Summary of Workshop

World Bank Group Risk Mitigation Solutions for Myanmar's Infrastructure Projects

June 3, 2015 @ Nay Pyi Taw

The World Bank Group (WBG) hosted a workshop titled Risk Mitigation Solutions for Myanmar's Infrastructure Projects in Nay Pyi Taw on June 3, 2015. Myanmar Ministries of Finance, National Planning and Economic Development, Electric Power, Communications and IT, and Transport presented an overview of their infrastructure development priorities and challenges. Officials from the Attorney General Office, the Ministry of Construction, the Ministry of Energy, and the Myanmar Investment Commission participated in the workshop.

Representatives from WBG team presented on how to prepare bankable projects, and how to get projects financed. EDF representatives contributed observations from the private sector on developing infrastructure projects in comparable markets. Reference was made to Myanmar's first successful power sector Public Private Partnership (PPP) tender, the Myingyan Power Generation Project, to demonstrate how a bankable project was prepared and expected to be financed in the prevailing environment Myanmar.

The WBG team presented an overview of the products and services available, including World Bank guarantees, IFC loans & equity investments and MIGA political risk insurance.

Summary of Main Messages

1. **Myanmar Development Priorities**

   The MOF and MNPED set out the GOM's key priorities; electricity, drinking water, agriculture, employment, tourism, monetary policy and trade and investment. All of the ministries present drew attention to the very substantial infrastructure development needs required to fulfill demand and meet the outlined development goals. There is broad understanding of the importance of Foreign Direct Investment (FDI) and PPP in order to finance these infrastructure projects. Support is being received from UNESCAP and work is underway across the board to develop the legal, policy and institutional frameworks necessary to facilitate effective private sector investment. However, the need to move this reform process forward (and particularly to develop expertise and models to mobilize financing and to identify and allocate risk) was highlighted by the GOM speakers.

2. **Project Preparation**

   Countries with well-developed capital markets can fund projects from their own local market, and domestic investors and lenders generally have more tolerance to local political and economic risks. However, international investors have a different perspective of host country risk, and this plays a major part in their investment decisions.

   The successful preparation of bankable projects is an important up-front and intensive undertaking by the public sector to successfully attract investments from the private sector. It requires a systematic process to create the enabling environment (policies, legislation,

institutions, and people), to determine which projects should be undertaken, and in what order, how these projects should be financed, and finally how they should be delivered and monitored.

Careful project preparation is crucial to the development of successful PPPs, and risk reduction is a critical component of this process. It can be divided into three stages: (i) converting uncertainty into risk, which can be assigned a probability and be priced; (ii) appropriately allocating the risk among the project partners; and (iii) finally resolving any residual risk through mitigation instruments such as credit enhancement. As private companies often overprice uncertainty, it is the role of the host government to convert uncertainty into risk well in advance of private sector engagement. It is also important to determine whether a "viability gap" between the anticipated economic benefits and the financial viability of the project exists. This is important to help determine one element of the support that the government will need to provide.

Successful development of a project requires a clear understanding of the differing needs of the key stakeholders. For example, consumers want a high quality service at a low price, lenders want acceptable risk profile commensurate with interest rate margin, and providers of equity want a risk profile that leads them to conclude they are likely to recuperate their investment. Debt is usually considerably cheaper than equity, while equity investors are generally willing to take on greater risk than lenders in expectation of greater returns. Mobilization of debt requires more risk mitigation.

The Nam Theun 2 Hydropower Project in Lao PDR developed by EDF and its partners demonstrates a number of key lessons on successful private project. EDF stressed the importance of a clear stable policy framework and governance, including transparency, communication, and political, financial, technical, and legal risk management. The financing of this project, although developed under standard project finance structure, required some special features to overcome specific challenges. The final agreements covering both debt and equity were extremely complex, involving loans and guarantees from 26 financial institutions.

EDF emphasized the need for the government to lead a collaborative process which involves all stakeholders, including financial institutions, from the very beginning. Although it is not a universally accepted principle, experience from Nam Theun 2 indicates that there are advantages in having government participation as a minority equity investor in the project. This ensures that they are fully involved in, and committed to the project from the outset. There appears to be no optimal level of government shareholding, however it is generally considered that it should not be a majority stake as this would only add to the challenge of bringing in private financing and would not allow the private partner sufficient control. Government can exert control through a concession agreement instead.

A long term vision and commitment from all stakeholders is essential, as infrastructure projects can take a number of years to reach financial close, many more to become operational and can continue to operate for decades even after the concession agreement expires.

