LPFM-16-038

REPORT ON SRI LANKA'S CURRENT PPP ENVIRONMENT AND RECOMMENDATIONS FOR FUTURE PPP STRATEGY

Leadership in Public Financial Management II

(LPFM II)

September 2016

This publication was produced by Nathan Associates Inc. for review by the United States Agency for International Development.

REPORT ON SRI LANKA'S CURRENT PPP ENVIRONMENT AND RECOMMENDATIONS FOR FUTURE PPP STRATEGY

Leadership in Public Financial Management II

(LPFM II)

Contract No. AID-OAA-I-12-00039

Task Order No. AID-OAA-TO-14-00040

COR: Theresa Stattel

Program Manager: Victoria Waite

STAIR COP: Thomas Burola

CONTENTS

ACRONYMS

CBA	Cost Benefit Analysis
CEB	Ceylon Electricity Board
GoSL	Government of Sri Lanka
LPFM II	Leadership in Public Financial Management II
MMWD	Ministry of Megapolis and Western Development
MOF	Ministry of Finance
PDF	Project Development Fund
PFM	Public Financial Management
PPA	Power Purchase Agreement
PPP	Public Private Partnerships
PSC	Public Sector Comparator
PSIDC	Private Sector Infrastructure Development Company
RFP	Request for Proposals
RFQ	Request for Qualifications
STAIR	Short Term Assistance to Improve Public Financial Management Reform
USAID	United States Agency for International Development
VfM	Value for Money
VGF	Viability Gap Fund

GLOSSARY OF TERMS

Definitions provided here are based on terminology used in this report. The source of each definition is included in italics.

Availability Payment: In PPPs largely paid by the public sector, government payments that depend on the asset or service being available at a contractually-defined quality. (Nathan Associates)

Concession: The right granted by the government for a private company to operate and profit from an otherwise public sector asset in exchange for a concession fee or other form of payment for use of those assets. (Nathan Associates)

Cost Benefit Analysis (CBA): The benefit-cost analysis concentrates on the direct economic benefits and costs of a project to government, investors, environment, users and nonusers in its specific area of influence. The estimated benefits have to be compared to the costs of implementing, operating, and maintaining the project to determine the economic value for the region. In this analysis, economic benefits and costs are expressed in monetary terms, and are adjusted for the time value of money, so that all flows of benefits and flows of project costs over time (which tend to occur at different points in time) are expressed on a common basis in terms of their net present value. (Nathan Associates Inc.)

Expression of Interest (EOI): The stage of the procurement process in which the procuring entity conducts an open process to short list a predetermined number of respondents to participate in the request for proposals stage. (New Zealand Treasury)

Feasibility Study: A detailed assessment of the parameters of a PPP project used to prepare a project for transaction development. (PPP Knowledge Lab)

Guarantee: An undertaking to fulfil the obligations of a third party in the event of a default. (PPP Knowledge Lab)

Institutional Framework: The series of institutions that together deliver the different functions and inputs from the Government needed to implement a PPP program. (PPP Knowledge Lab)

Offtake Purchase Agreement: The agreement whereby the offtake purchaser undertakes to purchase an amount of some or the entire project output (like a power purchase agreement for a power project and a water purchase agreement for a water treatment project). (PPP Knowledge Lab)

PPP Framework: The combination of legal, regulatory, institutional and financial framework that together facilitates the implementation of PPP, generally on a programmatic rather than ad hoc basis. (PPP Knowledge Lab)

PPP Legal Framework: The laws and regulations that create the enabling framework for a PPP program. (PPP Knowledge Lab)

PPP Policy: The Government policy on the implementation of the PPP program. (PPP Knowledge Lab)

PPP Unit: A Government unit or agency focused on PPP, often located in a powerful central agency (e.g. planning or finance) able to enforce the PPP policy and provide the support needed to implement PPP transactions. (PPP Knowledge Lab)

Pre-feasibility Study: An assessment of the basic parameters of a PPP project, used to decide whether to go forward with more in-depth and expensive studies (such as feasibility studies). (PPP Knowledge Lab)

Pre-qualification: The process whereby a limited number of qualified bidders are selected based on a pre-defined set of criteria, generally involving experience in the relevant field, site country experience, identity of local partners and international reputation. (PPP Knowledge Lab)

Procurement: The process by which the contracting agency obtains infrastructure services on terms and price considered to be the best available as they were reached through a competitive process. (PPP Knowledge Lab)

Project Development Fund: A fund for the cost of feasibility studies, transaction advisers and other costs of project development, to encourage contracting agencies to use high quality transaction advisers and best practice. (PPP Knowledge Lab)

Public Private Partnership (PPP): A government transfers the exclusive rights for developing and/or operating an infrastructure facility to a private operator or investor under certain conditions for a fixed period of time. (Nathan Associates)

Public Sector Comparator (PSC): An assessment of the likely cost of public sector project delivery, used as a comparator to assess whether a PPP proposal represents value for money. (PPP Knowledge Lab)

Request for Proposals (RFP): The stage of the procurement process in which short listed respondents develop proposals for delivering project outcomes. The procuring entity then evaluates the proposals from the competitive tender with the objective of selecting one respondent as the preferred bidder. (New Zealand Treasury)

Value for Money: VfM compares the value of a project developed by the government versus developed through a PPP by including the value of risk, cost of capital and other factors taken into consideration by the private sector but not the government. The adjusted government financial model is called the PSC. (Nathan Associates)

Viability Gap Fund (VGF): A special fund established to provide direct grants to an infrastructure project. VGF-based grants are generally provided to cover a percentage of the capital cost associated with an infrastructure project or the subsidization of some or all user tariffs/fees on an ongoing basis. (Nathan Associates)

EXECUTIVE SUMMARY

The Government of Sri Lanka (GoSL) has identified private sector participation and financing as the key to achieving its plans to new and improved infrastructure. With continuing economic growth and expansion, the role of government in the provision of public services and infrastructure has evolved, and governments have begun to look more and more to the private sector to participate in and provide these services in partnership with the public sector. The GoSL has determined that facilitation and encouragement of public-private partnerships (PPPs) is a way to enhance the provision of public services. Furthermore, the GoSL recognizes that better value can be achieved through a competitive tendering process rather than directly awarding projects to unsolicited or stand-alone development (negotiated transaction) bidders.

This report provides various recommendations for Sri Lanka's PPP development, separated into the following sections:

Section 1 discusses the current PPP environment in Sri Lanka, including the government objectives as explained to the Nathan team during the field visit in April 2016, the current legal and regulatory framework, the current institutions involved in the process, and details on past and current PPP projects.

Section 2 describes the paramount importance of a new PPP policy, what the policy should be composed of, and how the creation of the policy will act as a base from which further PPP legislation can develop.

Section 3 provides a roadmap of LPFM II's recommended action plan, which is composed of short, medium, and long term actions. In the short term, Nathan recommends that the GoSL create a solid contract in line with international best practices that can stand alone without any PPP legislation, while the PPP Policy and follow on legislation are being drafted and approved by the Cabinet or Ministers or passed through Parliament.

In the short-term, the GoSL should continue to follow the preparation and implementation process set forth in the 1998 PPP Guidelines II. In addition, the GoSL should reestablish both the Cabinet Appointed Negotiating Committee (CANC) and a temporary PPP Unit, such as the Board of Investment (BOI) under the Bureau of Infrastructure Investment (BII) or under another existing institution as described below. In the longer-term, these institutions will be formally established in the new PPP guidelines and/or legislation based on best PPP practices. In the short to medium-term, the BOI and active PPP line ministries should be provided the necessary resources to hire needed advisors.

In the medium-term, Nathan suggests that the GoSL create new PPP guidelines within the executive branch or amend the current 1998 guidelines taking into account the recommended GoSL PPP Policy. Implementing a new or amending the existing PPP guidelines will be a much faster process, while the new PPP Policy is being developed and approved.

Finally, the long-term action plan contains various recommendations, which should also be considered in the short and medium-term where possible, that encompass the legal, institutional and financial components of a national PPP framework. All aspects are essential to creating a robust PPP environment and each recommended action below is built off of the National PPP Policy. For this reason, Nathan recommends that the GoSL first develops and approves a clear and comprehensive PPP Policy. Once the Policy is in effect, the relevant government bodies can begin carrying out the additional recommended actions including: development of a national PPP Act, Regulations and Guidelines; creation of a National PPP Unit to replace the BOI and a PPP Committee to replace the CANC; and definition of sources for Project Development and Viability Gap Financing.

Lastly, Annex A includes details on the recommended capacity building program to improve the knowledge and understanding of PPP project preparation and implementation. A draft agenda for a one day executive level workshop, as well as a draft agenda for a four day comprehensive workshop are included.

1. SRI LANKA'S CURRENT PPP ENVIRONMENT

Since President Maithripala Sirisena was elected on January 8, 2015, Sri Lanka has been implementing various reforms to advance economic equality, transparency, and stability. During the past year and a half President Sirisena has accomplished various legislative changes as stipulated in his "100 Day Plan", including the passage of the 19th Amendment to the Constitution. The new government has also shown interest in redeveloping their Public Private Partnership (PPP) program and relevant PPP institutions. With this new push towards PPP, the Government of Sri Lanka (GoSL) requested that the Short Term Assistance to Improve Public Financial Management Reform (STAIR) project complete a review of the current status of PPPs in Sri Lanka. This section addresses the current PPP environment in terms of the government's objectives for pursuing PPP, the current legal and regulatory framework guiding PPP development, the current institutional bodies involved in the PPP process, and the current and recent PPP projects that have been implemented in the country.

