



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

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Project Number: 50211-001  
October 2016

## Proposed Loan Democratic Republic of Timor-Leste: Dili to Baucau Highway Project

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Asian Development Bank

## CURRENCY EQUIVALENT

The currency of Timor-Leste is the United States dollar.

## ABBREVIATIONS

ADB	–	Asian Development Bank
CAFI	–	Council for Administration of the Infrastructure Fund
EMP	–	environmental management plan
JICA	–	Japan International Cooperation Agency
km	–	kilometer
m	–	meter
MPWTC	–	Ministry of Public Works, Transport and Communications
PMU	–	project management unit
RNUSP	–	Road Network Upgrading Sector Project

## NOTE

In this report, "\$" refers to US dollars.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 50211-001</b>	
<b>Project Name</b>	Dili to Baucau Highway Project	<b>Department /Division</b>	PARD/PATE
<b>Country</b>	Timor-Leste, The Democratic Republic of	<b>Executing Agency</b>	Council for Administration of the Infrastructure Fund (also Conselho Administrativo do Fundo Infraestrutura)
<b>Borrower</b>	Democratic Republic of Timor-Leste		
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Transport</b>	Road transport (non-urban)		49.65
		<b>Total</b>	<b>49.65</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Adaptation (\$ million)	5.00
Environmentally sustainable growth (ESG)	Global and regional transboundary environmental concerns Urban environmental improvement	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	Some gender elements (SGE)	✓
Partnerships (PAR)	Institutional systems and political economy Bilateral institutions (not client government) Official cofinancing		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Rural	High
Household Targeting	No	Urban	Low
SDG Targeting	Yes		
SDG Goals	SDG3, SDG8, SDG9		
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	<b>Environment: B Involuntary Resettlement: B Indigenous Peoples: C</b>		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>49.65</b>	
Sovereign Project loan: Asian Development Fund		49.65	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>27.19</b>	
Government		27.19	
<b>Total</b>		<b>76.84</b>	
<b>9. Effective Development Cooperation</b>			
Use of country procurement systems		No	
Use of country public financial management systems		Yes	



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Democratic Republic of Timor-Leste for the Dili to Baucau Highway Project.<sup>1</sup>

2. The project will upgrade and climate-proof 105 kilometers (km) of the national road between the capital, Dili, and the second-largest town, Baucau, which is located on the north coast. The government has requested the Asian Development Bank (ADB) to cofinance the proposed project on a parallel basis with the Japan International Cooperation Agency (JICA). ADB will support upgrading and climate-proofing 56 km of the road connecting the towns of Manatuto and Baucau, and JICA will support the section between Dili and Manatuto (49 km).

## II. THE PROJECT

### A. Rationale

3. The government's Strategic Development Plan, 2011–2030 aims to promote economic growth, fast-track economic development, and modernize and diversify the economy by providing the country with high-quality infrastructure.<sup>2</sup> Current government operational plans concentrate on upgrading roads to achieve quick returns and transformational changes needed for economic progress, inclusive development, and social stability.

4. ADB's country partnership strategy, 2016–2020 for Timor-Leste maintains ADB's focus on the development and management of infrastructure, and on complementary activities that support the private sector as a driver of change.<sup>3</sup> The country partnership strategy aims to help the country make services more available outside of the capital city of Dili by improving transport connectivity, which will (i) reduce poverty by giving the poor access to markets and basic public services, and (ii) help spread economic activity and the benefits of the country's petroleum wealth more broadly to areas beyond the capital. The Dili to Baucau road is expected to stimulate a range of economic activity, particularly tourism, which Timor-Leste is specifically targeting to create employment opportunities.

5. The road network in Timor-Leste deteriorated during a 25-year conflict from 1975 until 1999 that preceded independence in 2002 due to a lack of investment in maintenance and rehabilitation. Progressive deterioration continued during 2002–2011, and poor road conditions have constrained the country's efforts to develop. In 2010, ADB, JICA, and the World Bank signed a joint aide memoire pledging to coordinate their support for a 5-year, 1,000 km core road program.<sup>4</sup> At the time, ADB was working with JICA toward cofinancing of the Dili to Baucau road as part of this core road program. Subsequently, JICA decided it would support the Dili to Baucau road on its own, while ADB developed its support for other priority roads. Since then, ADB, JICA, and the World Bank have continued to collaborate closely with each other, and a vigorous program of road upgrading is now under implementation and managed by a joint project management unit (PMU).

