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Report No: PAD2204

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED GRANT

IN THE AMOUNT OF US$16 MILLION
FROM THE TRUST FUND FOR GAZA AND WEST BANK

WITH CO-FINANCING FROM THE PARTNERSHIP FOR INFRASTRUCTURE DEVELOPMENT MULTI-DONOR TRUST FUND
IN THE AMOUNT OF US$20 MILLION

TO THE
PALESTINE LIBERATION ORGANIZATION
(FOR THE BENEFIT OF THE PALESTINIAN AUTHORITY)

FOR A
THIRD MUNICIPAL DEVELOPMENT PROJECT

JUNE 28, 2017

SOCIAL, URBAN, RURAL AND RESILIENCE GLOBAL PRACTICE
GOVERNANCE PRACTICE
MIDDLE EAST AND NORTH AFRICA REGION

CURRENCY EQUIVALENTS

(Exchange Rate Effective Februrary 24, 2017)

Currency Unit	=	New Israeli Shekel (NIS)
US$1	=	DKK7.0
US$1	=	NIS3.71
EURO0. 94	=	US$1

FISCAL YEAR
January 1 - December 31

Regional Vice President:	Hafez M. H. Ghanem
Country Director:	Marina Wes
Senior Global Practice Directors:	Ede Jorge Ijjasz-Vasquez, Deborah L. Wetzel
Practice Managers:	Ayat Soliman, Renaud Seligmann
Task Team Leader(s):	Ellen Hamilton, Noriko Oe, Rama Krishnan Venkateswaran

ABBREVIATIONS AND ACRONYMS

AFD	Agence Française de Développement (French Development Agency)
ASA	Advisory Services and Analytics
BTC	Belgian Technical Cooperation
CD	Capacity Development
CSC	Citizen Service Center
CTA	Central Treasury Account
DA	Designated Account
DRO	Representative Office of Denmark
DP	Development Partner
EA	Environmental Assessment
ESMP	Environmental and Social Management Plan
EMSRP	Emergency Municipal Services Rehabilitation Project
ESMF	Environmental and Social Management Framework
EU	European Union
FM	Financial Management
GAM	Grant Allocation Mechanism
GDP	Gross Domestic Product
GIZ	Gesellschaft für Internationale Zusammenarbeit (German Federal Enterprise for International Cooperation)
GoI	Government of Israel
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion and Results Report
ICUD	Integrated Cities and Urban Development Project
IDA	International Development Agency
IFRs	Interim Financial Reports
IFMIS	Integrated Financial Management Information System
JSC	Joint Service Councils
NIS	New Israeli Shekel
IT	Information Technology
KfW	German Development Bank
KPI	Key Performance Indicator
LALAP	Land Acquisition and Livelihood Action Plan
LALPF	Land Acquisition and Livelihood Policy Framework
LGPA	Local Governance Program Assessment
LGUs	Local Governance Units
LGCBP	Local Government Capacity Building Project
LGSIP	Local Governance and Services Improvement Program
LTCs	Local Technical Consultants
MDLF	Municipal Development Lending Fund
MDP	Municipal Development Project
M&E	Monitoring and Evaluation

MoFP	Ministry of Finance and Planning
MoLG	Ministry of Local Government
MTR	Mid-Term Review
OM	Operations Manual
O&M	Operations and Maintenance
OP	Operational Policy
PA	Palestinian Authority
PACPA	Palestine Association of Certified Public Accountants
PAD	Project Appraisal Document
PCBS	Palestinian Central Bureau of Statistics
PDO	Project Development Objective
PID-MDTF	Partnership for Infrastructure Development – Multi-Donor Trust Fund
PLC	Palestinian Legislative Council
PLO	Palestinian Liberation Organization
PP	Procurement Plan
PPL	Public Procurement Law
PPSD	Project Procurement Strategy for Development
RAP	Resettlement Action Plan
RBMM	Results-Based Monitoring Manual
SAACB	State Audit and Administrative Control Bureau
SDC	Swiss Agency for Development and Cooperation
SDIP	Strategic Development and Investment Plan
TFGWB	Trust Fund for Gaza and West Bank
TOR	Terms of Reference
TTL	Task Team Leader
US$	United States Dollar
USAID	United States Agency for International Development
VNG International	International Cooperation Agency of the Association of Netherlands Municipalities

BASIC INFORMATION

Is this a regionally tagged project?	Country(ies)	Financing Instrument
No		Investment Project Financing

[ ] Situations of Urgent Need of Assistance or Capacity Constraints

[ ] Financial Intermediaries

[ ] Series of Projects

Approval Date	Closing Date	Environmental Assessment Category
20-Jul-2017	28-Feb-2022	B - Partial Assessment

Bank/IFC Collaboration
No

Proposed Development Objective(s)

Enhance the institutional capacity of municipalities in the West Bank and Gaza for more accountable and sustainable service delivery

Components

Component Name	Cost (US$, millions)
Municipal Performance and Service Delivery	29,954,255.00
Capacity Development	1,063,830.00
Municipal Partnership Projects	930,000.00
Project Implementation Support and Management Cost	4,051,915.00

Organizations

Borrower :	Palestine Liberation Organization (For The Benefit of the Palestinian Authority)
Implementing Agency :	Municipal Development Lending Fund (MDLF)

PROJECT FINANCING DATA (US$, Millions)

[✓] Counterpart Funding	[✓] Trust Funds	[✓] Parallel Financing

Total Project Cost:	Total Financing:	Financing Gap:
95.63	95.63	0.00
	Of Which Bank Financing (IBRD/IDA):	
	0.00	

Financing (in US$, millions)

Financing Source	Amount
Borrower	11.59
FRANCE: Govt. of [MOFA and AFD (C2D)]	10.64
Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ	0.16
NETHERLANDS, Govt. of THE (Except for MOFA/Min of Dev. Coop	1.28
GERMANY: KREDITANSTALT FUR WIEDERAUFBAU (KFW)	31.91
Partnership for Intrastructure Development MDTF	20.00
Special Financing	16.00
SWITZERLAND: Swiss Agency for Dev. & Coop. (SDC)	4.04
Total	**95.62**

Expected Disbursements (in US$, millions)

Fiscal Year	2017	2018	2019	2020	2021	2022

Annual	0.00	10.00	9.00	9.00	8.00	0.00
Cumulative	0.00	10.00	19.00	28.00	36.00	36.00

INSTITUTIONAL DATA

Practice Area (Lead)

Social, Urban, Rural and Resilience Global Practice

Contributing Practice Areas

Governance

Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

Yes

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

Yes

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

Yes

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	High
7. Environment and Social	Moderate

8. Stakeholders	Moderate
9. Other	
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	✓	
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09	✓	
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12	✓	
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description

The following legal covenant is applicable for the project: 1) Trust Fund Grant Agreement between the Palestine Liberation Organization (PLO) and IDA and 2) The Partnership for Infrastructure Development in the West Bank Multi Donor Trust Fund Agreement between the PLO and IBRD/IDA.

By no later than April 30, 2018, the PLO shall commit a sum of no less than 10% of the Aggregate Donor

Commitment to funding the Project, and thereafter, PLO shall disburse the committed funds on a quarterly basis

Sections and Description

The PLO, shall ensure that prior to the commencement of any works on the sections within the Project area where land acquisition or resettlement may be required, that the Project Implementing Entity:

(a) prepare a Land Acquisition and Livelihood Action Plan or Plans, acceptable to the IDA, in accordance with the Land Acquisition and Livelihood Policy Framework; and disclose and carry out consultations for said Land Acquisition and Livelihood Resettlement Action Plans in accordance with the provisions of the Land Acquisition and Livelihood Policy Framework;

(b) carry out the Project in accordance with the Land Acquisition and Livelihood Action Plan or Plans, as the case may be; and

(c) not amend, suspend or abrogate any of the provisions of the Land Acquisition and Livelihood Action Plan or Plans, as the case may be, without the prior agreement of the Association.

The PLO, through the Project Implementing Entity:

(a) shall not commence any works in any section of the Project Area where Resettlement has been carried out by the PLO prior to the date of this Agreement, where the Resettlement was done for the purposes of carrying out the Project activities;

(b) shall not commence any works under the Project in any section of the Project Area where Resettlement becomes required, without first preparing a Land Acquisition and Livelihood Action Plan, satisfactory to the IDA, in accordance with the Land Acquisition and Livelihood Policy Framework, and then ensuring that such land acquisition has been carried out in accordance with the Land Acquisition and Livelihood Action Plan; and

(c) shall carry out the Project in accordance with the Land Acquisition and Livelihood Policy Framework and respective Land Acquisition and Livelihood Action Plans and shall not amend, suspend, abrogate or waive any of the provisions of the respective Land Acquisition and Livelihood Action Plans without the prior agreement of the IDA.

With regard to the withdrawal of grant proceeds and notwithstanding the provisions of the General Provisions of Section IV of the Trust Fund Grant Agreement, no withdrawal shall be made:

(a) for payments made prior to the date of this Agreement.

(b) under Category 1 unless an ESMP and a Land Acquisition and Livelihood Action Plan have been prepared, and any land acquisition has been carried out in accordance with paragraph 4 of Section I(C) of Schedule 2 and the Land Acquisition and Livelihood Action Plan.

Conditions

PROJECT TEAM

Bank Staff

Name	Role	Specialization	Unit
Ellen Hamilton	Team Leader(ADM Responsible)	Lead Urban Specialist	GSU11
Noriko Oe	Team Leader	Urban Development Specialist	GSU11
Rama Krishnan Venkateswaran	Team Leader	Lead Financial Management Specialist	GGO25
Lina Fathallah Rajoub	Procurement Specialist(ADM Responsible)	Senior Procurement Specialist	GGO05
Nadi Yosef Mashni	Financial Management Specialist	Financial Management Specialist	GGO23
Andrianirina Michel Eric Ranjeva	Team Member	Finance Officer	WFALN
Edith Ruguru Mwenda	Team Member	Senior Counsel (alternate)	LEGAM
Emilie Suarez Santos	Team Member	Legal Analyst	LEGAM
Helen Z. Shahriari	Safeguards Specialist	Sr Social Scientist	GSU05
Maha Muhammad Bali	Team Member	Sr Program Assistant	MNCGZ
Manuel Emilio Figueredo Thomson	Team Member	Urban Consultant	GSU11
Natalia Robalino	Team Member	Senior Counsel (primary)	LEGIA
Philip Winchell Bottern	Team Member	Sr Social Development Specialist	GSU05
Salimatou Drame-Bah	Team Member	Program Assistant	AFMGN
Sarah Keener	Team Member	Sr Social Development Specialist	GSU05
Tracy Hart	Environmental Specialist	Sr Environmental Specialist	GEN05

Extended Team

Name	Title	Organization	Location

WEST BANK AND GAZA
GZ-THIRD MUNICIPAL DEVELOPMENT PROJECT

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I. STRATEGIC CONTEXT

A. Country Context

1. **The Palestinian Authority (PA) was established in the West Bank and Gaza shortly after the Oslo Accords of 1993**. The PA assumed civilian responsibility for most of the Palestinian residents, yet security powers were limited to the major urban centers. Israel maintained full control of large tracts of land around settlements and primary movement axes, leaving 61 percent of the West Bank (called Area C) outside the PA's reach. Under the Oslo accords, this arrangement was intended as a temporary measure, to be replaced by a final status agreement by the year 2000, but it still remains in force. Several peace processes were initiated but none so far have been successful.

2. In 2007, the National Unity Government collapsed and violent conflict erupted in Gaza, resulting in two separate government entities, one based in Ramallah and the other in Gaza. Although a consensus government was established in 2014 (made up of a cabinet of technocrats endorsed by both Fatah and Hamas) the internal polity remains divided. Service delivery in Gaza is particularly complicated by the existence of two distinct public services—one paid and managed by the PA in Ramallah, and the other by the *de facto* authority in Gaza. The local municipal elections announced in the summer of 2016 presented a window of opportunity for reunification, but in October 2016, the Palestinian High Court ordered the suspension of the elections due to issues related to legal jurisdiction of courts in Gaza and the inability to include East Jerusalem in the process. Municipal elections were eventually held in May 2017 only in the West Bank. The PA is planning to complete municipal elections across the Palestinian territories with a second round in October 2017.

3. **The economic situation remains worrisome with recent growth being mainly driven by Gaza reconstruction.** In 2016, unemployment rate reached 27 percent in the West Bank and Gaza. As much as a quarter of the population live below the national poverty line according to the latest available data (Palestinian Central Bureau of Statistics (PCBS), 2011). Following the war in Gaza in 2014, the Palestinian economy entered into a recession, as the Gaza economy contracted by 15 percent. Later, reconstruction efforts started to progress and this provided the economy with a boost leading to an increase in real gross domestic product (GDP) by 3.5 percent in 2015, followed by 4.1 percent in 2016. However, given the high population growth in the Palestinian territories, annual GDP growth levels have not been translated into improved living standards as per capita income levels have been almost stagnant.

4. **On the fiscal front, recent growth and fiscal consolidation efforts have reduced the relative size of the PA's deficit.** The PA's deficit fell from 25 percent of GDP in 2008 to 11 percent in 2015. In the first half of 2016, strong revenue performance offset the increase in spending and pushed the total deficit down by 23 percent (in nominal NIS terms). However, Palestinian economic growth and PA revenue potential remain significantly depressed by

movement and access restrictions placed by Israel on persons, goods and services. The inability of Palestinians to exploit economic opportunities in Area C, for example, has been estimated by the Bank as reducing potential Palestinian GDP by up to US$3.5 billion per year, and potential revenue by up to US$800 million a year. Low tax effectiveness in Gaza and lower than hoped for compliance in the West Bank also affect the PA's revenue potential. In addition, a significant drop in donor support led to a sharp decline in resources available to finance the deficit, in turn causing accumulation of further arrears.

5. **Fiscal pressures are expected to intensify if additional donor aid is not identified.** Aid to the PA budget has declined from 32 percent of GDP in 2008 to about 6 percent in 2016. In nominal terms, aid has declined from about US$2 billion in 2008 to US$761 million in 2016, while the PA's total deficit reached US$1.09 billion or about 8 percent of GDP in 2016, leading to a financing gap in excess of US$330 million. While both budget support and donor aid directed toward development projects have been reduced, the most significant drop occurred in budget support grants. As in previous years, the gap will be financed through borrowing from domestic banks and domestic arrears to the pension fund and private suppliers, unless additional donor aid is identified.

B. Sectoral and Institutional Context

6. **Local Government Units (LGUs) are critical for the delivery of key infrastructure and basic services, yet they struggle to meet their assigned functions due to: (i) sub-optimal revenue potential, (ii) weak budgetary practices, and (iii) administrative fragmentation**. Out of the 27 functional responsibilities specified by the Local Government Act of 1997 for LGUs, 80 percent of municipalities are providing fewer than 12 of the prescribed services.[1] In addition, capital investment expenditures exhibit significant intertemporal variability and remain relatively small, failing to address the critical needs for service extensions and economic development in rapidly growing municipalities. The financial and institutional capacity of municipalities in the West Bank and Gaza is also a key constraint limiting the potential to mobilize private capital for urban infrastructure.

7. **Overall, municipal revenues remain significantly below potential** with local government revenues accounting for only 11 percent of total government revenues, sufficient to cover only a minority of LGUs functions. Municipalities exhibit sub-optimum user fee collection and cost-recovery rates for all municipal services[2]. Municipal tax revenues represent only a fraction of municipal budget and are also significantly underutilized[3]. With little tax revenue, municipalities that provide water and/or electricity often divert user fees to cover other

[1] Despite wide coverage of electricity, water services, and solid waste management, the large majority of municipalities (93 of the 120 surveyed) still lack a sewage network (PCBS, 2015). Road infrastructure is also of poor quality in most municipalities.
[2] For example, one of the key municipal services - solid waste management - has rates of only 30, 60, and 60 percent of its user fees collected in Bethlehem, Birzeit, and Beit Surik, respectively.
[3] Municipal tax revenues account for 29 percent of total revenues for municipalities without utility revenues compared to 5 percent for municipalities with utility revenues.

municipal costs, contributing to the national debt to water and electricity suppliers.[4] In addition, no formalized and regular grants or transfers are available from the PA to supplement the shortage of LGUs' own-source revenues.

8. **Municipal financial management practices continue to be weak, and administrative fragmentation prevents economies of scale in service delivery.** Despite significant achievements over the years, most municipalities require further improvements in financial management practices to effectively facilitate decision-making and performance monitoring for municipal service. A new functional budgeting format was introduced by the Ministry of Local Government (MoLG) in 2015, yet municipalities continue to report budgets in the old format, using cash accounting as opposed to accrual accounting, which allows municipalities to show budget surpluses that--after accounting for payment arrears--should have been significant budget deficits. In addition, service delivery is also negatively affected by excessive local administrative fragmentation**.** While more than 54 percent of the population in the West Bank and Gaza reside in 11 municipalities, there are over 100 municipalities with fewer than 25,000 residents, with the smallest municipality consisting of only 2,500 residents. Despite measurable gains in municipal capital works and infrastructure planning facilitated by the rollout of Strategic Development and Investment Plans (SDIPs) under the Municipal Development Project (MDP), the quality of municipal planning could be further improved to better link municipal plans to more realistic budget envelopes, and to achieve greater economies of scale through coordinated inter-municipal planning practices and frameworks. To achieve economies of scale, some municipalities and village councils have formed Joint Service Councils (JSC) to jointly provide services, planning and development functions. However, utility service consolidation remains slow, as evidenced by the 226 small-scale water service providers.[5]

9. **Despite the many challenges faced by municipalities in the West Bank and Gaza, the support through the MDP over the past decade enabled significant gains in municipal financial management, investment planning, and social accountability.** For example, 49 percent of municipalities reached performance rank B+ by 2014.[6] The MDP, developed by the PA in 2009 with the support of the World Bank and Development Partners (DPs), was designed to incentivize the development of municipal management capacity through performance-based grants, supported with demand-driven capacity development activities. With the MDP's support, as many as 30 municipalities started to record basic operating and enterprise budget surpluses, and 122 municipalities now have an updated fixed asset register in place. In addition, municipal awareness and adoption of citizen feedback channels were enhanced. Ninety-four

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[4] For municipalities directly providing electricity or water, the utility fees are the most important source of income. The O&M costs for the electricity and water distribution services are also not prioritized, causing asset depletion and affecting utility service delivery outcomes.

