



Report and Recommendation of the President to the Board of Directors

Project Number: 45007
November 2013

Proposed Multitranche Financing Facility Mongolia: Ulaanbaatar Urban Services and Ger Areas Development Investment Program

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 4 November 2013)

Currency unit	–	togrog (MNT)
MNT1.00	=	\$0.0005856
\$1.00	=	MNT1,707

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CDC	–	community development council
EIB	–	European Investment Bank
FAM	–	facility administration manual
km	–	kilometer
LARP	–	land acquisition and resettlement plan
MFF	–	multitranches financing facility
MUB	–	Municipality of Ulaanbaatar
OCR	–	ordinary capital resources
PMO	–	program management office
SDC	–	small and medium-sized enterprise development council
SMEs	–	small and medium-sized enterprises
USUG	–	Ulaanbaatar Water Supply and Sewerage Authority

NOTE

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

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PROJECT AT A GLANCE

1. Project Name: Ulaanbaatar Urban Services and Ger Areas Development Investment Program			
2. Project Number: 45007-003			
3. Country: Mongolia		4. Department/Division: East Asia Department/Urban and Social Sectors Division	
5. Sector Classification:			
Sectors		Primary	Subsectors
Water and other Municipal Infrastructure and Services		√	Water supply and sanitation Other municipal services Slum upgrading and housing Urban sector development
6. Thematic Classification:			
Themes		Primary	Subthemes
Environmental sustainability		√	Urban environmental improvement
Private sector development			Public-private partnerships
Governance			Economic and financial governance
Capacity development			Organizational development
6a. Climate Change Impact		6b. Gender Mainstreaming	
No Climate Change Indicator available.		Gender equity theme (GEN)	
		Effective gender mainstreaming (EGM) √	
		Some gender elements (SGE)	
		No gender elements (NGE)	
7. Targeting Classification:		8. Location Impact:	
General Intervention	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium development goals	Income poverty at household level
		√	
		National Medium	
		Regional Low	
		Rural Low	
		Urban High	
9. Project Risk Categorization: <i>Complex</i>			
10. Safeguards Categorization: <i>Project 1 has been classified environment category B, involuntary resettlement category A, and category C for indigenous peoples.</i>			
11. ADB Financing:			
Sovereign/Nonsovereign	Modality	Source	Amount (\$ Million)
Sovereign	MFF-Facility	ADB Loan	160.0
Sovereign	MFF-Tranche 1(Loan)	Asian Development Fund	22.5
		Ordinary capital resources	27.5
		Total Tranche 1:	50.0
12. Cofinancing:			
Financier	Category	Amount (\$ Million)	Administration Type
ADB Trust Funds, Urban Environmental Infrastructure Fund-UFPF Tranche 1	Official-Grant	3.7	Full
Financier	Category	Amount (\$ Million)	Administration Type
European Investment Bank Tranche 1	Loan	28.38	Parallel collaborative cofinancing
European Investment Bank Facility	Loan	60.3	Parallel collaborative cofinancing
13. Counterpart Financing:			
Government Facility		\$96.00 million	
Government Tranche 1		\$22.44 million	
14. Aid Effectiveness:			
Parallel project implementation unit		No	
Program-based approach		No	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed multitranche financing facility (MFF) to Mongolia for the Ulaanbaatar Urban Services and Ger Areas Development Investment Program (the program).

2. The MFF will support the Ulaanbaatar City master plan by upgrading priority service and economic hubs (subcenters) in *ger* (yurt or traditional tents) areas. It proposes an integrated response to urgently needed basic urban services and to develop urban subcenters to catalyze growth in *ger* areas.¹

II. THE INVESTMENT PROGRAM

A. Rationale

3. In 2012 Ulaanbaatar had a population of 1.3 million. Since the 1990s, it has had limited formal extension of its core, which largely comprises apartment blocks with comprehensive utility services, including dedicated heating, water, and sanitation. However, successive waves of in-migration with *ger* tents have reshaped the city's geography, with (i) little upgrading or extension of basic urban services; and (ii) government policy, since 2003, to give each citizen about 700 square meters of land.² A vast low-density peri-urban area, named *ger* areas, now extends around the city core, characterized by unplanned settlement of low- and medium-income households with land ownership,³ unserviced plots, unpaved roads, and poor facilities. The *ger* area population is estimated at 800,000, representing 60% of Ulaanbaatar or 30% of the country population. Despite their size, *ger* areas have until recently been considered temporary settlements. However, their official integration in the 2013 city master plan provides the necessary provision to plan the redevelopment of a formal peri-urban area.

4. Living conditions in *ger* areas are difficult. Poor sanitation—households almost exclusively rely on open pit latrines—and poor waste collection have created highly unsanitary living conditions. Air pollution is among the most severe in the world, particularly during winter because of inadequate household heating systems⁴ and unpaved roads. Access to water, supplied by kiosks operated by the Ulaanbaatar Water Supply and Sewerage Authority (USUG), is limited.⁵ In 2011, most of the 40,000 people migrating to Ulaanbaatar settled in *ger* areas; by 2022 the population is estimated to grow by 400,000 from in-migration and natural growth. Under current situation, the forecasted population increases is a serious threat to the city environment and the health of the population if the situation is not improved.

