



# Report and Recommendation of the President to the Board of Directors

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Project Number: 48271-001  
November 2014

## Proposed Loan GMR Megawide Cebu Airport Corporation Mactan Cebu International Passenger Terminal Project (Philippines)

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 1 October 2014)

Currency unit	–	peso/s (P)
P1.00	=	\$0.02225
\$1.00	=	P44.94

## ABBREVIATIONS

ADB	–	Asian Development Bank
DOTC	–	Department of Transportation and Communication
EMP	–	environmental management plan
EPC	–	engineering, procurement, and construction
GDP	–	gross domestic product
GIL	–	GMR Infrastructure Ltd
GMCAC	–	GMR Megawide Cebu Airport Corporation
IEE	–	initial environmental examination
MCC	–	Megawide Construction Corporation
MCIA	–	Mactan Cebu International Airport
MCIAA	–	Mactan Cebu International Airport Authority
mppa	–	million passengers per annum
PPP	–	public–private partnership
TA	–	technical assistance

## NOTES

- (i) The fiscal year of GMR Megawide Cebu Airport Corporation ends on 31 December.
- (ii) In this report, “\$” refers to US dollars.

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## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan of up to \$75,000,000 to GMR Megawide Cebu Airport Corporation (GMCAC) for the Mactan Cebu International Passenger Terminal Project in the Philippines.<sup>1</sup>

## II. THE PROJECT

### A. Project Identification and Description

#### 1. Project Identification

2. The Philippines is an archipelago of more than 7,100 islands spread over almost 300,000 square kilometers. The archipelagic topography increases the nation's difficulties in disseminating the benefits of robust economic growth to the country's population and improving living standards of the country's poor, many of whom are scattered in remote islands including those in the central and southern regions.<sup>2</sup> Development of an efficient transport network is critical to achieve seamless movement of people and goods across the country and beyond; and to extend the benefits of economic and social growth to more of the population.<sup>3</sup>

3. With respect to transport infrastructure, the Global Competitiveness Report, 2013–2014 ranked the Philippines 113th for airports and 116th for seaport facilities out of 148 countries.<sup>4</sup> This underscores the extent to which the country has lagged in the development of critical infrastructure, which is a key bottleneck to sustainable and inclusive economic growth in the country. A World Bank study reported that the Philippines' investments in infrastructure represented an average of only 2.1% of its gross domestic product (GDP) in 1980–2009, which was far below the World Bank's benchmark of 5% of GDP. As a result, the country's infrastructure is in a dire state—deterring investments in other key sectors such as industry and agribusiness.

4. Public resources to support infrastructure development are limited in the Philippines. The Government of the Philippines has promoted public–private partnership (PPP) for infrastructure development to address the constraints. In support of government initiatives, the Asian Development Bank (ADB) approved technical assistance (TA) in 2011<sup>5</sup> to improve the government's PPP design and capacity, and to finance the bid preparation and implementation of PPP projects, including the project, being administered by the Philippine PPP Center.<sup>6</sup> The project would be the first large scale PPP project awarded by government under its PPP agenda.

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> The country has seen robust economic growth despite the global financial crisis and recession. The government reported gross domestic product (GDP) growth of 7.2% in 2013 and 6.7% in 2012.

<sup>3</sup> The Philippines' challenges remain, for example, as in the poverty incidence at 19.7% in 2012, according to the National Statistics Coordination Board. Unemployment is another example, at an estimated 12.1 million or about 27.5% of the population of adults in the labor force during the last quarter of 2013 as reported by Social Weather Stations in February 2014.

<sup>4</sup> World Economic Forum. 2013. *The Global Competitiveness Report, 2013–2014*. Geneva. [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2013-14.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf).

<sup>5</sup> ADB. 2011. *Technical Assistance to the Republic of the Philippines for Strengthening Public–Private Partnerships*. Manila (February).

<sup>6</sup> Since the Philippines PPP program was launched in 2010, eight projects, (including this project) have been successfully awarded to the private sector concessionaire through a competitive and transparent bidding process as of 15 September 2014. Another six projects are going through the tender processes. The government hopes to award 15 PPP projects before the end of the term of the current administration in June 2016.

