



Report and Recommendation of the President to the Board of Directors

Project Number: 53325-001
July 2020

Proposed Project Readiness Loan Papua New Guinea: Transport Sector Preparatory Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 2 July 2020)

Currency unit	–	kina (K)
K1.00	=	\$0.289000
\$1.00	=	K3.460208

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
DOT	–	Department of Transport
DOW	–	Department of Works and Implementation
FMA	–	financial management assessment
km	–	kilometer
MFF	–	multitranchise financing facility
PAM	–	project administration manual
PIU	–	project implementation unit
PMU	–	project management unit
PNG	–	Papua New Guinea
PPRR	–	project procurement-related review
PRF	–	project readiness financing
TA	–	technical assistance

NOTE

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

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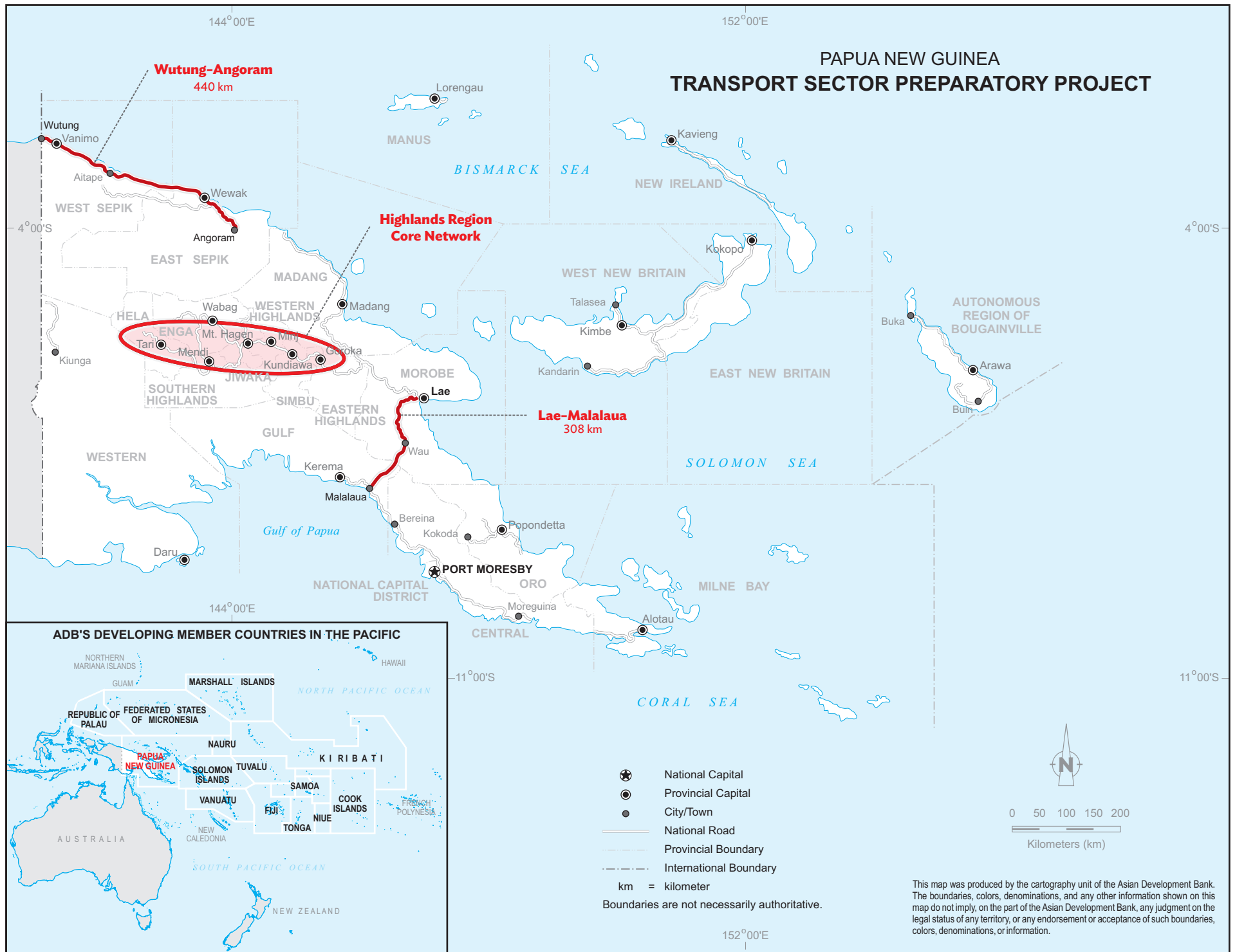
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PROJECT READINESS FINANCING AT A GLANCE

