Technical Assistance Report

Project Number: 49021-002
Transaction Technical Assistance (TRTA)
November 2017

People’s Republic of China: Heilongjiang Business Development Services Support to Strengthen Financial Intermediation Component Implementation (Financed by the Financial Sector Development Partnership Special Fund)

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Asian Development Bank
CURRENCY EQUIVALENTS
(as of 14 November 2017)

Currency unit – yuan (CNY)
CNY1.00 = $0.1505
$1.00 = CNY6.6452

ABBREVIATIONS

ADB – Asian Development Bank
BDS – business development services
EIB – European Investment Bank
EMP – environmental management plan
ESMS – environmental and social management system
FIIC – financial intermediation component
ha – hectare
HBC – Harbin Bank Corporation
HDRC – Heilongjiang Development and Reform Commission
HFD – Heilongjiang Finance Department
HMG – Hegang Municipal Government
HPMO – Hegang project management office
JMG – Jixi Municipal Government
JPMO – Jixi project management office
LBC – Longjiang Bank Corporation
PRC – People’s Republic of China
QMG – Qitaihe Municipal Government
QPMO – Qitaihe project management office
SMEs – small- and medium-sized enterprises
SMEFP – small- and medium-sized enterprise financing platform
SMG – Shuangyashan Municipal Government
SPMO – Shuangyashan project management office

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

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I. THE PROPOSED PROJECT

1. **Rationale.** The project cities of Hegang, Jixi, Qitaihe, and Shuangyashan are located in east Heilongjiang and share a border with the Russian Federation to the east and to the north. Their total population is 5.2 million and the land area is 66,028 square kilometers. The project cities have been fundamentally reliant on coal mining and related industries, which make their economies vulnerable to coal price fluctuations and changing global and domestic energy and climate change policies. The significant fall of coal prices in 2013 resulted in rapid economic decline, increasing unemployment and urban poverty, wage erosion, and population loss in the project cities.\(^2\) There is an urgent need to revitalize and transform the local economies toward a sustainable non-coal future, including by strategic promotion of priority non-coal industries that will deliver new and inclusive employment. Further, a long tradition of large coal-mining state-owned enterprises dominating the cities’ economies makes private sector development and entrepreneurship, and diversification into new industries, difficult to achieve. The problem is compounded by a lack of effective enabling policies and programs for the development of small- and medium-sized enterprises (SMEs); severe constraints to SME financing combined with a lack of capacity to develop and expand businesses; and inability to boost technical skills, develop a strategic workforce, and put in place product research and development mechanisms.

2. The project cities also suffer from environmental loss and degradation (pollution of soil, water, and air) caused by more than 60 years of coal mining, which together with inadequate urban infrastructure and services (e.g., water supply, wastewater management, and drainage systems) makes for poor livability. Aging pipes render district heating seriously inefficient. Key links of the road network are missing and lead to detours and traffic jams, especially in Shuangyashan. All project cities lack proper road maintenance as well as adequate public transport, bus lanes, bus stops, and sidewalks, and urgently need road rehabilitation. Some rivers, especially in Hegang and Jixi, flood during heavy storms and snowmelt in the spring; river courses are narrow and scattered with solid waste; and water is polluted from untreated discharge of domestic and industrial wastewater.

3. An economic diagnostics study and diversification roadmap was prepared during project preparation, which defined options, strategies, and investments to enable diversification into non-coal industries. The provincial and municipal five-year plans include diversification and define the pillar industries including several non-coal activities, such as green food processing, graphite high-tech materials and products, machinery, logistics and trade, and tourism, which the ADB-financed project will support. SME development is also included in government programs. However, an assessment shows that while the programs have good intentions, they also have significant weaknesses and gaps. These will be rectified by two project components, financial intermediation component (FIC) and business development services (BDS), which are also designed to complement government initiatives, serve as catalyst for private sector development, and improve government support programs.

