

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

Approved by the Board of Directors on 2 September 2020¹

BOSNIA AND HERZEGOVINA
GrCF2 W2 - Banja Luka Water - Phase 2

[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 / CURRENCY CONVERSIONS

BAM	Bosnian Mark
BiH	the State of Bosnia and Herzegovina
CP	Condition Precedent
DSCR	Debt Service Coverage Ratio
DSRA	Debt Service Reserve Account
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
EHSS	Environment, Health and Safety and Social
EIA	Environmental Impact Assessment
EIRR	Economic Internal Rate of Return
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESIA	Environmental & Social Impact Assessment
ESDD	Environmental and Social Due Diligence
EU	European Union
FOPIP	Financial and Operational Performance Improvement Programme
GCAP	Green Cities Action Plan
GDP	Gross Domestic Product
GET	Green Economy Transition
HSE	Health, Safety and Environmental
IAS	International Accounting Standards
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
ILI	Infrastructure Leakage Index
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
KM	Local abbreviation for BAM
KPI	Key Performance Indicator
LA	Loan Agreement
LAP	Land Acquisition/Expropriation Plan
LSA	Loan Support Agreement
LTIP	Long Term Investment Plan
NEAP	National Environmental Action Plan
NRW	Non-Revenue Water
PA	Project Agreement
PIP	Priority Investment Programme
PIU	Project Implementation Unit
PP&E	Property, Plant and Equipment
PP&R	Procurement Policies and Rules
PRs	EBRD's Performance Requirements
PSC	Public Service Contract
RAP	Resettlement Action Plan
RFI	Rapid Financing Instrument
RS	Republika Srpska
SEP	Stakeholder Engagement Plan
SSF	EBRD Shareholder Special Fund
TC	Technical Co-operation
WB	World Bank
WWTP	Waste water treatment plant

CURRENCY CONVERSIONS

EUR 1.0 = BAM 1.96 (nominal exchange rate)

PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report concerning an operation in favour of the City of Banja Luka (the “City”), Bosnia and Herzegovina, are submitted for consideration by the Board of Directors.

The facility will consist of a sub-sovereign loan to the City in the amount of up to EUR 6 million.

The operation will enable the City to finance its investment plan for the upgrade of the water and wastewater infrastructure in Banja Luka (the “Project”). The Project will address a priority environmental challenge identified by the Green Cities Action Plan (“GCAP”) and is part of the City’s overall long term investment plan of EUR 56 million into strengthening its water and wastewater infrastructure. The expected transition impact of the project is (i) Green and (ii) Well-governed. The Project is expected to support the framework objectives by: (i) introducing improved quality and reliability of water supply, and extended sewage collection, and (ii) introducing a Public Service Contract (“PSC”) between the City and the Public Utility “Vodovod” a.d. Banja Luka (the “Company”), eliminating cross-subsidy tariff system and improving operational efficiency of the Company.

It is expected that the Project will be co-financed with a EUR 4 million grant from the European Union (“EU”), under its Instrument for Pre-Accession Assistance (IPA II) 2020.

The Project requires a derogation from EBRD Environmental and Social (“E&S”) Policy due to no existence of a centralised wastewater treatment plant (“WWTP”) in Banja Luka. Neither the City nor the Company have the [REDACTED] capacity to finance a new, capital intensive WWTP in the near-term [REDACTED].

I am satisfied that the operation is consistent with the Bank’s Strategy for Municipal and Environmental Infrastructure Sector Strategy, Country Strategy for BiH, Green Economy Transition approach (“GET”) and with the Agreement Establishing the Bank.

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

Jürgen Rigterink
Acting President

BOARD DECISION SHEET

BOSNIA AND HERZEGOVINA - GrCF2 W2 - Banja Luka Water - Phase 2 – DTM 49668 Framework: GREEN CITIES FRAMEWORK 2 WINDOW 2 – DTM 50647	
Transaction / Board Decision	Board approval ² is sought for a sub-sovereign loan of up to EUR 6 million in favour of the City of Banja Luka (the “City”) to finance critical water and wastewater investments. The Project is part of the Green Cities Framework and was identified as a priority investment in the City’s Green City Action Plan. Whereas Phase 1 was approved by Management, Phase 2 requires Board approval as the Project requires a derogation from EBRD’s Environmental and Social (“E&S”) Policy as Banja Luka does not have a centralised wastewater treatment plant (“WWTP”). The City does not have the [REDACTED] capacity to finance a new, capital intensive WWTP in the near-term [REDACTED]. The proposed project, which includes the rehabilitation and an extension of the City’s sewerage network is the first step in addressing the City’s wastewater challenges. As per its Green Cities Action Plan (“GCAP”), the City has a target to develop a WWTP by 2030.
Client	The client and the borrower is the City of Banja Luka. The project entity is the Public Utility “Vodovod” Banja Luka (the “Company” or the “Project Entity”).
Main Elements of the Proposal	<ul style="list-style-type: none"> - <u>Transition impact</u> Primary Quality – Green by introducing improved quality and reliability of water supply, and extended sewage collection. Secondary Quality – Well-governed by introducing a Public Service Contract (“PSC”) between the City and the Company, eliminating cross-subsidy tariff system and improving operational efficiency of the Company. <u>Additionality</u> A repeat transaction with additionality sources addressed by the financing structure (tenor and terms and conditions) and policy, sector, institutional or regulatory change (PSC and tariff system improvements) - <u>Sound banking</u> The Bank’s financial model and stress tests take into account the impact of the Covid 19 pandemic. [REDACTED]
Key Risks	<p><i>Institutional and financial framework</i> - Revenues and expenditures are clearly regulated by law and subject to acceptable public accounting standards and reporting.</p> <p><i>Political risk</i> - The Project is a high priority for both the Republika Srpska and the City; both have a strong interest in ensuring its smooth implementation.</p> <p><i>Completion risk</i> - This risk will be mitigated by experienced consultants as well as by the fact that Phase 1 has already been successfully tendered out and under implementation.</p>
Strategic Fit Summary	The Project is in line with the Bank’s Municipal and Environmental Infrastructure Sector Strategy, Country Strategy for BiH and Green Economy Transition approach (“GET”).

