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Town Development Fund

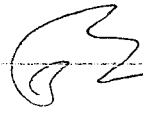


Lending and Grant Policy

April 25, 2011 (Baishakh 12, 2068)

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PART A: LENDING POLICIES

1. OBJECTIVES OF LENDING

The main purpose of TDF, as a sustainable financial institution, is to mobilize increased financial resources from Development Partners (DP) and Government of Nepal (GoN) and, in the long run, raise private debt from domestic capital market, for high priority urban infrastructure investments, contributing directly to improved living standards of urban population. Specifically, the TDF would:

- fund viable urban infrastructure projects,
- provide efficient technical assistance including improved financial management of its clients,
- facilitate the participation of private sector in infrastructure development.

This lending policy describes the broad lending principles and procedures to be followed by the TDF. Policy and procedures would be reviewed and modified, if necessary, by the Board of TDF. On the basis of this policy, the detail Standard Operation Procedures (SOP) will be developed.

2. LENDING POLICIES

2.1 Guiding Principles

Foreign Exchange Exposure: The Fund will not incur foreign exchange exposure.

Investment Policy: TDF is a medium and long term lender and as such will avoid excessive short term borrowing/lending. Cash flow forecasts will be maintained in order to ensure the optimum use of liquid funds. The TDF will match the terms of its loans and borrowings in order to minimize its exposure to interest rate fluctuations. The TDF will invest only in securities issued by or guaranteed by the Government of Nepal (GoN), fixed deposits of commercial banks, and investment grade securities of corporate issuers.

Exposure Limit: Exposure limits to projects and borrowers will be defined by TDF board on regular basis.

Security: The TDF will apply appropriate security mechanisms, e.g. escrow accounts, revenue intercepts, step-in rights, and through Debt Service Reserve Fund (DSRF).

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Loan Coverage: The loan does not exceed 90% of the cost of the project sponsored by borrowers.

Default: Borrowers for whom payments are in arrears will not be eligible for further loans.

2.2 Lending Criteria

The TDF shall ensure that a project and borrower that sponsors such a project, in respect of which a loan application or requests made to the TDF, shall meet the following eligibility criteria.

Eligible Projects:

- Projects which are given high priority in the capital expenditure program of the borrower.
- Support all kinds of urban infrastructure as per the Local Self Governance Act, 1999.
- Adopt the appropriate proven and most cost effective technology and technical norms and specifications.

If required, appropriate statutory and environmental clearances have been obtained and these are documented in the project evaluation report.

Eligible Items:

The TDF will finance the costs of civil works, services, equipments and goods. The TDF will not finance the land acquisition costs, and the working capital.

Eligible Borrowers:

The borrowers of TDF are municipalities, urbanizing Village Development Committees (VDC), District Development Committees (DDC), Urban Local Bodies Joint Committees (as per LSGA and Regulations), Town Development Committees (TDC), and public corporation boards. For those borrowers, the following norms would be required:

- Maintain a ratio of Total Expenditure, TE (Recurrent) / Total Revenue, TR (tax and regular non-tax revenue including GoN regular Grants) < 1.
- Ensure that Debt Service, DS (Interest + Repayment)/ Total Revenue, TR < 30%.
- Having adequate internal control, accounting and financial management systems to produce information and reports on the implementation performance of the project being financed. The systems should provide for accurate and timely reports on the accounts (Source and Uses of funds) of the project and the physical performance of the

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key project components. In case borrowers do not meet these requirements, the TDF should set the conditions of sanction/disbursement of the sub-loan along with time bound action plans for implementation.

- Having adequate procurement/contract management system. In case, the borrowers do not have adequate system, they agree to implement recommendations of the procurement consultant sent by the TDF on streamlining of procurement systems/procedures and strengthening of staff within an agreed time-frame starting with the establishment of procurement management table as the minimum condition for the sanction or disbursement of the TDF loan.

In addition, all the borrowers should have the institutional capacity to implement the project and to operate and maintain the constructed facilities in a satisfactory manner. In case where the institutional capacity of the borrower is not adequate, the TDF will ask the project sponsor to procure the technical assistance services.

3. LENDING TERMS

3.1 Fund Structure

TDF loan contributions can be allocated up to 90% of total project cost. Correspondingly, the matching funds (Own Source Contribution, OC) allocated by the borrower will be at least 5%.

3.2 Interest Rate

The interest rate depends on cost of funds, operating cost, anticipated default (loan loss), and return on equity of a financing program.

The interest rate will be subject to review by the TDF at least every two years according to business policy considerations.