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

<sup>2</sup> Government of Timor-Leste. 2011. *Timor-Leste Strategic Development Plan, 2011–2030*. Dili.

<sup>3</sup> ADB. 2016. *Country Partnership Strategy: Timor-Leste, 2016–2020*. Manila. The country partnership strategy addresses four of the five core areas of ADB operations designated by ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>4</sup> ADB, Japan International Cooperation Agency (JICA), and the World Bank. 2010. Aide Memoire. 5-Year, 1,000 km Core Road Program. ADB–JICA–World Bank Joint Consultation Mission. Dili, Timor-Leste. 8–15 November.

6. When detailed engineering design and associated cost estimates were completed under the JICA-financed project preparatory work, it became clear that there would be a significant shortfall in the financing plan for the construction of the Dili to Baucau road, primarily because of the devaluation of a yen-denominated loan from JICA. The shortfall comprises 100% of the civil works cost of the Manatuto to Baucau section of the project (approximately \$59 million). The government, which had originally intended to self-finance the shortfall, became aware of the advantages of availing itself of concessional financing rather than depleting its sovereign wealth fund.<sup>5</sup> The government now aims for at least 75% of a project designated for loan financing to be loan-financed. This policy was reinforced by recommendations resulting from the International Monetary Fund's yearly bilateral discussion with Timor-Leste.<sup>6</sup> The government also appreciates that oversight of development partners provides a better framework for disciplined project administration and implementation. The government has therefore requested ADB to help meet the financing shortfall.

7. The project comprises two civil works packages, both of which have been procured and awarded in accordance with JICA procurement policies. ADB has been requested to finance the package for the Manatuto to Baucau section of the project. ADB has conducted a detailed post-review of the procurement process carried out by the government for that package, including prequalification and bidding documents, bidding procedures, and contract documentation procurement process and bid evaluation. ADB has concluded that the package was procured in a manner consistent with the principles of ADB's Procurement Guidelines (2015, as amended from time to time). A summary of the assessment is in paras. 19–20 and 25. ADB's financing of the Manatuto to Baucau section will enable the entire road between Dili and Baucau to be accomplished to the appropriate standards, and help achieve the full benefits of the project.

8. ADB has financed the Road Network Development Sector Project, the Road Network Upgrading Project, and the Road Network Upgrading Sector Project (RNUSP).<sup>7</sup> The Road Network Upgrading Project and the RNUSP were scaled up with additional financing from ADB. In total, development partners will have supported the upgrading of about 560 km (39%) of the most important sections of the national road network by the end of 2019. The Government of Australia and the European Union have focused on road rehabilitation and maintenance of secondary rural roads through the development of small-scale contractors and community involvement. The European Union is financing a project for rehabilitating 43 km of rural roads in economically important coffee-growing areas, which will be administered by ADB. ADB's projects are on track to upgrade 287 km of national roads by 2019, of which 100 km have been completed. Projects completed to date are of high standards and are delivering the expected benefits.

9. The Ministry of Public Works, Transport and Communications (MPWTC) lacks the institutional capacity needed to properly implement capital works or maintain road assets. ADB-financed technical assistance is supporting the implementation of a capacity development

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<sup>5</sup> Timor-Leste has a sovereign wealth fund (the Petroleum Fund) of approximately \$16 billion, which is derived from its oil and gas revenues.

<sup>6</sup> International Monetary Fund. 2016. Republic of Timor-Leste: 2016 Article IV Consultation–Press Release; Staff Report; and Statement by the Executive Director for Timor-Leste. *International Monetary Fund Country Report*. No. 16/183. Washington, DC.

<sup>7</sup> ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to the Democratic Republic of Timor-Leste for the Road Network Development Sector Project*. Manila; ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Republic of Timor-Leste for the Road Network Upgrading Project*. Manila; and ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Republic of Timor-Leste for the Road Network Upgrading Sector Project*. Manila.

framework and a strategic development plan for the MPWTC. A PMU embedded in the MPWTC is responsible for managing ADB, JICA, and World Bank programs. It has considerable experience in dealing with the requirements of development partners and other government agencies. The PMU has successfully coordinated the various programs of development partners and has ensured that technical standards and safeguards have been consistently applied across these programs.

