PHILIPPINES CLIMATE CHANGE MITIGATION PROGRAM

A Joint Program of the

Philippines Department of Energy

US Agency for International Development

TERMINAL REPORT

Technical Assistance to DOE for Enhancing Private Sector Participation in New and Renewable Energy Investments for Off-Grid Rural Electrification)
(TASK 4 – Project Evaluation and Prioritization)

Submitted to the:

United States Agency for International Development (USAID)

and the

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Task 4 - **PROJECT EVALUATION AND PRIORITIZATION**
TERMINAL REPORT

Introduction.

The subject of Task 4 is "Evaluation and Prioritization of Project Proposals". The specific activities of the task are:

(a) Compilation, listing, and pre-screening of project proposals on rural off-grid electrification in the pipeline of the DOE, NPC-SPUG, PNOC, NEA, Development Bank of the Philippines, and the Land Bank of the Philippines;
(b) Review and comparison of the existing guidelines (criteria and methodology) of the DOE-EUMB, NEDA, LBP, and DBP for evaluating the viability of project/investment proposals, as bases, among others, for the development and documentation of a formalized and standard set of guidelines to be adopted by the DOE-EUMB for evaluating the viability of off-grid rural electrification projects; and
(c) Implementation of the project evaluation guidelines on the project proposals that are included in the list developed in (a);
(d) Preparation of criteria for project prioritization and implementation thereof on viable projects from (c); and
(e) On a best effort basis, assistance to at least two (2) project proponents (1 LGU and 1 private sector) from the priority list in item (d) in obtaining a financing agreement with either the DBP and LBP, on a best effort basis.

The objectives are 1) to provide the DOE with a report on the status of projects in the pipeline of LBP and DBP, 2) provide DOE with guidelines in providing assistance to NRE projects proponents in packaging their proposals and 3) actually assist to two projects in obtaining financing from the banks.

A summary of the specific deliverables and the actual accomplishments are as follows:

Item of Deliverable	Comments/Remarks
1. Long List of Pipeline Projects	Delivered
2. Guidelines for project evaluation & prioritization – for use of DOE	
(a) Draft Document	Delivered
(b) Final Document	Delivered
3. Guidelines for use of NRE project proponent	Delivered. This is a new deliverable that arouse during the meeting at PA Consulting on April 5, 2001 when the draft proposed guidelines was presented to the members of PPT
4. Implementation of Project Evaluation & Prioritization Guidelines	
(a) Full project evaluation report for 2 priority item proposals from item (1)	The deliverable could not be submitted due to the absence of documents and information on pipeline projects of the banks. The "principle of confidentiality" does not allow the banks to disclose information and documents entrusted by a proponent.

	In lieu of this deliverable, the consultant was required to submit a white paper on "How to overcome the hesitancy of banks to provide loans to NRE projects."
(b) Project Evaluation training for 2 EUMB staff	Delivered. Lesson Plan and Training materials were submitted. More than 10 staff of DOE were given lectures on project assessment and management. To maximize the opportunity, EUMB invite staff in other units of DOE who are involved in projects.
(c) Prioritized list of 25 viable projects and summaries/ project briefs	Prioritized list could not be delivered for similar reason as 3.a. The deliverable has been replaced by a white paper.
5. Commitment from DBP/LBP to pursue project financing approval for 2 projects/ proponents	The deliverable has been replaced for similar reason mentioned in item 3. (a) The deliverable has been replaced by a white paper.
6. White Paper of delivery of financing for NRE in areas avoided by the banks	Delivered
7. Draft of Letter requesting DOF for the inclusion of NRE projects	Delivered. This was an additional deliverable that arose during the presentation of outputs at USAID on June 14, 2001.

Assessment of Bank Regulations and Policies in Financing Projects and Approving Credit Proposals.

There are two entities that comprise the private sector when reckoning private sector participation. These are the private investors and the banks. The private investors infuse their money into projects because of profit potential. The banks, on the other hand, infuse their money into projects by way of loans because the risk involved is not high enough that they anticipate no problem in recovering the principal and earnings of the amount they lend.

Banks are necessary components in the financing of projects because in most cases, provide the bulk of financing in pursuing a project. The proponent possess assets but the banks hold the cash needed to pursue a given project.

In the effort to catalize private sector participation in NRE, the DOE staff should understand how the banks operate and the parameters in their lending operations. The specific matters that should be appreciated are:

1. How banks evaluate request for loans
2. Regulations .

How Banks Evaluate Request for Loans

In evaluating request for loans, banks take into consideration two major items 1) the bankability of the proponent and 2) the viability of the project that will be financed by the proceeds of the loan. Bankability of the proponent includes the proponent's track record of business performance, credit record and asset base. Project viability involves those factors that affect the overall business performance that include marketing, production, operations and financial aspects. A schematic diagram of the matters looked into by a bank when evaluating a project is marked as Annex "A".

It is only when there is a viable project presented by a bankable proponent that a bank acts favorably on a request for loan financing. A favorable credit decision is grounded on an assessment that the risks relative to a specific credit transaction is within the level acceptable to the banks.

Banking Rules and Regulations

Banks are by nature regulated entities as they have to contend with so many regulations in their credit decisions. Among the rules and regulations that affect credit decisions are the following:

1. General Banking Law of 2000 (R.A. No. 8791) – Section 34 to 49 of the law governs the lending operations. The essence of the provisions is for the banks to exercise caution in their credit decisions.
2. Circulars issued by the Bangko Sentral ng Pilipinas (BSP) – BSP Circulars cover specific subjects that results in restriction of relaxation of the lending guidelines of the banks.

As a result of the financial crisis that affected Asia, including the Philippines, since 1997, the banks have been saddled with non-performing loans. Numerous BSP rulings were issued on non-performing loans resulting into a restrictive lending environment. In a restrictive lending environment, the banks have the tendency to lend short term loans only to the most bankable clients. Banks use pricing as an instrument to discourage non-target clients or may just give outright denial for loan applications. Developmental loans (which include loans to NRE) characterized by long tenor loans and non-prime borrowers are avoided .

Case Study: Assessment of the DBP's Financing of NRE Projects

Because of FINESSE, DBP is the only bank with the capability to assess NRE projects for purposes of providing financing. Because of Window III, DBP may be the only bank that has the kind of money that matches the requirements of NRE projects.

The level of DBP's portfolio in NRE projects, however, is lower than expectations. Among the factors identified are:

1. Absence of Bankable proponents - Like any other Philippine bank, the DBP practices "balance sheet" financing in its lending operations. Under a "balance sheet" financing concept, the bank's major consideration in a credit decision is the level of asset that the proponent can contribute which include the assets that can be submitted

as collateral and viability of the project becomes a secondary consideration. This is contrasted to a project financing concept where the viability of the project becomes a primary consideration in a credit decision.

2. Concern for information – To justify NRE proposal to the approving authorities of the Bank, the following information should be made available to DBP:
   a. Market identification and validation of market assumptions. DOE will make an report about the existence of a market, the characteristic of the market and other basic market data. It should also 1) prove the assumption on the population and its growth, 2) provide estimates on tariff rates and 3) provide estimates on cost of delivery of electricity.
   b. Technical validation and verification of the viability of the technology. DOE will pre-screen the technology and will indicate in a report that would include information 1) if the technology has been pilot tested and the results of the pilot test, 2) if there existing projects in the Philippines using the technology and the performance of the project and 3) if there are of similar projects in other countries and their performance.
   c. Institutional evaluation including assessment of the readiness of the community and the livelihood component.
   d. Verification of "cost of service delivery" calculation/pricing or tariff formula

In a countryside environment, there are a very few entities that can meet the criteria of the bank for bankability. As such, there is a need to arrange for a joint venture or similar imports between the proponent at the site and a stronger entities.

For the information requirements, it was agreed during the meeting on April 5, 2001 that DOE, as part of its role in catalizing private sector participation in NRE, will provide the information.

White Paper on Addressing the Strict Requirements of Banks on NRE Projects.

The white paper examined the hesitancy of banks to lend to NRE. The areas examined include the following:

1. Creditworthiness of LGU as proponent of NRE
2. The support given to NRE and to the LGU and
3. Readiness of the banks to lend to NRE

Finding from the analysis are the following:

1. NRE has all the attributes of a profitable and viable enterprise that include existence of a market, availability of a proven technology and available financing.
2. There are two categories of proponents, the first round proponents and the second round proponents. The first round proponent take a higher of risk because they infuse equity before the project can create a track record. For NRE, the LGUs are the

appropriate first round proponents of NRE projects. There is a need, however, to strengthen them by arranging for strategic partners and venture capitalists

3. Newness of NRE in a business environment makes investors and banks apprehensive about business and credit risks. To allay the apprehensions, guarantees, special funds, incentives, flexibilities on rulings and other forms of support should be given to projects as well as the first round proponents and the banks willing to bet their loanable funds into NRE projects.

Specifically, the following actions are being recommended:

1. Setting up of a guarantee facility for NRE to cover credit risks especially for the first round proponents that are not LGUs. The LGUGC only guarantees loans obtained by the LGUs.
2. Setting up of a group that will provide assistance to NRE proponents in walking through the documentary maze of setting up a business enterprise, in complying with loan requirements and in availing grants and incentives. The group should have the capability to assist the LGUs in dealing with banks, venture capitalists, foreign funders and potential strategic partners.
3. Inclusion of loans to NRE as alternative compliance to the Agri-Agra Law as incentive for banks to lend to NRE projects
4. Issuance of a BSP Circular to classify NRE among projects with long gestation periods. This will provide banks greater flexibilities in their loan terms to NRE projects without the risk of getting audit exceptions.
5. Setting up of a special with tenor of more than 10 years such that there is a fund that can be used by the banks in lending to NRE
6. Renegotiate with the World Bank for the inclusion of NRE in the list of projects that qualify for MDF funding
7. Training given to DBP personnel under the FINESSE projects should be echoed to loan officers of other banks to further disperse the potential source of loans
8. Negotiate with foreign governments for possible sources of grant funds that will be provided to first round proponents as a kick starter.
9. Negotiate with the Bureau of Customs to reduce hassles in the entry of foreign made equipment and components to be used in NRE projects

A tabulation of the recommendations and proposed actions is marked as Annex “B”.

***Proposed Guidelines on NRE Project Evaluation and Prioritization*.**

The proposed guidelines on project evaluation was meant to be a tool for the staff of DOE that are involved in providing assistance to NRE proponents. By using the guidelines, DOE staff will be able to help proponents in properly packaging project proposals and in presenting proposals that contains all the elements needed by the banks in coming up with a credit decision. The proposed guidelines is a consolidation of the lending guidelines of DBP and LBP as well as of the DOE, PNOC-EDC and NPC-SPUG. The following are hoped to be accomplished trough the proposed guidelines

- Improve the approval rating of loan applications of NRE projects

- Enhance acceptability of projects to prospective investors and
- Come up with policies to strengthen weaknesses encountered during the course of the evaluation
- Set up a system in preparation to a bigger fund for NRE projects that will be obtained from the international funding agencies.

The proposed guidelines has three major sections which are:
1. Introduction – It discusses the content and objectives of the guidelines as well as the framework within which the guidelines were made.
2. The Process – It discusses the process flow involved and
3. Evaluation – This constitutes the bulk of the document. It discusses in detail the suggested steps in assessing the credit record of the proponent, financial evaluation of the proposed project, marketing, organization and management, risk/key success factors, collateral, second way out, pricing and socio-economic, environmental and other issues.

The proposed guidelines was presented to the members of the PPT on April 5, 2001 for consultation. The suggested changes which were incorporated in the Introduction section of the final version of the guidelines are:
1. Inclusion of the definition of the role of DOE as catalyst
2. A statement that the guidelines will not attempt to duplicate the efforts of the banks but will only enhance the acceptability of the project proposals and
3. A statement that there is no attempt to violate the confidentiality of relationships between the bank and the proponent.

The proposed guideline was designed to cover wide range of applications including possible joint venture arrangements between LGU and the private investors.

Assistance to Enhance Technical Capability of NRE Sector to Prepare NRE Project Proposals.

To enhance the technical capability of the NRE Sector to prepare NRE Project Proposals, trained over 10 staff of DOE who are involved in projects. The training has two major sections, the discussion portion and the practical application. A lesson plan, two sets of reading materials and a case problem were given to EUMB. The training was conducted on May 24, 2001.

The training has imparted into the participants the correct perspective when looking at a project. Extensive knowledge of the participants on technical and marketing aspects is a good starting point and it is suggested that follow up training should be given to broaden their perspective on project evaluation. The end of the training program should be to enable the participants to eventually help NRE proponents in properly packaging their project proposals.

Conclusions and Recommendations.

There are a lot of opportunities for NRE to become a viable enterprise and to become an area of interest of the private sector, particularly the private investors and the banks. The opportunity can become a reality only if there is support to prop a developing industry which is NRE until it reaches a stage where it can stand on its own. Previous efforts of the DOE to nurse NRE to commercialization has moved the industry forward to a stage that is almost commercialization. There are, however, a number of elements still missing towards the end and these are the following:

1. The active participation of banks – The white paper identified the reasons why banks are hesitant in lending to NRE. Likewise, recommendations were made to further boost their confidence in lending to NRE
2. Strengthening further the capability of DOE to catalize NRE – Arranging and project packaging functions are necessary component in the development on entities comp rising the NRE industry. It was noted that there is an absence of entities willing to arrange (that is to match potential investors for example an LGU with private investors) and assist in packaging NRE projects. By compulsion, DOE may have to handle the tasks of arranging and assistance in packaging, as well as other tasks mentioned in previous sections, for the NRE industry to move forward. DOE has to perform these tasks until such time that a private entity that emerges to handle such tasks.

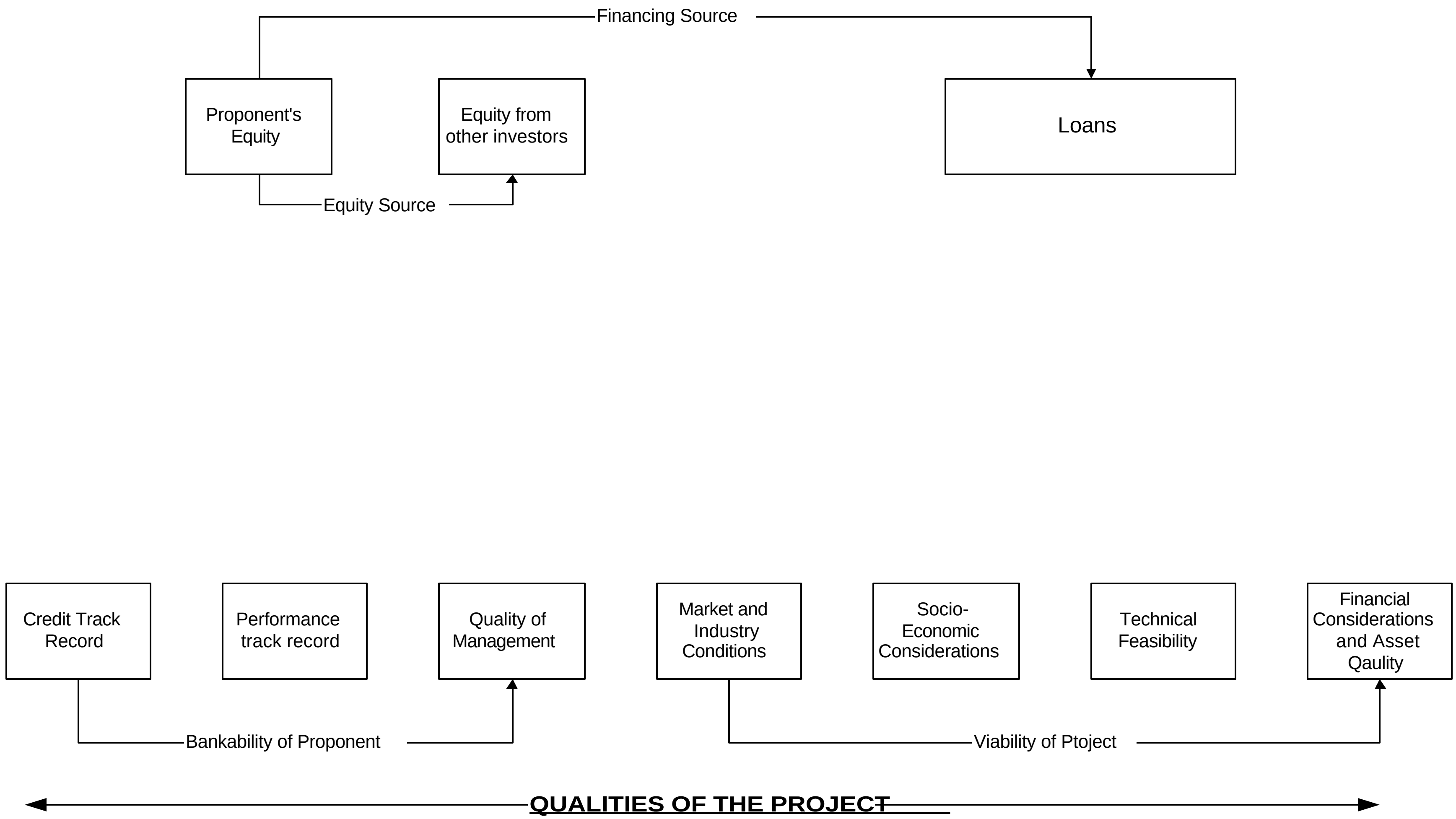
***Appendices*.**

- A - White Paper
- B - Draft of Memo to DOF on inclusion of NRE in MDF Qualified Projects
- C - Proposed Guidelines on Project Evaluation
- D - Proposed guidelines for NRE Proponents
- E - Proposed Prioritization Scheme for Pipeline Projects
- F - Training Kit
- G - Minutes of Meeting

ANNEX “A”

Annex "A"

FINANCING FRAMEWORK



ANNEX “B”

Table of Recommendations

Recommendation	Ultimate Objective	Responsible Agency	Subsequent Actions
1. Setting of a Guarantee Facility	Set up guarantee facility for NRE	Dept. of Energy	• Ascertain possible sources of funds for seed capital. Funding will most likely come from foreign sources • Coordinate with DOF for compliance with documentary requirements to obtain seed fund • Negotiate with GFSME and SBGFC for the implementation of the guarantee facility and in coming up with the guidelines for the issuance of the guarantee • Consult with the Banks to get feedback on acceptability and doability of guidelines in the issuance of guarantee • Formalize all agreements
2. Assistance Desk	Help proponents properly package and present their proposals	Dept. of Energy	• Create a team within DOE that will specialize in providing assistance to proponents • Identify and accredit groups with the capability to package NRE projects • Training of team members by trainors from countries successful in NRE as business enterprises • Training of team members with the banks on project evaluation and packaging
3. Loans to NRE Agri-Agra Compliant	Banks to be more NRE friendly	Dept. of Energy	• Make representations with the BSP re plans to include NRE as alternative compliance with Agri-Agra Law • Prepare appropriate documents necessary for the issuance of an appropriate executive order • Make representations with the Office of the President for the issuance of the executive order
4. NRE classified as long gestating project	Banks to be more NRE friendly	Dept. of Energy	• Make representations with the BSP re plans to classify NRE as long gestating project • Prepare appropriate documents necessary for the issuance of an appropriate BSP Circular • Request the Monetary Board for the issuance of the appropriate BSP Circular

Recommendation	Ultimate Objective	Responsible Agency	Subsequent Actions
5. Special funds for loans to NRE	Banks to be more NRE friendly	Dept. of Energy	• Negotiate with NRE Friendly funders for them to make available by way of a loan or any other form of liability a fund that can be given to NRE project proponents. The tenor should be long term, with low interest rate and if possible untied • Obtain the assistance of DOF in complying with the requirement of the lender as the National Government is most likely to become the borrower • Negotiate for the Detailed terms and conditions of the facility • Negotiate with the local banks that will handle the funds. Included in the negotiations is the terms and conditions with which the funds will be relent • Documentation of Agreements
6. Renegotiate with WB on MDF	Provide additional loanable funds for NRE projects	Dept. of Energy and Dept. of Finance	• Obtain from DOF the requirements for the amendment of the Loan Agreement with World Bank regarding the MDF Facility • Prepare the necessary justifications and other requirements for the amendment of the loan agreement • Request the DOF to make the necessary representations with World Bank
7. Training of bank account officers on NRE	Diffuse expertise on assessment of NRE projects	Dept. of Energy and Development Bank of the Phil.	• Design a training program that takes into consideration the realities of banking in the Philippines, previous experience and the objectives for NRE • Consult with the Training Departments of the Banks to get inputs on the training program • Obtain funding for the program • Implementation • Monitoring and reporting

Recommendation	Ultimate Objective	Responsible Agency	Subsequent Actions
8. Networking for grants to support first round proponents	Enhance available financial support for first round proponents	Dept. of Energy	• Come up with a grand plan that would incorporate private sector participation and possible grants and soft loans to proponents • Identify NRE friendly countries and determine acceptable schemes that they can fund by was of grant or soft loan or a combination of the two • Come up with various schemes to be presented to the embassies of the countries identified • Make a formal request through the DFA
9. Bureau of Customs to reduce hassles on NRE importation	Facilitate entry of imported equipment and spare parts	Dept. of Energy and Dept. of Finance	• Come up with appropriate document identifying among others the specific items covered and the suggested procedure to facilitate release of imported items and documents thereof • Consultation with Bureau of Customs people regarding the documents • Formally request approval of the DOF Secretary

Appendix A

White Paper

White Paper on NRE

EXECUTIVE SUMMARY

NRE has all the elements of a viable project but could not obtain loans from the banks because of barriers related to the newness of the enterprise. In examining the hesitancy of banks to lend to NRE, the following were examined in addition to an analysis of the viability of the NRE:

1. Creditworthiness of LGU as proponent of NRE
2. The support given to NRE and to the LGU and
3. Readiness of the banks to lend to NRE

The analysis addresses a problem which is defined as follows:

<u>How to overcome the hesitancy of banks to provide loans to NRE Projects?</u>

The analysis revealed the following:

1. Although there are no documentary evidences attesting the profitability and viability of NRE projects as business enterprises, NRE possesses all the attributes of a profitable and viable enterprise
2. The LGUs are the appropriate first round proponents of NRE projects. There is a need, however, to strengthen them by arranging for strategic partners and venture capitalists
3. Newness of NRE in a business environment makes investors and banks apprehensive about business and credit risks. To allay the apprehensions, guarantees, special funds, incentives, flexibilities on rulings and other forms of support should be given to projects as well as the first round proponents and the banks willing to bet their loanable funds into NRE projects.

Specifically, the following actions are being recommended:

1. Setting up of a guarantee facility for NRE to cover credit risks especially for the first round proponents that are not LGUs. The LGUGC only guarantees loans obtained by the LGUs.
2. Setting up of a group that will provide assistance to NRE proponents in walking through the documentary maze of setting up a business enterprise, in complying with loan requirements and in availing grants and incentives. The group should have the capability to assist the LGUs in dealing with banks, venture capitalists, foreign funders and potential strategic partners.
3. Inclusion of loans to NRE as alternative compliance to the Agri-Agra Law as incentive for banks to lend to NRE projects

4. Issuance of a BSP Circular to classify NRE among projects with long gestation periods. This will provide banks greater flexibilities in their loan terms to NRE projects without the risk of getting audit exceptions.
5. Setting up of a special with tenor of more than 10 years such that there is a fund that can be used by the banks in lending to NRE
6. Renegotiate with the World Bank for the inclusion of NRE in the list of projects that qualify for MDF funding
7. Training given to DBP personnel under the FINESSE projects should be echoed to loan officers of other banks to further disperse the potential source of loans
8. Negotiate with foreign governments for possible sources of grant funds that will be provided to first round proponents as a kick starter.
9. Negotiate with the Bureau of Customs to reduce hassles in the entry of foreign made equipment and components to be used in NRE projects

TEXT OF THE REPORT

Introduction

Efforts to develop, promote and commercialize New and Renewable Energy (NRE) sources was first launched in 1977. NRE development has surpassed experimental stage and commercialization of NRE has been the focus of efforts in recent years. Foremost among the efforts to commercialize NRE are:

1. Setting up of NRE database at DOE be available to interested proponents. Among the database is the NRE resource map and technical information on specific NRE technology
2. Setting up of NCED at DOE to provide direction to the development of NRE
3. Setting up of various NGOs to assist in the development of NRE
4. Setting up of FINESSE where bank people were trained on assessment of NRE projects
5. Setting up of ANEC as extension arm for NRE in the countryside
6. Setting up of REAP to encourage private sector participation in NRE projects
7. Conduct of various researches that addresses on the various components for the commercialization of NRE

The direction of these efforts is the setting up of a critical mass of NRE enterprises such that NRE moves forward from emerging stage to development stage. As an enterprise consisting of many individual business projects, NRE goes through a stage of development which is conceptually presented as Annex “A”. Concerted effort from the government and the private sector is needed to move from one stage of development to the next.

A conceptual diagram of the desired development direction of NRE is presented as Annex “B”.

Despite the efforts mentioned, the growth of NRE projects has been below expectation. Among the major reasons cited is the hesitancy of banks to provide loans to NRE projects and this hesitance limits the amount of funds available for setting up project. Banks, particularly the GFIs, asserts that they have the funding and the willingness to lend to NRE but this statement seems to be short from being a commitment. The absence of loans from the banks is limiting the growth of NRE projects.

Among the possible reasons for the slow growth of NRE are the following:

1. The efforts may not be properly focused the factors contributing to the success of NRE
2. The efforts may not be sufficient

Since the banks are in the best perspective in judging the viability of projects considering that they take on an actual risk once they decide to lend to a project, it was deemed proper to state the problem with the favorable consideration of the bank as the main focus.

While it is true that there are efforts to promote NRE, it is helpful also to make an assessment of existing efforts to determine if:

1. The efforts are focused in areas that are critical to the success of NRE and
2. The efforts are sufficient

Statement of the Problem

The problem is, therefore, stated as follows:

How to overcome the hesitancy of banks to provide loans to NRE Projects?

In addressing the problem, the intention is to bring electric energy to the over 8,000 unelectrified barangays.

The Approach

For purposes of the foregoing discussions, NRE projects shall mean projects that are operated to deliver electric energy to a number of potential buyers for a fee. NRE for individual use like solar home systems shall be discussed in a separate section.

To appropriately address the problem requires an examination of the issues relative to the hesitance of the banks to grant loans to NRE. The hesitancy to lend to NRE will be examined not only from the viewpoint of the project proponent but also from the viewpoint of the Bank.

To address the stated problem, therefore, there is a need to break the problem into more manageable component issues or problems. These components, which are the critical success areas of NRE, are as follows:

1. Viability - Is NRE really viable as a business project in the Philippines?
2. Proponents - Are there creditworthy proponents of NRE projects?
3. Support - Are the required support for NRE present?
4. Funding - Are Banks really ready to lend to NRE?

Addressing the issues mentioned will subsequently result into addressing the barriers that make banks hesitant to provide loans to NRE.

A conceptual presentation of the methodology in addressing the problem is marked as Annex “C”.

The specific direction is the setting up of viable NRE projects to provide electric energy to the remaining unelectrified barangays in the Philippines. It is premised that NRE is the appropriate technology and the least cost alternative to provide electric energy to these barangays.

Viability of NRE as a business project

NRE is an emerging business enterprise in the Philippines. As such, its viability as a business activity is yet to be proven. Success stories are still in the making as it was only recently that NRE projects were being operated as business entities. Although these projects are operating smoothly, it is too early to judge their viability using standards of a viable business entity like Internal Rate of Return, Payback Period, Profitability ratios and liquidity ratios, among others. Success stories of NRE as business entities, however, are numerous in other countries, among them India.

Project viability goes hand in hand with the bankability of the proponent and these two items are the basic foundations of a financing framework. A conceptual presentation of the framework is marked as Annex “D”. For purposes of focus in the discussions, however, issues on the viability of NRE projects has been separated from the issues on bankability of proponents.

An alternative method to ascertain the viability of NRE is to assess the presents of the components that determine the viability of a business entity. These components are:

1. Market – DOE has divided the whole NRE market into various market packages. Each market package, composed of an average of 10 barangay, possesses the necessary attributes to support NRE business enterprise. Using the market package approach, there is a viable market for NRE.

2. Technical Feasibility – DOE has complete studies of the locations of resources that can support NRE projects. NRE is technically feasible in areas specifically identified by DOE using a specified NRE technology.

3. Socio-Economic Considerations – There is economic and social justification in providing energy in unelectrified barangays because of the findings that electricity is a catalyst of economic development

4. Financing – There is a viable financing scheme for NRE. This is discussed in detail in a separate section.

5. Packaging – The chances of a project getting a loan is improved if the project is properly presented. Proper presentation highlights the critical decision areas and allows both the bank and the proponent to discuss critical areas. Private consultants can prepare project packages but at a high cost. The setting up of a unit at DOE to perform packaging function at reasonable cost to the proponent would be desirable.

It can be concluded at this point that NRE has the elements to be a viable business enterprise. The existence of a market and a viable technology is a good starting point.

Given adequate financing, operating and management support, NRE enterprise can be operated viably and profitably.

Proponents of NRE projects

The potential proponents of NRE are the following:

1. Individual Households – The predominant type would be solar home systems (SHS). Financing for acquisition of SHS by households shall be discussed separately.
2. Investors
3. Existing Business Entities – For own use of NRE
4. Electric Cooperatives
5. Non-Government Organizations
6. Local Government Units

There are two categories of proponents/investors in a developing enterprise and these are:

1. The first round proponents who are willing to provide the equity to an enterprise at the early stage of development
2. The second round proponents who will provide equity to the enterprise on the basis of historical performance of projects. These type of proponents may opt to purchase the equity holdings of the first round proponents or provide equity to projects with characteristics similar to those where the first round proponents have an equity position.

It is therefore, important the first round investor are successful otherwise continuous development of NRE will not be sustained.

