Philippines

Type of state	Unitary
State / regional government level *(number)*	Regions (17) Provinces (81)[1]
Local general government levels *(number)*	Cities (146) Municipalities (1,488) Villages (42,046)
Total subnational liabilities, 2020 (state/regional + local)	PHP 662.03 billion, (USD 13.34 billion eq.)
Local government outstanding liabilities, *% of total subnational, 2020*	75.67%
Total subnational liabilities growth*, CPI adjusted[2], 2016-2020*	30.5%
Total local government liabilities growth*, CPI adjusted, period 2016-2020*	24.57%

Legal & regulatory environment	• Borrowing & lending enabled at all sub national government levels • No local government specific insolvency framework
Borrowing readiness	• Local governments have operating margins and debt-service levels well below mandated limits • High dependency on fiscal transfers • Local governments have accessed credit from public and private sources
Macro credit conditions	• 5.7% GDP growth in 2021 after pandemic recession in 2020[3] • Early-stage level of financial development: Limited institutional investor base[4] • lending from commercial sources remains low relative to public sources

Highlights

- Local governments have a well-established history of borrowing and with a variety of instruments (government and private bank loans, private placement bonds)
- Government Financial Institutions (GFIs) dominate lending to local governments; Private Financial Institutions (PFIs) have a history of lending to LGUs but the share of commercially-sourced lending has steadily declined in recent years
- Overall debt levels of municipalities remain low, reflecting strict oversight requirements, general conservatism of local policymakers and limited scope of municipal capital investment responsibilities.[5]

Borrowing legal & regulatory environment

Overview: Subnational governments in the Philippines are divided into 17 regions, 81 provinces, 146 cities, 1,488 municipalities, and 42 046 villages (*barangays*). Each level of subnational government is self-governing and elections for national and local officials are synchronized.[6] In 1991, the Local Government Code (LGC) defined local government's structure, competencies, and powers of local governments. Together with the 1987 Constitution, the Local Government Code also outlines the intergovernmental fiscal framework and expenditure responsibilities of local governments. While the Philippines has a long history of decentralization, most local governments are still heavily dependent on central government transfers, mostly via National Tax Allotments (NTA).[7]

Borrowing framework & process: Local governments in the Philippines have been authorized to access debt financing since 1975.[8] The Local Government Code (LGC) is the main legislation governing local governments borrowing. The LGC establishes local government access to credit (including loans, deferred payment schemes and bonds) from both public and private sources – limiting the contracting of long-term debt to infrastructure, capital investment/acquisitions and other self-financing projects.

Short term-borrowing is also allowed in order to stabilize local government finances.[9] Central government oversight of borrowing is strong: local government debt service is limited to 20% of 'regular income' (defined as a combination of intergovernmental fiscal transfers and own-source revenues)[10], with the Bureau of Local Government Finance (BLGF) providing monitoring and certification of debt capacity.

Local governments must first seek legislative authorization at the local entity level for each credit operation. The borrowing local government must then submit to the Bureau of Local Government Finance financial statements certified by the Commission on Audit that indicate the debt service requirement of the proposed instrument will not incur violation of the 20% threshold. Once this standard has been met, the municipality must then obtain approval of the Monetary Board of the *Bangko Sentral de Pilipinas* (BSP, the central bank); the BSP also requires follow up reporting from local governments on loan liabilities/terms and conditions. No local government-specific insolvency framework exists and controls are *ex-ante* in nature.

Borrowing restrictions:

General restrictions:

- Long-term debt can be issued only to finance infrastructure, capital investment/acquisitions and other self-financing projects.
- Both the Bureau of Local Government Finance and the Monetary Board of the *Bangko Sentral de Pilipinas* need to approve.

