
GRANT NUMBER 0157-NEP(SF)

GRANT AGREEMENT
(Special Operations)

(Second Small Towns Water Supply and Sanitation Sector Project)

between

NEPAL

and

ASIAN DEVELOPMENT BANK

DATED _____

GAS:NEP 41022

**GRANT AGREEMENT
(Special Operations)**

GRANT AGREEMENT dated _____ between NEPAL (the "Recipient") and ASIAN DEVELOPMENT BANK ("ADB").

WHEREAS

(A) the Recipient has applied to ADB for a grant for the purposes of the Project described in Schedule 1 to this Grant Agreement;

(B) the Project will be carried out by the Ministry of Physical Planning and Works and the Town Development Fund and for this purpose the Recipient will make available to the Town Development Fund part of the proceeds of the Grant upon terms and conditions satisfactory to ADB; and

(C) ADB has agreed to provide a grant to the Recipient from ADB's Special Funds resources upon the terms and conditions hereinafter set forth and in the Project Agreement of even date herewith between ADB and the Town Development Fund.

NOW THEREFORE the parties agree as follows:

ARTICLE I

Grant Regulations; Definitions

Section 1.01. All provisions of the Special Operations Grant Regulations of ADB, dated 7 February 2005 (the "Grant Regulations"), are hereby made applicable to this Grant Agreement with the same force and effect as if they were fully set forth herein:

Section 1.02. The definitions set forth in the Grant Regulations are applicable to this Grant Agreement unless the context requires otherwise. In addition, the following terms have the following meanings:

(a) "Component" means a component of the Project as described in Schedule 1 to this Grant Agreement;

(b) "Consulting Guidelines" means ADB's Guidelines on the Use of Consultants by Asian Development Bank and Its Recipients (2007, as amended from time to time);

(c) "DWSS" means the Department of Water Supply and Sewerage of the MPPW or any successor thereof;

(d) "EARP" means the Environmental Assessment and Review Procedures prepared for the Project in accordance with ADB's Environment Policy (2002) and set out in Supplementary Appendix K of the RRP;

(e) "EIA" means environmental impact assessments prepared for the Project in accordance with the EARP;

(f) "EMP" means any environmental management plan prepared for the Project in accordance with the EARP and ADB's Environment Policy (2002);

(g) "GESI Action Plan" means the Gender Equality and Social Inclusion Action Plan prepared for the Project and approved by the Recipient and set out in Appendix 10 of the RRP;

(h) "Goods" means equipment and materials to be financed out of the proceeds of the Grant, and includes related services such as transportation, insurance, installation, commissioning, training, and initial maintenance, but excluding consulting services;

(i) "IEE" means initial environmental examinations prepared for the Project in accordance with the EARP;

(j) "Legislation" means the Water Resources Act, 2049 (1992) and the Local Self Governance Act, 2055 (1999), and any implementing regulations issued thereunder, as amended from time to time;

(k) "Local Bodies" means Village Development Committees, and Municipalities as provided under the Legislation of the Recipient;

(l) "MLD" means the Ministry of Local Development of the Recipient and any successor thereof;

(m) "MOF" means the Ministry of Finance of the Recipient and any successor thereof;

(n) "MPPW" means the Ministry of Physical Planning and Works of the Recipient and any successor thereof;

(o) "Municipality" means a municipal governing authority in an administrative area of the Recipient;

(p) "NGO" means a nongovernment organization registered under the prevailing laws of the Recipient and includes a community based organization;

(q) "OBA" means the output based aid scheme adopted by the Recipient for the Project and referred to in paragraph 16 of Schedule 4 to this Grant Agreement;

(r) "O & M" means operation and maintenance in respect of a Subproject;

(s) "PCC" means the Project Coordination Committee referred to in paragraph 3 of Schedule 4 to the Grant Agreement;

(t) "PMO" means the Project management office established by DWSS to manage Project implementation and coordination;

(u) "Procurement Guidelines" means ADB's Procurement Guidelines (2007, as amended from time to time);

(v) "Procurement Plan" means the procurement plan for the Project dated 21 July 2009 and agreed between the Recipient and ADB, as updated from time to time in accordance with Procurement Guidelines, Consulting Guidelines, and other arrangements agreed with ADB;

(w) "Project Agreement" means the project agreement of even date herewith between ADB and TDF;

(x) "Project Executing Agency" for the purposes of, and within the meaning of the Grant Regulations means MPPW;

(y) "Project facilities" means the facilities to be constructed and the goods and equipment to be provided under the Project;

(z) "Project town" means a town which has been selected for participation in the Project and which will enter into, or has entered into, a Town Project Agreement;

(aa) "RF" means the Resettlement Framework prepared for the Project in accordance with ADB's Involuntary Resettlement Policy (1995) and set out in the Supplementary Appendix M of the RRP;

(bb) "RP" means any resettlement plan prepared for the Project in accordance with the RF;

(cc) "RRP" the Report and Recommendation of the President to ADB's Board of Directors for the Project;