[5] JSCs also suffer from weak governance by member LGUs, reflected in the lack of legal agreement among members and unclear rules on fee contribution and arrears management.

[6] Achievement of 3-4 key performance indicators (KPIs) out of the following menu constitutes B+ ranking under Second MDP. The KPIs are: (i) basic operation and enterprise account surplus (more than 5 percent); (ii) fixed assets register in place and updated; (iii) O&M plan in place and updated; (iv) public disclosure of all municipal investments, SDIP execution, and external audit reports; and (v) satisfactory collection efficiency and own revenue generation (specified own revenues > 50 NIS per capita, or 5 percent above last two years' average).

percent of municipalities applied at least two public disclosure methods to key municipal planning and budgetary documents,[7] while 80 percent applied participatory approaches to update their SDIPs.

10. **The proposed Third MDP (MDP 3) will consolidate and scale up past gains under MDP 1 and MDP 2 in municipal performance and accountability enhancement.** In addition, the proposed MDP 3 will help strengthen the enabling environment at the central level and municipal partnerships with the private sector to improve the efficiency and sustainability of municipal services. The basic municipal capacity developed in financial management and budgeting will need to be taken to the next level of improving arrears management practices and own-source revenue performance so that municipalities are able to achieve financial sustainability. Participatory processes need to be integrated throughout the municipal investment cycle thereby renewing the social contract between municipalities and citizens/stakeholders. In addition, the proposed MDP 3 will strengthen the capacity of the Municipal Development Lending Fund (MDLF) and MoLG to enhance sustainability of the municipal sector. The proposed MDP 3 will also provide support to MoLG in strengthening its regulatory and oversight role for the LGU sector. Further, municipalities will be supported to develop their capacity to look for partnerships with the private sector to improve efficiency and sustainability of municipal services. More generally, the MDP will continue to serve as a model for an eventual fiscal transfer system for the PA.

11. **The proposed MDP 3 is at the center of a series of interlocking interventions by the Bank and donor partners in collaboration with the PA that are aimed at strengthening the institutional development, accountability and financial sustainability of local governance and service delivery in the West Bank and Gaza.** The recently approved Integrated Cities and Urban Development Project (ICUD) enhances the capacity of selected urban agglomerations to jointly develop regional growth frameworks upon which municipal investments would be rationalized. Similarly, the Local Governance and Services Improvement Program (LGSIP) has been capacitating village councils and JSCs, which are not targeted by the MDP in the West Bank. These three operations together cover all levels of LG sector: village councils and JSCs (through LGSIP); municipalities (through MDP); and urban agglomerations (through ICUD). The proposed MDP 3 will also be complemented by a series of advisory services and analytics (ASAs) to establish sustainable and sufficient financing for municipal services. In particular, the programmatic technical assistance for municipal financial management will support the MDLF to develop a municipal lending framework and roadmap to facilitate municipalities' access to long-term capital investment financing from the commercial banking sector in the future, as well as provide inputs for strengthening local government public financial management systems. While the proposed MDP 3 enhances the municipal revenue performance and expenditure efficiency, the Local Government Sector Reform ASA will support the PA to put in place transparent and reliable fiscal transfers to municipalities, as well as municipal revenue and expenditure assignment reform. In addition, the ongoing Local Government Performance Assessment ASA will provide household-level

[7] SDIPs, annual external audits, project-related data, municipal budgets and performance rankings. Prior to MDP 1, no municipalities applied at least two public disclosure methods.

information of municipal service delivery outcomes that can be utilized by the MoLG and MDLF to monitor municipal service delivery performance rigorously.

C. Higher Level Objectives to which the Project Contributes

12. The project is aligned with the PA's long-term strategy to consolidate and strengthen service delivery in the LG sector and to nurture financially sustainable LGUs as specified in the MoLG's recently shared outline for the PA's Local Governance Sector Strategy for 2017 – 2022. The main challenges identified in the Sector Strategy and addressed by the proposed project include: (i) optimizing the use of scarce financial and natural resources while maintaining service quality; (ii) creating enabling environment for local economic development; and (iii) enhancing LGU accountability through strengthened citizen participation.

13. The proposed project is fully aligned with the World Bank Group's forthcoming Assistance Strategy for the West Bank and Gaza, whose overarching objective is to create conditions that enable greater private sector activity and job creation, including through sectoral reforms and institutional strengthening, and simultaneously mitigate the risks faced while investing in a fragile and uncertain environment. The proposed project also contributes to the implementation of the World Bank Group's Middle East and North Africa Strategy, in particular, its pillar on renewing the social contract. The proposed project supports this strategy by keeping institutional development of municipalities, accountability and financial sustainability of local service delivery as the key development objectives. The proposed MDP 3 will help renew the social contract between citizens and municipalities by ensuring that citizen engagement is conducted throughout the life cycle of sub-projects.[8] The proposed project will strengthen the linkages with the private sector by enhancing the capacities of municipalities to partner with the private sector in municipal service delivery and local economic development. In addition, by improving municipalities' financial position and the MDLF's capacity to facilitate access to investment financing, the proposed project will also enable municipalities to leverage private sector resources.

14. Moreover, by supporting improved access to services and enhanced potential for economic growth for municipalities, which will potentially affect 74 percent of the population, the proposed project contributes to the World Bank Group's twin goals of eliminating extreme poverty and boosting shared prosperity in a sustainable manner. The block grant portion of the proposed MDP 3 helps reduce the disparity of municipal infrastructure among municipalities by linking grant size to the degree of infrastructure deficit. The performance-based grants under the proposed MDP 3 incentivize and support municipal institutional capacity

[8] Through improved citizen engagement in local investment planning, strengthening complaint and grievance redress systems and improved transparency and accountability through citizen participation in municipal budgeting process and enhanced information disclosure.

development that is critical for improved good governance and accountability, while simultaneously helping to facilitate private-sector-led economic growth.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

15. The project development objective (PDO) is to enhance the institutional capacity of municipalities in the West Bank and Gaza for more accountable and sustainable service delivery.

B. Project Beneficiaries

16. The participants of the project are all 144 municipalities in the West Bank and Gaza. The beneficiaries are the population in all the municipalities estimated at 3,611,649[9] representing 75 percent of the total population of the West Bank and Gaza.

C. PDO-Level Results Indicators

PDO Result Area	*Indicators*
Strengthened municipal institutions	1. Number of municipalities that moved up one rank in the performance assessment system [10]
Accountable and responsive service delivery	2. People provided with improved urban living conditions (WB core) 3. Municipalities with Public Disclosure of executed budget and executed SDIP
Financially sustainable municipalities	4. Number of municipalities with Operating and Enterprise[11] surplus and no increase in arrears

[9] Based on Palestinian Central Bureau of Statistics predicted populations for 2016.
[10] The ranking system has 10 ranks based on 4 categories (A, B, C, D) with 21 KPIs.
[11] Operating Budget (General Budget): non-commercial services provided by LGU. Those services include health services, public works, educational services, cultural services, social services and security. Enterprise budget refers to commercial services (that incur profits) provided to civilians like water, electricity, sewage, vegetable and fruit markets, fish markets, slaughterhouses, etc.

III. PROJECT DESCRIPTION

A. Project Components

Component 1: Municipal performance and service delivery (US$79,433,053 total, of which US$13,311,702 from the Trust Fund for Gaza and the West Bank (TFGWB) and US$16,642,553 from the Partnership for Infrastructure Development – Multi-Donor Trust Fund (PID-MDTF))

17. **The project will finance municipal infrastructure for improved service delivery.** The project's block grants will provide the basic funding for eligible municipalities for infrastructure development based on needs and equity, while the performance grants will provide an incentive for eligible municipalities to improve their performance. Half of the total component 1 financing would be allocated for the block grants and another half for the performance-based grants. The block grants will be allocated based on population (40 percent) and needs[12] (60 percent). Gaza municipalities will be allowed to use 20 percent of their grants for recurrent expenditures[13] to reflect the special circumstances they face. The eligible expenditures will be defined in the project's operations manual.

18. **Block grant eligibility**. Municipalities must fulfill the basic eligibility criteria to receive the project's block grants. From the outset, municipalities are required to have an annual budget approved by the municipal council and submitted to MoLG. From the third year of the project, a second eligibility criterion will be added requiring a SDIP to be prepared according to new SDIP guidelines that are to be introduced in early 2018. All eligible municipalities will have access to the basic block grants.

19. **Performance grants.** The performance-based grants will be provided to the block grant eligible municipalities that further fulfill minimum eligibility criteria for performance grants. Municipal performance is measured through 21 key performance indicators (KPIs) that are designed to cover three performance areas, namely: (i) financial performance and sustainability; (ii) institutional performance; and (iii) transparency, accountability and participation. Based on the achievement of KPIs, the municipalities are categorized into performance categories ranging from D to A as well as a total of 10 ranks from D to A ++. Municipalities with higher rankings receive more funds per capita. Municipal performance will be assessed in 2017, 2019, and 2021.

20. **Grant cycle**. Based on the municipal performance assessments, the MDLF will announce

[12] The MDP 2 relied on proxy indicators-- availability of roads, water, public space, office space (80 percent) and PCBS data on poverty (household) measured at governorate level (20 percent). As the governorate level poverty data does not provide municipality level results, it was agreed to drop this measure.
[13] Under this scheme, no funds will be channeled to Gaza municipalities. Recurrent expenditure payments will be made by MDLF to suppliers against invoices of recurrent expenditure on behalf of Gaza municipalities, and in accordance with the MDLF's financial management policies and procedures manual. The list of eligible expenditures and ceiling will be further defined in the project's operations manual. Recurrent expenditures should be verifiable, traceable, and reportable.

allocations from block and performance grants in October 2017 (for the first cycle) and October 2019 (for the second cycle). Based on the allocations, municipalities will select sub-projects to be funded by the grants from the list of sub-projects that were prioritized in their SDIPs.

Component 2: Capacity development to municipalities and Palestinian institutions (US$5,137,766 total, of which US$531,915 from TFGWB and US$531,915 from PID-MDTF)

21. **This component will provide capacity development support to municipalities and national level institutions, namely, the MDLF and the MoLG.** The MDLF will prepare a Capacity Development Plan at the start of the project in consultation with all stakeholders, which will provide a detailed description of the priorities, activities and their inter-linkages for this component.

22. **Capacity development support to municipalities**. The support would be provided through: (i) basic capacity development support to participating municipalities; and (ii) targeted capacity development support to strengthen creditworthiness of high performing municipalities based on the criteria identified in the project's operations manual. The basic capacity development support will aim at improving municipal performance measured against the program's KPIs, as well as improving sub-project implementation capability (e.g., pre-feasibility study, procurement, financial management, and safeguards). For the municipalities with good capacity, targeted capacity development support will be provided to enhance their capabilities to access market finance in the long run. Accordingly, targeted advice and training will be provided to strengthen the performance of municipalities in areas such as revenue and expenditure management, management of receivables and payables, cash management, oversight, and project management.

23. **Development of municipal management systems**. This activity will support the strengthening of municipal management systems. Effective systems to regulate and guide municipal activities make a critical contribution to available capacity through clarifying and streamlining procedures and requirements, as well as improving their efficiencies through automation. Support will be provided for the development of procedural, analytical and technical frameworks and analyses in targeted areas such as revenue management, municipal integrated financial management and information system (IFMIS), capital investment preparation, and social accountability.

24. **Capacity development of the MoLG and the MDLF**. Recognizing the critical role played by national level institutions in the strengthening of governance and service delivery at the municipal level, the project will provide capacity development support to MoLG and MDLF to enable them to play their respective mandated roles and responsibilities more effectively. Accordingly, support will be provided to the MoLG to develop municipal audit standards and related implementation guidance in collaboration with the State Audit and Administrative Control Bureau (SAACB), and the Palestine Association of Certified Public Accountants (PACPA). The MDLF will also receive capacity support in accordance with its Strategic Plan to become a financial intermediary for local governments in the long run. The details of

activities are to be informed by the ongoing Bank-executed TA to strengthen municipal lending framework and to include training to MDLF staff, as well as preparation of internal procedures and risk management system.

Component 3. Municipal partnership projects (US$2,542,766 total, of which US$930,000 from TFGWB)

25. This component will provide technical assistance and project financing to municipalities to: (a) engage more effectively with the private sector, and (b) work across administrative boundaries to develop joint and/or innovative investments for municipal service delivery and local economic development. Only the technical assistance portion under sub-component A will be financed by TFGWB.

Sub-Component A. Private sector partnership support (US$2,117,234 total, of which US$930,000 from TFGWB)

26. In order to better leverage private sector engagement, this sub-component will strengthen the capacity of participating municipalities to identify, design and implement modalities for private sector engagement in municipal service delivery and local economic development on a demand-driven basis. This sub-component will support municipalities in selecting the most relevant or appropriate modality based on feasibility, as well as design and implementation of the agreed modality. Specific areas for support would range from issuing permits and other processes to structuring private sector participation in infrastructure and service delivery (contracting out, joint ventures, special purpose vehicles and build-operate-transfer agreements), as well as strategic land use planning and associated infrastructure development related to economic growth priorities. The sub-component will be particularly important in terms of supporting technical and human capacity development at the municipal level. This sub-component, through DP parallel financing, will also provide project financing to facilitate local economic development in cooperation with the private sector.

Sub-Component B. Joint municipal project development support (US$425,532 total)

27. This sub-component will not include any funding from the TFGWB or PID MDTF. With parallel financing provided by other DPs, this sub-component will provide financing to participating municipalities, complementary to the grant allocations under component 1, to incentivize municipalities and LGUs to jointly prepare and implement investments.

Component 4. Project implementation support and management costs (US$8,513,011 total, of which US$1,226,383 from TFGWB and US$2,825,532 from PID-MDTF).

28. This component will finance goods and consultants' services for monitoring and evaluation, outreach and communication and local technical consultants for the engineering supervision of component 1, and the MDLF management cost.

B. Project Cost and Financing

29. The project will be co-financed through the World Bank-administered PID-MDTF, [14] since the Government of Denmark has confirmed its interest in co-financing the proposed MDP 3 through the PID-MDTF. Furthermore, France (through Agence Française de Développement (AFD)), Germany (through Gesellschaft für Internationale Zusammenarbeit (GIZ) and German Development Bank (KFW)), Switzerland (through Swiss Agency for Development and Cooperation (SDC)) and the Netherlands (through International Cooperation Agency of the Association of Netherlands Municipalities (VNG)) will provide financing in parallel (see table 1 further below). The PA will also provide counterpart funding of no less than 10 percent of the total amount committed by DPs.

Project Cost and Financing (US$)

Project Components	TFGWB	PID-MDTF	Parallel financing[15]	Counterpart[16]	Project Cost
Component 1: Municipal performance and service delivery	13,311,702	16,642,553	41,663,830	7,814,968	79,433,053
Component 2: Capacity development to municipalities and Palestinian institutions.	531,915	531,915	1,105,851	2,968,085	5,137,766
Component 3. Municipal partnership projects.	930,000	0	1,612,766	0	2,542,766
Component 4: Project implementation support and management costs.	1,226,383	2,825,532	3,649,468	811,628	8,513,011
TOTAL	16,000,000	20,000,000	48,031,915	11,594,681	95,626,596

C. Lessons Learned and Reflected in the Project Design

30. **Among the three dimensions of municipal management—planning, finance, and service provision — MDPs' support for strengthening municipal finance most often yielded**

[14] The Government of Denmark is expected to replenish PID-MDTF for the amount of 140 million Danish Krone. From that amount, the PID-MDTF will co-finance US$20 million equivalent to the proposed MDP 3.
[15] DPs contributions reflect the amounts committed to date and will be made in Euros.
[16] This contribution reflects the PA's new commitment for MDP 3 as 10 percent of donor financing, as well as carry over funds from MDP 2.

successful results. As evidenced by an IEG study of 190 MDPs, the best MDPs led to stronger own-revenue flows, better financial management, improved municipal information systems, and local management of procurement. The proposed MDP 3 will focus on strengthening municipalities' financial sustainability by incentivizing improvements in municipal financial management. To that end, KPIs will include more focus on revenue improvement and arrears management.

31. **MDPs serving many municipalities—or wholesale MDPs—have yielded better outcomes than retail MDPs over the last decade.** Wholesale MDPs have benefited from: (i) spreading the downside risk of failure broadly across many municipalities; (ii) competition among municipalities, which means both that municipalities that fail to meet MDP performance criteria may no longer be entitled to project support and that weak municipalities that do not qualify at the outset may become eligible for project funding later if their performance improves; (iii) a significantly larger share of project spending to technical assistance and institutional development. The proposed MDP 3 will target 144 municipalities and also build on the lessons learned from wholesale MDPs.

32. **A simple performance measurement system is key to strengthening municipal incentives and lowering transaction costs.** Despite improvements in municipal capacity under MDP 1 and MDP 2, the complex ranking system used limited the ability of MDP to design, calibrate, and assess performance without strong support. During MDP 2 all municipalities (except one) ended up being clustered into three out of 11 ranks (C+, B and B+) and no municipality advanced to the highest category A, as certain KPIs were very difficult to fulfill. The revised system is refined to more clearly define a "ladder" for a stepwise improvement of municipal performance from the lowest category D to the highest A with carefully developed steps reflected in the KPIs. The performance system in the proposed MDP 3 will also be adjusted by simplifying the KPIs, and focusing more on outcomes of municipal financial and institutional performance instead of inputs.

