Report and Recommendation of the President to the Board of Directors

Project Number: 52173-002
May 2020

Proposed Loan
Republic of the Philippines: Local Governance Reform Project

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Asian Development Bank
CURRENCY EQUIVALENTS
(as of 29 May 2020)

Currency unit – peso (₱)

₱1.00 = $0.01978
$1.00 = ₱50.56

ABBREVIATIONS

ADB – Asian Development Bank
BLGF – Bureau of Local Government Finance
COVID-19 – coronavirus disease
DOF – Department of Finance
FMA – financial management assessment
GDP – gross domestic product
LGU – local government unit
OSR – own-source revenue
PAM – project administration manual
RPT – real property tax
RPVARA – real property valuation and assessment reform act
RPVS – real property valuation service
SMV – schedule of market values

NOTE
In this report, “$” refers to United States dollars.

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</tbody>
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# PROJECT AT A GLANCE

## 1. Basic Data

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Local Governance Reform Project</th>
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<tbody>
<tr>
<td>Country</td>
<td>Philippines</td>
</tr>
<tr>
<td>Borrower</td>
<td>Republic of the Philippines</td>
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<td>Country Economic Indicators</td>
<td><a href="https://www.adb.org/Documents/LinkedDocs/?id=52173-002-CEI">https://www.adb.org/Documents/LinkedDocs/?id=52173-002-CEI</a></td>
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<td>Portfolio at a Glance</td>
<td><a href="https://www.adb.org/Documents/LinkedDocs/?id=52173-002-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=52173-002-PortAtaGlance</a></td>
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</tbody>
</table>

## 2. Sector

- **Public sector management**
  - Subsector(s): Decentralization

<table>
<thead>
<tr>
<th>ADB Financing ($ million)</th>
<th>26.53</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>26.53</td>
</tr>
</tbody>
</table>

## 3. Operational Priorities

- Addressing remaining poverty and reducing inequalities
- Accelerating progress in gender equality
- Making cities more livable
- Strengthening governance and institutional capacity

### Climate Change Information

- GHG reductions (tons per annum): 0
- Climate Change impact on the Project: Low

### ADB Financing

- Adaptation ($ million): 0.00
- Mitigation ($ million): 0.00

### Cofinancing

- Adaptation ($ million): 0.00
- Mitigation ($ million): 0.00

## 4. Risk Categorization:

- Low

## 5. Safeguard Categorization

- Environment: C
- Involuntary Resettlement: C
- Indigenous Peoples: C

## 6. Financing

<table>
<thead>
<tr>
<th>Modality and Sources</th>
<th>Amount ($ million)</th>
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<tbody>
<tr>
<td><strong>ADB</strong></td>
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<tr>
<td>Sovereign Project (Regular Loan): Ordinary capital resources</td>
<td>26.53</td>
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<tr>
<td><strong>Cofinancing</strong></td>
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<tr>
<td>None</td>
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<tr>
<td><strong>Counterpart</strong></td>
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<tr>
<td>Government</td>
<td>4.96</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>31.49</td>
</tr>
</tbody>
</table>

**Currency of ADB Financing:** US Dollar

Source: Asian Development Bank

This document must only be generated in eOps.
I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of the Philippines for the Local Governance Reform Project.

2. The project will help the Government of the Philippines boost local government revenue mobilization to improve local public service delivery and strengthen local governance. The focus will be on improvements to the administration of the real property tax (RPT) and on management reforms. In particular, the project will (i) support institutional development and policy formulation for property valuation, (ii) implement a property tax valuation database and information systems, (iii) enhance the RPT administration for selected local government units (LGUs), and (iv) professionalize local assessors and strengthen the capacity of LGUs. The project complements the programmatic approach of the Local Governance Reform Program, which was approved in November 2019.¹

II. THE PROJECT

A. Rationale

3. Development challenges. Strong economic growth in the Philippines has yet to deliver equitable benefits to its citizens. From 2011 to 2019, gross domestic product (GDP) grew on average at 6.2% per year, higher than the Association of Southeast Asian Nations' median GDP growth rate of 5.7% for 2018.² However, this growth did not result in a significant reduction of long-standing disparities in the Philippines. The country's income inequality exceeds that of regional peers, and national averages mask significant regional variation.³ The national poverty incidence fell from 26.6% in 2006 to 16.6% in 2018 but remains among the highest in Southeast Asia. The poverty incidence is rising in parts of eastern Visayas and in southern and western Mindanao; in these areas, the poverty incidence can exceed 30.0%. Women are especially at risk; poverty incidence among women in the former Autonomous Region in Muslim Mindanao reached 55.1% in 2017.⁴ The country’s geographic diversity also creates unique development challenges, and service delivery costs can be extremely high in many remote parts. Local governments can help reduce such disparities and create opportunities for economic development, but accountable service delivery depends on well-calibrated intergovernmental relations and appropriate resourcing in line with local governments' roles and responsibilities.