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

ADDITIONAL SUMMARY TERMS FACTSHEET

EBRD Transaction	<p>A sub-sovereign loan in the amount of up to EUR 6 million to the City of Banja Luka (the “City”) to finance the City’s investment plan for the upgrade of its water and wastewater infrastructure (the “Project”).</p> <p>The Project will address a priority environmental challenge identified by its Green Cities Action Plan (“GCAP”). It is part of the City’s overall long term investment plan of EUR 56 million into strengthening the water and wastewater infrastructure which was identified in the due diligence report by independent consultants. This Project will be the second phase (Phase 2) of the rehabilitation and expansion on the water and sewage network. The first phase (Phase 1) EUR 4 million loan was signed in September 2019 and implementation started in October 2019. The technical documentation (i.e. design) has been completed for Phase 2 and the tendering has started.</p> <p>The City has applied for a EUR 4 million grant from the European Union (“EU”), to be financed from the Instrument for Pre-Accession Assistance (IPA II) 2020. The project was positively screened and the discussions on the Contribution Agreement, to be prepared under the existing EBRD – EU Framework Agreement, are currently ongoing. The grant is expected to be available and required for disbursement in early 2021.</p> <p>Given that, at present, there is no centralised wastewater treatment plant (“WWTP”) in Banja Luka and the City or the Company has no [REDACTED] capacity to finance a new, capital intensive WWTP in the near-term [REDACTED], a derogation from EBRD’s Environmental and Social (“E&S”) Policy is sought for this Project. As per the GCAP, the City has a target to develop a WWTP by 2030. The proposed project, which includes rehabilitation and an extension of the City’s sewerage network is the first step in addressing the City’s wastewater challenges.</p>
Existing Exposure	Total portfolio in Bosnia and Herzegovina (“BiH”) as at 30 June 2020 was EUR 1,274 million [REDACTED]
Maturity / Exit / Repayment	10 years [REDACTED]
Potential AMI eligible financing	EUR 4 million grant from the EU, through its Instrument for Pre-Accession Assistance (IPA II) 2020.
Use of Proceeds	<p>The loan proceeds will be used for investments into the water and wastewater infrastructure in the City of Banja Luka.</p> <p>A single works contract is currently under tendering through the Open Tender Single Stage in accordance with the requirements of the Bank’s Procurement Policies and Rules (“PP&R”) for public sector operations and will be subject to prior review by the Bank. Tender Documents for the procurement of works are based on the latest version of the Bank’s Standard Tender Documents for Procurement of Works.</p>
Investment Plan	[REDACTED]
Financing Plan	[REDACTED]
Key Parties Involved	<p>The City of Banja Luka, as the Borrower.</p> <p>The Public Utility “Vodovod” a.d. Banja Luka, as the Project Entity.</p>

Conditions to subscription / disbursement	[REDACTED]
Key Covenants	[REDACTED] Sign the Public Service Contract (“PSC”) with the Company [REDACTED]
Security / Guarantees	[REDACTED]
Other material agreements	Loan Agreement with the City. Grant Agreement with the City.
Associated Donor Funded TC and co-investment grants/concessional finance	<p>A. Technical Cooperation (TC)</p> <p>Although there is no technical cooperation, Phase 2 benefits from Technical Cooperation (“TC”) provided under the Phase 1 (OPID 51214).</p> <p>Combined Technical and E&S due diligence – [REDACTED] Assignment completed.</p> <p>Advance Procurement Support – [REDACTED], assignment ongoing. The consultant is providing support with the tendering for Phase 2.</p> <p>Project Implementation Support / Supervision – [REDACTED]. The assignment is ongoing. The consultant will do the supervision services for both phase.</p> <p>Financial and Operational Performance Improvement Programme (“FOPIP”) – [REDACTED]. The tendering for the selection of the consultant is ongoing and the tender will be closed on 30 July 2020.</p> <p>B. Co-investment grants / Concessional Finance (Non-TC)</p> <p>IPA II Grant - the City has applied for a [REDACTED] grant [REDACTED] and the discussions on the Contribution Agreement [REDACTED] are currently ongoing. The grant is expected to be available for disbursement in early 2021.</p>

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

Banja Luka's water and wastewater infrastructure suffers from historic underinvestment [REDACTED] The existing drinking water system consists of groundwater wells, water treatment plants, storage and distribution pipework. There is sufficient water supply to meet water demand for the foreseeable future provided that the network losses are addressed. The Infrastructure Leakage Index ("ILI"), which indicates real losses, is very high [REDACTED] and inefficient use of water resources result in higher electricity costs, too. [REDACTED] EU standards for drinking water quality is only achieved for around 60 percent of the population served.

