



# Report and Recommendation of the President to the Board of Directors

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Project Number: 46094-001  
March 2014

Proposed Loan  
Republic of Indonesia: Neighborhood Upgrading and  
Shelter Project (Phase 2)

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 13 Feb 2014)

Currency unit	–	rupiah (Rp)
Rp1.00	=	\$ .0000827472
\$1.00	=	Rp12,085

## ABBREVIATIONS

ADB	–	Asian Development Bank
BKM	–	community implementation organization
CDD	–	community-driven development
DGHS	–	Directorate General of Human Settlements
LCO	–	local coordination office
MDG	–	Millennium Development Goal
MPW	–	Ministry of Public Works
NSD	–	new site development
NUAP	–	neighborhood upgrading action plan
O&M	–	operation and maintenance
PNPM	–	Program Nasional Pemberdayaan Masyarakat (National Program for Community Empowerment)
RPJMN	–	Rencana Pembangunan Jangka Menengah Nasional (National Medium-Term Development Plan)
RTRW	–	Rencana Tata Ruang Wilayah (Spatial Plan)
SPPIP	–	Strategi Pengembangan Permukiman dan Infrastruktur Perkotaan (Strategy for the Development of Urban Settlements and Infrastructure)

## NOTES

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

<b>Vice-President</b>	S. Groff, Operations 2
<b>Director General</b>	J. Nugent, Southeast Asia Department (SERD)
<b>Country Director</b>	A. Ruthenberg, Indonesia Resident Mission (IRM), SERD
<b>Team leader</b>	W. Kubitzki, Principal Portfolio Management Specialist, IRM, SERD
<b>Team members</b>	F.P.A. Arifin, Associate Project Analyst, IRM, SERD A. Gill, Senior Country Specialist, IRM, SERD S. Hasanah, Senior Project Officer, IRM, SERD N. Mardiniah, Safeguards Officer, IRM, SERD Suzana, Senior Operations Assistant, IRM, SERD S. Zaidansyah, Senior Counsel, Office of the General Counsel
<b>Peer reviewers</b>	T. Gallego-Lizon, Principal Urban Development Specialist, South Asia Department, SARD F. Steinberg, Senior Urban Development Specialist, SERD

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## PROJECT AT A GLANCE

<b>1. Project Name:</b> Neighborhood Upgrading and Shelter Project - Phase 2				<b>2. Project Number:</b> 46094-001			
<b>3. Country:</b> Indonesia			<b>4. Department/Division:</b> Southeast Asia Department/Indonesia Resident Mission				
<b>5. Sector Classification:</b>							
		<b>Sectors</b>	<b>Primary</b>	<b>Subsectors</b>			
		Multisector	√	Water supply and sanitation			
				Road transport			
				Urban sector development			
<b>6. Thematic Classification:</b>							
		<b>Themes</b>	<b>Primary</b>	<b>Subthemes</b>			
		Environmental sustainability	√	Urban environmental improvement			
		Private sector development		Promotion of private sector investment			
		Capacity development		Institutional development			
<b>6a. Climate Change Impact</b> No climate change indicator available.				<b>6b. Gender Mainstreaming</b>			
				Gender equity theme (GEN)			
				Effective gender mainstreaming (EGM)		√	
				Some gender elements (SGE)			
				No gender elements (NGE)			
<b>7. Targeting Classification:</b>				<b>8. Location Impact:</b>			
<b>General Intervention</b>	<b>Targeted Intervention</b>			Urban		High	
	<b>Geographic dimensions of inclusive growth</b>	<b>Millennium development goals</b>	<b>Income poverty at household level</b>				
		√ MDG7					
<b>9. Project Risk Categorization:</b> Low							
<b>10. Safeguards Categorization:</b>							
				Environment		B	
				Involuntary resettlement		B	
				Indigenous peoples		C	
<b>11. ADB Financing:</b>							
		<b>Sovereign/Nonsovereign</b>	<b>Modality</b>	<b>Source</b>	<b>Amount (\$ Million)</b>		
		Sovereign	Project loan	Ordinary capital resources	74.4		
		Total			74.4		
<b>12. Cofinancing:</b> No Cofinancing available.							
<b>13. Counterpart Financing:</b>							
				<b>Source</b>		<b>Amount (\$ Million)</b>	
				Beneficiaries		6.0	
				Government		21.6	
				Total		27.6	
<b>14. Aid Effectiveness:</b>							
				Parallel project implementation unit		No	
				Program-based approach		No	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of Indonesia for the Neighborhood Upgrading and Shelter Project (Phase 2).
2. The project will adopt a community-driven development (CDD) approach and provide direct support to slum communities in 20 cities to upgrade basic infrastructure and establish new housing sites. About 670,000 low-income families will benefit from improved access to social services and essential infrastructure.<sup>1</sup>

