ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 40517
September 2008

Proposed Loans and Technical Assistance Grant People's Republic of Bangladesh: Public–Private Infrastructure Development Facility

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 5 September 2008)

Currency Unit	–	taka (Tk)
Tk1.00	=	$0.01459
$1.00	=	Tk68.50

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ADP	–	*adivasi* development plan
BPDB	–	Bangladesh Power Development Board
DESA	–	Dhaka Electric Supply Authority
DFI	–	development finance institution
EIA	–	environmental impact assessment
EMP	–	environmental management plan
EMS	–	environmental management system
ESS	–	environmental and social safeguards
ESSF	–	environmental and social safeguards framework
ESSMU	–	Environmental and Social Safeguards Management Unit
FDI	–	foreign direct investment
GDP	–	gross domestic product
IDB	–	Islamic Development Bank
IDCOL	–	Infrastructure Development Company Limited
IEE	–	initial environment examination
IPFF	–	Investment Promotion and Financing Facility
LIBOR	–	London interbank offered rate
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
PGCB	–	Power Grid Company of Bangladesh
PICOM	–	private infrastructure committee
PMU	–	project management unit
PPIDF	–	Public–Private Infrastructure Development Facility
PPMS	–	project performance monitoring system
PPP	–	public–private partnership
PSIDP	–	Private Sector Infrastructure Development Project
PSIG	–	private sector infrastructure guidelines
PSTN	–	public-switched telephone network
REB	–	Rural Electrification Board
RES	–	renewable energy system
SDR	–	Special Drawing Rights
SEAR	–	short environmental assessment report
SHS	–	solar home system
SMIP	–	small and medium-sized infrastructure subproject
SOE	–	statement of expenditure
SSAR	–	short social assessment report
SSF	–	social safeguard framework
TA	–	technical assistance

WEIGHTS AND MEASURES

A (ampere)	–	unit of current
kV (kilovolt)	–	1,000 volts
kWh (kilowatt-hour)	–	1,000 watt-hours
MVA (megavolt-ampere)	–	1,000 kilovolt-amperes
MW (megawatt)	–	1,000 kilowatts
VA (volt-ampere)	–	unit of reactive power
W (watt)	–	unit of active power
Wh (watt-hour)	–	unit of energy

NOTES

(i) The fiscal year (FY) of the Government and the Infrastructure Development Company Limited ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2008 ends on 30 June 2008.

(ii) In this report, "$" refers to US dollars.

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LOAN AND PROJECT SUMMARY

Borrower	People's Republic of Bangladesh
The Proposal	The proposed Public–Private Infrastructure Development Facility (PPIDF) includes an $82 million loan from the Asian Development Bank's (ADB)'s ordinary capital resources (OCR), an $83 million equivalent loan from ADB's special funds resources and a technical assistance (TA) grant of $500,000 for capacity building and supporting project implementation.
Classification	Targeting classification: General intervention Sector: Multisector (transport and communications; water supply, sanitation, and waste management; energy) Subsectors: Roads and highways, water supply and sanitation, energy sector development Themes: Sustainable economic growth, private sector development, capacity development Subthemes: Fostering physical infrastructure development, private sector investment, and institutional development.
Environment Assessment	The PPIDF is classified as category FI in accordance with ADB's *Environment Policy* (2002). An environmental and social safeguards framework has been developed to assist in the environmental and social safeguards assessment of subprojects during implementation of the Project and to ensure compliance with all relevant ADB policies.
Project Description	Component A will use ADB's OCR funds of $82 million to provide financing to the Government of Bangladesh (the Government) for relending to the Infrastructure Development Company Limited (IDCOL) to finance private sector-sponsored large infrastructure subprojects with a subproject size of more than $30 million. Component B will provide Asian Development Fund (ADF) support of $50 million equivalent to the Government for relending in local currency to IDCOL to finance small and medium-sized infrastructure subprojects primarily located in rural and semiurban areas, especially in the energy sector. IDCOL's total exposure to an individual small and medium-sized infrastructure subproject will not exceed $10 million. Component C will provide ADF funding of $33 million equivalent for the purpose of promoting renewable energy systems in Bangladesh. IDCOL will finance the set-up of renewable energy systems such as solar home systems and/or biomass installations through a microfinance-based, direct sales program.
Rationale	Over the last few years, public investments in the infrastructure sector in Bangladesh have remained stagnant, consisting of only 6%–7% of gross domestic product. The Global Competitiveness Report 2007–2008 ranked Bangladesh 120 out of 131 countries for its quality of infrastructure. Persistent neglect of public infrastructure services has hampered domestic economic growth and restrained

Bangladesh from living up to its full potential from a regional standpoint of being able to assume the role of a transport and transshipment hub for the subregion. Furthermore, inadequate infrastructure limits the country's opportunities for integrating economically with its neighbors. To meet the growth targets of the Government, the current level of investments in infrastructure has to be raised substantially.

Cognizant of its role in the changing economic and technological climate for catalyzing infrastructure development, the Government is pursuing infrastructure development through (i) developing the requisite legal and regulatory frameworks and contractual arrangements; (ii) thorough planning and coordination, particularly with respect to the public–private interface; and (iii) assuring the quality of infrastructure. In pursuit of these, policy actions have been taken across sectors for reducing risks and by enhancing the enabling environment, thereby providing stability to long-term cash flows and assisting in building capacity for project appraisal to facilitate financing.

IDCOL is the only financial institution in Bangladesh which is mandated and specializes in providing long-term debt financing for infrastructure and renewable energy. The recent strengthening of IDCOL's balance sheet (through several capital injections by the Government) to support the company's expansion plans and growing balance sheet demonstrates the Government's intention to continue supporting the company and its mandate. At present, no other financial institution in Bangladesh is in a position to catalyze international funds and know-how for infrastructure financing.

The proposed PPIDF will directly support the Government's infrastructure development agenda by providing (currently scarce) long-term funds for infrastructure financing. With ADB's assistance through the facility, IDCOL will be able to provide funds at commercial terms with maturity of more than 20 years for infrastructure subprojects, which are otherwise currently not available from the market.

The Project is an integral part of ADB's sector strategy and complements ADB's parallel initiatives in governance, capital markets developments, and the promotion of public–private partnerships (PPP), all of which contribute to creating an enabling environment for infrastructure development in Bangladesh.

Impact and Outcome

The impact of the PPIDF will be an improved infrastructure sector in Bangladesh through increased private sector participation, thereby promoting economic growth and reducing poverty. Private participation offers significant potential to speed up the pace of infrastructure development, expand access, and deliver efficient services. The design of the PPIDF serves to attract commercial financing, thereby reducing the pressure on the public budget.

Private sector participation will also introduce new technologies and help increase the efficiency of the infrastructure sector by ensuring commercial orientation and discipline at the subproject level. The PPIDF's outcome is to help address the infrastructure deficiencies in Bangladesh through providing long-term debt financing and catalyzing private sector participation.

It is estimated that the $165 million facility will help catalyze investments of about $600 million from the private sector to finance approximately 15–20 PPP subprojects, which will add at least 900 megawatts (MW) of power generation capacity in the private sector and provide electricity to approximately 100,000 additional households through IDCOL's renewable energy programs. The main targets and indicators are (i) the number of high-quality and viable infrastructure assets sponsored by international and local firms, and (ii) the financing of roughly 100,000 SHSs, 15 biomass installations, and 100 biogas power plants covering all regions of Bangladesh. PPIDF also seeks to develop capacity of IDCOL to (i) appraise subprojects, (ii) manage the renewable energy program, and (iii) implement the environment and social safeguards framework. In addition, line ministries will be supported to develop PPP frameworks.

Financing Plan

The financing plan assumes that IDCOL will provide financing up to its maximum allowed investment limit of 40% of total subproject cost to each subproject (while the sponsor will be required to inject at least 20% equity), therefore catalyzing 60% from private sector sponsors and other financial institutions. Typically, IDCOL's share will be smaller, varying between 10% and 30%, to reflect the fact that most infrastructure transactions are financed by a consortium of financial institutions, and IDCOL will be just one among many. Hence, IDCOL's catalytic effect is expected to be much larger.

Financing Plan
($ million)

Source	**Foreign Exchange**	**Local Currency**
Asian Development Bank (OCR)	82.0	0.0
Private Sector Sponsors and Banks (large subprojects)	328.0	0.0
Asian Development Bank (ADF)	83.0	0.0
Private Sector Sponsors and Banks (SMIPs and renewable energy)	0.0	332.0
Islamic Development Bank	85.0	15.0
Total	**578.0**	**347.0**

ADF = Asian Development Fund, OCR = ordinary capital resources, SMIP = small and medium-sized infrastructure subproject.

Parallel Financing

The Islamic Development Bank (IDB) has allocated concessional financing of $15 million on similar terms as ADB's ADF loan for IDCOL's solar energy program. Based on a further review of a well-developed pipeline of large power and infrastructure subprojects, IDB is processing an OCR-type funding of up to $85 million for the financing of eligible large infrastructure subprojects. Approval by IDB's board is expected to be obtained by January 2009. IDB's cofinancing will be provided under a parallel cofinancing arrangement.

Facility Amount and Terms

(i) Lending terms of component A (large infrastructure subprojects)

The OCR loan will be provided to the Government with a 25-year term, including a 5-year grace period, an interest rate determined in accordance with ADB's London interbank offered rate-based lending facility, a commitment fee of 0.15% per annum, and such other terms and conditions as set forth in the loan agreements. The OCR loan proceeds will be relent to IDCOL in dollars. The relending rate will be the London interbank offered rate plus 100 basis points for a term of 20 years for the purpose of foreign currency disbursements pursuant to a subsidiary loan agreement with such other terms and conditions acceptable to ADB.

Onlending by IDCOL to eligible subprojects will be at interest rates that reflect IDCOL's cost of funds plus a spread to cover transaction costs and risks. Subloans will be on full commercial and competitive terms at IDCOL's discretion.

(ii) Lending terms of component B (small and medium-sized infrastructure subprojects)

The ADF loan will be provided to the Government as Special Drawing Rights equivalent in a suitable currency and relent to IDCOL in taka. The ADF loan will have a term of 32 years, including a grace period of 8 years and an interest charge of 1.0% per annum during the grace period and 1.5% per annum thereafter. The Government will make the loan available to IDCOL under a subsidiary loan agreement at the relending rate of the Bangladesh Bank Rate with a term of 20 years. IDCOL will onlend the proceeds from the ADF loan under this component at market rates. The Government will bear the foreign exchange risk.

(iii) Lending terms of component C (renewable energy subprojects)

The ADF loan will be provided to the Government as Special Drawing Rights equivalent in a suitable currency and relent to IDCOL in taka. The ADF loan will have a term of 32 years, including a grace period of 8 years and an interest charge of 1.0% per annum during the grace period and 1.5% per annum thereafter. The Government will make the loan available to IDCOL at a fixed rate of 3% or such higher rate as may be necessary to ensure that IDCOL's onlending spread to its sub-borrowers is not more than 300 basis points, under a subsidiary loan agreement with a term of 20 years. The proposed onlending terms reflect current market rates for this type of intervention (the financing of renewable energy installations in rural areas in Bangladesh). The Government will bear the foreign exchange risk.

Loan Closing Dates

The loan closing date for the OCR loan and the ADF loan will be 31 December 2013.

Subproject and Sub-Borrower Selection Criteria

Each subproject and sub-borrower will satisfy at all times the subproject and sub-borrower selection criteria which include, inter alia, appraisal for technical, economic, and commercial viability. In addition, each sub-borrower will (i) be selected in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time); (ii) have adequate resources and financial capability to raise resources to complete and operate the relevant qualified subproject successfully; (iii) not be in default on any prior loan to any participating members of the consortium including IDCOL or any bank or nonbank financial institution in Bangladesh; (iv) be able to provide security as required by the consortium of lenders; (v) maintain appropriate financial record of income and expenditure to the satisfaction of ADB and IDCOL; and (vi) comply with ADB's and national and state policies and laws, and regulations relating to environment, resettlement, and indigenous peoples.

Implementation Arrangements

The Ministry of Finance, acting through its Finance Division, will be the executing agency, and IDCOL will be the implementing agency of the Project. Policy direction and strategic oversight will be provided by IDCOL's board of directors. A project management unit will be established by IDCOL to monitor the screening and selection of subprojects. In addition, the project management unit will be responsible for developing and implementing a project performance monitoring system.

Procurement

For subprojects to be financed out of component A, IDCOL will require its sub-borrowers to adopt internationally competitive bidding procedures in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time) and the Government's guidelines, policies, and regulations.

For subprojects to be financed out of components B and C, ADB will encourage IDCOL to require its sub-borrowers to adopt international competitive bidding procedures in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time) when the amount of the investment is unusually large and economy and efficiency can be gained by following such procedures.

For procurement of goods and services to be financed by subloans out of the loan proceeds, the sub-borrower will ensure, and certify to ADB if requested, that goods and services obtained are suitable for the subloans, that the price paid is least-cost, and that account is taken of factors such as time of delivery, efficiency, and the reliability of goods.

Disbursement Arrangements

The Government will establish three imprest accounts with the Bangladesh Bank, one for the OCR loan (component A) and one for each of the two components under the ADF loan (components B and C). The initial amount deposited into each imprest account shall not exceed 10% of each loan or estimated expenditures for the first 6 months of project implementation, whichever is lower.

IDCOL as the implementing agency will be responsible for preparing disbursement projections, collecting supporting documents, preparing withdrawal applications and sending them to ADB in accordance with ADB's *Loan Disbursement Handbook* (2007, as amended from time to time), and such other arrangements as may be agreed between ADB and IDCOL. For disbursement amounts of less than $100,000, IDCOL can follow statement of expenditure procedures.

Technical Assistance

To enhance the sustainability of the PPIDF, ADB will provide TA of $500,000 for 1.5 years. The main objectives of the TA are to (i) assist line ministries in the drafting of proper PPP frameworks in Bangladesh based on IDCOL's experience in financing private sector-led infrastructure projects when requested by those line ministries; (ii) provide the Government and its agencies with feedback about bottlenecks, issues, and concerns from the market and from private sector sponsors, and offer advice and solutions; (iii) conduct sector and industry studies; (iv) support the development of additional capacity within IDCOL to appraise subprojects, manage its expanding subproject portfolio, and supervise the implementation of its renewable energy program; (v) provide training to staff in relevant government agencies in credit and risk assessment, management, and mitigation; and (vi) provide training to IDCOL in the environmental and social assessment of subprojects.

Project Benefits and Beneficiaries

The Project will have a direct impact on poverty reduction by increasing farm and nonfarm productivity. Empirical evidence indicates a correlation between growth in provincial gross domestic product and poverty reduction. Investment in infrastructure as a whole and on roads and transportation in particular has a direct contribution to this reduction by (i) reducing transaction costs; (ii) enabling economic agents such as individuals, firms, and governments to respond efficiently to demand; (iii) lowering costs of inputs; (iv) opening up opportunities for entrepreneurs; (v) creating employment especially in public works both as social protection and as a countercyclical policy in times of recession; and (vi) enhancing human capital by improving access to health and education.

Risks and Assumptions

Effective Demand. A strong pipeline of private sector-sponsored infrastructure subprojects that could be eligible for IDCOL financing has been identified. The estimated volume of the expected funding for those subprojects is more than enough to absorb the proposed ADB loans to IDCOL. A significant number of these subprojects are priority investments designed to address crippling energy shortfalls, and ADB support through the PPIDF is perceived as critical to overcoming financing constraints and facilitating implementation.

Institutional Capacity. While IDCOL's staff strength of 36 is commensurate to the current level of operations, it might not be able to cope with additional and more complex activities, especially relating to large infrastructure subprojects. IDCOL currently outsources most of these activities. To address this concern, IDCOL has started to strengthen its subproject assessment capabilities and capacity and has initiated its own marketing program to source potential business opportunities. These activities will be further supported by the ADB TA. To improve its skill and capacity, IDCOL will also enter into strategic partnerships with international organizations involved in infrastructure investments, advisory services, and development of renewable energy.

Change in Government Policies. The current emphasis on private participation to boost infrastructure development and promotion of renewable energy may change. A change in government might lead to the implementation of more restrictive laws and policies concerning infrastructure project financing, foreign investment, currency exchange, and other matters, thereby affecting the ability of IDCOL to fund infrastructure subprojects. The risk of adverse policies being introduced is considered minimal since the Government is keen on pursuing infrastructure sector development through private sector participation. In addition, ADB's ongoing policy dialogue with the Government will facilitate adoption of progressive sector polices.

Governance. Good governance is an essential precondition for sustainable development in Bangladesh's infrastructure sectors. The Government has put good governance at the center of infrastructure sector reform policies. Various measures have been included in the Project's design to promote good governance and mitigate the risk of corruption by enhancing predictability, transparency, and accountability in doing business. These measures include professional management of IDCOL and continued commercialization and financial strengthening of IDCOL. In addition, IDCOL's organizational structure and business processes have been thoroughly assessed to determine vulnerability to corruption. A risk assessment has been undertaken and the Project design, implementation arrangements, and legal arrangements include appropriate risk mitigation measures.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on two proposed loans to the People's Republic of Bangladesh for the Public–Private Infrastructure Development Facility (PPIDF). The report also describes the proposed technical assistance (TA) for Capacity Development for the Infrastructure Development Company Limited (IDCOL) and if the Board approves the proposed loans, I, acting under the authority delegated to me by the Board, will approve the TA. The design and monitoring framework is included in Appendix 1.

II. RATIONALE: SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES

A. Performance Indicators and Analysis

1. Overall Performance

2. Over the last 4 years (FY2004–FY2007) Bangladesh has witnessed remarkable economic growth, with an average real gross domestic product (GDP) growth rate of 6.3% per annum and an annual GDP growth rate of 6.2% in FY2008. This performance, coupled with an impressive decline in the population growth rate from 2.5% in the 1980s to 1.7% in 1990–2004, has led to a doubling of annual per capita GDP growth, from 1.6% in the 1980s to 3.3% in 1990–2004. However, to keep the positive momentum going, and to achieve the Millennium Development Goals income poverty targets, Bangladesh needs to accelerate its medium-term economic growth rate to at least 7%–8% per annum.[1]

3. While macroeconomic management—measured by fiscal deficit, inflation, and foreign exchange reserves—has seen moderate success, public investments in infrastructure have remained stagnant at only 6%–7% of GDP. Of the 131 developing and industrialized countries ranked by the Global Competitiveness Report 2007–2008,[2] Bangladesh ranked 120th for quality of infrastructure, which was lower than most other developing countries in South Asia with the exception of Nepal.[3] Lack of public investment in infrastructure could not be covered through foreign direct investments (FDI). Political uncertainty, poor infrastructure, and a weak business environment have deterred investments. The inward FDI potential and performance indices of the United Nations Conference on Trade and Development indicate FDI inflows of only $625 million in 2006 (10% less than in 2005).

4. Infrastructure obstacles are a major problem for the economy of Bangladesh.[4] Many years of underinvestment have taken a toll and resulted in poor access to basic infrastructure for a large part of Bangladesh's population, particularly the economically disadvantaged and those in rural areas. Although 60% of urban households have an electricity connection, only 22% of rural households do.[5] Sixty nine percent of enterprises in rural areas report no access to electricity at all. Of those which have access to electricity, frequent power outages and surges pose significant costs to enterprises, with only 1.8% of the roughly 3 million rural enterprises owning a generator. Poor road conditions and lack of transportation and means of communication (only 1.5% reported to have access to a fixed-line telephone service) add to the

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1 ADB. 2005. *Country Strategy and Program (2006–2010): Bangladesh*. Manila.
2 World Economic Forum. 2008. *The Global Competitiveness Report 2007–2008.* Geneva. Also available: http://www.weforum.org/en/initiatives/gcp/index.htm.
3 India was ranked 67, Pakistan 72, Sri Lanka 73 and Nepal 128.
4 World Bank. 2007. *Bangladesh: Strategy for Sustained Growth*. Dhaka.
5 World Bank. 2000. *Voices of the Poor*. Washington, DC. Oxford University Press.

costs for Bangladesh's economy and leave the potential for growth in rural areas unfulfilled. Access to hygienic sanitation and safe water is alarmingly inadequate. In addition, Bangladesh cannot reach its full potential to be a transport[6] and transshipment hub, and this limits the country's opportunities for economic integration with its neighbors. An assessment of key infrastructure sectors can be found in Appendix 2.

5. Historic underinvestment in infrastructure (with the infrastructure stock per capita growing at only 1.2% annually) means that huge investments in power, gas, ports, roads, railways, and water supply and sanitation are required. Investments required by 2015 for new power generation and transmission are estimated at $6.4 billion; nearly $7.7 billion will be required for exploring and developing additional gas reserves during the same period, and significant investments are envisaged for the development of the coal sector. About half of these estimated investments are expected from the private sector and the balance from the Government of Bangladesh (the Government) and development partners.

6. The private sector in Bangladesh has already made important and innovative contributions in the provision of infrastructure services, particularly in telecommunications, power, water, and sanitation. In telecommunications, the six private companies currently reach about 29 million subscribers, compared to 1.3 million by the Bangladesh Telegraph and Telephone Board. In the water and sanitation sector, contributions include privately financed hand pump programs, water vending in Dhaka, efforts by nongovernment organizations (NGO) to extend formal water services to urban slum areas, and the provision of credit by microfinance institutions for the development of water systems in rural and semiurban areas. In the power sector, independent power producers presently produce about 38% of the total national generation.

B. Analysis of Key Problems and Opportunities

7. As it is the case in most of South Asia, the public sector has been the main provider of basic infrastructure in Bangladesh. However, public financing alone will not be able to generate the investments needed to provide the required level of infrastructure facilities.[7] At present, most public service providers show weak financial performance and inadequate investment. To enhance the role of the private sector in the provision of infrastructure services, the Government is (i) revising policies and regulations across sectors for enhancing private sector participation in infrastructure development including through public–private partnership (PPP),[8] (ii) enabling arrangements for bridging the enormous deficit in infrastructure financing especially for long-term funds through all possible sources, and (iii) strengthening the capacity at all levels. While the Government has pursued reforms for establishing a framework conducive to infrastructure development and broadening the range of financing modalities, significant scaling up of infrastructure development still faces formidable challenges in the adaptation and implementation of those reforms.

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[6] As a result of inadequate transport infrastructure, the average cost of exports is estimated to be 80% higher and for imports 35% higher than for most countries in South Asia.

[7] The Government's underinvestment in infrastructure is largely attributable to the very low level of government revenue collection (currently less than 11% GDP compared with a South Asian average of 19%).

[8] PPP projects are typically projects developed, implemented, and operated by bidders (stand-alone special purpose vehicles). Further, these projects have been selected on the basis of a competitive and transparent bidding arrangement and are expected to be build-and-operate infrastructure based on a concession with the Government.

1. Private Sector Infrastructure Guidelines

8. To enhance private infrastructure development, the Government issued the Private Sector Infrastructure Guidelines (PSIG)[9] in October 2004. The guidelines formally acknowledge the positive impacts of the private sector in telecommunications, gas, and power, and seek to translate this success to other sectors. Further, the PSIG identifies that the lack of guidelines and operating procedures in sourcing and developing potential infrastructure projects impedes private sector participation. Accordingly, the PSIG provide for a national high-profile private infrastructure committee (PICOM) under the prime minister's office to facilitate and promote private infrastructure projects, while the Board of Investment acts as PICOM's secretariat. Infrastructure projects initiated by private sponsors or line ministries require Government approval to be listed as a private infrastructure project. Based on PICOM's analysis and recommendation, the cabinet committee on economic affairs approves the project, following which PICOM oversees its implementation by the executing agency. PICOM does not have any approval authority but facilitates and monitors private infrastructure projects.

9. While the PSIG provide broad guidelines for PPPs and lay down the basic principles, they lack the details usually found in a national PPP framework. While earnest efforts have been made to upgrade the existing PPP guidelines, no detailed PPP framework has emerged so far. Some infrastructure sectors—in particular those that have been very successful in integrating the private sector in their development like gas, power, and telecommunications—have set up sector-specific private sector policies.

2. Key Infrastructure Sector Reforms

10. To catalyze infrastructure development, the Government is (i) developing legal and regulatory frameworks and contractual arrangements, (ii) enhancing planning and coordination, and (iii) ensuring quality of infrastructure. To pursue these, policy actions and reforms (Table 1) have been taken across sectors to reduce risks and to strengthen the enabling environment.

Table 1: Policies and Reforms in Infrastructure Sectors

Sector	Policies and Reforms
General Transport	National Land Transport Policy, 2004, to encourage greater private sector participation. A private sector participation policy for the shipping sector is being considered.
Roads	Road master plan, which emphasizes the importance of private sector involvement, being considered for approval. Most of the potential private sector projects under the road master plan are planned on a build–operate–transfer basis with concession periods of 25–30 years.
Inland Water Transport	In 2005, the Government declared 13 land custom stations as land ports to be bid out under build–operate–transfer arrangements to the private sector. In March 2007, the Chittagong Container Terminal was handed over to a private operator, which has resulted in a 30% cost reduction so far.