4. Impact of the coronavirus disease (COVID-19) pandemic. COVID-19 is exacting a heavy toll on the Philippines with the economy expected to contract by 1% or more in 2020, and the potential for a sharp increase in both poverty and unemployment. Fiscal pressures are also increasing as pandemic response requirements result in new expenditures, and revenues are squeezed due to reduced trade, investment, and economic activity. These factors add new urgency to the domestic resource mobilization agenda. Local government revenue mobilization will be necessary to support critical relief activities and to provide local governments with the necessary resources for economic recovery. Land and property values are relatively inelastic and are likely to be less affected by the pandemic than other revenue sources. As a result, COVID-19 may have a positive effect on incentives for property tax reform, as revenue needs mount and other revenue sources such as income and consumption tax are compressed, encouraging both central and local governments to pursue property tax reforms.

³ The Philippines’ Gini coefficient is 0.44, compared with 0.39 in Indonesia, 0.38 in Thailand, and 0.34 in Viet Nam.
5. **Local governance.** Compared with regional peers, the Philippines is significantly decentralized in administrative and political dimensions. Local government is broadly divided into three levels: provinces and independent cities, municipalities, and barangays. As of 31 December 2019, the country had 81 provinces, 145 cities, 1,488 municipalities, and 42,045 barangays. However, fiscal matters are relatively less decentralized, especially when it comes to revenue mobilization. About 29% of LGU revenue is from local own sources (raised by local governments themselves), the rest comes from central transfers; this compares with an average of more than 40% own-source revenues (OSR) raised by local governments in industrial economies. In most decentralized systems, land and property taxes typically represent an important source of revenue for local governments; however, in the Philippines, the property tax administered by local governments accounted for only 28% of all local OSR (or 9% of total revenues), compared with 44% from business tax and 28% from nontax revenues.

6. **Property tax.** Property tax collection in the Philippines is low for several reasons. RPT is imposed on land and structures based on the assessed value of the property, and LGUs exercise significant control over the setting of rate and assessment levels. However, political and institutional challenges create conflicting incentives for local officials, which prevent revenue optimization. The schedule of market values (SMV), which is the basis for property assessments, is heavily influenced by local electoral politics, which discourages regular updates. True market values are shown to be 2 to 75 times higher than assessed values. The politicization of the SMV also creates an opening for rent seeking: the decision to update the SMV is timed to the preference of decision makers, in consideration of taxpayers, or to attract investments on the basis of lower property taxes. This causes inconsistencies between property valuations by LGUs and the Bureau of Internal Revenue on which capital gains taxes from the sale of a property are calculated and collected. Although national valuation standards and methods are improving, weak capacity of local valuation staff results in inconsistent valuation systems. Coupled with poor record keeping and outdated reporting systems, real property values are distorted. Moreover, RPTs collected as a percentage of GDP declined from 0.45% in 2004 to 0.35% in 2016. Acknowledging these valuation constraints, the Bureau of Local Government Finance (BLGF) estimates that in the same period, provinces and municipalities missed collecting ₱9.4 billion in forgone property tax revenues, while cities could have collected an additional ₱20.3 billion.

7. **Reform measures.** The government has embarked on various reforms to strengthen local governance and mobilize local revenues, submitting to Congress several amendments to the Local Government Code with the intention of updating the legal framework for local governance. The amendments cover revenue provisions, such as aligning business tax collection with the geographic area in which the business activities take place, harmonizing fees and fines across LGUs to reduce uncertainty for investors, and increasing local autonomy in the use of revenues from natural resources (footnote 1). The government also proposed a new real property valuation and assessment reform act (RPVARA) to Congress. If passed, a single valuation base would apply to all property taxation purposes of national and local governments; reviews of compliance with valuation standards would be compulsory; and the approval of the SMV would be handled centrally again by the Department of Finance (DOF) to ensure valuation of real property is not compromised.

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politically driven. The DOF will prescribe valuation standards, build capacity of local appraisers and assessors, and develop an up-to-date property information system consisting of an electronic database of real property transactions from the LGUs and other stakeholders such as the private sector. The proposed law will also make LGUs ineligible for conditional or performance-based grants and prevent them from accessing credit financing if they do not update their SMVs regularly. Under this proposed legislation, the government estimates that RPT revenues would increase by ₱12.6 billion ($252 million), including ₱3.7 billion ($74 million) for provinces and municipalities and ₱8.9 billion ($178 million) for cities. Additional measures to improve collection efficiency under the RPVARA are expected to add around ₱30 billion ($600 million) in local tax collections.\textsuperscript{11}

8. **Binding constraints.** In reforming the administration of the RPT, the government faces three primary constraints. First, the Philippines does not have a structured and institutionalized mechanism or body to implement and sustain real property valuation reforms. The many institutions and agencies involved in land management and taxation have overlapping and sometimes conflicting roles and mandates. The legal framework for land management is complex, and no duly organized and recognized national appraisal service exists. Complex revenue mobilization reforms typically require multiple years of commitment. The absence of an established body that can sustain the reform momentum raises the risk of incomplete or ad hoc reform implementation. Likewise, international standards and methods for property valuation exist and continue to evolve, but the absence of an institutionalized body of practitioners in the Philippines forestalls the opportunity to transfer this knowledge to a professional cadre of assessors. The result is a significant variation in the approach and methodology of property valuation across the Philippines, increased administrative costs, and lower tax compliance.

