

Policy for PPPs in Infrastructure



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FOREWORD

This document presents the public-private partnership (PPP) policy of the Government of Punjab to seek private sector investments for infrastructure projects. Punjab, with its population of more than 90 million people, has always been on the forefront of national economic growth, as evident from its 60% contribution to the GDP compared to 55% share in the country's total population. Punjab's economic growth rate has often surpassed the rate for national economic growth. To sustain this economic growth, the Government needs to develop infrastructure at an adequate pace, including roads, water supply schemes, transport network and power plants. Although in recent years the public sector investments in infrastructure have been on the rise, the investments needs of the province far surpass the Government's resources. To bridge this infrastructure financing gap, the Government intends to seek private investment through the PPP approach. Such a strategy will not only provide opportunities for the private sector to grow and flourish in partnership with the Government but will also create fiscal space for the Government to allocate scarce resources to other developmental needs. The efficiency gains from private sector involvement in infrastructure projects are likely to further strengthen this partnership, thereby creating a win-win situation for both sides.

The Government however recognizes that private investments can only be sought under a sound and comprehensive framework that ensures transparency and provides confidence to potential investors. While such a framework should include a sound legal fundament, a robust institutional structure and appropriate financial support, the Government feels that most of all such a framework requires a strong policy commitment to PPP development and the related enabling environment. This policy therefore lays the foundation for creating this comprehensive framework by demonstrating the Government's commitment to PPPs. The other integral components of the PPP framework are also in the process of being developed and will soon be integrated into a comprehensive strategy as laid out in this PPP policy.

MESSAGE FROM THE CHIEF MINISTER

The Government of Punjab is committed to the well being of its people through sustained economic growth and provision of infrastructure services and facilities such as roads, schools, hospitals and power plants. We believe that in order to develop these facilities at a rapid pace despite limited public sector resources, it is critical to forge an effective and strong partnership with the private sector, promoting investment by domestic and international investors in Punjab's infrastructure sectors.

The Government has already demonstrated its commitment to modernizing the infrastructure in the province by investing in landmark projects like Lahore Ring Road. To undertake similar projects in various sectors across Punjab and to develop state-of-the-art infrastructure throughout the province, the Government is adopting a sound and comprehensive public-private partnership (PPP) strategy to attract private capital to these projects by providing policy and legal certainty to the investors.

The PPP policy underlines the Government's commitment to ensuring transparency and developing institutional support within the public sector to respond effectively to the private sector partners. The policy also lays out our intention to develop a cross-departmental PPP institutional framework to undertake PPP projects in various sectors. Very soon, this policy will be supported by appropriate PPP legislation providing further comfort to the prospective investors. Through this PPP policy the Government intends to attract the private sector to come ahead and partner with it to develop effective and robust infrastructure for the people of Punjab.

We hope that this PPP policy will be a harbinger for a new wave of private investments from investors from Pakistan and abroad, which in turn will pave the way for better and affordable infrastructure facilities and services, through faster project implementation, leveraging public funds, a shift from public to private sector management and enhanced accountability.

MIAN SHAHBAZ SHARIF
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MESSAGE FROM THE CHAIRMAN, P&D

Punjab's infrastructure needs are mounting with growing population and increased urbanization. While on one hand these growing needs put competing demands on limited public resources, on the other, they provide ample opportunities for the private sector to invest in the Government's priority areas and develop a public-private partnership (PPP). Such PPP projects will provide medium to long-term investment opportunities for private investors, while easing the fiscal pressure for the Government.

The PPP policy underscores the Government's objective and resolve to attract private capital for infrastructure projects in Punjab and lays out a structured approach to smoothly undertake such projects. There are numerous financially attractive PPP opportunities in Punjab, in sectors like roads, water supply and sanitation, solid waste management, and power plants, where there is a great potential for private sector's involvement.

The PPP policy is aimed at facilitating various government agencies in coming up with appropriate infrastructure projects and offering them to the private sector. The policy also demonstrates the Government's firm intention to undertake these investments in a transparent and efficient manner, providing full institutional support and utmost protection to the prospective investors and abiding by the principles of legal certainty, fairness, transparency, competition, contract sanctity and mutual support and benefit. The PPP policy clearly establishes a strong commitment by the Government to do what ever it takes to develop an overarching comprehensive framework, so that investors can partner with the Government without any apprehensions.

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CHAIRMAN

PLANNING AND DEVELOPMENT BOARD

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ABBREVIATIONS

BOT	–	build- operate-transfer
FD	–	Finance Department
GF	–	Guarantee Fund
IPDF	–	Infrastructure Project Development Facility
IPFF	–	Infrastructure Project Financing Facility
JV	–	joint venture
P&DD	–	Planning & Development Department
PDF	–	Project Development Facility
PPP	–	public-private partnership
VGf	–	viability gap funding

I. INTRODUCTION

1. There is a close correlation between infrastructure spending and economic growth. If infrastructure investments are not kept at the required level of at least 6% of gross domestic product, economic growth becomes constrained by power shortages, traffic congestion, high transport costs, and other infrastructure bottlenecks.

2. The Government of Punjab (the Government) has highlighted in its Medium-Term Development Framework 2005-2010 the importance of enhancing infrastructure services for sustaining economic and social development. Expanded service coverage and improved service quality in power and water supply, solid waste management and sewerage treatment, transport and logistics, and health and education are vital for Punjab's economy and the livelihood of its people. Tight fiscal constraints require innovative supplementary approaches – away from the Government's traditional role as the only infrastructure service provider – to ensure that the massive investment needs are met.

3. The Government recognizes the need for and importance and benefits of private sector participation in infrastructure development. Punjab accounts for more than half of Pakistan's population and economic output. However, it is estimated that less than 50% of its infrastructure investment requirements can be met by public sector funds. The Government wants to fill the gap through public-private partnerships (PPPs) and other forms of private sector participation. PPPs have been recognized worldwide as an essential mode of public service delivery. They attract private capital investment, increase efficiency through the profit motivation of the private sector, and help reform sectors through the reallocation of roles and risks.

4. Given the constraints on the government budget, PPPs will have to be mainstreamed in Punjab, rather than being used just for a few special projects. To fully utilize the PPP potential and ensure that PPP projects are successful and mutually beneficial for the public and private sector, a comprehensive PPP framework covering the relevant policy, legal, institutional, regulatory, cost recovery and financing aspects is being developed that will provide an enabling environment for private investments in infrastructure facilities. The Government is committed to eliminating any undesirable obstacles to such investments.

5. The PPP Policy aims at reinforcing the considerable enthusiasm for PPPs in various sectors, addressing the lack of trust between the public and private sectors to collaborate in infrastructure projects, and facilitating the creation of effective partnerships. The Government hopes to fully utilize the potential of PPPs for Punjab by strategizing and standardizing the PPP development. To ensure this, the PPP Policy states the objectives to be achieved through PPPs, provides guidance to the public sector on initiating, evaluating and executing PPP projects, and communicates the Government's position on PPPs to other stakeholders, including potential private partners and the public at large.

6. The PPP Policy is consistent with the federal-level *Policy on Public-Private Partnerships: Private Participation in Providing More and Better Public Services through Improved Infrastructure*, drafted by the Infrastructure Project Development Facility (IPDF) in Islamabad in May 2009. The PPP Policy describes both what needs to be done for PPPs and how to do it in a consistent manner. First, the theoretical foundation of the PPP concept is provided, the objectives and principles of the PPP Policy are outlined, and the sectors of its application are specified. This is followed by a description of the various components of the PPP framework providing an enabling environment for private investments in infrastructure. Finally, the recommended approach to the preparation and execution of PPP projects is presented.

