



# Report and Recommendation of the President to the Board of Directors

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Project Number: 47252-002  
August 2017

## Proposed Loan and Technical Assistance Grant Nepal: Regional Urban Development Project

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 16 August 2017)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
NRs 1.00	=	\$0.0097477
\$1.00	=	NRs102.588

## ABBREVIATIONS

ADB	–	Asian Development Bank
CRIPP	–	combined resettlement and indigenous peoples plan
DUDBC	–	Department of Urban Development and Building Construction
GESI	–	gender equality and social inclusion
IEE	–	initial environmental examination
km	–	kilometer
MOUD	–	Ministry of Urban Development
O&M	–	operation and maintenance
PAM	–	project administration manual
PBSEDP	–	performance-based socioeconomic development program
PCO	–	project coordination office
PIU	–	project implementation unit
PMC	–	project management consultant
SWM	–	solid waste management

## NOTE

In this report, “\$” refers to US dollars.

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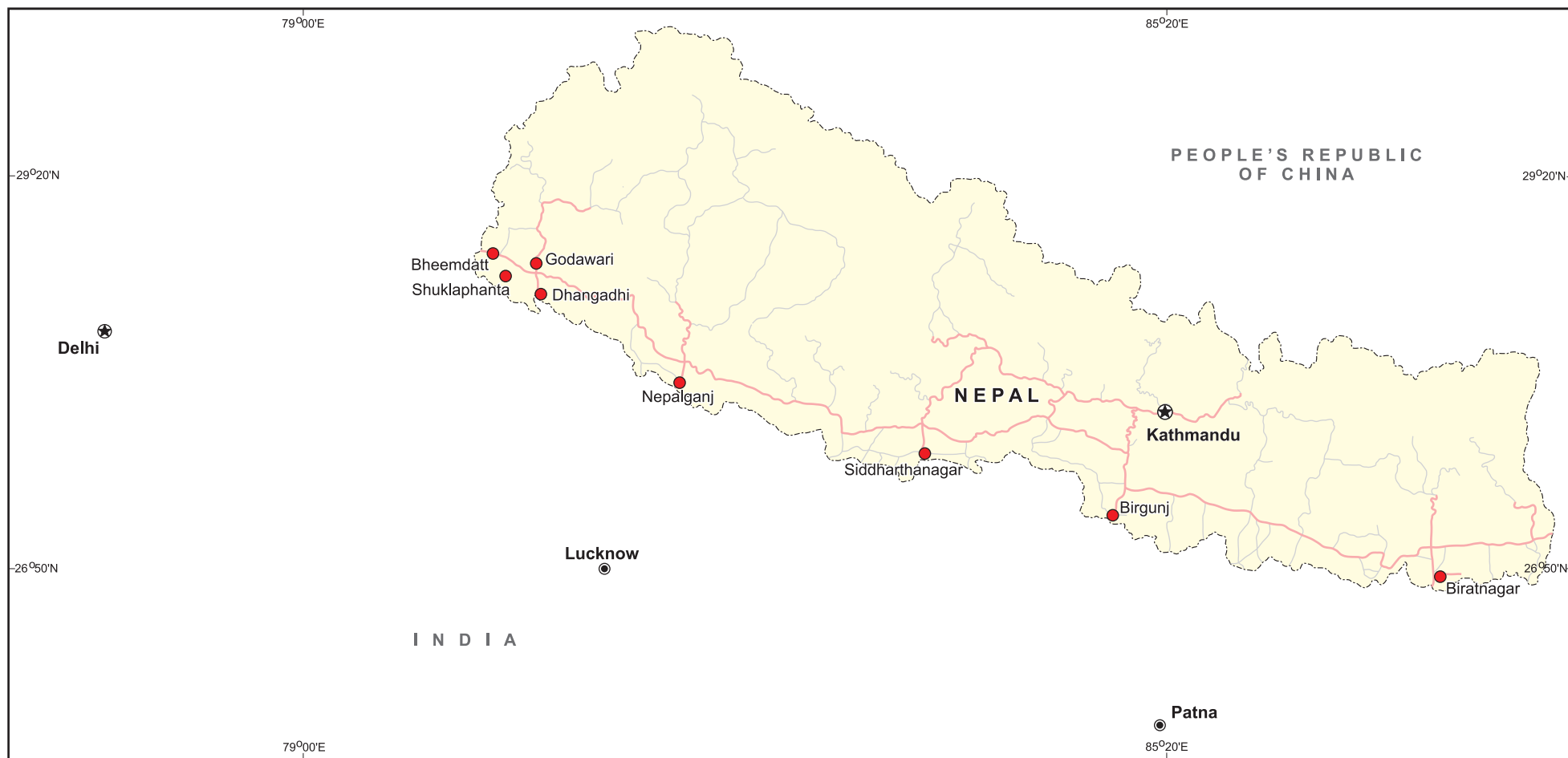
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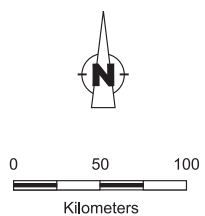
## PROJECT AT A GLANCE

1. Basic Data		Project Number: 47252-002	
Project Name	Regional Urban Development Project	Department /Division	SARD/SAUW
Country Borrower	Nepal Government of Nepal	Executing Agency	Ministry of Urban Development
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Other urban services		30.00
	Urban flood protection		61.00
	Urban policy, institutional and capacity development		12.00
	Urban sanitation		22.00
	Urban solid waste management		22.00
	Urban water supply		3.00
	Total		150.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Adaptation (\$ million)	14.70
Environmentally sustainable growth (ESG)	Disaster risk management	Mitigation (\$ million)	6.10
	Global and regional transboundary environmental concerns	CO <sub>2</sub> reduction (tons per annum)	20,500
	Urban environmental improvement	Climate Change impact on the Project	Medium
Regional integration (RCI)	Pillar 1: Cross-border infrastructure Pillar 4: Other regional public goods		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Organizational development Public financial governance	Effective gender mainstreaming (EGM)	✓
Private sector development (PSD)	Public sector goods and services essential for private sector development		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Urban	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG6, SDG11		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: B Involuntary Resettlement: B Indigenous Peoples: B		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		150.00	
Sovereign Project (Concessional Loan): Ordinary capital resources		150.00	
Cofinancing		0.00	
None		0.00	
Counterpart		64.00	
Government		56.10	
Others		7.90	
Total		214.00	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-6) in the amount of \$1,000,000.			





