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**OVERVIEW OF THE PHILIPPINES' PPP FRAMEWORK AND PROGRAMME**

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## **OVERVIEW OF THE PHILIPPINES' PPP FRAMEWORK AND PROGRAMME<sup>1</sup>**

### **1. Introduction**

The Philippines' Public-Private Partnership (PPP) programme is rightly seen as a success. Indeed, the way in which this has been accomplished by the Philippine authorities is already being copied far beyond its shores. This overview seeks to identify the key dimensions of the PPP programme and discuss issues around the Programme as it moves through the next stages. This overview is a summary of a separate report by the OECD commissioned by the Philippine Government and supported by the Government of Australia. The main mission took place 4-14 April 2015. The views expressed in this report can solely be attributed to the OECD.

#### **1.1 The infrastructure gap**

PPPs can be an important instrument for national development. Any assessment of a particular country's PPP arrangements must however be in reference to the specific development goals which motivate the choice of this instrument, and take into account how well the local institutional environment does or does not enable PPPs to achieve their declared purpose. For the Philippines the current drive to promote PPPs reflects the Philippines' determination to "close the infrastructure gap". This gap can be seen as the infrastructure not meeting the needs of the country's fast-growing economy and in its relative low performance in infrastructure competitiveness according to the World Economic Forum. According to the WEF Global Competitiveness Report (2013-2014), the country's infrastructure competitiveness ranking stands at 98th place out of 148 countries surveyed. It lags behind Malaysia (25th), Indonesia (82nd), and Thailand (61st). The Philippines have a strong catch up potential vis-à-vis its neighbour countries in south-east Asia, with a GDP per capita (at USD 2 790 per capita) lower than Thailand (USD 5 674), *Malaysia (USD 10 549)* or Indonesia (USD 3 509).

The Philippine government knows that national development is constrained by inadequate infrastructure and is addressing the issue. Infrastructure outlay grew from PHP 306.9 billion in 2013 to PHP 562.3 billion in 2015. In 2010 a new emphasis was placed on PPPs as a key component of an overall growth strategy. Executive Order No. 8 (2010) revitalised the programme and placed the PPP Center at the heart of this initiative. The focus of the PPP programme thus far has been on transportation infrastructure, with projects to build, upgrade and or operate toll roads, transit lines and airports being prominent. This type of infrastructure is a key factor in growth and economic development.

A review of the projects thus far awarded, indicates that the market is dominated by a handful of local corporate groups including San Miguel, Ayala, Megawide and Metro Pacific. These large local conglomerates are well entrenched in the Philippine economy and may be more comfortable making the large investments required than foreign investors due to their superior knowledge of the local context.

#### **1.2 The pipeline and its perspective**

The changes made in 2010 and the impetus shown by the Philippines in promoting private investment in infrastructure has resulted in the award of nine projects (total investment of

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<sup>1</sup> All data as of November 2015

USD 2.9 billion) and helped increase the project pipe-line from 11 projects (USD 3.3 billion) in November 2010 to 46 projects (USD 21.6 billion) in 2015.

International experience has shown that the initial stages of a PPP programme are the most difficult as government must acquire new and complex skills and investors must become comfortable with the PPP framework and investment climate. The Philippines is to be commended and lauded for its efforts.

However, success cannot be assumed from projects being rolled out or the signing of contracts. The signing of the project or concession agreement is a significant milestone but in many ways marks the end of the initial stages of a project with much hard work on implementation and project management remaining ahead. The programme can only truly be deemed a success if the service provided is of high quality and is provided on a basis that creates value for money for the government and ultimately its citizens.

The question going forward therefore centres on how to maintain the notable momentum while ensuring that those contracts signed are successfully implemented and ensuring that new PPP projects contribute to overall welfare and represent value for money (VfM) relative to other forms of infrastructure procurement. As the programme develops it will become increasingly important that projects are affordable for users and/or the government budget and that the fiscal risks stemming from the projects are prudently managed.

The Philippine authorities are aware that implementation and the capacity of Implementing Authorities (IAs) is an issue that needs attention. To this end, the PPP Center is strengthening the project implementation capabilities of the IAs, as well as its PPP contractual compliance tracking and monitoring efforts.

### **1.3 Financing PPPs**

The Philippine PPP market is dominated by a handful of large local conglomerates. While all stakeholders consulted agreed that there was robust competition for projects, as illustrated by the fact that subsidies available to bidders have not been taken up and instead premiums have been provided, the domination by a small number of powerful local firms could be perceived as a damper on competition, especially by foreign bidders.

Those PPP transactions entered since 2010 have been financed by local capital. There are advantages to this including the avoidance of currency exchange and foreign exchange risk issues. There is also a view that there remains sufficient liquidity and capacity in the local financial sector to continue to fund projects in the pipeline. If the programme continues to grow it is likely that at some point in the medium-term, international lenders will be required to provide financing. There are already suggestions that some Philippine banks are pushing up against borrowing limits with regard to the main PPP protagonists.

If the need comes to look to private international lenders, they will expect contractual terms and language that meets international bankability standards including around issues such as compensation upon termination. It is not clear that the contracts currently in place meet these standards.

It is worth noting that the PPP Center brings in internationally experienced PPP transaction advisers through the Project Development and Monitoring Facility (PDMF) to facilitate international bankability inputs at critical project structuring stages. In addition, the PPP Center is working with the Securities and Exchange Commission (SEC) on policy and process enhancements to facilitate entry and participation of international institutional investors and pension funds in financing these PPP Projects.

#### **1.4 Foreign ownership restrictions**

The constitutional requirement that at least 60% of a project proponent be owned by Filipinos is often cited as a significant barrier to foreign participation in the Philippines' PPP programme. Foreign participation is not an end in and of itself, but is rather one element whereby robust competition, and therefore value for money is ensured. Foreign participation as a project proponent is also a catalyst of foreign investment. The reality that this ownership requirement is part of the economic provisions of the Philippine constitution makes it difficult to amend and clearly beyond the mandate of the authorities responsible for PPP issues.

