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## Challenges and Opportunities in Subnational Public-Private Partnerships in the Philippines

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DISCUSSION PAPER SERIES NO. 2024-43

# Challenges and Opportunities in Subnational Public-Private Partnerships in the Philippines

*Adoracion M. Navarro*



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# Challenges and Opportunities in Subnational Public-Private Partnerships in the Philippines

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## **Abstract**

If designed and implemented well, public-private partnership (PPP) projects can fill the gaps in the public provision of infrastructure facilities and social services at the subnational level. The more than three decades of implementing subnational PPPs in the Philippines brought to the fore many challenges, partly due to capacity gaps at the subnational level and the fragmentation in the previous legal frameworks. The fragmentation was characterized by varying and inconsistent local legislative council ordinances on PPPs and joint ventures in the case of local government units and the nationally designed joint venture guidelines in the case of water districts. The policy environment has evolved from a fragmented one to having a legal framework that unifies the various policy approaches of subnational entities. Going forward, the new PPP Code can help subnational government entities be more judicious in entering into new PPP contracts. However, some of the ongoing and newly awarded contracts have remaining issues that will still have to be resolved. One possible solution is contract redesign or amendment when the existing contract is burdensome to the end-users or has the potential to make the end-users unnecessarily bear a huge part of project performance risks. This is permitted under Section 19 of the new PPP Code. Moreover, execution level policymaking should continue, such as the updating of joint memorandum circulars, the revision of manuals and guidelines, the updating of PPP Governing Board policies, and new policies for maximizing commercial value capture or land value capture. To address knowledge and capacity gaps, new technical assistance support for capacity building must be put together. A community of practice must also be supported. Lastly, the promotion of subnational PPPs in sectors where the PPP program can be expanded should also be pursued.

**Keywords:** subnational public-private partnerships, PPP Code, PPP policy framework, PPP pipeline, contract design, regulation by contract

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# Challenges and Opportunities in Subnational Public-Private Partnerships in the Philippines

***Adoracion M. Navarro\****

## **1. Introduction**

Public-private partnership (PPP) is one mode of financing and implementing projects at the subnational level and Philippine regional socioeconomic development plans under various administrations have been promoting this. Some local governments' comprehensive development plans also propose PPPs. If designed and implemented well, PPP projects can indeed fill the gaps in the public provision of infrastructure facilities and social services at the subnational level.

The Philippines already has 33 years of experience in pursuing PPP subnational projects, starting with a build-transfer contract for the Mandaluyong City public market in 1991. But there are knowledge gaps on the lessons from experience because there is scant research on subnational PPPs in the Philippines. Among the available research are reports by two multilateral agencies and these cover various sectors. The Asian Development Bank (ADB) examined PPPs by local government units (LGUs) as part of its analytical and advisory support to the Philippines and the report informed the reforms supported by the ADB's PPP technical assistance to the country (ADB 2016). The World Bank (WB) presented brief case studies from various countries in its modular guidelines on municipal PPPs and included three Philippine cases (WB 2019). There are sector-specific researches on PPPs that contain subnational PPPs, such as Banzon et al. (2013) on local health PPPs and Ballesteros and Ancheta (2022) on agriculture value chains with LGU participation, but the discussions have not been comprehensive. This study therefore helps fill the knowledge gaps on Philippine subnational PPPs.

At the same time, recent developments on the policy front make this study highly relevant. In 2019, the Supreme Court ruled on the Mandanas-Garcia case and expanded the revenue base for computing the LGUs' share in national tax revenues (the "Mandanas-Garcia ruling" hereafter). In 2023, the Philippine Congress enacted Republic Act (RA) 11966 or the PPP Code, which replaced the fragmented policy frameworks for the Philippine PPP program. Policymakers and stakeholders will thus benefit from the examination of the remaining challenges that may have to be addressed to take advantage of opportunities made possible by these policy developments. Moreover, policymaking and decision-making will be supported by the identification of the remaining policy gaps, most of which are at the execution level, that are necessary to expand the pipeline of subnational PPPs.

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Using desktop review and focus group discussion as main research methods, this study aims to: analyze the challenges encountered and lessons learned from subnational PPPs under the previous policy frameworks (mainly RA 6957, as amended by RA 7718, and supplemented by other policies); examine possible areas or sectors where a pipeline of subnational PPPs can be generated given the new PPP Code, additional LGU resources resulting from the Mandanas-Garcia ruling, and the devolution of national government programs; and derive policy insights and recommendations.

This paper structures the research into four sections, starting with this section on the introduction. Section 2 discusses the previous and current policy and legal frameworks for subnational PPPs. Section 3 then explains the challenges encountered in projects implemented under the old legal framework, the challenges that remain or are anticipated under the new legal framework, and the opportunities that can be tapped given the recent policy developments. Section 4 concludes and provides policy recommendations.

## **2. Evolution of the policy environment and the investment pipeline**

### ***2.1 Coverage of subnational PPPs***

Since an important feature of the evolution of the policy environment and the investment pipeline for subnational PPPs is the coverage of subnational PPPs, a clarification on the concept is in order. Subnational PPPs are those PPP arrangements entered into by government entities below the national level, such as provinces, cities, municipalities, and subnational public enterprises, with their private sector partners. The Organisation for Economic Co-operation and Development (OECD) uses the term without defining it but clarifies that most PPPs in the OECD region happen at the subnational level and provides examples at the level of states, cities, and local authorities (OECD 2018). The World Bank uses the term "municipal PPPs" and treats it as covering various forms of subnational government bodies in different countries (World Bank 2019). The ADB uses the term "local PPPs" in its assessment of the Philippine experience (ADB 2016) because the legal frameworks in the country uses this term.

