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The World Bank

Report No: NCO00003531

NOTE ON CANCELLED OPERATION REPORT
(IBRD-81190)

ON A

LOAN

IN THE AMOUNT OF JPY 3,842,600 MILLION
(US$50.0 MILLION EQUIVALENT)

TO THE

DEVELOPMENT BANK OF THE PHILIPPINES

FOR A

REGIONAL INFRASTRUCTURE FOR GROWTH PROJECT

December 10, 2015

Social, Urban, Rural and Resilience Global Practice
East Asia and Pacific Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective June 19, 2015)

Currency Unit = Peso
US$ 1.00 = PhP 45.07
PhP 1.00 = US$ 0.02
US$ 1.00 = JPY 123

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
CAS	Country Assistance Strategy
DBM	Department of Budget and Management
DBP	Development Bank of the Philippines
DILG	Department of Interior and Local Government
DOF	Department of Finance
FIL	Financial Intermediary Loan
GFI	Government Financial Institution
GoP	Government of the Philippines
JICA	Japan International Cooperation Agency
KPI	Key Performance Indicator
LA	Loan Agreement
LBP	Land Bank of the Philippines
LGU	Local Government Unit
LGUGC	LGU Guarantee Corportation
MDFO	Municipal Development Fund Office
NEDA	National Economic and Development Authority
ODA	Official Development Assistance
OP	Operational Policy
PAD	Project Appraisal Document
PD	Program Development
PDF	Philippines Development Forum
PDO	Project Development Objective
PFI	Private Financial Institution
PMT	Project Management Team
RIGP	Regional Infrastructure for Growth Project
SLA	Subproject Loan Agreement
SPMT	Sub-Project Management Team
SSWSPs	Small Scale Water Providers
WSP	Water and Sanitation Program

Regional Vice President:	Axel van Trotsenburg, EAP
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PHILIPPINES
Regional Infrastructure for Growth

CONTENTS

A. Basic Information			
Country:	Philippines	Project Name:	PH – Regional Infrastructure for Growth
Project ID:	P108904	L/C/TF Number(s):	IBRD-81190
NCO Date:	12/10/2015		
Lending Instrument:	FIL	Borrower:	REPUBLIC OF THE PHILIPPINES
Original Total Commitment:	USD 50.00M	Disbursed Amount:	USD 0.12M
Revised Amount	USD 0.13M	Environment Category:	B
Implementing Agencies: Development Bank of the Philippines (DBP)			
Co-financiers and Other External Partners: N/A			

B. Key Dates				
Process	**Date**	**Process**	**Original Date**	**Revised /Actual Date(s)**
Concept Review:	06/26/2009	Effectiveness:	05/02/2012	10/11/2012
Appraisal:	04/15/2010	Closing:	11/03/2016	06/19/2015
Approval:	12/01/2011			

C. Rating Summary	
Performance Rating by NCO	
Outcomes:	Not Applicable
Risk to Development Outcome:	Not Applicable
Bank Performance:	Moderately Unsatisfactory
Borrower Performance:	Moderately Unsatisfactory

D. Sector and Theme Codes		
	Original	
Sector Code (as % of total Bank financing)		
General agriculture, fishing and forestry sector	21	
General industry and trade sector	21	
General water, sanitation and flood protection sector	21	
Rural and Inter-Urban Roads and Highways	21	
Sub-national government administration	16	
	Original	
Theme Code (as % of total Bank financing)		
City-wide Infrastructure and Service Delivery	20	

Natural disaster management	20	
Other Private Sector Development	20	
Regional integration	40	

E. Bank Staff		
Positions	**At NCO**	**At Approval**
Vice President:	Axel van Trotsenburg	James W. Adams
Country Director:	Motoo Konishi	Bert Hofman
Practice Manager/Manager:	Abhas Jha	Mark C. Woodward
Project Team Leader	Christopher T. Pablo	R. Mukami Kariuki
NCO Team Leader	Christopher T. Pablo	

F. Ratings of Project Performance in ISRs				
No.	**Date ISR Archived**	**DO**	**IP**	**Actual Disbursements (USD millions)**
01	04/11/2012	Satisfactory	Satisfactory	0
02	05/26/2012	Moderately Satisfactory	Moderately Satisfactory	0
03	12/16/2012	Satisfactory	Satisfactory	0
04	06/26/2013	Moderately Unsatisfactory	Moderately Unsatisfactory	0
05	12/29/2013	Moderately Unsatisfactory	Unsatisfactory	0
06	08/06/2014	Moderately Unsatisfactory	Unsatisfactory	0
07	04/01/2015	Highly Unsatisfactory	Highly Unsatisfactory	0

1. Context, Project Development Objectives, and Design

Country and sector background

1. The average annual economic growth rate of the Philippines over the period 2000-2008 was 2.8 percent, quite low compared to the 8.7 percent average growth rate of other East Asian countries. The share of the population below the poverty line increased in 2003 and 2006, income inequality remained high, and the country risked missing the Millennium Development goals on education and maternal health. At the time, the external environment threatened to dampen growth prospects, including the possibility of facing fiscal pressures. In addition, weak governance was recognized as a constraint to sustained growth and poverty reduction. The challenge of inclusive growth required a sustained effort from both the public and private sector agencies involved in development.

