Government of Balochistan
PUBLIC PRIVATE PARTNERSHIP UNIT

September 27, 2022

NOTIFICATION

NOTIFICATION NO. 03/2022:- In exercise of powers conferred by Section 30 read with Section 7 of the PPP Act 2021, the Board of Balochistan Public Private Partnership is pleased to notify the following guidelines, namely:-

THE RISK MANAGEMENT GUIDELINES, 2022

GLOSSARY

"**Concessionaire**" has the meaning given to it in Section 2(1)(e) of the PPP Act;

"**Government**" means the Government of Balochistan;

"**Government Support**" means the Government support for a PPP Project, in terms of Section 17 of the PPP Act;

"**Implementing Agency**" has the meaning given to it in Section 2(1)(i) of the PPP Act;

"**PPP**" or "**Public Private Partnership**" has the meaning given to it in Section 2(1)(t) of the PPP Act;

"**PPP Act"** means the Balochistan Public Private Partnership PPP Act, 2021;

"**PPP Agreement**" has the meaning given to it in Section 2(1)(u) of the PPP Act;

"**PPP Authority**" has the meaning given to it in Section 2(1)(v) of the PPP Act;

"**PPP Board**" has the meaning given to it in Section 2(1)(p) of the PPP Act;

"**PPP Project**" means a project implemented on a PPP basis;

"**PPP Unit**" has the meaning given to it in Section 2(1)(q) of the PPP Act;

"**Project Proposal**" means the project proposal prepared in the prescribed manner by the Implementing Agency for a PPP Project;

"**Province**" means the province of Balochistan;

"**Unsolicited Proposal**" has the meaning given to it in Section 2(1)(y) of the PPP Act;

"**Viability Gap Fund**" means the viability gap fund established in accordance with Section 19 of the PPP Act; and

"**Viability Gap Funding**" means the funding from the Viability Gap Fund to the Concessionaire, as approved under the PPP Act, in respect of a PPP Project.

PART-A

1. INTRODUCTION

1.1. The Government is striving towards achieving sustainable and inclusive socio-economic development to uplift the standard of living of the people of Balochistan.

1.2. The Government intends to actively engage the private sector and promote investments across sectors through PPP mode as a means of delivering physical infrastructure, social services and other public-interest projects in Balochistan.

1.3. For the successful promotion and implementation of the PPP program in Balochistan, it is essential to identify viable projects suitable for private sector investment. However, the Government has capacity and resource constraints that impede its ability to proactively develop a pipeline of bankable PPP Projects.

1.4. To overcome these constraints, the Government has taken steps to establish a robust legal and regulatory framework for initiation and implementation of PPP Projects. In this regard, the PPP Authority has been established to initiate, structure, develop, procure, negotiate, execute and implement PPP Projects, and the PPP Unit has been established to, *inter alia*, evaluate projects and provide feedback and advice to the PPP Authority at all stages of a PPP Project.

1.5. An important contributing factor for the success of a PPP Project is risk identification, assessment, allocation, and mitigation. It is essential that key risks associated with PPP Projects are timely identified and mitigated, including through allocation to the party better suited to bear such risks. From the Government's perspective, it is essential that through appropriate risk management at the outset, the Government is cognizant of any direct and contingent liabilities that may arise from a PPP Project (including from provision of any financial support and guarantees) for adequate budgetary allocation and fiscal accounting.

1.6. Under the PPP Act, the PPP Unit is responsible to, *inter alia*, perform risk assessment for PPP Projects to ensure that relevant risks are appropriately allocated between the public and private sectors, and the Government's overall exposure is well managed. The dual objective of risk management through the PPP Unit is to support infrastructure development through PPP Projects while maintaining the fiscal sustainability of the Government's budget.

1.7. These Risk Management Guidelines (these "**Guidelines**") have been prepared by the PPP Unit and approved by the PPP Board pursuant to Section 7(1)(c) of the PPP Act and set out the mechanism and procedure for evaluation of risk management in relation to PPP Projects set up in Balochistan.

