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Enabling poor rural people
to overcome poverty

President's report

Proposed loan to the Republic of the Philippines for the

Integrated Natural Resources and Environmental Management Project

Note to Executive Board representatives

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Abbreviations and acronyms

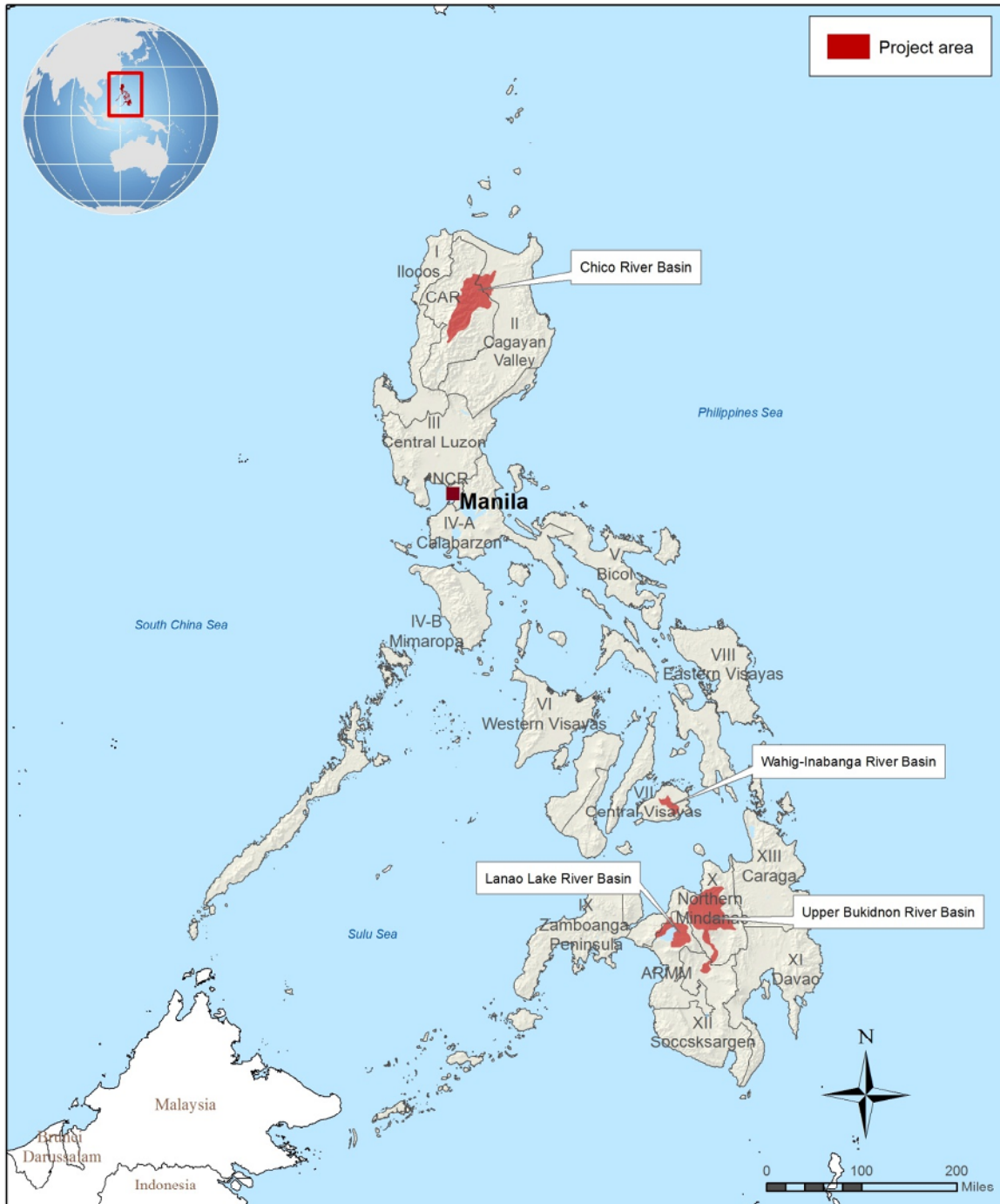
AsDB	Asian Development Bank
DENR	Department of Environment and Natural Resources
INREM	Integrated Natural Resources and Environmental Management Program
LGU	local government unit
MDFO	Municipal Development Fund Office
M&E	monitoring and evaluation
NPCO	national project coordination office
PES	payments for environmental services
REDD+	Reduced emissions from deforestation and forest degradation and conservation/enhancement of carbon stocks
URB	upper river basin
WMP	watershed management plan

Map of the project area

Philippines

Integrated Natural Resources and Environmental Management Project

President's report



29-9-2011



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD

Republic of the Philippines

Integrated Natural Resources and Environmental Management Project

Financing summary

Initiating institution:	Asian Development Bank (AsDB)
Borrower:	Republic of the Philippines
Executing agency:	Department of Environment and Natural Resources
Total project cost:	US\$148.62 million
Amount of IFAD loan:	SDR 13.25 million (equivalent to approximately US\$20.0 million)
Terms of IFAD loan:	20 years, including a grace period of 5 years, with an interest rate of one half of the reference interest rate per annum as determined by the Fund semi-annually
Cofinancier(s):	AsDB Climate Change Fund (CCF) of AsDB Global Environmental Facility (GEF)
Amount of cofinancing:	AsDB: US\$100 million CCF of AsDB: US\$1.41 million GEF: US\$2.5 million
Contribution of borrower:	US\$18.29 million
Contribution of beneficiaries:	US\$6.42 million
Appraising institution:	IFAD
Cooperating institution:	AsDB

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the Republic of the Philippines for the Integrated Natural Resources and Environmental Management Project, as contained in paragraph 30.