[9] Prime Minister's Office, Government of the People's Republic of Bangladesh. 2004. *Bangladesh: Private Sector Infrastructure Guidelines.* Dhaka. Also available: http://www.boi.gov.bd/psig-bgd.pdf.

Sector	Policies and Reforms
Railways	Various activities, such as information technology and ticketing of Bangladesh Railway, have been outsourced to the private sector. A railway sector investment program is ongoing with ADB's assistance to improve Bangladesh Railway's operational and financial performance.
Urban Transport	A strategic transport plan with a time frame of 20 years was commissioned in 2005 by the Dhaka Transport Coordination Board. The plan proposes the building of three subway lines and three bus rapid transit schemes in Dhaka.
Water and Sanitation	A sector development program for the water and sanitation sector was issued in 2006 to ensure minimum service for all citizens through decentralization and capacity building of local governments. A partnership framework on urban water and sanitation sector reforms was signed by the Government and major donors, including ADB, in November 2007.
Power	A Power Cell was created as the focal point for private sector investment in the power sector in 1995, and a private sector power generation policy for Bangladesh was established in 1996. A vision and policy statement on power sector reforms was issued in 2000 to provide reliable electricity supply to the entire population by 2020. A 3-year road map for power sector reforms, which contains private sector participation as one of the main strategic pillars, was issued in 2006. A sustainable power sector development program linked to the road map for power sector is ongoing under ADB assistance.
Renewable Energy	A national energy policy suggests the establishment of a renewable energy development agency as the focal point for the development and diffusion of renewable energy technologies.

ADB = Asian Development Bank.
Source: Asian Development Bank.

11. Notwithstanding the progress, these reforms can be characterized, at best, as work in progress. Development partners are unanimous that sustained and significant improvements in the enabling environment are necessary, and this will require development partners to work closely with the Government in pursuing these reforms. Asian Development Bank (ADB) is already supporting the reforms through a number of interventions (paras. 26–27).

3. Governance Challenges

12. Bangladesh's economy is widely regarded as suffering from issues related to governance. Despite progress in many social indicators, perceived widespread corruption adds to the costs of doing business and reduces the nation's competitiveness and attractiveness for FDIs. Significant governance challenges in Bangladesh occur at three levels—national, sector, and corporate. Through the good governance program,[10] ADB is (i) strengthening the ongoing

[10] ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the People's Republic of Bangladesh for the Good Governance Program*. Manila. As a prelude to this project, ADB provided technical assistance through (i) ADB. 2003. *Technical Assistance to the People's Republic of Bangladesh for Supporting Good Governance Initiatives*. Manila, and (ii) ADB. 2005. *Technical Assistance to the People's Republic of Bangladesh for Supporting Good Governance Initiatives II*. Manila. These were meant to promote medium- to long-term development of collective anticorruption efforts at various institutions and to enhance the capacity of the Anticorruption Commission.

consensus-building on good governance, integrity, and anticorruption reforms; (ii) supporting judicial reforms with a focus on the performance, transparency, and accountability of the judiciary, particularly on its role in the anticorruption agenda; (iii) strengthening the role and reach of the Anticorruption Commission to better fight corruption; and (iv) bringing good governance and anticorruption initiatives into the mainstream within selected sector-level agencies to enhance their effectiveness.

13. Public procurement procedures that are universally associated with high levels of corruption are being addressed by ADB, the World Bank, and other development partners. The Parliament passed the Public Procurement Act in 2006. The Government has recently demonstrated strong commitment to pursuing critical governance reforms with focus on combating corruption, ensuring the effectiveness and independence of the judiciary, and depoliticizing the civil service. It has already reconstituted the Anticorruption Commission with new commissioners, framed new laws to tackle corruption, taken tough legal and prosecutorial actions, and ratified the United Nations Convention Against Corruption.

4. Infrastructure Financing

14. The inability to mobilize debt for infrastructure projects is a key impediment to infrastructure financing. As debt accounts for nearly 75% of a typical financing package, its availability in terms of volume and maturities necessary for large-scale infrastructure projects is a binding constraint in many developing countries, and particularly in Bangladesh, where constraints to long-term debt mobilization are compounded by the nation's lack of credit rating.[11] Furthermore, with a balance of payments problem, Bangladesh cannot rely exclusively on foreign capital to finance its infrastructure. International commercial banks have exposure limits to countries and sectors, and find it difficult to lend at maturity terms suitable for infrastructure projects (12–15 years or more) given the market and political risks in Bangladesh. With an underdeveloped financial sector, Bangladesh is likely to face severe constraints in securing long-term foreign and domestic funding for private sector infrastructure projects.

a. Underdeveloped Capital Market

15. Bangladesh’s capital market—the market for trading long-term debt and equity securities, consisting of primary and secondary markets—remains underdeveloped. So far, the volume of funding sourced from the local debt and equity market for private investment expenditure in Bangladesh has been quite small. The absence of an active long-term corporate debt market in Bangladesh adds to the dearth of financing for infrastructure from domestic sources. Private sector sponsors still rely more on banks and internal resources than on market borrowings, indicating weakness in debt markets. Commercial banks also prefer loans to investing in bonds as there is no mark-to-market[12] requirement for loans, whereas bonds are subject to the mark-to-market rule and as a result require provisioning for downward adjustment in valuation. In response to these, commercial banks charge floating rates for infrastructure loans as a matter of general practice. This effectively makes a loan a short-duration instrument. The pivotal impediment to the development of a debt market lies in the extraordinarily high-yield structure

[11] At present, Bangladesh does not have a sovereign rating issued by any international rating agency.
[12] Mark-to-market is the assigning of a value to a position held in a financial instrument based on the current market price for that instrument.

on savings schemes such as the national savings certificates.[13] This artificially high-yield premium of savings schemes tends to drive up the cost of bank deposits and deter the issuance of market-priced private sector debt instruments.

b. Limited Providers of Long-Term Debt

16. Commercial banks in Bangladesh are facing maturity mismatches in their asset and liability management as they rely on short-term deposits as their financial source, and this prevents them from providing long-term financing for infrastructure projects. Therefore, most commercial banks focus on short-dated lending activities, in particular, to the emerging consumer finance sector. Also, loan officers of banks are typically not trained in assessing long-term stability of cash flows from a project finance perspective as they lack the technical ability to analyze and structure project finance transactions.

17. Other potential sources of debt, such as institutional investors like provident funds or insurance companies, are potentially an important source of demand for long-term debt. However, this investor class has limited market penetration in Bangladesh and is typically averse to undertaking equity-like risks often associated with long-term infrastructure debt financing in developing countries. Furthermore, if commercial lenders include the necessary risk premium to compensate fully for the perceived risks of the transaction, sponsors and/or governments will often deem the price prohibitive.

c. Reforms

18. The ongoing financial sector reforms focus on (i) greater autonomy for the Bangladesh Bank (the central bank), (ii) strengthening Bangladesh Bank's capabilities and technical skills to perform its enhanced responsibilities, (iii) strengthening prudential regulations and supervision, (iv) restructuring the management and internal processes of state-owned commercial banks and ultimately privatization, (v) strengthening the legal and judicial processes, and (vi) improving the money and debt markets. These reforms have been supported by the World Bank, the International Monetary Fund, and ADB.

19. The World Bank's Financial Institutions Development Project[14] has enhanced the government debt market from a market with limited maturities and literally no secondary trading to an active market with regular auctions for debt with maturities up to 10 years. In addition, simplification of market regulations to facilitate bond and security issues and rules and procedures for bonds and debentures were also developed and implemented. The World Bank is also strengthening the capacity of the Bangladesh Bank[15] and is reforming some nationalized commercial banks, leading to their privatization, under the Enterprise Growth and Bank Modernization Project[16] and Second Development Support Credit Project.[17] The progress on

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[13] National savings certificates are issued by the Government as part of its borrowing program targeted at retail investors. No interest is paid over the tenor of these instruments, which is typically 5 years. On redemption, all the proceeds are free of tax. The interest rate is currently approximately 10.6%.

[14] World Bank. 1999. *Financial Institutions Development Project*. Washington, DC.

[15] World Bank. 2003. *Central Bank Strengthening Project.* Washington, DC. This supports implementation of Bangladesh Bank's strengthening program by providing assistance in three major areas: legal framework, reorganization and modernization, and capacity building.

[16] World Bank. 2004. *Enterprise Growth and Bank Modernization Project*. Washington, DC.

[17] World Bank. 2003. *Second Development Support Credit*. Washington, DC.

key reforms have been integrated in the International Monetary Fund's Poverty Reduction Growth Facility.

20. The ADB-financed Capital Market Development Program[18] helped enhance the market capacity and develop a fair, transparent, and efficient domestic capital market in order to attract investment capital for augmenting the capital resources of the banking system and improve efficiency in allocating resources. More recently, an ADB TA loan[19] is supporting governance and capacity building of the capital market as well as the insurance sector.

21. While significant reforms and reform initiatives are under way, several regulatory challenges in infrastructure sectors persist, policy, institutional, and market gaps remain. The impact of the ongoing reforms in the financial sectors will only be realized during the medium- to long-term, and, as a result, the already significant gap in infrastructure financing will further increase. Addressing the prevailing market inadequacies and at the same time keep the infrastructure development agenda moving forward are important for Bangladesh.

C. Description of the Infrastructure Development Company Limited

22. Development partners recognize the role of infrastructure in inclusive development and poverty reduction in Bangladesh. Insufficient capacity across infrastructure sectors is widening infrastructure gaps, resulting in lower productivity, higher transport and logistics costs, and reduced competitiveness. Considering these, and specifically in the context of the magnitude of infrastructure investments required and the very limited supply of long-term resources, there is a need to catalyze increasing amounts of financing for bankable infrastructure projects that have emerged even when the reforms are evolving. There is a sufficient number of infrastructure projects in Bangladesh that need access to long-term financing for implementation. Enabling the financing of such projects by a consortium of investors and lenders will facilitate the deepening of project development and financing skills in the country and enhance private sector participation in infrastructure development. This is an essential element of the overall reforms for infrastructure development.

23. IDCOL is the only financial institution in Bangladesh that can catalyze international long-term foreign currency funding and international know-how for infrastructure finance. Incorporated on 14 May 1997 as a 100% government-owned public limited company under the Companies Act, 1994, IDCOL was set up with World Bank assistance under the Private Sector Infrastructure Development Project (PSIDP).[20] IDCOL's initial function was to administer the Private Sector Infrastructure Development Fund set up under the PSIDP initiative and to onlend funds to eligible privately sponsored infrastructure projects. Projects were designed to be

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[18] ADB. 1997. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the People's Republic of Bangladesh for the Capital Market Development Program*. Manila.

[19] ADB. 2006. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the People's Republic of Bangladesh for the Improvement of Capital Market and Insurance Governance Project.* Manila. Part 1 will enhance the governance and capacity of the capital market and target the regulator, stock exchanges, market practitioners, and investors. It reflects a continuing effort by ADB to help develop the domestic market, which will be critical if resources are to be mobilized to support private sector activity and promote economic growth. Part 2 will enhance the governance and capacity of the insurance sector as it will support Government-led reforms currently being pursued in the insurance sector. These twin efforts are being undertaken in parallel with a reform program supported by the International Monetary Fund and the World Bank aimed at strengthening Bangladesh's banking sector.

[20] World Bank. 1997. *Private Sector Infrastructure Development Project*. Washington, DC.

funded off-balance sheet, and IDCOL was eligible for some up-front and monitoring fees only; the principal and interest repayments were directly deposited to government repayment accounts. However, since 2005, IDCOL has widened its operation and started financing on its balance sheet after the Government injected further equity capital into the company.

24. Currently, the company's paid-up capital stands at Tk400 million ($.5.9 million). The Government has nominated seven board members from both the public and private sectors. Appendix 3 summarizes information on IDCOL including its board composition, business activities, lending policies, current projects under its management, and corporate governance structure, while Supplementary Appendix A provides the memorandum and articles of association of IDCOL. In general, the funding sources of IDCOL include its equity capital, reflows of outstanding loans from its project finance activities, and refinancing funds from donors. As of June 2008, IDCOL had an off-balance sheet lending portfolio of Tk7.7 billion ($112.4 million), an on-balance sheet lending portfolio of Tk1.2 billion ($17.5 million), and net earnings of Tk140.0 million ($2.1 million) during its FY2008. Although IDCOL can operate in many sectors, it has confined its activities to the infrastructure sectors in order to serve a niche market. Its product range is the financing of small, medium, and large infrastructure and renewable energy projects using funds from reflows of loans made under various donor-supported programs, and its own equity resources. Two local rating agencies[21] gave IDCOL AA and AA1 ratings, the highest rating given to any local financial institution. Appendix 4 provides the financial analysis of IDCOL. Supplementary Appendix B provides the financial due diligence report on IDCOL.

25. The recent strengthening of IDCOL's balance sheet through several capital injections by the Government demonstrates the Government's intention to continue supporting the company and its mandate and expanding its operations.

D. ADB's Strategy and External Assistance to the Infrastructure Sector

1. ADB's Sector Strategy

26. ADB's country strategy and program 2006–2010 for Bangladesh prioritizes the need for ADB's support of private sector-led infrastructure development. ADB support aims to address the critical constraints that impede broad-based economic growth, particularly by improving the investment climate for private sector-led growth and employment generation. The country and strategy program also states that ADB will contribute to the achievement of the pro-poor economic strategy of the Government by (i) developing and upgrading strategic transport corridors, (ii) increasing access and improving quality of energy supplies, and (iii) connecting the southwest region with the rest of the country. The National Poverty Reduction Strategy[22] also recognizes the importance of improving infrastructure in order to increase private sector investment and FDI inflows to the country.

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[21] The two local rating agencies are (i) Credit Rating Information and Services Limited incorporated in 1995, which has entered into a joint venture with Rating Agency Malaysia Berhad, Malaysia, and JCR-VIS Credit Rating Company Limited Pakistan for technical and equity support; and (ii) the Credit Rating Agency of Bangladesh, established in 2004, which has a technical collaboration agreement with International Credit Rating Agency Limited of India.

[22] Planning Commission, Government of the People's Republic of Bangladesh. 2005. *National Strategy for Accelerated Poverty Reduction.* Dhaka.

2. ADB's Sector Assistance

27. The energy sector is the largest infrastructure sector in Bangladesh in terms of the amount of assistance provided by ADB (see Supplementary Appendix C). ADB has provided 31 loans totaling $2.5 billion to this sector to date. ADB has also provided 43 TA projects, totaling about $21 million. Roads and highways constitute the second largest sector of ADB assistance, providing 18 loans totaling $1.4 billion and 19 TA projects totaling $13.4 million. ADB's sector assistance aims to address both critical infrastructure constraints and key sector reforms pursued by the Government. In addition, the good governance program (footnote 10) is bringing good governance and anticorruption initiatives into the mainstream within selected sector-level agencies to enhance their effectiveness. The ongoing TA loan for the Improvement of Capital Market and Insurance Governance Project (footnote 19) will help develop the domestic capital market for mobilizing resources to support private sector activity and promote economic growth.

3. External Assistance

28. As of September 2007, the World Bank's portfolio in the infrastructure sector of Bangladesh (including the International Development Association) consisted of 13 projects amounting to $1.1 billion.[23] In June 2006 the World Bank established a $60 million (of which $10 million is from the Government) Investment Promotion and Financing Facility (IPFF)[24] at Bangladesh Bank for part financing[25] of government-approved private sector infrastructure projects especially in the power sector.[26]

29. Japan and Germany are the other development partners with major infrastructure interventions in Bangladesh. As of June 2006, the Japan Bank for International Cooperation had committed eight projects for a total of ¥59,275 million ($531.92 million) mainly in power, water, telecommunications, and construction subsectors.[27] Germany has made financial commitments to Bangladesh amounting to €55.2 million ($78.8 million). Currently, German development cooperation through KfW has three infrastructure projects in its portfolio including (i) a transmission line which is cofinanced with ADB, (ii) rural markets and roads, and (iii) promotion of renewable energy.[28] The third of these (renewable energy) is currently being successfully implemented by IDCOL. A summary of the external assistance to the infrastructure sector in Bangladesh is provided in Appendix 5.

E. Lessons

30. A review carried out by ADB's Operations Evaluation Department on the performance of ADB's financial intermediation loans to development finance institutions (DFIs) highlighted

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[23] http://web.worldbank.org/external/projects/main?query=bangladesh&menuPK=51526214&pagePK=218616&piPK=217470&status=A&theSitePK=40941 (accessed 22 August 2008).

[24] World Bank. 2006. *Investment Promotion and Financing Facility.* Dhaka.

[25] Thirty percent of the cost of any approved project will be borne by the entrepreneur; 20% of the remaining 70% (14% of the total) to be financed by the participating financial institutions, and the remaining 56% from the Investment Promotion and Financing Facility.

[26] So far, disbursements amounting to Tk 1 billion ($14.6 million) were made for a power project financed by National Credit and Commerce Bank. Bangladesh Bank is currently reviewing 6 more applications—all for projects in the power sector.

[27] Japan Bank for International Cooperation. ODA Project Data. http://www.jbic.go.jp/english/oec/project/yen_loan_list.php (accessed 22 August 2008).

[28] KfW Entwicklungsbank. Projects in Bangladesh. http://www.kfw-entwicklungsbank.de/EN_Home/Countries_and_Projects/Asia/South_and_Central_Asia/Bangladesh63/Projects.jsp (accessed 22 August 2008).

governance issues including direct lending, weak credit analysis, deficiencies in the monitoring of projects, and pricing mismatches.[29] The need to strengthen ownership structures of DFIs and enhance the skills of credit assessment were among the critical remedial measures proposed by ADB's Operations Evaluation Department.

31. IDCOL is not a DFI but rather a long-term financier with the objective of operating on fully commercial terms independently of the Government, and for catalyzing private sector funds to the infrastructure sector. Given the small size and the underdeveloped nature of the financial markets in Bangladesh, development partners consider IDCOL as an appropriate intermediary, which focuses exclusively on infrastructure and is the only provider of long-term financing in the country. ADB carried out thorough due diligence to appraise the financial strength and credit-assessment capacity of IDCOL and found both satisfactory. In addition, a detailed review was conducted on corporate governance in Bangladesh and the structure in place at IDCOL. IDCOL's pipeline of transactions ready for financing is considered to be robust and extensive.

32. In addition to lessons learned from the ADB evaluation, World Bank's experience with IDCOL was also analyzed. World Bank approved in 1997 a loan and a TA of $225 million to the Government for the PSIDP in support of IDCOL, the Infrastructure Investment Facilitation Center, and other implementing agencies. The objective was to assist in infrastructure development in Bangladesh by promoting private sector participation. Under the project, IDCOL was established to assume the role of the fund manager on behalf of the Government. The Infrastructure Investment Facilitation Center was formed two years later to assist IDCOL in identifying, structuring, promoting, and procuring for suitable projects. Under the PSIDP, only approximately $80 million was disbursed. The project was closed in 2002 and was rated in the recently published implementation completion and results report[30] as moderately unsatisfactory. The key lesson drawn from the PSIDP is to allow flexibility in selection and financing of projects. The PSIDP was designed for majority private-owned greenfield projects. As a result, it excluded joint ventures, concessions, management contracts, PPPs, capacity extension, redevelopment, and social sector projects. The PSIDP also did not allow local currency transactions, which disadvantaged local sponsors.

F. Policy Dialogue and Development Partner Coordination

33. ADB's extensive support for infrastructure development is underpinned with sustained policy dialogue in coordination with development partners. In the transport sector, the ongoing policy dialogue aims to improve the capacity, governance, and accountability of Bangladesh Railway and to overcome capacity constraints for providing improved access to markets and services. Ongoing ADB TAs are facilitating further private sector investments and PPPs in the power sector[31] and to help ensure transparency and fairness in the tendering process.[32] In the gas sector, ADB has helped explore private sector participation,[33] and has also processed a

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[29] ADB. 2005. *Annual Evaluation Report on 2005 Annual Evaluation Review*. Manila.
[30] World Bank. 2007. *Implementation Completion and Results Report on a Loan to the People's Republic of Bangladesh for a Private Sector Infrastructure Development Project* . Washington, D.C.
[31] ADB. 2006. *Technical Assistance to Bangladesh for the Promotion of Private Sector Participation in the Power Sector*. Manila.
[32] ADB. 2007. *Technical Assistance to Bangladesh for the Tendering Process for Independent Power Producer Plants*. Manila.
[33] ADB. 2004. *Technical Assistance to Bangladesh for Promoting Private Sector Participation in the Energy Sector*. Manila.

loan[34] to support sector reforms and enhance the natural gas infrastructure in the country. In addition, preparatory work is ongoing for a proposed gas sector development program.[35] Policy dialogue in collaboration with development partners and emphasis on private sector participation are being pursued for expediting reforms and catalyzing resources.

34. For improving overall governance in the various infrastructure sectors, ADB support at the sector level has incorporated components that focus on good governance. This has meant that good governance is being brought into the mainstream in the sectors, which is also one of the key goals of the good governance program (footnote 10). Some sector projects and programs where this has been evident include, for example, the sustainable power sector development program,[36] the railway sector investment program,[37] and the Chittagong port trade facilitation project.[38] Furthermore, ADB interventions in the financial sector are being coordinated with the other development partners (paras. 28–29).

III. THE PROPOSED PROJECT

35. The PPIDF will directly support the Government's infrastructure development agenda through enhancing the availability of the much needed long-term funds for infrastructure financing. With ADB's assistance, the PPIDF will provide funds at commercial terms for maturities currently not being provided by the market. The PPIDF complements ongoing financial sector reforms, PPPs, and infrastructure projects, all of which aim to create an enabling environment for long-term financing for the infrastructure sector.

A. Impact and Outcome

36. The impact of the PPIDF will be an improved infrastructure sector in Bangladesh through increased private sector participation, thereby promoting economic growth and reducing poverty. Private participation offers significant potential to speed up the pace of infrastructure development, expand access, and deliver efficient services. The design of the PPIDF serves to attract commercial financing, thereby reducing the pressure on the public budget. Private sector participation will also introduce new technologies and help increase the efficiency of the infrastructure sector by ensuring commercial orientation and discipline a the subproject level. The PPIDF's outcome is to help address the infrastructure deficiencies in Bangladesh through providing long-term debt financing and catalyzing private sector participation. With ADB's assistance through the Project, IDCOL will be able to provide foreign exchange and local currency funds for infrastructure subprojects at commercial terms with a 20-year maturity currently not available in the domestic capital markets.

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[34] ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the People's Republic of Bangladesh for the Gas Transmission and Development Project.* Manila (Loans 2188/2189).
[35] ADB. 2007. *Technical Assistance to Bangladesh for Preparing the Gas Sector Development Program*. Manila.
[36] ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the People's Republic of Bangladesh for the Sustainable Power Sector Development Program.* Manila (Loans 2332/2333/2334-BAN).
[37] ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Multitranche Financing Facility and Technical Assistance Grant to the People's Republic of Bangladesh for the Railway Sector Investment Program.* Manila (Loans 2316/2317-BAN).
[38] ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the People's Republic of Bangladesh for the Chittagong Port Trade Facilitation Project.* Manila (Loan 2147-BAN).

B. Outputs

37. The design of the PPIDF builds on consultations with all stakeholders including the Government and IDCOL. The PPIDF is divided into three main components having different target groups and objectives. Component A will use ADB's ordinary capital resources (OCR) funds to provide dollar financing to the Government for relending to IDCOL to finance large private sector-sponsored infrastructure subprojects. Component B will provide Asian Development Fund (ADF) funding to the Government for relending in local currency to IDCOL to finance small and medium-sized infrastructure subprojects (SMIP) primarily located in rural and semiurban areas, especially in the energy sector. Component C will provide ADF funding for continuing IDCOL's successful renewable energy program. The Project design is explained in Appendix 6. Further details on the three Project components follow.

38. It is estimated that the $165 million facility will help catalyze investments of about $600 million from the private sector to finance approximately 15–20 PPP subprojects,[39] which will add at least 900 megawatts (MW) of power generation capacity in the private sector and provide electricity to approximately 100,000 additional households through IDCOL's renewable energy programs. The main targets and indicators are (i) the number of high-quality and viable infrastructure assets sponsored by international and local firms, and (ii) the financing of roughly 100,000 SHSs, 15 biomass installations, and 100 biogas power plants covering all regions of Bangladesh. PPIDF also seeks to develop capacity of IDCOL, among others, for project appraisal portfolio management, and environment and social safeguards due diligence.

1. Component A: Financing of Private Sector-Sponsored Large Infrastructure Subprojects

39. The proposed OCR loan of $82 million will be used to finance large-scale private sector-sponsored infrastructure subprojects with a total size of each subproject more than $30 million and should be an integral part of the Government's priority plan for the relevant sector. Paras. 70 and 71 provide further details on the selection criteria for sub-borrower and subprojects eligible for IDCOL financing under component A.

