

PROJECT BUDGETING & FINANCING



LECTURE OBJECTIVES

By the end of the lecture, participants are expected to:

- Understand basic concepts of budgeting and financing of projects
- Identify various sources of project financing for LGUs

BUDGETING

Budgeting includes aggregating costs of activities and determining project's cash flow needs to a established system of report and control

It also involves sharing limited resources among several project groups or functions in a project environment

BUDGET ANALYSIS

Budget analysis can serve any of the following purposes:

- Plan for resource expenditure
- Project selection criterion
- Projection of project policy
- Basis for project control
- Performance measure
- Standardization of resource allocation
- Incentive for improvement

APPROACHES IN BUDGETING

Top-down budgeting

- Involves collecting data from upper-level sources such as top and middle managers
- Figures supplied may come from their personal judgment, past experience or past data on similar project activities
- Top management provides the global budget, while the functional level worker provides specific budget requirements for project items

APPROACHES IN BUDGETING

Bottom-up budgeting

- Detailed budget request make use of elemental activities and their schedules, descriptions, and labor skill requirements
- Line workers familiar with the specific activities are requested to provide cost estimates
- Estimates are made for each activity in terms of labor, time, materials and machine time

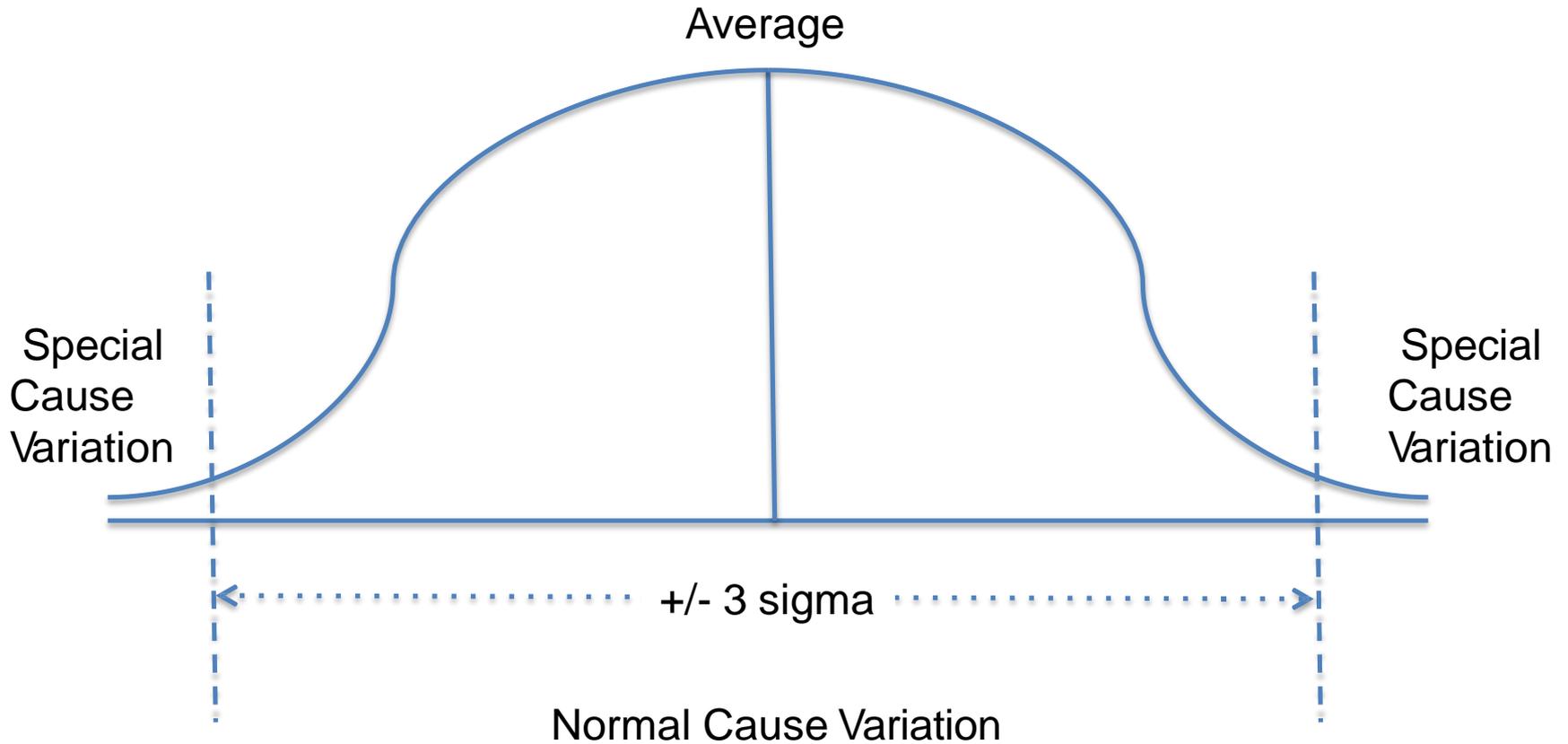
CAPITAL RATIONING/ BUDGETING

The decision-making process by which organization identifies and evaluates the financial benefits of proposed projects and decides:

- Which investment projects are needed
- Possible and special focus on projects that require significant up-front capital investment
- How to allocate available capital between different projects
- If additional capital is needed

Sophisticated capital budgeting techniques take into consideration depreciation schedules, tax information, inflation and other economic concerns

BUDGETING VARIATIONS



BUDGETING VARIATIONS

Occurs in all work processes and has to be anticipated in the project costs.

- More routine processes and activities are, the less variation occurs
- More unusual work and high in human interaction, the more opportunities for variation
- Normal variation may come from many small causes that are inherent in a work process
- Special variation occur out of something extraordinary

