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MARKET FOCUS: THE SMALL PROVINCIAL AUTHORITY DOING BIG THINGS IN PAKISTAN

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Sindh province is said to have the most active PPP authority in Pakistan. After highways, it has turned to billion-dollar special economic zones, water supply and wastewater treatment PPPs, drawing investors, advisors and legal experts to the country, reports Rouhan Sharma

Asia

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Just a few years ago, Ali Khan, founder and managing partner at Ali Khan Law Associates didn't want to have anything to do with the government in Pakistan's Sindh province.

"Private firms are usually reluctant to work with the government because of the usual problems one hears about that plague governments in developing economies," says Khan, who has worked in the US, Latin America and the UK.

But while at another firm, he was dragged into contact with the Sindh provincial government after lenders to the province's first PPP infrastructure project – the Hyderabad-Mirpurkhas dual carriageway – engaged his services in 2011. A concession agreement was already in place, so Khan dove straight into the financing documents to structure the financial aspects.

Local banks, hesitant at first, because of concerns over the commercial viability of the project and weak credit rating of the provincial government, finally agreed to finance the project after revenue and interest rate guarantees, as well as a viability gap funding, were provided by the government.

The project turned operational in 2012 with a 30-year concession and Khan has been involved in every PPP infrastructure project since then in Sindh province.

But the project was also a turning point for the Sindh PPP unit, set up in 2010, that had hired international consulting firms from Pakistan, India, South America and UK to advise them on the transaction.

"While we were developing the institutional framework for PPPs, we were simultaneously trying to offer this road project for bidding," says Khalid Mehmood Shaikh, director-general of the province's PPP unit, adding it was a lot like learning on the job. "We hired the best consultant in Pakistan and the foreign consultants helped them to make the project business-friendly as well as helped us to develop the institutional framework for PPPs."

Now, there is a palpable buzz about the province.

Of the total 10 projects that have turned operational since those early days, seven have been in the last five years and another one – a bridge over the river Indus – is currently under construction. A twelfth project – Malir expressway – has just been awarded and the thirteenth – the DSEZ project – will be awarded within the next few days. There are nine projects that are in their late stages of development and expected to be offered to investors within the next couple of years and another 16 being worked on that are in the pipeline.

Sindh buzz

The imminent closure of the USD 1.5bn transaction to build a special economic zone as a PPP is a landmark for the PPP unit of Sindh province.

Its largest transaction till date, the Dhabeji Special Economic Zone (DSEZ) project, together with the USD 231m Malir expressway awarded in January this year – are indicative of just how far the unit has come since its first concession for the USD 80m expressway signed in 2009.

Back then, the unit did not even have a PPP framework in place while it was tendering that first expressway project.

"We were simultaneously trying to offer this road project for bidding while developing the institutional framework for PPPs," says Shaikh at the PPP unit, adding it was a lot like learning on the job.

In the last decade, the likes of EY and KPMG showed interest and have worked extensively as advisors for projects from the Sindh province's PPP unit. They are now increasingly being joined by other multinational firms. Recently, Rotterdam-based consulting major Rebel Group bid for two projects in Sindh in the last few months – one of which saw another first time bidder, La Salle Technova from Spain, also a first-time bidder.

Figuring among the top ten global law firms both by number of lawyers and revenue, London-headquartered Norton Rose Fulbright recently started working with Ali Khan Law Associates on Sindh's first water treatment PPP project.

Sindh's executed PPPs	Department	Cost	Project Structure
Hyderabad Mirpurkhas Dual Carriageway	Road & Transportation	PKR 6.8bn	Toll road with Minimum Revenue Guarantee (MRG)
Jhirk Mulla Katiyar Bridge	Road & Transportation	PKR 4.5bn	Annuity based payments
Karachi Thatta Dual Carriageway	Road & Transportation	PKR 8.8bn	Annuity based payments
Safety and Security at NICH	Health	PKR 135m	Management Contract
Performance-Based Contracts Health – 2015	Health	Variable	Management Contracts
Children Hospital North Karachi	Health	Variable	Management Contract
Regional Blood Centers	Health	Variable	Management Contract
Sindh Ambulance Service	Health	Variable	Management Contract
Teachers Training Institute - Hussainabad	Education	Variable	Management Contract
Education Management Organizations	Education	Variable	Management Contract
Source: PPP unit, Government of Sindh			

In the early days, multilateral banks were among the first entrants with the Asian Development Bank (ADB) helping to establish the PPP framework, followed by a law that was enacted and is now called the Sindh Public Private Partnership Act 2010. The provincial government then constituted a PPP policy board headed by Sindh's chief minister as its chairman, finance minister as vice chairman and other senior government functionaries as board members. The board identifies and evaluates the importance of programmes and projects to be taken up in a PPP, under different departments of the provincial government, says Shaikh, adding that various policies and guidelines were further formed, approved and notified in 2012.

