I. Project Context

Country Context

Uruguay is an upper-middle income country that has experienced strong growth rates over the past decade. In 2011, Uruguay’s growth rate reached about six percent and economists estimate that annual growth will stay around four percent for the remainder of the decade. Uruguay is renowned in Latin America for its high literacy rate, its large urban middle class, advanced education and security systems, high coverage and quality of public services, and relatively even income distribution. In April 2012, Standard and Poor’s raised Uruguay’s credit rating to investment grade. Uruguay is on the cusp of transitioning from a developing country to a developed country.

In the 2010 to 2015 National Budget, the Uruguayan Government identified “strengthening competitiveness through increased coverage, better quality of infrastructure and a more conducive business environment” and “protecting the environment by mitigating and adapting to the effects of climate change” as key to consolidating Uruguay’s economic development. The National Water Supply and Sanitation Company, Administración de las Obras Sanitarias del Estado (OSE), a financially self-sufficient state owned enterprise, can directly help promote these development goals through improving its environmental, economic and social sustainability.

II. Sectoral and Institutional Context

According to the UN’s Millennium Development Goals, one hundred percent of the Uruguayan population has access to potable water and adequate sanitation systems. Of this coverage, OSE provides 98 percent of the urban population with household connections and continuous service to potable water. The water bill represents approximately 0.96 percent of the income of the average Uruguayan family. OSE is also responsible for providing sewerage services to the entire country with the exception of the Municipality of Montevideo, which is served by the Municipality itself. OSE provides sewerage service to 43 percent of the interior of the country and treats 60 percent of the wastewater collected. The population that OSE does not provide water and sanitation services to has access to potable water (via wells and public stand pipes) and adequate sanitation (via septic tanks). OSE is working to expand household connections to potable water in rural communities and sewerage services in the interior.

In the early 2000s, Uruguay initiated a series of institutional reforms aimed at dividing policy-making, regulation and operational functions in the water sector. These reforms were cemented by a constitutional amendment, which declared the right to water a human right and made the provision of Water Supply and Sanitation (WSS) services the exclusive right of public entities. Prior to these reforms, OSE acted as the de facto policy maker, regulator and operator. Now, the Ministry of Housing, Land and the Environment (MVOTMA) is in charge of policy making. MVOTMA’s National Directorate for Water and Sanitation (DINAGUA) is responsible for formulating policies that pertain to WSS and water resource management, and MVOTMA’s National Directorate for the Environment (DINAMA) is responsible for the supervision of the water quality of water streams and control of wastewater discharge. The Regulator of Energy and Water Services (URSEA), a technically autonomous and decentralized executing unit, regulates the provision of power, fuels, and water supply and sanitation services. Its functions include regulating water prices and quality. OSE, the operator, is responsible for providing potable water and sewerage services to the entire country with the exception of Montevideo, which provides sewerage services to its population. The Departments are in charge of providing drainage services.

Over the past 10 years, the water sector has made important progress in defining and implementing a legal and institutional framework. Significant achievements include the creation of a Water Law, URSEA’s water quality regulations, the National Plan for Integrated Water Resource Management and regional integrated water resource management councils in the Laguna del Sauce and the Uruguay River. OSE has played a key role in the consolidation of the sector by providing its technical expertise in the policy debate and complying with the new regulations.

In its 24 year relationship with OSE, the Bank has seen OSE transition from a slow-moving, public utility to one of the most advanced utilities in the region. Early projects focused on improving OSE’s WSS infrastructure to expand coverage and enhance service. The ongoing Adaptable Program Loan Phase 2 (APL2) built on the progress made in earlier projects, but shifted the focus from infrastructure rehabilitation to modernization. The APL2 focuses on improving OSE’s transparency, accountability, attention to clients and efficiency. The APL2 helped...
establish an active non-revenue water program, an environmental management unit, and a modern commercial operative system. OSE’s jump in investment levels highlight this transformation; OSE increased its investments from US$8 million in 2003 to US$90 million in 2012. OSE’s delivery of water supply and wastewater collection and treatment services are now considered exemplary in the region. OSE has reached a point in its development where it can look beyond day-to-day operations and adopt measures to ensure its future sustainability.