9. Second, the Philippines does not have a consistent, reliable property information and valuation database for record keeping of the true market value of land. Multiple central and local agencies have fragmented responsibilities for different dimensions of land management and record keeping. While some LGUs have developed individual property information and valuation data systems, these are ad hoc, and the quality varies significantly across LGUs. Individual systems may use different protocols, classifications, and data formats, compromising the ability of central oversight agencies to obtain a consistent set of data on property values. Some LGUs also rely on private sector actors to prepare and maintain property valuation information. This tends to result in inconsistent valuations prepared by different government agencies and private entities and reflecting varying values for similarly located and comparable properties. In the absence of a unified data standard and policy for data sharing, administrators of property taxes face serious difficulties in establishing an integrated information technology tax system and linking information from different government agencies and the private sector.

10. Third, property taxation is fraught with political, institutional, and administrative challenges. Tax reforms are often complex undertakings; national reforms which are to be implemented by a large number of local government stakeholders are even more so. Past efforts to increase property tax collections have been stymied by the absence of a well-articulated strategy to address these challenges, particularly incentive and accountability mechanisms which will support consistent reform implementation across diverse localities. For reform measures to be successful, an appropriate balance of autonomy and accountability is needed in order to influence property tax policy and its administration. The mobilization of property tax revenue must be linked to improved levels of responsive, efficient, and accountable service delivery.

\textsuperscript{11} BLGF calculations, June 2019.
11. **Government strategy.** The government has a renewed focus on the role of local governments in delivering quality services and promoting local economic development. The Philippine Development Plan, 2017–2022 underscores the importance of local government in promoting local investment, social protection, and other service delivery. The government also made land management reform a part of its priority agenda for economic development, including ensuring the security of land titling to encourage investments, and addressing bottlenecks in land administration and titling agencies. The Department of Environment and Natural Resources in particular is pursuing updates to the Land Sector Development Framework (2010–2030) with support from the Food and Agriculture Organization. Under the pillar of “Ensuring Sound Macroeconomic Policy,” the Philippine Development Plan targets an increase in local sources of LGU revenue (footnote 12). Local revenue mobilization is prioritized in both revisions to the Local Government Code of 1991 and the proposed RPVARA (para. 6).

12. **Strategic alignment.** The project is aligned with Strategy 2030 of the Asian Development Bank (ADB). Table 1 shows the specific links with the operational priorities of Strategy 2030.

<table>
<thead>
<tr>
<th>Strategy 2030 Priorities</th>
<th>Project Intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addressing remaining poverty and reducing inequalities</td>
<td>Strengthen local service delivery and foster local economic opportunities to reduce regional disparities</td>
</tr>
<tr>
<td>Accelerating progress in gender equality</td>
<td>Reduced compliance burden and improved services for women-owned businesses; gender informed policy development for real property tax</td>
</tr>
<tr>
<td>Making cities more livable</td>
<td>Mobilize revenues to support accountable municipal service delivery</td>
</tr>
<tr>
<td>Strengthening governance and institutional capacity</td>
<td>Professionalize local assessors and strengthen the capacity of local government units</td>
</tr>
</tbody>
</table>


13. **Development coordination.** ADB plays a leading role in local governance in the Philippines and coordinates support with other development partners so that efforts are well-aligned and complementary to the government’s overall agenda. ADB meets regularly with the United States Agency for International Development on local infrastructure development and regional assistance to Mindanao. ADB is also coordinating closely with the Japan International Cooperation Agency on advisory services and capacity building for the newly established Bangsamoro Autonomous Region in Muslim Mindanao. ADB coordinates with the World Bank on public financial management reforms, particularly the links between national efforts (supported by the World Bank) and subnational efforts (supported by the ADB), as well as on revenue reforms. ADB has worked on local governance issues with Agence Française de Développement (French Development Agency), which also provided technical assistance to the government, including a study on the French approach to inter-LGU service delivery coordination.

**B. Project Description**

14. The project is aligned with the following impact: efficient, effective, and equitable public service delivery enhanced (footnote 12). The project will have the following outcome: service

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13 Land management issues and the government’s reform agenda are discussed in more detail in Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2).


delivery ability and local governance performance of LGUs improved. It will strengthen the policy and administrative environment for increasing local OSR from RPTs by instituting reforms in real property valuation and assessment.

