



Report and Recommendation of the President to the Board of Directors

Project Number: 42184-027
Loan Number: 3388-MON
September 2018

Proposed Loan for Additional Financing Mongolia: Southeast Gobi Urban and Border Town Development Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 23 August 2018)

Currency unit	–	togrog (MNT)
MNT1.00	=	\$0.000405
\$1.00	=	MNT2,467.00

ABBREVIATIONS

ADB	–	Asian Development Bank
IFAS	–	integrated fixed-film activated sludge
m ³	–	cubic meter
MCUD	–	Ministry of Construction and Urban Development
PAM	–	project administration manual
PMU	–	project management unit
PUSO	–	public utility service organization
SGAP	–	social and gender action plan
TA	–	technical assistance
WWTP	–	wastewater treatment plant

GLOSSARY

<i>aimag</i>	–	provincial administrative unit
<i>aimag center</i>	–	<i>aimag</i> capital
<i>ger</i>	–	traditional felt tent
<i>khural</i>	–	citizens' representative committee
<i>soum</i>	–	administrative subunit of <i>aimag</i>

NOTE

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

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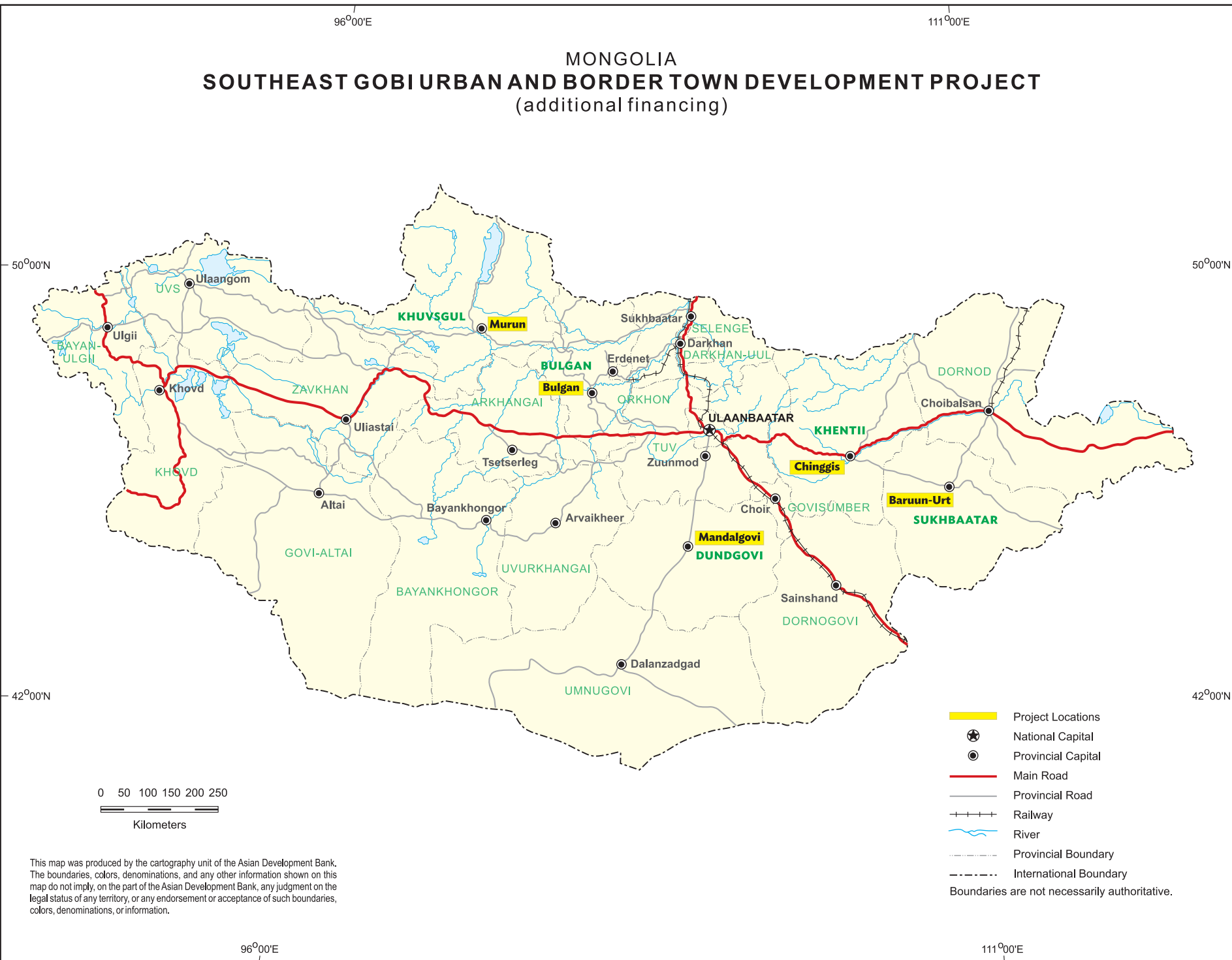
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PROJECT AT A GLANCE

1. Basic Data		Project Number: 42184-027	
Project Name	Southeast Gobi Urban and Border Town Development Project (additional financing)	Department /Division	EARD/EASS
Country Borrower	Mongolia Government of Mongolia	Executing Agency	Ministry of Construction and Urban Development
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Urban sewerage		20.00
		Total	20.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Urban environmental improvement		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development	Effective gender mainstreaming (EGM)	✓
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Urban	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG6, SDG9		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: B Involuntary Resettlement: B Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		20.00	
Sovereign Project (Regular Loan): Ordinary capital resources		20.00	
Cofinancing		0.00	
None		0.00	
Counterpart		1.75	
Government		1.75	
Total		21.75	

MONGOLIA

SOUTHEAST GOBI URBAN AND BORDER TOWN DEVELOPMENT PROJECT (additional financing)



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I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to Mongolia for the additional financing of the Southeast Gobi Urban and Border Town Development Project. The loan will scale up and extend the socioeconomic benefits of the project by improving the quality and reliability of wastewater management services in five additional *aimag* centers in other regions of the country.