(dd) "SEIU" means the Sector Efficiency Improvement Unit established in the MPPW;

(ee) "Subloan Agreement" means the agreement entered into between the TDF and the relevant WUSC for the partial financing of a particular Subproject;

(ff) "Subproject Financing Agreement" means an agreement entered into by the relevant WUSC, PMO on behalf of the Recipient, the relevant Local Body and the TDF regarding the financing arrangements of a particular Subproject, as referred to in paragraph 6 of Schedule 4 to this Grant Agreement;

(gg) "Subproject" means a subproject to construct facilities under the Project, in a Project town;

(hh) "Subsidiary Loan Agreement" means an agreement between the Recipient and TDF under which a certain portion of the Grant proceeds are lent to TDF on terms and conditions satisfactory to ADB;

(ii) "TDF" means the Town Development Fund constituted under the Town Development Fund Act, 2053 (1997) and any successor thereof;

(jj) "TDF Loan Account" means the account established by the TDF to administer the Project related funds for which it is responsible;

(kk) "Town Project Agreement" means an agreement entered into by the relevant WUSC, PMO on behalf of the Recipient, relevant Local Body and the TDF regarding a Subproject and related implementation arrangements as referred to in paragraph 6 of Schedule 4 to this Grant Agreement;

(ll) "TPCC" means a Town Project Coordination Committee established by a Project town that undertakes or intends to undertake a subproject and set up in accordance with paragraph 4 of Schedule 4 to this Grant Agreement;

(mm) "UWSSSP" means the Urban Water Supply and Sanitation Sector Policy (2009) of the Recipient;

(nn) "VDC" means a Village Development Committee being a certain governing authority in an administrative area of the Recipient;

(oo) "Works" means construction or civil works to be financed out of the proceeds of the Grant, includes services such as drilling or mapping, and project related services that are provided as part of a single responsibility or turnkey contract, but excluding consulting services;

(pp) "WSSDO" means a Water Supply and Sanitation Divisional/Subdivisional Office of DWSS;

(qq) "WUA" means a Water Users Association constituted and recognized under the Legislation and any successor thereof; and

(rr) "WUSC" means a Water Users and Sanitation Committee which is the executive body of the relevant WUA and which is duly authorized to act on behalf of that WUA.

ARTICLE II

The Grant

Section 2.01. ADB agrees to make available to the Recipient from ADB's Special Funds resources on terms and conditions set forth in this Grant Agreement an amount of forty-five million and one hundred thousand Dollars (\$45,100,000).

ARTICLE III

Use of Proceeds of the Grant

Section 3.01. Except as ADB may otherwise agree:

(a) the Recipient shall make available to MPPW twenty-eight million one hundred thousand Dollars (\$28,100,000) of the Grant and shall cause MPPW to apply proceeds of the Grant to the financing of expenditures under the Project in accordance with the provisions of this Grant Agreement; and

(b) the Recipient shall lend to TDF seventeen million dollars (\$17,000,000) of the Grant under the Subsidiary Loan Agreement upon terms and conditions satisfactory to ADB and shall cause TDF to apply such loan proceeds to the financing of expenditures under Component 2 of the Project. Except as ADB shall otherwise agree, the terms and conditions of the loan to TDF shall include a repayment period of twenty (20) years, including a grace period of five (5) years, and an interest rate not exceeding three per cent (3%) per annum. The Recipient shall apply all amounts repaid by TDF under the Subsidiary Loan Agreement to poverty reduction programs in Nepal. The Recipient shall cause TDF to onlend the loan proceeds under the Subloan Agreements to WUSCs, participating in the Project at an interest rate not exceeding five per cent (5%) per annum, with a repayment period of up to twenty (20) years including a grace period of up to five (5) years.

Section 3.02. The Goods, Works and consulting services and other items of expenditure to be financed out of the proceeds of the Grant and the allocation of amounts of the Grant among different categories of such Goods, Works and consulting services and other items of expenditure shall be in accordance with the provisions of Schedule 2 to this Grant Agreement, as such Schedule may be amended from time to time by agreement between the Recipient and ADB.

Section 3.03. Except as ADB may otherwise agree, all Goods, Works and consulting services to be financed out of the proceeds of the Grant shall be procured in accordance with the provisions of Schedule 3 to this Grant Agreement.

Section 3.04. Withdrawals from the Grant Account in respect of Goods, Works and consulting services shall be made only on account of expenditures relating to

- (a) Goods which are produced in and supplied from and Works and consulting services which are supplied from such member countries of ADB as shall have been specified by ADB from time to time as eligible sources for procurement, and
- (b) Goods, Works and consulting services which meet such other eligibility requirements as shall have been specified by ADB from time to time.

Section 3.05. The Grant Closing Date for the purposes of Section 8.02 of the Grant Regulations shall be 31 March 2016 or such other date as may from time to time be agreed between the Recipient and ADB.

