



# Periodic Financing Request Report

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Project Number: 41456-043  
March 2015

## Viet Nam Water Sector Investment Program: Tranche 3

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 3 March 2015)

Currency Unit	–	Viet Nam Dong (D)
D1.00	=	\$0.0000468
\$1.00	=	D21,343

## ABBREVIATIONS

ADB	–	Asian Development Bank
EMP	–	environmental management plan
FFA	–	framework financing agreement
km	–	kilometer
LIBOR	–	London interbank offered rate
MFF	–	multitranche financing facility
MPI	–	Ministry of Planning and Investment
NRW	–	nonrevenue water
O&M	–	operation and maintenance
OCR	–	ordinary capital resources
PFR	–	periodic financing request
PMU	–	project management unit
RP	–	resettlement plan
SAWACO	–	Saigon Water Corporation
WSC	–	water supply company
WTP	–	water treatment plant

## NOTES

- (i) The fiscal year of the Socialist Republic of Viet Nam and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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## TRANCHE AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 41456-043</b>	
<b>Project Name</b>	Water Sector Investment Program, PFR 3	<b>Department /Division</b>	SERD/SEUW
<b>Country Borrower</b>	Viet Nam, Socialist Republic of Viet Nam, Socialist Republic of	<b>Executing Agency</b>	People's Committee
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ Water and other urban infrastructure and services	Urban water supply	142.50	
		<b>Total</b>	<b>142.50</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG) Environmentally sustainable growth (ESG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive Urban environmental improvement	Climate Change impact on the Project	High
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD) Knowledge solutions (KNS) Partnerships (PAR) Private sector development (PSD)	Civil society participation Institutional development Organizational development Knowledge sharing activities  Bilateral institutions (not client government) Implementation Conducive policy and institutional environment	Effective gender mainstreaming (EGM)	✓
<b>5. Poverty Targeting</b>		<b>Location Impact</b>	
Project directly targets poverty	No	Urban	High
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	Environment: B Involuntary Resettlement: B Indigenous Peoples: C		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>142.50</b>	
Sovereign MFF-Tranche (Loan): Ordinary capital resources		142.50	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>26.50</b>	
Government		26.50	
<b>Total</b>		<b>169.00</b>	
<b>9. Effective Development Cooperation</b>			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

## TRANCHE AT A GLANCE

Date of Receipt by ADB of PFR: 14 November 2014

Tranche Number: 3

### 10. Country Operations Business Plan

CPS  
COBP

<http://www.adb.org/sites/default/files/institutional-document/33042/files/cobp-vie-2012-2014.pdf>

### 11. Tranche Summary

In November 2014, Asian Development Bank (ADB) received the State Bank of Vietnam's periodic financing request letter for project 3 requesting \$142.5 million to finance seven water companies (WSCs) having completed their project preparation and initiated advance action under project 2. The investments would improve water services for 1.2 million persons, including 17,500 poor households with their own piped water connection for the first time.

Project 3 outputs will support the multitranche financing facility (MFF) outputs: (i) increased coverage; (ii) improved business planning, financial management, and asset management; and (iii) effective nonrevenue water reduction for seven WSCs for the following: Bac Giang City, Cua Lo Town, Nghi Son Economic Zone, Tam Hiep-Dien Nam, Dien Ngoc Towns, Thai Hoa Town, Thai Nguyen City and Vinh City in four provinces.

Special features of project 3 include (i) promoting technical and financial sustainability by enforcing water tariff increase to full-cost recovery, while reducing subsidies and meeting targets of selected key performance indicators; (ii) providing access to finance for second-ranked WSCs willing to secure their debt through water tariff increase, resulting in greater access to safe water for the poor; and (iii) promotion of engineering, procurement, and construction (EPC) contracts.

The Ministry of Planning and Investment (MPI), coordinating agency for the MFF, is responsible for (i) selecting WSCs that can access the MFF, and (ii) consolidating reports with the assistance of the WSCs. Under project 3, the project management is delegated to the WSCs, and the provincial people committees (PPCs) are the executing agencies. Each WSC has set up a project management unit (PMU) in its organizational structure under project 2. The PMU organizes the procurement of consulting services and works. The MPI has no role in procurement.

Project 3 is structured with one loan to the government. The Ministry of Finance will sign seven subsidiary loan agreements with the participating WSCs with a letter of guarantee from the respective PPC, after the loan signing. Each WSC, acting as implementing agency, will implement its procurement plan separately. The MPI will consolidate the reporting with assistance of the WSCs. The project performance management information system was set-up under project 1 and applies to all subsequent tranches.

**Impact and Outcome:** The impact will be sustainable provision of safe water in Bac Giang, Nghe Anh, Quang Nam, Thai Nguyen, Thanh Hoa Provinces. The outcome will be improved efficiency of participating water supply companies.

**Outputs:** (i) increased coverage, (ii) improved business planning, asset and financial management, and (iii) nonrevenue water reduced.

**Implementation Arrangements:** People's Committee will be the executing agency.

**Project Readiness:** Readiness criteria for loan fact finding include: (i) approval of project detailed outline (PDO) according to Decree 131/2006/ND-CP or any subsequent legislation; (ii) endorsement of feasibility study report according to Decision 48/2008/QD-TTg by the water companies before submission to the local government for approval after loan fact finding; (iii) agreed project administration manual (PAM), including procurement plan; (iv) agreed cost estimate, financing and counterpart funds; (v) agreed PMU structure and staffing levels; (vi) agreed draft project implementation plan; (vii) agreed safeguard framework and tranche frameworks or plans; (viii) agreed financial management system and auditing arrangements; and (ix) agreed consulting services and technical assistance.