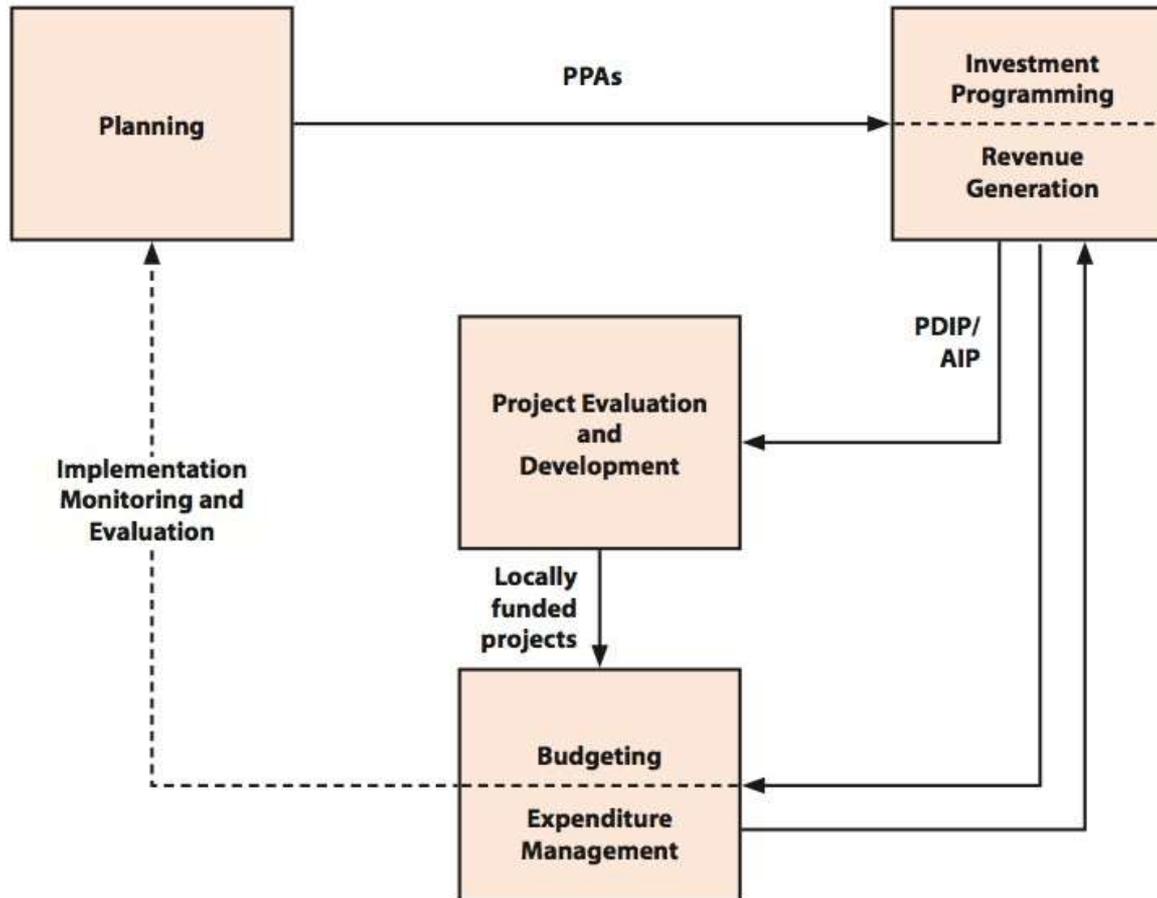
GOVERNMENT BUDGETING

Government budgeting is the critical exercise of allocating revenues and borrowed funds to attain the economic and social goals of the country

- Performance informed budgeting
- Zero-based budgeting
- Bottom-up budgeting

PROJECT FINANCING & BUDGETING

PLPEM Guideline/ Framework



PROJECT FINANCING

LGUs must be able to use a variety of funding opportunities with intensified local revenue efforts and augment by external resources

Regular local revenue	Borrowings	Foreign and local grants
Capital income from sale/use of assets	LGU's Funding Sources	Cost recovery elements
Cost sharing with LGUs or NG	PPP	Combination

LGU RESOURCE MOBILIZATION TOOLS [1]

The LGC provides LGUs with powerful resource mobilization tools of potential revenue sources:

- Land-based tools
- Community activity-based tools
- Infrastructure-based tools
- Debt-based tools
- Revenue sharing tools.

LGU RESOURCE MOBILIZATION TOOLS [2]

Land-based tools rely on the real property resources of the LGUs such as

- Basic real property tax
- Special education fund
- Land transfer tax
- Idle land tax
- Public land use tax
- Land sale of foreclosed real properties
- Land investment
- Land reclassification
- Land development permit fee
- Tax on sand, gravel and other quarry resources

LGU RESOURCE MOBILIZATION TOOLS [3]

Community activity-based tools rely on the flow of economic activity within the LGU's territory

- Business tax/ Community tax/ Franchise tax
- Tax on business of printing and publication
- Professional tax
- Amusement tax
- Annual fixed tax on delivery trucks or vans
- Fees and charges (on business and occupation)
- Fees for sealing and licensing of weights and measures
- Fishery rentals, fees and charges
- Service fees and charges

LGU RESOURCE MOBILIZATION TOOLS [4]

Infrastructure-based tools are based on the “user”-pay principle as benefits derived from the use of public infrastructure. Usually cost recovery mechanisms for infrastructure projects

- Special levy