40. The eligible subsectors, which meet the Government's current priority plan, include (i) power generation, which—given the acute power shortage in the country—is expected to receive priority in terms of financing under this component of the PPIDF; (ii) roads and bridges; (iii) railways; (iv) ports (including seaports and airports); (v) gas and gas-related infrastructure; (vi) water supply, sewage, and solid-waste management; (vii) information technology; (viii) renewable energy; and (ix) other infrastructure development subprojects as may be approved by the Government, ADB, and IDCOL's board.

41. This component will enable IDCOL to provide dollar funding to cover up to 40% of the costs of an individual subproject while the subproject sponsor will be required to invest a minimum of 20% of the total subproject cost as equity, thereby better balancing the risk factors between the subproject sponsor and the Government via IDCOL. The remaining debt financing will be sourced from private sector financiers.

[39] IDCOL will finance subprojects only as a member of consortium where its total lending to any subproject does not exceed 40% of the total capital cost for the subproject.

42. The goal will be for IDCOL to play a catalytic role in attracting other commercial funding sources in order to fill the financing gap, as commercial banks and the domestic capital market cannot provide enough long-term project financing. Since these large infrastructure subprojects are normally financed in dollars with the help of a consortium of international banks, there is no need for the Government (or IDCOL) to swap the dollar proceeds from the OCR loan into any other currency.

2. Component B: Small and Medium-Sized Infrastructure Subprojects

43. Up to $50 million equivalent of the ADF loan will be provided to IDCOL for the purpose of financing SMIPs, primarily in the energy sector in rural and semiurban areas and other infrastructure sectors. Subprojects should require local currency financing, be financially viable on their own with robust and predictable cash flows, and meet the Government, ADB, and IDCOL environmental and social assessment requirements.

44. IDCOL's total exposure to an individual SMIP will not exceed $10 million. Sponsors of eligible SMIPs should preferably be from Bangladesh or have significant operations in the country and have a proven track record of successfully developing, financing, and operating similar infrastructure subprojects. Apart from the above specific requirements, the same selection criteria apply to component A as well as component B (paras. 70 and 71).

45. This component will enable IDCOL to provide financial support in taka for SMIPs which are being developed by local companies and sponsors. IDCOL will provide long-term funding denominated in local currency to those subprojects that typically earn revenues in taka and cannot absorb foreign exchange rate risks without unduly endangering their operating gross margin or debt service coverage ratios.

46. Debt finance for developers and sponsors of SMIPs is constrained in part because of the generally limited level of development of Bangladesh's financial sector and therefore unavailability of long-term local currency funding. It is also constrained because lenders perceive the risks associated with these activities as too high. This component will therefore address both the risk perception and credit availability.

3. Component C: Renewable Energy Subloans

47. The balance of the ADF loan, amounting to $33 million equivalent, will be used by IDCOL for the promotion of renewable energy systems (RES) in Bangladesh. IDCOL will finance the set up of RESs such as SHSs and/or biomass installations through a microfinance-based, direct sales program.

48. In particular, IDCOL will use the proceeds of the ADF loan to (i) provide loans to participating organizations to refinance up to 80% of the loans that rural households receive for the purchase of SHSs, (ii) provide loans to companies for biomass installations in rural or semiurban areas, and (iii) finance commercial or semicommercial biogas plants or biogas-based electricity plants. The objective of this component is to promote the use of environmentally friendly RESs in rural areas and support initiatives in rural areas through participating organizations for the productive use of electricity to increase household income.

49. IDCOL has been very successful in the recent past in undertaking renewable energy subprojects. The company had an initial target of financing 50,000 SHSs, which it achieved in August 2005, 3 years ahead of the target date and $2 million below estimated costs. Following

the success of IDCOL's solar program, the World Bank extended its support for financing renewable energy subprojects and German development cooperation through KfW provided €16.5 million ($21.3 million) in 2005 as a grant to the Government to be used for the further financing of renewable energy subprojects. As of April 2008, 200,000 SHSs with a capacity of 11 MW providing electricity to more than 1 million people have been installed under IDCOL's solar energy program.

50. IDCOL has now set an ambitious target to extend the program by installing more than 1 million SHSs by 2012. The implementation will be undertaken through 15 qualified participating organizations (Appendix 7 provides the eligibility criteria), which are primarily NGOs and microfinance institutions, to take advantage of their grassroots networks. Participating organizations select subproject areas and potential customers, extend loans, install the systems, monitor their performance, and provide maintenance support. IDCOL will provide grants and refinancing, set technical specifications for solar equipment, develop publicity materials, provide training, and monitor the performance of participating organizations. IDCOL currently offers local currency loans with a 10-year maturity and a 2-year grace period at 6% per annum interest to the participating organizations. The households will buy SHSs either for cash or on credit. Participating organizations then extend microcredit loans of up to 80% of the price of the SHS[40] to the households purchasing these systems. The loan tenor varies from 1 to 5 years, and interest rate varies from 8% to 15% per annum. In all instances, the periodic repayment is on a monthly basis.

51. The credit program will also be open to support wind energy, small hydropower subprojects and biomass installations, commercial and semicommercial biogas plants, biogas-based electricity plants, and other renewable energy subprojects developed by the private sector, NGOs, and communities. Appendix 8 provides a more detailed overview of IDCOL's renewable energy program. Subject to availability, the use of grant funds (for instance, through the application of funds from the Climate Change Fund and the recently established Clean Energy Financing Partnership Facility)[41] to complement the above activities will also be considered.

C. Infrastructure Development Company Limited's Subproject Pipeline

52. The firmness of IDCOL's subproject pipeline varies by sector. The pipeline is well-advanced in electricity generation, but is less-well developed in other sectors such as transportation and water. Supplementary Appendixes D and E provide a detailed overview and description of IDCOL's pipeline transactions.

53. IDCOL's pipeline requiring taka financing for 2008–2011 includes 20 small- to medium-scale power subprojects up to 80 MW, including two captive power plants. Fifteen of them have already signed the project agreements, including the power purchase agreement with either the Ministry of Energy or, for the captive power plants, with their respective entities. In those cases

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[40] A typical SHS installation with a capacity of 50 watts costs approximately $400. IDCOL currently offers a nonrefundable subsidy of $50 (€30) to lower the price of an SHS and increase the affordability of the system.

[41] In April 2007, ADB established the Clean Energy Financing Partnership Facility, funded by multiple development partners, to provide the additional financial resources and technical support for components of investment projects to improve energy security in ADB's developing member countries and decrease the rate of climate change through increased use of clean energy.

the equity–debt portion has been fixed. For six of the power plants, the lead arranger[42] has been appointed and IDCOL has received an information memorandum. These six subprojects are supported by the same two sponsors and all use proven technology.

54. From 2009–2011, three new very large subprojects in the energy sector will come to the market, which will require foreign currency financing from IDCOL. These are the 450 MW Bibiana Power Plant at Hobigonj,[43] the 450 MW Sirajganj clean-fuel combined cycle power plant, and the 450 MW Meghnaghat Phase 3 combined cycle power plant.[44] All three subprojects are build-own-operate projects to be financed and built by private sector sponsors for commissioning by 2010 and require large amounts of dollar long-term financing ($400 million–$600 million for each subproject). The ADB OCR loan to IDCOL is expected to be primarily utilized for the partial financing of some of these interventions.

55. IDCOL is also targeting the financing of approximately 89,000 SHSs under its existing renewable energy program until the end of 2008 for a total subproject cost of Tk2.73 billion ($39.9 million), of which IDCOL's share is roughly 67%. Given the fast pace of IDCOL's solar energy program, which currently finances the installation of 12,000 SHSs per month, it is expected that the KfW funds will be fully utilized by the end of 2008 at the latest—2 years ahead of schedule. IDCOL then intends to use the ADF loan of $33 million to provide refinancing facilities to its participating organizations to finance a further 98,000 SHSs, 15 biomass gasification-based power plants, and 100 biogas-based power plants. Until 2011, IDCOL plans to finance the installation of additional 396,000 SHSs for Tk11.88 billion ($173.7 million) and the construction of 15 biomass gasification-based power plants and 200 biogas-based power plants.

D. Financing Arrangements

56. The Government has requested an $82 million loan from ADB's OCR to assist in financing the Project. The OCR loan will have a 25-year maturity, including a 5-year grace period, an interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment fee of 0.15% per annum, and such other terms and conditions as set forth in the relevant loan agreement. The Government has provided ADB with (i) the reasons for its decision to borrow under ADB's LIBOR-based lending facility on the basis of these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any communication or advice from ADB.

57. The loan proceeds will be relent to IDCOL in dollars at a relending LIBOR rate plus 100 basis points per annum and for a 20-year term[45] for the purpose of foreign currency disbursements pursuant to a subsidiary loan agreement with such other terms and conditions acceptable to ADB. Onlending by IDCOL to eligible subprojects will be at interest rates that

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[42] In four cases, the lead arranger is the Infrastructure Investment Facilitation Center, the World Bank-financed facility, and the Standard Chartered Bank (for two captive power plants).

[43] Prequalification bidding for the project has been completed. Four consortiums have been prequalified to participate in the second round of bidding. The whole process is expected to be completed by October 2008. The International Finance Corporation is acting as the lead advisor to the Government and is providing some technical assistance on the preparation of the bid documents and the bidding process.

[44] ADB is acting as Lead Advisor to the Government for the Sirajganj and Meghnaghat phase 3 projects. The process is expected to be completed by end of 2008.

[45] Any reflows of the ADB loan from IDCOL to the Government due to the difference in tenor will have to be used by the Government for lending activities with similar objectives and focus.

reflect IDCOL's cost of funds plus a spread to cover transaction costs and risks. Subloans will be on full commercial and competitive terms[46] at IDCOL's discretion.

58. The Government has also requested an $83 million equivalent loan from ADB's Special Funds resources. The ADF loan will have a 32-year term, an 8-year grace period, and an interest charge of 1.0% per annum during the grace period and 1.5% per annum thereafter. It will include such other terms and conditions as may be set forth in the loan agreement.

59. The Government will make up to $50 million equivalent from the ADF loan available to IDCOL under a subsidiary loan agreement at the Bangladesh Bank rate[47] with a 20-year term. IDCOL will onlend the proceeds from the ADF loan to SMIPs at market rates,[48] while the Government will bear the foreign exchange risk.

60. To provide participating organizations with funding for renewable energy installations in rural areas in Bangladesh, the Government will make $33 million equivalent from the ADF loan available to IDCOL at a fixed rate of 3% per annum or such higher rate as may be necessary. This is to ensure that IDCOL's onlending spread to its sub-borrowers is not more than 300 basis points,[49] under a subsidiary loan agreement with a 20-year term, and with terms acceptable to ADB. The proposed onlending terms to sub-borrowers reflect current market rates for this type of intervention. The Government will bear the foreign exchange risk. A summary financing plan is provided in Table 2.

Table 2: Financing Plan
($ million)

Source	Foreign Exchange	Local Currency	Total	% of Total
Asian Development Bank (OCR)	82.0	0.0	82.0	8.8
Private Sector Sponsors and Banks (large subprojects)	328.0	0.0	328.0	35.5
Asian Development Bank (ADF)	83.0	0.0	83.0	8.9
Private Sector Sponsors and Banks (SMIPs and renewable energy)	0.0	332.0	332.0	35.9
Islamic Development Bank	85.0	15.0	100.0	10.9
Total	**578.0**	**347.0**	**925.0**	**100.0**

ADF = Asian Development Fund, OCR = ordinary capital resources, SMIP = small and medium-sized infrastructure subproject.
Source: Government of Bangladesh and Asian Development Bank estimates.

[46] IDCOL currently charges LIBOR plus 350 basis points for its senior loans and LIBOR plus 400 basis points for subordinated loans. The maximum maturity of a senior loan is 15 years including a 4-year grace period. For subordinated loans, final maturity will be a maximum of 23 years, including an 8-year grace period.
[47] Bangladesh Bank Rate means the rate published by Bangladesh Bank on its website (http://www.bangladesh-bank.org) in accordance with Article 21 of the Bangladesh Bank Order, 1972, being the weighted average 6-month yield on the treasury bills of the Government.
[48] For small and medium-sized urban projects, IDCOL currently charges an interest rate of Bangladesh Bank Rate plus a spread of 400 basis points, provided however that the margin is not less than 250 basis points. The maximum maturity is 12 years including a grace period of up to 3 years. For projects implemented in rural areas that receive grants or subsidies from multilateral agencies and/or the Government, IDCOL charges an interest rate of up to 8% per annum with a maximum maturity of 10 years and a grace period of up to 2 years.
[49] IDCOL currently offers taka-denominated loans of 10-year maturity with a 2-year grace period at 6% per annum interest to participating organizations.

61. Table 2 assumes that IDCOL will finance up to its maximum allowed investment limit of 40% of total cost to each subproject, therefore catalyzing 60% from private sector sponsors and banks. In practice, IDCOL's share will typically vary between 10% and 30% to reflect the fact that most infrastructure transactions are financed by a consortium of financial institutions, of which IDCOL will be one of the many participants. Hence, IDCOL's catalytic effect is expected to be much larger.

62. **Parallel Cofinancing.** Financing from commercial sources during the Project implementation period will be encouraged for additional investments into the infrastructure sector of Bangladesh and to complement ADB financing. The Islamic Development Bank (IDB)[50] has allocated concessional financing of $15 million on similar terms as ADB's ADF loans for IDCOL's solar energy program (component C). Based on further review of a well-developed pipeline of large power and infrastructure subprojects, IDB is processing an OCR-type funding of up to $85 million compliant with Shariah principles to fund eligible large infrastructure subprojects (component A). Approval by IDB's board is expected to be obtained by January 2009. IDB's cofinancing will be provided on a parallel cofinancing basis.[51]

E. Special Features

63. The Government's request for promoting private sector participation in infrastructure financing is in recognition of ADB's extensive involvement in infrastructure development in Bangladesh and the region. Consultations with the Government and other stakeholders, including development partners, enabled the design of the PPIDF to be that of a second-generation financial intermediation loan to address effective demand and is well anchored to the ongoing reforms in the infrastructure and financial sectors aimed at bridging the growing infrastructure financing gap.

64. **Transaction Costs.** The PPIDF is designed to enable ADB to leverage its resources to finance a wide range of subprojects across infrastructure subsectors rather than discretely finance individual subprojects. This is expected to reduce transaction costs for the Government as well as for ADB.

65. **Public–Private Synergy.** The PPIDF draws on the extensive ADB support for infrastructure development through greater private sector participation in other developing member countries. IDCOL is well-positioned to finance PPP subprojects. Financing of such subprojects by a consortium of investors and lenders, including the PPIDF, ensures deepening of subproject preparation and financing skills and options in the country. Among the development partners, ADB is uniquely placed to finance PPP subprojects by offering customized financing options through its public and private sector windows.

66. **Long-Term Benchmark Rate.** By providing long-term lending on commercial terms, IDCOL will facilitate pricing of risk for infrastructure subprojects. This will help establish

[50] As per the aide memoire signed on 9 January 2008 between ADB and the IDB, both institutions have agreed to collaborate to jointly set up an Asian Infrastructure Financing Facility of up to $2 billion over the next 3 years for sovereign-guaranteed operations that would participate in the prospective infrastructure subproject pipelines of both institutions in common member countries. Any co-investment under the PPIDF would be the first such intervention under the aide memoire.

[51] A joint ADB-IDB mission went to Bangladesh on 18–24 June 2008 to introduce IDB to the Project, hold discussions with the Government, and provide background information to IDB on the intervention. IDB already received approval from the Government to commence due diligence on its proposal to cofinance part of IDCOL's investment portfolio over the next 3 years alongside ADB.

benchmark rates for infrastructure bonds, which will enable diversification of the investor base and bring in latent investors, boosting the corporate bond market. The presence of IDCOL as a long-term financier in the market is also meant to provide comfort to equity investors who have exposure to subprojects for the length of the concession period.

67. **Facilitative and Adaptive Design.** Learning from experience (paras. 30–32), the PPIDF allows flexible lending criteria in terms of subproject selection, sector focus, and financing instruments that can evolve as the financial and infrastructure reforms progress. While ADF and OCR funds have been correlated to subprojects types based on the extent of private sector participation and the clean energy priority, the onlending terms for both ADF ad OCR reflect local market terms to avoid currency and pricing mismatches (para. 32). The PPIDF is designed to complement IPFF (para. 28) in providing access to scarce long-term local currency funds. PPIDF and IPFF could collaborate with local commercial banks for financing subprojects.

68. **Environment and Social Safeguard Framework.** ADB took the lead in developing a common Environment and Social Safeguard Framework (ESSF) for harmonizing the safeguards policy framework for involuntary resettlement, the environment, and indigenous peoples. Showing remarkable awareness of the need for environmental and social safeguards in all aspects of infrastructure development, IDCOL participated in the development of ESSF and adopted the same. This is the first ESSF developed for any financial institution in Bangladesh and will serve as a template for future financial sector interventions of ADB in the country.

F. Implementation Arrangements

69. **Executing and Implementing Agencies.** The Ministry of Finance, acting through its Finance Division, will be the executing agency and IDCOL will be the implementing agency of the Project. IDCOL’s board of directors will provide policy direction, strategic oversight and overall approval of subprojects. A project management unit (PMU) will be established to monitor the screening and selection of subprojects and for day-to-day implementation of the Project. The PMU will be staffed with existing IDCOL staff to the extent possible, and consist of risk and project management experts. A senior officer, reporting directly to the chief executive officer of IDCOL, will be appointed to head the PMU. A dedicated finance and accounts officer will be in charge of the financial management of the Project. The PMU will also house an environmental and social safeguards management unit to ensure and certify subproject compliance with the ESSF. The environmental and social safeguards management unit will identify, screen, select, and monitor all subprojects, ensuring compliance with ADB, state, and national environmental, involuntary resettlement, and indigenous people policies. The PMU will also develop and implement a project performance monitoring system (PPMS).

70. **Sub-Borrower Selection Criteria.** For a sub-borrower to receive funding from the ADB loan out of components A and B, IDCOL will apply the following eligibility criteria. The sub-borrower must

- (i) be majority-owned (i.e., at least a 51% majority) by private sector parties and continue to be so for the duration of the subloan;
- (ii) have sponsors that have a proven track record of successfully developing, financing, and operating similar infrastructure subprojects in Bangladesh or in countries at a similar level of development;
- (iii) have equity investment in respect of the subproject of at least 20% of the total subproject costs;
- (iv) have adequate resources and financial capability to raise and maintain resources to complete and operate the subproject successfully;

(v) not be (nor its sponsors be) in default of any prior loan from IDCOL or from any of the participating members of the consortium of lenders or any bank or nonbank financial institution in Bangladesh;
(vi) be able to provide security as required by the consortium of lenders;
(vii) maintain appropriate financial records of income and expenditure to the satisfaction of IDCOL and ADB;
(viii) comply (and cause its relevant subproject to comply) with ADB's policies, and national laws and regulations relating to environment, involuntary resettlement, and indigenous peoples; and
(ix) have entered into relevant concession and/or license agreements, which provide for satisfactory cost adjustment and escalation, or have signed memoranda of understanding in respect thereof.

71. **Subproject Selection Criteria.** For subprojects to be financed out of components A and B and biogas and biomass power plants to be financed out of component C, IDCOL will apply the following eligibility criteria. The subproject must

(i) be an integral part of the borrower's priority plan for the relevant sector or subsector;
(ii) use technology which has a successful track record in countries with similar infrastructure environment and capacity as Bangladesh;
(iii) be renewed and approved by IDCOL's credit committee for its economic and commercial viability, and by the PMU for adherence to the ESSF;
(iv) obtain all necessary government approvals and licenses and comply with ADB's policies and national laws and regulations relating to environment, involuntary resettlement, and indigenous peoples; and
(v) have an economic rate of return of not less than 12%.

72. For solar energy subprojects to be financed out of component C, IDCOL will provide refinancing facilities to those partner organizations that qualify with the eligibility criteria as detailed in Appendix 7.

73. **Approval Procedure for Subprojects.** Subprojects under components A and B and biogas and biomass power plants under component C will be prepared and processed as follows:

(i) IDCOL will review the preliminary designs and cost estimates for all subprojects as approved by the lending consortium.
(ii) IDCOL's assessment with respect to any issues related to environmental, involuntary resettlement, and indigenous peoples, as stipulated in the ESSF, will be reviewed and updated to ensure their relevance and consistency with the applicable legal framework in Bangladesh and ADB's environmental and social safeguard requirements.
(iii) IDCOL will collect from the sub-borrower the following documents and submit them to ADB for approval: a detailed information memorandum or business plan, a copy of the minutes from the meeting of IDCOL's board or credit committee through which the subloan was approved, compliance with respect to ADB's procurement guidelines, and a copy of the subloan agreement.
(iv) IDCOL will periodically review ongoing subprojects to ascertain their compliance with the approved safeguard frameworks. These review reports will be submitted to ADB, together with other relevant safeguard documents, for information and

review. If any major noncompliance is found during such a review, ADB will request a corrective action plan, which will be prepared by IDCOL and submitted to ADB for review and approval. In addition, any subproject which is financed under the PPIDF will follow the approved common safeguards frameworks.

(v) IDCOL will submit a safeguard compliance certificate to ADB for approval.

74. For the approval of solar energy subprojects under component C, IDCOL will collect from the participating organizations a summary sheet which will provide the following information: (i) compliance with exposure limits for each participating organization, (ii) name and address of each end-user, (iii) cost of equipment and any other related costs, (iv) total grant amount received for each particular installation, and (v) net amount funded by IDCOL.

75. **Economic Analysis of each Subproject.** Each subproject should be subjected to an economic analysis to establish economic viability. Economic analysis should be carried out following the economic analysis guidelines[52] and the analyses should cover all the key areas—macroeconomic and sector context, demand analysis, economic rationale, project alternative analysis, cost–benefit analysis, sustainability analysis, distribution analysis, and sensitivity and risk analysis. Subprojects with an economic internal rate of return of less than 12% should not be financed.

76. **Maximum Subloan Size and Free Limit.** IDCOL's lending policy stipulates that it cannot finance more than 40% of the total subproject cost. This is applicable to all subprojects to be financed under components A and B. For the SMIPs to be financed under component B, IDCOL's total loan to each subproject cannot exceed $10 million. ADB is not stipulating any additional limitation on the size of the subloans so as to provide sufficient flexibility to IDCOL in utilizing the funds, and to support the catalytic role of IDCOL in mobilizing financial resources from the private sector for large subprojects. However, all subprojects financed by IDCOL under component A and the first three subloans to be provided by IDCOL from the proceeds of component B will be subject to prior review and approval of ADB. Thereafter, for subsequent loans a suitable free limit pursuant to the provisions of the *Operations Manual* section on financial intermediation loans may be determined for IDCOL based on (i) ADB's assessment of IDCOL's performance, (ii) appraisal standards, (iii) portfolio quality, (iv) management, (v) the quality of IDCOL's subproject environmental due diligence reports submitted for ADB's review, (vi) IDCOL's management commitment to the application of ESSF, (vii) its safeguard capacity, and (viii) its subproject pipeline.[53] ADB will, however, reserve the right to review subprojects even below the free limit to ensure safeguard compliance. Also, in the case of issues related to ADB's safeguard policies, IDCOL will be required to submit all safeguard documents regardless of the investment amount.

77. **Procurement.** For subprojects under component A, IDCOL will require its sub-borrowers to adopt internationally competitive bidding procedures in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time) and the Government's Public Procurement Act (2006, as amended from time to time). ADB will have the right to review and approve the procurement procedures.

78. For subprojects under components B and C, ADB will encourage IDCOL to require its sub-borrowers to adopt international competitive bidding procedures in accordance with ADB's

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[52] ADB. 1997. *Guidelines for the Economic Analysis of Projects.* Manila.

[53] ADB. 2003. *Operations Manual.* Section D6/OP: Financial Intermediation Loans. Manila (15 December).

Procurement Guidelines (2007, as amended from time to time) when the amount of the investment is large (equal to or more than $5 million equivalent) and economy and efficiency can be gained by following such procedures.

79. For procurement of goods and services to be financed by subloans out of the loan proceeds, the sub-borrower will ensure, and certify to ADB if requested, that goods and services obtained are suitable for the subloans, that the price paid is least-cost, and that account is being taken of relevant factors such as time of delivery, efficiency, and reliability of goods.

80. For build-operate-transfer subprojects and variants, if the subproject sponsor or engineering, procurement, and construction contractor is selected through competitive bidding among international entities in accordance with procedures acceptable to ADB, such subproject sponsor or contractor may apply its own procedures for procurement provided that such procurement is for goods, services, and works supplied from, or produced in, ADB member countries. Moreover, such subproject sponsors or contractors must only be nationals of ADB member countries.

