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Report No: PAD3625

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED STRATEGIC CLIMATE FUND LOAN AND GRANT

IN THE AMOUNT OF US\$24 MILLION

(US\$17.9 MILLION LOAN AND US\$6.1 MILLION GRANT)

TO

NEPAL

FOR A

FORESTS FOR PROSPERITY PROJECT

June 26, 2020

Environment, Natural Resources and Blue Economy Global Practice
South Asia Region

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CURRENCY EQUIVALENTS

(Exchange Rate Effective DATE)

Currency Unit = NRS

= US\$1

US\$ = NR111

FISCAL YEAR

January 1 - December 31

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ABBREVIATIONS AND ACRONYMS

BAU	Business as Usual (counterfactual/without project)
BEC	Bid Evaluation Committee
CBFM	Community Based Forest Management
CF	Community Forest
CFM	Collaborative Forest Management
CFUG	Community Forest User Group
CGAS	Computerized Government Accounting System
CPF	Country Partnership Framework
DFO	Division Forest Officer
DGM	Dedicated Grant Mechanism
DoFC	Department of Forests and Soil Conservation
DTCO	District Treasury Controller Office
E&S	Environment and Social
EIB	European Investment Bank
ESA	Environment and Social Assessment
ESCP	Environment and Social Commitment Framework
ERP	Emissions Reduction Program
ESF	Environmental and Social Framework
ESMF	Environmental and Social Management Framework
ESMS	Environmental and Social Management System
FBE	Forest-based Enterprise
FCPF	Forest Carbon Partnership Facility
FI	Financial Intermediary
FIP	Forest Investment Plan
FM	Financial Management
FPDB	Forest Products Development Board
PPMU	Federal Project Management Unit
FY	Financial Year
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GoN	Government of Nepal
GRM	Grievance Redress Mechanism
GRS	Grievance Redress Service
IFC	International Finance Corporation
INGO	International Non-Governmental Organization
IP	Indigenous Peoples
IPP	Indigenous Peoples Plan
IPPF	Indigenous Peoples Planning Framework
IRR	Internal Rate of Return
IUFR	Interim Unaudited Financial Report
LMBIS	Line Ministry Budget Information System
LHF	Leasehold Forest
MAI	Mean Annual Increment
MIS	Management Information System
M&E	Monitoring and Evaluation

MoF	Ministry of Finance
MoFE	Ministry of Forests and Environment
MoITFE	Ministry of Industries, Tourism, Forests & Environment
MSFP	Multi-Stakeholder Forest Program
NDC	Nationally Determined Contribution
NFC	Nepal Forest Corporation
NGO	Non-Governmental Organization
NPV	Net Present Value
NTFP	Non-Timber Forest Product
OP	Operational Plan
PB	Private Bank
PDO	Project Development Objective
PEC	Proposal Evaluation Committee
PLMBIS	Provincial Line Ministry Budget Information System
PLMG	Public Land Management Group
PMU	Project Management Unit
PMP	Pest Management Plan
POM	Project Operational Manual
PPMU	Provincial Project Management Unit
PPSD	Project Procurement Strategy for Development
PTCO	Provincial Treasury Comptroller Office
RAP	Resettlement Action Plan
REDD	Reducing Emissions from Deforestation and Forest Degradation
REDD IC	REDD Implementation Centre
RPF	Resettlement Policy Framework
SEP	Stakeholder Engagement Plan
SFM	Sustainable Forest Management
SME	Small and Medium Enterprise
STEP	Systematic Tracking of Exchanges in Procurement
SuTRA	Sub-national Treasury Regulatory Application
TAL	Terai Arc Landscape
TCN	Timber Corporation of Nepal
TSA	Treasury Single Account
UNFCCC	United Nations Framework Convention on Climate Change
WB	World Bank
WBG	World Bank Group



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DATASHEET

BASIC INFORMATION				
Country(ies)	Project Name			
Nepal	Forests for Prosperity Project			
Project ID	Financing Instrument	Environmental and Social Risk Classification		
P170798	Investment Project Financing	Substantial		
Financing & Implementation Modalities				
<input type="checkbox"/> Multiphase Programmatic Approach (MPA)	<input type="checkbox"/> Contingent Emergency Response Component (CERC)			
<input type="checkbox"/> Series of Projects (SOP)	<input type="checkbox"/> Fragile State(s)			
<input type="checkbox"/> Performance-Based Conditions (PBCs)	<input type="checkbox"/> Small State(s)			
<input checked="" type="checkbox"/> Financial Intermediaries (FI)	<input type="checkbox"/> Fragile within a non-fragile Country			
<input type="checkbox"/> Project-Based Guarantee	<input type="checkbox"/> Conflict			
<input type="checkbox"/> Deferred Drawdown	<input type="checkbox"/> Responding to Natural or Man-made Disaster			
<input type="checkbox"/> Alternate Procurement Arrangements (APA)	<input type="checkbox"/> Hands-on Enhanced Implementation Support (HEIS)			
Expected Approval Date	Expected Closing Date			
08-Jul-2020	30-Sep-2025			
Bank/IFC Collaboration				
No				
Proposed Development Objective(s)				
The Project Development Objective (PDO) is to improve sustainable forest management; increase benefits from forests and contribute to net Greenhouse Gas Emission (GHG) reductions in selected municipalities in Province 2 and Province 5 in Nepal.				



Components

Component Name	Cost (US\$, millions)
Policy & capacity building support for new government structures and processes for sustainable forest management	2.90
Community-based sustainable forest management and smallholder forest plantations	10.76
Forest enterprise improvement and development	7.35
Project management, monitoring and learning	2.99

Organizations

Borrower:	Nepal
Implementing Agency:	Ministry of Forests and Environment

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	24.00
Total Financing	24.00
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	24.00
Strategic Climate Fund Credit	17.90
Strategic Climate Fund Grant	6.10

Expected Disbursements (in US\$, Millions)

WB Fiscal Year	2020	2021	2022	2023	2024	2025	2026
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Annual	0.00	2.46	4.77	5.79	4.85	3.85	2.29
Cumulative	0.00	2.46	7.23	13.02	17.86	21.71	24.00

INSTITUTIONAL DATA

Practice Area (Lead)

Environment, Natural Resources & the Blue Economy

Contributing Practice Areas

Finance, Competitiveness and Innovation

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	● Substantial
2. Macroeconomic	● Substantial
3. Sector Strategies and Policies	● Moderate
4. Technical Design of Project or Program	● Substantial
5. Institutional Capacity for Implementation and Sustainability	● Substantial
6. Fiduciary	● High
7. Environment and Social	● Substantial
8. Stakeholders	● Moderate
9. Other	
10. Overall	● Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[] Yes [✓] No



Does the project require any waivers of Bank policies?

[] Yes [✓] No

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

E & S Standards	Relevance
Assessment and Management of Environmental and Social Risks and Impacts	Relevant
Stakeholder Engagement and Information Disclosure	Relevant
Labor and Working Conditions	Relevant
Resource Efficiency and Pollution Prevention and Management	Relevant
Community Health and Safety	Relevant
Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Relevant
Biodiversity Conservation and Sustainable Management of Living Natural Resources	Relevant
Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Relevant
Cultural Heritage	Relevant
Financial Intermediaries	Relevant

NOTE: For further information regarding the World Bank's due diligence assessment of the Project's potential environmental and social risks and impacts, please refer to the Project's Appraisal Environmental and Social Review Summary (ESRS).

Legal Covenants

Sections and Description

By no later than forty-five (45) days after the Effective Date, the Borrower shall prepare and adopt a Project Operational Manual.

The Borrower shall establish by two (2) months after the Effective Date Federal Project Management Unit, Provincial Project Management Unit 2 and Provincial Project Management Unit 5, each of which headed by a project coordinator, with adequate professional and administrative staff in sufficient numbers and with



qualification and experience and under terms of reference satisfactory to the World Bank, and provided with resources and powers as shall be required for it.

The Borrower shall establish by one (1) month after the Effective Date, and thereafter maintain, throughout the period of implementation of the Project, one Project Steering Committee at the Federal Level, one Project Steering Committee for Province 2 and one Project Steering Committee for Province 5 at the Provincial Level, with functions, composition, and resources acceptable to the World Bank.

Conditions

Type	Description
Effectiveness	<p>(a) the execution and delivery of the Grant and Loan Agreements on behalf of the Recipient have been duly authorized or ratified by all necessary governmental action;</p> <p>(b) the SCF Grant Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Recipient to make withdrawals under it (other than the effectiveness of this Agreement) have been fulfilled; and</p> <p>(c) the Subsidiary Agreement has been executed on behalf of the Borrower and the Project Implementing Entity.</p> <p>The Additional Legal Matter consists of the following, namely that, the Subsidiary Agreement has been duly authorized or ratified by the Borrower and the Project Implementing Entity and is legally binding upon the Borrower and the Project Implementing Entity in accordance with its terms.</p>
Disbursement	<p>(a) under Categories (2)(a), (2)(b), (2)(c) and (4)(a) until and unless legislation/policy/regulations satisfactory to the World Bank have been furnished to the World Bank showing that the Borrower has implemented reporting procedures to ensure appropriate and timely reporting by the Participating Provinces and Selected Municipalities to the Federal Government on the use of the proceeds of the Financing for their intended purposes.</p> <p>(b) under Categories (2)(a), (2)(b) (2)(c) and (3) until and unless the Project Operational Manual has been prepared, approved and adopted by the Borrower in a manner and substance satisfactory to the World Bank;</p> <p>(c) under Category (4)(a) until and unless the CBFM Grant Manual has been prepared, approved and adopted by the Borrower, in a manner and substance satisfactory to the World Bank; and</p> <p>(d) under Categories (4) (b) until and unless the Plantation Grant Operational Manual has</p>



been prepared, approved and adopted by the Borrower, in a manner and substance satisfactory to the World Bank.



I. STRATEGIC CONTEXT

A. Country Context

1. A new government, backed by an unprecedented majority in Parliament took office on February 15, 2018.

This follows successful elections for all three tiers (local, state and federal) of the new state architecture defined by the 2015 constitution, marking a protracted-but-successful conclusion of a political transition that began with the signing of the Comprehensive Peace Agreement in November 2006. State governments largely mirror the coalition at the center. At the sub-national level, funds, functions and functionaries hitherto managed by the central, district and village authorities are moving to the seven new provinces and 753 local governments for which new legislation, institutions and administrative procedures are being formalized as constitutionally prescribed. Meanwhile, the central level authority is being streamlined with a focus on national policies and oversight. This profound level of state restructuring is expected to result in improved outreach and service delivery in the medium term but is likely to take time before becoming fully operational.

2. Over the past decade, Nepal's economy has performed reasonably well. Real growth domestic product (GDP) growth averaged 4.9 percent (at market prices) over 2010-19. Although declining as a share in the economy, agriculture continues to play a large role, contributing over 29 percent of GDP in FY2019. The service sector has grown in importance, accounting for 46 percent of GDP in FY2019. Industry and manufacturing have grown more slowly and their relative share in the economy has averaged 14 percent of GDP over the past decade. Similarly, exports continue to struggle, while imports are fueled by remittances. Remittances have remained stable, with its share as a percentage of GDP averaging 24.5 percent, supported by an increased transfer of funds through formal channels in recent years. Inflation has been in single digits for most of the past decade, with the peg of the Nepalese rupee to the Indian rupee providing a nominal anchor. Fiscal balances remained sustainable owing to strong revenue growth and modest spending. However, the federal government is now sharing revenue and transferring grants to provincial and local governments, as part of the recent reforms linked to federalism. The poverty headcount ratio (at the international line of US\$1.90/day) is estimated at 8 percent in 2019, down from 15 percent in 2010. At a higher line (US\$3.20/day), 39 percent of the population is estimated to be poor in 2019, which is a decline of more than 10 percentage-points from 2011. Despite the declining poverty trend, vulnerability remains high. Almost 10 million people (close to 29 percent of the population) are estimated to live between US\$1.9 and US\$3.2 a day in 2019 and face a significant risk of falling into extreme poverty, should a shock occur.

3. GDP growth was 7.1 percent in FY2019 backed by tourism and strong agricultural growth; in FY2020, the COVID19 pandemic is expected to cause a large reduction in growth. The service sector grew by 7.5 percent in FY2019, supported by remittance inflows and tourist arrivals which in turn contributed to expansion of retail trade, transport, hotel and restaurant activity. Agriculture grew by 5 percent, due to good monsoons together with increased commercialization, the availability of fertilizers and seeds, and irrigation facilities. This helped raise paddy production, maize, and wheat to historic highs, almost doubling agriculture's contribution to GDP growth. In FY2019, agriculture accounted for 29 percent of overall GDP growth. Government revenue has performed well in FY2018 and FY2019 compared to previous years. However, the COVID-19 pandemic is expected to significantly reduce growth in FY2020. Activity in the tourism sector has been significantly impacted, causing a reduction in hotel occupancy rates and transport services that is estimated to exceed 50 percent. Also, expenditure levels are expected to increase significantly as government puts in place programs and measures to mitigate the impact of COVID on the economy and support recovery. This will add to existing spending pressures from ongoing implementation of federalism and federal transfers to provincial and local governments.



4. **Inflation averaged 4.5 percent year on year (y/y) in FY2019, lower than the monetary policy target of 5.5 percent.** The price of non-food items grew by 5.8 percent, driven mainly by housing and utilities, while food prices rose only 3 percent due to good agricultural production. In the last two months of FY2019 (i.e., June/July 2019), inflation spiked to 6 percent (y/y). This was driven by higher food prices due to increased pesticide tests on vegetables and fruits imported from India which resulted in lower uptake of imported food and increased domestic prices. Over the first six months of FY2020, inflation averaged 6.4 percent (y/y), driven by higher vegetable prices and increased import duties on certain agricultural and industrial goods. This has widened the inflation gap with India and contributed to a 2.1 percent (real effective) appreciation of the Nepalese Rupee. As the effects of the COVID pandemic unfold, in terms of domestic demand and supply shocks, this is expected to put more pressure on inflation.

B. Sectoral and Institutional Context

5. **The government's forest sector strategy and policy have the goal to increase forests' contribution to national prosperity and climate change mitigation.** The 2016 Forest Sector Strategy and the National Forest Policy 2019 describe Nepal's vision as one where the "potentials of forest ecosystems, biodiversity and watersheds are fully optimized for peoples' prosperity". Forest ecosystems and watersheds are managed to be sustainable and climate resilient through a decentralized, competitive, and well-governed forest sector providing inclusive and equitable incomes, employment, and development opportunities. Sustainable Forest Management (SFM) is mentioned as a tool for achieving the forestry ministry's vision of "Forests for Prosperity". In its Nationally Determined Contribution (NDC) (2016) to address climate change, Nepal has committed to reduce greenhouse gas emissions from deforestation and forest degradation.

6. **Nepal's total forest area (including shrubs)¹ is 6.4 million ha representing a forest cover of 45 percent of the land area.** Most forest is state-owned, with private forests occupying less than one percent. State-owned forests are further divided into protected areas and national forests, with the latter comprising government-managed forests, community forest, collaborative forest, leasehold forest, forest conservation areas and religious forest.

7. **Although Nepal is richly endowed with forest resources, the forest sector productivity is low with the country importing wood products.** Officially reported harvests of roundwood average about 60,000m³/yr². It is estimated that 1.2 million m³ of fuelwood and 900,000 m³ of timber could be sustainably harvested annually, generating employment opportunities for 4.8 million people. After decades of effective protection, a significant area of forest under community-based forest management (CBFM) now has potential for the sustainable production of timber and non-timber forest products (NTFPs) to help meet rural livelihood needs, sustain local forest-based enterprises and jobs, and substitute imports.

8. **The Constitution of Nepal involves a major transformation of forest sector governance.** New opportunities have been created for enhancing forest governance and the regulatory framework by (i) strengthening local level accountability and responsibility, and (ii) tailoring regulatory provisions to meet the needs of the provinces. Each province can now develop its own policy and regulatory framework, to collect taxes and share revenues from natural resource use. As part of the federalization process, the Federal Government has recently passed a new Federal Forest Act (2019) and Provincial and Local Governments are now expected to follow suit by developing their own legislation and regulations that reflect their new roles. Technical, administrative and managerial capacity needs to be established at all levels. Civil society organizations, NGOs, communities and the private sector also need to understand their new

¹ DFRS, 2015. State of Nepal's Forests. Forest Resource Assessment, Nepal. MoFSC, Kathmandu

² Magrath, William B., Ashish Shrestha, Bhishma Subedi, Hari Bansha Dulal, and Rex Baumback. 2013. Nepal Forest Sector Survey: Policy priorities and recommendations. Washington, DC: Program on Forests (PROFOR).



roles, responsibilities, and opportunities. The procedures and protocols to transfer forests to CBFM groups for their management under the new 3-tier federal government is clarified in the 2019 Forest Act.

9. Successful CBFM has over the past 30 years has been the key to reversing deforestation and forest degradation. The Government has gradually transferred the national forest user rights to communities for their management under various models³. CBFM was originally to achieve forest conservation and meet household subsistence requirements⁴. About 2.23 million hectares (34 percent) of Nepal's forests are now managed by 22,266 community forest user groups (CFUG) representing 2.9 million households. Poorer households have been effectively supported through land allocation inside community forests for fodder and NTFP production. CBFM remains a mainstay of Nepal's Forest Sector Strategy (2016) and is a priority under Nepal's 15th National Development Plan along with forest-based enterprise development and ecotourism. Nepal intends to hand over additional forest areas to communities for SFM.

10. Small and medium-sized forest-based enterprise (SMEs) development is hampered by several constraints. Forest-based SMEs could generate more than US\$8.7 billion/yr and 1.38 million workdays through 400,000 sustainable full-time green jobs⁵. Yet, small entrepreneurs are poorly integrated, have no access to modern technology to reduce waste, increase the value and quality of their products and reduce imports. Development of SMEs is constrained by complex, lengthy, and incomplete regulatory requirements. Nepal ranks 110 out 190 countries in the Ease-of-Doing-Business Report. Business development services are not available, including support to develop sustainable business management plans, and to produce and sell commercially viable products. Banks cite lack of liquidity for extending credit to forest-based SMEs. Other impediments include lack of market access, financial literacy of potential clients and information services for SMEs in rural communities.

11. Forests remain important livelihood assets for poor, rural, landless people, yet employment and income earning opportunities remain scarce contributing to out-migration. Prior to the COVID-19 crisis, migration of mainly young males to cities and abroad left aging and gender-biased village populations. Remittances contributed significantly to many household incomes whilst reduced availability of farm labor and improved market access led to changes in subsistence agriculture with a shift towards cash crops, reduction in livestock and abandonment of less productive land. Dependency on local forests for energy, fodder, building materials and other products has reduced, especially for better-off households. However, since the COVID outbreak, this trend has been reversed (probably temporarily) with migrant workers returning to villages. There's anecdotal evidence of increased pressure on forest and wildlife resources. Income from remittances will also have dropped significantly.

12. Women's involvement in commercial forest sector activities is limited. Traditionally, women have been involved in collection and utilization of subsistence forest products, whilst timber harvesting for commercial sales, and forest product utilization and processing involving skilled work and business activities have been male dominated. The potential to generate paid employment and equal opportunities in skilled and entrepreneurial positions has yet to be realized. Creation of such opportunities is now relevant given the extent of rural, male out migration and the enhanced education of women and girls.

13. Land use patterns in rural areas are changing. Less productive areas of privately-owned farmland in both the Terai and mid-hills are increasingly coming out of agricultural use, primarily due to lack of farm labor or sometimes

³ The modalities under community-based forest management are community forestry, collaborative forestry, leasehold forestry, and protected area buffer zone management – CFUGs are legally registered under the Forest Act.

⁴ Springate-Baginski & Blaikie, 2007. Forests, people and power: the political ecology of reform in South Asia

⁵ MFSP, 2014. Potential of Forestry Sector in Economic Growth and Development: Short Concept Notes on five themes. Kathmandu, Nepal.



because of excessive wildlife damage to crops adjacent to protected areas. In the Terai, underutilized farm land often has no irrigation whilst in the mid-hills it may be steep with thin rocky soils and tiny terraces only cultivable under rainfed agriculture. Owners are keen to utilize these lands more productively in less labor-intensive ways.

