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**Guidelines on Viability Gap Funds for
PPP Project**



MINISTRY OF FINANCE
GOVERNMENT OF PAKISTAN

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Ministry of Finance

Guidelines on Viability Gap Funds for PPP Project

Whereas:

The Government of Pakistan recognises the importance of improving and expanding infrastructure services for sustaining economic and social development. To help finance growing infrastructure needs, the Government has developed a Public Private Partnership (PPP) program for Pakistan. This program aims to develop, amongst other things:

- An institutional structure to coordinate and promote PPP activities
- A facility to provide long-term, fixed-rate financing in local currency
- Policies and a mechanism for targeted subsidies for PPP projects.

Therefore:

In accordance with its policy objectives, the Government of Pakistan has decided to subsidise economically viable PPP projects that will not be financially viable if they are constrained to charge affordable user tariffs or unitary payments. The government will make such PPP projects financially viable by dedicating a portion its budget to fund the gap between the expected project revenues and costs. This dedicated budget shall be known as the Viability Gap Fund.

These Guidelines set the criteria for eligibility to receive funding from the Viability Gap Fund, the procedures for applying for, approving, disbursing and monitoring the Fund, and the arrangements for managing, controlling and governing the Fund.

ARTICLE I

General Provisions

Section 1. Objectives: These Guidelines set the criteria and procedures that should be followed to apply for, approve, disburse, and monitor Viability Gap Funds for PPP Projects.

Section 2. Definitions of Terms: Unless otherwise stated, the terms used in these Guidelines shall have the following meaning:

“Competitive Selection Process” or “CSP” means the process whereby a Private Party is granted the right to undertake a PPP Project, and which involves transparent and open competition among at least two unrelated bidders. The financial bid variable for selecting the Winning Bidder shall be the present value of the Viability Gap Funds required by the Private Party. The present value shall be calculated using an appropriate discount rate that reflects cost of capital of the government;

“Cost-recovery Revenue” means the revenue that is equal to or greater than, in present value terms (at approved discount rate of private party), the True Cost of the PPP Project;

“Economic Benefit” means the positive contribution to gross national product (or other measure of value) from an economic activity or project;

“Economic Cost” means the difference in costs between a without and with PPP project situation—that is, the extra use of resources necessary to achieve the corresponding Economic Benefits;

“Institution” means:

- i) Government,
- ii) person performing functions pursuant to any law in connection with the affairs of a Government, or
- iii) a person whose ownership or control is vested in a Government or whose ownership or control is vested in a person falling within number ii) above;

Explanation: For the purposes of number iii) above, the expression ‘ownership’ means the direct or indirect ownership of more than fifty-one percent of the voting rights in a person, and ‘control’ means the ability, directly or indirectly, to direct or cause the direction of the votes attaching to the majority of its issued shares or interests carrying voting rights, or to appoint or remove or cause the appointment or removal of those of its directors or equivalent office bearers holding the majority of the voting rights on its board of directors or equivalent body;

“Measurable Outputs” include completion of construction works (for example: building a road or rail or a section of it, building a reservoir, installing a pipe, or installing a water supply or electricity connection), achieving contract milestones (for example: contract effective date, financial closure date, commercial operations date, and so on) or achieving a defined level of service (for example: supplying potable water continuously for 24 hours per day, 7 days per week; hours per day of availability of a power plant; and so on);

“Net Economic Benefit” means the present value of economic benefits minus the economic costs of the PPP project. The present value shall be calculated using an appropriate discount rate that reflects cost of capital of the government ;

“Public Private Partnership” or **“PPP”** means a commercial transaction between an Institution and a Private Party by which the Private Party:

- a. performs an Institutional function on behalf of the Institution; and/or
 - b. assumes the use of public property for its own commercial purposes;
 - c. assumes substantial financial, technical and operational risks in connection with the performance of the Institutional function or use of the public property;
- and

