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RESTRUCTURING PAPER

ON A

PROPOSED PROJECT RESTRUCTURING

OF

PHILIPPINES ELECTRIC COOPERATIVE SYSTEM LOSS REDUCTION PROJECT (ECSLRP)

GEF TRUST FUND GRANT NUMBERS TF053360-PH AND TF053361-PH
APPROVED ON MAY 5, 2004

TO THE

REPUBLIC OF PHILIPPINES

OCTOBER 18, 2011

ABBREVIATIONS AND ACRONYMS

DOE	Department of Energy
DOF	Department of Finance
EC	Electric Cooperative
EC-PCG	Electric Cooperative Partial Credit Guarantee
ECSLRP	Electric Cooperative System Loss Reduction Project
ERC	Energy Regulatory Commission
GEF	Global Environment Facility
LGUGC	LGU Guarantee Corporation
MTR	Mid-Term Review
NEA	National Electrification Agency
PMB	Project Monitoring Board

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PHILIPPINES ELECTRIC COOPERATIVE SYSTEM LOSS REDUCTION PROJECT (ECSLRP)
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RESTRUCTURING PAPER

This restructuring paper is in response to a request by the Department of Finance of the Republic of the Philippines. In letters received from the Department of Finance (June 17 and July 13, 2011) and LGUGC (June 10, 2011), the following changes were requested:

(a) Reallocation of proceeds of the GEF Grant TF 053361-PH; and

(b) Extension of closing date for GEF Grants TF 053360-PH and TF 053361-PH

The reallocation of proceeds does not result in a change either to the project development objective or to project activities as described in the GEF Grant Agreements. This is the first request for an extension of closing date for these grants. This is the second re-allocation of proceeds of GEF Grant TF 053361-PH, the last re-allocation dating from March 2, 2010.

Details of the proposed restructuring are discussed in Annex 1 (Re-allocation) and Annex 2 (Extension of closing date).

ANNEX 1
Reallocation of Proceeds (TF 053361)

1. This memorandum seeks your approval for a proposed Reallocation Letter for the above-mentioned Grant, concerning the reallocation of the grant proceeds set out in category (1)-(4) under the Grant Agreement – Schedule 1. The LGU Guarantee Corporation requested a reallocation of the GEF grant proceeds in a letter to the Bank dated July 28, 2011 (see Attachment 1). The re-allocation is being requested as a direct outcome of the very positive developments in project implementation. With a greatly increased deal flow, incremental operating cost projections have increased greatly, as the LGUGC program management unit responds to market demand for inclusion in the Electric Cooperative Partial Credit Guarantee (EC-PCG) program.

2. Proceeds of the GEF Grant for the Philippines Electric Cooperative System Loss Reduction Project [GEF 053361 – P066352] are proposed to be reallocated as follows:

Proposed expense category reallocation table
(TF053361-PH)

	Category		Original GEF Grant Allocation	Revised Grant Allocation (February 2010)	Proposed Re-allocation
(1)	Goods		45,000	39,000	43,000
(2)	Consultant Services	(a) Audit	5,000	17,000	21,000
		(b) Other	688,000	707,000	534,000
(3)	Training		100,000	24,000	12,000
(4)	Incremental Operating Costs		39,000	90,000	267,000
	Total		**877,000**	**877,000**	**877,000**

3. Background: the objective of the Project is to achieve significant and sustained energy efficiency improvements in electric cooperatives (ECs) in order to provide current and prospective viable EC customers with reliable and least-cost power supply over the long term. The global objective of the Global Environment Facility (GEF) support is to reduce GHG emissions through the removal of barriers to energy efficiency investments in the rural power distribution sub-sector.

4. Towards this end, the Project has attempted to (i) develop and test financial and contractual mechanisms to support private sector investment, management and operation, and risk

sharing to support system loss reduction measures in selected ECs; and (ii) support commercial lending to qualified ECs for efficiency improvements. For (i), it was found that there were significant barriers, both in attracting qualified private sector entities, and in fostering the right conditions for those private players that actually looked at the proposed deals. Accordingly, the decision was made to concentrate the project on (ii), access to affordable term loans, facilitated by the EC-PCG Program.

5. The key change in the allocation of the grant proceeds is to significantly increase the budget for incremental operating expenses. This category pays certain project management overheads and expenses to actually run the EC-PCG program. With a view to, in parallel, obtaining a two-year extension to the project, LGUGC is proposing to re-configure the allocations such that the incremental operating expense category is sufficient to perform program management and monitoring in 2012 and 2013. They have reduced allocations for training and consultants. The allocation for consultants will be focused on the specialist consulting inputs that support due diligence on deals in the pipeline, so even though the overall category has been reduced, the nature of the consulting work will shift from studies to operational work.

