

The Philippine Water Revolving Fund Support Program

ANNUAL REPORT

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Chapter 1: Overview of Project and Highlights of Year 1 Accomplishments

The Clean Water for People Initiative (CWPI), a partnership of the Governments of the United States of America (USG) and Japan (GOJ) to help selected countries achieve their targets for water supply and sanitation under the Millennium Development Goals (MDG) spurred the development of the Philippine Water Revolving Fund. The Philippines is one of the pilot countries of CWPI.

The initiative to establish a water revolving fund started with the feasibility assessment and the design and implementation framework done under an earlier technical assistance program of USAID. The PWRF Support Program is a follow-through effort to establish and operationalize the water revolving fund. The Program is linked with another USAID assistance, a co-guarantee agreement of the Development Credit Authority with the LGU Guarantee Corporation, a private third party guarantor, which provides credit enhancements to private financing institutions for, among others, water sector lending.

The PWRF was developed under a multi-stakeholder collaboration of the Philippine Government, USAID and JBIC, and private financing sector representatives. A Steering Committee has been providing policy guidance to the design team. The members of the Committee are the Department of Finance (Chair), National Economic and Development Authority, Development Bank of the Philippines, Municipal Development Fund Office, LGU Guarantee Corporation, Bankers Association of the Philippines, USAID and JBIC. The Committee is supported by a Technical Working Group (TWG) that does the preliminary analysis. All agencies represented in the Steering Committee are also in the TWG plus the Local Water Utilities Administration and the Department of Interior and Local Government.

A. Project Objectives and Scope

The Philippine Water Revolving Fund is envisioned to help achieve the following goals:

- Improve access to safe drinking water and sanitation through the establishment of a successful PWRF;
- Through the successful utilization of PWRF and subsequent investment in water and sanitation infrastructure, help reduce morbidity and mortality from waterborne diseases and, specifically in the case of sanitation and wastewater treatment, contribute to biodiversity conservation, particularly in coastal areas;
- Attract private sector investment in water and sanitation infrastructure projects thereby enabling the Philippines to meet its MDG commitments; and

- Strengthen the capacity of key institutions in the water and finance sectors – chiefly water utilities – to effectively obtain and utilize funds for infrastructure investments.

A. 1 Phase 1 Objectives

The PWRF Program is divided into five components listed below and will be implemented in two phases over five years. Phase I “PWRF Establishment” has three objectives:

- Set up the appropriate institutional arrangements for the PWRF, including supporting efforts to secure the JBIC loan and its operating and policy guidelines; and USAID’s DCA guarantee agreement;
- Strengthen selected water and finance sector institutions vital to PWRF Program’s success; and
- Assist LGUs and WDs to develop a pipeline of viable projects in anticipation of an operational PWRF by June 2007.

Phase II is supposed to provide assistance for the “PWRF Operation”. However, in view of changes in enabling conditions, emerging priorities, and new developments in both the water sector and financial markets, USAID and our technical assistance team are re-configuring the thrusts and strategy of the Phase II work plan. The overall objective of meeting investment needs and mobilizing private capital remain the same.

A.2 Project Scope

Component 1: PWRF Set-up and Institutional Development - involves establishing and operationalizing the PWRF lending program in DBP, and putting the DCA co-guarantee agreement with LGUGC in place; specific tasks include facilitating approvals from GRP and executing agencies, facilitating processing of the JBIC loan to capitalize PWRF, preparing the implementation guidelines and business plan; also includes conduct of a study tour on water revolving funds in the USA or India.

Component 2: Water and Sanitation Project Preparation - involves assisting water districts and LGUs to improve or update pre-investment studies and implement immediate measures to enhance project bankability or the creditworthiness of borrower. The Year 1 work plan targeted 7 to 10 projects ready for PWRF financing.

Component 3: Water and Finance Sector Strengthening - involves helping implement strategic reforms that facilitate achieving the targets under Components 1 and 2; the most immediate and critical reform is the rationalization of credit programs for the

water sector. The rationalization is intended to level the playing field for PWRF vis-à-vis other credit programs using ODA or GRP resources re-lent at concessional terms.

Component 4: General PWRF Program Support- involves serving as the technical secretariat to the PWRF Steering Committee and Technical Working Group and supporting USAID in reporting, advocacy, and collaboration with JBIC on the PWRF.

Component 5: Small Grants Program Administration- involves the preparation of a small grants program under Phase I to support PWRF objectives, e.g. activities related to capacity building of utilities, advocacy programs for sanitation investments.

The expected outputs for each of the components are shown in Table 1.

B. Highlights of Year 1 Accomplishments

Establish and operationalize PWRF- The Year 1 work plan of the PWRF Support Program focused on the establishment of the PWRF in DBP as a special lending window that would implement a co-financing arrangement with private financing institutions. The pre-requisite of this deliverable however, is the execution of the JBIC loan with DBP, which will be used to capitalize DBP's loan share. The JBIC loan processing was however delayed in view of unresolved policy issues between the Governments of Japan and the Philippines. With this delay and the uncertainty of the loan execution, the team and USAID mutually agreed to postpone some of the activities directly related to the PWRF special lending window's set-up and operation. Nonetheless, our team has started to put in place the implementation guidelines for PWRF. We have prepared the Fund's financial projections, operating policy guidelines, and drafted its standard loan agreement, including the inter-creditor agreement. We have also conducted a training workshop for officers and staff of DBP and commercial banks on familiarization with the water sector and project appraisal.

We conducted a study tour on water revolving funds in the US, participated in by our key partners from DOF, NEDA, DBP, LWUA, LGUGC, and LBP. The study tour aimed to impart lessons from the experiences of three US States (Maryland, New Jersey, and New York) in establishing water revolving funds and lessons on how to encourage aggregation of utilities. It also aimed to engage the US experts in the discussion of key areas of concern on the long-term evolution of the PWRF as a sustainable financing mechanism. The insights gained and lessons learned from the study tour are now driving the formulation of a plan for policy reforms and informing the long term financing structure that will meet the overall objectives of the sector.

Project Development – Under the Year 1 work plan, our team targeted 7-10 water projects ready for financing. However, in view of the delay in the JBIC loan approval,

as agreed with USAID, we slowed down our effort to prepare projects for financing. We assisted only two water districts (Cabanatuan and Puerto Princesa) and one LGU (El Nido) to improve their feasibility studies. We followed up the survey of utilities started under the JBIC demand analysis (done in 2006) to identify projects in the utilities' immediate and medium term investment programs. From this follow-up survey, we identified the projects listed in Table 2. We prepared the conceptual framework of a project development facility that will be the pre-cursor of a feasibility assessment and design effort in Year 2.

