



Report and Recommendation of the President to the Board of Directors

Project Number: 41665-013
April 2016

Proposed Loan, Administration of Grant, and Technical Assistance Grant Local Water Utilities Administration Water District Development Sector Project (Guaranteed by the Republic of the Philippines)

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 14 March 2016)

Currency unit	–	Philippine peso (P)
P1.00	=	\$0.02151
\$1.00	=	P46.490

ABBREVIATIONS

ADB	–	Asian Development Bank
CKWD	–	City of Koronadal Water District
COA	–	Commission on Audit
EARF	–	environmental assessment and review framework
EIRR	–	economic internal rate of return
EMP	–	environment management plan
FIRR	–	financial internal rate of return
GOCC	–	government-owned and controlled corporation
IEE	–	initial environmental examination
LWUA	–	Local Water Utilities Administration
LGU	–	local government unit
MSFWD	–	Metro San Fernando (La Union) Water District
NEDA	–	National Economic and Development Authority
PAM	–	project administration manual
PIU	–	project implementation unit
PMU	–	project management unit
RF	–	resettlement framework
RP	–	resettlement plan
SPS	–	Safeguard Policy Statement
TA	–	technical assistance
UEIF	–	Urban Environmental Infrastructure Fund
UFPF	–	Urban Financing Partnership Facility
WACC	–	weighted average cost of capital
WFPF	–	Water Financing Partnership Facility

NOTE

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

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 41665-013	
Project Name	Water District Development Sector Project	Department /Division	SERD/SEUW
Country	Philippines	Executing Agency	Local Water Utilities Administration
Borrower	Local Water Utilities Administration		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Urban sanitation		10.00
	Urban water supply		50.00
		Total	60.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Urban environmental improvement		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Anticorruption Institutional development Institutional systems and political economy Organizational development Public financial governance	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Partnerships (PAR)	Civil society organizations Official cofinancing		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	Yes	Nation-wide	High
MDG-targeting (TI-M)	MDG7		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: B Involuntary Resettlement: B Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		60.00	
Sovereign Project loan: Ordinary capital resources		60.00	
Cofinancing		3.00	
Urban Environmental Infrastructure Fund-UFPF Multi - Grant		2.50	
Water Financing Partnership Facility - Multi Donor - Grant		0.50	
Counterpart		13.00	
Government		13.00	
Total		76.00	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		Yes	

I. THE PROPOSAL

1. I submit for your approval this report and recommendation on (i) a proposed loan, to be guaranteed by the Republic of the Philippines, and (ii) proposed administration of a grant to be provided by the Urban Environmental Infrastructure Fund (UEIF)¹ under the Urban Financing Partnership Facility (UFPF), both to the Local Water Utilities Administration (LWUA) for the Water District Development Sector Project. The report also describes proposed administration of technical assistance (TA) to be provided by the UEIF under the UFPF and by the Multi-Donor Trust Fund under the Water Financing Partnership Facility (WFPP)² for capacity building for water district development, and if the Board approves the proposed loan and administration of the grant, I, acting under the authority delegated to me by the Board, approve the TA.³

2. The project will enable LWUA, a government-owned and controlled specialized lender, to fulfill its mandate to help less advanced water districts which operate outside Metro Manila. The project will expand and rehabilitate water supply systems, build new sanitation facilities, and provide capacity development to strengthen the sustainability of LWUA and these water districts, and to promote sanitation partnerships with local government units (LGUs). Greater access to piped water supply and improved sanitation will reduce water-related diseases caused by unsafe drinking water and the lack of sanitation facilities.

II. THE PROJECT

A. Rationale

3. Provincial water and sanitation coverage has not kept pace with the country's growing population and needs significant improvement. While over 90% of Metro Manila's residents have access to piped water, it is estimated that less than half of the people living in provincial areas do. Sanitation remains a big challenge especially outside Metro Manila where there are no significant sewerage systems and septic tank effluent is discharged without treatment, exposing millions to water-related diseases. Acute watery diarrhea is one of the leading causes of morbidity in the country.⁴ The Government of the Philippines seeks to catalyze urban water supply and sanitation to improve health and living conditions and promote inclusive growth.

4. **Sector performance.** Outside Metro Manila service is fragmented and suffers from weak planning, monitoring and investment. Water utilities are operated by a selection of service providers, including (i) water districts, (ii) LGU-owned and operated water utilities, and (iii) private sector operators, mostly in urbanized areas; and (iv) community-based organizations, mostly in rural areas.