Debt limits:

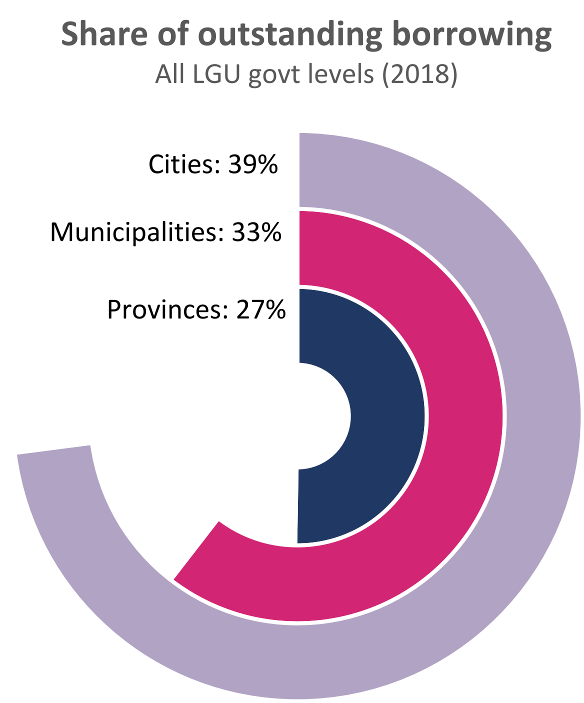
- local government debt service is limited to 20% of 'regular income' (defined as a combination of intergovernmental fiscal transfers and own-source revenues).

Borrowing incentives / credit enhancements: Government Financial Institutions (GFIs) and approved Private Financial Institutions (PFIs) that hold National Tax Allotments (NTA) transfers can use such deposits as collateral.[11]

Penalties related to public debt management: Failure to comply with the debt limits and general restrictions prescribed by law results in the budget becoming "inoperative" with consequent withholding of intergovernmental transfer allotments.[12]

Debt management

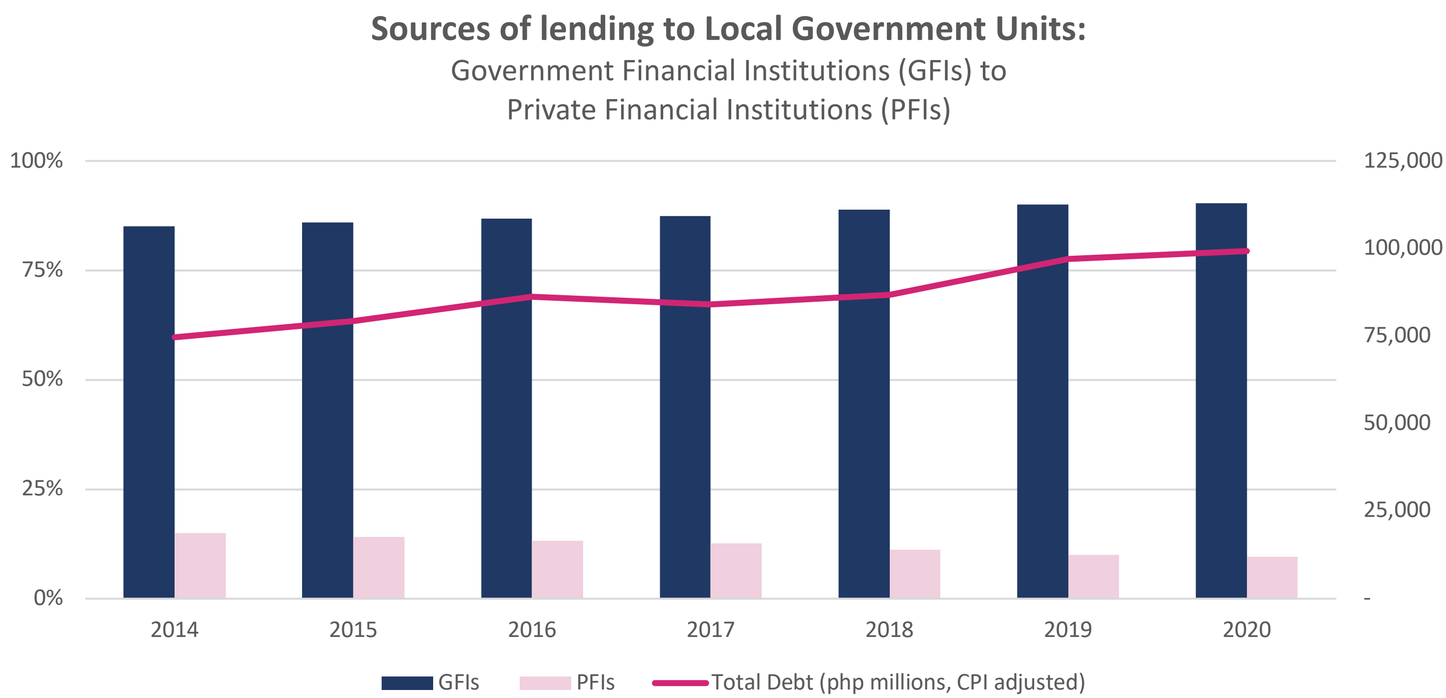
Aggregate debt levels: Despite clear legal provisions and some well-established credit options, aggregate local government borrowing levels remain low as a percentage of GDP and local income.[13] As of 2020, total liabilities, including current and non-current liabilities, were at 2.84% of GDP (about USD 8.8 billion) and just over 17% of these reported liabilities were in the form of contractual debt (loans and bonds). Outside of the major urban centers, most local governments are relatively small and rural. Until the recent *Mandanas* ruling (see below), major infrastructure projects have been mostly implemented at the national level, with limited expenditure mandates devolved to local governments.[14] Other identified factors driving low levels of local government debt in the Philippines are difficulties related to project planning and implementation processes (resulting in less projects) and a general fiscal conservatism by administrations.[15] Between the levels of subnational government (including provinces), cities have the highest proportion of outstanding borrowing, followed by municipalities and then provinces.