2. The Local Government Code of 1991 provided local government units (LGUs) increased local autonomy and accountability and empowered LGUs to improve public services and stimulate development. The Code gave LGUs the mandate to raise additional funds for investments in infrastructure and services through taxation and borrowing. However, progress in generating own source revenue and sourcing credit financing from the local capital markets was slow. As a result, many LGUs were plagued with inadequate access to basic services such as water and electricity, declining literacy rates, environmental degradation, high unemployment, lack of low-cost housing, and inadequate services. Limited access to affordable finance, a high degree of fragmentation of LGUs, and weak coordination between the national government and LGUs in local development planning contributed to generally poor LGU performance.

3. To strengthen LGUs and support the implementation of the Code, the Government of the Philippines (GoP) established the Working Group on Decentralization and Local Government under the umbrella of the Philippines Development Forum (PDF).[1] This Working Group brought together national government oversight agencies, LGU leagues, civil society organizations and donor partners to identify and tackle a common reform agenda. Three key support areas were identified: (i) expanding access to finance by introducing reforms that would enable LGUs to have greater access to the capital markets; (ii) promoting inter-LGU cooperation, including cooperation-enabling frameworks and stimulating joint investment financing across multiple LGUs; and (iii) improving planning by streamlining and harmonizing procedures for planning, budgeting and resource mobilization at the local level, developing and

[1] The PDF is the primary Government mechanism for policy dialogue among stakeholders in the country's development agenda. It also serves as a process for developing consensus and generating commitments among different stakeholders toward critical actionable items of the Government's reform agenda.

disseminating tools that enable joint planning across LGUs; and building capacity for strategic development planning.

Rationale for Bank assistance

4. The GoP requested Bank assistance in designing and financing a project that would support the reforms identified by the PDF by expanding access to finance through the Development Bank of the Philippines (DBP), a Government Financial Institution (GFI). In addition to enabling LGUs to identify and finance investments that would promote physical and economic integration, the said financing project was envisioned to encourage LGUs to work with private partners to accelerate the pace of service provision and support Private Financial Institution (PFI) lending for local public infrastructure and services by piloting a wholesale lending facility to on-lend to LGUs, public utilities and private sector providers. The project would also expand credit access to smaller LGUs (third or fourth income class), which comprised 75 percent of all LGUs. Thus, the Regional Infrastructure for Growth Project (RIGP) was conceived.

5. At the time of appraisal, the Bank had been supporting local government reforms in the Philippines, and had a comparative advantage in its long involvement in policy dialogue, technical assistance and LGU lending. The Bank had been playing a strategic role in supporting GoP in LGU finance since the mid 1980s, and could bring global knowledge from similar projects to bear on the design of RIGP. The project would allow the Bank to continue supporting the development and refinement of the LGU financing framework and enable DBP to expand its capacity to finance a wider spectrum of infrastructure and services, and to target a broader range of public and private actors. Also, in the aftermath of the October 2009 disaster brought by Typhoons Pepeng and Ondoy, the Government requested DBP to finance the rehabilitation of infrastructure and services identified in a Post-Disaster Needs Assessment prepared jointly by the Government and Development Partners. The project would therefore provide an avenue for the Bank to support rehabilitation and reconstruction efforts of LGUs affected by natural disasters. Finally, the Bank's access to global knowledge was important for piloting wholesale lending by PFIs willing to on-lend for local public infrastructure and services.

6. The Project was to contribute to the overall objective of the Country Assistance Strategy's (CAS) for the period FY2010-2012[2] of *achieving more inclusive*

[2] World Bank. 2009. *Philippines - Country assistance strategy for the period FY2010-2012*. Washington, DC: World Bank. (Project ID: P113433)

growth in the Philippines. The Project would particularly support the CAS strategic objective of *Improved Investment Climate* through (i) increased and improved delivery of infrastructure, (ii) increased investments and employment opportunities in urban and rural areas, and (iii) increased delivery and access to financial services.

Project description and costs

7. The project development objective (PDO) in the PAD was: "to stimulate integrative investments within regions by improving access to finance for local public infrastructure and services, and to contribute to the economic recovery of participating LGUs by improving access to local public infrastructure and services." The formulation in the Loan Agreement (LA) was very similar: "(i) to stimulate integrative investments in the territory of the Guarantor by improving access to finance for local public infrastructure and services; and (ii) to contribute to the economic recovery of LGUs participating in the Project by improving access to local public infrastructure and services." Key performance indicators (KPIs) were: (i) number of eligible integrative investments included in Provincial, Regional or Sector Development Plans; (ii) percentage of participating LGUs are third and fourth income class; and (iii) percent of participating LGUs have increased or sustained local public infrastructure.

8. The Project was designed as a Financial Intermediary Loan (FIL) with the following components.

   Component 1: Support for Regional Infrastructure Investment (IBRD $40.0 million, Total $40.0 million). This component was to support improved physical and economic integration within participating provinces or regions by increasing access to finance for an open menu of local public infrastructure and services. Financing was to be provided through either: (i) the Retail Lending Window, to LGUs, the private sector, and public utilities proposing priority subprojects identified by the provincial development council or other regional body and that should contribute to infrastructure and service delivery objectives identified in sector, regional, provincial, city or municipal development/investment pans and (ii) the pilot Wholesale Lending Window that would extend long-term financing to accredited PFIs, including thrift and rural banks, for on-lending to eligible sub-borrowers and subprojects.