## **2. The Project Development and Monitoring Facility (PDMF)**

The PDMF is a key component of the successful Philippine programme and is explained in more detail in this section. One of the major stumbling blocks impeding infrastructure investment in the Philippines, and in particular PPPs, is the considerable cost and time needed to properly prepare projects. Project preparation is a complicated undertaking: it requires multidisciplinary skills (legal, financial, technical, social, economic, environmental) and encompasses several activities and phases. In the context of developing economies, such costs may prove prohibitive for national budgets, hence the need for donor support. In response to this the PDMF was set up in 2010.

The PDMF is a revolving fund with initial funding from the Government of the Philippines and the Government of Australia through the Asian Development Bank (ADB). The general objective of the PDMF is to provide a facility to fund and facilitate pre-investment activities of potential PPP projects and develop a robust pipeline of viable PPP projects. More specifically, the PDMF may be used for: (a) preparation of project pre-feasibility and feasibility studies; (b) project structuring; (c) preparation of bid documents & draft contracts; (d) transaction advisory and (e) assistance in the tendering process, including bid evaluation and award of the PPP contract.

Only projects included in the government's list of priority infrastructure programmes are eligible for PDMF assistance. In order to use the PDMF, IAs contact the PPP Center to request PDMF support. The PPP Center evaluates the request on the basis of the ability of the IA and the nature of the project. The PPP Center then submits the request for approval to the PDMF Board. Upon PDMF Board approval, the IA and the PPP Center enter into a Technical Assistance Agreement (TAA) that sets out the terms of the collaboration between the IA and the PPP Center. This is the basis for the hiring of transaction advisors that will work with the IA and PPP Center on the project. The PPP Center manages the contracts and financing of the technical advisors.

Advisors are recruited and retained for three years in a non-committal basis through an Indefinite Delivery Contract (IDC) to provide transaction advisory services for the development and bidding of bankable PPP projects. Currently 22 consulting consortia are part of a panel that may receive a request for proposals from the PPP Center. The consultant is paid on the basis of a lump-sum rather than on the basis of the actual number of person/hours spent on the assignment. As a consequence, the consultant has to estimate how many person/days he/she will have to allocate to the task. The output of the work of the transaction advisors serves two distinct purposes: (a) it contributes an analytical basis to the "internal" process that leads to the consideration of the project by The Philippine National and Economic Development Authority or NEDA-Board/Investment Coordination Committee (ICC); and (b) prepares and documents the deal structure that will be put to tender. The competencies of the transaction advisors bring credibility to the projects in terms of good project preparation.

Adjustments to the contract are usually asked for by the transaction advisors due to change of scope and extension of the timetable. Adjustment is allowed upon endorsement by the IAs. The transaction advisors on average work 2-2.5 years on each project. The government is perceived to be a demanding client. Since the inception of the PDMF, it has supported 68% of the PPP projects in the pipeline. The remaining 32% were funded from other sources, such as the World Bank, International Finance Corporation, Japan International Cooperation Agency, etc. Also, not all applications

submitted for PDMF support were approved and only about 60% were granted.<sup>2</sup> As of 21 April 2015, a total of USD 57 million have been committed by the PDMF for project preparation and/or tender.

Ultimately, the project development cost will be recovered by the PDMF from the successful bidder upon successful completion of the bidding process, plus an administrative fee of 10%. The reimbursement of the project development costs will be a condition for contract award to the private sector concessionaire. The 10% administrative fee will be used to ensure the sustainability of the revolving fund. Not all projects supported by PDMF were reimbursed by a winning bidder. In some cases project costs were refunded by the IAs due to the decision not to pursue a PPP tender or due to a failed bidding process.

### **3. Ensuring value for money: Processes for planning, procurement, and monitoring**

#### ***3.1 What is value for money in infrastructure in general and for the Philippines?***

An established definition of value for money is what governments judge to be an optimal combination of quantity, quality, features and price (i.e. cost) expected over the whole of a project's lifetime. It thus covers both quantitative and more qualitative aspects.

Value for money can also be defined as relative and absolute value for money. Relative value for money is a question of which procurement methodology is the more efficient from a field of options. Absolute value for money is when the intervention overall represents a net benefit for society as reflected in a traditional cost/benefit analysis (i.e. whether the asset should be built at all). Both the relative and absolute approaches to value for money are relevant for the Philippine PPP programme.

Given the Philippine infrastructure gap, there has been a great focus on enhancing the infrastructure pipeline with PPP projects. In the Philippine Development Plan it is clearly stated that PPPs are a way to supplement limited budget appropriations. It seems reasonable to suggest that most, if not all, projects that are prioritised by the Philippine government represent absolute value for money. In other words, the quite reasonable assumption has been that all projects on the priority list have represented value for money on a societal scale and therefore the imperative has been to get the asset built and into operation. In a country with relatively high growth, increasing the debt stock using a moderate PPP programme should not represent a high-risk proposition, as long as the liabilities are transparently measured and managed. This is even more manageable if projects recover their costs as most are meant to do in the Philippines.

In some countries the focus has been on relative value for money from PPPs. The premise for relative value for money from PPPs is that due to incentive structures and the use of private sector methodologies, PPPs will be relatively more cost-efficient than traditional infrastructure procurement methodologies, even when the higher cost of private sector finance is included. While also dependent on a competitive market, the comparison between procurement modalities can be difficult and there has globally been a tendency to unduly focus on a few quantitative figures. The Philippine process discussed below follows good practice and takes the key issues into account. The process can be further strengthened, but is on the right track and is delivering projects.