## NEPAL REGIONAL URBAN DEVELOPMENT PROJECT



- Project City
  - ★ National Capital
  - State Capital
  - National Highway
  - Feeder/District Road
  - - - - International Boundary
- Boundaries are not necessarily authoritative.

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## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to Nepal for the Regional Urban Development Project. The report also describes proposed technical assistance (TA) for Strengthening Capacity for Urban Planning, Urban Design, and Investment Planning. If the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The project will improve the resilience and delivery of urban services and facilities in eight municipalities<sup>1</sup> in the southern Terai region of Nepal bordering India, including four municipalities from the less-developed Province 7 in far western Nepal.<sup>2</sup> The project will support municipal infrastructure investments, urban planning, and institutional strengthening.

## II. THE PROJECT

### A. Rationale

3. **Nepal's urbanization and economic growth.** Although Nepal has been urbanizing at a rapid rate of 6% since the 1970s, its economic growth is lower than that of other South Asian countries.<sup>3</sup> Inadequate urban planning, weak urban institutions and municipal finances, neglect of operation and maintenance (O&M), and limited capabilities for urban infrastructure development have partly contributed to the lower rate of growth.<sup>4</sup> The government would need to double its share of gross domestic product spent on urban infrastructure to meet the backlog and future demand up to 2030 with an estimated \$24.5 billion for its 217 municipalities.<sup>5</sup> Planned urbanization through a regional approach can stimulate economic growth in Nepal, especially in the southern Terai region, where opportunities for economic growth have increased due to regional cooperation and trade.<sup>6</sup>

4. **Importance of investing in the Terai region.** The Terai region has the country's largest urban population outside the Kathmandu and Pokhara valleys, and its urban areas are growing. Most trade in landlocked Nepal flows through the three Terai municipalities of Biratnagar (population: 235,000), Birgunj (population: 240,000) and Siddharthanagar (population: 73,000).<sup>7</sup> A fourth municipality, Nepalgunj (population: 175,000), is a major industrial and business hub of its province. Along the border with India, regional clusters of nonfarm economic activities are emerging, which could be fostered to boost economic growth. Several initiatives have been completed or are ongoing in the Terai, many supported by the Asian Development Bank (ADB), to facilitate trade and improve regional connectivity, rural–urban links, power supply, agricultural

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<sup>1</sup> The eight project municipalities are Biratnagar in Province 1; Birgunj in Province 2; Nepalgunj and Siddharthanagar in Province 5; and Bheemdatt, Dhangadhi, Godawari, and Shuklaphanta in Province 7.

<sup>2</sup> The project preparation was supported by technical assistance. ADB. 2014. *Technical Assistance for the Far Western Region Urban Development Project*. Manila (TA 8817-NEP, approved in 2014); and ADB. 2015. *Supplementary Technical Assistance for the Far Western Region Urban Development Project*. Manila. (TA 8817-NEP, approved in 2015).

<sup>3</sup> World Bank. 2013. *Urban Growth and Spatial Transition in Nepal*. Washington, DC.

<sup>4</sup> Government of Nepal. 2017. *National Urban Development Strategy*. Kathmandu.

<sup>5</sup> ADB. 2016. *Technical Assistance to Nepal for Setting Infrastructure Investment on a Growth Trajectory (Urban Development Chapter)*. Manila.

<sup>6</sup> The regional approach is an integrated and planned approach of spatial development of urban centers surrounded by adjacent or smaller municipalities and rural areas to enhance competitiveness and stimulate economic growth by facilitating common infrastructure, strategic infrastructure, proximity to supply chains and networks, and concentration of human resources and skills. The project is expected to lay the foundation for greater regional development.

<sup>7</sup> World Bank. 2014. *Nepal Trade Facilitation and Improvement Study*. Washington, DC.

productivity, and the quality of technical education.<sup>8</sup> ADB-financed urban projects are also near completion in the four regional economic centers of Biratnagar, Birgunj, Nepalgunj, and Siddharthanagar.<sup>9</sup> The urban projects have reduced the duration of flooding during heavy rains in the core areas of the four municipalities from an average of 3.5 days to 3 hours. Additional support is required to scale up previous efforts to minimize flooding, strengthen municipal operations, and make the Terai region more livable and competitive.

5. **Investing in the Terai of Province 7.** Province 7 in the far west of Nepal is one of the poorest provinces in Nepal, with 40% of the population living below the poverty line.<sup>10</sup> Urban infrastructure and basic services in this province need significant improvement. None of the Province 7 municipalities has solid waste and wastewater collection and treatment facilities, and storm water drainage is inadequate. One-third of households experience chronic waterlogging and/or do not have modern toilet facilities. Key roads are in poor condition and peri-urban areas are expanding haphazardly. Growth opportunities in the province are likely to increase with the anticipated construction of the Mahakali River Bridge connecting India and far western Nepal. Investments in urban infrastructure and planned urbanization in Province 7 will have a multiplier effect on economic growth and job creation while reducing regional disparities.

