



Project Readiness Financing Report

Project Number: 51335-002
November 2019

Republic of Vanuatu: Luganville Urban Water Supply and Sanitation Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 November 2019)

Currency unit – Vatu (Vt)

Vt1.00 = \$0.0086

\$1.00 = Vt115.5600

ABBREVIATIONS

ADB	–	Asian Development Bank
DWR	–	Department of Water Resources
LMC	–	Luganville Municipal Council
LUWSSP	–	Luganville Urban Water Supply and Sanitation Project
MIA	–	Ministry of Internal Affairs
MLNR	–	Ministry of Lands and Natural Resources
PMU	–	project management unit
PRF	–	project readiness financing
SPGC	–	Sanma Provincial Government Council
TOR	–	terms of reference
VPMU	–	Vanuatu project management unit

NOTE

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

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 51335-002	
Project Name	Luganville Urban Water Supply and Sanitation Project	Department/Division	PARD/PAUW
Country	Vanuatu	Executing Agency	Ministry of Finance & Economic Management
Modality	Project Readiness Financing (Grant)		
Borrower	Government of Vanuatu		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=51335-002-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=51335-002-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Urban policy, institutional and capacity development		1.00
	Urban sanitation		0.80
	Urban water supply		1.20
	Total		3.00
3. Operational Priorities		Climate Change Information¹	
✓ Addressing remaining poverty and reducing inequalities		Climate Change impact on the Project	Medium
✓ Accelerating progress in gender equality			
✓ Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability			
✓ Making cities more livable			
✓ Strengthening governance and institutional capacity			
Sustainable Development Goals		Poverty Targeting	
SDG 1.4		Geographic Targeting	✓
SDG 5.5		Household Targeting	✓
SDG 6.1, 6.2, 6.3, 6.4			
SDG 10.3			
SDG 11.1, 11.5			
SDG 12.4			
4. Risk Categorization:	Low		
5. Safeguard Categorization	Not Applicable.		
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		3.00	
Sovereign Project Readiness Financing (Grant): Asian Development Fund		3.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.50	
Government		0.50	
Total		3.50	
Currency of ADB Financing: US Dollar			

¹ The project reduces greenhouse gas emissions. However, it does not fall under the eligibility criteria for climate mitigation finance as defined by the joint multilateral development bank methodology on tracking climate finance, which notes that not all activities that reduce greenhouse gases in the short term are eligible to be counted towards climate mitigation finance. Accordingly, greenfield fossil fuel projects are excluded, and climate mitigation finance is considered zero.

I. PROJECT READINESS FINANCING

A. Rationale

1. Luganville in Sanma Province is Vanuatu's second largest town after the capital, Port Vila. In 2016, the population of Luganville recorded was 15,951 with a growth rate of 4.9% per year.¹ Luganville town is administered by Luganville Municipal Council (LMC) and has an area of 8,970 hectares. The peri-urban area of Luganville administered by Sanma Provincial Government Council (SPGC) and in 2016 had a population of 3,000 and was estimated to be growing at the rate of 6.8% per year. Luganville is the main administrative, commercial and trans-shipment center for Vanuatu's four northern provinces. The International Airport in Pekoa and the Northern Provincial Hospital are in Luganville. Over 50% of Vanuatu's exports pass through Luganville, with around 12,000 tourist arrivals by air each year, and around 50,000 tourist arrivals by sea.

2. The Department of Water Resources (DWR) provides the water supply service in Luganville supplying 3,030 customers. However, it only covers 51% of households in Luganville Municipality and 10% in peri-urban Luganville. Unconnected households rely on rainwater tanks and shallow wells. Connected households suffer from intermittent water supply with low pressures. Luganville's water supply is sourced from a shallow well at Sarakata which was developed in 1943 and has been poorly maintained. The Sarakata source has water safety issues due to the contamination of the groundwater from surrounding houses, cattle farming, and potential flooding. As a result, the drinking water quality testing frequently fails to meet WHO standards. Annual water intake from the Sarakata source is estimated as 1.51 million cubic meters of which 0.76 million cubic meters is sold to DWR water supply customers. This indicates a non-revenue water ratio exceeding 50%. The poor quality of drinking water has increased disease burden, with negative economic consequences that disproportionately impact women, the poor, and vulnerable sections of the society. Production from the Sarakata water source exceeds the sustainable aquifer yield and drawdown is increasing. The Government recognizes the need to expand and improve the Luganville water supply service and the limited capacity of DWR to achieve its water supply aspirations for Luganville. On that basis, the government proposes to outsource the operation of the Lakatore, Lenakel and Luganville water supply systems to the private sector.²