33. **Social accountability can be enhanced through specific output/outcome indicators, coupled with capacity development support.** Under MDP 2**,** significant advances were made in the disclosure of planned and executed SDIPs and budgets, the establishment of grievance redress systems in some municipalities, and the adoption of manuals/guides on participatory planning. The proposed MDP 3 will scale up the social accountability activities that were piloted under MDP 2 and integrate participatory process as part of the municipal management and expenditure cycle. For example, ongoing changes to the guidelines on the municipal investment process (SDIP) will integrate good practice and lessons learned from participatory budgeting and participatory monitoring and evaluation pilots, disclosure and accountability. In addition, feedback on investments post-construction can provide a signal of the adequacy of feasibility analysis done up front (are roads actually usable and then actually used, for example). Lastly, the ongoing budget pilots will shed light on the degree to which currently disclosed budgets are understood by the population, with a view to increasing their accessibility to a broad audience.

34. **PA counterpart contribution is key to building local ownership for the proposed MDP 3.** The MDP was initiated as the PA's program with the vision to ultimately adopt the MDP's performance-based grant allocation formula for central fiscal transfers to the municipalities. However, delayed counterpart contributions under MDP 1 and 2 hampered sub-project implementation. For the proposed MDP 3, the PA has committed to provide no less than 10 percent of the total donor contribution in counterpart funding for the first time through a cabinet level decision and has agreed to make payments on a quarterly basis.

35. **Results from MDP 2 confirm that some municipalities are ready to take on enhanced safeguards and fiduciary responsibilities.** The MDLF has been effective in improving financial management (FM) systems within municipalities while satisfactorily fulfilling its role as the implementing agency. In light of the enhanced capacities of certain municipalities, the proposed MDP 3 is envisioned to increase fiduciary and safeguard responsibilities of selected municipalities that attain the higher ranking (B++ and above). The exact conditions and safeguards arrangement will be defined after the baseline municipal assessment, planned for August 2017, and will be included in the project's operations manual.

36. **Donor coordination institutionalized under the past MDPs has been effective for aligning approaches within the LG sector, and will therefore be continued under the proposed MDP 3.** Following the Emergency Municipal Services Rehabilitation Project (EMSRP), and MDPs 1 and 2, DPs' approaches to municipal support have been more unified and standardized. For MDP 2, this included joint financing report to all donors, single procurement, financial management, and monitoring systems, and joint supervision missions. The unified approach was expanded further during the preparation of the Local Governance Services Improvement Program supported by essentially the same group of DPs as the proposed MDP 3. This lesson is used through the joint preparation of the proposed MDP 3 and by incorporating approaches from LGSIP in the proposed MDP 3.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

37. Municipalities are responsible for implementing the infrastructure projects that are financed from their individual basic and performance-based grants allocated from the project under its component 1, called sub-projects, under the MDLF's oversight and supervision. Municipalities will identify such sub-projects through a participatory public consultation process. Procurement by the municipalities as well as contract management will follow the updated MDLF procurement manual and be overseen by the MDLF. The municipalities will also be responsible to advise the MDLF to release payments to their contractors and suppliers in accordance with the signed contracts. The usage of 20 percent of the basic and performance-based grants for recurrent expenditure was permitted for the municipalities in Gaza Strip during the MDP 2 to reflect special circumstances and additional development challenges they faced. This practice will be adjusted under the proposed MDP 3 and the ceiling of such recurrent expenditure as well as its eligible expenditure list will be further defined in the project's

operations manual.

38. For selected municipalities in the West Bank that are proven to have strong performance based on the performance assessment, the MDLF will cease to make direct payments to contractors and suppliers on their behalf. Instead, the component 1 funding will be transferred in tranches directly to the municipal bank accounts for them to handle associated payment and reconciliation on their own. The continued disbursement from the second tranche onward, however, will be subject to the municipalities' demonstrated ability to conduct proper financial management, procurement, and supervise works by contractors to ensure satisfactory sub-project quality[17]. The direct transfer will be financed out of the Bank's contribution to the project with other DPs who are willing to join the arrangement. This change from the MDP 2 implementation arrangement is to enhance the municipal ownership of sub-projects while reflecting municipal capacity built through the MDP 2.[18] This practice will not be applied to municipalities in Gaza Strip in light of its higher overall risk than in the West Bank.

39. The MDLF will continue to serve as the project's implementing agency by directly implementing component 2, 3, and 4, while retaining overall management responsibility for the component 1 sub-projects implemented by municipalities. For all municipal sub-projects, the MDLF and independently contracted local technical consultants (LTCs) will conduct the supervision and verification of works, including technical audits, and fund management to be of satisfactory quality. For the selected West Bank municipalities that will receive sub-grants directly, the MDLF will transfer sub-grants subject to technical and financial verification. For all other municipalities (including all municipalities in the Gaza Strip) the release of payment to contractors will be subject to the financial and technical verification from LTCs and MDLF staff in addition to municipal request. The MDLF is an independent, semi-governmental organization, governed by a Board of Directors (the Board), which is the policy and strategy setting authority responsible for monitoring the direction and performance of the Fund. The Board Chairman is the Minister of Local Government and its nine members consist of representatives of public sector entities (Ministry of Local Government, Ministry of Finance and Planning, Ministry of Public Works and Housing, and Palestinian Monetary Authority), civil society (Engineers Association, Association of Palestinian Local Authorities, and another civil society representative appointed by the Council of Ministers following a recommendation from the MoLG) and two LGU representatives. MDLF is managed by the Director General and the executive administration that includes an operations manager and six specialized departments: Strategic Planning and External Relations, Technical, Financial and Administration, Institutional Building and Technical Assistance, Contract Management and Procurement, and Internal Audit.

40. The MDLF has demonstrated its capacity to administer donor-funded projects since its establishment in 2005, including the multi-donor financed MDP 1 and MDP 2. The proposed MDP 3 builds on the achievements under MDP 1 and MDP 2. MDLF has administered the World Bank-financed Emergency Municipal Services Rehabilitation Project (EMSRP), the

[17] The requirement for municipalities to continue to receive direct transfers will be specified in the Operations Manual.
[18] The risk mitigation measures are to be specified in the Operations Manual

multi-donor EMSRP 2, and the Local Government Capacity Building Project (LGCBP, financed by Denmark and administered by the World Bank), in addition to bilateral contributions by DPs.[19] The MDLF is staffed with all key positions required for project implementation. Municipalities have during MDP 1 and 2 demonstrated capacity for sub-project implementation with proper no objection clauses and support from MDLF. The few municipalities that will be provided funding to their bank accounts for payment to contractors for sub-project implementation in the proposed MDP 3, will all be high performers at B++ and above, and meet safeguards and fiduciary requirements to be defined in the project's operations manual. Gaza municipalities will follow the standard approach from MDP 2.

41. The recipient of the grant is the Palestinian Liberation Organization (PLO) for the benefit of the PA as with nearly all cases of assistance provided under the TFGWB. The PLO will make the proceeds of the grant available to the PA through a Subsidiary Agreement. An On-Granting Agreement between the PA and the MDLF will further make the proceeds of the grant available to the MDLF as the implementing agency. The Bank and the MDLF will also sign a Project Agreement. The MDLF would implement the project in accordance with the legal agreements and the project's operations manual. The Ministry of Finance and Planning would open the Designated Account (DA) on behalf of MDLF, under the Central Treasury Account (CTA). However, advances made to the DA would not be commingled with other resources of the government or donors. The MDLF would be responsible for managing the account but the Ministry of Finance and Planning is responsible for requesting replenishments from the World Bank. Development partners may have different arrangements for withdrawal applications.

B. Results Monitoring and Evaluation

42. The project uses indicators aimed at fostering the principles of strengthened municipal institutions, accountable and responsive service delivery, and financially sustainable municipalities. To the extent possible, quantitative output indicators will be disaggregated based on gender including direct and indirect benefits. Data on outcome results, including municipal performance rankings and MDLF annual reports, will be made public. A key area of monitoring will include citizen feedback on service delivery improvements and systems transparency, reviewed by the MDLF and MoLG and published periodically. The survey questionnaires and baseline on public services will be reviewed to ensure a gender-sensitive approach to target groups. Such feedback will be used to trigger management decisions on adjustments and for distilling lessons learned, to enable the PA to formulate and redesign its policies and procedures towards improving the lives of citizens. PDO and intermediate indicators are presented in the results framework. Data from the scaled up grievance redress mechanism (GRM) processes on level of resolution will also be reviewed to provide one indication of the level of responsiveness of municipalities to citizen complaints.

43. Arrangements for results monitoring. The MDLF will be responsible for monitoring the achievements of the PDO and intermediate indicators, and physical, financial and procurement

[19] Germany, France, Sweden, the Netherlands, Switzerland, and the EU.

performance of the project. The MDLF will continue to use a web-based Program Management Information System, as well as the Financial Management Information System (FMIS) to automate data aggregation, storage, and presentation as part of a results-based M&E system. In addition to data collection exercises carried out directly by the MDLF for project reports, surveys will be conducted to measure progress towards achievement of the PDO by utilizing lessons from Local Government Performance Assessment (LGPA) as well as citizen satisfaction surveys.[20] The MDLF will produce semiannual and annual progress reports and quarterly Interim Financial Management Reports, to report progress on achievement of the PDO and implementation progress of the project activities (see Annex 2).

44. Results-based outcome monitoring at the MDLF. The MDLF uses a results-based M&E system, which attempts to measure the relevance, effectiveness, efficiency, impact, and sustainability of initiatives implemented by the institution. The MDLF's results-based monitoring manual (RBMM) has aligned the individual objectives of various projects and programs with the PA's strategic objectives. The M&E arrangements proposed under the project, including the results framework and municipal ranking survey are fully consistent with the RBMM and the MDLF's M&E system. As such, no additional arrangements or staff are required for the M&E of this project.

C. Sustainability

45. The project's performance-based grants encourage long-term performance improvements in key areas of financial management, planning and transparency. The focus on public financial management (including financial policies and procedures, fixed asset registration, standardized budgets, and IFMIS) creates a system that ensures long-term fiduciary and accountability improvements beyond the scope of the project. Improvements in transparency and participation (e.g., Citizen Service Centers--CSCs, public participation in the strategic planning process, and public disclosure of the municipal budget) systemically strengthen the relationship between the municipality and its citizens and these effects are expected to continue beyond the life of the project. The added emphasis in the proposed MDP 3 towards scaling up and integrating simple accountability and participation mechanisms into the core municipal processes should also decrease the long-term costs of such mechanisms. Further, feedback on citizen satisfaction with SDIP and other investments should shed light on the level of sustainability of infrastructure investments post-construction.

D. Role of Partners

46. The Government of Denmark is expected to provide co-financing through PID-MDTF, while France (through AFD), Germany (through GIZ and KFW), Belgium (through BTC), and Switzerland (through SDC) and the Netherlands (through VNG) are expected to provide financing in parallel (see table below). The PA will provide counterpart funding of no less than

[20] LGPA is the Bank-executed TA that provides the baseline values and methodologies to measure household level municipal service delivery outcomes.

10 percent of the aggregate donor commitment to funding the project.

Table 1: Expected Allocations from World Bank and Development Partners

Development Partner	Expected allocation		Comment
	US$ million	Euro million	
PA	8.4	7.9	New commitment for MDP 3 calculated as 10% of total DP and Bank commitments
PA (carry over from MDP 2)	3.2	3	Carry over of PA's contribution from MDP 2[21]
WB	16	15	TFGWB
DRO	20	18.8	Through PID-MDTF
KfW	31.9	30	Parallel financing
GIZ	0.2	0.2	Parallel financing
EU			Complimentary activities in area C
AFD	10.6	10	Parallel financing
SDC	4.0	3.8	Parallel financing
VNG	1.3	1.2	Parallel financing
Total	95.6	89.9	

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

Risk Category	Rating
1. Political and Governance	High

[21] MDLF will use exchange rate gains from TFGWB and PID-MDTF under MDP 2 to finance sub-projects that were originally planned to be financed from the PA counterpart contribution from MDP 2. Accordingly, the PA counterpart contribution for MDP 2 will be transferred to MDP 3.

2. Macroeconomic	High
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	High
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	
OVERALL	Substantial

47. The overall risk of the project is substantial reflecting the risks associated with direct transfer of sub-project funds to the selected West Bank municipalities, as well as lessons from the recent Bank-financed operations in other sectors in Gaza Strip.

48. **Political and Governance**. Political and governance risk is high. The peace process remains vulnerable and the domestic political situation remains unsettled. There is an increasing unwillingness from the PA to continue financing services in the Gaza Strip that may benefit the de facto authorities in Gaza through 30 percent pay cuts of its employees in Gaza and by reducing payments for electricity in Gaza. Although municipal elections were held eventually in May 2017, the poll was postponed from October 2016 following a court ruling and held only in the West Bank. The PA is planning to complete municipal elections across the Palestinian territories with a second round in October 2017. Political instability and the long lasting Israeli restrictions on movement, access and trade are substantial impediments to project implementation in Palestinian territories, particularly in Gaza. To mitigate the risk, political and security developments are monitored routinely for the World Bank Group to remain alert to any situation that may require adjustments to its operation. The World Bank Group also partners with local communities, municipalities, non-governmental organizations, utilities and educational institutions which could provide additional modes of implementation to ensure continuity.

49. **Macroeconomic.** Macroeconomic risk is high. Political instability, including the 2014 war in Gaza and the outbreak of clashes in the West Bank, have remarkably increased the level of uncertainty and negatively impacted business confidence. Also, the ongoing system of restrictions on movement, access and trade imposed by the Government of Israel (GoI) presents a key binding constraint to private sector investment and economic growth. On the fiscal side, risks relate to the PA's persistently high fiscal deficit financed through donor grants that have been unpredictable and on a declining path since 2008. Also, the possibility of suspensions of revenue transfers for taxes collected by the GoI on behalf of the PA and the latter's lack of control over public finances and economic management by certain PA agencies in Gaza significantly add to the risks. A possible further reduction in the level of donor

assistance poses significant risks to the sustainability of the macroeconomic and fiscal framework. While the PA has charted a course toward lesser dependence on external aid and is undertaking the relevant reforms, it will take time for the PA to achieve fiscal sustainability and that will only be possible if there is a political settlement that allows for strong private-sector-led growth. Thus, a further reduction in the overall level of donor assistance or lack of its predictability is a significant source of risk to the PA's finances and the Palestinian economy as a whole.

50. **Sector Strategies and Policies**. In the LG sector, resources for capital investments as well as operation and maintenance for improved service delivery remain scarce. There is a need for consolidation in the sector to improve financial sustainability and improve basic service delivery. The PA's fiscal distress may continue putting pressure to use centrally collected local resources for national level priorities. This would deprive local authorities of much needed public financial resources and further limit fiscal space for investments. Movement and access restrictions limit the scope of local infrastructure interventions, and permit requirements from the Israeli Civil Administration are subject to protracted approval. Risk considerations for this project are addressed and embedded in the proposed project design and mitigated against as part of the capacity development activities supporting the government systems and the municipalities, such as emphasis on own-source revenue performance improvement and transparency in PA's fiscal transfer, as well as embedded incentives on joint-planning for investments.

51. **Institutional Capacity for Implementation and Sustainability**. Drawing from the performance of recent Bank-financed operations in Gaza Strip, the project will have more rigorous implementation and implementation support arrangements than MDP 2. In addition to the existing technical supervision and auditing arrangement by MDLF and LTCs), a periodic internal audit that examines correlation between financial and fiscal performance of sub-projects will be introduced. To further enhance accountability, social accountability measures will also be introduced. Finally, the Bank will intensify its fiduciary supervision to be conducted on a quarterly basis.

52. **Fiduciary**. The procurement risk is moderate and the overall financial management risk for this grant is assessed as high before mitigating measures, mainly because of the risks associated with transferring the project funds to municipalities' bank accounts. The following set of actions will help decrease financial management risk to substantial: For example, implementing the agreed upon mitigating measures, the positive outcomes of the previous and ongoing TA to MDLF and municipalities, as well as the Bank's implementation support. The risk will be partially mitigated by hiring qualified local technical consultants and independent auditor, as well as additional reporting requirements to the implementing agency. A detailed description of fiduciary risks and related mitigating measures is provided in Annex 2.

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

53. The proposed project supports 144 municipalities in the West Bank and Gaza through block and performance-based grants for capital investments and through capacity development activities. Municipalities identify and prioritize sub-projects for investment based on their SDIPs. While municipalities select investments from the menu of legally mandated municipal infrastructure, given the demand-driven nature of municipal investments it is not possible to determine a priori the exact composition of sub-projects. As a result, economic and financial benefits for sub-projects cannot be measured ex ante. The MDLF therefore has the responsibility to assess the economic and financial viability of sub-projects based on the applications completed by municipalities, as per guidelines in the project's operations manual. In the past, evidence from selected feasibility studies and ex-post cost-benefit analysis under MDP 1 and MDP 2 show that there are substantial benefits associated with the expected investment choices.

54. A cost-benefit analysis completed under the Implementation Completion and Results Report (ICR) for MDP 1 reviewed the two main categories of sub-projects implemented: roads and public facilities. Together, these two categories of sub-projects accounted for 78.8 percent of MDP 1 resources. The ICR analyzed all 265 roads sub-projects, which accounted for 63.6 percent of MDP 1 costs. Benefits of road sub-projects are quantified based on time saved to users and saved vehicle maintenance cost, while costs were based on investment costs and operating and maintenance costs over the lifetime of the sub-projects. The main indirect benefits, which were not quantified in the cost-benefit analysis, are due to the reduction in accidents (many roads serve schools and other public buildings) and appreciation in market values of real estate properties adjacent to the rehabilitated roads. The economic analysis of investment of US$49 million in road sub-projects (US$41.7 million less VAT) show ERR of 29.7 percent and NPV of US$48.9 million (using an 8 percent social discount rate). Sensitivity analysis shows that if the net benefits had been 25 percent lower compared to the base case, this would lead to ERR of 20.2 percent and NPV of US$27.5 million. Similarly, the economic analysis for investments of US$6.8 million in construction of public buildings public buildings yielded ERR of 15.70 percent and NPV of US$2.5 million. Evidence from similar international projects supports similar conclusions (i.e., Ethiopia, Uganda, Tanzania).