C. Relevance to Higher Level Objectives

14. The Bank has committed to a strategic forest engagement with Nepal and the project is central to that engagement. In 2018, the Bank developed a Nepal forest note “*Forests for Prosperity at a Time of Transformation*” presenting a programmatic forest landscape approach (“Program”) in support of Nepal’s forest sector strategy. The Program supports sustainable management of Nepal’s natural assets by linking REDD+, forest conservation, sustainable forest management and integrated watershed management. The related operational investment framework is provided through the Emissions Reduction program (ER-P) for the Terai Arc Landscape (TAL) which identifies areas for new and additional forestry and forest-smart investments. The project is consistent with this forest engagement and combines scaling up and improving the successful model of CBFM with piloting new and transformational activities such as small holder plantation forestry, forest enterprise development and access to affordable finance for forest activities for later scaling up. The recently launched Environmental Sector Diagnostic for Nepal underscores that forests provide critical ecosystem services beyond timber and fuelwood and support key sectors, including agriculture, hydropower, and tourism.

15. The project is consistent with three priority areas of the World Bank Group Country Partnership Framework for Nepal FY19-23⁶: (i) strengthening public institutions; (ii) private sector led jobs and growth, and (iii) inclusion and resilience. The project will enhance the contribution of the forest sector to economic growth, livelihoods, job creation, and prosperity; and improve the regulatory framework as well as institutional capacity (particularly at the municipal and provincial levels) for managing forests. One of the objectives of the inclusion and resilience priority areas is the increased adoption of sustainable natural resources management, about which CPF states that “the World Bank will support Nepal’s efforts towards sustainable use of natural resources to enhance resilience and underpin economic growth”. The project also supports the Maximizing Finance for Development (MfD) approach as the project will facilitate and support forest-based private sector investment to add value to and meet the domestic demand for roundwood, sawn timber and other timber and non-timber products.

II. PROJECT DESCRIPTION

A. Project Development Objective

16. The Project Development Objective (PDO) is to improve sustainable forest management⁷, increase benefits from forests and contribute to net Greenhouse Gas Emission (GHG) reductions in selected municipalities in Province 2 and Province 5 in Nepal.

17. It is expected that overall forest productivity will increase in the short-to medium-term while increasing forest area and quality. This will be achieved by moving from a conservation and subsistence-oriented approach to sustainable forest management and to establish smallholder forest plantations on public and private lands. Sustainably managed forests and plantations will provide monetary and non-monetary benefits⁸ to communities and entrepreneurs, including income from sales of timber and non-timber forest products (NTFPs) and salaries from forest-

⁶ World Bank Group Country Partnership Framework for Nepal FY19-23, Report No. 83148-NP; July 10, 2018 discussed at the Board on August 7, 2018

⁷ SFM is defined by FAO as “managing forests sustainably [for] increasing their benefits, including timber and food, to meet society's needs in a way that conserves and maintains forest ecosystems for the benefit of present and future generations”.

⁸ Non-monetary benefits from SFM: ecosystem services such as habitat provisioning, water regulating services and supporting services.



based jobs. The project will have about 110,000 beneficiaries. SFM and plantations will increase forest cover and carbon sequestration while reducing net greenhouse gas emissions. The project will directly benefit the communities, including indigenous peoples, women and other disadvantaged groups participating in CBFM, and small and medium sized entrepreneurs (and their employees) involved in forest product harvesting, sale, transport and processing. The project will contribute to the post-COVID-19 recovery in Nepal because of its investments in CBFM in rural areas and the creation of new jobs in both harvesting and processing of wood and non-wood products.

18. The project has the following PDO indicators⁹:

- Forest area brought under management plans (ha)
- People in targeted forest and adjacent communities with increased monetary or non-monetary benefits from forests (#, disaggregated by gender and disadvantaged group)
- Net GHG emissions (tons CO₂ eq.)
- Share of project beneficiaries who report being satisfied with project interventions (livelihoods, forest management, other) (percent, disaggregated by gender and disadvantaged group)

B. Project Components

19. The project has three interlinked components¹⁰. The project is designed to increase the forest area under sustainable community-based productive management and under private plantations, resulting in greater supplies of wood and non-wood forest products. Investments in forest-based SMEs will be stimulated to utilize these products and generate paid employment, by removing regulatory constraints, and by providing technical assistance and access to credit. Nepal's recent Federal Constitution requires significant capacity building of the different institutions operating in the forest sector.

20. The project will be implemented in Province 2 and Province 5, selected for their sustainable forest management potential, as suitable locations for forest-based SMEs and their importance for the Emissions Reductions Program (ER-P) for the Terai Arc Landscape¹¹. Within these two provinces, 50 municipalities will be selected¹² for project implementation according to agreed criteria including: the potential for community-based sustainable forest management; new plantation establishment; location of forest-based enterprises; the currently low levels of rural employment and incomes; and the willingness and basic capacity to participate in the project. Local governments with fully staffed finance and administrative sections that are prepared to hire their own technical (forestry) staff will be preferred. Forest-based enterprises located anywhere within these two provinces can be supported.

21. All project interventions will help support the revival of the rural economy once the COVID-19 lock down measures are lifted. These activities through, working with the Provinces, Municipalities and local communities include the more immediate investments in green infrastructure such as tree planting, gully plugging, construction of embankments in erosion prone areas, utilizing the natural capital that has built up in the forests managed by the CBFM groups for increased harvesting and processing, and providing support for SMEs in the forest sector for increased value addition and green value chains.

⁹ For definitions measurement methodology, data source and responsibility for tracking the indicators, see chapter VII.

¹⁰ A fourth component is dedicated to project management.

¹¹ The 50 municipalities (25 in Province 2 and 25 in Province 5) will be selected by the provincial governments with a no-objection from the federal government based on agreed criteria which are included in the Project Operations Manual (POM).

¹² Selection criteria for municipalities include: availability of suitable areas for plantations and/or forest to transfer to CBFM groups; financial management capacity of municipal administration; willingness to invest own resources in forestry sector; track record in forest sector planning and/or land-use planning; suitable locations for enterprise establishment; within ER-P area.



Component 1: Policy and capacity building support for new government structures and processes for sustainable forest management (US\$2.90 million - 100% grant)

22. **This component will provide capacity building for implementation of new roles and responsibilities under the Constitution by respective parts of the government including:**

- (a) support to the forestry institutions at the Federal Level for formulation of processes to develop or review forest policies, strategies, laws and regulations at the Federal Level and development of a national third-party certification process;
- (b) support to the Participating Provinces for development of Provincial Level forest sector policies, strategies, laws and regulations consistent with the federal framework as well as training on technical forest management; and
- (c) support to the Selected Municipalities for forest development activities involving CBFM groups and development of forest information sharing and networking hubs to foster partnerships and build capacities and awareness of municipalities and CBFM groups.

23. **Support for federal level forestry institutions:** Consultant support will include reviewing and developing processes for federal forest policy, strategy and regulations in the context of the new constitution, in accordance with the Federal Forest Act (2019) and to meet various international commitments. The project will provide MoFE with technical assistance for a national third-party SFM certification process.

24. **Support to Province 2 and Province 5 to fulfill their assigned roles and responsibilities:** Activities include technical assistance, including training to develop provincial level forest sector policies, strategies, laws and regulations under the umbrella of the national level law and policy. The staff of Provincial Forest Directorates, Division Forest Offices (DFO) and Sub-division Forest Offices will be trained in technical aspects of SFM to enable them to advise and support Local Governments and communities.

25. **At the Local level, the 50 selected municipalities will be provided with capacity support.** Activities include training for elected representatives, sectoral and administrative staff, covering participatory, forest sector planning, land-use planning, financial management and safeguards application. This will enable them to effectively guide and support forest development in their jurisdictions through deliberative and accountable processes. Local Governments will provide support, through service providers, to CBFM groups for SFM planning, forest enterprise development and provision of targeted services for disadvantaged forest users especially women, Dalits and Indigenous Peoples (IPs)¹³. Support will be provided for the Forest and /or, Environment and/or Disaster and /or Waste Management Sections of the Local Government Administration in the form of training, goods and works. This will enable them to develop as forest information sharing and networking hubs working with CBFM groups and individuals and foster partnerships, build capacities and awareness and provide a linkage with Dedicated Grant Mechanism (DGM)¹⁴ activities.

26. **The results of a functional review and institutional assessment of the forest sector will further guide this component.** Project activities under this component will complement and add value to those activities being implemented under the DGM for Indigenous Peoples (IPs) and Local Communities (LC) Project which focuses on enhancing the capacities of women, Dalits, IPs and other forest dependent people.

¹³ A separate grant manual will define eligibility criteria and operational procedure for allocating these grants.

¹⁴ The DGM Nepal is a separate project supported under the Forest Investment Program. It will be implemented by indigenous peoples and local community groups (IPLC) and promote a small grants mechanism for forest-dependent people in the same geographic area where the Forests for Prosperity Project will be implemented. The project will have a grant allocation of US\$4.5million.



Component 2: Community-based sustainable forest management and smallholder forest plantations (US\$10.76 million - 3% grant, 97% loan)

27. **This component will improve the productivity and increase the area of natural and plantation forests under community management.** Consistent with Nepal's Forest Sector Strategy target to bring 40 percent of Nepal's forests under community-based management, this component will increase the forest area under CBFM. The component will also establish plantations and agroforestry by smallholder farmers on private degraded, underutilized or marginal land and on degraded public lands. No plantations will be established within forests or on forest land and no invasive species will be used.

28. **Component 2 will be implemented in Province 2 and Province 5, especially in parts of Terai districts where access to forests and forest products is limited.** The component provides co-financing for interventions 1¹⁵ and 2¹⁶ under Nepal's Emissions Reductions Program (ER-P)¹⁷ and covers 50 municipalities in 9 of the 13 ER-P Terai-Arc Landscape (TAL) districts and in the remainder of the Terai, adjacent Chure and mid-hills.

Sub-component 2.1: Sustainable forest management through CBFM (US\$5.83 million - 6% grant, 94% loan)

29. This sub-component will provide

- (a) CBFM Grants from Province 2 and Province 5 to existing and new CBFM groups for the preparation of improved and revised forest management plans,
- (b) training and technical assistance from the selected municipalities to build capacity among existing CBFM groups to implement sustainable forest management and harvesting plans, and to improve CBFM groups' governance and technical aspects of forest management, and
- (c) technical assistance for the transfer of user rights of national forests in Provinces 2 and 5 to communities, including: (i) identification of the Selected Municipalities and protocols; and (ii) forming and operationalizing new CBFM groups for management of transferred forests, such as development and implementation of their constitutions and sustainable forest management and harvesting plans.

30. **Local Governments will provide support for the implementation of activities by CBFM groups.** Community groups will receive training and capacity building for technical and organizational improvements in CBFM. Local governments will hire local service providers to support group governance, capacity development, leadership, equitable benefit sharing and pro-poor decision-making. Technical aspects of SFM including the establishment of forest management demonstrations and for tackling site-specific issues such as removal of invasive species (esp. *Lantana* sp. and *Eupatorium* spp.) and for fire management and control will also be provided. Under this sub-component, for about 650 poor households, with preference given to Dalits and other IP groups, who have limited land of their own, land will be allocated inside community managed forests for production of fodder and NTFPs.

31. **The user rights of an additional 15,000 ha of national forest area will be transferred to approximately 100 new CBFM groups in accordance with the 2019 Forest Act involving about 10,000 rural households in the mid-hills, Chure and Terai under the various proven CBFM models (CF, CFM, LHF)¹⁸.** Provincial governments will hire service providers to support group formation including the preparation of constitutions as required under government guidelines.

32. **For about 93,000 ha of forest under CBFM, Provincial Governments will provide grants to CBFM groups for the preparation of improved and revised forest management plans based on sustainability principles.** CFUGs will develop

¹⁵ Improve management practices on existing community and collaborative forests building on traditional and customary practices

¹⁶ Localize forest governance through transfer of National Forests to Community and Collaborative Forest User Groups

¹⁷ https://www.forestcarbonpartnership.org/system/files/documents/Nepalpercent20ERPDpercent2024May2018final_CLEAN.pdf

¹⁸ The process for handing over user rights for national forests to community groups is an established process in Nepal.



simple and locally appropriate management and forest product harvesting plans and systems that will enable sustainable yet more productive forest use. CFUGs may hire technicians (experts) to support the development of these plans. The PPMUs will provide capacity building and training on procurement to CFUGs as needed. Provincial Division Forest Officers (DFO) will approve and monitor the implementation of the plans. The processes, administration and implementation of the grants will be governed by an approved Grant Operation Manual - priority for receiving grants will be assessed by DFOs based on criteria including those groups within participating municipalities having outdated operational plans (i.e. requiring revision) whilst having forest with productive potential.

Sub-component 2.2: Smallholder Plantations on public & private land (US\$4.93 million - 100% loan)

33. This sub-component will provide
 - (a) technical assistance through selected municipalities to build capacities to establish PLMGs for agroforestry plantation; and
 - (b) results-based payment through Plantation Grants, technical assistance and planting materials, to establish agroforestry plantations on private land of farmers as well as public land managed by PLMGs.
34. **Local government will support the establishment of and assist about 275 public land management groups (PLMGs) in the Terai.** Local government will procure local service providers to provide technical assistance (extension advice) and physical inputs (i.e. seedlings, materials, etc.) but not labor, for mixed agroforestry by planting trees and bamboo, and implementing soil and water conservation measures covering approximately 1,350 ha, for the benefit of about 4,500 poor households. The exact extent of public land available will be determined during year 1 of project implementation.
35. **Around 16,000 farmers in Province 2 and Province 5 will be supported to establish approximately 5,000 ha of fast-growing trees and agroforestry plantations on their private land.** For private plantations, the Local Governments will contract service providers to provide financial, technical and monitoring support to participating farmers on a payment-by-results basis. The identified species have performed well in the past, none are invasive, and they can produce cash incomes from poles, small timber and NTFPs. Establishment of mixed agroforestry plantations combining timber and horticultural species with bamboos and grasses will also be supported.
36. **For both private and public land, the project will provide incentives for smallholder plantations.** The local governments will provide grants to farmers and PLMGs (governed by the grants manual) to subsidize the cost of establishing plantations (seedlings, planting costs and other inputs such as weeding and protection) in form of results-based payments based on regular growth and survival monitoring. The local government will hire a service provider to monitor the implementation of the activities and verify that benchmarks for payments have been achieved. To promote gender equality consistent with GESI, one of the selection criteria for grant allocation will be to give preference to applicants with land under joint (male/female) ownership. Service providers contracted by Local Governments will monitor the grant implementation and provide technical support as needed. A pilot project for private plantation certification under recognized international standards e.g. W+, Plan Vivo etc. will be developed with the potential for future expansion of this approach.

Component 3: Forest Enterprise Improvement and Development (US\$7.35 million - 4% grant, 96% loan)

37. **The forest product based private sector will be supported by improving the enabling conditions and providing access to finance.** This component will address the constraints linked to the enabling and regulatory environment for the improvement, establishment and operation of existing and new small-scale forest-based businesses. It will ensure a favorable policy and regulatory environment for forest-based enterprises as well as ensuring predictable supplies of



raw materials. Removing these constraints will increase the demand for financial products offered by participating financial institutions (PFI) and private banks (PB).

38. CBFM groups and farmers will be supported to harvest timber and NTFPs from sustainably managed forests and plantations and to identify markets for the products. Under this component, a credit line for forest-based enterprises will be piloted to provide access to finance for existing and new forest-based SMEs. At the same time, existing and potential new entrepreneurs and forest-based enterprise owners will be provided with capacity support and training to access the new credit line for establishing and improving their industries. This component has potential to be scaled up in additional municipalities and provinces.

Sub-component 3.1: Enabling environment for the forest-based private sector (US\$1.08 million - 14% grant, 86% loan)

39. This sub-component will

- (a) carry out of studies, technical assistance and awareness raising activities to improve enabling conditions for a stronger forest industry to spur economic growth and employment;
- (b) provide training to identified small-business advisors to build capacity among existing and new business owners and entrepreneurs to prepare business plans, including financing plans and loan applications for forest based small and medium enterprise development;
- (c) provide capacity building to support innovation and new investment opportunities in forestry and forest product processing as well as to disseminate information regarding sustainable roundwood harvesting and innovative uses; and
- (d) provide technical assistance to CBFM groups to sustainably and safely supply raw materials through development and implementation of landscape-level forest harvesting plans in multiple forest areas within the Participating Municipality.

40. The enabling conditions for the establishment and functioning of forest-based enterprises as a source of economic growth and rural employment through the provision of technical assistance will be improved. Under this sub-component the federal and provincial governments will help remove bottlenecks for developing and sustaining a strong forest-based industry by providing technical assistance for supporting: (i) deregulation of the of constraining factors to timber harvesting, sales, transport, utilization and processing (including regulations affecting establishment of sawmills and forest based enterprises) to stimulate a more dynamic, market-oriented and productive domestic forest industry; (ii) awareness building in financial institutions to recognize forestry as a productive and investment-worthy sector; (iii) an assessment of the effects of duties on the import of forest products and forest and timber processing equipment; (iv) the development of labor standards and occupational health and safety of the forest industry; (iv) studies on gender-integrated value chains and the current status of timber harvesting, sales, transport and product utilization; and (v) a feasibility study for a real-time online timber auction system, followed by the design of an appropriate system. This sub-component will inform component 1 by identifying viable policy and regulatory options to be considered by all levels of government.

41. Small-business advisors will be identified by the PPMUs, trained and encouraged to work closely with existing and interested businesses and entrepreneurs (especially women). The advisors will provide training to entrepreneurs to prepare and submit business plans including financing plans and applications for loans (to be granted on a pilot basis) for forest-based SME development from the identified private banks.

42. Innovation and support for new investment opportunities will be fostered. PPMUs will hire service providers to create awareness and training on the use of wood and wood-based products in building as a ‘green’ and environmentally sustainable alternative to steel and cement and reduce GHG emissions; testing wood utilization and new technology in collaboration with academic and research institutions; architectural demonstrations; and other



discussion forums. Other capacity building includes the development of costs/financial, technical, technological, and market analysis skills. A silvicultural working group will be established by MoFE to disseminate information about sustainable roundwood harvesting and innovative uses.

43. Sustainable supply of raw materials will be ensured by introducing landscape-level forest harvesting plans from several CBFM forest areas within a municipality. Providing a sustainable supply chain will justify the establishment/improvement of roundwood and other utilization enterprises while ensuring that environmental and social standards for production are being met. CBFM groups and other local people will be provided with access to harvesting and safety equipment through the Forest and /or Environment and/or Disaster Management sections of Local Government Administrations supported under component 1 and will be provided with professional training in its use.

Sub-component 3.2: Design and piloting of a viable credit line for forest-based SME establishment and improvement (US\$6.28 million - 3% grant, 97% loan)

44. This sub-component will provide

- (a) capacity building to the Agricultural Development Bank Limited (ADBL) acting as a Project Implementing Entity (PIE) and the eligible Financial Intermediaries (FI) to design and pilot a credit line for establishment or improvement of forest-based small and medium enterprises, including product development, risk assessment and mitigations, and marketing; and
- (b) sub-loans for sub-projects through the PIE to the eligible FIs, which will be on-lent to the beneficiaries.

45. The credit facility design and piloting will support uptake of the financial sector lending to forest-based SMEs, a segment still facing constraints of limited access to finance and financial services in Nepal. The model will crowd in the private sector in line with the government strategy. There is limited access to finance to the forest-based SMEs, particularly for businesses without immovable collateral for medium-term tenure loans for equipment. Lack of financial literacy and entrepreneurial skill are also among the reasons why banks are reluctant to lend. In addition, many medium and large scale wood contractors, traders and other forest based enterprises may not be borrowing from the banks due to disclosure requirements related to tax.

46. This sub-component will provide US\$6 million through on-lending to eligible FIs in local currency. The intermediation will be managed by the ADBL. ADBL will act as an APEX bank for the intermediation to other eligible FI and retail service providers will on-lend directly to forest based MSMEs/ enterprises as per process described in the POM. ADBL will assume the credit risk of on-lending to FIs. MoF will directly provide the loan to ADBL – there will be a loan agreement between MoF and the ADBL. The credit line will support various activities for timber and NTFP treatment and processing.

47. Capacity will be built in ADBL and selected FIs to develop a pipeline, disburse and monitor the evolving forest-based SME portfolio. The Technical Assistance will help in enhancing the credit department to assess and monitor the forest-based SME portfolio, new product development, risk mitigations strategies (including potential collaterals, immovable and movable), marketing material, etc.