6. **Regional Urban Development Project.** The project will scale up investments in the four municipalities of Biratnagar, Birgunj, Nepalgunj, and Siddharthanagar, where ADB's ongoing urban projects are near completion. The project aims to reduce flooding duration to less than 1 hour in these municipalities. In the four municipalities of Province 7 (Bheemdatt, Dhangadhi, Godawari, and Shuklaphanta), ADB for the first time will invest in urban infrastructure that will improve flood management, mobility, and solid waste management. The project will support the development of urban plans and bylaws that reflect greater disaster risk resilience, improved land management, and regional development. The subprojects were selected based on households' priorities, the municipalities' priorities, feasibility studies, and institutional mandate. To create incentives for the Province 7 municipalities to improve governance and financial and operational performance, the project will support the implementation of the performance-based socioeconomic development program (PBSEDP).<sup>11</sup> The project will also support a project development facility<sup>12</sup> for the preparation of a pipeline of urban infrastructure projects with high readiness to reduce future startup delays.

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<sup>8</sup> ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the Road Connectivity Sector I Project*. Manila; ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to Nepal for the South Asia Tourism Infrastructure Development Project*. Manila; ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the Subregional Transport Enhancement Project*. Manila; ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the Energy Access and Efficiency Improvement Project*. Manila; ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the South Asia Subregional Economic Cooperation Power System Expansion Project*. Manila; and ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the South Asia Subregional Economic Cooperation Roads Improvement Project*. Manila.

<sup>9</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to Nepal for the Secondary Towns Integrated Urban Environmental Improvement*. Manila; and ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for the Integrated Urban Development Project*. Manila.

<sup>10</sup> Government of Nepal and United Nations Development Programme. 2014. *Nepal Human Development Report*. Kathmandu.

<sup>11</sup> The PBSEDP builds on the experience of the community development program of previous ADB-financed urban projects while introducing a performance-based element.

<sup>12</sup> The project development facility is a mechanism under which consultants will be recruited to prepare detailed project reports to develop an investment pipeline of projects with high readiness.

7. **Alignment with policies and strategies.** The project is aligned with Nepal's Fourteenth Plan and with the National Urban Policy 2007, which aim for a balanced national urban system by developing centers of growth that provide an alternative to the Kathmandu Valley.<sup>13</sup> The project is also aligned with Nepal's National Urban Development Strategy (2017), which also aims for regionally balanced development, as well as more planned and sustainable urbanization (footnote 4). The project is in line with ADB's country partnership strategy, 2013–2017 for Nepal,<sup>14</sup> which supports the government's development objective of sustainable, broad-based, and inclusive economic growth through the development of urban infrastructure and better access to basic services.

8. **Lessons.** The project incorporates the following lessons from ADB's previous urban development operations in Nepal and other countries: (i) provide an integrated set of investments that will have a tangible impact;<sup>15</sup> (ii) secure early commitment of municipalities, including on safeguards compliance and land acquisition; (iii) provide significant support and monitoring for institutional strengthening and an increase in own-source revenue;<sup>16</sup> (iv) provide adequate resources in civil works contracts for shifting of utilities and utility mapping; (v) include a regional dimension for planning and development to tackle challenges more holistically; and (vi) ensure projects with high readiness.

9. **Value added by ADB assistance.** The project will improve capacity and competitiveness of border municipalities and complement the efforts of the ADB-supported South Asia Subregional Economic Cooperation Program, which has enabled greater connectivity and trade facilitation between Nepal and other countries in the region. The project builds on ADB's long-standing partnership and experience supporting urban development in Nepal and will reduce regional inequalities by supporting Province 7. ADB assistance emphasizes resilience in spatial and infrastructure planning and sustainability of infrastructure through (i) high-quality designs, including for climate resilience; (ii) support and monitoring of action plans to increase municipalities' own-source revenue; and (iii) O&M capacity building. The project will introduce a PBSEDP and a project development facility, both of which address development challenges in a novel manner. The PBSEDP is a grant provided to Province 7 project municipalities upon achieving governance and institutional performance parameters. The project complements the work of other development partners in various municipalities on disaster risk management and public financial management.

## **B. Impacts and Outcome**

10. The project is aligned with the following impacts: sustainable, inclusive, and resilient urban areas developed; and a balanced and prosperous subnational urban system achieved (footnote 4). The project will have the following outcome: quality, sustainability, and disaster resilience of urban services, and competitiveness in eight municipalities of the Terai region improved.<sup>17</sup>

## **C. Outputs**

11. **Output 1: Urban infrastructure in eight municipalities with climate-resilient and sustainable designs constructed or rehabilitated.** The project will (i) construct or rehabilitate

<sup>13</sup> Government of Nepal. 2016. *Fourteenth Plan, 2016/17–2018/19*. Kathmandu.

<sup>14</sup> ADB. 2013. *Country Partnership Strategy: Nepal, 2013–2017*. Manila.

<sup>15</sup> ADB. 2013. *Urban Operational Plan, 2012–2020*. Manila.

<sup>16</sup> ADB. 2010. *Special Evaluation Study: Post-Completion Sustainability of Asian Development Bank-Assisted Projects*. Manila.

<sup>17</sup> The design and monitoring framework is in Appendix 1.

200 kilometers (km) of stormwater drains; (ii) improve 240 km of roads and construct at least 40 km of footpaths responsive to the needs of the elderly, women, children, and people with disabilities; (iii) construct four sanitary landfills and resource recovery centers through contracts that include O&M; (iv) construct 20 km of sewers and connect 7,500 households to the sewerage system in Biratnagar;<sup>18</sup> (v) construct septage treatment facilities in Godawari, Bheemdatt, and Dhangadhi; and (vi) ensure that at least 30% of the PBSDEP is spent on socioeconomic infrastructure and activities related to gender equality and social inclusion (GESI). The PBSDEP funds may be used as per the agreed annual program on small community infrastructure, capacity building for municipal staff and communities, and outreach activities. Detailed guidelines for planning, implementation, financial management, and reporting will guide the program.<sup>19</sup> Salient subprojects under output 1 include improving the main access road from central Siddharthanagar to its international airport, being upgraded with ADB financing and expected to stimulate the municipality's growth; improving border access roads; improving the eastern section of Birgunj's bypass road as part of the municipality's planned expansion; strengthening resilience by increasing stormwater drainage capacity; and expanding wastewater service coverage in Biratnagar.