5. Lack of long-term planning, infrastructure investment, and land use regulation in *ger* areas have resulted in haphazard development, limited availability of space for public facilities, poor access to socioeconomic services, reduced livelihood opportunities, and insecure

¹ The Asian Development Bank (ADB) provided project preparatory technical assistance financed by the Japan Fund for Poverty Reduction. ADB. 2010. *Technical Assistance to Mongolia for Preparing the Ulaanbaatar Urban Services and Ger Areas Development Investment Program*. Manila (TA 7970); and ADB. 2011. *Technical Assistance for Urban Infrastructure Development and Financing*. Manila (TA 7918).

² Large-scale in-migration, started in 1991 during the economic transition, has been exacerbated by recent severe winters (*dzud*). During 2000–2010, the population of *ger* areas increased by about 400,000.

³ Most *ger* residents have two types of land ownership: right of possession or right of use. Rights of possession are gradually converted into rights of ownership subject to an administrative procedure and a small fee.

⁴ Most households rely on unimproved individual coal stoves.

⁵ Water consumption in *ger* areas is low at about 10 liters per capita per day (half the recommended minimum by the World Health Organization in similar context). Residents pay 2–10 times more than non-*ger* area residents.

neighborhoods. The lack of basic urban infrastructure is constraining rational and dynamic urban development, increasing the costs of doing business and of accessing services. The city core where jobs and services are concentrated now has unprecedented congestion. The service gap between the city core and *ger* areas means *ger* residents are poorly integrated in the urban economy; it is one of the most urgent and difficult development challenges. While various government and development partner initiatives have significantly improved living conditions in *ger* areas, approaches have generally focused on specific sectors, failing to design a sustainable vision and provide integrated solutions for the problems of peri-urban development.

6. **Subcenter upgrading.** High construction cost,⁶ lack of urban planning, and inadequate infrastructure constrain the upgrading of *ger* areas. These areas are predominately residential with pockets of activity nodes, called subcenters, providing commercial and administrative services. The influence area of a subcenter varies from 30,000 to 100,000 people. Despite the critical function of subcenters in overall spatial and local development, urban services have not been substantially improved. The lack of basic infrastructure limits economic growth and increases negative environmental impacts.

7. The program approach aims to initiate a redevelopment process in *ger* areas. Improving infrastructure within the *ger* area subcenters and connectivity with the city core center is critical for inclusiveness and important to facilitate the movement of people and goods, develop urban corridors, and create clusters of subcenters. Better urban planning combined with a network of infrastructure along priority roads will initiate a structural change of subcenter urban fabric. This will (i) improve residents' access to basic urban services, public space, and socioeconomic facilities; (ii) support local economic development; (iii) allow residents and businesses to take advantage of urban economies; and (iv) provide better housing options.⁷ The changes in land use and higher urban density will improve water, sanitation, and heating services delivery.

8. **Road map.** Based on government and Municipality of Ulaanbaatar (MUB) priorities to redevelop *ger* areas, the road map for the program will support the MUB in establishing a network of well-developed subcenters to provide jobs, housing, and economic opportunities with reduced soil and air pollution. It comprises sequenced investments, municipal reforms, and capacity building (policy, planning, and monitoring), with four strategic objectives: (i) expand roads and basic urban services (water, sewerage, and heating) within subcenters and improve connectivity to initiate land use transformation; (ii) increase economic and public services through investments in socioeconomic facilities to meet population needs, increase urban functions, and encourage job creation; (iii) increase service provider efficiency by improving water supply, sewerage, and heating service operations; and (iv) strengthen institutions and capacity by improving urban planning and subcenter development, community awareness, participation and empowerment, service provider operations and management, and program implementation capacity.

9. **Strategic context and sector policy.** In February 2013, Parliament approved the Adjustments to the Ulaanbaatar City Urban Development Master Plan 2020 and Development Directions 2030. The master plan produced two important outcomes: (i) integration of *ger* area development into the city master plan, and (ii) acknowledgement of the value and function of *ger* area subcenters as key elements of future city growth.⁸ The MUB is developing the *Ger Area*

⁶ Partly due to cold climate conditions and outdated construction standards.

⁷ Up to 60% of subcenter households may consider exchanging their land for fully serviced apartment units.

⁸ ADB has helped the MUB introduce a redevelopment strategy for *ger* areas through the project preparatory technical assistance [footnote 1] and ADB. 2010. *Technical Assistance to Mongolia for Ulaanbaatar Water and Sanitation Services and Planning Improvement*. Manila (TA 7591).

Development Program and established a *Ger* Area Development Agency, supervised by the vice mayor in charge of urban development and investment. On 30 May 2013, the city council resolution No.10/38 endorsed the program, subcenter locations under project 1, and coordination of the investment program with the city master plan. The MUB proposed a special purpose development vehicle (subcenter redevelopment authority) to facilitate, supervise, and coordinate the redevelopment process of the selected subcenters. In addition, the Ministry of Economic Development's Street Project is to improve road conditions in Ulaanbaatar and includes a *ger* area component. The National Development Strategy and the New Reconstruction Midterm Program (2008–2016) constitute the national framework for program implementation. The program is consistent with the Asian Development Bank (ADB) country partnership strategy, 2012–2016 for Mongolia;⁹ ADB's Strategy 2020¹⁰ priorities, including environmental sustainability and private sector development; as well as the core themes of green, competitive, and inclusive cities of ADB's Urban Operational Plan.¹¹

10. Policy dialogue and capacity development. To supplement the strong policy framework, policy dialogue and capacity development will focus (i) in communities, on community participation, awareness, and empowerment,¹² including design and implementation of the social and gender action plan; and establishment of community development councils (CDCs) and small- and medium-sized enterprise (SME) development councils (SDCs); (ii) in subcenters, on subcenter upgrading, including technical guidance for preparing and implementing local development plans, urban zoning regulation and construction standards, and a development framework with a transparent mechanism to regulate land redevelopment insuring current residents are integrated in the redevelopment plan; and (iii) in the city, on the master plan through ongoing ADB technical assistance to strengthen urban planning capacity.¹³ Capacity development for water and wastewater utilities will target (i) improving the MUB and USUG management contract, (ii) defining a clearer tariff road map, and (iii) providing technical support to the Water and Sewerage Regulatory Commission. For heating, the focus will be to ensure financial sustainability and capacity of new and existing heating facilities operators in the selected subcenters and to strengthen provisions in management contracts.

