

Report and Recommendation of the President to the Board of Directors

Project Number: 46526-007 August 2017

Proposed Loan Islamic Republic of Pakistan: Punjab Intermediate Cities Improvement Investment Project

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 14 August 2017)

Currency unit	_	Pakistan rupee/s (PRe/PRs)
PRs1.00	=	\$0.0095
\$1.00	=	PRs105.3750

ABBREVIATIONS

ADB	-	Asian Development Bank
CIU	_	city implementation unit
EIRR	_	economic internal rate of return
km	_	kilometers
LARP	-	land acquisition and resettlement plan
LG&CD	-	Local Government and Community Development
O&M	-	operation and maintenance
PAM	-	project administration manual
PMU	-	project management unit

NOTES

- (i) The fiscal year (FY) of the Government of Pakistan and its agencies ends on 30 June. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2017 ends on 30 June 2017.
- (ii) In this report, "\$" refers to United States dollars.

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PROJECT AT A GLANCE

1.	Basic Data			Project Numb	er: 46526-007
	Project Name	Punjab Intermediate Cities	Department	CWRD/CWUW	
		Improvement Investment Project	/Division		
	Country	Pakistan Jalamia Ropublia of Pakistan	Executing Agency	Local Governme	ent and
	Borrower			Department, Go	vernment of
				Punjab	
2.	Sector	Subsector(s)	•	ADB Financing	(\$ million)
1	Water and other urban	Other urban services		5	86.60
	infrastructure and services	Urban flood protection			15.40
		Urban policy, institutional and capacity d	evelopment		24.00
		Urban sewerage			48.00
		Urban water supply			26.00
			Tot	al	200.00
3.	Strategic Agenda	Subcomponents	Climate Change In	formation	
	Inclusive economic growth	Pillar 2: Access to economic	Adaptation (\$ million	n)	34.60
	(IEG)	opportunities, including jobs, made	Mitigation (\$ million)	26.00
	Environmentally sustainable	More Inclusive	CU ₂ reduction (tons	s per annum)	10 Medium
	arowth (ESG)	environmental concerns	Project		Weddini
	5	Urban environmental improvement			
4.	Drivers of Change	Components	Gender Equity and	Mainstreaming	
	Governance and capacity	Institutional development	Effective gender ma	ainstreaming	1
	development (GCD)		(EGM)		
5.	Poverty and SDG Targeting		Location Impact		
	Geographic Targeting	Yes	Rural		Medium
	SDG Targeting	NU Yes	Urban		Medium
	SDG Goals	SDG3, SDG5, SDG6, SDG8, SDG11,			
		SDG13			
6.	Risk Categorization:	Complex			
7.	Safeguard Categorization	Environment: B Involuntary Res	ettlement: A Indig	enous Peoples: C	
8.	Financing				
	Modality and Sources		A	mount (\$ million)	
	ADB			200.00	
	Sovereign Project (Regula	ar Loan): Ordinary capital resources		200.00	
	Cofinancing			0.00	
	None			0.00	
	Counterpart			50.00	
	Government			50.00	
	Total			250.00	





I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Islamic Republic of Pakistan for the Punjab Intermediate Cities Improvement Investment Project.

2. The project will improve the quality of life of residents in the two intermediate cities of Sahiwal and Sialkot in Punjab Province. This will be achieved by improving urban infrastructure and services and enhancing the operation and maintenance (O&M) capacity for urban service delivery.¹

II. THE PROJECT

A. Rationale

1. Background

3. Cities are the economic, social, and innovative core of Pakistan. They generate most of the country's wealth and are home to about 40% of the population.² Pakistan's cities, particularly the intermediate cities,³ are developing at a fast rate. This has led to rapid expansion of the urban environment in an uncoordinated, unplanned, and unregulated manner. Basic urban services, such as water supply, wastewater collection and treatment, storm water drainage, and the urban road networks, are increasingly unable to respond to population pressures and economic demands. Residents are suffering from an acute shortage of open spaces and civic amenities. This has increased demand to make Pakistan's cities more livable—to promote better living standards, improve public health, and develop the country's economy in a sustainable manner.