12. **Output 2: Municipal capacity strengthened.** The project will ensure that (i) urban development plans and planning and building bylaws with disaster risk resilience and inclusive accessibility and safety features are adopted in Province 7 project municipalities; (ii) O&M plans are prepared and reflected in the municipalities' annual budgets; (iii) a house-numbering method based on a geographic information system is developed and includes 80% of households in core areas; (iv) computerized property tax systems are installed in Godawari and Biratnagar with 70% of property records encoded; (v) improved municipal organizational structures, including a social development section, are approved by the municipal councils of Godawari and Shuklaphanta; (vi) 40 municipal staff (33% women) report knowledge on mainstreaming GESI approaches into planning and operations; and (vii) municipal office buildings for Godawari and Shuklaphanta are constructed following energy-efficient and disaster-resilient standards.

13. **Output 3: Project preparation capacity improved.** Output 3 will support the Department of Urban Development and Building Construction (DUDBC) and municipalities to develop an investment pipeline with high readiness by funding consultants to prepare detailed project reports through a project development facility.<sup>20</sup> The project development facility will support preparation of detailed project reports for a multisector subregional investment program; and for solid waste management (SWM), drainage, roads, water supply, and sanitation subsectors. The project will support the preparation and adoption of guidelines to ensure the efficient use of the project development facility.

#### **D. Summary Cost Estimates and Financing Plan**

14. The project is estimated to cost \$214.0 million (Table 1). Detailed cost estimates by expenditure category and by financier are in the project administration manual (PAM).<sup>21</sup>

<sup>18</sup> A sewage treatment plant with adequate capacity was constructed under the Secondary Towns Integrated Urban Environmental Improvement Project (footnote 9).

<sup>19</sup> Section IX H of the Project Administration Manual contains details on the management of the PBSDEP and the subprojects allowed, and Appendix 1 of the PAM contains the scoring methodology against the defined performance indicators (accessible from the list of linked documents in Appendix 2). The allocation for the PBSDEP is \$4.1 million or 2% of the project cost.

<sup>20</sup> Section IX G of the PAM contains details on the management of the two consultancy packages supported under output 3, and Appendix 3 of the PAM contains a summary of the DUDBC's draft project development facility guidelines and project selection criteria (accessible from the list of linked documents in Appendix 2).

<sup>21</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

**Table 1: Summary of Cost Estimates**  
(\$ million)

Item	Amount <sup>a</sup>
<b>A. Base Cost<sup>b</sup></b>	
1. Urban infrastructure	160.6
2. Municipal capacity	13.9
3. Project preparation capacity	6.0
<b>Subtotal (A)</b>	<b>180.5</b>
<b>B. Contingencies<sup>c</sup></b>	<b>27.3</b>
<b>C. Financial Charges During Implementation<sup>d</sup></b>	<b>6.2</b>
<b>Total (A+B+C)</b>	<b>214.0</b>

<sup>a</sup> Includes taxes and duties of \$17.4 million to be financed from government resources by cash contribution. Nominal taxes and duties expected on consultancy services financed by ADB shall also be borne by ADB.

<sup>b</sup> In early 2017 prices using an exchange rate of \$1 = NRs102.70 during project preparation.

<sup>c</sup> Physical contingencies calculated at 8.5% for civil works, equipment, and project management. Price contingencies calculated at 1.4%–1.5% on foreign exchange costs and at 7.0%–8.5% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

<sup>d</sup> Interest during construction for the ADB loan has been calculated at 1.0% per annum.

Sources: Asian Development Bank and the Government of Nepal.

15. The government has requested a concessional loan in various currencies equivalent to SDR108,008,000 (\$150 million equivalent)<sup>22</sup> from ADB's ordinary capital resources to help finance the project. The loan will have a 32-year term, including a grace period of 8 years; an interest rate of 1.0% per year during the grace period and 1.5% per year thereafter; and such other terms and conditions set forth in the draft loan agreement.

16. The summary financing plan is in Table 2. ADB will finance expenditures related to works, equipment, consultants, PBSEDP, recurrent costs, contingencies, and interest during construction. The government has assured that it will cover any shortfall in the finance required to meet the agreed outputs. Details are in the PAM (footnote 21).

**Table 2: Summary Financing Plan**

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary capital resources (concessional loan)	150.0	70.1
Government	64.0 <sup>a</sup>	29.9
<b>Total</b>	<b>214.0</b>	<b>100.0</b>

<sup>a</sup> Includes contributions of \$7.9 million by municipalities.

Sources: Asian Development Bank and the Government of Nepal.

17. The project studies<sup>23</sup> estimate that climate change mitigation will cost \$6.1 million and climate change adaptation is estimated to cost \$14.7 million. ADB will finance 76% of mitigation and adaptation costs. Details are in the PAM.<sup>24</sup>

## **E. Implementation Arrangements**

18. The executing agency is the Ministry of Urban Development (MOUD). The DUDBC under MOUD will host the project coordination office (PCO) for the project as well as the regional project

<sup>22</sup> SDR0.72= \$1.00 as of 7 July 2017.

<sup>23</sup> By 2050, the project area may receive additional rainfall in the range of 3%–16% during the monsoon (ADB. 2016. *WRPPF- Package 3: Flood Hazard Mapping and Preliminary Preparation of Risk Management Projects. Final Report*. Manila).

