

PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: AB7262

Project Name	HN WSS Modernization Additional Financing
Region	LATIN AMERICA AND CARIBBEAN
Country	Honduras
Sector	Water supply (47%);Wastewater Treatment and Disposal (26%);Sub-national government administration (12%);Sanitation (8%);Central government administration (7%)
Project ID	P144357
Parent Project ID	P103881
Borrower(s)	GOVERNMENT OF HONDURAS
Implementing Agency	Secretariat of Finance (SEFIN)
Environment Category	[] A [X] B [] C [] FI [] TBD (to be determined)
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1. Country and Sector Background

In 2003, Honduras passed the Water and Sanitation Sector Framework Law (*Ley Marco*) that mandated the decentralization of the water and sanitation provision to the municipal level¹ aimed at expanding coverage and ensuring service quality and affordability to the population. This law also created new national sector entities: the National Council for Water and Sanitation (CONASA), integrated by representatives from all relevant sector institutions and in charge of adopting policies and strategies and planning the development of the WSS sector; and the Water and Sanitation Sector Regulator (ERSAPS) responsible for the standardization, coordination and regulation of the provision of drinking water and sanitation services in the country. Although there have been relevant advances, the ongoing Monitoring Country Progress in Water and Sanitation (MAPAS, P132281) initiative reveals the sector still faces significant challenges to underpin progress in water supply and sanitation. These include significant financial gaps, the need to raise the sector profile among political priorities within the high-level national agenda, ensuring the functionality of existing institutions for effective sector governance, planning, and regulation, and an incomplete decentralization of service provision. This is associated with a still on-going process of consolidation of decentralized urban service providers.

The World Bank, among other donors, plays a key role in promoting the continuity of the Sector Framework's implementation. The PROMOSAS project is emblematic in the sector reform and is currently supporting around 7 mid-to-small-size cities representing a total population of 1 million inhabitants to adopt autonomous service provider models through a combination of technical assistance (TA), short-term improvement measures, and investment funding; fostering

¹ By transferring service provision from the National WSS Utility (SANAA) to municipal autonomous service providers and/or by promoting the creation of autonomous service providers in those municipalities already operated directly by municipalities.

transparency and accountability; and increasing professional capacities in the national sector institutions.

2. Objectives

The Project Development Objectives (PDO) are: (a) to improve the sustainability, efficiency, and reliability of the Recipient's water supply and sanitation (WSS) services in eligible municipalities; (b) to improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law; and (c) to improve the Recipient's capacity to respond promptly and effectively to an eligible emergency.

3. Rationale for Bank Involvement

The Government of Honduras (GoH) officially requested the Additional Financing (AF) with the purpose of consolidating and expanding the water sector reform and its impact on the population in terms of access to a sustainable and efficient WSS service, emphasizing that the proposed AF is fully aligned with the Government priorities laid out in the Country Vision (2010-2038) and National Plan (2010-2022). The proposed activities are also consistent with the World Bank Group's Country Partnership Strategy (CPS) 2012–2014 (Report No.63370-HN, discussed by the Executive Directors on November 1, 2011) and would support two of the three Strategic Objectives laid out in this CPS: *Enhancing Good Governance, and Expanding Opportunities through Reducing Vulnerability*. The AF would also enable the continuity of the World Bank's engagement in the WSS Sector and strengthen its support to the implementation of the Honduras' WSS framework. The AF would also strengthen the Project's alignment with WSP activities, especially for the work with new municipalities (small towns) and institutional strengthening activities, leveraging the Bank support in the Country and the Sector. Specifically, the AF activities would allow the Project to meet its original targets and planned activities, focusing on service quality and sustainability within current municipalities (*covering the financing gap*). Furthermore, they would enhance the contribution to the ongoing decentralization process encouraged by the Framework Law by incorporating new municipalities that were not prioritized under the original Project's eligibility criteria² (*scaling up*).

4. Description

The Project will support the following five components (revised from the parent original Project, in order to accommodate Additional Financing, include an Immediate Response Mechanism (IRM) as a fifth component, and to adjust the description of activities of components 1 and 3):

² The eligibility criteria to select new municipalities have been revised with the purpose of expanding the eligible group to small-size municipalities and to add a poverty focus criteria. The parent Project focused on municipalities within the range from 40,000 to 300,000 inhabitants. From the 9 municipalities included in this range, PROMOSAS has worked with 6, and there is no perspective of working with any of the three remaining ones. On the other hand, several municipalities with a population range from 10,000 to 40,000 have expressed their interest to participate in the Project. The work from PROMOSAS with small-size cities will also tie in with WSP's Small Towns NLTA (P132283), thus bringing synergies to the World Bank's support to this area and to the broader WSS Sector. The poverty criteria for the AF establishes that the Project will focus on municipalities classified as C or D according to the Municipal Development Index (GoH, Department of Information and Statistics).

