



Success Factors in the Philippines' PPP Program

**Research Commissioned by the Australia APEC Study Centre at
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1 Executive Summary

The government of the Philippines first established a PPP framework in 1990. By 2010, PPPs in the Philippines were beset by a wide range of issues, and were not being used effectively to assist in meeting the country's infrastructure needs.

Since 2010, significant progress has been made. The Philippines' PPP program has been widely recognised as a success. This report investigates the factors behind the success, and identifies the following as key lessons that can be applied in other economies:

- There usually will not be a single "silver bullet" that alone will produce a successful PPP program, rather a broad effort across multiple aspects of the program will be required.
- Ensuring that the PPP framework is robust and continually improving it are significant catalysts for a successful PPP program. In this respect:
 - A whole of government approach is necessary to implement a successful PPP program and is valuable to give confidence to potential investors.
 - Appropriate governance is an important factor supporting a whole of government approach to PPPs, protecting government against the risks associated with the PPP program and enhancing private sector confidence in government decision-making.
 - The motivations for undertaking PPPs in developing economies can differ from the motivations in developed economies with mature PPP programs. The context in which a PPP program is undertaken is also different in developing economies compared to developed economies. Nevertheless, developing economies should consider introducing practices from developed economies where these will enhance the success of the PPP program. For example, the Philippines has introduced the appointment of a probity adviser for large and complex projects to help ensure that the tender process is impartial and fair to all bidders. This is a role seen in various forms in mature PPP markets in developed countries such as Australia and Canada, but is not a role commonly seen in developing countries.
- Development of a successful PPP program relies heavily on the government's ability to make available the financial and human resources required to properly identify, appraise, structure, tender, manage and monitor PPPs.
- Governments can benefit from close engagement with the private sector during the development and tendering of PPP projects, provided transparency and fairness are protected.
- A comprehensive and well-structured communications strategy can play a valuable role in educating a wide range of stakeholders about the program, dispelling myths, and building confidence in the program.

Some issues and challenges remain, and the government of the Philippines will need to maintain momentum and make further improvements if it is to effectively and efficiently meet its infrastructure needs. Nevertheless, the Philippines' experience provides a clear illustration of the comprehensive approach required to implement a successful PPP program.

2 Background

In 1990, the Philippines was one of the first developing countries to enact a law providing for build operate transfer projects, a form of PPP. This law was used with some success to generate private investment in the power sector, however investment in other infrastructure sectors was limited during the two decades following enactment of the law.

2010-11 – Evidence of failure and of new beginnings

In late 2010, a joint fact-finding mission conducted by the Asian Development Bank, the Australian Agency for International Development, and the Canadian International Development Agency examined the Philippines' capacity to successfully develop and implement public–private partnerships. This informed a technical assistance report issued by the Asian Development Bank that identified a litany of deficiencies in the following areas:

1. The Government of the Philippine's governance arrangements for PPP projects
2. The policy, legal and regulatory frameworks for PPPs
3. The institutional arrangements within the Government and its institutional capacity to manage PPPs
4. The government's systems and capacity to prepare bankable projects
5. The financing of projects.

In 2011, the Economist Intelligence Unit released its "Asia Infrascopes", a benchmark index and learning tool that assesses economies' readiness and capacity for sustainable, long-term PPP projects. This assessment identified a similar range of issues to the Asian Development Bank report. The Philippines' score against the Infrascopes index was very similar to the scores of Indonesia and Thailand, with each of these countries being rated as an "emerging" PPP market.

The deficiencies identified by the Asian Development Bank and the Economist Intelligence Unit are detailed in Appendix 2 to this report.

2010 also marked the election of President Benigno Aquino. The President recognized the need to improve the Philippines' infrastructure. Soon after taking office, he signed an executive order making initial changes to the institutional arrangements for the management of private investment in infrastructure. These changes created the Public-Private Partnerships Center of the Philippines.

By the end of 2010, the joint fact-finding mission conducted by the Asian Development Bank, the Australian Agency for International Development, and the Canadian International Development Agency had reached agreement with the Philippine government on a set of actions to strengthen the Philippines' capacity to successfully develop and implement public–private partnerships. Thus 2010-11 provided evidence of both a troubled climate for private investment in infrastructure, and potential signs of new beginnings that might address the problems.

