VIABILITY GAP FUND (VGF) GUIDELINES 2012

For Public Private Partnership Projects In Sindh

Public Private Partnership Unit Sindh
Finance Department
Government of Sindh

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Finance Department

VIABILITY GAP
FUNDING GUIDELINES 2012

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1. INTRODUCTION

1.1. The Government of Sindh (GoS) intends to improve infrastructure across all economic and social sectors in a manner that is both affordable and of long term durability. This will achieve sustained development across all sectors and will bring about socio-economic uplift of all the people of the province.

1.2. Towards the achievement of this objective, the Government will not shy away from procuring large-scale development projects or multiple groups of smaller scale projects that require large investment, simply because of a paucity of public funds. It intends to attract finance from the private sector and from International Financial Institutions and Donor Agencies by using the technical strength, expertise and efficiency of Public-Private Partnership (PPP) procurement.

1.3. The Government will use PPP procurement principally but not exclusively where it is possible for the private sector to charge the users of the infrastructure or its beneficiaries in order to recover its costs repay its debts and make a return on its investment. The Government recognizes, however, that there will be many projects where it is policy not to charge the users of assets, for example public schools, public hospitals, rural roads, etc. There will also be economically justifiable projects where the payment by users or beneficiaries will be insufficient to make the project financially viable, for example where the operators of such projects are constrained, either by Government or by the market, from charging unacceptably high tariffs.

1.4. The Government also recognizes that there would be many infrastructure projects where user charges are not sufficient to meet the developer required return or there are projects which shall be developed on Annuity Based, Shadow toll/ income, or Performance based payments. Thus, a Viability Gap Fund (VGF) shall be used to make such requisite payments.

1.5. The Government wants to attain PPP mode generated efficiencies in these projects and therefore has decided to dedicate a portion of its budget to the creation of a Viability Gap Fund (VGF) that will be used to make such economically viable projects financially viable.

1.6. The Government therefore approves and promulgates these Guidelines which set out the criteria that have to be met before a project is regarded as being eligible for support from the VGF;

i. **Application:** the procedures for applying for such support;

ii. **Distribution:** the mechanism for approving, disbursing and monitoring the funding;

iii. **Management:** And setting out the arrangements for managing, controlling and governing the VGF itself.