#### ***3.2 Project planning and prioritisation***

The overall targets of the Philippine Government are set out in the Philippine Development Plan 2011-2016. The first step of operationalising these objectives is found in the Revalidated Public Investment Program (PIP) which covers investment goals of PHP 4.2 trillion for the period. It is a long list of projects that IAs have submitted to NEDA for inclusion in the Program. Within this framework, priority is placed on strategic Core Investment Programs and Projects (CIPs). The main decision points for project approval are: ICC Technical Working Group (TWG), Cabinet Investment Coordination Committee (ICC-CC) chaired by the Secretary of the Department of Finance and finally

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<sup>2</sup> [www.ppp.gov.ph](http://www.ppp.gov.ph), [http://ppp.gov.ph/?page\\_id=26094](http://ppp.gov.ph/?page_id=26094).

the NEDA Investment Board chaired by the President (see Box 3.1.). With regards to the project development and approval process for PPPs, as of the first quarter of 2014, the ICC-TWG *for PPPs* was created to take the role of review/appraisal of PPP projects from the general ICC-TWG. Effectively this means that the co-ordinating secretarial duties of the Technical Working Group were shifted from NEDA to the PPP Center. This process should ensure a long term strategic vision and prioritisation going hand in hand with increased project development for both PPPs and non-PPPs.

### **3.3 Project appraisal and approval**

Project appraisal and approval begins with the submission of a project by the IA to the ICC-Technical Working Group (TWG). The PPP Center, acting as the PPP Secretariat to the ICC-TWG, receives the request of an IA for project approval and conducts initial project assessment. The IA submission must be endorsed by the head of the Agency/Department, and includes a feasibility study or business case and project evaluation form, among other documents. It should be noted that the feasibility study includes VfM considerations with respect to PPP versus traditional procurement. Based on the VfM assessments done by the PPP Secretariat, about 4 out of 14 projects since 2014 were found not viable for PPPs based on cost-recovery issues.

The PPP Secretariat prepares the project term sheet, which contains their initial evaluation and the other ICC-TWG members' evaluations. The PPP Secretariat includes the identified recommendations, and all issues/views are considered and discussed in the ICC-TWG.

The Department of Finance (DOF) looks at the revenue estimates and project structure submitted by agencies and verifies whether the cost recovery element is sufficient and contingent liabilities appear manageable. It also validates the feasibility of PPP versus traditional procurement based on the assumptions provided in the feasibility study or business case.

#### **Box 3.1. ICC and NEDA Board**

The NEDA Board is the country's premier social and economic development planning and policy co-ordinating body. It is chaired by the President and co-Chaired by the Head of NEDA/Socio-economic Planning Secretary. Its members are the: Secretaries of Departments of Finance, Budget and Management, Interior and Local Government, Agriculture, Public Works and Highways, Transportation and Communication, Environment and Natural Resources, Energy, Science and Technology, Trade and Industry; and Heads of Metro Manila Development Authority, Housing and Urban Development Coordinating Council, Presidential Communications Development and Strategic Planning Office, Presidential Management Staff, Bangko Sentral ng Pilipinas (Central Bank of the Philippines), Autonomous Region for Muslim Mindanao, Mindanao Development Authority, Union of Local Authorities of the Philippines, Cabinet Secretary.

Investment Coordination Committee -Cabinet Committee (ICC-CC) reviews the fiscal, monetary, and balance of payments implications of major capital projects, and recommends to the President the timetable of the implementation of these projects and programmes. It is the highest decision-making body in the Executive Branch that approves major capital projects, but whose approval is subject to confirmation by the NEDA Board. It is composed of Secretaries of Finance (Chair), NEDA (Co-Chair), and Executive Secretary, Budget and Management, Trade and Industry, Agriculture, Energy, Central Bank (Members). The ICC- Technical Working Group (TWG) consists of the ICC ministries at senior civil servant level and prepares the cases for the ICC-Cabinet Committee.

Source: ICC Guidelines and Procedures, March 2005.

The PPP Secretariat, in co-ordination with the NEDA-ICC Secretariat, sets the agenda for PPPs in the ICC-Cabinet Committee (ICC-CC) for approval of the project. Upon recommendation by the ICC-CC, the project is submitted to the NEDA Board for approval and confirmation to proceed with the PPP tender.

### **3.4 Bidding Stage**

The IA establishes the Special Bids and Awards Committee (SBAC) and TWG and undertakes the bidding process. The PPP Center assists the IA at the bidding stage. The Center provides support in the drafting of transaction documents, which can be either through the PDMF transaction advisors or as direct support to IAs. The PPP Center also sits as a non-voting member on the Special Bids and Awards Committee (SBAC) and to the TWG of the IA. The main role of the PPP Center is to ensure that the parameters approved by the ICC and the NEDA Board are adopted in the bid documents, and more importantly in the contract. During the bidding process, the Department of Finance (DOF) reviews and provides opinion on contracts, refinement of contracts, and partakes in contract negotiation. It reviews the draft contract with emphasis on financial clauses. An important stage during bidding is securing the approval of the Office of the Solicitor General or the Office of the General Corporate Counsel before the IA issues the final draft contract to the bidders.

### **3.5 Some key questions**

The above process conforms to good practise and the Philippines should be commended on streamlining and capacitating the PPP development process. The process and the PDMF has clearly succeeded in boosting the PPP pipeline in terms of the identification and award of PPP projects. Below are some of the key questions that should be addressed going forward.

#### **3.5.1 Are investment projects sufficiently prioritised?**

All investment projects should be prioritised at the senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project. The Philippine process of moving from a list of prioritised projects to actual implementation via IA sponsorship balances well the top down and the bottom up approach. With regards to PPP, the strong political impetus provided is a clear driver behind the focus on PPPs as an infrastructure procurement modality. Procurement of PPPs has been established as a largely separate system to the traditional procurement of infrastructure. The choice of PPP procurement is also driven by the political importance of particular projects. This is reasonable given the context where there is a backlog of high value infrastructure projects. The challenge in the future will be to ensure that the highest priority projects are built regardless of procurement modalities, taking into account scarce public sector resources in terms of financing and implementation capacity.

