

SOLOMON ISLANDS GOVERNMENT (SIG) DIRECT BORROWING EVALUATION GUIDELINES

Solomon Islands Government

Approved by Minister of Finance

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SIG DIRECT BORROWING EVALUATION GUIDELINES

Contents

ABBREVIATIONS	4
1. INTRODUCTION.....	5
2. EVALUATION PROCESS – FOUR POOL APPROACH.....	5
2.1. Exempt proposals from the four pool approach	6
3. POOL 1 - SELF-ASSESSED POOL	7
3.1. Self-assessment test	7
4. POOL 2 - ANNUAL BORROWING POOL (ABP)	8
4.1. Required proposal information.....	8
4.2. Due date to provide required proposal information	8
4.3. Responsibility for compiling ABP	8
5. POOL 3 - ANNUAL BORROWING LIMIT POOL (ABLP).....	9
5.1. Prioritisation process	9
5.1.1. Criteria for prioritising and ranking proposals in the ABP	9
5.1.2. Annual borrowing limit (ABL).....	9
5.2. Review by DMAC.....	9
5.3. Notification process of inclusion in ABLP	10
6. POOL 4 - DMAC POOL	11
6.1. Proposal assessment.....	11
6.1.1. Entity credit risk assessment.....	11
6.1.1.1. Entities not credit worthy	11
6.1.2. Project assessment	12
6.1.2.1. Financial viability.....	12
6.1.2.2. Non-financial characteristics.....	12
6.1.2.3. Net economic return	13
6.1.3. Required proposal information.....	13
6.2. Review by DMAC.....	14
6.3. DMAC recommendation to Minister	14
6.4. Notification of Minister’s decision	14
APPENDIX 1 - Self-assessment test template	15

APPENDIX 2 - Indicative evaluation process timeline.....	19
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ABBREVIATIONS

ABL	Annual Borrowing Limit
ABP	Annual borrowing pool
ABLP	Annual borrowing limit pool
CAPEX	Capital expenditure
DMAC	Debt Management Advisory Committee
DMS	Debt Management Strategy
DMU	Debt Management Unit
IRR	Internal Rate of Return
MDPAC	Ministry of Development, Planning and Aid Co-ordination
NDS	National Development Strategy
NIIP	National Infrastructure Investment Plan
NPV	Net Present Value
NPF	National Provident Fund
PFMA	Public Financial Management Act
SIG	Solomon Islands Government

1. INTRODUCTION

These Solomon Islands Government (SIG) Direct Borrowing Evaluation Guidelines outline the evaluation process that should be followed by stakeholders (e.g. proposing entities, the DMAC Secretariat¹ and DMAC²) for SIG direct borrowing proposal evaluation. This process aims to establish a fair, efficient and transparent process for assessing and prioritising proposals so as to optimise the expected broader economic and social returns to be derived from Solomon Islands' limited Government borrowing capacity. These Guidelines should be read in conjunction with the SIG Direct Borrowing Policy.

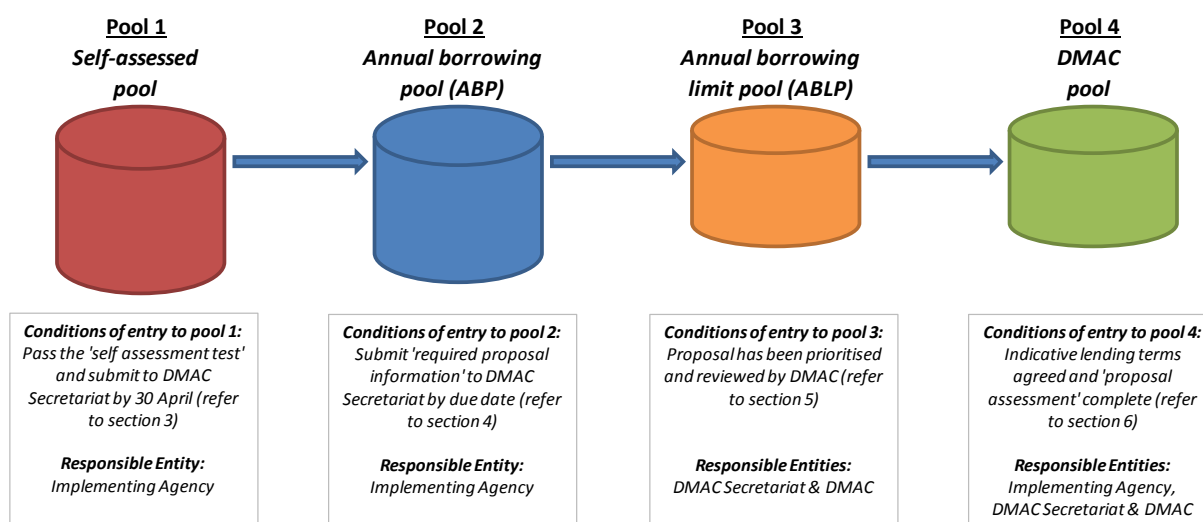
SIG direct borrowing is usually undertaken to fund projects that are managed by a SIG agency/ministry (an 'Implementing Agency').