Under project 3, all the readiness criteria for loan fact finding have been met. For loan negotiations, the respective PPC already approved the feasibility study reports for each of the seven WSCs. All seven WSCs completed the basic design as part of the feasibility study report and initiated consultant recruitments for detailed design and preparation of bid documents under project 2. The WSCs have endorsed project 3 safeguard documents and disclosed through the ADB website with hard copies available to the affected people at the district offices in the project area.

Prior to loan effectiveness, the remaining readiness criteria need to be complied with: (i) the government and the participating PPCs and WSCs have assured ADB that the implementation of project 3 will conform to all applicable policies of ADB, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents; (ii) each participating WSC needs an updated road map for water tariff increase during the project, which will be updated annually, based on the audited financial statements and the latest legislation on methodology for calculating water tariff increase, during loan review missions. Thanh Hoa PPC provided additional assurance to negotiate a concession agreement, including regulatory arrangement for water tariff, quality of service, and termination of service on water supply in the Nghi Son Economic Zone between the public WSC, Song Chu One member Limited Company and the current private WSC, in a manner acceptable to ADB; (iii) Quang Nam WSC has an additional covenant: no withdrawal shall be made for disbursement of works until its water supply and sanitation operations have been ring-fenced from the non-core operations that demonstrate no cross subsidy for water tariff in a manner acceptable to ADB. This withdrawal condition applies individually and severally to Quang Nam WSC. In addition, the government will need to: (i) confirm counterpart funds for the first year of implementation; (ii) establish PMU with appointed key staff; (iii) execute a subsidiary loan agreement with the Ministry of Finance

## TRANCHE AT A GLANCE

with terms acceptable to ADB.

### 12. Significant Developments in the MFF and Previous Tranches

In February 2011, ADB approved an MFF for \$1 billion from the ordinary capital resources (OCR). This is the first time the government borrowed on OCR terms and conditions for the water sector. The framework financing agreement (FFA) was signed on 5 May 2011. From 2011 to 2020, the MFF is expected to benefit 15 million people with improved service, including 500,000 poor people, which will receive their own piped water for the first time.

In 2011, ADB approved a \$138 million loan for project 1 with the Saigon Water Corporation (SAWACO). The loan was effective in May 2012. The loan closing was extended by 2 years from 2016 to 2018 because of delayed project start-up due to delay in signing the subsidiary loan agreement. The government relented in foreign currency the proceeds of the loan to the WSCs, requiring guidance from the Prime Minister twice on how to manage the foreign currency exchange. It was agreed that the local government, owner of the SAWACO will guarantee the loan. SAWACO already set up a gender-balanced PMU with a full time director and 20 full time staff, in line with the requirements in the gender action plan. In 2014, SAWACO already recruited two firms for supervision (\$7.5 million) and operation management (\$2.5 million). Individual consultants were recruited for climate change thematic studies on water conservancy and disaster management and preparing bid documents for the main contracts. Two works contracts representing two thirds of the loan are under bidding: (i) information communication technology (\$25 million) has been tendered in October 2014; and (ii) 10 kilometers transmission pipe (\$78 million) through an EPC contract is under evaluation. These two contracts are on track for contract awards in early 2015.

ADB approved project 2 in December 2012 for a loan of \$212 million. Project 2 was effective in September 2013. All the WSCs set up a PMU with a full-time director and started recruiting consultants for detailed design and preparation of bid documents. All the other WSCs have already signed a subsidiary loan agreement with the Ministry of Finance. One private WSC (Dak Lak, Cui Kin) has requested a cancellation of the ADB loan under project 2 and will finance its project through a build-own-operate contract with private and commercial financing.

Project 1 and 2 comply with the FFA, including safeguards, undertakings, and financial ratios. Project 1 has only unanticipated impacts for resettlement to be confirmed after detailed design. Project 2 has no safeguard issues identified at this early stage of project implementation with ongoing activities limited to consulting services. Resettlement plans will be updated based on the detailed measurement surveys and sent to ADB for approval after the detailed design is completed. Project 1 and 2 met contract award and disbursement in 2014.

### 13. Milestones

Estimated Approval	Estimated Effectiveness	Estimated Completion <sup>a</sup>
19 March 2015	15 May 2015	30 June 2020

### 14. Linked Documents

	Required Document	Disclosure Date
(i) Environment	IEE - Initial Environment Examination	6 October 2014
Weblink:	<a href="http://www.adb.org/projects/41456-043/documents">http://www.adb.org/projects/41456-043/documents</a>	
(ii) Involuntary resettlement	RP - Resettlement Plan	6 October 2014
Weblink:	<a href="http://www.adb.org/projects/41456-043/documents">http://www.adb.org/projects/41456-043/documents</a>	
(iii) Indigenous peoples		
Weblink:		

<sup>a</sup> For Tranches, this refers to the financial closing date.