Policy and Institutional Reform- In this component, we prioritized policy reform critical to the success of PWRF. We prepared the analysis and draft guidelines to rationalize the credit programs for the water sector. The guidelines address the leveling of the playing field for PWRF to operate viably alongside ODA-funded credit programs targeting the same market. We also prepared a conceptual framework for the transition of the PWRF to a capital market-based mechanism. This framework together with the lessons learned from the US study tour will be considered in the design of the long term mechanism for PWRF. We have also drafted a position paper for DOF's consideration, petitioning Central Bank to include water lending among the alternative compliance for mandatory credit under the Agri-agra law. This was one of the incentives the banks requested. Lastly, we started the technical assistance (TA) to LGUGC for the preparation of its policy and guidelines for pricing guarantee fees. This TA addresses as well the due diligence required for the next guarantee agreement of USAID Development Credit Authority with LGUGC.

Overall Program Support for PWRF- During the year our team organized three Steering Committee meetings to discuss and resolve various policy issues. We backstopped DBP in the fact-finding mission of JBIC for the PWRF loan. We also organized a donors' meeting to discuss the progress of PWRF and donors' related initiatives. One of the main agreements of the group is to constitute a separate working committee under the Philippine Development Forum to focus on water sector issues.

Cooperation with other USAID projects- We worked with SCOTIA in providing technical assistance to the El Nido LGU in appraising the LGU's feasibility study for water supply as well as in the preparation of the financial analysis and financing options for its water supply and sewerage projects. Our assistance on the financial analysis complemented the work of SCOTIA on the technical solution for the sanitation component. We also worked with the EcoGov project on exploring options for the operation of septage management services in General Santos City. We are looking into service provision arrangements between the City and the water district. We have also exchanged information on and shared lessons learned with the EcoAsia sub-project on developing a new lending product for LWUA geared for the less than creditworthy water districts.

C. PWRF Impact on PFI Interest to Finance WSPs

One of the externalities of the PWRF development exercise is the awareness fostered among private financing institutions of the opportunities in lending to the water sector. This awareness together with LGUGC's aggressive marketing; the continuing liquidity of banks and the prevailing low interest rate regime have all contributed to banks' growing appetite to lend to water projects. To date there have been three loan transactions originated by PFIs and financed entirely by them or co-financed with LWUA¹, but still with PFIs taking on the lion's share. Moreover, PFIs for now are relying on LGUGC's guarantee for credit enhancement, but they said they foresee foregoing this in the near future.

"I can say with certainty that LGUGC and its accredited private financial institutions (AFIs) would not have considered water sector lending without the influence of the USAID and JBIC collaboration for a water financing program. Our introduction to water sector lending under the Municipal Water Loan Financing Initiative (MWLFI), which resulted in the co-financing of Metro-Iloilo Water District by DBP and PNB, opened LGUGC management's eyes to the opportunity in the water sector market. This led us to the expansion of LGUGC's guarantee services to water districts, which previously were focused on LGU loans and bonds.

The follow through of MWLFI with the PWRF development—supposedly the long term financing mechanisms with private sector participation, prodded us to develop a due diligence template on WDs and an internal WD borrower risk rating system, and to aggressively market our water guarantee service among the AFIs and WDs. The PWRF initiative and other mutually reinforcing factors such as greater market liquidity and competitiveness of PFI rates, contributed to private financing institutions growing appetite to lend to the sector. To date, some AFIs have fully financed water district loans. Moreover, our guarantee has not only encouraged them to get into the market but is now also driving the AFIs' pricing down. These AFIs, which have the early market advantage, have indicated that they may soon be—unfortunate as it may be for LGUGC—ready to lend without the LGUGC guarantee."

-Lydia Oriol
President, LGU Guarantee Corporation

¹ LGUGC and LWUA signed an MOU on July 31, 2007 for a co-financing arrangement with PFIs. The structure is similar to the PWRF.

D. Challenges and Opportunities

Challenges

Injunction on EO 279 - The development of PWRF was anchored on the financing policy stated in Executive Order 279 (see Box 1). However, the implementation of the EO has been held in abeyance in view of a writ of injunction thereon (obtained by LWUA employees who filed a case at the local court, questioning the merits of the EO's provisions on LWUA's reorganization). The EO 279 Oversight Committee has not met on the EO's implementation since the issuance of the temporary restraining order. This has affected the policy implementation momentum. Although this has not necessarily stopped PWRF's development, it would have benefited from the complementary reforms, e.g., the Oversight Committee was supposed to develop a technical and capital assistance plan for the less than creditworthy water service providers, that should have been done parallel to PWRF's development. This technical and assistance plan would have helped with the rationalization of credit programs that would level the playing field for PWRF's operation.

PWRF Interim Capitalization – The interim funding of PWRF is largely dependent on the JBIC loan execution. Hence, until then the full scale implementation of the PWRF co-financing arrangement between DBP and commercial banks will be deferred.

Opportunities

DOF Leadership – DOF has started to take the lead in looking at comprehensive policy reforms for the sector. It has committed to take bold steps, such as national government financing to meet the needs of the sector.

Partnerships – The initiatives of various donors in the sector, such as the GTZ-led water supply road map, the WB technical assistance to LWUA's institutional

Box 1. Salient Provisions of Executive Order 279

Rationale

- Constraints in the availability of national government funding for water
- Need to mobilize resources from international grants, GFIs, PFIs and LGUs
- Need to rationalize current financing policies to ensure more efficient flow of resources

Reform Objectives

- Improve investor confidence in the sector
- Rationalize allocation of scarce resources through market segmentation
- Allow freedom of choice in sourcing financing
- Increase participation of LGUs, GFIs and PFIs in financing the sector investments
- Improve performance and overall financial viability of utilities
- Grant incentives to encourage utilities to graduate to creditworthy status
- Establish an independent economic regulator for the sector

Policy Guidelines on Financial Reforms

- Classify water service providers (WSPs) into creditworthy, semi-, pre- and non-creditworthy to target government support
- Shift lending to creditworthy WSPs to GFIs and PFIs at commercial lending rates
- Source concessional debt financing and grants for the less than creditworthy WSPs

strengthening, and the active participation of the private sector, i.e., LGUGC and PFIs in the development process of PWRF, all contribute to greater impetus to develop the sector.

Credit Market Growth – The increasing maturity of the domestic private credit market augurs well for the plan to increase private sector participation in the sector’s financing. It is also opportune for WSPs to tap PFI financing at the prevailing low interest rate regime.