5. The Mactan Cebu International Airport (MCIA) is located in the province of Cebu, Central Visayas region. The region, which is composed of four island provinces with a population of 6.8 million in 2010, is a major regional economy accounting for 6.2% of the country's gross domestic product. It is among the three fastest growing regions with annual average growth of 7.9% in 2010–2011<sup>7</sup>. Cebu, which is the region's center, is one of the most developed provinces in the country and the second most populated province with a population of about 4.2 million in 2010. The economy of Cebu is the largest after Metro Manila. The major economic driver of growth for Cebu is tourism, industries and business process outsourcing. The island of Cebu is the most accessible place in the country with more domestic air and sea linkages than any other city in the Philippines, which is an ideal location for trade and industry. The province is also a popular vacation destination of both international and domestic tourists.

6. The MCIA is the international gateway to Visayas. There are no other airports in the region that is designed to handle high volume of international traffic. Opened for commercial operations in the 1960s, MCIA is designed to serve 4.5 million passengers per annum (mppa). The government's liberalization of the airline industry and increased focus on tourism and industrial and commercial development have resulted in an increasing number of flights and passengers using the country's airports, including the MCIA.<sup>8</sup> The airport has experienced impressive passenger growth over the past decade and in 2012, MCIA served more than 6.7 million passengers. This has strained airport infrastructure, affected service and passenger convenience, and exposed the airport's lack of capacity to handle more passengers, especially during peak hours. Without the proposed expansion at MCIA, the infrastructure constraint could limit further growth in the tourism and other key sectors, which are essential in providing employment opportunities for sustainable and inclusive economic growth in the region.

7. The Department of Transportation and Communication (DOTC) and Mactan Cebu International Airport Authority (MCI AA) launched an invitation to bid for the project on 21 December 2012. Seven groups responded to the invitation and submitted bids on 28 November 2013 for a concession right to the project.<sup>9</sup> The consortium of GMR Infrastructure Ltd (GIL) and Megawide Construction Corporation (MCC) submitted the highest bid by offering a premium of P14.4 billion for the rights to the project. The notice of award was issued to the GIL–MCC consortium by DOTC on 4 April 2014. The government and the GIL–MCC consortium signed the Mactan Cebu airport concession agreement on 22 April 2014. ADB was in discussions with the consortium, before the bid, for its potential financial assistance to the project. The project fully meets ADB's strategic, country, and sector approaches for infrastructure development and poverty reduction.

## 2. Project Design

8. The project involves (i) construction of a new passenger terminal with a designed capacity of 8 mppa, (ii) renovation of the existing passenger terminal with a designed capacity of 4.5 mppa,<sup>10</sup> (iii) construction of an apron for the new passenger terminal, (iv) development and construction of commercial facilities, and (v) the operation and management of both passenger

<sup>7</sup> Regional Development Council. Central Visayas Region. [www.rdc7.net.ph](http://www.rdc7.net.ph)

<sup>8</sup> The government has increased focus on building the country's tourism industry to boost air traffic to the country, with the aim of attracting 10 million visitors per year by the end of 2017, up from almost 4.7 million visitors in 2013.

<sup>9</sup> The seven groups are (i) AAA Airports Partners (Ayala, Aboitiz, ADBC & HAS consortium); (ii) Filinvest and Changi Airport consortium; (iii) First Philippine Airports (Lopez and Infratil Asia consortium); (iv) GMR Infrastructure and Megawide consortium; (v) MPIC, JG Summit, and Aeroports de Lyon Consortium; (vi) Premier Airport Group (Zurich Airport, Citadel, and SM Group); and (vii) SMC and Incheon Airport Group.

<sup>10</sup> The renovation would be undertaken after construction of the new passenger terminal is completed.

terminals and commercial facilities over a 25-year concession period starting from the handover date. During the term of the concession, GMCAC may undertake capital expenditures to augment capacity to ensure compliance with performance standards specified under the concession agreement.

### **3. The Borrower and Sponsors**

9. GMCAC is a special purpose vehicle established to implement the project. The sponsors, GIL and MCC, will contribute 40% (GIL) and 60% (MCC) of the equity.<sup>11</sup>

10. GIL is a holding company based in India. It has a portfolio of investments in several infrastructure projects in four segments: airports, energy, road, and sports and urban infrastructure. In the airports sector, GIL is considered the fourth largest private airport operator in the world, having invested about \$4 billion in three airports.<sup>12</sup> For the year ending March 2013, the GIL airports handled close to 80 million passengers combined. GIL airports include (i) India's busiest airport, the Indira Gandhi International Airport in New Delhi; (ii) Rajiv Gandhi International Airport in Hyderabad; and (iii) Istanbul Sabiha Gökçen International Airport in Turkey.<sup>13</sup> Under the leadership of GIL, these airports received several accolades.<sup>14</sup>

11. MCC is engaged in the general construction business in the Philippines. It is a publicly listed company. MCC is recognized as a leader in the construction industry for the use of modern technology. In addition to winning the project in partnership with GIL, MCC has won three PPP projects—the building of classrooms (Phase 1 and 2) and the modernization of the Philippine Orthopedic Center, which it is implementing.