11. Financing modality. An MFF is the proposed financing modality to promote a long-term partnership between ADB, the government, and the MUB to facilitate the development of sustainable, inclusive, and livable *ger* areas. The MFF will support the policy framework for the redevelopment of *ger* areas, and provide opportunities for constructive dialogue and capacity development on city planning, policy reforms, and physical and nonphysical investments. It will generate critical mass, predictability, and continuity for basic urban services provision in *ger* areas, and enable ADB to better respond to MUB needs.

12. Development coordination. In preparing the program, ADB coordinated closely with development partners involved in Ulaanbaatar's urban sector. Three ADB-financed projects will directly support the program: (i) a bus rapid transit line from the city center to Selbe subcenter;¹⁴

⁹ ADB. 2012. *Country Partnership Strategy: Mongolia, 2012–2016*. Manila.

¹⁰ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

¹¹ ADB. 2013. *Urban Operational Plan, 2012–2020*. Manila.

¹² The consultative and participatory approach to *ger* area redevelopment, introduced by the United Nations Human Settlements Programme (UN-Habitat) during program preparation, was introduced for the project 1 subcenters.

¹³ ADB. 2013. *Technical Assistance to Mongolia for Ulaanbaatar Urban Planning Capacity Improvement*. Manila. Financed by the Japan Fund for Poverty Reduction.

¹⁴ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Mongolia for the Urban Transport Development Investment Program*. Manila (Loan 0070). Implementation of the loan is independent of and will not affect implementation of the proposed program.

(ii) support for housing and micro-, small-, and medium-sized enterprise financing in *ger* areas targeted by the program;¹⁵ and (iii) capacity development technical assistance to strengthen MUB urban planning capacity (footnote 13).

B. Impact and Outcome

13. The impact of the program is improved living conditions in Ulaanbaatar. The outcome is a network of livable, competitive, and inclusive subcenters in Ulaanbaatar's *ger* areas.

C. Outputs

14. The program has four outputs: (i) roads and urban services are expanded within priority subcenters, and connectivity between them is improved; (ii) economic and public services in targeted areas are improved; (iii) service providers become more efficient; and (iv) institutions and capacity for urban development, program management, and service delivery are strengthened. The program will be implemented over three tranches.

15. **Project 1.** The first tranche will support implementation of a city master plan to develop Selbe and Bayankhoshuu subcenters: (i) extend the sewerage network from the city core: collector main (6.1 kilometers [km]) and sewer pipes (2.9 km); (ii) within subcenters, develop priority roads (15 km), water supply network (18.6 km), sewerage network (20 km), district heating network (21 km), and five heating facilities using most suitable state-of-the-art environmentally friendly technologies; (iii) construct social and economic facilities, i.e., two kindergartens, green areas, and small squares; and two business incubators, associated with two vocational training centers; (iv) improve USUG operations and service delivery efficiency of water supply and wastewater collection; and (v) provide institutional and capacity development to (a) prepare detailed design and construction supervision; (b) support community participation, awareness, and SME development; (c) improve subcenter redevelopment; (d) strengthen program management office (PMO) capacity; and (e) support service provider reforms.

16. **Projects 2 and 3.** The projects will (i) expand coverage of similar investments in project 1 subcenters, and in other subcenters in the northern and eastern *ger* areas; and (ii) improve road connections between targeted subcenters. Khaniin Material and Market Area subcenters are tentatively targeted for project 2, and Ulyastai and Amgalan subcenters for project 3. Other subcenters may be considered. Heating solutions developed under tranches 2 and 3 will prioritize gas-fired state-of-the-art environmentally friendly technology, subject to satisfactory due diligence.

D. Investment and Financing Plans

17. The total cost of the program is estimated at \$320.00 million. The cost of Project 1 is estimated at \$104.52 million (Table 1). The government has requested an MFF in an amount up to \$163.70 million, or 51.2% of the investment program, from a blend of ADB resources: the Asian Development Fund (ADF) and ordinary capital resources (OCR), and cofinancing to be administered by ADB. This includes cofinancing from the Urban Environmental Infrastructure Fund¹⁶ (UEIF) under the Urban Financing Partnership Facility in the first tranche and may

¹⁵ TenGer Financial Group will onlend a portion of an ADB private sector loan to XacBank. An estimated \$6.0 million–\$10.0 million could be made available for the targeted areas. ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to Mongolia for XacBank and TenGer Financial Group for Supporting Micro, Small, Medium-Sized Enterprises and Leasing Finance*. Manila.