E. *Next Steps*

USAID extended the project’s base year to March 2008 to enable the completion of the deferred outputs. It also exercised the option years, but will obligate funds on an annual basis. The Year 2 work plan submitted and agreed with USAID is being reviewed in the light of new developments and the on-going reformulation of the overall strategies for the sector. Furthermore, with the uncertainty of the JBIC loan approval, the institutional support to set up PWRF will again be deferred.

USAID advised the team to be flexible and agile with the work plan activities to ensure responsiveness and effectiveness of technical assistance support.

We, however, expect to maintain the four main scopes of work: PWRF set-up (if the JBIC loan proceeds as planned); project development; policy and institutional reform and overall program support. Major efforts will be on the design of the long-term financing mechanism for PWRF and the structuring of a Project Development Facility.

Table 1: Summary of Year 1 Expected Outputs and Accomplishments

Expected Outputs	Accomplishments for the Year
<i>Component 1: Establish and operationalize PWRF</i>	
<ul style="list-style-type: none"> ▪ Updated financial model for the PWRF 	Completed and submitted financial model of the PWRF to DBP; continually did sensitivity analysis at the request of DBP
<ul style="list-style-type: none"> ▪ Information memorandum for ICC 	Obtained NEDA ICC Cabinet Committee approval of the PWRF on May 9, 2007
<ul style="list-style-type: none"> ▪ PWRF Operating Policy Guidelines (OPG) 	Submitted final draft of OPG to DBP; upon the request of JBIC, the OPG integrated the Environment Development Program Loan and the PWRF lending and operating guidelines
<ul style="list-style-type: none"> ▪ MDFO Implementation Guidelines for the Stand-by Credit Line 	Submitted final draft of the guidelines to MDFO
<ul style="list-style-type: none"> ▪ Draft credit framework arrangement between DBP and PFIs 	Submitted the PWRF Standard Loan Agreement including the inter-creditor agreement to DBP; obtained DBP approval but finalization is subject to comments from PFIs; documents are currently being reviewed by PFIs
<ul style="list-style-type: none"> ▪ MOA between DBP and PFIs and inter-creditor agreement; 	Postponed
<ul style="list-style-type: none"> ▪ PWRF Business Plan 	Postponed
<ul style="list-style-type: none"> ▪ Training workshops on familiarization with the water sector and project appraisal 	Conducted workshop for PFI head office officers and staff; the PFIs requested that similar training be conducted for officers and staff in their regional offices
<ul style="list-style-type: none"> ▪ Study tour on water revolving funds 	Conducted a study tour for seven (7) GOP and private sector representatives in the US from Sept. 16-22, 2007; lessons learned from study tour will inform the design of the long term financing mechanism for PWRF
<ul style="list-style-type: none"> ▪ Credit screening guidelines for WDs 	TOR has been agreed with LGUGC; TA will be implemented in November 2007
<i>Component 2: Assist in the preparation of at least 7 to 10 projects for PWRF financing</i>	
<ul style="list-style-type: none"> ▪ Rapid assessment of priority projects identified in the JBIC-SAPROF demand analysis 	Conducted a survey on WSPs investment programs, complementing the 2006 JBIC SAPROF Demand Survey.
<ul style="list-style-type: none"> ▪ At least 7 and up to 10 projects are ready for PWRF funding 	Providing technical assistance to Cabanatuan WD, Puerto Princesa WD and El Nido with improvement of feasibility studies. Puerto Princesa and El Nido ready to apply for financing.
	Four projects (Silang, Sta. Maria, San Fernando Pampanga and Calamba) accessed/ing PFI financing; all projects will be enrolled with DCA for co-guarantee

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| ▪ Conceptual framework for Project Development Facility | Draft for submission to USAID in November 2007 |
| ▪ Establishment of procurement mechanism for technical assistance to utilities. | Postponed |
| ▪ Credit rating of 2 utilities | Postponed |

Component 3: Strengthen the policy, regulatory, and institutional environment for enhancing the viability of PWRF operation.

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| ▪ Draft EO 279 implementing guidelines to rationalize credit programs and draft ICC resolution adopting guidelines | Draft submitted to DOF and to the PWRF Steering Committee members; awaiting comments before finalization of report; Issuance of guidelines will be through an ICC resolution and memorandum from DOF to the executing agencies or oversight committees |
| ▪ Position Paper for Central Bank on eligibility of water projects for Agri-Agra Law compliance | Draft submitted to DOF; awaiting comments from Usec Paul and DOF CAG |
| ▪ Concept and framework of bond issue for WSS project financing | Presented concept paper to PWRF Steering Committee; got agreement in principle to transition PWRF to a capital market-based mechanism, possibly securitization or pooled bond financing |
| ▪ Long-term business planning framework for water districts | Business planning framework currently being prepared; expected completion is November 2007 |
| ▪ Action plan to institute credit rating | Dropped upon mutual agreement with USAID, instead LGUGC will be given TA to prepare its credit rating manual for WDs |
| ▪ Pricing policy for LGUGC | Together with USAID-DCA commenced TA to LGUGC prepare its guarantee pricing framework and formula |
| ▪ Small grants program | Dropped |

Component 4: Provide overall program support to USAID and JBIC

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| ▪ At least one meeting per quarter for the Steering Committee | Organized three meetings of the Steering Committee |
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Chapter II: Accomplishments for Year 1

1. *Component 1: PWRF Set-up and Institutional Development*

Component 1 of the technical assistance basically covers two areas: 1) the institutional support for the establishment of the PWRF Lending Facility within DBP and 2) the institutional support needed to gain official approvals and complementary activities to enhance stakeholder “buy-ins” to the PWRF.

Establishment of the PWRF Lending Window

The establishment of the PWRF lending window was faced with various challenges namely: 1) changes of senior personnel at DOF and DBP which required new rounds of briefing and revalidation of commitment to PWRF’s implementation; 2) delay in the pledging of the JBIC loan; and 3) DBP senior management and JBIC questions on the features of the PWRF financing structure (e.g. standby credit facility, exit mechanisms for DBP, eligibility of projects and proponents). Our team conducted several consultative meetings in order to come up with a resolution of the issues and concerns. In the end, we obtained consensus from DBP and JBIC on the Operating Policy Guidelines of the PWRF. The current draft of the OPG is the fifth version. We expect iteration on this draft after the JBIC appraisal and the loan negotiation between DBP and JBIC.

We also drafted the OPG and designed the parametric pricing formula for the MDFO Standby Facility for LGU water and sanitation projects. The MDFO OPG is currently under consideration of the Policy Governing Board.