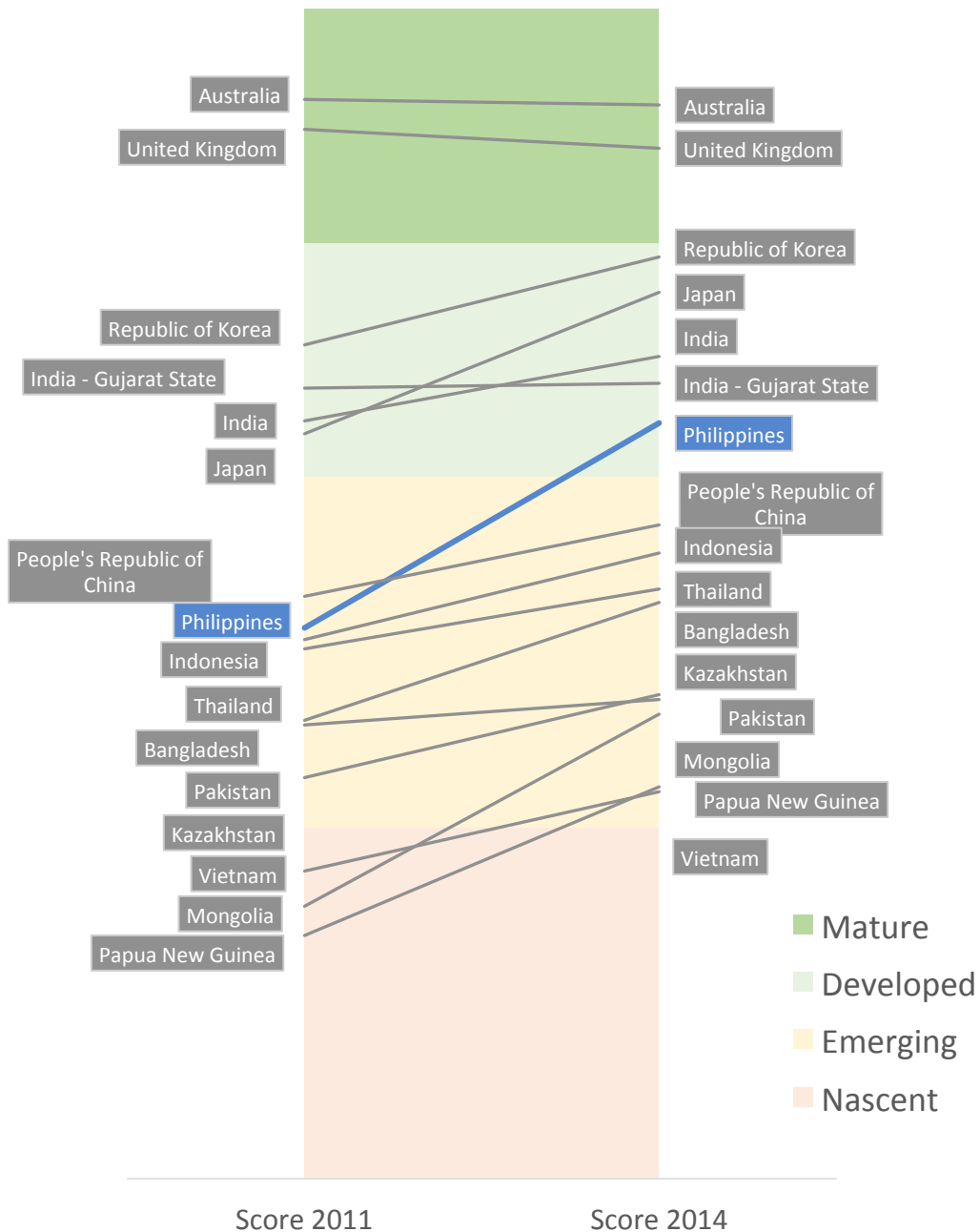
2014-15 – A PPP Program Widely Considered to be a Success

In April 2015, the Economist Intelligence Unit released its updated Asia Infrascopes, reassessing economies' PPP readiness and capacity as at December 2014. The Philippines'

score against the Infrascope index had improved dramatically since 2011. In 2014 it was rated as a “developed” PPP market, with a significantly higher degree of readiness and capacity than Indonesia and Thailand, which remained as “emerging” markets.

Figure 1 illustrates the dramatic improvement in the Philippines’ score against the Infrascope index in comparison to other economies.

Figure 1: Countries' scores against the Asia Infrascope index in 2011 and 2014 (Source: Economist Intelligence Unit)



The Economist Intelligence Unit’s assessment was reflected more broadly in widespread recognition of the improving climate for private investment in Philippine infrastructure. For example:

- In June 2014, the UK-based global publication Partnerships Bulletin named the PPP Center of the Philippines as the “Best Government PPP Promoter” for the year.
- In October 2014, the Director General of the Japan International Cooperation Agency’s Southeast Asia and Pacific Department stated that the “Philippines is known globally as having one of the best PPP policies”.
- In March 2015, leading global infrastructure information service IJ Global named the PPP Center of the Philippines as its “Asia-Pacific Grantor of the Year”.
- Also in March 2015, the President of the Asian Development Bank stated that “Today, PPPs are well-established in the Philippines”.
- In May 2015, the PPP Center was again a finalist for Partnerships Bulletin’s “Best Government PPP Promoter” award, and projects from the Philippines were also finalists in the “Best Education Project” and “Best Transit Project” categories.

Thus the Philippines managed, in just a few years, to convert a PPP program beset by problems into a program widely considered to be a success. Some issues and challenges remain, as evidenced by the announcements in November 2015 that the contractor for the Modernization of the Philippine Orthopedic Center project had purported to terminate the contract due to years of delays by the Department of Health and in December 2015 that only a single bidder has prequalified for the Road Transport Information Technology (IT) Infrastructure Project Phase II. Nevertheless, the significant improvement in the PPP program opens the prospect for other economies to learn from the initiatives undertaken in the Philippines. Section 3 of this report outlines the range of initiatives undertaken.

3 Initiatives undertaken to address issues in the Philippines' PPP program

The apparent dramatic development of the Philippines' PPP program from 2010-11 to 2014-15 was the result of numerous coordinated and interrelated initiatives undertaken by a variety of government bodies. Appendix 1 to this report sets out a number of the key initiatives, illustrating how they were progressively introduced over time. Appendix 2 identifies the relevance of the government's initiatives as responses to the issues that had been identified by ADB and the Economist Intelligence Unit.

The bodies responsible for implementing these initiatives included:

- The PPP Center
- The Office of the President
- The Ministry of Finance
- The Department of Budget Management
- The Central Bank of the Philippines.

The initiatives included:

- Changes to the PPP framework, governance and institutional arrangements
- Improvements in the availability of financial resources and the capacity of the human resources deployed in the PPP program
- The adoption of specific examples of international good practice.

It is clear that the initiatives undertaken to improve the Philippines' PPP program from 2010 onwards were directed at the specific issues that existed at that time. Other economies wishing to improve their PPP programs may face different issues, and therefore need to implement different interventions. Nevertheless, some key success factors relevant to other economies can be identified from the Philippines' experience. Section 4 of this report discusses those success factors.