ARTICLE IV

Particular Covenants

Section 4.01. In the carrying out of the Project and operation of the Project facilities, the Recipient shall perform, or cause to be performed, all obligations set forth in Schedule 4 to this Grant Agreement.

Section 4.02. (a) The Recipient shall (i) maintain, or cause to be maintained, separate accounts for the Project; (ii) have such accounts and related financial statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; (iii) furnish to ADB, as soon as available but in any event not later than 9 months after the end of each related fiscal year, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the Grant proceeds and compliance with the financial covenants of this Grant Agreement as well as on the use of the procedures for imprest account/statement of expenditures), all in the English language; and (iv) furnish to ADB such other information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) The Recipient shall enable ADB, upon ADB's request, to discuss the Recipient's financial statements for the Project and its financial affairs related to the Project from time to time with the auditors appointed by the Recipient pursuant to Section 4.02(a) hereabove, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Recipient unless the Recipient shall otherwise agree.

Section 4.03. The Recipient shall enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Grant, and any relevant records and documents.

ARTICLE V

Suspension and Cancellation

Section 5.01. The following are specified as additional events for suspension of the right of the Recipient to make withdrawals from the Grant Account for the purposes of Section 8.01(k) of the Grant Regulations or cancellation of the Grant pursuant to Section 8.02 of the Grant Regulations:

(a) any material change to the Legislation that affects the implementation of the Project;

(b) TDF shall have failed to perform any of its obligations under the Project Agreement.

ARTICLE VI

Effectiveness

Section 6.01. The following is specified as an additional condition to the effectiveness of this Grant Agreement for the purposes of Section 9.01(e) of the Grant Regulations: the Project Agreement shall have been duly executed and delivered, on behalf of TDF and shall have become legally binding upon TDF in accordance with its terms, subject only to the effectiveness of this Grant Agreement.

Section 6.02. The following is an additional matter, for the purposes of Section 9.02(c) of the Grant Regulations, to be included in the opinion to be furnished to ADB: the Project Agreement has been duly authorized or ratified by, and executed and delivered on behalf of TDF, and is legally binding upon TDF in accordance with its terms, subject only to the effectiveness of this Grant Agreement.

Section 6.03. A date ninety (90) days after the date of this Grant Agreement is specified for the effectiveness of the Grant Agreement for the purposes of Section 9.04 of the Grant Regulations.

ARTICLE VII

Miscellaneous

Section 7.01. The Secretary, MOF is designated as representative of the Recipient for the purposes of Section 11.02 of the Grant Regulations.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the Grant Regulations:

For the Recipient

Ministry of Finance
Singha Durbar
Kathmandu, Nepal
Facsimile Number:

977-1-4211164.

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Facsimile Numbers:

(632) 636-2444
(632) 636-2293.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Grant Agreement to be signed in their respective names and to be delivered at the principal office of ADB, as of the day and year first above written.

NEPAL

By _____
Authorized Representative

ASIAN DEVELOPMENT BANK

By _____

Schedule 1

Description of the project

1. The objective of the Project is to improve the water supply and sanitation services to promote the improved health, economic and environmental living conditions of people living in the Project towns.

2. The Project has three Components:

Component 1. Developing the Urban Water Supply and Sanitation Sector

Supporting the development of the urban water supply and sanitation sector, including (i) the implementation of UWSSSP, (ii) establishing water supply and sanitation service standards and measuring and monitoring performance of service levels provided by all utilities (including Local Bodies and WUSCs), (iii) enhancing sector coordination, (iv) assisting the formulation of new laws, policies and guidelines that fall, including the umbrella Water Supply and Sanitation Act and national technical standards for sewerage and wastewater management, under the responsibility of the MPPW and (v) equipment and incremental recurrent costs in SEIU and (vi) consulting services for sector improvement.

Component 2. Water Supply and Sanitation Services

(A) Development of additional water sources, construction of water treatment facilities and storage tanks, rehabilitation and/or expansion of transmission and distribution systems in approximately twenty (20) Project towns.

(B) Construction of sanitation facilities, including public toilets and sludge drying bed for septic tank sludge disposal in the Project towns. Wastewater management systems to be introduced as pilot projects in an agreed number of Project towns.

(C) Introduction and improvement of solid waste management in the Project towns.

(D) Construction of drainage systems in the core areas of the Project towns.

(E) Provision of OBA to service providers who provide water and sanitation facilities to pre-determined households in the Project towns.

(F) Consulting services for design and construction supervision.

Component 3. Project Management and Operation

The provision of Project management and operations support including:

(i) training and capacity building programs to WUSCs, WSSDO and regional monitoring and supervision offices;

(ii) equipment and incremental recurrent costs in PMO and WSSDO;

- (iii) administrative costs including engaging management staff to be retained by WUSCs;
 - (iv) consulting services for project management; and
 - (v) establishment and full operation of five regional water quality and meter calibration laboratories which will provide water quality testing and meter calibration services to WUSCs.
3. The Project is expected to be completed by 30 September 2015.

