MANDALUYONG CITY, PHILIPPINES

Case Study (Public Buildings)

Project Summary:

Manila, the capital of the Republic of the Philippines, has the eighteenth largest metropolitan area in the world, which includes fifteen cities and two municipalities. Mandaluyong City is the smallest city of the cities in Metro Manila, with an area of only twelve square kilometers and a population of over 278,000 people.

A public market was located in the heart of Mandaluyong City, on a 7,500 square meters area along Kalentong Road, a main transit route. In 1991, the market was destroyed in a major fire, in large part because most of the structure was made of wood. As a temporary answer for the displaced vendors, the government allowed about 500 of them to set up stalls along the area's roads and sidewalks. This rapidly proved to be impractical, in that it led to both traffic congestion and sanitation problems. Rebuilding the public market became a high priority for the city government, but financing a project with an estimated cost of P50 million was beyond the city's capability. Local interest rates were high, averaging approximately 18 percent annually, and the city was not prepared to take on the additional debt that construction of a new market would have required. The city government was also concerned that if the charges to stall owners became too onerous, the increased costs would have to be passed on to their customers, many of whom were lower-income residents of the area.

The answer to this problem that the city government decided to utilize was based on the Philippines' national Build-Operate-Transfer law of 1991. This provided the statutory basis for developing a public-private partnership (PPP) for the project. A business consortium was created – called the Macro Funders and Developers, Inc. (MFD) – to complete the project. A seven-story commercial center, named The Marketplace, was designed, to include a public market, street-front stores, a parking garage, commercial shops, department stores, a bowling alley, and a movie theater. Through this partnership, the commercial activity conducted in the new structure generates incomes that are used to recoup the capital investment by the private sector.

The economic impact of this project was significant. The construction of the Marketplace led to a near-term doubling of the property value and to a significant increase in city revenue from business and entertainment taxes (an additional P$10 million to P$20 million per year). Hundreds of new jobs were created to operate the Marketplace's many new businesses. With the vendors relocated into this modern facility, traffic congestion was reduced on area streets, and sanitation problems eliminated. By using a PPP, the Mandaluyong City government gained a modern public market at a much lower cost to the city, making the project possible when it had not been before.

Project Objectives:

The first objective of the partnership was to replace the lost public market space. The fire displaced about 500 vendors, who could not be left on the sidewalks indefinitely because of the resulting traffic congestion and sanitation problems in an already crowded metropolitan area. For the livelihood of the venders and convenience of their customers, the market was considered a key component of the local economy and accordingly had to be replaced.

A second objective was to minimize the operational costs of the market, to provide the low-income population with a viable and economically appropriate location for their shopping. The city government did not want to lose venders as a result of higher stall fees nor did it want low-income customers to face the resulting higher prices, forcing them to shop elsewhere.

Project Description:

1. Partners

A business consortium of several private sector companies was formed to develop this project, under the collective name of Macro Funders and Developers, Inc. Ten different companies had initially expressed interest in the project, but with uncertainties about oil prices caused by the 1991 Gulf War and resulting economic uncertainties, their bids were not considered attractive. The mayor took a strong leadership role in recruiting viable private sector partners to encourage them to participate in the project. As a result of these discussions and negotiations, the city government agreed to change the project design to include a larger commercial component, making the project more attractive to investors. Most of those who initially had submitted individual company bids ultimately participated in formation of MFD and bid collectively on the reconstituted project, which had a higher commercial potential than the initial concept of replacing the original market. The bidding and negotiations process took about six months to complete.

2. Implementation Environment

The Philippine national government passed Republic Act 6957 (the Build-Operate-Transfer Law) in 1991, which was amended in May 1994 with the passage of Republic Act 7718. This statute permits private companies to implement, both fully and partially, infrastructure projects, but stipulates that BOT contracts cannot exceed 50 years. The law covers a wide array of sectors: included are power plants, highways, ports, airports, canals, dams, hydropower projects, water supply, irrigation, telecommunications, railroads, transport systems, land reclamation projects, industrial real estate, housing, government buildings, tourism projects, markets, slaughterhouses, warehouses, solid waste management, information technology networks and database infrastructure, education and health facilities, sewerage, drainage, and dredging. (Also see the Manila Water case study: http://www.ncppp.org/undp/manila.html)

The Marketplace was one of the first projects in the Philippines to apply the then recently passed Build-Operate-Transfer law.

3. Financial Agreement

By adding the commercial component to the project, the original estimated cost of PS50 million increased to an estimated P$300 million for the whole project. This was financed in three ways: 25 percent in equity from MFD, 25 percent in advances from shops and charitable contributions, and 50 percent in general debt held by the private companies. The Asian Financing and Investment Corporation, a subsidiary of the Asian Development Bank, provided a ten-year loan at concessional rates to MFD for the project.

