



Policy Paper

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Establishing the Project Design Facility

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
COBP	–	country operations business plan
DMC	–	developing member country
OCR	–	ordinary capital resources
PDA	–	project design advance
PDF	–	project design facility
PPA	–	project preparation advance
PPF	–	project preparation facility
RCOBP	–	regional cooperation operations business plan
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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CONTENTS

	Page
I. INTRODUCTION	1
II. FINANCING PROJECT DESIGN WORKS	1
A. Background and Rationale	1
B. Establishing the Project Design Facility at ADB	3
III. PILOT IMPLEMENTATION	5
IV. RECOMMENDATIONS	6
 APPENDIX	
Mobilizing the Project Design Facility	7

I. INTRODUCTION

1. In 2009, the Asian Development Bank (ADB) undertook a comprehensive review of its business processes. Mandated by Strategy 2020¹ and the Asian Development Fund (ADF) X Implementation Plan,² the business process reforms aim to improve ADB's responsiveness to its clients and strengthen its results orientation.³ Based on the recommendations of the 2009 review, ADB completed comprehensive reforms that resulted in the phased implementation of the streamlined business processes from January 2010.

2. Improvements in ADB's client responsiveness, as well as its results orientation, require more than just adjustments in business processes. The 2009 review concluded that ADB also needs to expand its menu of financing instruments to address the emerging needs of its developing member countries (DMCs), including budget support, financial crisis response, additional financing, financing of regional cooperation and integration, results-based lending, and project development. Some of these have been pursued through a review or clarification of existing lending instruments,⁴ or ADB's response to the global economic crisis.⁵

3. This paper discusses the establishment of a project design facility (PDF). The PDF is partly patterned on a financing modality of the World Bank in order to harmonize ADB's approach with its development partners. The second section of the paper outlines the rationale and design of the proposed facility. The third section discusses pilot implementation of the PDF. The paper concludes with recommendations for approval by the Board of Directors.

II. FINANCING PROJECT DESIGN WORKS

A. Background and Rationale

1. Detailed Engineering Design

4. Under the current technical assistance (TA) policy, detailed engineering design is regarded as part of loan⁶ implementation work and excluded from the scope of work to be financed by TA grants. Detailed engineering design is typically financed by the construction loan and carried out after project effectiveness, causing a significant time lag between loan approval and the start of construction—1.5 years on average (Table 1).

¹ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

² ADB. 2008. *Ninth Replenishment of the Asian Development Fund and Fourth Regularized Replenishment of the Technical Assistance Special Fund*. Manila.

³ ADB. 2009. *Country Partnership Strategy: Responding to the New Aid Architecture*. Manila; and ADB. 2009. *Better and Faster Loan Delivery*. Manila.

⁴ ADB. 2009. *Program Lending Policy: Clarification*. Manila; ADB. 2010. *From Supplementary Financing to Additional Financing: Enhancing Development Effectiveness*. Manila; ADB. Forthcoming. *Review of ADB's Policy-Based Lending*. Manila.

⁵ ADB. 2009. *Enhancing ADB's Response to the Global Economic Crisis: Establishing the Countercyclical Support Facility*. Manila.

⁶ In this paper, the term "loan" or "lending" refers to both loans and ADF grants, except where otherwise specified.

Table 1: Duration of Detailed Engineering Design and Loan Implementation

Duration of DED Works (years)	Loan Implementation Period (years)	Share of DED Works Period (%)
1.5	4.9	30.6

DED = detailed engineering design.
Source: Asian Development Bank.

5. This practice also implies that ADB may make a loan commitment without a confirmed project design. Deferment of detailed engineering design financing hinders early contract award and disbursement for subsequent construction work. Thus, it has been a major cause of delays in starting projects, particularly those for infrastructure development, a core area of ADB operations under Strategy 2020 (Box). In addition, since the detailed project design is not available at the time of Board approval, the cost estimates are rough and based only on feasibility studies. This encourages the inclusion of large contingencies in project proposals, which is an inefficient use of ADB resources. In some cases, the cost estimates for a project after detailed engineering design are much larger than the original estimates. This causes further delays in project implementation as the viability of the project has to be assessed again and additional resources have to be mobilized.

