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INTERNATIONAL BANK OF RECONSTRUCTION AND DEVELOPMENT

PROJECT PAPER

FOR

PROPOSED ADDITIONAL FINANCING

**IN THE AMOUNT OF
US\$100.0 MILLION**

TO

THE ISLAMIC REPUBLIC OF PAKISTAN

FOR THE

HIGHWAYS REHABILITATION PROJECT

November 17, 2005

**Energy and Infrastructure Sector Unit
South Asia Region**

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CURRENCY EQUIVALENTS

(Exchange Rate Effective November, 2005)

Currency Unit = Pak Rupees (Rs)
Rs 59.7 = US\$ 1.00
US\$ 0.0166 = Rs 1.00

FISCAL YEAR

July 1 - June 30

ABBREVIATIONS AND ACRONYMS

AJ&K	Azad Jammu & Kashmir
CAS	Country Assistance Strategy
CSR	Composite Schedule of Rates
EA	Environmental Assessment
EAF	Environmental Assessment Framework
EMP	Environmental Management Plan
FSL	Fixed Spread Loan
FWO	Frontier Works Organization
HRP	Highways Rehabilitation Project
ICB	International Competitive Bidding
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
KKH	Karakoram Highway
MTBF	Medium Term Budgetary Framework
MOF	Ministry of Finance
NA	Northern Areas
NHA	National Highway Authority
PD	Project Director
PMU	Project Management Unit
RMA	Road Maintenance Account
RPF	Resettlement Policy Framework
SA	Social Assessment
SEA	Sectoral Environmental Assessment
SOE	Statement of Expenditures
SMEC	Snowy Mountain Engineering Corporation

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PROJECT PAPER DATA SHEET

Date: November 17, 2005 Country: Pakistan Project Name: Highways Rehabilitation Project Project ID: P099040	Team Leader: Zafar I. Raja Sector Manager: Guang Z. Chen Country Director: John W. Wall Environmental Category: B				
Borrower: Pakistan Responsible agency: National Highway Authority					
Revised estimated disbursements (Bank FY/US\$m)					
FY	2005	2006	2007	2008	2009
Annual	24.50	50.00	75.00	75.00	75.00
Cumulative	25.00	75.00	150.00	225.0	300.00
Current closing date: June 30, 2009					
Does the restructured or scaled-up project require any exceptions from Bank policies? Have these been approved by Bank management? Is approval for any policy exception sought from the Board? To allow for further processing of the operation, Management approved a waiver of paragraph 1.8 (c) of the Bank's Procurement Guidelines to permit the Frontiers Works Organization, a financially and managerially autonomous government organization, to undertake the rehabilitation works required under the Project, so as to respond promptly to the emergency. For this purpose, Management approved the use of Direct Contracting under paragraph 3.6(e) of the Bank's Procurement Guidelines.					<input checked="" type="radio"/> Yes <input type="radio"/> No <input checked="" type="radio"/> Yes <input type="radio"/> No <input type="radio"/> Yes <input checked="" type="radio"/> No
Revised project development objectives/outcomes:					
<p>The Highways Rehabilitation Project is being restructured with the help of additional financing to add a new component in response to the earthquake of October 8, 2005. The restructuring is being processed under OP/BP 13.20—Additional Financing for Investment Lending and OP/BP 8.50—Emergency Recovery Assistance. The proposed new component would reconstruct and rehabilitate three national highways and one provincial highway damaged by the earthquake. There is no change to the project development objective, but the scope of the network conservation is broadened with the addition of the rehabilitation of about 180 km of the earthquake damaged highways.</p> <p>The expected outcome is to return the damaged highways to fully operational conditions that guarantee 24 hours and 7 days (24/7) access to the 8 earthquake hit districts having an area of about 25,000 square kilometers, thereby ensuring un-hindered earthquake assistance to about 5.7 million persons.</p>					
Does the scaled-up or restructured project trigger any new safeguard policies? No					

For Additional Financing

[X] Loan [] Credit [] Grant

For Loans/Credits/Grants:

Total Bank financing (US\$m.): 100.0 Loan

Proposed terms: (for IBRD Loan) 15.5 years to maturity with a 5-year grace period

Financing Plan (US\$m.)