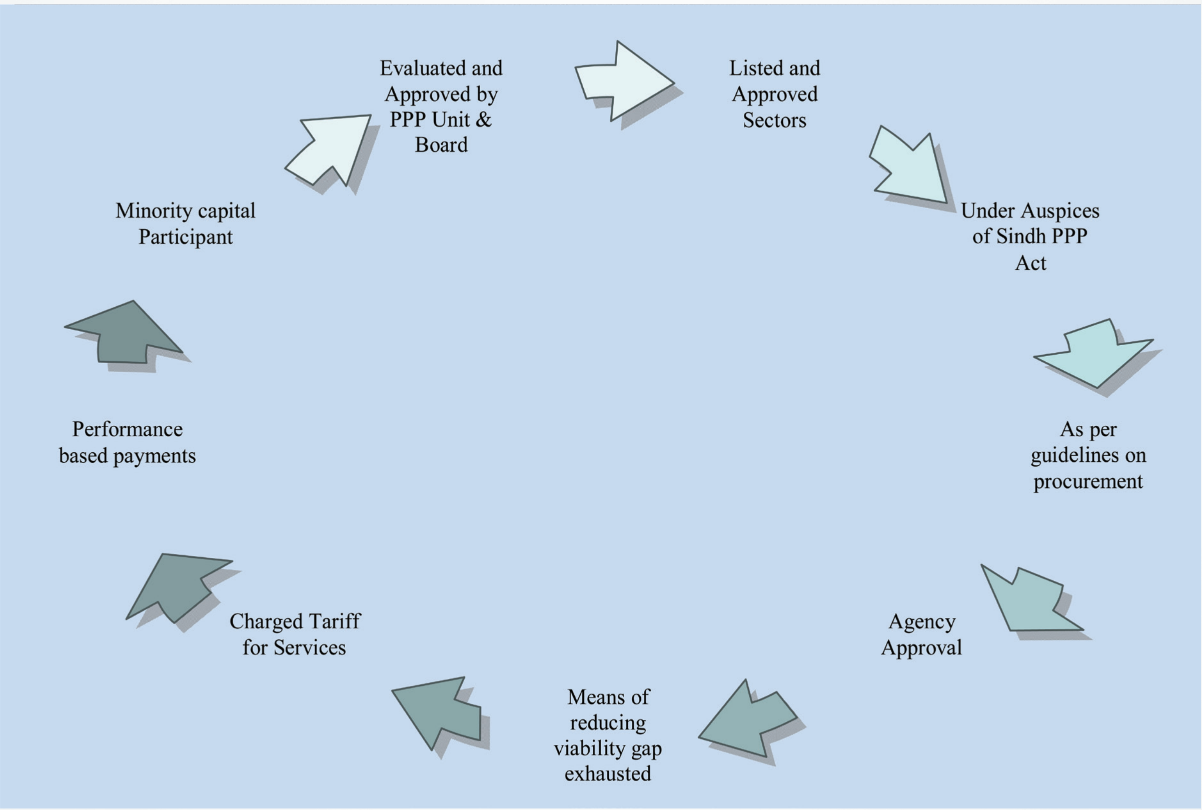
2. VIABILITY GAP FUNDING

2.1. The VGF will provide the funds for those projects approved by the Government that are economically viable but financially unviable. *The funds shall be disbursed to the private sector operator/ project company which has been contracted to carry out the project under any PPP variants mentioned in the Sindh PPP Act, 2010.*

2.2. The VGF will therefore *cover all of the contractual payment where the users or beneficiaries are not required to pay*. Alternatively, the VGF will pay the difference between the contractual payment necessary for the Developer to recover his costs and to meet his agreed return on investment and the estimated amount that will be recovered from the users. This will entice the interest of the private sector in important public infrastructure projects as they will be satisfied that there are sufficient funds to allow successful project implementation. It will also provide the necessary reassurance to the lenders of the project company by enhancing the creditworthiness of the project.

3. ELIGIBILITY CRITERIA

3.1. A project that is procured through transparent and fair PPP competition, in accordance with procedures that have been approved by the PPP Policy Board, shall be eligible for VGF funding if it satisfies all of the following criteria:



3.1.1. **Listed and Approved Sectors:** The project must provide infrastructure in one of the sectors listed in Schedule I of the Sindh Public-Private Partnerships Act, 2010 (the Act).

3.1.2. **Under Auspices of Sindh PPP Act:** The Government support through VGF in a PPP Project shall be subject to Sindh Public Private Partnership Act 2010.

3.1.3. **As per guidelines on procurement:** The procurement of the project must have been in accordance with the Act,the Rules, Guidelines and any guidance relating to procurement issued by the Board, the PPP Unit or any other Government Agency.

3.1.4. **Agency Approval:** The project must have been vetted and endorsed by the administrative head of the Agency and associated Ministerial Authority.

3.1.5. **<u>Means of reducing viability gap exhausted:</u>**The concerned procurement agency should certify, with reasons;

3.1.5.1. That the tariff/user charge cannot be increased to eliminate or reduce the viability gap of the PPP.

3.1.5.2. That the Project Term cannot be increased for reducing the viability gap;

3.1.5.3. That the capital costs are reasonable and based on the standards and specifications normally applicable to such projects and that the capital cost cannot befurther restricted for educing the viability gap.

3.1.6. **<u>Charged Tariff for Services:</u>** The project should provide a service against payment of a pre-determined tariff or user charge .

3.1.7. **<u>Performance based payments:</u>** Any contractual payment to the project operator/company must be able to be reduced if the project operator/company fails to perform its obligations: in particular, the payment must be linked to the delivery of outputs specified in the contract and an acceptable system of measuring that performance must be in place to ensure that full payment is only made if full performance is achieved.

3.1.8. **<u>Minority capital Participant:</u>** In case where the support from VGF is by way of financing the capital expenditures of the project or through equity participation in the Project Company, the VGF shall not be (i) the largest shareholder in the Project Company (ii) the largest financer of the capital expenditure in the Project.

3.1.9. **<u>Evaluated and Approved by PPP Unit and Board:</u>** examined and evaluated by the PPP Unit, and approved by the PPP Policy Board (the Board).

3.1.10. **<u>Relevant procedures and requirement met:</u>** The calculation of the amount required from the VGF must have been included by the Agency in the feasibility study and must have been reviwed by the PPP Unit and approved by the PPP Board. The Agency must certify in any final request for VGF that they have taken all necessary steps to reduce the need for VGF support by:

3.1.10.1. Increasing any tariff or direct user charge;

3.1.10.2. Increasing the project term;

3.1.10.3. Reducing the combined initial capital and lifecycle costs to bring them into line with prevailing market conditions.

