

PALAU WATER SECTOR IMPROVEMENT PROGRAM PROGRESS

A. Introduction

1. The Palau Water Sector Improvement Program (WSIP) was approved by the Asian Development Bank (ADB) Board on 9 November 2010. The loan agreements were signed on 6 October 2011 and the loan became effective on 5 December 2011. The program loan is disbursed in two tranches. Tranche 1, disbursed on effectiveness was \$9.8 million. The policy actions required for Tranche 2, of \$6.2 million, are expected to be complete by 31 March 2013.

B. Impact and Outcome and Outputs

2. The impact of the program will be sustainable water and sewerage services. The program outcome will be that the demand for water and sewerage services is met.

1. Legal and Policy Framework for Water Sector Improvement is in Place

3. The program is establishing the policy and legal framework to enable the provision of sustainable and efficient water and sewerage services by an independent, government-owned corporate entity. The Water and Sewer Corporation Act (act) 2010 established the Palau Water and Sewer Corporation (PWSC) to provide water and sewerage services throughout Palau and set tariffs for full cost recovery. The act covers (i) the transfer of physical water sector assets from the government to PWSC; (ii) the transfer of the existing staff from the relevant government ministries; and (iii) the right to collect and retain revenue and enter into debt.

2. An Independent Palau Water and Sewer Corporation Delivers Improved Services

4. **Transition to Palau Water and Sewer Corporation.** To improve the operational efficiency and reduce the fragmentation of responsibilities in the sector, the PWSC has been created. The PWSC was established on 29 March 2012. Board members were appointed in December 2011 and sworn in during March 2012. The necessary regulations, policies, and plans for the PWSC to be able to deliver water and sewerage services are being prepared. These will include: (i) preparation of an organizational structure to deliver the functions of the PWSC; (ii) finalization of an assets register; (iii) development of an asset management plan; (iv) preparations to transfer current staff from the government to the PWSC; (v) a human resource management plan; (vi) adoption of financial management arrangements and systems; and (vii) development of new billing and collection systems. In addition to providing support for organizational and management-related strengthening, a capacity building program will begin in the 4th quarter 2012 in technical management and planning, including through the development of (i) guidelines and technical standards; (ii) an infrastructure maintenance plan; (iii) an investment plan; and (iv) an institutional development plan. The program will provide ongoing technical support for 15 months.

5. **Capacity building.** The capacity building program will also cover (i) mentoring of management personnel; (ii) strengthening administrative capacity; and (iii) developing the technical skills of the water and sewerage operation teams. The government will ensure PWSC is professionally managed and operated, and the PWSC act requires an experienced management team to be in place.

6. **Improving Palau Water and Sewer Corporation operational efficiency.** Consistent with the Medium Term Development Strategy's¹ overarching goal of reducing costs and ensuring water conservation, the government will set benchmarks for operational efficiency improvements. During transition to full cost recovery, PWSC will be expected to (i) reduce nonrevenue water from 43% to 25%; (ii) progressively increase tariffs to achieve full cost recovery by FY2015; and (iii) improve collections to at least 95% of billings by FY2015. The Board will consider additional performance standards for the PWSC.

7. To achieve these benchmarks, the PWSC will have to improve the efficiency of water and sewer sector operations, including by (i) implementing 100% consumer metering; (ii) disconnecting all illegal connections; (iii) identifying non-metered connections and scheduling their meter connections; (iv) improving water management through better monitoring by installing flow meters within the existing network and at all storage tanks; and (v) reducing system losses through the preparation and implementation of a leak detection and repair program. Some of these measures will take until FY2015 to complete. Meeting these benchmarks will help achieve reliable and affordable services.

2. Full Cost Recovery is achieved in the Water and Sewerage Sector

8. The Medium Term Development Strategy outlines the government's policy of requiring people to pay tariffs that allow services and utilities to operate on a full cost-recovery basis. This will allow the government to remove subsidies and enable the sector to self-invest in maintenance and infrastructure development. Transition to full cost recovery will take until 2015. The program supports (i) progressive tariff increases up to the point of full cost recovery; and (ii) budget support to cover the difference between tariff revenue and actual costs during this transition. The first and second tariff increases were regulated by the Minister of Finance to become effective in February 2011 and February 2012. The third and fourth tariff increases being recommended to achieve full cost recovery for PWSC will be enacted by the PWSC board in subsequent years.

