



Report and Recommendation of the President to the Board of Directors

Project Number: 50165-003
November 2020

Proposed Loan and Grant for Additional Financing Kingdom of Bhutan: Phuentsholing Township Development Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 October 2020)

Currency unit	–	ngultrum (Nu)
Nu1.00	=	\$73.800
\$1.00	=	Nu0.01355

ABBREVIATIONS

ADB	–	Asian Development Bank
CDCL	–	Construction Development Corporation Limited
COVID-19	–	coronavirus disease
DHI	–	Druk Holding and Investments Limited
EIRR	–	economic internal rate of return
O&M	–	operation and maintenance
PAM	–	project administration manual
SAP	–	strategic action plan

NOTE

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

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 50165-003	
Project Name	Phuentsholing Township Development Project - Additional Financing	Department/Division	SARD/SAER
Country	Bhutan	Executing Agency	Druk Holding and Investments Limited
Borrower	Kingdom of Bhutan		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=50165-003-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=50165-003-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Other urban services		2.50
	Urban flood protection		12.00
	Urban sanitation		3.00
	Urban sewerage		4.00
	Urban solid waste management		4.00
	Urban water supply		3.00
	Total		28.50
3. Operational Priorities		Climate Change Information	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
✓ Accelerating progress in gender equality		Climate Change impact on the Project	High
✓ Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability			
✓ Making cities more livable		ADB Financing	
✓ Strengthening governance and institutional capacity		Adaptation (\$ million)	0.05
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.5		Some gender elements (SGE)	✓
SDG 5.5			
SDG 6.1		Poverty Targeting	
SDG 10.2		General Intervention on Poverty	✓
SDG 11.1, 11.5, 11.6, 11.7			
SDG 12.2			
SDG 13.a			
4. Risk Categorization:	Low		
5. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		28.50	
Sovereign Project grant: Asian Development Fund		10.00	
Sovereign Project (Concessional Loan): Ordinary capital resources		18.50	
Cofinancing		0.00	
None		0.00	
Counterpart		1.50	
Government		1.50	
Total		30.00	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed loan and (ii) a proposed grant, both to the Kingdom of Bhutan for the additional financing of the Phuentsholing Township Development Project.

2. The proposed additional financing will cover cost overruns of the ongoing Phuentsholing Township Development Project.¹ The ongoing project will construct river walls and raise ground levels to protect Phuentsholing city and a new township from floods and riverbank erosion. It will also develop common infrastructure on about 66 hectares (ha) of new urban land to enable the safe and sustainable expansion of human settlements and commercial activities. The project will also support capacity development to improve flood risk management and the delivery of urban services.

II. THE PROJECT

A. Rationale

3. Bhutan's development strategy has a focus on the potential of growth centers in the south near the Indian border to boost export-oriented industrial development. Bhutan's Eleventh Five-Year Plan, 2014–2018 identified Phuentsholing as a regional growth center that could be safely expanded through the construction of flood protection works and planned urbanization.² Located on two major trade corridors developed under the South Asia Subregional Economic Cooperation framework, Phuentsholing handles more than 80% of Bhutan's trade and is the country's largest commercial and industrial hub and main trading gateway with India. Phuentsholing is also Bhutan's second most populous city, with 25,000 residents, and is anticipated to grow by 5% per year subject to land availability.³

4. Land scarcity is a key growth constraint for Phuentsholing, which is physically confined by steep and unstable Himalayan foothills, the Amochhu River, and an international border. The city is vulnerable to precipitation- and earthquake-triggered landslides and has been significantly impacted by flood damage and riverbank erosion. The impacts of flash floods triggered by monsoon rains are being experienced more frequently because of urban expansion into unsafe areas, increasingly dense urban development, the loss of natural ground cover, and climate change.⁴ Since 2002, the Government of Bhutan has worked to mitigate Phuentsholing's land constraints and exposure to geophysical and flood hazards. It has constructed flood and erosion defenses along the Amochhu and Omchhu rivers and planned for city expansion away from the mountain slopes to flat areas suitable for residential, commercial, and recreational uses.⁵

5. The Phuentsholing Township Development Project supports the government with achieving these mitigation efforts by strengthening flood defenses and constructing safe, new urban areas. The ongoing project was approved by the Asian Development Bank (ADB) Board of

¹ Asian Development Bank (ADB). 2018. [*Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to the Kingdom of Bhutan for the Phuentsholing Township Development Project*](#). Manila. ADB provided ADB. 2016. [*Project Preparatory Technical Assistance Report to the Kingdom of Bhutan for the Amochhu Land Development and Township Project*](#). Manila. The Phuentsholing Township Development Project will develop the first 66 hectares of 460 hectares that are ultimately planned for development.