II. PPP CONCEPT

A. Rationale

7. The worldwide successful introduction of PPPs has demonstrated the following main benefits:

- (i) Attracting private capital investment into infrastructure sectors (and thereby releasing public resources for other needs);
- (ii) Increases in efficiency and improvements in quality of infrastructure services;
- (iii) Increases in the effectiveness of the use of available resources and facilities; and
- (iv) Reform of infrastructure sectors through a reallocation of roles, risks and incentives.

B. PPP Definition

8. There is no universally accepted definition of this term on the international scene. Instead, a wide range of definitions can be found. For the purpose of this PPP Policy, the following definition, which captures the core PPP concept, is adopted:

PPPs are mostly long-term contractual arrangements between the public sector and a private sector company for the provision of an infrastructure facility and/or service with a clear allocation of risks between the two parties.

9. The main PPP features can be described in more detail as follows:

PPPs have been adopted around the world as a service delivery tool. Instead of the public sector procuring a public asset and providing a public service, the private sector creates the asset through a dedicated standalone business (usually designed, financed, built, maintained and operated by the private sector) and then delivers a service to a public sector entity/consumer, in return for payment that is linked to performance. PPPs permit the public sector to redirect its capital expenditures to meet urgent social needs and convert the infrastructure costs into affordable operating expenditure spread over time. PPPs allow each partner to concentrate on activities that best suit their skills. For the public, sector that means focusing on developing sector policies and identifying service needs, while for the private sector the key is to deliver those services efficiently and effectively.

10. The PPP approach represents a fundamental shift in the philosophy of public procurement. While the emphasis still remains for the public procurement to be as efficient as possible, there is a change in the evaluation of what is being procured. The focus under PPPs is towards outputs, i.e., services being provided. By contrast, the focus in the traditional procurement has always been on inputs.¹

¹ For example, in the case of building a power plant under traditional public procurement, the objective is to achieve the lowest construction price. If the same project is to be done under a PPP scheme, the objective will be the lowest cost of per unit of electricity generated throughout the lifetime of the power plant.

11. The capital and operational expenses incurred by the private investor can be recovered under the PPP concept by charging users for the service provided, through fixed or partially fixed periodic payments, or receiving availability payments in the form of unitary payments or annuities from the public sector over the concession period, or by a combination of both. Infrastructure projects require long gestation periods to ensure affordable tariff levels, which expose private investors' investment to significant risks. A clear and fair sharing of risks in financing, operating and maintaining infrastructure services between the public and private sector, based on a mutual commitment to achieve a desired public sector outcome while obtaining appropriate rate of returns for the private sector, is a distinguished feature of PPP projects and essential for their success.

C. PPP Modalities

12. Table 1 shows the range of key PPP types or modalities covered under this PPP Policy, with the role of the private sector gradually increasing down the table. Depending on the PPP modality, the infrastructure service is delivered with or without the construction of an infrastructure facility. The emphasis on service is important in this context as it distinguishes PPPs from traditional public projects where private companies may be involved in engineering, procurement and construction, but do not finance such projects, nor do they operate and maintain them after commissioning.

Table 1: PPP Classification

Modality	Owner-ship	Invest-ment	O&M	Commercial Risk	Duration (years)	Typical Example
Service Contracts	Public	Public	Public/ private	Public	1-3	Meter reading and billing, or road maintenance outsourcing
Management Contracts	Public	Public	Private	Public	2-5	Public utility management
Lease Contracts	Public	Public/ private	Private	Public/ private	10-15	Existing tourism facilities
Concessions	Public/ private	Private	Private	Private	25-30	Water supply concession
BOT Contracts	Public/ private	Private	Private	Private	20-30	Independent power producers

BOT = build-operate-transfer; O&M = operation and maintenance.

Source: Public-Private Partnership Handbook, Asian Development Bank, Manila, 2008.

13. As to the difference between concessions and build-operate-transfer (BOT) contracts,² the customer is usually the end user in the former, and the private sector thus bears the full commercial risk in terms of tariff collection and demand (e.g., water supply concession in an urban area). In BOTs, the private sector finances, builds, operates and maintains the facility according to the specifications of a public sector entity that in turn provides the service to the end users. In this case, it is the public sector that bears the tariff collection and demand risks (e.g., an independent power producer selling electricity in bulk to a government-owned power

² Or their variations such as build-own-operate (BOO), build-own-operate-transfer (BOOT) and rehabilitate-operate-transfer (ROT) contracts.

distribution company). BOTs are mostly greenfield or expansion projects, while concessions cover both existing and new facilities within the service area.

14. The high-grade PPP modalities frequently involve complementary investments from the public and private sector. An example is private investments in power generation that are complemented by public investments in power transmission and distribution. In the transport sector, the public sector can either implement the network of feeder roads to supplement a privately financed and operated toll road, or provide the land required for the toll road. PPPs in social sectors are often based on service contracts such as the training of public sector nurses in a large private hospital or the provision of hot water supply by an NGO in a small rural hospital.

15. As defined in this PPP Policy, the PPP modalities do not include privatization, which is handled under a different framework and by different institutions such as the Privatization Commission and the Punjab Privatization Board.

D. The Role of Joint Ventures

16. Joint ventures (JVs) are an alternative to full privatization in which a company is co-owned and operated by the public and private sector partners. While they may be suitable for economic sectors such as manufacturing and agriculture, JVs in the infrastructure sectors pose several problems. The Government's dual role as the regulator and a part owner could lead to conflicts of interest. A clear risk allocation, which is a major advantage of PPPs, is blurred by JVs. There could also be a tendency for direct negotiations, with the resulting lack of transparency and potential for corruption. In case of tendering, potential private sector bidders could be deterred by the dual role of the public sector as bidder and evaluator, as well as its information advantage, thus stifling competition.³

III. POLICY OBJECTIVES AND PRINCIPLES

17. In using the PPP approach, the Government has the following objectives:

- (i) Promoting **social development and inclusive economic growth** through development of infrastructure;
- (ii) Ensuring **sustainable long-term funding for infrastructure development** through mobilization of private investments;
- (iii) Ensuring **technical, economic and financial viability of infrastructure projects** through adequate project preparation;
- (iv) Improving the **efficiency of management, operation and maintenance of infrastructure facilities** through introduction of modern technology and management techniques;

³ According to the draft *Policy Guidelines on Public-Private Partnerships* of the Government of Sindh, the worst possible manner of executing a PPP is by assuming a part of responsibility for delivery of outputs through ownership via an equity investment in the project company. The *Guidelines* therefore rule out any equity support, or even a debt injection, for PPP projects. In the instances where government assets are utilized for a particular PPP, the *Guidelines* recommend that such assets be leased out to the private sponsors for a fixed term and at a commercial lease rate.

- (v) Achieving a **larger scope and better quality of infrastructure services** for end users through the additional financial and human resources mobilized from the private sector;
- (vi) Ensuring **financial sustainability of infrastructure services** through full cost recovery supplemented by viability gap funding (VGF), if necessary; and
- (vii) Protecting the **best interests of all stakeholders** including end users, the Government and the private sector.

18. To achieve these objectives, the Government is committed to adhering to the following principles:

- (i) **Legal certainty** – compliance with the relevant laws and regulations of Pakistan and Punjab;
- (ii) **Fairness** – creation of a level-playing field for all private investors, without any discrimination;
- (iii) **Transparency** – access to information to private investors and the public at all stages of the project cycle;
- (iv) **Competition** – absence of any limitations on participation in tendering;
- (v) **Contract sanctity** – securing of rights and interests of parties to the PPP agreement; and
- (vi) **Mutual support and benefit** – fair and mutually beneficial cooperation of parties to the PPP agreement.