Proposed loan to the Republic of the Philippines for the Integrated Natural Resources and Environmental Management Project

I. Strategic context and rationale

A. Country and rural development and poverty context

1. The growth in GDP in the Philippines averaged 2.3 per cent per year between 2001 and 2010, which compares unfavourably with several high-performing Asian economies. In 2010, GNI per capita was US\$4,002. The Human Development Index (HDI) for the Philippines in 2010 was 0.638, placing the Philippines 97th among 169 countries; this represents a decline from the 1998 HDI of 0.744, making clear that development efforts over those 12 years had been unable to improve the human development status of the country. The country's Gender Development Index decreased from 0.768 in 2005 to 0.742 in 2008. Similarly, the Gender Empowerment Measure fell from 0.590 in 2005 to 0.560 in 2008. The share of the agriculture sector in the real GDP fell from 23.0 per cent to 18.6 per cent during the 1986-2006 period. The share of the forestry subsector declined from 1.7 per cent to 0.1 per cent during the same period, indicating rapid deforestation. Although agriculture performed poorly in relative terms in the 1980s and 1990s, growth of the sector in absolute terms improved during 2001-2006, averaging about 3.7 per cent per year.
2. The national poverty incidence decreased slightly over the 2006-2009 period (from 21.1 per cent to 20.9 per cent), but because of population growth, the number of poor households rose from 3.67 million to 3.86 million. Poverty in the Philippines is mainly a rural phenomenon, with almost three out of every four poor people living in rural areas. The rural poverty rate is 48.8 per cent, far higher than the urban rate of 18.6 per cent. The main causal factors include: (i) distortionary policies limiting farm and economic diversification; (ii) inadequate provision of public goods and the biased nature of public expenditure in rural areas; (iii) limited access to productive resources including land and credit; (iv) unsustainable natural resource management; and (v) poor alignment of the institutional framework with the demands of the agriculture sector. The poverty situation is even worse among the upland communities and particularly those living in upper river basins (URBs), including the URBs to be targeted by the project. Poverty incidence within the selected project sites ranges from 35.8 per cent in the Chico River Basin to 48.3 per cent in the Wahig-Inabanga River Basin, compared with a national average of 20.9 per cent (2009).
3. Indigenous peoples groups and other ethnic minorities constitute around 74 per cent of the population living in headwater regions. Limited access to social services and markets most strongly reinforces poverty conditions in the extremely rural URBs. Siltation of rivers and lake systems in the URBs has contributed to the shortening of reservoir lifespans by as much as 30 per cent in service areas, resulting in loss of dry season water supply and increased operating costs in the electric utility and water sectors. Associated losses in power output are estimated at over 50 per cent in the Lake Lanao and Upper Bukidnon River Basins. Siltation of coral reefs and destruction of mangroves has also reduced artisanal fish catches, a

key source of income and protein for poor coastal communities and the basis for support of the tourism sector.

4. Increased soil and nutrient loss is adversely impacting natural resource productivity in the URBs. The seasonality of production, with low cropping intensities and low levels of diversification, has led to high unemployment rates, estimated at 7.1 per cent in 2010. Underemployment stood at 18.5 per cent in 2010 for the poor, with off-farm and non-farm employment insufficient to absorb excess agricultural labour.

B. Rationale and alignment with government priorities and RB-COSOP

5. The rationale for IFAD's financing of the project is twofold. First, the project will address the major constraints in natural resource management in the priority URBs, contributing directly to increased agricultural productivity and rural poverty reduction. URB watersheds comprise an estimated 45 per cent of the country's total land area and are home to one in four Filipinos, including indigenous communities. Second, natural resources in URBs are the primary source for domestic energy and the local production base. Moreover, the forest ecosystems play a critical role in economic development by regulating water quantity and quality for sustaining national irrigation systems, hydropower generation and domestic water supplies, maintaining and restoring biodiversity and mitigating climate change through carbon sequestration.
6. The project reinforces the strategic priorities of the Philippine Development Plan 2011-2016 and the Department of Environment and Natural Resources (DENR) Framework Plan for Environment and Natural Resource Management. It fully supports the Government's poverty reduction, watershed management, biodiversity conservation and climate change policy objectives. The project design and scope is directly aligned with the Philippine Development Plan's core goal for the environment and natural resource sector, namely improved conservation, protection and rehabilitation of natural resources. The project will adopt integrated ecosystem management as a strategy for (i) sustainable resource utilization in critical watersheds; (ii) sustainable management of forest lands and ancestral domains for enhanced carbon stock and reduced greenhouse gas emission; and (iii) adaptation to different climate change scenarios. The project supports current institutional programmes and policy directions, including (i) the National Convergence Initiative between the Department of Agriculture, the Department of Agrarian Reform and DENR to integrate and strengthen the development framework for sustainable rural development; (ii) the moratorium on cutting and harvesting timber in natural and residual forests; (iii) the National Greening Program, which aims at consolidating and harmonizing all government, civil society and private-sector greening efforts and initiatives; and (iv) the Government's reorganization of the Cabinet including setting up the Climate Change Adaptation and Mitigation Cluster to focus on the conservation and protection of the environment and natural resources.
7. The project will contribute to IFAD's Results-based Country Strategic Opportunities Programme (RB-COSOP) for the Philippines, 2010-2015, by empowering upland poor women and men to achieve higher incomes and improved food security through enhanced access to and sustainable control and use of land and water resources for environmentally sustainable endeavours, and through access to essential socio-economic public infrastructure. Linkages will be built with the Department of Agriculture under the Second Cordillera Highland Agricultural Resource Management Project. Lessons learned in the ongoing and previous projects have been incorporated in the design.

II. Project description

A. Project area and target group

8. The project will address unsustainable watershed management in the following four priority river basins, selected on the basis of their biophysical condition, socioeconomic and conservation values, and state of degradation: (i) the Chico River Basin in the Cordillera Administrative Region; (ii) the Wahig-Inabanga River Basin on Bohol Island; (iii) the Lake Lanao River Basin in the Autonomous Region of Muslim Mindanao; and (iv) the Upper Bukidnon River Basin in Bukidnon. The project will target 23 watersheds in nine provinces, covering over 1.13 million hectares with an estimated population of around 2.7 million. It will benefit approximately 220,000 people, the majority from vulnerable and marginalized sectors. The project will have a particular focus on indigenous peoples and resource-poor communities. To ensure that the concerns of vulnerable sectors are addressed and benefits equitably distributed, the project has prepared: (i) a consolidated consultation and participation plan; (ii) a resettlement framework; (iii) an indigenous peoples planning framework; and (iv) a gender action plan to empower women in terms of participation and decision-making on natural resource management and to improve their access to services.

