



# **On-lending Policy**

**2013**

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## Table of Contents

1. Executive Summary .....	3
2. Background .....	6
3. Policy objectives .....	7
4. Legal basis for lending .....	8
5. Administration .....	8
6. On-lending, Subsidiary Loan Agreements and CSO Policy .....	9
7. Impact on the National Budget .....	10
8. Project evaluation and approval process .....	10
9. Classification of Projects .....	12
10. Eligibility for a subsidiary loan .....	13
11. All financing to be made on commercial terms .....	14
12. Key terms and conditions of subsidiary loans .....	14
13. Default procedure and writing-off loans .....	16
14. Review of this policy .....	17
Schedule 1 – Other terms and conditions to be included in a Subsidiary Loan Agreement	19
List of Abbreviations .....	22

## 1. Executive Summary

### Scope of this policy

1.1. This policy provides for lending by the State to State entities (via subsidiary loans)for:

- projects which have been partly or wholly financed by a loan to the State and will be implemented by a State entity (on-lending);and
- projects which are partly or wholly funded by general Government revenue and will be implemented by a State entity.

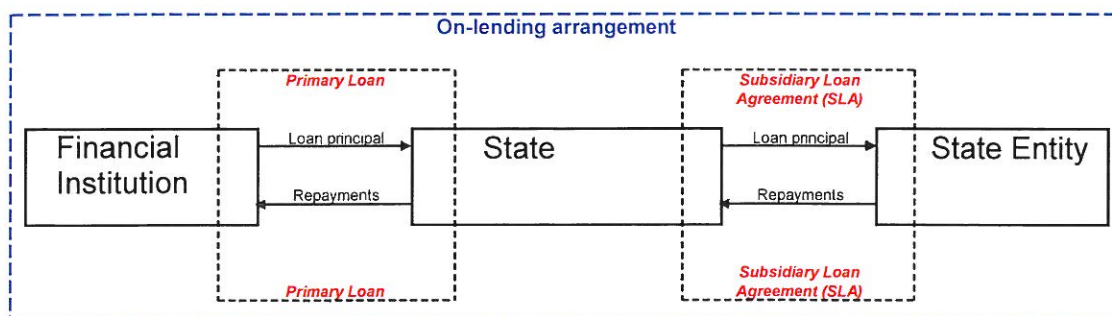
Under this policy a State entity is a company, trust or Statutory Authority which is more than 50% owned by the State or more than 40% owned by the State and no other entity owns a greater share than the State. The policy is also intended to be applicable to funding State entities' participation in Public-Private-Partnerships (PPPs).

1.2. With the exception of legislative approved investment activity, the State will not lend to private companies or other levels of Government as experience has shown that these organisations are likely to default on loans from the State.

### What is an on-lending arrangement?

1.3. An on-lend arises when the State receives a loan from a financial institution and is responsible for making repayments to that financial institution. The State then passes on the loan principal to a State entity via a Subsidiary Loan Agreement (SLA), who in turn repays the principal to the State.

#### Typical on–lending arrangement



1.4. All expenditure under an on-lending arrangement will be included in the National Budget as no disbursement of funds from the State can be made without a budget appropriation. Therefore any loan will be guided by the Medium Term Development Plan, Medium Term Fiscal Strategy and Medium Term Debt Strategy.

### **Benefits and risks of on-lending**

- 1.5. State entities often have the legal authority to borrow on their own terms; however, they are generally not in a strong financial position and therefore are unable to access funds from commercial lenders or international financial institutions. On-lending provides a means for the State entities to benefit from the strength of the Government's balance sheet and access to finance. It is also a means for State entities to deliver the Government's development projects.
- 1.6. On-lending to State entities is only one way for the Government to deliver development projects. Under an on-lend, the Government bears the risk that the State entity will default on their loan. As this risk is significant, on-lending should be carefully considered against other alternatives such as open tenders, public-private-partnerships or direct private sector development.
  - The high risk of lending to State entities has been reflected in previous on-lending arrangements, with only 10% of all money which has been on-lent likely to be recovered.

### **Policy Objectives**

- 1.7. The policy aims to promote transparency of State entity funding.
  - The State will on-lend funds to State entities at commercial rates so that the State does not provide non-transparent subsidies to State entities via cheap financing.
  - The State may subsidise non-commercial projects through the Community Service Obligation (CSO) policy. CSO contracts are a transparent way to recognise Government investment which is not commercial.
- 1.8. Lending at commercial rates also encourages efficiency in State entities and efficiency in resource allocation within the economy by:
  - discouraging State entities from pursuing projects with low rates of return unless directed to do so by the State under a CSO contract; and
  - ensuring that the State entities do not receive an unfair advantage over private sector firms when they are engaged in direct competition.
- 1.9. To reduce the default rate on subsidiary loans, only State entities which have a reasonable prospect of repaying loans will be eligible for a loan.
  - The Government may choose an ineligible State entity to implement a project under a CSO contract. It is more transparent to recognise the subsidy to a State entity through a CSO contract funded by a budget appropriation.