## I. BACKGROUND

1. In February 2011, the Asian Development Bank (ADB) Board of Directors approved a multitranche financing facility<sup>1</sup> (MFF) for \$1 billion from the ordinary capital resources (OCR). This is the first time the government borrowed on OCR terms and conditions for the water sector. The framework financing agreement (FFA) was signed on 5 May 2011. From 2011 to 2020, the MFF is expected to benefit 15 million people with improved service, including 500,000 poor people, which will receive their own piped water for the first time. The MFF is designed as a series of four tranches to finance the water supply sector in Viet Nam and support the sustainable provision of water in Viet Nam and improve the efficiency of the water supply companies (WSCs).

2. Viet Nam's water sector already achieved the Millennium Development Goal (Target 7c for access to safe water supply) with 95% coverage for improved water in 2012, compared to 62% in 1990.<sup>2</sup> However, urban water supply only covers 79% of urban areas in 2014. The MFF addresses significant gaps in service reliability, by providing access to finance for operational improvement and increased coverage. The MFF allows deserving smaller WSCs to borrow for capital expenditures by securing their debt through water tariff increases.

3. Three key legislations detail vision and target to sustain the strong water sector policy framework: (i) The water decrees<sup>3</sup> require WSCs to operate on full-cost recovery;<sup>4</sup> (ii) The water supply orientation plan<sup>5</sup> details requirement for coverage; and (iii) the decision on nonrevenue water<sup>6</sup> (NRW) reduction set ambitious targets for NRW reduction from 26% in 2014 to 18% by 2020. The NRW reduction is in line with the target of 25% for 2015, but in a context of a low service pressure and only one third of the WSCs achieving a continuous water service with a provision of 100 liters per capita per day. The socioeconomic development plan (2011–2015) includes the following water sector objectives: (i) identify water as a limiting factor for growth, and (ii) improve quality of life and health by providing safe water. The water program, summarized in the sector assessment in Supplementary Appendix, is included in the country partnership strategy for Viet Nam, 2012–2015, is consistent with those policies. ADB's Water Operational Plan 2011–2020 is built around the theme of water security, supported by the MFF.

4. Under the first two periodic financing requests (PFR1<sup>7</sup> or project 1 and PFR2<sup>8</sup> or project 2), 16 WSCs borrowed a combined amount of \$350 million, including \$5 million allocated to nine WSCs<sup>9</sup> to complete the project preparation and advance action for investment under a subsequent tranche. Seven WSCs<sup>10</sup> are financing improvement and increasing coverage to benefit 5.5 million people, including 37,500 poor households with their own piped water connection for the first time.

5. In November 2014, ADB received the State Bank of Vietnam's periodic financing request letter for project 3 (PFR3) requesting \$142.5 million to finance seven WSCs<sup>11</sup> having completed

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<sup>1</sup> ADB. 2011. *Report and Recommendation of the President to the Board of Directors. Proposed Multitranche Financing Facility to the Socialist Republic of Viet Nam for the Water Sector Investment Program*. Manila (MFF0054-VIE).

<sup>2</sup> World Health Organization / United Nations Children Fund. 2014. Joint Monitoring Program.

<sup>3</sup> Decree 117/2007 Clean Water Production, Supply and Consumption, supplemented by Decree 124/2011.

<sup>4</sup> Full cost recovery aims to cover operation and maintenance cost and the higher of depreciation or debt service.

<sup>5</sup> Decision 1929/2009 orientations for developing water supply in Viet Nam's urban centers and industrial parks up to 2025. Decision 2147/2010 on Approval of National Unaccounted-for-Water and NRW Program to 2025.

<sup>6</sup> NRW is the portion of water produced but not sold because of physical losses and commercial losses.

<sup>7</sup> ADB. 2011. *Water Sector Investment Program Tranche 1*. Manila (L2754-VIE).

<sup>8</sup> ADB. 2012. *Water Sector Investment Program Tranche 2*. Manila (L2961-VIE).

<sup>9</sup> WSCs from Bac Giang, Dak Lak (Cui Kin), Nghe Anh (3), Lam Dong (2), Quang Nam, and Thai Nguyen provinces.

<sup>10</sup> Ho Chi Minh City is included in PFR1 and six WSCs in PFR2 from the Provinces of Binh Duong, Dak Lak, Quang Tri, Thua Thien Hue and the Cities of Da Nang and Hai Phong.

<sup>11</sup> The seven WSCs are from Bac Giang City, Cua Lo Town, Nghi Son Economic Zone, Quang Nam Province, Thai Hoa Town, Thai Nguyen City, and Vinh City.



their project preparation and initiated advance action under PFR2. The investments would improve water services to 1.2 million persons, including 17,500 poor households with their own piped water connection for the first time.

6. Special features of project 3 include (i) promoting technical and financial sustainability by enforcing water tariff increase to full-cost recovery, while reducing subsidies and meeting targets of selected key performance indicators; (ii) providing access to finance for second-ranked WSCs willing to secure their debt through water tariff increase, resulting in greater access to safe water for the poor; and (iii) promotion of engineering, procurement, and construction (EPC) contracts.