4 Key Success Factors

A range of key success factors that can be identified in the Philippines' PPP program are set out below.

A comprehensive program of improvements and reforms was required (there is no silver bullet)

A notable feature of the reform of the PPP program is the large number of different improvements made. Reviews during 2010-11 such as the Asian Development Bank's fact-finding report and the Asia Infrascope identified numerous issues in a number of broad areas. Appendix 2 provides evidence of the large number of actions taken to address these issues. Appendix 1 illustrates how the reform activities were rolled out as part of a multi-year program.

The Philippines' experience demonstrates that there usually will not be a single "silver bullet" that alone will produce a successful PPP program, rather a broad effort across multiple aspects of the program will be required.

Getting the Framework right and continually improving it

Legal, policy and regulatory frameworks are foundation stones for a PPP program. Since 2010, the government of the Philippines has put in place numerous improvements to these frameworks. The range of improvements and their timing demonstrates a commitment to continual improvement of the frameworks. This reflects the experience even in mature PPP markets such as Australia, where governments continue to adjust their approaches to PPPs in light of changing circumstances.

It is notable that a balance has been struck in the Philippines between timely implementation of reforms to the PPP framework and institutionalisation of those reforms. Significant use has been made of Executive Orders and Policy Circulars to put in place elements of the framework in circumstances where attempting to legislate such reforms may significantly delay their implementation. Executive Orders and Policy Circulars are, however, at risk of being overturned upon a change in administration. The government has therefore sought to mitigate this risk by introducing legislation to institutionalise some of the reforms that have already been made by way of Executive Orders and Policy Circulars.

It is also evident that the Philippines has made extensive use of international good practice to guide the evolution of the PPP framework. Examples include:

- In addition to working with development partners such as the World Bank and ADB, the PPP Center has entered into Memoranda of Understanding with Infrastructure New South Wales (Australia) and Japan International Cooperation Agency to enhance knowledge transfer and capacity development.
- Draft policy briefs developed on a range of PPP framework issues have examined relevant practices in India, the European Union, and Australia, with some also drawing on practices in numerous other countries including Canada, Brazil, Colombia, Mexico, South Africa, Argentina, Chile, Costa Rica, Guam, Italy and Korea.
- A review of the Philippines' PPP Program has been conducted by the organization for Economic Cooperation and Development to determine key success points and lessons that can be learned.

- The Philippines is playing a leadership role in working with other regional economies for:
 - PPP knowledge sharing, and capacity building; and
 - Consolidation of resources, development partners' support, and country initiatives towards a regional PPP strategy.

The Philippines' experience demonstrates that getting the PPP framework right and continually improving it is a significant catalyst for a successful PPP program.

A Whole of Government Approach

Improvements in the Philippines' PPP program have not been the result of a single government agency acting alone. A whole of government approach has been taken. This is, perhaps, not surprising given the strong support that the current president has given to the PPP program (the media often refers to it as a "flagship" program of the President).

Through the Implementing Rules & Regulations under the Build Operate Transfer Act (the key legislation governing PPPs) and other measures, clear accountabilities and responsibilities have been allocated to different government agencies, and coordination mechanisms have been put in place.

The 2012 revision of the Implementing Rules & Regulations set in place standard processes and time lines to be followed by implementing agencies and local government units in identifying, prioritizing, approving, tendering and implementing projects. National government projects and large local government projects must be approved by the National Economic and Development Authority's Investment Coordination Committee or its Board, hence the prioritization and approval of projects occurs on a whole of government basis. The Implementing Rules & Regulations also require implementing agencies and local government units to report to the PPP Center upon meeting certain milestones, thus enabling the PPP Center to monitor the overall progress of the PPP program.

A range of subsidiary documents have been issued to embed the whole of government approach in respect of specific aspects of the PPP framework. For example:

- The PPP Governing Board has issued a Policy Circular that sets out roles and responsibilities for the appraisal of PPP projects. Key aspects of the appraisal are undertaken by a Technical Working Group, which includes representatives of the relevant central agencies (the National Economic and Development Authority Secretariat, the Department of Finance, the Department of Environment and Natural Resources, and the PPP Center). The Policy Circular sets out in detail the specific aspects of the appraisal that are to be undertaken by the implementing agency, those aspects that are to be undertaken by specific members of the Technical Working Group, and the aspects of the appraisal that are to be undertaken jointly by members of the Technical Working Group.
- Other PPP Governing Board Policy Circulars provide additional detail on the processes to be followed by implementing agencies in areas such as project identification, market sounding, and contract monitoring.
- The Department of Budget and Management has issued a National Budget Circular setting out the submission process for agencies to request funding from the Public-

Private Partnership Strategic Support Fund and a Project Development and Monitoring Facility (these funds are discussed below).

Although individual implementing agencies continue to manage their own projects, the whole of government approach ensures consistency of practice.

The Philippines' experience demonstrates that a whole of government approach enables government to implement a successful PPP program efficiently and effectively, and is valuable to give confidence to potential investors.

Appropriate Governance

The development of the Philippines' PPP program has included the establishment of strong governance mechanisms such as the PPP Governing Board, bringing together all of the key agencies involved within government, and the appropriate division of responsibilities between the implementing agencies, the PPP Center, the Ministry of Finance and the Department of Budget Management to ensure that appropriate checks and balances are in place. These actions have increased the likelihood that the different arms of government will work efficiently and effectively with one another to progress suitable projects in a timely manner while mitigating the risks to government.