   Component 2: Support for Post Disaster Reconstruction (IBRD $10.0 million, Total $10.0 million). This component was to provide support for post-disaster reconstruction needs of participating LGUs. Post-disaster reconstruction support was to be made available throughout the project period but limited to rehabilitating and reconstructing local public infrastructure and services in LGUs that declare a state of calamity following a natural disaster.

Component 3: Institutional Support and Strengthening of Local Service Providers (DBP $0.5 million, IBRD-Water and Sanitation Program $0.4 million, Total $9.0 million). This component was to support the management and supervision of the project, including the provision of technical assistance to eligible local service providers, concerned national agencies, and DBP personnel to enhance prioritization and planning of investments as well as improve efficiency in subproject implementation.

Implementation arrangements

9. DBP, a development finance institution with a mandate to support GoP's development agenda, was designated as the executing agency. DBP had two Program Development (PD) departments that, in coordination with other DBP units, were responsible for overseeing implementation of foreign-funded projects such as RIGP. The PD was organized into project teams whose main responsibility included reviewing project proposals generated by Account Officers. For RIGP, DBP designated a Project Management Team (PMT), composed of staff drawn from DBP's PD units. The PMT was responsible for the day-to-day implementation of the entire project, including collaborating with other units in DBP to: (i) support wholesale lending; (ii) monitor fiduciary and safeguard compliance; and (iii) monitor overall project implementation progress. Depending on the type of subproject, DBP would identify and bring in internal and external specialists to support the PMT when needed.

10. The DBP marketing units, mostly based at the local level, were the point of contact for most clients. For RIGP, the marketing units were responsible for promoting the project to potential clients, and assisting them in the preparation and submission of subproject proposals and in meeting fiduciary and safeguard requirements. Each sub-borrower (i.e. local service provider) was required to establish a Sub-Project Management Team (SPMT) primarily responsible for supervising and monitoring progress of subproject implementation. The PMT was to provide offsite and onsite assistance to the SPMTs. For the wholesale lending facility, DBP was responsible for reviewing subproject proposals submitted for approval by the PFIs, and monitoring the PFI's overall condition.

2. Post-Approval Experience and Reasons for Cancellation

11. The Loan was approved by the Board on December 1, 2011, signed on February 2, 2012, and made effective on October 11, 2012. It took the project about three years from concept review stage to effectiveness (See Table 1 below):

Table 1. Project Milestones

Milestone	Date
Concept Review Meeting	June 26, 2009
Authorization to Appraise/Negotiations	May 06, 2010
Bank Approval	December 01, 2011
Loan Signing	February 02, 2012

Effectiveness Date	October 11, 2012
Mid-Term Review	June 19 to 27, 2014
Cancellation	June 19, 2015

12. The factors that contributed to the lack of progress and eventual cancellation are discussed below.
    a. ***Implementation delays.*** From concept review stage, it took about 30 months for the RIGP to be approved. This was mainly on account of the series of reviews of the PAD (i.e. the initial proposal was for a $100 million loan but DBP management decided at the later stage of the appraisal to scale down the loan to $50 million, prompting another round of reviews) and delays in securing the preconditions to negotiations (i.e. GoP Monetary Board Opinion, Special Authority from the President) and presentation to Bank board (i.e. DBP Audit Report for 2010). The project was declared effective (after three loan effectiveness date extensions) 10 months after Board approval despite the fact that there was only one effectiveness condition i.e., the Borrower (DBP) had to adopt the Operations Manual, in form and substance satisfactory to the Bank.

    b. The Bank conducted the first supervision mission in April 2012, after loan signing in February 2012, to address remaining concerns (i.e. submission of the Operations Manual) and worked with DBP to jumpstart project implementation (i.e. developing an updated pipeline, technical assistance for capacity development). On September 25, 2012, nearly eight months after project signing, the Borrower submitted the Operations Manual, for which the Bank provided its no objection on October 10, 2012. Effectiveness was declared on October 11, 2012. The Project subsequently encountered major delays in launching the facility. In the May 27, 2013 Management Letter, the Bank called DBP's attention to the little progress made in completing preparatory activities. Six months after effectiveness, DBP had yet to launch RIGP and orient its Marketing Units and prospective sub-borrowers on project requirements and processes.

    c. ***Lack of disbursement.*** DBP failed to develop a viable subproject pipeline and no single project had been approved under RIGP. While DBP provided the Bank a list of subprojects, these lacked the supporting information (e.g., technical studies, feasibility studies, detailed engineering design) necessary to assess eligibility, viability and readiness for implementation. The delay between appraisal and effectiveness saw many prospective LGU sub-borrowers (including those that were affected by Typhoons Pepeng and Ondoy during appraisal) going to other sources of funds to meet their investment or post-disaster reconstruction needs. The local elections in 2013 also contributed to delays in pipeline build-up. The RIGP was to be presented to newly-elected officials after the local elections.