Any reference to Policy in these Guidelines refers to the SIG Direct Borrowing Policy.

2. EVALUATION PROCESS – FOUR POOL APPROACH

SIG will utilise a four pool approach to identify and evaluate projects that seek to be funded, in part or in full, through SIG direct borrowing. This approach is depicted in Figure 1 below. An indicative evaluation process timeline is shown in Appendix 2.

FIGURE 1: FOUR POOL APPROACH



Pool 1 - 'Self-assessed pool'

The onus is on the Implementing Agency wishing to finance, in part or in full, a project through direct borrowing, to complete the '**self-assessment test**' (refer to section 3.1 of these Guidelines). If a proposal passes the self-assessment test, then it is eligible to be considered for SIG direct borrowing and therefore qualifies for inclusion in the '**self-assessed pool**'.

¹ Refer to section 8.1 of the Debt Management Strategy (DMS)

² Refer to section 3.2.1.1.5 of the DMS.

Pool 2 - 'Annual borrowing pool (ABP)'

To progress a proposal from the self-assessed pool to the **'annual borrowing pool (ABP)'**, an Implementing Agency has to satisfy the requirements of entry into the ABP (refer to section 4 of these Guidelines for further information on the ABP).

Pool 3 – 'Annual borrowing limit pool (ABLP)'

The **'annual borrowing limit pool (ABLP)'** is a subset of the ABP (refer to section 5 of these Guidelines for further information on the ABLP). The DMAC Secretariat will prioritise and rank proposals in the ABP against a set of criteria through a 'prioritisation process' (refer to section 5.1 of these Guidelines for further information on the prioritisation process), resulting in a prioritised ABP. This prioritised ABP will then be evaluated by the DMAC, which will advise the Minister of Finance on which proposals should proceed for further consideration to the ABLP. The most highly ranked proposals that can be funded within the annual borrowing limit (ABL) will progress to the ABLP.

Pool 4 – 'DMAC pool'

To progress from the ABLP to the **'DMAC pool'**, indicative lending terms must be agreed between SIG and the proposed lender and the DMAC Secretariat must have completed the 'proposal assessment' (refer to section 6.1 of these Guidelines for further information on the proposal assessment). Should the requirements of the proposal assessment be met, then the proposal will progress to the DMAC pool where it will be reviewed by the DMAC and a recommendation to the Minister of Finance will be made.

2.1. Exempt proposals from the four pool approach

Only in exceptional circumstances may a proposed SIG direct borrowing be exempt from being evaluated through the four pool approach. A proposal may by-pass the four pool approach if for example:

1. A lender has indicated that funding for a SIG direct borrowing is due to expire before a proposal can be evaluated through the four pool approach; or
2. There are key strategic project specific milestones that need to be achieved before a proposal can be evaluated through the four pool approach.

This list of examples is by no means exhaustive and the onus is on the Implementing Agency to make a case for a proposal to be exempt from the four pool approach.

