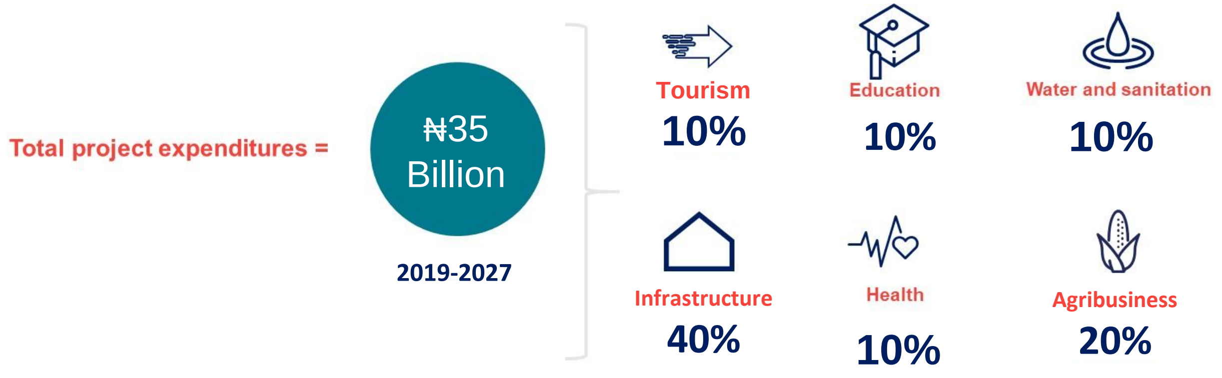
Oyo State Government PPP Support

FCCL Framework

December, 2023

Introduction.

- Early stage of development
    - PPP Project as outlined from the Oyo State Development Plan (2020-2025) report identified 20 projects with PPP potential
    - 15 projects have progressed to concept / PFS stage (initial estimated capital investment is over ₦35billion) – including infrastructure, real estate, agribusiness and renewable energy sectors. Meanwhile in the Oyo State Infrastructure & Development Master Plan projects infrastructure investment requirements at NGN 40tn (approximately USD 48 billion) for the 2019-2027 period
- The State Development Plan (SDP) 2021-2025 had set an overall investment target of more than NGN 2.33 trn (approximately USD 5.6 billion) over the five-year period from public and private sources.



PPPs and private investment are very critical in driving the economic growth of Oyo state.

Exiting regulatory framework.

Relevant Law	Relevant provisions and impact
Oyo State Fiscal Responsibility Law (FRL) 2016	FRC, established under the ambit of the FRL. The FRL defines the procedure for the preparation and approval of the **Medium-Term Expenditure Framework (MTEF)** The MTEF must also contain: • **A Debt Statement which describes the fiscal debt liability** of OYSG from the Debt Management Office (DMO) • A Statement describing the nature and **fiscal significance of contingent liabilities and measures to minimize/ mitigate such liabilities.** The FCCL framework will have to comply with the requirements of the MTEF to ensure adherence to the provisions of the FRL.
Debt Management Law (DML), 2015	Deals with both domestic and external debt; establishment of the Debt Management Office (DMO), • Maintaining databases of loans and loan guarantees • Verifying and servicing external debt guaranteed. This is done in conjunction with the Federal Debt Management Office (FDMO) • Verifying and servicing debt directly taken by the OYSG. This is done in conjunction with, the state Accountant General (AG) • Liaison with International Financial Institutions (IFIs) and donor agencies. Functions of the DMO particularly as they relate to guarantees, will require all PPP projects to go through a vetting process by the DMO. **The FCCL will also be included in the DMO database**.
Oyo State Public Finances (Control and Management) Law (PFML), 2016	Focused on ensuring proper accountability for use of government monies but has no specific provisions at present with respect to FCCL.

Existing regulatory framework.

Relevant Law	Relevant provisions and impact
Oyo State Public Procurement Law (OYSPPL), 2016	Functions of the Oyo State Bureau of Public Procurement (BPP) and Oyo State Investment Promotion and Public Private Partnership Agency (OYSIPA), PPP Manual prescribes that representatives of BPP are included in the tender committees for procurement of PPP projects.
PPP Policy, 2023	OYSIPA and the relevant Ministry, Department and Agencies (MDAs) are expected to review different aspects of a PPP project during preparation and procurement stages, including the review of contingent liabilities.
PPP Manual, 2023	Affordability and VfM checks are conducted under the project preparation stage as part of developing the Outline Business Case (OBC). The Concession Agreement Checklist in the PPP Manual includes an item for "Contingent Liabilities of the MDA". The FCCL framework will need to align with this approach of pre-contract assessment of contingent liabilities by MDAs.
OYSIPA Law, 2019	Entrusts investment promotion and facilitation responsibilities to OYSIPA. Currently under review. The review report recommends that the role of project preparation, VfM analysis and assessment of risks for a PPP project be segregated from the approval/ authorization of fiscal risks and liabilities. The review report suggests that the MOF's risk unit should undertake the role of confirming risk transfers in VfM analyses, including analysis of contingent liabilities.

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FCCL management for PPP projects covering the entire project lifecycle is not covered in the current regulatory framework.

FCCL management framework.

Objective

Provide a methodological approach for public officials of the:

- Oyo State Investment Promotion and Public Private Partnership Agency (OYSIPA),
- Ministry of Finance (MoF),
- Fiscal Responsibility Commission (FRC),
- Debt Management Office (DMO), and
- the Contracting Authorities (CA) or Responsible MDA’s

to assess and manage FCCL arising from PPP projects

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FCCL framework will be mandatory for all PPP projects submitted for consideration and approval by the OYSIPA Board (or the PPP Unit established under OYSIPA) from [insert date].

What are FCCL?

- Although PPPs are viewed as means of leveraging financial resources from the private sector, government assumes fiscal commitments over the life of the contract as set out under the PPP agreement.
- Under a PPP arrangement, the government almost always bears some risk which can take the form of support that gives rise to an on-going **fiscal commitment** - either a contingent liability or an actual direct liability.