19. The Government's commitment to promoting PPPs is expected to lead to the following benefits:

- (i) **More services** that will help cover both the current huge backlog and future needs in water and sanitation, solid waste management, transport, electricity supply, health, education and other basic services.
- (ii) **Better services** that will improve the quality of life of large segments of population.
- (iii) **Affordable services** that will allow access by low-income end users. Certain segments of the population cannot pay commercial tariffs, whereas the private service provider needs to fully recover its costs in order to sustain operations. In such cases, the Government will provide subsidies in the form of VGF, which are targeted to low income consumers, explicit rather than hidden as budget support, and performance based (i.e., paid to the provider only once the service such as 24 hour clean drinking water supply to the consumer's dwelling is actually delivered).
- (iv) **Timely services** that will help the Government meet the urgent service demands of its citizens.

20. These benefits will be achieved by the following means:

- (i) **Faster project implementation** by the private sector resulting in projects being completed on time. As borne out by experience in both developed and developing countries, public sector projects experience more delays than those undertaken by the private sector.
- (ii) **Leveraging public funds** with private financing from local and international markets. For every rupee that the Government spends it will strive to leverage the maximum possible from the private sector. The ultimate objective will be to limit the Government's contribution to providing targeted subsidies to low income consumers in order to allow full cost recovery by the private service provider.
- (iii) **Enhanced accountability** in service delivery by linking service provision to a firm contractual arrangement. The service levels will be defined clearly in the PPP agreements in terms of outputs and outcomes required from the private sector. The government agencies will be required to put in place strict monitoring mechanisms. Poor performance by the private service provider will be penalized and may result in contract termination.
- (iv) **Public sector management shift** from budget expenditure to whole life cycle cost management. Most of the services in the public sector are of poor quality because government agencies take a short-term viewpoint without considering whole life costing of assets, with the result that once these are commissioned they are not maintained and refurbished or upgraded in time. Since the focus in engaging with the private sector is on services it provides during the entire concession period, the private investors will have the incentive to ensure that the underlying assets are of good quality and adequately maintained.

21. The PPP Policy puts a great weight on safeguarding public interest and consumer rights by

- (i) Aiming at **uninterrupted public access** to essential infrastructure;
- (ii) Safeguarding the **interests of end users** in local communities, particularly those belonging to the vulnerable groups;
- (iii) Ensuring **public health and safety**;
- (iv) Protecting the **environment**;
- (v) Providing adequate protection of **end users' rights to privacy**;
- (vi) Providing **information to the public** about the obligations of the private sector and the Government; and
- (vii) Setting **affordable user charges** and tariff structure.

IV. SECTORAL COVERAGE OF THE PPP POLICY

22. PPP projects have been traditionally used worldwide in the hard core infrastructure sectors such as energy, transport and water supply. More recently, the use of this approach has been expanded to physical infrastructure in social sectors, such as education and health facilities. Suggestions have been made to expand the scope of the PPP Policy to all sectors. While it is beneficial to promote private participation in economic sectors such as manufacturing and agricultural production, the likely form is JVs, which are not considered to be the best practice for infrastructure PPP projects. As pointed out in para. 16, one of the main advantages of infrastructure PPP projects – the separation of the role of the Government as the policy-maker, planner and regulator from that of the owner and operator, and assignment of the latter to the private sector – is lost with JVs. Without such separation of the roles, a clear allocation of risks is not possible.

23. In addition, there are two fundamental differences between the infrastructure and economic sectors. As defined in para. 8, infrastructure PPP projects are long-term contractual arrangements between the public sector and a private company for the provision of infrastructure services, which have the character of public goods. Typical examples of such services, which are regulated by the Government, are supply of water; collection and disposal of solid waste; and provision of toll roads for vehicle users. In these sectors, services are the output and PPP projects are the preferred approach to private sector participation. By contrast, the economic sectors are unregulated and produce private goods such as industrial equipment, cars, milk or rice. Products are the output, and private investors get involved in these sectors through partial or full privatization. It is not possible to cover these different outputs and approaches by the same legal and institutional framework.

24. Based on the above considerations, this PPP Policy covers the following infrastructure projects defined in a broader sense to cover also the social sectors:

- (i) **Transport and logistics** including provincial and municipal roads, rail, airports, as well as warehousing, wholesale markets, slaughter houses and cold storage;
- (ii) **Mass urban public transport** including integrated bus systems as well as intra and inter-city rail systems;
- (iii) **Local government services** including water supply and sanitation, solid waste management; low cost housing, and education and health facilities;
- (iv) **Energy projects** including hydro and thermal power generation projects other than those being undertaken at the federal level;
- (v) **Tourism projects** including cultural centers, entertainment and recreational facilities and other tourism-related infrastructure; and
- (vi) **Industrial projects** including industrial parks and special economic zones.

V. PPP FRAMEWORK

25. Given the intense global and domestic competition for capital, the Government is putting in place a PPP framework that aims at attracting private investments by

- (i) Providing **policy and legal certainty** to investors;
- (ii) Introducing **effective institutional arrangements** for PPPs;

- (iii) Ensuring **fair risk sharing** between the public and private sector;
- (iv) Developing **adequate regulatory arrangements**, including effective mechanisms for dispute resolution;
- (v) Introducing tariff regimes that are based on **full cost recovery**;
- (vi) Making **supplementary financing arrangements** for project preparation and implementation; and
- (vii) Developing a **pipeline of attractive PPP projects**.

26. The PPP framework, which consists of various policy, legal, institutional and regulatory components, has the following main objectives:

- (i) Creating an **enabling environment for private sector participation** in infrastructure development (i.e., doing whatever is required to attract private investors); and
- (ii) Ensuring **consistency in preparing and executing PPP projects** across infrastructure sectors.

27. Table 2 summarizes how the different components of the PPP framework are linked to the above-mentioned prerequisites for attracting private investors.

Table 2: Components of the PPP Framework

Prerequisite	Component
Policy certainty	PPP policy and guidelines on its implementation
Legal certainty	PPP law
Effective institutional arrangements	PPP network (PPP Steering Committee, PPP Cell, Risk Management Unit, and PPP Nodes)
Fair risk sharing	Risk management guidelines
Adequate regulatory arrangements	Initially regulation by contract, later independent regulatory bodies
Full cost recovery	Cost-based tariff setting and adjustment mechanisms, complemented by direct government support through viability gap funding (if necessary)
Supplementary financing arrangements	Project Development Facility and Infrastructure Project Financing Facility
Pipeline of attractive PPP projects	Preparation and execution of pilot projects to start the process

VI. PPP LAW

28. For the private investments in infrastructure to materialize, a comprehensive and consistent cross-sector legal framework is essential that establishes a clear and predictable environment within which investors will finance, implement and operate PPP projects. International experience indicates that several areas are especially important for the success or failure of such projects. A failure is more likely when the responsibilities within government for PPP development are not clearly delineated, the procedure for selecting the private partners is vague, the procedure for dealing with unsolicited project proposals from private investors is not defined, and the content of the PPP agreement is not specified.

29. To provide a firm legal framework, the *Punjab PPP for Infrastructure Act* is expected to be enacted in June 2009. The new law is based on an inter-country comparison, incorporates international best practices, and is consistent with the other components of the enabling PPP framework. Apart from specifying the various sectors and PPP modalities covered, the law outlines the institutional arrangements for PPPs; specifies the government agencies acting as the public sector partners; assigns the responsibility for PPP project identification and preparation; stipulates the rules, procedure and responsibility for the selection of the private sector partners; describes the procedure for handling unsolicited PPP project proposals; lists the main terms and conditions of PPP agreements; outlines the types of government support; and defines the cost recovery and risk sharing principles.