48. ADBL will on-lend to other FIs and forest based MSMEs as per the prevailing rules/ regulations and guidelines issues for “A” class commercial bank by Nepal Rastra Bank (Central Bank of Nepal). The ADBL will be one of the retail institutions, especially at the beginning of project implementation yet, the project legal document does provide for other retail financial institutions to take part in the future. The on-lender will assume the credit risk of the sub-loans. The FIs will be selected by the wholesale lender based on their financial health (including adequate profitability, capital, and quality portfolio with sound financial indicators), as well as experience in lending to forest-based enterprises or



similar sectors. The FIs' eligibility criteria will be stipulated in the Project Operations Manual (POM). All FIs/ forest based MSMEs/enterprises meeting the eligibility criteria and assessment needs provided in the POM will be allowed to participate in the project subject to the no objection by the World Bank's and the project management units.

49. ADBL will sign Sub-Loan Agreements (SAs) with the selected FIs. The FIs will then sign further Sub-Loan Agreements (SLAs) with SMEs. ADBL will make the sub-loans available to the FIs at a commercial or marginally commercial interest rate that will include, at a minimum, the cost of the World Bank funding to GoN plus a marginally commercial markup. On-lending will take place on an "open door" and "first-come first-serve" model for the eligible SMEs through the FIs. FIs will also be served on a "first-come first-serve" basis until the funding is fully used. Further criteria will be established in the POM. Performance of FIs will be assessed periodically to ensure that they continue to meet the eligibility requirements. The FIs sub-loan amount will be equivalent to the aggregate amount of principals of all the sub-loans made by the respective bank.

50. M&E of the sub-projects will be the responsibility of the FIs, including ADBL as one of the retail financial institution. The PMU will monitor the subprojects for compliance with WB's ESF standards, and applicable WB and GoN fiduciary requirements. ADBL (and any subsequent retail FIs) are expected to monitor the sub-project financial and commercial performance. In case ADBL is the sole retail bank providing loans, an independent third-party monitoring of the implementation of the credit line is recommended.

Component 4: Project Governance, Monitoring and Learning (US\$2.99 million - 84% grant, 16% loan)

51. **Component will finance the management of the project** including project governance and oversight, annual business planning and budgeting, financial management, procurement and contract management, environmental and social risks management and monitoring through FPMU, PPMU2 and PPMU5 as well as documentation of lessons learned from project implementation of project activities and stakeholders' efforts to scale-up good practices.

52. **The project will have Project Management Unit (PMU) at federal government level and an additional PMU in each of Province 2 and 5.** The role of each PMU is to support and manage project implementation working closely with the responsible Federal, Provincial and Local Government institutions for (a) project governance and oversight through effective stakeholder engagement; (b) budgeting; (c) annual work planning; (d) contract management; (e) financial management; (f) procurement of goods, works and services; (g) technical assistance (h) environmental and social risks management; and (i) conducting financial, environmental and social monitoring. The development of a forest sector Management Information System (MIS) will be supported by providing technical assistance to help design the system and the necessary hardware for its rollout in project supported offices at all three levels of government. The MIS will provide information for more effective forest sector planning, development and monitoring/control. The PMUs will be responsible for documenting lessons learned from the implementation of project activities to inform government and other stakeholder efforts to scale-up good practices and for preparing regular progress and financial reports as required. Cost centers in the Local Governments of the 50 selected municipalities will be established.

C. Project Beneficiaries

53. **The project will benefit government and non-government actors at municipal, provincial and federal levels.** Key project beneficiaries include CBFM groups whose members (especially women, Dalits and IPs) will benefit from improved forest management that will create increased supplies of forest products such as fuelwood, timber, fodder, medicinal plants, and other NTFPs. Households will also gain through benefit-sharing of group income from the sale of forest products and from new employment opportunities generated by sustainable harvesting and utilization. Special provisions will be made by CBFM groups to support the poorest households, consisting mainly of Dalits, IPs and women, through land allocation inside community forests for fodder and NTFP production (component 2.1) and, in the Terai,



through the establishment of PLMGs (component 2.2). New pro-poor leasehold forest groups will also be established specifically targeting poorer households. Capacity development will focus on group governance and that equitable benefit sharing for identified poor and disadvantaged households is included in group constitutions and operational plans. Collaborative Forest Management Groups will continue to provide subsidized or free forest products from their depots to meet the needs of distant users in the southern Terai. CBFM group members will benefit from forest management training (including improved SFM and harvesting practices) and from technical and financial support to invest in sustainable value chain and enterprise development.

54. Private plantation establishment (mainly in the Terai) will benefit smaller landowners especially where the land title is held jointly by both male/female household members. Beneficiaries will be selected considering socio-economic status with emphasis on smaller farmers and landowners. Provisions will also be made for landless and poor households in the Terai through the establishment of PLMGs.

55. Investments in forest-based enterprises and skill development will benefit those seeking skilled and better paid jobs in rural areas. Additional provisions will be made for safer working environments through upgrading of existing enterprises and technologies. Job creation under component 3 will emphasize the need to create equal opportunities for women, Dalits and IPs.

56. All levels of government will benefit from building capacity and technical skills to fulfill their respective roles and responsibilities. In the context of federalization, the project will also increase the technical capacities and awareness of new roles and responsibilities of forestry staff at all levels of government especially for elected representatives and staff of local governments and including those staff involved in planning, financial management and safeguards implementation.

D. Results Chain

57. The Theory-of-Change (ToC) reflects an ambitious yet transformational project design (annex 2). The project addresses the overall challenge that Nepal's forests are contributing below their potential to economic growth. In the medium term, the project is expected to lead to reforms in forest sector policy and the enabling environment (including for establishment and functioning of forest-based enterprises), improved SFM and resulting benefits for communities from forests and watersheds (especially in the Chure) and expansion of new and existing forest-based SMEs. Long-term project impacts will include increased forest productivity, greater contribution to economic growth, improved incomes and new jobs in rural areas, the adoption of institutional reforms consistent the new Federal Constitution resulting in better sector planning and service provision and the improved provision of environmental services e.g. GHG sequestration, watershed protection, protection of habitat for biodiversity, etc..

E. Rationale for Bank Involvement and Role of Partners

58. The World Bank is following a programmatic forest landscape approach (“forest engagement”) to better tackle forest and associated land use challenges¹⁹. Considering the challenges and opportunities associated with Nepal's forests and the ongoing federalization, the forest engagement supports exploring the under-tapped potential of Nepal's forests for economic growth, job creation, social stability and addressing climate change. This engagement is being implemented through a set of forest-smart-climate-smart operations in several sectors that address barriers and promote opportunities to further enhance the economic and climate contribution of forest landscapes.

¹⁹ Forest Engagement Note: Nepal - “Forests for Prosperity at a Time of Transformation”



59. **This forest engagement links the ongoing activities supported by the WB's FCPF and the FIP.** There is also potential to enhance WBG support for forest-smart investments in sectors that may affect or depend on forests such as agriculture, infrastructure and hydropower projects. The WB has supported Nepal with the ongoing REDD+ Readiness Project and the preparation of the Emissions Reductions Program (ER-P) in the Terai Arc Landscape (TAL).

60. **The project will also closely work together and complement the FIP-supported DGM Nepal.** The DGM will support a small grants mechanism for forest-related activities, including capacity development measures to be implemented by indigenous peoples and local community groups (IPLC) in Province 2 and Province 5. The DGM Nepal is expected to start implementation in FY21.

61. **The project has great potential to be replicated in additional municipalities and provinces.** The government is committed to handing over more forests to communities for their sustainable management and supporting forest-based private enterprise development. The preparation and implementation of the project has been just the beginning of a broader process which will require ongoing support by the World Bank and other development partners.

F. Lessons Learned and Reflected in the Project Design

62. **The project builds on lessons learned from several community-based forest operations.** Applicable lessons from similar World Bank-supported operations in other countries include (i) the need for legal, regulatory, and institutional reforms to shift from a command and control approach to a more facilitative role with communities, and time and commitment by forest departments; (ii) the importance of strengthening social capital, (iii) the recognition of the value of collective governance and traditional institutions, (iv) the opportunities to implement a variety of interventions at the forest-landscape level to better address the drivers of deforestation and degradation, (v) the potential and limits of technical assistance provided by extension agencies, knowledge networks and private service providers, and (vi) the importance of strong inter-institutional arrangements.

63. **The project design incorporates lessons learned from the Multi-Stakeholder Forest Program (MSFP).** This program (2011-2016) supported Nepal's forest sector and was funded by UK, Switzerland and Finland and built on earlier initiatives supported by these countries as well as Australia, Germany, Denmark and USA. These all promoted and supported CBFM as an effective approach for forest conservation, and by building the technical and governance capacity of forestry groups as autonomous and effective community-based organizations, have enabled them to plan and take equitable decisions for the benefit of their member households. Starting from a largely protection and subsistence forest product production role, these groups have now evolved into multi-functional local institutions taking responsibility for a range of local development roles including outside the forestry sector. They proved to be robust and able to continue to function during the conflict period (1996-2006) and have more recently taken on responsibility for a range of community-level climate change adaptation actions supported by various development partners.

64. **Forests under CBFM are now in greatly improved condition after two or more decades of protection.** Subsistence demands for forest products (i.e. firewood) have declined and are likely to continue to do so at the same time as the need for cash income and paid employment in rural areas has increased. The importance of forests for addressing climate change including reducing emissions from deforestation and forest degradation as well as the provision of environmental services that can enhance climate resilience such as soil and water conservation, biodiversity conservation and slope stabilization is now widely understood in Nepal and internationally. At the same time, forests have the potential to contribute to Nepal's economy that can help to lift households out of poverty and enhance their climate resilience. The lesson learnt from elsewhere is that increasing the productivity of forests through



sustainable management needs to be complemented by enhanced investment in forest product utilization, modern equipment and capacity development in order to achieve this.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

65. MoFE will be the implementing agency and responsible for the overall management and coordination of the project. However, project activities under Components 1, 2 and 3 and 4 will be executed by all three tiers of government including MoFE, the Ministries of Industry, Tourism, Forests and Environment (MoITFE) in Province 2 and Province 5, and Local Governments for the 50 selected municipalities in these provinces, consistent with the 2015 Constitution. These institutions will work directly with CBFM groups of various kinds, with service providers and with private farmers. Three Project Implementation Units (PMUs) will be established: one in the REDD Implementation Center (REDD IC), MoFE (federal PMU - FPMU) and one each in the two provincial MoITFEs (Provincial PMU – PPMU). Each PMU will be headed by a project coordinator (PC) and will have technical, financial management, procurement, M&E and administrative staff. Project oversight and accountability will be provided by three project steering committees which will include representatives from government (MoFE and MoF) and their provincial government equivalents and local government representatives (selected from participating municipalities), community representatives (selected by networks of CBFM groups covered by the project), and private sector representatives from forest-based industry. At local government level multi-stakeholder forums will be established for the project and will coordinate with formal local government structures. ADBL will be responsible for the implementation of the credit line and communicate on a regular basis with the FPMU and the PPMUs. Reporting requirements on the credit line to MoF will be identified in the loan agreement between MoF and the ADBL. See annex 1 for detailed information on the implementation arrangements.

B. Results Monitoring and Evaluation Arrangements

66. The FPMU will have the overall coordinating role of the M&E function. The project coordinator will ensure that data and information from the provincial-level PMUs and the ADBL are produced and collected on time and are of good quality. A web-based project management and monitoring platform to integrate the information coming from different sources and levels will be created (component 1). A beneficiary feedback loop will be established to strengthen citizen engagement at all levels. Gender-related indicators have been developed and so have applicable corporate results indicators. Internal monitoring will be carried out by MoFE where the Project Coordinator will receive monthly progress reports from each PMU.

C. Sustainability

67. The project will generate significant economic returns (see economic analysis). The shift to SFM will create the momentum from the ground up which, as experience in other countries shows, is likely to be sustained well beyond the project. Community-based SFM will have a long-term impact, as communities will have the option of using the returns to establish revolving funds to refinance and expand their income-generating activities. The GoN is committed to scaling up forest sector investments following recent successes. In that context, the project will pilot a credit line which will be channeled via selected financial intermediaries (banks) to enable them to provide loans to entrepreneurs for the establishment and upgrading of small-medium forest-based enterprises and for forest nurseries. The project has strong ownership within GoN as it will directly contribute to the goals of the 15th Plan. The project will also contribute directly to the implementation of MoFEs Forest Sector Strategy (2016).



IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

68. **Technical analysis.** Project investments in SFM and forest plantations on public and private lands, will contribute to increased climate resilience and generate significant mitigation benefits (estimated 5.3 tCO₂ eq per ha/yr). The project will: (a) address core technical forestry functions - planning, monitoring, inventory and improving planting materials; (b) will improve productivity of community-managed forests; (c) establish forest plantations on degraded public lands and marginal private land, and (d) strengthen the forest-based private sector. Improving the productivity of forests will contribute to long-term sustainability of the changes introduced by the project. The project will also hand over the user rights of national forests to communities for their management, establish plantations, and supporting NTFP production, allocating land inside CBFM areas for fodder/NTFP production by poor households and managing degraded public lands. All of which have proved to be technically sound practices. The focus of the project on capacity support for provincial and local governments and CBFM groups will ensure long-term success of forest conservation and management.

69. **Working with Banks.** Banks, especially private, are currently not lending to SMEs for forest-related activities which has been identified as a major bottleneck to modernize and expand the forest-based private sector. The project will pilot a credit line for forest-based activities in Province 2 and Province 5, which, if successful, the GoN intends to scale up in other provinces. The GoN acknowledges that this credit line is a new type of product. PBs are not only reluctant to lend and take the risk for forest-based activities, they also face liquidity constraints.

70. **Investment Project Financing (IPF) Policy compliance review.** The project includes a line of credit and therefore is subject to the World Bank's IPF Policy on Financial Intermediary Financing. ADBL was assessed by the World Bank as appropriate to function as the Apex body for the credit line. Hence, the arrangements outlined in the Project Appraisal Document (PAD) are compliant with IPF Policy requirements.

71. **The project meets all OP 10 requirements on design.** The credit facility design and piloting will support uptake of the financial sector lending to forest-based SMEs, a segment still facing constraints of limited access to finance and financial services in Nepal. The strategy to develop and pilot a credit line fits well into the Project goal. The model will crowd in the private sector in line with the government strategy.

72. **ADBL institutional set-up assures ongoing monitoring and evaluation, based on the context.** However, there is need to enhance capacity to develop pipeline, disburse and monitor a forest-based SME portfolio. The Technical Assistance component will help ADBL and selected FIs developing the management capacity for the forest-based SME portfolio.

73. **The selection of the FIs to be conducted by ADBL under the project and the no-objection procedure from the World Bank and the FPMU** will further ensure that participating FIs are well-managed, with adequate corporate governance structure and sound financial performance indicators, to operate at market conditions and to implement the project. The ADBL/FIs will be assessed and the FIs selected based on their financial health as well as experience in lending to forest-based enterprises. To be eligible, the additional retail FIs would have to be in good standing with national regulators and have clean recent audits. Capital adequacy return on equity, portfolio quality, and liquidity (credit to deposit ratio) would be expected to be within normal parameters for national financial institutions.

74. **M&E** of the sub-projects will be the responsibility of FIs and ADBL, under the Responsible Agency, MoFE. PMU will monitor the subprojects for compliance with World Bank's ESF standards, and applicable WB and GoN fiduciary requirements. FIs will monitor the sub-project financial and commercial performances and flag identified operational



risks at sub-project level to the ADBL. ADBL will monitor the portfolio financial and commercial performances and flag identified operational risks at sub-project and portfolio level to MoFE and respective FIs. It is recommended including financial sector performance indicators in the results framework/ intermediate levels (e.g.: ROA, ROE, and NPL ratios).

75. **Economic analysis.** A benefit cost analysis evaluated several quantifiable economic benefits under Component 2, notably increases in the value of timber, fuelwood and other non-timber forest products related to shifts of forestland to community forestry and to sustainable forest management of existing community based managed forests. In addition, the global economic value of carbon sequestration due to the project, estimated to total 17.74 million tons CO₂ equivalent over 30 years. These benefits were compared with the total project investment costs, recurrent incremental forest management costs, and opportunity costs of agriculture on deforested areas and the one-time revenues from clear-cut in deforested forest land.

76. Without taking into consideration the global economic value of carbon sequestration, the EIRR of the project is estimated at 14.4%. The NPV and B/C ratio at a discount rate of 6.4% are estimated at US\$ 86million and 5.9, respectively, using a discount rate of 6.4%. The results point to substantial project efficiency, considering that some incremental benefits could not be estimated due to data constraints. Adding the value of carbon sequestration, at the lower social value of carbon reduction, US\$ 40/ tCO₂e (in 2020), the net benefits increase significantly. Since the entire stream of net benefits is positive, it is impossible to calculate an EIRR; the NPV and B/C ratio at d=6.4% are US\$492 million and 28.8 respectively. The results are robust to changes in the value assumptions of key model parameters. The detailed economic analysis is presented in annex 3.

B. Fiduciary

77. **Financial Management.** The MoFE has experience with the Bank's financial management and disbursement requirements having implemented the Bank financed projects (i.e. FCPF REDD+ Readiness Project). The dedicated Accounts Officer and Accountant in the FPMU will ensure effective overall financial management, monitoring and coordination for the Project supported by consultant(s) as required. In addition to the FPMU, the project design implies multiple cost and accounting centers at provincial and local levels with fiduciary capacity deficit. Additional risks are posed by yet to be developed internal controls in sub-national governments. Particularly for sub-grants, risks exist on excess payments or payments being made to ineligible beneficiaries. For sub-loans, while involvement of financial institutions (ADBL and other FIs) supports in beneficiary screening and monitoring, the risk of funds being used for unintended purpose increases with additional layers in funds flow. The identified risks will be mitigated by: (a) designated finance staff in FPMU and PPMU (b) service providers supporting local level on financial management of beneficiaries (c) funds flowing from federal to sub-national as conditional grants to ensure intended purpose (d) internal controls procedures institutionalized through POM and monitored by FPMU and PPMUs (e) accounting and reporting through accounting software in all cost centers (d) assurance reviews by FPMUs as agreed with the Bank (f) for sub-loans, payment to the ADBL/ FIs only at the time of disbursing to beneficiaries to prevent FIs earning interest from project financing (other than from sub-loans) and (g) establishing right to conduct assurance reviews/ audits of the ADBL/ FIs on project expenditures as required through the relevant agreements. The FPMU will provide capacity building to the PPMUs and cost centers as needed.

78. The FPMU will consolidate financial reports from all the cost centers (provincial and local governments) on trimester basis. The FPMU will submit consolidated Interim Unaudited Financial Report (IUFR) to the Bank by sixty days from the end of each trimester (period of four months). The consolidated report will also include reporting by the ADBL to the FPMU and by the sub-grantees to the sub-national governments on project expenditures. The FPMU will coordinate external audit of annual consolidated project financial statements and submit by nine months from the fiscal year end. The PPMUs will facilitate in consolidation, coordination and monitoring given the geographical



proximity to the local governments. The details on financial management arrangements including required internal controls and monitoring mechanisms will be built into the POM. The Project will focus on fiduciary capacity building, particularly of the sub-national governments. The details on financial management arrangements, including fund flow, budgeting, internal controls, accounting, reporting, audit and oversight are presented in Annex 1 and required mechanisms will be built into the POM. Given the delay in submission of the overdue audit reports of FY19 for two of the Bank financed projects implemented by MoFE due to COVID-19 situation, exception has been obtained to proceed for Project Negotiation and Board approval notwithstanding the overdue audit reports, which are expected to be received after the lockdown is lifted.

79. **Procurement.** While the FPMU has the experience of implementation of Bank financed projects (FCPF), the PPMUs, Forest Offices and Municipalities have very limited or no procurement experience on Bank procurement procedure. Based on the fiduciary assessment of several municipalities carried out by the Bank fiduciary team and outsourced consultants, it has been found that fiduciary risks have substantially increased in the federal context impacting the Bank's portfolio including procurement management.