	Definition	Examples
Direct liability	Takes the form of a defined and quantified undertaking to pay or carry a funding obligation for a feature, phase or item in a PPP project essential to its development, operation and/or completion. Its salient characteristic is that the occurrence of the payment obligation is known, although uncertainty may remain as to the size.	• Supplying the land needed for the project; • Upfront "viability funding gap" payments, in which the government makes a capital contribution to ensure a project that is economically desirable but commercially unattractive can proceed; and • Annuity or availability payments in which a regular unitary payment over the life of a project is conditional on the availability of the service, etc.
Contingent liability	An obligation that arises from a particular discrete but uncertain future event (i.e. one that may or may not occur) that is outside the control of the government. For contingent liabilities, the occurrence (trigger event), value, and timing of a payment may all be unknown or cannot be definitively determined. Such liabilities include guarantees on specific risk variables.	Examples of contingent liabilities are exchange rate, inflation, prices and traffic, force majeure, termination payments and credit guarantees, among others.

What are FCCL?

Fiscal Commitments

- Specified in PPP agreements.
- Can also come from **implicit sources**.
  - For example, a letter of support for a specific project may be considered a type of guarantee for some stakeholders.
  - Also, socio-political, economic and environmental sustainability of the projects may be expected to be rescued by government in the event of financial distress.

Type of FCCL	Examples
Direct - Explicit Liabilities / Fiscal Commitments	• Up-front commitments such as contribution to capital investment, land acquisition costs, etc. • On-going commitments such as availability payments, output based subsidies, operational subsidies, and capital subsidy obligations
Contingent Liabilities (CLs) / Fiscal Risks	• State guarantees on project loans, minimum levels of demand / revenue guarantees, exchange rate risks, put call option agreements (PCOA), etc. • Termination payment in case of concessionaire default, contracting authority default, or force majeure
Indirect - Implicit Liabilities	• Implicit liabilities that are not explicit because they are not expressed and defined contractually but they are, nonetheless, expected to be the responsibility of government. Perhaps the most obvious and often overlooked liability is the implicit guarantee from governments that ultimately underwrites all public infrastructure and services.

Illustrative public liabilities in a PPP scheme

What are FCCL?

Fiscal risk

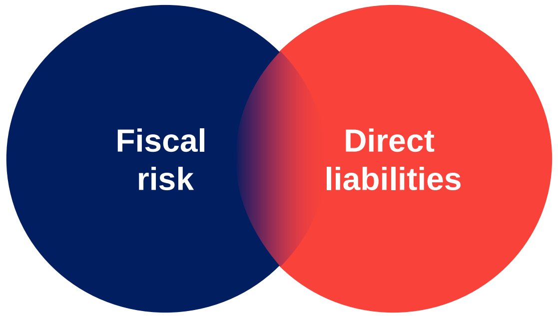
Definition

Factors that cause fiscal outcomes to deviate from expectations or forecasts.

Cause

Arise from the occurrence of an uncertain event and from the realization of macroeconomic shocks, or other unpredictable variables that trigger contingent liability obligations.

CLs are by definition fiscal risks.



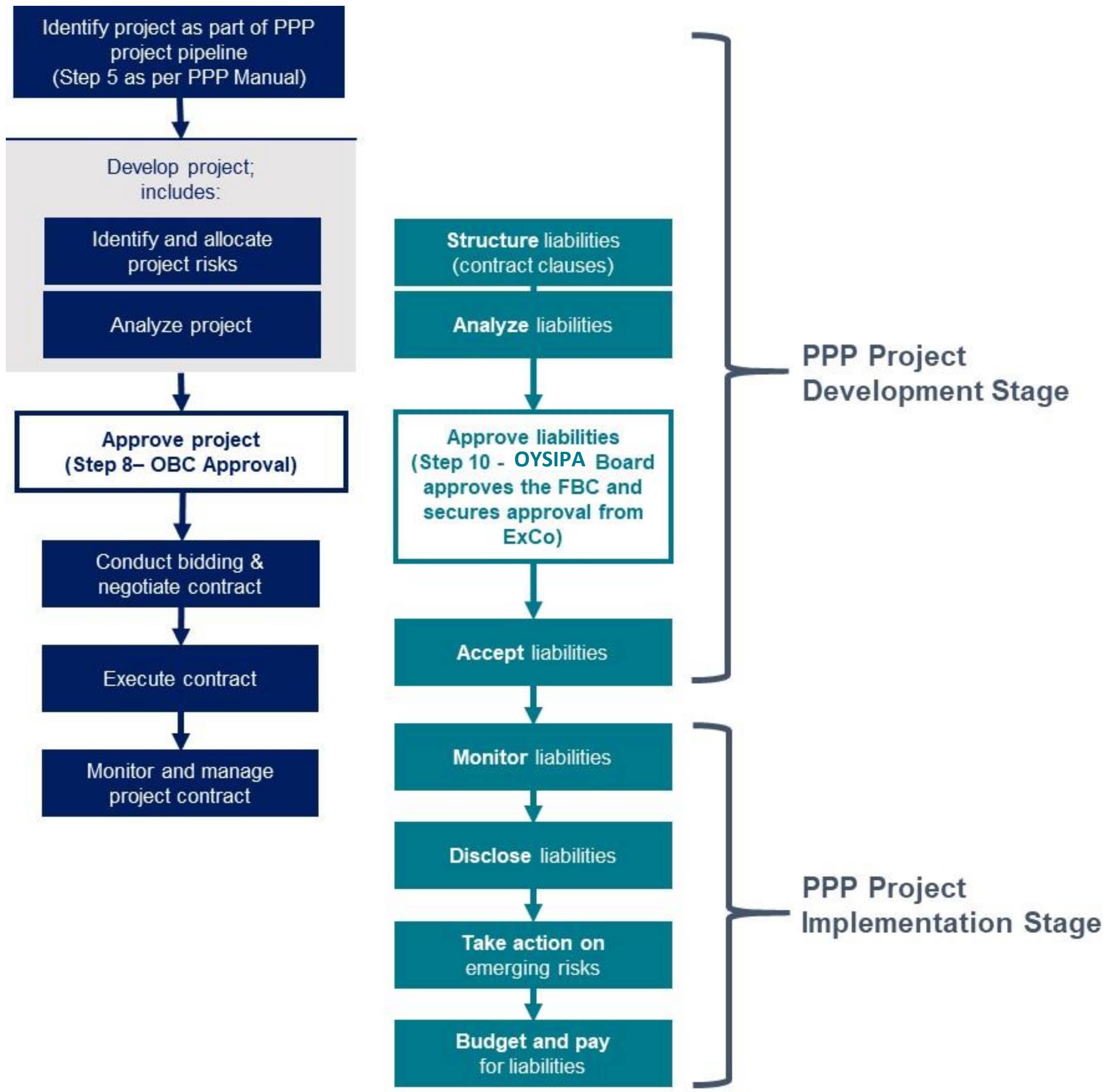
Direct liabilities may be subject to fiscal risks when they may change because of uncertain parameters.