The First Round Proponent

From among the prospective investors mentioned above, the LGU is the most appropriate entity to be the first round investors because of the following:

1. It is part of their mandate to bring development to the citizens
2. They have the borrowing capacity
3. It has the necessary political clout to support and push the project
4. It has the capability to tap funds from various sources

The potential location of NRE projects, however, are the lower class municipalities whose revenues are low and the LGU's equity contribution and borrowings may not fully cover the funding needed to pursue the NRE project. Further, LGUs are not in the business of power generation and are likely to lose money if they were to handle the operation and management of the NRE project. There is a need, therefore, to look for parties or entities that will cover for the gap. Among the options are equity from a strategic partner to form a joint venture and from venture capital institutions

Joint Venture Option (with Strategic Partnership)

A conceptual presentation of a Joint Venture option is presented as Annex "E".

Entities go into strategic partnership with another entity to enhance their capabilities in certain undertakings with joint venture agreement as the legal instrument. In the case of the LGUs, they have to look for a strategic partner in NRE projects to compensate for perceived weaknesses that include management capability and technical and operational expertise in managing NRE projects. Potential strategic partners of an LGU are:

1. Electric cooperatives – The coops can contribute accumulated business knowledge in making the NRE project operate profitably
2. Equipment suppliers – The equipment suppliers may be willing to retain portion of the equipment cost as equity into the project as a proof of their confidence that the project will deliver the service under local conditions and to transfer the required technical and management knowledge in the profitable operation of the project.
3. Entities under the DOE may have funds that can be used for joint venture. If such funds are available and are infused as contribution in a joint venture, the DOE has the moral as well as the legal bases in leading the enterprise in making appropriate decisions.

To make a successful joint venture, a skilled arranger is needed. The service of arranging may be provided by banks, consultancy firms or by trained staff of DOE. It is suggested that DOE staff be given the training in deal arrangement to reduce the cost to the proponent. Likewise, there is a higher chances of success for a DOE staff to do the arranging compared to a passive consultant.

Equity from Venture Capitalist

GFIs have subsidiaries engaged in venture capital business. The DOE can make arrangement with the GFI management such that part of the venture capital funds are earmarked for NRE projects.

Barriers to the First Round Investors

The first round proponent, in the conduct of due diligence process prior to a decision to invest into NRE project, is likely to encounter the following barriers:

1. High Project Development and Investment Cost – The high level of fixed investment required on NRE project may frighten the proponent and is likely to ignore the presence of a business opportunity knowing that its capital base is limited.
   There is a need to come up with options to reduce the initial investment cost of the proponent and among the possibilities are:
   a. Grants from foreign sources – Countries supplying the equipment may be able to provide grants to reduce the cost of the project. In addition, low cost funds may be available for the loan portion of the project cost.

   b. Subsidy from the government – The government may be able to come up with funds as subsidy to reduce the investment cost to the proponent.
   c. Waiver of duties and taxes on imported equipment and components thereof – This can result in substantial reduction in the cost of the project.

2. Documentary Requirement – Setting up a business, complying with registration requirements and applying for a loan requires a lot of documentary requirements that turns off the interest of countryside investors. LGU staff may not have the patience and the needed knowledge to properly comply with documentation, hence lose patience.
   The banks and regulatory bodies may have to be requested to simplify their documentary requirements and lessen the burden of compliance on the part of the project proponents. Assistance must be provided to proponents where the documentation can not be simplified as in the case of the bank.

3. Feasibility Study Requirements – Banks require feasibility studies especially for projects with more than one year repayment terms. LGUs may not have the capability to prepare nor have the funds to cover the cost of preparing feasibility studies.
   The Coordinating Council for Private Sector Participation (CCPSP) can provide funding for preparation of feasibility studies. The LGUs, however, need assistance and guidance to be able to access the funds because their distance from Metro Manila makes compliance difficult for them. Appropriate guidelines of CCPSP is marked as Annex "F"

4. No track record – LGUs do not have business track record. In the eyes of the lender, absence of track record aggravates the credit risk.
   LGUGC provides guarantees to borrowings of the LGUs up to the extent of their borrowing capacity. Potential problems with respect to the guarantee of LGUGC are:
   a. The implementation of the NRE project will have to be suspended if the borrowing capacity of the LGU is lower than the cost of the project. As such, other alternative schemes must be explored.
   b. NRE is not among the qualified projects that can be the subject of guarantee. Negotiations should be made with LGUGC to include NRE among the projects that can qualify for a guarantee.

   Appropriate guidelines of LGUGC is marked as Annex "G"

5. Poorly capitalized – Majority of the LGUs with unlectrified barangays are considered poor in terms of revenue generation and have limited capability to raise funds to capitalize NRE project. It should be stressed at this point that borrowings of the LGU to partially finance project cost will be recognized as liabilities and not equity of the LGU into the project. This is because the major consideration in a credit decision is the capability of the project to generate funds to service the obligations to be incurred. To strengthen the capitalization of the project, there should be a group that will assist and guide the LGU in seeking for investors. Potential investors include equipment suppliers, entities concerned with the environment and venture capitalist.

The Second Round Proponents

The second round proponents are not risk-takers and will invest because the first round investors have proven that NRE is a viable enterprise. The first round investors have identified and successfully the business problems that NRE is now considered less risky project.

Second round investors do not have funding limitations and may opt to buy out the equity of the first round proponents or may set up similar NRE projects.

The role of the first round proponents is very critical to the growth and the setting up of more NRE project. As such, it is necessary that the first line proponents are given the necessary support such that they will succeed. Care should be taken, however, such that assistance and financial schemes are not used as justification for project that are not viable and should not be pursued at all.

Support for NRE Projects

NRE, being an emerging enterprise and is expected to operate in a countryside environment especially areas not yet reached by electricity. The presence of electric power in target areas of the countryside is expected to brings forth both beneficial effect to the rural economy and the environment. As such, NRE deserves support from both the government and the private sector. The forms of support that can be given to NRE projects and to the LGU, being the first round proponent should include the following:

- Incentives
- Special funding
- Assistance on feasibility studies preparation
- Grants and subsidies
- Arranging assistance
- BSP rules considerate of the peculiarities of NRE

INCENTIVE

From the government sector, the enterprise should be entitled of the following:

1. Tax Incentives – Under BOI rules, pioneering enterprises (which include NRE) is entitled for 5-year tax holiday. NRE projects should be entitled for a longer period (possibly 12 years) of tax holiday as a premium to the first round proponents because of the following:
   a. Target project site is the countryside. Premiums are given to investors that decide to invest their money in countryside enterprises
   b. It will catalyze economic activity leading to the improvement of the income of the people. What the government will lose from the foregone taxes will be more than recovered from the business and income taxes from businesses to be set up from because of the availability of power.
   c. The project is developmental in nature

2. Waiver of customs duties from imported NRE equipment and components – Duties on imported NRE equipment and components are waived but the importers are not getting the said benefit because of conflicting interpretations from the examiners from the Bureau of Customs. Further, Customs people sometimes take time to resolve issues to the disadvantage of the proponent.
   The government should, therefore, make a clearer policy on customs duties, one that is not subject to conflicting interpretations. Through clearer policies, proponents can avoid unnecessary cost from delays in the release of equipment and from paying additional cost which they should not have paid in the first place.

3. Preferential benefits – NRE projects can achieve certain benefits if
   - Loans of banks to NRE projects can qualify as alternative compliance to the Agri-Agra Law and
   - If there is a BSP circular that includes NRE among projects with long gestation periods.

   Representations should be made with the appropriate government body for purposes of having issuances favorable to NRE.

Special Funding

The Municipal Development Fund (MDF) which is being administered by the DOF can be a source of funding for NRE projects with LGU as proponent. The MDF is an appropriate funding because of the following attributes:

- Availment is a combination of a loan component and a grant component. Grant component can reach as high as 70% and is given to projects of 5th and 6th class LGUs
- Loan portion has a maximum term of 15 years and a 3-year grace period.
- It does not require collateral in addition to the IRA of the LGU

Funding for the MDF is sourced from the World Bank. Under the loan agreement between the Philippine Government and the World Bank, NRE was not among the qualified projects that can be financed by MDF.
For NRE projects of LGUs to qualify for MDF funding, the Philippine Government should renegotiate with the World Bank for the inclusion of NRE among qualified projects. Further, NRE should be entitles to the maximum 70% grant portion.

The MDF guidelines is marked as Annex "H"

Grants and Subsidies

Grants and subsidies for projects may come from local as well as foreign sources. Local sources of grants are budget appropriations and budget savings of the line agencies as well as from a number of foundations. Sources of foreign grants include foreign governments and private foundations.

The 5th and 6th class LGUs may neither have the data base nor the knowledge on the procedure of availing the grants and subsidies for NRE projects that they intend to pursue. There has to be a group to assist and guide the LGUs such that they can avail of the money from grants and subsidies.

Arranging Function

The deal arranging function is a very important component of the whole set up. The DOE is in the best position to perform the arranging because it has the best intentions to push for the commercialization of NRE. As such, it is suggested that DOE staff should be able to acquire the skills in arranging business deals.

Readiness of banks to lend to NRE Projects

The readiness of banks to lend to NRE projects can be assessed in terms of

- Perception of the banks on the risks involved in lending to NRE
- Internal Policies of the Bank
- BSP Rules and
- Sources of loanable funds

To place the analysis in a proper perspective, it is necessary first understand the processes going on in their lending operations. Banks face conflicting issues when making a decision to lend to NRE. These conflicting issues are:

- The developmental role of banks as catalyst of the economy of the areas where they operate
- Soundness of the credit decision to NRE and

BANK'S DEVELOPMENTAL ROLE

Banks have the responsibility of contributing to the economic development of the areas where they operate. As such, banks are required to lend to the local community a certain percentage of the deposit they generate from their area.

Because of the critical role of credit in the economic development , the economic status of an area has usually a direct relation to the level of credit given to the business entities and the residents.

SOUNDNESS OF CREDIT DECISION

Banks are institutions of trust. People deposit money with the banks because they feel confident that they can get their money back on demand or at a certain determinable time in the future. Money generated from deposits constitute the bulk of the funds given as loans to qualified borrowers.

Banks are regulated institutions. Regulations are imposed on banks to make sure that they exercise prudence and make good business judgment. There are regulations that banks observe covering almost all aspects of its operations. Among the rules and regulations that banks are bound to observe are those included in its corporate charter, circulars of the Bangko Sentral ng Pilipinas, provisions of existing laws, Generally Accepted Accounting Principles, international laws and practices and internal policies of the bank. Regulations are necessary component in the of operation of a bank because trust and confidence of the public is its most important asset.

Criteria for lending

Banks do not avoid risk but rather manage risk relative to their lending operations. Management of risk requires identification of the sources of risks and the exercise of appropriate measures to mitigate the effect of the risks.

Loans are the primary source of income for the banks. Loans are also the principal source of risk as credit decisions can make or break a bank. The risks involved in the lending process are:

1. Credit risk – This is the probability that the bank will not be able to fully recover the principal and interest earnings of the amount loaned to borrowers.
2. Liquidity risk – The probability that the bank will not be able to service demand for deposit withdrawals because of inability to generate cash from collection of loans.

On credit risk - To mitigate risk of losses arising from credit risk, banks need to exercise care and due diligence in their lending operations. This requires a continuing process of evaluation that commences at the time the borrower files for an application for loan and only ends once the principal and interest earnings on the loan is collected in full.

A bank account officer focuses on two areas in the process of evaluating a request for a loan. These are:

1) bankability of the proponent and
2) viability of the project.

The account officer relates the two areas with the possible sources of credit risk which are the following:

1. The Borrower – The borrower may possess qualities that can either increase or decrease the credit risk.
2. The Project – The nature and characteristics of the project in terms of stability of income, cash flows, investment levels, operating costs and seasonability can either increase or decrease the level of credit risk
3. The Economic environment – The prevailing conditions of the economic environment affects the performance of the project

4. Fortuitous events – Fortuitous events adversely affect performance. The critical thing to look into is the resilient of the proponent and the project to recover in case a fortuitous event occurs.

The process of assessment has as its bottom line the bank being able to eventually recover the principal amount and the earnings of whatever they lend to the proponents. Banks take the necessary precautions prior to granting loans and one of the precautions taken is a careful evaluation of the proponent and the project before arriving at a decision to lend money.

RISKINESS OF NRE PROJECTS

The level of loans in a given enterprise or industry is indirectly related to the level of perceived risks involved. If an enterprise or industry is perceived to he high risk, banks are likely to avoid lending or limit their loan exposures in said industry of enterprise.

Despite the claims of the GFIs that they have the funds and the technical capability to evaluate NRE projects, the issue remains that there is no substantial lending to NRE project. The reasons identified for the low level of exposure in NRE projects are:

1. Absence of local fund source that would match the nature and characteristics of loans for NRE Projects. NRE projects require a 10 to 15-year loan tenor and an average of two (2) years grace period in amortization payments. Bulk of the funds being used by banks in their lending operations come from savings deposit. Saving Deposit is considered a short term fund source because the depositor can withdraw his/her deposit on demand.
   No local fund is available to match the kind of money required by NRE and this serves as a major barrier for banks from earmarking or committing loanable money for NRE projects.
   There is a need, therefore, to look for funds from local and international sources to be used by banks in lending to NRE projects. The availability of said type of money mitigates risks from having liquidity problems when they lend substantially to NRE.

2. Lack of track record of performance of NRE projects - NRE business projects are fairly new as these were previously funded as stand-alone demonstration projects implemented by international development and bilateral aid programs. Particular areas of concern of the banks are the following:
   - ✓ Presence of successful projects that can serve as model for financing
   - ✓ Profitability – Banks have doubts on the capability of NRE projects to operate at a profit in a countryside environment where the disposable income of the clients are low and the demand is low
   - ✓ How reliable is the technology in delivering the power

   To mitigate the risk from absence of track record, there is a need for proponents to provide collaterals or to obtain a guarantee from guarantee institutions.

3. High transaction cost – There is high transactions cost associated with the marketing, service, and credit collection in rural areas. Long distances, poor transport infrastructure, impassable roads during monsoon, low literacy rates, cash-and-barter transactions, and lack of technical skills mean high transaction cost. Costs and staff time needed for marketing, credit or fee collection, service, establishing business infrastructure, and training staff can be high.
4. Unfamiliarity of NRE Technology - NRE technologies are considered high risk as they are unproven. This unfamiliarity with the technologies can deter lenders from making an investment. It is critical to ensure that NRE projects involve technologies that have a proven track record and that the terms and conditions of the contracts are well understood (e.g. product guarantees, warranties and service). The perception that NRE technologies are unproven and unreliable is pervasive within the investment community.
5. Absence of Second way out – Most NRE projects are site specific meaning that they were designed for a particular area. As such, the equipment has not value if transferred to another area. In the event of a foreclosure, therefore, the bank's recovery on the equipment is nil. Attempt to establish a secondary market for NRE equipment has been unsuccessful as even suppliers refuse to buy NRE equipment, if foreclosed by the banks.
6. Weak Cash Flow – Non-grid connected NRE projects are not covered by enforceable power supply agreement that can become a guarantee of cash inflows. Further, NRE business projects in a countryside environment are providing power to a sector with a questionable capability to pay for power deliveries.
7. Absence of Creditworthy Proponents – Philippine banks place heavy emphasis on the balance sheet of the proponent. Countryside entrepreneurs may have the real estate assets but values thereof are low because of their location. As such, they are considered poorly capitalized and are considered high risk borrowers.

BSP Rules

Banks are regulated institutions and bulk of the regulations that the banks are supposed to observe are those of the Bangko Sentral ng Pilipinas (BSP). The regulations are mean to guard banks from getting into speculative transactions. Loans that are deemed high risks are considered speculative and hence prohibited act.

BSP examiners audit the banks from time to time to determine their compliance to regulations. Violation of BSP rulings result into penalties, sanctions and suspension of certain privileges of the banks.

Newness of NRE as a new enterprise explains why NRE is considered high risk.

Internal Policies of the bank

Internal credit policies of the bank are most of the time more restrictive than what the BSP ruling stipulates to allow for a margin of error. The situation makes it more difficult for loans to NRE as stand alone project to get application for loans approved by the bank management.

Funding Sources

As discussed above, the mismatch between the kind of money required by NRE and the kind of money that banks can use for lending is a major problem if banks were to lend to NRE.

HOUSEHOLDS AS BORROWERS FOR NRE

Households may avail of loans from micro credit sources to partially finance the acquisition cost of SHS and other NRE suitable for household use. The high interest costs of loans obtained from micro credit sources, however, serves as barrier to the number of households than are willing to buy NRE.

CONCLUSIONS AND RECOMMENDATIONS

Viability

Although NRE enterprises are yet to make a documentary evidence of business success, NRE projects possess the qualities to make a viable business enterprise.

Proponents

The LGU is a worthy first round proponent but should be supported by strategic partners and venture capitalists

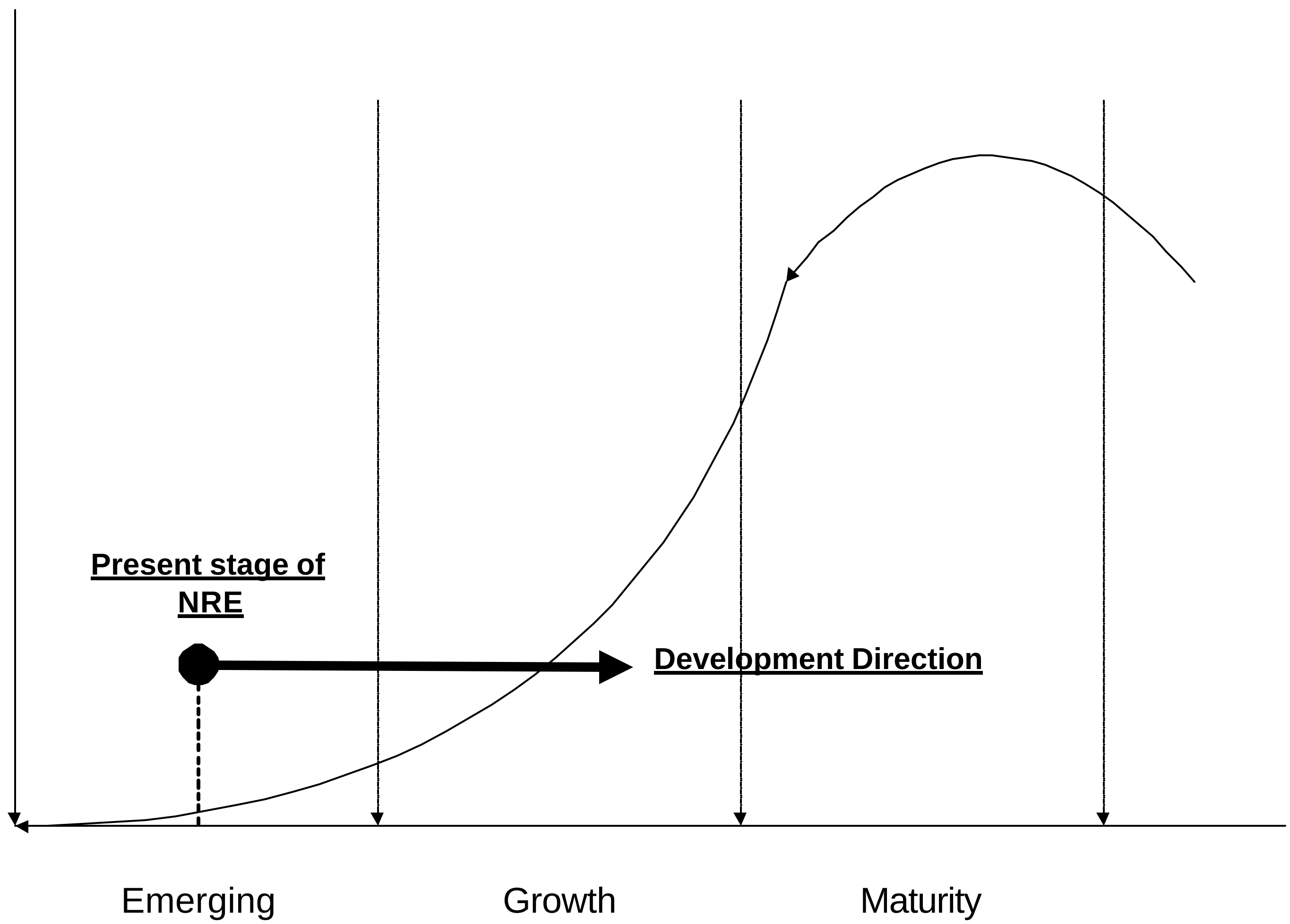
Support

There are still areas that need to improved as discussed above.

Funding

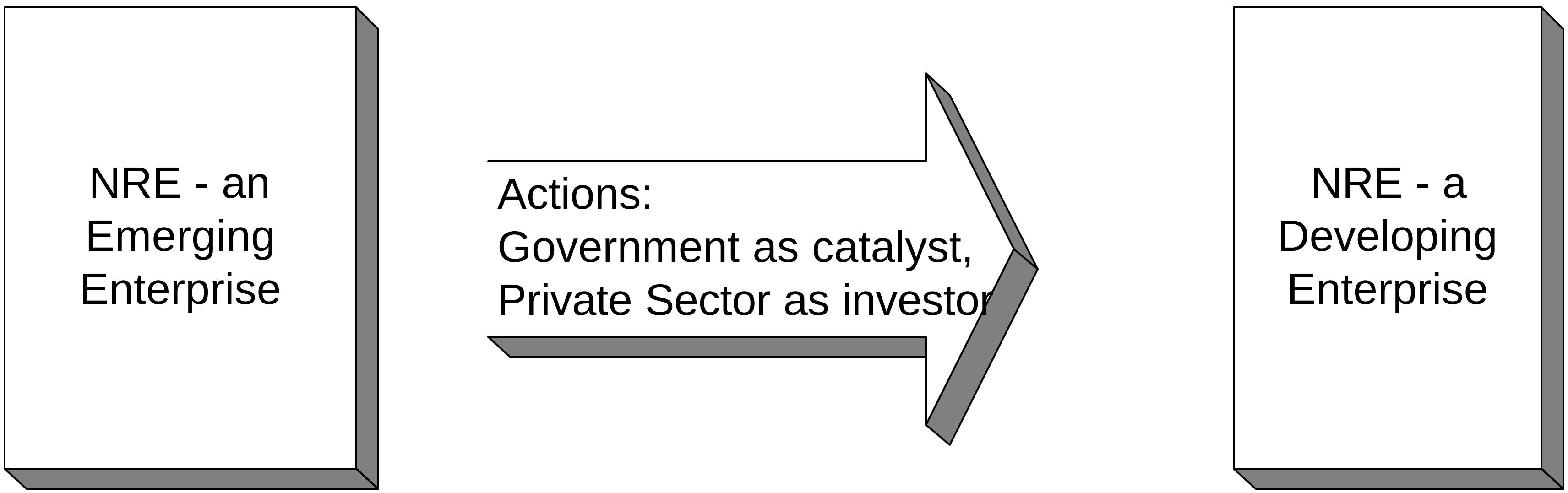
Only DBP is ready to lend to NRE. There are, however, a number of areas that need to be done to lessen the credit and liquidity risk to the lender.

Annex “F” is a tabulation of the conclusions and the recommendations discussed in the texts of this paper.

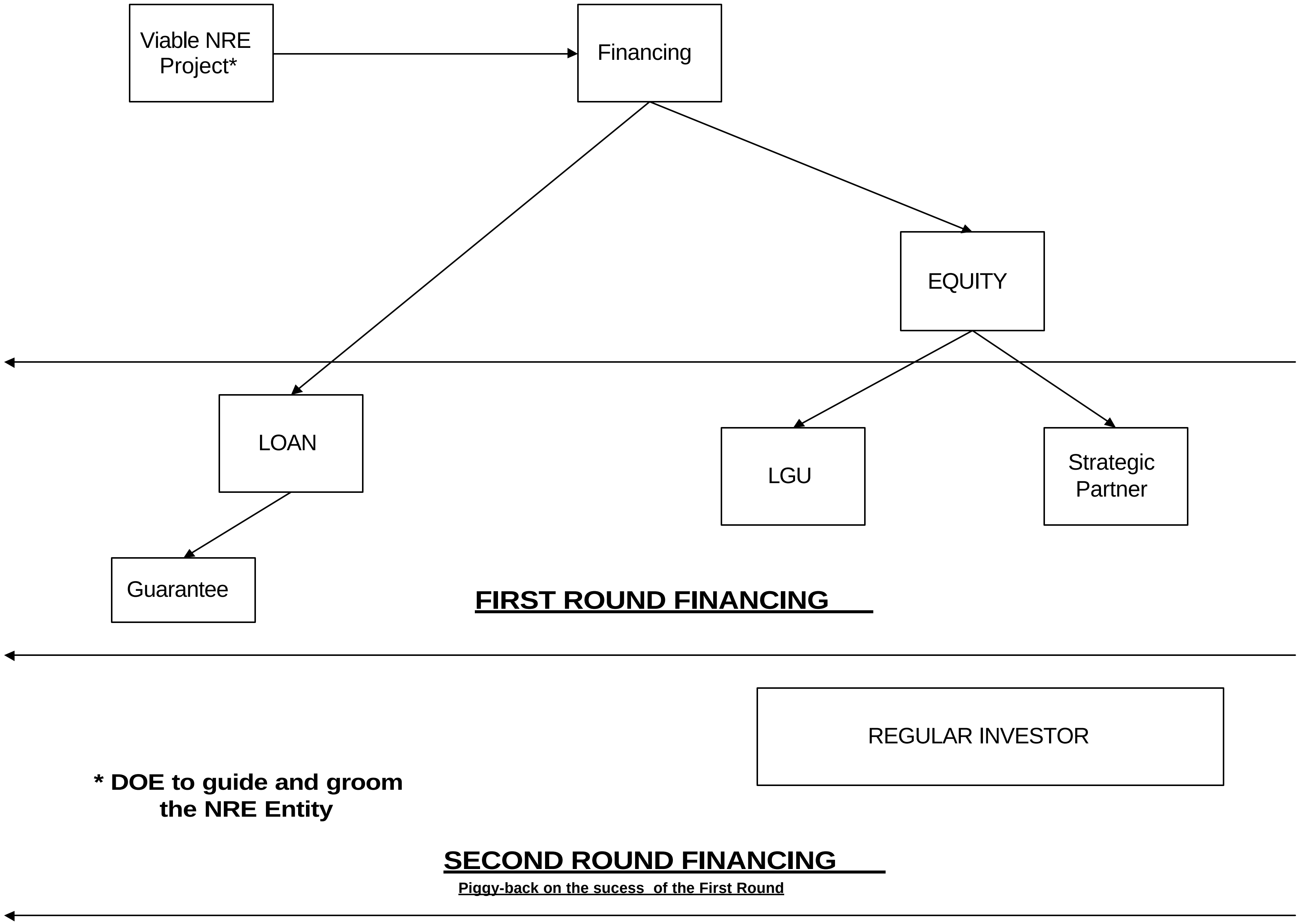


ANNEX "A"
NRE Development Stages

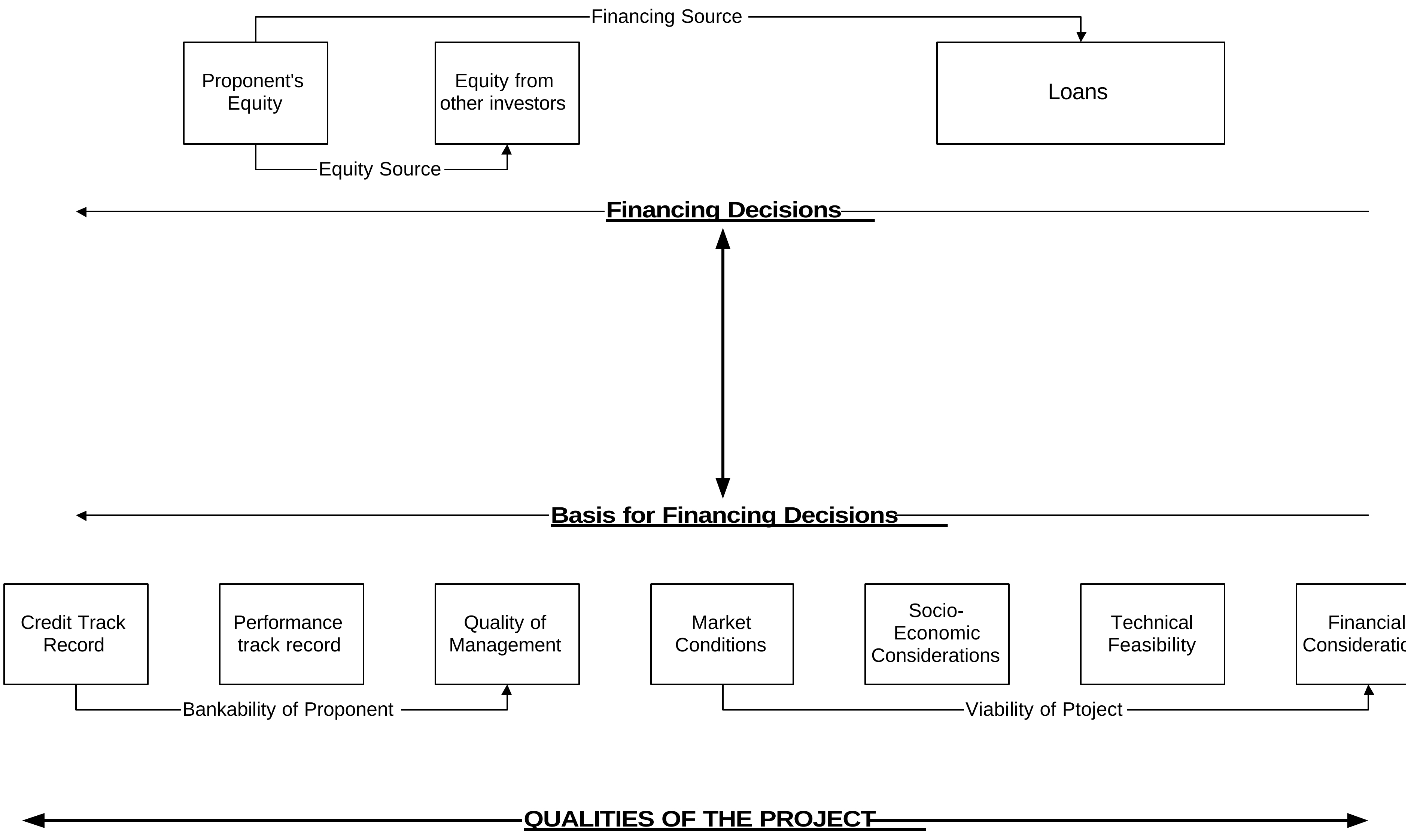
ANNEX "B"