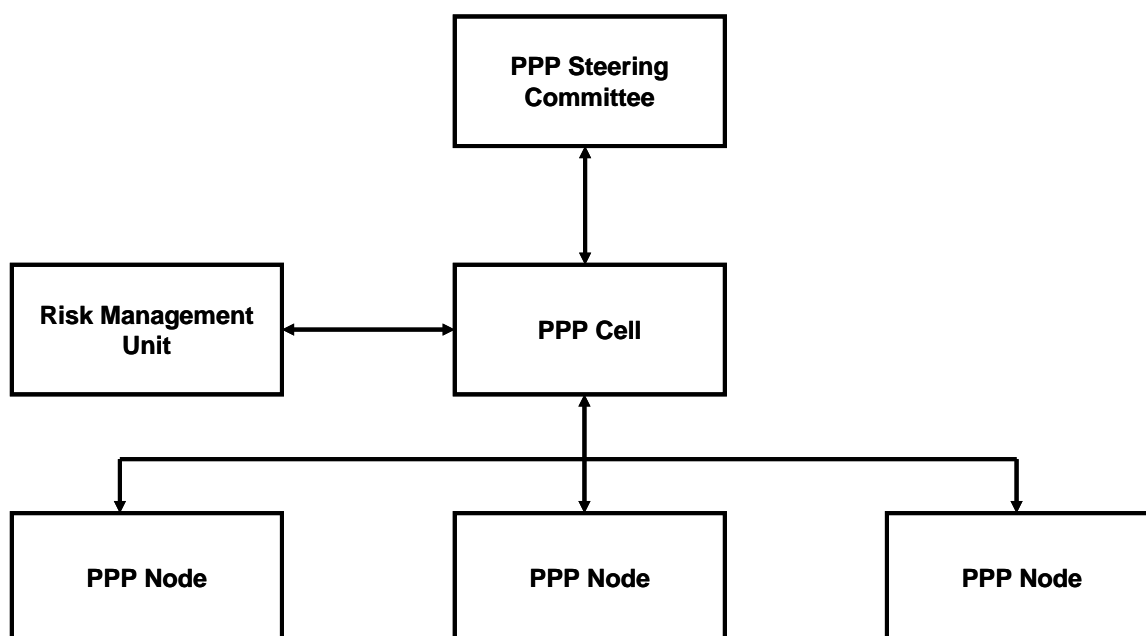
VII. INSTITUTIONAL ARRANGEMENTS

A. Main Components

30. International experience suggests that establishing clear, effective and efficient institutional arrangements is another prerequisite for successful implementation of PPP projects. The Government will therefore create the following new entities as an integral part of the enabling PPP framework (see Figure 1):

- (i) A high-level inter-departmental **PPP Steering Committee**;
- (ii) A central **PPP Cell** located in the Planning & Development Department (P&DD) to provide support to the PPP Steering Committee and PPP Nodes;
- (iii) **PPP Nodes** as focal points for specific PPP projects in line departments and city district governments; and
- (iv) A **Risk Management Unit** as fiscal guardian in the Finance Department (FD).

Figure 1: PPP Institutional Framework



B. PPP Steering Committee

31. To ensure a consistent approach to PPPs across sectors and an efficient use of funds by line departments and local governments, strong and effective coordination is essential. Such coordination will be provided by the PPP Steering Committee consisting of Minister for Planning & Development (Chair), Minister for Finance (Vice Chair), Minister for Local Government, Chairman Planning & Development Board, Secretary Finance Department, Secretary Planning & Development Department, Secretary Irrigation & Power Department, Secretary Communication & Works Department, Secretary Transport Department, Secretary Housing Urban Development & Public Health Engineering Department, Secretary Commerce & Investment Department, Secretary Education Department, Secretary Health Department, Member (PPP) Planning & Development Board (Secretary).

32. The PPP Steering Committee will be the final deciding body for all PPP projects in Punjab. As such, it will have the following responsibilities:

- (i) Formulate the PPP Policy for approval by the Government;
- (ii) Supervise and coordinate implementation of the PPP Policy by line departments and local governments;
- (iii) Approve or reject PPP Nodes' requests for financial assistance for project preparation through the Project Development Facility (PDF);
- (iv) Approve, reject or send back for reconsideration PPP project proposals submitted by line departments and local governments;
- (v) Approve, reject or send back for reconsideration recommendations submitted by line departments and local governments on contract awards to private sector partners; and
- (vi) Assist line departments and local governments in solving major problems impeding PPP project preparation and implementation.

C. PPP Cell

33. The PPP Steering Committee will be administratively and technically supported by the PPP Cell in P&DD. Its mandate will be to promote and facilitate PPP development in Punjab and assist line departments and local governments in preparing and executing high-quality PPP projects. To fulfill this mandate, the PPP Cell will perform the roles of a PPP catalyst and advocate, knowledge manager, and policy and project advisor.

34. The PPP Cell will have the following main functions:

- (i) Develop operating guidelines, procedures and model documents for PPP projects for approval by the PPP Steering Committee;
- (ii) Provide support and advice to line departments and local governments throughout the PPP process;
- (iii) Provide financing to PPP Nodes for project preparation through the PDF;
- (iv) Evaluate and prioritize PPP project proposals submitted by line departments and local governments;

- (v) Evaluate the type and amount of government support sought for PPP projects in close cooperation with the Risk Management Unit;
- (vi) Review bid evaluation reports, submitted by line departments and local governments;
- (vii) Serve as the focal point on PPP projects for investors, the business community and general public;
- (viii) Prepare and regularly update a pipeline of PPP projects;
- (ix) Maintain a PPP website with the relevant policy, legal, regulatory and project-related information; and
- (x) Perform any other functions as may be assigned to it by the PPP Steering Committee.

D. Risk Management Unit

35. Some PPP projects will require direct support from the Government to close the viability gap, while others will only need contingent support in the form of guarantees. A third category may need both types of support. Given the likely magnitude of such direct and contingent liabilities, the Risk Management Unit will be set up in FD, which has traditionally been performing the role of fiscal guardian for public sector projects.

36. The Risk Management Unit will have the following main functions:

- (i) Develop risk management guidelines for PPP projects;
- (ii) Examine whether requests for government support and the proposed risk sharing arrangements are consistent with the risk management guidelines and fiscally sustainable;
- (iii) Ensure the inclusion of approved government support in the Government's Annual Development Program;
- (iv) Monitor the Government's direct and contingent liabilities related to PPP projects;
- (v) Monitor the financial performance of PPP projects during their operation; and
- (vi) Perform any other functions as may be assigned to it by the PPP Steering Committee.

E. PPP Nodes

37. For the day-to-day management of PPP projects, PPP Nodes will be created in various line departments, city district governments and other government agencies. They will be responsible for furthering the PPP agenda within the realm of their respective departments and sectors, with responsibilities ranging from project identification to project preparation to tendering to monitoring of project implementation to contract enforcement during operation. At the initial stage of PPP development in Punjab, PPP Nodes will be established in those line departments and local governments, which have a good potential in terms of PPP opportunities. These include the Irrigation & Power Department, Communication & Works Department and City District Governments in Lahore, Rawalpindi, Faisalabad, Multan and Gujranwala. Later on such PPP Nodes will be created in other government departments and agencies, as required.

