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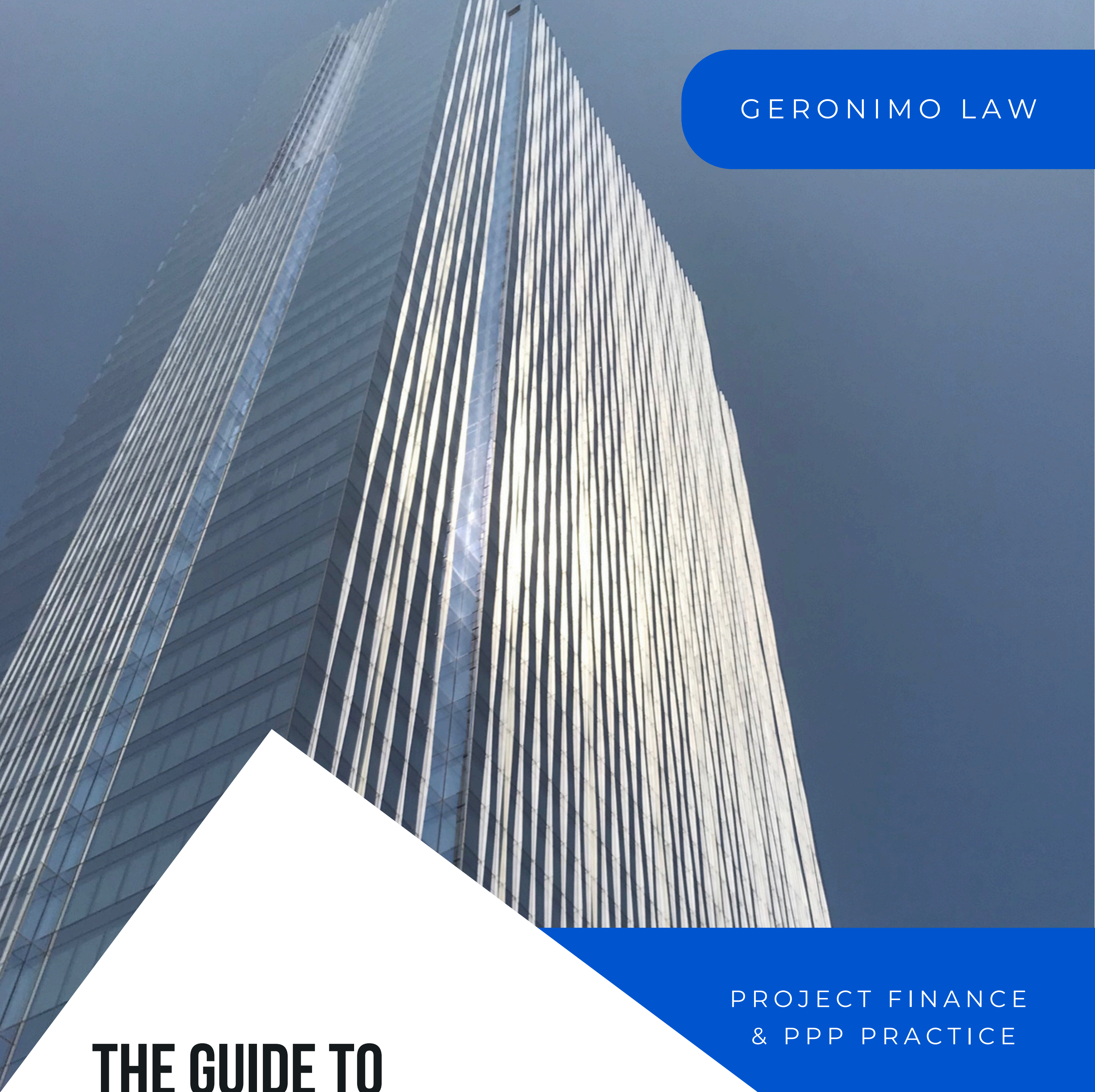

