



# Completion Report

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Project Number: 35201-013  
Loan Number: 2201  
July 2016

## Sri Lanka: Local Government Infrastructure Improvement Project

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Asian Development Bank

## CURRENCY EQUIVALENTS

Currency Unit – Sri Lanka rupee/s (SLRe/SLRs)

	<b>At Appraisal</b>	<b>At Project Completion</b>
	15 October 2005	30 January 2013
SLRe1.00 =	\$0.009847	\$0.007906
\$1.00 =	SLRe101.550	SLRs126.49

## ABBREVIATIONS

ADB	–	Asian Development Bank
CLG	–	Commissioner of Local Government
DMF	–	design and monitoring framework
DPR	–	detailed project report
DSC	–	design and supervision consultant
EIRR	–	economic internal rate of return
FLIP	–	financial and local improvement plan
km	–	kilometer
LGESP	–	Local Government Enhancement Sector Project
LLDF	–	Local Loans and Development Fund
MLGPC	–	Ministry of Local Government and Provincial Councils
NSC	–	National Steering Committee
O&M	–	operation and maintenance
PCU	–	Project Coordination Unit
SDR	–	special drawing right
SLILG	–	Sri Lanka Institute of Local Governance
SPCU	–	Subproject Coordination Unit
SWM	–	solid waste management

## NOTE

- (i) The fiscal year (FY) of the Government of Sri Lanka and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

<b>Vice-President</b>	W. Zhang, Operations 1
<b>Director General</b>	H. Kim, South Asia Department (SARD)
<b>Director</b>	S. Bonu, Urban Development and Water Division, SARD
<b>Team leader</b>	M. Fan, Senior Urban Development Specialist, SARD
<b>Team members</b>	S. Barbin, Associate Operations Officer, SARD
	V. Castro-Wooldridge, Urban Development Specialist, SARD
	H. Jayasundara, Associate Programs Officer, SARD
	P. Puspus, Senior Operations Assistant, SARD

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## BASIC DATA

### A. Loan Identification

- |    |                                  |  |
|----|----------------------------------|--|
| 1. | Country                          | Sri Lanka  |
| 2. | Loan Number                      | 2201-SRI   |
| 3. | Project Title                    | Local Government Infrastructure Improvement Project  |
| 4. | Borrower                         | Sri Lanka  |
| 5. | Executing Agency                 | Ministry of Provincial Councils and Local Government |
| 6. | Amount of Loan                   | \$50,000,000   |
| 7. | Project Completion Report Number | SRI 1582   |

### B. Loan Data

- |    |                                  |  |
|----|----------------------------------|--|
| 1. | Appraisal                        |  |
|    | – Date Started                   | 24 March 2005                                    |
|    | – Date Completed                 | 7 April 2005                                     |
| 2. | Loan Negotiations                |  |
|    | – Date Started                   | 13 October 2005                                  |
|    | – Date Completed                 | 14 October 2005                                  |
| 3. | Date of Board Approval           | 24 November 2005                                 |
| 4. | Date of Loan Agreement           | 19 January 2006                                  |
| 5. | Date of Loan Effectiveness       |  |
|    | – In Loan Agreement              | 31 May 2006                                      |
|    | – Actual                         | 30 June 2006                                     |
|    | – Number of Extensions           | 1  |
| 6. | Closing Date                     |  |
|    | – In Loan Agreement              | 30 April 2012                                    |
|    | – Actual                         | 30 January 2013                                  |
|    | – Number of Extensions           | 1  |
| 7. | Terms of Loan                    |  |
|    | – Interest Rate                  | 1.0% during the grace period;<br>1.5% thereafter |
|    | – Maturity (number of years)     | 32 years   |
|    | – Grace Period (number of years) | 8 years  |
| 8. | Disbursements                    |  |
| a. | Dates                            |  |

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<b>Initial Disbursement</b>	<b>Final Disbursement</b>	<b>Time Interval</b>
28 July 2006	30 July 2014	96 months

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Effective Date	Original Closing Date	Time Interval
30 June 2006	30 April 2012	60 months

## b. Amount (SDR)

Cat No.	Category	Original Allocation <sup>a</sup>	Last Revised Allocation <sup>b</sup>	Amount Cancelled <sup>c</sup>	Net Amount Available	Amount Disbursed	Undisbursed Balance
(1)	(2)	(3)	(4)	(5=4-6)	(6)	(7)	(8-6-7)
01	Civil Works	20,833,000	20,833,000	1,268,680	19,564,320	17,649,778	1,914,542
02	Equipment	3,835,000	3,835,000	1,839,590	1,995,410	2,190,543	-195,133
03	Furniture and Vehicle	268,000	268,000		268,000	256,439	11,561
04	Studies and Workshop	587,000	587,000	253,740	333,260	84,256	249,004
05	Staff	1,487,000	1,487,000	888,080	598,920	243,793	355,127
06	Development	3,680,000	3,680,000	348,890	3,331,110	3,054,678	276,432
07	Consulting Services	1,934,000	1,934,000	190,300	1,743,700	1,654,701	88,999
08	Project Management	893,000	893,000	0	893,000	593,628	299,372
09	Interest during Construction	979,000	979,000	919,790	59,210	0	59,210
99	Unallocated	0	0	0	0	0	0
	Imprest Account						
	<b>TOTAL SDR<sup>d</sup></b>	<b>34,496,000</b>	<b>34,496,000</b>	<b>5,709,069</b>	<b>28,786,931</b>	<b>25,727,815</b>	<b>3,059,116</b>

cat = category, SDR = special drawing right.

<sup>a</sup> Based on Loan Agreement.<sup>b</sup> Latest date of category reallocation: 15 July 2011 (figures from Loan Financial Information System 20 May 2016).<sup>c</sup> Amount cancelled as of 15 July 2011.<sup>d</sup> Numbers may not sum precisely because of rounding.

## C. Project Data

## 1. Project Cost (\$ million)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost	21.1	17.9
Local Currency Cost	45.6	38.9
<b>Total</b>	<b>66.7</b>	<b>56.8</b>

## 2. Financing Plan (\$ million)

Cost	Appraisal Estimate	Actual
Implementation Costs		
Borrower Financed	16.7	17.1
ADB Financed	48.7	38.8
<b>Subtotal</b>	<b>65.4</b>	<b>55.9</b>
Interest and Service Charges		
Borrower Financed	0.0	0.0
ADB Financed	1.3	0.9
<b>Subtotal</b>	<b>1.3</b>	<b>0.9</b>
<b>Total Project Cost</b>	<b>66.7</b>	<b>56.8</b>

ADB = Asian Development Bank.

## 3. Cost Breakdown by Project Component (\$ million)

Component	Appraisal Estimate	Actual
<b>A. Base Cost</b>		
1. Component A: Provincial, Municipal and Urban Management Improvement	6.5	5.6
2. Component B: Basic Local Government Infrastructure and Service Delivery	42.6	44.9
3. Component C: Project Coordination and Administration Support	3.9	5.4
<b>Subtotal (A)</b>	<b>53.0</b>	<b>55.9</b>
<b>B. Contingencies</b>	<b>4.7</b>	<b>0.0</b>
<b>C. Taxes and Duties</b>	<b>7.7</b>	<b>0.0</b>
<b>D. IDC</b>	<b>1.3</b>	<b>0.9</b>
<b>Total</b>	<b>66.7</b>	<b>56.8</b>

IDC = interest during construction.

## 4. Project Schedule

Item	Appraisal Estimate	Actual Award of Contract	Completion
<b>Date of Contract with Consultants</b>			
1. Project Management Consultants			
– BCEOM	May 2006	Nov 2007	Jul 2012
– Greentech Consultants	May 2006	Nov 2007	Jul 2012
– Resources Development Consultants	May 2006	Nov 2007	Jul 2012
2. Design and Supervision Consultants	-	Feb 2010	Jul 2012
3. Capacity-Building Provider			
– Sri Lanka Institute of Local Governance	May 2006	Feb 2009	Jan 2013
<b>Civil Works Contract (202 Contracts)</b>			
1. Central Province (27 contracts)	Dec 2007	Mar 2008	Jan 2013
2. Eastern Province (11 contracts)	Dec 2007	Mar 2008	Jan 2013
3. Northern Province (20 contracts)	Dec 2007	Mar 2008	Jan 2013
4. North Central Province (29 contracts)	Dec 2007	Mar 2008	Jan 2013
5. North Western Province (38 contracts)	Dec 2007	Mar 2008	Jan 2013
6. Sabaragamuwa Province (14 contracts)	Dec 2007	Mar 2008	Jan 2013
7. Southern Province (26 contracts)	Dec 2007	Mar 2008	Jan 2013
8. Uva Province (16 contracts)	Dec 2007	Mar 2008	Jan 2013
9. Western Province (21 contracts)	Dec 2007	Mar 2008	Jan 2013
<b>Equipment and Supplies</b>			
– First Procurement	May 2006	Nov 2010	Nov 2010
– Last Procurement	-	Aug 2012	Aug 2012
<b>Capacity Building Program</b>			
– First Training	Oct 2005	Jan 2008	Dec 2012
– Last Training	Jun 2010	Oct 2012	Dec 2012

## 5. Project Performance Report Ratings

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
Jan 2006–May 2006	Satisfactory	Satisfactory
Jun 2006–Oct 2006	Satisfactory	Satisfactory
Oct 2006–Sep 2007	Satisfactory	Satisfactory
Oct 2007–Oct 2008	Satisfactory	Satisfactory
Nov 2008–Apr 2009	Satisfactory	Satisfactory
May 2009–Oct 2009	Satisfactory	Satisfactory

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
Nov 2009–May 2010	Satisfactory	Satisfactory
Jun 2010–Dec 2010	Satisfactory	Satisfactory
Jan 2011–Jun 2011	Satisfactory	Satisfactory

#### D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members
Project Inception	16–22 May 2006	3	19	f,d
Project Review 1	10–17 Oct 2006	3	21	f,g,h
Project Review 2	16–19 Oct 2007	2	8	b,e
Consultation Mission 1	12–16 May 2008	1	5	a
Consultation Mission 2	17–18 Jul 2008	2	4	b,c
Consultation Mission 3	10–11 Nov 2008	4	8	b,c,d,o
Special Review Mission	1–4 Dec 2008	4	16	b,c,d,o
Project Review 3	27–30 Apr 2009	2	8	b,o
Project Review 4	20–26 Oct 2009	2	14	b,o
Loan Midterm Review Mission	7–11 Jun 2010	3	15	b,n,o
Project Review 5	29 Nov–1 Dec 2010	2	5	b,k
Project Review 6	2–10 Jun 2011	3	27	b,k,l
Project Review 7	21–24 Feb 2012	3	12	b,l, j, m
Project Review 8	8–14 Aug 2012	2	14	b,l, j
Project Completion	2–16 Jul 2014	2	25	b,o

a = director; b = urban development specialist; c = head, project administration unit; d = project implementation officer; e = senior evaluation specialist; f = urban development and planning specialist; g = project economist; h = project implementation specialist; i = senior project officer; j = safeguards specialist; k = portfolio management specialist; l = social development and gender specialist; m = project analyst; n = assistant project analyst; o = consultant.



## I. PROJECT DESCRIPTION

1. On 24 November 2005, the Asian Development Bank (ADB) approved a \$50 million project loan to increase the growth potential of and reduce poverty in Sri Lanka's urban centers. The Local Government Infrastructure Improvement Project<sup>1</sup> aligns with the Government of Sri Lanka's development priorities and ADB's country strategy and program (2004–2008)<sup>2</sup> to improve urban infrastructure and services provision. The project's expected impact was to provide sustainable economic growth and poverty reduction through the provision of urban infrastructure services and the promotion of urban management improvement to Sri Lanka's urban local authorities. The project's expected outcome was improved urban management and improved living conditions for the local authority population outside Colombo.<sup>3</sup> The project outputs included: Component A: provincial, municipal and urban management improvement, which covered (i) revenue enhancement and participatory governance, (ii) human resource development, and (iii) institutional strengthening of the Local Loans and Development Fund (LLDF); Component B: basic local government infrastructure and services delivery, which covered improved (i) water supply provision, (ii) sewerage provision, (iii) drainage, and (iv) solid waste management (SWM) systems; and Component C: project coordination and administration support.