Before the enactment of RA 11966, the policies for subnational PPPs distinguished "local PPPs" from national PPPs and considered in the category those PPPs implemented by LGUs, LGU-created commercial enterprises, LGU-managed distribution utilities, local universities and colleges (which are also run by LGUs), and water districts. The pipeline of local PPPs in the PPP Center monitoring system also included water districts. Under RA 11966, however, PPPs entered into by water districts are now considered national projects. Water districts in the Philippines are considered government-owned and controlled corporations (GOCCs)<sup>1</sup> and RA 11966 considers GOCC-implemented PPPs as national PPPs.

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<sup>1</sup> As declared by the Supreme Court on September 30, 1991 in G.R. No. 95237-38, Davao City Water District et al. vs. Civil Service Commission.

Nevertheless, this study deems it proper to include water district PPPs in the study of subnational PPPs given that they share many characteristics with PPPs involving LGUs or LGU-run entities, namely:

- (a) a water district's service area is limited by the geographic scope of the LGU where the water district was created<sup>2</sup>;
- (b) the principles for effectively and efficiently operating water districts are the same as those for LGU-run water distribution utilities;
- (c) in water districts, the appointing authority for the board of directors is the local chief executive (except for one seat in case the water district has availed of financial assistance from the Local Water Utilities Administration (LWUA), in which case the appointing authority is LWUA), similar with LGU-run entities where the appointing authority for the governing board or top management is the local chief executive; and
- (d) the end-users of the PPP facility are the local population within the LGU.

Although water districts now strictly follow the review and approval processes for national PPPs given the new legal framework, they will significantly benefit from the interventions meant to beef up the capacity of LGUs to pursue PPPs, such as interventions related to capacity building, subnational risk management, and credit enhancements. Thus, it will help water sector development in the countryside if assessments cover the water sector challenges and opportunities in the subnational PPP landscape.

## ***2.2 Evolution of the policy and legal frameworks***

The first law for PPPs in the Philippines, RA 6957 or the erstwhile Build-Operate-Transfer (BOT) Law which was enacted in 1990, specifically included LGUs and GOCCs in the government entities authorized to enter into contracts with private sector proponents under BOT or build-transfer (BT) schemes. It also required that the BOT or BT projects be part of their priority infrastructure programs and be confirmed by their local development councils. The Local Government Code of the Philippines, RA 7160 enacted in 1991, confirmed the authority of LGUs to enter into BOT projects under RA 6957. It also stipulated additional terms and conditions, such as notification and public bidding requirements.

In 1994, RA 7718 amended RA 6957. The amended BOT Law expanded the types of contracts that can be entered into by government entities. It also maintained the inclusion of LGUs and GOCCs as implementing agencies for BOT contracts and other variants and provided the principles and procedures for handling unsolicited proposals and direct negotiation of contracts.

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<sup>2</sup> Presidential Decree (PD) 198, as amended, authorizes the local legislative body or *sanggunian* of any city, municipality, or province to create a water district.



In addition to the requirement that local development councils confirm the projects of LGUs, the amended BOT Law established cost thresholds on the levels of council confirmation, as follows:

- a. municipal development council confirmation – for project cost of up to 20 million pesos (PHP) project cost
- b. provincial development council confirmation – for project cost above PHP20 million and up to PHP50 million
- c. city development council confirmation – for project cost of up to PHP50 million
- d. regional development council confirmation – for project cost above PHP40 million and up to PHP200 million
- e. National Economic and Development Authority (NEDA) Board-Investment Coordination Committee (ICC) confirmation – for project cost above PHP200 million

In the case of water districts, joint ventures had been the frequently preferred contractual arrangement by the contracting parties. The Guidelines and Procedures for Entering into Joint Venture Agreements (JV) between Government and Private Entities issued by NEDA pursuant to Section 8 of Executive Order (EO) 423, series of 2005, became the policy framework. LGUs are not covered by the NEDA JV Guidelines, but the LGUs that implemented PPPs took inspiration from the NEDA JV Guidelines in forming their own JV ordinance, as they did with the amended BOT Law when they enacted their own PPP ordinance.

To clarify the policy environment and procedural requirements, the Department of the Interior and Local Government (DILG) also issued various circulars on its own or jointly with the PPP Center. The PPP Governing Board, an inter-agency body responsible for strategy setting in the overall PPP program and handling the policy concerns on the Project Development and Monitoring Facility (PDMF, a revolving fund), also issued various resolutions on specific subnational PPP policy concerns. The PPP Center also formulated a pro forma LGU PPP Code that served as a guide for local legislative councils, and published a PPP manual and a joint ventures guidebook for LGUs.

In 2023, RA 11966 or the PPP Code of the Philippines unified the legal frameworks by covering all the contractual arrangements under RA 6957, RA 7718, and NEDA JV Guidelines, as well as other potential contractual arrangements that fit the risk-sharing and financing arrangements described by the PPP Code. It also institutionalized the PPP Governing Board and the PDMF.

Given that the new PPP Code unified the legal framework for the national and local levels, LGUs no longer need to enact their own local PPP codes. The new law already provides guidelines for LGUs on detailed PPP procedures, such as but not limited to:

- a. determining completeness of project proposals;
- b. setting minimum parameter, terms, and conditions in the contracts;
- c. using criteria for approval of local PPPs; and
- d. setting parameters for detailed evaluation of unsolicited proposals.