4. The Government of Pakistan has realized the importance of making its cities more livable, particularly the intermediate cities, and has put the urban sector at the forefront of its national development strategy. Pakistan's Vision 2030⁴ and Framework for Economic Growth⁵ envisage livable cities as engines of national growth and centers of economic activity, culture, and knowledge. The Framework for Economic Growth also recognizes the advantage of local governments in managing urban development, being closer to the beneficiary population, better situated to identify citizens' preferences, and having the flexibility to respond rapidly to cities' evolving needs. The government amended its constitution in 2010 to decentralize urban services to the provincial governments.⁶

5. About 53% of Pakistan's urban population lives in Punjab cities, and the urban areas of Punjab generate an estimated 50% of the country's gross domestic product.⁷ The Government of Punjab has pioneered several key urban sector initiatives. In 2006, it created the Urban Unit to manage urban sector issues in Punjab Province. Following the positive experience in Punjab,

¹ The Asian Development Bank (ADB) provided project preparatory technical assistance through the Punjab Intermediate Cities Improvement Investment Program (TA 8683-PAK), as well as through resources from the Urban Climate Change Resilience Trust Fund and the Cities Development Initiative for Asia.

² Government of Pakistan, Finance Division. 2016. *Pakistan Economic Survey 2015-16*. Islamabad.

³ The Urban Unit of Punjab categorizes cities by population size—large: 1.9 million–9.0 million; intermediate: 0.25 million–1.9 million.

⁴ Government of Pakistan, Planning Commission. 2007. *Vision 2030: Pakistan in the 21st Century*. Islamabad.

⁵ Government of Pakistan, Planning Commission. 2011. *The Framework for Economic Growth*. Islamabad.

⁶ The 18th Amendment to the Constitution of Pakistan. 2010. Islamabad.

⁷ Government of Pakistan, Planning Commission. 2011. *Punjab Urban Development Sector Plan 2018*. Islamabad.

other provincial governments established urban units using a similar approach. The Local Government and Community Development (LG&CD) Department of Punjab is the line government ministry responsible for providing municipal services at provincial level.

2. Challenges and Opportunities

6. In its Medium-Term Development Framework, 2013–2016,⁸ the Government of Punjab included an urban sector development strategy, comprising 106 urban projects. As part of the implementation of this framework, the Government of Punjab requested the Asian Development Bank (ADB) and the Cities Development Initiative for Asia to undertake a comprehensive urban sector assessment,⁹ which identified the following challenges and opportunities in making the cities in Punjab more livable and sustainable.

7. **Inadequate infrastructure.** The urban population in Punjab, the most populous province in Pakistan, is growing at an unprecedented speed—demographic projections show a rise from the current 32 million to 60 million by 2030 (footnote 8). Despite government efforts, urban infrastructure development has not kept pace with the rapid population growth. Punjab's cities provide piped water to only 45% of their residents while more than half of the wastewater flows in open drains and is discharged untreated into natural water bodies or onto agricultural lands. Poor public transport and inadequate street management constrain urban mobility. Much of the cities' daily economic activity takes place along narrow inner city streets competing with buses, cars, motorcycles, and pedestrians.

8. **Poor capacity and weak institutional framework.** The Government of Punjab currently provides key urban services at city level but these services are often unreliable and do not meet the service standards customers expect. Improvement of urban services in Punjab is limited by inadequate staff capacity and a weak institutional framework, which offers little incentive to staff and no accountability to customers. Little attention has been paid to day-to-day operations and service provisions. A new institutional setup is urgently needed to restore public confidence in key urban services. The project will support the Government of Punjab to establish urban services companies in the cities of Sahiwal and Sialkot. The Government of Punjab will entrust the above urban services companies with the responsibility of municipal services including water, sanitation, and urban spaces management. These companies will adopt key corporate governance requirements. For instance, the board of directors in the companies will oversee and manage the company's strategic directions, policies, service standards, and operational performance. Corporate decisions and operational performance will be publicly disclosed to enhance transparency and accountability to customers. Evidence shows that such companies in Pakistan deliver more reliable urban services.¹⁰ Upon establishment of the new companies, the Government of Punjab will enter into agreements¹¹ with these companies to transfer government

⁸ Government of Punjab, Planning and Development Department. 2013. *Medium Term Development Framework, 2013–16.* Chandigarh.

⁹ ADB. 2016. *Medium Term Integrated Climate Resilient Urban Infrastructure Investment Program and Prefeasibility Study.* Consultant's report. Manila (TA8556-REG).

¹⁰ Cities of Abbottabad, Kohat, Mardan, among other cities, have set up new urban service companies that have taken over municipal services from respective city governments. The new companies have contributed to deliver more reliable and sustainable urban services in these cities.

¹¹ The Government of Punjab, with ADB-funded consultants, prepared Services and Asset Management Agreements in July 2017. The Government of Punjab is currently preparing for the establishment of the new companies. These companies will be established in 2018.

owned urban infrastructure and assets. These companies will deliver urban services through managing various service contracts.