The wastewater collection network currently covers approximately 90 per cent of urban inhabitants of the City with some individual households connected to septic tanks, where many of these tanks are sub-standard. The City has no centralised wastewater treatment plant and the wastewater collected is directly discharged into the rivers Vrbanja and Vrbas untreated. [REDACTED]

The Project is a follow-on investment from Banja Luka's Green City Action Plan³ ("GCAP") [REDACTED].

The loan and grant proceeds will finance the rehabilitation and expansion of the City's existing water supply and wastewater networks [REDACTED], improve the quality of water provided to customers to EU standards [REDACTED] and enhance the operational efficiency of the Company. The Project is also the first step towards addressing the City's lack of wastewater treatment, as without proper and reliable wastewater collection channels it will be harder to make the future WWTP feasible. Moreover, the investments under the Project will help to remove local spread pollution from untreated effluent through the new sanitary sewers provisions.

In the wake of the Covid -19 pandemic, the City is keen to speed up the proposed investments. While the proposed project will improve wastewater collection and help reduce local pollution, the City currently does not have the financial capacity to build a capital intensive Waste Water Treatment Plant ("WWTP") on its own budget. Given that, on the account of affordability constraints, derogation from EBRD's Environmental and Social ("E&S") Policy is sought for the Project from the Board.

The Project is meets the criteria set forth under the Green Cities Framework 2 and is in line with the Bank's Municipal and Environmental Infrastructure Sector Strategy, Country Strategy for BiH and Green Economy Transition approach ("GET").

COVID-19 impact: The COVID-19 pandemic and country's response to it has been causing major disruption in the country's overall economy. A lockdown (curfew, schools, all non-essential business closed and air traffic suspended) caused a sharp fall

³ Banja Luka launched its GCAP in September 2018, and the draft final report was presented by the consultants to the City Administration in June 2020. Adoption of the GCAP by the City Council is expected by end of September 2020.

of economic activity. Supply chains are disrupted [REDACTED]. The services sector is hit the hardest due to a temporary complete business shutdown (which are now reopened). Remittances, [REDACTED], are expected to decline with a negative impact on consumption, a major growth driver prior to the pandemic outbreak.

The Executive Board of the International Monetary Fund (“IMF”) approved USD 361 (EUR 333 million) in emergency assistance for BiH under the Rapid Financing Instrument (“RFI”) on 20 April 2020. The loan will help the country meet an urgent balance of payments need due to the global outbreak of the COVID-19 pandemic. Part of the loan (61.5 per cent) will be provided to and repaid by the Federation of Bosnia and Herzegovina, 37.5 per cent by Republika Srpska (“RS”) and 1 per cent by Brcko District.

The pandemic has highlighted the fragility of the existing drinking water and wastewater infrastructure and its importance to securing public health. The proposed investments in Banja Luka strengthen physical system resilience and its reliability with interventions that aid crisis response and beyond, additionally delivering positive climate mitigation and adaptation.

The Project is not under the Bank’s Vital Infrastructure Support Program (“VISp”), however it will help the City to maintain the needed infrastructure investments to support the economy in this difficult situation.

Whilst the crisis slowed down the physical implementation of the Phase 1 (OPID 51214) project slightly, its implementation and disbursements continue. As the tendering process for Phase 2 was launched in May 2020, it is possible that the crisis will not cause major delays in project implementation.

1.2 TRANSITION IMPACT

The Project is in line with GrCF 2, a strategic and multi-project approach targeting environmental issues in selected large cities in our countries of operation. The primary goal is to achieve significant environmental improvements and promote the **green** transition quality in participating cities. The GrCF2 also aims to build necessary capacity and facilitate better coordination and buy-in among various stakeholders in participating cities in order improve governance, operational efficiency and financial sustainability of the targeted investments and initiatives. These objectives are supported by the development and implementation of a city-specific Green City Action Plan (“GCAP”) identifying and prioritising environmental challenges and ways to address them through targeted investments, services and policy instruments.

The transition qualities promoted under this framework are: (i) *Green* and (ii) *Well-governed*. The Project is expected to support the framework objectives through: (i) introducing improved quality and reliability of water supply, and extended sewage collection, and (ii) by entering into a Public Service Contract (“PSC”) between the City and the Company, eliminating cross-subsidy tariff system and improving operational efficiency of the Company.

In September 2018, the City with the Bank’s support launched the GCAP for Banja Luka. The GCAP was developed over the course of approximately 18 months and was delayed due to COVID-10. The draft report was finalised in June 2020 and is currently

under review by the City. It will be considered for adoption by the City's Assembly at the end of September 2020. The proposed Project is mentioned in the draft final report as one of the top priorities for the City.

The transition impact objectives and their relevance for the Project are detailed in the table below. The Project forms part of the same originally structured operation (OPID 51214, Phase 1 signed in September 2019, rated ETI 70). Phase 1 and Phase 2 share the same TI objectives. This project is therefore rated the same (ETI 70, PTI 70), but excluded from TI portfolio calculations.

Delivery Risks: A risk to achieve the transition impact is failure by the City to implement the GCAP. This risk is mitigated by the City's interest in pursuing a green agenda as demonstrated by its commitment during the preparation of the GCAP as well as the Bank's ongoing policy dialogue.