The new PPP Code also removed the cost thresholds for levels of approval of local PPPs and stipulated that local PPPs shall be approved by the respective local council of the concerned LGU, or by the governing boards of the local universities and colleges (LUCs) in PPPs implemented by LUCs. Local PPPs that propose national government undertakings, however, will have to secure endorsement by the regional development council (RDC) in the region where the local PPP is located, and approval by the NEDA Board-ICC upon favorable RDC endorsement. Local PPPs that will affect the development plans of the national government or national projects (e.g., if there are overlaps in project route alignment) will also have to secure RDC endorsements.

Since water district projects are categorized as national PPPs, the cost threshold applies. National PPPs that cost PHP15 million and above need ICC evaluation and NEDA Board approval.

### *2.3 Evolution of the subnational PPP investment pipeline*

The first subnational PPP under the Philippine PPP program is the Mandaluyong City Public Market build-transfer project in 1991 that involved the reconstruction of the public market that was destroyed by fire at a time when the city government did not have adequate funds for rebuilding. Under the contractual arrangement, the transfer is not immediately after the construction but after the 40-year contract period. The city government retained ownership of the land. It is also responsible for operating the market and collecting fees from tenants. The private partner, on the other hand, is responsible for security and maintenance. In lieu of the city government paying lease to the private partner, the latter generates revenues from the commercial complex portion of the public market. The World Bank considers the Mandaluyong City Public Market PPP a success story (World Bank 2019).

Other public market PPPs followed suit. Public markets, slaughterhouses, and property development then became the frequently preferred PPP projects by LGUs in the succeeding years. Given the digitalization drive in LGUs, information and communications technology (ICT) PPPs also followed. By 2004, property development and ICT projects dominated the list of operational local PPPs. The operational local PPPs as of 2004 consisted of five public markets, one slaughterhouse, one city hall development, three ICT projects, one electric power system, and one waterworks system (ADB 2016).

At present, local PPPs cover more sectors, as shown by data on concluded, terminated, and operational local PPPs as of August 22, 2024<sup>3</sup> (see Table 1). Note that the projects categorized under the “agriculture/food security” sector are mostly public market or slaughterhouse projects.

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<sup>3</sup> The complete list using other categories of project status (e.g., awarded, under construction, or under negotiation) is not available because the status of 11 projects and the sectoral category of 2 projects in the list are still being verified as of this writing.

**Table 1. Number of concluded and operational local PPPs by sector, as of August 22, 2024**

<b>Sector</b>	<b>Concluded</b>	<b>Terminated</b>	<b>Operational</b>
Agriculture/Food Security		3	11
Energy	1		
Health		1	1
Information and Communications Technology (ICT)	3	1	6
Port			2
Property Development	1	3	7
Road			1
Solid Waste Management			3
Terminal			2
Tourism			1
Water and Sanitation	1		5
<b>Total</b>	<b>6</b>	<b>8</b>	<b>39</b>

Note: Concluded means the PPP period has ended. Terminated means the contract was rescinded before the end of the originally stated contracting period.

Source: PPP Center (2024a).

In terms of value, the local PPPs as of December 4, 2024 consist of PHP740.64 billion PPPs under implementation, PHP196.82 billion PPPs in the pipeline, and PHP2.41 billion PPPs that are either concluded or terminated (see Table 2). There are more unsolicited local PPPs than solicited local PPPs under all project status categories. Relative to national PPPs, local PPPs are also fewer in number and have lower project cost.

**Table 2. Summary of PPP projects as of December 4, 2024**

<b>Project category and procurement mode</b>	<b>Number of projects</b>	<b>Estimated project cost</b>	
		<b>in billion PHP</b>	<b>in billion USD<sup>1</sup></b>
<b><u>PPP Projects Under Implementation</u></b>	<b>218</b>	<b>3,347.30</b>	<b>66.95</b>
<b>National</b>	<b>134</b>	<b>2,606.66</b>	<b>52.13</b>
<i>Solicited</i>	39	1,080.92	21.62
<i>Unsolicited</i>	90	1,119.22	22.38
<i>For verification of procurement mode</i>	5	406.51	8.13
<b>Local</b>	<b>84</b>	<b>740.64</b>	<b>14.81</b>
<i>Solicited</i>	15	1.22	0.02
<i>Unsolicited</i>	62	739.42	14.79
<i>For verification of procurement mode</i>	7	0.00	0.00
<b><u>PPP Projects in the Pipeline<sup>2</sup></u></b>	<b>176</b>	<b>2,549.07</b>	<b>50.98</b>

Project category and procurement mode	Number of projects	Estimated project cost	
		in billion PHP	in billion USD <sup>1</sup>
<b>National</b>	<b>116</b>	<b>2,352.25</b>	<b>47.04</b>
<i>Solicited</i>	82	1,177.55	23.55
<i>Unsolicited</i>	34	1,174.69	23.49
<b>Local</b>	<b>60</b>	<b>196.82</b>	<b>3.94</b>
<i>Solicited</i>	19	8.07	0.16
<i>Unsolicited</i>	41	188.75	3.78
<b><u>Concluded and Terminated PPP Projects</u></b>	<b>56</b>	<b>313.97</b>	<b>6.28</b>
<b>National</b>	<b>42</b>	<b>311.55</b>	<b>6.23</b>
<i>Solicited</i>	37	268.60	5.37
<i>Unsolicited</i>	4	42.95	0.86
<i>No available information on the procurement mode</i> <sup>3</sup>	1		
<b>Local</b>	<b>14</b>	<b>2.41</b>	<b>0.05</b>
<i>Solicited</i>	5	0.71	0.01
<i>Unsolicited</i>	9	1.71	0.03

Notes:

<sup>1</sup> Using USD1 = PHP50 conversion rate.