4. Responding to the urgent need for comprehensive sustainable and integrated urban and economic development, the project will improve the environment for private sector development by enabling and catalyzing a diverse, non-coal economic future for the project cities. The project will support key public investments, capacity development, and financing for SMEs to strategically promote priority non-coal industries. This will deliver new, inclusive, and more gender-balanced employment, building on and expanding existing industries and promoting selective new

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2. After 255,000 people out-migrated during 2010–2015, the population declined by 4.7%.
industries through upstream and downstream diversification. It will improve the capacity of and access to finance for SMEs, as well as key infrastructure, facilities, and support for non-coal SMEs. The project will also improve urban livability and help change the project cities’ image from “coal cities” to clean, green, vibrant, and attractive urban centers. This is a prerequisite to economic transformation toward value-adding, knowledge-based activities, and for attracting and retaining residents, workers, and companies. The project will improve public safety, and human and environmental health through remediation of impacts from coal mining, and cleanup of degraded and polluted environments. It will support improvements in urban infrastructure and public services, including water supply, wastewater management, drainage, river ecology and flood protection, sustainable urban public transport, and roads in a connected, holistic manner.

5. The project is aligned with the following impacts: (i) economy revitalized and diversified and non-coal industries in the cities of Hegang, Jixi, Qitaihe, and Shuangyashan developed; and (ii) living environment, safety, and public health in the cities of Hegang, Jixi, Qitaihe, and Shuangyashan improved (footnote 1). The project will have the following outcome: non-coal economic activities and urban livability in project cities increased.

6. Outputs. The project will have five outputs. Detailed descriptions are included in the design and monitoring framework (report and recommendation of the President, Appendix 1) and in the project administration manuals (PAMs).\(^3\)

7. Output 1: Capacity in business development services and integrated project planning and management developed. This output will support project management and capacity development to ensure successful diversification and project sustainability in areas of (i) project planning and management, procurement, and financial management; (ii) BDS for SMEs and local SME bureaus; (iii) human resources and skills development; (iv) smart city cluster cooperation; (v) mining remediation planning and implementation; (vi) flood risk management, climate resilience, and sponge city planning;\(^4\) (vii) water, wastewater, and drainage system design, construction, and operation; and (viii) sustainable urban transport, road safety, and public transport management.

8. Output 2: Sustainable small- and medium-sized enterprises investment and access to finance in project cities improved. The project will establish an SME financing platform, using the FIC modality,\(^5\) to mobilize domestic financing. The platform will offer (i) cofinancing loans for SME investments by financial intermediaries in which the ADB loan component is subordinated in return for longer-term project loans, (ii) a first-loss cash collateral facility to mobilize commercial guarantees and ease access to commercial financing for investments and longer-term working capital of up to 3 years,\(^6\) and (iii) entrusted loans for high-priority projects for local governments. The FIC will be linked to the BDS subcomponent (output 1).

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\(^3\) Project Administration Manual: Investment Project Components (Section A) and Project Administration Manual: Financial Intermediation Component and Business Development Services Subcomponent (Section B) (accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President).

\(^4\) Sponge city is a concept of comprehensive urban water resources management, in which greenways, parks, and wetlands maximize ecosystem services, including stormwater management, using ecosystems-based adaptation.

\(^5\) Output 2 will be implemented through subprojects by SMEs, selected according to criteria described in section B (Financial Intermediation Component and Business Development Services Subcomponent) of the PAM (accessible from the list of linked documents in Appendix 2). The FIC modality is most appropriate for aggregate projects facilitating diversification into non-coal industries through SMEs, for which financing requirements are not large enough to allow direct lending by ADB.

\(^6\) The cash collateral facility will cover (i) first loss of 20% for a guarantee company to assume risk for 80% of SME loan exposure and thus facilitate longer-term (3–5 years) debt financing by local financial intermediaries, and (ii) straight loans for higher-risk project loans in priority sectors.
9. **Output 3: Key infrastructure and small- and medium-sized enterprises facilities in non-coal industrial parks in project cities constructed.** The project will build and make operational key infrastructure and facilities, including (i) roads with advanced safety features and associated utility pipes; (ii) industrial wastewater treatment plants; and (iii) multifunction facilities for SMEs and start-ups, as well as for training and business services.

10. **Output 4: Remediation and environmental cleanup from mining impacts in project cities improved.** The project will develop mining remediation strategies, prepare investment plans, and implement pilot demonstration projects as models for replication. In Hegang, an open-pit mine will be remediated, reclaimed, and reused as a park and for light industry. In Jixi, a former mining area and waste-rock dumpsite will be remediated and afforested, and a subsidence monitoring and training center will be built and operated. In Qitaihe and Shuangyashan, waste-rock dumpsites and subsidence areas will be remediated and reused as green open spaces and agricultural land.