NRE - an Emerging Enterprise
Actions:
Government as catalyst,
Private Sector as investor
NRE - a Developing Enterprise

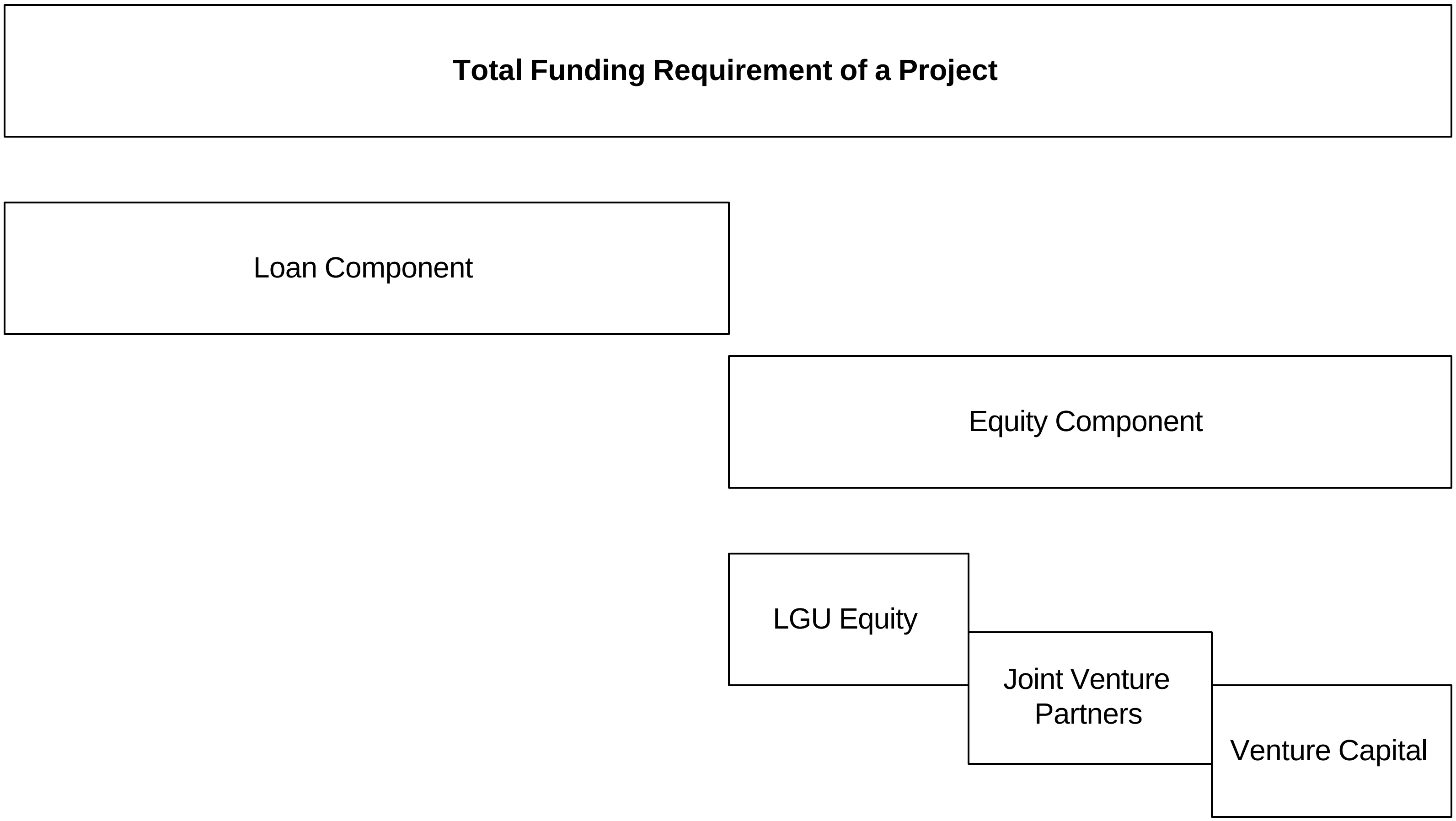
ANNEX "C"


Viable NRE Project*
Financing
EQUITY
LOAN
LGU
Strategic Partner
Guarantee
FIRST ROUND FINANCING
REGULAR INVESTOR
* DOE to guide and groom the NRE Entity
SECOND ROUND FINANCING
Piggy-back on the sucess of the First Round

Annex "D"
Financing Framework



ANNEX "E"


Total Funding Requirement of a Project
Loan Component
Equity Component
LGU Equity
Joint Venture Partners
Venture Capital

ANNEX "I"

	Status/Condition			
Criteria	**Ideal**	**Actual**	**Deficiency**	**Proposed Action**

SUMMARY

Viability of NRE				
Market Feasibility	Market size big enough for project to be profitable	Market packages are big enough to support viable NRE projects	n.a.	n.a.
Technical Feasibility	Project technically feasible in target site; cost to produce power low	Cost of producing power lower compared to power source currently used by market	n.a.	n.a.
Socio-Economic	Project to enhance earnings of users	Presence of power source to perk up existing economic activities and will create new ones	n.a.	n.a.
Financing	Available under terms that matches peculiarities of NRE	Financing terms do not match the peculiarities of NRE	Financing will be discussed separately	To be discussed separately
Packaging	Project properly packaged and presented	No entity helping proponents package proposals	A government or a private entity that understands and can package renewable energy projects	DOE to set up a unit focused on assisting proponents in packaging NRE projects

ANNEX "I"

	Status/Condition			
Criteria	**Ideal**	**Actual**	**Deficiency**	**Proposed Action**

Creditworthiness of Proponents				
First Round proponent LGUs	LGU can comply with the bank criteria	Lower category LGUs may lack the revenue levels to qualify for a loan that is high enough to finance total project cost	A party that can cover both the financial and other limitations of the LGU	An entity that can identify possible entities that are willing to contribute initial equity into NRE projects
Strategic Partners	Ready to provide additional capital and strengthen operational capability of project	Equipment suppliers, DOE and engineering firms can be strategic partners	An entity to broker a deal between the LGU and the strategic partner	An entity to act as intermediary to broker a deal between LGU and a strategic partner
Venture Capitalist	Provide additional capital under acceptable terms	The GFIs have subsidiaries engaged in venture capital business	GFI subsidiaries to include NRE in their list of priority investments	An appropriate deal with the GFI subsidiaries
Barriers of first round investors – the LGU				
High Project Cost	Total Project cost should match the	Cost of project too high that it discourages proponent despite benefits	Subsidy or a grant that will reduce the project cost from the proponent's viewpoint	Negotiate for grants to NRE projects with international funding institutions like DANIDA, NORAD and JBIC
Documentary Requirement	Documentary requirements for setting up of project and in obtaining a loan are designed such that proponents can comply	Low tolerance to numerous documents required	Simplification of the documentary requirements; assistance in compliance	Set up a group that will provide assistance and guidance to LGUs and other first round investors
Feasibility Study requirement	Feasibility study funding accessible to LGU and other first round proponents	Unable to access funds to pay for the cost of feasibility study preparation	Assistance to help qualify for feasibility study funds from CCPSP	A group that will provide assistance and guidance to LGUs and other first round investors
Track record	First round investors with track record in other business projects to vouch capability to run project	LGUs and other first round proponents with no business track record and are new to NRE	Alternative track record	Setting up of a guarantee facility for NRE project

ANNEX "I"

	Status/Condition			
Criteria	**Ideal**	**Actual**	**Deficiency**	**Proposed Action**
	viably			
Capitalization	First round investors having the necessary level of capitalization to pursue NRE projects	LGUs and other first round proponents with no adequate capitalization	Source of additional capitalization for NRE projects	A group that will negotiate with potential investors
Second Round proponent Electric Coops Households Local investors NGOs Existing businesses	Entities to spontaneously invest into NRE because it is perceived to be viable and can generate acceptable profit level	Not applicable	Business framework that will encourage entry of the second round investors	A group that will study the needs and prepare for the entry of the second round NRE proponents

ANNEX “I”

	Status/Condition			
Criteria	**Ideal**	**Actual**	**Deficiency**	**Proposed Action**
Support from the Government				
Incentives				
Funding from MDF	NRE projects to qualify for long term loans from MDF program	NRE Projects not included in the list of projects qualified under MDF	MDF to include NRE in the list of qualified projects	The government to renegotiate the loan agreement with World Bank to include NRE among qualified projects
Agri-Agra Law	Loans to NRE included as alternative compliance with the Agri-Agra law	n.a.	n.a.	Issuance of an appropriate BSP circular
Assistance on Studies	• Sources of funds for studies are identified • Assistance to first round proponents in complying with requirements to access funds for studies preparation	CCPSP has funds for feasibility studies. There are also foreign donors that provide funds for feasibility studies	Assistance to first round proponents in having access to these funds	A group that will provide assistance and guidance to LGUs and other first round investors
Grants and Subsidies	• Sources of grants and subsidies are identified • Assistance to first round proponents in complying with requirements to access of these grants and subsidies	Grants and subsidies are available but first round proponents could not access	Assistance to LGUs and other first round proponents	A group that will provide assistance and guidance to LGUs and other first round investors
Arranging function	An entity that will put together the first round investors, the potential strategic partners, the venture capitalists and the GFIs to set up the NRE project	n.a.	n.a.	A group that will provide assistance and guidance to LGUs and other first round investors
BSP Rules on NRE	BSP to issue guidelines in lending to NRE	n.a.	n.a.	A group to formulate and propose BSP guidelines for NRE

ANNEX "I"

	Status/Condition			
Criteria	**Ideal**	**Actual**	**Deficiency**	**Proposed Action**
				NRE
Readiness of banks to lend to NRE				
Project Risks arising from • High project cost • Lack of track record • High transaction cost • Unfamiliarity with technology • Weak cash flow • Absence of a second way out	Project risks are mitigated. Risks to be mitigated include: • Credit risk • Liquidity risk	No specific scheme to mitigate the risks of the banks when lending to NRE	Risk mitigation schemes	• Setting up of a guarantee scheme for NRE • Setting up of a special fund that banks can use in lending to NRE
Funding Source	Funds that the GFIs can access to be able to finance NRE projects	Not existing		Setting up of a special fund that will match the peculiarities of NRE
BSP Rules	BSP rules considerate of the realities in financing NRE	Rules are formulated such that they have general applicability		A group to formulate and propose BSP guidelines for NRE
Internal policies	Internal policies of the bank considerate of the realities in financing NRE	Internal policies are formulated such that they have general applicability		A group to formulate and propose Banks guidelines for NRE

Appendix B

Draft Memo to DOF on Inclusion of NRE in MDF Qualified Projects

MEMORANDUM:

FOR : The Secretary, Department of Finance

FROM : The Secretary, Department of Energy

SUBJECT : Request for inclusion of NRE among qualified projects to be financed by the MDF Facility

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1.0 The Request

We wish to request the Department of Finance to make representations with the World Bank for the inclusion of New and Renewable Energy Projects among the qualified projects to be financed.

2.0 Background Information

2.1 One of the thrust of the Department of Energy (DOE) is poverty alleviation and rural development to provide greater opportunities and benefits to underprivileged Filipinos in remote and rural areas. Towards this end, the DOE aims to bring electricity to 8,000 barangays in ___ municipalities. All of the municipalities belong to 6th class category and are in no means qualified for financing from the regular financing windows of GFIs and commercial banks.

2.2 ___ of the unelectrified barangay mentioned can be reached by the grid within the next 2 years. The remaining, however, can be electrified using generators that consume fossil-based fuel or using New and Renewable Energy (NRE) sources like generator powered by solar energy, wind energy and hydro power. The DOE opts for NRE sources because they are environment-friendly in that there is no CO2 emission. Further, NRE is least cost alternative in the long run because they are powered by resources that are free and are replenished by nature. (A briefer on NRE is attached as Annex "A")

2.3 In its attempt to bring electricity to the countryside, the DOE intends to make electrification a community based project. Studies show that project where the active participation of the community is sought are more likely to be sustainable. Considering that the target market is marginalized group, the enterprise of bringing electricity shall focus on full cost recovery plus profit. The level of expected profit, however, is not expected to reach a level that is attractive to the private investor. As such, the municipal LGU is the appropriate proponent for such project as it would be in pursuance of LGU's mandate of spurring development. Such projects are viable because there is a market which are the residents of unenergized barangays and the technology has been proven.

2.4 Funding, however, becomes a problem because the banks and GFIs shun away from 6th class LGUs. It is for this reason that the DOE looks at the MDF as the possible source of funding for LGU electrification projects. There is a need, however, for DOF to make representations with World Bank for the inclusion of NRE among the projects that qualify for MDF financing. If the municipal

LGUs were to pursue NRE projects, it would not only fulfill their social mandate but would also improve the standards of living of the less privileged sectors of society. Likewise, it is in consonance with the policy of the State of local autonomy that will enable the LGUs to attain their fullest development as self-reliant communities and make them more effective partners in the attainment of national goals.

2.5 The estimated average cost of NRE project per municipal LGU is P10 Million. If all the ___ municipal LGU were to pursue NRE projects, the total project cost would be _____ Million.

2.6 Considering that NRE projects are environment friendly and that proponents are among the least privileged municipal LGUs, the DOE will work with NEDA for the possible 70% subsidy portion for such projects.

3.0 Justification: The DOE is endorsing favorably the proposed inclusion because of the following:

a. The project would benefit the least privileged sectors of society
b. It will spur economic development in the countryside

For consideration

VICENTE PEREZ
Secretary, Department of Energy

Appendix C

Proposed Guidelines on Project Evaluation

PART 1
PROPOSED GUIDELINES ON PROJECT EVALUATION FOR
NEW AND RENEWABLE ENERGY PROJECTS
DEPARTMENT OF ENERGY

I. INTRODUCTION

The proposed guidelines consists of two parts as follows:

Part 1 – This is the "PROPOSED GUIDELINES ON PROJECT EVALUATION FOR NEW AND RENEWABLE ENERGY PROJECTS." This set of guidelines is intended for the use of DOE. This is the subject of the foregoing discussions.

Part 2 – This is the "PROPOSED GUIDELINES FOR PROPONENTS OF NEW AND RENEWABLE ENERGY PROJECTS". This set of guidelines is intended for the use of proponents of NRE. This is the subject of another set of documents, which is appropriately captioned.

1.1 Content and Objectives of the Guidelines

1.1.1 Prior to the foregoing proposed guidelines, the Department of Energy used fragmented references in the evaluation of NRE projects. Although the staff of DOE tried their best to provide assistance to NRE projects, the fragmented source of guidelines is an obstacle to effective delivery of the assistance.

1.1.2 The foregoing guidelines, therefore, sets into a single source documents the standards used by DBP and LBP as well as of the DOE, NEA, PNOC-EDC, NPC-SPUG and NEDA in the evaluation of projects. The guidelines were written from the viewpoint of DOE with the end of providing assistance to NRE proponents in obtaining financing from the Banks as well as in raising equity from prospective investors. It does not attempt to duplicate the processes performed by the DBP, LBP, NEA, PNOC-EDC, NPC-SPUG and NEDA but draws lessons from them.

1.1.3 The proposed guidelines were formulated within the framework that DOE's role in NRE projects is that of a catalyst and not as an investor or a lender. As a catalyst, DOE's specific objectives in coming up with guidelines are as follows:

- To improve the approval rating of loan applications of NRE projects
- To enhance acceptability of projects to prospective investors and
- To come up with policies to strengthen weaknesses encountered during the course of the evaluation
- To set up a system in preparation to a bigger fund for NRE projects that will be obtained from the international funding agencies.

1.1.4 Proposed guidelines are useful to DOE especially to the staff that will be specifically tasked to provide assistance to NRE project proponents in obtaining financing.

1.1.5 Perceived assistance is in the form of endorsement of project as well as effecting necessary changes in any aspect of the proposal to increase its chances of getting approval for a loan.

Role of DOE

1.2 DOE plays the role of a Catalyst for Private Sector Participation of NRE Projects. As a catalyst, it would provide assistance to proponents of NRE. The proponent, however, remains primarily responsible for the project. DOE will assist the proponent in dealing with the banks but will not encroach into the credit decision-making processes of the banks. In the performance of its role as catalyst, it should not duplicate the efforts of the banks. It is important, however, that the staff of DOE understand what the banks are doing such that they can provide appropriate advice to the proponent and can intelligently discuss with the account officers of the banks where the need arises.

1.2.1 It is only when DOE is requested by the client or by the bank that it provides assistance. This is to avoid infringing into the "confidentiality of relationship" between the bank and the proponent/borrower. The assistance of DOE is optional and should not be a preliminary requirement for loan application filed with the Banks. Banks should accept NRE projects even in the absence of preliminary evaluation of the DOE.

1.2.2 The nature of assistance requested by a proponent may include the following:

a. Market identification and validation of market assumptions. DOE will make an assessment of the existence of the market and will present to the banks a document stating the existence of a market, the characteristic of the market and other basic market data. It should also 1) prove the assumption on the population and its growth, 2) provide estimates on tariff rates and 3) provide estimates on cost of delivery of electricity.
b. Technical validation and verification of the viability of the technology. As some banks do not have the capability to evaluate technical aspects of NRE projects, DOE will pre-screen the technology. It will indicate in a report that would include information 1) if the technology has been pilot tested and the results of the pilot test, 2) if there existing projects in the Philippines using the technology and the performance of the project and 3) if there are of similar projects in other countries and their performance. The technology has bearing project cost and operating costs. The two costs will, in turn, affect the financial viability of the project.
c. Institutional evaluation including assessment of the readiness of the community and the livelihood component.

d. Verification of "cost of service delivery" calculation/pricing or tariff formula

1.2.3 DOE can likewise provide information on the areas where NRE are appropriate as well as the appropriate matching technology. DOE has an existing NRE resource map that can be made available to the banks and to proponents upon request.

1.2.4 Where requested by Banks, DOE shall provide assistance on areas of institutional strengthening, identification of possible joint venture partners and evaluation of technical feasibility. DOE, however, would not like to make the assistance as a preliminary requirement for loan application filed by proponents with the Banks.

1.3 What it takes to enhance public participation in NRE Projects

1.3.1 The potential investors/proponents and bank/lenders are the two target sectors whose participation is being sought for NRE projects. DOE could catalyze flow of investment and loan funds into NRE projects by understanding the expectations of both and through helping them in achieving these expectations.

1.3.2 Expectation of investors/proponents – The investors/proponents are the risk takers who commit their resources to the project with the expectation that their money would earn a rate higher compared to placing their money into securities. The bottom line of equity investors is the level of earnings that they expect to generate from the project and that they have a reasonable degree of assurance that they can recover their investments as well as their earnings.

1.3.3 Expectations of the Banks – Banks place their money into the projects based on 1) the representation by the proponent/borrower about the project and 2) the confidence of the Bank onto the capability of the proponent/borrower. Banks are concerned about the bankability of the borrower and the viability of the project that is presented to the bank for purposes of funding. The bottom line of the banks is recovery of the principal amount and the earnings of whatever they lend to the proponents. Banks take the necessary precautions prior to granting loans. They focus their evaluation in two areas: 1) the viability of the project and 2) the bankability of the proponent.

1.4 Methodology

1.4.1 The proposed guidelines took into consideration the lending guidelines of DBP, LBP and PNOC-EDC and the project guidelines of DOE, NEDA and

NPC-SPUG. The guidelines, however, were written under the viewpoint that DOE takes the position of a Catalyst.

1.4.2 The proposed guidelines has the DOE Assistant as a centerpiece. A proponent is assigned to a specific DOE Assistant who will not only provide assistance described in this document but also to communicate with other units of DOE where necessary.

1.4.3 The output of the DOE Assistant is an Action Sheet marked as Annex "A". The Action Sheet specifies, among other things, the subsequent action recommended by the DOE Assistant taking into consideration the findings he had from the evaluation of the project.

2. THE PROCESS

2.1 The Process flow within which this proposed guidelines has been formulated is as follows:

2.1.1 The proponent requests DOE for assistance in the packaging of a project. This is after the technical group of DOE has completed assessment of the project and found the same technically feasible.
2.1.2 The DOE Assistant requests the proponent to submit documents indicated in item 3.2
2.1.3 If documents are sufficient, the DOE Assistant conducts an evaluation. Upon completion of the evaluation, an Action Sheet is prepared.
2.1.4 The findings of the DOE assistant on matters pertaining to item nos. 1.2.2 (a) to (e) will be summarized in a report form and will be presented to the PPT or any other body to be defined later on.

2.2. Where a DOE unit or any of its attached agencies prepared the project feasibility study, the DOE Assistant will perform items 2.1.2 and 2.1.3. In addition, he/she will
2.2.1. Come up with a financing model to be presented to prospective investors
2.2.2. Where requested, will present the project to the prospective investor and
2.2.3. Will provide assistance to the prospective investor in doing the groundwork for the investment.

3. EVALUATION

3.1 The purpose of evaluation is to consider all the elements that have bearing to the success and failure of the project and to make a sound judgment on issues arising from each of these elements. Present judgment has bearing on future results, which are usually expressed in financial terms through the projected financial statements.

3.2 Project documents presented to the DOE Assistant for purposes of the evaluation should contain at least the following:

a. Organizational Papers - Articles of Incorporation and By-laws, if the proponent is a corporation or cooperative, Articles of Partnership if a partnership, or Bureau of Domestic Trade Registration if a sole proprietorship
b. If the proponent is an LGU, a resolution from the Municipal/City/Provincial council approving the project, authorizing the LGU to borrow and authorizing for the encumbering of LGU assets including its Internal Revenue Allotment
c. Bio-data of Principal officers and directors of the business
d. Feasibility Study usually prepared by proponent's consultant. Attached to the feasibility study is a statement from the appropriate unit of DOE stating that the technical assumptions in the feasibility study were validated and found substantially correct. If the feasibility study was prepared by a unit of the DOE upon the request of the proponent, the study will be accepted as is.
e. Transfer Certificate of Title and other forms of certificate of ownership on assets proposed to be mortgaged to secure the proposed loan
f. Financial Statement of the proponent for the last three years
g. If the proponent organization is new, Balance Sheet as of a given date and the Financial Statement of the Principal Stockholders for the last three years. If the financial statements are not available, an audited statement of Assets and Liabilities may be submitted.
h. Statement from the proponent and principal officers and directors about cases filed against them in courts.

3.3 The evaluation process starts with an assessment of the proponent. It addresses the question "How bankable is the proponent?" Are the banks willing to place their money into the proponent knowing the circumstances of the proponent?

3.4 Next to be evaluated is the viability of the Project. It focuses on the following issues:
a. Will the proposed project inure incremental benefits to the proponent
b. What are the risks involved and
c. What are the risk mitigation measures necessary

3.5 The Evaluation address risks and profitability in the loan transaction, which are the primary concern of the bank. The banks invest only after conducting an extensive due diligence process and such practice is worthy of replication to increase chances of projects getting approval for a loan. The said process is conceptually presented in Annex "B". A discussion of the process is marked as Annex "C".

3.6 The product of the evaluation is the financial package that will be presented to the Banks and prospective investors. If the proponent presented a financial package, the task of the DOE Assistant is to affirm the financial package or to suggest amendments to make package more acceptable. The Financial Package shall have the following components:
a. The amount of Equity needed in addition to equity contribution of proponent

b. Performance Measures on proposed project that include FIRR, BEP, Payback Period and NPV
c. Terms of the loan to be obtained from the bank include
   1) Amount – Amount of loan is a function of the project cost and the level of equity contributed by the proponent. Elements of project cost is discussed in a separate section of this guideline
   2) Tenor – Tenor is the number of years within which the borrower is to effect full payment of the loan. It is dependent on the projected cash flow. Grace period is allowed for the gestation period but not to exceed two years. Gestation period is the time from started of project up to the time that the project starts to generate revenues. A shorter grace period is allowed in payment of interest portion.
   3) Purpose of Loan – Purpose of loan is to partially finance proposed project.
   4) Interest Rate – Discussed in foregoing section
   5) Drawdown – Most terms loans are released according to stages of completion of project. The initial release is usually made after reaching a certain percentage of project completion using funds from equity contribution from proponent. Subsequent releases are made after the appraiser has verified that proponent has spent a specified amount for the project or after reaching a certain stage of completion.
   6) Repayment – Quarterly payment is convenient to both the proponent and the bank. When cash flows are tight, a maximum of 2-year grace period on principal and 6 months grace on interest.
   7) Collateral/Security – Discussed in foregoing section
   8) Insurance – Collateral should be insured with reputable insurance company.
   9) Compensating Business – Banks prefer that proponent maintains deposit account with them

   Detailed discussion of the above is the subject of Annex "C"

3.7 The evaluation shall highlight on the concerns of the banks particularly the following:

a. Credit Record of proponent
b. Financial Aspects – Historical Financial Performance of proponent and Projected performance
c. Marketing aspect
d. Operations and Technical Aspects
e. Organizational Aspect
f. Risk involved in the credit transaction
g. Pricing
h. Collateral/Security and Second Way out
i. Socio-economic considerations

CREDIT RECORD OF THE PROPONENT

3.8 Proponents may be hesitant to discuss credit record especially where there is adverse record on the proponent. The DOE Assistant, however, has to extract from the proponent the nature of adverse findings, if any, such that remedial measures can be effected before the application is filed with the bank. Bank uses exhaustive procedures in the conduct of credit investigation and it is likely that it will find out the adverse finding.

3.9 Bank obtains credit record of the proponent/borrower through the process called credit investigation. The Credit Investigator (CI) sends queries about the level of loans, the status and payment record with the other banks in the area and nearby area as well as with its branch offices. The CI likewise looks into the records of the court for the existence of court cases against the proponent and of the principal officers and stockholders, if proponent is a corporation or cooperative. The CI, likewise make a random interview of the neighbors of the proponent and certain suppliers to assess the character of the proponent.

3.10 Adverse findings from the credit investigation may result in the disapproval of loan application of a good project. If the proponent is honest enough to disclose any unfavorable findings, if any, the DOE Assistant can suggest measures to correct the weakness before the loan application is filed with the bank. It should be noted that it is very difficult to correct the initial impression of the account officer of a bank once there are adverse findings.

FINANCIAL EVALUATION OF HISTORICAL PERFORMANCE

3.11 Evaluation of historical financial performance is applicable where the proponent is an existing entity. Historical performance is assessed separately from the projected performance of proposed project. The proposed project is evaluated separately based on its incremental effects, that is, increases in revenues and costs become the basis of the evaluation.

3.12 Financial Statements consist of three statements, 1) Income Statement, 2) Balance Sheet and 3) Cash Flow Statement or the Statement of Sources and Uses of Funds. Income statement shows the results of operations over a certain span of time, usually one-year. The Balance Sheet shows what the business entity owns and what it owes as of the date indicated in the statement. The Cash Flow Statement shows the sources of funds that came into the entity and where the funds went over a certain time span, usually one-year.

3.13 Financial Statements to be useful for analysis, should be prepared in accordance with generally accepted accounting principles and is the duly certified by a Certified Public Accountant (CPA). The DOE Assistant should read the audit report and that the CPA expressed an Unqualified Opinion of the Auditor on the Statements.

3.14 Tool for financial evaluation is a “Financial Spread Sheet” which places in a single document the items in the financial statement that needs to be analyzed. Financial SpreadSheet is included as Annex “D”. Electronic copy is included in this proposed manual.

3.15 The evaluation of the financial statements using the spreadsheet gives an indication of the financial health of the proponent. Guidelines in the Analysis of Financial Statements is contained in Annex “E”

FINANACIAL EVALUATION OF PROPOSED PROJECT

3.16 Where the proponent is a recently organized entity with no previous track record of performance, focus of evaluation is proposed project.

3.17 Statements that are subjected to evaluation are the Projected Income Statement, the Projected Balance Sheet and the Projected Cash Flow. Sample format is marked as Annex “F” which is an electronic worksheet. The electronic worksheet is part of this manual.

3.18 If proposed project is an expansion of existing business activity, the expansion project should be analyzed as a project that is separate and distinct from an existing project. This is to be able to assess the add-on value of the new project to the existing operation. Only the incremental revenues and costs will be considered.

3.19 Sunk cost, or cost of assets that has already been paid, will not be considered even if these assets are used in the expansion projects.

Project Cost and Financing

3.20 Since evaluation of proposed project pivots on project cost, it is important that this item should be given initial attention. Project performance is gauged against the total cost of the project.

3.21 The components of projects of project costs should be examined to determine their appropriateness and sufficiency. Components of project cost are:

a. Cost of Preparing the feasibility study
b. Cost of Land
c. Cost of Land Improvements
d. Cost of Equipment including installation and supervision cost
e. Pre-operating expense which include cost of securing business permits, licenses, cost in organizing the entity, personnel cost and such other costs incurred prior to start of commercial operations
f. Allowance for Contingencies – This is a provision for possible increases in cost resulting from the depreciation of the peso and such other unforeseen events resulting into an escalation in the total cost of the project. Allowance for Contingencies is usually set at 15% of total projected cost.

g. Working Capital - This represents the minimum level of balance maintained in the cash vault, receivables, and inventories in spare parts and prepaid expense necessary for a continuous and unhampered operation of the entity.

3.22 The total project cost, once determined and validated, should have a matching fund sourcing which may be either loan or equity. Some rules of thumb to determine the appropriate mix between loan and equity are as follows:

a. Banks do not ordinarily finance the cost of acquiring land. Land should be part of the equity contribution of the proponent
b. Working capital – There are should be available financing for the initial working capital requirement of the entity. Some banks allow initial working capital requirement to be financed by a medium to long term credit product while other banks allow only short term loan products of the bank to finance working capital needs.
c. Except for Working Capital, all of components **a to e** in item 3.15 qualify for long term funding which is either equity or medium to long term loan. A medium term loan has a tenor of 5 to 7 years while a long-term loan has a tenor of 7 to 10 years.
d. In the presence of collateral with loan value that can fully cover a given amount of loan, the bank can provide the proponent a loan equivalent to 75% of total project cost, that is items a to f of item 3.15. Part of the 75% is the Working Capital loan discussed in item 3.16.a.

