

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 8 December 2021¹

KOSOVO

Mitrovica Wastewater Development Project

[Redacted in line with the EBRD's Access to Information Policy]

[Information considered confidential has been removed from this document in accordance with the EBRD's Access to Information Policy (AIP). Such removed information is considered confidential because it falls under one of the provisions of Section III, paragraph 2 of the AIP]

¹ As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

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ABBREVIATIONS

AMP	Asset Management Plan
DSCR	Debt Service Cover Ratio
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
EBRD	European Bank for Reconstruction and Development
EH&S	Environmental, Health and Safety
EIB	European Investment Bank
EIRR	Economic Internal Rate of Return
ESAP	Environmental and Social Action Plan
E&S	Environmental and Social
ESDD	Environmental and Social Due Diligence
ESMS	Environmental and Social Management System
EUR	Euro
FDI	Foreign Direct Investment
FIRR	Financial Internal Rate of Return
FOPIP	Financial and Operational Performance Improvement Programme
GET	Green Economy Transition
GoK	Government of Kosovo
IFI	International Financial Institution
IMF	International Monetary Fund
KPI	Key Performance Indicator
LALRF	Land Acquisition and Livelihood Restoration Framework
LALRP	Land Acquisition and Livelihood Restoration Plan
MEI	Municipal and Environmental Infrastructure
MoEE	[Ministry of Economy] ²
MoF	[Ministry of Finance, Labour and Transfers] ³
MoU	Memorandum of Understanding
NPV	Net Present Value
NRW	Non-Revenue Water
NTS	Non-Technical Summary
P.E.	Population equivalent
PIP	Priority Investment Programme
PIU	Project Implementation Unit
PP&R	Procurement Policies and Rules
PR	Performance Requirements
PSA	Project Support Agreement
PSC	Public Service Contract
RWC	Regional water and wastewater companies
SAA	Stabilisation and Association Agreement
SEP	Stakeholder Engagement Plan
SPP	Stakeholder Participation Programme
SSF	Shareholder Special Fund
TC	Technical Cooperation
VAT	Value-Added Tax
VISP	Vital Infrastructure Support Programme
WBIF	EU-Western Balkans Investment Framework
WSRA	Water and Services Regulatory Authority
WWTP	Wastewater Treatment Plant

² Formerly the Ministry of Economy and Environment, renamed following a restructure in 2021.

³ Formerly the Ministry of Finance, renamed following a restructure in 2021.

PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report concerning an operation in favour of Kosovo for the benefit of Regional Water Company Mitrovica (“**RWCM**” or the “**Company**”), a state-owned regional water utility company registered in Kosovo, are submitted for consideration by the Board of Directors.

The operation consists of a sovereign loan in the amount of up to EUR 13.5 million for the construction of a new wastewater treatment plant and rehabilitation and extension of the wastewater network in the Municipality of South Mitrovica (“**Mitrovica**”) and the Municipality of Vushtrri (“**Vushtrri**” and together the “**Municipalities**”) (the “**Project**”).

The Project will be co-financed with a sovereign loan from the European Investment Bank (“**EIB**”) [REDACTED] and an investment grant in the amount of up to EUR 5 million from the European Union (“**EU**”) through the Western Balkans Investment Framework (“**WBIF**”) which was approved in December 2020. In addition, WBIF has provided grant funding for project implementation support.

The expected transition impact of the Project includes *Green* and *Well-Governed* qualities by increasing the volume of treated wastewater and revising the existing public service contract between the Municipalities and the Company. The Project is also fully in line with the Bank’s Green Economy Transition (“**GET**”) Approach 2021-2025, and qualifies as 100 per cent GET by promoting environmental and social benefits and public health improvements, and mitigating the effect of climate change and other forms of environmental degradation.

Post-signing TC support for the preparation of tender documents, procurement and implementation will be provided by the WBIF. In addition, the Project includes TC support for financial and performance improvement programme (“**FOPIP**”), which will include a revision of the Public Service Contract and an asset management plan, to be financed by the Swiss State Secretariat for Economic Affairs (“**SECO**”).

I am satisfied that the operation is consistent with the Bank’s Country Strategy for Kosovo, the Municipal and Environmental Infrastructure Sector Strategy 2019-2024, the Green Economy Transition Approach 2021-2025 and with the Agreement Establishing the Bank.

I recommend that the Board approve the proposed loan substantially on the terms of the attached Report.

Odile Renaud-Basso

BOARD DECISION SHEET

KOSOVO- Mitrovica Wastewater Project - DTM 50458	
Transaction / Board Decision	Board approval ⁴ is sought for a sovereign loan in the amount of up to EUR 13.5 million in favour of the Republic of Kosovo (the “ Borrower ”), to be on-granted to Regional Water Company Mitrovica (“ RWCM ” or the “ Company ”), a state-owned water utility incorporated in Kosovo, for the construction of a new wastewater treatment plant (“ WWTP ”) and rehabilitation and extension of the wastewater network in the Municipality of South Mitrovica (“ Mitrovica ”) and the Municipality of Vushtrri (“ Vushtrri ”) (the “ Project ”). EIB will provide co-financing in the amount of up to EUR 13.5 million alongside the Bank. EBRD will be the lead IFI. This financing will be complemented by a EUR 5 million WBIF investment grant approved by the WBIF Steering Committee in December 2020.
Client	The Borrower is the Republic of Kosovo. The Client is RWCM, a water and wastewater utility company covering South Mitrovica, Vushtrri and Skenderaj together with outlying villages that surround these urban conurbations. The Company is wholly owned by the Government of Kosovo, represented by the Ministry of [Economy] (“ MoE ”) ⁵ .
Main Elements of the Proposal	<p><u>Transition impact</u></p> <p>Primary Quality – Green, via: (i) construction of an EU-compliant WWTP and rehabilitation and extension of the existing sewer network; and (ii) increasing the volume of treated wastewater being safely returned into the environment which additionally protects water resources from sewage-related contamination.</p> <p>Secondary Quality – Well-governed, via: (i) revision of the Public Service Contract (“PSC”), (ii) Financial and Performance Improvement Programme (“FOPIP”) implementation; and (iii) approval of the Asset Management Plan.</p> <p><u>Additionality</u></p> <p>Financing structure: The Bank will provide necessary long-term financing, which is currently not available from local commercial banks.</p> <p>Policy, sector institutional and regulatory change: The Bank will mobilise TC to revise the PSC between the Company and the municipalities in line with EU standards and to ensure compliance with the Bank’s environmental, social and procurement policies.</p> <p>Sound banking: The transaction is a sovereign loan. Kosovo’s sovereign debt levels are projected to remain prudent under 30 per cent of GDP in the medium term, despite the pandemic crisis and consequent GDP contraction.</p>
Key Risks	<ul style="list-style-type: none"> • <u>Project implementation risk</u> – [REDACTED]. The Company will be supported by experienced international consultants during project preparation, implementation and construction supervision to minimise the risks. Procurement will be carried out following the Bank’s Procurement Policies and Rules (“PP&R”). • <u>Environmental and social risk</u> – This risk is mitigated through appropriate mitigation measures and implementation of the Environmental and Social Action Plan (“ESAP”) with the support of the project implementation consultant.
Strategic Fit Summary	The Project is fully consistent with the Bank’s Country Strategy for Kosovo and the GET Approach 2021-2025 by financing projects in the water and wastewater sector that achieve tangible environmental and social benefits and public health improvements. The Project is also consistent with Municipal and Environmental Infrastructure Sector Strategy 2019-2024, which promotes financing wastewater investments that comply with EU Accession requirements.