- Within the context of PPP agreements, other sources of fiscal risks than those embedded in direct or contingent liabilities merit attention.
- Other sources of fiscal risks are those channeled through provisions – controlled by the government– of the PPP contract. For example, an extension of the project scope – allowed in the PPP contract and subject to government's consent – that modifies the costs of the project to the government.
- Other sources of fiscal risk are outside the scope of liabilities to be paid by the government to the private partners. For instance, a reduction of user-based revenues used by the government to fund a project. This reduction does not affect the government's liabilities to the concessionaire (that may be fixed and independent of user-revenues performance) but it does have a fiscal impact.

Examples of FCCL.

Type of Project	Fiscal commitment	Contingent liabilities	
		Payment and Termination	Other fiscal risks
Park Management System	• Upfront capital subsidy • Service payment adjusted by macroeconomic parameters and contingent events	• Revenue or traffic guarantee • Termination payment in case of concessionaire or contracting authority default, or force majeure.	• Change of scope that modifies the service payment. • Compensation for imposed decrease in toll rates due to social unrest
Infrastructure	• Availability payment adjusted by macroeconomic parameters and contingent event	• Termination payment in case of concessionaire or contracting authority default, or force majeure.	• Disputes on land acquisition or resettlement • Change of scope or governance
Tourism	• Viability Gap Funding	• Take or pay commitment from public utility • Termination payment	• Change in weather conditions • Renegotiation
Agribusiness Industrial Pack or Estate	• Availability payments	• Guarantee on occupation • Termination payment	• Change in political and strategic business model or governance

FCCL Management across PPP project lifecycle.



Project development **Project implementation**

Project Development Stage

The assessment and required approvals of the project FCCL are carried out by:

- Initial assessment during project preparation stage, through feasibility studies including project risks analysis and finance structuring
- Approval of initially assessed FCCL by the required institutions
- Updated assessment during procurement (i.e. prior to PPP agreement signature) taking in account variance based on the contracting authorities' assessment and bids received
- Checking accurate representation of FCCL in the final version of the project agreement

Project Implementation Stage

Monitoring and recording of FCCL are made through annual budget documents that need to provide systematic disclosure of key fiscal risks and indications of potential impacts.

Institutional Framework for FCCL.

- While the primary FCCL oversight role is assigned to the FRC, the general governance and institutional framework, including the specific functions that need to be undertaken to manage direct and contingent liabilities during the PPP project lifecycle, is shared.

Function	Objectives	Role/ Responsibility
Preparing	To develop a project design that will be bankable and ensure that the risks the government will bear are consistent with good risk allocation principles, borne at the lowest cost and with minimal fiscal impact.	**Contracting Authorities / OYSIPA:** Project feasibility analysis and implementation plans.
Analysing	To inform decision making when the project is structured and approved, and provide a basis for monitoring and budgeting for liabilities.	**Contracting Authorities / OYSIPA / Project Delivery Team (PDT)** Fiscal risk assessments and other tools for analyzing liabilities.
Approving	To ensure the use of government resources (which take the form of liabilities) are: focused on policy priorities; represent value for money; and are consistent with good fiscal management.	**OYSIPA Board / ExCo** Centralized approval to ensure that PPPs are focused on the government's policy priorities, represents value for money, and are consistent with good fiscal management. **P&BC, DMO, MoF** Allocated the overall responsibility of approving the fiscal commitments and contingent liabilities before submission to the PPP Committee for approval.
Accepting	To clarify the government's commitment to its liabilities (i.e. financial obligations), and to ensure the executed contract is consistent with earlier analysis and approval	**Contracting Authorities, OYSIPA, DMO, MoF, MoJ** Involves the government executing formal instruments such as project agreements, issuing letters of support or performance undertakings with the purpose of guaranteeing that they will honour its obligations and commitments.

FCCL guidelines.

Function	Objectives	Role/ Responsibility
Monitoring	To provide information needed to disclose, act on emerging issues and, if necessary, budget for liabilities	**Contracting Authorities, DMD, P&BC, OYSIPA** To help government track its exposure to fiscal risks from year to year, and improve its ability to take action to reduce the cost and/or likelihood of an event triggering a payment.
Budgeting and paying	To ensure resources are available to make payments promptly when required, improving credibility and clarity as to how costs of liabilities will be borne, and mitigating the fiscal impact.	**Contracting Authorities, P&BC, MoF, DMO** Establish a well-defined system for budgeting and paying for liabilities will ensure the government has the resources available to meet its obligations and mitigate the fiscal or budgetary impact of contingent liabilities.
Disclosing	To improve accountability for decision makers, and increase transparency of the government's commitments to third parties (such as credit agencies and lenders).	**FRC, DMO, OYSIPA, P&BC** Reporting on exposure to liabilities through the budget and government accounts to increase transparency and improve the accuracy and completeness of information available to external parties.
Mitigating	To help reduce the cost to government of bearing contingent liabilities by reducing the likelihood or cost of the occurrence of those liabilities.	**Contracting Authorities, MoF, DMO, OYSIPA, P&BC, FRC** Continuous monitoring of exposure to contingent liabilities from PPP projects, and actively managing that exposure where possible, by identifying and taking action on emerging issues.