## II. THE PROJECT

### A. Rationale

3. Indonesia is one of the fastest urbanizing countries in Asia. Currently, about half of the population (51%) lives in cities; this is projected to increase to 68% by 2025. Many of the growing cities are having difficulty coping with the rapid increase of in-migrants seeking new economic opportunities. They are forced to settle in disadvantaged neighborhoods due to limited financial resources, lack of affordable adequate housing, and/or failure to find well-paid jobs.<sup>2</sup> In 2011, about 12.5% of the urban population was forced to live in slum areas.<sup>3</sup> The project will demonstrate an integrated approach to upgrade slum neighborhoods by (i) providing resources directly to disadvantaged communities to improve their living conditions; (ii) establishing new settlements for poor families; and (iii) as part of the capacity development component, assisting local administrations in managing pro-poor urban development including the development of multisector strategies to address urban poverty issues beyond infrastructure upgrading.
4. Better public infrastructure is considered vital to sustain inclusive economic growth and stimulate economic opportunities for the growing urban population. Yet infrastructure improvements have not kept up with the rapid urbanization; infrastructure investment has lagged economic development. Most infrastructure and public services in poor neighborhoods do not meet the needs of the increasing number of inhabitants. Environmental and social problems related to accessibility to adequate services for people's daily needs are increasing due to widespread constraints in the provision of clean water; insufficient sanitation facilities; deteriorating roads, pathways, and drainage; ineffective flood control; lack of constant power supply; and poor solid waste management. Only about 40% of the urban population has access to safe water; about 28% does not have access to improved sanitation facilities. About 35% of urban areas lack proper drainage systems. To meet local needs the project will provide grants to slum communities for upgrading basic infrastructure including improving sanitation facilities and access to safe water.
5. Problems are aggravated by the absence of sound land use planning and land management regulations that are contributing to increased congestion and haphazard informal development. A multifaceted approach is required to address these challenges, including strengthening the capacity of city administrations to manage urban development in an environmentally and socially sustainable manner; modernizing land policies and permit regulations; expanding access to, and targeting of, housing finance and subsidies; increasing community involvement in spatial planning; and engaging the private sector in development planning. Rapid

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> Overall poverty incidence in Indonesia fell to 12% in 2012; the national urban poverty rate was estimated at 9.1%.

<sup>3</sup> The official government publication, Report on the Achievement of the Millennium Development Goals in Indonesia 2011, states that 12.57% of the urban population was living in slums.

urbanization has triggered growing demand for housing; the availability of affordable housing in cities for low-income groups appears to be declining.<sup>4</sup>

6. The National Medium-Term Development Plan, 2010–2015 (RPJMN) identifies insufficient investment in infrastructure as one cause of poverty. Thus improving basic infrastructure is considered an effective catalyst to reduce poverty and close gaps in income inequality in disadvantaged urban neighborhoods. While Indonesia has generally made good progress in accelerating achievement of the Millennium Development Goals (MDGs), the MDG targets for achieving significant improvement in the lives of slum dwellers (MDG target 7D) and halving the proportion of urban households without sustainable access to safe drinking water and basic sanitation (MDG target 7C) need special attention.<sup>5</sup> The project, which aims to upgrade basic public infrastructure in slums, will contribute to meeting both MDG targets. To address issues of the rapid urbanization, the government launched the Cities without Slums Program<sup>6</sup> and issued Law No. 1, 2011, Housing and Settlement Areas.<sup>7</sup> To contribute to the Cities without Slums Program, the government requested the Asian Development Bank (ADB) to prepare and partly finance the Neighborhood Upgrading and Shelter Project (Phase 2) to help 20 cities improve basic infrastructure and living conditions in selected slums.<sup>8</sup>

7. The project builds on lessons from the government's foremost poverty reduction program, the National Program for Community Empowerment (PNPM Mandiri), which adopts a CDD approach and provides nationwide assistance for improving essential social services and basic infrastructure by providing block grants to poor communities.<sup>9</sup> Addressing poverty issues and basic infrastructure needs through CDD is considered more effective, sustainable, and equitable than use of centralized arrangements, as communities become active partners in development. The CDD approach adopted under the PNPM gives communities control over planning decisions and investment resources, and focuses on community empowerment to improve basic infrastructure and service delivery. Community participatory planning and design of specific investments is a key feature. The community controls resources; hence funds are transferred directly to community-managed bank accounts. The community also manages project implementation supported by consultants and facilitators when required. The CDD process is designed to systematically mobilize the capacity of communities to prioritize their development needs, design activities, seek technical assistance, manage resources, and implement and sustain development actions.<sup>10</sup> Building on

<sup>4</sup> According to World Bank estimates published in the Indonesia Economic Quarterly Report (March 2013), 600,000–900,000 housing units are required per year. The number increases as urbanization continues: 700,000–1,000,000 housing units are estimated to be needed per year during 2014–2021.

<sup>5</sup> The 2015 MDG target for the proportion of the urban population living in slums is 6%; in 2011, 12.6% of the urban population lived in slums. The 2015 MDG target for the proportion of households with sustainable access to an improved water source is 75.5%; in 2011, 40.5% of urban households had access to an improved water source, 72.5% had access to basic sanitation. The proportion of households with access to safe water and basic sanitation in slum areas is assumed to be much lower.

<sup>6</sup> The Cities without Slums Program is incorporated in the National Long-Term Development Plan, 2005–2025. It aims to reduce slum areas in cities by 2025 by promoting concerted initiatives by the central and local governments, private sector, and civil society.

<sup>7</sup> The law specifies the roles and responsibilities of central and local governments for providing housing and settlements, including housing for the poor, and upgrading slum areas.

<sup>8</sup> Relevance of the project is discussed in the Sector Assessment (Summary): Urban Infrastructure (accessible from the list of linked documents in Appendix 2).

<sup>9</sup> PNPM Mandiri was launched in 2007. The RPJM, 2010–2014 includes PNPM Mandiri as a development tool to accelerate poverty alleviation with an indicative budget allocation of \$6,754 million over 5 years.