1. Basic Data		Project Number: 53325-001	
Project Name	Transport Sector Preparatory Project	Department/Division	PARD/PATC Department
Country	Papua New Guinea	Executing Agency	of Transport, Department
Modality	Project Readiness Financing (Loan)		of Works and
Country Economic Indicators	Government of Papua New Guinea		Implementation
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=53325-001-CEI		
	https://www.adb.org/Documents/LinkedDocs/?id=53325-001-PortAtaGlance		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✔ Transport	Transport policies and institutional development		31.00
		Total	31.00
3. Operational Priorities		Climate Change Information	
✔ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
✔ Promoting rural development and food security		Climate Change impact on the Project	Low
✔ Strengthening governance and institutional capacity			
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Poverty Targeting	
SDG 10.2		Geographic Targeting	✔
SDG 11.2			
4. Risk Categorization:	Low		
5. Safeguard Categorization	No Safeguards Categorization available.		
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		31.00	
Sovereign Project Readiness Financing (Concessional Loan): Ordinary capital resources		31.00	
Cofinancing		0.00	
None		0.00	
Counterpart		3.10	
Government		3.10	
Total		34.10	
Currency of ADB Financing: US Dollar			

PAPUA NEW GUINEA TRANSPORT SECTOR PREPARATORY PROJECT



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I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed project readiness loan to Papua New Guinea (PNG) for the Transport Sector Preparatory Project.

2. The proposed project readiness financing (PRF) project will finance the preparation of the feasibility study and the detailed engineering design, including bidding documents and procurement support for three ensuing projects along the northern region road corridor and within the core road network of the Highlands region, to achieve high-level readiness and to ensure timely and cost-effective achievement of the outcomes of such projects.

II. PROJECT READINESS FINANCING

A. Rationale

3. **Strategic context.** PNG's long-term transport development goals are encapsulated in the country's National Strategic Plan (Vision 2050) as an economic development framework.¹ Vision 2050 identified the development of human capital and wealth creation as the country's top priorities, with the expansion of transport services underscoring all these goals. The PNG Development Strategic Plan, 2010–2030 aims to increase the country's share of national roads in good condition from 33% in 2010 to 100% by 2030, in addition to tripling the network length to 25,000 kilometers (km).² This strategy recognizes the northern region road corridor as one of the most critical economic corridors in PNG. Improving the corridor is also in line with the National Transport Strategy, 2014–2030, which is the government's road map for transport sector development.³ The Medium Term Development Plan III, 2018–2022 serves as the national policy framework to deliver the key development outcomes, with a rolling 5-year investment plan.⁴ The northern region corridor program is identified as a priority investment also in both the Medium-Term Development Plan III and the National Road Network Strategy, 2018–2037.⁵

4. **Improvement needs.** The northern region road corridor starts at the Indonesian–PNG border at Wutung near Vanimo (capital of West Sepik Province) and extends southeast along the northern coast to Wewak (capital of East Sepik Province) and Madang (capital of Madang Province), then farther south via Lae (capital of Morobe Province) and finally to Kerema (capital of Gulf Province) on the south coast of New Guinea island. The total length of the northern region corridor is 1,457 km. It connects the ports of Vanimo, Wewak, Madang, and Lae to the Highlands highway and southern region corridor. The existing northern region road is largely in very poor condition. Significant parts are unpaved earth roads and many of them are single lanes that need to be widened to two lanes. The route includes three missing links: (i) Vanimo–Aitape (106 km), (ii) Bogia–Angoram (101 km), and (iii) Wau–Malalaua (133 km). It will be very challenging to complete the route, given the total length, the swampy terrain in the Sepik region, and the mountainous terrain in Morobe and Gulf provinces. Vanimo and Wewak ports are potential hubs

¹ Government of PNG, National Strategic Plan Taskforce. 2011. *Papua New Guinea Vision 2050*. Port Moresby. http://www.treasury.gov.pg/html/publications/files/pub_files/2011/2011.png.vision.2050.pdf.

