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Report No. 45763-PH

PROJECT PAPER

FOR A

PROPOSED ADDITIONAL FINANCING LOAN

IN THE AMOUNT OF US$40 MILLION EQUIVALENT

TO THE

DEVELOPMENT BANK OF THE PHILIPPINES,
DEPARTMENT OF ENERGY AND
THE REPUBLIC OF THE PHILIPPINES

FOR THE

RURAL POWER PROJECT

IN SUPPORT OF THE
RURAL POWER DEVELOPMENT PROGRAM

March 12, 2009

Transport, Energy and Mining Sector Unit
Sustainable Development Department
East Asia and Pacific Region

CURRENCY EQUIVALENTS
(Exchange Rate Effective February 17, 2009)

Currency Unit	=	Philippine Peso
PHP 48	=	US$1
JPY 89	=	US$1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

APL	Adaptable Program Loan
CAS	Country Assistance Strategy
CO_2	Carbon Dioxide
CPAR	Country Procurement Assessment Report
DBP	Development Bank of the Philippines
DENR	Department of Environment and Natural Resources
DOE	Department of Energy
EC	Electric Cooperative
ECC	Environmental Clearance Certificate
EDP	Energy Developmental Plan
EMP	Environment Management Plan
ERR	Economic Rate of Return
FM	Financial Management
FMIRR	Financial Management Implementation Review Report
FSL	Fixed-Spread Loan
GEF	Global Environment Facility
GHG	Greenhouse Gas
HH	Household
IBRD	International Bank for Reconstruction and Development
ICB	International Competitive Bidding
KPI	Key Performance Indicator
LGU	Local Government Unit
MDSF	Market Development Support Facility
MFI	Micro Finance Institution
MSME	Micro, Small and Medium Enterprises
NCB	National Competitive Bidding
NG	National Government
NPC	National Power Corporation
O&M	Operation and Maintenance
PCA	Procurement Capacity Assessment
PD	Program Development
PDO	Project Development Objective
PEER	Project Evaluation and Endorsement Report
PFI	Participating Financial Intermediary
PMO	Project Management Office
PPF	Project Preparation Fund
PSP	Private Sector Participation
PV	Photovoltaic
RET	Renewable Energy Technologies
RPP	Rural Power Project
SHS	Solar Home System
TA	Technical Assistance
UNDP	United Nations Development Programme
WTP	Willingness-to-pay

Vice President:	James W. Adams, EAPVP
Country Director:	Bert Hofman, EACPF
Sustainable Development Leader:	Mark C. Woodward, EASPS
Task Team Leader:	Salvador Rivera, EASTE

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PHILIPPINES
ADDITIONAL FINANCING FOR RURAL POWER PROJECT

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ADDITIONAL FINANCING FOR THE RURAL POWER PROJECT

PROJECT PAPER DATA SHEET

Date:	March 12, 2009	Team Leader:	Salvador Rivera
Country:	Philippines	Sustainable Development Leader:	Mark C. Woodward
Project Name:	Additional Financing for Rural Power Project	Country Director:	Bert Hofman
Project ID:	P113159	Environmental Category:	F

Borrower: Development Bank of the Philippines; Republic of the Philippines as guarantor
Responsible Agency: Program Development Sector of the Development Bank of the Philippines

Revised Estimated Disbursements (Bank FY/US$m)

FY	2009	2010	2011	2012	2013
Annual	3	19	9	6.5	2.5
Cumulative	3	22	31	37.5	40.0

Current Closing Date: December 31, 2009
Revised Closing Date [if applicable]: December 31, 2012

Does the scaled-up project require any exceptions from Bank policies?	[ ] Yes [X] No
Have these been approved by Bank management?	[ ] Yes [ ] No
Is approval for any policy exception sought from the Board?	[ ] Yes [X] No

Revised project development objectives/outcomes:

There are no changes in the PDOs.

The additional financing seeks to scale-up a pipeline of projects identified in APL 1. It further aims to support rural electrification by targeting more households (HHs), encouraging more private sector participation (PSP) by sharing in investment risks in generating, transmitting, and distributing electricity with emphasis on new and renewable sources of energy, and upgrading ECs to become financially viable and operationally efficient.

The outcomes of the additional financing would be gauged on the basis of the following Key Performance Indicators (KPIs):

(i) Prevention of at least 20,000 tons of CO_2 emissions; and
(ii) Direct access to electricity through mini-grid electrical connection or individual renewable energy technology (RET) services to 10,000 new customers in rural areas.

Does the scaled-up or restructured project trigger any new safeguard policies?	No

For Additional Financing			
[X] Loan	[ ] Credit	[ ] Grant	
For Loans/Credits/Grants:			
Loan Currency: Japanese Yen			
Total Bank financing (US$ m): US$40 million equivalent			
Proposed terms: Fixed-Spread (FSL) disbursement-linked loan in Japanese Yen, 23.5 years maturity with an 8-year grace period, maturity type is level, and payment dates on February 1 and August 1.			

Financing Plan (US $ m)[1]			
Source	Local	Foreign	Total
Borrower/ Recipient	0.035		0.035
IBRD		40.000	40.000
GEF		0.578	0.578
Local Sources of Borrowing Country			
Sub-borrowers	7.743		7.743
UNDP			
Total	7.778	40.578	48.356

[1] DBP funding is estimated at about US$0.035 million to cover the counterpart funding, notably taxes, related to the capacity building component. Private sector investors/sub-borrowers contribution estimated at about US$7.743 million based on the pipeline projects. Sub-borrowers equity for the credit facility ranges from 10–20 percent. Equity for the Project Preparation Fund is 50 percent. GEF grant to DBP amounting to US$0.9 million has an outstanding balance of US$0.225 million for capacity building and US$0.353 million for GEF Project Preparation Fund.