<sup>10</sup> Encouraged by the success of the PNPM scheme, three ADB-financed infrastructure improvement projects were aligned with the PNPM using the project loan modality and adopting a CDD approach: (i) ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Rural Infrastructure Support to the PNPM Mandiri Project*. Manila; (ii) ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Rural Infrastructure Support to the PNPM Mandiri Project II*. Manila; and (iii) ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Republic of Indonesia for the Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project*. Manila.

lessons of the overall PNPM program and the latest ADB-financed CDD projects, the proposed ADB project will follow a similar CDD approach.<sup>11</sup>

8. The project builds on lessons from (i) the first Neighborhood Upgrading and Shelter Sector Project;<sup>12</sup> (ii) the first and second Rural Infrastructure Support to the PNPM Mandiri Projects, and (iii) the ongoing Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project (footnote 10). The Ministry of Public Works (MPW) has been implementing the projects. Lessons incorporated into the project design include (i) involve beneficiaries in the planning and implementation of neighborhood upgrading, (ii) support development of strong political commitment to support pro-poor urban development, (iii) promote integrated development approaches and link upgrading investments of individual communities with overall city development planning, (iv) reduce the number of project cities and neighborhoods to lessen transaction costs in project management, (v) increase the investment amount per neighborhood to boost means for improving living conditions in slums, (vi) provide transparent fund flow and implementation mechanisms, and promote community control of decision-making over resources and investment choices; (vii) develop strong accountability procedures, such as public disclosure of budgets and contracts; and (viii) establish effective mechanisms for operation and maintenance (O&M) of infrastructure.<sup>13</sup> The project is included in ADB's country operations business plan, 2013–2014 for Indonesia and will contribute to achievement of the targets of the results framework of ADB's country partnership strategy, 2012–2014 for Indonesia and ADB's Strategy 2020.<sup>14</sup> The country partnership strategy includes support for government efforts to achieve more inclusive growth by improving basic infrastructure for poor communities in selected cities. The project is aligned with ADB's Urban Operational Plan, 2012–2020 as it (i) provides support to urban shelter sector programs; (ii) contributes to upgrading of local infrastructure in the four core areas of water supply, sanitation, water management, and urban transport; and (iii) improves community services, employment opportunities, and livelihood development.<sup>15</sup>

## **B. Impact and Outcome**

9. The impact of the project will be improved living conditions in urban areas. The outcome will be improved infrastructure and access to service delivery in slum neighborhoods in 20 cities.

## **C. Outputs**

10. The project will have three outputs: (i) institutional capacity for managing pro-poor urban development strengthened; (ii) infrastructure in slum neighborhoods upgraded; and (iii) new settlements for poor families established.

<sup>11</sup> The project loan modality was applied as the project is limited to providing targeted support to improve basic infrastructure in slum neighborhoods of 20 cities, adopts a CDD approach, and does not address overall policy issues or legal and regulatory frameworks, which would require involving other line ministries and government agencies.

<sup>12</sup> ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Republic of Indonesia for the Neighborhood Upgrading and Shelter Sector Project*. Manila. The project closed in December 2010 and is rated *successful*. ADB. 2011. *Completion Report: Neighborhood Upgrading and Shelter Sector Project in Indonesia*. Manila.

<sup>13</sup> In addition to ADB, other development partners have had a long-standing engagement with Indonesia in infrastructure development. In 1999, the WB started the financing of the Urban Poverty Project, which aimed at reducing urban poverty by increasing income of the urban poor, empower urban communities and improve local government capacity to assist the urban poor. The UPP has created momentum for addressing poverty issues and basic infrastructure needs through CDD, which was further developed under the Government's PNPM scheme. An overview on the development cooperation related to urban infrastructure is accessible from the list of linked documents in Appendix 6.

<sup>14</sup> ADB. 2012. *Country Operations Business Plan: Indonesia 2013-2014*. Manila; ADB. 2012. *Country Partnership Strategy. Indonesia, 2012-2014*. Manila; ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

<sup>15</sup> The project will contribute to inclusive development, planning, and governance through capacity building support provided under output 1 and adoption of a CDD approach.

11. **Institutional capacity for managing pro-poor urban development strengthened.** The project will provide capacity building assistance to local administrations in the project cities for (i) community-driven settlement upgrading and new site development (NSD); (ii) building community member awareness on sanitation and hygiene; (iii) project management; (iv) public–private partnerships for NSD, with special focus on the poor; and (v) O&M of upgraded facilities and NSD through community-based efforts. Within the first year of project implementation and with the help of consultants, each participating city will conduct a capacity assessment identifying challenges and capacity building needs to strengthen spatial planning and pro-poor urban development. Based on the results of the assessments, city administrations will prepare capacity building and training proposals, which will be consolidated by MPW’s Directorate General of Human Settlements (DGHS), the executing agency. DGHS will facilitate joint training and study programs, and other capacity building assistance for selected staff from the 20 local administrations. To address poverty issues beyond infrastructure upgrading, the project will support the preparation of multisector slum improvement action plans. The plans will represent an attempt to combine physical environmental improvements with other support mechanisms that will require collective efforts from entities beyond MPW.