81. **Disbursement Arrangements.** The Government will establish three imprest accounts with the Bangladesh Bank: one for the OCR loan (component A), and one for each of the two components under the ADF loan (components B and C). The initial amount deposited in each imprest account shall not exceed 10% of each loan, or estimated expenditures for the first 6 months of Project implementation, whichever is lower. IDCOL as the implementing agency will be responsible for preparing disbursement projections, collecting supporting documents, preparing withdrawal applications, and sending the applications to ADB in accordance with ADB's *Loan Disbursement Handbook* (2007, as amended from time to time), and such other arrangements as may be agreed between ADB and IDCOL. For disbursement amounts of less than $100,000, IDCOL can follow statement of expenditure (SOE) procedures. The closing date for the OCR loan and the ADF loan will be 31 December 2013 or such other date as may be agreed between ADB and the Government.

82. While making disbursements requests to ADB, IDCOL will submit to ADB the following documents (or such other documents as shall be satisfactory to ADB):

(i) **Components A and B.** (a) Evidence of payment of a subloan or requirement to make a subloan to the sub-borrower, (b) independent assessment and/or engineer's certificate on physical progress and financial progress, (c) a cash flow or utilization request verified by a chartered accountant, and (d) notice of draw down by the agent of the sub-borrower confirming all conditions precedent to disbursement are satisfied and no event of default has occurred or is continuing.

(ii) **Component C.** A copy of the summary sheet collected from each sub-borrower detailing the number of SHSs being financed, the total cost per SHS, and the total amount of financing sought from ADB.

(iii) **Components A, B, and C.** Where the amounts are above the SOE ceiling, a complete set of supporting documents has to be provided to ADB.

83. **Governance and Anticorruption Policy.** ADB’s *Anticorruption Policy* (1998, as amended to date) was explained to and discussed with the Government and IDCOL. ADB has

assessed the financial management policies of IDCOL and found them to be satisfactory.[54] Consistent with its commitment to good governance, accountability, and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the subprojects under the Project. To support these efforts, relevant provisions of ADB's *Anticorruption Policy* (1998, as amended to date) are included in the loan regulations relevant to the Project. In addition, all subprojects financed by ADB in connection with the PPIDF will include provisions specifying the right of ADB to audit and examine the records and accounts of IDCOL, its sub-borrowers, and other service providers as they relate to the subprojects.

84. **Accounting, Auditing, and Reporting.** IDCOL will establish and maintain separate records for works, goods, and services financed out of loan proceeds. The company will maintain separate Project accounts according to generally accepted accounting principles for all expenditures incurred under the PPIDF and the subprojects, whether out of loan proceeds or from other sources, and record, in a transparent manner, all funds received from the Government, ADB, and other sources.

85. Consolidated annual Project accounts, as maintained by IDCOL, will be (i) audited by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB; and (ii) submitted to ADB within 6 months of the end of the financial year. The annual audit report will specifically include a separate audit opinion on the use of loan proceeds, free limit, the soundness of the imprest fund and SOEs procedures, and compliance with financial loan covenants. IDCOL has been briefed on ADB's policy regarding delayed submission of audits and requirements for a satisfactory and acceptable audit of accounts.

86. **Project Performance Monitoring and Evaluation.** IDCOL will be responsible for establishing a PPMS acceptable to ADB no more than 3 months from loan effectiveness. For the PPMS, IDCOL will first select a set of clearly measurable performance monitoring indicators relating to implementation and improvements and institutional development and capacity-building milestones, including those in the design and monitoring framework (Appendix 1). IDCOL will establish baseline data for each of the selected indicators within 6 months of loan effectiveness. Subsequently, IDCOL will conduct annual surveys and will update ADB on the progress against each indicator. IDCOL will also submit quarterly progress reports in the format to be attached to the facility administration memorandum. IDCOL will submit to ADB a project completion report within 3 months of the completion of all ADB-supported subprojects.

87. **Project Review.** ADB will, at its discretion, conduct reviews of the management, financial, and operational performance of IDCOL and subprojects financed under the Project, initially after the closing of withdrawals. The review will include safeguard implementation and procurement procedures utilized by the PPIDF infrastructure subprojects.

88. Performance of the PPIDF will be reviewed periodically at three levels—monthly by IDCOL, quarterly by IDCOL's board of directors, and annually by ADB. The monthly performance review by IDCOL will be completed by the 10th day of the next month. IDCOL's board of directors will review the performance every quarter and will forward the quarterly progress reports to ADB by the 10th day of the month after the quarterly review. ADB will review the quarterly progress reports during annual review missions, and during the tripartite reviews

[54] Asset and Investment Management Services Bangladesh, a local investment firm, was hired to carry out the financial due diligence on IDCOL.

chaired by the Government. In addition, a midterm review of the investment program will be conducted in FY2010. The review will cover disbursement, implementation progress including progress against capacity-building milestones, and compliance with environmental and social aspects including safeguards implementation. The midterm review will identify problems or weaknesses in implementation; suggest nominal changes in scope, outputs, and due diligence; and agree on changes that may be needed.

IV. TECHNICAL ASSISTANCE

89. To enhance the sustainability of the PPIDF, ADB will provide TA of $500,000. It will commence in parallel to the loans and will be for 1.5 years. The TA will be available to IDCOL mainly to (i) assist line ministries in the drafting of proper PPP frameworks and policies in Bangladesh based on IDCOL's experience in financing private sector-led infrastructure subprojects upon request of those line ministries; (ii) provide the Government and its agencies with feedback about bottlenecks, issues, and concerns from the market and from private sector sponsors and offer advice and solutions; (iii) conduct economic, sector, and industry studies; (iv) support the development of additional capacity within IDCOL to appraise subprojects, manage its expanding subproject portfolio, and supervise the implementation of its renewable energy program; (v) provide training to staff in relevant government agencies in credit and risk assessment, management, and mitigation; and (vi) provide training to IDCOL in the environmental and social assessment of subprojects.

90. The Ministry of Finance, acting through the Finance Division, will be the executing agency and IDCOL will be the implementing agency. The TA outcomes will be monitored by the Ministry of Finance, ADB, and IDCOL through consultants' reports and periodic consultations and review missions. To carry out the TA, international consultants will be engaged by ADB in accordance with ADB's *Guidelines on the Use of Consultants* (2007, as amended from time to time). The scale of consultant inputs, terms of reference, cost estimates, and implementation arrangements are described in Supplementary Appendix F.

V. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Benefits and Impacts

91. Benefits of the PPIDF are grouped into three areas:

(i) **Beneficiaries.** (a) The people of Bangladesh, especially in rural areas, who will have increased access to more adequate and efficient infrastructure services; (b) the Government, which will benefit through the addition of infrastructure development resources and the introduction of private sector efficiency and management culture in the infrastructure sectors; and (c) private sector investors, both local and foreign, who will receive financial, institutional, and policy-related assistance for investment in new infrastructure subprojects in the country.

(ii) **Macro benefits.** (a) Reduced need for public investment in infrastructure development, thus enabling the Government to deploy more funds to meet poverty alleviation and social development objectives; (b) rapid development of a modern and efficient infrastructure system in Bangladesh through the financial, technical, and managerial resources of the private sector; (c) balanced economic growth in urban and rural areas; (d) increased FDI flow into new infrastructure subprojects; and (e) significant employment generation in the construction and operation of new infrastructure subprojects.

(iii) **Project benefits.** (a) Addition of at least 900 MW of power generation capacity in the private sector; (b) provision of electricity to approximately 100,000 additional households through IDCOL's renewable energy programs; (c) development of subprojects to enhance port capacity, establish new toll highways, and augment water supply; and (d) increased capacity in the country for promoting environmentally friendly and socially acceptable implementation arrangements for privately sponsored infrastructure subprojects.

B. Environmental and Social Safeguards

92. The PPIDF is classified as category FI in accordance with ADB's *Environment Policy* (2002). IDCOL will ensure that for each subproject, an initial environmental and social examination, environmental and social impact assessment, and environmental management plan, as applicable, will be carried out. For large subprojects to be financed under component A, IDCOL will submit the above documents for ADB's review and approval. For the SMIPs under component B, IDCOL will submit to ADB for review and approval the above documents for the first three SMIPs to be financed by the company. For component C, which includes the financing of IDCOL's ongoing renewable energy program, environmental issues are expected to be minimal—primarily related to the disposal of used lead acetate batteries and compact fluorescent lamps. IDCOL will also ensure that all resettlement plans are submitted to ADB prior to its approval of each subproject.

93. As part of the ADB assistance to IDCOL, ADB helped prepare and finance the drafting of an ESSF[55] (Appendix 9) based on IDCOL's existing environmental and social appraisal manual. The ESSF outlines the operating procedures for addressing environmental and social issues associated with project planning, development, and operation. The main purpose of the ESSF is to provide IDCOL and subproject sponsors with an overall framework to identify environmental and social effects and prepare necessary environmental and social documents to support the IDCOL loan appraisal process, and implement environmental and social programs both at the subproject and organizational levels. The ESSF comprises the environmental management system (EMS) and the social safeguards framework (SSF). The provisions for environmental and social safeguards and assessment and mitigation measures contained in the EMS and SSF will be applicable for all subprojects financed from the proceeds of the ADB loans. IDCOL will monitor that the subproject developers ensure that civil works contractors do not employ children or discriminate against women. IDCOL will not finance subprojects (using ADB funds) which do not adequately address ADB's and the Government's environmental and social safeguards (ESS) requirements. The company will provide ADB with an annual environmental and social safeguard compliance monitoring report, showing that IDCOL has complied with its obligations under the ESSF. Supplementary appendixes G and H provide a comparative assessment of the Government's environmental impact assessment (EIA) framework and the ESS of ADB and a comparison of the Government's and ADB's social safeguard approach regarding involuntary resettlement and indigenous peoples.

[55] The process of preparing the ESSF was guided by ADB's Environment and Social Safeguards Division. The draft ESSF was uploaded to the ADB website on 11 June 2008. Available: http://www.adb.org/projects/project.asp?id=40517.

C. Poverty Impact[56]

94. Investments in infrastructure as a whole and in road transport and electricity in particular help reduce income poverty, with road transport improvements having a stronger impact. Access to roads reduces prices under conditions of competitive transport services provision, increases mobility, and reduces labor market imperfections, enabling the poor to find better paying work, thereby allowing production of higher-value cash crops and supply of cheaper agricultural inputs. Rural electrification helps stimulate the rural economy and increases opportunities for off-farm employment for the poor. Use of televisions in rural areas leads to improved information on crops and contributes to improved farm productivity.

95. Infrastructure projects also contribute to increased trade and growth in countries in the context of regional cooperation. The impact on nonincome poverty is also significant. Roads reduce travel time and provide better access to basic education and health services. Electricity also impacts on nonincome poverty. Better lighting increases the time for studies and years of schooling. It increases safety and security and provides better medical services in rural areas. Further information about the impact of infrastructure investments on poverty is provided in the summary poverty reduction and social strategy (Appendix 10).

D. Infrastructure Development Company Limited's Corporate Governance

96. ADB has carefully reviewed the corporate governance structure of IDCOL to ensure that sound and transparent business processes and management systems are in place to mitigate any potential corruption risks and vulnerabilities. IDCOL is governed by the Companies Act (Bangladesh) 1994 and the Financial Institutions Act 1993, which prescribe disclosure norms. IDCOL intends to self-regulate and has incorporated best practices of nonbanking finance companies. In addition, IDCOL has been rated AA and AA1 by two local rating agencies for strengthening its compliance with best international practices.[57] A governance and anticorruption risk assessment is provided in Appendix 11.[58]

E. Assumptions, Potential Risks, and Mitigation Measures

97. While the growing recognition of the significance of infrastructure development and the ongoing reforms in the financial sectors provide the context for the facility, the envisaged benefits and impact depend on several assumptions that are subject to varying degrees of risk. Mitigation measures have been put in place where feasible and appropriate.

98. **Effective Demand.** A strong pipeline of private sector-sponsored infrastructure subprojects that could be eligible for IDCOL financing has been identified. The estimated volume of the expected funding for those subprojects is more than enough to absorb the proposed ADB loans to IDCOL. Several subprojects in the energy sector are at advanced stages of development. Some of these transactions are likely to be financed within the next 1–2 years. A significant number of these subprojects are priority investments designed to address crippling energy deficiencies, and ADB support through the PPIDF is perceived as critical to overcoming financing constraints and facilitating their implementation.

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[56] ADB. 2004. *Scaling up Poverty Reduction Potential of Infrastructure Projects—Lessons from the Asia-Pacific Region.* Manila. Also available: http://www.adb.org/Documents/Events/2004/Global_Learning/Infra_Final.pdf.

[57] International credit rating agencies closely monitor all aspects of operational performance, and failure to comply with best practice is likely to lead to a rating downgrade and an increase in financing costs.

[58] Supplementary Appendix I provides the Financial Management Assessment.

99. **Change in the Government's Policies.** The current emphasis on private participation to boost infrastructure development and promotion of renewable energy may change. More restrictive laws and policies concerning infrastructure project financing, foreign investment, currency exchange, and other matters affecting the ability of IDCOL to fund infrastructure subprojects might be implemented. The risk of adverse policies being introduced is considered minimal since the Government is keen to pursue infrastructure sector development. In addition, ADB's ongoing policy dialogue with the Government will facilitate adoption of progressive sector polices.

100. **Governance.** Good governance is an essential precondition for sustainable development in Bangladesh's infrastructure sectors. The Government has put good governance at the center of infrastructure sector reform policies. Various measures have been included in the Project's design to promote good governance and mitigate the risk of corruption by enhancing predictability, transparency, and accountability in doing business. These measures include professional management of IDCOL (which is independent of the Government), and continued commercialization and financial strengthening of IDCOL. In addition, IDCOL's organizational structure and business processes have been thoroughly assessed to determine vulnerability to corruption. A risk assessment has been undertaken and the Project design, implementation arrangements, and legal arrangements include appropriate risk mitigation measures.

101. **Institutional Capacity.** IDCOL needs to adopt a long-term vision and operational strategy based on commercial operations through an effective organization. While IDCOL's present staff strength of 36 is commensurate to the current level of operations, it might not be equipped to cope with additional and more complex activities, especially relating to large infrastructure subprojects. IDCOL currently outsources most of these activities. To address this, IDCOL has started to strengthen its subproject assessment capabilities and capacity and has initiated its own marketing program to source potential business opportunities independently. These activities will be further supported by the ADB TA with capacity building. To improve its skill and capacity, IDCOL will also enter into strategic partnerships with international organizations involved in infrastructure investments, advisory services, and development of renewable energy.

102. **Environmental and Social Risks.** As IDCOL will finance multiple subprojects, there is a potential risk that certain decisions by IDCOL during implementation may not fully adhere to ADB's safeguard requirements. To address this concern, ADB has helped develop a comprehensive ESSF which fully addresses environmental risks, involuntary resettlement, and impacts on indigenous peoples arising from land acquisition, changes in land use, or restrictions of access to resources. IDCOL will also avail itself of the ADB-sponsored or approved environmental and social safeguard training.

VI. ASSURANCES

103. In addition to the standard assurances, the Government and IDCOL have given the following assurances, which will be incorporated into the loan agreements:

(i) In the event of any change in the structure of IDCOL, the Government, IDCOL, and ADB will assess the potential impact on the Project and evaluate any change in scope, amendment, or continuation, as appropriate, of PPIDF.

(ii) IDCOL complies at all times with the prudential norms, as made applicable to it, including capital adequacy, income recognition, classification, and provisioning of nonperforming assets.

(iii) IDCOL maintains a debt service coverage ratio of at least 1.0 and ensures that it has no arrears in repayment of its current debt obligations.

(iv) The subprojects and sub-borrowers meet the eligibility criteria agreed with ADB, including financial and economic viability and positive developmental impact.

(v) All subprojects under components A and the first three subprojects under component B are submitted to ADB for prior review, unless otherwise agreed between ADB and IDCOL.

(vi) The onlending rates to sub-borrowers are market-based, and adequate to cover all costs and risks associated with onlending, including any foreign exchange risk premium.

(vii) The sub-borrowers adopt and implement appropriate procurement procedures that are based on competitive bidding, and foster economy, efficiency, and transparency.

(viii) A subloan to a sub-borrower will be made only for such subprojects that involve procurement of goods, works and/or consulting services from member countries of ADB, and the amount of which is at least equal to the size of the subloan for such subproject.

(ix) Provisions are stipulated in all civil works contracts to require contractors to (a) incorporate minimum workplace occupational health and safety norms in accordance with national legislation, (b) comply with all applicable labor laws, (c) not employ child labor in any aspect of their activities, (d) provide appropriate facilities for women and children in construction campsites if such sites are established, (e) provide appropriate training and information materials for workers on AIDS prevention using an NGO approved by the ministry of health, (f) observe local protocols concerning acceptable behavior toward the local population, (g) use local unskilled labor, and (h) not differentiate between men and women for work of equal value. A specific clause shall be included in all bidding documents, and compliance shall be strictly monitored during Project implementation.

(x) IDCOL maintains its ESSF in accordance with its terms and conditions and acceptable to ADB to ensure that each subproject is undertaken in compliance with applicable environmental laws of Bangladesh and ADB's *Environment Policy* (2002). IDCOL will also ensure that for each subproject under component A and B and biogas and biomass power plants under component C, an initial environmental examination (IEE), EIA, and environmental management plan, as applicable, are submitted to ADB before its approval of the subproject. IDCOL will also ensure that for any category A or environmentally sensitive category B subproject, the summary IEE or the summary EIA is made available to the public 120 days before a disbursement request is submitted to ADB and will be posted on ADB's website. The company will ensure that full IEE or EIA reports will be made available upon request. IDCOL will submit an annual monitoring report to

ADB covering performance of subprojects and ESSF, and recommendations to address issues.

(xi) IDCOL ensures that each subproject which involves land acquisition and resettlement is undertaken in compliance with all the applicable laws of Bangladesh and ADB's *Involuntary Resettlement Policy* (1995). IDCOL will also ensure that all resettlement plans are submitted to ADB prior to its approval of each subproject, and cause each subproject sponsor to ensure that (a) all land and rights-of-way required for subproject are obtained in a timely manner, (b) the provisions of the resettlement plans are implemented in accordance with its terms, (c) all compensation and resettlement assistance is given to the affected persons prior to their dispossession and displacement and commencement of civil works, (d) resettlement plans are updated upon completion of the detailed design and submitted to ADB for approval prior to commencement of civil works, (e) adequate staff and resources are committed to supervising and monitoring implementation of the resettlement plans, and (f) an independent agency acceptable to ADB and IDCOL is engaged by the subproject sponsor to monitor and evaluate results of implementation of resettlement plans and forward reports to ADB and IDCOL as required.

(xii) Subprojects do not adversely affect vulnerable groups, such as indigenous peoples, and in the event of impact, IDCOL will implement the ESSF in accordance with its terms to ensure compliance with ADB's *Policy on Indigenous Peoples* (1998).

(xiii) For large subprojects to be financed under component A, IDCOL will be required to submit an initial environmental and social examination, an environmental and social impact assessment, and an environmental management plan, as applicable, to ADB for review and approval. For the SMIPs under component B and biogas and biomass power plants under component C, IDCOL will be required to submit to ADB for review and approval the above documents for the first three SMIPs to be financed by the company. For subprojects to be funded under component C, which includes the financing of renewable energy subprojects, environmental issues are expected to be minimal and no submission of the above documents is required.

(xiv) IDCOL will ensure that from the date of loan effectiveness, an adequate number of consultants with the required environmental and social expertise will be hired to carry out the functions as outlined in the ESSF. The consultants will also train IDCOL's staff to fully implement and comply with the ESSF.

(xv) IDCOL will hire a risk manager within 6 months of loan effectiveness to ensure that all risks related to credit, market, and the company's operations are independently and objectively assessed, managed, and mitigated.

(xvi) Accountability and transparency in IDCOL are maintained in its operations through the stakeholder meetings and publication of progress reports for the duration of the Program. Internal procedures and controls are instituted, maintained, and complied with to prevent any corrupt, fraudulent, collusive, or coercive practices. All contracts financed by ADB in connection with the subprojects specify the right of ADB to audit and examine the records and accounts of the sub-borrowers, contractors, suppliers, consultants, and other service providers as they relate to the subprojects.

(xvii) All IDCOL subloan agreements appropriately reflect the obligations assumed by IDCOL and the respective subproject sponsors under the Project.

VII. RECOMMENDATION

104. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve

(i) the loan in various currencies equivalent to Special Drawing Rights 52,870,000 to the People's Republic of Bangladesh for the Public–Private Infrastructure Development Facility (PPIDF) from ADB's Special Funds resources with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; 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 and Project Agreements presented to the Board; and

(ii) the loan of $82,000,000 to the People's Republic of Bangladesh for the PPIDF from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan and Project Agreements presented to the Board.

C. Lawrence Greenwood, Jr.
Vice President

11 September 2008

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
Impact Improved per capita infrastructure availability	Access to electricity from present 38% to 60% of population by 2015 Total road network increased by 25% by 2015 Increased percentage of population using gas as a primary fuel from 6% to 10% by 2015 Increase by 10% in number of private sector and PPP infrastructure projects financed by 2015	Annual reports on infrastructure availability Studies conducted by bilateral and multilateral organizations Economic survey, Bangladesh Bank reports, and other government publications International and domestic business climate surveys	**Assumptions** • Macro economy remains stable and economic reforms are sustained • Continuing priority accorded to infrastructure sector • Continuing priority accorded to capital market development • Increased efficiency of infrastructure investment • Continued financing by IDCOL of private sector infrastructure subprojects **Risk** • Lack of conducive environment for private sector investments
Outcome Enhanced private sector participation in infrastructure development	3 large subprojects with private financing of at least $100 million each by 2013 10 medium sized subprojects with private financing of at least $30 million each by 2013 At least 100,000 solar energy home systems, 15 biomass power plants, and 100 biogas power plants installed by the private sector by 2013	PPMS data and reports IDCOL reports Project completion reports	**Assumptions** • Strong government commitment to IDCOL • Infrastructure reform agenda is pursued by the Government • Bangladesh remains a conducive environment for foreign direct investments • Political and economic stability • Continued priority accorded to infrastructure sector • Increased efficiency of infrastructure investment • IDCOL's long-term lending mandate continues **Risks** • Regulatory changes deter foreign investors • Deterioration in political and security situation • IDCOL's credit rating deteriorates

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
			• Scope of capital market and infrastructure sector reform agenda is reduced • Sovereign credit standing deteriorates
Outputs 1. Improved lending terms of IDCOL for infrastructure subprojects	Reduction in average borrowing costs by 20% for IDCOL by 2013 Increase in tenor of available financing provided by IDCOL to 25 years by 2013	Project MIS data Rating agency reports Bank and project finance agencies reports IDCOL annual reports PPMS data and reports	**Assumptions** • Capital market and infrastructure reform program continues • IDCOL maintains and/or improves rating **Risks** • IDCOL's credit rating deteriorates • Scope of capital market and infrastructure sector reform agenda is reduced • Sovereign credit standing deteriorates
2. Improved ability of IDCOL to mobilize long-term capital	Issuance of at least 2 debt market instruments by IDCOL by 2013 At least 5 syndications by IDCOL for the financing of infrastructure subprojects by 2013	Rating agency reports Foreign direct investments inflow statistics IMF reports IDCOL annual reports PPMS data and reports	**Assumptions** • IDCOL's long-term lending mandate continues • IDCOL undertakes structured borrowing program based on risk-return considerations **Risks** • Deterioration in portfolio quality resulting in need to reduce loan duration • Regulatory risks
3. Enhanced governance at IDCOL	Improved local credit rating of IDCOL from AA to AAA by 2009 IDCOL obtains a credit rating from an internationally accepted agency in 2010	Rating agency reports IDCOL annual reports PPMS data and reports	**Assumptions** • IDCOL implements required organizational structure and human resources plan • IDCOL's capital base is strengthened in tandem with increased asset size **Risks** • IDCOL does not have adequate means to implement required

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
			human resources policy • Difficulties in locating and retaining qualified staff
4. Enhanced capacity for application of environmental and social safeguards standards	ESSF reports from 2008 onwards Year-on year increase in number of subprojects assessed for compliance under ESSF by 10% annually	IDCOL annual reports PPMS data and reports	**Assumptions** • Deployment of suitable personnel • Trained staff do not leave IDCOL • IDCOL absorbs capacity with regard to ESSF issues through TA • Availability of counterpart staff **Risks** • Trained staff leave the government or are not retained • Capability may degrade over time without refresher training
5. Enhanced efficiency of IDCOL in developing and financing infrastructure subprojects	Reduction in processing time for new proposals from 6 months to 4 months by 2010	IDCOL annual reports PPMS data and reports	**Assumptions** • Deployment of suitable personnel • Trained staff do not leave IDCOL • IDCOL absorbs capacity for project appraisal through TA • Availability of counterpart staff **Risks** • Experienced staff leave the government or are not retained • Capability may degrade over time without refresher training

Activities with Milestones	Inputs
1. Subproject financing 1.1 Processing and due diligence of subprojects to be financed through ADB funds (October 2008 onwards) 1.2 Application of ESSF with trained staff (December 2008 onwards) 1.3 Documentation for first debt issue of IDCOL completed by June 2009 1.4 First debt issue by December 2009 1.5 Documentation for second debt issue of IDCOL completed by	**ADB Loan** • $82 million OCR loan for large infrastructure subprojects • $50 million equivalent ADF loan for SMIPs • $33 million equivalent ADF loan for IDCOL’s

Activities with Milestones	Inputs
June 2010 1.6 Second debt issue by December 2010 1.7 One syndication completed by June each year during 2009-2013 for financing of subprojects **2. Credit Rating** 2.1 Annual review of IDCOL's domestic credit rating to be done by June each year during 2009-2013 2.2 IDCOL obtains a credit rating from an internationally accepted agency in 2010 **3. Capacity building** 3.1 Assess capacity building requirements (by December 2008) 3.2 Develop model PPP guidelines (by March 2009) 3.3 Disseminate the model PPP guidelines to key line ministries (April 2009 – March 2010) 3.4 Develop guidelines and specifications (by March 2009) − sector assessment − subproject appraisal − credit and risk assessment, management, and mitigation − debt issue best practices and documentation − syndication options and documentation − portfolio management 3.5 ESSF application training (December 2008 - December 2009) 3.6 Provide capacity development to IDCOL (April 2009 - March 2010) − sector assessment − subproject appraisal − credit and risk assessment, management, and mitigation − debt issue best practices and documentation − syndication options and documentation − portfolio management 3.7 Assess impact of training to feed into redesign, if necessary, of training programs by September 2009	renewable energy program • Review missions • Participation in tripartite meetings **ADB TA Grant** $500,000 • International consultants (20 person-month) • National consultants (22 months) • Review missions • Participation in tripartite meetings **Government and IDCOL** • Counterpart staff • Office accommodation and transport • Participation in tripartite meetings

ADB = Asian Development Bank, ADF = Asian Development Fund, ESSF = environmental and social safeguards framework, IDCOL = Infrastructure Development Company Limited, IMF = International Monetary Fund, OCR = ordinary capital resources, MIS = management information system, PMU = project management unit, PPMS = project performance monitoring system, PPP = public-private partnership, SMIP = small and medium-sized infrastructure subprojects, TA = technical assistance.