3. POOL 1 - SELF-ASSESSED POOL

Proposals are only eligible to be included in the self-assessed pool if the Implementing Agency:

1. completes and passes a 'self-assessment test' (refer to test template included as Appendix 1 to these Guidelines); and
2. Submits the completed 'self-assessment test' to the DMAC Secretariat by **30 April** of the year preceding the year in which SIG expects to commit (i.e. sign the financing agreement) to the direct borrowing (refer to the indicative evaluation process timeline at Appendix 2).

3.1. Self-assessment test

The self-assessment test enables the Implementing Agency to self-determine if it is eligible to implement a project that is to be funded by SIG direct borrowing.

Further information on the 'self-assessment test' is contained below in Box 1.

BOX 1: 'SELF-ASSESSMENT TEST'

The self-assessment test consists of two steps, being an 'entity test' and a 'project test'.

Step 1 (Entity test) – Determine if your **Implementing Agency** is eligible to implement a project that is to be funded by SIG direct borrowing under section 3.1 of the Policy.

If your Implementing Agency self-determines eligibility, then your Implementing Agency passes the 'entity test'.

If your Implementing Agency passes the 'entity test', then proceed to step 2 (Project test).

If your Implementing Agency fails the 'entity test', then your proposal **fails** the 'self-assessment test' and is not eligible to enter into a direct borrowing.

Step 2 (Project test) – Determine if your **project** is eligible under section 3.2 of the Policy.

If your Implementing Agency self-determines that your project is eligible, then your project passes the 'project test'.

If your project passes the 'project test', then your proposal **passes** the 'self-assessment test'.

If your project fails the 'project test', then your proposal **fails** the 'self-assessment test' and is not eligible to be funded by SIG direct borrowing.

4. POOL 2 - ANNUAL BORROWING POOL (ABP)

A proposal in the self-assessed pool is only eligible to progress to the ABP if the Implementing Agency provides the 'required proposal information' (refer to section 6.1.3 of these Guidelines):

1. to the DMAC Secretariat; and
2. by the due date (refer to section 4.2 of these Guidelines).

4.1. Required proposal information

An Implementing Agency that proposes SIG direct borrowing must submit the 'required proposal information' to the DMAC Secretariat if they would like their proposal to progress to the ABP.

4.2. Due date to provide required proposal information

The 'required proposal information' must be provided to the DMAC Secretariat by the due date. The due date will be the '**Bid due date**' that is set each year as part of the Development Budget process.

Note that key dates for the annual Development Budget process (e.g. issuance of Budget circular and Bid due date) change from year to year.

An Implementing Agency that proposes SIG direct borrowing should maintain regular communication with the DMAC Secretariat to be aware of the due date for submitting the 'required proposal information'.

Typically, the due date (i.e. Budget bid due date) for submitting the 'required proposal information' will be around August of the year, preceding the year in which the SIG is considering to commit (i.e. sign the financing agreement) to the direct borrowing.

4.3. Responsibility for compiling ABP

The DMAC Secretariat will be responsible for compiling the ABP. The compilation processes shall occur annually.

5. POOL 3 - ANNUAL BORROWING LIMIT POOL (ABLP)

A proposal in the ABP is only eligible to progress to the ABLP if it has been:

1. prioritised and ranked through the 'prioritisation process' (refer to section 5.1 of these Guidelines); and
2. reviewed by the DMAC.

5.1. Prioritisation process

The DMAC Secretariat, in consultation with the Ministry of Development, Planning and Aid Co-ordination (MDPAC), will undertake a preliminary assessment to prioritise and rank all Government borrowing proposals in the ABP. A prioritised ABP will result from this preliminary assessment. This prioritised ABP will be presented, with supporting evidence to justify the ranking, to the DMAC for evaluation.

5.1.1. Criteria for prioritising and ranking proposals in the ABP

Government borrowing proposals in the ABP will be prioritised and ranked by conducting a comparative evaluation of how well each proposal:

- meets the objectives of debt management in the Solomon Islands (refer to section 6 of the DMS); and
- complies with DMS Rules 18 and 19 (refer to sections 8.14 and 8.15 of the DMS).

5.1.2. Annual borrowing limit (ABL)

ABLs are to be determined annually and disclosed annually as part of the annual Budget process (refer to section 8.7 of the DMS).

