

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

Approved by the Board of Directors on 28 August 2020¹

TAJIKISTAN

KULOB WATER AND WASTEWATER 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.

TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	4
ABBREVIATIONS / CURRENCY CONVERSIONS.....	5
PRESIDENT'S RECOMMENDATION.....	6
BOARD DECISION SHEET	7
ADDITIONAL SUMMARY TERMS FACT SHEET.....	8
1. STRATEGIC FIT AND KEY ISSUES.....	10
1.1 STRATEGIC CONTEXT.....	10
1.2 TRANSITION IMPACT	11
1.3 ADDITIONALITY	12
1.4 SOUND BANKING - KEY RISK	13
2. MEASURING / MONITORING SUCCESS.....	14
3. KEY PARTIES	15
3.1 BORROWER.....	15
3.2 KMK AND KMK SUBSIDIARY	15
4. MARKET CONTEXT	16
5. FINANCIAL / ECONOMIC ANALYSIS	16
5.1 FINANCIAL PROJECTIONS	16
5.2 SENSITIVITY ANALYSIS	16
5.3 PROJECTED PROFITABILITY FOR THE BANK.....	16
6. OTHER KEY CONSIDERATIONS.....	16
6.1 ENVIRONMENT.....	16
6.2 INTEGRITY	18
6.3 AFFORDABILITY ANALYSIS	18
ANNEXES TO OPERATION REPORT.....	24
ANNEX 1: INTEGRATED APPROACH TO WATER SECTOR AND REGIONALISATION CONCEPT	25
ANNEX 2: TRANSITION IMPACT SCORING CHART	27
ANNEX 3: EIRR.....	28

ABBREVIATIONS / CURRENCY CONVERSIONS

Bank or EBRD	The European Bank for Reconstruction and Development
CDP	Corporate Development Programme
DSCR	Debt Service Coverage Ratio
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
EHS	Environmental Health and Safety
EIRR	Economic Internal Rate of Return
ESAP	Environmental and Social Action Plan
E&S	Environmental and Social
ETC	Early Transition Country
EUR	Euro
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRR	Internal Rate of Return
KPI	Key Performance Indicator
LGD	Loss Given Default
MIS	Management Information System
PIU	Project Implementation Unit
PIP	Priority Investment Programme
PP&R	Procurement Policies and Rules
PR	Performance Requirements
PSA	Project Support Agreement
PSC	Public Service Contract
SPP	Stakeholder Participation Programme
SSF	EBRD Shareholder Special Fund
TC	Technical Co-operation
TJS	Tajik Somoni
VAT	Value Added Tax

1 EUR = 12.1 TJS
(as of 27 July 2020)

PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report concerning an operation in favour of the Republic of Tajikistan (the “RT”), are submitted for consideration by the Board of Directors.

The facility will consist of a sovereign loan to the RT in the amount of up to EUR 7.5 million. The loan proceeds will be on-lent to the State Enterprise for Kulob water and wastewater services (the “KMK Subsidiary” or the “Company”). This is a subsidiary of the State Unitary Enterprise Khojagii Manziliyu Kommunalii's (the “KMK”). The EBRD loan will comprise of two tranches: a committed tranche of up to EUR 3.0 million (“Tranche 1”) and an uncommitted tranche of up to EUR 4.5 million (“Tranche 2”).

The operation will enable the RT to rehabilitate water supply and wastewater infrastructure in the city of Kulob (the “Project”). The expected transition impact of the Project includes Green and Well-governed qualities, with the objective of improving water supply and wastewater services.

The EBRD loan is proposed to be co-financed by a capital grant in the total amount of EUR 7.5 million, to be provided by the European Union (the “EU”) through the Investment Facility for Central Asia (the “IFCA”). [REDACTED]

I am satisfied that the operation is consistent with the Bank’s Strategy for Tajikistan, with the Municipal and Environmental Infrastructure Sector Strategy, with the GET approach and with the Agreement Establishing the Bank.

Due to affordability constraints and limited financial resources, under the proposed limited short-term investment programme it is not possible at the present time to bring the existing facilities and operations of the Company into full compliance with EU drinking water quality and wastewater treatment and discharge standards, as required by the EBRD's 2014 Environmental and Social Policy (“ESP”). Derogation from this Policy is therefore required.

I recommend that the Board approve, on a no-objection basis, the proposed operation substantially on the terms of the attached Report.