13. ***Underlying reasons for lack of project progress.*** The lack of disbursement and delays are due to fundamental implementation weaknesses:

a. **Lack of full-time Project Management Team and supervision consultants.** DBP never established a full-time PMT even when the need for one was critically underscored due to lack of project progress. Instead of a dedicated PMT, DBP insisted on a PMT with an ad-hoc composition of personnel that also performed non-project functions in other DBP units. Focus on project concerns was compromised as the efforts of the PMT personnel were divided between the RIGP and their other tasks. DBP was not agreeable to Bank's recommendations to hire technical consultants to augment the capacity of the PMT even when a credible pipeline of subprojects failed to materialize.

b. **Change in key counterpart staff.** A number of key DBP officials and staff involved during project appraisal and approval either retired or were reassigned at project commencement. This resulted in a PMT that did not fully appreciate the context of the agreements reached during project appraisal and negotiations and contributed to significant delays as it spent considerable time clarifying and contesting the provisions of the PAD and the Loan Agreement (such as those pertaining to the Subproject Loan Agreement) rather than focusing on building a robust pipeline of integrative investments. This also affected the project implementation approach by DBP. Support for integrative investments was a key project feature that was highlighted and agreed with GoP and DBP during design and approval. However, this feature was not pursued in the PMT identification of subprojects as they reverted to the traditional LGU lending business model, i.e., DBP processing much localized LGU investments.

c. ***Exogenous factors***. The three project preparation years saw market interest rates declining, especially at the time of project effectiveness. By that time, RIGP's on-lending rate could not compete with the market and DBP's internal funds (the average lending rate at the time of implementation was around 4.5%). This was due to the fixed fees (around 4% for sovereign guarantee and exchange rate cover) that GoP imposed that add to the Bank's lending rate (around less than 2%). These make up the base cost upon which DBP adds a spread (about another 2-4%). The non-competitive rates generally overshadowed the Project's advantage of providing fixed long-term funds and affected project demand.[3] It also created an implicit disincentive for DBP to use the Project for its retail and wholesale on-lending operations (because DBP's internal funds are cheaper and thus, easier to promote). Subprojects in

[3] GFIs also price their interest rates based on the risk and credit rating of LGUs. Hence, those with lower credit rating get higher than market rates – this is where RIGP could have competed. As a development Bank, DBP could have introduced enhancements to move RIGP - there are LGUs (lower income class) that appreciate fixed interest-long term credit over low-variable interest credit because the former provide regularity in financial planning.

the initial Project pipeline were delisted as the proponent LGUs found lower rates, among other reasons (DBP letter to the Bank dated September 24, 2013). Also, efforts to pilot the wholesale window to supply credit to Small Scale Water Providers (SSWSPs) were faced with fundamental constraints – lack of scale, capacity and information – that underpin the lack of interest of PFIs to lend to SSWSPs. No financial structuring or innovation can truly and sustainably unlock the credit market for SSWSPs without addressing these weaknesses.

14. ***Steps taken to resolve problems. The following measures were carried out:***
    a. An implementation support mission was undertaken prior to effectiveness to assist DBP in developing the Operations Manual.
    b. The Bank conducted an orientation workshop on Bank operational policies and project development processes to build the implementation capacity of the PMT.
    c. Since the start of implementation, the Bank repeatedly communicated to DBP the need to establish a full-time PMT and recruit the necessary implementation consultants to help in developing a robust pipeline of integrative investments. However, DBP maintained its decision that the PMT set-up was sufficient and that consultants would be hired only as needed.
    d. The Bank provided support to the PMT in formulating a Subproject Loan Agreement (SLA) that was consistent with the requirements of the LA. However, the PMT contested the inclusion of several provisions from the LA into the SLA and requested revisions to the LA instead. The Bank was considering the request but emphasized the need to build the pipeline before modifying the LA. The Bank planned to include the proposed LA modification in the processing of DBP request for restructuring to use project funds to support post Typhoon Yolanda reconstruction efforts (see item "g").
    e. The Bank mobilized support from the Bank's Water and Sanitation Program (WSP) to help DBP build a pipeline under the RIGP wholesale facility, including drafting a wholesale operations manual. A WSP grant amounting to $32,000 was mobilized to support preparation of proposals from small scale water service providers (SSWSPs). The Bank led DBP to possible client LGUs and facilitated discussions with the Department of Interior and Local Government (DILG) that was leading a program for LGUs pursuing water projects.
    f. On October 22, 2013, the Bank proposed to conduct an implementation support mission to assess the status of subproject pipeline development, agree on a revised implementation plan to address the lack of progress, and to further discuss the changes to the sub-loan agreement. However, on October 29, 2013, DBP requested to defer this mission.
    g. When super typhoon Yolanda (International Name: Haiyan) struck the country in November 2013 and devastated the central Philippines, discussions shifted to restructuring the Project to utilize the project funds to assist the Typhoon Yolanda-affected LGUs. On February 3, 2014, the Department of Finance (the Guarantor) wrote to the Bank endorsing the DBP's request for

such a restructuring. The Bank saw this as a window to jumpstart project implementation especially since the proposed financing arrangement for the restructured project would involve grant financing from GoP (making RIGP funding attractive as it addresses the issue of RIGP's uncompetitive lending rates. The Bank agreed to the request to restructure and started preparing the restructuring package, which would have entailed changing the PDO, and amending the Loan Agreement and the SLA. In a letter dated November 11, 2014, the Department of Budget and Management (DBM) confirmed GoP's commitment to provide grant funding through the Project to finance up to 90% of the cost of LGU reconstruction subprojects. On the basis of this commitment, the Bank encouraged DBP to step up its pipeline generation efforts and suggested certain performance targets be included as covenants in the restructured Project. However, DBP would not agree to the inclusion of any covenant in the Loan Agreement that obliged the Borrower to meet suggested performance targets by certain dates. The restructuring was never approved and, finally on June 19, 2015 DBP requested to cancel the Project.

