ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 46538-002
November 2016

Proposed Loan, Administration of Grant, and Administration of Technical Assistance Grant Islamic Republic of Pakistan: Supporting Public–Private Partnership Investments in Sindh Province Project

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 15 October 2016)

Currency unit	–	Pakistan rupee/s (PRe/PRs)
PRe1.00	=	$0.0096
$1.00	=	PRs104.54

ABBREVIATIONS

ADB	–	Asian Development Bank
ADP	–	annual development plan
ESMS	–	environmental and social management system
GOS	–	Government of Sindh
P&DD	–	Planning and Development Department, Government of Sindh
PAM	–	project administration manual
PDF	–	project development facility
PMU	–	project management unit
PPP	–	public–private partnership
PSF	–	Public–Private Partnership Support Facility
SFD	–	Sindh Finance Department
TA	–	technical assistance
VFM	–	value for money
VGF	–	viability gap fund

NOTES

(i) The fiscal year (FY) of the Government of Pakistan and its agencies ends on 30 June. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2016 ends on 30 June 2016.

(ii) In this report, "$" refers to US dollars, "£" refers to pound sterling.

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PROJECT AT A GLANCE

1. Basic Data			**Project Number:** 46538-002
Project Name	Supporting Public–Private Partnership Investments in Sindh Province	**Department /Division**	CWRD/CWPF
Country	Pakistan	**Executing Agency**	Finance Department,GOS
Borrower	Islamic Republic of Pakistan		

2. Sector	**Subsector(s)**	**ADB Financing ($ million)**
✓ **Public sector management**	Public administration	25.00
	Public expenditure and fiscal management	25.00
Energy	Energy sector development and institutional reform	25.00
Transport	Transport policies and institutional development	25.00
	Total	**100.00**

3. Strategic Agenda	**Subcomponents**	**Climate Change Information**	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low

4. Drivers of Change	**Components**	**Gender Equity and Mainstreaming**	
Governance and capacity development (GCD)	Civil society participation Institutional development Public financial governance	No gender elements (NGE)	✓
Partnerships (PAR)	Bilateral institutions (not client government) Civil society organizations Implementation Official cofinancing		

5. Poverty and SDG Targeting		**Location Impact**	
Geographic Targeting	No	Regional	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8, SDG9		

6. Risk Categorization: Low

7. Safeguard Categorization **Environment:** FI **Involuntary Resettlement:** FI **Indigenous Peoples:** FI-C

8. Financing

Modality and Sources	**Amount ($ million)**
ADB	**100.00**
Sovereign Project loan: Ordinary capital resources	100.00
Cofinancing	**23.98**
Government of the United Kingdom - Grant	19.23
Government of the United Kingdom - Technical Assistance	4.75
Counterpart	**65.00**
Government	65.00
Total	**188.98**

9. Effective Development Cooperation

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Islamic Republic of Pakistan for Supporting Public–Private Partnership Investments in Sindh Province Project. The report also describes (i) the proposed administration of a grant, and (ii) the proposed administration of technical assistance (TA), both to be provided by the Government of the United Kingdom for Supporting Public–Private Partnership Investments in Sindh Province, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the grant and the TA.[1]

2. The Government of Sindh (GOS), through the Government of Pakistan, has requested the assistance of the Asian Development Bank (ADB) for public–private partnership (PPP) investments and services in Sindh.

II. THE PROJECT

A. Rationale

3. After experiencing economic growth with a compound annual growth rate of 5.1% during 2001–2007, Pakistan witnessed a significant decline during 2008–2015. During this period the compound annual growth rate was 3.8%, characterized by a challenging investment climate, political instability, weak but recently improving fiscal discipline, weak public sector governance, and an unresolved energy crisis. Despite a modern banking system, Pakistan's financial service intermediation is low and deteriorating. The ratio of credit to the private sector to gross domestic product declined from 28% in 2007 to 15% in 2015, indicating the massive public sector borrowing that undermines private access to affordable credit. Financial inclusion remains very low and access to credit is worsening, with only 3% of the adult population having loan accounts and 30% having deposit accounts.[2]

4. With 44 million inhabitants (23% of Pakistan's population) and a gross domestic product share of 32%, Sindh has large infrastructure and social service needs, and these exceed the provincial public resources available.[3] With limited sources of revenue, federal transfers constituted 79% of Sindh's budget in 2016. Only PRs225 billion or 25% of Sindh's annual budget was allocated to the annual development plan (ADP) in FY2017, which funds infrastructure investments. The World Bank estimates that Sindh's annual infrastructure investments only represent up to 4% of the requirements in transport, electricity, water supply and sanitation, solid waste, telecommunication, and irrigation. In addition, Sindh requires investments in health and education. This also highlights the inability of the GOS to effectively utilize its budget for meeting its infrastructure needs via public procurements. To meet the needs of infrastructure in the province, such investments must be augmented by stronger private participation. In addition to bridging the funding gap for infrastructure investments, PPPs may also help accelerate completion and improve operating efficiency. However, PPPs carry significant fiscal risks that need to be managed and mitigated.