9. To achieve full cost recovery in 4 years, tariffs for consumption of up to 5,000 gallons² of water per month will need to increase from \$0.85 to \$1.47 per 1,000 gallons consumed by 2015. Sewerage tariffs will also need to be charged, and will start at \$0.30/1,000 gallons and increase to \$0.36/1,000 gallons. Tariffs for high residential water users (over 5,000 gallons) and non-residential users will increase more steeply to \$4.51/1,000 gallons. These rates will encourage prudent consumption and facilitate maintaining a sustainable supply of treated water. Commercial sewerage tariffs will be introduced at \$1.70/1,000 gallons and increase steadily \$4.13/1,000 gallons over the 4 years.

10. During the transition to full cost recovery, PWSC will operate at a loss. The government, through the program, has committed to fund the shortfall through annual budget appropriations totaling \$5.1 million. This budget support was \$2.4 million in FY2011, \$1.5 million in FY2012. The government will enter into a financial agreement with the PWSC to (i) assist in implementing the sector reforms; (ii) make possible the improvements in technical and managerial capacity and operational efficiency; and (iii) promote water conservation and health awareness. The government will provide financial assistance in the form of a loan of up to

¹ Government of Palau. 2009. *Medium-Term Development Strategy, Actions for Palau's Future 2009–2014*. Koror.

² 1 gallon is equal to 3.785 liters.

\$6 million to the PWSC to achieve these objectives. Through the financial agreement, the government will also provide grant transition financing of up to \$2.6 million.³ The grant will cover the difference between revenue collected by the PWSC and the full cost of operations.

11. At the end of the transition to full cost recovery in October 2015, the government will no longer provide financial support to the sector. The PWSC will have the ability to charge tariffs to maintain infrastructure and make new investments. The government will have improved its fiscal position by at least \$2.2 million (1.1% of gross domestic product) per year as recommended by the International Monetary Fund.

4. Effective Public Consultation is in Place

12. ADB lessons from implementing reform across the Pacific stress the importance of public consultation before and during the reforms. Broad public support is important to achieving reform in the water and sanitation sector. Under the program, the government has undertaken a public advocacy program with politicians, civil society, and community groups on the government's policy, its importance to Palau's future, and the impact on the people. In doing so, they have sought support for the creation of PWSC and for tariff reform, thereby reducing the risk that support will wane over time. The PWSC will conduct an awareness campaign on the importance of water conservation and behavior change to help the community adapt to the new policy arrangements and minimize their impact. The awareness campaign will include support for sanitation, hygiene, water use, and health awareness.

C. Recent Developments

13. Following general elections in October 2012, a new administration entered into office in January 2013. The new administration immediately implemented policies to reduce the cost of managing and operating public utilities (electricity, water, and sewerage) through shared services and facilities. The Utilities Consolidation (UC) Act⁴ was signed into law (6 June 2013) to consolidate the delivery of electricity, water and sewerage services by a single autonomous and independent entity, the Palau Public Utilities Corporation (PPUC), and gave PPUC the mandate for the delivery of electricity, water and sewerage services. As a consequence, PWSC, which was established as one of the conditions to the first tranche release, ceased to exist and its functions were absorbed into a new water and wastewater operations division created within PPUC.

14. The UC Act has resulted in a reduction in the cost of delivery of water and sewerage services in Palau. The savings are achieved through a single Board of Directors, a single chief executive office and chief finance officer, and shared support services including human resources, finance, customer service and IT for both water and sewerage services and electricity services. The UC Act requires PPUC to set tariffs for electricity, water and sewerage to meet operational costs and recover the cost of capital. Prior to the promulgation of the UC Act, PPUC was prohibited by law from recovering the cost of capital for electricity operation through electricity tariffs. The UC Act also requires that PPUC water and wastewater operations and PPUC electricity operations operate as separate business units and prohibits cross-subsidization of water and sewer services and electricity services.

³ The value of the grant will be determined by the date on which the PWSC is declared operationally effective. Until this time, budget support will be channeled through the Ministry of Public Infrastructure, Industry and Commerce.

