



Major Change in Scope, Financing Plan, and Administration of Grant Cofinancing

Project Number: 40554
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Nepal: Rural Reconstruction and Rehabilitation Sector Development Project

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 31 August 2008)

Currency Unit	–	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	\$0.0143
\$1.00	=	NRs69.80

ABBREVIATIONS

ADB	–	Asian Development Bank
DFID	–	Department for International Development of the United Kingdom
DOLIDAR	–	Department of Local Infrastructure and Agricultural Roads
EIRR	–	economic internal rate of return
km	–	kilometer
SDC	–	Swiss Agency for Development and Cooperation

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Rural Reconstruction and Rehabilitation Sector Development Program¹ was approved on 12 December 2007. It comprises program and project grant components, each for \$50 million,² with the objective of promoting rehabilitation, economic growth, and poverty reduction through policy and institutional reforms and rural infrastructure investment. The grants became effective on 1 February 2008 and will close on 31 December 2011. The total cost of the project component (the Project) is \$78.4 million; it is being funded by a \$50 million grant from the Asian Development Bank (ADB), a \$10 million loan from the OPEC³ Fund for International Development, \$15.7 million equivalent in counterpart financing from the Government of Nepal (the Government), and a \$2.7 million equivalent contribution by beneficiaries.

2. This paper seeks approval of a major change in scope, financing plan, and administration of grant cofinancing. The changes are required as a result of confirmation of cofinancing of the Project by two donor agencies. The Department for International Development (DFID) of the United Kingdom will provide a £10 million (\$20 million equivalent) grant to be administered by ADB. The Swiss Agency for Development and Cooperation (SDC) will provide technical assistance support of \$1.5 million equivalent as parallel financing for district consultant services⁴ and construction materials for trail bridges. This will increase the total cost of the Project to \$106.8 million (including the increased Government and beneficiary contributions in line with the agreed 20% and 2.7% cost shares, respectively). ADB's financing share will decrease from 64% to 47%. As DFID and SDC intend to finance rural roads, and the increased Government and beneficiary contributions will mainly finance supplementary infrastructure, the total length of rural roads to be improved and/or constructed will increase to 859 kilometers (km) from 560 km (including motorable bridges of 1,319 meters from 1,100 meters); and the number of supplementary infrastructure structures, including rural water supply schemes, will increase to about 1,360 from 875.

II. BACKGROUND

3. The impact of the original Project is to reduce rural poverty in hill, mountain, and terai (lowland) districts where isolation and hardship are common. The outcome is to improve connectivity, enhance livelihood opportunities, and increase rural communities' access to markets and social services. These outcomes will be achieved by constructing and upgrading rural roads, providing supplementary infrastructure according to community demands, and strengthening the institutional capacity of stakeholders. The Project aims to directly benefit 2.6 million people and enhance the incomes of the poor and disadvantaged by generating 15.8 million person-days of employment opportunities from rural roads. Key physical targets are (i) improvement of 560 km of rural roads and construction of 1,100 meters of motorable bridges; (ii) construction of 485 supplementary infrastructures such as village trails, trail bridges, microirrigation, market buildings, primary school infrastructure, and health posts; and (iii) construction and rehabilitation of 390 rural water supply systems.

4. The Project has five components: (i) rural roads, (ii) supplementary infrastructure, (iii) community empowerment, (iv) institutional capacity development, and (v) project management services. The Ministry of Local Development (MLD) is the Executing Agency. The Department of

¹ ADB. 2007. *Report and Recommendation of the President to the Board of Directors on Proposed Grants to Nepal for the Rural Reconstruction and Rehabilitation Sector Development Program*. Manila (Grants 0093-NEP and 0094-NEP[SF]).

² The \$50 million program grant was disbursed on 12 February 2008 in a single tranche.

³ OPEC = Organization of Petroleum Exporting Countries.

⁴ SDC's parallel cofinancing will fund services of district implementation support teams (consultants) in four of the project districts.

Local Infrastructure Development and Agricultural Roads (DOLIDAR) is the central implementing agency, and district development committees are the district implementing agencies. The Project will be implemented in 20 districts not yet covered by major externally funded rural infrastructure projects. Additionally, it will provide complementary support to the ongoing Decentralized Rural Infrastructure and Livelihood Project⁵ for rural water supply schemes and supplementary infrastructure.