38. The PPP Nodes will have the following main functions, during the performance of which they may seek support and advice of the PPP Cell:

- (i) Identify suitable PPP projects and prioritize these within their sector or geographical area of responsibility;
- (ii) Recruit transaction advisors for project preparation and tendering;
- (iii) Supervise the preparation of feasibility studies and if their outcome is positive, submit the PPP project proposals to the PPP Steering Committee;
- (iv) Conduct a competitive tendering process consisting of pre-qualification and bidding to select the private sector partners;
- (v) Carry out bid evaluation and submit recommendations on contract award to the PPP Steering Committee;
- (vi) Negotiate and sign the PPP agreement; and
- (vii) Monitor and evaluate implementation and operation of PPP projects.

F. Demarcation of Responsibilities

39. Table 3 summarizes the demarcation of the principal responsibilities within the PPP institutional framework. The demarcation reflects the crucial role played by the PPP Nodes in the identification, preparation, tendering and monitoring of PPP projects; the quality control and prioritization role played by the PPP Cell; the fiscal guardian's role played by the Risk Management Unit with regard to government support; and the approving authority exercised by the PPP Steering Committee during the project preparation and tendering phases.

Table 3: Demarcation of Main Responsibilities for PPP Projects

Entity	Proposed Location	Project-Related Responsibility
PPP Steering Committee		<ul style="list-style-type: none"> • Inter-departmental coordination • Approval/rejection of PPP project proposals • Approval/rejection of contract award recommendations • Decision-making on major PPP policy and implementation issues
PPP Cell	Planning & Development Department	<ul style="list-style-type: none"> • Quality control (review of PPP project proposals for completeness and viability) • Cross-sectoral and intra-provincial prioritization • Technical support to the PPP Steering Committee
Risk Management Unit	Finance Department	<ul style="list-style-type: none"> • Review of justification and eligibility for government support • Fiscal sustainability
PPP Nodes	Line departments and city district governments	<ul style="list-style-type: none"> • Project identification • Project preparation (feasibility study) • Selection of private sector partners (tendering) • Monitoring of implementation and operation

VIII. RISK SHARING AND MANAGEMENT

A. Risk Management Guidelines

40. To ensure that the desired high level of private investments in PPP projects materializes, adequate risk mitigation and fair risk sharing between the public and private sector are essential. A sound investment climate is the best risk mitigation mechanism. This calls for continuous and sustained policy reforms that lead to a stable macroeconomic environment, well-functioning judicial system, independent and technically sound regulation, full cost recovery (or a well-targeted output-based subsidy where the full cost recovery would make such services unaffordable), and open access in the infrastructure sectors.

41. During the transition period before these ideal conditions are achieved and confidence is built up, investors will ask for government guarantees to help mitigate risks that are not under their control. However, some hard lessons have been learnt from the Asian financial crisis in 1997, particularly in the power sector.⁴ The principal lesson is that the previous practice of extensive guarantees should not be repeated. What is necessary is to identify the various types of risks in each sector and for each project type, and to allocate them to the party that can best control them. There is no universal solution applicable to all situations, and the range of possible solutions is wide, depending on the specific circumstances of each case. The other important lesson is that while the risk allocation should be clearly laid out for each project, the overall risk allocation principles should not be cast in stone. Instead, there should be a gradual transfer of risks from the public sector to private investors as the conditions improve, until the stage is reached when market instruments rather than government guarantees can be used for risk hedging.

42. As a part of the enabling PPP framework, the Government will develop risk management guidelines for the infrastructure sectors as an instrument for assessing, pricing, monitoring and managing the contingent liabilities that arise from selective guarantees for PPP projects against risks related to policies and performance of the Government and its agencies. In view of the links to its existing budgeting, fiscal accounting and debt management systems, FD will play a key role in developing and implementing the guidelines through the Risk Management Unit, with the view to ensuring that risks of individual PPP projects are appropriately allocated between the public and private sector, and that the Government's overall exposure is well managed.

43. The dual objective of the risk management guidelines will be to support infrastructure development while maintaining the fiscal sustainability of Punjab's budget. The guidelines will describe the following:

- (i) The types of risks to be borne by the Government (in particular, the political risks such as changes in policy, delay of agreed tariff adjustments, and expropriation);

⁴ Capacity expansion by independent power producers helped in the first half of the 1990s attract major private investments and thereby eliminate power shortages in South and Southeast Asia. However, the financial crisis highlighted the risks of the then prevailing long-term take-or-pay contracts indexed to exchange rates, namely, the so-called triple mismatch. The currency mismatch resulted from the use of foreign exchange to implement projects generating revenues in local currency. For example, it proved impossible after the sharp currency depreciations to pass the foreign exchange risk on to consumers and the governments had to bail out the power utilities and/or tariffs had to be re-negotiated. The maturity mismatch was attributable to the use of short-term loans for capital-intensive projects with long service lives. And, finally, the capacity mismatch resulted from a conversion of the previous power shortages into significant surpluses, partly because of capacity over-contracting and partly due to the slowdown in demand growth in the aftermath of the crisis.

- (ii) Those to be borne by the private sector (in particular, the commercial risks such as construction cost overruns and delays, and failure to perform according to specifications);
- (iii) Those to be assigned on a case-by-case basis such as force majeure, inability of government agencies to pay for infrastructure services (the so-called credit or off-take risk), and demand risk;
- (iv) The main principles for providing government support such as (a) legality; (b) PPP project quality in terms of technical, economic and financial viability; (c) fiscal prudence in terms of total exposure and annual budget; and (d) transparency in terms of deciding about government support before bidding; and
- (v) Review and approval procedures for government support.

B. Identification, Allocation and Mitigation of Risks

44. Under public procurement, the Government bears all or most of the risks. A major advantage of PPP projects is that as many risks as appropriate are shifted to the private sector, which then receives the rewards for its investment and risk taking.

45. Risks can be looked at from the perspective of the different parties concerned: (i) the private sector partners, (ii) the lenders, (iii) the Government, and (iv) the users of the services provided by the PPP project. Risks can also be grouped into categories according to their type: (i) commercial risks, which are related to the sector or business activity being contemplated (e.g., power generation or solid waste management); (ii) risks specific to a country, which include political, economic, and financial risks; and (iii) risks of a general nature such as force majeure. Risks can also be differentiated according to when they arise in the project cycle: (i) development phase risks, (ii) construction phase risks, and (iii) operation phase risks. PPP risks are both generic and project specific. The feasibility study prepared by the Government for each PPP project will identify and propose allocation of all these types of risks. Based on their companies' strengths, bidders for PPP projects will make their own assessment of risks and their ability to mitigate and overcome these, and will incorporate the results of this assessment in their bid prices.

46. The general risk process to be followed when developing PPP projects will start with risk identification. The type of the project and the choice of the PPP modality will determine what risks are applicable. A PPP project involving a service or operation and maintenance contract may have little or no market risk. In other PPP projects such as BOTs, such risk is very significant. The risk identification will be followed by risk allocation. The basic principle will be that risks should generally be borne by the party best able to manage them at minimum cost. This implies that the optimum risk allocation is not the same as the maximum risk transfer to the private sector. Typical examples are construction and operation risks, which are usually borne by the private sector, and policy and expropriation risks, which are clearly within the control of the Government and therefore borne by the public sector. Proper risk allocation will generate incentives to and penalties for the private sector to supply cost-effective and higher-quality infrastructure and service delivery.

47. The Government will ensure that the private sector takes appropriate and least-cost risk mitigation measures on its part in order to sustain the PPP project. Guidelines will be issued on risk mitigation principles, and the request for proposals from the private sector will include the Government's suggestions for risks related to the specific project under tendering. For the risks

allocated to the public sector, the Government will issue, if necessary, guarantees to backstop the obligation of its agencies, which have entered into a PPP agreement with private firms. The fiscal impact of these contingent liabilities⁵ will be quantified and monitored by the Risk Management Unit in FD.

