Philippines' PPP programme tries to take off

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The Philippines has emerged as Asias most promising market for PPP. Singapore, the market leader in terms of maturity, has a patchy pipeline, while Indonesia, the most promising newcomer, is struggling to develop a workable template. The Filipino bank market is liquid and has developed a strong track record financing toll roads and power plants. A small number of well-capitalised and bank-friendly sponsors are angling for upcoming concessions, and a newly launched infrastructure fund plans to funnel public pension money into the countrys infrastructure.

The country has been successful in raising a sovereign official redevelopment assistance loan from collateral lenders. The willingness of the Philippines government to look at PPP suggests that it wants to achieve meaningful risk transfer, as well as shift an ambitious investment programme off-balance sheet. If that is the case, then the first social infrastructure project to emerge from the programme will have been something of a disappointment to PPP purists.

BLT bundles

The first bundles of schools procurements will use a build-lease-transfer structure more akin to the forfaiting method through which PPP sceptics in Germany procure government buildings than the elaborate structures that the UK, Alberta and Queensland have developed. The structure lends itself to a fast procurement process: if the financing closes before mid-November the entire procurement will have taken less than eight months. It will allow the countrys president, Benigno Aquino, to fulfil his promise to deliver the classrooms by July 2013.

The department would in any case find it difficult to transfer much of the operating risk of the new classrooms, because most of them are located at existing sites that have established maintenance arrangements. The Canadian province of Ontario used build-finance structures for many of the first hospitals that it procured under its PPP programme, because these were expansions to existing facilities. One adviser familiar with the process is confident that Philippines debt and equity providers can assume more operational and life-cycle risk on other availability deals.

If the BLT model was also designed to attract large numbers of domestic bidders it succeeded. The request for expressions of interest for the package attracted 15 responses in February, and from that list the countrys Department of Education shortlisted six bidders, all of them domestic. In April, the department prequalified BF Corporation/Riverbanks Development, Citicore Holdings/Megawide Construction, DM Consunji, Makati Development/First Balfour, DM Wenceslao & Associates/Datem and Makati Development/DDT Konstract.

Of that list, however, only two groups submitted final bids BF Corporation/Riverbanks and Citicore/Megawide. The smaller number of RFP respondents may be a result of the departments insistence that the bidders construct demonstration classrooms so that it could physically examine their work. The practice is not a common feature of PPP procurement anywhere else.

Both pairs of bidders were successful, with BF/Riverbanks coming in lowest on region Is 2,157 classrooms, and Citicore/Megawide winning region IIIs 2,885 and region IV-As 4,259 when bids were opened in August. The two groups of sponsors reached commercial close on the packages on 8 October, and have 60 days to reach financial close, although given the tight construction timetable they were trying to close with lenders before the end of October.

One of the biggest potential hurdles to financial close on the schools is the willingness of lenders to accept appropriations risk that the countrys legislature will approve the lease payments for the three bundles of schools. The issue was intractable enough that commercial banks eventually passed on the deal, leaving state lenders to fill the gap. Even these lenders had some misgivings about the credit profile. Given that the lenders to the project are mostly state-owned [the Development Bank of the Philippines and the Land Bank of the Philippines are the main lenders] I was surprised that they were the most concerned about this, observes the adviser close to the process.

The department of education has won multi-year obligational authority from the countrys department of budget and management for its Ps1.628 billion ($40 million) per year in lease payments. Commercial lenders do not necessarily dislike availability-based deals, but they would prefer that their counterparty, whether a hospital, water concessionaire or transit authority, have its own revenue-generating capacity.

SLEX appeal

Another PPP procurement, for a more familiar asset, reached commercial close in April the Daang Hari-South Luzon Expressway Link. Ayala Corporation holds this concession, which involves building a 4km connection road at a cost of Ps1.96 billion ($44 million) under a 30-year build-transfer-operate road concession. Ayala, together with Spanish contractor Getinsa Ingineieria, won the concession in December 2011.

The Department of Public Works and Highways issued the request for qualifications for Daang Hari-SLEX in September 2011, after two larger projects, both transit-related, were held back for further studies. The road concession is the first procurement to be officially dubbed a PPP, after the 2010 launch of the programme and establishment of the PPP Center, the renamed Build-Operate and Transfer Center that was transferred from the Department of Trade and Industry to the National Economic and Development Authority. But the project has been in development for much longer, and was submitted to the Toll Regulatory Board as early as 2007. According to the preliminary information memorandum, the section will carry an estimated 21,000 vehicles per day.

Ayala raised Ps6.45 billion in corporate equity (14 million shares at Ps430 per share) in September, with the intention of using the proceeds to fund its commitments to PPP projects, and more recently mandated BPI to run a Ps10 billion bond issue. Market observers say that the small financing requirement on Daang Hari-SLEX, not to mention Ayalas substantial war-chest, means that the road is unlikely to come to market as a debt financing, and Ayala has yet to contact lenders about the project.

Ayala says that it plans to bid on several of the other eight projects in the programmes first wave, including the NAIA Expressway, the Cavite-Laguna Expressway, and the LRT Line 1 operations and maintenance contract. It has also formed a joint venture with Aboitiz Equity Ventures to bid on the Mactan-Cebu airport concession.