² Government of Bhutan. 2013. *Eleventh Five-Year Plan, 2014–2018*. Thimphu.

³ Government of Bhutan, Ministry of Works and Human Settlements. 2013. *Phuentsholing Structure Plan 2013–2028 (Vol. 01)*. Thimphu. Phuentsholing receives more inward migration from rural areas than any other city in Bhutan.

⁴ The most devastating event in recent history was Cyclone Alia in 2009, which caused loss of land and infrastructure.

⁵ Government of Bhutan. 2004. *Urban Development Plan, 2002–2017: Phuentsholing, Bhutan*. Thimphu.

Directors on 5 June 2018 and was financed by a concessional loan of \$28.74 million from ADB's ordinary capital resources and a grant of \$24.26 million from ADB's Special Funds resources (Asian Development Fund). Under the project, about 66 hectares of vacant riparian land immediately adjacent to the existing city along the left bank of the Amochhu River are being developed, based on the Amochhu Development Master Plan.⁶ The executing agency is Druk Holding and Investments Limited (DHI), which is a state-owned entity, and the implementing agency is the Construction Development Corporation Limited (CDCL), a fully owned subsidiary of DHI. The closing date for the loan and grant under the ongoing project is 31 December 2025.

6. Specifically, activities under the ongoing project are (i) constructing river walls and common urban infrastructure in a new greenfield area, (ii) raising land, (iii) installing a flood early warning system, (iv) implementing a flood management plan, and (v) helping the government prepare subsequent phases of development. To implement and administer the new urban area, the government is applying a new integrated project modality by entrusting DHI and CDCL to implement and sustainably operate and maintain the river defenses, building plots, and common urban infrastructure. The ongoing project will also build the capacity of both the new township office and Phuentsholing municipality to ensure that coordination and high service standards are achieved, while ensuring the disaster resilience of the facilities with proper monitoring and maintenance.

7. **Coronavirus disease (COVID-19) pandemic.** The project remains highly relevant in a post covid-19 strategic context. Efforts are being made to restart the economy and mitigate the adverse impact of the lockdown, particularly on employment of the vulnerable population. The additional financing will provide needed support for the long-term growth prospects of the economy. The construction of the river walls and new township is generating local employment, the new commercial area will stimulate the local economy and create service sector jobs, and the new town will be equipped with new hospitals and clinics that offer health services and medical supplies.

8. **Ongoing project performance.** The ongoing project is performing well. It was rated *on track* since project effectiveness and, as of 20 August 2020, had achieved 96% of projected cumulative contract awards (\$37.6 million) and exceeded cumulative disbursement targets (\$22.8 million, 135% of projections). The ongoing project is also on track to achieve the project outputs. In terms of physical achievements, output 1 activities (flood and erosion protection measures) are under way, and the construction of the wall and backfilling are due to be completed in July 2021. Output 2 activities (municipal infrastructure) will start in April 2021, supported by output 3 (installation of township management systems), which will be initiated in the first quarter of 2022. The compliance with safeguard policy requirements of the ongoing project is proceeding satisfactorily. All risks detailed in the risk assessment and risk management plan are being managed successfully.

9. **Reason for additional financing.** The additional financing will finance cost overruns on the ongoing project. Since the project appraisal, the cost increase is attributed to two civil works packages: the river protection works, and the urban common infrastructure. The river protection works contract was awarded in July 2018 and was 37% higher than the engineer's estimate.⁷ The higher bid price was the results of the delayed approval of the ongoing project and the lowest

⁶ Government of Bhutan, Druk Holding and Investments Limited. 2017. *Amochhu Development Master Plan*. Thimphu. The master plan is aligned with the Phuentsholing Structure Plan 2013–2028.

⁷ The contract was awarded on 18 July 2018 to the second lowest responsive bid, which was 37% higher than the engineer's estimate (\$45.09 million compared with the engineer's estimate of \$32.80 million).

bidder withdrawing after its specialist equipment for wall construction was no longer available.⁸ The contract's price adjustments (labor, steel, cement, fuel, and lubricant) have also been higher than expected at project appraisal, increasing the contract price by 12% compared with the standard 5% price contingency provided. The updated contract amount also allows for upgrading a short section of the Omchhu River's banks (360 meters) which is contiguous with the ongoing works (4 kilometers).⁹ Overall, the river protection works contract increased from \$33 million to \$48 million (145%). The common urban infrastructure package has also increased since project appraisal, when only its feasibility level design and cost estimate were available. The detailed designs and engineer's estimate are now completed, and the package's cost has increased from \$11.9 million to \$20.8 million. The asset management system costs also increased with the finalized cost estimate and incorporating the maintenance equipment costs of \$2.1 million. Additional financing includes 10% contingencies as the river protection works package is still under construction and the common urban infrastructure package has yet to be awarded. The activities under the additional financing are expected to be completed by 31 December 2025, which is the closing date of the loan and grant under the ongoing project.