5. To reduce the infrastructure gap in the context of extremely limited fiscal resources, the GOS began facilitating PPP investments by promulgating the Sindh Public Private Partnerships

1 The design and monitoring framework is in Appendix 1.
2 International Monetary Fund. Access to Finance Database. http://www.imf.org/ (accessed 27 August 2013).
3 M. Arby and M. Rasheed. 2010. Estimating Gross Provincial Accounts of Sindh. *Pakistan Business Review* (October). No official estimates of provincial gross product are available for Sindh.

Act 2010,[4] along with legislation guidelines and procurement rules and public financing. The PPP Policy Board, led by the chief minister, was established to approve PPPs. A PPP unit within the Sindh Finance Department (SFD) helps line departments identify and develop suitable PPPs. A project development facility (PDF) to support the use of transaction advisory services and a viability gap fund (VGF) for the public financing portion of PPPs were also established in 2010. As of September 2016, Sindh had funded five PPP investments that commenced operation in 2013–2015. A pipeline of projects has been identified by the GOS; 36 projects have passed concept approval, with an estimated cost of PRs240 billion.[5]

6. However, initial experience demonstrates that considerable efforts are required to improve the leverage of public financing with private capital, improve governance and financing policies, and minimize fiscal risks related to PPPs. As PPP investments and contingent liabilities grow, it is essential to better prioritize project selection, and follow this with proper structuring to minimize fiscal risks. As a first step, PPP project identification and selection has to initiate from the line department when it is evaluating the requirement for ADP funds. Government departments should carefully consider project revenue generation and identify potential risks and the corresponding mitigation actions.

7. Although the VGF is mandated to support affordability for infrastructure services while ensuring commercial viability of PPP investments, it has so far been used for different purposes by providing (i) funding to investments through government equity, subordinated loans, and loans to PPPs; and (ii) full cash collateral to back GOS revenue guarantees and annuity payments to bank debt and equity sponsors. While such purposes appeared to address Sindh's low creditworthiness, the initial PPP projects were not properly structured and executed, which led to (i) high fiscal cost and contingent liabilities that undermined the benefits of PPPs; and (ii) private concessionaires and banks being favored, with PRs22 billion of public funding being used for only eight PPP projects signed during 2011–2016. The use of public resources for PPP projects must be limited to ensure appropriate separation of commercial risk to be borne by the private party from political and regulatory risks to be borne by the government. Government support through a VGF should only be deployed to provide sufficient funding for the commercial viability of the PPP and not be excessive and favor private participants and banks. Prudent management of fiscal risks and contingent liabilities must be put in place to limit fiscal risks within well-defined limits.

8. The structure of Sindh's PPPs must be significantly improved through (i) robust policy that guides the selection of eligible viable PPP projects based on Sindh's ADP, (ii) equitable risk participation from investors and lenders, (iii) rigorous risk management policies and supporting systems that address project and related fiscal risks, and (iv) sound policies that guide the use of public funding.

9. The project will support the development policies of the GOS for sustainable infrastructure provision through PPPs.[6] It is aligned with ADB's midterm review of Strategy 2020,[7] in which PPPs are a key driver of change, and ADB's country partnership strategy,

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[4] Government of Sindh. 2010. *Public Private Partnerships Act 2010*. Karachi.

[5] A detailed list of the PPP project pipeline is available at http://www.pppunitsindh.gov.pk.

[6] Government of Sindh. 2013. 2013–2014 Budget Speech by Sindh Chief Minister. Karachi; Government of Sindh. 2011. *Policy for Public–Private Partnership Projects*. Karachi; Government of Pakistan. 2010. *Pakistan Policy on Public–Private Partnerships*. Islamabad; and Government of Pakistan, Ministry of Planning. Development and Reforms. *Vision 2025 Approach Paper*. http://www.pc.gov.pk/?page_id=137.

[7] ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

2015–2019 for Pakistan.[8] The project builds on ADB's partnership with the GOS to develop the PPP framework under a program cluster in 2009,[9] using lessons learned from that program and ADB's country assistance program evaluation for Pakistan.[10]

B. Impact and Outcome

10. The project impact is aligned with improved infrastructure investments and services in Sindh.[11] The outcome will be increased fiscally responsible private sector participation and investment in infrastructure in Sindh.