SCHEDULE 2

Allocation and Withdrawal of Grant Proceeds

General

1. The table attached to this Schedule sets forth the Categories of Goods, Works and consulting services and other items of expenditure to be financed out of the proceeds of the Grant and the allocation of amounts of the Grant to each such Category (hereinafter called the Table). (Reference to "Category" or "Categories" in this Schedule is to a Category or Categories of the Table.)

Percentages of ADB Financing

2. Except as ADB may otherwise agree, the items of the Categories listed in the Table shall be financed out of the proceeds of the Grant on the basis of the percentages set forth in the Table.

Reallocation

3. Notwithstanding the allocation of Grant proceeds and the withdrawal percentages set forth in the Table,

(a) if the amount of the Grant allocated to any Category appears to be insufficient to finance all agreed expenditures in that Category, ADB may, in consultation with the Recipient, (i) reallocate to such Category, to the extent required to meet the estimated shortfall, amounts of the Grant which have been allocated to another Category but, in the opinion of ADB, are not needed to meet other expenditures, and (ii) if such reallocation cannot fully meet the estimated shortfall, reduce the withdrawal percentage applicable to such expenditures in order that further withdrawals under such Category may continue until all expenditures thereunder shall have been made; and

(b) if the amount of the Grant then allocated to any Category appears to exceed all agreed expenditures in that Category, ADB may, in consultation with the Recipient, reallocate such excess amount to any other Category.

Disbursement Procedures

4. Except as ADB may otherwise agree, the Grant proceeds for financing Goods, Works, and consulting services and other items of expenditure shall be disbursed in accordance with ADB's "Loan Disbursement Handbook" dated January 2007 (ADB's Loan Disbursement Handbook), as amended from time to time.

Imprest; Statement of Expenditures

5. (a) Except as ADB may otherwise agree, the Recipient shall establish immediately after the Effective Date, an imprest account for the Project for MPPW at Nepal Rastra Bank. The imprest account shall be established, managed, replenished and liquidated in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed upon between the Recipient and ADB. The currency of the imprest

account shall be the dollar. The maximum amount to be deposited into the imprest account shall not exceed the lower of (i) the estimated expenditure to be financed from the imprest account for the proceeding six months of Project implementation, or (ii) the equivalent of ten percent (10%) of the Grant amount.

(b) The statement of expenditures (SOE) procedure may be used for reimbursement of eligible expenditures and to liquidate advances provided into the imprest account, in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed upon between the Recipient and ADB. Any individual payment to be reimbursed or liquidated under the SOE procedure shall not exceed the equivalent of \$100,000.

Retroactive Financing

6. Withdrawals from the Grant Account may be made for reimbursement of reasonable expenditures incurred under the Project before the Effective Date but not earlier than twelve (12) months before the date of this Grant Agreement, subject to a maximum amount equivalent to twenty percent (20%) of the Grant amount.

Condition for Disbursement

7. No disbursement shall be made from the Grant Account, in respect of any Civil Works and Goods with respect to Component 2, unless and until the Subsidiary Loan Agreement has been duly signed between the Recipient and TDF, in a form and substance satisfactory to ADB.

TABLE

ALLOCATION AND WITHDRAWAL OF GRANT PROCEEDS (Second Small Towns Water Supply and Sanitation Sector Project)			
CATEGORY			ADB FINANCING
Number	Item	Amount Allocated \$ Category	Percentage and Basis for Withdrawal from the Grant Account
1	Civil Works and Goods	30,807,000	62 percent of total expenditure
2	Office Equipment and Vehicles	456,000	100 percent of total expenditure*
3	Output Based Aid	665,000	50 percent of total expenditure*
4	Incremental Recurrent Costs	637,000	30 percent of total expenditure
5	Consulting Services and Capacity Development	8,151,000	100 percent of total expenditure*
6	Unallocated	4,384,000	
	Total	45,100,000	

* Exclusive of taxes and duties imposed within the territory of the Recipient.

SCHEDULE 3

Provisions on Procurement and Consulting Services

A. General

1. All Goods, Works and consulting services to be financed out of the proceeds of the Grant shall be subject to and governed by the Procurement Guidelines, and the Consulting Guidelines, respectively.
2. All terms used and not otherwise defined in this Grant Agreement have the meanings provided in the Procurement Guidelines and/or the Consulting Guidelines, as applicable.

B. Procurement for Goods and Works

3. Except as ADB may otherwise agree, Goods and Works shall only be procured on the basis of the methods of procurement set forth below:

International Competitive Bidding
National Competitive Bidding
Shopping
Direct Contracting
Community Participation in Procurement

The method of procurement is subject to, among other things, the detailed arrangements and threshold values set forth in the Procurement Plan. The Recipient may only modify the methods of procurement or threshold values with the prior agreement of ADB, and modifications must be set out in updates to the Procurement Plan.