10. The MPWTC plans to introduce performance-based maintenance contracts for all upgraded roads. However, civil works contracts for all development partner-financed roads require contractors to carry out routine maintenance for 2 years after the defects notification period.<sup>8</sup> Two performance-based maintenance contracts have been piloted under ADB's Road Network Development Sector Project (footnote 7). An international road maintenance specialist financed by ADB has provided support to the MPWTC's newly created maintenance division in preparing its detailed road maintenance plan for 2016. Technical assistance from JICA is supporting a 3-year capacity development program for road maintenance. It commenced in May 2016 and is actively supporting implementation of the 2016 annual road maintenance plan and the development of future programs.

11. The proposed project comprises upgrading the most heavily trafficked road outside of Dili, which links the capital to Bacau as well as the entire eastern half of the island. Traffic volumes vary between 2,000 and 1,200 vehicles per day along its length, comprising a high proportion of light goods vehicles and buses. The existing road is 4.5 meters (m) wide and in poor condition. Upgrading will comprise climate-proofing measures and widening to 6.0 m, with 1.0 m shoulders. Climate change and climate resilience measures include drainage designed for increased rainfall intensity, provision of a resilient pavement surfaced with 50-millimeter-thick asphalt, raising of the road in flood-prone areas, and general application of best engineering practices. The European Space Agency provided technical assistance that allowed for more accurate determination of historical rainfall intensity in the catchments of water courses affecting the project. This information resulted in the conservative design (oversizing) of drainage structures to cater for the increased rainfall intensity that has been forecasted for the future.

12. ADB is supporting a national road safety action plan under the RNUSP (footnote 7). The government established a Road Safety Directorate in the Ministry of the Interior in early 2016, which will be responsible for prioritizing and implementing activities under the national road safety action plan. All donor-financed projects (including past projects) include raising road safety awareness in roadside communities and schools.

## **B. Impact and Outcome**

13. The impact of the project will be increased and more efficient movement of people and goods. The outcome will be a more reliable and safer road network.

## **C. Outputs**

14. The outputs of the project will be the (i) upgrading and climate-proofing of 105 km of the national road between Dili and Bacau, (ii) expansion of performance-based maintenance, and (iii) generation of awareness of road safety and transport-related social issues.

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<sup>8</sup> A defects notification period is where the contractor is responsible for correcting defects and making repairs on an upgraded road within 1 year after completion of construction. The contractor is responsible for maintenance of the accepted works for 2 years after this 1-year period ends.



## D. Investment and Financing Plans

15. The project is estimated to cost \$126.58 million (Table 1).

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

Item	Amount <sup>a</sup>
<b>A. Base Cost<sup>b</sup></b>	
1. Civil works <sup>c</sup>	107.60
2. Resettlement	1.50
3. Consulting services	6.50
<b>Subtotal (A)</b>	<b>115.60</b>
<b>B. Contingencies<sup>d</sup></b>	<b>6.12</b>
<b>C. Financing Charges During Implementation<sup>e</sup></b>	<b>4.86</b>
<b>Total (A+B+C)</b>	<b>126.58</b>

<sup>a</sup> Includes taxes and duties of \$10 million to be financed from government resources, and Asian Development Bank (ADB) and Japan International Cooperation Agency loan resources.

<sup>b</sup> In mid-2016 prices.

<sup>c</sup> The civil works cost is the accepted contract amount, which includes 2% for contingencies.

<sup>d</sup> Price contingencies computed at 4% on foreign exchange costs and 4% on local currency costs. The currency of Timor-Leste is the United States dollar.

<sup>e</sup> Includes interest charges. Interest during construction for the ADB loan has been computed at 2% per annum on disbursed amounts.

Source: Asian Development Bank estimates.

16. The government has requested a loan in various currencies equivalent to SDR35,467,000 (\$49.65 million equivalent) from ADB's Special Funds resources to help finance the project. The loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2.0% per annum during the grace period and thereafter, and such other terms and conditions set forth in the draft loan agreement. The loan will finance civil works, consulting services, taxes and duties, and financing charges during implementation on the Asian Development Fund loan.

17. The government will contribute \$27.19 million to the cost of the overall project. The government contribution will finance civil works, land acquisition, taxes and duties, audit costs, and resettlement costs.<sup>9</sup> The government has assured ADB that it will meet any financing shortfall to help support the full implementation of project outputs. In 2012, JICA provided loan cofinancing in the amount of JPY5,278 million on a parallel basis. This amount will finance civil works for the Dili to Manatuto section and consulting services. The financing plan is in Table 2.

