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RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
MUNICIPAL SERVICES PROJECT
LOANS 7312-TU AND 7885-TU

TO THE
ILLER BANKASI ANONIM ŞİRKETİ
(successor to ILLER BANKASI)
WITH THE GUARANTEE OF THE
REPUBLIC OF TURKEY

December 14, 2011

ABBREVIATIONS AND ACRONYMS

BOD	Biochemical oxygen demand
DSI	General Directorate of State Hydraulics Works
EIA	Environmental Impact Assessment
IB	İller Bankası (General Directorate of İller Bank)
ILBANK	İller Bankası Anonim Şirketi
MESKI	Mersin Water and Sewerage Administration
MoEF	Ministry of Environment and Forestry (former)
MoEU	Ministry of Environment and Urbanization
NRW	Non-Revenue Water
PMU	Project Management Unit (within ILBANK)
SCADA	Supervisory Control and Data Acquisition System
WWTP	Wastewater water treatment plant

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**TURKEY
MUNICIPAL SERVICES PROJECT**

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MUNICIPAL SERVICES PROJECT

RESTRUCTURING PAPER

SUMMARY

1. This project restructuring paper seeks the approval of the Country Director for the following changes to the project: a) amending the Loan Agreements and Guarantee Agreements of the original and additional loans (7312-TU and 7885-TU) to reflect the Borrower's change in legal status from General Directorate of Iler Bank to Iler Bankası Anonim Şirketi (ILBANK); b) extension of the closing date of the original loan (7312-TU) by twelve months to December 31, 2012; c) reallocation of loan proceeds in the additional loan (7885-TU) to correct a minor error in the division of loan proceeds between categories; and, d) revisions in targets in the results framework for both the original loan (7312-TU) and the additional loan (7885-TU) to correct typographical errors in the target values and to account for a change in proposed investments by Mersin Water and Sewerage Administration and Beypazari Municipality under the additional loan (7885-TU).

2. The project restructuring has been requested by the Borrower through letters dated August 10, 2011, and confirmed by the Guarantor, through letters dated October 24, 2011. The closing date of the project (December 31, 2014) remains unchanged.

PROJECT STATUS

3. The Municipal Services Project, in an amount of €212.9 million (US\$275 million equivalent), was approved on June 23, 2005 and became effective on May 18, 2006. On May 6, 2010, an additional loan of €178.2 million (US\$240 million equivalent), was approved and became effective on July 26, 2010. The project development objective, which remains unchanged, is to support sustainable environmental services in selected municipalities.

4. The project is being implemented in a satisfactory manner and is on track to meet its development objectives. As of September 30, 2011, the majority of the works under the original loan have been completed and disbursements have reached 93% (€197,907,427.63). A total of €795,000 has been disbursed from the additional loan which corresponds to a ratio of 0.45%. Procurement is ongoing under the additional loan and disbursements related to physical construction will commence in FY12 as planned.

5. The project was previously restructured three times: 1) in December 2009, to extend the original loan from its original closing date of June 30, 2010 to the current closing date of December 31, 2011; and, 2) in May 2010, to amend the project indicators;

and, 3) in May 2010 via an Omnibus Amendment to introduce cross-debarment provisions approved by the Bank's Board.

PROPOSED CHANGES

6. ***Reform of General Directorate of Ilker Bank to Ilker Bankası Anonim Şirketi.*** The Borrower, Ilker Bank (Ilker Bankası), has recently changed legal status from a general directorate of the Government to an incorporated state-owned development and investment bank, as a result of the *Law on the Establishment of Ilker Bankası Anonim Şirketi* No. 6107 [the ILBANK Law No. 6107] adopted by the Grand National Assembly of Turkey on January 26, 2011 and published in the Official Gazette on February 8, 2011. The ILBANK Law No. 6107 repealed the previous Ilker Bank Law No. 4759 dated June 13, 1945 and its amendments, under which General Directorate of Ilker Bank had been established and was operating. Article 5 of the ILBANK Law No. 6107 specifies that Ilker Bankası Anonim Şirketi assumes all of the authority, rights, liabilities, receivables and debt of the General Directorate of Ilker Bank.

7. Implementation of Ilker Bank reform through the enactment of the ILBANK Law No. 6107 was predicted and supported by the project, as described in the Project Appraisal Document of the original loan. The legal reforms that have been enacted by the passage of the ILBANK Law No. 6107 support ILBANK's transition from its original status as a direct financing arm of government to a development bank focusing on the needs of municipalities and special provincial directorates, and subject to the provisions of the Banking Law. The objectives and investment priorities of Ilker Bankası Anonim Şirketi are fully consistent with the content and objectives of the project.

