



Report and Recommendation of the President to the Board of Directors

Project Number: 50301-001
September 2017

Proposed Multitranche Financing Facility Democratic Socialist Republic of Sri Lanka: Second Integrated Road Investment Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 3 August 2017)

Currency unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.006515
\$1.00	=	SLRs153.49

ABBREVIATIONS

ADB	–	Asian Development Bank
EIRR	–	economic internal rate of return
EMP	–	environmental management plan
IEE	–	initial environmental examination
JICA	–	Japan International Cooperation Agency
km	–	kilometer
MFF	–	multitranches financing facility
MOHEH	–	Ministry of Higher Education and Highways
PBM	–	performance-based maintenance
RDA	–	Road Development Authority

NOTE

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

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INVESTMENT PROGRAM^a AT A GLANCE

1. Basic Data		Project Number: 50301-001				
Project Name	Second Integrated Road Investment Program	Department /Division	SARD/SATC			
Country Borrower	Sri Lanka Democratic Socialist Republic of Sri Lanka	Executing Agency	Ministry of Higher Education and Highways			
2. Sector	Subsector(s)	ADB Financing (\$ million)				
✓ Transport	Road transport (non-urban)		900.00			
		Total	900.00			
3. Strategic Agenda	Subcomponents	Climate Change Information				
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Adaptation (\$ million)	40.10			
Environmentally sustainable growth (ESG)	Global and regional transboundary environmental concerns	Climate Change impact on the Project	Medium			
4. Drivers of Change	Components	Gender Equity and Mainstreaming				
Governance and capacity development (GCD)	Organizational development	Effective gender mainstreaming (EGM)	✓			
Private sector development (PSD)	Conducive policy and institutional environment					
5. Poverty and SDG Targeting		Location Impact				
Geographic Targeting	No	Rural	High			
Household Targeting	No					
SDG Targeting	Yes					
SDG Goals	SDG8, SDG9					
6. Risk Categorization:	Complex					
7. Safeguards Categorization [Tranche 1]	Environment: B Involuntary Resettlement: B Indigenous Peoples: C					
8. Financing						
Modality and Sources	Indicative Tranches (\$million)					Amount (\$million)
	I	II	III	IV	V	
ADB						900.00
Sovereign MFF-Tranche (Concessional Loan): Ordinary capital resources	60.00	25.00	0.00	0.00	0.00	85.00
Sovereign MFF-Tranche (Regular Loan): Ordinary capital resources	90.00	125.00	200.00	200.00	200.00	815.00
Cofinancing						0.00
None	0.00	0.00	0.00	0.00	0.00	0.00
Counterpart						184.60
Government	22.10	22.10	28.70	28.70	83.00	184.60
Total	172.10	172.10	228.70	228.70	283.00	1,084.60
9. Country Operations Business Plan						
CPS	https://www.adb.org/sites/default/files/institutional-document/342216/cps-sri-2018-2022.pdf					
COBP	https://www.adb.org/documents/sri-lanka-country-operations-business-plan-2017-2019					
10. Investment Program Summary						
The investment program will improve the accessibility of the road network in Sri Lanka's rural areas, and thereby increase the involvement of the rural population in nationwide economic and social development. It will upgrade and maintain about 3,400 kilometers (km) of rural access roads to an all-weather standard; rehabilitate and maintain to a good condition about 340 km of national roads in Eastern, Northern, Uva, and Western provinces; and improve the capacity of road agencies with respect to safeguards, road safety, maintenance, research capacity, and road design and construction.						
Impact: Connectivity between rural communities and socioeconomic centers in Sri Lanka improved.						

INVESTMENT PROGRAM^a AT A GLANCE

Outcome: Transport efficiency on project roads increased.

Outputs: (i) Road conditions between the selected rural communities and socioeconomic centers improved, and (ii) capacity of road agencies enhanced.

Implementation Arrangements: Ministry of Higher Education and Highways will be the executing agency.

Project Readiness: The proposed Second Integrated Investment Program was approved by the cabinet on 24 January 2017. Bidding documents for the first package had been prepared. The bids were announced in June 2017. Contracts are expected to be awarded by December 2017.

11. Milestones

Modality	Estimated Approval	Estimated Completion ^b
Multitranche financing facility	28 September 2017	31 March 2027
Tranche I	2 October 2017	30 June 2020
Tranche II	28 September 2018	30 June 2021
Tranche III	30 September 2019	30 June 2022
Tranche IV	30 September 2020	30 June 2023
Tranche V	30 September 2021	31 December 2026

12. Project Data Sheet (PDS)

PDS^c <http://www.adb.org/projects/50301-001/main>

^a Multitranche Financing Facility (MFF).

^b For MFF, this refers to the end of the availability period; for tranches, this refers to the tranche closing date.

^c Safeguard documents can be viewed by clicking the Document's hyperlink in the Project Data Sheet (PDS) page.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed multitranche financing facility (MFF) to the Democratic Socialist Republic of Sri Lanka for the Second Integrated Road Investment Program.