Jürgen Rigterink
Acting President

BOARD DECISION SHEET

TAJIKISTAN – Kulob Water and Wastewater Project - DTM 51436	
Transaction / Board Decision	<p>Board approval² is sought for a sovereign loan of up to EUR 7.5 million in favour of the Republic of Tajikistan to rehabilitate water supply and wastewater infrastructure in Kulob (the “City”).</p> <p>The sovereign loan will have two tranches: Tranche I (committed) of up to EUR 3 million and Tranche II (uncommitted) of up to EUR 4.5 million. Approval to commit the uncommitted tranche is delegated to Management.</p>
Client	<p>The loan to the Republic of Tajikistan will be on-lent to the State Enterprise for Kulob water and wastewater services (the “KMK subsidiary” or the “Company”). This is a subsidiary of the State Unitary Enterprise Khojagii Manziliyu Kommunali (the “KMK”). The KMK is a 100 per cent state-owned enterprise.</p>
Main Elements of the Proposal	<p><u>Transition impact</u></p> <ul style="list-style-type: none"> • Green – the Project’s GET financing share is 100 per cent. The Project’s benefits will be delivered through the provision of infrastructure that enhances the City’s climate resilience towards projected increases in water stress and related extreme events, such as flooding • Well-governed – the Project and associated TCs will mandate the introduction of a regional authority and improve ineffective contractual arrangements; <p><u>Additionality</u></p> <ul style="list-style-type: none"> • Risk mitigation/financing structure/triggers policy change; • Sound banking – this is a direct sovereign loan to the Republic of Tajikistan. [REDACTED]
Key Risks	<p><u>Sovereign risk.</u></p> <p>Tajikistan remains vulnerable to external shocks. Public debt was 44.6 per cent of GDP in 2019. However, the proposed transaction’s sovereign risk remains acceptable.</p> <p><u>Exchange rate risk.</u></p> <p>The EBRD loan will be denominated in EUR, while the Company’s revenues are denominated in TJS. [REDACTED]</p> <p><u>Project implementation risk.</u></p> <p>This risk will be mitigated by the involvement of a Project Implementation Support consultant.</p>
Strategic Fit Summary	<p>The Project is consistent with the Bank’s country strategy for Tajikistan, and corresponds with the Municipal and Environmental Infrastructure Sector Strategy and with the GET approach.</p>

² Article 27 of the AEB provides the basis for this decision.

ADDITIONAL SUMMARY TERMS FACT SHEET

EBRD Transaction	<p>A sovereign loan of up to EUR 7.5 million to the Republic of Tajikistan, consisting of:</p> <ul style="list-style-type: none"> • <u>Tranche I</u> of up to EUR 3.0 million (committed). • <u>Tranche II</u> of up to EUR 4.5 million (uncommitted). <p>Approval to commit the uncommitted tranche is delegated to Management.</p> <p>The sovereign loan's proceeds are to be on-lent to the KMK Subsidiary.</p>
Existing Exposure	Sovereign exposure: EUR 434 million. [REDACTED]
Maturity / Exit / Repayment	The loan's tenor is 15 years [REDACTED]
Potential AMI eligible financing	It is proposed that the total amount (potentially up to EUR 7.5 million) of EU investment grants count towards the Bank's Annual Mobilised Investments. [REDACTED]
Use of Proceeds	<ul style="list-style-type: none"> • Tranche I: (i) rehabilitation of water mains, intakes, network and pumping stations, (ii) the front-end fee; • Tranche II: rehabilitation and modernisation of the wastewater treatment plant, wastewater network and supply/installation of water meters. <p>The loan will be co-financed by a EUR 7.5 million co-financing grant from the EU Investment Facility for Central Asia ("IFCA").</p> <p>Proceeds from the loan and grant will be made available to the RT for the KMK subsidiary's benefit, and available amounts may be drawn down from time to time [REDACTED]</p>
Investment Plan	[REDACTED]
Financing Plan	[REDACTED]
Key Parties Involved	<ul style="list-style-type: none"> • Borrower: the Republic of Tajikistan; • Project Support provider: the City of Kulob; • Implementing agency: KMK; • Beneficiary: KMK Subsidiary.
Conditions to disbursement	<p>Conditions for Tranche I:</p> <ul style="list-style-type: none"> • Loan Agreement; Grant Agreement, [REDACTED] and the Project Support Agreement with the City executed and delivered; • Appoint consultants for Project Implementation Support. <p>Conditions for Tranche II commitment:</p> <ul style="list-style-type: none"> • Establish a regional water company in Kulob. More details on regionalisation process are provided in Annex 1;
Key Covenants	[REDACTED]
Security	Sovereign loan