² Government of PNG, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010–2030*. Port Moresby.

³ Government of PNG, Department of Transport. 2013. *National Transport Strategy: Volume 3—Detailed Strategy*. Port Moresby. <http://www.transport.gov.pg/images/pdf/NTSVol3DetailedStrategy.compressed.pdf>.

⁴ Government of PNG, Department of National Planning and Monitoring. 2018. *Medium Term Development Plan III, 2018–2022*. Port Moresby.

⁵ Government of PNG, Department of Works and Implementation. 2018. *PNG National Road Network Strategy, 2018–2037*. Port Moresby.

for palm oil exports but are in poor condition and require upgrading in terms of channel dredging, wharf extension, and general infrastructure updates. Vanimo and Wewak have no customs facilities. Servicing international maritime trade from Vanimo and Wewak to Indonesia and beyond will play a key role in the economic growth of the northern coast area.

5. **Value added by ADB assistance.** The Government of PNG has requested the support of the Asian Development Bank (ADB) to (i) improve the northern region corridor and (ii) continue the improvement of the core road network of the Highlands region. ADB is supporting the government through technical assistance (TA) to prepare the financial analysis, risk and procurement assessments, financial management assessment, sector assessment, climate risk vulnerability assessment, gender assessment and gender action plan, and poverty and social assessment for these projects.⁶ As both the government and ADB are paying increasing attention to the readiness of projects to be approved, and recognizing lessons from the ongoing multitranche financing facilities (MFFs), additional support is required. In this regard, the government requested ADB to provide a PRF for the feasibility study, detailed design, and related activities in parallel with the TA to (i) achieve high-level readiness, (ii) ensure smooth commencement of procurement and other implementation activities, and (iii) ensure timely and cost-effective achievement of the project outcomes. Packaging the feasibility study, detailed design, and safeguard studies to be prepared by the same consultancy assignment will ensure the design incorporates all safeguard mitigation measures. The objective is to design MFFs for two ensuing programs and one stand-alone project. The PRF will also expand and complement ongoing MFFs and represent significant value added for the government's investment in the road transport subsector by providing further capacity support to supplement ongoing investment programs and integrate findings and lessons from previous experience into the project designs. Investment in infrastructure can also aid the post coronavirus disease (COVID-19) economic recovery.

6. **Consistency with the ADB Strategy.** The PRF is aligned with ADB's Pacific Approach, 2016–2020 by supporting the target to reduce costs through improving domestic and regional connectivity via transport infrastructure, managing risks, and enabling value creation.⁷ The PRF is also aligned with ADB's Strategy 2030, by (i) addressing remaining poverty and reducing inequalities, (ii) promoting rural development and food security, and (iii) strengthening governance and institutional capacity, as it will support physical designs of transport network to improve access.⁸ Entry points for gender mainstreaming in the ensuing projects will be explored through PRF and TA activities. The PRF is in line with ADB's country partnership strategy for PNG, 2016–2020, which supports more efficient, safer movement of people and goods—one of the core areas of government sector objectives in the country partnership strategy.⁹ The MFFs, PRF, and TA to support the design of investment programs are included in ADB's country operations business plan, 2020–2022 for PNG.¹⁰ It is expected that the ensuing stand-alone project (Lae–Malalaua) will be included in the country operations business plan 2021–2023.

⁶ ADB. Papua New Guinea: Preparing the Land and Maritime Transport Projects. <http://www.adb.org/projects/53092-002/main>.

⁷ ADB. 2016. *Pacific Approach, 2016–2020*. Manila.

⁸ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

⁹ ADB. 2015. *Country Partnership Strategy: Papua New Guinea, 2016–2020*. Manila. The PRF will also be in line with the proposed Country Partnership Strategy 2021–2025.