12. **Infrastructure in slum neighborhoods upgraded.** About \$60 million of the loan proceeds will be allocated for upgrading basic infrastructure in slum neighborhoods in 20 cities. Participating cities have been preliminarily selected based on the following criteria: (i) local governments have approved spatial plans (RTRWs) and development strategies (SPPIPs) that identify slum areas and provide guidance to improve slums; (ii) at least 5,000 households live in slum areas; (iii) at least 5% of households located in slum neighborhoods fall in the category of extreme poor;<sup>16</sup> (iv) formal confirmation of the local government to participate in the project; and (v) confirmation that households without legal title to the land (informal dwellers) in the selected slum neighborhoods would be allowed to participate in and benefit from the project.<sup>17</sup>

13. To be selected to participate in the project, local governments of the project cities will sign a memorandum of agreement with DGHS validating their readiness and contributions, including (i) establishing a local coordination office (LCO) with experienced and committed staff; (ii) providing additional resources to finance complementary infrastructure works and to improve public services in slum areas; (iii) ensuring compliance to adopt a CDD approach to identify the specific type and mix of interventions to be financed by the project based on needs assessments carried out by the communities; and (iv) adjusting and/or revising spatial plans and development strategies based on feedback received during the consultation process with slum communities.

14. Project funds will be allocated for each city based on the number of slums: (i) cities with more than 100 slums will receive up to \$4.5 million; (ii) cities with 50–100 slums will receive up to \$3.5 million; and (iii) cities with less than 50 slums will receive up to \$2.4 million. Funding for infrastructure upgrading investments provided to each slum will vary and depend on the actual situation and needs of the communities.

15. City administrations will identify the specific slum neighborhoods to be supported by the project based on a close consultation process with slum communities and agreed selection criteria. The final list of project slum neighborhoods will be confirmed by a *bupati* (mayor) decree and

<sup>16</sup> Households living on a monthly income of less than Rp2.2 million are considered extreme poor.

<sup>17</sup> During project preparation, 50 cities were considered eligible to participate in the project based on the precondition criteria. During a thorough consultation process between DGHS and the candidate cities, which included field visits to explain the project scope and CDD approach to the city administrations and community groups, 20 cities confirmed their commitment to participate in the project. Based on lessons from earlier CDD infrastructure projects executed by MPW, the formal commitment of the city administration to participate in and contribute to project implementation and specify resources is considered crucial. The preliminary list of project cities includes Ambon, Batam, Bandar Lampung, Banjarmasin, Bengkulu, Bima, Bone, Kapuas, Kendari, Makassar, Palangkaraya, Palembang, Palopo, Pasuruan, Pekalongan, Semarang, Serang, Sukabumi, Tanjung Jabung Barat, Tanjung Balai.



submitted to ADB by DGHS for endorsement within 3 months after loan effectiveness. The process of engaging with slum communities will start with road shows in each project city to inform potential slum communities of the project scope and approach, and the selection criteria to be eligible for participation in the project. Selection criteria are based on socioeconomic indicators, and the readiness and commitment to participate in the project.<sup>18</sup> Overall information on the project and the selection process will be publicly disclosed in each project city. Cities with more than 100 slum locations will nominate at least 20 slum neighborhoods, but not more than 35; cities with 50 to 100 slum locations will nominate at least 15 slum neighborhoods, but not more than 20; and cities with less than 50 slum locations will nominate up to 15.

16. Each selected neighborhood will work through a community implementation organization (BKM). Supported by consultant teams, BKMs will facilitate infrastructure assessments for the slum neighborhoods, to be carried out by the community members, to assess basic infrastructure needs in the community; evaluate community implementation capacity; establish efficient planning and decision-making processes; formulate neighborhood upgrading plans (NUAPs) and specific subproject investment plans; prepare simple technical designs; organize works to be carried out by the community members; and formulate O&M plans of completed project facilities.

17. To achieve a wider development impact for cities and address infrastructure issues beyond the boundaries of individual slum neighborhoods, LCOs with the help of consultants will establish a consultation mechanism for project BKMs, and the city administration to formulate a consolidated infrastructure upgrading investment plan, which will integrate the individual NUAPs. In the process of preparing the overall infrastructure upgrading investment plan, BKMs, and the city administration will jointly evaluate NUAPs from each slum neighborhood, agree on collaboration to link upgrading activities between neighborhoods, concur on fund allocations per neighborhood within the overall investment amount for the respective project city, and revise individual NUAPs to be aligned with the agreed consolidated infrastructure upgrading investment plan for the project city. The consolidated city investment plans will be approved by DGHS and ADB and include the revised NUAPs with agreed investment amounts for each project slum neighborhood. The project will ensure that the consultation process is conducted in a transparent and fair manner. During this consultation process, BKMs, and city administrations will assess whether individual NUAPs are aligned with spatial plans and development strategies at the city level and agree on any necessary adjustments.

18. Based on the complexity of infrastructure upgrading plans, civil works will be carried out by the communities or by firms to be engaged by DGHS. Following the PNPM approach, funds for works implemented by communities will be based on contracts between the BKM, and city administration<sup>19</sup> and transferred through block grants directly from the project imprest account to community bank account managed by the BKMs.<sup>20</sup> Detailed guidance related to eligibility criteria and procedures to use grant funds will be explained in the guidelines (JUKLAK) and

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<sup>18</sup> Selection criteria for the project neighborhoods include: (i) the neighborhood must be located in a participating city; (ii) formal confirmation of the head of the neighborhood or BKM verifying (a) interest and willingness to participate in the project, (b) contribution to the planning and implementation of upgrading activities, (c) willingness to establish required O&M arrangements for facilities constructed by the project; and (iii) the neighborhood must be listed as a slum neighborhood in the applicable city development plan.

<sup>19</sup> Contracts will specify payment modalities. Detailed information on the fund flow mechanism and implementation of neighborhood upgrading plans is in the Project Administration Manual (accessible from the list of linked documents in Appendix 2).