## II. ASSESSMENT OF MFF IMPLEMENTATION

7. In 2011, ADB approved a \$138 million loan for project 1 with the Saigon Water Corporation (SAWACO). The loan was effective in May 2012. The loan closing was extended by 2 years from 2016 to 2018 because of delayed project start-up due to delay in signing the subsidiary loan agreement. For the first time, ADB lent OCR to the water sector and the government relent in foreign currency the proceeds of the loan to the WSCs, requiring guidance from the Prime Minister twice. SAWACO already set up a gender-balanced project management unit (PMU) with a full time director and 20 full time staff, in line with the requirements in the gender action plan (GAP). In 2014, SAWACO already recruited two firms for supervision (\$7.5 million) and operation management (\$2.5 million). Individual consultants were also recruited: two for climate change thematic studies on water conservancy and disaster management and two for preparing bid documents. Two works contracts representing two third of the loan are under bidding: (i) information communication technology (\$25 million) has been tendered in October 2014; and (ii) 10 kilometers (km) transmission pipe (\$78 million) through an EPC contract is under evaluation. These two contracts are on track for contract awards in early 2015. The planned outputs are in line with the MFF: (i) increased coverage; (ii) improved business planning, asset and financial management; and (iii) reduced NRW.

8. ADB approved project 2 in December 2012 for a loan of \$212 million to meet the outputs in line with the MFF: (i) increased coverage; (ii) improved business planning, asset and financial management; and (iii) reduced NRW reduction for six WSCs (footnote 10); and advance action for nine WSCs (footnote 9). Project 2 was effective in September 2013. All the WSCs already set-up a PMU with a full-time director and started recruiting consultants for detailed design and preparation of bid documents; one work contract is being reviewed by ADB for bidding in 2014. One private WSC in Dak Lak has requested the cancellation of the ADB loan under project 2 and will finance its project through a build-own-operate contract with private and commercial financing.

9. Project 1 and 2 comply with the FFA, including safeguards, undertakings, and financial ratios. Project 1 has only unanticipated impacts for resettlement to be confirmed after detailed design. Project 2 has no safeguard issues identified at this early stage of project implementation with ongoing activities limited to consulting services. Resettlement plans (RP) will be updated based on the detailed measurement surveys and sent to ADB for approval after the detailed design is completed. Project 1 and 2 are rated on track for implementation as of 31 December 2014.

10. A lesson learned from the implementation of project 1 is to incorporate advance action, authorized since 2013,<sup>12</sup> to prevent delay in project implementation. All the participating WSCs under project 3 borrowed under project 2 to finance detailed design and prepare bid documents.

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<sup>12</sup> Decree 38/2013/ND-CP *Management and Utilization of Official Development Assistance and Concessional Loans from Donors*. Viet Nam.

Each tranche represents selected WSCs borrowing in line with the MFF Design and Monitoring Framework and the roadmap.

### III. PERIODIC FINANCING REQUEST

#### A. Impact and Outcome

11. Project 3 impact will be sustainable provision of safe water in Bac Giang, Nghe Anh, Quang Nam, Thai Nguyen, and Thanh Hoa Provinces. The outcome will be improved efficiency of participating WSCs. Impact and outcome of project 3 will contribute to the overall impact of the MFF: sustainable provision of safe water in Viet Nam.

#### B. Outputs

12. Project 3 outputs will support the MFF outputs: (i) increased coverage; (ii) improved business planning, asset and financial management; and (iii) reduced NRW. Table 1 provides details on the seven WSCs, which are borrowing to finance investments for water supply.

**Table 1: Water Supply Subprojects Implemented by Water Supply Companies**

Cities and Towns / Province	Water Supply Subproject
<b>Bac Giang City / Bac Giang Province</b>	(i) Constructing an intake, pumping station and about 2.2 km D700 raw water transmission pipeline and ancillary works; (ii) Constructing one WTP capacity about 25,000 m <sup>3</sup> /d and ancillary works; (iii) Constructing about 76 km D75-D700 transmission and distribution pipes; (iv) Installing about 16,000 household connections.
<b>Cua Lo Town / Nghe An Province</b>	(i) Constructing one WTP capacity about 10,000 m <sup>3</sup> /d; (ii) Constructing transmission and distribution pipes D100-D500; (iii) Constructing service network pipeline D40-D90; (iv) Constructing booster pumping station, office building and ancillary works; (v) Installing about 7,352 household connections.
<b>Thai Hoa Town / Nghe An Province</b>	(i) Constructing an intake, pumping station about 12,000 m <sup>3</sup> /day and about 5.5 km D500 pipeline; (ii) Constructing one WTP capacity about 6,000 m <sup>3</sup> /day and ancillary works; (iii) Constructing about 34 km D110-D350 transmission and distribution pipes and about 93 km D32-D90 service pipeline; (iv) Supplying and Installing about 7,916 household connections.
<b>Tam Hiep and Dien Nam – Dien Ngoc Towns / Quang Nam Province</b>	<b>Tam Hiep expansion:</b> (i) Constructing raw water intake, pump station and about 300 m pipeline; (ii) Increasing capacity of Tam Hiep WTP from 5,000 to about 20,000 m <sup>3</sup> /d; (iii) Constructing about 18 km D300-D500 transmission and about 39 km D110-D250 distribution and about 75 km service network pipelines; (iv) Supplying and installing about 10,000 household connections. <b>Dien Nam and Dien Ngoc water supply:</b> (i) Constructing an intake and about 2.4 km D500 raw water pipeline; (ii) Constructing WTP capacity about 15,000 m <sup>3</sup> /d; (iii) Constructing about 18 km D300-D400, transmission, about 54 km D110-D250 distribution and about 90 km D32-D63 service network pipelines; (iv) Supplying and installing about 10,000 household connections.
<b>Thai Nguyen City / Thai Nguyen Province</b>	(i) Constructing an intake, pumping station and about 0.17km D800 raw water pipeline and ancillary works; (ii) Constructing WTP capacity about 50,000 m <sup>3</sup> /d and ancillary works; (iii) Constructing two treated water tanks (2 x 5,000 m <sup>3</sup> ), pumping station, chemical house, and ancillary works; (iv) Constructing about 22 km D300-D800 transmission, about 20 km D100-D200 distribution pipes, about 62 km D50 service network pipeline; (v) Supplying and installing about 4,134 household connections.