B. Project development objective

9. The project's objective is improved condition of watersheds in the four targeted URBs thereby generating livelihood benefits. The expected outcome is increased rural household incomes and local government unit (LGU) revenues in the selected watersheds. The project will reduce degradation of watersheds and associated environmental services caused by forest denudation and unsustainable farming practices. It will provide incentives to LGUs and the DENR by generating sufficient and tangible economic benefits. Mechanisms to achieve these project objectives include: (i) payments for water regulation, soil conservation, carbon offsets and biodiversity; (ii) income-generation from sustainable use/management and value-added processing of timber and non-timber forest products; (iii) improved natural resource productivity; and (iv) improved climate resilience in the targeted watersheds.

C. Components/outcomes

10. The project has four components grouped around the following four outputs:
- (a) **Output 1: River basin/watershed management and investment plans developed to place 1.13 million hectares under improved management.** Indicative development plans (IDPs) will be drawn up by regional and provincial DENR offices in coordination with relevant national agencies and LGUs for the four URBs for adoption by Regional Development Councils and/or Provincial Legislative Councils. Based on land-capability assessments that identify appropriate management zones, the IDPs will combine science-based land management regimes with local indigenous knowledge and practices. Watershed management plans (WMPs) will be prepared for the selected watersheds based on the IDPs. WMPs will define and prioritize subprojects and establish a work programme for implementation by LGU clusters and Municipal Development Councils. WMPs will take account of existing tenurial arrangements and treat ancestral domains as management sub-units.
 - (b) **Output 2: Smallholder and institutional investments increased in conservation and economic productivity enhancement in the forestry, agriculture and rural development sectors.** Subproject investments will be undertaken within the target watersheds based on outputs from output 1. Interventions for watershed restoration and rehabilitation, covering over 325,590 hectares, will be implemented by DENR. They will include community-based protection, reforestation and/or assisted natural regeneration, and

- production forestry including agroforestry and conservation farming demonstrations. Livelihood enhancement investments will be undertaken by LGUs and will include: (i) 645 kilometers of rural access roads and foot trails; (ii) communal irrigation systems servicing 3,040 hectares; (iii) 275 units of potable community water facilities; (iv) a provincial trading/processing centre supporting farming communities; and (v) seed funds for replication/expansion of tested and mature farming technologies.
- (c) **Output 3: River basin and watershed management capacity and related governance mechanisms strengthened.** Working with relevant institutions, the project will train LGU/local community organizations on land-use assessments and watershed management/planning, and provide support for technical extension and information communication services, watershed monitoring, and rural infrastructure maintenance.
- (d) **Output 4: Project management and support services delivered.** The project will support the establishment of a national project coordination office (NPCO) at DENR, which will coordinate (i) consultant recruitment and supervision; (ii) procurement of materials, equipment and vehicles for project implementation; and (iii) resource mobilization for capacity-building of DENR's regional and provincial units and LGUs. A geographical information system-based database will be established for appraisal and monitoring of project performance.
11. **The Climate Change Fund of the Asian Development Bank (AsDB) and the Global Environmental Facility Fund** will mainstream climate change mitigation through investments for: (i) establishing smallholder-based biomass energy forest demonstration plots in Bukidnon with private-equity contributions; (ii) establishing and verifying Reduced Emissions from Deforestation and Forest Degradation and Conservation/Enhancement of Carbon Stocks (REDD+) through demonstration activities; and (iii) implementing appropriate climate-change adaptation measures in upland production systems. Biodiversity conservation will be mainstreamed in watersheds through application of a community-based biodiversity corridor approach for conserving the remaining mossy forest stands in the Chico-Agno-Magat River Basins tri-boundary headwaters area of the Cordillera. In addition, payments for ecosystem agreements will be developed between indigenous peoples' organizations (IPOs) and downstream ecosystem-service beneficiaries, initially in the tri-boundary area between three IPOs and the National Power Corporation. Seed capital will be provided to establish revolving funds. Options for bundling payments for environmental services (PES) with carbon credits will be explored.

III. Project implementation

A. Approach

12. Within each of the URBs, a gradual approach will be taken to work from one watershed to the next until all the URBs are covered. Four out of the twenty-three sample watersheds (one per URB) have been selected as representative subprojects in an initial phase, namely Bauko in the Chico River Basin, Wahig-Pamaksalan in Wahig-Inabanga, Manupali-Kitanglad in the Upper Bukidnon River Basin and Bubong in the Lake Lanao River Basin. The four sites encompass the diversity concerns of DENR's Integrated Natural Resources and Environmental Management Program (INREM), ensuring that development investments can be replicated nationwide. At the end of the initial phase before the expansion to additional watersheds, a thorough review will be undertaken based on agreed trigger indicators and review criteria. The project approach also includes: (i) devolving specified environmental and natural resources management functions and responsibilities to local governments; (ii) promoting recognition of indigenous peoples' rights to their ancestral domains and the adoption of community-based forest management as the main strategy for sustainable forest management; and

(iii) strengthening the capacity of regional DENR offices, LGUs and local communities in natural resource management. Project interventions will support results-based management through DENR's organizational performance indicator framework for improved service delivery. The project will be implemented over a period of seven years to allow for the longer commitment recommended for natural resource management projects. Some 73.5 per cent of estimated household beneficiaries are indigenous peoples/ethnic minorities. An indigenous peoples' planning framework has been prepared through comprehensive participatory consultations and endorsed by the Government. Ethnic minorities such as the Maranaos of Muslim Mindanao were consulted, and participation/benefit-sharing arrangements are in line with the specific provincial and municipal LGU structures and the Autonomous Region of Muslim Mindanao's Organic Act.

B. Organizational framework

13. DENR will be the lead project agency assuming full responsibility for project supervision, coordination, administration and management. The NPCO in DENR will oversee project implementation. An interagency national project steering committee will provide policy guidance. At the regional level, the DENR regional offices, through the Regional Project Coordinating Offices, the Provincial Project Management Offices (PPMO) in each of the participating provinces and Watershed Management and Project Coordination Offices at host municipalities will provide support to project implementation. The Municipal Development Fund Office (MDFO) in each municipality will manage the project funds for infrastructure investment to be implemented by the LGUs. Project-specific policy guidance and coordination will be provided by the existing regional development councils. Similar structures will be organized at provincial and municipal levels to coordinate project implementation. DENR will execute a memorandum of agreement with LGUs and other implementing partners for project implementation. Private- and public-sector partners, NGOs and community organizations will be contracted to implement individual activities.