15. **Output 1: Institutional development and policy support for property valuation strengthened.** The project will support policy formulation and institutional development within the BLGF to implement fair, efficient, and effective property valuation. The activities under this output include: (i) the establishment and operationalization of the real property valuation service (RPVS) within the BLGF to strengthen property valuation, institutionalize good international practices on valuation, and support the operational work of other BLGF divisions; (ii) policy formulation and implementation support for real property taxation, focusing on the gender and development dimensions of tax administration and compliance management; (iii) formulation and dissemination of operating manuals and procedures aligned with international standards on valuation; (iv) comprehensive nationwide rollout of training for central government agencies and regional BLGF offices; and (v) formulation of policies and processes for compliance monitoring on valuation standards for public and private real property. Previous ADB experience on land administration reform has shown that stakeholder consultation is critical. To build a constituency for reform, this output will also cover consultations with national oversight and implementing agencies, such as the Department of Environment and Natural Resources, LGUs, and the private sector, including female property owners and the Philippine Commission on Women.

16. **Output 2: Property tax valuation database and information systems implemented.** This output will result in more accurate and timely real property valuation data and greater transparency and accountability in the reporting of real property-related transactions. Activities include: (i) development, operationalization, and nationwide rollout of a real property information system and of an electronic field appraisal and assessment sheet for maintaining property data and computing real property valuations; (ii) development and operationalization of a comprehensive electronic property tax billing and payment system; (iii) rollout of the electronic property tax billing and payment system in selected municipalities; (iv) development and operationalization of an online portal for public access to the SMV, local tax codes, local investment and incentives code, ecozone information, and LGU performance in property tax collection; (v) development and implementation of institutional mechanisms for data and information exchange between public and private sector stakeholders; and (vi) development of a computer-assisted mass appraisal system and its rollout to selected cities, integrated with geographic information system technologies. These activities will be coordinated closely with the Bureau of Internal Revenue, DOF, Department of Information and Communications Technology, Department of the Interior and Local Government, private sector, civil society, and women's groups. The proposed database and information systems will enable the collection of sex-disaggregated data to ascertain women's contributions to LGU revenues.

17. **Output 3: Real property taxation of selected LGUs enhanced.** Newly created cities, municipalities, and provinces exhibit a particularly high dependence on fiscal transfers from the central government. The project will provide targeted assistance to selected LGUs to help decrease this dependence. Activities include: (i) technical support, coaching, and mentoring on SMV updates and on a general revision of assessments and property classification, with specific targets for participation across different sectors; (ii) updates of tax maps and related tax records; (iii) more in-depth assistance with the adoption of integrated electronic systems for tax assessment and collection; (iv) more in-depth assistance with the preparation of tax and revenue impact studies incorporating gender and development perspectives; (v) tax compliance reviews

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16 The design and monitoring framework is in Appendix 1.
to improve the collection of property taxes; and (vi) strengthening of compliance management practices, e.g., by conducting taxpayer registration drives and updating taxpayers’ registries.\textsuperscript{17} While the property maps generated will be used primarily for tax purposes, they can be combined with other information systems to conduct asset valuations for disaster risk financing and insurance under other government programs.

18. Output 4: Local assessors professionalized and capacity of LGUs strengthened. The project will focus on developing and sustaining a professional cadre of assessors to meet public and private sector needs. The output is also aligned with efforts under the Real Estate Service Act, 2009 for professional assessment and valuations services in coordination with state universities and colleges, the Professional Regulation Commission, and the Commission on Higher Education. Activities include: (i) conducting a diagnostic study and mapping the core competencies for local assessors and appraisers; (ii) developing expanded academic and training course curricula and performance assessment programs with training manuals, through a partner state university or college and a training institution; (iii) developing and implementing an e-learning platform for assessing appraisers and assessors; (iv) rolling out provincial, city, and municipal training for local assessors; and (v) reviewing and harmonizing inconsistent government policies related to academic programs and capacity building for property valuation. The BLGF will coordinate closely with academic institutions that offer training in valuation, assessment, and local administration to deliver this output. The BLGF will also initiate a capacity development arrangement with an international academic and training institution, and participate in selected international training events, seminars, conferences, and technical exchange programs to further advance and promote property valuation practices in the country.

C. Value Added by ADB

19. The project complements a broader program of ADB support for local economic development in the Philippines. Specifically, the project supports implementation of the Local Governance Reform Program, a policy-based loan approved in November 2019 that targets policy reforms to strengthen the legal and institutional basis for local governance in the Philippines, modernize local public financial management, and strengthen local economic development and financing options (footnote 1). While the policy-based loan supports the legal and institutional framework for local revenue mobilization, the proposed project will support national and local government implementation of the policy changes. ADB also provided significant technical assistance to support the preparation of the project, the preparation of the RPVARA, a review of local government systems for the electronic monitoring of revenue and expenditure, and policy advisory services for project design. The project is especially critical in the context of the COVID-19 pandemic and the urgent need to mobilize resources and support economic recovery for LGUs.