PROJECT FINANCE
& PPP PRACTICE

THE GUIDE TO PHILIPPINE SOVEREIGN GUARANTEE

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THE GUIDE TO PHILIPPINE SOVEREIGN GUARANTEE

I. Introduction

Sovereign guarantees are commitments by the Philippine government to cover certain financial obligations if a borrower or project company defaults or if specific risks materialize. Such guarantees can make infrastructure and development projects more attractive to private investors and lenders by effectively shifting risk to the government. However, the Philippine government's policy on sovereign guarantees has evolved to be cautious and selective. In practice, there is an ongoing balancing act between attracting private investment (for example, in public-private partnerships or **PPPs**) and protecting public finances from undue contingent liabilities. Officially, Philippine authorities emphasize prudent risk-sharing (a stance shaped by past experiences where heavy guarantees saddled taxpayers with enormous costs), yet the practical implementation of this policy can seem unclear.

This article provides the legal framework, government policy, and current practices on sovereign guarantees in the Philippines, including their role in PPPs, official development assistance (**ODA**) financing, and other blended finance transactions.

II. Legal Framework and Government Policy on Guarantees

A. Constitutional and Statutory Basis

Under the 1987 Philippine Constitution, the President may contract or guarantee foreign loans on behalf of the Republic with prior concurrence of the Monetary Board of the *Bangko Sentral ng Pilipinas* (**BSP**).

The Foreign Borrowings Act (Republic Act No. 4860) authorizes the President to guarantee foreign loans of government-owned and/or -controlled corporations (**GOCCs**) for development purposes, but caps the total outstanding government guarantees for GOCC or government financial institution (**GFI**) borrowings at US$7.5 billion. Direct foreign loans of the National Government carry a higher ceiling of US$10 billion, though ODA loans are generally exempt from a fixed cap. These limits are intended to contain contingent debts.

B. Risk Management Policies

In line with these legal constraints, the Department of Finance (**DOF**) has adopted a risk-based approach to issuing guarantees. DOF Circular No. 1-2016, for example, established a framework for charging guarantee fees and foreign-exchange risk cover fees to GOCCs that benefit from National Government guarantees. The intent is to price the risk of guarantees and discourage indiscriminate use by ensuring that borrowing entities shoulder some cost of the credit support.

1. Government's Stated Stance

Philippine fiscal authorities in recent years have repeatedly emphasized a conservative stance on sovereign guarantees. The DOF has explicitly stated that it cannot provide guarantees for a significant portion of project risk, when the private sector makes more than adequate returns for taking on its limited share of risk. Private investors should bear a fair portion of market and commercial risks in infrastructure projects, rather than passing those risks onto the government (and ultimately the taxpayers).

DOF has also raised concerns in the past over contingent liabilities, i.e. potential obligations that the government might have to pay in the future if certain conditions are met (such as a guarantee being called due to revenue shortfalls or project termination).

2. Past Lessons Influencing Policy

The cautious policy is rooted in hard lessons from past projects. In the 1990s and early 2000s, the Philippines issued extensive guarantees in sectors like power and water (for instance, take-or-pay provisions with independent power producers and rate-of-return guarantees for utilities), which eventually led to massive government payouts or debts when assumptions didn't pan out.

Some PPP contracts even contained clauses (such as automatic tariff increases, non-interference commitments, or non-compete undertakings) that stripped the government of its regulatory authority and increased contingent liabilities, effectively locking in private profits at the public's expense. These experiences made sovereign guarantees a contentious political issue and underscore why today's policy circles insist that guarantees, if given at all, be prudent and not "sweetheart" deals.

Critics of earlier PPP policies often portrayed sovereign guarantees as using public funds to guarantee business profits. Thus, current policy strives for greater transparency and balance in risk allocation.

III. Sovereign Guarantees in Public-Private Partnerships (PPPs)

A. No Blanket Guarantees in PPPs

PPPs are a key area where demands for sovereign guarantees frequently arise, since private proponents seek assurance on risks like political/regulatory changes, revenue shortfalls, or government performance. The Philippine government's official policy is to avoid extending blanket sovereign guarantees to PPP projects, especially guarantees of commercial or market risks. In practice, this meant steering away from guarantees on private investors' returns or demand levels.