II. THE PROJECT

A. Rationale

2. **Current project.** On 19 April 2010, the Asian Development Bank (ADB) approved a grant of \$15.0 million from its Special Funds resources for the Southeast Gobi Urban and Border Town Development Project to support the provision of urban infrastructure and service improvements in the fast-growing urban areas of the Southeast Gobi.¹ The grant has been extended and its closing date is 31 May 2019.² To complement the outputs of the grant, ADB approved a loan of \$19.43 million on 22 April 2016 as additional financing for the construction and operation of wastewater treatment plants (WWTPs) in four *aimag* centers.³ The loan was approved with attached technical assistance (TA) of \$1.0 million provided by the Sanitation Financing Partnership Trust Fund under the Water Financing Partnership Facility.⁴ The TA was to support the Government of Mongolia in addressing sludge reuse, including implementing a pilot program in one of the four *aimag* centers. The loan closing date is 30 June 2020, while the TA closing date is 31 October 2019. Project implementation progress is *satisfactory*. The grant was implemented on time and completed by July 2018 with both physical progress and disbursement at 98%. The first additional financing is *on track* with disbursement at 19.7% and contract awards at 58.3% by July 2018.

3. **Additional financing.** The Government of Mongolia prioritized the request for a second additional financing loan to replicate some of the outputs of the current project⁵ in other *aimag* centers with comparable geographic and economic characteristics and similar wastewater treatment needs. The proposed loan will finance the construction and operation of WWTPs in five *aimag* centers: Baruun-Urt (Sukhbaatar province), Bulgan City (Bulgan province), Chinggis City (Khentii province), Mandalgovi (Dundgovi province), and Murun (Khuvsgul province).

4. The project *aimags* are examples of rapidly growing second-tier cities. With an aggregate urban population of about 115,000, the project *aimags* made up about 5.4% of Mongolia's urban population in 2017.⁶ Two of the project *aimags* centers (Chinggis City and Baruun-Urt) have shown above-average increases in population and share of the gross domestic product, while the population and gross domestic product in the remaining three (Bulgan City, Mandalgovi, and Murun)

¹ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to Mongolia for the Southeast Gobi Urban and Border Town Development Project*. Manila.

² The implementation of the grant is complete, with only a small disbursement remaining. The good performance of the grant enabled its extension and the subsequent processing of the proposed additional financing.

³ ADB 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Additional Financing and Administration of Technical Assistance Grant to Mongolia for the Southeast Gobi Urban and Border Town Development Project*. Manila. The *aimag* centers are Arvaikheer (Uvurkhangai), Dalanzadgad (Umnugovi), Sainshand (Dornogovi), and Tsetserleg (Arkhangai).

⁴ Financing partner: Bill & Melinda Gates Foundation. Administered by ADB.

⁵ For clarity, the original grant and the first additional financing loan are referred to as "the current project" and the proposed second additional financing as "the proposed project."

⁶ The total number of direct beneficiaries is estimated at 30,273 households in the apartment and *ger* areas once plants are operating at full capacity and includes businesses and institutions within *aimag* centers.

have grown at or slightly below the national average outside the capital, Ulaanbaatar.⁷ All project cities have a sewerage network that serves the core urban area. The public utility service organizations (PUSOs) have found that the relatively young sewerage systems are in generally good condition and not in need of replacement or expansion.⁸ All project cities have WWTPs, which employ waste stabilization (oxidation) ponds as the main biological treatment process. The pond systems are preceded in some cases (Chinggis City and Mandalgovi) by preliminary (screening and grit removal) and primary (sedimentation) treatment processes. However, these preliminary treatment units are no longer fully operational.⁹ Similarly to *aimag* centers under the current project, all the treatment systems (i) are generally in a poor state of repair, (ii) represent a technology that is not suitable for Mongolian climatic conditions, and (iii) are not providing a consistent level of treatment that complies with Mongolian wastewater discharge standards. In addition, these *aimag* centers are growing rapidly, driven by the government's support for a large apartment construction program.¹⁰ This will lead to significant increases in wastewater flows over the next decade as new apartment blocks are occupied, exceeding the capacity of most of the existing WWTPs.

5. **Performance of the current project.** The current project has performed well¹¹ and is rated *on track*.

- (i) **Output delivery.** The current project has made significant progress toward achieving its outcomes. It has (a) improved access to water supply, sewerage, solid waste management, and heating coverage in planned (non-*ger*) areas in the project *soums*; (b) ensured that almost 95% of *ger* area dwellers in the project *soums* have access to potable water within 300 meters of their dwellings; (c) reduced the time women and children take to collect water; and (d) established and made operational new water supply, sewerage, and heating networks. The current project is also on track to accomplish all of its outputs. Under part A,¹² standard lease agreements now form the basis of the service agreements between the local governments and PUSOs. Urban development plans (general plans) for Khanbogd, Gurvantes, and Tsogttsetsii *soums* of Umnugovi *aimag* and Sainshand *soum* of Dornogovi *aimag* were prepared and approved by *aimag khurals* and the relevant state expertise agency.¹³ Capacity building seminars and training on institutional and human resource development, urban planning and implementation of the general plans, and land acquisition and resettlement were held for more than 250 *aimag* officials, of whom 35% were women. Under part B, new water supply, wastewater collection, solid waste management, and heating system improvements have been financed in Dalanzadgad, Gurvantes, Khanbogd, Sainshand, Tsogttsetsii, and Zamyn-Uud. While most assets delivered under part A of the current project are completed and

⁷ Based on ADB. 2015. *Mongolia National Urban Assessment*. Ulaanbaatar; and *aimag* population records. Average population growth rates from 2008 to 2017 were as follows: national 1.4%, Bulgan City 0.7%, Baruun-Urt 3.5%, Chinggis City 3.4%, Mandalgovi 1.2%, and Murun 1.0%.

⁸ PUSOs are agencies responsible for managing and operating water and wastewater services on behalf of the *aimag* governments.

⁹ Existing pond systems will be decommissioned, except in Bulgan City, Chinggis City, and Murun, where they will be reused as polishing ponds. The capacities of existing plants are as follows: Baruun-Urt 720 cubic meters per day (m³/day); Bulgan City 800 m³/day; Chinggis City 1,100 m³/day; Mandalgovi 1,400 m³/day; and Murun 1,000 m³/day.