10. **Eligibility criteria for additional financing.** The additional financing project meets the eligibility criteria for additional financing. The overall project (i) remains technically feasible and economically viable; (ii) is accorded high priority by the government; (iii) is consistent with the project's development objectives; (iv) is consistent with ADB's country partnership strategy for Bhutan, 2019–2023;¹⁰ and (v) is aligned with ADB's Strategy 2030 operational priorities of (a) making cities more livable; (b) tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability; and (c) strengthening governance and institutional capacity.¹¹ The additional financing is included in ADB's country operations business plan for Bhutan, 2020–2022.¹²

11. **Suitability of using additional financing.** Additional financing is the most appropriate way to fund the cost overruns to complete the project in the most efficient way while providing the township with the requisite physical and institutional resilience against the impact of the natural disasters. The project will be completed within the ongoing project completion date. Through this approach, current effective implementation arrangements—such as the project steering committee, executing and implementing agencies, project implementation unit, and civil works contractor and supervisor—will be maintained to ensure a high degree of readiness for the implementation of the additional financing.

⁸ The circulation of the report and recommendation of the President to the Board awaited the consultations by the government with a neighboring country. Meanwhile, the executing agency chose to delay contract award until ADB confirmed the Board consideration date.

⁹ The Omchhu River is a tributary of the Amochhu River that flows through Phuentsholing. The additional financing will extend the Omchhu River protection wall constructed under the ongoing project and within the existing project boundaries.

¹⁰ ADB. 2019. [Country Partnership Strategy: Bhutan, 2019–2023—Fostering Diversification and Reducing Disparities](#). Manila.

¹¹ ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

¹² ADB. 2019. [Country Operations Business Plan: Bhutan, 2020–2022](#). Manila.

B. Project Description

12. The impacts and outcome of the overall project will remain unchanged. The project is aligned with the following impacts: (i) balanced and sustainable development of human settlements ensured (footnote 2) and (ii) smart growth principles applied in planning and development¹³. The project will have the following outcome: Phuentsholing's urban area protected from floods and expanded with improved amenities and services.¹⁴

13. The outputs of the overall project will remain unchanged. These are (i) flood and erosion protection measures installed, (ii) municipal infrastructure constructed, and (iii) township management systems installed. The additional financing will finance cost overruns experienced across all three project outputs.

C. Value Added by ADB

14. During preparation of the ongoing project, ADB helped the government incorporate integrated urban planning principles that address the social, economic, environmental, and physical aspects of the new township into the township master plan. During implementation, ADB has continued to support DHI and CDCL with improving the detailed designs of the common urban infrastructure. ADB has also supported DHI and CDCL with (i) streamlining coordination between the new township and Phuentsholing municipality to enhance service delivery, connectivity, and links with the existing city and ongoing and future multisector ADB projects; (ii) developing a sustainable and effective model for township management; (iii) ensuring sustainability by embedding the project within longer-term strategic plans for the wider economic area; and (iv) ensuring that strong marketing machinery is in place to attract investors. ADB's support has resulted in development of a strategic action plan (SAP) for sustainable township management. The plan was updated and elaborated during preparation of the additional financing, based on progress achieved and outstanding tasks associated with developing a legal, institutional, and administrative framework for the new township. The project will improve the capacity and competitiveness of the Phuentsholing urban area and complement the efforts of the ADB-supported South Asia Subregional Economic Cooperation Program, which has enabled greater connectivity and facilitated trade between Bhutan and other countries in the region.

D. Summary Cost Estimates and Financing Plan

15. The overall project is estimated to cost \$93.00 million (Table 1). Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM).¹⁵

¹³ Government of Bhutan, Ministry of Works and Human Settlements. 2013. *Phuentsholing Structure Plan 2013–2028*. Thimphu.

¹⁴ The design and monitoring framework is in Appendix 1. One indicator (output 1b) in the design and monitoring framework has been revised.

¹⁵ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

Table 1: Summary Cost Estimates
(\$ million)

Item	Current Amount ^a	Additional Financing	Total ^b
A. Base Cost^c			
1. Output 1: Flood and erosion protection measures installed	47.31	2.51	49.82
2. Output 2: Municipal infrastructure constructed	11.90	14.28	26.18
3. Output 3: Township management systems installed	2.74	2.09	4.83
Subtotal (A)	61.95	18.88	80.83
B. Contingencies^d	0.00	10.67	10.67
C. Financing Charges During Implementation^e	1.05	0.45	1.50
Total (A+B+C)	63.00	30.00	93.00

^a Refers to the original approved amounts for the ongoing project.