4. Domestic Preference. The Recipient may grant a margin of preference in the evaluation of bids under international competitive bidding in accordance with paragraphs 2.55(a) and 2.56 of the Procurement Guidelines for domestically manufactured Goods and paragraphs 2.55(b) and 2.56 of the Procurement Guidelines for domestic Works.
5. National Competitive Bidding. For National Competitive Bidding the Recipient's Public Procurement Act, 2007, and Public Procurement Regulations, 2007, shall be used, subject to the modifications set out in the Procurement Plan.

C. Selection of Consulting Services

6. Quality-and-Cost-Based Selection. Except as ADB may otherwise agree, the Recipient shall apply quality-and-cost-based selection for selecting and engaging consulting services for firms. Individual consultants shall be selected in accordance with Consulting Guidelines.

D. Industrial or Intellectual Property Rights

7. (a) The Recipient shall ensure that all Goods and Works procured (including without limitation all computer hardware, software and systems, whether separately procured or incorporated within other goods and services procured) do not violate or infringe any industrial property or intellectual property right or claim of any third party.

(b) The Recipient shall ensure that all contracts for the procurement of Goods and Works contain appropriate representations, warranties and, if appropriate, indemnities from the contractor or supplier with respect to the matters referred to in subparagraph (a) of this paragraph.

8. The Recipient shall ensure that all ADB-financed contracts with consultants contain appropriate representations, warranties and, if appropriate, indemnities from the consultants to ensure that the consulting services provided do not violate or infringe any industrial property or intellectual property right or claim of any third party.

E. ADB's Review of Procurement Decisions

9. All contracts procured under international competitive bidding procedures, contracts procured under national competitive bidding, and contracts for consulting services shall be subject to prior review by ADB, unless otherwise agreed between the Recipient and ADB and set forth in the Procurement Plan.

SCHEDULE 4

Execution of Project and Operation of Project Facilities; Financial Matters

Implementation Arrangements

1. MPPW shall be the Project Executing Agency and shall be responsible for the overall execution of the Project.
2. The PMO, established in DWSS, will be responsible for the overall project planning and management for Component 2, including selection of Project towns, procurement of civil works contractors, assistance for design, construction supervision and O&M, and overseeing safeguard compliance. The PMO will be headed by an experienced full-time project director satisfactory to ADB, supported by two full-time deputy project directors. The WSSDO acting under the guidance of the PMO, will carry out overall management of Subprojects, including supervising the feasibility studies and detailed designs, recruiting and supervising NGOs services, and providing technical support for O&M. The PMO shall ensure that for each Subproject, a dedicated core group headed by a qualified engineer under the supervision of the WSSDO head will undertake day-to-day Project management in respect of such Subproject.
3. The Recipient shall ensure that within three months from the Effective Date, the PCC will be established with the Secretary of MPPW as the chairperson and the Joint Secretary of MPPW as the alternate chairperson. The PCC will comprise the Director General of DWSS, Executive Director of TDF, and senior representatives from MOF, MLD, Ministry of Health and Population, Ministry of Law and Justice and National Planning Commission. The PMO Director will serve as member-secretary. The PCC will meet at least twice a year to review the overall progress and discuss and resolve key issues that require to be addressed at the central level.
4. At each Project Town, a TPCC will be established within three months from the selection of a respective Subproject. If a TPCC is established in a Municipality, the TPCC will be chaired by the mayor of the Municipality or if there is no mayor, by the chief executive officer designated by the MLD and shall also comprise, the executive officer of Municipality and representatives from the relevant WSSDO and WUSC. If a TPCC is established in respect of a Subproject area governed by a VDC, the TPCC will be chaired by the head of the relevant WSSDO, and comprise of representatives from the relevant WUSC and VDC. If a VDC has an elected chairperson or such chair person has been selected by relevant stakeholders, such elected or selected chairperson of the VDC shall co-chair such TPCC. The TPCC shall also comprise of representatives of the relevant WSSDO and WUSC and from other relevant bodies. TPCCs will meet quarterly, or as often as necessary, to oversee the Subproject progress and effectiveness of all relevant activities and discuss any relevant issues to ensure smooth implementation and operation of the Subproject.
5. The SEIU will be the Project implementation agency for Component 1. SEIU will be headed by joint secretary of the Water Supply and Sanitation Division of MPPW and consist of dedicated staff, including one at under secretary level, sufficient to adequately discharge its duties and responsibilities under the Grant Agreement. Such duties and

responsibilities of the SEIU shall include: (a) supporting the implementation of UWSSSP, with its clear monitoring and evaluation mechanism put in place, (b) establishing water supply and sanitation service standards and measuring and monitoring performance of service levels provided by all utilities (including Local Bodies and WUSCs), (c) enhancing sector coordination, and (d) assisting the formulation of new laws, policies and guidelines that fall under the responsibility of the MPPW, including the umbrella Water Supply and Sanitation Act and national technical standards for sewerage and wastewater management.