2. The investment program will improve the accessibility of the road network in Sri Lanka's rural areas, and thereby increase the involvement of the rural population in nationwide economic and social development. It will upgrade and maintain about 3,400 kilometers (km) of rural access roads to an all-weather standard; rehabilitate and maintain to a good condition about 340 km of national roads in Eastern, Northern, Uva, and Western provinces; and improve the capacity of road agencies with respect to safeguards, road safety, maintenance, research capacity, and road design and construction.¹

II. THE INVESTMENT PROGRAM

A. Rationale

3. Sri Lanka's economy has grown at an annual average of 6% since 2003. With strong economic growth, the poverty rate dropped significantly, from 22.7% in 2002 to 6.7% in 2012–2013.² About 82% of Sri Lanka's population (21 million in 2015) lives in rural areas.³ The rural sector also recorded a remarkable reduction in poverty, from 24.7% in 2002 to 7.6% in 2012–2013.

4. Despite rapid progress in reducing poverty, Sri Lanka faces several challenges to fully eradicate poverty. Disparities in the poverty rate exist across provinces and districts, particularly in districts in Eastern, Northern, and Uva provinces, where headcount poverty rates are close to, or exceed, 20%. The Western Province, which has Sri Lanka's lowest headcount poverty rate, still retains pockets of poverty—36% of the population remains vulnerable and lives close to the poverty line (on less than \$4 per day). Consumption and income inequality have both increased since 2009, with slower consumption and income growth among the poorer half of the population than among the wealthier half.⁴ Pro-poor economic growth will need to be driven not only by high rates of public expenditure, but also by market-oriented value addition and private sector-led investment. Access to markets, and business and knowledge opportunities and benefits, especially along agricultural value chains, will be key to further poverty reduction and shared prosperity in rural areas. However, these have been hindered by poor transport infrastructure, particularly poorly maintained provincial and local authority roads.

5. Sustainable and inclusive development remains a key concept as the government seeks to secure prosperity for everyone. The government's development policy statements identified five development goals: (i) generate 1 million jobs, (ii) enhance income levels, (iii) develop rural economies, (iv) ensure land ownership in rural and estate sectors, and (v) create and grow a

¹ The Road Development Authority (RDA) prepared the proposed investment program with assistance from the consultants recruited for the Integrated Road Investment Program. Asian Development Bank. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Democratic Socialist Republic of Sri Lanka for the Integrated Road Investment Program*. Manila.

² Government of Sri Lanka, Department of Census and Statistics. 2015. *Household Income and Expenditure Survey 2012/13*. http://www.statistics.gov.lk/HIES/HIES2012_13FinalReport.pdf. The Department of Census and Statistics conducted the 2012–2013 survey from July 2012 to June 2013 and the 2002 survey from January to December 2002.

³ World Bank. 2016. *World Development Indicators*. Washington, DC.

⁴ World Bank. 2016. *Country Partnership Framework for the Democratic Socialist Republic of Sri Lanka for the Period FY17–20*. Washington, DC.

strong middle class.⁵ To develop rural economies, the government plans to establish 2,500 rural development centers as rural economic market hubs. This will be achieved by grouping many villages as potential development centers with access to fully equipped rural economic market units, and by upgrading or rehabilitating rural access routes.⁶

6. **Road map.** Sri Lanka's road network is dense and well laid out, providing basic access to the country's population and economic activity centers. The 117,012-km road network is classified into national, provincial, and local authority roads, based on administrative responsibility.⁷ The central government is responsible for transport policy.

7. Notable progress has been made since 2005 in addressing trunk road network deficiencies,⁸ but progress in improving provincial and rural roads has been relatively slow.⁹ Improvement of the poor rural transport infrastructure is key to achieving the government's development goals. Improving connectivity is challenging because most rural access roads, including provincial and local roads, cannot provide all-weather, user-friendly access, and parts of the trunk road network are in poor condition. These issues stem from (i) competition for budget allocations; (ii) limited availability of suitable raw materials; (iii) the limited project implementation capacity of road agencies, particularly at provincial and local levels; (iv) ad hoc selection of provincial and local project roads that lacks clear criteria; and (v) insufficient community involvement in rural road development.

8. Preserving the asset value of rehabilitated infrastructure, particularly road infrastructure managed by the provinces and local authorities, is also challenging.¹⁰ Several factors must be addressed to ensure sustainability of rural road assets, including (i) inadequate rural road design standards and construction specifications; (ii) poor provincial and local-level contractor capacity; (iii) limited technical maintenance and road asset management capacity on the part of provincial and local-level road agencies; (iv) lack of capital investment coupled with sound maintenance regimes; and (v) insufficient maintenance budget allocations to rural roads.

9. **Policy framework.** The government has adopted a two-tier strategy to provide nationwide connectivity: (i) establish a trunk road network with expressways and well-connected national roads linked to the global value chain, and (ii) complete a rural road network to connect the rural population to trunk roads for poverty reduction and shared prosperity. The Public Investment Programme, 2017–2020, provides policy directions for the road sector to facilitate the country's economic growth by creating an efficient road network that (i) connects large and emerging cities,

⁵ From the Prime Minister's economic statements to Parliament on 5 November 2015 and on 27 October 2016.

⁶ The government is implementing a \$1.8 billion rural road connectivity investment plan designed to provide physical infrastructure and capacity to enhance rural road connectivity. The previous government originally selected about 1,000 rural communities as rural hubs, based on their population and development potential. The current government recently expanded the number of rural hubs to 2,500.