<sup>2</sup> Pipeline refers to projects under procurement, comparative challenge, negotiation, approval by relevant approving bodies, development, conceptualization, evaluation by implementing agencies (IAs), and unsolicited projects endorsed to the IA by the PPP Center after being determined to be complete pursuant to Section 10 of the PPP Code.

<sup>3</sup> This refers to the Subic Zambales Diesel Power Plant 1 project of the National Power Corporation (NPC). According to NPC, there are no available project documents on procurement mode and approved project cost. NPC is certain that this is a PPP project, hence it was still listed in the PPP Center project database.

Source: PPP Center (2024b).

Under the new legal framework provided by the PPP Code, ten proposals for local PPPs have already been submitted as of December 10, 2024. However, all of these are unsolicited PPPs and the PPP Center are conducting completeness checking of the proposals.<sup>4</sup>

### 3. Challenges and opportunities

#### 3.1 Challenges encountered in Philippine subnational PPPs

The ADB assessment in 2016 showed that projects implemented by LGUs using BOT or similar schemes encountered the following challenges, among others: transparency in bidding out the PPP project; start-up delays due to permits and right-of-way issues (among other causes of delays);

<sup>4</sup> As communicated by the PPP Center representatives during the December 10, 2024 focus group discussion between the author and national government agency representatives.

subnational entities' capacity to enforce viable tariffs and fees; delays in regulator's approval of tariffs or lack of tariff regulator in the sector; unreliable concessionaire/private partner's performance; weak subnational capacity in contract preparation, negotiation and finalization; inadequate sectoral expertise at the subnational level; and limited time frame for LGU chief executives in undertaking new PPPs (ADB 2016). In one case study, the World Bank in 2019 also discussed how failing to secure stakeholder buy-in as early as possible contributed to distrust by users even after facility completion, leading to unsustainability of the partnership (World Bank 2019).

A focus group discussion<sup>5</sup> that was conducted for this study revealed that in addition to the above-mentioned issues, the following challenges also hounded the subnational PPP landscape. The new PPP Code addresses these challenges, though it is still too early to say how effectively it does so.

**Some local PPP ordinances deviated from good practices in upholding transparency and value for money.** The ideal is for LGUs to adopt best practices in adopting transparency mechanisms and ensuring that the project gives value for money. But as LGUs enacted their own legislation for implementing PPPs, the responsiveness of legal frameworks to what is required by PPPs became inconsistent across LGUs. Lack of competence or experience in crafting responsive local legislation on PPPs partly explains some of the disadvantageous subnational PPP deals. The new PPP Code is supposed to address this as the law now provides the unifying legal framework for all local PPPs.<sup>6</sup> The PPP Governing Board is also empowered to issue rules for local PPPs, effectively centralizing the rulemaking power on all local PPPs to this Board, with the aim of ensuring that rules are rational and harmonized across LGUs. The PPP Code also strengthened the ability of implementing agencies to request policy opinions from the PPP Governing Board and non-policy opinions from the PPP Center.

**Shortcuts in the development stage and lack of due diligence during contract review led to risks not being properly identified and mitigated.** As a result, key performance indicators (KPIs), which were supposed to address project construction risks and project lifetime risks, were either not identified or improperly identified. This had been the usual case in water district joint ventures. In water district joint venture agreements, issues related to KPIs fell into the following categories: (a) complete absence of contractual provisions on KPIs; (b) KPIs are to be determined only after a year or a few years from contract signing; and (c) KPI contractual provisions exist but penalties for not achieving the KPIs are absent. Going forward, this practice is supposed to be eliminated as the new PPP Code requires all implementing agencies to evaluate and render decisions on PPPs based on project-specific parameters, terms, and conditions (PTCs). These PTCs include project scope, service level requirements, KPIs, safeguards, and penalties.

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<sup>5</sup> On December 10, 2024, the PIDS study team held a focus group discussion with representatives from the PPP Center, NEDA, and DILG. The DOF group handling PPPs sent in writing their specific answers to the FGD questions and the answers were considered part of the FGD results. Invitees who were unable to participate in the FGD were representatives from the Commission on Audit and the Union of Local Authorities of the Philippines.

<sup>6</sup> Local PPPs are defined in the law as those PPPs implemented by LGUs and LUCs with their private sector partners.

**Proper contract management systems were lacking, and contract oversight was ambiguous in older PPP contracts.** As many PPPs are long-term undertakings, a proper contract management system is needed to follow up the commitments of contracting parties. Some of the older PPP contracts lacked provisions on contract monitoring and dispute resolution and had no clear oversight mechanisms. This limited the authority of LGUs and water districts to oversee projects and weakened the accountability of the private partners, resulting in compromised service quality. This, however, is being addressed by the new PPP Code through mandatory contract management and risk mitigation plans, dispute avoidance and dispute resolution mechanisms, and project supervision and monitoring. Under the old legal framework, the lack of standardized guidelines and unclear lines of authority in reporting issues created gaps in oversight and lowered accountability. The new PPP Code unified the monitoring and reporting standards to address these issues and boost stakeholder confidence in the PPP scheme.