<p>Other material agreements</p>	<ul style="list-style-type: none"> • Project Agreement between the Bank and the KMK Subsidiary; • Project Support Agreement between the Bank and the City; • Grant Agreement between the Bank and the Government of Tajikistan.
<p>Associated Donor Funded TC and co-investment grants/concessional finance</p>	<p>A. Technical Cooperation (TC)</p> <p><i>Pre-signing:</i></p> <ul style="list-style-type: none"> • TC 1: Feasibility Study including updating technical, financial, environmental and social due diligence. [REDACTED] <p><i>Post-signing:</i></p> <ul style="list-style-type: none"> • TC 2. Project Implementation and Engineering Supervision Support, incl. design and tender preparation, evaluation, contract awarding, administration and supervision. [REDACTED] • TC 3: Corporate Development Programme (“CDP”) for the KMK Subsidiary will be implemented as part of the KMK’s regionalisation. [REDACTED]. <p>Reimbursement: The above assignments will be non-reimbursable transactional TCs required to evaluate the investment needs and assist the client with Project implementation and capacity building.</p> <p>Cost sharing: As a parallel cost sharing contribution to the Project, the KMK Subsidiary will be responsible for paying all VAT and other indirect taxes applied to the post-signing TC assignments (VAT is levied at 18 per cent in Tajikistan). Additionally, the KMK Subsidiary will provide an “in-kind” contribution in the form of office space, communication connections, etc., for the consultant’s work, presumed to amount to 3 per cent of the total TC budget.</p> <p>B. Co-investment grants</p> <p>The Project will benefit from an investment grant in the amount of up to EUR 7.5 million [REDACTED].</p>

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

There is rising pressure on water resources in Tajikistan, stemming from population growth, increased resource consumption and a lack of infrastructure development. This is causing high levels of water loss. At the utility level, low tariffs and poor collection rates by public sector companies are the main factors causing financial difficulties. [REDACTED]

In order to address the sector's challenges, the Government of Tajikistan approved the Water Sector Reform Programme for 2016-2025. The reform process foresees the development of self-sustaining, independent regional companies under KMK.

KMK is a national utility holding company, responsible for the delivery of basic municipal services such as water supply and wastewater services. Established in 2001, it has 125 subsidiaries located in cities across Tajikistan. KMK has been the Bank's main counterpart in the municipal sector, with eight (six water and two solid waste) projects signed to date. As a holding company, KMK does not generate any tariff revenues and relies on payments from participating utility providers under on-lending agreements to service the EBRD's loans.

The Project will significantly contribute to the availability, reliability and quality of water and wastewater services. This is a necessary precondition for the utility's commercialisation, which will trigger sectorial changes and have significant positive impacts on public health and the environment.

1.1 STRATEGIC CONTEXT

- The Project is consistent with the Bank's country strategy for Tajikistan, and corresponds with the Municipal and Environmental Infrastructure Sector Strategy and GET approach. The EBRD has been working in the Tajik water sector since 2004, with ten projects³ signed covering 22 cities throughout the country. Based on the Bank's early success with water projects in Khujand, the Government of Tajikistan asked the EBRD to prepare and finance a municipal water infrastructure programme in secondary cities. The proposed programme was later called the Bank's Integrated Approach for Water Projects in Tajikistan. As the transition challenges in the Tajik water sector are large, it is difficult to achieve reform objectives within the scope of one project alone. The Integrated Approach to water projects was launched in 2010 with the objective of providing urgently needed water infrastructure to select cities in Tajikistan, as well as supporting sector wide reform to create operationally and financially sustainable water supply operations. By establishing a dedicated regional water company in Kulob, the Project will also contribute to the reform agenda previously targeted by the Integrated Approach.

³ The Khujand Water Rehabilitation project was signed in 2004, the Khujand Water Rehabilitation Phase II project in 2008 and Khujand Wastewater Phase III in 2014, the South Tajik Water project in 2009 was followed by the North Tajik Water project in 2010, the Central Tajik Water project in 2011, and the North Tajik Water II and Khatlon Water Rehabilitation Project projects in 2012. Tajik Water II – Khorog GBAO (BDS/10-261 Addendum 1) was signed in 2014 and the Nurek Water and Wastewater Project signed in 2016.