⁷ The central government, through the Road Development Authority (RDA), manages 161 kilometers (km) of expressways and 12,208 km of class A and class B roads classified as national roads. The provincial councils manage the provincial road network, which comprises 19,083 km of class C and class D roads. Local authorities manage the 85,560 km of local authority roads classified as class E. In addition, other government agencies (e.g., forest and irrigation departments) manage about 20,000 km of roads.

⁸ The proportion of national roads in good and fair condition rose from 48% in 2005 to 70% in 2015, and those in poor condition declined from 52% to 30% during the same period.

⁹ The government has established a rural road program, Maga Neguma, to improve rural roads through the RDA. Since 2004, the program has improved about 10,000 km of rural roads at the request of local authorities. In total, the government has rehabilitated 4,900 km (26%) of provincial roads, and 39,000 km (37%) of rural roads.

¹⁰ About 80% of the rural access road network still requires rehabilitation.

townships, economic centers, and rural hubs, and (ii) ensures safety and equity.¹¹

10. For the rural road network enhancement program (footnote 6), the government established an implementation framework for the Road Development Authority (RDA) to improve provincial and local authority roads with local road agencies. The objective was to accelerate completion of the rural road network by supplementing the limited capacity of the local agencies. To overcome shortcomings in previous rural road development programs, the framework increased subproject selection criteria accountability and strengthened community participation.

11. To manage the national road network, the RDA deployed a comprehensive road asset management system in its planning division and is currently enhancing the system, with assistance from the World Bank, to improve internal management efficiency. Expansion of the road asset management system to provincial and local authority roads is supported under the Integrated Road Investment Program approved in 2014.¹² A road maintenance trust fund was established in 2005, which through its operational budget provides sustainable funding for routine and periodic maintenance of the national road network. The maintenance budget increased from SLRs1.8 billion in 2005 to SLRs4.3 billion in 2015, following the establishment of the road maintenance trust fund.¹³ The budget increase, together with the RDA's enhanced technical maintenance capacity and the introduction of a road asset management system, has improved the condition of national roads, but rural road sustainability still needs improvement.¹⁴ Initiatives were undertaken in the first program to improve rural road sustainability through (i) improvement of rural road design and specifications, (ii) introduction of a 3-year performance-based maintenance (PBM) contract, and (iii) technical capacity development of local road agencies.

12. **Strategic context.** In line with the government's national strategy, the country partnership strategy, 2018–2022 of the Asian Development Bank (ADB) for Sri Lanka aims to address major development constraints by (i) strengthening the drivers of economic growth, and (ii) improving the quality of growth.¹⁵ The transport sector is a key area for implementing the strategy, and ADB places high value on improving the accessibility of the road network to integrate rural communities with socioeconomic centers.

13. **Investment program.** The proposed Second Integrated Road Investment Program aligns with the government strategy and policy to establish fully connected rural development centers with upgraded rural roads. The proposed investment program targets the three lagging provinces of Eastern, Northern, and Uva, and Western Province, and will complement assistance under the first program in other areas to cover all of the country's priority rural development hubs.¹⁶ The proposed investment program will play a catalytic role in the sustainable development of rural areas.

¹¹ Government of Sri Lanka, Ministry of National Policies and Economic Affairs, Department of National Planning. 2017. *Public Investment Programme, 2017–2020*. Colombo.

¹² ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranches Financing Facility to the Democratic Socialist Republic of Sri Lanka for the Integrated Road Investment Program*. Manila.

¹³ Given the inflation rate during the period, the budget has stayed at the same level in real terms.

¹⁴ Although the overall rating is *successful*, a recent completion report on a provincial road project rated sustainability as less than likely to be achieved (ADB. 2016. *Completion Report: Eastern and North Central Provincial Road Project in Sri Lanka*. Manila).

¹⁵ ADB. 2017. *Country Partnership Strategy: Sri Lanka 2018–2022*. Manila.

¹⁶ ADB approved the first program, with an MFF of \$800 million, to upgrade the rural road network in the Central, North Central, North Western, Sabaragamuwa, and Southern provinces, and in the Kalutara district in Western Province. The proposed investment program will also cover the Kalutara district in Western Province (the project allocation to the district under the first program was insufficient).

14. An MFF is proposed for the financing modality for the investment program because it will allow long-term partnership between the government and ADB on policy dialogue and capacity development within the large-scale program. The MFF uses a time-slicing approach to increase the efficiency of financial resource utilization during program implementation.¹⁷ Under the proposed MFF, the RDA identified the projects, all of which have a low safeguards risk classification (none are classified as category A). Subsequent MFF tranches will finance the identified projects in accordance with disbursement requirements.

15. A portfolio review of ADB-funded road projects confirmed that Sri Lanka has adequate implementation capacity. Review missions for the first program also observed that it is being implemented smoothly with no critical implementation capacity issues.¹⁸ RDA awarded all contracts for rural roads under the first program. Physical progress of the civil works is about 47.1% as of June 2017. Lessons from the review are incorporated in the design of the proposed investment program. Major improvements include (i) stronger community participation, (ii) more rational contract package, and (iii) modified contract conditions.¹⁹

16. **Development coordination.** There has been continuous coordination among development partners active in Sri Lanka's road sector since 2004, which include ADB, the Japan International Cooperation Agency (JICA), and the World Bank. JICA has assisted in the rehabilitation of national and provincial roads.²⁰ The World Bank has supported the rehabilitation of national, provincial, and local authority roads, and institutional changes and reforms in road maintenance management. In 2016, the World Bank approved the Transport Connectivity and Asset Management Project to support modern road asset management in the RDA.²¹

B. Impact and Outcome

17. The impact of the investment program will be improved connectivity between rural communities and socioeconomic centers in Sri Lanka, in line with the Public Investment Programme, 2017–2020. The outcome will be increased transport efficiency on project roads.