The Myingyan Power Generation Project, which was the first competitively tendered Build-Operate-Transfer project in Myanmar, is also a good example of the project preparation process. The goal was to set up risk allocation in a way that attracted international developers

and maximized the use of long term debt in order to achieve the lowest cost electricity. It is expected that financial close will be reached soon, with a good result both in terms of price and efficiency. The total cost of the project is about USD 300 million, of which at least 70 % will be financed by debt.

Although there is significant market interest in Myanmar, technically and financially qualified investors want to see properly structured projects. Standard due diligence requirements for an infrastructure project like this comprise assessments of the legal and regulatory framework, technical feasibility, financial viability, demand forecasting, market interest and environmental and social issues. In Myanmar certain regulations and legislation that form a key part of this process does not exist or are still under preparation. However it was possible to find solutions to these deficiencies through risk mitigation and agreements to rely on precedence or benchmarks from other countries in the region.

3. Risk Allocation

Under a typical risk allocation for infrastructure project finance, several types of risk are commonly borne by a project company. These include: the financing risk (raising equity and debt); the construction risk (completing on time, within budget and to specification); the operation and maintenance risk of the facility; and natural force majeure risk affecting the PPP. Risks that are not under the control of the PPP such as demand risk (demand volume, tariff adequacy and buyer payment risk), foreign exchange risks, changes in laws and regulations, political risks (expropriation, war, civil disturbance), natural force majeure risk affecting the public sector buyer, and fuel supply and price risks (if provided by a state-owned supplier) are generally borne by the public sector to make the project bankable. Risk mitigation instruments such as WB Partial Risk Guarantees backstops these public sector risks to enhance the bankability of the transaction if the government is unrated or has a credit rating below “investment grade”.

Power Purchase Agreement (PPA) for the Myingyan project was developed based on the PPA model drafted by ADB, by the IFC transaction advisory team including international legal advisors based on regional models, which allocate risk to the parties best able to manage it. It has generally followed the typical risk allocation, however special features include:

- While in most emerging markets MOF or the Central Bank is usually required to guarantee the payment obligation under the PPA, as this guarantee policy is still under development in Myanmar, MOEP provided guarantee payment undertaking on behalf of MEPE, with confirmation from Union Attorney General Office and an acknowledgement from MOF, which would be expected to be further backstopped by a MIGA guarantee.
- While PPA tariff is typically linked to foreign currency and payable in local currency with the currency conversion/transferability risk borne by the government, in Myingyan, MEPE has agreed to pay the tariff in USD to avoid the difficulty of indexing the local currency to the USD. The foreign currency adequacy risk that the GOM does have a sufficient supply of USD is covered by a GOM guarantee, which may need to be further backstopped.

- In the case of political events that prevent operation of the plant, the project company would continue to receive a 'capacity payment', and if the problem continues the project company would be entitled to terminate the project to receive compensation.

- Risk related to natural force majeure affecting the power plant will be managed by the project company through insurance. However if force majeure affects the off-taker, (e.g. the transmission lines) then MEPE would be required to continue payments. WBG advises that insurance should be taken out to the extent available on the market. While it is beneficial to have standardized definitions of force majeure in all projects, the risks can vary according to the type of project or technology, so there may be a need for some differences to reflect this. However the definitions for related projects such as upstream gas projects and gas-fired power projects should be aligned.

4. Funding Modalities for Market Based Projects

In the case of an infrastructure project financed by sovereign borrowing, including state enterprise (SE) borrowing with full credit guarantees of the government, the lender will look at the country's sovereign credit rating. At this time Myanmar is not likely to attract international market lenders due to its lower credit standing. In the case of corporate financing by an SE or a sub-national entity, the lenders will look at the balance sheet and credit rating of this entity. Limited recourse project financing is whereby equity investors and lenders look at the contractual framework of the project to assess the reliability, stability & adequacy of cash flow to pay debt services and earn equity return.

Varied risk mitigation solutions are applied depending on the type of financing as above and the creditworthiness of the transaction. Obtaining and improving a credit rating is a long and complicated process, however even in a country with an inadequate credit rating, if the project contractual agreement is solid and there is appropriate backstopping of government obligations, it can still be possible to attract investment interest. An increase in competition among talented bidders results in a better price. Backstopping of government obligations from creditworthy institutions such as the WBG or export credit agencies can effectively upgrade the credit rating of government undertaking.

