

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

Approved by the Board of Directors on 12 October 2021¹

REPUBLIC OF TAJIKISTAN

FAYZOBOD WATER AND WASTEWATER

[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

| | |
|---|-----------|
| TABLE OF CONTENTS | 2 |
| ABBREVIATIONS / CURRENCY CONVERSIONS | 3 |
| PRESIDENT’S RECOMMENDATION | 4 |
| BOARD DECISION SHEET | 5 |
| ADDITIONAL SUMMARY TERMS FACTSHEET | 6 |
| 1. STRATEGIC FIT AND KEY ISSUES | 8 |
| 1.1 STRATEGIC CONTEXT | 8 |
| 1.2 TRANSITION IMPACT | 9 |
| 1.3 ADDITIONALITY | 9 |
| 1.4 SOUND BANKING - KEY RISKS | 11 |
| 2. MEASURING / MONITORING SUCCESS | 11 |
| 3. KEY PARTIES | 13 |
| 3.1 BORROWER, PROJECT ENTITY AND REGION | 13 |
| 4. MARKET CONTEXT | 13 |
| 5. FINANCIAL / ECONOMIC ANALYSIS | 14 |
| 5.1 FINANCIAL PROJECTIONS | 14 |
| 5.2 SENSITIVITY ANALYSIS | 14 |
| 5.3 PROJECTED PROFITABILITY FOR THE BANK | 14 |
| 6. OTHER KEY CONSIDERATIONS | 14 |
| 6.1 ENVIRONMENT | 14 |
| 6.2 INTEGRITY | 15 |
| 6.3 OTHER ISSUES | 16 |
| ANNEXES TO OPERATION REPORT | 17 |
| ANNEX 1- TRANSITION IMPACT SCORING CHART | 18 |
| ANNEX 2– SOVEREIGN DEBT SUSTAINABILITY | 19 |
| ANNEX 3 – EIRR | 20 |
| ANNEX 4 - PROJECT IMPLEMENTATION | 21 |

ABBREVIATIONS / CURRENCY CONVERSIONS

| | |
|--------------|--|
| Bank or EBRD | The European Bank for Reconstruction and Development |
| CDP | Corporate Development Programme |
| DSCR | Debt Service Coverage Ratio |
| 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 |
| SECO | Swiss State Secretariat for Economic Affairs |
| SPP | Stakeholder Participation Programme |
| SSF | EBRD Shareholder Special Fund |
| TC | Technical Co-operation |
| TJS | Tajik Somoni |
| VAT | Value Added Tax |

1 EUR = 13.4 TJS
(as of 1 September 2021)

PRESIDENT’S RECOMMENDATION

This recommendation and the attached Report regarding an operation in favour of the Republic of Tajikistan, is submitted for consideration by the Board of Directors.

The facility will consist of a sovereign loan to the Republic of Tajikistan (“RT”) of up to EUR 1.8 million. The proceeds of the loan will be on-lent to the State Unitary Enterprise “Khojagii Manziliyu Kommunalii of Fayzobod Region” (the “Company”), a municipal entity responsible for provision of water, wastewater and other services in the Region of Fayzobod.

The operation will enable the RT to rehabilitate water supply and wastewater infrastructure in the City of Fayzobod and connect 13 neighbouring communities to a continuous, clean drinking water supply, expand the sewer network and improve wastewater treatment (the “Project”). The expected transition impact of the Project will be achieved through significant water losses reduction and improvement of access to better drinking water under Green quality (100 per cent GET) and improvement of contractual arrangements of the Company, as well as supporting tariff setting approach improvement and tariff to reach cost-recovery level under Well-Governed. The Project is gender additional as it will support the Company with development and implementation of a gender action plan as well as policies and procedures to promote equal opportunities at the workplace.

The loan is proposed to be co-financed by a capital grant of EUR 2.6 million which has already been approved by the Swiss Confederation represented by the Swiss State Secretariat for Economic Affairs (“SECO”). [REDACTED].

Due to affordability constraints and limited financial resources under the proposed limited short-term investment programme, it is not possible at present to bring the current 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 2019 Environmental and Social Policy (“ESP”). Derogation from this Policy is therefore required.

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 Green Economy Transition Approach 2021-2025 and with the Agreement Establishing the Bank.