2. The project aimed to improve, upgrade, and expand urban infrastructure facilities and basic urban services (water supply, urban roads, urban drainage and sewerage, SWM, and community infrastructure such as health clinics) in local authorities in all of the country's nine provinces. A key project design feature was a line of credit through a financial intermediary, LLDF. The project also involved institutional strengthening and capacity building of LLDF and other state, provincial, and local agencies in urban management and urban service provision. Subprojects were implemented in 108 local authorities—with a total of 202 civil works and equipment contract packages—and many targets were exceeded.<sup>4</sup> All packages were physically completed by 30 January 2013. During implementation, the project suffered initial delays related to the limited capacity within local authorities and LLDF, as well as to the effects of the country's civil war.

## II. EVALUATION OF DESIGN AND IMPLEMENTATION

3. The main project implementation events are presented chronologically in Appendix 1.

### A. Relevance of Design and Formulation

4. The project was *relevant* to government sector strategies at the time of appraisal and completion. The project had been formulated within the context of the 13th amendment of the government's constitution, which supported the devolution of resources and power to local governments for municipal service delivery. The project also supports the government's development policy framework, which highlights the need for balanced regional development to ensure every household benefits equally from economic development.<sup>5</sup> The project provided a

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<sup>1</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Local Government Infrastructure Improvement Project*. Manila.

<sup>2</sup> ADB. 2003. *Country Strategy and Program: Sri Lanka, 2004-2008*. Manila.

<sup>3</sup> Local government is the third and lowest level of government in Sri Lanka – after the central government and provincial councils.

<sup>4</sup> Subprojects were not defined at project appraisal since this was a financial intermediary project and original targets were indicative. Design and monitoring framework (DMF) targets were revised in February 2009.

<sup>5</sup> Government of Sri Lanka. 2010. *Mahinda Chintana—Vision for the Future: The Development Policy Framework*. Colombo.

unique opportunity for local authorities to access financing outside the traditional government system and outside commercial markets—since most local authorities do not have the requisite creditworthiness and financial capacity to borrow from commercial banks, and the local market for municipal lending is weak. The project's goals strongly complement the government's development plans for urban development and local governance. The government's Economic Development Framework (July 2004) stresses regional balance and poverty reduction, as well as continuing policy, regulatory, and institutional reform. The Budget 2005 expands upon the framework, emphasizing revenue mobilization, more effective public financial management, and improved infrastructure.

5. In line with the government's vision for the urban sector, the project contributed to (i) improving the framework for decentralization, devolution, and local governance; (ii) strengthening the revenue position of local authorities; (iii) reforming the fiscal transfer system; (iv) introducing more participatory processes in local governance;<sup>6</sup> and (v) enhancing local government accountability and transparency. The project investments helped empower local governments by giving them the role to prepare and implement their projects.

6. In addition to the development of infrastructure and improved services, the project aimed to develop a viable model to finance urban infrastructure projects planned and implemented at the local level. Local authorities were responsible for identifying, preparing, and implementing subprojects. LLDF was responsible for implementing Component B, by appraising, approving, monitoring, and evaluating local authority subprojects. The project was the first financial intermediary loan for the government, requiring significant support to transform LLDF from a debt-collecting agency to a financial intermediary for the urban sector.

7. In line with central and local government policy to improve institutions, infrastructure, and urban environment through decentralization, the project also built capacity of provincial councils, local authorities, and LLDF to deliver project outputs, and supported reforms for local authorities to provide and sustain services. The project was instrumental in raising awareness among local authorities of the potential to borrow for capital investments, as this was a new concept. Borrowing for infrastructure also required local authorities to practice financial discipline to be able to repay the loans. As such, the project gave LLDF the opportunity to develop as a financial intermediary, to provide technical and financial assistance to local authorities. The project was, thus, designed to address key development needs of Sri Lanka's urban sector, including infrastructure and access to finance, and stronger institutions for local service delivery.

8. The project loan was administered and channeled to end users by a financial intermediary. This approach was relevant at the time of appraisal and completion considering the government's decentralization efforts. The project continues to be relevant, given Sri Lanka's upward urbanization trends, demand for infrastructure finance, and government prioritization of urban infrastructure and service delivery.

## **B. Project Outputs**

9. The project improved water supply, sanitation, drainage, roads, and community or public buildings<sup>7</sup> in 108 local authorities, and built institutional capacity of state, provincial, and local authorities, which benefited households, businesses, and about 6 million people at completion

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<sup>6</sup> Project design included community participation in financial and local improvement plan preparation and in subproject selection.

<sup>7</sup> Buildings included libraries, health centers, and local authority office buildings.

(2013), from 4 million people at appraisal (2005).<sup>8</sup> The project also included safeguards training for Ministry of Local Government and Provincial Councils (MLGPC) and local authorities, as well as socioeconomic and environmental monitoring of works to ensure compliance with ADB social safeguards. Appendix 2 compares project performance with the revised design and monitoring framework (DMF) included in the report and recommendation of the President.<sup>9</sup>

## 1. Component A – Provincial, Municipal and Urban Management

10. At appraisal, Component A consisted of three key areas: (i) infrastructure development planning and financial management support to local authorities (financial and local improvement plans [FLIPs]), (ii) project development assistance support to provincial councils, and (iii) LLDF management strengthening. The project provided in-service training to provincial councils, local authorities, and LLDF officials and staff on basic infrastructure planning, budgeting, and procurement, as well as on basic engineering skills needed to prepare and/or appraise projects. The component also included (i) provision of a tool kit for provincial council and local authority staff to help prioritize investment needs, (ii) support to compile subproject proposal applications, and (iii) preparation of tailored FLIPs. The FLIPs outlined steps to enhance revenue, improve governance and service delivery, and build capacity. The project contracted out much of the capacity building to a government institute, the Sri Lanka Institute of Local Governance (SLILG), to provide continued support to local-level governance.

11. **Local authority capacity building.** The FLIP was introduced as an action plan for local authorities to identify and implement realistic initiatives to improve their performance. Development and adoption of this action plan, with clear steps and milestones to increase revenue bases and undertake other identified reforms, was a prerequisite to accessing LLDF funds. FLIPs provided direction for local authorities to improve their own-source revenue through, for example, property tax collection. In total, 108 local authorities implemented and adopted FLIPs with project support. MLGPC has since replicated these plans for local authorities in a subsequent ADB project, the Local Government Enhancement Sector Project (LGESP).<sup>10</sup>

12. **Project development assistance support.** The low capacity of provincial councils and local authorities to formulate, develop, and implement infrastructure projects was identified as a major impediment to providing improved services. The project provided support from three international advisors in the Office of the Commissioner of Local Government (CLG), covering each of the three provincial councils. The advisors served as a 'help desk' to respond to requests from local authorities or provincial councils on FLIP or subproject preparation (feasibility studies, financial analysis, and detailed project report [DPR] review), while building capacity of provincial council staff to do the same in the future. A user-friendly operations manual was prepared for the local authorities (borrowers) and LLDF (lender).

13. **Local Loans and Development Fund strengthening.** LLDF's role under the project was to (i) provide financial resources to local authorities for small- and medium-sized

<sup>8</sup> Contributions to ADB Results Framework: (i) 230 kilometers (km) provincial, district, and rural roads built or upgraded versus 290 km target, (ii) 13.6 km drainage completed versus 13.5 km target, (iii) 5,142 households with new or improved water supply completed vs. target of 6,125 households, (iv) 1,461 households with new or improved sanitation versus target of 1,400 households, (v) eight local authorities with land improved through roadside drainage versus target of 20 (estimated at 55 hectares of land), and (vi) land improved through waterlogging in five local authorities versus target of five local authorities (estimated at 50 hectares of land).

<sup>9</sup> DMF targets were revisited and revised in February 2010.

<sup>10</sup> ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Local Government Enhancement Sector Project*. Manila.

infrastructure, equipment, and consulting services; (ii) analyze local authority capacity to plan, implement, and manage basic infrastructure investments, and to integrate the associated expenditures and revenues into their budgets; and (iii) enhance its own capacity to serve as the country's financing intermediary for local authorities. As the government's primary financial intermediary (defined in ADB's Operation Manual D6/OP of 23 December 2003) for local authority infrastructure, LLDF was supported by the project to (i) prepare a business plan for performance improvement, (ii) develop software for loan management and financial reporting, and (iii) develop an operational manual outlining credit and grant appraisal requirements. LLDF financed operations under Component B through its project appraisal unit, later renamed as the Project Management Unit (PMU). Originally, the project had targeted 80 local authorities to become LLDF clients; at project completion, 108 local authorities had received loans.

14. Component A helped strengthen government capacity during implementation. FLIPs were implemented in all 108 local authorities, and included revenue enhancement measures, development of annual plans, and preparation of citizen's charters. About 2,000 personnel from MLGPC, LLDF, provincial councils, municipal councils, and local authorities participated in learning events. At completion, 85 of the 108 local authorities (or 79%) had achieved their FLIP revenue targets, and 30 local authorities had increased their own-source revenue by 40%. All local authorities covered by the project are complying with their debt service obligations. The loan repayments are used to capitalize LLDF.

## 2. **Component B – Basic Local Government Infrastructure and Service Delivery**

15. Component B aimed to improve local authority infrastructure and services, including (i) water supply; (ii) sanitation; (iii) drainage; (iv) roads; (v) SWM; and (vi) basic health clinics, public libraries, and parks. With the support of provincial councils, interested local authorities prepared and submitted applications to LLDF for approval. All 202 civil works and equipment packages in 108 local authorities were completed as of 31 January 2013. At appraisal, the cost of urban infrastructure was estimated at \$42.6 million. The final cost at completion was \$41.4 million. The average cost per package was about \$205,000. Support for some subsectors—notably other local authority services, such as health clinics, public libraries, and local authority office buildings—has been requested more than envisaged, while the SWM and water supply subsectors received few requests because of government grant financing to local authorities for these subsectors.

16. **Water supply, sanitation, and solid waste.** The project achieved the following outputs compared to DMF targets: (i) 5,142 new household connections under water supply provided in seven local authorities (target of 6,000 households); (ii) uninterrupted water supply achieved in four local authorities (target of four local authorities); and (iii) public health improved through access to sanitation facilities for 1,461 households under two schemes (target of 1,400 households). The targets for SWM were removed during the February 2010 midterm review, when it was clear that the government provided grant financing to local authorities for SWM.<sup>11</sup>

17. **Roads and drainage.** The project achieved the following outputs compared to DMF targets: (i) 230 kilometers (km) of new roads constructed (target of 290 km), (ii) 13.6 km of drainage improved (target of 13.5 km), (iii) waterlogging reduced in five local authorities (target of five local authorities), and (iv) roadside drains built alongside major roads in eight local authorities (target of 20 local authorities).

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<sup>11</sup> The performance targets and indicators for Component B were revised in February 2010.

18. **Facilities.** Component B also included the construction or improvement of public facilities, for which outputs exceeded the DMF targets. Against a target of 35 buildings, 66 buildings were constructed (20 health centers, 23 administrative buildings, 4 crematoriums, and 19 community halls). The project initially envisaged that more local authorities would select subprojects for basic services such as water, sanitation, and solid waste. However, the project was demand-based, and the demand was greatest for buildings (53 local authorities), as well as roads and road maintenance. During initial implementation, there were inadequate technical (engineering) experts to support the implementing agencies. During implementation, government resources provided the local authorities basic urban services (water supply, sanitation, and SWM); therefore, local authorities opted for roads and community facilities.

**Comparison of Subprojects for Basic Urban Services**

Sector	At Appraisal		At Completion (as of 31 January 2013)	
	Targets (Revised)	Amount (\$ million)	Targets Achieved	Amount (\$ million)
1. Water supply and sanitation	6,125 households 1,400 households	10.49	5,142 households 1,461 households	3.78
2. Drainage	13.6 km	4.32	13.6 km	1.15
3. Solid waste		8.60	-	-
4. Roads and road equipment <sup>a</sup>	290 km	10.50	230 km	15.82
5. Buildings	35	8.65	66	20.63
• Health clinics	20		23	
• Community halls	19		19	
• Buildings	23		23	
6. Subprojects	80		128	
<b>Total</b>		<b>42.56</b>		<b>41.38</b>

- = data not available, km = kilometer.

<sup>a</sup> Some road subprojects include roadside drainage.