5.2. Review by DMAC

DMAC will evaluate the prioritised ABP against the ABL. Each proposal in the prioritised ABP will be assigned an amount that reflects the SBD face/notional value of the Government borrowing (refer to sections 8.3 and 8.4 of the DMS).

The DMAC will effectively review the priority assigned to each proposal and then cull the prioritised ABP to a point where the cumulative assumed Government borrowing obligation of the proposals for the year is less than the ABL for the specified year. Prioritisation will be checked against the 'Criteria for prioritising and ranking proposals in the ABP' referred to above in section 5.1.1 of these Guidelines.

The culling process is demonstrated in Box 2 below. In this example, five proposals have been prioritised by the DMAC in the prioritised ABP and the ABL has been set to SBD \$200 million. Only the top three prioritised proposals progress to the ABLP. Proposals prioritised 4 and 5 are culled as they do not fit within the ABL.

BOX 2: DETERMINING THE ABLP

Annual borrowing limit (SBD \$m) 200

Prioritised ABP				ABLP			
<i>Priority</i>	<i>Type of Government borrowing</i>	<i>Amount of Government borrowing (SBD \$m)</i>	<i>Cumulative Government borrowing (SBD \$m)</i>	<i>Priority</i>	<i>Type of Government borrowing</i>	<i>Amount of Government borrowing (SBD \$m)</i>	<i>Cumulative Government borrowing (SBD \$m)</i>
1	On-lend to SOE	55	55	1	SOE On-lend	55	55
2	Guarantee of SOE	26	81	2	SOE Guarantee	26	81
3	SOE direct borrowing	70	151	3	SOE Borrowing	70	151
4	SIG direct borrowing	72	223				
5	On-lend to private	60	283				

If in the above example the ABLP included the proposal prioritised 4, the cumulative assumed debt obligation recognised by SIG (i.e. SBD \$223 million) would exceed the ABL (SBD \$200 million) and would therefore constitute a breach of the DMS.

The DMAC will determine which proposals progress to the ABLP and notify the Minister of Finance of which proposals are to be included in the ABLP.

5.3. Notification process of inclusion in ABLP

Should an Implementing Agency's proposal be included in the ABLP, the Implementing Agency will be notified of the proposal's status by the DMAC Secretariat.

If the Implementing Agency receives notification, then they should regard this as representing SIG's 'de facto' commitment to the proposal and in-principle consent for the entity to proceed with feasibility studies or similar.

6. POOL 4 - DMAC POOL

A proposal in the ABLP is only eligible to progress to the DMAC pool if it meets the following requirements:

1. Indicative lending terms have been agreed between SIG and the proposed lender (refer to section 5 of the Policy for 'Guidance on acceptable SIG direct borrowing terms'); and
2. DMAC Secretariat has completed a 'proposal assessment' (refer to section 6.1 of these Guidelines).

If a proposal meets the above requirements and is included in the DMAC pool, then the:

1. DMAC Secretariat will present the proposal to the DMAC for evaluation; and
2. DMAC will, subsequent to evaluation, make a recommendation to the Minister of Finance on whether to authorise the SIG direct borrowing.

6.1. Proposal assessment

The 'proposal assessment' will include:

1. an 'entity credit risk assessment', to be undertaken by the DMAC Secretariat; and
2. a 'project assessment', to be undertaken by the DMAC Secretariat.

An Implementing Agency must provide the DMAC Secretariat with the 'required proposal information' (refer to section 6.1.3 of these Guidelines) to facilitate the proposal assessment.

6.1.1. Entity credit risk assessment

An Implementing Agency's credit worthiness will be determined by the DMAC secretariat that will conduct an 'entity credit risk assessment'.

The entity credit risk assessment will be conducted by evaluating the Implementing Agency's financial management systems and the financial management systems imposed by the lender with respect to the disbursement of loan funds.

The DMAC secretariat will assign the Implementing Agency with one of the following credit ratings to characterise the Implementing Agency's credit worthiness:

1. credit worthy; or
2. not credit worthy.

6.1.1.1. Entities not credit worthy

Typically, if an entity credit risk assessment deems the Implementing Agency to be 'not credit worthy', then the proposal will not progress to the DMAC pool.