C. Outputs

11. The outputs are (i) GOS capacity to select and develop PPP projects strengthened; (ii) PPP project-related fiscal risk effectively managed by the Public–Private Partnership Support Facility (PSF); and (iii) PPP project selection and management capacity of line departments, finance department, and planning and development department (PDD) strengthened.

1. Output 1: Government of Sindh Capacity to Select and Develop Public–Private Partnership Projects Strengthened

12. This output will be pursued by improving project screening and selection criteria in line with the PPP policy, and to assess the bankability of projects across all relevant government departments. In this process, the capacity of the PPP unit and PPP nodes in government departments will be improved so they are able to identify financially viable PPP projects and rigorously assess unsolicited proposals. This output will strengthen the technical skills needed to select and develop PPP projects, financial management, transparent procurement, and sound regular financial reporting and external auditing. Well-qualified professional staff will be able to evaluate prefeasibility studies and structure transactions with the assistance of transaction advisors.

13. The PDF was established in 2010 and the Guidelines for PDF Utilization were issued in 2011. The PDF is a pool of funds available for engaging consulting services to assist in preparing and structuring target PPP projects. The PPP Policy Board approves the utilization and disbursements of the PDF at the request of line departments; such requests are routed through the PPP unit. Funds are managed by the Sindh Fund Management House, which is a unit of the SFD. The guidelines to identify and select viable PPP projects will be further refined to provide additional guidance to line departments, the PDD, and the PPP unit in identifying and prioritizing PPP projects consistent with the ADP in forecasting demand for provincial PPP projects in electricity, transport, water supply, and sanitation infrastructure.

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[8] ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.

[9] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Loan for Subprogram 1 to the Islamic Republic of Pakistan for the Sindh Growth and Rural Revitalization Program*. Manila (Loan 2484-PAK); and ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Subprogram 2 to the Islamic Republic of Pakistan for the Sindh Growth and Rural Revitalization Program*. Manila (Loan 2645-PAK).

[10] ADB. Forthcoming. *Country Operations Business Plan: Pakistan, 2017–2019*. Manila. For lessons learned, consult the Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2); ADB. 2014. *Completion Report: Sindh Growth and Rural Revitalization Program in Pakistan.* Manila; and ADB. 2013. *Country Assistance Program Evaluation for Pakistan.* Manila.

[11] Government of Sindh, Bureau of Statistics, Finance Department (project implementing agency), and PPP unit status reports.

14. The financial and transaction advisors engaged by the PDF will undertake rigorous analyses to ensure value for money (VFM) for the GOS. They will provide advice to make target PPP projects commercially viable and bankable. VFM will include public sector comparators that estimate the life cycle cost of a project delivered by a public sector agency to properly benchmark PPPs. The VFM assessment compares the estimated project cost, including estimated operational efficiency gains provided by a private concessionaire.

15. Project selection criteria and monitoring will be rigorously applied as described in the project administration manual (PAM).[12] Technical, financial, and economic analyses will be undertaken to ensure the viability of the proposed projects. For large PPP projects,[13] transaction advisors will assist in drafting and managing requests for proposals to ensure responsive bidding. The PPP unit will assess the capability of private sponsors and lenders to provide financing and services, as well as establish an environmental and social management system (ESMS) to determine, mitigate, and manage environmental and social impacts of PPP projects as a basis for recommending projects for consideration by the PPP Policy Board.

2. Output 2: Public–Private Partnership Fiscal Risk Effectively Managed by the Public–Private Partnership Support Facility

16. This output will establish policies and procedures as well as systems for identifying the appropriate use and level of support by the VGF to avoid the excessive use of public funds, and effectively manage the contingent liabilities arising from PPP projects. The PSF will be established under Section 42 of the Companies Ordinance, 1984 as a not-for-profit company to manage the new VGF, thereby enhancing corporate governance and transparency of the new VGF. Loan and grant proceeds and government counterpart funding will be channeled through the PSF.[14]

17. Under the project, the exposure of the existing VGF will be separated from the proposed new VGF. The PSF will ensure that the new VGF funded under this project will enhance service affordability and VFM as determined by policies and standard operating procedures that support socially and economically viable projects and improve their commercial viability within well-defined fiscal risk limits. The new VGF may provide upfront capital investment and guarantees to partially offset cost and risks during the construction period and reduce noncommercial risks for public service investments related to land acquisition. The new VGF may also be used to augment user fee revenue to be collected by a private concessionaire or to provide equity, quasi-equity, or subordinated debt and guarantees to a PPP.