Annex "G" discusses the various loan products of the Bank and their appropriate uses. The Annex guides the DOE Assistant in providing the appropriate advice to proponents on the kind of loan product to be used.

3.23 If the proponent does not have the necessary resources to cover the portion of project cost that could not be covered by a loan, there may be a need to assist the proponent to obtain equity from various sources. Potential sources of equity funding are:

a. Equipment Suppliers – Some Equipment Suppliers are willing to infuse as equity into the project portion of the purchase price of the equipment. Suppliers, however, are concerned with the full collection of their money and as such, the projected financial statements must consider soonest redemption of equity of suppliers as the cash flows may warrant. Further, suppliers may want assured revenues in which case, a Non-Participating Preferred Shares may be issued to such suppliers
b. Local Companies – Big companies with operations near the project site may be willing to infuse equity especially if the said companies are known supporters of environment friendly technologies.
c. Investment Companies – Some banks and insurance companies have subsidiaries that invest in developmental projects especially those with good potential
d. Local Investors – There may be people in the project locality who may be willing to contribute equity into the project. As in the case of the suppliers,

they may want assured income and a specific schedule for the redemption of their investment. In such case issuance of preferred shares may be appropriate.

e. Local Government Unit (LGU) – The LGU may be the proponent or may be interested to place equity into a project especially where there is a tremendous socio-economic benefit from the project.

f. NGO – Some NGOs may have funding for equity investment. To maintain the nature of the firm as a private entity, it is suggested that the NGOs should only take a minority interest in the undertaking or else take Preferred Non-Participating shares.

3.24 The timing of disbursement of cost for project should be in accordance with a schedule presented in a PERT/CPM or a Gantt Chart. The DOE Assistant should see to it that the funds are made available when needed. If there is a risk for a cost overrun, the DOE Assistant should recommend for the setting up of a contingency allowance as the occurrence of a fund shortfall during the implementation of the project hurts both the bank and the proponent in the following manner:

- Banks accrue interest on the loan despite non-completion of the project that generates cash to service the loan. The obligations of the borrower continue to mount even in the absence of the capability to pay.
- The bank cannot collect despite the existence of the claim against the borrower. If it could not collect after a certain period, the bank may be required to provide allowance for bad debts, which may hurt the financial picture of the bank.

Financial Projections

3.25 Financial Projections are the expectations of management about business performance within a given span of time into the future. The starting point is now and the bridge to the future is the project, which is being funded jointly by internally generated funds and equity on the one hand and by a loan on the other hand. The underlying assumptions must be understood because it tells much about the feasibility of an expansion project. Projections, if placed side by side with historical performance and, if connected with management analysis would indicate whether the decision to pursue a given project is a sound financial judgment.

3.26 In evaluating projections, see to it that expansion portion is a stand-alone project and can generate the required cash flows to pay off the loan as scheduled. Cash generated from existing capacity should not subsidize the payment of loan amortization from the loans incurred to finance expansion. In worse scenario, it should only serve as a buffer just in case the expansion project miscarries. Analyze assumptions of the proponent as basis for preparing the projections, as well as the environmental issues like pending bills, long term bulk orders, new contracts;

these developments can affect company performance. Likewise, identify and analyze for possibilities of a drop in selling price and other sensitivities.

Projected Income Statement

3.27 The first statement is the Projected Income Statement, which shows in financial terms how the project is expected to perform. The Income Statement has two major items, 1) Revenue or Income Items and 2) Expense items. The difference between Revenues and Expenses is the Projected Net Income

Expenses

3.28 Expense items should be examined first. It is in this area where delays occur in the evaluation of the project by the bank because the supporting schedules are not available in the documents submitted.

3.29 Items of Expenses should be examined to determine accuracy and appropriateness of figures. Supporting schedule will enable the bank to validate if a specific expense item is overstated or understated. Each item of cost should be supported by schedule. This is to minimize the processing period of the loan application that results from queries of the Account Officer on how the proponent arrived at the figure presented in the projections. A list of major of the items of cost and the appropriate supporting schedules are presented below:

Cost Item	Supporting Schedule
Salaries and Wages	Payroll schedule
Depreciation Expense	Depreciation Schedule
Cost of Goods Sold	Detailed Cost of Goods Statement
Maintenance Expense	Detailed assumptions provided by equipment supplier
Other Expense	Assumptions computed based on percent or Sales Revenue or Cost of Goods Sold
Interest Expense	Schedule of loan amortization

3.30 The DOE Assistant should be able to establish that the items of expense are reasonable and are within acceptable limits.

Revenues

3.31 The basis for computing revenues should be indicated in projected statements. It is helpful to present revenues in the following manner:

	Year 1	Year 2	Year 3 & After
No. of Households in coverage area			
Target no. of households			
Consumption per household			

Total Projected Demand			
Plant Capacity			
% Capacity Utilization			
Selling Price per kilowatt			
Total Revenue			

3.32 The projection on revenue should be related to the marketing strategy, which is discussed in the marketing assessment.

3.33 Suggested Format of projected financial statement as well as supporting schedules are included in Annex "F" which is an electronic worksheet.

<u>Projected Cash Flow</u>

3.34 Projected Cash Flow reflects the sources and uses of cash for the project. For the first two years of operations, Projected Cash Flow is usually prepared on a monthly basis to detect months where shortage in cash can possibly occur. In subsequent years, yearly cash flow projections are sufficient.

3.35 It is helpful to see that temporary need for cash are supported by cash generated from existing operations.

3.36 Projected cash flow reflects whether the project is in a position to generate cash to be able to service a specific loan amortization. With provisions for deviation included, Cash Flow Projection becomes the basis for a decision as to whether to lengthen or to shorten the grace period for the payment of a loan. It is also an indication of the capability of the project to effect payment of dividends.

3.37 Suggested format for Projected Cash Flow is included in Annex "F". Such format facilitates the computation of FIRR, Payback period, Break even point and such other performance ratios on projects.

<u>Projected Balance Sheet</u>

3.38 Projected Balance Sheet shows the financial position of the project. It shows the gradual build up of equity position and the decline in the level of long term liabilities.

3.39 The Projected Income Statement and Projected Cash Flow are tied to the Projected Balance Sheet. For example, the projected level of Account Receivable is related to Sales and the policy on giving credit. The level of inventories is related to the projected level of Cost of Goods Sold and the level of inventory in which the entity finds it comfortable.

3.40 Suggested format for Projected Balance Sheet is included in Annex "F"

Performance Assessment

3.41 Three situations should be presented 1) projections without the project, that is, expected performance of existing operation 2) Projections on the project, that is, the expansion project as a stand-alone and 3) combined projections on existing and expansion. Such an exercise is necessary to enhance the comfort zone of the Bank Account Officer in endorsing the proposed loan for management approval.

3.42 It is helpful to place the figures in the projected financial statements into a worksheet. This will allow for vertical and horizontal comparison of figures and comparison with projects of similar nature. If the project is an expansion of an existing business operation, the spreadsheet on the projection can be compared with the spreadsheet on historical operations as basis for determining consistency of assumptions.

3.43 Performance measures are Financial Internal Rate of Return (FIRR), Net Present Value (NPV) of projects, Payback Period and Break Even Point (BEP). These performance are discussed in Annex "F", an electronic copy of which is also attached.

3.44 In doing sensitivity analyses of project, revenues are adjusted downward and costs adjusted upward to determine the capacity of the project to absorb results of negative events in the environment.

MARKETING ASSESSMENT

3.45 Marketing assessment describes the target market in terms of capacity to pay for the service both for the present and foreseeable future. In describing the future movement of demand, it should identify the basis why demand is expected to improve at a given percentage within the foreseeable future.

3.46 It should identify the barriers in the marketing of services that include direct and generic competition, culture, and hesitancy for the use of the product and such other constraints.

3.47 To address these barriers is a marketing strategy. Strategy covers such areas like pricing, promotion, packaging and product delivery. Along with this strategy is a proposed marketing budget to assure the implementation of the strategy.

ORGANIZATION AND MANAGEMENT

3.48 People run organizations and it is for this reason that the proponent must posses the credibility necessary to run the project as a business. Credibility means that the proponents, the lenders and prospective investors have the confidence that proponent can deliver his/her end in the commitments.

3.49 In examining the organization structure of the proponent, the DOE Assistant should examine the tasks and sub-tasks in running the project as a business enterprise. Examination of the resume of key officers submitted, may reveal weak point that require appropriate recommendations from the DOE Assistant.

3.50 In the assessment of the organization, the following should be looked into:

a. Company Background

1) Brief History of the Company

2) Pertinent Details on its operations

3) Other information on the company's operations (i.e. market, product lines, etc.)

Include in this section a brief chronological account of how the business started and how it grew to what it is now. Details on operations should cover the scope of market, whether international, local or covers a certain region; as to what portion of production output is done in house and what portion by sub-cons; extent of utilization of production capacity.

b. Products/Service - Include peso amount and the percentage of contribution to total revenue of the main product/services and secondary product/services

c. Ownership Structure - Indicate if proponent is a sole proprietor, partnership or corporation or cooperative. If corporation, indicate whether it is a domestic corporation or a fully owned subsidiary of a foreign corporation. If the proponent is a joint venture (JV) company, indicate the parties in the JV as well as their role and the advantages they can bring into the arrangement.

d. Equity Participation - Indicate the authorized capitalization, the number of shares and the par value per share. List in tabular form the names of the stockholders, their citizenship, the amount subscribed and the amount paid by each and their share to total paid up. This section will tell whether proponent qualifies under the minimum ownership by Filipinos in the corporation.

e. Management/Officers

1) Board of Directors

2) Key Officers/Personnel - The Management Team, usually composed or controlled by the controlling stockholder/s, is the prime mover of the business organization. Its outlook, plans, attitudes, beliefs and style of handling human, financial and other resources shape the culture of the organization and it has much to do with the continued success or the decadence of the organization. Look into the quality and depth of the management team because this is where

Character of the borrower, which is the first C of Credit, will be judged.

3) Monitor presence of the following in the proponent:
- Adequacy of internal control systems
- Degree of professionalization of managers
- Adequacy of their training
- Management caliber, depth and succession plans
- Credit record and integrity of principal officers
- Management and/or ownership changes and their effect on the business

f. Related business/interest - Include information on the other businesses and sources of income of the proponents. These are looked upon as secondary sources of cash for servicing obligations.

g. Plant and Facilities - Include a brief description of the facilities and indicate if water, power and transport facilities are available. Indicate the estimated production capacity and the extent of its utilization. Indicate the number of employees.

RISKS/KEY SUCCESS FACTORS

3.51 The strengths and weaknesses of a proponent should be analyzed in relation to industry conditions, competition, labor situations, government regulations affecting the business and political and economic climate.

3.52 There are always risks involved in pursuing the expansion project and these should be identified. Identify potential risks that may adversely affect the project and why you think the proponent has the capability to weather off these risk and remain viable. Discuss the factors that adversely affected the proponent in the past, how it managed to survive the adversities and stayed viable. Mention the strengths of the proponent like existence of a captive market, stable raw material source, investment incentives, favorable laws, market share dominance, etc. Mention also other factors, which have positive impact on company's operations.

3.53 Risks in Business include the following:

a. Depreciation of the Peso against other currencies – If there is peso depreciation, peso denominated liabilities may bloat
b. Succession Issues – The project may discontinue if the key proponent dies or becomes incapacitated
c. Failure to reach target revenues – Proponent may have difficulty of paying amortization if volume targets are not reached.

3.54 Business risks are often raised in the discussions among lending authorities. As such, it is necessary to address these business risks outright by discussing options of the company should the anticipated risks occurs. For example, on the issue of Peso Depreciation, the proponent may opt to book peso denominated loans to avoid said risk. With respect to succession issues, there should be a line up of possible successors just in case the key proponent dies.

COLLATERALS

3.55 Collaterals and guarantees serve as "fall back" if projected earnings and cash flow fall below expectations to support repayment commitments of the proponent. A collateral is defined as money or property put up by a proponent/borrower to back up a loan. In case of default, the collateral may be liquidated to pay off the loan. Term loans should be structured such that cash for the loan repayment is generated from the business and that it is not depending on the liquidation of collateral.

3.56 There are two types of collateral: the primary and the secondary collateral. A collateral is primary if there is a specific set of cash, near cash items and hard assets identified to cover for whatever exposure that the bank has in the proponent/borrower; a collateral is secondary if there is none. A primary collateral can be given a valuation while a secondary collateral cannot be given a valuation.

The common forms of primary collateral are as follows:

a. Real Estate Mortgage (REM) - a piece of real estate property covered by a Title including existing and proposed improvements thereon is as security for the payment of a loan. Real estate assets other than the site of the project being financed may be used as collateral. Untitled property or pieces of Real Estate covered by Tax Declaration only are not acceptable ac collateral. Real estate asset in the name of a third party may be acceptable as collateral provided that the registered owner is the signatory of the REM. Special Power of Attorney (SPA) issued by the registered owner allowing the borrower to mortgage the real estate assets in not acceptable because of a high incidence of fraud in the issuance of the SPA.
b. Chattel Mortgage (CM) - machinery, equipment and/or personal property are used as security for a loan.
c. Hold-out on Deposits - a specific amount of Saving or time deposit is being held by the back as collateral under as Deed of Assignment. Like in the case of REM, the depositor may not be the same as the proponent/borrower, in which case the depositor should sign the deed of assignment.
d. Mortgage Trust Indenture - the bank is given a Certificate of Participation indicating issued by a trustee who was appointed custodian to a property of enormous value. The certificate indicates the extent or percentage of the property, which secure the loan of the bank. This type of collateral is encountered where the loan given to a proponent/borrower is syndicated or where more than one bank have loaned money to the proponent using same collateral.

The following are secondary collateral:

a. Joint and Several Signatures (JSS) or Suretyship – Under a JSS or Suretyship, the surety (signatory of the JSS document) binds him/herself solidarily with the principal debtor and there is a JSS in almost all loan contracts. If the borrower is a corporation, the JSS encumbers the personal assets of the surety to the liabilities of the corporation. In JSS, the surety is not liable unless and until the principal proponent/borrower is held liable. A number on conventions on JSS are as follows:
   - if the proprietor/proponent/borrower is the husband, the wife executes a JSS & vice-versa. A third party other than the spouse may also execute a JSS;
   - if the proponent/borrower is a corporation, the principal directors and stockholders execute the JSS
b. Cross Guaranty - a person or corporation guarantees the loan of another that likewise guarantees the loan of the former.
c. Negative Pledge - an undertaking of the proponent/borrower not to mortgage, encumber, transfer or dispose of his fixed assets without the consent of the Bank. This is usually encountered where the proponent/borrower is prime and has a good track record

3.57 A proponent cannot borrow to the extent of full market value of assets submitted as collateral. The banks use the terminology “Appraised Value” and “Loan Value.

3.58 Appraised Value is the valuation given by a bank on specific assets. In the case of land, valuation given is usually based on the averages of zonal value, last sales transaction of a piece of land that is near the property and the market value as quoted by real estate agents. The value may be increased because of the location or may not be given any value at all because of the absence of a right of way. If the land is agricultural, the maximum value is the price given by DAR for such property. Valuation is likewise given to improvements introduced on the land.

If the proposed collateral is equipment, the value given is the estimated replacement cost of the equipment net of depreciation; if the equipment is new, it is based on the purchase price of the equipment.

3.59 “Loan Value” is the amount of loan that that the proponent/borrower can obtain from the bank which is a percentage of the Appraised Value. Loan Value schedule is as follows:

Collateral	Loan Value
Land	60%
Building and Land Improvements	60%
Chattels	50%
Deposit Hold-Out	100%

3.60 Collateral can be valuable in term lending, but relying on it as the main justification of support is not the right attitude. Historical performance is still the best gauge in viewing the proponent's ability to service future debts. It is essential to look into the ability of the proponent/borrower to repay from the earnings generated in the normal course of the business.

3.61 Where the proponent is a start up, there is no business history to indicate what their future earnings power will be. Projections may be a good indicator but should be substantiated by evaluation of market, management, technical matters, etc. Collateral becomes important consideration.

3.62 In case of guarantee, it is good psychological help but does not automatically ensure that the guarantor will immediately repay a debt or that the lender will have access to the assets of the guarantor without strong legal action.

3.63 The DOE Assistant should be able to advise proponent of unacceptable collateral that include:

a. Collateral previously mortgaged to another bank. Second mortgages are not acceptable
b. Real estate assets without right of way
c. Real estate assets with lis pendense, adverse claim and other limitations annotated at the back of the title

SECOND WAY OUT

3.64 Risk of lower than expected level of performance is always present and it would enhance the comfort zone of the bank if the other sources of payment short of disposing assets can be identified.

3.65 The presence of collateral mitigates the risk and increases the comfort zone of a bank with respect to collecting its exposure into the proponent/borrower

PRICING

3.66 The Costs that should be considered by the Proponent/borrower consists of the following:

a. Interest on the loan
b. Service Fee which is a fee collected by the bank per transaction. The amount is supposed to reimburse the bank of its cost in processing the transaction
c. Handling fee, which represents the cost of the bank evaluating the loan transaction. Handling fee is a one-time expense and is usually 1% of approved loan amount
d. Commitment Fee – This is a fee for the inability of the proponent/borrower to draw on the approved loan within the drawdown period as defined under the loan agreement. By imposing a commitment fee, the bank is recovering the opportunity cost from allotting funds to service the loan drawdown. Commitment Fee is usually 1% or lower per annum based on the undrawn balance of the loan.

e. Documentary Stamp Tax (DST) – This paid to the Government. Amount paid, which is usually deducted from the proceeds of loan is P0.20 per P300.00 value indicated in the document. Loan agreements and promissory notes are subject to DST.
f. Penalty Charge – The amount collected by the bank if borrower cannot promptly pay loan amortization schedule.

3.67 The Interest rate of a loan depends on a number of factors. The primary determinant of interest rate is the Interest rate on Treasury bills(T-Bills). Interest rate on T-Bills becomes the base rate as it is the type of investment that banks would opt if they decide not to lend their money. As such, quotations on interest rate are usually stated in "91-day T-Bills Rate plus ____% spread" at the time of availment. The interest rate is usually adjusted or "repriced" every 90 days to take into consideration of the changing cost of money to the banks. T-Bills rate is published in the newspapers.

3.68 The other benchmark used by banks is the "Prime Rate" or the best rate that it can give to its best proponents. Prime Rate is a market established rate and may be higher or lower than the T-Bills rate. Some banks publish their prime rates in the newspapers.

3.69 The "plus ___% spread" is a factor that takes into consideration the following:

a. Business Risk - This is the risk that the loan will not be repaid in full with interest within the time frame agreed upon. The higher the perceived risk, the higher is the spread of the bank.
b. The level of compensating business - If the proponent has other business deals with the bank, the situation may merit for the scaling down of the spread. Likewise, presence of substantial amount of deposit will merit a reduction of the spread of the bank.
c. Potential change in the cost of funds in the future. This is especially important when interest rates are fixed.
d. Financial risk - This is the risk that loan funds will be tied up and not be available as other opportunities present themselves to the bank (opportunity loss).
e. Demand Deposits - those deposits that each loan will bring to the bank or each loan will retain for the bank (free balances after activity charges).
f. Time Deposits - while these may have some influence, if the bank is paying a market rate, then time deposits add little in compensation for a favorable rate
g. Competition - those rates that are actually available from other lenders.
h. Timing of interest payment - whether discounted, paid at maturity, paid monthly or paid quarterly, etc.

SOCIO-ECONOMIC, ENVIRONMENTAL & OTHER ISSUES

3.70 Presence of socio-economic impact helps justify a project although it could not serve as a primary justification. Possible multiplier effect of the project should be described in qualitative terms

3.71 On account of the growing environmental awareness, banks now require that projects obtain an environmental clearance certificate (ECC) from DENR. If the ECC is yet to be obtained, the status of getting the ECC should be mentioned in the study.

3.72 Peace and Order – Where the project is placed in remote areas, statement on the peace and order problem should be made in the studies such that the bank account officers and the passive investors would not be guessing of the status.

AMENDMENTS TO THE GUIDELINES

4.0 The provisions of the foregoing guidelines shall be amended, updated or revised or additional provisions shall be incorporated to take into consideration changing realities of NRE as an industry. The foregoing set of guidelines was initially prepared in April 2001.

<table>
<tr><th colspan="2">PROPOSED PROJECT EVALUATION SHEET</th></tr>
<tr><td>1. Proponent Name</td><td>2. Address</td></tr>
<tr><td colspan="2">3. Brief Description of Project</td></tr>
<tr><td>3. Project Cost
Land
Improvements
Equipment
Pre-Operating Cost
Working Capital
Total</td><td>4. Project Funding
Equity of Proponent
Equity of other investors
Grants
Loans
Total</td></tr>
<tr><td>5. Concerns for the Project Proposal as presented (Please be specific)
a.
b.
c.</td><td>6. Proposed Actions: (Please be specific)
a.
b.
c.</td></tr>
<tr><td>7. Schedule of consultation meeting with proponent</td><td>8. Completion Report: Proponent has successfully hurdled the pre-qualifications for loan and for the raising of equity from other investors. The project may now be submitted to the Bank for purposes of obtaining loan or to a group of potential investor for the possible infusion of additional equity.

Signed: DOE Assistant</td></tr>
</table>

DETAILED PROJECT ASSESSMENT

1. Financials

Historical Financial Performance

Financial Highlights - Historical Performance:
(Amount in Million Pesos)

	2000	1999	1998	1997	1996
Gross Revenues					
Net Operating Income					
Interest Expense					
Net Income After Tax					
Total Assets					
Total Fixed Assets					
Total Current Assets					
Total Liabilities					
Total Current Liabilities					
Total Long Term Liabilities					
Net Equity					
Debt/Equity Ratio					
Current Ratio					
Interest Expense Coverage					
Debt Service Coverage					
Net Income/Net Worth (%)					

Comments and Recommendations:
1.
2.

Projected Financial Performance

Financial Highlights of Projected Financial Statement on Proposed Project
(Only Incremental effect of Proposed Project is Reflected)
(Amount in Million Pesos)

	Year 1	Year 2	Year 3	Year 4	Ave. Yr. 5 & beyond
Gross Revenues					
Net Operating Income					
Interest Expense					
Net Income After Tax					
Total Assets					
Total Fixed Assets					
Total Current Assets					

Total Liabilities					
Total Current Liabilities					
Total Long Term Liabilities					
Net Equity					
Debt/Equity Ratio					
Current Ratio					
Interest Expense Coverage					
Debt Service Coverage					
On Proposed Project					
Project Cost					
Equity Component	Amount:		Percent:		
Loan Component	Amount:		Percent:		
FIRR	Based on Proj. Cost:		Based on Equity:		
NPV at __% (cost of Money)	Based on Proj. Cost:		Based on Equity:		
Break Even Point	Peso:		Volume:		
Payback Period					

Comments and Recommendations:
1.
2.

2. Technical

a. Validation of Costs:
b. Validation of the technical assumptions:
c.

3. Credit Record

4. Marketing

5. Organization and Management

6. Risk in the Credit Transaction

7. Second Way out

8. Pricing

9. SOCIAL, ENVIRONMENTAL AND OTHER CONSIDERATIONS

ANNEX "C"
THE PROJECT EVALUATION PROCESS

The project evaluation process is both a screening process and a matching process. It is a screening process because by understanding the business of the borrower and its basic fundamentals, as an evaluator, you have to decide whether to recommend the request for credit facility or to deny the request.

It is a matching process because after validating that the client is qualified to obtain the credit facility requested and really needs a credit facility, you have match the following elements:

1. The amount of the loan matches with the amount needed after taking into consideration the equity share of the client;

2. The loan tenor and repayment matches with the amount and characteristics of the cash flows;

3. The conditions required of the client is commensurate to the level of exposure of the Bank into the client and

4. The conditions required of the client can cover the bank against perceived credit risk and are commensurate to the level of perceived risk.

Bulk of the process is meant to identify and assess the nature and extent of risk at all phases of the borrower's business. If possible revenues are cited in the report of recommendation, the revenue estimate serves only as an additional justification but not the pivot point of the recommendation. No amount of potential revenues can justify for an undue level of risk exposure because it has been proven that you can never recover your loss in principal from your earnings in interest.

The model for evaluation is marked as Annex B. The foregoing discussions will revolve around the various elements contained in the annex.

BASIS FOR GRANTING CREDIT

Although there are an established set of Project Criteria, the project proponent, in most cases, relies much on the judgment of the evaluator on the individual elements of the business and how each element complement each other to form a total business picture. He has to make a judgment on the individual components of the client's business. He has to help identify weakness of project proposals such that these can be corrected before the project is presented to the banks and potential investors for funding. A complete and properly presented project proposal facilitates the decision of the Banks and investors with respect to request for funding.

Analysis and evaluation involves the following process:

1. Break down the borrowing entity into its business functional components and assess its strengths and weaknesses in each of the components. This is referred to as the "Analysis" phase.
2. Determine environmental threats and opportunities and make an assessment as to how can the business entity effectively capitalize on the opportunities and/or weather the threat. This is referred to as the "Interpretation" phase.
3. Make a credit judgment. This is the "Decision" phase.

When analyzing a project, compare attributes of an entity against a set of attributes that the borrower should possess to be bankable. These predetermined attributes or standards are found in industry norms and from many other sources. Generally, however, there is a list of characteristics of a good borrower and these are:

1. The basic fundamentals of the business indicate that it is sound
2. There is a stable business environment and the business can absorb predictable fluctuations
3. There are no legal constraints with respect to the purpose of the loan and on the continued operation of the business.

What Analysis is all about

Evaluation is a set of predetermined steps performed by an account officer to determine the bankability of a borrower and the project or activity that entity wants to finance. In analysis, we want to:

1. Assess the risks involved in giving a loan to a particular borrower;
2. Estimate possible income that can be derived from the loan relationship and
3. Determine the conditions that the borrower ought to comply to mitigate the risks involved.
4. Attributes of the borrower meet the benchmark or the minimum criteria acceptable to the Bank.

The obvious focus of evaluation is Credit risk or the possibility that the borrower will not be able to liquidate the obligation, principal and accrued interest thereon, in the due course of the business. Sources of Credit Risk, which are the focal point of analysis, are the following:

1. Business condition: This may be a possible downward trend in demand, interest and foreign exchange (forex) fluctuations, and other environmental and economic shifts that may adversely affect the client's viability or competitive position.

2. Financial Condition: The capacity of the firm to remain viable given the present level of liabilities as well as the capacity of the company to absorb a higher level

of liabilities.

3. Management capability: The capacity of existing management to manage the company viably, to cope with existing and potential problems, for the continuity of viable operations and the capacity of the company to attract new talents.

4. Credit record: This is concerned with the repayment history of the company, level of availments on existing credit facility and the propensity to be in default if there are business shocks.

5. Purpose of financing: Part of the task of a Bank is providing advisory services to a client. The bank should know the real purpose of financing such that the AO can give the appropriate credit product and so that loan terms and conditions are appropriate for the circumstances of the client.

The above elements are discussed in the guidelines and in the other annexes.

LOAN TERMS AND CONDITIONS

The DOE Assistant should be aware that loan terms and conditions are meant as hedge of the bank against possible events, which may increase credit risks. They are imposed and should be observed by client because they serve as self-policing mechanism for the account relationship. They are formulated in consultation with the proponent since the proponent will be obliged to comply with the conditions. The consultation will reveal if:

- all conditions are acceptable
- some conditions are not practical and could not be implemented

Terms and conditions usually cover the following areas:

- Tenor
- Pricing & fund sourcing
- Availment/Drawdown schedule
- mode of payment
- miscellaneous conditions - insurance, commitment as to foreign currency transaction coursed through the bank and ADB on deposits

A list of standard terms and conditions imposed on all loan accommodations, where applicable, are enumerated below:

1. Loans are subject to periodic review by the bank and the bank has the discretion to refuse further loan drawdown in cases of violation of the loan covenants.

2. The Bank is held free and harmless from any and all consequences as a result of inability to make funds available.

3. Insurable collateral shall be insured for full-appraised value with an insurance company accredited by the Bank.

4. Credit extension is subject to presentation of proof that all taxes due on collateral are updated.

5. The registered owner/s of the collateral, if other than the borrower, shall sign on the mortgage contract as third party mortgagor/s.

6. Collateral mortgage must be registered.

7. All collateral must be free from all liens and encumbrances, prior to loan release.

8. Unless otherwise specified, rates refer to prevailing and negotiable rates.

9. The borrower should maintain an ADB of deposits to meet the minimum ARE/APR required.

______________ COMPANY
INCOME STATEMENT

	AUDITED							VERTICAL ANALYSIS			HORIZONTAL ANALYSIS			
	2000	1999	1998	1997	1996	2000	1999	1998	1997	1996	2000-99	1999-98	1998-97	1997-96
Net Sales	1,000	1,000	1,000	1,000	1,000	100.00%	100.00%	100.00%	100.00%	100.00%	0.00%	0.00%	0.00%	0.00%
Cost of Goods Sold	600	600	600	600	600	60.00%	60.00%	60.00%	60.00%	60.00%	0.00%	0.00%	0.00%	0.00%
Gross Profit	400	400	400	400	400	40.00%	40.00%	40.00%	40.00%	40.00%	0.00%	0.00%	0.00%	0.00%
Operating Expenses	120	120	120	120	120	12.00%	12.00%	12.00%	12.00%	12.00%	0.00%	0.00%	0.00%	0.00%
Income (Loss from Operations)	280	280	280	280	280	28.00%	28.00%	28.00%	28.00%	28.00%	0.00%	0.00%	0.00%	0.00%
Other Income (Charges)														
Interest	100	100	100	100	100	10.00%	10.00%	10.00%	10.00%	10.00%	0.00%	0.00%	0.00%	0.00%
Net Income before Tax	180	180	180	180	180	18.00%	18.00%	18.00%	18.00%	18.00%	0.00%	0.00%	0.00%	0.00%
Less: Tax Provision	58	58	58	58	58	5.76%	5.76%	5.76%	5.76%	5.76%	0.00%	0.00%	0.00%	0.00%
Net Income (Loss) After Tax	122	122	122	122	122	12.24%	12.24%	12.24%	12.24%	12.24%	0.00%	0.00%	0.00%	0.00%

RATIOS

PROFITABILITY RATIOS					
NIAT/Sales	12.24%	12.24%	12.24%	12.24%	12.24%
NIAT/Total Assets	13.45%	13.45%	13.45%	13.45%	13.45%
NIAT/Net St. Equity	61.20%	61.20%	61.20%	61.20%	61.20%
NIAT/Fixed Assets	24.48%	24.48%	24.48%	24.48%	24.48%
NIBIT/Interest Expense	280.00%	280.00%	280.00%	280.00%	280.00%
Gross Profit Margin	40.00%	40.00%	40.00%	40.00%	40.00%
LIQUIDITY RATIOS					
Current Ratio	3.636	3.636	3.636	3.636	3.636
Quick Assets Ratio	1.818	1.818	1.818	1.818	1.818
Receivable Turnover	10.000	10.000	10.000	10.000	10.000
Inventory Turnover	10.000	10.000	10.000	10.000	10.000
No. of Days Receivables	36.000	36.000	36.000	36.000	36.000
No. of Days Inventory	36.000	36.000	36.000	36.000	36.000
SOLVENCY RATIO					
Debt/Equity Ratio					
Debt	78%	78%	78%	78%	78%
Equity	22%	22%	22%	22%	22%

ANNEX "E"
GUIDELINES IN FINANCIAL STATEMENTS ANALYSIS

The Financial Statements of a business entity. Financial Statements, especially if audited by a reputable Certified Public Accountant, can say much about the company. It can be an indicator of how successful is its management in running the business and subsequently, the risks that the bank expects to assume if the decision is to give a credit facility to the business entity.