The Philippines' experience demonstrates that appropriate governance is an important factor supporting a whole of government approach to PPPs, protecting government against the risks associated with the PPP program and enhancing private sector confidence in government decision-making.

Proper Resourcing

The identification, appraisal, structuring, tendering and ongoing management of PPP projects can be costly and requires appropriately skilled and capable staff in all of the relevant government agencies. The success of the Philippines' PPP program would not have been possible if the government did not have in place the appropriate financial resources, human resources, and assistance from its development partners.

Financial Resources

President Aquino's Executive Order No. 8 of 2010 provided for the establishment of a Public-Private Partnership Strategic Support Fund and a Project Development and Monitoring Facility.

The Strategic Support Fund is available to fund right-of-way acquisition and related costs (including resettlement), and costs associated with any government delivered components of a project. Having such funds available reduces the risk that a project is delayed or does not proceed because government is unable to meet the cost of acquiring the land or undertaking preparatory or interfacing works.

The Project Development and Monitoring Facility is available to fund project preparation, structuring, tendering and related advisory services. Having such funds available reduces the risk that the project fails because of deficient preparation, structuring or tendering processes.

The creation and use of these funds enabled the Government of the Philippines to overcome two key financial challenges faced by developing economies seeking to establish PPP

programs by ensuring that the activities undertaken by government in a PPP project are adequately funded.

In addition to funding the activities undertaken by government in a PPP project, the government must also fund any payments that it will be required to make under the PPP contract. In the case of government-pays projects (in which the private sector's revenue comes from the government rather than users), the private sector appears content to rely upon the Philippine's investment grade credit rating to give assurance that the agreed payments will be made. However two other categories of payments must also be considered:

1. Some user-pays projects, although economically viable (that is, having a benefit-cost ratio greater than one and hence being of value to society), are not financially attractive to the private sector. In these projects, some form of financial support from the government may be necessary to make the project financially attractive and hence attract a competitive bidding field. This is often referred to as Viability Gap Funding.
2. In both government-pays and user-pays projects, certain risks are allocated to government. The allocation of these risks to government creates contingent liabilities. If the risk eventuates, the government must make a payment to the private sector, however the government may not have the necessary cash on hand or budget appropriation to make the payment. The need to raise cash and obtain a budget appropriation can be a significant concern to the private sector, as it may delay payment by many months or even more than a year.

The initiatives to improve the Philippines PPP program have included actions to provide for both of these categories of payments.

The Philippines' PPP Governing Board has issued a Policy Circular which specifies that Viability Gap Funding can be made available for solicited concession-based PPP projects (that is, projects in which the private sector charges the public user fees) which are economically viable but are not financially attractive. The Viability Gap Funding takes the form of a cash subsidy made available by government to the SPV. There is no separate fund created for these payments. The key benefit of the Policy Circular is that it provides a clear and consistent basis for the provision of Viability Gap Funding.

The Government of the Philippines has also created a contingent liability fund, and is in the process of operationalizing this fund. Such a fund provides government with a pool of liquidity to assure investors and lenders that the government will be able to meet its payment obligations in respect of any contingent liabilities that materialize, without the payment being delayed by ordinary government budget or cash management processes.

Human Resources

The skills and capabilities required to manage a successful PPP program differ from the skills and capabilities commonly found within government. For example, research that examined central PPP units in four APEC economies concluded that the most essential professional skills in such a unit are relevant legal skills and project finance skills.

A notable feature of the Philippine PPP Center has been its ability to recruit senior personnel (including the Executive Director) with significant relevant private sector experience. The Center has also been able increase its number of staff as its workload has grown.

Comparative research suggests that the Center is less reliant than other regional PPP units on external resources such as consultants.

A different situation exists in implementing agencies. In common with many other developing economies (and in contrast to some developed economies), public sector employment arrangements in the Philippines are not well suited to resourcing of PPP project teams in implementing agencies. Often project-specific roles cannot be created, and government's internal project team consists of a small number of public sector employees who have other ongoing duties that they retain while working on the PPP project. Hence the public sector employees involved can only devote part of their time to the PPP project, and heavy reliance is placed on external transaction advisors (often a commercial or engineering consultancy) during project procurement.

Appointment of external transaction advisers can solve some of the challenges of structuring and resourcing PPP project teams. However, a PPP project can give rise to a myriad of policy and social issues for government throughout the procurement process. While a typical external transaction adviser such as a commercial or engineering consultancy may be able to advise on these, or coordinate input from other consultants, such a transaction adviser may have limited capability to manage policy and social issues. In its North-South Railway – South Line project, the Philippines' Department of Transport and Communications has jointly appointed the Asian Development Bank and the Development Bank of the Philippines as its transaction advisers. In this role, the Asian Development Bank can apply its extensive experience of social safeguards to provide advice better aligned to the specific needs of the project than that available from a typical external transaction adviser. This provides an example of the government seeking to appropriately match the human resources to the needs of the project.

The use of the English language in the Philippines may also have been a factor that has enhanced the ability of government personnel to gain knowledge from the leading PPP jurisdictions (such as Australia and Canada) and multilateral institutions that have assisted the government of the Philippines reform its PPP program.

Development Partners

It is also notable that the Government of the Philippines has had significant assistance from a range of development partners in improving its PPP program. The contribution from these partners has been both financial and in the form of technical expertise.

The Philippines' experience demonstrates that the development of a successful PPP program relies heavily on the government's ability to make available the financial and human resources required.

Engagement with the Private Sector

Concerns about transparency, fairness and corruption lead some governments to refrain from engaging with the private sector outside of formal tender processes. While this approach may mitigate some risks, it amplifies the risks that government and the private sector do not understand one another's needs and objectives. This can lead to misalignment and project failure. Experience in mature PPP markets indicates that the greater the depth of engagement between the public and private sectors during the development and tendering of PPP projects, the more likely the project is to deliver the desired outcomes, provided the risks to transparency and fairness are appropriately managed.

