DOCUMENT OF THE WORLD BANK

RESTRUCTURING PAPER

ON A

PROPOSED PROJECT RESTRUCTURING

OF

BR PERNAMBUCO SUSTAINABLE WATER

APPROVED ON JANUARY 14, 2010

TO

STATE OF PERNAMBUCO

WATER

LATIN AMERICA AND CARIBBEAN

Regional Vice President: Jorge Familiar Calderon
Country Director: Martin Raiser
Senior Global Practice Director: Guang Zhe Chen
Practice Manager/Manager: Rita E. Cestti
Task Team Leader: Marcos T. Abicalil
## I. BASIC DATA

### Product Information

<table>
<thead>
<tr>
<th>Product Information</th>
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<tbody>
<tr>
<td>Project ID</td>
<td>Financing Instrument</td>
</tr>
<tr>
<td>P108654</td>
<td>Specific Investment Loan</td>
</tr>
<tr>
<td>Original EA Category</td>
<td>Current EA Category</td>
</tr>
<tr>
<td>Full Assessment (A)</td>
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</tr>
<tr>
<td>Approval Date</td>
<td>Current Closing Date</td>
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<tr>
<td>14-Jan-2010</td>
<td>30-Sep-2017</td>
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### Organizations

<table>
<thead>
<tr>
<th>Organizations</th>
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<tbody>
<tr>
<td>Borrower</td>
<td>Responsible Agency</td>
</tr>
<tr>
<td>State of Pernambuco</td>
<td>State Government of Pernambuco, State Secretariat of Planning and</td>
</tr>
<tr>
<td></td>
<td>Management of Pernambuco - SEPLAG</td>
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### Project Development Objective (PDO)

Original PDO

The Project development objective is to improve sustainable water supply and sanitation services for the population residing in the Capibaribe river basin and MRR.

### Summary Status of Financing

<table>
<thead>
<tr>
<th>Ln/Cr/Tf</th>
<th>Approval</th>
<th>Signing</th>
<th>Effectiveness</th>
<th>Closing</th>
<th>Net Commitment</th>
<th>Disbursed</th>
<th>Undisbursed</th>
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<td>IBRD-77780</td>
<td>14-Jan-2010</td>
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<td>15-Jun-2010</td>
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<td>190.00</td>
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### Policy Waiver(s)

Does this restructuring trigger the need for any policy waiver(s)?

No

## II. SUMMARY OF PROJECT STATUS AND PROPOSED CHANGES
A. Project Status

1. The Pernambuco Sustainable Water Project was approved by the Board on January 14, 2010 and became effective on June 15, 2010. The original Project cost was estimated at US$410 million co-funded by an IBRD loan of US$190 million and US$220 million by the State of Pernambuco. To date, US$126.80 million or 66.7 percent of the loan has been disbursed, 95.7% of loan proceeds have been committed to ongoing or completed contracts and the remaining funds are committed to advanced procurement processes. The Project Development Objective (PDO) is to improve sustainable water supply and sanitation services for the population residing in the Capibaribe river basin and in the Metropolitan Region of Recife (MRR).

2. The project was first restructured in 2015, with an extension of the Project’s closing date by 22 months to September 30, 2017, to allow for the completion of major project activities essential to achieving the PDO. Additional minor changes and adjustments to the original Loan Agreement were requested by the Borrower, including: (i) revisions to the Project implementation agencies; (ii) minor revisions to the Project scope; (iii) some adjustments to comply with updated Bank’s procurement guidelines; (iv) reallocation of loan and counterpart resources among components and activities in accordance with scope adjustments; and (v) modifications to the Results Framework.

3. Project implementation experienced significant delays during the procurement process for a large turnkey contract and a few result-based contracts. Other factors that contributed to delays were: (i) the weak capacity of project implementing agencies at early years of implementation; (ii) the initial lack of understanding of Bank policies and procedures on procurement, which in many cases resulted in the unsuccessful bidding processes; (iii) the need to align the Bank safeguards requirements with Brazilian policies, especially related to counterpart financed resettlement activities; (iv) the competition with the federal government’s infrastructure investment program (“Programa de Aceleração do Crescimento” – PAC), which overburdened teams that had to implement several investments simultaneously; (v) the lack of detailed and up-to-date engineering designs at Project start, required many revisions during implementation; (vi) three major natural disasters – floods in 2010/2011, drought in 2013-2017 and floods in 2017 – affected implementation as Project teams and resources were needed for recovery and reconstruction activities.

4. Performance Ratings: The PDO and the IP ratings are currently rated Moderately Satisfactory (MS). However, there are several factors that suggest an upgrade in both PDO and IPs rating by the next ISR, namely: (i) all works have been contracted and a number are reaching final stages of implementation; (ii) disbursements have picked-up recently; and (iii) and a much more capable project management team is in place, who has a much stronger capacity to supervise contracts and coordinate inputs and activities. As a result, the two PDO indicators are advancing and in line to be achieved by the project closing. With regard to the 7 intermediate indicators, 3 were already achieved and 4 are advancing and in line to be achieved.