D. Summary Cost Estimates and Financing Plan

20. The project is estimated to cost $31.49 million (Table 2). Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM).\textsuperscript{18}

\textsuperscript{17} The proposed project draws on technical assistance provided by ADB in 2011 for local government revenue generation and land administration reforms, which showed the need for a demand-driven approach and for local and national governments working in partnership to sustain reforms. The project tackles the problems previously encountered with small-scale or short-lived support for land and property tax reforms by scaling up resources and institutionalizing reform mechanisms for the future. ADB, \textit{Philippines: Support to Local Government Revenue Generation and Land Administration Reforms}, Manila.

\textsuperscript{18} Project Administration Manual (accessible from the list of linked documents in Appendix 2).
Table 2: Summary Cost Estimates

<table>
<thead>
<tr>
<th>Item</th>
<th>Amounta ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Base Cost</strong>b</td>
<td></td>
</tr>
<tr>
<td>1. Output 1: Institutional development and policy support for property valuation strengthened</td>
<td>12.47</td>
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<tr>
<td>2. Output 2: Property tax valuation database and information systems implemented</td>
<td>9.98</td>
</tr>
<tr>
<td>3. Output 3: Real property taxation of selected LGUs enhanced</td>
<td>3.86</td>
</tr>
<tr>
<td>4. Output 4: Local assessors professionalized and capacity of LGUs strengthened</td>
<td>1.83</td>
</tr>
<tr>
<td><strong>Subtotal (A)</strong></td>
<td>28.14</td>
</tr>
<tr>
<td><strong>B. Contingencies</strong></td>
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</tr>
<tr>
<td><strong>C. Financing Charges During Implementation</strong>d</td>
<td>1.67</td>
</tr>
<tr>
<td><strong>Total (A+B+C)</strong></td>
<td>31.49</td>
</tr>
</tbody>
</table>

LGU = local government unit.

* a Includes taxes and duties estimated at $2.75 million, to be financed by the government through cash contribution.

* b In September 2019 prices.

* c Physical contingencies computed at 4% for civil works; 5% for information technology equipment, furniture, and fixtures; and 3% for vehicles and training. Price contingency is computed based on local inflation and exchange rate variations at purchasing power parity.

* d Includes interest and commitment charges. Interest during implementation was computed at the 5-year United States dollar fixed swap rate plus an effective contractual spread of 0.5% and maturity premium of 0.2%. Commitment charges are 0.15% per year to be charged on the undisbursed loan amount.

Source: Asian Development Bank estimates.

21. The government has requested a regular loan of $26,532,604 from ADB’s ordinary capital resources to help finance the project. The loan will have a 28-year term, including a grace period of 9 years; an annual interest rate determined in accordance with ADB’s London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average maturity is 18.75 years, and the maturity premium payable to ADB is 0.20% per year.

22. The summary financing plan is in Table 3. ADB will finance the expenditures in relation to project implementation consultants: (i) procurement of information technology equipment, software, and hardware; (ii) furniture and fixtures; (iii) vehicles; (iv) capacity development and twinning programs; (v) operational expenses of the project management unit; (vi) annual audit costs; and (vii) cost of labor and materials for the construction of training centers. The government, through the executing agency, will finance counterpart support staff, provision of land for the construction of training facilities, applicable taxes and duties, and financial charges, equivalent to $4,959,700 in total.

Table 3: Summary Financing Plan

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount ($ million)</th>
<th>Share of Total (%)</th>
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</thead>
<tbody>
<tr>
<td>Asian Development Bank</td>
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</tr>
<tr>
<td>Ordinary capital resources (regular loan)</td>
<td>26.53</td>
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<tr>
<td>Government</td>
<td>4.96</td>
<td>15.75</td>
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<td><strong>Total</strong></td>
<td>31.49</td>
<td>100.00</td>
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</table>

Source: Asian Development Bank estimates.

E. Implementation Arrangements

23. The implementation arrangements are summarized in Table 4 and described in detail in the PAM (footnote 18).
### Table 4: Implementation Arrangements