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

Odile Renaud-Basso

BOARD DECISION SHEET

| TAJIKISTAN – FAYZOBOD WATER AND WASTEWATER - DTM 52574 | |
|--|--|
| Transaction / Board Decision | Board approval ² is sought for a sovereign loan of up to EUR 1.8 million in favour of the Republic of Tajikistan to rehabilitate water supply and wastewater infrastructure in Fayzobod Region (the “Region”). |
| Client | The sovereign loan to the Republic of Tajikistan will be on-lent to the Company. |
| Main Elements of the Proposal | <p><u>Transition impact:</u></p> <ul style="list-style-type: none"> • <u>Green</u> - 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 Region’s climate resilience towards projected increases in water stress and related extreme events, as well as significant water losses reduction and improving access to the safe drinking water; • <u>Well-governed</u> – the Project and associated TCs will mandate improvement of contractual arrangements, including full-scale PSC signing and CDP introduction and improvement of existing tariff setting approach. <p><u>Additionality:</u></p> <ul style="list-style-type: none"> • 18-year loans are not currently available from commercial banks; • The Bank’s involvement will be additional because of the imposition of a set of conditionalities (e.g. applying EBRD PP&R, implementing ESAP), which will allow the Project to be implemented more efficiently. <p><u>Sound banking:</u></p> <ul style="list-style-type: none"> • The Republic of Tajikistan is the borrower; • Implementation risk will be mitigated by engaging an experienced Project Implementation Support, Design and Engineering Supervision consultant; • A Corporate Development Programme consultant will improve the Company’s financial, institutional, operational and financial capacity. |
| Key Risks | <p><u>Sovereign risk.</u> Tajikistan remains vulnerable to external shocks. Public debt was 48 per cent of GDP in 2020. However, [REDACTED] debt service costs remain modest. The proposed transaction’s sovereign risk remains acceptable.</p> <p><u>FX risk.</u> The Republic of Tajikistan is expected to be able to manage the FX risk given small size of the loan relative to country’s tax revenues and net exports.</p> <p><u>Project implementation risk.</u> The implementation risk will be mitigated by the involvement of a Project Implementation Support consultant and increased oversight from the project team.</p> |
| Strategic Fit Summary | The Project is consistent with the Bank’s country strategy for Tajikistan, the Municipal and Environmental Infrastructure Sector Strategy, Strategy for the Promotion of Gender Equality and with the Green Economy Transition Approach 2021-2025. |

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

ADDITIONAL SUMMARY TERMS FACTSHEET

| | |
|---|--|
| EBRD Transaction | A sovereign loan of up to EUR 1.8 million to the Republic of Tajikistan. The loan proceeds will be on-lent to the Company. |
| Current Exposure | Sovereign exposure: [REDACTED]. The Region: none The Company: none |
| Maturity / Exit / Repayment | The loan's tenor is 18 years [REDACTED]. |
| Potential AMI eligible financing | None. |
| Use of Proceeds | The proceeds will be used to finance (i) development of a hydraulic model of the water network (ii) rehabilitation of a water intake and expansion of water supply networks including water storage and disinfection, (iii) procurement and installation of water meters (iv) expansion of the sewer network and improvements to the current wastewater treatment plant ("WWTP"), and (iv) refurbishment of operational infrastructure including procurement of critical machinery. Progress reports will be prepared by the Project Implementation Support consultant for the Bank on quarterly basis. |
| Investment Plan | [REDACTED] |
| Financing Plan | [REDACTED] |
| Key Parties Involved | <ul style="list-style-type: none"> • Borrower: the Republic of Tajikistan; • Project Support provider: the Region of Fayzobod; • Implementing agency and beneficiary: Khojagii Manziliyu Kommunali of Fayzobod Region. |
| Conditions to effectiveness / disbursement | <i>Conditions precedent to effectiveness:</i> Loan Agreement; Grant Agreement, Subsidiary Loan Agreement (on-lending agreement) [REDACTED]. |
| Key Covenants | <ul style="list-style-type: none"> • [REDACTED] Develop and adopt the recommendations on tariff methodology improvement to achieve cost-recovery level; [REDACTED]. |
| Security / Guarantees | Sovereign loan |
| Other material agreements | <ul style="list-style-type: none"> • Project Agreement between the Bank and the Company; • Project Support Agreement between the Bank and the Region; • Grant Agreement between the Bank, the Government of Tajikistan and the Company. |
| Associated Donor Funded TC and co-investment grants/concessional finance | <p>A. Technical Cooperation (TC)</p> <p><i>Pre Loan Signing:</i></p> <ul style="list-style-type: none"> • TC 1&2: Feasibility study of the investment, including preparing the long-term investment plan and procurement plan for the Company; environmental and social due diligence and update of the feasibility study to account for COVID-19 effect and revise investment plan. [REDACTED] <p><i>Post Loan Signing:</i></p> |

- **TC 3: Project Implementation Support.** The TC will support the Project Implementation Unit with detailed engineering design and approval, procurement, tender preparation and evaluation, contract awarding and administration/construction supervision, financial control, project management and reporting. [REDACTED].
- **TC 4: Corporate Development Programme** for the Company, to include: support for the Company to implement a Financial and Operational Performance Improvement Programme (the FOPIP), the SPP and introduce a PSC between the Company and the Region. [REDACTED].