¹⁰ In 2015, the national government launched the "100,000 houses" program. It aims to build 25,000 homes in *aimags* and *soums*, and the remaining 75,000 in Ulaanbaatar. The program does not target a specific group, which means it is open to all people who want to own apartments and who can meet the requirements. The program has been funded through bonds that were issued by the Development Bank of Mongolia.

¹¹ Summary of Project Performance (accessible from the list of linked documents in Appendix 2).

¹² The current project included a total of 10 outputs presented under two parts, Part A and B.

¹³ General plans for Khanbogd, Gurvantes, and Tsogttsetsii *soums* of Umnugovi *aimag* were approved by *aimag khural* on 27 March 2014 and by the State Great Khural on 6 August 2015. The general plan of Sainshand *soum* of Dornogovi *aimag* and New Sainshand residential district partial general plan were approved by *aimag khural* on 4 December 2013 and by the State Great Khural on 24 June 2015.

- operational, others are *on track*, according to the current implementation plan (footnotes 1 and 3).
- (ii) **Implementation progress.** The current project's implementation progress is *satisfactory*, and both disbursement and contracts awards are *on track*. For the first additional financing, the following contracts were awarded: (a) consulting package for project management, procurement, and supervision support in June 2017; (b) capacity support for the project management unit (PMU) and PUSOs in September 2017; (c) Umnugovi WWTP in December 2017; and (d) Uvurkhangai WWTP in February 2018. The tender for the Arkhangai WWTP was issued in February 2018. The modification of detailed designs for the Dornogovi WWTP and its 4.4-kilometer sewerage pipeline connection were approved in November 2017.
 - (iii) **Safeguard compliance.** Safeguard requirements have been met satisfactorily. Environmental and social safeguard screening procedures have been well established under the current project and applied to every subproject. The environmental management plan has been executed according to project safeguard requirements.
 - (iv) **Management of risk.** The reports and recommendations of the President for the current project identified the following project risks: (a) poor capital investment and budget planning, (b) underdeveloped institutional frameworks and poor capacity, (c) lack of monitoring and evaluation, (d) poor procurement integrity, and (e) weak national contractors. The PMU provided project management and implementation support, and project implementation units successfully managed most of the risks by (a) building the capacity of local government service institutions in investment planning and improved service delivery and operation, (b) supporting institutional change on measuring and improving service delivery performance, (c) adopting a modality for procurement of priority infrastructure improvements to attract better-qualified national contractors, and (d) combining small civil works activities into larger contract packages to generate economies of scale.

6. **Additional financing eligibility criteria met.** ADB's due diligence confirmed that the proposed project meets the eligibility criteria and standards. It is in line with the government's action plan for 2016–2020, which prioritizes the development of infrastructure and services in *aimag* centers.¹⁴ The proposed project is included in ADB's country operations business plan for Mongolia, 2019–2021¹⁵ and is aligned with ADB's country partnership strategy for Mongolia, 2017–2020.¹⁶ With its objective to contribute to inclusive economic and environmentally sustainable growth, the proposed project is aligned with ADB's Strategy 2030 and follows ADB's urban and water operational plans.¹⁷ The additional financing is also consistent with the current project's development objective to expand access to sustainable infrastructure and services in *aimag* urban centers. Further, with the inclusion of the additional financing, the current project remains technically feasible, economically viable, and financially sound.

7. **Additional financing priority met.** The proposed additional financing is for *aimag* centers similar to those in the current project and offers a treatment technology that is identical to the first additional financing. The proposed project has a high degree of readiness: subprojects are clearly identified and detailed designs have been fully prepared and are ready for approval. This has

¹⁴ Government of Mongolia. 2016. *Government Action Plan, 2016–2020*. Ulaanbaatar.

¹⁵ ADB. 2018. *Country Operations Business Plan: Mongolia, 2019–2021*. Manila.

¹⁶ ADB. 2017. *Country Partnership Strategy: Mongolia, 2017–2020—Sustaining Inclusive Growth in a Period of Economic Difficulty*. Manila.

¹⁷ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila. The proposed project demonstrates alignment with the operational priorities of ADB Strategy 2030 particularly in terms of environmental sustainability and integrated solutions for livable cities.

allowed the required due diligence to be carried out promptly and efficiently, and for feasibility to be firmly established. Because the proposed project will use the management arrangements of the current project, the implementation capacity is well advanced through the PMU's experience with similar technical, economic, financial, and safeguard requirements. The existing PMU's capacity for project management and implementation support to the *aimag* governments, built during the current project, adds to the proposed project's readiness and supports the effective administration of the additional financing. These features will allow the executing agency and ADB to properly and comprehensively mitigate implementation-related risks.

8. **Changes in project scope.** In response to a request from the government, the proposed project will (i) extend the geographical scope of the current project by including the construction of five new WWTPs in the additional *aimag* centers of Baruun-Urt, Bulgan City, Chinggis City, Mandalgovi, and Murun;¹⁸ and (ii) extend the institutional reform and capacity building being carried out under the current project to the five additional *aimag* centers. Consequently, the focus of the proposed project's outcome extends to achieving government standards for wastewater discharges and reuse of sewage effluent. The proposed project will contribute to a more balanced national urban system and stronger urban–rural relationships by contributing to the development of second-tier cities in the country. It will also improve environmental conditions and reduce environmental pollution in and around the project cities. The proposed project will support improvements to the cities' wastewater management by building new WWTPs, complemented by support for project management, capacity development, and training. The new WWTPs include an energy-efficient treatment process adopting integrated fixed-film activated sludge (IFAS) technology, which is working well under the first additional financing.¹⁹ This system is suitable for the project *aimag* centers' cold climate and will produce effluent that meets national and international standards.