9. **Choice of cities**. The Government of Punjab is closely working with various development partners that are supporting urban infrastructure development, reforms, and capacity development in the province.¹² The World Bank supports five large cities in Punjab (Faisalabad, Gujranwala, Lahore, Multan, and Rawalpindi). In March 2014, the Government of Punjab requested ADB to finance a new urban sector project covering two intermediate cities (Sahiwal, and Sialkot) that are strategically important but not covered by the World Bank project.¹³ These cities have also been proposed due to their proximity to the China-Pakistan Economic Corridor, which provides greater economic opportunities for increased trade and regional cooperation. They also represent a mix of socioeconomic growth models, ranging from well-established industrial cities (e.g. Sialkot) to cities that grew from rural agricultural centers to major service centers (e.g. Sahiwal). Sahiwal and Sialkot are also selected due to good project readiness and the timely completion of the urban sector assessment (footnote 9) that highlights: (i) improvement of municipal infrastructure, and (ii) institutional strengthening and capacity development, as key priorities for making the two cities more livable and sustainable.

10. **Lessons learned.** Lessons learned from previous urban sector projects supported by ADB in Pakistan indicate, among others, the need to (i) link infrastructure development with robust institutional strengthening and reforms, supported by capacity development; (ii) avoid complex implementation arrangements; (iii) have fewer subprojects and locations for ease of project implementation; (iv) work with cities that have strong political will to implement reforms; and (v) establish clear service standards for effective outsourcing. A project preparatory technical assistance (footnote 1) has supported the needed institutional reforms with the formation of an urban services company in each city. Prepaid water meters will be pilot tested as an innovative approach, along with activities to build awareness of the dividends of clean drinking water and sanitation services to improve the population's willingness to pay for the services. Nonrevenue water will be reduced by upgrading or replacing infrastructure and enhancing O&M capacity to locate and rectify system leakages. Cost recovery tariffs will be introduced with targeted subsidies, where required, to ensure the long-term sustainability of services.

11. **ADB's value addition.** In addition to the financing it provides, ADB facilitates access to a wealth of knowledge, technologies, and international best practices. Major value additions are summarized below:

(i) Institutional reform and formation of new urban services companies. The Government of Punjab, with ADB's support, has developed two reform actions including: (a) time-bound financing sustainability action plan¹⁴ that entails ten actions ranging from consumer surveys, tariff policy development, and awareness campaign; and (b) formation of the new urban services companies that will provide more reliable municipal services with improved corporate governance structure (para.8). Operational efficiency and sustainability will be improved with the implementation of these reform actions.

¹² Key development partners implementing urban sector projects include the World Bank, the Department for International Development of the United Kingdom, and Japan International Cooperation Agency. The Asian Infrastructure Investment Bank may open a new resident mission in Pakistan, and may implement urban sector projects in Punjab.

¹³ The project is aligned with ADB. 2015. *Pakistan: Country Partnership Strategy (2015–2019)*. Manila.

¹⁴ Financial sustainability action plan will be implemented as defined in the Project Administration Manual (accessible from the list of linked documents in Appendix 2).

- (ii) Innovations and international best practice. The project will introduce several innovations such as prepaid water metering for effective commercial user-fee collection and an inclusive green city approach that combines infrastructure development with climate change resilience and disaster risk management. For instance, river bank improvement is designed to combine public green space with flood management features. Another example is street management to improve conditions for all competing street users including pedestrians and all modes of transport while also improving green urban environment. Bus terminals in both cities will also adopt international best practice (para. 15).
- (iii) Pro-poor focus. Access to clean water, sanitation, and urban public spaces is vital to all residents irrespective of socioeconomic status. Civil works to improve water distribution networks, such as new boreholes and pipe connection, will target special distribution network zones which are inhabited by those vulnerable groups. Improvement on parks, streets, and greenbelts will also be prioritized in the above network zones. The selected special distribution network zones include Azam Block, Farid Town, Tariq Bin Ziad Colony, and other areas in the two cities.
- (iv) Capacity development support. Based on the robust training needs assessment carried out by the project, a capacity development program was prepared. The program will support: (a) a specialized program focused on technical engineering and operational aspects; and (b) a management program that addresses project management, tariff policy, customer services, and other general administration.

B. Impact and Outcome

12. The project is aligned with the following impact: living standards, health, and economy in Sahiwal and Sialkot improved.¹⁵ The project will have the following outcome: access to quality urban services by the residents of Sahiwal and Sialkot cities improved.¹⁶

C. Outputs

13. **Output 1: Water supply systems improved**. This will be achieved through the installation and rehabilitation of 114 boreholes and tube wells (Sahiwal-19; Sialkot-95); 22 water reservoirs (Sahiwal-12; Sialkot-10); 20 water pumping stations (Sahiwal-8; Sialkot-12); about 350 kilometers (km) of water pipes (Sahiwal-54 km; Sialkot-312 km); up to 15,000 metered customer connections (Sahiwal-6,400; Sialkot-8,800), 1,400 of which will be piloting prepaid meters; and new supervisory control and data administration (SCADA) systems.