Cost sharing: No cash contribution is expected from the Client due to the affordability constraints. In line with the Bank's cost-sharing policy dated 1 January 2021, cash contributions will not be provided taking into account Company's publically owned status and lack of sufficient funds to make such contribution. The Company is to be exempt from paying VAT or other indirect taxes, hence no parallel cost-sharing will be envisaged too.

B. Co-investment grants

Co-investment grant of up to EUR 2.6 million from SECO under the contribution agreement [REDACTED].

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

There is growing pressure on water resources in Tajikistan, which stems from population growth, increased resource consumption and a lack of infrastructure development (leading to high levels of water loss). At the utility level, low tariffs and low collections from public sector companies are the main factors causing financial constraints. Collection and billing rates are particularly low in cities where improvements in water supply services are not yet noticeable, despite a recent increase in investment.

The EBRD and international partners, have been working in the water sector of Tajikistan since 2004 with investing in 9 Projects covering 23 cities throughout the country. The projects combined small affordable loans with capital grants to mitigate affordability concerns and technical assistance to support with implementation, operational improvements, and public awareness campaign among population for smoother introduction of tariff increases. Based on the early success with the EBRD's water Projects in Khujand city, the second biggest city after Dushanbe, the Government of Tajikistan asked the EBRD to prepare and finance a municipal water infrastructure programme in secondary cities throughout the country. The proposed programme, which was later to be called the EBRD's Integrated Approach for Water Projects in Tajikistan, is now under implementation.

The implementation of the investment projects under the Integrated Approach has generally progressed well [REDACTED].

The Project builds up on the success of the previous projects in the water sector of Tajikistan aiming to (i) address the critical water and wastewater infrastructure rehabilitation needs, (ii) contribute towards improving the quality and reliability of potable water supply and sewerage collection and treatment services, and (iii) improve financial and operational standing of utility achieved through a general reform programme.

The Project is consistent with the Bank's country strategy for Tajikistan, and corresponds with the Municipal and Environmental Infrastructure Sector Strategy, Strategy for the Promotion of Gender Equality and with the GET approach.

The proposed Project will 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) SDG 13: Taking urgent action to combat climate change and its impacts.

1.2 TRANSITION IMPACT

Primary Quality: Green

| Obj. No. | Objective | Details |
|----------|---|---|
| 1.1 | The percentage of EBRD use of proceeds allocated to the project that qualifies as GET is 50 per cent or higher. | The proceeds allocated to the Project qualify as 100 per cent GET. The Project is expected to result in significant water losses reduction, increase in wastewater treated and increased number of people with access to clean water. |

Secondary Quality: Well-Governed

| Obj. No. | Objective | Details |
|----------|--|--|
| 2.1 | A well-defined public service contract in line with international practice will be introduced (not a revision to a current PSC) where such contracting structures are common in the country or sector. | The CDP consultant and the Company will develop a PSC (contractual arrangement to bring them in line with international best practice). [REDACTED]. |
| 2.2 | The project supports an improvement to the current tariff regulatory regime or tariff methodology. | The Project supports an improvement to the current tariff methodology by allowing recovery of operating and financing costs during the project's lifetime. The dual option tariff methodology will be introduced to allow both norm-based billing and consumption-based billing. In parallel, the Project will covenant follow-on tariff increases to reach a cost-recovery level. |

1.3 ADDITIONALITY

| Identified triggers | Description |
|--|--|
| A subsequent/consecutive transaction (issuance) with the same client/group, either with the same use of proceeds or in the same destination country (repeat transaction). | EBRD has financed a number of sovereign projects in Tajikistan, including in the water sector. However, this is a first EBRD project in the Fayzobod Region. |