5. The Project's physical progress is 10% complete, with 16% of the implementation period elapsed as of 31 August 2008. A project coordination unit established within DOLIDAR is fully staffed. District project offices are in place in all districts, and all staff positions are scheduled to be filled by 15 November 2008. Individual consultants in key areas such as resettlement, environment, procurement, and financial management, as part of the central implementation support consultant, were mobilized in April 2008. Selection of a consulting firm for the remaining consultant inputs is in the final stage. Procurement of national consulting firms for the district implementation support teams is at an advanced stage after a comprehensive orientation program for district project office staff. The process of procurement of vehicles and equipment is also in the final stage.⁶ In March 2008, ADB provided an advance of \$5 million to DOLIDAR's imprest account. Improvement of rural roads in four districts (Dolakha, Kavre, Sindhuli, and Sindhupalchowk), where SDC will provide technical assistance for district implementation support team services as part of its cofinancing, is targeted to begin within 2008. Implementation of the Project's initial activities is satisfactory.

III. PROPOSED CHANGES

A. Project Cost and Financing Plan

6. The total cost of the Project will increase to \$106.8 million from \$78.4 million with (i) DFID cofinancing of £10 million (\$20 million equivalent), (ii) SDC cofinancing of \$1.5 million for district consultant services and bridge construction materials, and (iii) increased Government contributions of \$5.6 million and beneficiary contributions of \$1.3 million to maintain the agreed cost-sharing arrangements of 20% by Government and 3.7% by beneficiaries (Table 1).

Table 1: Project Financing Plan
(\$ million)

Source	Original Plan		Revised Plan	
	Total	%	Total	%
Asian Development Bank	50.0	63.7	50.0	46.8
Department for International Development of the United Kingdom			20.0	18.7
OPEC Fund for International Development	10.0	12.6	10.0	9.4
Swiss Agency for Development and Cooperation			1.5	1.4
Government of Nepal	15.7	20.0	21.3	20.0
Beneficiaries	2.7	3.7	4.0	3.7
Total	78.4	100.0	106.8	100.0

OPEC = Organization of Petroleum Exporting Countries.
Source: Asian Development Bank estimates.

⁵ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Kingdom of Nepal for the Decentralized Rural Infrastructure and Livelihood Project*. Manila (Loan 2092-NEP and TA 4397 approved on 24 September)

⁶ The project implementation schedule in the report and recommendation of the President (footnote 1) identifies these as core project activities to be completed before commencement of field programs. Hence, these achievements are interpreted in terms of physical progress of the Project.

B. Project Investment Plan

7. As DFID and SDC intend to utilize their contributions mainly for rural roads, the total cost of the rural roads component will increase to \$63.5 million from \$45 million. The total cost of the supplementary infrastructure will increase to \$26.4 million from \$18 million, which will be covered by the increased Government contribution and partly by the ADB grant (Table 2).

Table 2: Project Investment Plan
(\$ million)

Item	Original Amount ^a	Revised Amount ^a
A. Base Cost^b		
1. Rural Transport	45.0	63.5
2. Supplementary Infrastructure	18.0	26.4
3. Community Empowerment	3.2	3.2
4. Institutional Capacity Development	0.3	0.3
5. Project Management Services	7.8	7.8
Subtotal (A)	74.3	101.2
B. Contingencies^c	3.8	5.3
C. Interest during Implementation	0.3	0.3
Total	78.4	106.8

^a Includes taxes and duties of \$4.6 million.

^b In October 2007 prices.

^c Physical contingencies computed at 5% for civil works, equipment, and vehicles. Price contingencies computed at a foreign price escalator of 0.8% per year, and a domestic price escalator of 5.4% in the first year, 5.1% in the second year, and 5.0% in the following years.

Source: Asian Development Bank estimates.

C. Administration of Department for International Development Grant Cofinancing

8. ADB will administer DFID's grant following the ADB's partial administration grant cofinancing modality.⁷ ADB will supervise works, goods, and services procured using the DFID grant in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time) and eligibility requirements. ADB will also provide disbursement administration services in accordance with ADB's *Loan Disbursement Handbook* (2007, as amended from time to time) by reviewing withdrawal applications and advising DFID for eligible payments. The applicable service charge from DFID will be \$30,000 or 0.1% of the amount disbursed, whichever is greater.