¹⁰ ADB. 2019. *Country Operations Business Plan: Papua New Guinea, 2020–2022*. Manila. Concept clearance is not required when PRF is included in the country operations business plan.

7. **Lessons.** ADB assistance to the transport sector began in 1972. Three MFFs were approved, two for national road development and one for aviation development, between 2008–2019.¹¹ The government and ADB agreed to improve project readiness in future projects, given that the Sustainable Highlands Highway investment program has encountered implementation delays. The completion report of project 1 of the Highlands Region Road investment program also recommended that consulting services be in place well before construction starts, and emphasized that future projects need to address weak procurement procedures.¹²

B. Outputs and Activities

8. **Output 1: Feasibility study, including option analysis, environmental and social safeguard studies, detailed engineering design, bidding documents, and advance procurement actions for ensuing projects completed.** The PRF will support the preparation activities of the proposed ensuing projects by preparing the feasibility studies, including environmental and social safeguards; the detailed engineering designs; and the bidding documents, including procurement support for three ensuing projects.

9. **Output 2: Capacity of executing agencies and implementing unit for project management improved.** The PRF will finance financial audits and project pre-implementation capacity-building activities for executing agencies linked to the ensuing projects by establishing a project implementation unit (PIU) within the Department of Works and Implementation (DOW).

C. Ensuing Projects

10. **Northern region road corridor (Momase international highway) from Wutung to Angoram.** This section will be the first phase of the proposed MFF program to improve the existing road from Wutung to Angoram, including (i) the construction of the missing link from Vanimo to Aitape, with a total length of 440 km; and (ii) upgrading of Vanimo and Wewak ports.¹³ The indicative financing amount of the program is \$630 million, and the expected year of approval of the program and tranche 1 is 2021.¹⁴

11. **Northern region road corridor from Lae to Malalaua via Bulolo (Trans-Island highway).** This project will improve the Trans-Island highway from Lae to Malalaua, with a total length of 308 km, including rehabilitating the existing road from Lae to Meniyama and constructing the missing link of 190 km from Meniyama to Malalaua. The PRF will prepare the feasibility study and the detailed design for the project road. The indicative financing amount is \$200 million and the expected year of approval is 2022.

12. **Highlands Region Road Improvement Investment Program, Phase 2.** The PRF will prepare a new MFF, which will be a continuation of the existing Highlands Region investment program. The second phase of the Highlands Region investment program will improve about 500 km of roads of the Highlands core road network. The PRF will prepare the detailed designs

¹¹ ADB. [Papua New Guinea: Highlands Region Road Improvement Investment Program – Project 1](#); ADB. [Papua New Guinea: Sustainable Highlands Highway Investment Program](#); and ADB. [Papua New Guinea: Civil Aviation Development Investment Program](#).

¹² ADB. 2019. *Completion Report. Highlands Region Road Improvement Investment Program – Project 1 in Papua New Guinea*. Manila.

¹³ The consecutive tranches of the program will be designed using the resources of the first tranche.

¹⁴ The name of the ensuing program in the country operations business plan is the Land and Maritime Transport and Trade Corridor Program. The name has been revised to be in line with the government's official name of the corridor.

for approximately 370 km of roads to be improved through the program.¹⁵ The indicative financing amount of the proposed program is \$800 million and the expected year of approval of the program and tranche 1 is 2021.¹⁶

D. Cost Estimates and Financing Arrangements

13. The PRF is estimated to cost \$34.1 million (Table 1). Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM).¹⁷

Table 1: Summary Cost Estimates
(\$ million)

Item	Amount ^a
A. Base Cost^b	
1. Output 1: Feasibility study, including option analysis, environmental and social safeguard studies, detailed engineering design, bidding documents, and advance procurement actions for ensuing projects completed.	28.8
2. Output 2: Capacity of executing agencies and implementing unit for project management improved.	1.6
Subtotal (A)	30.3
B. Contingencies^c	3.8
Total (A+B)	34.1

Note: Numbers may not sum precisely because of rounding.

^a The government will finance taxes and duties of \$3.1 million (noncash contribution).

^b In mid-2019 prices as of June 2020.

^c Includes interest. Interest during implementation for ADB loan has been computed at 2% for ordinary capital resources.