- 1.10. Finally, the policy aims to achieve appropriate risk sharing between the State and State entities.
- The State is in a better position to manage the financial risks of the primary loan than State entities. Therefore, the State can borrow in a foreign currency but may only on-lend in Kina at a fixed rate of interest (the interest rate will remain the same over the life of the loan).
- 1.11. It is not an objective of this policy to generate revenue for the State at the expense of State entities, but to ensure that scarce resources are allocated to where they are most needed, such as funding necessary capital expenditure that either generates a commercial return or is subsidised in accordance with CSO policy.

### **Key Elements of the policy**

- 1.12. Projects funded through this policy may be funded through an on-lend or a mixture of an onlend and other Government funding such as that provided by a CSO arrangement.
- Projects which are commercial in nature may be funded 100% by an on-lend.
  - Projects which are non-commercial, that is they are not expected to generate positive cash flows, may be funded solely by CSO payments.

In all cases, the State entity is expected to obtain finance (whether debt or equity from the State or from other entities) on commercial terms.

For projects that comprise both commercial and non-commercial elements this policy is to be applied to those sub-elements accordingly.

- 1.13. The State, like any other commercial lender, would need to determine whether the interest charged on a loan to a State entity is sufficient to compensate it for the credit risk exposure. Entities that are in default of previous subsidiary loans will need to be examined carefully to determine whether they have an acceptable level of credit risk.
- 1.14. The interest rate on a subsidiary loan will be the indicator lending rate<sup>1</sup> plus a margin of between -1% and -0.5% depending on the repayment period of the subsidiary loan. Repayment periods will be between 5 and 10 years whereby this option is negotiable between the State and the State entity.

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<sup>1</sup>This is the rate that domestic banks publish as a guide to the variable interest rate at which they will lend to private companies. It is published by the Bank of Papua New Guinea in their fortnightly statistics bulletin.

## **2. Background**

### **2.1. Previous on-lending**

Up until now, the State has on-lent approximately K460 million via SLAs. The terms and conditions of these SLAs have been individually negotiated with borrowers outside of a policy framework. To date, the Department of Treasury (DoT) has written off around K312 million in on-lending as unrecoverable and K103 million is currently in arrears. Only around 10% of all money which has been lent is likely to be recovered. This poor performance has been caused by a number of factors including:

- lending to private firms which are no longer in business or have changed their names and cannot be located;
- lending to six Provincial Governments, all of whom have defaulted with only one having made any repayments at all;
- lack of proper record keeping by the DoT; and
- lending to loss making State entities that are unable to make loan repayments.

This policy aims to address these factors by lending on commercial terms only (whether to State entities or private entities), including improving record keeping and assessing the ability to repay loans, and not lending to Provincial Governments.

### **2.2. Funding and financing of Development Projects**

Development projects are allocated National Government funds as part of the Public Investment Program (PIP) which is administered by the Department of National Planning and Monitoring (DNPM). DNPM will assess the merits of the project against the objectives of the Medium Term Development Plan.

Project proposals are usually submitted by the entity which will implement the project. The proposals often include the expected source of funding.

In the case of loan financing, the lender will usually conduct a project evaluation to determine whether they will offer financing for the project. DoT assesses whether the financing is consistent with the Medium Term Debt Strategy. If consistent, negotiations are held between the implementing entity, the lender, the DNPM and the DoT, to establish the terms of the loan. Often the lender will require that the Government provide part of the project's costs upfront. This is called counterpart funding.

This policy is to be applied to the PIP process described above. Namely, that State loans to State entities will be done on a commercial basis, and any subsidy be provided only in accordance with the CSO Policy.



### **3. Policy objectives**

#### **3.1. Transparency**

The policy, together with CSO policy, aims to improve the transparency of State entity financing and funding by requiring the Government to explicitly recognise when it is subsidising a capital investment by a State entity. This objective has two aspects:

- the policy provides for on-lending at commercial terms so that the State does not provide non-transparent subsidies to State entities via cheap financing; and
- for projects which are not expected to earn commercial returns but have significant flow-on benefits to the economy and community, a subsidy may be provided in a transparent manner through a CSO contract funded through the Budget.

#### **3.2. Resource efficiency**

On-lending at commercial rates encourages efficiency in State entities and efficiency in resource allocation within the economy by:

- discouraging State entities from pursuing projects with low rates of return unless directed to do so by the State through the CSO Policy; and
- ensuring that the State entities do not receive an unfair advantage over private sector firms when they are engaged in direct competition.