¹⁶ Contributor: the Government of Sweden. Administered by ADB.

include ADB-administered cofinancing from other ADB Trust Funds and development partners, who expressed interest in provision of cofinanced grants for MFF's subsequent tranches' components related to water, climate change, and urban sectors. The MUB will finance \$96 million, or 30% of the total cost, including taxes and duties, resettlement, and other miscellaneous costs. Cofinancing is estimated at \$60.3 million equivalent, which may be provided as loans or grants. The financing plan is in Table 2. The MFF's three tranches are to be implemented over 9 years, subject to the government's submission of related periodic financing requests, execution of the related loan and project agreements for each tranche, and fulfillment of terms and conditions and undertakings set forth in the framework financing agreement.¹⁷

Table 1: Investment Program
(\$ million)

Item	Investment Program	Project 1
A. Base Cost^a		
1. Expanded roads and urban services		
1.1 Roads improvement	93.21	24.59
1.2 Water supply system improvement	35.23	12.39
1.3 Sewerage system improvement	42.91	13.31
1.4 Heating services expansion	74.67	30.14
Subtotal (1)	246.02	80.43
2. More efficient service providers	11.48	3.70
3. Increased economic and public services	15.36	5.00
4. Institutional strengthening and capacity development		
4.1 Program management implementation support	6.13	2.00
4.2 Strengthening service providers	1.53	0.50
4.3 Subcenter development and community engagement	4.59	1.50
Subtotal (4)	12.25	4.00
Subtotal (A)	285.11	93.13
B. Contingencies^b	22.63	7.40
C. Financing Charges During Implementation^c	12.25	4.00
Total (A+B+C)	320.00	104.52

Note: Numbers may not sum precisely because of rounding.

^a In mid-2013 prices. Includes value-added tax and import duties estimated at \$16.7 million for the investment program and \$6.18 million for project 1. The government will finance these taxes and duties through tax exemptions.

^b Physical contingencies computed at 5% of civil works and consulting services. Price contingencies calculated at rates ranging from 3%–8.0% for local currency costs and 0.5%–2.2% for foreign exchange costs; includes provision for exchange rate fluctuations under a purchasing power parity exchange rate.

^c Includes interest and commitment charges. Financing charges during implementation of the Asian Development Bank (ADB) loans are computed (i) at 2.0% per annum of the first tranche's loan from ADB's Special Funds resources; and (ii) at the 5-year dollar fixed swap rate plus an effective contractual spread of 0.4%, and a commitment charge of 0.15% on the undisbursed portion of the first tranche's loan from ADB's ordinary capital resources. Financing charges during implementation for the European Investment Bank loan were also calculated based on the 5-year dollar fixed swap rate.

Source: Asian Development Bank estimates.

18. Any ADF allocation will be subject to (i) the general availability of ADF resources from time to time, (ii) Mongolia's access to such resources pursuant to ADB's then applicable graduation policy and the requirements of ADF donors, and (iii) the availability of such resources to Mongolia pursuant to ADB's then applicable policy on performance-based allocation of ADF resources. Cofinancing may be provided as loans or grants, and may be parallel or joint.

¹⁷ Framework financing agreement and periodic financing request for tranche 1 have been negotiated. Their signing by the government is being delayed due to the need on the part of the government to complete intergovernmental procedures and to obtain requisite signing authorizations. The signing is expected after the Board approval.

19. For project 1, ADB will finance \$53.70 million or 51.3% of the total investment requirement. About 21.5%, or \$22.5 million equivalent, will be financed from the ADF; \$27.5 million or 26.3% from OCR; and \$3.7 million as a grant from the UEIF. The ADF loan for \$22.50 million equivalent will have a 25-year term, including a grace period of 5 years, a 2.0% annual interest rate, and repayments in equal amortization. The proposed OCR loan for \$27.50 million will have a 20-year term including a grace period of 5 years, an interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions to be set forth in the relevant loan agreements. EIB is currently processing parallel cofinancing of up to €50 million for approval by its board by 6 December 2013. The EIB loan would have a 20-year term including a grace period of 5 years and an interest rate in accordance with its LIBOR-based lending facility. The portion of such cofinancing will be limited to water supply and sanitation. The Government of Mongolia will relend the proceeds of the loans and pass on the grant to the MUB upon terms and conditions satisfactory to ADB.

Table 2: Financing Plan

Source	Amount(\$ million)	Share of Total (%)
Investment program		
Asian Development Bank MFF	163.70	51.20
Municipality of Ulaanbaatar	96.00	30.00
Cofinancing ^a	60.30	18.80
Total	320.00	100.00
Project 1		
Asian Development Bank		
ADF loan	22.50	21.50
OCR loan	27.50	26.30
UEIF-UFPF	3.70	3.50
Subtotal (ADB)	53.70	51.30
Municipality of Ulaanbaatar ^b	22.44	21.50
Cofinancing	28.38	27.25
Total	104.52	100.00

ADB = Asian Development Bank, ADF = Asian Development Fund, MFF = multitranches financing facility, OCR = ordinary capital resources, UEIF-UFPF = Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility.

Note: Numbers may not sum precisely because of rounding.

^a The European Investment Bank has expressed interest in providing parallel collaborative cofinancing (not administered by ADB) for water supply and sanitation, up to \$60.30 million equivalent for the MFF, including \$28.38 million equivalent for project 1. If this cofinancing does not materialize as planned, the Government of Mongolia will undertake necessary measures to substitute for the shortfall with suitable funding.

^b This includes local taxes and duties for project 1 only, which will be borne by the Government of Mongolia in the form of an exemption.

Source: Asian Development Bank estimates.