C. Outputs

18. The outputs of the proposed investment program will be (i) improved road conditions between the selected rural communities and socioeconomic centers, and (ii) enhanced capacity of road agencies.²²

¹⁷ Comparison of Financing Modality and Approach to Time-Slice Financing (accessible from the list of linked documents in Appendix 2).

¹⁸ Summary Review of the First Investment Program (accessible from the list of linked documents in Appendix 2). As for the capacity development component, more than 60 workshops and training programs have been carried out on road safety, community participation methodology, contract management, and safeguards. Technical specifications for rural road construction and maintenance are also being updated. Support for the road asset management development will start within 2017.

¹⁹ Other lessons are also incorporated such as (i) more accurate cost estimates and design and/or bills of quantity that consider local conditions and climate change impacts, and (ii) strengthening the capacity development component.

²⁰ The Japan International Cooperation Agency (JICA) originally planned to finance part of the rural road connectivity program but has shifted its strategic focus from the transport sector to urban transport in Colombo. However, cofinancing opportunities with other development partners will be further explored in subsequent tranches

²¹ World Bank. 2016. *Project Appraisal Document: Sri Lanka—Transport Connectivity and Asset Management Project*. Washington, DC.

²² The capacity development component will involve (i) training on safeguards, road safety awareness, contract management, and rural road design and construction; (ii) enhancement of the RDA's research capacity, including procurement of laboratory equipment; (iii) development of pavement design, road asset management, information management system, and road safety guidelines; and (iv) institutional support for financial sustainability.

D. Investment and Financing Plans

19. The investment program is estimated to cost \$1,084.60 million (Table 1).

Table 1: Investment Program
(\$ million)

Item	Amount ^a
A. Base Cost^b	
1. Civil works	892.40
2. Equipment	5.80
3. Consulting services for project implementation and capacity development	37.90
4. Recurrent costs (project management)	17.20
Subtotal (A)	953.30
B. Contingencies^c	108.30
C. Financing Charges During Implementation^d	23.00
Total (A+B+C)	1,084.60

^a Includes taxes and duties of \$124.3 million to be financed from government resources.

^b In mid-2017 prices.

^c Physical contingencies computed at 10.0% for civil works, 10.0% for equipment, and 10.0% for consulting services. Price contingencies computed at about 1.5% on foreign exchange costs and about 5.0% on local currency costs; includes provision for potential exchange rate fluctuation.

^d Includes interest and commitment charges. Interest during construction for Asian Development Bank's (ADB) regular ordinary capital resources (OCR) loan has been computed at the 5-year fixed swap London interbank offered rate (LIBOR) plus a spread of 0.50% and a maturity premium of 0.20%. Commitment charges for ADB's regular OCR loan are 0.15% per year to be charged on the undisbursed loan amount. Interest during construction for ADB's concessional OCR loan has been computed at 2.00% per year.

Source: Asian Development Bank estimates.

20. The government has requested an MFF in an amount up to \$900 million from ADB's ordinary capital resources, in regular and concessional terms, to help finance a part of the investment program. The MFF will consist of several tranches, subject to the government's submission of related periodic financing requests, execution of the related loan and project agreements for each tranche, and fulfillment of terms of conditions and undertakings set forth in the framework financing agreement.²³ Each tranche will finance parts of the works, equipment, and consulting services contracts using the time-slice approach for the large-scale program. Once a tranche is substantially disbursed, the government will submit a periodic financing request for a subsequent tranche, which will continue to finance the contracts awarded under the first tranche.²⁴

21. The MFF will provide regular and concessional loans up to the aggregate MFF amount. Any allocation for concessional loans will be subject to (i) the availability of such resources, (ii) Sri Lanka's access to such resources pursuant to ADB's Graduation Policy and the requirements of donors to such resources,²⁵ and (iii) the availability of such resources to Sri Lanka given ADB's performance-based allocation of such resources.²⁶ Any change in the amount of concessional loans will be balanced by a corresponding change in the regular loans, with total financing provided under the MFF not to exceed the aggregate MFF amount.

22. The first tranche of the MFF will comprise (i) a regular loan of \$90 million, and (ii) a concessional loan of \$60 million. The regular loan will have a 30-year term, including a grace

²³ Framework Financing Agreement (accessible from the list of linked documents in Appendix 2).

²⁴ Approach to Time-Slice Financing (accessible from the list of linked documents in Appendix 2).

²⁵ ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila.

²⁶ ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources*. Manila; and ADB. 2008. *Refining the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

period of 7 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year (the interest and other charges during construction to be capitalized in the loan); and such other terms and conditions set forth in the draft loan and project agreements. Based on the straight-line method, the average maturity is 18.75 years, and the maturity premium payable to ADB is 0.20% per year.²⁷ The concessional loan will have a 25-year term, including a grace period of 5 years; an interest rate of 2.00% per year during the grace period and thereafter (the interest during construction to be capitalized in the loan); and such other terms and conditions set forth in the draft loan and project agreements.