GOVERNMENT OBJECTIVES FOR USING PPP

Governments have a wide range of motives for pursuing PPP and these objectives and desired outcomes play an important role in determining how the PPP program should be designed and implemented. For this reason, a clear definition of government objectives should be the first step in developing a country's PPP program.

Generally, the GoSL has recognized that the private sector can play a dynamic role in accelerating growth and in developing infrastructure projects, and therefore is committed to promoting PPP in the country. During the meetings held in Colombo over the three week in-field mission, objectives for pursuing PPP in Sri Lanka were discussed. A number of these objectives are also included in the 2007 (unpublished) Guidelines. Some of the identified objectives included:

- Gaining the ability and resources to undertake more projects at the same time as a result of the private sector's funding and executory capacity;
- Transfering certain risks, such as design, construction, operation, and (sometimes) demand risk, to the private sector, who is better at managing these risks;
- Acquiring the needed additional funding for infrastructure development, especially considering that the government's budgetary provision for infrastructure sectors cannot be enhanced as needed due to other priority requirements;
- Benefiting from the technical capacity and capacity building provided by the private sector;
- Improving the quality of services, including more efficient management and operation;

- Being able to consider potentially viable and desirable unsolicited infrastructure proposals which are now shelved for the project pipeline (e.g., renovation and operation of 100 km of rail from Colombo east);
- Using government funds to invest in more socially oriented projects, such as health and education, seeing as the private sector can alleviate budgetary constraints for the more traditional infrastructure projects (such as ports and toll roads); and
- Engaging with the private sector for projects using pay-for-availability schemes, in which the users are not directly charged (allowing for projects such as non-toll roads or for potable water).

Once the objectives are clearly defined, they should be incorporated into the PPP Policy. Furthermore, as Sri Lanka's PPP program becomes more developed, its objectives for using PPP will likely evolve.

LEGAL AND REGULATORY FRAMEWORK

In the short-term, and due to the lack of a viable PPP Policy, Act, and implementing regulations, PPP transactions can be initiated and implemented through contractual arrangements. In the long-term, the lack of a legal framework may discourage private investment in such projects, or discourage government from pursuing such arrangements. The enabling legal, regulatory, and institutional structure impacting PPP implementation must be in place in order to successfully develop and implement a PPP project and to promote confidence in investors that their interests and their rights are protected. Both the government and private sector can benefit significantly from public-private partnerships, but development of these projects must be done carefully, and both must work under a clear legal and regulatory framework to properly allocate the benefits, risks, and responsibilities associated with such projects.

Additionally, the lack of a PPP legal structure in Sri Lanka leaves all of the specifics of the PPP arrangement to be defined by the respective parties during the tendering process and contract signing phase. This can jeopardize the PPP effort or cause the GoSL to agree to less favorable conditions under a specific PPP project due to the additional risk perceived by the private sector and particularly foreign investors.

A dedicated PPP Act and implementing regulations will provide clarity and stability of the law and better functionality as far as implementation is concerned. Investors are attracted to the legal certainty provided by a dedicated law, and implementing regulations. Additionally, the proper legal and regulatory framework will also provide the required elements of an open and transparent process and requirements for a successful PPP arrangement.

INSTITUTIONAL FRAMEWORK

The GoSL has never had PPP Legislation. PPPs were and are currently being implemented pursuant to the 1998 Guidelines on Private Sector Infrastructure Projects (BOO/BOT/ BOOT

PROJECTS) Part II under the original procurement guidelines, and the Guidelines on Government Tender Procedure (revised in 1997). Although the original 1998 guidelines were replaced by the Government Procurement Guidelines of 2007, they remain unpublished, and have no force and effect. Various circulars have since been issued on the 1998 PPP Guidelines Part II, including the Guidelines used by line Ministries and/or Government Agencies when dealing with unsolicited/stand-alone development proposals. This circular (Supplement 23 issued in 2011), which has since been withdrawn, provided very broad conditions under which the PPP projects (Category II) could be awarded without a competitive bid. In order for projects to be implemented without a competitive bid, they had to be approved by the Cabinet Appointed Negotiating Committee (CANC) and Cabinet of Ministers and they had to meet the following broad conditions:

- Projects of strategic importance;
- Projects within the planned development programs;
- Projects expected to be based on superior knowledge and therefore, could not be pursued competitively;
- Projects that achieve substantial value of money and therefore savings to the Government, and
- Projects that already have acceptable/attractive funding.

Various PPP-related institutions were established within the 1998 PPP Guidelines Part II, though many of these institutions have become inactive, with the exception of the offices/departments within the specific PPP active line ministries that are responsible for PPP's (e.g., Ceylon Electricity Board and the Ministry of Megapolis and Western Development). These institutions include:

- **Bureau of Infrastructure Investment (BII)**, a permanent office under the Board of Investment (BOI) within the Ministry of Finance (MoF), which was established to promote, facilitate and co-ordinate PPP efforts for the Line Ministries. The BII was the only permanent institution with a permanent staff of technical and project management experts.
- **Cabinet Appointed Negotiation Committee (CANC)** which was created on a project-by-project basis by the Cabinet of Ministers and was responsible for reviewing the projects at various important stages (e.g., prequalification list, prior to issuing the RFP, etc.) and recommending action to the Cabinet. The CANC usually included the Secretary or Deputy Secretary to the Treasury, the relevant Line Ministry, and the Chairman of the BOI.
- **Project Committee (PC)** was created by the MoF on a project-by-project basis and was responsible for providing support to the given CANC on a specific project. The Project Committee usually consisted of the representatives of the relevant Line Ministry (ies) and state agencies (e.g., regulatory and environmental authorities), MoF, and Attorney General.
- **Negotiating Committee** which was also appointed by the MoF and handled matters pertaining to the PPP, including making recommendations on the winning bidder.

Under the guidelines, the contractual commitments, guarantees, and other contingent liabilities related to a PPP must be developed in consultation with the Treasury and Attorney General and then be approved by the Cabinet. On the other hand, unsolicited proposals under the guidelines require that the competitive bid process be followed with no advantage to the original bidder other than the opportunity to resubmit an improved proposal based on the RFP. These guidelines must be followed unless urgent and exceptional circumstances exist in which case the Cabinet can approve a deviation to negotiate directly and award the project to the bidder.

It should be noted that contrary to best practices, there is no current requirement that the GoSL undertake a feasibility study prior to issuing an RFP. In fact, the government mostly relies on the private sector bidders to ascertain whether the project is economically and financially viable. With respect to unsolicited proposals, this oversight allows the private sector to influence the terms and conditions of the contracts and the nature of the projects. From feasibility studies, the government can obtain the insight to set the main guidelines and parameters for the project in the RFP. Without these parameters, it is difficult to compare solicited proposals and determine the best proposal. Additionally, by relying on the private bidders' feasibility studies, the GoSL is required to closely scrutinize all feasibility studies during the selection process to ensure that they are realistic and fair. The costs of moving forward with unfeasible projects are very high for the government and the government will end up paying these costs sooner or later. In the long run, it is better that the government prepares their own feasibility studies in order to avoid delays, lack of credibility, and problematic PPP projects.

PAST AND CURRENT PPP PROJECT EXPERIENCE

Sri Lanka has a long history of implementing PPPs in their development of infrastructure. Between 1990 and 2014 Sri Lanka entered into 73 PPP projects with a total investment of over $6 billion[1]. However, these projects were limited to the following three sectors: electricity, telecommunications/ICT and ports. Although the aggregate number and value of these PPPs is impressive, it should be noted that all projects (with the exception of two port projects) are either in the electricity or telecommunications (including cellphones) sectors. This amount also represents roughly 90 percent of the total indicated investment. As in most developing countries, the development of PPPs in these two sectors were implemented under specific telecommunications and energy tendering laws outside of the PPP process. As described throughout this report, Sri Lanka lacks a strong enabling PPP environment and still requires additional capacity for undertaking PPPs in other critical sectors (roads, water, waste, social services, etc.).

The following table shows a breakdown of the number of projects and total investment in the three sectors over the 24 year period.

[1] The World Bank Private Participation in Infrastructure Database

Table 1: Total Investment in Electricity, Telecommunications and Ports (1990-2014)

Sector	Project Count	Total Investment (USD Million)
Electricity	64	1,438
Telecommunications/ICT	7	3,953
Ports	2	740

Source: The World Bank Private Participation in Infrastructure Database

Some of the largest projects by investment size during this time period include:

Table 2: Largest PPP Projects by Investment Size (1990-2014)

Project	Total Investment (USD Million)
Sri Lanka Telecom	2,418
Dialog Telecom Ltd	1,295
Colombo South Container Terminal	500
Norochcolai Coal Power Plant	450
Etisalat (former Celltel Lanka)	414
Suntel Pvt Ltd.	301
Mobitel Pvt. Ltd (Merged with Sri Lanka Telecom)	273
Colombo Port	240
Lanka Bell Pvt Ltd.	194
Hutch (former Lanka Cellular Services)	145

Source: The World Bank Private Participation in Infrastructure Database

The largest project, Sri Lanka Telecom (also known as Mobitel) reached financial close in 1997 and the primary equity investor was the Malaysian company, Usaha Tegas Sdn Bhd, which acquired 45 percent of the company with the balance ownership remaining with the GoSL. The contract was for 20 years.