C. Planning, monitoring and evaluation, and learning and knowledge management

14. An annual participatory planning and budgeting exercise will be undertaken from the village, municipal and provincial levels to the regional to national levels. The project will provide technical assistance to design a results-based participatory monitoring and evaluation (M&E) system and a management information system, with support of geographic information system (GIS), for database management. Training will be provided to DENR project staff at national, regional, provincial and municipal levels to operate the system. Lessons learned from other ongoing projects will be integrated to strengthen the system. The M&E system will consist of quarterly and annual reports from the M&E units of the regional, provincial and municipal levels and implementing partners. The NPCO will consolidate monitoring data analysis for the overall project. Indicators will include input, output, outcome and impact indicators in social, environmental and economic dimensions as provided in the project's Design and Monitoring Framework. A baseline survey, to be carried out in the four URBs at the start of the project, will include the baseline status of demographic, socio-economic, environmental, natural resources and GIS-based land-use information. Performance and benefit monitoring will be undertaken annually from the end of the second project year (PY) through an independent contracted organization. An independent institution will monitor social and environmental compliance and the magnitude and quality of environmental services developed by the project. Semi-annual project reviews and a full review of project performance by the end of PY4 will be undertaken. The M&E unit will undertake an impact assessment before closing the project in PY7. Project knowledge will be generated through the project's M&E system to identify lessons from project implementation and for its strategic planning, and to compile case studies or other documentation on special project features. The project will prepare

semi-annual and annual progress reports summarizing accomplishments, problems encountered and solutions applied and recommending future directions.

D. Financial management, procurement and governance

15. There will be two designated accounts for the IFAD loan, one for the MDFO to finance rehabilitation and improvement of rural infrastructure in Bukidnon only and one for DENR to finance agroforestry, URB forest conservation and protection, sustainable forest management, livelihood activities (in Bukidnon only), land use planning, capacity building, and project management. The additional conditions precedent to withdrawal are as follows: (a) the AsDB Financing Agreement has become effective; and (b) the GEF Grant Agreement has become effective. The proceeds of the IFAD loan will be released to the Department of Budget Management through the Bureau of Treasury for disbursement to: (i) DENR, through budgetary allocations to finance agroforestry, URB forest conservation and protection, sustainable forest management, livelihood activities, land-use planning, capacity-building and project management; and (ii) the MDFO, to finance rehabilitation and improvement of rural infrastructure. Based on memorandums of agreement, the DENR Central Office will transfer the project funds through sub-allotments to the DENR field offices and other implementing agencies to implement the activities under their responsibility. DENR will account for all project funds. The NPCO will ensure that all accounts at the Central Office, field offices and the MDFO are consolidated and audited by the Commission on Audit or other auditors acceptable to AsDB. DENR, as the lead agency, will submit consolidated financial statements to IFAD on a semi-annual basis and ensure that the consolidated accounts are audited on an annual basis by the Commission of Audit or another auditor acceptable to AsDB. Land-use assessment planning, zoning, delineation and demarcation will be conducted under the direct supervision of DENR through consultative processes using DENR guidelines. Consistent with the commitment to good governance, accountability and transparency, a zero-tolerance policy will be applied, whereby a range of sanctions will be enforced, in accordance with the provisions of applicable rules and regulations and legal instruments.
16. The IFAD financing will be administered by AsDB as the cooperating institution. In line with the harmonization principles embodied in the Paris Declaration on Aid Effectiveness, the project will follow AsDB's policies and procedures for implementation reporting and information, auditing, procurement, financial reporting and information, and anticorruption. Relevant provisions will be incorporated in the financing agreement to reflect this.

E. Supervision

17. AsDB, IFAD and the Government will jointly supervise the project at least twice a year. Project supervision during the first 12-18 months will focus on ensuring that there are no delays in project start-up and will address any bottlenecks that may occur. The key aspects of supervision will include reviews of project implementation progress, outputs and outcomes by component, sustainability and fiduciary management. In PY4, AsDB, IFAD and the Government will conduct a midterm review to assess progress, examine the continued validity of design assumptions, and identify the need for any adjustments in project design and in implementation arrangements

IV. Project costs, financing, benefits

A. Project costs

18. The total estimated project cost is US\$148.6 million, including contingencies, taxes and duties. The base cost is US\$138.55 million, with physical and price contingencies accounting for 2 per cent and taxes for 4 per cent. The investment plan by component is summarized in table 1.

B. Project financing

19. The financing plan by component and sources of financing is set out in table 2. The sources of financing are AsDB (67.3 per cent); IFAD (13.5 per cent); the Government and LGUs (12.3 per cent); the Global Environmental Facility (1.7 per cent); AsDB's Climate Change Fund (0.9 per cent); and beneficiaries (4.3 per cent). The IFAD loan will be used to finance the following eligible expenditures: (i) civil works in the Bukidnon Upper River Basin only; (ii) equipment in Northern Mindanao (Region X) only; (iii) vehicles in Region X only; (iv) conservation forestry in the Bukidnon Upper River Basin only, including forest protection and monitoring (block grant) and forest establishment and maintenance costs; (v) livelihood inputs in the Bukidnon Upper River Basin only; (vi) individual local consultants to be selected to work as contracted staff for the project management offices at national, regional and provincial levels; (vii) capacity-building in Region X only; and (viii) incremental operating costs in Region X only. The IFAD loan will not finance sustainable forest management, agroforestry and commercial forest plantation under output 2 of the project. The IFAD loan will be on intermediate terms and conditions.