E. Implementation Arrangements

20. The MUB will be the executing agency for the program. The MUB's Urban Development and Investment Office will be responsible for coordinating program implementation. A PMO will be established under the vice mayor in charge of urban development and investment. A program steering committee, chaired by the mayor of Ulaanbaatar and comprising government officials, has been established to provide strategic and policy guidance. The program will be implemented from December 2013 to December 2022. Project 1 implementation will start in December 2013 and be completed by December 2017.

21. A procurement plan is included in the facility administration manual (FAM).¹⁸ Goods and works financed under the ADB loan and grant will be procured following ADB's Procurement Guidelines (2013, as amended from time to time). ADB has approved advance contracting and retroactive financing of up to 20% for all tranches. The eligible expenditures incurred, not exceeding 12 months prior to signing of the ADB loan documents, would be financed retroactively from the ADB loans and grant, as applicable, upon effectiveness. The government has been informed that approval of advance procurement actions and retroactive financing does not in any way commit ADB to finance the program. The project management consultant will assist the PMO in implementing project 1 and provide training in project management, financial management, disbursement, and reporting. Details of consulting services inputs and outline terms of reference are in the FAM.

Table 3: Implementation Arrangements

Aspects	Arrangements	
Implementation period (program)	December 2013–December 2022	
Estimated completion date (project 1)	December 2017	
Management		
(i) Oversight body	Steering committee (mayor, Ulaanbaatar (chair), Ministry of Economic Development, Ministry of Finance, Ministry of Environment and Green Development, MUB, Ministry of Construction and Urban Development, relevant departments and agencies from the MUB)	
(ii) Executing agency	Municipality of Ulaanbaatar	
(iii) Key implementing agency	Urban Development and Investment Office under the MUB	
(iv) Implementation unit	The PMO is established and will be transferred under the vice mayor in charge of MUB's Urban Development and Investment Office	
Procurement (tranche 1)	International competitive bidding	13 contracts
Consulting services (tranche 1)	Quality- and cost-based selection	International: 222.5 person-months; national: 749 person-months
	Individual selection (PMO staff)	National: 325 person-months
Retroactive financing and/or advance contracting (tranche 1)	ADB Management approved advance contracting and retroactive financing for program management activities and consulting services. Retroactive financing will include all consulting services except those pertaining to strengthening service providers, advance contracting for strengthening service providers, heat distribution networks, and water and wastewater operation improvement packages.	
Disbursement	The Asian Development Fund, and ordinary capital resources loan and UEIF–UFPF grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2012, as amended from time to time).	

ADB = Asian Development Bank, MUB = Municipality of Ulaanbaatar, PMO = program management office, UEIF–UFPF = Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility.

Source: Asian Development Bank.

III. DUE DILIGENCE

A. Technical

22. Technical due diligence included comparative analyses, technical specifications, sustainability, design methods, and standards specific to *ger* areas and the cold climate.

B. Economic and Financial

23. Economic and financial internal rates of return confirmed the viability of the MFF and project 1 under adverse scenarios. The estimated costs were valued at their economic prices

¹⁸ Facility Administration Manual (accessible from the list of linked documents in Appendix 2).

using the domestic price numeraire. Benefits include incremental water sales computed according to willingness-to-pay and resource cost savings, reduced health risks from water-related disease and outdoor air pollution, and annualized increase in land rent as well as savings in vehicle operating costs as a result of the project. The base case results indicate economic internal rates of return of 15.1%–25.1%, exceeding the assumed economic opportunity cost of capital of 12%. Financial internal rates of return were calculated for revenue-generating subprojects and compared with the weighted average costs of capital, estimated at 0.75% for water supply and sewerage and 1.31% for heating services. Revenues calculated include incremental tariffs from improved water, sanitation, and heating services. The base case results show financial internal rates of return of 3.3% for water supply and sewerage and 3.7% for heating services. The affordability analysis confirms the proposed tariffs for water sanitation and heating fall within the willingness-to-pay and affordability limits of target beneficiaries.

C. Governance

24. Assessments of financial management and procurement capacity confirm the capacity to manage finances and undertake procurement under the investment program. ADB's Anticorruption Policy (1998, as amended to date) was explained, discussed, and agreed with the government and the MUB. The specific policy requirements and supplementary measures are described in the FAM. All contracts financed by ADB in connection with the program will include provisions specifying the right of ADB to audit and examine the records and accounts of the executing agencies and all contractors, suppliers, consultants, and other service providers as they relate to the program. ADB retains the right to suspend or cancel the entire program in case of proven wrongdoing.

D. Poverty and Social

25. Poverty, social, and gender analyses were conducted in accordance with ADB guidelines.¹⁹ Project 1 will benefit about 129,000 households with improved access to water supply and sewerage, roads, heating services, kindergarten facilities, business incubators, and vocational training programs.²⁰ A social action plan was prepared to ensure community participation in project planning, implementation, and monitoring.²¹ It will (i) establish a CDC and SDC in each subcenter; (ii) develop a comprehensive information, education, and communication campaign in the *ger* area redevelopment schemes, SME development plan, basic hygiene practices, water conservation, and operation and maintenance of social and economic services; and (iii) strengthen community-based monitoring and evaluation of new basic infrastructure and service delivery. Contracts for construction will require contractors to comply with core labor standards and applicable national labor laws and regulations, and provide HIV/AIDS awareness training.