80. This project is not a procurement intensive project in terms of value and complexity of the procurement activities. However, it involves large numbers of small value procurement activities scattered across federal, provincial and local government implementing agencies. The Bank's Procurement Regulations for IPF Borrowers, July 2016 (Revised November 2017 and August 2018) and the provisions stipulated in the Financing Agreement will be applicable for procurement of Goods, Works, Non- Consulting and Consulting Services. The FPMU will be responsible for procurement management of all the procurement activities to be covered by its budget. PPMU-2 and PPMU-5 will be responsible for all procurement activities to be covered by their respective budget. In addition to this, PPMU-2 and PPMU-5 will be responsible for approving procurement plan of works above NPR 2.0 million and goods, consulting and non-consulting services above NPR 1.0 million for municipalities and forest offices under respective provinces. Implementing agencies under provincial level, i.e. municipalities and forest offices will follow community-driven development (CDD) procedure in accordance with the Bank's Procurement Regulations for works contracts below NPR 2.0 million and goods, consulting and non-consulting contracts below NPR 1.0 million. For such CDD type of procurement, GoN procurement procedure will be applied and the PPMU-2 and PPMU-5 will have the responsibility to regularly monitor the implementation.

81. The Bank team has conducted procurement risk assessment of the implementing agency (MoFE/REDD IC), which has the experience with the implementation of Bank financed projects (FCPF). The detailed assessment report will be uploaded in the Bank's Procurement Risk Assessment and Management System (P-RAMS), which contains procurement risks and appropriate mitigation measures.

C. Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

D. Environmental and Social



82. From the assessment of the proposed project activities, at appraisal all WB Environmental and Social Standards (ESSs) are determined to be relevant for the project. Table 1 lists all the ESF Standards.

Table 1: Relevant Social and Environmental Standards for the Project

WB ESSs	Relevant / Not Relevant
ESS 1: Assessment and Management of Environmental and Social Risks and Impacts	Relevant
ESS 2: Labor and Working Conditions	Relevant
ESS 3: Resource Efficiency and Pollution Prevention and Management	Relevant
ESS 4: Community Health and Safety	Relevant
ESS 5: Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Relevant
ESS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources	Relevant
ESS 7: Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Relevant
ESS 8: Cultural Heritage	Relevant
ESS 9: Financial Intermediaries	Relevant
ESS 10: Stakeholder Engagement and Information Disclosure	Relevant

83. The appropriate Environmental and Social Instruments have been prepared. The project supports an approach shift from forest protection and subsistence use to forest protection and productivity increase by supporting SFM. While SFM supports an increase in the harvesting volume for timber and non-timber products, it does so by ensuring that harvesting rates are within sustainable levels and while improving forest quality and area. Yet, key environmental and social risks associated with the project components relate to the possible over-harvesting of trees, impacts on hotspot areas or critical habitats, use of chemicals, production of waste water and community health and safety issues, exclusion of disadvantaged or otherwise vulnerable groups from project benefits, weak capacity on the part of different stakeholder groups, and complications from the decentralization process. To manage and mitigate any adverse environmental and social impacts associated with these risks, the FPMU has developed, consulted on and disclosed 1) a comprehensive Environmental and Social Management Framework (ESMF) incorporating the results of Environmental and Social Assessment (ESA) for the project, a Resettlement Policy Framework (RPF) and an Indigenous Peoples Planning Framework (IPPF); and 2) a Stakeholder Engagement Plan (SEP) in accordance with the relevant ESSs and Nepal's legal framework. The ESMF specifies rules, guidelines and procedures for the activities requiring ESMPs, Pest Management Plans (PMPs), Indigenous Peoples Plans (IPP), and other E&S impact mitigation, management and monitoring actions. An Environmental and Social Commitment Plan (ESCP) has also been prepared and agreed on with the implementing agency. The ESCP sets out measures and actions required for the project to achieve compliance with the relevant ESSs over a specified timeframe. For example, this document establishes that Labor Management Procedures (LMP) will be prepared after project approval yet before the implementation of the activities. The ESCP forms part of the project legal agreement. Costs associated with any land acquisition, restrictions on land use and involuntary resettlement (if applicable) will be covered by the client.

84. Climate change and Co-benefits. The project will contribute to the climate change mitigation and resilience agenda. The net carbon balance has been calculated over 5 years of implementation phase and 25 years of capitalization phase. Over the total 30 years, the forest in the project area would sequester 17.74 million tons of carbon dioxide equivalent (tCO₂e). This would mean a carbon sequestration of 166.9 tCO₂e per ha or 5.6 tCO₂e per ha per year. Activity wise, afforestation would sequester 2.19 million tCO₂e, and the improved forest management would contribute 15.55 million tCO₂e. In addition, the shift to SFM will increase the resilience of forest ecosystems to the impacts of climate



change and other natural disaster and improve social resilience as ecosystem services are maintained that are essential for rural livelihoods such as soil stabilization, water regulation and habitats for biodiversity.

Citizen engagement. Nepal has a long history of engaging forest-dependent people through the promotion of community-based forest management (CBFM), both to achieve conservation outcomes and meet household subsistence needs. The project's active support of such people and communities will promote demand-side social accountability. Feedback mechanisms will be developed to ensure transparency, accountability, and learning as well as a continuous dialogue with target beneficiaries and other stakeholders. The framework for citizen engagement includes (a) engagement of local communities in CBFM; (b) community engagement in site-specific planning for smallholder forest plantations on public lands; (c) support to a feedback mechanism for the targeted beneficiaries through social audits and satisfaction surveys; (d) support for building the government's capacity for meaningful engagement with the targeted beneficiaries; and (e) third-party monitoring of project activities. The protocol and mechanisms for elements of this citizen engagement framework will be detailed in the Project Implementation Plan and the POM. A PDO-level indicator, "Share of targeted forest-dependent people with rating 'Satisfied' or above on project interventions (livelihoods, forest management, other) (percent, disaggregated by gender and disadvantaged group)" captures beneficiary satisfaction with and feedback on the project.

85. **Gender.** The project's design has benefited from gender analysis conducted as part of the ESA carried out for the project as well as under the Nepal REDD+ Readiness project. In Nepal, almost 89% of women compared to 70% men are involved in agriculture and forestry value chain management. Despite their substantive input and role in the forestry sector it is limited at subsistence level hence likely undervalued as unpaid work. Women's representation is also negligible in forestry policy making decision bodies, institutions and in forest related skilled jobs. The data shows that less than 1.2% women fully/partially own 183,000 operational MSMEs (Micro Small and Medium Enterprises) in Nepal²⁰ including forestry related MSMEs. Lack of financial literacy, entrepreneurial skills, financial services and unequal property rights are key barriers identified for women's engagement in skilled jobs and enterprises. The project aims to close the above gender gaps by (a) creating opportunities for women to benefit directly from extending CBFM and forest plantations on public lands by prioritizing grants to applicants with land under joint (male/female) ownership and allocating poor female headed households with land inside community managed forests for fodder and NTFPs production ; (b) ensuring representation of women in bodies created and/or maintained by the project at various levels, including in technical positions in the PMUs; (c)supporting female farmers and entrepreneurs with credit line and related capacity building for forest based enterprises; and (d) building the knowledge and skills of women in both informal and formal institutions, through participation in capacity-building activities. The activities are expected to narrow the gender gap including achievement of 50% increase in number of women with skilled jobs in the forestry value chain and in forestry related enterprises.

86. **Maximizing Finance for Development (MFD).** The project will enable and directly support the development of forest-based enterprises and sustainable private sector solutions to provide value for money while meeting the highest environmental, social, and fiscal responsibility standards.

V. GRIEVANCE REDRESS SERVICE

²⁰ www.uncdf.org/article/4358/is-lack-of-access-to-finance-impeding-the-growth-of-female-led-small-businesses-in-nepal. February 26, 2019



87. **Communities and individuals who believe that they are adversely affected by a World Bank-supported project may submit complaints to existing project-level grievance redress mechanisms or the World Bank's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project-affected communities and individuals may submit their complaint to the independent Inspection Panel which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and World Bank Management has been given an opportunity to respond. For information on how to submit complaints to the corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org

VI. KEY RISKS

88. The overall risk for the project is **Substantial**.

89. **Political and Governance (Substantial).** In contrast to the frequent changes in government that characterized Nepal's decade-long transition to federalism, the new government until recently had enjoyed a two-thirds majority in Parliament. However, with the pull out by the Samajbadi Party, the government now has only simple majority. At the same time, state restructuring on this scale is uncharted territory for Nepal and smoothing the transition from the previous unitary system to the new federal one will remain a challenging task. The new system, in principle, provides opportunities to decentralize development benefits and make service delivery more effective and accountable. However, the risks of jurisdictional overlap between the three tiers of government, lack of clarity and coherence between policies and devolved powers, and duplication of efforts will remain during the coming few years which will affect service delivery in all sectors. In the forest sector, the three tiers of government have a concurrent mandate regarding the management of forests which has led to conflicting views on roles and responsibilities. Hence, key aspects of the new system require further definition and may continue to be contested by different population groups. Component 1 of the project will support capacity building for implementation of new roles and responsibilities under the Constitution by respective parts of the government. Despite the lack of clarity at this stage to define roles, the government's efforts to clarify rules and create governance capacity at the provincial and local levels for forest management, the residual political and governance risk is Substantial.

90. **Macro-economic risk (Substantial).** The recent COVID-19 pandemic is expected to significantly disrupt economic activity and raise the macroeconomic risk. To date, official figures indicate that Nepal has been able to contain widespread transmission of COVID-19. Despite that, economic activity is expected to be seriously affected through three channels, specifically: services sector due to the shock to tourism; imports and related supply chains for industry; outmigration and related remittance which have been a major source of foreign exchange and liquidity for the financial sector. The situation continues to be fluid making precise estimates of impacts a challenge. However, the COVID pandemic is expected to significantly reduce growth in FY2020. The large shock to GDP growth is expected to substantively reduce revenue while expenditure increases as government programs are implemented to deal with the pandemic, including needed economic support to households, businesses and possibly financial institutions. This is expected to create a significant financing gap. Results from the most recent Debt Sustainability Analysis indicate that Nepal remains at low risk of debt distress, primarily due to the important role of remittances. All external debt and debt service indicators are projected to be comfortably below their policy-dependent indicative threshold values, including under the extreme shock scenario. Following a prolonged decline, to 25.6 percent of GDP in FY2015, the sum of external and domestic public debt rose to 30.1 percent of GDP in FY2019. A further rise in total public debt is projected to



average about 32 percent of GDP over the period FY2020 to FY2023 and around 46 percent over the long term. However, the recent COVID-19 pandemic may push the debt figures higher.

91. COVID-19 will likely impact forest resources by increasing local pressure on forest products and slowing down the ability to derive resources from the productive uses of Nepalese forests. Forests are a traditional safety net in times of hardship, in that people can realize the capital value built up in trees and can harvest NTFPs as a valuable source of nutrition. Increased numbers in the villages, coupled with the economic downturn, will create increased demand for NTFPs including fuelwood. The danger is that these resources could be locally over harvested in the short-term, particularly in areas of easy access. Timber market could also be disrupted, but it is too early to tell. Yet, forests also provide an opportunity for relief and recovery from the current economic crisis and to build back more sustainably and more resilient. Components 2 and 3 of the project will increase income for local communities, including indigenous peoples and other vulnerable groups and create new job opportunities of skilled and unskilled labor.

92. Given the above context, Nepal remains committed to achieving prudent macroeconomic management. Government has been working proactively to put in place measures to mitigate the potential impact of the pandemic including public information campaigns and establishment of quarantine and intensive care facilities. There is also engagement with development partners to assess the financing needs and identify appropriate interventions for households, firms and financing institutions, to facilitate the eventual recovery. Government and private investments to increase air connectivity and tourism infrastructure are expected to boost tourist arrivals and also contribute to the recovery of growth, following the pandemic. The fiscal deficit is expected to widen in response to the pandemic. Government will continue to support reforms to strengthen capacity to implement at the subnational levels. Reforms will also focus on broadening the tax base. The current account deficit is expected to narrow, with an expected slowing of import growth and reconstruction activities, and as better electricity supply reduces demand for petroleum products. Broader growth in exports will happen only in the longer term as structural reforms start yielding results. As a result of these mitigating measures, the residual risk is “Substantial”.

93. **Technical design of the project (Substantial).** The technical design risk is rated “substantial” as the overall responsibility for the project lies with MoFE which has not implemented a World Bank investment finance operation for 15 years. The relatively newly established provincial and local governments also have limited capacity for the implementation of project activities. These risks will be mitigated by implementing activities under component 1 which are specifically designed to improve the capacities of the new structures and institutions.

94. For component 2 of the project, the design risk is lower as CBFM has been consistently successful for over 30 years in Nepal and is internationally recognized as a successful approach to forest conservation and governance. The project includes a functional review of the forestry sector and site-specific planning for forestry interventions, which will require further adjustments, training of field staff and opportunities for decision making at the three levels of government. These risks will be mitigated by multi-stakeholder consultations to build ownership and performance incentives for early adopters and joint training and exposure visits with communities.

95. In addition, the project will pilot a credit line for forest-based activities and work with forest-based SME to improve forest sector productivity (Component 3). So far, banks have limited experience with the sector and are reluctant to engage with SMEs. Risk mitigation measures include the close collaboration between the selected banks, interested entrepreneurs and the Apex Body to design a credit line which is viable and can support the improvement and development of forest-based enterprises in Nepal. The program will be designed to create awareness of the potential the forest sector has for increasing productivity and creating jobs.



96. If other retail financial institutions do not participate in the project, working with a single retail institution can present risks and limit outreach. If ADBL experiences operational issues (due to COVID or other exogenous causes for instance) and is not able to serve as an effective retailer, then the project could be blocked from reaching producers.

97. **Institutional capacity for implementation and sustainability (Substantial).** Institutional capacity risk is substantial as the MoITFEs in Province 2 and Province 5 have limited project implementational experience and staff lack sufficient technical capacities for supporting productive SFM by CBFM groups. This risk will be addressed through component 1 which will strengthen the capacities at all levels of federal structures and processes in the forestry sector. This component includes activities like reviewing and developing processes for federal and provincial forest policy, strategy and regulations in the context of the latest constitution, supporting MoFE in establishing a national third-party certification process for SFM against agreed national forest sector standards, training staff of Provincial Forest Directorates, Division Forest Offices and Sub-division Forest Offices in technical aspects of SFM including the management of E&S risks. At the Local Government level, capacity building activities will focus on training for elected representatives and sectoral and administrative staff on participatory forest sector planning, land-use planning, financial management and safeguards application. The relationship between MoFE and MoITFE with municipalities and CBFM groups will be improved by changing the enabling and regulatory environment which is perceived as a bottleneck for developing a healthy forestry sector and by building partnerships between communities and municipalities supported under components 2 and 3 respectively.

98. **Fiduciary (High).** From the fiduciary perspective, due to the concurrent mandates of the 3-tier government for forests management, the project design implies multiple cost and accounting centers in dispersed locations across the two provinces with weak fiduciary capacity in sub-national cost centers. The internal control systems at the subnational level are yet to be established. This is mainly due to human resources constraints and low capacity for enforcing internal controls. There is a risk that financial reports may not be prepared and consolidated on time. Therefore, the fiduciary risk is rated “high”.

99. Specific actions to improve capacity and internal controls and thereby mitigating fiduciary risks will be taken by the respective cost centers after effectiveness. These are outlined in FM and Procurement sections above and in Annex 1. In addition, component 1 is dedicated to support the three levels of governments with capacity development.

100. **Environmental and Social (Substantial).** The project supports sustainable CBFM, enterprise development for forest-based SMEs and implementation of new governance arrangements in the forest sector to support the shift to a federal system which will have positive environmental and social benefits. It will support community groups in sustainable forest management planning and implementation. The key environmental risks of the project relate to potential unsustainable practices and activities such as (i) over-harvesting of trees and setting harvesting quotas too high; (ii) implementation of activities in hotspot areas, critical habitats, and/or strict protection zones; or (iii) implementation of activities that would involve significant use of chemical pesticides. Other potential environmental risks include the production of waste materials associated with forest-based enterprises. Additional significant risks arise from the weak capacity of local governments in the management of natural resources and their possible over-exploitation.

101. These risks are ultimately considered possible but not likely, as there are a number of mitigating factors. For example, the main component (component 2) focuses on improving the productivity of CBFM and handing over more public forestlands to communities for their sustainable management, consistent with an established and accepted procedure. The Dedicated Grant Mechanism for Indigenous Peoples and Local Communities (DGM Nepal) project will also help mitigate the social risks as the DGM project will complement the activities supported by this project with the



objective of developing the capacity of indigenous peoples and local communities for SFM, while also ensuring their inclusion in decision-making and benefit sharing.

102. Regarding the possible implementation of activities in hotspot areas, the project is not providing any support to activities taking place in protected areas or their buffer zones. In another example, the project is supporting the procurement of timber harvesting equipment and wood utilization equipment which may lead to indiscriminate and over-harvesting of trees. These risks will be mitigated by developing forest management plans based on sustainability principles that will be reviewed and approved by the appropriate technical authorities and that are consistent with best practice environmental standards. The project will support expert guidance and assistance to ensure that felling is done in accordance with these plans, in response to the relevant provisions of the ESMF.

103. Component 3 will work with existing and interested entrepreneurs to develop a competitive and modern forest-based private sector. Existing private firms will be able to upgrade their machinery, reduce waste and meet occupational health and safety standards. Business plans will be developed based on sustainability principles and raw materials will be sourced only from forests that are managed by communities that have an approved forest management plan and by private landowners. As these private firms will be supported by Financial Intermediaries (FI), their operations will be guided by the Environmental and Social Management Systems (ESMS) established and maintained by those FI.

104. **Stakeholders (Moderate).** Nepal has a good track record with participatory approaches and stakeholder engagement. Still the above-mentioned social dynamics between stakeholder groups can become a challenge when there is lack of stakeholder dialogue. In addition, more productive use of forests under CBFM will increase the level of incomes generated from the forest and could lead to greater political influence or benefit capture by elites. Hence, the stakeholder risk is rated “moderate”. Stakeholder consultations have been carried out during project preparation in at least 74 locations in Province 2 and Province 5 with forest-dependent communities, civil society, local governments, and others during which risks were identified and mitigation measures discussed. The identified risks will be mitigated by putting in place a system of regular audits by one or more third-party monitors, to increase transparency at the community level. Information on the project-specific GRM will be made widely available to help address grievances at their point of origin.

105. An equitable approach to benefit sharing will ensure that all relevant stakeholders will receive benefits from the implementation of the project activities. Several project-supported activities are specifically targeted for poor and socially disadvantaged groups such as women, Dalits and IPs, including land allocation inside CBFM areas, public land management in the Terai and pro-poor leasehold forest management which have already proved popular and beneficial for these groups.

106. Support for plantations on private land will inevitably favor landowners who can afford to place some of their landholding under plantations. Since land title is normally held by men, the grants paid for plantations will be adjusted to favor joint ownership of land by males/females in a household to avoid this from becoming a male-dominated activity.



VII. RESULTS FRAMEWORK AND MONITORING

Results Framework

COUNTRY: Nepal

Forests for Prosperity Project

Project Development Objectives(s)

The Project Development Objective (PDO) is to improve sustainable forest management; increase benefits from forests and contribute to net Greenhouse Gas Emission (GHG) reductions in selected municipalities in Province 2 and Province 5 in Nepal.