**Table 2: Financing Plan**

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Special Funds resources (loan)	49.65	39.2
Japan International Cooperation Agency	49.74 <sup>a</sup>	39.3
Government	27.19	21.5
<b>Total</b>	<b>126.58</b>	<b>100.0</b>

<sup>a</sup> The amount of JPY5,278 million, parallel cofinancing was recorded in 2012.

Source: Asian Development Bank estimates.

<sup>9</sup> The amount of taxes and duties (i) is within the reasonable threshold identified during the country partnership strategy preparation process, (ii) does not represent an excessive share of the project investment plan, and (iii) will only be financed in respect of ADB-financed expenditures. Financing of taxes and duties is material and relevant to the success of the project.

## E. Implementation Arrangements

18. A PMU established in the MPWTC is responsible for the management of all loan- and grant-financed projects for upgrading of national roads, including those of ADB. The PMU is headed by a project manager and has a full-time professional staff, including a chief technical advisor, a road construction advisor, a road maintenance engineer, and a financial administrator. As the PMU's portfolio responsibilities grow, it has also strengthened steadily. International and national specialists provide a full-time safeguards unit within the PMU.

19. The government carried out the procurement of both civil works packages for the project through international competitive bidding in accordance with JICA procurement policies. The multilateral development banks' harmonized standard bidding documents with JICA's requirements were used. The civil works contract for the road section from Manatuto to Baucau (to be financed by the ADB loan) was awarded on 22 December 2015 and signed by the government and contractor on 31 March 2016. To accommodate the government's request to finance this contract, ADB (with assistance from an external consultant) conducted a detailed post-review of the procurement process and bid evaluation for this civil works package to ensure that procurement was undertaken in a manner consistent with the principles of ADB's Procurement Guidelines.<sup>10</sup> The review confirmed that this is the case. Financing the contract (instead of rebidding under ADB requirements) helps achieve economy and efficiency in project implementation given the use of standard bidding documents and substantial similarity of procurement and evaluation processes. Eligible bidders were provided with the same information and equal opportunity to compete in the bidding, and there was sufficient competition. There was adequate transparency in the single-stage procurement process, i.e., two-envelope procedure preceded by a prequalification exercise with detailed evaluation reports prepared by the government that were subject to JICA's prior review and clearance for the prequalification, technical evaluation, and price evaluation stages. While the contractor is a joint venture comprising two firms from ADB members, the contract does not place any restriction on the origin of goods to be supplied under the contract. Neither the joint venture nor the firms constituting the joint venture are subject to ADB sanctions. The government and JICA confirmed that no representations or complaints were received in connection with the procurement. Since the procurement of the contract has already been completed and can no longer be carried out under ADB's Procurement Guidelines, and because the contract does not restrict the origin of goods to be supplied under the contract to ADB members, the Board's approval is sought to waive the applicability of ADB's Procurement Guidelines and ADB's member country procurement eligibility restrictions<sup>11</sup> for the financing of this contract package.

20. The government has also requested retroactive financing for the Manatuto to Baucau contract up to 20% of the ADB loan amount for a period not exceeding 12 months from the signing of the loan agreement. One of the requirements for retroactive financing is for procurement to follow ADB's Procurement Guidelines. The Board's approval is sought to waive this requirement on the grounds that procurement has already been completed under JICA auspices, and that ADB is satisfied with the manner in which the procurement was undertaken. To ensure that other ADB requirements are adhered to, environmental and social safeguard provisions under ADB's Safeguard Policy Statement (2009) as well as other pertinent policy provisions (such as those related to labor standards and anticorruption) will be incorporated in

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<sup>10</sup> Executive Summary of Procurement Review on ICB/21/MPWTC-2015–Upgrading of Manatuto–Baucau Road (accessible from the list of linked documents in Appendix 2).

<sup>11</sup> To permit procurement (i) in countries that are not (a) developing member countries of ADB or (b) developed member countries of ADB that have contributed to the Asian Development Fund; and (ii) of goods, works, and services produced in such countries.

this civil works contract through a contract amendment to be signed by the government and the contractor prior to loan disbursement. Similarly, the consulting firm (financed under the JICA loan) overseeing construction supervision will agree to contract amendment to incorporate ADB requirements prior to loan disbursement.