2. ROLE OF THE PPP UNIT IN RISK MANAGEMENT FOR PPP PROJECTS

2.1. The PPP Unit shall act as, *inter alia*, the secretariat of the PPP Board, and in accordance with Section 7(1) of the PPP Act, perform the following risk management functions:

(a) provide support and advice to the Implementing Agency with regard to risk management in a PPP Project throughout the PPP process;

(b) for submitted PPP Projects, examine and assess whether requests for Government Support and the proposed risk sharing arrangements are:

(i) consistent with the PPP Act and the rules and regulations made thereunder; and

(ii) fiscally sustainable,

and facilitate the PPP Board in the consideration and subsequent approval of Government Support for PPP Projects;

(c) perform risk assessment, covering fiscal risks, project risks, and all related risks associated with PPP Projects;

(d) review and assess the type and amount of Government Support that may be made available for a PPP Project;

(e) while performing risk management function, facilitate the PPP Board to process cases for consideration and subsequent approval of all kinds of the Government Support;

(f) recommend and seek approval of the PPP Board for the inclusion of approved Government Support in the budget of the Province;

(g) monitor direct and contingent liabilities of the Government incurred through PPP Projects; and

(h) carry out such other functions as may be conferred on it by the PPP Board under the PPP Act.

3. RISK EVALUATION PROCESS

3.1. The process for evaluation and approval of proposed risk sharing arrangements for a PPP Project, including Government Support, as specified in a Project Proposal or an Unsolicited Proposal, shall be as follows:

(a) the PPP Unit shall, within forty-five (45) days of receipt of a Project Proposal under Section 12 of the PPP Act, or an Unsolicited Proposal under Section 16(2) of the PPP Act:

(i) examine and assess whether the proposed risk sharing arrangements, including request for Government Support (as applicable), are in accordance with the PPP Act, these Guidelines and the rules and regulations made under the PPP Act;

(ii) critically evaluate the project documents, assess project risks, and analyze the fiscal impact as well as the related direct and potential contingent liabilities;

(iii) assess the type and amount of Government Support that may be made available for a PPP Project;

(iv) make its recommendation on whether to accept or reject the Project Proposal or the Unsolicited Proposal (as the case may be) to the PPP Board;

(v) if deemed necessary, make recommendations to the Implementing Agency with regards to the Project Proposal or the Unsolicited Proposal (as the case may be) and require revisions to the risk allocation and/or mitigation (including availability of Government Supports) in relation thereto; and

(b) the PPP Board shall:

(i) review the proposed risk sharing arrangements, including the requests for Government Support (as applicable), submitted as part of the Project Proposal or the Unsolicited Proposal (as the case may be), on the basis of recommendations of the PPP Unit, and may, within thirty (30) days from the receipt of such Project Proposal or Unsolicited Proposal (as the case may be), approve the proposed risk sharing arrangements, and/or the request for Government Support, with or without modifications, or reject them, or return the Project Proposal or the Unsolicited Proposal (as the case may be) to the Implementing Agency for amendment and resubmission. In case a Project Proposal or an Unsolicited Proposal (as the case may be) is returned by the PPP Board for amendment, the Implementing Agency shall take suitable action to amend the Project Proposal or the Unsolicited Proposal (as the case may be) and resubmit it to the PPP Board for approval via the PPP Unit. After resubmission of amended Project Proposal or the Unsolicited Proposal (as the case may be), the process specified in clause (a) above shall apply; and

(ii) recommend a PPP Project to the Provincial Cabinet for final approval where:

A. the project cost equals or exceeds PKR 5.0 billion; or

B. the cost of the land being provided by the Government equals or exceeds PKR 500 million; or

C. the provincial guarantees being provided by the Government equal or exceed PKR 500 million; or

D. the contingent liabilities exceed PKR 500 million.

3.2. An Implementing Agency may submit a written request to the PPP Unit, seeking support in relation to risk management, at any stage throughout the PPP process, and the PPP Unit shall facilitate the Implementing Agency in respect of such requests within thirty (30) days of receipt thereof.

