

PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: AB7446

Project Name	AZ Second National Water Supply and Sanitation Project (Additional Financing)
Region	EUROPE AND CENTRAL ASIA
Country	Azerbaijan
Sector	Water supply (60%); Wastewater Collection and Transportation (20%); Wastewater Treatment and Disposal (19%); Central government administration (1%)
Project ID	P147378
Parent Project ID	P109961
Borrower(s)	GOVERNMENT OF REPUBLIC OF AZERBAIJAN Ministry of Finance 83, S. Vurgun Street Azerbaijan, AZ 1022 Tel: +994-12-596-7184, Fax: +994-493-0546
Implementing Agency	Azerbaijan Amelioration and Water Management JSC 23 Niyazi Street Azerbaijan, AZ 1066 Tel: 994-12-493-80-11, Fax: 994-12-493-80-12
Environment Category	[X] A [] B [] C [] FI [] TBD (to be determined)
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Country and Sector Background

1. Since project effectiveness in July 2009, Azerbaijan has continued its path of economic growth driven by the oil-economy, although growth has slowed down from 5.0 percent in 2010 to only 2.2 percent of real GDP growth in 2012. However, growth is expected to increase again and stabilize at a moderate level with projections of annual growth of approximately 3.8 percent during 2013–16 (CPS Progress Report FY11-14). To sustain this growth, Azerbaijan will need to diversify its economy, introduce market-based policies, and strengthen public services. Particularly in rural areas, improving the coverage, quality, and sustainability of water supply and sanitation services remain a key Government priority.

2. Azerbaijan inherited a relatively extensive water supply system from the Former Soviet Union (FSU). About 95 percent of the population in Baku and about 83 percent of those living in secondary cities and small towns are connected to piped water, but the quality of infrastructure and services has deteriorated severely since independence, due to a lack of investment and deferred maintenance. In many secondary and small towns, water treatment facilities are largely dysfunctional or lacking completely, leaving the population in these towns without access to safe water. In addition, almost everywhere in the country, the piped water supply is unreliable and often available fewer than 12 hours per day. Centralized piped water supply systems are rare in

rural areas, where less than 33 percent of the population has access to a piped water supply. Azerbaijan has declared its commitment to using part of its new oil wealth to address infrastructure deficits in water supply and sanitation and to develop the sector to become financially sustainable. Important actions toward this goal include: i) implementation of a large countrywide water program composed of numerous projects financed by international development institutions and the state budget with aim to rehabilitate, extend or construct the water and sanitation systems in all secondary cities across the country and the Greater Baku area; and ii) institutional development, including the consolidation of local subsidiaries, the introduction of International Financial Reporting Standards (IFRS), the application of European water supply and wastewater standards, a comprehensive capacity-building program for operational and managerial staff, a new billing and collection system, and the establishment of Geographic Information System (GIS)-based asset management system.

3. The IBRD loan in the amount of US\$230 million and the IDA credit in the amount of US\$30 million equivalent were approved by the Bank for the Second National Water Supply and Sanitation Project (SNWSSP) on May 27, 2008 following the approval of an earlier US\$230 million IBRD loan for the National Water Supply and Sanitation Project (NWSSP). These two projects are very similar in design but implemented by two different agencies. The SNWSSP's loan and credit became effective on July 13, 2009 and was initially expected to close on February 28, 2013. The original PDO was *to improve the availability, quality, reliability and sustainability of water supply and sanitation services in selected regional (rayon) centers in Azerbaijan*. The project has originally included 21 rayons where implementation of investments in mainland was originally assigned to Azersu OJSC while the Nakhchivan's State Amelioration and Water Management Agency (SAWMA) was responsible for investments in Nakhchivan Autonomous Republic. Immediately after effectiveness, the project faced implementation difficulties. These pertained to: (i) insufficient project preparation caused by the absence of feasibility and environmental studies; (ii) a shortage of funds due to underestimation of investment costs at appraisal caused by limited record of market costs in the water sector, which resulted in a reduction of project scope; and (iii) the inability of the original implementing agency to implement the massive countrywide water program with multiple donors. In addition, project activities were not adequately aligned with the PDO and the results framework. These issues were addressed by a Level II restructuring approved on September 18, 2009 to transfer the implementation responsibility from Azersu to Azerbaijan Amelioration and Water Management JSC (AAWM) and level I restructuring approved on November 18, 2011 to downsize the original scope to 8 rayons (i.e. Siyazan, Shabran, Aghsu, Ismayilli, Lerik, Yardimli, Masalli and Jalilabad) and modify its PDO and results framework. On February 26, 2013 the project closing date was extended from February 28, 2013 to December 31, 2014 to allow the Borrower to complete the works under on-going contracts and meet the project's development objectives.