The Government of the Philippines has pursued significant engagement with the private sector while also putting in place controls to ensure transparency and fairness and prevent corruption. These forms of engagement have included market soundings in relation to potential projects, one-on-one meetings with prequalified bidders, and the provision of project information through virtual data rooms.

Although it is not uncommon for a losing bidder to challenge the outcome of a tender process in the Philippines, experience to date suggests that the various forms of private sector engagement undertaken have not, in themselves, compromised the outcome of tender processes. The Philippines has also introduced the appointment of a probity adviser for large and complex projects to help ensure that the tender process is impartial and fair to all bidders. This is a role seen in various forms in mature PPP markets in developed countries such as Australia and Canada, but is not a role commonly seen in developing countries.

The Philippines' experience demonstrates that governments can benefit from close engagement with the private sector during the development and tendering of PPP projects, provided transparency and fairness are protected.

Communications

The Philippines' PPP program has been accompanied by an extensive communications strategy. The PPP Center maintains a website containing a wide range of information, including relevant policy documentation and details of existing projects and the future project pipeline. A number of international "roadshows" have been conducted to provide information to potential project investors. PPP Center representatives are regular speakers at a wide variety of international PPP events, and the PPP Center has an active social media presence that provides informative and timely updates on developments in the PPP program.

The Philippines' experience demonstrates that a comprehensive and well-structured communications strategy can play a valuable role in educating a wide range of stakeholders about the program, dispelling myths, and building confidence in the program.

5 Conclusions

Since 2010, the Government of the Philippines has made significant progress in improving its PPP program. The key lessons from this progress that can be applied in other economies are as follows:

- There usually will not be a single "silver bullet" that alone will produce a successful PPP program, rather a broad effort across multiple aspects of the program will be required.
- Ensuring that the PPP framework is robust and continually improving it are significant catalysts for a successful PPP program. In this respect:
 - A whole of government approach is necessary to implement a successful PPP program and is valuable to give confidence to potential investors.
 - Appropriate governance is an important factor supporting a whole of government approach to PPPs, protecting government against the risks associated with the PPP program and enhancing private sector confidence in government decision-making.
 - Developing economies should consider introducing practices from developed economies where these will enhance the success of the PPP program. For example, the Philippines has introduced the appointment of a probity adviser for large and complex projects to help ensure that the tender process is impartial and fair to all bidders. This is a role seen in various forms in mature PPP markets in developed countries such as Australia and Canada, but is not a role commonly seen in developing countries
- Development of a successful PPP program relies heavily on the government's ability to make available the financial and human resources required to properly identify, appraise, structure, tender, manage and monitor PPPs.
- Governments can benefit from close engagement with the private sector during the development and tendering of PPP projects, provided transparency and fairness are protected.
- A comprehensive and well-structured communications strategy can play a valuable role in educating a wide range of stakeholders about the program, dispelling myths, and building confidence in the program.

Some issues and challenges remain. The ADB and the Economist Intelligence Unit have identified a range of areas for further improvement, and it is notable that improvements in the financing environment for PPPs and the associated financial markets frameworks have lagged behind the improvements in the PPP framework (see Box 1 on the following page for a discussion of potential constraints on the financing of PPPs). The Government of the Philippines will need to maintain momentum and make further improvements if it is to effectively and efficiently meet its infrastructure needs. Nevertheless, the Philippines' experience provides a clear illustration of the comprehensive approach required to implement a successful PPP program.

Box 1: Potential constraints on the financing of PPPs in the Philippines

At the conclusion of the tender process for a PPP project, the winning bidder (which is often a consortium of companies) usually incorporates a new company, known as a special purpose vehicle or SPV, to enter into the PPP contract and undertake the project. In order to meet the capital costs of the project, the SPV raises capital in the form of equity and debt.

In the Philippines, consistent with the common practice in developing countries, the SPV's equity is usually provided by the companies that will construct and operate the infrastructure (or their related companies), and the debt finance is generally provided by domestic banks.

Potential Constraints on Equity Finance

The provision of equity by the companies that will construct and operate the infrastructure (or their related companies) is a logical approach to financing a PPP project and ensures that these companies have an interest in the success of the project beyond the margin they receive under their construction and operating contracts. However reliance upon these companies providing equity can also have some downsides, in particular:

- Equity investors can face conflicts of interest if they are also responsible for constructing or operating the infrastructure – for example, if construction is progressing badly due to poor construction management, the equity investors may seek to renegotiate the PPP contract with the government, rather than trying to resolve the construction management issues or replace the construction contractor. In these circumstances, there are benefits if some or all of the equity is provided by financial investors who are not involved in construction or operations and have no other interest in the project. Such investors are less common in developing countries, however an example exists in the Philippines in the form of the Philippine Investment Alliance for Infrastructure, which was a member of the winning consortium for the P65-billion Light Rail Transit line 1 Cavite Extension and Operations & Maintenance Project.
- At some point in the future, the capacity of some local infrastructure constructors and operators to provide equity for PPP projects may be exhausted, as has occurred in India. If this occurs in the Philippines, it will be necessary for infrastructure constructors and operators wishing to bid for new projects to either divest their equity in existing projects, thus freeing up funds, or to team up with financial investors as an alternative provider of equity for new projects. The PPP Center has been working with the Securities Exchange Commission and the Philippine Stock Exchange on a proposed framework that will allow companies engaged in PPPs to raise funds through equity and bond issuances. If successfully implemented, this reform could allow infrastructure constructors and operators to divest their equity by listing it on the stock exchange.