Project Development Objective Indicators

Indicator Name	PBC	Baseline	End Target
to improve SFM; increase benefits from forests and contribute to net GHG emssion reductions			
People in targeted forest and adjacent communities with increased monetary or non-monetary benefits from forests (Number)		0.00	110,000.00
Net GHG emissions reduced (Metric ton)		0.00	17,740,000.00
Share of project beneficiaries with rating "Satisfied" or above on project interventions (livelihoods, forest management, other) (Percentage)		0.00	80.00
Forest area brought under management plans (CRI, Hectare(Ha))		0.00	15,900.00

**Intermediate Results Indicators by Components**

Indicator Name	PBC	Baseline	End Target
1 - Policy and Capacity Building for Federal Structures & Processes			
Policy and regulatory reforms supported at federal, state and municipal levels supporting SFM (Number)	0.00		50.00
Local governments with approved land-use plans and/or strategic forest sector plans (Number)	0.00		50.00
Awareness of the federal forest sector structure (Number)	0.00		0.00
Quality of services provided by local government to communities and forest-based enterprises (Percentage)	0.00		80.00
2 - Community-based sustainable forest management and forest plantations			
Forest area under CBFM (Hectare(Ha))	530,000.00		545,000.00
Poor households with land allocation inside CBFM areas (Number)	0.00		650.00
Private smallholder plantations area (Hectare(Ha))	0.00		5,000.00
Area of public land managed by disadvantaged/poor groups for plantation/agroforestry (Hectare(Ha))	0.00		1,350.00
3 - Forest enterprise improvement and development			
Timber and non-timber forest enterprises registered (Number)	0.00		0.00
Roundwood supplied from CBFM areas (Cubic Meter(m3))	0.00		0.00
Increase in number of women with skilled jobs in the forestry value chain (Percentage)	0.00		50.00
Finance provided for establishing or improving FBEs (Amount(USD))	0.00		6,000,000.00
Project management, monitoring and learning			
Annual participation of stakeholders in project governance (Number)	0.00		5,000.00



Indicator Name	PBC	Baseline	End Target
Documents, including studies, stories and surveys produced and shared with open access. (Number)	0.00		30.00

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
People in targeted forest and adjacent communities with increased monetary or non-monetary benefits from forests	This indicator includes all paid work attributable to the sustainable forest management including plantations and in forest-based enterprises. Data will be dis-aggregated by gender and disadvantaged group.	Mid-term and end of project	Surveys	A sample survey forming part of the baseline survey with the methodology repeated at mid-term and for the final survey (year 5).	Federal and Provincial PMUs commissioning the survey
Net GHG emissions reduced	This includes sequestration through improved forest condition and tree planting on non-forest lands and emissions reduction from reduced forest degradation	Once - at the end of the project.	Remote sensing data and official records	FAO EX-ANTE Carbon Balance Tool (EX-ACT)	Federal PMU
Share of project beneficiaries with rating “Satisfied” or above on project interventions (livelihoods, forest	This indicator measures the level of satisfaction of targeted forest-dependent	At mid-term and end of project	Survey results	Survey	Provincial PMUs



management, other)	people on project interventions (livelihoods, forest management, other). Data will be dis-aggregated by gender and disadvantaged group.				
Forest area brought under management plans		Annual	DFO	DFO records	Provincial PMUs

Monitoring & Evaluation Plan: Intermediate Results Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Policy and regulatory reforms supported at federal, state and municipal levels supporting SFM	This indicator applies a wide definition to cover all policies, acts, regulations, directives, guidelines, protocols, and standards relevant to SFM and FBEs coming from all levels of government (Federal, Provincial, Local). It tracks not just new policies/regulations but also existing policies/regulations that have been revised to promote sustainable and productive forest management and FBEs. Disaggregated by	Annual	Records kept by federal, provincial and local governments	Records of all policy and regulatory changes will be monitored and maintained by Federal and Provincial PMUs and provided in project annual reports. Disaggregated by government level.	Federal and Provincial PMUs



	government level.				
Local governments with approved land-use plans and/or strategic forest sector plans	This indicator records the number of municipalities/rural municipalities that have prepared land-use plans and longer-term strategic plans for the forest sector	Annual	Municipality records.	The Provincial Government will receive copies of the targeted information for the PMU to retrieve.	Provincial PMUs
Awareness of the federal forest sector structure	This indicator assesses the extent to which stakeholders in the forest sector are aware and implementing their new roles and responsibilities under the federal system – the extent to which sector reforms have taken place and been institutionalized. The indicator is measured as a score.	mid-term and end of project	Survey	Awareness survey (of a sample) based on aggregated data from different stakeholder groups	Federal and Provincial PMUs which have commissioned the surveys
Quality of services provided by local government to communities and forest-based enterprises	This indicator will measure the client satisfaction of the services provided to communities and forest-based enterprises .	Mid-term and end of the project.	Survey	Survey results	Provincial PMUs compile government records
Forest area under CBFM	The total area for which new sustainable forest management plans have been prepared and are being implemented according to the agreed	Annual	Records kept by DFOs and sub-divisions under Provincial Governments	Aggregation of hectares from record keeping system at DFOs and sub-divisions under Provincial Governments.	Local Governments and DFOs



	timber harvesting prescriptions. It includes plans for all types of CBFM including CF, CFM, and LHF and includes newly established and existing CBFM groups for which revised plans have been prepared.		.		
Poor households with land allocation inside CBFM areas	This indicator records the number of poor or disadvantaged households for which specific provision has been made in CFUG operational plans. Data will be dis-aggregated by disadvantaged group and female/male household.	Annual	CBFM records and service providers	Aggregation of number of households that received support packages provided by the project e.g. seed, planting material & from land allocation agreements kept by CFUGs	CBFM groups and Local Governments with support from Provincial PMUs
Private smallholder plantations area	This indicator records the area of private (non-forest) land that has been supported by the project for tree planting and/or agroforestry (normally underutilized or abandoned agricultural land or land owned by absentee landlords)	Annual	Records held by local government service providers	Aggregation of area provided through local governments (lists of participating landowners in each municipality)	Local Governments with support from provincial PMUs and DFOs.
Area of public land managed by disadvantaged/poor groups for	This indicator records the area of public land (under	Annual	Records from Local	Aggregation of area reported from the list	Local Governments with support from Provincial



plantation/agroforestry	Local Government jurisdiction and often located along river banks and in flood-prone areas in the Terai) that has been assigned to PLMGs (poor and otherwise disadvantaged farmers) for tree planting and agroforestry activities. Data will be dis-aggregated by disadvantaged group.		Government	of Public Land Management Groups registered with Local Government and areas assigned to each	PMUs
Timber and non-timber forest enterprises registered	This indicator monitors the registration of all types of small, medium and large forest-based enterprises with women-owned and/or managed enterprises tagged. Data will be dis-aggregated by type and ownership.	Mid-term and end of project	Registration records	Aggregation of numbers from records	Provincial PMUs
Roundwood supplied from CBFM areas	This indicator measures the volume of timber produced (from several forest areas within a single landscape/municipality) as a result of implementation of revised sustainable forest management plans with total production being	Mid-term and end of project	Annual sales reports from CBFM groups.	Aggregation of sales recorded by all CBFM groups. If a royalty is being levied, then this figure can also be used to record the volume harvested.	Provincial PMUs & possibly Local Governments



	geared towards ensuring a predictable, sustainable timber supply.				
Increase in number of women with skilled jobs in the forestry value chain	This indicator records the extent to which women are participating in and benefiting from enhanced productive work in the forest sector. The aim is to find the percent of women involved as skilled workers in different types of enterprise and parts of the value chain for forest products.	Mid-term and end of the project	Surveys	Data will be collected through a mid-term and a final survey.	Provincial PMUs
Finance provided for establishing or improving FBEs	This indicator records the type of enterprises and the size of loans being provided from the project and the extent to which women are also benefiting. Data will be dis-aggregated by loan type, loan size and enterprise ownership. ADB will share the performance of the forestry SME portfolio supported by the project in a separate report on an annual basis.	Annual	Records of loans issued by private banks	Aggregation of type, size of loan and enterprise, and gender of borrower loans	Financial Institutions and provincial PMUs
Annual participation of stakeholders in	This indicator records the	Annual	Progress	Aggregation of number	Federal and Provincial



project governance	number of stakeholders who have participated in various project governance related meetings/workshops including project steering committees, and coordination and sector planning meetings at Local, Provincial and Federal levels. Data will be disaggregated by gender and disadvantaged group. The figure is expected to remain constant throughout the project.		reports, project records, meeting records	of stakeholders who participated.	PMUs and Local Governments
Documents, including studies, stories and surveys produced and shared with open access.	This indicator tracks publications and social media/website usage and the subsequent incorporation of new ideas and practices into regular planning, monitoring and implementation activities of forest sector institutions. It includes documentation and dissemination of good practices such as gender specific activities and safeguard mechanisms.	Annual	Project records in federal and provincial PMUs	Aggregation of number of products and users from each PMU.	Federal PMU



The World Bank

Forests for Prosperity Project (P170798)



VIII. INDICATIVE TERMS AND CONDITIONS FOR THE GUARANTEE (When Applicable)

Not applicable.



ANNEX 1: Implementation Arrangements and Support Plan

COUNTRY: Nepal
Forests for Prosperity Project

1. Project Institutional and Implementation Arrangements

- a. **The Federal Ministry of Forest and Environment (MoFE) is responsible for overall management and coordination of the project.** Project activities under Components 1, 2 and 3 will be executed by Federal, two provincial and 50 local governments consistent with their mandates under the 2015 Constitution. These will work directly with CBFM groups of various kinds, service providers and private landowners by providing them with grants or services procured through intermediaries such as local NGOs, federations and local resource persons. Implementation details are provided in the Project Operational Manual (POM).
- b. **A credit line will be established** for component 3 and the Federal Ministry of Finance (MoF) will provide a loan in the amount of US\$6 million to ADBL to on-lend to selected financial intermediaries (banks) to enable them to provide loans to entrepreneurs for the establishment and upgrading of forest-based SMEs and for forest nurseries. Implementation details are provided in the POM. There will be a project agreement between the World Bank and the ADBL.
- c. **Three PMUs will be established.** One in the Federal MoFE (REDD Implementation Center) and one each in the two provincial MoITFEs covered by the project. The role of each PMU is to support and manage project implementation working closely alongside the responsible government forestry institutions at Federal, Provincial and Local levels on (a) budgeting and accounts management; (b) preparing annual work plans; (c) contract management; (d) financial management; (e) procurement; (f) environmental and social risks management; (g) communications; (h) M&E, (i) technical assistance and (j) capacity building. PMUs will manage baseline and final surveys for the project, will conduct regular financial, environmental and social monitoring and will procure any additional consultancy services required during the project.
- d. **Each PMU will be headed by a project coordinator (PC) deputed from government** (1 from federal level and one from each participating province). Accounts officers and accountants will also be deputed from the respective governments. These will be complemented by contracted teams of technical, financial management, procurement and M&E specialists with administrative staff in all three PMUS. Provision is made for upgrading, equipping and operating PMU offices with office premises and services being provided by the respective government forestry institutions.
- e. **Project oversight and accountability will be provided by three project coordination/steering committees** - one at Federal Level and one in each participating province. Membership of each of these the coordination/steering committees will include representatives from federal government (MoFE and MoF) and their Provincial Government equivalents plus Local Government representatives (selected from the participating municipalities), community representatives (selected from CBFM groups covered by the project), and private sector representatives from forest-based industry.
- f. **The three PMUs will undertake overall project planning and implementation at Federal and Provincial levels.** They will have primary responsibility for implementing the POM, including procurement, financial management, monitoring, reporting, policy advocacy and awareness raising. They will prepare guidelines and technical manuals for project activities as well as providing technical support for project implementation to Divisions and Sub-divisions of



Provincial Forest Directorate and to the sections of Local Governments responsible for field level implementation through CBFM groups and with individual farmers.

g. **Component 1 will be implemented by all three levels of Government** each with different specific responsibilities (see Table 1) and consists largely of activities that will be implemented directly by the respective governments or through service contracts e.g. for training or consultancy and advisory services. Several activities, especially those at municipality level will be linked to the capacity development activities being financed through DGM Nepal which will focus on enhancing the capacities of IPLC to engage with project activities including for policy and strategy development as well as field-level implementation.

h. **Partnership Development** between local governments and CBFM groups within each municipality will be fundamental to implementation of field level activities under component 2 as well as for forest sector and land-use planning that will be a precursor to their implementation. Partnership arrangements will be facilitated by intermediaries such as local NGOs, federations or trusted individuals. Staff from sub-Divisional Forestry Offices will provide technical inputs and support.

i. **All activities under Components 2.1 and 2.2 will be implemented through CBFM groups with the exception of smallholder plantations** which will be implemented directly by private landowners. Provincial Forest Directorates will support formation of new CBFM groups and revision of Operational Plans for existing CBFM groups through contracted service providers and will themselves provide technical and monitoring support through their sub-Divisional Offices. Project activities under component 2 will build on, expand and improve on the successful practices of working with community groups developed over the past 3 decades in Nepal. Formation and handover of forest to new CBFM groups will follow the procedures of the Forest Act (2019) and associated regulations and guidelines. Preference will be given to transferring additional forest areas to existing groups wherever possible rather than creating new groups, especially where areas originally handed over were small.

j. Table 1 summarizes the implementation roles played in the project by each type of Government and by CBFM groups

Table 1: Project roles and responsibilities

Level	PMU Role/Responsibility
Federal Government (with support of Federal PMU in the REDD Implementation Center and service providers as required)	<ul style="list-style-type: none">Overall project coordination and reporting to World BankPreparation of Annual Workplans for the projectReporting to Federal Steering CommitteeProject related M&E and financial reportingFederal forest policy and strategy developmentRevision of federal regulations and deregulation as requiredDevelopment of forest sector standardsMIS development linking all levels of governmentReview and revision of technical and other guidelinesReview and revision of forestry equipment import regulationsCapacity building at Federal Level on forest sector governance and technical aspectsCommissioning studies, reviews and analysisMaintaining a project grievance redressal mechanism (Federal Level)Promotion and awareness for financial institutions on forest sector investment potentials
Provincial Government (with support of Provincial	<ul style="list-style-type: none">Preparation of annual project workplans for the provinceProvincial forest policy and strategy development



Level	PMU Role/Responsibility
PMU in MoITFE and service providers as required	<ul style="list-style-type: none"> • Reporting to Federal PMU • Reporting to Provincial Coordination Committee • Preparation of Annual Plans and Budgets for forest sector activities for the project • Project related M&E and financial reporting • Revision of provincial forestry regulations and deregulation as required • Capacity building at Provincial Level on forest sector governance and all technical aspects of the project being implemented through Local Government • Facilitate formation and handover to new CBFM groups (approval by DFO) • Commissioning studies, reviews and analysis • Maintaining a project grievance redressal mechanism (Provincial Level) • Provincial MIS development linked with Federal and Local levels. • Development of Provincial forest sector standards and guidelines • Rules and regulations (including deregulation) for forest-based SME operation including establishment, harvesting, sales, transport and utilisation • Results-based support for plantations on underutilized private land and subsequent maintenance • Capacity support for landscape level harvesting plans and associated IA/EIAs • Provision of safety equipment and training for timber harvesting and extraction • Commissioning studies for forest-based SMEs and value chains
Provincial Forest Directorates (DFOs and sub-divisions) and service providers as required	<ul style="list-style-type: none"> • Technical and capacity support and facilitation for all project activities • Support for Sustainable Forest Management Plan Preparation (existing CBFM groups) and their approval • Group formation & handover for CBFM (all kinds) • SFM demonstrations (through CBFM groups) • Coordination between local governments (joint activities etc) • Monitoring of project activities
Local Government (with support from divisions/sub-divisions of Provincial Forest Directorates and service providers as required)	<ul style="list-style-type: none"> • Preparation of simple municipality-led land-use plans and forest sector strategic plans • Preparation of Annual Plans and Budgets for forest sector activities • Capacity building for elected representatives, sector staff of Local Governments, and administrative staff of Local Government • Capacity building for CBFM groups on governance and technical forestry aspects • Establishment of PLMGs and implementation of group plantation activities (on public land) and subsequent maintenance and associated soil and water conservation activities. • Support implementation and monitoring of smallholder plantation program • Creation of emergency funds for CBFM groups • Development of municipal legislation and regulations for the forest sector • Survey and registration of forest-based enterprises • Partnership-building with CBFM groups of various kinds • Coordination with DGM activities through Municipal Forests or /and environment or/and Disaster management or/and Waste Management units • Support for implementation of all activities under component 3 that are undertaken via CBFM groups directly or via local intermediaries and service providers
CBFM groups (with support from divisions/sub-divisions of Provincial Forest Directorates and capacity)	<ul style="list-style-type: none"> • Revision of Operational Plans and Constitutions (existing CBFM groups of various kinds) • Land allocation with fodder and NTFP management and livestock support inside CBFM areas (for Dalits and women) • Implementation of harvesting and utilisation as per harvesting plans and SFM plans including



Level	PMU Role/Responsibility
support from local service providers)	sale of forest products
ADBL and FIs	<ul style="list-style-type: none"> • ADBL will be responsible to manage the credit line for forest-based activities and on-lend to eligible FIs/ MSMEs ; • FIs²¹ will monitor the sub-project financial and commercial performances and flag identified operational risks at sub-project level to the ADBL; • ADBL will monitor the portfolio financial and commercial performances and flag identified operational risks at sub-project and portfolio level to MoFE and respective FIs. • ADBL will report to the FPMU and PPMUs on the use of the credit line; • ADBL will report to MoF on the performance of the credit line as requested in the loan agreement.

k. **Simple municipality-led land-use plans and forest sector plans** (covering at least 5 years) prepared during the first year of the project will provide the basis for project support in each municipality. These will be prepared under the relevant Advisory Committees of the Local Government Executives with technical support provided by section staff, DFOs and sub-divisional offices of the Provincial Forest Directorates and any additional external support as required. The project will provide finance for preparing these plans. Land-use and forest sector plans will be simple and readily understandable (map-based as far as possible) and are prepared through a deliberative process including community level consultation with a range of key stakeholders and with cross-sectoral coordination. The project will develop guidelines for the planning processes required. Sector plans approved by the Local Government Assemblies will form the basis for subsequent Annual Planning & Budgeting and further project activities will not be supported unless these plans are in place.

l. **Annual Plans & Budgets** covering project financed activities to be implemented through Local Governments will be prepared by each participating municipality based on the previously prepared and approved land-use plans and forest sector plans according to the provisions and planning schedule of the Local Government Operation Act (2074).

m. **Implementation of activities under Component 2 by Local Governments and Provincial Governments** will follow fiscal transfers (conditional grants) from MoF direct to Local and Provincial Governments according to the provisions of the Inter-Governmental Fiscal Management Act (2074). For activities implemented through CBFM groups including: Sub-component 2.1 - Operational Plan & constitution preparation & revision for CBFM; Sub-component 2.2 - Sustainable forest management through CBFM; plantation establishment on public land though PLMGs and including associated soil and water conservation actions; and land allocation inside CF for Dalits/poor, grants will be provided through CBFM groups according to the Procurement Regulations (2075) and for associated services to be provided, local service providers will be procured according to the Procurement Regulations (2075).

n. **For supporting plantations on private land**, Local Governments will procure local service providers as intermediaries between the project and individual farmers for technical support, monitoring and grant payment. Payments will be on a by-results basis in 3 installments over 3 years after field checks of maintenance, survival and growth have been carried out. To support gender equality, selection criteria for grant proponents will include an incentive to register a land title in joint names (male and female) by households.

o. **Component 3 utilizes a credit line via PBs.** This will provide a source of credit for forest-based SME owners and entrepreneurs to purchase equipment and new technology and upgrade operations for a forest-based utilization sector

²¹ ADBL can also function as the FI for the credit line.



that makes better use of the enhanced forest productivity (resulting from component 2) to create paid employment (especially skilled jobs) in Nepal's 'green' sector. The development of the credit line by ADBL and its implementation will be detailed further in a dedicated manual. Particular focus will be on enterprises that have potential to create quality jobs especially for women, Dalits and poorer households especially in rural areas.

p. **Linkages with DGM.** Activities under DGM Nepal focusing on capacity building for communities and IPs will be implemented in the same provinces and municipalities as the project. The primary link between DGM and the Project will be the Municipal Forests or /and Environment or/and Disaster Management or/and Waste Management Sections of each participating municipality which will receive project support. These will form a focus for a range of forest sector capacity building, knowledge-sharing, information dissemination, planning activities and technical support and will also form a focus for activities under DGM. Where project activities are taking place, DGM support will be used to promote closer and more active engagement by communities and IPs, and especially inclusion of women and Dalits.

q. **Technical support will be provided for field-based activities** by procurement contracts between Local and/or Provincial Governments and service providers such as local NGOs, local experts, trainers and resource persons. For example, an individual or local organization may be contracted by the Local Government to provide training or other specific technical services to a number of CBFM groups within a municipality.