48. The Government will decide at a later stage whether a Guarantee Fund (GF) should be set up to cover all guarantees for PPP projects. The GF would be an entity separate from the Government and would have its own capital base. The GF would not issue guarantees creating an exposure or contingent liability greater than its capital. The GF would issue guarantees only for risks that the Government can influence, or which are uncontrollable and uninsurable. To be eligible to receive a guarantee, a project would have to be economically and financially viable, and the private partners would have to be competitively selected.

IX. REGULATORY ARRANGEMENTS

49. Some PPPs in Punjab will be in unregulated sectors, while others will be regulated by line departments and local governments. During this initial phase, regulation by contract will play an important role. The Government will therefore develop good model contracts in each sector as part of the pilot PPP project preparation (see paras. 78-79).

50. To ensure strong private sector participation in infrastructure development, there must be a gradual shift in the role of the Government from service provider to policy maker, planner, coordinator, facilitator, and purchaser of infrastructure services. In line with this shift, the Government intends to devolve, in the medium term of 3-5 years, its regulatory functions to newly created independent bodies, with the Government keeping the responsibility for policy making and sector planning. This separation of responsibilities will enhance the credibility of economic regulation and give confidence to investors that tariff matters are handled without political interference. There are two options – having either a separate regulator in each of the main infrastructure sectors, or a single cross-sector regulatory body. International experience suggests that the first option is preferable.

51. Economic regulation will have two main objectives: (i) ensuring that consumers have access to essential services on a sustainable and affordable basis, and (ii) encouraging private sector participation in the development of infrastructure facilities required to provide those services. In pursuing these objectives the new regulatory bodies will have the following functions:

- (i) Setting (approving) tariffs and other service charges;
- (ii) Establishing standards for the terms and conditions of providing services;
- (iii) Making and enforcing market rules for the sector;
- (iv) Monitoring economic and management performance of the regulated entities;
- (v) Issuing, reviewing and canceling licenses (with respect to the viability of commercial arrangements);
- (vi) Reviewing PPP agreements; and

⁵ A contingent liability is defined by the International Accounting Standards Board as a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

- (vii) Arbitrating disputes within the sector.

X. COST RECOVERY

A. User Charges and Other Revenues

52. The Government is aware that private investors will come to Punjab only if they can fully recover their cost and earn an adequate rate of return. Current tariff levels are low, reflecting the mistaken belief that infrastructure services are an entitlement. Consequently, such services have been provided at a very low cost to customers, with tariffs bearing little relationship to the actual cost of supply. Compounding the low tariffs are the high technical losses in transmission and distribution systems, excessive non-technical losses such as theft, and poor revenue collection. The poor quality of most infrastructure services leads to public opposition to any tariff increases. Breaking this vicious circle and achieving full cost recovery requires strong political will and time. The Government of Pakistan has already demonstrated such will by starting to implement a phased program of electricity tariff increases.

53. Depending on the type of the PPP project and its likely financial performance, there can be several potential sources of revenue or income:

- (i) Revenue solely from user charges if the project is financially viable;
- (ii) Revenue from user charges plus government support if the project is marginally viable and such support is justified on social grounds; or
- (iii) Unitary/annuity type payments wherein the Government contracts to pay the private partner for providing the infrastructure and related services either an agreed fixed amount each year of operation or an amount based on the future situation (e.g., future traffic levels). Such payments can either be linked with user charges or can be independent of them.

54. For many infrastructure services such as transport and water supply, a user tariff-based PPP agreement is appropriate. Estimates of the initial tariffs and formulas for the subsequent tariff escalation during the concession period will be developed in the feasibility study to ensure a proper or market acceptable rate of return based on an efficient operation. The tariff setting will have to reflect the following two frequently contradictory considerations:

- (i) The need to fully recover the capital, operation and maintenance costs in order to ensure that the project is financially viable and that users, rather than general taxpayers, pay for the services; and
- (ii) The need to take into account the ability of the users to pay the proposed tariffs and make the services affordable to them. If this affects the project's financial viability, the VGF concept described in the next section will be applied.

55. For certain types of PPP projects, such as those without a direct revenue stream, or with a weak revenue base, or with a low demand, or with higher than acceptable risks, the feasibility study may recommend a system of annual unitary payments to the concessionaire based solely on outputs (i.e., the meeting of specific project targets by the concessionaire).

B. Viability Gap Funding

56. The Government will provide VGF⁶ for PPP projects that have a strong economic and social justification but fall short of financial viability because of affordability constraints imposed on tariffs. VGF will be an explicit subsidy that is performance driven (based on the private service provider achieving measurable outputs) and targeted towards socio-economically disadvantaged users or groups of users. The need for and the form of VGF will be established in the feasibility study, and announced in the tender documents. Its exact amount will be determined through competitive tendering to ensure the lowest liability for the Government. In view of the Government's resource constraints, only the highest priority projects will receive the VGF subsidy.

57. The Government will issue VGF guidelines setting the eligibility criteria and limits for VGF; describing in detail the procedures for applying for, approving, disbursing and monitoring the subsidy; and presenting the institutional arrangements, which may ultimately include a dedicated VGF company.

XI. SUPPLEMENTARY FINANCING ARRANGEMENTS

A. Project Development Facility

58. Government agencies in Punjab have capacity and resource constraints and find it sometimes difficult to develop PPP projects that deliver value for the Government and consumers and, at the same time, are attractive to private investors. To overcome this obstacle, the Government will establish the PPP Cell and Risk Management Unit, which will be staffed by well-qualified technical, financial and legal specialists. All PPP Nodes, which want to implement a PPP project in their sector or geographical area of responsibility, will have to involve the PPP Cell in project preparation and implementation.

59. Project preparation has the following objectives:

- (i) Ensuring overall success of the PPP program;
- (ii) Ensuring technical, economic and financial viability and environmental sustainability of PPP projects;
- (iii) Designing sound contractual structures for PPP projects that make these bankable;
- (iv) Minimizing and fairly allocating risks of PPP projects;
- (v) Allowing informed decision making by the Government, based on good-quality feasibility reports;
- (vi) Enhancing competition and thereby ensuring success of tendering;
- (vii) Providing the basis for contract negotiations;
- (viii) Minimizing the transaction costs of PPP projects and avoiding unnecessary delays; and

⁶ The VGF concept is referred to in some countries as public service obligation, which is defined as the government-directed provision of infrastructure services to disadvantaged groups such as the poor or geographically isolated. This situation occurs when for social reasons, government explicitly requires the provision of loss-incurring services to these groups that the infrastructure provider would not choose to do on a commercial basis.

- (ix) Facilitating financial closure for PPP projects.

60. Given the complexity of PPP projects, external experts will be needed to provide advice during project preparation and transaction execution. To structure viable and bankable PPP projects, the PPP Nodes will have to recruit transaction advisors with proven track records. However, the cost of such advisors is significant and may exceed the available budget. Recognizing the importance of adequate project preparation, the Government will establish the PDF for feasibility studies and transaction execution advisory services. The PDF, which will be administered by the PPP Cell, will ultimately be a revolving fund, with the project preparation costs reclaimed from winning bidders.

B. Infrastructure Project Financing Facility

61. Unlike the traditional public sector projects, PPP projects entail greater risks for the private sector and require significantly larger investments and participation beyond the construction period. For their implementation, long-term financing is required in the form of both equity and debt. The responsibility for arranging such financing from their own resources and commercial lenders has to be borne by the private sponsors. Nevertheless, to facilitate this endeavor and fill financing gaps, if any, the Government intends to establish, in the medium term and with the assistance of its multilateral and bilateral development partners, the Infrastructure Project Financing Facility (IPFF) as a non-banking financial institution.