| Additionality sources | Evidence of additionality sources |
|--|---|
| Financing structure - EBRD offers financing that is not available in the market from commercial sources on reasonable terms and conditions [REDACTED]. This financing is necessary to structure the project. | EBRD will provide a loan with an 18-year tenor to match the economic life of the assets. These terms are not currently available from commercial banks. |
| 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. | The [REDACTED] Company will amend an existing tariff methodology to achieve cost – recovery levels in line with CDP consultant's recommendations as well as introduce dual option tariff setting approach that will include norm-based billing and consumption-based billing. |
| Standard-setting - The Company makes use of EBRD's expertise in best international procurement standards. | EBRD PP&R will be applied. |
| Standard-setting - The Company seeks use of EBRD's expertise on higher inclusion and gender standards and/or equal opportunity action plans (improving women's access to essential water infrastructure). | The Project will improve equal opportunities and practices of the Company through a review of the current HR policies and practices and development of a gender action plan. The Company will also establish policy and procedures to address gender based violence and harassment (GBVH) in the work place. It will also establish grievance mechanisms and investigation procedures to enable GBVH to be reported in a safe and confidential way. This activities will be part of the Corporate Development Plan. |
| Knowledge, innovation and capacity building - EBRD provides expertise, innovation, knowledge and capabilities that are material to the timely realisation of the project's objectives, including support to strengthen the capacity of the client . | The Company's procurement, financial and implementation capacity will be developed as part of the Project through dedicated TC assignments. |
| Risk mitigation - EBRD helps the client mitigate environmental, social and governance (ESG) risks through identification of risks related to the depletion of natural capital assets, raw materials and water availability, etc., and to manage these risks. | Implementation of an ESAP will enable the Company to efficiently manage the environmental and social issues. |

1.4 SOUND BANKING - KEY RISKS

| Risks | Probability / Effect | Comments |
|-----------------------------|----------------------|---|
| Borrower's creditworthiness | Medium / High | <p>External debt stood at 48 per cent in December 2020 and IMF forecasts that public debt will be 49.8 per cent of GDP in 2021 before stabilising at 48 per cent in 2026. [REDACTED] 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 in the longer term.</p> <p><i>Effects of COVID-19</i></p> <p>COVID-19 affected public finances, and the economy in general, both of which are heavily dependent on remittances predominantly from Russia. However, the effect has been relatively mild and most SMEs have been able to operate through the pandemic. The country was mainly affected by disruptions to transportation links and flight suspensions.</p> |
| Implementation risk | High/High | [REDACTED]. To strengthen its implementation capacity further, the PIU will be supported by the TC regarding procurement, project implementation and strengthening corporate capacity. |
| FX risk | Medium/High | The currency depreciation was relatively mild - the official exchange rate weakened by 14 per cent in 2020. The sovereign nature of the loan is expected to provide sufficient mitigation. |

The Project's PD rating of 6.7 reflects Tajikistan's credit risk as the Borrower. [REDACTED]. The country has taken steps to improve indebtedness and agreed the implementation of fiscal consolidation measures [REDACTED] to ensure debt sustainability. The proposed transaction's sovereign risk remains acceptable.

2. MEASURING / MONITORING SUCCESS

| Overall objectives of project | Monitoring benchmarks | Implementation timing |
|---|---|-----------------------|
| Timely project implementation | Completion according to the timeline and within budget. | [REDACTED] |
| Maintaining appropriate environmental standards | Successful and timely implementation of the ESAP. | [REDACTED] |

TI indicator(s), primary Quality: Green

| Obj. No. | Monitoring indicator | Details | Baseline | Target | Due date | TC |
|----------|--|---|------------|------------|------------|------------|
| 1.1 | Water saved (m3/year) | Reduction of water losses. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| 1.2 | Wastewater treated (m3/year) | Increase in wastewater treated. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| 1.3 | Number of individuals benefiting from improved water and wastewater services | Number of people with access to drinking water. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |

TI indicator(s), secondary Quality: Well-Governed

| Obj. No. | Monitoring indicator | Details | Baseline | Target | Due date | TC |
|----------|---|--|------------|------------|------------|------------|
| 2.1 | Public service contract signed and implemented | Public Service Contract is developed by the CDP consultant and the Client, signed and implemented. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| 2.2 | Legal, institutional or regulatory frameworks in target areas improved (cost-reflective tariffs introduced) | Development and adoption of the recommendations on tariff methodology improvement to achieve cost-recovery level, which includes dual tariff setting approach: (i) norm-based; and (ii) consumption-based. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| 2.3 | Performance or action plan implemented by the client: corporate development plan | CDP developed and adopted. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| 2.4 | Tariffs reached the target level | The tariffs for water and wastewater are increased in line with covenants in Project Agreement and CDP consultant's recommendation to reach cost recovery level. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |

Additional Indicators

| Indicator type | Monitoring indicator | Details | Baseline | Target | Due date | Donor |
|------------------------------|--|--|------------|------------|------------|------------|
| Advisory & Policy Indicators | Practices of the relevant stakeholder improved (inclusive procurement practices of companies in the client's supply chain) | Policy and procedures to address gender based violence and harassment in the workplace developed. The project will help the Company establish its policy and procedures to address gender based violence and harassment (GBVH) in the workplace. This will include awareness raising campaigns among staff and community as well as mandatory staff training to mitigate GBVH in the workplace | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| Advisory & Policy Indicators | Practices of the relevant stakeholder improved (social protection measures) | Grievance mechanism and investigation procedures that enable reporting of GBVH developed The project will also support the Company to establish a grievance mechanism and investigation procedures that enable GBVH to be reported in a safe and confidential way. | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |

3. KEY PARTIES

3.1 BORROWER, PROJECT ENTITY AND REGION

Borrower

The Republic of Tajikistan is the borrower under the Project. An analysis of the country's debt sustainability is presented in Annex 2.