Cities and Towns / Province	Water Supply Subproject
<b>Nghi Son Economic Zone / Thanh Hoa Province</b>	(i) Constructing raw water intake and ancillary works; (ii) Constructing three pumping stations, electrical substations and ancillary works; (iii) Constructing about 39 km D400-D1200 raw water transmission pipeline and ancillary works.
<b>Vinh City / Nghe An Province</b>	(i) Constructing about 35 km transmission D250-D500, about 33 km distribution pipes D100-D200 and about 195 km service pipeline D32-D90; (ii) Supplying and installing about 18,000 household connections; (iii) Defining NRW zoning with about 25 km D100-D250 pipe replacement; (iv) Implementing Supervisory Control And Data Acquisition (SCADA) system at about 15 locations; (v) Implementing an institutional strengthening program to upgrade financial information systems, improve operation and maintenance (O&M) capabilities and reduce NRW.

D=diameter; km=kilometer; m<sup>3</sup>/d=cubic meter per day; NRW=nonrevenue water; WTP=water treatment plant.  
Source: Periodic Financing Request – Government of Viet Nam, after negotiation.

### C. Investment and Financing Plans

13. Project 3 is estimated to cost \$169.00 million. The government has requested a loan of \$142.50 million from ADB's OCR to help finance the project.<sup>13</sup> The loan will have a 25-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 (the interest and other charges during construction are capitalized in the loan), and such other terms and conditions set forth in the draft loan and project agreements. Based on the above loan terms and straight repayment option, the average loan maturity is 15.75 years and the maturity premium payable to ADB is 0.10% annually. The government has provided ADB with (i) the reasons for its decision to borrow under ADB's LIBOR-based lending facility based on these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any communication or advice from ADB. Table 2 summarizes the investment plan for project 3.

**Table 2: Tranche Investment Plan (\$ million)**

Project Components	Amount <sup>a</sup>
<b>A. Base Cost<sup>b</sup></b>	
Subproject 1: Bac Giang City	20.81
Subproject 2: Cua Lo Town	13.19
Subproject 3: Nghi Son Economic Zone	29.13
Subproject 4: Quang Nam Province	22.57
Subproject 5: Thai Hoa Town	9.51
Subproject 6: Thai Nguyen City	23.97
Subproject 7: Vinh City	19.68
<b>Subtotal (A)</b>	<b>138.86</b>
<b>B. Contingencies<sup>c</sup></b>	<b>22.65</b>
<b>C. Financing Charges During Development<sup>d</sup></b>	<b>7.49</b>
<b>Total (A+B+C)</b>	<b>169.00</b>

Note: Number may not add up because of rounding.

<sup>a</sup> Includes taxes and duties of \$13.17 million, financed from government resources from cash contribution.

<sup>b</sup> In September 2014 prices, including taxes and duties.

<sup>c</sup> Physical contingencies computed at 9.8% for works and consulting services. Price contingencies computed at 6.7% on foreign exchange costs and 5.3% on local currency costs

<sup>d</sup> Includes interest and commitment charges. Interest during construction for the ADB loan has been computed at the 5-year USD fixed swap rate plus ADB's effective contractual spread of 0.50% p.a. and the applicable maturity premium of 0.10% p.a. Commitment charges for an ADB loan are 0.15% per year to be charged on the undisbursed loan amount.

Source: ADB estimates.

<sup>13</sup> ADB loan may finance local transportation and insurance costs.

14. The seven WSCs committed counterpart funding of \$26.50 million equivalent to cover taxes and duties in full and part of contingencies. One of the project objectives is to service the debt through water tariff increases to help phase out subsidies and assist WSCs to self-finance their future investment program. As such, the WSCs developed water tariff increase road maps endorsed by their respective people's committees (owners of the WSCs) against key operational and financial performance indicators to be monitored in the project implementation. Table 3 summarizes the financing plan for project 3.

**Table 3: Financing Plan**

<b>Source</b>	<b>Amount (\$ million)</b>	<b>Share of Total (%)</b>
Asian Development Bank	142.50	84
Government	26.50	16
<b>Total</b>	<b>169.00</b>	<b>100</b>

Source: ADB Project Team estimates.

#### D. Implementation Arrangements

15. The Ministry of Planning and Investment (MPI), coordinating agency for the MFF, is responsible for (i) selecting WSCs that can access the MFF, and (ii) consolidating reports with the WSCs' assistance. Under project 3, the project management is delegated to the WSCs and the provincial peoples committees (PPCs) are the executing agencies. Each WSC has set up a PMU in its organizational structure under project 2. The PMU organizes the procurement of consulting services and works. The MPI has no role in procurement. The implementation arrangements are summarized in Table 4 and described in details in the project administration manual.