TI Objectives Table

Obj. No.	Framework Objective	Transition Indicators	Contribution of Operation to Framework Objectives	Baselines	Target Values (for Phase 1 and Phase 2)	Implementation Timelines
Primary TI Quality: Green						
1.1	Multiple green investments: Each participating city makes on average at least 3 investments that address priority environmental challenges identified by the GCAP, where all EBRD financed projects reduce emissions or improve resource efficiency by minimum 20 per cent or promote climate change resilience.	Implementing an eligible Green Cities project	The Project will assure that the quality of drinking water is [REDACTED] compliant with the EU Drinking Water Directive.	[REDACTED]	[REDACTED]	[REDACTED]
1.2	Environmental impact: To achieve significant environmental improvements for at least one priority environmental challenge, i.e. the promotion or protection of certain performance levels (colour codes) for critical environmental challenges as specified in the GCAPs, for more than 50 per cent of the Green Cities.	Achieving significant environmental impact in a priority environmental challenge identified in the GCAP	Contributes to [REDACTED]reduction in water losses [REDACTED] Contributes to reduction in [REDACTED]equivalent CO2 emissions The Project will extend water supply and wastewater services to the currently underserved population primarily in rural areas of the city.	[REDACTED]	[REDACTED]	[REDACTED]
1.3	Effective GCAP implementation: To achieve the overall objective, the Framework will also have an implementation objective of achieving at least 50 per cent of all verifiable targets, set in all GCAPs, within 5 years after the respective GCAP	Implementing a project identified as a	The Project addresses the GCAP target for clean, potable water supply and healthy wastewater collection accessible to everyone, in	[REDACTED]	[REDACTED]	[REDACTED]

	finalisation (including both investments and well defined policy measures).	target for the GCAP	compliance with EU water management standards (Strategic objectives WR1 and WR2 in the GCAP).			
1.4	Strong follow-on support: At least 50 per cent of transactions and investment volume under GrCF2 being follow-on investments addressing critical environmental challenges identified in the GCAPs.	Implementing a follow-on project	Follow-on – the Project is a follow-on investment from the GCAP that addresses the priority challenge for clean, potable water supply.	[REDACTED]	[REDACTED]	[REDACTED]
Secondary TI Quality: Well-governed						
2.1	New GCAPs: 10 additional GCAPs finalised and approved where all GCAPs include priority actions and a monitoring strategy.	GCAP developed and submitted for approval	Banja Luka’s GCAP final draft report was provided by the consultant in May 2020. The report is currently being reviewed by the City, and once completed, it will be sent to the Assembly for adoption [REDACTED].	[REDACTED]	[REDACTED]	[REDACTED]
2.2	PSCs and tariff increases: PSCs and effective tariff increases in line with the respective PSCs, aimed at cost-recovery or improved fare-box ratio, for the majority of all sub-projects benefitting revenue-generating operators.	Public service contract signed and implemented	Preparation and signing of the PSC is covenanted under the loan agreement.	[REDACTED]	[REDACTED]	[REDACTED]
		Tariffs reached the target level	Covenanted tariffs [REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2.3	Access to financial markets: Develop green finance roadmaps in 4 cities to address the key elements required to access green finance markets, including green bonds.	A green finance roadmap finalised	n/a	[REDACTED]	[REDACTED]	[REDACTED]

1.3 ADDITIONALITY

Identified triggers	Description
A subsequent/consecutive transaction with the same client/group either with the same use of proceeds or in the same country (repeat transaction).	This project is Phase 2 of needed water and wastewater investments in the City of Banja Luka. Phase 1 was signed in September 2019 and is under implementation. Moreover, the Bank signed a loan for investments in the district heating in the City in November 2017. This loan will represent the Bank's third project with the City.
Additionality sources	Evidence of additionality sources
Financing Structure - EBRD offers a tenor , which is above the market average and is necessary to structure the project. EBRD offers financing that is not available in the market from commercial sources on reasonable terms and conditions .	The overall tenor is above market average which is required in order to keep the City within legally set borrowing limits. [REDACTED]
Policy, sector, Institutional or regulatory change – 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.).	The Bank's additionality also includes the implementation of corporate governance improvements envisaged for the Company. The Project will help the Company prepare the FOPIP and PSC through TC-funded consultants.
Standard-setting: helping projects and clients achieve higher standards – Client seeks EBRD expertise on corporate governance improvements, including for climate risk management. Client seeks EBRD expertise on best international procurement standards.	The technical assistance for advance procurement will enable the client to implement high international procurement standards.

1.4 SOUND BANKING - KEY RISKS

Risks	Probability / Effect	Comments
Credit risk	Low / High	The City owns the infrastructure and will be the borrower for the proposed loan. The financial analysis confirms the City's creditworthiness. [REDACTED]
Institutional and financial framework	Low / High	Revenues and expenditures are clearly regulated by law and subject to acceptable public accounting standards and reporting. The division of taxes and expenditures between the government and lower level institutions is in place and predictable [REDACTED]
Completion risk	Medium / Medium	This risk will be mitigated by the experienced consultants that will help the City and the Company with tendering and contract management in accordance with EBRD's Procurement Policies and Rules ("PP&R").
Political risk	Low / Medium	Sub-sovereign loan to the City. [REDACTED]
Macro-economic risk	Medium / Medium	COVID-19 impact: [REDACTED]. .

Risks	Probability / Effect	Comments
FX risk	Low / Medium	Since the local currency is pegged to the EUR under a currency board arrangement, the probability of any change to the current system in place is considered to be very low.
Interest rate risk	Medium / Low	The change of interest rate alone will not strain the cash flows of the City to the point that it will not be able to repay its debt obligations.