5. Water districts provide about two-thirds of all provincial piped water connections and therefore can play an important role in expanding coverage. Water districts are corporatized utilities that LGUs were encouraged to form under the 1973 Provincial Water Utilities Act. Run by a general manager and a five-person board of directors appointed by the mayor or governor, each water district must operate on a full cost recovery basis.⁵ The 1973 act also established

¹ Financing partner: the Government of Sweden.

² Financing partners: the governments of Australia, Austria, Norway, Spain, and Switzerland.

³ The design and monitoring framework is in Appendix 1.

⁴ Government of the Philippines, Department of Health (DOH). 2012. *Field Health Service Information System, Annual 2011*. Manila.

⁵ An LGU forms a water district after analyzing, with LWUA, the water district's likely financial viability. The LGU then enacts a resolution to corporatize its water supply assets and secures a conditional certificate of conformance from

LWUA to help water districts develop systems and achieve sustainability through providing (i) concessionary loans;⁶ and (ii) engineering, technical, and institutional development services. The act allows LWUA to take over water district management under special circumstances, powers that LWUA has occasionally exercised to rehabilitate mismanaged districts.

6. It is generally accepted that water districts provide better service than utilities run by LGUs and have demonstrated more resilience after disasters, with corporatization and LWUA's financing and technical assistance as key success factors.⁷ While a growing number of water districts have achieved scale and sustainability and can now access funding from government banks and private sector banks, the majority of the 506 operational water districts are small, with fewer than 3,000 connections and limited system coverage. Most small water districts cannot access funding from local banks, and rely on LWUA for technical, operational, and institutional expertise. Many small water districts are characterized by high nonrevenue water levels, low efficiency and profitability, and weak institutional and technical capacity. The project will stimulate water and sanitation investments, and help smaller water districts expand coverage, reduce nonrevenue water levels, and become more efficient.⁸ The project will enable LWUA to extend longer-term loans and build LWUA's technical capacity in sanitation, while water districts will be able to borrow for the first time from LWUA to finance sanitation projects.

7. **Strategic context.** Water districts provide an established corporatized platform for broader and improved water and sanitation coverage outside Metro Manila to help the government achieve its development goals for safe drinking water and improved sanitation, as articulated under the Philippine Development Plan, 2011–2016 and its Midterm Update.⁹ LWUA is a focal point to facilitate this. The National Economic and Development Authority (NEDA) board approved the project proposal in 2014, and it is highlighted in the government's Revalidated Public Investment Program.¹⁰ The project also supports the National Sewerage and Septage Management Program, which aims to catalyze the installation of septage management systems in all LGUs by 2020 and encourages LGUs to share costs with water districts.

8. Assistance to this key sector is part of the Asian Development Bank (ADB) country partnership strategy for the Philippines, 2011–2016.¹¹ The project reinforces core principles in ADB's water operational plan, 2011–2020,¹² fostering corporatization and cost recovery, and promoting sanitation. The project meets all the requirements for a sector loan:¹³ (i) the government has a sector development plan¹⁴ and the institutional capacity to implement it, (ii) its

the LWUA for the new water district to become eligible for LWUA's financial, technical, institutional development, and regulatory support.

⁶ Since 1973, LWUA has been funded mainly through loans from ADB and other development partners.

⁷ Most water districts' operations bounced back faster after Typhoon Yolanda because of (i) more climate-proof systems, (ii) stronger technical skills, and (iii) LWUA's institutional assistance. LWUA's comprehensive damage and loss assessment within a few days demonstrated its technical and institutional capacity.

⁸ For very small or less-viable water districts, the government will channel grants for these water districts through LWUA, and the project can fund the loan portion of such loan-grant funding.

⁹ Government of the Philippines, National Economic and Development Authority (NEDA). 2014. *Philippine Development Plan 2011–2016, Midterm Update with Revalidated Results Matrices*. Manila.

¹⁰ Government of the Philippines NEDA. 2014. *Philippine Development Plan 2011–2016, Revalidated Public Investment Program*. Manila.

¹¹ ADB. 2011. *Country Partnership Strategy: Philippines, 2011–2016*. Manila.

¹² ADB. 2011. *Water Operational Plan, 2011–2020*. Manila.

¹³ ADB. 2003. Sector Lending. *Operations Manual*. OM D3/BP. Manila. The project will fund water and sanitation subprojects, applying ADB's safeguards, procurement, and disbursement processes, as per OM D3.

