INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT PAPER

FOR A

PROPOSED ADDITIONAL FINANCING CREDIT

IN THE AMOUNT OF SDR 26.2 MILLION
(US$ 43 MILLION EQUIVALENT)

TO THE

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

FOR THE

NORTH EAST HOUSING RECONSTRUCTION PROGRAM

May 5, 2008

Sustainable Development Unit
South Asia Regional Office

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CURRENCY EQUIVALENTS
(Exchange Rate Effective March 31, 2008)

Currency Unit = Sri Lankan Rupee
107.4 Rupees (Rs.) = US$1
US$ 1.64 = SDR 1

FISCAL YEAR
January 1 - December 31

ABBREVIATIONS AND ACRONYMS

CAS Country Assistance Strategy
CSIA Continuous Social Impact Assessment
EIQ Environmental Information Questionnaire
GAC Governance and Anti Corruption
IDA International Development Association
NB & EID Nation Building & Estate Infrastructure Development
NEHRP North East Housing Reconstruction Project
NEHRU North East Housing Reconstruction Unit
UN United Nations

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Task Team Leader: Naresha Duraiswamy
SRI LANKA
NORTH EAST HOUSING RECONSTRUCTION PROGRAM

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SRI LANKA
ADDITIONAL FINANCING FOR THE NORTH EAST HOUSING RECONSTRUCTION PROGRAM

Project Paper Data Sheet

Date: May 5, 2008
Country: Sri Lanka
Project Name: North East Reconstruction Program, Additional Financing
Project ID: P110317

Team Leader: Naresha Duraiswamy
Sector Director/Manager: Junaid K. Ahmad
Country Director: Naoko Ishii
Environmental Category: B

Borrower: Sri Lanka
Responsible agency: Ministry of Nation Building and Estate Infrastructure Development

Revised estimated disbursements (IDA FY/US$m)

<table>
<thead>
<tr>
<th>FY</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual</td>
<td>14.0</td>
<td>15.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Cumulative</td>
<td>14.0</td>
<td>29.0</td>
<td>43.0</td>
</tr>
</tbody>
</table>

Current closing date: June 30, 2009
Revised closing date: December 31, 2011

Does the restructured or scaled-up project require any exceptions from Bank policies?
- Yes
- No

Have these been approved by Bank management?
- Yes
- No

Is approval for any policy exception sought from the Board?
- Yes
- No

Revised program development objectives/outcomes:
The Project Development Objectives remain unchanged from the original Project Appraisal Document. A Joint Donor Needs Assessment in 2003 estimated that 290,615 houses, destroyed during the conflict in the North and East prior to 2002, needed repair. 25,300 more houses in the Batticaloa and Trincomalee districts were badly damaged in 2006. The destruction to housing at different times coincided with significant levels of population displacement and economic deprivation as armed hostilities erupted.

206,995 conflict-damaged houses of the pre-2002 caseload still remain unrepaired. 23,398 houses destroyed in 2006 are yet to be rebuilt. The North East Housing Reconstruction Program (NEHRP) is the only program in Sri Lanka intended to rebuild conflict-damaged houses on the scale envisaged. The parent project was intended to rebuild 34,784 houses. IDA rated progress towards achieving NEHRP's Development Objective and its Implementation Performance as satisfactory. Implementation complied with IDA fiduciary, social and environment safeguards. The Government of Sri Lanka was keen to scale-up the program given its results in a challenging security environment.

The Ministry of Finance requested additional IDA funds for NEHRP on November 27, 2007. The Government wanted to reconstruct more conflict-damaged houses. It was keen that IDA resources finance the repair of an added 13,615 houses that would include both those destroyed prior to 2002 and those damaged with the resumption of hostilities in 2006. It hopes to facilitate housing repair in areas where the conflict has since subsided and would be unlikely to interrupt civil works. The proposed repair of more houses is part of a broader strategy to support the return of the displaced to areas where the security environment has improved and restart economic activity.
There are no available funds under NEHRP to meet the requested extra caseload. IDA reviewed different options. This included a new stand alone project, a repeater project and Additional Financing. Additional Financing offered the simplest, quickest and most direct way to respond to the Government's desire to scale-up the parent project. It would retain the design and Development Objective of NEHRP. It would maintain the existing village selection and beneficiary identification criteria. It would retain current safeguards to ensure compliance with IDA social and environment guidelines. The implementation and fund flow mechanisms would remain unchanged. The latest IDA Consultant and Procurement Guidelines would apply.