21. The implementation arrangements are summarized in Table 3 and described in detail in the project administration manual.<sup>12</sup>

**Table 3: Implementation Arrangements**

Aspects	Arrangements		
Implementation period	July 2016–30 May 2022		
Estimated completion date	30 May 2022; loan closing date: 30 November 2022		
Management			
(i) Oversight body	Council for Administration of the Infrastructure Fund Minister of planning and strategic development (chair) Minister of public works, transport and communication (member) Minister of finance (member)		
(ii) Executing agency	Council for Administration of the Infrastructure Fund		
(iii) Key implementing agency	MPWTC		
(iv) Implementation unit	MPWTC, 15 staff (existing established unit)		
Consulting services	Individual consultant selection	30 person-months	\$1.0 million
Retroactive financing	Civil works and consulting services. Maximum 20% of the loan amount for expenditures incurred before loan effectiveness, but not more than 12 months before the signing of the loan agreements.		
Disbursement <sup>a</sup>	The loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2015, as amended from time to time) and detailed arrangements agreed upon between the government and ADB.		

ADB = Asian Development Bank; MPWTC = Ministry of Public Works, Transport and Communications.

Source: Asian Development Bank.

22. The detailed engineering design and construction supervision for the two civil works packages is financed from the JICA loan. ADB will finance the civil works contract package for the Manatuto to Baucau road; JICA will finance the civil works package for the Dili to Manatuto road on a parallel basis. Design and procurement of construction supervision services (covering both packages in a single contract) have also been completed under the auspices of JICA and are 100% financed by the JICA loan. Construction commenced in August 2016.

### III. DUE DILIGENCE

#### A. Technical

23. The project is relatively straightforward and adopts the same technical specifications and procedures applied in other national road upgrading projects financed by ADB and the World Bank. The pavements of the roads to be upgraded will be reconstructed and will allow for faster travel and substantially reduced vehicle operating costs. Climate resilience is emphasized in all designs regardless of the source of financing. Vulnerability to damage from extreme rainfall, sea level rise, and other potential effects of climate change will be reduced through engineering countermeasures, including providing suitably sized drainage structures, raising road levels in flood-prone areas, and using bioengineering to promote slope stability. A 2-year post-construction performance-based maintenance component is included in both the ADB and JICA civil works packages.

<sup>12</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

## B. Economic and Financial

24. Economic and financial analysis has been undertaken for the project in accordance with ADB's Guidelines for the Economic Analysis of Projects.<sup>13</sup> The project has an economic internal rate of return of 14.8% and a net present value of \$16.5 million. Fuel prices as of June 2016 have been used in the analysis. If fuel prices return to June 2015 levels, the economic internal rate of return would increase to approximately 16.6%. As civil works contracts have already been awarded, construction costs are known with a high degree of certainty. The engineering assessment found that the cost of maintaining an upgraded road in Timor-Leste is significantly less than the maintenance cost of unimproved roads. The cost of maintaining the road in the with-project case is \$0.25 million per year, while the cost of maintaining the road in the without-project case is estimated to be \$0.75 million. From 2013 to 2016, the government has allocated \$43.5 million for the rehabilitation of roads, in addition to approximately \$15 million per annum for reconstruction of national roads. The Petroleum Fund currently stands at approximately \$16 billion and is prudently managed, so Timor-Leste is well placed to allocate funds for maintenance of assets.<sup>14</sup>

## C. Governance

25. The National Procurement Commission was established in 2011. Since 2012, it has satisfactorily administered a number of bidding processes for ADB-financed projects in accordance with ADB's Procurement Guidelines. However, the transparency and efficiency of procurement still needs improvement, and a balance between risk and accountability for projects that do not have development partner oversight has not yet been achieved.

26. The public financial management system is heavily centralized with numerous controls that have slowed payment processes and weakened budget implementation. The Ministry of Finance has promoted decentralization of noncore financial management functions to line ministries, as capacity within these agencies has increased. However, the system for payments continues to involve a number of agencies in reviewing the payment certificates provided by the PMU and MPWTC.

27. The financial management assessment was conducted in accordance with ADB's Guidelines on the Financial Management and Analysis of Projects, and Financial Due Diligence: A Methodology Note.<sup>15</sup> The financial management assessment considered the capacity of the Council for Administration of the Infrastructure Fund (CAFI) through the Major Projects Secretariat, and of the MPWTC through the PMU, including funds flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements. Based on the assessment, the key financial management risks identified are the absence of internal audit function, inadequate reporting by the PMU, and the lack of credibility of the budget process. The overall pre-mitigation financial management risk of the CAFI and MPWTC, as it relates to the project outputs, is moderate. The CAFI (through the Major Projects Secretariat) and the MPWTC (through the PMU) have agreed to implement an action plan as a key measure to address the deficiencies.