8. The change in legal status of ILBANK has not changed the implementing arrangements of the project, including fiduciary arrangements. ILBANK's PMU has been maintained at the same staffing levels as before, and has been assessed during project supervision to have adequate capacity and authority to continue to carry out the project. The financial management and procurement systems have been reviewed and found to be satisfactory, and unchanged from the systems used prior to the legal change.

9. ***Update in investments in Mersin and Beypazari.*** Due to changes in priorities and available sources of finance for the water and wastewater sectors in Mersin and Beypazari Municipalities since the approval of the additional loan, the following changes to the investment content have been agreed: a) for Mersin Water and Sewerage Administration (MESKI) the proposed water supply rehabilitation will be replaced with wastewater network expansion; and b) for Beypazari Municipality the project will focus on construction of the wastewater treatment plant and trunk sewers rather than water network rehabilitation, as these will be provided by a grant from Ankara Municipality through Ankara Water and Sewerage Administration. The descriptions for these two subcomponents in Annex 2 of the Project Paper for the Additional Loan¹ are updated as per the following table.

¹ Additional Loan Project Paper dated April 8, 2010 can be found at http://imagebank.worldbank.org/servlet/WDSContentServer?IW3P/IB/2010/04/20/000334955_20100420014903/Rendered/PDF/532320PJPR0P08101Official0Use0Only1.pdf

Extract from Annex 2: Summary of Proposed Sub-Projects, Project Paper for Additional Loan

Municipality	Summary of Proposed Sub-Project
Mersin	The subproject will finance the construction of new sewerage networks in Tece, Davultepe and Kuyuluk, areas under MESKI's jurisdiction for which sewerage networks are currently not available. The subproject will also finance pumping stations, a pressure main, and major collectors in the Western Basin area of Mersin.
Beypazari	The subproject would finance the construction of a wastewater treatment plant and associated trunk sewers

10. The proposed changes have been agreed by the Ministry of Development and are included in the Government's annual investment program. Investments in all other municipalities remain unchanged. The changes in Beypazari and Mersin do not require the triggering of additional safeguard policies. A new EMP for Mersin has been prepared, approved by the Bank and disclosed. For Beypazari, the subproject has been classified as Category A, an EIA has been prepared and is under review by the Bank.

11. **Results/indicators.** Changes to correct typographic errors in the Board-approved versions of the results frameworks for both the original and additional loans are proposed as follows: a) in both loans, change the wording of the indicator "Percentage of municipal wastewater in participating municipalities that is treated to required standards (%)" to "Percentage of population served by wastewater treatment plants treating to required standards (%)" to more accurately reflect standard data collected by the municipalities on an ongoing basis and thereby aligning the project with more easily comparable data between cities; b) in the results framework for the additional loan, correct the typographical errors in the targets for several indicators; and, c) amend the targets for MESKI and Beypazari to reflect the changed investment scope.

12. **Reallocation.** No reallocations are envisaged for the original loan (7312-TU). Minor reallocations are proposed for the additional loan (7885-TU) to correct an error in distribution between categories in the approved version. The proposed revised allocations are as follows:

Category	IBRD Loan		
	Original Amount (in Euro)	Revised Amount (in Euro)	Percentage of Expenditures to be financed
(a) Goods and works for sub-projects under Component 1	167,600,000	167,602,636	100%
(b) Consultants' services and training under Component 2	9,100,000	9,100,000	100%
(c) Consultants' services, Audit and Training under Component 3 of the Project	1,054,500	1,051,864	100%
(d) Front-end Fee	445,500	445,500	Amount payable pursuant to Section 2.03 of this Agreement in accordance with Section 2.07(b) of the General Conditions
(e) Interest Rate Cap or Collar Premium	0	0	Amounts payable pursuant to Section 2.07(c) of this Agreement
Total	178,200,000	178,200,000	

13. **Closing date.** An extension of the closing date for the original loan (7312-TU) of 12 months from December 31, 2011 to December 31, 2012, is proposed. The closing date of the additional loan (7885-TU), which is currently December 31, 2014, would remain unchanged. There are no outstanding audit reports for either 7312-TU or 7885-TU. The most recent audit reports dated December 2010 for the entity and the project (7312-TU and 7885-TU) had clean audit opinions.