Does the scaled-up or restructured project trigger any new safeguard policies: No

<table>
<thead>
<tr>
<th>Source</th>
<th>Local</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower/Government of Sri Lanka</td>
<td>0.7</td>
<td>43</td>
<td>43.7</td>
</tr>
<tr>
<td>IDA additional financing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>43.7</td>
</tr>
</tbody>
</table>

For Additional Financing

[ ] Loan  [X ] Credit  [ ] Grant

For Loans/Credits/Grants:
Total Bank financing (US$m): US$ 43.0 Million Equivalent

Proposed terms (IDA): The financial terms of the additional financing will be those currently offered to Sri Lanka, being IDA hardened lending terms for "IDA gap" countries, specifically a ten year grace period and twenty year maturity, with principal repayable at ten percent per year for years 11-20, and zero interest payments.
INTRODUCTION

1. Sri Lanka has witnessed a conflict since 1981. Most hostilities were centered in the island’s North and East. A formal cease-fire was in effect from February, 2002 to January, 2008 despite renewed fighting in 2006. As at September 2007, 503,381 persons were internally displaced in Sri Lanka while 131,160 persons were registered as refugees overseas. Among the 152,000 who returned to their villages last year, many had no place to live in due to widespread destruction. The formal abrogation of the cease-fire in January 2008 led to a further intensification of the conflict in parts of Sri Lanka’s North and East.

2. A Joint Donor Needs Assessment in 2003 estimated that 290,615 houses, destroyed during the conflict in the North and East prior to 2002, were unrepaired\(^1\). 25,300 more houses in the Batticaloa and Trincomalee districts were badly damaged in 2006\(^2\). The destruction to housing at different times coincided with significant levels of population displacement and economic deprivation.

3. IDA had approved the SDR 51.1 million (equivalent today to US$ 84 million\(^3\)) North East Housing Reconstruction Program (NEHRP) on December 14, 2004 and declared it effective on March 15, 2005. NEHRP was intended to rebuild conflict-damaged houses in areas where reconstruction was possible and to facilitate the return of the war-affected poor. It was a commitment to support development where feasible and strengthen the economic preconditions for a durable peace. The European Commission provided Euros 15.6 million (US$ 24.6 million equivalent\(^4\)) in two separate tranches of parallel-financing given robust implementation in an otherwise uncertain environment.

4. NEHRP\(^5\) continues to demonstrate results on the ground despite shifting hostilities. It was intended to rebuild 34,784 houses in 2,712 villages\(^6\). The reconstruction/repair of 14,530 houses was complete as at March 2008. The reconstruction of another 14,671 houses is ongoing with completion of most anticipated in June. 84% of the entire project caseload is therefore either complete or nearing completion. Work on 5,597 houses is yet to start. These are largely located in two districts i.e. Kilinochchi and Mullaitivu where NEHRP is temporarily on hold due to the non-availability of construction materials. The two districts are on the front line of direct hostilities.

5. The home-owner-driven approach of NEHRP was a best practice response to address the housing needs of the conflict-affected poor with minimal intermediation costs. The community review of beneficiary selection and participation in construction empowered villagers, reduced grievances and strengthened transparency. The success of NEHRP led to the replication of the home-owner driven strategy to other IDA-financed projects in Sri Lanka i.e. the Tsunami Emergency Recovery Credit (TERC) and the Puttalam Housing Project.

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\(^1\) 83,620 houses of the original 290,615 have since been or are being repaired under donor-financed projects. This leaves a remainder of 206,995 today.

\(^2\) An added 9,000 houses were further damaged in 2006 but are not included here since they had already been enumerated under the pre-2002 caseload. Of the 25,300 houses destroyed in 2006, 1,900 have been repaired using other donor funds.

\(^3\) As at March 31, 2008

\(^4\) As at March 31, 2008

\(^5\) i.e. the IDA Credit and first tranche of European Commission parallel-financing

\(^6\) There are 5,012 villages in the North and East. The 34,784 houses include the 3,514 houses rebuilt under the first tranche of European Commission parallel-financing.
6. US$ 64.2 million of the IDA Credit was disbursed as at April 28, 2008. This represented 77% of the IDA Credit. Another US$ 3 million is expected to be disbursed by the end of FY 08 and US$ 6 million in the first half of FY 09. The remaining US$ 10 million is kept in reserve for the Kilinochchi and Mullaitivu districts to finance future civil works when construction materials are available and the security environment feasible. In short, all remaining IDA funds under NEHRP are fully committed.

RATIONALE FOR ADDITIONAL FINANCING

7. 206,995 houses destroyed before the 2002 cease-fire need to be repaired today. An added 23,398 houses destroyed in 2006 also need to be reconstructed. NEHRP is the only program in Sri Lanka intended to rebuild conflict-damaged houses on the scale envisaged. IDA rates NEHRP’s progress towards achieving its Development Objective and its Implementation Performance as satisfactory. Implementation complied with IDA fiduciary, social and environment safeguards. The Government of Sri Lanka was keen to scale up the program given the results.