23. The proposed tranche schedule and financing plan are in Table 2. The government will finance taxes and duties, and part of contingencies, for a total of \$184.6 million.

Table 2: Financing Plan

Source	Amount (\$ million)	Share of Total (%)	Indicative Tranche Schedule and Amount (\$ million)					
			1 (2017)	2 (2018)	3 (2019)	4 (2020)	5 (2021)	
ADB								
OCR (regular loan)	815.0	75.1	90.0	125.0	200.0	200.0	200.0	
OCR (concessional loan)	85.0	7.8	60.0	25.0	0.0	0.0	0.0	
Government of Sri Lanka	184.6	17.0	22.1	22.1	28.7	28.7	83.0	
Total	1,084.6	100.0	172.1	172.1	228.7	228.7	283.0	

ADB = Asian Development Bank, OCR = ordinary capital resources.

Note: Percentages may not total 100% because of rounding.

Source: Asian Development Bank.

E. Implementation Arrangements

24. The implementation arrangements are summarized in Table 3 and described in detail in the facility administration manual.²⁸

Table 3: Implementation Arrangements

Aspects	Arrangements		
Implementation period	September 2017–March 2027		
Estimated completion date	31 March 2027		
Management ^a			
(i) Executing agency	Ministry of Higher Education and Highways		
(ii) Key implementing agency	RDA		
(iii) Implementation unit	4 implementation units under the RDA with 205 staff		
Procurement	International and/or national competitive bidding (civil works)	53 contracts	\$892.4 million
	Shopping (equipment)	11 contracts	\$5.8 million
Consulting services	Project implementation consultants (QCBS 90:10), including for training programs	144 person-months of international services and 9,741 person-months of national services (4 contracts)	\$33.2 million
	Individual consultants ^b	104 person-months of international services and 198 person-months of national services	\$4.7 million
Retroactive financing and/or advance contracting	The RDA will use retroactive financing and advance contracting for civil works, equipment, and consulting services. ADB will provide retroactive financing to finance expenditures incurred prior to loan effectiveness but not earlier than 12 months		

²⁷ The maturity-based premium of 0.20% is based on the loan terms and the government's choice of repayment option and dates.

²⁸ Facility Administration Manual (accessible from the list of linked documents in Appendix 2).

	before the date of signing of the loan agreements and not exceeding 20% of the loan amount.
Disbursement	The loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.

ADB = Asian Development Bank, QCBS = quality- and cost-based selection, RDA = Road Development Authority.

^a A national steering committee and provincial steering committees will be established as oversight bodies, as detailed in the Facility Administration Manual (accessible from the list of linked documents in Appendix 2).

^b The RDA will recruit individual consultants for research capacity enhancement, mechanistic-empirical pavement design development, road asset management, information management system, road safety guidelines, and institutional support for financial sustainability.

Sources: Asian Development Bank and Road Development Authority.

III. DUE DILIGENCE

A. Technical

25. The RDA has identified the projects to be included under the investment program on the basis of specific selection criteria.²⁹ Engineering designs have been prepared for the project roads by RDA engineers, which are optimized for local conditions, construction efficiency, and economy, with due attention to climate change impacts.³⁰ The designs use a higher-standard asphalt pavement than the traditionally used bituminous surface treatment, in order to reduce maintenance requirements and increase long-term economic efficiency. The RDA will strengthen community participation through a context-sensitive design approach to accommodate local requests and concerns. Civil works contracts include 3-year performance-based maintenance (PBM) (5-year PBM for national roads) to ensure efficient maintenance and implementation performance of contractors.

B. Economic and Financial

26. **Economic analysis.** The economic analysis of the investment program follows ADB guidelines, and compares life-cycle costs in with- and without-project scenarios, using a 9% discount rate and the economic internal rate of return (EIRR) as decision criteria.³¹ All roads proposed under all tranches of the time-slice investment program were evaluated. Quantified benefits include savings in vehicle operation costs, travel time, and road maintenance costs, as well as a reduction in carbon dioxide emissions. The overall EIRR of the investment program is estimated to be 17.2%, with an estimated poverty impact ratio of 34.0%.³² The sensitivity analysis demonstrated the robustness of the projects.

27. **Financial sustainability.** The project will not generate revenue. Financial requirements for the maintenance of road assets will decrease in the first 10 years after construction due to (i) lower routine maintenance costs resulting from improved pavement conditions, and (ii) the inclusion of PBM contracts. After the PBM contracts elapse, project road maintenance will become the responsibility of respective road agencies. The incremental recurrent costs of national roads are estimated to be 0.7% of the RDA maintenance budget, while the incremental recurrent

²⁹ The main criteria for rural roads are (i) number of households (50 or more); (ii) availability of electricity and water; (iii) presence of health and medical facilities, educational facilities, and commercial and market facilities; and (iv) absence of land acquisition, and environmentally sensitive areas.

³⁰ The incremental cost to address climate change adaptation is estimated at 5.2% of the civil works cost. This includes the additional cost of drainage, culverts, retaining walls, and concrete pavement in flooded areas to address identified climate risks and vulnerabilities such as flooding, soil erosion, and landslide.