¹⁴ Government of the Philippines, National Economic and Development Authority. 2010. *Philippine Water Supply Sector Roadmap, 2nd Ed.* Manila.

policies applicable to the sector are appropriate, and (iii) LWUA has demonstrated capacity. The project is in the country operations business plan for the Philippines, 2016–2018.¹⁵

9. **Previous ADB involvement and lessons learned.** LWUA has a long history of working with ADB. From the 1970s to the 1990s, ADB provided LWUA with loans for six investment projects and funded five TA projects to finance water districts and strengthen institutions. Of the three projects that were rated, two were *successful* and one was *partially successful* because of delays in construction and a lack of quantifiable and measurable targets for project beneficiaries. This project will provide implementation support to LWUA to avoid the delays experienced previously. It will also fund a review of LWUA's corporate planning and asset management to strengthen LWUA.¹⁶

B. Impact and Outcome

10. The impact will be improved living and health conditions for the communities outside Metro Manila that the participating water districts serve. The outcome will be increased access to safe drinking water and improved sanitation.

C. Outputs

11. The project will finance water and sanitation investments that will improve public health in communities outside Metro Manila. The key project outputs are

- (i) the extension and rehabilitation of water supply systems of at least 20 water districts, including the two pilots (CKWD and MSFWD), and sanitation projects of at least four water districts (potentially including CKWD);¹⁷ and
- (ii) capacity development and institutional strengthening for LWUA, selected water districts, and LGUs to address planning, financial and project management, and operations and maintenance capacity gaps.¹⁸

12. LWUA will help the water districts expand their systems and achieve sustainability, including overseeing the design of proposed water intake and distribution systems, and sanitation facilities. LWUA will prepare feasibility studies and safeguard documentation for the additional subprojects. Subproject eligibility criteria is in Appendix 2 of the project administration manual (PAM).¹⁹ LWUA will also organize promotion campaigns and workshops to encourage sanitation partnerships between LGUs and water districts, and integration or cooperation among smaller water districts.

13. **Special features.** In the Philippines, scale and regulatory risk (resource and economic) have deterred more private investment in water and sanitation. While the government is working to establish a national regulator, corporatization continues to be the important first step for public water utilities. The sector loan will strengthen water districts by funding expanded service

¹⁵ ADB. 2015. *Country Operations Business Plan: Philippines, 2016–2018*. Manila.

¹⁶ A project preparatory TA prepared feasibility studies and safeguard documentation for two pilot water districts: City of Koronadal Water District (CKWD) and Metro San Fernando (La Union) Water District (MSFWD). In August 2015, LWUA submitted to ADB a list of probable water subprojects totaling \$60 million.

¹⁷ In 2007, following the government's request, ADB approved project preparatory TA for \$1.5 million (including \$0.3 million from the government). TA consultants were mobilized in 2008, five pilot water districts were selected and feasibility studies prepared. The final report was submitted in May 2010. In January 2012, after the appointment of LWUA's new management, the government renewed its interest in the project. Of the original pilot water districts, CKWD and MSFWD remain.

¹⁸ This output is financed by the TA described in para. 20.

¹⁹ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

coverage and nonrevenue water reduction. The attached TA will provide capacity development to water districts and promote integration and cooperation among very small water districts. The project will also demonstrate the scalable national platform that LWUA and water districts provide for sanitation investments: a 20% grant will be offered for sanitation projects, and the TA will promote sanitation partnerships between LGUs and water districts.

D. Investment and Financing Plans

14. The project is estimated to cost \$76 million (Table 1).

Table 1: Project Investment Plan

Item	Amount ^a
A. Base Cost^b	
Water Supply and Sanitation	56.7
Capacity Development ^c	1.0
Subtotal (A)	57.7
B. Contingencies^d	11.4
C. Financing Charges during Implementation^e	6.9
Total (A+B+C)	76.0

^a Includes taxes and duties of \$8.5 million to be financed from government resources through exemption. LWUA and the participating water districts will provide in-kind contribution with no incremental cost for the project management unit and project implementation units, office space for the consultants, and audit costs.

^b Prices as prepared by project participatory technical assistance (TA) consultants in mid-2013 and revalidated by Local Water Utilities Administration's technical staff in mid-2015.

^c This is funded by the TA for the Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility for \$0.5 million and from the Multi-Donor Trust Fund under the Water Financing Partnership Facility for \$0.5 million.

^d Physical contingencies computed at 5% for land acquisition and resettlement expenses, and 10% for other base costs. Price contingencies computed at an average of 1% on foreign exchange costs and an average of 3.9% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

^e Includes interest and commitment charges. Interest during construction for the Asian Development Bank (ADB) loan has been computed at the 5-year forward London interbank offered rate plus a spread of 0.5%. Commitment charges for the ADB loan are 0.15% per year, to be charged on the undisbursed loan amount.

Source: Asian Development Bank estimates.