Project Entity

The Company is the Project's beneficiary. It is a municipal entity (wholly owned by the Region) providing water, wastewater and other municipal services in the City, with separate accounting established for water and wastewater activities. The Company serves around 10,390 people and 67 businesses and state organisations. Seventy two per cent of the City's population is connected to the water supply system, and 25 per cent to the centralised wastewater system.

[REDACTED]. The population's willingness to pay is low as the water is provided only few hours a day. Revenue mainly comes from other municipal services provided to the city, which include street cleaning, event organisation and other ad hoc services on an as-needed basis.

The Region

The Region of Fayzobod is a large (900 km²), but scarcely populated administrative district in the Rasht Valley. The population of the Region is about 110,000. The Region's total revenue is around EUR 4.4 million with approximately EUR 1.4 million in tax collections and EUR 3 million in central government subsidies

4. MARKET CONTEXT

Municipally operated drinking water and wastewater services in Tajikistan can be broadly characterised as follows:

- Severely deteriorated water supply and wastewater infrastructure;
- Very limited wastewater treatment especially in rural communities;
- High operation and maintenance costs [REDACTED];
- Unreliable water supply, sometimes for only a couple of hours every other day;
- Drinking water often unfit to drink;
- High risk of wastewater related pollution and contamination events affecting unserved or poorly served communities;
- Poor public health, mostly impacting women;
- Low institutional capacity to manage operationally and financially sustainable water supply services.

From 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

Categorised B (2019 ESP) and Low-Medium risk. The Project was initiated in 2016 and the Environmental and Social Due Diligence (ESDD) for the original PIP was carried out as part of the Feasibility Study (FS) by independent consultants in 2017. The FS and ESDD were revised in 2021 to include an update of the earlier ESDD covering health, safety and other social impacts of the COVID-19 pandemic on the Company and the population; renewal of the Bank's affordability analysis; a GVBH review; and a review of climate-related vulnerabilities of the PIP components.

The ESDD showed that the implementation of the Project would significantly increase access to safe drinking water for 33 thousand people through improving the reliability of water supply services in the City of Fayzobod and by the connection of thirteen additional villages with approximately 19,700 people. The Project will also include construction/reconstruction of the wastewater networks, which will allow for connection of approximately 5,400 new customers. Other positive environmental and social benefits of the PIP include reduction of the risk of morbidity by infectious diseases in rural areas; reduced water losses to 25-30 per cent; improved quality of drinking water; provision of the guaranteed 24-hour water supply to all users of the city of Fayzobod; provision of a stable water supply of 4 villages located along the waterway routes; improvements to system reliability and decrease in repairs reducing associated nuisance for dwellers and traffic disturbances, lower accident rate at networks resulting in lower number of water supply interruption cases and lower risk of secondary contamination; reduction of contamination in the Loyak and Elok rivers; reduction of energy consumption; reduction in unsustainable water consumption; better working conditions; and improvements in operational safety.

Current water supply in Fayzobod and surrounding villages is poor and limited to a few hours per day. There are community health risks related to the secondary contamination of the Loyak River by untreated wastewater, which is used as drinking water source by rural communities.

The Company has limited capacity on EHSS matters. It does not have an E&S Management System or HR policies and related procedures, such as a grievance mechanism or GBVH policy. The Company is not fully in compliance with national environmental legislation and does not hold permits for water abstraction. The Company has no internal laboratory; water quality control is exercised only by testing of residual chlorine content. The Company largely meets national requirements on occupational health and safety; however, further improvements are required to meet EBRD PR4.

Adverse E&S impacts associated with the implementation of the PIP will be limited, localised and temporary, and prevented or mitigated by adhering to good construction practices. The proposed project areas will be mainly confined to existing Company sites, or within the existing pipeline corridors. ESDD has confirmed that no sensitive areas are found in the Project area. Some of the water mains, either new or those to be refurbished, run through the natural landscapes. Construction works in these areas may cause disturbance to the local wildlife, which is a particular risk during the nesting and breeding seasons.