Component 1: Supporting eligible municipalities to create autonomous WSS service providers and invest in efficiency, rehabilitation, and expansion of WSS service delivery

The component supports the implementation of the Sector framework law (“Ley Marco”) in small-medium-size cities through a combination of technical assistance for reforms and investments for infrastructure. Specifically, the Project supports the creation of autonomous municipal service providers, following the Sector Framework. Municipalities with an urban population between 10,000 and 300,000 inhabitants and classified as C or D under the Municipal Development Index (see footnote 2), that intend to transfer their water supply or sanitation services to a municipal service provider as mandated by the Ley Marco are eligible to participate in this component.

This component uses a demand-based stepped approach to support municipalities during all reform steps, in which in Step 1, municipalities receive technical assistance (TA) focused on designing a management model. Once the proposed model has been sent to and reviewed by ERSAPS (the regulator), municipalities qualify for Step 2 assistance including support to provide the service providers with tools (institutional and operational), and start improving the efficiency of service provision. Once services are transferred, municipalities move to Step 3, and qualify for investments in system rehabilitation and expansion. To the date, 7 municipalities (including one association of small municipalities) are participating in Component 1.

Sub-component 1A: Technical Assistance for transfer preparation: This Sub-Component consists of providing TA to the participating municipalities while they design the new service provider and plan and implement the services transfer process (whether from SANAA or from a municipal department).

Sub-component 1B: Support to equip service providers and improve their efficiency: Once a municipality has successfully identified and designed a management model, it obtains support in creating the municipal WSS service provider, as planned for in the Ley Marco. This sub-component finances activities such as the rehabilitation or construction of offices and the acquisition of basic management tools. This sub-component also supports rapid efficiency gains, including: (i) Technical (such as leak detection, network sectorization, meter installation), (ii) Commercial (billing and collection, reduction of non-revenue water). Municipalities and service providers will be free to propose activities of their choice within a maximum investment amount as long as they are consistent with the Project’s Operations Manual.

Sub-Component 1 C: Investment for system rehabilitation and expansion: As a complement to the efficiency improvements reached under Sub-Component 1B, this sub-component finances investments in infrastructure after the service providers start operating the system. This sub-component enables service providers to expand and improve services. Investments funded under this component can include rehabilitation, connection to and expansion of water supply and sewer networks, on-site sanitation facilities, and wastewater treatment systems. Water supply investments can include coverage extension, rehabilitation of existing networks, tanks and treatment plants, and the development of new water production capacity. Piped sewerage investment can include rehabilitation and expansion of standard, small-bore, and condominium systems. Wastewater treatment investments can include simple treatment systems such as stabilization ponds, artificial wetlands, and communal septic tanks. Investments are limited to an

agreed list of facilities and terms of implementation, as per Project's Operations Manual. Service providers have the freedom to decide which investments they would like to execute within the support from an external TA provider and following the Operations Manual.

Component 2: Tegucigalpa Non-Revenue Water Reduction

The component supports a performance-based service contract with a private company to reduce technical and commercial losses in a limited geographic area of the municipality of the Metropolitan District. This component aims to improve, in the short term, the operative situation of the WSS service provider in Tegucigalpa. By freeing up water production capacity, continuity of service delivery can be improved and water supply services expanded. International experience shows that good financial paybacks are possible with well-designed Non-Revenue Water (NRW) reduction programs. A performance-based service contract provides an efficient means to achieve significant improvements in operational and financial efficiency, thereby creating immediate benefits and fostering a positive dynamic to support further reform. The activities of this component are funded by the PROMOSAS parent Project only, thus the Additional Financing has no funds assigned to this component.

Component 3: Institutional strengthening of national and regional sector institutions

This component provides support for the water sector planning entity (CONASA), the regulating agency (ERSAPS), and the national utility (SANAA) to fulfill their new roles in a timely, efficient, and transparent manner. The component has 3 sub-components: (i) Sub-Component 3A: Technical assistance to national institutions; (ii) Sub-component 3B: Severance payments; (iii) Sub-component 3C: Preparatory activities for Tegucigalpa transfer³.

Component 4: Project management

This component finances the cost of salary, travel, and general operating of the project management unit (UAP, “*Unidad Administradora de Proyectos*”). In addition, this component finances monitoring and evaluation (M&E) activities, audits, and other project management activities on governance and transparency and strengthening of the implementing agencies through participation in training and study tours, purchase of vehicles and equipment, and upgrading of the working environment.