1. Forms of Government Support

While outright sovereign guarantees of profits or revenues have been curtailed, the government does employ more limited support mechanisms in PPPs. The newly enacted Philippine PPP Code of 2023 (Republic Act No. 11966) codifies the menu of government support that may be available, subject to approvals. Under this law, allowable "Government Undertakings" in PPP projects include: (a) guarantees on demand (e.g. minimum traffic or volume guarantees), (b) guarantees on private sector returns, (c) guarantees on loan repayment, (d) viability gap funding (VGF) or other direct subsidies, and (e) monetary compensation for contingent liabilities via a dedicated fund. Providing any of these forms of support triggers higher-level review. Undertakings financed by the National Government must be approved by the National Economic and Development Authority (NEDA) Board's Investment Coordination Committee (ICC).

B. Viability Gap Funding vs. Guarantees

The use of VGF deserves special mention. Instead of guaranteeing a private operator's revenue, the government may opt to provide a one-time or periodic subsidy to make a project financially viable while still letting market demand play out. For example, the government can shoulder a portion of the upfront construction cost or provide an availability payment in an availability-based PPP (where the government pays for the infrastructure's availability/service instead of the private partner relying solely on user fees). This reduces the revenue risk for the private proponent without formally guaranteeing that they will earn a certain profit.

Some commentators have argued that VGF is effectively a form of sovereign guarantee "through the backdoor," since it ensures the private proponent recoups part of its investment from public funds. Legislators critical of an earlier draft of the PPP law claimed it would institutionalize sovereign guarantee through VGF.

The government, however, frames VGF not as a guarantee of profits but as a transparent subsidy to achieve social objectives (like affordable tariffs or bridging viability gaps in social infrastructure), a policy choice that can be justified for public good, provided it is granted in a competitive and judicious manner. Unlike open-ended guarantees, VGF commitments are usually capped and accounted for upfront in the budget, giving the state more control over its exposure.

C. Contingent Liability Management in PPPs

Even without explicit guarantees, PPP contracts can create contingent liabilities (for instance, obligations to compensate the private party if certain events occur, such as termination due to government default or a material adverse government action).

The NEDA Board (through its ICC) has moved to institutionalize rigorous risk assessment as part of PPP project approval. DOF recommended, and the ICC in late 2021 required, that proposals be evaluated not just on cost and benefits, but also on potential government guarantees and contingent liabilities before they are approved. Moreover, the PPP Code and its implementing rules call for transparency in contingent liability disclosure.

D. Risk Management Fund

One of the landmark innovations in the PPP Code is the creation of a PPP Risk Management Fund at the national level. This fund is designed as a ready pool of money to pay legitimate government obligations arising from PPP contracts (such as termination payments or guarantee calls), without derailing the national budget process.

F. Real-World Practice

In current practice, sovereign guarantees in PPPs are granted sparingly, and the trend is towards specific, targeted guarantees rather than broad assurances. For example, rather than guaranteeing a private toll road operator a minimum traffic volume (which would oblige the government to pay for any shortfall in toll revenues), the government might offer support in the form of shouldering right-of-way acquisition costs, or agreeing to a revenue-sharing mechanism if traffic exceeds a certain level, or committing to terminate the concession with compensation if a competing government road is built.

IV. Sovereign Guarantees in ODA and Government Loans

Outside the realm of PPPs, sovereign guarantees also come into play in ODA financing and other public-sector borrowings. The Philippines is a significant recipient of ODA loans (from multilateral institutions like the World Bank, Asian Development Bank, JICA, etc., and bilateral lenders), which fund infrastructure, social programs, and budget support. By definition, most ODA loans to the Philippines are extended to the National Government and thus carry the full faith and credit of the Republic. These are direct sovereign obligations rather than contingent liabilities. However, when ODA or other foreign loans are obtained by LGUs, GOCCs, or GFIs, a National Government guarantee is often required by the lenders.

A. National Government as Guarantor

The typical arrangement for decades has been that if an LGU or GOCC wants to borrow from foreign sources, the National Government (through the DOF) will either on-lend the funds or guarantee the loan. Lenders have traditionally insisted on this sovereign guarantee to mitigate credit risk. In fact, it used to be virtually impossible for Philippine sub-national entities to access foreign loans without a sovereign guarantee, since practically all donor partners, multilateral and bilateral, refused to lend without one.