FCCL technical guidance.

Purpose:

1 Develop an analytical process to identify, assess and monitor FCCL during the project life cycle of PPP projects

2 Detail a methodology for implementing the tools involved in the management of FCCL including pre-formatted tools for the identification and quantification of FCCL.

Project Development Stage

Design project → **Prepare project** → **Procure project**

The FCCL framework includes:

- Identification and assessment of fiscal commitments and risks, and
- Assessment of affordability. Both activities will help authorities to take well-informed decisions over the project.

Main tools:

- Identification and evaluation of PPP fiscal risks through the PFRM and Project Fiscal Risk Register (PFRR)
- Calculation of FCCL through the FCCL Register

FCCL technical guidance.

Purpose:

1 Monitor FCCL during the implementation of PPP projects to manage risks and trigger mitigation

2 Disclosure of FCCL for transparency and accountability.

3 Accounting for FCCL appropriately in the OYSG budget and financial statements

Project Implementation Stage

Monitoring — **Disclosing** — **Accounting**

The FCCL framework includes:

- Monitoring requirements and frequency,
- Reporting and disclosure requirements: and
- Accounting framework.

Project Fiscal Risk Matrix (PFRM).

Preparation of a PPP project

Assessment and allocation of project risks should be completed

OYSIPA / CA
(or the Transaction Advisors appointed for the project by the CA or OYSIPA as the case may be)

Create a risk matrix and a risk register, documenting the evaluation of the likelihood and impact of each risk

Periodically assessed by the CA

- Objective of **PFRM** is to support the **identification, assessment, and mitigation of common fiscal risks from each specific PPP project**.
- Prepared on a project-by project basis as part of OBC
- Overall assessment of fiscal risks of a PPP project follows a **six-step approach**.

Identification	• **11 Risk categories** • **Sub-categories**
Likelihood	• **Low** • **Medium** • **High**
Fiscal Impact	• **Low** • **Medium** • **High**
Risk rating	• **Equal to [Likelihood x Fiscal Impact]** • **Irrelevant, Low, Medium, High, Critical**
Mitigation measures	• **Is mitigation measure in place?** **Yes or No**
Priority actions	• **Function of Rating and Mitigation Measure** • **No action, Low / Medium / High, Critical**

A. PFRAM approach

Identification of fiscal risks (and allocation)

The identification of fiscal risks focuses on those risks that may have significant fiscal implications.

In doing so, it looks into both contractual risks and other risks not allocated directly by contract (for example, risks arising from the governance structure, legal framework, or government institutional capacity). It does not assess all of the potential risks that can arise during the project cycle

Risk categories

	Main Risk Category	Number of Risks Subcategories
1	Governance Risks	3 detailed risks
2	Construction Risks	11 detailed risks
3	Demand Risks	7 detailed risks
4	Operation & Performance Risks	6 detailed risks
5	Financial Risks	4 detailed risks
6	Force Majeure Risks	No Subcategories
7	Material Adverse Government Actions (MAGA)	No subcategories
8	Change in Law	No Subcategories
9	Rebalancing of Financial Equilibrium	3 detailed risks
10	Renegotiation Risks	No Subcategories
11	Contract Termination Risks	2 detailed risks

Source: PFRAM 2.0 User Manual

PFRM.

Risk Identification		Allocation	Likelihood	Fiscal Impact		Rating	Mitigation
Category	Event type	Govt/Private/ Shared	Probability of occurrence	Base Costs	Cost of occurrence		Measures and costs
Governance	Risk A						
	Risk B						
Construction	Risk A						
	Risk B						
	Risk C						
Demand	Risk A						
Operation	Risk A						
	Risk B						

B. Assessment of likelihood risks

After identifying the relevant risks for a PPP project, the evaluator shall assess the likelihood of such risks materializing in the future.

Initially, it is sufficient to identify whether the likelihood is low, medium, or high. A number of factors can help determine the likelihood. For example, the logic illustrated in the table below could be used as a reference.

	Low	Medium	High
Likelihood	• Very unlikely but not negligible • Would require highly unusual circumstances	• Likely and possible • Not unprecedented	• Very likely, almost certain • Extensive precedents

Source: PFRAM 2.0 User Manual

In case the risk rating is high, and its further assessment is a priority in accordance with the project heat map, the probability of occurrence may need to be determined for the purpose of contingent liabilities monitoring

C. Estimation of fiscal impact of risks

Project Officer (PO) / Accounting Officer (AO):

Evaluate the potential fiscal impact of a particular risk in a holistic manner from a qualitative perspective, providing as much information as possible to support the assessment of low, medium, or high.

For instance, this qualitative assessment could be made by comparison with the state GDP or with the project costs. The fiscal implications of governance risk materializing would be reflected also in terms of the government's loss of reputation, efficiency, availability, and transparency.

Fiscal impact assessment of identified risks

Scale	Value	Fiscal Impact
Low	< 0,1% of GDP or < 5% of CAPEX	• Impact on government deficit and debt lower than X % of GDP (accumulated construction cost of the asset) • Minimal damage to government's reputation, service availability, and operation
Medium	0,1%-0,2% of GDP or 5%-25% of CAPEX	• Impact on government deficit and debt between X% and Y% of GDP (accumulated construction cost of the asset) • Limited damage to government's reputation, service availability, and operation
High	>0,2% of GDP or >25% of CAPEX	• Impact on government deficit and debt above Y % of GDP (accumulated construction cost of the asset) • Significant damage to government's reputation, service availability, and operation

D. Determination of risk taking

The qualitative likelihood and fiscal impact are put together to estimate the overall risk rating (typically called the *severity of the risk*). This is done by combining the likelihood and fiscal impact, as show in Table 3-5. Risks assessed as having a high likelihood and a high fiscal impact, would be regarded as "critical". A "high" risk rating would be the result of a high likelihood and a medium fiscal impact, as well as a medium likelihood and a high fiscal impact.