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Arrangements</th>
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<tr>
<td>Implementation period</td>
<td>June 2020–June 2024</td>
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<tr>
<td>Estimated completion date</td>
<td>30 June 2024</td>
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<tr>
<td>Estimated loan closing date</td>
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</tbody>
</table>
| Management                   | (i) Oversight body: Chair: DOF Members: BIR, DBM, DICT, DILG, DOF, local government leagues, NEDA, NGOs  
(ii) Executing agency: DOF-BLGF  
(iii) Key implementing agencies: BIR, DBM, DICT, DILG, and selected LGUs  
(iv) Implementation unit: Project management unit under BLGF  
Procurement                   | Open competitive bidding (nationally advertised): goods: 2 contracts $2.12 million  
                              | Open competitive bidding (nationally advertised): works: 3 contracts $2.01 million  
                              | Request for quotation: goods: 4 contracts $0.62 million  
Consulting services          | Individual consultant selection: 484 PM $1.48 million  
                              | Quality- and cost-based selection (firms): 802 PM $9.68 million  
                              | Consultants’ qualification selection: 20 PM $0.23 million  
Retroactive financing and advance contracting | Advance contracting will be used to recruit the consulting firm for the project management unit. Retroactive financing may be used up to a maximum of 20% of the ADB loan proceeds to finance eligible expenditures incurred before loan effectiveness, specifically for consulting services, but not more than 12 months before the signing of the loan agreement.  
Disbursement                  | Disbursement of the loan proceeds will follow ADB's Loan Disbursement Handbook (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.  
ADB = Asian Development Bank, BIR = Bureau of Internal Revenue, BLGF = Bureau of Local Government Finance, DBM = Department of Budget and Management, DICT = Department of Information and Communications Technology, DILG = Department of the Interior and Local Government, DOF = Department of Finance, LGU = local government unit, NEDA = National Economic and Development Authority, NGO = nongovernment organization, PM = person-months.  

### III. DUE DILIGENCE

#### A. Economic and Financial Viability

24. The economic impacts of the project are expected to be substantial. Benefits accrue from: (i) an increase in LGU spending to produce economic benefits from investments and service delivery; (ii) better quality of local spending through local taxation alignment with local needs and preferences; (iii) reduced reliance on distortionary nontax revenues, including fees and fines; and (iv) more efficient allocation of capital and development of unused land. The economic analysis estimated potential net economic benefits of the project under various assumptions of efficiency gains expected through the listed channels. Using conservative estimates of 2% efficiency gains, the economic analysis estimates the project’s potential net economic benefits at $400 million.\(^{19}\)

#### B. Sustainability

25. The project will institutionalize mechanisms to support professional real property valuation and assessment functions in the Philippines. In doing so, the project will help ensure that international good practice on property tax administration and property valuation is absorbed and sustained over the long term. Investments in digital systems will help the government establish and sustain a historical record of land and property values using modern and consistent valuation systems.

\(^{19}\) Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).
standards. Partnerships with local academic institutions and training facilities will help ensure that competency frameworks, curricula, and course materials for local assessors can be delivered on an ongoing basis, resulting in a sustainable cadre of professional assessors for the public and private sectors. The project also supports the implementation of the RPVARA, which will underpin the sustainability of reforms. While the project team envisages significant consulting services, the government plans to absorb mission-critical personnel under the operating budget for the RPVS subject to satisfactory performance and relevance. The additional tax revenues collected and the government budget for the RPVS will more than cover the cost of servicing the project loan, the principal repayment, and operations; as such, the project is considered financially viable.

C. Governance

26. The financial management assessment (FMA) conducted during October–November 2018 followed ADB’s Guidelines for the Financial Management and Analysis of Projects and Financial Due Diligence: A Methodology Note. Based on the FMA, the pre-mitigation financial management risk is substantial. The key financial management risks are (i) the BLGF’s financial management division has staffing shortcomings, (ii) the BLGF’s fixed asset registry requires strengthening, (iii) the BLGF is not subject to internal audit, and (iv) financial reporting can be delayed due to the absence of computerized budgeting and bookkeeping systems. However, the FMA found the BLGF’s capacity to administer advance fund and statement of expenditures procedures to be adequate. The risks will be managed by establishing a project management unit to undertake regular financial management responsibilities. The BLGF also agreed to implement an action plan to rectify the deficiencies. The FMA and the related action plan are discussed in detail in the PAM (footnote 18).

27. ADB’s Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, and the BLGF. The specific policy requirements and supplementary measures are described in the PAM (footnote 18).

D. Poverty, Social, and Gender

28. Reforms under the project will help the government achieve its poverty reduction targets by expanding the quality and range of public services available to the poor, and by providing opportunities for local economic development. Local revenue mobilization increases the resources available to LGUs for delivering public services to poor and marginalized groups. Reducing LGUs’ reliance on transfers from the central government will improve the quality of local spending, as LGUs must balance its spending against taxation. The project is categorized some gender elements. Improvements in the tax administration and a reduction in the compliance burden will specifically benefit women entrepreneurs and owners of small and medium-sized enterprises, who are least able to bear the costs of cumbersome tax administration. The project also has built-in monitoring for sex-disaggregated data. Planned tax compliance and impact studies will incorporate an explicit gender dimension to understand how the RPT affects different taxpayers, including women and other marginalized groups. Finally, ADB will recruit a gender consultant to strengthen the project’s gender dimensions.

E. Safeguards

29. In compliance with ADB’s Safeguard Policy Statement (2009), the project’s safeguard categories are as follows: category C for the environment, involuntary resettlement, and

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indigenous peoples. Because minor civil works to expand existing training facilities are planned, a construction environment code of conduct has been prepared by ADB and government.