I. INTRODUCTION

1. The Project Paper seeks the approval of the Executive Directors to provide an Additional Financing loan in the amount of US$40 million equivalent to the Development Bank of the Philippines for the Rural Power Project (RPP) P066397; Loan Number 72040.

2. **Summary.** The RPP APL 1 was approved on December 8, 2003, with an original loan amount of US$10 million and a GEF grant of US$9 million. The Development Bank of the Philippines (DBP) is the borrower of the APL 1 and the beneficiary of the proposed additional financing operation. The Department of Energy (DOE) is the implementation agency of the GEF grant. The Project Development Objectives (PDOs) of the RPP APL 1 are to:

- (i) Test and demonstrate viable business models that maximize leverage of public resources with private investment for decentralized electrification;
- (ii) Support transformation of electric cooperatives (ECs) through institutional and operational improvements; and
- (iii) Avoid CO_2 emission through wider use of renewable energy.

There are no changes in the PDOs since the additional financing would fund similar activities supported by DBP as in the original RPP APL 1.

3. The original US$10 million financing approved for APL 1 has been fully committed by DBP a full one year ahead of schedule; hence the need for additional funds. The additional financing will scale-up a pipeline of sub-projects identified during implementation of the APL 1. It further aims to support rural electrification by targeting more households (HHs) and barangays, encouraging more private sector participation (PSP) by sharing in investment risks on new and renewable sources of energy, and upgrading ECs to become financially viable and operationally efficient.

4. **Expected Outcomes.** The additional financing will enable DBP, and the sector, to further expand the public-private partnership in the provision of energy access, particularly in Mindanao where over 50 percent of the scaled-up projects will take place. The additional resources will also strengthen the social economic and poverty alleviation impact by targeting 10,000 new customers in the poor rural areas. Their access to electricity is expected to substantially improve the quality of life of the beneficiaries and promote rural economic development in the project areas.

5. The Project's outcome indicators and expected outcomes will remain unchanged except the targets for two of the Key Performance Indicators (KPI) are increased to reflect the increased coverage of new customers and further reduction of CO_2 emissions:

- (i) Prevention of at least additional 20,000 tons of CO_2 emissions per year, which will make the overall end of APL 1 target 40,000 tons; and

(ii) Direct access to electricity through mini-grid electrical connections or individual renewable energy technology (RET) services to 10,000 new customers in rural areas which will make the overall end of APL 1 target 20,000 new customers.

6. The revised targets are shown in Table 1.

Table 1: Original and Revised APL 1 Targets

Indicator	Original APL 1 Target	Revised APL 1 Target	Status as of October 30, 2008
1. New customers in rural areas provided with mini-grid electrical connection or individual PV services	10,000	20,000	Mini-grid: 1,100 Solar PV: 2,674 HH Communal facilities: 384 systems
2. CO_2 tons avoided per year	20,000 tons	40,000 tons	11,560 tons

7. **Major Changes Being Proposed.** The additional financing follows the same project design as the RPP APL 1. It is proposed that over the first two years of the additional financing implementation period, the project would utilize the remaining GEF funds carried forward from APL 1, consequently the closing date of the GEF grant will be extended to December 31, 2011. Further, in view of the highly satisfactory performance in implementation of procurement arrangements, and consistent with World Bank procurement guidelines for financial intermediary borrowers, it is proposed to increase the threshold for sub-loans to private borrowers under commercial practices, acceptable to the Bank, to US$6 million. Also, in view of the advance state of preparation and urgency of pipeline investments, the additional financing would support up to 20 percent of retroactive financing of the loan amount, as per OP 6.00.

II. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING IN THE AMOUNT OF US$40 MILLION

8. The RPP has been successful in achieving and implementing the PDO, and in meeting all relevant requirements set by the World Bank. Key project data are presented below (see Table 2).

Table 2: Key Project Data and Performance

Key Project Data		Project Performance	
Effectiveness Date:	05/06/04	Development Objectives:	Satisfactory
Closing Date:	12/31/09	Implementation Objectives:	Satisfactory
Project Age:	4 years and 6 months	Risk Flags:	None
Loan Disbursed:	As of 09/30/08, 92 percent of the project loan		
Loan Commitment:	As of 09/30/06, 100 percent has been fully committed		
GEF Grant Disbursed:	As of 10/31/08, 36 percent		

Rural Electrification Subprojects: Status and Performance

9. There are two sub-components: (a) Grid-Connected EC Subprojects; and (b) Decentralized Electrification. The first subcomponent was funded by the Bank loan

through onlending by DBP, while the second subcomponent was mainly funded by a Bank-GEF grant through DOE for RET projects.

(a). **Grid-Connected EC Subprojects Sub-Component.** For areas that are economic to serve through EC distribution networks, this supports subprojects aimed at (i) improving power supply system safety, reliability, efficiency, and power service quality for existing customers, through rehabilitation and capacity upgrades of the existing supply system (including purchase of sub-transmission facilities); (ii) removing supply constraints; (iii) encouraging institutional development of ECs; and (iv) improving employee productivity, safety, and efficiency of provision of customer service. This sub-component is funded by the Bank loan through direct financing by the Development Bank of the Philippines (DBP). As indicated in Table 3 below, project implementation has been highly satisfactory and, based on the results and demands, it will be scaled-up in the proposed additional financing project.

(b). **Decentralized Electrification Sub-Component**. This supports investments in the small power generation, decentralized grids, and stand-alone Renewable Energy Technologies (RET) systems, most notably Photovoltaic (PV) systems. An important objective of the APL is to pilot various types of service delivery mechanisms and adopt the most successful one for the subsequent phases of the APL. It is funded by the Bank loan through direct financing by DBP, and Bank-GEF grant through DOE for RET subprojects. Following early difficulties, which are natural in these programs, the number of connections has increased threefold in the last six months. This trend is expected to continue based on a turnaround plan agreed with the government.