3.3 Maturity and Grace Periods:

The determination of maturities for loans will allow flexible adaptation of repayment schemes to the cash flow of the specific project up to 20 years, including up to 5 years grace period.

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4. LENDING PROCEDURES

Registration: Borrowers would be required to submit a *Formal Request for Loan* to the TDF along with their financial statements (Financial Operations Plan, FOP), a comprehensive *Feasibility Study Report (FSR)* in the format to be designated by the TDF as part of its application. The TDF would assist the prospective borrowers to prepare the project outline in the prescribed format.

Initial Loan Appraisal: On the basis of the above Feasibility Study Report (FSR), the TDF would undertake initial appraisal and prepare the Initial Loan Appraisal Report (ILAR). The ILAR would contain an eligibility check on the borrower and the project. The TDF shall complete the initial appraisal process within two weeks from the date of submission of the application.

Final Loan Appraisal: After the ILAR is approved by the Executive Director (ED), Borrower shall apply to TDF for the proposed loan amount with Detail Project Report (DPR) i.e. details engineering report. TDF will complete the detailed appraisal containing technical, economic, financial, organizational, legal, social and environmental evaluation. The Final Loan Appraisal Report (FLAR) should be prepared within 2 months from the date of the approval of ILAR. The Final Appraisal Report (FLAR) will cover:

(a) Eligibility Criteria for projects and borrowers; (b) suitability of site; (c) availability of inputs; (d) appropriateness of and proven experience with, the technology offered; (e) project design; (f) arrangements for detailed engineering; (g) cost estimates; (h) construction and procurement arrangements; (i) arrangements for operation and maintenance; (j) arrangements for compliance with environmental, resettlement and social standards; (k) financing plan; (l) economic and financial viability of the project; (m) adequacy of the proposed financing; (n) the corporate and capital structure of the borrower; (o) institutional assessment; (p) required technical assistance; and (q) required covenants.

Based on the approval of FLAR by the Executive Director (and TDF Board/Donor Agency as necessary), TDF will enter into a Financial Agreement with the borrower.

Approval/Disbursements: Based on the decision on FLAR, the proposed loan will be approved by the TDF and a Loan Agreement between TDF and the borrower will be made. The conditions of approval would specify required covenants & procurement conditions, while disbursement conditions would be linked to implementation schedules. The TDF would

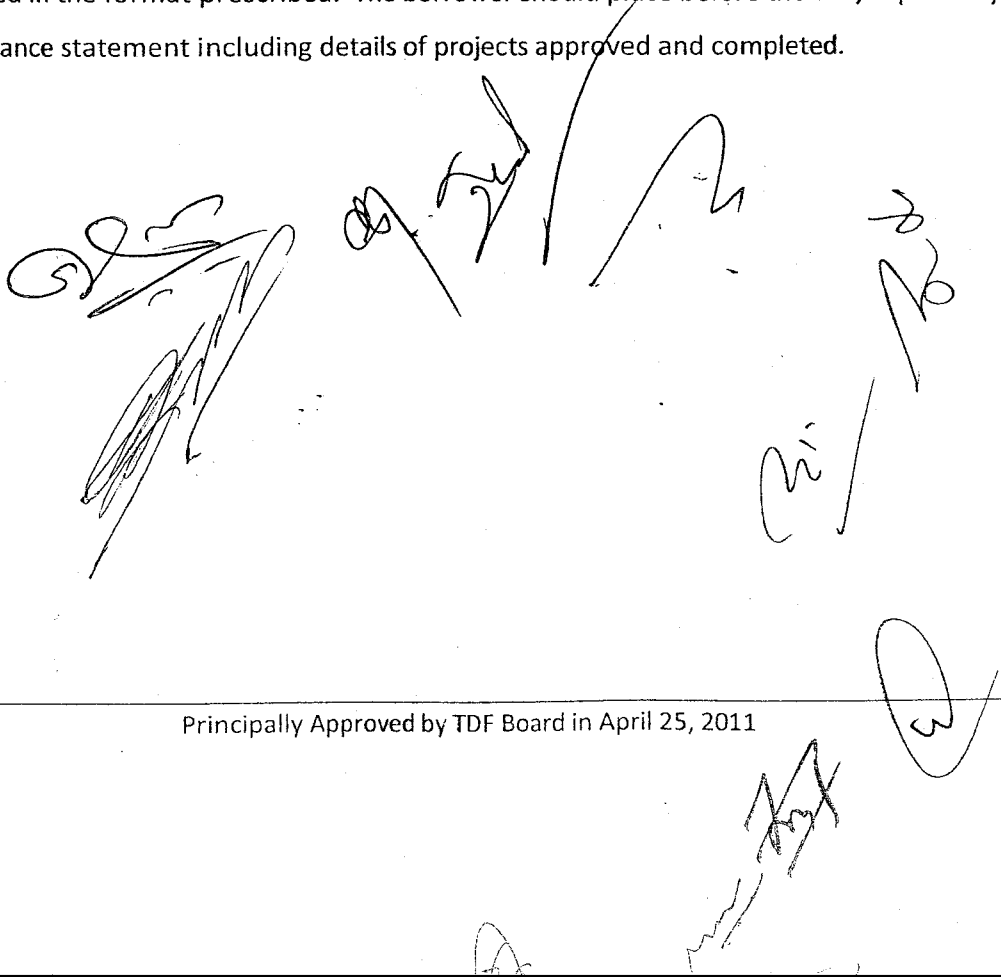
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also put in place a monitoring mechanism to ensure that its disbursement and procurement conditions are satisfied before further installments are released.