#### **3.3. Mitigating default risk**

Some aspects of the policy are designed to mitigate default risk. In particular, the State will not lend to private companies that are unlikely to repay or other levels of Government as experience has shown that these organisations are likely to default on loans from the State.

#### **3.4. Promoting realistic project cost/benefit analysis**

This policy provides incentives to State entities to be realistic about their cost and revenue projections. In particular:

- it discourages State entities from being overly optimistic in their assessment of the financial benefits of the project because it affects their ability to repay the loan, and the State will improve its credit assessment and other lending processes; and
- it encourages accurate assessment of the economic benefits of a project to justify receiving CSO funding.

#### **3.5. Appropriate risk sharing**

The State is in a better position to manage the financial risks of the primary loan than State entities. That is, it has a larger and more diverse balance sheet and diverse revenue sources. Therefore, the State can borrow in a

foreign currency but may only on-lend in Kina at a fixed rate of interest (the interest rate will remain the same over the life of the loan). The State also bears the risk that the State entity will default on the loan.

- 3.6. The State entity will generally have more information than the State on the costs and benefits of the project and the project's chance of success. Therefore, under the policy the State entity bears the risk that the return from the project is lower than anticipated and the project becomes loss making for them.

#### **4. Legal basis for lending**

- 4.1. Under section 38 of the *Public Finances (Management) Act (1995)* (PFMA), the Minister responsible for Finance has the power to make loans on behalf of the State, where the loan is made for purposes approved by the Head of State acting on advice from NEC.
- 4.2. Under section 54 of the PFMA, a public body is able to accept a loan from the Minister on such terms and conditions as are agreed between the public body and the Minister.
- 4.3. Under the *Independent Public Business Corporation of Papua New Guinea Act 2002* (IPBC Act), a State Owned Enterprise has the power to borrow as granted by the *Companies Act 1997*. However, for a Majority State Owned Enterprise under the *IPBC Act*, the capital expenditure must be approved by the IPBC Board as required by section 46G of the *IPBC Act* and the borrowing must be approved by the IPBC Board as part of the State entity's annual plan as required by section 46E of the *IPBC Act*.

#### **5. Administration**

- 5.1. Financial Management Division (FMD), or its successor, in the DoT will be responsible for administering this policy.
- 5.2. FMD will maintain a database using the Commonwealth Secretariat Debt Recording System which records all the details of subsidiary loans. This database will be used by FMD to:
  - invoice State entities for repayments under the subsidiary loans;
  - record payments made by the State entity under the subsidiary loans; and
  - report on subsidiary loans in the Government's financial statements.
- 5.3. State entities entitled to apply for a loan under this policy are listed below:



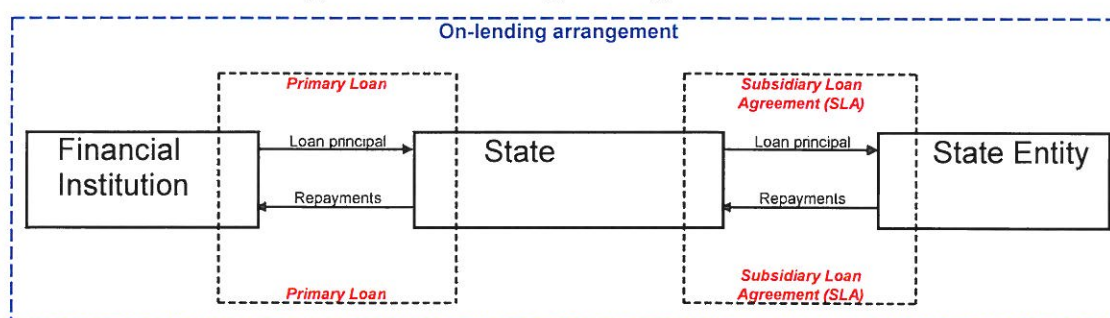
- State Owned Enterprises (SOEs) where the State has greater than 50% ownership or greater than 40% ownership and no other entity holds a greater share;
  - Trustees of State Owned Enterprises (such as IPBC); and
  - Statutory Authorities (SAs).
- 5.4. Provincial and local level Governments will not be eligible for a loan.

## 6. On-lending, Subsidiary Loan Agreements and CSO Policy

6.1. Lending to State entities by the State shall be governed by a Subsidiary Loan Agreement (SLA). The State may lend from two sources of funds, on-lent funds and general Government revenue.

- An on-lending arises when the State receives a loan from a financial institution and is responsible for making repayments to that financial institution. The State then passes on the loan principal to a State entity via a SLA, who in turn repays the principal to the State. The terms and conditions of the SLA need not correspond with those of the primary loan.