### 3. Component C – Project Coordination and Administration Support

19. Component C covered the incremental administration costs and counterpart staff of MLGPC, LLDF, provincial councils, and local authorities. It also included some consulting services to (i) provide administration and coordination support to the Project Coordination Unit (PCU) for implementing project outputs, including the project performance management system's development and implementation; (ii) assist Subproject Coordination Units (SPCUs) in supporting the local authorities; (iii) strengthen the National Steering Committee (NSC); and (iv) implement and enhance community participation strategies, particularly for prioritizing subprojects and supporting operation and maintenance (O&M). The project provided LLDF with staff and consultants, and design and supervision consultants (DSCs) were recruited to support local authorities. About 2,000 staff from local authorities and provincial councils participated in project administration training. Some SPCU staff are applying the skills gained in this project through their involvement in the LGESP.

### C. Project Costs

20. At appraisal, the total project cost was \$66.7 million equivalent, comprising \$21.10 million in foreign currency (31.6%), and \$45.60 million in local currency (68.4%). The ADB loan was \$50 million, of which \$38.8 million (77.6%) was used (excluding interest charges). Appendix 3 compares estimated and actual project costs. Appendix 4 provides the exchange rates used to convert local currency to the dollar equivalent. The summary of contracts is in Appendix 5.

21. Appendix 6 shows the project's financing plans, at appraisal and after completion. After completion, the total project cost was \$56.8 million. The ADB loan contributed \$39.7 million to the financing; the government (\$13.7 million) and local authorities (\$3.4 million) financed the local currency cost. ADB's financing share decreased from 75% to 70%, as a result of loan savings of \$9.0 million, leading to a partial cancellation of that amount in July 2011. The remaining undisbursed SDR3,059,116 represents the project portion that was cancelled in October 2015. The amount was not disbursed at the closing date because of incompleteness of subproject infrastructure, as well as capacity-building activities.

22. For the basic infrastructure credit line, the Ministry of Finance and Planning provided SDR24,667,000 (\$35.8 million) to LLDF through a Subsidiary Loan Agreement based on the same terms and conditions of the ADB loan to the government. LLDF transferred the money to local authorities based on loan and grant agreements that determined the loan-to-grant ratios applicable to the local authority.<sup>12</sup> The local authorities contributed 7% to the cost of the projects under their purview. All sub-borrowers (local authorities) had a loan interest rate of 9%.

23. At the request of the government, ADB approved a minor change in scope in February 2009 that resulted in the reallocation of unused loan proceeds to (i) increased consultant inputs, (ii) furniture and vehicles for road maintenance, and (iii) increased project management costs. Project implementation had been slow because of the local authorities' inadequate capacity to prepare and implement subprojects. These limitations were corrected through the minor change, which approved additional staff and consultant inputs.

24. The actual costs at completion indicate underspending in several categories, including staff development and workshops. These cost items were reduced through increased consultant and project management inputs, as the DSCs and international and national consultants provided the capacity development.

#### **D. Disbursements**

25. Under the project loan, disbursements from ADB to the executing agency through the imprest account totaled \$39.70 million<sup>13</sup> out of the total allocation of \$46.09 million (86.1%), net of the \$9 million equivalent cancellation from cost savings. Cost savings of \$9 million resulted from (i) savings in civil works and equipment compared to engineers' estimates as a result of competitive bidding, (ii) savings in capacity development, and (iii) non-use of unallocated funds. The savings were transferred to the new project, LGESP. Initial loan disbursement started on 28 July 2006, and the final disbursement was in July 2014. At project start-up, disbursements were slow because of the local authorities' lack of capacity in preparing DPRs and FLIPs, loan criteria for LLDF, and procurement thresholds, among others, which delayed procurement. Through a minor change in scope in February 2009, disbursements were facilitated. The minor change included (i) providing DSCs, (ii) increasing inputs of project management staff at the provincial level, (iii) improving loan criteria for LLDF, (iv) increasing procurement thresholds, and (v) supporting a full-time consultant to assist in the initial implementation. The breakdown of actual disbursements is in Appendix 7.

<sup>12</sup> The loan-to-grant ratio was 60:33 for Municipal Councils, 50:43 for Urban Councils, and 40:53 for *Pradeshiya Sabhas* (local government). All local authorities contributed 7% of the total project cost.

<sup>13</sup> On 28 August 2015, the amount refunded to ADB from the imprest account was about \$519,790.

## **E. Project Schedule**

26. The project was to be implemented over 6 years. ADB approved the project on 24 November 2005; the loan agreement was signed on 19 January 2006 and became effective on 30 June 2006. From project approval, it took 3 months to declare the loan effective and 12 months to mobilize project implementation consultants. Start-up delays also occurred because of the (i) delay in establishing the NSC and provincial steering committees; (ii) delay in recruiting project staff; (iii) need to undertake intensive marketing due to initial reluctance of local authorities to access loans for their projects; and (iv) lack of capacity of local authorities in preparing FLIPs, DPRs, and technical designs for urban infrastructure. There was also a project lull in 2008 and 2009 because of the ongoing civil war. The project closed on 30 January 2013, after just a 9-month extension, despite initial delays and compared with the majority of ADB projects, which are completed after 2 years' extension. Moreover, the project handled many small contracts, relative to other urban projects. The planned and actual implementation is in Appendix 8.

## **F. Implementation Arrangements**

27. The MLGPC was the project's executing agency, and LLDF was a financial intermediary.<sup>14</sup> The project established an NSC to oversee implementation. The NSC was chaired by the MLGPC secretary and comprised senior-level representatives from the Ministry of Finance and Planning, External Resources Department, National Planning Department, Finance Commission, National Water Supply and Drainage Board, and other ministries. The MLGPC set up a PCU led by a full-time project director. The PCU was responsible for (i) coordinating all project activities; (ii) liaising with and reporting to ADB; (iii) managing the PMU account; (iv) managing finances and reporting project accounts; (v) liaising with other government agencies; (vi) developing training materials, policy manuals, and technical guidelines; (vii) monitoring and evaluating SPCUs; and (viii) providing management and policy support to SPCUs.

28. A project appraisal unit was likewise established in LLDF to assist local authorities in meeting the requirements for funding activities, compile annual data on local authorities' technical and financial performance, and manage disbursements of local authority funds. In each of the nine provincial councils, at the Office of the CLG, an SPCU was headed by the CLG. The SPCU was responsible for preparing annual development programs for each respective province, managing the project development assistance, accounting for expenditures, providing assistance to local authorities with weak capacity to implement civil works, conducting quality assurance, and conducting performance monitoring and evaluation.

29. A challenge was that there were two agencies for decision making: PCU (MLGPC), which was responsible for Components A and C; and PMU (LLDF), responsible for Component B. Both had their own set of consultants and budgets, which resulted in parallel structures. The lack of a full-time chief executive officer in LLDF exacerbated the problem.

## **G. Conditions and Covenants**

30. ADB declared the loan effective on 30 June 2006, once the government met conditions for the effectiveness of the loan agreements. No covenants were modified, suspended, or waived during implementation. The government was generally in compliance with major loan

<sup>14</sup> At project start, LLDF was under the MPCLG; during implementation, LLDF was relocated to the Ministry of Finance and Planning.

covenants. There were some initial delays in submissions of audited financial accounts regarding compliance with Article IV, Section 4.02 (a), which was promptly addressed by the executing agency. The status of compliance with covenants is in Appendix 9.

31. Covenants for project implementation and O&M of project-supported facilities were met satisfactorily. During early implementation, delays in audited financial account submissions were because of inadequate PCU, SPCU, and PMU staff (financial experts). However, this improved after the minor change in scope was approved for additional implementation support. Local authorities, SPCU, and LLDF were allowed to select and engage the required consultants to augment their financial and project implementation.

## **H. Consultant Recruitment and Procurement**

### **1. Consultants**

32. At appraisal, the project allocated \$0.63 million to consulting services for project coordination and implementation support. This was revised to \$5.1 million at loan closing to supplement the implementation capacity of the executing agencies, as well as SPCUs and local authorities. The project engaged (i) one international consultancy team (124 person-months) through one package, (ii) two domestic consultancy teams (630 person-months) through three packages, and (iii) DSCs through 50 contract packages (individuals). The scope of work for the international team included (i) supporting implementation of Components A, B, and C at the central level; (ii) providing overall guidance to the PCU, PMU, and SPCUs; (iii) developing loan management systems software and a project website; (iv) reviewing preparation and implementation of FLIPs; (v) capacity building; and (vi) project monitoring. The domestic consultants were responsible for supporting implementation of Components A and B at the provincial level through SPCUs. The consultancy services packages for the international team and two domestic firms were increased from 414 to 754 person-months. In addition to the international and domestic consultancy packages, national capacity-building provider SLILG delivered training and support at LLDF, provincial, municipal, and local authority levels.

33. The project engaged consulting firms using the quality- and cost-based selection procedure and the least-cost selection methods to assist the government. The loan-financed consultants were recruited following ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). Three firms worked from November 2007 to July 2012. The project planned to appoint consultants assisting the PCU at the central level and SPCUs at the provincial level in the fourth quarter of 2006, but they were only mobilized in November 2007.

34. In February 2009, a minor change in implementation arrangements was approved to reallocate funds for additional support to the executing agency and local authorities. The inputs of the international consulting firm and two domestic firms were increased to provide greater overall support. Initially, many of the experts provided support on an intermittent basis; additional inputs were required to ensure engagement of full-time experts. SLILG's inputs were also extended to provide additional capacity building to the provincial council, LLGF, and local authorities. Crucially, the project recruited DSCs to support local authorities in the detailed engineering design and construction supervision work.

35. **Design and supervision consultants.** Slow project implementation led to a review and restructuring of implementation arrangements. It was necessary to strengthen the engineering capacity for design and construction supervision, as government units and project consultants were short of personnel, particularly engineering professionals, to deliver the project on time



and to a high quality standard. Thus, in February 2009, it was planned that SPCUs in each province would engage a national DSC to help prepare the detailed designs, estimates, and bid documents for subprojects in the respective province. However, only the Northern Province contracted a provincial DSC to work with several local authorities that were quick to define their project scope.<sup>15</sup> Other provinces (and local authorities) wanted to move more quickly and could not afford the long recruitment process. For these, it was more practical to contract DSCs as individuals, to work with local authorities on a needs basis.

## 2. Procurement

36. MLGPC oversaw all procurement activities, such as tendering, contract award, and disbursements, for ADB-financed contract packages following ADB's Procurement Guidelines (2015, as amended from time to time). The decentralized arrangement made provincial council and local authority staff responsible for procurement following ADB's procedures. To help facilitate implementation, procurement was improved through (i) increasing the procurement threshold for civil works and (ii) improving the qualification criteria for bidders. Mobilizing both individual consultants and firms experienced in procurement and project management likewise supported the PCU and SPCUs to ensure the 202 contracts were implemented successfully.

### I. Performance of Consultants, Contractors, and Suppliers

37. **Consultants.** The international consultants' performance was *satisfactory*. The consultants provided all consulting services stipulated in the terms of reference. With assistance from ADB and PCU, the consultants managed the project adequately, established professional management systems in the executing agencies, prepared the loan management system software for LLDF, and built the capacity of the executing and other agencies.

38. The overall performance of the domestic consultants, including training consultants, DSCs, and external monitoring agencies, was *satisfactory*. They provided the required services timely following their contracts.

39. Despite initial implementation delays, the civil works contractors completed the civil works following the required technical specifications. Implementing agencies rated the contractors' performance as *satisfactory*. Similarly, the suppliers' performance was *satisfactory*, as equipment were provided in accordance with the contract terms and conditions.

40. Following the minor change in scope for the implementation arrangements, no major contractual problems were encountered in the packaging of contracts, preparation of bidding documents, and evaluation of bids.

41. **Contractors and suppliers.** The project had 202 contracts to equip and construct the subprojects of 108 local authorities. The total amount of the contracts was \$41.8 million. The MLGPC, provincial councils, and local authorities reported that the performance of the majority of contractors was generally satisfactory. All goods and services under the project loan were procured following ADB's Procurement Guidelines. Bidding documents were prepared in a manner that ensured maximum competition under national competitive bidding. The contractors' performance was *generally satisfactory*.

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<sup>15</sup> In the war-torn areas, many of the local authorities opted for office buildings.

## **J. Performance of the Borrower and the Executing Agency**

42. The government was the borrower. The MLGPC was the executing agency. All project outputs were completed successfully, although there was an overrun of about 9 months to complete the project, because of the need to modify the implementation arrangements, and delays in completing construction and subproject commissioning.

43. Overall, the MLGPC, with assistance from PCU and SPCUs and through implementation arrangement changes, satisfactorily demonstrated its capacity to oversee the engineering, procurement, and construction done by contractors according to approved standards and to the satisfaction of ADB. The borrower established its project management team with appointment of key staff even before the loan became effective. These actions demonstrated the executing agency's commitment and capability to implement the project.