- d. receives a benefit for performing the Institutional function or from utilising the public property, either by way of:
 - i. consideration to be paid by the Institution from its budget or revenue; or
 - ii. charges or fees to be collected by the Private Party from users or customers of a service provided to them; or
 - iii. a combination of such consideration and such charges or fees;

“Socio-economic Characteristics” means quantitative factors that provide a direct or indirect measure of the social and economic status of a group of people;

“Socio-economically Disadvantaged” means a group of people that is below average in terms of several Socio-economic Characteristics, compared to the general population of Pakistan or to the relevant regional sub-population;

“Tariffs” means a Rupee amount charged to service users or consumers per unit of service provided (for example, Rs/m³, Rs/kWh, Rs/trip);

“Total Capital Cost” means the full and reasonable cost of making a PPP project operational, including project design, authorization and field development costs, material costs, construction costs, and equipment costs;

“True Cost” means the full efficient cost of a PPP Project, and which includes all fair and reasonable costs including Total Capital Cost and Operating Costs, and a reasonable return on investment, that must be recovered in order to enable the Private Party to operate the PPP Project in a financially viable manner;

“Unitary Payment” means the payment made by the Institution to the private party in respect of the services provided by the private party;

“Viability Gap Fund” is as defined in Article IV Section 1;

“Viability Gap Funds” means the funds that the VGF Company will transfer to an Institution, or to a Private Party on behalf of the Institution, to cover part or all of the difference between the expected True Cost of a PPP Project and the expected revenue from the Tariffs charged or Unitary Payment made for the services provided by such PPP Project and which includes Capital and Operating Viability Gap Funds;

“Viability Gap Funds – Capital” means the Viability Gap Funds which are transferred during the development (including design, development, construction prior to the commencement of operations) phase of the PPP Project;

“Viability Gap Funds - Operating” means the Viability Gap Funds which are transferred on a periodic basis (i.e. monthly, quarterly, half yearly, yearly etc)

during the period wherein the private party provides services under the PPP Project after the commencement of operations;

“Viability Gap Fund Company” or “VGF Company” means a company incorporated and limited by guarantee in accordance with the Companies Ordinance 1984, which is governed by a Board appointed by the Federal Government, and whose budget shall come from transfers made by the Ministry of Finance following requests by the Board of the VGF Company;

“Winning Bidder” means the Private Party that was fully technically compliant with the bid documents, including having the technical qualifications and accepting the technical specifications of the PPP project, and that proposed the lowest value for the financial bid variable in the Competitive Selection Process for a given PPP.

ARTICLE II

Eligibility Provisions

Section 1. Eligibility Criteria. To be eligible to receive Viability Gap Funds, a PPP Project shall meet the following seven criteria:

- 1) **Economically Viable:** The Net Economic Benefit of the PPP project shall be equal to or greater than zero; and
- 2) **Limited Viability Gap Funding:** The ratio of the present value of the Viability Gap Funds to the present value of True Cost of the PPP Project shall not be greater than zero point two (0.2);

Provided that the Board of Directors of VGF Company may, on a case to case basis, exempt projects which have a Total Capital Cost equal to or less than five hundred million rupees (Rs. 500,000,000);

Further provided that if this ratio is greater than 0.2 and the Institution can provide credible evidence that either it has the capacity in its budget or has other committed sources in addition to Federal Funding, to provide the additional funds needed, the PPP Project would be deemed eligible; and

- 3) **Unaffordable:** Users of the services provided by the PPP project are unable to afford a Tariff, or the Institution is unable to pay a Unitary Payment, that is expected to generate a Cost-recovery Revenue; and
- 4) **Targeted:** In a PPP Project where it is practical to segregate groups of users in accordance to Socio-Economic Characteristics, the Viability Gap Funds are only used to reduce the Tariffs charged to Socio-Economically Disadvantaged groups of users; and
- 5) **Competitively Procured:** The private party that will undertake the PPP Project is selected through a Competitive Selection Process; and
- 6) **Output-Based:** The disbursement of Viability Gap Funds is linked to the private party achieving Measurable Outputs, and
- 7) **Selected Sectors:** The PPP project belongs to one of the following sectors:

- a) **Transport and logistics** including roads, rail, seaports, airports, fishing harbours as well as warehousing, wholesale markets and cold storage; or
- b) **Mass Urban Public Transport** including buses, and intra and inter-city rail, or
- c) **Municipal Services** including water supply and sanitation; solid waste management; low cost housing, and health / education facilities; or
- d) **Energy Projects**; or
- e) Any other infrastructure sectors that the Federal Government may define.