- The proposed Project will also contribute to Sustainable Development Goals (the “SDGs”) under the UN’s 2030 Agenda, specifically to: i) SDG 3: Improving health by increasing access to safe water, sanitation and reducing air pollution; ii) SDG 6: Ensure availability and sustainable management of water and sanitation for all; and iii) SGG 13: Taking urgent action to combat climate change and its impacts.
- The COVID-19 crisis has had an unprecedented social and economic impact in the EBRD’s region including the Republic Tajikistan. Access to reliable drinking water is now even more essential to the safeguarding public health. Governments and water company revenue streams are temporarily and significantly decreasing because of COVID-19, government responses, exacerbated by an increase in demand for water services coupled with increased expenses for addressing the crisis. Policy responses have caused liquidity constraints, putting water companies at risk of not having enough working capital to keep vital and often fragile infrastructure functioning when needed most. The Project will facilitate access to drinking water and target the crisis’ medium term impacts by focussing on a more secure water supply service. This is vital for tackling the crisis, mainly through (1) increasing system resilience to provide more continuous water services, and to better cope with increases/changes in demand for drinking and healthcare purposes; (2) increasing direct access to higher quality water which could improve hygiene and decrease the chance of infection; and (3) providing critical emergency drinking water infrastructure and contingency planning guidance to help maintain a continuity of water supply during outages.

1.2 TRANSITION IMPACT

1 Primary Quality: Green

Obj. No.	Objective	Details
1.1	<i>The percentage of EBRD use of proceeds allocated to the project that qualifies as GET is 15% or higher.</i>	The proceeds allocated to the Project qualify as 100 per cent GET.
1.2	<i>The environmental impact of the project is expected to meet or exceed one or more of the quantitative physical scale thresholds as outlined in the GET TI assessment methodology.</i>	The Project targets the reduction of water losses [REDACTED]

2 Secondary Quality: Well-governed

Obj. No.	Objective	Details
2.1	<i>The project supports an improvement to the existing tariff regulatory regime or tariff methodology.</i>	The Project supports an improvement to the existing tariff methodology by allowing recovery of operating and financing costs, while protecting low-income families from hardship. In parallel,

		the Project will covenant follow-on tariff increases, as appropriate.
2.2	<i>Specific limited improvements of corporate governance will be implemented (e.g. higher financial transparency, simplified group structure).</i>	The Project supports improvements to corporate governance at the utility level by developing a CDP, introducing a management information system and restructuring the KMK by merging smaller utility companies into larger ones.
2.3	<i>The project will mandate material improvements to the existing ineffective contractual arrangement to bring them in line with international best practice (e.g. EU rules) as one of the first in the country.</i>	The CDP consultant and KMK will develop a PSC (contractual arrangement to bring them in line with international best practice). The PSC signing will be covenanted.
2.4	<i>The project mandates the regionalisation/consolidation of infrastructure assets driven by economic efficiency (e.g. with verifiable reductions in infrastructure costs or increased provision or better quality infrastructure for the same cost level).</i>	The Project foresees the development of a self-reliant, independent regional company. The establishment of such regional water company will be a CP for committing Tranche II.

Delivery Risks

The key transition risk to successful commercialisation stems from the need to align multiple stakeholders (national authorities, cities and KMK) to establish the regional water operator. Continuous support and guidance will be provided by the Bank and through the TC to mitigate this and establish an operationally and financially sustainable operator. The City's institutional capacity for signing and implementing the PSC is a further potential risk, to be mitigated by the CDP and Consultants.

Delays in implementing the improved tariff methodology is another risk. The Government and the Company remain fully committed to reform, but tariff reform is constrained by the prevailing affordability restrictions. Proposed CDP support will mitigate some of these risks. The Transition Impact Scoring Chart is provided in Annex 2.

1.3 ADDITIONALITY

Identified triggers	Description
A subsequent/consecutive transaction with the same client/group with the same use of proceeds or in the same country (repeat transaction).	The KMK subsidiary in Kulob is an existing client of the Bank. It has significant investment needs for rehabilitating water supply and wastewater infrastructure, as confirmed by the Bank's independent due diligence consultant. This need is acute if the Company is to maintain service levels. The previous transaction with the KMK subsidiary was approved by the Board and signed in 2008. It financed less than 6 per cent of the City's water and wastewater sector investment needs.

Additionality sources	Description
Financing Structure: the EBRD offers financing that is not available in the market from commercial sources on reasonable terms and conditions , and tenor , and to close the funding gap .	The Bank is able to offer long-term facilities for infrastructure projects which are not available to Tajikistan on the market.
Policy, sector, Institutional or regulatory change: the EBRD's involvement in a project is considered additional when it is designed to trigger a change in policy .	The Bank is able to offer reform processes that supports the development of self-reliant, independent regional companies
Risk mitigation: the EBRD helps clients mitigate Environmental, Social and Governance ("ESG") risks through risk identification related to natural capital asset depletion, raw material and water availability, etc. The Bank also helps manage these risks.	The Bank's standards, with respect to project preparation and implementation assistance, regular reporting (including through ESAP) and sector reform are more advanced than national and sectoral standards.