Table 1
Project investment plan
 (Thousands of United States dollars)

	<i>Local</i>	<i>Foreign</i>	<i>Total</i>	<i>% Foreign Exchange</i>	<i>% Total Base Costs</i>
A. River basin and watershed management plans	9 769	1 948	11 717	17	8
B. Smallholder/commercial/institutional investments					
1. Conservation, rehabilitation and protection of URB state forests	42 631	-	42 631	-	31
2. Sustainable forest management, agroforestry and commercial forest plantations with community participation	19 984	609	20 594	3	15
3. Rehabilitation and improvement of rural infrastructure	30 550	11 289	41 839	27	30
4. Conservation farming and livelihood support	9 382	487	9 868	5	7
5. Investment in watershed management	873	43	916	5	1
Subtotal	103 421	12 428	115 848	11	84
C. Enhanced capacity for river basin and watershed management	2 036	72	2 108	3	2
D. Project management support	8 082	795	8 876	9	6
Total baseline costs	123 307	15 242	138 549	11	100
Physical contingencies	1 136	85	1 222	7	1
Price contingencies	1 439	260	1 699	15	1
Total project costs	125 882	15 588	141 469	11	102
Interest during implementation (AsDB loan)	-	6 518	6 518	100	5
Commitment charges (AsDB loan)	-	632	632	100	-
Total costs to be financed	125 882	22 738	148 620	15	107

Table 2
Financing plan
 (Thousands of United States dollars)

	GOP		AsDB		IFAD		GEF		CCF		LGUs		Beneficiaries		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%			
A. River basin and watershed management plans	1 456	12.0	7 598	62.6	1 320	10.9	1 487	12.3	274	2.3	-	-	-	-	12 136	8.2	2 005	8 675	1 456
B. Smallholder/commercial/institutional investments																			
1. Conservation, rehabilitation and protection of URB state forests	-	-	37 232	86.9	5 306	12.4	-	-	326	0.8	-	-	-	-	42 863	28.8	-	42 863	-
2. Sustainable forest management, agroforestry and commercial forest plantation with community participation	30	0.1	14 475	69.0	-	-	-	-	267	1.3	-	-	6 203	29.6	20 974	14.1	620	20 324	30
3. Rehabilitation and improvement of rural infrastructure	3 698	8.7	25 794	60.6	4 812	11.3	-	-	-	-	8 067	18.9	223	0.5	42 595	28.7	11 508	26 469	4 617
4. Conservation farming and livelihood support	1 124	10.8	2 925	28.2	6 322	61.0	-	-	-	-	-	-	-	-	10 371	7.0	512	8 735	1 124
5. Investment in watershed management	47	5.1	-	-	-	-	530	57.3	347	37.6	-	-	-	-	924	0.6	43	834	47
Subtotal	4 899	4.2	80 427	68.3	16 439	14.0	530	0.4	940	0.8	8 067	6.9	6 426	5.5	117 727	79.2	12 683	99 226	5 818
C. Enhanced capacity for river basin and watershed management	263	12.0	730	33.4	663	30.3	336	15.4	196	9.0	-	-	-	-	2 188	1.5	74	1 851	263
D. Project management support	2 218	23.6	4 094	43.5	1 579	16.8	147	1.6	-	-	1 380	14.6	-	-	9 419	6.3	825	7 604	989
Total project costs	8 836	6.2	92 850	65.6	20 000	14.1	2 500	1.8	1 410	1.0	9 447	6.7	6 426	4.5	141 469	95.2	15 588	117 356	8 526
Interest during implementation	-	-	6 518	100.0	-	-	-	-	-	-	-	-	-	-	6 518	4.4	-	-	-
Commitment charges	-	-	632	100.0	-	-	-	-	-	-	-	-	-	-	632	0.4	-	-	-
Total disbursement	8 836	5.9	100 000	67.3	20 000	13.5	2 500	1.7	1 410	0.9	9 447	6.4	6 426	4.3	148 620	100.0	15 588	117 356	8 526

C. Summary benefit and economic analysis

20. The expected benefits and resources to be mobilized from PES, sustainable forestry and agriculture will strengthen decentralized governance mechanisms and facilitate a stable and long-term policy framework to address ad hoc decision-making. Project beneficiaries – including local-level stakeholders, public utilities and their customers, river basin stakeholders and the regional community – will benefit from increased incomes generated from the provision of rural infrastructure, sustainable forestry and agricultural activities and extension services initiated and supported by the project. The project is expected to yield substantial benefits: (i) incremental benefits from increased crop yields and productivity through investment in improved rural accessibility and irrigation, extension services, sustainable forestry and agricultural diversification activities; (ii) incremental employment creation estimated at 8 million person days of wage-generating opportunities for households and local communities from proposed investments; (iii) households benefiting from safe drinking water, hence avoiding water-related diseases and significant health care costs; (iv) improved water quality within URBs at reduced operating and delivery costs, significantly benefiting public utilities, household enterprises, small- and medium-sized enterprises and downstream farmers; (v) increased economic activity, improved service delivery and greater security from the adverse impacts of climate change and natural disasters benefiting the population within URBs and 81 LGUs, the majority of which are categorized as low-income class municipalities; (vi) reduced carbon dioxide and better protection and conservation of biodiversity benefiting the population in all URBs and LGUs and to a certain extent the global community; (vii) ecosystem services such as climate regulation, watershed protection, water quality regulation, soil erosion prevention and nutrition retention realized by improved forest ecosystems in the four URBs; and (viii) avoided loss of forest cover, critical in the URBs servicing downstream infrastructure. The economic analysis of five sample investments¹ in the four sample watersheds indicates that base case economic internal rates of return range between 18.0 per

¹ Including (i) small-scale communal irrigation systems rehabilitation and improvement; (ii) rural access roads rehabilitation and improvement; (iii) communal drinking water supply; (iv) agroforestry; and (v) plantation forestry.

cent and 43.0 per cent, demonstrating the viability of the packaged subproject investments. Benefits generated from productive investments are sufficient to sustain the investments of those not generating readily quantifiable revenue streams.

D. Sustainability

21. The proposed measures to address deficiencies in capabilities in project implementation and environment and natural resource management will help ensure the sustainability and benefits of project activities beyond the life of the project. Technical assistance will be provided for rural infrastructure and will focus on strengthening LGUs' capacities in planning, and operation and maintenance. Project interventions in the form of policy recommendations, especially with regard to harvesting of forest products, improved infrastructure and capacity of local institutions are expected to provide sufficient stimulus for the private sector to invest and carry on activities with their own financing. The PES scheme is assumed to be the key to the sustainability of project interventions in the LGUs, with a performance-based grant system designed to ensure sustainability of the governance of the environment and natural resources and fiscal reforms.