18. The PSF will have strong corporate governance, including requirements for regular internal and external audits. The facility will have a board of directors composed of at least five members, of which at least three will be independent members not affiliated with the government and equipped with relevant professional experience. The board of directors will elect an independent director as its chair. The principal managers of the company will include the chief executive officer, chief financial officer, and chief risk officer. The principal manager will be an experienced professional with relevant private sector experience and will be recruited through a transparent and competitive process. The PSF will recruit staff with the skills and expertise needed to determine the appropriate level and use of VGF funding for proposed PPP projects, and to manage its execution by supervising and monitoring the performance of PPPs

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[12] Project Administration Manual (accessible from the list of linked documents in Appendix 2).
[13] The GOS defines infrastructure projects of over $5 million as large projects.
[14] Footnote 12, Section III.

supported by the new VGF. PPPs approved for funding by the PSF will require ADB's prior consent, which will not be unreasonably withheld. Such consent may subsequently be replaced by a free limit when ADB is satisfied with the successful execution of at least three approved projects by PSF.

19. The PSF will ensure the VFM of PPPs and effectively manage fiscal risks by (i) improving its selection of projects and risk management by recommending appropriate structures and risk participation, and (ii) minimizing cash collateralization practice. The PSF will also provide (i) early participation and feedback on PPP selection, (ii) possible funding that the VGF may support, and (iii) periodic reports on the contracted and contingent liabilities related to PPP projects funded by the new VGF.

20. The PSF will manage the utilization of the new VGF. The new VGF will be funded by government counterpart funds, a grant from the Government of the United Kingdom, and the ADB loan upon ADB's satisfaction that policies and procedures and staffing of the PSF are in place and comply with the covenants set forth in the loan and project agreements and the PAM. The PSF will also report quarterly to the PPP Policy Board, ADB, and the project management unit (PMU) in the SFD, which will prepare quarterly consolidated project progress reports.[15] The PSF will also assist the GOS in monitoring existing VGF and contingent liabilities.

3. Output 3: Public–Private Partnership Project Selection and Subsequent Management Capacity of Line Departments, Finance, and Planning and Development Departments Strengthened

21. This output will build capacities in the SFD, PDD, PPP unit, and the PPP nodes of line departments to effectively perform their duties. The GOS is currently unable to manage the fiscal risk of PPP projects. The SFD will engage two risk management specialists who will assess the fiscal risks of PPP projects, measure contingent liabilities, propose appropriate allocations of risk between public and private partners, and provide effective independent risk advice until the PSF is formed. Once constituted, the PSF will apply similar effective and enhanced risk management practices in relation to the management of the new VGF. The specialists will assist the PPP unit and GOS to assess the risks associated with PPP projects and develop recommendations for managing those risks. They will monitor adherence to the budget allocation of the GOS and assist the government in formulating and embedding risk tolerance strategies into budgetary planning processes. To avoid duplication of efforts, the two risk management specialists will be transferred to the PSF after it is constituted to carry out the same role in close coordination with the PPP unit.

22. The lack of experienced staff in the PPP nodes to process PPP transactions is a significant constraint on developing PPPs. Support will be required to build skills for (i) managing PPP contracts and environmental and social safeguards; (ii) understanding relevant legal issues, and preparing loan documentation and requests for proposals and concession agreements; (iii) developing financial expertise to structure transactions; and (iv) assessing and managing the market and operational risks. Under the project, the SFD will implement a comprehensive PPP capacity building plan.

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[15] The PMU will facilitate VGF reimbursements from the project proceeds through the withdrawal application process. A detailed fund and document flow diagram is in the Project Administration Manual (accessible from the list of linked documents in Appendix 2).

23. The project and the attached TA will support (i) on-the-job and modular training on alternative financing plans and credit enhancement products, including means of leveraging investment funds for PPPs from international, regional, and local syndicated banks; export credit agencies; and capital markets; and (ii) promotion of a culture of periodic, in-depth consultations with local commercial banks and international financial institutions and multilateral and bilateral development partners active in project financing.

D. Investment and Financing Plans

24. The total project cost as detailed in the PAM is estimated at $184.2 million equivalent (Table 1) and includes funding by the GOS and ADB, and grant cofinancing by the Government of the United Kingdom through the Department for International Development, to be administered by ADB (Table 2).