### Typical on-lending arrangement



- The primary lender is usually an International Financial Institution that provides finance on concessional terms and conditions, intended for development projects. Primary lenders can however also be commercial domestic finance institutions. The primary loan can therefore be external or domestic.
- Often projects are funded from both a primary loan and Government revenue (otherwise known as counterpart funding). Under this policy the total cost of the project can be lent to the State entity, including the counterpart funding. The on-lending of the primary loan and lending of counterpart funding will both be governed by the same SLA.
- Often projects are funded out of general Government revenue. Under this Policy, the State can lend general Government revenue to State entities to fund specific projects.

- 6.2. Related to this policy is the CSO policy, which allows for Government funding for a State entity project which is not commercial. CSO payments will be made under a CSO contract which will set out how funds are to be paid to the State entity.

## **7. Impact on the National Budget**

- 7.1. An appropriation is still required for expenditure of funds under a subsidiary loan agreement<sup>2</sup>. Therefore, the decision to on-lend funds will not make a difference to the budget at the time of expenditure.
- 7.2. Receipts from on-lending are recognised as revenue in the National Budget. Therefore, on-lending will improve the budget position when loans are repaid. Receipts will be paid into consolidated revenue and be spent through the National Budget.

## **8. Project evaluation and approval process**

- 8.1. This policy requires that projects are subject to an evaluation and approval process.
- 8.2. The State entity must provide the DoT and DNPM with a project evaluation report either written or endorsed by the primary lender (if applicable). This must contain:
- a statement regarding the objectives and proposed outcomes of the project, in particular, whether the project is entered into for profit making purposes and/or to fulfil social and community obligations;
  - a statement regarding how the project will assist the Government achieve the targets set out in the Medium Term Development Plan;
  - an estimate of the capital costs of the project and timeframe for project implementation;
  - an estimate of the expected operating cash flows arising from the project;
  - an estimate of the maximum subsidiary loan that the project could comfortably sustain given its expected cash flows; and
  - other relevant information which will assist the Government in deciding whether or not to approve the project.
- 8.3. The State entity must also provide audited financial statements for each of the five year's preceding the loan or if the entity has been in existence for

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<sup>2</sup>Under sections 13 and 14 of the *Public Finances (Management) Act 1995*, all money borrowed by the State must be paid into consolidated revenue and cannot be paid out without an appropriation.

less than five years, financial statements for each year in which it has been operating plus a business plan and a five year cash flow projection.