**In many cases, the tariff regulation scheme to be followed was not anticipated early enough during contracting or, in cases when regulation by contract was already resorted to, the contract lacked robust tariff setting and adjustment mechanisms.** The absence of a dedicated regulatory body that approves base tariffs and adjustment mechanisms in LGUs and the existence of sector regulators at the national level can create confusion during the project development stage, such as what happened in the Cebu-Cordova Link Expressway (see Box 1). Regulation by contract was the frequent recourse and yet many subnational implementing agencies lacked the capacity to set, review, and approve tariffs and rates. As a result, many PPP contracts lacked tariff adjustment mechanisms that could respond well to the cost implications of economic shocks, or the PPP implementation had inconsistencies in rate setting. The result in some cases were strained project finances, lower project viability, increased consumer costs, and risks of service disruptions. The PPP Code addresses the tariff regulation issue in local PPPs by requiring that the maximum base tariffs and the adjustments for these be stipulated in the contract and by providing the LGU or LUC the option to create a local rate setting body. In the case of tariff regulation of water district PPPs, however, the jurisdiction issue between the Local Water Utilities Administration (LWUA) and the National Water Resources Board (NWRB) is still an unsettled one. Some of the water districts that entered into joint venture agreements claimed that they are outside the jurisdiction of LWUA and argued that the NWRB is the appropriate regulator.

#### **Box 1. The case of the Cebu-Cordova Link Expressway project**

The Cebu-Cordova Link Expressway (CCLEx) is an 8.9-kilometer toll bridge that links Cebu City and Cordova municipality. The Metro Pacific Tollways Corp. (MTPC) proposed it as an unsolicited joint venture proposal to the two LGUs in 2014 to decongest traffic in the two bridges linking Cebu City and Mactan Island, which is composed of Lapu-Lapu City and Cordova municipality. After the review period and no other proponent challenged the unsolicited proposal, the joint venture agreement with the LGUs was concluded in April 2016 and the Cebu Cordova Link Expressway Corporation (CCLEC) was created to manage the project. The CCLEC was granted the concession to finance, design, construct, operate and maintain the CCLEx in October 2016. The concession agreement is for a period of 35 years, after

which the toll bridge facility will be turned over to the two LGUs. The project was completed and opened to vehicles in April 2022.

With respect to toll regulation, the initial design was for the Toll Regulatory Board (TRB) to be the regulator, but the TRB eventually clarified that it does not have jurisdiction over local toll roads. The resort had been to create a toll regulatory council with the participation of the two LGUs involved in CCLEx. The October 2016 concession agreement was amended in January 2019 to incorporate this change, adding delays to project milestones.

The amended concession agreement required each of the two LGUs to enact an ordinance for the creation of the local toll regulatory council (LRTC), which the LGUs passed in August 2021. The established LRTC consists of five members—one member appointed by the Cebu City government, one member appointed by the Cordova municipal government, and three members jointly appointed by the LGUs (as grantors of the concession) from a list of nominees submitted by CCLEC (the concessionaire). The amended concession agreement empowered the LRTC to issue, amend, and adjust the toll rates charged to the direct users of the toll bridge. It also authorized the LRTC to establish secretariat, technical and legal offices to assist the regulator in performing its mandate under the contract. The operational and administrative expenses of the LRTC are charged to the concessionaire and are limited by the allowable overhead expenses detailed in the contract.

**Overlaps in scope and alignment of infrastructure projects and inter-dependencies of projects were weakly considered.** A project that has overlaps with another project in the same sector can be quickly addressed at the national level since there is only one sectoral agency implementing the projects. In the case of subnational PPPs, correcting the overlaps and managing the inter-dependencies became difficult as project milestones were pursued despite coordination deficiencies with the implementors of other projects where there were overlaps or interdependencies. Such had been the case in the Makati Intra-City Subway project, which was supposed to approach the alignment of a subway project implemented by the national government (see Box 2). The new PPP Code is now aiming to address this challenge by requiring local PPPs that affect national or sectoral development plans and national projects to secure national government endorsement through the regional development council where the LGU is located. Moreover, the law now requires an interconnection or interface plan from a PPP project that will interconnect or interface with an existing or proposed local or national infrastructure facility. The plan should be formalized in a memorandum of agreement among concerned parties.

#### **Box 2. The case of the Makati Intra-city Subway project**

The Makati Intra-city Subway project was an unsolicited joint venture project proposed in 2018 to the Makati City government by a consortium composed of Filipino firm IRC Properties, Inc. and its Chinese partners Greenland Holdings Group, Jiangsu Provincial Construction Group Co. Ltd., Holdings Ltd., and China Harbour Engineering Company Ltd. It was supposed to be an 11-kilometer subway with 10

underground stations and connections to the Metro Rail Transit Line 3, the Pasig River ferry system, and the then proposed Metro Manila Subway system.

No other proposal was received during the comparative challenge period and the Makati City government and the Philippine Infradev Holdings, Inc., the new name of IRC Properties, Inc., signed the joint venture agreement in October 2019. Under the agreement, the Makati City government's contribution is land. The private partner is in charge of building, operating, and maintaining the subway.