14. The extension of the original loan Closing Date is primarily required to ensure the satisfactory commissioning, operation and monitoring of the wastewater subproject in Mugla Municipality. While construction of the secondary wastewater treatment plant (WWTP) financed under the project has been completed, the WWTP has yet to be put into operation because it has been necessary to change the originally approved WWTP discharge system. In order to ensure that the WWTP is commissioned and operated properly, and detailed monitoring can be carried out for a minimum of 9 months of operation, it is necessary for ILBANK and the World Bank, to maintain a relationship with Mugla Municipality until December 2012. As Mugla Municipality is not a sub-borrower under the additional loan, an extension of the original loan is necessary as explained in the following paragraphs. The proposed extension is the second for the original loan (7312-TU), whose original closing date was June 30, 2010. Details are given below:

15. The subproject in Mugla Municipality under the original loan comprises wastewater network rehabilitation and the construction of a secondary wastewater treatment plant (WWTP) and treated effluent discharge. Mugla is located on a high altitude plain with no permanently flowing streams or rivers, and due to the unique topographic, geologic and hydrologic conditions, options for discharging the treated effluent from the WWTP are very limited. At the time that the Environmental Impact Assessment (EIA) for the subproject was approved by the Ministry of Environment and Forestry (MoEF) and the World Bank in 2008, the selected option was to discharge the WWTP effluent to a temporary, impermeable storage facility in an abandoned quarry and then to reuse the effluent for irrigation. However, during implementation of the project, it became clear that while some of the treated effluent can be reused and Mugla has made preparations for this, there would not be sufficient irrigation demand for the entire effluent quantity.

16. Mugla Municipality, ILBANK and the World Bank teams have carried out detailed technical analysis including hydrogeologic field testing to determine a feasible alternative discharge scheme. Mugla Municipality's consultants have prepared an update to the project feasibility study that reanalyzes all options for the discharge scheme and recommends a combination of reuse and aquifer recharge as the preferred option. Reuse of effluent for irrigation will continue to be prioritized, and Mugla Municipality has received a grant from the Ministry of Development to construct a dedicated water network within the city to distribute treated effluent from the WWTP to the city's parks and gardens. Under the recommended option, the portion of the treated effluent that cannot be reused for irrigation will be discharged into the abandoned quarry to percolate into the underlying aquifer.

17. The Ministry of Environment and Urbanization (MoEU)² and General Directorate of State Hydraulics Works (DSI) have confirmed that the recommended solution is consistent with Turkey's environmental laws and regulations. Mugla Municipality is preparing an addendum to the subproject EIA, and has confirmed that prior to starting operation of the WWTP, the EIA addendum will be finalized, consulted and disclosed. Moreover, before operation begins, all necessary civil works will be carried out to prepare the quarry to accept the treated effluent discharge prior to operation of the scheme. A water quality monitoring program for the aquifers in the area has been designed and agreed. Results of the monitoring program will be provided to ILBANK and the World Bank on a regular basis.

18. By extending the original loan and its associated sub-loan agreement between ILBANK and Mugla Municipality for one year until December 2012, proper implementation of the discharge scheme and monitoring program will be ensured. The extension will also ensure ILBANK's continued close supervision of the component. Furthermore, the extension will allow the remaining loan proceeds to be available to Mugla Municipality to finance the monitoring program and civil works in the quarry.

² The Ministry of Environment and Urbanization (MoEU) replaced the former Ministry of Environment and Forestry (MoEF) in June 2011 during a government restructuring.

19. The extension is also necessary to allow MESKI to complete its planned works under the original loan. During the implementation period of the original loan, MESKI's loan allocation was increased and two high priority activities to establish a SCADA control system and customer inventory were added to the project. Due to the difficult technical nature of these activities, MESKI has been unable to finalize implementation of these activities prior to the current closing date. MESKI has completed all other activities under the original loan.

ANNEX 1:
Results Framework and Monitoring
TURKEY: MUNICIPAL SERVICES PROJECT

PDO	Project Outcome Indicators (Project Paper dated April 8, 2010)	Revised Outcome Indicators	Use of Project Outcome Information
To support sustainable environmental services in selected municipalities.	<ul style="list-style-type: none"> • Percentage of NRW over the supply area of the municipal government/ municipal water company. • Total annual BOD load reduction from municipal wastewater in the participating municipalities. • Amount of waste safely disposed in rehabilitated solid waste landfills. • Sectoral Financial Working Ratio of municipalities/ municipal companies. • Percentage of projects financed by ILBANK that are implemented by municipalities or municipal companies[#] 	No changes.	To track progress on overall achievement of efficiency, environmental and sustainability goals.
Intermediate Outcomes	Intermediate Outcome Indicators (Project Paper dated April 8, 2010)	Revised Intermediate Outcome Indicators	Use of Intermediate Outcome Monitoring
Component 1: Increased provision of water supply, wastewater and solid waste services in municipalities	<ul style="list-style-type: none"> • Number of new population served by expanded water supply service. • Percentage of population served by sewerage collection network in participating municipalities. • Percentage of municipal wastewater in participating municipalities that is treated to required standards • Constructed capacity of landfills. 	<p style="text-align: center;">No change</p> <p style="text-align: center;">No change</p> <ul style="list-style-type: none"> • Percentage of population served by wastewater treatment to required standards in participating municipalities. <p style="text-align: center;">No change</p>	To track physical progress towards completion of the agreed components.
Component 2: Municipal Technical Assistance	<ul style="list-style-type: none"> • Number of Operational Plans completed. • Number of man-days of training for PMU staff. 	No change.	To track progress towards improved capacity and sustainability of municipalities.

