Public Private Partnership Support Facility

Extract of Risk Report

Jan to Mar 2023

1. Introduction and Overview

This Risk Report serves multiple purposes such as:

- Highlights project specific risks and elaborate upon risk mitigation measures already embedded in the projects' Concession Agreement, and to suggest risk mitigation measures for risks assessed by PSF.
- Provides a complete picture of fiscal commitments that the GoS may have to incur in the likely occurrence of the assessed risk events. These fiscal commitments include direct obligations, contingent obligations and measures of affordability against available fiscal space.

2. Project-wise Risk Analysis

Education Sectors PPPs[1]

Education Management Organization (EMO) reform is one of the GoS initiatives focusing on the objectives of improved access and governance, better quality education and effective utilization of public resources. For this purpose, the operation and management of selected public schools/institutes is outsourced to credible and experienced private sector parties to make them helpful in achieving the targets as set out in Key Performance Indicators (KPI) framework based on the objectives of the EMO reform.

Three key aspects of education sector PPP projects can be discussed in the risk report to highlight the PSF recommendation to select a project under PPP mode:

(i) the affordability of the fiscal implications,

(ii) its sustainability and

(iii) the justification of the fiscal exposure in terms of value for money.

The following perspectives have been considered for the discussion of these three aspects of the education PPP projects in the risk report;

- *Affordability*:
    - The fiscal impact of one particular project should be affordable within the long-term budget constraints of the implementing agency as per the medium term expenditure framework for at least the first 5 years of the PPP term.
    - The fiscal impact of the direct liabilities should be affordable within the overall debt balance of the government
- *Sustainability:*
    - From risk perspective, there is no material risks in terms of high probability of occurrence in combination with a high fiscal impact. We can further define any risk, if identified, along with its mitigating measures.
    - High probability of occurrence is defined as a probability of more than 50%
- *Justification (of undertaking the risks):*
    - Value for money should be positive for every transaction.

[1] EPPP project has been amended time to time since its inception. The following legends are used for education PPP project analysis;

- The funding amount has been calculated from April 2018 to December 2022 with different applicable dates for each project due to their actual effective dates
- The partner contribution ratio for projects of RFP#1 to RFP#3 is taken as ADB+FCDO @65.48% and GoS @ 34.52% upto June 2022
- After the amendment in project agreement, the partner contribution ratio of whole amount of the projects RFP#4-6 and TTI is taken as ADB + FCDO @ 76.49% and GoS @ 23.51% whereas same ratio has been taken for the payable amounts between July to December 2022 for the project RFP#1-3.
- The project amount (exclusive of taxes) to be incurred during the EPPP period, is then divided in accordance with the relevant ratio of the partner contribution as mentioned above.
- The tax amount is to be paid by GoS.
- These amounts may also change in future as another amendment of extension of EPPP project till June 2024 is expected to be signed soon.

The PPP Support Facility (PSF) has to date approved funding of 171 schools and 3 (three) teacher training institutes, which were outsourced under 6 rounds of procurements, amounting to PKR 11,078 million in terms of nominal value. The overall risk profile of the project is proposed to be low as PSF is of the view that the Concession Agreements have satisfactorily allocated the perceived risks between the Government and the private parties, which might be mitigated if implemented with true spirit.

From budgetary perspectives, PSF could identify and set thresholds for putting in affordability criteria:

Education PPPs	# of Procurements	# of Schools	Funding Approved (Rs. In mn)
EMOs	6	171	9366.048
TTIs	1	3	1712.784

As per the Affordability and Contingent Liability Analysis conducted by the PSF, both these amounts will not make adverse financing burden on the GoS budgetary outlays and resources. Our finding is based on the following indicators:

- For affordability analysis, total bid cost of all education projects, so far, for 10 years' period was compared to the current FY ADP budget of GoS which ranges from 0.018% - 0.325% of the GoS provincial ADP Budget of FY 2022-23. When it is compared to ADP budget of SELD for FY 2022-23, the EMO cost of all these projects shall have an impact range, in percentage terms, between 0.382% (2016) and 7.042% (2023)
- The contingent liabilities as percentage of GoS-School Education provincial ADP Budget of current FY 2022-23 ranges from 0.218% (AY 2032)- 0.748%(2026) during 2022 to 2032.

During this quarter, following project related risks have been identified which have already been discussed with PPP Unit Finance Department and PPP Node of SELD to take risk mitigation measures.

- The challenge of Rehabilitation of old buildings of SBEP schools has been in demand of immediate attention of the authority as the current project structure does not allow private parties to rehabilitate these schools, hence these schools have to be rehabilitated through the GoS ADP schemes. However, this issue has not been addressed on priority basis which may result in interruptions and challenges in overall performance of the project.
- Recent floods and heavy rains (2022) caused unpredicted damages to the school buildings, some of them are being managed by EMOs. As mentioned earlier that the current project structure allows private sector parties to only do minor repair and maintenance. For the repair and maintenance of post-floods and rain damages, the EMOs seek the technical support and financial assistance of the authority. This challenge may grow to higher level if it is not attended in due time.
- Effective contract management is still a big challenge as it was in the initial days of the project. The remedial strategy of appointment of contract compliance manager in the project team also couldn't bring the desired results. The other reasons for ineffective contract management include insufficient number of staff, weak administrative powers and capacity to timely address the project issues and poor record keeping at PPP-N of SELD.
- Quarterly/ annually progress evaluation reports i.e. KPIs reports are generally not submitted in due time by the EMOs. Subsequently, the delay of evaluation and annuity payments is occurred which leads to compromise effective accountability, monitoring or remedial measures. This challenge is slowly causing the reversal of initial success of the EMO reform.
- Another risk is also growing towards medium level as some of the EMOs are facing retention of the key staff or hiring the key personnel whose qualification and relevant experience are not compatible to the project requirement as was committed in the technical bids of the EMOs.
- A delay is seen in opening the escrow accounts of schools under EMO-RFP#6. The delay is considered as a potential risk which may impede some or all the operations and management of schools, especially the activities relating to capex cost.
- Same delay is also observed in opening the escrow account of TTIs project which is also a condition precedent for execution of the contract. This delay may cause following challenges;