The second largest project, also in the telecommunications sector, was Dialog Telekom Ltd which reached financial close in 1993. The main equity investor in the project was Axiata Group Berhad with 85 percent ownership. The term of the project was also for 20 years.

The third and eighth largest PPP projects that came to financial close were the 35-year Colombo South Container Terminal and the 30-year Colombo Port projects. As set forth below, the equity investors included multinational companies. The Colombo South Container Terminal was awarded based on "lowest cost of construction or operation". The contract was signed in 2012 and the primary equity investors were Aitken Spence & Company Ltd with 30 percent ownership and China Harbour Engineering Company Ltd with 55 percent ownership. The Colombo Port project reached financial closure in 1999, with the AP Moller – Maersk Group owning 33 percent and John Keels Holding Ltd. owning 43 percent of the project.

In the electricity sector, the largest power project was the 300 MW Norochcolai Coal Power Plant, which reached financial closure in 2010. This project is 100 percent owned by China National Heavy Machinery Corporation.

A list of the largest investors in Sri Lanka's PPP projects are presented below, along with the number of projects they have invested in and the total amount of investment:

Table 3: Involved Investors in Sri Lanka's Infrastructure (1990-2014)

Investor/Operator	Country of Origin	Sector(s) of Focus in Sri Lanka	Total Investment (USD Million)	Number of Projects
Axiata Group Berhad	Malaysia	Telecommunications	1,100	19
Usaha Tegas Sdn Bhd	Malaysia	Telecommunications	1,088	28
Aitken Spence & Company Ltd.	Sri Lanka	Electricity and Ports	591	4
China National Heavy Machinery Corporation	China	Electricity	450	1
Emirates Telecommunications Corporation	United Arab Emirates	Telecommunications	414	17
China Harbour Engineering Company Ltd	China	Ports	275	1
TeliaSonera	Sweden	Telecommunications	166	8
Distilleries Company of Sri Lanka Limited	Sri Lanka	Telecommunications	147	11
Hutchison Whampoa Ltd	Hong Kong, China	Telecommunications	145	14
Hayleys Group (Sri Lanka)	Sri Lanka	Electricity	132	5

Source: The World Bank Private Participation in Infrastructure Database

Current Pipeline of the Ministry of Megapolis and Western Development

The Ministry of Megapolis & Western Region Development has a robust infrastructure project pipeline. In the following table, examples are presented of these infrastructure projects in the pipeline that may be implemented as PPP's.

Table 4 – Ministry of Megapolis and Western Development Project Pipeline

Project	Cost SLR (Mil)	Cost USD (Mil)
Transport		
Railway Electrification, Modernization & Expansion	18,000	120
Colombo Rapid Transit System (RTS)	435,000	3,000

Project	Cost SLR (Mil)	Cost USD (Mil)
Construction of New Expressway	800,000	5,500
Bonded Highway for Logistics Corridor	150,000	1,000
Development of Multimodal Transport Hubs and Centers	32,000	220
Development of Off-Street Parking and Metering	6,000	42
Improve Traffic Flow, Stop Light & IT Based Traffic Management System	16,000	110
Supply of CNG & Electric Charging Facility (50 Centers)	3,500	25
Energy		
Sapugaskanda Oil Refinery Expansion & Modernization	282,000	1,945
600 MW Natural Gas Combined Cycle Power Plant, Kerawalatpitya	64,000	440
Water		
Variety of water projects, including treatment, reservoirs and supply	410,000	2,800
Solid Waste and Wastewater		
Solid Waste Management – Colombo and Suburban Area	30,000	210
Wastewater Collection, Treatment & Disposal Negombo Township	16,500	115
Wastewater Collection, Treatment & Disposal Kelaniya-Peliyagoda	13,000	90
Wastewater Collection, Treatment & Disposal Sri Jayawardenapura Kotte	40,000	280
Wastewater Collection, Treatment & Disposal Ja-Ela,/Ekala& Ratmalana	15,000	100
Wastewater Collection, Treatment & Disposal Gampaha Municipal Council	18,000	125
Wastewater Collection, Treatment & Disposal Horana Industrial Zone	15,000	100
Wastewater Collection, Treatment & Disposal Mirigama Industrial Zone	12,000	80
Ports and Airports		
Cruiser Lines & Yachts – Colombo Port	7,200	50
Construction of West Container Terminal 1 – Colombo Port	85,000	585
Extension/Expansion Breakwater & Development of West Container Terminal 2 – Colombo Port	113,000	780
North Port Development Project	324,000	2,230

Project	Cost SLR (Mil)	Cost USD (Mil)
Establishment of Cargo Village	1,000,000	6,890
Industrial, IT & Incubator Parks		
Industrial Township Development – Meerigama	36,000	250
Industrial Township Development – Horana	45,000	310
Eleven Industrial Parks	10,000	70
Business Incubators	1,000	7
Malabe Science City	44,000	300
Tourism and Spiritual Developments		
Tourism Development & Expansion – Negombo Township	35,000	240
Senior Recreation & Care Villages	6,000	40
Relocation of Government Offices		
Relocation of Government Offices from CBD to Government Park in Colombo Outskirts	8,000,000	55,000

Source: Ministry of Megapolis and Western Development, April 2016

2. PPP POLICY: BASIS FOR SRI LANKA'S PPP STRATEGY

Consideration of PPP as a contracting mechanism is a complex, time consuming, and resource intensive process that must be undertaken thoughtfully and carefully. While PPP can be an important way for the government to expand coverage and enhance the quality of public services with a lower impact on limited budget resources, it is not a panacea and is not appropriate in all circumstances. In many cases, PPP can be more costly than traditional procurement, despite being the favoured mechanism for project implementation for many governments due to limited resources. It is important to recognize that although PPP arrangements can bring many benefits, they can also have negative results or impacts if not undertaken properly.

As such, it is recommended that the GoSL drafts and approves a formal PPP Policy to help relevant government agencies and stakeholders to understand what PPPs are, when PPPs should be used over traditional procurement, what the process is to implement PPPs, and why PPPs can be useful to achieve national government objectives. The Policy should also outline the institutions and agencies that should be established and involved throughout the process.

Definition of PPP

There is no universally accepted definition of PPP, as it is not a "one-size-fits-all" approach and many countries adapt the PPP model to their specific needs. Therefore, it is of paramount importance that the concept of PPPs is explicitly defined in the PPP Policy. The authors' definition of PPP is as follows: *A government transfers the exclusive rights for developing and/or operating an infrastructure facility to a private operator or investor under certain conditions for a fixed period of time.* Although the private sector will deliver the service, the public sector retains its legal/public obligation to provide the public service/infrastructure. The government also maintains responsibility for establishing minimum quality standards, regulatory oversight, and for imposing economic regulation in cases where monopolistic services are provided.

Under a PPP arrangement, the public sector maintains a significant role in the project either through purchase of the services provided, provision of public assets to be managed and improved by the private sector, and/or through creation of the proper enabling environment for the PPP project to be successful. In any PPP arrangement, the government maintains its role as strategic planner, policy maker, and regulator.

Under a PPP, neither the government nor any government enterprise shall go beyond their obligation to provide basic infrastructure services. As such, the recommended PPP Policy should not apply to purely private sector-driven enterprises where no government asset or public service is required.

As part of a PPP, the private sector commonly provides design, construction, financing, operation, and maintenance services, as well as technical expertise and managerial skills, and is compensated according to performance. The public sector takes the lead role in identifying and implementing PPP projects[2], including conducting feasibility studies, mobilizing resources, risk sharing, monitoring, and regulation. Risks must be identified and allocated to the party best able to bear and manage them at the lowest cost.

Ideally, PPP projects are financed by the private sector, however in some cases the Government or third-party donors participate in the long-term financing structure, provide guarantees or other credit enhancements, or provide some form of capital contribution, when this offers value for money. Repayment sources for PPP projects can come entirely from service tariffs or user charges, entirely from Government budgets, or a combination of both.

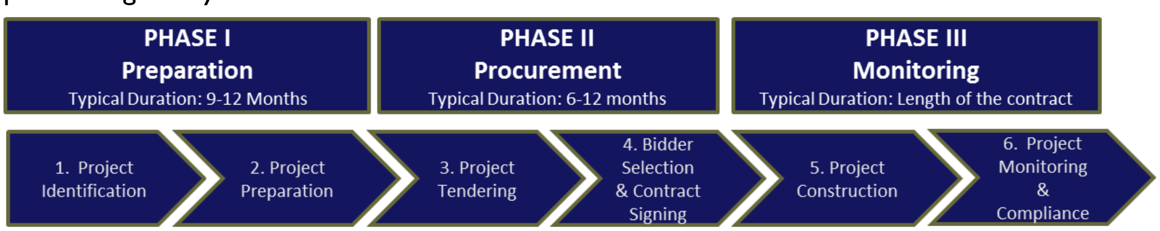
The typical sectors covered under PPP arrangements include transport (ports, airports, rail, and roads), telecom, energy, and water/wastewater and can also include social sectors such as health, housing, and education; however other sectors can also be considered. The recommended PPP policy should not limit the sectors under which PPP arrangements will be considered, as long as those projects are in line with the government's established objectives.

Appropriateness of PPP over Traditional Procurement

Both the government and private sector can benefit significantly from PPPs, but development of these projects must be done carefully, and both must work under clear rules to properly allocate the risks, benefits, and responsibilities associated with such projects. In determining the appropriateness of PPP, the new PPP Policy should outline the various preliminary analyses that should be undertaken. One such analysis is the Public Sector Comparator (PSC). As defined by the World Bank, a PSC is an assessment of the likely cost of public sector project delivery, used as a comparator to assess whether a PPP proposal represents value for money. In determining the value provided by the public vs. private sector, a PSC analysis considers the cost of service as well as the costs associated with risk.