^b Includes taxes and duties of \$0.15 million. Such amount does not represent an excessive share of the project cost. The Government of Bhutan will finance taxes and duties of \$0.15 million in the form of cash contribution. The government will also provide exemption from import duties on civil works and equipment contracts to be financed by the project. The value of this exemption is estimated to be \$3.84 million.

^c In May 2020 prices.

^d Physical contingencies computed at 10% for civil works and equipment for the overall project. Price contingencies computed, on average, at 0.3%–1.6% on foreign exchange costs and 3.8%–5.0% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate for the overall project from 2021. Ongoing project contingencies have been reallocated to output 1 and contingencies for the ongoing and yet-to-be-awarded contracts are shown under additional financing.

^e Includes interest. Interest during construction for the concessional ordinary capital resources loan has been computed at the applicable interest rate during the grace period (1.0% per year).

Source: Asian Development Bank estimates.

16. The government has requested (i) a concessional loan of \$18.5 million from ADB's ordinary capital resources and (ii) a grant not exceeding \$10.0 million from ADB's Special Funds resources (Asian Development Fund) to help finance the project. The loan will have a 32-year term, including a grace period of 8 years, an interest rate of 1.0% per year during the grace period and 1.5% per year thereafter, and such other terms and conditions set forth in the draft loan and project agreements. The government will provide the loan and grant proceeds to DHI through a subsidiary financing agreement. The subsidiary loan will have a 32-year term, including a grace period of 8 years, and an interest rate of 1.00% per year during the grace period and 2.55% thereafter. The grant will be provided as a grant to DHI.

17. The government will ensure that the counterpart funds for the project are provided in a timely manner and has assured that it will cover any shortfall in the finance required to meet the agreed outputs. The summary financing plan is in Table 2.

Table 2: Summary Financing Plan

Source	Ongoing ^a		Additional Financing		Total	
	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)
Asian Development Bank						
OCR (concessional loan) ^b	28.74	45.6	18.50	61.7	47.24	50.8
Special Funds resources (ADF grant) ^c	24.26	38.5	10.00	33.3	34.26	36.8
Government of Bhutan	10.00	15.9	1.50	5.0	11.50	12.4
Total	63.00	100.00	30.00	100.0	93.00	100.0

ADF = Asian Development Fund, OCR = ordinary capital resources.

^a Refers to the original approved amounts for the ongoing project.

^b Additional financing includes \$10 million from ADF 12 disaster risk reduction funding.

^c ADF 12 disaster risk reduction funding will finance \$10 million of the additional financing.

Source: Asian Development Bank estimates.

18. For the additional financing, climate adaptation is estimated to cost \$50,000. ADB will finance 100% of adaptation costs.¹⁶ The climate change risk is *high* because of the increased frequency and magnitude of extreme precipitation events. In response to these risks, the project design incorporates increased river training wall levels and embankment level to account for increased flood flows.

E. Implementation Arrangements

19. The implementation arrangements are summarized in Table 3 and described in detail in section III of the PAM (footnote 15). The implementation arrangements for the overall project will remain unchanged. DHI will serve as the executing agency and CDCL as the implementing agency.

Table 3: Implementation Arrangements

Aspects	Arrangements
Implementation period	December 2020–December 2025
Estimated completion date	30 June 2025
Estimated loan and grant closing date	31 December 2025
Management	
(i) Oversight body	Project advisory committee Chief executive officer, DHI (chair) Executive secretary or chief urban planner from Phuentsholing <i>thromde</i> (municipalities); chief urban planner, Ministry of Works and Human Settlement; chief level, Department of Hydrology, Ministry of Economic Affairs; chief level, Ministry of Finance; chief executive officer, CDCL (members) Project director, CDCL (member secretary)
(ii) Executing agency	DHI, a wholly owned holding company of the Government of Bhutan, was established in 2007 to hold and manage the government's existing and future investments for the long-term benefit of Bhutan.
(iii) Key implementing agencies	The CDCL, a wholly owned subsidiary of DHI, is responsible for preparing and implementing construction projects throughout Bhutan, including this project.

¹⁶ Climate Change Assessment (accessible from the list of linked documents in Appendix 2).

Aspects	Arrangements		
(iv) Implementation unit	Project management unit, Thimphu, 11 staff members Project implementation unit, Phuentsholing, 22 staff members		
Procurement	International competitive bidding	4 contracts	\$68.33 million
Consulting services	Quality- and cost-based selection	414 person-months	\$7.50 million
	Individual consultant selection	16 person-months	\$0.28 million
Retroactive financing and/or advance contracting	Advance contracting and retroactive financing of civil works and consulting services. Retroactive financing for civil works will be considered for eligible expenditures not exceeding 20% of the loan and grant amounts incurred prior to effectiveness, but not earlier than 12 months before the loan and grant agreements are signed.		
Disbursement	The loan and grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.		