8. The Ministry of Finance requested supplemental funds for NEHRP in November 2007. It sought IDA resources to finance the repair of an added 13,615 conflict-damaged houses that would include both those destroyed prior to 2002 and those damaged with the resumption of hostilities in 2006. The Government intends to facilitate housing repair in areas where the conflict has subsided and would be unlikely to interrupt civil works. The proposed repair of more houses is part of a broader strategy to support the return of the displaced to areas where the security environment has improved and restart economic activity.

9. There are no available funds under the parent project to meet the requested caseload. IDA reviewed different options. This included a new stand alone project, a repeater project and Additional Financing. Additional Financing offered the simplest, quickest and most direct way to respond to the Government's desire to scale-up the parent project. It would retain the design and Development Objective of NEHRP. It would keep intact existing village selection and beneficiary identification criteria. It would retain current fiduciary, social and environment safeguards to comply with IDA requirements. The implementation and fund flow mechanisms would remain unchanged. The latest IDA Consultant and Procurement Guidelines would apply.

10. There are eight districts in Sri Lanka's North and East, six of which are Government-held. The NEHRP funds allocated for four of these districts have either been disbursed or would be used up shortly. The Government had targeted more houses for repair in the four districts using some NEHRP resources allocated for the Kilinochchi and Mullaitivu districts where disbursement is temporarily on hold. The construction of houses in the four districts would be completed and all NEHRP funds utilized in FY08.

11. Security-related transport bottlenecks led to a relatively slower pace of housing construction in two other Government-held districts. However, implementation progress in the...
two districts is still rated satisfactory with construction expected to be completed between June and August 2008 with all NEHRP funds disbursed soon thereafter.

12. As mentioned, project implementation in the Kilinochchi and Mullaitivu is temporarily on hold due to the non-availability of construction materials. 1,224 houses were earlier completed under the parent project. While some resources have been redirected for construction elsewhere, IDA, in consultation with the Government, has since decided not to divert any further funds and to keep US$ 10 million on hold should the possibility of construction resume. This would ensure geographic equity in light of the 49,010 conflict-damaged houses that remain un repaired in the two districts. IDA and the Government would revisit the situation in FY 09 and decide at that time whether to reallocate the amount to other districts.

13. The proposed Additional Financing fits in with the Government strategy to reduce acute poverty in the conflict-affected districts and to mitigate the impact of the conflict through development. It would have economic spin-offs such as the increased employment for construction workers, secure title to land, expanded retail activity and improved living conditions. Restored habitat is often a precursor to renewed livelihood.

<table>
<thead>
<tr>
<th>Anticipated Disbursement of Parent Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated IDA Disbursement (IDA FY/US$m)</td>
</tr>
<tr>
<td>Fiscal Year</td>
</tr>
<tr>
<td>Disbursement</td>
</tr>
</tbody>
</table>

* US$ 10 million is on hold for Kilinochchi and Mullaitivu once construction is possible there

KEY COMPONENTS OF THE ADDITIONAL FINANCING OPERATION

14. An additional 13,615 houses would be rebuilt in the North and East under the proposed IDA Additional Financing. This would include houses both from the pre-2002 caseload of 206,995 conflict-damaged units\(^{13}\); and the 2006 caseload of 23,398 that need to be repaired. The houses to be rebuilt under the parent project, European Commission parallel-financing and supplemental IDA funds covers 18% of the original caseload. The houses to be reconstructed would be distributed across the eight districts in proportion to the incidence of conflict-damage. The most vulnerable households would be identified.

15. The first tranche of Euros 5.8 million in European Commission resources currently supports the reconstruction of 3,514 houses under the parent project. The second tranche of Euros 9.8 million would support the reconstruction of 4,900 houses to complement the IDA Additional Financing. The 13,615 houses to be covered under IDA and the 7,742 to be rebuilt under the second tranche of the European Commission parallel-financing add up to a total of 21,357 houses.

16. The Additional Financing would support the three components of the parent project i.e. (i) Housing Assistance; (ii) Housing Technical Support and Monitoring; and (iii) Program Management. The Government would provide counterpart funds for the third component.

17. **Housing Assistance** (IDA: US$ 40.2 million): As mentioned before, 13,615 houses would be rebuilt. A housing support cash grant of Rs 325,000 would be provided in five tranches to recipients selected on housing damage and vulnerability criteria. The cash grant would be transferred, where relevant, to joint bank accounts in the names of both husband and wife of the

\(^{13}\) 83,620 houses of the original 290,615 houses have either been or are being repaired. NEHRP and TERC financed the repair of most. There was a considerable overlap between the conflict-damaged and tsunami-damaged caseload.
identified household. The pace of installments would be performance-based and the recipient household would have five months to complete construction. The village and beneficiary identification criteria would be identical to that in NEHRP\(^4\). IDA would finance this component in full.

18. **Housing Technical Support and Monitoring** (IDA: US$ 2.1 million): The Additional Financing would include comprehensive technical support to ensure smooth implementation and protect against fiduciary and reputational risks. The technical support would consist of the Training of Construction Workers, a Communications Campaign, a Continuous Social Impact Assessment, Environment Assessment, Technical Audit and Beneficiary Eligibility Audit. A Risk Mitigation Action Plan was prepared by the Government outlining measures to address operational, fiduciary or reputational risks.