## **B. Development Impacts, Outcome, and Output**

### **1. Impacts**

12. The project will contribute to (i) improved international and domestic air transport services in the Philippines, and (ii) greater private sector investment in airport PPPs in the Philippines. The government plans to establish a sustainable transport system in the Philippines that would not only improve the mobility of the country's population but would also significantly increase the development of the various provinces in the country. The project will demonstrate the commitment of the government to provide critical infrastructure, the lack of which has impeded economic growth and capital investments. Successful financing and implementation of the project will encourage further investments in similar projects under a PPP arrangement.

### **2. Outcome**

13. The outcome will be efficient and high-quality operations at the MCIA that meet required standards. The outcome will be measured, among others, by increased international passenger traffic to Cebu; increased air traffic movements; achievement of at least International Air Transport Association C service standards; and increased government revenues in the form of

<sup>11</sup> The Philippines' constitution restricts foreign ownership of public utilities such as airports to 40% of equity.

<sup>12</sup> The three larger private airport operators are (i) Ferrovial S.A., (Spain), (ii) TAV (Turkey), and (iii) PSP Investments (Canada).

<sup>13</sup> GIL sold its equity stake in the Istanbul airport in December 2013.

<sup>14</sup> New Delhi airport was recognized as the second best airport in the 25–50 mppa category in 2012 by the Airports Council International; and the world's most improved airport in 2012 by SKYTRAX. Hyderabad Airport was recognized in 2010, 2011, and 2012 as the second best airport in the world in the 5–15 mppa category in Airport Service Quality; and India's third best airport in 2012 by SKYTRAX. Istanbul airport was cited the best airport in the World Low Cost Airline Awards in 2010.

premium payment for the concession and taxes from the project. The growth in passengers will generate direct and indirect employment opportunities in the province of Cebu.

### 3. Output

14. The project's output will be improved airport facilities at the MCIA, which will be reflected in (i) a new passenger terminal completed and another passenger terminal renovated and operational by 2019, (ii) passenger capacity increased from 4.5 million in 2014 to 12.5 million by 2019, and (iii) about 400 workers employed for construction work.

### C. Alignment with ADB Strategy and Operations

15. The project is consistent with ADB's Midterm Review of Strategy 2020, which aims to achieve inclusive economic growth in its developing member countries through the provision of infrastructure that would connect the poor to markets and increase their access to basic productive assets.<sup>15</sup> Strategy 2020 promotes PPP arrangements in the transport sector and encourages ADB support for PPP projects through direct financing.

16. ADB's country partnership strategy, 2011–2016 aims to help the country achieve high, inclusive, and sustainable growth.<sup>16</sup> The strategy supports infrastructure development, which includes improvement of the country's port operations through PPP arrangements.

17. ADB's Sustainable Transport Initiative emphasizes private sector participation in transport as an integral part of mainstreaming sustainable transport in its developing member countries.<sup>17</sup>

### D. Implementation Arrangements

18. Table 1 summarizes the implementation arrangements.

**Table 1: Summary of Implementation Arrangements**

Aspects	Arrangements
Regulatory framework	Build–own–transfer law that allows the government to enter into contractual arrangements with private sector entities for infrastructure facilities
Management	GMCAC, a special purpose company, incorporated in the Philippines. GMCAC is owned by MCC and GIL. MCC is a local construction company with a strong reputation for delivering infrastructure projects using modern industry practices; GIL is the fourth largest private airport operator in the world.
Construction arrangements	
Type of arrangement	Fixed price turnkey EPC contract
Contractor	GISPL and MCC are jointly responsible for the construction works of the project. GISPL is a subsidiary of GIL.

<sup>15</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>16</sup> ADB. 2011. *Country Partnership Strategy: Philippines, 2011–2016*. Manila.

<sup>17</sup> ADB. 2010. *Sustainable Transport Initiative: Operational Plan*. Manila (July).