#### **3.5.2 Are the right projects for PPP chosen?**

Governments should carefully investigate which investment method is likely to yield the most value for money. The ability of the project to recover its cost through user charges has been important in terms of selecting projects in the Philippines. This is to be expected and mirrors developments in other countries in both the region and e.g. Latin America. Other factors motivating the choice of PPP include speed of delivery, service performance, and consideration of maintenance costs which are perceived as being better served through PPPs. There is evidence from OECD countries that indicates this to be true, but only in the right circumstances. Finally the PDMF may create a separate incentive for PPP vs more traditional methods. Going forward it might be beneficial to define further the characteristics that would make a project a strong candidate for PPP. Inspiration could be taken from OECD Guidance in this matter (OECD, 2012).

#### **3.5.3 How are PPP and TIP compared?**

The PPP Center, through the Policy Formulation, Project Evaluation and Monitoring Service (PFPEMS) conducts VfM assessments using a public sector comparator (PSC) based on the Australian PSC/VfM model. As in many countries, there is a lack of robust data that the PSC can rely on. There is no systematic collection of actual costs from traditionally procured projects or PPP projects so the PSC will have to be based on certain assumptions and expert opinions. It needs to be

emphasised that the PSC should not be perceived as a ‘pass or fail’ test, it should be one of many elements in a careful value for money assessment case. In this regard the Philippines are on the right track, and as all countries will benefit from enhancing project assurance.

### ***3.5.4 How are risks allocated between the public and private parties?***

Project risks should be defined, identified and measured and borne by the party for whom it costs the least to prevent the risk from occurring, or for whom a realised risk costs the least. The Philippine risk allocation matrix overall confirms to standard practise. The challenge is to keep updating this matrix in light of experiences and international practise.

### ***3.5.5 How are the Philippines preparing for maintaining value for money during the operational phase?***

To date, the focus of the PPP programme has been on pipeline development, moving through to contract award. Specific financing in support of PPPs have focussed on support for feasibility studies and upstream technical work. Securing value for money requires vigilance and consistent effort. In the coming years the IAs in particular should work to be prepared for the operational phase. The IAs and the PPP Center are fully aware of this issue and are preparing for an enhancement of the capacity in the relevant sectors. It is appropriate that the scope of the PDMF and other donor assistance should include provision to meet this demand.

### ***3.5.6 How will re-negotiations be handled?***

The private sector should effectively carry the risk it was allocated, and paid for, in the contract. However, unforeseen issues may arise that can undermine the project, in which case re-negotiation is relevant. Any re-negotiation should be made transparently and subject to the ordinary procedures of PPP approval. Clear, predictable and transparent rules for dispute resolution should be in place. Evidence from the Latin American and Caribbean region illustrates the fact that renegotiation will happen in the Philippines: 55% of the PPP contracts in transport (1980-2000) were renegotiated fairly quickly after the signature of contract - 3.1 years on average (Gauch et al, ITF presentation, 2014). The challenge for the Philippines is therefore to execute a transparent and clear process that will govern any re-negotiations.

### ***3.5.7 Is there sufficient competition in the market to ensure value for money?***

The government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the PPP programme so that there is an ongoing functional market. The Philippine economy and its construction sector is characterised by a handful of large players. In some cases a number of aggressive bids were quite similar, indicating keen competition, in other cases the government may only have had a few bids to work with. Concerns have also been raised with respect to the 60-40 rule as mentioned previously in this report. The challenge for the government will be to maintain a healthy competition in the future.

## **4. Managing expenditure and fiscal risks**

### ***4.1 The roles of the financial agencies in ensuring affordability, value for money and managing fiscal risks***

The Government of the Philippines has a clear commitment to fiscal discipline, and is taking steps to enhance its Public Financial Management (PFM) capabilities, including with respect to PPPs. As guardians of the public purse, the Department of Finance has two key roles:

- Contributing to the development of PPP projects through the technical working group stage with advice on the financial structure most advantageous to the government, including assessment of direct subsidies and contingent liabilities.
- Chair of the ICC, which makes recommendations to the NEDA Board.

An agency under the Department of Finance, the Bureau of the Treasury is focussed on the risk implications of the PPP programme, under its mandate to finance the government. The Department of Budget and Management implements both the national budget, including appropriations for PPP commitments, and determines the fiscal space available to make those commitments, based on inputs from the Department of Finance and the Bureau of the Treasury.

It should be noted that most PPPs in the pipeline are primarily user funded and thus currently do not represent the same burden as availability based/shadow toll types of PPPs.

#### **4.2 Identifying, pricing and managing contingent liabilities**

A critical component in ensuring the affordability of PPPs is the identification, pricing and management of contingent liabilities. This helps contain fiscal costs and limit overall public sector long-term commitments to levels that are fiscally affordable. The Department of Finance takes the lead in assessing and advising on Contingent Liabilities through the technical working group process.

Decisions on risk allocation are guided at the project level by the Generic Preferred Risk Allocation Matrix (GPRAM), a qualitative representation of the risks associated with a project<sup>3</sup>. The risks are identified and quantified based on the result of the feasibility study. These are discussed among the transaction advisors, implementing agencies, and the PPP Center. The technical advisors attempt to quantify the risks and incorporate such in the financial model and in some cases in the economic analysis. However, there are no existing standard guidelines referring to risk quantification.

The DOF conducts financial appraisal and evaluates the risk allocation matrix submitted by the implementing agency. It assesses the appropriateness of the risk structure and the proposed allocation of the project's fiscal requirements and government undertakings and ensures that they are in accordance with existing laws, rules and regulations. The DOF aims to ensure that the risks to which the government is exposed are contained, can be managed by the government, and do not negatively impact on fiscal sustainability.

The Philippine Bureau of the Treasury (BTr) supports the DOF with identification and particularly valuation of contingent liabilities on a project basis once the contract is signed. An internal process is underway between the DOF, Department of Budget and Management (DBM), BTr and PPP Center to assess and value contingent liabilities on both a project and an aggregate basis. Rather than using a probability weighted approach while the eligible pool is small, this process is currently based on a quantitative assessment of maximum liability on a contract by contract basis, followed by a qualitative assessment of the aggregate volume for budget purposes, based on the likelihood of occurrence.