Since most of the risk was borne by MFD, cost overruns were the responsibility of the consortium. The final cost of construction was P$450 million, but this 50 percent increase in costs was paid for by the equity holders of MFD.

4. Contract Provisions

The PPP project for The Marketplace was based on two different but related concepts: build-transfer (BT) and build-operate-transfer (BOT). MFD constructed the public market on the ground floor of the commercial center and transferred control to the Mandaluyong City government immediately following completion. Half of the stalls in the public market were constructed by the city government and the other half were constructed by the stall owners, per the agreement between the city and the Association of Stall Owners. The Mandaluyong City government was designated as the operator of the public market because it controls the collection of stall fees (under Philippine law the operator is whoever collects the revenue). Maintenance and security for the public market were outsourced to MFD.

The remainder of The Marketplace – the commercial complex – fell under the BOT scheme. MFD and the Mandaluyong City government agreed to a 40 year concession for the operation and maintenance of this portion of the complex. The government retained ownership of the land used in the project, but did not require lease payments from MFD for its use. The government does not share in any of the revenue generated by the commercial complex, and that revenue is used by MFD to recoup the capital and operating costs. At the end of the 40 years, MFD will transfer the operation and maintenance of the commercial complex to the Mandaluyong City government.

Construction and project risk for The Marketplace was held by MFD, not the Mandaluyong City government because of the high commercial potential for this project and the city's contribution of a site with high land value.

5. Implementation Metrics

Mandaluyong City's desired metrics were simply for a new public market to replace the one that was destroyed in a fire. MDF exceeded the City's expectation by updating the market to include a greatly reduced number of wooden structures, and adding efficient loading and unloading facilities. The loading facilities for the public market were moved to the back of the complex, away from the main thoroughfare, which led to a reduction in congestion in front of the market. Construction of the public market also included construction of a box culvert from the main road to the San Juan River to help solve the frequent flooding in the area. MDF turned over the public market to the Mandaluyong City government upon completion and began construction on the six-story commercial complex above the market.

Once completed, the commercial complex contained four stories of retail and entertainment space, two stories of parking, department stores, commercial shops, a movie theater, a bowling alley, and a food court. The Marketplace helped generate about six hundred jobs for Mandaluyong City, as well as providing a stable location for the venders who were originally displaced by the fire. The Mandaluyong City Government collects about P$10 million to P$20 million in additional tax revenues from the businesses located in the Marketplace. MFD and city have seen major increases in the property value – within the first two years of the signing of the contract, the property value doubled from P$10,000 per square meter to P$20,000 per square meter. The property value has continued to escalate and is now over P$50,000.

Commentary:

1. Overcoming Impediments

There were several obstacles to the completion of this project. High local interest rates, coupled with uncertainties caused by the 1991 Gulf War made businesses leery of funding a project with limited revenue potential. Through persistence on the part of the mayor and the government's flexibility in project design, a consortium was able to develop to funds to rebuild and expand the public market. By allowing MFD to build a different type of structure on the same site, the government gained a modern public market at lower costs and was able to reduce congestion and improve sanitation problems once venders relocated back within the public market. For the private companies involved, creating a consortium helped to spread the equity needs risk among the companies, making it easier to raise the requisite funds.

Another obstacle for MFD was the increased construction costs for the project. Originally the project was estimated at P$300 million, but final costs were P$450 million, a 50 percent increase. Because the project had such high commercial potential, MFD took on all the construction risk and absorbed this increase.

2. Key Points for Success or Failure

Overall, the rebuilding of the public market in Mandaluyong City was a success. By utilizing two PPP schemes, the government received a state-of-the-art public market at minimal public costs and saw the value of the market's land more than double. They also gained about P$10 million to P$20 million in annual business and entertainment taxes.

The project also helped create about 600 new jobs and restored the livelihood of the displaced venders. Stall fees were kept low, which helped venders keep their prices low for their low-income customers.

A key lesson learned from this project is the need for flexibility and negotiation in project design. The City's original concept of simply replacing the original market did not provide enough revenue-generating potential to be commercially viable. By transforming the concept into a multi-story, mixed-use retail/entertainment venue, the City achieved commercial viability, and much greater benefit to the City and its citizens than a simple market would have provided.

This project also demonstrates the importance of appropriate risk allocation, especially when world conditions are uncertain. Had the risk been shared differently on this project, the Mandaluyong City government could have potentially faced a dire situation from the 50 percent increase in project costs. Because of the effective structuring of the partnership, MFD was able to absorb the additional costs. If this had not been the case, the project might not have been completed.