ADB = Asian Development Bank, CDCL = Construction Development Corporation Limited, DHI = Druk Holding and Investments Limited.

Source: Asian Development Bank.

20. **Project readiness in the context of COVID-19.** Readiness is high as additional financing is for the ongoing project where the first civil works package is already under construction and the second major civil works has been tendered. The implementation consultants, recruited in 2016, will continue to support the overall project. The COVID-19 pandemic has not affected the project's implementation arrangements or overall cost. A nationwide lockdown was imposed by the government on 11 August 2020 and project construction works were stopped for 38 days. The additional financing implementation period of 5 years provides adequate cushion for the lockdown delay and the project is programmed to be completed within the existing implementation period. Based on government orders, health and safety guidelines and standard operating procedures on construction sites have been developed and are being strictly implemented, with compliance monitoring being ensured by the project manager.

III. DUE DILIGENCE

21. The additional financing is to bridge cost overruns within the existing project scale and scope. Due diligence was carried out on the economic viability and the financial sustainability of the whole project.

A. Technical

22. The ongoing project and the additional financing remain technically feasible and comply with Bhutanese and international engineering standards, local regulations, and conditions. The strengthening of existing river walls along the Omchhu River (footnote 9) maintains the same design as the river protection works being constructed under the ongoing project, the design of which included a thorough evaluation of hydrological, hydraulic, and sediment transport conditions to assess probable flood levels; the projected impact of climate change; sedimentation; and scour. The section of the Omchhu River in which the works will take place is an engineered channel and the works will not extend beyond the width of the existing river channel. Urban infrastructure design incorporates smart technology to monitor water supply and wastewater operations to ensure maximum efficiency in the management of assets. Since the same climate baseline and

projections are still applicable and the expected impacts are the same as for the ongoing project, the climate risk and vulnerability assessment prepared during project appraisal remains applicable.

B. Economic and Financial Viability

23. **Economic analysis.** Increased land value accounts for about 75% of total project benefits, with reduced flood damage to infrastructure and increased benefits from water and power supply accounting for the remaining 25%. Given several uncertainties related to the project, a risk modeling framework was used to estimate the value of the project benefits. With the additional financing included, the project's mean economic internal rate of return (EIRR) has reduced from 11.28% at project appraisal to 9.87%. The economic analysis indicates that the overall project is economically viable. The project's economic feasibility is sensitive to unfavorable changes in investment costs and economic benefits. However, within the expected range of variations of these key variables, the EIRR remains above the economic opportunity cost of capital of 9% unless investment costs increase by 10.20% or benefits decrease by 8.54%. The project's EIRR is less sensitive to changes in operation and maintenance (O&M) costs. The poverty impact ratio was estimated at 4.1%. It is assumed that occupants of residential housing—including social housing reserved for the poor—will value the new land they occupy at higher lease rates than would be payable to the government, primarily because the quality of urban infrastructure and services will be much better than can be found elsewhere in Bhutan.

24. **Financial analysis.** The overall project's financial sustainability assessment was updated in accordance with ADB's guidelines. The project's cash inflows mainly comprise revenues generated from leasing the developed land, which the government will promote to investors with financial and regulatory incentives. Revenues will also include water supply, wastewater treatment, and solid-waste management service charges. The financial analysis found the project, including the additional financing, to be financially viable. The net present value is positive and the internal rate of return of 2.64% is higher than the weighted average cost of capital of 1.39%. The financial internal rate of return is sensitive to adverse changes in variables such as increase in construction cost, increase in O&M costs, and decrease in lease revenues. However, the project remains financially viable under most adverse scenarios, except for a decrease of lease rates of more than 23%. The project supports the establishment of the new township's institutional arrangements and implementation of the SAP, which includes a time-bound plan for the O&M.¹⁷ Further, the urban works package includes 5 years of O&M, which will further mitigate the financial sustainability risk.

C. Sustainability

25. This project will develop a modern township designed on sustainable principles of equity, livability, and competitiveness. The project is expected to provide opportunities for investment, create jobs, and relieve existing housing pressures. Integrated planning and infrastructure, strengthening DHI institutionally, and creating a township management unit will ensure the sustainability of investments in a climate- and disaster-resilient township. The project's commercial approach, support for investor outreach, and strong focus on O&M will ensure the new township's financial and operational sustainability (para. 24). Moreover, expanding the municipality's tax base will help it finance its own investments and operations.

¹⁷ The PAM includes the draft SAP, which is to be approved by the Ministry of Works and Human Settlements. To mitigate the risk of delays in SAP approval, the SAP has been included in the loan agreement and will be monitored through quarterly progress reports.