SECTOR ANALYSIS

A. Power Sector

1. Introduction

1. The Bangladesh power sector has experienced numerous institutional and operational improvements during 2002–2008 but huge disparities remain between the various sector entities as measured by their financial performances. With a total population of 140.7 million as of 2007, one third of the population has access to electricity[1] and the distribution system has 8.84 million consumers. While the two key sector entities, the Power Grid Company of Bangladesh (PGCB) and the Dhaka Electric Supply Company, outperformed other entities, the Bangladesh Power Development Board (BPDB) and Dhaka Electric Supply Authority (DESA) continue to make financial losses. The power sector needs tariff adjustments, particularly for the distribution to the retail sector, as the current tariff structure is not sufficient to cover costs and expenses. There has been a reduction in system losses especially in transmission, however further improvements in distribution are needed.

2. Power Sector Overview

2. In Bangladesh, inadequate electricity supply has been a major constraint to economic growth and poverty reduction. At about 158 kilowatt-hours (kWh) annually, per capita generation is among the lowest in the world. The country's current dependable generating capacity is about 4,120 megawatts (MW), while peak demand is about 4,700 MW. The available generation capacity as of June 2005 was 5,025 MW, out of which 3,735 MW came from BPDB and 1,290 MW came from independent power producers and other entities.

3. High system losses are a major concern for the Bangladesh power sector. During the last 25 years, overall transmission and distribution losses have varied between 27.2% and 40.2% of net generation. A high proportion of losses at transmission and distribution level include nontechnical losses (e.g., theft). Transmission system losses declined from 3.8% in 2002 to 3.4% in 2005. Reduction of technical losses depends on large investments for upgrade and reinforcement of the transmission and distribution network and retrofitting of plants with more efficient auxiliary devices. Reduction of nontechnical losses depends on good management through administrative measures with some investment in supportive hardware such as meters and test instruments. In recent calculations, technical losses for the Rural Electrification Board (REB) system varied between 8% and 10% at different 33/11 kilovolt (kV) substations.

4. Given the high cost of generation, which is partly due to supply shortages that force BPDB to purchase power from all available generation units regardless of cost and operational efficiency, the Government of Bangladesh is now pursuing several less costly natural-gas-fired independent power producer projects totaling about 1,400 MW of new generation capacity.

3. Tariffs

5. The power sector in Bangladesh has three types of tariffs: (i) wholesale tariffs, (ii) transmission wheeling charges, and (iii) retail distribution tariffs charged to end-use

[1] Bangladesh Bureau of Statistics. 2006. *Statistics for Monitoring Attainment of MDGs in Bangladesh*. Dhaka.

consumers. Up until 2003, the Government had a semiannual automatic power tariff adjustment formula to reflect fuel price changes and local currency fluctuations. Since the establishment of the Bangladesh Energy Regulatory Commission in April 2004, there has been no tariff adjustment despite significant fuel price increases and local currency depreciations, exacerbating the financial difficulties of the sector entities caused by a very low wholesale tariff not sufficient to cover generating costs. An Asian Development Bank (ADB) evaluation report[2] points out that the current tariff level is substantially below the long-run marginal cost estimated at Tk4.2 per kWh at the 132 kV supply point. The PGCB's tariff, with wheeling charges of Tk0.23 per kWh for bulk delivery to distribution entities, is sufficient for PGCB to have financial gains. The transmission of electricity through the grid network has been steadily increasing, with growth of 9.2% in 2004 and 5.9% in 2005. Like wholesale generation tariffs, retail tariffs are not structured for cost recovery and are essentially inflexible to such external price fluctuations as increases in fuel costs, local currency depreciation, and inflation.

4. Institutional Framework and Reform Overview

6. The East Pakistan Water and Power Authority, established in 1959, was the sole utility responsible for generation, transmission, distribution, and sale of electricity throughout the province of the then East Pakistan. After the independence of Bangladesh in 1972, BPDB took on the same function. In 1977, the REB was created to undertake electrification in rural Bangladesh. Since its creation, BPDB's commercial performance has been weak. To improve services to the consumers and to increase revenue collection by reducing the prevailing high system loss, the Government created the DESA in March 1990. DESA took over the electrical distribution network of about 7,472 square kilometers (km) in the Greater Dhaka area; the liabilities and receivables were also transferred to DESA, which started operating on 1 October 1991 with an insufficient capital base. Recognizing the need to improve the sector's performance, the Government, in consultation with major development partners,[3] adopted a policy paper in 1994 entitled *Power Sector Reforms in Bangladesh*.[4] The policy paper outlined the reform process to gradually remove constraints in the sector through (i) separating sector regulation and operation; (ii) creating autonomy and commercial orientation among the sector entities; (iii) unbundling generation, transmission, and distribution; and (iv) increasing private sector participation. As part of the reform program, the *Private Sector Power Generation Policy of Bangladesh* was approved in October 1996 to facilitate the development of private sector power projects. The policy includes fiscal incentives, tax and value-added tax exemptions, and tariffs for bulk purchases. In 2000, the Government issued its *Vision and Policy Statement for Power Sector Reforms*[5] that further clarified specific details of the structural changes in generation, transmission, and distribution, along with the principles of corporatization and commercialization. In March 2003, the Electricity Regulatory Commission Act, 2003, was passed in Parliament for its establishment as an independent and impartial regulatory commission to regulate electricity, gas, and petroleum sectors. In April 2004, the Bangladesh Energy Regulatory Commission started operating. It was established as an independent regulatory body under the Bangladesh Energy Regulatory Commission Act, 2003, to regulate

[2] ADB. 2003. *Sector Assistance Program Evaluation of ADB Assistance to Bangladesh Power Sector*. Manila.
[3] ADB, Department for International Development of the United Kingdom, German Development Cooperation through KfW, Japan Bank for International Cooperation, the United States Agency for International Development (USAID), and World Bank.
[4] Power Division, Government of the People's Republic of Bangladesh. 1994. *Power Sector Reforms in Bangladesh.* Dhaka.
[5] Power Division, Government of the People's Republic of Bangladesh. 2000. *Vision and Policy Statement for Power Sector Reforms.* Dhaka.

energy businesses including the power sector. In 2006, the Government issued a 3-year plan for power sector reforms to undertake further organizational restructuring towards improving corporate governance and promoting commercialization.

7. As a result of implementing the reform policy, several new public sector entities have been established and made operational. These include the Ashuganj Power Station Company, Dhaka Electric Supply Company, the Electricity Generation Company of Bangladesh, PGCB, and the West Zone Power Distribution Company. In addition, private sector independent power producers, including the Rural Power Company, have been established and have started operations. The Government, through the Power Division of the Ministry of Power, Energy and Mineral Resources, wholly owns and supervises BPDB, DESA, and the REB.

5. Generation

8. At present, about 85% of the power generation capacity in the country is gas-based, 10% is based on imported fuel, and 5% is hydro power. In terms of energy generation, about 90% of the total in FY2005 was from gas-fired power plants. Present gas reserves and production are considered adequate to serve the existing power plants, and it is highly probable that additional reserves could be developed to serve the needs of those power plants projected until 2025. Over the last 10 years, consumption of electricity in Bangladesh grew at an average compound annual rate of 8.1% and it is expected that demand for electricity will grow at an annual rate of about 8.0% for the next 10 years. The ADB-funded power system master plan update projected that a total capacity expansion of 17,900 MW would be necessary by 2025, 3,500 MW of which would be needed by 2010.[6]

6. Distribution

9. Power distribution systems need to be expanded in tandem with the generation and transmission capacity expansions to enable delivery of power to consumers. At present, several entities are involved in the power distribution business in Bangladesh. DESA[7] and Dhaka Electric Supply Company cover Dhaka areas, while Palli Bidyut Samities cover most rural areas and BPDB primarily covers urban areas outside Dhaka. The West Zone Power Distribution Company is taking over BPDB’s distribution networks in the western parts of the country, and the North Western Zone Power Distribution Company is taking over distribution networks in the northwest of the country.

B. Telecommunications Sector

10. Telecommunications is a rapidly growing capital-intensive sector in Bangladesh with increasing needs for financing. The fixed telephony is inadequate and outmoded, resulting in low teledensity.[8] Due to the emergence of private sector mobile and fixed telephone operators, the industry has flourished since 1996, growing into the current large market with over 20 million connections. As of July 2007, there were 28 million mobile phone and 1.1 million fixed telephone users in the country, resulting in a teledensity rate of 19.8. The estimated current demand is around 40 million mobile and 1.5 million fixed telephone connections. There are five

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[6] ADB. 2004. *Technical Assistance to the People’s Republic of Bangladesh for Preparing the Power Sector Development Program II (Financed by the Japan Special Fund)*. Manila.
[7] Dhaka Power Distribution Company Limited will take over DESA’s operations.
[8] Teledensity is the number of fixed lines per 100 people.

private and one public sector mobile phone companies, 14 private public-switched telephone network (PSTN) operators, and one state-owned fixed telephone operator. The central zone, comprising the capital (Dhaka city) was opened for PSTN licensing in August 2007 and the Bangladesh Telecom Regulatory Commission has awarded licenses to three operators. The PSTNs use wireless technology like code division multiple access, not requiring any cable connectivity.

11. The per capita telecommunications services expenditure in Bangladesh is 1.3% of gross domestic product compared with 3% in developed countries. Before opening up of the telecommunications sector in 1996, the Bangladesh Telegraph and Telephone Board (the only telecommunications operator at the time), could not fully explore the telecommunications market.

C. Transport Sector

12. Bangladesh needs vastly improved transport and other infrastructure for sustaining higher gross domestic product growth over the medium term. Due mainly to inadequate transport infrastructure, the average cost for exports is 80% higher and for imports 35% higher than for most countries in the region. This creates significant drag on the economy. The Bangladesh transport system for domestic and international traffic consists of roads, railway, inland waterways, seaports, maritime shipping, and civil aviation. The extensive and diversified system consists of 140,000 km of roads, 2,706 km of railroads, 5,970 km of perennial and seasonal waterways, two major seaports, and three international (Dhaka, Chittagong, and Sylhet) and eight domestic airports.

13. The public sector develops and maintains transport infrastructure, including most rail and port services. Private sector involvement in road, inland water transport and ocean shipping has increased significantly in recent times. The private sector has also been involved over the past decade in domestic air transport and more recently in international (regional) air transport, the passenger rail market, and transport logistics. The inland waterways system is limited due to geographical reasons; a large number of rivers lack high-capacity bridges and there is a consequent reliance on ferries, which results in the use of small trucks for intra- and inter-urban distribution services. Limited network capacity and poor infrastructure constrain rail services, with major rail sections deteriorating due to inadequate maintenance. Unfavorable regulations and subsidies limit cost recovery for all modes of transportation. Asset replacement, particularly for the railways, is inadequate and unplanned, resulting in low transport quality and high transport costs.

14. The road sector performance has improved in the past several decades, aided by road network extensions and rapid increases in road transport demand. This has led to the shifting of modal share of transport in favor of roads, which have become the principal mode of transport. The seaports are constrained by outmoded customs regulations, physical capacity, and inadequate hinterland transport connectivity.

INFRASTRUCTURE DEVELOPMENT COMPANY LIMITED

A. Constitutional Documents and Ownership

1. The Infrastructure Development Company Limited (IDCOL) was created by the Government of Bangladesh with assistance from the World Bank as part of the Private Sector Infrastructure Development Project [1] (PSIDP). IDCOL was registered as a public limited company under the Companies Act, 1994, and licensed by the Bangladesh Bank as a nonbank financial institution on 5 January 1998. IDCOL's share capital is fully subscribed by the Government.

2. IDCOL's mission is to promote economic development in Bangladesh by encouraging private sector investments in infrastructure subprojects. Its specific development objectives are to

- (i) participate in the financing of privately owned infrastructure subprojects by providing structured finance in the form of senior and subordinated loans;
- (ii) mobilize third-party lending from private sources to privately sponsored infrastructure subprojects at financial closing of subproject development;
- (iii) provide investment advisory services to development subprojects that are led by private Bangladeshi developers;
- (iv) provide refinancing for small infrastructure subprojects (renewable energy) implemented by nongovernment organizations and microfinance institutions, and other private entities; and
- (v) arrange technical assistance for private sponsors and executing agencies promoting small infrastructure and renewable energy subprojects.

B. Management

3. IDCOL has a multiskilled workforce comprising economists, financial and market analysts, engineers, lawyers, information technology experts, and accountants. IDCOL follows a competitive career path for its workforce. The low turnover of senior staff indicates good personnel management.

C. Strategy

4. Being a government agency charged with fostering infrastructure development of the country, IDCOL adopts and crafts its strategy in line with the policy of the Government. In the past, IDCOL's strategy was also vested on the support it received from its development partners. IDCOL's business activities and programs are designed to take into account the local conditions. Initially, IDCOL was designed to have a finite life, i.e., to end with the specific subprojects it carried out on behalf of its development partners. However, the Government decided to convert IDCOL into a company with corporate structure and boosted its capital basis. In its present form, IDCOL is financially independent of both the Government and development partners, and can meet its operational expenses from its own income.

[1] World Bank. 1997. *Private Sector Infrastructure Development Project* . Washington, DC.

D. Products and Services

5. Currently, IDCOL is involved in five distinct programs:
   (i) financing small, medium, and large infrastructure subprojects;
   (ii) refinancing nongovernment credits of organizations and microfinance institutions for the promotion of renewable energy subprojects;
   (iii) arranging both debt and equity financing for eligible infrastructure subprojects;
   (iv) providing financial advisory services to financial institutions and subproject sponsors; and
   (v) organizing training courses on project finance and financial modeling.

6. IDCOL has contributed to capacity building in the project financing area in Bangladesh by conducting numerous training courses and assistance to its participating institutions. The company provides professional training on project finance and finance modeling to mid-level and senior professionals of banks, financial institutions, and private companies. Over the last 8 years, IDCOL has trained nearly 400 professionals through various courses and workshops.

E. Lending Policies

7. As a lender to small, medium, and large infrastructure subprojects, IDCOL is a complementary source of funds and is able to provide loans covering up to 40% of the subproject cost within the framework of an appropriate financing plan.

8. The subproject developer or sponsor is expected to infuse a level of equity that is appropriate to the subproject considering the risks associated with its implementation and operation but, at a minimum, that investment must be at least 20% of the total subproject cost. Banks and other credit institutions (both public and private) often cooperate with IDCOL in drawing up the overall financing packages for major subprojects and participating with loans and other services.

F. Loan Classification

9. In terms of loan classification, IDCOL follows the provisions of the Bangladesh Bank's circular No. 8 of 3 August 2002, circular No. 11 of 31 October 2005, and circular No. 3 of May 2006, which is applicable for all nonbank financial institutions in Bangladesh operating under a Bangladesh Bank license. IDCOL does not have any special provision or arrangement of its own in this regard. Table A3.1 presents the current loan classification policy of Bangladesh Bank.

Table A3.1: Loan Classification as per Bangladesh Bank Directives[a]

Amount Outstanding for	Classification	Provisioning per Bangladesh Bank (%)
Up to 6 months	Unclassified	1 (general provision)
6–9 months	Substandard	20
9–12 months	Doubtful	50
Over 12 months	Loss	100

[a] For loans with a maturity of 5 years and more.
Source: Bangladesh Bank.

G. Business Process and Documentation

10. IDCOL has a well-devised set of assessment tools and policies in place, which conforms to international standards. The company's business processes are documented in its project appraisal manual, which was prepared by an international consultant under the World Bank-funded Private Sector Infrastructure Development Project. The consultant also conducted training in this regard for the employees of IDCOL. Subprojects financed by IDCOL are typically funded on a limited recourse basis.

H. Monitoring

11. Depending on the complexity and size of an individual subproject, a team of two dealing officers is normally assigned for the monitoring of a single subproject. However, the major role of monitoring typically lies with the lead arranger; therefore, regular inspections and close monitoring are normally done by IDCOL for those subprojects in which the company assumes the role of an arranger. For other subprojects where IDCOL only participates as a member of a consortium, its role is limited to carrying out a review of the progress report from the lead arranger and certifying the conditions precedent prior to the disbursement of any loan tranche. In cases where IDCOL assumes the role of the security custodian, the company also verifies and validates physical custody of all original contracts and securities documents. IDCOL also outsources expertise from specialized consultants and engineering universities, such as the Bangladesh University of Engineering and Technology and other public and private universities, for evaluation and verification of subprojects, the preparation of market studies and for the inspection of subproject plants and machinery.

I. Corporate Governance Structure of the Infrastructure Development Company Limited

1. Board of Directors

12. As per IDCOL's memorandum and articles of association, the number of directors will not be less than four or more than nine, or such number as may be determined from time to time by IDCOL in its general meeting in accordance with the aforesaid limit and provisions of the Companies Act (Bangladesh), 1994. Currently, IDCOL has an eight-member board of directors consisting of four high government officials, three leading businessmen from the private sector, and one executive director and chief executive officer. The secretary of the Economic Relations Department presently chairs the board.

13. With representatives from both private sector and government, the composition of the board of IDCOL is a key factor in the success of the company. Although the Government appoints all the directors, its board and management have a track record of independence regarding investment decisions on the basis of the subproject.

14. Proposals requiring an IDCOL board decision must be submitted in written form to the board for consideration. Decisions can be taken by the board either unanimously or based on simple majority. IDCOL has a comprehensive administrative manual that provides for administrative procedure of the company. Any change in the manual requires prior approval of the board. IDCOL's board meets once every month.

2. Infrastructure Development Company Limited's Board Committees

15. IDCOL's board forms special committees comprising board members or any other external and independent members for special purposes. The following are the existing committees of the IDCOL board.

a. Credit Committee

16. The credit committee of IDCOL is primarily responsible for reviewing all final term sheets and subproject appraisal reports before these are submitted to the board for approval. The approval of this committee is mandatory before these documents are submitted to the board for final approval. The credit committee also makes recommendations for pricing of all IDCOL loans. The five-member committee is currently headed by the secretary of the prime minister's office. The other four members are the secretary of the Power Division, two private sector directors of IDCOL's board, and IDCOL's chief executive officer.

b. Recruitment and Promotion Committee

17. The recruitment and promotion committee of IDCOL is a six-member committee comprising IDCOL's chairman, the secretary of the Power Division (director), the secretary of the prime minister's office (director), two directors nominated from the private sector, and IDCOL's chief executive officer. The committee is responsible for reviewing and making recommendations to the board regarding all new recruitment and promotion of personnel within IDCOL. All performance evaluations of internal staff and recruitment of new staff are done in accordance with the provisions under the operational manual. All written tests for recruitment are conducted independently by a university. Only short-listed candidates are then interviewed by the recruitment and promotion committee. Promotion of existing qualified staff is also done on the basis of performance and length of service.

c. Audit Committee

18. In compliance with the audit requirements of its various development partners, IDCOL has a two-member audit committee to assure the independence of its internal control functions and audit activities. This committee is responsible for (i) overseeing activities of IDCOL's internal auditor, (ii) defining the scope of the IDCOL audit, and (iii) taking appropriate actions to address any violations of independence that are brought to its attention by IDCOL internal and external auditors.

J. Conclusion

19. The operations of IDCOL are governed by the Companies Act (Bangladesh), 1994, and the segregation of policy making, implementation, functional responsibilities, and the absence of loan origination within the organization point towards a corporate governance structure that incorporates international best practices. The corporate governance structure of IDCOL is also subject to review by the two domestic credit rating agencies, and noncompliance would have an immediate and adverse impact on IDCOL's funding program.

FINANCIAL ANALYSIS OF THE INFRASTRUCTURE DEVELOPMENT COMPANY LIMITED

1. **Credit Rating.** The Government of Bangladesh is currently in the process of obtaining a sovereign credit rating from reputable international rating agencies such as Moody's, Standard and Poor's, and Fitch. In May 2007, the Infrastructure Development Company Limited (IDCOL), a 100% government-owned company, received its initial ratings from the two Bangladeshi rating agencies—AA from the Credit Rating Information and Services Limited and AA1 from the Credit Rating Agency of Bangladesh.

2. The above ratings are the highest rating afforded to any local financial institution in Bangladesh. The key determining factors for IDCOL's rating include (i) its policy role of financing Bangladesh's infrastructure development, (ii) its links with the state, (iii) strong liquidity, (iv) good profitability, and (v) good asset quality.

3. **Capital.** IDCOL has adequate capital for its operation. As of June 2008, its total paid-in capital was Tk400 million, an increase from Tk260 million in 2006. The paid-up capital of the company is expected to be increased to Tk500 million this year through the accumulation of retained earnings. It was only Tk100,000 as of 30 June 2005, and the Government has since injected significant capital. Total shareholder equity including retained earnings was Tk548 million as of June 2008. Since most of IDCOL's past loans were booked off-balance sheet, IDCOL's debt–equity ratio is only 2.57, which indicates ample room for borrowing from external sources, including the Asian Development Bank (ADB), and expanding its on-balance sheet operations.

4. IDCOL has paid a cash dividend of Tk30 million in its FY2007 and has proposed to pay another Tk30 million in FY2008, both of which are reasonable considering its capital base and profit level.

5. The Ministry of Finance holds 99.97% of the total shareholding and the remaining 0.03% is held by representatives from the Government and IDCOL.

6. **Balance Sheet and Asset Quality.** The total assets of IDCOL stood at Tk2.0 billion as of June 2008. The company's asset size has been rapidly increasing, from Tk444.0 million in FY2006 to Tk1.35 billion in FY2007 representing an increase of 203%. Since past lending programs funded by external resources such as the World Bank and KfW were classified as off-balance, the on-balance source of funding is dominated by loans and paid-in capital from the Government. IDCOL's assets include long-term loans of Tk980 million, short-term investments of Tk459.0 million, and short-term loans and advances of Tk238.0 million. Reflecting IDCOL's rapid expansion of its on-balance lending activities, supported by the capital enhancement, the company's portfolio of total loans and advances increased by Tk862.7 million, or 717%, in FY2007.

7. To date, IDCOL has financed 14 subprojects in the power, energy, telecommunications, ports, and information technology sectors, of which three were financed as off-balance sheet transactions amounting to Tk8.5 billion, and eleven were on-balance sheet transactions amounting to Tk1.5 billion.