Table 3: Summary of RPP Key Performance Indicators (cumulative)

Indicator	APL 1 target	Status as of October 30, 2008
1. Loan disbursements	100%	Of the US$10m loan from the Bank, about 92 percent has been disbursed.
2. New customers in rural areas provided with mini-grid electrical connection or individual PV services	10,000	Mini-grid: 1,100 Solar PV: Total HH: 2,674 HH Communal facilities: 384 systems
3. New RET suppliers accredited by DOE and operating	4	7
4. New electrical mini-grid system established and operating	2	1
5. Participating ECs have achieved satisfactory financial performance, as indicated by an actual debt service coverage ratio of at least one (1)	85% of participating ECs	Five of the six (83%) participating ECs have achieved satisfactory financial performance.
6. CO_2 tons avoided per year	20,000	11,560

Partial Credit Guarantee Fund

10. The partial credit guarantee fund provides grant funds to partially cover any loan losses incurred in the provision of loans to RET purchases and suppliers. It is funded by

a UNDP-GEF grant. Two microfinance institutions have started operations and two more are pending accreditation, one of them focusing on Mindanao.

Capacity Building

11. A Bank GEF grant provides support to DOE, DBP, PFIs, and participating enterprises to (i) reduce market barriers to the commercialization of RETs by building capacity of the concerned public and private sector entities; (ii) reduce investment risks by supporting project development, appraisal, procurement, and supervision of RET subprojects; and (iii) support the development and implementation policies on energy tariffs and subsidies, regulation, and planning. The project has launched two initiatives — a Market Development Support Facility (MDSF) and an Incubator MDSF — which facilitates business development activities for market participants.

Rationale for Additional Financing

12. The borrower requested the use of additional financing to respond to the immediate needs for funding in its pipeline of projects. DBP has made significant progress in advocating PSP on rural electrification with emphasis on the use of new and renewable sources of energy and, based on that progress, a substantial positive response from private and public participants has taken place. Consequently, the additional financing will solidify the development effectiveness of APL 1 while providing quick financing support for urgent sub-projects, particularly on energy shortage regions such as Mindanao.

13. The Table 4 shows the status of the project with regard to the proposed performance triggers for APL 2.

Table 4: Performance Triggers for APL 2

Trigger for APL 2	Status as of June, 2008.	Remarks
Implementation satisfactory to the Bank, of reforms in the rural power sector, as evidenced by: (a) the issuance of a regulatory framework for the provision of electricity by qualified third party in areas unserved by the Distribution Utilities; and (ii) issuance of DOE circular governing rationalization of subsidy for solar PV systems.	DOE has issued acceptable circulars on both areas.	Ongoing implementation.
About 50 percent of disbursement of APL 1; and substantial commitment of the remaining loan balance.	About 67 percent of IBRD/GEF funds have been disbursed, DBP has achieved close to 100 percent disbursement.	DOE disbursements lag behind by about 36 percent of original estimates at appraisal stage, this is also the case in terms of expected Solar Home connections.
For the EC grid subcomponent, about 85 % of participating ECs achieve satisfactory financial performance, as evidenced by the DSCR of at least 1 time.	Five of the six participants, that is 83%, have achieved satisfactory financial performance.	NA

14. While the triggers for APL 2 have been met, the KPIs for solar electrification (a component executed by DOE) connections targets for APL 1 (10,000 by end of APL 1) and APL 2 (aggregated connections of 28,000), are well behind schedule. However, a turnaround plan has been submitted by the DOE. It shows that at the current pace of connections, it will take about two years to catch up with the targeted figures, well within the closing date of the proposed additional financing. This is a crucial element in the APL's overall objective of improving the quality of life in rural areas through the provision of adequate, affordable and reliable energy services in partnership with the private sector.

15. Equally important, the energy sector has undergone a dramatic transformation since the original APL was designed back in early 2000, including in particular: the privatization of generation assets and therefore the gradual removal of the National Power Corporation (NPC) from the market as provider of electricity to Electric Cooperatives (ECs); the concessioning to the private sector of the Transmission system; the implementation of a new tariff system for distribution companies/ECs; the gradual divestiture of the Sub-transmission assets to qualified ECs; the tightening of the commercial credit market in response to the financial crisis, the increased volatility of oil prices, and the upcoming opening of the wholesale power market, which will affect the majority of ECs which are currently under financial stress.

16. These challenges also present new opportunities brought about by these changes and, therefore, the need to ensure that subsequent phases of the APL are properly designed to support these institutional reforms. The additional financing will provide a bridge to assess not only the results of APL 1 but also needed changes or restructuring in the design or main parameters, including outcome targets, to respond to the new challenges and opportunities.

17. The proposed US$40 million equivalent Additional Financing is the most effective way to respond to the immediate opportunity to enhance development impact, particularly in power shortage areas such as Mindanao, and provide a bridge for the proper preparation of the APL 2 taking into account the changes, and needs, in the power sector.

III. PROPOSED CHANGES

18. Except for procurement, there will be no changes on the RPP's project management, financial management, environmental, and social arrangements. The closing date for the APL 1 and associated GEF Grant will be extended to December 31, 2012.

19. **Procurement.** A procurement capacity assessment (PCA) was carried out, covering: (a) the DBP as the Borrower that acts as the financial intermediary for the financing of sub-projects and is responsible for project implementation including oversight and supervision of the procurement process being executed by the implementing entities; and (b) a representative sample of Implementing Entities comprising one private company and two rural electric cooperatives. Based on the PCA

and the satisfactory implementation of the procurement arrangement under the RPP, it was recommended to continue to allow the use of established private sector or commercial practices that are acceptable to the Bank in accordance with Section 3.12 of the Procurement Guidelines. Further, it was also recommended to increase the threshold for the use of ICB method to US$6 million or more per contract to be procured by private sector entities.