9. Lessons from the current project on the selection of the treatment technology and the capacity of the plants were incorporated in the proposed project design. Through the current project, useful knowledge has ensured the quality of detailed designs which are completed, saving time on preconstruction activities and increasing the reliability of cost estimates. Valuable experience from the current project will also allow efficient procurement packaging that secures optimal response to tenders and proficient evaluation of contractor capabilities. In addition, the enhanced institutional support and capacity building provided under the proposed project take into consideration similar activities under the first additional financing and their degree of success. Consequently, the proposed use of national consultants to assist the PUSOs is focused on incorporating optimized organizational and management reforms set out under the current project and through previous urban development projects in Mongolia.²⁰

¹⁸ Since 2014, the Ministry of Construction and Urban Development (MCUD) has been implementing a program to rehabilitate WWTPs across all *aimags*. MCUD selected these five *aimag* centers according to (i) urgency in terms of levels of water pollution and numbers of affected people, and (ii) suitability for replication of technology and design from the current project.

¹⁹ The IFAS system emerged as the most suitable for use in the project *aimags* as a result of a two-stage evaluation process, which assessed the operational efficiency, cost effectiveness, and robustness of WWTPs of this size under Mongolian conditions. This selection was ratified by a technical committee under MCUD. The IFAS system has the additional benefits of (i) being the technology used for the WWTPs included under the first additional financing project in Arvaikheer, Dalanzadgad, Tsetserleg, and Sainshand; (ii) being the technology used for the new ADB-supported treatment plant in Darkhan; and (iii) having been successfully adopted for treatment of wastewater in two *aimag* centers of similar size to the project *aimags* (Sukhbaatar and Zunmod). Further details on selected technology are in para 16.

²⁰ These reforms aim at strengthening ownership and accountability of PUSOs during and beyond the project life cycle. This refers not only to project management, procurement, and safeguards monitoring but also to sound asset management including operation and maintenance (O&M), and more efficient debt collection systems.

B. Impact and Outcomes

10. **Project impact and outcomes.** The proposed project's impact and outcomes are aligned with those of the current project. The proposed project is aligned with the following impact: economic development and livability in *aimag* centers (mining and border towns in Southeast Gobi) enhanced.²¹ The proposed project will have the following outcomes: urban governance improved and access to sustainable infrastructure and services expanded in urban places in Southeast Gobi and other *aimags*.²²

C. Outputs

11. The proposed project will have the following outputs: (i) wastewater collection and treatment infrastructure constructed and operationalized, delivering effluent that satisfies Mongolian wastewater discharge standards; and (ii) strategic planning, management, and cost recovery for wastewater management strengthened.

12. **Output A: Wastewater collection and treatment infrastructure constructed and operationalized.** The proposed project will establish modern wastewater treatment facilities with individual operating capacity of 3,000 m³ in the *aimag* centers of Baruun-Urt, Bulgan City, Chinggis City, Mandalgovi, and Murun, replacing the inadequate waste stabilization pond systems.²³ Based on the findings from the pilot operation carried out under ADB's TA for Management and Reuse of Sewage Sludge from On-Site Sanitation Facilities and Decentralized Wastewater Treatment Plants,²⁴ the project will support the provision of vacuum evacuation trucks to all *aimag* centers to improve *ger* area sanitation and prevent ground and surface water pollution (footnote 4).

13. **Output B: Strategic planning, management, and cost recovery for wastewater management strengthened.** The proposed project will (i) provide expert support for project management, institutional enhancement and capacity development in utility management, operation and service provision, emergency preparedness and response, and construction supervision; and (ii) strengthen PMU and PUSO capacities. Training and study tours will be provided during implementation. The proposed project will include policy dialogue with the PUSOs on water and wastewater tariff reform and sanitation improvements. It will support public awareness campaigns on environmental management and sanitation, as well as improve institutional capacity in utility service provision, strategic planning, and operations.

D. Investment and Financing Plans

14. The proposed project is estimated to cost \$21.75 million. For the current project, the grant financing (\$21.87 million) and the first additional financing (\$21.17 million) total \$43.04 million. The investment for the proposed project includes physical and price contingencies, financing charges during implementation. Table 1 presents the project investment costs.

²¹ National Development and Innovation Committee. 2010. *Infrastructure Development Plans for the Southern Gobi*. Ulaanbaatar; and Government of Mongolia. 2016. *Government Action Plan, 2016–2020*. Ulaanbaatar.

²² The revised design and monitoring framework is in Appendix 1.

²³ The 3,000 m³ capacity will be fully utilized at the design year 2030. The current and future flows include those for all commercial establishments, businesses, and institutions within the *aimag* centers. In addition, many *ger* dwellers (not connected to the central network) use apartments of friends or family members within the connected areas for bathing.

²⁴ ADB. 2016. *Technical Assistance to Mongolia for the Management and Reuse of Sewage Sludge from On-site Sanitation Facilities and Decentralized Wastewater Treatment Plants*. Manila (TA 9100-MON).

Table 1: Project Investment Plan
(\$ million)

Item	Current Amount ^a	Additional Financing ^b	Total
A. Base Cost^c			
1. Civil works	25.41	13.74	39.15
2. Materials and equipment	4.43	3.61	8.04
3. Project management and consulting	5.12	1.08	6.20
Subtotal (A)	34.96	18.43	53.39
B. Contingencies^d	7.45	2.03	9.48
C. Financing Charges During Implementation^e	0.63	1.29	1.92
Total (A+B+C)	43.04	21.75	64.79

^a Refers to the grant and first additional financing. Includes taxes and duties of \$3.19 million (\$1.45 million from initial financing and \$1.74 million from additional financing) financed by the government through cash contribution. Such amount does not represent an excessive share of the project cost.

^b Includes taxes and duties of \$1.75 million to be financed by the government through exemption.

^c Current amount includes financing and other charges. The additional financing is based on first quarter of 2018 prices.

^d Current amount is based on actual cost. For the additional financing, physical contingencies are computed at 5% for works and goods. Price contingencies for foreign cost components are 2.6% in 2018, 2.1% in 2019, 2.0% in 2020, 1.9% in 2021, and 1.8% in 2022, and thereafter; and for local cost components, 6.0% in 2018, 5.8% in 2019, 6.7% in 2020, 6.5% in 2021, and thereafter; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

^e Includes interest and commitment charges. Interest during construction for a regular ordinary capital resources loan has been computed at the 5-year US dollar fixed swap rate plus an effective contractual spread of 0.5% and maturity premium of 0.1%. Commitment charges for a regular ordinary capital resources loan are 0.15% per year to be charged on the undisbursed loan amount.