Source: Asian Development Bank estimates.

14. The government has requested a concessional loan of \$31,000,000 from ADB's ordinary capital resources to help finance project preparation and design activities. The loan will have a 25-year term, including a grace period of 5 years; an interest rate of 2.0% per year during the grace period and thereafter; and such other terms and conditions set forth in the draft loan agreement.

15. The summary financing plan is in Table 2. ADB will finance the expenditures in relation to consulting services, audit fees, and surveys. The ensuing loan or loans will refinance the PRF.

Table 2: Summary Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary capital resources (concessional loan)	31.0	91.0
Government	3.1	9.0
Total	34.1	100.0

Source: Asian Development Bank estimates.

¹⁵ Approximately \$70,000 of savings from the ongoing Highlands Region investment program are being used to prepare tranche 1.

¹⁶ Tranche 1 of the program is included in the country operations business plan.

¹⁷ Project Administration Manual (accessible from the list of linked documents in the Appendix).

E. Implementation Arrangements

16. The implementation arrangements are summarized in Table 3 and described in detail in the PRF PAM (footnote 17). Procurement will follow the ADB Procurement Policy (2017, as amended from time to time) and its associated staff instructions.

Table 3: Implementation Arrangements for Project Readiness Financing

Table 6: Implementation Arrangements for Project Readiness Financing			
Aspects	Arrangements		
PRF implementation period	August 2020–December 2024		
Estimated PRF completion date	31 December 2024 (estimated loan closing date 30 June 2025)		
Management			
(i) Executing agencies	Department of Works and Implementation (for road component) Department of Transport (for port component)		
(ii) Key implementing agencies	Project implementation unit under Department of Works and Implementation		
Consulting services	Quality- and cost-based selection	3 firms (570 person-months)	\$29.32 million
	Individual consultant selection	8 consultants (306 person-months)	\$1.63 million
	Least-cost selection	National	\$0.05 million
Advance contracting	Advance contracting will be used to commence consultant recruitment before approval and to accelerate consulting services.		
Disbursement	Disbursements under PRF will follow ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.		

ADB = Asian Development Bank, PRF = project readiness financing.

Sources: Asian Development Bank and government estimates.

17. The PIU will establish tentatively three project design offices (PDOs) within the DOW provincial office premises in West Sepik, Morobe, and Western Highlands provinces. The PIU and PDOs will be supported and coordinated by the existing project management unit (PMU), which is based in Port Moresby. The PIU will enable the timely start-up and preparation of the ensuing projects and, through support from consultants, provide on-the-job training and knowledge transfer to the executing agencies.

18. **Consulting services.** The government delegated the consultants' selection from the executing agencies to ADB. The executing agencies and ADB will jointly prepare the terms of reference, budget estimates, and short-listing criteria; and recommend the choice of selection method. The DOW will negotiate the contract with the first-ranked firm; and the DOW, the Department of Transport (DOT), and consultants will sign the contracts. ADB may assist negotiations, if required. The recruitment of all consultants will follow the ADB Procurement Policy (2017, as amended from time to time), Procurement Regulations for ADB Borrowers (2017, as amended from time to time), and associated staff instructions. ADB has advised the borrower that approval of advance contracting does not commit ADB to finance the PRF.

III. DUE DILIGENCE

A. Technical

19. The PRF will support the preparation of the feasibility studies, including option analysis, environmental assessment, and resettlement plan; detailed design; and bidding documents, including support for bidding of the works for the ensuing projects. The designs to be prepared

will include necessary road safety features and will be subject to road safety audits. The roads to be improved will follow the existing alignment to the extent possible to minimize land acquisition and because the road corridor available is typically limited by mountainous terrain and/or the sea. The designs to be prepared will integrate any measures needed to (i) promote resilience to climate change and disasters triggered by natural hazards, (ii) encourage benefits for women, and (iii) contribute to gender equality. The tentative gender category for the ensuing projects is *effective gender mainstreaming or some gender elements*.¹⁸