2. Financial Management

r. The FM responsibilities for the project will be vested with PMUs established within the MoEF and in the two Provincial MoITFES. Each PMU will have an Accounts Officer and an Accountant with financial management consultant to support. Additional staff/ consultant will be hired as required as project progresses, particularly for monitoring purpose. The finance staff of local level will manage local level expenditures, which will be limited to the extent possible to capacity building of local level and beneficiaries. There are at least two Accounts staff (one Accounts Officer and one Accountant) in municipalities and at least one Accounts staff in rural municipalities. The FM arrangements for the project are reliant on the use of country systems. The additional required internal controls procedures will be built into the Project's Operational Manual.

s. The project will build capacity for Provincial and Local governments on managing WB-funded projects and will strengthen their overall financial management capacity. The focus will be on Local Governments with support provided by trained service providers (under component 1) either to individual municipalities or in a cluster arrangement based on a need assessment of selected municipalities/rural municipalities.

t. **Annual Planning and Budgeting.** The annual planning and budgeting process for the project will be elaborated in the project's Operational Manual. The Project budget will be prepared and approved as per the Fiscal procedures and Financial Responsibility Act, Inter-Governmental Fiscal Management Act and Local Government Operation Act. There will be three level of budgeting: (i) Federal (ii) Provincial and (iii) Local Government. Federal Government will prepare a detailed budget for the Project including conditional grants to be provided to sub-nationals. Based on budget ceiling for Conditional Grants provided by the Federal Government, Provincial and Local Governments will incorporate conditional grants in their budget. The activities-based budgeting of the Federal Government including for Conditional Grants to sub-nationals will ensure intended purpose of the project financing. The Federal PMU will prepare a detailed consolidated Annual Work Plan and Budget for the entire project in the Line Ministry Budget Information System (LMBIS) based on inputs from provincial PMUs and local governments. Based on conditional grant ceiling/ activities as advised by the federal PMU, provincial PMUs will enter budget in the Provincial Line Ministry Budget Information System (PLMBIS) and local level will enter in SuTRA or other accounting software that they are using. For local governments without SuTRA, The federal District Treasury Controller Offices (DTCOs) will provide local level with a copy of activity-



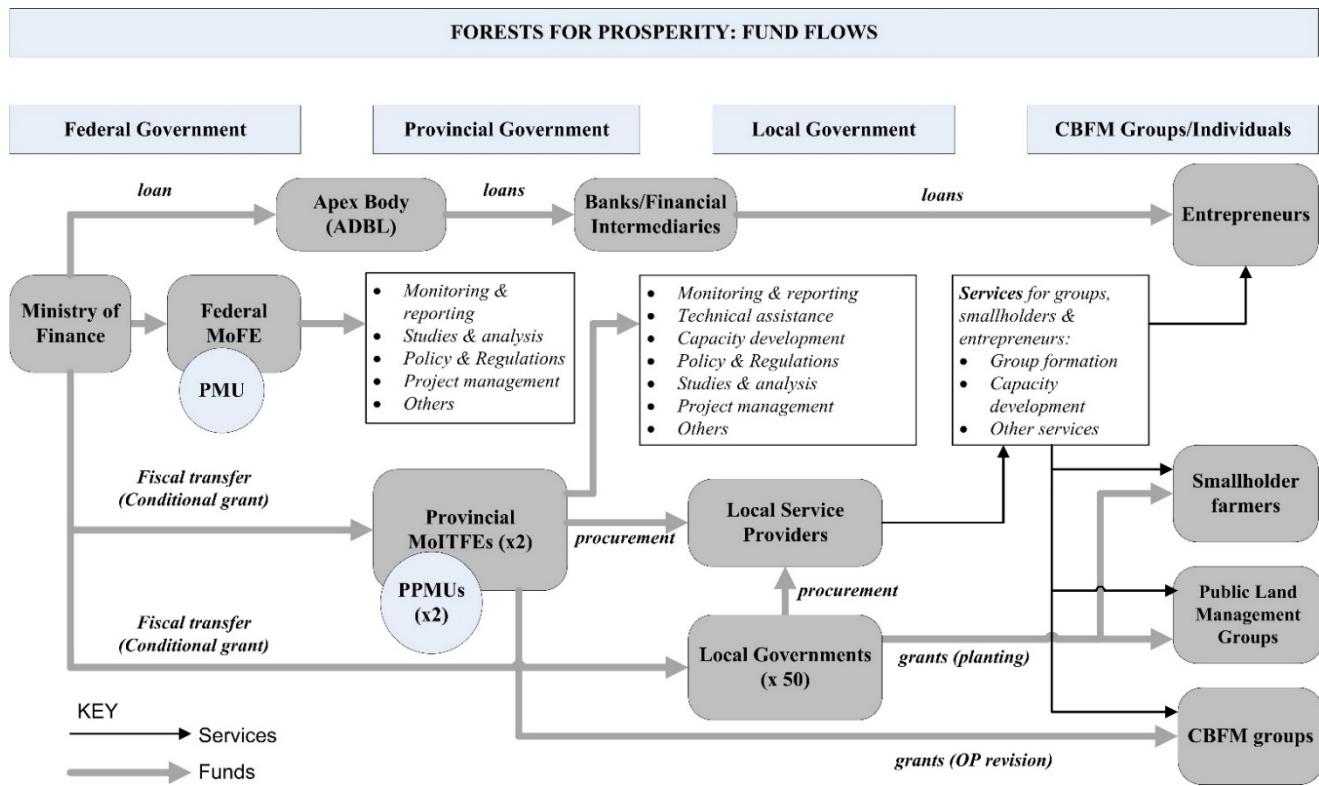
wise conditional grants information for them to budget/spent accordingly. The federal PMU will closely work with provincial PMUs and local governments in preparation of consolidated project budget. A separate budget head for the Project will be provided in the Federal Government's Red Book. The on-lending to ADBL will be budgeted as loan in the Federal Government's budget.

u. **Flow of funds.** Loan and grant funds for the project will be provided to the federal government. It will be made available to MoFE through the regular budget transfer process. Funding to the Provincial Governments (MoITFE) and to participating Local Governments will be made through fiscal transfers (conditional grants) according to the federal government's approved annual budget and work program. The FPMU will incur expenditures for federal level budget through payments from federal treasury. The federal District Treasury Controller Offices (DTCOs) will release conditional grants on periodic basis to the sub-nationals' respective consolidated funds from the federal treasury based on approved conditional grants. The quarterly tranche releases to sub-nationals will be based on expenditure reporting of prior release. Upon receipt of funds, the PPMUs and local governments will incur expenditures by making payments from their respective consolidated funds as per the activity-wise conditional grants budget provided by the federal government, which is incorporated accordingly in their respective budgets. For sub-grants, payments will be made by the local level based on recommendation of the service providers as per the criteria set in POM. The tranche payments for sub-grants will be made into beneficiary's bank account based on expenditure reports. With regard to the credit line, MoF will pre-finance the loan to ADBL for further disbursement to FIs only at the time of payment to beneficiaries in order to prevent ADBL and FIs earning interest from project financing (other than from the sub-loans). It would be agreed with FIs to only make payment to beneficiary bank accounts based on periodic expenditure reporting. The detailed mechanisms will be laid out in POM.

v. **MoF through DTCOs will release the budget as planned for the Project,** according to the approved annual work program and budget to: (i) MoFE PMU for incurring project expenditure at Federal level; (ii) to MoITFE PMUs for incurring provincial level expenditures ; (iii) to Local Governments for incurring project expenditure at local level including grants to eligible CBFM groups as per the provisions of POM.



Figure 1: Project Fund Flows



w. **Internal controls.** The internal control system at Provincial and Local Government levels are yet to be established, although some elements of internal control do exist, e.g. segregation of key roles and responsibilities; level of authority in decision-making processes; budget planning steps; public hearings etc. The project will support participating Provincial Governments and Local Governments to strengthen their internal control systems. The internal control systems of the Federal and sub-nationals will be described in the POM. One of the criteria for selecting municipalities for participating in the project will be the existence of reasonable level of internal control system; use of SuTRA and adequate accounting staff in place. Further details on the criteria and eligibility for disbursement of conditional grants to Local Governments and for grants to CBFM groups will be documented in the Project's Operations Manual. In terms of CBFM groups, service providers will support local level in screening, supervision and monitoring. In terms of sub-loans, the involvement of FIs will help in screening, supervising and monitoring beneficiaries. The right to conduct assurance reviews/ audits of the ADBL/ FIs as required in relation to project expenditures will be established through the relevant agreements as legally feasible. The need for adequate monitoring and oversight of project expenditures, particularly sub-national expenditures will be emphasized in POM. To ensure intended purpose, the assurance reviews will also be conducted by the Federal PMU for sub-national expenditures. The size and scope of such reviews will be agreed with the World Bank.

x. **Accounting.** Federal, Provincial and Local Governments use a cash-based accounting system. The Nepal Public Sector Accounting Standards will be used as the accounting standard. Federal PMU will maintain their project accounts in the Computerized Government Accounting System (CGAS) and use e-payment; PPMUs will use FMIS, CGAS or other



accounting software. Local Government offices will use the Sub-national Treasury Regulatory Application (SuTRA) for budgeting, accounting/record keeping and reporting. All project offices will maintain a separate sub-ledger to record and report budget and expenditures by category, component, sub-component and activity as prescribed in the POM. The government chart of account (2074), approved by Auditor General of Nepal, is used for budgeting and accounting by all levels of government. Provincial and Local Governments have limited capacity and experience of accounting and reporting for World Bank projects. The required trainings will be provided to sub-nationals on accounting and reporting as per the POM. The ADBL will also maintain separate accounts for the Project in a computerized system and provide reports to FPMU on trimester basis and as requested by FPMU.

y. **Financial reporting:** The financial progress of the project will be reported to World Bank on a four-monthly basis through the Interim Unaudited Financial Reports (IUFRs) to be submitted within 60 days from the end of each four-month period. To prepare consolidated IUFR, the FPMU will obtain financial information from the two Provincial PMUs and local governments by 30 days from the end of each trimester. Local governments will also submit a copy to the respective PPMUs, which will facilitate FPMU in consolidation of reports (resources to Local Governments will be disbursed subject to the received reports). Consolidated annual unaudited and audited financial statements will be submitted to the World Bank within 3 months and 9 months respectively from the end of each Fiscal Year. The consolidated reports and Statement of Expenditures will also incorporate reporting by ADBL to FPMU on sub-loans expenditures and by sub-grantees under sub-components 2.1 and 2.2 to local level on sub-grants expenditures. There would be periodic reporting of expenditures incurred for sub-grants from the beneficiaries to local level, based on which tranche payments will be reimbursed. As labor cost for tree plantations will constitute most of the sub-grants expenditures, the geographical applicable labor rates will be considered to the extent possible for sub-grant expenditure reporting. For sub-loans, the FIs will obtain periodic expenditure reports from beneficiaries and report to the Apex body. The Apex body will consolidate reports from various FIs and report to the FPMU, which would be included in the Statement of Expenditures for reimbursement. The required information and periodicity of all reporting requirements will be laid out in POM.

z. **Internal auditing** for the federal expenditures will be carried out by DTCOs. The internal audit of the provincial and local governments will be conducted as per their own policies. Metropolitan and sub-metropolitan cities have internal audit sections or internal auditors but other municipalities have not recruited internal auditors or established audit section in their offices. They hire internal auditors as required. The DTCO has no mandate to carry out internal audits of municipalities/rural municipalities although internal audits have been carried out by the DTCO at the request of some municipalities. Municipalities in Province 5 have created internal auditor positions in their respective offices and are in the process of recruitment. ADBL's internal audit including that of the project accounts will be conducted as per its policies.

aa. **External audit.** The Office of the Auditor General (OAG) of Nepal is mandated by the constitution of Nepal to conduct the external audit of all levels of government. The external (final) auditing of project activities implemented by Federal, Provincial, Local Governments and ADBL will be carried out by the OAG. The right for OAG to audit the ADBL and concerned FIs in relation to the project audit will be established through the relevant agreements. Given the involvement of considerable numbers of implementing agencies at all levels and, in some cases, their remoteness, the final (external) audit report of the project for each year of project implementation will be submitted within nine months from the end of each fiscal year. The FPMU will coordinate with all cost centers and OAG to ensure timely project audit. PPMUs will facilitate FPMU in coordinating with local governments for timely external audit. To the extent possible/feasible, performance audits by OAG will also be conducted for the Project. The annual audited project financial statements and the audit report will be disclosed on the websites of MoFE and the World Bank.



Table 2: Financial Management Risks and Mitigation

Risk Category	Risk Rating	Description of Risk	Mitigation Measures
Organization and Staffing	High	Federal governance is new model for Nepal and new organizational setup is time-consuming. Local Governments have little or no previous experience and many lack key staff, some of the municipalities have only one Accountant	Staff recruitment is in progress. The project will provide additional financial management support for staff.
Budgeting (Provincial & Local Governments)	Medium	There is a lack of experience with the budget preparation process combined with insufficient staff, limited training on budgeting, planning and application of PLMBIS and SuTRA.	The funds will flow to sub-national governments as Conditional Grants with activities pre-defined by the Federal government, which sub-national governments can only incorporate in their budget as provided.
Fund flow & Disbursement Arrangements	Substantial	Funds are disbursed as conditional grants to Provincial and Local Governments. As the disbursements from the Bank will be based on expenditure reporting from sub-nationals, delay in reporting may impact disbursement.	Capacity building support will be provided by the project for improving the quality and timeliness of reporting. Accounting and reporting in SuTRA will improve quality and timeliness. Refunding of unspent conditional grant to the federal treasury will reduce the risks of disbursement for unintended purpose.
Internal Controls	High	Inadequate internal control systems in Provincial and Local Government offices.	Internal controls are included as a part of capacity building support from the project.
Accounting, Financial Reporting & Monitoring	Substantial	Accounting, financial reporting and monitoring are weak at both Provincial and Local Government levels.	This is mainly a staffing problem and is expected to be resolved when vacant posts are filled. New staff will be trained to use SuTRA in local governments and other accounting software in PMUs for accounting, financial reporting and monitoring.
Internal Audit	High	Almost no internal audits are being done at Local Government level. Some Local Governments have requested the DTCO for internal audit.	The local governments of Province 5 have created Internal auditor positions, for which recruitment is in process. The FPMU will conduct assurance reviews of sub-national project expenditures.
External Audit	Medium	Timeliness of external audits may be impacted due to multiple cost centres.	The timeline of external audit report submission has been extended to nine months.
Overall Project Financial Management Risk	High	After operationalization of the mitigation measures, the fiduciary risk is expected to be medium.	

3. Disbursement



bb. **Disbursement Schedule.** The Federal PMU will be responsible for disbursement management with the World Bank. This includes disbursement for expenditure incurred by Provincial and Local Governments as well as ADBL. World Bank disbursements will be based on the Statement of Expenditures (SOEs). Based on the expenditure reports, including those from Federal, Provincial and Local Governments, the FPMU will prepare a consolidated report for claiming reimbursement from the World Bank to federal treasury. As is the practice in Nepal, disbursement for project expenditures will be generally be pre-financed from the federal treasury. For FPMU expenditures, direct payment or special commitment payment can also be made from the World Bank for amounts above the threshold specified in the Disbursement Letter issued by the Bank.

cc. **Withdrawal Categories.** The World Bank will finance eligible expenditures as provided in table 3:

Table 3: Withdrawal Categories

Category	Category description	Loan (US\$)	Grant (US\$)
1(a)	Goods, works, consulting, non-consulting services and Training under Part 1 of the Project	0	153,000
1(b)	Incremental Operating Costs for Federal Government under Part(s) 4 of the Project	26,200	254,000
1(c)	Goods, works, consulting, non-consulting services and Training under Parts 3.1, 3.2(a) and 4 of the Project	369,500	504,000
2(a)	Transfer to the Participating Provinces and Selected Municipalities for goods, works, non-consulting services, consulting services and Training under Part 1 of the Project	0	2,745,000
2(b)	Transfer to the Participating Provinces and Participating Municipalities for Incremental Operating Costs under Part(s) 4 of the Project	0	648,000
2(c)	Transfer to the Participating Provinces and Participating Municipalities for Goods, works, consulting, non-consulting services and Training under Parts 2.1(b), 2.1(c), 2.2, 3.1 and 4 of the Project	2,481,800	1,796,000
3	Sub-loans under Part 3.2(b) of the Project	6,000,000	0
4(a)	CBFM Grants under Part 2.1(a) of the Project	4,662,500	0
4(b)	Plantation Grants under Part 2.2(b) of the Project	4,360,000	0
	TOTAL	17,900,000	6,100,000

dd. In case of categories 1(b), 1(c) and 2(c), withdrawal of funds would be first made from the Grant, before withdrawal from Loan.

4. Procurement

ee. **Implementation Arrangement:** The project procurement activities will be implemented through three levels of implementing agencies: (i) FPMU; (ii) PPMU-2 and PPMU-5; and (iii) at local level, Municipalities, and Division and Sub-Division Forest Offices. The FPMU will be responsible for procurement management of all the procurement activities to be covered by its budget. PPMU-2 and PPMU-5 will be responsible for all procurement activities to be covered by their



respective budget. The FPMU will be responsible for its own procurement management, monitor the procurement functions of PPMU-2 and PPMU-5, and provide technical support to PPMU-2 and PPMU-5, as required. The FPMU will have dedicated procurement staff from civil service and at least one full time procurement consultant in the beginning of the project and then intermittently depending upon the workload. The MoEF procurement consultant will provide training/orientation on project procurement and STEP to PPMUs, collect reports and corresponds with the Bank. Province level PMUs, i.e. PPMU-2 and PPMU-5 will be responsible for managing their own procurement activities and monitor the procurement functions of local level implementing agencies and provide technical support to local level implementing agencies, i.e. Municipalities, and Division and Sub-Division Forest Offices. PPMU-2 and PPMU5 will also have dedicated procurement staff from the civil service and at least one full time procurement consultant in the beginning of the project and then intermittently, depending upon the workload. As in the case of FPMU, PPMU level procurement consultants will also provide training/orientation on project procurement and STEP to local level implementing agencies.

ff. Applicable Procurement Procedure: The Bank's Procurement Regulations for IPF Borrowers, July 2016 (Revised November 2017 and August 2018) and the provisions stipulated in the Financing Agreement will be applicable for procurement of Goods, Works, Non- Consulting and Consulting Services. Procurement of goods, works, and non-consulting services, may be carried out using international and/or national procurement procedures, as agreed in the Project Procurement Strategy for Development (PPSD) and Procurement Plan, with caveats for national procedures as indicated in the PSD and procurement Plan in STEP. In this regard, PPMU-2 and PPMU-5 will be responsible for approving procurement plan of works above NPR 2.0 million, and goods, consulting and non-consulting services above NPR 1.0 million for municipalities and forest offices under respective provinces. PPMU 2, PPMU 5 and local level implementing agencies under provincial level will follow community-driven development (CDD) procedure in accordance with the Bank's Procurement Regulations for works contracts below NPR 2.0 million, and goods, consulting and non-consulting contracts below NPR 1.0 million. For such CDD type of procurement, GoN procurement procedure will be applied and the PPMU-2 and PPMU-5 will have the responsibility to regularly monitor the implementation. The Grant Operating Procedure, under the Project Operational Manual should contain a Procurement Section detailing the procurement procedure for activities to be funded under the grant.

gg. While the FPMU has the experience of implementation of Bank financed projects (FCPF), province level PPMUs, Forest offices and Municipalities have very limited or no procurement experience under Bank procurement procedure. Based on the fiduciary assessment of several municipalities carried out by the Bank fiduciary team and outsourced consultants, it has been found that fiduciary risks have substantially increased in the federal context impacting the Bank's portfolio including procurement management.

hh. Procurement Significance: This project is not a procurement intensive project in terms of value and complexity of the procurement activities. However, it involves large numbers of small value procurement activities scattered across federal, provincial and municipality level implementing agencies.

ii. Procurement Plan and Use of Bank's STEP System: Procurement will follow best international practice for cost effectiveness, least disruption and to maximize economic benefits. The project will implement the World Banks' Systematic Tracking of Exchanges in Procurement (STEP) system for procurement planning and tracking. This provides data on procurement and establishes benchmarks. STEP will incorporate the details of the procurement activities included in project's Procurement Plan. Procurement methodologies and approaches are detailed in project's Operational Manual.

jj. The FPMU and PPMUs will have separate accounts for STEP and respective staff of all the 3 PMUs will get a STEP profile for all procurement related transactions including procurement planning, bidding, bid/proposal evaluation, contract awarding and contract management for both prior review and post review contracts. PPMU-2 and PPMU-5 will



be responsible for maintaining STEP for procurement activities to be implemented by respective local level implementing agencies. All the procurement activities except those under CDD procedure, will be uploaded in STEP by PPMU-2 and PPMU-5 for their respective local level implementing agencies.