- Toll fees or charges
- Public utility charges

LGU RESOURCE MOBILIZATION TOOLS [5]

Debt-based tools allow LGUs to secure debt finance for income-generating projects and make investments in financial debt instruments

- Debt financing
- Financial investment such as bank time deposits in public or private banks

LGU RESOURCE MOBILIZATION TOOLS [6]

Revenue sharing-based tools are based on national government revenues shared with LGUs provided by the LGC

- Share in mining, fishery and forestry taxes
- Share in gross sales or taxes of GOCC engaged in development and exploitation of natural resources located in the LGU

CONSIDERATION FOR FINANCING STRATEGY

In selecting appropriate financing instrument, the following should be considered

- Legality
- Characteristics of the sources
- Adequacy of the funds wrt to capital and MOOE requirements
- Impact on LGU's budget
- Political and administrative feasibility

LEGALITIES ON LGUs FINANCING

RA 7160 [1]

LGUS may avail of credit lines from government or private banks and lending institutions for the purpose of stabilizing finances as stipulated under RA 7160 Section 296:

“It shall be the basic policy that any local government unit may create indebtedness and avail of credit facilities to finance local infrastructure and other socio-economic development projects in accordance with approved local development plan and public investment program”

LEGALITIES ON LGUs FINANCING

RA 7160 [2]

On loans, credits and other forms of indebtedness

LGUs “may contract loans, credit and other forms of indebtedness with any government or domestic private bank and other lending institutions to finance the construction, installation, improvement, expansion, operation, or maintenance of public facilities, housing projects. The acquisition of real property and the implementation of other capital investment projects- subject to such terms and conditions as may be agreed by the LGU and the lender. The proceeds from such transactions shall accrue directly to the LGU concerned” (Section 297)