14. **Output 2: Sanitation systems improved**. This will be achieved through the installation of 18 sewage pumping stations (Sahiwal-10; Sialkot-8), replacement of about 41 km of sewer pipes (Sahiwal-11 km; Sialkot-30 km), provision of equipment for wastewater management, unblocking of local drains, and construction of a centralized wastewater treatment plant (WWTP) in Sahiwal. Equipment will also be procured for improved collection and segregation of solid wastes.

15. **Output 3: Urban public spaces improved.** This will be achieved through the rehabilitation of 11 parks (Sahiwal-6; Sialkot-5), three greenbelts (Sahiwal-2; Sialkot-1), footpaths, riverbank paths, streets, and three bus terminals (Sahiwal-2; Sialkot-1) that are critical hubs for

¹⁵ Government of Punjab, Planning and Development Department. 2015. *Punjab Growth Strategy 2018: Accelerating Economic Growth and Improving Social Outcomes*. Chandigarh.

¹⁶ The design and monitoring framework is in Appendix 1.

regional transport systems. Local vendors and companies will expand new business opportunities with the upgraded bus terminal facilities. New bus terminal buildings will also be equipped with new platforms, ticketing offices, tourist information centers, passenger amenities including concourse, cafeterias, and accessibility for differently abled persons.

16. **Output 4: Institutional support and capacity developed**. This will be achieved through support to institutional reforms such as the establishment of urban services standards, enhancement of the customer service function, and development of new tariff structures. Various capacity development programs—including O&M of key urban services, urban planning, project management, and tariff policy—will also be delivered to relevant staff in the government and the urban service companies. This output will also promote behavior changes in hygiene practice and environment through partnership with youth groups and civil society organizations.

D. Summary Cost Estimates and Financing Plan

17. The project is estimated to cost \$250 million (Table 1). Detailed cost estimates by expenditure category are included in the project administration manual (PAM).¹⁷

Item			Amount ^a
Α.	Base	e Cost ^b	
	1.	Water supply systems improved (output 1)	26.0
	2.	Sanitation systems improved (output 2)	49.1
	3.	Urban public spaces improved (output 3)	103.9
	4.	Institutional support and capacity developed (output 4)	26.0
		Subtotal (A)	205.0
В.	Cont	lingencies ^c	29.8
C.	Fina	ncial Charges During Implementation ^d	15.2
		Total (A+B+C)	250.0

Table 1: Summary Cost Estimates

(\$ million)

^a Includes taxes and duties of \$24.3 million. Such amount does not represent an excessive share of the project cost.
 ^b In January 2017 prices.

^c Physical contingencies computed at 10.0% for all cost categories. Price contingencies computed at average of 1.5% on foreign exchange costs and 4.9% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

^d Includes interest and commitment charges. Interest during construction for the ordinary capital resources loan has been computed at the 6-year US dollar fixed swap rate plus an effective contractual spread of 0.50%. Commitment charges for the ordinary capital resources loan are 0.15% per year to be charged on the undisbursed loan amount. Sources: Asian Development Bank and Government of Punjab.

18. The government has requested a regular loan of \$200 million from ADB's ordinary capital resources to help finance the project. The loan will have a 20-year term, including a grace period of 6 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; and such other terms and conditions set forth in the draft loan and project agreements. Based on custom-tailored repayment method, the average maturity is 12.99 years. There is no maturity premium payable to ADB.

19. ADB will finance the expenditures in relation to (i) civil works, (ii) equipment, (iii) environment and social mitigation measures, and (iv) consulting services, and others as justified during project implementation. The government will finance expenditures relating to financial charges, taxes and duties, land acquisition and resettlement, and project administration

¹⁷ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

costs. The borrower will be the Government of Pakistan, which will relend the loan proceeds to the Government of Punjab on the same terms and conditions. Detailed cost estimates are in the PAM. The summary financing plan is in Table 2.

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary capital resources (regular loan)	200.0	80.0
Government	50.0	20.0
Total	250.0	100.0
Sources Asian Development Depk		

Table 2: Summary I	Financing Plan
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Source: Asian Development Bank.

20. The climate adaptation and mitigation components is estimated at \$34.6 million and \$26.0 million, respectively. The climate adaptation components will include elements, such as river bank improvement with flood management features, and installation of new sewage pumping stations and sewer pipes, while the mitigation components include elements such as the development of urban green belts, parks, and modernized bus terminals.