However, against this backdrop was a long-standing dispute between Makati City and Taguig City governments over territorial jurisdiction in some areas that will incidentally be traversed by the intra-city subway. On September 28, 2022, the Supreme Court ruled with finality that the areas that had been contested since 1993 belong to Taguig City. The ruling affected a planned depot and two planned stations, which were decided as actually part of Taguig City. Since the project is supposed to be intra-city, within Makati only, the subway route will have to be shorter and the project will no longer become economically viable. Eventually, the private partner declared in September 2023 that the project is no longer feasible and stopped its construction activities. It also sent to Makati City government a Notice of Intent to discuss the implications of the Supreme Court ruling.

The experience not only highlights the importance of early and sustained coordination to address overlaps, interconnection, and interface in subnational PPPs. It also stimulated discussions within government on whether large interconnecting transport projects such as subways and airports should be pursued by LGUs on their own or these should be primarily the responsibility of the Department of Transportation.

**There were persistent capacity and knowledge gaps in addressing political risks and termination risks through contract design such as provisions for material and adverse government action (MAGA) and termination events.** In the PPP Center's list of local PPP projects being monitored for MAGA (including change in law) and termination procedure provisions, many contracts have no provisions on MAGA nor termination procedures. As of December 13, 2024, out of 70 local PPP contracts that are with the PPP Center, 31 contracts (44.29%) have no MAGA provisions and 14 contracts (20%) have no provisions on termination and consequences of termination.<sup>7</sup>

**The absence of dedicated PPP units in many LGUs and water districts weakened the prioritization of project implementation or hampered project oversight and contract management after the change in political administration.** Most of the time, the PPP unit heads were newly appointed and lacked the technical know-how to manage PPPs, or were designated PPP focal persons only and handle other duties and responsibilities within the local government. This is one of the findings of the DILG when it developed an online

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<sup>7</sup> This is not based on the complete list of all awarded local PPP projects because the list of awarded local PPP contracts for monitoring is still being built up by the PPP Center. Moreover, the agency's efforts to validate the list is ongoing through coordination with implementing agencies, project site visits, and contract review.



monitoring portal for local PPPs.<sup>8</sup> Populating and updating the portal had been difficult because of the absence of dedicated PPP units and personnel.

**In water district joint ventures, there were too many issues related to lack of competition, incompleteness of contracts, and procedural lapses in evaluation.** Table 3 lists the issues based on the review of 121 signed water district joint venture agreements (JVAs). Per the old joint venture guidelines, implementing agencies were required to submit the signed JVAs to the NEDA as the guidelines designated the agency as repository of information on JVAs. Issues such as having a short period to purchase eligibility documents (during the qualification stage) or bid documents, the high cost of eligibility or bid documents, and very stringent technical or financial requirements (i.e., not commensurate with the scale and scope of the project), can be deemed as anti-competitive because these discourage prospective competitors from participating in the project. Many contracts are also incomplete, especially when it comes to crucial elements like key performance indicators, business efficiency measures, tariff regulation, and consumer concerns. There were lapses in evaluation procedures, such as lack of transparency in costs and contributions, incomplete proofs of qualification, and incomplete documentary basis for evaluation, and yet the parties proceeded to execute the contracts. The new PPP Code aims to address these issues by including joint venture arrangements for delivering within a cooperation period an infrastructure facility or development service typically provided by the public sector (that is, excluding joint ventures for purely commercial purposes) in the scope of PPP review procedures.

**Table 3. Issues in water district joint ventures, as of May 5, 2024**

<b>Issues</b>	<b>Frequency of occurrence in reviewed joint venture agreements (%)</b>
Lack of third-party independent valuation of government contribution	74
Short period to purchase bid/tender documents	74
Short period to purchase eligibility documents	70
High cost of eligibility/bid documents	70
No key performance indicators and business efficiency measures set under the joint venture (JV) agreement	63
Tariff adjustments with no requirement for public hearing	55
Revenue-sharing basis / computation not provided	55
Stringent technical and/or financial requirements	38

<sup>8</sup> The DILG has already closed the portal but plans to revise it based on the new PPP Code and its implementing rules and regulations.

Issues	Frequency of occurrence in reviewed joint venture agreements (%)
Incomplete evaluation of the JV partners, evaluated only the lead JV partner's technical and financial qualification	27
Incomplete documents provided (e.g., technical evaluation, financial evaluation, selection of JV partner)	17
Project cost not disclosed	15
Government contribution not disclosed	12
Private partner contribution not disclosed	12

Source: NEDA (2024).

Many of the challenges discussed above continue to persist. It is still too early to say how successful the new PPP Code will be in dealing with these challenges and in avoiding problems going forward. It is clear though that problems in ongoing and recently awarded subnational PPPs will have to be resolved through better contract management, stakeholder engagement, and, if needed, contract redesign or amendment.

### ***3.2 Opportunities for expanding subnational PPPs***

The 2019 Supreme Court ruling on the Mandanas-Garcia case directly increased LGUs' fiscal resources. Before the ruling, the share of LGUs in national taxes was based only on national internal revenue taxes. But the petitioners argued for a "just share" in government revenues by including in the base all kinds of national taxes and the Supreme Court granted this petition. For fiscal year 2025, the National Tax Allotment (NTA) of LGUs is PHP1.03 trillion (see Table 4), shared among LGU levels as follows: 23 percent for provinces, 23 percent for cities, 34 percent for municipalities, and 20 percent for barangays. The increase in resources for LGUs means more opportunities for them to enter into PPP deals that require sharing in project financing and to fund the project identification, feasibility studies, transactions advisory, tendering process, and contract management in their respective PPP programs. These have the potential to expand the pipeline of subnational PPPs.