## **K. Performance of the Asian Development Bank**

44. The ADB's overall performance was *highly satisfactory*. It monitored the project closely and regularly, and provided guidance on project management. ADB fielded 10 supervision missions. It acted promptly on government proposals for change in scope, partial cancellation, reallocation, and extension of the loan closing date to ensure project success. ADB jointly administered the project with the borrower. Although ADB procedure was quite new to the implementing agency, the project was completed successfully. ADB supported the project by its frequent missions and capacity development of the executing and other agencies, such as provincial councils and local authorities.

# **III. EVALUATION OF PERFORMANCE**

## **A. Relevance**

45. The project is rated *relevant*. The project reflected government policies and ADB country strategies, and, in fact, became more relevant over time with the government's increasing emphasis on decentralization and improved urban service delivery. The project likewise supported the government's Economic Development Framework (July 2004), which focused on regional balance and poverty reduction, and continued policy, regulatory, and institutional reforms. These include an innovative financing mechanism, with LLDF as a financial intermediary, and measures to strengthen local authorities' capacity to plan and implement projects and to provide services. The project design focused on strengthening local government by enabling stronger planning and capacity to implement projects and provide services.

46. During implementation, minor scope changes were undertaken, which included the provision of additional technical assistance to augment expertise in engineering, project, and financial management. Because of increased demand for urban services, Colombo district was added, which resulted in an increase from eight to nine participating local authorities. Procurement thresholds and loan eligibility criteria were likewise relaxed to allow local authorities to access loans. Implementation arrangements were changed to reflect the need for a second-tier project management unit at the provincial level. Funds were reallocated to increase provision for consultant and project management, and to equipment and vehicles for basic urban services. Consequently, the combined capacity building; increased technical assistance; and improved loan, procurement, and implementation arrangements enabled the project to be on track using the revised design and monitoring framework (DMF) approved on 10 February 2010. Almost all DMF targets were exceeded.

## **B. Effectiveness in Achieving Outcome**

47. The project is rated *effective*. The targets for improved urban management included (i) 30 participating local authorities increase their financial viability and own-source revenues by 40%; (ii) at least 30 local authorities adopt FLIPs; (iii) 50 local authorities are able to borrow from LLDF; (iv) the operation and appraisal manual for LLDF is developed and used; (v) 80 subprojects are implemented; and (vi) 30 local authorities use the citizen redress system. At completion, 30 local authorities had increased their financial viability and reached the own-source revenue target of 40%, 108 local authorities had FLIPs and had borrowed from LLDF, and 128 subprojects had been implemented. The construction or upgrading of buildings helped provide much-needed community spaces such as libraries and health clinics, and provided local authorities with necessary office space to carry out their mandate, which was particularly important in conflict zones where local authority offices had been demolished. Operation and project appraisal manuals were prepared by the consultants and implemented by LLDF, and citizen redress mechanisms were installed in all 108 local authorities. The innovative and transformative FLIP implementation and LLDF outputs have contributed to local administration's improved financing, resource mobilization, and governance. The project contributed to improving basic urban infrastructure and services in selected local authorities. The minor scope changes of increased consultant and project management inputs helped address initial delays. Capacity building at the central, provincial, and local levels included about 5,000 technical and administrative officers and staff. The majority of the DMF targets were exceeded.

## **C. Efficiency in Achieving Outcome and Outputs**

48. The project is rated *efficient*. Overall, the project was implemented within cost, with an extension of only 9 months because of initial delays. After a slow start during the first 2 years, the project ran smoothly, and its implementation quickly accelerated.

49. The project's economic benefits were estimated as the incremental value of benefits that the population of participating local authorities can expect to receive as a result of improved infrastructure attributable to the project. The economic internal rates of return (EIRRs) were recomputed for the project roads, water supply, sanitation and drainage, and buildings, with quantifiable benefits attributed to each beneficiary for improved health, time and cost savings, and other benefits. The monetized value of the benefits compared with the project's estimated economic costs yielded EIRRs ranging from 13.9% to 26.7%, exceeding the opportunity economic cost of 12.0% (see Appendix 10). Sensitivity tests show project economic viability can withstand changes in the assumptions used in the cost-benefit analysis. The project's resulting rate of return reflects improved productivity and cost savings resulting from key provincial, municipal, and urban services.

50. The economic analysis reviews recent trends to establish the basis for its positive assessment of the project. The resulting EIRRs have been estimated at completion. The EIRRs calculated for this project were subjected to sensitivity tests that show the project economically viable even in adverse circumstances. The EIRRs are sensitive to an increase in O&M costs, recalculated to 13.2%, and a decrease in benefits, recalculated to 25.9%, which are more than the 12.0% cutoff rate. The project's positive externalities and longer-term intergenerational social benefits have not been quantified. These potentially include (i) spillover effects to non-project local authorities and (ii) environmental benefits that accrue to the project-area population.

## D. Preliminary Assessment of Sustainability

51. The project is *likely sustainable*. The sustainability of project achievements is supported by the follow-on project, the LGESP. Under the LGESP, the extension of project interventions will further develop important initiatives. A preliminary project assessment shows many positive indications for its long-term sustainability. These include (i) the commitment shown by MLGPC and LLDF in implementing the project and exceeding many targets, and (ii) the improvement in local authorities' performance through the adoption of policies and practices that improved their financial positions and accountability.

52. At the same time, the final output delivery includes the adoption of FLIPs, financial management improvement, and LLDF capacity enhancement. The combination of more accountable and sustainable governance approaches at the local authority level and pressure from communities for continued and improved services make it likely for local authorities to sustain services long term. Local authorities should be able to continue to generate revenues to cover O&M costs.<sup>16</sup> Demand for services and facilities in the local authorities is projected to grow substantially. Since project completion, local authorities have undertaken various infrastructure development loans from LLDF. Likewise, revenue enhancement activities through FLIPs have indicated increased local revenues. Moreover, LLDF and local authorities have sufficient human, institutional,<sup>17</sup> financial, and other resources to sustain the outputs and outcome after the project.

53. The project's financial sustainability was reviewed. The sustainability assessment of the 108 local authorities indicates local authorities can cover the O&M costs for the subprojects. At completion, their annual commitment, as a percentage of the total budget, was estimated at 2%. Some local authorities have increased their water tariffs and, with LLDF's assistance, pioneered obtaining advance deposits from users to defray part of the capital costs of water supply network expansion. Local authorities' financial capacity has been strengthened to the extent envisaged at appraisal, particularly because of implementing area-based property taxation schemes and service charges. The financial rates of returns ranged from 6.6% to 8.7%, exceeding the weighted average cost of capital of 3.0%, indicating the project's financial viability (see Appendix 10).

## E. Impact

54. The project impact is rated *significant*. The project made a substantial impact on institutional development and provincial, municipal, urban and/or community infrastructure development. As the first financial intermediary loan in the sector, the project also made a substantial impact on strengthening the local government sector.

55. **Institutional development.** The project's impact on LLDF was significant. From a debt collection agency in 2006, LLDF gradually transformed into a financial intermediary and has grown in competence. A strong accountability system among the local authorities will be essential for the institutional reforms to have significant impact. The improvements in capacity and confidence, which began under the project, will continue under the LGESP. Capacity development under the project has provided the necessary mechanisms for effective management, improved governance, and enhanced revenue.

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<sup>16</sup> The consultants have undertaken technical capacity building for O&M through workshops and staff development and the preparation of O&M manuals and guidelines. Moreover, tariff setting support and training programs are provided in collaboration with the National Water Supply and Drainage Board.

<sup>17</sup> Under the project, about 5,000 staff has been trained on management and project management programs.

56. **Environment.** No adverse environmental impacts were identified, since adequate safety measures and periodic monitoring were in place, and ADB reviewed the environmental impact assessment and monitoring reports. Following government guidelines on environmental clearances, the construction of urban infrastructure requires clearance from government authorities. There were a few compensatory issues related to resettlement for the subprojects constructed; these were amicably mitigated through community grievance mechanisms. The equipment purchased in the project did not produce environmental hazards. The project has provided environmental benefits through the drainage and sanitation subprojects.

57. **Social assessment.** The project was gender neutral with regard to beneficiaries. All urban service consumers benefited from greater service reliability in the local authorities. Community consultations were held with primary and secondary stakeholders prior to and during implementation. Special focus was given to assess negative social impacts, if any, for affected parties such as vulnerable groups.

58. Component B involved the construction of various infrastructure and provision of vehicles and equipment. Local authorities chose subprojects that were beneficial to the local government and community, including roads, office and multipurpose buildings, community health centers, libraries, crematoriums, and water supply and sanitation systems. The subprojects avoided human dwellings and activities that could negatively impact the communities. The resettlement plan for the urban infrastructure component (Part B) identified 11 (out of 131) project-affected parties. The government compensated the affected parties for loss of land, houses, and livelihoods following ADB's Safeguards Policy Statement, 2009.

#### IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

##### A. Overall Assessment

59. The project is rated *successful*, based on the ratings of *relevant*, *effective*, *efficient*, and *likely sustainable*. The project was successful in achieving most of the outcome targets and outputs in the revised DMF. Implementation of the three outputs was achieved with full involvement of the executing agency, other agencies, provincial councils, and local authorities. Project outputs were achieved per the revised targets, despite initial implementation delays.<sup>18</sup> The project succeeded in transforming LLDF from a debt-collecting agency into a financial intermediary. Although LLDF is not yet operating as a full-pledged financial intermediary, the project served as a catalyst in providing a long-term financial intermediation for the sector. The project likewise strengthened LLDF's capacity and raised awareness on and acceptance of a financial intermediary for capital investments. Also, despite delays, the project completed and exceeded the revised targets on the infrastructure for local authorities' continued development. The project successfully delivered the capacity development programs. MLGPC, LLDF, the nine provincial councils, and 108 local authorities improved their capacity to plan and implement urban infrastructure and governance projects. The local authorities built capacity in developing and implementing FLIPs, and succeeded in reaching resource mobilization targets for improved sustainability. MLGPC replicated the FLIP approach through adoption of reform plans under the LGESP, a subsequent ADB urban sector project (sector loan modality). The LGESP was approved in September 2011 and is being implemented, building on the project's experience.

<sup>18</sup> As this was a financial intermediary project, the types of subprojects to be implemented were not known in advance. Therefore, the original targets were only indicative.

60. The changes made in implementation arrangements were essential for the project's success. Both the government and ADB responded effectively to address government bodies' weak capacity. The subprojects were carried out successfully once additional implementation support was provided along with the project extension. Significant capacity support was needed both at the early and implementation stages since the project required several activities that were relatively new to local authorities, provincial councils, and LLDF. Although the project had less impact on basic services (e.g., water supply and sanitation) than envisaged at appraisal, overall performance was still satisfactory. Many of the revised targets were exceeded, while remaining within budget.

## **B. Lessons**

61. **Adequate support to local authorities.** At the outset, it was clear a more robust support system to local authorities for design and supervision was required. Advisors at the provincial council level supported local authorities intermittently, but additional support for preparing feasibility studies, cost estimates, engineering designs, and bidding documents was required for smooth implementation. The project rectified this gap reallocating for additional DSC consultancy packages and increasing existing consultants' inputs. Projects need to be realistic about what can be achieved given the capacity. It would be prudent to include in DSCs' terms of reference the preparation of O&M plans for new subprojects.

62. **Standardization.** Since the project packages were numerous and relatively small, documents and processes should have been standardized as much as possible for efficiency and quality. For example, project-specific bidding document templates, as well as standard terms of references for all project committees, could have been drafted by PCU and approved by ADB at an earlier stage. Standard documents, reports, and monitoring forms to be used by SPCUs were introduced on 20 June 2008.

63. **Requirement for financial intermediary transformation.** For LLDF's professional operation, the project established systems, such as loan management software and operational manuals. However, the organization requires a full-time, qualified head to further drive its growth and sustainable expansion. The current part-time status of the chief executive officer will make it difficult for the organization to thrive. In addition, linkages between LLDF and the Finance Commission, which determines allocations to the nine provinces, could help mainstream LLDF as a sector player that catalyzes continuous improvement of local-level administration and governance through financial incentives.

64. **Project leadership.** The project had two nuclei for management—PCU and PMU. Although this arrangement was a risk-mitigating measure since LLDF had no project experience, future projects should have only one project director responsible for the project (e.g., PCU under MLGPC was responsible for the overall project, and leadership was under the PMU director).