Ε. **Implementation Arrangements**

21. The LG&CD Department of Punjab (para.5) will be the executing agency for the project, and the city governments of Sahiwal and Sialkot (municipal corporations) will be the implementing agencies. A project management unit (PMU) has been established to support the LG&CD Department at provincial level, and two city implementation units (CIUs) have also been established to implement the project in Sahiwal and Sialkot. The Urban Unit will provide advisory support to the LG&CD Department on the capacity development component. Under the guidance of the project steering committee, the LG&CD Department will be responsible for the overall execution of the project. The city governments of Sahiwal and Sialkot will be responsible for the day-to-day project implementation. Consultants will be engaged to assist with project implementation, audit, and institutional strengthening. The implementation arrangements are summarized in Table 3 and described in the PAM.

Aspects	Arrangements		
Implementation period	31 December 2017–31 December 2023		
Estimated completion date	31 December 2023		
Estimated loan closing date	30 June 2024		
Management			
(i) Oversight body	Project steering comm	littee ^a	
(ii) Executing agency	Punjab Local Governn	nent and Community Development De	partment
(iii) Key implementing agencies	City governments of S	ahiwal and Sialkot (municipal corpora	tions)
Aspects	Arrangements		
(iv) Implementation unit	Project management u	unit, city implementation units, and the	Urban Unit
Procurement ^b	International	8 contracts	\$84,010,000
	competitive bidding		
	National competitive	7 contracts	\$97,600,000
	bidding		
Consulting services	Quality- and cost-	182 person-months (international)	\$20,880,000
	based selection	1,175 person-months (national)	
Advance contracting and/or retroactive	Three consulting ser	rvice packages and the costs rec	uired for the
financing	establishment of the pr	roject management unit and city impler	nentation units
	are proposed for advance contracting and retroactive financing, equivalent		
	to 20% of the loan amount. I erms of references and requests for proposals		
	were prepared to initiate the recruitment processes of the three consulting		
	tirms.		

Table 3: Implementation Arrangements

Aspects	Arrangements
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.

Note: The above information is indicative as of 30 January 2017.

^a Consists of the chairperson, Planning and Development Department; secretary, Planning and Development Department; secretary, Finance Department; secretary, Local Government and Community Development Department; chief executive officer, Urban Unit, city governments of Sahiwal and Sialkot; managing directors, Sahiwal and Sialkot urban services companies; program director, project management unit; city managers, city implementation units; and executive officers, cantonment boards, Sahiwal and Sialkot cities.

^b Inclusive of taxes and duties.

Source: Asian Development Bank.

III. DUE DILIGENCE

A. Technical

22. A detailed feasibility assessment and preliminary design of the proposed civil works components were undertaken for the project using an integrated urban planning approach. The project components and project sites were selected through consultations with stakeholders and communities, building on lessons learned (paras. 9 and 10). A geographic information systembased map was prepared for each city, indicating project sites and their interconnectivity. Each project component designed for each city allows for achieving independent results, in most cases without the risk of delay or lack of completion of other project components. For Sahiwal, the WWTP and drainage systems were designed in coordination with the Environment, Natural Resources and Agriculture Division of ADB's Central and West Asia Department as the division is preparing a new project for water quality in irrigation systems that will be linked with the WWTP operations (output 2). A climate change vulnerability assessment was conducted, which confirmed the project's medium climate risk categorization, and mitigation actions were incorporated in the project design. The project adopts good practices to improve project sustainability and impact. For example, prepaid water metering systems will be introduced to make service delivery more equitable and sustainable. With the prepaid water metering system, collection efficiencies will be improved for sustainable services.

B. Economic and Financial

23. The economic analysis of the project was conducted in accordance with ADB's guidelines for the economic analysis of projects.¹⁸ A project is considered feasible when the economic internal rate of return (EIRR) equals or exceeds the social discount rate of 9.0%. The analysis shows that the project components will have major quantifiable and nonquantifiable benefits, including (i) incremental water consumption and time savings from water collection (output 1), (ii) health benefits from improved sanitation (outputs 1 and 2), (iii) travel time savings and reduction of traffic accidents as a result of reduced congestion and more efficient bus terminal operations (output 3), (iv) reduction of flood risks owing to riverbank path improvement (output 3), and (v) an average rental price increase near greenbelts and parks (output 3). The estimated EIRR is 11.7% for Sahiwal and 21.6% for Sialkot, which is higher than the economic opportunity cost of capital estimated at 9.0%. The overall project has an EIRR of 17.1%.