Process to Implement PPP

The Policy should outline the three phases of the PPP Project Cycle: Preparation, Procurement, and Monitoring, as well as how the different agencies involved in the process interact at each point along the cycle.



[2] Although the private sector can also identify PPP opportunities.

The first phase involves the necessary preparation and analysis to ensure that the projects are well aligned with government objectives, that they are financially and technically viable, incorporate public consultation and support, and that they provide the best value for money.

For any potential PPP project, the government must undertake a full feasibility study, generally through a sector specialist consulting firm, prior to beginning the tendering process. The feasibility study will provide the contracting authority and regulator with an understanding of:

- If the project can achieve a better value for money than traditional government procurement;
- If the project is affordable to the government;
- What the proper risk value and allocation should be;
- What the rate/tariff setting should be to achieve full cost recovery;
- If the concession contract will result in the service provider realizing excessive profits to determine how much and what should be the concession and leasing fees (usually a significant part of the selection criteria), and;
- If the project will require viability gap financing or subsidization of the capital investment and/or fees/tariffs.

The second phase, project tendering and bid selection, must be transparent and managed well as the private sector will only participate in a bidding process if it believes that the chances of successfully being awarded the eventual contract are proportionate to the costs to be incurred in bidding and that the project has good chances of a successful implementation. In addition, having standard PPP contracts and clauses, a credible adjustment procedure, and an in-depth procurement options analysis all help strengthen investor confidence during the procurement stage.

The final stage of the PPP cycle involves project construction and contract monitoring. Properly monitoring contract compliance is critical to ensure that public infrastructure provided under a PPP agreement is provided according to the requirements set forth in the PPP contract and that the project continues to generate value for money throughout the life of the project. Any PPP project should have clearly defined public sector roles for project monitoring (including a schedule and indicators) and active stakeholder engagement throughout the implementation.

Next Steps for Sri Lanka

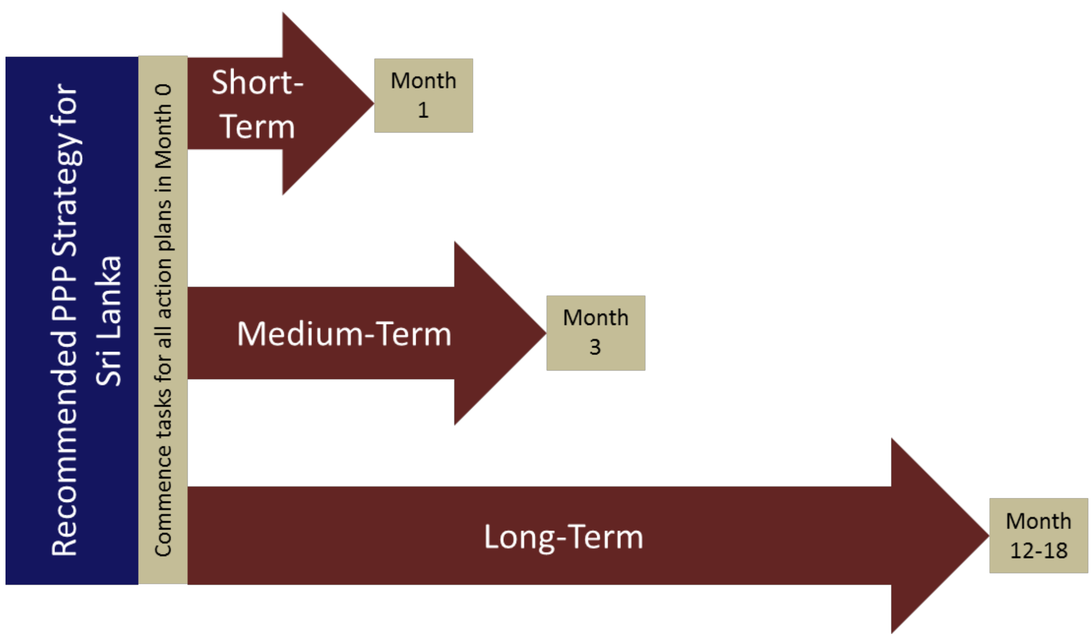
The new Policy should call for the creation of a National PPP Unit and PPP Committee, should dedicate resources for project development financing, and should serve as a basis for the preparation of additional legal documents, such as:

a. New PPP Act;
b. New PPP Regulations, and;
c. New PPP Guidelines (to replace the 1998 PPP Guidelines).

In the section that follows, the short, medium and long-term recommended action plans are outlined. It is important to emphasize the role that a new PPP Policy will play on the progress of these action plans. A clear policy will simplify the further development of the PPP legal and institutional framework, clearly define PPPs and the GoSL's objectives for using them, and will specify the roles that different institutions will play throughout the process. It is therefore essential that the GoSL place a high priority on developing their PPP Policy.

3. RECOMMENDED ACTION TO DEVELOP SRI LANKA'S PPP STRATEGY

As discussed in the previous section, the importance of a clear and well-defined PPP Policy is integral to the further development of Sri Lanka's PPP Strategy. Establishing a new proper PPP framework (Policy, Act, Regulations, and Guidelines) can be a lengthy task due to the approval that must be received from Parliament. In order to avoid stagnation while the long-term action plan is being addressed, it is recommended that the GoSL pursue both the short-term and medium-term action plans outlined below. Both the short and medium-term plans must be in line with the objectives of the long-term action plan. Consistency amongst the three action plans is critical for the development of Sri Lanka's PPP Strategy[3].



[3] It should be noted that this section does not apply to the CEB's tendering process for Power Purchase Agreements, which for the most part appears to follow best practices and is, in fact, currently in the process of adopting a process that awards contracts based simply on the price of electricity rather than the process of setting an acceptable price and evaluating the proposals and awarding the contracts based on the bidders' technical criteria.

SHORT-TERM ACTION PLAN

While steps are being taken to move ahead with both the medium-term and long-term action plans, GoSL should also consider making a few adjustments in the short-term so that any upcoming PPP projects are contracted in a way more in line with international best practices.

Draft Contracts for PPP Projects

Due to the lack of a clear and well-defined PPP legal framework, the PPP Contract in Sri Lanka currently serves as the legally-binding document for all PPP projects. As a short-term solution, the GoSL should draft a sample PPP Contract to be included in bidding documents and slightly adjusted as necessary per the terms of the project in question. By including the contract in the bidding documents, it allows for bidders to ask for further consultation on different aspects of the contract, thus making the process more transparent. Based on international best practices, the draft contract should include the following provisions:

- ***Technical Parameters:*** It is recommended that only the core minimum requirements of design, construction, and investment in the project be stated in the contract and flexibility be included to allow the concessionaire to innovate and add value. However, the desired technical aspects, capacity, level of services, and required output of the facility should be clearly specified in the technical bid including a clear calendar that establishes the desired milestones.
- ***Concession Period:*** The guiding principles on the concession period should depend on the time required to recoup the investment in the project.
- ***Concessionaire Rights and Obligations:*** The concessionaire rights and obligations have to be specified including the required inputs, outputs, and performance calendar.
- ***Government Rights and Obligations:*** The government's rights and obligations must be specified including the required inputs, outputs, and the performance calendar.
- ***Concession Fee:*** The Concession Fee payable by the concessionaire must be clearly stated in the concession contract. The concession fee formula should be defined on a case by case basis depending on the specific circumstances and government objectives of each project. However, the concession fee formula should meet the following objectives: i) promote efficiencies and high-level of services for users; ii) promote productive investments; iii) maximize profits for the PPP partners; and iv) be objective and easy to measure.
- ***Risk-Benefit Allocation:*** Risks and benefits should be allocated to the party best suited to manage them. Typically, the technical risks with respect to construction, operations, maintenance, and traffic development are allocated to the concessionaire. In most cases, commercial risks and benefits, such as development of commercial revenues, are allocated to the concessionaire as the party with the greatest capacity to maximize such revenues.
- ***Project Implementation****:* Project implementation must commence as per an agreed timeframe included in the concession contract. Adherence to the time schedule will

assist in bringing about significant reductions in costs and the timely provision of the infrastructure being constructed.

- ***User Fee:*** The mechanism to establish user fees to be charged should be agreed upon by both the government and the concessionaire as part of the bidding process and should be stated in the concession contract.
- ***Construction:*** The Contract must clearly state the process for handing over possession of the required land and other infrastructure, and obtaining environmental clearance, as well as any other conditions precedent to be satisfied by the government before financial close.
- ***Operations and Maintenance:*** The operations and maintenance of the project is of utmost importance and should be governed by strict standards to ensure a high level of service to users. Any violations should receive penalties, and such penalties should be stated in the Contract.
- ***Right for Substitution:*** The Contract should provide substitution rights so that the concession can be transferred to another company or individual in the event of failure of the concessionaire to operate the project successfully.
- ***Force Majeure:*** The Contract must contain provisions for dealing with force majeure events. This is necessary in order to provide protection to the concessionaire against political actions that may have serious adverse effects on the project.
- ***Termination:*** The Contract should have provisions for the termination of the contract or for a compulsory buy-out by the Contracting Authority to specify that the concessionaire may not use the public assets to recover its investments. A penalty to the concessionaire for termination of the contract should be included in the contract to discourage early termination. In the event of termination, the government is obligated to replace the concessionaire to ensure that the project continues to operate, services continue to be provided, and that existing debt continues to be repaid.
- ***Monitoring and Supervision:*** The Contract should have provisions that allow the government to intervene only in the event of concessionaire default or national interest. The Contract should also make provisions for an Independent Engineer (a qualified independent firm) for the monitoring and supervision of construction, operations, and maintenance of the project.
- ***Government Support and Guarantees:*** The Contract may have provisions for government or Contracting Authority support and guarantees to provide or facilitate some key elements necessary for the success of the concession project, for example the availability of land for project expansion, the right of way on privately held land, or even expropriation of land when necessary. Other cases may include protection of revenue shortfall resulting from political force-majeure or default by the Contracting Authority.
- ***Dispute Resolution:*** An effective dispute resolution mechanism is important and must be contained in the Contract. The Contract must also address issues relating to suspension of rights, change in law, insurance and defects liability, indemnity, redress of public grievances, and disclosure of project documents, among others.