Example of heat map based on risk rating

Risk Rating = Likelihood x Fiscal Impact

Fiscal Impact		Likelihood: LOW	Likelihood: MEDIUM	Likelihood: HIGH
	High	Medium	High	Critical
	Medium	Low	Medium	High
	Low	Irrelevant	Low	Medium

Source: PFRAM 2.0 User Manual

E. Identification of mitigation strategy

The question is whether there are measures in place to mitigate the potential fiscal impact. Possible mitigation measures vary with the risks.

Appendix A

Source: PFRAM 2.0 User Manual

F. Determination of priority actions

Based on the risk rating and the mitigation measures, an assessment of the priority of the required actions is to be undertaken as demonstrated in Table 3-6. The more severe risks - those with a high rating - should be addressed first. Risks rated as critical, paired with no mitigation measures in place, would result in the need to implement a "critical" priority action; the priority would be considered a "high priority" if mitigation measures exist. Addressing the less important risks, even if they are an easy fix, does not improve the overall risk profile of the project and does not reduce the risk for the government

Prioritization of risk mitigation measures

Priority action = Risk rating x Mitigation measure

Mitigation measure		Irrelevant	Low	Medium	High	Critical
	NO	No action	Medium priority	High priority	High Priority	Critical
	YES	No action	Low priority	Medium priority	Medium priority	High priority

Risk Rating

Source: PFRAM 2.0 User Manual

Risk Mitigation Measures.

- Some suggested types of mitigation measures by the Government:

1 Preventative measures

To limit the possibility of an undesirable outcome. Some examples are: insurance products, risk guarantees (such as those provided by financial institutions to mitigate the risk of the public entity failing to perform its financial obligations), financial instruments (to mitigate financial risks, such as interest rate, exchange rate, commodity prices) and provisions in such instruments to cap the risks based on a pre-determined thresholds on a project-to-project basis.

2 Corrective measures

To correct undesirable outcomes. For instance, a contingency plan in case of natural disasters, or in case of in case of contract termination.

3 Detective measures

To identify instances of undesirable outcomes. Here we find all monitoring activities and reports. For example, if government provides a termination payment in case of default of the contracting authority, it shall monitor financial performance and CA’s compliance with its obligations.

PFRM – Heat Map.

- The PFRM which will provide for a heat map for the monitoring of fiscal risks during the project life cycle.

Project fiscal risk matrix

Risk identification	Likelihood	Fiscal Impact	Risk Rating likelihood Impact	Mitigation strategy is it in place?	Priority actions	Suggested Mitigation Strategy
Governance Risks	Low	Medium	Low	No	Medium Priority	
Construction Risks	Medium	High	High	Yes	Medium Priority	
Demand Risks	Medium	Low	Low	No	Medium Priority	
Operational and Performance risks	Low	Low	Irrelevant	Yes	No action	
Financial risks	Medium	Medium	Medium	No	High Priority	
Force Majeure	Low	Low	Irrelevant	Yes	No action	
Material adverse government actions	Medium	Medium	Medium	No	High Priority	
Change in law	Medium	High	High	No	Critical	
Rebalancing of financial equilibrium	High	Medium	High	Yes	High Priority	
Renegotiation	High	Low	Medium	Yes	Medium Priority	
Contact termination	Medium	Medium	Medium	Yes	Medium Priority	

Source: PFRAM 2.0 User Manual

FCCL Register.

- Quantify the contingent liabilities arising from the occurrence of a fiscal risk identified in the PFRM and analyzed the PFRR – based on priority actions determined on the project heat map and address the risks which have been qualified as critical or requiring high priority monitoring.
- Direct and indirect liabilities consolidated in FCCL Register:
    - type of liability
    - Description of adjustment factors and trigger events
    - location (which will depend on the stage of the project).

FCCL register

Fiscal Commitment	Type of fiscal commitment/Definition	Adjustment factors/Trigger events	Location
Project X			
Payment 1	Direct Explain payment concept, periodicity, and form of calculation	Detail adjustment factors and trigger events if apply	Specific location where this information was taken (Feasibility Study, PPP Contract, Letter of Support, etc.) -
Payment 2	Contingent Explain payment concept, periodicity, and form of calculation		
Payment 3	-	-	-

- Guidelines on what measures and methodologies to use for the assessment of typical FCCL.

FCCL register

FCCL	Estimate	Function of available information
Direct Liabilities		
Upfront payment	• Annual cost over life of project • Present value of payment stream for the period of agreement	• Base Case
Availability payment		
Availability payment a by adjusted permanently macroeconomic parameters		• Scenario analysis • Qualitative analysis of likelihood of reaching trigger values • Probability of occurrence
Availability payment adjusted by contingent events		
Contingent liabilities		
Revenue guarantee	• Estimated annual cost over life of project • Estimated present value of payment stream for the period of agreement	• Scenario analysis • Qualitative analysis of likelihood of reaching trigger values • Probability of occurrence
Debt guarantee		
Guarantee over annual payment by state-owned enterprise, local or subnational government		
Termination payment	• Maximum value	
Other fiscal risks		

Source: CPCS

FCCL affordability analysis.

- With the estimations of fiscal costs, the government must now check if the project is affordable. The three common instruments used to check affordability are:

1

Comparing annual cost estimates against the projected budget

First instrument entails the CA and OYSIPA checking whether the project is aligned with budget constraints and priorities.
The affordability analysis must be consistent to the overall liability and fiscal risk management of the P&BC.

2

Assessing the impact on debt sustainability

Fiscal commitments from PPPs are considered debt-like obligations. Hence, the DMO may consider the consistency of treatment of such obligations within the overall government liabilities and fiscal management framework. PPP commitments could be included in debt measures to determine a project’s impact on overall debt sustainability.