Source: Asian Development Bank estimates.

15. The government has requested a regular loan of \$20.00 million from ADB's ordinary capital resources to help finance the proposed project. The loan will have a 25-year term, including a grace period of 6 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year (the interest and other charges during construction to be capitalized in the loan); and such other terms and conditions set forth in the draft loan and project agreements. Based on the straight-line repayment method, the average maturity is 15.75 years, and the maturity premium payable to ADB is 0.10% per year. The government will finance 100% of the taxes and duties totaling \$1.75 million. The financing plan of the current project and additional financing is in Table 2.

Table 2: Financing Plan
(\$ million)

Item	Current ^a		Additional Financing		Total	
	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)
Asian Development Bank	34.43	80	20.00	92	54.43	84
Special Funds resources (loan)	19.43	45			19.43	30
Special Funds resources (grant)	15.00	35			15.00	23
Ordinary capital resources (loan)			20.00	92	20.00	31
Government of Mongolia (<i>aimag</i>)	8.61	20	1.75	8	10.36	16
Total	43.04	100	21.75	100	64.79	100

Source: Asian Development Bank estimates.

E. Implementation Arrangements

16. The Ministry of Construction and Urban Development (MCUD) will be the executing agency for the proposed project; the *aimag* governments will be the implementing agencies, supported by the existing PMU, which will extend its responsibilities for the current project to include the proposed additional financing. The PMU's professional capacity will be strengthened by the addition of six technical positions in the fields of construction management and supervision. MCUD will nominate

a project director, and the PMU will continue to be headed by a project coordinator. MCUD will be responsible for overall strategic guidance, technical supervision, and execution of the proposed project and ensuring compliance with loan covenants through the existing state-level steering committee for externally financed urban projects. The project steering committee will provide overall policy guidance on the project and will have the authority to make decisions on matters relating to project execution. At the *aimag* level, project supervision will be assisted through PUSO support units comprising staff assigned part-time to the project. Project management and implementation support will be provided to the PMU through consultants hired under the proposed project. The consultants will assist the PMU and PUSO support units in project management, procurement, and safeguards monitoring. The implementation arrangements are summarized in Table 3 and described in detail in the project administration manual (PAM).²⁵

Table 3: Implementation Arrangements

Aspects	Arrangements		
Implementation period	September 2018–December 2021		
Estimated completion date	31 December 2021		
Estimated loan closing date	30 June 2022		
Management			
(i) Oversight body	Project steering committee		
(ii) Executing agency	Ministry of Construction and Urban Development		
(iii) Key implementing agencies	<i>Aimag</i> governments		
Procurement ^a	National competitive bidding	6 contracts	\$19,530,000
Consulting services	Quality- and cost-based selection	52 person-months	\$218,000
	Individual consultants selection	119 person-months	\$252,000
Disbursement	The loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time), and the detailed arrangements agreed upon between the government and ADB.		

ADB = Asian Development Bank.

^a Procurement will be in accordance with ADB's Procurement Guidelines (2015, as amended from time to time).

Source: Asian Development Bank.

III. DUE DILIGENCE

A. Technical

17. The project is assessed as technically feasible based on detailed technical assessment and evaluation of wastewater management systems in extremely cold climate conditions around the world and in Mongolia, under operating conditions where temperatures can reach -40°C . The wastewater treatment technology proposed for adoption in all five *aimags* was subjected to intensive scrutiny and analysis, resulting in a short list of technology choices most appropriate for operation under local conditions. A two-stage process was adopted to evaluate alternative wastewater treatment solutions and select the best and lowest-cost solution. In carrying out this analysis, ADB made maximum use of current operating experience in Mongolia, as well as the analysis and discussions carried out during preparation of the Darkhan Wastewater Management Project and the first additional financing to the current project (footnote 3) which adopted the same technology.²⁶ The evaluation concluded that the IFAS process provides the most appropriate and operationally sustainable technical solution for wastewater treatment. Measures to mitigate possible operational and lifetime risks will be implemented, including (i) ensuring that the existing WWTPs can be operated throughout the entire reconstruction process while meeting treatment standards; (ii) using the polishing ponds as emergency storage if a WWTP fails; and (iii) committing

²⁵ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

²⁶ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant to Mongolia for the Darkhan Wastewater Management Project*. Manila.

the contractor to continue to support plant operation for 3 years after commissioning, and take responsibility for the continuity of the performance during this period. While a few of the still-functioning waste stabilization ponds will be reused along with the new WWTPs, most of the existing facilities will be decommissioned by the PUSOs with support from MCUD.²⁷

B. Economic and Financial

18. Economic and financial analyses were conducted for the overall project and for individual subproject *aimag* centers and PUSOs following ADB guidelines.²⁸ Available information from subprojects was verified to support new additional financing subproject sites. The economic analysis included a least-cost analysis of alternative options to ensure that optimum benefits accrue to service the populations in the *aimag* centers. The least-cost analysis resulted in the choice of IFAS technology rather than bioreactor. The proposed project will generate health benefits such as avoided medical costs; resource cost savings, including domestic wastewater disposal time and treatment; and an improved and safer environment. The economic benefits were estimated from the results of willingness-to-pay surveys conducted in the appointed service areas. The economic analysis indicated that the individual subprojects are economically viable with economic internal rates of return of 10.6% for Bulgan City, 13.2% for Chinggis City, 12.6% for Mandalgovi, 10.7% for Baruun-Urt and 11.3% for Murun—all exceeding the economic opportunity cost of capital of 9%. The economic internal rate of return for the overall project is estimated at 11.5% with an economic net present value at MNT10,785 million.