## **C. Recommendations**

### **1. Project Related**

- a. **Future monitoring.** The government will need to continue monitoring the (i) repayment of loan from local authorities to LLDF, (ii) repayment of loan from LLDF to government, (iii) status of revolving fund at LLDF (if fund for relending to other subprojects is available), and (iv) revenue

enhancement in local authorities to ensure O&M. MLGPC should continue to promote, support, and monitor local authority performance accountability for subproject and service sustainability. There is currently no centralized performance data collection for local authorities.

- b. **Covenants.** The government complied with all of the covenants. There were delays in the submissions of audited financial statements because of inadequate PCU and SPCU staff (financial experts) during early project implementation. The project addressed this by recruiting additional financial consultants through a minor scope change in 2009. This should be avoided in the beginning.
- c. **Additional assistance.** The government may require further technical and financial support from ADB to address the sector's investment and capacity needs in the medium term. ADB should also provide continued support for strengthening local authorities' operational and financial capacity.
- d. **Timing of project performance evaluation report.** A project performance evaluation mission should be fielded in the fourth quarter of 2017 to prepare a performance evaluation report.

## 2. General

65. The project scope has been substantially achieved. The project strengthened urban governance and finance in 108 local authorities; improved basic services and access to urban facilities and infrastructure; developed the capacity of a financial intermediary for the urban sector; and built project management capacity at different government levels. The office buildings constructed under the project enable local authorities to more efficiently provide services. Many local authorities are aware of and have confidence in LLDF as a source of finance for capital expenditures. The government should build on project experience to continue strengthening LLDF through dynamic leadership, and focusing on improving local authority systems, service provision, and capacity.

## CHRONOLOGY OF MAIN EVENTS

Date	Event
<b>2005</b>	
24 March–7 April	ADB fact-finding mission
13–14 October	Loan negotiations
24 November	ADB Board approval of the loan
<b>2006</b>	
19 January	Loan signing
17 April	Project coordination unit established
16–22 May	ADB project inception mission
8 June	First National Steering Committee convened
30 June	Loan effectiveness
10–17 October	ADB project review mission (1)
December	Baseline data received
<b>2007</b>	
16–19 October	ADB project review mission (2)
<b>2008</b>	
1st January	Consultants for Project Coordination Unit and Subproject Coordination Unit began work
12–16 May	Consultation mission (1)
20 June	Draft implementation plan from project performance monitoring system report received
17–18 July	Consultation mission (2)
23 October	Project Appraisal Unit renamed to Project Management Unit
10–11 November	Consultation mission (3)
1–4 December	Consultation mission (4)
<b>2009</b>	
February	Minor change in scope approved
27–30 April	ADB project review mission (3)
20–26 October	ADB project review mission (4)
<b>2010</b>	
February	Targets in the design and monitoring framework revised
29 Nov–1 December	ADB project review mission (5)
<b>2011</b>	
1 January	Local authorities dissolved
March	Local Loans and Development Fund came under Ministry of Finance and Planning
2–10 June	ADB project review mission (6)
15 July	Partial cancellation of \$9 million (SDR5.71 million) equivalent of loan savings approved
<b>2012</b>	
21–24 February	ADB project review mission (7)
30 April	Loan closing date (appraisal)
April	Loan extension to 31 January 2013 approved
8–14 August	ADB project review mission (8)
<b>2013</b>	
30 January	Loan closure
<b>2014</b>	
2–16 July	ADB project completion review mission

ADB = Asian Development Bank, SDR = special drawing right.



## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
<b>Impact</b> Sustainable economic growth and poverty reduction provided through the provision of urban infrastructure services and the promotion of urban management improvement to Sri Lanka's urban local authorities	Basic service levels improved in about 50 local authorities through investment in infrastructure and O&M. <sup>1</sup>	<ul style="list-style-type: none"> <li>• Government economic policy framework</li> <li>• National budget for local authorities</li> <li>• Reports of various aid agencies</li> </ul>	<b>Assumptions</b> <ul style="list-style-type: none"> <li>• Macroeconomic stability</li> </ul> <b>Risks</b> <ul style="list-style-type: none"> <li>• Natural disasters</li> <li>• Civil conflicts</li> <li>• Enabling framework for decentralization not effective</li> <li>• No improvement in fiscal transfer system between provincial councils and local authorities</li> </ul>	Support for improvement of infrastructure was provided for local authorities across nine provinces in the country. Basic services improved in 108 local authorities.
	Provincial councils, local authorities, and community strengthened to take active participation in basic services in about 50 local authorities.			108 local authorities were covered. The executing agency strengthened the implementation capacity of provincial councils and local authorities by establishing PCU at the central level and SPCU in all nine provinces. Consultants supported these at all levels, and provincial officials were involved in implementation during stakeholder consultations, project design, procurement (through technical evaluation and procurement committees), and contract execution. LLDF was strengthened with staff and consultants to assist in appraising project reports, funding basic services, and building loan management capacity.
	Long-term finance on a sustainable basis available to local authorities through LLDF.			LLDF was designated to appraise projects and provide loans. GoSL transferred ADB funds at the rate it had obtained the loan, and LLDF on-lent the funds to local authorities with a grant and loan combination. LLDF provided long-term finance to local authorities.

<sup>1</sup> **Original target (additional):** About \$5 million additional annual investment in infrastructure on an ongoing basis; project pipeline of about 20 new projects annually for LLDF.

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
<b>Outcome</b> Urban management and living conditions improved for local authority population outside Colombo	About 30 participating local authorities' financial viability increased and own-source revenues increased by 40% by end of project (above baseline established at end of year 1).	<ul style="list-style-type: none"> <li>• PPMS</li> <li>• Central Bank annual report and local government budgets</li> <li>• LLDF annual reports</li> <li>• Local authority annual reports</li> </ul>	<b>Assumptions</b> <ul style="list-style-type: none"> <li>• Favorable political and macroeconomic conditions</li> <li>• Government committed to strengthening local government capacity through decentralization</li> </ul> <b>Risks</b> <ul style="list-style-type: none"> <li>• Community participation not accepted</li> <li>• Interference in project operation and revenue enhancement efforts</li> </ul>	30 local authorities achieved the 40% target following the details collected from SPCUs and local authorities.
	FLIP adopted and implemented by at least 30 local authorities.			108 local authorities adopted and implemented FLIPs (target exceeded).
	About 50 local authorities able to borrow from LLDF.			LLDF approved and implemented subprojects in 108 local authorities (target exceeded).
	Operation and appraisal manual developed for and used by LLDF. <sup>2</sup>			Draft operation and appraisal manual prepared by technical assistance consultants and implemented by LLDF.
	About 80 subprojects implemented.			128 subprojects were completed (target exceeded).
	Citizen redress system used in 30 local authorities.			Citizen redress system is used in all 108 project local authorities (target exceeded). System of complaint box was introduced, and a citizen day is observed on a fixed day of every week in 108 local authorities. All 108 local authorities have published the Citizen Charter; 78 local authorities have submitted the Citizen Charters to PCU.
<b>Outputs</b>				
<b>Component A: Urban provincial, municipal, and urban management improvement</b> A.1. Revenue enhancement and	A.1.1. Own-source annual revenue increased by at least 10% in about 30 local authorities.	<ul style="list-style-type: none"> <li>• PPMS</li> <li>• LLDF annual reports</li> <li>• Operations manual</li> </ul>	<b>Risks</b> <ul style="list-style-type: none"> <li>• Delays in the design and implementation of subprojects</li> <li>• Staff not available</li> </ul>	A.1.1. 30 Local authorities achieved the 10% target.
	A.1.2. Stamp duty recovery improved; arrears reduced to less			A.1.2. 32 local authorities improved stamp recovery and

<sup>2</sup> **Original target:** Development and use of operation and appraisal manual, etc. for LLDF.

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
participatory governance	than 50% of annual amount due in about 30 local authorities.	<ul style="list-style-type: none"> <li>• Annual plans</li> <li>• Appraisal reports</li> </ul>	in the local authorities, provincial councils, and LLDF	reduced arrears to less than 50%.
	A.1.3. Annual expenditure on O&M increased by about 5% of the existing levels in about 20 local authorities.	<ul style="list-style-type: none"> <li>• Annual reports and tax collection records of local authority</li> <li>• Random WTP and consumer satisfaction studies</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation delays because of slow progress with start-up activity system, citizens charter</li> </ul>	A.1.3. All 108 local authorities' DPRs have provision of setting aside 1%–5% of the project cost for projects' O&M, depending on the nature of the projects. Local authorities were advised to make the same provision in their annual budgets.
	<p>A.1.4. FLIP action plan and milestones developed in about 20 local authorities.</p> <p>A.1.5. FLIP implemented in about 20 local authorities, leading to development of annual plan for local authorities' operation; annual accounts updated.</p>	<ul style="list-style-type: none"> <li>• Records and minutes of standing and steering committees</li> <li>• Gazette notifications of government</li> <li>• Annual reports of provincial councils and local authorities</li> </ul>		<p>A.1.4. FLIP action plans were prepared for 108 local authorities. These plans included proposals for (i) enhanced revenue, (ii) improved governance, (iii) local authority services, and (iv) staff training and/or capacity building.</p> <p>A.1.5. FLIP was implemented in all 108 local authorities, annual plans were developed, and annual accounts were updated. SLILG assisted weak local authorities in finalizing the annual accounts updated and under Phase 2 of the capacity- building program. NGOs and CBOs were invited to workshops on revision of FLIPs. Complaint redress systems were initiated in 108 local authorities.</p>
A.2. Human resource development	A.2.1. Project development assistance and consultants' roster developed and operational in all provinces.			A.2.1. PCU, SPCU, and DSC consultants assisted in all subprojects; additional consultants assisted during implementation.
	A.2.2. Awareness built among local authority officials and elected representative; 200 local authorities participated in			A.2.2. More than 200 local authorities participated in workshops. Many local authority staff and

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
	workshops.			Provincial Council staff were trained. The elected representatives of about 280 <i>pradeshiya sabhas</i> were trained on local administration.
	A.2.3. 300 staff from provincial councils and local authorities attended workshops.			A.2.3. About 2,000 staff from provincial councils and local authorities attended workshops.
	A.2.4. Various training conducted for about 100 central, provincial, and local technical officials (MLGPC, LLDF, CLGs, and local authorities).			A.2.4. Training programs were conducted under Component C. About 2,500 central, provincial, and local technical officials participated in the training.
A.3. Institutional strengthening of LLDF	A.3.1. Operational manual and lending policy being strictly followed.			A.3.1. Operational manual and lending policy was prepared and followed by LLDF. Manuals were prepared in December 2008.
	A.3.2. Annual budgets and plans prepared after market and fund assessment.			A.3.2. Annual budgets and plans were prepared after market and fund assessment. Budgets and plans were prepared in December 2008.
	A.3.3. Technical staff in LLDF available to meet long-term objectives.			A.3.3. LLDF was supported by a senior manager, finance, senior operations manager, compliance officer, and duty manager. LLDF was assisted by two engineers and two financial consultants.
	A.3.4. Annual funding of basic infrastructure projects raised to \$5 million as a revolving facility.			A.3.4. Based on LLDF records, funding of basic infrastructure in LLDF increased to about \$5 million as a revolving facility (for LGIIP, about \$4.4 million achieved as of 30 June 2014; other sources include two other ADB projects and other loan sources).

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
	A.3.5. Default percentage levels reduced by 50% of existing levels.			A.3.5. Default reduced to 18.6% as of 30 June 2014, from 39.8% in December 2012.
	A.3.6. All technical staff attend about at least two training programs.			A.3.6. Training programs on loan management and banking activities were conducted. About 200 technical staff participated.
	A.3.7. About 80 local authorities are LLDF clients.			A.3.7. 259 local authorities are LLDF clients, of which 108 are from the project (target exceeded).
<b>Component B: Basic local government infrastructure and services delivery<sup>3</sup></b> Component B.1. Improved water supply provision	B.1.1. Revised (Feb 2010) – community water supply provided to 6,125 households by end of the project. <sup>4</sup>	<ul style="list-style-type: none"> <li>Local authority annual reports (quantity and quality of supply)</li> <li>PPMS</li> <li>Random sample surveys</li> <li>District statistics</li> <li>Reports of other externally funded and international NGO-implemented projects</li> <li>Random consumer satisfaction studies</li> </ul>	<b>Assumptions</b> <ul style="list-style-type: none"> <li>Increased community participation in selection, design, and implementation of subprojects</li> <li>Community willingness to pay for improved services</li> <li>Participating local authorities able to increase their revenue base</li> <li>MLGPC proactively prepares and implements the institutional recommendations emerging from the project for level and administrative improvements</li> </ul>	B.1.1. 5,142 household connections were achieved.
	B.1.2. Revised (Feb 2010) – water supply volume increased and quality improved to target population, reaching minimum national standard in about nine local authorities.			B.1.2. Water supply projects reaching minimum standards were implemented in seven local authorities.
	B.1.3. Revised (Feb 2010) – duration of water supply increased to about 24 hours per day in four local authorities. <sup>5</sup>			B.1.3. Projects were designed and implemented to supply water about 24 hours per day in four local authorities.