55. **Alternative project designs**. The proposed project design was compared with possible alternatives, including a no project scenario. In the absence of the project, most municipalities would lack sufficient resources to meet their infrastructure needs, as municipalities depend on limited, unpredictable, and inadequate intragovernmental transfers for their capital investments. Municipal assets would deteriorate and the local infrastructure gap would continue to increase. Doing nothing also implies forgoing an opportunity to strengthen municipal management capacity and systems, and thus a setback to strengthening municipal accountability, responsiveness, and financial sustainability.

56. The proposed project is also likely to yield a higher rate of return than alternative project arrangements. Relative to top-down mechanisms, a decentralized funding approach will lower investment costs and increase benefits through enhanced allocative and productive efficiency. Allocative efficiency will improve as municipalities are closely situated to their citizens, allowing them to elicit citizen responses and optimize resources based on local preferences and needs. Municipal grants can also improve productive efficiency by reducing transaction costs, which are associated with centralized financing of municipal infrastructure. In addition, unlike gap-filling approaches, performance-based grants, supported by demand-driven capacity development activities, incentivize municipalities to improve the delivery of public services.

57. **Public sector intervention**. Public sector funding is critical to address the infrastructure deficit across municipalities in the West Bank and Gaza. The provision of local public goods selected by municipalities as sub-projects, such as roads, sidewalks, public buildings, and solid waste infrastructure, are typical public sector responsibilities as these goods are non-excludable and non-rival in nature. Public sector intervention is also warranted as the proposed project directly supports local governments by strengthening municipal systems and capacity. In addition, the fiscal risks associated with the project are low and can be accommodated by the PA, given that the majority of project funds, with exception of the counterpart contribution from the PA, comes from development partner grants.

58. **Rationale for Bank intervention**. The Bank's involvement in the design and implementation of the proposed MDP 3 will maximize the net development impact of the project. MDPs have been the Bank's principal instrument to help strengthen municipal management over the past decade with over 190 operations in 3,000 municipalities worldwide. The Bank's technical input based on international experience will allow the implementing agency to draw on global lessons to improve project design. In addition, the Bank's extensive involvement in the local government sector in the Palestinian territories allows it to build on lessons learned from past and ongoing projects, such as MDP 1, MDP 2, ICUD, and LGSIP to ensure continued sector progress in line with government objectives. Lastly, the Bank also adds value by convening and coordinating development partners' support to the MDLF and their technical and financial contributions to the project.

B. Technical

59. The project design with an overall performance-based grant allocation mechanism and capacity development activities have proven to be an effective mechanism to improve municipal management performance and to implement relevant municipal investments for improved service delivery. This has not only been the case during MDP 1 and MDP 2 but also in other countries, where performance-based grant systems have demonstrated to effectively improve local government performance in public financial management, planning, compliance with procurement, account, audit processes and outcome[22] including in the Bank-financed

[22]Performance Based Grants Systems – Concept and International Experience, 2010 UNCDF.

operations in Tanzania and Uganda. In the West Bank and Gaza, MDP 1 and 2 have notably improved municipal management performance in planning, financial management and accountability.

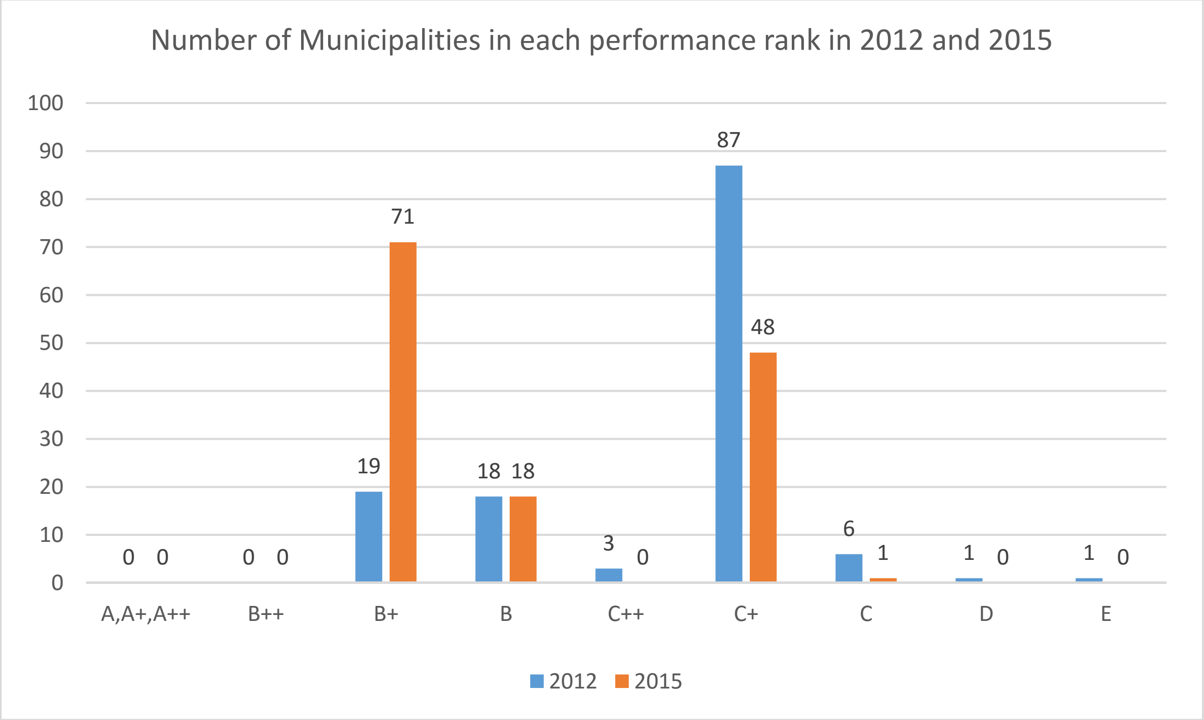
60. The proposed transfer mechanism, which is the basis for the capital grant allocation, has been successfully implemented under MDP 1 and 2. The mechanism is well institutionalized in MDLF/MoLG and most municipalities. In total, 115 municipalities have updated (or nearly updated) SDIPs for selection of relevant infrastructure investments following the municipal functions according to the LGA (1997). Planning includes procedures for the participation of women and youth in committee formulation and meetings on priorities. After municipalities have been capacitated and supported (if needed) by local technical consultants to ensure smooth project implementations including high quality standards, it is assessed that some municipalities will be able to increasingly manage their funds from the grant by undertaking greater responsibility for sub-project management.[23] This modality is already being implemented in the Local Governance Services Improvement Program in the West Bank only for larger village councils (more than 4,000 inhabitants) to enhance their management capacity.

61. The proposed MDP 3 will continue the performance-based approach to municipal development, following successful experiences during MDP 1 and MDP 2. For MDP 3 the performance system has been revised for simplifications and transparency with more measurable KPIs and more focus on financial sustainability and social accountability. Municipalities are also required to fulfill more advanced KPIs to reach higher level of performance than in MDP 2.

62. As part of the project preparation an analysis was carried out of the performance system during MDP 2, where municipal management performance was measured against 16 KPIs, which were organized into a progression that coincided with different performance ranks ranging from E to A++. The analysis confirmed that the performance system has worked as 52 municipalities (38 percent) have achieved a higher performance rank during MDP 2 and thereby improved their performance. The analysis also demonstrated that all municipalities (except one) are clustered in just three (C+, B and B+) of 11 ranks and no municipality has advanced to Category A in spite of 10 municipalities fulfilling more than 80 percent of 16 KPIs.

[23] As detailed in the Technical Manual.

Figure 1. Improvement in Municipal Performance during MDP 2.



63. The MDP 3 system is designed to facilitate smoother progression in municipal ranking through revised indicators. The revised system has been designed more clearly as a "ladder" for a more stepwise improvement of municipal performance from the lowest category D to the highest A with carefully developed steps reflected in the KPIs.

64. The MDLF will still ensure and provide guidance on the quality of sub-projects by: (i) ensuring that all works conform to national technical norms and standards for each type of sub-project; (ii) enforcing these norms and standards through technical design and community-responsive, effective procurement procedures; (iii) ensuring the involvement of independently recruited LTCs in the design and supervision of works and requiring their verification for the payments to contractors to be processed; (iv) capacity development for appropriate municipal staff in relevant areas of quality enhancement; and (v) conducting technical audits,[24] in addition to verifying technical soundness and compliance with safeguards.

65. The project's capacity building is designed according to the needs of the municipalities in particular based on the results of the performance evaluation by the end of MDP 2, where specific needs are identified. Experiences show, however, the importance to provide capacity development more holistically focusing on all areas of municipal performance and on different needs according to municipal capacity and size.

[24] Under MDP 2, 5-6 percent of total sub-projects were sampled and subjected to technical audits. The sample size will increase under the proposed MDP 3.

C. Financial Management

66. The financial management capacity of the MDLF was assessed, and a representative sample of 12 municipalities was reviewed in depth to update the financial management arrangements for the MDP 3. MDP 3 will continue to follow most of the existing FM arrangements under MDP 2. The MDLF will continue to manage the project FM and disbursement functions. Under MDP 3, it is envisaged that some well capacitated municipalities will receive sub-project funds directly to their designated bank accounts. The selection of these municipalities will be based on the performance assessment (ranking of B++ and above),[25] as well as including additional fiduciary safeguard measures such as the submission of approved budgets and unqualified audited financial statements. For municipalities in Gaza and for those that do not qualify for the direct transfer of funds, MDLF will be handling the financial management of the grant funds.

67. The General Directorate of Supervision and Direction at MoLG will be in charge of implementing the capacity development related to MoLG. This capacity development activity will include hiring a consultant to develop Palestinian municipal auditing and municipal financial reporting standards. This is to be done in close coordination with the SAACB and the PACPA to avoid duplication or working at cross-purposes. No funds will be transferred to MoLG, and MDLF will pay consultants on behalf of MoLG.

68. An external auditor will also be appointed based on terms of reference (TOR) acceptable to the Bank and DPs to audit the project's financial statements. The auditors will be expected to express an opinion on the project financial statements. The audit reports will be submitted to the World Bank and all DPs within six months after the end of each fiscal year. The Internal Audit Department of MDLF will carry out the internal audit of the project that will assess the physical and financial progress of subprojects and implementation progress through field visits.

D. Procurement

69. All goods, works, non-consulting services and consulting services required for the project and to be financed out of the proceeds of the grant shall be procured in accordance with the requirements set forth or referred to in the World Bank Procurement Regulations for Borrowers under Investment Project Financing dated July 1, 2016, and the provisions of the recipient's procurement plan for the project dated April 3, 2017. The project will be carried out in accordance with the provisions of the "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated October 15, 2006 and revised in January 2011. Furthermore, the PA Public Procurement Law (PPL) No. 8 of year 2014, which applies to municipalities, entered into effect on July 1, 2016. Specific components of the national procurement system which would be acceptable for use in the project have been identified. DPs agreed that procurement for components under parallel

[25] According to the baseline for MDP 3 using the updated performance ranking.

financing, will be implemented following the procedures outlined in MDLF Procurement Manual and the modality in place for MDP 2. The same will be outlined in their respective financing agreements with the PA/MDLF. The Procurement Manual used for MDP 2, dated September 2014, will be reviewed and updated in accordance with the Bank Procurement Regulation and the PPL. It shall be prepared by MDLF and approved by the World Bank and DPs by effectiveness.

70. MDLF will continue to hold the overall responsibility for procurement following the same arrangements in place for MDP 2. More specifically, MDLF will act as the Bank's counterpart for all procurement aspects of the project. MDLF will carry out procurement for the capacity development component and will provide oversight over procurement to be carried out by municipalities for the sub-projects under the components for performance grants and municipal partnership projects.

71. The enactment of the new Public Procurement Law No. 8 of year 2014, which applies to municipalities, has brought substantial improvement to the legal framework for public procurement on aspects related to efficiency, transparency, accountability and integrity; however, implementation of various provisions of the law is still work in progress. Procurement performance for MDP 2 has been satisfactory. MDLF has significant previous experience in procurement implementation under the World Bank-financed projects. Municipality procurement capacity has also improved, although at varying levels. Some municipalities still have weak procurement and contract management capacities, which could result in implementation delays, improper application of procurement procedures, or use of funds for unintended purposes. The scheduling of procurement packages under municipal infrastructure sub-projects has often resulted in capacity challenges to local contractors. This is particularly noted in the road sector, which represents the major category of sub-projects. The performance and quality of the outputs of local consultants hired under the capacity development component has not always been satisfactory.

72. The MDLF has established a sound control and audit system of procurement activities carried out by municipalities for infrastructure sub-projects. The system, which requires municipalities to seek MDLF's no objection prior to proceeding with key steps of the procurement process, will continue to apply for MDP 3. Municipalities will continue to receive technical assistance from local technical consultants. In addition, MDLF will commission technical compliance audits, and municipalities will receive procurement and contract management training. MDLF prepared a procurement plan for the first 18 months of MDP 3 implementation for packages under components 2 and 4 to be managed by MDLF (and MoLG).

E. Social (including Safeguards)

73. **Social, including citizen engagement:** MDP 3 will build on the advances of MDP 2 on embedding citizen engagement and social accountability into the functioning and performance incentives of municipal development. During MDP 2 implementation, significant advances were made in budget transparency and disclosure, as noted above. Numerous WB/GIZ-

SDC/MOLG supported pilots are in the process of advancing methods, such as developing models for a "readable budget" and participatory monitoring and evaluation pilots in selected municipalities. Advances were achieved in terms of better defining and communicating the "social compact" in the form of norms (via the creation of CSCs and associated public information around these). Citizen monitoring of municipal SDIPs were strengthened via a participatory M&E manual. Grievance redress systems were improved with a move towards computerization, which allows citizens to track their transactions/services via the web and via the CSC, and applied in many municipal services (beyond safeguards).

74. During MDP 3 the focus will be on evaluating, deepening and mainstreaming a number of these advances in transparency and citizen engagement, and focusing on how they contribute to improvements in municipal performance. MDP 3 will also seek to strengthen the quality of municipal-citizen relationship and opportunities for citizen feedback through all phases of the municipal expenditure cycle including implementation of the capital grant sub-projects. In concrete terms, ongoing changes to the municipal investment process will integrate good practice and lessons learned from participatory budgeting and participatory monitoring and evaluation pilots on participation, disclosure and accountability. Municipalities themselves will be provided with some space to test simple and innovative feedback systems on investments post-construction, on providing updates to citizens on pre-construction feasibility and on satisfaction with the CSCs. Complaints handling mechanisms will be scaled up and linked to the national grievance redress mechanism of the MoLG.

75. Part of the shift to quality will include looking at how feedback generated (whether grievances, satisfaction surveys, or feedback from participatory planning) is integrated into municipal decision-making and management processes ("closing the feedback loop") as part of the capacity development component.

76. As with MDP 2, the project will continue its explicit focus on gender; quotas (30 percent minimum) for the inclusion of women and youth in community committees were embedded in the manual and policy notes for SDIP planning processes. Grant application forms were updated to be gender-sensitive, and specific efforts were made to ensure a gender balance in the capacity development components (with 27 of 90 participants being women) in training under MDP 2. CSCs are now able to generate gender-sensitive reports (i.e., records and statistics per gender) which can be the basis for analysis to better understand any existing gender gaps in service provision, problem identification, or response times. The new generation of SDIPs and new SDIP manual will include recommendations on strengthened community participation, including of women and youth.

77. **Social safeguards.** Under component 1, a number of infrastructure projects, including roads, sidewalks, public facilities, rehabilitation and maintenance of existing water systems (water wells, water networks, wastewater and sanitation), wastewater and electricity services not provided by utility companies will be funded as long as they do not have significant environmental and/or social impact. As a result, OP 4.12 is triggered in case any of these projects would require land, impact livelihoods or the public land used for constructing a given

project is encroached or has a claim on it. A Land Acquisition and Livelihood Policy Framework (LALPF) has been prepared and disclosed in-country and the Bank's Infoshop on March 26 and April 20, 2017, respectively. The LALPF is prepared to set up the principle and criteria to be followed in case projects might need land or impact livelihoods. In summary, the LALPF will be the guide for the preparation of site-specific Land Acquisition and Livelihood Action Plans (LALAPs) when needed. Since exact sub-projects that will be funded in each municipality were not identified by appraisal, individual LALAPs could not be prepared. Moreover, the sub-projects will be primarily built in public land; however, in unlikely cases that land and other assets as well as livelihoods are impacted, the LALPF will be the basis for the preparation of site-specific LALAPS that will be prepared, consulted, and disclosed before the commencement of any civil works. The LALPF includes a check list that will be used by the MDLF and municipalities involved to determine if any of the sub-projects funded under MDP 3 will require land and accordingly prepare the needed instruments. In case a sub-project will need preparation of the LALAP MDLF and the relevant financier will make sure that the Resettlement Action Plan (RAP) is prepared in compliance with the LALPF. All RAPs will be disclosed in the country and Infoshop.

F. Environment (including Safeguards)

78. The sub-projects to be funded include development and rehabilitation of municipal infrastructure, including (but not limited to) roads, parks, electricity services not provided by a utility, street lighting and improvement, and extension, rehabilitation and maintenance of existing water systems (water wells, water networks, wastewater and sanitation). In MDP 2, 80 percent of the sub-projects were in the road sector, and it is expected that MDP 3 demands will be similar. In the Gaza Strip, incremental costs for service delivery and rehabilitation are also financed. The environmental and social impacts of these sub-projects are expected to be positive. Minor temporary negative impacts which are expected during the construction phases will be mitigated using procedures described in the project ESMF.

79. This project is a category 'B' project. The screening criteria described in the ESMF and the project's operations manual includes a negative list of ineligible interventions. Furthermore, the size of grant to be allocated to different municipalities limits the sub-project scope. MDLF is responsible for ensuring that the approved sub-projects comply with the subproject screening criteria, apply the relevant sectoral sub-project Environmental and Social Management Plans (ESMPs) as needed, and that they are properly monitoring as per the ESMF.

