply:

a) **Cost benefit analysis:** The Cost Benefits Analysis shall be done at the start by the IA in coordination with the TA and shall be updated at every transaction point. The Economic Internal Rate of Return (EIRR) shall be more than10 percent for all PPP projects.

b) **VfM from a public-sector comparator (PSC) approach:** VfM should reflect the difference between the assumed costs to the GOP when the project is implemented through traditional procurement and the costs to the government in case of delivery through PPP and which confirm that the PPP scheme is more favorable for the government, using a public sector comparator approach. The IA in coordination with the TAshalldemonstrate that the project has a positive VfM using a PSC approach.After the financial close, the RMU shall continue to evaluate project VfM through continuous monitoring of project IE and IA reports.

BUDGET – PLANNING AND ENSURING FUNDS ARE AVAILABLE

Budget – Planning and Ensuring Funds are Available

Budgeting for PPPs involve ensuring the allocation of funds and availability of resources to cover the costs associated with GOP commitments. However, due to uncertain contingent liabilities and long-term nature of direct liabilities, traditional annual budget cycles may pose challenges. Therefore, it is crucial to adopt credible and practical budgeting approaches that address the unique characteristics of PPPs and provide assurance to private partners regarding timely payments.

To ensure comprehensive fiscal control and management, it is essential to integrate the assumption of long-term direct liabilities and contingent liabilities into the national budgetary process. This requires considering the cost implications of all government fiscal actions, including cash spending on future land acquisitions, fiscal commitments, and contingent liabilities, as part of a cohesive plan. By integrating direct and contingent expenditures in annual PSDP ceilings, a balanced approach to budgeting can be achieved.

Budgeting for direct liabilities: Long-term direct commitments, like availability or annuity payments, represent sustained payment obligations by the GOP. Such commitments necessitate a systematic calculation by the IA for each project. During each budget preparation cycle, the direct commitments for the next year shall be aggregated by the P3A and relayed to MOPD&SI and Implementing Agencies. This ensures their effective integration within the annual and medium-term PSDP ceilings as pivotal fiscal priorities. After MOPD&SI submits its budgetary proposals with sectoral priorities, the Budget Wing then reflectsthese commitments in:

i. Annual budget statements
ii. Medium-term budgetary framework

BUDGET – PLANNING AND ENSURING FUNDS ARE AVAILABLE

Further, in situations where the allocated PSDP funds fall short of the commitments, MOPD&SI shall prioritize PPP projects to ensure their smooth financial progression as outlined in the PFM Act 2019 and Guidelines for Committed Control (2022).

Budgeting for contingent liabilities: Since the occurrence of contingent liabilities is not certain; budgeting for them can be difficult. When a contingent liability occurs, and if there are no funds available within the appropriations of that fiscal year, the IA will be required to request for additional appropriation, which can be fiscally constrainingwithin the allocated PSDP ceiling. To mitigate impact of uncertain contingent liabilities and create a fiscal buffer, the RMU shall prepare the Contingency Budget Estimates against the contingent liabilities of present value of PPP portfolioallocating up to 4 percent as part of the annual budget exercise through budget call circular.This estimate shall be delivered to the MOPD&SI through P3A to be included within the PSDP Indicative Budget Ceiling given by Budget Wing of Finance Division. MOPD&SI shall subsequently budget for contingent liabilities of the PPP portfolio against the VGF through PSDPand reflect the same in its annual PSDP &medium-term framework.

REPORT – DISCLOSING FCCLS FOR TRANSPARENCY

Report – Disclosing FCCLs for Transparency

Effective reporting of FCCLs in PPP projects is important for public disclosures and transparency. Transparency in disclosing FCCLs ensures that the public and relevant stakeholders have access to comprehensive information regarding the potential fiscal risks associated with PPP projects. This transparency promotes accountability, enhances public trust, and allows for informed decision-making. Reporting FCCLs will fulfill a crucial governance requirement and will also help maintain credibility and confidence in the PPP framework, fostering a conducive environment for private sector participation.

Responsibilities: To effectively manage FCCLs arising from PPP projects, the RMU must maintain accurate and up-to-date records of all commitments at both the project and portfolio levels. The RMU will be responsible for monitoring liabilities from PPPs at both project and portfolio level, maintaining updated estimates of the relevant ratios as identified in the Control chapter above.

The responsibility of gathering information from the concessionaire will lie typically with the IA in coordination with independent engineers and auditors, which maintains the direct contractual relationship with the PPP company/concessionaire. The information requirements will be clearly defined in the PPP contract, specifying the necessary data such as, traffic information, key financial ratios, and performance indicators that must be provided to IA on quarterly basis, which will consequently share this with P3A and RMU as part of ongoing risk management exercise.