DISCUSSION FRAMEWORK

The discussion on the subject matter of Financial Analysis shall be as follows:

1. The Spread Sheet, various ratios and explanations thereof

2. Usefulness of financial statement analysis and

3. Understanding the financial statements - This section is intended for readers who do not have any accounting background

Financial Statement Analysis is one of the most important it focuses on the statement which summarizes in financial terms the status of the business entity as of a given date and its operating performance over a given period usually one year. Through an analysis of Financial Statements over three years or more, assessment can be made on the following:

1. If the client's financial performance can justify for the granting of a credit accommodation and meets the standard requirements of the bank

2. To determine how much the client needs and how much the bank is comfortable in giving and

3. If the historical performance of the client can support what he claims he can accomplish.

THE FINANCIAL SPREADSHEET

The financial statements are attached to a credit proposal as supporting documents. There is, however, a separate sheet that presents the contents of the financial statements in a predefined and condensed format; this is referred to as "Spread Sheet". The text of the credit facilities proposal include an interpretation of the Account Officer of what the ratios try to tell the Credit Decision makers especially in areas critical to the decision.

SPREADSHEET

To effectively analyze financial statements, we have to simplify or reduce the data into to more understandable terms. Financial statement figures are meaningless; they are mere summaries of what the books of accounts show at the end of the year. We have to organize the data to make them more meaningful such that we can draw conclusions from the figures.

We can derive meaning in financial statement figures if we can relate or compare specific items with other items or group of items in the financial statements. By relating, for example, Net Income and Sales or Net Income and Capital within the same year as against those of previous years, we can deduce conclusions as to what is happening with the profitability of the enterprise.

To facilitate the process of analysis, bankers designed an electronic worksheet written in Lotus 123 or Excel format. The worksheet is more popularly known as "Spread Sheet." If the Account Officer fills up the relevant worksheet cells, the ratios are automatically computed. This relieves the Account Officer of the tedious process of computing and proving computations, thus allowing him/her to focus his/her efforts to more important items that include analysis, interpretation, confirmation of information and other tasks.

The spreadsheet presents the financial statements of an entity in a condensed format over a period of three years. Through simplification and rearrangement of the accounts in the financial statements, accounting data become concise, informative and focused on those element that a credit decision maker want to look into in assessing. It contains the income statement, the balance sheet and the cash flow presented in the prescribed format as well as the various rations and percentages.

PLERIMINARY PROCEDURES

Before entering the items in the financial statements into the spreadsheet, there is a need to assess the statements taking note of the following:

1. The Auditor/s - The Certified public Accountant expressing an opinion on the financial statements must be reputable if the Bank is considering a loan of substantial amount to the prospective borrower.

2. Audit Report - Auditor's opinion should be "unqualified" or "clean". Explanatory notations and supplementary information should be analyzed thoroughly.

3. If presentation is complicated or are yearly comparison is not possible because or change in accounting treatment, recast the Financial Statement by:

    a. Combining similar items - This will reduce the number of items for study and will allow you to focus on the important ones.

    b. Classifying and arranging the items in the format of the spread sheet.

4. Round off each account as a whole number representing thousands or millions.

In addition, it is helpful to visit the company's head office to have an idea on the following:

1. Manner in which prospective client maintains its books of accounts

2. How wide is the variance between the recorded asset values and the possible liquidation values of the assets and

3. Are there possibilities that the figures in the financial statements, especially asset and revenue accounts, manipulated upward or downward?

RATIOS & PERCENTAGES

HORIZONTAL PERCENTAGES

Our primary concern as Account Officer is to determine the ability of an entity to service its obligation. This information cannot be derived directly but can be gleaned from historical trend of net earnings, the historical replacement and/or build up of fixed assets, and the historical trend in the reinvestment or ploughing back of current earnings back into operations.

To the Account Officer, the real Value of the assets is not its book value but the earning power that it inures to the business. The real value to a going concern of assets such as inventories, plant and equipment and prepaid expense depend on the amount realized on them in the course of future operations. If the account officer is evaluating for a short term credit, he looks at the historical earnings on a year to year basis to determine if the operating earnings can cover for the interest expense on new or additional credit accommodation and the level of his margin of safety. Although it is assumed that servicing of the principal takes place within the normal economic cycle, the AO must look into trends of asset build up because there may be indications of an unsound financial practice such as

1. Using working capital to finance capital equipment acquisition

2. Being liberal with sales on account to get more sales but at the risk of difficulty in collecting the receivables

3. Over-investment in certain asset accounts like inventories

If, on the other hand, the AO is evaluating for a medium to long term loan to finance capital expenditures, the loan applicant has to submit financial projections in addition to historical financial statements. We have to evaluate financial projections because we want to determine the value that we are trying to finance in terms of future earnings and not the resale value of the capital asset. Asset value depends primarily on future earnings of the assets and not on its liquidation value as of statement date.

We place heavy emphasis on historical performance in validating financial projections because future earnings has a high correlation with

1. The historical level of earnings in previous years

2. The level of asset build up as a result of income reinvestment and infusion of additional equity and

3. The trust of the owners in the enterprise as evidenced by additional equity infusion and continuing reinvestments in income.

By analyzing specific items or groupings in the financial statements in previous years, the account officer can find hints as to whether or not the enterprise growing and performing well and will continue to do so.

VERTICAL PERCENTAGES

In vertical percentages, the significance of an account to the totality is looked upon. For the Balance sheet for example, the relationship of cash and other individual balance sheet accounts to total assets is being looked into over the three year span. For the income statement, the individual items of expenses and other income accounts are related to the Net Sales figure.

THE FINANCIAL RATIOS

The relationship of one financial statement item to another expressed in a mathematical format is called a financial ratio or ratio for short. It is important to supplement absolute data with ratios in order to establish relationships between related items.

A ratio by itself is meaningless and does not depict any financial picture unless there is a basis for comparison. Ratios derived from the financial statements of an entity may be compared with

1. Those of previous years to detect trends
2. Industry averages and with those of closest competitors to determine relative performance and
3. Mental picture based on accumulated experience of the Account Officer as to what the ratios are of a healthy company.
4. Derivation by the Account Officer from formalized business plan of what the management of the firm believes to be an ideal financial picture of a healthy company.

It is ideal that firm's ratios should be compared with those of the industry and with the closest competitors. Available industry data and competitor statements, however, are two years delayed and that they have little relevance to decision making. It is for this reason that the experience and training of the account officer count a lot in the decision making process.

When correctly chosen and properly interpreted, ratios serve as guide in determining the solvency, adequacy of earning power, and the relative efficiency of the management operations of a firm. Ratios provide a common denominator for comparing the operations of one firm to another, or the performance of one firm to that of the industry as a whole.

PRINCIPLES OF RATIO ANALYSIS

1. Objectives of financial analysis - Facilitation of financial statement interpretation by reducing the large numbers of financial statement items to smaller set of ratios. Ratios are symptoms of firm's economic condition intended to guide the analyst in his financial investigation.

2. Ratio formation - There are 3 types of ratio relationship

    a. Ratio should relate matching components such as earnings to investments base. Test for matching is whether an economic relationship exists between the two values

    b. Ratios should be formed only from elements based on common values

    c. Ratios should be formed only if the functions are functionally related, that is, if they vary in some definable manner.

3. Ratio Interpretation

    a. The good-bad ratio interpretation and

    b. The comparison with industry standard averages or the industry central tendency. Cautions in using standards are:

        1. Is the industry framework appropriate for the ratio analysis?

        2. Why should the industry average be regarded as optimal target with which an examined ration should be compared?

        3. Should inferences be based on the absolute or relative differences from standard?

        4. What measure of central tendency - the mean, mode, median - should serve as standard;

        5. Which industry is most appropriate and what degree of homogeneity should be chosen.

PRESCRIBED RATIOS AND FIGURES

SOLVENCY

These sets of rations indicate the extent of contribution or financial sourcing by the owners compared with that provided by outside financiers or creditors. These ratios give a picture of the business borne by two main source of financing - owners and creditors. If a larger part of the contribution comes from the owners, the risks are borne mainly by them. If the owners raised most of the funds from debt, the owners benefit or have the advantage of maintaining control of the business with limited exposure. This is otherwise known as "Trading on the Equity." The advantage is more if the earnings from the borrowed funds (return on invested borrowed money) are more than the price of borrowings (interest).

Focus: Structure of finance source - debt & equity: fixed charges and earnings.

Ratios and figures prescribed by the spreadsheet are as follows:

Total Net Worth
Tangible Net Worth
Debt:Equity Ratio
Leverage
Long Term Leverage

Name of Ratio: Debt to Equity

Computation: Total Debt / Net Worth

Significance: Relates the exposure of the creditors to that of the owners; normally 100% is considered moderate. Creditors prefer low percentage while owners prefer high.

LIQUIDITY

Liquidity Ratios serve as indicators of how efficient is the management of a firm managing its working capital. Standards for efficient working capital management are:

1. The company can promptly pay current debts and maturing portions of long term obligations;

2. There is sufficient level of working capital to allow for uninterrupted flow of operations and for the implementation of a sound and balanced marketing strategy

3. There are no over-investments in certain items like inventory and receivables that would result into a high carrying cost.

LIQUIDITY RATIOS:

Purpose : To measure the capability of an entity to meet its currently maturing obligations and its principal needs for current operations.

Focus : Liquid resources, that is current assets, particularly cash, marketable securities and money placements; receivables, (net) inventory and prepaid expenses, and the current liabilities.

Ratios and Figures prescribed by the spreadsheet are as follows:

Net Working Capital
Current Ratio
Acid Test Ratio
Receivables Turnover
Days Receivables Outstanding
Inventory Turnover
Average Days Sales Inventory

Name of Ratio: Current Ratio or Working Capital Ratio or Banker's Ratio

Computation: Current Assets / Current Liabilities

Significance : It indicates the degree of safety with which short term credit may be extended to the firm as it signifies the ability or the inability of a firm to meet its currently maturing obligations using its current resources. Likewise, it gives an indication of the possible tolerable shrinkage in current resources without threat to the claim of current creditors.

Rule of thumb: 2:1 meaning that for every peso of current debt, the firm has P2.00 current resources to answer for the debt.

Name of Ratio: Acid-Test or Liquid Ratio

Computation : Acid and near Cash items / Current liabilities
Acid Assets = Marketable securities, money market placements (short term) and the like.

Significance: This measures the immediate solvency. It measures more conservatively how liquid the firm is by using the most liquid form of current assets and discarding the less liquid items which are more susceptible to loss or shrinkage before or upon cash conversion.

Name of Ratio: Trade Receivables Turnover

Computation: Net Credit Sales / Average Trade Receivables

Significance : Approximate the number of times receivables have been collected during the period

Name of Ratio: Average Collection Period or No. of days in receivable

Computation: 365 / Trade Receivables Turnover

or Trade Receivables x 365 / Net Credit Sales

or Trade Receivables / Ave. Sales per day

Significance : Gives the number of days sales remained uncollected or the number of days sales receivables remained tied up, This can be used by trend or compared with industry and company's credit terms.

Name of Ratio: Inventory Turnover

Computation: Cost of Goods Sold / Average Inventory

Significance : Indicates the activeness or movement of inventory. It approximates the number of times inventory has been moved that is sold and replaced during the period. The rate can be compared with the industry norm, past experience and competitors.

Name of Ratio: Average Days per inventory turnover

Computation: 365 / Inventory turnover

Significance : Reflects the average age of inventory. Related ratios are as follows:

PROFITABILITY

PROFITABILITY RATIOS: Reflects the earnings capacity of a firm by showing the total revenue and its distribution to or absorption by various costs and expenses leaving finally the position available to the investors. It, likewise, gauges the worthiness and soundness of the investment by determining the returns on the relevant invested resources.

Net Income/Net Worth
Net Income/Net Sales
Asset Turnover
Sales Growth Rate
Net Income Growth Rate

Name of Ratio: Assets Turnover

Computation: Net Sales / Total Assets

Significance : Indicates low or high "Trading of Assets" - meaning the extent of revenue generated by the total resources of the firm. Low ratio means possible excessive investment in idle assets or poor revenue generation

USEFULNESS OF FINANCIAL STATEMENT ANALYSIS

With Financial Statement Analysis as tool, one can study relationships and trends to determine whether or not the financial position and results of operations and the financial progress of the company are acceptable to the bank to warrant a certain level of credit accommodation. His interpretation should be validated by the figures and relationships lifted from the spreadsheet.

Analytical methods and techniques are used to ascertain or measure the relationships among financial statement items of a single set of statements and the changes that have taken place in these items as reflected by successive financial statements.

In financial analysis, we try to assess the financial strength of an entity. Financial strength refers to the ability of a business to

1. meet the claims of creditors not only under current economic and business conditions but also under unfavorable situation that may occur in the future

2. take advantage of business dealings or expansion that require internally generated funds, external funding, additional equity infusion and favorable credit rating and

3. continue dividend and interest payments without interruption.

Predictive capability of Financial Statement Analysis is enhanced through the following:

1. Time-Series (intra-firm Analysis) - It is to predict future values of ratios. The approach is to search for systematic patterns in the historic behavior of the series; knowledge of such patterns can then be used in the prediction pattern. Assumption is that the underlying process generating the ratio series is stable over time, i.e. the process continues to operate as it did in the past.

2. Cross-sectional (inter-firm) Analysis - To derive information needed for financial decision by comparing the investigated ratio with exogenous norms or standards. Standard ratio techniques use industry-wide measures. Comparability is enhanced if the firms:

   a. Belong to the same industry
   b. Are of similar size
   c. Use similar accounting methods
   d. Are located in the same geographical region

   Evidence regarding the firm-size affects on ratio:

   a. Short-term liquidity ratios are related to size of firm in positive parabolic manner. That is the relationship is positive for smaller firms and negative for larger firms.

   b. Long-term solvency are also related to size of firm in a positive parabolic manner

   c. Capital turnover ratios vary inversely with size of the firm

   d. Profit margin ratios vary directly with size of the firm

   e. Return on investments rations also vary directly with the size of the firm.

3. Combination of Time-Series and Cross Section Analysis; the Residual Method:

   Basic Premise - If the investigated variable (e.g. stock prices) is cross-sectionally correlated, its variability can be decomposed into 2 parts; general factors affecting all firms and caused by specific factors affecting only the firm under study.

4. CONCEPT OF HOMEOSTASIS, which means equilibrium maintained by self-regulatory mechanism, is a major characteristic of all living organisms. If equilibrium is disturbed, forces are set to motion to restore it. The concept applies to business organizations. Optimal Equilibrium relationship among various inputs and outputs are determined by organization and efforts are made to maintain them in the face of disturbances. Equilibrium is derived from economic optimality criteria designed to enhance operational efficiency. For any given level of

activity, there exists optimal relationship between labor and capital inputs, inventory and sales, cash and short term securities, debts and capital inputs and so forth. Actual relationships among inputs and outputs, which may deviate from the optimal ones, are presented in the firm's financial statements. Changes may result from:

a) Planned actions by management such as increase in ratio of short term securities to cash induced by increase in market rates and

b) Unplanned changes resulting from unexpected events, such as change in the firm's capital structure caused by general decrease in stock prices.

Analysis is horizontal if the financial statements for a number of years are reviewed. Analysis is vertical if period covered is one date or for one accounting period.

Review of changes is important because they give an indication of the direction in which the business and its financial characteristics are developing. They indicate direction of movement with respect to financial position and operating results.

UNDERSTANDING THE FINANCIAL STATEMENTS

BACKGROUND

To fully appreciate financial analysis, one must have an in-depth understanding of the object of analysis, which are the financial statements. As a backgrounder, one should understand the following:

1. The Balance Sheet, Income Statement, Cash Flow Statement (or Statement in Changes in Working Capital), and Statement in Changes in Retained Earnings comprise the Financial Statements of a business entity. These statements are usually prepared at the end of the year such that the stakeholders of the company as well as the government regulatory authorities would know how much profit the entity earned for the year as well as the financial status of the company as of the end of the year.

2. Figures indicated in the Financial Statements are summaries of figures recorded in the Books of Accounts. The Books of Accounts consists of the General Ledger and The Subsidiary Ledgers. The debit and credit components of each Business Transactions, expressed in terms of Pesos, are recorded in the Books of Original Entry and then into the General Ledger, usually at the end of the month. Every transaction recorded in the Books of Original Entry is likewise recorded in the Subsidiary ledgers such that the details of the transaction can be monitored.

3. The recording of the transactions in the Books of Accounts and the subsequent preparation of the financial statements are governed by a rule known as the Generally Accepted Accounting Principles or GAAP and by the Statement of Financial Accounting Standards.

4. To assure the stakeholders and other potential users that what is reflected in the financial statements are accurate, the statements are subjected to an external audit. The auditors examine the accuracy of the figures indicated in the statements as well as the records from which the statements were prepared. The examination is based on accounting standards discussed in No. 3.

AUDITED FINANCIAL STATEMENTS

We will focus our discussion on audited financial statements which is the one submitted to us for evaluation. Audited Financial Statement consists of the following:

1. The Auditor's Certificate
2. Balance Sheet
3. Income Statement
4. Statement of Sources and Uses of Funds and
5. Notes to Financial Statements

AUDITOR'S CERTIFICATE

The certified public accounting firm is an independent entity that examines financial statements prepared by the client and renders an informed opinion as to whether they fairly present the client's financial condition. Since the accountant's opinion is relied on by a wide variety of interested parties, he can incur professional liability. The standard auditor's certificate, written in letterform and addressed to the board of directors of the examined company, is composed of two sections, ordinarily contained in two paragraphs:

1. An indication of the scope of the work performed
2. A professional opinion as to whether the financial statements fairly present the client's financial condition.

In the auditor's opinion is unqualified (also called a clean certificate), it means to say that the auditing firm has performed all the tests necessary to perform a complete examination and has found nothing material in the presentation to which it takes exceptions.

If the auditor has reservations about a particular aspect of the client's financial statements, he may issue a qualified certificate. This has the effect of alerting the reader to some irregularity in the scope of the examination or the method of presentation and serves to modify the accountant's professional liability concerning that item. The certificate is altered in two ways:

1. A separate paragraph is included explaining the item(s) to which the auditor takes exception.
2. The phrase beginning with “subject to” or “except for" in the opinion paragraph to notify the readers about the reservations of the auditor on the statements.

There may be occasions when the terms of the engagement do not permit sufficient examination to satisfy the minimum requirements of "generally accepted accounting principles" or when the CPA believes that management's financial statements do not present the company's condition fairly. In this case the accountant will issue a disclaimer letter indicating the objections he has to the presentation and removing all professional responsibility to any reader who might take action based on the statements in question.

In certain cases, the auditor is requested to merely assemble an unaudited financial statement in the proper format for presentation to creditors or other interested parties. The auditor in this case issues a compilation letter which states that his only responsibility was to prepare the statements in acceptable format from the client's books and records and no outside verification was done.

If the accountant should follow-up on any irregularities that become apparent during the casual examination of the supporting data and try to resolve them while preparing the statements, a review letter accompanies the finished product (note that once again, the CPA plainly states that no formal auditing procedure was performed).

THE BALANCE SHEET

The basic accounting statement is Assets = Liabilities + capital. This means that funds used to acquire a company's assets came from two sources - capital invested by the owners and debt owed to the creditors. The balance sheet is a numerical representation of this equation.

The Balance sheet reflects the financial condition of a business at a particular point in time usually the close of the business day indicated by the date of the statement. The statement reflects the basic accounting equation, which is

Assets = Liabilities + capital

There are three major accounts in the Balance Sheet are assets, liabilities and capital accounts. Assets are resources or rights incontestable controlled by an entity at accounting date that is expected to yield it future economic benefits. Liabilities are obligations of an entity at the accounting date to make future transfers of assets or services (sometimes uncertain as to timing and amount) to other entities. Capital or Equity is the residual interest in the assets of an entity that remains after deducting its liabilities, that is the interest of the owners in a business enterprise.

Amounts indicated therein represent remaining balances of the accounts after the adjusting and closing process in the General Ledger has been completed.

Grouping is usually included in the Balance sheet to make the statement more meaningful to the reader. Assets and liabilities may be grouped by several characteristics:

1. By Liquidity, which can be current and non-current. Current Assets can be sold or transformed

into cash within one operating cycle or one year in the normal course of operations; non-current assets are those which could not be transformed into cash within one year. Current liabilities can be satisfied within one year while non-current liabilities are those falling due after one year.

2. By physical form which can be tangible and intangible. Tangible Assets are those with physical existence while intangibles are characterized by legal rights on assets with no physical existence.

3. Valuation, which can be monetary and non-monetary. A monetary asset or liability has a fixed value in terms of cash; examples are accounts receivable or payable. A non-monetary asset or liability has no fixed exchange value, the amount of cash to be received or paid is dependent upon economic conditions. Examples are plant and equipment and inventory.

Because liquidity, the ability to transform assets into cash, is such an important factor in decision making by readers of financial statements, balance sheet conventionally reflects current versus non-current classification.

There are groupings and sub-groupings in the major accounts which are not frequently found in the books of accounts such as "Current Assets", "Fixed Assets" and "Current Liabilities";

INCOME STATEMENT

The Income Statement shows the revenues realized from the business operations and the cost incurred in the process or earning the revenue over a given period. The Income Statement reveals the net income or loss resulting from the operation of the business during the period covered which is usually one year. Seen from a different perspective, an Income Statement indicates the changes in owner's equity (and changes in net assets) over a period of time resulting from the operations of the business, excluding contributions or withdrawals on the part of the owners (which is indicated in the statement of changes in owners' equity).

Two major items are found in the Income Statement: Revenues and Expenses. Revenues are inflows or other enhancements of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations. It is derived from sale of products or services, or realized from interest on loans to third parties, dividends received from stock investments, interest received from commercial papers held, rental received from properties owned, or royalties earned from patents or licenses.

Expenses, on the other hand, are outflows or other using up of assets or incur of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out activities that constitute the entity's ongoing major or central operation. They are a measure of the effort of the enterprise in its pursuit for revenues.

Gains and losses that are unlikely to recur and are not related to ongoing activities of the enterprise are classified as extra-ordinary items.

Presentation in financial statements depends on the nature of business operations. Trading and Manufacturing concerns present Sales first followed by cost of goods sold to get gross profit, then present operating expenses to get operating income. Other statements combine all revenues regardless of nature first and then present expenses.

STATEMENT OF CASH FLOW

Statement of cash flows is a summary of cash receipts and cash disbursements - all of the transactions that affect cash account. It reports changes in cash position during a period of time. It tells how the entity acquired cash and how it utilized the cash. Major groupings in the statement are:

1. Operating activities: It includes firm's production, selling and administrative activities. In some statements, Net Income is reflected with non-cash expenses added back and non-cash income deducted.

2. Investing activities: It covers purchase and sale of marketable securities, plant and equipment, and the payment and collection of loans to others.

3. Financing activities: This covers issuance and retirement of stocks and bonds and the payment of dividends.

STATEMENT OF CHANGES IN RETAINED EARNING

This statement links the income statement and the balance sheet. Owners' equity is equal to capital contribution plus retained earnings. Retained Earnings are the sum of the earnings of the accounting periods that the company has been in existence less the amounts paid for dividends to stockholders. The statement follows the following format:

Retained Earnings at beginning of the year

Plus: Income for that period per income statement

Less: Dividends declared

Equals: Retained Earnings End of the Year

The statement is sometimes incorporated in the balance sheet under the equity portion.

STATEMENT IN CHANGES OF OTHER OWNER'S EQUITY ACCOUNTS

The statement reports the changes in the firm's capital structure as a result of issuance of new shares or retirement of outstanding shares. It reconciles changes in owner's equity. This statement is often incorporated in the equity portion of the balance sheet.

NOTES TO FINANCIAL STATEMENTS

Numerical representations on the financial statements or of the transactions that created them are frequently insufficient to give the reader a clear picture of what has taken place. Expository material is needed to anticipate some of the questions an analyst might have. Typical kinds of information contained in the notes to financial statements are:

1. Accounting methods used (to calculate depreciation, inventory, taxes, reserves, etc.)
2. Details of fixed assets, investments, Sales and cost of goods sold; details of long term liabilities, including interest rates, collateral and tenor; and details of extraordinary gain or loss.
3. Contingent liabilities, such as pending litigation, lease obligations, or guarantees of the debts of others.
4. Explanatory details (schedules of term debts, fixed assets)
5. Developments, which took place between the date of the financial statement and completion of the audit that, change materially the financial picture of the entity.

An entry further explained by a note contains reference to the note in the body of the financial statement. The notes are not addendum to the statements; they are an integral part. They are considered necessary for full comprehension of the Financial Statements.

The Account Officer should make it a point to read the Notes to Financial Statements because it may contain information that is critical to the Credit Decision.

RELIABILITY OF THE FINANCIAL STATEMENTS AS BASIS FOR DECISION

Financial statements, especially if audited by a reputable Certified Public Accountant, can be used as basis for decision by interested parties because they are prepared within the framework of generally accepted accounting principles or GAAP. The GAAP is a sent of guidelines observed by practitioners of the accounting profession. GAAP is observed to assure a desirable degree of consistency in accumulating financial and operating data; to provide comparability of accounting data that are presented to management, creditors, investors, the public, and governmental bodies; and to provide a basis for decision making and formulation of solutions to the many complex accounting problems encountered.

The GAAP revolves on the fundamental accounting concepts, which are the following:

1. Business entity concept. The assumption is that a business activity shall be accounted for separately from its owners.

2. Going concern concept. A going concern represents an established business being conducted with the expectation of continuing indefinitely; that is, when a business is organized, the going-concern concept of accounting assumes a continuity of existence for the accounting entity longer than that of any of its components.

3. Unit of measurement concept - Accounting is based on the assumption that for accounting purposes, money is the unit of measurement to be used in recording, classifying, summarizing, and reporting business transactions and the results thereof. This concept provides a common denominator for which all transactions, whether past, present, or future, may be accounted for.

4. Cost concept - Accounting data are recorded at cost as of the date of acquisition, and these costs are maintained on the records and statements unless there is a write-down to recognize a loss.

5. Realization concept - Revenue is realized when the earnings process is virtually completed and the selling price is assured; that is, when bona fide sale, or exchange of economic values takes place between the business and an outside firm or individual.

6. Time period concept - While business activity is a continuous flow, the reporting process breaks up that flow into periods. A year, calendar or fiscal, usually serves as the basic accounting period.

7. Stable monetary concept - The primary statements of financial condition, fluctuations in the monetary values must not be permitted to affect the amount shown.

8. Objective evidence concept - An important reason for the confidence placed in the financial statements of a business is the fact that auditors require verifiable, objective evidence to support the accounting transaction that are recorded in the accounting records.

9. Disclosure concept - It is imperative that all material facts bearing on the financial condition and operating prospects of the company, whether of a monetary nature or not, be disclosed.

10. Consistency concept - Where there are several accepted methods of accounting for transactions, the accountant should apply the best suited for each particular case consistently from year to year. Method being used should be disclosed. Disclosure on the changes in methods should also be made.

11. Conservatism concept - Losses that can be anticipated and estimated should be charged against income, whereas, income should not be recorded until there is objective evidence that it is bona fide.

12. Matching of revenue and cost concept - periodic matching of cost incurred during the year.

LIMITATIONS OF FINANCIAL STATEMENTS

1. They do not reflect factors that affect financial condition and operating results because these factors cannot be expressed in monetary terms. Among these factors are reputation and

prestige of the company with the public; credit rating of the company; efficiency, loyalty and integrity of management and the employees; and sources and commitments for materials and supplies.

2. Financial statement values are not liquidation values. Patents, trademarks and organizational costs may have a book value of P1.00 but may be liquidated at a very substantial amount. Fixed Assets are reflected at cost less accumulated depreciation and not at replacement cost or at amounts that they can be disposed.

SUPPLEMENTAL NOTES ABOUT FINANCIAL STATEMENTS

BALANCE SHEET - A statement of the Assets, Liabilities and Owners' Equity of the business as of a certain date, usually end of the year.

ASSETS - The Resources of a business

LIABILITIES - Claims on business resources by non-owners such as suppliers, government, bankers, etc.

OWNERS'/STOCKHOLDERS' EQUITY - Claim by Owners on the assets or resources of a business.

Formula:

Resources = Claims on resources

Assets = Liabilities + Owners' Equity

INCOME STATEMENT - A statement of revenues and expenses of a business over a time period (for example, one quarter, one semester, one year)

REVENUES - Resources earned by the business

EXPENSES - Resources used up by the business to produce the revenues

NET INCOME - Revenues less expenses

ASSET COMPONENTS

INVESTMENT - needed by the business to operate

CASH - needed to meet expense, pay bills, do financial transactions

RECEIVABLES - needed to encourage sales

RAW MATERIALS INVENTORY - needed to support production

FINISHED GOODS/MERCHANDISE INVENTORY - needed to support sales

FIXED ASSETS - needed for production, increase productivity

Assets should not be too little, otherwise sales and production may suffer. It should not be too much, otherwise, it is costly.

