Sri Lanka: Fund for the infrastructure development by the private sector

Ex post evaluation report

OECD sector	24030 - Financial institutions of the formal financial sector	
BMZ project ID	1996 65 977	
Project executing agency	Private Sector Infrastructure Development Company Ldt. (PSIDC)	
Consultant	Not applicable	
Year of ex post evaluation	**2006**	
	Programme appraisal (planned)	Ex post evaluation (actual)
Start of implementation	01/1997	01/1997
Period of implementation	5 years	7 years
Investment cost	No information available	No information available
Counterpart contribution	No information available	No information available
Financing, of which FC funds	EUR 2.43 million	EUR 2.43 million
Other institutions / donors involved	World Bank	World Bank
Performance (overall rating)	5	
• Significance / relevance (sub-rating)	5	
• Effectiveness (sub-rating)	5	
• Efficiency (sub-rating)	5	

Brief description, overall objective and project objectives with indicators

The aim of the project was in cooperation with the World Bank to provide a credit line to PSIDC in the amount of EUR 10.2 million to refinance investments by the private sector in the construction, operation and maintenance of infrastructure facilities in Sri Lanka at market conditions.

The overall objective of the project was to support economic growth, incomes and employment in Sri Lanka by promoting the participation of the private sector in the construction, operation and maintenance of infrastructure facilities. It was assumed that the overall objective was achieved once the project objective had been achieved. From today's perspective it would be required to define indicators to measure the achievement of the overall objective and to include the aspect of financial system development in the definition of the overall objective.

The following project objectives were defined: 1) successful promotion of a financing instrument for the extension of long-term loans at market conditions to private investors (operating companies) and 2) creation as well as sustainable and efficient use of infrastructure facilities under private ownership and financing.

According to this definition the objectives were considered achieved if
- at least 90% of debt service payments are made in due course;

- debt service arrears of more than three months do not exceed 5% of the respective loan portfolio and
- the capacity utilisation rates, on which cashflow calculations are based, are achieved as from the second year of operation of the individual projects.

From today’s perspective we consider the indicators as not having been defined in enough detail. Even though these aspects were not included at the time of the project appraisal when the indicators for the overall objective and the project objective were defined it would have been reasonable to specify indicators for the sustainable built-up of a portfolio and the successful establishment of a new instrument for infrastructure financing including the definition of minimum volumes for the number and scope of the financed infrastructure projects.

The target group was defined as domestic and/or foreign private investors and operators. The target group in a narrower sense is composed of the users of the privately financed infrastructure facilities in the respective sectors (e.g. electricity consumers).

Project design / major deviations from the original project planning and their main causes

The project executing agency was the Private Sector Infrastructure Development Company Ltd. (PSIDC), which had been founded in August 1995 on the initiative of the World Bank. The only task of PSIDC was to finance profitable infrastructure projects by on-lending the donor funds handed out to the government of Sri Lanka (GOSL) by the World Bank and KfW.

PSIDC received the funds from the GOSL at IDA conditions and was to on-lend them at market conditions (fixed interest rates depending on the loan term or the lifetime of the investment object of up to 22 years with no more than 8 grace years) to private investors for the purpose of financing individual projects. The currency risk was to be borne by the private investors.

Regardless of factors such as risk or maturity the World Bank had fixed a margin of 3% for PSIDC. However, this margin gave PSIDC only very limited scope to act in a risk-adjusted, market-conforming and profit-oriented manner. In consequence, complex or risky projects could usually not be considered for financing by PSIDC since the standard margin of PSIDC appeared not to be sufficient to cover the risks associated with the respective projects and, thus, the investment could not be supported or implemented. On the other hand, in the event of attractive or profitable project financing transactions PSIDC was frequently not able to contract the deal because investors found interest rates not to be attractive enough and preferred to use alternative, often public sources of finance.

Thus, given the fact that financing was provided for only two infrastructure projects (which, looked at separately, did indeed produce real-economy effects) and the outflow of funds was very slow, the overall development of the infrastructure fund remained below expectations. PSIDC was not successful in handing out the funds provided for infrastructure loans. In consequence, both the World Bank and KfW Entwicklungsbank cancelled the project in 2003/2004 and reduced the loan amount in line with the funds committed until then (KfW Entwicklungsbank: EUR 2.43 million).

Key results of the impact analysis and performance rating

Only one project inspected in the framework of the ex post evaluation was refinanced from FC funds: In June 2002 PSIDC had concluded a loan agreement in the amount of LKR 218 million with the investor Didul Private Ltd. to finance the construction and operation of a small hydropower plant (produced by Siemens with a capacity of almost 9 MW) in the district of Ratnapura on the basis of a build-operate-own arrangement. The investor Didul is a special purpose vehicle (SPV) established by the renowned Ceylonese power utility Vallibel Power owned by the well-known multi-millionaire Dhamnika Perera. After the loan amount had been increased to LKR 266 million (EUR 2.4 million) the power plant was put into operation in May 2004. In the second year of operation, due to clearly lower rainfall in the region, the capacity utilisation rate was lower (27%) than expected (40%). The break even point, however, was exceeded (21%), this means that the ability to repay the loan (ability to pay interest and principal; see below) should be ensured (also through the assignment of an escrow account to which the Sri Lankan state-owned energy utility CEB makes payment for the power purchased under the project. Another project in the port of Colombo was financed by the World Bank.