Reporting: RMU will ensure that sufficient information is provided to the concerned IA, P3A, MOPD&SI, DMO, EA Wing, and Budget Wing for reporting on PPP FCCLs, which will be disclosed in the following GOP publications.

i. Debt SustainabilityAnalysis
ii. Medium-Term Budgetary Framework.

iii. Annual Budget Statement.
iv. Fiscal Risk Statement and
v. Annual debt review and public debt bulletin and
vi. Any other publication as approved by the Finance Division from time to time.

Annex 1: Fiscal Affordability Assessment and Risk Register

Risks coverage under FAA report: The FAA report prepared by the RMU will holistically capture FCCLs from both direct and contingent liabilities. While exact risks will be determined at the project stage, the risks coverage under FAA will include, but not limited to, the following:

Table 5. Risks Coverage under Fiscal Affordability Assessment

Risk	Description	Impact on Direct Liabilities	Impact on Contingent Liabilities
Financial Viability	The risk that the projected financial performance of the PPP project may not meet expectations or be sustainable.	Additional capital injections or subsidies to support the project	Activation of government guarantees or backup payment obligations
Funding Risk	The risk that adequate funding may not be available to support the project throughout its lifecycle.	Increased borrowing or debt issuance by the government	Activation of contingent financing arrangements or alternative funding sources
Cost Overrun	The risk of unexpected increases in project costs beyond the initially estimated budget.	Additional payments to cover cost overruns	Potential claims for compensation or penalties due to contract breaches
Revenue Shortfall	The risk of lower-	Additional	Potential claims for

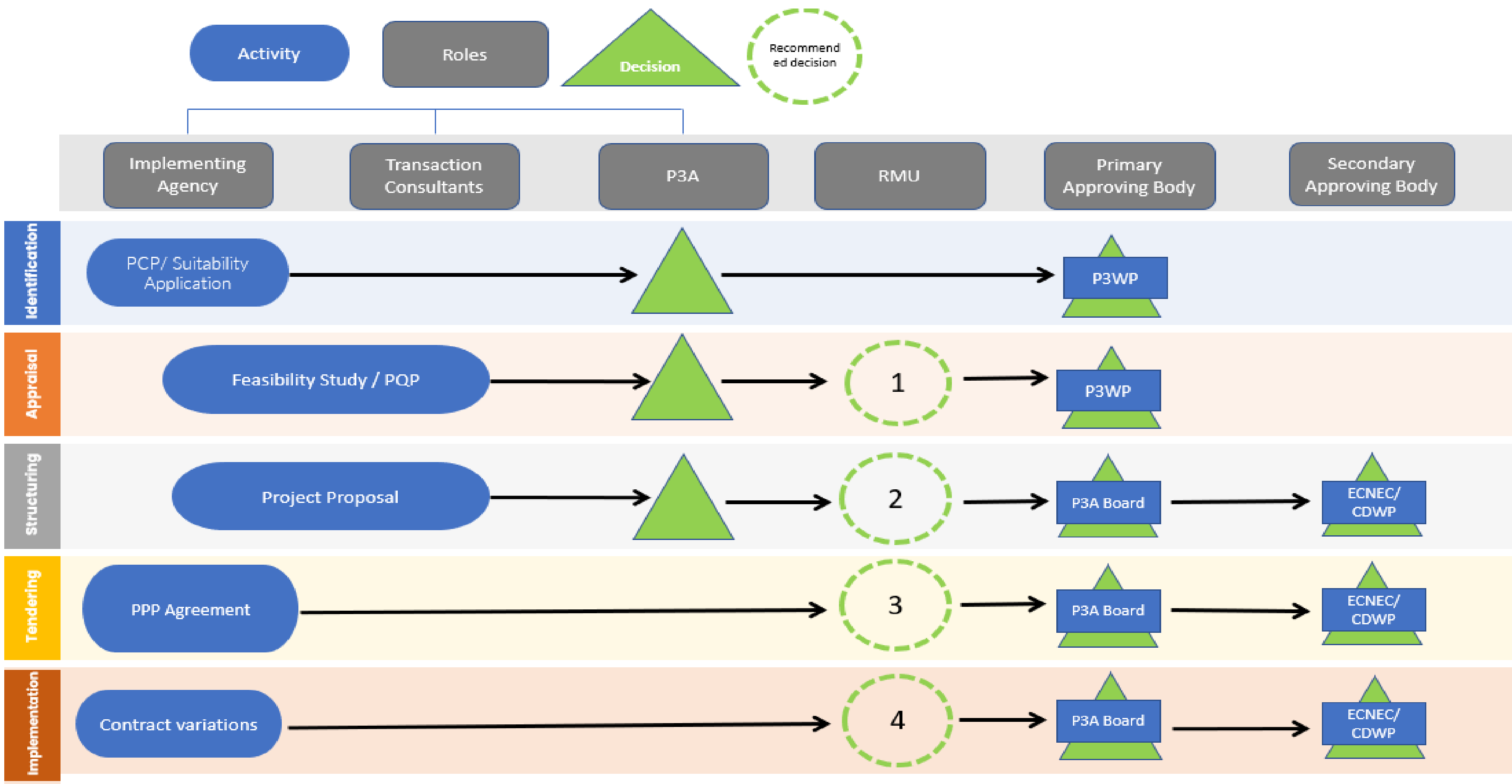
	than-expected revenues generated by the project, impacting its financial viability.	subsidies or payments to compensate for revenue shortfalls	revenue guarantee or compensatory payments
Inflation Risk	The risk of inflation affecting project costs or revenues, potentially impacting the project's profitability.	Adjustments to contract prices or payments to account for inflation	Potential claims for inflationary compensation or indexing of revenues
Interest Rate Risk	The risk of changes in interest rates affecting project financing costs or debt servicing obligations.	Higher interest payments or refinancing costs	Activation of interest rate hedging instruments or derivative contracts
Exchange Rate Risk	The risk of adverse exchange rate fluctuations impacting project costs or revenues, particularly for foreign currency-denominated components.	Increased foreign exchange conversion costs or hedging expenses	Activation of currency hedging instruments or contingent foreign exchange arrangements
Construction Risk	The risk of delays, cost overruns, or quality issues during the construction phase of the project.	Additional payments for construction-related expenses	Potential claims for liquidated damages or penalties for construction delays
Operations Risk	The risk of operational challenges, such as technological failures, inadequate	Increased operating or maintenance costs	Potential claims for compensation due to service disruptions or performance

