



Kyzylorda Water Project

State Sector Project Assessment

Prepared in line with the EBRD's Access to Information Policy¹

Country Kazakhstan

Sector Municipal and environmental infrastructure

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Operation Description

In December 2014, GKP Kyzylorda Su Zhuyesi (the "Company" or the "Borrower"), a municipal water and wastewater company, wholly owned by the Akimat of Kyzylorda City ("the "City Akimat"), entered into a loan agreement with the European Bank for Reconstruction and Development (the "Bank" or the "EBRD") for a senior loan of up to USD 10 million with 13 years of maturity (the "Loan"). The Loan was supported by the Akimat of Kyzylorda Oblast (the "Oblast Akimat") and the City Akimat through a Project Support Agreement (the "PSA"). It was co-financed by grant contribution from the state budget under the Enhanced Partnership Framework Agreement (the "EPFA"²) and by a contribution from the Oblast Akimat (together the "GoK Grant").

The Loan was to finance priority capital investments, including complex modernisation and optimisation of the water and wastewater infrastructure throughout the network rehabilitation, the introduction of water demand management, reduction of water losses, and the improvement of water quality supplied to the customers (the "Project").

The Project also included one pre-signing and two post-signing technical cooperation (the "TC") grants: 1) Feasibility Study (the "FS"), technical, environmental and financial due diligence funded by the EU's Infrastructure Fund for Central Asia (the "IFCA") Framework for TC, budget EUR 295,000;

¹ As required by Section IV paragraph 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose information (excluding Confidential information) contained in Operational Performance Assessment (OPA) reports for State Sector Projects selected for extended review, within 60 calendar days after completion of the relevant OPA report.

² EPFA is the agreement signed between the Bank and the Government of Kazakhstan (the "GoK") in May 2014 that provided a framework to enhance its cooperation to promote and foster the economic development process in Kazakhstan, including through the use of diverse investment instruments, investment grants, technical assistance and policy dialogue.

2) Project Implementation Support (the “PIS”) funded by the Government of Kazakhstan (the “GoK”) under the EPFA to assist the Company with implementation of the Project including preparation of tender documents, tendering, construction supervision, budget EUR 499,900; and

3) Corporate Development Programme (the “CDP”) funded by the GoK under the EPFA to assist the Company with improvement of its financial and operating performance, budget EUR 400,000.

The Project was part of the Bank’s strategic cooperation with the GoK under the EPFA in the field of the modernisation of the water and wastewater infrastructure and services in the country.

Simultaneously, the GoK had been implementing various institutional reforms in the utilities sectors: development and adoption of a modern and transparent regulation framework and the introduction of full cost recovery tariffs. The Bank financed the Tariff Reform TC (the “Tariff TC”) to reform the current system of tariff regulation. It adopted a modern and transparent framework for regulation and strengthened the framework’s institutional implementation and administration. The Bank made recommendations on improving its tariff policy and regulatory framework. The Project was also selected for the development and introduction of a Public Service Management Contract (the “PSMC”), planned for replication across the country. The PSMC was developed by the CDP consultant and agreed/approved by the Client, the City/Oblast Akimats and the Bank.

The Project’s primary objective was to improve water and wastewater treatment services in the City of Kyzylorda by financing priority investments aimed at rehabilitating and modernising existing infrastructure to enhance energy and water efficiency, loss reduction and environmental standards improvements.

The following TI objectives were set at approval:

- Private Sector Participation: through conducting open and transparent tendering and signing the PSMC.
- Institutions, laws, and policies that promote market function and efficiency: through the PSMC, bringing the new approach to the contractual relationship between the private management company and the City of Kyzylorda.
- Setting standards for corporate governance and business conduct: through a strong demonstration effect across the country for the improved operational and financial performance, significant reduction of losses and compliance with the environmental requirements.

The Project included seven components at the signing stage. The Company started implementation of the Project in 2016. One component was completed, two components were partly completed, and four components were cancelled by the Client. In total, 11 per cent of the Loan amount was disbursed.