⁴ Republic of Palau Public Law 9-4: The Utilities Consolidation Act 2013.

D. Policy Actions

13. Table 1 provides a list of the policy actions for the first tranche that have already been completed. The first tranche was released on effectiveness on 5 December 2011. Policy actions for tranche 2 release have begun, or will be shortly. Table 2 provides a status report on tranche 2 progress.

Table 1. Policy Matrix

Policy Actions for First Tranche Release

A.1. The Law on the establishment of an autonomous independent Water and Sewer Authority (PWSC) will have been enacted and declared effective.

A.2. The Government will have issued a regulation on the increase of water supply charges to be effective 1 February 2011, in accordance with the following scheme:

- Domestic, 25% increase on the current metered water supply charge for the first 5,000 gallons;
- Domestic, 25% increase on flat fee water supply charge;
- Domestic, 50% increase on the current metered water supply charge for consumption in excess of 5,000 gallons per month;
- Non-Domestic, 50% increase on the current volumetric water supply charge.

A.3. The Government will have issued a regulation to levy a volumetric sewerage charge on metered connections to be effective 1 February 2011, in accordance with the following scheme:

- Domestic, \$0.30/1,000 gallons of water used;
- Non-Domestic, \$1.70/1,000 gallons of water used.

B.1. The PSC will have endorsed a detailed transitional plan, acceptable to ADB, enabling the PWSC to begin full operations which at least encompasses activities to:

- appoint Consultants;
- appoint the PWSC Management Team and board Members;
- establish the financial management systems;
- establish the billing and collections systems.

C.1. The Budget Bill submitted to OEK will have shown that the Government has allocated \$2,526,000 to MPIIC for the supply of water and sewerage services budget line, for FY2011 operations and maintenance costs.

D.1. The MOF will have prepared, approved and implemented a Community Consultation Plan (CPP) for the establishment of PWSC.

BPW = Bureau of Public Works, EQPB = Environmental Quality Control Board, Government of Palau = Government of Palau, HR = human resources, HRD = human resource development, OEK = Olbiil Era Kelulau (Congress), **PWSC = Palau Water and Sewer Corporation.**

Table 2. Second Tranche Policy Action Status Assessment

Policy Actions for Second Tranche Release	Status at October 2013
A.1. The President will have approved the <i>National Water Resources Management Plan</i> , in a form and substance acceptable to ADB.	A.1. Complete Policy approved by the President
A.2. The Government will have submitted to the OEK a bill, in a form and substance, acceptable to ADB, which would provide a mandate for the regulation of water abstraction. K Journal showing that the bill has been submitted to the OEK.	A.2. Complete. Bill submitted to OEK on 27 May 2013
A.3. PWSC will have issued a regulation to increase the water supply charges, ¹ to be effective 1 February 2012, in accordance with the following scheme: <ul style="list-style-type: none"> • Domestic, 10% increase on the existing metered water supply charge for the first 5,000 gallons; • Domestic, 10% increase on the existing flat fee water supply charge; • Domestic, 50% increase on the existing metered water supply charge for consumption in excess of 5,000 gallons per month; • Non-Domestic, 50% increase on the existing metered water supply charge. 	A.3. Substantially Complete. ² Regulation issued with correct tariffs
A.4. PWSC (footnote 1) will have issued a regulation to increase the volumetric sewer charge on sewerage connections, to be effective 1 February 2012, in accordance with the following scheme: <ul style="list-style-type: none"> • Domestic, 5% increase on the existing volumetric charge; • Non-Domestic, 30% increase on the existing volumetric charge. 	A.4. Complete. Regulation issues with correct tariffs
B.1. The President will have declared that the PWSC is in full operation to take over	B.1 Complete Declared on 23 July

¹ PWSC was merged into the Palau Public Utilities Corporation in June 2013 following the promulgation of the Utilities Consolidation Act 2013. PPUC's Water and Wastewater Operations division is responsible for the delivery of water supply and sewerage services.

