

SAFE AND CLEAN WATER FOR THE POOR AND BY THE POOR



MDG ACHIEVEMENT FUND IN THE PHILIPPINES

Review of the National Government- Local Government Unit (NG-LGU) Cost-Sharing Policy for Water Supply and Sanitation



JULY 2011

ABOUT THE MDGF ACHIEVEMENT FUND

The United Nations (UN) MDG Achievement Fund was created in December 2006 with a generous donation from the government of Spain in fulfillment of its aid commitments in relation to MDG 8 (developing global partnership for development). With almost \$700 million invested in 128 programmes in 49 countries around the world, the MDG Achievement Fund is currently the largest global fund dedicated to achieving the MDGs. The MDG Fund represents a unique initiative of the United Nations that brings together more than 22 UN agencies and programmes, building on the strength of each to deliver effective multisectoral interventions that improve the lives of poor and marginalized citizens

MDG-F 1919 Programme Management Office

National Economic and Development Authority
2/F NEDA-sa-Pasig Building
12 Josemaria Escrivá Drive
Ortigas Center, Pasig City
Tel. No.: (+632) 470-8039, Fax No.: (+632) 470-8039

Water Supply and Sanitation Unit-OPDS

Department of the Interior and Local Government
5/F A. Francisco Gold Condominium
Diliman, Quezon City
EDSA cor. Mapagmahal Street
Tel. Nos.: (+632) 925-1145, Fax No.: (+632) 925-7342

SAFE AND CLEAN WATER FOR THE POOR AND BY THE POOR



MDG ACHIEVEMENT FUND IN THE PHILIPPINES

MDG-F 1919:

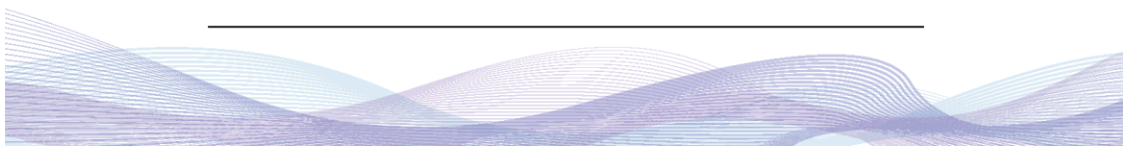
**Enhancing Access to and Provision of Water Services
with the Active Participation of the Poor**

**Review of the
National Government-
Local Government Unit
(NG-LGU)
Cost-Sharing Policy
for Water Supply and
Sanitation**

JULY 2011

TABLE OF CONTENTS

ABOUT THE MDGF 1919	3
LIST OF ACRONYMS AND ABBREVIATIONS	4
DEFINITION OF TERMS	6
EXECUTIVE SUMMARY	7
1.0 INTRODUCTION	8
2.0 EXISTING FRAMEWORK FOR NG-LGU COST SHARING	9
3.0 COST SHARING ARRANGEMENTS IN PRACTICE	11
4.0 FINANCING LOCAL WATER SUPPLY AND SANITATION THROUGH COST SHARING	15
5.0 PROPOSED FRAMEWORK FOR SUBSIDY PROVISION AND COST SHARING ARRANGEMENT SCHEME IN THE PROVISION OF WATER SUPPLY SERVICES WITH EMPHASIS ON WATERLESS AND/OR RURAL MUNICIPALITIES	17
5.1 RATIONALE	15
5.2 POLICY FRAMEWORK	18
5.3 PRIORITIZATION PROCESS	19
5.4 POLICY PRONOUNCEMENTS	20
5.5 GUIDING PRINCIPLES	21
5.6 POLICY IMPLEMENTATION GUIDELINES	22
5.7 OUTLINE OF IMPLEMENTATION STRATEGY	24
6.0 CONCLUSIONS AND RECOMMENDATIONS	25
NOTES ON THE STUDY	28



ABOUT THE MDGF 1919

Joint Programme on Enhancing Access to and Provision of Water Services with the Active Participation of the Poor

The MDGF 1919 Joint Programme on Enhancing Access to and Provision of Water Services with the Active Participation of the Poor is jointly implemented by the Philippine Government and United Nations partners to enhance provision of and access to water services by filling the “soft” component gaps of existing national government programs that focus only on infrastructure (“hard” components) provision.

Bringing together the NEDA, DILG, and the NWRB, with UNDP and UNICEF as UN Partners over a three-year period (starting May 2009), the Joint Programme specifically aims to contribute in partially addressing issues in low investments and low capacities by 1) establishing investment support mechanisms to improve efficiency, access, affordability and quality of water; and 2) enhancing capacities at the local level to develop, operate and manage water utilities, to benefit 122,000 households in 36 municipalities in Regions 2, 5, 9, 10, and 13.

OUTPUT	
Outcome 1:	Investment support mechanisms established for poor communities/municipalities to improve efficiency, access, affordability and quality of potable water
Output 1.1	Incentives mechanisms and partnership modalities developed and enhanced for public and private investments in “waterless” and poor communities
Output 1.2:	Financing and programming policies in the sector reviewed and amended as necessary to rationalize assistance and increase ownership and accountability
	<ul style="list-style-type: none"> • Output 1.2.1: NG-LGU cost sharing policy reviewed and amended, as necessary • Output 1.2.2: P3W programming policies reviewed and amended, as necessary
Output 1.3:	Local WATSAN councils and water user associations organized to effect participative provision of water supply services
Output 1.4:	Adjustment of NWRB’s tariff-setting guidelines for small water service providers
Outcome 2:	Enhanced local capacities to develop, operate and manage water utilities
Output 2.1:	Capacities at the local level strengthened, with participation of marginalized groups especially women.
	<ul style="list-style-type: none"> • Output 2.1.1: Skills and knowledge transferred/shared through institutionalization of local mentoring mechanisms • Output 2.1.2: WATSAN Toolbox rolled out and implemented.
Output 2.2:	Improved sector plans formulated and monitoring mechanisms established
Output 2.3:	Localized customer service code developed and adopted
Output 2.4:	Information, education and communication programs

LIST OF ACRONYMS AND ABBREVIATIONS

BLGF	Bureau of Local Government Finance
BOT	Build Operate Transfer
BWSA	Barangay Waterworks and Sanitation Association
CG	Capital Grant
DAR	Department of Agrarian Reform
DBCC	Development Budget Coordination Committee
DBP	Development Bank of the Philippines
DBM	Department of Budget and Management
DILG	Department of Interior and Local Government
DOF	Department of Finance
DOH	Department of Health
DPWH	Department of Public Works and Highways
DSWD	Department of Social Welfare and Development
FGD	Focus Group Discussion
GFI	Government Financing Institution
HH	Household
ICC	Investment Coordinating Committee
IRA	Internal Revenue Allotment
JBIC	Japan Bank for International Cooperation
KALAHI-CIDSS	Kapit-Bisig Laban sa Kahirapan - Comprehensive and Integrated Delivery of Social Services
LGC	Local Government Code
LGU	Local Government Unit
LOGOFIND	Local Government Finance and Development Project
LWUA	Local Water Utilities Administration
LWUA-WDF	Local water Utilities Administration – Water District Finance
MDF	Municipal Development Fund
MDG-F1919	Millennium Development Goal Achievement Fund
NEDA	National Economic and Development Authority
NEDA-ICC	National Economic and Development Authority-Investment Coordinating Committee
NGA	National Government Agency
NG-LGU	National Government-Local-Government Unit
NLIF	Non-LWUA Initiated Funds
NSO	National Statistics Office
NWRB	National Water Resources Board
O&M	Operation and Maintenance