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<sup>13</sup> ADB. 1997. *Guidelines for the Economic Analysis of Projects*. Manila.

<sup>14</sup> The Petroleum Fund is a sovereign wealth fund derived from petroleum revenue and used for financing the Infrastructure Fund, which funds infrastructure development.

<sup>15</sup> ADB. 2005. *Guidelines on the Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

28. The executing agency, the CAFI, was established in 2011 to oversee the use of the Infrastructure Fund. The Civil Service Act provides standards, principles, definitions, and guidelines for civil service administration; a code of ethics for civil servants; and an administrative disciplinary mechanism. A law creating the new Anti-Corruption Commission became effective in 2009, and the first anticorruption commissioner was appointed in 2010.

29. To mitigate risks, the MPWTC has implemented a number of ADB-supported infrastructure projects through its PMU. The PMU will oversee the implementation of the project. The PMU has a financial administrator who has considerable experience with ADB-financed projects. Based on previous project implementation experience, the PMU has demonstrable capacity to manage the project.

30. ADB's Anticorruption Policy (1998, as amended to date) was explained to the government and CAFI. Specific policy requirements and supplementary measures are described in the project administration manual (footnote 12).

#### **D. Poverty and Social**

31. The primary beneficiaries of the project are (i) road users, including vehicle drivers, passengers, and nonmotorized transport users; (ii) households in communities that sell cash crops and other agricultural produce; (iii) providers of passenger and goods transport services, and commercial truck drivers; and (iv) small businesses and traders, including vendors at local markets, trade store owners, coffee and other produce buyers, and small- and medium-sized enterprises. These groups will particularly benefit from more reliable and less costly transportation, resulting in lower cost of production and improved and more diversified economic activities. Key social service providers, such as those in the education and health sectors, will also benefit from increased accessibility and utilization of social services due to road upgrading. Women have been generally excluded from infrastructure-related jobs and decision-making related to infrastructure development. To address this within the project, it will incorporate women's views during implementation, and women will be encouraged to participate in an HIV/AIDS prevention program, and road safety and other awareness activities. Flexibility in the existing project design will be explored to incorporate gender elements where feasible.

#### **E. Safeguards**

32. **Environment.** The project is categorized as B for environment. Following the process and procedures already established by the PMU, JICA-financed consultants completed an environmental assessment, including an environmental management plan (EMP), for the Dili to Baucau section of the national road. ADB reviewed the environmental assessment (including the EMP) to confirm that it complies with Timor-Leste's country safeguard system for environment and the requirements of ADB's Safeguard Policy Statement. The assessment confirms that the environmental effects of the project will be similar in scale and impact to those of completed and ongoing road projects. The potential impacts will be site-specific and readily mitigated through measures identified in the EMP. Few, if any, of the impacts will be irreversible. Capacity building of the PMU's environmental safeguards staff will be ongoing through extension of the contracts of the international specialists providing mentoring and on-the-job training. Additional resources will be provided through specialists assigned to the design and supervision consultants' teams to help support the PMU effectively implement this project. For environment safeguards, next steps will include (i) providing induction training to the successful contractor for preparation, and subsequent implementation, of the site-specific EMP; and (ii)

monitoring the contractor's compliance with the site-specific EMP approved by the PMU, and preparing and submitting semiannual safeguards monitoring reports by the PMU.

33. **Social safeguards.** The project is categorized as B for involuntary resettlement and C for indigenous peoples in accordance with ADB's Safeguard Policy Statement. Road upgrading and rehabilitation will be conducted within the existing road corridor, with widening requiring small strips of land beyond the government-reserved area. As much as possible, construction limits are set within the existing alignment to minimize land acquisition impacts. The ADB-funded Manatuto to Baucau section is considered the most sensitive, with 137 affected persons experiencing major impacts from losing residential houses and/or permanent commercial kiosks, which constitute more than 10% of each affected person's income-earning assets. The JICA-financed Dili to Manatuto section will have 133 affected persons experiencing the same impacts. Two separate resettlement plans (one for the Dili to Manatuto section and one for the Manatuto to Baucau section) have been prepared jointly by JICA-financed project design consultants and the PMU and started implementation in July 2016. A social compliance audit has been undertaken to assess the project's compliance with the Safeguard Policy Statement and to recommend corrective actions to bring it into compliance prior to ADB financing of civil works. ADB and JICA will administer their respective road sections with joint supervision and monitoring of safeguards activities through the PMU, which will work closely with the safeguards team under the construction supervision consultant. Key stakeholders and affected persons have been consulted during the resettlement plan preparation and disclosure, and will be further consulted during implementation. The social compliance audit report will be disclosed on the ADB website and to affected persons and other relevant stakeholders. Capacity building of the PMU's national social safeguard staff will be provided by maintaining and extending the contracts of international specialists in the PMU.