2. MEASURING / MONITORING SUCCESS

Indicator	Projected Impact	Implementation Timing
Green		
Estimated reduction in water loss	Contributes to [REDACTED] water loss reduction ([REDACTED] water savings).	[REDACTED]
Reduction in energy consumption	Contributes to reduction in [REDACTED]equivalent CO2 emissions.	
Total Population benefitting from improve drinking water quality and new sanitary sewer.	Water quality: [REDACTED]. Wastewater: [REDACTED].	
Well-Governed		
Public service contract or Public Service Obligation signed and implemented.	Preparation and start of implementation of FOPIP and preparation and signing of PSC.	[REDACTED]
Elimination of cross-subsidy tariff system.	Revised tariff system in line with the PSC and FOPIP recommendation eliminating any cross-subsidies between consumer groups.	[REDACTED]
Improvement of operational efficiency of the Company	Implementation of FOPIP measures which will result in improved operation efficiency of the Company [REDACTED]	[REDACTED]

3. KEY PARTIES

3.1 CITY OF BANJA LUKA / BORROWER

The City is the economic, financial, political and administrative centre of the Republika Sprska ("RS"), which is one of the two political entities that make up Bosnia and Herzegovina. The City has a population of 199,191 people (based on the results of the 2013 census).

3.2 THE COMPANY / PROJECT ENTITY

The Company provides services to the city of Banja Luka, the municipality of Celinac and a portion of the municipality of Laktasi. The Company provides services to 186,000 consumers. [REDACTED].

The Company holds ISO 9001 (Quality Management System) and ISO 14001 (Environmental Management System) certifications and also HACCP⁴ certificate for water production and distribution. In addition, the Company is a member of the International Association of Water Supply Companies in the Danube River Catchment Area ("IAWD") benchmarking network that is using methodologies for establishing the database and producing water utility benchmarking with European Benchmarking Co-operation ("EBC") and the International Benchmarking Network for Water and Sanitation Utilities ("IB-NET") methodologies.

4. MARKET CONTEXT

The City owns the water and wastewater infrastructure. The City council approves tariffs, annual reports and the annual business plan of the Company. The investment under the Project will be made in the infrastructure owned by the City. The City will then, as is common practise, transfer the infrastructure to the Company for management and maintenance (presented as intangible assets in the books of the Company).

The latest tariff increase took place in March 2019. As a result, the household tariff was adjusted and a monthly water-meter maintenance fee was introduced. Whilst there are no tariff increases covenanted under the Project, the City will sign a public service contract with the Company. The recommendations from the FOPIP will provide the City with the relevant data to determine the cost recovery tariff levels and the terms of the PSC, while respecting the affordability limits and eliminating cross subsidies between consumer groups. These steps have been covenanted in the loan document.

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL PROJECTIONS

[REDACTED]

⁴ HACCP (Hazard Analysis and Critical Control Point) is a formal system that helps operators assess how they handle water and introduces procedures to make sure the water produced is safe to drink.

5.2 SENSITIVITY ANALYSIS

[REDACTED]

5.3 ECONOMIC ANALYSIS

[REDACTED]

5.4 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT AND SOCIAL

Categorised B (2014 ESP). The Phase 2 project, through the rehabilitation and expansion of the water and wastewater networks infrastructure in the City will improve the quality, safety and reliability of the drinking water supply for 12,440 customers of which 5,700 are new users, and the new sanitary sewer is expected to benefit 4,200 people including 2,400 new users.

An independent Environmental and Social due diligence (“ESDD”) was undertaken by external consultants as part of the feasibility study prepared for both Phases (Phase 1 and Phase 2) of the Project in 2019, and this was further supplemented by the Bank’s review of the additional Covid-19 questionnaire and discussions. Most of Phase 2 investments are focussed on improving drinking water supply, and ESDD confirmed that the quality of the drinking water supply provided under the Project Implementation Programme (“PIP”) will meet relevant national and EU requirements. [REDACTED]

Phase 2 of the project will improve the coverage and reliability of wastewater collection in Banja Luka and reduce the risk for groundwater contamination through construction of the new sewers. This is a step in the right direction towards enabling a longer-term solution of the sewage treatment for Banja Luka, and will help to remove local urban pollution from untreated effluent. However, as a result of the new user connections the volume of wastewater and untreated direct discharges to the local rivers will be increased by an estimated 603 thousand m³/annum. The untreated wastewater discharges present high risks for human health. To reduce risks to human health and the environment, the Company and the City will be required to (i) conduct enhanced regular monitoring of the discharges and of water quality at the points of discharge into the local rivers and upstream/downstream and inform stakeholders accordingly of any issues; (ii) take steps for preventing contamination of the areas used for drinking water intake and recreation/leisure activities to make sure the consequences for public health are eliminated/minimised; and (iii) carry out capacity building among the public with regards to potential risks to public health and measures to be taken. These actions have been added into the updated Environmental and Social Action Plan (“ESAP”).

The Company has an ISO 14001 certified Environmental Management System and also HACCP certificate for production and water distribution, benchmarking its practices

with other water utilities in the Danube river catchment area. However, the Company has no established Occupational Health and Safety (“OHS”) Management System yet and will need to further improve its OHS practices. There are 365 employees, with over 25 per cent women, and associated human resources (“HR”) policies and procedures in place are aligned with PR2. There is designated staff responsible for environmental and OHS management, and the Company currently has all necessary permits in place for its operations. The Company carries out stakeholder engagement activities, including a grievance mechanism, in connection with the planning and construction of its infrastructure. ESDD also confirmed that Company’s response to Covid-19 has been adequate.