E. Risk identification and mitigation

22. Major risks and mitigating measures are summarized in table 3.

Table 3

Summary of risks and mitigating measures

<i>Risks</i>	<i>Mitigating Measures</i>
<p>Policy and institutional framework. Delays in:</p> <p>(i) Government's enabling policy adjustments;</p> <p>(ii) approval of watershed management plans (WMPs)</p> <p>Project level. (i) Relatively weak fiduciary and procurement capacities of DENR, MDFO and LGUs;</p> <p>(ii) dwindling counterpart funding commitments;</p> <p>(iii) revenue streams from REDD and local PES mechanisms not realized.</p>	<p>(i) Participating LGUs approve and adopt indicative development plans for watersheds within their jurisdiction; and (ii) social marketing and multistakeholder consultations during pre-implementation enable clarification of roles and approval of WMPs by relevant agencies.</p> <p>(i) Advance contracting, including tailor-made training packages on financial management, disbursement and procurement; (ii) dedicated project staff to be assigned for financial management, project/contract administration at DENR; (iii) consultant support in MDFO to assist with processing LGU submissions; municipal resolutions to be secured to serve as binding agreements on counterpart commitments; revolving funds to be established to provide seed capital; and local ordinances supporting PES to be instituted.</p>

V. Corporate considerations

A. Compliance with IFAD policies

23. The project design is aligned with the IFAD Strategic Framework 2011-2015 and complies with relevant IFAD strategies and policies, particularly IFAD's Climate Change Strategy, its Policy on Targeting, its Policy on Engagement with Indigenous Peoples, and its Policy on Gender Equality and Women's Empowerment.

B. Alignment and harmonization

24. The project's objectives are aligned with the Philippine Development Plan, the Government's Sustainable Forest Management Bill, the National Land Use Bill, the Agriculture and Environment and Natural Resources Sector Road Map for the Philippines, and the National Convergence Initiative. The project has been harmonized with the initiatives of other development partners through the government Cabinet clusters and the Philippine Harmonization Committee. The project will use the Harmonized Philippine Bidding Documents as required by the Government Procurement Policy Board and use an independent procurement evaluator to assess transparency of the bidding process and contracting for major rural infrastructure investments.

C. Innovations and scaling up

25. The project's innovative features include: phased implementation; high levels of stakeholder participation; emphasis on PES; support for upland poor households and indigenous peoples; and implementation of a gender action plan. The project also represents a scaling up of lessons learned in the Philippines on natural resource management over the last 20 years.

D. Policy engagement

26. DENR as the Lead Project Agency will undertake the following specific policy-related work under the project: (i) review the Guidelines on the Continuing/Phased Devolution of Environment and Natural Resources Functions to LGUs to prepare a roadmap towards fully attaining policy objectives of the Local Government Code and the INREM approach with respect to river basins, watersheds, environment and natural resources management; (ii) assess and update the Philippines Master Plan for Forestry Development and promulgate administrative measures to effectively implement the plan; and (iii) prepare a draft Philippine sustainable forest management act for consideration by the Philippine Congress. The project will raise other policy issues and concerns for consideration by respective oversight agencies through the national project steering committee to influence policies that relate to natural resources and environmental management. It is expected that the project will undertake additional policy-related studies during implementation.

VI. Legal instruments and authority

27. A financing agreement between the Republic of the Philippines and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached as an annex.
28. The Republic of the Philippines is empowered under its laws to receive financing from IFAD.
29. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Lending Policies and Criteria.

VII. Recommendation

30. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall provide a loan on intermediate terms to the Republic of the Philippines in an amount equivalent to thirteen million two hundred and fifty thousand special drawing rights (SDR 13,250,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement

LOAN NO.

FINANCING AGREEMENT

Integrated Natural Resources and Environmental Management Project
(INREMP)

between the

REPUBLIC OF THE PHILIPPINES

and the

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Signed in

on

FINANCING AGREEMENT

Loan Number:

Project Title: Integrated Natural Resources and Environmental Management Project
(the "Project")

The Republic of the Philippines (the "Borrower")

and

The International Fund for Agricultural Development (the "Fund" or "IFAD")

(each a "Party" and both of them collectively the "Parties")

hereby agree as follows:

WHEREAS, the Borrower and the Asian Development Bank ("ADB") expect to enter into a Financing Agreement (the "ADB Financing Agreement") to provide financing in the amount of one hundred million United States Dollars for the Project;

WHEREAS, the Borrower and the ADB expect to enter into a Grant Agreement (the "GEF Grant Agreement") to provide financing in the amount of two million five hundred thousand United States Dollars for the Project from the Global Environmental Facility; and

WHEREAS, the Fund has agreed to provide financing for the Project.

Section A

1. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1), the Allocation Table (Schedule 2), and the Special Covenants (Schedule 3).
2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended from time to time (the "General Conditions") are annexed to this Agreement, and all provisions thereof shall apply to this Agreement, except for the provisions identified in Section E paragraph 4 below. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein.
3. The Fund shall provide a Loan to the Borrower (the "Financing"), which the Borrower shall use to implement the Project in accordance with the terms and conditions of this Agreement.

Section B

1. The amount of the Loan is Thirteen Million Two Hundred and Fifty Thousand Special Drawing Rights (SDR 13 250 000).
2. The Loan is granted on intermediate terms.
3. The Loan Service Payment Currency shall be the United States Dollar.
4. The first day of the applicable Fiscal Year shall be January 1.

5. Payments of principal and interest shall be payable on each 1 May and 1 November.

6. There shall be two Designated Accounts in United States Dollars in a Bank acceptable to IFAD for the benefit of each of the Municipal Development Fund Office (MDFO) to finance rehabilitation and improvement of rural infrastructure under the Project in Bukidnon only and the Lead Project Agency to finance agro forestry, Upper River Basin (URB) forest conservation and protection, livelihood activities (in Bukidnon only), land use planning, capacity building, and Project management.

Section C

1. The Lead Project Agency shall be the Department of Environment and Natural Resources (DENR).

2. The following are designated as additional Project Parties: Department of Agriculture (DA); Participating Local Government Units (LGUs); and MDFO.

3. The Project Completion Date shall be 30 June 2020 and the Financing Closing Date shall be 31 December 2020, or such later date as the Fund may designate by notice to the Borrower.