34. The project is not expected to impact any distinct and vulnerable groups as defined by the Safeguard Policy Statement and therefore does not require an indigenous peoples plan. The project will support and promote the participation of local communities, and it will work to provide them with culturally appropriate benefits.

## F. Risks and Mitigating Measures

35. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>16</sup> The risks can be managed and are mitigated by the design of the project. The intended benefits and impacts are expected to outweigh the costs.

**Table 4: Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigating Measures</b>
Land acquisition delays the start of civil works	Resettlement plans will be finalized and compensation will be paid before civil works begin. Significant impacts will be avoided through design.
Difficult environment (high rainfall and unstable terrain)	Climate change adaptation and climate resilience measures are incorporated in the engineering designs.
MPWTC in-house capacity for technical guidance and supervision is weak	An existing and experienced PMU within the MPWTC will be maintained and strengthened to implement this project. More personnel will be added, where required.
Inadequate reporting on project costs, lack of internal audit function that undermines internal controls, and the lack of credibility of the budget process	The PMU will (i) enhance its financial management capacity to improve credibility of its reporting systems; (ii) implement internal controls through ensuring well-defined responsibilities and segregation of duties, supplemented by a financial management manual.

<sup>16</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Risks	Mitigating Measures
Lack of post-construction maintenance leads to asset deterioration	The road maintenance unit of the MPWTC will be strengthened to enhance its capability to submit budget proposals; and (ii) manage outsourced maintenance contracts. Routine maintenance for 2 years after completion of construction is included in the civil works contract.

MPWTC = Ministry of Public Works, Transport and Communications; PMU = project management unit.  
Source: Asian Development Bank.

#### IV. ASSURANCES AND CONDITIONS

36. 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.

37. The government has agreed with ADB on certain covenants for the project, which are set forth in the loan agreement.

38. The government has agreed with ADB on the following conditions for disbursement: (i) the government and the contractor will sign an amendment to the works contract in form and substance satisfactory to ADB to incorporate ADB-specific requirements into the contract; (ii) the government and the construction supervision consultant will sign an amendment to the construction supervision contract in form and substance satisfactory to ADB to incorporate ADB-specific requirements into the contract; (iii) the government will have implemented the resettlement plan, particularly the corrective actions from ADB's social compliance audit, for compliance with ADB's Safeguard Policy Statement; and (iv) the National Directorate of Pollution Control and Environmental Impact of the government has issued the environmental license incorporating all provisions from the initial environmental examination and/or simplified environmental impact statement, and the government has incorporated relevant provisions from the EMP into the works contract, for compliance with the Safeguard Policy Statement; and (v) the borrower shall have paid the initial \$10.14 million of the sums due to SCG-ABIPRAYA Joint Venture (the works contractor) under the works contract (including any advance payment) from its own resources.

#### V. RECOMMENDATION

39. 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

- (i) the loan in various currencies equivalent to SDR35,467,000 to the Democratic Republic of Timor-Leste for the Dili to Baucau Highway Project, from ADB's Special Funds resources, with an interest charge at the rate of 2% per annum during the grace period and 2% per annum thereafter; for a term of 25 years, including a grace period of 5 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; and
- (ii) the waiver of applicability of ADB's Procurement Guidelines (2015, as amended from time to time) and of ADB's member country procurement eligibility restrictions for the financing of the civil works contract for the Manatuto to Baucau road section as discussed more fully in paras. 19–20 of this report.