ODA	Official Development Assistance
P3W	President's Priority Program for Water
PAP	Program, Activity, Project
PBGS	Performance Based Grant System
PBIP	Performance Based Incentive Policy
PDAF	Priority Development Assistance Fund
PDO	Provincial Development Office
PFI	Private Financing Institution
PhP	Philippine Peso
PED	Planning, Engineering and Design
PMO	Project Management Office
PWRF	Philippine Water Revolving Fund
RWSA	Rural Waterworks and Sanitation Association
RWSSP	JBIC-assisted Rural Water Supply and Sanitation Project
STF	Sanitary Toilet Facilities
SPD	Subproject description
TA	Technical Assistance
TWG	Technical Working Group
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
WD	Water District
WSP	Water Service Provider
WSS	Water Supply System



Flooded Water N' A Bottle Jose Melencio Brillo

DEFINITION OF TERMS

Access to Water Supply is determined thorough national and local data based on category:

- i. Level I: the farthest user is not more than 250 meters from the point source.
- ii. Level II: the farthest house is not more than 25 meters from the communal faucet system.
- iii. Level III: the house has service connection from the system.

Adequately Served - refers to those with access to safe water in accordance with the following rate of consumption:

Level I at least 20/liters/capita/day

Level II..... at least 60 liters/capita/day

Level III..... at least 100 liters/capita/day

Sanitation refers to the hygienic and proper management, collection, disposal or reuse of human excreta (feces and urine) and community liquid wastes to safeguard the health of individuals and communities.

Septage is the sludge from septic tank or from any individual on-site wastewater disposal system.

Sewerage refers to the entire system of sewage or wastewater collection (sewer), treatment and disposal.

Waterless municipalities are municipalities where less than 50% of their total number of households have access to potable or safe drinking water. Waterless municipalities are being identified by NAPC.



Family is Waiting Abram Joseph Lozada

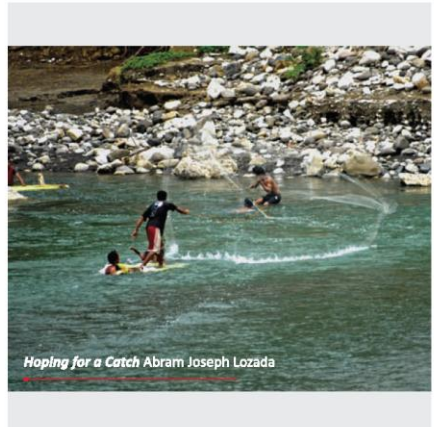
Executive Summary

The enactment of the Local Government Code (LGC) of 1991 has devolved the delivery of water and sanitation to local government units. (LGUs). However, national government agencies continue to package, finance and implement water and sanitation programs. National government (NG) recognizes that it needs to continue supporting LGUs to enable them to provide basic water and sanitation services and at least meet the Millenium Development goals of halving the population without access to safe water by 2015.

This study, Output 1.2.1 is about the review of the NG-LGU Cost Sharing policy specifically for water and sanitation. It looked at current experiences at national and international levels in cost sharing arrangements and assess its effectiveness with the end view of recommending relevant amendments to the existing policy and practice of cost-sharing.

Highlights of the study are captured in this abridged version. Some of the main points that the study raised are as follows:

- a. Use of access to water as basis for grants instead of the usual income class of the LGUs.
- b. Inclusion of pre-implementation costs (such as feasibility studies) and post implementation costs (i.e.capacity building) as part of the total project costs, not just construction related costs to ensure sustainability of services.
- c. Allowing cash and kind forms of equity.
- d. NG-LGU Cost sharing of 80% NG grant to 20% LGU equity (10% in cash, 10% in kind.) for waterless municipalities. Only Level II systems will qualify for the grants and NG can organize loan-grant-equity mix for some LGUs that are validated to require such assistance.
- e. Putting in place an enabling environment at national and local level to ensure a well-coordianted effective, efficient and sustainable water and sanitation service delivery.
- f. The need to ensure simple, clear, transparent, well communicated and uniform application of the new rules and institutional roles of the water agencies.
- g. the need for a holistic approach to water and sanitation, incorporating other components of water resources management such as its environmental dimensions. Water and sanitation must be given high priority and proper attention at national and local levels.



1.0 Introduction

In April 2009, the Philippine Government embarked on a Joint Programme entitled: "Millennium Development Goal Fund (MDG-F 1919)—Enhancing Access to and Provision of Water Services with Active Participation of the Poor", with funding from the Spanish Government and administered by UNDP and UNICEF. The Joint Programme aims to contribute to the improvement of efficiency, access, affordability and quality of potable water services by establishing support mechanisms that would help facilitate investments in water quality expansion and/or improvements and enhancing local capacities to plan, implement, operate and manage water supply system.

This particular study, Output 1.2.1, is the *Review of the NG-LGU Cost Sharing Policy for Water Supply and Sanitation*. The study aims to review and amend, as necessary, the National Government-Local Government Unit (NG-LGU) cost sharing policy to increase ownership and accountability among LGUs, as well as rationalize assistance to promote better targeting of national government assistance.

Specifically, the objectives of the study are as follows:

- (i) To review the implementation and effectiveness of the current cost sharing arrangement;
- (ii) To formulate a framework for cost sharing between the NG and LGUs; and
- (iii) To amend as necessary the NG-LGU cost sharing arrangement based on the formulated framework for cost sharing.

The review focuses on how to balance limited social subsidies with better accountability and responsibility. Cost sharing should consider: a) non-viability of areas, wherein grant should be provided regardless of income class of the local government unit (LGU); and b) limit use of NG grant/subsidy to funding capital expenditure for communities within the periphery of populated areas or in the hinterlands, and/or to water supply association formation/capacity development, among others.



Family is Waiting Abram Joseph Lozada

2.0 EXISTING FRAMEWORK FOR NG-LGU COST SHARING

2.1 Policy Framework for NG Financing of LGU Projects (1996)

In May 1996, the Investment Coordinating Council (ICC) issued a Policy Framework for National Government Financing of Local Government Projects with Environmental and Social Objectives. The basic objective of the ICC Policy Resolution is to define appropriate financing policies and assignment of roles in government to facilitate the transition towards new arrangements mandated by the LGC.