26. Project 1 is designed as effective gender mainstreaming. The gender action plan for the investment program will ensure gender mainstreaming in project outputs including (i) representation by women on CDCs and SDCs; (ii) universal design features in infrastructure improvements (sidewalks, lighting, access ramps, seating at bus stops), and women's participation in all community consultation activities, such as planning and design on improved subcenter infrastructure and services; (iii) access to vocational training; and (iv) access to employment opportunities generated by the project. Poverty, gender, and social assessments will help prepare subsequent tranches to determine their categorization and required actions.

¹⁹ Summary of Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

²⁰ Based on the 2011 National Statistical Office *Khoroo* population estimates.

²¹ The social action plan is accessible in the FAM (accessible from the list of linked documents in Appendix 2).

E. Safeguards

27. **Environment.** The MUB prepared an environmental assessment and review framework.²² Project 1 is categorized B for environment. An initial environmental examination was disclosed.²³ It complies with ADB's Safeguard Policy Statement (2009) and is deemed adequate. Environmental impacts are anticipated during construction, including dust and noise (arising from earthworks, transport, and handling of aggregate materials and waste), temporary traffic disturbance, risks to community and occupational health and safety, and impacts of the heating subcomponent operations (gas emissions, ash, and slag). Mitigation measures defined in the environmental management plan, such as construction site management and regular monitoring of the project's environmental performance during construction and operation, will reduce anticipated impacts and other construction-related health and safety concerns to acceptable levels. Subsequent projects are expected to be categorized B for environment.

28. **Land acquisition and resettlement.** The resettlement framework prepared for the program outlines procedures required to prepare satisfactory land acquisition and resettlement plans (LARPs) and stipulates arrangements for consultation and public participation, grievance redress, and monitoring and evaluation. Project 1 is categorized A for resettlement. LARPs were prepared for Bayankhoshuu and Selbe subcenters and disclosed to the affected people in their local language. Copies of the LARPs are available in subdistrict and community offices in the project 1 area. While road design is optimized to minimize the resettlement impact, small strips of land (3,800 square meters) will be acquired to widen roads in the two subcenters. The project will affect about 12 residential structures, 32 toilets, 21 ground attachments, five *gers*, and 75 fences; and a total of 75 households and 379 people. The LARPs will be updated based on a census of affected persons and a detailed measurement survey during project implementation.

29. **Indigenous peoples.** Project 1 is categorized C for indigenous people. Subsequent projects are expected to be categorized C.

F. Risks and Mitigating Measures

30. Major risks and mitigating measures are summarized in Table 4 and detailed in the risk assessment and risk management plan.²⁴

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Delay in project implementation	The government will ensure that the PMO is staffed with experienced professionals. A procurement specialist will be recruited in advance to assist with the tendering process.
Changes in city master plan and political consideration	Provisions are included to strengthen local and city master planning to ensure consistency and alignment of the planning process and strategic direction. Continuous dialogue is to strengthen awareness in the MUB, Ministry of Economic Development, and MCUD.
Lack of community and private sector involvement in subcenter development	Throughout implementation, community engagement and private sector involvement will be supported. The MUB, supported by the program, will facilitate, supervise, and coordinate the redevelopment process of subcenters and guide a fair land redevelopment process. Along with an improved local urban plan, the activities will maximize benefits to current residents encouraging them to not move away.
MUB implementation capacity is not sufficient for large and	Specific funding covers consulting services, support, and additional staff with experience and suitable skills. MUB capacity and performance will be built during program implementation, particularly for improving project imprest account management and

²² Environmental Assessment and Review Framework (accessible from the list of linked documents in Appendix 2).

²³ Initial Environmental Examination (accessible from the list of linked documents in Appendix 2).

²⁴ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

sophisticated works	reporting, project accounting, contract management, and project performance monitoring and reporting.
Inefficient procurement and corruption	Reviews will assess procurement to validate reported procurement capacity and address gaps that may impede program effectiveness. Relevant provisions of ADB's Anticorruption Policy (1998, as amended to date) are included in the investment program's loan regulations and bidding documents. The executing agency will disclose to the public and annually update the program's current status and how facility proceeds are used.

ADB = Asian Development Bank, MCUD = Ministry of Construction and Urban Development, MUB = Municipality of Ulaanbaatar, PMO = program management office.

Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

31. The government has assured ADB that implementation of the investment program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the FAM and loan documents. The government has given ADB certain undertakings for the MFF, which are set forth in the framework financing agreement. Specific covenants and conditions agreed by the government with respect to individual tranches under the MFF are set forth in the loan, grant, and project agreements for the respective tranches.

32. ADB will consider financing subsequent tranches if the government adheres to the general agreement for the MFF as set forth in the framework financing agreement. The government should also comply with specific conditions, assurances, and conditions for disbursement for EIB-cofinanced components of a subproject for project 1. Progress toward achieving the outputs and expected outcomes in the design and monitoring frameworks for the program and project 1 will be among the decision-making criteria for financing subsequent tranches under the MFF.

V. RECOMMENDATION

33. I am satisfied that the proposed multitranche financing facility would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the provision of financing under the multitranche financing facility (MFF) in an aggregate principal amount not exceeding \$163,700,000 equivalent to Mongolia for the Ulaanbaatar Urban Services and Ger Areas Development Investment Program, comprising

- (i) loans from ADB's Special Funds resources, with interest and other terms to be determined in accordance with ADB's applicable policies relating to Special Funds resources, subject to conditions set forth in paragraph 18 of this report;
- (ii) loans from ADB's ordinary capital resources, with interest and other terms to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; and
- (iii) the administration by ADB of cofinancing under the MFF to be provided by the Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility and other developmental partners as described in paragraph 17 of this report;

and such other terms and conditions as are substantially in accordance with those set forth in the draft framework financing agreement presented to the Board.