3

Introducing limits on PPP commitments

Specific limits or thresholds on direct fiscal commitments of PPPs. The objective is to avoid tying up too much of the budget (within a specific sector or at aggregated level) in long-term payments.

FCCL affordability analysis.

Fiscal commitment	Cost	Indicator of fiscal affordability (Including projections over PPP contract length-beyond medium-term horizon)
Direct liabilities	• Estimated Annual payments • NPV	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of sub-national public debt • Cost as percentage of GDP
Guarantees	• Estimated annual payment, or expected average payment • NPV • (Base/Downside cases)	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of contingency line • Cost as percentage of public debt • Cost as percentage of GDP
Termination payment	• Estimated worst-case payment or expected average payment • NPV	• Cost as percentage of national budget • Cost as percentage of contingency line • Cost as percentage of GDP
Other fiscal risk	• Estimated worst-case payment or expected average payment • NPV • (Base/Downside cases)	• Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget • Cost as percentage of contingency line • Cost as percentage of GDP

Appendix A – PFRAM Risks and Mitigation Measures.

- **1. Governance Risks**

- **R1.** If the Public Investment Management (PIM) framework is not strong enough to guarantee that only priority projects are selected, a non-priority project might be implemented and absorb public resources, crowding out priority projects and leading to efficiency losses. To mitigate this risk, the public investment management framework should to be reinforced.
- **R2.** If the Ministry of Finance (MOF) is not able to effectively manage fiscal risks arising from this project, the risks might be amplified, and the probability and impact of other fiscal risks may be higher than they would be with adequate experience and capacity. To mitigate this risk, capacity in the fiscal risk management team in the MOF/Budgetary authority should be strengthened.
- **R3.** If project and contract information is not disclosed adequately, public concerns regarding the governance of the project/contract may arise, preventing users from acting as independent auditors of the project and/or exerting pressure to change the project. To mitigate this risk, the government should put in place a strong communication strategy engaging stake holders and creating ownership of the project, together with clear and standardized disclosure procedures for project information and, ultimately, contract disclosure.

- **2. Construction**
- **R4. Risks related to land availability**

- If the land is not already available, the government might face additional fiscal costs arising from possible compensation for construction delays. To mitigate this risk, (1) a complete assessment of land needs should be undertaken prior to contract closure; (2) the land acquisition process should be prepared; and (3) buffers and flexibility clauses should be included in the contract.
- If the project might be canceled due to lack of land, the government might face costs due to compensation to the private partner and the project redesign. To mitigate this risk, the government should ensure land availability at an early stage of the project cycle.
- If the private partner has to pay for the land acquisition, the private partner might not be able to cope with the cost; the government would be confronted with the cost of project cancellation and retender, or renegotiation at higher fiscal cost. To mitigate this risk, the government should ensure land availability at an early stage of the project cycle or provide sufficient information regarding the need and value of the land to ensure that the private partner is able to cope with the cost.
- If the government has to pay for land acquisition, it may face additional fiscal costs arising from the acquisition and possible delays due to unavailability of land, which might lead to compensation payments for possible delays. To mitigate this risk, the government should (1) complete the assessment of land availability and cost prior to contract closure; and (2) build in buffers and flexibility clauses in procurement and contracts.

Appendix A – PFRAM Risks and Mitigation Measures.

- **R5. Risks related to relocation of people and activities**
  - If people and/or activities are subject to relocation due to project implementation:
  - If the government is paying for the relocation of people and/or activities and possible project delays, it will face the cost of relocation and compensation. To mitigate this risk, the government should undertake a timely assessment of relocation needs and engage in effective stakeholder management.
  - If the private partner is paying for the relocation of people and/or activities and is unable to cope with cost, the government will be faced with the cost of project cancellation and retender, or renegotiation at higher fiscal cost. To mitigate this risk, the government should ensure timely assessment of relocation needs and provide sufficient information on relocation needs and costs.
- **R6. Risks related to land decontamination**
  - If the government has to pay for land decontamination and the need for decontamination arises, this will result in fiscal costs. To mitigate this risk, the government should undertake a timely assessment of the need and cost of decontamination.
  - If the private partner has to pay for land decontamination and is not able to cope with the cost, the government may face the cost of project cancellation and retender, or renegotiation at higher fiscal cost. To mitigate this risk, the government should (1) ensure a timely assessment of decontamination needs; and (2) should provide sufficient information on land condition.
- **R7. Risks related to environmental and archeological issues**
  - If there is a possibility of facing environmental/archeological issues and the government has to pay for them, the government may face costs (1) for environmental and archeological issues; and (2) for compensation payments it might have to make to the private partner due to project delays. To mitigate this risk, the government should (1) specify environmental constraints prior to tender (including permits and licenses); and (2) develop a plan to deal with archeological findings.
  - If there is a possibility of environmental/archeological issues and the private partner has to pay for them, the private partner might not be to cope with the associated costs; the government may be faced with the cost of project cancellation and retender, or renegotiation wat higher fiscal cost. To mitigate this risk, the government should (1) specify environmental constraints prior to tender (including permits and licenses); and (2) develop a plan to deal with archeological findings.
- **R8. Risks related to geological issues**
  - If there is a possibility of geological issues and the government has to pay for them, it may face compensation payments. To mitigate this risk, the government should (1) ensure a timely assessment of the geological conditions and their implications for the project; and (2) develop a plan to deal with these issues.
  - If there is a possibility of geological issues and the private partner must pay for them, the private partner might not be able to cope with the costs related to these issues; the government may be faced with the cost of project cancellation and retender, or renegotiation at higher fiscal cost. To mitigate this risk, the government should (1) ensure a timely assessment of the geological conditions and their implications for the project; and (2) provide sufficient information regarding geological conditions.

Appendix A – PFRAM Risks and Mitigation Measures.