8. Table A4.1 shows IDCOL's portfolio as of June 2008, including both off-balance sheet and on-balance sheet lending. While 86.6% of IDCOL's credit portfolio still consists of off-balance sheet items, the company is not pursuing further off-balance sheet financing. The

quality of the current portfolio is excellent since there has been no principal or interest overdue on IDCOL's loan portfolio. One significant risk factor, however, is the concentration of its on-balance sheet lending; the outstanding balance of the Tk628 million loan to Pacific Bangladesh Telecom accounts for 52.3% of its total on-balance sheet loans and 32.0% of its total assets. IDCOL is aware of this risk and is in the process of mitigating the risk by the diversification of its portfolio through new loans to various borrowers and sectors. While the largest loan by IDCOL has been the $80 million loan to Meghnaghat Power Project, which accounts for 57.3% of the total portfolio, this item is classified as off-balance sheet under the Private Sector Infrastructure Development Project.

Table A4.1: IDCOL's Outstanding Portfolio as of 30 June 2008

Project[a]	**Amount**[a] **(Tk million)**	**Share of Category (%)**	**Share of Total Portfolio (%)**
Off-Balance Items			
A. Private Sector Infrastructure Development Project			
Meghnaghat Power Project	5,145	66.1	57.3
Pacific Bangladesh Telecom Phase 1	78	1.0	0.9
DNS SatComm Satellite Earth Station Project	21	0.3	0.2
B. Electrification and Renewable Energy Development Project			
IDCOL Solar Project	2,509	32.2	27.9
Dream Power Biomass Project	5	0.1	0.1
IDCOL Biogas Project	22	0.3	0.2
Total Off-Balance Sheet Funding	**7,780**	**100.0**	**86.6**
On-Balance Items			
Panama Hilli Port Link Limited	34	2.8	0.4
Panama Sonamasjid Port Link Liimited	49	4.1	0.5
Pacific Bangladesh Telecom Phase II	80	6.7	0.9
Pacific Bangladesh Telecom Phase II	548	45.6	6.1
Summit Power Limited	139	11.6	1.5
Ranks Telecom Limited	13	1.1	0.1
GrameenPhone Network Expansion Project	125	10.4	1.4
Thermax Trade Limited	14	1.2	0.2
Malancha Holdings Limited	200	16.6	2.2
Total On-Balance Sheet Funding	**1,202**	**100.0**	**13.4**
Total	**8,982**		**100.0**

IDCOL = Infrastructure Development Company Limited.
[a] Loans in US dollars are converted at the rate of $1 = Tk68.5.
Source: Infrastructure Development Company Limited's FY2008 financial statements.

9. **Profitability.** IDCOL's asset base and return on assets over the past 3 fiscal years have grown substantially. An impressive improvement in IDCOL's profitability was observed in FY2008 when the company generated an after-tax profit of Tk140.0 million compared with Tk75.0 million in FY2007 and Tk17.0 million in FY2006. Despite the rapid increase in its asset size, the return on asset ratio also improved, from 5.6% to 7.1% reflecting IDCOL's expansion of its asset base, accompanied by the improved ability to generate additional profit through its on-balance sheet activities.

10. The main drivers have been two income components: income from IDCOL's renewable energy subprojects, and interest from loans of the infrastructure subprojects it financed. In terms

of the income from renewable energy subprojects, the management fees of the new solar program sponsored by the German development cooperation through KfW contributed an additional Tk87.8 million. With respect to the interest generated from infrastructure subprojects, the new loans to Pacific Bangladesh Telecom produced additional revenue of Tk58.3 million in total.

11. Table A4.2 shows that the income from loans accounts for 41.8% of IDCOL's total income, and this figure highlights IDCOL's expansion of its on-balance sheet lending, which is part of its strategy to finance privately sponsored infrastructure subprojects from its own balance sheet. While the level of the income from project finance (which mainly consists of monitoring and other fees from off-balance sheet transactions) remains stable, the proportion declined to 7.1% in FY2008 compared with 12.1% in FY2007 and 29.1% in FY2006.

Table A4.2: Income Contribution, FY2006–FY2008
(Tk million)

Item	FY2008		FY2007		FY2006	
	Amount	%	Amount	%	Amount	%
Income from project finance (off-balance sheet transactions)	20.4	7.1	20.5	12.1	21.9	29.1
Income from renewable energy projects	102.5	35.9	56.6	33.2	16.0	21.2
Income from loans (on-balance sheet transactions)	119.4	41.8	65.0	38.2	11.7	15.5
Income from short-term investment	36.9	12.9	26.6	15.6	23.8	31.5
Other income	6.7	2.3	1.5	0.9	2.1	2.8
Total	**285.9**	**100.0**	**170.2**	**100.0**	**75.4**	**100.0**

Source: Infrastructure Development Company Limited.

12. With respect to recurrent expenses, general and administration expenses slightly decreased. Other noncash items such as depreciation and amortization remained almost the same as the previous year.

13. **Cash Flow.** IDCOL has been sustaining stable cash flow from FY2005–FY2008. The net cash flow was –Tk11.4 million in FY2005 and positive net cash flows were recorded in FY2006 (Tk18.0 million), FY2007 (Tk61.6 million) and FY2008 (Tk158.6 million). While cash flows from operating activities were negative in the past three years, the shortfall increased from Tk27.9 million in FY2007 to Tk149.1 million in FY2008. This was mainly due to IDCOL's increased investment in fixed deposits. Due to the positive net cash flow, IDCOL has cash and cash equivalent of Tk246.8 million as of June 2008.

EXTERNAL ASSISTANCE TO THE INFRASTRUCTURE SECTOR

Table A5.1: World Bank

Project Name	Amount ($ million)	Date Approved
Haripur Power Project	183.00	1 Jun 2000
Air Quality Management Project	5.93	25 Jul 2000
Renewable Energy Development Project	8.20	5 Jun 2002
Rural Electrification and Renewable Energy Development	290.10	25 Jun 2002
Social Investment Program Project	22.54	18 Mar 2003
Rural Transport Improvement Project	255.00	19 Jun 2003
Telecommunications Technical Assistance Project	11.11	19 Jun 2003
Power Sector Development Technical Assistance Project	20.50	3 Jun 2004
Bangladesh Water Supply Program Project	55.11	17 Jun 2004
Investment Promotion and Financing Facility	105.20	2 May 2006
Railway Reform Programmatic Development Policy Credit	40.00	19 Oct 2006
Social Investment Program (Supplemental)	9.45	24 May 2007
Water Management Improvement Project	136.70	18 Sep 2007
Total	**1,142.84**	

Source: Compiled from World Bank projects database website.

Table A5.2: Japan Bank for International Cooperation

Project Name	Amount (¥ million)	Date Approved
Rural Electrification Project (Phase V-B)	1,460.0	29 Mar 2001
Greater Faridpur Rural Infrastructure Development Project	4,055.0	29 Mar 2001
Rupsa Construction Project	8,300.0	29 Mar 2001
Paksey Bridge Construction Project (II)	9,209.0	31 Mar 2003
Eastern Bangladesh Rural Infrastructure Development Project	11,345.0	22 Mar 2005
Grid Substations and Associated Transmission Lines Development Project	4,642.0	29 Jun 2006
Karnaphuli Water Supply Project	12,224.0	29 Jun 2006
Telecommunication Network Development Project	8,040.0	29 Jun 2006
Total	**59,275.0**	

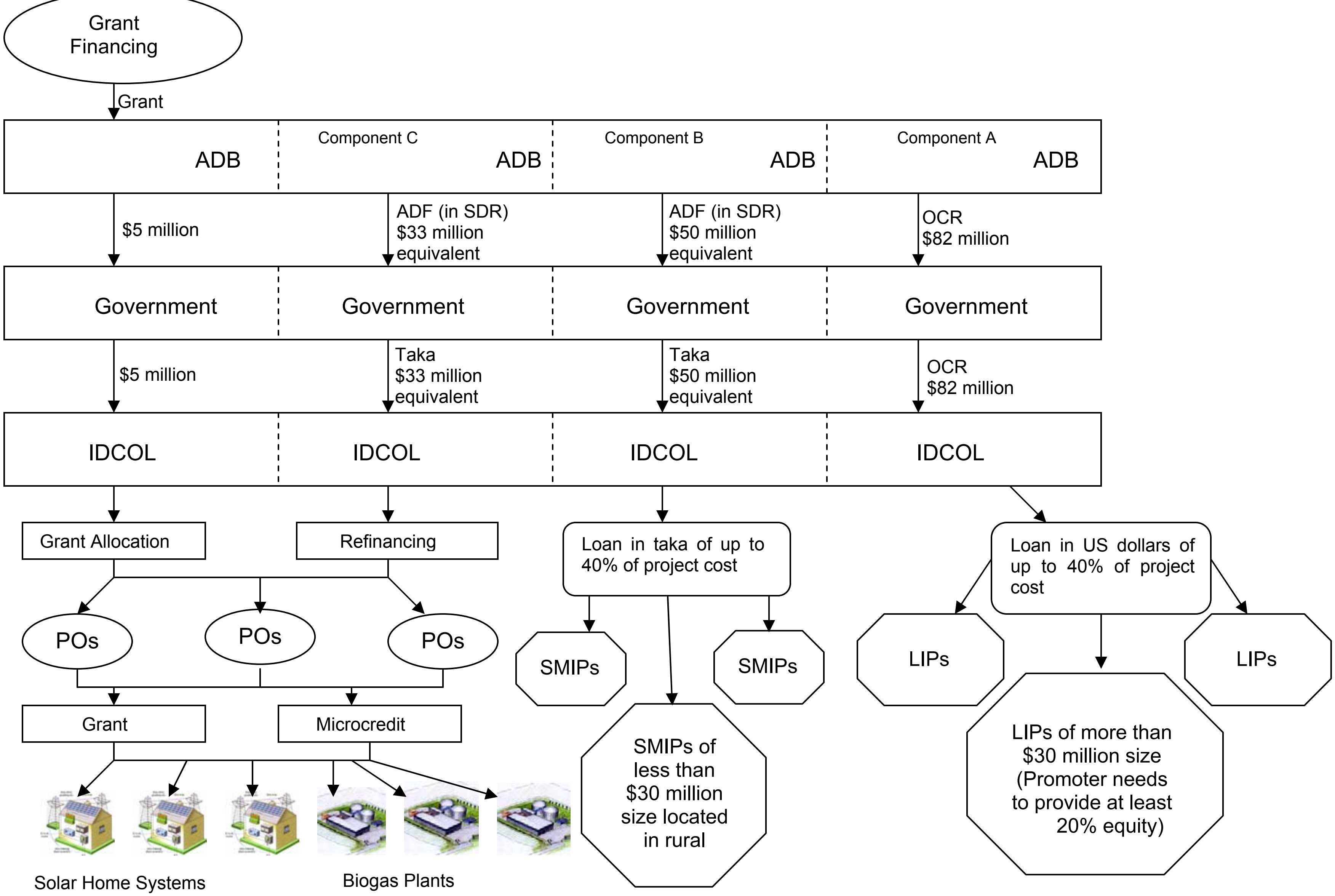
Source: Compiled from the Japan Bank for International Cooperation ODA project data website.

Table A5.3: German Development Cooperation through KfW

Project Name	Amount (€ million)	Date Approved
230 kV Transmission Line Baghabari-Bogra (cofinancing with ADB West Zone Power System Development Project)	23.7	2001
Renewable Energies I – Solar Energy Installations	16.5	2002
Rural markets and roads, Khulna Division	15.0	2002
Total	**55.2**	

Source: KfW. http://www.kfw-entwicklungsbank.de/EN_Home/Countries_and_Projects/Asia/South_and_Central_Asia/Bangladesh63/Projects.jsp.

PROJECT DESIGN



ADB = Asian Development Bank, ADF = Asian Development Fund, IDCOL = Infrastructure Development Company Limited, LIP = large infrastructure subproject, OCR = ordinary capital resources, PO = participating organization, SDR = Special Drawing Rights, SMIP = small and medium-sized infrastructure subproject.
Note: POs comprise nongovernment organizations and monetary financial institutions.
Source: Asian Development Bank.

ELIGIBILITY CRITERIA FOR PARTICIPATING ORGANIZATIONS

A. For All Participating Organizations

1. General Criteria

1. The following general criteria apply to all organizations participating in Infrastructure Development Company Limited (IDCOL)'s renewable energy subprojects:

(i) Satisfactory business plan approved by the participating organization's board of directors as to the overall planning in relation to the use of the IDCOL refinancing facility, including (a) proposed internal organization to implement the business plan; (b) details of responsible business team; (c) capacity to originate, evaluate, and approve lending proposals; (d) manage subsequent follow-up monitoring and loan recoveries; and (e) details of similar financing schemes that the participating organization operates.

(ii) Particulars of the operational and financial results of the participating organization for at least the previous 2 years based on an acceptable audited report. The participating organization's operations should be profitable for at least the past 2 years. However, in reaching an assessment about potential profitability, IDCOL will also consider (a) forward looking business prospects and potential for profitable operations; and (b) in case the participating organization is operating a solar program, the performance of the solar business.

(iii) The participating organization should furnish proof to IDCOL that the organization's financial performance is in conformity with the applicable financial criteria.

(iv) After fulfilling the eligibility criteria for program entry, the participating organization will continue to meet the aforementioned eligibility criteria, satisfactory to IDCOL, which shall monitor the participating organization's compliance therewith annually. If the participating organization fails at any time to satisfy the above specified criteria, IDCOL reserves the right to suspend subloan authorizations under the Project until the participating organization has taken specific steps to address its problems in a manner satisfactory to IDCOL.

(v) The participating organization has established and maintained sound and transparent accounting, management information, and internal audit systems.

(vi) Accounts are audited by a reputable external auditor on an annual basis.

2. Specific Financial Criteria

2. The following specific financial criteria apply to all organizations participating in IDCOL's renewable energy subproject:

(i) must have a minimum equity of Tk1 million;
(ii) must have a debt–equity ratio of the microfinance institutions not in excess of 3.0;

(iii) must have minimum total cash collection ratio of principal and interest on current loan portfolio calculated on a rolling 12-month basis of 95%;
(iv) in case of an existing solar home systems loan portfolio, must have a minimum total cash collection ratio of principal and interest calculated on a rolling 12-month basis of 95%;
(v) must have a minimum after-tax profit equivalent to 4% per annum on revolving loan fund;
(vi) in cases where prospective business profitability is considered to be positive, should be at least breaking even after meeting operational expenses and debt service. However, in such cases, continued eligibility will be conditional on being able to meet the 4% per annum after-tax profit criterion the following year; and
(vii) must have a minimum debt service coverage ratio of 1.25 times.

B. For Microfinance Institutions

3. In addition to above criteria, microfinance institutions have to comply with the following criteria:

(i) must be registered with appropriate registration authority to conduct microfinance services;
(ii) must be currently conducting microfinance services with soft loan funds from
    (a) Palli Karma-Sahayak Foundation as a participating organization,
    (b) the Bank of Small Industries and Commerce, and
    (c) any other similar national or international funding source;
(iii) must have microfinance operations in subproject areas identified in the priority list for the solar home system program;
(iv) must have not less than 10,000 beneficiaries; and
(v) must be capable of managing a rural renewable energy program.

INFRASTRUCTURE DEVELOPMENT COMPANY LIMITED'S RENEWABLE ENERGY PROGRAM

1. The Infrastructure Development Company Limited (IDCOL) has been very successful in the recent past in undertaking renewable energy programs. These include a solar energy program, a biomass gasification-based power plant subproject, and a biogas-based electricity plant subproject. IDCOL plans to allocate the $33 million Asian Development Fund (ADF) loan to each program as shown in Table A8.1.

Table A8.1: Allocation of the ADF Loan

Renewable Energy Program	**Installation and construction**	**Equivalent** (MW)	**Cost per plant** ($)	**Loan and Refinancing per plant** ($)	**Total Loan and Refinancing** ($ million)
Solar Energy	98,000	4.90	404	275	26.9
Biomass Power Plants	15	7.50	579,710	289,855	4.3
Biogas Power Plants	100	5.00	36,232	18,116	1.8

ADF = Asian Development Fund, MW = megawatts.
Source: Infrastructure Development Company Limited.

A. Solar Energy Program

1. Objective

2. The objective of the program is to support Bangladesh's efforts to raise levels of social development and economic growth by increasing access to electricity in remote rural areas and to reduce carbon emissions by overcoming market barriers for renewable energy development. IDCOL's solar energy program has the mission of fulfilling basic electricity requirements in the rural areas of Bangladesh and supplementing the Government's vision of Electricity for All by 2020. IDCOL, with support from various development partners, is channeling funds to small-scale renewable energy subprojects under this program.

2. Program Overview

3. The program is being implemented through nongovernment organizations and microfinance institutions referred to as participating organizations. So far 15 participating organizations[1] have signed participation agreements with IDCOL to work under the solar energy program.

4. Participating organizations select subproject areas and potential customers, extend loans, install the systems, and provide maintenance support. IDCOL will provide grants and refinancing, set technical specifications for solar equipment, develop publicity materials, provide training, and monitor the performance of participating organizations. IDCOL offers soft loans of

[1] Bangladesh Rural Advancement Committee Foundation, Bangladesh Rural Integrated Development for Grub-Street, Center for Mass Education in Science, COAST Trust, Grameen Shakti, Hilful Fuzul Samaj Kalyan Sangstha, Integrated Development Fund, Mukti, Padakhep Manabik Unnayan Kendra, Palli Daridra Bimochan Foundation, Rural Services Foundation, Shubashati, SRIZONY Bangladesh, Thengamara Manila Shabuj Shangha, and Upakulio Biddutayan O Mohila Unnayan Samity.

10-year maturity with a 2-year grace period at 6% per annum interest to the participating organizations. Usually, IDCOL does not require any collateral or security for the loan, except for a lien created on the subproject accounts. Unless and until there is an event of default, participating organizations are authorized to operate the subproject accounts on their own.

5. Households can buy solar home systems (SHS) either in cash or on credit. Participating organizations extend loans on various terms and conditions to the households for purchase of SHSs. The loan tenor varies from 1 to 5 years, and the interest rate varies from 8% to 15% per annum on declining balance method and 10% to 15% per annum on equal principal payment method. In all instances the repayment frequency is monthly.

6. Under the participation agreements, the households are required to pay a minimum of 10% of the system cost as a down payment. On receipt of the down payment, the participating organizations enter into a sale or lease agreement (provisions of which are approved by IDCOL), install the system, and make electronic disbursement requests to IDCOL for refinance and grants, as applicable. Installations are usually made within 1 month from the down payment, sometimes within 2–3 days depending on the practice of each participating organization. After in-house checking, IDCOL conducts a physical verification of the SHSs installed. IDCOL releases grants and refinance amounts only if the inspection result is satisfactory. While a typical 50 watt SHS costs around $400, the refinance amount does not exceed $230 equivalent in taka per system. IDCOL makes the disbursement within 21 days from the receipt of disbursement request.

7. In addition to refinancing, IDCOL provides grants to bring down the capital cost of SHSs and to meet the incremental operating costs of the participating organizations and thus build their institutional capacity. Since IDCOL's principal objective is the commercialization of SHSs, it has adopted a policy of declining grant with the progress of the subproject, which is shown in Table A8.2 below. The current grant is approximately 10% of the total cost, while over 15% was available at the initial stage.

Table A8.2: Phased Reduction of the Grants

Item	Amount of Grant Available per Solar Home System per Household		
	Total	Buy-down grant	Institutional Development Grant
First 20,000 systems	$90	$70	$20
Next 20,000 systems	$70	$55	$15
Next 30,000 systems	$50	$40	$10
Next 88,160 systems	€38	€30	€8
Next 35,000 systems	€36	€30	€6
Next 35,000 systems	€34	€30	€4

Source: Infrastructure Development Company Limited.

3. Current Status of the Program

8. IDCOL had an initial target of financing 50,000 SHSs, which it achieved in August 2005, 3 years ahead of the target date and $2 million below estimated costs. Following the success of IDCOL's solar program, the World Bank extended its support for financing renewable energy subprojects and German development cooperation through KfW provided €16.5 million ($21.3 million) in 2005 as a grant to the Government to be used for the further financing of renewable energy subprojects. Up to April 2008, a total of approximately 200,000 SHSs have been installed under IDCOL's solar program.

9. So far, IDCOL has arranged grants for 228,160 SHSs and refinancing for 225,000 SHSs from the World Bank and German development cooperation through KfW and GTZ. Table A8.3 shows allocation of grant and refinancing as of January 2008.

Table A8.3: Utilization of Funds Available
(as of January 2008)

Item	IDA and GEF	KfW	GTZ
Grant			
Available (for number of SHS)	70,000	100,000	58,160
Disbursed (for number of SHS)	70,000	58,005	33,660
Amount Allocated	$6.8 million	€5.5 million	€2.7 million
Amount Utilized	$6.2 million	€2.2 million	€1.4 million
Refinancing			
Available (for number of SHS)	170,000	55,000	—
Disbursed (for number of SHS)	153,503	—	—
Amount Allocated	SDR27 million	€9.7 million	—
Amount Utilized	SDR24 million	—	—

GEF = Global Environment Facility, IDA = International Development Association, SHS = solar home system.
Source: Infrastructure Development Company Limited.

10. Currently, IDCOL uses primarily funding from KfW to finance approximately 10,000 SHSs per month—more than double the figure estimated at the time of appraisal by KfW. At the present rate of project implementation, the KfW funds, which were originally available for the financing of a total of 100,000 SHSs, will be exhausted within 2 years (by the end of 2008) rather than the original target of 4 years.

11. In terms of financial status, there has been no default or any other repayment issues on loans from IDCOL to the participating organizations so far. The current repayment rate of the loans from the participating organizations to the households is very high (approximately 96%).

4. Program Target

12. The revised target for installation of SHSs for 2008–2012 is shown in Table A8.4. Based on the rapid installation of SHSs in the past 5 years, IDCOL now has an ambitious target of installing more than 928,000 SHSs by 2012.

Table A8.4: Installation Targets for Solar Home System, 2008–2012

Item	Up to 2007	2008	2009	2010	2011	2012
Installation		102,000	126,000	156,000	180,000	198,000
Installation (cumulative)	166,624	268,624	394,624	550,624	730,624	928,624
Equivalent MW (cumulative)	8.3	13.4	19.7	27.5	36.5	46.4

MW = megawatt.
Source: Infrastructure Development Company Limited.

13. Of the proposed ADF loan of $33 million allocated for the renewable energy component, IDCOL plans to extend $26.9 million for refinancing, which will aid the installation of approximately 98,000 SHSs, or 4.9 megawatt (MW) equivalent. The rest will be extended to the other renewable energy programs, including biomass and biogas power plants.

5. Monitoring and Evaluation of Outcomes and Results

14. During implementation, all participating organizations will prepare a monthly program of SHS installation and submit them to IDCOL. As installation proceeds, the information will be recorded and stored in a database and IDCOL will prepare consolidated periodic progress reports based on the reports. During the follow-up phase, IDCOL will prepare an annual report on the number of SHSs that are operational based on a 100% survey of all the households carried out by the participating organizations. The participating organizations will also submit to IDCOL a monthly report of the installment payments made to the participating organizations by the households which have bought the SHS on credit. All data will be collected and kept for the crediting period plus 2 years.

6. Development Impact of the Program

15. SHSs are a convenient way to supply power for small electrical loads such as lights, radio and cassette players, and black and white television sets. Although available for a limited number of hours in a day, the supply is reliable and the system can be managed with a little training. The program has also brought positive changes to the economy of the rural people, as they are now using SHSs for their income-generating activities, e.g., working hours have been increased for small-business operators, weavers, tailors, hairdressers, and handicraft makers. Students are also getting benefits through extended hours of study at night. In addition, the use of television and radio has enhanced rural people's access to the wider world. Many women stated that they were feeling more secure at night after the installation of an SHS.

16. Furthermore, IDCOL estimates that each SHS saves at least $61.80 worth of kerosene every year and reduces carbon dioxide (CO_2) emissions by 375 kilograms (kg) annually as a result. Therefore, the installation of estimated 98,000 SHSs through ADB funding will save more than $6 million and reduce approximately 36,750 tons of CO_2 emissions annually over the 20-year life of the SHSs.

7. Job Creation in Participating Organizations' Subproject Areas

17. A significant number of job opportunities, both for skilled and unskilled labor, have been created. In particular, each unit office hires a local youth who has good knowledge of the area. It has paved the way for creating job opportunities locally. In addition, a significant number of diploma engineers have been employed by participating organizations to look after the technical aspects of SHSs. IDCOL estimates that around 1,500 new jobs have been created by the program.

8. Promotion of Indigenous Technology

18. An SHS system includes a photovoltaic module, battery, charge controller, solar lamp, and switch. Except for the photovoltaic module, all other components are produced locally. For example, Rahimafrooz, a local battery supplier, has doubled its capacity to meet the demand for SHS. Charge controller and solar lamp manufacturers provide poor women with a job opportunity. IDCOL is also trying to establish a 1–2 MW solar panel assembly plant in Bangladesh through private sector participation in order to reduce the cost of the photovoltaic module.