Source: BLGF

Lenders and types of instruments*:* The overwhelming majority of outstanding non-current borrowing is with Government Financial Institutions (GFIs), which as of FY 2020 held just over 90% of outstanding local government balances. Of the 9% from Private Financial Institutions (PFIs), over 95% is from the Philippines National Bank and the Philippines Veteran's Bank, both formerly of GFI status with legacy approval to hold local government financial deposits. This last point is critical as the use of revenue intercept on intergovernmental transfers as a risk mitigation measure is technically restricted:[16] those institutions that have permission to hold local government financial deposits can apply a *de facto* intercept by ensuring service to loans through pre-existing depository accounts that receive transfers. For the majority of local governments, often small with high levels of dependency on NTA transfers, it is harder for private financial institutions to find the necessary security to structure loans. On the other hand, large cities have far greater levels of income diversification and therefore sources to pledge as security to private lenders.

However, if the lending institution is not approved to hold government depository accounts, then each credit approval requires the specific assertion by the lender that it will not hold any financial pledges other than general obligation on the local government.[17] It is possible that this policy has impacted the availability of credit from commercial sources: while overall borrowing by local governments increased from 2014 to 2020, the share of lending from commercial sources in fact decreased over the period from 15% to 8% (see Figure 1).



Source: BLGF, 2020

Local governments have accessed loans and private-placement bonds with at least 19 issuances completed and guaranteed by the Local Government Unit Guarantee Corporation since the late 1990s.[18] However, in the last decade the issuance of bonds has subsided in favor of loans due to perceptions of higher associated fixed costs of bonds and the relative ease of borrowing from GFIs.[19] As of end of FY 2020, bonds outstanding represented only 0.6% of the total debt portfolio of local governments, the remainder coming in the form of loans from GFIs and PFIs. Interest rates between GFI and PFI loans are comparable, but PFIs generally offer shorter tenors than the GFIs, which can extend loans with tenors from 7-12 years.

Use of Special Purpose Entities and Public-Private Partnerships*:* Under the terms of the 1990 Build-Operate-Transfer Law and 1991 Local Government Code, LGUs are enabled to enter into private sector participation in infrastructure arrangements as well as joint ventures in service delivery with NGO and private operators.[20] A number of LGUs – at the provincial, city and municipal level – have entered into such arrangements. The Philippine

Public-Partnership Center provides a list of 86 projects implemented by LGUs, including pre-construction (13), construction (6), operational (62) and concluded (5). These arrangements are reported as assets under the equity method of IPSAS 36 and any likely contingent liabilities are recorded off-balance sheet in the notes to financial statements in the Commission on Audit annual report(s).