6. Project financing is composed of two Global Environment Facility Trust Fund Grants totaling $12-million – one in the amount of US$11.23 million to the Republic of the Philippines and one in the amount of US$0.877 million to LGU Guarantee Corporation (LGUGC). LGUGC is requesting a change in the expense categories of its grant.

7. Project Status – The project is rated "Marginally Satisfactory;" this is an upgrade, in the latest ISR, from Unsatisfactory, because until the second half of 2010, no guarantee transactions had been done. But in 2010, due to increased focus and coordination among Government agencies, the project has started to take off. Seven deals have now been done and another seven could be done in the balance of 2011. Another dozen deals at least are forming in the pipeline. Each deal represents a loan from a commercial bank to a specific EC; 80% of the principal amount, and three months interest, can be guaranteed through the EC-PCG program, which protects the participating banks from the threat of default.

8. Disbursement of GEF Grants as of September 20, 2011– Of the total $12-million granted to the Philippines in the two GEF grants, most has been disbursed. $10-million has now been disbursed to the Guarantee Reserve Account, so this is now funded at its full design level. Because of accrued interest, resources available to back guarantees amount to over $12-million, and at a 1:5 leveraging ratio about $60-million in obligations can be covered. The Department of Energy has utilized about 30% of its $1.12-million grant and is initiating work on a significant activity to update the credit risk rating system for electric cooperatives. This major effort will revive what has been a moribund component of the project. Of LGUGC's $877,000 grant, 58% has been disbursed. LGUGC believes that the remaining $367,000 that is undisbursed will be sufficient to cover eligible expenses through the end of 2013 (see Annex 2).

9. Financial management and reporting – coincident with the GOP request for re-allocation and restructuring, the Bank supervision team has worked closely with each implementing agency on the timeliness of financial management and audit reporting, and on the follow-up to auditor observations. Timeliness and quality of reports has improved, and the Bank team will continue with intensive supervision of these aspects through the close of the project.

10. The Reallocation Letter has been cleared by LEGES and LOA.

ANNEX 2
Extension of Closing Date (TFs 053360 and 053361)

1. LGUGC and the Department of Energy, through the Department of Finance, have requested an extension in the closing dates of the two grants. If the proposed extension is approved by the Bank, the two grants will close December 31, 2013.

2. Implication of extension: Because the GEF grant for the Guarantee Reserve Account has been made in perpetuity, the point of the extension is not to enable the EC-PCG program to continue per se. Given that the money is in an escrow account, the program can continue past December 31, 2011 (the current closing date of the grants), provided that there is a program manager and that there is market demand for the program. Indeed, the intention of the GEF grant is that the program does continue as long as the project objectives remain relevant. Rather, the rationale behind the request for extension is three-fold: first, continuity at a critical time in program development; second, provision of more time to allow results of investments to develop; and third, a desire on the part of the counterpart agencies to have the Bank more closely involved in the medium term than would be the case if the closing date is not extended. LGUGC and DOE have requested a two-year extension, which they believe will be long enough for the program to mature, and is consistent with the funds remaining available under the grants for project management, program monitoring, and policy support.

3. Continuity: This is the key rationale behind the extension request. Due to a variety of institutional factors beyond the control of LGUGC, no deals were done during the first five years of the project (out of the original seven year grant implementation period). During this period, however, due diligence on 15 deals was done, involving considerable consultant and operating expenses. But there were important lessons learned, including the identification of the need to forge a closer link between the EC-PCG program and NEA. This relationship was formalized in late 2009 with agreement on a co-financing partnership between LGUGC and NEA. Since then, the program has taken off. From zero deals as of June 2010, there have now been seven loan closings, and another three are imminent. LGUGC expects to have at least four more guarantees booked by end-2011, and the pipeline now has over a dozen EC's in it (it should be noted that, for pipeline entry, an approval from the Board of the specific electric cooperative is necessary). Closure of the grants has the implication that program management and due diligence costs, much of which are now paid for by the grant proceeds, would need to be paid fully by the participants in the program. While eventually this is how the program will have to be financed if it is to be sustainable, the reality is that the program remains in a formative stage, and LGUGC and its partners across the Government apparatus (especially the National Electrification Agency and the Energy Regulatory Commission, NEA and ERC respectively) are still developing the routines and processes that will provide a stable operating context for electric cooperative financings.[1] Now is not an opportune time to introduce major pricing changes into the EC-PCG program.

