1. Project Objectives and Components

a. Objectives

1. Strengthen the Ministry of Environments (MOE) capacity to coordinate and implement projects;
2. reduce the discharge of partially and untreated sewage into the Baltic;
3. restore and enhance the surface and groundwater quality in Haapsalu;
4. improve the quality, reliability and cost efficiency of water supply and sanitation services;
5. improve operational efficiency and management in Haapsalu Veevark (HV) - the water utility, now a joint stock company;
6. promote management of point and non-point source pollution in Matsalu Bay; and
7. promote development and sustainable management of areas around Matsalu Bay and adjacent coastal areas.

b. Components

Total Costs ($ millions) were: Support to Project Implementation Unit (3%); Water Supply and Distribution (7%); Sewerage Networks ((21%); Wastewater Treatment Plant (30%); Twinning, TA and Training (5%); Environmental Management of Matsalu Nature Reserve and Catchment (25%); Lihulu (8%)

c. Comments on Project Cost, Financing and Dates

Only $30,000 of a planned $440,000 was spent on TA for the Project Implementation Unit (PIU). All contracts were won by lead Estonian firms despite the use of ICB. The Eco-Tourism component of $90,000 was dropped.

3. Achievement of Relevant Objectives:

1. The Ministry developed skills in planning and management of large internationally funded projects with both investment and institutional components;
2. water quality in the Matsalu and Haapsalu Bays was improved and reductions of direct discharge and improved treatment efficiency enabled effluent to meet all regional environmental standards;
3. discharge of untreated water was reduced improving both surface and groundwater quality;
4. coverage by connection to water and sewerage network increased from 67 to 90%, water losses per km of pipe were halved and energy savings of 30-50% were achieved at pumping stations.
5. HV has been established as a joint stock company with a stable management structure;
6. environmental monitoring and management practices improved throughout the project area; and
7. processes for active environmental management of key coastal eco-zones were established and overgrowing of coastal grasslands was arrested.

4. Significant Outcomes/Impacts:

1. MOE and the Municipality gained extensive hands-on experience of international procurement procedures, negotiation and modern financial management methods;
2. savings in procurement costs and winning of ICB bids by local contractors led to substantial savings for HV, allowing the addition of a pump modernization sub-component;
3. experience was gained in decentralized capacity building and transformation of government owned services into...
companies;
4. participatory environmental management had significant developmental impact at multiple levels - "it changed the way we think";
5. An exemplary monitoring system has contributed to international efforts to establish WS&S benchmarks.

5. Significant Shortcomings (including non-compliance with safeguard policies):
1. Water demand was not predicted well, leading to a shortfall of revenue and an over-dimensioned flow capacity for the wastewater plant - average incoming flow presently is 3000 m³/d compared to a design capacity of 7,240 m³/d;
2. the ex-post ERR for the baseline case was only 4.3% as a result of the unanticipated declines in operating revenues - the operating margin was only 40% of the SAR projection and cost recovery covenants could not be met. This was, however the first such project in Estonia and only part of the environmental benefits were quantified in monetary terms;
3. the municipality was not ready to assume foreign exchange risk and lack of cover has now created significant repayment difficulties - "choosing the US$ as a loan currency was a mistake" (comments from MOE.) The municipality remains committed to sustaining the improvement in service quality and environmental standards.

6. Ratings:

<table>
<thead>
<tr>
<th>Outcome</th>
<th>ICR</th>
<th>OED Review</th>
<th>Reason for Disagreement /Comments</th>
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<tbody>
<tr>
<td>Institutional Dev.</td>
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<td></td>
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<tr>
<td>Sustainability</td>
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<td>Bank Performance</td>
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<tr>
<td>Borrower Perf.</td>
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<tr>
<td>Quality of ICR</td>
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</tbody>
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NOTE: ICR rating values flagged with '*' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:
1. Focus on supporting infrastructure improvements in urban areas can effectively support complementary actions in adjacent coastal area;
2. skills gained through participatory environmental planning and management can be applied to a wide range of activities including municipal and community development;
3. demand estimates should take account of the approximate elasticity of demand and comparable experience in other transition economies - for instance the decline in industrial demand as uneconomic industries close down.

8. Assessment Recommended? ☑ Yes  ● No

9. Comments on Quality of ICR:
Comprehensive and well written but too long. While the annex presents model indicators for water supply, there is no corresponding table of pre and post-project environmental monitoring indicators. Comprehensive comments from co-financiers and Estonian Agencies reflect the close interest and high level of TA/political support for what was a comparatively small project.