Transparency & open data*:* There are no requirements for local governments to make public their financial data on their proprietary platforms (websites, data portals etc.). In addition, there are no rating agencies active in the sub-national market of the Philippines, and ratings have not been required for any of the loans and bond issuances taken on by local governments. However, the Commission on Audit and the DoF - Bureau of Local Government Finance publish fiscal and financial data on provinces and cities - at both the individual administration level and in aggregate. These data are released on a quarterly and annual basis.[21]

Official, publicly available statistics on liabilities and borrowing				
Item	***Total liabilities***	***Total liabilities breakdown by level of government***	***Sources of borrowing breakdown***	***Borrowing instruments breakdown***
Official source(s)	Commission on Audit	Commission on Audit	Bureau of Local Government Finance	Bureau of Local Government Finance
Latest update; (periodicity)	2021 (annual)	2021 (annual)	2021 (quarterly)	2021 (quarterly)

Source: CCI-LGBD

Financial & debt management*:* As indicated by the BLGF, local governments in the Philippines are characterized by a conservative attitude towards debt and this is reflected in the data.[22] Debt service in aggregate remains far below the 20% of regular income limit, coming in at close to 2% of revenues across units. New debt acquisition is also low at under 2% of revenue across units in 2020. In aggregate, municipal governments operate with a surplus.[23] The vast majority of LGU debt is in good standing with only 0.5% of all outstanding debt marked as in arrears.

Subnational government finances: key ratios (2020)				
Level of government	***Total liabilities, % of total revenue***	***Borrowing (loans & bonds), % of total liabilities***	***Debt service, % of total expenditures***	***Operating surplus, % of total revenue***
Local (Cities, Municipalities, Barangrays)	81%	Not reported	Not reported	12%
All sub-national governments (Provinces, Cities, Municipalities, Barangrays)	82%	17%	2.5%	16%

Source: CCI-LGBD

Recent initiatives related to subnational government access to borrowing

Creditworthiness Rating Index*:* Under its mandate to monitor the overall financial health of Municipalities, the BLGF is developing a methodology to provide regular, public assessments of local government creditworthiness. The index proposes to move beyond the scope of the 20% debt service capacity assessment to an annual, publicly available examination of local government revenue generation capacity, rigidity of expenditures, financial management capacity, investment and debt capacity and repayment experience.[24] The index assessments will be conducted by BLGF and will provide the basis for Department of Finance approvals and recommendations for local government credit applications.

Mandanas-Garcia Ruling: In 2018 the Philippines Supreme Court ruled that the LGU shares of intergovernmental transfers had been incorrectly calculated and that henceforth (from 2022), the allotment would include not just internal revenues but also customs, excise and other duties. The result is that LGUs will receive an over 38% greater share of transfer revenues than before. The change heralds a greater role for LGUs in planning and financing long-term capital investments. On June 1, 2021, President Duterte signed *Executive Order 138* which envisages significant devolution of responsibilities in response to the Mandanas ruling. The order includes provisions to build up project planning and implementation capacity as well as transparency, yet questions remain regarding local governments' ability to handle this dramatic change in scope of fiscal flows and services mandate.[27] The combined effect of the Mandanas ruling and Executive Order 138 on LGU borrowing demand remains unclear: there are currently (2022) no official projections on whether the increased share of tax revenues will be enough to cover the devolution mandated by Executive Order 138.[28]

Covid 19: As in many countries, local governments in the Philippines experienced fiscal strain as a result of the Covid 19 pandemic and response. As intergovernmental transfers are calculated based on the third preceding fiscal year, the immediate impact was primarily seen in local government own-source revenues. According to the Development Budget Coordination Committee, own-revenues of LGUs were close to 50% below target for 2020. In response, LGUs have been looking to increase sources of non-recurrent revenues; LGU asset sales went from PHP 160 million in 2019 to PHP 2.4 billion in 2020. In terms of borrowing, a PHP 80 billion, LGU-specific lending facility was set up with the Land Bank of the Philippines, the public bank that held 51% of pre-pandemic credit to LGUs. The facility was bolstered by a 2% interest rate subsidy through to the end of 2022. However, there are conflicting reports regarding the extent to which LGUs have availed themselves to borrowing and year-on-year absolute borrowing amounts have not increased significantly in aggregate.