15. LWUA has requested a loan of \$60 million from ADB's ordinary capital resources to help finance the project. Loan proceeds will finance civil works, equipment, consulting services, transportation and insurance, contingencies, and interest and commitment charges during implementation. The loan will have a 25-year term, including a grace period of 6 years and a straight-line amortization; an annual interest rate determined in accordance with ADB's London interbank offered rate-based lending facility;²⁰ a commitment charge of 0.15% per year (interest and other charges during implementation to be capitalized); and such other terms and conditions set forth in the draft loan and guarantee agreements.

16. The UEIF (footnote 1) under UFPF will provide a \$2 million investment grant, administered by ADB, to subsidize new sanitation facilities. Making such projects more affordable and demonstrating sustainability will catalyze other sanitation investments.

17. LWUA, the water districts, and the LGUs will contribute \$13 million for land acquisition, resettlement costs, and taxes and duties. LWUA and the water districts will provide in-kind

²⁰ The interest includes a maturity premium of 10 basis points. This is based on the above loan terms and LWUA's choice of repayment options and dates.

contributions with no incremental cost for the project management unit (PMU) and project implementation units (PIUs), office space for the consultants, and audit costs. The financing plan is in Table 2.

Table 2: Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary Capital Resources	60.0	78.9
Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility (grant) ^a	2.5	3.3
Multi-donor Trust Fund under the Water Financing Partnership Facility (grant) ^b	0.5	0.7
Government ^c	13.0	17.1
Total	76.0	100.0

^a Financing partner: the Government of Sweden. This includes a \$2 million investment grant and a \$0.5 million grant for the TA described in para. 20.

^b Financing partners: the governments of Australia, Austria, Norway, Spain, and Switzerland. This will support the TA described in para. 20.

^c LWUA and the participating water districts will provide in-kind contribution with no incremental cost, for the project management unit and project implementation units, office space for the consultants, and audit costs. Source: Asian Development Bank estimates.

18. LWUA is the borrower of the ADB loan, which will be guaranteed by the Republic of the Philippines. This loan will allow LWUA to onlend funds to small water districts, many of which are unable to borrow long-term funds or substantial amounts from local banks. LWUA intends to extend subloans with a term of up to 25 years (including a grace period of up to 6 years), at a fixed interest rate of 7.9% per annum. Foreign exchange risk will be borne by the water districts.²¹

E. Implementation Arrangements

19. Implementation arrangements are summarized in Table 3 and detailed in the PAM. The project is cofinanced with ADB-administered cofinancing resources and OCR resources; universal procurement will apply to all contract packages financed under the project.²²

Table 3: Implementation Arrangements

Aspect	Arrangement		
Implementation period	April 2016-April 2022		
Estimated completion date	30 April 2022 (physical completion); 31 October 2022 (loan closing)		
Management			
(i) Executing agency	Local Water Utilities Administration Project Management Unit		
(ii) Implementing agencies	Participating water districts		
(iii) Implementation units	A project implementation unit in each participating water district		
Procurement	International competitive bidding	1 contract	\$9.3 million
	National competitive bidding	6 contracts	\$3.1 million
Consulting services	Quality- and cost-based selection	95 person-months	\$1.0 million
Advance contracting	Advance procurement action for recruitment of detailed engineering design and project management consultants.		

²¹ The subloans will carry such other terms and conditions as are currently applied by LWUA. This longer term stretches out debt service and modulates the impact on tariffs. LWUA intends to provide capacity development to water districts to enable them to mitigate foreign currency risk.

²² ADB. 2016. *Enhancing Operational Efficiency of the Asian Development Bank*. Manila.

Disbursement	The loan and grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2015, as amended from time to time) and detailed arrangements agreed upon between LWUA and ADB.
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Source: Asian Development Bank.

III. TECHNICAL ASSISTANCE

20. The attached TA is estimated to cost \$1.1 million, of which \$500,000 will be financed by a grant from the UEIF (footnote 1) under UFPF and \$500,000 will be financed by a grant from the Multi-Donor Trust Fund (footnote 2) under WFPF. ADB will administer both grants.²³ The TA will provide support to the project in order to (i) strengthen water district sustainability through training and promoting integration and cooperation among smaller water districts; (ii) promote sustainable sanitation partnerships between LGUs and the water districts; and (iii) prepare a strategic business review of LWUA, strengthen its corporate planning capacity and redefine its role in the sector, enhance its viability, and improve its accounting systems to address audit issues raised by the COA. LWUA will provide counterpart support in the form of staff, office accommodation, and other in-kind contributions.