To mitigate this risk construction work will need to be scheduled outside of these periods. The findings of the local EIA, which is yet to be undertaken, and resulting recommended mitigation measures will need to be incorporated into the EBRD Environmental and Social Action Plan (ESAP). The project implementation will not require any resettlement, and only limited and temporary disturbance to arable land is anticipated. This can be managed to avoid economic impact on harvests. Nevertheless, requirements to carry out a resettlement screening procedure and develop a compensation and/or livelihood restoration action plan, if required, have been included in the ESAP.

Climate warming by several degrees in Dushanbe region, increasing water demand both by the environment and human activities and ongoing depletion of water resources require further improvements to water efficiency and water demand management to optimise the use of limited water resources. Climate change may also increase in the frequency and severity of flooding posing a threat to vulnerable infrastructure, such as the sewage drainage system and the biological treatment ponds. The updated PIP includes a dam to protect the biological treatment facilities from erosion and flooding impacts.

Through implementation of the PIP the Project will achieve compliance with EU standards for drinking water quality but not for waste water. To achieve full compliance with EU environmental standards for water and wastewater systems it is estimated that additional long-term investments of more than EUR 11 million would be necessary. Therefore, due to affordability constraints, derogation from the EBRD's Environmental and Social Policy is sought in relation to EU drinking water quality and wastewater treatment and discharge standards. The human health implications of the shortfalls from EU standards are assessed to be minor as compared with the substantial benefits of the PIP implementation resulting in more reliable, efficient and better quality water supply to the local population as well as improved wastewater management. Significant improvement of the water quality and sanitary conditions of the Loyak and Elok Rivers and improvements to operational efficiency and health and safety of employees and contractors are expected. There will be a significant improvement to the sanitary conditions in rural villages thereby reducing the risk of water-borne diseases.

The affordability assessment carried out by the Bank did not identify significant water tariff affordability concerns from the implementation of the project investments with the envisaged grant support and subsidies from the respective regulatory bodies for more vulnerable groups.

An ESAP has been prepared to address impacts associated with the Project and the Company's existing weak E&S management capacity and systems and agreed with the Client. A Stakeholder Engagement Plan and Non-Technical Summary are under preparation and will be disclosed once finalised. The Company will provide the Bank with annual environmental and social reports, including updates on the implementation of the ESAP. The Bank may also conduct monitoring visits, as required. The Bank will closely monitor the implementation of the post-signing Corporate Development Programme and PIU TCs to ensure compliance.

6.2 INTEGRITY

In conjunction with the OCCO, integrity due diligence was undertaken on the Company and its management. The review did not identify any concerns and it was therefore concluded that this project does not pose an unacceptable integrity or reputational risk to the Bank.

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project

files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the project.

6.3 OTHER ISSUES

Concessional Finance: [REDACTED].

Affordability Analysis: The proposed tariffs are expected to remain affordable for all households. However, in case the grant is not provided, the resulting tariffs will cause some affordability breaches for the poorest households during the first years after tariff increase, which is expected to be eliminated closer to the end of project life.