11. **Output 5: Integrated urban infrastructure and services in project cities improved.** This output will enhance urban livability and attractiveness through improved, spatially integrated infrastructure and services: (i) Hegang—river rehabilitation, drainage system, sustainable urban and public transport, urban greening, and district heating; (ii) Jixi—integrated improvements to the core area of Hengshan District and West Jixi, including river rehabilitation, urban roads, water supply, wastewater management, and drainage system; (iii) Qitaihe—water supply, wastewater system, and public transport system improvements; and (iv) Shuangyashan—sustainable urban transport by building key missing road links, water supply, sewerage, and drainage systems.

12. The government has requested a regular loan of $310 million from ADB’s ordinary capital resources to help finance the project, of which $254 million will be used for the investment project components, and $56 million for the FIC. The loan will have a 25-year term, including a grace period of 5 years; an annual interest rate determined in accordance with ADB’s London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year (the interest and other charges during construction to be capitalized in the loan); and such other terms and conditions set forth in the draft loan and project agreements. Based on the custom-tailored repayment method, the average maturity is 15.20 years, and the maturity premium payable to ADB is 0.10% per year. The European Investment Bank (EIB) will provide loan cofinancing equivalent to $220 million, not administered by ADB. EIB will cofinance the expenditures in relation to civil works, equipment and its installation of outputs 3 and 4.

II. **THE TECHNICAL ASSISTANCE**

A. **Justification**

13. The attached technical assistance (TA) is designed to enhance the sustainability of SME development and non-coal diversification in the project cities by monitoring, detecting, and rectifying weaknesses of SME performance during the subloan implementation and the repayment period. It will also support the financial intermediaries and associated guarantee companies in implementing the environmental and social management system (ESMS). This will enhance the sustainability of the Asian Development Bank (ADB)-financed investment by strengthening the capacity of SMEs that benefit from subloans extended through the FIC of the proposed loan. The TA will reduce the risk of nonperforming SMEs loans through capacity

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1 Subsidence is lateral or vertical ground movement and failure caused by the underground coal mines.

2 EIB cofinancing will be on a joint collaborative basis and not administered by ADB. However, EIB will contribute to the financing of the same components and contracts as ADB. EIB approval is expected by Q1 2018.
development and implementation of corrective measures. It will enhance the capacity of the financial intermediaries for safeguard due diligence. The government requested ADB’s TA support, and it is essential to support private sector development and FIC implementation in the project cities complementary to activities financed by the proposed loan.

B. Outputs and Activities

14. The TA will monitor, detect, and rectify weaknesses through action planning and capacity development facilitating the implementation of corrective measures of SME performance during subloan implementation and repayment period.

15. **Output 1: Small- and medium-sized enterprises performance and identification of weaknesses during the subloan repayment period monitored.** This will analyze strengths and weaknesses of SMEs’ subproject implementation balance sheets, audited financial statements, financial management, sales, marketing and product technology, and competitiveness in the marketplace. Performance issues will be detected early during regular visits and assessments, which will take place quarterly during project implementation and semiannually thereafter.

16. **Output 2: Small- and medium-sized enterprises performance improvement action plan and capacity building plan developed.** This will require close cooperation with the SMEs concerned and involves, preparing scenarios and an action plan with corrective measures to bring subprojects and companies back on track, help achieve their performance targets, and reduce the risk of subproject and company failure.

17. **Output 3: Capacity of small- and medium-sized enterprises in implementing corrective measures improved.** This will provide hands-on training and consulting support to SMEs to help them implement the action plan. It will deliver capacity building in key disciplines that may include business management, accounting, budgeting, customer relations, human resource development, technical, production, and others as needed.

18. **Output 4: Capacity of financial intermediaries in implementing the environmental and social management system improved.** This will improve skills of the financial intermediaries in green and inclusive financing, and the capacity of their environmental and social units, which are to be established for the project. The output will include training on ESMS implementation—e.g., screening, categorization, monitoring of environmental and social safeguard issues of SMEs, and subloan proposals—and support the preparation of safeguard due diligence as well as monitoring and reporting to ensure compliance with ADB safeguard policies during implementation.

C. Cost and Financing

19. The TA is estimated to cost $800,000, of which $450,000 will be funded from the Technical Assistance Special Fund-Other Sources, and $300,000 will be financed on a grant basis by the Financial Sector Development Partnership Special Fund. The key expenditure items are listed in Appendix 1. The city governments will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, and other in-kind contributions.

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3 The TA was requested by the Heilongjiang Provincial Government during the ADB TA review mission on 21–24 February 2017, and the request was reiterated during the ADB fact-finding mission on 27 March–7 April 2017.