Source	Local	Foreign	Total
Borrower	0.00	0.00	0.00
IBRD	50.0	50.0	100.0
Others			
Total	50.0	50.0	100.0

A. INTRODUCTION

1. This Project Paper seeks the approval of the Executive Directors to provide an additional loan in an amount of US\$100 million to Pakistan Highways Rehabilitation Project (HRP; Project ID: P010556, Loan Number: 7212 PAK).
2. The proposed additional loan would help finance the costs associated with restructuring of HRP to urgently address reconstruction/rehabilitation of four main highways that were damaged by the earthquake of October 8, 2005. There would be no change to the ongoing project activities. Most of the remaining funds have been committed, with a large number of contracts ongoing, and it would be important to complete ongoing activities as planned in order to achieve the original project development objective. The new component, to be implemented in parallel to the original components, would also be implemented by the National Highway Authority (NHA) through its fully staffed Project Management Unit (PMU) that has sufficient technical and fiduciary capacity.
3. The expected outcome is to return the damaged highways to fully operational conditions that guarantee 24 hours and 7 seven days (24/7) access to the 8 earthquake hit districts having an area of about 25,000 square kilometers, thereby ensuring un-hindered earthquake assistance to about 5.7 million persons.

B. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING

Project Data and Performance

4. HRP was approved on December 23, 2003, with a credit amount of SDR 105.9 million (US\$150.0 million equivalent), and a loan amount of ¥ 5,605.5 million (US\$50.0 million equivalent). Key project data and performance is tabulated below:

Key Project Data		Project Performance	
Effectiveness date:	February 27, 2004	Development Objectives:	<i>Satisfactory</i>
Closing date:	June 30, 2009	Implementation Progress:	<i>Satisfactory</i>
Project Age:	20 months (31%)	Risk Flags:	None
Credit Disbursed:	USD 36.53 mil equiv. (24%)		
Loan Disbursed:	USD 0.52 mil equiv. (1%)		

5. The project's original development objective is the sustainable delivery of a productive and efficient national highway network, contributing to lower transportation costs. This is to be achieved through implementation of the following two project components:
 - a. **Network Conservation Component** – consisting of: (i) Rehabilitation & Improvement of about 550 km of highway (including structures), (ii) Resurfacing & Strengthening of about 306 km of highway, (iii) Safety improvement works, (iv) Afforestation, (v) Relocation of utilities, (vi) Resettlement & land acquisition, and (vii) Design, contract administration & construction supervision consultant services.
 - b. **Policy Support and Institutional Development Component** –including technical assistance, training, equipment support and incremental operating costs to: (i) help implement improved sub-sectoral policies (Medium Term Budgetary Framework (MTBF) – to improve targeting of public sector resources; and Road Maintenance

Account (RMA) – to provide stable and secure funding for maintenance), and (ii) strengthen NHA institutional capacity, improve performance and efficiency.

6. The development objective and implementation progress are rated as ‘Satisfactory’ since: (a) a substantial portion (about 50%) of total NHA road sector expenditures are being directed towards network conservation; (b) there is encouraging progress towards the institutionalization of a rational and secure road maintenance management and funding arrangement; and (c) procurement and implementation of the civil works contracts is proceeding well – of the 15 civil works contracts, 12 valued at US\$133 million have been awarded, and work valued at US\$17 million has been completed (slightly delayed as compared to the appraisal schedule).

7. Award of the 13th contract, which is under process, will fully commit the remaining Credit/Loan funds available under the project, since recent bids have substantially exceeded the engineer estimates¹. Additional financing amounting to US\$65.0 million (32.5% of the original Credit/Loan amounts) is required to cover cost over-run, which is being processed separately for Board’s approval.

8. There is no change to the project development objective, but the scope of the network conservation would be broadened with the addition of the rehabilitation of about 180 km of the earthquake damaged highways.