D. Governance

26. **Financial management.** An updated financial management assessment has been conducted for the CDCL, in accordance with ADB's guidelines.¹⁸ The financial management assessment found that the CDCL has adequate financial management capacity to (i) record the required financial transactions, (ii) provide reliable annual financial statements and audit reports, and (iii) safeguard the financial assets. The assessed pre-mitigation financial management risk is *moderate* because of the following: (i) complex financing structure with five sources of financing; (ii) there is scope for improving the quality of financial reporting under the ongoing project; and (iii) in the past, there has been delay in submitting the audited project financial statements to ADB. The main risk mitigation actions are (i) providing training in ADB's financial management and disbursement procedures and systems; (ii) strengthening the frequency, timeliness, and quality of financial reporting; and (iii) adopting measures to ensure that the audited project financial statements are submitted to ADB on time. As per established practice, the project financial statements will be audited annually by an auditor acceptable to ADB, following auditing standards acceptable to ADB.

27. **Procurement.** All procurement and recruitment of consultants to be financed by the ADB loan and grant will be carried out in accordance with the ADB Procurement Guidelines (2015, as amended from time to time) and Guidelines on the Use of Consultants (2013, as amended from time to time). The additional strengthening of the Omchhu River's banks will be included in the ongoing civil works contractor's scope as a contract amendment. The municipal infrastructure is part of the procurement plan of the ongoing project. The procurement of goods and the landscaping component will be procured separately from the municipal infrastructure package because of their small value.

28. The procurement capacity assessment conducted for the ongoing project concluded that the project's overall procurement risk is *moderate*.¹⁹ Procurement specialists supporting the ongoing project will continue to help the CDCL prepare and evaluate bids.

29. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, DHI, and the CDCL. The specific policy requirements and supplementary measures are described in the PAM (footnote 15).

E. Poverty, Social, and Gender

30. **Poverty.** The erosion and annual flooding experienced by the existing municipality disproportionately affects the poor, who lack the resources to cope and recover quickly. By addressing this problem, the project is expected to boost the economy, create more and better employment opportunities in the longer term, and help alleviate poverty. Moreover, adding housing stock to the new township will relieve pressure in the existing municipality by making housing more affordable. Therefore, the project will directly benefit vulnerable local inhabitants in several ways. The second project output includes the development of recreation areas and pedestrian safety features such as streetlights, public toilets, road markings, ramps, and footpaths. The ongoing project summary poverty reduction and social strategy has been updated for the additional financing.²⁰

¹⁸ ADB. 2009. [Financial Due Diligence: A Methodology Note](#). Manila; and Financial Management Assessment (accessible from the list of linked documents in Appendix 2).

¹⁹ ADB. 2018. [Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to the Kingdom of Bhutan for the Phuentsholing Township Development Project](#). Manila.

²⁰ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

31. **Gender.** The project is categorized as having some gender elements as it will promote women's participation in project consultations and reduce women's time poverty through improved urban infrastructure services, including water and sanitation. Women and women's organizations, differently abled people, the elderly, and children will be encouraged to participate in public planning meetings associated with the project, especially those related to the development of municipal infrastructure and the flood early warning system. The civil works contracts include labor provisions to ensure that women and men receive equal pay for equal work, and that hygiene, HIV prevention, and COVID-19 awareness campaigns are conducted for laborers and local communities. The additional financing will continue to aim for at least 30% female participation in the community consultations and awareness campaigns, when possible.

F. Safeguards

32. The social and environmental safeguard requirements for the ongoing project are unchanged. The additional financing will cover the shortfall in the loan and grant amount resulting from cost increases to complete the components in the ongoing project. The environmental and social safeguards plan implementation, monitoring, and reporting and the grievance redress mechanism established for the ongoing project will remain unchanged and will also be applicable to the additional financing.

33. **Involuntary resettlement (category C) and indigenous peoples (category C).** The ongoing project will remain category C for involuntary resettlement and for indigenous peoples. The additional financing is also classified C for involuntary resettlement and indigenous peoples in compliance with ADB's Safeguard Policy Statement (2009).²¹ There are no indigenous peoples living in the project site and no land acquisition is envisaged for the additional financing. Social safeguard measures will be achieved in line with the provisions stated in the PAM and no land acquisition and resettlement plan or indigenous peoples plan will be required.

34. **Environment.** The ongoing project will remain category A for environment. The additional financing will be category C for environment as it will have no significant adverse environmental impacts. The existing environmental management plan will be updated to include the strengthening of an additional 360 meters of the Omchhu River protection wall. Since the majority of additional financing funds will be used for covering cost overruns and the scope of the river wall extension works are minor, no significant adverse environmental impacts are anticipated. Therefore, no changes to the ongoing project environmental impact assessment will be required.