Aspects	Arrangements
Operations arrangements	
Revenue structure	The project will be implemented under a 25-year concession agreement with DOTC and MCIAA. GMCAC is responsible for the construction and operation of a new passenger terminal, and the renovation and operation of the existing terminal. GMCAC will be entitled to collect terminal fees, airport parking fees, and other commercial revenues during the term of the concession.
Operation and maintenance	GIL will provide technical assistance to GMCAC for 25 years for the operation and management of the project under a technical services agreement. The assistance includes preparation of policies, training of GMCAC personnel, and provision of qualified experts.
Performance monitoring	GMCAC will issue regular reports on finances, construction, operations, and environmental and social monitoring. Performance indicators are shown in the design and monitoring framework.

DOTC = Department of Transportation and Communication, EPC = engineering, procurement, and construction, GIL = GMR Infrastructure Ltd, GISPL = GMR Infrastructure (Singapore) Pte Ltd, GMCAC = GMR Megawide Cebu Airport Corporation, MCC = Megawide Construction Corporation, MCIAA = Mactan Cebu International Airport Authority.

Source: Asian Development Bank.

### III. THE PROPOSED ADB ASSISTANCE

#### A. The Assistance

19. The proposed ADB assistance is a direct loan of up to \$75 million. The loan will be denominated in US dollars. The financing agreements will contain standard provisions for transactions of this nature.

#### B. Value Added by ADB Assistance

20. ADB's support for the project is justified based on the following:

- (i) The successful implementation of the first large infrastructure project awarded under the government's PPP program would attract interest in long-term investments in the country. ADB's involvement will help ensure the government's long-term support for the project, which would give comfort to international investors and lenders.
- (ii) ADB's investment in the project will help ensure that GMCAC will adopt best practices in airport terminal operations including ADB's safeguard standards, which could be replicated.
- (iii) The proposed long-tenor debt from ADB plays a crucial role in ensuring the economic and financial viability of the project. ADB will also contribute prudent structuring of the financing package in line with regional models.

### IV. POLICY COMPLIANCE

#### A. Safeguards and Social Dimensions

21. In compliance with ADB's Safeguard Policy Statement (2009), the project is classified category B for environment, category C for involuntary resettlement, and category C for



indigenous peoples. The potential environmental and social impacts of the project have been identified and effective measures to avoid, minimize, mitigate, and compensate for the adverse impacts are incorporated in the safeguard reports and plans. The institutional capacity and commitment of GMCAC to manage the project's social and environmental impacts are deemed adequate.

22. The social compliance audit included in the IEE confirmed that no land acquisition or resettlement issues, relevant to the existing facilities that will be rehabilitated, are pending. New facilities will be constructed on a portion of state-owned land inside Mactan–Benito Ebuen Air Base. Except for military buildings and facilities, no other informal structures or encroachments are inside the security controlled air base. The road network to be improved will be undertaken on existing rights-of-way requiring no additional land acquisition or involuntary resettlement. Cebu and Mactan are highly urbanized areas and no indigenous peoples, ethnic groups, or tribal groups in the project area fall under the category of indigenous peoples described in ADB's Safeguard Policy Statement (2009).

23. **Other social dimensions.** The project is categorized as having some gender elements. GMCAC is considering the project design features that cater to the needs of women and the disabled. GMCAC is required to ensure that the design and features of the airport will follow the provisions of the Philippine Accessibility Law (Batas Pambansa Bilang 344), 1982. GMCAC will also organize orientation and training programs on specialized topics such as HIV/AIDS awareness and trafficking of women. MCIAA personnel, whose functions are directly involved in the terminal operations, were offered a transfer to GMCAC. Consultations have been carried out indicating no diminution of salary and benefits. GMCAC will comply with ADB's Social Protection Strategy and report regularly to ADB on their compliance (including contractors) with national labor laws, and adherence to internationally recognized core labor standards.

## **B. Anticorruption Policy**

24. The sponsors and GMCAC were advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

## **C. Investment Limitations**

25. The proposed direct loan is within the medium-term country, industry, group and single project exposure limits for nonsovereign investments.