- **R9. Risks related to licensing**
  - If the project is subject to licensing and the government pays compensation for project delays due to delayed licensing, the government may face the costs of compensation for project delays. To mitigate this risk, the government should ensure that subnational governments are fully supportive of the project and that project deadlines are consistent with subnational regulations.
- **R10. Risks related to failures/errors/omissions in project design**
  - If the government can be held responsible for design failures, errors, or omissions, it may have to pay compensation for failures in designs presented to the private partner if the cost of design risks is not fully transferred to the private partner. To mitigate this risk, the tender process and the contract should ensure that the private partner takes full responsibility for the design.
- **R11. Risks related to inherent defects in assets transferred to the private partner**
  - If the government can be held responsible for any inherent defect in assets transferred to the private partner, it may have to pay compensation to the private partner for inherent defects and the costs of defect remediation. To mitigate this risk, the government should ensure a prior assessment of the quality of the assets to be transferred to the private partner, allowing for full pricing of identifiable defects.
- **R12. Risks related to changes in project design and scope required by procuring agencies**
  - If the government is responsible for compensation due to changes in design and scope required by procuring agencies, it may have to compensate the private partner for net costs due to changes in the design and/or scope. To mitigate this risk, the contract should include provisions allowing for changes in the design/scope of the project, up to a predetermined limit. In addition, the accountability framework to monitor project cost overruns should be reviewed and improved, as necessary.
- **R13. Risks related to changes in input prices**
  - If the government is responsible for compensation in the event of excess volatility in input prices, it may have to pay compensation for significant changes in input prices. To mitigate this risk, the volume and prices of the relevant inputs should be monitored, and sufficient funds should be allocated for expected compensation payments.
  - If the private partner faces any excess volatility of input prices, the private partner may not be able to cope with significant changes; the government may be faced with the cost of project cancellation and retender, or renegotiation at higher fiscal cost. This risk can be mitigated by renegotiating the contract to re-establish financial equilibrium.
- **R14. Risks related to changes in nominal exchange rate**
  - If the government is responsible for compensation in the event of excess volatility in nominal exchange rate, it may have to pay compensation for significant increases. To mitigate this risk, the volume of foreign currency required and the exchange rate should be monitored, and sufficient funds should be allocated for expected compensation payments.
  - If the private partner faces any excess volatility in the nominal exchange rate, the private partner may not be able to cope with significant changes; the government may be faced with the cost of project cancellation and retender, or renegotiation at higher fiscal cost. This risk can be mitigated by renegotiating the contract to re-establish financial equilibrium.

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3. Demand

- If the PPP is **fully funded by the government**, and the **payments are linked to the volume** of service being provided:
- **R15.** If a cap is in place, the project may be confronted with much higher demand than included in the contract, which might require a costly renegotiation of the cap or require the government to purchase services from other providers. This risk can be mitigated by managing demand and possibly diverting demand to less costly alternative services.
- **R16.** If no cap is in place, the government may face higher than expected demand, leading to higher than expected costs. This risk can be mitigated by managing demand and possibly diverting demand to less costly alternative services.
- **R17.** If the project is suffering from insufficient demand, this may lead to project failure; the government may face costs for early termination or renegotiation. This risk can be mitigated by managing the demand or by renegotiating the contract to re-establish financial equilibrium.
- If the PPP is **fully funded by the government**, and the **payments are not linked to the volume** of service being provided:
- **R18.** If demand is much higher than expected, the project may collapse, and the government may face the cost of early termination or contract collapse. This risk can be mitigated by managing or diverting demand, which could have a fiscal cost.
- **R19.** If demand is much lower than expected, the project might be challenged; the government would not face additional fiscal costs, but it would pay for a service that is not/not fully being taken up by the user. This risk can be mitigated by managing demand by increasing demand or diverting it from other projects.
- If the project is either **totally user-funded or funded by a combination of government payments and user fees:**
- **R20.** If users consider user fees—regulated or not—excessive relative to services received, this might have a bearing on the reputation of the government. This risk can be mitigated by effective communication.
- **R21.** If the project is suffering from insufficient demand, this might lead to project failure, presenting the government with additional fiscal costs for early termination or renegotiation. This risk can be mitigated by managing the demand or by renegotiating the contract to re-establish financial equilibrium.

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4. Operation & Performance

- **R22.** If the PPP contract does not ensure that the government has full access to information on project performance, the government may be unable to effectively manage the contract. To mitigate this risk, the information-sharing requirements should be included in the contract and addressed in the legal framework.
- **R23**. If the contract does not clearly specify performance indicators, reference levels, and penalties or deductions, the government may face significant risks for not being able to address poor performance by the private partner. Failure to monitor project performance can lead to poor contract enforcement, which has administrative, efficiency, and political costs. It may also cause difficulties in applying project cancellation clauses and possibly in using step-in rights by financiers. To mitigate this risk, (1) key performance indicators should be included in the PPP contract, with reference levels, linked to penalty mechanism (preferably automatic deductions form periodic payments); and (2) the core contract management team should be involved in contract negotiation to guarantee that performance indicators/levels are fair, measurable, and contractible, that is, able to be presented as evidence in court.
- **R24**. If the government does not have the capacity and procedures in place to monitor performance, it faces significant risks for not monitoring performance, which has administrative, efficiency, and political costs. To mitigate this risk, contract monitoring procedures should be in place when contracts are signed; a core contract management team should be assigned before contract closure and should be involved in contract negotiation to guarantee that contract management procedures are feasible and efficient.
- **R25**. Depending on whether and how the contract addresses the introduction of new technologies, technical innovation may create explicit and implicit fiscal risks for the government. To mitigate this risk, the duration of PPP contracts should not exceed the expected life cycle of the technology used in the sectors, enabling the government to respond to technological innovation within a reasonable timeframe. For PPP contracts for projects including high and low innovation components, it can be appropriate to separate the two components—for example, a hospital building from the medical equipment—into separate contracts that might be of different duration or nature; the high-tech component might not be under a PPP contract but might be undertaken as traditional public procurement.
- **R26**. If there is a scarcity of specialized human resources, this could lead to performance issues. To mitigate this risk, the government should reallocate human resources from other activities or plan capacity-building activities in advance.
- **R27**. If there is a risk of significant increases in labor costs, this may lead to project failure. To mitigate this risk, the government should plan capacity building activities ahead of time.