⁴ Article 27 of the AEB provides the basis for this decision.

⁵ Formerly the Ministry of Economy and Environment, renamed following a restructure in 2021.

ADDITIONAL SUMMARY TERMS FACTSHEET

EBRD Transaction	A sovereign loan in the amount of up to EUR 13.5 million to the Republic of Kosovo, for the benefit of RWCM, a state-owned water utility incorporated in Kosovo, for the construction of a new wastewater treatment plant (“ WWTP ”) and rehabilitation and extension of the wastewater network in the Municipality of South Mitrovica (“ Mitrovica ”) and the Municipality of Vushtrri (“ Vushtrri ”) (the “ Project ”). The Project will be co-financed with an EIB sovereign loan of up to EUR 13.5 million and a WBIF investment grant in the amount of EUR 5 million that was approved in December 2020.
Existing Exposure	Total Bank’s exposure to the sovereign as of end-September 2021 was EUR 181 million in 7 projects, with operating assets amounting to EUR 26 million. The Bank does not have any direct exposure to the Client.
Maturity / Exit / Repayment	Up to 15 years [REDACTED].
AMI eligible financing	None.
Use of Proceeds	<p>The proceeds of the loan will be used to co-finance: i) the construction of a WWTP with a capacity of 123,000 population equivalent in South Mitrovica, at an industrial area in the confluence of the Ibar and Sitnica rivers; with sufficient space for a potential later expansion and upgrade for further nutrient removal; (ii) replacement, upgrading and new construction of urban sewers and interceptors in South Mitrovica; (iii) replacement, upgrading and new construction of urban and rural sewers and interceptors in Vushtrri, including a combined sewer overflow (CSO) and [REDACTED] interceptor to connect Vushtrri with South Mitrovica. In total, interceptors with a total length of 50.2 km will be constructed along the Ibar, the Llushta, the Sitnica and the Trepca rivers, preventing discharge of raw sewage to these rivers and conveying all wastewater to the treatment plant.</p> <p>The Bank’s use of proceeds will be controlled via the application of the Bank’s Procurement Policies & Rules and the Disbursement handbook for public sector projects complemented by regular reporting on the overall project implementation as covenanted in the loan agreement. In addition, the Client will be supported by a dedicated PIU benefitting from implementation consultancy, which will assist in ensuring adequate application of EBRD requirements, including use of proceeds ones.</p>
Investment Plan	[REDACTED]
Financing Plan	[REDACTED]
Key Parties Involved	<ul style="list-style-type: none"> • Ministry of [Finance, Labour and Transfers] of the Republic of Kosovo⁶ • Regional Water Company Mitrovica • EIB • EU/WBIF
Conditions precedent to effectiveness	[REDACTED]
Conditions to 1st Disbursement	[REDACTED]. Satisfactory implementation of ESAP.
Key Covenants	[REDACTED]
Security / Guarantees	Sovereign loan
Financing Agreements	<ul style="list-style-type: none"> • Loan Agreement between the Borrower and EBRD; [REDACTED].
Other material agreements	<ul style="list-style-type: none"> • Grant Agreement between Bank and the Borrower; [REDACTED].

⁶ Formerly the Ministry of Finance, renamed following a restructure in 2021.

Associated Donor Funded TC and co-investment grants/concessional finance	<p>A. Technical Cooperation (TC)</p> <p><u>Post-signing:</u></p> <ul style="list-style-type: none"> • Project implementation support consultant including, project preparation, procurement and implementation assistance to the PIU as well as works supervision; the entire budget for this consultancy assignment is EUR 2,940,000 out of which EUR 700,000 is financed by a WBIF grant to cover the consultancy cost related to project implementation and procurement support, whereas the project preparation and works supervision will be financed by the loan proceeds in the total amount of EUR 2,240,000. • Financial and Operational Performance Improvement Programme which will include a revision of the PSC, and an Infrastructure Asset Management Plan; EUR 300,000, to be financed by the Swiss State Secretariat for Economic Affairs (“SECO”). <p><u>Reimbursement:</u> The above assignments will be non-reimbursable transactional TCs required to assist the Company in project implementation and performance improvement.</p> <p><u>Cost sharing:</u> The Government of Kosovo will make a parallel contribution to the Project by financing: i) the works supervision from the loan proceeds [REDACTED], and ii) preparation of the detailed design for the sewer network [REDACTED].</p> <p>[and] paying all VAT and other indirect taxes that are applied to the post-signing TC assignments as a parallel cost sharing contribution to the project (VAT is levied at 18 per cent in Kosovo). Additionally, the Company will also provide “in-kind” contributions in the form of office space, communication connections, etc., for the consultants to work [REDACTED].</p> <p>B. Co-investment grants / Concessional Finance (Non-TC)</p> <p>The Project will be co-financed with a WBIF investment grant in the amount of EUR 5 million that was approved in December 2020.</p>
Technical Cooperation (TC)	[REDACTED]

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

The structure of the water and wastewater sector in Kosovo is based on river catchment areas or service areas. Accordingly, provision of water and wastewater service is the responsibility of regional water companies (“RWCs”), which serve around 70 per cent of the population in Kosovo. The remainder is supplied from water systems managed by local communities, many of which resist integration on tariff grounds.