Table 1: Project Cost Summary

Item	**Amount** ($ million)[a]	**Share of Total** (%)
A. Project development facility	7.9	4.3
B. Public–Private Partnership Support Facility (PSF)[b]	5.0	2.7
C. New viability gap fund managed by PSF	163.2	88.6
D. Project management unit	0.7	0.4
E. Contingencies	2.9	1.6
F. Financing charges during implementation[c]	4.5	2.4
Total	**184.2**	**100.0**

[a] Exclusive of taxes and duties imposed in the territory of the borrower. These will be financed by the government through its funds or exemptions.
[b] To fund the operating cost of PSF.
[c] Includes interest and commitment charges.
Source: Asian Development Bank estimates.

Table 2: Financing Plan

Source	**Amount** ($ million)	**Share of Total** (%)
Asian Development Bank (ordinary capital resources)	100.0	54.3
Government of the United Kingdom[a]	19.2	10.4
Government of Sindh	65.0	35.3
Total	**184.2**	**100.0**

[a] Administered by the Asian Development Bank. The Government of the United Kingdom through the Department for International Development has committed to provide a grant of £14,749,410 to jointly finance the project, converted to United States dollars using the prevailing exchange rate on 11 August 2016, i.e., £1 = $1.3041. The estimated US dollar equivalent of $19.23 million includes a provision for foreign exchange fluctuations (if any), to the extent that these are not covered by the interest and investment income earned on this grant. The Government of the United Kingdom has no obligation to contribute additional funds should the total funding requirement fall below the estimated US dollar equivalent as a result of adverse foreign currency fluctuations. The Government of Sindh has agreed to finance any shortfall in financing plan in this regard.
Source: Asian Development Bank estimates.

25. The government has requested a loan of $100 million from ADB's ordinary capital resources. The loan will have a 20-year term, including a grace period of 5 years, straight-line repayment terms, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year (the interest and other charges accumulated during the grace period will be capitalized), and such other terms and conditions as set forth in the draft loan and project agreements. Based on this, the average loan maturity is 12.75 years and there is no maturity premium payable to ADB.

26. The loan and grant proceeds will be made available to the GOS on terms and conditions acceptable to ADB. The GOS will use the loan proceeds to fund (i) the new VGF that will be reflected in the assets and liabilities of the PSF, and (ii) interest and commitment charges during project implementation. The grant proceeds will be used to finance the new VGF and the PDF. Loan proceeds will be disbursed to the borrower in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time) upon compliance with all requirements for fund release and all conditions precedent to loan effectiveness.

E. Implementation Arrangements

27. The SFD will be the executing agency and implementing agency for the project. The PSF will also assist the SFD in implementation by managing the new VGF and fiscal risks emanating from PPP transactions. An interdepartmental PMU in the SFD, with representatives from the PPP unit, PDD, and key line departments, will coordinate project implementation and TA activities (Table 3). Procurement in relation to the use of the new VGF and PDF will be done in accordance with the Sindh Public Procurement Rules 2010 (amended 2013), which closely follow ADB's relevant procurement guidelines.[16] As the project will be cofinanced by the Government of the United Kingdom and administered by ADB, universal procurement will be applied.[17] SFD capacity to implement the project was assessed and found to be adequate. The project counterparts' capacity will be further developed with TA to ensure that these systems reflect best practice. The project will be completed by June 2022.

Table 3: Implementation Arrangements

Aspects	Arrangements
Implementation period	April 2017–June 2022
Estimated completion date	30 June 2022 (Closing date: 31 December 2022)
Management	
(i) Executing agency	Sindh Finance Department
(ii) Implementing agency	Sindh Finance Department Public–Private Partnership Support Facility
(iii) Implementation unit	Project management unit in Sindh Finance Department
Disbursement	The loan proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time) and detailed arrangements agreed between the government and ADB.

ADB = Asian Development Bank.
Source: Asian Development Bank.

III. TECHNICAL ASSISTANCE

28. ADB will administer capacity development TA that aims to (i) develop GOS staff capability to manage PPPs; (ii) ensure effective project management and monitoring of results and risks; (iii) provide necessary support to the PSF for project implementation; and (iv) improve awareness and ability of public and private stakeholders to design and manage PPPs through workshops, training, and consultation sessions. The SFD will be the executing agency and will be responsible for coordinating TA activities.[18] The TA is expected to cost $4,819,860, of which

[16] Government of Sindh, Sindh Public Procurement Regulatory Authority. 2013. *Sindh Public Procurement Rules, 2010 (Amended 2013)*. Karachi. Under the Sindh Public Procurement Rules, Sindh selects private entities for PPP projects in a transparent manner by adopting competitive bidding procedures. These private entities, in turn, will apply their own procedures for procurement, which are also required to be applied in a transparent manner.
[17] ADB. 2015. *Enhancing Operational Efficiency of the Asian Development Bank.* Manila.
[18] Attached Technical Assistance (accessible from the list of linked documents in Appendix 2).