6. Following selection of a Project Town and prior to the commencement of detailed design work on a Subproject, the relevant Local Body, WUSC, PMO and the TDF shall execute a Town Project Agreement. The provisions of the Town Project Agreement shall include (a) the proportion of cost-sharing both for water supply and sanitation system, and (b) acceptance of the principles of integrated water supply and sanitation, tariff collection and the OBA. Following detailed design work in respect of a Subproject, the relevant Local Body, WUSC, PMO and the TDF shall execute a Subproject Financing Agreement, which shall provide for, (i) the amount of contribution from each party in respect of Subproject costs, (ii) the proposed level of tariff to be collected by WUSCs, and (iii) the target and level of subsidy to be paid under the OBA.

7. Prior to the award of any procurement contract in respect of a Subproject, the Recipient shall ensure that the TDF and the relevant WUSC have executed a Subloan Agreement, satisfactory to ADB. The provisions of such Subloan Agreement shall include a loan to the WUSC for partial construction costs of the Subproject, at an interest rate not exceeding five per cent (5%) per annum, with a repayment period of up to twenty (20) years including a grace period of up to five (5) years.

8. The WSSDO shall select local NGOs services to assist in carrying out Project implementation activities including (i) sensitize communities and assist the formulation of WUSC, (ii) conduct socio-economic survey and identify those eligible for OBA grants, (iii) provide health and hygiene education, (iv) implement the GESI action plan, (v) support the implementation of house connections under the OBA, and (vi) assist the implementation of resettlement plans. Local NGOs will also act as independent verification agents under the OBA framework to verify that agreed outputs have been actually delivered. The WSSDO shall select local NGOs using selection criteria including: (i) experience relevant to the Project objectives; (ii) ties with the Project town; (iii) financial integrity; and (iv) record of proven competence in group formation. The WSSDO shall continually evaluate performance and techniques employed by the NGOs and provide feedback to the NGOs.

9. Within twelve (12) months of the Effective Date, the Recipient shall ensure that it shall establish and make fully operational five (5) regional water quality and meter calibration laboratories.

Project Town and Subproject Selection

10. The Recipient shall ensure that the PMO shall (a) screen and undertake the necessary studies and evaluations for Project town selection and Subproject selection on the basis of the relevant criteria set out in Appendix 4 of the RRP; and (b) any selection of a Project town or Subproject shall be made strictly on the basis of the Project town selection or Subproject selection criteria set out in Appendix 4 of the RRP.

11. Without prejudice to the provisions set out in paragraph 10 above, the Recipient shall ensure that:

- (a) with respect to the selection of a Project town:
 - (i) poverty is weighted so that a Project town with a higher proportion of poor people scores more;
 - (ii) a Project town that does not have a piped water system, should be awarded maximum scoring points;
 - (iii) additional scoring points are awarded to Project town that does not have any system of wastewater drainage; and
 - (iv) community demand is assessed by the interest shown by people by participating in a public meeting at pre-feasibility stage.
- (b) with respect to the selection of a Subproject:
 - (i) it complies with all requirements of relevant national laws and regulations and ADB's policies, including, ADB's *Environment Policy* (2002), ADB's *Involuntary Resettlement Policy* (1995) and ADB's *Indigenous Peoples Policy* (1998);
 - (ii) it has an economic internal rate of return of 12% or higher in respect of the water supply part (or scheme) of the Subproject;
 - (iii) a Town Project Agreement has been executed;
 - (iv) a Subproject Financing Agreement has been executed; and
 - (v) a Subloan Agreement has been executed.

12. Prior to any Subproject implementation, the PMO will submit to ADB for review and concurrence (i) a summary sheet showing that the selection criteria set out in paragraph 10 above have been met, (ii) salient features of each Subproject, (iii) Subproject RP if any Subproject involves involuntary resettlement and/or land acquisition, and (iv) other safeguard documents, feasibility studies and/or detailed design reports, as maybe requested by ADB.

Role of TDF and WUSCs

13. The Recipient shall ensure that the TDF shall be responsible for assessing the financial sustainability of Subprojects, and it will (a) examine the Subproject costs in connection with the repayment capabilities of the WUSCs and Local Bodies in coordination with the PMO, (b) recommend and monitor tariffs to cover O&M expenditures, replacement and future expansion in accordance with the UWSSSP, and debt service payment, (c) provide training in tariff setting, bookkeeping, accounting and financial management to members and/or employees of WUSCs, and (d) disburse and collect loans from WUSCs. TDF shall maintain its own financial sustainability by: (i) making adequate provisions for non-

performing assets; (ii) maintaining a debt service coverage ratio of at least 1.1 times; and (iii) exercising such other due diligence and good banking practices as required for a prudent financial institution.

14. TDF shall recommend appropriate levels of water tariffs to the relevant WUSCs and shall ensure that the WUSCs take appropriate measures to effect proper collection of outstanding water bills and protect the water resources and facilities. TDF shall develop a suitable tariff accounting framework for WUSCs and shall monitor water tariffs in the Project towns to ensure that they are collected and recorded. TDF shall disburse to, and collect loans from, WUSCs to meet Subproject construction costs and ensure that the loan proceeds under the Subloan Agreements are used for the intended Subprojects.