We updated the standard loan agreement package (previously prepared under the FORWARD program). The standard loan agreement (SLA) consists of five documents: general conditions, term loan agreement, deed of assignment of revenues, deed of assignment of reserve fund with hold-out; and guarantee agreement. The standard loan agreement incorporates the inter-creditor agreement, i.e., between DBP and the participating PFI. We submitted the documents and held consultations with DBP to have them vetted. The current version already incorporates DBP’s comments, including its legal department’s. Using this version, we have requested comments from the PFIs on the SLA.

To familiarize the marketing units of DBP with PWRF as well as identify constraints in the implementation, we conducted briefings for the Head Office Marketing Department and for the Luzon Regional Marketing Centers (covering National Capital Region and Region IV), wherein 39 officers from the latter attended. The briefings elicited mixed responses from the account officers. Although they are aware that as

a development bank they are expected to play a catalytic role in bringing in private sector financing, implementing the PWRF will adversely affect their performance target, which is focused on loan volumes. For account officers, who are the front liners of PWRF, the latter will have a greater bearing. DBP senior management recognizes the problem but is reluctant to change the Bank's performance indicators. Already, this presents an implementation challenge to PWRF.

Institutional Support for PWRF Approvals

Our team supported concerned DBP officials get PWRF approval from their Board and later from the NEDA Investment Coordination Committee. The latter is a pre-requisite for the JBIC loan application. We drafted the project proposal to the NEDA ICC secretariat, as well as prepared the presentation to the Board. We also backstopped the MDFO in presenting and seeking approval of the PWRF stand-by credit line from their Policy Governing Board (PGB). The PGB approved the re-financing arrangement and allocated PHP 500 million for the LGU water and sanitation program under the PWRF.

Our team coordinated and facilitated the signing of a MOU among key implementers of PWRF, i.e., DBP, MDFO, LGUGC, USAID and JBIC which stated commitment to the establishment of the program and delineated roles and responsibilities to establish the Fund.

We conducted consultative meetings with PFIs to assess their interest on water sector lending and on the PWRF arrangement. This was one of the run-up activities to the presentation of PWRF to the NEDA ICC. The ICC evaluation team wanted explicit expressions of interest from the PFIs on the PWRF. The PFIs not only affirmed their interest and readiness to lend. They manifested this interest a few months later by originating loans on their own and providing 100% funding. Some deals were done with LWUA co-financing, but PFIs took on the lion's share of the loan.



A Memorandum of Understanding seeking to establish a PWRF was signed by state-owned Development Bank of the Philippines (DBP), the Municipal Development Fund Office (MDFO), LGU Guarantee Corporation (LGUGC), Japan Bank for International Cooperation (JBIC), and the United States Agency for International Development (USAID). Photo shows (from left to right) LGUGC President Lydia Oriol, Deputy Mission Director Francis Donovan, DBP President Reynaldo David, and JBIC Senior Representative Jin Wakabayashi.

Training of PFIs on Project Appraisal

To build up PFI's capacity to transact business with water service providers, we organized a two-day seminar workshop that included water sector overview—legal, policy, and institutional framework—and project appraisal. The latter covered both financial and technical analysis of water projects as well as operation of water utilities. The training catered to officers of DBP and 14 commercial banks in their head offices. In all we had 28 participants from the PFIs, DBP, LGUGC and MDFO. The post training evaluation showed positive responses in terms of relevance, clarity, and effectiveness of speakers. Upon the request of the participants, we agreed to roll out the training to regional centers to give their regional and branch officers the same opportunity.

Study Tour on Water Revolving Funds

Our team organized a Study Tour of US Water Revolving Funds for senior government and private sector officers involved in water sector financing. The participants included representatives from DOF, NEDA, DBP, LGUGC, LWUA and LBP. The objective of the study tour was to broaden and deepen the knowledge of participants on water revolving funds. In particular, the study tour aimed to:



Usec. Jeremias Paul, DDG Rolando Tungpalan, COO Edgardo Garcia, SVP Mar Enecio, Pres. Lydia Oriol, Mr. Mar Quitariano and VP Liduvino Geron, USAID & PWRF

1. Impart to participants lessons from the experiences of three US states in establishing water revolving funds (Maryland, New Jersey, and New York)²;
2. Impart lessons by one water utility on how it successfully aggregated the services of several utilities under one umbrella organization;
3. Enable participants to discuss with US experts key areas of concern related to:
 - a. The design of the PWRF and the policy environment in which it will operate;
 - b. Institutional governance and organization/operation of the PWRF;
 - c. Its long-term evolution to mobilizing capital from the domestic bond market;

² One of the participants had the chance to also meet with the Massachusetts State Revolving Fund.

- d. The use of subsidies to lower the cost of financing for projects; and
 - e. How to support project development.
4. With the insights gained, facilitate the exchange of ideas among the key implementers in determining the way forward for PWRF's development and the mobilization of resources and support for expanding investment in safe water and effective sanitation services.

The tour was very fruitful judging from the feedback of the participants. From the meetings and discussions among participants, the tour was able to galvanize support for a broader-based water sector policy and financing reform for the Philippines. The group realized that it is necessary to address policy and institutional issues parallel to establishing a financing program. Moreover, it



realized that the financing program should be focused on clear objectives and targets for the sector and not solely on the goal of shifting the financing to the private sector. Hence, the financing should be calibrated based on how best to meet these objectives. The Department of Finance representative, Undersecretary Paul, expressed willingness to work for funding support to the sector through budgetary appropriation or an ODA to the national government to establish a long-term financing mechanism for the PWRF that can adapt to the needs of the small to large utilities.

2. Water and Sanitation Project Preparation

Review of potential projects for PWRF financing

Our team reviewed the list of projects identified in the JBIC SAPROF demand analysis, as well as projects identified by LGUGC and DBP. The updated list was narrowed down to potential projects of 11 water districts and 8 LGUs. The WDs include Silang, Davao, Puerto Princesa, Sta. Maria, Cabanatuan City, Metro Cebu, San Pedro, Tagum, Zamboanga, Bacolod, and San Jose Del Monte. The LGUs include Allacapan in Cagayan, Bolinao in Pangasinan, Polangui in Albay, and in Palawan: El

Nido, Brooke's Point, Narra, Rizal, and Roxas. The projects were prioritized on the basis of preparedness, i.e., feasibility study completed and/or expression of interest from the WD or LGU to seek project financing. See Table 2.

PWRF Survey of WSPs

The JBIC demand analysis surveyed creditworthy utilities and identified 21 candidate projects for PWRF funding with estimated costs of Php 8.2 billion. The projects were based on submittals from 52 WSPs, which constituted 41% of the total number of surveyed WSPs.