9. There is substantial compliance with credit/loan covenants².

Rationale for Additional Loan

10. The earthquake of October 8, 2005 badly damaged three national highways, namely N-15, N-35, and S-2 that link the rest of Pakistan to the disaster areas. Of the three, N-15 is most badly hit – a 34 km stretch north of Balakot to Mahindri in the Kaghan valley is mostly wiped out and is closed to traffic since the earthquake. Rescue and relief efforts along this valley are being conducted through helicopters. Damages on N-35 and S-2 do not extend throughout the entire length but are at numerous locations and in discrete sections of varying lengths primarily caused by landslides. These two highways have been opened to traffic though landslides continue to temporarily block some segments of these highways (so far over 1,000 aftershocks have been registered since the main earthquake). Generally, damages can be characterized as settlement of road, longitudinal and transverse cracking of the pavement structure, and collapse of hydraulic and other structures.

¹ Engineer estimates were prepared in 2003. The unprecedented hike in oil price in 2005 has considerably increased cost of bitumen (an oil based road construction material) as well as cost of other road construction materials due to higher transportation charges.

² Since creation of NHA in 1991, the government is financing its capital program as cash development loans. This financing practice is unsustainable, since NHA does not have an independent source of revenue to repay this debt. Accordingly, provisions were made in the legal agreements according to which it was agreed that the government will: (a) on-lent the proceeds of the credit/loan to NHA as a grant, (b) carry out a review to identify available options for financing NHA’s investment program on a sustainable basis, and (c) take a decision regarding the treatment of the existing stock of NHA debt, and the mode of all future NHA funding. The government has complied with (a) and (b) above. However, the decision regarding stock and future funding mode has become overdue. During the September 05 supervision mission the Ministry of Finance indicated that the government decision is likely by December 05.

11. The earthquake also very badly damaged a highway in Azad Jammu & Kashmir (AJ&K) called Jhelum Valley Road that links Muzaffarabad with Chakothei. Some of its sections are totally wiped out and still close to traffic.

12. Preliminary damage assessment indicates that the earthquake damaged about 600 km of major highways including about 200 km national highways, 200 km provincial highways in NWFP, and 200 main highways in AJ&K.

13. The earthquake-damaged national highways are strategic roads of national importance. N-35 (popularly known as the Karakoram Highway) links the Northern Areas (NA) of Pakistan with rest of the country and is the overland trade route to China. S-2 links Muzaffarabad, the capital of AJ&K with rest of Pakistan. And, N-15 provides basic access to a number of towns and villages along the Kaghan/Naran valleys that are also among the top summer tourism attractions in Pakistan. *There is an urgent need to rehabilitate the three national highways and the Jhelum valley road to ensure un-hindered 24 hours and 7 days (24/7) movement of earthquake assistance and to restore normalcy of economic activities.* Without rehabilitation of these highways, heavy goods transport will not be able to access some parts of the earthquake hit areas that will adversely affect relief/reconstruction operations and restoration of normal trade and economic activity between these areas and the rest of Pakistan, and leave millions of people substantially cut-off. Disaster recovery takes natural precedence over other needs and priorities of governments and development partners alike. NHA will, therefore, have to divert some of its financial resources to the affected highways that, in turn, may create financing shortfall for the on-going project. Thus, additional financing will also help make up any shortfall.

C. PROPOSED CHANGES

14. A new component called '**PART C: Reconstruction and Rehabilitation of Earthquake Damaged Roads**' (US\$100.0 million) would be added to HRP. The new component is supporting rehabilitation of about 180 km of highways. Accordingly, the project output indicator relating to '*number of km of highways rehabilitated*' is enhanced from 550 km to 730 km. Moreover, the additional financing will directly contribute towards the achievement of the original development objective, and in fact, expedite the pace of its achievement through the use of emergency delivery mechanisms.

15. The activities under the new component, indicative costs and proposed Bank financing are indicated in the following table³:

PART C: Reconstruction and Rehabilitation of Earthquake Damaged Roads	Indicative Costs (US\$ M)	% of Bank-financing
1. Carrying out of civil works for reconstruction and rehabilitation of earthquake damaged roads including:		100%
a. Reconstruction of about 65 km of National Highway: N-15 (Basian-Balakot-Mahindri-Naran section).	38.0	
b. Rehabilitation of about 45 km of National Highway: N-35 (Battal-Batgram-Thakot section)	14.0	
c. Rehabilitation of about 15 km of National Highway: S-2 (Kohala-Muzaffarabad section).	4.0	
d. Rehabilitation of about 55 km of Jhelum Valley Road	28.0	

³ The road sections in the table are of the highest priority for reconstruction and are likely to use up most of the additional financing. However, some more provincial road sections may be added in case of any cost savings.