5. Progress by Component: To date, the Project has been able to deliver results on the ground in all its components:

- Component 1 - Water Resources Management and Institutional Development are the following: (i) The State Water and Climate Agency (APAC) is fully operational; (ii) the State Regulatory Agency (ARPE) has set a new tariff model for WSS services; (iii) state capacity to monitor water resources and climate has significantly improved with a much denser automatic, real time monitoring network and a 24/7 situation room, now even more robust with a Band S meteorological radar fully operational; (iv) participatory management of water resources has been strengthened through 11 new water users associations and river basin committees; (v) new flood modelling has been developed for
flood prone areas of the state; (vi) the state territory is now covered with state of the art aerial survey/digital
mapping, which is available to the public through the Internet (www.pe3d.pe.gov.br). Other activities are being carried
out currently, such as updating the state WRM plan, the study to start water use charging, the study to assess the
conditions of the state's main groundwater systems, the development of management models for rural WSS, etc.

- Component 2 - Improving Efficiency in the Provision of Water Supply and Sanitation Services, for increasing
supply and improving efficiency of water services, are being implemented: (i) equipment for water supply monitoring
and pressure control is now operational; (ii) a results-based contract for improving water supply services and reducing
non-revenue water in the city of Olinda (500,000 inhabitants) is being carried out and the two initial stages are
completed; works for improving water supply and reducing non-revenue water in the hills of Recife are also being
carried out.

- Component 3 – Water Supply and Sanitation Services Expansion, (i) the works for the implementation of
sewerage systems in the town of Surubim are being executed and the contract for the construction works for the
sewerage services in the town of Santa Cruz do Capibaribe (turnkey contract) is signed and effective; (ii) engineering
designs for water improvements and sewerage services in several cities in the Capibaribe river basin are being carried
out; (iii) works to augment water supply to the Agreste region is completed and improvements in hydraulics,
mechanics and power systems are under way. Remaining works to rehabilitate and reduce risks in the area around the
Jordão Water Supply Service Reservoir are ongoing. Counterpart financed works to increase water supply in the MR of
Recife through the construction of the Pirapama Water System is completed.

B. Rationale for Restructuring

6. The proposed restructuring aims at extending the project closing date by 18 months, from September 30, 2017
to March 30, 2019. This would be the second extension of the Project, for a cumulative amount of 40 months from the
original closing date and is needed to complete ongoing works and will not require any changes to the PDO nor trigger
new safeguard policies.

7. A total of US$46.3 million has been disbursed against completed contracts, while US$ 135.5 million is committed
against ongoing contracts. To date, this totals US$181.8 million, or 95.7% of the Loan Amount. The project still has a
total of US$13.8 million of contracts that are being procured, which include some rapid response activities related to
recent extreme drought and flood events in the state. The amount is more than the remaining available Loan balance
of about US$ 8 million. The State decided to move ahead with these contracts given the risks of not disbursing the
total loan amount due to exchange rate variations. If all loan funds are fully disbursed before the closing date or
contracts are still not completed, the necessary funds will be secured by the Borrower.

8. The main risks that ongoing contracts will not be completed before the new closing date are related to
unexpected delays in civil works, particularly those with innovative approaches. Among others, there might be delays
to get the necessary licenses and environmental permits for turn key contracts, or unexpected archeological or
geological findings in cities where works are being carried out. There are also risks of fiscal constraints that might
affect the capacity of the state to invest and reduce execution rate of works. These technical and fiscal risks are being
closely monitored by both the PMU and the Bank. In the case that any of these ongoing contracts are not completed
by project closing, the Borrower is committed to complete them with own funding, following Bank technical and
safeguards requirements.
9. Like other sub-national governments in Brazil, the State Government of Pernambuco is facing tremendous fiscal constraints and has a very limited operational budget or capacity for new lending. The ongoing Project activities are critical to reach the PDO and cannot be implemented without Bank financing. The entire IBRD loan is already committed to completed and ongoing contracts (95.7%) and advanced procurement processes. All counterpart financed works have been completed.

10. The proposed restructuring fully complies with OP/BP 10.00, as the (a) the project is not subject to suspension of disbursements, and (b) the Borrower does not have any outstanding audit reports nor there are any audit reports that are not satisfactory to the Bank.

III. DETAILED CHANGES

LOAN CLOSING DATE(S)

<table>
<thead>
<tr>
<th>Ln/Cr/Tf</th>
<th>Status</th>
<th>Original Closing</th>
<th>Revised Closing(s)</th>
<th>Proposed Closing</th>
<th>Proposed Deadline for Withdrawal Applications</th>
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