We conducted a follow-up survey to capture the WSPs which failed to reply to the SAPROF survey, as well as the additional water districts classified as creditworthy or semi-creditworthy in the 2006 LWUA classification exercise. Out of the total 27 WSPs surveyed, only six WDs and four LGUs responded.

We also requested information from DILG on LGUs with potential projects for PWRF funding and conducted exploratory talks with those who have. This led to an agreement with the Municipality of Polangui, Albay for us to provide technical assistance to update and improve the Municipality's feasibility study for its water supply project.

Table 2: Project Pipeline as of end-October 2007

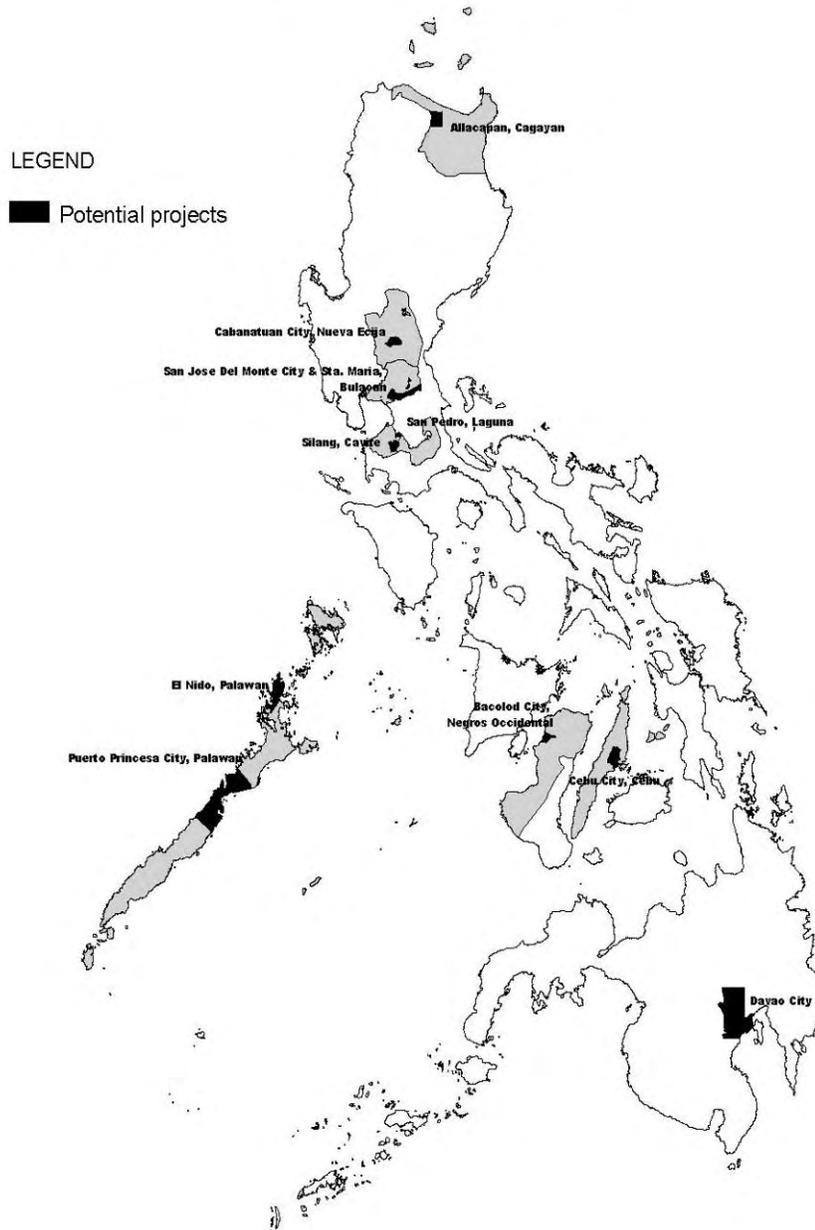
WSP	Project Description	Issues/Status
1 Silang WD Classification: CW	The project involves development of new water sources and system expansion covering 21 barangays. Proposed works include: 1. Drilling of 20 production wells 2. Construction of two elevated tanks and four ground reservoirs 3. Mainline extension/rehabilitation The project is estimated to cost around P198 million (excluding land acquisition costs).	Approved for loan financing by the Philippine National Bank
2 Davao WD Classification: CW	> Bunawan-Lasang Project The project involves the expansion and improvement of the existing water system covering the barangays of Panacan, Tibungco, Bunawan and Lasang. The proposed works are: 1. Drilling of two production wells 2. Construction of a ground reservoir	WD is open to proposals for project financing. Project FS has been forwarded to LGUGC and DBP.

WSP	Project Description	Issues/Status	
	<p>3. Re-drilling of two production wells</p> <p>4. Installation of:</p> <ul style="list-style-type: none"> - 4,043m x 200mm dia PVC - 17,158m x 250-400mm steel pipe (SP) - Mainline extension/pipeline looping (100-250mm PVC/SP) <p>The project was estimated to cost around P237 million, but part of the works has been undertaken by the WD using its internal funds. The project is now estimated to cost a little less than P200M.</p> <p>Other projects:</p> <ul style="list-style-type: none"> > Dumoy System Rehab (P100 million project cost) > Tamugan Surface Water Development Project (P6 billion project cost) > Indangan Project (P40 million project cost) 	<p>Project may be financed by LWUA with 50-50 sharing with a PFI. Still, the GM informed the PWRF team that the WD is still open to other financing options/offers. Pre-investment documents forwarded to DBP and LGUGC.</p> <p>FS updating to be tendered in 2007.</p> <p>Project deferred</p>	
3	<p>Puerto Princesa WD</p> <p>Classification: SCW</p>	<p>The project involves the expansion and improvement of the water district system in 36 barangays.</p> <p>The proposed works are:</p> <ol style="list-style-type: none"> 1. Drilling of seven production wells 2. Construction of 3,930 m³ storage facility 3. Provision of 16 standby power generator sets 4. Installation of: <ul style="list-style-type: none"> - 146.9 km of 50mm-400mm distribution pipelines - 2,437 service connections <p>Estimated project cost is P340 million (Phase 1)</p>	<p>LWUA prepared the technical analysis section of the project feasibility study.</p> <p>The PWRF Team assisted the WD review the project design, determine the optimum phasing of implementation, and prepared the project financial analysis.</p> <p>DBP and LGUGC are both evaluating it for a co-financing arrangement.</p>