Under the 2015 Budget, appropriations of approximately PHP 30 billion were made into a Contingent Liability fund, and DBM, DOF and the BTr are finalising guidelines for its use.

#### **4.3 Aligning the budget system with the needs of PPP contractual commitments**

A PPP programme presents inherent challenges to any public financial management system. PPPs depend on stable contractual relationships between public and private parties, including in terms of public financial commitments to private operators.

In the Philippines, financing of the ongoing implications of PPPs is largely managed through the relevant implementing agencies core budget on an annual basis, with up to two years for disbursement of capital expenditure. The core government budget retains responsibility for contingent liabilities that may be realised. The Philippine Constitution is clear that any funds to be disbursed, either under contracts with franchisees or to entities selling goods and services to the Government, are subject to prior appropriation by Congress.

To date, the Philippine Government **has met its financial obligations to its PPP counterparties**. There have been no instances of early terminations large enough to create a fiscal (and corresponding, appropriations) issue. The government does not have a record of defaulting on its debts, whether arising from international loans or from PPP obligations.

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3. Issued by the ICC-CC on September 2010, updated on December 2014.

The short-term nature of the appropriations system versus the long-term nature of a PPP contract can impact both on budget management, and on the confidence of private parties to enter into PPP agreements with the government. In the absence of the practise of enacting multi-year appropriation measures, Multi-year Obligational Authority (MYOA) is issued by the DBM to enable implementing agencies to enter into contract for the entire cost of the project and be assured that DBM will include the annual requirements in the annual budgets to be submitted to Congress.

#### **4.4 Where required, determining the level and nature of the government subsidy**

Within the Philippine framework, government financial commitments to a project subsidy are made on a case-by-case basis, subject to certain constraints. Under the current programme, PPP projects do not have required viability gap funding, and the focus has been on establishing legal constraints and limits for government share and viability gap funding. As the PPP Pipeline grows and moves more into social infrastructure, agencies will be required to assess the minimum required government subsidy to ensure financial viability of socially and economically desirable projects.

#### **4.5 Ensuring integrity, affordability and value for money through audit**

A Supreme Audit Institution (SAI) is a critical piece of institutional machinery to ensure appropriate use of taxpayers' funds. In many jurisdictions it also conducts *ex post* value for money assessments of both Traditional Infrastructure Procurement (TIP) and PPP infrastructure projects. *Ex post* VfM assessments may also be conducted by the procuring line ministries, the finance ministry, or the PPP unit (Burger and Hawkesworth, 2011).

Within the Philippines, the Commission of Audit (COA) maintains the exclusive authority to audit government transactions. It runs a hub-and-spoke model, with around 5 000 auditors, the majority of whom are based in the regional offices of implementing agencies, and conduct financial, compliance and fiduciary audits by project. These regional auditors also have a mandate to audit regional and local government. A small Manila-based staff of around 135 supports their activities from the centre.

In terms of traditional procurement, the regional auditors perform transactional audits of the agencies *ex post*. The COA is also engaged in the Bids and Awards process as observers, and audits the procurement for rule compliance. At present, those auditors are also responsible for auditing PPP projects. There are proposals to create a specific office in Manila for PPPs.

As for the nine PPP projects awarded, the COA was not involved in VfM analysis and has yet to conduct a compliance audit.

### **5. Assessment of PPP investment at the sub-national level in the Philippines**

#### **5.1 The Local government system**

The Philippine government maintains that local government units (LGUs) have an important role in the achievement of sustainable development and inclusive growth. As will be discussed below, this is proving difficult for a number of reasons, but focussing on the big urban centres could prove fruitful.

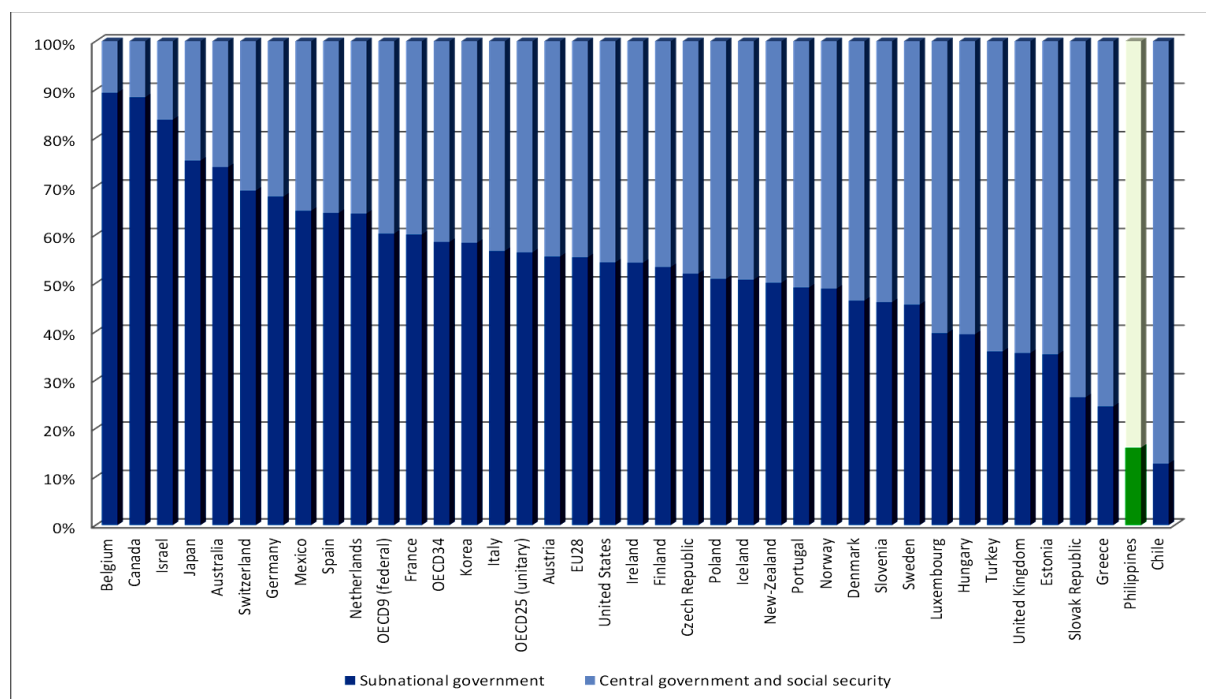
The LGUs comprise 80 provinces, 138 cities, 1 496 municipalities and 41 945 barangays. Each have control of their own resources. For administrative purposes, provinces are clustered into 17 regions. In 1991 the Local Government Code was enacted providing each LGU with a constitutionally guaranteed Internal Revenue Allotment (IRA) to a combined annual total of 40% of the country's tax collection of three years before. The Code also granted LGUs considerable discretion over local taxes and services, a wide range of policy competencies, and some funding and provision for credit for the construction of local infrastructure. On paper the Code laid the foundations for a local government system with high autonomy which could, over time, play a major role in the country's development.