F. Summary of Risk Assessment and Risk Management Plan

30. Significant risks and mitigating measures are summarized in Table 5 and described in detail in the risk assessment and risk management plan.22

<table>
<thead>
<tr>
<th>Risks</th>
<th>Mitigation Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delays in the passage of the RPVARA may reduce local revenue mobilization efforts.</td>
<td>The BLGF prepared a strategy for project implementation in case of delays in the passage of the RPVARA, focusing on other legal channels and promoting compliance reforms within the existing purview of the BLGF.</td>
</tr>
<tr>
<td>Supreme court decision to increase the internal revenue allotment for local government units dampens the incentive to mobilize own-source tax revenue.</td>
<td>The government mounted a strong consultative effort to raise awareness of the importance of local tax mobilization. Design considerations ensure local collection efforts for the real property tax are effectively incentivized. The RPVARA clarifies the assignment of revenue responsibilities across various levels of government to ensure fair and equitable incentives are aligned.</td>
</tr>
<tr>
<td>Complex legal and institutional mandates for land management make coordinating and sustaining reforms challenging.</td>
<td>The project design specifically incorporates extensive stakeholder consultation, particularly with central agencies such as the Department of Environment and Natural Resources and has allocated resources for it. Stakeholder mapping will be undertaken to understand roles, responsibilities, and incentives of key players.</td>
</tr>
<tr>
<td>Weaknesses in financial management at the BLGF have the potential to impact the quality and timeliness of project spending, recording, and reporting.</td>
<td>The project design incorporates specific planning to: (i) provide external support for the project’s procurement and financial management activities; and (ii) build capacity at the BLGF to better undertake financial management.</td>
</tr>
</tbody>
</table>


IV. ASSURANCES

31. The government and the DOF-BLGF have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, financial management, and disbursement as described in detail in the PAM and loan documents. The government and the DOF-BLGF have agreed with ADB on certain covenants for the project, which are set forth in the draft loan agreement.

V. RECOMMENDATION

32. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of $26,532,604 to the Republic of the Philippines for the Local Governance Reform Project, from ADB’s ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB’s London interbank offered rate (LIBOR)-based lending facility; for a term of 28 years, including a grace period of 9 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President
29 May 2020

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21 ADB, Safeguard Categories.  
22 Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).
## DESIGN AND MONITORING FRAMEWORK

**Impact the Project is Aligned with**
Efficient, effective, and equitable public service delivery enhanced (Philippine Development Plan, 2017–2022)

<table>
<thead>
<tr>
<th>Results Chain</th>
<th>Performance Indicators with Targets and Baselines</th>
<th>Data Sources and Reporting Mechanisms</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outcome</strong></td>
<td>By 2025:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Number of LGUs meeting BLGF’s revenue collection efficiency targets reached 80% (3-year rolling average) (2017 baseline: 75%)</td>
<td>a. BLGF revenue collection efficiency reports</td>
<td>Delays in passing the RPVARA reduce the impact of reforms to local revenue mobilization.</td>
</tr>
<tr>
<td></td>
<td>b. Total own-source LGU revenues increased by 30% in nominal terms (2017 baseline: ₱206 billion)</td>
<td>b. BLGF Local Government Financing Performance Monitoring System</td>
<td>Complex legal and institutional mandates for land management challenge the coordination and sustainability of reforms.</td>
</tr>
<tr>
<td><strong>Outputs</strong></td>
<td>By 2024:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1. Institutional development and policy support for property valuation strengthened</td>
<td>1a. Reports on oversight body meetings and accomplishments, BLGF staffing records</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1a. Property valuation function in BLGF established and operational with 30 core staff (2017 baseline: not functional or operational, no staff)</td>
<td>1b. Copies of RPT policies and instruments (e.g., manuals and procedures) issued</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1b. Implementing rules and regulations for RPT reforms drafted (2017 baseline: not drafted)</td>
<td>2a. System and audit reports, documentation of monitoring visits</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2a. National real property information system established with sex-disaggregated data functionality (2017 baseline: system not established)</td>
<td>2b. Analytics report of the portal’s web administrator</td>
<td></td>
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<tr>
<td></td>
<td>2b. Property tax system implemented and operational in at least 60% of participating LGUs (2017 baseline: not applicable)</td>
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<tr>
<td></td>
<td>3a. Property assessment records updated in at least 50% of participating LGUs (2017 baseline: not applicable)</td>
<td>3a. Review of SMV database, review of integrated tax assessment system portal</td>
<td>LGUs lack the political will to adopt improved valuation and taxation policies.</td>
</tr>
<tr>
<td></td>
<td>3b. Property tax system implemented and operational in at least 50% of participating LGUs (2017 baseline: not applicable)</td>
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</tbody>
</table>
### Appendix 1