ARTICLE III

Request and Approval Procedures

Section 1. Request for Pre-approval: Prior to launching the Competitive Selection Process, the Institution will submit to the VGF Company a request for pre-approval of the Viability Gap Funds for a specific PPP project. The request shall include the evidence needed to demonstrate compliance with the eligibility criteria listed in section 1, Article II and categorise such request as VGF Capital or VGF Operating. The VGF Company will develop the detailed instructions that applications should follow to demonstrate compliance with eligibility criteria.

Section 2. Pre-approval: Within fifteen (15) business days from the date on which the VGF Company receives a request for pre-approval prepared in accordance with the instructions issued, the VGF Company shall reach a decision on pre-approving all, part or none of the Viability Gap Funds requested by the Institution.

The VGF Company can extend this deadline once for a maximum of fifteen (15) business days if the information or evidence included in the request for pre-approval was insufficiently detailed or verified so as to enable the VGF Company to reach a decision within thirty (30) business days of receiving the request for pre-approval, and the VGF Company has issued a letter to the Institution requesting specific, additional information.

Requests from Institutions will be reviewed by VGF Company on a first-come first-serve basis.

The decision of the VGF Company shall be based on its assessment of whether:

- i. The PPP Project is eligible, in accordance to the criteria listed in Article II section 1, to receive Viability Gap Funds; and
- ii. The assumptions made on Net Economic Benefits, True Cost, Cost-recovery Revenues, affordable Tariffs, Unitary Payment and Targetting are fair and reasonable, or whether adjustments in the Viability Gap Funds should be made to reflect the VGF Company's assessment of these assumptions; and
- iii. The Viability Gap Fund has sufficient uncommitted funds to honor the Viability Gap Funds disbursements in the dates required by the PPP Project; and
- iv. If the ratio referred to in Article II, Section 1(2) is greater than zero point two (0.2), the Institution has the capacity in its budget or has other

committed sources in addition to Federal Funding, to cover the additional funds needed.

The VGF Company's decision shall be communicated to the Institution and should include the present value of the Viability Gap Funds pre-approved for the PPP Project.

In case, it is imperative to revise the scope and manner of VGF in light of the pre-bid interaction with the potential bidders, the process of Pre-Approval of VGF will have to be re-initiated by the institution.

Section 3. Request for Final Approval: After completing the Competitive Selection Process, the Institution will submit to the VGF Company, a request for final approval of the Viability Gap Funds for the pre-approved PPP project.

The request shall include:

- i. Evidence that the Competitive Selection Process was carried out, as well as a report summarising its results; and
- ii. An initialled draft of the PPP agreement between the Private Party and the Institution; and
- iii. The present value of the Viability Gap Funds requested by the Winning Bidder.

The VGF Company will prepare instructions that Institutions should follow when preparing their requests.

Should the present value of the Viability Gap Funds of the Winning Bidder be equal to or less than the Viability Gap Funds pre-approved by the VGF Company, the VGF Company's final approval shall be based exclusively on its satisfaction that the selection of the Winning Bidder followed a Competitive Selection Process, and that the draft PPP agreement is consistent with terms included in the request for pre-approval.

Should the present value of the Viability Gap Funds of the Winning Bidder be more than the Viability Gap Funds pre-approved by the VGF Company, the VGF Company's final approval shall be based on its satisfaction that the True Cost of the Winning Bidder is fair and reasonable and that it still meets the eligibility criteria "Limited Viability Gap Funding" as described in Article II, Section 1(2).