<sup>20</sup> No withdrawal from the imprest account will be made for civil works for output 2 until, among other things: (i) the separate bank account for the BKM of the corresponding slum neighborhood has been opened, (ii) the consolidated investment plan of the corresponding participating town, integrating the NUAPs of project slum neighborhoods has been approved by ADB and DGHS, and (iii) a contract for the relevant subproject has been concluded between the BKM for the relevant slum neighborhood and the city administration.

implementation manuals (JUKNIS) to be developed with the help of consultants and approved by DGHS at the beginning of the project.

19. **New settlements for poor families established.** A model of partnership for each NSD between the central government, local administrations, developers, and financial institutions to provide housing for poor people will be developed. The project will take a catalytic role to develop examples for replication and promote public–private alliances in five cities<sup>21</sup> whereby: (i) local governments will provide land from their own resources and issue land titles for potential new house owners (titles are required as collateral to receive loans from financial institutions); (ii) MPW will provide the basic infrastructure (roads, water and electricity supply, and sanitation facilities) financed by loan proceeds; (iii) private developers will prefinance the house construction, and coordinate connections to the main networks of service providers (water and electricity); (iv) financial institutions will provide loans to poor families to buy (or construct) new houses; (v) NGOs, in close cooperation with the local administration, will organize socialization campaigns to explain the NSD scheme to poor families living in slum neighborhoods of the project city, develop transparent criteria to select poor beneficiary families to be eligible to apply under the NSD scheme, and facilitate the selection process. To establish the basic infrastructure for new settlements, the project will provide about \$5.0 million to finance civil works. The legal title to the land of the NSD sites must be held in the name of the participating cities. Within 18 months after loan effectiveness, the project cities will present a full NSD proposal, which is endorsed by the *bupati* (mayor), to ADB and DGHS for review and approval. The proposal will include (i) proof of land ownership; (ii) detailed technical designs with cost estimates for infrastructure to be financed by the loan proceeds; (iii) basis for the selection of a local developer; (iv) proposed loan schemes, including commitments from financial institutions to provide loans to poor families under the NSD scheme; and (v) a transparent selection process to identify slum dwellers prepared to buy houses at the NSD site. DGHS will ensure that the houses constructed under the project will not be sold or resold within 10 years after completion. The proposed NSD sites will be vacant and ready for infrastructure development, and will not be subject to environmental threats.

#### D. Investment and Financing Plans

20. The project is estimated to cost \$102.0 million (Table 1).

**Table 1: Project Investment Plan**  
(\$ million)

Item	Amount <sup>a</sup>
<b>A. Base Cost</b>	
Output 1: Institutional capacity strengthened	5.0
Output 2: Slum neighborhoods upgraded	76.4
Output 3: New settlements developed	16.2
<b>Subtotal (A)</b>	<b>97.6</b>
<b>B. Contingencies</b>	0.4
<b>C. Financing Charges During Implementation<sup>a</sup></b>	4.0
<b>Total (A+B+C)</b>	<b>102.0</b>

<sup>a</sup> Includes interest and commitment charges. Interest during construction for the ADB loan has been computed at the 5-year forward London interbank offered rate plus a spread of 0.3%. Commitment charges for the ADB loan are 0.15% per year to be charged on the undisbursed loan amount. Cost includes \$1.56 for taxes and duties financed by the government.

Source: Asian Development Bank estimates.

21. The government has requested a loan of \$74.4 million from ADB's ordinary capital resources to help finance the project. The loan will have an 18-year term, including a grace period

<sup>21</sup> The NSD cities will be part of the 20 project cities.

of 6 years; an interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per annum on any undisbursed amount of the loan; and such other terms and conditions set forth in the draft loan agreement. The financing plan is in Table 2.

**Table 2: Financing Plan**

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank (ordinary capital resources)	74.4	72.9
Government	21.6	21.2
Beneficiaries	6.0	5.9
<b>Total</b>	<b>102.0</b>	<b>100.0</b>

Source: Asian Development Bank estimates.

## E. Implementation Arrangements

22. The implementation arrangements are summarized in Table 3 and described in detail in the project administration manual (PAM). DGHS will be the executing agency. The project will be implemented from July 2014 to December 2017. In each project city, a local project management unit will be established with experienced and qualified staff to facilitate project implementation. Their tasks are described in detail in the PAM. All procurement financed under the ADB loan will be in accordance with ADB's Procurement Guidelines (2013, as amended from time to time). Consultant services will be recruited in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time).

**Table 3: Implementation Arrangements**

Aspects	Arrangements		
Implementation period	July 2014–December 2017		
Estimated project completion date	31 December 2017		
Project management			
(i) Oversight body	Housing and Settlements Steering Committee Members include BAPPENAS, MOF, MOHA, MPW, MPH, BPN, MOH		
(ii) Executing agency	DGHS within MPW		
(iii) Key implementing agencies	DGHS and administrations of 20 city districts		
(iv) Project implementation unit	Project management unit, DGHS, MPW, 5 staff City and district project management units in 20 participating cities and/or districts, 3–5 staff in each unit		
Block grants for basic infrastructure upgrading	Community procurement	1,000 contracts	\$41.0 million
Complex infrastructure upgrading	Procurement through DGHS	70 contracts	\$24.0 million
Consulting services	2,297 person-months of national consultants		\$9.4 million
Retroactive financing and/or advance contracting	Four management consultant packages will be procured using advance contracting, including the national project management consultant team (estimated contract amount \$6,623,000). The contract will be signed after the loan is declared effective.		
Disbursement	ADB loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2012, as amended from time to time) and detailed arrangements agreed between the government and ADB.		