Stakeholders that work with Sindh's PPP unit say it is the most active PPP authority in the country.

“The projects from the Sindh province’s PPP unit have a bigger scope and are more complex as the unit has moved on from simple highway projects to doing special economic zones, water supply, wastewater treatment, as well as technology projects,” says Huzefa Mazahir, principal, transaction advisory services at EY Pakistan.

Yes prime minister

The biggest institutional reform was to minimize the intervention of the public sector in project preparation and procurement.

“We introduced the concept of an environment impact study (EIA), escrow bank accounts, independent engineers and auditors to evaluate projects and created a framework that replaced the cumbersome public sector reviews and approval mechanisms,” says Shaikh. “This proved to be extremely efficient and our transactions began to be seen as credible."

However, Shaikh credits the province’s success largely to the political backing for PPPs, and the arrangement where the chief minister is the head of the policy board that approves projects, working in its favour. This is also the reason why Sindh has pulled ahead of what it sees as its competition – the Punjab provincial and federal PPP authorities, respectively – both of which do not have either the chief minister or the Prime Minister as heads of those institutions.

“This matters a lot as our political leadership has put all its weight and efforts behind this PPP unit to ensure PPPs are successful,” adds Shaikh.

Sindh live PPPs	Sector	Cost	Project Structure
Ghotki Kandkot Bridge	Roads & Transportation	PKR 14bn	Annuity based payments
Malir Expressway	Roads & Transportation	PKR 28bn	Toll road with Minimum Revenue Guarantee (MRG) support
Dhabeji Special Economic Zone	Industrial Development	PKR 19bn	Revenue sharing model with a windfall sharing mechanism

Source: PPP unit, Government of Sindh

A third reason for its success is human resources.

“The framework may be in place, but we still need a good team to run it efficiently who understand both the capabilities of the private and public sectors,” says Shaikh, adding that both sets of officials have worked well together so far.

“I generally play the role of a bridge between both of them since I have been here from the first day onward,” he says, adding that the continuity has helped to develop and implement the Vision and mission of the institution.

Staffed with a core team of 15 people with notable academic track records, drawn from the private sector from top banks and corporate firms worldwide, the team’s experience and expertise span investment research, law, policy-making, financial modelling, deal structuring, project finance and civil engineering, among other critical areas.

Pakistan's problem

The team has its task cut out, more so because public expenditure on infrastructure has remained well below required levels.

The Asian Development Bank estimates that Pakistan’s annual infrastructure investment deficit is about 6% of its gross domestic product (GDP). With a GDP of almost USD 300bn, the gap in the country’s annual infrastructure investment works out to about USD 18bn.

For Sindh, which contributes about 30% to the nation’s GDP, with Karachi – the country’s largest city and financial hub – alone contributing over half that figure, the provincial government needs to invest USD 4bn-USD 5bn annually in creating and upgrading infrastructure, says EY’s Mazahir.

Public transport, water, sanitation, solid waste, air and environmental pollution, are all areas that need immediate attention, according to a World Bank report that estimates a required investment of USD 10bn in Karachi city over a 10-year period through 2026, in the aforementioned areas.

The report estimates that 45 people compete for a single bus seat in Karachi, compared to 12 in Mumbai and eight in Hong Kong, necessitating an upgrade to its transportation services and infrastructure. Traffic congestion is a critical issue as well as the lack of parking spaces. As a result, the city requires an investment of about USD 5bn in urban transportation alone for which the private sector too needs to contribute.

The report also notes water supply and sanitation are severe challenges with only 55% of water requirements currently being met. The shortage stands at about 750 million gallons per day.

“We’re collecting revenue for only a little over 20% of the water supplied to the city,” says Shaikh, who is also the managing director of the Karachi Water and Sewerage Board (KWSB).

Revenue collection has actually decreased, and government institutions and utilities are among the largest defaulters to the water utility, according to the World Bank report which also notes that the water redistribution system is about half a century old with corroded pipes that are unfit for use. Sewerage network coverage is estimated at 60% with challenges of inadequate sewer trunk mains, malfunctioning pumping facilities, and insufficient wastewater treatment capacity. There are three wastewater treatment plants that are dysfunctional and no industrial effluent treatment plants. All waste, including medical waste, is discharged directly into the Arabian Sea.

“The situation is alarming,” says Shaikh.

Prioritising water

The Sindh government’s focus for the next few years will be on delivering a pipeline of water treatment and solid waste management projects, given the dire need for their proper management.

“Primary and secondary water treatment projects are both being prepared, and we are aiming to have a sizeable number of such projects that we can start offering to investors for bidding by 2023,” says Shaikh, adding that this is the top priority.