Typically, the conditions of approval would also specify the nature of collateral where applicable and the methods of repayments such as escrow accounts, debt service reserve fund, step-in rights, revenue intercept as needed. The conditions may require that the borrower shall take out and maintain with responsible insurers such insurance, against such risks and in such amount, as shall be consistent with normal business practice. The disbursements will be made to the borrowers only.

Monitoring: All borrowers would be required to submit quarterly progress reports to the TDF indicating physical and financial milestones targeted and achieved. The TDF would monitor implementation and in case where a time/cost overrun is anticipated, an immediate report describing the reasons and remedial actions including modifications if needed must be submitted by the borrower which will be re-appraised by the TDF. The borrower must receive formal re-approval by the TDF before commencing the work. The TDF would reserve its right to suspend/cancel the loans, if during course of project implementation there are serious violations of the approval/disbursement conditions.

Post Evaluation: After the projects are completed, a post evaluation report stating the costs, benefits, financial ratios, technical/social parameters achieved by the project would be submitted in the format prescribed. The borrower should place before the TDF, a quarterly performance statement including details of projects approved and completed.



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PART B: GRANT POLICIES

1. OBJECTIVES OF GRANT

With grant financing, the TDF fulfills its mandate as a service provider of TA to its clients which are in need for such support for project preparation, planning and implementation. In addition, the TDF follows the provisions of the central government in urban infrastructure financing in regards to the sector priorities and ceiling/cap for the allocation of capital grants.

2. GRANT POLICIES

2.1 Guiding Principles

Grants will be made available for:

- (1) Technical Assistance (TA) for Design and Supervision Management (DSM);
- (2) Projects which are eligible in the following sectors (Municipal projects specified in the LSGA, 1999):

- o **Social Infrastructures:** Drainage (Roads/Bridges/Culverts if part of drainage), Public Toilets, Slum Area Improvement (water, road, drainage, solid waste, and access roads to hamlets of the poor communities), SWM (Collection, Transportation and Disposal including equipments), Sanitation Programmes, Pre-primary Schools, Libraries/Reading Halls (book bank for poor children), Health Centres/Health Posts, Fire Station, Aged Rest-Houses/Orphanages, Water Pollution (including Sewerage, Waste Water Treatment Plants etc.), Social Housing, School buildings (hostels for girls and physically challenged), Green Zones/Parks/ Play Grounds, Municipal Hospitals, Aurvedic Hospitals etc.
- o **Basic/Utility infrastructures:** Roads and Bridges, Drinking Water, Preservation of Natural/Cultural/Archaeological/Heritage Sites, Slaughter House, Street Lightings, Municipal Buildings, Community Buildings and Rest Houses, Sports/Stadium, Recreational Area, Crematoriums, Museums, Protection of Natural resources including Controlling Air and noise pollution, Public Land Protection Works, River

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Cuttings/Floods/Soil Erosion Control, Preservation of Rivers/Streams/Ponds/Deep Water Wells/Lakes/Stone Spouts; and Plantation on Road sides etc.

- **Economic/Revenue Generating Infrastructures:** Bus Parks and Parking Spaces for Rikshwas/Horse Carts/Trucks etc., Cottage/Medium/Small Industries, Tourism Projects, Haat Bazar/Market Fair Centres/Exhibition Centres, Land Pooling, Communication Facilities, Generation/Distribution of Electricity etc.

The TDF board will revisit the above sectors on regular basis based on the government policy.

(3) Preparation of Resettlement Action Plan required in the course of a major project.