³¹ ADB. 2017. *Guidelines for the Economic Analysis of Projects*. Manila.

³² The economic internal rate of return (EIRR) (excluding carbon dioxide emissions savings) is 17.1%.

costs of provincial and local roads in Eastern, Northern, and Uva provinces are estimated to require a 2%–7% increase in the maintenance budget of provincial authorities, and a 29%–40% increase in the maintenance budget of local authorities.³³ Improvements in institutional funding arrangements are required to ensure the sustainability of provincial and local road investments over their design life. In addition to the government's commitment to allocate sufficient maintenance funds, the RDA will recruit institutional management specialists under the investment program to propose feasible policy improvements or alternatives to the existing road maintenance scheme. ADB will closely monitor progress during program implementation.

C. Governance

28. **Policy and legal.** Implementation arrangements will involve the central, provincial, and local governments.³⁴ At the central level, the Ministry of Higher Education and Highways (MOHEH) is responsible for the formulation of policies and performance monitoring. The RDA was established as a statutory authority with separate legal status by the Road Development Authority Act, 1981. The RDA chairperson reports to the MOHEH secretary. Under the 13th amendment to the Constitution (enacted in 1987) and the Pradheshiya Sabha Act, No. 15 of 1987, provincial councils (which constitute provincial-level government agencies) are responsible for the work of local authorities within the areas served by the provincial councils. In keeping with the devolution norm of Sri Lanka, the RDA operates as though it was contracted by the provincial authorities to construct roads that belong to the local authorities. The implementation arrangements satisfy the RDA Act, which requires the RDA to consult with other government agencies on projects within their areas. The national steering committee and provincial coordination committees will ensure proper coordination.

29. **Institutional capacity.** MOHEH and the RDA have sufficient capacity, experience, and institutional strength to procure civil works, equipment, select consultants, and administer contracts. Provincial, district, and local authorities will participate in the steering and coordination committees, with consideration of their respective institutional capacity.

30. **Financial management.** The RDA has prior and ongoing experience in implementing ADB-funded projects. A financial management assessment of the RDA found that the RDA's overall risk is *moderate*. The RDA has a dedicated project accounting and finance team with suitably qualified accountants. The RDA will establish and maintain separate project records and accounts to identify the financing resources received and expenditures made for the project, thus ensuring an adequate audit trail. The government's Auditor General's Department will audit the project accounts and financial statements annually, following international auditing standards.

31. **Procurement and anticorruption.** Procurement will be undertaken in accordance with the ADB Procurement Guidelines (2015, as amended from time to time). All consultants will be engaged in accordance with the ADB Guidelines on the Use of Consultants (2013, as amended from time to time). The Bribery Act, No. 11 of 1954 (as amended from time to time); the Declaration of Asset and Liabilities Act, No. 1 of 1975; and the Permanent Commission to Investigate Allegations of Bribery and Corruption Act, No. 19 of 1994 provide a legal basis for addressing bribery and corruption. The auditor general will check procurement activities. The ADB Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, MOHEH, and the RDA. The specific policy requirements and supplementary

³³ Costs in Western Province are expected to decrease by 3% of the maintenance budget.

³⁴ The governance arrangements for the proposed investment program are the same as those used in the first program. No major issues have been observed in terms of the RDA's implementation capacity.

measures are described in the facility administration manual.

D. Poverty and Social

32. **Poverty reduction and social impacts.** The investment program will improve the socioeconomic situation and enhance poverty reduction in Eastern, Northern, Uva, and Western provinces (para. 26). About 9.8 million people live in the project area's 145 divisions. A socioeconomic assessment found that the main sources of income for users of the proposed roads are agriculture, fisheries, self-employment, and wage labor. Employment in the public and private sectors is significant in larger towns. Over 90% of surveyed households described the current road conditions as bad. Communities indicated that poor road conditions affected day-to-day activities. Improved access to education and health, road safety, and increased job opportunities were listed among the positive benefits expected to result from the improvements. Many of the roads to be improved under the investment program are in areas that were affected by the 26-year civil conflict, and upgrading these roads will benefit post-conflict rehabilitation and the continued revival of the rural economy.

33. **Gender and development.** The socioeconomic assessment found that women were actively engaged in family and community activities and decision-making processes, although results vary among provinces. Women surveyed for the assessment said they were willing to participate in the projects by (i) working as maintenance or civil works wage laborers, and/or (ii) operating a small business to provide services to contractors. The gender action plan prepared for tranche 1 includes key gender mainstreaming activities.³⁵ Tranche 1 is classified as effective gender mainstreaming.

34. **HIV, AIDS, and human trafficking.** The HIV prevalence rate is low in Sri Lanka. The establishment of the National Program for Sexually Transmitted Diseases and AIDS Control helps refurbish health clinics and establish outreach and awareness programs throughout the country. The investment program has incorporated measures to mitigate HIV and AIDS risks by providing awareness training for civil works contractors and for project-affected communities at prominent village locations. Awareness-raising activities will be conducted separately for men and women. The social impact assessment did not identify human trafficking as a significant issue in the project area. It is anticipated that civil works contractors will hire local laborers; as a mitigation measure, affected communities will be provided with awareness training on human trafficking. Specific provisions in the bid documents and the works contracts financed under the program will ensure that the contractors follow all applicable international core labor standards and national labor laws.