19. **Program Management** (IDA: 0.7 million and Government: US$ 0.7 million): This component would support project administration. It would finance the operational expenditure of the North East Housing Reconstruction Unit (NEHRU), the NEHRU District Program Units and NEHRU staff at the divisional level. It would cover staff costs, operational expenditure including goods, the grievance redressal mechanism, land dispute resolution and the internal audit. The Government would provide US$ 700,000 in counterpart funds.

20. The Government of Sri Lanka counterpart contribution would total US$ 700,000. The Results Framework has been updated\(^5\) with revised performance indicators and targets in-line with the IDA Additional Financing and European parallel-financing.

**PROPOSED CHANGES**

21. As noted above, the proposed Additional Financing would retain the NEHRP Project Development Objective. It would retain NEHRP financial management, procurement, environment and social safeguards. The project components would not change. The Additional Financing would only scale-up the original project. The activities to be supported with supplemental IDA funds and the indicative financing are given below:

<table>
<thead>
<tr>
<th>Project Costs by Components</th>
<th>Total Project Costs</th>
<th>NEHRP</th>
<th>Additional IDA Funds</th>
<th>Government Counterpart Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Assistance</td>
<td>109</td>
<td>68.8</td>
<td>40.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Housing Technical Support/Monitoring</td>
<td>4.80</td>
<td>2.7</td>
<td>2.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Project Management</td>
<td>6.10</td>
<td>2.70</td>
<td>0.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Unallocated Category</td>
<td>0.8</td>
<td>0.8</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>120.7</strong></td>
<td><strong>75</strong></td>
<td><strong>43.0</strong></td>
<td><strong>2.7</strong></td>
</tr>
</tbody>
</table>

22. **Impact on Implementation Timeline:** IDA would extend the project closing date for NEHRP by two and a half years from June 30, 2009 to December 31, 2011 to accommodate the activities under the Additional Financing. This would be implemented in all eight districts over 30 months.

\(^4\) For a fuller discussion, see the **Project Appraisal Document** for NEHRP dated November 9, 2004 i.e. Report No: 30436-LK – pages 3-6 and Annex 4 of that document.

\(^5\) Please see Annex 1 for updated Results Framework.

\(^6\) This Financing Plan covers the parent project, the Additional Financing and the total thereof.

\(^7\) The totals have been rounded up to the nearest decimal.
Projected Disbursement of IDA Additional Financing

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Projected Disbursement (IDA FY/US$ m)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY09</td>
</tr>
<tr>
<td>Disbursement</td>
<td>14</td>
</tr>
</tbody>
</table>

23. **Disbursement Arrangements:** The designated dollar account for the parent project would be retained for the Additional Financing. This would relieve the client from the administrative burden of operating two accounts. The transaction-based method of disbursement would continue. US$ 40.2 Mn would be allocated for the housing cash grants with 100% of expenditure financed by IDA. This would be in keeping with the parent credit.

24. The table below presents the category of items, the allocation of the amounts under each category and percentage of expenditure to be financed in each category.

**Indicative Allocation By Expenditure Category**

<table>
<thead>
<tr>
<th>Expenditure category</th>
<th>Additional Financing Amount in US$ (millions)</th>
<th>IDA Balance from Parent Project as at December 31, 2008</th>
<th>Percentage of Expenditure to be Financed - Additional Financing&lt;sup&gt;18&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-grants</td>
<td>40.2</td>
<td>15.86</td>
<td>100%</td>
</tr>
<tr>
<td>Goods</td>
<td>0.29</td>
<td>0.27</td>
<td>100%</td>
</tr>
<tr>
<td>Consultants services</td>
<td>2.30</td>
<td>0.45</td>
<td>100%</td>
</tr>
<tr>
<td>Training</td>
<td>0.21</td>
<td>0.06</td>
<td>100%</td>
</tr>
<tr>
<td>Incremental Operating Costs</td>
<td>0.00</td>
<td>0.82</td>
<td>0</td>
</tr>
<tr>
<td>Refunding of Project Preparation Advance</td>
<td>0.00</td>
<td>0.52</td>
<td>Refinanced pursuant to Section 2.02 (b) of DCA</td>
</tr>
<tr>
<td>Unallocated</td>
<td>0.00</td>
<td>0.50</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>43.00</td>
<td>18.48</td>
<td></td>
</tr>
</tbody>
</table>

25. **Implementation Schedule:** The anticipated Additional Financing would be effective in September 2008. Activities financed by it would be completed by June 30, 2011 while the credit itself would close on December 31, 2011.