80. OP 4.01 (Environmental Assessment) is applicable to MDP 3. An ESMF was prepared, updating the MDP 2 ESMF, and has been disclosed in-country and at the Bank's InfoShop on March 6 and 15, 2017, respectively, with the executive summaries in English and Arabic. The ESMF includes a detailed assessment of the regulatory and institutional framework and capacity of MDLF, environmental assessment of possible impacts and mitigation measures, an environmental and social management plan, as well as a monitoring plan with clear indicators and mechanisms for implementation and reporting. Lastly, the ESMF describes the training and capacity development required for effective environmental safeguards at the municipal

level. As part of MDP 3 preparation, the MDLF consulted with other DPs supporting the MDP, and it was agreed that the World Bank's safeguards policies will continue to apply to the project as a whole and ESMF benefited from DPs' review and endorsement. As directed by the ESMF, site-specific environmental assessments and environmental management plans will be prepared for applicable sub-projects, building on sectoral ESMPs, by client municipalities prior to the start of sub-project construction.

81. The Bank Policy OP 4.09 (Pest Management) is also applicable to MDP 3. Thus, the ESMF includes a Pest Management Plan (PMP), with specific guidelines to assure that only chemicals approved for Bank financing are procured and that these chemicals are handled, stored, and administered safely. These guidelines have been authorized by the Palestinian Ministry of Health. MDP 3 will follow Palestinian Water Authority protocol where required for water sector sub-projects for clearance/no-objection; this process will be documented in sub-project files.

82. MDLF institutional capacity for safeguards management, including compliance monitoring and reporting, is high, as the unit has acquired considerable experience through MDP 1 and MDP 2 implementation. MDLF safeguards team responsibilities during MDP 3 will continue to include building municipal capacity for sub-project screening and construction-phase site monitoring. For those municipalities that will be assessed as having enough capacity the responsibilities for safeguards will be transferred in phases, as it is described in the Environmental and Social Management Framework (ESMF). These municipalities also will receive training on safeguards by the MDLF. An outline of this pilot in included in the ESMF, with details in the OM.

G. Other Safeguard Policies (if applicable)

H. World Bank Grievance Redress

83. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY : West Bank and Gaza
GZ-Third Municipal Development Project

Project Development Objectives

Enhance the institutional capacity of municipalities in the West Bank and Gaza for more accountable and sustainable service delivery

Project Development Objective Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Number of municipalities that move up one rank in the performance assessment system		Number	0.00	100.00	2017, 2019, 2021	MDLF Performance Assessment	MDLF
Description: The PDO indicator will measure number of municipalities that move up one rank in performance. The ranking system has 10 ranks based on 4 categories (D, C, B and A) with 21 KPIs from D to A++.							
Name: People provided with improved urban living conditions		Number	0.00	500000.00	2019, 2021	MDLF from information on municipal sub-projects.	MDLF
Female beneficiaries		Number	0.00	250000.00	2019, 2021	MDLF	MDLF

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Description: The Corporate Result indicator (CRI) measures the cumulative number of people living in urban areas that have been provided with access to improved services, housing, tenure, neighborhoods, public spaces, parks, resilience, and/or urban environmental conditions, through the direct interventions of operations supported by the World Bank. Its a new CRI and will added to the WB Portal. Target of 500.000 will be reviewed in 2019.							
Name: Municipalities with public disclosure of executed budget and executed SDIP		Number	0.00	100.00	2017, 2019, 2021	MDLF Performance assessment	MDLF
Description: The disclosure will take place on social media platform, (Facebook), municipal bulletin board, MoLG's homepage and/or other platform. From year three (2019) the readable format from MoLG will be used, once endorsed by MoLG.							
Name: Number of municipalities with operational and enterprise surplus and no increase in arrears		Number	40.00	80.00	2017, 2019, 2021	MLDF Performance Assessment	MDLF
Description: This indicators will measure municipalities that have surplus in their operational and enterprise account and no increase in arrears from last year. Municipalities that fulfill this criteria have not increased net debt to suppliers of water and electricity. Baseline will be updated in June 2017.							

Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Number of municipalities graduated to category A		Number	5.00	15.00	2017, 2019, 2021	MDLF Performance Assessment	MDLF
Description: The indicator will measure number of municipalities that graduate to category A the highest category in the performance system. It is measured by the project's performance assessment system to measure municipal performance from category D (the lowest) to A the highest. Baseline will be updated in June 2017.							
Name: Number of municipalities completing sub projects within each cycle		Number	0.00	140.00	2019, 2021	MDLF	MDLF
Description: The indicator will measure the number of municipalities that complete sub projects within each of the two budget cycles: 1 January 2018 to 31 December 2019 and 1 January 2020 to 31 December 2021.							
Name: Number of municipalities with functional complaint system		Number	22.00	100.00	2019, 2021	MDLP Performance Assessment	MLDF
Description: The indicator will measure that a functional municipal complaint system exists in 2021 following National guidelines. Functional municipal complaints system will include ability to produce data on grievances by type and by level of resolution. For baseline and in 2019 the indicator will only measure that the complaint system exists in Citizen Service Centers.							
Name: Percentage of		Percentage	0.00	80.00	2017, 2019, 2021	MDLF assessment of 5-6%	MDLF

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
investments financed under the project in adequate technical state and used as intended						of all sub projects in 2017, 2019 and 2021.	
Description: The indicator will measure the percentage of investments with acceptable standard and acceptable usage. Measured as "adequate state of usability" according to MDLF assessment of 5-6 % of executed projects. The baseline will be update in June 2017.							
Name: % of beneficiaries satisfied with municipal sub projects executed under MDP 3		Percentage	0.00	80.00	2017, 2019, 2021	MDLF Performance Assessment or the Local Government Performance Assessment (LGPA) questions 2.6 and 9.10.	MDLF
Description: The indicator will measure the % of beneficiaries that are satisfied with municipal sub-projects. The baseline will be updated in July 2017. It will be gender disaggregated.							
Name: Percentage of municipalities satisfied with MDLF support		Percentage	75.00	95.00	2017, 2019, 2021	MDLF satisfactory survey	MDLF
Description: The indicator will measure the number of municipalities that are satisfied with the support received from MDLF. The baseline will be updated in June 2017.							
Name: Road Map for MDLF as Lending Intermediary consulted with relevant		Yes/No	N	Y	2021	MDLF	MDLF

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
stakeholders							
Description: A TA is supporting the development of a Road Map for MDLF's transformation into a lending intermediary for municipal borrowing. The Road Map shall be consulted with relevant stakeholders in a seminar or similar.							
Name: Municipal audit standard developed		Yes/No	N	Y	2021	MoLG	MoLG
Description: MoLG develops standards for how external municipal audits shall be carried out							
Name: Number of municipalities with yearly increase in revenues collected by the municipality		Number	50.00	120.00	2017, 2019, 2021	MDLF Performance assessment based on the latest available data e.g. 2014 to 2016 for the assessment in 2017.	MDLF
Description: The indicator will measure the number of municipalities that increase the revenues collected by the municipality from year to year. It will not cover revenues collected by Ministry of Finance e.g. property taxation and transportation tax.							
Name: Number of municipalities reporting enhanced capacity to engage with private sector for municipal service delivery and/or local economic development		Number	0.00	25.00	2019 and 2021	MDLF's survey in every 2 years to assess the effectiveness of its capacity development for municipalities.	MDLF

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Description: The indicator will measure the number of municipalities that reports enhanced capacity to engage with private sector for municipal service delivery and/or local economic development following concrete actions/TA from MDP 3.							

Target Values

Project Development Objective Indicators

Indicator Name	Baseline	YR1	YR2	YR3	YR4	YR5	End Target
Number of municipalities that move up one rank in the performance assessment system	0.00	0.00	0.00	50.00	50.00	100.00	100.00
People provided with improved urban living conditions	0.00	0.00	0.00	250000.00	250000.00	500000.00	500000.00
Female beneficiaries	0.00	0.00	0.00	125000.00	125000.00	250000.00	250000.00
Municipalities with public disclosure of executed budget and executed SDIP	0.00	0.00	0.00	50.00	50.00	100.00	100.00
Number of municipalities with operational and enterprise surplus and no increase in arrears	40.00	40.00	40.00	60.00	60.00	80.00	80.00

Intermediate Results Indicators

Indicator Name	Baseline	YR1	YR2	YR3	YR4	YR5	End Target
Number of municipalities graduated to category A	5.00	5.00	5.00	10.00	10.00	15.00	15.00
Number of municipalities completing sub projects within each cycle	0.00	0.00	0.00	100.00	100.00	140.00	140.00

Indicator Name	Baseline	YR1	YR2	YR3	YR4	YR5	End Target
Number of municipalities with functional complaint system	22.00	22.00	22.00	44.00	44.00	100.00	100.00
Percentage of investments financed under the project in adequate technical state and used as intended	0.00	0.00	0.00	60.00	60.00	80.00	80.00
% of beneficiaries satisfied with municipal sub projects executed under MDP 3	0.00	0.00	0.00	70.00	70.00	80.00	80.00
Percentage of municipalities satisfied with MDLF support	75.00	75.00	75.00	85.00	85.00	95.00	95.00
Road Map for MDLF as Lending Intermediary consulted with relevant stakeholders	N	N	N	N	N	Y	Y
Municipal audit standard developed	N	N	N	N	N	Y	Y
Number of municipalities with yearly increase in revenues collected by the municipality	50.00	50.00	50.00	85.00	85.00	120.00	120.00
Number of municipalities reporting enhanced capacity to engage with private sector for municipal service delivery and/or local economic development	0.00	0.00	0.00	12.00	12.00	25.00	25.00

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ANNEX 1: DETAILED PROJECT DESCRIPTION

West Bank and Gaza
GZ-Third Municipal Development Project

1. **The proposed MDP 3 will support and incentivize improvements in the development of municipal management capacity**. Previous MDPs financed municipal infrastructure and service delivery through the provision of basic block and performance-based grants, and provided demand-driven capacity development support for municipalities. This approach was very innovative at design and has shown to be highly effective. The proposed MDP 3 would continue this overall approach while focusing more on improving financial sustainability and accountability in municipal service provision.

2. **Performance grants will retain the same basic design as in MDP 1 and MDP 2, given the positive outcomes in municipal management and service delivery associated with the grant incentive structure.** Like MDP 1 and 2, municipal performance will be measured through Key Performance Indicators (KPIs), yet these have been substantially revised to reflect a greater focus on the sustainability of municipal services. Performance measurements will encompass three main areas for reform: (i) financial performance and sustainability, (ii) institutional performance, and (iii) transparency, accountability and participation.

3. A summary of the result framework and a description of the proposed components are presented below.

Table 1: Summary Result Framework	
Project Development Objective	Enhance the institutional capacity of municipalities in the West Bank and Gaza for more accountable and sustainable service delivery
PDO Result Area	PDO Indicators
1. Strengthened municipal institutions	1. Number of municipalities that moved up one rank in the performance assessment system[26]
2. Accountable and responsive service delivery	2. People provided with improved urban living conditions (WB core) 3. Municipalities with public disclosure of executed budget and executed SDIP
3. Financially sustainable municipalities	4. Number of municipalities with operational and enterprise surplus and no increase in arrears
Intermediate Indicators	
Municipal level	1. Number of municipalities graduated to category A 2. Number of municipalities completing sub-projects within each cycle 3. Number of municipalities with functional complaint

[26] The ranking system has 10 ranks based on 4 categories (D, C, B and A) with 21 KPIs. (Please see details below)

	system 4. Percentage of investments financed under the project in adequate technical state and used as intended.[27] 5. Percentage of beneficiaries satisfied with municipal sub-projects executed under MDP 3. 6. Number of municipalities with yearly increase in revenues collected by the municipality 7. Number of municipalities reporting enhanced capacity to engage with private sector for municipal service delivery and/or local economic development
MDLF	8. Percentage of municipalities satisfied with MDLF support 9. Roadmap for MDLF as lending intermediary consulted with relevant stakeholders
MoLG	10. Municipal audit standard developed

A. Project Components

Component 1. Municipal performance and service delivery (US$79,433,053 total, of which US$13,311,702 from TFGWB and US$16,642,553 from PID-MDTF)

4. **The project will provide block grants and performance-based grants** to municipalities for investments in municipal infrastructure. The block grants will provide a basic funding for eligible municipalities for infrastructure development based on needs and equity, while the performance grants will in addition provide an incentive for municipalities to improve their performance within the three performance areas. Half of the total component 1 financing would be allocated for the block grants and another half for the performance-based grants. The block grants will be allocated based on population (40 percent) and needs (60 percent). For municipalities in Gaza, 20 percent of the basic and performance-based grants can be applied for recurrent expenditure as under MDP 2 to reflect the special circumstances they face. Only specific traceable expenditures, for example, maintenance will be allowed. The eligible expenditures will be defined in the project's operations manual.

5. **Block grant eligibility**. Municipalities must fulfill basic eligibility criteria to receive the project's block grants. From the outset, municipalities are required to have an annual budget approved by the municipal council and submitted to MoLG. This eligibility criterion reflects progress achieved under the MDP 2, and a technical preliminary assessment completed during project preparation shows that a majority of municipalities will be able to achieve the eligibility condition. From the year 3 of the project, a second eligibility criterion will be added requiring a SDIP to be prepared according to the new SDIP guidelines. This criterion ensures that eligible municipalities will follow national guidelines for sub-project selection, including proper procedures for prioritization, capital

[27] Based on technical audit.

budgeting, selection, and inclusive participation. As all municipalities will receive capacity development support on application of the new guidelines starting from August 2017 in order to prepare their SDIPs for 2018-2022, it is expected that all municipalities will be able to fulfill both criteria for the assessment in 2019. All eligible municipalities will have access to the basic block grant.

6. **Performance grants**. The performance-based grants will be provided to block grant eligible municipalities according to their fulfillment of 21 KPIs. It is based on the same model as MDP 1 and 2 with four performance categories ranging from D to A with a total of 10 ranks from D to A++. To receive the performance grant, municipalities have to reach the lowest category, which involves fulfilling three basic KPIs. In the performance system a municipality will be placed in a category based on the assessment. Municipalities have to fulfill more and more advanced/demanding KPIs to move from category D upwards to the highest category A. The KPIs have been categorized systematically with three basic KPIs in D and six KPIs in each of categories C, B, and A. Municipalities need to fulfill all KPIs under D, C, B and A to graduate to that level. Municipalities can achieve + and ++ to a category, if a certain number of KPIs are fulfilled. Better performing municipalities will receive a higher relative share of the performance grant. For example, municipalities in rank D will receive a simple per capita allocation for performance, while each higher rank will receive a per capita allocation multiplied with the respective weight factor. In rank A++, the per capita allocation will be based on the weight factor 10.

Municipal Performance Measurement

7. The municipal performance measuring system is created to provide the right incentives for the municipalities' performance under MDP 3 following performance progress during MDP 1 and MDP 2. It is developed based on three basic principles for KPIs:

   i. **Outputs and results.** KPIs should be performance-based and focused on results achieved rather than the means by which the results are achieved. This includes some process indicators to strengthen certain steps to reach the outputs (e.g. a manual for O&M).
   ii. **Transparency and simplicity**. The performance system and its underlying KPIs (and how these are measured) should be transparent and the municipalities themselves should be able to predict and verify their results.
   iii. **Reform and strategy.** KPIs should support municipalities to implement reforms guided by the PA's sector strategy, including strategies for financial sustainability, planning, electricity, and water.

8. The KPIs for MDP 3 have been adjusted based on experiences from previous phases of MDP as explained above. KPIs are now better able to capture: (i) municipal net lending and operational surplus; (ii) sustainability; and (iii) accountability. Prevailing KPIs from MDP 2 are in general in a lower category to put more demand on municipal performance, e.g. having "an asset register in place" is now at category C instead of B and "unqualified audit" is in category B instead of A. Specific adjustments from MDP 2 to the proposed

MDP 3 KPIs include the following changes:

a. **Municipal net lending and operational surplus**. Under MDP 2, KPIs did not sufficiently address the issue of net lending, and KPIs on operation and enterprise surplus did not capture growing municipal net debt. The proposed MDP 3 will include a KPI on "no increase in net lending", and KPIs to improve the accounting methods with the aim to separate accounting for operation and enterprise expenditure.
b. **Sustainability**. A KPI on "at least 10 percent of the budget execution for O&M" is now included, in addition to "an O&M plan in place". A KPI on "Year-on-year Increase or more than 50 NIS per capita own source revenues" has been included instead of specific KPIs on revenue efficiency.
c. **Accountability**. A specific performance area has been included on transparency, accountability and participation with several KPIs on disclosure of budget, budget execution and SDIP, and gradual establishment of municipal complaint system.

9. An overview of the grant allocation mechanism with the basic grant, the performance grant, and all KPIs grouped into the three performance areas and categories is presented below. The performance assessment will be carried out in 2017 (baseline), 2019 and 2021.