PART-B

4. RISK MANAGEMENT IN A PPP PROJECT

4.1. Risk management in respect of a PPP Project generally constitutes risk identification and assessment, risk allocation, and risk mitigation. These Guidelines aim to provide a high-level outline of the process and key factors involved in risk management in respect of a PPP Project. Risks in PPP Projects may be generic or project specific, therefore, the risk management for each PPP Project shall be carried out on a case-to-case basis.

5. RISK IDENTIFICATION AND ASSESSMENT

5.1. The nature of a PPP Project and the choice of PPP modality shall guide in the determination of the types of risks applicable to a PPP Project. Furthermore, risks may be assessed from the perspective of different concerned parties such as the Concessionaire, the Government (including the Implementing Agency), or financial institutions.

5.2. Generally, the following main risk categories are applicable to PPP Projects:

(a) project disruption caused by events outside the control of the parties;

(b) project disruption caused by adverse acts of the Government;

(c) construction and operation risks;

(d) financial risks; and

(e) commercial risks.

5.3. Risk identification and assessment should be carried out at the outset, during project preparation and inception stage (as part of the feasibility study) and accordingly reflected in the bidding documents. The Implementing Agency when preparing a Project Proposal or when assessing an Unsolicited Proposal is advised, on best practice basis, to undertake market sounding and consult relevant stakeholders (including interested private parties and financial institutions) to ensure that the transaction structure is bankable (where financing may be relevant for the PPP Project) and commercially viable to ensure competitive bids are received from interested private parties during the bidding process.

6. RISK ALLOCATION

6.1. Risk allocation refers to the allocation of respective risks in a PPP Project to the party that is best able to manage and mitigate the consequences of each event identified as a PPP Project risk, taking into account which party is best able to control such risk and is in a position to mitigate at the lowest cost, in accordance with the specific requirements of the PPP Project.

6.2. The definition of "Public-Private Partnership" under the PPP Act envisages, *inter alia*, the transfer of financial, technical, operational, and other associated risks in connection with performance of a public function, provision of public service, or use of public property by the Concessionaire. Thus, a major advantage of undertaking projects in PPP mode is the transfer of risks to the private sector which undertakes the PPP Project as a commercial transaction and recovers its investment either through revenue generated from the PPP Project (including from user levies) or annuity payments by the Government. However, maximum risk transfer to the private sector should not be construed as optimum risk allocation, as such a practice would likely increase the cost of the PPP Project and reduce competitiveness of bids.

6.3. Risk allocation should minimize the costs associated with the PPP Project. Typical example is for insurable risks (such as non-political force majeure events) being allocated to the Concessionaire, and other risks (such as change in law and political force majeure events) being allocated to the public sector.

7. RISK MITIGATION

7.1. Risk mitigation involves the adoption of different preventive measures by the parties involved in a PPP Project, with a view to mitigating the risks allocated to them. It is essential for the success of a PPP Project that all concerned parties should take appropriate and least-cost mitigation measures with respect to the risks allocated to them. The parties involved in a PPP Project should strive to find risk management solutions that will minimize the monitoring, negotiation, and management costs.

7.2. Risk mitigation shall be determined on a case-to-case basis, taking into account the risks arising in a PPP Project. However, the overarching risk mitigation measure that the Government should strive toward is the creation of an investor friendly climate to attract and retain investment in PPP Projects. This necessitates a structured legal and regulatory framework coupled with continuous and sustained policy reforms to ensure a stable macroeconomic environment, efficient means for dispute resolution through arbitration or judicial system, and full cost recovery (or a well targeted subsidy or Viability Gap Funding where full recovery would render services unaffordable).

7.3. Additionally, the Government may provide one or more of the Government Supports in the form of guarantees or other supports, as detailed in Section 17 of the PPP Act.