Component 5: IRM Contingent Component

This component provides support to respond to an eligible emergency. Inclusion of this component builds on the flexibility provided by the World Bank Operational Policy 8.00 that allows using simplified procedures and rapid restructuring of project portfolios to meet crises and emergency needs. Accordingly, implementation arrangements as well as application of fiduciary and safeguard policies, detailed in a specific country-wide IRM Operations Manual, seek to ensure smooth implementation based on rapid and effective disbursement of funds undisbursed and uncommitted.

³ Sub-components 3B and 3C will not receive funds from the Additional Financing. They were already implemented by the parent Project.

The AF would cover the financing gap identified in Component 1 in order to complete activities for which indicator and beneficiary targets may otherwise not be achieved within the original Project amount and timeframe; and scale up the Project to incorporate new municipalities to enhance the Project's development effectiveness, as well as to include additional institutional strengthening activities under Component 3 for national and regional WSS Sector Institutions.

5. Financing

The Bank will finance eligible expenditures under the AF Credit accordingly to the percentages specified in the disbursement schedule. There is no counterparts funds foreseen from the National Government, however, municipal counter-part funds for component 1 activities are included.

Source:	(\$m.)
BORROWER/RECIPIENT ⁴	0.9
International Development Association (IDA)	10
Total	10.9

6. Implementation

The original Project has been well-performing and has accomplished significant results particularly on the institutional side. However, the creation of new and fully operational WSS service providers was found to be more costly and time-consuming than expected at appraisal in 2007 and the mainstreaming and acceptance by municipalities of some aspects relevant to the sustainability of the service provision, such as cost-recovery, tariffs and metering, proved to be a longer process than initially anticipated. As a consequence, the ratings related to Implementation Progress and Progress Towards Achievement of the PDO of the Project have been rated Moderately Satisfactory for the past 12 months. In this context, the additional funds under the Additional Financing (AF) and the extended implementation time proposed (3 years) will be key for ensuring sustainability, efficiency and reliability of the service providers supported by the Project and thereby moving towards the achievement of the PDO, by complementing the investments needed.

The Secretariat of Finance (SEFIN) will continue as the main implementing agency through a dedicated Project Implementation Unit (PIU) operating in the framework of the Project's Administrative Unit (UAP), which provides transversal services to several IFIs projects. SEFIN will maintain overall coordination, technical and fiduciary responsibility for the Project and will keep working in coordination with the Grupo Interinstitucional de Coordinacion (GIC), comprising all of the Project's participating institutions - particularly the National Water Sector Institutions (CONASA, ERSAPS and the national WSS utility, SANAA) - and the participating municipalities, including the municipality of Tegucigalpa.

Implementation of the AF will follow the same implementation structure as the original Project, including the same financial management and procurement structure. Regarding the procurement arrangements, the last version of the Procurement and Consultant Guidelines (2011) will apply

⁴ From municipalities participating in Component 1.

instead of the 2006 version, which currently governs the project. The Operations Manual will be updated accordingly.

Implementation is expected to progress speedily once the AF is effective given the continuity of the proposed activities and the PIU/UAP's familiarity with the implementation arrangements.

7. Sustainability

The risk of poor sustainability of the investments at the local level has been gradually mitigated in the parent Project by the implementation of a series of Technical Assistance activities. In addition, the overall level of investments foreseen under Component 1 is fairly small, thus reducing the likelihood that operation and maintenance of the relatively small works would exceed the capacity of the utilities. However, some current PROMOSAS municipalities are struggling to reach financial cost recovery, and the Project actors have recognized that the provision of a good quality and sustainable service may require additional support and time. The Additional Financing of PROMOSAS was conceived exactly to consolidate the on-going sustainability and service quality efforts, and it is also bringing additional implementation time. Specifically, the Project includes activities that aim at improving continuity, cost recovery, and commercial efficiency of the utilities, while ensuring that these activities are carried out in a social and environmentally sustainable way. Finally, the Project also builds on efforts to strengthen the institutional capacity of the national and regional WSS sector institutions aimed at guaranteeing the proper performance and long-term sustainability of the sector.

8. Lessons Learned from Past Operations in the Country/Sector

Lessons from previous studies, Bank-assisted projects, and partner activities in the country have yielded the following lessons: (a) the Bank may need to mediate the many, sometimes conflicting, interests of diverse government institutions; (b) various Bank interventions must also be harmonized and coordinated with support of other donors; (c) ad hoc devolution of services to municipalities, privatization, and incentive structures may result in unsustainable coverage gains; (d) experience from the passage of the 1990-91 Municipal Law shows the need to promptly develop and apply the legislation's tools in order to demonstrate benefits of the modernization; and (e) attractive financing rules at the municipal level are key to ensure buy-in of the municipalities in the process and success of the stepped approach.