15. ***Implications of Cancellation.*** RIGP was designed to demonstrate a more efficient use of municipal finance through support to integrative investments (e.g. cross-border infrastructure). The cancellation represents a missed opportunity in this regard. Also, the RIGP would have been a natural follow-up engagement with Philippine LGUs. The Bank is supporting a similar operation with another GFI (Land Bank of the Philippines' Support to Strategic Local Development and Investment Project (Ln. 4833) closing in April 2016), which supported about 75 LGU subprojects since becoming effective on February 28, 2007. It also financed earlier operations implemented by the Department of Finance (i.e., the Local Government Finance and Development Project, Ln. 4446 and the Community Based Resource Management Project, Ln. 4299) which introduced matching grants for LGU subprojects. It should be noted that there are other financing programs for LGUs offered by other Development Partners (e.g. KfW, ADB and JICA, among others). As a result of the RIGP cancellation, financing support from the Bank for municipal infrastructure (through LGUs) came to a halt.

3. Assessment of Bank Performance

16. ***Quality at Entry was Unsatisfactory.*** At appraisal, the Bank identified appropriately the core issues that contributed to the slow process of development at the local level: (i) limited access to affordable financing, (ii) high degree of fragmentation of LGUs and (iii) weak NG-LGU coordination in local development planning. The PDO was appropriate as it aimed to support investments that would benefit several LGUs or integrate local economies, address key gaps in local infrastructure provision, and offer support for reconstruction needs in the aftermath of two devastating typhoons that hit the Philippines at the time of appraisal. While the project was designed as an innovative intervention to target integrative investments, it faced challenges on the "demand side" given the institutional and political set-up of LGUs in the

Philippines and the conventional approach to local development planning that focuses on individual political jurisdictions rather than broader complementation among adjacent LGUs. Though innovative, targeting integrative investments is a challenge given the institutional and political set-up of LGUs in the Philippines. There was a disconnect between the Project's focus on the integrative-type and (i) the open menu approach, and (ii) the target LGUs (3rd and 4th class municipalities that, given their income status and capacity, could hardly afford lumpier investments). "Integrative" investments would have been more appropriately proposed at the provincial level (in that a number of municipalities make a province). What constitutes an 'integrative investment' was not adequately defined in the PAD and was therefore subject to interpretation during implementation. For example, a majority of subprojects in DBP's initial project pipeline were water systems that catered to only one LGU; the pipelined subprojects were not different from subprojects supported by the Bank's other municipal finance operations (e.g. those funded by the SSLDIP of LBP).

17. The project was designed as a FIL, which was appropriate considering DBP's role as a financial intermediary. Key risks were identified during appraisal but additional mitigating measures could have been made to cover two important risks, as follows:
    a. Market risk. The PAD discussion on the wholesale lending window recognized the market liquidity overhang but indicated the possibility that demand could pick up once market liquidity was reduced (PAD Annex 4, paragraph 15). The appraisal team also expected DBP to fine-tune its wholesale loans to ensure attractiveness to PFIs. But excess market liquidity persisted throughout implementation, driving domestic market rates lower and making the Project's lending rates uncompetitive. The low domestic market rates likewise affected the demand for the retail window. The possibility of a project operating in a low interest rate environment should have been identified as a key risk, and the project could have been designed to offer options for subproject financing under such market conditions.[4]
    b. Institutional readiness of DBP. Given the open menu approach, the PAD rightly assessed that DBP had limited technical capacity in implementing the project. As a mitigating measure, a PMT would be set up to provide implementation support and DBP would assign internal or hire external specialists as the need arose. The staff assigned to the PMT however did not serve on a full-time basis. Also, despite being encouraged to do so, DBP did not hire technical consultants to augment PMT's capacity during implementation. Stronger measures could have been identified at appraisal to

[4] During implementation, when Typhoon Yolanda affected a number of LGUs in 2013, the Government proposed to restructure the project to provide financing to affected LGUs with GoP counterpart grant funding. The provision of the grant eventually addressed the issue of uncompetitive lending rates (see paragraph 14 item g) and thus opening a window for the project to progress despite the low interest rate environment.

mitigate capacity risks. These measures include requiring DBP to commit to a timeline for the establishment of a full-time implementing unit or PMO or the hiring of full-time technical consultant after a certain period after loan effectiveness). This should have been agreed given previous Bank operations under DBP were rated unsatisfactory.

18. ***Bank's Supervision and Implementation Assistance is Moderately Satisfactory.*** The Bank conducted a supervision mission immediately after loan signing to help the Borrower in meeting the effectiveness condition and developing a pipeline of subprojects. The Bank had identified key implementation bottlenecks at the outset and repeatedly brought the need to address performance shortcomings to the attention of PMT and DBP. Considering that the PMT members were mostly not involved in project design and appraisal, the Bank immediately organized and conducted an orientation workshop to support their understanding of the project Measures were suggested to remedy the lack of progress, including the hiring of full-time consultants to augment PMT's capacity, and the possibility of including performance targets as a covenant during the restructuring (see para 14 items a to f).

