



1. Project Data:		Date Posted : 09/01/2004	
PROJ ID: P039022		Appraisal	Actual
Project Name: LGU Urban Water & Sanitation	Project Costs (US\$M)	32.1	8.81
Country: Philippines	Loan/Credit (US\$M)	23.3	4.75
Sector(s): Board: WS - Water supply (91%), Sanitation (6%), Flood protection (3%)	Cofinancing (US\$M)	0	1.01
L/C Number: L4422			
	Board Approval (FY)		99
Partners involved : Asian Development Bank (ADB)	Closing Date	09/30/2002	09/30/2003

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2. Project Objectives and Components

a. Objectives

The project is the first phase of the program of the Local Government Unit (LGU) Urban Water and Sanitation Development of the Republic of Philippines. The objective of the project was to provide practical demonstration, through a reasonably large sample of LGUs, that with appropriate technical and financial designs, pricing rules and institutional incentives, water supply systems, irrespective of size, can be made both viable and sustainable. The project would assist selected LGU's to: (i) provide sustainable water and sanitation services; and (ii) strengthen their institutional and technical capacity to manage water utilities.

b. Components

1) Water Supply Component (appraisal US\$23.3 million, actual US\$ 6.63 million) was to finance civil works, equipment and supervision for improved water supply systems for small towns that had traditionally been viewed as having "non-viable" and poorly functioning water utilities, managed by municipal agencies themselves. The component financed the construction of new systems and the rehabilitation and expansion of existing systems.

2) Sanitation Program (appraisal US\$1.6 million, actual US\$ 0.0 million) was to finance physical improvements in household toilets, on-site sanitation facilities including soakaway pits for septic tank effluents or the disposal of wastewater flows arising from augmented water supplies.

3) Drainage Program (appraisal US\$0.8 million, actual US\$ 0.0 million) was to finance investments and consultant services in micro-drainage infrastructure.

4) Water Utilities Private Sector Participation Facility (appraisal US\$1.5 million, actual US\$ 0.0 million). Provide Technical Assistance (TA) to help LGUs and Water Districts prepare information memoranda as a basis of bidding by private operators, to evaluate such proposals, and to identify the most appropriate form of more competitive private sector involvement.

5) Project Development for Water Supply and Sanitation (appraisal US\$2.5 million, actual US\$ 1.01 million). Provide TA to create a revolving fund from which LGUs could access resources for water supply or sewerage development.

6) Institutional Capacity Building Program (appraisal US\$2.0 million, actual US\$ 0.94 million). Provide TA to strengthen managerial and technical capacities of organizations and staff involved in (a) implementing the project; (b) regulating private operators; and (c) assisting LGUs in building institutional capacity and appropriate training program.

c. Comments on Project Cost, Financing and Dates

The total disbursements were US\$ 4.75 million and US\$ 18.54 million was cancelled. The components for sanitation and drainage were not implemented and water systems in 10 municipalities were constructed instead of 35 municipalities.

- The Asian Development Bank channelled money to the Development Bank of Philippines (DBP), however, this was through parallel financing.
- The project closed one year after the original closing date. The reason for the one year delay is not addressed in the ICR.

3. Achievement of Relevant Objectives:

The project failed to achieve its major relevant objective.

- At loan closing, 10 municipal water supply systems were financed and constructed compared to the appraisal estimate of 35

municipalities. A number of LGUs withdrew their interest because of absence of clear policy direction from the national government on private sector participation (PSP) and access to subsidized credit from other sources.

- For the sanitation and drainage sub-components, no tangible outcomes were achieved as these sub-components were not implemented.
- On the institutional side, progress was made in improving the capacity of the 10 participating LGUs. The project was able to introduce PSP. About 30% of the LGUs signed lease agreement with PSP partner.
- Regarding support for preparation of next batch of projects, 95 LGUs out of 110 completed the feasibility studies for water systems.

4. Significant Outcomes/Impacts:

- LGUs were exposed to the financing rules for borrowing long-term capital for infrastructure development. The participating LGUs are using commercial principles in the operation of their water supply systems.
- The project assisted in drafting the regulatory legislation for water utilities. Also, the bidding documents for the Design-Build-Lease arrangement for water systems for the second batch of LGUs were prepared.

5. Significant Shortcomings (including non-compliance with safeguard policies):

1. The quality at entry was unsatisfactory for the following reasons: (i) poor risk assessment of the LGU credit market which led to high dropout rates for LGUs; (ii) assumption that the private sector would actively compete for LGU water utility operations given the uncertain regulatory framework and unfavorable business environment for private sector participation (PSP); (iii) inadequate assessment of the capacity of the Development Bank of Philippines (DBP) to carry out its role as a financial intermediary for this type of operation; (iv) poor quality of the feasibility studies of the some individual subprojects (i.e. lacking in data, analysis not thorough), leading to implementation delays and problems; (v) some of the project-funded systems were overdesigned in terms of capacity, due mainly to unrealistic parameters for projecting demand; and (vi) inadequate assessment of the demand for the sanitation component.
2. During implementation there were: (i) procurement irregularities at sub-project level; (ii) problems due to poor execution of feasibility studies in some instances; (iii) lack of firm commitments from LGUs for investments in water systems; and (iv) unwillingness of LGUs to engage directly in a credit operation for sanitation investments in individual households.
3. The policy framework for PSP in the water sector remained indeterminate and the project stakeholders were exposed to the risk of changing rules and politics at the local Government level. There was poor coordination of the Government credit operations. The market for LGU financing made little progress because LGU believed that grant financing or subsidized financing would be available from the central government. The Government later approved other credit/grant facilities to LGUs financing similar activities under this project, but with different (or no) policy or fiduciary requirements.
4. Weak regulatory framework, the Government was unable to pass the regulatory legislation which was prepared under the project.

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Unsatisfactory	Unsatisfactory	
Institutional Dev .:	Modest	Modest	
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	The Bank performance is rated Satisfactory though marginally so as the Bank appraisal of the project was poor and the quality at entry was unsatisfactory. Supervision was satisfactory and the Bank actively worked with the Borrower to try to improve performance.
Borrower Perf .:	Satisfactory	Unsatisfactory	The Borrower Performance is rated "Unsatisfactory" for the following reasons: (i) unsatisfactory quality at entry, (ii) lack of clear policy direction from the national government on PSP, (iii) lack of firm commitments from LGUs for investments in water systems, (iv) unwillingness of LGUs to engage directly in a credit operation for sanitation investments in individual households, and (v) the implementing agency (DBP) could have improved project performance, especially if it had reduced its interest rates earlier.
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with '*' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

Involvement of private sector in water sector requires improvements in the overall regulatory environment and should be accompanied by adequate legal and administrative arrangements for conflict resolution. Also, for countries embarking on decentralized service delivery, a consistent national policy on local government financing with regard to grant/subsidies is needed.

8. Assessment Recommended? Yes No

9. Comments on Quality of ICR:

The quality of the ICR is satisfactory. It is frank and adequately discusses the reasons for the failure of the project to achieve its objectives. There is some discrepancy in the Bank disbursement figures shown in the ICR and the World Bank Integrated Controllers System that are given in this ICR review. Also, the ICR did not discuss the reason for one year delay in project completion.