7.4. Given the climate of fiscal austerity and limited financial resources available, while certain risks may be allocated to the Government, the documentation developed on a case-to-case basis should include options for the Government to compensate (other than recourse to Government guarantees and payments of relief costs) the Concessionaire upon occurrence of any event categorized as relief event;

(a) where there is damage to assets (to the extent not recovered from insurance) the Concessionaire may avail financing or sponsor support to bear restoration costs and the Government may commensurately extend the concession period to permit the Concessionaire to recover its losses/profit from revenue generated or annuity payments from the Government; and

(b) where relief costs or restoration costs payable by the Government are too high, the Government may opt to terminate the PPP Agreement (upon payment of termination payments to ensure the Concessionaire is made whole for its investment) and take over the PPP Project's assets.

PART C

Part C of these Guidelines highlights best practices for allocation and mitigation of main risk categories in PPP Projects, as identified in Section 5.2 of these Guidelines.

8. PROJECT DISRUPTION CAUSED BY EVENTS OUTSIDE THE CONTROL OF THE PARTIES

8.1. The parties and the financiers involved in a PPP Project face the risk that the PPP Project may be disrupted by, *inter alia*:

(a) unforeseen or extraordinary natural disasters, the occurrence of which is outside of their control, such as floods, earthquakes, or pandemics; or

(b) the result of human actions, such as riots, mass strikes, blockades or sanctions by third-party governments, or terrorist attacks.

Such unforeseen or extraordinary events may cause a temporary interruption in the implementation of the PPP Project or its operations, resulting in construction delays and/or loss of revenue. Severe occurrences of such events may also cause physical damage to the PPP Project, or cause destruction which renders the parties unable to restore, rehabilitate or repair the PPP Project.

Such risks can generally be categorized as: (i) insurable events; and (ii) uninsurable events.

8.2. The risk of insurable events is generally allocated to the Concessionaire under the PPP Agreements. The Government may determine on a case-to case basis whether it will bear the full or partial cost arising due to any uninsurable and uncontrollable natural and political events. A guarantee or coverage for such uninsurable costs (or where the cost of insurance is too high, thus rendering such event uninsurable) is generally a pre-requisite for financiers extending loans to the PPP Project, thus impacting the bankability of the PPP Project.

8.3. The following mitigation strategies may be adopted for risks in this category:

(a) the Government may provide guarantees (as permitted under Section 17 of the PPP Act) for risks which are not insurable on commercial terms; and/or

(b) extend the concession period to permit the Concessionaire to recover its losses/profit from revenue generated or annuity payments from the Government.

9. PROJECT DISRUPTION CAUSED BY ADVERSE ACTS OF THE GOVERNMENT:

9.1. The parties and the financiers involved in a PPP Project face the risk that the project execution may be negatively impacted by the acts of the federal or provincial governments or their subordinate entities. Such risks may be classified into following three main categories:

(a) "traditional" political risks, including, confiscation, expropriation, nationalization or deprivation (the "**CEND**") of the Concessionaire's assets, or the imposition of new taxes that jeopardize the Concessionaire's prospects of debt repayment and investment recovery;

(b) “regulatory” risks, including, introduction of more stringent standards for service delivery, the opening of a sector to competition; or the imposition of payment structure which do not reflect full cost recovery; and

(c) “quasi-commercial” risks, including, breaches by the Implementing Agency of its obligations under the PPP Agreement, or interruptions to the PPP Project due to changes in the Implementing Agency’s priorities and plans.

9.2. The risks in this category are generally allocated to the Government. Thus, the Government is expected to provide compensation to the Concessionaire, for:

(a) loss of income or revenue due to the occurrence of the foregoing events or extend the concession period to permit the Concessionaire to recover its losses/profit from revenue generated or annuity payments from the Government; or

(b) as permitted under section 26(1)(b) of the PPP Act, termination payments in accordance with the PPP Agreement, following the occurrence of a CEND event or other breach, if the impact of such CEND event or other breach is not cured within the specified cure period provided in the PPP Agreement.