	maintenance, or supply chain disruptions, impacting the project's performance and financial sustainability.		failures
Regulatory/Policy Risk	The risk of changes in regulations, policies, or legal frameworks that could have a significant impact on the project's financial viability or contractual obligations.	Additional compliance costs or modifications to meet new regulatory requirements	Potential claims for compensation or renegotiation of contractual terms due to regulatory changes
Political Risk	The risk of political instability, changes in government, or policy reversals affecting the project's financial viability or contractual obligations.	Increased payments or penalties due to political interference	Potential claims for compensation or contract termination due to political actions
Force Majeure	The risk of unforeseen events or circumstances, such as natural disasters or acts of terrorism, impacting the project's financial viability or contractual obligations.	Costs associated with disaster recovery or emergency measures	Activation of force majeure clauses or compensation for project disruptions
Counterparty Risk	The risk of the private sector counterparty failing to fulfill its contractual	Additional payments to cover the counterparty's obligations	Activation of performance bonds or guarantees to

	obligations, potentially leading to financial losses for the government.		mitigate financial losses
Reputation Risk	The risk of damage to the government's reputation due to project failures, financial difficulties, or public perception issues related to the PPP project.	Costs associated with reputation management or public relations	Potential claims for compensation due to reputational damages or contract breaches

ANNEX 2 –ROLES AND RESPONSIBILITIES UNDER FCCL GUIDELINES

Annex 2 –Roles and Responsibilities under FCCL Guidelines



** **RMU Role & Reporting:** 1. Upon feasibility study (Financial Viability/ VfM); 2. Prior to tender launch (Risk Register & FAA); 3. Prior to signing PPP contract (Update RR & FAA); 4. During implementation (Update RR & FAA)

ANNEX 3 –QUANTIFYING DIRECT AND CONTINGENT LIABILITIES

Annex 3 –Quantifying Direct and Contingent Liabilities

I. Methodology to calculate direct liabilities: Direct liabilities pose a direct charge on government's budget.Direct liabilities can be of two distinct types:

i. User-pays PPPs: The extent to which the revenues from user charges are sufficient to recover the costs i.e., the need for possible co-financing from the GOP.

Table 6. MRG of user-pays PPPs (Assuming a simplified discounted cash flow analysis)

Assumptions										
Capital Expenditures	2,000									
Operating Expenditures	100									
Demand - Year 1	50									
Demand Growth per annum	3%									
Tariff	5									
Tariff Growth per annum	10%									
Cost of Capital	10%									
Discounted Cash Flow	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Capital Expenditures	2,000									
Operating Expenditures		100	100	100	100	100	100	100	100	100
Total Expenditures	2,000	100	100	100	100	100	100	100	100	100
Demand		50	52	53	55	56	58	60	61	63
Tariff		5	6	6	7	7	8	9	10	11
Revenue from User Charges		250	283	321	364	412	467	529	599	679
Balance	(2,000)	150	183	221	264	312	367	429	499	579
Viability (NPV)	(243)									

This exhibit is applicable to various types of economic infrastructure projects such as roads, ports, and water facilities, and acknowledges that the user charges alone are inadequate to cover the project cost and meet the expected returns required by capital providers. This creates a viability gap, which is evident in the negative Net Present Value (NPV) of the project cash flows.