IV. DUE DILIGENCE

A. Technical

21. In designing sample water subprojects, wells have been sized based on daily peak demand. Water supply facilities primarily consist of (i) submersible pumping systems with associated back-up generation in wells with sustainable water yields, (ii) suitable chlorination facilities for water disinfection, (iii) transmission and distribution networks with pipe diameters ranging from 50 to 200 millimeters, and (iv) new service connections. Improved sanitation in sample subprojects will be secured through a combination of (i) desludging of septic tanks with vacuum trucks (with standard capacities ranging from 4 to 8 cubic meters, for ease of access to the household), and (ii) septage treatment facilities. The resulting effluent will meet Class B body discharge standards prescribed by the Department of Environment and Natural Resources.

B. Economic and Financial

22. **Economic analysis.**²⁴ The economic analysis of the pilot subprojects evaluated technical options and confirmed that the subproject components are the least-cost options that support each water district's long-term development plan. The economic internal rate of return (EIRR) was computed at 25% for CKWD and 14% for MSFWD, above the 12% economic opportunity cost of capital assumed by ADB. The EIRR remained above 12% for all sensitivity scenarios except MSFWD's worst case scenario (increased costs and decreased benefits). The EIRR would have been higher if other benefits were quantified (i.e., avoided morbidity and mortality from other waterborne diseases such as dysentery and cholera, income generated from the use of water for livelihood purposes, and the multiplier effect of increased income), and would likely be above 12% for MSFWD's worst case scenario. The economic benefits of the water supply subprojects include (i) resource cost savings on non-incremental water in terms of avoided costs of producing, collecting, treating, and storing non-piped water because of a shift in demand to piped water supply; (ii) economic value of incremental water from the increased

²³ This TA will finance the output described in paragraph 10(ii). Attached Technical Assistance (accessible from the list of linked documents in Appendix 2).

²⁴ Economic Analysis (accessible from the list of linked documents in Appendix 2).

supply; (iii) economic value of water that would have been lost for nontechnical reasons; and (iv) avoided income loss including the value of time saved for not having to collect water from existing non-piped sources, and productivity savings because of reduced incidence of diseases (but excluding income generated from the use of water for livelihood purposes and the multiplier effect of increased income, because of lack of data). Economic costs were derived from the financial estimates of capital investments and operation and maintenance costs after eliminating all duties and taxes, estimating the traded and non-traded components of costs, and multiplying the net results by appropriate conversion factors based on guidelines set by the NEDA's Investment Coordination Committee: a shadow exchange rate for traded goods of 1.2, and a shadow wage rate factor of 0.6 for unskilled labor.

23. **Financial analysis.**²⁵ The financial cost-benefit analysis of the pilot water districts' subprojects confirmed their financial viability. The financial internal rate of return (FIRR) of CKWD's subprojects (water and sanitation) is 22.1%, exceeding the weighted average cost of capital (WACC) of 5.7%. The FIRR of MSFWD's water subproject is 7.1%. Sensitivity and risk analysis revealed that the subprojects' FIRRs are most sensitive to changes in revenues (mainly from tariffs) and operating costs. Sustainability depends heavily on the implementation of tariff increases, the aggressive connection of new customers (for water subprojects), and the collection of sanitation fees from customers who are not connected to the water system (for sanitation subprojects). Financial analysis also confirmed that the pilot water districts have the funds necessary to finance equity, operation and maintenance of the completed facilities, and debt service. To be eligible for financing, additional subprojects must demonstrate an FIRR exceeding the relevant WACC.

24. As part of due diligence, LWUA's financial condition was assessed. LWUA's profitability and leverage continued to improve in the 2014 fiscal year. It expects to operate viably in the next 5 years by (i) reviewing its competitiveness to deter current borrowers from prepaying loans and attract new borrowers; (ii) more proactively managing nonperforming loans; and (iii) serving as a funding conduit for national government grants to smaller water districts and waterless communities.

C. Governance

25. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and LWUA. As a government-owned and controlled corporation (GOCC), LWUA is bound by the good governance commitments set forth in the performance agreement contract between LWUA and the Governance Commission for GOCCs.

26. The financial management assessment concluded that LWUA adheres to the transparency and accountability elements of good governance. Although overall risk is still substantial, financial management arrangements for the project are adequate. LWUA has developed reasonable institutional capacity to undertake international and national competitive bidding for civil works through its direct participation and involvement in procurement for previous projects financed by ADB and other official development assistance. The assessment of the pilot water districts indicated more limited experience; assessments will be undertaken for other participating water districts. Capacity development assistance on financial management, fund disbursement, and procurement will be provided. The specific policy requirements and supplementary measures are described in the PAM.

²⁵ Financial Analysis (accessible from the list of linked documents in Appendix 2).