9.3. The following mitigation strategies may be adopted for risks in this category:

(a) the private party may acquire political risk insurance from Multilateral Development Banks / Multilateral Financial Institutions providing such insurances (not available from other insurance providers) to protect its investments against such risks; and

(b) the Government may provide, as permitted under Section 17 of the PPP Act, protection and coverage to the private party against the risk in this category, covering:

(i) investment grants to improve the financial internal rate of return of an economically viable PPP Project in the event of the project’s revenue being constrained by tariffs set by the Government below full cost-recovery levels;

(ii) guarantees for such risks which directly affect the cost of the PPP Project, including any change in law, or a change in the agreed tariff adjustment formula or its application;

(iii) guarantees for performance risk, where the Implementing Agency is autonomous from the Government, to cover the breach of the Implementing Agency’s obligations under the PPP Agreement;

(iv) guarantees for credit risks, in the event the Implementing Agency defaults on its payments to the Concessionaire (as applicable);

(v) guarantees against adverse acts of the Government, which are detrimental to the rights of the Concessionaire, or otherwise substantially impact the implementation of the PPP Project; and/or

(vi) pay compensation to the Concessionaire for any additional costs incurred as a result of occurrence of any events in this category or extend the concession period to allow the Concessionaire to recover its loss/profit.

10. CONSTRUCTION AND OPERATIONS RISKS:

10.1. Construction and operations risks may be classified into the following categories:

(a) completion risk, which is based on the contingency that the PPP Project cannot be completed at all;

(b) construction delay risk, which is based on the contingency that the construction of the PPP Project is not completed within the agreed timeline;

(c) performance risk, which is based on the contingency that the PPP Project fails to meet the required performance standards; and

(d) cost overrun risk, which is based on the contingency that the cost of the PPP Project exceeds the original cost estimates provided by the private party in their proposal at the time of submission of bid.

10.2. Construction and operations risks are generally allocated to the Concessionaire, and construction delay or default in meeting operational key performance indicators may result in imposition of liquidated damages and/or encashment of performance bond(s). However, where such risks arise due to an action or inaction of the Implementing Agency or due to occurrence of events categorized as relief events (such as force majeure), such risks may be allocated to the Implementing Agency.

10.3. The following mitigation strategies may be adopted for construction and operations risks:

(a) the Concessionaire may be allowed to outsource the construction, and operations and maintenance responsibility to its contractors / sub-contractors, provided that outsourcing to such contractors / sub-contractors shall be subject to the requirements that:

(i) the Implementing Agency shall not be held liable in case of any breach by such contractors / sub-contractors;

(ii) the contracts entered into with the contractors / sub-contractors shall be assignable to the Implementing Agency in case of termination of the PPP Agreement;

(iii) proper due diligence exercise is conducted to ensure that qualified parties are engaged.

For such purpose appropriate requirements for engagement of contractors / sub-contractors and qualification criteria for their engagement should be specified in the bidding documents; and

(b) where the Government is responsible, the Government may:

(i) provide guarantees against adverse acts of the Government, which are detrimental to the rights of the Concessionaire, or otherwise substantially impact the implementation of the PPP Project;

(ii) during construction phase, extend time for completion to permit the Concessionaire to make-up for delay in construction activities;

(iii) during operations phase, pay limited costs such as fixed operating costs and/or financing costs; and / or

(iv) extend the concession period to permit the Concessionaire recover its losses/profit from revenue generated or annuity payments from the Government.

11. COMMERCIAL RISKS:

11.1. Commercial risks are based on the contingency that the PPP Project may not be able to generate the expected revenue due to changes in market prices or the demand for goods or services it generates, thus impairing the Concessionaire's capacity to service its debt, or compromising the financial viability of the PPP Project.

11.2. The following risk allocation practices may be adopted for commercial risks:

(a) for annuity-based PPP Projects, there is generally no market risk, assuming that the PPP Agreement specifies adequately structured payment provisions; and

(b) for revenue-based PPP Projects, the market risk is ordinarily allocated to the Concessionaire. However, there are exceptions to this general principle. PPP Projects that are economically viable, but financially unsustainable, may benefit from an investment subsidy (such as Viability Gap Funding) or a revenue deficiency guarantee provided by the Government. The decision of the Government with respect to sharing such risk should depend on the priority of the infrastructure sector and the likely cost of the fiscal support to the Government.