1.4 SOUND BANKING - KEY RISK

Risks	Probability/ Effect	Comments
Borrower's creditworthiness	Medium / High	<p>[REDACTED] Apart from the Eurobond, the external public debt portfolio is comprised of loans granted by IFIs on favourable terms. Given concessional financing terms, debt-servicing costs are relatively modest.</p> <p><i>Effects of COVID-19</i></p> <p>COVID-19 will significantly affect public finances, and the economy in general, both of which are heavily dependent on remittances predominantly from Russia. Remittance inflows are expected to [REDACTED] decline in 2020[REDACTED]</p>
Implementation risk	Medium/Medium	The PIU's staff is experienced in dealing with IFIs. To strengthen its implementation capacity further, the PIU will be supported by the TC regarding procurement, project implementation and strengthening corporate capacity.
FX risk	High/High	<p>The exchange rate was weakening until mid-2019, when it stabilised.</p> <p><i>Effects of COVID-19</i></p> <p>The National Bank of Tajikistan officially maintains managed float regime, but keeps the exchange rate largely fixed by imposing restrictions on FX transactions. [REDACTED]</p>

[REDACTED] The proposed transaction's sovereign risk remains acceptable.

2. MEASURING / MONITORING SUCCESS

<i>Overall project objectives</i>	<i>Monitoring benchmarks</i>	<i>Implementation timing</i>
<ul style="list-style-type: none"> - On-time project implementation - Maintaining appropriate environmental standards 	<ul style="list-style-type: none"> - Completion according to the timeline and within budget - Successful and timely implementation of the ESAP. 	<ul style="list-style-type: none"> - [REDACTED]

<i>Transition Impact Monitoring Indicators and Benchmarks</i>						
Quality	Obj. No.	Monitoring Indicator	Details	Baseline	Target	Due date
Green	1.1	The number of individuals benefitting from improved water supply services.	Number of people with access to good quality water.	[REDACTED]	[REDACTED]	[REDACTED]
	1.2	The number of individuals benefitting from improved wastewater services.	Number of people with access to wastewater services.	[REDACTED]	[REDACTED]	[REDACTED]
	1.3	Water leakages reduction.	Expected decrease of water leakages (%).	[REDACTED]	[REDACTED]	[REDACTED]
Well-governed	2.1	The Project supports improvements to the existing tariff regulatory regime.	Adopt a cost-recovery tariff methodology.	[REDACTED]	[REDACTED]	[REDACTED]
	2.2	The Project will mandate material improvements to the existing ineffective contractual arrangements to bring them in line with international best practice (e.g. EU rules) as one of the first in the country.	Development and signing the PSC.	[REDACTED]	[REDACTED]	[REDACTED]
	2.3	The Project mandates the regionalisation/consolidation of infrastructure assets.	The regional water company becomes fully operational.	[REDACTED]	[REDACTED]	[REDACTED]
	2.4	Specific limited improvements to corporate governance.	The CDP will be developed and implemented.	[REDACTED]	[REDACTED]	[REDACTED]

3. KEY PARTIES

3.1 BORROWER

The RT, as the Borrower, will be a counterparty to the Loan Agreement. [REDACTED]

Despite moderate public debt levels, Tajikistan remains at a high risk of debt distress. [REDACTED] The debt burden primarily reflects currency depreciation, inflating the value of foreign currency denominated debt, measured in somoni, and the 2017 Eurobond issuance. The bulk of public debt is external; around 36 per cent of GDP in 2019.

Moody's Investor Service confirmed its 'B3' sovereign credit rating with negative outlook for Tajikistan in May 2020. The negative outlook reflects Moody's assessment that the coronavirus shock increases Tajikistan's external liquidity risks as remittances fall sharply and the government's pending needs rise. While in the near term, significant financial support from the international community will likely cover Tajikistan's external financing needs, beyond 2020, the government will be challenged to sustain its fiscal consolidation objective in order to preserve macroeconomic stability. [REDACTED] The affirmation of the B3 rating reflects progress made by Tajikistan in stabilizing its external payments position over the past year, alleviating some of the pressures on its foreign exchange reserves that led to the initial change in the rating outlook to negative in December 2018.