The work done by the Bank team with the Government and with other stakeholders during the preparation and implementation of the original Project shows the following lessons learned, which are being incorporated into the design of the AF activities: (a) operationalizing newly created WSS utilities requires significant financial support and time; (b) efficiency and financial sustainability improvements in the utilities' performance require targeted interventions and, on top of that, buy-in of municipal authorities in order to adopt sensitive measures such as metering and tariff's reviews; and (c) the transfer of service from the National WSS utility to the municipal level and the consequent rationalization of the number of staff imply severance payments which requires significant funding and lengthens the transfer process.

9. Safeguard Policies

(i) *Environmental*: The Project and its AF are categorized as B for the Bank's safeguards purposes, given the small scale of physical investments and that no significant environmental impacts are foreseen. The parent Project has been consistently rated as Satisfactory in terms of compliance with its environmental safeguards⁵. The Project Environmental Social Management Framework (ESMF) was updated and approved by the Bank and disclosed within the country and in the InfoShop on March 11, 2013. For more details, see the Project/AF ISDS.

(ii) *Social*: The Project currently has both an Indigenous Peoples Planning Framework (IPPF) and an Involuntary Resettlement Policy Framework (IRPF). The parent Project produced very minor impacts as related to the Bank's social safeguard policies. Specifically, the IPPF did not produce any Indigenous Peoples Plans so far (none of participating municipalities had investments that would have affected indigenous lands). On the other hand, the Project's IRPF did produce one small-scale Abbreviated Involuntary Resettlement Plan for one affected family. Although impacts during the AF are expected to be minor, a lesson learned from the original project is the need to improve the detection and reporting of potential cases from the municipal to the central levels of the program to support and ensure timely preparation of plan(s) and Bank approval. The AF will provide funds to enhance the application of the detailed steps established by each framework in order to identify potentially affected people as well as potential positive and negative impacts on indigenous peoples in the new project areas, in order to allow an appropriate social analysis and free, prior and informed consultation process in these areas.

(iii) *Legal*: An assessment of the scaling up of the Project concluded that some of the potential new municipalities could be located in trans-boundary basins. Therefore, given the type of interventions contemplated under Component 1 and the potential location of new beneficiary municipalities, the Bank team has decided to trigger OP 7.50 *Projects on International Waterways* for the overall Project (PROMOSAS and AF). The Bank team has assessed the interventions of the Project in the context of OP 7.50 and concludes that while OP 7.50 applies to the Project, the Project meets the criteria for exception to the riparian notification requirement laid out paragraph 7(a) of said Policy, due to the expected nature of the planned interventions (consisting mainly of rehabilitations or minor additions to existing schemes)⁶. This exception was processed and approved by RVP on March 5, 2013. The exception to notification Memo highlights, however, that in the event that the Project's works and activities in municipalities located in any trans-boundary basin should exceed the original scheme, change its nature, or so alter or expand its scope and extent as to make it appear as a new or different scheme, a notification process will be carried out in accordance with OP/BP 7.50 procedures. The ESMF makes reference to this procedure.

10. List of Factual Technical Documents

World Bank Documents:

⁵ The environment safeguards triggered for the Project are Environmental Assessment (OP/BP 4.01), Natural Habitats (OP/BP 4.04), and Physical Cultural Resources (OP/BP 4.11). A concise environmental safeguards review that reflects the contents of the Safeguard Checklist for Additional Financing is available in the Project files.

⁶ An analysis of the previous investments carried out in the existing 7 municipalities of the parent project shows that activities and works essentially involved minor additions and rehabilitation of ongoing schemes, such as rehabilitation of existing networks or plants, cleaning of wells or repair of tanks, which did not adversely change the quality or quantity of water flows. The same kinds of interventions are expected in the new municipalities.

- Project Appraisal Document: Honduras Water and Sanitation Sector Modernization Project (P103881). World Bank, report 39570-HN, 2007.
- Honduras: Strategy and Action Program for WSS in Small Towns (P132283). The World Bank Water and Sanitation Program. *In progress*.
- Honduras: Water and Sanitation Public Expenditure Review. World Bank. *In progress*.
- Monitoring Country Progress in Water Supply and Sanitation (MAPAS) Initiative (P132281). The World Bank Water and Sanitation Program. *In progress*.
- Country Partnership Strategy (CPS) 2012–2014. World Bank, report 63370-HN, 2011.

Government Documents:

- Visión de País 2010-2038 y Plan de Nación 2010-2022. República de Honduras. 2010.
- Plan Estratégico de Modernización del Sector de Agua Potable y Saneamiento. República de Honduras. 2005.

Laws and Regulations:

- Ley Marco del Sector de Agua y Saneamiento. Decreto 118-2003, República de Honduras. 2003.

11. Contact point at World Bank and Borrower

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