3. Luganville does not have a sewerage system. Vanuatu's Public Health Act requires landholders to construct on-site sanitation systems, and to maintain them in a sanitary state. The Act delegates enforcement to LMC and SPGC. In 2016, about 68% of Luganville households had improved sanitation, mainly pit toilets and septic tanks.³ LMC currently provides two public toilets facilities managed on user-pays basis and are below the hygiene standards expected by tourists. School sanitation facilities are not adequate and likely impacting on school attendance, especially for girls. Two private contractors provide septage desludging services, with disposal to unregulated and unlined pits on private farmland. However, the septic tanks are not desludged regularly, leading to overflows. Such pollution may contaminate groundwater. A regulated and affordable disposal facility is needed to minimize the risk of environment and health impacts.

¹ Government of Vanuatu. 2017. *2016 Post – TC Pam Mini-Census Report*. Port Vila.

² Government of Vanuatu. 2017. *National Water Policy (2017–2030)*. Port Vila; and Government of Vanuatu. 2017. *Vanuatu Water Policy Institutional Urban Water Options*. Port Vila.

³ UNICEF and WHO define improved sanitation as any flush toilet, water seal toilet, ventilated pit latrine (VIP), pit latrine with slab or composting toilets. Any shared toilet is not counted as improved sanitation.

4. Based on the economic importance and urbanization demands, the Vanuatu government has proposed Luganville Urban Water Supply and Sanitation Project (LUWSSP) which is listed in the ADB's country operations business plan, 2020–2022 for 11 small Pacific island countries.⁴ It will expand the water supply service, improve the water supply quality and reliability, and reduce the nonrevenue water (NRW) in Luganville. Sanitation services will also be improved to minimize the water pollution and improve the hygiene. The project will also have an awareness program to promote sustainable hygiene awareness and behaviors. The program will also foster water conservation and willingness to pay for water supply services. Besides the physical infrastructure, LUWSSP also includes a performance-based service contract to improve the delivery of water supply services in Luganville.

5. The project readiness financing (PRF) will prepare LUWSSP and facilitate a smooth transition to project implementation and will expedite contract awards and initial disbursements. The PRF will finance consulting firms and individual consultants to achieve three outputs—(i) Ensuing project water supply components are procurement and approval ready; (ii) Ensuing project sanitation components are procurement and approval ready; and (iii) Project start-up and capacity-building activities are completed. The PRF is also included in ADB's country operations business plan, 2020–2022 for 11 small Pacific island countries (footnote 4).

B. Outputs and Activities of the Project Readiness Financing

6. **Output 1: Ensuing project water supply components are procurement and approval ready.** This output will support preparatory activities for the proposed service improvement contract for the Luganville water supply system. The PRF will support: (i) detailed investigations and an assessment of existing service levels, (ii) preparation of performance specifications to improve service levels, (iii) preparation of procurement documents, (iv) support for advance contracting, and (v) preparation of due diligence documents for ADB approval of the ensuing project.

7. **Output 2: Ensuing project sanitation components are procurement and approval ready.** Activities will support the detailed design and procurement for the following investments: (i) construction, operation, and maintenance of a septage treatment and disposal facility; (ii) upgrade of selected public toilets and public toilets in schools; and (iii) design of a sanitation pilot activity to be delivered under the ensuing project such as elevated pit latrines in low-lying areas. The PRF will support: (i) detailed investigations and surveys, (ii) detailed designs, (iii) preparation of procurement documents, (iv) support for advance contracting, and (v) preparation of due diligence documents for ADB approval of the ensuing project.

8. **Output 3: Project start-up and capacity-building activities are completed.** Limited human and financial resources and the limited project management and technical capacity within DWR present barriers to the effective delivery of the ensuing project. The PRF will support the establishment of key project management unit (PMU) roles and other activities required to support institutional reform and capacity building of the water and sanitation subsectors.