Section 4. Final Approval: Within fifteen (15) business days from the date on which the VGF Company received a request for approval prepared in accordance with the instructions, the VGF Company shall determine whether the PPP Project is approved to receive Viability Gap Funds, or whether additional time and information is needed to establish if the True Cost of the Winning Bidder is fair and reasonable. If additional time and information is needed to establish if the True Cost of the Winning Bidder is fair and reasonable, the VGF Company must issue a written notice to the Institution notifying the Institution of the delay in approval, and may take a maximum of fifteen (15) business days from the date of issuing the written notice to reach a decision.

If the VGF Company is unable to reach a decision within this period, the request will be deemed approved for the entire amount requested by the Institution.

The VGF Company's decision shall be communicated to the institution in writing.

Section 5. Tripartite Agreement: Within sixty (60) business days from the date in which the VGF Company has issued its final approval, the Institution, Winning Bidder, and the VGF Company shall enter into a Viability Gap Funds Agreement which will be based on the model agreement prepared to that effect by the VGF Company.

ARTICLE IV

Management and Control of Viability Gap Fund

Section 1. To manage and control the Viability Gap Funds, the Ministry of Finance will create an arrangement with all of the following features:

- **Establishment:** The Viability Gap Fund shall be incorporated as a company limited by guarantee in accordance with the Companies Ordinance, 1984.
- **Funding:** The budget of the VGF Company shall come from transfers made by the Ministry of Finance following requests by the Board of the VGF Company.
- **Governance:** The VGF Company shall be governed by a Board whose members are appointed by the Federal Government.

The Board shall have the power to, amongst others:

- i. Approve Viability Gap Funds for eligible PPP projects. The Board may delegate to the Chief Executive Officer (CEO) the power to approve PPP Projects that have a total capital cost equal to or less than a defined threshold. The present value of the Viability Gap Funds approved by the Board or CEO shall not exceed the uncommitted budget of the VGF Company when the approval was granted
- ii. Approve the procedures to be followed for submission, appraisal and approval of Viability Gap Funds
- iii. Approve model Viability Gap Funds Agreements
- iv. Approve a business plan (including budget) prepared by the CEO
- v. Request additional budget allocations from the Ministry of Finance.

Management: The VGF Company will be managed by a CEO appointed by the Board.

The power and functions of the CEO are to:

- i. Prepare annual business plans and seek their approval by the Board
- ii. Hire and fire the staff of the VGF Company
- iii. Oversee the general management and administration of the VGF Company
- iv. Analyse requests for Viability Gap Funds pre-approval and approval submitted by Institutions, make recommendations to the Board on

whether it should approve these requests, or make decisions on requests for those PPP Projects where the Board has delegated its authority

- v. Enter into Viability Gap Funds Agreement for approved PPP Projects
- vi. Make Viability Gap Funds Payments to Institutions or Private Parties in accordance with Viability Gap Funds Agreements
- vii. Monitor the effective use of Viability Gap Funds by Institutions or Private Parties, in accordance with Viability Gap Funds Agreements
- viii. Represent the VGF Company in disputes or any other type of legal case
- ix. Prepare quarterly operational and financial performance reports to the Board.

Accounts and Audits: The accounts of the VGF Company shall be operated jointly by the CEO and one officer of the VGF Company as directed by the Board.

The accounts shall be maintained in accordance with the provisions of the Companies Ordinance 1984 and shall be audited annually in accordance with the provisions of the said ordinance, and shall be subject to audit by the Auditor General.

ARTICLE V

Disbursement and Monitoring

Section 1. Disbursement: Upon completion of agreed, measurable outputs defined in the Viability Gap Funds Agreement, the Private Party shall submit an invoice to the Institution, and the Institution shall verify that the outputs have been delivered. The Institution shall submit the approved invoice to the VGF Company for payment.

Section 2. Random Verification: The VGF Company will have the right to directly, or through a third party, conduct at its own discretion audits to directly verify that outputs have been delivered.