**Table 4: Implementation Arrangements**

<b>Aspects</b>	<b>Arrangements</b>		
Implementation period	July 2015 – June 2020		
Estimated completion date	30 June 2020 (Loan closing date 31 December 2020)		
<b>Management</b>			
(i) Oversight body (Coordinating Agency)	Ministry of Planning and Investment Director General Foreign Economics Relation Department		
(ii) Project Executing agencies	Respective PPC owning or controlling the relevant WSC, implementing a subproject (total of five executing agencies; one executing agency, Nghe An PPC has 3 Subprojects)		
(iii) Key implementing agencies	WSCs of Bac Giang City, Cua Lo Town, Nghi Son Economic Zone, Quang Nam Province, Thai Hoa Town, Thai Nguyen City, Vinh City (Total of seven implementing agencies)		
Procurement	International competitive bidding	7 contracts	\$128.31 million
Consulting services	QCBS	7 contracts	\$6.18 million
	LCS	7 contracts	\$0.39 million
	CQS	1 contract	\$0.13 million
Retroactive financing	Up to \$14.25 million and no more than 12 months before signing the Loan Agreement for works and consulting services.		
Disbursement	The loan proceeds will be disbursed following ADB's Loan Disbursement Handbook (2012, as amended from time to time) and detailed arrangements agreed upon between the Government and ADB		

ADB = Asian Development Bank; CQS = consultant qualification selection; LCS = least cost selection; PPC = provincial people's committee; QCBS = quality and cost-based selection; WSC = water supply company.

16. The project 3 is structured with one loan to the government. The Ministry of Finance will sign seven subsidiary loan agreements<sup>14</sup> with the participating WSCs with a letter of guarantee from the respective PPC, after the loan signing. Each WSC, acting as implementing agency, will implement its procurement plan separately. The MPI will consolidate the reporting with assistance

<sup>14</sup> Decree 78/2010 *Relending of the Government Foreign Loans*.

with the WSCs. The project performance management information system was set-up under PFR1 and applies to all subsequent tranches.

#### **E. Project Readiness**

17. The PPCs approved the feasibility study report for the seven WSCs. All seven WSCs completed the basic design as part of the feasibility study report and initiated consultant recruitments for detailed design and preparation of bid documents under project 2. The WSCs have endorsed project 3 safeguard documents and disclosed through the ADB website with hard copies available to the affected people at the district offices in the project area.

#### **F. Advance Contracting and Retroactive Financing**

18. The FFA has a provision to allow advance contracting and retroactive financing of up to 10% of the proposed loan for eligible expenditures incurred before loan effectiveness, but not more than 12 months before the loan agreement signing date. The government was advised that ADB's approval of the advance contracting and retroactive financing does not constitute a commitment to finance the ensuing project.

### **IV. DUE DILIGENCE**

#### **A. Technical**

19. A separate capacity development technical assistance<sup>15</sup> assists the WSCs to improve their operational performance. Two consultants assessed the WSCs under project 2 and proposed a road map for operational improvements. Twinning arrangements under the water operator partnership, managed by ADB and private sector participation are ongoing to strengthen some WSCs' operation and maintenance capacities. Because of the improved financial sustainability of the WSCs due to tariff increases, the private sector has a renewed interest in public-private partnership.

#### **B. Economic and Financial**

20. Financial analyses of the seven subprojects determined all the subprojects are financially viable and sustainable based on the methodology as prescribed under ADB's Operation Manual G2: Financial Management, Cost Estimates, Financial Analysis and Financial Performance Indicators (2014). Local governments carry the foreign exchange risk through a letter of guarantee to the Ministry of Finance, as part of the subsidiary loan agreement. The water tariffs roadmaps approved in 2013 and 2014 are sufficient to finance the subproject components and for the WSCs to be cash flow positive, build cash reserves and phase out subsidies from the local government. As required under the FFA, the WSCs will operate on full cost recovery after the 6-year grace period and comply with the methodology for calculating the water tariff.<sup>16</sup> The WSCs increase the water tariff every 2 years, currently set at about \$0.30 per cubic meter. The financial internal rate of return varies from 4.1% to 6.9% between WSCs, and the weighted average cost of capital is extremely low at less than 0.2%. Based on these analyses, the seven subprojects are financially viable. On least cost analysis, the economic internal rate of return calculated for each subproject ranges from 12.4% to 17.4% when compared with the economic opportunity cost of capital of 12%. This indicates that all the subprojects are economically viable.

<sup>15</sup> ADB. 2013. *Technical Assistance to Viet Nam for Improving the Performance of the Water Supply Sector*. Manila.

<sup>16</sup> The methodology to calculate water tariff is based on Inter-Circular 75/2012 (Ministry of Finance, Ministry of Construction, and Ministry of Agriculture and Rural Development).

21. The sensitivity analyses were based on a 10% increase in capital; 10% increase in operation and maintenance (O&M) cost; 10% decrease in revenue; 10% increase in capital and O&M cost, with a 10% decrease in revenue; and a 2-year project delay with a 20% increase in O&M cost. The financial internal rate of return is mostly robust and resilient, mainly because of the recent tariff increase and projected increase in coverage to the population generating additional revenues to the WSCs. Some of the WSCs are highly leveraged, but presented a financially sustainable subproject with the debt serviced by a combination of water tariff increases and an increase in revenues from the subproject. The economic internal rate of return may fall below 12% in Bac Giang, Nghi Son and Cua Lo, with unfavorable changes to benefits or investment costs. This would also be the case for a combination of unfavorable changes to benefits, investment costs and O&M costs in Quang Nam, Thai Nguyen and Thai Hoa. This means that the PPCs should be prepared to provide additional working capital support (or raise water tariffs in excess of the assumed increases).