20. The reason for the proposed change is two-fold: (i) to put DBP on the same level playing field as other financial intermediaries, where procurement is done on the basis of commercial practices; and (ii) to allow more flexibility during procurement implementation in support of the project's development objective of attracting and encouraging private sector investment for decentralized electrification, and to promote the wider use of renewable energy. Annex 3 presents a summary of procurement arrangements.

21. The GEF Project Preparation Fund (GEF-PPF) has several projects in the pipeline. It is expected that the allocated amount of US$400,000 will be fully disbursed on or before the end of 2009. A review of implementation progress, and GEF-PPF needs, will be undertaken by mid-2009 and, if required, further increases will be sought from reallocations and/or GEF. It is expected that some of these projects will become eligible candidates under APL 2, starting in late FY10:

Disbursement Arrangements

22. Given the urgent need of the project to mobilize financial support for the pipeline of projects, which, as indicated below, are expected to start disbursement in the first quarter of 2009, the Additional Financing Project includes a provision for the use of up to 20 percent of loan amount as retroactive financing per OP 6.00.

23. The DBP shall be open and maintain a Designated Account (DA) in U.S. dollars, in a commercial bank acceptable to the Bank. The ceiling of the DA shall be US$4.0 million and the minimum value of the size of the withdrawal applications shall be US$400,000. The disbursement methods available under the loan are the advance and reimbursement methods. Reporting of actual utilization of the loan to the World Bank is through the submission of the Statement of Expenditures.

IV. CONSISTENCY WITH CAS

24. There is strong evidence that access to modern energy services (particularly electricity) has positive impact on the lives of the people, demonstrated through its beneficial impacts on health, education, productivity, and general well being of the people. These objectives are consistent with the Country Assistance Strategy of the Republic of the Philippines and the broader goals of reducing poverty.

V. APPRAISAL OF SCALED-UP PROJECT

25. The appraisal activities applicable to the proposed project included: (i) an updated capacity procurement assessment of the borrower (DBP) and implementing agencies. The assessment confirmed that based on its satisfactory track record under APL 1, and systems in place, DBP has adequate capacity to oversee and supervise the procurement implementation of the project; (ii) updated environmental and social aspects of proposed project pipeline; and (iii) financial management aspects. Given the programmatic approach of the project, the technical aspects of the proposed pipeline are similar to those under active supervision in APL 1. The technical appraisal has been completed for year 1 activities and outer year activities will be appraised as part of supervision prior to being financed under the additional financing.

26. The proposed scale-up under the Additional Financing Project does not trigger any new safeguard policy and or require any exception to Bank's policies. Below is a summary of the appraisal conducted.

Economic

27. The additional financing would enhance the economic impact of the RPP and is justified on economic grounds in a number of ways. First, it would further enhance rural electrification particularly at the household level. Second, investments in renewable energy and non-fossil fueled energy sources yield significant foreign exchange savings from the avoided cost of importing fuel for power generation. Third, investment in plant rehabilitation, and transmission and distribution system loss reduction stave off requirements for additional generating capacity. The economic analysis of projects in the pipeline under the proposed additional financing demonstrates significant economic rates of return (ERR) as shown in Annex 1. Investments in on-grid renewable energy show rates of return above 35 percent. For investments in EC efficiency improvement and system loss reduction, the returns range from 19 percent to over 35 percent. The average ERR for all sub-projects is over 50 percent. The ERR estimates go up from the baseline average reported in Annex 1 when scenarios for higher oil prices are evaluated as this increases the foreign exchange savings generated by the subprojects. Once all sub-projects are commissioned by 2013, an estimated 40,000 tons of CO_2 emissions per year would be avoided.

Financial

28. The financial rates of return based on the financial analysis of a typical project under standard assumptions are as follows: (i) grid connected mini-hydro and biomass — around 19 percent; (ii) rehabilitation of bunker-fired plant — 28 percent; and (iii) EC system integration and loss reduction — 20 percent.

Technical

29. There are no major technical issues. The renewable energy technologies to be employed are not new to the Philippines. The Electric Power Industry Reform Act

(EPIRA) mandates the divestment of sub-transmission assets to distribution utilities or directly connected consumers. Under the RPP, providing financing support for the acquisition of sub-transmission assets will trigger the capability of electricity distribution utilities to strategically implement system loss reduction.

Institutional

30. There are no major institutional issues. The institutional arrangements with DBP have worked well and will be continued in the additional financing. DBP, a state-owned universal bank, is a 60-year old institution that promotes the financing of sustainable development. Recognized as one of the financially sound banks in the Philippines, DBP kept its financials strong. Its performance showed a consistently substantial improvement in profitability that underscored the sustained viability of its operations. It registered more than PH 2.7 billion in net profit in 2007.

Financial Management

31. The current FM system of DBP meets the financial management requirement as stipulated in OP/BP 10.02. The Project has an adequate project financial management system that can provide reasonable assurance of accurate and timely information on the status of the Project. DBP has an internal audit unit and a compliance monitoring office that report directly to an Audit Committee of DBP.