<sup>24</sup> Appendix 4 of the PAM provides an explanation of how the climate adaptation costs were calculated.

implementation unit (PIU) for the Province 7 subprojects, which include multi-city contracts. Municipalities, other than those in Province 7, will be the implementing agencies for their respective subprojects. Province 7 project municipalities will form project implementation support units. An interagency project steering committee chaired by the secretary of MOUD will meet at least quarterly. The implementation arrangements are summarized in Table 3 and described in detail in the PAM.

**Table 3: Implementation Arrangements**

Aspects		Arrangements	
Implementation period	September 2017–December 2022		
Estimated completion date	31 December 2022		
Estimated loan closing date	30 June 2023		
Management			
(i) Oversight body	Project steering committee Chair: Secretary, MOUD Members: Joint secretaries of MOFALD, MOUD, NPC, and MOE; representative from MOF; directors general of DUDBC, DOR, and DWSS; executive director of SWMTSC; executive officers of municipalities; president of MuAN; project director (head of PCO) Secretariat: PCO		
(ii) Executing agency	MOUD through the PCO in DUDBC		
(iii) Key implementing agencies	Municipalities of Biratnagar, Birgunj, Nepalgunj, Siddharthanagar; DUDBC Kailali Division office		
(iv) Implementation unit	PIUs (4) with 7–10 staff members each Regional PIU in DUDBC Kailali Division office with 10 staff members PISUs (4) to implement the PBSEDP		
Procurement	ICB	9 contracts	\$131.91 million
	NCB	1 contract	\$1.59 million
	Shopping	9 contracts	\$0.30 million
	Community procurement	40 contracts	\$1.50 million
Consulting services	QCBS	2,263 person-months	\$12.25 million
	ICS	27 person-months	\$0.21 million
Retroactive financing and advance contracting	Advance contracting is being implemented for four civil works packages of non-Province 7 municipalities and for recruitment of seven consultants. Retroactive financing will be up to 20% of the ADB loan amount for eligible expenditures incurred no more than 12 months before the loan agreement signing in connection with civil works, design and supervision, project management, and capacity building.		
Disbursement	The loan proceeds will be disbursed following ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.		

ADB = Asian Development Bank, DOR = Department of Roads, DUDBC = Department of Urban Development and Building Construction, DWSS = Department of Water Supply and Sanitation, ICB = international competitive bidding, ICS = individual consultancy services, MOE = Ministry of Environment, MOF = Ministry of Finance, MOFALD = Ministry of Federal Affairs and Local Development, MOUD = Ministry of Urban Development, MuAN = Municipal Association of Nepal, NCB = national competitive bidding, NPC = National Planning Commission, PBSEDP = performance-based socioeconomic development program, PCO = project coordination office, PISU = project implementation support unit, PIU = project implementation unit, QCBS = quality- and cost-based selection, SWMTSC = Solid Waste Management Technical Support Center.

Source: Asian Development Bank.

### III. ATTACHED TECHNICAL ASSISTANCE

19. The proposed transaction technical assistance (TRTA) for Strengthening Capacity for Urban Planning, Urban Design, and Investment Planning has two outputs: (i) capacity for urban

and regional planning and urban design of DUDBC and municipalities strengthened; and (ii) capacity for scaling up urban infrastructure investments strengthened. Under the first output, the TRTA will develop urban design, landscaping, and architectural guidelines for Nepal's municipalities, and support the review of multiple city development plans under preparation by DUDBC. Under the second output, the TRTA will (i) refine and improve the methodology and approach to existing urban infrastructure investment programs; (ii) restructure and update DUDBC's business plan, taking into consideration the National Urban Development Strategy approved in 2017 (footnote 4); (iii) strengthen capacity of and support the DUDBC and municipalities in reviewing the engineering designs and related safeguard documents; and (iv) develop phased investment plans for two large municipalities (or cluster of municipalities). The TRTA is estimated to cost \$1.1 million, of which \$1.0 million will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-6).<sup>25</sup> The government will provide counterpart support in the form of staff, office space, and other in-kind contributions. MOUD will be the executing agency for the TA, which will be implemented over a period of 2.5 years.

#### IV. DUE DILIGENCE

##### A. Technical

20. The appraisal of the subprojects confirmed technical viability and compatibility with local implementation and O&M capacity. The pending detailed design will adhere to subproject selection and agreed design criteria, address the flood risks and increases in rainfall due to climate change, and analyze least life-cycle costs. Municipal buildings will be earthquake resistant. Stormwater management planning will take a catchment-wide approach. Utility mapping will be done in project areas to provide municipalities with the required geospatial data to improve management of underground assets. Technical audits will be undertaken through a government agency to help ensure the quality of works.

##### B. Economic and Financial

21. **Economic analysis.** The economic internal rate of return was estimated at 11.9%, indicating sufficient economic return compared with the economic opportunity cost of capital of 9.0%. The results of the sensitivity analysis are also satisfactory against all downside risks, i.e., (i) a capital cost overrun of 20%, (ii) an overrun in O&M costs of 20%, (iii) a decline in estimated benefits of 20%, and (iv) a 1-year delay in operations.

22. **Financial analysis.** The financial analysis assessed whether the municipalities can cover the incremental costs of the project since not all subprojects will generate revenues. The overall municipal financial position is projected reflecting incremental revenues and expenditures as well as debt service requirements based on past performance, growth trend of revenue streams, and expected population growth. The analysis confirms that the municipalities will have adequate financial capacity to cover counterpart costs, incremental O&M costs of the subprojects, and debt service requirements of existing loans.