The water and wastewater services in the Mitrovica service area are provided by two public entities: i) RWCM and ii) Ibar Water Company (“JPK Ibar”). RWCM is the larger of the two companies, supplying drinking water to municipalities of South Mitrovica, the near-by town of Vushtrri and to the town of Skenderaj together with outlying villages that surround these urban conurbations.

The Project will finance the construction of a new wastewater treatment plant and rehabilitation and extension of the wastewater network in the Municipality of South Mitrovica and the Municipality of Vushtrri. The proposed capacity of the WWTP is 123,000 population equivalent, and will serve the urban centre of South Mitrovica, the town of Vushtrri and the surrounding villages including Trepca, Broboniq, Vaganica and Koshtove. The new WWTP will be the second largest planned WWTP in the country after Pristina, and the capacity will be considerably larger than the other plant financed by the Bank in Gjilan. Importantly, the facility will be designed in such a way that at a later point it could be expanded to also serve North Mitrovica and Zvecan sewer as well as upgraded to provide more stringent nutrient removal (should this be required). Such a follow on phase will be considered and submitted separately for approval subject to the northern catchment area being integrated under the management of RWCM.

It is worth noting that the Project will have wide benefits as it will significantly reduce wastewater pollution flowing into the four rivers [REDACTED]. As such, all communities that have access to the four rivers directly and those users downstream, including transboundary recipients in Serbia, will benefit from reduced sewage related pollution.

At the end of 2018, only 58 per cent of the population in the Company’s current service area was connected to the sewage network and 88 per cent connected to the water supply network compared to 74 per cent and 90 per cent national average, respectively. The service area suffers from significant under-investment in its water and wastewater infrastructure and has severe deficiencies, with part of the sewer network obsolete, leaking or simply open, and shortcomings in the water mains resulting in poor water quality and water losses of up to 59 per cent. Beyond a small dedicated facility operated by RWCM at Skenderaj (9,000 PE) there is no other centralised wastewater treatment; instead raw sewage and industrial waste collected are discharged into the environment untreated contaminating both below-ground and surface waters. Most of the operating industries discharge untreated effluent straight into the streams and tributaries of the Ibar, Lushta, Trepca and Sitnica Rivers which eventually flow into the Danube. In rural areas, the majority of properties rely either on septic tanks or cess-pits with infiltration to ground. The majority of septic tanks are of poor condition, not emptied efficiently or bypassed causing septic waste to be improperly discharged into streams, natural ponds

or create informal sewage ponds. These rural systems – whether ineffectual septic tanks or cess-pits with infiltration - cause further harm to the environment and increase the risk to public health from contaminated drinking water sources.

The Project will help to address these challenges by providing a permanent, sustainable and resilient infrastructure solution. Specifically, the Project will: i) increase sanitation service coverage [REDACTED] in the Company's service area and ii) reduce wastewater pollution loads flowing into the rivers [REDACTED]. Once complete, the Project will therefore positively benefit the environment, increase the health and well-being and socio-economic development of all local communities in and around Mitrovica. The Company will focus on extending drinking water connections once the Project is implemented.

The Project was listed as a priority in a Memorandum of Understanding ("MoU") signed on 8 March 2018 between the Bank and the Government of Kosovo that outlined strategic areas of cooperation in the municipal and environmental sector. The Project is also in line with Kosovo's National Water Strategy 2014 – 2033 which lists as a strategic objective the protection of water resources to be achieved through rehabilitation and expansion of wastewater collections systems and construction of WWTPs to ensure compliance with the EU Urban Wastewater Treatment Directive. Furthermore, the Project is consistent with Kosovo's commitments under the Stabilisation and Association Agreement with the EU to reduce water pollution and prevent contamination of rivers that flow into international waters.

The Project is fully in line with the Bank's GET Approach 2021-2025 which promotes investments in the water and wastewater sector to achieve tangible environmental and social benefits and public health improvements, and mitigate the effects of climate change.

The Project is fully consistent with the Bank's Country Strategy for Kosovo, which proposes constructing and modernising wastewater treatment systems taking into account affordability constraints.

The Project is also consistent with the Municipal and Environmental Infrastructure Sector Strategy 2019-2024 which promotes financing projects for water supply and wastewater treatment systems to achieve environmental and social benefits and public health improvements.

Finally, the Project also contributes to a host of UN Sustainable Development Goals (SDGs), namely: (i) SDG 3: Good Health and Well-being; (ii) SDG 6: Clean Water and Sanitation; (iii) SDG 9: Industry, Infrastructure and Innovation; (iv) SDG 11: Sustainable Cities and Communities; and (v) SDG 14: Life Under Water.

1.2 TRANSITION IMPACT

This will be the Bank's second loan to the wastewater sector in Kosovo following the Gjilan Wastewater Development Project signed in May 2019.