### **C. Governance**

22. The seven WSCs proposed for financing under project 3 have been equitized.<sup>17</sup> As such, the WSCs are managed autonomously and can produce their own financial statements following Vietnamese accounting standards. There is no independent regulation, but the regulatory function is performed by the PPC, the executive branch of the local government, and WSC owner, with an oversight from the People's Council (legislative branch). The seven WSCs have presented water tariff increase road maps and increased water tariffs in the last two years, as a prerequisite for loan negotiation. A financial management assessment was undertaken and confirms that the project financial management arrangements are adequate. Since 2011, some PMU staff in participating WSCs have been trained in procurement, disbursement and safeguards, but will be further trained under various capacity development programs provided by ADB.

23. ADB's Anticorruption Policy, 1998 (as amended to date), was explained to and discussed with the government and the WSCs during the loan fact-finding mission. The specific policy requirements and supplementary measures are described in the project administration manual.

### **D. Poverty, Social, and Gender Dimensions**

24. A poverty, social, and gender assessment was conducted during the project preparation to determine socioeconomic characteristics, needs and priorities, and opportunities for participation of project area beneficiaries. A summary poverty reduction and social strategy identifies the design and implementation of a GAP, a stakeholder communication strategy, and a participation plan with measures to enhance project benefits and mitigate potential risks or negative impacts to the population. The project 3 will have significant positive impacts by expanding water services to new areas, substantially reducing water purchase costs of households without access to piped water. The key poverty and socially inclusive design features of the project 3 include (i) pro-poor water tariff structure comprising a subsidized "lifeline" quota of water per person per month; and (ii) free connections for every household in the project area.

25. Based on the gender analysis and proposed actions, the project 3 is a gender mainstreaming category II – effective gender mainstreaming. The gender assessment identified that women within households (i) have greater responsibility for ensuring water supply for households needs, (ii) are poorly represented in the WSCs, (iii) are less able to participate in public

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<sup>17</sup> A privatization process under Prime Minister's Decision No. 38/2007, in which state-owned water companies are incorporated into a 'one member limited company' or a joint stock company with shares.

debates on issues which concern community water supply and management, and (iv) face problems in accessing household water connections. A GAP was prepared to promote gender equality: (i) 50% female targets in PMU staffing; (ii) 30% female staff training and capacity development; (iii) 30% female targets in key decision-making and implementing structures; (iv) assurance of affordable water tariff pricing policies through Vietnam Women's Union representation in decision-making forums; (v) 30% targets for employment in technical and managerial positions in the water sector; (vi) gender-inclusive monitoring, evaluation and reporting with sex-disaggregated data in project performance management information systems; and (vii) provision of national social development consultants to support GAP implementation. Each subproject includes a GAP, to be implemented through the supervision consultants and the PMU.

## **E. Safeguards**

26. An environmental assessment review framework, involuntary resettlement framework (RF), and indigenous peoples planning framework were finalized and approved under the MFF. They guide the preparation of safeguards plans for any subprojects the MFF supports. Project 3 is categorized B for resettlement and environment and C for indigenous peoples. Safeguard documents for project 3 have been prepared according to government regulations and ADB's Safeguard Policy Statement (2009) with local communities and authorities consulted.<sup>18</sup> These were approved by the seven WSCs, as project owners, and disclosed on ADB website. Hard copies are available at the district offices in the project areas. A grievance redress mechanism has been developed and is functional under project 3 and included in the safeguard document to help resolve complaints on project performance. The PMUs have designated responsibility for safeguards and will prepare bi-annual monitoring reports to be submitted to ADB. Project 3 is assessed high risk for climate change impacts, due to risk of flooding, drought and landslides by 2050. A detailed climate change assessment will be initiated before loan effectiveness with findings to be included into the design of the project 3 to ensure that potential climate change risks are addressed.

27. Project 3 is categorized B for involuntary resettlement because the seven subprojects are assessed to cause insignificant involuntary resettlement impacts. For the Vinh subproject, the investments will support pipe laying and pipe replacement within public roads, hence, there is no detailed alignment yet. Should there be any land acquisition and resettlement impacts during the final alignment, the WSC will prepare an RP, based on the MFF resettlement framework during detailed design. One subproject in Cua Lo already completed land acquisition and resettlement activities for which a due diligence report is prepared. Land acquisition for the construction of the water treatment plant (WTP) is about 8.2 hectares and 1.25 hectares for booster pumping station and administration office, managed by Cua Lo town. None of the 32 households own the affected land; local authorities had allowed people to temporarily plant trees and cultivate fish on public land. The compensation payments for all assets was paid to them and the due diligence report confirms the same. There are no gaps in accordance with MFF resettlement framework and no comprehensive action plan is required. The remaining five subprojects include about 420 affected households (about 1,890 people) under project 3. These impacts are mostly partial with no relocation required and no structure affected. There are 26 severely affected households (117 people) that will lose more than 10% of their total productive land holding under project 3 (25 households in Nghi Son Economic Zone and one in Thai Hoa Town). The RPs and the entitlement matrix include sufficient provisions and mitigating measures for all the impacts. Involuntary resettlement is limited to the footprint required to build the WTPs and the pumping stations. The

