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Investing in rural people

President's memorandum

Proposed additional financing to the Kingdom
of Cambodia for the
Tonle Sap Poverty Reduction and Smallholder
Development Project

Note to Executive Board representatives

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For: Approval

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed additional loan to the Kingdom of Cambodia for the Tonle Sap Poverty Reduction and Smallholder Development Project as contained in paragraph 25.

Proposed additional financing to the Kingdom of Cambodia for the Tonle Sap Poverty Reduction and Smallholder Development Project

I. Background

1. This memorandum seeks the Executive Board's approval for additional financing in the form of a loan of US\$10 million on highly concessional terms for the Tonle Sap Poverty Reduction and Smallholder Development Project.
2. This Asian Development Bank (AsDB)-cofinanced project was approved by the Executive Board in December 2009 with a loan of SDR 4,250,000 and a Debt Sustainability Framework grant of SDR 4,250,000, which became effective on 15 February 2010, had a 28 February 2018 completion date and had an 31 August 2018 closing date. Both financing instruments are almost fully disbursed (the disbursement rate is 99.95 per cent).
3. The project's overall goal is to improve the livelihoods of resource-poor households in five target provinces of the Tonle Sap basin by 2023. The objective is to increase agricultural productivity and improve access to markets for vulnerable small farmers. Expected improvements include: better agricultural support and improved access to rural financial services; increasing diversification of household economic activities; the creation of on- and off-farm livelihood opportunities; and enhanced rural infrastructure.
4. While the programme is supervised by AsDB, IFAD has participated in its supervision since 2015, increasing the performance of the project significantly. The successes of the project and the need for continued support to vulnerable poor people have led to strong demand by the Government and beneficiaries for scaling up activities and addressing market issues, as recorded during AsDB's country programming mission in May 2016 and confirmed in joint IFAD-AsDB follow-up missions. Subsequently, the Government requested that AsDB and IFAD provide additional financing of US\$66 million to scale up project activities in the current target provinces and two additional provinces. Based on this request, on 30 August 2017, AsDB's board approved additional financing of US\$50 million to address the persisting demand for agricultural production infrastructure aimed at poverty reduction in the Tonle Sap basin.
5. The additional financing provided under a cofinancing arrangement with AsDB is suitable since it will continue to create efficiency gains and maintain strong links with the original project design and implementation arrangements.

II. Justification and rationale

6. Development challenges in Cambodia's agriculture sector include low agricultural productivity, underdeveloped value chains, deteriorating natural capital and high vulnerability to climate threats. For poor people in particular, the inefficient use of resources, poor productive infrastructure and limited access to rural financial services are major constraints. Thanks to support from IFAD and AsDB in rural infrastructure, agricultural productivity and natural resources management since 1998, the average poverty rate in Cambodia's rural areas decreased from

53 per cent in 2007 to 20 per cent in 2012. However, the number of vulnerable people remains high: the loss of only US\$0.30 per day would bring Cambodia's poverty rate back up to 40 per cent.

7. Disasters including extreme climate events such as floods and droughts have had adverse impacts on agriculture and other sectors. Cambodia is consistently ranked among the top 10 most vulnerable countries to extreme climate events. With climate change, these impacts may worsen over time, with adverse implications for competitiveness of the agriculture sector, and even more so for poor people. This makes it essential to continue building on the successes achieved by the project with enhanced climate and disaster resilience through additional financing.
8. The proposed additional financing will contribute to: (i) the Government's Rectangular Strategy for Growth, Employment, Equity and Efficiency Phase III, especially for enhancing the agriculture sector through diversification, value addition and productivity, and infrastructure development; and (ii) the Agricultural Sector Strategic Development Plan 2014-2018.
9. The original project meets all eligibility criteria for additional financing, including: (i) overall project implementation progress of 96 per cent and cumulative disbursements of US\$43.63 million (95.5 per cent); (ii) indicators that the overall outcome has been achieved; (iii) an overall economic internal rate of return of more than 26 per cent and a cost-benefit ratio of 1.3:1; (iv) full compliance with environmental safeguard reporting for all subprojects; (v) regular review of risk assessment and risk management plan implementation status; and (vi) no adverse climatic risks impacting overall project performance.
10. Additional financing is suitable since it will benefit from the original project's design and implementation arrangements. The sector modality will also continue to be used since it has proven efficient and effective in the original project. The additional financing will enable coordination with similar projects financed by AsDB and other development partners, especially the Community-Based Disaster Risk Reduction fund to integrate disaster risk management in the community-planning process, and the Investment Assessment and Application of High-Level Technology for Food Security in Asia and the Pacific project focusing on climate-resilient rice varieties. It will also coordinate with the Climate-Resilient Rice Commercialization Sector Development Program by developing secondary and tertiary canals to connect with that project's canals, and adopt climate-resilience measures in road design developed through the Rural Roads Improvement Project. With the additional financing, the momentum of success can be built on and the use of the current project resources optimized.