In the 1996 Policy Framework, the provision of national government grant funds for water supply projects is premised on equity considerations and is therefore limited to fifth and sixth class LGUs as classified by the Department of Finance - Bureau of Local Government Finance (DOF-BLGF). Grant assistance is extended only for Level I (point source) systems. The share of the national government should be within a range of zero to fifty percent of the total capital cost, inclusive of the cost of labor and land. The magnitude of the national share is applied on a case-to-case basis, depending on the assessment of the LGUs' revenue generating capability. The remaining 50 percent should be provided as equity by LGUs, communities, or Barangay Waterworks and Sanitation Associations (BWSAs)/ Rural Waterworks and Sanitation Associations (RWSAs). Meanwhile, all costs pertaining to operation and maintenance after the system has been put in place should be shouldered by the LGUs or communities.

2.2. NG-LGU Cost Sharing Scheme for the Water Supply and Sanitation Sector (2003)

Table 1: 1996 Cost sharing mix for the water supply sector

Sector/Activity	LGU Income Class	NG Share (%)	Remarks
Water Supply (only for Level I)	1st and 2nd	0	No NG grants for Level II and III water systems
	3rd and 4th	0	
	5th and 6th	50	

In August 2002, the ICC Cabinet Committee (ICC-CC) delegated to the Municipal Development Fund Office-Policy Governing Board (MDFO-PGB) the determination of appropriate loan-grant-equity mix to particular sectors/projects and LGU income class. Among the objectives are to: i) rationalize the terms of financial assistance to LGUs; ii) channel financial assistance to the least creditworthy LGUs; iii) partially correct the distortion of IRA formula which favors more the cities than municipalities and provinces; and iv) to expand the coverage to include other devolved activities that have greater impact on development.

The NG-LGU Cost Sharing Policy applies to projects submitted and approved by the ICC effective 01 January 2003. Basically, the Loan-Grant-Equity Mix is

based on the income class of the LGUs (provinces, municipalities and cities). It is clear that the income class was used as proxy of the credit-worthiness of LGUs.

The matrices below refer to subprojects related to water supply and sanitation:

Cluster 1 – subprojects that are generally considered as public economic enterprises (including Water Supply Level III)

Table 2: 2003 Cost sharing mix for Level III water supply systems

LGU Income Class	Municipalities and Province			Cities		
	Loan	Grant	Equity	Loan	Grant	Equity
1st & 2nd	0	0	0	0	0	0
3rd & 4th	70	20	10	0	0	0
5th & 6th	40	50	10	0	0	0

Cluster 2 – subprojects that are generally social and green/blue environment related (including Water Supply Levels I & II)

Table 3: 2003 Cost sharing mix for Level III water supply systems

LGU Income Class	Municipalities and Province			Cities		
	Loan	Grant	Equity	Loan	Grant	Equity
1st & 2nd	0	0	0	0	0	0
3rd & 4th	70	20	10	0	0	0
5th & 6th	40	50	10	0	0	0

Cluster 3 – brown environment related subprojects (including Sewerage and Sanitary Support Facilities)

Table 4: 2003 Cost sharing mix for sewerage and sanitary support facilities

LGU Income Class	Municipalities and Province			Cities		
	Loan	Grant	Equity	Loan	Grant	Equity
1st & 2nd	60	20	20	80	0	20
3rd & 4th	45	40	15	80	0	20
5th & 6th	40	50	10	60	20	20

3.0 Cost Sharing Arrangements in Practice

The study enumerates several local practices that applied cost-sharing schemes in financing WSS sub-projects in the Philippines. This enumeration is not exhaustive, however. Apparently, the guidelines for the cost-sharing scheme were not strictly followed. An explanation to the apparent noncompliance with the cost-sharing policy is that most of these local projects were implemented prior to the implementation of the recent cost-sharing policy, the guidelines of which were clarified only in 2009.

3.1 KALAHI-CIDSS

KALAHI-CIDSS, which stands for Kapit-Bisig Laban sa Kahirapan-Comprehensive and Integrated Delivery of Social Services, is the Philippine government's flagship poverty-alleviation project implemented by the Department of Social Welfare and Development (DSWD) through the financial support of the World Bank. The project's main strategies include the empowerment of the poor; support poor LGUs in local development; and, focus of investment on people more than projects. To date, the project has covered 12 regions, 42 provinces, 214 municipalities and 4,841 barangays. KC municipalities have an average poverty incidence of 53% based on the 2003 small area poverty estimates of NSCB.

The cost-sharing scheme for this project follows the 70% grant-30% local counterpart mix. The National Government through the DSWD provides the LGUs with 70% grant component in the implementation of various sub-projects which include Level II water supply and sanitation. The local counterpart includes both cash and in-kind contributions from the municipal local government unit and the barangay local government unit as well as from the communities that benefit from the sub-projects. Funds are released directly to the villager's KALAHI-CIDSS bank accounts. Villagers also manage, monitor and supervise the implementation of sub-projects.

3.2 JBIC Rural Water Supply and Sanitation Project Phase V

The Japan Bank for International Cooperation (JBIC)-assisted Rural Water Supply and Sanitation Project Phase V (RWSSP V) implemented by the Department of Interior and Local Government (DILG) aimed at reducing the incidence of water-borne and other related diseases caused by poor sanitation and lack of potable water supply sources.

DILG-JBIC (2007) reported that the Project was developed based on the national government policy of equal sharing of total project cost of Level 1 water supply investments in 5th and 6th income class municipalities between the National Government and the LGU using the NG-LGU Cost Sharing policy. Under the Project, the software components consisting of consultancy, equipment support and NGO assistance were financed by the loan proceeds and coursed to the Project through the DILG. This was provided as a grant to the LGUs by the Project. The cost of the civil works component was shared between the DILG, using the loan proceeds, and the participating LGUs. In effect, a substantial

portion of the civil works was an additional grant to the LGUs by the Project. The participating LGUs shouldered the costs of land acquisition and administrative support. In order to achieve approximately equal sharing between the NG and LGUs at the end of project implementation, the LGU share of the cost of civil works in the overall program was set at 64% during the project appraisal. By province, the LGU share ranged between 61 to 67%.

Table 5: NG-LGU Cost Sharing Per Appraisal

Components	Total Project		Ilocos Sur		Occ. Mindoro		Or. Mindoro		Nueva Vizcaya		Palawan	
	NG	LGU	NG	LGU	NG	LGU	NG	LGU	NG	LGU	NG	LGU
Civil Works	36	64	36	64	33	67	38	62	35	65	39	61
Equipment	100	0	100	0	100	0	100	0	100	0	100	0
Consultancy	100	0	100	0	100	0	100	0	100	0	100	0
NGO Assistance	100	0	100	0	100	0	100	0	100	0	100	0
Administrative Support	46	54	36	64	62	38	48	52	48	52	44	56
Land Acquisition	0	100	0	100	0	100	0	100	0	100	0	100
Contingencies	46	54	45	55	45	55	46	54	45	55	47	53
Total	50	50	50	50	50	50	50	115.54	50	114.29	50	50

3.3 LOGOFIND

Local Government Finance and Development Project (LOGOFIND) is a \$60 million World Bank-assisted project of the Department of Finance implemented by the Municipal Development Fund Office (MDFO). It is a demand-driven project that provides long-term financing and technical support to Local Government Units nationwide. The Project aims to (1) assist local government units in expanding and upgrading basic infrastructure, services and facilities; (2) promote local self-reliance and enhance the creditworthiness of local government units; and, (3) to enhance capabilities at the national level in providing technical guidance to local government units.