**Table 4. National tax allotment of LGUs in the 2025 National Expenditure Program**

<b>Region</b>	<b>Provinces</b>	<b>Cities</b>	<b>Municipalities</b>	<b>Barangays</b>	<b>Total</b>
National Capital Region	810,164,730	43,005,118,596	240,601,641	18,264,086,176	62,319,971,143
Cordillera Administrative Region	9,842,935,505	3,246,230,115	13,482,012,597	4,401,190,726	30,072,368,943
Region I	12,439,860,529	7,814 823,499	22,080,240,878	12,572,263,568	54,907,188,474
Region II	14,018,646,164	7,592,330,732	21,955,257,728	8,822,427,452	52,388,662,076
Region III	25,324,698,328	19,304,879,304	35,871,157,231	20,223,352,313	100,724,087,176
Region IV-A	28,927,286,561	32,884,768,869	34,608,405,153	26,292,682,103	122,713,142,686
MIMAROPA <sup>1</sup>	12,661,873,562	5,993,847,567	19,708,044,434	6,583,422,796	44,947,188,359
Region V	15,836,357,768	7,499,784,920	24,971,897,989	13,855,416,150	62,163,456,827
Region VI	17, 702,059,042	20,952,850,722	25,603,835,422	17,136,304,196	81,395,049,382
Region VII	14,473,782,160	20,283,992,630	23,160,187,547	15,163,618,216	73,081,580,553
Region VIII	14,100,082,413	10,315,439,722	23,508,921,361	13,945,387,879	61,869,831,375
Region IX	8,850,335,260	10,117,531,694	14,568,506,848	8,207,366,517	41,743,740,319
Region X	12,555,383, 038	14,936,363,608	18,030,760,544	9,735,216, 025	55,257,723,215
Region XI	11,701,289,206	15,933,429,026	14,132,783,042	8,208,174,829	49,975,676,103
Region XII	12,293,953,668	6,637,933,467	18,163,726,632	7,085,035,808	44,180,649,575
Region XIII	10,771,158,995	8,857,708,404	14,692,370,478	5,799,274,355	40,120,512,232
BARMM <sup>2</sup>	15,649,252,941	3,668,927,857	25,900,105,073	10,625,754,691	55,844,040,562
<b>Total</b>	<b>237,959,119,870</b>	<b>239,045,960,732</b>	<b>350,678,814,598</b>	<b>206,920,973,800</b>	<b>1,034,604,869,000</b>

Note: <sup>1</sup> MIMAROPA - stands for **M**indoro (Occidental Mindoro and Oriental Mindoro), **M**arinduque, **R**omblon, and **P**alawan.

<sup>2</sup> BARMM - refers to the Bangsamoro Autonomous Region in Muslim Mindanao.

Source: Department of Budget and Management (2024).

At the same time, LGUs must contend with additional responsibilities as the national government, with fewer resources at its disposal, redirects or completes the devolution strategy first outlined in the Local Government Code of 1991. Previously, the national government implemented certain programs that are supposedly devolved by law to the LGUs as it recognized the limited capacity of LGUs to implement projects. Given the Mandanas-Garcia ruling, the national government through Executive Order Number 138, series of 2021 (EO 138, s. 2021) directed the full devolution of certain government functions to LGUs, tasked national government agencies to prepare full devolution transition plans, mandated the creation of a Growth Equalization Fund (GEF) to address fiscal imbalances across LGUs and allow poor LGUs to gradually absorb devolved functions, and instructed key agencies to develop the capacity of LGUs to take on the devolved functions.

President Ferdinand Marcos, Jr. suspended the implementation of EO 138, s. 2021 and announced that he will come up with a new EO on the devolution. He also instructed the economic managers to conduct a study on the transition to devolution and the appropriate sharing of roles and responsibilities with respect to the functions devolved by the Local Government Code. As of this writing, NEDA is leading the conduct of the study and a new EO has not yet been released. Notwithstanding the suspension, the expansion of devolved activities that will eventually happen means expansion of need for more financing especially since the increase in NTA of LGUs may not be commensurate with their actual need. Table 4 shows that regions with greater proportion of poor population, and expectedly with greater developmental needs, have smaller shares of the NTA. For example, in fiscal year 2025, provinces in Region IX (Zamboanga Peninsula) and the Cordillera Administrative Region (CAR) have the smallest share in NTAs for provinces (3.72% and 4.14%, respectively), cities in CAR and BARMM have the smallest share in NTAs for cities (1.53% and 1.36%, respectively), municipalities in CAR and Region XI (Davao Region) have the smallest share in NTAs for municipalities (3.84% and 4.03%, respectively), and barangays in CAR and Region XIII (Caraga Region) have the smallest share in NTAs for barangays (2.13% and 2.80%, respectively). (Note that this study excluded the National Capital Region in the reckoning of shares since the region has no provinces, has only one municipality, and is an outlier in the number of cities and urban barangays.) This expanded need for financing of certain LGUs means LGUs have to be more innovative in finding ways to fund the projects for their constituents. The PPP mode is one way of doing that.

#### **4. Policy recommendations**

In the more than three decades of implementing subnational PPPs in the Philippines, the policy environment has evolved from a fragmented one to having a legal framework that unifies the various policy approaches of subnational entities. The fragmentation in the previous framework was characterized by varying and inconsistent local legislative council ordinances on PPPs and joint ventures in the case of LGUs and the NEDA joint venture guidelines in the case of water districts. The new PPP Code addresses most of the challenges encountered under the old legal frameworks and it is hoped that subnational government entities will be more judicious in entering into new contracts going forward.

