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## Summary of the Operation Performance Evaluation Review

Review evaluation of water supply and sewerage services project

May 2007

### THE PROJECT

The company was formed as a wholly owned limited-liability company of the municipality with a mandate to provide water supply and sewerage services. The project aimed to upgrade water supply and waste-water utilities within the city, both in physical facilities and institutional capacity. The total project cost amounted to approximately €66.7 million. Technical assistance for procurement and tendering support and construction supervision was granted. The Bank financed a total of €1.3 million of three technical cooperation (TC) assignments to provide consulting services for capacity building and project preparation. The Bank approved a €26 million senior loan to this project. A grant fund of €34 million was also provided by another agency. The Bank signed a municipal support agreement (MSA) with the municipality to ensure that the implementation of the project will be supported through several measures including tariff increases to be assisted by the municipal government.

In 1998, 5 per cent and 13 per cent of the population did not have access to water supply and central sewerage, respectively. Only 25 per cent of waste water was treated. By 2005, 95 per cent of waste water was treated before being discharged into rivers. The population coverage increased from 88 per cent to 96 per cent of people with access to water supply and sewerage services. The follow-on investment envisaged the further improvement in the quality of drinking and waste water and the reduction of pollution.

### PROJECT RATIONALE

The project rationale for the Bank consisted of a large potential of transition impact, namely establishing the water utility company's self-financing capacity. Enlarging the financing capacity also constituted the rationale for the borrower and the municipality, as a pioneer case in the municipal utility sector.

### ACHIEVEMENT OF OBJECTIVES

The objectives of the project are threefold: (i) reducing pollution in waterways and meeting the national and EU environmental standards; (ii) demonstrating feasibility of lending to a municipal utility company without sovereign or municipal guarantee; and (iii) preparing future private sector involvement for the municipal water sector. The OPER team considers that the fulfilment of the objectives is *satisfactory* overall.

### OVERALL ASSESSMENT

The overall performance of the project is rated *successful*. The achievement of objectives is considered *satisfactory*. The project achieved *good* transition impact at corporate as well as sector level by introducing the MSA for the first time and implementing the corporate development programme under the TC assignments. The environmental performance is highly positive with visible substantial change as a result of upgrading of the facilities, and is rated *good*. The Bank handled the project in a highly professional manner, which led to the next investment. The Bank's additionality is *verified in all respects* and Bank handling is *excellent*. The financial performance of the company is very sensitive to the water tariffs that are still exposed to politics to a certain extent. Unrealised tariff increases since 2002 have resulted in the company's cash flow weakening. While the project financial performance is *good* since the financial covenants had all been compliant, the company financial position is considered *satisfactory*. The Bank's return on the loan is evaluated as being *satisfactory* in quantitative terms despite the prepayment.

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## TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

The project performed well and delivered positive transition impact at the corporate level and in the sector. While the project has succeeded in establishing a good example of direct lending to the utility company, limited development is anticipated in private sector involvement although the company was willing to pursue the option. The OPER team has assessed transition impact as *good* with *medium* risks.

The Bank functioned in an indispensable manner throughout the project as a TC designer and administrator, financier, counsellor for the municipality and adviser for the follow-on investment to pursue further transition. The Bank's additionality in finance and design function is *verified in all respects*.

The environmental performance of the project is rated *good* given that (i) there have been substantial improvements in water quality; and (ii) via the funding, waste-water treatment plants have been upgraded. The environmental change resulting from the project is rated *substantial* as the quality of drinking water has improved and the level of untreated waste water entering the rivers and the sea has been considerably reduced.

## BANK HANDLING

The operation team has dealt with the large, complex, multi-donor investment with four TC assignments in a highly professional, proactive and efficient manner. The project design and formulation was comprehensive despite the Bank's first attempt in various fields. Periodic monitoring of implementation including procurement, environment, transition and financials was carried out diligently. Bank handling is assessed as *excellent*.

## MAIN OPER ISSUES AND LESSONS LEARNED

**Demonstration effects can be multiplied by a successful first project in the municipal and environmental infrastructure sector when soon pursued by a follow-on investment.** The first project in the sector has often a greater demonstration effect than any follow-on or similar projects. Its success is therefore highly visible and encouraging for the sector and could deliver a strong message to peer enterprises. In this project, when the subsequent project was launched soon after the first, the demonstration effect even intensified in the conventional municipal infrastructure sector.

**Advantages of integrated approach with a single project scope for co-financing in infrastructure projects.** The integrated approach for a project with multiple financiers, which considers all the project components regardless of financiers in a single project scope, appears to be more sound and effective for implementation and monitoring. In addition, it helps to ensure the quality of the project. Discrepancy of defined project scope among co-financing parties needs to be reconciled as it would make monitoring and evaluation rather difficult.

**Transition momentum needs to be maintained when designing a follow-on investment.** In repeat financing when a different financing mode is applied, the project design and structure should build on the state of progress or, if not, the unfulfilled covenants and the Bank's mandate-related conditionality should be maintained.

**Difficulty in reassuring tariff increases in a political context.** Confronting voter's preference, even a well-thought-out contractual framework could have a limited enforceability for increasing user charges. The municipality and a water company, when committing to the water infrastructure project, should be encouraged to promote and raise public awareness of the need for water investments to support the necessary tariff increases.

**Importance of grant-based finance for environmental infrastructure.** Grant financing plays a vital role in financing the environmental infrastructure in economic and financial terms. The

viability of the investment hinges on the grant funds; while the project is able to fully cover recurring operation and maintenance costs, the utility company could not have afforded the entire capital investment without the grant component. The facilities financed from grant funds, although they do not carry interest, need to be promptly implemented and completed in order to ensure the project benefits to flow as early as possible.

**Need for development of construction-related services in early accession countries.** In early accession countries, recognising the out-migration patterns, the Bank may wish to consider not only financing the project, but also helping the related sector in development projects, which could foster local construction firms. It would assist the construction market in expanding, thereby meeting growing demands.