Why foreign bidders are reluctant to participate in the Philippine PPP Program

November 27, 2014

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Philippine toll road highway 710

Last week, we attended the Land Transport Infrastructure Conference organized by Trueventus in Manila.

Local government officials, local and international consultants, local PPP developers and other parties involved in the Philippine PPP Program got together to discuss the progress being made by the Aquino administration and also existing constraints to further develop the program.

The general feeling is that **the Government has made a great job awarding up to eight PPP projects during the last three years**. Things currently stand at a point that was unimaginable back when the Program was rolled out.

During the same period, neighboring countries such as Indonesia, Thailand and Vietnam have struggled to move forward even with a single PPP project in spite of having a long pipeline of projects already selected.

The Philippines has made progress because of two main reasons.

1. There is a much greater understanding within Government of how these projects should be structured. The PPP Center is leading this understanding by publishing updates on each project including the actual concessions, building capacity at the Center and in other Departments and by being prepared to change the terms of a deal if it does not find favour with the market as happened with LRT line 1.
2. There has been significant appetite from local conglomerates (see below), supported by local banks – at least until they reach single borrower limits.

The Philippines is indeed in desperate needs of adequate infrastructure to cover the basic needs of the society. For instance, the current situation of Manila's road traffic is causing millions of dollars in inefficiencies and unproductivity. Locals spend hours and hours driving from home to work and vice versa through highways full with cars. In fact, it's common to see professionals using personal drivers so that they can use their time in cars to work while they are stuck in traffic.

We believe that **the general sentiment of foreign players towards the PPP Programs is however not as good as it should apparently be**, given the quick roll-out of projects.

The Program seems to be dominated by several domestic conglomerates that are winning most of the projects: Ayala Corporation, San Miguel Corporation, Megawide Construction Corporation, Metro Pacific Investment Corporation and Aboitiz.

Although several foreign PPP developers and infrastructure operators have bought bidding documents to participate in the projects, at the end, the list of final proposals does not usually include any of them. Australian infrastructure investor Macquarie has been the exception.

After extensive discussions at the event, we can summarize the problems that foreign players are encountering to bid for PPP projects in the Philippines in five main points:

1. **Limitations in foreign ownership of PPP projects**

According to a national law, foreign companies can only own a maximum of 40 % of public utility franchises, which by definition in local law include public transport, roads, water, and other projects.

Although this is discouraging for foreign investors, a representative of the Department of Transport and Communications (DOTC) explained that this limitation applied only to the Operator Company subcontracted by the PPP contract owner in the case of the Light Rail Train-1 project in Manila. It did not apply at the concessionaire level. This so – called anti dummy law was central to the Manila airport terminal 3 dispute which, twelve years on, is still in arbitration. The Government needs to clarify the impact of this restriction and is considering raising the 40% limit which would be welcome.

1. **Projects structured with demand & real estate/commercial risk**

According to information provided by speakers of the public and private sector, bids for the Cavite-Laguna road project and the Laguna Lakeshore project will be conditioned by adjacent urban properties owned by the main local conglomerates. As a consequence, if you are a foreign private player and you don't have any real estate interests in the corridors it seems not plausible to be competitive against these local conglomerates.

It was announced at the event that the only bid for Light Rail Train-1 project in Manila also included a significant portion of commercial revenues. However, the total amount was not revealed.

Domestic investors have been bullish in this respect. Ayala and MPIC offered a 9.35 billion pesos premium on the LRT1 extension when the Government had been prepared to pay Viability Gap Funding of up to 8 billion pesos. As on other deals, there is no Government support on traffic numbers. Significant differences of opinion exist, therefore, as to the value of the real estate to be developed in this project. Time will tell who was right.

1. **Modification of contract terms after qualification process**

In our view, another important constraint for the Program is that the final Terms of the contracts end up being very different compared with what they were before the qualification process.

Having the dialogue after the qualification process prevents many potential bidders of entering the race to win the projects once they have acceptable terms for the private sector.

A local consultant confirmed he worked with foreign bidder who quit from bidding for a PPP project at a preliminary stage. However, final Terms of the contract changed considerably and would have been considered acceptable for the same bidder.

1. **Regulatory risk remains**

For example, Ayala and Aboitiz recently won the 35 billion pesos ($787 million) Cavite Laguna Expressway (CaLaX) deal with a premium of 11.6 billion pesos. San Miguel had previously been eliminated on a technicality concerning its bid bond but would apparently have bid Peso 20 billion. The President has ordered re-bidding the project.

1. **Government decision-making has, at times, still been slower than the private sector would like**

For example, it took four years for the Government to issue the performance undertaking to San Miguel's Universal LRT on the LRT 7 combined rail / road project.

In conclusion, the Philippines is well ahead of its neighbours in applying PPPs. To maintain momentum, though, it needs to address several key issues.

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