Currently, 24 years after the introduction of the Local Government Code, LGU expenditure is very low by international standards. Total LGU spending increased from an average of 1.6% of Gross National Product (GNP) during 1985–91 to about 3% in the late 2000s (compared to 16% of GDP in

the OECD). LGUs represent nearly 17% of total government expenditures and around 14% of public investment (compared to 60% in OECD countries) (Figure 2).<sup>4</sup>

All “hard” public infrastructure investment (major roads, ports, airports etc.) is undertaken by central government departments. The Code allocates responsibilities to LGUs to provide services in the areas of agriculture, health and social services, infrastructure, tourism, and environmental protection. However, these responsibilities are “shared competencies” and the decisions on who pays for what in these areas are ad hoc.

**Figure 5.1. Sub-national government investment in the Philippines compared to OECD countries**



Source: OECD national account and Department of Finance of the Philippines (2015)

Notable features of this local government system are: the high number of LGUs-and therefore small size of many budget holding LGUs; the limited tax autonomy and large reliance on external funding; the significance for unit resourcing of the Type of LGU; and finally the fact that the national LGU funding arrangements are not designed to have an equalisation role.<sup>5</sup>

**5.2 LGUs’ current role in infrastructure**

LGUs currently play a very limited role in the nation’s infrastructure development. Their spending and revenue raising ambitions are strongly influenced by the three-year local electoral cycle and by the small size and capacity of many LGUs. In many cases these pressures squeeze out infrastructure investment. Funds earmarked for infrastructure are frequently reallocated to social spending. Furthermore there is a reluctance to take on debt for big infrastructure projects both because they may lack short term political payoff, and because debt servicing further restricts the availability of untied funding. In these circumstances it tends to be more politically expedient to lobby for support from the national government, than to increase local revenue.

Generalisations based on the numbers of LGUs – without reference to Type – can be misleading. Not only is the total of people in cities more than in any other LGU type, but as the Table 5.1

4. Asian Development Bank, 2014

5. Cities are regarded as having been favoured above other Types by the Code arrangements

demonstrates, cities as a whole are less dependent on national transfers. Bigger Cities have a number of advantages over other LGU types: they have more local taxing powers, they have a larger local revenue base; their citizens tend to be more demanding of political accountability thus mitigating the risk of elite capture; and they have the resources to hire more skilled administrators.

This differentiation of LGUs becomes even more marked if one separates out from the total of 135 cities, the 35 Highly Urbanised Cities and the 5 Independent Component cities. This group of cities serves a combined population of more than 20 million, and have a much higher resource mobilisation capacity for infrastructure and other purposes than any other group of LGUs.<sup>6</sup>

**Table 5.1. Local government finances: Key ratios by type of unit, 2010**

Type of Local Government Unit	Surplus as % revenue	Debt service as % revenue	Transfers as % revenue	Borrowings as % revenue	Total revenue (pesos millions)
<i>Cities</i>	13.4	1.3	41.3	5.2	126 763
<i>Municipalities</i>	11.7	0.8	78.4	2.1	99 270
<i>Provinces</i>	16.0	1.6	76.2	3.7	71 596
<i>Overall</i>	13.5	1.2	62.0	3.8	297 629

Source: Department of Finance, 2010

### **5.3 Low disposition for inter-jurisdictional co-operation**

LGUs have proven reluctant to club together to achieve economies of scale by creating common infrastructure such as recycling facilities. There are intra-regional planning and co-ordination mechanisms - in particular the Provinces themselves and the Regional Development Councils supported by NEDA. However, the bulk of the funds available for investment are controlled by individual LGUs, and there is no co-ordinating body with the legal personality for the purposes of entering into jointly funded multi-jurisdictional infrastructure contracts. Without a robust inter-LGU contract, participating mayors or governors might walk away and potential private sector partners might be reluctant to invest.

### **5.4 Implementation of the PPP programme at the sub-national level**

In summary, the Government faces serious challenges in meeting its objective to mainstream PPPs into LGUs because:

- Many municipalities are very small and because of that, lack the capacity to take on PPPs as an individual government. This problem cannot be resolved by training or technical assistance. It arises from the fragmented architecture of the LGU system.
- The evidence to date is that many LGUs have weak incentives to invest - in infrastructure-including a reluctance to raise local taxes and charges for this purpose.
- The key capacities needed for PPP are institutional. Individually focussed training and associated activities, does not necessarily translate into more capable local organisations.