WSP	Project Description	Issues/Status
4 Sta. Maria WD Classification: SCW	Scope of Work is being reviewed by the WD.	PNB Board approval expected in the last quarter of 2007.
5 Allacapan LGU	The project involves development of a Level III water system for 10 barangays. Proposed works include: 1. Drilling of four production wells 2. Installation of iron removal facilities 3. Construction of 160 m ³ elevated water tank 4. Installation of: - 12.7 km of 50-150mm PVC pipes - 660 service connections Estimated project cost is P32.63 M.	DBP is reviewing the mode of financing for Allacapan.
6 El Nido LGU	Water Supply Component: Covering six barangays, the proposed project involves the improvement/expansion of the LGU water system. The proposed works include: 1. Drilling of three production wells 2. Construction of 400 m ³ ground reservoir 3. Installation of: - 50-250mm distribution pipes Estimated project cost is P49.4M. Sanitation Component: Involves construction of a separate sewage collection system and a centralized sewage treatment plant (STP). Estimated project cost is P50M+ (SCOTIA).	Detailed design for the water supply component is being finalized by a local engineering firm. The LGU is still evaluating its options, i.e., on its account or through private sector service provision, to implement the project.
7 Cabanatuan City WD	Surface water source development involving construction of intake structures, transmission lines, and a water treatment plant. Estimated minimum project cost is P100M.	FS is being prepared by WD and PWRF team. PWRF TA was extended to the WD for water treatment and financial/economic analyses.
8 Metro Cebu WD Classification: SCW	Bulk water acceptance involves distribution system improvement/expansion (related to Carmen Project). Estimated project cost: P680 million	The Carmen Water Supply Project (Ayala BOT) is still being pursued by the Ayala Group. Issue on the water rights valuation is holding back the 'Swiss Challenge' (required under the BOT Law for unsolicited proposals) WD is also looking at alternative water source development projects (Cotcot and Bonbon rivers), in case the Carmen project does not push through.

WSP	Project Description	Issues/Status
		The WD is preparing for the necessary project studies for these alternative water sources (rough cost estimates at PhP 1.1 billion for the development of the two sources).
9 San Pedro WD: Classification: CW	Project design on-going	FS under preparation by local consulting firm.
10 Tagum WD: Classification: CW	Surface water source development	FS on "hold". PWRF TA for project development offered to WD, but still no response from the WD.
11 Zamboanga WD: Classification: SCW	Pipeline Replacement/ Upgrading and Water Development/ Secondary Line Project. Estimated project cost: P195 million	With an offer for full financing from a private bank, WD still is weighing financing options.
12 Bacolod WD: Classification: SCW	Based on accomplished survey questionnaire (May 2007), the WD is proposing three (3) new projects, with a combined cost of around P490 million. The projects involve new source development (45,000 m ³ /day) and expansion of the distribution system (10% additional coverage).	
13 San Jose Del Monte WD Classification: SCW	Based on an on-going FS by local consulting firm, the project will involve utilization of an additional 30,000 m ³ /day of water supply from MWSS. Estimated project cost: P700M (preliminary)	FS completed on October 2007.
Projects endorsed by DILG (FS prepared under LGUWSP)		
14 Bolinao, Pangasinan	Estimated project cost: P20M (1999-2000 prices)	
15 Polangui, Albay	Estimated project cost: P100M (1999-2000 prices)	MOU with PWRF for technical assistance for signing.
16 Brooke's Point, Palawan	Estimated project cost: P53M (1999-2000 prices)	
17 Narra, Palawan	Estimated project cost: P69M (1999-2000 prices)	
18 Rizal, Palawan	Estimated project cost: P58M (1999-2000 prices)	Endorsed to MDFO.
19 Roxas, Palawan	Estimated project cost: P83M (1999-2000 prices)	

Figure 1. POTENTIAL PROJECTS
Philippine Water Revolving Fund (PWRF)



Technical Assistance to WSPs

Our team provided technical assistance to three (3) WSPs, namely: the Cabanatuan and Puerto Princesa Water Districts, and the Municipality of El Nido in Northern Palawan.

- Cabanatuan City WD

The Cabanatuan WD is evaluating tapping surface water from Pampanga River, which crosses the City, as an alternative source. Presently, the City relies on groundwater only, but rapidly-declining pumping water levels strongly suggest over-utilization of the aquifer beyond its estimated recharge rates. Meanwhile, water demand is projected to increase at an average rate of 3.5% a year. By Year 2025, the maximum water demand is expected to rise to 67,000 m³/day or about 31,000 m³/day more than the present year demand. To ensure stable future water supply in the long-term, it is inevitable for the WD to use the river source in addition to groundwater supplies.



MOU signing for the PWRF technical assistance to the Cabanatuan City Water District (CCWD). Signing for the PWRF and the CCWD are COP Alma D. Porciuncula and GM Mario G. Villasin, respectively.

We assisted the WD in preparing the feasibility study for using Pampanga River as an alternative water source. The TA focused on the development of the water treatment system.

We have deployed the following consultants for the TA: a Water Supply/Project Development Specialist, a Water Treatment Specialist, a Water Resource Specialist and a Riverworks Specialist. A Financial Specialist will later prepare the project financial analysis.

Our consultants reviewed the water demand projections by the WD, data and studies on the yield of both surface and groundwater sources, and made recommendations on the phasing-in of the surface water supply facilities. Considering the complicated physical nature of the sections of Pampanga River within Cabanatuan City, a Riverworks Specialist was tasked to conduct a study on the location, type and design of the water intake structure.

Since there is no available water quality data, the WD had to take several test samples for the feasibility study. The tests took a few months to complete, thus

delaying the analysis of the Water Treatment Specialist on alternative water treatment systems.

- Puerto Princesa

Puerto Princesa Water District is proposing a comprehensive water system expansion and improvement project, which will entail development of new water sources, transmission and distribution lines, and treatment and storage facilities. To expand its bulk water source, the WD is proposing to draw more surface water from Irawan River, which presently partly supplies the

City's needs. A new groundwater well field is also being considered. The WD engaged LWUA for the preparation of the project feasibility study.



Head office of the Puerto Princesa Water District (PPCWD).

As part of our technical assistance to the water district, we reviewed the technical design, conducted the financial analysis and recommended a phased implementation plan that will enable them to meet cash flow requirements for the financing of the project. In particular, we prepared several alternatives on the project development design, especially on the phasing of the source development. These alternatives were evaluated further with respect to their impact on the financial position of the WD, including the necessary tariff rate increases. We recommended deferment of the surface water development and related transmission facilities.

The WD accepted our recommendations and is programming their investment program on this basis. As of this writing, DBP and LGUGC are separately but in parallel evaluating the project for a co-financing arrangement with a commercial bank.