9. All designs and specifications will include features to (i) address climate change and disaster risk, (ii) address the different gendered needs of end users and local communities, and (iii) ensure accessibility and safety for end users.

⁴ ADB. 2019. *Country Operations Business Plan: 11 Small Pacific Island Countries, 2020–2022*. Manila.

C. Ensuing Project of Luganville Urban Water Supply and Sanitation Project

10. The ensuing project will improve access to safe and reliable water supply and improved sanitation by (i) implementing water supply, sanitation, and hygiene improvements; and (ii) strengthening the institutions managing water supply and sanitation. The indicative financing, for the ensuing project, proposed for 2020, is \$16.6 million comprising a \$3.0 million Asian Development Fund grant, an \$8.0 million concessional loan, and \$5.6 million of grant cofinancing.

D. Cost Estimates and Financing Arrangements

11. The project readiness financing is estimated to cost \$3.5 million (Table 1). Detailed cost estimates by expenditure category are included in the project administration manual.⁵

Table 1: Summary Cost Estimates
(\$ million)

Item	Amount ^a
A. Base Cost^b	
1. Ensuing project water supply components are procurement and approval ready.	1.2
2. Ensuing project sanitation components are procurement and approval ready.	0.8
3. Project start-up and capacity-building activities are completed.	1.2
Subtotal (A)	3.2
B. Contingencies	0.3
Total (A+B)	3.5

^a Includes taxes and duties of about \$0.3 million (17.5% value-added tax on international consultant costs). The Government of Vanuatu will give an exemption on the taxes and duties as its contribution to the project.

^b In mid-2019 prices as of 1 November 2019.
Source: Asian Development Bank estimates.

12. The government has requested a grant not exceeding \$3,000,000 from ADB's Special Funds resources (Asian Development Fund) to help finance the PRF.⁶ The government will provide in-kind contributions of \$0.5 million. The summary financing plan is in Table 2.

Table 2: Summary Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Special Funds resources (ADF grant)	3.0	85.7
Government ^a	0.5	14.3
Total	3.5	100.0

ADF = Asian Development Fund.

^a Government contribution will be in-kind and include exemption from taxes and duties, office space, and key counterpart staff.

Source: Asian Development Bank estimates.

E. Implementation Arrangements

13. The implementation arrangements are summarized in Table 3 and described in detail in the project administration manual (footnote 5). Procurement will follow the ADB's Procurement Policy (2017, as amended from time to time) and Procurement Regulations (2017, as amended from time to time).

⁵ Project Administration Manual (accessible from the list of linked documents in the Appendix).

⁶ ADB will finance consulting services for studies, surveys, detailed design, procurement support, and due diligence.

Table 3: Implementation Arrangements for Project Readiness Financing

Aspects	Arrangements		
PRF implementation period	1 December 2019–30 November 2022		
Estimated PRF completion date	30 November 2022	PRF closing date	30 April 2023
Management			
(i) Executing agency	Ministry of Finance and Economic Management		
(ii) Key implementing agencies	Ministry of Lands and Natural Resources' Department of Water Resources Ministry of Internal Affairs' Department of Local Authorities Luganville Municipal Council		
Procurement	Request for Quotations	3 contracts	\$65,000
Consulting services	Quality- and cost-based selection (90:10)—firm	Output-based contract for design and bidding documents for Luganville Urban Water Supply and Sanitation Project	\$1,450,000
	Consultant's qualification selection—firm	Output-based contract for independent technical design review firm	\$200,000
	Individual consultants	About 28 person-months of international consultant inputs and 66 person-months of national consultant inputs.	\$1,040,000
Advance contracting	Advance contracting will be used to commence consultant selection prior to approval and to accelerate consulting services.		
Disbursement	Disbursements under the project readiness financing grant will be made 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, PRF = project readiness financing.

Sources: Asian Development Bank, Government of Vanuatu, and consultant estimates.