24. The cities of Sahiwal and Sialkot have not introduced comprehensive cost recovery tariffs for key municipal services. The fiscal capacity of both cities to finance the operating costs of the project was assessed. The urban sector assessment indicates that the two cities require about

¹⁸ ADB. 2003. Economic Analysis of Projects. Operations Manual. OM G1/OP. Manila; and ADB. 2017. Guidelines for the Economic Analysis of Projects. Manila.

\$6 million in incremental annual operating costs, which will be provided as revenue grants through budgetary transfers from the provincial government. While the financial sustainability of urban services may still depend on budgetary transfers, the above transfers are expected to reduce over time with the following measures. First, the two cities will introduce new tariff structures to improve financial and operational sustainability. Consultation with communities confirmed people's willingness to support and pay for improved services, and the viability of introducing a new tariff scheme. Second, the revenue innovation, through the installation of about 15,000 water meters (of which 1,400 are prepaid water meters) in the two cities as well as the introduction of volumetric tariffs, is expected to result in a reduction of about 10% in nonrevenue water. Prepaid meters will also improve the collection of fees for water use. Third, investment in a bus terminal will increase the revenue from fees levied on buses, and a portion of the increased revenue in bus terminal operation will be transferred to the newly established urban services companies. These companies will also provide maintenance and clearing services to the bus terminals, which will generate revenue for the companies.

C. Governance

25. The pre-mitigation financial management and procurement risks are assessed to be *substantial* for the executing and implementing agencies. In financial management, the executing and implementing agencies follow a single-entry accounting system; an adequate asset management system and effective internal audit mechanism are not in place. Mitigation measures proposed include the appointment of key financial management personnel, development of a financial policies and procedures manual, and outsourcing of the internal audit function in the PMU and CIUs. Regarding procurement, the executing agency needs to appoint a suitable procurement staff to ensure all procurement decisions follow ADB's operating principles, including economy and efficiency, fairness, and transparency. The executing agency will follow these procurement principles embodied in ADB's Procurement Guidelines (2015, as amended from time to time). ADB will also provide training on ADB procurement and disbursement procedures.

26. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with LG&CD Department, the Planning and Development Department, and the Urban Unit. The specific policy requirements and supplementary measures are described in the PAM.

D. Poverty, Social, and Gender

27. The project will benefit about 1.4 million people in Sahiwal and Sialkot cities, of which an estimated 29.5% are poor. It will contribute to poverty reduction in the two cities through (i) improved water supply and sanitation services, which will reduce the incidence of waterborne diseases and thus household health expenses; (ii) upgraded urban transport infrastructure including well-lit pedestrian walkways, and space for small vendors which will largely benefit the poor and low-income groups; (iii) increased functionality of public spaces and bus terminals, which will provide economic opportunities for small vendors and increase the use of outdoor spaces for healthy activities; (iv) increased public awareness of hygiene and waterborne diseases; and (v) additional employment opportunities for the local labor force.

28. The project is categorized *effective gender mainstreaming*, with significant direct benefits for women, including (i) the development of gender-inclusive urban infrastructure such as bus terminals with separate female toilets and the allocation of more commercial spaces for female vendors, well-lit pedestrian walkways, and women's facilities in the parks; and (ii) improvement of gender-inclusive urban service delivery through the recruitment of more female staff in customer service units and policy divisions of the urban services companies.

E. Safeguards

29. In compliance with ADB's Safeguard Policy Statement (2009), the project's safeguard categories are as follows.

30. **Environment (category B).** Impacts from the project are mostly related to the construction and rehabilitation of the trunk mains, distribution centers, and distribution networks; and are expected to be short-term and limited. These include dust, noise, vibration, labor and public safety issues, temporary blockage of household access, traffic disturbance, production and transportation of construction materials, and disposal of hazardous construction waste. Environmental impacts during the operation phase may include lowering of the groundwater table, disposal of WWTP sludge, accidental leakage from chlorination, noise from the WWTP and pumping stations, and increase in wastewater production. Mitigation measures to address all construction and operational impacts have been included in the environmental management plans prepared as part of the initial environmental examinations. The initial environmental examinations were disclosed on the ADB website on 7 April 2017. The PMU in the LG&CD Department will be responsible for implementation of the environmental management plan. A grievance redress mechanism to handle safeguard issues will be established after project effectiveness.