15. The Recipient shall ensure that WUSCs will be responsible for O&M of the water supply schemes and sanitation facilities constructed under the Project. In addition, a WUSC's duties shall include (a) assisting in the feasibility study of a Subproject, (b) developing and agreeing the technical proposals, and parameters of the service areas, (c) land acquisition and resettlement, if any, (d) participating in the bidding evaluation process and signing the contract with the main civil work contractor as a witness, (e) paying required financial contribution of the Subproject, (f) supervising the construction work and endorsing payments to contractors, (g) setting water tariffs at a level to cover necessary repayments to TDF under the Subloan Agreement and O&M expenditures, replacement and future expansion in accordance with the UWSSSP, and (h) ensuring smooth house connections. After the completion of the Subproject, WUSC will be responsible for (i) operating and maintaining, and expanding the water supply scheme and sanitation facilities, as and when appropriate, (ii) collecting the tariff, and (iii) repaying the debt to TDF. WUSCs will normally consist of nine executive members, of which, at least three will be women.

OBA

16. The Recipient shall ensure that the Project shall develop and implement OBA to ensure delivery of water supply and sanitation services primarily to the poor and vulnerable groups in Project towns. Under the OBA, grants will be paid to service providers, i.e. WUSCs, after delivery of the household connections have been verified by an independent verification agent. The Recipient agrees to ensure that OBA will be developed and implemented in accordance with the Framework for OBA set out in Appendix 5 of the RRP.

Condition for Disbursement

17. Notwithstanding any other provision of this Grant Agreement or Project Agreement, the Recipient shall ensure and shall cause TDF to ensure, that no withdrawals shall be made from the TDF Loan Account in respect of a Subproject unless and until (a) the relevant WUA is constituted as a legal entity and its WUSC is established and authorized to act on behalf of the WUA; (b) a legally binding and operative Town Project Agreement and Subproject Financing Agreement has been executed as provided in paragraph 11(b) on terms and conditions acceptable to ADB; (c) the Subproject is determined to be financially viable by TDF; and (d) the relevant WUSC has taken all necessary steps to (i) acquire the required land, rights in land and water, and rights-of-way to carry out expeditious implementation of the Subproject; and (ii) obtain all required permits in connection therewith.

Governance

18. The Recipient shall ensure that all contracts financed by ADB in connection with the Project shall include provisions specifying the right of ADB to audit and examine the records and accounts of implementing agencies and all contractors, suppliers, consultants, and other service providers as they relate to the Project.

19. The Recipient shall ensure that, (a) there will be compliance of the Recipient's Public Procurement Act and Regulations of 2007 as well as the Recipient's Financial Administration Act Regulations, 2007, (b) technical audits of Subprojects, as agreed with ADB, and (c) random independent spot checks of Project implementation by ADB, SEIU and PMO.

20. The Recipient shall ensure that the DWSS will set up a website within two (2) months from the Effective Date and disclose all key project-related information, including the main framework of the Project, criteria for selecting Project towns and Subprojects, results of Project town selection, project safeguard reports such as EIAs, IEEs and RPs, and project progress such as procurement and contract award. WUSCs will also fully disclose Town project-related information to members, such as Subproject cost, cost-sharing arrangements, progress of construction, connection cost and fee, financial status, available OBA and the endorsed list of those eligible for grant, through public briefings, bulletin boards or at the general assembly. A grievance mechanism in respect of Subprojects will also be established and grievances will be addressed at the WUSC. Unresolved grievances shall be elevated to the TPCC.

Counterpart Support

21. The Recipient shall ensure that there will be adequate staff, resources, and facilities at DWSS, PMO, SEIU and WSSDO to implement the Project. In particular, the Recipient shall ensure that adequate financial and technical support shall be provided to the WUSCs for adequate O&M for all Project facilities. The Recipient shall also make available all counterpart funds required for timely and effective implementation of the Project, including any funds required to make land available for the Project, to mitigate unforeseen environmental and social impacts and to meet additional costs arising from design changes, price escalation in construction costs and/or unforeseen circumstances. In addition, the Recipient shall provide adequate support and assistance to SEIU so as to ensure proper implementation of the UWSSSP and the sector development, and to fully discharge its obligations under the Project. The Recipient shall ensure that there will be no overlap of activities between Subprojects and projects funded by other development partners.

Environment

22. The Recipient shall ensure, and shall cause DWSS and WUSCs to ensure, that:

- (a) the Project is undertaken and all Project facilities are designed, constructed, implemented, operated, and maintained in accordance with the Borrower's applicable laws and regulations, ADB's *Environment Policy* (2002) and all assessments and examinations shall be undertaken and prepared in

accordance with the EARP. Any mitigation measures set out in any EIA, EMP or an IEE are carried out; and

(b) all contractors are provided with the EIA, IEE and EMP, and that (i) the contractors implement the required mitigation measures as described in the EMP in a satisfactory manner, and report the implementation of the EMP in accordance with the EARP, along with any deviation from the IEE; (ii) the bidding documents include the requirement to comply with the EMP; and (iii) closely monitor environmental impact and compliance by the contractors with the EMP and ensure that results of such monitoring are incorporated in the quarterly progress reports.