19. The financial analysis for the project was conducted in accordance with the guidelines of ADB's Financial Management and Analysis of Projects (footnote 28). A stand-alone assessment of project viability cannot be conducted at the PUSO level because they do not have a full cost-recovery tariff. Financial sustainability was assessed based on (i) subsidies from *aimag* governments, tariff increases, and efficiency improvements for the PUSOs; and (ii) recurrent costs for operation and maintenance and debt service obligations. While the PUSOs incur net losses nearly annually, *aimags* partly subsidize operations to avoid a degradation of services. Thus, project sustainability is at risk as it depends on these budget allocations. Since 2015 to 2016, the PUSOs implemented tariff increases based on rates approved by the National Water Regulatory Commission. Tariffs are proposed to be adjusted at least every 3 years, starting in 2019 when construction is underway. To maintain project sustainability, a combination of improved efficiency measures for the PUSOs, tariff increases, and assurances of subsidies have been covenanted.

C. Governance

20. Financial management assessments of the *aimag* governments and the PUSOs, coupled with a procurement capacity assessment of MCUD, rated the risks *moderate*. They concluded that MCUD and the *aimag* governments, with the support of the PMU, have adequate capacity for financial management and procurement under the project. PMU staff for the current project is

²⁷ In the case of Bulgan City, Chinggis City, and Murun, some of the existing ponds will be reused as maturation (polishing) ponds for treated effluent and sludge drying beds. These will remain within the security fencing of the new WWTPs. Those ponds at these three locations, which will not be reused, and the existing ones at Baruun Urt and Mandalgovi will be decommissioned. This will involve (i) draining or pumping wastewater for treatment; (ii) allowing remaining wastewater to evaporate and sludge to dry out; (iii) removing the dried sludge for retention on site to support vegetation growth, reuse in nurseries, or disposal in landfill sites; and (iv) reforming the land for reuse as grazing or for other purposes. These activities will be supervised by the PUSOs with support from MCUD through the PMU and its consultants.

²⁸ ADB. 1999. *Handbook for the Economic Analysis of Water Supply Projects*. Manila; ADB. 2017. *Guidelines for the Economic Analysis of Projects*. Manila; ADB. 2005. *Financial Management and Analysis of Projects*. Manila; and ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

familiar with ADB's requirements on disbursement, procurement, and safeguards, and will continue to support implementation of the proposed project.

D. Poverty and Social

21. Poverty incidence for the project *aimag* centers was estimated at 31.8%, which is higher than the national average. In 2016, among the five project *aimag* centers, Baruun-Urt (47.0%), Chinggis City (43.8%), Bulgan City (31.4%), Murun (29.1%) and Mandalgovi (22.8%), the first three experienced poverty rates higher the national average. The proposed project will benefit the poor and vulnerable households in the apartment and *ger* areas by improving their health conditions and reducing health care expenditure related to poor water quality and unsanitary environmental conditions. It will increase participation, especially of the poor and women, in improving public services. The proposed project will create about 256 jobs; most of the unskilled jobs will go to local people, including the poor, and at least 30% will be for women. Details on the specific measures to achieve the poverty and social benefits are in the social and gender action plan (SGAP) included in the PAM (footnote 25). The SGAP was prepared to ensure continued consultation and participation of the local communities during project implementation. Actions include (i) a public awareness program on improved wastewater public services; (ii) consultations and public hearings on a wastewater tariff increase; and (iii) targets for employment of local labor, women, and the poor during construction and operation. Implementation will be monitored through the project performance management system, project progress reports, and ADB missions.

22. **Gender.** The current project was classified *effective gender mainstreaming*. The current project gender action plan is ongoing with about 50% of the activities completed and 67% of targets achieved. The proposed project will focus only on improving the quality and reliability of wastewater management services in five additional *aimag* centers in other regions of the country. As the proposed project satisfies the threshold for *effective gender mainstreaming*, a combined SGAP was developed. The SGAP includes activities targeted at both males and females.

E. Safeguards

23. **Environment (category B).** The environment categorization of the current project is B since no unprecedented or irreversible impact on the environment is anticipated. In compliance with ADB's Safeguard Policy Statement (2009), an initial environmental examination and an environmental management plan were prepared for the components to be supported through the proposed project.²⁹ Short-term impacts are anticipated during construction, including dust, noise, and waste generated during earthwork and civil works activities, as well as minor community and occupational health and safety risks. Operation and maintenance training, as well as performance monitoring, will minimize operational impacts and risks and optimize environmental benefits. The proposed project's climate risk is *low*.

24. **Involuntary resettlement (category B) and indigenous peoples (category C).** The proposed project is categorized B for involuntary resettlement as it will affect the leased land and a fixed asset (40-meter deep well) of two private companies within the WWTP buffer zone in Chinggis City. The affected entities were consulted during resettlement planning. Replacement land will be allocated, while the affected asset will be compensated at replacement cost. A resettlement plan was prepared. The proposed project will be implemented in peri-urban areas where no specific communities of ethnic minorities or groups are living. No adverse impacts are expected, and all

²⁹ ADB. 2010. Safeguard Policy Statement. *Operations Manual*. OM F1. Manila; and Initial Environmental Examination (accessible from the list of linked documents in Appendix 2).

residents will benefit equally from the improved wastewater treatment service. Therefore, ADB policy requirements for indigenous peoples will not be triggered.

F. Risks and Mitigating Measures

25. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.³⁰ The overall risk rating of the project is *low to moderate*. The integrated benefits and impacts of the project extension are expected to outweigh the costs.

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Poor choice of technology or poor-quality construction and equipment installation	Designs based on experience with existing WWTPs in Mongolia. Management supervision and quality assurance provided through trained PMU staff and consultants throughout construction, commissioning, and early stages of operation.
Limited procurement and project management skills, capacity, and experience compromise tendering and project quality	PMU's experience with WWTP tender and construction; and provision of technical assistance to the PMU in due diligence, project management, and supervision.
Poor cost recovery compromises operational and financial sustainability	Technical assistance to be provided to the PUSOs in the development and implementation of an (i) institutional strengthening and reform road map, and (ii) action plan for improved financial management and cost recovery. A combination of tariff increases, efficiency measures for the PUSOs, and government assurances on subsidies will ensure the financial sustainability of the project.

PMU = project management unit, PUSO = public utility service organization, WWTP = wastewater treatment plant.
Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

26. The government, MCUD, and *aimag* governments have assured ADB that implementation of the proposed project shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the PAM and the loan documents, and have agreed on certain covenants for the project, which are set forth in the loan documents. No loan withdrawals will be allowed for civil works until the government has certified to ADB in writing that each *aimag* had executed the corresponding subsidiary loan agreement.