The implication of this scenario is that the project cannot be sustained without government assistance. However, if the project demonstrates social and economic justification, as assessed through an economic analysis outlined in the feasibility report, GOP support becomes necessary and justifiable to ensure project's viability.

ii. Government pays PPPs: In case of government-pays PPPs, the annual amount required as GOP contribution to recover the costs.

The financial modeling approach for a government pays PPP differs from a user pays PPP. In a government pays PPP, revenues are derived based on the cost assumptions. The required revenues are calculated to offset the project costs, aiming for a Net Present Value (NPV) of zero. The project value is considered as an input rather than an output, unlike a user pays PPP. The focus is on determining the necessary revenues to cover costs, while in a user pays PPP, revenues are assumed based on expected demand and tariff assumptions.

Assumptions										
Capital Expenditures	2,000									
Operating Expenditures	100									
Cost of Capital	10%									
Discounted Cash Flow	1	2	3	4	5	6	7	8	9	10
Capital Expenditures	2,000									
Operating Expenditures		100	100	100	100	100	100	100	100	100
Total Expenditures	2,000	100	100	100	100	100	100	100	100	100
Government payments		447	447	447	447	447	447	447	447	447
Balance	(2,000)	347	347	347	347	347	347	347	347	347
Viability (NPV)	(0)									

Table 7. DCF of Government pays PPP

II. Methodology to calculate contingent liabilities: Contingent liabilities may materialize if certain uncertain events or circumstances occur. These liabilities are not certain or immediate, but they carry the potential to create financial burdens for the GOP in the future. Therefore, it is important to assess and provisionally account for these in the FAA report.Following two types of contingent liabilities needs to be addressed:

ANNEX 3 –QUANTIFYING DIRECT AND CONTINGENT LIABILITIES

i. Specific risk variable:

To calculate specific risk variable contingent liabilities, such as Minimum Revenue Guarantees (MRGs), interest rate guarantee, exchange rate guarantee etc., a methodology based on a thorough assessment of the underlying factors can be employed. The calculation of MRGs, for instance, involves estimating the potential revenue shortfall that may occur if the actual project revenues fall below a predetermined threshold. The calculations of MRGs typically include analyzing historical data, market trends, demand projections, and other relevant factors to determine the expected revenue generation. This assessment helps establish a baseline revenue scenario against which the actual project performance can be measured. The below exhibit outlines the calculation of MRGs:

Table 8. DCF of MRG Liability

Assumptions										
Pre-defined revenue threshold	1,000									
Cost of Capital	10%									
Discounted Cash Flow	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Pre-defined revenue threshold	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Expected revenue	800	900	1,100	900	1,200	1,000	800	1,000	1,100	900
Revenue Shortfall	(200)	(100)	100	(100)	200	-	(200)	-	100	(100)
MRG Liability	(200)	(100)	-	(100)	-	-	(200)	-	-	(100)
Viability (NPV)	(474)									

ii. Early contract termination:

To incorporate the risk of Early Contract Termination (ECT) in the fiscal assessment, an approximation can be made based on historical data. According to the Private Participation database maintained by the World Bank, the worldwide percentage of PPP projects cancelled in the past decades is 4%-6%[3]. This figure can serve as a proxy to estimate the likelihood of ECT for each year of a PPP project. Assuming a 4%

[3]https://ppi.worldbank.org/content/dam/PPI/resources/ppi_publication/web_publication/WPS8054.pdf

annual probability of cancellation, the impact of ECT can be determined by considering factors such as the outstanding debt, paid-in capital, and the return on equity (ROE).

Table 9. DCF of Early Contract Termination

Assumptions										
Capital Expenditures	4,000									
Debt	2,800									
Equity	1,200									
Interest	8%									
Target ROE	17%									
Equity Compensation	1,404									
ECT Probability	4%									
Discounted Cash Flow	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Debt Balance O/S	2,800	2,607	2,398	2,173	1,929	1,666	1,382	1,075	744	386
Annuity	417	417	417	417	417	417	417	417	417	417
Interest	224	209	192	174	154	133	111	86	60	31
Principal	193	209	225	243	263	284	307	331	358	386
Debt Balance closing	2,607	2,398	2,173	1,929	1,666	1,382	1,075	744	386	-
Equity Compensation	1,404	1,404	1,404	1,404	1,404	1,404	1,404	1,404	1,404	1,404
Total Fiscal Exposure	4,011	3,802	3,577	3,333	3,070	2,786	2,479	2,148	1,790	1,404
ECT Probability	**4%**	**4%**	**4%**	**4%**	**4%**	**4%**	**4%**	**4%**	**4%**	**4%**
Fiscal Risk Exposure	160	152	143	133	123	111	99	86	72	56

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