However, there is a subset of important LGUs for whom the challenges to PPP outlined above either do not apply, or are manageable. These are the highly-urbanised cities and the independent component cities. Some of these LGUs have thrived as their cities have grown and prospered. Unlike other LGUs this group would appear to meet the preconditions for benefitting from the PPP approach. Such LGUs are experiencing pressure for better infrastructure and services, stemming from their transformation into growing urban centres. They are good candidates for PPPs and other investment initiatives, and are likely to demand more debt instruments; thus, relaxing the constraints which hinder their becoming more viable borrowers.<sup>7</sup>

6 Two of the three cities used as case studies for this assessment, are in this category.

7 The Philippines: Recent Developments in the Subnational Government Debt Markets 443

## **Annex 1. The organisational and legal framework for PPPs in the Philippines**

### **1 Legal Framework for PPPs in the Philippines**

There is a history of PPPs in the Philippines going back to the late 1980s in the water sector and early 1990s in the utility sector. In 2010 Executive Order (EO) No. 8 created the PPP Center and expanded its mandate and established the Project Development and Management Facility (PDMF). The legal framework was updated further in 2012 and in 2013 when the PPP Governing Board was created. The board is the overall policy-making body for all PPP-related matters and the PDMF<sup>8</sup>. The PDMF Committee was also created and tasked with overseeing the use of PDMF. In 2014, the Investment Coordination Committee – Technical Working Group (ICC-TWG) for PPPs was created to review PPP projects (discussed further below).

### **2 Who does what:**

#### **2.1 Implementing Agency/Local Government Unit**

The Implementing Agency (IA) or Local Government Unit proposes and implements the PPP project. It is the driving force behind a PPP in the Philippines. The IA is responsible for identifying and proposing the project, undertaking the feasibility study and presenting the project to the ICC-TWG for endorsement. The IA is assisted throughout by the PPP Centre and the PDMF.

#### **2.2 NEDA**

The National Economic Development Agency (NEDA) is the central economic planning and development agency that deals with policy formulation and co-ordination. NEDA is responsible for the Public Investment Programme, which is an indicative list of infrastructure projects that are considered national priorities. It is from this list that IAs, with the assistance of the PPP Center, select projects to bring forward for approval. Approval of projects occurs at two levels: The NEDA Board, which is chaired by the President, and the Investment Coordination Committee (ICC).

#### **2.3 PDMF**

The Project Development and Monitoring Facility (PDMF) is often looked upon as a key factor in the success of the Philippines in ramping-up its PPP pipeline. It provides transaction advisory services to IAs as they seek to develop a PPP project. It is addressed more thoroughly in Section 2 of this report.

#### **2.4 The ICC-Technical Working Group**

The ICC-Technical Working Group (ICC-TWG) was created to provide guidance to IAs and recommendations to ICC-CC specific to PPP projects. It is made up of members from the PPP Center, the Department of Finance, NEDA and the Department of Environment and Natural Resources-Environmental Management Bureau. Its role is to study the proposed project from technical, financial, value for money, socio-economic and environmental perspectives. The TWG makes a submission to the ICC to approve, reject or modify the project.

#### **2.5 PPP Center**

The PPP Center is at the heart of the Philippines' PPP efforts. From a staff of less than a dozen in 2010 the Center has evolved to employ about 100 and continues to grow. The Center is not

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7 Chairperson – Head of NEDA/Secretary of Socio-Economic Planning; Vice Chairperson – Secretary of Finance; Members – Secretaries of Budget and Management, Justice, Trade and Industry, Executive Secretary, National Competitiveness Council (Private Sector representative); Secretariat – Head of the PPP Center.

responsible for identifying or implementing projects. It assists implementing agencies and Local Government Units (LGUs) in advancing projects through a process of development and approval.

The PPP Center, headed by the Executive Director, is composed of: Project Development and Monitoring Facility (PDMF) Service – Manages and administers the PDMF, and the selection of the PDMF panel of transaction advisors; Project Development Service – Provides facilitation, advisory and technical assistance to various IAs in the PPP procurement process; Legal Service – Renders legal advice and assistance during the various project phases. Policy Formulation, Project Evaluation and Monitoring Service – works on policy and guidelines for the development, appraisal, implementation, monitoring and evaluation of PPP projects and contracts, and serves as PPP Secretariat for the ICC; Capacity Building and Knowledge Management Service – Provides capacity building activities to IAs in undertaking PPP processes, such as project identification and selection, development, preparation, procurement and implementation; Provides timely and reliable information and promotes the agenda of the PPP programme to various media entities; and, Manages and maintains a knowledge management portal for all PPPs. The PPP Center also acts as PPP Secretariat to the ICC-TWG.

## ***2.6 Department of Finance, Department of Budget and Management, Bureau of Treasury and Commission on Audit***

The Department of Finance's (DOF) Privatization and Corporate Affairs Group helps structure PPP projects. It helps the IAs and PPP Center in determining the appropriate structure for a project. It also examines the provision of support such as a performance undertaking, assesses and verifies the amount of subsidy requested.

The Department of Budget and Management (DBM) determines available fiscal space through the budget process, and in conjunction with the DOF and the Bureau of Treasury, checks the availability of fiscal space and verifies the amount of subsidy requested for a project in view of the fiscal position. The Bureau of Treasury provides inputs to these processes, and focusses on managing the risk implications of PPPs such as contingent liabilities. Specifically, the Bureau of Treasury analyses and measures contingent liabilities, and ensures all necessary processes are undertaken to determine the value of risks and contingent liabilities.

## ***2.7 Commission on Audit***

The Commission on Audit (COA) is the supreme audit institution of the Philippines with sole authority to audit IA processes, accounts, expenditures, and properties. The COA main office has about 135 employees composed of a pool of technical experts that may be tapped for sectoral audit. It also has regional offices and about 5 000 resident auditors deployed in various government offices in the national and local levels.

As part of the government's efforts on PPPs, the COA is planning on creating a separate unit to build its capacity for PPP audit.