Takehiko Nakao
President

19 November 2013

DESIGN AND MONITORING FRAMEWORK FOR THE INVESTMENT PROGRAM

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Improved living conditions in Ulaanbaatar</p>	<p>By 2028: Poverty headcount index reduced by 30% (baseline: 23.5% in 2012)</p> <p>Incidence of waterborne diseases reduced by 30% (baseline: 90,310 in 2012)</p> <p>Air pollution in Ulaanbaatar reduced by 30% (baseline: 1.286 PM₁₀ concentration in 2012)</p>	<p>National Statistical Office reports</p> <p>Government public health statistics</p> <p>National Statistical Office reports</p>	<p>Assumption Policy environment supports urban development and increased investments in urban infrastructure.</p> <p>Risk Urban infrastructure investments are constrained by fiscal and political factors.</p>
<p>Outcome A network of livable, competitive, and inclusive subcenters in Ulaanbaatar's <i>ger</i> (yurt or traditional tents) areas</p>	<p>By 2024: % of population with improved access to water, sanitation, and heating increased to 50% (baseline: 0% for water 0%; 0% for sanitation, and 0% for heating in 2012) in targeted areas</p> <p>Average density in targeted subcenter increased to 120 persons per ha (average baseline: 50 persons per ha in 2010)</p> <p>Number of business establishments increased by 30% (baseline: 33,140 in 2012) in targeted areas</p> <p>Unit production cost of water reduced by 50% (baseline: MNT5,940/ cubic meter in 2011)</p>	<p>MUB report on urban construction and districts records</p> <p>MUB report on urban construction and districts records</p> <p>MUB report on urban construction and districts records</p> <p>USUG operation and financial reports</p>	<p>Assumptions Political support and investment in urban infrastructure continue throughout the program.</p> <p>Improved services and urban governance lead to sustained economic growth in the <i>ger</i> areas.</p> <p>Risks Insufficient time and resources are devoted to community mobilization.</p> <p>Lack of private sector participation</p>
<p>Outputs</p>			
<p>1. Roads and urban services are expanded within the targeted subcenters and connectivity between subcenters is improved.</p>	<p>By 2016: 18.6 km of water supply network, 20.0 km of sewer network, and 6.0 km of collector mains constructed</p> <p>Five heating facilities, 21 km of heating network pipes, and 2.4 km of heating service connections constructed</p> <p>15 km of carriageway and 7.9 ha of landscaping and public space including universal design features such as sidewalk, lighting, and sitting</p> <p>By 2023: Water supply, sewer lines, urban roads, and heating constructed in 132 ha in 6 subcenters (baseline: 0 in 2012)</p> <p>Improvements and construction of respectively 14.8 km and 9.5 km of connecting roads (baseline: 0 in 2012)</p>	<p>PMO progress and completion reports</p>	<p>Assumption The MUB complies with ADB safeguard policies.</p> <p>Risk Rising world prices of energy and construction materials significantly increase the program's investment and operation and maintenance costs.</p>
<p>2. Economic and public services in</p>	<p>By 2023: At least 5,000 beneficiaries, 50% of</p>	<p>PMO progress</p>	<p>Assumption Investment in economic and</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
subcenters are improved.	<p>whom are women, receive vocational training (baseline: 0 in 2012)</p> <p>Constructed social facilities based on community needs fully staffed and operational in participating subcenters (baseline: 0 in 2012)</p>	and completion reports and district records	<p>social facilities leads to increased employment.</p> <p>Risks Inappropriate vocational training courses are provided.</p> <p>Demand for commercial facilities built is lacking.</p>
3. Service providers become more efficient	<p>By 2023: Water supply network pumping system is improved</p> <p>Distribution system is optimized</p> <p>Operation Control Centre is upgraded and expanded</p>	<p>USUG operating and financial reports</p> <p>PMO progress and completion reports</p>	<p>Assumptions Service providers are supportive of proposed policy and institutional reforms</p> <p>Customers continue to pay water and sewerage charges</p> <p>Risk The MUB fails to provide adequate subsidies to augment shortfalls of revenues.</p>
<p>4. Institutions and capacity for urban development, program management, and service delivery are strengthened.</p> <p>4.1 Subcenter development and community engagement</p> <p>4.2 Operations and management of service providers improved</p>	<p>By 2023: Six CDCs and SDCs fully functioning in targeted areas, with at least 40% women participating actively (baseline: CDCs established only in Bayankhoshuu and Selbe in 2012)</p> <p>Subcenters plan are prepared and endorsed by all the stakeholders through community consultation including at least 50% of women participants</p> <p>By 2017: USUG is autonomous in terms of financial and asset management (baseline: USUG not autonomous) Utility tariffs linked to direct cost recovery of O&M, including asset depreciation (baseline: tariffs barely cover O&M)</p> <p>Revised performance contract between the MUB and service providers in place</p>	<p>PMO progress and completion reports</p> <p>CDC reports</p> <p>USUG operating and financial reports</p> <p>USUG business plans</p>	<p>Assumptions Urban planning and subcenter development methodologies and tools and supporting legislation are in place at the start of program implementation.</p> <p>Subcenter redevelopment leads to more efficient land use and management.</p> <p>Risks Program implementation is slowed down by a lack of community and private sector participation.</p> <p>Women are not effectively mainstreamed into the program.</p> <p>Assumptions Policy reforms receive full government support.</p> <p>Appropriate user charges and/or tariffs are not implemented by the MUB, and/or not supported by the target consumers.</p> <p>Risks Inadequate program resources are allotted to support the policy and institutional reforms. Lack of incentives to attract</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks																						