26. **Other Proposed Changes:** The Additional Financing would no longer cover the repair of partly-damaged houses as did the parent project. Most houses that were partly-damaged before 2002 have already been repaired. The Government and UN agencies had likewise financed the repair of the partly-damaged caseload of 2006. The supplemental IDA funds would only finance the reconstruction of fully-destroyed houses. The Additional Financing would not include the Housing Finance Study and the establishment of the Management Information System, both of which had been completed under the parent project. There would be no provision for NGO Partner Organizations as this had been dropped under the parent project with the home-owner choosing not to avail of such a facility. The mandate of the Grievance Redressal Mechanism has been expanded to include any complaint pertaining to project implementation, not just those pertaining to the selection of villages and beneficiaries. The composition of the Grievance Redressal Committee at the divisional level would be expanded to include civil society participation and where needed multi-ethnic representation. The risk mitigation measures have been expanded<sup>19</sup>.

<sup>18</sup> Government counterpart funds would finance incremental operating costs

<sup>19</sup> For a fuller discussion, please see the Section on Risks.
CONSISTENCY WITH COUNTRY ASSISTANCE STRATEGY (CAS)

27. The upcoming CAS highlights the need to invest in development where IDA is better positioned to address the causes and consequences of Sri Lanka’s conflict. IDA would use the economic instruments at its disposal to enable an end to the economic causes of the conflict to the extent that it can. It would do so with an emphasis on reconciliation and development in the conflict-affected areas. While a political resolution to the conflict is not within IDA’s mandate, IDA would still endeavor to strengthen the economic pre-conditions for peace. Peace would be a precursor to sustained growth and poverty alleviation in Sri Lanka. The proposed Additional Financing would be in keeping with the conflict mitigation thrust of the upcoming CAS.

28. NEHRP Performance to Date: Please see Annex 2 for more information on the development impact of the parent project.

APPRAISAL OF SCALED-UP ACTIVITIES

29. Economic and Financial: Direct Benefits refer to the new housing stock worth US$ 40.2 million with over 1,200 employment opportunities during construction. The NEHRP experience indicates that on average labor cost is 35 percent of total construction cost of a housing unit. In other words, for every US$1 spent on the housing, US$0.35 would be plugged back to the community. US$ 40.2 million investment would generate US$ 14 million of wage income. Indirect Benefits include spin-off economic activities related to suppliers of goods and services, employment opportunities in the services sector (transport, sales etc) and skills training.

30. The housing units would be the primary asset of beneficiaries given their poverty. Housing can leverage resources as homeowners borrow at improved rates against home equity. With increased economic activity due to the Additional Financing and service provision under other donor-funded projects, the value of land and housing would likely appreciate in the coming years.

31. The training of construction workers would generate spin-off effects on wage income in an area with large scale unemployment. Skills training would ensure an increase in income of an individual trainee (incremental income level) by an average of about US$ 1,150 per annum or a net present value of income differential of US$ 7,020 over the course of their productive life (15 years). This benefit would far exceed the training cost of about US$ 400 per individual under the Additional Financing.

32. The Government would contribute US$ 700,000 in counterpart funds. The short term fiscal impact of the Additional Financing is neutral. The cash grant is for housing, a private good, the maintenance of which would not contribute to a future fiscal burden on the Government.

33. The long term fiscal impact is not significant. The US$ 43 million IDA credit is a concessional loan with a 10-year grace period, a maturity of 20 years, zero interest and a 0.75% service charge on the outstanding amount. The grant element of IDA credit would be 77 percent with disbursement spread over three years (32%, 36%, and 32%) under IDA terms, discounting at a conservative 14 percent. The debt service payment (of US$ 4 million per year on average) is not significant as a percentage of GDP.

34. Institutional: The line agency responsible for the Additional Credit is the Ministry of Nation Building and Estate Infrastructure Development. The North East Housing Reconstruction Unit (NEHRU), mapped to this Ministry but based in Trincomalee, implements the project.
Project administration is otherwise carried out at the district and divisional levels. NEHRU’s eight District Program Units supervise project activities on the ground. A National Steering Committee oversees the overall program. The institutional and administration arrangements for the Additional Financing are the same as in the parent project.20

35. **Procurement**: The procurement methods and thresholds under the parent project would be retained. The guidelines applicable to all procurement under the Additional Financing would be in accordance with Guidelines: Procurement Under IBRD Loans and Credits dated May 2004 (revised October 2006) and Guidelines: Selection and Employment of Consultants by World Bank Borrowers dated May 2004 (revised October 2006). IDA would review and approve the bid documents in use under the parent project. NEHRU submitted a new procurement plan for IDA review. Although IDA did not identify significant capacity issues during earlier supervision, it carried out a capacity assessment. Refresher training would be conducted if required to reinforce compliance with IDA procurement guidelines. NEHRP would adhere to the Financial Authority level for procurement decisions as set forth in the Government of Sri Lanka’s Procurement Manual dated 2006. Procurement Committees would likewise be set up to evaluate bids under the respective financial thresholds.