<p>Component 3: ILBANK Institutional Strengthening</p>	<ul style="list-style-type: none"> • Successful and on-time completion of annual project audits. • Number of man-days of training for PMU staff. 	<p>No changes.</p>	<p>To track progress towards improved capacity of ILBANK to manage the project.</p>
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**Municipal Services Project (additional loan – 7885-TU)
Arrangements for Results Monitoring**

Project Outcome Indicators	Sub-Projects	Baseline 2009	2011	2014	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
Percentage of NRW over the supply area of the municipal government/ municipal water company (%).	ASAT DENIZLI KIRSEHIR	47 51 78	45 47 65	36 43 53	Annual	Annual reports	PMU
Total annual BOD load reduction from municipal wastewater in the participating municipalities (tonnes/year).	BEYPAZARI	0	0	450	Annual	Annual reports	PMU
Amount of waste safely disposed in rehabilitated solid waste landfills (tonnes/year).	KAYSERI	0	0	390718	Annual	Annual reports	PMU
Sectoral Financial Working Ratio of municipalities/ municipal companies.	ASAT MESKI ISKI DENIZLI BEYPAZARI KAYSERI KIRSEHIR	1.21 0.66 0.56 0.66 0.74 1.66 1.09	1.01 0.67 0.63 0.76 0.74 1.29 1.00	0.94 0.64 0.63 0.55 0.68 1.06 1.00	Annual	Annual reports	PMU
Percentage of projects financed by ILBANK that are implemented by municipalities or municipal companies (measured as % of total disbursements) ^(c)		4.5	6	5 ^(d)	Annual	Annual reports	PMU
Intermediate Outcome Indicators							
Component 1: Municipal Development							

Number of new population served by expanded water supply service (#).	ASAT DENIZLI (R) KIRSEHIR (R+N) ^(a)	1000081 235000 100000	1082314 336000 110000	1223928 400000 150000	Annual	Annual reports	PMU
Percentage of population served by sewerage collection network in participating municipalities (%)	ASAT ISKI ^(b) DENIZLI MESKI	48 0 47 85	57 0 67 86	70 100 87 90	Annual	Annual reports	PMU
Percentage of population served by wastewater treatment to required standards in participating municipalities. (%)	BEYPAZARI	0	0	95	Annual	Annual reports	PMU
Constructed capacity of landfills (tonnes)	KAYSERI	0	0	2,639,487	Annual	Annual reports	PMU
Component 2: Municipal Technical Assistance							
Number of Operational Plans completed	ASAT MESKI ISKI DENIZLI BEYPAZARI KAYSERI KIRSEHIR	- - - - - - -	- - - - - - -	4 1 2 3 1 1 1	Annual	Annual reports	PMU
Number of man-days of training for Municipal PMU staff (#).	ASAT MESKI ISKI DENIZLI BEYPAZARI KAYSERI KIRSEHIR	30 70 0	50 43 10-45	50	Annual	Annual reports	PMU
Component 3: Ilker Bank Institutional Strengthening							
Successful and on-time completion of annual project audits (Y/N).		Y	Y	Y	Annual	Annual reports	PMU

Number of man-days of training for PMU staff (#).		231	300	390	Annual	Annual reports	PMU
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R: Rehabilitation

N: New network

- (a) Population of 2009 will be rehabilitated partially by this project.
- (b) The population of Akfirat (Tuzla) was taken into consideration rather than that of Istanbul.
- (c) This indicator measures ILBANK's transformation from an agency that directly financed and implemented projects, to one that appraises and finances projects proposed and implemented by municipalities.
- (d) Note that a small drop in percentage of direct disbursements is predicted in 2014 due to the increase in total lending volume in this period. This will be reviewed during the implementation of the additional loan to ensure that the final target is in accordance with ongoing lending trends in ILBANK.