Equity investment can also be affected by foreign ownership restrictions. Many PPPs are considered utilities, and the Philippine constitution mandates that these projects must be 60% Philippine owned. To date, interest from local investors has ensured that this requirement is met. The Mactan-Cebu International Airport project provides an illustration of the private sector working within this constraint: In this project, GMR Infrastructure (an India-based airport operator) is contributing 40% of the equity and Megawide Construction Corporation (a Philippines company) is contributing 60% of the equity. Nevertheless, this foreign ownership restriction may be a disincentive for some foreign investors seeking to enter the Philippine PPP market, and may prevent local equity investors divesting their equity if there are no domestic buyers.

There is no single “right” kind of equity investor. However a broader range of equity investors results in stronger competition for investment opportunities and hence improved value for money for the government and society. The involvement of the Philippine Investment Alliance for Infrastructure as an investor and the proposal to facilitate fund raising on the Philippine Stock Exchange are evidence of a broadening in the field of potential equity investors. As the PPP program further develops in the Philippines, the need for such alternative sources of equity investment is likely to increase.

Potential Constraints on Debt Finance

The provision of debt finance by domestic banks is a logical approach to financing a PPP project in a developing country. As such projects typically generate revenues in local currency, the SPV will seek to also have its debt denominated in local currency. Foreign lenders can be unwilling to bear the consequent exchange rate risk.

Reliance on domestic banks to finance PPPs has not yet been a significant problem in the Philippines, as these banks have strong liquidity positions and long-term relationships with the local construction and operating companies that bid for the projects. The well-structured risk allocation in a PPP project results in significant differences between lending for a PPP project and lending for other purposes, hence for PPP projects the Philippines' central bank has relaxed the single borrower limits that would otherwise apply as part of the prudential framework for the banking sector.

As the PPP program has matured, techniques such as syndicated loans have emerged to enable multiple banks to participate in the financing of individual projects.

Nevertheless, some lending constraints are beginning to affect PPPs in the Philippines. In particular, challenges are emerging in projects where the private sector is offered commercial development opportunities associated with the project and the return from the commercial development is expected to offset part of the cost of the project to the government or users. An example is the Laguna Lakeshore Expressway-Dike Project, in which the private partner will finance, design, construct, operate, and maintain a flood control dike with a toll road on top, and will also reclaim and develop neighboring land. There are indications that some domestic banks are reaching the limits of their capacity to lend for such commercial development. One means of avoiding this constraint would be to encourage foreign banks to enter the market, however the parties would need the means to manage or mitigate exchange rate risks.

A further constraint is the inability of domestic banks to provide longer term loans that can be repaid over the full life of the PPP contract. This is a common issue in many countries, including some with mature PPP programs and deep financial markets such as Australia, and generally reflects the need for banks to match the maturity of loans to the terms of their own sources of funding (that is, the banks need to avoid mismatches between their assets and their liabilities). A variety of solutions are available to reduce the impact of this constraint upon PPP projects. For example, in the Mactan-Cebu International Airport project, the Asian Development Bank participated in the financing, and this enabled the creation of a longer term debt financing package that could not have been provided by domestic banks alone.

In some PPP markets, SPVs can also raise debt finance by issuing bonds to investors rather than taking out bank loans. This is most common in economies with deep institutional investment markets, although in some cases bonds are also sold to retail investors. To date, no PPP project in the Philippines has raised finance by issuing bonds to institutional or retail investors, however, to finance the PPP in School Infrastructure project, the Citicore-Megawide consortium issued corporate loan notes (a form of bond) to a group of Philippine banks. During 2015, the government held discussions with the Securities and Exchange Commission, the Philippine Stock Exchange, and other stakeholders on measures to encourage the issuance of project bonds in the Philippines.

The role of Viability Gap Funding

The Philippines' PPP Governing Board has issued a Policy Circular which specifies that Viability Gap Funding can be made available for solicited concession-based PPP projects (that is, projects in which the private sector charges the public user fees) which are economically viable but are not financially attractive. The Viability Gap Funding takes the form of a cash subsidy made available by government to the SPV. (Unlike some other economies, the Philippines has chosen not to provide Viability Gap Funding in the form of government equity or concessional loans.)

If the financial attractiveness of a project is compromised due to constraints on debt or equity finance, Viability Gap Funding may provide a means of avoiding the constraint. For example, if a project is not commercially attractive because the expected user fees will be insufficient to repay debt within the maximum term available from banks, Viability Gap Funding paid as a subsidy in addition to the user fees may provide sufficient revenue to enable repayment of the debt within the term available from the banks, and thus enable the successful financing of the project.

Appendix 1 – Key initiatives in the development of the Philippines' PPP Program

The following table sets out some of the key initiatives in the development of the Philippines' PPP program. It aims to illustrate the wide range of initiatives undertaken, and is not intended to be a comprehensive list.

Year	Initiative
1990	<ul style="list-style-type: none"> Build-Operate-and-Transfer (BOT) Law Enacted
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.	.
1993	<ul style="list-style-type: none"> Build-Operate-and-Transfer (BOT) Law Amended
.	.
.	.
2010	<ul style="list-style-type: none"> Executive Order No. 8 entitled “Reorganizing and Renaming the Build-Operate-and-Transfer (BOT) Center to the Public-Private Partnership (PPP) Center of the Philippines and Transferring its Attachment from the Department of Trade and Industry to the National Economic and Development Authority and for Other Purposes.” issued. Initial funding allocated to the Project Development and Monitoring Facility (PDMF). PPP Center’s inaugural executive director appointed, with a private sector background in project management and finance. International PPP Investment Conference in Manila used by government to demonstrate its top-level political commitment to foster PPPs and present a substantial number of prospective projects.
2011	<ul style="list-style-type: none"> PPP Center’s deputy executive director appointed, with a private sector background in banking and consulting. First phase of the PPP Capacity Building Program for implementing agencies. PPP Center’s deputy executive director promoted to executive director. PDMF launched. Initial projects approved for PDMF support. First PDMF-funded consulting contract was signed.
2012	<ul style="list-style-type: none"> National Budget Circular entitled “Guidelines in the Submission of Agency Budgetary Proposals to be funded from Public-Private Partnership Strategic Support Fund (PPPSSF) and Project Development and Monitoring Facility (PDMF)” issued.