Table 2: Municipal Grant System under the proposed MDP 3				
1. Basic Grant (50%) allocated based on population and needs				
Eligibility Conditions	i. Annual Budget approved by the Municipal Council and submitted to MoLG on a timely basis ii. SDIP prepared according to new SDIP guidelines (from year 3)			
2. Performance Grant (50%). Grant allocated to municipalities based on performance according to KPIs				
Categories	D	C	B	A
No. of KPIs	3 KPIs	6 KPIs	6 KPIs	6 KPIs
Graduation	Compliance of all 3 KPIs	C: compliance of 2 out of 6 C+: compliance of (3,4) out of 6 C++: compliance of 5,6 out of 6 In addition to the KPIs in rank D	B: compliance of (2) out of 6 B+: compliance of (3,4) out of 6 B++: compliance of (5,6) out of 6 In addition to the KPIs in rank D & rank C	A: compliance of (2) out of 6 A+: compliance of (3,4) out of 6 A++: compliance of (5,6) out of 6 In addition to the KPIs in rank D & rank C and rank B
Performance Areas	Key Performance Indicators Matrix			
Financial Performance and Sustainability			At least 10% of the budget execution for O&M	O&M plan in place
		Year-on-year Increase or more than 50 NIS municipally collected revenue per capita	Operational surplus achieved	Staff costs <45% WB or <70% GZ) of operational and capital expenditure

	Separate banks accounts for enterprise revenues established	Separate financial accounting for enterprise revenues and expenditures established	No increase in net lending	Cost Accounting Systems set up
Institutional Performance	Financial accounting policies and procedures in place	Executed budget statement for the previous FY submitted to MoLG on time	Unqualified audit opinion from annual external audit	IFMIS implemented
		Fixed asset register in place and updated	At least 70% budget execution	Green spaces implemented[28]
Transparency, Accountability and Participation	Public disclosure of annual budget, SDIP and MDP performance ranking	Public disclosure of executed budget and executed SDIP	Audit opinion disclosed to citizens and stakeholders	
		Municipal complaint system established		Functional municipal complaint system following MoLG guidelines

10. The grant system under the proposed MDP 3, including the grant allocation mechanism (GAM), will be detailed further in the project's operations manual. All KPIs will be further defined in the GAM with more detailed information regarding their measurement, data sources, and procedures.

11. With estimated US$40 million for each of the municipal budget cycles in 2018-2019 and 2019-2020, the estimated allocation per capita for each cycle is presented below. The grant corresponds to about 10 percent of the total municipal operational budget in 2014 and almost all funding for capital investments[29].

[28] The indicator is related to the quality of urban livelihood and defined as follows: the municipality provides and maintains public green space (green areas, sport areas, play grounds, parks) of > 0.5 m² per capita in West Bank urban municipalities and > 0.3 m² per capita in Gaza and West Bank rural municipalities.
[29] The size of the municipal capital budget fluctuates substantially from year to year due to irregular inflows and registration in municipal budgets. The per capita ratio was about NIS 100 (US$27) from 2011 to 2013 (Public Expenditure Review of the Palestinian Authority, World Bank, June 2016).

Table 3: Estimated per capita allocations in municipalities in 2018-2019 and 2020-2021 (Euro)			
Grant allocation	Lowest	Highest	Average
Block grant	2	3	
Performance grant	2	9	5
Block and performance grant	7	23	11

Grant cycle

12. The proposed MDP 3 provides grant funding for capital investments based on municipalities' allocation of block and performance grants. Municipal performance assessments will be carried out in 2017 and 2019 to determine municipalities' corresponding grant allocations in 2018 and 2020, respectively. The MDLF will announce allocations from block and performance grants in October 2017 and October 2019, respectively, to be included in the municipalities' budget for the following years. Thus, it will follow a two-year municipal budget cycle with allocations for 2018-2019 and 2020-2021. Municipalities will select sub-projects prioritized and identified through their updated 2017 SDIPs and in the new SDIP from 2018 to 2022, and will conduct adequate economic and feasibility studies for their proposed investments. Sub-projects can then be implemented in the following years. The municipal allocations will be managed by the MDLF and as in MDP 2 paid directly to contractors following municipal requests. To enhance municipal capacity for public financial management a subset of the best performing municipalities will receive the funds directly in their bank accounts and pay contractors directly. This subset of municipalities will include high performing municipalities (ranking of B++ or above) that meet fiduciary and safeguard criteria to be clarified in the project's operations manual. The selected municipalities will follow the same procedures as all other municipalities for project implementation in terms of procurement and technical design. The annual investment grant flow is presented below.

Table 4. Annual Investment Grant Flow			
Year	**Date/Timing**	**Action**	**Responsible Party**
2017			
	August	Eligibility assessment for block grant assessment completed Municipal performance assessment completed	MDLF MDLF
	June to September	SDIP updated to include 2018	
	August	Municipal Capacity Development Plan developed	MDLF
	September	Capacity Development starts	MDLF
	October	Basic grant and performance grant are announced to municipalities	MDLF
	December	Municipal budgets submitted to MoLG including MDP 3 sub-project implementation	Municipalities
2018	January to December	Sub-project implementation	MDLF, municipalities
	January to June	Finalization of new SDIP 2018 to 2022	Municipalities
	December	Municipal budgets are submitted to MoLG including MDP 3 sub-project implementation	Municipalities
2019	January to December	Sub-project implementation	MDLF, municipalities
	June	Eligibility assessment for block grant assessment completed Municipal performance assessment completed	MDLF MDLF
	June	Municipal Capacity Development Plan updated	MDLF
	September	Capacity development starts	MDLF
	October	Basic grant and performance grant is announced	MDLF
	December	Municipal budgets submitted to MoLG including MDP 3 sub project implementation	Municipalities
2020	January to December	Sub-project implementation	MDLF, municipalities
	December	Municipal budgets are submitted to MoLG including MDP 3 sub project implementation	Municipalities
2021	January to June	Sub-project implementation	MDLF, municipalities
	June	Final performance assessment completed	MDLF

Component 2: Capacity development to municipalities and Palestinian institutions (US$5,137,766 total, of which US$531,915 from TFGWB and US$531,915 from PID-MDTF)

13. This component will provide capacity development support to: (1) municipalities to strengthen their institutional capacities to deliver services in an efficient, accountable and sustainable manner; and (2) national level institutions such as the MDLF and the MoLG to enhance their institutional capacities to fulfill their assigned mandates. The capacity development (CD) support provided through the project will be centered around the three performance areas of the project. While the CD component will provide support to all municipalities, specific attention will be paid to higher order needs of well capacitated municipalities that will enable them to improve their creditworthiness and ability to access market based financing options. The MDLF will prepare a Capacity Development Plan at the start of the project in consultation with all stakeholders providing a detailed description of the priorities, activities and their inter-linkages.

14. **Capacity development support to municipalities**. Capacity development support to municipalities would be provided through: (1) basic capacity development support to participating municipalities; and (2) targeted capacity development support to strengthen creditworthiness of high performing municipalities. In addition, the component will also support the development of Municipal Management Systems that will strengthen governance and management framework of all municipalities in the West Bank and Gaza.

15. As part of basic capacity development support, continuing the capacity development model of MDP 2, the project will provide support to participating municipalities to improve their institutional performance on the KPIs assessed periodically as part of the GAM. These will include support to strengthen core municipal management areas such as investment planning and budgeting, financial management, revenue management, O&M, and social accountability. The MDLF will devise a set of CD activities in these areas and will procure the services of consultants/experts to provide advisory support to municipalities to enhance their performance in the KPIs related to these areas. The CD activities will be demand-driven and will adopt a differentiated approach to address the varying requirements of municipalities in accordance with their performance rankings. Accordingly, the CD will include a mix of classroom training, hands-on technical support and advisory support on specific areas of municipal functions that will be customized to cater to the requirements of municipalities and their existing capacities and performance. In addition, support will also be provided to municipalities to strengthen their procurement and safeguard functions to enhance the overall fiduciary assurance of the project. The project will also support municipalities to learn from each other through peer learning exchange visits and workshops; good practices in specific areas of municipal management will be compiled and disseminated.

16. At the next level, targeted CD will be provided to selected municipalities to improve their creditworthiness and enhance their capabilities to access market finance. Accordingly,

targeted advisory services and training will be provided by mobile teams of specialists to strengthen performance of municipalities in areas such as revenue and expenditure management, management of receivables and payables, cash management, and project management. Initially, support will be provided only to selected municipalities based on the analysis of their current financial performance. The Bank is currently undertaking TA project on the feasibility of municipalities to borrow from market sources and the measures required to strengthen the legal and institutional framework to enable municipal borrowing. The recommendations of the TA will inform the design of specific activities under this component and will be included in the CD Plan.

17. **Development of Municipal Management Systems.** Effective systems to regulate and guide municipal activities make a critical contribution to available capacity through clarifying and streamlining procedures and requirements, as well as improving their efficiencies through automation. Support will be provided for the development of policy, analytical and technical frameworks and analyses in targeted areas such as revenue management, municipal IFMIS, capital investment preparation and social accountability. This component will support activities that lead to improved policy frameworks and operational procedures in these areas and the outputs of these activities will inform the development of training and support materials to be provided to municipalities. Most outputs are expected in the first three years of project implementation.

18. Activities to be undertaken in the first two years of the project under the above areas are described in the table below. This list of activities will be finalized and described in more detail in the Capacity Development Plan.

Table 5: Selected Systemic Capacity Development Activities for Municipalities[30]	
Area	**Activities**
Capital Investment Planning and Preparation	Preparation of guidelines for investment project appraisal by municipalities, including undertaking feasibility studies, cost-benefit analysis of investment choices and the efficient management of the project cycle through modern project management tools.
Municipal IFMIS	Rollout of IFMIS to municipalities with the objective of automating the financial management and revenue administration process. The details of the roll out will be included in the CD Plan
Revenue Management	1. Support to municipalities to map unbilled service users and complete municipal service users' database, including utility service users. 2. Support to municipalities to identify cumulative arrears per service user and record. 3. Support to municipalities to map unregistered municipal fixed

[30] The comprehensive list of capacity development activities will be able as part of the Capacity Development Plan and Operations manual.

	assets and update existing fixed asset registries.
Social Accountability	1. Finalize and disseminate Readable Budget Model 2. Update SDIP guidelines with inclusive and participatory planning models

19. CD for Social Accountability will be provided to institutionalize citizen engagement and social accountability in municipal governance through formal guidelines and procedures for strengthening citizen/beneficiary feedback on service delivery and municipal management and for enhancing the effectiveness of grievance redressal mechanisms. Support will also be provided for enhancing transparency and accountability of municipalities through improved disclosure of municipal budgets, and enabling citizen accessibility to and knowledge of the municipal budget process.

20. **Capacity development support to MoLG and MDLF**. Recognizing the critical role played by national level institutions in the strengthening of governance and service delivery at the municipal level, the project will provide capacity development support to MoLG and MDLF to enable them to play their mandated roles and responsibilities more effectively as envisaged under the PA's Local Governance Sector Strategy (2017-2022). The MoLG has recently issued a directive to all municipalities to have independent external audits annually conducted by private sector auditors. The component will support activities to implement this directive and thereby enhance the accountability framework of municipalities. Accordingly, support will be provided to the MoLG to develop municipal audit standards in collaboration with the SAACB and the PACPA. Support will also be provided to prepare implementation guidance for helping municipalities to adopt the new audit standards and to train auditors. Support will also be provided to MoLG for the robust review of municipal audit reports and to provide timely feedback to municipalities. In accordance with the strategic plan of the MDLF, capacity development support will be provided to MDLF to become a financial intermediary for local governments. The Bank is currently undertaking a TA to assess the capacity of MDLF and develop a roadmap for its capacity development. Specific activities will be designed for the capacity development of MDLF based on the recommendations of the TA.

21. **Implementation of CD activities**. The project's Capacity Development Plan will specify timelines and budgets for the various activities included in the plan. The Capacity Development Plan will make sure that the CD activities under the project are demand-driven and do not overlap with other donor-financed capacity development programs in the sector.[31] Based on the Capacity Development Plan, MDLF will prepare a work plan for each implementation cycle that will be shared with all stakeholders prior to the start of the two-year cycle. The Capacity Development Plan will be reviewed at the project's mid-term

[31] CD targets all 144 municipalities, irrespective of USAID's targeting of 55 municipalities.

review (MTR) and suitable changes will be made as necessary.

Component 3. Municipal partnership projects (US$2,542,766 total, of which US$930,000 from TFGWB)

22. This component will support municipalities to: (a) engage more effectively with the private sector; and (b) work across administrative boundaries to develop joint investments.

Sub-Component A. Private sector partnership support (US$2,117,234 total, of which US$930,000 from TFGWB)

23. In order to better leverage private sector engagement, this sub-component will strengthen capacity of municipalities to identify, design and implement potential modalities for private sector engagement in municipal service delivery and local economic development. Specific areas for support would range from issuing permits and other processes to structuring private sector participation in infrastructure and service delivery (contracting out, joint ventures, special purpose vehicles and build-operate-transfer agreements), as well as strategic land use planning and associated infrastructure development related to economic growth priorities. The sub-component will be particularly important in terms of supporting technical and human capacity development at the municipal level.

Sub-Component B. Joint municipal project development support (US$425,532 total)

24. This sub-component will not include any funding from the TFGWB and PID MDTF. With parallel financing, this sub-component will provide financing to participating municipalities to incentivize municipalities and LGUs to jointly prepare and implement investments. A top-up formula has been drafted by the MDLF and will be finalized contingent on funding availability from DPs for inclusion in the project's operations manual. Current draft specifies that the top-up to be provided for specific investments with a development impact beyond single municipal level (+50 percent) or innovative projects with specific environmental or social impact (+25 percent). Eligible criteria (positive and negative) will be finalized in the operations manual, and all eligible sub-projects will be identified through the SDIP process. The initial estimation of the financial needs is between 3 and 4.5 million Euros. AFD and BTC have expressed interest in funding this window, respectively for 1 million Euros and 4 million Euros.

25. ***Distribution of Municipal Population***

Population	Number of	Share of municipal
range	municipalities	Population
Below 4,000	*13*	1%

4,000 to 9,999	*63*	12%
10,000 to 19,999	*30*	11%
20,000-29,999	*17*	12%
30,000-49,999	*10*	10%
50,000-99,999	*5*	13%
100,000 -	*6*	41%
Total	*144*	100%

Source: PCBS 2016 prediction.

Component 4: Project implementation support and management costs (US$8,513,011 total, of which US$1,226,383 from TFGWB and US$2,825,532 from PID-MDTF)

26. This component will finance goods and consultants' services for monitoring and evaluation, outreach and communication and local technical consultants for the engineering supervision of Component 1 and the MDLF management fee.

ANNEX 2: IMPLEMENTATION ARRANGEMENTS

West Bank and Gaza
GZ-Third Municipal Development Project

Project Institutional and Implementation Arrangements

1. Component 1 sub-project implementation. Municipalities are responsible for implementing the infrastructure projects that are financed from their individual basic and performance-based grants allocated from the project under its component 1, called sub-projects, under the MDLF's oversight and supervision. Municipalities will identify such sub-projects through a participatory public consultation process. Procurement by the municipalities as well as contract management will follow the updated MDLF procurement manual and be overseen by the MDLF. The municipalities will also be responsible to advise the MDLF to release payments to their contractors and suppliers in accordance with the signed contracts. The usage of basic and performance-based grants for recurrent expenditure was permitted for the municipalities in Gaza Strip during the MDP 2 to reflect special circumstances and additional development challenges they faced. This practice will be adjusted under the proposed MDP 3 and the ceiling of such recurrent expenditure as well as its eligibility list will be further defined in the project's operations manual.[32]

2. For selected municipalities in the West Bank who are proven to have strong performance based on the performance assessment (ranked B++ and above) and meet safeguards and fiduciary requirements to be defined in the OM, the MDLF will cease to make direct payments to contractors and suppliers on their behalf. Instead the component 1 funds will be transferred in tranches directly to the municipal bank accounts for them to handle associated payment and reconciliation on their own. The continued disbursement from the second tranche onward, however, will be subject to the municipalities' demonstrated ability to conduct proper financial management, procurement, and supervise works by contractors to ensure satisfactory sub-project quality. The direct transfer will be financed out of the Bank contribution to the project with any other DPs who are willing to join the arrangement. This change from the MDP 2 implementation arrangements is to enhance the municipal ownership of sub-projects while reflecting municipal capacity built through the MDP 2. This practice will not be applied to municipalities in Gaza Strip in light of higher overall implementation risk than in the West Bank.

3. The MDLF will continue to serve as the proposed project's implementing agency by directly implementing components 2, 3, and 4, while retaining overall management responsibility for the component 1 sub-projects implemented by municipalities. For all municipal sub-projects, the MDLF and independently contracted Local Technical

[32] The definition of eligible recurrent expenditures will be included in the project's operations manual and the amount of such expenditure shall not exceed 20 percent of the total grant that municipalities receive under component 1.

Consultants will conduct the supervision and verification of works and fund management to be of satisfactory quality. This supervision will be further complemented by technical audits, and the release of payment to contractors will be subject to the financial and technical verification by LTCs and MDLF staff in addition to municipal request. The MDLF is an independent, semi-governmental organization, governed by a Board of Directors (the Board), which is the policy and strategy setting authority responsible for monitoring the direction and performance of the Fund. The Board Chairman is the Minister of Local Government and its nine members consist of representatives of public sector entities (State Ministry for Planning, Ministry of Finance, Ministry of Public Works and Housing, and Ministry of National Economy), civil society (Engineers Association, Banking Association, Association of Palestinian Local Authorities, Women's Association) and two mayors. MDLF is managed by the Director General and the executive administration that includes an operations manager and six specialized departments: Strategic Planning and External Relations, Technical, Financial and Administration, Institutional Building and Technical Assistance, Contract Management and Procurement, and Internal Audit.

4. The MDLF has demonstrated its capacity to administer donor-funded projects since its establishment in 2005, including the multi-donor-financed MDP 1 and MDP 2. The proposed project (MDP 3) builds on the achievements under MDP 1 and MDP 2. MDLF has administered the World Bank-financed EMSRP, the multi-donor EMSRP 2, and the LGCBP (financed by Denmark and administered by the World Bank), in addition to bilateral contributions by DPs. The MDLF is staffed with all key positions required for project implementation. Municipalities have during MDP 1 and 2 demonstrated capacity for sub-project implementation with proper no objection clauses and support from MDLF. During MDP 2 the intention was to pilot enhanced financial management to four to five municipalities, which, however, did not happen. The few municipalities that will be provided funding in their bank account for payment to contractors for sub-project implementation in the proposed MDP 3 will all be high performers at B++ and above, and meet safeguards and fiduciary requirements to be defined in the operations manual. Gaza municipalities will follow the standard approach from MDP 2.