Table 5: Indicative Financing Plan
(In US$ million)

Category	Indicative Total		GEF	GEF	Co-financing	
	Value	%	Grant	- PPF	Subproject	Total
Investment Component						
- Small scale power generation and/or mini-grid (new and renewable energy)	27	68%	0.225	0.353	6.213	33.791
- EC transformation	13	32%			1.530	14.530
Total Investment	40	**100%**	0.225	0.353	7.743	48.321
Capacity Building Component						
- Consultancy			0.138		0.030	0.168
- Training			0.061		0.000	0.061
- Goods			0.004		0.000	0.004
- Incremental Operating Costs			0.022		0.005	0.027
Total Capacity Building			0.225		0.035	0.260

Note: Pipeline projects exceeded the amount of US$40 million — priority will be given to fast moving accounts. Minimum 10 percent equity for private enterprises doing NRE projects. Ten percent equity participation of LGUs and ECs.

32. The financial management risk of the Project is considered moderate before and after mitigation. The main significant inherent risk of the Project is the wide geographic spread, including hard to reach areas, and sub-borrowers having varying FM capacity. DBP's track record and policies and procedures implemented for the Project have shown positive impact to mitigate the identified risk. The financial management of the Project

has been rated satisfactory. DBP has no outstanding financial reports due for all the Bank-assisted projects that DBP is implementing

33. The indicative financing plan (see Table 5) below presents the activities to be supported by the additional financing loan.

Project Loan Disbursements

34. **Disbursement Schedule.** Project construction activities are planned to be completed by December 2012. The projected additional finance disbursement is shown in Table 6.

Table 6: Additional Finance—Projected Disbursement Schedule by Quarter

FY Year	Quarter	Ending Date	Disbursements (US$ million)	Cumulative (US$ million)	Percentage
FY9	3	Mar. 30, 2009	2	2	5
	4	Jun. 30, 2009	1	3	7
FY10	1	Sep. 30, 2009	2	5	12
	2	Dec. 30, 2009	3	8	20
	3	Mar. 30, 2010	5	13	32
	4	Jun. 30, 2010	9	22	55
FY11	1	Sep. 30, 2010	1	23	62
	2	Dec. 30, 2010	4	27	72
	3	Mar. 30, 2011	2	29	75
	4	Jun. 30, 2011	2	31	80
FY12	1	Sep. 30, 2011	2	33	85
	2	Dec. 30, 2011	3	36	90
	3	Mar. 30, 2012	1	37	92
	4	Jun. 30, 2012	0.5	37.5	94
FY13	1	Sep. 30, 2012	0.5	38	95
	2	Dec. 30, 2012	2	40	100

Environmental and Social Aspects

35. There are no modified, expanded or new activities that have any safeguard implications under the additional financing hence no new safeguard policies will be triggered. Nevertheless, subprojects need to comply with the Environmental and Social Safeguards. The EMP has been established to provide a framework for a comprehensive monitoring and evaluation of the potential environmental impacts of the relevant subprojects throughout their entire project cycle.

36. With an ISO 140001 certification, DBP not only promotes economic development, but also ensures environmental protection and preservation by integrating environmental considerations in all aspects of its operation. Prior to sub-loan approvals, the Program Development Unit of DBP prepares Project Evaluation and Environmental Reports (PEER) for endorsement to the Lending Units. This document discusses and

evaluates the technical and environmental aspects of the proposed subproject being applied for funding. PEER also serves as a tool that determines whether a project is technically feasible. It carefully evaluates a subproject's sustainability, relevance, efficiency, effectiveness, reasonableness of cost and developmental impact.

37. Furthermore, subprojects have to secure an Environmental Clearance Certificate (ECC) from the Department of Environment and Natural Resources (DENR), which is a primary requirement in all loan applications. It officially declares and endorses that the subproject conforms to the environmental standards set by the DENR.

VI. EXPECTED OUTCOMES

38. The project is expected to yield significant development outcome and impact: more HHs, especially in the rural areas, will gain access to electricity; increased private sector investments in power generation, transmission, and distribution; infusion of new and renewable energy technologies; greater sector reforms and efficiency and lesser CO_2 emission. Furthermore, close to 75 percent of the investment will take place in Mindanao, home to the highest percentage of poor families by region, and Visayas.

39. Below are the quantifiable expected results of the pipeline projects:

- Additional household connections equivalent to 10,000; and
- Reduction in GHG emission equivalent to 20,000[2] tons of CO_2 per annum.

Please note that the there are projects that may operate beyond the commitment period of APL 1 additional financing thus, the projected CO_2 avoided in the revised APL 1 target is conservatively estimated at 40,000 tons.

VII. BENEFITS AND RISKS

40. The project incorporates the good practices applied in the successful implementation of the APL 1 especially as it pertains to the DBP implemented subcomponent. There are no foreseen risks that could jeopardize the achievement of the project's development objectives. Most of the proposed projects that will be financed through onlending by DBP—the main beneficiary of the additional financing, have already gone forward or are in the process of due diligence.

41. The benefits are quite clear, new added investments to ensure stable renewable electricity generation in Mindanao, the poorest region in the Philippines, further investments in distribution including the purchase and rehabilitation of sub-transmission assets would not only lead to loss reduction and hence reduce the need to invest in additional generating capacity, these would also enable ECs to coordinate their operational activities to achieve other significant cost savings to their consumers.

[2] During the period of the Additonal Financing Loan, 20,000 tons of CO_2 are expected to be avoided. The full CO_2 emissions reduction are not expected until all sub-projects are commissioned in 2013.

Coordination of market power for example would strengthen the ECs negotiating power in procuring bulk energy supplies from generators, and enable them to foster proper market behavior by poorly performing regional member ECs. Greater cooperation within regions may also bring about consolidation of regional administrative activities and accrue other benefits such as development of local renewable resources, and maintenance operations, and better coordination of billing and demand side management operations.

