

Chapter 21:

Project Development Guidelines



REDUCING POVERTY THROUGH GROWTH

Project Development Guidance

Overview of MCC Due Diligence once a Compact Proposal has been Received

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Millennium Challenge Corporation (MCC) Compact Assessment and Approvals Guidelines provides the framework for overall assessment of a country's proposal (Proposal) to determine whether the Program is sufficiently developed and qualified to advance to the Compact negotiation stage. Projects included in the Proposal will be assessed by MCC for relevance, suitability, technical viability and sustainability. This Guidance provides an overview of the principal assessments that MCC undertakes in order to make that determination. In addition to the steps outlined in this document, all projects will also be reviewed for compliance with other applicable guidelines, in particular the MCC Environmental Guidelines, MCC Gender Policy, and MCC Guidelines for Economic and Beneficiary Analysis of a Compact Proposal.

MCC typically does not commence Due Diligence on a proposed project until the country submitting a proposal provides data and information in sufficient detail and of acceptable quality. If such data and information are not available, the country should explore other applicable means of developing the data, including MCC's Section 609(g) funding, to prepare the project.

In general terms, Due Diligence can commence if all of the following information is provided by the country:

- *Project justification* within a national development context (or sector strategy) and clearly defined targets for poverty reduction
- *Project description* with sufficient detail regarding exact project site, the geographic areas to be served, preliminary identification of targeted beneficiaries, intended outcomes, products or services to be delivered, and methods of delivery
- *Pre-feasibility studies* (see items A- J below) with preliminary detailed cost estimates, using unit costs that are suitable for International Competitive Bidding, no older than 4 years, *Preliminary environmental and social review, including gender analysis.*

- *Institutional arrangement* for project implementation
- Concept designs and, if possible, adopted design criteria and standards.
- Preliminary economic and financial analysis, with an indication of economic and financial impact.

When a Pre-feasibility Study is absent and if the country is able to provide, and demonstrates that it can provide, similar information that is usually contained in a pre-feasibility study, then MCC may consider it to be sufficient to commence its Due Diligence.

MCC's Due Diligence process includes a review of the following:

A. Development Approach

The proposal should clearly identify the critical constraints or development opportunities that the project is going to address. The proposal should indicate how the proposed activities address these constraints or opportunities. The proposal should also confirm that the identified sub-sectors offer the best potential for income generation and job creation, including multiplier effects, and are inclusive of the economically viable poor.

B. Qualitative Analysis of Alternative Project Selection and Design

The MCC proposal should include a clear justification for the proposed activities, including analysis of project alternatives, quantified wherever possible. This should include the following: (i) what would happen without a project, which would help determine whether or not the project is necessary; (ii) a discussion on the chosen operation being the least cost alternative; (iii) justification for public funding, such as an effort to provide public goods to address a market failure; and (iv) consideration of alternatives in terms of choice of project, technology, design, construction, location, choice of target group, public-private provision, and public-private financing.

Based on available data and evidence, MCC Due Diligence is intended to:

- Establish evidence that alternatives were considered during the selection and design of the project

- Establish evidence that the project being appraised is the least-cost or the optimal Net Present Value (NPV) alternative
- Identify clearly the “with” and “without” project situations, and specify clearly and transparently their respective costs and (especially) income and other benefits.

C. Project Design and Costs

Based on available data and evidence, MCC Due Diligence is intended to:

- Confirm that results of stakeholder consultations have been considered adequately in designing the project
- Confirm quantitatively that the design parameters meet the objective of alleviating stated key constraints to sustainable growth
- Confirm that proposed project design will deliver expected benefits
- Examine the methodology for cost estimation. Ensure that costs reflect current industry contractor prices, material availability due to world demand, and inflation factors. Recheck country-specific unit costs employed in standard costing methods
- Evaluate physical and price contingencies (for local and foreign components separately), and foreign exchange rates for foreign components of the project cost and recommend adjustments as necessary
- Evaluate land development costs including any requisite land acquisition needs if relevant
- Provide evidence of local construction capacity (where appropriate) and availability of local materials, equipment, and labor and identify situations where off-shore procurement or importation is required
- Determine contracting method and reexamine project costs based on the likely method of contracting
- Where construction is required, examine the appropriateness of engineering standards and codes used in the project design

D. Fiscal Impact and Cost Recovery

The public and private affordability of the proposed operation must be analyzed. This is especially relevant in terms of the project's impact on the current public investment program or finances of the responsible public sector entity (e.g., Operations and Maintenance costs). The potential for sustaining the operation during and after implementation should be determined. MCC Due Diligence must analyze recurrent cost funding or identify cost recovery issues.