$4,750,530 (£3,642,765 equivalent)[19] will be financed on a grant basis by the Government of the United Kingdom, and administered by ADB. The SFD and PSF will be the implementing agency, with day-to-day project management undertaken by the PMU in the SFD. TA consultants will be engaged by ADB in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). ADB and the PMU in the SFD will each oversee consultant outputs. The TA will be implemented from November 2016 until June 2022.

IV. DUE DILIGENCE

A. Economic and Financial

29. The Sindh economy is constrained by inadequate infrastructure in the areas of transportation, energy, and water supply and sanitation. The GOS lacks the revenues and borrowing capacity to fund Sindh's infrastructure needs. PPPs offer opportunities to close the infrastructure gap.

30. Based on its due diligence and lessons learned from its previous support for Sindh PPPs, ADB estimated that the project may leverage an additional amount of private capital, over 5 years, that equals the public project cost of about $160 million to construct and operate infrastructure projects in Sindh, and will thereby stimulate economic activity and income and employment in Sindh. Major expected benefits are the creation and development of critical infrastructure as well as on-time delivery and lower cost overruns compared with public procurement.[20] An ADB financial management assessment considered the capacity of the SFD to be adequate, taking into account the risk mitigation measures described in para. 31.

B. Governance

31. The financial management risk rating, before risk mitigation measures, is considered substantial. The governance and operational policies and procedures in the existing VGF are inadequate. The SFD has agreed to improve oversight of the PDF and existing VGF through periodical external audits. Under the project, a new well-structured and established PSF will manage the new VGF in compliance with Securities and Exchange Commission of Pakistan governance, financial reporting, and auditing requirements. The following aspects must be improved prior to the first disbursement: (i) accounting and reporting systems for the PDF and new VGF must be confirmed satisfactory to ADB; and (ii) contingent liabilities related to PPP contracts must be adequately reflected in GOS financial statements and gaps identified in GOS financial audits beginning with the audit of FY2016, and be addressed through a time-bound action plan no later than 30 June 2017. Under the project, new VGF injections will be routed through the PSF, which will manage the funds. PSF staff, proficient in risk management, will institute a strong governance structure and support the SFD in managing the contingent liabilities arising from PPPs.

32. The SFD procurement team possesses adequate skills, experience, and capacity to procure goods and consulting services in accordance with Sindh Public Procurement Rules 2010. The team's capacity to follow ADB guidelines will continue to be strengthened. The GOS has drafted procurement procedures for efficient and transparent procurement processes for PPP projects. Processes for information management, effectiveness, and accountability measures are satisfactory. The PMU will include dedicated staff to handle procurement

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[19] Exchange rate on 11 August 2016.

[20] Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).

oversight and document flow. PMU staff skills and knowledge in these areas will be further strengthened through training under the attached TA. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the Government of Pakistan and the GOS. The specific policy requirements and risk mitigation measures are described in the PAM (footnote 11).

C. Poverty and Social

33. The project is classified *general intervention*. It will, however, generate indirect benefits through increased and improved infrastructure and services and may provide fiscal space for social expenditures in the long term when PPPs are more established. The project will help implement PPPs that reflect appropriate VFM, resulting in a net gain for the people of Sindh. This will benefit both urban and rural areas by increasing employment opportunities during PPP project construction as well as establishing ancillary facilities that will generate additional employment. Through the TA, the project will further support training on gender-responsive project selection criteria (i.e., impact on women beneficiaries, mitigation measures for any adverse impact on women, employment opportunities that will be created for women through the project, and capture of sex-disaggregated project data).

D. Safeguards

34. The project is classified *financial intermediation* for the environment and involuntary resettlement, and *financial intermediation* treated as *category C* for indigenous peoples. Due diligence shows that the PSF will support infrastructure initiatives that may have resettlement and environmental impacts. Civil works will include new construction, as well as rehabilitation of existing infrastructure in areas such as transport and renewable energy. No impacts on indigenous peoples are anticipated. An ESMS arrangement document setting out the safeguard requirements has been prepared. Prior to the first disbursement to the PSF, an ESMS that meets ADB's requirements must be in place. ADB will also need to be satisfied that the PSF has the accountability and capability to (i) manage the ESMS and environmental and social policies of the PSF and the PPP unit, and operational guidelines, safeguards screening, categorization, review procedures, and oversight during subproject implementation; and (ii) set out a plan to strengthen the environmental and social safeguards capability of the PSF and PPP unit through appropriate integration in the PSF risk management structure, and appropriate staffing, performance monitoring, and reporting. TA consultants will support the PSF in establishing the ESMS, and will periodically monitor and review ESMS implementation. The PSF will also contract the services of a firm on a retainer basis to assist it with the safeguards reviews of any proposals submitted for funding, and to support its accountability for managing the ESMS in line with ADB's Safeguard Policy Statement (2009). Disclosure of subproject safeguards documents are described in the ESMS. The ESMS will be subject to periodical external audit and review by ADB.[21]

E. Risks and Mitigating Measures

35. Overall project risks are assessed as high. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.[22] The integrated benefits and positive impact of the project are expected to outweigh the costs.