19. The Bank was candid with the Borrower with respect to evaluating progress towards the achievement of the PDO and implementation progress during implementation review missions. Aside from the missions, the Bank was in constant coordination with the Borrower to catch-up on the progress of agreed actions. It also extended significant efforts (e.g. conducted an orientation workshop to build implementation capacity, tapped WSP funding to try piloting wholesale lending, etc., see par14) to help the Borrower resolve implementation issues and develop a robust pipeline.

20. Considering the project's long preparation period, changes in leadership and staffing at DBP, as well as changing market conditions, the Bank could have proposed to restructure the project earlier, i.e., after effectiveness. However, the Bank deemed it extremely necessary to put in place the fundamental elements to implement the project prior to any restructuring: (i) preparation of a sub-loan agreement that fully complies with RIGP Loan Agreement, (ii) establishment of and strengthening of a project implementing unit, and (iii) development of a subproject pipeline. The Bank provided necessary support to DBP in these aspects. The Bank further felt that restructuring would be more meaningful if it is informed by lessons generated from on-the-ground implementation of sub-projects.[5] When DBP continued to have difficulties in building a credible pipeline a year after project effectiveness, the Bank downgraded the project's implementation rating from "moderately unsatisfactory" to "unsatisfactory,"

[5] Note also that there was a change in DBP top management (a new DBP President was appointed) hence it was necessary to allow the new management the opportunity to turn the project around. Therefore it did not seem right to restructure the project without giving the new management this chance.

flagging RIGP as a problematic project. The Bank provided options for DBP to pursue, including (i) restructuring the project to provide support to Yolanda-affected LGUs, and (ii) project cancellation when it was clear that the restructuring was unlikely to move forward. As the Bank could not cancel the loan unilaterally, it considered suspending the project by a certain timeline and pursue cancellation after six months of the suspension date if no progress was made. But this course of action became irrelevant as DBP eventually decided to cancel the Project.

4. Assessment of Borrower Performance

21. ***Performance of the Government is Moderately Satisfactory.*** GoP was supportive during preparation and implementation. It pursued discussions with the Borrower to resolve disbursement and implementation issues as part of monitoring of foreign-funded projects. The monitoring, however, seemed to have fallen short in terms of proposing measures to the Borrower and the Bank to address the implementation bottlenecks.

22. ***Performance of the Implementing Agency is Unsatisfactory:*** Loan effectiveness took much longer than expected due to delays in obtaining final government clearances for the loan and finalizing the Project OM. Subsequent delays were encountered by DBP in launching the product due to slow preparatory activities. Despite the support provided by the Bank and WSP to DBP in developing a pipeline of subprojects, no investment subprojects with sufficient information to determine viability and eligibility for funding under the Project's requirements were put forward by DBP for Bank review. A major bottleneck in project implementation stemmed from the lack of a full-time PMT that could focus on moving the project forward. DBP also did not recognize the need to hire implementation consultants to augment capacity despite the apparent difficulty in generating a credible, duly appraised pipeline. Despite repeated communication of the need to address this issue, especially when there was the possibility of RIGP increasing in size to support Yolanda reconstruction activities, DBP maintained its position that the existing set-up was sufficient to implement the project.

23. Though the change in financial market conditions during implementation affected the competitiveness of RIGP, DBP did not offer concrete actions to enable it to adapt to these market realities. DBP could have suggested to restructure the project, assess what adjustments could be made and offer a more appropriate lending instrument to the LGUs and local service providers, and review whether the wholesale window was still viable or, as suggested in the PAD, adjust its lending rates or spread so that PFIs could find the lending facility attractive.

24. Due to the lack of proactive measures by DBP to address implementation bottlenecks, the implementing agency performance is rated unsatisfactory.

5. Lessons Learned

25. The project offers important lessons that could be useful in design and supervision of municipal finance operations:

    a. ***Realistic assessment of implementation capacity and Borrower commitment is key***. Though the implementation capacity risk had been identified during appraisal, the mitigating measures identified in the PAD did not concretely identify actions that could adequately address the gaps in implementation capacity relative to the risk of DBP not having a full-time and dedicated Project unit. Establishment of project management offices fully staffed with the required skills would be an important condition for effectiveness. Recruitment of technical consultants at project commencement is another important condition. Unwillingness of DBP management to recruit full time staff and implementation support consultant should have been a concrete sign of fundamental disagreement between the Bank and the Borrower on how the project was to be implemented and an impetus for assessing Borrower commitment to the project design.

    b. ***Incentives for performance (and sanctions for non-performance) are still important features in project design.*** There are simply no such features considered in project design. Because the PMT was comprised of composite staff who are remunerated regardless of involvement in the project, the project staff are not compelled to generated business out of the project (unlike in cases where project staff are full time hires and are normally compensated based generally on project performance, or that there is a stake in project success or failure). To compound the problem, the commitment fee on the RIGP loan (having been negotiated and signed after September 27, 2007[6]) was waived and any delay in implementation was not seen as having any cost implication to the Borrower. This lack of financial implication to the Borrower does not compel even to restructure or cancel the loan even if it is not performing.

    c. ***Greater engagement of national government in oversight of problematic projects.*** Involvement of oversight agencies in proactive monitoring of problematic projects would be extremely helpful as it would allow early dialogue on contentious issues (such as project staffing and management). A mechanism can be supported that will strengthen national government role to evaluate progress and proactively propose measures that the Implementing Agency should undertake to address performance shortcomings.