36. **Financial Management**: The Additional Financing would retain the financial management (FM) and disbursement arrangements of the parent project. The project has a Moderate FM risk rating. NEHRU has a proven track record of sound financial management arrangements and compliance with financial covenants. There is a commitment by Government to submit the external audit reports on time after the last audit was received four months late. NEHRP would continue with on-going risk mitigation measures that include: (i) robust internal control procedures with adequate technical certification of construction progress and quality before making payments; (ii) continuous and comprehensive internal audit including a desk review of beneficiary eligibility on a sample basis; (iii) independent technical audit and follow-up on findings; (iv) independent fixed asset verification; 21 and (v) a communications campaign to enhance awareness of project activities. IDA would carry out a risk-based review of selected FM activities. Given the deteriorating security situation, the assistance of independent third parties would be sought to undertake reviews such as the physical existence of assets (including houses). A Risk Mitigation Action Plan is in place to ensure fiduciary safeguards.

37. **Environment**: Environmental issues that pertain to the proposed Additional Financing are the same as in the parent project. Minimal on-site environmental impact is anticipated given that the proposed sites are on existing housing plots. The foremost environmental impact is associated with the increased demand for construction material. The need for large quantities of sand, timber, rubble and clay to build an additional 13,615 houses would intensify mining and extraction. This can cause serious environmental damage unless adequate precautions are taken to ensure that natural resources are not exploited in an unsustainable manner.

38. NEHRU undertook numerous environmental assessments under the parent project to appraise the extent of environment impact. It operationalised procedures and guidelines to minimize unsustainable natural resource extraction. The Additional Credit would retain these measures and strengthen where possible existing mechanisms to regulate the supply and use of equipment and vehicles.

20 The Ministry of Local Government and Provincial Council’s National Policy Declaration for Local Government issued in July 2007 makes local authorities responsible for service provision. The two provincial council chief secretaries would represent the decentralized administration in the National Steering Committee.

21 Of equipment and vehicles
natural building material. This would minimize the impact of sand mining, clay mining and timber harvesting.

39. The environmental safeguards relevant to NEHRP would be retained. The Environmental Assessment and Management Framework developed for the parent project would also be retained. Each new village included would be assessed using the Environmental Information Questionnaire (EIQs). The EIQ had been drafted based on the findings of a pilot EIA carried out during the preparation of the parent project. Each EIQ would include an Environmental Management Plan. Institutional and implementation arrangements relevant to environmental safeguards would be carried over from the parent project. Should the scaled-up housing program require additional staff to implement environmental safeguards, they would be hired.

40. Social: The Additional Financing is expected to have limited negative impact. It would in fact have positive social impact. A CSIA is in place to identify potential negative impact for the duration of the Additional Finance. This social assessment is intended to ensure proper beneficiary selection, a robust Grievance Redressal Mechanism and a functioning Land Task Force. The CSIA would ensure that social concerns identified during implementation are promptly addressed.

41. IDA’S Operational Policy (OP/BP) 4.12 that governs involuntary resettlement is not triggered. There would not be any land acquisition or involuntary resettlement under the Additional Finance. NEHRP entails on-site home owner-reconstruction. The beneficiary identification criteria require proof of ownership of the land upon which the house would be rebuilt. The land task force would be revived to regularize beneficiary title deeds and resolve land disputes. OP 4.10 that governs indigenous peoples may be triggered. Given that the selection of beneficiaries would be an ongoing process, it is not yet clear whether indigenous communities would be involved as beneficiaries or not. Should these communities be included in the Additional Financing, a diagnostic consultation would be carried out with the communities in question at that point. The consultation would be undertaken by a qualified social scientist/institution, with knowledge of the traditions and culture of the indigenous people, to ascertain their specific wishes and minimize the possibility that project interventions inadvertently create adverse effects. Based on the consultation report, NEHRU would introduce specific interventions vis-a-vis these communities to.

EXPECTED OUTCOMES

42. The Additional Financing is intended to scale-up the development interventions and reinforce the outcomes achieved under the parent project. It would strengthen fragile conflict-affected communities through improved housing, secure land tenure, enhanced construction standards and skills training. These outcomes would be demonstrated by quantifiable outputs. Specifically over the implementation period, the Additional Financing would (i) support the reconstruction of an added 13,615 houses; (ii) train 500 construction workers; and (iii) regularize land title for 10,000 home owners.