LIABILITIES/DEBT

Should not be too little, otherwise, business may not take advantage of cheap funds for growth

Should not be too much, otherwise, business becomes financially risky, unstable, unable to pay obligations, strained relations.

BASIC FINANCING SOURCES

LIABILITY - Payable to suppliers, short-term loans, long term loans

OWNERS' EQUITY - Paid-in capital, Retained Earnings

FINANCIAL OBJECTIVES

1. Business is profitable and gives good return to owners
2. Business can pay the bills on time
3. Resources are used effectively and efficiently
4. Business is financially stable, able to pay banks
5. Business can grow.

______________ Company
PROJECTED BALANCE SHEET

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
ASSETS										
Current Assets										
Cash										
Receivables										
Inventories										
Total Current Assets										
Investments										
Fixed Assets										
Less: Accumulated Depreciation										
Net Fixed Assets										
Other Assets										
TOTAL ASSETS										
LIABILITIES & STOCKHOLDERS EQUITY										
Current Liabilities										
Accounts Payable										
Taxes Payable										
Notes Payable										
Current Portion of Long Term Debt										
Other Payables										
Total Current Liabilities										
Long Term Liabilities										
TOTAL LIABILITIES										
STOCKHOLDERS EQUITY										
Capital Stock										
Issued and Subscribed										
Paid up										
Retained Earnings Ending										
TOTAL STOCKHOLDERS EQUITY										
TOTAL LIABILITIES & STOCKHOLDERS EQUITY										

______________ Company

CASH FLOW PROJECTIONS

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CASH FLOW FROM OPERATIONS										
Sources of Funds										
Sales Revenues										
Uses of Funds										
Cost of Sales										
Operating and Marketing Expense										
General and Administrative Expense										
Sub-Total										
Cash Flow before tax										
Less: Taxes										
Cash Flow from Operations										
CASH FLOW FROM INVESTING & FINANCING ACTIVITY										
Sources of Funds										
Equity Infusion										
Proceeds from Loans										
Total		0	0	0	0	0	0	0	0	0
Uses of Funds										
Capital Expenditures										
Project Development										
Working Capital Requirement										
Payment of Loan										
Working Capital Loan										
Stock Retirement/Redemtion										
Interest Expense										
Total										
Cash Flow from Investing and Financing Activity										
NET CASH FLOW										
Opening Cash Balance										
Less: Debt Reserve										
Expansion Reserve										
Distributable Cash Flow										
Less: Dividends										
Preferred Shares										
ENDING CASH BALANCE										

______________ Company
INCOME STATEMENT

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
SALES REVENUE										
LESS										
OPERATING AND SELLING										
GEN. AND ADMINISTRATION										
NET INCOME FROM OPERATION										
LESS: INTEREST EXPENSE										
NET INCOME BEFORE TAX										
LESS: PROVISION FOR INCOME TAX										
NET INCOME AFTER TAX										
RETAINED EARNINGS BEGINNING										
ADD (DEDUCT)										
RESERVE										
BALANCE										
Less: Dividends										
RETAINED EARNINGS										

ANNEX "G"
BANK CREDIT PRODUCTS

In order that the DOE Assistant can provide appropriate advice to NRE project proponent, he must be aware and conversant about the credit products of the banks.

Traditionally, there are two basic credit products of a Bank, the working capital loans and term loans. A third kind which has gained popularity if previous years are consumer loans. We will discuss the nature, features and the purpose of each type.

WORKING CAPITAL LOANS

Working capital loans have been the traditional credit products of the Banks. These types of loans are meant to finance the cyclical increases in the level of Receivables and Inventories and are liquidated in the normal course of the business. In certain instances, the borrower is expected for an annual clean up of borrowings especially where there are unutilized funds during off-seasons.

Working capital loans are considered much safer than terms loans because the Bank is given the opportunity to review its relationship with the borrower over a short span of time. It is being preferred because it matches the nature the major funding source, savings deposit that can be withdrawn by the depositor on short notice.

The various short term loans and their uses and applications are as follows:

<u>SHORT TERM LOAN LINE</u> -

Nature/Purpose: Short Term Loan Line (STLL) is a credit facility given to a client intended to provide additional operating capital to finance seasonal or cyclical requirements of a client.

Term: One year and is reviewed before maturity to determine if it is renewed at the same amount, at an increased amount or at a reduced amount.

Availment: Via 90-day PN or for a longer term that parallels one operating cycle (the period it takes to convert inventories to sales to receivables and finally to cash)

Amount of Line: Theoretically equivalent to the sum of Accounts Receivable and inventories during peak production season less estimated level of internally generated funds. In actual situation, the level of line exceeds the theoretically determined level for the company to be able to handle unexpected orders from clients.

Other Info: Other terms used to refer to this type of facility are Working Capital Loan, Revolving Credit Line and Discounting Line.

<u>LC/TR LINE</u>

A Letter of Credit (LC) is a written undertaking by a bank to the seller, in accordance with the instruction of the buyer, to effect payment up to a prescribed amount within prescribed time period against prescribed documents, provided these are correct and in order, i.e., they conform with the instructions of the applicant (buyer). It serves as an instrument for payment and of goods and services under a specific contract for both domestic and foreign trade transactions. It assures the seller or exporter that money is available once there is delivery or fulfillment of the terms of any kind of underlying contract or agreement within the period specified by the LC and is the most popular instrument in foreign trade.

A Trust Receipt (TR) is an instrument wherein the bank retains ownership on the imported goods but allows the same to be released in favor of the client to allow client to operate uninterruptedly meantime that he is generating funds to pay for the full amount of the negotiation.

An LC/TR line is a facility is given to client to allow them to import their equipment and raw materials requirements. Some reminders with respect to this facility are as follows:

1. Indicate in the CFP the term of TR Availment. The usual term is 90 days renewable for another 90 days. If there is not restriction on the TR term, goods held under TR may have a term of 360 days.
2. Goods released under TR must be insured, and insurance endorsed in favor of the bank.
4. If client intends to avail of a Deferred and Standby LC, a separate line should be set up for the purpose as LC and TR lines are ordinarily intended for the importation of raw materials for goods to be sold for export or for local sales.

DEFERRED LETTERS OF CREDIT

Deferred L/Cs are import L/Cs payable in installments over a period of usually 3 to 5 years. It is usually opened for the importation of machinery, equipment or other capital goods. Considering the nature of the transaction, the evaluation of a request by a client for a deferred letter of credit should be similar to that of the evaluation of a term loan. The reason for this approach is that the bank will be held contingently liable mean time that the LC remains operative. The client shall deposit the peso equivalent corresponding to every drawing to be made against the letter of credit 30 days before each drawing is due, and upon failure to make the deposit so required herein the Bank may, at its option, enforce collection on the full amount of the letter of credit and institute the necessary legal action to protect its interest

A deferred LC Line, if ever granted, is given only to few valuable clients of the bank.

STAND-BY LETTERS OF CREDIT

Standby Letters of Credit are usually those opened to guarantee payment of foreign loans or performance of an agreed service over a certain period of time in case of failure of designated party/beneficiary to comply with original LC agreement.

TERM LOAN

A term loan is a credit facility with a term of more than one year and payable in a series of pre-determined amortization. The purpose of the loan is usually to finance the expansion of existing production capacity, for the replacement of exiting equipment or to finance the capital expenditures for a business different from the current business of the applicant. Some of the conventions in the packaging of a term loan are:

1. Where loan proceeds will be used to pay for equipment importation, include in the loan terms a provision allowing the client to use the approved term loan as a LC line for purposes of equipment importation. The availment will be converted into a term loan once there is negotiation on the LC.

2. The components of the capital expenditure for which financing is being requested and the estimated amount to be spent per component should be defined. In addition, the mode of financing per component, whether from equity or from loan proceeds, should be defined.

3. Analysis of expansion should be on incremental basis, that is, the expansion should be looked into as a stand-alone project. The expansion portion should be able to generate the cashflows to service loan amortization and that cash generated from existing operation serves as buffer in the event that the expansion miscarries.

Appendix D

Proposed Guidelines for NRE Proponents

PART 2
PROPOSED GUIDELINES FOR PROPONENTS OF
NEW AND RENEWABLE ENERGY PROJECTS
DEPARTMENT OF ENERGY

I. INTRODUCTION

Part 2 of the guidelines is for the use proponents of New and Renewable Energy Projects (NRE). It intends to provide focus to the effort of proponents towards areas relevant to the project, more particularly towards compliance with the requirements of banks and other lenders that provide loans for NRE projects. It serves as a guide to proponents in accomplishing documents and studies such that they address matters that the banks deem important. It likewise helps the proponent identify weak points at early stages such that remedies can be formulated before request for funding is filed with the banks.

1.1 Content and Objectives

1.1.1 The guidelines were formulated with the specific objective of improving the approval rating of loan applications.

1.1.2 You, the proponent, should be aware that DOE provides assistance as this is part of its task of catalyzing private sector participation in NRE. You, however, remain primarily responsible for the project proposal and can overrule any recommendation of DOE that does not fit your business plans.

1.2 Assistance from DOE

1.2.1 DOE shall provide assistance only if you have a written request. The nature of assistance given include:

a. Market identification and validation of market assumptions. DOE can help make an assessment of the existence of the market, characterize the market and provide basic market data. It can help on such areas like 1) proof on the assumption on the population and its growth, 2) estimates on tariff rates 3) cost of delivery of electricity (it varies depending on the location and the technology to be used) 4) technical feasibility.
b. Technical validation and verification of the viability of the technology. DOE can provide inputs about the technology of the project such as 1) if the technology has been pilot tested 2) existing projects in the Philippines using the technology and the performance of the project and 3) existence of similar projects in other countries and their performance. Such information is relevant to the banks.
c. Institutional strengthening - DOE can provide assistance in identification of possible joint venture partners.
d. Verification of "cost of service delivery" calculation/pricing or tariff formula

1.3 Framework – The guidelines focuses on how to comply with the requirements of the Banks. Banks place their money into the projects only if their assessment shows that there is reasonable assurance that they get back what they lend plus earnings thereon. Their assessments narrow down to two areas 1) your bankability which focuses on your credit recrd and 2) the viability of the project that is presented to the bank for purposes of funding.

1.3 Methodology

The guidelines took into consideration the lending guidelines of DBP, LBP and PNOC-EDC and the project guidelines of DOE, NEDA and NPC-SPUG.

2. EVALUATION

The foregoing set of guidelines is useful if you are willing to undertake an honest to goodness self-assessment. A self-evaluation is helpful if done prior to presentation of a request for a loan from a bank. The self-evaluation shall focus on two areas: 1) completeness of the documents and 2) the chances of the project proposal getting the approval of the bank.

<u>Completeness of Documents</u>

2.1 See to it that the following documents are included in the materials presented to the bank:
   a. Organizational Papers - Articles of Incorporation and By-laws, if the proponent is a corporation or cooperative, Articles of Partnership if a partnership, or Bureau of Domestic Trade Registration if a sole proprietorship
   b. If the proponent is an LGU, a resolution from the Municipal/City/Provincial council approving the project, authorizing the LGU to borrow and authorizing for the encumbering of LGU assets including its Internal Revenue Allotment
   c. Bio-data of Principal officers and directors of the business
   d. Feasibility Study usually prepared by proponent's consultant. Attached to the feasibility study is a statement from the appropriate unit of DOE stating that the technical assumptions in the feasibility study were validated and found substantially correct. If the feasibility study was prepared by a unit of the DOE upon the request of the proponent, the study will be accepted as is.
   e. Transfer Certificate of Title and other forms of certificate of ownership on assets proposed to be mortgaged to secure the proposed loan
   f. Financial Statement of the proponent for the last three years
   g. If the proponent organization is new, Balance Sheet as of a given date and the Financial Statement of the Principal Stockholders for the last three years. If the financial statements are not available, an audited statement of Assets and Liabilities may be submitted.
   h. Statement from the proponent and principal officers and directors about cases filed against them in courts.

Chances of the Proposal Getting Approved

Understand and appreciate the procedures performed by the bank as described below such that you can properly present your project proposal.

2.2 The bank evaluation process starts with the question "How bankable is the proponent?" Are the banks willing to place their money into the your project taking into consideration your present status? You should understand that banks have a way of finding out information critical to your request for a loan.

2.3 Next to be evaluated is the viability of the Project. It focuses on the following issues:
   a. Will the proposed project inure incremental benefits to your business?
   b. What are the risks involved and
   c. What are the risk mitigation measures necessary

2.4 The banks invest only after conducting an extensive due diligence process and such practice is worthy of replication to increase chances of projects getting approval for a loan. The said process is conceptually presented in Annex "A". A discussion of the process is marked as Annex "B".

2.5 When you request for a loan, you are actually presenting a financial package to a bank for its consideration. The Financial Package has the following components:
   a. The amount of Equity needed in addition to equity contribution of proponent
   b. Performance Measures on proposed project that include FIRR, BEP, Payback Period and NPV
   c. Terms of the loan to be obtained from the bank include
      1) Amount – Amount of loan is a function of the project cost and the level of equity contributed by the proponent. Elements of project cost is discussed in a separate section of this guideline
      2) Tenor – Tenor is the number of years within which the borrower is to effect full payment of the loan. It is dependent on the projected cash flow. Grace period is allowed for the gestation period but not to exceed two years. Gestation period is the time from started of project up to the time that the project starts to generate revenues. A shorter grace period is allowed in payment of interest portion.
      3) Purpose of Loan – Purpose of loan is to partially finance proposed project.
      4) Interest Rate – Discussed in foregoing section
      5) Drawdown – Most terms loans are released according to stages of completion of project. The initial release is usually made after reaching a certain percentage of project completion using funds from equity contribution from proponent. Subsequent releases are made after the appraiser has verified that proponent has spent a specified amount for the project or after reaching a certain stage of completion.

6) Repayment – Quarterly payment is convenient to both the proponent and the bank. When cash flows are tight, a maximum of 2 year grace period on principal and 6 months grace on interest.
7) Collateral/Security – Discussed in foregoing section
8) Insurance – Collateral should be insured with reputable insurance company.
9) Compensating Business – Banks prefer that proponent maintains deposit account with them

2.6 Banks are particularly concerned about the following:

a. Your Credit Record
b. Financial Aspects – Your Historical Financial Performance and Projected performance
c. Marketing aspect – How will you market your services/products
d. Operations and Technical Aspects – How will you operate
e. Organizational Aspect
f. Risk involved in the credit transaction
g. Pricing
h. Collateral/Security and Second Way out
i. Socio-economic considerations

CREDIT RECORD

2.7 If you have requested for DOE assistance, you should be honest enough to disclose any adverse record about the business, the officers or the stockholders. Banks are exhaustive in the conduct of credit investigation and it is likely that they will find out the adverse finding.

2.8 Bank obtains credit record of the proponent/borrower through the process called credit investigation. The Credit Investigator (CI) sends queries about the level of loans, the status and payment record with the other banks in the area and nearby area as well as with its branch offices. The CI likewise looks into the records of the court for the existence of court cases against the proponent and of the principal officers and stockholders, if proponent is a corporation or cooperative. The CI, likewise make a random interview of the neighbors of the proponent and certain suppliers to assess the character of the proponent.

2.9 Adverse findings from the credit investigation may result in the disapproval of your loan application of a good project. If you are honest enough to disclose any unfavorable information, DOE can suggest measures to correct the weakness before the loan application is filed with the bank. Note that it is very difficult to correct the initial impression of the bank once there are adverse findings.

FINANCIAL EVALUATION OF HISTORICAL PERFORMANCE

2.10 Evaluation of historical financial performance is applicable where have an existing business. Your historical performance is assessed separately from the projected performance of proposed project. The proposed project is evaluated separately based on its incremental effects, that is, increases in revenues and costs become the basis of the evaluation.

2.11 Financial Statements consist of three statements, 1) Income Statement, 2) Balance Sheet and 3) Cash Flow Statement or the Statement of Sources and Uses of Funds. Income statement shows the results of operations over a certain span of time, usually one-year. The Balance Sheet shows what the business entity owns and what it owes as of the date indicated in the statement. The Cash Flow Statement shows the sources of funds that came into the entity and where the funds went over a certain time span, usually one-year.

2.12 Financial Statements to be useful for analysis, should be prepared in accordance with generally accepted accounting principles and is the duly certified by a Certified Public Accountant (CPA). Make sure that the CPA expressed an Unqualified Opinion on the Statements.

2.13 Analyze your financial statements for purposes of getting indication as to how the banks perceive your financial health. Guidelines in the Analysis of Financial Statements is contained in Annex "C"

FINANACIAL EVALUATION OF PROPOSED PROJECT

2.14 Where you are a recently organized entity with no previous track record of performance, focus of evaluation is proposed project.

2.15 Statements that are subjected to evaluation are the Projected Income Statement, the Projected Balance Sheet and the Projected Cash Flow.

2.16 If proposed project is an expansion of existing business activity, the expansion project should be analyzed as a project that is separate and distinct from an existing project. This is to be able to assess the add-on value of the new project to the existing operation. Only the incremental revenues and costs will be considered.

2.17 Sunk cost, or cost of assets that has already been paid, will not be considered even if these assets are used in the expansion projects.

Project Cost and Financing

2.18 Since evaluation of proposed project pivots on project cost, it is important that this item should be given initial attention. Project performance is gauged against the total cost of the project.

2.19 The components of projects of project costs should be examined to determine their appropriateness and sufficiency. Components of project cost are:

a. Cost of Preparing the feasibility study
b. Cost of Land
c. Cost of Land Improvements
d. Cost of Equipment including installation and supervision cost
e. Pre-operating expense which include cost of securing business permits, licenses, cost in organizing the entity, personnel cost and such other costs incurred prior to start of commercial operations
f. Allowance for Contingencies – This is a provision for possible increases in cost resulting from the depreciation of the peso and such other unforeseen events resulting into an escalation in the total cost of the project. Allowance for Contingencies is usually set at 15% of total projected cost.
g. Working Capital - This represents the minimum level of balance maintained in the cash vault, receivables, inventories in spare parts and prepaid expense necessary for a continuous and unhampered operation of the entity.

2.20 The total project cost, once determined and validated, should have a matching fund sourcing which may be either loan or equity. Some rules of thumb to determine the appropriate mix between loan and equity are as follows:

a. Banks do not ordinarily finance the cost of acquiring land. Land should be part of the equity contribution of the proponent
b. Working capital – There are should be available financing for the initial working capital requirement of the entity. Some banks allow initial working capital requirement to be financed by a medium to long term credit product while other banks allow only short term loan products of the bank to finance working capital needs.
c. Except for Working Capital, all of components **a to e** in item 2.19 qualify for long term funding which is either equity or medium to long term loan. A medium term loan has a tenor of 5 to 7 years while a long term loan has a tenor of 7 to 10 years.
d. In the presence of collateral with loan value that can fully cover a given amount of loan, the bank can provide the proponent a loan equivalent to 75% of total project cost.

Annex “D” discusses the various loan products of the Bank and their appropriate uses.

2.21 Banks offer various financing options. DBP and LBP are the two banks that show keen interest in providing loans to NRE projects. Various product options and other relevant information are contained in Annex “E”.

2.22 If you do not have the necessary resources to cover the portion of project cost that could not be covered by a loan, you may be need to obtain equity from various sources. Potential sources of equity funding are:

a. Equipment Suppliers – Some Equipment Suppliers are willing to infuse as equity into the project portion of the purchase price of the equipment. Suppliers, however, are concerned with the full collection of their money and as such, the projected financial statements must consider soonest redemption of equity of suppliers as the cash flows may warrant. Further, suppliers may want assured revenues in which case, a Non-Participating Preferred Shares may be issued to such suppliers
b. Local Companies – Big companies with operations near the project site may be willing to infuse equity especially if the said companies are known supporters of environment friendly technologies.
c. Investment Companies – Some banks and insurance companies have subsidiaries that invest in developmental projects especially those with good potential
d. Local Investors – There may be people in the project locality who may be willing to contribute equity into the project. As in the case of the suppliers, they may want assured income and a specific schedule for the redemption of their investment. In such case issuance of preferred shares may be appropriate.
e. Local Government Unit (LGU) – The LGU may be the proponent or may be interested to place equity into a project especially where there is a tremendous socio-economic benefit from the project.
f. NGO – Some NGOs may have funding for equity investment. To maintain the nature of the firm as a private entity, it is suggested that the NGOs should only take a minority interest in the undertaking or else take Preferred Non-Participating shares.

2.23 The timing of disbursement of cost for project should be in accordance with a schedule presented in a PERT/CPM or a Gantt Chart. See to it that the funds are made available when needed. If there is a risk for a cost overrun, set up of a contingency allowance as the occurrence of a fund shortfall during the implementation of the project hurts both of you and the bank in the following manner:

- Banks accrue interest on the loan despite non-completion of the project that generates cash to service the loan. Your obligations continue to mount even in the absence of your capability to pay.
- The bank cannot collect despite the existence of the claim against you. If it could not collect after a certain period, the bank may be required to provide allowance for bad debts that may hurt the financial picture of the bank.

<u>Financial Projections</u>

2.24 Financial Projections are the expectations of management about business performance within a given span of time into the future. The starting point is now and the bridge to the future is the project funded jointly by internally generated funds and equity on the one hand and by a loan on the other hand. Understand the assumptions because these are subject of validation during your interview with the bank. Place your projects and historical performance in a single document so as to facilitate the work of the bank.

2.25 The project, may be considered an expansion portion, should stand-alone project and can generate the required cash flows to pay off the loan amortization. Cash generated from existing capacity should not subsidize the payment of loan amortization from the loans incurred to finance expansion. Cash from existing capacity should only serve as a buffer just in case the expansion project miscarries. Consider such environmental issues like pending bills, long term bulk orders, new contracts; these developments can affect performance. Likewise, identify and analyze for possibilities of a drop in selling price and other sensitivities.

Projected Income Statement

2.26 The first statement is the Projected Income Statement which shows in financial terms how the project is expected to perform. The Income Statement has two major items, 1) Revenue or Income Items and 2) Expense items. The difference between Revenues and Expenses is the Projected Net Income

Expenses

2.27 Check for supporting schedules and computations for each item of expense. Absence of schedules often result in delays in the evaluation of your request.

2.28 Examine the accuracy and appropriateness of each expense item. Make sure supporting schedules and computations are available to enable the bank to validate if a specific expense item is overstated or understated. A list of major of the items of cost and the appropriate supporting schedules are presented below:

Cost Item	Supporting Schedule
Salaries and Wages	Payroll schedule
Depreciation Expense	Depreciation Schedule
Cost of Goods Sold	Detailed Cost of Goods Statement
Maintenance Expense	Detailed assumptions provided by equipment supplier
Other Expense	Assumptions computed based on percent or Sales Revenue or Cost of Goods Sold
Interest Expense	Schedule of loan amortization

Revenues

2.29 The basis for computing revenues should be indicated in projected statements. It is helpful to present revenues in the following manner:

	Year 1	Year 2	Year 3 & After

No. of Households in coverage area			
Target no. of households			
Consumption per household			
Total Projected Demand			
Plant Capacity			
% Capacity Utilization			
Selling Price per kilowatt			
Total Revenue			

2.30 The projection on revenue should be related to the marketing strategy which is discussed in the marketing assessment.

Projected Cash Flow

2.31 Projected Cash Flow reflects the sources and uses of cash for the project. For the first two years of operations, prepare a monthly cash flow projection to detect months where shortage in cash can possibly occur. In subsequent years, yearly cash flow projections are sufficient.

2.32 It is helpful to see that temporary need for cash are supported by cash generated from existing operations.

2.33 Projected cash flow reflects whether the project is in a position to generate cash to be able to service a specific loan amortization. With provisions for deviation included, Cash Flow Projection becomes the basis for a decision as to whether to lengthen or to shorten the grace period for the payment of a loan. It is also an indication of the capability of the project to effect payment of dividends.

Projected Balance Sheet

2.34 Projected Balance Sheet shows the financial position of the project. It shows the gradual build up of equity position and the decline in the level of long term liabilities.

2.35 The Projected Income Statement and Projected Cash Flow are tied to the Projected Balance Sheet. For example, the projected level of Account Receivable is related to Sales and the policy on giving credit. The level of inventories is related to the projected level of Cost of Goods Sold and the level of inventory in which the entity finds it comfortable.

Performance Assessment

2.36 Three scenarios should be presented 1) projections without the project, that is, expected performance of existing operation 2) Projections on the project, that is, the expansion project as a stand-alone and 3) combined projections on existing and expansion. Such an exercise is necessary to enhance the comfort zone of the Bank Account Officer in endorsing the proposed loan for management approval.

2.37 It is helpful to place the figures in the projected financial statements into a worksheet. This will allow for vertical and horizontal comparison of figures and comparison with projects of similar nature. If the project is an expansion of an existing business operation, the spread sheet on the projection can be compared with the spread sheet on historical operations as basis for determining consistency of assumptions.

2.38 Performance measures are Financial Internal Rate of Return (FIRR), Net Present Value (NPV) of projects, Payback Period and Break Even Point (BEP). Include a computation of these figures in the documents you submit to the banks.

2.39 In doing sensitivity analyses of project, revenues are adjusted downward and costs adjusted upward to determine the capacity of the project to absorb results of negative events in the environment.

MARKETING ASSESSMENT

2.40 Marketing assessment describes the target market in terms of capacity to pay for the service both for the present and foreseeable future. In describing the future movement of demand, identify the basis why demand is expected to improve at a given percentage within the forceable future.

2.41 It should identify the barriers in the marketing of services that include direct and generic competition, culture, hesitancy for the use of the product and such other constraints.

2.42 To address these barriers is a marketing strategy. Strategy covers such areas like pricing, promotion, packaging and product delivery. Along with this strategy is a proposed marketing budget to assure the implementation of the strategy.

ORGANIZATION AND MANAGEMENT

2.43 People run organizations and it is for this reason that the proponent must posses the credibility necessary to run the project as a business. Credibility means that the bans have the confidence you can deliver your payment commitments.

2.44 Examine the tasks and sub-tasks in running the project as a business enterprise. Examine the resume of key officers; this may reveal weak point.

2.45 Scrutinize the following documents:

a. Company Background

1) Brief History of your Company/Business

2) Details on its operations

Include a brief chronological account of how the business started and how it grew to what it is now. Details on operations should cover the scope of market, whether international, local or covers a certain region; as to what portion of production output is done in house and what portion by sub-cons; extent of utilization of production capacity.

b. Products/Service - Include peso amount and the percentage of contribution to total revenue of the main product/services and secondary product/services

c. Ownership Structure - Indicate if you are a sole proprietor, partnership or corporation or cooperative. If corporation, indicate whether it is a domestic corporation or a fully owned subsidiary of a foreign corporation. If a joint venture (JV) company, indicate the parties in the JV as well as their role and the advantages they can bring into the arrangement.

d. Equity Participation - Indicate the authorized capitalization, the number of shares and the par value per share. List in tabular form the names of the stockholders, their citizenship, the amount subscribed and the amount paid by each and their share to total paid up. This section will tell whether proponent qualifies under the minimum ownership by Filipinos in the corporation.

e. Management/Officers

1) Board of Directors

2) Key Officers/Personnel - The Management Team, usually composed or controlled by the controlling stockholder/s, is the prime mover of the business organization. Its outlook, plans, attitudes, beliefs and style of handling human, financial and other resources shape the culture of the organization and it has much to do with the continued success or the decadence of the organization. Look into the quality and depth of the management team because this is where Character of the borrower which is the first C of Credit will be judged.

3) Monitor presence of the following in the proponent:

- Adequacy of internal control systems
- Degree of professionalization of managers
- Adequacy of their training
- Management calibre, depth and succession plans
- Credit record and integrity of principal officers
- Management and/or ownership changes and their effect on the business

f. Related business/interest - Include information on the other businesses and sources of income of the proponents. These are looked upon as secondary sources of cash for servicing obligations.

g. Plant and Facilities - Include a brief description of the facilities and indicate if water, power and transport facilitites are available. Indicate the estimated production capacity and the extent of its utilization. Indicate the number of employees.

SUCCESS FACTORS

2.46 Analyze your strengths and weaknesses in relation to industry conditions, competition, labor situations, government regulations affecting the business and political and economic climate.

2.47 Identify potential risks that may adversely affect the project and why you think you have the capability to weather off these risk and remain viable. Discuss the factors that adversely affected your business in the past, how you managed to survive the adversities and stayed viable. Mention the your strengths like existence of a captive market, stable raw material source, investment incentives, favorable laws, market share dominance, etc. Mention also other factors which have positive impact on company's operations.

2.48 Risks in Business include the following:

a. Depreciation of the Peso against other currencies – If there is peso depreciation, peso denominated liabilities may bloat
b. Succession Issues – The project may discontinue if the key proponent dies or becomes incapacitated
c. Failure to reach target revenues – Proponent may have difficulty of paying amortization if volume targets are not reached.

2.49 Address business risks outright by discussing options of the company should the anticipated risks occurs. For example, on the issue of Peso Depreciation, you may opt to book peso denominated loans to avoid said risk. On succession issues, there should be a line up of possible successors just in case the key people in the organization become incapacitated.

COLLATERAL

2.50 Collateral and guarantees serve as "fall back" if projected earnings and cash flow fall below expectations. Collateral is defined as money or property put up by a proponent/borrower to back up a loan. In case of default, the collateral may be liquidated to pay off the loan. Term loans should be structured such that cash for the loan repayment is generated from the business and that it is not depending on the liquidation of collateral.

2.51 There are two types of collateral: the primary and the secondary collateral. A collateral is primary if there is a specific set of cash, near cash items and hard assets identified to cover for whatever exposure that the bank has in the proponent/borrower; a collateral is secondary if there is none. A primary collateral can be given a valuation while a secondary collateral cannot be given a valuation.