² The Utilities Consolidation Act 2013 contains specific provisions for water tariffs to Palau's outlying states which effects 24% of PPUC's water customers. The introduction of a separate water tariffs for Koror and Airai and the outlying states is intended to account for the inferior level of service provided by the water supply systems in the outlying states in comparison to level of service provided by the Koror – Airai water supply system. In June 2013, the water tariffs for applicable for the outlying states, were reduced to the rates scheduled under the Regulations to Implement Fees and Charges for Water and Wastewater Services for 2011 and will remain at 2011 rates for 2 years as required by the Act. PPUC will marginally increase water tariffs for water services in Koror and Airai in October 2013 to account for the reduction in revue resulting from the reduction of water tariffs to the outlying states. The water tariffs for the outlying states will be reassessed in 2015 on the basis of the quality of water services and the principle of full cost recovery.

Policy Actions for Second Tranche Release**Status at October 2013**

the responsibility for managing and operating water and sewerage service in Palau.	2013
<p>B.2. PWSC will have:</p> <ul style="list-style-type: none">• control of the assets, determined as of 1 October 2011, to belong to the MPIIC Division of Water and Sewerage;• a staff establishment not less than the number and skills, determined as of 1 October 2010, to belong to MPIIC Division of Water and Sewerage and the Division of Billing and Collection of the MOF;• established commercial systems and procedures including customer billing and collections.	<p>B.2. Complete Assets transferred on 19 April 2013.</p> <p>Staff transferred on 19 April 2013</p> <p>Integrated into the PPUC commercial systems as of 6 June 2013.</p>
<p>B.3. PWSC will have prepared, approved, and implemented a user pays policy for water and sewerage service such that:</p> <ul style="list-style-type: none">• all illegal connections are disconnected;• non-metered connections are identified;• a schedule for connecting meters to unmetered sites and network assets is prepared.	<p>B.3. Complete. The policy was adopted by the PWSC in May 2013 and subsequently by the PPUC Board on 4 October 2013.</p>
<p>B.4. PWSC will have prepared, approved, and implemented a Policy and Plans, acceptable to ADB, for asset maintenance and infrastructure replacement.</p>	<p>B.4. Complete. Complete. The policy was adopted by the PWSC in May 2013 and subsequently by the PPUC Board on 4 October 2013.</p>
<p>B.5. PWSC will have prepared, approved, and implemented a policy on operational performance, which include guidelines on technical standards and an institutional development plan, acceptable to ADB.</p>	<p>B.5. Complete. Complete. The policy was adopted by the PWSC in May 2013 and subsequently by the PPUC Board on 4 October 2013.</p>
<p>B.6. PWSC will have adopted performance benchmarks to monitor its operations performance, including:</p> <ul style="list-style-type: none">• universal metering of domestic and commercial water connections metered;• Non-revenue water to be 25% by FY2015;• Collections at 95% by FY2015.	<p>B.6. Complete. Complete. The policy was adopted by the PWSC in May 2013 and subsequently by the PPUC Board on 4 October 2013.</p>
<p>C.1. The Government will have allocated \$1,500,000 budget for PWSC operation for FY2012.</p>	<p>C.1. Complied. The OEK approved budget appropriations of \$3,721,901 for</p>

Policy Actions for Second Tranche Release

Status at October 2013

C.2. A financing agreement, in a form and substance acceptable to ADB, between the MOF and PWSC for a grant in the amount not exceeding \$2.6 million and a loan in the amount not exceeding \$6 million will have been signed, in order to:

- provide financial support to improve its technical and management capability;
- provide budget support to meet the shortfall between operations, maintenance, debt servicing, and depreciation costs less projected revenue of the PWSC.

D.1. PWSC will have prepared, approved and implemented the Water Conservation Community Awareness Plan.

D.2. PWSC will have prepared, approved and implemented the Health Awareness Support Plan.

water and sewer operations for FY2012.

C.2. Complete. The financing agreement was executed on 12 September 2013.

D.1. Complied. The Water Conservation Community Awareness Plan is being implemented.

D.2. Complied. PPUC is currently implementing the Health Awareness Support Plan.

BPW = Bureau of Public Works, EQPB = Environmental Quality Control Board, Government of Palau = Government of Palau, HR = human resources, HRD = human resource development, OEK = Olbiil Era Kelulau (Congress), PWSC = Palau Water and Sewer Corporation (now merged into the Palau Public Utilities Corporation).