VIII. FINANCIAL TERMS AND CONDITIONS FOR THE ADDITIONAL FINANCING

42. In order to match its liability management strategy, the borrower has selected the following borrowing terms:

- Fixed-spread (FSL) disbursement-linked loan in JPY.
- 23.5 years maturity with an eighth-year grace period.
- Payment dates are February 1 and August 1 in each year.
- The front-end fee payable by the Borrower shall be equal to one quarter of percent (0.25 percent) of the loan amount.
- Maturity type is "level."

Annex 1: Rural Power Project APL 1
(US$40 million Additional Financing — Indicative Projects)
Philippines: Additional Financing for the Rural Power Project

I. SMALL-SCALE ENERGY GENERATION AND MINI-GRID SUB-PROJECTS

Borrower	Project	Location	Ammount of Loan (In Millions) (1 US$=PHP48) PHP	US$	IRR %	ERR[3/] %	Estimated Developmental Impact: Add'l Capacity (In KW)	Ave. Annual Generation (In KWH)	Additional Household Connections	Annual CO_2 Emissions Avoided
Renewable Energy Projects										
A. On-grid			1,088.00	22.67	19.5	43.9	17,200	121,017,158		
B. Off-grid			604.00	12.58	19.8	31.5	4,200	24,000,000		
Conventional Energy - Off-grid			20.00	0.42	28.2	270.6				
SUB-TOTAL			**624.00**	**13.00**	**15.9**	**104.8**	**4,200**	**24,000,000**	**10,000** [1/]	

II. EC GRID SUB-PROJECTS

Borrower	Project	Location	Amount of Loan (In Millions) (1 US$=PHP48) PHP	US$	IRR %	ERR [3/] %	Estimated Developmental Impact: KWH Saved[2/] Annually A	Additional Household Connections	Annual CO_2 Emissions Avoided In tons
SUB-TOTAL			651.00	13.56	20.4	24.7	7,354,941		
TOTAL (I + II)			**2,986.00**	**62.21**	**18.2**	**64.8**		**10,000**	**40,000** [4/]

1/ Computation based on Revised 1996 IPCC Guidelines, Consultant & CDM Baseline Construction for The Electricity Grid in the Philippines published by IGES, Japan.

2/ Kilowatt-hour (KWH) saved is based on the System Loss Reduced from the improvement in the distribution system.

3/ The following were considered in the computation of the ERR: 1) FOREX savings on oil import, 2) CER equivalent (assumed at US$5/ton of CO_2) and 3) Reduction in Subsidy. The Assumed number of years in the IRR and ERR computations were based on the term of

4/ The estimate refers to CO_2 emissions avoided once all sub-projects are commissioned in 2013. During the period of the additional financing loan, 20,000 tons of CO_2 are expected to be avoided.

Annex 2: Financial Management and Disbursement Arrangement
Philippines: Additional Financing for the Rural Power Project

Executive Summary

1. **Scope of review.** An updated financial management assessment review was carried out at the Development Bank of the Philippines (DBP) with the objective of ensuring that there is in place an adequate financial management (FM) system that satisfies the Bank's OP/BP10.02 requirements for the proposed Additional Financing for the Rural Power Project (RPP or the Project). According to the requirements of OP/BP 10.02, the borrower and the project implementing entities should maintain financial management systems — including accounting, financial reporting, and auditing — adequate to ensure that they can provide accurate and timely information regarding project resources and expenditures. The review was carried out in accordance with the Bank's guidelines under Financial Management Practices in World Bank-Financed Investment Operations. The review included (a) updating of the assessment carried out in 2003 for the Project on DBP's FM system and the inherent FM risks in the country; and (b) review of the results of the FM implementation reviews for Project since it started in 2004.

2. **Overall conclusion.** Overall, the current FM system of DBP meets the financial management requirement as stipulated in OP/BP 10.02. The Project has an adequate project financial management system that can provide with reasonable assurance of accurate and timely information on the status of the Project. DBP has an internal audit unit and a compliance monitoring office that report directly to an Audit Committee of DBP.

3. The financial management risk of the Project is considered moderate before and after mitigation. The main significant inherent risk of the Project is the wide geographic spread, including hard to reach areas, and sub-borrowers having varying FM capacity. The mitigating measures implemented by DBP for the Project including this additional financing are as follows:

a. The credit proposals under the project are reviewed by the DBP Project Management Office (PMO) for eligibility of the sub-projects to be financed under RPP before these are submitted to the relevant credit committee for review and approval. DBP has a comprehensive credit policy which provides, among others, that all credit proposals are evaluated and recommended for approval, at a committee based on established approving limits of authority.
b. An account officer is assigned to manage each sub-loan under the project which involves regular discussion with the sub-borrowers on the status of sub-project implementation and verification of payments to contractors.
c. DBP appraisers conduct physical inspection of sub-projects to validate the statement of work accomplished submitted by the contractor through the sub-borrowers before funds are released to the sub-borrowers.
d. DBP obtains copies of contractors' official receipts from the sub-borrowers to ensure that the contractors' bills were fully paid by the sub-borrowers using the loan proceeds and the counterpart fund.

e. DBP project management office (PMO) based in the head office also conducts regular visits to the sub-projects as part of its monitoring responsibility.

f. DBP internal audit also covers the sub-loans under the project in its regular annual credit review of the region/lending centers.

4. **FM rating of RPP**. The FM system of the RPP and its implementation, which has been rated satisfactory was found to be reliable to account and generate accurate financial information. DBP has been submitting the financial reports in accordance with the financial covenants under the Project. There are no outstanding audit reports due from DBP for all the Bank-assisted projects DBP is implementing.

Risk Analysis

5. A summary of the financial management assessment risk ratings is provided in the table below. The detailed discussion of each subject immediately follows hereunder.