LEGALITIES ON LGUs FINANCING

RA 7160 [3]

Sec 298: Deferred Payments and other Financial Long Term Securities

Sec 299: Bonds and other Long Term Securities

Sec 300: Inter-Local Government Loans, Grants and Subsidies

Sec 301: Loans from Funds by the National Government from Foreign Sources

IRR Rule XXXIII (Art 393 to 400)

MODES OF ACCESSING CREDIT MARKET

LGUS may access the credit market especially to finance vital development investment projects – income-generating and revenue-anticipating projects. Options include:

- Variants of the Build-Operate-Transfer (BOT) scheme
- Municipal bond flotation
- Direct borrowings from private and government financing institutions (GFIs) and government-managed lending lines
- Official Development Assistance: Multi/bilateral loans and grants

COMMON REQUIREMENTS FOR CREDIT ACCESS

Feasibility study of project

Projected cash flows and income statements of the project

Pertinent resolutions and approvals

Audited financial statements, past five years

Projected financial statements (balance sheet and income statement)

PHILIPPINE BOT LAW (RA 7718)

The BOT Law under RA 6957 as amended by RA 7718 entitled

An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes

PHILIPPINE BOT LAW

SALIENT FEATURES

- Recognizes private sector role in development
- Many allowable variants
- Covers most infrastructure sectors
- Allows procurement options (solicited and unsolicited mode)
- Allows reasonable return on investments made by the private sector
- Institutionalizes provision of government support (e.g. investment incentives, government undertakings especially for solicited proposals)

BOT PROJECT

- A form of public-private partnership in providing public infrastructure
- Gives to private company the right to build and operate facility
- Financing responsibility is shouldered by private company
- Stream of repayment is based on projects assets and revenue
- Long concession period (20-25 years) after which facility is transferred to the LGU

BOT PROJECT KEY FEATURES

- A contractual agreement or schemes
- Contractor undertakes the construction, financing, operation and maintenance of a given infrastructure facility
- The facility is operated by the contractor over a fixed term not to exceed fifty (50) years
- Contractor allowed to charge users of the facility appropriate fees, tolls, rentals and charges
- Facility is transferred to the LGU at the end of the fixed term
- Includes a supply and operate arrangement; provides technology transfer
- LGU Engineer plays a pivotal role since he is tasked to prepare plans and specifications for the proposed project for submission to the Sanggunian

BOT

PROJECT BENEFITS

- Alternative source of financing
- No investment cost to LGUs
- Offers proper allocation of risks
- Better and reliable service and consistent supply
- Project sustainability
- New technology and skills

BOT SCHEME VARIANTS

BOT and its Variants		
Transfer Immediately	Transfer After Cooperation Period	No Transfer
<p>BT: Build and transfer</p> <p>BTO: Build-transfer-and-operate</p>	<p>BOT: Build-operate-transfer</p> <p>ROT: Rehabilitate-own-and-transfer</p> <p>CAO: Contract-add-and-operate</p> <p>DOT: Develop-operate-and transfer</p> <p>BLT: Build-lease-and transfer</p>	<p>BOO: Build-own-and-operate</p> <p>ROO: Rehabilitate-own-and-operate</p>

*The sooner the transfer,
the lower the risk to the private sector.
The lower the risk,
the lower the payments.*

ELIGIBLE PROJECTS UNDER BOTSCHEME

Power Plants

Highways

Railroads and railways

Ports

Land Reclamation

Sewerage/ Drainage/

Dredging/ Solid Waste

Management

Airports

Health Facilities

Transport Systems

Telecommunications/IT

Canals/ Dams/ Irrigation/

Water supply

Tourism

Education

Industrial/ Tourism estates

Markets/ Warehouses/

Slaughterhouses

Housing

Government buildings

Other

infrastructure/development

Project

NATURE OF PROJECTS UNDER BOT SCHEMES

- Construction
- Rehabilitation
- Improvement
- Betterment
- Expansion
- Modernization
- Operation
- Maintenance

BOT PROJECTS SCALE AND THEIR APPROVAL [1]