31. **Involuntary resettlement (category A).** For output 1, the due diligence report shows that limited involuntary resettlement impacts are expected since project imprints are largely within the right-of-way. Impacts will be reassessed based on detailed designs and additional land acquisition and resettlement plans (LARPs) will be prepared as needed. For output 2, a LARP has been prepared and disclosed¹⁹ for Sahiwal WWTP and its conveyance system. Land acquisition for the WWTP and conveyance system will affect about 23 landowners who will lose about 5.6 hectares of arable land, about 50 mobile vendors, and 143 displaced persons operating commercial structures. Additional assessments may be required for some components under this subproject based on detailed designs. For output 3, the due diligence report shows that limited involuntary resettlement impacts are expected for parks and greenbelts, but impacts will be reassessed based on detailed designs and LARPs will be developed as needed. Output 4 has no involuntary resettlement impacts. All draft LARPs will be updated based on detailed designs, approved by ADB, and disclosed before implementation. A land acquisition and resettlement framework has been additionally prepared and disclosed²⁰ to guide the planning and implementation of social safeguards, as additional assessment may be required. Institutional capacity building will be provided to support the Punjab PMU and two CIUs in safeguards implementation through the project management consultant. A notice to proceed will not be given to contractors until LARPs have been implemented for each subproject.

32. **Indigenous peoples (category C).** No communities of indigenous peoples are in the project area, as defined in ADB's Safeguard Policy Statement (2009) for operational purposes. Accordingly, no indigenous peoples planning documents are required.

F. Summary of Risk Assessment and Risk Management Plan

33. Significant risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.²¹

¹⁹ The LARP for Sahiwal Centralized Sewerage Treatment Plant with Trunk Mains and Conveyance System was disclosed on the ADB website on 18 April 2017.

²⁰ The project land acquisition resettlement framework was disclosed on ADB website on 18 April 2017.

²¹ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Mitigating Measures
ADB will continue dialogue with relevant stakeholders throughout project
implementation to ensure commitment and support by any political leadership.
ADB will closely monitor progress. Significant recourse allocations will support
the new companies to strengthen institutional frameworks and governance
structures, develop staff capacity, and improve operational efficiency and
sustainability.
All procurement will follow the principles of ADB's Procurement Guidelines
(2015, as amended from time to time). Project management unit and
consultants will support the executing agency.
The government will implement the time-bound financial sustainability action
plan. The project will also support public awareness campaigns and policy
dialogue for gradual volumetric tariff increases. These activities will highlight
that improved urban services need to be linked with cost recovery measures.
Project implementation will follow a realistic schedule. Working with ADB's
Pakistan Resident Mission, the project team will maintain close liaison with
relevant government agencies.

Table 4: Summary of Risks and Mitigating Measures

Sources: Asian Development Bank pre-feasibility studies and project preparatory technical assistance studies.

IV. ASSURANCES AND CONDITIONS

34. The government, LG&CD Department, and the city governments of Sahiwal and Sialkot have 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 PAM and loan documents.

35. The government, LG&CD Department, and the city governments of Sahiwal and Sialkot have agreed with ADB on certain covenants for the project, which are set forth in the draft loan agreement and project agreement. Specific covenants agreed by the government are set forth in the loan agreement and project agreement.

36. No withdrawal shall be made under the loan agreement until (i) ADB has received a subsidiary loan agreement executed between the government and Punjab, and a further grant agreement between Punjab and Sahiwal and Sialkot; (ii) PMU and CIU staff have completed training on ADB's loan disbursement; (iii) a financial policies and procedures manual has been issued for use by the PMU and the CIUs; (iv) a firm of chartered accountants has been engaged for the internal audit of the PMU and the CIUs; and (v) dedicated financial management staff have been assigned in PMU and CIUs.

V. RECOMMENDATION

37. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$200,000,000 to the Islamic Republic of Pakistan for the Punjab Intermediate Cities Improvement Investment Project, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 20 years, including a grace period of 6 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao President

29 August 2017

DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with Living standards, health, and economy in Sahiwal and Sialkot improved (Punjab Growth Strategy 2018)^a