Takehiko Nakao  
President

19 October 2016

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the Project is Aligned with</b>			
Increased and more efficient movement of people and goods (ADB Country Partnership Strategy: Timor-Leste, 2016–2020; <sup>a</sup> Timor-Leste Strategic Development Plan, 2011–2030 <sup>b</sup> )			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Outcome</b> More reliable and safer road network	a. By the end of 2019, travel time on the road between Dili and Baucau decreases by 30% (2016 baseline: 3 hours)  b. Rate of road accidents on project roads does not increase (crashes resulting in serious injury or loss of life per year)	a–b. Project completion report prepared by MPWTC  b. National accident statistics produced by the Timor-Leste National Police Force	a–b. Lack of post-construction maintenance leads to asset deterioration  Private sector contractor capacity for performance-based maintenance is weak  b. Delivery of a national road safety action plan is not effective
<b>Outputs</b> 1. 105 km of national road between Dili and Baucau upgraded and climate-proofed  2. Performance-based road maintenance expanded  3. Awareness of road safety and transport-related social issues generated	1a. By the end of 2019, the average roughness of the 105 km section of national road between Dili and Baucau decreases to less than 4 m/km baseline: average of 8 m/km (2016)  2a. By the end of 2019, performance-based maintenance for the upgraded 105 km section of national road executed (2015 baseline: not applicable)  3a. By the end of 2019, at least 80% of children and 80% of women in project roadside communities receive road safety awareness education. (baseline: not applicable)  3b. Rate of increase of fatal injury due to road crash on the project road	1a. Annual road condition surveys by DRBFC; project monitoring reports from MPWTC  2a. Annual road condition surveys by DRBFC; DRBFC road maintenance program annual reports  3a. Records of road safety education delivered to schools maintained by the Ministry of Education  3b. Records of crash fatalities maintained by the Road Safety	Land acquisition delays the start of civil works  Difficult physical environment resulting from high rainfall and unstable terrain  MPWTC in-house capacity for technical guidance and supervision is weak



Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	is less than the rate of growth in the national vehicle fleet	Directorate, Ministry of the Interior, Timor-Leste National Police Force, and Ministry of Health	
<p><b>Key Activities with Milestones</b></p> <p><b>1. 105 km of national road between Dili and Baucau upgraded and climate-proofed</b></p> <p>1.1 Civil works contracts for the upgrading of the road sections (Dili to Manatuto and Manatuto to Baucau) commence by September 2016 and are completed by August 2019.</p> <p><b>2. Performance-based road maintenance expanded</b></p> <p>2.1 Maintenance is undertaken by day works during the defects notification period from September 2019 to August 2020.</p> <p>2.2 Performance-based maintenance is undertaken by the original contractors from September 2020 to August 2022.</p> <p><b>3. Awareness of road safety and transport-related social issues generated</b></p> <p>3.1 Awareness and education campaigns are conducted in roadside communities and schools from October 2016 to September 2020.</p> <p><b>Project Management Activities</b></p> <p>Maintain or strengthen project management unit capacity for management of overall development partner-financed national road upgrading program.</p> <p>Implement resettlement plan prior to commencement of works.</p> <p>Monitor implementation of environmental management plan.</p> <p>Manage performance of supervision consultant and contractors.</p>			
<p><b>Inputs</b></p> <p>ADB: \$49.65 million (ADF loan)</p> <p>Government: \$27.19 million</p> <p>JICA: \$49.74 million (loan)</p>			
<p><b>Assumptions for Partner Financing</b></p> <p>Outputs not administered by ADB that are necessary to reach the outcome include:</p> <p>Output (JICA): Upgrading and climate-proofing of 49 km of national road between Dili and Manatuto (included in aggregate project output).</p>			

ADB = Asian Development Bank; ADF = Asian Development Fund; DRBFC = Directorate of Roads, Bridges, and Flood Control; JICA = Japan International Cooperation Agency; km = kilometer; m = meter; MPWTC = Ministry of Public Works, Transport and Communications.

<sup>a</sup> ADB. 2016. *Country Partnership Strategy: Timor-Leste, 2016–2020*. Manila.

<sup>b</sup> Government of Timor-Leste. 2011. *Timor-Leste Strategic Development Plan, 2011–2030*. Dili.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=50211-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Transport (Nonurban Road Transport)
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. Initial Environmental Examination: Simplified Environmental Impact Statement
10. Resettlement Plan: Social Compliance Audit Report
11. Risk Assessment and Risk Management Plan

**Supplementary Documents**

12. Financial Management Assessment
13. Consultation and Participation Plan
14. Executive Summary of Procurement Review on ICB/21/MPWTC-2015–Upgrading of Manatuto–Baucau Road