kk. Selection of consultants: Large number of small value but diverse type of consulting assignments (both firms and individuals) are envisaged. Approximately 25 numbers of small value individual consulting assignments are envisaged to be engaged at the federal, provincial and municipality levels for diverse activities, such as development of federal forest policy/strategy/regulation/directives, development of subsidiary forest law at the provinces, development of import/export regulations of forest products & timber processing, forest sector land use planning, development of GESI strategy, development of training manuals for ESMF, Safeguard and GESI etc. For the day to day operation, in the FPMU, PPMU-2 and PPMU- 5, 14 experts (4 for PMU, and 5 each for PPMU-2 and PPMU-5), for Procurement, Financial Management, Technical, and Monitoring and Evaluation support etc., are envisaged to be hired on a continuous or intermittent basis. At the federal level, forest-based MIS System, linking municipal-provincial-federal levels will be developed. Other small value, diverse types of consulting assignments, range from assisting farmers on agroforestry, piloting innovative technology for wood processing, capacity support/training to existing/potential forest-based entrepreneurs; preparation of landscape harvesting plans, capacity building to Financial Institutions (FI) to manage forest-based SME portfolio; including preparation of guidelines development for EA, SFM, GESI and safeguard etc.

ll. Procurement of Goods: No major procurement of goods is envisaged, except goods required for project implementation such as safety equipment, harvesting timber extraction equipment, GIS based equipment & data, MIS related IT equipment, vehicles, office IT equipment, office furniture etc.

mm. Procurement of Works: No major works contract is envisaged. Works contract constitutes office upgradation works at PMU, PPMU2 and PPMU5, Municipalities under province 2 and 5. Other small-scale scattered works contracts are envisaged to support Dalit/women in land allocation with fodder management, livestock support etc., within CBFM. There will be small holder agroforestry plantation on public and private lands.

nn. Procurement under Community Driven Development procedure: Municipalities and forest offices will follow community-driven development (CDD) procedure in accordance with Bank's Procurement Regulations for works contracts below NPR 2.0 million and goods, consulting and non-consulting contracts below NPR 1.0 million. For such CDD type of procurement, GoN procurement procedure will be applied and PPMU 2 and PPMU 5 will have responsibility to regularly monitor the implementation.

oo. **Procurement Risk Assessment:** The Bank team conducted procurement risk assessment of the REDD Implementation Center (REDD IC), under MoFE. The REDD IC has also implemented two Bank financed trust fund projects. Based on the assessment and prior experience of implementing Bank financed projects, the procurement risk of REDD IC is "Substantial". The other two implementing agencies, i.e. MoITFE in Province 2 and Province 5 are relatively new offices, established under the new federal structure. With no experience under the Bank's procurement procedures, the procurement risk of these two agencies, is "High". Prior and Post Reviews: Considering all activities to be of small value, procurement review requirement is envisaged to fall under post review. However, the procurement plan approved in STEP will determine the review requirement.

pp. Procurement Support by the Bank: Bank team will provide implementation support at least twice a year at the field level. In the beginning of the project, a procurement orientation will be provided to all project related staff including project directors/coordinators, procurement officials and consultants, FM officials and consultants and others. The Bank procurement team will especially organize procurement clinics customized to the project need.



qq. E-Procurement: Since the National Public Procurement Act and Regulations were passed, procurement has gradually incorporated the use of electronic Government Procurement (e-GP). This is a single online procurement portal operated by PPMO. An upgraded system called e-GP II which allows for online entry of procurement plan, invitation of bids, online submission of bids, uploading of signed contract document. The project will use e-GP for its procurement as per the PPMO's e-GP directive. Table 3 identifies the main procurement risks and mitigation measures to be undertaken by the project.

5. Monitoring and Evaluation

rr. **The PMU at federal level will have the primary responsibility for all monitoring, evaluation and reporting activities** for the project. PPMUs will have the responsibility the same activities for their respective provinces. A rigorous M&E system equipped with GIS and other facilities for data collection, storage and analysis will be established at Federal Government level enabling the project's progress towards the results to be measured and assessed. The project M&E system will utilize existing country systems as far as possible. M&E within provinces will be coordinated by the PMU M&E specialists Provision has been made for specific studies to be commissioned by the FPMU and PPMUs provide in-depth analysis of specific monitoring indicators. ADBL will report to the FPMU on the use and performance of the credit line for project activities and on the financial performance to MoF as provided in the loan agreement. In case ADBL is the sole retail bank providing loans, an independent third-party monitoring of the implementation of the credit line will be established.

ss. **Project M&E specialists will actively lead on monitoring by Local Governments and communities** and will incorporate data and information originating at field level into the Results Framework. The frequency of data collection will be annual. The M&E specialist will also actively lead on activities to (a) generate information on project progress, (b) analyze and aggregate data generated at the regional and local levels, and (c) document and disseminate key lessons to all stakeholders in Province 2 and Province 5 together with the communication function of the PMU. The project will place special emphasis on mapping project interventions and results through geocoding of activities and overlay these geo-referenced activities with key indicators. This information will be accessible through platforms that will be built into the design of the MIS system to be developed under component 1.

tt. **Key sources of monitoring data** will include: (a) data generated by CBFM groups through participatory community-based monitoring on forest and forest utilization, fund-use and socio-economic parameters, (b) data compiled by Local Governments (c) data compiled by Divisions and sub-Divisions of Provincial Forestry Directorates and (d) data held by financial institutions providing credit under component 3 and (e) field surveys conducted by the project on a sample basis to capture socio-economic and other data. The Ex-Ante Carbon Balance Tool (EX-ACT) will be used to assess GHG emissions. To capture demand-side social accountability, regular social audits will be undertaken. The monitoring activities will be described in the Project's Operations Manual.

uu. **A baseline survey** will be conducted during project preparation and a final project survey and evaluation at the end of the project period (year 5). An independent mid-term review (MTR) will be carried out in year 3 during which the target values of all indicators will be reviewed, and any required adjustments made. Evaluations will draw on both qualitative and quantitative data on various aspects of the project activities.

vv. **PMUs will produce annual progress reports** to monitor outputs and results against the results framework. ADBL will report to the FPMU on the use of the credit line. The format for these reports will be described in the POM. They will provide information on beneficiary perceptions as well as measuring and recording outcomes and results. The FPMU



together with the World Bank will prepare an Implementation Completion and Results Report within six months of project closing.

ww. **Implementation support plan.** The strategy for implementation support will include formal supervision missions, including field visits to project sites and remote support to the implementing agency (MoFE). Special focus will be placed on the following:

- Monitoring overall project implementation and performance, including results indicators;
- Supporting the capacities of MoFE, MoITFEs, Local Governments, CBFM groups and participating financial institutions to monitoring their own performance;
- Supporting ADBL with the implementation of the credit line for forest-based activities through FIs;
- Assessing project activities and results and possibly engaging international experts in the areas of forest sector governance, forest management and silviculture, information communication, climate-change adaptation, community-led development, forest-based enterprise, procurement & financial management, communication, outreach, knowledge-sharing and M&E;
- Ensuring that service providers effectively build the required capacities for MoFE, MoITFEs, Local Governments and CBFM groups;
- Monitoring the development, implementation and performance of the supported forest-based enterprises
- Implementing a proactive communication and consultation strategy that requires stakeholder engagement at Federal, Provincial and Local Government levels and community level for implementation of project activities;
- Supporting multi-stakeholder governance and multi-sectoral dialogue;
- Ensuring that the complementarity between the Project activities and DGM supported activities is maintained.

xx. **The fiduciary implementation support plan** is based on risks. The financial management (FM) and procurement specialists for the project will participate in implementation support missions, as appropriate. Missions will involve review of the FM and procurement arrangements at MoFE and will include field visits to MoITFE in Province 2 and Province 5 to ensure that the arrangements are understood and being appropriately followed. FM issues identified during implementation support missions and arising through audits will be appropriately dealt with by MoFE for satisfactory closure. In the first year of project implementation, FM supervision will focus on the use of the IFMS for (a) generating the monthly divisional accounts for submission to the AG and (b) preparing unaudited IFRs for submission to the World Bank. Once the use of IFMS becomes institutionalized under the project, implementation support will review the project's FM system, including, but not limited to, accounting, reporting, and internal controls. Review and monitoring of procurement activities, as guided by the Procurement Plan, will be undertaken to ensure compliance with the Bank procurement policies and procedures. This will include post review of contracts not covered under prior review. Procurement training may be provided.

yy. **As part of environment and social risk management**, a comprehensive ESMF has been prepared, one that is sufficiently broad to cover the forthcoming DGM project also. The ESMF incorporates the results of Environmental and Social Assessment (ESA) for the project, a Resettlement Policy Framework (RPF) and an Indigenous Peoples Planning Framework (IPPF), in accordance with the relevant ESSs and Nepal's legal framework. Implementation support will be provided to the PMUs including continuous capacity building on the ESF and its application, supervision of social and environmental risk management actions at the project sites. This will involve the implementation of a Stakeholder Engagement Plan, Gender Action Plan, Grievance Redress Mechanism, Occupational Health and Safety measures, and generic Labor Management Procedures (LMP). Supervision will also cover provisions for training, capacity building and



guidance to the three PMUs, Government institutions, service providers and project beneficiaries, including CBFM groups and private forest owners, as well as to project-supported FBEs. Implementation support will focus on engagement with key stakeholders especially CBFM groups and Local Governments. Adequate staffing and budget for Environmental and Social Commitment Plan implementation will be ensured throughout the project period. In the proposed budget almost 30 percent of the project budget has been planned and allocated for gender-, social- and environment-integrated and specific activities. Adequate staffing for both environmental and social safeguards management will be ensured throughout the project period.

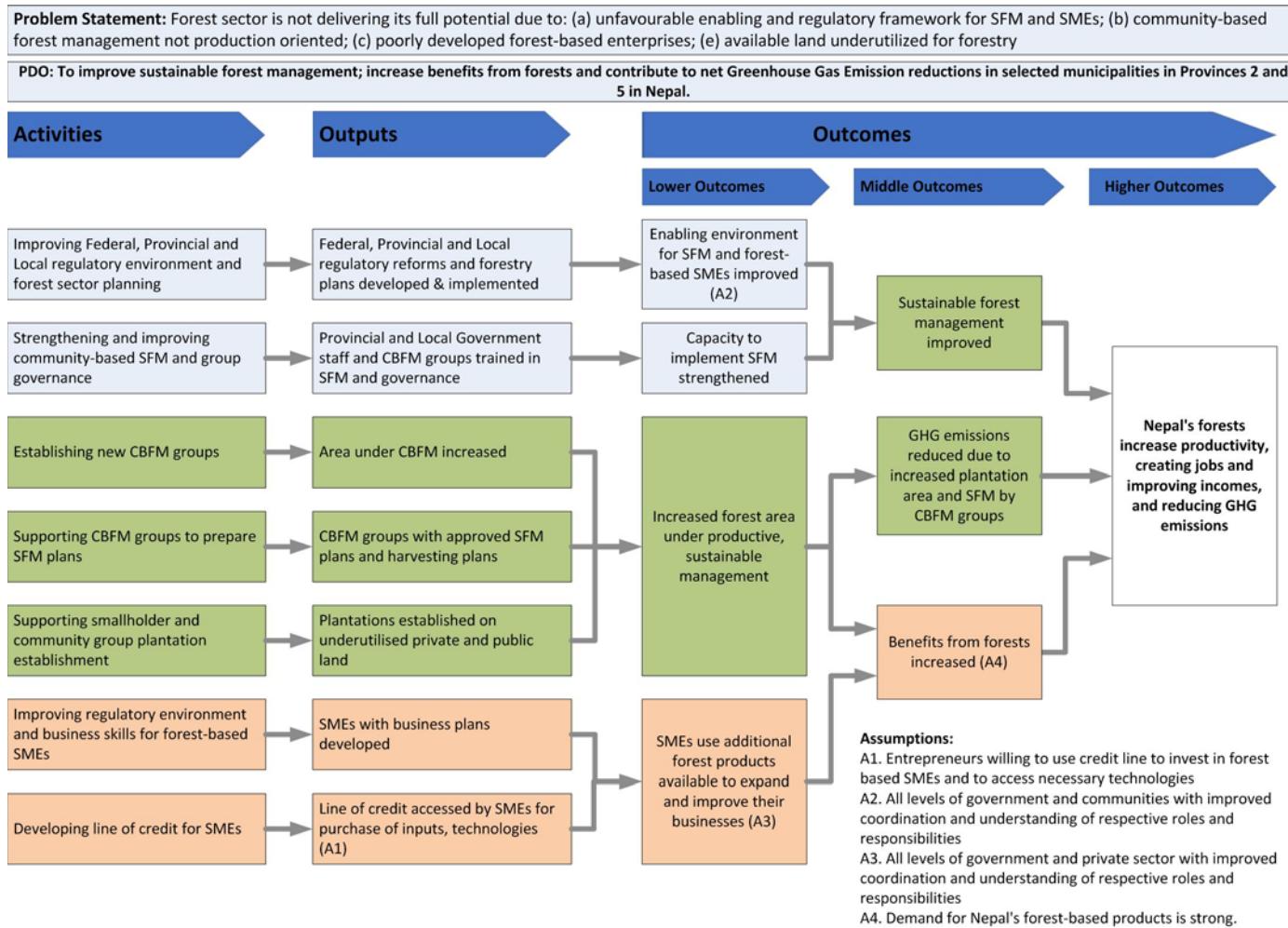
zz. The ESMF for the project is has been developed, as required, through a consultative process. It will provide: (i) the principles, rules, guidelines and procedures to assess the environmental and social risks and impacts of project; (ii) measures and plans to reduce, mitigate and/or offset adverse risks and impacts; (iii) budget estimates for taking the mitigating measures; and (iv) identification of agencies responsible for addressing risks and impacts including their capacity to manage them. The ESMF contains a negative list, as an annex, of activities that will be excluded from project financing.

aaa. The FPMU and each PPMU will have on board environmental and social safeguards specialists (SSs) who will oversee and provide overall coordination for ESMF implementation and compliance. The E&S SSs in the provincial-level PMUs will be responsible for supporting the local government in the screening of activities, drafting of site-specific ESMPs, and integrating the safeguards requirements into the tender and contract interactions with environmental agencies and local implementing entities, thereby ensuring effective implementation of both the current and coming safeguards documents.

bbb. Community groups, implementing entities and service providers will also be involved in preparing ESMPs, ensuring that all relevant stakeholder representatives are involved in their preparation. ESMPs developed by the local governments, communities and service providers will be reviewed by the corresponding PPMU before being approved.



ANNEX 2: Theory of Change





ANNEX 3: Economic Analysis and Greenhouse Gas Accounting

a. Economic Analysis

1. An economic cost-benefit analysis was carried out to evaluate the economic efficiency of the proposed project activities.

Overview of Project Benefits and Costs

Project Benefits

2. Column 2 of Table 1 lists the project benefits by sub-component, whereby benefit is defined as the value of additional goods or service produced due to the project relative to the counterfactual / without-project state. As such, project benefits are defined outcomes rather than intermediate outcomes or outputs. In this project, outcomes are provided by component 2, while components 1 and 3 support intermediate outcomes and outputs (see Annex 1 – Results Framework), which are necessary for the attainment of the component 2 benefits. Component 4 activities are similar in the sense that without day-to-day project management, fiduciary management, social and environmental risk management, and results monitoring and evaluation, the project outputs, and the intermediary and final outcomes would not be achieved. Therefore, in the economic cost-benefit analysis, the benefits from component 2 are evaluated against the cost of all four components.

3. The project's benefits are assessed in terms of incremental benefits of the with-project scenario over a counterfactual or business as usual (BAU) scenario. Column 3 in Table 1 presents information data availability to quantify the project benefits. Where data are available, the table presents the specific assumptions made in the estimation process are presented.

4. Key assumptions defining the incremental benefits are as follows:

- For both activities 2.1a and 2.1b, the increases in timber production are valued at current stumpage values, which equal market prices of roundwood minus harvest and transportation costs. The assumption that the market price will remain constants in the face of increasing production may or may not hold depending on the growth of demand for timber in Nepal and abroad. To address this uncertainty, the sensitivity of the efficiency metrics to variations in the price is examined.
- The mean annual increment (MAI) doubles going from CBFM to CBFM with SFM (Activity 2.1a) and increases by 25% going from government management to CBFM (Activity 2.1b). These values are conservatively assumed to stay constant after 2030.
- The yield factor for timber, ie the ratio of timber harvested as a percentage of MAI, is assumed to increase under both activities. Given the legal limit to overall (timber plus fuelwood) yield factor at 0.6 of MAI, the increase in timber harvest will mean a decrease in fuelwood extraction, even where the MAI increases.
- For the counterfactual scenario it is assumed that baseline conditions will persist or deteriorate due to continuing forest degradation and deforestation. Furthermore, deforestation and forest degradation are reduced going from government management to regular CBFM (Activity 2.1b)) and become zero going from regular CBFM to CBFM with SFM (Activity 2.1a) (Table 2).
- The project is expected to lead to the sequestration of a total of 17.74 million tons or 0.59 million tons annually



of carbon dioxide equivalent (tCO₂e) (see section “b. Greenhouse Gas Accounting” below). The economic value of the emission reductions is estimated using the lower bound of the range of carbon shadow values as of 2020 listed in the World Bank guidance note on carbon valuation, namely US\$40/tCO₂ e (World Bank 2017).

Table 1: Incremental economic benefits of the project, data availability for quantification, and assumptions made in estimating the quantifiable benefits.

Project Activity	Benefit Definition	Assumptions / data availability																				
2.1a. Improve existing CBFM (Switch from conservation focused management to SFM)	<ul style="list-style-type: none"> - Incremental market value of timber and fuelwood production on existing CBFM areas converted to SFM. <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th><th>Total</th><th>Chure</th><th>Terai</th></tr> </thead> <tbody> <tr> <td>CF</td><td>73,908</td><td>36,954</td><td>36,954</td></tr> <tr> <td>LHF</td><td>346</td><td>173</td><td>173</td></tr> <tr> <td>CFM</td><td>19,240</td><td>0</td><td>19,240</td></tr> <tr> <td>Total</td><td>93,494</td><td>37,127</td><td>56,367</td></tr> </tbody> </table>		Total	Chure	Terai	CF	73,908	36,954	36,954	LHF	346	173	173	CFM	19,240	0	19,240	Total	93,494	37,127	56,367	Stumpage value of timber and fuelwood: US\$207/m ³ and US\$15/m ³ (weighted averages across species) MAI in BAU in 2030: 1- 1.5m ³ /year MAI under SFM in 2030: 2-3m ³ /year Yield factor for timber in BAU: 0.15 (timber) Yield factor for timber under SFM: 0.54 Annual incremental cost of SFM=29 \$/ha (weighted average CF/LHF/CFM and Chure/Terai)
	Total	Chure	Terai																			
CF	73,908	36,954	36,954																			
LHF	346	173	173																			
CFM	19,240	0	19,240																			
Total	93,494	37,127	56,367																			
<ul style="list-style-type: none"> -Incremental market value of non-wood forest products 	Data not available																					
<ul style="list-style-type: none"> - Value of increases in other forest ecosystem services, including carbon sequestration, cultural services, erosion control, reduction of sedimentation, biodiversity conservation. 	Emission reductions valued in three ways using US\$40 /tCO ₂ e the lower range of global shadow value of carbon in 2020 and linearly rising to US\$50 / tCO ₂ e by 2030 ²² . Data on other ecosystem services are not available.																					
2.1b Transfer to CBFM (Switch from open access to conservation-focused management)	<ul style="list-style-type: none"> - Market value of increased timber and fuelwood production on national forest areas transferred to CBFM <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th><th>Total</th><th>Chure</th><th>Terai</th></tr> </thead> <tbody> <tr> <td>CF</td><td>10,225</td><td>5,112</td><td>5,112</td></tr> <tr> <td>LHF</td><td>158</td><td>79</td><td>79</td></tr> <tr> <td>CFM</td><td>5,515</td><td>0</td><td>5,515</td></tr> <tr> <td>Total</td><td>15,898</td><td>5,191</td><td>10,707</td></tr> </tbody> </table>		Total	Chure	Terai	CF	10,225	5,112	5,112	LHF	158	79	79	CFM	5,515	0	5,515	Total	15,898	5,191	10,707	Stumpage value of timber and fuelwood: US\$207/m ³ and US\$15/m ³ (weighted averages across species) MAI in BAU in 2030: 1- 1.5m ³ /year MAI under CBFM in 2030: 1.25-2.25 m ³ /year Yield factor for timber in BAU: 0.10 – 0.15 Yield factor under CBFM: 0.13-0.23 Annual incremental cost of CBFM=19\$/ha (weighted average CF/LHF/CFM and Chure/Terai)
	Total	Chure	Terai																			
CF	10,225	5,112	5,112																			
LHF	158	79	79																			
CFM	5,515	0	5,515																			
Total	15,898	5,191	10,707																			
<ul style="list-style-type: none"> -Incremental market value of non-wood forest products 	Data not available																					
<ul style="list-style-type: none"> - Value of increases in other forest ecosystem services, including carbon sequestration, cultural services, erosion control, reduction of sedimentation, 	Same values for carbon emissions reductions as above. Quantitative information on other ecosystem services is not available.																					