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[21] An environmental and social safeguards management system will be established to ensure that appropriate safeguards are incorporated in Sindh's PPP activities.

[22] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Poor security environment affects investor confidence.	Direct mitigation of the political and security risks are outside the scope of this project.
PPP policy project selection criteria may not be used by all PPP nodes	The Asian Development Bank will disqualify projects that do not apply policies and guidelines consistently.
High turnover of critical staff in the PPP nodes creates a risk of project implementation delays and inability to deliver projects.	The technical assistance will help develop a document management system, handbooks, and guidelines that will be used to train and transfer knowledge to new staff.
Prudent policies and procedures for VGF funding are not consistently applied.	The project development facility will be regularly audited. The PSF will take over the management of the VGF. The PSF will comply with all Securities and Exchange Commission of Pakistan financial reporting and auditing requirements.
VGF is not properly utilized.	The PSF is being formed with an elaborate governance structure to mitigate suboptimal utilization of the new VGF.

PPP = public–private partnership; PSF = Public–Private Partnership Support Facility, VGF = viability gap fund.
Source: Asian Development Bank.

V. ASSURANCES AND CONDITIONS

36. The Government of Pakistan and GOS have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents. The Government of Pakistan and GOS have agreed with ADB on certain covenants for the project, which are set forth in the loan and project agreements. In addition to the standard conditions to loan effectiveness, the following items have been identified and specified as conditions to loan effectiveness: (i) incorporation and full professional staffing and budgeting of the PSF, including appointment of its key senior management and board members; (ii) adoption of environmental guidelines for Sindh PPPs; (iii) revisions to the Sindh PPP policy and related guidelines and rules to reflect the new VGF structure and its governance; (iv) adoption of a detailed financial management manual for the PSF; (v) adoption of new project selection criteria for Sindh PPPs; and (vi) improved staffing of the PPP nodes in designated sectors, including appointment of procurement technical sector and financial specialists.

VI. RECOMMENDATION

37. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of $100,000,000 to the Islamic Republic of Pakistan for the Supporting Public–Private Partnership Investments in Sindh Province Project, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 20 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao
President

3 November 2016

DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned With

Infrastructure investments and services in Sindh improved[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Fiscally responsible private sector participation and investment in infrastructure increased in Sindh	By FY2022: a. Private investment in provincial infrastructure and service projects increased to 10% (FY2016 baseline: Percentage of PPP projects in ADP 6%) b. A contingent liability assessment and risk management plan included in 100% of project proposals submitted to the PPP Policy Board (2014 baseline: 0) c. Weighted average of VGF utilization with respect to project cost for PPP project portfolio decreased to 75% (2014 baseline: 96%)	a. Government of Sindh Bureau of Statistics, SFD reports b–c. PPP unit status reports	Agreed policy and institutional arrangements for PPPs are not used uniformly by all PPP nodes.
Outputs 1. Government of Sindh capacity to select and develop PPP projects strengthened	1a. Standardized project selection criteria for PDF in place by January 2017 (2014 baseline: Different sets of criteria used for each project) 1b. At least one staff member of four PPP nodes trained in proper application of selection criteria by April 2017, seven PPP nodes by December 2018 (2014 baseline: no standardized criteria) 1c. PDF replenished by $3 million upfront by January 2017 (2014 baseline: no PDF replenishment plan)	1a–b. Reports of key sector departments, PPP unit 1a–b. PMU status reports 1c. Provincial budget reports	High turnover of core staff at the PPP nodes creates a risk of project implementation delay
2. PPP project-related fiscal risk effectively managed by PSF	2a. PSF established by December 2016 2b. Established criteria for VGF utilization and management by PSF from June 2017 onwards (2014 baseline: criteria incomplete and not used systematically) 2c. Risk management measures applied by PSF to all PPP transactions from September 2017 onward (2014 baseline: no	2a. Constitution documents 2b–e. PSF quarterly risk management reports, annual reports, and audited financial statements 2b–d. Asian Development Bank review mission reports	