III. Description of the proposal for additional financing

11. The additional financing will scale up project activities in the original five provinces and an additional two provinces. It will also change the original project scope by enhancing climate and disaster resilience. The collective impact will be improved livelihoods and climate resilience in target communities within seven provinces in the Tonle Sap basin. The outcome will be agricultural productivity increased, climate and disaster resilience strengthened, and access to markets improved for 650,000 households in 271 communities within seven provinces in the Tonle Sap basin. The additional financing will continue to support the project's three components.
12. Component 1: Rural productive infrastructure and livelihood improved with capacity in disaster risk management enhanced. The additional financing will focus on climate- and disaster-resilient roads and irrigation schemes. It will rehabilitate an additional 450 km of roads and upgrade irrigation infrastructure for an additional 6,000 hectares of land to allow for at least two crops per year. Infrastructure subprojects will also be registered in the national

asset inventory to ensure ownership beyond the additional implementation period. The existing 1,241 livelihoods improvement groups will be strengthened and an additional 759 groups established. A livelihoods improvement group association will also be established with financial contribution from group members to improve the groups' sustainability. Disaster risk management in target communities will be strengthened through training on identifying, planning, and implementing disaster risk reduction measures, including incorporating disaster risk reduction into infrastructure subprojects.

13. Component 2: Enabling environment for increased agricultural productivity, diversification, and climate resilience created. To increase productivity and climate resilience, training on climate-smart agricultural practices will be provided to 200 paddy-selling groups, livelihoods improvement groups and market improvement groups. Production of four climate-resilient rice seed varieties will be promoted upon confirmation of market demand. Beyond production, to ensure diversification of agriculture products, the additional financing will also improve value addition for both rice and non-rice products such as vegetables, fish and chicken through: (i) establishing multi-stakeholder value chain platforms by bringing producers, processors and buyers together; (ii) establishing 364 market improvement groups; (iii) strengthening 103 existing small-scale agribusinesses; and (iv) establishing at least 97 additional agribusinesses.
14. Component 3: Project management strengthened. The existing executing agencies will continue to manage the project. Support in project management will continue for project staff at the national, provincial, district and community levels. Consulting services and support from special service providers will be provided or extended as required.

IV. Project costs, financing and benefits

15. AsDB will provide a grant of US\$4.28 million through the Disaster Risk Reduction fund and a concessional loan of US\$45.73 million from its ordinary capital resources. IFAD will provide a highly concessional loan of US\$10 million, which will be administered by AsDB. The Government will finance the equivalent of US\$6 million for the salaries of full-time staff, office space, land acquisition and resettlement costs, taxes and duties on items paid for by the Government, and taxes and duties for equipment, goods and services procured under the project through exemption.
16. The overall project management structure, including project coordination meetings, financial management, monitoring and evaluation, management information system and their recurrent costs will be supported by AsDB. The Government will contribute 10 per cent to cover taxes on IFAD-supported expenditures.