- The delay may take long time than usual for handing over facilities to the operators. The academic activities may have challenges to start in due time as they are linked to affiliating universities academic calendar.
- The delay may cause the lapse of a certain budgeted amount to be disbursed from FCDO grants if the account opening and disbursement process is completed before 30th April 2023.

One of the operators under TTIs project i.e. Sukkur IBA refused to continue its service partnership to operate and manage the GECE Sukkur. The refusal is justified on basis of increasing inflation which may, SIBA thinks, be the sole regulator in hindering the success of the project. Another operator i.e. IoBM had already refused to acknowledge the Acceptance of Letter for Award of Contract as the successful bidder for GECE Darsano Channo Karachi. Hence, contracts of two of four TTIs under same procurement package would not be executed due to refusal/ withdrawal of interest by the successful bidders. The executing agency should consider the terms and conditions of procurement management to avoid wastage of time and money which leads to delay the prospective benefits to the learners.

Malir Expressway Project

The Malir Expressway Project ('MEW'), with an estimated project cost of approximately PKR 28 billion, will be the single largest PPP transaction to date, and is expected to significantly ameliorate the road infrastructure of Karachi, the commercial capital of Pakistan. Therefore, it is imperative that MEW is executed completed and remain operational as per estimated costs, quality standards, maintenance and agreed timelines.

Failure to execute the project as per estimated costs and agreed timelines may result in reputational damage to the Government of Sindh, in addition to wastage of precious financial resources and loss economic value. Alternatively, if executed successfully, not only will the project realize the envisaged socio-economic benefits, but also strengthen the PPP credentials of the Government of Sindh.

In terms of the risk profile, the MEW project has allocated envisaged risks to a large extent between the GoS and Private Party. The Concession Agreement has also covered the envisaged risks extensively; however, some areas require further clarity. Moreover, PSF has conducted Affordability and Contingent Liability Analysis in order to provide the PPP Policy Board a broader picture of the fiscal implications of executing the project.

Our analysis indicates the following:

- The MEW is affordable for the GoS as the ratio of GoS support (both upfront equity and MRG) to the Annual Development Plan of the Local Govt. Department ranges from 0.42% to 6.9% based on conservative scenarios and methodology detailed in the main sections of this report.
- Contingent Liabilities however present a different picture, the quantum of which is dependent on the effective resolution of (i) Lead Costs (estimated by Transaction advisors to be around PKR 4.25 billion), and (ii) Land Acquisition issues. Since lead costs and land acquisition costs are to be borne by the GoS, therefore any delays in the timely execution of the project will result in ballooning of these costs, thereby affecting the project's Value for Money.
- PSF, ADB and FCDO will enable the project to comply with ESMS provisions through EIA and LARP studies. It is envisaged that any PSF's support will remain conditional on the adherence of ESMS provisions and their applicability in all letter and spirit throughout the project.
- The direct and contingent liabilities arising from termination and non-termination events range from a maximum of PKR 49.23 billion and PKR 29.39 billion to a minimum of PKR 15.57 billion and PKR 13.1 billion respectively.

By virtue of this Risk Report, the PPP Policy Board is requested to consider the significance of the following factors in the successful implementation of the MEW project, and to direct the concerned Department(s) / Agency to proactively work towards the timely resolution of the following issues:

- Capacity building with respect to contract administration and management, environmental and social safeguard implementation, and setup of fully functional PPP node in the Local Government Department;
- Delays in Land Acquisition;

- Section – 4 has already been issued on 18 Oct 2021. While necessary action/corrigendum has been requested by Project Director to DC office on May 03, 2022 in lieu of the recent changes in the alignment of MEX (for the sake of minimizing/avoiding the acquisition of private land up to the extent possible). Any further notification from DC office is still awaited.
- The Consultants (NESPAK) has completed the field activities pertaining to completion of Draft LARP of MEX and has submitted the same in mid of December, 2022. However, few smaller patches in the alignment are left pending intentionally because of the unavailability of formal approval of changes in the alignment (for some elevated sections of the alignment).
- The Draft LARP, as submitted by NESPAK in Dec 2022, has been reviewed and later shared with the PD MEX through PPP Unit before submitting to ADB. His response/feedback on the Draf LARP is still awaited.
- AG Sindh has issued legal opinion for lifting of sand from Malir River Bed vide letter AG-2763 0f 2020.

Some further issues also need to be addressed prior to project's financial closure. These include generically:

- Concession Agreement is silent on the mechanisms for the assignment and transfer of any project-related revenues that may accrue to the GoS, such as share of tolling revenues, class B dividends, levies and fines;
- Descriptive clauses detailing the treatment in terms of payments of relief events, for instance those relating to compensation prior to COD or post COD.

The earning profile in terms of benchmark revenues and sharing of excess revenues has been defined at the time of procurement. Therefore, no subsequent development by the concessionaire (such as the construction of additional interchange), from its own funds, should not be construed as a reason for alteration in the defined revenue sharing mechanism.