SUPPLEMENTAL CREDIT DOCUMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROPOSED SUPPLEMENTAL CREDIT OF SDR 2.2 MILLION
(US$3.2 MILLION EQUIVALENT)

TO
REPUBLIC OF SIERRA LEONE
FOR THE
URBAN WATER SUPPLY PROJECT

May 12, 2005

Water and Urban II
Africa Region
CURRENCY EQUIVALENT

Currency Unit = Leone (SLL)
US$ 1 = 2,836 SLL (as of May 2, 2005)

WEIGHTS AND MEASURES
Metric System

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ERR</td>
<td>Economic Rate of Return</td>
</tr>
<tr>
<td>GVWC</td>
<td>Guma Valley Water Company</td>
</tr>
<tr>
<td>GoSL</td>
<td>Government of Sierra Leone</td>
</tr>
<tr>
<td>ICR</td>
<td>Implementation Completion Report</td>
</tr>
<tr>
<td>IDA</td>
<td>International Development Association</td>
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<tr>
<td>NPA</td>
<td>National Power Authority</td>
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<td>PDO</td>
<td>Project Development Objective</td>
</tr>
<tr>
<td>SAR</td>
<td>Staff Appraisal Report</td>
</tr>
<tr>
<td>SDR</td>
<td>Special Drawing Rights</td>
</tr>
</tbody>
</table>

Vice-President : Gobind T. Nankani
Country Director : Mats Karlsson
Sector Manager : Eustache Ouayoro
Task Team Leader: Richard Verspyck
REPUBLIC OF SIERRA LEONE

URBAN WATER SUPPLY PROJECT

PROPOSED SUPPLEMENTAL CREDIT AND PROJECT SUMMARY

Borrower: Republic of Sierra Leone

Implementing Agency: Guma Valley Water Company

Amount and Terms: SDR 2.2 million
(US$ 3.2 million equivalent)
Standard IDA terms with a 40-year maturity, including
10 years of grace

Objective and Description: Financing outstanding payments for six works contracts
completed under the original credit. Project
restructuring and claims related to war interruptions
created a shortfall.

Benefits: The whole population of Freetown benefited from
improved water services associated with the contracts
in arrears. Settling the arrears will help improving
GVWC financial viability and contribute to overall
external creditworthiness of the country.

Staff Appraisal Report: Report No. 13309-SL

Project ID: P094848 (Supplemental Credit)
P002428 (Original Credit)

Map: None
A. Introduction

1. The following is a proposed supplemental credit of SDR 2.2 million (US$3.2 million equivalent) to Development Credit 2702-SL (Urban Water Supply Project), to permit financing the settlement of outstanding payments due to foreign and local contractors under IDA-financed contracts, as originally intended and documented in the Staff Appraisal Report (SAR) for the project.

B. Background

2. **Project Objectives and Description.** The original Credit in the amount of SDR24.5 million (about US$36 million equivalent) was approved on April 11, 1995, became effective on August 14, 1995 and closed on June 30, 2003, with an undisbursed balance of SDR 9,447.49, which was cancelled. The project’s primary objectives, as presented in the Staff Appraisal Report (SAR) were to: (i) improve water supply and sanitation services in Freetown; (ii) improve accessibility of these services to the urban poor; and (iii) ensure that water supply and sanitation services are sustained, by strengthening the sectoral institutions, especially Guma Valley Water Company (GVWC)—the public water utility in charge of Freetown’s water services,—and the agencies responsible for sanitation, and by identifying elements for private sector participation (PSP). The project initially encompassed the following main activities: (i) the rehabilitation and expansion of Freetown’s water system; (ii) the strengthening of GVWC; and (iii) the rehabilitation of Freetown’s sewerage system and the promotion of improved sanitation.

3. **Project Implementation and Restructuring.** The project was carried out in difficult conditions. The civil war interrupted the project’s implementation three times for a total of thirty-two months. Equipment and materials were plundered during the war, and/or spoiled during periods of heavy rainfall. Foreign consultants and contractors were obliged to evacuate the country several times. As the political and security situation of the country stabilized by mid-2000, GoSL requested urgent Bank assistance—in line with the Bank Group’s Interim Support Strategy—for the power, water and sanitation, health, transport and public management sector. The Bank responded by restructuring the entire portfolio, which entailed extending closing dates, increasing disbursement percentages and amending DCAs to address emergency needs. The project’s description was thus amended to allow for financing: (i) the overhaul and repair of power generation units that could not be funded under the Power Sector Rehabilitation Project; and (ii) emergency power generation and water supply in secondary cities. US$3.7 million of the credit funds were reallocated to finance those new activities. The closing date was extended from June 30, 2000 to June 30, 2002 and the disbursement percentages of all categories were increased to 100% of foreign and local expenditures.
4. The new activities started soon after the restructuring and were satisfactorily implemented by the National Power Authority (NPA) and the Sierra Leone Water Company (SALWACO), in charge of water services outside Freetown. The original activities of the project resumed in 2001. A further extension of the closing date to June 30, 2003 was granted to allow for completing all activities. Meanwhile, it appeared by mid-2002 that the Credit funds were insufficient to cover the project’s commitments. Withdrawal applications for several contracts had to be returned to GVWC and about US$2.8 million of completed works remained unpaid.