However, in exceptional circumstances, not credit worthy Implementing Agencies may progress to the DMAC pool if it can be demonstrated, by the Implementing Agency, that the proposed project will significantly improve the Implementing Agency's:

- management structure through the provision of technical assistance; and/or
- operational capacity through the provision of technical assistance.

6.1.2. Project assessment

A project's viability will be determined by the DMAC secretariat that will conduct a 'project assessment'.

A project assessment will be conducted by evaluating the project's:

1. financial viability;
2. non-financial characteristics; and
3. net economic return.

6.1.2.1. Financial viability

To evaluate a project's financial viability, the DMAC secretariat will require the Implementing Agency to:

1. complete project capital expenditure (CAPEX) analyses; and
2. complete a sensitivity analysis on the project's financial ratios and CAPEX analyses.

The relevant project CAPEX analyses are listed in Table 1 below.

TABLE 1: PROJECT ASSESSMENT – FINANCIAL VIABILITY - FINANCIAL RATIOS AND CAPEX ANALYSES

CAPEX ANALYSES	COMMENTS
Net Present Value (NPV) analysis	NPV should be positive and a plausible discount rate should be used.
Internal Rate of Return (IRR) analysis	The DMU will form a view as section of the IRR analysis on what is an appropriate IRR for the type of project.

The sensitivity analysis should test the project's financial ratios and CAPEX analyses by:

1. shocking the key assumptions (where applicable) around; and
 - a. Pricing structure;
 - b. Exchange rates;
 - c. Depreciation;
 - d. Inflation; and
 - e. Interest rates.
2. assuming the realisation of non-financial shocks (e.g. the provision of land for the project is thwarted because of land owner issues).

6.1.2.2. Non-financial characteristics

To evaluate a project's non-financial characteristics, the DMAC Secretariat will require the Implementing Agency to provide a business plan that includes, for example, a:

- pricing structure policy (where applicable);

- statement explaining whether the lender is proposing to impose any tied procurement³;
- statement explaining who is responsible for project management;
- statement of non-financial assumptions (e.g. around land provision);
- non-financial risk assessment;
- project plan showing a timeframe for project implementation;
- statement of contingency measures to account for unexpected delays in project implementation; and
- due diligence report.

The DMAC Secretariat will assess the business plan for reasonableness.

6.1.2.3. Net economic return

Refer to Appendix 3 of the DMS for more information on net economic return.

The DMAC secretariat will evaluate the expected net economic return of the project and will assign the project with one of the following ratings, which will characterise the project's expected net economic return:

1. no return;
2. small;
3. moderate; or
4. large.

This rating will be used to compare the proposed project against other projects that are being evaluated in the DMAC Pool.

6.1.3. Required proposal information

An Implementing Agency seeking to fund a project with SIG direct borrowing is required to provide the 'required proposal information' to the DMAC Secretariat to facilitate the 'proposal assessment' outlined above in these Guidelines.

The required proposal information should include:

1. A summary of the relevant sensitivity analysis conducted on the financial ratios and cash flow projection that will be assessed in the 'entity credit risk assessment' (refer to section 6.1.1 of these Guidelines);
2. A summary of project specific (refer to section 6.1.2.1 of these Guidelines) CAPEX analyses;
3. A summary of the sensitivity analysis conducted on the project's financial ratios and CAPEX analyses (refer to section 6.1.2.1 of these Guidelines for appropriate sensitivity analysis);
4. Business plan (refer to section 6.1.2.2 of these Guidelines for what should be included in the business plan); and

³ If a lender is proposing to impose tied procurement (i.e. in the form of materials, equipment and/or labor), then negative impacts of this need to be evaluated by the DMAC Secretariat and presented to the DMAC for evaluation.

5. Any evidence that will assist DMAC Secretariat in determining the expected net economic return of a project (refer to section 6.1.2.3 of these Guidelines).

6.2. Review by DMAC

The DMAC Secretariat will only present proposed SIG direct borrowing proposals to the DMAC for evaluation if: 1) indicative borrowing terms have been agreed by all parties; and 2) the 'proposal assessment' has been completed.