Obj. No.	Objective	Details
Primary TI Quality: Green		
1.1	The percentage of EBRD use of proceeds allocated to the Project that qualifies as GET is 50 per cent or higher.	<p>The expansion of wastewater infrastructure in Mitrovica and its neighbouring communities and the construction of the first wastewater treatment plant in Mitrovica, both in accordance with EU standards, will result in significant environmental benefits for local water resources and public health.</p> <p>By providing access to improved sanitation services to the local population through enhanced wastewater collection and treatment capacities, the Project will considerably reduce the volumes of sewage that pollutes groundwater sources and rivers Ibar, Liushta, Trepca and Sitnica and eventually the Danube.</p>
Secondary TI Quality: Well-Governed		
2.1	The project mandates the decentralisation of the client (e.g. transfer ownership to the relevant local authority).	<p>The historical challenge of water and wastewater utilities in Kosovo results from insufficient managerial and financial autonomy, low tariffs, lack of incentives to improve performance and operational inefficiencies. Through the Bank's involvement in the sector, the Bank will continue to promote decentralisation while enhancing local accountability and responsibility for the Company. The Project will promote such decentralisation by creating a PIU at the Company level to raise its implementation capacities. The PIU will help the Company gain the necessary experience to implement and monitor the Project independently from the Ministry of Economy and Environment. The Company will be supported by experienced procurement consultants. In addition, technical assistance will be mobilised to assist the Company to prepare and start implementing a FOPIP aimed at further reducing costs, improving efficiencies and increasing profitability.</p>

Delivery risks: Some risks may be associated with the Company's reluctance to approve and implement the FOPIP and sign the PSC. This risk is mitigated by covenanting the completion of the FOPIP and the signing of the PSC in the Loan Agreement.

1.3 ADDITIONALITY

Identified triggers	Description
A subsequent/consecutive transaction (issuance) with the same client/group either with the same use of proceeds or in the same destination country (repeat transaction).	This is the Bank's second project in Kosovo focusing on the rehabilitation of water and wastewater infrastructure.

Additionality sources	
Financing structure <ul style="list-style-type: none"> EBRD offers financing that is not available in the market from commercial sources on reasonable terms and conditions, e.g. a longer grace period. Such financing is necessary to structure the project. EBRD offers a tenor, which is longer than available to the client in the market on reasonable terms and conditions. Public sector: EBRD investment is needed to close the funding gap. At the same time, EBRD does not crowd out other sources, such as from IFIs, government, commercial banks and/or complements them. 	<p>Long-term financing required for infrastructure projects in Kosovo continues to be available predominantly from the IFIs. The EBRD loan offers 15-year tenor [REDACTED], terms which are not available in Kosovo from commercial banks.</p> <p>The Bank's loan is additional because a single financier cannot meet all of the sector's financing needs. This Project is co-financed with the EIB. EBRD does not crowd out other sources, such as from IFIs, government, commercial banks but complements them.</p>
Policy, sector, institutional, or regulatory change <ul style="list-style-type: none"> EBRD's involvement in a project is considered additional when it is designed to trigger a change in the policy, sector, institutional or regulatory framework, or enhance practices at the sector or country level (e.g., an introduction of cost-reflective pricing of energy, water etc.). 	<p>Through the Bank's involvement in the sector, the Bank will continue to promote decentralisation while enhancing local accountability and responsibility for the Company.</p> <p>In addition, technical assistance will be mobilised to assist the Company to prepare and start implementing a FOPIP aimed at further reducing costs, improving efficiencies and increasing profitability.</p>
Standard-setting: helping projects and clients achieve higher standards <ul style="list-style-type: none"> Client seeks/makes use of EBRD expertise on best international procurement standards. 	<p>Compliance with the Bank's PP&R will enhance the expertise and implementation capabilities of RWCM.</p>
Knowledge, innovation, and capacity building <ul style="list-style-type: none"> EBRD provides expertise, innovation, knowledge and/or capabilities that are material to the timely realisation of the project's objectives, including support to strengthen the capacity of the client. 	<p>The Bank will mobilise TC to amend the PSC between the Company and the Municipality of Mitrovica in accordance with best international practice.</p>

1.4 SOUND BANKING - KEY RISKS

Risk of Borrower – RWC HM	Probability / Effect	Comments
Tariff risk	Low/High	The Water and Services Regulatory Authority (the “ Regulator ” or “ WSRA ”) sets tariffs at cost recovery levels. The Project will require tariff increases to cover the operating and maintenance costs of the wastewater infrastructure. The Regulator has accordingly increased the tariffs for two WWTPs that are expected to become operational in the next two years. [REDACTED].
Dependence on subsidies	Low/High	[REDACTED]. Given environmental externalities and affordability concerns, the loan will be on-granted to the Company from the GoK which will remain responsible for servicing the debt.
Demand risk	Low/High	The demand in water/wastewater sector services is predictable and the risk is considered to be low.

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Collection risk	Low/Medium	The Company's collection ratio is around 72 per cent, and has improved over the past years. The TC for FOPIP will support the Company on improving the collection ratio further.
Operational inefficiency, need of additional investments	High/Medium	The Company's non-revenue water is high (52 per cent) due to the poor quality of its water network system. The Company will have to invest in the refurbishment of obsolete pipes to further improve its operational efficiency and service resilience. The proposed FOPIP TC will include a component for improving and developing an Asset Management Plan aimed at identifying targeted future programmes of investment.
Operating costs	Medium/ Medium	The Company has a high cost base with operating expenditures representing around 62 per cent of revenues. However, the Company will expand its service area and connections, thus increasing its revenues and EBITDA. The TC for FOPIP will assist the Company in developing a plan for improving the operational and financial efficiencies further.
Financial risk	Low/High	Sovereign loan to be on-granted to the RWCM.
FX and interest rate risk	Low/Medium	The loan will be in EUR, which is the legal tender in Kosovo. The interest rate risk will be borne by the sovereign.
Implementation risk	Medium/High	A PIU will be established at the Company level. The WBIF-funded TC will provide a comprehensive implementation support to the PIU, including for procurement and preparation of tender dossier. The WWTP is envisaged to be built following a design and build contracting by an internationally reputable company.
Overall Risk of Borrower - Low	Medium/ Medium	Kosovo has relatively low public debt levels and has capacity to increase sovereign borrowing (End 2020: 25 per cent of GDP and is expected to reach to 28.7 per cent in 2021). GDP growth in 2019 was 4.2 per cent, among the highest in the region, however, the economy contracted by 4.1 per cent in 2020 due to the pandemic crisis [REDACTED]. During the pandemic crisis, Kosovo is mobilising funding for its crisis response and the associated revenue shortfall, while relying on borrowings to fill this funding gap. However, in spite of the severity of the COVID-19 crisis, under the worst case scenarios from IMF, sovereign debt remains at a prudent level under 40 per cent of GDP (legal limit in Kosovo) in the medium-term.