D. Poverty and Social

27. **Poverty and social impacts.** The project will target less-resilient water districts. A poverty, social, and gender assessment was conducted under the project preparatory TA to determine socioeconomic characteristics and needs, as well as opportunities for participation for the pilot area beneficiaries. The poverty incidence in the pilot water districts was 36% for MSFWD and 46% for CKWD, with a high percentage of households headed by women (19% and 34%). A summary poverty reduction and social strategy has been prepared to identify measures to enhance project benefits and mitigate potential risks or negative impacts to the project population.²⁶ The project has two main poverty and inclusive design features: (i) enforcing LWUA's lifeline tariff policy; and (ii) ensuring water districts have initiatives for affordable access. Sanitation-awareness campaigns and pilot facilities will reduce the occurrence of waterborne and water-washed diseases and reduce associated health costs.

28. **Gender impacts.** The project's gender action plan will facilitate women's participation in project implementation (through the PMU) and in hygiene and sanitation training, and increase female representation on water district boards.²⁷

E. Safeguards

29. **Involuntary resettlement.** The project is classified category B for involuntary resettlement, in accordance with ADB's Safeguard Policy Statement (2009) (SPS), as land acquisition and resettlement impacts are limited. A resettlement framework (RF)²⁸ has been prepared, embodying specific requirements for all subprojects. A resettlement plan (RP) will be completed for each subproject with land acquisition and resettlement impacts financed under the sector loan, in accordance with the resettlement framework, as required, during implementation. Due diligence has been undertaken for all sample subprojects. Public consultations were conducted and an RP was prepared for MSFWD's water supply subproject which involves land acquisition; initial costs for land acquisition and resettlement including those for implementing the RP have been estimated and integrated into the project cost.²⁹ The RP follows a process consistent with the SPS and Philippine laws and regulations, and ensures compliance with them. In line with the RF, a due diligence assessment report was prepared for CKWD's subprojects, which concluded that no land acquisition or resettlement were expected to occur. A designated officer in the PMU will monitor land acquisition and resettlement implementation.

30. **Indigenous peoples.** The project is classified category C for indigenous peoples, in accordance with the SPS. An indigenous peoples planning framework³⁰ has been prepared to guide the preparation of an indigenous peoples plan, if required during implementation.

31. **Environment.** The project is classified category B for the environment as the subprojects are not expected to have any significant impact. An environmental assessment and review framework (EARF) has been prepared, embodying the specific requirements for all

²⁶ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

²⁷ Gender Action Plan (accessible from the list of linked documents in Appendix 2).

²⁸ Resettlement Framework (accessible from the list of linked documents in Appendix 2).

²⁹ Resettlement Plan: Metro San Fernando (La Union) Water District (accessible from the list of linked documents in Appendix 2). The resettlement plan will be updated based on the detailed design.

³⁰ Indigenous Peoples Planning Framework (accessible from the list of linked documents in Appendix 2).

subprojects to be financed under the sector loan.³¹ A designated officer at the PMU will be responsible for the application of the EARF and ensure that (i) all subprojects are selected in accordance with the environmental criteria in the EARF; (ii) the screening is conducted and environment safeguard documents are prepared for all subprojects in line with the SPS; (iii) an initial environmental examination (IEE), including an environment management plan (EMP) that ensures mitigation of identified environment impacts along with related costs, is prepared, and that the IEE is consistent and complies with the SPS and Philippine laws and regulations; (iv) the EMP is updated based on the detailed design, and relevant provisions are incorporated into the bidding documents; and (v) the implementation of the EMP is monitored and semiannual monitoring reports are submitted to ADB. Public consultations have been conducted and sample IEEs have been prepared for all subprojects, each including an EMP that ensures mitigation of identified environment impacts along with related costs.³²

32. Adequate incorporation of environmental considerations during design, and allocation of sufficient budget will mitigate potential adverse impacts during operation. Effective environment and social monitoring at all stages of implementation will be ensured. In compliance with ADB's information disclosure and consultation requirements, safeguard documents will be posted on ADB's website. A grievance redress mechanism has been developed and included in the safeguard documents to help to facilitate resolve complaints regarding project performance.

F. Integrity

33. Integrity due diligence has been conducted, in coordination with the Office of Anticorruption and Integrity, and information and clarification was obtained from LWUA and the government. The assessment included past issues the government and LWUA are addressing; if the suggested robust measures are implemented and adhered to, they are unlikely to have an adverse effect on the project. Appropriate loan covenants have been included in the loan documents to mitigate integrity risks.

G. Risks and Mitigating Measures

34. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.³³ The project's integrated benefits and impacts are expected to outweigh the costs.