The following risks that may jeopardize the achievement of the project objective were defined at project appraisal:

1) the stability of the overall framework for investments and the continuation of the path towards financial sector reforms as the prerequisite for the development of the private sector. A deterioration of macroeconomic conditions in Sri Lanka, which might adversely affected the investment propensity of private companies, did not occur. Nevertheless, it has to be stated that the overall framework for private investors in the infrastructure area did not develop as positively as expected.

2) at the level of the individual projects there was the risk that profitable projects – partly with donor assistance – were implemented by the public sector, thus leaving fewer profitable projects for the private sector. As the privatisation process in the energy sector did not advance at fast as expected this risk actually occurred (at least partially).

3) From the perspective that existed at the time of the ex post evaluation the restriction of the autonomy of PSIDC had not occurred, or at least cannot be blamed for the fact that the expected positive impacts of the project did not materialise.

In a summarised assessment of the above impacts and risks, we have arrived at the following rating of the developmental efficacy of project implemented with PSIDC:
Effectiveness

From a formal point of view one can say that the project indicators were sufficiently fulfilled for the two projects financed. As regards the FC-financed project, however, it has to be critically remarked that the capacity utilisation – even though due to the weather - was lower than expected. Overall, the project objectives were not reached:

PSIDC did not succeed in establishing a new financing instrument for the extension of long-term loans at market conditions to private investors in the Sri Lankan financial sector and to build up an infrastructure investment portfolio. With only two financed infrastructure investments, PSIDC remained far below the expectations at the time of the project appraisal. Accordingly, the objective of creation and utilisation of infrastructure facilities was achieved only insufficiently. PSIDC did not even succeed in implementing the first round of lending (first use of funds) for the funds provided by the World Bank and KfW Entwicklungsbank. In consequence there were no reflows to be used on a revolving basis. For this reason we rate the effectiveness of the programme as clearly inadequate (sub-rating 5).

Significance / Relevance

The overall objective of the project was to support economic growth, incomes and employment in Sri Lanka by promoting the participation of the private sector in the construction, operation and maintenance of infrastructure facilities. From today's perspective, we would also include the aspect of financial system development in the definition of the overall objective. The project did not have the desired broad-scale impact and, thus, failed to achieve the real-economy overall objective. The project was only able to a very limited extent to benefit from the potential available for financing infrastructure investments and it is not to be expected that in the future PSDIC, as a subsidiary of LPDB and without financial and technical support from international donors, will be successful in doing so. As regards the aspect of financial system development the developmental impacts of the project are clearly insufficient. Overall, from today's perspective we rate the achievement of the overall objective as clearly insufficient (sub-rating 5).

Efficiency

We rate the production efficiency of the project as clearly insufficient. PSIDC was set up as a separate institution for the purpose of financing infrastructure projects. However, during a period of six years the 4-5 permanent staff of PSIDC were only able to extent two sub-loans. Thus, PSI was not able to extend the donor funds provided as sub-loans or to build up a portfolio of infrastructure projects. In terms of cost efficiency, too, the financing of two projects by 4-5 PSIDC employees over a period of around six years is clearly insufficient. The margin income from two sub-loans would not have been sufficient to finance PSIDC as an institution. The allocation efficiency was equally insufficient. PSIDC did not succeed in on-lending the funds provided by the World Bank and KfW Entwicklungsbank. Overall, we rate the efficiency of the project as clearly insufficient (sub-rating 5).
In a summary assessment of the above impacts and risks, we judge the developmental efficacy of the project as insufficient (overall rating 5).

General conclusions and recommendations

In the context of the project subject to ex post evaluation here it has to be stated that in the event of complex infrastructure financings also in developing countries a considerable amount of time has to be invested in project planning and appraisal and in negotiations between investors and finance providers. Thus, besides setting a suitable framework for the project implementation, a realistic time horizon should be defined when designing comparable projects in the future.

Legend

Developmentally successful: Ratings 1 to 3	
Rating 1:	Very high or high degree of developmental efficacy
Rating 2	Satisfactory developmental efficacy
Rating 3	Overall sufficient degree of developmental effectiveness
Developmental failures: Ratings 4 to 6	
Rating 4	Overall slightly insufficient degree of developmental efficacy
Rating 5	Clearly insufficient degree of developmental efficacy
Rating 6	The project is a total failure.

Performance evaluation criteria

The evaluation of the "developmental efficacy" of a project and its classification during the ex post evaluation under one of the various levels of success described in more detail above concentrate on the following fundamental questions:

- Have the project objectives been achieved to a sufficient degree (project effectiveness)?
- Does the project generate sufficient significant developmental effects (project relevance and significance measured by the achievement of the overall development policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?
- Are the funds/expenses that were and are being employed/incurred to reach the objectives appropriate and how can the project's microeconomic and macroeconomic impact be measured (aspect of efficiency of the project conception)?
- To the extent that undesired (side) effects occur, can these be tolerated?

We do not treat sustainability, a key aspect to consider when a project is evaluated, as a separate evaluation category, but rather as an element common to all four fundamental questions on project success. A project is sustainable if the project executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms, or to carry on with the project activities independently and generate positive results after the financial, organisational and/or technical support has come to an end.