The provisions included above provide a preliminary guideline for what should be included in the standardized draft contract developed by the GoSL. In developing the draft contract for Sri Lanka's PPP projects, the GoSL may consider hiring a technical and legal advisor to assist them in drafting a contract that adheres to international best practices.

MEDIUM-TERM ACTION PLAN

Various line ministries and contracting authorities in Sri Lanka currently follow certain aspects of the 1998 PPP Guidelines, including the Ministry of Megapolis and Western Regions, the Ceylon Electricity Board, and the Ministry of Finance, though the guidelines are not followed strictly. These guidelines should be amended to facilitate further private sector involvement in infrastructure development. Amendments to the current guidelines will be a much faster process than the legal process to develop and approve a new PPP Policy, and to enact a new PPP Act and corresponding regulations. Therefore, it is recommended that these amendments be realized concurrently while stronger legal frameworks are being developed.

Amend 1998 Part II PPP Guidelines

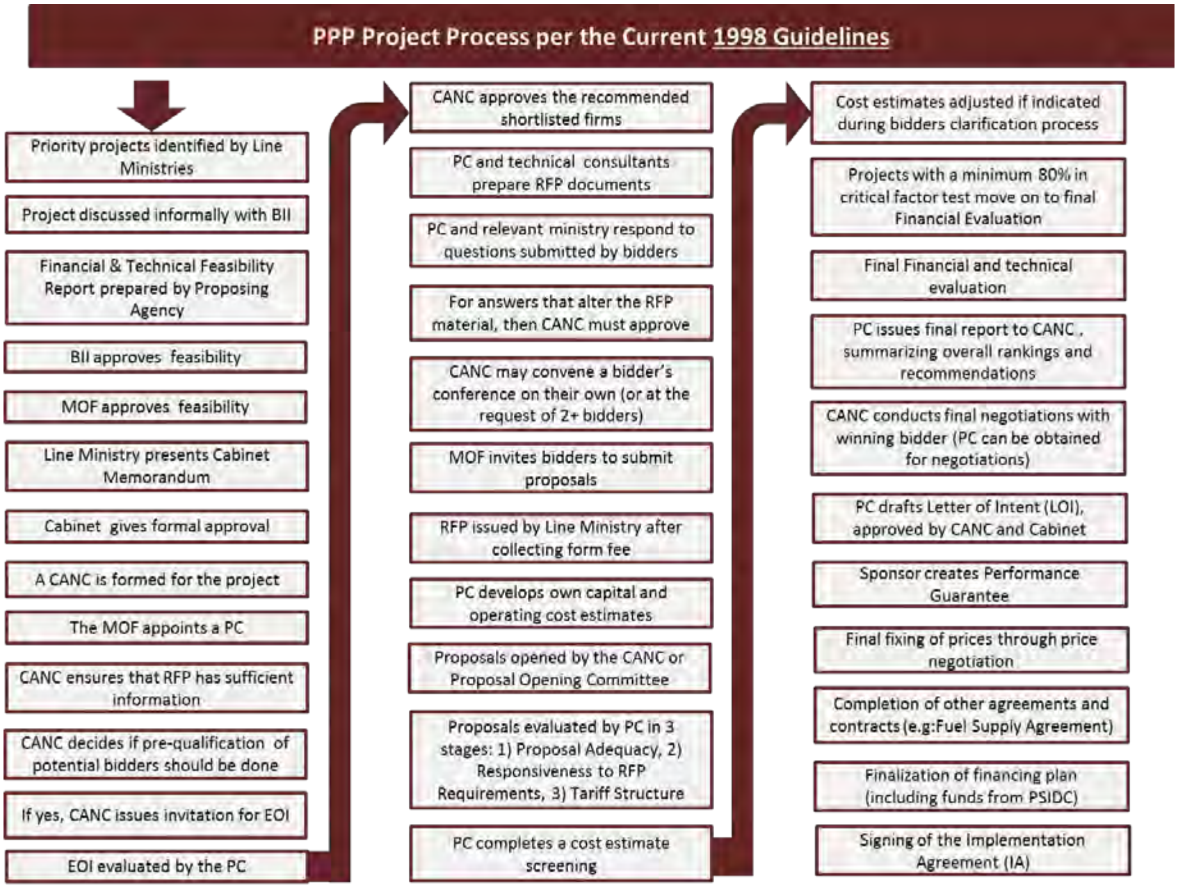
The 1998 PPP Guidelines should be amended or replaced to facilitate further private sector involvement in infrastructure development. A few comments on the current guidelines are included below:

- **226. Coordination:** This clause will need to be altered as it refers to the now defunct Bureau of Infrastructure Investment (BII) within the Board of Investment (BOI) as the PPP coordinating and regulating agencies. Therefore, a PPP Unit no longer exists. Once it is determined where the new PPP Unit will be placed, it should be incorporated in the new PPP guidelines or the amended 1998 PPP guidelines.
- **231: Formal Approval for the Project:** This clause states that the Ministry of Finance will provide preliminary clearance; however details on what the criteria determining if projects are approved is not clearly defined. This process should be stated in the guidelines, including a preliminary evaluation of affordability, value for money, economic viability, and legal, technical, environmental, and social feasibility. First, there needs to be confirmation that resources should be spent on a full feasibility study. After this approval of expenditure of resources and the confirmation of a full feasibility study, a second approval should take place following a PPP Committee review (or CANC as referenced in the 1998 PPP Guidelines) of the final PPP contracts and tendering documents. The process should not move forward to tendering without these two separate approvals. However, depending on the complexity, size and level of anticipated risk to be borne by the GoSL, another approval could be sought should the changes to the earlier reviewed PPP contract and tendering documents be significant (primarily an increase in the level of government risk).
- **235: Legal Obligations:** It should be clearly stated in the new guidelines that the department responsible for tracking and managing government risk within the MoF must approve any guarantees or contingent liabilities that will be incurred as a result of the project. The approval should be received well before negotiations commence. Again, should the level of risk or risk allocation change significantly to where the GoSL risk increases, a second approval will be required from the MoF.

- **240: Pre-Qualification of Proponents:** All projects should undergo a prequalification phase, with very limited exceptions.
- **244: Contents of RFP:** The contents of the initial draft RFP should include a draft contract, tender schedule, participating rules, minimum requirements, foreign investment regulations, assignment criteria, target outputs, government commitments and obligations, and technical and financial proposal formats. In addition, the Private Sector Infrastructure Development Company (PSIDC) no longer exists. Any amendments to these guidelines should define any new public or private funding mechanisms (such as a viability gap fund) and specify the process for applying these funds to PPP project development.
- **268: Indexation Risk:** The risk indexation included in these guidelines does not follow international best practices. Allocation of risk should be done during the initial analyses of the project, and then specified in the RFP and contracts. The allocation of risk should not be determined after proposals are received and it should not vary from proposal to proposal.
- **269: Evaluation of Price Escalations and 282: Price Negotiations Leading to a Final Fixing of Prices:** Price negotiations should not occur once the final RFP and contract have been issued. In accordance with international best standards, the risk assessment should be determined prior to receiving offers from bidders. Price, on the other hand, can be established in the final RFP and contract, or can be a selection criteria and therefore non-negotiable, unless as a result of a "Best and Final Offer". All qualified bidders should have the same opportunity to present an offer.
- **Chapter XXI:** This chapter relates directly to energy-related projects, outlining the process and requirements for Independent Power Producers and Power Purchase Agreements (PPA). It is not applicable to PPP projects in other sectors. As the policies, legislation and guidelines are developed, it is important that they all be "output" rather than "input" focused. In fact, the Ceylon Electricity Board is in the process of changing their tendering process in awarding PPAs solely based on price as long as the technical, environmental, etc. conditions are met.

The PPP project selection and approval process as stipulated in the 1998 Guidelines are presented in the figure below:

Figure 1: PPP Project Process per the Current 1998 Guidelines



Source: Nathan Associates based on the 1998 Guidelines

Hiring of Semi-Permanent PPP Advisors for Relevant Agencies

The learning curve for preparing, selecting, and implementing PPP projects can be relatively high, and the expertise required for implementation encompasses a variety of fields, with a deep level of understanding required for each field. Even governments with significant PPP experience depend on PPP advisors for the wide range of capacity required. The hiring of technical and transaction advisors is not only important for ensuring that the government has the appropriate technical capacity to properly structure and successfully implement PPP projects, but also for providing continuous capacity building to the government throughout the project structuring and implementation process.