	(Muzaffarabad-Chakothi section) e . Relocation of utilities, and resettlement and land acquisition	1.0	
2.	Provision of technical assistance for design & feasibility, environmental & social safeguards, contract administration and construction supervision	4.3	100%
3.	Incremental operating costs	1.5	100%
4.	Front end fee	0.25	
5.	Physical & price contingencies	8.95	
	Total	100.0	

16. Front end fee is the amount under Section 2.04 of the Loan Agreement. Physical and price contingencies are estimated as 10% for works and 5% for consultant services.

17. **Scope of Additional Works:** Civil works for reconstruction and rehabilitation of the earthquake damaged roads would involve removal of landslides, rock cutting, formation of sub-grade, patching and/or removal – where required – of existing bituminous and aggregate layer(s), placement of aggregate layers (if needed) and asphalt concrete base and surfacing courses. The works would also include localized realignment and slope stabilization measures including retaining walls, gabions etc., reconstruction/repair of hydraulic structures (bridges, culverts, cause-ways), drainage improvements; and safety improvements including widening to 7.3 meters on some sites, construction of up to 2.5 meter wide hard shoulders, construction of lay-byes, parapet walls, guardrail, road marking and traffic signs.

18. **Impact on Implementation Timeline:** *The earthquake works have increased the on-going project's scope of work, in physical terms, by about 22%; however, the completion date of project would not be impacted.* The new activities, which are geographically separated from the original project location, shall be carried out in parallel, while employing additional physical resources. The project closing date remains June 30, 2009.

19. Procurement

- a. **Civil Works:** All the three damaged roads are located in extremely inhospitable mountainous terrain with very harsh weather conditions, which necessitate an appropriately trained, equipped and experienced contractor to undertake reconstruction works. Frontier Works Organization (FWO) – a government owned entity – is the only local construction organization in Pakistan, capable of, and currently mobilized to respond to the disaster urgently and to successfully undertake these rehabilitation works in the prevailing circumstances. FWO was created in 1966 as a civil engineering construction wing of the Army Corps of Engineers for the purpose of building the KKH (N-35) and is maintaining and operating it since completion in 1978. Thus, it has about 40 years experience of working in the mountainous Northern Areas of Pakistan, and is uniquely qualified for rehabilitation of highways damaged by the earthquake.
- b. Based on the information provided by the government, FWO is a financially and managerially autonomous entity and Direct Contracting with them under Para 3.6 (e) of the Bank's Procurement Guidelines would be appropriate to respond promptly to the emergency. However, FWO is not legally autonomous as required under paragraph 1.8 (c) of the Bank's Procurement Guidelines and, therefore, would ordinarily not be eligible to participate in a Bank-financed project. Management has granted a waiver of this requirement in light of the emergency in the context of this operation.

- c. NHA will procure the services of FWO under Direct Contracting method using Bank's standard ICB large works contract document. Award of contract will be subject to Bank's prior-review.
- d. **Consultant Services**: NHA will employ the services of M/s SMEC (the existing contract administration & construction supervision consultants on the on-going project) to prepare designs, environmental & social assessments, contract documents and PC-1 as well as to supervise the earthquake related civil works under a variation order to their existing contract.
- e. The procurement sections of the legal documents will be adjusted to reflect both Direct Contracting with FWO and Single-Source Selection of SMEC.

20. Disbursement & Financial Management

- a. The Loan would be disbursed to the existing Loan Special Account being maintained by NHA for the ongoing project over a period of next three and a half years. Disbursements would be made using traditional disbursement procedures (replenishment and reimbursement supported by full documentation and against the Statement of Expenditures). Authorized Allocation for this Loan Special account – under paragraph 1 (c) of the Schedule to the Loan Agreement – will be *US\$ 15,000,000*.
- b. NHA has a comprehensive financial management system for the existing project, and the same would be used for the Additional Financing.