ADB = Asian Development Bank, BAPPENAS = Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency), BPN = Badan Pertanahan Nasional (National Land Agency), DGHS = Directorate General of Human Settlements, MOF = Ministry of Finance, MOH = Ministry of Health, MOHA = Ministry of Home Affairs, MPH = Ministry of Public Housing, MPW = Ministry of Public Works.

Source: Asian Development Bank.

### III. DUE DILIGENCE

#### A. Economic and Financial

23. About 670,000 low-income households are expected to benefit from the project. The expected economic benefits are significant and include (i) improved public health status and reduced per capita costs for health care and medical treatment due to increased coverage of sanitation services, improved access to safe drinking water, and improved hygiene particularly in densely populated neighborhoods; (ii) increased income-generating opportunities through improving essential infrastructure; and (iii) considerable short-term employment generation. Improving the overall living environments of poor urban neighborhoods where people are engaged in informal economic activities will enhance income-earning opportunities of small home industries, particularly related to food processing, handicraft, batik, and small repair services. Upgrading roads and pathways, and improving water and power supply will improve the overall business conditions for informal entrepreneurs (including food-stall owners, small restaurants, repair shops). Improved roads will also provide easier and safer access for residents to reach their places of work. Transportation costs in general will be reduced to improve access to local markets to deliver goods and services and buy products, and to schools and health centers. Improving drainage systems will contribute to reducing damage and losses due to flooding.<sup>22</sup>

#### B. Governance

24. The project will adopt a CDD approach, which is a key feature of instituting good governance practices. It will strengthen the ability of communities to articulate their needs and to seek support for development plans; it will improve the ability of district governments to respond to the demands of poor communities. Evaluations of CDD infrastructure projects suggest that community choices are more attuned to local needs; sustainable O&M is more likely as infrastructure projects chosen by the community members have a direct benefit. Participation in planning and implementing infrastructure projects yields better oversight and less corruption, and communities become active partners in development. The project will ensure transparency to enable the community to know every aspect of the project decision-making process. Management of funds will be transparent and shared with the entire community. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government. Within 3 months of loan effectiveness, DGHS will establish a project-specific website for public disclosure on use of the loan proceeds, including details of procurement and contract awards.

#### C. Poverty and Social

25. The project will target poor communities in slum areas that lack basic services and infrastructure. The selected neighborhoods will have higher than average poverty rates and lower than average achievement of the MDGs. Improvements of basic infrastructure will increase income-earning opportunities and accessibility to education and health services for the poor and near poor. Improved sanitation and cleaner environments resulting from project activities will reduce diseases linked to unsafe water and poor hygiene, thus contributing to improving the overall health status of the poor.<sup>23</sup> The project will address the key gender issues, including (i) limited participation and leadership of women in local decision-making processes related to community infrastructure investments; (ii) insufficient access of women to employment opportunities in local civil and maintenance works; and (iii) inadequate opportunities for female government staff to access technical training opportunities. The project's gender action plan includes (i) developing slum improvement action plans based on the needs of women and men for public facilities; (ii) ensuring women comprise 40% of participants in decision-making activities and 20% of BKM

<sup>22</sup> Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).

<sup>23</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

members, in aggregate; (iii) undertaking gender audits of all community investment plans; (iv) providing 20% of paid work created by the project to women; (v) ensuring women comprise 30% of trainees in all project capacity development activities and 30% of user group members; (vi) providing gender training to all key project stakeholders; and (vii) developing and using gender indicators to track implementation of the gender action plan and project outcomes for women.<sup>24</sup>

#### D. Safeguards

26. **Land acquisition and resettlement.** The project will not include physical displacement; less than 10% of productive assets will be lost as a result of involuntary land acquisition. In the context of specific neighborhood upgrading activities, i.e., construction of public sanitation facilities, small amounts of land may be acquired from community members or donated voluntarily.<sup>25</sup> The legal title of the land for NSD will be in the name of the project city; the land will be vacant and ready for implementation. As the scope of land acquisition is expected to be insignificant with no expected resettlement, the project is classified as category B for involuntary resettlement. Since communities will be identifying specific interventions during project implementation, potential issues related to land acquisition can be identified only after the type of infrastructure upgrading and the specific location are agreed on. A resettlement framework was prepared to provide guidance to communities on managing land acquisition.<sup>26</sup> The NUAPs will record the potential for land acquisition.

27. **Environment.** Overall, the infrastructure upgrading activities are expected to create positive impacts on the environment and improve the livelihoods at slum communities. The project is categorized as environment category B. Since it will use a CDD approach, communities will identify the specific project locations and types of infrastructure interventions during the first year of implementation. An environmental assessment and review framework was prepared to guide the environmental assessment process to screen specific infrastructure interventions and set up institutional arrangements in relation to environmental management and monitoring. Safeguard specialists and trained community advisors, in close collaboration with the communities, will conduct assessments in each project neighborhood in the process of preparing the NUAPs.<sup>27</sup> The NUAPs will record results of the environmental screening process. For the NSD under output 3, initial environmental examinations will be prepared at each site after the project city has formally confirmed its readiness to participate in the NSD component and designated the land for the project. The report will be part of the NSD proposals to be approved by DGHS and ADB. NSD proposals without an initial environmental examination report will not be endorsed.