Irawan River, one of the water sources being explored for the proposed PPCWD system expansion and rehabilitation project.

- El Nido

Our team provided technical assistance to the Municipality of El Nido in coordination with SCOTIA, another USAID project. The efforts focused on packaging a combined water supply and sanitation project. The feasibility study of the water supply project was prepared by a local firm and paid for by the Municipality. For the sanitation project, SCOTIA prepared the technical design and cost estimates.



The Municipality of El Nido, which is considering the implementation of a combined water supply and sanitation project. The LGU is being assisted by both PWRF and SCOTIA.

The PWRF reviewed the water supply feasibility study, prepared the financial evaluation of the combined water-sanitation scheme, and advised El Nido on alternative financing schemes, including showing the pros and cons of a PSP modality.

The financial analysis showed that the Municipality cannot afford to do both water supply and sanitation projects. Even the viability of the water supply is dependent on the willingness of the consumers to pay hefty tariffs. In view thereof, the Municipality is entertaining discussions with a private water service provider who claims it can provide water and sanitation services at affordable costs to consumers and without funding support from the Municipality.

Conceptual Framework of a Project Development Facility

Many utilities have highlighted the lack of funds for project development as a key constraint to building a robust pipeline of bankable water supply and sanitation projects.

Our team is drafting a concept paper of a Project Development Facility. It includes a review of the experiences of past and existing project development facilities that are being funded through various donor loan programs. Based on this review and discussions with key sector stakeholders, we have identified options for establishing a credit facility for project preparation. The draft report is expected to be finished in November 2007.

Participation in Conferences/Summits

Members of our team participated in various sector conferences as resource speakers. These conferences include the: East Asia Seas Congress in Hainan, China held in December 2006, Regional Sanitation Summit in Davao City held 26-27 June 2007, SCOTIA's Stakeholders Workshop in Dumaguete held in June 2007, and the LINAW National Conference held last 31 August 2007 in Muntinlupa City, Metro Manila.

3. Water and Finance Sector Strengthening

3.1 Rationalization of Credit Programs for the Water Sector

The rationalization of credit programs remains a priority policy measure of the program to set a level playing field for PWRF. Dr. Gilbert Llanto, a Credit Policy Expert, is leading the effort to prepare the analysis and the recommendations on how to rationalize the credit programs. We conducted one-on-one consultations among the key stakeholders: LWUA, GFIs, donors, DOF, NEDA, DILG, MDFO, private financing institutions and water service providers to ensure that their issues and views are considered. This was complemented by a multi-stakeholder consultation held in July. In September, Dr. Llanto presented the analysis and recommendations on the policy guidelines to the Steering Committee. The draft guidelines are summarized in Table 3. These are currently being reviewed by DOF, who will take the lead in the issuance of the guidelines.

Table 3: Summary of Credit Rationalization Guidelines

Guideline no. 1: Investment Coordination Committee (ICC) to issue a resolution requiring that future access of GFIs to ODA funds will be conditional on the leveraging of these funds with private financial institutions' resources

Guideline no.2: National Credit Council (NCC) to issue a resolution requiring government lending institutions (GFIs, MDFO, LWUA) to align their lending rates with prevailing market rates following government credit policy as enunciated in Executive Order 138; amend the implementing rules and regulations of EO 138 concerning the benchmark for pricing GFI loans to use more-market attuned benchmarks such as the PDST rates.

Guideline no. 3: DOF to send a memorandum to the LWUA Board of Directors enjoining it to pass a resolution directing the management (of LWUA) to adopt a clear policy to facilitate the grant of a waiver to water districts seeking loans from other lending institutions.

Guideline no.4: DOF to issue a memorandum to LWUA informing it of the need to allow water service providers/water districts/water utilities to have a free hand in accessing financing from any lending institution.

Guideline no. 5: DOF to issue a memorandum to LWUA directing it to use the classification of water districts/water utilities as an instrument for identifying potential candidates for technical assistance/grant from the government.

Guideline no. 6: DOF and LWUA to develop a water subsidy program that will provide time-bound technical assistance and/or grants (output-based subsidies) to less than creditworthy water utilities conditional on certain performance indicators and covenants. LWUA will implement an output-based subsidy program.

Guideline number 7: DOF to review the capacity of LWUA to perform its new mandate.

3.2 Pooled Bond Financing Conceptual Framework

We engaged Mr. Lyndon Saulog, a domestic bond market specialist to prepare this study. Having worked previously on bond issues and structured financing, we assigned him to prepare a framework to facilitate the transition of the PWRF from loans to capital market financing via securitization or pooled bond offering for water infrastructure projects. He identified the options for the paper's issuer, which can be an existing juridical entity such as LWUA or DBP or a Special Purpose Trust. He also mapped out the structure of the issue and recommended financing incentives to encourage banks to buy the securities. This paper together with the insights gained in the study tour will inform the long-term financing plan for the PWRF.

3.3 Financing Incentive for PFIs

In various consultations, PFIs consistently identified financing incentives that will push their decision to invest. These are: eligibility of water loans and bonds as alternative compliance to the mandatory credit of the Agri-agra law and as reserve requirements³. Banks find it difficult to comply with these two requirements of the Central Bank, and at times pay penalties for non-compliance.

With the help of Ms. Mariles Navarro, a Water Sector Policy Specialist, we drafted a position paper for DOF to request the Central Bank to allow water loans and bonds as alternative compliance to the Agri-agra law. The position paper justifies the social

³ The Agri – Agraria Law (Presidential Decree No. 717), *Providing an Agrarian Reform Credit and Financing System for Agrarian Reform Beneficiaries through Banking Institutions* was enacted into law in May 1975. The Law aims at enhancing the flow of credit to agriculture and agrarian reform. It requires, among others, all banking institutions, both government and private, to set aside at least 25% of loanable funds³ for agricultural credit in general.

The reserve requirements refer to Central Bank's mandatory minimum reserves to cover for deposits to Banks.

and economic benefits of water projects and in particular, how these benefits redound to the target beneficiaries of the Agri-agra law. We also cited precedents of alternative compliance, such as socialized housing, education and health projects. The draft position paper has been submitted to and is currently being reviewed by DOF.

3.4 LGUGC Technical Assistance

The PWRF Support Program is providing technical assistance to LGU Guarantee Corporation on two critical institutional capacity building requirements. The first is the formulation of policy guidelines and formula for pricing guarantee fees. This TA is being provided in coordination with USAID's Development Credit Authority. Two DCA resources, Messrs. Reid Click and Ed Roche will work with our local team to prepare the pricing policy framed by three inter-related factors on credit guarantees: rating, pricing, and provisioning. The team will take into account the three features that LGUGC identified: i) risk and return conditions; ii) cost of operations; and iii) competitiveness in the market.