14. The Ministry of Finance and Economic Management will be the executing agency. The implementing agencies for water supply will be the DWR under the Ministry of Lands and Natural Resources (MLNR), and the Department of Local Authorities (under the Ministry of Internal Affairs, MIA) and the LMC for sanitation. A project management unit (PMU) will be established within DWR for day-to-day management of the PRF. Given the capacity limitations of the implementing agencies, the PMU head and several other core PMU roles will be financed by the PRF during the start-up phase.

15. A Luganville infrastructure development steering committee will be set up to help lead and oversee the implementation of the PRF. The steering committee will be responsible for strategic oversight and will report to the Council of Ministers on strategic matters requiring government approval. The core members of the committee will be the directors general or directors of the MIA and MLNR, given their implementation responsibilities. Other ministries may be invited to attend steering committee meetings from time to time when their attendance is relevant to decisions.

16. Consulting firms and individual international and national consultants will be engaged to prepare surveys, designs, specifications, bidding documents, and due diligence documents. All consultants will be recruited in accordance with the ADB Procurement Policy (2017, as amended from time to time) and Procurement Regulations (2017, as amended from time to time). ADB will assist the executing and implementing agencies in preparing the terms of reference (TOR). The government will lead negotiations and award contracts. ADB and the government will jointly evaluate expressions of interest and proposals. Advance actions are under way to recruit firms and individuals. Ongoing implementation-phase advisory services may be included in the consulting firm's TOR, but will be financed under the ensuing project. To assist with technical review, an independent design review firm will be recruited. Outline TORs have been prepared and are included in the project administration manual (footnote 5).

II. DUE DILIGENCE

17. **Technical.** Studies prepared under previous ADB TA demonstrate that (i) the project is technically feasible, economically viable, and financially sound; and (ii) a medium-term service improvement contract for water supply is the most beneficial option for government and customers.⁷

18. **Governance.** The country procurement risk assessment conducted in February 2017 found overall procurement risk to be low at both the country and sector levels, although the proposed implementing agencies were not included in this assessment.⁸ The assessment found that most government departments do not have dedicated procurement staff and lack procurement knowledge and experience. ADB continues to provide specialist TA to the Port Vila-based Vanuatu Project Management Unit (VPMU) to help the government implement projects.⁹ While the executing agency has experience in ADB projects, the proposed implementing agencies have limited capacity and experience in the competitive procurement of goods, works, and consulting services under ADB procedures. To mitigate this risk, the government will (i) recruit an experienced national consultant for the role of PMU head and an international project management advisor, (ii) recruit national procurement and financial specialists for the PMU, and (iii) appoint the DWR's technical manager to negotiate and manage contracts and use the DWR's financial management team and Smartstream software for financial management until the PMU is fully established. Advance actions are under way to recruit the national PMU head, international project management advisor, and the finance and administration officer. Upon commencement, the PMU head will establish the procedures for the PMU, based on the established procedures of the VPMU, and lead the recruitment of other team members. ADB is also providing the services of a water institutional advisor to support the DWR with the institutional and technical aspects of the PRF and the ensuing project and proposed service improvement contract.¹⁰

19. **Safeguards.** Since the proposed activities consist of consulting services only, activities have not been categorized in accordance with ADB's Safeguard Policy Statement (2009). The safeguards categorization for the ensuing project is B for environment and involuntary resettlement, and C for indigenous peoples.

III. THE PRESIDENT'S DECISION

20. The President, acting under the authority delegated by the Board has approved the grant not exceeding \$3,000,000 to the Republic of Vanuatu from the Special Funds resources (Asian Development Fund) of the Asian Development Bank, for Preparing the Luganville Urban Water Supply and Sanitation Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement, and hereby reports this action to the Board.

⁷ ADB. 2017. *Luganville Water Supply Services: PPP Pre-Feasibility Study*. Manila.

⁸ ADB. 2017. *Technical Assistance for Developing Procurement Capacity for Improved Procurement Outcomes-Vanuatu Country and Sector Procurement Risk Assessment*. Consultant's report. Manila (TA 8262-REG).

⁹ ADB. 2018. *Infrastructure and Public Financial Management Support Facility*. Manila.

¹⁰ ADB. 2018. *Technical Assistance for Implementing a Differentiated Approach to Urban Development in the Pacific*. Manila.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=51335-002-PRF>

1. Grant Agreement
2. Project Administration Manual