##### C. Governance

23. **Financial management.** The overall risk assessment for the project is substantial. The PCO and non-Province 7 municipalities have experience in implementing ADB projects. For Province 7 municipalities, extensive support to the regional PIU and municipalities is needed for

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<sup>25</sup> Attached Technical Assistance Report (accessible from the list of linked documents in Appendix 2).

efficient financial management and implementation. DUDBC and all project municipalities can manage funds with the following mitigation measures: (i) training on project financial management; (ii) development of a computerized accounting system for PCO and PIUs; (iii) establishment of an internal audit section in Godawari and Shuklaphanta and appointment of qualified internal auditors in Biratnagar and Birgunj; (iv) enhancement of the accounting, billing and collection, and audit systems for Province 7 municipalities; and (v) preparation of municipal financial operating plans prior to formulation of budget, and implementation and close monitoring of plans to improve own-source revenue collection. The financial management arrangements are expected to be *satisfactory*.

24. **Procurement.** All procurement of goods and works will follow ADB's Procurement Guidelines (2015, as amended from time to time) or, for national competitive bidding, the public procurement monitoring office's standard bidding document as approved by ADB. All procurement of consultants, including for the project development facility, will follow ADB's Guidelines on the use of Consultants (2013, as amended from time to time). An assessment concluded that the overall procurement risk for the project is *substantial*. Procurement specialists from the Province 7 design and supervision consulting firm will support the regional PIU, and the project management consultant will support the PCO to prepare and evaluate bids.

25. **Anticorruption measures.** ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, MOUD, DUDBC, and project municipalities. The specific policy requirements and supplementary measures are described in the PAM. The constitutional anticorruption agency is the Commission for the Investigation of Abuse of Authority, which is empowered to investigate any project irregularities. The PCO and PIUs will follow government rules and procedures for expenses and revenues. They will establish a project website for transparency and a system for handling complaints.

#### **D. Poverty, Social, and Gender**

26. The project is categorized as effective gender mainstreaming. A summary poverty reduction and social strategy and a GESI action plan have been prepared. The project will include safety features such as streetlights, road markings, ramps, and footpaths. The project will strengthen the capacity of social development sections in project municipalities. The project will also support Province 7 municipalities in implementing the PBSEDP, which focuses on improving governance and service delivery, as well as implementing small infrastructure in low-income communities through the community procurement method. The project will promote the participation of women and other disadvantaged groups through community-based committees.

#### **E. Safeguards**

27. The PAM outlines the detailed implementation arrangements for safeguards. DUDBC has the capacity to implement safeguards based on its experience in the ongoing ADB-financed projects. Any subproject that causes significant impacts on the environment, involuntary resettlement, or indigenous peoples will be excluded from project financing. The PCO and PIUs have adequate capacity to manage environmental and social impacts. A consultant will support and build the capacity of the PCO and PIUs in social safeguard planning and implementation. Supervision consultants will supervise day-to-day safeguard implementation. The entitlement matrix includes measures to ensure compensation at replacement cost, rehabilitation assistance and special measures for vulnerable households, and criteria for accepting voluntary demolition of minor structures.



28. **Environment (category B).** An environmental assessment review framework and four initial environmental examinations (IEEs)<sup>26</sup> with environmental management plans were prepared in accordance with ADB's Safeguard Policy Statement (2009) and government laws. IEEs will be updated based on the detailed design. The documents were disclosed on ADB's website and relevant information disclosed to project communities. The IEEs concluded that no significant adverse impacts are anticipated. Any impacts will be mitigated through measures outlined in the environmental management plans. The drainage, road, and SWM works will reduce water and air pollution. The PCO will submit environment reports to ADB semiannually. Consultation and public participation will continue throughout implementation, and any environmental grievances will be handled in accordance with the grievance redress mechanism established for the project.

29. **Involuntary resettlement (category B).** The land acquisition and involuntary resettlement impact assessment confirms that impacts are not significant. The land acquisition process for a total of 30 hectares required for landfill sites has begun, and 65% is government land. A total of 27 households (172 people) are expected to be affected, of which 15 households (92 persons) will be significantly affected because they lose 10% or more of their productive assets. The land acquisition will affect three indigenous households. A combined resettlement and indigenous peoples plan (CRIPP) and three due diligence reports<sup>27</sup> were prepared in accordance with ADB's Safeguard Policy Statement (2009) to mitigate negative impacts. The resettlement impacts, mitigation measures, policy provisions, and SWM subproject details and related impacts were discussed with potentially affected persons. Meaningful consultations shall continue throughout implementation.

30. **Indigenous peoples (category B).** Indigenous peoples live in the project area. No confirmed negative impacts were identified, except for the acquisition of land belonging to three indigenous households for the landfill site in Dhangadhi. Indigenous peoples living in the project area are likely to experience positive impacts thanks to better roads, drainage, SWM, and sanitation. The PBSEDP will include an awareness program for indigenous peoples and their participation will be ensured during subproject design and implementation. A combined resettlement and indigenous peoples planning framework was prepared in accordance with ADB's Safeguard Policy Statement (2009) and applicable laws. If required, the framework will guide the preparation of resettlement and indigenous peoples plans during the detailed design. The PIUs were trained on the framework.

## F. Summary of Risk Assessment and Risk Management Plan

31. Major risks and suggested mitigating measures are summarized in Table 4. All major risks are described in detail in the risk assessment and risk management plan.<sup>28</sup> The overall benefits are expected to outweigh the costs of mitigation.

**Table 4: Summary of Risks and Mitigating Measures**

Risks	Mitigation Measures
Weak institutional capacity of project municipalities on financial management	Support for increasing municipalities' own-source revenue, development of computerized accounting system, establishment of an internal audit section and recruitment of additional financial administration staff in Godawari and Shuklaphanta, and support to strengthen internal audit in Biratnagar and Birgunj.

<sup>26</sup> IEEs were prepared for Dhangadhi, Godawari, Nepalgunj, and Siddharthanagar.