Typically, the various types of advisors that can be hired to contribute to the successful implementation of a PPP project include:

- Economic advisors
- Financial advisors
- Legal advisors

- Project managers
- Technical advisors
- Transaction advisors

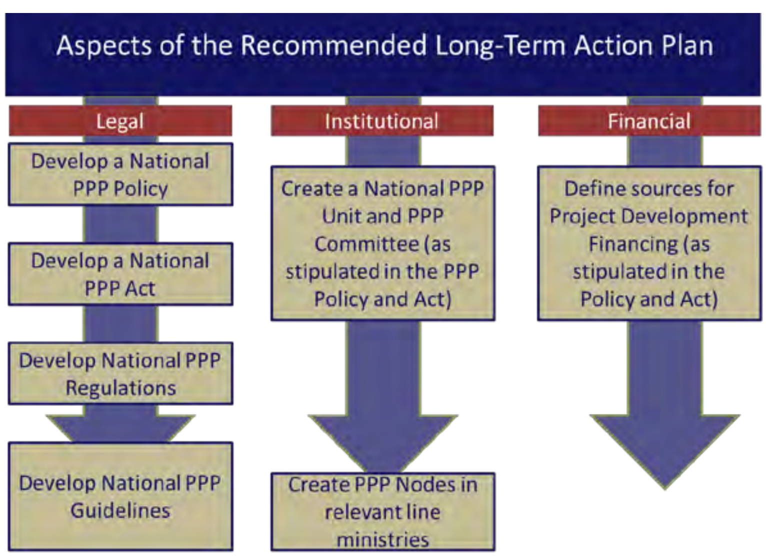
As a means to gain support and capacity, the GoSL should consider not only hiring PPP Advisors for help structuring and implementing a specific PPP contract, but also hiring a PPP advisor for the medium term to support a relevant line ministry (such as the Ministry of Megapolis, who showed interest) through the PPP cycle for a few pilot projects (including: Project Preparation, Project Tendering, and Project Monitoring). LPFM II agrees that this is a beneficial strategy because this advisor can add significant value to the process by:

- Providing his/her experience from multiple, similar transactions on a regular basis;
- Providing specialized technical strength to the Government's team;
- Providing legitimacy to the PPP process and placing an external stamp of endorsement on the transparency of the procurement process, thus increasing investor and public confidence;
- Broadening the pool of potential bidders through industry connections; and
- Providing an opportunity for training and knowledge transfer to the line ministry.

The PPP Advisor that is chosen should support the entire PPP process, including the identification and selection of PPP projects, pre-feasibility and feasibility assessments, the hiring of PPP consultants, transaction advisors, and independent engineers (if applicable).

LONG-TERM ACTION PLAN

The long-term action plan contains various recommendations encompassing the legal, institutional, and financial components of a national PPP framework. All aspects are essential to creating a robust PPP environment and each recommended action below is built off of the National PPP Policy. For this reason, LPFM II recommends that the GoSL first develops and approve a clear and comprehensive PPP Policy. Once the Policy is in effect, the relevant government bodies can begin carrying out the additional recommended actions included below.



National PPP Policy

Through a National PPP Policy, the Government of Sri Lanka can create a better understanding of the potential benefits of PPPs and provide guidance to both the government and private sector for future PPP implementation. The policy should provide a foundation for PPPs that supports competitive and efficient delivery of services and creates a more conducive environment for PPP projects.

Additionally, the PPP Policy's objectives should be to encourage private sector investment in public infrastructure and related services where value for money for government can be clearly demonstrated. It should also encourage innovation in the provision of infrastructure and related service delivery. Also of fundamental importance is ensuring the rigorous governance over the selection of projects for PPPs and the competition for and awarding of contracts. Another one of Sri Lanka's goals should be the promotion of a consistent, streamlined, and transparent approach to procuring PPPs across Sri Lanka. Likewise, the policy should state that the PPP process be sufficiently flexible to respond to strategic priorities, project specific requirements, and market conditions.

An effective PPP Policy should clearly state the scope of the policy, define what a PPP is, describe the process by which PPPs will be implemented, reviewed and approved, and should describe the roles of key stakeholders and how their interests and concerns about PPPs will be protected. A good PPP Policy should also provide a clear basis for the drafting of a dedicated PPP Law.

National PPP Act

A PPP Act should be used as a means to ensure that Sri Lanka has the ability to structure and manage PPPs properly, the process is open and transparent, and it also protects the interests of the private sector. The PPP Act will also help raise the profile of such transactions and demonstrate Sri Lanka's political commitment to the PPP program.

The PPP Act should establish guiding principles, processes, and institutional responsibilities for the Sri Lankan PPP program (such as for procurement, and dealing with disputes), along with the public financial management rules for PPPs. The PPP Act should set out principles that will be supported by more detailed regulations, with the intention of avoiding rigidity and enabling the PPP program to adapt over time.

The new PPP legal framework should also include provisions for establishment of the national PPP Unit. The establishment of clear processes and procedures is critical to the success of PPPs, so that the roles and responsibilities of each PPP coordinating body are clear both within and outside government.

The PPP Act should include the following elements: preliminary provisions such as the scope of the PPP Act and definitions, institutional framework and responsibilities, government financial support for PPPs, identification of potential projects and procedures for the award of concessions and PPP agreements, project tendering and private partner selection, unsolicited proposals, the PPP agreement, duration, extension and termination of the agreement, and dispute resolution, among other items.

During the field visit, it was mentioned that it may be more expeditious to incorporate what would be the PPP Act within the Public Financial Management Act which is currently being developed and expected to be submitted to the Parliament later this year. However, it is recommended that the GoSL create the separate PPP Act, seeing as PPPs should not be characterized as a subset of procurement but rather as its own form of financing and implementing infrastructure.

National PPP Regulations

The PPP Regulations are the standards and rules that govern how the PPP Act will be enforced, and are necessary to implement the authority of the Act. Even though the PPP Regulations would have the same force and effect as the Act, the regulations would still be ancillary or subordinate to the Act. As such, it is critical that the PPP Act contain all the required legal elements of PPPs in order to ensure that the regulations implement, interpret, or make specific the PPP Act's mandates.

The PPP Regulations should include the following elements: definitions, institutional framework and responsibilities, specific rules relating to the different phases of PPPs (i.e., identification and preparation of PPP projects, project tendering and private partner selection, etc.), procedures for requesting proposals, unsolicited proposals, post award project and contract management, and audit of the PPP process, among other items.

National PPP Guidelines

As part of the government's strategy to support and promote development of infrastructure through PPP, and following the development of the Sri Lanka National PPP Policy, Act, and implementing regulations, amendments to the 1998 PPP Guidelines should be developed to provide the proper guidance to public and private sector stakeholders on PPP project implementation in Sri Lanka. The Guidelines must be consistent with, and should be read and applied in conjunction with the Sri Lanka National PPP Policy, Act, and implementing regulations. However, it is important to note that in the case of any discrepancy between the legislative instruments (Policy, Act, and regulations) and the Guidelines, the legislative instruments shall prevail.

The Guidelines are meant to serve as a reference for those involved in identification, development, and implementation of PPP projects in Sri Lanka, in line with the legislation on the matter. The Guidelines should provide checklists to ensure that users of the guidelines possess a robust set of tools to allow for effective PPP program development.

The Guidelines should apply to projects implemented in partnership between the public and private sectors in Sri Lanka at both the national and local government levels. The Guidelines should also provide details on the procedures involved throughout the PPP project cycle from initial project inception through to financial close including definitions of what constitutes a PPP and the various models for PPP arrangements that can be considered, the analysis and assessment that goes into determining the appropriate structure for PPP, and the institutional and legal framework for PPP implementation in Sri Lanka.

The Guidelines should discuss the key aspects that should be examined when considering PPP as a model for project implementation, including the role of the public and private sectors, key considerations including value for money, risk management, and financial cost. Additionally, the Guidelines should outline the PPP project cycle including an introduction to the three main phases in the PPP process, as well as the approval process and institutions involved in PPP project implementation. Furthermore, the Guidelines should provide an overview of the various PPP structures available for consideration and the suitability of each PPP option, taking into consideration the specific aspects of a project. Specific detail should also be given on the processes and procedures involved in each of the three main phases of the PPP process:

- Project Identification and Assessment,
- Project Tendering and Selection, and
- Project Operations and Monitoring.

Guidance on each of these three phases could also include a checklist of tasks and responsibilities involved. Lastly, the Guidelines should include details on Sri Lanka's capacity building program to improve the knowledge and understanding of PPP project preparation and implementation.

National PPP Unit and Personnel Profiles

Given the high degree of intra-governmental coordination required for successful PPP project implementation, PPP units are often established as centralized units supporting PPP policies and coordinating the different Government stakeholder organizations involved in the transaction. This ensures that a PPP project is both supported and thoroughly assessed from inception through contract signing. The PPP Unit recommended for GoSL will replace the now defunct Bureau of Infrastructure Investment (BII) within the Board of Investment (BOI). There are several potential locations where the new PPP Unit could reside, including:

- The Board of Investment (which was the home of the previous PPP Unit through 2005);
- Ministry of Finance/Treasury (as an independent department); or
- Directly under the Prime Minister.

In determining which location will prove to be the best option, there are several keys to success that should be considered for any PPP unit to be able to properly manage the PPP process, including the following:

- The PPP Unit must have a **high level of political support** to ensure clear leadership and adequate resources are dedicated to making the project a success;
- The PPP Unit must have adequate powers and an **appropriate level of authority** to match the role it is expected to carry out and the goals it is expected to achieve; and
- The PPP Unit must have the **resources necessary to hire skilled staff**, undertake training, and/or hire short and long-term technical and PPP transaction advisors to provide the needed and multidisciplinary support for specific projects (if applicable).