2. MEASURING / MONITORING SUCCESS

<i>Overall objectives of project</i>	<i>Monitoring benchmarks</i>	<i>Implementation timing</i>
<ul style="list-style-type: none"> - Compliance with design standards and project specifications. - On-time project implementation 	<ul style="list-style-type: none"> - Progress reports, supervision reports, independent assessment, as covenanted in the Loan Agreement. - Completion according to the timeline and within the budget. 	[REDACTED]

<i>Transition Impact Monitoring Indicators and Benchmarks</i>							
Quality	Obj · No.	Monitoring Indicator	Details	Baseline	Target	Due date	TC Related?
Green	1.2	Wastewater treated (m3/year)	Additional annual wastewater treated in the project area	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Well-governed	2.1	Organisational restructuring completed as targeted	<p>The Bank will provide TC support for the development of a PSC in line with EU standards (covenanted).</p> <p>Financial Development (FOPIP) action plan implemented by the client (covenanted)</p> <p>Infrastructure Asset Management Plan to be prepared with support of TC funded consultants to be approved by the Company [REDACTED].</p>	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Core Client indicators			Number of beneficiaries benefiting from improved services	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

3. KEY PARTIES

3.1 BORROWER / INVESTEE COMPANY

The Borrower is the Republic of Kosovo, represented by the Ministry of [Finance, Labour and Transfers]⁷, which will on-grant the loan proceeds to the Company. Kosovo is not risk rated by any of the main credit rating agencies and has had no access to international capital markets.

3.2 COMPANY

RWCM is a utility company licensed to provide water supply and wastewater collection services to municipalities of South Mitrovica, Vushtrri and Skenderaj together with outlying villages that surround these urban conurbations.

The estimated population of South Mitrovica, Vushtrri and neighbouring municipalities is around 213,000 citizens; the Company provides drinking water to around 88 percent of people and wastewater services to 58 percent. In addition, it provides bulk treated water to JPK Ibar to serve around 20,000 customers in North Mitrovica and Zvecan.

RWCM is responsible for the maintenance of the 856 km water and 235 km wastewater network. Metered consumption is relatively low at 78 per cent, while water billed via metered supply is quite high in the region of 90 per cent. The service coverage ratio is low at 76 per cent compared to sector ratio of 94 per cent in water supply, and 58 per cent in wastewater service compared to 74 per cent sector coverage. Non-revenue water (“NRW”) is relatively high in the region at 52 per cent mainly caused by physical losses in the water network and illegal connections. In general, the network suffers from underinvestment, which has resulted in significant low levels of service including poor cost efficiency, coverage and reliability. [REDACTED].

Historical financial performance

The financial analysis is based on the Company’s audited IFRS statements for 2017-2020. The statements are qualified; however, the qualifications are not material. A summary of the financial result is presented in the table below, while more detailed information on the past financial performance is presented in **Annex 2**. [REDACTED].

COVID-19 impact: According to the COVID-19 Impact Analysis [REDACTED] prepared by an independent consultant, the pandemic outbreak and the associated restrictions affected the collection rates of the Company throughout the year especially during the first wave in April and May 2020. On the other hand, RWC Mitrovica is among the POEs eligible to receive emergency liquidity via the Ministry of [Finance, Labour and Transfers]⁸ under the EBRD’s Vital Infrastructure Support Programme (VISP).

4. MARKET CONTEXT

The current structure of the water and wastewater sector in Kosovo is based on river catchment areas. There are in total seven licenced regional water and wastewater companies, which are regulated by the WSRA. All seven companies are structured as JSCs and are wholly owned by the GoK, represented by the MoE⁹.

⁷ Formerly the Ministry of Finance, renamed following a restructure in 2021.

⁸ Formerly the Ministry of Finance, renamed following a restructure in 2021.

⁹ Formerly the Ministry of Economy and Environment, renamed following a restructure in 2021.

The current regulatory practice provides for the clear separation of responsibilities of the three key bodies involved in ensuring the provision of water and wastewater services to customers: (i) the Government deals with sector policy and legislation; (ii) the WSRA deals with tariff setting and customer interests protection; and (iii) the RWCs provide services to the customers.

A form of PSC is in place between the RWCs and the municipalities [REDACTED]. The RWCs provide annual performance reports and updates of their three year business plans to the MoE¹⁰, however there is no formal performance related agreement in place.

As per the Water Supply and Wastewater Services Tariff Policy (2017), tariffs for water supply comprise fixed and volumetric charges are based upon metered consumption of water. Tariffs for wastewater services are based on volume of water sold (in cases where a customer has a wastewater connection but not connect to the water supply, a flat rate based on an estimate of wastewater discharged is applied).

According to the WSRA Annual Performance Report for 2017, the sector has developed over the past years but it still faces challenges that need to be addressed as a matter of priority:

- *Water and wastewater service coverage* – currently over 90 per cent of the population receives water supply services, while only 74 per cent receive wastewater services. However, only 2 per cent of wastewater is currently treated, with only one wastewater treatment plant in operation (since 2012) in the city of Drenas, funded by EU grants, serving up to 10,000 residents.
- *Sustainability maintenance of existing services* - the collection ratio for water and wastewater services has been improving steadily to 84 per cent in 2017 from 74 per cent in 2015. However, to improve the financial sustainability of the RWCs, further improvements such as regular meter readings and billing, legal measures and disconnections of non-paying customers are required.
- *Water loss management* - the volume of water losses continues to be among the main concerns of the sector, with non-revenue water of 58 per cent in 2017 vs. the WSRA's target of 25 per cent in the medium term, which may seriously affect the long-term sustainability of RWCs.

Currently, four other WWTPs are being developed and constructed, including RWCs of Prizren, Gjakova and Peja, with grant funding from Germany and Switzerland via the KfW and SECO, respectively, and Pristina financed with a sovereign bilateral loan from the French government. The remaining RWC of Ferizaj has secured funding via a sovereign bilateral borrowing from the Hungarian government.