4. MANAGEMENT AND CONTROL OF THE VGF

4.1. The Finance Department (FD) of the Government of Sindh (GoS) shall be responsible in the first instance for the creation of a system to manage and control the VGF. The FD will manage the VGF from the date of issue of these guidelines. Because the VGF is designed to support long-term contractual payments it will be ring-fenced.

4.2. The FD will estimate, on a regular basis the likely annual demands that will have to be met from the VGF. The Sindh Fund Management House (SFMH) of Finance Department shall also have the power to review financial models, invoices and payment requisitions etc for each PPP Agreement that is signed in order to ensure for their own satisfaction that payments from the VGF have been properly calculated and authorized and that, if deductions have been made from any payment to a project company, the correct amount has been paid from the VGF. For review of the said calculations, SFMH shall rely on the data provided by the procuring agency, Project, PPP Unit or who-so-ever has requested support from the VGF. If the VGF is obliged to meet cost overruns or minimum levels of revenue (in the case of user-pay projects), the FD or its nominee shall have the power to see any information on costs or receipts that are held by the Sector Agency or by the project company.

4.3. The funding for those projects, that were initially envisaged to be financed from the Annual Development Plan (ADP) and were later decided to be implemented in the PPP mode, shall be transferred from the Development Fund (DF) to the VGF. The amount to be transferred shall be an estimate of the capital costs of providing that asset by traditional procurement.

4.4. The SFMH in coordination with PPP Unit and Budget Wing will estimate on a semi-annual basis the contingent liabilities (including guarantees, warranties, etc.) relating to the VGF. The FD will publish on a semi-annual basis the total amount of contractually-committed payments from the VGF and an estimate of all non-contractually-committed contingent liabilities. The amount for each future year shall be identified separately.

4.5. The FD will report to every meeting of the PPP Board the inflows into the VGF, the outflows from the VGF, *the remaining and envisaged liabilities of the* VGF, and the balance of the VGF and shall ensure to release the requisite funds required to meet these obligations.

4.6. The VGF fund can be financed through the budget, gifts, grants, transfers or by any other means the Finance Department deems appropriate.

5. REQUEST AND APPROVAL PROCEDURES

5.1. Before seeking support from the VGF, the Agency will have produced a *feasibility study which will contain an estimate of the VGF support necessary to make the project viable*. Before launching a PPP competitive bidding procedure, the Agency shall prepare a proposal for pre-approval of VGF support for a specific project based on the estimate in the feasibility study. The proposal shall include the evidence necessary to demonstrate compliance with the eligibility criteria and categories the request for support as VGF Capital or VGF Operating. The Unit shall evaluate the project proposals and suggest any changes which may reduce the level of government support.

5.2. The PPP Unit will develop the detailed instructions that applications should follow to demonstrate compliance with the eligibility criteria.

5.3. Within thirty (30) business days, from the date that the PPP Unit receives the complete proposal for pre-approval of VGF support in accordance with issued instructions, the Unit will make recommendations to the Board. The Board shall decide on pre-approving all, part or none of the VGF requested by the Agency.

5.4. The Unit can extend this period if the information or evidence included in the proposal for pre-approval is incomplete, insufficient or unable to be verified and the Unit has issued a letter to the Agency requesting specific additional information.

5.5. The decision of the Board shall be based on its assessment of whether:

5.5.1. The PPP project is eligible in accordance with these eligibility criteria;

5.5.2. The assumptions made about net economic benefits, true cost, cost recovery amounts, affordable tariffs and/or the unitary payment are fair and reasonable; and

5.5.3. The VGF has sufficient uncommitted funds to honour the VGF timing and amount of the disbursements set out in the proposal.

5.6. The Board can substitute its own assumptions described in 5.5.2 after consultation with the Sector Agency.

5.7. The Board's decision will be communicated to the Agency and will include its calculation of the present value of the VGF support pre-approved for the PPP project.

5.8. If, at financial close, the scope and/or manner of VGF support need to be revised, the Agency shall submit an amended proposal for approval of VGF support in accordance with this guidance to the PPP Board. Provided that minor changes which do not exceed the 20% of agreed VGF level, in such an occurrence it can be decided at the TFEC level to allow such an amendment when the latter is evaluating and approving the financing documents.

5.9. The amended proposal shall contain:

5.9.1. An initialed draft of the PPP Agreement between the Agency and the project company; and

5.9.2. The estimated present value of the VGF support to make the project financially viable.

5.10. The Unit will recommend to the Board, with the updated VGF support required, whether the contract award should be approved or refused.

5.11. When the minutes of the Board have been approved, the Unit shall communicate the decision of the Board to the Agency in writing.