RISKS

43. Please see table below for a discussion on risks.

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22 For a broader discussion on the subject, please see the Project Appraisal Document for NEHRP – page 72.
<table>
<thead>
<tr>
<th>Risk to Development Objectives</th>
<th>Risk Rating</th>
<th>Risk Mitigation Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>The first risk is the political. Sri Lanka's North and East faces an uncertain security situation. This increases the risk of political interference by outside stakeholders and armed groups. The implementation environment is strained with potential weakened financial safeguards. Further, the perceived attempts at demographic re-engineering increases the reputational risk to IDA.</td>
<td>H</td>
<td>The upcoming IDA Country Assistance Strategy includes safeguard measures to address such risks. The proposed measures have been operationalized under the Additional Financing. Activities under the Additional Financing would be screened through a 'conflict filter' to ensure that (i) NEHRP benefits continue to be transparently distributed solely in accordance with established vulnerability criteria; (ii) operational decisions reflect the development needs of communities; and (iii) the housing program is used to promote ethnic reconciliation where applicable, thereby endeavoring to address causes and consequences of the conflict. Measures have been introduced to strengthen the Grievance Redressal Mechanism established under the parent project to go beyond complaints that pertain to the identification of villages and beneficiaries to include any complaint pertaining to project implementation. The Grievance Redressal Committee at the Divisional Level would also be expanded to include NGO, CBO and ethnic stakeholders (where the divisions are multi-ethnic) to ensure greater civil society supervision. A stipulated number of structured focal group discussions in different districts and ethnicities/religions would be minuted under the CSIA and shared with IDA to strengthen avenues for increased stakeholder feedback. The CSIA would identify opportunities to support reconciliation and inter-ethnic trust. An example here would be the training of masons and carpenters from one community to help those from another community build their houses. Project management would be more explicitly sensitized on inter-ethnic issues through structured briefings with Buddhist clergy, Hindu social work organizations, Mosque federations and church groups in the region every six months.</td>
</tr>
</tbody>
</table>
The ongoing Communication Campaign under the parent project would be strengthened further to reach out to and disclose accurate and timely project information across a broader array of political stakeholders, public fora and media.

| It is conceivable that the houses rebuilt in certain areas could be subject to renewed damage due to the conflict or abandoned due to general insecurity. | S | IDA resources would be allocated across districts and divisions on established criteria such as the caseload of conflict-damaged housing stock, the number of IDP returnees and vulnerability. Once allocated, they would not easily be transferred across districts. This would ensure geographic equity.

Actual reconstruction however would only commence in those divisions where the conflict is unlikely to resume and the houses rebuilt likely to remain intact. Indicators have been developed to help identify divisions and villages where it would be safe to commence construction on a sustainable basis. The division-specific indicators include the (i) number of displaced who have returned, (ii) restoration of civil administration, (iii) extent of de-mining and (iv) reduction of 'security incidents' as recorded by the United Nations High Commissioner for Refugees.

Should housing reconstruction not be possible in certain districts due prolonged conflict, the funds allocated would not be transferred without prior IDA concurrence. IDA no-objection would only be granted in the case of an acute and compelling housing need in other 'safer' districts. The objective is to ensure geographic equity given its salience to the conflict.

| Misappropriation of resources in the context of the uncertain Governance environment given the resumed conflict. | S | The Additional Financing retains adequate fiduciary, risk mitigation measures and social safeguards to guard against the misappropriation of resources. A Risk Mitigation Action Plan is annexed to the Operational Manual. NEHRP audits are up-to-date. NEHRP has robust internal control systems. The technical certification of construction by technical officers precedes actual payment of the cash grant. There is a continuous and comprehensive Internal Audit. The audit reviews payment to beneficiaries. There is an |
There is the risk that IDA supervision may not be possible. The volatile environment could impede IDA missions. Security-related impediments could prevent hands-on supervision.

In such a scenario, IDA would seek regular updates from the North East Housing Reconstruction Unit on conflict-related damage to newly rebuilt houses and rebuilt houses abandoned due to resumed displacement. It would assign reputed NGOs to cross check and undertake asset verification, if needed. The verification would cover the (i) physical existence of the asset (this includes housing); (ii) usage of the asset by the intended user; and (iii) quality of the asset in line with its specification. A Risk Mitigation Action Plan outlines the fiduciary and operational safeguards in place.

Risk Rating – H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk).

RESULTS FRAMEWORK

44. The Results Framework of the parent project was revised in light of European Commission parallel-financing and the proposed IDA Additional Financing. The updated Results Framework is provided in Annex 1.

FINANCIAL TERMS AND CONDITIONS FOR ADDITIONAL FINANCING

45. The financial terms of the Additional Financing would be those currently offered to Sri Lanka, being hardened IDA lending terms for IDA gap countries, specifically a ten year grace period and twenty year maturity, with principal repayable at ten percent per year for years 11-20, and zero interest payments. The financial, environment and social safeguards would remain the same as in the original credit. The latest IDA Consultant and Procurement Guidelines would apply.
### RESULTS FRAMEWORK

**Project Development Objective**

NEHRP (i.e. the parent IDA Credit, the Additional Financing and European Commission Parallel-Financing) is intended to provide the poorest conflict-affected families with improved and affordable housing units in Sri Lanka’s North and East. This would help improve living conditions, a precursor to the resumption of economic activity.