Objectives

4. The current Project Development Objective (PDO) of the original project is "to provide the quality and reliability of water supply and sanitation services in selected regional (rayon) centers in Azerbaijan".

5. The project development objective of the original project will be refined to align with baseline situation. The new PDO will be "to improve the quality and reliability of water supply

and expand water supply and sanitation services in selected regional (rayon) centers in Azerbaijan”.

Rationale for Bank Involvement

6. Investments under the AF include: (i) additional household connections; (ii) additional metering; (iii) increased water and wastewater treatment plant capacity; and (iv) additional institutional modernization components and construction supervision and management. The proposed investments do not go beyond the original objectives of the project, but would allow more people to benefit from project activities.

7. The AF will support additional activities to scale-up on-going civil works in selected rayons. These activities are expected to increase the overall impact and benefits of investments, cover a larger number of utility customers, and strengthen the financial sustainability of capital investments. An additional 30 suburban villages will be supplied with gravity water and connected to a sanitation network providing an additional 120,000 people with piped water supply and sanitation services. The AF will also fund larger sanitation networks accompanied by larger capacity wastewater treatment plants. This would enable water utilities to collect and treat larger volumes of effluents, thus reducing the negative environmental impact from the use of septic tanks by households. The AF will also contribute to regional development by providing sustained and improved services, and a greater positive impact on the health and quality of life of low-income households in select rural centers.

8. The proposed AF is fully aligned with the Government’s Water Sector Strategy for 2006–2015, which establishes the provision of reliable water and sanitation services as one of the top priorities for the country. This strategy was developed jointly by the Bank and the Government and is based on the Water Sector Issues and Options Report prepared and presented to the Government by Bank’s water team in 2006. The ongoing SNWSSP and the proposed AF are also consistent with, and form an integral part of, the government’s ambitious country-wide \$4 billion Azerbaijan Water Program, which is being supported by several development partners including the World Bank, ADB, KfW, IDB, and JICA.

Description

1. The original project finances activities under three components to achieve this objective. The cost per component and funds allocated under the original loan are summarized in Table 1. The original components include:

Component A: Rayon Investment Component

This component finances the rehabilitation and extension of water supply and sewerage systems, as well as facilities for water, wastewater and sludge treatment in selected regional (rayon) centers in Azerbaijan (i.e. Siyazan, Shabran, Aghsu, Ismayilli, Masalli, Jalilabad, Yardimli, and Lerik rayons). The project covers the rayon centers and the villages located in close proximity of the urban centers or along the transmission mains supplying the centers.

Component B: Institutional Modernization Component

This component supports capacity building and modernization of the utility, through: (a) the provision of training for management, financial management, customer service, procurement, preventive maintenance and other subjects pertinent to effective and efficient management of the utilities; (b) development of performance monitoring, preventive maintenance and leak detection and repair; and (c) design and technical support for construction management, including procurement support and contract supervision for the investments.

Component C: Project Implementation and Management

This component supports project implementation by financing project management activities including incremental operating costs and project audits.

Table 1: Original cost and fund allocation by component (USD million)

Component	Original cost	
	Total estimate (incl. VAT)	IBRD + IDA ¹
A: Rayon Investment Component	392.0	246.8
B: Institutional Modernization Component	15.8	11.4
C: Project Implementation and Management	1.6	1.2
Front-end Fee	0.6	0.6
TOTAL	410.0	260.0

Project performance

9. It is worth noting that project implementation has turned around over the last two years, after the implementation responsibility was transferred to another implementing agency, with all available funds committed and disbursements exceeding 65percent. Project is on track to achieve its current PDO. The Project Implementation Status Report (ISR) ratings for implementation progress (IP) and development objectives (DO) are currently rated at MS level and planned to be upgraded once the AF is approved. Procurement has been completed and construction is progressing in all rayons covered under the project's current scope. About half of civil work contracts are expected to be completed within the current closing date of December 31, 2014. As such Government has recently inaugurated the new water supply and sanitation networks in Siyazan, Shabran, Aghsu, Ismayilli and Lerik and design and construction is progressing in other sites. Fully meeting key PDO indicators will require completion of rehabilitation works, including construction of scaled up water supply and sanitation systems included under this AF.

10. Project impact to date has been broadly consistent with expectations set out in the Project Appraisal Document (PAD). The Government's commitment to the project remains strong and

¹ IBRD +IDA financing excludes VAT which is financed under the Government contribution

good progress has been made under all components. Results have been particularly impressive in construction of new water supply and sanitation networks. Most of key performance indicators demonstrate progress towards achieving the PDO. In particular, the following results are noteworthy:

- a. Water supply and sanitation networks in five rayons centers (Siyazan, Shabran, Aghsu, Ismayilli and Lerik) have been inaugurated;
- b. More than 120,000 project beneficiaries have been provided with reliable piped water supply and sanitation services;
- c. European water supply and wastewater standards have been introduced in Azerbaijan. The capacity-building program for field based operational and managerial staff of water utilities has been prepared.