ANNEXES TO OPERATION REPORT

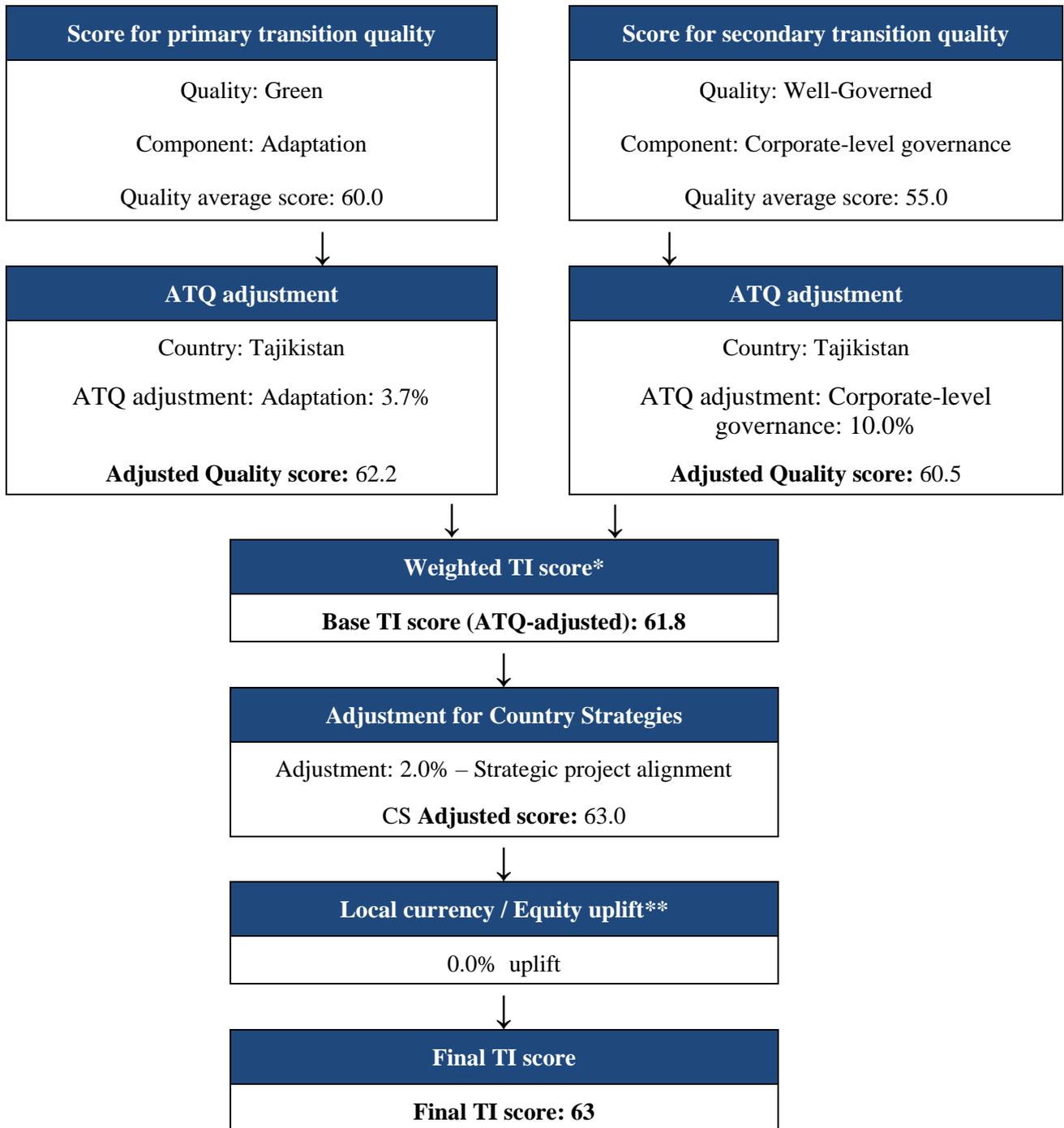
ANNEX 1 TRANSITION IMPACT SCORE CHART

ANNEX 2 SOVEREIGN DEBT SUSTAINABILITY

ANNEX 3 EIRR

ANNEX 4 PROJECT IMPLEMENTATION

ANNEX 1- TRANSITION IMPACT SCORING CHART



ANNEX 2– SOVEREIGN DEBT SUSTAINABILITY

Despite external pressures, Tajikistan’s economy grew by 4.5 per cent in 2020 and 8.7 per cent in 1H 2021 thanks recovering domestic demand and fixed investments. Industrial output grew at a very high rate (23.4 per cent y-o-y in the 1H 2021) with strong gains in mining (150 per cent y-o-y) and manufacturing (20.3 per cent y-o-y). Agriculture expanded by 8.1 per cent over the same period. Trade deficit narrowed in the 1H 2021 to EUR 500 million from EUR 714 million in . Exports surged by 1.9x driven by precious metals. Imports rose by 23 per cent due to increase in domestic demand. However, remittances data from Russian central bank show that remittances to Tajikistan declined by 37 per cent y-o-y in USD terms.

The exchange rate was mildly devalued. In response to deteriorating external accounts, the central bank devalued the exchange rate by 5 per cent in March 2020 and further 10 per cent in November 2020. Overall, the official exchange rate weakened by 14 per cent in 2020. Inflation rose to 9.0 per cent in 1H2021, well above 4-8 per cent corridor established by National Bank.

Fiscal accounts improved in 2021. In January-May 2021 state budget surplus was TJS 133 million compared to a deficit of TJS 364 million a year ago. Revenue increased by 31 per cent year-on-year thanks to growth in tax receipts. Expenditure increased by 24.3 per cent year-on-year primarily in the energy sector, transport and communications as well as healthcare and social protection. In 2021, authorities expect that tax receipts will amount to TJS 18.8 billion (or 22.2 per cent of GDP), up by 22 per cent from 2020 thanks to higher tax collections (VAT, excises and income tax).

The government financed the higher deficit related to COVID-19 by borrowing. To address the pandemic’s challenges and to close the fiscal deficit arising from the revenue shortfall, international organisations supported the government by stepping up healthcare projects and budget support programs. International emergency assistance in the form of grants and loans was agreed with the IMF, ADB, and EFSF for the total of USD 350 million.