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL PROJECTIONS

[REDACTED]

5.2 MACROECONOMIC OUTLOOK

Kosovo grew robustly over the last years, averaging 4 per cent. However, due to the pandemic crisis, the economy contracted by 4.1 per cent in 2020. The Kosovo economy

¹⁰ Formerly the Ministry of Economy and Environment, renamed following a restructure in 2021.

is recovering mainly on the back of a supportive external sector. GDP increased by 16.3 per cent year-on-year in April-June 2021, posting growth for the third consecutive quarter. Household consumption is upheld by a continuously growing inflow of remittances, which expanded by 23 per cent year-on-year in the first eight months of 2021, and credit growth. Exports of services, which were more than four times exports of goods pre-pandemic, doubled in the first seven months compared with the same period in 2020, surpassing the respective 2019 level by 11 per cent. The strongest jump so far was observed in May-June when travel-related services increased more than four-fold compared with the 2020 level and by 34 per cent compared with the pre-pandemic year. Goods exports grew strongly as well, nearly doubling in nominal terms versus the same period in 2019. This comes largely on the back of a successful recent expansion of the furniture sector, which is expected to continue supporting expansion of exports and their geographical diversification. The economy is forecast to grow by 7.7 per cent in 2021 and by 4.5 in 2022. The main risks to the outlook relate to the pandemic and potential weaknesses in the external sector.

[REDACTED]. Due to the implementation of pandemic related support measures and recession-induced loss of tax revenues, the authorities allowed a relaxation of the fiscal rule over 2020-21. While fiscal revenues in 2020 declined by about 9 per cent, primary spending increased by over 6 per cent, because of mitigation and recovery measures that led to a rise in subsidies and transfers of about 40 per cent. The “fiscal rule” deficit (that excludes capital investment financed by IFIs and bilateral sources contracted after 2015) reached 5.8 per cent of GDP during 2020, and is projected at 4.9 per cent for 2021, significantly above the 2 per cent of GDP deficit ceiling. After 2021, the “Fiscal rule” deficit is expected to gradually return to below 2 per cent of GDP through the medium-term.

Kosovo has relatively low public debt levels and has capacity to increase sovereign borrowing. Sovereign debt was only 17.6 per cent of GDP at end-2019, however, as a result of the pandemic, government debt grew to 24.5 per cent of GDP in 2020 and is expected to reach to 28.7 per cent in 2021. The short-term fiscal financing needs arising from the impact of COVID-19 were and will continue to be secured through drawdowns from existing government bank balances, official financing from World Bank and other IFI resources, EU grants, and larger domestic issuance of government bonds. Beyond 2021, the increase in debt reflects the assumption of a moderate increase in absorption capacity of IFI financing for new capital investments.

Debt figures do not include any implicit contingent liabilities related to potential legal obligations of the Privatisation Agency of Kosovo for reimbursement of claims related to privatization (1.5 per cent of GDP), POEs debt (estimated at around 2–3 per cent of GDP), or debt contracted under former Yugoslavia (estimated at 2.4 per cent of GDP at end-2019, but declining over time as Serbia continues to service it).

Gross financing needs are projected to remain below the sustainability threshold in the medium-term. After peaking at close to 14 per cent of GDP in 2020, gross financing needs are expected to moderate to 9.4 per cent of GDP in 2021 and then decline and situate within the 7 - 8 per cent of GDP range over 2022 – 25. Resorting to the implementation of the fiscal rule beyond 2021 and increasing the average maturity of domestic debt should limit the vulnerabilities arising from the absence of external market access.

Table 2. Public debt sustainability framework

	2019	2020	2021	2022	2023	2024	2025
Public Debt (% of GDP)	17.6	24.5	28.7	30.4	31.7	32.9	34.1
<i>Key underlying assumptions for the baseline</i>							
Real GDP growth (%)	4.9	-6.0	4.5	5.5	4.0	4.0	4.0
Inflation (GDP deflator rate, in %)	0.6	2.1	-0.3	1.5	1.8	1.9	1.7
Primary Balance (% of GDP)	-2.5	-9.1	-5.5	-2.4	-2.0	-2.1	-2.0

Source: IMF, February 2021

Kosovo's large current account deficit in 2020 reflects both the COVID-19 impact and structural factors. The current account deficit increased from 5.5 per cent of GDP in 2019 to 7.5 per cent in 2020, given the implementation of mitigation and recovery measures and a significant decrease in diaspora-related flows. This reflects a current account structure that is mainly shaped by flows originating in the Kosovar diaspora: A large trade deficit in goods is financed by diaspora-related inflows in tourism, remittances, FDI in real estate, and other unaccounted diaspora-related flows reflected in relatively large errors and omissions. Other investments in Kosovo usually include government investments partly through borrowings from IFIs as well as treasury borrowings from domestic banks and donor investments in public infrastructure.

Continued compliance with the fiscal rule remains the key anchor to preserve fiscal sustainability in the medium term. Extending the maturity of debt and diversifying the sources of financing remain key policy priorities to contain financing risks.

5.3 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT

Categorised B in accordance with the EBRD's Environmental and Social Policy 2014. The environmental and social due diligence ("ESDD") for the Project was carried out as part of the feasibility study prepared for the Project by independent consultants. It included a review of current practices, an assessment of the Project's potential environmental and social ("E&S") impacts and a review of the Company's E&S management systems and capacities. The Project is designed to achieve compliance with national and EU wastewater treatment standards and the EBRD Performance Requirements ("PRs"). An environmental and social action plan ("ESAP") has been developed for the Project. A stakeholder engagement plan ("SEP") and a non-technical summary ("NTS"), including outline of key environmental mitigation and management measures, have also been developed and disclosed by the Client locally on its website.

The Project will provide substantial environmental and health benefits compared to the existing situation by improving the wastewater management services in the Municipality of Mitrovica and Municipality of Vushtrri through the construction of a new wastewater treatment plant with the capacity of 123,000 PE (Phase 1) and replacement, upgrading and new construction of urban and rural sewers and interceptors in Mitrovica and Vushtrri and several neighbouring communities. There are no centralised wastewater systems currently in the rural settlements, and the untreated wastewater is currently being discharged directly into the Ibar and Sitnica rivers and eventually into the Danube. The Project will result in a significant reduction in pollution of the local water resources due to improved wastewater collection and treatment. The Project will result in 6.7 million m³ wastewater treated per year after Phase I. The total

population benefitting from improved access to wastewater services will be 213,000 people, with additional 30,000 citizens that will be connected to the wastewater network. Future Phase II, which is not part of the current Project, is anticipated to increase the total capacity of the WWTP to 146,430 PE and introduce enhanced nutrient removal.

