CONCEPT PAPER

July 28, 2017

Subject: **Rationalization of Generation Tariff Parameters**

1. As part of its regulatory process, the Authority has reviewed various tariff components for necessary changes needed therein. This aims to ensure that the power sector tariffs approved and awarded are consistent and reflective of prevailing economic and financial circumstances that implicate power generation tariffs approved by NEPRA.

2. After a comprehensive review and discussion with various stakeholders, the Authority has decided to revise certain benchmarks and ceilings to be allowed for tariff components of generation projects. In this respect, the Authority would like to seek input of all stakeholders on these recommendations before these are finalized for application in tariffs.

3. The Authority in principle continues to move towards promoting the competitive mode in generation tariffs. However, the projects that are specific to be considered under cost plus regime and for certain parameters to be used in upfront tariffs, these benchmarks will be used accordingly (unless deemed necessary for modification).

4. **Banking Spread:**

4.1 In view of discussion held with the State Bank of Pakistan (SBP), various commercial banks, DFIs and Islamic banks of different scale and exposure in power sector; following spreads are proposed for local and foreign financing:

4.2 *Local Financing:*

a. To benefit from prevailing low cost of debt and to complement SBP Re-financing Scheme Ref No. IHSMEFD Circular No. 3 dated June 20, 2016 for RE Projects, till the validity period of Financial Close till Jun 2019, it should be mandatory for all RE Projects to avail this credit facility @ 6% with the debt duration up to 12 years.

b. For the balance amount over Rs. 6 billion, spread will be allowed for RE Projects with ceiling of KIBOR + 1.75% (except hydel) with saving in the spread to be shared in the ratio of 50:50 between power producer and power purchaser. For small hydel Projects a spread ceiling up to 2% over KIBOR can be allowed on justified grounds.

c. For Projects (other than RE) which are not eligible to avail aforementioned SBP's refinance scheme, the sponsors will have to carry out competitive process with the max ceiling of spread allowed of 2% over KIBOR. The sponsors will be required to ensure a transparent and open competitive process adopted.

d. For large hydel power projects, considering the larger gestation period and peculiar circumstances, a spread range of upto 2.5% over KIBOR will be considered. Furthermore, this range will be considered by Authority as per Project specific dynamic for either a competitive process or negotiated spread, however aforementioned spread range shall not exceed.

4.3 *Foreign Financing:*

a. No change is proposed to existing spread of LIBOR + 4.5% being allowed to various technologies

b. However, for large hydel power projects giving due consideration to long gestation, specific risks, a spread up to 5% will be allowed. In the event of saving over spread, the gain will be shared equally (50:50) between power producer and power purchaser

c. With export credit insurance (e.g. Sinosure) allowed; the spread will be rationalized upto LIBOR + 3.5% with saving initiative of 50:50 to be shared between power producer and power purchaser

4.4 Where deemed appropriate for projects, the Authority will continue to allow mix of foreign and local financing. For foreign financing, currency/ exchange rate fluctuation will continue to exist.

5. **Debt Equity:**

5.1 To ensure that an optimal debt equity ratio exists, which could be suitable for sponsors and lenders with least burdening of end consumers, following debt equity ratio is proposed:

a. For all technologies (except Hydel), the equity more than 20% of the project cost shall be treated as debt.

b. For Hydel Projects a Debt : Equity ratio will be decided on case to case basis. However, the equity more than 25% of project cost shall be treated as debt.

5.2 Though few DFIs have desired for a 75:25 ratio to be allowed for all technologies, however, have not been able to supplement their request so far with any firm commitment reflective of the extent to which they would be broadening their existing portfolio in Energy Sector in Pakistan.

6. **IDC & ROEDC:**

6.1 To ensure that the cost of idle funds during construction period is not borne by the consumers, more efficiency is being considered to be brought in to project's fund management during the construction period allowed. Following aspects are therefore recommended accordingly:

a. For all cost plus Projects, at the time of tariff petition being filed, sponsors/ petitioners will submit the closest approximation between the payments with the debt drawdowns and equity injections suitable for the project. This will be justified and ensured to be aligned for timely completion of project as per the construction period allowed the project technology.

b. Atleast 90% payments of all major Project Cost components (including EPC) should be simultaneously paid in counter-financed mode consistent to the Debt Equity ratio allowed. <u>OR</u>

The IDC will be allowed on justified actual drawdown basis whereas the returns on equity during construction will be fixed by the Authority with a predetermined equity injection timelines in tariff determination with no subsequent adjustment.

c. Payment to the contractors, suppliers etc to be made directly through lenders and the date of payment by the lender will be considered as debt drawn for computation of cost of debt.

7. **<u>Financing Fee:</u>**

7.1 The existing financing fee structure has been noticed to vary and need to be better negotiated between borrowers and lenders. Accordingly, following benchmarks are recommended:

a. The components of financing fee will be restricted to (a) Arrangement fee, (b) Commitment fee and (c) Agency fee; with a maximum cumulative amount limit not exceeding 2% of the debt allowed.

b. For other costs of lender's advisors, bank charges, etc. will be considered and accounted for under the head of Project Development Cost (PDC) on justified basis.

c. For hydel projects, due to their particular site specific aspects, the financing fee amount not exceeding 2% of debt allowed will be considered for large hydel projects, whereas an amount up to 2.50% of debt for small hydel projects will be considered as financing fee on justified grounds.

8. **<u>Insurance:</u>**

8.1 In view of the continuous decline in global reinsurance index and considering the existing local insurance trends and, after close discussion with major power sector insurance stakeholders, following revised insurance cost benchmarks are recommended to be allowed in tariff:

Technology	Average construction period allowed	During Construction %age of EPC cost	During Operations %age of EPC cost
Wind	15-18 months	0.50%	0.40%
Solar	12 months	0.40%	0.40%
Thermal	24-30 months	0.75%	0.70%
Small hydel	36 months	1.00 %	1.00%
Large Hydel	6 years	2%	1%

9. **Withholding Tax on dividend:**

9.1 No W.H tax on dividend will be allowed in any tariff type/regime.

All stakeholders including any organization or person interested in the subject or affected by it may submit written comments in the matter within thirty (30) days of the publication of this concept paper.

28 July '17