#### Results Chain

<table>
<thead>
<tr>
<th>4. Local assessors professionalized and capacity of LGUs strengthened</th>
<th><strong>Performance Indicators with Targets and Baselines</strong></th>
<th><strong>Data Sources and Reporting Mechanisms</strong></th>
<th><strong>Risks</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>3b. Tax compliance and tax efficiency studies with gender perspective conducted in at least 50% of participating LGUs (2017 baseline: conducted in 0 LGUs)</td>
<td>3b. Accomplishment reports, copies of studies completed by the LGUs</td>
<td>Supreme court decision to increase the internal revenue allotment for LGUs dampens the incentive to mobilize own-source tax revenue.</td>
<td></td>
</tr>
<tr>
<td>4a. At least 85% of women assessors trained on how to update the SMV (2017 baseline: 0 local assessors trained)</td>
<td>4a. Reports from steering committee meetings and training accomplishment reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4b. An e-learning platform for licensing and assessments of appraisers and assessors developed and implemented (2017 baseline: not applicable)</td>
<td>4b. BLGF report</td>
<td></td>
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</tbody>
</table>

#### Key Activities with Milestones:

**Output 1: Institutional development and policy support for property valuation strengthened**

1.1. Establish and operationalize the property valuation office within the BLGF (Q2 2024)
1.2. Prepare real property taxation policies, including infrastructure funds and tax increment financing, and their implementing instruments (Q2 2024)
1.3. Develop operating manuals and procedures aligned with international standards (Q2 2021)
1.4. Conduct comprehensive nationwide rollout of training for national government agencies (Q1 2022)
1.5. Enforce standards for monitoring and ensuring compliance (Q2 2024)
1.6. Establish the valuation training center and corresponding training hubs (Q4 2023)

**Output 2: Property tax valuation database and information systems implemented**

2.1. Establish the RPIS (Q2 2024)
2.2. Develop, implement, operationalize, and promote a comprehensive IT property tax valuation, billing, and collection system (Q2 2024)
2.3. Roll out the RPIS to all LGUs (Q2 2024)
2.4. Roll out the IT property tax valuation, billing, and collection system to enrolled LGUs (Q2 2024)
2.5. Develop an online transparency portal for the SMV, local tax codes, and LGU performance in RPT collection (Q2 2024)
2.6. Develop and implement institutional mechanisms for data and information exchange (Q2 2024)
2.7. Develop and roll out the CAMA system with GIS technology to selected LGUs (Q2 2024)

**Output 3: Real property taxation of selected LGUs enhanced**

3.1. Develop and update market-based SMV (Q1 2022)
3.2. Update tax maps and related tax records (Q1 2022)
3.3. Adopt integrated computerized systems for tax assessment and collection (Q2 2024)
3.4. Conduct tax compliance reviews (Q2 2021)
3.5. Enhance collection practices, including conducting taxpayer registration drives and regular updates of taxpayer registries (Q2 2024)

**Output 4: Local assessors professionalized and capacity of LGUs strengthened**

4.1. Conduct a diagnostic study and competency mapping for local assessors (Q2 2021)
4.2. Develop expanded academic and training course curricula for property valuation, including training manuals and e-learning tools (Q2 2021)
4.3. Roll out training for local assessors and appraisers in provinces, cities, and municipalities (Q2 2023)
4.4. Develop an e-learning platform for licensure and assessment for appraisers and assessors (Q2 2023)
4.5. Develop a monitoring and evaluation system to ensure compliance and performance (Q1 2023)
**Project Management Activities:**
- Advance contracting of the consulting firm for the project management unit (Q2 2020)
- Opening of the advance account (Q4 2020)
- Establishment of the project management unit (Q3 2020)
- Consultant selection and engagement (Q2 2021)
- Audit and submission of project financial statements (Q1 2021, Q1 2022, Q1 2023, Q1 2024)
- Implementation of gender action plan key activities (Q2 2023)
- Annual and/or midterm review (Q3 2021, Q3 2022, Q3 2023, Q2 2024)

<table>
<thead>
<tr>
<th><strong>Inputs</strong></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>ADB: $26,532,604 (loan)</td>
<td></td>
</tr>
<tr>
<td>Government: $4,959,700</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Assumptions for Partner Financing</strong></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Not applicable.</td>
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</tbody>
</table>

ADB = Asian Development Bank, BLGF = Bureau of Local Government Finance, CAMA = computer-assisted mass appraisal, GIS = geographic information system, IT = information technology, LGU = local government unit, Q = quarter, RPIS = real property information system, RPT = real property tax, RPVARA = real property valuation and assessment reform act, SMV = schedule of market values.


LIST OF LINKED DOCUMENTS
http://www.adb.org/Documents/RRPs/?id=52173-002-3

1. Loan Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Project Administration Manual
4. Economic and Financial Analysis
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan

Supplementary Document

7. Financial Management Assessment Report