E. Safeguards

35. **Involuntary resettlement and indigenous peoples.** Projects identified under the time-slice investment program are classified *category B* for involuntary resettlement in accordance with

³⁵ Gender Action Plan: Tranche 1 (accessible from the list of linked documents in Appendix 2). Key gender mainstreaming activities for tranche 1 include (i) ensuring at least 35% of those engaged for design consultations are women; (ii) integrating features that increase safety and meet the needs of the elderly, women, children, and the disabled; (iii) encouraging employment of local women as road construction workers; (iv) ensuring that at least 30% of local employees hired for road maintenance are women and that they receive equal wages for equal work; (v) conducting awareness training on road safety, HIV, and sexually transmitted infections, with women comprising a minimum of 40% of participants; (vi) appointing gender focal persons at all levels; (vii) building knowledge and skills of the transport sector on gender and inclusivity; and (viii) developing an online grievance reporting mechanism, and tracking gender-disaggregated data regarding complainants.

ADB's Safeguard Policy Statement (2009).³⁶ Rural access road and national road improvements will be made within the existing alignments, with no widening required. Due diligence identified no impacts to land, structures, private trees, or community resource properties. However, minimal land acquisition for national roads may be required at black spots to ensure road safety. A grievance redress mechanism will be established in all project areas. The resettlement framework will guide compliance with social safeguard requirements.³⁷ A voluntary land donation system was used effectively in the first program, and will be used if land should be required for rural roads during project implementation. Specific procedural requirements for land donation involve comprehensive consultations with the communities, and are specified in the resettlement framework. The government will ensure that land donation is undertaken without coercion and documented in a transparent manner, and will have the process verified by an independent monitor. National roads requiring land acquisition will follow government and ADB's Safeguard Policy Statement requirements, as specified in the resettlement framework. The identified projects are not expected to impact indigenous peoples and are consequently classified *category C*. An indigenous peoples planning framework has been prepared.³⁸

36. **Environmental impact.** The scope of works under the investment program involves rehabilitation and maintenance of existing rural and national roads. Therefore, the identified projects are classified *category B* in accordance with ADB's Safeguard Policy Statement. The RDA has prepared consolidated provincial initial environmental examination (IEE) reports for the four provinces, and an environmental assessment and review framework to guide compliance with the environmental safeguard requirements of the government and ADB's Safeguard Policy Statement during program implementation.³⁹ The IEE and the environmental assessment and review framework fulfill ADB's Safeguard Policy Statement requirements. Anticipated environmental impacts entail typical road construction-related issues such as generation of dust, noise, exhaust, and waste from construction sites and worker camps; water contamination; occupational health and safety; erosion; and siltation. The standard environmental management plan (EMP), which forms part of the IEE, includes mitigation measures. Contractors will be required to prepare contract package-specific EMPs based on the final design, road-specific environment checklists, and the standard EMP. The RDA conducted consultations during project preparation, and the IEEs incorporate the concerns of the affected persons and stakeholders.

37. Each provincial project implementation unit will include a senior environment safeguards officer and environment assistants to monitor the implementation of environment safeguards. In addition, the experienced safeguards team from the RDA's Environment and Social Development Division will provide technical support and monitor the implementation of safeguards. The environment specialists and project implementation consultants will also support program implementation units in monitoring and reporting on safeguards implementation. Project implementation consultants will hold regular safeguards training workshops.

F. Risks and Mitigating Measures

38. The overall risk assessment is *moderate*. Major risks are (i) insufficient budget allocation under the fiscal consolidation, and (ii) inadequate maintenance of the road asset. These risks and

³⁶ The RDA has identified and prepared all projects under the time-slice MFF concept. Tranche 1 and all future tranches are classified *category B* for involuntary resettlement and the environment and *category C* for indigenous peoples.

³⁷ Resettlement Framework (accessible from the list of linked documents in Appendix 2). The resettlement framework was disclosed on the ADB website in June 2017.

³⁸ Indigenous Peoples Planning Framework (accessible from the list of linked documents in Appendix 2).

³⁹ Initial Environmental Examination and Environmental Assessment and Review Framework (accessible from the list of linked documents in Appendix 2). Both were disclosed on the ADB website in June 2017.

mitigating measures are described in detail in the risk assessment and risk management plan.⁴⁰ The integrated benefits and impacts are expected to outweigh the costs.

IV. ASSURANCES

39. The government, MOHEH, and the RDA have assured ADB that implementation of the investment program 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 facility administration manual and loan documents.

40. The government, MOHEH, and the RDA have given ADB certain undertakings for the MFF, which are set forth in the framework financing agreement. Specific covenants agreed to by the government, MOHEH, and the RDA with respect to individual tranches under the MFF are set forth in the loan agreement and project agreement for the respective tranches.

V. RECOMMENDATION

41. I am satisfied that the proposed multitranche financing facility would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve the multitranche financing facility to the Democratic Socialist Republic of Sri Lanka for the Second Integrated Road Investment Program in an aggregate principal amount not exceeding the equivalent of \$900,000,000, which comprises

- (i) the provision of loans from ADB's ordinary capital resources, in regular terms, with interest and other terms to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, and
- (ii) the provision of loans from ADB's ordinary capital resources, in concessional terms, with interest and other terms to be determined in accordance with ADB's applicable policies relating to ordinary capital resources,

and is subject to such other terms and conditions as are substantially in accordance with those set forth in the framework financing agreement presented to the Board.