Despite moderate public debt levels, Tajikistan remains at a high risk of debt distress. According to IMF, general government gross debt declined from 50.4 per cent of GDP in 2017 to 44.6 per cent at end-2019. The debt burden primarily reflects the depreciation of the currency—which inflates the value of foreign-currency-denominated debt measured in Tajik Somoni—and the 2017 Eurobond issuance. The bulk of public debt is external: around 36 per cent of GDP in 2019. The country’s public debt reached almost 48 per cent of GDP by December 2020. Given concessional financing terms, debt servicing costs are relatively modest. FX reserves amounted to at USD 1.9 billion (23 per cent of GDP or 5 months import coverage) in August 2020 (latest data available).

Since Tajikistan has a high risk of debt distress, any new non-concessional borrowing adds to the pressure on public debt sustainability. To ensure the soundness of public finances, the government committed to consolidating the budget and updated its Debt Management Strategy for 2021-2023 to guide through borrowing criteria and debt ceilings over the medium term. IMF forecasts that public debt will reach 49.8 per cent of GDP in 2021 before stabilising at 48 per cent in 2026. Tajikistan’s debt is vulnerable, especially to export shocks and contingent fiscal liabilities. 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.

PUBLIC

ANNEX 3 – EIRR

[REDACTED]

ANNEX 4 - PROJECT IMPLEMENTATION

Procurement classification – *Public [sovereign]*

[REDACTED] An experienced PIU support consultant will be selected with a comprehensive TOR to support the Client in establishing, and capacity building, a PIU, as well as establishing internal project management and operating procedures, development of detailed designs, full procurement cycle and project management. Apart from the above, the Consultant will act as the Engineer (construction supervision) for all works contracts included in the Project.

As the Client does not have any procurement capacity, a Bank hired individual consultant will be engaged to help the Client in selection of a PIU Consultant. In addition, formation of a PIU with staffing and a TOR acceptable to the Bank will be made a CP for disbursement. It is expected that the Bank will review and approve the composition of the PIU (staffing matrix) as well as the actual CVs of the experts to be included in the key positions of the PIU. [REDACTED].

1. *Contracts risk assessment*

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Moderate

From the contracting point of view, all contracts included in the Project are standard and relatively low-risk, but due to Client's low capacity this risk has still been assessed as "moderate".

[REDACTED]. As the PIU Consultant will act as the Engineer and will manage these contracts, there are no major risks envisaged from the contracting point of view. Experience has shown that there are number of companies in the local market who always participate in tenders for works of this scale and therefore an adequate competition is envisaged.

The goods contracts included in the Project are very straightforward, off-the-shelf goods. Due to the low cost-estimate it is expected that the main tenderers will be local suppliers/agents instead of the manufacturers. The goods have been combined into lots with the aim of increasing contract estimates as much as possible, without compromising on competition (i.e. similar goods combined together).

The consultancy contracts are standard and do not pose major risks from a contracting point of view. The procurement related risks are described below.

Project implementation arrangements:

The PIU Support Consultant will be responsible for preparing detailed designs for the works contracts, as well as technical specifications for the goods contracts. It will also support the PIU in the procurement process and will provide full supervision services for the abovementioned assignments.

Therefore, the success of the Project hinges on the qualification and professionalism of the PIU Consultant. The cost estimate for this assignment is low [REDACTED] considering the scope of services described above. However, to mitigate the risk of underfunding, the loan agreement will contain a provision allowing the finance the supervision services (part of the PIU Consultant's ToR) from the loan proceeds, if necessary.

Apart from the above, the Project contains two Consultancy contracts: a) Corporate Development Programme that is relatively straightforward and does not pose a major risk in development; and b) “Hydraulic modelling of water mains and water distribution networks” – this Contract will be managed by the PIU Consultant.

A brief description of the project implementation arrangements, including the client’s implementation set up, consultancy support and involvement of the lender’s supervisor, if any, is provided below. These arrangements will also include the risk mitigation measures, proposed for the Project.

Procurement arrangements:

All goods, works and services included in the Project will be procured following open tendering and competitive selection procedures in accordance with the Bank’s PP&R. All procurement activities will be conducted through the EBRD’s Client e-Procurement Portal (ECEPP) using the latest standard templates issued by the Bank. [REDACTED].

Additional information:

COVID-19 related risks during procurement phase are expected to be mitigated by using a fully electronic procurement process via ECEPP. The associated risks during contract implementation will be managed in line with the relevant contract provisions. Considering possible delays in the process, relevant contingency amounts will be included in the works contracts to cover accidental costs caused by COVID-19. [REDACTED].