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
LWUA and participating water districts will not have sufficient capacity to utilize funds during implementation; reluctance of water districts to borrow, especially for sanitation.	The project will fund a review of LWUA's corporate planning and asset management. LWUA is working with the Commission on Audit (COA) to address the audit issues raised by COA. LWUA has a long list of water and sanitation projects. Most have low technical complexity; the more technical can be outsourced by LWUA, if necessary. The project will fund capacity building to enhance sustainability and encourage sanitation investments. Participating water districts will be offered a 20% investment grant for sanitation subprojects.
Operation of new infrastructure is not sustainable because of low tariffs, poor collection,	LWUA's lending policies promote full-cost pricing including setting a price per unit of water that covers all the costs involved in treating water and delivering it to the customer, and ensuring annual water tariff reviews. LWUA can take over

³¹ Septage Treatment Subproject of City of Koronadal Water District, for the City of Koronadal and Water Supply Subproject of City of Koronadal Water District, for Brgy. Paraiso, City of Koronadal.

³² Initial Environmental Examinations for MSFWD and CKWD (accessible from the list of linked documents in Appendix 2). The IEEs will be updated after the DEDs of the subprojects are finalized.

³³ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Risks	Mitigating Measures
inefficient operations, and/or limited human resources.	management of a water district. Awareness of importance of safe water is increasing.
Water districts' limited capacity in financial management and procurement of ODA-funded projects, managing foreign exchange risk, and sanitation.	Project management support and capacity development will strengthen the financial management and procurement capacity of the executing and implementing agencies, and provide sanitation training. To enable water districts mitigate the foreign exchange risk, LWUA intends to allow a tariff mechanism to pass on to consumers foreign exchange losses.
Potential integrity risks at LWUA.	Based on IDD undertaken, the government and LWUA addressed past issues. Loan covenants include: (i) LWUA will meet all obligations set by the Governance Commission for GOCCs; and (ii) any employees convicted or under criminal or other investigation are not involved in the project. ADB will review the first five subprojects and all subprojects of \$2 million or more.

GOCC = government-owned and controlled corporation, IDD = integrity due diligence, LWUA = Local Water Utilities Administration, ODA = official development assistance.

Source: Asian Development Bank.

V. ASSURANCES AND CONDITIONS

35. The government and LWUA 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 project administration manual and loan documents.

36. The government and LWUA have agreed with ADB on certain covenants for the project, which are set forth in the loan agreement, grant agreement, and guarantee agreement.

VI. 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

- (i) the loan of \$60,000,000 to the Local Water Utilities Administration, to be guaranteed by the Republic of the Philippines, for the Water District Development Sector Project, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 25 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 guarantee agreements presented to the Board;
- (ii) the administration by ADB of the grant not exceeding the equivalent of \$2,000,000 to the Local Water Utilities Administration for the Water District Development Sector Project, to be provided by the Urban Environmental Infrastructure Fund under the Urban Financing Partnership Facility.