23. The Recipient shall ensure that prior to the issuance of bidding documents for a Subproject, ADB shall have reviewed and cleared all EIAs for category A Subprojects and IEEs for all category B sensitive Subprojects (as these categories are determined under the EARP and ADB's *Environment Policy* (2002)) including any EMP or any updated or revised versions thereof. All environmental mitigation measures required for a Subproject shall be incorporated in the relevant contract for civil works.

Resettlement Issues

24. The Recipient shall ensure that all land acquisition and resettlement activities under any Subproject shall be prepared and implemented in accordance with (a) ADB's *Involuntary Resettlement Policy* (1995), (b) the RF, and (c) the relevant laws and regulations of the Recipient. The Recipient shall make its best efforts to ensure that all land acquisition and resettlement issues, in respect of the Project, are minimized.

25. The Recipient shall ensure that all RPs (including any revisions and updates) are prepared in accordance with the RF and shall be submitted to ADB for its review and approval prior to any land acquisition or resettlement activity. The Recipient shall also ensure that all land and rights-of-way required under the Project will be acquired in a timely manner and payment of compensation at full replacement value and other entitlements shall be paid in full, in accordance with the RF, and prior to the award of civil works contracts in respect of the relevant Subproject.

26. The Recipient shall ensure that any Subproject that may cause significant resettlement impact i. e. where 200 or more people experience major resettlement impact, shall not be selected for financing under the Project.

Social issues

27. The Recipient shall ensure that all Project implementation agencies shall actively seek beneficiary participation in the design and implementation of all Project activities. ADB's *Policy on Indigenous Peoples* (1998) shall apply in respect of all Project activities.

28. The Recipient shall ensure, and cause all project implementation agencies to ensure, that the GESI Action Plan is duly considered and complied with, and its principles incorporated in Project planning and implementation. MPPW shall ensure that all surveys

and assessments to be conducted under the Project shall include gender, caste, and ethnicity disaggregated data.

29. MPPW shall take all necessary and appropriate actions to ensure that women and vulnerable groups are equitably represented in all committees and units established under the Project.

30. The Recipient shall ensure that all civil works contractors comply with all applicable labor laws, including those on occupational health and safety, do not employ child labor, as defined in national legislation, for construction and maintenance activities, and provide appropriate facilities in construction campsites, including separate facilities for female laborers. MPPW shall take all appropriate and necessary measures to employ poor and vulnerable groups under the Project, particularly women and landless farmers and encourage contractors to use local unskilled labor. MPPW shall require contractors not to differentiate wages between men and women for work of equal value. Specific clauses to cover these items shall be included in bidding documents, and compliance shall be strictly monitored throughout Project implementation.

Project Performance Management System

31. Within three (3) months of the Effective Date, the Recipient shall have caused PMO to have established a project performance management system satisfactory to ADB, which shall include baseline indicators and targets including, incidence of water-related diseases and quality and quantity of water supply services available, level of on-site sanitation facilities. All data, including those on services provided under the Project, shall be disaggregated by gender, caste, and ethnicity. Within nine (9) months of the Effective Date, DWSS will conduct a benchmark survey for the first batch of Project towns and submit for ADB's review and concurrence, an implementation plan for monitoring performance and preparing benchmark information.

Project Review and Reporting

32. The Recipient shall ensure and shall cause DWSS to ensure that ADB is provided with quarterly progress reports on Project implementation. DWSS will prepare information on the Project's physical progress and status of Project management (Components 2 and 3), and consolidate them with Component 1 issues and any other material issues relating to the Project and submit a combined report to ADB within one (1) month of the end of the relevant quarter. Within six (6) months of physical completion of the Project, DWSS will submit to ADB, a Project completion report in a form satisfactory to ADB.

33. The Recipient and ADB will jointly review the Project at least twice a year. Such reviews shall include the performance of Recipient's departments and other Project implementation agencies, consultants, NGOs and contractors; progress of sector development, physical progress of subprojects and capacity building; inclusion of the poor and vulnerable groups in subproject planning and implementation; compliance with grant assurances; and assessment of subproject sustainability in technical and financial terms.

34. The Beneficiary and ADB will also undertake a comprehensive midterm review in the third year of Project implementation to identify problems and constraints encountered

and suggest measures to address them. Specific items to be reviewed will include: (a) appropriateness of scope, design, implementation arrangements and schedule of activities; (b) assessment of implementation pace against Project indicators; (c) effectiveness of capacity building; (d) evaluation of the policy implementation, establishment and monitoring of service standards and sector coordination for effective and efficient sector development; (e) compliance with safeguard measures; (f) extent to which GESI Action Plan is being complied with in Subprojects; (g) lessons learned and good practices and potential for their replicability, and (h) any changes to be recommended with respect to improving Project implementation and effectiveness.