The second TA deals with the preparation of a credit rating system for water districts. LGUGC will use this system for credit scoring of utility borrowers. This TA is scheduled to commence in November 2007.

4. *General PWRF Support Program*

Our team serves as the technical secretariat to the PWRF Steering Committee. We organize the meetings, prepare the agenda and the analysis papers, facilitate the discussions and draft the minutes of the meetings. This year three meetings were held and were used to discuss and resolve issues.

We also provided overall support to the USAID – JBIC collaboration, such as organize monitoring meetings and provide inputs to internal reports or papers.

We have started the preparation of a PWRF website, but will hold off with the set-up until the program is launched.

Chapter IV: Level of effort (person-days)

Position	Budget LOE	LOE Used (July - Sept 2007)	LOE Used (Oct 2006 - Sept. 2007)	Remaining LOE Sept. 2007
DAI				
LTTA				
Alma Porciuncula Chief of Party	204.0	76.3	198.25	5.75
Project Management & Administration				
Aida Mendoza Administrative Support Specialist	220.0	592.5	215.06	4.94
Liza Cruz Exec. Asst & Bookkeeper	260.0	557.0	231.63	28.37
Home Office Support				
Del McCluskey Home Office Technical Support	47.0	25.6	46.25	0.75
Cannady/Melazzo/Cunningham Project Associate	30.0	9.1	12.01	17.99
Pricing Policy STTA-DAI	47.0	-	0.00	47.00
STTA				
Gilbert Llanto Senior Policy/Institutional Specialist	30.0	30.0	30.00	-
Antonio De Vera Senior Legal Specialist	15.0	4.0	4.00	11.00
Cecilia Soriano Senior Financial Policy Specialist	20.0	10.0	10.00	10.00
Lyndon Saulog Water Sector & Institutional Finance Specialist	20.0	-	0.00	20.00
Manuel Gonzales Senior Legal/Policy Financing Specialist	20.0	-	0.00	20.00
George Calderon	3.0	3.0	3.00	-
Anna Maria Mendoza	20.0	-	0.00	20.00
Subtotal LOE -DAI	936.0	1,307.5	750.2	185.8
SUB CONTRACTS				
TCGI				
LTTA				
Antonio Pantillano Senior Sanitation Infrastructure Financing Specialist	192.0	79.0	184.00	8.00
STTA				
Billand/Painter Senior Advisor	21.0	6.4	17.57	3.43
Matzie Mid Level Specialist	6.4	-	0.00	6.40
Subtotal LOE -TCGI	219.4	85.4	201.6	17.83
CEST				
LTTA				
Mariles Navarro/TBD Senior Policy Framework Specialist	65.0	-	1.50	63.50
Ferdinand Asuncion Senior Project Specialist	143.0	65.4	125.25	17.75
STTA				
Andrew Montalbo	20.0	1.0	1.00	19.00
Edmund Piquero	20.0	3.0	3.00	17.00
Mariles Navarro	20.0	15.0	15.00	5.00
Leila Flores	20.0	6.0	6.00	14.00
Enrico Gregorio	20.0	4.0	4.00	16.00
Subtotal LOE -CEST	308.0	94.4	155.8	152.3
TOTAL PROGRAM LOE	1,463.4	1,487.3	1,107.6	355.9

Note: Ms. Navarro opted to work as an STTA.

Annex 1. List of Reports, Workshops and Steering Committee Meetings

Table 1: PWRF Reports in Year 1

Title of Report	Status	Prepared by
Paper on the Proposed Inclusion of PWRF Lending as a Mode of Alternative Compliance to the Agri-Agra Law (PD 717)	Draft final report submitted to DOF	Mariles Navarro
Rationalization of Credit Programs for the Water Sector	Draft final report submitted to DOF and Steering Committee	Gilbert Llanto, PhD
Philippine Water Bond Conceptual Framework	Ongoing	Lyndon Ner Saulog
Concept Paper on the Project Development Facility	Ongoing	Ferdinand Asuncion
Business Planning Framework for Water Service Providers	Ongoing	Antonio de Vera
Integrated PWRF-EDP Operating Policy Guidelines (5 th Version)	Draft final report submitted to DBP	Rodolfo Pantillano
Operating Guidelines for the MDFO Standby Credit Facility	Draft final report submitted to MDFO	Rodolfo Pantillano
TA assessment report and scopes of work for each LGU interested in the PWRF	Ongoing	Leila Flores/Ferdinand Asuncion
Report on the US Study Tour on Water Revolving Funds	Submitted to participants	Del McCluskey, Alma Porciuncula, Audi Pantillano

Table 2: Consultations and Workshops

Consultations/ Workshops	Date/Venue	No. of Participants
1. PFI Consultations: meeting with account officers and credit board representatives of PFIs to confirm PFI interest on PWRF	December 5, 2006/DBP Head Office	30
2. Workshop for DBP: Experiences on Revolving Funds and the PWRF Financing Arrangement	March 13, 2007/ Suite 5, 12/F, DBP Bldg.	17
3. Workshop for DOF: Experiences on Revolving Funds and the PWRF Financing Arrangement	March 16, 2007/ Visayas Room, 6/F, DOF Bldg	20
4. Stakeholders' Consultation on the Rationalization of Credit Programs for the Water Sector	July 17, 2007/ Heritage Hotel, Pasay City	31

5. Training on Water Sector Overview and Water Supply and Sanitation Project Appraisal	August 22 & 23, 2007/Sapphire Room A, Crowne Plaza Galleria Manila Hotel, Pasig City	27
6. PWRF Briefing and Consultations with DBP Regional Marketing Centers for Luzon	September 5, 2007/Suite 5, DBP Head Office, Makati City	45
7. PWRF US Study Tour	September 17-22, 2007/USA	7
8. Water Donors Meeting (sponsored by USAID)	October 3, 2007/ Ballroom B, G/F, Dusit Hotel Nikko Ayala Center, Makati City	28

Table 3: Schedule of PWRF Steering Committee Meetings

Steering Committee Meeting	Date/Venue
1. Joint Meeting of the Steering Committee and Technical Working Group	November 8, 2006/Emilia Room, Dusit Hotel Nikko Manila
2. Meeting of the Steering Committee - Philippine Water Revolving Fund Support Program	March 6, 2007/IFG Conference Room, 5/F, DOF Bldg.
3. Meeting of the Steering Committee - Philippine Water Revolving Fund Support Program	September 5, 2007/IFG Conference Room, 5/F, DOF Bldg.