D. CONSISTENCY WITH CAS

21. The last CAS covered the period July 2003-June 2005, and a CAS for the period July 2005-June 2008 is under finalization. The draft CAS identifies three pillars of Bank assistance corresponding to the strategic priorities of the government's PRSP: (i) sustaining growth and improving competitiveness; (ii) improving government effectiveness and service delivery; and (iii) improving lives and protecting the vulnerable. Supporting these pillars, the Bank Group's lending program is proposed to primarily target: (i) infrastructure, (ii) human development; and, (iii) programs targeting the poor and vulnerable.

22. The proposed additional finance is fully consistent with the CAS pillars and program priorities. It provides finance for the reconstruction and rehabilitation of key national and provincial highways which link the backward and under-developed Northern Areas and Azad Jammu & Kashmir region to the rest of the country. This is essential for improving the lives and protecting the vulnerable in these areas whose lives were further devastated by the earthquakes. Moreover, it also supports the restoration of vital transport links between the northeast region to the rest of the country which helps expand trade and economic activities in the region, and generates economic growth opportunities.

E. APPRAISAL OF MODIFIED PROJECT ACTIVITIES ADDED AS PART OF PROJECT RESTRUCTURING

Economic

23. A rapid economic appraisal was undertaken on the economic viability of the additional finance for the reconstruction and rehabilitation of the three national highways. The analysis was carried out using the Highway Design and Management Model (HDM-IV), taking into account the estimated economic cost, current road condition, traffic volume and its projected growth. The appraisal also considers the option of reconstruction only as well as reconstruction with necessary geometric and safety

improvements. The results indicate that the proposed investment on these three national highways is economically justified, with the economic rate of return ranging from 14% for N-15, 23% for N-35 and 34% for S-2, under the option of reconstruction to original standard with necessary geometric and safety improvements. With these rates of return, the project as a whole continues to remain economically viable. It was agreed that a more detailed economic analysis will be conducted at the design stage to re-confirm the above rapid assessment based on the final engineering design, which will also determine the final reconstruction alternative to be adopted. This analysis will also cover the Jhelum valley road.

Financial

24. The following additional budgetary allocations are needed in NHA's Annual Development Plan (ADP) to finance the new component:

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09
Additional allocation (Rs million)	900.00	1,800.00	2,400.00	900.00
As % of NHA's annual expenditures	4.5%	9.0%	12.0%	4.5%

25. It was agreed that NHA will re-appropriate funds from its FY 2005-06 allocations to finance the earthquake works during the current fiscal year, and the Ministry of Finance (MOF) will make appropriate budgetary provisions for the remaining years. It was also agreed that in case actual contract cost exceeds the preliminary estimates, NHA/MOF will finance any such shortfall.

Technical

26. NHA employed a consulting firm to carry out a rapid damage assessment of the three national and one provincial highway who confirmed the critical nature of the proposed works. It was agreed that NHA will immediately initiate the process for declaring the Jhelum valley road as a national highway.

27. It was agreed that the reconstruction/rehabilitation works proposed under the project shall be based on proven engineering designs and construction techniques, which would be durable and require low maintenance. Designs, technical specifications and procurement documents shall be prepared under the guidance of experienced international consultants working in close coordination with NHA, and will be reviewed and cleared by the Bank.

28. Civil works on the four highways will be packaged as one contract (three/four contract sections with separate Bill of Quantities), spanning a construction period of 24 months, and a post construction defect liability period of 12 months. Civil works will be constructed to internationally accepted standards and supervised by internationally experienced consultants.

29. It was also agreed that NHA will negotiate rates with FWO on the basis of its most recent composite schedule of rates (CSR) appropriately adjusted to reflect current market prices.

Institutional

30. The government established an Earthquake Reconstruction and Rehabilitation Authority (ERRA) soon after the earthquake. The ERRA is an apex body at the federal level to lead and coordinate the reconstruction and rehabilitation effort. Its role and responsibilities as well as detailed implementation mechanisms are currently being worked out. At present, it is not implementing any earthquake related projects at the provincial and district levels. The government has indicated that until ERRA is fully operational existing institutional arrangements already in place under the HRP will be used for implementation of the earthquake related interventions and activities.