62. The IPFF would make equity contributions in the local currency to PPP projects or provide residual 15-20 year funding at commercial rates through fixed-rate rupee-based loans if the financing needs of the private sponsors cannot be fully met by the market. The IPFF would set minimum quality standards for project proposals. Its day-to-day operations would be independent from the Government, and reporting to the Government would be made through its Board of Directors.

XII. PPP PROJECT LIFE CYCLE

A. General

63. The following four main phases can be distinguished in the life cycle of PPP projects:

- (i) Project inception;
- (ii) Project preparation (feasibility study);
- (iii) Transaction execution (procurement of private partners); and
- (iv) Construction, operation and transfer (development, delivery and exit).

The sequence of activities during these phases is shown in Figure 2 and described below. To complement the PPP Policy, the Government will issue detailed guidelines for each phase, using those prepared at the federal level by IPDF as the basis.

B. Project Inception

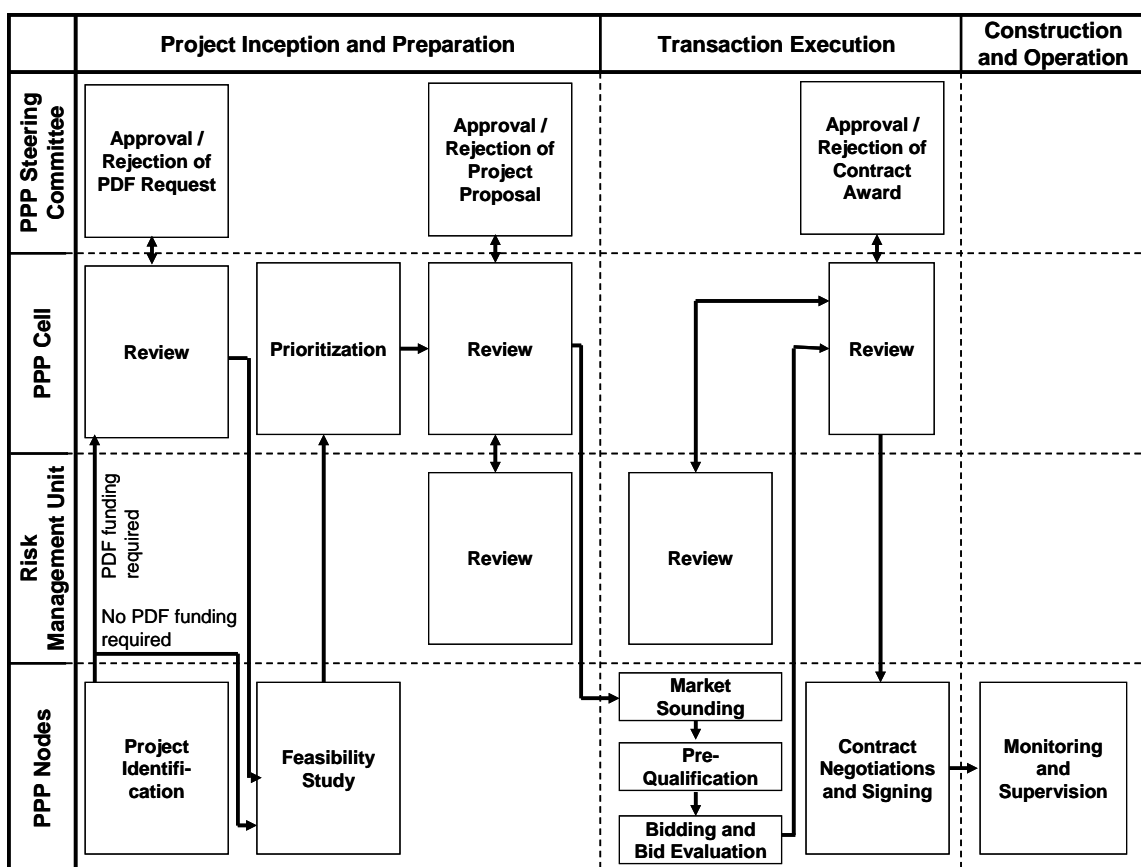
64. The PPP Nodes in the line departments and local governments will identify and conceptualize potential PPP projects from their master plans and other planning documents. This phase will include an initial needs and options analysis to determine the best solution for

developing the given infrastructure facility and/or providing the necessary infrastructure service, as well as an initial viability analysis. To help prepare the PPP projects and select the private sector partners, the PPP Nodes will recruit transaction advisors. Prior to doing so, they will decide whether to fund the cost of these advisors from their own budget or the PDF. In the latter case, the PPP Nodes will submit a request for PDF funding through the PPP Cell to the PPP Steering Committee.

C. Project Preparation

65. The PPP Nodes will manage preparation of the PPP projects by the transaction advisors. The preparation will consist of a feasibility study, supplemented by an initial environmental examination, environmental impact assessment (if required), risk analysis, assessment of the need for government support, stakeholder consultations, determination of the PPP modality (project structuring),⁷ and drafting of tender documents including the PPP agreement. An important part of the feasibility study will be financial modeling to determine project bankability and affordability, including estimates of viability gap, if any. Another important activity will be stakeholder consultations.

Figure 2: Flow Chart of Project-Related Activities



66. Upon completion of the feasibility studies, the PPP Nodes will prioritize the identified PPP projects within their sectors and geographic areas, using criteria such as supply and

⁷ These activities are sometimes referred to as technical, legal, environmental and financial due diligence.

demand gaps, social and economic benefits, financial attractiveness, risks and uncertainties involved, and readiness for implementation. The prioritized PPP project proposals will be submitted through the PPP Cell to the PPP Steering Committee.

67. The PPP Cell will exercise quality control by reviewing the viability of the PPP project proposals and the completeness of their documentation, as well as their compliance with the objectives and principles of the PPP Policy. PPP projects that pass this review will be prioritized by the PPP Cell across sectors and the province, taking into account Punjab's development objectives, and submitted to the PPP Steering Committee for approval. The approved PPP projects will be included in a provincial priority list and widely publicized by the PPP Cell.

68. Requests for government support through VGF, if required, will be an integral part of the PPP project proposals submitted by the PPP Nodes. The PPP Cell will forward all requests with budgetary implications to the Risk Management Unit, which will review their justification and eligibility, and analyze the fiscal impact of the related direct and contingent liabilities. Based on this review and analysis, the Risk Management Unit will make a recommendation to the PPP Steering Committee on approval, rejection or modification of the requested government support. If approved, the Risk Management Unit will make the necessary arrangements for including such support in the Annual Development Program.

D. Transaction Execution

69. Private partners for all PPP projects will be selected through transparent and competitive tendering, using a two-stage process of pre-qualification and bidding. Direct negotiations to select private partners will not be allowed. After obtaining approval for the PPP project and government support, if any, from the PPP Steering Committee, the PPP Node will publish a notice inviting private companies and consortia of such companies to submit pre-qualification applications. Based on appropriate pre-defined criteria such as legal requirements, technical capability as documented by previous experience with similar projects, and financial capability, the PPP Node will evaluate all pre-qualification applications to determine which among the companies and consortia meet these criteria. If less than two applicants are pre-qualified, the PPP Node will analyze the reasons for this outcome, improve project structuring, and re-initiate the pre-qualification process for additional participants.