TPLEX and Cavitex

Domestic banks once considered wary of construction, revenue and rights-of-way risk now dominate infrastructure finance. They provided Ps11.5 billion in ten-year debt towards the Ps19 billion Tarlac-Pangasinan-La Union Toll Expressway (TPLEX), which closed in June 2011. BDO underwrote Ps7 billion of that debt total, and Development Bank of the Philippines and Land Bank of the Philippines provided the rest. Of the remaining cost of the road, Ps4.6 billion came as equity from an 11-strong sponsor group led by DMCI and San Miguel, and another Ps2.9 billion came from government, either as grants or in-kind as rights of way.

The 35-year concession for that 84km road was not part of the PPP programme, but served as a demonstration that the smaller Daang-Hari SLEX and schools PPP deals would be digestible in the bank market, albeit with some state lender support. Lenders willingness to accept traffic risk and construction risk on TPLEX, as well as fund construction before the sponsors had received all of their rights of way from the Department of Public Works and Housing, suggest that they will be the first institutions that sponsors on upcoming toll concessions contact.

Local lenders have already eliminated the small beachhead that the US high-yield market established in Philippines infrastructure, when BDO and RCBC together underwrote the bank refinancing of the bond debt on the Manila Cavite toll road. Cavitex launched a tender in March for the bonds on the toll road, which runs 14km and connects Metro Manila, Ninoy Aquino airport and the port of Manila to Cavite.

It issued $160 million in bonds in the US high-yield market to finance an extension between Bacoor and Kawit, in a deal that Bank of America underwrote and which carried a coupon of 12%. At the time of the original financing, accessing the US high-yield market was competitive with the domestic bank market, though it did open projects to currency risk. Development finance institutions, which have financed greenfield toll concessions in the past, have often insisted on more restrictive covenants than sponsors would like.

But the struggles of the Manila Cavite road in the face of vehicle numbers that were less than a quarter of its 45,000 forecast meant that the bonds debt service coverage ratio fell below the 1.15x threshold stipulated in the financing documents. Cavitex, controlled by the Virata family, launched the tender for the bonds to avoid losing control of the road. In this context, the domestic bank participation was less muscle flexing, more rescue financing.

Pushing the pipeline

The Philippines government has also floated the idea of project bonds with a maturity of 20-25 years as a new potential funding source, though the instruments will not be non-recourse obligations of projects. Instead, the National Economic and Development Authority, which benefits from a sovereign guarantee, would issue the bonds and lend them on to infrastructure projects.

The structure has an analogue in the way that Land Bank of the Philippines has closed a $275 million 25-year loan from the World Bank, with a sovereign guarantee, and will lend the proceeds on to the two concessionaires for Manilas water system. Ayala controls Manila Water, which serves the east of the city, while Metro Pacific controls the restructured Maynilad, which serves the west.

Domestic lenders are largely unconcerned about the possible emergence of a cheaply funded competitor, suggesting that were it to get off the ground, it might help improve projects debt service and amortization profile by making longer-dated commitments alongside the ten years that commercial banks can now reach. And NEDA would need to issue debt at a ferocious pace to meet the PPP programmes medium-term debt requirements. The Development and Land banks, which already participate in infrastructure financings, have yet to crowd out commercial lenders.

But the push towards bonds is best understood as offering reassurance to banks that the government is prepared to help them refinance their holdings of PPP debt in advance of them breaching single borrower limits. At present the Philippines Monetary Board has allowed banks to separate PPP exposures from their corporate exposures for the next three years, and would grandfather these separate exposures in the event that it ended this dispensation. But NEDA funds might be a way to pick up the financing slack, or if necessary help clean up bank balance sheets, if banks health did take a turn for the worse.

For now, however, the pipeline of projects near market is unlikely to tax domestic lenders. The nearest roads to market are the 7.15km Ps15 billion NAIA Expressway, which will improve the notoriously bad access to Manilas notoriously poor international airport, and on which bids are due in January 2013, and the NLEX-SLEX connector, a Ps25 billion 13.53km section of road, on which a request for qualifications is imminent.

Possibly the largest project in this initial wave is the extension and operation of the LRT line one, which has a projected cost of Ps60 billion. It involves extending the line 11.7km, from Baclaran to Cavite, and taking over the whole lines maintenance. Not all of the project costs would be privately-sourced, because the government is likely to procure the rolling stock directly, and a rail project will attract a higher proportion of export credit agency debt than a road project. Behind these projects stand a clutch of healthcare, water, agriculture, and other transport assets.

Local banks insist that their success in winning business is less down to aggressive pricing than a fall in their cost of funding. The yield curve has flattened, notes one lender. Remember that the ten-year benchmark is down in the last three years from maybe 8% to nearer 5%. We can keep our credit spreads pretty constant and win business from other debt providers, though there have also been improvements in the types of risks we are willing to accept.

Their biggest competition probably comes from official development assistance loans, usually attached to unsolicited capital-intensive project proposals for which lenders home country contractors would be the perfect candidates. ODA-funded projects have a history of cost overruns, though government likes to stress that all-in costs (inclusive of cross-currency swaps) or 3%, and tenors of up to 40 years (with ten-year grace periods) mean that government can still come out ahead.

And government shows an awareness of the uses and limitations of ODA loans. Schools and roads, which lack opportunities for the export of capital goods, are less obvious targets for ODA loans. Airports and transit systems are much more popular. The Department of Transportation and Communications, which runs airports and transit systems (Public Works is responsible for most of the countrys roads system), suggests that it might bid out the operations and maintenance of ODA-financed airports, giving foreign sponsors if not banks something to gain from the effort.