5. Flow of funds and legal relationships. The recipient of the grant is the Palestinian Liberation Organization (PLO) for the benefit of the PA as with nearly all cases of assistance provided to the Palestinian people under the TFGWB. The PLO will make the proceeds of the grant available to the PA through a Subsidiary Agreement. An On-Granting Agreement between the PA and the MDLF will further make the proceeds of the grant available to the MDLF as the implementing agency. The Bank and the MDLF will also sign a Project Agreement. The MDLF would implement the project in accordance with the legal agreements and the OM. The Ministry of Finance and Planning (MoFP) would open the Designated Account (DA) on behalf of MDLF, under the Central Treasury Account (CTA). However, advances made to the DA would not be commingled with other resources of the PA or donors. The MDLF would be responsible for managing the account but the Ministry of Finance is responsible for requesting replenishments from the World Bank.

Development partners may have different arrangements for withdrawal applications.

Financial Management

6. The overall financial management risk for the project is assessed to be high before mitigating measures mainly due to the following factors:
   a. The political situation and the imposed access restrictions to the West Bank and especially to Gaza, may affect the physical and financial progress of the operation and the verification of actual physical progress on the ground.
   b. Risk of weak FM capacity (including accounting, reporting, internal control, budgeting, funds flow, and external audit) at municipalities that will have increased responsibilities to manage funds for their sub-projects.
   c. Risk of poor coordination of financial management issues between MDLF and municipalities.
   d. Risk of commingling project's funds with other ongoing projects and/or with other development partners' funds at the municipality level.
   e. Risk of overestimating project's cash flow projections or replenishments.

7. The following measures will be taken to mitigate FM-related risks:
   a. MDLF will hire local technical consultants to supervise works contracts, and to ensure contractors' compliance with contractual obligations. Also, project payment requests will be reviewed and approved by the local technical consultants to provide assurance that payment-related activities are in line with physical progress and for goods actually supplied and installed.
   b. MDLF will make direct payments to suppliers and contractors against original invoices for the recurrent expenditure scheme to Gaza municipalities. Also, MDLF and the local technical consultant will verify procured items under the recurrent scheme. In addition, the external auditor's scope of work will include a provision for verification and tracing payments for the recurrent expenditures to Gaza municipalities. In addition, technical audits under the project as well as MDLF's internal audit department will pay specific attention to subproject implementation in Gaza through frequent site visits and rigorous assessment of physical and financial progress of sub-projects.
   c. MDLF will open a separate general ledger in its accounting system to separately account for MDP 3 funds and expenditure incurred by window, component, development partner, and by municipality. Also, MDLF will maintain a comprehensive sub-grants allocation sheet, this sheet should include all municipalities' sub-projects linked to the funds of respective development partner. This tool would minimize the risk of commingling of project's funds with other development partners' funds.
   d. An independent external auditor, acceptable to the Bank and DPs, will be hired on a competitive basis, to perform annual external audit for the project's financial

statements. In addition, the auditor will be required to review the quarterly Interim Financial Reports (IFRs), in accordance to terms of reference acceptable to the Bank and DPs. As part of the audit process, the external auditor will also review, on a sample basis, the reports from the technical audit as well as the MDLF's internal auditor.

e. MDLF will estimate cash flow projections based on the approved annual budget and disbursement plan.

8. The financial management arrangements under MDP 2 will continue to be followed under MDP 3, except for the FM arrangements for the eligible municipalities that will pay contractors directly. The MDP 3 will be implemented by the MDLF in close partnership with municipalities. The MDLF will be responsible for the implementation of all project components.

9. There will be two types of financial management arrangements. Type 1, selected municipalities in the West Bank that are proven to have strong financial management arrangements and a sound control environment, based on the performance assessment criteria would be responsible for financial management for their sub-projects financed under component 1. Hence, MDLF will not transfer direct payments to contractors and suppliers on behalf of such municipalities and instead transfer the component 1 project funds directly to these municipalities' bank accounts for them to handle associated payment and reconciliation on their own. Type 2, for the rest of municipalities in the West Bank and Gaza under component 1, MDLF will be responsible for making payments to contractors and suppliers on their behalf. Municipalities that lack the capacity to prepare and implement sub-projects (including sub-project application, tendering documents, environmental and social impacts, safeguard policies, procurement and supervision of works) would receive assistance from LTCs. Below is a detailed description for each type of FM arrangements.

10. **Municipalities that will receive funds to their bank accounts will have increased FM responsibilities**. As part of project preparation, an assessment of the FM capacities of municipalities was carried out using a representative sample of municipalities. Based on the assessment, it was determined that while some municipalities are well capacitated in terms of their FM systems and procedures, there are still weaknesses in the FM capacities of other municipalities. The performance assessment of municipalities carried out by MDLF includes several indicators relating to FM capacity, and thus, provides a good indicator of the FM capacities of municipalities. Accordingly, municipalities with a high performance ranking will be granted greater responsibility for managing funds for their sub-projects under component 1. MDLF should verify that the municipality is eligible to receive funds based on the following criteria: (i) specified performance ranking; (ii) MoLG approval of the previous year budget of the municipality; and (iii) external auditor did not express an adverse or disclaimer audit opinion on the municipality's previous year financial statement.

11. Following are the FM arrangements required to control project funds and mitigate the risk at eligible municipalities that will receive funds to their bank accounts:
    i. A Subsidiary Agreement will be signed between MDLF and each fund receiving municipality. The Subsidiary Agreement will explicitly state such fund flow arrangements.
    ii. MDLF will open a separate general ledger in its accounting system to account for funds advanced and expenditure incurred by each selected municipality. In turn, each selected municipality will open a separate general ledger in its accounting system.
    iii. Each selected municipality will open a separate bank account to receive and disburse funds for its allocation.
    iv. Payment of direct grants to eligible municipalities will be semiannual installments for their pertinent allocation over the two-year grant cycle. Municipalities will submit evidence of eligible expenditures. Payments for the sub-grant will be against documentation of eligible expenditures. Ineligible expenditures will remain as advance to the municipalities until provision of eligible expenditures in lieu or refunding the grant account.
    v. Each municipality will submit to MDLF within 15 days of the end of each semester the following simplified Interim Unaudited Financial Reports (IFRs): (i) Statement of Cash Receipts and Expenditures, for the period and cumulatively from project inception; (ii) Statement of Designated Accounts reconciling period-opening and end balances; (iii) comparison of budget versus actual for the period and cumulatively from project inception, with justification of significant variance; (iv) cash flow projection for the coming six months; (v) physical progress reports which include narrative information and output indicators linking financial information with physical progress, and highlighting issues that require attention; (vi) fixed assets schedule; (vii) contract list; and (viii) list of grants and advances balances to municipalities in the West Bank and Gaza.

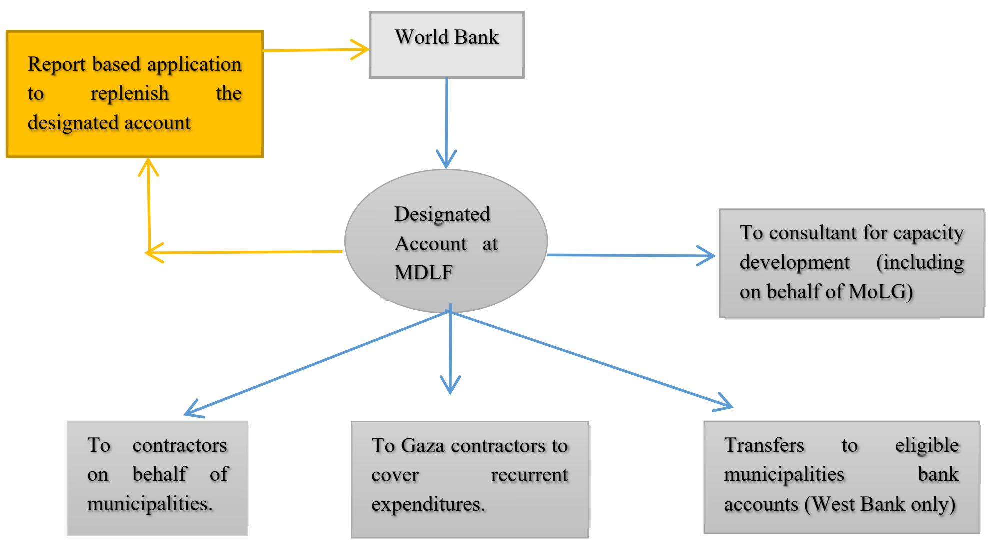
12. Recurrent expenditure scheme to Gaza municipalities. Under this scheme, no funds will be channeled to Gaza municipalities. Recurrent expenditure payments will be made by MDLF to suppliers against invoices of recurrent expenditure on behalf of Gaza municipalities, and in accordance with the MDLF's FM policies and procedures manual. The list of eligible expenditures and ceiling will be further defined in the project's operations manual. Recurrent expenditures should be verifiable, traceable, and reportable.

13. **FM arrangements for the rest of the West Bank and Gaza municipalities that will not receive funds to their bank accounts.** Funds will not be channeled to municipalities under this category, MDLF will have the sole responsibility to disburse on behalf of municipalities to contractors. Payments will be reviewed and approved by the MDLF according to MDLF's policies and procedures manual.

14. Budgeting and funds flow. In consultation with municipalities and department heads,

MDLF will maintain a consolidated project annual budget and a detailed disbursement plan. The budget will separately identify activities to be financed by individual DPs, including the World Bank, and MDLF will submit it to the DPs as part of the semiannual IFRs. The budget will reflect the detailed specifications for project activities, schedules (including procurement plan), and expenditure on semiannual project activities. The budget will also include detailed cash projections (based on six-months cash projections). The annual budget will be sent to the Bank at least two months before the beginning of the fiscal year for review and approval. Funds will be disbursed through a separate Designated Account maintained in the Euro currency for each DP; each DA will be opened by the MoFP and will be managed by the MDLF. No funds will be channeled to Gaza municipalities. There will be three fund flow arrangements under MDP 3:

I. Transfers to eligible municipalities bank accounts that will have increased FM responsibilities.
II. Transfers to consultants and contractors on against subproject contracts on behalf of municipalities.
III. Transfers to consultants for MDLF, and MoLG capacity development. The General Directorate of supervision and direction at MoLG will be in charge of implementing this capacity development activity. No funds will be transferred to MoLG, and MDLF will pay to consultants on MoLG behalf. The following chart describes the funds flow for the TFGWB and PID MDTF:



15. Accounting system and reporting. MDLF maintains an acceptable, Oracle-based, accounting system. The accounting system is not part of the country systems since MDLF

is an independent semi-government organization. Also, the accounting system is not linked with any municipality in the West Bank and Gaza. However, the accounting system is computerized, and is capable to capture project-related transactions. The accounting system is capable of tracking and reporting on the project's funds separately by window, component, development partner, and by municipality. Also, the system is capable to generate Semiannual IFRs, while the variance analysis and the Designated Account reconciliation are performed manually by means of spreadsheets. To minimize the risk of commingling of project's funds with other DPs' funds, MDLF will maintain a comprehensive sub-grants allocation sheet, this sheet should include all municipalities' sub-projects linked to the funds of respective development partner. This tool will also enable MDLF to track the financial and the physical status of each sub-project.

16. MDLF will be responsible for preparing the semiannual IFRs. Semiannual IFRs will consist of: (i) Statement of Cash Receipts and Expenditures, showing funds received from the World Bank and from all DPs separately, for the period and cumulatively from project inception, and expenditures (by category, component and subcomponent for each DP) for the period and cumulatively from project inception; (ii) Statement of Designated Accounts reconciling period-opening and end balances; (iii) comparison of budget versus actual for the period and cumulatively from project inception, with justification of significant variance; (iv) cash flow projection for the coming six months; (v) physical progress reports which include narrative information and output indicators linking financial information with physical progress, and highlighting issues that require attention; (vi) fixed assets schedule; (vii) contract list; and (viii) list of grants and advances balances to municipalities in the West Bank and Gaza. The IFRs should be submitted to the Bank not later than 45 days after the end of the reporting quarter.

17. Reporting at the municipal level. All municipalities that will receive project funds directly to their bank accounts will have to submit IFRs to MDLF within 15 days after the end of each half year, to enable the MDLF to consolidate and submit them to the Bank within 45 days of the same period. IFRs required by all municipalities include: (i) Statement of Cash Receipts and Expenditures, for the period and cumulatively from project inception, and expenditures; (ii) comparison of budget versus actual for the period and cumulatively from project inception, with justification of significant variance; (iii) cash flow projection for the coming six months; (iv) physical progress reports which include narrative information and output indicators linking financial information with physical progress, and highlighting issues that require attention; (v) fixed assets schedule; (vi) contract list. MDLF will review the IFRs to make sure that there are no ineligible expenditures incurred by the municipalities out of the project funds. If any such case of ineligible expenditures is detected, MDLF will report them to the Bank and initiate steps to recover funds from the concerned municipalities.

18. Internal audit function. The current internal audit function at MDLF is considered effective. The internal audit function follows a risk-based approach, with adequate coverage of matters of financial and compliance interest. The internal audit function can be relied upon

for this operation. The internal audit will compare financial and physical progress of sub-projects as well as assess whether payments have been made in accordance with established procedures. Specific attention will be paid to sub-project implementation in Gaza with more frequent field visits by the internal audit team.

19. Semiannual review of IFRs. Semiannual review of IFRs will be conducted by independent and qualified auditor and in accordance with international standards, according to the terms of reference (TOR) acceptable to all DPs. The cost of the review will be financed from project funds. The replenishment of the DA will be conditional upon the receipt of satisfactorily reviewed IFRs.

20. Annual external audit: The project's financial statements will be annually audited by a qualified independent auditor acceptable to the Bank, in accordance with internationally accepted auditing standards, and TOR acceptable to the Bank and DPs. Among other requirements, the auditor will be required to:
    i. Ensure that municipalities have been selected in compliance with allocation formula, and that contracts have been awarded in accordance with procedures agreed with the DPs.
    ii. Conduct field visits to the West Bank and Gaza municipalities with clear scope to verify physical progress.
    iii. Conduct field visits to eligible municipalities that will receive funds to examine sub-projects financial transaction, and to express an opinion on whether the uses of funds were in compliance with the Subsidiary Agreement, and the project FM policies and procedures manual.
    iv. The external auditor will review, on a sample basis, the reports from the technical audit as well as the MDLF's internal auditor.

21. Spot audit of municipalities' expenditures: In addition to the financial audit, the external auditor will perform spot audit of municipalities' expenditures, on sub-projects in the West Bank and Gaza, according to TORs acceptable to the Bank. The objective of this audit is to perform agreed upon procedures regarding the verification of municipalities' expenditures. Such procedures will ensure that sub-projects administered by the MDLF are being implemented, and that the related expenditures are properly supported and documented. For Gaza spot audits, the auditor will cover 100 percent municipalities, and will verify physical progress of a representative sample of sub-projects executed by each individual municipality. This sample of sub-projects will include different projects, at different sites, each year over the life of the projects.

22. The audit report and management letter will be submitted by MDLF to the DPs within six months after the end of the audit period. MDLF will be responsible for preparing the TORs for the auditor and submitting them to the Bank and DPs for clearance. The consolidated financial statements will be comprehensive and will cover all aspects of the project, including all sources of financing and not only the portion related to the World Bank. The project's audited financial statements will include: (i) Statement of Sources and Uses (by

window, by component, and showing Bank and each counterpart funds separately); (ii) Statement of Designated Account reconciling period-beginning and ending balances; and iii) Notes to the Financial Statements for the significant accounting policies and all other relevant information. Additionally, the MDLF will submit the consolidated audited financial statements for the entity as a whole. According to the World Bank Policy on Access to Information issued on July 1, 2010, the audit report with audited financial statements of the project will be made available to the public.

23. Staffing. MDLF Finance and Administration Department structure is comprised of a Finance and Administration Manager, Financial Controller, Senior Accountant, and two Accountants which allows for proper segregation of duties. MDLF's FM capacities were assessed during project preparation and were found adequate for project implementation.

Disbursement

24. Each source of funds will be disbursed through a separate segregated Designated Account (DA) maintained in Euro currency; each DA will be opened by the MoFP at National Bank (Ramallah) and will be managed by the MDLF. The proceeds of the grant will be disbursed in accordance with the Bank's disbursements guidelines as outlined in the disbursement letter and in accordance with the Bank's disbursement guidelines for projects.

25. Report-based disbursements. There will be no ceiling to the DA, the initial deposit into the DA will be based on a nine-month cash flow projection prepared by the MDLF. Subsequent disbursements into the DA will be based on the Semiannual IFRs. Similar to MDP 1 and 2 disbursement arrangements, Bank's disbursements will be transferred into the respective Designated Account based on audited (IFRs), the audited IFRs will provide actual expenditure for the preceding quarter and cash flow projections for the next six months. The IFRs together with the withdrawal application will be reviewed by the Bank's financial management specialist and approved by the task team leader before the request for disbursement is processed by the Bank's Loan Department.

26. Direct payment method. In addition, the direct payment method involving direct payments to suppliers for works, goods and services, as well as special commitments may also be used. The disbursement letter stipulates the minimum application value for direct payment and special commitment procedures.

Procurement

27. All goods, works, non-consulting services and consulting services required for the project and to be financed out of the proceeds of the grant shall be procured in accordance with the requirements set forth or referred to in the World Bank Procurement Regulations for Borrowers under Investment Project Financing dated July 1, 2016, and the provisions of the recipient's procurement plan for the project dated April 3, 2017. The project will be

carried out in accordance with the provisions of the "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated October 15, 2006 and revised in January 2011. Furthermore, the PA Public Procurement Law (PPL) No. 8 of year 2014, which applies to municipalities, entered into effect on July 1, 2016. Specific components of the national procurement system which would be acceptable for use in the project, have been identified. DPs agreed that procurement for components under parallel financing, will be implemented following the procedures outlined in MDLF Procurement Manual and the modality in place for MDP 2. The same will be outlined in their respective financing agreements with the PA/MDLF. The Procurement Manual used for MDP2, dated September 2014, will be reviewed and updated in accordance with the Bank Procurement Regulation and the PPL. It shall be prepared by MDLF and approved by the World Bank and DPs by effectiveness.