2.2 Eligible Grantees

TDF's Eligible Grantees are: municipalities, urbanizing Village Development Committees (VDC), District Development Committees (DDC), Urban Local Bodies Joint Committees (as per LSGA and Regulations), Town Development Committees (TDC), and Public Corporation Boards.

3. GRANT FINANCING TERMS

3.1 Grant for Design and Supervision Management

For Design and Supervision management, grants will be allocated up to 12% of total investment cost. Grantees are obliged to contribute at least 10% of DSM cost.

3.2 Capital Grant for Projects in Eligible Sectors

The capital grants, as a share of total investment, under the above mentioned eligible sectors will be allocated as follows:

- 80% for Social Infrastructure Projects
- 60% for Basic/Utility Infrastructure Projects
- 30% for Economic/Revenue Generating Infrastructure Projects and other projects under the LSGA.

The maximum grant (cap) for the concerned municipality will be based on the criteria developed by the GoN/MLD. However the above percentage and the cap will be reviewed by the TDF Board as per the Urban Infrastructure Financing Policy of GoN.

3.3 Grant for Preparation of Resettlement Action Plan

Grant will be allocated only to such projects which require major resettlement schemes, subject to an own source contribution of the grantee with 10% of total cost.

3.4 Grant Service Fee

The service fee is based on the operational cost of grant service. The service fee will be subject to review by the TDF Board on a regular basis according to business policy considerations.

4. GRANT PROCEDURES

4.1 Design Consulting Service Grant

Projects financed by TDF grants can be designed either by the borrowers who submit the Final Design and Cost Estimate to the TDF, or with support of a qualified consultant to be financed and/or selected by the TDF following this policy. In case the borrower submits a Grant Application Form for financial assistance for Study of the projects; the TDF will evaluate the study application and provide financial support for study; and in case the borrower requests for TDF to hire and manage such consultants, TDF will tender the study, enter into and manage the Study Contract with the consultant through a tripartite agreement among the TDF, Borrower and the selected consultant.

Based on the TOR, the consultant will prepare the Pre-Feasibility and Feasibility Study Reports which needs the consent of the Stakeholder's Meeting and approval by the TDF. At this stage, the TDF will evaluate the project with regard to technical, economic, financial, institutional, legal, environmental, and social aspects and prepare Draft Appraisal Report (DAR).

Based on the Final Detailed Engineering Report or Detail Project Report (DPR), the final appraisal will be made and the Final Appraisal Report (FAR) will be prepared by the TDF.

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4.2 Capital Grant

Based on the eligibility of grantees and sectors mentioned in this policy and that of the FAR mentioned in 4.1 above, the capital grant allocated to the project will be approved and be entered into the Grant Agreement with the eligible grantee. The Grant Agreement will specify conditions of disbursement, withdrawal, suspension and cancellation of the grant.

Monitoring: All grantees would be required to submit quarterly progress reports, indicating physical and financial milestones targeted and achieved to the TDF. The TDF would monitor implementation and in case where a time/cost overrun is anticipated, an immediate report describing the reasons and remedial actions including modifications should be submitted to the TDF by the Grantees; and should get approval before the commencement of further work. The TDF would reserve its right to suspend/cancel the grant, if during course of project implementation there are serious violations of the approval/disbursement conditions.

Post Evaluation: After the projects are completed, a post evaluation report stating the costs, benefits, financial ratios, technical/social parameters achieved by the project would be submitted in the format prescribed. The Grantee would place before the TDF, a quarterly performance statement.

4.3 Supervision Consulting Service Grant

Projects financed by TDF can be supervised either by the project sponsors or with support of a qualified consultant to be selected and financed by this policy. In case the borrower submits a Grant Application Form for financial assistance for Supervision Consulting Services for the projects; the TDF will evaluate the application and provide financial support for supervision consulting services; and in case the borrower requests for TDF to hire and manage such consultants, TDF will tender, enter into and manage the Contract with the consultant through a tripartite agreement among the TDF, Borrower and the selected consultant.

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Supervision consultant would be required to submit monthly progress reports, indicating physical and financial milestones targeted and achieved to the TDF/project sponsor. Project sponsor and TDF would monitor implementation and in case where a time/cost overrun is anticipated, an immediate report describing the reasons and remedial actions including modifications should be submitted to the TDF by the Project Sponsor; and should get approval before the commencement of further work. The TDF would reserve its right to suspend/cancel the grant, if during course of project implementation there are serious violations of the approval/disbursement conditions.

PART C: FEE-BASED SERVICES

TDF can offer its service to its DPs and GoN to channel loans or grants (retailing) on mutually agreed fee based terms and conditions. TDF services will include efficient delivery of project management services.

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