D. Physical Outputs

9. The availability of additional financing will increase the length of rural roads under the Project by 299 km (from 560 km to 859 km) and motorable bridges by 219 meters (from 1,100 meters to 1,319 meters). Similarly, the supplementary infrastructure component, comprising village trails, trail bridges, microirrigation, market buildings, primary schools, and health outposts will increase by 250 structures (from 485 to 735) and the number of rural water supply schemes will increase by 201 (from 390 to 591). The total number of beneficiaries will increase by 0.7 million (from 2.6 million to 3.3 million) and the total person-days of employment generated from the rural roads will increase by 8.4 million (from 15.8 million to 24.2 million). Additional details are provided in the revised design and monitoring framework in Appendix 1.

⁷ ADB. 2003. *ADB-Administered Grant Cofinancing: Partial Administration Modality and Related Service Charges*. Manila (R289-03).

IV. ASSESSMENT AND IMPLICATIONS

A. Issues and Problems

10. The Project has not had any major implementation issues thus far. Implementation of initial project activities are almost on schedule. Development of rural infrastructure continues to be the Government's priority and demand from rural communities is high.

B. Implications for Outcomes and Impact

11. The outcomes of the Project continue to be improved connectivity, enhanced economic and employment opportunities, and increased access to market and social services of rural communities. The expected impact of the Project remains to reduce rural poverty in hill, mountain, and terai districts where isolation and hardship are common. The increased length of rural roads and number of supplementary infrastructure will increase the scope of the expected outcomes and impact of the Project.

C. Economic Analysis

12. Economic benefits of the Project were computed on the basis of five representative infrastructure subprojects (four rural roads and one water supply). The economic internal rates of return (EIRRs) of the five subprojects ranged from 13% to 27%. For both roads and drinking water supply subprojects, sensitivity analysis was computed for cost overruns (+20%), benefit underachievement (-20%), and a combination of both. With increased costs and decreased benefits, the EIRRs generally remained viable, and in all cases positive. Financial internal rates of return were not computed at the time of project design. Each rural road subproject will have to be approved based on an EIRR and sensitivity analysis following the same method applied in the original project design. As the basis for costs and benefits remains generally valid since the analysis for the original Project, no further economic analysis is required at this time.

D. Environmental and Social Safeguards

13. During the project design, frameworks and procedures were prepared to ensure that ADB's safeguard policies on environment, indigenous people, and resettlement are complied with during implementation. These procedures and frameworks are based on safeguard needs identified for the five core subprojects studied during project design. As each road subproject (new construction or upgrading) will require safeguard assessments and plans for mitigating impacts before contracts can be awarded, no further update or preparation of new safeguards plans is required.

E. Implications for the Project Implementation Schedule

14. The increased project cost and scope is not expected to have major implications for the timing and scheduling of project implementation; no changes will be made at this time. Stakeholder demand is high, as is preparedness for the improvement and construction of rural roads and supplementary infrastructure. The additional civil works are expected to be accommodated within the existing work plan. The funds freed up as a result of SDC's financing of district implementation support team services in four project districts could be utilized if additional consulting services are required to fulfill the expanded project scope. The adequacy of project management services to realize the increased scope within the original timeframe will be carefully assessed during the Project's midterm review, scheduled for the last quarter of 2009. Any necessary actions can be taken at that time in consultation with the Government and cofinancing partners.

F. Amendment to the Grant Agreement

15. If the changes recommended in para.16 are approved, the Grant Agreement may be amended as appropriate to reflect the changes.

V. THE PRESIDENT'S RECOMMENDATION

16. The President recommends that the Board approve, on a no-objection basis,

- (i) the major change in the project scope to include total additional funding of \$28.4 million from the Department for International Development (DFID) of the United Kingdom (DFID), Swiss Agency for Development and Cooperation (SDC), the Government of Nepal, and beneficiaries; with no increase in ADB funding (Table 1);
- (ii) the major change in the financing plan (Table 2); and
- (iii) the administration by the Asian Development Bank of the DFID grant of \$20 million equivalent under the partial administration modality (paras. 6–9).