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<sup>18</sup> Documents already disclosed on ADB's website: (i) resettlement plans for Bac Giang, Quang Nam, Nghi Son, Thai Hoa, and Thai Nguyen and resettlement due diligence for Cua Lo; (ii) initial environment examinations and environmental management plans for Bac Giang, Cua Lo, Quang Nam, Nghi Son, Thai Hoa, Thai Nguyen, and Vinh.

construction of the networks mostly takes place in the right of way of the urban road network with temporary land acquisition and resettlement impacts. All unanticipated impacts will be mitigated in accordance to the MFF RF. When there are information changes noted after detailed design and during project implementation, project 3 RPs will be updated and disclosed.

28. Project 3 is categorized B for environment, as environmental impacts are not irreversible and primarily related to construction works and the safe disposal of sludge the WTPs produce. These would be mitigated through environmental management plans (EMPs), covering design, pre-construction, construction, and operations phases. Climate resilience measures have been integrated into the project primarily pertaining to water availability as well as site preparation. Environmental impacts related to siting, design, construction, and operation, and mitigation measures for environment impacts are incorporated in the EMPs. The final EMPs specific to each subproject, cleared by ADB, will form part of the contract bidding documents. The adequate incorporation of environmental considerations during design, and allocation of sufficient budget for operation and maintenance will mitigate the potential adverse impacts during operation. Water balance will be maintained by the water utilities through compliance with the Decree 201/2012 on water abstraction. Public consultations were conducted as part of the project preparation and included communities upstream and downstream of water source and intake points. The initial environment examinations will be updated during detailed design.

29. Project 3 is categorized C for indigenous peoples. Due diligence confirmed that there are no ethnic minority peoples in the project's areas who may be considered indigenous peoples based on ADB's Safeguard Policy Statement. Nevertheless, the MFF's indigenous peoples planning framework will guide the application of indigenous peoples safeguards should any unanticipated impact on ethnic minority communities arise during project 3 implementation.

## **F. Risks and Mitigating Measures**

30. The major risks are mitigated through a technical assistance (footnote 15), implemented in parallel to the MFF, that supports WSCs and their local governments to implement institutional water reforms, including water tariff increases. Appendix 9 includes the financial management and risk assessment for each of the WSC and project 3. The key risks identified for project 3 are summarized, as follows:

- (i) Local governments may fail to enforce water tariff increases, threatening the investment program's financial sustainability. The seven WSCs and their local governments have committed, through past substantial tariff increases, to a road map to full cost recovery and the phasing out of subsidies during the project, to qualify for financing under the MFF.
- (ii) The equitization of water companies without adequate oversight will not improve service delivery. Under the MFF, any WSC borrowing for physical investments will have to ring-fence its water operations and report performance data transparently in a service contract with the water users and its local government. WSCs will benefit from additional consultants support to prepare business plans and service contracts under the technical assistance program (footnote 15).
- (iii) Project start-up delays reflect late availability of counterpart funding, consultant recruitment, and resettlement. The WSCs are recruiting consultants under project 2 to start detailed design while project 3 processing and approval are ongoing. Counterpart funding is already available from the PPC and the WSCs.



**G. Risk Categorization**

31. Project 3 is assessed as low risk because (i) the loan amount is below \$200 million, (ii) there is no categorization A for any of the safeguards, and (iii) the seven WSCs are already borrowing under project 2 and have experience with ADB financing and project implementation.

**V. ASSURANCES AND CONDITIONS**

32. The government and the participating PPCs and WSCs have assured ADB that implementation of the project will 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.

33. Each participating WSC have already approved a road map for water tariff increase during the project implementation period, which will be updated annually, based on the audited financial statements and the latest legislation on methodology for calculating water tariff increase (footnote 16), during loan review missions. Thanh Hoa PPC provided additional assurance to negotiate a concession agreement, including regulatory arrangement for water tariff, quality of service, and termination of service on water supply in the Nghi Son Economic Zone between the public WSC, Song Chu One Member Limited Company and the current private WSC, in a manner acceptable to ADB.

34. Quang Nam WSC has an additional covenant: no withdrawal shall be made for disbursement of works until its water supply and sanitation operations have been ring-fenced from the non-core operations that demonstrate no cross subsidy for water tariff in a manner acceptable to ADB. This withdrawal condition applies individually and severally to Quang Nam WSC.

35. No disbursements may be made for any WSC until it has (i) set up a PMU for PFR3 under Vietnamese legislation and acceptable to ADB, and (ii) executed a subsidiary loan agreement with the Ministry of Finance with terms acceptable to ADB.

**VI. RECOMMENDATION**

36. On the basis of the approval by ADB Board of Directors for the provision of loans under the multitranche financing facility in an aggregate principal amount not exceeding \$1,000,000,000 to the Socialist Republic of Viet Nam for the Water Sector Investment Program, it is recommended that the President approve the proposed tranche as described in paragraph 13 of this report and the draft loan agreement and project agreement for the proposed tranche substantially in the forms attached to this report.