9. Environmental Issues and Safeguard Policies

19. SHSs have a variety of positive social impacts enabling the users to access radio and television signals, and students and others to work in a safer and more pleasant environment. They will also be environmentally beneficial as the use of fossil fuel will be reduced. The only potential environmental hazard may arise from improper disposal of lead-acid storage batteries used in SHSs. Participating organizations have agents all over Bangladesh and they are already assisting SHS owners in the operation and maintenance of their systems, which includes the safe disposal of batteries. These arrangements are an integral part of participating organization operations and will continue. No negative environmental impacts are therefore expected.

B. Biomass-Based Power Plant Project

20. IDCOL has financed a 250 kilowatt biomass-based power plant at Kapasia, Gazipur. IDCOL has provided concessional loans and grants to Dreams Power Private Limited, the subproject sponsor, for setting up the plant. The total cost of the subproject was Tk25 million, and the plant uses locally available agricultural residues, i.e., rice husks, as fuel for power generation. Ankur Scientific Energy Technologies Bangladesh is the equipment supplier of the subproject. Being located in an unelectrified area, the plant supplies environmentally friendly grid quality power to 300 households and commercial entities in the area. The plant started commercial operation in December 2007.

21. IDCOL intends to finance 15 additional biomass gasification-based power plants in the next few years. It is envisaged that $4.3 million of the ADF loan will be extended in order to finance up to 50% of each subproject cost. These 15 plants will produce 7.5 MW in total. According to IDCOL's assessment, however, a portion of subproject cost has to be financed as a grant to make these plants financially viable.

C. Biogas-Based Electricity Plant Subproject[2]

22. IDCOL also plans to finance biogas-based electricity plants[3] on a pilot basis. While a few biogas-based electricity plants have already been installed in Bangladesh, a technical challenge remains to remove impurities from the biogas before it enters into the generator. After assessing the technical and financial feasibility through the pilot subproject, IDCOL intends to finance around 100 biogas plants through participating organizations. It is envisaged that $1.8 million will be extended to this subproject from the ADF loan, and will result in 5.0 MW generation capacity in total.

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[2] IDCOL has been undertaking the national domestic biogas and manure program under Netherlands Development Organization (SNV) and KfW assistance since 2006. Under the program, 2,200 biogas plants had been installed by the end of 2007. These biogas plants produce gas and slurry but do not generate electricity, and these plants therefore mainly serve cooking purposes (gas) and agricultural production (slurry as good organic fertilizer). In the new project, IDCOL intends to introduce biogas-based electricity plants.

[3] The major difference between biomass gasification and biogas technologies are the source of the biomass energy and the way they produce gas. Gasification technologies make biogas by heating wood chips or other vegetable biomass in an oxygen-starved environment. Biogas technologies take advantage of the natural fermentation of human and animal excreta and other garbage that produces methane gas.

SUMMARY ENVIRONMENTAL AND SOCIAL SAFEGUARDS FRAMEWORK

A. Introduction

1. The environmental and social safeguards framework (ESSF) comprises the environmental management system (EMS) and the social safeguards framework (SSF). The provisions for environmental and social safeguards and the assessment and mitigation measures contained in the EMS and SSF are applicable for all components and subprojects financed through the resources from the Asian Development Bank (ADB) by the Infrastructure Development Company Limited (IDCOL), through direct lending and refinance operations to both public and private sector companies.

2. Given the structure of components under the Public–Private Infrastructure Development Facility (PPIDF), the ESSF will apply at the Project level for components A and B and for biogas and biomass power plants financed under component C. For solar energy subprojects financed under component C, the ESSF will apply at the program level. The ESSF is not limited to IDCOL; all lead banks and sponsors interested in seeking financial assistance from IDCOL, where financing from ADB is used, will need to conduct business in a manner such that IDCOL can be compliant with this ESSF.

3. The ESSF builds upon the environmental and social appraisal manual that was prepared in 2000 by a team of external consultants in response to the requirements of the World Bank in processing the Private Sector Infrastructure Fund. Importantly, the ESSF incorporates updates on environmental and social governance of the Government of Bangladesh and the requirements of ADB's safeguard policies,[1] i.e., the *Involuntary Resettlement Policy* (1995), the *Policy on Indigenous Peoples* (1998), and the *Environment Policy* (2002).

B. Overview and Structure of the Environmental and Social Safeguards Framework

4. IDCOL's ESSF has been structured to reflect the following:

(i) environmental and social policies,
(ii) operational steps on environmental and social procedures as practiced in subproject processing and in the subproject life cycle,
(iii) guidance and checklists,
(iv) institutional structure to operate the ESSF,
(v) capacity development plan at IDCOL,
(vi) allocation of responsibilities,
(vii) annual environmental and social reporting, and
(viii) updating of the ESSF.

[1] Safeguard policies are generally understood to be those operational policies that seek to avoid, minimize, or mitigate adverse environmental and social impacts, including the protection of the rights of those affected or likely to be marginalized by the development process. There is no formal definition of ADB's safeguard policies. However, the three policies mentioned here are identified as safeguard policies in ADB. 2003. *Review of the Inspection Function: Establishment of a New ADB Accountability Mechanism*. Manila (page 60).

1. Environmental and Social Policy Statement of IDCOL's Environmental and Social Safeguards Framework

5. IDCOL gives due importance to environmental and social considerations in appraising and financing infrastructure subprojects in order to minimize adverse impacts and risks to the environment and people that may be affected.

6. IDCOL is committed to comply with all relevant environmental and social policy and legislative requirements and laws of the lands with which it engages and remain responsive to the environmental and social requirements of ADB.

2. Environmental Management System Framework

7. The EMS framework defines policy procedures, roles, and responsibilities for managing adverse environmental impacts and risks due to subprojects that are financed by IDCOL. The EMS has been prepared as part of IDCOL's commitment to comply with the Government's environmental policies, laws, and regulations, and ADB's environmental safeguard policy.

8. The objectives of the EMS are to

(i) avoid and minimize adverse environmental impacts and risks due to subprojects that will receive finance from IDCOL, especially in environmentally sensitive areas;
(ii) ensure that adverse environmental impacts and risks are well mitigated to achieve applicable environmental standards;
(iii) comply with applicable Government laws and regulations and environmental safeguards requirements of development partners; and
(iv) provide guidance to lead banks and sponsors in preparing subprojects for appraisal at IDCOL and in conducting subsequent monitoring and reporting, and in undertaking corrective actions.

9. Supplementary Appendix G shows a comparative assessment between the Government's environmental impact assessment (EIA) framework and the environmental and social safeguards (ESS) of ADB. This comparison shows that the Government's EIA framework has significant weaknesses and deviations from the ESS of ADB. The areas of differences are schemes of subproject categorization, scoping, alternatives, and requirements of public consultation and disclosure.

3. Social Safeguards Framework

10. The SSF defines and outlines policies, procedures, roles, and responsibilities for managing involuntary resettlement impacts and risks, and effects on *adivasi*[2] peoples of subprojects that are financed by IDCOL. The SSF is part of the commitment of IDCOL to comply with the Government's social policies, laws, and regulations, and to comply with ADB's social safeguard policies.

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[2] Groups referred to by international organizations as indigenous peoples can be referred to in Bangladesh as ethnic minorities or *adivasi(s)*. *Adivasi* is the term employed in the draft national policy on involuntary resettlement.

11. A key objective of the SSF is to provide guidance to subproject sponsors in preparing subprojects for appraisal for the PPIDF and in conducting subsequent monitoring, and reporting, and in undertaking corrective actions. As the facility will make investments in companies with significant operations in Bangladeshi infrastructure, in some circumstances such development or expansion may cause involuntary resettlement impacts on people. In these and other circumstances, the lives and livelihoods of *adivasis* may also be affected. In such cases, relevant Government legislation and policies would apply, as would either or both of ADB's involuntary resettlement and indigenous peoples policies (as reflected in this framework).[3]

12. Other key objectives for this SSF are to ensure that subproject-affected people benefit from the proposed subprojects to the extent possible and that they are consulted about the subproject throughout the life of the subproject. IDCOL will ensure that involuntary resettlement impacts of any subproject submitted for financing under the facility are dealt with in accordance with the applicable Government and regional laws and regulations governing land acquisition, compensation, relocation, and resettlement, and in accordance with ADB's policies on involuntary resettlement.

13. Objectives for managing involuntary resettlement impacts and risks are to

(i) avoid involuntary resettlement wherever feasible,
(ii) minimize resettlement where population displacement is unavoidable, and
(iii) ensure that affected people receive assistance so that they will be at least as well off as they would have been in the absence of the subproject.

14. Objectives for managing subproject impacts on *adivasis* are to

(i) achieve the greatest possible reduction of poverty and vulnerability among the affected *adivasi* populations;
(ii) minimize negative impacts, if they are unavoidable;
(iii) ensure transparency and accountability of any mechanism applied as part of subproject intervention;
(iv) deliver culturally appropriate programs and benefits, and
(v) ensure meaningful consultations take place regarding the scope and delivery of compensatory mechanisms and benefits.

15. Supplementary Appendix H shows a comparison of the Government's social safeguards approach as it relates to involuntary resettlement and indigenous people issues from that of ADB. For the indigenous people (*adivasi*) issues, a significant difference is the lack of national coverage in the Government legislation along with differences in terms of consultation requirements. For involuntary resettlement, the areas of difference include payment of market versus replacement cost for lost land and assets, as well as in eligibility and entitlement.

C. Integrated Application of Environmental Management System and Social Safeguards Framework for the Public–Private Infrastructure Development Facility

[3] There are some significant differences between the Government's involuntary resettlement policies (i.e., land acquisition policies) and those of ADB, particularly the latter's emphases on (i) utilizing the principle of replacement price over market price, (ii) livelihood restoration, and (iii) recognizing nontitled persons' rights to compensation. Similarly, the Government *adivasi* framework does not include all such populations in the country and does not include requirements for development plans for projects affecting *adivasis*.

16. Considering the components under the PPIDF, the ESSF is structured on subproject and program levels**.** Since various subprojects that will be financed under components A and B could have potential environmental and social issues, the ESSF will operate at the subproject level. On the other hand, the subprojects supported under component C (with the exception of biogas and biomass power plants) will not have significant environmental and social impacts at the subproject level. On the program level, however, there could be environmental and social impacts that may need to be attended to. Hence, the ESSF will operate at the program level for component C.

1. Subproject Processing Steps at IDCOL for Components A and B

17. There will be two possibilities for the application of the ESSF for IDCOL's PPIDF depending on the timing of the subproject loan application.

18. **Case A.** The first case applies to all subprojects that have already received the preliminary letter of support from IDCOL but have not yet received final loan approval by IDCOL's board of directors at the time of ADB loan effectiveness. This case will be transitional. For such subprojects, the process will essentially be of due diligence and will be as follows:

(i) Categorize the subprojects as to whether it warrants initial environment examination or EIA, or the equivalent of a full or short resettlement plan and/or a full or short *adivasi* development plan (ADP).

(ii) Identify gaps, if any, in environmental and social compliance. If there are no gaps, then review all relevant environmental management plans (EMPs), resettlement plans, and/or ADP reports and plans. If such reports are not available, then prepare internal environmental and social appraisal reports using resources at IDCOL's Environmental and Social Safeguards Management Unit (ESSMU) and/or external expert(s) as appropriate. For category A subprojects or for equivalent of full resettlement and/or full ADPs, include field visit of environmental and social safeguards specialist.

(iii) If there are gaps on environmental or social compliance, or in the proposed EMPs, resettlement action plans or ADP (in terms of coverage, adequacy, and costing) then direct the lead bank and/or sponsors to carry out time-targeted actions to attain compliance and strengthen provisions made for EMP, resettlement action plans, and ADP appropriately.

(iv) In cases where the lead bank and/or sponsor approaches IDCOL with all land and preparatory physical assets acquisitions already having been completed, IDCOL will initiate a process of due diligence to assess the circumstances and nature of such acquisitions.

(v) Due diligence aims to
   (a) identify any outstanding issues regarding land and livelihood assets purchased;
   (b) identify any outstanding *adivasi* issues regarding subproject plan, design, and implementation, particularly the proportionate inclusion of *adivasi* populations in subproject benefits or opportunities;
   (c) confirm that the laws and regulations of the Government were followed;
   (d) determine specific involuntary resettlement issues such as:

(i) Is there any ongoing encroachment on subproject lands?
(ii) Were people excluded from compensation on the grounds of being illegal squatters on the land purchased?
(iii) Was all compensation paid as promised? Was it according to replacement value? Are there any outstanding claims?
(iv) Was the area claimed and/or purchased the same as the area actually taken by the subproject?

(vi) Due diligence is pursued through the following measures:
(a) By using a social assessment (commissioned by the sponsor and proportionate in scope to the significance of social impact) to identify gaps, if any, in social compliance as per this SSF.
(b) By IDCOL reviewing the social assessment report issued.
(c) If there are no gaps, then IDCOL will review all relevant involuntary resettlement and/or *adivasi*-related reports or plans. For equivalent of full resettlement plans and/or full ADPs, include field visit of the ESSMU social safeguards specialist (social safeguards liaison officer) to confirm the social appraisal report.
(d) If there are gaps on social compliance, by directing subproject sponsors to carry out time-targeted actions to attain compliance, documented in a written action plan.
(e) By setting loan conditionality (in loan sanction letter and elsewhere, as necessary) to include these commitments in social (resettlement and *adivasi*) safeguard covenants.

(vii) Reissue revised indicative term sheet (as necessary) to include these requirements towards environmental and social (resettlement and *adivasi*) compliance.

(viii) On obtaining concurrence from the lead bank and/or sponsor, follow steps as per (v) of case B.

19. **Case B.** The second case applies to all subprojects that have not yet received a preliminary letter of support by IDCOL at the time of ADB loan effectiveness. This case will represent the situation of normal subproject processing and monitoring. The procedural steps for this case are as follows.

(i) Brief the lead bank and/or sponsor on the ESSF during the "know your client" meeting. Explain the environmental and social requirements in the completion of the loan application form.[4]

(ii) In preparing loan applications, it is strongly advised that the subproject sponsor be familiar with the environmental and social requirements of the Government. The lead bank and/or sponsor will provide IDCOL with a preliminary description of the subproject configuration, including the location of the subproject, the land requirements and how it was obtained, the types of people at the subproject site

[4] Presently, IDCOL's loan application form does not ask for basic environmental and social information. Recently, under the World Bank-supported Investment Promotion and Financing Facility, the Bangladesh Bank has introduced a section on environmental compliance. Under this ESSF, IDCOL will include a similar section in its loan application form.

(including the presence or absence of *adivasis*), and a brief assessment of the social conditions at the subproject location. Similarly, brief information will need to be provided on the environmental setting of the location (any sensitive flora, fauna, water bodies, or populations), information on raw materials, products, outputs and fuel proposed to be used, and plans on management of wastes and/or emissions.

(iii) Prepare environmental and social section of the preliminary subproject appraisal based on completed loan application form from the lead bank and/or sponsor. This section will conduct environmental categorization[5] and preliminary screening of proposed subprojects to identify key environmental issues, resettlement effects, and impacts on *adivasis*.

(iv) If the preliminary subproject appraisal determines that significant environmental issues that are irreversible and cannot be mitigated exist, or if it is found that there are highly significant involuntary resettlement effects or likely significant negative effects on *adivasis*, then financing of the subproject will not be recommended.

(v) If it is found that the environmental and social issues can be well addressed through appropriate prevention and mitigation measures, then a preliminary letter of support will be recommended with an indicative term sheet that will state various environmental and social requirements and conditions. Inform ADB and provide it with all the key documents that are prepared for the issuance of the preliminary letter of support.

(vi) For component A and B subprojects, submission of the EMP, resettlement action plan and ADP documents for ADB's approval will be mandatory for subprojects financed after ADB loan effectiveness. After receiving approval, IDCOL will continue to be responsible for due diligence adherence to the guidelines of this ESSF.

(vii) These requirements will include submission of a short environmental assessment report (SEAR) and a short social assessment report (SSAR). These reports will need to be prepared by the lead bank and/or sponsor in accordance with this ESSF.

(viii) In cases where the lead bank and/or sponsor approaches IDCOL with all land and preparatory physical assets acquisitions already having been completed, IDCOL will initiate a due diligence process to assess the circumstances and nature of such acquisitions, as set out earlier.

(ix) The SSAR is a technical report prepared at the instruction of the lenders and on behalf of the subproject sponsor or lead bank. The SSAR will report the results of the social assessment, focusing on the likely involuntary resettlement effects and

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[5] Categorization will be done based on both the Government and ADB environmental safeguard systems. The Government follows categories like green, orange-1, orange-2, and red whereas equivalent categories of ADB are C, B, and A, with A corresponding to the red category of the Government. In the case of differences, the most sensitive category of the two will take precedence.

impacts on *adivasis* of the proposed subproject. The SSAR will be based on quantitative and qualitative subproject-site investigations by a qualified social science professional. The extent of the SSAR should be proportionate to the expected involuntary resettlement and adivasis impacts, as indicated by the initial screening for the preliminary subproject appraisal.

(x) The SEAR will include a draft EMP covering site preparation, construction, operation, and closure cycles of the subproject, drawn in response to issues identified and towards meeting compliance requirements of various environmental regulations of the Government. The EMP may be accompanied by a disaster management plan as appropriate. The EMP and/or disaster management plan should reflect good or environmentally sound practices, especially in the choice of technology, equipment, and materials and fuel.

(xi) Once the preliminary letter of support is issued, IDCOL's interest in financing the subproject is to be posted on its website with a short subproject description and with a provision to receive feedback over 60 days for subprojects under component A and 30 days for subprojects under component B (sensitive subprojects).

(xii) Review the SEAR, reaffirm the subproject categorization (category A), and determine the adequacy, coverage, and effectiveness of the outline EMP submitted. Recommend the terms of reference for the conduct of the EIA on this basis if the same is not yet completed or commenced.

(xiii) Based on the SSAR, assess the magnitude of involuntary resettlement impacts and determine whether a short or full resettlement plan is required for the subproject. A full resettlement plan will be required where resettlement is significant. Involuntary resettlement is deemed significant when 200 or more people will experience major impacts, which are defined as being physically displaced from housing or losing 10% or more of their productive (income-generating) assets.

(xiv) Similarly, with regard to impacts on *adivasis*, a determination will be made as to the significance of impacts and whether a short or full ADP is required. The impacts of subprojects on *adivasis* will be considered significant if the impacts positively or negatively (a) affect their customary rights of use and access to land and natural resources; (b) change their socioeconomic status; (c) affect their cultural and communal integrity; (d) affect their health, education, livelihood, and social security status; or (e) alter or undermine the recognition of indigenous knowledge.

(xv) Prepare environmental and social section of the subproject appraisal report. Review all documents required towards environmental and social compliance as per checklists and review adequacy, coverage, and costing of the EMP and resettlement action plan (short or full).

(xvi) Involve external expert as required, especially if complete or up-to-date documentation is not available at this stage. For subprojects financed under component A or for equivalent of full resettlement plans and/or full ADPs, include field visit of ESSMU staff and the external expert.

(xvii) Develop section on environmental and social aspects of the common term sheet based on the outcomes of the appraisal.

(xviii) Recommend to the credit committee and to IDCOL board to include conditions for environmental and social compliance in the loan sanction letter and loan agreement.

(xix) In the case of environment category B (sensitive) or category A subprojects, the summary initial environment examination or the summary EIA is made available to the public 120 days before a disbursement request is submitted to ADB and is posted on ADB's website.

(xx) Obtain ADB's approval for the entire category A subproject prior to the issue of loan sanction letter.

(xxi) Monitor whether the conditions have been met, especially on approvals (such as environmental clearance certificate) and whether satisfactory and full implementation of the EMP, resettlement action plan and ADP has been achieved. Subproject sponsors should make environmental and social monitoring reports available to affected people. All monitoring reports should be sent to ADB and disclosed publicly to affected stakeholders.

(xxii) Continue monitoring progress on the subproject through reports received from the lead bank and/or sponsor. Conduct field visits if required by sending the staff of ESSMU. Conduct third-party monitoring in the case of subprojects financed under component A and in case of subprojects under component B where there are instances of repeated noncompliance. Recommend direct adaptations in the EMP, resettlement action plan and ADP as needed.

(xxiii) For third-party monitoring to add value and not serve as an imposition, IDCOL may consider offering annual service of rapid energy efficiency audits to power-generating subprojects. These energy efficiency audits will include emission monitoring and thus provide status on both energy efficiency and environmental compliance. Fees to third parties for such rapid energy efficiency audits may be supported from the budget under ADB's technical assistance.

20. The steps as outlined for case B, i.e., normal subproject processing and monitoring, will thus bring the ESSF into the mainstream of the PPIDF.

2. Application of the Environmental and Social Safeguard Framework for Component C of the Public–Private Infrastructure Development Facility

21. Component C will support IDCOL's already successful renewable energy program which finances solar home systems and biomass-based installations in rural areas.

22. Financing of SHSs does not entail significant environmental and social impacts at the level of an installation or a system. No involuntary resettlement and rehabilitation issues are expected under this component (with the exception of biogas and biomass power plants) as land acquisition is not involved.

23. The package under the renewable energy system (RES) will involve provision of lead acetate batteries and compact fluorescent lamps. Since thousands of such packages are expected to be financed and implemented, disposal of used lead acetate batteries and compact fluorescent lamps needs to be looked into.

24. IDCOL has already formulated a lead acetate batteries recycling policy and operational guidelines. This system will be followed and improved under this ESSF.

25. Based on the principles laid down under this ESSF, IDCOL should make efforts to use long-life lead acetate batteries and low-mercury compact fluorescent lamps to the extent possible. IDCOL may in addition explore the setting up of compact fluorescent lamp recycling plants at strategic locations in partnership with agencies such as GTZ and Waste Concern.

26. IDCOL has a comprehensive monitoring system for the RES that has tiers of inspectors, IDCOL officers, and independent assessors.

D. Environmental and Social Safeguards Management Unit

27. IDCOL is managed by an eight-member independent board of directors and has a small and multiskilled workforce comprising economists, financial and market analysts, engineers, lawyers, information technology experts, and accountants. IDCOL's stakeholders include the Government, private sector, nongovernment organizations, multilateral institutions, academics, and the general population.

28. IDCOL has some resident staff with experience in reviewing environmental and social aspects but does not have trained environmental and social experts or a dedicated environmental and social management unit. Considering the scope of the PPIDF, it is proposed that IDCOL sets up an ESSMU.

29. The ESSMU will have two full-time staff as safeguard liaison officers. These staff members will oversee and coordinate internal reviewing and approvals processes. The environmental specialist will have a master's degree in environmental science and/or engineering and/or planning with at least 10 years of experience in conducting and reviewing environmental and social assessments. Familiarity with government regulations and procedures will be essential and exposure to ESSs at ADB will be desirable. The social assessment specialist will have a master's degree in social development and allied areas with at least 5 years of experience in the preparation of resettlement actions plans and ADPs.

30. The ESSMU staff will receive training in (i) screening prospective subprojects for environmental issues, involuntary resettlement, and effects on *adivasis*; (ii) resettlement plan and ADP preparation and appraisal; (iii) plan monitoring; and (iv) reporting. The ESSMU initially will have consultants to assist it in reviewing subproject proposals. It could also contract with an external agency to carry out the social safeguard assessment, guidance, appraisal, monitoring, and reporting functions for which IDCOL will be responsible. Selection of the external agency will be to ADB’s satisfaction.

31. To assist in the detailed review during subproject appraisals, the ESSMU will draw on additional specialists as necessary under a contract. These specialists may be drawn from a panel and be on a subproject-by-subproject basis. This panel may consist of experts that have familiarity with sectors like energy and infrastructure, with some exposure to environmental and social issues.

E. Capacity Development Plan

32. The ESSMU of IDCOL will undertake an awareness program for IDCOL's staff for familiarizing them with the ESSF, especially its interface with IDCOL's subproject processing and monitoring processes.

33. Since the effectiveness of IDCOL's ESSF depends considerably on the understanding and preparedness of lead banks and sponsors, it is important that IDCOL makes efforts to sensitize the lead banks and/or sub-borrowers on management of environmental and social issues, provides guidance, and encourages them to build requisite capacities.

34. IDCOL, with the assistance of the ESSMU, will prepare a short brochure on communicating in particular the benefits, process, and requirements of the ESSF. It will also make efforts to offer lead banks and sponsors short programs (0.5–1 day) to explain IDCOL's ESSF. These efforts may encourage lead banks and/or sponsors in particular to consider adopting the proposed ESSF.

F. Allocation of Responsibilities

35. Proposals to IDCOL will typically arise from lead banks and sponsors either for seeking direct lending or for refinance.

36. Lead bank means a financial institution that is funding the subproject and is designated as such by the interinstitutional group or consortium provided the risk exposure of IDCOL is less than that of the lead bank in a subproject.

37. The lead banks and sponsors will be expected to provide IDCOL with all the required documentation (EIA report, environmental clearance certificate, resettlement action plan, ADP, etc.) in line with the requirements of IDCOL's ESSF.