Infrastructure Development and Detailed Engineering Design

Infrastructure development is designated as one of the five core areas of operations under Strategy 2020 of the Asian Development Bank (ADB). Infrastructure also supports ADB's three development agendas for the region: inclusive economic growth, environmentally sustainable growth, and regional integration. ADB's support for infrastructure development almost tripled from \$1.9 billion in 1990 to \$5.4 billion in 2009. Infrastructure's share of total sovereign lending has averaged 52% per year since 1990, while ADB financing for infrastructure has been growing at an average rate of 9% a year. The Work Program and Budget Framework, 2011–2013 envisages that infrastructure will account for 80% of ADB's sovereign operations.

One of the key elements of infrastructure development is detailed engineering design. In 2009, about \$164 million was allocated to detailed engineering design, accounting for 1.3% of the sovereign ordinary capital resources and Asian Development Fund operations. The number of projects that used detailed engineering design and the resources allocated varied significantly across regional departments—ranging from 3 to 11 in 2009. Some regional departments use the multitranche financing facility as a major instrument for infrastructure financing. In these departments, much of detailed engineering design work is undertaken using resources from the ongoing tranches. Therefore, the number of projects that include a separate cost item for detailed engineering design is small. The average amount of resources used for design in regional departments ranged from \$5.50 million to \$81.73 million, predominantly based on the size of the project. For many projects, detailed engineering designs are not needed or are financed outside of the project.

Source: Asian Development Bank.

6. ADB also offers stand-alone TA loans that allow financing of detailed engineering design before making a commitment on a construction loan. However, these have not always been effective financing instruments. TA loans can be provided to finance engineering design,⁷ but as stand-alone lending operations they are processed essentially through a separate round of the full-fledged business processes applicable to investment loans. Because of the complexity of this processing requirement, project preparatory TA loans have been used only sporadically and have not provided substantial resources for detailed engineering design (Table 2).

Table 2: Approved Technical Assistance Loans, 2004–2009

Item	2004	2005	2006	2007	2008	2009	Total
Number	3	4	3	3	3	3	19
Amount (\$ million)	23.0	39.0	18.0	36.4	33.5	17.5	167.4

Source: Asian Development Bank.

2. Experience of the World Bank

7. The World Bank has an instrument called the project preparation facility (PPF) to finance (i) preparatory activities for investment operations, including preliminary and detailed designs and limited initial implementation activities; and (ii) preparation of programs to be supported by development policy lending operations. The PPF allows quick disbursement of resources to be refinanced by the ensuing loan. It has a bank-wide pool of reimbursable resources that are to be provided as project preparation advances (PPAs) through abbreviated business processes. From time to time, the Board determines the ceilings on both the revolving commitment authority of the entire PPF and PPAs to individual projects. In turn, the World Bank's management sets indicative regional allocations within the limit of the commitment authority and adjusts them periodically, as needed. PPAs are made to individual projects at the request of potential clients, upon completion of due diligence by the project team and with the approval of the country director. PPAs are normally refinanced by ensuing loans. The regional units monitor their commitments against the indicative allocations to ensure that limits are observed.

8. Since the World Bank established the PPF with an initial commitment authority of \$5 million in 1975, it has been expanded, reaching \$290 million approved by the Board in 1996. The approval authority of individual PPAs has also been delegated to the country director for its maximum amount (up to \$5 million in the case of emergency), and reporting to the Board has been streamlined. Since the PPF is structured as a revolving fund, its benefits far exceed the size of the commitment authority. Available information on the 12-year period since FY1996 indicates that PPAs have provided steady support to the lending pipeline. By 30 June 2007, 998 PPAs had been approved for total commitments of \$811.8 million, of which about three-quarters were made on International Development Association terms and the rest on International Bank for Reconstruction and Development terms. In any given year, the number of PPAs represented 20%–30% of the number of approved projects.