28. MDLF will continue to hold the overall responsibility for procurement following the same arrangements in place for MDP 2. More specifically, MDLF will act as the Bank's counterpart for all procurement aspects of the project. MDLF will carry out procurement for the capacity development and project management components and will provide oversight over procurement to be carried out by municipalities for the sub-projects under the components for performance grants and joint/innovative projects. Municipalities will be responsible for subproject procurement, under MDLF's supervision. Procurement shall be processed in accordance with the sub-project procurement plan and the updated MDLF Procurement Manual. Municipalities will also be responsible for contract management and for settling payments or advising MDLF on the release of payments to contractors/suppliers in accordance with the signed contracts. Few high performing municipalities (ranked B++ and above) that meet fiduciary and safeguards criteria to be defined in the OM, will receive funds from MDLF and will be responsible for settling payments directly to contractors/suppliers. MOLG will be responsible for procurement and contract management in relation to MOLG capacity development for municipal audits (US$50,000) under component 2 and for advising MDLF on the release of payments to consultants in accordance with the signed contracts.

29. An updated procurement risk and capacity assessment of MDLF and municipalities was completed by the World Bank. The assessment concluded that the enactment of the new procurement law has brought substantial improvement to the legal framework for public procurement on aspects related to efficiency, transparency, accountability and integrity, however, implementation of various provisions of the law is still work in progress. Procurement performance for MDP 2 has been satisfactory. MDLF has significant previous experience in procurement implementation under the World Bank-financed projects. Municipality procurement capacity has also improved, although at varying levels. Some municipalities still have weak procurement and contract management capacities, which could result in implementation delays, improper application of procurement procedures or use of project funds for unintended purposes. The scheduling of procurement packages under municipal infrastructure sub-projects, has often resulted in capacity challenges to local contractors. This is particularly noted in the road sector, which

represents the majority of sub-projects. The performance and quality of the outputs of local consultants hired under the capacity development component has not always been satisfactory.

30. The MDLF has established a sound control and audit system of procurement activities carried out by municipalities for infrastructure sub-projects. The system, which requires municipalities to seek MDLF's no objection prior to proceeding with key steps of the procurement process, will continue to apply for the proposed MDP 3. However, based on an assessment of municipalities' procurement capacity and past performance, more municipalities may be released from the current 100 percent prior review requirement, for smaller contracts to be procured following the shopping method.[33] Municipalities with weak procurement capacity will continue to receive technical assistance from LTCs throughout the planning and implementation of the sub-projects, including for procurement and contract management. In addition, technical compliance audits will be commissioned by MDLF, and municipalities will receive procurement and contract management training which aims at introducing them to the new legal framework for public procurement and strengthening their capacity for implementing procurement.

31. In addition to identifying potential risks and proposing appropriate mitigation measures, the assessment identified the components of the national procurement system (e.g., national standard bidding documents, single procurement portal, complaint handling mechanism, etc.) which are acceptable for use in the proposed MDP 3 procurement. The same will be reflected in an updated MDLF Procurement Manual, to be approved by the Bank and DPs by effectiveness.

32. Procurement risk is rated moderate. The methods for procurement methods outlined in MDLF Procurement Manual will continue to apply for the proposed MDP 3. The World Bank prior review thresholds for moderate risk rating projects are outlined in the table below. In addition to prior review, the Bank will carry out two implementation support missions a year, including one ex-post procurement review.

Procurement Prior Review Thresholds (US$ millions)

Type of procurement	Prior Review Threshold
Works (including turnkey, supply & installation of plant and equipment, and PPP)	15
Goods, information technology and non-consulting services	4
Consultants: firms	2
Consultants: individuals	0.4

[33] The final arrangement will be available in the procurement manual that is subject to DPs' approval

33. The project will finance goods, works and non-consulting services for municipal infrastructure sub-projects, and will finance goods and consultants' services for the capacity development components. Given their demand-driven nature, procurement packages for municipal infrastructure sub-projects may not be defined upfront. Based on the World Bank Procurement Regulations, MDLF prepared a Project Procurement Strategy for Development (PPSD). The PPSD includes: (i) the Project Overview, (ii) Operational Context, including governance, economic factors, sustainability aspects, technology factors, (iii) Market Research, and (iv) Implementation Capacity (for MDLF and municipalities). In addition, MDLF prepared a procurement plan for the first 18 months of MDP 3 implementation which includes for packages under Components 2 and 4 to be managed by MDLF (and MOLG).

Environmental and Social (including safeguards)

34. **Social, including citizen engagement.** The proposed MDP 3 will build on the advances of MDP 2 on embedding citizen engagement and social accountability into the functioning and performance incentives of municipal development. During MDP 2 significant advances were made in budget transparency and disclosure with 79 percent of municipalities disclosing their budget in cycle 1. Numerous GIZ-supported pilots advanced practices with regard to various social accountability tools (formalized in the National Social Accountability Toolkit), including "readable budgets" and participatory budgeting in selected municipalities. Advances were achieved in terms of better defining and communicating the "social compact" in the form of norms (via the creation of Citizen Service Centers and associated public information around these); citizen monitoring of municipal Strategic Development and Investment Plans were strengthened via a participatory M&E manual. Grievance redress systems were improved with a move towards computerization, which allows citizens to track their transactions/services via the web and via the CSC, and applied in many municipal services (beyond safeguards).

35. During the MDP 3 implementation, the focus will shift to deepening, scaling up and institutionalizing a number of these advances in transparency and citizen engagement, and focusing on how they contribute to improvements in municipal performance indicators. The proposed MDP 3 will also seek to strengthen the municipal-citizen relationship through all phases of the public expenditure cycle including implementation of the capital grant sub-projects. In concrete terms this will include awareness raising and community communication on respective roles and responsibilities before and during sub-project implementation; possibly integrating a participatory monitoring pilot on service quality, municipal responsiveness and citizen feedback; and increasing the availability of public information on sub-project type, budget and duration. Citizen Service Centers which provide a one-stop shop for service requests and complaints will be further scaled up under the proposed MDP 3, and complaints handling mechanisms will be scaled up as well and linked to the national Grievance Redress Mechanism of the Ministry of Local Government.

36. While under MDP 1 and MDP 2 a large number of transparency and accountability measures were piloted, under the proposed MDP 3 the emphasis will be on collecting lessons learned, focusing on defining metrics to better evaluate and monitor the quality of participatory processes, and their ability to contribute to improved municipal development indicators. Part of the shift to quality will include looking at how feedback generated (whether grievances, satisfaction surveys, or feedback from participatory planning) is integrated into municipal decision-making and management processes. Capacity development around citizen engagement and accountability activities will continue, and also bring in innovations in participatory methodologies that go beyond the traditional town meeting.

37. As with MDP 2, the project will continue its explicit focus on gender; quotas (30 percent minimum) for the inclusion of women and youth in community committees were embedded in the manual and policy notes for SDIP planning processes. Grant application forms were updated to be gender-sensitive, and specific efforts were made to ensure a gender balance in the capacity development component (with 27 of 90 participants being women) in training under MDP 2. CSCs are now able to generate gender-sensitive reports (i.e. records and statistics per gender) which can be the basis for analysis to better understand any existing gender gaps in service provision, problem identification, or response times. The new generation of SDIPs and new SDIP manual will include recommendations on strengthened community participation, including of women and youth.

38. **Social safeguards.** Under component 1, a number of infrastructure projects, including roads, sidewalks, public facilities, rehabilitation and maintenance of existing water systems (water wells, water networks, wastewater and sanitation), wastewater and electricity services not provided by utility companies will be funded as long as they do not have significant environmental and/or social impact. As a result, OP 4.12 is triggered in case any of these projects would require land, impact livelihoods or the public land used for constructing a given project is encroached or has a claim on it. A Land Acquisition and Livelihood Policy Framework (LALPF) has been prepared and disclosed in-country and the Bank's Infoshop on March 26 and April 20, 2017, respectively. The LALPF is prepared to set up the principle and criteria to be followed in case projects might need land or impact livelihoods. In summary, the LALPF will be the guide for the preparation of site-specific Land Acquisition and Livelihood Action Plans (LALAPs) when needed. Since exact sub-projects that will be funded in each municipality were not identified by appraisal, individual LALAPs could not be prepared. Moreover, the sub-projects will be primarily built in public land; however, in unlikely cases that land and other assets as well as livelihoods are impacted the LALPF will be the basis for the preparation of site-specific LALAPs, that will be prepared, consulted, and disclosed before the commencement of any civil works. The LALPF includes a check list that will be used by the MDLF and municipalities involved to determine if any of the subprojects funded under MDP 3 will require land and accordingly prepare the needed instruments. In case a sub-project will

need preparation of a LALAP, MDLF and the relevant financier will make sure that the LALAP is prepared in compliance with the LALPF. All LALAPs will be disclosed in the country and Infoshop.

39. MDLF institutional capacity for safeguards management, including compliance monitoring and reporting, is high, as the unit has acquired considerable experience through MDP-1 and MDP-2 implementation. MDLF safeguards team's responsibilities during MDP 3 will continue to include building municipal capacity for sub-project screening and construction-phase site monitoring. For those municipalities that will be assessed as having enough capacity, the responsibilities for safeguards will be transferred in phases, as it is described in the Environmental and Social Management Framework (ESMF). These municipalities also will receive training on safeguards by the MDLF. An ESMF was prepared, updating the MDP 2 ESMF, and has been disclosed in-country and at the Bank's InfoShop on March 6 and 15, 2017, respectively, with the executive summaries in English and Arabic.

40. **Environment.** As environmental and social management is considered major component for MDP project management, the MDLF Technical Department has a qualified core team who follows implementation of the environmental and social considerations stated in ESMF, provides the continuity of the understanding of the Palestinian laws and policies, as well as the policies of the World Bank and other donors; tracks municipalities' adherence to environmental and social considerations to follow up the environment indicators and social safeguards monitoring and reports on the compliance (or lack of it) with the ESMF; conducts auditing and monitoring of construction works, and provides on-the-job training in environmental management for municipalities. The team has the experience on the ground in monitoring and mitigating the anticipated environmental and social implications of the implemented sub-projects.

41. The West Bank team consists of environmental and social specialists, who report to the technical department manager and MDLF management. In Gaza, social aspects are followed by a social specialist; however, environmental management is followed by the technical department in Gaza, supported by the MDLF main office in addition to the support of LTCs, who assist the MDLF team in environmental screening.

42. Furthermore, MDLF might conduct the above mentioned task itself or hire consultancy firms to assist. These tasks are detailed in the LTC terms of reference, as part of the OM.

43. Municipalities as the project beneficiaries have proven to have the basic knowledge and willingness to implement and follow environmental and social considerations according to national and World Bank policies. The responsibility of managing environmental considerations will be assessed at the end of each cycle and transferred to eligible municipalities, with capacity development conducted for others.

44. Environmental and social monitoring will be an integral part of MDLF's managing work

in the course of the project implementation. The MDLF (Environmental and Social Officers and or LTCs) and Municipality Supervision Engineers will be responsible to ensure that contractors are familiar with ESMF and instruct workers/personnel on the compliance with the ESMF and the site-specific ESMP.

45. The concerned municipality will conduct regular on-site supervision of civil works to verify contractors' adherence to the requirements set out in ESMPs following environmental and social liabilities of MDLF Contractors. MDLF consultants or teams conduct supervisory and environmental and social monitoring visits. For environmental self-managing municipalities, municipalities will be responsible for supervising and monitoring the environmental and social management and reporting it. In this case, MDLF will post review the supervision and monitoring.

Monitoring and Evaluation

46. The project uses indicators aimed at fostering the principle of institutionally strengthened municipalities, accountable and responsive service delivery, and financially sustainable municipalities. To the extent possible, quantitative output indicators will be gender-disaggregated, including direct and indirect benefits. Data on outcome results including municipal performance rankings and MDLF annual reports will be made public. Citizen feedback on service delivery improvements and systems' transparency will also be sought and published periodically based on the results of the Local Government Performance Assessment focusing on direct beneficiaries under components 1 and 2. The survey questionnaires and baseline on public services will be reviewed to ensure a gender-sensitive approach to target groups. Such feedback will be used to trigger management decisions on adjustments and for distilling lessons learned, to enable the PA to formulate and redesign its policies and procedures towards improving the lives of citizens. PDO and intermediate indicators are presented in the results framework.

47. Arrangements for results monitoring. The MDLF will be responsible for monitoring the progress towards achievements of the PDO and intermediate indicators, and physical, financial and procurement performance of the project. MDLF will continue to use a web-based Program Management Information System as well as the Financial Management Information System (FMIS) to automate data aggregation, storage, and presentation as part of a results-based M&E system. In addition to data collection exercises carried out directly by MDLF for project reports, the Local Government Performance Assessment Surveys will also be used in order to measure achievement of the PDO. The MDLF will produce Semi-Annual and Annual Progress Reports and Quarterly Interim Financial Management Reports, to report on the achievement of the PDO and implementation progress of the project activities.

48. Results-based outcome monitoring at the MDLF: The MDLF uses a results-based M&E system, which attempts to measure the relevance, effectiveness, efficiency, impact, and sustainability of initiatives implemented by the institution. The MDLFs results-based

monitoring manual (RBMM) has aligned the individual objectives of various projects and programs with the PA's strategic objectives. The M&E arrangements proposed under the project, including the results framework and municipal ranking survey are fully consistent with the RBMM and the MDLF's M&E system. As such, no additional arrangements or staff is required for the M&E of this project.

Role of Partners (if applicable)

49. The project will be co-financed through the World Bank-administered PID-MDTF. Denmark is replenishing the PID MDTF with an amount of DKK 140 million and an amount of US$20 million would be provided from the PID MDTF to co-finance the proposed MDP 3. The Government of Denmark is expected to co-finance through PID-MDTF, while France (through AFD), Germany (through GIZ and KFW), and Switzerland (through SDC) the Netherlands (through VNG) are expected to provide financing in parallel (see table below). A critical element is the development of a PA counterpart funding modality, so PA contributions will be timely in contrast to MDP 2, where PA has not contributed as anticipated.

Table: Expected Allocations from the World Bank and Development Partners

Development Partner	Expected allocation		Comment
	US$ million	Euro million	
PA	8.4	7.9	10% counterpart
PA (carry over from MDP 2)	3.2	3	Primarily caused by exchange rate differences (Euro to US$)
WB	16	15	TFGWB
DRO	20[34]	18.8	PID MDTF
KfW	31.9	30	Parallel financing
GIZ	0.2	.02	Parallel financing
EU			Complimentary activities in area C
AFD	10.6	10	Parallel financing
SDC	4.0	3.8	Parallel financing
VNG	1.3	1.2	Parallel financing
Total	95.6	89.9	

ANNEX 3: IMPLEMENTATION SUPPORT PLAN

West Bank and Gaza
GZ-Third Municipal Development Project

Strategy and Approach for Implementation Support

1. This proposed project intends to use to the largest extent possible the ongoing Second Municipal Development Project (MDP 2) implementation mechanism through the MDLF to reinforce an integrated approach to the LG sector by the Bank. The implementation support missions will also continue to be done jointly and semi-annually with Development Partners who either co-finance or parallel-finance the MDP to minimize the donor coordination burden on the implementing agency. Considering the increased implementation risks in the project arising from funds flowing directly to some municipalities, there will be intensive supervision of the fiduciary aspects of the project by the Bank task team. The task team will pay specific attention to sub-project implementation in Gaza with frequent fiduciary supervision visits (at least once very quarter) and using local consultants when access to Gaza is constrained. In addition, robust off-site supervision will be carried out by the task team through the review of technical and financial audit reports as well as the reports of the internal audit and project supervision teams of MDLF. The task team will explore the use of social accountability techniques as part of project supervision especially in the Gaza Strip when access is constrained.

Implementation Support Plan (ISP) and Resource Requirements

2. The ISP is built around semiannual missions, monthly video conference meetings between the Bank team and counterparts, and fiduciary compliance reviewers. Support from a country-based STC or staff will also be provided throughout the proposed project cycle. An MTR will be conducted after approximately 26 months of implementation to review performance in depth, based on progress and studies commissioned for the MTR, and make any necessary adjustments to the proposed project substance and schedule.

3. The following skills mix and resource needs are estimated:

Main Focus in Terms of Support to Implementation

Time	***Focus***	***Skills Needed***	***Resource Estimate***
First twelve months	Capacity development for municipalities, MoLG, and MDLF.	Sub-project feasibility studies, municipal revenue enhancement, arrears	200,000

		management (production of reduction plan), financial management, safeguards, M&E	
Until MTR	Continued capacity development, review of analytical outputs	Same as above	180,000
MTR	MTR	Same as above	120,000
Following MTR	Continued capacity development, implementation of analytical outputs	Same as above	100,000
Total (4 years)			600,000

Skills Mix Required

Skills Needed	***Number of Staff Weeks***	***Number of Trips***	***Comments***
TTL	20	9	Ongoing implementation support to the client, twice yearly implementation support missions, additional supervision visit during the project start-up period
Municipal Finance Specialist	12	5	Two mission in FY 1, followed by yearly mission and MTR
Investment planning specialist	12	5	Two mission in FY 1, followed by yearly mission and MTR
Operational Support / M&E	40	County Office Based	Ongoing implementation support to the client, twice yearly implementation support missions
Program Assistant	16	Country Office Based	Ongoing team support
Procurement	8	Country Office Based	Twice-yearly missions and MTR
Financial Management	8	Country Office Based	Twice-yearly missions and MTR
Environmental Safeguards	8	Country Office Based	Twice-yearly missions and MTR
Social Safeguards and	10	8	Twice-yearly missions

Social Development			
Legal	1	0	Staff weeks for any restructuring
Disbursement	1	0	Staff weeks for any restructuring
Total	180		