No significant adverse impacts were identified by the external ESDD, and any impacts will be mostly construction-related, temporary by nature, and will be mitigated through good EHS construction practice. The new pipelines will also in the majority of their length follow the existing roads. The ESDD confirmed that the PIP components will not affect any sensitive or designated nature conservation areas, however precautionary biodiversity protection measures including a pre-construction biodiversity assessment based on a walkover survey will be conducted and, if necessary, a corresponding Biodiversity Management Plan (“BMP”) developed, once the design documentation is completed and the final alignments for the networks are defined.

The Project will not involve any involuntary resettlement, and no buildings would be affected. however there will be some economic displacement. A Land Acquisition and Resettlement Framework (“LARF”), including the compensation matrix covering all categories of the project affected people (“PAPs”), has been prepared in line with PR5 and a detailed LARP will be developed based on the LARF. A Stakeholder Engagement Plan (“SEP”), including a grievance mechanism, and a Non-Technical Summary (“NTS”) have also been prepared and will be disclosed for the Project.

The ESAP has been prepared and agreed with the Company and the City to mitigate the identified E&S issues and impacts and to bring the Company’s operations into compliance with the EBRD’s PRs. The ESAP will be part of the Loan Agreement and includes among others measures to be taken by the Company to: (i) ensure completion of any additional environmental and/or biodiversity studies that may be required by the competent environmental authorities for the project components in order to obtain the relevant environmental and construction permits; (ii) develop further plans for a new WWTP and the associated sludge management and disposal procedure in line with EU requirements; (iii) include in contractors contracts an obligation to develop and implement construction EHS Management Plan and apply good working practices during construction; (iv) inform all residents in a timely manner about expected construction impacts and anticipated mitigation measures; (v) finalise and disclose LARF and SEP, including external grievance mechanism; (vi) following from LARF, develop and implement a detailed LARP; (vii) develop and implement an OHS Management System; (viii) develop and implement an annual monitoring programme of the industrial discharges in the municipal wastewaters, as required by the current Water Permit; (ix) several measures, as outlined above, to reduce risks to public health. The Company will implement the updated corrective ESAP, and further capacity building and implementation support is foreseen through PIU that was established

under Phase 1 with supervision and procurement support/contract management, FOPIP consultant and Instrument for Pre-Accession Assistance (IPA II) consultant. The Bank will monitor the Project through review of Annual Environmental and Social Reports (“AESRs”) and site visits as required.

6.2 INTEGRITY

In conjunction with OCCO, integrity due diligence was undertaken on the City of Banja Luka, its mayor, deputy mayor and senior executives, as well as on the public water company Vodovod a.d. Banja Luka and its senior executives. The [REDACTED] Project does not pose an unacceptable reputational or integrity 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.

ANNEXES TO OPERATION REPORT

ANNEX 1	Historical Financial Statements
ANNEX 2	Project Implementation (Procurement Plan)
ANNEX 3	Economic Analysis – Project EIRR
ANNEX 4	Technical Project Description
ANNEX 5	Implementation progress of GrCF / GrCF2
ANNEX 6	Maps

ANNEX 1 – HISTORICAL FINANCIAL STATEMENTS

Historic financials of the City

[REDACTED]

ANNEX 2 – PROJECT IMPLEMENTATION

Procurement classification – *Public Sub-Sovereign*

[REDACTED] It has been identified that there is a strong in-house technical expertise in water, wastewater and related municipal infrastructure in the City of Banja Luka but also within the Public Utility Company. The City and the Company will be capable to evaluate and assess the actual technical specifications that the market may offer and its compliance with their needs.

The City has previous experience with EBRD funded projects (Banja Luka District Heating Projects – DTM 49407 and Banja Luka Water – Phase 1 – DTM 51214) and it has previous experience procuring projects of a similar volume; however, lack of experience with international tendering represents a moderate risk to efficient procurement of the expected works and consultancy contracts. An experienced advance procurement consultant will guide the City and the Company through the procurement process and contract administration to mitigate this risk. The advance procurement consultant is currently assisting the City to procure the works and consultancy services under the Project (Phase 2) in accordance with the EBRD PP&R. The Client has currently limited resources and capacity for implementation of the project and has established a PIU for this project. The Client's capacity implementation risk will be mitigated by the already engaged of experienced international consultants that will help the Company with the supervision services and contract management.

The capacity of the City to implement the Project was assessed as part of the technical due diligence and through a meeting with representatives of the City, the Public Utility Company and the Business Procurement Specialist in Banja Luka. The procurement capacity assessment was conducted in July 2019 based on the outcome of the PPAD internet based toolkit and verified by the team's Business Procurement Specialist.

The Contract's Risk assessment: Moderate

Contracts proposed to be financed from the Bank's loan are detailed in the attached Procurement Plan. The support of the experienced advance procurement consultant will ensure that technical specifications are suitable for open tendering, and that any procurement and contractual issues that may arise are addressed in a professional and timely manner.

The nature of the works contract is generally considered of medium complexity and has a relatively medium to low degree of implementation risk. This risk was partially mitigated by appointing an independent consultant to prepare the technical, environmental and economic due diligence which also set the technical specifications for the expected water and wastewater networks extension and it is strengthened with the appointment of an independent consultant that will support the Client during the works contract implementation.