B. Establishing the Project Design Facility at ADB

9. Establishment of the PDF is proposed to support project preparation, particularly detailed engineering designs, through advances to clients. These advances are to be provided

⁷ ADB. 1977. *Technical Assistance Operations*. Manila; ADB. 1986. *Technical Assistance Operations and Fund Arrangements*. Manila; ADB. 1997. *Review of the Bank's Technical Assistance Operations*. Manila.

from the ADB-wide facility and are envisaged to be refinanced by ensuing ordinary capital resources (OCR) or ADF loans. The proposed PDF is intended to provide quick-disbursing resources for project formulation, including detailed engineering design and broader project and program preparatory work (such as feasibility studies and due diligence, safeguard, and pre-implementation work), including those for policy-based lending and nonsovereign operations,⁸ if requested by the client.

10. The approval of individual project design advances (PDAs) is proposed to follow flexible processes. Following Board approval of the ADB-wide commitment authority and the ceiling on individual advances, Management will approve individual PDAs. A client's proposal for a PDA will be documented in the memorandum of understanding signed by the client or an aide-memoire confirmed by the client during an ADB mission or separately submitted to ADB. One or more PDAs may be provided for an operation, up to the ceiling set for an individual PDA.⁹

11. In assessing a DMC's request for a PDA, ADB will exercise proper due diligence with regard to (i) the soundness of the overall proposal (in terms of the purpose and proposed activities, expenditure items, safeguards, and duration of project preparation); (ii) the proposed amount of the advance and cost estimates; (iii) the proposed implementation arrangements (including procedures for procurement of goods and services); (iv) the applicable ADB resources (OCR or ADF); and (v) a suitable deadline for refinancing or repaying the PDA. The PDA agreement between the client and ADB spells out the purposes, terms (including the applicable interest period, interest reset dates, and coinciding loan service payments dates) and conditions of the PDA.

12. ADB's procurement policies and practices for loans are applicable to PDAs.¹⁰ The client may delegate PDA administration (including engagement of consultants and procurement of goods and services) to ADB on a case-by-case basis when considered appropriate to be economical and efficient, provided that the executing agency negotiates and signs the contracts for goods, services, and consulting services.

13. The project financed by the ensuing ADB loan can be cofinanced by development partners. If no ADB loan becomes effective for refinancing, for reasons including the availability of alternative financing by development partners, the PDA (with the accrued interest, as applicable to OCR or ADF loans) needs to be repaid to ADB, except in the case of ADF grants. Details on PPF mobilization for sovereign operations are in the Appendix.

⁸ While a PDA can finance project preparation of nonsovereign operations, the related credit risk should be examined rigorously by the Investment Committee. At present, the committee comprises the following: vice-president, private sector and cofinancing operations; vice-president, operations 1 or vice-president, operations 2, whoever is responsible for the geographical region of the transaction; managing director general; general counsel; director general, Private Sector Operations Department; director general, Regional and Sustainable Development Department; director general of the relevant regional department; and the head of the Office of Risk Management. The currently effective pilot period of the Sub-sovereign and Nonsovereign Public Sector Financing Facility (NSP) will expire 31 August 2011. Accordingly, the use of the PDA for NSP should be withheld at the moment and subjected to mainstreaming (or extension of the pilot period) of the NSP with Board approval. ADB. 2008. *Pilot Financing Instruments and Modalities: Extension of Pilot Period for the Sub-sovereign and Nonsovereign Public Sector Financing Facility*. Manila. The PDA does not finance actual land acquisition, resettlement, and civil works.

⁹ ADB's policy on additional financing is not applicable to subsequent PDAs. ADB. 2010. *Additional Financing: Enhancing Development Effectiveness*. Manila.

¹⁰ ADB. 2010. *Procurement Guidelines*. Manila (as amended from time to time); ADB. 2010. *Guidelines on the Use of Consultants*. Manila (as amended from time to time).