V. RECOMMENDATION

27. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$20,000,000 to Mongolia for the additional financing of the Southeast Gobi Urban and Border Town Development Project, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 25 years, including a grace period of 6 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao
President

5 September 2018

³⁰ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

REVISED DESIGN AND MONITORING FRAMEWORK

Impact the Project Is Aligned with			
Current project (original grant and first additional financing) Economic development and livability in <i>aimag</i> centers (mining and border towns in Southeast Gobi) enhanced (Infrastructure Development Plans for the Southern Gobi and Government Action Plan, 2016–2020) ^a			
Overall project^b Unchanged			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcomes Current project Urban governance ^c improved and access to sustainable infrastructure and services expanded in urban places in Southeast Gobi and other <i>aimags</i>	Current project^d a. Water, sewerage, SWM, and heating coverage in planned (non- <i>ger</i>) areas increased from 0% to 95% in <i>soums</i> , and from 95% to 100% in <i>aimag</i> centers, by September 2015 (2010 baseline: Not applicable) b. <i>Ger</i> area population with access to water kiosks within 300 meters of dwelling increased to 95% by September 2015 (2010 baseline: 20%) c. Revenues of service operators increased from 95% to 100% of recurrent costs by September 2015 (2010 baseline: Not applicable) d. 20% reduction in average time women spend on accessing drinking water by September 2015 (2011 baseline: 17.8 minutes) e. New water, sewerage, SWM, and heating use in planned (non- <i>ger</i>) areas increased to 95% in <i>soums</i> , and to 100% in four <i>aimag</i> centers, by 2016 (2010 baseline: <i>soums</i> 0%, four <i>aimags</i> 95%) f. At least 12,000 m ³ /day of fully treated wastewater discharged in four <i>aimag</i> centers and <i>soums</i> by 2020 (2015 baseline: 0 m ³ /day) g. At least 3 of 4 PUSOs with annual revenues greater than expenses by 2020 (2014 baseline: 1) h. At least 90% of new infrastructure projects started in 2016–2020 follow approved urban master plans in <i>soums</i> and <i>aimag</i> centers by 2020 (2014 baseline: Not applicable)	a. Annual National Statistics Office Yearbook, national government; annual statistics yearbooks of local and <i>aimag</i> governments b–c. Annual statistics yearbooks of local and <i>aimag</i> governments d. Annual audited financial account statements of PUSOs e–f. Annual household survey, PUSOs annual progress reports	Operation-related funds from local governments are not available in a timely manner
Overall project Unchanged	Overall project a–e. Unchanged		

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>f. At least 27,000 m³/day of fully treated wastewater discharged in nine <i>aimags</i> centers and <i>soums</i> by September 2022 (2015 baseline: 0 m³/day; 2018 baseline: 0 m³/day)</p> <p>g. At least 7 of 9 PUSOs with annual revenues greater than expenses by September 2022 (2014 baseline: 1; 2018 baseline: 2)</p> <p>h. At least 90% of new infrastructure projects commenced between 2018 and 2022 followed approved urban master plans in <i>soums</i> and <i>aimag</i> centers by September 2022 (2014 and 2018 baselines: Not applicable)</p> <p>i. <i>Ger</i> area population in five <i>aimag</i> centers with access to pit latrine emptying service increased to 80% by September 2022 (2018 baseline: 20%)</p>		
<p>Outputs Part A</p> <p>Current project</p> <p>1. Infrastructure services reforms including performance-based contracts for urban services delivery implemented</p> <p>2. Urban planning and policy making, including master plans for participating towns strengthened</p> <p>3. Cross-border cooperation established</p> <p>Overall project Unchanged</p> <p>Part B</p> <p>Current project</p> <p>4. Water source development,</p>	<p>Current project</p> <p>1a. Operating management contracts for provision of basic services in place and operational in both project <i>aimags</i> by November 2014 (2010 baseline: 0)</p> <p>2a. Four urban plans prepared and adopted by the participating <i>aimag</i> and <i>soum</i> governments by November 2014 (2010 baseline: 1)</p> <p>2b. At least 30% of participants in consultative workshops are women (2010 baseline: Not applicable)</p> <p>3a. Zamyn-Uud-Erlian Joint Border Development Commission established with urban development working group (2010 baseline: Not established)</p> <p>Overall project</p> <p>1a. Unchanged (completed)</p> <p>2a.–2b. Unchanged (completed)</p> <p>3a. Unchanged (completed)</p> <p>Current project</p> <p>4a. At least 38 km of transmission and distribution water main installed by</p>	<p>1a., 2a., 3a. Quarterly project progress reports of PMU</p> <p>2b. Annual gender action plan implementation report, PMU</p> <p>4a–10b. Annual National Statistics Office</p>	<p>Lack of government support for reforms, regional cooperation, and institutional strengthening</p> <p>Political interference with project implementation</p>

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
transmission, storage, and distribution completed	September 2015 (2010 baseline: 0) 4b. 11 water kiosks constructed and operational in <i>ger</i> areas by September 2015 (2010 baseline: 0) 4c. Three water reservoirs constructed by September 2015 (2010 baseline: 0)	Yearbook, national government, quarterly project progress reports of PMU	
Overall project Unchanged	Overall project 4a.–4c. Unchanged (completed)		
Current project 5. Wastewater collection and treatment infrastructure constructed and operationalized	Current project 5a. At least 30 km of sewers installed and operational by 2020 (2010 baseline: 0; 2015 baseline: 28) 5b. Four WWTPs of 3,000 m ³ /day constructed and operational by 2020 (2010 and 2015 baselines: 0)		
Overall Project Unchanged	Overall project 5a.–5b. Unchanged (completed) 5c. Four WWTPs of 3,000 m ³ /day by 2020, and five WWTPs of 3,000 m ³ /day by 2022 (2010, 2015, and 2018 baselines: 0 m ³ /day) 5d. Five vacuum evacuation trucks delivered and operational by 2022 (2010, 2015, and 2018 baselines: 0)		
Current project 6. District heating infrastructure constructed and operationalized	Current project 6a. Eight heating boilers of 4 megawatts supplied, installed, and operational by September 2015 (2010 baseline: 0) 6b. At least 8 km of heating pipeline supplied, installed, and operational by September 2015 (2010 baseline: 0) 6c. Three heat distribution centers installed and operational by September 2015 (2010 baseline: 0)		
Overall project Unchanged	Overall project 6a.–6c. Unchanged (completed)		
Current project 7. Surfaced central roads constructed	Current project 7a. About 9 km of concrete access roads constructed by September 2015 (2010 baseline: 0)		
Overall project Unchanged	Overall project 7a. Unchanged (completed)		