The common forms of primary collateral are as follows:

a. Real Estate Mortgage (REM) - a piece of real estate property covered by a Title including existing and proposed improvements thereon is as security for the payment of a loan. Real estate assets other than the site of the project being financed may be used as collateral. Untitled property or pieces of Real Estate covered by Tax Declaration only are not acceptable ac collateral. Real estate asset in the name of a third party may be acceptable as collateral provided that the registered owner is the signatory of the REM. Special Power of Attorney (SPA) issued by the registered owner allowing the borrower to mortgage the real estate assets in not acceptable because of a high incidence of fraud in the issuance of the SPA.
b. Chattel Mortgage (CM) - machinery, equipment and/or personal property are used as security for a loan.
c. Hold-out on Deposits - a specific amount of Saving or time deposit is being held by the back as collateral under as Deed of Assignment. Like in the case of REM, the depositor may not be the same as the proponent/borrower, in which case the depositor should sign the deed of assignment.
d. Mortgage Trust Indenture - the bank is given a Certificate of Participation indicating issued by a trustee who was appointed custodian to a property of enormous value. The certificate indicates the extent or percentage of the property which secure the loan of the bank. This type of collateral is encountered where the loan given to a proponent/borrower is syndicated or where more than one bank have loaned money to the proponent using same collateral.

The following are secondary collateral:

a. Joint and Several Signatures (JSS) or Suretyship – Under a JSS or Suretyship, the surety (signatory of the JSS document) binds him/herself solidarily with the principal debtor and there is a JSS in almost all loan contracts. If the borrower is a corporation, the JSS encumbers the personal assets of the surety to the liabilities of the corporation. In JSS, the surety is not liable unless and until the principal proponent/borrower is held liable. A number on conventions on JSS are as follows:

- if the proprietor/proponent/borrower is the husband, the wife executes a JSS & vice-versa. A third party other than the spouse may also execute a JSS;
- if the proponent/borrower is a corporation, the principal directors and stockholders execute the JSS

b. Cross Guaranty - a person or corporation guarantees the loan of another who likewise guarantees the loan of the former.

c. Negative Pledge - an undertaking of the proponent/borrower not to mortgage, encumber, transfer or dispose of his fixed assets without the consent of the Bank. This is usually encountered where the proponent/borrower is prime and has a good track record

2.52 You cannot borrow to the extent of full market value of assets submitted as collateral. The banks use the terminology “Appraised Value” and “Loan Value.

2.53 Appraised Value is the valuation given by a bank on specific assets. In the case of land, valuation given is usually based on the averages of zonal value, last sales transaction of a piece of land that is near the property and the market value as quoted by real estate agents. The value may be increased because of the location or may not be given any value at all because of the absence of a right of way. If the land is agricultural, the maximum value is the price given by DAR for such property. Valuation is likewise given to improvements introduced on the land.

If the proposed collateral is equipment, the value given is the estimated replacement cost of the equipment net of depreciation; if the equipment is new, it is based on the purchase price of the equipment.

2.54 “Loan Value” is the amount of loan that that the proponent/borrower can obtain from the bank which is a percentage of the Appraised Value. Loan Value schedule is as follows:

Collateral	Loan Value
Land	60%
Building and Land Improvements	60%
Chattels	50%
Deposit Hold-Out	100%

2.55 Collateral can be valuable in term lending, but relying on it as the main justification of support is not the right attitude. Historical performance is still the best gauge in viewing the proponent’s ability to service future debts. It is essential to look into the ability of the proponent/borrower to repay from the earnings generated in the normal course of the business.

2.56 Unacceptable collateral that include:

a. Collateral previously mortgaged to another bank. Second mortgages are not acceptable
b. Real estate assets without right of way
c. Real estate assets with lis pendense, adverse claim and other limitations annotated at the back of the title

PRICING

2.57 The Costs of borrowing include:
a. Interest on the loan
b. Service Fee which is a fee collected by the bank per transaction. The amount is supposed to reimburse the bank of its cost in processing the transaction
c. Handling fee which represents the cost of the bank evaluating the loan transaction. Handling fee is a one-time expense and is usually 1% of approved loan amount
d. Commitment Fee – This is a fee for the inability of the proponent/borrower to draw on the approved loan within the drawdown period as defined under the loan agreement. By imposing a commitment fee, the bank is recovering the opportunity cost from allotting funds to service the loan drawdown. Commitment Fee is usually 1% or lower per annum based on the undrawn balance of the loan.
e. Documentary Stamp Tax (DST) – This paid to the Government. Amount paid, which is usually deducted from the proceeds of loan is P0.20 per P300.00 value indicated in the document. Loan agreements and promissory notes are subject to DST.
f. Penalty Charge – The amount collected by the bank if borrower cannot promptly pay loan amortization schedule.

2.58 The Interest rate of a loan depends on a number of factors. The primary determinant of interest rate is the Interest rate on Treasury bills(T-Bills). Interest rate on T-Bills becomes the base rate as it is the type of investment that banks would opt if they decide not to lend their money. As such, quotations on interest rate are usually stated in "91-day T-Bills Rate plus ____% spread" at the time of availment. The interest rate is usually adjusted or "repriced" every 90 days to take into consideration of the changing cost of money to the banks. T-Bills rate is published in the newspapers.

2.59 The other benchmark used by banks is the "Prime Rate" or the best rate that it can give to its best proponents. Prime Rate is a market established rate and may be higher or lower than the T-Bills rate. Some banks publish their prime rates in the newspapers.

2.60 The "plus ___% spread" is a factor that takes into consideration the following:
a. Business Risk - This is the risk that the loan will not be repaid in full with interest within the time frame agreed upon.The higher the perceived risk, the higher is the spread of the bank.

b. The level of compensating business - If the proponent has other business deals with the bank, the situation may merit for the scaling down of the spread. Likewise, presence of substantial amount of deposit will merit a reduction of the spread of the bank.
c. Potential change in the cost of funds in the future. This is especially important when interest rates are fixed.
d. Financial risk - This is the risk that loan funds will be tied up and not be available as other opportunities present themselves to the bank (opportunity loss).
e. Demand Deposits - those deposits that each loan will bring to the bank or each loan will retain for the bank (free balances after activity charges).
f. Time Deposits - while these may have some influence, if the bank is paying a market rate, then time deposits add little in compensation for a favorable rate
g. Competition - those rates that are actually available from other lenders.
h. Timing of interest payment - whether discounted, paid at maturity, paid monthly or paid quarterly, etc.

SOCIO-ECONOMIC, ENVIRONMENTAL & OTHER ISSUES

2.61 Presence of socio-economic impact helps justify a project although it could not serve as a primary justification. Possible multiplier effect of the project should be described in qualitative terms

2.62 On account of the growing environmental awareness, banks now require that projects obtain an environmental clearance certificate (ECC) from DENR. If the ECC is yet to be obtained, the status of getting the ECC should be mentioned.

2.63 Peace and Order – Where the project is placed in remote areas, statement on the peace and order problem should be made in the studies such that the bank account officers and the passive investors would not be guessing of the status.

Appendix E

Proposed Prioritization Scheme for Pipeline Projects

PROPOSED GUIDELINES PRIORITIZATION OF
NEW AND RENEWABLE ENERGY PROJECTS
DEPARTMENT OF ENERGY

BACKGROUND

New and Renewable Energy (NRE) projects originate not only from the Department of Energy but also from the following:

- Private sector that include electric service companies and cooperatives
- Local Government Units
- NPC-SPUG
- NPC-EDC and
- National Electrification Administration

Some private sector NRE projects are forwarded directly to the banks for funding without passing through the DOE. Information about these projects do not register in the records of DOE the principle of "Confidentiality of Relationship" between the bank and the proponent is a constraint.

There is a need for DOE to conduct an inventory of pipeline NRE projects and for the inventory of pipeline project updated at least twice a year. The proposed process is as follows:

1. DOE will get a list of pipeline NRE projects from the banks and with the agencies identified above. The inventory will constitute the long list of projects. The list given by the banks may not identify the proponent but should have a reference number to facilitate account identification later on.
2. From the long list of pipeline projects, will come up with a short list of projects as defined below.

The inventory of pipeline projects to be useful, must be action oriented. The proposed report contains and defines the following elements:

- Priority status
- Criteria for classifying a project under such priority status
- Expected action of DOE where proponent requests for assistance

Priority status of pipeline projects is divided into 5 and is presented in the following schedule. Ranking of pipeline NRE projects serves as guide of what actions to take to further fast track projects.

PRIORITIZATION SCHEME

For purposes of prioritization, the following will be the categories:

Priority Category	Criteria	Possible Scenarios	Action of DOE
Category 1	Project proposals with banks that have the following attributes: • Proponent passes the risk assets acceptance criteria of the banks • Proponent has substantially complied with the requirements of the bank • The bank as made substantial evaluation of the project and the proponent • The bank is expected to come up with a decision within 3 months	The Account Officer of the Bank could not endorse approval of requested loan because: • There are certain technical matters that need to be clarified • The proponent does not have sufficient collateral and/or equity to merit favorable action of the decision makers • The management capability of proponent is questionable	If requested by the bank, DOE will: • Provide clarifications on certain technical matters If requested by the proponent, the DOE will: • Assist in looking for potential investors to cover for equity shortfall and for guaranty facility to collateral shortfall • Assist proponent in strengthening the organizational and its management
Category 2	Project proposals with banks that have the following attributes: • Hurdled the risk asset acceptance criteria of banks • Proponent has not fully submitted the documents required by the bank	• The bank account officer may encounter difficulty in assessing technical feasibility of project • Proponent may have difficulty in complying with the requirements of the bank like additional equity, additional collateral, etc.	DOE will provide the bank or the proponent assistance on technical matters if requested. It can, likewise, assist proponent in complying with the other requirements of the bank. If proponent has insufficient capitalization, DOE can identify sources of additional equity investment.

Category 3	Those proponents whose request for loan are about to be denied because: • Proponent could not comply with additional equity or collateral required by the bank • The bank account officer noted certain problems in the marketing and financial aspect of the project	Proponent may not have been given appropriate advise prior to presentation of request for financing by the bank.	If requested by the borrower, DOE will review the project proposal and will strengthen the identified weak points of the project.
Category 4	Those projects the evaluations of which have been completed by DOE, NPC-SPUG, NEA and PNOC-EDC but have not yet been forwarded to the banks for financing. The proponent, which has already been identified, is in the process of complying with the requirements of the banks.		It is desirable that at this stage, the evaluation procedure as contained in proposed guidelines be used. This will enable the DOE to identify weaknesses of the proposal such that these weaknesses are corrected before they are presented to the bank for purposes of obtaining loan financing.
Category 5	Bank previously denied the proponent's request for a loan because of the following reasons: • Proponent's equity is not sufficient to reach the level required by the banks' • Value of proposed collateral is insufficient • There is unfavorable credit findings about proponent	Projects previously denied may be feasible if properly packaged and appropriate support were given.	Through the guidelines, the DOE can make a quick assessment of the merits of the project. If the DOE Assistant finds that the project is feasible, the DOE Assistant can perform a more thorough evaluation of the project.

DEPARTMENT OF ENERGY
PRIORITY LIST OF PROJECTS

Proponent	Project Site	Project Description	Project Cost	Project Loan	Project Status	Possible Action of DOE
CATEGORY 1						
Provincial LGU & Paleco	Palawan	400 stand-alone Solar home system		10.70	Loan approved but delayed in implementation because of change in Administration DBP sent termination letter	DOE to provide assistance if requested by the Prov. Gov't of Palawan.
Edward Marcs		Inventory Financing		50.00	Approved Dec. 2000 and being implemented	
PLDT	Murcia, Bacolod	PV for Relay Station		9.60	Awaiting PLDT Management approval	
Municipal LGU	Loreto, Surigao del Norte	500 kW mini-hydro		48.00	For DBP Management Approval	
ROMELCO	Sibuyan, Romblon	Detailed FS for a 900 kW Mini-hydro		1.00	Approved and documented but implementation is delayed because of difficulty in getting NEA endorsement	

DEPARTMENT OF ENERGY
PRIORITY LIST OF PROJECTS

Proponent	Project Site	Project Description	Project Cost	Project Loan	Project Status	Possible Action of DOE
CATEGORY 2						
Provincial LGU & Smith Bell Resco	Dapitan, Zamboanga Del Norte	11.8 MW Mini-hydro		To be determine	Final details still being discussed	
Agusan Power	Agusan del Sur			$35.00	Final Details still being discussed	
Tawi-Tawi LGU	Panglima Sugala & Bongao, Tawi-Tawi			45.00	Final Details still being discussed	

DEPARTMENT OF ENERGY
PRIORITY LIST OF PROJECTS

Proponent	Project Site	Project Description	Project Cost	Project Loan	Project Status	Possible Action of DOE
CATEGORY 4						
Catanduanes LGU & Spie-Trans	Virac, Catanduanes	2.5 MW Mini-Hydro			Feasibility Study level	
Loreto LGU	Loreto, Dinagat Is. Surigao del Norte	.55 MW Mini-hydro	48.50		Proponent applying for hydro operating contract	
Catanduanes LGU & Spie-Trans	Virac, Catanduanes	6.9 MW Mini-hydro			Feasibility Study level	
Palawan LGU	Narra, Palawan	7.0 MW Mini-Hydro			Feasibility Study level	
ANECO & Cumming C. Ltd	Butuan City, Agusan del Norte	7.0 MW Mini-Hydro	231.61		Feasibility Completed. On hold because of excess power capacity	
Gingoog Power & Gingoog LGU	Gingoog City, Misamis Oriental	10 MW Mini-Hydro	690.77		FS Completed. Developer yet to submit requirements for a contract	
Eastern Samar LGU	Lawa-an, Eastern Samar	4.0 MW Mini-Hydro	191.43		Desk Study Level	
Iloilo Electric Coop	Igbaras, Iloilo	3.6 MW Mini-Hydro	57.35		Pre-FS Completed. For complete FS	
Zamboanga del Norte LGU	La Libertad, Zamboanga D N	3.75 MW Mini-Hydro	202.00		Pre-FS Level	

DEPARTMENT OF ENERGY
PRIORITY LIST OF PROJECTS

Proponent	Project Site	Project Description	Project Cost	Project Loan	Project Status	Possible Action of DOE
NAPOCOR	Kicharo, Agusan del Norte	6.8 MW Mini-Hydro	$13.46		FS Completed. No interested Developer	
SORECO I	Sorsogon, Sorsogon	2.5 MW Mini-Hydro	66.08		FS Level	
Samar LGU	Calbayog, Western Samar	1.05 MW Mini-Hydro	48.75		FS Completed. No interested Developer	
NAPOCOR	Puerto Princesa Palawan	6.8 MW Mini-Hydro	$15.60		FS Completed. No interested Developer	
Phil-Can Power & CCL	Culaman, Bukidnon	10 MW Mini-Hydro	603.20		FS Completed. CEPALCO did not pursue project	
NAPOCOR	Siaton, Negros Oriental	5.4 MW Mini-Hydro	$16.67		FS Completed. No interested Developer	
ROMELCO	San Fernando, Sibuyan Island, Romblon	.9 MW Mini-Hydro	62.71		Pre-FS Level	

NOTES TO PIPELINE
NEW AND RENEWABLE ENERGY PROJECTS
IN THE PRIORITY LIST

<u>Process In Coming Up With The Priority Long List</u>

1. Gathered from the DOE-Hydro Division a list of pipeline projects and feasibility studies prepared for the pipeline projects. A review of the feasibility studies revealed the following:
   a. Most of the studies need updating. Technical and economic data contained in the feasibility studies need to be revalidated as these are more than two (2) years old
   b. The project proposals were not appropriately packaged. It was noted that there were no financial information about the proponent. Likewise, authority to borrow on the part of the proponent were not included in the studies
   c. Issues like equity of the proponent, the portion to be funded by the banks and security of the loans to be obtained were not discussed in the studies. The proponent should be able to address issues before presenting a proposal to the bank.

   Because of the shortcomings mentioned above, projects with DOE-Hydro Division cannot be included in the priority list, that is, projects that can be provided with assistance in getting financing from the banks.

2. On March 12, 2001, I called on VP Mendoza of DBP to obtain background information on pipeline NRE projects of DBP. I was informed that information about the project and the borrower are confidential in nature and cannot be revealed unless there is a formal request.
3. I also met FVP Selespara of LBP on March 28, 2001. He informed me that the Provincial Government of Tawi-Tawi has a request for a loan to finance NRE project. He instructed his people to obtain information of pipeline projects filed with the branches. I was asked to go back to his office after a week.
4. I prepared a request to DBP and LBP through DOE for a profile of pipeline projects (copy of requests attached). Also requested NPC-SPUG, PNOC-EDC and NEA by telephone for a profile of projects.
5. DBP provided a schedule of pipeline projects (copy of the schedule attached). The information contained in the schedule are the only information that the DBP can reveal without violating the rule on confidentiality. As a rule, banks are not supposed to reveal or share to any party information to about the proponent or the project without the written approval of the proponent. This principle was reiterated during the meeting at PA Consulting on April 5, 2001.
6. I gathered that LBP is still in the process of packaging the NRE projects of the Province of Tawi-Tawi. The LGU has already submitted the appropriate financial statements and LGU resolutions. The LGU, however, has yet to submit the feasibility studies.
7. NPC-SPUG, PNOC-EDC and NEA have pipeline projects and this was confirmed likewise during the meeting on April 5, 2001.

On The Long List Of Projects

1. The long list of projects was therefore based from the inventory list provided by the DBP and LBP and from an examination of the feasibility studies on file with the DOE-Hydro Division.
2. Although projects already filed with the bank are included in Category 1, no one among the projects can be provided with the assistance defined under the TOR because of the limitations from "confidentiality principle" mentioned above.

Appendix F

Training Kit

TRAINING FOR DOE ASSISTANTS
EVALUATION OF NEW AND RENEWABLE ENERGY PROJECTS

Objectives

This training manual is designed for the use of DOE staff who will be assigned to provide assistance to proponents of New and Renewable Energy (NRE) projects. The materials included herein are extensive and are meant to become reference material of the DOE staff for possible scenarios to be encountered in the performance of their work.

The training will take 5 days and on the 6^{th} day, there will be a lecture to be attended by DOE people about project evaluation.

Lesson Plans for the 5-day period and the 6^{th} day are presented below.

Day 1

Objectives:
1. Provide trainees with an overview of the tasks to be accomplished as catalyst of NRE
2. Discuss details of the guidelines on Project Evaluation and Proposed Guidelines for Proponents of NRE
3. Discuss mechanics in the evaluation of projects

Methodology: Lecture

Outline of Discussions:
1. The specific tasks of DOE as Catalyst of NRE Project
2. The importance of the Guidelines for both DOE and Proponent
3. The form to be accomplished – Annex A
4. The Framework of Evaluation – Annex B
5. Details of the Evaluation Process

Day 2

Objectives:
1. Teach trainees in judging a good project proposal from one that is not
2. Teach trainees in dealing with proponents

Methodology: Lecture and discussion of a sample proposal

Outline of Discussions:
1. Discussion of a sample proposal and identifying its attributes
2. Discussion of the attributes of a good proposal

Day 3

Objectives:
1. Expose trainees to a possible situation in project evaluation
2. Teach trainees how to analyze and synthesize

Methodology: Case Method

Outline of Discussions:
1. Presentation of the facts of the case
2. Definition of what is expected at the end of the case

Day 4

Trainees will be given the whole day to prepare what is expected from them

Day 5

Objectives:
1. Teach trainees the correct approach in actual projects
2. Teach trainees on proper presentation of projects

Methodology: Case method

Detailed Outline of Discussions:
1. Trainees to be asked to present their output
2. Discussion of their output and pointers to further strengthen the output

Day 6

Objective: Provide background on project evaluation

Methodology: Lecture

Outline of Discussions:
1. The tasks relative to the role of DOE as catalyst
2. The framework of project proposal
3. Attributes of a good project proposal
4. Closing

Introduction to Project Appraisal

How you as DOE officer help proponents in presenting their projects to bankers and investors

Introduction

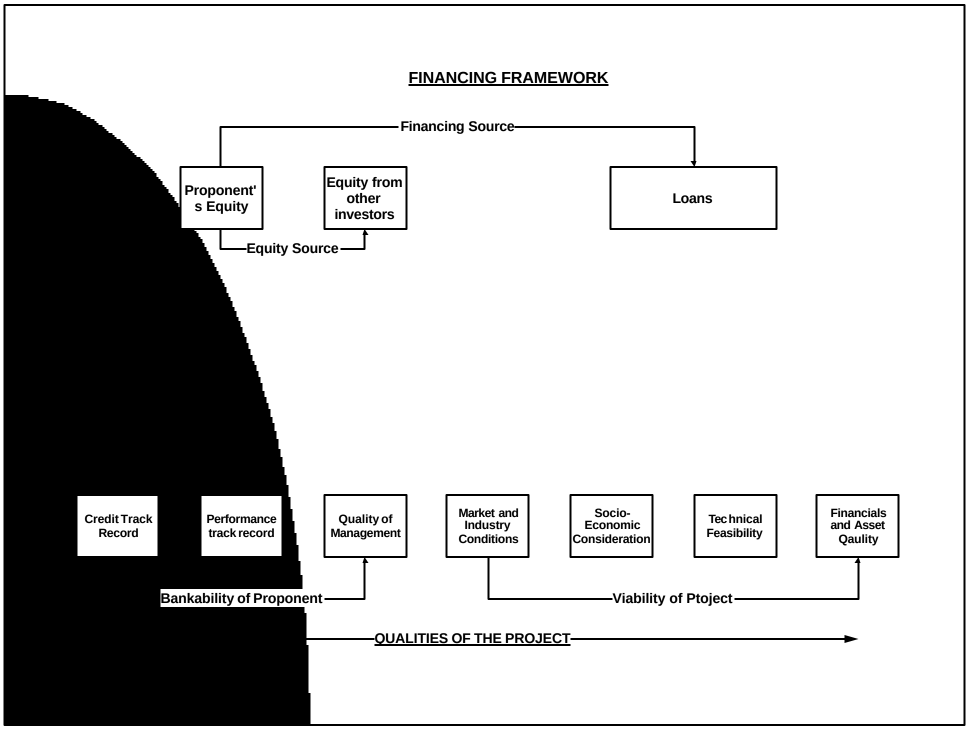
- Within the next 2 hours, we will discuss how banks evaluate project.
- Think like a banker or an investor
- A presentation of project can mean success or failure

Financing Components

- Loan
- Equity

Due Diligence Process

- Not all technically feasible projects are commercially viable
- Viability should be analyzed from the point of view of the funders
- Think like a banker or investor
- Examine studies so proponents can present an adequate report and in acceptable format



Viability of a Project

- Cost of Project
- Existence of a market
- Technically feasible
- Socio-Economic Impact
- Financially Viable

Bankability of Proponent

- No adverse credit finding
- Adequate capital
- Can manage project profitable

Financial Statements

- Basics of Financial Statements
- Historical
- Projected
- Analysis of Financial Statements

Integration

- Project
- Financing

TEXT OF LECTURE

Slide 1 - Introduction

Director Benito, Mr. Quejas, Mr. Arrila, distinguished officers and staff of the Department of Energy, Good Morning.

During one of my meetings with Director Benito two months ago about NRE projects, he mentioned about transfer of technology on the evaluation of projects to the DOE. In my subsequent discussions with Reuben Quejas relative to a task that I was engaged to accomplish, it became apparent that there is a need to familiarize the officers and staff of DOE who deal on projects. This transfer of technology is compelling because the DOE is promoting New and Renewable Energy which is an emerging enterprise. As you may have read in management books, an emerging industry practically confronts all the problems you can think of as a business enterprise.

There are so many approaches in handling the problems of NRE ranging from strategic to operating, top-down approach to bottom-up approach. These are the approaches that you as energy professionals can handle expertly.

What I believe is missing, therefore, is the capability to present what you know to another set of experts, the bankers and the investors. As the saying goes, HE WHO HAS THE MONEY MAKES THE RULES.

Our task in today's lecture, therefore, is to transfer to you the technology of presenting a proposal for a project to bankers and prospective investors.

Slide 2

Role of DOE – Assist the proponents by guiding them of the proper way of preparing their proposals. Think like an investor or a banker with the following specific objectives:

- To improve the approval rating of loan applications of NRE projects
- To enhance acceptability of projects to prospective investors and

The above can be accomplished if the proponent can be guided to present his/her proposal properly. A proposal is proper if it addresses all the concerns of the bank and it is presented in a proper format.

Slide 3

Our ultimate objective is to help the proponent obtain a loan from the bank and to solicit equity contributions from other entities.

At this point, the following should be made clear

1. The proponent which is the private sector is primarily responsible for the project. You are there to guide and assist but do not assume responsibility
2. He who has the money makes the rules. The investor and the banks are the principal players
3. As catalyst, it is helpful that you understand the language of the banks so you can discuss with the client more intelligently. You should expect the proponents to ask for your assistance in dealing with the banks.
4. Proponent should solicit your serves, otherwise the banks will ignore you. Banks observe "confidentiality principle".
5. The nature of assistance expected from you by the banks are
   a. Market identification and validation of market assumptions. Is there a market and what are its characteristics? Are there data available about the market?
   b. Technical validation and verification of the viability of the technology.
   c. Institutional evaluation including assessment of the readiness of the community and the livelihood component.
   d. Verification of "cost of service delivery" calculation/pricing or tariff formula

Slide 4

In order that guidance and assistance can be given, the proponent must be willing to undergo a self examination.

In making a self-examination, consider all the elements of the business enterprise. In other words, we perform a due diligence process. Due diligence process means undertaking the necessary measures to see to it that the investment decision or the credit decision will not result into losses.

There are certain pointers to be remembered and these are:

- Not all technically feasible projects are commercially viable
- Viability should be analyzed from the point of view of the funders
- Think like a banker or investor
- Examine studies so proponents can present an adequate report and in acceptable format

Slide 5

What are the areas that need to examined? It is broken down into two categories: the viability of the project and the bankability of the proponent.

The evaluation shall highlight on the concerns of the banks particularly the following:

a. Credit Record of proponent
b. Financial Aspects – Historical Financial Performance of proponent and Projected performance
c. Marketing aspect
d. Operations and Technical Aspects
e. Organizational Aspect
f. Risk involved in the credit transaction
g. Pricing
h. Collateral/Security and Second Way out
i. Socio-economic considerations

CREDIT RECORD OF THE PROPONENT

3.1 Proponents may be hesitant to discuss credit record especially where there is adverse record on the proponent. The DOE Assistant, however, has to extract from the proponent the nature of adverse findings, if any, such that remedial measures can be effected before the application is filed with the bank. Bank uses exhaustive procedures in the conduct of credit investigation and it is likely that it will find out the adverse finding.

3.2 Bank obtains credit record of the proponent/borrower through the process called credit investigation. The Credit Investigator (CI) sends queries about the level of loans, the status and payment record with the other banks in the area and nearby area as well as with its branch offices. The CI likewise looks into the records of the court for the existence of court cases against the proponent and of the principal officers and stockholders, if proponent is a corporation or cooperative. The CI, likewise make a random interview of the neighbors of the proponent and certain suppliers to assess the character of the proponent.

3.3 Adverse findings from the credit investigation may result in the disapproval of loan application of a good project. If the proponent is honest enough to disclose any unfavorable findings, if any, the DOE Assistant can suggest measures to correct the weakness before the loan application is filed with the bank. It should be noted that it is very difficult to correct the initial impression of the account officer of a bank once there are adverse findings.

FINANCIAL EVALUATION OF HISTORICAL PERFORMANCE

3.4 Evaluation of historical financial performance is applicable where the proponent is an existing entity. Historical performance is assessed separately from the projected performance of proposed project. The proposed project is evaluated separately based on its incremental effects, that is, increases in revenues and costs become the basis of the evaluation.

3.5 Financial Statements consist of three statements, 1) Income Statement, 2) Balance Sheet and 3) Cash Flow Statement or the Statement of Sources and Uses of Funds. Income statement shows the results of operations over a certain span of time, usually one-year. The Balance Sheet shows what the business entity owns and what it owes as of the date indicated in the statement. The Cash Flow Statement shows the sources of funds that came into the entity and where the funds went over a certain time span, usually one-year.

3.6 Financial Statements to be useful for analysis, should be prepared in accordance with generally accepted accounting principles and is the duly certified by a Certified Public Accountant (CPA). The DOE Assistant should read the audit report and that the CPA expressed an Unqualified Opinion of the Auditor on the Statements.

3.7 Tool for financial evaluation is a "Financial Spread Sheet" which places in a single document the items in the financial statement that needs to be analyzed. Financial SpreadSheet is included as Annex "D". Electronic copy is included in this proposed manual.

3.8 The evaluation of the financial statements using the spreadsheet gives an indication of the financial health of the proponent. Guidelines in the Analysis of Financial Statements is contained in Annex "E"

FINANACIAL EVALUATION OF PROPOSED PROJECT

3.9 Where the proponent is a recently organized entity with no previous track record of performance, focus of evaluation is proposed project.

3.10 Statements that are subjected to evaluation are the Projected Income Statement, the Projected Balance Sheet and the Projected Cash Flow. Sample format is marked as Annex "F" which is an electronic worksheet. The electronic worksheet is part of this manual.

3.11 If proposed project is an expansion of existing business activity, the expansion project should be analyzed as a project that is separate and distinct from an existing project. This is to be able to assess the add-on value of the new project to the existing operation. Only the incremental revenues and costs will be considered.

3.12 Sunk cost, or cost of assets that has already been paid, will not be considered even if these assets are used in the expansion projects.

Project Cost and Financing

3.13 Since evaluation of proposed project pivots on project cost, it is important that this item should be given initial attention. Project performance is gauged against the total cost of the project.

3.14 The components of projects of project costs should be examined to determine their appropriateness and sufficiency. Components of project cost are:

a. Cost of Preparing the feasibility study
b. Cost of Land
c. Cost of Land Improvements
d. Cost of Equipment including installation and supervision cost
e. Pre-operating expense which include cost of securing business permits, licenses, cost in organizing the entity, personnel cost and such other costs incurred prior to start of commercial operations
f. Allowance for Contingencies – This is a provision for possible increases in cost resulting from the depreciation of the peso and such other unforeseen events resulting into an escalation in the total cost of the project. Allowance for Contingencies is usually set at 15% of total projected cost.
g. Working Capital - This represents the minimum level of balance maintained in the cash vault, receivables, and inventories in spare parts and prepaid expense necessary for a continuous and unhampered operation of the entity.