**Annex 2: Awarded Projects and Projects in the Pipeline**  
(as of 23 April 2015)

***Awarded/in operation***

<u>Project Name</u>	<u>Implementing Agency</u>	<u>Description</u>	<u>Estimated Project Cost (billions)</u>	<u>Tenure and structure</u>	<u>Status</u>
The PPP for School Infrastructure Project (PSIP) Phase 1	Dept. of Education	Construction of schools and classrooms.	PHP 16.28billion/USD 362 million	BLT, 10-year term	In operation
PPP for School Infrastructure Project (PSIP) Phase II	Dept. of Education	Construction of schools and classrooms.	PHP 3.86/USD 0.09	BT	In operation
Integrated Transport System (ITS) – Southwest Terminal Project	Dept. of Transportation and Communications (DOTC)	Integrated transportation system hub	PHP 3.15/0.07 USD	BTO, 35-year term	Notice of award on 1/23/15, contract signing pending
LRT Line 1 Cavite Extension and Operation & Maintenance	(DOTC)	Extension of existing LRT line and operation and maintenance of entire line	PHP 44.65/USD 0.99	BTO, 32-year term	Ongoing procurement of independent consultant.
Mactan-Cebu Int. Airport Passenger Terminal	DOTC	Construction of a new terminal and operation of old and new facilities	PHP 34.44/USD 0.77	BOT, 25-year term	Ongoing Independent consultant procurement
Automatic Fare Collection System	DOTC	Replacement of old ticketing system with contactless smart cards on three transit lines	PHP 2.24/USD 0.05	BTO and BOO 10-year term	Pre-operation testing
Daang Hari-SLEX Link Road	Dept. of Public works and Highways	Toll Road (4km)	PHP 2.22 billion/ USD .05 million	BTO	Construction ongoing, 80% complete
NAIA Expressway Phase 2	Dept. of Public works and Highways	Construction of 7.75 KM elevated expressway	PHP 23.9 billion/ USD 0.531	BTO 30-years	Construction ongoing, 27% complete
Total Project Cost (USD 1 = PHP 45)			136.37 PHP/3.03 USD	Project costs include Premium Payments	

**Projects in the Pipeline**

<u>Project Name</u>	<u>Implementing Agency</u>	<u>Description</u>	<u>Estimated Project Cost (billions)</u>	<u>Tenure and structure</u>	<u>Status</u>
Cavite-Laguna Expressway (CALEX) Alignment	Dept. of Public works and Highways	Toll Road (47km)	PHP 55.51/ USD 1.23	BOT 35-year term	Bid proposal submissions 18 May 2015
Regional Prison Facilities	Dept. of Justice	Prison with a capacity for 27,000 inmates	PHP 50.18/ USD 1.12	BTM 23-year term	Submission of prequalification documents 6 May 2015
New Bohol (Panglao) Airport	Dept. of Transportation and Communications (DOTC) and Civil Aviation Authority of the Philippines	Operation and maintenance of New Bohol Airport (to be built by DOTC with assistance of JICA)	PHP2.34/ USD 0.052	Operate – add and transfer 30-year term	Submission of prequalification documents May 2015
New Centennial Water Source – Kaliwa Dam Project	Metropolitan Waterworks and Sewerage Systems	Construction of dam and water supply intake system	PHP 18.72/ USD 0.416	BT 30-year term	Evaluation of prequalification documents
LRT Line 2 Operation and Maintenance	DOTC	Operation and maintenance of existing LRT line	No capital expenditure required	O&M 10-year term (5-year extension possible)	Bid proposal submission July 2015
Laguna Lakeshore Expressway-Dike Project	Dept. of Public works and Highways	47km flood control dike with 6 land expressway on top, reclamation of 700 hectares	PHP 122.8/ USD 2.73	BOT (highway & dike) 37-year term BT (reclamation)	Bid proposal submission July 2015
Integrated Transport System (ITS) Project South Terminal	DOTC	Development of an integrated transportation system hub.	PHP 4.0/ USD 0.089	BTO 35-year term	Bid proposal submission on 18 May 2015
Bulacan Bulk Water Supply Project	Metropolitan Waterworks and Sewerage Systems	To provide bulk water to districts of Bulacan	PHP 24.4/ USD 0.54	BOT 30-year term	Bid proposal submission 15 July 2015

**Projects in the Pipeline (cont'd ...)**

<b><u>Project Name</u></b>	<b><u>Implementing Agency</u></b>	<b><u>Description</u></b>	<b><u>Estimated Project Cost (billions)</u></b>	<b><u>Tenure and structure</u></b>	<b><u>Status</u></b>
Development, Operations and Maintenance of Puerto Princesa Airport	DOTC and Civil Aviation Authority of the Philippines	Upgrade and operation of airport and navigation facilities	PHP 5.81/ USD 0.13	Operate – add – transfer 30-year term	ITPB published 15 December 2014
Development, Operations and Maintenance of Laguindingan Airport	DOTC and Civil Aviation Authority of the Philippines	Upgrade and operation of airport facilities	PHP 14.64/ USD 0.32	Operate – add – transfer 30-year term	Submission of prequalification documents May 2015
Development, Operations and Maintenance of Davao Airport	DOTC	Upgrade and operation of airport facilities	PHP 40.57/ USD 0.90	Operate – add – transfer 30-year term	Submission of prequalification documents May 2015
Development, Operations and Maintenance of Bacolod Airport	DOTC	Upgrade and operation of airport facilities	PHP 20.26/ USD 0.45	Operate – add – transfer 30-year term	Submission of prequalification documents May 2015
Development, Operations and Maintenance of Iloilo Airport	DOTC	Upgrade and operation of airport facilities	PHP 30.40/ USD 0.68	Operate – add – transfer 30-year term	Submission of prequalification documents May 2015
Davao Sea Port Modernisation	DOTC	Upgrade and operate port facilities	PHP 18.99/ USD .422		ITPB published on 10 April 2015
Total Indicative Cost (USD 1 = PHP 45)			PHP 408.61/ USD 9.08	Project costs include Premia	

Source: PPP Center

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