38. Similarly, the lead banks and sponsors will be responsible for regular monitoring and periodic evaluation of compliance of the subproject with agreed milestones and performance levels, particularly for purposes of disbursement of IDCOL funds. The lead banks and/or sponsors will send periodic progress reports in such form and at such times as may be prescribed by IDCOL. The lead banks and sponsors will therefore be responsible for reporting environmental and social compliance of the subproject to IDCOL in the formats as prescribed by the ESSF.

39. The responsibility for complying with safeguards policy requirements lies with each sponsor. However, the ESSMU will make sure such compliance is achieved by the sponsor prior to the disbursement of the loan.

40. The sponsor will be responsible for planning, preparing, financing, disclosing, and implementing an EMP, a resettlement action plan (including land acquisition and the payment of compensation), and/or an ADP in accordance with this ESSF and the applicable policies, laws, and regulations. Sponsors will engage the requisite environmental and social scientific expertise in environmental protection and conservation, involuntary resettlement, and *adivasi* development matters to help carry out the necessary studies, analyses, and document preparation. Such experts will also need to oversee sponsor implementation of any plans developed. Qualifications should include familiarity with devising (i) EMPs and resettlement

plans according to both national and international standards, and (ii) ADPs with the cultures and social structure of *adivasi* groups.

41. The sponsor will be responsible for regular monitoring and periodic evaluation of compliance of the subproject with agreed milestones and performance levels, particularly for purposes of disbursement of IDCOL funds. It will send periodic progress reports in such form and at such times as may be prescribed by IDCOL. The lead banks and/or sponsors will therefore be responsible for reporting EMP, resettlement plan, and/or ADP compliance of the subproject to IDCOL in the formats as prescribed by the plans.

G. Annual Environmental and Social Reporting and Disclosure

42. IDCOL will prepare annual environmental and social reports through the ESSMU.

43. The annual report will be developed by the ESSMU and will be submitted to the IDCOL board along with corrective actions, if any. After the board's approval, this report will be included in the annual report of IDCOL. A soft copy of this report will be kept on IDCOL's website.

44. Apart from annual environmental and social reporting, IDCOL will need to prepare reports, from time to time, as required by ADB which will contain, for instance, reporting on environmental and social performance of past subprojects and corrective action plans. In addition, management of environmental and social issues of proposed subprojects where preliminary letters of support have been issued will need to be reported.

45. **Information Disclosure.** IDCOL will work with the subproject sponsor to ensure that relevant information (whether positive or negative) on environmental and social safeguard issues is made available, in a form, manner, and language(s) accessible to the affected communities and accessible to other key stakeholders, including the general public, for them to provide meaningful inputs into subproject design and implementation. IDCOL will disclose (including by posting on its website) the following safeguard documents:

(i) For each proposed subproject (other than those expected to have minimal or no adverse impacts), a draft environmental assessment, involuntary resettlement plan, and indigenous people plan before loan approval.
(ii) Environmental, involuntary resettlement, and indigenous people monitoring reports submitted by subproject sponsors during subproject implementation.

H. Updating the Environmental and Social Safeguard Framework

46. IDCOL's ESSF will be maintained on its website on a dedicated page for the purposes of sharing and for receiving any comments or suggestions.

47. The ESSF will be reviewed each year, especially after the results of annual environmental and social audits. Based on the experience gained, and considering further changes, if any, in the Government's environmental policy and regulatory framework or in the ESS of ADB, the ESSF document will be appropriately updated. This task will be the responsibility of IDCOL's ESSMU.

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country/Project Title: Bangladesh: Public–Private Infrastructure Development Facility (PPIDF)			
Lending/Financing Modality:	Sovereign Loan	Department/ Division:	South Asia Department Governance, Finance and Trade Division

I. POVERTY ANALYSIS AND STRATEGY

A. **Linkages to the National Poverty Reduction Strategy and Country Partnership Strategy**

The Project supports both the Government's and the Asian Development Bank's (ADB)'s development goals for Bangladesh in the area of poverty reduction.

B. **Poverty Analysis** **Targeting Classification: General Intervention**

1. Key Issues. Infrastructure development and economic growth are strongly linked. Greater provision of infrastructure and related services has a particularly beneficial impact on the poor by, for instance, improving access to markets and areas with greater economic and employment opportunities. For the poor, in particular, improved water supply and sanitation, rural electrification, and better community and subdistrict infrastructure can have tremendous beneficial impacts. Bangladesh's poor investment climate and major deficiencies in infrastructure provision have been identified as key constraints to growth. Due to lack of adequate investment for maintenance, the quality of existing infrastructure has worsened over the last 10 years.

Bangladesh continues to rank among those countries most requiring improvement in infrastructure services. Increasing access to infrastructure services and improving their quality will be important factors in reducing poverty levels. Infrastructure services are critical to reducing poverty and achieving the Millennium Development Goals in Bangladesh. Erratic public sector services have imposed significant costs and hindered the growth of the country's economy. Power shortages reduce industrial output by an estimated $1 billion per year and gross domestic product growth by 0.5% per year. Congestion in the nation's ports costs the country in forgone exports and impedes the ability of entrepreneurs to access imported inputs rapidly. Improving the country's transport system, along with other actions, is essential to reducing product delivery times. Similar observations hold true for all the other infrastructure subsectors in the country, especially for energy where only 22% of rural households and 60% of urban households have an electricity connection.

The absence of local infrastructure services is most critically felt by the poor who are acutely aware of the effects of inadequate national infrastructure on their livelihoods. Shocks to the national economy, such as the rationing of electricity, are particularly evident to large numbers of people dependent on employment by small enterprises in the informal sector. While indirect benefits are harder for poor people to perceive, it is clear that the development and maintenance of national infrastructure is essential if Bangladesh is to secure the potential gains from globalization. Improving availability at the local level alone is unlikely to transform the economy, and developmental benefits will not be fully realized unless simultaneous local and national improvements are introduced and managed.

The proposed intervention seeks to expand the availability of finance to the Infrastructure Development Company Limited (IDCOL) and simultaneously improve IDCOL's capacity in accessing market sources of finance. The availability of additional long-term resources will significantly assist IDCOL in fulfilling its mandate of expanding the availability of high-quality infrastructure in Bangladesh. Further, the proposed assistance will also result in subprojects being priced on competitive terms, thereby reducing financing risk and reducing pricing of services to the end borrower.

2. Design Features. Pro-poor—the Project creates employment opportunities for unskilled urban and rural labor and will thus support income generation.

The key anticipated impact on poverty will be through greater affordability of high quality infrastructure. With more efficient and lower cost infrastructure subprojects being envisaged through the PPIDF, analysis would be necessary to see if this translates into greater affordability and higher usage. This in turn is expected to lead to greater incidence of compliance with tariffs and reduction in leakages.

C. Poverty Impact Analysis for Policy-Based Lending
N/A

I. SOCIAL ANALYSIS AND STRATEGY

A. Findings of Social Analysis

The social analysis indicates that only 22% of rural households have electricity connection while 60% of urban households do; 69% of enterprises in rural areas report no access to electricity at all. Of those who have electricity connection, frequent power outages and surges pose significant costs to enterprises, with only 1.8% of the roughly 3 million rural enterprises owning a generator. Poor road conditions and lack of transportation and means of communication (only 1.5% reported having access to fixed-line telephone service) add to the costs for Bangladesh's economy and leave the potential for growth and social development unfulfilled, especially in rural areas.

B. Consultation and Participation

1. Provide a summary of the consultation and participation process during the project preparation.

Extensive consultation meetings were held with the Finance Division of the Ministry of Finance (the executing agency), IDCOL (the implementing agency), Bangladesh Bank, Ministry of Finance, and the private sector. Furthermore, on-site due diligence was conducted with sponsors of large infrastructure subprojects and participating organizations under IDCOL's renewable energy program.

2. What level of consultation and participation (C&P) is envisaged during the project implementation and monitoring?

☐ Information sharing
☒ Consultation
☐ Collaborative decision making
☐ Empowerment

3. Was a C& P plan prepared? ☐ Yes ☒ No

C. Gender and Development

1. Key Issues. Women will benefit from the Project through improved access to various infrastructure subsector services and more affordable pricing of the same. The same is true for women entrepreneurs who have suffered due to lack of high-quality infrastructure such as regular power supply for production units and roads for market access reducing the need to walk through difficult terrain. Further, regular water supply and drainage improves working conditions for women employees. Moreover, high-quality infrastructure will assist women and other vulnerable groups through better quality health care and education. Finally, women will benefit from subprojects that conform to required environmental standards.

2. Key Actions. Measures included in the design to promote gender equality and women's empowerment—access to and use of relevant services, resources, assets, or opportunities and participation in decision-making process:

☐ Gender plan ☐ Other actions/measures ☒ No action/measure

II. SOCIAL SAFEGUARD ISSUES AND OTHER SOCIAL RISKS			
Issue/s	**Significant/ Limited/ No Impact**	**Strategy to Address Issue**	**Plan or Other Measures Included in Design**
Involuntary Resettlement	Significant	A resettlement framework has been developed as part of the environmental and social safeguards framework to guide the resettlement assessment of subprojects during the implementation of the PPIDF. Based on the framework, appropriate resettlement plans will be prepared for each subproject having resettlement impacts.	☐ Full Plan ☐ Short Plan ☒ Resettlement Framework ☐ No Action
Indigenous Peoples	Significant	A social safeguards framework covers the basic requirement of screening and planning to address any tribal (indigenous) population issues arising from any subproject. Appropriate tribal peoples development plans will be prepared for each subproject having any impacts.	☐ Plan ☐ Other Action ☒ Indigenous Peoples Framework ☐ No Action
Labor ☐ Employment opportunities ☐ Labor retrenchment ☐ Core labor standard standards	Limited	IDCOL and the sponsors of its subprojects will comply with national labor standards.	☐ Plan ☐ Other Action ☒ No Action
Affordability	No impact		☐ Action ☒ No Action
Other Risks and/or Vulnerabilities ☐ HIV/AIDS ☐ Human trafficking ☐ Others(conflict, political instability, etc), please specify	No impact	The subprojects are expected to be fully compliant with the ADB's environmental and social safeguards policies, other development policies, and those of the Government. Subprojects will be required to provide adequate environment and social projection plans. Further, the subproject developers will have to ensure that civil works contractors do not employ children or discriminate against women and disseminate information on sexually transmitted diseases.	☐ Plan ☐ Other Action ☒ No Action
III. MONITORING AND EVALUATION			
Are social indicators included in the design and monitoring framework to facilitate monitoring of social development activities and/or social impacts during project implementation? ☒ Yes ☐ No Monitoring on core labor standards will be maintained during PPIDF implementation.			

GOVERNANCE AND ANTICORRUPTION RISK ASSESSMENT

A. Background

1. Public investments in infrastructure in Bangladesh have remained stagnant over the last decade. The infrastructure finance market in Bangladesh is largely characterized by inadequate flow of long-term funds. The Infrastructure Development Corporation Limited (IDCOL) is the only financial institution in Bangladesh mandated and specialized to provide infrastructure debt financing, renewable energy financing, transaction advice, and training in project financing. At present no other financial institution in Bangladesh can catalyze international knowledge and funds for infrastructure finance.

2. The proposed Asian Development Bank (ADB)-financed $165 million Public–Private Infrastructure Development Facility (PPIDF) will directly support the infrastructure development agenda of the Government of Bangladesh by enhancing the availability of much needed long-term funds for infrastructure financing. With ADB assistance through the PPIDF, IDCOL will provide funds at commercial terms with up to 20 years maturity for infrastructure subprojects, which are currently not being provided by the market. PPIDF aims to attract further commercial financing, thereby reducing the pressure on the public budget for infrastructure development.

1. Why Risk Assessment

3. ADB's Second Governance and Anticorruption Action Plan specifies that project design should incorporate findings of governance, and corruption risk assessments, and that project documentation should clearly identify risk and risk management measures. Accordingly, this assessment considers the following: (i) relevant governance issues in Bangladesh's infrastructure sector, (ii) relevant risk analysis of the development finance sector, (iii) risk mitigation measures at the IDCOL level, and (iv) recommendations on how the findings of the assessment can be incorporated into the implementation of the PPIDF.

B. Relevant Governance Issues and Risks

4. Bangladesh's economy is widely regarded to suffer from weak governance. Despite good progress in many social indicators, perceived corruption adds to the costs of doing business and reduces the nation's attractiveness for foreign direct investment. Public procurement procedures that are universally associated with high levels of corruption are addressed in a major reform program supported by ADB, World Bank, and other development partners and the Parliament passed the Public Procurement Act in 2006. The Government has recently demonstrated strong commitment to pursuing critical governance reforms with focus on combating corruption, ensuring the effectiveness and independence of the judiciary, and depoliticizing the civil service. It has already reconstituted the Anti-Corruption Commission, framed new laws to tackle corruption, taken tough legal and prosecutorial actions, and ratified the United Nations Convention Against Corruption.

5. ADB, through its $150 million good governance program, is actively supporting the Government policy reform program to: (i) strengthen the ongoing consensus building on good governance, integrity, and anticorruption reforms and bring good governance and anticorruption initiatives into the mainstream within sectoral-level agencies to enhance their effectiveness. The Government has put good governance at the center of infrastructure sector reform policies. Various measures have been included in the design of PPIDF to promote good governance and mitigate the risk of corruption by enhancing predictability, transparency, and accountability in

doing business. Governance and risk issues with respect to the infrastructure financing and managing of IDCOL can be considered along the following lines: (i) Corporate Governance (including on regulation and supervision); (ii) Institutional and political dimensions, and (iii) Institutional Capacity and weak financial management.

6. **Corporate Governance.** The Companies Act (Bangladesh), 1994, is the law which governs incorporated domestic entities in Bangladesh. It governs the creation, functioning, and dissolution of companies; the relationship of shareholders to a company, periodic disclosure and audit requirements; the functions of the registrar of joint-stock companies; and the jurisdiction of the courts in relation to companies. Currently, IDCOL has an eight-member board of directors consisting of four high-government officials, three leading businessmen from the private sector, and one executive director and chief executive officer. At present, the secretary of Economic Relations Department chairs the board. IDCOL's Board is vested with the power to define, direct, and guide IDCOL's overall operational policy; however, its effectiveness is somewhat indeterminate.

7. **Potential Conflict of Interest.** Another issue is conflict of interest among the directors when it comes in choosing or deciding on any contract that may benefit their own businesses or activities. Asking them to desist from voting on any such decision or penalizing them with a fine not exceeding Tk5,000 is not sufficient to discourage such actions.

8. **Inadequate Disclosure.** Once elected to a board, the Companies Act imposes certain responsibilities and rights upon directors. Disclosure of IDCOL's performance is also an issue because the information that is required to be disclosed by a company to its shareholders and to members of the public in accordance with the law is practically the only tool shareholders and investors have to judge the performance of a company and monitor the activities of the directors and management. Due to various reasons, including lack of knowledge on the part of the persons responsible to maintain the records, shareholder apathy, lack of proper monitoring by the registrar of joint-stock companies and firms, lack of quality auditing services, often the disclosures are not accurate or complete.

9. **Independent Directors.** Critical for establishing good corporate governance is the inclusion of independent directors on the board of directors. In the context of Bangladesh, directors often current or former government officials or bureaucrats are appointed as independent director to help the company get licenses or as payback for previous favors. When boards need an independent opinion they rely on employing outside consultants or advisors. Therefore, independent directors do not usually serve as an advocate for minority shareholders or as a source of new and different ideas.

10. **Policy Environment.** With regard to the current emphasis on private participation to boost infrastructure development, improved corporate governance is essential. Current laws and policies relating to infrastructure project financing, foreign investment, currency exchange, and other matters concerning the private sector still do not constitute an enabling environment. The risk of policies detrimental to the infrastructure sector exists though the Government is keen on pursuing infrastructure sector development.

11. **Weak Institutional Capacity.** Being a government-owned institution and working as the financing arm of the Government in promoting infrastructure projects in the country, IDCOL needs a long-term vision and operational strategy through an effective organization. The company's human resources are relatively narrow (present staff strength of only 36), but commensurate with the current level of operations. The existing workforce is capable of

handling its current business load, but is not equipped to handle more complex activities, especially those that require special skills and capacity; particularly to provide TA to large infrastructure subprojects. IDCOL currently outsources most of these activities.

12. **Lack of Long-Term Debt Financing.** Another constraint in IDCOL's responsibility to implement infrastructure subprojects is the lack of long-term debt financing. A strong pipeline of infrastructure subprojects has been identified that could be eligible for IDCOL financing. Some of these transactions are likely to be financed within the next 1–2 years. However, without a long-term debt financing, financial viability will not be ensured, given their large size, long economic life and payback periods involved.

13. **Institutional Dimensions of Development Financial Institutions.** A recent review carried out by ADB's Operations Evaluation Department on the performance of ADB's loans to development finance institutions (DFIs)[1] found that the success rate of ADB-supported DFI projects was "low." This was primarily due to a range of factors including: (i) weak ownership incentives; (ii) poor assessment of demand for credit; and (iii) governance issues including directed lending, weak credit assessment, corruption, and inadequate monitoring.

C. Risks and Risk Mitigation Measures

1. Risk Mitigation at the Sectoral level

14. **Policy and Regulatory Risks.** Despite the current reform climate, several regulatory challenges in infrastructure sectors persist, and policy, institutional, and market gaps remain. To address these constraints, the Government is (i) developing legal and regulatory frameworks and arrangements, (ii) enhancing planning and coordination, and (iii) ensuring quality of infrastructure. Policy reforms have been taken across sectors to reduce risks by enhancing the enabling environment, providing stability to long-term cash flows, and assisting in subproject appraisal to facilitate financing. However, the impact of the ongoing reform in the real and financial sectors will only be realized during the medium- to long-term. Innovative responses consistent with the Government's policy agenda such as PPIDF shall address the prevailing market inadequacies and to keep the infrastructure development agenda moving forward.

15. **Private Sector Infrastructure Guidelines.** To tap private sector participation in infrastructure the Government issued the private sector infrastructure guidelines (PSIG)[2] in October 2004 to facilitate private investment in telecommunications, gas, and power sectors; and translate such success to other sectors. The PSIG aim to overcome the cumbersome procedures in sourcing and developing potential infrastructure subprojects with private sector participation. The PSIG enable public–private partnerships (PPP); however, they, lack the details usually found in a national PPP framework. Efforts have been made to upgrade the existing PPP guidelines though a sector-wide PPP framework is yet to be drafted. Some infrastructure sectors such as gas sector, power, and telecommunication have set up sector-specific private sector policies.

16. **Institutional Capacity and Weak Financial Management.** Insufficient capacity across infrastructure sectors is widening infrastructure gaps, resulting in lower productivity, higher transport and logistics costs, and reduced competitiveness. Hence, there is a need to catalyze

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[1] ADB. 2005. *Annual Evaluation Review 2005*. Manila.
[2] www.boi.gov.bd/psig-bgd.pdf

financing for bankable infrastructure subprojects that have emerged even when the reforms are evolving. There are a sufficient number of infrastructure subprojects in Bangladesh that need access to long-term financing for implementation. Considering such subprojects by a consortium of investors and lenders will ensure deepening of the subproject development and financing skills in the country. This is an essential element of the overall reforms for infrastructure development.

17. **Private Infrastructure Committee.** The PSIG provide for a national high-profile private infrastructure committee (PICOM) under the Prime Minister's Office to facilitate and promote private infrastructure subprojects while the Board of Investment acts as PICOM's secretariat. Subprojects initiated by private sponsors or line ministries require government approval to be listed as a private infrastructure subproject. Based on PICOM's analysis and recommendation, the cabinet committee on economic affairs approves the subproject, following which PICOM oversees its implementation. PICOM does not have any approval authority but can facilitate and monitor private infrastructure subprojects. Thus, a sound institutional mechanism is in place.

2. Risk Mitigation Measures at IDCOL

18. **Corporate Governance.** IDCOL is a professionally managed company with a limited mandate and functional responsibility. Its operations are governed by the Companies Act (Bangladesh), 1994, and the segregation of policy making, implementation, functional responsibilities and the absence of loan origination within the organization point toward a corporate governance structure that legally incorporates international best practices. The corporate governance structure of IDCOL is also reviewed by two domestic credit rating agencies and non-compliance could have an immediate and adverse impact on IDCOL's rating and ultimately on its funding program. IDCOL governance requires directors elected to the board to disclose interest in any contract or arrangement entered into by or on behalf of the company and to desist from voting on any such decision.

19. **Policy Commitment to IDCOL.** Since 2005, IDCOL widened its operation and started financing on its balance sheet after Government of Bangladesh injected further equity capital into the company. IDCOL acts as a catalyst for attracting private debt financing in infrastructure subprojects as it pursues its objective of developing infrastructure. The recent strengthening of IDCOL's balance sheet through several capital injections by Government of Bangladesh demonstrates the government's intention to continue supporting the company and its mandate. It is also the only financial institution that catalyzes international knowledge and funds for infrastructure finance.

20. **Institutional Reforms at IDCOL.** IDCOL has started to strengthen its subproject assessment capabilities and capacity and has initiated its own marketing program to source potential business opportunities independently. These activities will be further supported by the ADB technical assistance for capacity building. To improve its skill and capacity, IDCOL may also enter into strategic partnerships with international organizations involved in infrastructure investments, advisory services, and development/marketing of renewable energy. IDCOL is also working on a human resources strategy to address the concern that the company's management team is quite small. Committees have been formed to conduct specific responsibilities to ensure that IDCOL operates efficiently and with clear responsibilities. These include: (i) credit committee—reviews all final term sheets and subproject appraisal reports before these are submitted to the Board for final approval, the multi-stakeholder committee also makes recommendations for pricing of all IDCOL loans; (ii) recruitment and promotion committee, a six-member committee reviews and recommends to the Board all new

recruitments and promotions of personnel within IDCOL; and (iii) audit committee, a two-member committee to ensure the independence of IDCOL's internal control functions and audit activities in compliance with the audit requirements of its various development partners. This Committee is responsible for: overseeing the activities of IDCOL's internal auditor; defining the scope of the IDCOL audit; and taking appropriate actions to address any violations of independence that are brought to its attention by IDCOL's internal and external auditors.

21. **Transparency Measures.** ADB has reviewed the corporate governance structure of IDCOL to ensure that sound and transparent business processes and management systems are in place to mitigate any potential corruption risks and vulnerabilities. IDCOL is governed by the laws which prescribe disclosure norms. IDCOL intends to self-regulate and has incorporated best practices of nonbanking finance companies. In addition, IDCOL has been rated AA and AA1 respectively by two local rating agencies for strengthening its compliance with best international practices. ADB held consultations with the executing agency Economic Relations Division and IDCOL, Bangladesh Bank, Ministry of Finance, and the private sector. Furthermore, on-site due diligence was conducted with sponsors of large infrastructure subprojects and participating organizations under IDCOL's renewable energy program.

22. **Systematized Reviews.** IDCOL's performance on PPIDF will be reviewed periodically at three levels—by IDCOL on a monthly basis, quarterly by IDCOL's board of directors, and annually by ADB. The review of performance for each month by IDCOL will be completed by the 10th day of the next month. IDCOL's board of directors will review the performance every quarter and will forward the quarterly progress reports to ADB by the 10th day of the month after the quarterly review. ADB will review the quarterly progress reports during annual review missions, and during the tripartite reviews chaired by the Government. In addition, a midterm review of the investment program will be conducted in FY2009–FY2010 that will identify problems or weaknesses in implementation, suggest nominal changes in scope, outputs, and due diligence, and agree on changes that may be needed.

23. **Due Diligence.** The following due diligence measures have been undertaken to mitigate the risks faced by the PPIDF: (i) ADB carried out a thorough financial due diligence to appraise the financial strength and credit assessment capacity of IDCOL and found both satisfactory; (ii) a detailed review of the corporate governance practice in Bangladesh and the structure in place at IDCOL was conducted, IDCOL's pipeline of transactions ready for financing was reviewed and found to be very robust and commercially sound; and (iii) the financial terms of the Asian Development Fund and ordinary capital resources loan (such as currency and interest rates) reflect local market terms and avoid currency and pricing mismatches.

D. Recommendations

24. The preceding governance and corruption risk assessment points to several recommendations for enhancing the design and implementation of the PPIDF. These recommendations include (i) drawing from the risk analysis conducted here, incorporate several provisions on good governance and anticorruption as loan conditions and assurances as relevant; (ii) review the risk analysis with the Government and IDCOL management as necessary; (iii) get stakeholder buy-in to—and concurrence of—governance and corruption risk mitigation strategies; and (iv) acquire information during monitoring review missions on (a) revised structures and processes within IDCOL to assess progress in managing governance and corruption risks, (b) review of incidences of mismanagement and inefficiencies in IDCOL operations, and (c) policy dialogue and briefings that may refer to pertinent issues related to the infrastructure financing and private sector development in Bangladesh.