As cancellation of the major part of the Loan resulted in modest project implementation achievements, the targets stipulated at the Loan signing were not achieved. The Client has reported some positive impacts from the investment programme. For example, the purchase and installation of hydraulic model secured a more sustainable operation monitoring and accident prevention.

Relevance

The Project was consistent with the Kazakhstan Country Strategy, which sets as a priority the support of the municipal sector in upgrading utility services in regional municipalities. In terms of operational response, the strategy

stated that the Bank will further promote reform and strengthen private sector involvement in the municipal sector, through support of the commercialisation of public utilities and the application of market mechanisms, such as management contracts, public service contracts and tariff reform in water, waste management, including through an Integrated Approach.

The Project is in line with the EPFA objectives to improve the quality and accessibility of public services and measures to address sustainable regional development.

The Project was also consistent with the Bank's Municipal and Environmental Infrastructure Sector Strategy as it promoted: (i) commercialisation; (ii) private sector participation; (iii) regulation and tariff regimes; (iv) increasing the number of people with access to affordable, drinkable tap water; (v) decreasing water losses from water supply systems; (vi) increasing energy efficiency in the water and wastewater sub-sector; and (vii) improving the regulatory and enforcement capacity of public sector bodies.

The Loan was fully additional, as no commercial alternative for long-term local/foreign currency financing was available in the municipal services sector in Kazakhstan at the time of project structuring and signing.

*The Project delivered **additionality** as follows:*

- **Long-term financing:** The market for long-term financing for municipalities/utilities in Kazakhstan remains limited. Considering the nature of the Project i.e. rehabilitation/modernisation of the water and wastewater infrastructure in the city of Kyzylorda, it was crucial for the Company and the local authorities to secure long-term financing. Therefore, the Bank providing necessary long-term financing was highly additional, contributing to improvement of water and wastewater services.
- **Attributes:** With its extensive knowledge of the water sector institutional and operational setup, as well as the ability to evaluate and assess sector and regional risks, the Bank took the lead in supervising the improvements to water and wastewater services and dialogue with the GoK on tariffs and sector reforms. As part of this support, the Bank mobilised TC funds to support implementation of the Project and support sector-wide reforms.
- **Conditionalities:** The Project included standard EBRD conditions related to commercialisation. The Bank also ensured that the design and procurement processes complied with international standards, as well as improvement of financial disclosure through IFRS audits and environmental standards through the Environmental and Social Action Plan (the "ESAP") implementation.

Effectiveness

The Project's transition impact *potential* was expected to stem from:

- (i) **Successful open and transparent tendering and signing of the PSMC.**

This was not achieved.

The PSMC developed and agreed with the Company and both Akimats, the City and the Oblast. The PSMC was tendered several

times but all tenders failed as there was no interest from local and foreign operators due to a low remuneration fee budgeted by the Oblast Akimat and due to an inability to increase the tariffs to full cost recovery level.

- (ii) **Tariffs and metering.** Benchmarks: 1) Aggregate increase of all tariffs; 2) 100 per cent metering coverage for individual customers; 3) Implementation of meter-based billing for all customers.

These benchmarks were not achieved.

- 1) The aggregate tariff increase at the time of evaluation vs the base line in 2014 was as follows: water – average tariff by 33 per cent and wastewater – average tariff by 11 per cent. A full cost recovery tariff introduction has not been achieved at the time of evaluation mainly due to tariff growth limitations imposed by the GoK.
- 2) The metering coverage as of 2020 was 88.4%. The Company expects to increase the coverage in the following years.
- 3) Meter-based billing is available for all consumers, but due to the lack of meters, only consumers with meters can be billed according to consumption-based billing.

- (iii) **Corporate Governance and Business Conduct.** Benchmarks: 1) increased collection rates; 2) Reduction of water losses; 3) implementation of the Management Information System (the “MIS”); 4) implementation of the Stakeholder Participation Programme (the “SPP”), including annual publication of performance targets by the Company; 5) the Financial and Operational Performance Improvement Programme (the “FOPIP”) developed and introduced.

These benchmarks were partly achieved.