<sup>27</sup> CRIPP for landfill site in Dhangadhi; and due diligence reports for subprojects in Biratnagar, Godawari, and Shuklaphanta municipalities.

<sup>28</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

<b>Risks</b>	<b>Mitigation Measures</b>
Insufficient municipal counterpart funding	Provide support through the project for the municipalities to achieve the targets agreed in the comprehensive financial management improvement plans.
Poor oversight of consultant and contractor performance	PMC and PCO shall undertake regular site visits. Project will engage National Vigilance Center to undertake third party technical audit at multiple intervals during project implementation. Poor performance of contractors shall be reported to relevant government authority for action.
Local opposition to landfill construction	Extensive awareness campaigns will be undertaken on the benefits and importance of landfills, meaningful consultations will be ensured, and PBSEDP funds for community infrastructure will be prioritized to benefit affected persons.
Behavioral change takes longer than the project timeline	Extensive education and communication campaigns on solid waste management, property tax collection, and willingness to pay for wastewater management services; and engagement with politicians and local community leaders to support the behavioral change process.
Political instability leads to strikes that delay works	This risk may be unavoidable, but mitigation measures are taken to reduce delays: use of advanced contracting and retroactive financing, training implementing agencies on project management, and early land acquisition.

PBSEDP = performance-based socioeconomic development program, PCO = project coordination office, PMC = project management consultant.

Source: Asian Development Bank.

## **V. ASSURANCES**

32. The government and MOUD 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, and disbursement as described in detail in the PAM and loan documents. The government and MOUD have agreed with ADB on certain covenants for the project, which are set forth in the draft loan agreement.

## **VI. RECOMMENDATION**

33. 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 in various currencies equivalent to SDR108,008,000 (\$150,000,000 equivalent) (footnote 22) to Nepal for the Regional Urban Development Project, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 32 years, including a grace period of 8 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.

Takehiko Nakao  
President

29 August 2017

## DESIGN AND MONITORING FRAMEWORK

Impacts the Project is Aligned with Sustainable, inclusive, and resilient urban areas developed; and balanced and prosperous subnational urban system achieved (National Urban Development Strategy) <sup>a</sup>			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<b>Outcome</b> Quality, sustainability, and disaster resilience of urban services, and competitiveness in eight municipalities of the Terai region improved	<b>By 2023:</b> a. Flood inundation period in core areas (24,000 hectares) reduced to less than 1 hour (2016 baseline: average of 5 hours) b. Travel time on project roads in all 8 project municipalities reduced by an average of 50% (2016 baseline: 25 minutes per 10 km) c. Solid waste from at least 65% of households collected, recycled, and disposed of in sanitary landfills in Province 7 project municipalities (2016 baseline: 0%) d. At least 50% of fecal sludge collected and treated in Province 7 project municipalities (2016 baseline: 0) e. Property tax collection to support urban services increased by at least 125% (2016 baseline: non-Province 7 <sup>b</sup> average of NRs45 million; and Province 7 <sup>b</sup> average of NRs12 million)	a–e. Annual reports of DUDBC	Behavioral change takes longer than the project timeline.
<b>Outputs</b> 1. Urban infrastructure in eight municipalities constructed or rehabilitated with climate-resilient and sustainable designs	<b>By 2022:</b> 1a. 200 km of stormwater drains constructed or rehabilitated (2016 baseline: 0) 1b. 240 km of roads improved and at least 40 km of footpaths constructed responsive to the needs of EWCD (2016 baseline: 0) 1c. Four sanitary landfills with at least 30-year lifespan and resource recovery centers constructed with O&M embedded in contracts (2016 baseline: 0) 1d. 20 km of sewers constructed, with 7,500 households connected to sewerage system in Biratnagar (2016 baseline: 0 households) 1e. Septage treatment facilities constructed in Godawari, Bheemdatt, and Dhangadhi (2016 baseline: 0) 1f. At least 30% of the PBSEDP spent on socioeconomic infrastructure and activities related to GESI (2016 baseline: 0%)	1a–f. Quarterly project progress reports	<b>For all outputs:</b> Political instability may lead to strikes that delay works. Local political and community opposition during implementation (e.g., stopping work at landfill sites).

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
2. Municipal capacity strengthened	<p><b>By 2022:</b></p> <p>2a. Urban development plans, and planning and building bylaws with disaster risk resilience and inclusive accessibility and safety features, adopted through municipal council decision in Province 7 municipalities (2016 baseline: n.a.)</p> <p>2b. O&amp;M plan prepared and reflected in annual budget of project municipalities (2016 baseline: 0)</p> <p>2c. GIS operational with 80% house numbering in core areas (2016 baseline: 0)</p> <p>2d. Computerized property tax systems installed in Godawari and Biratnagar with 70% of property records encoded (2016 baseline: not existing in Godawari and Biratnagar)</p> <p>2e. Improved municipal organizational structure, including a social development section, approved by municipal councils of Godawari and Shuklaphanta (2016 baseline: n.a.)</p> <p>2f. 40 municipality staff (33% women) reported increased knowledge on mainstreaming GESI approaches into planning and operation (2016 baseline: 0)<sup>b</sup></p> <p>2g. Municipal office buildings for Godawari and Shuklaphanta constructed following energy-efficient and disaster-resilient standards (2016 baseline: 0)</p>	2a–g. Quarterly project progress reports	
3. Project preparation capacity improved	<p><b>By 2022:</b></p> <p>3a. Memo issued by MOUD instructing the use of project development facility guidelines (2016 baseline: n.a.)</p> <p>3b. At least one DPR prepared for multisector, subregional investment program using project development facility (2016 baseline: n.a.)</p> <p>3c. At least two DPRs prepared for SWM, drainage, roads, water supply, and/or sanitation subsectors using project development facility (2016 baseline: n.a.)</p>	<p>3a. Annual reports of the Ministry of Urban Development</p> <p>3b–c. Annual reports of DUDBC</p>	
<b>Key Activities with Milestones</b>			
<p><b>1. Urban infrastructure in eight municipalities constructed or rehabilitated with climate-resilient and sustainable designs</b></p> <p><u>Non-Province 7 municipalities</u></p> <p>1.1 Award all supervision consulting contracts (Q3 2017).</p> <p>1.2 Award all civil works contracts (Q4 2017).</p> <p>1.3 Complete physical works (Q4 2020).</p>			