28. **Indigenous peoples.** The project is not expected to have any negative impacts on indigenous peoples. It will not discriminate against them or other marginalized groups. Following CDD principles, the project will include opportunities for screening project impacts on indigenous groups and incorporating mitigation measures, if any, into the consolidated city investment plans. In accordance with ADB's Safeguard Policy Statement (2009), the project is classified category C for indigenous peoples.<sup>28</sup>

<sup>24</sup> Gender Action Plan (accessible from the list of linked documents in Appendix 2).

<sup>25</sup> Community members will pay for land from their own resources; loan proceeds will not be used.

<sup>26</sup> Safeguard specialists will direct and supervise implementation of land acquisition by BKMs, and LCOs based on the resettlement framework, which has been disclosed (accessible from the list of linked documents in Appendix 2).

<sup>27</sup> National and regional consultant teams will include environmental safeguard experts, who will guide communities and LCO to carry out environmental screening and supervise the process. The environmental assessment and review framework has been disclosed (accessible from the list of linked documents in Appendix 2).

<sup>28</sup> Indigenous people and other vulnerable groups will be part of the capacity-building, planning, implementation, and post-implementation processes; minority and marginalized groups will be represented on BKMs; and indigenous groups will benefit from easier access to service delivery, rural infrastructure, training, and construction-related jobs.

29. **Operation and maintenance.** To ensure sustainability of infrastructure investments, DGHS will ensure that O&M arrangements are well reflected in the NUAPs. The O&M of facilities upgraded under output 2 will be managed through a community participatory approach, involving the local BKM and beneficiary communities. In the preparation of the NUAPs, consultant teams will guide communities and LCOs to understand the need for O&M provisions and ensure that appropriate technical and financial measures for O&M are included. BKMs, supervised by the city administrations, will handle O&M of new sites under output 3.

#### **E. Risks and Mitigating Measures**

30. In the past, some CDD programs have bypassed local government planning procedures. The project will mitigate this risk by facilitating a consultation process between BKMs and the city administrations to jointly formulate consolidated investment plans and ensure that NUAPs are aligned with spatial plans and development strategies. For the NSD, a potential risk involves successfully engaging with private stakeholders to establish new housing sites for poor families. This risk will be mitigated through targeted awareness campaigns to illustrate the mutual benefits for all stakeholders. Project consultants will be engaged to facilitate dialog among developers, financial institutions, local administrations, and community members. Previous CDD projects indicate a risk of “elite capture”—where wealthy and/or articulate, educated community members dominate decision-making processes. This risk will be mitigated by (i) using transparent processes in conducting needs assessments and preparing NUAPs; (ii) working through BKMs with elected representative from the neighborhoods; and (iii) publicly displaying decision-making processes, tender documents, fund transfers, and progress of civil works. Experienced consultant teams will support communities in preparing technical designs and implementing civil works to ensure high quality of infrastructure and effective O&M arrangements. DGHS will set up units to handle complaints at each project city that will review and address grievances from stakeholders.<sup>29</sup>

### **IV. ASSURANCES AND CONDITIONS**

31. The government has 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 project administration manual and loan documents. The government has agreed with ADB on certain covenants for the project, which are set forth in the loan agreement.

### **V. RECOMMENDATION**

32. 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 \$74,400,000 to the Republic of Indonesia for the Neighborhood Upgrading and Shelter Project (Phase 2), from ADB’s ordinary capital resources, with interest to be determined in accordance with ADB’s London interbank offered rate (LIBOR)-based lending facility; for a term of 18 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 agreement presented to the Board.

Takehiko Nakao  
President

7 March 2014

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<sup>29</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b> Improved living conditions in urban areas</p>	<p>By 2020, in line with the MDG target 7D: The proportion of urban population living in slums of the 20 project cities is reduced to at least 6% Baseline (2011): 12.26%<sup>1</sup></p>	<p>Central Bureau of Statistics (Biro Pusat Statistik) MDG progress reports</p>	<p><b>Assumption</b> National and local budget funds are adequate and provided in a timely manner. Central and local governments continue to prioritize reduction of slums.</p>
<p><b>Outcome</b> Improved infrastructure and access to service delivery in slum neighborhoods in 20 project cities</p>	<p>By 2017: At least 670,000 households living in slum neighborhoods benefit from the infrastructure upgrading.  At least 50% of community members in project locations, of which half are women, are satisfied with improvements in roads, provision of drinking water, sanitation facilities, and other basic urban infrastructure (perception survey to be conducted by 2017)</p>	<p>PPMS reports Consultant reports District and city administration evaluation reports</p>	<p><b>Assumptions</b> National and local governments continue to support community-driven development.  <b>Risk</b> Natural disasters will impact the project areas.</p>
<p><b>Outputs</b> 1. Institutional capacities for managing pro-poor urban development are strengthened</p>	<p>Local government officials involved in developing and/or revising integrated urban development plans and SIAPs adopt community-driven development approaches by 2017.  At least 100 local government staff (30% women) dealing with spatial planning trained on CDD approaches adopted in urban development; and environmental subjects related to water treatment, sanitation, solid waste management, project management, O&amp;M, and other areas identified in the capacity needs assessments</p>	<p>PPMS reports Consultant reports District and city administration evaluation reports Feedback from communities (survey)</p>	<p><b>Assumption</b> Participating local governments continue to be committed to pro-poor spatial planning.  <b>Risk</b> Informal leaders dominate the decision-making process during preparation of slum upgrading and community investment plans.</p>
<p>2. Infrastructure in slum neighborhoods upgraded</p>	<p>Individual NUAPs of project neighborhoods integrated in consolidated city infrastructure upgrading investment plans and harmonized with approved</p>	<p>PPMS reports Consultant reports District and city administration evaluation</p>	<p><b>Assumption</b> Community members have enough resources to carry out simple civil works</p>

<sup>1</sup> The baseline will be updated in 2014 after the project slum neighborhoods are confirmed.