14. To ensure proper Board oversight, the indicative rolling country operations business plan (COBP) or the regional cooperation operations business plan (RCOBP) will include potential PDAs.¹¹ The Board will also be informed upon Management's approval of individual PDAs. The post-approval Board information paper should include (i) a brief description of the ensuing project, its outcome and outputs, and its economic justification, as well as whether it is likely to be financed by OCR or ADF; (ii) the activities to be financed by the PDA, and their appropriateness; (iii) the indicative refinancing date; and (iv) the procurement methods and disbursement arrangements.

III. PILOT IMPLEMENTATION

15. Establishment of the PDF with a commitment authority of \$150 million is proposed for implementation on the pilot basis in 2011–2013.¹² Management will set indicative allocations among operations departments within the overall Board-approved commitment authority, and adjust these periodically. The ceiling for an individual PDA is proposed to be set at \$5 million or 1% of the estimated cost of the ensuing OCR or ADF loan, whichever is larger. Given the short pilot period, the commitment authority is proposed to be fixed.

16. The PDF is expected to streamline the provision of resources for detailed engineering design and broader project preparation. One advantage of the PDF is its shorter processing time compared with a TA loan. The PDF also helps in providing more realistic cost estimates, obviating the need for large contingencies and relieving resource constraints for project preparation. Pilot testing will allow the Board and Management to monitor and assess the viability, relevance, effectiveness, and uptake of the PDF. The pilot implementation will be monitored with performance indicators that may include:¹³

- (i) the number and values of PDAs approved;
- (ii) the number of PDAs not resulting in an approved loan or grant;
- (iii) the time from loan approval to the awarding of the first construction contract, comparing loans with PDAs against those before the introduction of the PDF;
- (iv) contract award performance indicators of the resulting loans; and
- (v) allocation of contingency in project cost estimates.

17. Based on an evaluation of PDF implementation, the Board and Management will decide whether to mainstream this facility into ADB's business model. If the PDF becomes a permanent instrument, the introduction of a revolving funding system (as adopted in the World Bank's PPF) will be considered. Consequential and specific changes will be incorporated into ADB policies and operating procedures, as required. If PDF mainstreaming entails scaling up the commitment authority and the ceiling of an individual PDA in the future, the replacement and discontinuation of the TA loan as a stand-alone lending instrument may also be considered.

¹¹ At the request of a DMC, a PDA that was not included in the COBP or RCOBP can still be processed exceptionally. However, in such a case, information on the envisaged PDA should be reported to the Board at least 21 calendar days before Management approval of the PDA, unless it is indicated in the current year pipeline of the COBP or RCOBP circulated to the Board.

¹² Since the PDF is a pilot, the commitment authority is set conservatively on the non-revolving basis during this period. The amount of the PDF represents about one-third of the 1.3% of sovereign OCR and ADF operations envisaged for 2011–2013.

¹³ Not all of the indicators can be monitored for PDAs in the 3-year pilot implementation period. In particular, performance of the resulting loans can be assessed only when project implementation has made substantive progress. As such, indicators should be used selectively, depending on the context of individual PDAs and their ensuing projects.

IV. RECOMMENDATIONS

18. The President recommends that the Board approve the establishment of the project design facility, on a pilot basis for an initial period expiring on 31 December 2013, and:

- (i) provision of financing under the project design facility in an aggregate principal amount not exceeding \$150,000,000, in the form of project design advances, each not exceeding \$5,000,000, or 1% of the indicative amount of the ensuing financing from ordinary capital resources or Special Funds resources, whichever is higher; and
- (ii) authorization to the President, and for the President to authorize the relevant vice-presidents for operations within their respective areas of responsibility, to approve project design advances for individual projects.

MOBILIZING THE PROJECT DESIGN FACILITY

A. General Characteristics

1. The Asian Development Bank (ADB) may provide a project design advance (PDA) from the project design facility (PDF) to a borrowing country to finance preparatory activities for prospective lending operations, including preliminary and detailed designs and due diligence, safeguard, and pre-implementation work.