The terms of the Project are as follows:

- Loan Component: 15 years repayment period inclusive of a 3-year grace period on principal payments with 12% fixed interest rate per annum
- Grant Component: 10%-70% of the sub-project cost depending on the subproject type and LGU income class
- Equity Component: ranges from 10% to 20% of the subproject cost depending on the subproject type and LGU income class.

3.4 ODA through other NGAs

NG agencies (e.g. DILG, DPWH, and DAR) and GFIs (e.g., LWUA, Development Bank of the Philippines and Land Bank of the Philippines) provide relending of ODA funds to LGUs. Several ODA-funded programs and projects provide grant

financing for water supply provision. These programs and projects typically require LGUs to provide their counterpart funds to address issues on project sustainability and ownership as well as local government accountability.

3.5 Performance Based Grant for Local Government Performance

The Performance Based Incentive Policy (PBIP) and the preliminary design of the Performance Based Grant System (PBGs) were approved by the Development Budget Coordination Committee (DBCC) on February 20, 2009. The PBIP is an incentive framework to rationalize National Government intergovernmental fiscal transfers to LGUs towards improving the overall LGU performance in governance. It seeks improvements in LGU performance by linking the incentive to the achievement of a set of governance conditions and progressive performance based targets. On the other hand, the PBGS provides the mechanism on how to implement the PBIP.

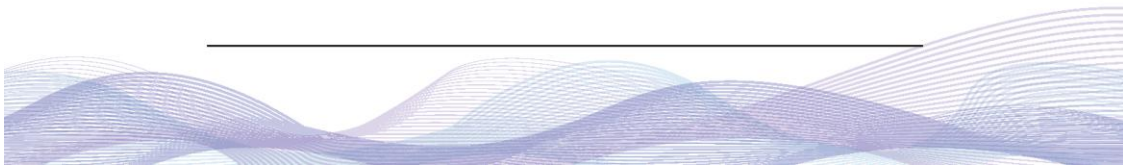
The LGU who meet the required CGs would get 30% of the total grant derived through the basic allocation formula and the balance (70%) when it fulfills the agreed Performance Measures. The 30%-70% grant allocation will be applied to motivate LGUs to achieve better/higher level of performance since a higher grant shall be provided. On the other hand, the allocation of CDG would depend on the results of the LGU assessment in terms of their capacity development needs.

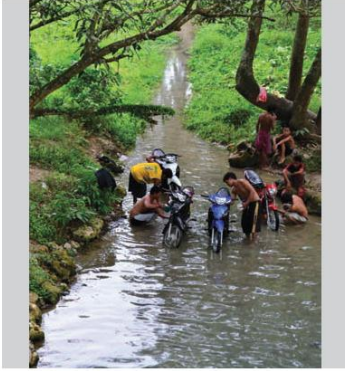
3.6 Issues relating to the Existing NG-LGU Cost Sharing Mix

The Cost-Sharing scheme was conceptualized more than a decade ago but discussions with relevant implementing agencies and institutions as well as pertinent stakeholders in the provision of water supply and sanitation services apparently show that the scheme has yet to be uniformly implemented. Considering that the guidelines for the implementation of the scheme was formulated only in 2003, there are still activities and projects that do not follow the cost sharing mix provided for in the Framework. Moreover, many LGUs are still not adequately informed on how the framework works.

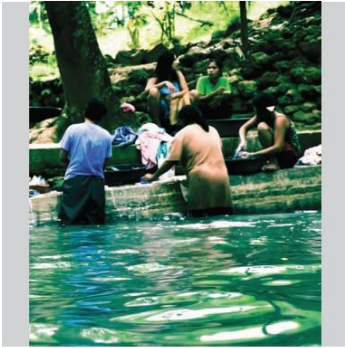
Project Sustainability and the Financing Mix

There were mixed reactions to the current financing mix in relation to its responsiveness to the local situation. Some LGUs argued that the local and economic conditions will not facilitate the financing of the provision of water supply and sanitation using the current cost-sharing arrangement. Some LGUs are not financially capable to still avail of the loan because of their existing loans while others are cash-strapped to provide cash equity to qualify them under the cost-sharing scheme. In particular, many LGUs are still dependent on their internal revenue allotment with only the 20% development fund being actually allocated to development projects while the rest of the IRA are spent on personnel services and maintenance and other operating expenses.





Off Service on Wash Day Art Fil Sandalo



Laundry Day with Friends Art Fil Sandalo



A Prince In A Slum Alan Pimentel

Balancing National Subsidy and Local Financial Independence

In the FGDs done by the study, the participants agree that the increase in the allowable grant would be tantamount to increasing dependence of the LGU from the National Government. However, they argued, that such should be a non-issue considering that the role of the NG in providing basic services was not totally removed by the LGC.

Taking cognizance of this fact is the proposition of some of the FGD participants that rather than being focused on balancing national subsidy and local financial independence, the government must be more concerned on whether the populations are actually being provided with a potable water supply. The participants believe that more than anything else, it is the provision of basic services to the people that is important. The Philippines will not be able to attain its commitment to the MDGs because many LGUs are still not financially capable of financing the projects that will promote the attainment of the MDGS, one of which is halving the population without access to sustainable potable water supply.

Guiding Policies of the Cost Sharing Scheme

Some issues emerged with regard to the specific policies provided in the cost-sharing scheme. These include among others:

- a. maximum grant of 50% is not attractive enough for LGUs
- b. the required cash equivalent of 10% of the project is very limiting. Equity in kind such as labor and other pre-implementation/pre-construction expenses must also be considered.
- c. income classification of LGUs as the sole basis of the amount of subsidy that a certain LGU will receive is not sufficient and responsive to the actual situation on the ground.

These issues stem from the fact that the LGUs identified to be waterless claim to have no disposable funds to finance water supply particularly in areas outside the urban or poblacion areas. Some specific proposals were generated by the study through the FGDs and shall be discussed in succeeding chapters as part of the study recommendations.

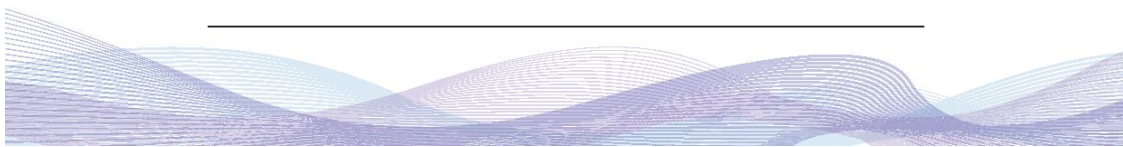
4.0 Financing Local Water Supply And Sanitation Through Cost Sharing

Financing is one of the major issues identified by the various local government units with regard to the provision of the devolved function of water supply and sanitation services. The most common source of funding are the subsidies from the national government, internal cash generation of national government entities (e.g. LWUA), public and private financial institutions, ODA grants and loans, investments from international sources (e.g. ADB, JBIC, and WB), private sector investments, proceeds from the countryside development fund, internal revenue allotment and internally generated revenues of local government units.