Category of Risk (Issues/Factors)	Risk Rating	Risks Mitigating Measures In Place	Residual Risk	Condition of Negotiations, Board of Effectiveness (Y/N?)
Inherent risk	S		M	
Country level Perceived high corruption in the country	H	Sub-borrowers under the project are mostly revenue earning private entities which are less affected by the high corruption perceived for the government agencies. These private entities have more structured reporting responsibilities to their stakeholders. Corruption risk present in local government institutions are mitigated by the measures already implemented in the Project as described under Project below.	S	
Entity DBP being a financial institution has a complex operation.	S	The Project is limited to on-lending of the loan proceeds to sub-borrowers with qualified proposed sub-projects.	M	
Project Wide geographic spread, including hard to reach areas and FM capacity of sub-borrowers vary.	S	• DBP has lending centers and branches in various parts of the country with defined roles and responsibilities. • DBP internal audit also covers the sub-loans under the project in its regular annual credit review of the regional/lending centers.	M	
Control risk				
Budget	L		L	

Category of Risk (Issues/Factors)	Risk Rating	Risks Mitigating Measures In Place	Residual Risk	Condition of Negotiations, Board of Effectiveness (Y/N?)
• Accounting DBP is guided by the rules and regulations issued by the COA and the Bangko Sentral ng Pilipinas (BSP), which require the adoption of International Accounting Standards and International Financial Reporting Standards.	M		M	
• Internal controls DBP being a financial institution is guided by established policies and procedures	L	The internal controls implemented for the project is considered adequate to ensure that funds are used for the intended purpose.	L	
• Funds flow There are no issues affecting funds flow because of the procedures implemented under the project.	L	DBP's policy of requiring DBP appraisers to physically inspect the sub-projects to validate the statement of work accomplished of the contractor submitted by sub-borrower before funds are released to the sub-borrower is also adopted for the project. This ensures that funds are used for the intended purpose.	L	
• Auditing COA auditors assigned in DBP are already very familiar with Bank policies.	L		L	
Overall control risk –	M		M	

Note: Risk Rating: H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

Financial Management Arrangements for the Project

The financial arrangements for the additional financing follow those of the original loan which are found to be effective.

6. **External Audit.** The external audit of the Project is carried out by COA.

7. **Financial Reporting.** There are no outstanding financial reports due under all the Bank-assisted projects that DBP is implementing.

8. The reports that DBP has been required under the Project are as follows:

a. Unaudited Interim Financial Reports (IFRs) **within 60 days** after the end of each calendar quarter, which shall consist of the: (a) financial reports which should include the current and cumulative data compared with plan; (b) physical progress report; and (c) procurement status report. The physical accomplishment report must be linked to the financial report.

b. Annual audited entity and project financial statements, statements of special accounts and a copy of the management letter reflecting the auditor's findings and recommendations, which are due to the Bank no later than 6 months after the end of each fiscal year.

c. **Funds Flow/Disbursement Arrangements for the additional financing.** The funds flow for the additional financing will follow the same arrangement as the original loan of RPP.

9. ***Financial Covenants*** — the financial reports submitted to the Bank under this Project, which shall include the additional financing, are as follows:

a. Unaudited Interim Financial Reports (IFRs) within 60 days after the end of each calendar quarter, which shall consist of the (a) financial reports consisting which include the current and cumulative data compared with plan; (b) physical progress report; and (c) procurement status report.

b. Annual audited entity and project financial statements and a copy of the management letter reflecting the auditor's findings and recommendations, which are due to the Bank no later than 6 months after the end of each fiscal year.

10. ***Condition for loan negotiation*** — submission of the 2007 audited entity and project financial statements. This condition has already been met in December 2008.

11. ***Supervision Plan*** — the frequency of the FM supervision will be inline with the FM Manual and EAP FM regional guidelines and is dependent on the FM risk rating of this project in any given year during project implementation. The scope of the supervision is left to the professional judgment of the FM specialist. It may include any of the following among others: (i) review of the continuous maintenance of adequate FM system by DBP; (ii) review of selected transactions, where deemed necessary; (iii) follow up of timeliness of FM reporting and actions taken on issues raised in previous review missions; (iv) review of financials reports of the project; and (v) review of compliance with the financial covenants. In addition, the FM implementation review includes desk review of the quarterly IFRs, and audited financial statements and management letter submitted to the Bank.

Annex 3: Procurement Plan for Additional Financing
Philippines: Additional Financing for the Rural Power Project

1. The procurement for the proposed Project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated on May 2004, revised on October 2006, and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated on May 2004, revised on October 2006; and the provisions stipulated in the Legal Agreement. As in the ongoing APL 1, the same prior review arrangements are to be adopted for the additional finance loan, the current arrangements under APL 1 are summarized below:

Kind	Contract Value Threshold	Procurement Method	Contracts Subject to Prior Review by DBP
(a) Private Sector sub-borrower (Types A and C)	US$1 million or more	Commercial Practice	All contracts above threshold
	Regardless of estimated cost	Commercial Practice	All contracts for secondhand sub-transmission facilities
(b) Private sector sub-borrower (Type B)	US$500,000 or more	Commercial Practice	All contracts above threshold
(c) Private sector (Type D)	US$500,000 or more	Commercial Practice	All contracts above threshold
(d) LGU sub-borrower	US$5million for Works and US$1milion for Goods, or more	ICB	All contracts above threshold
	US$100,000 for Works and US$100,000 for Goods, or more	NCB	All contracts equal to or above US$200,000

2. **Procurement Arrangements for Additional Financing**:

2.1 Contracts for goods, works and non-consulting services estimated to cost US$6 million or less to be procured by private entities will be done through established commercial practices acceptable to the Bank (Section 3.12 of the Procurement Guidelines). Based on the PCA Report, the acceptable Private Sector or Commercial Practices are

a). Competitive bidding amongst accredited suppliers and contractors provided that: (a) the accreditation system gives the opportunity for any interested bidder, including foreign bidders, to register or apply for accreditation at any time during the year. The General Procurement Notice to be published for the Additional Financing Loan will indicate this arrangement; and (b) the bidding document will disclose the criteria for evaluation and award of contract.

b). Shopping or canvass of at least three qualified suppliers or contractors, the selection of which will depend on the nature and/or limitation of supply market of the item to be procured.

c). Direct contracting for items that are proprietary or obtainable from one source provided the contract price is reasonable.