8.4. Before a SLA can be signed the following **must** take place:

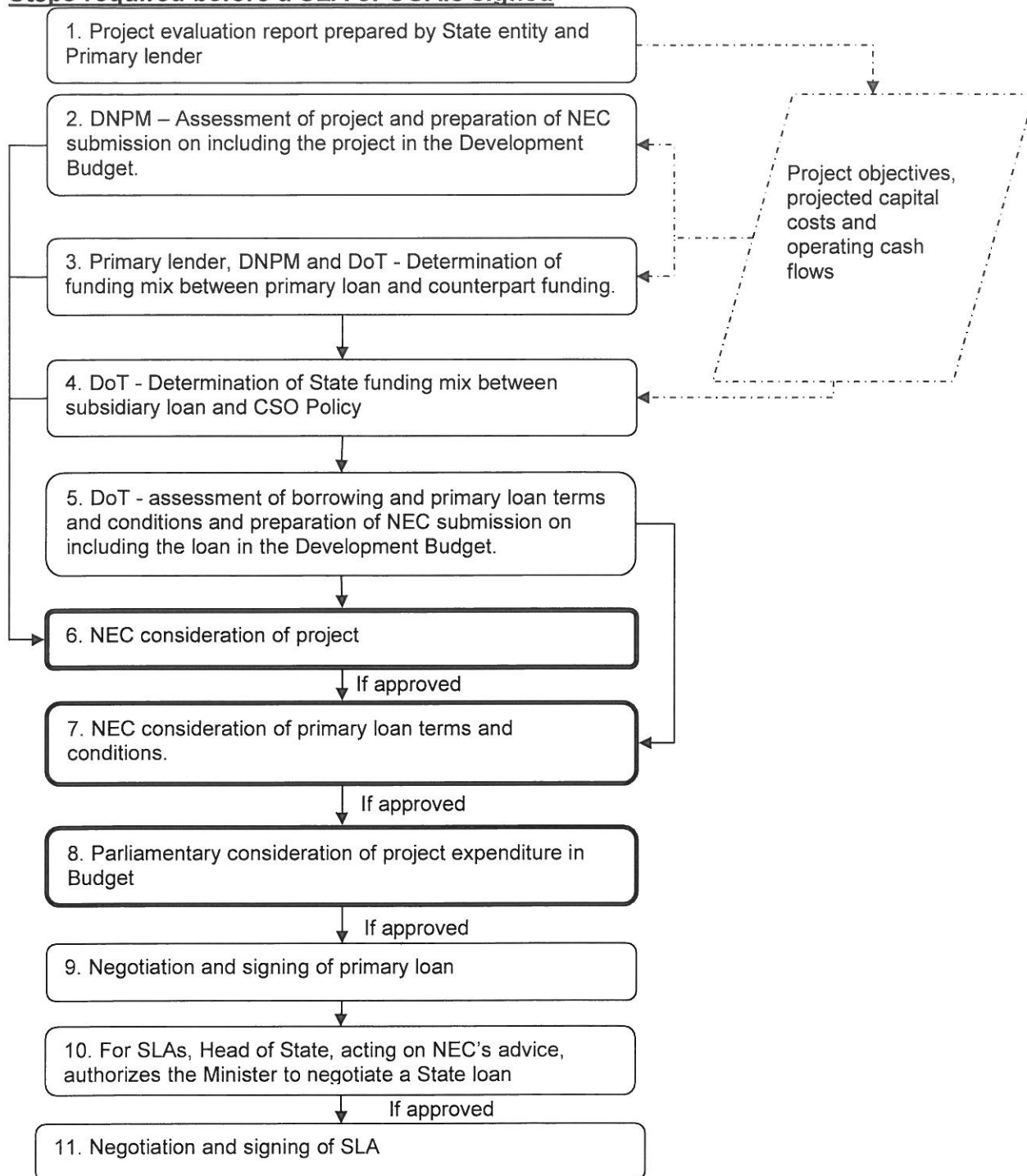
- DNPM must assess the project and it must be consistent with the objectives of the Medium Term Development Plan;
- DoT must assess the borrowing and primary loan terms and conditions and these must be consistent with the Medium Term Debt Strategy;
- If the State entity is a Majority State Owned Enterprise under the *IPBC Act*, the project and borrowing must be approved by the Board of the IPBC;
- DoT must do an assessment of the nature of the project and eligibility of the State entity to enter into a SLA under this policy;
- if a State entity is ineligible for a loan, DoT must inform NEC that funds cannot be on-lent to this entity so that NEC can take this into consideration in its deliberations on the project;
- the project must be approved by NEC after consideration of a submission written or endorsed by DNPM and sponsored by the Minister responsible for DNPM;
- the terms and conditions of the primary loan must be approved by NEC after consideration of a submission written or endorsed by DoT and sponsored by the Minister responsible for DoT;
- if there is to be a loan to a State entity, the Head of State, acting on advice from NEC, must authorise the Minister to negotiate a State loan for the purpose of implementing the project;
- the first year's forecast expenditure on the project must be included in the National Budget and approved by Parliament; and
- the primary loan agreement must be signed (however, the SLA can be signed before the primary loan agreement is declared effective<sup>3</sup>).

8.5. The diagram below demonstrates this process.

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<sup>3</sup> There can be a delay between when a loan is signed and the loan is declared effective by the lender. This is to allow time for legal clearance of the agreement and other matters which must be in order prior to the project commencing.

### Steps required before a SLA or SGAs signed



## **9. Classification of Projects**

- 9.1. The project evaluation report should include a statement setting out the objectives and planned outcomes of the project as well as the project's

expected return and projected operating cash flows. This will be used by DoT to make an assessment of the nature of the project.

9.2. A project will fall into one of two categories depending on its nature:

- A commercial project will be undertaken as a profit making venture and is expected to make commercial returns<sup>4</sup> over the long-term.
- A non-commercial project will be undertaken at least partially to fulfil social and community obligations and is expected to lose money(i.e. not make a return that covers the cost of capital) over the long-term.

## **10. Eligibility for a subsidiary loan**

10.1. Before the State enters into a SLA with a State entity, there must be a reasonable expectation that the State entity is willing and able to repay the loan. Generally, a State entity will be eligible for a subsidiary loan if:

- in each of the two years preceding the loan, the State entity achieves break-even or profit making financial performance and has positive net operating cash flows;
- the State entity is not in default of an existing loan, this includes on-lending arrangements unless the State entity has finalised a debt restructure for any defaults with FMD(DoT) and has complied with the restructured loan for at least one year;
- the State entity does not have other significant financial obligations which are likely to hinder its ability to repay the State; and
- the State entity has provided DoT with the information listed in 8.2 and 8.3 of this policy.

10.2. For a new entity, it is up to the discretion of the DoT to assess whether it will be eligible. This decision will be based on whether the entity is likely to be profit making.