The following are the financing and management options available to LGUs as identified in NEDA Board Resolution No. 6, series of 1996:

- a. **LGU-Financed and Managed.** The LGU finances the investment from its income and other resources available to it (e.g. IRA, locally-generated taxes, grants) or borrows from financial institution. It then establishes a profit center within the LGU office with a separate cost accounting system. Under this arrangement, the LGU directly manages the operations of the commercial risk.
- b. **Service Contract.** The LGU finances the investment and directly operates and manages the system. It enters into contract with a private party to undertake billing and collection and/or repair and maintenance activities for a fee. The LGU maintains a profit center within the LGU office and assumes the commercial risk.
- c. **Management Contract.** The LGU finances the investment and enters into contract with a private party to manage the system. The private party collects the water tariffs set by the LGU, operates and manages the system and in turn, is paid a management fee by the LGU. The LGU maintains a profit center within the LGU office and assumes the commercial risk.
- d. **Lease Contract.** The LGU finances the capital expenditures and leases the facility to the private sector. The private sector assumes the commercial risks and the responsibility to operation and maintenance. To recover its costs, the private party is allowed to collect user fees as well as any other charges on behalf of the LGU.
- e. **Concession contract.** The LGU enters into contract with a private party to undertake the investment. The private party assumes the assets of the LGU and undertakes to expand the services according to the terms and conditions of the contract. The private party is allowed to operate the system and to collect user fees to recover its costs and earn a reasonable return on its investment. After the contract expires, the system reverts to the LGU or may be contracted out again by the LGU.

- f. **Creation of a Local Water District.** The local water district finances the investment from a loan from the LWUA and operates and manages the system. The local water district is then supervised by LWUA.
- g. **LGU Company.** The LGU may form a water company to handle to provision of the service. The water company shall be duly registered with the Securities and Exchange Commission and shall have share holdings which can be sold to the private sector in the future. The LGU appoints the board members to be selected from the private sector who would then manage the company along commercial principles.
- h. **Build-Operate-Transfer.** Under the BOT scheme, the private sector finances the investment or any of its variants operates it for a certain period of time after which the asset is transferred to the LGU. The private party is allowed to collect user fees to recover its costs and earn a reasonable rate of return on its investment. The LGU and the BOT proponent negotiate on the risk sharing.
- i. **Joint Venture Agreement.** Under a joint venture agreement, the LGU and the private party share in the risks of the project and operate the system through a shared management and organizational structure.



5.0 Proposed Framework For Subsidy Provision And Cost Sharing Arrangement Scheme In The Provision Of Water Supply Services With Emphasis On Waterless And/Or Rural Communities/Municipalities

5.1 Rationale

Based on the financial assessment of waterless municipalities and the insights gathered during the FGDs participated in by the representatives of the various LGUs across the country, it is apparent that the financial resources available to the LGUs are deemed insufficient to finance the urgent need to provide water supply and sanitation services to the identified waterless municipalities. The fiscal issues are further aggravated by the lack of uniformity in the implementation and interpretation of the cost-sharing policy, more particularly with regard to the provision of grant or subsidy. There is a need to formulate a framework that harmonizes all the policies and practices on providing subsidy and grants to LGUs.

Using the principles of good governance as criteria in the evaluation of the existing cost-sharing policy, it was found that improvement in the policy itself as well as its implementation will contribute a great deal in attaining the primary objectives of extending financial assistance to local government units. More specifically, the following observations have to be addressed in the revision/amendment of the existing policy:

- **Leadership and participation.** Political leadership is an issue in the provision of water supply and sanitation services. Local chief executives are more inclined to prioritize “traditional” and more “visible” infrastructures such as roads and bridges and tend to give less importance to the provision of potable water supply. Likewise, continuity of water supply project, in case it has been prioritized by the incumbent local chief executive, could become a concern comes a change in local leadership. It is apparent that in some areas, the local constituency is not given effective and meaningful participation in the identification and implementation of water supply and sanitation projects.
- **Clarity and simplicity.** Rules, guidelines and procedures, including the cost-sharing mix and the coverage of the scheme- are not clear to the LGUs. Also, the implementation of the scheme is varied in terms of the maximum allowable grant/subsidy and the interest rates being imposed.
- **Transparency and accountability.** On top of the seemingly complex procedures in the availment of cost-sharing scheme is the paucity of information on the rules, guidelines and procedures that actually reach the LGUs. Moreover, the roles and responsibilities of the relevant national government agencies are not clearly defined and understood by the LGUs and other relevant stakeholders. These observations can ultimately pose accountability and transparency issues in the future.

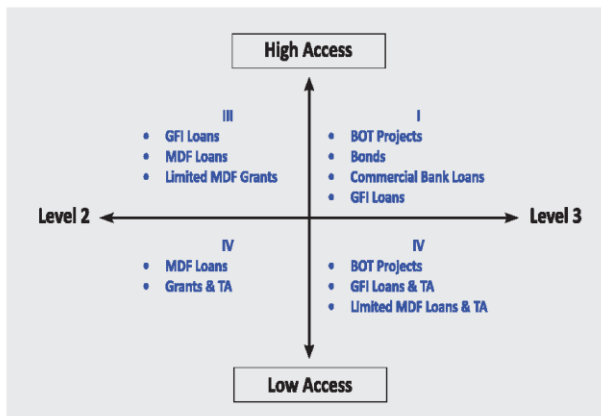
- **Efficiency and effectiveness.** There is no established mechanism to determine the efficiency and effectiveness of the cost-sharing policy. The monitoring of availment of LGUs, for instance, is being done per agency and, apparently, there is no agency that acts as repository of these important pieces of information.
- **Equity and Fairness.** Income classification being the sole basis of the cost-sharing mix poses issues on the principle of equity and fairness. Vertically, that is a comparison across levels of LGUs (e.g. municipality vis-à-vis city), it appears to be fair and equitable. However, if horizontal equity and fairness are considered, the cost-sharing scheme having income class as the sole basis of the loan-grant-equity mix is not satisfactory.
- **Sustainability.** Considering that the cost-sharing policy is focused only on the construction of civil works, there have been observations that the neglect on the pre-implementation and post-implementation of the water supply and sanitation projects can adversely affect the sustainability of the project. Likewise, local leadership is an added factor that has to be considered in sustaining the project.

5.2 POLICY FRAMEWORK

Based on its assessment, the Study Team proposes the revision of the existing Cost-Sharing Policy as it relates to the provision of water supply and sanitation services. The changes being proposed by the Study Team aim to make the design of the grant/subsidy to LGUs consistent with the objective of extending financial assistance to LGUs and in promoting investments in water supply and sanitation services to its poor communities.