<b>Key Activities with Milestones</b>	
<u>Province 7 municipalities</u>	
1.4	Commence surveys and investigations (Q2 2017).
1.5	Commence community briefings to raise awareness on integrated SWM approach (Q2 2017).
1.6	Finalize land acquisition for landfill sites (Q3 2017).
1.7	Approve year 1 programs for the PBSEDP (Q1 2018).
1.8	Develop infrastructure master plans and phased capital investment plans (Q3 2018).
1.9	Commence procurement of civil works contracts (Q3 2018).
1.10	Award all civil works contracts, ensuring gender- and disadvantaged-sensitive designs (Q4 2019).
1.11	Complete physical works (Q4 2022).
<b>2.</b>	<b>Municipal capacity strengthened</b>
<u>Non-Province 7 municipalities</u>	
2.1	Finalize and adopt asset inventory and management plans (Q4 2018).
2.2	Encode 80% of household data (Q3 2020).
<u>Province 7 municipalities</u>	
2.3	Prepare urban development plans, land use plans, and bylaws for each municipality (Q4 2017).
2.4	Computerize municipal revenue administration systems for billing and collection (Q3 2018).
2.5	Launch awareness campaign for improving property tax payments (Q4 2018).
2.6	Launch community-awareness campaign on reducing, reusing, and recycling solid waste (Q1 2019).
<b>3.</b>	<b>Project preparation capacity improved</b>
3.1	Prepare community and consultation plan for Biratnagar SWM (Q1 2018).
3.2	Prepare guidelines for project development facility (Q3 2017).
3.3	Mobilize first project development facility consultant (Q1 2019).
3.4	Prepare DPRs of urban infrastructure estimated at least \$350 million (Q1 2022).
<b>Inputs</b>	
Asian Development Bank: \$150.0 million (concessional OCR loan)	
Government of Nepal: \$64.0 million (includes \$7.9 million contribution from project municipalities)	
<b>Assumptions for Partner Financing</b>	
Not applicable	

DPR = detailed project report; DUDBC = Department of Urban Development and Building Construction; EWCD = elderly, women, children, and persons with disabilities; GESI = gender equality and social inclusion; GIS = geographic information system; km = kilometer; MOUD = Ministry of Urban Development; n.a. = not applicable; OCR = ordinary capital resources; O&M = operation and maintenance; PBSEDP = performance-based socioeconomic development program; Q = quarter; SWM = solid waste management.

<sup>a</sup> Government of Nepal. 2017. *National Urban Development Strategy*. Kathmandu.

<sup>b</sup> The design and supervision consultant for Province 7 project municipalities will design and administer a structured questionnaire at least 1 year after the training to assess the knowledge gained through project activities on GESI mainstreaming. The survey shall assess whether (i) GESI-targeted funds are allocated in the annual plan and budget of the respective municipality as per the Ministry of Federal Affairs and Local Development's GESI policy, (ii) annual GESI budget audit is conducted as per the Ministry of Federal Affairs and Local Development's guidelines, and (iii) GESI disaggregated monitoring and evaluation data system has been developed and is being used in planning and operation at the municipality level.

<sup>c</sup> Province 7 municipalities include Bheemdatt, Dhangadhi, Godawari, and Shuklaphanta. Non-Province 7 municipalities include Biratnagar, Birgunj, Nepalgunj, and Siddharthanagar.

<sup>d</sup> Unless target area is specified, the indicators cover the core areas of eight project municipalities.

Source: Asian Development Bank.

## LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=47252-002-3>

1. Loan Agreement
2. Sector Assessment (Summary): Water and Other Urban Infrastructure and Services
3. Project Administration Manual
4. Contribution to the ADB Results Framework
5. Development Coordination
6. Project Climate Risk Assessment and Management Reporting
7. Attached Technical Assistance Report: Strengthening Capacity for Urban Planning, Urban Design, and Investment Planning
8. Financial Analysis
9. Economic Analysis
10. Country Economic Indicators
11. Summary Poverty Reduction and Social Strategy
12. Gender Equality and Social Inclusion Action Plan
13. Initial Environmental Examination: Solid Waste Management Subproject, Dhangadhi Sub-metropolitan City, Kailali District
14. Initial Environmental Examination: Solid Waste Management Subproject, Godawari Municipality, Kailali District
15. Initial Environmental Examination: Drainage and Road Construction and Improvement Works at Nepalgunj Sub-metropolitan City
16. Initial Environmental Examination: Drainage and Road Construction and Improvement Works at Siddharthanagar Municipality
17. Environmental Assessment and Review Framework
18. Combined Resettlement and Indigenous Peoples Plan: Construction of Integrated Waste Processing Sites (IWPS) Subproject in Dhangadhi Municipality
19. Combined Resettlement and Indigenous Peoples Planning Framework
20. Risk Assessment and Risk Management Plan

### Supplementary Documents

21. Financial Management Assessment
22. Cost and Benefit Flow Streams of Each Project Municipality
23. Project Procurement Risk Assessment Report
24. Due Diligence Report: Construction of Drainage and Road Improvement in Biratnagar Sub-metropolitan City
25. Due Diligence Report: Development of IWPS in Godawari Municipality
26. Due Diligence Report: Development of Landfill Site and Construction of Municipal Building Subprojects in Shuklaphanta Municipality