## **D. Assurances**

26. Consistent with the Agreement Establishing the Asian Development Bank, the Government of the Philippines will be requested to confirm that it has no objection to the proposed assistance to GMCAC. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

## V. RECOMMENDATION

27. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of up to \$75,000,000 to GMR Megawide Cebu Airport Corporation for the Mactan Cebu International Passenger Terminal Project in the Philippines from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao  
President

17 November 2014

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p><b>Impacts</b> Improved international and domestic air transport services in the Philippines</p> <p>Greater private sector investment in airport PPPs in the Philippines</p>	<p>International and domestic passenger traffic in the Philippines increased by 10% from 37.67 million in 2013 to 41 million by 2023<sup>a</sup></p> <p>At least six airport projects managed by the private sector by 2023 with an estimated combined investment inflow of about \$1.6 billion (2014: 1 airport, \$720 million)</p>	<p>Civil Aviation Board <a href="http://www.cab.gov.ph">www.cab.gov.ph</a> (baseline data) and ADB estimates</p> <p>Government statistical reports</p>	<p><b>Assumptions</b> Government continues to liberalize civil aviation and encourages fair competition under its PPP policy</p> <p>Increased business and leisure travel to the Philippines from ASEAN countries</p> <p><b>Risks</b> Delays in the implementation of the upgrade of Philippine airports</p> <p>Natural disasters reduce domestic and international tourists</p>
<p><b>Outcome</b> Efficient and high-quality operations at MCIA</p>	<p>International passenger traffic in Cebu increased from 1.6 million in 2013 to 3.7 million by 2020</p> <p>International air traffic movement between Cebu and other countries increased from 11,000 in 2013 to 23,768 by 2020</p> <p>Domestic passenger traffic in Cebu increased from 5.4 million in 2013 to 10.5 million by 2020</p> <p>Domestic air traffic movement between Cebu and other cities in the Philippines increased from 54,000 in 2013 to 96,132 by 2020</p> <p>Total tax payments to the government of about P43.6 billion (\$970.2 million) during the concession period</p>	<p>Client and MCIAA reports</p> <p>Development effectiveness monitoring reports</p> <p>Audited financial statements</p>	<p><b>Assumption</b> Mactan airport has the financial and human resources to meet all safety, commercial, and service quality standards under the concession agreement</p> <p><b>Risk</b> Natural disasters prevent full use of the new airport</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
	<p>MCIA achieves a level of service of at least C International Air Transport Association service standards by 2020<sup>9</sup></p> <p>100 full-time employees will be directly hired by GMCAC</p> <p>460 full-time employees will be hired by contractors of GMCAC for various services</p>	<p>Client and MCIAA reports</p> <p>Reports from the company's human resources department</p>	
<p><b>Output</b> Improved airport facilities at MCIA</p>	<p>Concession fees paid to government in the amount of P16.1 billion (\$369 million) inclusive of taxes in 2014</p> <p>A new passenger terminal will be completed and another passenger terminal will be renovated and operational by 2019</p> <p>Total passenger capacity increased from 4.5 million in 2014 to 12.5 million by 2019</p> <p>Local goods and services of about P8.0 billion (\$188.6 million) purchased during construction</p> <p>About 400 workers will be employed for construction works</p> <p>Airport design features include women and/or child-friendly facilities; 100% of directly hired GMCAC airport personnel provided training and orientation on sexual harassment and trafficking of women and children</p>	<p>Department of Transportation and Communication and MCIA progress reports</p> <p>ADB review missions</p> <p>Development effectiveness monitoring reports</p> <p>Audited financial statements</p> <p>Environmental and social monitoring report</p>	<p><b>Assumption</b> Effective project implementation</p> <p><b>Risk</b> Construction delay caused by unexpected events</p>

<b>Activities with Milestones</b>	<b>Inputs</b>
1. Financial close by January 2015  2. Construction commencement for terminal 2 by January 2015  3. Civil works completion of terminal 2 by January 2018  4. Start of renovation for terminal 1 by January 2018	

ADB = Asian Development Bank, ASEAN = Association of Southeast Asian Nations, GMCAC = GMR Megawide Cebu Airport Corporation, MCIA = Mactan Cebu International Airport, MCIAA = Mactan Cebu International Airport Authority, PPP = public-private partnership.

<sup>a</sup> In 2013, total airline passengers of 37.65 million included 20.33 million domestic passengers and 17.32 million international passengers. Source: Government of the Philippines, Department of Transportation and Communications, Civil Aeronautics Board. [www.cab.gov.ph](http://www.cab.gov.ph)

<sup>b</sup> Key performance indicators for service quality include waiting time in queue, time taken for baggage delivery from aircraft arrival, and time taken to assist disabled passengers.

Source: Asian Development Bank.