4. Given the availability of the remaining grant funds, a better approach will be to provide an extension of the closing date. About $367,000 remains undisbursed, and LGUGC has

[1] NEA is responsible for helping individual EC's prepare investment plans. The process has evolved into a system under which a rolling, 5-yr investment plan is maintained. NEA also helps to coordinate financing possibilities as needed, and assists in shepherding qualified (creditworthy) EC's into the EC-PCG program. The resulting investment plans need to be approved by ERC; LGUGC and NEA help participating EC's guide their investment plans through the ERC process.

provided a detailed budget breakdown to the Bank showing how these funds would be sufficient for two additional years of program management, based on the portfolio and pipeline of deals now in place. With more deals to shepherd through the process, and with upcoming expenses related to monitoring of deals in implementation, the incremental operating cost budget has been raised significantly. While some of this increase comes from a reduced budget for consultants, within that budget, all of the remaining effort will be focused on ensuring that a high standard of due diligence is maintained.

5. Monitoring results: implementation time for investments that are supported by the EC-PCG program is about one year (up to about 18 months). Assets financed under the very first loan that was supported, dating back to July 2010, are therefore only now coming into service. From an evaluation point of view, one can measure the financial volume of investments that will have been supported by December 31, 2011, but almost none of the financed assets will have come into service, so the loss reduction impact of the investments will not be measurable. DOE and LGUGC are keen to work with the Bank during the extension period to monitor and evaluate actual results. Additionally, work on updating loss reduction planning methodologies (financed by the Japanese Government) has just started at NEA; this work is important because of the role that NEA, as the apex agency of the electric cooperatives, plays in providing technical assistance to the electric cooperatives as they prepare their investment plans.

6. Bank participation: LGUGC and DOE would like the World Bank to remain more closely involved in the program than would be the case if the closing dates are not extended. The Bank team has been closely involved in helping to foster the co-financing agreement between NEA and LGUGC which got NEA more heavily involved in the project; prior to this co-financing agreement, there were no booked guarantees. Additionally, the Bank team has helped identify technical changes in the EC-PCG operating guidelines that have allowed more efficient processing of deals, and have increased the capacity of the Guarantee Reserve Account to back new commercial lending. This means that much more commercial lending is now supported – previously the program could operate at a leverage ratio of 1:1 (one dollar in the reserve account backed one dollar in lending); this has been increased first to 1:3 and now to 1:5, enabling the guarantee reserve account to back $50-million in commercial bank lending. Additionally, LGUGC is now counting and additional $2-million in accrued interest income as part of the Guarantee Reserve Account, adding another $10-million in coverage. And because participating banks can only have 80% of their total loan so secured, the GEF grant of $10-million for the Guarantee Reserve Account can leverage $75-million in private commercial lending to the sector. It should be pointed out that the higher leveraging ratio does not entail the assumption of much greater risk; rather, it is consistent with good practice in the Philippines and elsewhere and is at the lower end of the range that is typical in such programs, where leverage ratios of up to 1:10 can be found. The larger volume of lending and greater number of deals is another reason why program management expenses have increased.

7. The Bank team has also started to participate in Project Monitoring Board (PMB) meetings. PMB's are formed each time a loan is agreed, and include representatives from the borrowing EC, NEA, the lender, LGUGC, and DOE. For LGUGC, PMB participation is funded out of incremental operating expenses. The purpose of the PMB is to monitor the implementation of the investment plan, including in its procurement, environmental, and social aspects. PMB meetings are intended to be held at least once annually, so at this point only the first handful of deals have had PMB meetings. The

meetings will also typically be hosted by the borrower, so site visits to specific investment locations will be facilitated. LGUGC and DOE believe that extension of the grant closing dates will help in ensuring that PMB meetings become an institutionalized feature of the EC-PCG program.

8. Recommendation: The EC-PCG program has started to work. At very low incremental cost to the World Bank, an extension to the grant closing dates will help the program to continue to develop, leading to full utilization of the capacity of the guarantee fund. Authorization of an extension of the closing date is therefore requested.