COVID-19 effect

COVID-19 will primarily affect household consumption, which dominates the GDP structure and is financed by remittances (32 per cent of 2019 GDP, mainly from Russia), as well as China's appetite for investment (China accounted for 76 per cent of FDI received by Tajikistan in 2019). Remittances fell by 22 per cent year-on-year in March 2020. [REDACTED]

Tajikistan faces exceptional balance of payments needs resulting from the impact of COVID-19 and has received 6 month debt relief from the IMF (amounting to USD 10 million), with potential extensions, up to a maximum of full two years from 14 April 2020, subject to availability of sufficient grant resources. IMF also approved a disbursement of USD 189.5 million. IMF and the authorities agreed on the implementation of fiscal consolidation measures of 2 percent of GDP in 2021-22 to ensure debt sustainability. [REDACTED]

Owing to commitments to fiscal consolidation and avoidance of non-concessional borrowing, Tajikistan's public debt is assessed as sustainable [REDACTED] based on the authorities' commitment to fiscal consolidation and avoiding non-concessional borrowing, debt stabilizes over the medium term and is assessed as sustainable in a forward-looking sense. Tajikistan's debt is vulnerable, especially to export shocks and contingent fiscal liabilities. A more severe or prolonged COVID-19 shock could heighten debt vulnerabilities. On the other hand, greater-than-expected progress with economic diversification or higher energy and non-energy exports would improve debt sustainability over the longer term.

3.2 KMK AND KMK SUBSIDIARY

The Bank's loan will be extended to the Republic of Tajikistan and will include an on-lending arrangement with the KMK Subsidiary.

The KMK Subsidiary's main activities are providing drinking water and wastewater services to households (18,325 households) and private (220) and public sector companies (139). The KMK Subsidiary is not currently creditworthy for the proposed loan due to low tariffs and poor coverage. [REDACTED]

4. MARKET CONTEXT

[REDACTED] Water supply operations in Tajikistan can be characterised as follows:

- [REDACTED] Unreliable water supply, sometimes for only a couple of hours every other day;
- Families storing water in bathtubs and buckets when supply is available;
- Outbreaks of water borne disease, especially during the summer;
- Low institutional capacity to manage operationally and financially sustainable water supply services.

Since 2006, the water sector has gone through several stages of reform but major implementation steps remain. Water sector reform aims to lay the foundation for introducing decentralisation and devolution to service delivery by dividing responsibility between the ministries' agencies and operators. The reform process foresees the development of self-reliant, independent regional companies.

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL PROJECTIONS

[REDACTED]

5.2 SENSITIVITY ANALYSIS

[REDACTED]

5.3 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT

The Project is categorised B under the 2014 Environmental and Social Policy. The environmental and social due diligence ("ESDD") includes a review of the due diligence documents and reports from earlier projects with the Company. It also includes an independent environmental and social audit/review of the Company's current operations and facilities (focusing on the issues identified during the ESDD for the first project), as well as analysis of potential environmental and social issues associated with the proposed priority investment programmes. Improvements in the Company's environmental and social management systems were also reviewed and assessed.

The investment components will mainly involve construction, expansion and rehabilitation of water mains, water supply networks, water intakes, water pumping stations, sewers and sewerage networks, and the rehabilitation of the existing WWTP. Implementing the investment components will result in limited, localised and short-term adverse environmental impacts, including noise generated by equipment, local short-term increases in traffic intensity and corresponding increases in air pollution levels, soil and landscape disturbances during excavation works, and potential temporary economic displacement. These will be mitigated by adhering to good construction practices.

The City's existing wastewater collection and treatment system was constructed during the Soviet period and neither national nor EU standards. The Company's Priority Investment Programme ("PIP") will increase the City's sewage collection rate from 70 to 82 per cent and will cover both the WWTP's rehabilitation and improvement to sludge management. This will enable compliance with national and EU standards for treated wastewater discharge and sludge management. For households not connected to the wastewater system, cesspits will continue to be emptied by Company trucks and will be treated at the upgraded WWTP.

The ESDD concluded that the Project will improve the drinking water supply's reliability and quality, meeting local and EU requirements for the areas covered under the PIP, but not for the all City. Altogether, additional long-term investment, estimated at over EUR 33 million, would be required; EUR 8 million to bring water and EUR 25 million to bring wastewater systems in Kulob to EU requirements. The investments required to meet EU standards for wastewater and water supply include rehabilitating and expanding the wastewater collection system and constructing a new WWTP to increase treatment capacity and further replacing and expanding the water network. Financing for the long-term investment programme from the Company's own revenues cannot currently be confirmed, and no potential sources of external funding have been identified. Therefore, on account of constraints arising from affordability and limited financial resources, derogation from the EBRD's Environmental and Social Policy is sought.

The ESDD showed that the Project will have a significant and positive impact on health and the environment despite the Project not being able to achieve full EU compliance in the short term. The human health implications of not reaching EU standards have been assessed as minor compared to the benefits of delivering a safer and more reliable water supply to the local population. Mitigation plans, including awareness raising programmes, will be developed and implemented to minimise the associated health risks to local communities and to prevent risk of water borne diseases.