<sup>3</sup> **Original target-(Performance Indicator):** Conditions for Commencement of Component B: LLDF has approved the following and the ADB review is satisfactory: LLDF vision statement and business plan; operational manual, including safeguard procedures; codes of conduct and governance; model loan agreement, model provincial council guarantee, model performance agreement; preparation of financial projections (including key assumptions) for 10 year period commencing 2005; LLDF appraisal unit established with required staff.

<sup>4</sup> **Original target:** Community water supply to over 60,000 households by end of the Project.

<sup>5</sup> **Original target:** Increase in duration of water supply to about 24 hours per day in 15 local authorities.

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
B.2. Improved sewerage provision	B.2.1. Revised (Feb 2010) – access to sewerage and sanitation facilities provided to nearly 1,400 additional households by end of project. <sup>6</sup>		<ul style="list-style-type: none"> <li>• Interference in procurement process</li> <li>• Availability of contractors</li> </ul>	B.2.1. Access to sanitation was provided to 1,461 households under two schemes (Hingarankoda and Welimada).
	B.2.2. Revised (Feb 2010) – two participating local authorities report improvement in public health reduction in vector-borne diseases. <sup>7</sup>			B.2.2. Hingarankoda and Welimada (two local authorities) have taken up sewerage schemes, and reports indicated improved public health reduction in vector-borne diseases.
B.3. Improved drainage	B.3.1. About 13.5 km of drainage systems improved and/or built. <sup>8</sup>			B.3.1. 13.58 km of drains were improved under six subprojects.
	B.3.2. Waterlogging reduced in five local authorities. <sup>9</sup>			B.3.2. Construction of drainage in five local authorities has reduced waterlogging.
	B.3.3. Roadside drainage available, especially on major roads, in 20 local authorities.			B.3.3. Roadside drainage was built in eight local authorities.
B.4. Improved SWM systems	<p>B.4.1. About 275 tons of solid waste safely collected and disposed of.</p> <p>B.4.2. Frequency of collection in neighborhoods increased to at least once a day in 15 local authorities.</p> <p>B.4.3. Waste source segregation increased by about 65% in 15 local authorities.</p>			This output was dropped in February 2010 in a minor scope change, because of an ongoing grant from the government to local authorities for the SWM subsector.
B.5. Improved local authority roads	B.5.1. About 290 km of local authority roads improved. <sup>10</sup>			B.5.1. About 230 km of roads were improved.

<sup>6</sup> **Original target:** Access to sewerage and sanitation facilities to nearly 18,000 additional households by end of the Project.

<sup>7</sup> **Original target:** 20 participating local authority report improvement in public health— reduction in vector-borne disease.

<sup>8</sup> **Original target:** About 85 km of improved and new drainage systems.

<sup>9</sup> **Original target:** Reduction in water logging in 20 local authorities.

<sup>10</sup> **Original target:** Improvements to about 350 km of local authority roads.

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
B.6. Improved community health facilities/other local authority facilities	B.6.1. About 35 improved local authority facilities (health and institutional) through subprojects operational. <sup>11</sup>			B.6.1. 66 facilities—20 health centers, 23 administrative buildings, 4 crematoriums, and 19 community halls—were constructed.
	B.6.2. Use of community health centers (for facilities, immunizations) increased in 10 local authorities. <sup>12</sup>			B.6.2. Access to facilities was increased in 66 beneficiary local authorities.
	B.6.3. Public libraries improved in 25 local authorities.			B.6.3. 32 libraries were built in 32 local authorities.
<b>Component C: Project coordination and administration support</b> C.1. Institutional strengthening of LLDF	C.1.1. Technical staff—at least two in LLDF—available.		<b>Assumptions</b> <ul style="list-style-type: none"> <li>Local authority willing to implement recommendations emerging from the project</li> </ul> <b>Risks</b> <ul style="list-style-type: none"> <li>Low absorption capacity to sustainable projects because of low cost recovery of services</li> <li>Stakeholders interested only in the infrastructure projects and not the management improvement of the local authorities</li> </ul>	C.1.1. LLDF was staffed with five technical staff (two in LLDF): senior manager, accounts manager, compliance officer, deputy manager for environment, and deputy manager for social. LLDF was also supported by two engineers (consultants) and two financial experts (consultants). The chief executive officer position was not full-time for a prolonged period.
C.2. Project management	C.2.1. Regular training conducted for counterpart staff.	<ul style="list-style-type: none"> <li>LLDF annual reports</li> </ul>		C.2.1. Regular training was conducted.
	C.2.2. About 50% of technical staff mainstreamed as provincial council workforce.	<ul style="list-style-type: none"> <li>PPMS</li> <li>List of projects developed</li> <li>List of workshop attendees</li> </ul>		C.2.2. The majority of provincial councils had mainstreamed more than 50% of technical staff from the project. Also, some SPCU technical staff were absorbed under LGESP SPCUs and, hence, remain at provincial levels.

<sup>11</sup> **Original target:** About 10 improved local authority facilities (health, institutional) through subprojects operational.

<sup>12</sup> **Original target:** Increased use of community health centers facilities, immunization, etc., in 15 local authorities.

Design Summary	Performance Indicators/ Targets	Monitoring Mechanisms	Assumptions and Risks	Actual Achievement (as of 30 January 2013)
	C.2.3. Project management arrangements at the provinces institutionalized.			C.2.3. LGIIP SPCUs are being used in the subsequent ADB project; hence, project management systems continue at the provincial level. The SPCU staff regularly provide on-the-job training to local authority and provincial staff.

ADB = Asian Development Bank, CBO = community-based organization, CLG = Commissioner of Local Government, DPR = detailed project report, DSC = design and supervision consultant, FLIP = financial and local improvement plan, GoSL= Government of Sri Lanka, km = kilometer, LGESP = Local Government Enhancement Sector Project, LGIIP = Local Government Infrastructure Improvement Project, LLDF = Local Loans Development Fund, MLGPC = Ministry of Local Government and Provincial Councils, NGO = nongovernment organization, O&M = operation and maintenance, PCU = Project Coordination Unit, PPMS = project performance management system, SLILG = Sri Lanka Institute of Local Governance, SPCU = Subproject Coordination Unit, SWM = solid waste management, WTP = willingness to pay.



**COMPARISON OF ESTIMATED AND ACTUAL PROJECT COSTS**  
(\$'000)

Item	Appraisal Estimate			Total Cost	Actual			Total Cost
	ADB	Government MPCLG	Local Authorities		ADB	Government MPCLG	Local Authorities	
<b>A. Investment Cost</b>								
1. Civil Works	16,781	4,699	1,779	23,259	27,298	10,240	3,076	40,614
2. Equipment	18,974	256	70	19,300	3,368	570	307	4,245
3. Furniture and Vehicles	143	-	-	143	385	302	-	687
4. Studies and Workshops	4,632	-	-	4,632	131	-	-	131
5. Staff Development	1,844	-	-	1,844	373	-	-	373
6. Consulting Services	602	-	-	602	4,689	475	-	5,164
7. Project Management	2,173	710	246	3,129	2,534	2,137	-	4,671
<i>Base Cost</i>	<i>45,149</i>	<i>5,665</i>	<i>2,095</i>	<i>52,909</i>	<i>38,778</i>	<i>13,724</i>	<i>3,383</i>	<i>55,855</i>
<b>B. Contingencies</b>	3,557	806	423	4,786	-	-	-	-
<b>C. Taxes and Duties</b>	-	5,531	2,150	7,681	-	-	-	-
<b>D. Interest Charges</b>	1,294	-	-	1,294	919	-	-	919
<b>Total</b>	<b>50,000</b>	<b>12,002</b>	<b>4,668</b>	<b>66,670</b>	<b>39,698</b>	<b>13,724</b>	<b>3,383</b>	<b>56,805</b>

- = data not available, ADB = Asian Development Bank, MPCLG = Ministry of Provincial Councils and Local Government.

Note: Numbers may not sum precisely because of rounding.

**ANNUAL AVERAGE EXCHANGE RATES**

<b>Fiscal Year</b>	<b>Sri Lanka Rupees (SLRs) per \$</b>
2006	107.45
2007	107.45
2008	113.40
2009	114.35
2010	110.95
2011	115.40
2012	127.00
2013	130.83
2014	135.00
2015	138.00

**SUMMARY OF CONTRACTS**

<b>Category No.</b>	<b>Description</b>	<b>Allocation Amount (\$)</b>	<b>Contracts Amount (\$)</b>	<b>Disbursed Amount (\$)</b>
01	Civil Works	30,277,012	29,376,025	27,298,401
02	Equipment	3,068,025	3,454,985	3,368,382
03	Furniture and Vehicles (net of tax)	402,748	390,521	384,913
04	Studies and Workshops (net of tax)	514,708	130,565	130,565
05	Staff Development (net of tax)	920,491	540,859	372,618
06	Consulting Services	5,107,059	4,996,229	4,689,482
07	Project Management	2,672,318	2,529,426	2,534,131
<b>Total</b>		<b>42,962,361</b>	<b>41,418,610</b>	<b>38,778,492</b>

**PROJECT FINANCING PLAN**  
(\$ million)

Source	Appraisal Estimate			Actual		
	Foreign	Local	Total	Foreign	Local	Total
ADB	21.10	28.90	50.00	17.86	21.83	39.70
GoSL	0.00	12.00	12.00	0.00	13.72	13.72
Local Authorities	0.00	4.67	4.67	0.00	3.38	3.38
<b>Total</b>	<b>21.10</b>	<b>45.57</b>	<b>66.67</b>	<b>17.86</b>	<b>38.94</b>	<b>56.80</b>

ADB = Asian Development Bank, GoSL = Government of Sri Lanka.

Note: Numbers may not sum precisely because of rounding.

Source: Project Completion Report Mission estimates.

## BREAKDOWN OF ACTUAL DISBURSEMENTS OF LOAN PROCEEDS

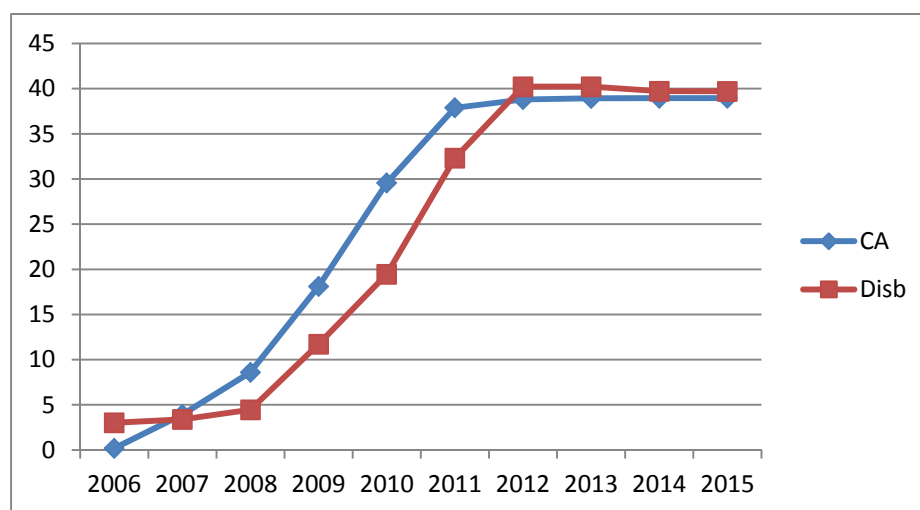
**Table A7: Breakdown of Actual Disbursements of Loan Proceeds**  
(\$ million)

Year	Quarter	Quarterly Disbursements	Cumulative Disbursements	Percentage Disbursed <sup>a</sup> (%)
2006	III	3.000	3.000	15.7
2009	IV	2.289	5.289	27.6
2011	II	2.095	7.384	38.6
	III	3.862	11.246	58.7
2012	I	0	11.246	58.7
	II	4.221	15.467	80.8
	III	3.495	18.962	99.0
	IV	0.192	19.154	100.0
2014	I	0	19.154	100.0

<sup>a</sup> Based on net loan amount.