35. To date, the CDCL is satisfactorily implementing all safeguards requirements, and any safeguard implementation issues arising during implementation are being addressed effectively. The CDCL submits environmental safeguard monitoring reports to ADB, and these are reviewed and disclosed in accordance with ADB's Safeguard Policy Statement. The project's safeguard and environmental specialists will continue (i) building the capacity of the CDCL and relevant stakeholders in environmental monitoring, (ii) ensuring that the project is implemented in accordance with social and environmental safeguard requirements, and (iii) monitoring safeguard compliance. An independent environmental monitoring expert is already engaged by the CDCL under the ongoing project. The expert will continue to monitor project implementation and document implementation of the environmental management plan and compliance with ADB's Safeguard Policy Statement and the government's environmental clearance.

²¹ ADB. [Safeguard Categories](#).

G. Summary of Risk Assessment and Risk Management Plan

36. Significant risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.²²

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Lower than expected demand for leasable land that may be exacerbated by the impacts of the coronavirus disease (COVID-19) pandemic.	The grant financing will be on-granted to Druk Holding and Investments Limited (DHI), and favorable onlending terms will apply to the loan financing amount. These measures will enable DHI to offer competitive lease rates. The project will also appoint a reputable firm to help DHI attract investors and provide transaction advisory services.
Disasters triggered by natural hazards, pandemics, and extreme weather conditions lead to implementation delays.	There are no plausible mitigation measures to manage disasters triggered by natural hazards that may prevent or delay implementation. Measures to control COVID-19 may also slow down construction schedules. Nevertheless, implementation delays are not expected, primarily because the works are routine and contract packages have already been prepared. The project environmental management plan will contain measures to control COVID-19.

Source: Asian Development Bank.

IV. ASSURANCES

37. The government, DHI, and the CDCL have assured ADB that implementation of the 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 loan and grant documents.

38. The government, DHI, and the CDCL have agreed with ADB on certain covenants for the project, which are set forth in the draft loan and grant agreements.

V. RECOMMENDATION

39. I am satisfied that the proposed loan and grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the loan of \$18,500,000 to the Kingdom of Bhutan for the additional financing of the Phuentsholing Township Development Project, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% per year thereafter; for a term of 32 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board; and
- (ii) the grant not exceeding \$10,000,000 to the Kingdom of Bhutan, from ADB's Special Funds resources (Asian Development Fund), for the additional financing of the Phuentsholing Township Development Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant and project agreements presented to the Board.

Masatsugu Asakawa
President

4 November 2020

²² Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

REVISED DESIGN AND MONITORING FRAMEWORK

The revised design and monitoring framework strikes out content for deletion and underlines content to be added.

Impacts the Project is Aligned with ongoing project			
(i) Balanced and sustainable development of human settlements ensured (Eleventh Five-Year Plan, 2014–2018) ^a			
(ii) Smart growth principles applied in planning and development (Phuentsholing Structure Plan 2013–2028) ^b			
Results Chain	Performance Indicators	Data Sources and Reporting Mechanisms	Risks and Critical Assumptions
Outcome Phuentsholing’s urban area protected from floods and expanded with improved amenities and services	By 2026: a. Phuentsholing and reclaimed land protected from 100-year flood events in the Amochhu River (2018 baseline: Phuentsholing is protected from mean annual floods) (OP 3.2.1) b. At least 10% of fully serviced plots tendered for development (2018 baseline: not applicable)	a. Hydrology report at project completion b. Annual reports of Druk Holding and Investments Limited, and Construction Development Corporation Limited	Risk: Lower than expected demand for leasable land that may be exacerbated by the impacts of coronavirus disease (COVID-19).
Outputs 1. Flood and erosion protection measures installed	By 2025: 1a. 4km <u>4.77 km</u> of climate- and erosion-resilient river walls constructed to protect against 100-year probable flood (2018 baseline: 0) (OP 3.2, OP 3.2.5) 1b. At least 66 ha of land reclaimed (2018 baseline: 0) (OP 3.2, OP 3.2.1) 1c. A flood early warning system and community-based flood management plan established and operational (2018 baseline: not applicable) (OP 3.2.4)	1a.–c. Annual project progress reports	Risk: Disasters triggered by natural hazards, pandemics, and extreme weather conditions lead to implementation delays.
2. Municipal infrastructure constructed	2a. 10 km of roads with footpaths, landscaping, and streetlights planned with at least 30% female participation <u>during project consultation</u> (2018 baseline: 0) (OP 4.1, OP 4.1.2)	2a.–i. Annual project progress reports	