Takehiko Nakao
President

Date

DESIGN AND MONITORING FRAMEWORK

Impacts the project is aligned with:			
Improving the level and standard of service in the water and sanitation sector (Updated Philippine Development Plan 2011–2016). ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources or Reporting Mechanisms	Risks
Outcome Increased access to safe drinking water and improved sanitation for the communities outside Metro Manila that the participating water districts serve.	By 2023 a. 200,000 more people will have access to piped water service connections (a baseline will be established for each subproject at the start of subproject implementation) b. 400,000 more people will have access to improved sanitation (a baseline will be established for each subproject at the start of subproject implementation).	a. Water district records b. Project records	Operation of new infrastructure is not sustainable because of low tariffs, poor collections, inefficient operations, and/or limited human resources.
Outputs 1. Water supply systems extended and rehabilitated, and new sanitation facilities constructed.	By 2022 1a. At least 20 new water supply subprojects, financing new deep wells and other raw water sources, reservoirs, transmission, and distribution pipelines expanded and/or rehabilitated (2016 baseline: 0) 1b. At least four new wastewater facilities developed (2016 baseline: 0) 1c. At least 400 barangay health workers and/or science or health public school teachers trained in sanitation information, education, and communication (100 per sanitation subproject, of which 50% will be female) (2016 baseline: 0)	1a-c. Records of water districts, project management unit, LWUA, and LGUs	LWUA and water districts will not have sufficient capacity to fully utilize the funds available for onlending. Water districts have limited capacity in financial management and procurement of ODA-funded projects, and managing foreign exchange risk on loans. Water districts reluctant to borrow, especially for sanitation. Potential integrity risks at LWUA.
2. Capacity of participating water districts and LWUA developed	By 2018: 2a. At least 10 capacity building workshops conducted for LWUA and water districts to enhance sustainability (at least 300 trained, of which at least 30% will be female) (2016 baseline: 0) 2b. At least 5 capacity building workshops conducted to catalyze sanitation investments (at least 200 trained, of which at least 30% will be female) (2016 baseline: 0) 2c. At least 5 capacity building workshops conducted for LWUA and water districts in safeguards and gender-responsive planning,	2a-c. Project performance and monitoring system reports progress reports, monitoring and evaluation reports	High turnover rate of trained staff.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources or Reporting Mechanisms	Risks												
	and compliance with gender action plans and safeguards action plans (RPs, IPPs, and EMPs) (at least 100 trained, of which at least 30% of will be female) (2016 baseline: 0)														
Key Activities with Milestones															
<p>Output 1. Water supply systems improved and extended, and sanitation projects operating.</p> <p>1.1 Recruit project implementation consultants by September 2016</p> <p>1.2 Prepare detailed design of water subprojects of pilot water districts by March 2017 and non-pilot water districts by March 2018</p> <p>1.3 Prepare detailed design of sanitation subprojects by March 2019</p> <p>1.4 Procure civil works and equipment from July 2017 to June 2021</p> <p>1.5 Implement and complete civil works from July 2017 to March 2022</p> <p>Output 2. Capacity of participating water districts and LWUA developed</p> <p>2.1 Identify planning and project management capacity gaps of water districts by February 2017</p> <p>2.2 Prepare and approve LWUA corporate plan by May 2017</p> <p>2.3 Conduct capacity development workshops for water districts to enhance sustainability of their operations, including business planning, project implementation, MIS, nonrevenue water reduction, by December 2017</p> <p>2.4 Public sanitation promotion campaigns and sanitation workshops organized by LWUA to catalyze partnerships between LGUs and water districts by June 2018</p>															
<p>Inputs</p> <table border="0"> <tr> <td>ADB Loan:</td> <td>\$60,000,000</td> </tr> <tr> <td>UEIF–UFPF Grant:</td> <td>\$2,000,000</td> </tr> <tr> <td>Government:</td> <td>\$13,000,000</td> </tr> <tr> <td colspan="2">TA to finance output 2:</td> </tr> <tr> <td>UEIF–UFPF Grant:</td> <td>\$500,000</td> </tr> <tr> <td>Multi-Donor Trust Fund Grant under the Water Financing Partnership Facility:</td> <td>\$500,000</td> </tr> </table>				ADB Loan:	\$60,000,000	UEIF–UFPF Grant:	\$2,000,000	Government:	\$13,000,000	TA to finance output 2:		UEIF–UFPF Grant:	\$500,000	Multi-Donor Trust Fund Grant under the Water Financing Partnership Facility:	\$500,000
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UEIF–UFPF Grant:	\$500,000														
Multi-Donor Trust Fund Grant under the Water Financing Partnership Facility:	\$500,000														
<p>Assumptions for Partner Financing</p> <p>Not Applicable.</p>															

ADB = Asian Development Bank, EMPs = environmental management plans, IPPs = indigenous peoples plans, LGU = local government unit, LWUA = Local Water Utilities Administration, MIS = management information system, PIU = project implementation unit, PMU = project management unit, RPs = resettlement plans.

^a Government of the Philippines, National Economic and Development Authority (NEDA). 2014. *Philippine Development Plan 2011–2016, Midterm Update with Revalidated Results Matrices*. Manila.

Source: Asian Development Bank.

Tatiana Gallego-Lizon
Director, SEUW

James Nugent
Director General, SERD

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=41665-013-3>

1. Loan Agreement
2. Grant Agreement
3. Guarantee Agreement
4. Sector Assessment (Summary): “Water and Other Urban Infrastructure and Services,” based on the 2014 Project Classification System.
5. Project Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Attached Technical Assistance: Capacity Development for Water District Development Sector Project
9. Economic Analysis
10. Financial Analysis
11. Country Economic Indicators
12. Summary Poverty Reduction and Social Strategy
13. Gender Action Plan
14. Initial Environmental Examination: Septage Treatment Subproject of City of Koronadal Water District, for the City of Koronadal
15. Initial Environmental Examination: Water Supply Subproject of City of Koronadal Water District, for Brgy. Paraiso, City of Koronadal
16. Initial Environmental Examination: Water Supply Subproject of Metro San Fernando Water District
17. Environmental Assessment and Review Framework
18. Resettlement Plan: Metro San Fernando (La Union) Water District
19. Resettlement Framework
20. Indigenous Peoples Planning Framework
21. Risk Assessment and Risk Management Plan