5. **Project Outcome.** The Implementation Completion Report (Report No. 26510 of December 24, 2003) found that the first two development objectives of the project were partially achieved. They would have been entirely achieved, had the population of Freetown not substantially increased with the flow of displaced persons during the war. The third objective was not achieved, particularly because the country situation made it an unlikely target for PSP. The ICR also found that the achievement of outputs had been very satisfactory, and allowed to increase water production capacity in Freetown by 55 percent and to extend access to water services to 70 percent of the population, and to provide basic services in secondary cities.

6. In assessing the project’s outcome OED upgraded the ICR’s assessment from Unsatisfactory to Moderately Unsatisfactory. OED noted the increased availability and access to water services and the positive efficiency of the project (the final ERR was higher than the SAR forecast; see para. 16). OED also noted that the Bank missed the opportunity to revise the development objectives in view of the country situation at the time of project restructuring.

C. Proposed Supplemental Credit

7. **Project Funding Gap.** At the time of the project restructuring, uncertainties remained about (i) the eventual completion of the contracts that were signed before the war; and (ii) the financial impact of the claims that could be raised by the contractors. Actually, all the pre-war contracts were completed and the war-related claims were settled for an amount of US$1.7 million. Together with the impact of foreign exchange variations and of the increased disbursement percentages after the restructuring, this created a funding gap for the project prior to its closing. In view of the then existing IDA allocation, the Bank suggested to explore the possibility of using further IDA budget support through Economic Recovery credits. The latter did not materialize as it appeared that the full repayment of the project arrears would not be consistent with the country policies regarding the reduction of commercial debt.

8. In view of the Bank policy established in similar cases, it was eventually agreed that the Bank should: (i) be prepared to provide the necessary resources to pay for legitimate claims; (ii) be specific about the intended purpose of the funds; (iii) seek incremental resources to ensure that IDA’s planned support to the country’s Poverty Reduction Strategy is not jeopardized; and (iv) establish that expenditures were incurred in a manner consistent with the respective contracts.
9. Therefore the proposed supplemental credit would provide additional resources that would allow GoSL to settle the legitimate claims of foreign and local contractors, without jeopardizing the implementation of the Poverty Reduction Strategy. All contractors' claims have been reviewed through a process comprising: (i) the confirmation by GVWC of the certificates for payment established by the supervising engineers; (ii) the substantiation of interest charges accrued on outstanding payments; and (iii) the deduction of partial payments in local currency made by GVWC after the closing date. The Region's procurement staff visited Freetown to monitor the review and its outcome, which were found satisfactory. The staff is also satisfied that the current investigation of INT regarding the misprocurement of goods under the original credit is not connected to any contract or contractors covered by the supplemental credit.

10. **Amount of Supplemental Credit.** The proposed supplemental credit in the amount of SDR 2.2 million (US$3.2 million equivalent) would retain the same objectives as the project. It would aim to complete the contractual payments outstanding under Category I (Civil Works) of Schedule 1 to the DCA since the closing of the project. The arrears-related contracts—which fall under Part A (1) (Rehabilitation and Expansion of GVWC's Water System) of the project description as stated in Schedule 2 to the DCA—are the following:

- Two works contracts for the rehabilitation and expansion of the distribution networks in Freetown (outstanding payments: US$1.54 M equivalent);
- One works contract for the rehabilitation of the water treatment plant supplying Freetown (outstanding payments: US$0.74 M equivalent);
- Two works contracts for the construction of storage reservoirs in Freetown (outstanding payments: US$0.37 M equivalent); and
- One works contract for the improvement of the water system of Kongo (outstanding payments: US$0.37 M equivalent).

11. **Implementation Arrangements.** Given the nature of the expenditures to be financed, the project procedures will be simplified. All payments are expected to be made on the basis of the verified outstanding amounts (including accrued interest), using the direct payment procedure. No procurement activity is required, beyond the due diligence carried out in preparing the supplemental credit. GVWC has established an acceptable accounting and reporting system. Independent auditors will audit the use of all IDA funds available under the supplemental credit and the audit reports will be submitted to IDA no later than six months after the end of the fiscal year.

12. **Retroactive Extension of the Closing Date.** It is proposed to re-open the Credit Account and to establish December 31, 2005 as the closing date of the supplemental credit. Re-opening the Credit Account will allow to finance retroactively expenditures that were eligible under the original Credit. A Completion Note will be prepared within six months after the Credit closes.