Source: Asian Development Bank.

**Figure A7: Project's Contract Awards and Disbursement S-Curve**  
(\$ million)



CA = contract awards, Disb = disbursement.

## IMPLEMENTATION SCHEDULE

No.	Project Components	2006				2007				2008				2009				2010				2011				2012				2013				2014			
		1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
	<b>A. Component A. Provincial/Municipal/Urban Management Improvement</b>																																				
	<b>1. Local Authority Capacity Building (FLIP)</b>																																				
	<b>2. PC Capacity Building</b>																																				
	a. LA Project Implementation Performance																																				
	b. Development of Citizen's Charter/Grievance																																				
	c. Project Development Assistance																																				
	<b>3. LLDF Enhancement</b>																																				
	a. Vision and Code of Conduct																																				
	b. Business Plan and Operational Manual																																				
	c. Other FI Financial Due Diligence Review																																				
	d. Appraising Proposals																																				
	e. Monitoring repayment																																				
	f. Study into diversion of LLDF Operation																																				
	<b>B. Component B. Basic Local Infrastructure and Service Delivery</b>																																				
	1. Commencement Assessment																																				
	2. Demand-Driven Basic Social Infrastructure																																				
	<b>C. Component C: Project Coordination and Administration Support</b>																																				
	1. Project Performance Management System																																				
	a. Promoting Dialogue Between PCs and LAs																																				
	b. Promoting Civic Participation in Infrastructure Delivery																																				
	2. Project Reporting																																				
	3. Project Review Missions																																				
	4. Project Completion																																				

Legend:

Projected:

Actual:

FLIP = financial and local improvement plan, LA = local authority; LLDF = Local Loans and Development Fund, PC = provincial council.

### STATUS OF COMPLIANCE WITH MAJOR LOAN COVENANTS

Covenant	Reference in Loan Agreement	Status of Compliance
MPCLG shall establish a PCU to be headed by a full-time Project Director experienced in handling externally funded projects and local government issues. The Project Director will be exclusively charged with the execution of the project. The Project Director will be directly responsible for coordination of the activities under the project, overall project quality, monitoring, supervision, and reporting. The Project Director shall report to the Secretary of MPCLG for routine matters of operation, management, and administration of the project. The Project Director will be supported by full-time compliance officers responsible for legal, procurement, documentation, environment, and social compliance; a senior accountant; administrative staff and supplemented by consultants, as required.	Schedule 6 Para. 3	Complied. PCU was established in April 2006, headed by full-time director and supported by full-time staff.
The PCU shall (i) consolidate the overall project implementation plan and annual work plan, (ii) assist the PCs and the local authorities in implementing the capacity-building program, (iii) monitor and supervise the project administration and coordination activities, (iv) lead monitoring and evaluation exercises, and (v) prepare quarterly project reports and the project completion report.	Schedule 6, Para. 4	Complied.
In each of the PCs, at the office of the CLG, a SPCU shall be established. The SPCU will be headed by the CLG. A full-time accountant, a full-time civil engineer, an assistant engineer, and support staff will support the CLG. A part-time financial management specialist, compliance officer, and consultants with expertise in social development and environment would be made available, as required.	Schedule 6, Para. 5	Complied. SPCUs were established in all nine provinces.
The NSC shall hold its first meeting within 3 months of the Effective Date and shall meet at least once every 6 months thereafter.	Schedule 6, Para. 6	Complied. NSC was established. The first meeting was held on 8 June 2008, and regular meetings were held thereafter.
A PSC shall be established at each of the nine PCs to provide overall strategic guidance and coordination support.	Schedule 6, Para. 7	Complied. The PSC was established in all provinces.
A Project Appraisal Unit within the LLDF shall be established for the implementation of Component B of the project. The Project Appraisal Unit shall comprise a fund manager with economic or financial background, a civil engineer, an environment or special development specialist, and accountants.	Schedule 6, Para. 8	Complied. PCU was established in June 2007. PCU was renamed Project Management Unit, and was fully staffed with finance manager, civil engineers (two consultants), environment engineer, and accountants (two financial consultants).
The existing Board of Commissioners of the LLDF shall include one member representing the civil society.	Schedule 6, Para. 9	Complied. Three representatives from civil society became members of the Board of Commissioners.
All the Subprojects shall be selected by LLDF on the basis of selection criteria agreed with ADB and as set forth in Appendix 4 to the RRP as agreed with the Borrower.	Schedule 6, Para. 10	Complied.
LLDF shall ensure that the local authorities prepare the Subproject proposals in format agreed between the Borrower and ADB. The Subproject proposals shall be prepared by the local authorities and	Schedule 6, Para. 11	Complied.

Covenant	Reference in Loan Agreement	Status of Compliance
submitted to the SPCU, under CLG, which will assess the Subproject proposals based on the selection criteria as described in Appendix 4 to the RRP as agreed with the Borrower. Each CLG will present the Subproject proposals to LLDF for approval. ADB will assess the first two Subprojects from each of the five Subsectors. Subsequently, ADB will review all Subprojects over \$500,000.		
LLDF shall ensure that the funding of each Subproject shall be disbursed to the local authorities partly as grants and partly as loan on the following basis: MC: 40% grant and 60% loan; UC: 50% grant and 50% loan; and PS: 60% grant and 40% loan.	Schedule 6, Para. 12	Complied.
Interest rate for the Subloans shall be at least equivalent to SLIBOR (12 month) per annum. The Borrower and LLDF shall revise the interest rate every 6 months.	Schedule 6, Para. 13	Complied. At the start of implementation, the SLIBOR (12 month) rate was 21.0%. The current rate (SLIBOR – 12 months) is 14.5%. But this was discussed with ADB and the MoFP, and the rate of interest was revised to 9%. All loans are being funded at this rate of interest.
For each Subproject from LLDF to a local authority, LLDF shall enter into (a) a Subloan Agreement for the loan component in form and substance acceptable to ADB, setting out the terms and conditions for onlending by LLDF to each participating local authority, including detailed operating instructions; (b) a Performance Agreement with each local authority for the grant component in form and substance acceptable to ADB; and (c) a Guarantee Agreement with the respective PC in form and substance acceptable to ADB.	Schedule 6, Para. 14	Complied.
LLDF shall channel part of the proceeds of the Loan to the local authorities for carrying out Component B of this project. In providing the funds to the local authorities, LLDF shall observe the following operational principles, unless modified by agreement with the Borrower and ADB.	Schedule 6, Para. 15	Complied.
SPCU shall assist the local authority in identifying a technical expert from the roster of consultants located at the PC level. Following the improvement of the Subproject proposal, SPCU shall submit the completed application for Subproject to LLDF. ADB final approval is required.	Section 4.02 (b) and PA Section 2.09 (b)	Complied. SPCUs assisted in preparation of feasibility reports.
MPCLG, LLDF, and each of the PCs and SPCUs shall maintain separate records and accounts for the project.	Section 4.02 (a) and PA Section 2.09 (a)	Complied. There were initial delays in the submission of audited financial accounts due to inadequate PCU, SPCU, and Project Management Unit staff (financial experts) during early project implementation. This was addressed through the recruitment of additional financial management and monitoring and evaluation consultants.
Submission of audited accounts and financial statements and the report of the auditors relating thereto all in the English language.	Section 4.02 (a) and PA Section 2.09 (a)	Complied.
The Borrower shall enable ADB, upon ADB's request, to discuss each of MPCLG, LLDF, the PC's, and SPCU's financial statements for the project and its financial affairs related to the project	Section 4.02 (b) and PA Section 2.09 (a)	Complied.



Covenant	Reference in Loan Agreement	Status of Compliance
from time to time with the Borrower's auditors, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower shall otherwise agree.		
Without limiting the generality of Section 6.05 (a) of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the project.	Section 4.03 (b) and PA Section 2.08 (b)	Complied.
The Borrower shall enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.	Section 4.04	Complied.
The Borrower shall take all action which shall be necessary on its part to enable MPCLG and LLDF to perform its obligations under the Project Agreement, and shall not take or permit any action which would interfere with the performance of such obligations.	Section 4.05	Complied
The Borrower shall exercise its rights under the Subsidiary Loan Agreement in such a manner as to protect the interests of the Borrower and ADB and to accomplish the purposes of the Loan.	Section 4.06 (a)	Complied.
No rights or obligations under the Subsidiary Loan Agreement shall be assigned, amended, or waived without the prior concurrence of ADB.	Section 4.06 (b)	Complied.
Submission of project completion report by LLDF	PA, Section 2.08 (c)	Complied.
<u>Sustainability</u> The Borrower shall ensure that by the end of the project, local authorities, with the assistance of consulting services, shall have come up with long-term operation and maintenance procedures and sustainable funds which represent at least 5% of the Subproject costs to operate and maintain the assets upgraded or constructed under the project.	Schedule 6, Para. 17	Complied.
<u>Resettlement</u> All lands and rights-of-way required for the project are made available in a timely manner, adequate compensations are provided prior to the commencement of civil works, and any resettlement activity is carried out in accordance with the resettlement framework agreed upon between the Borrower and ADB, the Borrower's National Involuntary Resettlement Policy and ADB's Policy on Involuntary Resettlement (1995). The Borrower shall ensure that a Resettlement Plan in accordance with the Borrower's National Involuntary Resettlement Policy and ADB's Policy on Involuntary Resettlement is prepared and submitted to ADB for approval for the first Subproject involving land acquisition or resettlement activities. This will serve as a model for preparing Resettlement Plan for any subsequent Subproject involving land acquisition or resettlement activities. All Subprojects involving a Resettlement Plans will be submitted to ADB for review and approval of such Plan.	Schedule 6, Para. 18	Complied.
<u>Environment</u>	Schedule 6,	Complied.

Covenant	Reference in Loan Agreement	Status of Compliance
Design, construction, operation, and implementation of all Subproject facilities is carried out in accordance with the environmental assessment framework agreed upon between the Borrower and ADB, and complies with the Borrower's environmental laws and regulations and ADB's Environmental Policy. Any adverse environmental impacts arising from the construction, operation and implementation of the Subproject facilities will be minimized by implementing the environmental mitigation and management measures, and other recommendations specified in environmental assessment reports (e.g., IEEs).	Para. 19	
<u>Indigenous Peoples</u> The Borrower shall ensure that Subprojects will not affect vulnerable population groups, such as indigenous peoples. In the event of their involvement in any of the Subprojects, the Borrower shall ensure that the Subprojects are carried out in accordance with the indigenous people development framework agreed upon between the Borrower and ADB and comply with ADB's Policy on Indigenous Peoples (1998).	Schedule 6, Para. 20	Complied.
<u>Block grants from the Borrower</u> The Borrower shall ensure that the annual block grant allocation currently provided by the Borrower to local authorities continues to be provided and does not decrease, irrespective of this project and whether the total revenue level of each local authority increases. The Borrower shall ensure to disburse the funds to the local authorities on a timely manner.	Schedule 6, Para. 22	Being complied with.
<u>Good governance and transparency</u> Consistent with ADB's and with the Borrower's commitment to good governance, accountability and transparency, the Borrower shall ensure that the project funds are utilized effectively and efficiently to implement the project and to achieve the project objectives. ADB shall have the right to conduct spot audits at any time during the project implementation to determine the degree to which project funds have been effectively and efficiently utilized to implement the project and achieve its objectives, outputs, and performance indicators. ADB shall also have the right to investigate any possible financial or management impropriety in conducting the project. The Borrower shall cooperate with any such audit and investigation and extend necessary assistance, including access to all relevant books and records, as well as engagement of independent auditors and experts that may be needed for satisfactory completion of such audits and investigations. All external costs related to the audits and investigations shall be funded from the Loan.	Schedule 6, Para. 23	Being complied with.
<u>SPCU Staff</u> Before the completion of the project, the Borrower shall ensure that at least 50% of the technical staff of the SPCU engaged during this project is retained and mainstreamed by the PCs.	Schedule 6, Para. 24	Complied. Another project (LGESP) maintained the main technical staff for MPCLG at the provincial level.