6.3. DMAC recommendation to Minister

Pursuant to review, the DMAC will provide a recommendation to the Minister of Finance on whether to authorise the proposed SIG direct borrowing. This is consistent with the DMS and the *Public Financial Management Act* (PFMA) that requires all Government borrowing proposals to go through the DMAC process.

6.4. Notification of Minister's decision

The Implementing Agency shall be notified, in writing, by the Minister of Finance on whether their proposed SIG direct borrowing has been approved.

APPENDIX 1 - Self-assessment test template

If you are an Implementing Agency seeking to finance, in part or in full, a project proposal through SIG direct borrowing, then you are required to complete the **‘self-assessment test’** contained in this self-assessment test template. The self-assessment test includes an ‘entity test’ (step 1) and a ‘project test’ (step 2).

If your Implementing Agency fails the self-assessment test, your proposed project will not be eligible to be financed by SIG direct borrowing.

If your Implementing Agency passes the self-assessment test, then you must submit this completed self-assessment test template to the Debt Management Unit (DMAC Secretariat) by the deadline date (see below) for checking. If the DMAC Secretariat confirms your self-assessment test result, your proposed SIG direct borrowing will progress to the ‘self-assessed pool’ of the evaluation process.

Deadline date: The deadline date to submit your self-assessment test template is **30 April** of the year preceding the year in which SIG expects to commit (i.e. sign the financing agreement) to the direct borrowing. This date roughly aligns with the annual issuance date of the Budget Circular that outlines the annual budget timetable and line agency responsibility in the budget process.

Begin filling in the self-assessment test template below:

Question Number	Question	Answer
1	In which calendar year do you expect SIG to commit to the proposed direct borrowing?	

Step 1 – ‘Entity test’

Question Number	Question	Answer
2	Does your Implementing Agency currently have any trade creditor arrears?	Yes / No
3	Does your Implementing Agency currently have any National Provident Fund (NPF) arrears?	Yes / No

If you answered ‘Yes’ to any of the above questions, then your Implementing Agency **fails** the ‘self-assessment test’ and is not eligible to directly borrow.

If you answered ‘No’ to both questions 2 and 3 above, then you should proceed to **Step 2 – Project test** of this template.

Step 2 – ‘Project test’

Question Number	Question	Answer
4	Does your project comply with sections 8.13 and 8.14 of the Debt Management Strategy (DMS)?	Yes / No
5	Do you expect your project to deliver a net economic return (including social benefits) to the Solomon Islands?	Yes / No

If you answered ‘Yes’ to all of the above questions, then your project **passes** the ‘self-assessment test’. It is therefore eligible to be funded by SIG direct borrowing and will be included by the DMAC Secretariat in the ‘self-assessed pool’ of the evaluation process.

If you answered ‘No’ to any of the above questions, then your project **fails** the ‘self-assessment test’ and is not eligible to be funded by SIG direct borrowing.

If you have completed the self-assessment template and passed the ‘self-assessment test’, please sign below and submit to the DMAC Secretariat by the deadline date.

Name of person completing this template:

Title of person completing this template:

Contact details of person completing this template:

Date this template submitted to DMAC Secretariat:

APPENDIX 2 - Indicative evaluation process timeline

Timeline	Implementing Agency action	DMAC Secretariat and DMAC action
January	Conduct 'Self-assessment test' (refer to section 3.1 of the Guidelines) Due date to submit 'Self assessment test template': 30 April	Liaise with and field queries from Implementing Agencies and lenders (DMAC Secretariat)
February		
March		
April		
May	Submit 'required proposal information' to DMAC Secretariat	Check submitted 'Self-assessment template' (DMAC Secretariat)
June	(Refer to sections 4.1 and 4.2 of the Guidelines)	Compile Annual Borrowing Pool (DMAC Secretariat)
July	Due date: To be confirmed annually	Establish Annual Borrowing Limit Pool (DMAC Secretariat & DMAC)
August	Liaise and collaborate with the DMAC Secretariat Negotiate terms of direct borrowing (Ongoing)	Establish DMAC Pool (DMAC Secretariat & DMAC)
September		DMAC review and recommendation to Minister (Ongoing)
October		
November		
December		