	<p>2b. Water treatment plant with a capacity of 4 MLD constructed (2018 baseline: none) (OP 4.1, OP 4.1.2)</p> <p>2c. 12 km of new primary and secondary water mains constructed (2018 baseline: 0)</p> <p>2d. 9 km of new sewer mains and 9 km of new storm drains constructed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p> <p>2e. A sewerage treatment plant with a capacity of 3 MLD constructed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p> <p>2f. A resource recovery system for solid-waste management installed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p> <p>2g. A 630 kVA grid substation constructed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p> <p>2h. 16 circuit-km of 415-volt power distribution lines installed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p> <p>2i. 11 circuit-km of telecommunication transmission cables installed (2018 baseline: 0) (OP 4.1, OP 4.1.2)</p>		
<p>3. Township management systems installed</p>	<p>3a. At least 80% of township management staff reported improved knowledge of modern urban management (2018 baseline: not applicable) (OP 6.1.1)</p> <p>3b. An asset management system established with 100% of project infrastructure and facilities geocoded in a database (2018 baseline: not applicable) (OP 4.1, OP 4.2.1)</p>	<p>3a–c. Annual project progress reports</p>	

	3c. At least 10 potential investors attended investor outreach campaigns (2018 baseline: not applicable) (OP 6.1.2)		
<p>Key Activities with Milestones</p> <p>1. Flood and erosion protection measures installed</p> <p>1.1. Award works contract for constructing river walls and land reclamation by June 2018 (<u>completed</u>).</p> <p>1.2. Operationalize flood early warning system (ongoing project March 2020, changed September 2021).</p> <p>1.3. Operationalize flood management plan (ongoing project December 2021, changed December 2022).</p> <p>1.4. Complete and commission all facilities (ongoing project June 2022, changed June 2023).</p> <p>2. Municipal infrastructure constructed</p> <p>2.1. Award works contract for constructing roads, water supply, and sanitation systems (ongoing project June 2021, changed April 2021).</p> <p>2.2. Complete and commission all facilities (June 2024, unchanged).</p> <p>2.3. Procure operation and maintenance equipment (March 2025, unchanged).</p> <p>2.4. Complete first year of 5-year operation contract (June 2025, unchanged).</p> <p>3. Township management systems installed</p> <p>3.1. Recruit urban management advisor (March 2022, unchanged).</p> <p>3.2. Recruit investment promotion advisor (September 2022, unchanged).</p> <p>3.3. Recruit sustainable township management capacity development consultant (December 2022, unchanged).</p> <p>3.4. Initiate activities to build the capacity of township management staff (January 2023, unchanged).</p> <p>3.5. Recruit investor promotion and transaction advisory services consultant (June 2023, unchanged).</p> <p>3.6. Initiate investor promotion activities (July 2023, unchanged).</p> <p>3.7. Establish geographic information system database for built infrastructure (September 2024, unchanged).</p>			
<p>Project Management Activities</p> <p>Mobilize project implementation consultant (<u>completed</u>)</p> <p>The Asian Development Bank undertakes biannual review missions.</p>			
<p>Inputs</p> <p>Asian Development Bank</p> <p>Concessional ordinary capital resources loan: \$28.74 47.24 million (<u>\$18.50 million additional</u>)</p> <p>Asian Development Fund grant: \$234.26 million (<u>\$10.00 million additional</u>)</p> <p>Government of Bhutan: \$40.00 11.50 million (<u>\$1.50 million additional</u>)</p>			

ha = hectare, km = kilometer, kVA = kilovolt-ampere, MLD = million liters per day, OP = operational priority.

^a Government of Bhutan. 2013. *Eleventh Five-Year Plan, 2014–2018*. Thimphu.

^b Government of Bhutan, Ministry of Works and Human Settlements. 2013. *Phuentsholing Structure Plan 2013–2028 (Vol. 01)*. Thimphu.

Contribution to Strategy 2030 Operational Priorities

Note: The expected values and methodological details for all operational priority indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/documents/rfps/?id=50165-003-3>

1. Loan Agreement
2. Grant Agreement
3. Project Agreement: Druk Holding and Investments Limited and Construction Development Corporation Limited
4. Sector Assessment (Summary): Multisector (Agriculture, Natural Resources, and Rural Development; and Water and Other Urban Infrastructure and Services)
5. Project Administration Manual
6. Summary of Project Performance
7. Financial Analysis
8. Economic Analysis
9. Summary Poverty Reduction and Social Strategy
10. Risk Assessment and Risk Management Plan
11. Contribution to Strategy 2030 Operational Priorities
12. Climate Change Assessment

Supplementary Documents

13. Country Economic Indicators
14. Financial Management Assessment
15. Economic Assessment
16. Detailed Financial Analysis and Evaluation