Scale	Cost Range	Approval
National	P 300 M and above	Investment Coordination Committee (ICC) & NEDA Board
	Below P 300 M	ICC
	Any amount (negotiated)	ICC and NEDA Board

BOT PROJECTS SCALE AND THEIR APPROVAL [2]

Scale	Cost Range	Approval
Local	P 200 M and above	ICC
	P 50-200 M	Regional Development Council
	P 50 M	City Development Council
	P 20-50 M	Provincial Development Council
	P 20 M	Municipal Development Council
All LGU		Local Sanggunian Approval before bidding and before contract awarding

BOT PROJECTS

MODES OF PROCUREMENT [1]

- Public bidding
 - Option 1:* Pre-qualification undertaken prior to issuance of the request for proposal (RFP)
 - Option 2:* Qualification included in the RFP
- Direct Negotiations
- Unsolicited Proposals

BOT PROJECTS

MODES OF PROCUREMENT [2]

- *Direct negotiation* shall be resorted to when there is only one complying bidder (IRR Rule 9.1)
- *Unsolicited Proposals* are submitted by the private sector to undertake infrastructure or development projects which may be entered into by agency/LGU if
 - New concept or technology and/or not in the list of priority projects
 - No direct government guarantee, subsidy, equity
 - Government agency/LGU concerned must solicit comparative proposals

BOT PROJECTS

LGU OBLIGATIONS

- Lays down minimum design and performance standards and specifications
- Grants franchise to BOT contractor
- Approves detailed engineering design
- Provides for right-of-way and other facilities
- Takes charge of technical supervision of the project

BOT PROJECTS

CONTRACTOR OBLIGATIONS

- Provide funds for the construction of the facility
- Prepares detailed engineering design and plans in conformity with the minimum design and performance standards and specifications set by the LGU
- Builds the facility
- Operates the facility
- Undertakes maintenance and repair of the facility
- Collects tolls/ fees/ rentals/ charges on users of the facility
- Provides the LGU with a share in the revenues

BOT PROJECTS

REPAYMENT SCHEMES

- Project proponent repaid through:
 - Tolls, fees, rentals and other charges from users of facility for a fixed term not to exceed 50 years
 - Share in revenue of the project
 - Other non-monetary payments
- For negotiated contracts/natural monopolies
 - Tolls and other fees require approval of appropriate government regulatory bodies
 - User charges may be subject to adjustment

BOT PROJECTS

SOURCE OF FINANCING

- Projects with difficulty sourcing funds may be partially financed from Official Development Assistance (ODA)
- Financing from ODA shall not to exceed 50% of project cost

BOT PROJECTS

INVESTMENT INCENTIVES

- Fiscal incentives under BOI's Omnibus Investment Code
- Other incentives provided under existing laws (e.g. Tourism incentives program, Mini-hydroelectric power incentives act, etc.)
- Additional LGU tax incentives

MUNICIPAL BOND FLOTATION [1]

Bonds are defined as a written promise to pay a specified amount, called *principal amount* or maturity value, at a future date in equal payments at a specified interest rate, at equal intervals until the redemption date

- Municipal bonds are issued by LGUs to fund priority revenue-generating or revenue-anticipating projects.
- Taps funds of the capital market
- LGU determines to a large extent the terms and conditions of its indebtedness.

MUNICIPAL BOND FLOTATION [2]

Entities involved in MBF

- *LGU* as the issuer of bonds
- *Financial advisor of LGU* who advises issuer on details of bond flotation and designs features of bond
- *Underwriter* as the seller of bonds (wholesale)
- *Trustee bank* as fund custodian, fund manager, paying agent
- Bond holders or investors

MUNICIPAL BOND FLOTATION [3]

Projects that are revenue-generating, usually urban utilities, services and facilities such as:

Ports and airports

Transportation terminal

Mass transport system

Commercial complex

Food processing plants

Industrial & tourism estates

Housing

Waste disposal system

Water supply system

Slaughterhouse

Public market

MUNICIPAL BOND FLOTATION [4]

Among the benefits of MBF are:

- Promotion of self-reliance of the LGU in determining terms and conditions for its indebtedness
- Residents are allowed to participate and earn from interest earnings
- Enormous funds of the capital market are being tapped

DIRECT LOANS FROM GFIs [1]

Includes commercial bank loans or loans from government financing institutions or specialized government-managed lending lines