- 1) The Company has a good collection record in the recent years.
- 2) To date the Company has managed to achieve significant water loss reduction. It was expected that the Company could reduce water losses further.
- 3) MIS: the CDP TC consultant analysed and recommended the computer-based MIS, however, the Company is not currently in a position to procure it.
- 4) SPP is implemented by the Company: all information on progress including performance targets are kept by the Company and available upon request.
- 5) FOPIP was implemented partly: a TC Consultant assisted and trained the Borrower in the preparation of tariff calculation with a full cost recovery and in the preparation of the financial statements in accordance with IFRS. The TC consultant assisted the Company to prioritize capital investment to improve the services and the environmental performance. The Company had been trained to implement the ESAP.

The Bank believes that use of the full Loan would have secured greater efficiency in the improvement of the City's water and wastewater infrastructure and reduced operating costs, improving the Company's financial performance. However, due to the partial Loan cancellation, not all of the targets stipulated at the Loan signing were achieved. The Client has reported some positive impacts from the investments made. For example, the purchase and installation of a hydraulic model secured a more sustainable operation monitoring and accident prevention.

Efficiency

The Project's investment programme was based on the FS prepared by international consultants. The FS included technical, legal, social, institutional and financial assessment. There were no issues during the preparation of the Project, all reports were up to date and provided enough details.

The Bank's contribution to the structure of the Project was significant in terms of incorporating the Bank's conditionalities. These requirements included stricter and more frequent reporting and a thorough monitoring of the Project during construction and operation, specifically in areas such as social and environmental matters.

To provide assistance to the Company to prepare and conduct the tender process, construction supervision and general Project management, a PIS consultant, financed by the GoK under the EPFA was selected. The Company assembled an internal Project Implementation Unit (the "PIU") which was fully operational from 2015 and included specialists from the Company's financial, procurement, engineering and planning departments. From a technical and operational point of view, the investment programme was sufficient and the design was of high quality reflecting the Company's priority operational needs and repair requirements. The investment programme reduction resulted from factors out of the Bank's control (as explained in the Implementation Summary below).

To increase the Company's institutional capacity the CDP consultant was selected by the Company and financed by the GoK under the EPFA. The main outputs of this TC were: (i) enhancement of the Company's financial management and accounting system; (ii) preparation of a corporate development plan and strategic business plan, and (ii) provision of assistance to the Company with preparation, signing and implementation of the PMSC. The consultant fulfilled its obligations in full except for signing and implementing the PMSC.

The Bank actively facilitated implementation of pre-signing and post-signing TCs through regular meetings (including monitoring visits) and calls with the Client and Akimats. The Bank was focused both on the project's physical completion and the achievement of transition impact objectives.

Overall, the handling was adequate in the current circumstances and was fully in line with the Bank's mandate.

Unfortunately, due to cancellation of the major part of the Loan and inability to complete the investment programme, the Project did not achieve all the sustainable results envisaged at the signing stage.

Implementation Summary

The Project was intended to modernise the water and wastewater infrastructure in Kyzylorda. The EBRD financing was reduced from USD 10 million to USD 1.1 million by a decision of the Borrower. Following the

deterioration of its financial position as it was unable to adjust tariffs to a full cost recovery level. The following component was implemented under the revised investment programme: the installation of a hydraulic model, including an electronic water and wastewater map and updated laboratory equipment. It helped the Company resolve a few specific issues associated with technical modernisation to achieve a sustainable water supply. The Project resulted in: (i) the increase in water supply reliability and safety; (ii) the improvement of drinking water quality; and (iii) the upgrade of the company's laboratory equipment.

The Project, with Technical Cooperation financed by the GoK, supported the improvement of the Company's operational and environmental performance. It meets minimal requirements for drinking water quality supplied to the population and is reporting on its environmental and social performance. While the Company has made some progress in implementing relevant measures under the ESAP, limited progress was made with regards to the improvement of standards for water supply and wastewater treatment. This was due to the significant reduction of the originally approved investment programme. The water and wastewater infrastructure in Kyzylorda will need further improvement. This can be achieved through additional investments in the future.