Figure 1 presents the NG-LGU Cost Sharing Policy Framework for WSS, which is an adaptation of the Credit Policy Framework developed by the DOF in 1996.

Figure 1: Proposed NG-LGU Cost Sharing Policy Framework for WSS



The framework maintains the primary objective of the 1996 Framework, which is to lessen LGU dependence on the National Government and promote partnership with the private sector. This will be achieved by limiting grants to Level II water supply systems that are upgradeable to Level III. The rationale for excluding Levels I and III water systems are as follows:

- Level I water supply systems are relatively low cost and can be shouldered either by the municipal government or by the communities/barangays which will utilize the water system; and
- Level III water supply systems are revenue-generating and they can be managed by a Water District or by the LGU. Another option is to tap private sector financing. The National government can only provide technical assistance and limited MDF loans.

Level II systems, on the other hand, are in the middle of the spectrum. They are the most suitable for NG grants due to the following reasons: a) unlike Level III systems which are revenue generating, investment costs for Level II systems cannot be recovered since the fees collected from households can cover for O&M costs only; and b) unlike Level I systems which can serve up to 15 households only, the number of household beneficiaries for Level II systems can be maximized since they can serve up to 100 households and can be designed to be upgraded to Level III.

As an exception to the above rule, 100% grant financing may be considered for Level I WSS on specific areas where there are limited and/or there are no other existing water supply options. The reason for this is not to isolate an area where the only available source of water is Level I (point source) and where the municipality does not have the financial capability to put up the system. In such a case, verification should be done by the NG implementing agency to ascertain that the two conditions exist (i.e., no other existing water supply options are available other than Level I and the municipality does not have the financial capability to put up the system).

5.3 PRIORITIZATION PROCESS

In the provision of grants, the prioritization process will be done at two levels:

1. Municipal level prioritization – at the municipal level, access to potable water shall be the main determinant for the provision of NG grants. Waterless municipalities (less than 50% of total number of households has access to potable water) will be given priority.
2. Community/barangay level prioritization – in the selection of recipient communities or barangays, the municipality shall prioritize the provision of NG grants based on the following criteria: i) number of households without access to potable water; ii) poverty incidence; iii) incidence of waterborne diseases; iv) willingness to provide counterpart funds; and v) willingness to be trained for operation and maintenance.

5.4 POLICY PRONOUNCEMENTS

- a. The delivery of water supply and sanitation services to the waterless municipalities shall be a joint and shared responsibility of the National Government and the LGUs.
- b. Any LGU may avail of the grant facilities being offered by the National Government to finance the provision of water supply and sanitation services to its constituents in accordance with its Comprehensive Development Plan and Public Investment Program as approved by the Local Sanggunian.
- c. Public-private partnerships in financing water supply and sanitation services shall be encouraged to ensure the viability of local autonomy. Hence, financing contracts with private persons shall be preferred over LGU borrowings or NG subsidy/grant.
- d. In the determination of the percentage of grant to be extended to LGU beneficiaries, access to potable water supply and basic sanitation shall be used as criterion.
 - d.1. Access to water supply is categorized as follows :
 - i. Level I: the farthest user is not more than 250 meters from the point source.
 - ii. Level II: the farthest house is not more than 25 meters from the communal faucet system.
 - iii. Level III: the house has service connection from the system.
 - d.2. As regards sanitation, access is defined as "availability of toilet facility within the household premises which can be used anytime by any member of the household".

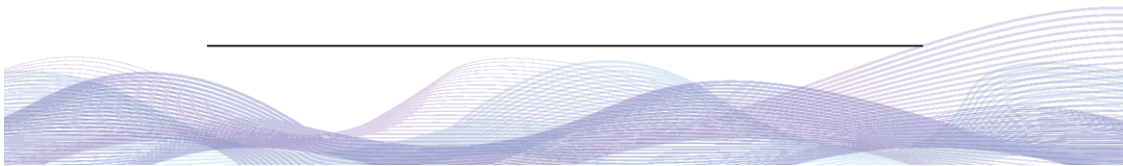


Isang Patak, Isang Buhay Artemio Layno

5.5 Guiding Principles

In the implementation of the cost-sharing policy for water supply and sanitation sub-projects, the following principles shall be taken into consideration:

- a. An **enabling environment both at the national and local levels** must be created to ensure the delivery of water supply and sanitation services in a decentralized, responsive, and participatory manner. An environment must also be created to ensure that high priority is given to the provision of water supply and sanitation. Active and effective participation of all the relevant stakeholders must be encouraged at the earliest possible phase of water supply and sanitation project cycle.
- b. Rules, procedures, and guidelines on the cost-sharing policy for water supply and sanitation must be **clear, simple and easily understood** by the relevant stakeholders. Likewise, these rules, procedures and guidelines must be communicated to the prospective users.
- c. Creation of a **transparent means of communication and coordination** between and among the national government agencies, the local government units, the private sector, and the other relevant stakeholders.
- d. **Harmonization of the operational guidelines and rules** being formulated by the different national government agencies for the implementation of the cost-sharing policy.
- e. Establishment of a mechanism to determine the efficiency and effectiveness of the cost-sharing policy. **Monitoring of the performance of the cost-sharing policy** is crucial in ensuring that basic services to the local population are effectively and efficiently delivered without the LGUs becoming too dependent from the National Government for financial resources.
- f. In addition to the focus on the construction of civil works, importance shall be given to the **pre-implementation and post-implementation** of the water supply and sanitation projects to ensure sustainability of the project.
- g. Institution of a **local champion**, which can either be an institution or a person, to ensure that the provision of water supply and sanitation services is given high priority and proper attention.
- h. There must be a **holistic approach to the provision of water supply and sanitation services**. Water supply and sanitation programs and projects must incorporate other components of water resource management such as its environmental dimensions. Water supply projects must be implemented together with the sanitation projects.



5.6 Policy Implementation Guidelines

- a. The proposed revised cost-sharing policy is **formula based**. This eliminates discretion that is given to authorities in determining the amount of grant that shall be extended to LGU recipients. However, instead of LGU income classification as the sole criterion in the determination of the amount/percentage of grant to be extended to the recipient LGU, access becomes the determinant of cost-sharing mix.
- b. The provision of grant to LGUs is **well-targeted**. In addition to access as criterion, the proper mix of grant and local counterpart is computed based on financial analysis using factors such as investment requirement, LGU borrowing capacity, and national government allocations to water supply and sanitation sector, among others. Recipients are grouped according to the level of water access. The clustering of recipients based on water access reflects the primary objective of providing universal access to water and sanitation in accordance with National Government policy pronouncements and its commitment to the attainment of the MDGs.
- c. To avoid disincentives for the LGUs to raise local taxes and/or tap private sources of funds to finance provision of services to their respective locality, **conditional matching grants** shall be provided to the LGUs that intend to invest in water supply and sanitation project. The recipient LGU must match the funds to some degree. The local counterpart shall consist of minimum 10% equity in cash and maximum 10% local counterpart in kind.