- Executive Order No. 78 issued to promote the use of Alternative Dispute Resolution mechanisms in PPP contracts.
- Final Draft: Review of the PPP Institutional Set-Up issued.
- Post Consultation Draft Policy Briefs issued on:
 - Selection and Prioritisation of PPP Projects
 - Unsolicited Proposals.
- 2012 Revision of the BOT Law Implementing Rules and Regulations published.
- PPP Program Booklet published.

2013

- Bangko Sentral ng Pilipinas Circular No. 779 entitled "Amendment to Regulations on Single Borrower's Limit" issued
- Post Consultation Draft Policy Briefs issued on:
 - Contract Management
 - Monitoring and Evaluation
 - Government Share of PPP Project Costs and Risks
 - Dispute Resolution.
- Executive Order No. 136 created the PPP Governing Board.

2014

- PPP Code for Local Government Units drafted.

2015

- Policy Circulars issued by the PPP Governing Board on the following topics:
 - Guidelines and Procedures for the Appraisal of PPP Projects
 - Pipeline Development
 - PPP Best Practices
 - Viability Gap Funding
 - Appointment of Probity Advisers
 - Termination Payments
 - PPP Monitoring Framework and Monitoring Protocols.
- The PPP Center and World Bank launched PPP knowledge toolkits for local government units and water districts pursuing PPPs in the water and sanitation sectors.
- A new PPP Law was submitted to Congress to institutionalize many of the reforms of recent years.

Appendix 2 – Deficiencies in the Philippines' PPP Program in 2011, the government's responses, and the outcomes

Deficiency (in 2011)	Response	Outcome
Weak governance		
Governance of the PPP Program was seen as weak.	<p>A review of institutional arrangements was conducted and released in September 2012.</p> <p>The PPP Governing Board (an overall policy making body) was established in 2013. The members of the PPP Governing Board include the Secretaries of Socio-Economic Planning, Finance, Budget and Management, Justice, and Trade and Industry, as well as the Private Sector Co-Chairman of the National Competitiveness Council. The PPP Center now reports to the Board.</p> <p>For large projects, a practice has been introduced of appointing probity advisors to provide assurance of the fairness and transparency of tender processes.</p>	Governance has been strengthened. There appears to be significant coordination between the PPP Center, Implementing Agencies, the National Economic and Development Authority, and the Ministry of Finance.
Unsolicited proposals were common	<p>Improved governance has led to improved decision making as to which projects should be priorities for government. Draft Policy Briefs on Selection and Prioritization of PPP Projects and on Unsolicited Proposals were issued in September 2012.</p> <p>A significant project pipeline has been identified by government and is widely publicized.</p> <p>Under the Revised Implementing Rules and Regulations for the BOT Law, unsolicited proposals are subject to a competitive process through the "Swiss challenge" method.</p>	Unsolicited proposals are now the exception and are subject to an appropriate governance framework.
Inadequate Policy, Legal and Regulatory Frameworks		
Frameworks were unclear	The Implementing Rules and Regulations were updated in 2012. A range of subsidiary instruments have been issued to	The Framework has been clarified. Some further amendments to the Framework are likely to be

Deficiency (in 2011)	Response	Outcome
	clarify specific aspects of the Framework. Amendments to the BOT Law are currently passing through Congress (as at 4 February 2016).	required to resolve remaining issues.
Frameworks were not consistently applied	Improved governance, increased capability in the PPP Center and in implementing agencies, and clear political leadership have all been put in place.	There appears to be significantly greater consistency in the application of the relevant frameworks.
Projects were not competitively tendered	Improved governance has led to projects being competitively tendered in accordance with the Framework. Under the Revised Implementing Rules and Regulations for the BOT Law, unsolicited proposals are subject to a competitive process through the "Swiss challenge" method.	Almost all projects are competitively tendered.
Government was unwilling or unable to carry out its contractual commitments	The PPP Center has issue a draft policy brief on PPP Contract Management containing proposals to formalize a policy for the management, monitoring, evaluation and administration of PPPs, post tender to project termination. An Executive Order has established rules on arbitration and dispute resolution. A contingent liability fund is being established.	Significant progress has been made to improve the willingness and ability of government to carry out its contractual commitments. Some issues and challenges remain, as evidenced by the contractor for the Modernization of the Philippine Orthopedic Center project purporting to terminate the contract due to delays by the Department of Health. Further strengthening of management systems for, and funding of, PPP contingent liabilities is required.
Right of Way acquisition processes and government budgets for land acquisition were inadequate	The Strategic Support Fund was established.	The Strategic Support Fund ensures that there is a pool of funds available for land acquisition. Further work is required for implementing agencies to improve their systems of assessing and budgeting for right-of-way acquisition and resettlement
Government was unable to grant automatic franchises	The grant of a franchise is now provided for in the BOT Law's revised Implementing Rules and Regulations.	The revised Implementing Rules and Regulations resolve the problem for the time being, but need to be institutionalized through legislation.
There was no viability gap funding	The BOT Law's revised Implementing Rules and Regulations	Viability gap funding has been institutionalized,