The first wastewater treatment project is already in the works.

The project's aim is to provide 40-50 million gallons of recycled wastewater to an industrial area, freeing up potable water for the city. At present, enterprises in the area either use potable water through informal channels or secure treated brackish water. This is still inadequate for their needs and has affected their expansion plans, says Shaikh.

For the project, KWSB has received an unsolicited proposal from a large local company.

Prominent projects in pipeline	**Description**
Link Road (M9 to N5)	20 km road to connect main highways of Karachi
Urban Road Initiatives in Karachi Katiyar Bridge	Different projects of roads/bridges
Municipal Wastewater Recycling Plant	Wastewater recycling
Wastewater Recycling for Potable Water Production Project at TP-III	Wastewater recycling
Marble City Project	Special Economic Zone
NED Technology Park	Technology & Innovation
Nabisar to Vajihar Water Transmission	Water supply for power projects

Source: PPP unit, Government of Sindh

A solid waste management project is in the preparatory stages for which a kick-off meeting has been held with the province’s solid waste management board and a multilateral lender that is keen to provide support.

Urban transport is in focus as well and old roads may be upgraded and new ones built to ease the problem of congestion, Shaikh says. Healthcare and education are also priorities and projects involving hospitals, blood centre and schools are under preparation, he adds.

Pooled funding

Project finance has been challenging in Pakistan, and not just in Sindh, with local banks unwilling to support projects without upfront cash guarantees.

"Funded guarantees have now reduced but it remains a challenge," says Shaikh.

The government of Sindh has been able to provide these upfront cash collaterals 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 Khan. "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 a collateral that was 15% higher than the cost of the project.

In recent transactions, the requirement of funded guarantees has reduced to about 50-55% of the project's cost, according to Muhammad Danish, finance director at Sindh's PPP unit.

In the unit's most recent transaction – the DSEZ project – due to be awarded to a Chinese bidder in a few days, the provincial government is neither extending any viability gap funding nor providing any funded guarantees.

"Structured on a revenue sharing model, the private party is taking on complete demand risk," says Danish, adding that in the Malir Expressway project, the viability funding is also lower than in earlier times.

"The era of funded guarantees may be coming to an end," says Mazahir who advised the Sindh Economic Zones Management Company on the DSEZ project, adding that as more projects are successful and the investor base diversifies, banks will also gain confidence and have a portfolio of projects that perform to expectations. "There is still a need to also look for alternate sources of debt capital from local institutions," he says.

Meanwhile, in Punjab

Pakistan's constitution gives provinces responsibility for local infrastructure development but certain sectors like power plants have historically been handled at the federal level, says Mazahir, adding that the power sector has implemented many PPPs, but not as part of a national, dedicated PPP framework.

"This has resulted in power PPPs attracting investments while other infrastructure segments have lagged," he adds.

The Punjab provincial government has done two infrastructure projects in a PPP and two more are seeking financial closure while Khyber Paktunkhwa is attempting to successfully offer its first PPP – an expressway project – to investors.

The federal PPP Authority has called for bids for a few projects but is still working on refining a framework, says Khan, who is advising the federal authority.

"It will be another three to six months before they step up activity levels," he says, adding that the changes being made are in the areas of defining the powers and scope of the authority, approval mechanisms for projects and policy support. While there is recognition for the potential for PPPs for infrastructure development, regulatory risks remain around dispute resolution and arbitration is unclear.

While authorities across the country are preparing their moves into PPPs, Sindh's PPP unit isn't resting on its laurels just yet. The unit is planning to amend its framework further to accept unsolicited proposals from private parties to enable privately-initiated PPPs, as well as government-to-government direct transactions.

"This will help the public sector to identify and develop projects that align with government's infrastructure plans and with identified societal and economic needs," says Danish.

What is clear is that PPPs will catch on as the federal and the two provincial authorities of Khyber Pakhtunkhwa and Punjab have settled on the format for developing their infrastructure.

The Sindh PPP unit is about to get a run for their money.

Deal Profile

Malir Expressway PPP

PAKISTAN | Transport | Roads | PPP | Greenfield

Karachi NED University Science and Technology Park PPP

PAKISTAN | Social Infrastructure | Education | PPP | Greenfield

Dhabeji Industrial Zone PPP Development

PAKISTAN | Other | Other | PPP | Greenfield

Grantor Financial Advisor	**EY**
Grantor Legal Advisor	**EA Consulting**, **RIAA Barker Gillette (RIAA LAW)**

Advisor Profile

Asian Development Bank

PHILIPPINES | Financial | Deal count: 15

EY

UNITED KINGDOM | Financial | Deal count: 939

Norton Rose Fulbright

UNITED KINGDOM | Legal | Deal count: 1001

KPMG

NETHERLANDS | Financial | Deal count: 798

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