In addition, an advance procurement consultant has been mobilised to support the PIU during the tendering and evaluation process ensuring that the procurement is being carried out in compliance to the Bank's PP&R.

There are on-going projects of similar magnitude, nature and complexity executed in the country (i.e. Phase 1 of the Banja Luka Water project) with good implementation and operation track-records, which may ensure adequate competency available in the region.

Project implementation arrangements: Moderate

The PIU has been established within the City and the Public Utility Company and it has overall responsibility for the implementation of the Project. The PIU will be supported by a donor-funded experienced procurement consultant during the tendering and procurement activities. The consultant will also assist the City in all aspects of procurement and the implementation of the Project in accordance with the Bank's policies and support PIU in meeting requirements of Financing Documents. When necessary, the consultant will train the City and PIU staff in addressing the project procurement and implementation matters.

During project implementation, the PIU will also be supported by a donor-funded experienced supervision consultant that will assist the Client with all aspects concerning design, contracts administrations, disbursement, and environmental and social ("E&S") requirements specific to the Project and in line with the EBRD policies and rules.

With the involvement of the supervision consultant the Client will have access to the best practice in the implementation of the Project administration of works contract, as well as advice on specific technical issues including E&S requirements.

The Project is also expected to support the Preparation of Financial and Operational Performance Improvement Programme and Public Service ("FOPIP") to assist the Company in increasing operational efficiency and improving financial control, to review and update the tariff model of the Company and to prepare and sign a Public Service Contract ("PSC").

Procurement arrangements: Moderate

The project envisages the expansion of the Banja Luka drinking water distribution network as well as the wastewater collection network through its second phase. A single works contract is currently under tendering through Open Tender Single Stage in accordance with the requirements of the Bank's Procurement Policies and Rules (PP&R) for public sector operations and will be subject to prior review by the Bank. Tender Documents for the procurement of works are based on the latest version of the Bank's Standard Tender Documents for Procurement of Works.

In relation to the Technical Assistance, a combined technical and environmental and social due diligence supported the completion of the Tender Documents and technical requirements. Following, an advance procurement consultant was directly awarded in order to support the Client with the Tender Documents preparation and procurement of the expected works contract as well as consultancy supervision services for the works contracts for Phase I and Phase II. The supervision consultant was procured through

competitive single stage method (in Phase I). The last planned Technical Assistance contract involves the consultancy services for Preparation of Financial and Operational Performance Improvement Programme and Public Service (“FOPIP”). The services will be procured through Competitive Single Stage. The 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 details of planned investment and consultancy assignments.

Additional information:

The advance procurement support helped the Client to launch the procurement process in parallel to the loan approval and negotiation process for Phase I. In order to maximise efficiency and leverage cost savings; the advance procurement support for Phase I and Phase II will be delivered under a single consultancy contract.

he contracts for Phase I were tendered via the EBRD Client e-Procurement Portal (“ECEPP”). Phase II will use the same approach.

ANNEX 3 – ECONOMIC ANALYSIS – PROJECT EIRR

[REDACTED]

ANNEX 4 – TECHNICAL PROJECT DESCRIPTION

Background

Banja Luka is the second largest city in BiH and is the de facto the capital city of RS. Banja Luka has a total population of around 185,300 inhabitants of which 139,000 inhabitants live in the urban area whereas 46,300 inhabitants live in neighbouring, rural communities. Nearly half of the rural settlements have less than 500 inhabitants, primarily in the western and south-western part of the City. Over the last five years the population in the City has grown which is the combination of internal migrations within RS, depopulation of villages and relocations into the City.

The Vrbas River basin presents the most important water resource for the City, given that the major part of the City area belongs to it. The River has numerous tributaries, the largest being the Vrbanja River, discharging to the Vrbas in the eastern part of the city. In particular, the Vrbas River in the City is under significant pressure being the main recipient of untreated industrial and sanitary wastewater from the area.

The city's economy is primarily based on small and medium-sized enterprises. The main economic activities are processing industries (primarily wood processing, and to a minor extent metal, food production, paper and plastic), construction, services, trade, etc.

Drinking Water Services

Drinking water supply in Banja Luka is provided centrally via a 839 km water mains network served mainly from the Novoselija water source, and from a number of local/rural water supply schemes that were taken over by the water utility company in Banja Luka during 2017 and 2018. The Company now manages, operates and maintains the central and local water supply schemes.

Of the 179,000 population receiving water services within the administrative limits of the City of Banja Luka, 158,000 are supplied from the central system receive drinking water from the central system and the remaining around 21,000 from local systems. Two neighbouring settlements within Laktaši Municipality (Glamočani and Trn) are also supplied from the Banja Luka central water supply system with connected population of around 7,700. Overall service coverage of the Vodovod's service area is estimated at around 97 per cent. In addition, the Company also provides bulk water supplies to the Čelinac Municipality and the settlement of Slatina (part of Laktaši Municipality). [REDACTED]

Wastewater Services

Wastewater collection services are provided to about 90 per cent of the urban population through a sewer network totalling 285 km in length. The major portion of the sewage system is combined (a mix of storm water and foul components) with a minor part of the network being separate (foul only). The collected wastewater is discharged untreated directly into nearby natural waterbodies, the Vrbas and Vrbanja Rivers, from 126 discharge points. Population in villages use septic tanks - which discharge to ground - or dispose their raw sewage directly into nearby streams. Process water from the Novoselije water treatment plant is also discharged to the Vrbas River untreated. [REDACTED]

Proposed Priority Investment

The Project aims to improve water supply and wastewater services to the currently underserved population primarily in rural areas of the city of Banja Luka. The Priority Investment Programme (or “PIP”) is formed in two phases and includes a set of subprojects related to integration, extension and rehabilitation of the existing water supply network (primary and secondary), installation of new water storage, pumping and limited extension and rehabilitation of the existing sewage network. The majority of sub-projects will be developed in the neighbouring communities connecting them to better centralised services.