	criteria) 2d. At least six PPP projects supported by PSF by March 2022 (2014 baseline: 0) 2e. Quarterly risk management reports submitted by PSF to the PPP Policy Board from July 2017 onward (2014 baseline: PPP policy and project decisions not linked with contingent liability management)	2d. PMU status reports	
3. PPP project selection and subsequent management capacity of line departments, finance, and PDDs strengthened	3a. Screening criteria adopted for all proposed development projects by July 2017 and utilized with respect to projects in all government departments by January 2018 3b. 50% of PPP proposals to the PPP Policy Board contain standardized selection criteria by June 2017, 100% by June 2019 (2014 baseline: no standardized selection criteria) 3c. Annual status reports issued by the departments implementing PPP projects for 50% of projects by December 2017 and 100% by December 2018 (2014 baseline: no status reports) 3d. All PPP node staff in the energy, planning and development, transport, works, and services departments trained on contract and project management by December 2017; and in education and health departments by June 2022 (2014 baseline: 0)	3a. Government of Sindh staff notifications, Planning Commission form 1 (investment project proposal), provincial budget reports, SFD contingent liability updates 3b. PPP Unit status reports 3c–d. PMU status reports 3c. Line departments' websites	Introducing multiple PPPs in the market concurrently may reduce the quality of projects, given the limited absorptive capacity of the Government of Sindh

Key Activities with Milestones
1. **Government of Sindh capacity to select and develop PPP projects strengthened** 1.1 Approve environmental guidelines for PPP projects for use by June 2017; hire an environmental safeguards specialist to the PPP unit by December 2016. 1.2 Prepare and adopt criteria to identify projects eligible for support from the PDF by January 2017. 1.3 Develop and implement a system to ensure that such identification criteria are used by January 2017. 1.4 Develop training modules and conduct training for staff of PPP unit and PPP nodes in SFD, PDD, and user departments with PPP portfolios by April 2017 up to June 2022. 1.5 Replenish the PDF by $3 million through government counterpart contributions by January 2017. 2. **PPP project-related fiscal risk effectively managed by PSF** 2.1 Revise PDF guidelines, PPP guidelines, VGF guidelines, Sindh Public Procurement Act 2009, and Sindh Public Procurement Rules 2010 to incorporate the project selection criteria and the PSF by April 2017. Revise PPP Act 2010 to incorporate the project selection criteria and the PSF by September 2017 2.2 Set up and fund the PSF by December 2016. 2.3 Recruit two risk management staff to SFD by December 2016. 2.4 Adopt an operational and organizational plan by PSF for risk management by March 2017. 2.5 Establish a monitoring and evaluation system by PSF to manage the direct and contingent liabilities of PPP projects by June 2017. 2.6 Develop and implement an outreach and training program by PSF for all PPP nodes regarding risk management, VGF management, and other relevant PSF operations by December 2017 up to June 2022. 2.7 Develop and present to the government a conceptual plan by PSF for an infrastructure guarantee fund and alternate financing sources by December 2018. 3. **PPP project selection and subsequent management capacity of line departments, finance, and PDDs strengthened** 3.1 Adopt screening criteria by the Government of Sindh to identify the optimal structuring models for all proposed development projects by July 2017. 3.2 Utilize screening criteria with respect to projects in all government departments by January 2018 and incorporate PPP project identification by PDD in the ADP development process by June 2018. 3.3 Deploy PPP advisors and specialists in three PPP nodes to support project selection, project development, and project and contract management by December 2016. 3.4 Develop training modules for staff in PPP nodes by June 2017 and utilize modules to train key PPP node staff by December 2017 up to June 2022.
Inputs Asian Development Bank: $100,000,000 (ordinary capital resources) Government of the United Kingdom: $4,750,530 (technical assistance grant) Government of the United Kingdom: $19,234,706 (grant) Government of Sindh: $65,000,000 (for PDF, PSF, staff, and logistical support)
Assumptions for Partner Financing Not applicable

ADP = annual development plan, PDD = planning and development department, PDF = project development facility, PMU = project management unit, PPP = public–private partnership, PSF = Public–Private Partnership Support Facility, SFD = Sindh Finance Department, VGF = viability gap fund.

[a] Government of Sindh, Bureau of Statistics, Finance Department (project implementing agency), and PPP unit status reports.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=46538-002-3

1. Loan Agreement
2. Project Agreement
3. Grant Agreement: Externally Financed
4. Sector Assessment (Summary): Public Sector Management
5. Project Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Attached Technical Assistance
9. Economic and Financial Analysis
10. Country Economic Indicators
11. Summary Poverty Reduction and Social Strategy
12. Financial Intermediary: Environmental and Social Management System Arrangement
13. Risk Assessment and Risk Management Plan