The Project is not expected to have significant impact on biodiversity due to the use of mainly agricultural land. The location of the Project is neither within nor in the vicinity of any protected area of high ecological value, and no sensitive areas are involved. The affordability assessment carried out by the consultant did not identify significant wastewater tariff affordability concerns from the implementation of the Project.

The Project involves permanent land acquisition (approximately 3.8 ha of privately owned agricultural land plots affecting 10 persons) for the purpose of construction of the WWTP and the access road on the site. This will give rise to economic displacement of a concrete plant which will need to be relocated. A land acquisition and livelihood restoration framework (“LALRF”) in line with the national legislation and EBRD PR5 has been prepared and disclosed for the Project, including an entitlements matrix, public consultation and grievance mechanism. The Project’s land acquisition process is not progressed enough to develop a land acquisition and livelihood restoration plan (“LALRP”), so this needs to be prepared ahead of actual implementation of the land acquisition and construction activities for the Project, as required by the ESAP. Post-signing implementation assistance will be provided to the Client to support overall ESAP implementation, including LALRP preparation.

Any adverse impacts will be localised and temporary, and prevented or mitigated by adhering to good construction practices. The identified impacts include noise, air pollution/dust, restricted access to buildings and roads, possible effect of vibration on buildings, soil and landscape disturbances during excavation works, debris, spoils, and traffic congestion. All potential adverse impacts can be managed through appropriate mitigation measures. Emergency response plan will be in place to handle accidental pollution and/or natural disasters.

The Company has no proper environmental and social management system and lacks competent environmental, health and safety (“EHS”) staff at the corporate level. Establishment of an effective environmental and social management system (“ESMS”) is required to ensure that the Company implements the Project in line with the national environmental requirements and EU urban wastewater standards.

The ESAP requires the Company to implement a number of improvements designed to meet the EBRD’s PRs. The key ESAP actions are related to: increasing the Company’s EHS capacity and development of EHS procedures relating to the main EHS risks; produce design documents and prepare local ESIA for the permitting procedure; obtaining construction permits for WWTP and the collector pipes and effluent discharge permit; development of HR policies and procedures; improvement of worker grievance mechanism; development and implementation of LALRP prior to construction; development of construction phase E&S management and monitoring plan; excavation and trench occupational health and safety (“OHS”) procedures; improved waste water quality monitoring and laboratory facilities; commitment to implementation of the enhanced nutrient removal under Phase II WWTP; odour management at the WWTP premises; sludge management and disposal planning; implementation of the SEP together with a public grievance mechanism.

The Bank will monitor the implementation of the Project and the ESAP as well as the Company's environmental and social performance by reviewing the Company's annual environmental and social reports and undertaking monitoring visits as needed.

6.2 INTEGRITY

In conjunction with OCCO, an updated integrity review was performed on the Company, its directors, senior management and other relevant counterparties. The review found [REDACTED] concerns are deemed mitigated and do not pose an unacceptable reputational or integrity concern to the Bank.

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the project.

6.3 AFFORDABILITY ANALYSIS

According to the affordability model developed by the EBRD, an average income household is expected to allocate between 1.6 and 2 per cent of its disposable income on water and wastewater services throughout the period considered. Assuming a stable average daily water consumption of 100 litre per capita, the expenses on water and wastewater services for a poor household are expected to remain below 3.3 percent of the overall expenditure. In conclusion, the analysis indicates that water and wastewater services are projected to remain affordable in Mitrovica based on the tariff structure projected by the financial model.

ANNEXES TO OPERATION REPORT

ANNEX 1	PROJECT DESCRIPTION
ANNEX 2	HISTORICAL FINANCIAL STATEMENTS OF THE COMPANY
ANNEX 3	PROJECT ECONOMIC INTERNAL RATE OF RETURN
ANNEX 4	PROJECT IMPLEMENTATION
ANNEX 5	TRANSITION IMPACT SCORING CHART

ANNEX 1 – PROJECT DESCRIPTION

The objective of the Project is to collect and treat all the wastewater in the urban areas of Mitrovica, Vushtrri and its surrounding villages. The Project components are shown in Figure 1 below.

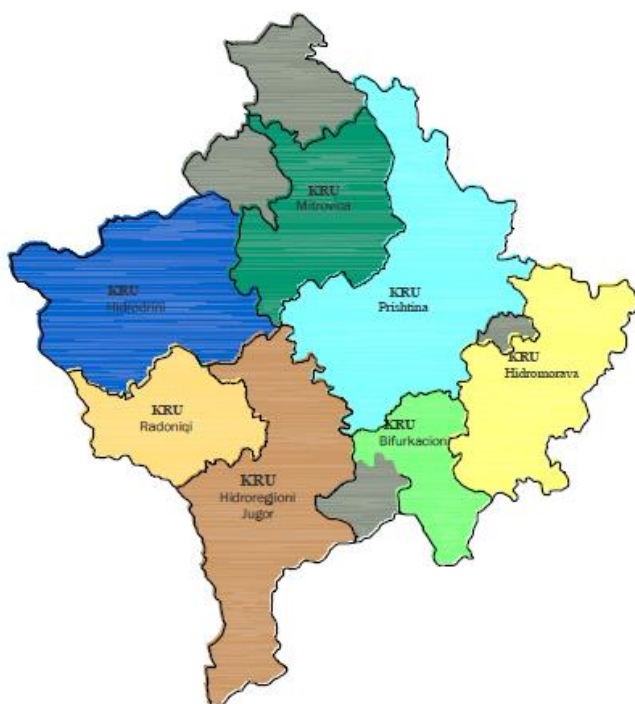
Figure 1.1: Project components



The planned design horizon is 2043. The following elements are proposed:

- A WWTP at the conjunction of Rivers Ibar and Sitnica; designed for a future capacity of 123,000 people equivalent (pe) achieved with two treatment trains with Imhoff tanks and Sequencing Batch Reactors (SBRs); it includes wastewater sludge dewatering and the potential to upgrade for further nutrient removal.
- Replacement and upgrading of urban sewers in Mitrovica to improve the functionality of the sewer network.
 - Replacement of existing sewers: 2.5 km
 - Installation of new sewers: 7 km
- Construction of new sewers to unify the fragmented networks and new sewer interceptors along the rivers in Mitrovica so that the sewage is conveyed to the WWTP.
 - 11.5 km of sewers along Ibar river
 - 14.3 km of sewers along Llushta river
 - 10.9 km along Trepca River
- Construction of new sewer interceptors inside Llushta culvert along 1.5 km.
- Replacement and upgrading of urban sewers in Vushtrri town to improve the functionality of the sewer network.
- Construction of new sewers and interceptors in Vushtrri to convey the wastewater to the WWTP:
 - 12 km of sewage collectors and interceptors along Sitnica river
 - Combined Sewer Overflow at the main discharge point downstream of Vushtrri fitted with an automatic screen
 - Sewers and collectors in rural areas

Figure 1.2. Municipalities in the Project area



KRU Prishtina	KRU Hidroregioni jugor	KRU Hidroregioni	KRU Mitrovica	KRU Radoniqi	KRU Bifurkacioni	KRU Hidromorava	Komunitat jashtë shërkimeve të KRU
Prishtinë Podujevë Fushë Kosovë Obiliq Lipjan Drenas Shtime Gjakovë	Prizren Suharekë Malishevë Dragash Mamushë	Pejë Klinë Istog Junik Deçan	Mitrovicë Skenderaj Vushtrri	Gjakovë Rahovec	Ferizaj Kaçanik Hani i Elezit Shtërpoc	Gjilan Kamenicë Viti Novokëndë Klokot Ranillugë Partesh	Mitrovica e Veriut Zubin Potok Leposaviq Zveçan

ANNEX 2 – HISTORICAL FINANCIAL STATEMENTS

[REDACTED]

ANNEX 3 – PROJECT ECONOMIC INTERNAL RATE OF RETURN

[REDACTED]

ANNEX 4 – PROJECT IMPLEMENTATION AND PROCUREMENT PLAN

Procurement classification – *Public sovereign*

[REDACTED]. In accordance with the current EBRD Country Procurement Risk Index 2017¹¹, Kosovo is allocated “high” level of risk to be applied to all public sector projects. The index is based on the level of compliance with the EBRD Core Public Procurement Principles as assessed in the EBRD Public Procurement Assessment 2011 and adjusted to consider the scores from the Transparency International Corruption Perceptions Index 2017. In the particular case for Kosovo the Country risk assessment is also based on Transparency International Score.

The Client’s capacity assessment related risk: *High*

The Company operates under Kosovo Public Procurement Law and has no previous experience in public international procurement. It has low procurement capacity having no recent experience in procuring large investment contracts or technical experience with WWTP. The day to day procurement activities of the Company are small and concerns procurement of consumables, spare parts, maintenance materials and equipment, inventory/equipment, recurrent services and small works for upgrade and maintenance of the water and sewage network.

The main challenge remains the capacity of the Company to administer the procurement processes in accordance with the EBRD Procurement Policies and Rules and in English language which represents a moderate risk to efficient procurement and implementation of the expected works and services. An experienced PIU, implementation and supervision consultant will guide the Company and the PIU through the preliminary and detailed designs, tender preparation, procurement process and contract administration to mitigate this risk.

Contracts risk assessment: *Moderate*

The scope of the contract covered by the Project is not technically challenging. The Project envisages the following four (4) contracts: a) the expansion and rehabilitation of sewage network in Mitrovica; b) expansion and rehabilitation of sewers in urban and rural areas in Vushtrri and construction of the interceptors in Vushtrri to convey the wastewater to Mitrovica; c) the construction of WWTP in Mitrovica and d) project implementation, PIU and supervision contract for the three works contracts. Additionally, there will be another consultancy contracts, grant funded, that will cover the FOPIP. [REDACTED]

Procurement arrangements:

The Project is classified as a public sector operation for procurement purposes. Goods, works and services financed under the Bank’s loan will be procured by Open Tendering procedures in accordance with the Procurement Policies and Rules (“PP&R”) for the public sector and the Company will use the Bank’s Standard Procurement Documents.

Due to the very low capacity of the Company to manage the project, a dedicated PIU for the Project will be set up as a separate unit within the Company. The PIU will be formed from staff within the Company’s organization (mainly the managers and the technical experts).

¹¹ [EBRD Country Procurement Risk Index 2017, Edition V.5 January 2017.](#)

The Company will be supported in the implementation of the procurement activities as well as loan administration by a PIU Support consultant to be engaged with the help of TC Grant Funds. The PIU will also be supported by a Supervision Engineer that will manage the day to day activities under the three works contracts. The Bank's Procurement Specialist will support the Company as needed. In order to maximize the available Loan and Grant budget, it is proposed to merge the three envisaged consultancy assignments (PIU support, procurement and contracting support and supervision) under one single contract that will run along the entire project cycle.

The expansion and the rehabilitation of the sewage network contract will be subject to single stage procurement tender using the EBRD standard procurement documents for works and Red FIDIC Conditions of Contracts.

The construction of WWTP, which includes design and built of the plant (and may include operation and maintenance), will be tender out as multiple stage open tender using the EBRD standard procurement documents for works and Yellow FIDIC Conditions of Contracts.

The Implementation Consultant, including the PIU and Supervision consultancy services under the project will be tender out as two stage competitive selection process using the EBRD standard procurement documents, while FOPIP consultancy contract will be tendered out as single stage competitive selection process. Consultancy contracts will be procured following the provisions of the Bank's PP&R Section 5 (Procurement of Consultant Services).

The Procurement Plan below provides the procurement strategy and details of planned investment and consultancy assignments

Additional information:

The Contracts will be tendered via the EBRD Client e-Procurement Portal ("ECEPP"). [REDACTED].

ANNEX 5 – TRANSITION IMPACT SCORING CHART