The PPP Unit should support the PPP Committee/CANC and make recommendations on the functional areas the committee is responsible for, including: value for money analysis, risk analysis, and feasibility analyses. In addition, the PPP Unit can act as a technical advisor and provide capacity building for relevant line ministries, other potential contracting authorities and government officials. PPP Units should be the knowledge center for PPP transactions, providing model contracts and tendering documents as well as other manuals and support material. Furthermore, the PPP Unit should actively market and promote PPPs to both the government and the private sector, as well as assist with project identification.

To ensure that the PPP Unit is effective and able to manage well-structured and successful PPP projects, the PPP Unit must be staffed with personnel with relevant experience. At the onset of the PPP Unit, some of the following key roles should be filled by leading experts in the field:

- ***Director of the Unit:*** Responsible for technical and strategic leadership and for interacting with relevant government bodies, potential investors, and the general market.
- ***Support Unit Manager:*** Responsible for managing back-office functions (administration, archiving, accounting, and auditing) and supporting the Director and other managers on administrative and logistical issues.
- ***Project Planning and Studies Manager:*** Responsible for working with the Director to identify potential PPP projects, to assess projects to determine whether additional resources should be committed to the project, and to present the identified project.
- ***Structuring and Transaction Oversight Manager:*** Responsible for working with the Project Manager and Director to manage the preparation of feasibility studies, tendering documents, and contracts. Also responsible for managing the entire tendering process through awarding and implementation.
- ***Monitoring and Compliance Manager:*** Responsible for working with and informing the Project Managers and the Director on managing monitoring for compliance and, if necessary, enforcement of contracts.
- ***Project Managers:*** Responsible for managing one or more PPP projects from when a project has been identified through the end of the contract. Responsibilities will include working with the Director in overseeing and managing the project related studies, tenders, evaluations, selections, negotiations and implementations of specific projects, and monitoring and managing the related contracts to ensure that the processes are implemented efficiently and in a timely manner, including after implementation through to termination/expiry. The number of Project Managers will need to increase as the pipeline and number of PPP transactions increases.
- ***Technical Specialists:*** Responsible for providing advice on issues related to determining the technical/engineering viability of a project.
- ***Legal Specialists:*** Responsible for advising on all legal issues and for preparing drafts of all legal and contractual issues/documents linked with specific PPP projects. Legal focus will be on procurement, contracts, regulation, and general business law.

- ***Financial Analysis Specialists:*** Responsible for providing advice on all financially related issues and preparing pre- and full-feasibility studies to determine the financial feasibility of a project, the value for money, and the affordability of the project to the GoSL and/or the users.

The above positions are preliminary recommendations. The actual PPP Unit's staffing and implementation plan should be influenced by the PPP objectives outlined in the proposed PPP Policy.

National PPP Committee/Permanent CANC

The PPP Committee is a standing committee of senior officials from relevant line agencies with the powers of final approval at different stages of the PPP project cycle. Typically, a senior official from the Ministry of Finance or the Secretary to the Treasury chairs the PPP Committee and oversees all budgeting and financing matters related to PPP projects under consideration.

Additional ministries and departments involved in the PPP process, which therefore should have representatives on the National PPP Committee, include: the Attorney General's Office, the National Procurement Commission, the Ministry of Megapolis and Western Development, the Ministry of Transportation, the Ministry of Education and Highways, and other relevant state agencies or other agencies, ministries, and departments as appropriate.

The PPP legal framework should give the PPP Committee (or a permanent Cabinet Appointed Negotiating Committee (CANC)) the authority to approve or reject any PPP projects under consideration. As such, the Committee has the overall responsibility to determine that the project achieves value for money, that it is affordable for the government and service users, and that all risks are properly allocated and acceptable to the MoF. The PPP Committee should review project feasibility studies and recommend projects for approval or denial. Projects recommended for approval should then be sent to the Minister of Finance for signature and official approval before the tendering process begins. The PPP Committee should also review and approve bidding documents and review contracts prior to approval and signature by the Ministry of Finance. In addition, the PPP Committee/CANC should review project compliance with PPP acts, regulations, guidelines, and other sector-specific acts in regards to proper identification, selection, tendering, awarding, and implementing of PPP projects.

As should be stipulated in the PPP Policy, the recommended PPP Unit will report to the PPP Committee.

PPP Nodes

Once a clear and formal PPP legal and institutional framework at the national level is established, including the drafting of a PPP Policy, Law and Implementing Regulations, and the establishment of a centralized PPP Unit, the GoSL may also be consider creating PPP nodal agencies (or "nodes") at the line-ministry or contracting authority level which would play an integral role in identifying and developing sector-specific PPP projects.

PPP "Nodes" are established within specific line ministries or authorities (e.g., port or airport authorities) charged with development and management of PPP projects within their specific sector. Often these PPP Nodes work alongside a centralized PPP Unit that coordinates all PPP projects at a national level, and then delegates and/or provides support to PPP Nodes within specific line ministries.

It is recommended that once the national PPP Unit is in place, it may be beneficial to create a PPP Node within an active line ministry, such as the Ministry of Megapolis and Western Development. The Ministry of Megapolis, even though it has only recently been established, has already made significant steps towards developing PPP projects in Sri Lanka. The Ministry has an infrastructure development pipeline of over 100 projects. For this reason, it could be beneficial to place a PPP coordinating body within the ministry to act as a PPP advocate, project advisor, and to identify additional projects for consideration.

Sources of Project Development Financing

Governments may provide a number of different types of financial support to a PPP project, including guarantees, indemnities, capital contributions, land, tax incentives, guaranteed traffic, equity, debt, and operating grants. This financial support/leverage can be financially more efficient, allocating to Government certain risks and tasks that might be difficult or expensive to allocate to the private sector. The nature and size of the Government financial support are determined based on the needs of each specific project. After the initial financing resources, the PPP project should be financed by the private sector, but in some cases the Government or third party donors may participate in the long-term financing structure.

It is recommended that the GoSL provide the necessary initial financial resources to ensure a properly-structured project can attract the high-quality private sector investors/operators. The PPP Policy should incorporate clauses allowing for project development financing, such as project development funds (PDF). These funds can be used to finance project development costs including pre-feasibility and feasibility studies, hiring technical and transaction advisors, and other aspects. It is intended that PDF funds used for such activities will be recovered at financial close, paid by the winning bidder, in order to ensure the sustainability of the PDF for future projects.

Another form of project development financing to be incorporated into the PPP policy is viability gap funding (VGF). These are funds that are required to make a project, that would otherwise not be financially viable, become financially feasible and therefore of interest to private sector investors. Generally, the more economically attractive a project, the more the government is willing to invest to make the project financially viable. GoSL should consider including viability gap facilities, such as those currently in place in India primarily in the road sector.

From meetings with the Department of Finance, LPFM II understands that there is about LKR 200 billion (around US $1.3 billion) per year that can be used to finance PPP project development (project feasibility studies and transaction advising) and co-investing in infrastructure to make potential PPP projects financially or commercially viable. This budget should be leveraged accordingly through the use of PDF and VGF.

ANNEX A: DRAFT AGENDAS FOR POTENTIAL PPP CAPACITY BUILDING WORKSHOPS

Executive-Level One Day Workshop Program: Strategies & Techniques for Managing Effective Public-Private Partnership (PPP) Projects

Colombo, Sri Lanka August 2016

Time	Session Title	Key Components of Session:	Learning Outcome Statements (LOS)
	1.1: Welcome & Introductions	• Introduction and Workshop Overview • Participant Introductions	• Understand the overall goals of the training workshop • Know fellow participants and their individual objectives
	1.2: PPP Definition, Structuring Options Institutional Requirements for PPP Frameworks	• Definition of "Public-Private Partnership" & Key goals of PPPs • Forms of PPP Contracts: Service or Management Contracts, Leases, BOTs, BOOs, Concessions • The International PPP Investment Record & Key Issues Facing PPPs in the Future • Policies for the PPP Project-life Cycle • The role of PPP project selection and identification in PPP Project Cycle • Role of Project Development Fund (PDF) • The role of Viability Gap Funding (VGF) in PPP projects • Interactive Analysis and Discussion of Sri Lanka's PPP policy, legal, institutional and procedural framework for PPPs	• Develop a common definition and rationale for "PPP" • Distinguish between different forms of PPP contracts • Illustrate PPP development principles through real examples of PPPs • Understand the key requirements of PPP framework • Able to assess the general strengths, weaknesses, opportunities & threats to Sri Lanka's PPP framework
	1.3: PPP Project Identification & Selection Techniques	• The role of PPP project identification and selection within the PPP project management cycle • PPP Project identification and selection criteria and options for infrastructure projects • Case examples of PPP project identification and selection techniques and models	• Use basic PPP project identification & selection tools • Understand the issues and requirements for selecting appropriate candidate project
	1.4: Project Development & Viability Gap Funds & Structuring Financing for PPP Investments	• Defining project financing for infrastructure, and explain how it differs from corporate financing (e.g., revenue based loans) • Pros & Cons of project-backed financing for PPPs • The role of Project Development Fund (PDF) • Managing PDF analyses and decision-making (revolving vs. grant fund) • The role of Viability Gap Funding (VGF) for project financings • Managing VGF analyses and decision-making	• Understand the overall requirements of PPP financing options • Understand the role of Viability Gap Funding (VGF) in making PPP investments "bankable" • Understand key challenges to financing PPP, and the key role that Governments play in determining PPP bankability