²² As per World Bank 2017. “Guidance note on shadow price of carbon in economic analysis” Nov 12, 2017 OPCS.



Project Activity	Benefit Definition	Assumptions / data availability
	biodiversity conservation.	
2.2. Smallholder plantations on private and public land	- Increased or new yields of timber, fuelwood, NTFPs in beneficiary private forests	Data limitations.
	- CO2 emission reduction	Same values for carbon sequestration as above.
	- Enhanced recreational opportunities	Data not available to assess this benefit.

MAI: Mean annual increment; CF: Community forestry; CFM: Collaborative forest management; LHF: Leasehold forestry.

Table 2. Assumed annual rates of forest degradation and deforestation, by region and by scenario (%)

	Business as Usual				Intervention 1		Intervention 2	
	Deforestation		Degradation		Deforestation	Degradation	Deforestation	Degradation
	CBFM	Gov-managed	CBFM	Gov-managed	CBFM with SFM		Regular CBFM	
Chure	0.18	0.18	0.02	0.10	0	0	0.05	0
Terai	0.20	0.60	0.05	0.20	0	0	0.05	0

Project Costs

5. The total investment cost of the project activities is estimated at US\$24 million (in financial terms) and will be incurred over a period of 5 years, as detailed in Table 3 below. A constant adjustment factor of 0.9 is used to convert financial cost and benefit estimates to economic figures, accounting for taxes and other transfers, and the opportunity cost of labor being less than the financial wages in some cases.

Table 3: Program investment costs by intervention and year (US\$ '000)

	Year 1	Year 2	Year 3	Year 4	Year 5	All
Component 1: Policy & capacity building support for new government structures and processes for sustainable forest management						
Total Component 1	435,586	836,486	1,035,135	445,045	145,946	2,898,198
Component 2: Community-Based Sustainable Forest Management & Forest Plantations						
2.1 Sustainable Forest Management through CBFM (2.1a and 2.1b)	688,739	1,248,198	1,450,000	1,284,234	1,162,162	5,833,333
2.2 Smallholder plantations on private and public land	161,036	609,234	1,069,144	1,544,369	1,543,468	4,927,252
Total Component 2	849,775	1,857,432	2,519,144	2,828,604	2,705,631	10,760,586
Component 3: Forest Enterprise Improvement & Development						
Total Component 3	111,712	1,713,063	2,377,027	1,646,622	1,505,405	7,353,829
Component 4: Project Governance, Monitoring & Learning						



Total Component 4	841,622	531,712	572,252	513,694	529,009	2,988,288
TOTAL (all components)	2,238,694	4,938,694	6,503,559	5,433,964	4,885,991	24,000,901
TOTAL (all components) – Economic*	2,014,824	4,444,824	5,853,203	4,890,568	4,397,392	21,600,811

* Estimated using a conversion factor of 0.9.

6. In addition, where applicable, annually recurrent operations and maintenance costs related to the implementation of the project activities during and after the 5-year project period were incorporated in the analysis. Notably, the annual forest management costs (excluding any forest product harvest costs) increase from nearly zero to \$19/ha going from government management to CBFM (Activity 2.1b), and by \$29/ha going from regular CBFM to CBFM with SFM (Activity 2.1a). (These management cost figures are weighted averages reflecting relative areas under CF/LHF vs. CFM and in the Terai vs Chure - see Table Column 3 of Table 1).

7. Furthermore, project interventions have opportunity costs. Notably, under Activities 2.1a and 2.1b, reduction in deforestation that would have occurred in the counterfactual (business as usual) scenario would have also led to benefits from the one-time clearcutting and sale of timber, and the recurrent economic benefits from use for agricultural production or infrastructure. In this analysis, we used net revenues from clearcutting estimated by Rai et al (2017) in community forests in Chure and the Terai and collaborative forests in the Terai. The weighted average was calculated as US\$23,326/ha under Activity 2.1a and US\$ 22,280/ha under Activity 2.1b. Regarding annual recurrent opportunity cost, we assume that all deforested forest areas would be used for agricultural production and used net annual benefits ascertained by Rai et al 2017 in Chure and Terai, with a weighted average of US\$157/ha under Activity 2.1a and US\$245 under Activity 2.1b. Finally, the opportunity cost of reduced fuelwood production (in favor of timber production) is also incorporated in the calculations.

Additional Notes on Methodology

8. The analysis period is taken as 30 years, including 5 years of project implementation, which is a reasonable perspective for investments in improved forest management and plantations which have long rotation periods. The project's economic efficiency is measured in terms of three metrics, namely economic rate of return (EIRR), net present value (NPV) and benefit-cost (B/C) ratio. The discount rate used for the calculation of EIRR and B/C ratios is taken as 6.4%, which is double the historical long-term annual GDP growth as per 2016 guidance to World Bank staff²³. The impact of discounting on the efficiency of the project is gauged as part of the sensitivity analysis.

Results

9. The analysis to date has considered most quantifiable incremental benefits of Activities 2.1a and 2.1b²⁴ and the carbon emission reductions associated with the entire program. During appraisal, availability of data on other benefits listed in Table 1 will be explored, notable those of Activity 2.2. In addition, any changes in planned project outputs and cost estimates will be incorporated during appraisal. Table 4 presents the annual streams of estimated benefits of the project using the basic model parameter values as discussed above.

Table 4. Annual streams of cost and benefits (US\$ million)

Year	1	2	3	4	5	6	7	10	15	20	30
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OPSQ 2016. "Discounting Costs and Benefits in Economic Analysis of World Bank Projects"

²⁴ With the exception of the incremental benefit of additional fuelwood availability under intervention 1.



Project Costs	\$2.0	\$4.4	\$5.9	\$4.9	\$4.4	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Benefits	(\$6.0)	(\$14.7)	(\$13.6)	(\$10.5)	(\$6.8)	\$5.4	\$7.8	\$14.8	\$20.0	\$63.0	\$63.0
2.1a. Improve existing CBFM	(\$4.6)	(\$8.7)	(\$10.1)	(\$7.6)	(\$5.2)	\$5.6	\$7.9	\$14.8	\$19.8	\$19.8	
21.b. Transfer to CBFM	(\$1.3)	(\$6.1)	(\$3.5)	(\$2.9)	(\$1.6)	(\$0.2)	(\$0.1)	\$0.1	\$0.2	\$0.2	\$0.2
Net Benefits without carbon value	(\$8.0)	(\$19.2)	(\$19.5)	(\$15.4)	(\$11.2)	\$5.4	\$7.8	\$14.8	\$20.0	\$20.0	\$20.0
EIRR	14.4%			NPV	\$86		B/C ratio	5.9			
Economic value of carbon sequestration	\$24.2	\$24.7	\$25.3	\$25.9	\$26.4	\$27.0	\$27.6	\$29.5	\$33.0	\$36.9	\$46.1
Net benefits with carbon value	\$16.2	\$5.5	\$5.8	\$10.4	\$15.3	\$32.5	\$35.4	\$44.4	\$53.0	\$56.9	\$66.1
EIRR	NA			NPV	\$492		B/C ratio	28.8			

10. Without taking into consideration the global economic value of carbon sequestration, the EIRR of the project is estimated at 14.4%. The NPV and B/C ratio are estimated at US\$ 153million and 9.6, respectively, using a discount rate of 6.4%. The results point to high project efficiency. Adding the value of carbon sequestration, the net benefits increase significantly. Since the entire stream of net benefits is positive, it is impossible to calculate an EIRR; the NPV and B/C ratio at d=6.4% are US\$560 million and 32.3 respectively. The incorporation of the incremental benefits associated with subcomponent 2.2 would increase the EIRR, NPV and B/C ratio further.²⁵

11. **Sensitivity analysis.** The impact on the EIRR, NPV and B/C ratio of the variation in the values of key model parameter values was examined. As Table 5 indicates, the efficiency metrices are robust to decreases in the stumpage value of timber, MAI growth rates, project investment costs, incremental forest management costs, and to decreases in the value of fuelwood, fodder and leaf litter under Activity 2.1b. Finally, the project NPV and B/C ratio are above 0 and 1, respectively, at a discount rate of 14%.

Table 5. Sensitivity of project efficiency matrices to changes in key parameter values

Variation from basic model value indicated in Table 4	EIRR	NPV (MUS\$) (d=6.4%)	B/C ratio (d=6.4%)
100%	14.4%	\$86.3	5.9
Average stumpage value for timber			
90 %	12.8%	\$67	4.8
56 % (switch value)	6.4%	\$0	1.0
MAI growth in Activity 2.1a			
90 %	13.5%	\$75	5.2
22% (switch value)	6.4%	\$0	1.0
MAI growth in Activity 2.1b			
90 %	14.3%	\$86	5.8
20 %	14.1%	\$83	5.7
Project investment costs			
110%	14.1%	\$85	5.3
200%	11.8%	\$69	2.9
Annual incremental forest management costs under CBFM- SFM			

²⁵ Barring exceptionally unusual circumstances where the total opportunity cost of the plantation areas plus the plantation management costs exceed the total incremental timber benefits from plantations.



110%	14.1%	\$83	5.7
200%	11.4%	\$55	4.1
Annual incremental forest management costs under regular CBFM			
110%	14.3%	\$86	5.8
200%	14.0%	\$83	5.7
Average stumpage value of fuelwood			
110 %	14.3%	\$86	5.8
200%	13.9%	\$81	5.6
Timber yield factor under CBFM -SFM			
90%	12.7%	\$66	4.7
58% (switch value)	6.4%	\$0	1.0
Discount rate			
d=3%		\$190	10.7
d=14%		\$2	1.12

b. Greenhouse Gas Accounting

12. The Bank has calculated the Greenhouse (GHG) contribution of the project using FAO EX-ANTE Carbon-Balance Tool (EX-ACT). As per the World Bank guidance on GHG Accounting for Forest Sector Investment Projects (July 2016), GHG contributions have been estimated only for site specific investment activities that would directly lead to emissions or removal of GHG. Non site-specific activities such as capacity building and strengthening of forest institutions are excluded.

13. The Project will support plantation/agroforestry in an area of 1,150 ha and private plantation on 4,050 ha. In addition, 14,231 ha of government-managed forests will be brought under CBFM through an established forest handover process. Moreover, 86,827 ha of forests currently under CBFM will be managed more intensively as a result of revised forest management plans. These data were entered into EX-ACT with the following assumptions:

- Regarding *plantation*, it is assumed that 5,200 ha will be planted on degraded lands and no fire will be used. In addition, no fertilizer and other chemicals like herbicide and pesticide will be applied.
- Regarding *sustainable forest management*, assumptions include: a) the initial state of degradation of 14,231 ha is “moderate”, and it will remain the same without the project, but the state of degradation after the project will be “low”; b) the initial state of degradation for 86,827 ha is “moderate”, and it will remain the same without the project, but the state of degradation after the project will drop to “very low”; and c) the occurrence and severity of fire will affect 2percent of the project area without the project and it will be zero with the project.

14. The net carbon balance has been calculated over 5 years of implementation phase and 25 years of capitalization phase. Over the total 30 years, the forest in the project area would sequester 17.74 million tons of carbon dioxide equivalent (tCO₂e). This would mean a carbon sequestration of 166.9 tCO₂e per ha or 5.6 tCO₂e per ha per year. Activity wise, afforestation would sequester 2.19 million tCO₂e, and the improved forest management would contribute 15.55 million tCO₂e.



ANNEX 4: Assessment of Apex Body to implement the Credit Line

World Bank Bank projects with lines of credit are required to be reviewed to ensure that there are no risks to the overall financial system and that certain good practices related to interest rates, subsidies, credit allocation and institutional arrangements are considered in the final design of the project. An OP 10 review is required, since the project includes a line of credit to forest-based SMEs (subcomponent 3.2). The objective of the review was to ensure the effectiveness and sustainability of the credit line so that it can reach thousands of people active in the forestry sector in Province 2 and Province 5.

Assessment Summary

- **The project meets all WB requirements on design.** The credit facility design and piloting (Sub-component 3.2) will support uptake of financial sector lending to forest-based SMEs, a segment still facing constraints of limited access to finance and financial services in Nepal.
- **Strategy.** The strategy to develop and pilot a credit line, given the expected amount to be allocated of about 25% of the total project size of US\$24 million, fits well into the Project goal of improving sustainable forest management, increasing benefits from forests and contributing to net Greenhouse Gas Emission reductions in selected municipalities in provinces 2 and 5 in Nepal. The model will crowd in the private sector in line with the government strategy.
- **The institutional set-up assures ongoing monitoring and evaluation, based on the context.** ADBL's set-up assures ongoing monitoring and evaluation. However, there is need to enhance capacity to develop pipeline, disburse and monitor a forest-based SME portfolio. The FIs will be selected based on their financial health as well as experience in lending to forest-based enterprises. To be eligible, the FIs must be in good standing with national regulators and have clean recent audits.
- **The Technical Assistance component.** The TA component will help ADBL and selected FIs developing the above-mentioned forest-based SME portfolio management capacity in enhancing the credit department to assess and monitor the forest-based SME portfolio, new product development, risk mitigations strategies (including potential collaterals, immovable and movable), marketing material, etc.
- **At midterm review, it would be helpful to consider leveraging factors.** One approach would be for commercial banks using their own funds to match project funds to expand total available funds for eligible projects.

1. Final Project Design Summary

Financial intermediation will be done by the Agricultural Development Bank Limited (ADBL) selected by the Ministry of Finance (MoF) in collaboration with Ministry of Forestry and Environment (MoFE) and approved by MoF, based on a comparative analysis on proved ability to manage and monitor loan funds prudently. The ADBL will be one of the retail institutions, especially at the beginning of project implementation yet, the project legal document does provide for other retail financial institutions to take part in the future. ADBL will assume the credit risk of the subproject loans to forest-based SMEs.

2. Overview and Macroeconomic framework

A stable macroeconomic framework and policies help to promote investment and encourage banks and other financial institutions to provide credit in traditional and innovative ways. For the credit line to be effective, it will be important to monitor the macroeconomic trends. The economy has rebounded since the disruption in 2015. Based on the GDP's trends, during past few years the growth for Nepalese economy has been higher than that for emerging market and



developing economies. The World Bank's estimated real GDP growth rate of 7.1% for FY 2018/19 is higher than the 5.9% estimated for South Asia. For FY20, due to COVID, the revised estimate is 4% GDP growth. With the foreign exchange reserve growing by 2.1% in FY 2017/18, inflation under control (4.5% estimated for first eleven months of FY 2018/19), manageable level of both public and foreign debt, and improving GDP growth, the macro-economic conditions of Nepal can be considered stable. It is unclear how significant the short term effects of COVID-19 will be on the macroeconomic situation.

3. Financial Sector

For a small country, Nepal has a lot of financial institutions – including 27 commercial banks, 24 development banks, 22 finance companies, and 87 micro-finance institutions as of mid-Jan 2020. The Merger Bylaws 2011 and the increase in minimal capital requirements introduced a few years ago is slowly helping to consolidate the market, although the number of practitioners is still high. The overall capital adequacy ratio is 13.97% as of mid-Jan 2020. However, the credit to deposit ratio ranges from 85.55% for development banks to 89.32% and 89.52% for commercial banks and finance companies respectively, limiting the credit growth. The sharp rise in fixed deposit rates between Oct-2016 and July-2017 also indicates the cut-throat competition between commercial banks for term deposits. With a recent slowdown in deposit mobilization, credit is becoming more difficult for firms to obtain. The overall NPL ratio for BFIs is low: 1.52% as of mid-July 2019, slightly increased to 1.77% as of mid-Jan 2020. The NPL ratio for the ADBL in mid-July 2019 was 3.29%, the lowest over the past 3 years.

4. Interest rate structure

These are determined by the market, with banks free to set the lending interest rate based on a regulated base rate from Nepal Rastra Bank and the risk premium that banks determine for clients. However, there is a restriction on the weighted average interest rate spread, a maximum of 4.5 or 5% (depending on the bank's class) set by Nepal Rastra Bank. Savings rates range from 2.6% for short-term to 8.6% for maturities over one year. There is strong competition in the market to attract deposits, given prudential regulations on liquidity ratios. There is a maturity mismatch issue facing the banking sector, although it varies by bank. Information on a bank's asset/liability maturity match is not required to be public so it may not be possible to quantify it.

5. Interest rate for lending under the project level- The interest rate structure of the fund flow mechanisms is in line with the market interest rate structure and it is not undercutting the market. On the contrary, the credit line is encouraging financing to forest-based SMEs where access to finance is a constraint. By providing medium-term liquidity to the banks, the project will help in extending the tenure of the sub-loans and will contribute reducing the maturity mismatch in the banks' balance sheets.

6. Role and Capacity of the Implementing Agency

ADBL will be responsible for the implementation of the credit line in coordination with the PMU. The credit risk is taken by ADBL, which will conduct direct assessment of the FIs for further on-lend to forest-based SMEs. ADBL was selected by the MoF in collaboration with MoFE) and approved by MoF based on a technical and financial analysis. It is a public financial institution specialized in agricultural lending established in 1968. It has a good footprint and experience to support access to finance in agriculture and some experience in forest-based SME lending. With a staff of 2069 and a dedicated monitoring and evaluation unit, the Bank task team is confident that ADBL will be able to manage the technical aspects of the line of credit work. However, if other retail financial institutions do not participate in the project, working with a single retail institution can present risks and limit outreach. If ADBL has operational issues (due to COVID or other exogenous causes for instance) and is not able to serve as an effective retailer, then the project could be blocked from



reaching producers.

7. Capacity of the Financial Institutions (FIs)

If the project invites additional retailer institutions to participate, key selection criteria will be the presence of bank in the targeted provinces and financial infrastructure and performance (number of branches, size of loan portfolio, share of current loan portfolio attributable to forestry sector, default rate, etc.). If additional retail institutions are invited to participate, the selection of the FIs would be conducted by ADBL as a project implementing agency, with the no objection of the due diligence and selection by the World Bank. This review would confirm that participating FIs are well-managed, with adequate corporate governance structure and sound financial performance indicators, to operate at market conditions and to implement the project. To be eligible, the additional retail FIs would have to be in good standing with national regulators and have clean recent audits. Capital adequacy, return on equity, portfolio quality, and liquidity (credit to deposit ratio) would be expected to be within normal parameters for national financial institutions.

8. M&E

M&E of the sub-projects will be the responsibility of FIs, including ADBL as one of the retail financial institution. The PMU will monitor the subprojects for compliance with WB's ESF standards, and applicable WB and GoN fiduciary requirements. ADBL (and any subsequent retail FIs) are expected to monitor the sub-project financial and commercial performance. Whether as a formal part of the results framework (preferred approach) or as part of less formal monitoring, it is recommended that ADBL shares the performance of the forestry SME portfolio supported by the project. In case ADBL is the sole retail bank providing loans, an independent third-party monitoring of the implementation of the credit line is recommended.

9. IFC

While designing the project, dialogue has been conducted with IFC. IFC is not engaged at the moment in access to finance credit lines to forest-based SME sector in Nepal. The proposed WB line of credit could pave the way for a future IFC engagement in the country to support forest-based SMEs. By crowding into the private sector and demonstrating viability of investments, the Project aims at creating a demonstration effect in the forest-based SMEs space.