Despite OSE’s significant accomplishments, OSE still has a number of areas that it needs to improve to ensure its future sustainability. First, OSE needs to improve the resiliency and reliability of its infrastructure as well as its capacity to plan for risk to meet current and future water supply and sanitation needs. Over the past two decades, OSE’s systems have faced operational challenges because of severe floods and droughts. For example, in 2007 the city of Durazno entered a state of emergency due to extreme floods. The Water Treatment Plant shut down for three days, and OSE had to bring in water trucks and distribute bottled water. The 2007 flood was one of the most significant floods Durazno had experienced, but it was not an isolated experience. The Water Treatment Plan in Durazno faced operational challenges due to floods in 2000, 2001 and 2009 as well. Uruguay has also been challenged by droughts. In 2009, the Department of Canelones suffered a drought so severe that the National Army and OSE had to step in to distribute water. The droughts have particularly affected the rural populations livelihoods. Surmounting infrastructure and logistic challenges will become increasingly important as extreme weather events become more frequent and water resources become scarcer. Climate models for Uruguay predict that over the next 50 years temperatures will raise by 2.5 degrees and the frequency and intensity of extreme weather events will increase. To mitigate these risks, OSE is focusing on investing in reliable water supply and sanitation systems, incorporating risk analyses into its decision making process and working with other agencies to coordinate responses to disasters.

Second, OSE needs to improve its efficiency in service provision through building on the synergies between the water and energy sectors. A significant source of inefficiency at OSE is a high level of non-revenue water (NRW). As part of a national program to increase efficiency, OSE is reporting its level of NRW losses to the central Government. OSE has made progress in reducing NRW over the course of the APL Projects. In addition to establishing a NRW program, OSE successfully reversed a trend of increasing levels of NRW losses. From 2006 to 2010, OSE recovered an annual average of 14.2 million m3, which represents annual savings of US$6.8 million. Nevertheless, OSE still has significant work to do as it could further reduce NRW by almost 20 million m3/year saving about US$9.5 million more per year. To further reduce losses and institutionalize the NRW program throughout OSE, the NRW team, drawing on the lessons learned from the APL Projects, is approaching NRW loss with a holistic vision that incorporates institutional, physical and social and environmental actions. Reducing NRW water loss will have a direct impact on OSE’s financial and operational sustainability.

Another source of inefficiency at OSE is the high level of energy consumption. OSE is the single largest energy consumer in Uruguay, making the company vulnerable to price swings in the energy market. Electricity costs currently account for 13 percent of total operating costs. In addition, OSE’s high consumption of energy makes it a key player in the nation’s efforts to respond to climate change and improve energy efficiency. In 2009, the government passed a law on energy efficiency (Law No. 18.597) in order to reduce greenhouse gas (GHG) emissions, increase competitiveness and assist in sustainable development. OSE’s current electricity intensity is 0.69 kWh per m3, which represents an opportunity to improve operational efficiency. A preliminary evaluation of OSE’s energy consumption indicated that short term measures could generate 12 percent savings in energy use and have a two to three year payback period. The government has also sponsored a national movement for energy efficiency in the public sector under which public organizations are encouraged to create energy efficiency plans. OSE is actively participating in this program and has made energy efficiency a companywide priority. OSE has begun conducting energy audits and has drafted strategic lines of action for energy efficiency at OSE.

Third, OSE needs to strengthen its management’s capacity to better and more effectively coordinate and plan for the future. During the implementation of the APL Projects, OSE’s management began focusing on not only the “what,” but also the “how” of service delivery, improving, among other areas, OSE’s customer service and monitoring and evaluation capacity. In an effort to consolidate and build on the achievements made during the APL program, OSE has prioritized improving corporate management, environmental stewardship and strategic planning. These improvements will become increasingly important to OSE’s sustainability to ensure reliable, high quality water service to Uruguay’s future generations.

To respond to these challenges in an efficient and effective manner, OSE’s management created a five year strategic plan that is focused on the following three pillars: (i) Investing in Reliable Infrastructure, (ii) Improving Operational and Commercial Efficiency, and (iii) Strengthening Utility Management. The OSE Sustainable and Efficient Project will play a key role in supporting OSE’s Strategic Plan.

III. Project Development Objectives

The Project Development Objective (PDO) is to increase the sustainability of OSE by improving the reliability and resilience of its water supply and sanitation systems, enhancing its efficiency, and strengthening its management capacity.

IV. Project Description

Component Name

Component 1: Investing in Reliable Water Supply Infrastructure.
Component 4: Knowledge Sharing and Project Management Activities.

V. Financing (in USD Million)

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<td><strong>Total</strong></td>
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VI. Implementation
The proposed Project will be implemented by OSE through the Gerencia de Programas con Financiamiento Externo (PFE), OSE’s unit in charge of managing projects with external financing. The same institutional arrangement was used for the completed first phase of the Adaptable Program Loan (APL1, P063383) and the ongoing second phase (APL2, P101432). The APL2 is proceeding smoothly with satisfactory ratings on procurement and fiduciary aspects. In addition, OSE has received satisfactory ratings in the APL1 ICR. The PFE, in coordination with other units, will also be in charge of procurement, financial management, monitoring and evaluation, and reporting.

VII. Safeguard Policies (including public consultation)

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VIII. Contact point

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