Competition issues can be addressed through prudent compliance with the recommended procedures and transparency principles in the PPP Code. The absence of sector regulator at the subnational level can be addressed through regulation by contract or the creation of local rate setting bodies, as recommended in the PPP Code. Incompleteness of contracts and unbalanced risk sharing can be avoided by setting parameters, terms, and conditions and ensuring that the crucial elements for risk sharing are in the PPP contracts, as prescribed by the PPP Code.

For ongoing and newly awarded contracts, issues will still have to be resolved and the remaining challenges will have to be addressed. One possible solution is contract redesign or amendment when the existing contract is burdensome to the end-users or has the potential to make the end-users unnecessarily bear a huge part of project performance risks. Issues related to lack of key performance indicators, absence of contractual provisions on project lifetime risks such as default by contracting parties and termination, and unreliable or non-transparent tariff setting and adjustment mechanisms can be addressed through contract variation, which is permitted under Section 19 of the PPP Code. Since it is the head of the implementing agency (meaning, the local chief executive in the case of local PPPs and the water district general manager in the case of water district PPPs) that is supposed to recommend the change in the contract, the national government can only steer this process. Nevertheless, the national government through the PPP Center as repository of all executed PPP contracts and designated monitor of the whole Philippine PPP program will play a large part in calling out the attention of stakeholders when there are potential public interest concerns in contracts, as required in Section 24 of the PPP Code. The PPP Governing Board as overall policy-making body for PPP-related matters can also set the policy direction for settling the contract-related issues with potential public interest concerns. This approach should keep in mind that the local autonomy principle in the 1991 Local Government Code is balanced by mechanisms that allow the national government to extract accountability from LGUs, such as the oversight functions of national agencies, the auditing power of the Commission on Audit, the national government's management of the overall contingent liabilities by the public sector, and the hierarchy of laws (where the Constitution and national laws take precedence over local councils' ordinances).

In the meantime, policy formulation at the executive level should continue, such as the updating of joint memorandum circulars among agencies overseeing the subnational PPP program, the revision of manuals and guidelines for subnational PPPs, the updating of PPP Governing Board policies for local PPPs, and guidance on setting up dedicated PPP units at the subnational level. Policies for maximizing commercial value capture or land value capture can also be formulated,

as this kind of value capture can be an important source of additional financing for the subnational government entity and an incentive for the private partner's performance.

New technical assistance support from the national government and international development finance institutions for the subnational entities' capacity building needs must also be put together. Gaps in sector-specific knowledge, project development capacity, negotiation skills, contract design, stakeholder engagement, and governance practices must be urgently addressed as the subnational entities are now compelled by the PPP Code to be more accountable and judicious in handling PPPs. The Local Government Academy of the Philippines can help implement the capacity building program as the DILG and the PPP Center primarily steer the process.

To improve project preparation, stakeholder engagement, contract design, and the overall practice of subnational PPP implementation, a community of practice can also be built. The closest so far to the community of practice in the current environment is the annual gathering of focal persons assigned to the NEDA Regional Offices' PPP Knowledge Corners. This, however, is severely limited as the focal persons have other responsibilities in addition to being PPP focal persons.

To build the community of practice, the periodic gathering of subnational PPP practitioners from LGUs, water districts, state universities and colleges (SUCs), LUCs, and consultants or researchers in the extension services of SUCs and LUCs can be sponsored by the national government and leagues of LGUs, possibly through the help of international finance institutions. This will provide a venue for exchanging ideas on best practices and innovation. This can help address the current inadequacies in sector-specific expertise or knowledge at the subnational level, misalignment of risk sharing with developmental objectives, incompleteness of contracts, and weaknesses in appreciating what works and what does not when it comes to stakeholder engagement and contract management.

Promotion of subnational PPPs in sectors where the PPP program can be expanded should also be pursued. No PPPs for LUCs, for example, have been implemented yet. The PPP Center reported that there were few attempts but nothing was sustained because of the usual problems related to capacity gaps and the lack of dedicated teams in LUCs for PPPs. Hopefully, the inclusion of the Commission on Higher Education in the PPP Governing Board can help address this issue. PPPs that involve clustering of LGUs to achieve economies of scale can also be expanded, such as PPPs on bulk water supply, wastewater treatment, solid waste management, waste-to-energy conversion, digital connectivity, and transport terminals. PPPs for school infrastructure can also be revived, but this time enhancing the program to address other basic requirements of school such as facilities for water supply and sanitation, electricity connection, and digital connection. Performance issues that may arise due to the varying useful life of these components of school infrastructure may be addressed by having distinct warranties for the school building and the other infrastructure facilities. PPPs in the agriculture sector may also be expanded, especially since the country is food insecure and heavily food import dependent. But for PPPs in this sector to be successful, coordination issues within the Department of Agriculture (DA) itself must be addressed. The DA has various bureaus that can come together to develop partnerships in agriculture value chains, research and innovation, infrastructure upgrading, and joint business strategy development and marketing. Agriculture PPP typologies and multi-party standard contract agreements among farmers or fisherfolks, cooperatives, industry partners, LGUs, and national government technical

assistance providers exist in other countries that tried agriculture PPPs. The DA can examine these and distill lessons that can be applied in the Philippine setting.

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