31. Senior management of NHA are committed to the proposed activities and participated fully during project appraisal. NHA will act as the 'Employer'. M/s SMEC will act as the 'Engineer' in accordance with the FIDIC stipulations; and will be responsible for design, environmental and social assessments; and contract administration and construction supervision of all works carried out by FWO including quality control and payment certifications.

32. The PMU is appropriately staffed, and has adequate financial management system in place that would be able to cover the additional component as well. Some incremental field staff will be needed to implement the additional component. The Project Director (PD) of the ongoing project will also function as PD of the emergency works and will be responsible for overall coordination, internal/external processing of all approvals, procurement of civil works, procurement of design, contract documents, management of supervision consultant's services, operating special account and financial management. He will be assisted by two Project Coordinators in the field who will be responsible for general administration, management of environmental & social safeguards, and timely land acquisition and relocation of various utility services.

Safeguard Policies and Arrangements

33. The proposed new component has been classified as Category "B" for the purposes of OP 4.01, similar to the original project.

34. Since the civil works involve rehabilitation of the earthquake damaged roads, there will be a lot of earthwork to remove landslides and stabilize slopes, along with reconstruction of retaining walls and restoration of road pavements and drainage structures. Thus, most of the 'design' work will be carried out on the ground with assistance of the contractor who will be clearing the way for the design consultants to follow. It was agreed that rapid environmental and social assessments shall be carried out to identify: adverse environmental/social impacts, number of affected persons and property/assets that would be eligible for compensation, any safeguards that may get triggered, and provide a monitoring and supervision strategy.

35. A *Resettlement Policy Framework (RPF)* for the ongoing project already exists. In addition, NHA will prepare⁴ an *Environmental Assessment Framework (EAF)* containing appropriate environmental mitigation measures and will clear it with the Bank before commencing implementation of the earthquake rehabilitation works. NHA will apply EAF and RPF on the earthquake damaged roads to ensure compliance with the Bank's environmental and social safeguards requirement.

36. In view of the above-described emergency circumstances, the requirement of disclosure of the updated EMP prior to appraisal is waived, and instead shall be made public during implementation of civil works. Such exemptions are allowed under paragraph 12 of OP 4.01 (Emergency Recovery Projects; Environmental Assessment).

37. Safeguard Policy on Projects in Disputed Areas OP 7.60 will be triggered as the proposed project will be carried out in AJK, an area over which India and Pakistan have been in dispute since 1947. By financing the proposed Loan, IBRD does not intend to make any judgment as to the legal or other status of any disputed territories or to prejudice the final determination of the parties' claims.

⁴ The Sectoral Environmental Assessment (SEA), Environmental Assessment and Environmental Management Plans (EA/EMPs), and Social Assessment and Resettlement Plans (SA/RPs) for the existing project will serve as templates for the EAF.

F. EXPECTED OUTCOMES

38. The expected outcome for the additional component is to return the four damaged highways to fully operational conditions that guarantee 24 hours and 7 days (24/7) access to the 8 earthquake hit districts to ensure un-hindered earthquake assistance. This would be achieved through reconstruction/rehabilitation of about 180 km of highways damaged by the earthquake. The project output indicator relating to '*number of km of highways rehabilitated*' is enhanced from 550 km to 730 km. This indicator will continue to be monitored through periodic progress reports, disbursement reports, and supervision reports.

G. BENEFITS AND RISKS

39. The major risk associated with the additional component is the likelihood of new landslides re-damaging the reconstructed/rehabilitated infrastructure. In order to reduce this risk, the project would introduce geotechnical engineering solutions that are resistant and long-lasting. The additional component will benefit people resided in the project area through facilitating their socio-economic recovery during and after the earthquake-reconstruction period.

H. FINANCIAL TERMS AND CONDITIONS FOR THE ADDITIONAL FINANCING

40. US\$100.0 million would be provided as a Fixed-Spread Loan (FSL) with 15.5 years to maturity, including 5 years grace, commitment fee equal to 0.85 percent for the first 4 years and 0.75 percent for the remaining period, and a front end fee equal to 0.25 percent. The loan would be denominated in US Dollars. Retroactive financing up to 20% of the proposed additional finance could be allowed in accordance with the Bank's operational policy on retroactive finance.

41. There are no effectiveness conditions.