Main legal provisions	
Approved lenders:	Government and private financial institutions
Instruments:	Loans, bonds, other deferred payment schemes
Central govt guarantee:	Approval by the Secretary. of Finance required. Fee-based guarantees are available via Philguarantee, a public corporation.
Revenue intercept (pledge) of government transfers:	Formal intercepts are restricted (only for loans with MFDO), but GFIs and approved PFIs that hold NTA transfers can use such deposits as collateral[25]
Institutions that can hold financial depository accounts:	Only approved institutions, mainly public sector & 2 private banks
Insolvency framework:	None, government default-risk management mainly *ex-ante* in approvals & monitoring
Accounting basis:	Accrual: incomplete implementation across local governments
Credit rating requirements for borrowing:	Central government-maintained transparency systems (BLGF, COA). BLGF will roll out a proprietary creditworthiness index
Debt service limit:	Flow-based: 20% of regular income (OSRs + transfers, 3-year average), as assessed by BLGF
Reporting of contingent liabilities:	According to the *Accounting Manual for Local Governments,* LGUs are not required to report contingent liabilities on their balance sheets. If a contingent liability is likely to be realized it should be outlined in the notes accompanying the annual Commission on Audit financial statements[26]
Reporting of Joint Ventures & Public Private Partnerships:	Interests in joint ventures and Public Private Partnerships are recognized using the equity method as outlined in IPSAS 36

Organizational roles and responsibilities: debt	
National govt. regulatory & process	
Bangko Sentral de Pilipinas - Monetary Board	Approval of local government credit applications for balance of payment issues; regulatory oversight
Department of Finance - Bureau of Local Government Finance	Regulation of loan approval process; debt service capacity assessment & monitoring
Commission on Audit	Audit of financial statements; certification of no adverse findings prior to BLGF debt capacity analysis
Guarantee facilities	
Local Government Unit Guarantee Corporation[29]	Credit enhancement guarantees of municipal debt. LGUGC is owned 38% by Bankers Association of Philippines, 37% by the Development Bank of the Philippines (a GFI), and 25% by the Asian Development Bank (ADB). The corporation was dissolved in 2019.
Main lenders	
Land Bank of the Philippines	GFI holder of most local government financial deposits & 51% of all outstanding credits
Municipal Development Fund Office	GFI lender to low-income local governments. Only institution officially permitted the use of revenue intercept
Philippines Veterans Bank	Largest private lender to local governments with 3% of all outstanding credits

Significant legal and regulatory instruments	
Primary legislation	
Local Govt. Code Section 296, art 395	Authorization for local governments to access credit from government and private lenders
Local Govt Code, Section 324	Provision of Statutory limit of debt service equivalent to 20% of revenues
New Central Bank Act, Article II	On the issuance of government securities and prior certification by the Monetary Board
Primary regulation	
Presidential executive orders	
Executive Order No. 127, s. 1987	Authorizing the Department of Finance - BLGF to collect data on local government debt levels and to certify in advance of borrowing
Executive Order No. 809, s. 2009	Enabling LGUs to access credit from multilateral financing institutions
Department of Finance circulars	
DOF-LFC 1-2000	Certification of Borrowing and Debt Service Capacities of Provinces, Cities and Municipalities
DOF Department Order No. 054.2016	Outlining the process for applying and having loan approved by DOF-BLGF, CoA and BSP-MB
DOF Department Circular No 01-2017	Guidelines for authorized government depository banks (and list of approved banks)
Central Bank circulars:	
CBP CIRCULAR NO. 1389, Section 24	Prior central bank approval needed for foreign currency loans
CIRCULAR NO. 41	Guidelines for Bond flotation without central govt. guarantee
CIRCULAR NO. 110	Regulations on local government acceptable financial institutions for financial deposits

CIRCULAR NO. 190 & *CIRCULAR NO. 736*	Loans to local governments to be counted toward 25% Agri-Agra capital requirements
CIRCULAR LETTER NO. CL-2012-030	Regulating the 20% limit on debt service for local governments

Sources

Commission on Audit (years 2017 & 2018) Annual Financial Report - Local Government vol I.

IMF. 2018. Financial Development Index Database. IMF. Washington DC.

LGUs fiscal & debt data for All Provinces/Cities/Municipalities // Bureau of Local Government Finance (2018)

Nino Raymond B. Alvina – "Credit Financing for Local Development: the Sub National Debt in the Philippines", Asian Development Bank Institute: https://www.adb.org/publications/credit-financing-local-development-subnational-debt-philippines and from direct discussions with the BLGF staff

SNG-WOFI. 2016. Country and territory profiles. OECD

Philippines Statistics Authority (2019) // 2018 Philippine Standard Geographic Code // Department of the Interior and Local Government– LGU Directory web portal.

Socio-economic indicators: World Bank // UNDP // IMF-GFS.