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- **5. Financial**

- **R28.** If the private partner is unable to obtain finance for project implementation, the government may face project failure **before implementation starts**, being forced to take over the project, re-tender, or redesign and re-tender the project. To mitigate this risk, the government should (1) undertake a proper due diligence on private bidders' financial conditions and their ability (technical and managerial) to conduct the project; (2) establish adequate qualification requirements; (3) consider bid bonds and performance bonds to discourage not suitable candidates from bidding for PPPs; and (4) require some degree of commitment by financing parties during tender for very sensitive projects in less developed financial markets

- **R29**. If the private partner is unable to refinance short-term financing instruments, the government may face project failure **after implementation starts.** In such cases, the government could (1) be required to pay compensation for capital investment, (2) take over the project, or (3) renegotiate an interim financial solution and then re-tender the project (possibly under worse cost conditions for government). To mitigate this risk, in addition to undertaking the measures listed under **R28**, the government may require bidders to obtain long-term financing for very sensitive projects.

- **R30**. If the private partner is unable to cope with excess volatility in interest rates, the government may face project failure **after implementation starts**. The government could (1) be required to pay compensation for capital investment, (2) assume the project, or (3) renegotiate an interim financial solution and then re-tender the project (possibly under worst cost conditions for government). To mitigate this risk, the government should undertake the measures listed under the **R28**.

- **R31**. If government contractually accepted some exchange rate risk, fiscal support may be needed in the form of compensation; it may have to paying compensation for excessive volatility of exchange rate. Also, if the private partner is unable to cope with excess volatility in the nominal exchange rate, the government may have to (1) renegotiate under stress or face project collapse and pay compensation for capital investment; or (2) assume the project and then re-tender under a different risk allocation scheme. To mitigate these risks, the government should ensure a proper consideration of exchange rate risk, which may lead to better risk sharing and proper use of hedging mechanisms.

- **6. Force Majeure**

- **R32**. If there is no exact list of events to be considered force majeure tailored for the project, the government might have to pay compensation, adjust, or even terminate the contract due to force majeure events. Full or partial compensation by the government may even force the government to buy the assets or assume debt. To mitigate this risk, the scope of the force majeure events should be clearly stated in the contract, considering the legal requirements and specific project conditions. The contract should create incentives for the private partner to get insurance against some risks when insurance is available at a reasonable cost and to effectively manage risks by designing assets and managing services in ways that minimize the probability of occurrence and size of impact.

- **7. Material Adverse Government Actions (MAGA)**

- **R33**. If no clear definition of events to be considered MAGA are included in the contract, the government might have to pay compensation, adjust, or even terminate the contract due to acts and omissions by public entities, potentially forcing the government to buy the assets or assume debt. To mitigate this risk, contract managers should monitor the channels through which government's actions and omissions can affect the project during the life of the contract. Executive government actions and policy changes should be carefully evaluated by the contract manager and the fiscal management team to assess any impact on the PPP contract.

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- **8. Change Law**

- **R34**. If the PPP contract does not identify changes in law that do and do not require compensation by the government, the government might have to pay unforeseen compensation when adjusting or even terminating the contract due to changes in law. Changes in law might also benefit the private partner and, if not considered in the contract, increase the private partner's profit margin without benefitting the government. The cost of changes in law might include compensation payments, need to buy the asset or to assume debt, or loss of potential compensation paid by the private partner to the government. To mitigate this risk, the PPP contract should clearly identify changes in law that trigger a compensation or the right to terminate and should define the consequences. In addition, legislation and public policies should be in place to efficiently deal with this risk.

- **9 Rebalancing of financial equilibrium**

- **R35**. The legal framework may prescribe that the government is paying compensation and/or terminating the contract due to requirement to reinstate financial equilibrium. The government may have to pay compensation or cancel the project. To mitigate the risk from this, the PPP contract should restrict its application to the cases of force majeure, MAGA, avoiding its application to a wider range of situations.
- **R36**. The government might have to pay compensation and/or terminate the contract due to contract guaranteeing a rate of return for the private partner. To mitigate this risk, clauses and expectations on a guaranteed level of project rate of return or the shareholder's rate of return should be avoided.
- **R37**. The government might have to pay compensation and/or terminate the contract due to excessive protection against some hardships. To mitigate this risk, hardship clauses, if needed, should be precise and strict. Alternative methods to reduce excessive private sector risks should be considered, including insurance, future markets, and other hedging mechanisms.

- **10. Renegotiation**

- **R38**. If the government opens an uncontrolled renegotiation process, under information asymmetry and no competitive pressure, it might jeopardize economic efficiency by allowing the private partner to transfer to the government costs and risk that had originally been accepted by the private partner, with the fiscal impact depending on the government's ability to manage the renegotiation process. To mitigate this risk, the government should have a strategic view of PPP contract management and create the capacity to renegotiate.

- **11. Contract Termination**

- **R39**. If the government enters into an early termination process without clear knowledge of the consequences and procedures, the lack of clarity regarding consequences on early termination increases the private partner's bargaining power, leading to increases in the cost of termination; possibly preventing the government from cancelling non-performing contracts, or generating incentives for governments to nationalize a project or assets without proper assessment of the cost of that decision. To mitigate this risk, contracts should include a clear definition of the reasons for early termination (for example, underperformance of the private partner, public interest, or force majeure) and should present its consequences in terms of transfer of assets and responsibilities, namely, financial compensation for capital investment. Compensation should vary according to the party responsible for the early termination.
- **R40**. If the government terminates the contract without a clear understanding of transfer processes, including financial consequences, then (1) it may need to pay for stock of inputs or outputs; (2) human resources issues may imply financial compensation or increased current expenditures; and (3) licenses needed to continued operation may create fiscal surprises. To mitigate this risk, contracts should include a clear definition of the termination process; all financial consequences and identified gaps in the contract should be resolved by having both parties sign transfer protocols detailing the rules.