13. **Environmental and Social Aspects.** No environmental or social issues are associated with the settlement of arrears, which has no physical impact.
14. **Sustainability.** As mentioned above, the facilities built under the arrears-related contracts are adequately operated and maintained. The financial viability of GVWC is being strengthened under the ongoing Power and Water Project (Cr. 3945-SL), which provides technical assistance for improving commercial and financial performances.

15. **Risks.** The specific risks associated with the settlement of outstanding payments pertain to the materiality and legitimacy of the arrears. They have been mitigated by the thorough review of contractual claims carried out jointly by GVWC, GoSL and Bank staff, as part of the preparation of the supplemental credit.

16. **Benefits.** The contracts under which the arrears were accrued were completed to satisfaction and comprised essential elements of the restoration and improvement of basic water supply and electricity services that helped to mitigate the humanitarian crisis faced by the country. The ICR estimated the economic rate of return (ERR) of the urban water supply investments at 12 percent, to be compared to the SAR estimate of 8 percent. The increase of the ERR results from the increased demand for water generated by the inflow of population.

17. Settling the arrears would also help restoring the credibility of GVWC vis à vis the foreign suppliers at a time where further capital investments are needed. In addition, the Supplemental credit would be in line with the Bank’s support to the PRSP objective of improving Governance and establishing responsible public management. Clearing up these arrears will contribute to overall external creditworthiness.

18. **Justification of the Supplemental Credit.** The proposed supplemental credit meets the requirements of OP 13.20, as follows:

(a) The cost overrun is due to the conjunction of: (i) the reallocation of funds carried out in the portfolio restructuring; (ii) unfavorable exchange rate variations between the SDR and the main currency of payment of the contracts; and (iii) the increase of disbursement percentages.

(b) As of the closing date of the Credit, the Borrower was in compliance with all covenants of the DCA. However, GVWC had been unable to meet the financial covenants of the Project Agreement, which were out of reach in the country circumstances, as noted by OED. There is no outstanding audit report for GVWC.

(c) The conjunction of the post-conflict urgent needs and of the prior contract commitments to meet water demand made it impossible to reduce the scope of the project to fit the available resources without significantly impairing the project's capacity to achieve its objectives.

(d) GoSL is not in a position to obtain funds from other lenders to pay for amounts outstanding under IDA-financed contracts and is unable, given its tight fiscal constraints and the substantial financing requirements of its poverty reduction strategy, to provide the necessary funds from the budget.
(e) The processing of a supplemental credit, which clearly associates the arrears with the original project, provides the most direct and ringfenced mechanism to settle the outstanding payments.

(f) Recent Bank missions to Freetown found that the facilities that were built under the project are adequately operated and maintained. Production facilities operate at full capacity. In addition, GoSL evidenced its commitment to solving the contract arrears issue by transferring Leones 300M (US$122,000 equivalent) to GVWC in April 2004 to pay a portion of the arrears.
REPUBLIC OF SIERRA LEONE
PROPOSED SUPPLEMENTAL CREDIT TO
THE URBAN WATER SUPPLY PROJECT

ESTIMATED ADDITIONAL COSTS AND FINANCING SOURCES
(In US$ million)

**COSTS**

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<th>Foreign</th>
<th>Total</th>
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<td>Civil Works</td>
<td>0.22</td>
<td>2.98</td>
<td>3.20</td>
</tr>
<tr>
<td><strong>TOTAL COSTS</strong></td>
<td>0.22</td>
<td>2.98</td>
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**FINANCING SOURCES**

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<tr>
<td><strong>TOTAL COSTS</strong></td>
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<td>2.98</td>
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**SUMMARY OF PROPOSED PROCUREMENT ARRANGEMENTS**
(In US$ million)

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<th>Project Element</th>
<th>Procurement Method</th>
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<td></td>
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<td>NCB</td>
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<tr>
<td>Civil Works</td>
<td>3.20</td>
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</tr>
<tr>
<td><strong>TOTAL</strong></td>
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<td></td>
</tr>
<tr>
<td>IDA</td>
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1 All contracts have been already awarded under ICB
### ALLOCATION AND DISBURSEMENT OF IDA SUPPLEMENTAL CREDIT
(In US$ million)

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<th>Category</th>
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<tr>
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### ESTIMATED DISBURSEMENT SCHEDULE
(In US$ million)

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<tr>
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<tr>
<td>Cumulative</td>
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ANNEX 2

REPUBLIC OF SIERRA LEONE
PROPOSED SUPPLEMENTAL CREDIT TO
THE URBAN WATER SUPPLY PROJECT

TIMETABLE OF KEY PROJECT PROCESSING EVENTS

(a) Time taken to prepare: Four months
(b) Prepared by: Government with IDA assistance
(c) Appraisal/Negotiations: May 11-12, 2005
(d) Planned Date of Effectiveness: July 30, 2005
(e) Completion: September 30, 2005
(f) Closing Date: December 31, 2005