**Outcome Indicators**

56,141 beneficiaries have a rebuilt habitable home.

**Use of Outcome Indicators**

Information on the pace of implementation and achievement of outcomes would be used to align NEHRP with other development initiatives in the conflict-affected region in an integrated and seamless manner to improve overall living standards.

<table>
<thead>
<tr>
<th>Intermediate Results</th>
<th>Results Indicators For Each Component</th>
<th>Use of Results Monitoring</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Component One – Housing Assistance</strong></td>
<td><strong>Component One</strong></td>
<td><strong>Component One</strong></td>
</tr>
<tr>
<td>Identified beneficiaries build houses in the allotted amount of time and to specified technical standards.</td>
<td>56,141 housing units reconstructed within specified time and allocated budget over a six year period.</td>
<td>Low levels point either to capacity constraints or security-related impediments and the need to design amelioration procedures for identified constraints. The latter could include human, physical or institutional capacity.</td>
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<tr>
<td></td>
<td>Percentage of grants disbursed within the five month period and within each disbursement phase (i.e. purchase of material, construction of foundation, superstructure and completion).</td>
<td>Low percentage flags ineffective targeting mechanisms and would be used for its redesign where possible</td>
</tr>
<tr>
<td></td>
<td>Percentage of identified beneficiaries that are amongst the most vulnerable, including women-headed households, the disabled, those who had lost immediate family members to the war, those subject to multiple displacement etc (as a percentage of total beneficiaries and % of total most vulnerable)</td>
<td></td>
</tr>
<tr>
<td><strong>Component Two – Capacity Building and Monitoring</strong></td>
<td><strong>Component Two</strong></td>
<td><strong>Component Two</strong></td>
</tr>
<tr>
<td>Adequate capacity available to support and monitor housing reconstruction</td>
<td>1,900 trained construction workers assisting in NEHRP construction</td>
<td>Low levels flag discrepancies in demand for and supply of skilled labor. Data will be used to refine subcomponent.</td>
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<td></td>
<td>62,000 land disputes resolved through re-established mobile land task forces at the District level</td>
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<td></td>
<td>Number of perceived complaints captured by the Continuous Social Impact Assessment</td>
<td></td>
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<tr>
<td></td>
<td>Percentage of Technical defects reported out of sample by the independent Technical Audit</td>
<td>High number of technical defects point to the lack of engineering oversight and insufficient technical support to the home-owner.</td>
</tr>
<tr>
<td>All actors (NEHRU, district program units, divisional officers) aware of roles and responsibilities and comply accordingly.</td>
<td>Percentage of home-owner compliance with technical standards</td>
<td>Percentage of grievances resolved</td>
</tr>
</tbody>
</table>
Annex 2

Performance to date of Parent Project

1. NEHRP was intended to rebuild 34,784\textsuperscript{23} houses in 2,712 villages. The development impact of the parent project has been documented through regular IDA supervision, the Continuous Social Impact Assessment (CSIA), the Technical Audit and other reports. One survey revealed that over 80\% of the rebuilt houses remained occupied despite continuing displacement elsewhere in the North and East. All beneficiaries had secure legal title to their land. The reliance on the money lender had declined by 40\% as debts, earlier incurred for housing repair, were no longer needed. Transport services to NEHRP villages increased by 11\% in response to renewed demand by the returnee population. All beneficiaries reported improved self-esteem and social standing in the broader community.

2. Over 70\% of beneficiaries reported that restored housing facilitated the resumption of livelihood. The NEHRP home-owner often relied upon the security of a rebuilt house to invest in home gardening, livestock, poultry farming, home-based retail trade and tailoring. The CSIA indicated that beneficiary household income had increased in seven of the eight districts due to such activity. The beneficiary savings rate increased four-fold reflecting improved income. NEHRP trained 1,100 masons and carpenters to provide construction labor, stabilize wages and help beneficiaries save. The home-owner was able to save 14\% on labor with the increased availability of skilled construction workers. The training also provided recipients with non-farm employment in project areas and beyond. The Technical Audit revealed that the structural stability, quality of materials used and quality of workmanship had improved each successive year of the project.

3. Eight mobile land task forces were set up under NEHRP - one in each district of the North and East - to regularize title to land. This had become an issue due to pervasive conflict-related displacement and encroachment. The mobile land task forces had registered 96,385 land disputes, investigated 73,475 cases and resolved 52,721 instances of disputed/unclear land title. They issued 44,279 valid land right documents, serviced thousands of beneficiary and non-beneficiary households alike and provided considerable social benefits to the wider population of the affected districts. NEHRP facilitated a tree replanting campaign to compensate for the timber used. This included approx. 49,000 coconut, teak, jak and mango saplings planted in 2006 and 2007.

\textsuperscript{23} This number includes the 3,514 houses rebuilt under the European Commission parallel-financing.