Deficiency (in 2011)	Response	Outcome
scheme in place	allow for viability gap funding. A policy circular on viability gap funding was issued in March 2015.	although future budget appropriations must be secured.
There was no credible guarantee mechanism. This was a significant concern, given the level of political opposition.	<p>A contingent liability fund has been established. A methodology for valuing PPP projects' contingent liabilities has been developed and a process for monitoring contingent liabilities has been established.</p> <p>Fiscal oversight has been moved from the PPP Center to the Ministry of Finance.</p> <p>Policy documents on government's share of PPP project costs and risks, and viability gap funding have been issued.</p>	There are now clearer mechanisms for government to take on PPP related liabilities. Ongoing work is required to ensure that contingent liabilities are appropriately monitored and funded.
Dispute resolution was weak	An Executive Order has established rules on arbitration and dispute resolution. This has been supplemented by a policy statement.	The new rules provide transparent and fair processes. Nevertheless, the Economist Intelligence Unit has found that these are slow.
There was no compensation framework	<p>Guidelines have been issued on termination payments, and guidelines on material adverse government action have been drafted.</p> <p>A contingent liability fund is being established.</p> <p>Fiscal oversight has been moved from the PPP Center to the Ministry of Finance.</p>	Key components of a compensation framework are now in place. Further strengthening of management systems for, and funding of, PPP contingent liabilities is required.
Insufficient Institutional Arrangements and Insufficient Institutional Capacity		
The PPP Center lacked technical capacity	<p>The PPP Center has grown significantly. An Executive Director with extensive private sector finance experience was appointed. The Center also recruited a significant number of professional staff, some with relevant private sector experience.</p> <p>The PDMF and donor support have been used to complement the PPP Center's internal capacity with external support.</p>	The technical capacity of the PPP Center has improved significantly. Some further strengthening is required elsewhere within government (for example, in implementing agencies and local government units).

Deficiency (in 2011)	Response	Outcome
The PPP Center lacked authority	Revisions to the PPP Framework and governance strengthened the PPP Center's authority, as did strong political support for the PPP program.	In October 2015, ADB described the PPP Center as "empowered".
The delineation of responsibilities between the PPP Center and the National Economic and Development Authority's BOT Group were unclear	Revisions to the PPP Framework and governance clarified institutional responsibilities. Policy statements (for example, the Guidelines and Procedures for the Appraisal of PPP Projects) have provided further clarity.	Responsibilities of the different institutions have been clarified.
Government lacked the Systems and Capacity to Prepare Bankable Projects		
Implementing agencies had insufficient project preparation capacity	The PPP Center initiated a range of activities to build project preparation capacity in implementing agencies, including: <ul style="list-style-type: none"> Developing a PPP Manual and Capacity Building Program Providing training and technical assistance for local government units. 	The capacity of implementing agencies to prepare projects has been improved, as evidenced by the number of projects proceeding to successful procurement.
Implementing agencies lacked the resources necessary to obtain expert advice	The PDMF was established and provides a source of funds to enable implementing agencies to obtain expert advice.	The government now has an effective revolving source of funds to meet the cost of preparing bankable projects (the fund also has other uses).
The existing Project Development Fund was non-operational	The Project Development Fund was replaced with the PDMF.	The government now has an effective revolving source of funds to meet the cost of preparing bankable projects (the fund also has other uses).
Financing Projects was Difficult		
Banks were reluctant to provide long term loans	Bangko Sentral ng Pilipinas Circular No. 779: Amendment to Regulations on Single Borrower's Limit was issued to amend regulatory limits affecting loans for PPP projects. A number of projects of various sizes have been successfully financed, however, in the case of the Mactan-Cebu	Availability of finance has improved, but there is still some reliance on multi-lateral development banks. Some lending constraints may be emerging in projects where the private sector is offered commercial development opportunities associated with the project.

Deficiency (in 2011)	Response	Outcome
	<p>International Airport, long-tenor debt from ADB played a crucial role in ensuring the viability of the project</p>	
<p>Consortium lending was uncommon</p>	<p>There is little scope for regulatory intervention in respect of this issue. However the banking market has responded to the growth of the PPP program and consortium lending is no longer uncommon.</p> <p>Mactan-Cebu International Airport was financed by a consortium of six Philippine Banks and the Asian Development Bank.</p> <p>A syndicated loan from multiple banks was also negotiated for the Modernization of the Philippine Orthopedic Center project, however that project has not proceeded.</p> <p>To finance the PPP in School Infrastructure project, the Citicore-Megawide consortium issued corporate loan notes to a group of Philippine banks.</p>	<p>There is a developing market for consortium lending.</p>
<p>Non-bank finance markets were weak and under-developed – the corporate debt market was small, equity investors were not active, and pension funds and insurance companies were small and unwilling to invest</p>	<p>The government is supporting reforms in these areas, including:</p> <ul style="list-style-type: none"> • The PPP Center has been working with the Securities Exchange Commission and the Philippine Stock Exchange on a proposed framework that will allow companies engaged in PPPs to raise funds through equity and bond issuances. • The Government Service Insurance System, the largest pension fund in the Philippines, was a founding investor in the US\$625 Philippine Investment Alliance for Infrastructure, the first infrastructure fund dedicated to the Philippines. 	<p>Some progress is being made in opening up non-bank finance markets, however the banking market still dominates.</p> <p>The majority of the Philippine Investment Alliance for Infrastructure's investments have been in the energy sector. However it was a member of the winning consortium for the P65-billion Light Rail Transit line 1 Cavite Extension and Operations & Maintenance Project, demonstrating the scope for such funds to support new PPP projects.</p>

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