		• Understanding the key constraints to project financing & strategies to address them • Institutional requirements for project financing • Case examples of PPP projects financed in South East Asia	
	1.5: Case Study of India's PPP Framework	• India's PPP Framework Objectives, Rationale, & Framework • India's PPP Policies, Laws, Regulations, Institutions & Procedures • Understanding India's Viability Gap Fund for PPP investments • Review of performance record of PPP transactions in India • Interactive Analysis and Discussion of Lessons Learned from India's PPP policy, legal, institutional and procedural framework for Sri Lanka	• Understand how India established its PPP goals, rationale, and policy framework • Understand how India's PPP framework determined the investment results of its PPP program • Be able to compare Sri Lankan's PPP framework with other countries, including India.
	3.5: Workshop Summary, Conclusion & Evaluation	• Discussion of the key lesson learned from workshop and recommendations for PPP framework and PPP project initiatives in Sri Lanka • Completion of Workshop Evaluations by participants • Workshop conclusion	• Develop practical recommendation for improving PPP framework in Sri Lanka • Develop practical recommendations for improving PPP project implementation in Sri Lanka • Complete the workshop evaluations

PPP Training Program – Introduction to Public PPP Training Program – Introduction to Public-Private Partnerships (PPPs) & Managing the PPP Project Cycle

Colombo, Sri Lanka August 2016

DAY #1:			
Time	**Session Title**	**Key Components of Session:**	**Learning Outcome Statements (LOS)**
	1.1: Welcome & Introductions	• Introduction and Workshop Program Overview • Participant Introductions	• Understand the overall goals of the workshop • Meet fellow participants and understand their individual PPP objectives
	1.2: PPP Definition, Rationale, Key Features & Structuring Models for PPPs	• Definition of "Public-Private Partnership" • Background/History of PPPs and the Key Issues Facing PPPs in the Future • How PPPs differ from traditional public procurements • The role of PPPs within overall infrastructure sector reform requirements • Reasons for PPPs: Better Value for Money (VfM), Contracted outputs & performance standards, increased consumer welfare benefits, Additional Capital Investment & Financing, Technology Transfer, Risk/Reward allocation, etc… • Models & examples of PPP contracts (Service Contracts, Management Contracts, Leases, BOTs, BOOs, Concessions, & Hybrids) • Case examples of PPP projects from Asia, Africa & island developing economies: Sri Lanka, Mauritius, Zanzibar, South Africa, India, etc.	• Develop a common definition and rationale for "PPP" for the Sri Lanka • Understand how PPPs differ from traditional public procurements • Distinguish between different forms of PPP contracts • Illustrate PPP development principles through real case examples of PPPs
	1.3: PPP Policy, Legal & Institutional Frameworks, and Key Pre-Requisites for PPPs	• Definition of PPP policy, legal, institutional, and regulatory frameworks and their purpose. • Overview of key phases of the PPP Project Management Cycle: Identification & Selection, Feasibility Analysis, Tendering & Contract Management • Public PPP Policy Objectives, Rationale, & Key Components • PPP Legal Framework components & requirements • PPP institutional framework requirements & design options • Review of PPP frameworks in Africa and Island Economies: Mauritius, Zanzibar, South Africa, India, etc. • Interactive Analysis and Discussion of Lessons Learned from PPP policy, legal, institutional and procedural framework for the Sri Lanka	• Understand the overall purpose and goals PPP Frameworks • Understand the structure and key requirements of the PPP policy statements, PPP Laws & PPP Regulations • Understand PPP Institutional arrangements required to effectively manage PPPs • Assess the strengths, weaknesses, opportunities & threats (SWOT) to PPP framework development in the Sri Lanka
	1.4: Project Preparation (Identification,	• PPP Project identification and selection criteria and options for PPPs • Key contents of PPP Project Concept Papers & Pre-Feasibility Studies o PPP Project Identification & Selection Case Studies	• Able to use basic PPP project identification & selection tools to candidate PPP projects • Able to use basic tools and model outline to

	Feasibility Studies, PDF, VGF, Concept Notes)	o Preparing and managing the PPP Pre-Feasibility Case Study • The role of Project Development Fund (PDF) o Managing PDF analyses and decision-making (revolving vs. grant fund) • The role of Viability Gap Funding (VGF) for project financings o Managing VGF analyses and decision-making • Discussion of lessons learned from case study for PPP selection and pre-feasibility.	complete a PPP Pre-Feasibility Study • Understand the practical challenges, issues and constraints to effective PPP project selection & Pre-Feasibility Studies • Able to identify practical options for improving PPP project selection and pre-feasibility studies
DAY #2:			
Time	**Session Title**	**Key Components of Session:**	**Learning Outcome Statements (LOS)**
	2.1: Review of Day #1	• Review key outcomes of Day #1	• Be able to apply Day #1's learning outcomes to understanding of PPPs
	2.2: Planning and Structuring PPPs & PPP Risk Management	• Preparing the PPP Feasibility Study work plan and schedule o Retaining qualified PPP advisors for the PPP Feasibility Study o Conducting PPP Demand Analysis o Conducting PPP Technical Options Analysis o Conducting PPP Financial Analysis & Estimating Costs/Tariffs o PPP legal and institutional feasibility analysis o PPP environmental and social impact analyses • PPP Risk Identification & Analysis Matrix o Preparing Risk-Adjusted Public Sector Cost estimates and Value for Money analysis o Preparing PPP contract structure & proposed risk-allocation • Review of PPP Feasibility Study by PPP Unit and PPP Committee • Case Examples of PPP Feasibility Analyses	• Able to prepare and to manage a PPP Feasibility Study work plan & schedule • Able to oversee PPP advisors in completing a PPP Feasibility Study and Draft Bid Documents • Able to use basic PPP project feasibility analysis management checklist tools • Understand the practical challenges, issues and constraints to managing and completing effective PPP Feasibility Studies • Able to identify practical options for improving PPP feasibility study management
	2.3: Group Exercise: PPP Planning and Structuring	• Break-out groups continue to analyze case studies and make specific recommendations regarding project planning and structuring • Plenary session: Group share responses & discussion of lessons learned from the Exercise	• Understand lessons learned from the exercise on effective PPP planning and structuring • Understand how to apply lessons learned from exercise to PPP planning and structuring
	2.4: Implementing PPP Tenders	• Role of PPP Tendering & Procurement in the PPP Project Cycle • How PPP Tendering differs from traditional public procurement • PPP Procurement Options: One & Two Envelopes, Best & Final Offer (BAFO) Techniques • Drafting, distributing, and revising PPP procurement documents: RfEoIs, Info Memos, RfQs, RfPs, and PPP Contracts • Evaluation PPP qualifications and bid and award decisions • Completing PPP contract negotiations and initialing PPP contracts	• Understand how PPP tendering differs from traditional public procurement • Able to manage a PPP tendering work plans & schedules • Able to oversee PPP advisors in completing a completing PPP tendering • Able to use basic PPP procurement management checklist tools

		• Case examples of PPP tendering & procurement	
	2.5: Group Exercise: PPP Tendering & Procurement Management	• Plenary introduction to PPP tendering exercise background information • Break-out groups continue to analyze case and make specific recommendations • Plenary session: Group share responses & discussion of lessons learned from the Exercise	• Understand lessons learned from the exercise on effective PPP tendering & procurement management
DAY #3:			
Time	**Session Title**	**Key Components of Session:**	**Learning Outcome Statements (LOS)**
	3.1: Review of Day #2	• Review key outcomes of Day #2	• Be able to apply Day #2's learning outcomes to understanding of PPPs
	3.2: Project Finance Structures & Compensation Mechanisms for PPPs	• Understanding key economic & investment characteristics of infrastructure: capital-intensive, long-term financing required, high-fixed costs, demand characteristics, etc. • Understanding financing options for infrastructure investments: Sovereign Finance vs. Corporate Finance vs. Limited-Recourse Project Finance • Understanding PPP bankability requirements and credit enhancement options • Understanding the lender due diligence process, requirements, and reaching financial closure	• Understand how the key economic characteristics of infrastructure investments determine PPP financing structures • Understand lender requirements for project financing and what contracting authorities should do to facilitate & support PPP financial closure • Understand public sector risk-sharing and credit enhancement options for PPP financing
	3.3: PPP Contract Negotiations, Management & Performance Monitoring	• Designing and managing PPP contract management units & Project Management Units • Monitoring PPP performance during construction and operational phases • Models for PPP tariff adjustment formulas & price regulation techniques • Managing periodic requests for PPP contract revision & renegotiations • Strategies for financial restructuring of PPP projects (between investors & lenders) • Alternative dispute resolution mechanisms for long-term PPP contracts • Case examples of PPP contract management & performance monitoring	• Understand the specific options for regulation and adjustment of PPP contract prices and tariffs • Understand how to manage instances of requests to revise or renegotiate PPP contracts • Understand PPP contract dispute resolution mechanisms
	3.4: Case Study of PPP Contract Negotiations, Management & Monitoring	• PPP project case study background information • Analysis of case study contract management & performance monitoring options & results • Discussion of PPP project results and lessons learned for the Sri Lanka	• Understand lessons learned from the case study on effective PPP contract management • Understand how to apply lessons learned from case study to PPP contract management
	3.5: Workshop Summary & Conclusion	• Review of workshop program • Participant evaluations • Workshop Conclusion	• Understand the overall requirements of managing the PPP project cycle