10.3. In exceptional circumstances, the DoT may deem a loss making State entity to be eligible for a subsidiary loan. These circumstances must be expected to significantly improve the entity's operating performance such that the entity is expected to earn profits in the future. The circumstances must arise from a transaction or agreement with a party external to the State entity, for example:

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<sup>4</sup>What constitutes a commercial return depends on the risk of the project. However, the Asian Development Bank estimates that a commercial investment is expected to return at least 10% to 15% [ADB (2009), *Finding Balance: Making State-Owned Enterprises Work in Fiji, Samoa and Tonga*]. This policy effectively sets a minimum return for projects which are undertaken for profit making purposes. This will be the interest rate outlined in section 10 of this policy.

- a contract which is likely to result in an increase in profits to the State entity (such as a CSO contract); or
- an acquisition of an asset which is likely to generate revenue for the State entity.

They must not arise from an organisational restructure of the State entity or a change in management.

10.4. The DoT may deem a profit making State entity to be ineligible for a subsidiary loan for one of the follows reasons:

- circumstances have arisen which are expected to significantly hinder the entity's performance such that the entity is expected to make losses in the future. Circumstances may include, but are not limited to, a market downturn, undertaking of a large financial commitment, court ruling, regulatory change or natural disaster; or
- the previous two year's positive financial performance were due to exceptional factors which are not expected to continue into the future.

10.5. If an entity has been deemed ineligible, DoT will inform NEC that the project would normally be subject to a subsidiary loan; however as it is likely that the State entity will default, the State entity is ineligible for on-lending.

## **11. All financing to be made on commercial terms**

11.1. Under this policy, the State will lend on commercial terms to eligible State entities. The eligibility of State entities for a loan may be significantly affected by the entity entering into a CSO contract.

## **12. Key terms and conditions of subsidiary loans**

12.1. Primary loans are usually made on concessional terms which include long repayment periods and low interest rates. They can be in foreign currency or domestic currency. However, subsidiary loans to State entities shall be in Kina and done on commercial terms as outlined below.

12.2. Principal repayments shall begin in the year that the project is expected to be fully operational and realising revenue. Principal may be repaid over 5 or 10 years, whereby this option is negotiable between the State and the State entity.

12.3. The interest rate of subsidiary loans shall be fixed for the life of the loan.

12.4. A commercial fixed rate of interest cannot be readily observed from the market. However, domestic banks publish an Indicator Lending Rate (ILR) which is a guide to the variable interest rate at which they will lend to



private companies. The Bank of Papua New Guinea publishes the highest and lowest ILR each fortnight in their fortnightly statistics report.

- 12.5. Most variable business lending is done at a margin to the ILR for periods of up to 5 years. Low risk corporate entities borrow at a margin below the ILR and high risk corporate entities at a margin above. Under this policy, it is assumed that the cost of borrowing for State entities is equivalent to a low risk corporate entity at a margin of 1% below the ILR for a five year period.
- 12.6. The longer the principal repayment period, the higher the risk that the State entity will default on its loan repayments, therefore under this policy the margin to the ILR increases with the length of the repayment period.
- 12.7. The interest rate on SLAs shall be the lowest ILR published by BPNG, at the time the primary loan is signed plus an annual interest margin as per the table below.

**Interest Rates for State loans**

Principal repayment period	Interest Rate
5 years	ILR – 1%
10 years	ILR – 0.5%

- 12.8. The SLA will also contain provisions according to the attached schedule to this policy.

**12.9. Comments on key terms and conditions**

This policy is designed to promote transparency and resource efficiency by on-lending at commercial interest rates. However, the terms and conditions offered under the policy are still more favourable than what private sector firms in the same industry would receive. The deviation from pure competitively neutral terms and conditions is due to some simplifying assumptions and measures to reduce the risk of default. These are explained below.

**Uniform terms and conditions for all State entities**

Normally, an entity's level of credit risk will determine the interest rate at which it can borrow funds. While this policy distinguishes between high risk entities, that are not eligible for a subsidiary loan and low risk entities that are, it makes a simplifying assumption that all State entities eligible for a subsidiary loan have the same credit risk. This assumption was made because it is unlikely that DoT would have the resources or detailed information required to make further distinctions between the credit risks of State entities.

**Long-term fixed lending**

Lending long-term at a fixed rate of interest in Kina is not entirely

consistent with competitive neutrality as most business lending in PNG is done at variable rates of interest or the interest rate is only fixed for short periods<sup>5</sup>. In addition, under fixed rate lending, the State undertakes the risk that if interest rates fall, the State entity will attempt to renegotiate the loan. However, fixed rate lending was considered necessary due to the significant likelihood that State entities would default on variable rate loans if interest rates increased.