9. The Closing Date extension letter has been cleared by EASIN's GEF Coordinator, LEGES and LOA.

Attachment 1 – Status of portfolio and pipeline under EC-PCG Program

STATUS OF EC-PCG ACCOUNTS APPROVED and IN THE PIPELINE as of July 13, 2011

EC	Total Project Cost (Php Million)***	Loan Under EC-PCG (Php Million)	Lender	EC-PCG Exposure 80% of Amount			USD (@P43:$1)	EC-PCG Leverage Ratio**	Status/Remarks
				Principal	Interest*	Total			
A. Booked Accounts									
MORESCO I	933.55	115.00	Security Bank	92.00	1.61	93.61	2.18		P75.265MM released
PANELCO I	435.80	113.00	BPI	90.40	1.58	91.98	2.14		P71.692MM released
SOCOTECO I	509.03	102.00	BPI	81.60	1.43	83.03	1.93		P30.500MM released
BUSECO	910.96	135.90	BPI	108.72	1.90	110.62	2.57		EC awaiting ERC Authority to Secure Loan for drawdown
SURNECO	384.67	85.00	UCPB	68.00	1.19	69.19	1.61		1st drawdown of P10MM released May 30, 2011
FIBECO	595.40	143.00	Allied Bank	114.40	2.00	116.40	2.71		Signing ceremony held May 10, 2011. 1st drawdown of P38.7MM released June 13, 2011
BOHECO I	400.39	109.62	DBP	87.70	1.53	89.23	2.08		Signing ceremony held June 3, 2011
CANORECO	516.92	133.25	BPI	106.60	1.87	108.47	2.52		Signing ceremony held July 12, 2011
Sub-Total	**4686.70**	**936.77**		**749.42**	**13.11**	**762.53**	**17.73**	**1.48**	
B. LGUGC Board Approved Accounts									
LANECO	481.74	112.94		90.35	1.58	91.93	2.14		Selection of AFI/lender deferred
CAMELCO	344.57	140.00		112.00	1.96	113.96	2.65		Approved by LGUGC Board on May 9, 2011. Selection of AFI/lender on-going
Sub-Total	**826.31**	**252.94**		**202.35**	**3.54**	**205.89**	4.79	**0.40**	
C. Total of A and B	**5,513.01**	**1,189.71**		**951.77**	**16.66**	**968.42**	**22.52**	**1.88**	
D. Accounts in the pipeline									
SOCOTECO 2	692.38	141.52		113.22	1.98	115.20	2.68		Credit Memo being prepared for Board Presentation
MORESCO 2	535.28	135.49		108.39	1.90	110.29	2.56		
DANECO	1284.71	172.37		137.90	2.41	140.31	3.26		
AURELCO	241.67	133.50		106.80	1.87	108.67	2.53		
PALECO	632.71	140.38		112.31	1.97	114.27	2.66		Due diligence being scheduled
BENECO		140.00		112.00	1.96	113.96	2.65		
NEECO I		140.00		112.00	1.96	113.96	2.65		
Sub-Total	**3,386.75**	**1,003.26**		**802.61**	**14.05**	**816.66**	**18.99**	**1.58**	
E. Total of C and D	**8,899.76**	**2,192.97**		**1,754.38**	**30.70**	**1,785.08**	**41.51**	**3.46**	
F. Prospective Accounts									
LUELCO		100.00		80.00	1.40	81.40	1.89		EC Board orientation being arranged/scheduled
DORECO		100.00		80.00	1.40	81.40	1.89		
DASURECO		100.00		80.00	1.40	81.40	1.89		
CAGELCO 2		100.00		80.00	1.40	81.40	1.89		
MOELCI I		100.00		80.00	1.40	81.40	1.89		
MOELCI 2		100.00		80.00	1.40	81.40	1.89		
TARELCO 1		100.00		80.00	1.40	81.40	1.89		
TARELCO 2		100.00		80.00	1.40	81.40	1.89		
SUKELCO		100.00		80.00	1.40	81.40	1.89		
ZAMSURECO 2		100.00		80.00	1.40	81.40	1.89		
DORELCO (Leyte 1)		100.00		80.00	1.40	81.40	1.89		
Sub-Total	**-**	**1,100.00**		**880.00**	**15.40**	**895.40**	**20.82**	**1.74**	
GRAND TOTAL	**8,899.76**	**3,292.97**		**2,634.38**	**46.10**	**2,680.48**	**62.34**	**5.19**	

* 3 months interest on guaranteed principal amount computed at 7%

** Based on US$12 MM EC-PCG Guarantee Reserve Fund

***Total Project Cost is based on the 5-year Investment Plan submitted and/or approved by ERC