Allows LGU to tap private and government capital invested in private banks and government financing institutions to finance priority capital projects

Used to finance establishment, development or expansion of income generating projects

DIRECT LOANS FROM GFIs [2]

Usual terms of direct loans

- Prime interest rates subject to periodic adjustment in interest rates
- In the case of government financing institutions and specialized lending lines, rates may be lower than prime rates for LGUs, especially for projects that have special lending windows
- Requires mortgage of real estate or equipment
- Amount of loan is equivalent to amount required by the project and based on value of collateral
- Specified maximum number of years with grace period and subject to debt restructuring

DIRECT LOANS FROM GFIs [3]

Interest rates are usually higher than the municipal bond rate

Project depends on the financing institution's guidelines and implementing rules

Terms and conditions of the financing institutions are usually fixed and inflexible

INTER-LOCAL GOVERNMENT LOANS

This includes loans, grants and subsidies from other LGUs.

LGUs can extend assistance to other LGUs in the spirit of “bayanihan” and can jointly address issues and concerns that transcend political boundaries

LGUs can attend to common service delivery concerns of adjacent LGUs

OFFICIAL DEVELOPMENT ASSISTANCE [1]

OECD defines ODA as:

loans and grants to the Philippines provided by bilateral and multilateral institutions

Concessional in character with a grant element of at least 25%

Seeks to promote economic development and welfare

OFFICIAL DEVELOPMENT ASSISTANCE [2]

RA 8182 or the Official Development Assistance Act of 1996 defines ODA as loans and grants given that:

- Administered with the objective of promoting sustainable social and economic development and welfare
- Contracted with governments of foreign countries with whom the Philippines has diplomatic, trade relations or bilateral agreements or which are UN members
- There are no available comparable financial institutions;
- Contain a grant element of at least 25%

OFFICIAL DEVELOPMENT ASSISTANCE [3]

Concessional Loans	Grants
Interest rates: 0-7 % Maturity periods: 4-40 yrs Grace periods: 0-10 yrs	No repayment obligation Provided in terms of expertise, equipment and training
Main uses: (1) capital formation; (2) commodity aid/supply of goods; (3) budget support	Main uses: (1) transfer of technology; (2) pre-investment activities; (3) R&D; (4) institution building; (5) human resources development

ODA

DEVELOPMENT PARTNERS [1]

Loans

Multilateral

Asian Development Bank
World Bank-International
Bank for Reconstruction and
Development (IBRD)
International Fund for
Agricultural Development,
(IFAD)
OPEC Fund for International
Development
European Investment Bank

Bilateral

Denmark Danida
Germany Kreditanstalt für
Wiederaufbau (KfW)
Swedish International
Development Cooperation
Agency
Saudi Fund for Development
Austria, Canada, Italy,
Finland, France, Japan
Norway, Spain, Switzerland,
UK

ODA

DEVELOPMENT PARTNERS [2]

Grants

Multilateral

Asian Development Bank
European Community
United Nations Development Programme
UN Children's Fund
UN Industrial Development Organization
UN Population Fund
Food and Agricultural Organization
International Labor Organization

Bilateral

Australian Agency for International Development
Canadian International Cooperation Agency
French Private Sector Study Fund
Japan International Cooperation Agency
Norwegian Agency for Development Cooperation
Czech Republic, Korea, NZ
Singapore, Spain, UK, US

ODA FOR LGUs [1]

LGUs can be:

- Implementor of ODA-assisted projects
- Beneficiaries of NG-implemented ODA loan and grant projects
- Can access ODA loans via GFIs or the municipal development finance office

Some issues on LGU involvement with ODA projects are its capacity to provide equity for projects, technical capability, and leadership continuity among others

ODA FOR LGUs [2]

Examples of ODA

Grant Assistance for Grassroots Human Security Project (General Grant Program) includes self-supporting socio-economic development activities to benefit sectors at the grassroots level with emphasis on poverty alleviation and livelihood improvement

Credit Line for Energy Efficiency and Climate Protection provides funding for energy efficiency and climate protection

Perez-Guerrero Trust Fund for Economic and Technical Cooperation Among Developing Countries provides assistance on FS financing, implementation of projects within the framework of the Caracas Programme of Action of ECDC

THANK YOU