Table 6. Proposed Cost Sharing Mix Matrix

	NG Grant	LGU Counterpart
Waterless Municipalities (<50% access to potable water)	80%	20%

- d. **Grant is extended only to investments Level II** water supply and sanitation projects. No grant from the National Government shall be provided for Level III system. Level III water systems are revenue generating, hence, LGUs are encouraged to partner with the private sector to finance such systems. LGUs may opt to form a water district or explore public-private partnership in the provision of WSS within their respective locality.

As an exception to this rule, 100% grant financing may be considered for Level I WSS on specific areas where there are limited and/or there are no other existing water supply options. The reason for this is not to isolate an area where the only available source of water is Level I (point source) and where the municipality does not have the financial capability to put up the system.

- e. In the computation of the **local counterpart** of the recipient LGU, pre-implementation costs shall be included (i.e., conduct of feasibility study, acquisition of the right-of-way or land acquisition, and social preparation). The amount of investment required to finance sanitation facilities is included in the computation of the total project cost.

- f. The costs associated with the maintenance and operation of the water supply and sanitation projects shall not be included in the computation of the total project cost. Hence, it is required that as a condition to the grant, aside from equity contributions of the beneficiary community and the recipient LGU, **user fees** shall be imposed to cover at least the maintenance and operation of the water system. This would address issues on ownership by the beneficiaries as well as sustainability issues.
- g. LGUs shall be required to initiate the **formation of community-based organizations** such as the Rural Waterworks and Sanitation Associations (RWSAs)- non-stock, non-profit organizations envisioned to operate and manage Level II water supply facilities . The formation of community-based organizations shall be through a consultative and participatory approach that provides effective mechanisms by which relevant stakeholders could participate in the decision-making process. Through consultations and participation, the key stakeholders get to appreciate and understand the issues and problems in the planning, implementation and operation of WSS projects. The LGUs shall facilitate the accreditation and registration of these community-based organizations with the appropriate government authorities. Such organizations shall be under the overall supervision of the LGU concerned.
- h. LGUs that are recipient of grants shall be required to open a **special bank account** wherein funds shall be deposited. This will ensure the tracking and monitoring of both the grants from the national government and the equity share of the LGUs.
- i. The list of LGUs that are qualified for NG grants based on the level of access to water has to be regularly reviewed and updated. This is to ensure that LGUs that have been extended grants through cost-sharing shall **graduate from being waterless** and hence will not be eligible for NG grant or subsidy for waterless communities.
- j. The proposed revised cost-sharing policy shall be **uniformly applied** to all water supply and sanitation projects financed with grant component regardless of the source of funds. The revised cost-sharing scheme shall be prospectively applied by the National Government to programs and projects that are yet to be approved.
- k. The cost-sharing policy shall be **performance-based**. To make the provision of grant performance based, a certain portion of the grant component shall be converted to local counterpart in proportion to the rate of success determined six (6) months to one (1) year after the project turnover. The project success rate shall be determined by an independent technical working group composed of representatives from the provincial government, municipal government, barangay and the end-users. An illustration of how this proposed performance-based works is shown below:

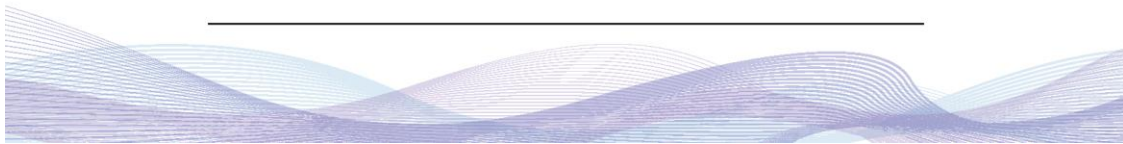
Table 7: Performance-based arrangement

Scope of Work	Accomplished Work	Project Success Rate*	Initial Arrangement	Final Arrangement**
100 HHs	50 HHs	50%	80% Grant 20% Local counterpart	65% Grant 35% Local counterpart

5.7 Outline of Implementation Strategy

Crucial in the successful implementation of any policy is the preparation of an environment that is conducive to its effective implementation and that complements the objectives of the policy to be implemented. Hence, for the implementation of the proposed cost-sharing policy, it is crucial that an enabling environment has to be created for the effective targeting of grant/subsidy to recipient LGUs. Both the policy and institutional environments have to complement the cost-sharing policy. In this regard, the following activities have to be undertaken to create an enabling environment for the implementation of the cost-sharing policy:

1. **Creation of a database of the LGUs that are to be prioritized under the revised cost-sharing policy framework.** If access to water will be the basis for qualifying LGUs for a grant, a reliable and updated database is necessary to ascertain status and other relevant information.
2. **Creation of a database on LGU financial operation.** The database is critical in the identification of LGUs that have adequate funds but are still considered waterless because of their misguided priorities. They would not qualify to access the grants under the cost-sharing policy.
3. **Local fiscal policy studies with the aim of harmonizing other fiscal policies that complement the cost-sharing policy.** Among the policies that have to be reviewed are regulations for LGU bank depository and those that relate to the effective and efficient management by LGUs of their debts.
4. **Harmonization of operational guidelines for cost-sharing policy implementation.** Amongst the most critical activities in the harmonization of those guidelines are: (a) clarification of the roles of GFIs, MDFO, PFIs and other NGAs in channeling of grants to LGUs through a memorandum; (b) issuance of an order harmonizing the operational guidelines of the cost-sharing policy; and, (c) communication of rules, guidelines, and procedures to respective users.
5. **Technical assistance to LGUs, water associations, and other water service providers.** There is a need to (a) clarify the roles of the NGAs in the provision of financial, technical and institutional support to all local water utilities including those run by LGUs; (b) clarify and enhance the role of the MDFO in assisting LGUs to finance their WSS projects; (c) provide capacity building trainings to LGUs such as in the preparation of feasibility studies, accessing resources, and assistance in the preparation of necessary documents, among others; and, (d) provide training assistance to creditworthy LGUs on private market opportunities for financing water supply and sanitation projects.
6. **Monitoring and review of cost-sharing policy implementation.** It is imperative that regular monitoring and review of the implementation of the cost-sharing policy is done vis a vis the improvement of access to water supply and sanitation services of LGUs-beneficiaries.



6.0 Conclusions and Recommendations

Conclusions

On the Governance Framework:

- Absence of a clear legal and regulatory framework for the provision of grants and subsidies to local governments by the National Government.
- The roles of the various NGAs involved in the implementation of the current cost-sharing policy are unclear.
- There is an inadequate existing guidelines for the implementation of the cost-sharing scheme.
- There is paucity of information on the rules, guidelines and procedures that actually reach the LGUs.
- There is no established mechanism to determine the efficiency and effectiveness of the cost-sharing policy.