B. Governance

20. **Financial management.** ADB has conducted a financial management assessment (FMA) following its financial management guidelines. The assessment considered the DOW and DOT as the executing agencies and the PIU to manage project implementation. The FMA identified several financial management risks in staffing, reporting and monitoring, information systems, audits, and funds flow. The project procurement-related reviews (PPRRs) prepared by ADB's Office of Anticorruption and Integrity highlighted continuing weaknesses in financial management.¹⁹ Several mitigating measures have been implemented since the previous FMA in 2017, but further measures are proposed for the satisfactory implementation of the project and considering that the PRF will finance only consulting services. The most relevant mitigating measures are (i) the recruitment of qualified accounting staff for the new PIU supported by targeted training on ADB financial management, (ii) inclusion of the PRF in the audit plan of the Internal Audit Division, and (iii) expediting the implementation of the international financial management system to include all regional and provincial offices under a unified system. The establishment of a separate account is a requirement before the disbursement of the initial advance by ADB. The detailed risk management plan is in the PAM (footnote17). The financial risk is *substantial*.

21. **Procurement.** ADB conducted a procurement capacity assessment of the DOW and the PMU under the DOW, as part of the preparation of the sustainable Highlands investment program in 2017. The assessment identified substantial risks in staffing and effectiveness; and moderate risks in information management, the procurement practices of consulting services, and accountability measures. The procurement risk identified in the areas of PMU staffing and procurement practices still exists, but some progress has been achieved since 2017. Additional staff, including international specialists for the ADB PMU, was recruited in 2018. They and other DOW staff have prepared procurement documents, which resulted in the award of several large works and consulting contracts. Consequently, the procurement of goods and works and the recruitment of consultant services by the DOW have become more efficient and are conducted in adherence with the ADB Procurement Policy, regulations and guidelines, with quality and transparency acceptable to ADB. In 2019, ADB provided formal procurement training to the executing agencies and implementing agencies including the DOW. The training reviewed and discussed procurement issues based on findings reflected in two PPRRs prepared in June 2017 (footnote 19). Therefore, the risks involved in procuring consulting services are considered lower

¹⁸ Gender due diligence (including gender analysis) and financial due diligence (including financial analysis) are activities included in the scope of work of the consultants preparing due diligence for the ensuing projects to be financed through separate TA.

¹⁹ ADB. 2017. *Project Procurement-Related Review: Bridge Replacement for Improved Rural Access Sector Project in Papua New Guinea*. Manila. <https://www.adb.org/sites/default/files/project-documents/43200/43200-024-pprr-en.pdf> *Project Procurement-Related Review Loans 2783-PNG and 2784-PNG(SF): Bridge Replacement for Improved Rural Access Sector Project*; and ADB. 2017. *Project Procurement-Related Review: Highlands Region Road Improvement Investment Program – Projects 1 and 2 in Papua New Guinea*. Manila. <https://www.adb.org/sites/default/files/project-documents/40173/40173-023--en.pdf>.

than in 2017. ADB will provide additional support through ADB resources during the implementation of PRF to address the issues reflected in the PPRRs. The procurement risk is *substantial*.

22. **Overall.** The overall inherent and project risk is *substantial*. Key risk mitigation measures are listed above and discussed in more detail in the PAM (footnote 17).

C. Safeguards

23. Since the proposed activities consist of consulting services only, activities have not been categorized per ADB's Safeguard Policy Statement (2009). The anticipated safeguard categories for all ensuing projects are *category B* for the environment, *category B* for involuntary resettlement, and *category C* for indigenous peoples, based on existing transport projects in PNG with a similar scope of work. The final categorization will be confirmed early during the studies, based on the documentation of baselines. The updated safeguard documents, and, if required, clearance under the country system and environmental permits issued by the Conservation and Environmental Protect Authority and any conditions included in the permits, will form part of the bidding documents.

IV. ASSURANCES

24. The government has assured ADB that PRF implementation shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents.

V. RECOMMENDATION

25. I am satisfied that the proposed project readiness loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$31,000,000 to Papua New Guinea for the Transport Sector Preparatory Project, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 2.0% per year during the grace period and 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.

Masatsugu Asakawa
President

16 July 2020

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=53325-001-3>

1. Loan Agreement
2. Project Administration Manual