Stephen Groff
Vice-President

6 September 2017

⁴⁰ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK FOR THE INVESTMENT PROGRAM

Impact the Program is Aligned with Connectivity between rural communities and socioeconomic centers in Sri Lanka improved (Public Investment Programme, 2017–2020) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Transport efficiency on project roads increased	By 2027: a. Travel time on rural project roads reduced by 20% from 2016 rate (2016 baseline: travel time of each project) b. Travel time on national project roads reduced by 10% from 2016 rate (2016 baseline: travel time of each project) c. Average daily vehicle-km increased to 4.6 million (2016 baseline: 3.5 million vehicle-km)	a–c. RDA survey	Government's budgetary constraints lead to inadequate maintenance of road assets.
Outputs 1. Road conditions between the selected rural communities and socioeconomic centers improved 2. Capacity of road agencies enhanced	1a. By 2024: at least 3,400 km of rural access roads improved to an all-weather standard and maintained under PBM contracts (2017 baseline: not improved) 1b. By 2026: at least 340 km of national roads rehabilitated and maintained under PBM contracts (2017 baseline: not rehabilitated) 1c. By 2024: at least three awareness sessions per district held on (i) road safety, with women comprising more than 50% of participants; and (ii) sexually transmitted diseases, including HIV, with women comprising more than 40% of participants (2017 baseline: not applicable) 1d. By 2026: at least 30% of local maintenance workers hired are women (2017 baseline: not applicable) By 2024: 2a. Knowledge and skills of at least 100 road agency staff regarding safeguards, road safety awareness, PBM contract management, and rural road design and construction increased (2017 baseline: not applicable)	1a–d. RDA project performance monitoring system 2a. Training program reports	Implementation is delayed by extreme weather conditions.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>2b. Full set of research equipment commissioned and action plan for research capacity enhancement implemented (2017 baseline: not commissioned and implemented)</p> <p>2c. Mechanistic-empirical pavement design, road asset management system, information management system, and rural road safety guidelines developed (2017 baseline: not developed)</p> <p>2d. Policy measures on financial sustainability endorsed by MOHEH and RDA (2017 baseline: not endorsed)</p>	2b–d. Capacity-building program reports	
<p>Key Activities with Milestones</p> <ol style="list-style-type: none"> 1. Road conditions between the selected rural communities and socioeconomic centers improved <ol style="list-style-type: none"> 1.1 Mobilize project implementation consultants by 2018 1.2 Complete engineering design and bidding documents by 2017 1.3 Award all contracts for civil works by 2019 1.4 Complete civil works by 2021 1.5 Implement performance monitoring survey of the investment program from 2017 to 2027 2. Capacity of road agencies enhanced <ol style="list-style-type: none"> 2.1 Mobilize project implementation consultants by 2018 and other capacity development consultants by 2019 2.2 Develop capacity development training programs for road agencies by 2019 2.3 Procure equipment by 2020 and implement action plan for research capacity enhancement by 2024 2.4 Develop mechanistic-empirical pavement design, road asset management system, information management system, and rural road safety guidelines by 2021 2.5 Develop policy alternatives to improve financial sustainability by 2019, have MOHEH and RDA endorse the most suitable policy arrangements by 2020, and implement the identified policy by 2022 2.6 Conduct the training programs by 2024 			
<p>Inputs ADB: \$900 million (loan) Government: \$184.6 million</p>			
<p>Assumptions for Partner Financing Not Applicable</p>			

ADB = Asian Development Bank, km = kilometer, MOHEH = Ministry of Higher Education and Highways, PBM = performance-based maintenance, RDA = Road Development Authority.

^a Government of Sri Lanka, Department of National Planning, Ministry of National Policies and Economic Affairs. 2017. *Public Investment Programme, 2017–2020*. Colombo.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=50301-001-3>

1. Framework Financing Agreement
2. Periodic Financing Request for Tranche 1
3. Sector Assessment (Summary): Transport (Road Transport [Nonurban])
4. Facility Administration Manual
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Economic and Financial Analysis
8. Country Economic Indicators
9. Summary Poverty Reduction and Social Strategy
10. Gender Action Plan: Tranche 1
11. Initial Environmental Examination: Eastern Province
12. Initial Environmental Examination: Northern Province
13. Initial Environmental Examination: Uva Province
14. Initial Environmental Examination: Western Province
15. Environmental Assessment and Review Framework
16. Resettlement Framework
17. Indigenous Peoples Planning Framework
18. Risk Assessment and Risk Management Plan

Supplementary Documents

19. Involuntary Resettlement Due Diligence and Socioeconomic Assessment: Eastern Province
20. Involuntary Resettlement Due Diligence and Socioeconomic Assessment: Northern Province
21. Involuntary Resettlement Due Diligence and Socioeconomic Assessment: Uva Province
22. Involuntary Resettlement Due Diligence and Socioeconomic Assessment: Western Province
23. Comparison of Financing Modality
24. Approach to Time-Slice Financing
25. Climate Risk Assessment and Management Report
26. List of Projects
27. Summary Review of the First Investment Program