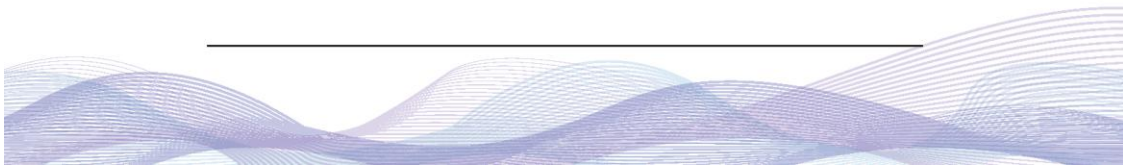
On the Current Cost-Sharing Policy Financing Mix:

- Income classification as the sole basis of the amount of grant to be given to LGUs not entirely relevant to the determination of which LGUs actually need the grant to provide access to water to its constituents, especially the poor communities.
- Access to water is a better indicator of which LGUs actually need support from the National Government through subsidies and grants.
- There is a misguided focus on the civil works aspect of the project, which in effect, relegates the pre-implementation phase and the operation and maintenance phase of the project to being lesser priorities.
- Financial resources available to the LGUs are deemed insufficient to finance the urgent need to provide water supply and sanitation services to the identified waterless municipalities.
- Political leadership is an issue in the provision of water supply and sanitation services.

Recommendations:

On the Governance Framework and Implementation of the Cost-Sharing Policy:

- Creation of a database of the LGUs that are to be prioritized under the revised cost-sharing policy framework.



- Creation of a database on LGU financial operation.
- Local fiscal policy studies with the aim of harmonizing other fiscal policies that complement the cost-sharing policy.
- Harmonization of operational guidelines for cost-sharing policy implementation.
- Technical assistance to LGUs, water associations, and other water service providers.
- Monitoring and review of cost-sharing policy implementation.

On the Cost-Sharing Policy and Mix

- Use access to water as determinant of the cost-sharing mix instead of income classification.
- Include in-kind contributions from the LGU as part of the computation of the project cost.
- Include pre-implementation (i.e., feasibility study, capability building, and land acquisition) as part of local counterpart.
- Replace the existing mix with 80% grant and 20% local counterpart.

Table 8 summarizes the issues and challenges that impede the effective implementation of the current cost-sharing policy on water supply and sanitation. It also outlines the actions that are proposed to be undertaken to address these issues and challenges.



Water is Life Erwin Lim

Table 8. Summary of Issues and Proposed Actions

Observation	Proposed Actions	
	Immediate Actions	Long-Term/Legislative Actions
Absence of a clear legal and regulatory framework for the provision of grants and subsidies to LGUs	Streamline local credit financing mechanisms and management of grants and subsidies to LGUs	Law or statute that will effectively delineate the roles of NG in funding functions that have already been devolved to LGUs by the LGC of 1991; explore amendments to LGC of 1991 to balance local independence and financial autonomy
Inadequacy of the existing guidelines for the implementation of the cost-sharing scheme/ Unclear roles of the various NGAs involved in the implementation of cost-sharing	<ul style="list-style-type: none"> Clearly delineate the roles of line agencies and oversight agencies in the formulation and implementation of subsidy policies for various types of programs and projects Harmonize operational guidelines through executive order and memorandum orders which must be prepared and disseminated to all the relevant stakeholders more particularly to LGUs. LGUs must be familiar with the procedural requirements. The same must also be acceptable to all the NGAs as well as to the LGUs Amend the regulations issued by the BSP and the COA in such a way as to allow private banks to be the depository banks of LGUs Formulation of borrowing policy for LGUs and provide technical assistance to LGUs in effectively and efficiently managing their debts 	<ul style="list-style-type: none"> Explore the prospect of making ODA loans directly accessible to LGUs with the end in view of amending the LGC and other laws pertinent to the provision of guarantee by the National Government Amend LGC of 1991 to explicitly state that private banks can also serve as depository banks for LGUs
Lack of monitoring of the implementation of the cost-sharing policy	<ul style="list-style-type: none"> Create and update a baseline database on WSS Collection of and regular updating of database on LGU financial operation as well as disseminating the same to users 	
Income classification not entirely relevant to effective and better targeting of LGUs in need to be extended national subsidy	<ul style="list-style-type: none"> Use access to water as determinant of the cost-sharing mix instead of income classification; therefore, amendment of the existing policy is in order 	
Water supply and sanitation projects are seldom a local priority; sustainability also is an standing issue	<ul style="list-style-type: none"> Provide technical assistance to LGUs, water associations, and other water service providers Include in-kind contributions from the LGUs as local counterparts to increase sense of ownership and accountability Highlight pre-implementation of the WSS project Replace the existing mix with 80% grant and 20% local counterpart 	

Notes on the Study

- a. The full study was prepared in July 2011 by a Study team composed of Engr. Julian Tajolosa (Team Leader/Water Policy Expert), Engr. Edwin V. Alzate (Economic/Financial Specialist) and Atty. Mark Anthony M. Gamboa (Institutional Specialist).

Engr. Julian Tajolosa (Team Leader/Water Policy Expert) is formerly an Operations Area Manager of the Local Water Utilities Administration (LWUA). Competence in the field of drinking water supply system was developed through working with LWUA for 33 years in various capacities. At present, he is a part-time Consultant (Water Supply and Sanitation Technical Expert) for the DBP-Environmental Development Project.

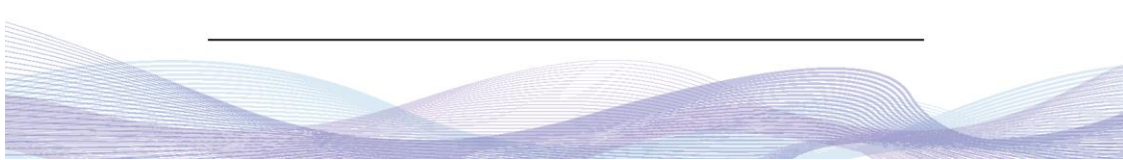
Engr. Edwin V. Alzate (Economic/Financial Specialist) has more than 15 years' experience in the financial and economic evaluation of infrastructure projects, gained while working in the government as well as in the private sector and as an independent consultant. He is currently affiliated with GHD Pty Ltd, an international consulting firm.

Atty. Mark Anthony M. Gamboa (Institutional Specialist), a lawyer and licensed environmental planner, is a member of the faculty of the U.P. National College of Public Administration and Governance (UP-NCPAG). He has served as a specialist/expert in the fields of institutional, legal and policy development for various projects funded by national agencies, local government units, non-government organizations, and international institutions.

- b. A copy of the full study report can be requested from the National Economic and Development Authority. Interested parties may contact **Ms. Kathleen P. Mangune, Project Manager** (kpmangune@neda.gov.ph).

- c. This summary document was prepared by Rosario Aurora L. Villaluna based on the final report of the Study Team. This report feeds into the Integrated Policy Document on Pro-poor water supply and sanitation.

Ms. Rosario Aurora L. Villaluna is currently the Chairperson-elect of the Philippine Water Partnership and is a member of the NEDA Sub-committee on Water Resources. She is currently the Chairperson of the Philippine Ecological Sanitation network and the Executive Secretary of the Streams of Knowledge.



Implementing Partners:



Department of the Interior
and Local Government



National Water
Resources Board



National Economic and
Development Authority



United Nations
Children's Fund



United Nations Development
Programme