4 Established by ADB. Financing partner: the Government of Luxembourg.
D. Implementation Arrangements

20. ADB will administer the TA. Its East Asia Department will select, supervise, and evaluate the consultants. The Heilongjiang Provincial Government and the project cities will be the implementing agencies of the TA. The Heilongjiang Development and Reform Commission and the Heilongjiang Finance Department will be coordinating TA implementation. The project steering committee—chaired by the deputy director general of the reform commission and comprising officials from the Heilongjiang Finance Department, representatives of the project cities, and financial intermediaries—will provide guidance on TA implementation. The project cities will be implementing the TA in coordination with the financial intermediaries.

### Table 1: Implementation Arrangements

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicative implementation period</td>
<td>March 2018–February 2023</td>
</tr>
<tr>
<td>Executing agency</td>
<td>Heilongjiang Provincial Government</td>
</tr>
<tr>
<td>Implementing agencies</td>
<td>HMG, JMG, QMG, SMG, HBC, and LBC</td>
</tr>
<tr>
<td>Consultants</td>
<td>To be selected and engaged by ADB</td>
</tr>
<tr>
<td>QCBS</td>
<td>46 person-months $650,000</td>
</tr>
<tr>
<td>ICS (social and resettlement safeguard and ESMS specialist)</td>
<td>6 person-months $50,000</td>
</tr>
<tr>
<td>ICS (environmental safeguard and ESMS specialist)</td>
<td>6 person-months $50,000</td>
</tr>
<tr>
<td>Advance contracting</td>
<td>The contracts proposed for advance contracting include (i) social and resettlement safeguard and ESMS specialist; and (ii) environmental safeguard and ESMS specialist.</td>
</tr>
<tr>
<td>Disbursement</td>
<td>The TA resources will be disbursed following ADB’s <em>Technical Assistance Disbursement Handbook</em> (2010, as amended from time to time).</td>
</tr>
</tbody>
</table>


21. **Consulting services.** The consultants will be engaged by ADB in accordance with the Guidelines on the Use of Consultants (2013, as amended from time to time).

22. **Cofinancier requirements.** The monitoring and reporting requirements specific to the trust fund include the preparation and submission of semiannual progress reports.

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5 Terms of reference for consultants (accessible from the list of linked documents in Appendix 2).
### COST ESTIMATES AND FINANCING PLAN
($’000)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>E. Technical Assistance Special Fund (TASF-other sources)</strong></td>
<td></td>
</tr>
<tr>
<td>1. Consultants</td>
<td></td>
</tr>
<tr>
<td>a. Remuneration and per diem</td>
<td></td>
</tr>
<tr>
<td>i International consultants</td>
<td>122.0</td>
</tr>
<tr>
<td>ii National consultants</td>
<td>225.0</td>
</tr>
<tr>
<td>b. Out-of-pocket expenditures</td>
<td></td>
</tr>
<tr>
<td>i International and local travel</td>
<td>32.0</td>
</tr>
<tr>
<td>ii Training, seminars, and conferences</td>
<td>22.0</td>
</tr>
<tr>
<td>iii Reports and communications</td>
<td>12.0</td>
</tr>
<tr>
<td>2. Surveys</td>
<td>10.0</td>
</tr>
<tr>
<td>3. Contingencies</td>
<td>27.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>450.0</strong></td>
</tr>
<tr>
<td><strong>F. Financial Sector Development Partnership Special Fund</strong>&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>1. Consultants</td>
<td></td>
</tr>
<tr>
<td>a. Remuneration and per diem</td>
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<tr>
<td>i International consultants</td>
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<tr>
<td>ii National consultants</td>
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<tr>
<td>b. Out-of-pocket expenditures</td>
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<tr>
<td>i International and local travel</td>
<td>20.0</td>
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<tr>
<td>ii Training, seminars, and conferences</td>
<td>20.0</td>
</tr>
<tr>
<td>iii Reports and communications</td>
<td>8.0</td>
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<tr>
<td>2. Contingencies</td>
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</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>300.0</strong></td>
</tr>
</tbody>
</table>

Note: The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, and other in-kind contributions. The value of government contribution is estimated to account for 6.25% of the total TA cost.


Source: Asian Development Bank estimates.
LIST OF LINKED DOCUMENTS
http://www.adb.org/Documents/LinkedDocs/?id=49021-002-TAResport

1. Terms of Reference for Consultants