The ESDD showed that the earlier project's ESAP implementation has been poor. The Company still has weak Environmental Health and Safety ("EHS") management capabilities and underdeveloped EHS management systems, and the current occupational health and safety and stakeholder engagement practices require further improvement to meet the EBRD's Performance Requirements (PRs). Lessons from the earlier project will need to be carefully assessed by the post-signing CDP consultants to ensure that the Company build their corporate environmental and social capacity and implement the ESAP. The ESAP was prepared and agreed with the Company. A Stakeholder Engagement Plan and Non-Technical Summary were also prepared and will be disclosed after signing.

The Company will provide the Bank with annual environmental and social reports, including updates on the ESAP's implementation. The Bank may also conduct monitoring visits, as required. The Bank will closely monitor implementation of the post-signing CDP and PIU TCs to ensure compliance.

6.2 INTEGRITY

In conjunction with OCCO, integrity due diligence was undertaken on Kulob Water and Wastewater Services State Unitary Enterprise (“KMK”) and its senior management. The [REDACTED] project does not pose an unacceptable integrity or reputational risk to the Bank. [REDACTED]

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

Affordability Analysis – Based on the tariff structure projected by the financial model, analysis shows that water and wastewater services are expected to remain affordable for average income households in Kulob. The model also assumes that the Ministry of Finance subsidises 100 per cent of debt service until 2025, gradually reducing it to 0 per cent by 2034. [REDACTED]

ANNEXES TO OPERATION REPORT

**ANNEX 1 INTEGRATED APPROACH TO WATER SECTOR AND
REGIONALIZATION CONCEPT**

ANNEX 2 TRANSITION IMPACT SCORE CHART

ANNEX 3 EIRR

ANNEX 1: INTEGRATED APPROACH TO WATER SECTOR AND REGIONALISATION CONCEPT

Background

The Bank has been active in Tajikistan's municipal and environmental infrastructure sector since 2004, when the Bank first invested finance in critical water infrastructure in Khujand, Northern Tajikistan.

Based on early success in Khujand, the Government of Tajikistan asked the EBRD to prepare and finance a municipal water infrastructure programme in secondary cities throughout the country. As of end-2019, the EBRD is implementing ten projects across 23 cities in Tajikistan, aimed at improving critical water and wastewater infrastructure (~USD 104 million of investments, including loans of USD 43 million and grants of USD 61 million, mainly from the EU and SECO).

Supported by the Bank's Integrated Approach to water projects in Tajikistan, the Tajik water sector underwent structural changes. Small water utilities have been merged into Regional Water Companies ("RWCs"). The first two pilot RWCs were established in 2016, covering the Northern and Central parts of the country.

Key Objectives of the Integrated Approach

Given the range of transition challenges faced by the Tajik water sector, some reform objectives are difficult to achieve within the scope of one project. The Integrated Approach to water projects was launched in 2010 (Board approved in November 2010) with the objective of providing urgently needed water infrastructure to selected cities in Tajikistan, as well as supporting sector wide reform support to create operationally and financially sustainable water supply operations.

Once the Integrated Approach is complete, we would anticipate (i) significant improvements in water supply, water quality and sewerage systems; (ii) significant improvements in the regulatory framework, including tariff methodology; (iii) significant improvements in operational performance; (iv) significant improvements in financial performance and (v) some institutional changes, including decentralisation and other organisational alterations.