2.2. Contracts for works and goods estimated to cost US$6 million, or more, to be procured by private entities will be done following ICB method.

2.3. For LGUs, procurement of goods, works and non-consulting services will adopt the country threshold for ICB and NCB following the 2007 CPAR which has been delivered to government in June 2008. The NCB Annex in Section 6 below will apply. Consequently, the following threshold will be followed by the LGUs.

Kind	Procurement Method	Threshold
Works and non-consulting services	ICB	US$5million and more
	NCB	US$100,000 to less than $5million
	Shopping	Less than US$100,000
Goods	ICB	More than US$1million
	NCB	US$100,000 to less than US$1million
	Shopping	Less than US$100,000

Selection of Consultants.

4.1 **Prior Review Threshold**: Following the arrangement in RPP APL 1 Loan Agreement, the prior review of contracts will be done by DBP, as follows:

Sub-borrower	Contract Value Threshold	Procurement Method	Contracts Subject to Prior Review by DBP
1. Private Sector	US$100,000 or more for firms, and US$50,000 or more for individuals	Commercial Practices	All contracts above threshold
2. LGUs	US$100,000 or more	Selection Based on Consultants' Qualification	All contracts above the threshold
	US$50,000 or more	Individual Selection	All contracts above the threshold
	US$100,000 or more	Single Source Selection	All contracts above the threshold. The Bank will also review.

4.2 **Short list comprising entirely of national consultants.** Not Applicable as commercial practice is used for all contracts.

4.3 Selection Arrangements:

Private sector or commercial practices that are acceptable to the Bank are:

a) From an accredited list of consultants, the private sector determined who are interested to bid for the contract and, from those who are interested, come up with a shortlist. Invitation to submit a proposal is issued to the shortlisted firms. The proposals submitted are evaluated based on which is the most technically sound proposal with due consideration to the price using certain weights, depending on the nature of the Assignment.

b) Single source is done based on criteria, such as: (a) downstream work; (b) small assignment; (c) there is only one consultant who can do the Assignment; and (d) in case of emergency.

5. Implementing Agency Capacity Building Activities

5.1. In this section the indicative Capacity Building Activities are listed with time schedule

No	Expected outcome / Activity Description	Estimated Cost US$	Estimated Duration	Start Date	Comments
1	Hydropower Financing and Project Economy	19,226.89	5 days	Nov 2008	100% GEF Grant
2	Project and Procurement Management Course	1,750.00	10 days	Apr 2009	100% GEF Grant

6. World Bank requirements for NCB

6.1 Eligibility screening shall not be applied. However, bids that do not contain any of the following documents will not pass the documentary compliance check:
(a) evidence of the required financial, technical or production capability; (b) audited

financial statements; (c) credit line or cash deposit certificate; (d) bid security; and (e) authority of the bid signatory.

6.2 A ceiling may be applied to bid prices provided the following conditions are met: (a) Bidding documents are obtainable free of charge on a freely accessible website. (b) the agency has procedures in place to ensure that the ABC is based on Engineer's Estimate; (c) The agency has trained cost estimators on estimating prices and analyzing bid variance; (d) the agency has established a system to monitor and report bid prices relative to ABC and Engineer's estimate.

6.3 Domestic or regional preferences will not be applied in the evaluation of bids, and other preference in effect in the Philippines will not be used except with prior concurrence of the Bank.

6.4 In case of contracts for prior review, modification exceeding 15 percent of contract amount and materials changes in the conditions during implementation require prior Bank concurrence.

6.5 Foreign suppliers and contractors shall be allowed to participate, if interested, without first being required to associate with, or enter into joint venture, with local firms. Moreover, foreign bidders shall be allowed to bid, even without registration, licensing, and other government authorizations, leaving these requirements for after award and before signing of contract.

6.6 For works contract, the experience qualification requirement shall be: (a) at least one previous contract at 80 percent of the estimated cost of the contract being procured; and (b) an annual turnover from all works averaged over the last three years equal to 100 percent of the estimated cost of the contract being procured.

6.7 Alternative procurement methods defined in the implementing rules and regulations such as Limited Source Bidding, Direct Contracting and Shopping as acceptable. The use of the other alternative methods will require prior Bank concurrence.

6.8 A period of at least 30 days for bid preparation shall be allowed.

Annex 4: Project Preparation and Appraisal Team Members
Philippines: Additional Financing for the Rural Power Project

Name	Title	Unit
Salvador Rivera	Task Team Leader, Senior Energy Specialist	EASTE
Victor Dato	Infrastructure Specialist	EASPS
Edward Daoud	Senior Finance Officer	LOAFC
Minneh Kane	Lead Counsel	LEGES
Ferdinand Vinuya	Economist	EASTE
Hiroshi Tsubota	Lead Financial Officer	BDM
Cecilia Vales	Lead Procurement Specialist	EAPCO
Preselyn Abella	Financial Management Specialist	EAPCO
Maya Gabriela Villaluz	Operations Officer (Environment)	EASRE
V. Florian Lazaro	Operations Officer (Social Development)	EASSO
Galina Menchikova	Program Assistant	EASTE
Gia Mendoza	Program Assistant	EACPF
Demilour Reyes Ignacio	Team Assistant	EACPF