11.3. The following mitigation strategies may be adopted for commercial risks:

(a) market risk assessment and demand forecasts should inform the design of the PPP Projects; and

(b) the Government may provide:

(i) minimum revenue guarantee or a revenue deficiency guarantee;

(ii) investment subsidy in the form of equity or grant in the form of Viability Gap Funding; and / or

(iii) guarantees to backstop the financial obligations of an Implementing Agency, in the event the Implementing Agency defaults on its payment obligations towards the Concessionaire.

12. FINANCIAL RISKS:

12.1. Financial risks may be classified into three categories:

(a) exchange rate risk, which is based on the contingency that changes in foreign exchange rates may alter the exchange value of cash flows from the PPP Project;

(b) risk of availability, convertibility, or transferability of foreign exchange, which is based on the contingency that foreign exchange control or lowering of reserves may limit the availability or convertibility in the local market of the foreign currency needed by the Concessionaire to service its debt or repay the loans; and

(c) risk of interest rate variability, which is based on the contingency that in the absence of fixed rate finance, the interest rates may rise, and the PPP Project may be liable to bear additional financing costs.

12.2. The following risk allocation practices may be adopted for financial risks:

(a) the exchange rate risk and variable interest rate risk should be allocated to the Concessionaire when borrowing in foreign currency; and

(b) the Government may adopt the risk of providing the Concessionaire with guaranteed availability, convertibility, and transferability of foreign exchange for the purpose of servicing debt, paying dividends, or other such operational matters.

12.3. The following mitigation strategies may be adopted for financial risks:

(a) the private party may acquire relevant guarantees and / or insurance from Multilateral Development Banks / Multilateral Financial Institutions (not available other from insurance providers) to protect its investments against such risks; and / or

(b) the private party may acquire loans at a fixed rate of interest to mitigate the interest rate risk, in the absence of which, the finance package may include hedging facilities against interest rate risks, including, by way of interest rate swaps or interest rate caps.

PART D

13. PRINCIPLES APPLICABLE TO THE PROVISION OF GOVERNMENT SUPPORT

13.1. The PPP Projects seeking Government Support should be an integral part of the long-term development plan for the given infrastructure sector and be consistent with the provincial investment policies and / or the PPP investment plans.

13.2. While assessing the need of Government Support for a PPP Project, the PPP Unit shall take into consideration:

(a) the specific requirements of the PPP Project;

(b) the market conditions;

(c) the impact of such Government Support on the sustainability of the Government's financial budget; and

(d) the type of Government Support that is proposed is in accordance with the PPP Act.