Section D

The Financing shall be administered and the Project supervised by the ADB as the Cooperating Institution.

Section E

1. The following are designated as additional grounds for suspension of the right of the Borrower to request withdrawals from the Loan Account: (i) the ADB Financing Agreement shall have become liable for suspension and/or shall have become repayable prior to its agreed maturity date.

2. The following is designated as an additional ground for cancellation of this Agreement: (i) the ADB Financing Agreement shall have been cancelled.

3. The following are designated as additional conditions precedent to withdrawal:

- (a) The ADB Financing Agreement has become effective; and
- (b) The GEF Grant Agreement has become effective.

4. The following provisions of the General Conditions shall not apply to this Agreement:

- (a) Section 7.01 (b) (ii) and Article VIII (Implementation Reporting and Information): the Borrower shall monitor and evaluate the progress of the Project and prepare reports, as well as Annual Work plans and Budgets (AWPBs), in accordance with the ADB Financing Agreement.
- (b) Section 7.05 (Procurement): for purposes of this Agreement, all goods, works and consulting services to be financed out of the proceeds of the Financing shall be subject to Schedule 4 of the ADB Financing Agreement, as may be amended from time to time.
- (c) Article IX (Financial Reporting and Information): the financial arrangements and reporting systems of the Borrower shall be in accordance with Section 4.05 of the ADB Financing Agreement.

5. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Borrower:

Secretary of Finance
Department of Finance
DOF Building
Roxas Boulevard
Manila, Philippines

For the Fund:

The President
International Fund for Agricultural Development
Via Paolo di Dono 44
00142 Rome, Italy

This agreement, dated _____, has been prepared in the (English) language in four (4) original copies, three (3) for the Fund and one (1) for the Borrower.

REPUBLIC OF THE PHILIPPINES

Authorized Representative
Title

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

President

Schedule 1

Project Description and Implementation Arrangements

I. Project Description

1. The Project shall be the same as described in Schedule 1 of the ADB Financing Agreement, as such may be amended by the Parties thereto from time to time. The IFAD Financing shall be used to meet Eligible Expenditures in respect of the following:

- (a) Civil Works in Bukidnon Upper River Basin;
- (b) Vehicles (in Region X only);
- (c) Conservation Forestry in Bukidnon Upper River Basin only, including Forest Protection and Monitoring (Block Grant) and Forest Establishment and Maintenance Costs;
- (d) Livelihood Inputs in Bukidnon Upper River Basin only;
- (e) Individual local consultants to be selected to work as contracted staff for the Project management offices at the national, regional and provincial levels;
- (f) Capacity Building in Region X only; and
- (g) Incremental operating costs in Region X only.

II. Implementation Arrangements

2. The Project shall be implemented in accordance with the provisions of Schedule 5 of the ADB Financing Agreement, as such may be amended by the Parties thereto from time to time. In particular, physical investments during the initial phase of the Project shall be limited to four (4) core watersheds of Bauko, Wahig-Pamaksalan, Manupali-Kitanglad and Bubong, respectively within the Upper River Basins (URBs) of Chico River, Wahig-Inabanga, Upper Bukidnon and Lake Lanao. At the end of the initial phase, the Borrower, through the Lead Project Agency, (i) shall facilitate the review by the Fund and the ADB of the trigger indicators specified in the Project Administration Manual between the Borrower and ADB as updated from time to time ("PAM"), as pre-conditions for commencing implementation of physical investments during the second phase of the Project; and (ii) ensure that implementation is carried out in the prioritised watersheds where the Local Government Units (LGUs) are in a position to provide required counterpart funding.

3. During implementation, satisfactory arrangements shall be made to ensure that low-income (LGUs) in the URBs effectively participate in all parts of the Project including in respect of Component 2 (Smallholder and institutional investments in conservation and economic productivity enhancement in the forestry, agriculture and rural development sectors).

Schedule 2

Allocation Table

1. *Allocation of Loan Proceeds.* The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the allocation of the amounts of the Loan to each Category and the percentages of expenditures for items to be financed in each Category:

Category	Loan Amount Allocated (expressed in SDR)	Percentage of Eligible Expenditures to be financed
1. Civil Works (in Bukidnon URB only)	2 950 000	89% of total expenditure claimed
2. Equipment (in Region X only)	100 000	88% of total expenditure claimed
3. Vehicles (in Region X only)	100 000	88% of total expenditure claimed
4. Conservation Forestry (in Bukidnon URB only)		
4 A. Forest Protection and Monitoring (Block Grant)	1 200 000	100% of total expenditure claimed
4 B. Forest Establishment and Maintenance Costs	2 000 000	100% of total expenditure claimed
5. Livelihood Inputs (in Bukidnon URB only)	3 850 000	89% of total expenditure claimed
6. Contracted Local Staff-Consultants	800 000	88% of total expenditure claimed
7. Capacity Building (in Region X only)	450 000	88% of total expenditure claimed
8. Incremental operating costs (in Region X only)	750 000	88% of total expenditure claimed
9. Unallocated	1 050 000	
TOTAL	13 250 000	

2. For the purposes of this Schedule, the following terms have the following meanings:

“Equipment (in Region X only)” means: Eligible Expenditures for Geographical Information System network computer and office equipment for Region X under Component 4.

“Vehicles (in Region X only)” means: Eligible Expenditures for vehicles and motorcycles for Region X under Component 4.

“Contracted Local Staff-Consultants” means: Eligible Expenditures for individual local consultants to be selected to work as contracted staff for the Project management offices at the national, regional and provincial levels.

Schedule 3

Special Covenants

In accordance with Section 12.01(a)(xxiii) of the General Conditions, the Fund may suspend, in whole or in part, the right of the Borrower to request withdrawals from the Loan Account if the Borrower has defaulted in the performance of any covenant set forth below, and the Fund has determined that such default has had, or is likely to have, a material adverse effect on the Project.

1. **Fraud and Corruption.** The Borrower shall ensure that the Project is carried out in accordance with the provisions of the ADB's Anticorruption Policy, as may be amended from time to time. For the purposes of this Agreement, a finding of corruption pursuant to the provisions of ADB's Anticorruption Policy shall be deemed a finding of corruption under the "IFAD Policy on Preventing Fraud and Corruption in its activities and operations".
2. **Environmental and Social Safeguards.** The Borrower shall carry out the Project in accordance with ADB's Safeguard Policy Statement.