Based on available data and evidence, MCC Due Diligence is intended to:

- Assess adequacy of recurrent cost funding analysis or cost recovery analysis, including the underlying assumptions and assumed values
- Analyze and justify any subsidies for operating or recurrent costs, including the ability to target or limit subsidies (e.g., via means-testing) to poor beneficiaries
- Ensure adequate measures to permit project financial sustainability (during and after implementation) are included whether from public or private sources
- Ensure tariff and recovery requirements are clearly specified to achieve project objectives

E. Economic Analysis

All projects will be subject to economic evaluation by MCC's Economic Analysis Division in accordance with the MCC Guidelines for Economic Analysis, available at www.mcc.gov. Such evaluation is based on projections of net incomes and other benefits with and without a proposed MCA intervention.

Based on available data and evidence, MCC Due Diligence is intended to:

- Identify realistic benefit streams and assess their magnitude and sensitivity to changing conditions
- Establish quantitatively the link between economic contribution and poverty reduction
- Estimate impact on poverty reduction

- Identify key constraints that may hinder the realization of assumed benefits, whether public or private

F. Sensitivity / Risk Analysis

Assessment of impact that changes in different underlying parameters of the operation will have on the anticipated outcome. Switching values can also be used to help arrive at realistic expectations of the potential benefits of an operation.

Based on available data and evidence, MCC Due Diligence is intended to:

- Identify the underlying or causal factors that introduce risk and their likelihood of occurrence, and that would have an adverse impact on cost, quality, or timeliness
- Calculate switching values
- Ensure sensitivity analysis that reflects the risks
- Determine whether variations in key underlying variables have an important impact on Financial Internal Rate of Return (FIRR) or other benefits.

G. Monitoring and Evaluation Plan

All projects are required to include a comprehensive monitoring and evaluation plan that clearly describes how the poverty reduction and growth impacts of the proposal will be measured. Refer to the Guidelines for Monitoring and Evaluation Plans and the Guidelines for Economic Analysis documents for more details on required information and methodology.

F. Institutional Capacity and Risk Analysis

Assessment of the capacity and effectiveness of relevant government agencies and implementing agencies. Realistic actions to reduce risks must also be assessed. The risks identified should be used as parameters for the sensitivity analysis.

Based on available data and evidence, MCC Due Diligence will:

- Adequately assess institutional capacity to implement the proposed project

- Identify actions and their associated costs that may reduce identified ex-ante institutional capacity risks
- Develop realistic set of actions to include reduction of institutional risks during implementation
- Develop operational alternatives if identified institutional capacity constraints indicate material risks to meeting project outcome(s).

H. Poverty and Gender Analysis

All projects will be subject to Poverty and Gender analysis by the responsible groups of MCC to ensure that the proposed projects are designed in accordance with the MCC Gender Policy and the MCC Guidelines for Economic Analysis, available at www.mcc.gov.

I. Environmental and Social Impact Analysis

MCC Compacts are required to comply with MCC Environmental Guidelines (www.mcc.gov). The MCC Environmental and Social Assessment (ESA) Division is responsible for Due Diligence activities relating to environment and social matters in projects.

J. Donor Coordination

The activities of other donors in the sectors of potential MCC activity must be analyzed. The nature, size and status of these programs should be identified. The potential functional linkages with other donors should be determined. The following questions should be addressed

- How will MCA funds leverage, complement or reinforce other donor interventions? (i.e. Are there established institutions that could be leveraged for implementation? Are there successful programs that could be scaled up?).
- What are best practices/lessons learned from past donor interventions related to the areas identified in the MCC proposal, and how were they incorporated?

- How would other donor programs positively or negatively impact the MCA program? How could either be changed to maximize the positive complementarities?