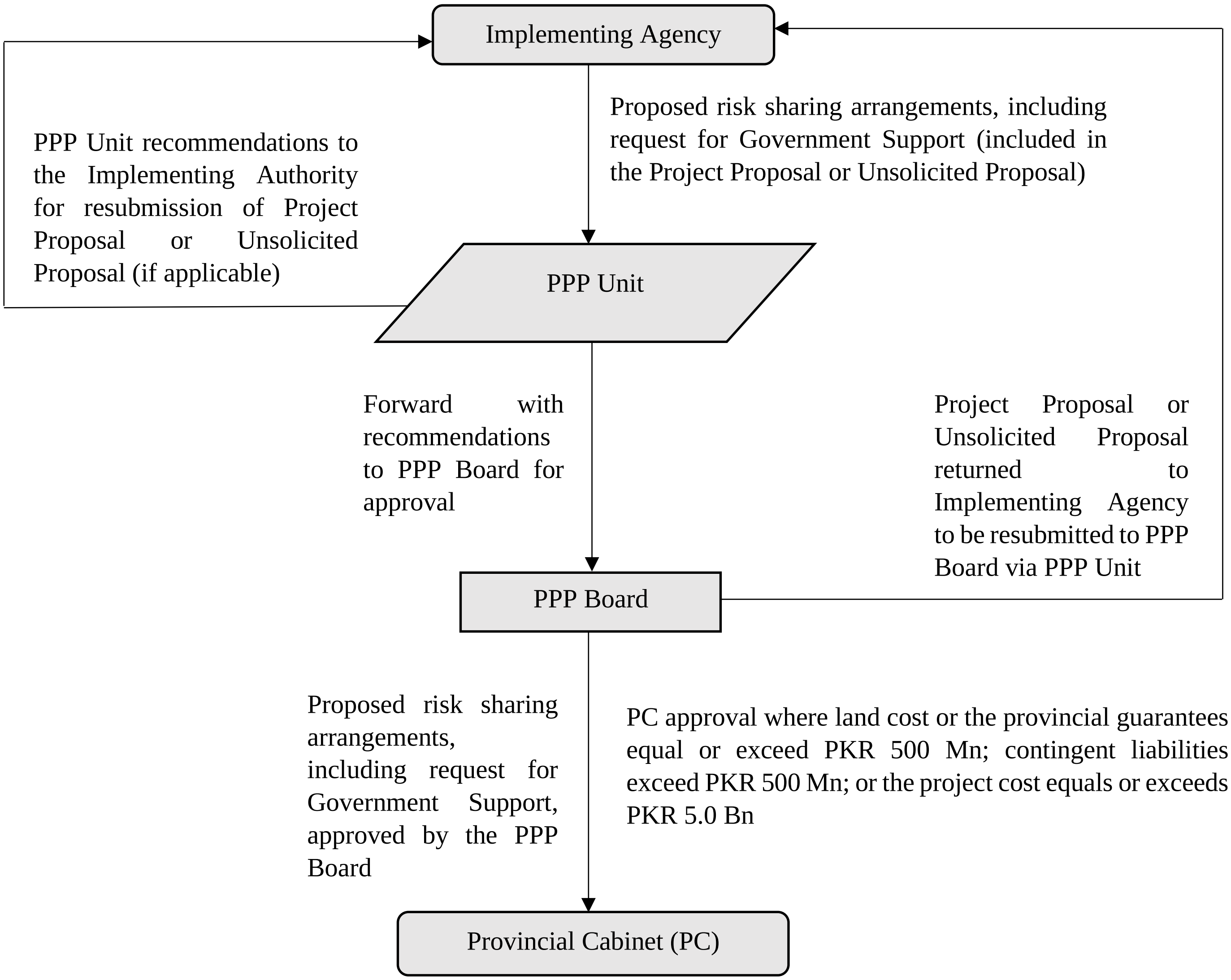
13.3. Prior to issuance of any Government guarantee for a PPP Project, adequate financial provision should be made against the expected cost of such guarantee. The PPP Agreements should define the guarantees available for a PPP Project and include the events that could trigger a call on the guarantee, the amount payable if the guarantee is called, and the period during which the guarantee will be valid.

PART E

14. INDEMNITY

14.1. The PPP Board, the PPP Unit and the PPP Authority, including any member, officer, servant, adviser or representative of the PPP Board, the PPP Unit, and the PPP Authority, as the case may be, shall enjoy immunity from all investigations, and proceedings, whether judicial or quasi-judicial, in respect of performance of their respective duties and discharge of their official functions under these Guidelines and the PPP Act.

ANNEXURE-A: RISK SHARING ARRANGEMENTS AND GOVERNMENT SUPPORT APPROVAL PROCESS



ANNEXURE-B: CHECKLIST FOR THE RISK MANAGEMENT PROCESS

The table below sets out the main steps that may be followed for risk assessment and management for a PPP Project:

SR. NO.	STEP	ACTION
I.	Analysis of the proposed structure of PPP Project	• Assessment of the proposed transaction structure in light of Implementing Agency's main objectives
II.	Risk assessment	• In light of the transaction structure and the Implementing Agency's main objectives, identify and assess potential risks that may be faced during various phases of the PPP Project commencing from the inception phase to closure phase. • Identification and analysis of risks commonly faced in similar transactions within the country or (if necessary) outside the country.
III.	Risk planning and reporting	• Based on a detailed assessment of data and the information available with respect to risks and their consequences, preparation of a comprehensive risk allocation plan setting out feasible options and measures for prevention and mitigation of such risks.
IV.	Implementation	• Implement measures and strategies as set out in the risk allocation plan. • Undertake periodic review and performance evaluation.