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[6] http://siteresources.worldbank.org/PROJECTS/Resources/40940-1250176637898/Engl.pdf

Annex 1. Bank Lending and Implementation Support/Supervision Processes

(a) Task Team members

Names	Title	Unit	Responsibility/ Specialty
Lending			
Christopher Casuga Ancheta	Sr Sanitary Engineer	GWADR	Municipal Engineer
Rosemary Mukami Kariuki	Lead Water and Sanitation Specialist	GWADR	Urban Specialist
Kamran M. Khan	Program Manager	EASSD - HIS	
Victoria Florian S. Lazaro	Operations Officer	GSURR	Social Safeguards Specialist
Rene SD. Manuel	Senior Procurement Specialist	GGODR	Procurement Specialist
Lawrence Tang	Urban Mgmt. Spec.	GSURR	Urban Mgmt. Specialist
Maya Gabriela Q. Villaluz	Senior Operations Officer	GENDR	Environmental Safeguards Specialist
Supervision			
Christopher T. Pablo	Senior Urban Specialist	GSURR	Task Team Leader
Artessa Saldivar-Sali	Municipal Engineer	GSURR	Municipal Engineer
Catherine Vidar	DRM Specialist	GSURR	DRM Specialist
Victoria Florian S. Lazaro	Operations Officer	GSURR	Social Safeguards Specialist
Maya Gabriela Q. Villaluz	Senior Operations Officer	GENDR	Environmental Safeguards Specialist
Rene SD. Manuel	Senior Procurement Specialist	GGODR	Procurement Specialist
Aisha Lanette De Guzman	Financial Management Specialist	GGODR	Financial Management Specialist
Kristine May SJ Ante	Program Assistant	EACPF	Program Assistant
Mari Trillana	Team Assistant	EACPF	Team Assistant
Rhoel Bernardo	Consultant	GSURR	Municipal Finance Specialist
Marilyn Martinez	Consultant	GSURR	Urban Specialist
Rosanna Martin	Consultant	GSURR	Project Specialist
Abegyl Albano	Consultant	GSURR	M&E Specialist
Hope Gerochi	Consultant	GSURR	M&E/Project Specialist

(b) Staff Time and Cost

Stage of Project Cycle	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	USD Thousands (including travel and consultant costs)
Lending		
FY 2008		26.54
Total:		26.54
Supervision		
FY 2014		50,555.67
FY 2015		68,716.42
FY 2016		7,918.36
Total:		127,190.45

Annex 2. List of Supporting Documents

1. Technical Preparation Mission Aide Memoire, February 1-12, 2010
2. Project Appraisal Document, November 02, 2011
3. World Bank Implementation Review Mission Management Letter and Aide Memoire dated:
    a. May 15, 2012
    b. June 26, 2013
4. World Bank Medium Term Review Mission Management Letter and Aide Memoire dated July 14, 2014
5. DBP Letters dated:
    a. October 29, 2013 (Implementation Support Mission deferment)
    b. April 5, 2013, September 24, 2013, Dec 9, 2013 and February 24, 2015 (on proposed Loan Agreement revisions, project pipeline and revised operations manual)
    c. July 15, 2015 (confirming DBP Management consent to restructure for Yolanda)
    d. July 28, 2014 (Response to findings of the Medium Term Review mission)
    e. May 6, 2015 and June 19, 2015 (Proposal to Cancel)
6. DOF letter dated February 3, 2014 endorsing request to restructure RIGP for Yolanda
7. DBM letter to the Bank dated November 11, 2014 confirming commitment for national government grant infusion
8. WSP (2014, draft note). Lessons on Credit Financing for Water Supply Projects in the Philippines: A Case Study on an Attempt to Introduce a Water Credit Facility in a World Bank Financial Intermediary Lending Project for Local Infrastructure Development.

IBRD 33466R4

PHILIPPINES

- SELECTED CITIES
- PROVINCE CAPITALS
- REGION CAPITALS
- NATIONAL CAPITAL
- RIVERS
- MAIN ROADS
- RAILROADS
- PROVINCE BOUNDARIES
- REGION BOUNDARIES
- INTERNATIONAL BOUNDARIES

I Ilocos
1 Ilocos Norte
2 Ilocos Sur
3 La Union
4 Pangasinan

CAR Cordillera Admin. Reg.
5 Abra
6 Apayao
7 Benguet
8 Ifugao
9 Kalinga
10 Mountain Province

II Cagayan Valley
11 Batanes
12 Cagayan
13 Isabela
14 Nueva Vizcaya
15 Quirino

III Central Luzon
16 Aurora
17 Bataan
18 Bulacan
19 Nueva Ecija
20 Pampanga
21 Tarlac
22 Zambales

NCR National Capital Reg.