Notes

[1] CCI-LGBD examines borrowing at the local government level. In most countries, this can be broken up into regional governments and local governments. In Philippines's case, "local governments" includes cities, municipalities and villages (*Barangrays*). Provincial governments are also classified as being a "Local Government Unit" by the Philippines government and borrowing data is aggregated on this basis.

[2] CPI adjusted numbers with 2016 as base year: www.worldbank.org/en/research/brief/inflation-database

[3] World Bank national accounts data accessed at https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=PH, August 10, 2022

[4] IMF 2019, Financial Development Index. The Philippines score for Financial Institutions Depth was 0.18, compared to 0.77 for South Africa, the top ranked emerging market country

[5] ADB, 2019

[6] The Republic Act No. 7166 in 1991, Section 2 on holding national and local elections on the same day

[7] SNG-WOFI 2016, according to the BLGF in 2020, the NTA shares for LGUs averaged at 63%, with cities averaging 47% and municipalities and villages above 80%

[8] Presidential Decree No. 752, 1975

[9] Local Government Code, Section 296 (b)

[10] Specifically, 'Average Regular Income' (ARI) is the 3-year annual average (as calculated by the BLGF) of Locally sourced Income, the Internal Revenue Allotment and National Wealth Payments. The ARI * .20 equals the maximum allowable debt service for local governments

[11] Alvina. N., *Credit Financing for Local Development: The Sub-national Debt in the Philippines*, June 2019

[12] Alvina. N., *Credit Financing for Local Development: The Sub-national Debt in the Philippines*, June 2019, Pg 8

[13] BLGF data

[14] As of 2021 a significant change will take effect as a result of the *Mandanas* ruling, which has mandated that LGUs receive a much greater share of the NTA. LGUs can expect to take on far greater operational and capital investment responsibilities as a result. For more see https://www.worldbank.org/en/news/press-release/2021/06/10/philippines-mandanas-ruling-provides-opportunities-for-improving-service-delivery-through-enhanced-decentralization

[15] See Liu Lili et al, *Until Debt Do Us Part, Subnational Debt, Insolvency, and Markets*, Pg 453 & Alvina, N, *Credit Financing for Local Government: The Subnational Debt in the Philippines*, Pg 11

[16] Alvina, pg

[17] Alvina. N., *Credit Financing for Local Development: The Sub-national Debt in the Philippines*, June 2019

[18] Information from LGUGC, accessed at http://Munigc.com/outstanding-accounts-Muni-p4/ (June 4, 2020)

[19] USAID, *DCA Philippines LGUGC evaluation*, pg 17 (2009)

[20] For a more detailed review of LGUs and PPPs, see Asian Development Bank, *Private Partnerships by Local Governments* (2016)

[21] Data can be found at http://blgf.gov.ph/lgu-fiscal-data/ (BLGF) and https://www.coa.gov.ph/index.php/local-government-units-lgus (CoA)
[22] Alvina, pg 11
[23] As calculated by the formula: *Net Surplus* = (*Transfers + OSR) – (Opex + Capex + Debt Service & other non-operating expenditures)*
[24] More information can be found at https://www.unescap.org/sites/default/files/PHILIPPINES_presentation.pdf (accessed June 2020)
[25] Alvina. N., *Credit Financing for Local Development: The Sub-national Debt in the Philippines*, June 2019
[26] Commission on Audit, *Accounting Manual for Local Governments*, accessed at https://www.coa.gov.ph/index.php/2013-06-19-13-06-41/manuals/category/8506-government-accounting-manual-gam-for-local-government-units (2021)
[27]World Bank, *Philippines Economic Update* (June 2021)
[28] One unofficial estimate forwarded by the governor of Sorsogon Province has calculated that the devolved responsibilities will cost as much as twice the amount of the additional NTA allocations. See https://newsinfo.inquirer.net/1538227/lgus-should-not-depend-on-windfall-from-mandanas-ruling
[29] While LGUGC was dissolved in 2019, The Electric Cooperative-Partial Credit Guarantee Program from the LGUGC was absorbed by Philguarantee. Through Executive Order No. 58, five of Philippines' guarantee programs and agencies were merged into Philguarantee (https://www.officialgazette.gov.ph/downloads/2018/07jul/20180523-EO-58-RRD.pdf)

City Creditworthiness Initiative

THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

PPIAF
Enabling Infrastructure Investment