70. After at least two prospective private partners have been pre-qualified, the PPP Node will issue an invitation to them to submit bids. To provide clarifications to bidders and discuss the terms and conditions of the draft PPP agreement, the PPP Node will conduct a pre-bid conference and will issue supplemental notices, as necessary. If only one valid bid is received on the specified date, the PPP Node will undertake market sounding to determine reasons for the weak competition, restructure the PPP project and government support accordingly, and conduct re-bidding. If only one valid bid is received even after the re-bidding, the PPP Node will evaluate it. Depending on results of the evaluation, the PPP Node will recommend through the PPP Cell to the PPP Steering Committee whether to negotiate the contract with the sole bidder or withdraw the PPP project from the market and undertake it in the traditional way by the public sector.

71. Bid evaluation by the PPP Node will be carried out in two phases. First, the technical, operational, environmental and commercial soundness of the bids received will be assessed vis-à-vis the requirements, criteria, minimum standards, and basic parameters specified in the tender documents, and non-compliant bids will be rejected. The responsive bids will be evaluated in the second phase from the financial viewpoint. The evaluation will be based on a

single parameter specified in the tender documents. Depending on the type of the PPP project, the following bid parameters may be used for the financial evaluation:

- (i) Lowest proposed tariff, toll, fee or charge at the start of operation of the project if a parametric formula for periodical tariff adjustment is prescribed in the tender documents;
- (ii) Lowest present value of the proposed tariffs, tolls, fees and charges for the period covered by the PPP agreement if there is no such formula;
- (iii) Lowest present value of payments from the Government;
- (iv) Lowest present value of VGF subsidy to be provided for the period covered by the PPP agreement;
- (v) Highest present value of the proposed payments to the Government, such as concession fees, lease/rental payments, fixed/guaranteed payments or variable payments/percentage shares of revenues for the period covered by the PPP agreement; or
- (vi) Any other appropriate single financial bid parameter approved by the PPP Steering Committee upon recommendation of the PPP Node, PPP Cell, or Risk Management Unit.

72. After the completion of the bid evaluation, the PPP Node will submit through the PPP Cell to the PPP Steering Committee a bid evaluation report, including a recommendation on award of the contract and a request for approval of VGF, if any. Subject to approval by the PPP Steering Committee, the PPP Node will announce results of the bidding and issue a notice of award to the selected private partner.

73. Contract negotiations between the PPP Node and its private partner will focus on terms and conditions not specified in the tender documents. No post-bid changes will be allowed during contract negotiations in those terms and conditions, which have been described in the tender documents as binding and have formed part of the bid evaluation. After the signing of the PPP agreement, the private partner will endeavor to achieve financial close within the period specified in the tender documents, but not exceeding 12 months.

E. Construction and Operation

74. The PPP Node will be responsible for monitoring and evaluating the PPP project during its construction and operation to ensure its conformity with the plans, specifications, performance standards, and tariffs in the PPP agreement. The PPP Node will submit annual reports on the PPP project to the PPP Cell.

XIII. PPP PROJECT PIPELINE

A. Pilot PPP Projects

75. The Government recognizes that even with a sound policy, legal, institutional, risk management and regulatory framework, private sector investors will come only if there are attractive PPP projects. The first step towards achieving this objective is the preparation and periodic updating of long-term sector strategies and master plans, which will outline the necessary physical expansion to meet the forecast demand. In line with their policy making and

planning functions, this is the responsibility of the line departments and local governments. These sector strategies and master plans will form a solid basis for screening infrastructure projects and selecting the best PPP candidates.

76. Given the emphasis the Government is placing on PPPs to meet Punjab's infrastructure needs, all projects in the sectors listed in para. 24 should first be considered for implementation on a PPP basis. If the concerned departments propose that a project be undertaken under traditional public procurement using public funds, they should justify their choice and demonstrate that this option would be more cost-effective for the Government or that the project does not meet selection criteria for PPPs. It should be noted that time saving is generally not a good justification to undertake a project in a non-PPP manner.

77. To reduce uncertainties for investors, the PPP projects will be thoroughly prepared before the selection of private sector partners by undertaking feasibility studies, acquiring the necessary land, and obtaining the necessary permits and approvals. There is ample evidence that shifting the responsibility for these preparatory activities to the private sector results in (i) land speculation; (ii) weak competition as each bidder has to prepare its own feasibility study; (iii) high bid prices as bidders include significant risk margins; and (iv) major delays in contract negotiations and financial closure, or even inability to achieve it, as there are too many uncertainties and issues left open in the tender documents.

78. Selection of the private sector partner will start only after the PPP project has been thoroughly prepared. It will be a transparent process consisting of prequalification and bidding. Direct negotiations will not be allowed as in the absence of competition, the Government would not know whether Punjab is getting the best value for its money. For major PPP projects, use of international transaction advisors will be the norm. To facilitate the selection process, model tender documents for different sectors and types of PPP projects will be developed.

79. Doing the first transactions the right way is essential for boosting investors' confidence in the PPP Policy and its implementation. The Government will therefore pilot suitable PPP projects in several sectors parallel to the development of the enabling PPP framework in order to demonstrate its application and benefits. When selecting the pilot projects, priority will be given to financially attractive projects of medium size with manageable risks, which require upfront investment by the private sector. If some of these projects are economically viable but financially marginal because of the current low user charges, there will be a commitment by the Government to provide VGF support until the charges have been brought up to full cost-recovery levels.

80. Preparation and execution of the pilot projects will be conducted in full compliance with the following main principles of the enabling PPP framework:

- (i) A clear separation of the roles of planner and regulator (the Government) and those of owner and operator (private sector partners);
- (ii) No direct negotiations with the prospective private sector partners;
- (iii) Preparation by the Government of feasibility studies, including the PPP project structuring and risk allocation, prior to tendering;
- (iv) Decision on the Government's direct and/or contingent support also prior to tendering;
- (v) Indication of such support, if any, in the tender documents; and

- (vi) Use of a transparent two-stage process for tendering (pre-qualification and bidding).

81. Depending on its type, the typical schedule for a pilot project will consist of about 6-9 months for the recruitment of transaction advisors, 6-12 months for the feasibility study and 9-12 months for the transaction execution from pre-qualification to bidding to contract award and signing, or 21-33 months in total. This could be reduced to 16-26 months if the sole sourcing method is used to directly appoint the transaction advisors.

B. Unsolicited Proposals

82. PPP projects are generally classified as solicited or unsolicited. Solicited projects are initiated by public sector institutions and are part of the Government's priority programs. By contrast, unsolicited projects are proposed by the private sector. All unsolicited proposals will be treated on a case-by-case basis, with the view to selecting projects that demonstrate genuine innovation and furthering of public policy. The following principles will be followed:

- (i) A private company may propose at its initiative a PPP project to the PPP Node in the line department or local government, provided the project is not included in Punjab's priority list and is economically and financially feasible without any VGF support.
- (ii) Such unsolicited proposal should be accompanied by a feasibility study and draft PPP agreement.
- (iii) The PPP Node will consider all technical, financial and other relevant aspects of the proposal, and may modify the same in consultation with the project proponent.
- (iv) The PPP Node will request the project proponent to submit details of its technical, commercial, managerial and financial capability.
- (v) The PPP Node will evaluate the unsolicited proposal and, if its feasibility as well as the technical and financial qualification of the project proponent is confirmed, submit it through the PPP Cell to the PPP Steering Committee for approval.
- (vi) If the unsolicited proposal is approved, comparative bids will be invited, following the procedure described in Section XII.D.
- (vii) If the project proponent does not prevail in the bidding, it will be reimbursed by the winning bidder reasonable costs incurred in project preparation, as determined by the PPP Node and specified in the bid documents.
- (viii) If no valid comparative bids are received, the PPP Node will negotiate the PPP agreement with the project proponent.