Table 1
Project costs by component and financier
(Millions of United States dollars)

Component	IFAD loan		AsDB loan		AsDB disaster risk reduction fund		Borrower/counterpart		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount
1. Rural productive infrastructure and livelihood improved with capacity in disaster risk management enhanced	6.02	12	33.68	69	4.28	9	4.66	10	48.63
2. Enabling environment for increased agricultural productivity, diversification, and climate resilience created	2.99	46	2.82	43	-	-	0.68	10	6.50
3. Project management strengthened	-	-	3.94	100	-	-	-	-	3.94
4. Contingencies	0.99	17	4.37	74	-	-	0.52	9	5.88
5. Financial charges during implementation	-	-	0.91	87	-	-	0.14	13	1.05
Total	10.00	15	45.73	69	4.28	6	6.00	9	66.00

Table 2
Project costs by expenditure category and financier
(Millions of United States dollars)

Expenditure category	IFAD loan		AsDB loan		AsDB disaster risk reduction fund		Borrower/counterpart		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount
1. Civil works	6.69	17	30.24	77	-	-	2.28	6	39.22
2. Livelihoods inputs	-	-	2.12	33	4.28	67	-	-	6.39
3. Goods and services	3.31	43	2.66	34	-	-	1.80	23	7.77
4. Capacity and development training	-	-	2.11	100	-	-	-	-	2.11
5. Consulting services	-	-	5.45	100	-	-	-	-	5.45
6. Recurrent costs	-	-	2.24	56	-	-	1.78	44	4.02
7. Financial charges during implementation	-	-	0.91	87	-	-	0.14	13	1.05
Total	10.00	15	45.73	69	4.28	6	6.00	9	66.00

V. Financial management

17. Financial management. The project is being implemented by the Ministry of Agriculture, Forestry and Fisheries, and the National Committee for Sub-National Democratic Development Secretariat. Both ministries have set up a project management unit for administration. In addition to technical and implementation services, each unit is responsible for providing human resources, procurement, administration and financial management services. During its first phase of implementation, the project's fiduciary risk was assessed as medium. AsDB will continue to act as cooperating institution for project administration. Financial management will continue to rely on arrangements designed by AsDB for the project's first phase; these arrangements have been assessed as satisfactory. Financial management arrangements are fully documented in the project administration manual.
18. Flow of funds. The Ministry of Economy and Finance will open three designated accounts in United States dollars at the National Bank of Cambodia to receive the advances from AsDB and IFAD. Five advance accounts will be opened at commercial banks and managed by the implementing agencies as follows:
- The Ministry of Agriculture, Forestry and Fisheries will administer two advance accounts for its project operations costs. One account will use AsDB loan funds and the second will use IFAD loan funds.

- (ii) The National Committee for Sub-National Democratic Development Secretariat will administer three advance accounts for its project operations costs. One account will use AsDB loan funds, the second will use AsDB grant funds and the third will use IFAD loan funds.
19. Audit. The project team will ensure that internal audits are conducted every year by the internal audit departments of the implementing agencies or by external auditors appointed by the project team. Internal audit reports will be submitted to AsDB and IFAD annually.
 20. External auditing of the project will be conducted in accordance with International Standards on Auditing and the Government's audit regulations by an independent auditor recruited by the Ministry of Economy and Finance who is acceptable to AsDB and IFAD. The audited project financial statements, together with the auditor's opinion, will be presented to AsDB and IFAD within six months of the end of the financial year by the implementing agencies. The audit report for the project financial statements will include a management letter and auditor's opinions. The audit report – but not the management letter – will be published in accordance with AsDB's disclosure procedures and IFAD Policy on the Disclosure of Documents.

VI. Proposed amendments to the project financing agreement

21. Subject to approval by the Executive Board, the project financing agreement will be amended to include the provisions for additional financing. The additional financing will be available upon signature of the related amendment by IFAD and the Government of Cambodia. This additional financing will not involve any changes to the project objectives or target group other than scaling up number of the beneficiaries and activities to support market linkages and disaster risk management. The main changes to the original financing agreement relate to: (i) provision of the additional financing; (ii) revisions to schedule 2, which integrates the additional financing; and (iii) a five-year extension of the project completion and closing dates.

VII. Legal instruments and authority

22. An amended financing agreement between the Royal Government of Cambodia and IFAD will constitute the legal instrument for extending the proposed additional financing to the Borrower.
23. The Royal Government of Cambodia is empowered under its laws to receive financing from IFAD.
24. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

VIII. Recommendation

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

RESOLVED: that the Fund shall provide an additional loan on highly concessional terms to the Royal Government of Cambodia in an amount equivalent to ten million United States dollars (US\$10,000,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Gilbert F. Hougbo
President