Logical framework

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>Impact Improved condition of watersheds generating livelihood benefits in the four URBs.</p>	<p>By 2025</p> <ul style="list-style-type: none"> ▪ 220,000 household beneficiaries, 73.5% of which are IPs, with diversified and increased income ▪ INREM replicated in 20 URBs across the Philippines ▪ Forest loss reversed and forest cover in URBs increased by 11%, from 763,000 ha in 2003 to 846,000 ha in 2025. 	<ul style="list-style-type: none"> ▪ DENR-RBCO reports on adoption of INREM approach in management of other priority river basins. ▪ NSO and NSCB census and poverty data. ▪ DENR and NAMRIA updates on forest cover. ▪ DENR-RBCO reports on adoption of INREM approach in management of other priority river basins. 	<p>Assumptions</p> <ul style="list-style-type: none"> ▪ Economic growth of the country remains steady and moderate. <p>Risks</p> <ul style="list-style-type: none"> ▪ Political instability or partisan rivalry in sub-Project sites.
<p>Outcome Increased rural household incomes and LGU revenues in selected watersheds in the four URBs.</p>	<p>By 2019</p> <ul style="list-style-type: none"> ▪ Rural HH incomes in project areas increased by 30 % from 2009 levels (P60,000-90,000 per annum). ▪ 81 LGU and PO/IPO based watershed enterprises generating revenues from livelihood investments, biodiversity protection and PES. ▪ 8 million person days of wage generating opportunities created from small holder/institutional investments and PES. 	<ul style="list-style-type: none"> ▪ Income Class ranking of river basin LGUs and HH in IPO areas. ▪ BLGF's income classification of LGUs (every 4 years). ▪ NSO and NSCB census and poverty data. ▪ DENR-RBCO and NEDA annual reports. ▪ Project monitoring reports generated under RBCO management system. 	<p>Assumptions</p> <ul style="list-style-type: none"> ▪ GOP's timely approval of land use assessments/ and zoning plans. ▪ Appropriate GOP directives enabling convergence of respective institutional mandates. <p>Risks</p> <ul style="list-style-type: none"> ▪ Delays in approval of management plans for selected URBs. ▪ Revenue streams from REDD and local PES mechanisms not realized. ▪ Extreme weather events impact negatively on ecosystem services.
<p>▪ Outputs 1. River basin/watershed management and investment plans developed to place 1.13 million hectares</p>	<p>By 2019:</p> <ul style="list-style-type: none"> ▪ Supportive policy and regulatory framework in place. ▪ River basin "indicative development plans" and watershed management plans adopted in four Project sites covering 1.13 million ha in total. ▪ 4 updated URBs land use plans delineated and mapped with effective zoning ordinances ▪ 81 Watershed management and investment plans established. ▪ Women's representation during consultations and assessment (30%). ▪ Committees to be established to comprise at least 30% women. 	<ul style="list-style-type: none"> ▪ DENR and NEDA annual reports. ▪ Satellite imageries/maps from NAMRIA and other sources. ▪ LGU Comprehensive/ Forest LUPs and Investment Plans. 	<p>Assumptions</p> <ul style="list-style-type: none"> ▪ GOP counterpart inputs are provided on time and are adequate. ▪ Target LCO/IPO beneficiaries are able to effectively participate in training programmes

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>under improved management.</p> <p>2. Smallholder, and institutional investments increased in conservation and economic productivity enhancement in the forestry, agriculture and rural development sectors.</p>	<ul style="list-style-type: none"> ▪ 231,580 ha protected. ▪ 94,010 ha rehabilitated. ▪ 5,370 ha of sustainable forest management. ▪ 24,450 ha of agro-forestry. ▪ 5,950 ha of commercial plantation. ▪ 14,350 ha of conservation farming. ▪ 560 km of rural access infrastructure, 85 km of foot trails, and 1 provincial trading center. ▪ 3,040 ha of improved Communal Irrigation Systems ▪ 275 of Potable Water Supply units. ▪ \$10,000 seed fund established in each of the four Project sites. ▪ 35% local labour for infrastructure construction 75% of household beneficiaries for field investments are IPs ▪ For infrastructure construction, at least 35% of local labour reserved for rural women. 	<ul style="list-style-type: none"> ▪ DENR watershed reports and management plans. ▪ River Basin Development and Management Plans. ▪ Project baseline surveys and Project RME reports. ▪ Review Mission reports. ▪ Project progress reports. ▪ Project completion report. 	<ul style="list-style-type: none"> ▪ Infrastructure investments improve support for intensive agriculture by communities and reduce transaction costs of access to public services. ▪ Potential negative climate change impacts are appropriately addressed and can be mitigated. ▪ Communities see sufficient incentives in diversification of agricultural techniques. ▪ Delays in government procurement can be minimized. <p>Risks</p> <ul style="list-style-type: none"> ▪ High staff turn over ▪ GOP budgetary support dwindles. ▪ Armed conflict (political and tribal) persists. ▪ LCOs/IPOs are not willing to cooperate / IPOs. ▪ LCOs ban access of surveyors and officials to CAD-T areas.
<p>3. River basin and watershed management capacity and related governance mechanisms strengthened.</p>	<ul style="list-style-type: none"> ▪ 9,000 local beneficiaries trained on: (i) land use assessment and URBMP; (ii) Technical extension and information communication (TE-IC); (iii) project management, accounting/ procurement; (iv) REDD technical capacity; (v) institutional & policy support to LGUs and DENR; and (vi) rural infrastructure maintenance. ▪ 1,332 barangays capacitated in developing land management systems to reduce CO₂ emissions. ▪ 23 Community Watershed Protection Brigades organized with at least 30% comprised of women. 		
<p>4. Project management and support services delivered.</p>	<ul style="list-style-type: none"> ▪ 1 PMO and 4 PIUs established by 2011. ▪ Project M&E, including GIS-based database established with a national hub and provincial and watershed-level nodes by 2015. ▪ Community based environmental monitoring of PES by 2019. ▪ GAP implementation and reporting on gender related achievements reflected in quarterly progress reports to AsDB. 		