# Water and environmental services project

## Summary of the Operation Performance Evaluation Review (April 2005)

## THE PROJECT

This water and environmental services project was initially intended to be approved in 1995, but due to internal staff changes at the EBRD and ongoing negotiations with the project parties, it was not approved until 1997. Part of this delay was to achieve a shift from sovereign to non-sovereign municipal lending. The project has since had a tortured history, requiring four addendums. The project has been implemented by an integrated, municipally owned water and waste-water company (the Company). While the project was designed to include discrete investment packages, it became a credit line for the Company to meet specific needs. When total investment needs were realistically estimated at €1 billion, a US$ 75 million investment (1997 project design amount) can only achieve specific activities, and when under €10 million (2004 actual) is actually disbursed, the funds are probably best managed as a credit line. This was a realistic outcome, but is not how the Project was conceived or presented to the Board.

## PROJECT RATIONALE

The Company is one of the largest water and waste-water companies in Europe. The water and waste-water systems of the city were severely neglected during the communist era. This was mainly due to funding constraints on the operation, maintenance, replacement and expansion of the system. In particular, the system required extensive rehabilitation of the water mains to reduce leakage, completion of a water treatment plant, installation of pressure reducing valves, replacement of service meters, installation of sewage collectors along the river, expansion and upgrade of the sewage treatment works, and extension of the service network to specified un-served and under-served communities within the municipality. In short, the system was in need of major repairs and upgrades throughout. Further, management systems were based on command and control systems, tariffs were artificially low, the Company was overstaffed and there were payment shortfalls, particularly by government agencies. The city was also identified as one of the major sources of pollution in the region.

It was in this context that donors began working with the municipality to address, among other things, issues relating to water and waste water. The World Bank was an early participant in discussions but backed out once the EBRD was established and actively engaged with the Steering Committee. Primarily due to the staff involved and prior relationships, the EBRD took overall leadership of the Steering Committee, and developed the project (as approved in 1997) incorporating significant contributions by the various Steering Committee members. Key to the success of the project launch was the long standing relationship with donors and collaboration among the Steering Committee members. One of major achievements of this project was the shift from sovereign guarantee to non-sovereign municipal guarantee.

## ACHIEVEMENT OF OBJECTIVES

Initially this project set out grand objectives in response to the huge undertaking faced by the Company. Over time, specific objectives were abandoned and redirected into follow-on projects. The Project essentially became a credit line which funded several specific, but unrelated activities. The major accomplishments of the project were:

- the establishment of a working relationship between the Bank and the Company
- the development of a long-term funding programme and the development of new projects that had been activities under the initial project
- a paradigm shift to an improved management structure

- specific cost savings and water demand activities.

Not accomplished under this project were the major investments in pollution control, which were envisioned at the start and had been the major justification for the project. Overall, fulfilment of project objectives was, therefore, rated *Satisfactory.*

**OVERALL ASSESSMENT**

The Bank's operation overall was rated ***Successful***. Environmental performance under the project, both from the perspective of the Bank and the water and waste-water services provider, was rated *Satisfactory.* However, environmental change was rated *None/Negative.* This rating reflects the fact that specific pollution reduction objectives under this project (river sewage collectors and waste-water treatment) were not met. However, PED recognises that the Bank has implemented follow-on waste-water projects in which some of the pollution reduction objectives will be met. The river sewage collectors remain an outstanding issue which will require significant new investment to resolve. The project benefited from extensive technical cooperation (TC) during its early stages. As several key objectives were not implemented under this project, but rather spun off into follow-on projects, fulfilment of objectives was rated *Satisfactory*. The project's financial performance was *Good*. Bank handling was also rated *Good.*

The project complied with the strategies and policies of the Bank. The project was one of the Bank's earliest experiences in the water and waste-water sector and has become a demonstration project for similar MEI projects in the country. The project's major successes were establishing a relationship with the Company and other partners and developing a long-term investment plan from which follow-on investments have been undertaken. This was the result of a shift in management style that is itself a direct result of support provided in the context of this project. However, because several critical activities were not implemented as envisioned, the resulting environmental and other anticipated benefits have not accrued within the context of this project. Fortunately, these have become follow-on projects under which the benefits will accrue.

**TRANSITION IMPACT AND THE BANK'S ADDITIONALITY**

PED has assigned an overall transition impact (TI) rating of *Satisfactory.* At the project corporate level TI was rated *Good*; while with respect to the economy as a whole, TI change was rated *Satisfactory*; for an overall rating of *Satisfactory*.

This project was an EBRD first-of-a-kind in developing non-sovereign municipal guarantees for water and waste-water projects. The project team developed a financial lending package that is based on a combination of grant funding and lending. The only other source of such funding would have been the World Bank. The Company could have continued to rely upon grant funding and municipal revenues, but could not then have envisioned the extent of upgrades planned. While the planned investments have not happened under this project, they are proceeding under new EBRD projects. The Bank has played an instrumental role in assisting the Company and the municipality design these projects. As a result, PED concludes that additionality was *Verified in All Respects*.

**BANK HANDLING**

PED rated bank handling overall as *Good.* The Banking Team has had to adjust to changing economic and other conditions. While this project has been consistently downsized, the Team has used the project as a relationship building opportunity from which they have created new projects. However, PED questions the decision to change the currency of the loan from US dollars to Deutschmarks, expecting that the sponsor was capable of hedging the currency risk and also assuming an appreciating rouble. In addition, the Banking Team should have utilised the waste-water specialists in the Environment Department to assist with the assessment of the status and need for additional improvements to the water and wastewater works.

The Banking Team could have continued to work under the umbrella of this project to implement the initial objectives (which would have needed to be significantly redefined), or develop a series of new projects – the path taken. The Bank's incentive structure rewards staff for new projects and puts relatively less emphasis on effective implementation of existing projects.

This project points to an alternative approach to lending in the sector in Russia and early/intermediate transition countries. Before large civil works can be undertaken, there is a need to achieve institutional and human resource development changes within the organisation and to develop long-term investment plans. Perhaps it is wise to define an investment programme with a sponsor, which is then implemented through a series of discrete projects. This is what has effectively happened with the Bank's relationship with the Company.

**MAIN OPER ISSUES AND LESSONS LEARNED**

**Institutional development is key to the success of municipal projects.** Early and judicious use of TC-funded technical assistance to support the institutional development of the municipal sponsors will lead to better understanding, planning and programming and thus better project outcomes.

**The right leadership is key.** The Company was fortunate to have a strong and capable leadership team willing to lead the "change process".

**Conservative economic scenarios should be assumed**. Economic projections should always assume conservative scenarios, regardless of existing currency and/or market trends, or political expectations.

**Projects should be implemented under long-term programmes.** The Banking Team should not incorporate too many discrete objectives into a single long-term loan. This is contrary to internal incentives and has proven difficult to implement, manage and monitor. Development of an investment programme, which then leads to specific projects, may provide greater flexibility, better project management, and function more effectively in the context of the new business volume-driven culture of the EBRD.