#### Proxy for fixed commercial rate

The approach of using the variable commercial rate as a proxy for a fixed commercial rate was chosen for its simplicity; however this approach has the following drawbacks.

- Longer-term interest rates contain a term premium and are higher on average than short-term interest rates. Under this policy the interest rate increases with the term of the loan, however not to the extent of the term premium. Therefore, in most circumstances the proxy interest rate will be lower than the theoretical fixed rate.
- If short-term interest rates are particularly high and are expected to fall, the margin between longer term rates and shorter-term rates could become negative. In this case, the proxy interest rate will be higher than the theoretical fixed rate.

### **13. Default procedure and writing-off loans**

- 13.1. All SLAs are required to include a provision to govern events of default by the State entity.
- 13.2. An event of default shall be deemed to have occurred under a SLA if the State entity fails to make good on the full amount of principal and/or interest due as at the close of business of the later of the following dates:
  - the repayment date shown on the repayment schedule; and
  - 20 business days after the date of the billing invoice provided by DoT to the State entity.
- 13.3. All SLAs are required to include a provision that requires the State entity to notify the First Assistant Secretary FMD, (or any successor to FMD) in writing of an expected event of default, at least 5 business days before the expected event of default.
- 13.4. In the event of default, no further disbursements will be made to the State entity until such time that the sum of all principal arrears, interest arrears and default interest arrears (i.e. total arrears) are paid to the DoT.

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<sup>5</sup>For example, according to their annual report (pg 50) at the end of 2008, BSP had 78% of their lending portfolio repricing within one year

- 13.5. Default interest shall compound daily on total arrears, using the applicable default rate of interest.
- 13.6. The applicable default rate of interest shall be equal to the SLA applicable annual rate of interest, plus a rate of 4% p.a.
- 13.7. In the event of a default the following process will be followed:
- FMD will write to the Head of the State entity demanding immediate payment of the arrears with interest. If the State entity provides sufficient evidence that it is genuinely unable to repay, FMD and the State entity will commence negotiations on a restructure of the loan.
  - If the default is not resolved by step 1, the Minister for Treasury will write to the Head of the State entity demanding immediate payment of the due amount or agreement to restructure the loan.
  - If the default is not resolved by steps 1 & 2, FMD will seek the Minister's approval for punitive measures. Punitive measures shall include:
    - : withholding warrants from the National Budget for funds intended to be paid to the State entity;
    - : including the entity on a publicly available list of defaulting entities posted on the DoT website;
    - : informing NEC that the State entity is in default of its loans and requiring the Head of the State entity to write to NEC explaining why the entity has defaulted on the loan; and
    - : deeming the entity ineligible for future on-lending arrangements.
- 13.8. If the loan is not refinanced and repayments have not recommenced within 3 years of the initial default, the loan will be written-off as unrecoverable. The entity will remain on the list of defaulting entities and be ineligible for future on-lends for a period of 10 years.

## **14. Review of this policy**

- 14.1. This policy shall be reviewed at least once every 5 years to ensure that terms and conditions remain appropriate given any change in circumstances. In particular the following shall be reviewed:
- the use of the indicator lending rate as the reference for the annual interest rate; and
  - the annual interest rate margins.

- 14.2. This policy shall also be reviewed in light of any changes in Government policy relating to the funding of State entities including funding of Community Service Obligations or payment of dividends to the State.

## **Schedule 1 –Other terms and conditions to be included in a Subsidiary Loan Agreement**

### **1. Principal loan amount – Disbursement**

- 1.1. Where the project is funded by a primary loan, SLAs are required to include a provision to govern the disbursement of the SLA principal loan amount to the State entity.
- 1.2. Where the project is funded partly or wholly from Government revenue, SGAs are required to include a provision to govern the transfer of funds to the State entity.

### **2. Principal loan amount – Repayment**

- 2.1. The principal to be repaid shall be the Kina value of the subsidiary loan component of the project's capital costs.
- 2.2. For disbursements made in a foreign currency, the exchange rate used to calculate the Kina value shall be the exchange rate as charged by the lender to DoT.
- 2.3. All SLAs are required to include an indicative repayment schedule that shows the timing and quantum of principal loan amount repayments. The amounts in the schedule shall be revised when the final capital costs of the project have been determined.
- 2.4. Principal loan amount repayment dates, shown in a SLA repayment schedule shall:
  - be semi annual, whereby the repayment dates are at the discretion of the State;
  - begin in the year that the project proposal is expected to be fully operational and realising revenue, as per the project evaluation undertaken by the primary lender; and
  - extend up to 20 repayment dates, whereby this option is negotiable between the State and the State entity.
- 2.5. Principal loan amount repayment amounts shown in a SLA repayment schedule on each repayment date shall be equal amounts.
- 2.6. The State entity is required to repay the full principal loan amount of a SLA. Debt forgiveness may only be considered by the DoT as part of a restructure of a SLA.