The first phase, “PIP1” or “Phase 1”, consists of the following:

- [REDACTED] HDPE new water distribution mains
- 4 № reservoirs/tanks providing an additional [REDACTED]potable water storage
- 1 № local booster station and 2 № water pumping stations, and
- [REDACTED]storm-water drain

This is expected to improve drinking water quality to [REDACTED] customers [REDACTED]. [REDACTED]Phase 1 has started with the physical implementation in October 2019. So far some 30% of the Phase 1 have been completed.

The second phase, “PIP2” or “Phase 2” (this project) consists of:

- [REDACTED] water mains replacement
- [REDACTED]HDPE new water distribution mains
- 5 № reservoirs/tanks providing [REDACTED]potable water storage, and
- 4 № water pumping stations, and
- [REDACTED]new sanitary sewers
- Up to 15 strategically located flow and pressure monitors in the water network

This is expected to improve drinking water quality [REDACTED]. The new sanitary sewer is expected to benefit [REDACTED].

Overall PIP1&2 (Phase 1 and Phase 2) will assure that the quality of drinking water is compliant with the EU Drinking Water Directive [REDACTED].

Meantime, the City of Banja Luka launched its GCAP in September 2018, and the draft final report was presented to the City Administration in June 2020. Pandemic. [REDACTED]

The GCAP identifies three environmental challenges related to the water sector: (i) inadequate drinking water supply network provision (both in terms of losses and coverage); (ii) inadequate wastewater collection (coverage) and treatment provision; and (iii) the consequential harm in local water bodies from wastewater etc. contamination, for example. The importance of addressing access to drinking water is recognised in the City's GCAP; it also prioritises wastewater provision, too [REDACTED].

The Project is also the first step towards the solution for wastewater treatment, as without proper and reliable wastewater collection channels it will be harder to make the future WWTP feasible. Moreover, the investments under the Project will help to remove local spread pollution from untreated effluent through the new sanitary sewers provisions.

IPA Grant financing

The EU IPA grant of EUR 4.0 million will continue to finance further reconstruction and expansion of the water and wastewater infrastructure in Banja Luka. [REDACTED]

Long Term Proposed Priority Investment

Meantime, a Long Term Priority Investment Programme ("LTPIP") has identified a EUR 56.1 million programme of potable water related investment to i) rehabilitate and upgrade (structural) existing water sources, ii) establishing sanitary protection zones, iii) rehabilitate existing water treatment plants, iv) provide disinfection facilities v) rehabilitate/replace of deteriorated distribution mains (to reduce water losses/inefficiencies), vi) further consolidation of rural water supply schemes, vii) extend water supply networks, viii) provide additional potable water storage ix) upgrade water pumping facilities, and xi) provide modern operational monitoring and control systems.

On the wastewater side the LTPIP, based on the identified deficiencies/gaps of the existing wastewater system, and the objective of improving municipal wastewater collection and treatment, an investment package of around EUR 58.8 million has been identified as follows:

1. Construction of a new, centralised wastewater treatment plant for the Banja Luka agglomeration in full compliance with the relevant national and EU regulations concerning urban wastewater treatment and management of wastewater sludge
2. Extension of the wastewater collection system in the central, sub-urban and rural parts of the wider Banja Luka sewer catchment area
3. Upgrade and rehabilitate the existing wastewater collection system to restore its full functionality (effectual drainage), and

4. Additionally, construction/completion of all major sections of main sewers in the wastewater collection system integrating a number of detached sub-catchments for conveyance to the planned new WWTP site.

The City of Banja Luka is planning to make further investments, as described above, through several phases as the investment needs exceed the borrowing capacity of the City.

ANNEX 5 – IMPLEMENTATION PROGRESS OF GrCF / GrCF2

The Green Cities Framework (GrCF), approved by the Board in November 2016, set an ambitious agenda for the Bank’s municipal business, with the over-arching aim being ‘to serve as a sector-wide catalyst for addressing environmental challenges at the City level’. After only 2 years of operation, the Framework proved its ability to act as such a catalyst with the utilisation of the entire EUR 250 million headroom. As a consequence, in October 2018 a new Framework was approved by the Board, Green Cities Framework 2 (GrCF2), with a headroom of EUR 1.1 billion, with EUR 700 million from the Bank’s own capital and the remainder from the Green Climate Fund (GCF) and other donors. Given the sizeable amount from the GCF, in the form of concessional loans and grants for both capex and TC and the requirement to confirm to GCF the availability of Bank co-financing, GrCF2 is divided into two windows: Window I for GCF co-financing and Window II for non GCF co-financing. Since 2016, the GrCF and GrCF2 have mobilised nearly EUR 1.5 billion in EBRD and donor funding. [REDACTED]

Existing wastewater collection system in urban area