11. In addition, a number of institutional development activities to strengthen key stakeholder institutions are being implemented under the first water project (NWSSP) and Public Investment Capacity Building Project (PICBP).

12. The Mid-Term Review (MTR) in November 2012 confirmed overall project implementation progress and the identified additional funding needs to finance the scale up of water supply and sanitation coverage in the original project rayons. The formal Government request for AF was submitted to the Bank on June 19, 2013.

13. The project is in compliance with all legal covenants entered into under the Loan Agreement IBRD-75180-AZ and Credit Agreement IDA-43970-AZ. The fiduciary management system is satisfactory, and there are no pending financial audit reports. Auditors issued an unqualified opinion for the latest audited project accounts covering the period ending December 31, 2012. Safeguards compliance for Operational Policy (OP)/Bank Procedures (BP) 4.01 (Environmental Assessment), OP/BP 4.47 (Safety of Dams) and OP/BP 4.12 (Involuntary Resettlement) is satisfactory. There are no unresolved environmental, social, or other safeguard issues as confirmed during the MTR and latest project implementation support mission completed in May 2013.

14. Financing

Source	(USD million)
Republic of Azerbaijan	84.0
International Bank for Reconstruction and Development	150.0
Total	234.0

15. The majority of AF funds will finance costs associated with additional activities under Component A “Rayon Investment Component”, Component B “Institutional Modernization Component”, and Component C “Project Implementation and Management”, but would not require significant changes to the project design. Additional activities under Component A include (i) additional household connections; (ii) additional metering; (iii) increased water and wastewater treatment plant capacity. In addition, Component B will include additional activities

for institutional modernization and construction supervision. Additional funds would also be allocated to Component C to cover additional expenses for project management required by the Project Implementation Unit (PIU).

Implementation

16. The AF and project restructuring does not require any changes to the implementation arrangements in place. The Azerbaijan Amelioration and Water Management JSC (AAWM) has the overall responsibility for project implementation. A Project Implementation Unit (PIU) has been established within the AAWM to manage day-to-day project management responsibilities. The PIU has been staffed adequately and functions well. The existing structures have proven to be very effective and the PIU at AAWM will remain the implementation unit in charge. The activities financed by this AF do not require additional capacity at the PIU.

Sustainability

17. The AF will support additional activities to scale-up on-going civil works in selected rayons. These activities are expected to increase the overall impact and benefits of investments, cover a larger number of utility customers, and strengthen the financial sustainability of capital investments. An additional 30 suburban villages will be supplied with gravity water and connected to a sanitation network providing an additional 120,000 people with piped water supply and sanitation services. The AF will also fund larger sanitation networks accompanied by larger capacity wastewater treatment plants. This would enable water utilities to collect and treat larger volumes of effluents, thus reducing the negative environmental impact from the use of septic tanks by households. An economic analysis has been conducted prior to decision meeting and its findings are included in the Project Paper. The AF will also contribute to regional development by providing sustained and improved services, and a greater positive impact on the health and quality of life of low-income households in select rural centers.

Lessons Learned from Past Operations in the Country/Sector

18. The proposed AF incorporates lessons learned from the original project and the National Water Supply and Sanitation Project. It also builds on the ongoing original project and will utilize its implementation structure and mechanisms which have proved successful.

Safeguard Policies (including public consultation)

The project falls under Category A for Environmental Assessment (EA) since it may provide financing for one or more wastewater treatment plants of considerable size and potential impact. Most sub-project investments in water supply, rehabilitation of infrastructure, and smaller wastewater treatment plants pose less risk. Prior to appraisal of the original project the client prepared an Environmental Assessment document which set out an environmental framework for screening, due diligence, mitigation and monitoring. The specific utility and sites locales have been determined during the implementation of the original project, and site-specific EIAs updated and approved for each selected site, which provide for the assessment of the associated environmental risks and put in place mitigation and monitoring mechanisms. Likewise, the possibility of small scale land acquisition was reflected in the existing Resettlement Policy

Framework, and specific social assessment reports including information on the land acquisition needs are under preparation by implementing agency for each selected site. These reports will provide for the assessment of the associated social risks and put in place mitigation and monitoring mechanisms before construction of wastewater and water treatment facilities have started. The project safeguards status has been extensively discussed and agreed to as part of the ISDS review meeting, which was approved by the RSC. Details are provided in the ISDS available at infoshop.

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