IV-A CALABARZON
23 Batangas
24 Cavite
25 Laguna
26 Quezon
27 Rizal

IV-B MIMAROPA
28 Marinduque
29 Mindoro Occidental
30 Mindoro Oriental
31 Palawan*
32 Romblon

V Bicol
33 Albay
34 Camarines Norte
35 Camarines Sur
36 Catanduanes
37 Masbate
38 Sorsogon

VI Western Visayas
39 Aklan
40 Antique
41 Capiz
42 Guimaras
43 Iloilo
44 Negros Occidental

VII Central Visayas
45 Bohol
46 Cebu
47 Negros Oriental
48 Siquijor

VIII Eastern Visayas
49 Biliran
50 Eastern Samar
51 Leyte
52 Northern Samar
53 Samar
54 Southern Leyte

IX Zamboanga Peninsula
55 Zamboanga del Norte
56 Zamboanga del Sur
57 Zamboanga Sibugay
--- Zamboanga City

X Northern Mindanao
58 Bukidnon
59 Camiguin
60 Lanao del Norte
61 Misamis Occidental
62 Misamis Oriental

XI Davao Reg.
63 Compostela Valley
64 Davao del Norte
65 Davao del Sur
66 Davao Oriental

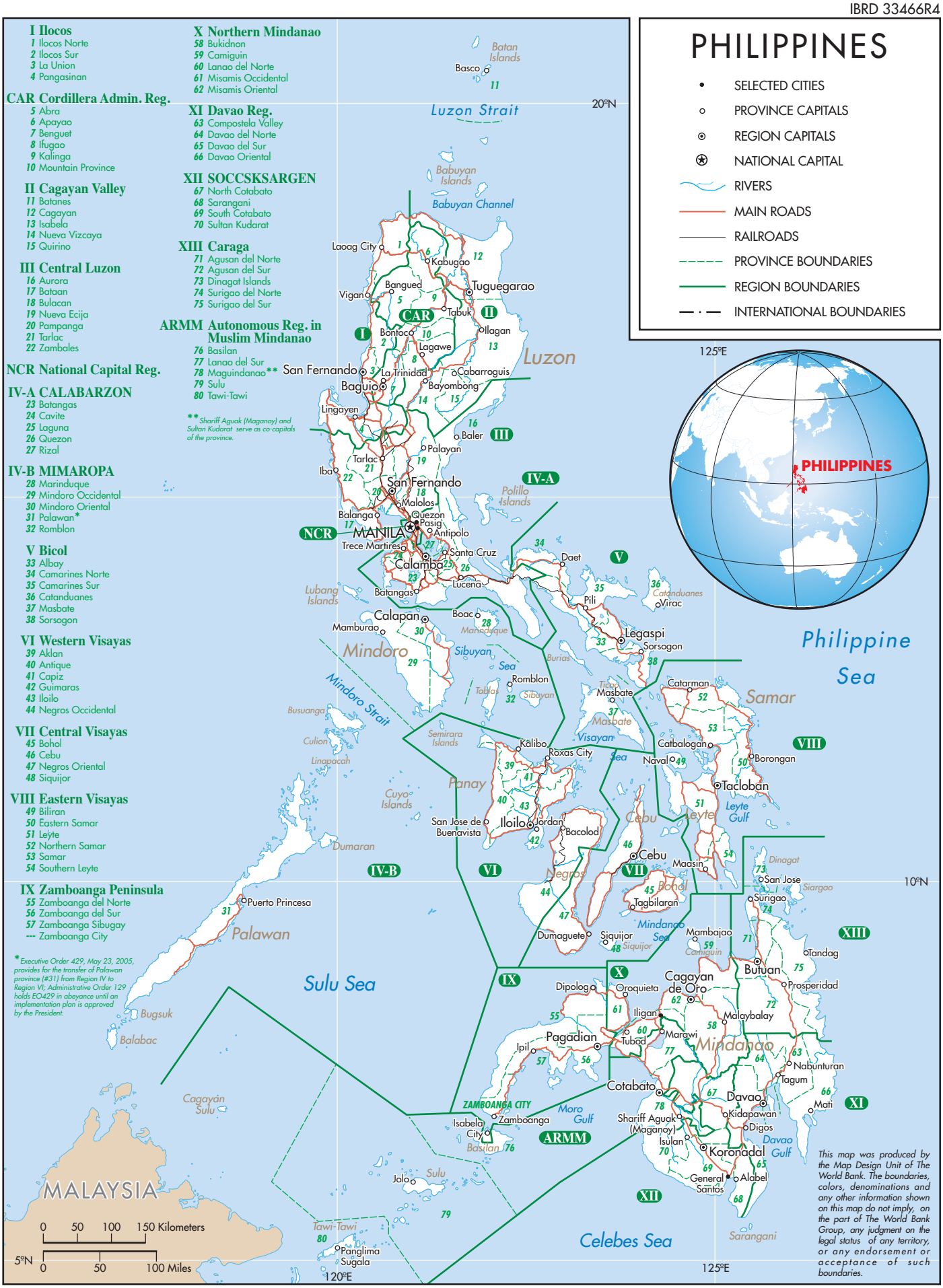
XII SOCCSKSARGEN
67 North Cotabato
68 Sarangani
69 South Cotabato
70 Sultan Kudarat

XIII Caraga
71 Agusan del Norte
72 Agusan del Sur
73 Dinagat Islands
74 Surigao del Norte
75 Surigao del Sur

ARMM Autonomous Reg. in Muslim Mindanao
76 Basilan
77 Lanao del Sur
78 Maguindanao**
79 Sulu
80 Tawi-Tawi

** Shariff Aguak (Maganoy) and Sultan Kudarat serve as co-capitals of the province.

* Executive Order 429, May 23, 2005, provides for the transfer of Palawan province (#31) from Region IV to Region VI; Administrative Order 129 holds EO429 in abeyance until an implementation plan is approved by the President.



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