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
	<p>spatial plans and development strategies</p> <p>Community implementation organizations (BKMs) in all project neighborhoods functioning with 40% representation of women involved in the decision-making processes</p> <p>1,500 km of neighborhood roads upgraded</p> <p>134,000 households benefit from upgraded water supply facilities and systems</p> <p>268,000 households benefit from upgraded sanitation facilities and systems</p> <p>At least 80% of infrastructure works evaluated as being in accordance with the national standard and have functioning O&amp;M arrangements</p>	<p>reports</p> <p>Feedback from communities (survey)</p>	<p>and/or construction.</p>
3. New settlements for poor families established	<p>New housing areas for poor families constructed in at least five cities</p> <p>PPP schemes to finance and construct new housing areas for poor families are established in at least five cities</p> <p>At least 800 poor families (priority to households headed by women) living in slums are provided with affordable houses in new housing areas.</p> <p>Housing deeds provided in the name of husband and wife, and in the name of the woman for households headed by women</p>	<p>PPMS reports</p> <p>Consultant reports</p> <p>MOUs and agreements between developers, financial institutions, and city administrations; contracts with low-income families</p> <p>District and city administration evaluation reports</p>	<p><b>Risk</b></p> <p>Engagement with private stakeholders to establish new housing sites for poor families is not successful.</p>

Activities with Milestones	Inputs	
<p><b>1. Institutional capacity for managing pro-poor urban development strengthened</b></p> <p>1.1 Recruit consultant teams to support DGHS and local community governments in preparing and implementing project activities (starting Q3 2014)</p> <p>1.2 Identify training needs for local government staff (starting Q4 2014)</p> <p>1.3 Select local government staff to be trained on pro-poor spatial planning and/or CDD approach (starting Q1 2015)</p> <p>1.4 Implement training for local government staff dealing with spatial planning (starting Q2 2015)</p>	<p><b>Loan</b></p> <p><b>ADB: \$74.4 million</b> (ordinary capital resources)</p>	
	<b>Item</b>	<b>Amount (\$ million)</b>
	Infrastructure	60.0
	NSD	5.0
	Support for institutional development	1.9
Consulting services	7.5	
	<p><b>Government: \$21.6 million</b></p>	



Activities with Milestones	Inputs	
1.5 Conduct workshops to develop the national housing and settlement network (starting Q1 2015)	Land	5.0
1.6 Establish a national housing and settlement network with members from at least 20 cities (Q2 2015)	Infrastructure improvements	5.9
	Institutional development	1.0
<b>2. Infrastructure investment plans for upgrading slum neighborhoods aligned with overall city development plans and implemented in 20 cities</b>	Project management, monitoring, and supervision	3.7
2.1 Socialization of the project scope in all project neighborhoods (starting Q3 2014)	Tax and duties	1.6
2.2 Help project neighborhoods to identify needs and to prepare NUAPs (starting in Q3 2014)	Contingency	0.4
2.3 Integrate NUAPs into consolidated infrastructure upgrading investment plans for each project city (starting Q4 2014)	Financing charges during implementation	4.0
2.4 <i>Bupatis</i> (mayors) approve consolidated infrastructure upgrading investment plans (Q4 2014–Q1 2015)	<b>Private Sector and Community Contribution: \$6.0 million</b>	
2.5 Establish user groups in 300 neighborhoods (starting Q1 2015)	Infrastructure and/or in-kind	2.0
2.6 Award civil work contracts for neighborhood upgrading (starting Q1 2015)	Houses (at NSD)	4.0
<b>3. New settlements for poor families established</b>		
3.1 Approve selection criteria for potential beneficiaries (Q4 2014)		
3.2 Complete MOUs between local governments and financial institutions and developers to finance and construct NSDs (Q2 2015)		
3.3 DGHS selects contractors to construct infrastructure at NSDs (starting Q3 2015)		
3.4 Construct infrastructure at NSDs (starting Q4 2015)		
3.5 Construct houses at NSDs (starting Q1 2016)		
3.6 Complete final selection of beneficiaries (Q3 2015)		
3.7 Beneficiaries and banks sign loan agreements (Q2 2016)		
3.8 Develop strategies to share partnership models for NSDs with other local governments (in Q4 2016)		

ADB = Asian Development Bank, BKM = Badan Keswadayaan Masyarakat (Community Empowerment Agency), BPS = Biro Pusat Statistik (Central Statistics Bureau), CDD = community-driven development, km = kilometer, MDG = Millennium Development Goal, MOU = memorandum of understanding, NSD = new site development, NUAP = neighborhood upgrading action plan, OCR = ordinary capital resources, O&M = operation and maintenance, PPMS = project performance monitoring system, PPP = public-private partnership, SIAP = slum improvement action plan. Source: Asian Development Bank estimates.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=46094-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Urban Infrastructure
3. Project Administration Manual
4. Contribution to the ADB Results Framework
5. Development Coordination
6. Economic and Financial Analysis
7. Country Economic Indicators
8. Summary Poverty Reduction and Social Strategy
9. Gender Action Plan
10. Environmental Assessment and Review Framework
11. Resettlement Framework
12. Risk Assessment and Risk Management Plan