### **3. Interest charges**

- 3.1. All SLAs shall be Kina denominated fixed rate loans, regardless of any floating rate charges that may apply under the primary loan.
- 3.2. All SLAs are required to include a repayment schedule that shows the timing of interest payment dates.
- 3.3. Interest payment dates, shown in a SLA repayment schedule shall:

- be semi annual, whereby the payment date are at the discretion of the State; and
  - start subsequent to the first disbursement of the principal loan amount to the State entity.
- 3.4. Interest holidays or interest free periods included in a primary loan shall not be passed on to the State entity under a SLA.
- 3.5. Interest payable shall be calculated:
- using an annual rate of interest, equivalent to the sum of the applicable annual reference rate and the applicable annual interest rate margin.
  - on the total principal loan amount outstanding;
  - on a semi annual basis, consistent with the interest payment dates shown in the repayment schedule and the first disbursement date; and
  - on the basis of actual number of days elapsed on a year of 365 days

#### **4. SLA - Other Primary Loan charges**

- 4.1. All SLAs are required to include a provision to govern the payment of primary loan charges, other than standard interest charges, payable by the State entity (i.e. Other Primary Loan charges) during the course of normal operations of the primary loan.
- 4.2. Other primary loan charges include service fees, commitment fees and any other fees/charges that are charged by the primary lender, in addition to the standard interest charges, payable by the State under the normal operations of a primary loan.
- 4.3. The State entity is required to reimburse the State for any cancellation or non-disbursement fees that are incurred by the State under the primary loan, due to actions taken, or inaction (including an event of default), by the State entity under the SLA.
- 4.4. The State entity will not be liable for any charges under the primary loan due to actions taken, or inaction, by the State where the State entity is not at fault.

#### **5. SLA - Cancellation by State entity**

- 5.1. All SLAs are required to include a provision to govern the cancellation of a SLA by a State entity.
- 5.2. In the event that a State entity cancels a SLA, the principal loan amount outstanding, any interest payable and any default interest payable, at the time of cancellation, shall be payable in full to the State by the State entity.



- 5.3. The State entity shall also be responsible for all cancellation or any other fees incurred by the State, resulting from the consequent cancellation of the primary loan by the State.
- 5.4. Furthermore, the State entity will be required to reimburse the State for all fees/charges under the primary loan, other than standard interest charges, previously paid by the State during the life of the primary loan.

#### **6. Process for billing and repayment**

- 6.1. All SLAs are required to include a provision to govern the process for billing and repayment under the SLA.
- 6.2. The DoT shall provide a billing invoice to the State entity, at least 20 business days prior to each repayment date shown in the repayment schedule, which shows the principal loan amount payable and interest payable.
- 6.3. Where an event of default occurs, the DoT shall provide a billing invoice, monthly from the time of an event of default, which shows the principal loan amount arrears, interest arrears and default interest arrears.

#### **7. Early repayment by the State entity**

- 7.1. All SLAs are required to include a provision to govern early repayment of the principal loan amount by the State entity.
- 7.2. For a SLA, in the event that the State entity repays the principal loan amount in advance of the repayment schedule and the State chooses to prepay the primary loan, the State entity shall not be responsible for any charges, which are charged by the primary lender, for the early repayment of the primary loan.
- 7.3. If the State elects to repay the primary loan early, the State entity will still be required to repay the subsidiary loan and will continue to make payments according to the SLA repayment schedule.

#### **8. Future loans by State entity**

- 8.1. All SLAs are required to include a provision to govern the process by which the State entity creates encumbrances on its assets as security for all future loans.
- 8.2. The State entity shall not, without the prior written consent of the State, create or seek to create any lien or other encumbrances on any of its assets as security for any debt, with the exception of any lien arising in the ordinary course of banking transactions or to secure a debt maturing not more than one year after its date.

#### **9. Other provisions**

- 9.1. The above provisions do not preclude the addition of other provisions within a SLA that are not inconsistent with the above provisions.

## **List of Abbreviations**

BPNG – Bank of Papua New Guinea

CSO – Community Service Obligation

DNPM - Department of National Planning and Monitoring

DoT - Department of Treasury

FMD - Financial Management Division

ILR - Indicator Lending Rate

IPBC – Independent Public Business Corporation

IPBC Act - *Independent Public Business Corporation of Papua New Guinea Act 2002*

NEC – National Executive Council

PIP - Public Investment Program

PFMA- *Public Finances (Management) Act (1995)*

PPPs - Public Private Partnerships.

SA – Statutory Authorities

SLA - Subsidiary Loan Agreement

SOEs–State-Owned Enterprises