Municipal Services Project (original loan - 7312-TU)
Arrangements for results monitoring

Project Outcome Indicators	Sub-Projects	Baseline 2006	2009	2012	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
Percentage of NRW over the supply area of the municipal government/ municipal water company (%).	POLATLI	48	47	43	Annual	Annual reports	PMU
	MESKI	66	61	50			
	ODEMIS	44	44	40			
	MUGLA	33	28	22			
	KUTAHYA	69	53	35			
	DENIZLI	-	51	47			
	ILICA	40	30	25			
	ELBISTAN	65	60	45			
	ASAT	52	47	43			
Total annual BOD load reduction from municipal wastewater in the participating municipalities (tonnes/year).	ODEMIS	0	0	3878	Annual	Annual reports	PMU
	MUGLA	0	0	1486			
	ASAT ^(c)	9056	10840	18109			
Amount of waste safely disposed in rehabilitated solid waste landfills (tonnes/year).	GELIBOLU	0	0	32227	Annual	Annual reports	PMU
	BERGAMA	0	0	21900			
Financial Working Ratio of municipalities/municipal companies.	POLATLI	0.86	0.88	0.81	Annual	Annual reports	PMU
	MESKI	0.64	0.66	0.67			
	GELIBOLU	0.74	0.70	0.65			
	ODEMIS	0.00	0.00	1.00			
	MUGLA	0.70	0.66	0.80			
	BERGAMA	-	-	1.00			
	KUTAHYA	0.30	0.50	0.65			
	DENIZLI	0.74	0.66	0.76			
	ILICA	0.15	0.08	0.08			
	ELBISTAN	0.76	0.72	0.50			
	ASAT	1.49	1.21	1.05			

Percentage of projects financed by ILBANK that are implemented by municipalities or municipal companies (measured as % of total disbursements) ^(b)		3.2	4.5	6	Annual	Annual reports	PMU
Intermediate Outcome Indicators							
Component 1: Municipal Development							
Number of new population served by expanded water supply service (#).	POLATLI (N) MESKI (R) MUGLA (R) KUTAHYA (R) DENIZLI (R) ILICA (N) ELBISTAN (R+N) ^(a) ASAT (R+N) ^(a)	- - - - - 78000 843641	- 350000 5200 70000 235000 4000 83000 1000081	6000 400000 10200 100000 336000 4500 87000 1126430	Annual	Annual reports	PMU
Percentage of population served by sewerage collection network in participating municipalities (%)	MUGLA DENIZLI ILICA ASAT	0 - 40 43	0 47 85 48	90 67 100 62	Annual	Annual reports	PMU
Percentage of population served by wastewater treatment to required standards in participating municipalities (%)	MUGLA ASAT ODEMIS	0 43 0	0 48 0	90 62 100	Annual	Annual reports	PMU
Constructed capacity of landfills (tonnes)	GELIBOLU BERGAMA	0 0	0 0	340700/Lot1 448100/Lot 2 438000	Annual	Annual reports	PMU
Component 2: Municipal Technical Assistance							

Number of Operational Plans completed	POLATLI	1	-	-	Annual	Annual reports	PMU
	MESKI	-	-	6			
	GELIBOLU	-	-	1			
	ODEMIS	-	-	2			
	MUGLA	-	1	3			
	BERGAMA	-	1	-			
	KUTAHYA	-	1	1			
	DENIZLI	-	-	5			
	ILICA	-	-	-			
	ELBISTAN	-	-	1			
ASAT	-	2	8				
Number of man-days of training for Municipal PMU staff (#).	POLATLI	35	-	-	Annual	Annual reports	PMU
	MESKI	-	70	43			
	GELIBOLU	10	0	20			
	ODEMIS	0	0	3			
	MUGLA	0	0	30			
	BERGAMA						
	KUTAHYA	4	0	0			
	DENIZLI	0	0	0			
	ILICA	12	30	10			
	ELBISTAN	5	3	8			
ASAT	20	30	50				
Component 3: Iler Bank Institutional Strengthening							
Successful and on-time completion of annual project audits (Y/N).		N/A	Y	Y	Annual	Annual reports	PMU
Number of man-days of training for PMU staff (#).		231	300	390	Annual	Annual reports	PMU

R: Rehabilitation

N: New network

(a) Population of 2006: To be rehabilitated; Population of 2009: Rehabilitation plus New network; Population of 2012: Rehabilitation plus New network

(b) This indicator measures ILBANK's transformation from an agency that directly financed and implemented projects, to one that appraises and finances projects proposed and implemented by municipalities.

(c) Lara WWTP financed by IB was put into operation in 2007 (BOD removed = 1784 t/yr)