This paradigm is slowly changing. ADB in recent years showed openness to lend directly to well-performing LGUs without National Government guarantee, but such cases are still the exception. The conservative view (held by the Philippine central government) is that if an LGU were to default on a foreign loan without a sovereign guarantee, it could still reflect poorly on the country's credit reputation. Thus, the default stance is for the National Government to backstop sub-national borrowings.

B. Guarantee Ceilings and Approvals

The aggregate cap of US$7.5 billion on the government's outstanding guarantees for GOCC and GFI foreign borrowings acts as a macro-level control to prevent excessive build-up of contingent debt. Any foreign loan to a GOCC or LGU that carries a sovereign guarantee must be approved by the Monetary Board and usually also gets reviewed by inter-agency bodies like the DOF's international finance group and often the NEDA ICC (for development loans).

There is a Congressional Oversight Committee on ODA (COCODA) that monitors ODA implementation, and even former Presidents sitting in oversight roles have scrutinized the use of these guarantees.

The DOF has clarified that GOCC/GFI borrowings are typically authorized by their own charters and are distinct from the National Government's direct debt, but if needed, the President can guarantee those loans under RA 4860.

C. Guarantee Fees and Risk Sharing

To further manage the moral hazard of guaranteed borrowing, the DOF charges guarantee fees to GOCCs and LGUs on loans it guarantees. For example, LGUs that borrow locally via the Municipal Development Fund Office or other facilities pay a guarantee fee.

DOF's own circulars set a sliding scale of guarantee fees based on the risk rating of the borrower and the tenor of the loan. These fees serve two purposes: they provide a modest revenue stream to the government to compensate for the risk, and they incentivize GOCCs/LGUs to improve their creditworthiness (since a stronger borrower could negotiate a lower guarantee fee or even avoid needing a sovereign guarantee altogether).

In practice, many GOCC loans are to large infrastructure agencies (like the National Power Corp in years past) and the guarantee fee becomes part of project cost. From a counterparty's perspective (say, a foreign lender or contractor involved in an ODA-funded project), the takeaway is that the Philippine government does stand ready to guarantee important sub-sovereign loans, particularly for infrastructure, but it does so under structured conditions and pricing, not as an automatic entitlement.

D. ODA without Sovereign Guarantee – Emerging Opportunities

There is growing interest in allowing capable local governments to borrow without burdening the national balance sheet. The Local Government Code already allows LGUs to borrow domestically without national guarantee, subject to debt service limits. For foreign borrowing, pilot programs have been discussed (e.g., an Executive Order in 2009 sought to enable top-tier provinces or cities to directly contract foreign loans without national guarantee, provided they meet certain credit criteria). Multilaterals like the World Bank have also introduced sub-national lending programs globally.

In the Philippines, any such initiative will be cautious. A well-prepared first case, perhaps a creditworthy city directly borrowing from ADB for a project, would serve as a showcase. Should this become feasible, it could reduce the need for sovereign guarantees in the long run by strengthening local fiscal management.

Until then, however, most ODA-backed projects that involve entities other than the National Government will continue to carry sovereign guarantees or be structured as relent loans (where the National Government on-lends funds to the LGU/GOCC). Clients engaging in ODA projects should plan for the additional step of securing the sovereign guarantee, unless explicitly advised that the lender does not require it.

V. Implications for Investors and Lenders

In negotiating project terms or loan agreements, it is crucial to identify which risks truly require government backing and to justify them in discussions with the DOF/NEDA. Political and regulatory risks (like changes in law, or government agency default) are areas where the state is more willing to concede guarantees or commitments, since those are under government's control.

Market risks (like user demand, price volatility, or an investor's debt repayment) are generally expected to be borne by the private side or mitigated through insurance and other instruments, rather than a sovereign guarantee. International lenders have adapted to this environment by sometimes seeking partial risk guarantees from multilateral institutions (e.g. World Bank's MIGA or ADB's guarantee programs) instead of or in addition to sovereign guarantees.

Should you require specific guidance on Philippine law and regulation, you may reach us through the following contact details:

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