Overall status of the Integrated Approach

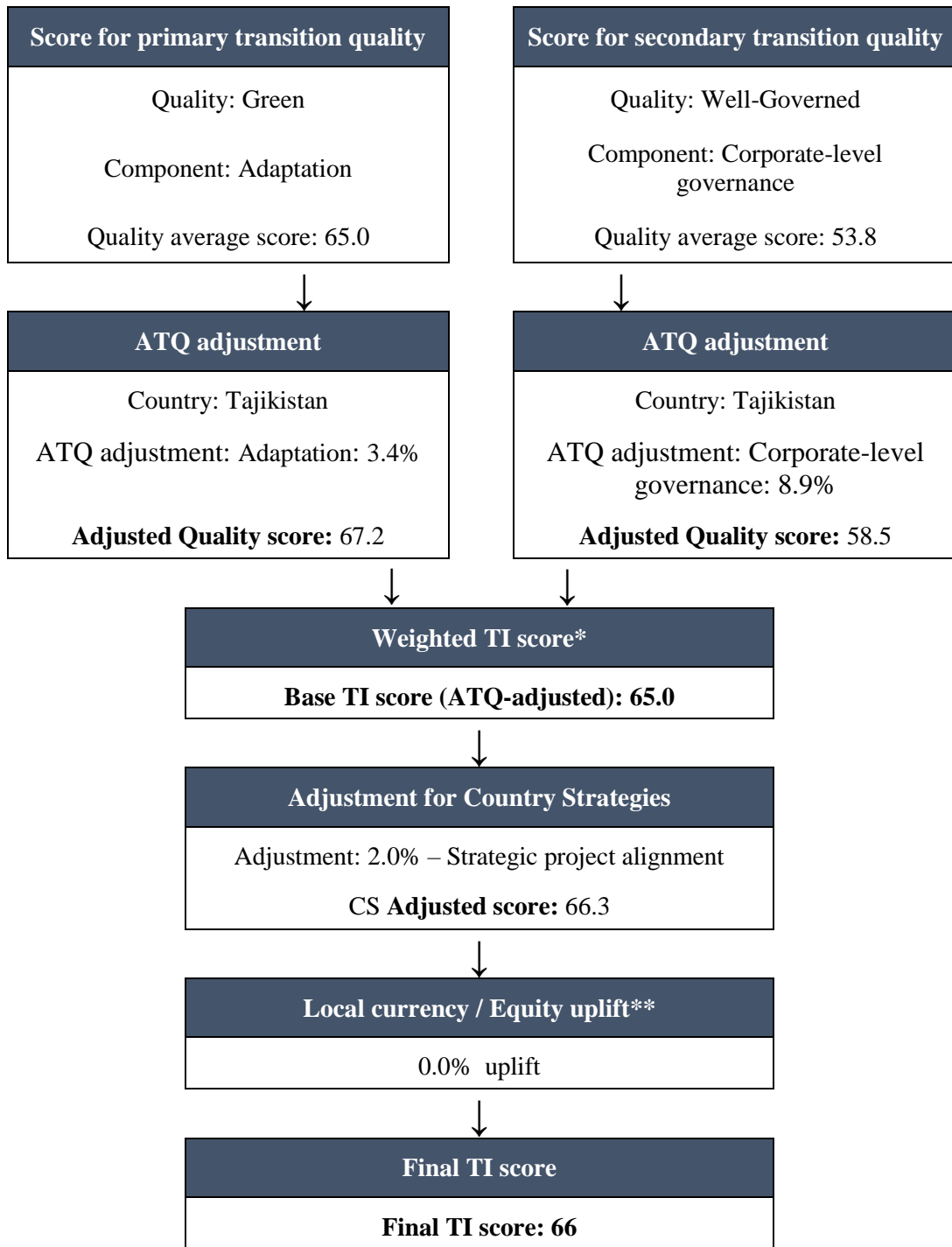
The main benefit of the Integrated Approach is seen at the sector level, which the Bank could fully support rather than a singular utility. The Tajik water tariff reform has had a positive effect on all water utilities countrywide, not just in those working with the Bank. This would have been impossible without the Integrated Approach. The policy dialogue was enhanced by the EPG's active participation during implementation. Coached by the Bank, relevant sector stakeholders successfully addressed sustainability issues. The relationship between KMK and the relevant sector regulators (e.g. the Anti-Monopoly Agency) benefitted from the Bank's deeper involvement, providing hands-on support throughout the decision-making process. The ultimate beneficiaries, the population, have also benefitted from support under the Integrated Approach. With enhanced sector sustainability, the Bank has been able to advance its investment programme to cover additional cities throughout the country.

Current Status

[REDACTED]The Government of Tajikistan approved the ‘Regionalisation Concept of KMK’ in 2015, and as mentioned above, two pilot RWCs have been operational since 2016. The regionalisation agenda developed under the study complements the actions considered by the Integrated Approach. The only difference is that the current structure accounts for involving other stakeholders, such as the Ministries of Finance, and Energy and Water Resources, to help utility providers implement the financial and fiscal incentives outlined in the study.

[REDACTED] The Bank is allocating staff resources to prepare and implement the Tajik water programme, the results of which are already visible. At the utility level, there is increased capacity for carrying out system maintenance, leading to more secure water supply. Utility providers now understand the importance of communicating with the public as a means of promoting conservative water use, leading to increased collection rates and the acceptance of increased water tariffs. The environmental benefits are substantial, and with better laboratory facilities, utility providers can now monitor water quality. As the investments approach completion, outbreaks of water borne diseases are becoming increasingly rare. However, at the utility level, financial management remains a challenge. It is expected that structural changes and sector reform, such as establishing the RWCs, will greatly enhance the financial capacity of water supply services.

ANNEX 2: TRANSITION IMPACT SCORING CHART



*The Primary Quality score is weighted 75% for the calculation of the Base TI Score. The Secondary Quality is weighted 25%.

ANNEX 3: EIRR

[REDACTED]