Feasible funding modalities for infrastructure projects depend on factors such as whether user fees can be charged, in which currency they will be paid, by whom and whether these will cover infrastructure investments. Funding models range from public project, which may be operated by the private sector, PPPs with public funding support of various types, or PPPs paid out through off-take contracts. In any event, government guarantees and undertakings backstopped by a credit worthy third party would play an important role to make a PPP transaction bankable.

As different types of infrastructure projects have different types of revenue stream, some are inherently more attractive to private investors than others. For example, domestic airports are generally harder to finance than international airports as the former rely on domestic revenues. Brown-field rehabilitation/expansion projects with operational assets and ongoing revenue stream are easier than green-field projects. Power generation projects and bulk water supply projects financed with off-take agreement can typically be paid out by contracted

tariffs. Market-based infrastructure projects without offtake contracts such as road and urban transport projects will generally require a PPP contractual structure with government financing support such as: government sharing of up-front financing requirements, availability payment scheme (covering capacity payments), operation subsidy payments, minimum revenue guarantees, etc. Projects with substantial capital costs such as sizable hydropower projects or urban transport projects may require up-front government financing support. It should be noted that these projects with government financing support would also additionally require government undertaking of risks beyond the control of the private project company.

5. WBG Products and Services

The WBG not only help finance infrastructure projects, but also offers a number of instruments to make a project more bankable. IDA, MIGA and IFC cooperate closely to provide complementary and optimal instruments.

World Bank Guarantees, which in Myanmar are provided through IDA, backstop government obligations to a specific project, thus improving bankability, facilitating project financing, reducing cost of capital and extending debt tenor. WBG guarantees include:

- Risk Guarantees cover lenders or project companies against the risk of government non-performance of its contractual obligations such as covering the nonpayment of ongoing PPA payments and termination compensation payments. This may be offered as Loan Guarantees which cover commercial project finance lenders; or in the form of Payment Guarantees benefiting the project company as a whole.
- IBRD Enclave Guarantees are available for projects with foreign currency revenues such as power export projects and cover host country government risks.
- Credit Guarantees cover lenders or bondholders against debt service default regardless the cause of default, and may support government/SE borrowing for fiscal support or public projects.

While these World Bank guarantees can enhance the attractiveness of the project and transaction, they do not increase contingent liabilities of the government as they only backstop government undertakings to the project, and all of the fees are covered by the private sponsors and not by the government. When a project developer is being selected under competitive conditions, World Bank guarantees can be offered as an option to all the bidders to help improve bids and enable financing. A World Bank guarantee is backed by explicit indemnity of the government, and it can facilitate the participation of IFC, MIGA and other official lenders.

International Finance Corporation (IFC) is the global leader in private sector development. In 2014, IFC made ~600 investments in ~100 countries. One of IFC's primary goals is to catalyze and mobilize other sources of finance for private sector development. IFC has been working with the GOM since 2012 on a wide spectrum of projects in the power, utilities, transport and natural resources sectors. IFC provides direct investment, including both debt and equity, as well as advice on private sector development and PPPs. IFC Infraventures is an initiative that enables IFC to serve as a co-

developer of projects and to bring in experienced staff to help structure the project so that it is made bankable and can reach financial close. IFC prides itself as an innovator, and is therefore very keen to work with the GOM to seek new solutions to infrastructure development challenges.

Multilateral Investment Guarantee Agency (MIGA) provides Political Risk Insurance to cover international equity and debt investments for the following political risks:

- Currency transfer and inconvertibility
- War and civil disturbance
- Expropriation
- Breach of contract

MIGA has supported more than 750 projects in a number of countries in the world, including many within the region. It specializes in frontier and challenging markets where few other insurers operate. Myanmar became the MIGA member country since December 2013, and MIGA is already being approached by lenders and private investors interested in opportunities here. A MIGA Guarantee is a key component of the financing of the Myingyan Project.

MIGA applies strict eligibility criteria related to economic viability, developmental impact, legal and integrity issues and social and environmental risk. MIGA Convention requires that MIGA secure Host Country Approval prior to the conclusion of a Contract of Guarantee. However this does not create any new obligations or liabilities for the government. MIGA Convention and Operational Policies provide for the Host Country Approval to be granted on a no objection basis after a specified period of time has elapsed. It is of note that although MIGA has provided insurance on 750 projects, as a result of careful due diligence and of MIGA's early involvement to facilitate settlement of issues, only seven claims have been paid to date.

In conclusion, the WBG is keen to provide assistance to the development and financing of infrastructure projects in Myanmar and would like to encourage GOM partners to engage us as early as possible to enable the provision of the full range of WBG instruments and solutions.