Covenant	Reference in Loan Agreement	Status of Compliance
<p><u>General and Counterpart Funds</u></p> <p>The Borrower and ADB agree that the project implementation arrangements reflect the present administrative structure of the Borrower in the project Area and that this may be changed during the implementation of the project. If the Borrower proposes to change the administrative structure in the project area, the Borrower shall immediately notify ADB of such change and shall take all steps necessary to ensure that the project arrangements are revised in consultation with ADB to reflect the new administrative structure and the viability of the project.</p> <p>Para. 26. The Borrower shall ensure that throughout the implementation of the project, adequate allocations of the required counterpart funds are made, approved, and released in a timely manner in order to ensure proper implementation of the project. The Borrower shall also allocate sufficient counterpart funds for MPCLG to cover the incremental recurrent costs of staff of SPCU for at least 10 years following the Closing Date.</p>	Schedule 6, Paras. 25 and 26	<p>Complied.</p> <p>Being complied with.</p> <p>SPCUs are continued for the next project and are funded by the LGESP.</p>
<p><u>Peace building and community reconciliation</u></p> <p>The Borrower, MPCLG and LLDF shall ensure that all project interventions contribute to, or do not detract from ongoing peace building and community reconciliation. In the event that during project implementation any intervention has or is thought to have negative impact on such peace building or community reconciliation efforts, the Borrower and ADB will mutually determine whether the intervention should be continued, redesigned, suspended, or cancelled.</p>	Schedule 6, Para. 28	Complied.
<p><u>Project Performance Management System</u></p> <p>29. Within one year of the Effective Date, the Borrower shall cause PCU to develop a Project Performance Monitoring System including (i) baseline data and output target set up during the FLIP and Subproject implementation manual preparation within Component A; (ii) comprehensive implementation-related performance duly collected and recorded by LLDF and SPCUs, periodically audited by PCU; and (iii) post-completion performance and impact data collected by PCU. Data to be compiled and analyzed for the purpose of performance monitoring and evaluation shall be in a format acceptable to ADB.</p>	Schedule 6, Para. 29	Complied.
<p><u>Semiannual Project Reviews</u></p> <p>The semiannual reviews carried out by the Borrower and ADB shall include an examination of budgetary allocations for the project, operation and maintenance costs, staffing and other incremental recurrent costs, implementation arrangements and achievements under the project. The review shall include assessing progress for each project component, identifying difficulties and constraints, and determining ways to overcome them. Before disbursement under Component B of the project, ADB shall carry out a review of the readiness of the</p>	Schedule 6, Para. 30	Complied. ADB missions held regularly.

Covenant	Reference in Loan Agreement	Status of Compliance
LLDF to carry out the project in accordance with ADB's requirements in Operations Manual D6/OP of 15 December 2003, as amended from time to time.		
<u>Midterm Review</u> MPCLG, PCU, SPCU, and ADB shall jointly carry out a midterm review of the project during the third year of project implementation or at any other time as may be agreed upon by the Borrower and ADB. The midterm review will (i) review the scope, design, and implementation arrangements of the project; (ii) identify changes needed since the time of project appraisal; (iii) assess implementation performance against project indicators; (iv) review and establish compliance with loan covenants; and (v) identify problems and constraints. The Borrower and ADB shall discuss the results of the midterm review and if required, appropriate corrective measures shall be formulated to ensure successful project implementation and achievement of project objectives.	Schedule 6, Para. 30	Complied. Midterm review completed (7–11 June 2010).

ADB = Asian Development Bank, CLG = Commissioner for Local Government, FLIP = financial and local improvement plan, GoSL = Government of Sri Lanka, IEE = initial environmental examination, LGESP = Local Government Enhancement Sector Project, LLDF = Local Loans and Development Fund, MoFP = Ministry of Finance and Planning, MPCLG = Ministry of Provincial Councils and Local Government, NSC = National Steering Committee, PCU = Project Coordination Unit, PSC = project steering committee, RRP = report and recommendation of the President, SLIBOR = Sri Lanka Inter Bank Offered Rate, SPCU = Subproject Coordination Unit.

## FINANCIAL AND ECONOMIC REEVALUATION

### A. Economic Reevaluation

#### 1. Introduction

1. The economic reevaluation was done in real terms using constant 2014 prices. The economic projections, economic internal rates of return (EIRRs), and sensitivity analysis are based on updated information on selected subprojects' basic urban services (e.g., water supply, sanitation drainage, and roads) and actual benefits and operating costs based on data from the local authorities. Other subproject types, such as buildings with less direct development impact, were likewise included in the economic analysis. The analysis at appraisal considered the project as an integral part of ongoing urban development sector programs. Since the project was an investment plan for as yet unspecified subprojects, the Asian Development Bank (ADB) guidelines for cost–benefit analysis (1997) were not directly relevant and were not undertaken at appraisal. During appraisal, ADB's Economics and Research Department suggested 10 areas of analysis as the basis for the project's economic evaluation.<sup>1</sup>

#### 2. Cost–Benefit Analysis

2. The economic analyses of the project were conducted following ADB's Guidelines for the Economic Analysis of Projects and the Framework for the Economic and Financial Appraisal of Urban Development Sector Projects.<sup>2</sup> Benefits and costs were determined through comparison of with- and without-project conditions.

3. At completion, the EIRRs for select subprojects with quantifiable benefits were calculated. The EIRRs of the project and individual sub-outputs were evaluated on a with- and without-project basis, apportioned based on incremental and non-incremental project effects. The project directly benefited 108 local authorities in nine provinces. The cost–benefit analysis confirms the government's achievement in incrementally improving local authority services through the project.

4. The main assumptions used in the economic re-evaluation are as follows:

- (i) An exchange rate of SLRs130.83 is applied throughout.<sup>3</sup>
- (ii) Economic analysis excludes price contingencies, as well as taxes and duties.
- (iii) Economic costs are converted from the financial costs based on (a) a shadow exchange rate factor of 1.04 applied to tradable inputs<sup>4</sup> and (b) a shadow wage rate conversion factor of 0.8 for local, unskilled labor.
- (iv) The economic life of the project is taken as 25 years, including the 6.75-year project implementation period.

5. The cost–benefit analysis indicates EIRRs ranging from 13.9% to 26.7%, which exceeds the economic cost of capital of 12.0%. The project benefits were quantified for (i) expanded and improved water supply services in seven local authorities, (ii) provided sanitation services in

<sup>1</sup> The 10 areas include: economic rationale, goals of the plan, plan to reach the goals, associated economic policies, economic risks, government capacity to implement the plan, government commitment to the plan, coordination of foreign aid, fungibility of government funds, and conditions attached to the loan.

<sup>2</sup> ADB. 2007. *Guidelines for the Economic Analysis of Projects*. Manila; ADB. 1994. *Framework for the Economic and Financial Appraisal of Urban Development Sector Projects*. Manila.

<sup>3</sup> Asian Development Bank. 2014.

<sup>4</sup> Report and Recommendation of the President, Local Government Enhancement Sector Project. September 2011.

three local authorities, (iii) improved roads and drainage systems in 70 local authorities, and (iv) constructed buildings in the participating local authorities. The economic benefits that have been quantified include (i) productivity gains because of lower incidence of sickness and waterborne diseases from improved water supply and sanitation; (ii) savings on health-related expenditures due to improved water supply and sanitation; (iii) resource cost savings because of improved water supply, sanitation, and roads; (iv) time savings from water collection; (v) time savings from travel due to improved roads; (vi) savings on administrative and other costs<sup>5</sup>. A sensitivity analysis was conducted by decreasing benefits (by 10%) and increasing operating costs (by 20%). The analysis confirmed the project's viability, with EIRRs ranging from 13.2% to 25.9%, higher than the required 12.0%, which indicates the project is robust under adverse conditions. Table A10.1 contains the EIRR and sensitivity analysis results.

**Table A10.1: Summary Economic Internal Rate of Return and Sensitivity Analysis (%)**

Subproject	Base Case		Sensitivity	
	EIRR at Appraisal	EIRR at Completion	10% Decrease in Benefits	20% Increase in O&M Costs
Water Supply	0	26.68	24.28	25.89
Roads and Road Equipment	0	14.53	13.25	14.31
Drainage and Sanitation	0	25.02	22.51	23.59
Buildings	0	13.94	13.17	13.92

EIRR = economic internal rate of return, O&M = operation and maintenance.

Source: Project Completion Report mission estimates.

6. Additional indirect social benefits that were not quantified include (i) improved city management, (ii) institutional and organizational benefits from improved local authority governance, and (iii) employment and benefits to women and marginalized groups.

7. Social infrastructure such as water supply, sanitation, drainage and flood control, roads, and community services have public goods characteristics and hence are typically the responsibility of governments. The provision of such infrastructure, coupled with support for financial reforms, has strengthened local authorities' operations. The following project benefits were thus achieved at completion: (i) improved and reliable water services in the participating local authorities; (ii) improved public health as a result of a cleaner environment; (iii) improved living environment through better urban services (e.g., drainage, roads, and sanitation); (iv) enhanced management and environmental capacity of the local authorities; and (v) increased governance at the provincial, municipal, and local levels. The project helped improve the investment environment for urban infrastructure and facilitated further expansion of the Local Loans and Development Fund (LLDF) as a financial intermediary for local authorities' development needs.

## **B. Financial Analysis**

8. Most subprojects under the project are nonrevenue generating in nature and will need to be considered against the respective local authority's financial capacity. An assessment was carried out to ascertain the project local authorities' financial capacity to sustain investments based on a medium-term (5 years) forecast. The proposed loan's sustainability was assessed based on local authorities' ability to support the operation and maintenance (O&M) of assets created under the project. The forecast is based on sustaining the improvements in own-source

<sup>5</sup> Detailed assumptions include (i) time savings per day: 22.4 minutes, and value of time: SLRs15,000 per month (6 months because of seasonal income of agricultural households); and (ii) annual health-care savings: 25% of annual household income.

revenue collection, such as through levies, taxes, fees, and user contributions. A sustainability assessment of the 108 local authorities indicates that local authorities can cover the O&M costs for the implemented subprojects. Some local authorities have increased their water tariffs and, with LLDF assistance, pioneered obtaining advance deposits from users to defray part of the capital costs of water supply network expansion. Local authorities' financial capacity has been strengthened as envisaged at appraisal, particularly because of the implementation of area-based property taxation schemes and service charges. Table A10.2 contains the summary FIRR of the water supply subprojects.

**Table A10.2: Summary Financial Internal Rate of Return of Water Supply Subproject and Sensitivity Analysis**

Scenario	Base Case	
	FIRR at Appraisal	FIRR at Completion (%)
Base Case	0	8.7
Benefit -10%	0	7.6
Cost +10%	0	7.7
Combined	0	6.6
<b>Weighted Average of Cost Capital</b>		<b>3.0</b>

FIRR = financial internal rate of return.

### C. Sustainability Analysis

9. Though full cost recovery is not realistic, it is intended that O&M costs will be recovered through user charges or cross-subsidized through other sources of own-source revenue, such as property tax. The governance reforms and strategies for improving revenue generation and cost recovery introduced through the project are expected to ensure subprojects are financially sustainable. The introduction of financial and local improvement plans (FLIPs) during the project has helped improve governance at the local level, particularly in revenue enhancement. The financial sustainability of subprojects has been secured mainly through the FLIP's project revenue enhancement targets, which help ensure cost recovery for O&M. The fiscal impact of subprojects' O&M is projected at about 2% of net income (see Table A10.3).

**Table A10.3: Fiscal Impact Analysis, 2013–2017**  
(in SLRs million)

	2013	2014	2015	2016	2017
<b>Local Authority (net income)</b>	2,119	2,225	2,336	2,453	2,576
<b>Total Project Cost</b>					
- ADB	5,795	-	-	-	-
- Government	1,796	-	-	-	-
- Local Authority	443	-	-	-	-
<b>Recurrent Cost</b>	44	46	47	48	50
<b>Fiscal Impact (%)</b>	<b>2.09</b>	<b>2.05</b>	<b>2.01</b>	<b>1.97</b>	<b>1.93</b>

- = data not available, ADB = Asian Development Bank.

10. **Financial intermediary – Local Loans and Development Fund.** Under the project, local authority capacity for own-source revenue collection was enhanced. This enabled local authorities to repay their loan to LLDF and strengthened their financial discipline. Under the FLIPs, local authorities had on average a 10% annual target for increasing own-source revenue. At completion, the participating local authorities were able to repay the loan, with little risk of defaulting, although there had been some late payments to LLDF. The assessment of the LLDF's financial viability has shown its portfolio to be robust.