4.3 Strengthened program implementation capacity	<p>By 2023: PMO is fully functioning with fully trained staff, at least 30% of whom are women (baseline: 0 in 2012)</p> <p>Sex-disaggregated program performance and monitoring system operational (baseline: 0 in 2012) Project feasibility studies, due diligence, and safeguards prepared for participating subcenters (baseline: 0 in 2012)</p>	<p>MUB reports</p> <p>PMO progress and completion reports</p>	<p>private sector participation</p> <p>Assumption Consultants and PMO staff work effectively as a team.</p> <p>Risk Failure to appoint and retain well qualified and experienced consultants</p>																						
Activities with Milestones for Tranche 1 (after Loan Effectiveness)			Inputs																						
<p>1. Roads and urban services expanded</p> <p>1.1 Detailed design of water and/or sewerage improvements completed (Apr 2014)</p> <p>1.2 Detailed design of heating improvements completed (Apr 2014)</p> <p>1.3 Detailed design of roads and/or other infrastructure completed (Apr 2014)</p> <p>1.4 Urban infrastructure constructed, commissioned, and operating in phases from Apr 2014 to 2016</p> <p>2. Economic and public services in subcenters improved</p> <p>2.1 Detailed design of kindergarten and business incubators and/or vocational training centers completed (mid-2014)</p> <p>2.2 Facilities constructed, commissioned, and operating in phases from the end of 2014 to 2017</p> <p>3. More efficient service providers</p> <p>3.1 Support improvements in operating efficiency</p> <p>3.2 Construction of upgraded facilities and measurement systems completed</p> <p>4. Institutions and capacity for urban development, program management, and service delivery are strengthened.</p> <p>4.1 PMO fully staffed (mid-Dec 2013)</p> <p>4.2 Hiring of capacity development consultants (Jan 2014)</p> <p>4.3 Subcenter redevelopment authority established and staffed (Dec 2013)</p> <p>4.4 Subcenter planning and development guidelines and regulations in place (Sep 2014)</p> <p>4.5 CDCs and SDCs fully functioning in targeted areas (mid-2014)</p> <p>4.6 Support to financial strengthening and improved regulatory and institutional framework (mid-2015)</p> <p>Tranche 2 is prepared and approved by 2016</p> <p>Tranche 3 is prepared and approved by 2017</p>			<p>Amount (\$ million)</p> <p>Investment Program</p> <table border="0"> <tr> <td>ADB MFF</td> <td>163.70</td> </tr> <tr> <td>MUB</td> <td>96.00</td> </tr> <tr> <td>Cofinancing</td> <td>60.30</td> </tr> <tr> <td>Total</td> <td>320.00</td> </tr> </table> <p>Project 1</p> <table border="0"> <tr> <td>ADB</td> <td></td> </tr> <tr> <td>ADF Loan</td> <td>22.50</td> </tr> <tr> <td>OCR Loan</td> <td>27.50</td> </tr> <tr> <td>UEIF-UFPF</td> <td>3.70</td> </tr> <tr> <td>MUB</td> <td>22.44</td> </tr> <tr> <td>Cofinancing</td> <td>28.38</td> </tr> <tr> <td>Total</td> <td>104.52</td> </tr> </table>	ADB MFF	163.70	MUB	96.00	Cofinancing	60.30	Total	320.00	ADB		ADF Loan	22.50	OCR Loan	27.50	UEIF-UFPF	3.70	MUB	22.44	Cofinancing	28.38	Total	104.52
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ADB = Asian Development Bank, ADF = Asian Development Fund, CDC = community development council, ha = hectare, km = kilometer, MFF = multitranchise financing facility, MUB = Municipality of Ulaanbaatar, OCR = ordinary capital resources, O&M = operation and maintenance, PM10 = Particulate Matter up to 10 micrometers in size, PMO = program management office, SDC = small and medium-sized enterprise development council, UEIF-UFPF = Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility, USUG = Ulaanbaatar Water Supply and Sewerage Authority.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://adb.org/Documents/RRPs/?id=45007-003-3>

1. Loan Agreement: Special Operations
2. Loan Agreement: Ordinary Operations
3. Grant Agreement
4. Project Agreement
5. Framework Financing Agreement
6. Periodic Financing Request for Project 1
7. Sector Assessment (Summary): Urban Development
8. Facility Administration Manual
9. Contribution to the ADB Results Framework
10. Development Coordination
11. Financial Analysis
12. Economic Analysis
13. Country Economic Indicators
14. Summary Poverty Reduction and Social Strategy
15. Gender Action Plan
16. Initial Environmental Examination
17. Environmental Assessment and Review Framework
18. Resettlement Plan: Bayankhoshuu
19. Resettlement Plan: Selbe
20. Resettlement Framework
21. Risk Assessment and Risk Management Plan

Supplementary Documents

22. Multitranchise Financing Facility as the Preferred Modality
23. Road Map and Policy Framework
24. Financial Analysis of Ulaanbaatar Water Supply and Sewerage Authority