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p>Current project 8. Solid waste collection and disposal enhanced</p>	<p>Current project 8a. Two solid waste landfill sites constructed and operational by September 2015 (2010 baseline: 0)</p> <p>8b. 12 sets of tractors and trailers for solid waste collection supplied and operational by May 2014 (2010 baseline: 0)</p>		
<p>Overall project Unchanged</p>	<p>Overall project 8a.–8b. Unchanged (completed)</p>		
<p>Current project 9. Stormwater drainage infrastructure constructed and operationalized</p>	<p>Current project 9a. At least 2 km of stormwater drainage line installed and operational by September 2015 (2010 baseline: 0)</p> <p>9b. At least 30% of participants in public meetings on project design and construction activities are women (2010 baseline: 0)</p>		
<p>Overall project Unchanged</p>	<p>Overall project 9a.–9b. Unchanged (completed)</p>		
<p>Current project 10. Strategic planning management, and cost recovery for wastewater management strengthened</p>	<p>Current project 10a. At least 100 PUSO and local government staff with new knowledge and skills on wastewater operations and management by 2020, of which 35% are women (2010 baseline: Not applicable)</p>		
<p>Overall project Unchanged</p>	<p>Overall project 10a. Unchanged (completed)</p> <p>10b. At least 300 PUSO and local government staff with new knowledge and skills on wastewater operations and management by 2020, of which 35% are women (2010 baseline: Not applicable)</p>		
<p>Key Activities with Milestones</p> <p>Outputs 1–3</p> <ol style="list-style-type: none"> 1. Establish and staff PMU, project implementation units, project steering committee, and <i>aimag</i> working groups (Q1 2011). 2. Establish all working arrangements, procedures, and responsibilities for project (Q1 2011). 3. Tender, award, and engage consultants to implement planning reforms and structure plan preparation (Q3 2012). 4. Prepare urban plans for all project towns (Q2 2014). 5. Tender, award, and engage consultants to support development of enhanced regulatory and institutional arrangements for service delivery (Q3 2012, Q4 2016, Q4 2018). 6. Establish and make operational a service delivery organization and prepare rolling annual business and investment plans (Q4 2014). <p>Outputs 4–10</p> <ol style="list-style-type: none"> 1. Tender advisory consultancy assistance for preparation of reference designs and management of D&B contracting (Q2 2012). 2. Complete reference designs and prepare D&B and operating management contract documents (Q3 2012). 3. Tender D&B and operating management contract; select preferred tender; and negotiate, prepare, and agree on 			

Key Activities with Milestones			
contract (operating management contract Q4 2014).			
4. Establish service provider and commence implementation of priority infrastructure improvements (Q4 2014).			
5. Implement construction and rehabilitation of priority infrastructure improvements and new WWTPs (Q2 2013–Q4 2021).			
6. Implement the social and gender action plan (throughout project implementation).			
Inputs			
Asian Development Bank			
Loan	Grant	Technical Assistance Grant	Technical Assistance Loan
\$19.43 million (current)	\$15.00 million (current)	\$0.00 (current)	\$0.00 (current)
\$20.00 million (additional)	\$0.00 (additional)	\$0.00 (additional)	\$0.00 (additional)
\$39.43 million (overall)	\$15.00 million (overall)	\$0.00 (overall)	\$0.00 (overall)
Cofinancier			
Loan	Grant	Technical Assistance Grant	Technical Assistance Loan
\$0.00 (current)	\$0.00 (current)	\$1.00 million (current)	\$0.00 (current)
\$0.00 (additional)	\$0.00 (additional)	\$0.00 (additional)	\$0.00 (additional)
\$0.00 (overall)	\$0.00 (overall)	\$1.00 million (overall)	\$0.00 (overall)
Government			
\$8.61 million (current)			
\$1.75 million (additional)			
\$10.36 million (overall)			
Assumptions for Partner Financing			
Not applicable			

D&B = design and build, km = kilometer, m³ = cubic meter, PMU = project management unit, PUSO = public utility service organization, Q = quarter, SWM = solid waste management, WWTP = wastewater treatment plant.

^a National Development and Innovation Committee. 2010. *Infrastructure Development Plans for the Southern Gobi*. Ulaanbaatar; and Government of Mongolia. 2016. *Government Action Plan, 2016–2020*. Ulaanbaatar.

^b “Overall project” refers to the current project and the proposed additional financing.

^c Urban governance refers to local government land use planning and allocation to achieve effective spatial development of urban areas, oversight of basic urban services provision, and accountability for carrying out these functions.

^d Refers to the information presented in the Revised Design and Monitoring Framework (Appendix 1) of ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Additional Financing and Administration of Technical Assistance Grant to Mongolia for the Southeast Gobi Urban and Border Town Development Project*. Manila.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=42184-027-3>

1. Loan Agreement
2. Project Agreement
3. Sector Assessment (Summary): Water and Other Urban Infrastructure and Services
4. Project Administration Manual
5. Summary of Project Performance
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Financial Analysis
9. Economic Analysis
10. Country Economic Indicators
11. Summary Poverty Reduction and Social Strategy
12. Risk Assessment and Risk Management Plan
13. Social and Gender Action Plan
14. Initial Environmental Examination
15. Land Acquisition and Resettlement Plan

Supplementary Documents

16. Environmental Management Plan
17. Financial and Economic Analysis
18. Financial Management Assessment
19. Procurement Capacity Assessment