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome	By 2024:		
Access to quality urban services by the residents of Sahiwal and Sialkot cities improved	 a. Percentage of total population in two cities consuming improved water supplies^b increased to at least 70% (2016 baseline: Sahiwal = 36%; Sialkot = 50%) 	a-c. ADB Project Completion Report	Capacity development and institutional strengthening do not take place at the desired pace
	 b. Volume of treated wastewater increased to at least 80,000 cubic meters per day in Sahiwal (2016 baseline: 0) 		
	 c. Percentage of intercity travelers using bus terminals increased to 30% (2016 baseline: Sahiwal = 25%; Sialkot = 24%) 		
Outputs	By 2023:		
systems improved	 22 water reservoirs, 114 boreholes and tube wells, 20 pumping stations built, and 350 km of water pipes installed; new SCADA system established (2016 baseline: 0) 	1a-c. Annual report of the project	Approvals and endorsements are delayed beyond the stipulated time frame for project implementation
	 Percentage of water supply connections that are metered increased by 70% (2016 baseline: 1%–50% in pilot zones) 		
	 600 prepaid water meters installed in Sahiwal and 800 in Sialkot (2016 baseline: 0) 		
2. Sanitation systems	By 2023:		
Improvea	 2a. 18 wastewater pumping stations installed or rehabilitated; 40 km of sewer pipes replaced (2016 baseline: 0) 	2a-c. Annual report of the project	
	2b. Centralized wastewater treatment plant constructed in Sahiwal (2016 baseline: 0)		
	2c. Untreated wastewater for irrigation not used (2016 baseline: used)		
3. Urban public spaces	Ву 2023:		
	 3a. 11 parks and 7 km of greenbelts rehabilitated, with at least one outdoor space for women's sports (2016 baseline: 0) 	3a-c. Annual report of the project	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	3b. Three bus terminals upgraded in Sahiwal and Sialkot, with separate waiting areas and toilets for women (2016 baseline: 0)		
	3c. At least 8 km (4 km in each city) of pedestrian footpaths upgraded (2016 baseline: 0)		
4. Institutional support and capacity developed	By 2023:		
	 4a. At least 160 staff (80 in each city) completed the newly developed capacity development program (2016 baseline: 0) 	4a-c. Annual report of the project	
	4b. Six program communication campaigns (three in each city) organized (2016 baseline: 0)		
	4c. All (75) technical and financial management staff (at least 20% women) of the project management unit, city implementation units, and Water and Sanitation Company trained (2016 baseline: 0)		
Key Activities with Milestones			
 Water supply systems improved Complete detailed engineering design for water supply and distribution systems (Q1 2018) Replace turbine pumps and motors in Sialkot (Q2 2019) Develop distribution network improvement zones and nonrevenue water program in selected zones, including installation of SCADA system, bulk meters, pressure gauges, and prepaid meters (Q2 2019) Construct new OHRs and new pumping stations with disinfection units (Q4 2019) Rehabilitate existing tube wells and existing OHRs (Q4 2019) Replace water supply pipelines with polyethylene pipes, and asbestos cement pipe (Q4 2019) Hand over complete set of assets to urban service companies (Q2 2023) 			
2. Sanitation systems improved			
 2.1 Complete detailed engineering design for wastewater treatment system improvement (Q2 2018) 2.2 Procure solid waste management equipment (Q2 2018) 			
2.3 Provide missing equipment for wastewater management (Q4 2018)			
2.5 Replace sewer pipes (Q4 2019)			
 2.6 Renabilitate disposal and pumping stations (Q1 2020) 2.7 Construct centralized wastewater treatment plant with trunk mains and conveyance system in Sahiwal (Q2 2020) 			
 2.8 Provide missing equipment for wastewater management in Sialkot (Q1 2020) 2.9 Hand over complete set of assets to urban service companies (Q2 2023) 			
 Urban public spaces improved Complete detailed engineering design for public space upgrading (Q2 2018) Rehabilitate six parks and two greenbelts in Sahiwal (Q4 2018) Improve city public transport routes and footpaths with traffic signals at road crossings, with adaptive traffic control and two bus terminals in Sahiwal and Sialkot (Q2 2021) Rehabilitate five parks and one greenbelt in Sialkot (Q2 2019) 			
3.5 Hand over comp	lete set of assets to urban service companies	, s (Q2 2023)	

4. Institutional support and capacity developed

- 4.1 Build capacity of urban services institutions to implement the project effectively (during implementation)
- 4.2 Establish project management unit and city implementation units (Q3 2017)
- 4.3 Issue request for proposal for the recruitment of project management and coordination; and engineering, procurement, and construction packages (Q3 2017)
- 4.4 Implement program communication activities with youth groups, schools, and civil society to promote awareness of project and life skills education (Q4 2017)
- 4.5 Support improvement of operation and maintenance of key urban services, urban policies and planning, finance management, and tariff policies (Q1-Q4 2018)
- 4.6 Develop project performance management system considering poverty, gender, environment and social development issues, management information system, geographic information system, and complaint management and reporting (Q2 2018)
- 4.7 Support the SMART city improvement (Q3 2018)
- 4.8 Provide training and send key staff to external training (Q2 2018)

Inputs

Asian Development Bank: \$200 million (regular OCR loan)

Government of Punjab: \$50 million

Assumptions for Partner Financing

Not applicable

km = kilometer, OCR = ordinary capital resources, OHR = overhead reservoir, Q = quarter, SCADA = supervisory control and data acquisition.

^a Government of Punjab, Planning and Development Department. 2015. *Punjab Growth Strategy 2018: Accelerating Economic Growth and Improving Social Outcomes*. Chandigarh.

^b According to drinking water standards of the World Health Organization.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=46526-007-3

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