2. The PDA complements other ADB methods of assisting project development, such as project preparatory technical assistance (TA) grants.

3. A PDA is made only when it is highly probable that an ADB loan will be made for the operation being prepared. However, the approval of the PDA does not commit ADB to finance the ensuing project. The PDA is designed to be refinanced out of the proceeds of the loan for the ensuing project. The PDA carries standard interest on ordinary capital resources (OCR) and Asian Development Fund (ADF) loans, or is provided at the ADF grant term, depending on the borrowing status of the country. Payment of interest or service charges, where applicable, is deferred until the PDA is refinanced out of the proceeds of the loan or other repayment terms take effect.

4. One or more PDAs may be provided for an operation, up to an aggregate amount of \$5 million or 1% of the estimated cost of the ensuing OCR or ADF loan, whichever is larger. A client's request for a PDA will be documented in the memorandum of understanding or its confirmation of the aide-memoire of the ADB mission. The draft PDA agreement with the clients should be attached to the memorandum of understanding or aide-memoire. The operations vice-president concerned may approve each PDA, preferably as an integral part of project concept clearance. While ADB's procurement policies and practices for loans¹ are applicable to PDAs, the client may delegate PDA administration (including engagement of consultants and procurement of goods and services) to ADB on a case-by-case basis with a request when considered appropriate to be economical and efficient (provided that the executing agency negotiates and signs the consulting service contract). Disbursement will follow ADB's standard disbursement procedures.

B. Refinancing

5. The PDA agreement² between the country and ADB spells out the purposes, terms (including the applicable interest period, interest reset dates, and coinciding loan service payments dates), and conditions of the PDA. It also specifies a date by which the advance is to be refinanced or the repayment process initiated. The refinancing date is the expected date of effectiveness of the loan agreement to be made for the operation being prepared. After this date, no withdrawals of the advance are made, and any unwithdrawn amount of the advance is canceled. If the loan agreement has not become effective within 2 years after the date of PDA approval, ADB and the developing member country concerned may agree upon a later refinancing date.

¹ ADB. 2010. *Procurement Guidelines*. Manila (as amended from time to time); ADB. 2010. *Guidelines on the Use of Consultants*. Manila (as amended from time to time).

² PDA agreements are signed by a representative authorized for loan signing on behalf of ADB. In lieu of agreements for individual PDAs, it is possible to conclude a framework agreement with each client.

6. To refinance the PDA, an amount sufficient to cover the principal amount of the advance plus the estimated accrued interest or service charges, where applicable, is allocated in a separate disbursement category in the loan agreement providing for the ADB loan. Any excess amount remaining in this category after refinancing the PDA may be reallocated to other disbursement categories in the disbursement schedule of the loan agreement.

7. Further disbursements for continuing PDA activities that have been included as eligible for financing under the loan are made against the appropriate disbursement categories in the loan agreement.

8. If no ADB loan agreement providing for the refinancing of the PDA has become effective by the refinancing date (including any extensions), except in the case of ADF grants, the client is required to repay the PDA (together with the accrued interest, as applicable) upon notice by ADB in 10 about equal semi-annual installments over 5 years after the refinancing date. However, if the disbursed amount of the PDA is \$50,000 or less, the country is required to repay it within 60 days after ADB's notice to repay. Sanction policy and waiver suspension, if applicable, should apply for late loan service payment.

9. In the case of ADF grants, the advance is not repaid by the country.

C. Suspension and Cancellation

10. ADB may suspend disbursements of the PDA upon occurrence of any of the events of suspension specified or referred to in the PDA agreement. ADB may also request a refund of any amount of the advance that has not been used in accordance with the provisions of the PDA agreement.

11. At any time after disbursements of the PDA have been suspended, or an amount of the advance has been refunded, ADB may cancel any remaining unwithdrawn amount of the PDA.