3.15 The total project cost, once determined and validated, should have a matching fund sourcing which may be either loan or equity. Some rules of thumb to determine the appropriate mix between loan and equity are as follows:

a. Banks do not ordinarily finance the cost of acquiring land. Land should be part of the equity contribution of the proponent
b. Working capital – There are should be available financing for the initial working capital requirement of the entity. Some banks allow initial working capital requirement to be financed by a medium to long term credit product while other banks allow only short term loan products of the bank to finance working capital needs.
c. Except for Working Capital, all of components **a to e** in item 3.15 qualify for long term funding which is either equity or medium to long term loan. A medium term loan has a tenor of 5 to 7 years while a long-term loan has a tenor of 7 to 10 years.
d. In the presence of collateral with loan value that can fully cover a given amount of loan, the bank can provide the proponent a loan equivalent to 75% of total project cost, that is items a to f of item 3.15. Part of the 75% is the Working Capital loan discussed in item 3.16.a.

3.16 The timing of disbursement of cost for project should be in accordance with a schedule presented in a PERT/CPM or a Gantt Chart. The DOE Assistant should see to it that the funds are made available when needed. If there is a risk for a cost overrun, the DOE Assistant should recommend for the setting up of a contingency allowance as the occurrence of a fund shortfall during the implementation of the project hurts both the bank and the proponent in the following manner:

- Banks accrue interest on the loan despite non-completion of the project that generates cash to service the loan. The obligations of the borrower continue to mount even in the absence of the capability to pay.
- The bank cannot collect despite the existence of the claim against the borrower. If it could not collect after a certain period, the bank may be required to provide allowance for bad debts, which may hurt the financial picture of the bank.

Financial Projections

3.17 Financial Projections are the expectations of management about business performance within a given span of time into the future. The starting point is now and the bridge to the future is the project, which is being funded jointly by internally generated funds and equity on the one hand and by a loan on the other hand. The underlying assumptions must be understood because it tells much about the feasibility of an expansion project. Projections, if placed side by side with historical performance and, if connected with management analysis would indicate whether the decision to pursue a given project is a sound financial judgment.

3.18 In evaluating projections, see to it that expansion portion is a stand-alone project and can generate the required cash flows to pay off the loan as scheduled. Cash generated from existing capacity should not subsidize the payment of loan amortization from the loans incurred to finance expansion. In worse scenario, it should only serve as a buffer just in case the expansion project miscarries. Analyze assumptions of the proponent as basis for preparing the projections, as well as the environmental issues like pending bills, long term bulk orders, new contracts; these developments can affect company performance. Likewise, identify and analyze for possibilities of a drop in selling price and other sensitivities.

Projected Income Statement

3.19 The first statement is the Projected Income Statement, which shows in financial terms how the project is expected to perform. The Income Statement has two major items, 1) Revenue or Income Items and 2) Expense items. The difference between Revenues and Expenses is the Projected Net Income

Expenses

3.20 Expense items should be examined first. It is in this area where delays occur in the evaluation of the project by the bank because the supporting schedules are not available in the documents submitted.

3.21 Items of Expenses should be examined to determine accuracy and appropriateness of figures. Supporting schedule will enable the bank to validate if a specific expense item is overstated or understated. Each item of cost should be supported by schedule.

Revenues

3.22 The basis for computing revenues should be indicated in projected statements.

3.23 The projection on revenue should be related to the marketing strategy, which is discussed in the marketing assessment.

3.24 Suggested Format of projected financial statement as well as supporting schedules are included in Annex “F” which is an electronic worksheet.

Projected Cash Flow

3.25 Projected Cash Flow reflects the sources and uses of cash for the project. For the first two years of operations, Projected Cash Flow is usually prepared on a monthly basis to detect months where shortage in cash can possibly occur. In subsequent years, yearly cash flow projections are sufficient.

3.26 It is helpful to see that temporary need for cash are supported by cash generated from existing operations.

3.27 Projected cash flow reflects whether the project is in a position to generate cash to be able to service a specific loan amortization. With provisions for deviation included, Cash Flow Projection becomes the basis for a decision as to whether to lengthen or to shorten the grace period for the payment of a loan. It is also an indication of the capability of the project to effect payment of dividends.

Projected Balance Sheet

3.28 Projected Balance Sheet shows the financial position of the project. It shows the gradual build up of equity position and the decline in the level of long term liabilities.

Performance Assessment

3.29 Three situations should be presented 1) projections without the project, that is, expected performance of existing operation 2) Projections on the project, that is, the expansion project as a stand-alone and 3) combined projections on existing and expansion. Such an exercise is necessary to enhance the comfort zone of the Bank Account Officer in endorsing the proposed loan for management approval.

3.30 In doing sensitivity analyses of project, revenues are adjusted downward and costs adjusted upward to determine the capacity of the project to absorb results of negative events in the environment.

MARKETING ASSESSMENT

3.31 Marketing assessment describes the target market in terms of capacity to pay for the service both for the present and foreseeable future. In describing the future movement of demand, it should identify the basis why demand is expected to improve at a given percentage within the foreseeable future.

3.32 It should identify the barriers in the marketing of services that include direct and generic competition, culture, and hesitancy for the use of the product and such other constraints.

3.33 To address these barriers is a marketing strategy. Strategy covers such areas like pricing, promotion, packaging and product delivery. Along with this strategy is a proposed marketing budget to assure the implementation of the strategy.

ORGANIZATION AND MANAGEMENT

3.34 People run organizations and it is for this reason that the proponent must posses the credibility necessary to run the project as a business. Credibility means that the proponents, the lenders and prospective investors have the confidence that proponent can deliver his/her end in the commitments.

3.35 In examining the organization structure of the proponent, the DOE Assistant should examine the tasks and sub-tasks in running the project as a business enterprise. Examination of the resume of key officers submitted, may reveal weak point that require appropriate recommendations

3.36 In the assessment of the organization, the following should be looked into:

a. Company Background
   1) Brief History of the Company
   2) Pertinent Details on its operations
   3) Other information on the company's operations (i.e. market, product lines, etc.)

b. Ownership Structure - Indicate if proponent is a sole proprietor, partnership or corporation or cooperative. If corporation, indicate whether it is a domestic corporation or a fully owned subsidiary of a foreign corporation. If the proponent is a joint venture (JV) company, indicate the parties in the JV as well as their role and the advantages they can bring into the arrangement.

c. Equity Participation - Indicate the authorized capitalization, the number of shares and the par value per share.

d. Management/Officers
   1) Board of Directors
   2) Key Officers/Personnel - The Management Team, usually composed or controlled by the controlling stockholder/s, is the prime mover of the business organization. Its outlook, plans, attitudes, beliefs and style of handling human, financial and other resources shape the culture of the organization and it has much to do with the continued success or the decadence of the organization. Look into the quality and depth of the management team because this is where Character of the borrower, which is the first C of Credit, will be judged.
   3) Monitor presence of the following in the proponent:
      - Adequacy of internal control systems
      - Degree of professionalization of managers
      - Adequacy of their training
      - Management caliber, depth and succession plans
      - Credit record and integrity of principal officers
      - Management and/or ownership changes and their effect on the business

e. Related business/interest - Include information on the other businesses and sources of income of the proponents. These are looked upon as secondary sources of cash for servicing obligations.

f. Plant and Facilities - Include a brief description of the facilities and indicate if water, power and transport facilities are available. Indicate the estimated production capacity and the extent of its utilization. Indicate the number of employees.

RISKS/KEY SUCCESS FACTORS

3.37 The strengths and weaknesses of a proponent should be analyzed in relation to industry conditions, competition, labor situations, government regulations affecting the business and political and economic climate.

3.38 There are always risks involved in pursuing the expansion project and these should be identified. Identify potential risks that may adversely affect the project and why you think the proponent has the capability to weather off these risk and remain viable. Discuss the factors that adversely affected the proponent in the past, how it managed to survive the adversities and stayed viable. Mention the strengths of the proponent like existence of a captive market, stable raw material source, investment incentives, favorable laws, market share dominance, etc. Mention also other factors, which have positive impact on company's operations.

3.39 Risks in Business include the following:

a. Depreciation of the Peso against other currencies – If there is peso depreciation, peso denominated liabilities may bloat
b. Succession Issues – The project may discontinue if the key proponent dies or becomes incapacitated
c. Failure to reach target revenues – Proponent may have difficulty of paying amortization if volume targets are not reached.

3.40 Business risks are often raised in the discussions among lending authorities. As such, it is necessary to address these business risks outright by discussing options of the company should the anticipated risks occurs. For example, on the issue of Peso Depreciation, the proponent may opt to book peso denominated loans to avoid said risk. With respect to succession issues, there should be a line up of possible successors just in case the key proponent dies.

COLLATERALS

3.41 Collaterals and guarantees serve as "fall back" if projected earnings and cash flow fall below expectations to support repayment commitments of the proponent. A collateral is defined as money or property put up by a proponent/borrower to back up a loan. In case of default, the collateral may be liquidated to pay off the loan. Term loans should be structured such that cash for the loan repayment is generated from the business and that it is not depending on the liquidation of collateral.

3.42 There are two types of collateral: the primary and the secondary collateral. A collateral is primary if there is a specific set of cash, near cash items and hard assets identified to cover for whatever exposure that the bank has in the proponent/borrower; a collateral is secondary if there is none. A primary collateral can be given a valuation while a secondary collateral cannot be given a valuation.

The common forms of primary collateral are as follows:

a. Real Estate Mortgage (REM) - a piece of real estate property covered by a Title including existing and proposed improvements thereon is as security for the payment of a loan. Real estate assets other than the site of the project being financed may be used as collateral. Untitled property or pieces of Real Estate covered by Tax Declaration only are not acceptable ac collateral. Real estate asset in the name of a third party may be acceptable as collateral provided that the registered owner is the signatory of the REM. Special Power of Attorney (SPA) issued by the registered owner allowing the borrower to mortgage the real estate assets in not acceptable because of a high incidence of fraud in the issuance of the SPA.
b. Chattel Mortgage (CM) - machinery, equipment and/or personal property are used as security for a loan.
c. Hold-out on Deposits - a specific amount of Saving or time deposit is being held by the back as collateral under as Deed of Assignment. Like in the case of REM, the depositor may not be the same as the proponent/borrower, in which case the depositor should sign the deed of assignment.
d. Mortgage Trust Indenture - the bank is given a Certificate of Participation indicating issued by a trustee who was appointed custodian to a property of enormous value. The certificate indicates the extent or percentage of the property, which secure the loan of the bank. This type of collateral is encountered where the loan given to a proponent/borrower is syndicated or where more than one bank have loaned money to the proponent using same collateral.

The following are secondary collateral:

a. Joint and Several Signatures (JSS) or Suretyship – Under a JSS or Suretyship, the surety (signatory of the JSS document) binds him/herself solidarily with the principal debtor and there is a JSS in almost all loan contracts. If the borrower is a corporation, the JSS encumbers the personal assets of the surety to the liabilities of the corporation. In JSS, the surety is not liable unless and until the principal proponent/borrower is held liable. A number on conventions on JSS are as follows:
   - if the proprietor/proponent/borrower is the husband, the wife executes a JSS & vice-versa. A third party other than the spouse may also execute a JSS;
   - if the proponent/borrower is a corporation, the principal directors and stockholders execute the JSS
b. Cross Guaranty - a person or corporation guarantees the loan of another that likewise guarantees the loan of the former.
c. Negative Pledge - an undertaking of the proponent/borrower not to mortgage, encumber, transfer or dispose of his fixed assets without the consent of the

Bank. This is usually encountered where the proponent/borrower is prime and has a good track record

3.43 A proponent cannot borrow to the extent of full market value of assets submitted as collateral. The banks use the terminology "Appraised Value" and "Loan Value.

3.44 Appraised Value is the valuation given by a bank on specific assets. In the case of land, valuation given is usually based on the averages of zonal value, last sales transaction of a piece of land that is near the property and the market value as quoted by real estate agents. The value may be increased because of the location or may not be given any value at all because of the absence of a right of way. If the land is agricultural, the maximum value is the price given by DAR for such property. Valuation is likewise given to improvements introduced on the land.

If the proposed collateral is equipment, the value given is the estimated replacement cost of the equipment net of depreciation; if the equipment is new, it is based on the purchase price of the equipment.

3.45 "Loan Value" is the amount of loan that that the proponent/borrower can obtain from the bank which is a percentage of the Appraised Value. Loan Value schedule is as follows:

Collateral	Loan Value
Land	60%
Building and Land Improvements	60%
Chattels	50%
Deposit Hold-Out	100%

3.46 Collateral can be valuable in term lending, but relying on it as the main justification of support is not the right attitude. Historical performance is still the best gauge in viewing the proponent's ability to service future debts. It is essential to look into the ability of the proponent/borrower to repay from the earnings generated in the normal course of the business.

3.47 Where the proponent is a start up, there is no business history to indicate what their future earnings power will be. Projections may be a good indicator but should be substantiated by evaluation of market, management, technical matters, etc. Collateral becomes important consideration.

3.48 In case of guarantee, it is good psychological help but does not automatically ensure that the guarantor will immediately repay a debt or that the lender will have access to the assets of the guarantor without strong legal action.

3.49 The DOE Assistant should be able to advise proponent of unacceptable collateral that include:

a. Collateral previously mortgaged to another bank. Second mortgages are not acceptable
b. Real estate assets without right of way
c. Real estate assets with lis pendense, adverse claim and other limitations annotated at the back of the title

SECOND WAY OUT

3.50 Risk of lower than expected level of performance is always present and it would enhance the comfort zone of the bank if the other sources of payment short of disposing assets can be identified.

3.51 The presence of collateral mitigates the risk and increases the comfort zone of a bank with respect to collecting its exposure into the proponent/borrower

PRICING

3.52 The Costs that should be considered by the Proponent/borrower consists of the following:
a. Interest on the loan
b. Service Fee which is a fee collected by the bank per transaction. The amount is supposed to reimburse the bank of its cost in processing the transaction
c. Handling fee, which represents the cost of the bank evaluating the loan transaction. Handling fee is a one-time expense and is usually 1% of approved loan amount
d. Commitment Fee – This is a fee for the inability of the proponent/borrower to draw on the approved loan within the drawdown period as defined under the loan agreement. By imposing a commitment fee, the bank is recovering the opportunity cost from allotting funds to service the loan drawdown. Commitment Fee is usually 1% or lower per annum based on the undrawn balance of the loan.
e. Documentary Stamp Tax (DST) – This paid to the Government. Amount paid, which is usually deducted from the proceeds of loan is P0.20 per P300.00 value indicated in the document. Loan agreements and promissory notes are subject to DST.
f. Penalty Charge – The amount collected by the bank if borrower cannot promptly pay loan amortization schedule.

3.53 The Interest rate of a loan depends on a number of factors. The primary determinant of interest rate is the Interest rate on Treasury bills(T-Bills). Interest rate on T-Bills becomes the base rate as it is the type of investment that banks would opt if they decide not to lend their money. As such, quotations on interest rate are usually stated in “91-day T-Bills Rate plus ____% spread” at the time of availment. The interest rate is usually adjusted or “repriced” every 90 days to take into consideration of the changing cost of money to the banks. T-Bills rate is published in the newspapers.

3.54 The other benchmark used by banks is the "Prime Rate" or the best rate that it can give to its best proponents. Prime Rate is a market established rate and may be higher or lower than the T-Bills rate. Some banks publish their prime rates in the newspapers.

3.55 The "plus ___% spread" is a factor that takes into consideration the following:

a. Business Risk - This is the risk that the loan will not be repaid in full with interest within the time frame agreed upon. The higher the perceived risk, the higher is the spread of the bank.
b. The level of compensating business - If the proponent has other business deals with the bank, the situation may merit for the scaling down of the spread. Likewise, presence of substantial amount of deposit will merit a reduction of the spread of the bank.
c. Potential change in the cost of funds in the future. This is especially important when interest rates are fixed.
d. Financial risk - This is the risk that loan funds will be tied up and not be available as other opportunities present themselves to the bank (opportunity loss).
e. Demand Deposits - those deposits that each loan will bring to the bank or each loan will retain for the bank (free balances after activity charges).
f. Time Deposits - while these may have some influence, if the bank is paying a market rate, then time deposits add little in compensation for a favorable rate
g. Competition - those rates that are actually available from other lenders.
h. Timing of interest payment - whether discounted, paid at maturity, paid monthly or paid quarterly, etc.

SOCIO-ECONOMIC, ENVIRONMENTAL & OTHER ISSUES

3.56 Presence of socio-economic impact helps justify a project although it could not serve as a primary justification. Possible multiplier effect of the project should be described in qualitative terms

3.57 On account of the growing environmental awareness, banks now require that projects obtain an environmental clearance certificate (ECC) from DENR. If the ECC is yet to be obtained, the status of getting the ECC should be mentioned in the study.

3.58 Peace and Order – Where the project is placed in remote areas, statement on the peace and order problem should be made in the studies such that the bank account officers and the passive investors would not be guessing of the status.

Slide 6

To recap, the viability of the project is dependent on the following:

- Cost of Project
- Existence of a market
- Technically feasible
- Socio-Economic Impact
- Financially Viable

Slide 7

The bankability of the proponent is dependent on the following:

- No adverse credit finding
- Adequate capital
- Can manage project profitable

Slide 8

Financial Statements are best windows in looking at the current and projected picture of the business enterprise.

- Basics of Financial Statements
- Historical
- Projected
- Analysis of Financial Statements

Slide 9

As recap, a project will not be pursued if the people that should be providing the support are not there. The proponent should be provided assistance but caution should be taken.

CLOSING

I would like to inform the DOE at this point that I would be willing to provide assistance even after the expiration of my TOR. I will be discussing details with Ruben regarding thematter.

Appendix G

Minutes of Meeting

Consultation Meeting on
PROPOSED GUIDELINES ON PROJECT EVALUATION FOR
NEW AND RENEWABLE ENERGY PROJECTS
2:00 p.m. on April 5, 2001
Venue: PA Consulting Conference Room

Present:

Arlene Pamintuan	-	PA Consulting
Boy Dulce	-	USAID
Junn Domingo	-	Land Bank of the Philippines
Offie Mendoza	-	Development Bank of the Philippines
Jet Salvatierra	-	Development Bank of the Philippines
Val Infante	-	National Electrification Administration
Fely Arreola	-	Department of Energy
Ruben Quejas	-	Department of Energy
Grace Yeneza	-	Preferred Energy Inc.

SUMMARY OF DISCUSSIONS

1. DBP's concern is the organizational readiness of DOE to handle the tasks as defined under the guidelines. DOE does not have the capability to handle such tasks as evaluation of collateral, conduct of a CI and analysis of Financial Statements. It became apparent in subsequent discussions that there are parts of the whole tasks that can be appropriately performed by the banks. As a catalyst, however, DOE should be aware what the banks are doing such that it can effectively provide assistance to proponent. DOE staff need to understand the language of the banks such that they can discuss intelligently with the loan officers of the banks.

2. DBP suggested for the creation of an Inter-Agency Committee similar to that of DOST. The IAC, to be composed by representatives of agencies that can contribute inputs to the project, will have the effect of increasing the comfort zone of the banks on project requiring loan.

3. The process flow being proposed with IAC in the picture is as follows:
    a. Upon receipt of application, DBP will conduct CI and appraise proposed collateral meantime that proponent is in the process of preparing documents required by the bank
    b. The DOE will simultaneously validate the assumptions pertaining to the technology and the market.
    c. The proponent will then, thereafter present the project proposal to the IAC for deliberation

4. USAID wanted for a clearer definition of DOE's Role in the entire process. DOE pointed out that its role is purely that of a catalyst and would provide assistance

consistent to this role. The proponent remains primarily responsible for the project proposal while the bank is primary responsible for the decision to grant a loan to the proponent.

5. In the subsequent discussions, a more specific definition of DOE's role as catalyst in Off-Grid RE Based Electrification Projects was agreed upon and they are as follows:
   a. Market identification and validation of market assumptions. DOE will make an assessment of the existence of the market and will present to the banks a document stating the existence of a market, the characteristic of the market and other basic market data. It should also 1) prove the assumption on the population and its growth, 2) provide estimates on tariff rates and 3) provide estimates on cost of delivery of electricity.
   b. Technical validation and verification of the viability of the technology. As some banks do not have the capability to evaluate technical aspects of NRE projects, DOE will pre-screen the technology. It will indicate in a report that would include information 1) if the technology has been pilot tested and the results of the pilot test, 2) if there existing projects in the Philippines using the technology and the performance of the project and 3) if there are of similar projects in other countries and their performance. The technology has bearing project cost and operating costs. The two costs will, in turn, affect the financial viability of the project.
   c. Institutional evaluation including assessment of the readiness of the community and the livelihood component.
   d. Verification of "cost of service delivery" calculation/pricing or tariff formula

6. DOE should likewise identify the areas where NRE are appropriate as well as the appropriate matching technology. DOE mentioned that it has an existing NRE resource map that can be made available to the banks and to proponents.

7. LBP and USAID inquired as to who will be the user of the proposed guidelines. It was pointed out that the guidelines were prepared for the use of DOE. The guidelines will be for the use of the Assistance Desk. When requested by the proponent, it will determine completeness of documents and if studies fit the requirement of the Banks. DOE performs the tasks of a Catalyst but the Proponent remains primarily responsible to the proposal.

8. It appeared in subsequent discussions of the absence of a guideline for proponents. The guidelines for use of proponents should serve as a guide of the different documents that must be submitted as well as various financial packages and the advantages of each. Each proponent has its own preference of banks and the proponents should be aware of the various financial packages offered by the banks.

9. Per DBP experience, mini-hydro projects must comply with 50% equity requirement to be viable. The equity requirement for mini-hydro should be higher.

10. In the definition of the role of DOE, there should be no duplication of work. DOE shall not perform the tasks of the banks, neither will it take on the role of the proponent.

11. LBP acknowledged the absence of staff that have technical competence to evaluate NRE project and may have to rely on DOE on matters pertaining to the evaluation of the technical aspects of projects. LBP would like to develop the competence as it recognizes that energy is a necessary component in the development of livelihood projects in a countryside environment.

12. The banks wants to be advised on such matters like probability that areas intended to be served by NRE project will be connected to the grid. NRE project will not prosper in an area that will be eventually be connected to the grid. NEA can provide the information requested by the banks.

13. The banks suggested that there should be a consolidation of information on all initiatives on NRE. The issue was raised because of a case in Palawan. DBP had to stop implementation of a previously approved project because another entity established a competing project that was funded by a grant. DOE is aware of the NRE initiatives in Palawan. DOE, however, does not have jurisdiction on the NRE projects because these are funded by the private funds and because DOE has no fund exposure in the projects.

14. While DOE is promoting the use of NRE, NEA is mandated to electrify the rural areas regardless of the type of technology. Seemingly, there is a conflict of roles of the two agencies. DOE, however, in its desire of to fast track the attainment of 100% electrification, took an innovative approach without necessarily encroaching into NEA's mandate. DOE's initiatives intend to complement NEA's effort and the seemingly conflict of roles is actually complementation of efforts.

15. In the past, NEA depended on congressional allotment for its projects. Sustainability of projects is an issue because of the difficulty of getting replenishment.

16. For a project to be sustainable should have livelihood component which in turn affect the household's capacity to pay. Households should be the reference point and electrification should result into additional income for them. Discussions on livelihood component will be included in the guidelines.

17. Rural electrification is appropriate for the LGUs and the Electric Coops. If Electric coops cannot pursue projects, the private sector are invited to participate by way of a joint venture together with the LGU.

18. There is a need to come up with a model per technology to serve as guide for the banks. Likewise, there is a need to categorize the market into different segments to allow for possible scenario analysis.

19. The credit decision is the call of the banks, after all, it is their money that is being employed into the project. What the banks want is an information that will enhance their confidence level on both the borrower and the project. Banks practice balance sheet financing. Project financing is not done locally.

20. NEA's concern is the cost that would be spent by a proponent in doing a feasibility study without any assurance that the proposal will be approved. Pre-feasibility study was suggested as alternative. The suggestion, however, would only increase the cost as there is more or less a standard set of requirements by the banks.

21. DBP and LBP stated that they could not provide two projects that can be assisted by DOE for purposes of getting approval under this project.

Prepared by:

ROSVID SUNICO

Meeting with DOE on Amendments to the
Proposed Guidelines On Project Evaluation For
New And Renewable Energy Projects
10:00 a.m. on April 10, 2001
Venue: DOE-NCED Conference Room

Present:

Ruben Quejas
Fely Arreola

SUMMARY OF DISCUSSIONS

1. DBP's concern on organizational readiness of DOE – The DOE appreciates the concern and is taking actions to be able to perform the role of a catalyst. The setting up of the guideline and the training of the DOE staff on the use of the guidelines is an initial step towards this effort.

2. Proposed Inter-Agency Committee(IAC) – DOE recognizes the merits of having an interagency committee. To avoid creating another committee, DOE will examine if the existing Project Preparatory Team (PPT) can perform the task of the IAC. The DOE thinks that the PPT is appropriate for the purpose as DBP, LBP, NEA, PNOC-EDC, DOE, NEDA and DOF are represented. The proposed guidelines will be amended to take into consideration the existence of the PPT in the project evaluation process.

3. Role of DOE – The specific definition of the role of DOE as agreed during the meeting on April 5, 2001 shall be incorporated in the guidelines.

4. On matters of "verification of cost of delivery", however, DOE can determine the upper limits of the figure and not the exact figures.

5. Areas where NRE are appropriate – DOE has an existing NRE resource map which is regularly updated. The banks will be provided with these maps.

6. Interaction with Proponents – USAID, NEA and LBP raised the issue on the absence of a guideline that will be distributed to the proponents such that they can properly present NRE projects. DOE recognizes the need to provide proponent with guidelines on project proposals to guide them of the steps to undertake and the things to look into when preparing a project proposal. Guidelines for proponents, however, is not among the sub-tasks of Task 4. Since the subtask "On a best effort basis, assistance to at least two (2) project proponents (1 LGU and 1 private sector) from the priority list in item (d) in obtaining a financing agreement with either the DBP and LBP, on a best effort basis" could not be delivered, the guidelines for proponents may

be delivered in lieu of the subtask mentioned. The matter will be discussed with PA Consulting.

7. 50% Equity Requirement for Mini-hydro – DOE considers critical the information from DBP on the 50% equity requirement for hydro projects as it has impact on future mini-hydro projects. DOE will make a subsequent verification on the matter.

8. Livelihood Component – The guidelines will include a provision on the livelihood component of NRE projects.

9. Financial Model per NRE technology – One of the intentions of DOE is to set up financial models per type of NRE technology. The presence of a model will greatly help DOE in its role as catalyst. The process, however, will take time as there is a need to build a data base to support such models. NRE is site specific and there would be many variations to be considered.

10. One-Stop Shop – The Market Support Center (MSC), one of the recommendations under the GEF project, may perform the role of a one stop shop. The MSC will serve on an advisory capacity and will not perform tasks for the proponent like obtaining permits and registrations.

11. Other Matters:

    - Transfer of Technology – Mr. Quejas designated two of his staff to have extensive training on project evaluation using the proposed guidelines. Case method shall be used for the training. Schedule, which will take two weeks, will start on April 19.
    - In the first week of May, there will be a half day discussion with DOE staff about project evaluation and assessment.
    - Adjustments on the contract will be discussed with PA Consulting. DBP and LBP disclosed during the meeting on April 5 that both banks cannot provide two projects that can be provided with assistance under the TA.

Prepared by:

ROSVID SUNICO

MEMORANDUM:

FOR : The Secretary, Department of Finance

FROM : The Secretary, Department of Energy

SUBJECT : Request for inclusion of NRE among qualified projects to be financed by the MDF Facility

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1.0 The Request

We wish to request the Department of Finance to make representations with the World Bank for the inclusion of New and Renewable Energy Projects among the qualified projects to be financed.

2.0 Background Information

2.1 One of the thrust of the Department of Energy (DOE) is poverty alleviation and rural development to provide greater opportunities and benefits to underprivileged Filipinos in remote and rural areas. Towards this end, the DOE aims to bring electricity to 8,000 barangays in ___ municipalities. All of the municipalities belong to 6^{th} class category and are in no means qualified for financing from the regular financing windows of GFIs and commercial banks.

2.2 ___ of the unelectrified barangay mentioned can be reached by the grid within the next 2 years. The remaining, however, can be electrified using generators that consume fossil-based fuel or using New and Renewable Energy (NRE) sources like generator powered by solar energy, wind energy and hydro power. The DOE opts for NRE sources because they are environment-friendly in that there is no CO2 emission. Further, NRE is least cost alternative in the long run because they are powered by resources that are free and are replenished by nature. (A briefer on NRE is attached as Annex "A")

2.3 In its attempt to bring electricity to the countryside, the DOE intends to make electrification a community based project. Studies show that project where the active participation of the community is sought are more likely to be sustainable. Considering that the target market is marginalized group, the enterprise of bringing electricity shall focus on full cost recovery plus profit. The level of expected profit, however, is not expected to reach a level that is attractive to the private investor. As such, the municipal LGU is the appropriate proponent for such project as it would be in pursuance of LGU's mandate of spurring development. Such projects are viable because there is a market which are the residents of unenergized barangays and the technology has been proven.

2.4 Funding, however, becomes a problem because the banks and GFIs shun away from 6^{th} class LGUs. It is for this reason that the DOE looks at the MDF as the possible source of funding for LGU electrification projects. There is a need, however, for DOF to make representations with World Bank for the inclusion of NRE among the projects that qualify for MDF financing. If the municipal

LGUs were to pursue NRE projects, it would not only fulfill their social mandate but would also improve the standards of living of the less privileged sectors of society. Likewise, it is in consonance with the policy of the State of local autonomy that will enable the LGUs to attain their fullest development as self-reliant communities and make them more effective partners in the attainment of national goals.

2.5 The estimated average cost of NRE project per municipal LGU is P10 Million. If all the ___ municipal LGU were to pursue NRE projects, the total project cost would be _____ Million.

2.6 Considering that NRE projects are environment friendly and that proponents are among the least privileged municipal LGUs, the DOE will work with NEDA for the possible 70% subsidy portion for such projects.

3.0 Justification: The DOE is endorsing favorably the proposed inclusion because of the following:

a. The project would benefit the least privileged sectors of society
b. It will spur economic development in the countryside

For consideration

VICENTE PEREZ
Secretary, Department of Energy